CHAPTER -I
INTRODUCTION

1.1 Background of the Study

Banks are the important representatives of financial intermediaries. As the name suggests, financial intermediaries are entities that intermediate between providers and users of financial capital. They are typically multifaceted, and their activities therefore can be understood from a variety of points. Banks are members of an expensive industry that provides a dazzling variety of financial intermediation services. All the financial institutions have in common is the processing of risk and its subtle complement information. Financial intermediaries produce information for two kinds of applications: (i) to match transactors like a marriage broker would and (ii) to manage risk and transform the nature of claims as when a bank produces credit information to control a borrower's credit risk.

Banking plays significant role in the economic development of a country. Bank is a resource for the economic development which maintains the self- confidence of various segments of society and extends credit to the people. So, commercial banks are those financial institutions mainly dealing with activities of the trade, commerce, industry and agriculture that seek regular financial and other helps from them for growing and flourishing, the objectives of commercial banks is to mobilized idle resources into the most profitable sector after collecting them from scattered sources commercial bank contributes significantly in the formation and mobilization of internal capital and development effort (Bhattarai, 1997).

Banks are in the business of safeguarding money and other valuables for their clients. They also provide loans, credit and payment services such as checking accounts, money orders and cashier's checks. Banks also may offer investment and insurance products and a wide whole range of other financial services (Financial Services Modernization Act by the US congress, 1999) which they were once prohibited from selling (Glass-Steagall or Banking Act,1933 in the USA).

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 economic 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

Banks grants 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. Therefore, proper financial decision making is more important in banking transactions for its efficiency and profitability. Most of the financial decision making loan management it plays the vital role in the business succession, so efficient management of lending policy is needed (Dahal & Dahal, 2002).

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, Non-Bank Financial Institutions occupy important role in mobilizing financial resources. There are about 17 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.

Capital accumulation plays an important role in accelerating the economic growth of a nation, which in terms is basically determined among others, by saving and investment propensities. But the capacity to save in the developing countries is quite low with a relatively higher marginal propensity of consumption. As a result, such countries are badly entrapped into the circle of poverty. So the basic problem for the developing country is raising the level of saving and thus investments (Bhattacharya, 1998).

Credit Management

Credit is the provision of resources (such as granting a loan) by one party to another party where that second party does not reimburse the first party immediately, thereby generating a debt, and instead arranges either to repay or return those resources(or materials) of equal value at a later date. The first party is called a Creditor, also known as a ‘Lender’, while the second party is called a Debtor, also known as a ‘Borrower.’

Credit is also traded in the market. The purest form is the credit default swap market, which is essentially a traded market in credit insurance. A credit default swap represents the price at which two parties exchange this risk- the protection “seller” takes the risk of default of the credit in returns for a payment, commonly denoted in basis (one basis point is 1/100 of a percent) of the notional amount to be referenced, while the protection “buyer” pays this premium and in the case of default of the underlying (a loan, bond or other receivable) delivers this receivable to the protection seller and receives from the seller the par amount (that is made whole). Borrowing money or money equivalent instrument through formal or informal lender is known as credit. Informal Lenders consists traditional type of borrowing (borrowing through Shahu, Mahajan, etc) but formal sector consists legally valid procedures. Borrowing through Bank or Financial institution which is established by obeying the government legal framework is known as formal lenders. In this study, researcher will test the credit of formal lenders. In credit rendering process, Bank or Financial Institution follows various guidelines/credit policies, which are provided by NRB as the main directives along with their own credit policies that are made within the boundary of NRB guidelines. The credit policy of the bank provides the framework to determine whether or not to extend credit and how much credit to be extended. The credit policy decision of a bank has two broad dimensions; credit standard and credit analysis.

Credit Management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that a borrower will fail to meet its obligations in accordance with the agreed terms and conditions. Credit risk is not restricted to lending activities only but includes off balance sheet and inters bank exposures. The goal of the credit risk management is to maximize a bank’s risk adjusted rate of return by maintaining the credit risk exposure within acceptable parameters. For most banks, loan are the largest and most obvious source of credit risk, however other sources of credit risk exist throughout the activities of a bank, including in the banking book and in the trading book and both on and off balance sheet. Banks are increasingly facing credit risk in various financial instruments other than land including acceptances; inter-bank transactions, trade financing, foreign exchange transactions, guarantees and the settlement of transactions. In Nepalese market various types of loan can be found against gold and silver, loan against first class bank guarantee, loan against mortgage of government security, demand loan, margin lending, overdraft pledge loan hypothecation, auto-loan, personal loan, structure demand loan etc. (Meir, 1996)

Credit is the amount of money lent by the creditor to borrower either on the basis of security of without security. Credit and advances is an important item on the side of the balance sheet of the commercial bank. Bank earns interest on credit and advances which is one of major source of income for banks. Banks prepares credit portfolio; otherwise it will not only effect debts but affect profitability adversely (Varshney & Swaroop, 1994).

Introduction of Sample Banks

Everest Bank Limited (EBL)

Everest Bank Limited is highly successful commercial bank of Nepal established on 18th October 1994 under the company Act 1964 and licensed by Nepal Rastra Bank as an "A" class commercial bank, United Bank of India Ltd, under technical services agreement signed between it and Nepalese promoters was managing the bank from very beginning till November 1996. Later on, it was handed over the management to Punjab National Bank Ltd. India (PNB). PNB is the largest Public Sector Bank of India having 109 years of banking history with more than 4400 offices all over India and is known for its strong systems and procedures and a distinct work culture. PNB is providing the top management services to EBL under a technical services agreement signed between the two institutions. EBL thus has advantage of the banking expertise and financial strength of its partner. Drawing its strength from its joint venture partner, EBL has been steadily growing in its size and operations and established itself as a leading Private Sector Bank.

At present, Everest Bank Limited has total paid up capital around Rs.2.62 Billion. EBL's main branch is located at New Baneshwor, Kathmandu, and Corporate/Head office is situated at Lazimpat, Kathmandu. It provides all the general services to its customers throughout the 61 branches of the bank. The branches are spread from Mechi, eastern part of Nepal to Mahakali, western part of Nepal.

Nepal Bank Limited (NBL)

Nepal Bank Limited is the first bank of Nepal, established in November 15, 1937. It is also the commercial bank that indicates formal banking in Nepal. In that early era of formal banking in Nepal, NBL had authorized capital of NRs. 2.5 million of which raising equity of only NRs. 842,000. NBL was established as a joint venture between Nepal government and private sector of which Nepal government held 40% share and rest was by 10 shareholders. At present, NBL is under management of “Nepal Rastriya Bank”, the central bank of the country.

Nepal Bank Limited was established as a result of need call from government side. In lack of proper financial institutions, development and economic progress of the country was being affected. The oldest bank of Nepal has crossed milestone of 80 years in the banking history. The bank has been providing boost to the economic operation of the country.

NBL after decade long loss and unmanaged governing system had managed to gear up in the last few years. The bank has launched various saving and deposit scheme and many other banking facilities to attract the customer. Currently, it has 129 branches with paid-up capital around NRs. 6.47 billion.

1.2 Statement of the Problem

This study is conducted to obtain overall status of credit management of the sampled banks. Credit management is one of the most important and complicated functions performed by the bank. Each bank has credit department and loan administration to conduct, monitor, and supervise credit operation. The administration of a particular loan ends when it is recovered. But the process never ends until the bank exists.

Commercial banks act as an investment intermediary linking the savers and users of capital. Capital formation is thus regarded as one of the indispensable functions executed by any commercial bank. Capital formation is done through credit advancement and its management. Credit disbursement and credit recovery is the prominent feature of credit management.

Trends of bank expansion, operations and establishment are in apex growth condition in Nepal. Recent political changes are also adding fuel to grow the financial sector. Daily various news are broadcasted by media in the concern of merge, upgrade, new establishment, branch expansion etc. Recent activities of banking sector are also unique, some of them are busy to introduce new deposit product in high interest rate, some other are trying to catch attention of client by lowering interest rate on loan. So competition is high enough but Nepal Rastra Bank is lowering various services by adding various circular (restriction on margin lending, gift/prizes distribution, revised capital adequacy etc). Thus study aim to answer following problem and has tried to analyze how the banks are performing in credit sector and how they stand in comparison to one another. Looking the increased interest rate on deposit of commercial bank, everyone says that bank are getting sufficient fund for their operation. So the matter of concern is to find out the movement of bank credit during the recent five years period. Normally, following problem of commercial bank will be solved by this study:

- What is the overall situation of credit risk management of EBL and NBL?
- What is the relationship between credit related indicators of banks and their profitability?
- Do EBL and NBL have same/different credit ratios and profitability?

1.3 Objectives of the Study

The primary concern of this study is to evaluate the performance of selected commercial banks (CBs) of Nepal and to recommend for the improvement of state of affairs .The specific objective are as follows:

- To find out overall situation of credit risk management of EBL and NBL.
- To examine relationship between credits related indicators and profitability of banks.
- To analyze the difference in the credit management indicators and profitability of EBL and NBL.

1.4 Significance of the Study

Credit performance analysis of any banking sector is very important because it is only one measure to evaluate prosperity or recession of organization. After having the real knowledge of indicators of financial performance any stakeholder can decide what they ought to do. Similarly any concerning bodies will be benefited to study whole organization. So this study will be fruitful for those who want to know about EBL & NBL in financial concern. Moreover this study can also be used by government bodies, investors, competitors.

Thus, a study on the commercials banks and especially in their Lending and investment practices carry a great significant to various groups but in particular is directed to a certain groups of people/organization which are as below:

- Importance to shareholders.
- Importance to the management bodies of these banks for the evaluation of the performance of their banks and in comparison with other banks.
- Importance to "outsiders" which are mainly the customers, financial agencies, stock exchanges
- Importance to the government bodies or the policy makers such as the central bank.
- This study would be important for the students as it provides theoretical as well as conceptual frame work of different aspect of credit management.

1.5 Limitations of the Study

- This study is concentrated only on few performance related factors that are related with credit practices.
- This study has focused on the credit management between two banks only.
- Whole study is based on data of five year period.
- Some of the financial tools of comparison shall be used in this study. Hence the drawbacks and weakness of those tools may adversely affect the outcomes of the study.
- Standard Performance level may not be available especially in Nepalese context. In thesis context, concerned experts are also consulted. Secondary sources of data will be taken for the study.
- The source of data is published annual report and internet website which is assumed to be correct.

1.6 Organization of the Study

The study has been organized in five chapter viz. Introduction, Literature review, Research methodology, Data presentation and analysis, and Summary, Conclusion, and Recommendation. Each of the chapters has been described as below:

Chapter I: Introduction

First chapter deals with introduction. This chapter provides general introduction and background of the study. It clarifies the motive behind the study. This includes background of the study, statement of problem, objectives of the study, limitation of the study and organization of study.

Chapter II: Review of Literature

Second chapter is the review of literature. We review available literatures in the related subject matter. Various books, papers, journals, articles and previous unpublished master degree dissertations have been reviewed in this chapter with their findings. Further, methodology used, sample size, period covered, etc. also has been reviewed in possible cases.

Chapter III: Research Methodology

Research methodology used here has been explained in third chapter. Different tools and techniques used by the researcher for the analysis purpose are described here. It includes research design, nature and sources of data, population and sampling, method of data collection and analysis, etc.

Chapter IV: Data presentation and analysis

Data presentation and analysis is the main part of a thesis. In fourth chapter, collected data is presented in a tabular form and analysis of these data id done by using different methods explained in third chapter. Further, different charts and graphs have been used to present the tabulated data.

Chapter V: Summary, conclusion and recommendation

The last chapter summarizes the thesis and presents the conclusion that flows from the study and offers suggestions for further improvement.

CHAPTER-II

REVIEW OF LITERATURE

This chapter deals with the review of materials related with 'credit management' in more detail and descriptive manner. It provides the basis for developing a comprehensive framework. In this chapter, an emphasis is given to the review of major related literature on the credit management and its analysis. To explore the relevant and true facts for the research purpose, this chapter highlights the literature available related to the study. An attempt has been made to look into bank publications, periodicals and central banks rules and regulations. In addition, informal interviews with bank personal and a few customer /borrowers have been aimed to receive. For review study, the researcher uses different books, reports, journals and research studies published by various institutions, unpublished dissertations submitted by master level students have been reviewed. This chapter is divided mainly into two parts, which are as follows:

- Conceptual Review
- Review of Different Studies

2.1 Theoretical Review

2.1.1 Defining Commercial Bank

Commercial bank is a corporate business venture which have certain paid up capital and provide loan, accept deposit, exchange money and other consultancy, agency, guarantee etc services are perform. Commerce is the financial transactions related to selling and buying activities of goods and services. Therefore commercial banks are those banks, which work from commercial viewpoint. They perform all kinds of banking functions as accepting deposits, advancing credits, credit creation and agency functions. They provide short-term credit, medium term credits and long terms credit as well as issuing guarantee, bonds, letter of credit, etc to trade and industry.

Commerce is the financial transactions related to selling and buying activities of goods and services. Therefore commercial banks are those banks, which work from commercial viewpoint. They perform all kinds of banking functions as accepting deposits, advancing credits, credit creation and agency functions. They provide short-term credit, medium term credits and long terms credit to trade and industry. They also operate off balance sheet functions such as issuing guarantee, bonds, letter of credit, etc. Commercial bank deals with other people's money. Commercial bank alone holds deposit to drawn upon by cheque. It has power of creation and application of money, within limits through the use of loan and deposit.

A commercial bank is the bank which exchanges money, accepts deposit transfers loans and performs banking functions (Commercial Bank Act, 1974). A banker is one who in the ordinary course of business honors cheque drawn upon him by persons from and for whom it receives money on current account (Ronald, 1951). Principally commercial bank accepts deposits and provides loans, primarily to business firms there by facilitating the transfer of fund in economy (Rose, 2003).

The commercial bank has its own role and contribution in the economic development. It is a resource for the economic development, it maintain economic confluence of various segments and extends credit to people (Ronald, 1951).

A Bank is a business organization that's receives and holds deposits and funds from others, makes loans and extend credits and transfer funds by written order of depositors.

Commercial Banks function as an intermediary; accepting deposits and providing credits to the needy area. The primary source of funds for commercial bank are capital (shareholder equity) reserve (retain earning) and other main source of the commercial bank is current deposit issue of commercial paper bond etc. Commercial banks are restricted to invest their funds in corporate securities. They invest their funds in long term as well as short-term needs of any trade and industry. They grant credits in the form of cash credits and overdraft**.**

Banks undertaking business with the objective of earning profits are commercial banks. Commercial banks pool scattered fund and channels it to productive use. Commercial Banks Apart from financing, they also render a variety of service like collection of bills and cheques, safe keeping of valuables, financial advising, agencies functions, keeping of guarantee etc to their value customers **(**Radhaswamy & Vesudevan, 1979).

2.1.2 Functions of Commercial Bank

The business of commercial bank is primarily to hold deposits and make credits and investments with the object of securing profits for its shareholders. Its primary motive is profit, other considerations are secondary. Regarding the function of commercial bank Commercial bank act state that a commercial bank is one that exchanges money, accept deposits, grants loans, and performs commercial banking functions. The functions and services of modern commercial banks are classified under the following headings.

a. Accepting Deposits

Commercial bank accepts deposits from customers in the forms of current, saving and fixed deposits. These deposits are repayable on demand. The depositors other than current A/c are paid interest.

b. Granting Loans and Deposits

The second main function of the commercial bank is to grant loans and advances to businessman, the industrialist, the individuals, the different organizations etc. in the forms of term loans, cash credit, overdraft, trust receipts, hire purchase loans etc. Banks charges interest on such loan and advances, which is the largest source of total income.

c. Agency Service

A modern commercial banks act as an agent of individual's customers, business institutions and different organization. The agency services of banks may involve collection of interest and dividends on debt and share capital. A bank buys and sells securities on behalf of the customers. Bank also collects cheques, draft promissory notes etc and receives their payments. Sometimes, it makes payments of insurance premium, bills of electricity, telephone etc. It takes commission for the services rendered.

d. Guarantee on Behalf of Customers

The need of bank guarantee arises in business. Generally, business customers enjoy this service. Sometimes, personal customers may also need a bank guarantee. A guarantee is a definite and irrevocable under taking by a bank on behalf of its customers to make payments up to a specified sum of money to the beneficiary on demand in case of default by its customers.

e. Issuance of Traveler's Cheque

The people traveling outside the country want to reduce the fear of getting money stolen during the travel. Bank sells the traveler's cheque. The unique feature of the traveler's cheque is that unless the purchaser of traveler's cheque signs for encashment it cannot be encashed.

f. Opening Letter of Credit

Today letter of credit has become very popular in foreign business. The letter of credit is established/ opened by the bank on the request of the customers.

g. Remittance Function

Sending and receiving fund to/from various places is the necessity of today's life. The remittance service of bank has benefited both business and personal customers. Funds transfers are made through various modes like demand drafts, telegraphic payment order, swift, and fax and mail payment orders.

h. Other Services

Modern commercial banks are equally important in undertaking safe custody of important valuable documents. Banks also offer some of the bank services at the door of highly valued customers. Few large banks conduct research and survey about the economic conditions and they supply trade statistics and information. In addition to these, banks also inform their customers about the credit standing.

Moreover, commercial bank assists the traders engaged in foreign trade of the country. He discounts the bills of exchange drawn by exporters on the foreign importers and enables the exporters to receive money in the home currency. Similarly, he also accepts the bills drawn by foreign exports.

Banks today are following in the footsteps of leading 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 strategies marketing advice and offering hedging services to protect their customers against risk from fluctuating world currency prices and changing interest rate. In this way they support the overall economic development of the country by various modes of financing.

2.1.3 Concept of Credit

Credit is the sum 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, 2006). 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 (Varsahney & Swaroop, 1994).

In Economics, the term credit refers to a promise by one party to pay another party for money or goods on demand at some future date **(**Johnson, 1985).

It 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 on demand. Banks generally grants credit on four ways (Cherry & Moses, 1998).

Banking is the business of collecting and safeguarding money as deposits and lending of the same. The banker’s business is then to taken the debt of other people to offer his own in exchange and hereby to create money. He may be a dealer in debts, but in distress it is only observe of wealth and it would be equally permissible to describe the banker as a liquefies of wealth.

Credit administration involves the creation and management of risk assets. The process of lending takes into consideration 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 weaknesses 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).

"Banking and Insurance Management", says that in banking sector or transaction, an unavoidable of loan management and its methodology is regarded very important. Under this management, many subject matters are considered and thought, For example, there are subject matters like the policy of loan flow, the documents of loan flow, loan administration, audit of loan, renewal of loan, the condition of loan flow, and the provision of security, the provision of the payment of capital and its interest and other such procedures. This management plays a great role in healthy competitive activities (Bhandari, 2003).

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 advances. Hence, risk of non-payment of loan is known as credit risk or default risk (Dahal & Dahal, 2002).

Portfolio management helps to minimize or manage the credit risks by spreading over the risk to various portfolios. These methods of managing credit risk is guided by the saying do not put all the eggs in a single basket (Bhandari, 2003).

2.1.4 Types of Credit

a. Cash Credit

The credit is not given directly in form of cash but deposit account is being opened in name of creditor and amount credited to that account. In this way, every bank loan creates deposits.

b. Term Credit (Loan)

It is principal form of medium term debt financing having maturities of 1 to 8 years. Term loans are usually repaid in level amounts over the period of the loan, either a large final or just a single payment at maturity.

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 principle in the regular installments. Special patterns of principle payments over time can be negotiated to meet the firm's special needs (Richard, 1996).

c. Overdraft

It is an agreement by which bank allows the customer to draw over and above the current account balance. In other words bank provide sum limit of money to their valued customer according to their beliefs and level of transaction. Interest on overdraft is charged on debit balance on daily basis.

d. Working Capital Credit

Short term capital assistance granted by banks or financial institution to a firm in subject to pay short term obligation such as outstanding salary, wages, tax etc is known as working capital credit. It is granted to the customers to meet their working capital gap for supporting production process. A natural process develops where in funds moving through the cycle are generated to repay a working capital.

e. Credit against Fixed Deposit

Fixed deposit is specified for fixed period of time. Depositor can use it as collateral for loan received before the maturity period.

f. Hire Purchase Financing (Installment Credit)

Hire-Purchase credits are characterized by periodic repayment of principle and interest over the maturity of the credit. Hirer agrees to take the goods on hire at a stated rental including their repayment of principle as well as interest with an option to purchase.

A recent survey of commercial banks indicates those banks are planning to offer installment credits on a variable rate basis. It can be secured and unsecured as well as direct and indirect installment credits on a variable rate basis. It can be secured and unsecured as well as direct and indirect installment credit.

Hire Purchase loan refers to specifically periodic repayment of Principal and interest over the maturity of the loan.

g. Housing Financing (Real-estate credit)

Financial institution adopts this policy 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. Financial institutions also extend 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.

h. 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 developers for the purpose of completing proposed projects. Maturities on developers for completing proposed projects. Maturities on construction credits range from 12 months to as long as 4 to 5 years, depending on the construction credits range from 12 months to as long as 4 to 5 years, depending on the size of the specific project . The basic guideline principle involved in disbursement policy is to advance funds corresponding to the completion policy is to advance funds corresponding to the completion stage of the project. Term of credit needed for project fall under it (Johnson, 1985).

i. Consortium Credit

No single financial institution grant loan to the project due to single borrower limit or other reason and two or more such institutions may consent to grant credit facility to the project of which is baptized as consortium loan. It reduces the risk of project among them. Financials bank equal (or likely) charge on the project's assets.

j. Credit Cards and Revolving Lines of Credit

Banks are increasingly utilizing cards and revolving lines of credit to make unsecured consumer credit. Revolving credit line lowers the cost of making credit since operating and processing cost are reduced. Due to standardization, centralized department processes revolving credits resulting reduction on administration cost. Continued borrowing arrangement enhances cost advantages. Once the credit line is established, the customer can borrow and repay according to his needs and the bank can provide the fund to the customer at lower cost.

k. 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 references 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.

l. Bank Guarantee

It 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.

m. Letter of Credit (L/C)

It is issued on behalf of the customer (buyer/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 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 same commodities (Johnson, 1985).

2.1.5 Objectives of Sound Credit Policy

The main purpose of Credit Policy is:

a. To have performing assets

Performing assets are those loans that repay principal and interest to bank from the cash flow it generates. Loans are risky assets though a bank invests most of it resources in granting loan and advances. If an individual bank has around 10% nonperforming assets/loans (NPAs), it sounds the death knell of that bank ceteris paribus (all other thing remain constant).The objectives of sound loan policy is to maintain the financial health of the bank which results in safety of depositors' money and increase in the returns to the shareholders. Since the loan is a risky asset there is inherent risk in every loan. However, the bank should not take risk above a certain degree irrespective of returns prospect.

b. To contribute to economic development

Sound credit policy is required to ensure that loans are given to the productive sector which contributes to the society and economic development of a country.

c. To give guidance to lending officials

A borrower should be assured that there will be no discrimination whether he deals with one officer or another and one branch or another .A sound credit policy is imperative to achieve a uniform standard procedure throughout the organization. In the absence of a sound credit policy it is likely that individual loan officers make judgment inconsistent from each other and also inconsistent with the organizational goal.

d. To establish standard for control

Every policy requires periodic follow up to ensure its proper implementation. A sound policy helps to determine the variance between actual performance and practices and to take corrective actions. A sound policy is always flexible and works as a guideline rather than as a straitjacket. However, if the deviation between the practice and policy is observed, proper education to lending officers or amendment of the policy becomes inevitable. These objectives can be summarized as the sound policies that help commercial banks to maximize quality and quantity of investment and thereby achieve the own objectives of profit maximization. Formulation of sound policies and coordinated planned efforts pushes forward the forces of economic growth. Sound policy is also important to find the deviation between the practice and policy and establish a standard for control.

2.1.6 Credit risk management

Lending operations are core banking activities and the most profitable assets of credit institutions. Credit risk is defined as the risk of a credit institution suffering losses due to default, late or incomplete execution of the debtor financial obligations before the credit organization in accordance with the terms of the contract. Credit risk involves the risk of a particular bank and the borrower's portfolio risk. Credit risk management determines the effectiveness of a commercial bank. The range of clients and volume of credit transactions has dramatically increased recently, which resulted in the need to establish full fledged risk management systems. The most active work is being done to create units of assessment and management of retail and small business credit risk. In many markets, banks have to operate in the economic environment, characterized by the existence of objective obstacles to good credit management, which demonstrates the importance of strengthening this type of management. However, banks often do not have any established credit risk management process. Risk management is a specific area of economic activity that requires deep knowledge of business analysis, methods to optimize business decisions, the insurance business, psychology, etc. Commercial Bank credit policy provides the basis of all the credit management. It establishes objective standards and parameters to be followed by bank employees responsible for the provision and processing of loans and management. If the credit policy is correctly formulated, carried out and well understood at all levels of the bank, it allows management to maintain proper standards of the bank loans to avoid unnecessary risks and correctly assess the opportunities for business development.

Strategic credit risk management is an activity designed to develop risky bank lending policies, including the definition of the fundamental objectives and the means to achieve them. Strategic management can be seen as a continuous process of selecting and implementing the goals and strategies of the organization. The effectiveness of strategic management of credit risk depends on three main strategic goals of the bank: growth, protection and development. The tools of strategic management of credit risk, in our view, include: the philosophy and mission of the bank, the overall credit risk strategy, credit policy in the realization of strategic goals and objectives of the bank in the management of credit risk. The most productive approach to strategic management of credit risk lies in the definition of basic credit risk policies and preferences of banking activities in accordance with the chosen direction of development. Strategic management of credit risk as a process can be presented in a sequence of several phases: definition of the philosophy and mission of the bank on credit risk; consolidated analysis of exogenous and endogenous factors affecting the system of credit risks; strategic planning for the desired conditions of the given risky positions; choice of credit risk strategy and the development of credit policies on the related credit risks; development of mechanisms for implementing credit risk policies and objectives of bank lending policies; monitoring and adjustment (Lepteva, 2009).

The unstable situation in financial markets affects the need to raise attention to the borrowers. Traditionally, credit risks are associated with financial status, sustainability of business, reputation, liquidity and other factors. In an unstable banking system, more attention should be paid to how the client's business depends on the financial market. For example, additional credit risk arises from the leasing companies. However, there are customers who do not incur additional credit risks in the context of financial market instability. This is true for the food industry and the sphere of services, calculated at the average level of consumption. It is very important in determining the credit risk to take into account the specifics of the industry. In some industries the level of credit risk is significantly higher than in the economy in general. These industries include, for example, construction, agriculture and other sectors whose income is unstable. Some banks create additional reserves for loans to companies operating in such industries. Effective management of credit risk is inextricably linked to the development of banking technology, which will enable to increase the speed of decision making and simultaneously reduce the cost of controlling credit risk. This requires a complete base of partners and con tractors. There is a need for reliable information on the borrower's credit history, so the credit bureau must play a significant role here.

Monitoring a specific borrower's credit risk is carried out over the entire period from the conclusion of the loan agreement to its fulfillment. The need for such controls is the fact that business conditions are often unpredictable and can be negative, and this may lead to changes in the borrower's financial position and their ability to repay the loan. In banking practice a number of fundamental principles of checks are worked out, for example: periodical checking of all types of loans; checking all the critical conditions of each credit agreement frequent checking of major credits, etc. Banks must constantly improve risk management to prevent deterioration in the quality of assets. In conclusion we want to point out that the development of risk management in Russian banks promotes compliance with the standards of Basel and the Bank of Russia demands. The evolution of risk management involves both the improvement of organizational and functional structures and the increase in the quality of risk management, as well as the introduction of modern systems of identification, measurement, evaluation and monitoring of various types of risk *(Letter from the Bank of Russia "On typical banking risks" 2004).*

2.1.7 Concept of Investment Policy

The income and profit of the bank depends upon its investment policy, lending policy and investment of its fund in different securities. In the investment procedures and policies it is always taken in mind that "the greater the credit created by the bank, the higher will be the profitability." A sound lending and investment policy is not only the pre-requisite for bank's profitability, but also crucially significant for the promotion of commercial savings of a financially backward country like Nepal.

The bank and finance companies are such type of institutions, which deal in money and substitute for money. They also deal with credit and credit instruments. To collects fund and mobilize them in a productive sector is a difficult task for any institutions. An investment of fund may be the question of life and death of the bank as there is various risk associated with it. Thus the banker must think seriously before making an investment decision. The investment policy of a bank consists of earning high returns on its un- loaned resources. But it has to keep in view the safety and liquidity of resources so as to meet the objectives of profitability which conflicts with each other and investment policy strikes a judicious balance among them. Therefore a bank should lay down its investment policy in such a manner so as to ensure the safety and liquidity of its funds and at the same time maximize its profit.

The investment objective is to increase systematically the individual wealth, defined as asset minus liabilities. The higher the level of designed wealth the higher it will be received. An investor seeking higher return must be willing to face higher level of risk (Chery & Moses, 1988).

Credit and investment command number first and number second positions and investment at times serves as substitute of loan. That is why when loan demands weakens; a bank increases securities in investment portfolio. Similarly banks start shedding securities from investment portfolio when loan demand increases to entertain loan request. This warrants careful management of investment portfolio so that net interest income/spread (excess of interest income over interest expenses) can be maximized (Dahal & Dahal, 2002).

Every bank manager should have awareness about the major risks associated with the securities. Because price of securities are affected by the some kind of risk like credit risk, interest rate risk and liquidity risk. These are the sources of investment risk. The policy should specify what rated securities it wants to held in the portfolio. If unrated, whether it buys or not. Since risk is overpriced during recession and under priced during boom, banks prefer buying medium grade and high grade securities during recession and boom respectively. Normally banks buy investment rated securities only (Dahal & Dahal, 2002).

2.1.8 Considerations for Sound Lending and Investment

The major source of income and profit generation of every banks and financial institution is its loan -investment in different sectors .If loans are not distributed properly and cautiously then it may be the main cause of the failure of the company .As prescribed by Bhattacharya in his book “Banking strategy, credit appraisal and lending decisions, a Risk-Return Framework,” the important consideration which the finance company should review and analyzed is briefly illustrated below.

a. Principle of Sound Lending

- **Safety**

Every finance company must invest in those opportunities which are safe against losses and risky. Collateral should be accepted which is not so depreciable and whose value hold constancy.

- **Security**

Finance company should accept that kind of security which is commercial, durable, marketable and high market price. In those cases, "MAST" should be applied for the investment.

Where,

M = Marketability
A = Ascertain ability
S = Stability
T = Transferability

- **Profitability**

Financial institution can maximize its volume of wealth through maximization of return on their investment and lending .So, they must invest their fund where they gain maximum profit. The profit of these companies mainly depends on the interest rate, volume of loan, its time period and nature of investment in different securities.

- **Liquidity**

People deposit money at these companies with confidence that they will repay their money when they need it. To maintain such confidence of the depositors, the company must keep this point in mind while investing its excess fund in different securities or at time of lending in different sectors so that it can meet short-term obligation when they become due for payment.

- **Purpose of Loan**

Why does a customer need a loan? This is very important question for any banker. If borrower misuses the loan granted by these companies they can never repay and company will passes heavy bad debts. Detailed information about the scheme of the project or activities should be examined before lending.

- **Diversification**

A financial institution should not lay all its eggs on the same basket. In order to minimize risk, diversification on its investment on different sectors should be adopted which helps to sustain loss according to the law of average because if securities of a company is deprived, there may be appreciation in the securities of other companies, so the loss can be recovered.

- **Legality**

Illegal securities will bring out many problems for the investor. The financial institution must follow the rules and regulations as different directions issued by Nepal Rastra Bank and other concerning bodies while mobilizing its funds.

- **Tangibility**

Though it may be considered that tangible property doesn't yield an income apart from direct satisfaction of possession of property, many times, intangible securities have lost their finance company, so they should prefer tangible security to intangible one.

- **National Interest**

Even if an advance (loan) satisfies all the aforesaid principles, it may still not be suitable. The lending program may run counter to national interest. Central Bank may have issued directives prohibiting finance companies to allow particular types of advances (Bhattacharya, 1998).

b. Major Information for Analyzing the Potential of Borrower for Lending

- Payment record and credit information from concern field

- Income level and its source
- Residence (local or migrates)
- Marital status (single ,married, widowed or divorced)
- Age factor
- References
- Reserves, assets and collateral

c. Basis of Granting Loan and Analysis of Credit Risk

- World is surrounded by certain risk associated with the related field of task. The risk is vital factor which can be seen in the field of lending and investing money by financial institution. It is true that "There is no return without risk." But by using certain criteria's they can minimize some portion of risk associated with it. With respect to this ,financial institution approach the loan request by analyzing five 'Cs' of credit risk as illustrated by Bhattacharya;
- Character of the applicant
- Capacity of qualification and work experience
- Capital of the proposed plan
- Collateral for security and its safety
- Conditions of credit environment and credit information
- Additionally, external factor also directly and indirectly affect on loan granting decision. They can be political crisis, national and international economic condition, policy and practice, cultural practice etc.

d. Basic requirement in a borrower / lending documentation

Commercial Banks cannot lend money to just anyone blindfold. It should be confident regarding the trustworthiness and intentions of the probable beforehand. The borrower, on the other hand, should provide all pertinent documents that the company seeks to build confidence on borrower. There are some requirements that should be fulfilled by the client to stand him as a probable borrower. The basic requirement that the borrower should submit with loan proposal are as follows:

- **If applicant is an individual**

  - Applicant should be Nepali citizen. Citizenship certificate should be submitted.
  - Should have good knowledge about work they intend to commence.
  - Normally the applicant should not have taken loan from any other institutions previously.
  - Applicant should present the job planning scheme with perfect business plan.
  - Personal information is also required.
  - Business and income tax registration certificate with renewal.
  - Quotation and personal guarantee with reference of well recognized personal.
  - Certificate of ownership.
  - Driving license if required.
  - Description of securities with full proof evidence.
  - Other documentation as per company rules whichever required

- **If the applicant is partnership firm**

  - The firm should be registered in related department.
  - The person dealing with the borrowing of the firm should specify in the partnership contract.
  - Income Tax Registration certificate with renewal.

- **If the Applicant is Private Limited Company or Public Limited Company**

  - Company should be registered.
  - Working place, project place should be specified and all the assets should be in the name of company.
  - Audited Balance sheet, profit and loss account, and other required financial statement.
  - Documents of at least of one year should be presented.
  - If the work place or project place is leased the lease contract should be presented
  - The authorized person should apply for the loan.
  - Loan amount applied must be within the limit of memorandum of the company or must be decided by the board.

- Decision of the promoters.
- Personal information of the main person is required.
- Written personal guarantee of the proprietors is required.
- Citizenship of promoters and proprietors is required.

e. Basic feature of Collateral

Collateral is the most important item for granting loan. Loan should be granted by analyzing details related to collateral. Generally in Nepalese practice- land and building; gold silver and some classified document are accepted as safe and reliable collateral, but there are some features which must be analyzed .They are

- Market availability
- Price stability
- Durability
- Storing facility
- Transportation
- Profitability

- **Guidelines for Assessing Risk**

Risk is dependent upon the quality found in each ‘c’ and the combination of these five ‘C_s’. Assuming the same conditions prevail, the following guideline is generally suggested.

Table 2.1: Guidelines of Assessing Risk

Applicant Characteristics	**Credit Risk**
Character +capacity	Very low
Character + capacity without capital	Low to moderate
Character + capacity but insufficient capital	Low to moderate
Capacity + capital but impaired character	Moderate
Capacity + capital without character	High
Character + capital without capacity	High
Character + no capital + No capacity	Very high
Capital + No character + No capacity	Very high
Capital + No character + No capital	Fraudulent

Source: Book by Bhattacharya, 1998

2.1.9 Lending Procedures

According to Dahal and Dahal, lending procedures include loan approval and disbursement process (Dahal & Dahal, 2002):

Loan Approval and disbursement Process

Loan is approved by approving authority only after being convinced that the loan will be repaid together with interest. There are many processes involved to approve the loan which has been listed below:

a. Application

A borrower is normally required to submit an application to the bank along with required documents: project proposal, historical financial statements and documents pertaining to company's legal existence.

b. Conducting the interview

During the loan rendering process respective clients are asked by the respective credit officer of banks about the financial strength to know the creditworthiness of clients. Documents that are submitted by the borrowers also give detail information about the borrowers which plays great important role to know the borrowers. Normally, such interview takes place at the bank premise.

c. The credit analysis

During the credit analysis phase various aspects are evaluated by the banks which is broadly included under the heading of 5c$_s$ which are: Character, Capacity, Condition, Collateral, and Capital.

d. Forecast and risk rating system

Based on the findings of historical analysis, and in light of present and foreseeable future environment, the analyst has to forecast impending major risks. The analyst should also highlight to what extent inherent risks will be mitigated and how unmitigated risks can be covered.

e. Return

The amount of loan has got inherent cost as it is obtained from either shareholder or depositor or creditor. The analysis should be made to calculate total return and compare whether it meets banks standard.

f. Liquidation

The analyst should ascertain bank's ability to recover loan in case of liquidation of the borrower. If liquidation analysis reveals insufficient security, additional security may be asked for.

g. Credit worthiness and debt structure

If analyst finds the borrower creditworthiness and decides to extend loan, he should structure the debt facility to be extended.

2.2 Review of Rules, Regulation and NRB Directives Regarding Credit Management of Commercial Banks

Various rules, regulation, acts and directives are reviewed while preparing the concept of this study. Different types of directives, which are issued for the commercial banks to manage credit in a proper way, obviously play the great role for the comparative analysis of credit management of the commercial banks.

NRB is the leader of the money market. It is the chief of all the banks operating in the country. It supervises, regulates and controls the functions of commercial banks and other financial institutions. Various directives have direct or indirect impact while making decisions to discuss those rules and regulations which are formulated by NRB in terms of investment and credit to- priority sector, deprived sector, other institutions, single borrower limit, CRR, loan loss provision, capital adequacy ratio, interest spread, productive sector investment etc. A commercial bank is directly related to the fact that how much fund must be collected as paid up capital while being established at a certain place of the nation, how much fund needed to expand the branch and counters, how flexible and helpful the NRB rules are important. But only those, which are related to credit aspect of commercial banks, are described in the study. The main provision established by NRB in the form of prudential norms in above relevant are briefly discussed here:

2.2.1 Regulation to Maintain Minimum Capital Fund by the Commercial Bank as per NRB Directive.

Capital adequacy ratio (CAR) is the relationship between capital funds to total risk weighted assets of the bank. The higher the CAR, the less levered the bank and safer from depositor's point of view because the proportion of shareholders' stake to the risk weighted assets is also high.

Risk weight is assigned to various assets and off balance sheet items of the bank to arrive at the risk weighted assets. Banks in Nepal are required to have minimum 6% core capital and 11% total capital fund of total risk weighted assets.

Table 2.2: Fund Required on the basis of RWA (%)

Core capital	Capital fund
6	11

Source: NRB directives 2015/16

- **Classification of Capital**

To calculate the capital fund, commercial banks should classify the capital in two parts:

a) Core capital
b) Supplementary capital
And,
Capital fund= Core capital + Supplementary capital

Provision for pass loan made up to 1.25% of total risk weighted assets is treated as supplementary capital.

$$\text{Capital fund ratio} = \frac{\text{Core Capital} + \text{Supplementary Capital}}{\text{Sum of Risk Weighted Assets}} \times 100$$

Where, sum of weighted risk assets (WRA) = Total WRA appeared in balance sheet+ Total WRA appeared outside the balance sheet.

2.2.2 Loan Classification and Loan Loss Provisioning

A bank is required to classify their loan on the basis of overdue ageing schedule and provide on a quarterly basis as follows:

a. Pass loan

All loan and advances whose principal amount is past due for period up to three months should be included in this category. These loans are classified as performing loans.

b. Substandard

All loans and advances that are past due for a period up to six months should be included in this category. Sub standard loan is classified as nonperforming loan.

c. Doubtful

All loan and advances that are due for a period of six months to one year should be included in this category. Doubtful loan is also from the category of nonperforming loan.

d. Loss

All loan and advances which are due for a period of more than one year should be included in this category.

Provision for Loss Loan

Loan should be classified as loss in the following cases,

- No security or security not as per contract.
- Borrower as been declared as bankrupt.
- In case of borrower not found.
- Purchased or discounted bill are not repayable within 90 days from due date.
- Loans amount has not been used for taken purpose.
- Loan provided for blacklisted borrowers.

2.2.3 Loan Loss Provision

The loan loss provision on the basis of outstanding loans and advances and bills purchased classified as per directives, which is as follows:

Table 2.3: Classification of Loans

Classification of loans	Loan loss provision
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Source: NRB Directives 2015/16

- Bank can reschedule and restructure loan if nonperforming loan receiver submit the external/internal reasons. If loan is restructured and rescheduled, provision requirement for such loan is minimum 12.5%.
- If priority and deprived sector loan is restructured and rescheduled, such loan will have to be provisioned at 25% of the provision percentage to loan loss.
- Provision requirement in case of loan given against personal guarantee only is additional 20% for pass, substandard and doubtful loans.
- Loss provision for performing loan is called general loan loss provision and loss provision for non performing loan is called specific loan loss provision.

2.2.4 Directives Relating to Single Borrower Credit Limit

With the objectives of lowering the risk of over concentration of bank loans to a few big borrowers and also to increase the access to small and middle size borrowers to the bank loans, NRB has directed commercial bank to set an upper limit for single borrower limit. According to the directive, commercial banks may extend credit to single borrower or group of related borrowers in such a way that the amount if fund based loan(overdraft, trust receipt, term loan etc) and advances up to 25%of core capital and non fund off the balance sheet facilities like letter of credit, guarantees, acceptances, commitments is up to 50% of its core capital fund, but in case of advances and facilities to be used for the purpose of importing specified merchandize by the following public corporations, the exemption in the limit of credits and facilities is not applicable:

Table 2.4: Public Corporation and their Specified Merchandize

Name of corporation	Merchandize
Nepal oil corporation	Petrol, Diesel, Kerosene and LPG gas
Agriculture Input corporation	Fertilizers, seeds
Nepal food corporation	Cereals

Source: NRB Directives 2015/16

2.2.5 Directives Regarding Investments in Shares and Securities by Commercials Banks

a. Arrangement as to implementation of investment policy under approval of the board of directors

Banks should prepare written policy relating to investments in the shares and securities of organized institutions. Such policies should be implemented only under the approval of restrictions as to investment by the banks securities by NRB.

b. Arrangement relating to investment in shares and securities of organized institutions

- Bank may invest in shares and securities of any organized institution not exceeding 10% of the paid up capital of such organized institution. Any amount of investment made in excess of this limit for the purpose of calculation of the capital fund, should be deducted from the core capital fund.
- The total amount of investment should be restricted to 30% of the paid up capital of the bank. Any amount of investment made on excess of 30% of paid up capital of the bank, for the purpose of calculation of the capital fund, should be deducted from the core capital fund.
- Banks should invest in the X shares and securities of organized institutions, which are already listed in the stock Bank exchange.
- Where the shares and securities are not listed within the period prescribed, provisioning equivalent to the whole amount of such investment be provided and credited to investment adjustment reserve. The outstanding amount in such reserve should not be utilized for any other purpose till the sold shares and securities of the organized institution are listed. The outstanding amount in investment adjustment reserve should be included supplementary capital.

- Banks should not invest in any shares, securities and hybrid capital instruments issued by any banks and financial institutions licensed by NRB where such investment exists prior to issuance of this directive such investment should be brought within the strives limitations imposed by this directive within 3 years.

2.2.6 Directives Regarding Interest Rate Spread

The interest rate spread is the difference between the interest taken from loan and advance or investment and the interest given to the depositor. As NRB direction lending rate and deposit rate should not exceed 5%. Such rates are calculated as under:

WALR= Interest income for a month/Total interest-earned asset
WADR= Interest expense for a month/Total deposit outstanding
Interest spread= WALR-WADR

Where;

WALR= Weighted average lending rate
WADR=Weighted average deposit rate

2.3 Review of Empirical Studies

Several studies have been conducted on the field of credit management, within the country and aboard. So, under this section, the available literatures related to credit management are divided into two parts i.e. Review from international context and Review from Nepalese context.

2.3.1 Review from International Studies

In International context, various studies have been done on the field of credit management and a different article has been presented to clarify the topic. Among these articles and book, some of which are reviewed in the following way:

Meir(1996), in his study, said that the gain to borrower is obvious, if these investments are sufficiently productive, you will be happy to pay interest on the loan to pay back in the future more purchasing power than you received. Lending is to gain from trade. The interest you pay gives lender a better return than they could achieve otherwise, what are their alternatives? They could make productive investment themselves. But finding productive investment is difficult .Some people are much better at it than others. Typically savers do better by lending their money to that highly productive use for it than by making investment themselves (Meir, 1996).

The committee examined the existing system of lending and recommended the following broad changes in the credit system.

- The credit needs of borrowers are assessed on the basis of their business plans.
- Bank credit only is supplementary to the borrower's resources and not is replacement of them, i.e. banks not to finance one hundred percentage of borrower's requirement.
- Borrowers are required to hold inventory and receives according to norms prescribed by reserve bank of India from time to time.
- Credit be made available in different components only, depending upon the nature of holding of various current assets.
- In order to facilities a close watches on the operations of borrowers, they are required to submit at regular intervals, data regarding their business and financial operations both for past and future period.

Crosse in his study has said that lending is the essences of commercial banking, consequently the formulation and implementation of sound policies are among the most important responsibilities of bank directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit creating function effectively and minimize the risk inherent in any extension of credit (Crosse, 1963).

Credit creating function or lending is very important for all commercial banks. But doing credit function without applying policies and practices is not enough to lead the success. So to manage the different kind of credit function, to maximize return and to minimize credit risk, every bank should be conscious about formulation and implementation of credit policies and practices.

Rose has emphasized on the factors affecting default risk and interest rates. He opines that another important factor causing one interest rate to differ from another in the global market place is the degree of default risk carried by individual assets. Investors in financial assets face many different kinds of risk, but one of the most important is default risk the risk that a borrower will but make all promised payments at the agreed upon times. All debts except some government securities, subject to varying degrees of default risk (Rose, 2003).

Default risk is one kind of investment risk, which is created from nonpayment of interest and principal by the security issuer at the fixed future date. A bank management should have awareness about such risk. Approving authority should consider that the loan will be repaid together with interest, for this loan approval process should conduct in better way.

Zerith (2008), in her article, "Credit Portfolio Management", affirmed that to manage the credit portfolio, bankers must understand not only the risk posed by each credit but also how the risks of individual lending and portfolios are interrelated. These relationships can multiply risk many times beyond what would be if the risks were not related. Until recently, few banks used modern portfolio management concepts to control credit risk. Now, many banks view the credit portfolio in its segment as well as among loans. These practices provide management with a more tools to analyze and control the risk. She further concluded that effective portfolio management begins with oversight of the risk in individual loans.

Tabak, Fazio and Cajueiro (2010), had studied 96 Brazilian banks and found that, the loan portfolio of Brazilian banks was average, moderate concentrated. He concluded that, loan portfolio concentration seems to improve the performance of Brazilian banks in both return and risk of default. The concentration indices were found to be positively related to returns and negatively related to risks.

Afroz (2013) has found that, Bangladesh Krishi Bank was concentrating its lending to primary agriculture to serve to poor people in rural area. Later on it has diversified its activities to secondary agriculture. After diversification, the financial position of the bank become more transparent and expected for better result soon.

.2.3.2 Review from Nepalese Context

In Nepalese context, here are some independent studies which are presented in the following ways:

a. Review of relevant studies from report and articles
b. Review from unpublished thesis

In the first section, effort has been made to examine and review some related articles and reports published in different journals, magazines, newspaper and books while in second section, unpublished thesis work conducted by various students have been presented.

Deposit is the life blood of any financial institution i.e. commercial banks, financial companies and co-operative or non government organization (Pradhan, 1996)**.** In consideration of ten commercial banks, nearly three dozens of finance companies, the latest figure produce a strong feeling that a serious review must be made on problems and prospects of deposit sector .Beside few joint venture banks, other organizations rely heavily on the business deposits receiving and credit disbursement. Pradhan (1996) has not only pointed out the problems but also suggested for the prosperity of deposit mobilization. They are given as:

By adding service hours system will definitely be an appropriate step. If deposit mobilizations materialize by providing sufficient institutions service in rural area, the generated fund can be used somewhere else by the bank which can be taken as major achievement. NRB could be endorsing this deposit collection by continuing to subsidize overhead cost for little longer period .A full scale of field office system could be taken back and made manpower strength deputed to cut down overhead cost.

NRB also organize training program to develop skilled manpower. By spreading co-operative to the rural areas, mini- banking services are to be launched.

Lastly, Pradhan mentioned, deposit mobilization carried out effectively is in the interest of depositors, society, financial sector and the nation. Lower level of deposit rising allows squeezed level of loan delivery leaving more room to informal sectors. That is why higher priority to deposit mobilization has all the relevance.

In an article, Bhattarai tried to indicate the problems of bank bad debt and non performing assets. According to him, “If a bank cannot recover its loan lending, banks cash flow will be badly affected. Similarly it can affect the close relationship between depositors (Bhattarai, 1997).

In an article, “Challenges of non-performing loan management in Nepal”, Karki has mentioned the causes of increasing trend of non-performing loan. She identified “the major causes such as poor loan analysis, guarantee oriented loan system, depreciation of valued assets, misuse of loan, lack of regular supervision of loan **(**Karki, 1996).

Loan mix is components of established credit policy. It is a kind of strategy in credit management for banks to be success. In context of Nepal, here are different sectors in economy such as priority sector, deprived sector, productive sector, government sector etc. So, there should be diversification in investment of every commercial bank. Making investment or lending to various sectors is necessary for the long term survival of banks.

Shrestha (1998), in her article “Lending operations of commercial bank of Nepal and its impact on GDP” presented the objectives of making an analysis of contribution of commercial banks lending to Domestic Product (GDP) of Nepal. She has set a hypothesis that there has been a positive impact of lending of commercial banks to the GDP. In research methodology, she has considered GDP as the dependent variable and various sectors of lending viz. agriculture, industrial, commercial, service, general, and social sectors as independent variables. A multiple regression technique has been applied to analyze the contribution. The multiple analysis have shown that all the variable expect service sector lending have positive impact on GDP. Thus, in conclusion, she has accepted the hypothesis, i.e. there has been positive impact on GDP by the lending of commercial banks in various sectors of economy, expect service sector investment.

Dhungana (2006), in his article, “Problems of NPL’s and the need of Financial Discipline in the Nepalese Banking System”, concluded that poor credit management and deterioration in the quality of loans give birth to non-performing assets. The internal measures play significant role to control the growth of NPL. Best credit practices, culture and policies are required to strengthen the internal factors. The banks should have a proper system and should insure that risk are accurately identified, assessed, and controlled properly. A proper risk management is undoubtedly an important tool for a good banking and NPL management.

Poudel (2012) appraised the impact of the credit risk management in bank's financial performance in Nepal using time series data from 2001 to 2011. The result of the study indicates that credit risk management is an important predictor of bank's financial performance.

Kattel (2015) investigated the credit risk identification techniques followed by commercial banks of Nepal. The result of the study indicates that the Nepalese bankers are aware of the importance of various techniques to effectively identify the risk level. Furthermore, the Nepalese commercial banks have used various techniques like interview, root cause effect, check list analysis, Strength, Weakness, Opportunity and Threat (SWOT) analysis, scenario analysis, expert judgment, simulation, stress testing etc. In addition, there was significant difference between all three categories of bank, namely State-Owned bank with Private Bank, State-Owned bank with Joint Venture Bank, and Joint Venture Bank with Private Bank in terms of tools and techniques used for credit risk identification.

2.3.3 Review of Thesis

Ojha (2002) conducted a study; "Lending practices- A study of NABIL, SCBNL and HBL" has outlined his major finding as follows: SCBL's contribution in loans and advances is the lowest and this has low degree of variation and low growth rate as compare to NABIL and HBL. The study has recommended SCBNL to give extra priority on productive and priority sector loan. SCBL, NABIL and HBL have to follow the NRB directives strictly. The ratio of total income to total expenses of NABIL and HBL is below than SCBL and below the combined mean of three banks. This ratio trends to be unfavorable due to the comparatively higher operating cost of these banks also. The productivity of the expenses in SCBL is significantly higher than NABIL and HBL. These banks improve their operational efficiency and increases the productivity of expenses made. The study has also recommended lowering gap in interest charged and interest offered. Lowering gap results in high volume and advances and helps in increasing sustainable lending practices.

Dhugana (2002) conducted a study “A comparative study on investment policy of Nepal Bangladesh bank limited and other joint venture banks”. The findings of the study were: NBBL has not good deposit collection it has not made enough cash and negligible amount of investment in government securities. NBBL has highest loan and advances to total deposit ratio, loan and advances to total working fund ratio, lowest loan loss ratio and higher investment on share and debenture to total working fund ratio.

NBBL has followed stable policy. NBBL is not in better position on regarding off-balance transaction. NBBL is able to manage its assets regarding its on balance transaction. Lending position, investment position and net profit position of NBBL is not better in compare to HBL. But it has better position in comparison to NSBL.

The study has suggested increasing the liquidity of NBBL, to invest in government securities instead of keeping idle fund. It has also suggested providing project oriented approach. It has suggested NBBL for developing effective portfolio management. It has suggested in developing innovative approach for bank marketing upgrades the banking facility, liberal lending policy and effective cost management cost.

Regmi (2004) in his thesis entitled “Credit practices of joint venture banks with reference to Nepal SBI bank Ltd and Nepal Bangladesh Bank Ltd” has emphasized to analyze the credit practices of concerned joint venture commercial banks.

This study is based on five years data 1988-2002 of concerned banks. It has found that liquidity position of both banks is satisfactory, on the basis of asset management ratio; NBBL is in better position than NSBL. In credit portfolio, both banks have invested more in private sector than other sector. NBBL has better lending efficiency than that of NSBL. Deposit mobilization per branch ratio and credit mobilization per branch ratio of NSBL is higher than NBBL. At last, the study has found that the profitability position of NBBL is better than that of NSBL.

NBBL should give focus on it liquidity position. Both banks should follow the NRB directives which help them to reduce credit risk. The study has also recommended that the both bank should adopt sound credit collection policy and the marketing strategies should be innovative.

Dahal (2009) conducted a study entitled “Credit Management of Nepal Credit and Commerce Bank” which found that the analysis of the lending process of commercial banks, their deposit utilization towards lending, the impact of credit policy on liquidity and the situation of nonperforming assets and loan loss provision.

The bank should decrease its volume of lending and invest the portion in other investment sector too .It should make a loan portfolio to diversify the risk. It should also reduce the amount of loan loss provision and non-performing as far as possible. Dahal said lending is possible only when there is availability of sufficient amount of deposit. So, it should bring the scheme to uplift the amount of deposit too.

Khadka (2012) in his study entitled “Credit Management of Bank of Kathmandu, Everest Bank Limited, and Himalayan Bank Limited”. The study has tried to analyze the relationship between the deposit collected and loan floated by the banks. Credit performance of sampled commercial banks is studied. It has examined the information procedure in controlling the credit policies and practices of commercial banks. This study has gone through norms laid by Nepal Rastra Bank with regard to credit management of commercial banks.

This study has recommended banks to increase their current ratio and increase some part of their capital in the share and debenture of other companies to diversify the risk under the provision of Nepal Rastra Bank. BOK have higher credit risk ratio so he recommended reducing it. Return on total working fund of BOK and HBL is comparatively low so, the study has recommended making the maximum utilization of their resources to increase their return. He recommends EBL to diversify its sector of investment because it has focused on particular sector only.

Sharma (2012) on her study entitled credit management of Nepal Bangladesh Bank has focused on the liquidity management, assets management, profitability and risk portion of NB bank. This study also has analyzed the lending practices, resource utilization, and trend of deposit utilization and impact of growth in deposit on liquidity of NB bank.

This study has recommended investing some percentage of cash and bank balance in some profitable sector. It has advised to increase the deposit to make more credit and advances and also to decrease the service charges. It has also suggested reducing the minimum amount needed to open the new accounts.

2.4 Research Gap

There are various factors which affect the lending practices of commercial banks. The directive of NRB changes over time, and commercial banks have to adopt these changes with their policy over the time. So that, up-to-date study over the change of time frame is major concern for the researcher and concerned organization. This study covers the recent financial data, NRB circulars, and guidelines than that of studies previously conducted.

It is major concern of shareholders to know portfolio behavior of the bank. This study puts its effort to find out the factors that are related with investment of banks. Analysis of lending efficiency shows the efficiency of the bank. No case study has yet been conducted on credit management of EBL and NBL bank. Hence, this study fulfills prevailing research gap about the in-depth analysis of lending efficiency. More recent data are used here so that updated values and findings can be seen in this research.

CHAPTER- III

RESEARCH METHODOLOGY

Research methodology is a systematize way to solve the research problem. The prime objective of this study is to compare, evaluate and assess the credit performance of selected commercial Banks i.e. EBL and NBL. This chapter contains the methods that make convenience for comparison of the performance made so far by these banks by analyzing the strength and weakness of the financial performance of these three sampled banks. 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.

3.1 Research Design

For the purpose of achieving the objectives of study, the descriptive and analytical methodology is used in this study. Research design is very important for scientific investigation. Research design gives the investigator a systematic direction to research work. It presents a series of guideposts to enable the researcher to process in the right direction in order to achieve the goal. Descriptive research can be explained as a statement of affairs as they are at present with the researcher having no control over variable. Moreover, "descriptive studies may be characterized as simply the attempt to determine, describe or identify what is, while analytical research attempts to establish why it is that way or how it came to be" (Ethridge,2004).

Descriptive research is "aimed at casting light on current issues or problems through a process of data collection that enables them to describe the situation more completely than was possible without employing this method" (Fox & Bayat,2007).

In its essence, descriptive studies are used to describe various aspects of the phenomenon. In its popular format, descriptive research is used to describe characteristics and/or behavior of sample population.

An important characteristic of descriptive research relates to the fact that while descriptive research can employ a number of variables, only one variable is required to conduct a descriptive study. Three main purposes of descriptive studies can be explained as describing, explaining and validating research findings.

Descriptive studies are closely associated with observational studies, but they are not limited with observation data collection method. Case studies and surveys can also be specified as popular data collection methods used with descriptive studies.

3.2 Sources of Data

This study is mainly based on secondary data. Secondary data are collected from respective annual report especially from profit and loss account, balance sheet and other publications made by the banks during the fiscal year 2011/12 to 2015/16. Also some data has been gathered from Nepal Stock Exchange’s website. Similarly, articles, journals, bank bulletins, newspaper related to financial performance study, previous research report etc, have also been taken into account while collecting information.

3.3 Population and Sample

The population in most studies usually consists of large groups. Because of its large size it is fairly difficult to collect detailed information from each member of population. Rather than collecting information from each member, a sub-group is chosen which is believed to be representative of Population. This sub group is called a Sample. The total commercial banks shall constitute the population of the data. So, among the various commercial banks in the banking industry-EBL as private bank and NBL as public bank are randomly selected as sample for the study to compare the credit management between them.

3.4 Methods of Data Analysis and Presentation

Data itself give no meaning. They should be analyzed and interpreted by using different tools and techniques. These tools and techniques may either be statistical or may be other. Various financial ratios and statistical tools are used to draw conclusion of the study. Besides some charts and tables have been presented to analyze and interpret the finding of the study. Since this is a comparative study, EBL and NBL are used for comparison. One is first commercial bank and another one is the reputed joint venture bank of Nepal.

3.5 Financial Tools

Financial tools basically help to analyze the financial strength and weakness of a firm. Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concerned especially to take output and credit decisions. Ratio analysis is used to compare firm's financial performance and status with of the other firms. Even though there are many ratios to analyze and interpret the financial statement following ratios are calculated and analyzed.

3.5.1 Credit /Loan related Ratios

In this study followings tools of ratio analysis have been used

a. Loan and Advances to total Assets Ratio

Loan and advances is an important part of total assets (total working fund). Total working fund play important role in profit earning through fund mobilization. So bank should carefully mobilize the total assets. The ratio of loan and advances to total assets measures the volume of loan and advances in the structure of total assets. A high ratio indicates better in mobilization of funds as loan and advances and vice-versa.

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

b. Total Investment to Total Deposit ratio

Commercial bank may mobilize its deposit by investing its fund in different securities issued by government and other financial and non-financial companies. Efforts have been made to measure the extent to which the banks are successful in mobilizing the total deposit on investment. A high ratio is the indicator of high success to mobilize the banking fund as investment and vice-versa.

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

c. Loan and Advances to Total Deposit Ratio

This ratio is calculated to find out how successfully the banks are utilizing their deposit on loan and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits.

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

d. Investment to Loan and Advances Ratio

This ratio measures the contribution made by investment in total amount of loan and advances and investment. The proportion between investment and loan measures the management attitude towards risky assets and safety assets. Investment and loan and advances in whole do not provide the quality of assets that a bank has created. The ratio indicates the mobilization of funds in safe area and vice-versa.

$$\text{Investment to loan and advances and investment ratio} = \frac{\text{Investment}}{\text{Loan and advances and investment}}$$

3.5.2 Credit Efficiency Ratio

It measures the performance efficiency of an organization from various angles of its operations. These ratios indicate the efficiency of activity of an enterprise to utilize available funds, particularly short term funds. These ratios are used to determine the efficiency, quality, and the contribution of loan and advances in the total profitability. The efficiency of a firm depends to a large extent on the efficiency with which its assets are managed and utilized. This ratio also shows the utilization of available fund. The following ratio measures the performance efficiency of the bank to utilize funds.

a. Loan Loss Provision to total Loans and Advances ratio

NRB has directed the commercial banks to classify its loan and advances into the category of pass, substandard, doubtful, and loss. NRB has classified the pass and substandard loan as performing loan and other two types of loan as non-performing loans. The provision created against the pass and substandard loan is called the general loan loss provision and provision created against the doubtful and loss loan is called specific loan loss provision. The provision of loan loss reflects the increasing probability of nonperforming loan. The provision of loan mean the net profit of the banks will come down by such amount. Increase in loan loss provision decreases profit that result to decreases in dividends but its positive impact is that it strengthens the financial conditions of the banks by controlling the credit risk and reduces the risks related to deposits. Loan loss provision to total loan and advances ratio is calculated by dividing loan loss provision by total loan and advances. The low ratio indicates the good quality of assets in total volume of loan and advances. High ratio indicates more risky assets in total volume of loan advances.

$$\text{Loan loss provision to total loan and advances} = \frac{\text{Loan loss provision}}{\text{Total loan and advances}}$$

b. Nonperforming Loan to total Loan and Advances Ratio

Nonperforming loans to total loan and advances ratio shows the percentage of non-recovery loan in total loan and advances. This ratio is calculated as dividing non-performing loan by total loan and advances.

$$\text{Non-performing loan to total loan and advances} = \frac{\text{Non-performing loan}}{\text{Total loan and advances}}$$

3.5.3 Profitability Ratio

In this regard following tools are taken for the effectiveness of credit mobilization:

a. Operating Profit to Loan and Advances Ratio

Operating profit to loan and advances ratio measures the earning capacity of commercial banks. This ratio is calculated dividing operating profit by loan and advances.

$$\text{Operating profit to loan and advances ratio} = \frac{\text{Operating profit}}{\text{Loan and advances}}$$

b. Net profit to Loan and Advances Ratio

This ratio measures the earning capacity of commercial banks through its fund mobilization as loan and advances. Higher ratio indicates greater success to mobilize fund as loan and advances and vice-versa. Mostly loan and advances includes loan cash credit, overdraft, bill purchased and discounted.

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

c. Interest Income to Total Loan and Advances Ratio

Interest income is the major source of bank revenue. Interest incomes are the functions of mobilized loan and advances which are mobilized under the different headings of credit. Higher interest income shows higher revenue for the bank.

Interest income to credit ratio = Interest income/ total loan and advances

d. Interest Expenses to Deposit ratio

Interest expenses are the functions of deposit products under the various headings, which is corporate, individuals, saving, fixed deposit, call etc. Since bank pays interest on the deposit fund, it is the cost or expenses of the bank which is a major part of the total expenses of the bank. But the cost of deposit and interest income of a loan is determined by market movement. So, bank does not have strong control over interest expenses.

Interest expenses to deposit= Interest income/ total deposit

3.6 Statistical Tools

For supporting the study, statistical tools such as -Mean, Standard Deviation, Coefficient of Variation tools have been used.

3.6.1. Arithmetic Mean

Averages are measures that condense a huge mass of data into single value representing whole data. Average is statistical constants which enable us to comprehend in a single effort the significance of the whole. It is calculated as

$$\overline{X} = \frac{Sx}{N}$$

Where,

$\overline{X}$ = Mean value or Arithmetic mean

□x =Sum of the Observation

N = Number of Observations

3.6.2. Standard Deviation

The standard deviation is the square root of mean squared deviations from the arithmetic mean and is denoted by standard deviation .It is calculated as

$$\text{Standard Deviation } (\sigma) = \sqrt{\frac{Sx^2}{N} - \left(\frac{Sx}{N}\right)^2}$$

Where,

σ = Standard Deviation

$\frac{Sx^2}{N}$ = Sum of Squares of Observation

$\left(\frac{Sx}{N}\right)^2$ =Sum of Square of mean

3.6.3 Co-efficient of Variation

The coefficient of variation (C.V) is the relative measure based on standard deviation and is defined as the ratio of standard deviation to mean expressed in percent. It is calculated as:

$$C.V = \frac{s}{\overline{X}} \times 100$$

Where,

C.V = Coefficient of Variation

σ = Standard Deviation

X = Mean

It is independent of units. Hence, it is suitable measure for comparing variability of two series with same or different units. A series with smaller coefficient of variation is said to be less variable or more consistent or more homogenous or more uniform or more stable than others and vice-versa.

3.6.4 Correlation

Correlation analysis is the statistical tool that describes the degree to which one variable is linearly related to other variable. Value of correlation coefficient lays in-between -1 to +1. If the correlation coefficient is positive, there exists a positive relation between dependant and independent variables. Likewise if the value is negative, there exists a negative correlation between two variables. If there is zero correlation between two variables then they are non- related with each other. Value of coefficient of correlation (r^2) , Probable error (P.Er) and 6P.Er is directly calculated from excel for testing of significant differences.

$$r = \frac{n\sum xy-(\sum x)(\sum y)}{\sqrt{n(\sum x^2)-(\sum x)^2}\sqrt{n(\sum y^2)-(\sum y)^2}}$$

3.6.5 Hypothesis Testing

A quantitative statement about the population parameter is hypothesis. It is an assumption to test the validity of parameters. The hypothesis tests helps to conclude whether it deserves the acceptance or rejection of parameters. In the research, hypothesis provides direction to the activities done by the researchers. The objectives of these tests are the significances regarding the parameters of the population on the basis of sample drawn from the population. Followings are the hypothesis test conducted between the sampled commercial banks.

1.Test of hypothesis on credit/loans ratios between NBL and EBL.
2.Test of hypothesis on credit efficiency ratios between NBL and EBL.
3.Test of hypothesis on profitability ratios between NBL and EBL.

The hypothesis is:

Null Hypothesis, $H_0 : \mu_1 = \mu_2$. There is no significant difference between credit/loans, credit efficiency, profitability ratio between NBL and EBL.

Alternative Hypothesis, H_1: $\mu_1 \neq \mu_2$. There is significant deference between credit/loans, credit efficiency, profitability ratio between NBL and EBL.

3.6.5.1 T-Statistics

T-statistics is one of the best methods to test hypothesis where sample size is small i.e. less than 30. The test is also called students t-statistics or simply students test since generally students use small size of sample for their study purpose. The t-statistics has been calculated and it has been compared with critical value at a significance level of 5%. T-statistics uses following formula:

$$t = \frac{\overline{X}_S - \overline{X}_E}{\sqrt{S_P^2\left(\frac{1}{n_S} + \frac{1}{n_E}\right)}} \sim t_{n_1+n_2-2}$$

The t-statistics has been calculated directly using Microsoft Excel. For the testing of hypothesis, following value and formulae have been used:

Level of Significance = 5%

Degree of Freedom = n_1+n_2-1

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the presentation, analysis and interpretation of relevant data of sampled commercial bank in order to fulfill the objectives of this study. To obtain best result, data have been analyzed according to the research methodology as mentioned in third chapter. The purpose of this chapter is to introduce the mechanism of data analysis and interpretation. With the help of this analysis, efforts have been made to highlight comparative credit management status of selected banks. For analysis, different types of analytical methods and tools such as financial ratio analysis and statistical tools are used to draw the conclusion of the study. Similarly analyzed results are graphically represented for the visibility and simplicity of conclusion.

4.1 Financial Tools

Various financial tools are used to draw the meaningful conclusion of the study. Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concerned especially to take output and credit decisions. Ratio analysis is used to compare firm's financial performances and status that of the other firms. Even though there are many ratios to analyze and interpret the financial statements, those ratios that are related to the investment and credit operation of the bank have been covered in this study.

4.1.1 Credit/Loan related ratios

This ratio shows the credit management of the commercial banks. How efficiently the banks are mobilizing their funds and their position can be studied through this ratio. In this study following ratios are analyzed.

4.1.1.1 Total loan and advances to total assets ratio

4.1.1.2 Total investment to total deposit ratio

4.1.1.3 Loans and advances to total deposit ratio

4.1.1.4 Investment to loan and advances and investment ratio

The descriptive analysis of credit/loan ratios are clearly shown in the following table.

Table 4.1: Credit/Loan related Ratios

Total loan and advances to total assets ratio:										
Banks	Years					Mean	S.D	C.V	Min	Max
	2011/12	2012/13	2013/14	2014/15	2015/16					
NBL	47. 21	50.32	50.06	57.78	59.19	52.91	5.26	9.93	47.21	59.19
EBL	64.34	66.01	67.53	54.95	59.67	62.50	5.15	8.24	54.95	67.53
Total investment to total deposit ratio:										
Banks	Years					Mean	S.D	C.V	Min	Max
	2011/12	2012/13	2013/14	2014/15	2015/16					
NBL	14.97	17.43	32.69	21.67	14.36	20.22	7.54	37.27	14.36	32.69
EBL	15.73	16.05	10.47	18.18	19.41	15.97	3.43	21.47	10.47	19.41
Loan and advances to total deposit ratio:										
Banks	Years					Mean	S.D	C.V	Min	Max
	2011/12	2012/13	2013/14	2014/15	2015/16					
NBL	49.37	56.54	56.30	65.35	68.50	59.21	7.69	12.98	49.37	68.50
EBL	71.83	75.18	76.60	65.57	72.50	72.34	4.25	5.88	65.57	76.60
Investment to loan and advances and investment ratio:										
Banks	Years					Mean	S.D	C.V	Min	Max
	2011/12	2012/13	2013/14	2014/15	2015/16					
NBL	23.37	23.56	36.73	24.90	17.33	25.16	7.10	28.20	17.33	36.73
EBL	17.96	17.59	12.03	21.70	21.12	18.08	3.85	21.28	12.03	21.70

4.1.1.1 Loan and Advances to Total Assets Ratio

Loan and advances is the major part of total assets for the bank. This ratio indicates the volume of loan and advances out of total assets. A higher degree of ratio indicates that the bank has been able to mobilize its funds throughout lending function but not better from the point of liquidity.

Table 4.1 shows that the mean ratio of total loan and advance to total assets of EBL is highest in recent five years being 62.5% with S.D of 5.26 and C.V of 9.93. In F/Y 011/012, NBL was with the average of 47.21 %, in F/Y 012/013 of 50.32%, in F/Y 013/14 of 50.06, in F/Y 014/15 of 57.78 and in F/Y 2015/16 of highest ratio of 59.19%. It seems that the ratio is in increasing trend of NBL by being able to mobilize its fund but it is in decreasing trend of that EBL in comparison to the previous year.

Figure 4.1 Loans and advances to total assets ratio

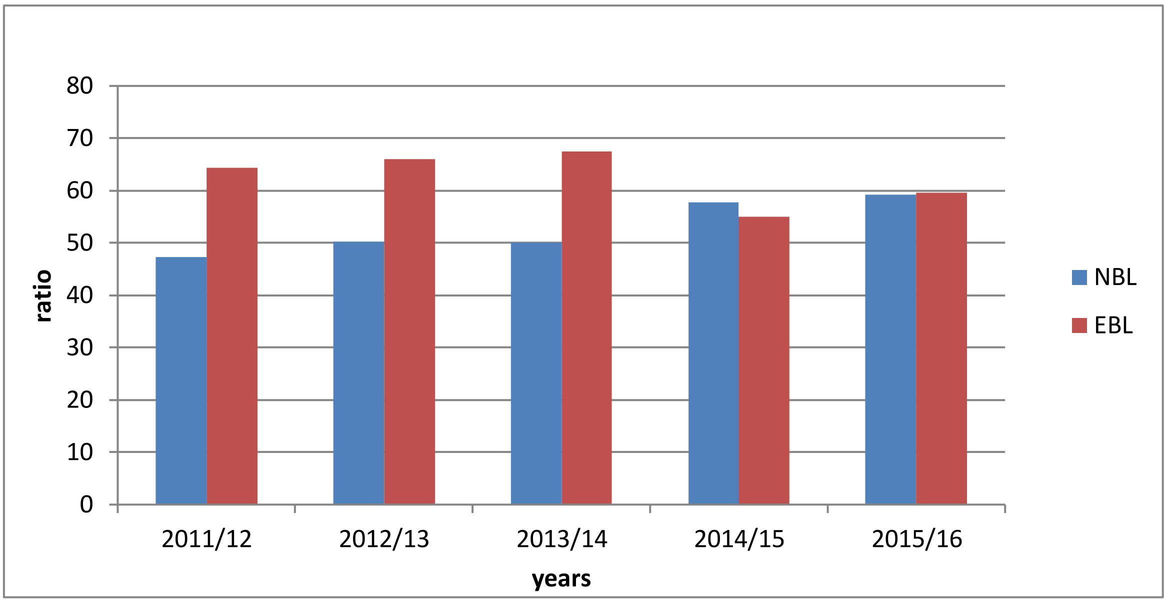


Figure 4.1 shows that the beginning loans and advances of EBL is highest than NBL. It has gone below that of NABIL in F/Y 2014/15. NBL has lowest amount of loans and advances in the beginning but with its increasing trend in it, it has reached to be equal with EBL in F/Y 2015/16. NBL, with small start goes up with increasing trend and finally has succeed to get equalize with EBL in F/Y 2015/16. It is seen that in more recent years, the percentage of loan and advance to total assets is almost same.

From the above study we can say that average lending capacity of sampled banks is catching the increasing trend and has improved lending efficiency along with lessening their liquidity position.

4.1.1.2 Total Investment to Total Deposit ratio

Commercial Banks may mobilize its deposit by investing its fund in different securities- issued by government and other financial and non- financial companies. High ratio is the indicator of high success to mobilize the banking fund as investment and vice-versa.

Table 4.1 shows the banks total investment to total capital ratio. The deposit mobilization ratio of NBL seems higher with an average of 20.22%. Similarly, EBL has less volatility in assets management ratio having S.D and C.V of 3.43% and 21.47% respectively. NBL have assets utilization of 20.22% and with C.V of 37.27 which seems more volatile than that of NBL.

Figure 4.2: Total Investment to Total Deposit Ratio

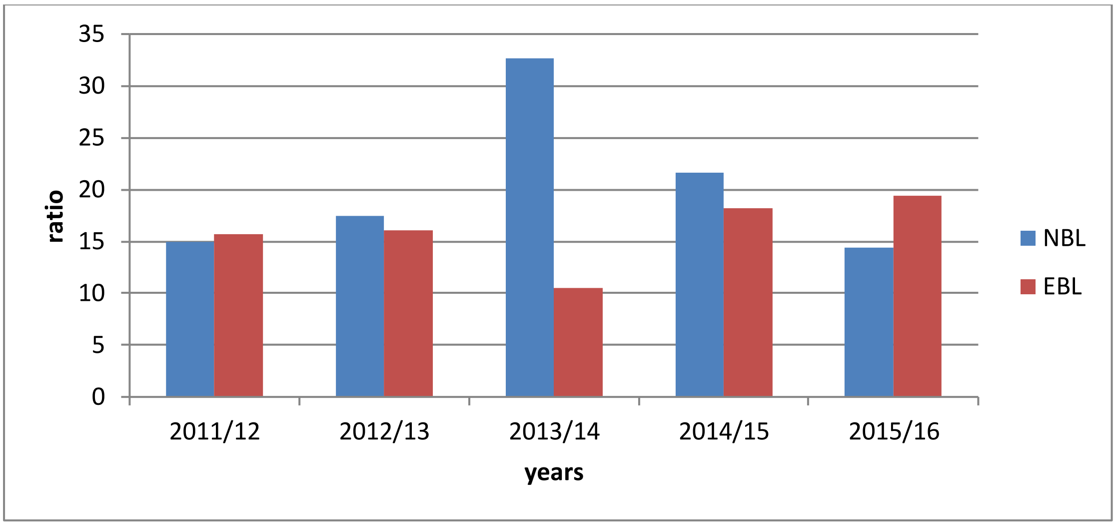


Figure 4.2 shows the assets utilization of EBL at the beginning has sharply declined in F/Y 2013/14 and then again gets increased slightly up to F/Y 2015/16. The assets utilization of NBL bank is maximum in F/Y 2013/14 and is in decreasing trend in current years. The overall assets managing trend is highly fluctuating of both banks.

4.1.1.3 Loan and Advances to Total Deposit ratio (C/D Ratio)

This ratio is calculated to measure the banks success in utilizing their deposits on loan and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits but may cause to face liquidity crunch. Similarly, lower indicators may defenses the liquidity crunch but restrict to reap interest income from the potential credit mobilization. Nepalese banks should maintain a provision of 80% of C/D ratio as directed by NRB.

Table 4.1 shows that the higher deposit utilization of EBL higher with mean ratio of 72.34% and also is less risky with S.D and C.V of 4.25 and 5.88. The deposit utilization efficiency of NBL is also satisfactory with average of 59.21 and S.D and C.V of 7.69 and 12.98 respectively.

Figure 4.3: Loan and Advances to Total Deposit Ratio

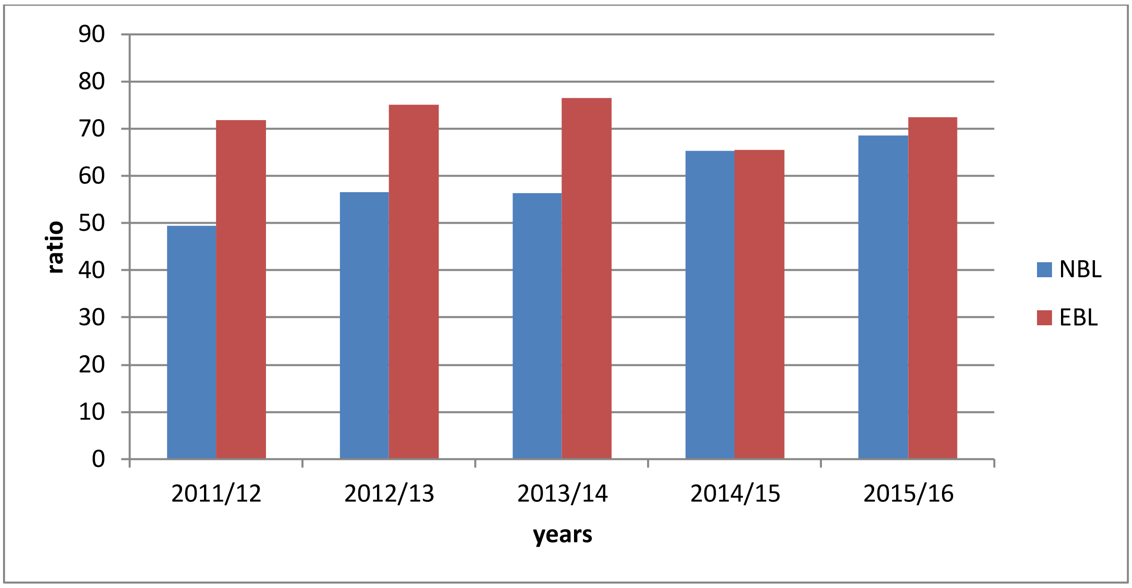


Figure 4.3 shows the rising trend in utilizing their deposits in loan and advances. In F/Y 2012/13 and 2013/14, EBL seems to have high efficiency in utilizing its deposits and has slightly decreased in next year and again got slightly increased in F/Y 2015/16. NBL's ratio has gone up gradually and in increasing trend.

4.1.1.4 Investment to Loan and Advances and Investment Ratio.

This ratio measures the contribution made by investment in total amount of loan and advances and investment .The proportion between investment and loan and advances measures the management attitude towards risky assets and safety of assets. Investment and loans and advances in whole do not provide the quality of assets that a bank has created. The ratio indicates the mobilization of funds in safe area and vice-versa.

Table 4.1 shows the higher average of fund mobilization ratio of NBL than EBL bank with the value in average of 25.16% having the S.D and C.V of 7.10 and 28.20. Similarly, EBL has the average fund ratio of 18.08. EBL in F/Y 2010/11 has high fund mobilization ratio in terms of investment with the ratio of 21.70% and lowest of 12.03% in F/Y 2009/2010. EBL has less volatile ratio and NBL has comparatively highly volatile ratio of utilization of funds.

Figure 4.4: Investment to Total Loan and Advances and Investment Ratio

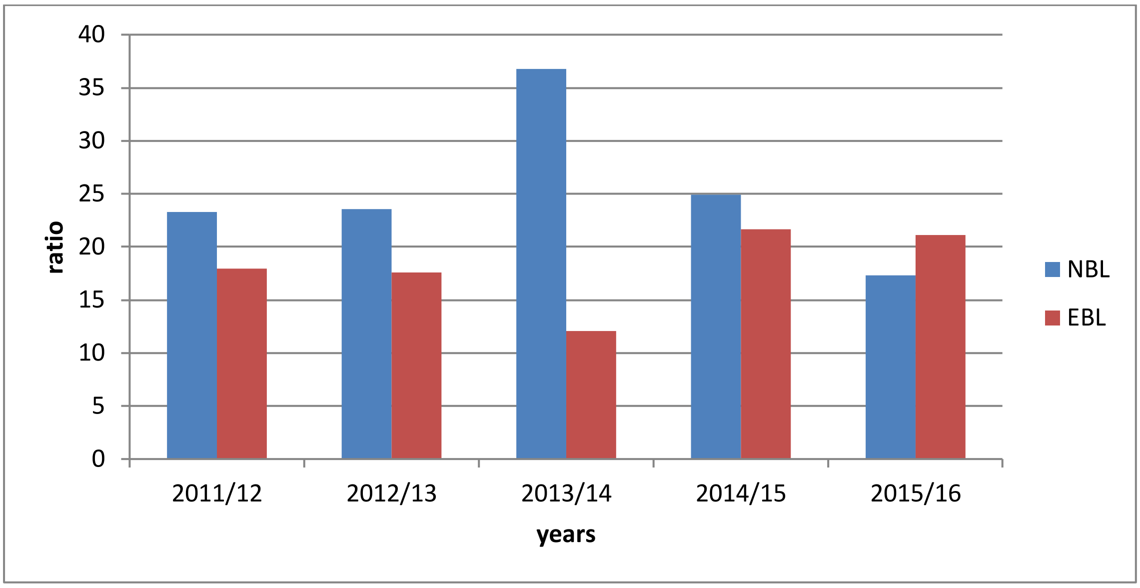


Figure 4.4 shows NBL has highest ratio in fiscal year 2013/14 than EBL and itself in comparison to any other fiscal years and it is in decreasing trend from same year. The amount of investment of EBL has been lower in all years than NBL except in the current year. In F/Y 2013/2014, the percentage of investment of EBL has decreased to the lowest.

4.1.2 Credit Efficiency Ratio

This ratio indicates the efficiency of activity of an enterprise to utilize available funds, particularly short term funds. These ratios are used to determine the efficiency, quality and the contribution of loan and advances in the total profitability. This ratio also shows the utilization of available fund. The following activity ratios measure the performance efficiency of the bank to utilize funds.

4.1.2.1 Loan loss provision to total loans and advances ratio

4.1.2.2 Non performing loan to total loans and advances ratio

The descriptive analysis of credit efficiency ratios are clearly shown in the following table.

Table 4.2: Credit Efficiency Ratio

Loan loss provision to total loans and advances ratio										
Banks	Years					Mean	S.D	C.V	Min	Max
	2011/12	2012/13	2013/14	2014/15	2015/16					
NBL	0.91	1.59	0.65	0.89	0.83	0.97	0.36	36.86	0.65	1.59
EBL	0.70	0.23	0.33	0.30	0.25	0.36	0.19	53.31	0.23	0.70
Non-performing loan to total loan and advances ratio										
Banks	Years					Mean	S.D	C.V	Min	Max
	2011/12	2012/13	2013/14	2014/15	2015/16					
NBL	6.00	5.57	5.40	4.17	3.23	4.87	1.14	23.45	3.23	6.00
EBL	0.86	0.64	0.99	0.67	0.39	0.71	0.23	32.25	0.39	0.99

4.1.2.1 Loan Loss Provision (LLP) to Total Loans and Advances Ratio

The provision for loan loss reflects the increasing profitability of nonperforming loan .Increase in loan loss provision decreases profit which results to decrease in dividend. But its positive impact is that it strengthen the financial condition of banks by controlling the credit risk and reduces the risk related to deposit .The low ratio indicates the good quality of assets in total volume of loan and advances. High ratio indicates more risky assets in total volume of loan and advances.

Table 4.2 shows that the average loan loss provision of NBL is highest i.e. 0.97%. The lowest average loan loss provision is of EBL. There is a maximum average loan loss provision of 1.59% of NBL in F/Y 2012/2013 and minimum of 0.23 in same F/Y of EBL. It can be assumed that profit percentage of NBL is lowest in F/Y 2012/2013 because of highest average ratio of loan loss provision to total loan and advance ratio. EBL is seen more consistent than NBL with having average of 0.36 and S.D and C.V of 0.19 and 53.31 in terms of credit efficiency. NBL seems more volatile according to this study.

Figure 4.5: Loan Loss Provision to Total Loan and Advances Ratio

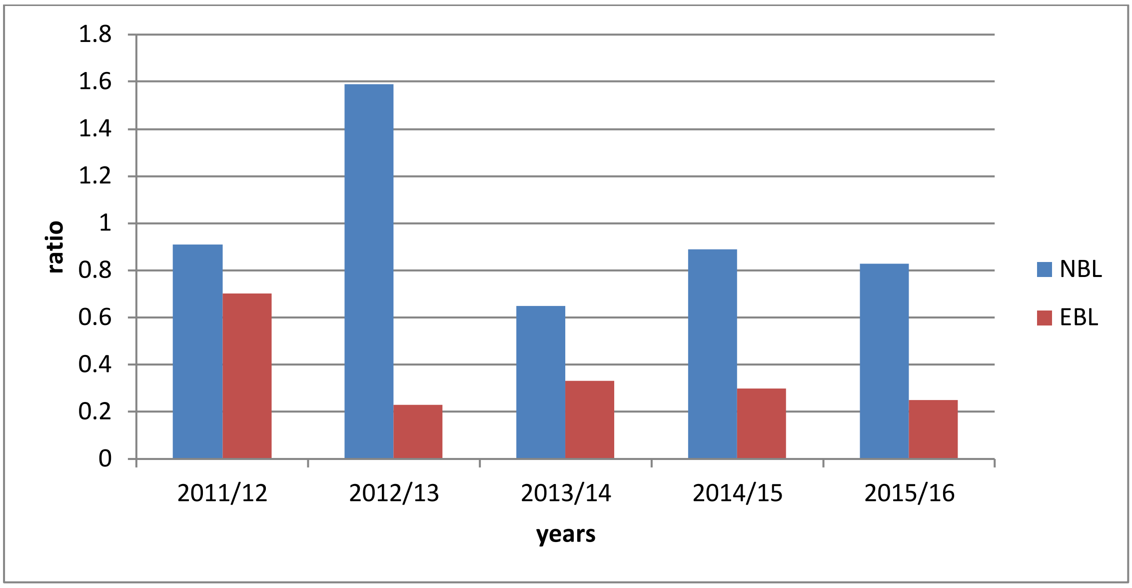


Figure 4.5 shows the provision of loan loss to total loans and advances of sampled banks has decreased then earlier. It has been a maximum of NBL in F/Y 2012/13 and then got settled with almost same average ratio in F/Y 2014/15 and 2015/16. Similarly, the ratio of EBL was highest in beginning and has been decreasing from F/Y 2013/14 by increasing the percentage of profit.

4.1.2.2 Nonperforming Loan (NPL) to Total Loan and Advances Ratio

Non- performing loans to total loan and advances ratio shows the percentage of non-recovery loans in total loan and advances. This ratio is calculated as dividing non-performing loan by a loan and advances. Loan loss provision is the function of substandard credit which is also known as non performing loan (NPL). Higher the NPL, higher would be deduction on profit because of provision.

Table 4.2 shows the average ratio of nonperforming loan to loans and advances ratio of NBL is 4.87% which is highest then EBL. This indicates that the credit efficiency of NBL is weak than EBL bank. NBL has highest Non- performing loan to loan and advances ratio in F/Y 2011/2012 and EBL has the lowest of 0.39 in F/Y 2015/16. In this context, NBL is more volatile and EBL is less having the S.D of 1.14 and 0.23 respectively.

Figure 4.6: Non-Performing Loan to Total Loan and Advances Ratio

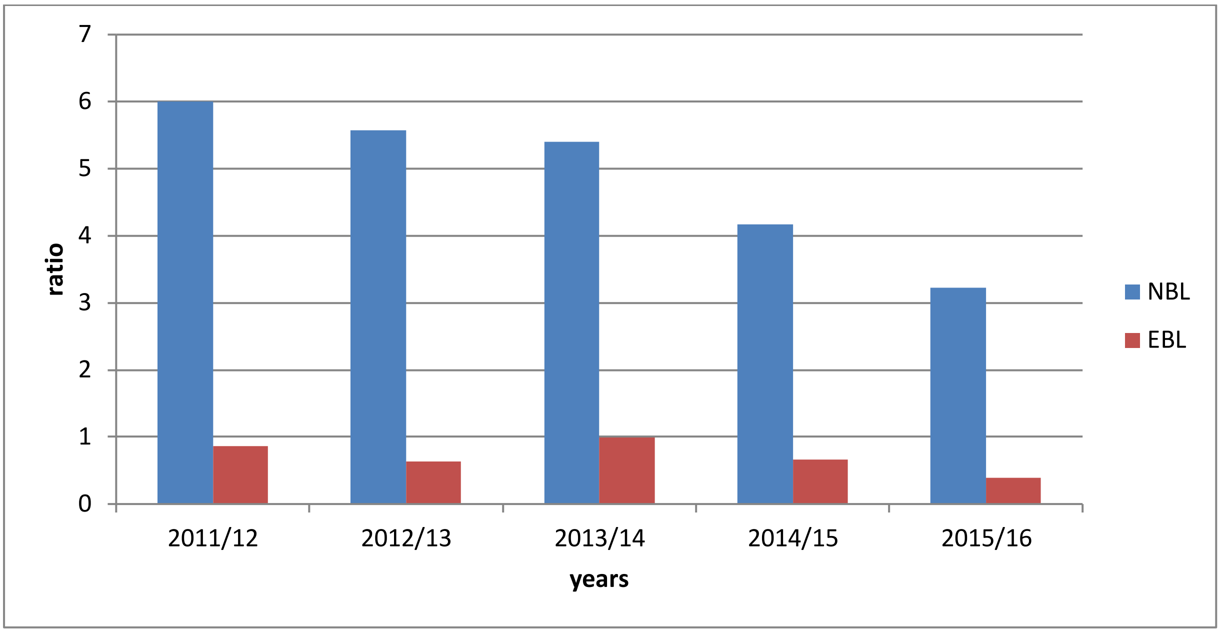


Figure 4.6 shows NBL has higher ratios of nonperforming loan to total loans and advances. In F/Y 2011/12, the ratio of HBL has gone higher which indicates higher amount of unrecoverable credits and somehow same in F/Y 2012/13 and 2103/14. In current years some positive signs have been seeing. EBL has higher NPL during the year of 2013/14 but after this period EBL is lowering the percentage of NPL. Declined NPL is the indicator of recovered or restructured loan so EBL is trying to make good credit at present by recovering the past due credits.

4.1.3 Profitability Ratios

Profit is the outcome of monetary or non monetary efforts that the bank has made from the clients. Main source of bank income is credit and main sources of expenses are deposit. So, the proper trade off should be made between this two variables. Besides this two components, various services generates income to the bank, similarly staffs, advertisement etc impose the cost of the bank. So, this study deals with the overall operating income, net income, interest expenses, interest income and spread analysis. In this study, following ratios are analyzed.

4.1.3.1 Operating profit to loans and advances ratio

4.1.3.2 Net profit to total loans and advances ratio

4.1.3.3 Interest income to total loans and advances ratio

4.1.3.4 Interest expenses to deposit ratio

The descriptive analysis of profitability ratios are clearly shown in the following table.

Table 4.3: Profitability Ratio

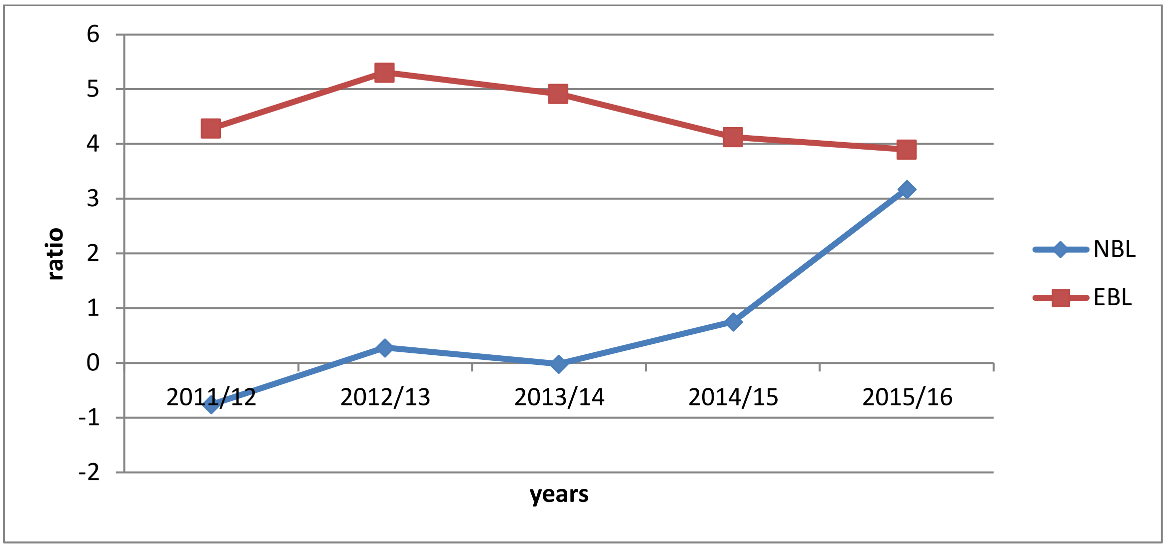
Operating profit to total loans and advances ratio										
	Years									
Banks	2011/12	2012/13	2013/14	2014/15	2015/16	Mean	S.D	C.V	Min	Max
NBL	(0.76)	0.29	(0.02)	0.76	3.18	0.69	1.49	217.10	(0.02)	3.18
EBL	4.28	5.31	4.91	4.13	3.18	4.51	0.59	12.98	3.18	5.31
Net profit to total loans and advances ratio										
	Years									
Banks	2011/2012	2012/13	2013/14	2014/15	2015/16	Mean	S.D	C.V	Min	Max
NBL	0.64	2.12	1.84	0.95	4.71	2.05	1.61	78.27	0.64	4.71
EBL	3.04	3.39	3.26	2.84	2.55	3.02	0.34	11.02	2.55	3.39
Interest income to total loans and advance ratio										
	Years									
Banks	2011/12	2012/13	2013/14	2014/15	2015/16	Mean	S.D	C.V	Min	Max
NBL	14.64	13.31	12.84	10.05	10.23	12.21	2.01	16.42	10.05	14.64
EBL	13.81	11.38	10.88	9.17	7.44	10.54	2.40	22.76	7.44	13.81
Interest expenses to deposit ratio										
	Years									
Banks	2011/12	2012/13	2013/14	2014/15	2015/16	Mean	S.D	C.V	Min	Max
NBL	3.92	3.52	3.16	2.32	1.85	2.95	0.85	28.91	1.85	3.92
EBL	5.75	3.78	3.64	2.55	1.95	3.53	1.45	41.14	1.95	5.75

4.1.3.1 Operating Profit to Loan and Advances Ratio

Operating profit to loan and advances ratio measures the earning capacity of commercial banks. This ratio is calculated dividing operating profit by loan and advances.

Table 4.3 shows that there is highest average ratio of operating profit of EBL resulting 4.51%. Similarly, NBL has low average among the two sampled banks. In F/Y 2011/12, EBL has registered the highest operating profit of 5.31% and in the fiscal year 2011/12 HBL has suffered high loss during the sampled period resulting the ratio of (0.76) %. Considering the risk factor or volatility of the earning of sampled banks, EBL is less volatile whereas NBL is the most having S.D and C.V of 0.59 and 12.98 (EBL) and 1.49 and 217.10 (NBL) respectively.

Figure 4.7: Operating Profit to Total Loan and Advances Ratio



The trend line in Figure 4.7 represents the operating profit pattern of the sampled banks. Here, we can see that the operating profit trend of NBL is smoothly going upward after F/Y 2013/14 but was suffered from losses in F/Y 2011/12 and 2013/14. The operating profit of EBL was satisfactorily going up but from F/Y 2012/13, it is has started to decrease. Comparing the recent performance of both banks, NBL's performance is looking better.

4.1.3.2 Net profit to Total Loan and Advances Ratio

This ratio measures the earning capacity of commercial banks through its fund mobilization as loan and advances. Higher ratio indicates greater success to mobilize fund as loan and advances and vice-versa. Mostly loan and advances includes loan cash credit, overdraft, bill purchased and discounted.

Table 4.3 shows the earning capacity of EBL is stronger among two sampled with an average earning of 3.02%. Similarly, the earnings ratio of NBL is 2.05%. NBL in F/Y 2015/16 has registered the highest return of 4.71% and in 2011/12 has the lowest ratio of net profit to total loans and advances. The earnings of EBL is less volatile among two sampled banks having S.D and C.V of 0.34 and 11.02 respectively. Similarly NBL has most volatile and fluctuating earning having S.D and C.V of 1.61 and 78.27 respectively.

Figure 4.8: Net Profit to Total Loan and Advances Ratio

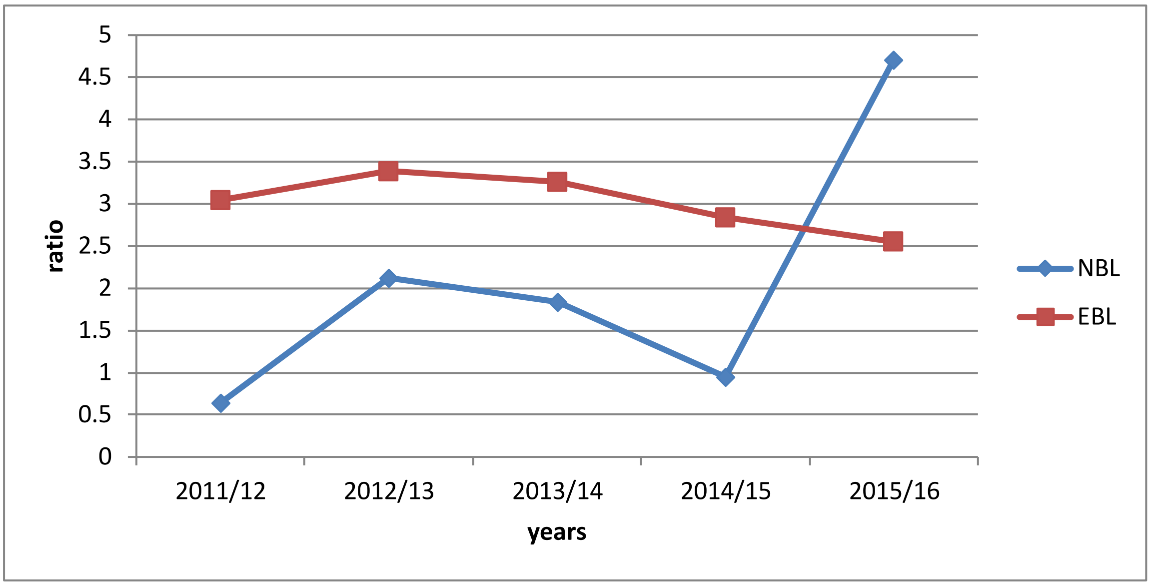


Figure 4.8 shows that EBL is more successful in earning among the two sampled banks. Here, we can see that the net profit trend of EBL was smoothly going upward in prior years with a slight decline in recent three years. The net profit ratio of NBL has been lowest in F/Y 2011/12 and has tried to get recovered again somehow same level of decline in F/Y 2014/15. The net profit of EBL was satisfactorily going up but from F/Y 2012/13, it is has started to decrease. The overall performance of EBL is good in comparison with another sampled bank in terms of net profit.

4.1.3.3 Interest Income to Total Loan and Advances Ratio

It tells income as interest from total credit and advances. It is useful to know the fact that whether credit has given good return or not. One can increase interest income by taking policy.

Figure 4.9: Interest Income to Total Loan and Advances Ratio

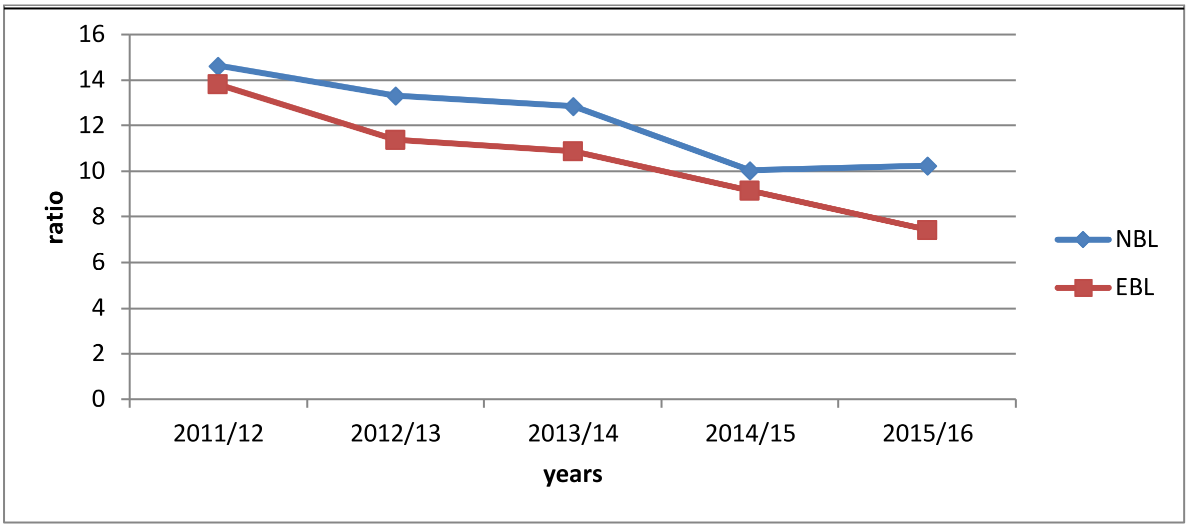


Figure 4.9 shows that both the sampled banks are not much successful in increasing their interest from loans and advances. EBL has sharply decreased its interest volume in comparison to NBL. We can see the banks have gone through unsound credit policy.

4.1.3.4 Interest Expenses to 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 bank is dependent upon its ability to generate cheaper fund. The cheaper fund has moved profitability of generating loans and advances and vice-versa.

Table 4.3 shows that EBL has accepted most expensive deposits in an average cost of deposit equal to 3.53 during the sampled five years of period. Similarly, the mean interest expenses ratio of NBL is 2.95. EBL has used the most expensive fund i.e. 5.75% in F/Y 2011/12 and similarly NBL was success in using cheaper fund i.e.1.85% in F/Y 2015/16. EBL‘s cost of fund is more volatile of fluctuating having S.D and C.V of 1.45 and 41.14 and the cost of NBL is less volatile having S.D and C.V of 0.85 and 28.91.

Figure 4.10: Interest Expenses to Total Deposit Ratio:

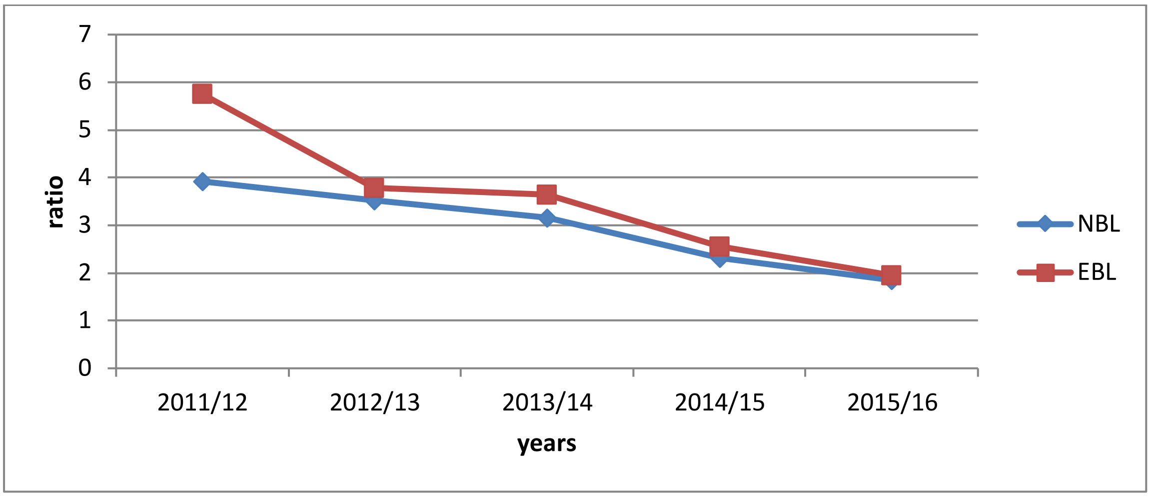


Figure 4.12 shows the decreasing cost of fund from the beginning of both sampled banks. We can see the sign of cost effectiveness of both banks. Both banks are using almost equal cost fund since F/Y 2012/2013.

4.2 Correlation Analysis

The statistical tool, coefficient of correlation has been studied to find out whether the two variables are inter-correlated or not. If the result falls within the correlated point, the two available variables are interring correlated otherwise not. Here, to find out the coefficient of correlation between credit/loans ratios, credit efficiency ratios and profitability ratios, the widely used method of Karl Pearson's coefficient of correlation has been used.

Correlation coefficient between credit/loan ratios and profitability ratios as well as correlation coefficient between credit efficiency and profitability ratios of NBL and EBL are clearly shown below.

Table 4.4: Correlation Analysis

Ratios	Banks	Profitability ratios				
		R	r^2	P.Er.	6P.Er	Impact
Credit/loan related	NBL	0.5545	0.3075	0.2335	1.401	Insignificant
	EBL	0.7962	0.6339	0.1235	0.741	Insignificant
Credit efficiency	NBL	1.00	1.00	0.0	0.0	Significant
	EBL	1.00	1.00	0.0	0.0	Significant

Correlation coefficient between credit/loan ratios and profitability ratios

Table 4.4 shows that the correlation coefficient of credit/loan ratio and profitability of NBL is 0.5545. This shows positive correlation between these two variables. The value of coefficient of determination (r^2=0.3075) is lower than the value of 6P.Er (1.401) which says there is no significant difference between credit/loan ratios and profitability ratios. In case of EBL the correlation coefficient of credit/loan ratios and profitability ratios is 0.7962. This also shows positive correlation between these two variables. The value of Coefficient of determination (r^2=0.6339) is also lower than the value of 6P.Er (0.741) which says there is also no significant difference between credit/loan ratios and profitability.

Correlation coefficient between credit efficiency ratios and profitability ratios

Table 4.4 shows that the correlation coefficient of credit efficiency ratios and profitability ratios of NBL is 1.00. This shows perfectly positive correlation between these two variables. The value of coefficient of determination (r^2=1.00) is higher than the value of 6P.Er (0.00) which says there is a significant difference between deposits and loan and advances. In case of EBL, the correlation coefficient of credit efficiency ratios and profitability ratios is also 1. This also shows perfectly positive correlation between these two variables. The value of coefficient of determination (r^2=1.00) is higher than the value of 6P.Er (0.00) which says there is also a significant difference between deposits and loan and advances.

4.3 Test of Hypothesis

To test significant relation between the ratios of two banks, t-test is suitable, so it has been done here.

4.3.1 The test of difference in credit/loans ratios between NBL and EBL

Following hypothesis has been set to test if there is significant difference between credit/loan ratios of NBL and EBL:

Null Hypothesis, $H_0 : \mu_1 = \mu_2$. There is no significant difference of credit/loans ratio between NBL and EBL.

Alternative Hypothesis, H_1: $\mu_1 \neq \mu_2$. There is significant deference of credit/loans ratio between NBL and EBL.

Tabulated value = 2.4470 (*being two tailed test)*

Calculated value=**0.609761042**

Table 4.5: T-test

Banks	Credit/loans related ratios			
NBL	52.91	20.22	59.21	25.16
EBL	62.50	15.97	72.34	18.06
Calculated T-value				**0.609761042**
Tabulated T-value				**2.4470**

Decision: Since the calculated value of t is **0.609761042** which is smaller than the tabulated value 2.4470, the null hypothesis is accepted which means there is no significant difference between credit/loan ratios of NBL and EBL.

4.3.2 Test of Difference in credit efficiency ratios between NBL and EBL

Following hypothesis has been set to test if there is significant difference between credit efficiency ratios of NBL and EBL:

Null Hypothesis, $H_0 : \mu_1 = \mu_2$. There is no significant difference of credit efficiency ratios between NBL and EBL.

Alternative Hypothesis, H_1: $\mu_1 \neq \mu_2$. There is significant deference of credit efficiency ratios between NBL and EBL.

Tabulated value **=** 4.3030 (*being two tailed test)*

Calculated value=**0.407310068**

Table 4.6: T-test

Banks	Credit efficiency ratio	
NBL	0.97	4.87
EBL	0.36	0.71
Calculated T-value		**0.407310068**
Tabulated T-value		**4.303**

Decision: Since the calculated value of t is **0.407310068** which is smaller than the tabulated value 4.3030, the null hypothesis is accepted which means there is no significant difference of credit efficiency ratios between NBL and EBL.

4.3.3 Test of Difference in profitability ratios between NBL and EBL

Following hypothesis has been set to test if there is significant difference between profitability ratios of NBL and EBL:

Null Hypothesis, $H_0 : \mu_1 = \mu_2$. There is no significant difference of profitability ratios between NBL and EBL.

Alternative Hypothesis, H_1: $\mu_1 \neq \mu_2$. There is significant deference of profitability ratios between NBL and EBL.

Tabulated value = 2.3060 (*being two tailed test)*

Calculated value=**0.803004931**

Table 4.7: T-test

Banks	Profitability ratios			
NBL	0.69	2.05	12.21	2.95
EBL	4.51	3.02	10.54	3.53
Calculated T-value				**0.471853925**
Tabulated T-value				**2.4470**

Decision: Since the calculated value of t is **0.471853925** which is smaller than the tabulated value 2.4470, the null hypothesis is accepted which means there is no significant difference between profitability ratios of NBL and EBL.

4.4 Major Findings:

Credit/ Loan related ratios

- Comparatively EBL is aggressively deploying credit, and NBL seems very defensive for credit mobilization. However, during the F/Y 2014/2015, NBL's credit has increased than that of EBL.
- Comparatively NBL is mobilizing higher deposit to investment, and EBL is in low level. However, during the period of 2011 and 2015, investment of EBL has exceeded than that of NBL.
- Deposit mobilization on credit of EBL is higher, and in the same way NBL is mobilizing its credit much lower than that of EBL.
- Ratio of investment to total loan and advance and investments is in higher side for NBL. Similarly, EBL has lower ratio.

Credit efficiency ratio

- NBL has higher loan loss provision and EBL has lower. It indicates that EBL is able to manage its credit more effectively and efficiently than NBL.

- Sampled banks are trying to lower the Nonperforming loan than past however ratio of NBL is higher than another which seems that NBL is inefficient in lowering nonperforming loan or improving credit efficiency. EBL has improved most among these two.

Profitability Ratio

- EBL is slightly losing the operating profit however it is satisfactory in comparison to NBL. NBL's operating profit is negative in 2011/12 and 2013/14 but is has been successful to make it positive in 2014/15 and a very good result in current sampled year.
- Relationship between net profit and loan advance of NBL seems fluctuating. NBL's ratio is the highest in current year than any of it's as well as EBL. The net profit of EBL is in decreasing trend. However, NBL has managed to get a highest ratio in current F/Y.
- Interest income and interest expenses ratios of NBL and EBL are almost moving in parallel trend. Looking at the movement of NBL, trends of interest income has highly exceeded the expenses in overall.
- Interest income to loan and advances of both NBL and EBL is in decreasing trend. But NBL has maintained to make a slight increment in current year.

Correlation Analysis

- There is positive correlation between the credit/loan ratios and profitability of NBL and there is no significant difference between these two variables.
- There is positive correlation between the credit/loan ratios and profitability of EBL and there is no significant difference between these two variables.
- There is perfectly positive correlation between credit efficiency ratios and profitability of NBL and also there exists significant differences between these two variables.
- There is perfectly positive correlation between credit efficiency ratios and profitability of EBL and also there is a significant difference between these two variables.

Hypothesis

- There is no significant difference between credit/loans ratios of NBL and EBL.

- There is no significant difference between credit efficiency ratios of NBL and EBL.
- There is no significant difference between profitability ratios of NBL and EBL.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This is the last chapter of the study which includes summary, conclusion and Recommendation. In this study, analysis of various aspect of the credit management of the commercial banks is done by using some important financial tools and statistical tools. The task of researcher is to summarize the study after completing basic analysis and recommend for further importance. It would be meaningful to the concerned banks to initiate the action and achieve the desired results.

5.1 Summary

Being the first chapter, as an introduction, this study basically provides the brief background of the bank regarding its establishment, its capital composition and its vision. As there are many commercial banks only two commercial banks, NBL and EBL are taken for sample study. This study gives brief view of credit aspect and evaluation of nonperforming loans, issues of profitability, liquidity position which is set as an objective of the study.

Chapter second deals with the overall review of credit related issues of other relevant studies in related areas so that all part of studies can be conducted. This study deals with major review of literature related to credit management in more descriptive and detailed manner. It consists of review from other articles, books, journals, research studies and conceptual review of overall banking sector and its growth in Nepal, legal frame work, guidelines and directives of Nepal Rastra Bank etc.

Chapter third consists of research methodology designed to solve the research problems. In this study among many tools of analysis, financial tools and statistical tools are used to draw out conclusion. All the data are taken from the secondary sources-Annual reports of banks, telephone conversation with bankers, etc so accuracy of data depends upon the publisher. Only five years data are taken so the results may not be fully applicable.

Fourth Chapter shows the presentation, analysis and interpretation of relevant sampled data of selected commercial bank. Various types of ratio and statistical tools are calculated and presented in proper diagram to show the real picture of the banks.

Chapter five presents the Summary, Conclusion and Recommendations of above studies.

The major findings of this study are summarized below:

* EBL is aggressively deploying credit but NBL seems defensive in credit mobilization.

* The deposit mobilization to investment of NBL is high than that of EBL.

* The loan loss provision of NBL is higher but EBL has been successful to manage its credit.

* Both banks are trying to lower the non-performing loan in comparison to past years.

* The operating profit of EBL is good in comparison to NBL but NBL has maintained to make slightly progress.

* The interest expenses ratio of EBL is more in comparison to NBL.

* There is positive relationship between the credit/loan ratios and profitability of both EBL and NBL.

* There is perfectly positive correlation between credit efficiency ratios and profitability of NBL and that of EBL.

* There is no significant difference between the credit/loan, credit efficiency and profitability ratios of both EBL and NBL.

5.2 Conclusion

From the study of the credit management of the two sampled banks i.e. EBL and NBL, it is found that to some extent the overall credit management of EBL seems better in comparison to NBL. EBL has effectively mobilized its credit which directly shows that it has been successful to gain goodwill and return through effective credit policies. NBL's deposit mobilization to investment is better than EBL's, which means that NBL has been successful to create efficient portfolio to investment.

The average operating profit of EBL is better in comparison to NBL. It denotes that EBL has properly maintained to provide fair returns to its stakeholders and properly maintained the earning capacity. But NBL has also been able to make a slight increase in interest income to loans and advances ratios. As the average loan loss provisions and non performing loans to total loans and advances of NBL is high, it means that there is higher deduction in profit and dividend. In this sense, the performance of EBL is better than NBL.

Most of the loan related ratios and profitability of both NBL and EBL has positive correlation. It means that their value increases or decreases together. Also the credit efficiency ratios and profitability ratios of EBL have perfectly positive correlation which means that if one variable increases then other also increases. However, the credit and risk management ratios of both banks are not significantly different.

5.3 Recommendations

Based on the study, following recommendations are made to the concerned banks:

- NBL seems very defensive in mobilization of credit and also seems weak in mobilizing deposits on credit which may lower its earnings. So, it is recommended to NBL to mobilize its fund properly by forwarding efficient credit policies and improve its lending capacity in order to gain goodwill and to reap interest income from potential credit mobilization. The loan loss provision of NBL is higher, so it is recommended to NBL to follow the credit guidelines properly and focus on proper regulation in its lending.
- The deposit mobilization to investment of EBL is low. So, it is recommended to EBL to create efficient portfolio for further investment in profitable sectors. Also, the interest expenses ratio of EBL is more than NBL, so it is recommended to EBL to reduce the cost of fund to increase profitability by adopting efficient financing decision.

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Nepal Bank Limited. **Annual Report,** FY 2011/12-2015/16

Web Sites

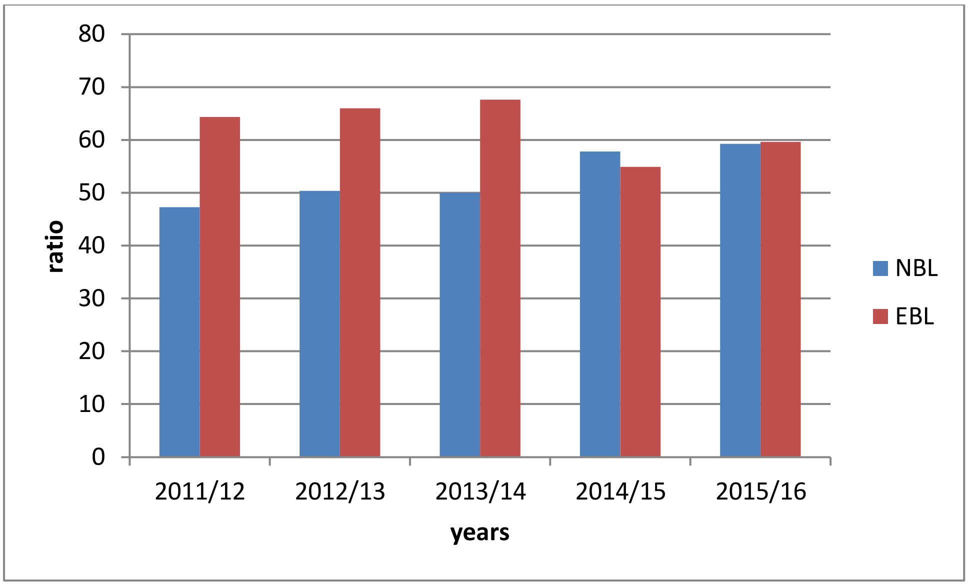
www.ebl.com.np

www.nbl.com.np

Appendix

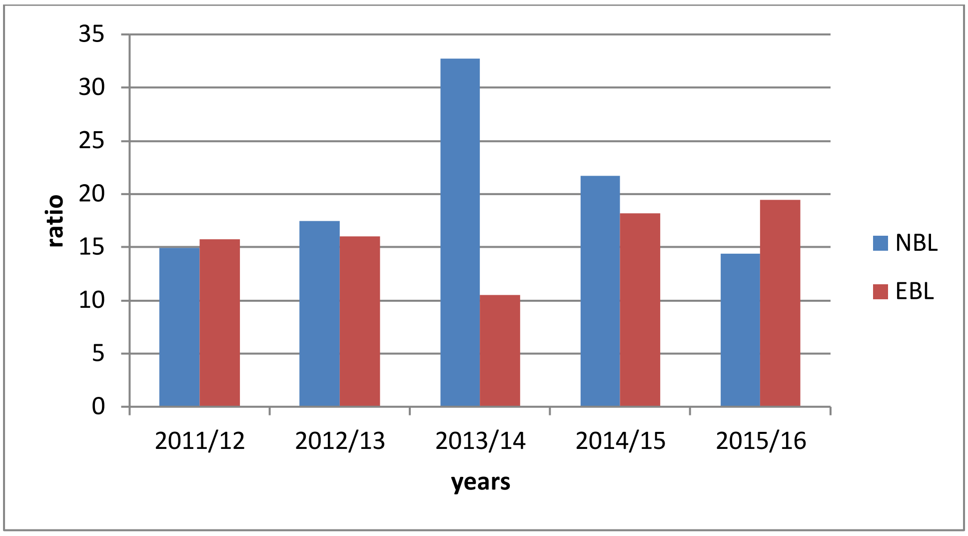
1.

Years								
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	47.21	50.32	50.06	57.78	59.19	52.912	5.255375	9.93
EBL	64.34	66.01	67.53	54.95	59.67	62.5	5.148252	8.24



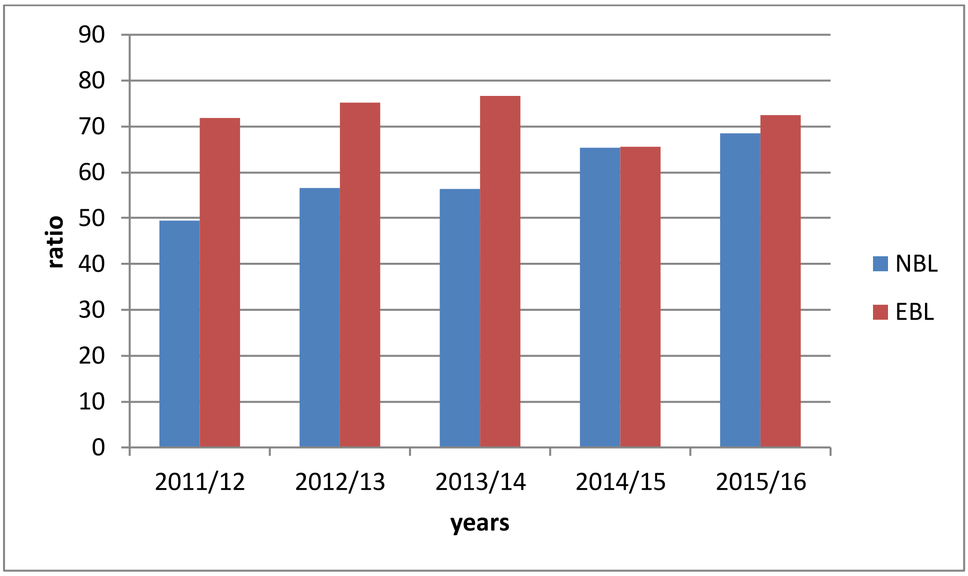
2.

Years								
Banks	2011/12	2012/13	2013/14	2014/15	2015/16	mean	S.D	C.V
NBL	14.97	17.43	32.69	21.67	14.36	20.224	7.538062	37.27
EBL	15.73	16.05	10.47	18.18	19.41	15.968	3.428982	21.47



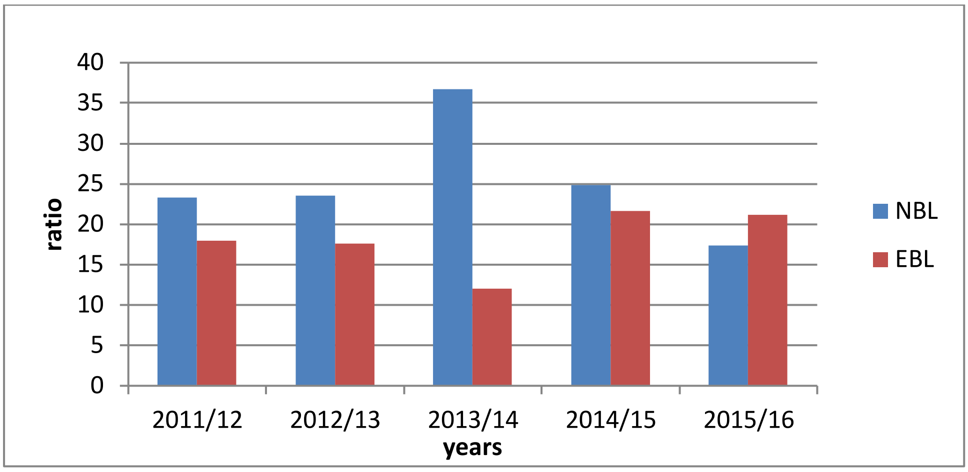
3.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	49.37	56.54	56.3	65.35	68.5	59.212	7.68808	12.98
EBL	71.83	75.18	76.6	65.57	72.5	72.336	4.252403	5.88



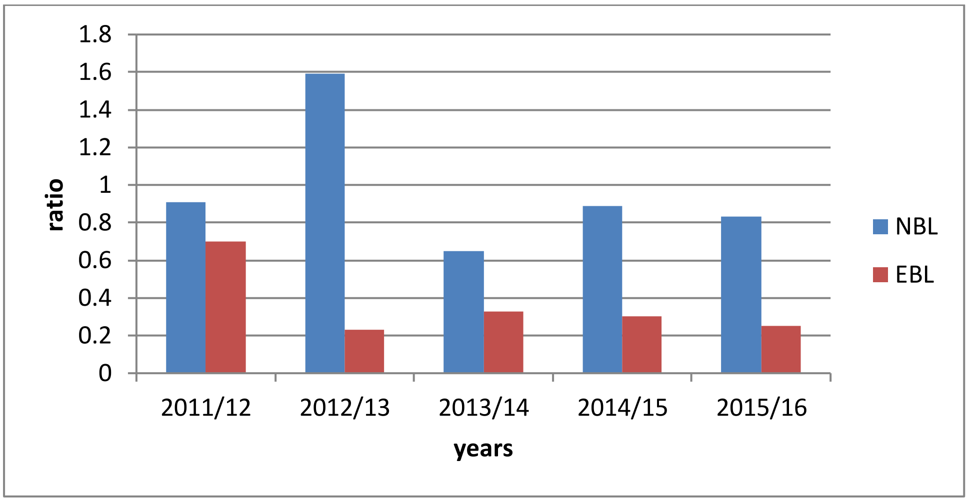
4.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	23.27	23.56	36.73	24.9	17.33	25.158	7.095306	28.20
EBL	17.96	17.59	12.03	21.7	21.12	18.08	3.847174	21.28



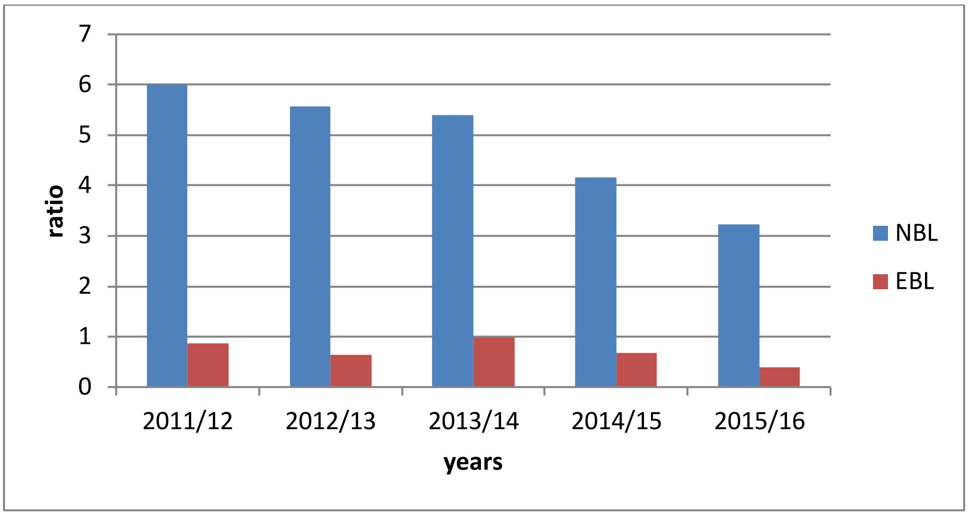
5.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	0.91	1.59	0.65	0.89	0.83	0.974	0.359277	36.86
EBL	0.7	0.23	0.33	0.3	0.25	0.362	0.193054	53.31



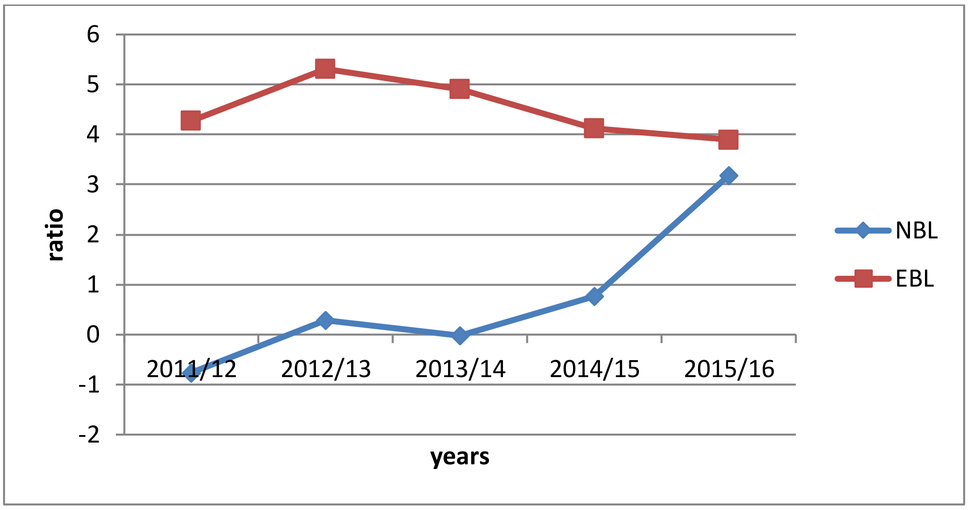
6.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	6	5.57	5.4	4.17	3.23	4.874	1.143167	23.45
EBL	0.86	0.64	0.99	0.67	0.39	0.71	0.22902	32.25



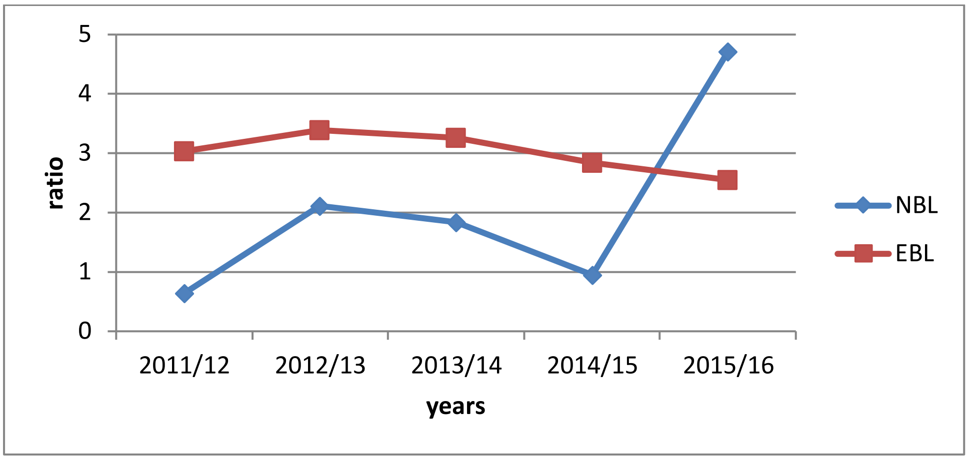
7.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	-0.76	0.29	-0.02	0.76	3.18	0.69	1.497631	217.10
EBL	4.28	5.31	4.91	4.13	3.9	4.506	0.58509	12.98



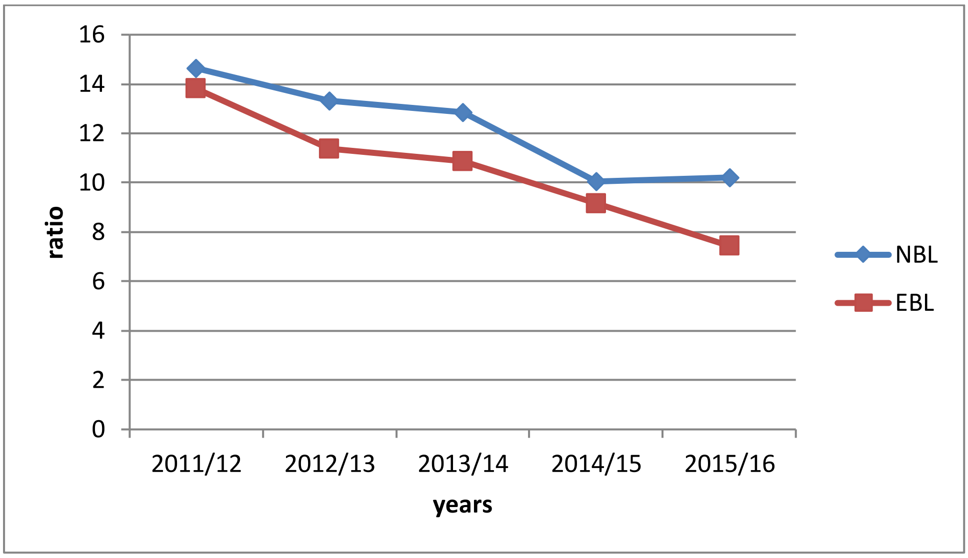
8.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	0.64	2.12	1.84	0.95	4.71	2.052	1.606446	78.27
EBL	3.04	3.39	3.26	2.84	2.55	3.016	0.334709	11.02



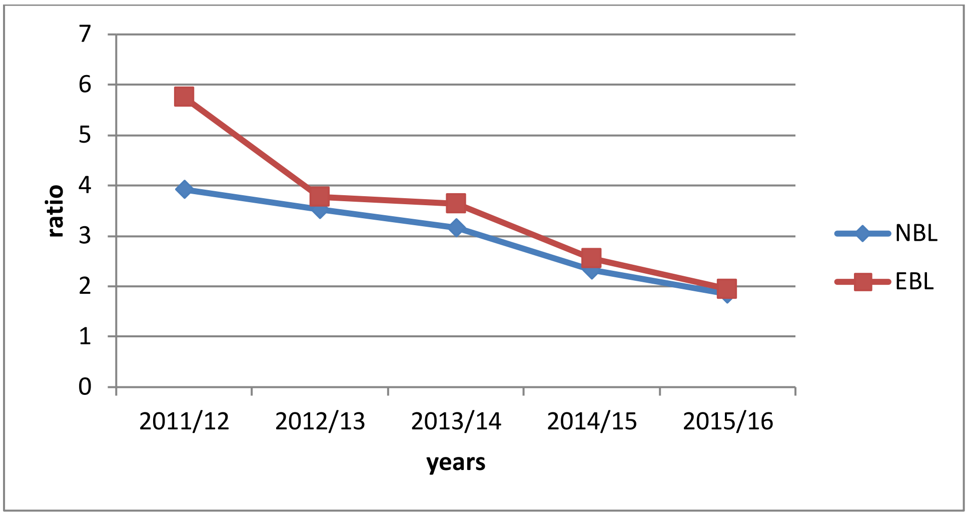
9.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	14.64	13.31	12.84	10.05	10.23	12.214	2.006098	16.42
EBL	13.81	11.38	10.88	9.17	7.44	10.536	2.397964	22.76



10.

			Years					
Banks	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**mean**	**S.D**	**C.V**
NBL	3.92	3.52	3.16	2.32	1.85	2.954	0.85392	28.91
EBL	5.75	3.78	3.64	2.55	1.95	3.534	1.45428	41.14



11.

Ratios	Banks	Profitability ratios				
		R	r^2	P.Er	6P.Er	Impact
1.credit/loan related	NBL	0.5545	0.3075	0.2335	1.401	Insignificant
	EBL	0.7962	0.6339	0.1235	0.741	Insignificant
2.Credit efficiency	NBL	1	1	0	0	Significant
	EBL	1	1	0	0	Significant

12.

Banks	Credit/loans related ratios			
NBL	52.91	20.22	59.21	25.16
EBL	62.50	15.97	72.34	18.06
Calculated T-value				**0.609761042**
Tabulated T-value				**2.4470**

13.

Banks	Credit efficiency ratio	
NBL	0.97	4.87
EBL	0.36	0.71
Calculated T-value		**0.407310068**
Tabulated T-value		**4.303**

14.

Banks	Profitability ratios			
NBL	0.69	2.05	12.21	2.95
EBL	4.51	3.02	10.54	3.53
Calculated T-value				**0.471853925**
Tabulated T-value				**2.447**