

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

The trend of rising anticipation and ambition of people at present context of society realized the need for cyclone socio-economic development in the nation building process. The government felt of impart a dynamic role and charge the public sector with greater responsibility in fulfilling national goals and objectives. With this realization the government mushroomed into a number of establishments like agriculture, industry, commerce, public works, transport, and other sectors.

In this circumstance, banking has been seen as major components to uplift the economic conditions of public, and country and the world as well. Therefore the government was forced to adopt a liberal economic policy regarding operation of banks. About the financial liberalization process, it is said that the interest rate deregulation curtailment or elimination of directed credits, lifting entry and exit barriers for financial intermediaries, restructuring of banking system and institution for regulatory and supervisory mechanism is some of the key components of such liberalization. This led to the influx of commercial banks in Nepal.

Certainly banks can be identified by the functions they perform in the economy. Indeed, many financial institutions-including security dealers, brokerage firms, mutual funds, and insurance companies are trying to be as similar as possible to banks in the services they offer. Bank plays a vital role in developing economy of any country. It is a resource mobilizing institution which accepts deposit from various source and invest such accumulated resources in the field of agriculture, trade, commerce, industry, tourism etc. The banking sector is largely responsible for collecting household saving in terms of different types of deposit and regulating it in the society by lending in

different sector of economy. But lending their resources in small scale industries under intensive banking program has enabled the bank to share in the economic growth of the economy.

Banks are among the most important financial institutions in the economy. They are the principal source of credit (loanable funds) for million of individual and families and for many units of government (school districts, cities, countries, etc). Moreover, for small local business ranging from grocery stores to automobile dealers, banks are after the major source of credit to stork the shelve with merchandise or to fill a dealer's showroom with new cars. When business and consumers must make payment for purchase of goods and services, more often than not they use bank-provided cheques, credit card, or electronic device connected to a computer network. And when they need financial information and financial planning, it is the banker to whom they turn most frequently for advice and counsel.

There is an ongoing debate in the theory of finance and economics about why banks exist. What essential services do banks provide that other business and individual cannot provide from themselves?

This question has proven to extremely difficult to answer. Research evidence has accumulated over many years showing that our financial system and financial markets are extremely efficient. Funds and information flow readily to both lender and borrowers, and the prices of loans and securities seem to be determined in highly competitive markets. In a perfectly competitive and efficient financial system, in which all participants have open and equal access to the financial markets and can borrow and lend at the same interest rate, in which no one participant can exercise control over interest rates or prices, in which all pertinent information affecting the value of loans, securities and other assets is readily available to all market participants at negligible cost, in which transactions costs are not significant impediments to trading assets, and all

loans and securities are available demolitions to anyone can afford, why would banks be needed at all?

Another contribution banks make is their willingness to accept risky loans from borrowers, while issuing low-risk securities to their depositors. In effect, banks engage in risky arbitrage across the financial markets.

Nowadays, two types of banking practices are seen in the financial market, Commercial banking and Development banking. The commercial banks usually make business in urban areas whereas development banks provide services in rural areas. In the commercial lending, usually the same client is repeated of loan repaid. But in development finance is such repetition occurs, the outreach could not be extended. Generally commercial banks play a vital role to meet the cash need of different organs of the society.

1.1.1 Profile of the Selected Banks

a) Himalayan Bank Limited

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

Himalayan Bank is always committed to providing a quality service, with a personal touch, to its valued customers. All customers are regarded as valued clients and treated with utmost courtesy. The Bank, wherever possible, offers tailored facilities to its clients, to meet unique needs and requirements of different clients. To further extend the reliable and efficient services to its valued customers, Himalayan Bank has adopted the latest banking technology

and runs the world class banking software Globus on IBM platform. The Bank can now boast of its state-of-the-art IT infrastructure with an identical Disaster Recovery System, offsite. This has not only helped the Bank to constantly improve its service level but has also prepared the Bank for future adaptation to new technology. The Bank already offers unique services such as Himal Remit, SMS Banking, Pre-paid Credit Cards and Internet Banking to customers and will be introducing more services like these in the near future.

b) Everest Bank Limited

Everest Bank Limited (EBL) started its operations in 1994 with a view and objective of extending professionalized and efficient banking services to various segments of the society. EBL joined hands with Punjab National Bank (PNB), India as its joint venture partner in 1997.

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. EBL is ranked as No. 2 bank by NRB as per CAMELS.

The bank is providing its services through a wide network of 23 branches across the nation and over 250 correspondents across the globe. All the major branches of the bank are connected through Anywhere Branch Banking System (ABBS), a facility which enables a customer to do banking transactions from any of the branches irrespective of their having accounts in other branch.

EBL is playing a pivotal role in facilitating remittance to and from across globe. Being the first Nepalese bank to open a representative office in Delhi, India, the Nepalese in India can open account in Nepal from the designated branches of Punjab National bank and remit their savings economically through banking channels to Nepal. The bank has a Drafts Drawing Arrangement with 175 branches of PNB all over India.

1.2 Statement of the Problem

Due to globalization and liberalization of economy, the number of commercial banks is increasing in Nepal. But the banking service per person is very low. Poorer or deprived sector of the economy is granted loan only due to the strict directives set by Nepal Rastra Bank. Banks are not easily accessible to the people of remote and village areas because private banks are established mostly in the cities and capital of the country.

The main function of commercial bank is loan management. It is very challenging task on the part of bank because the bank has to disburse loan in the appropriate sector and recover it in time as well. In this competitive environment, it is very difficult to choose right and productive sectors for granting loan. Hence, there is the chance is flowing bank's deposit in unproductive sector.

Bank has special facilities for different types of loan but most of the people are not utilizing it. This study finds out the problems why they are not getting benefits of the customer loan and its facilities provided by bank. Many people are unaware of its procedures and techniques to apply too and have no idea how to apply for loan and don't know how effective it will be during at the scarcity. Taking aforementioned problems under consideration, some research questions are raised as follows:

- a. Whether the deposit of the bank has been efficiently mobilized in loan disbursement?
- b. Is the bank efficient in controlling non performing loan, and keeping the sufficient provision on loan loss?
- c. What relationship exists of loan and advances with net profit, total deposit, total investment and non performing loan?
- d. What will be the trend value of loan and advances, total deposit, total investment, non performing loan and net profit of the bank?

- e. What opinion do people have about the efficiency of bank in loan management?

1.3 Objectives of the Study

The main objective of this study is to analyze, examine and interpret the loan management of HBL and EBL. The other specific objectives of the study are as follows;

- a. To evaluate the loan investment and deposit mobilization of HBL & EBL.
- b. To analyze the non performing loan in term of growth rate of loan outstanding, loan recovery, loan investment and provision made.
- c. To examine the relationship between net profit and loan & advances, loan & advances and total deposit, loan & advances and total investment, non performing loan and loan and advances.
- d. To analyze the trend of loan and advances, total deposit, total investment, non performing loan and net profit after tax.
- e. To measure the efficiency of HBL & EBL in managing loan.

1.4 Significance of the Study

The study is very significant to professionals, students, teachers and general public, who want to know about the loan management of Commercial Banks. The research findings may also be valuable to the banks taken for study. The findings may be useful for the bank to overcome its weaknesses to alter and make new policies and strategies regarding loan management. The study will be helpful to the borrowers who want to approach bank for loan. Further, the study will also be reference to the future researcher to do research on loan management.

1.5 Limitations of the Study

The scope of the study has been made limited by the following factors:

- a) Although there are 31 commercial banks existing in Nepal, the study concentrates only on two Commercial Banks, HBL & EBL. So, the overall loan management in Nepal cannot be known with this study.
- b) The study is focused only on loan management as a result the other financial aspects of Banks are excluded.
- c) The study analyses secondary data, whose reliability depends absolutely on the annual reports.
- d) The accuracy of the primary data depends on the responses provided by the sampled respondents.
- e) The study covers only five years data of 2005/06 to 2009/10.

1.6 Organization of the Study

The whole study has been organized into five chapters:

Chapter I: Introduction

This chapter includes background of the study, statement of the problem, objectives of the study, significance of the study and limitations of the study.

Chapter II: Review of Literature

The second chapter consist of conceptual framework and review of literature under which the term loan management has been described as well as previous related research works have also been reviewed.

Chapter III: Research Methodology

In the third chapter the research methodology followed to achieve the purpose of this study has been designed which includes research design, period covered, nature and source of data, tools used to analyze the data and research variables are described.

Chapter IV: Data Presentation and Analysis

The fourth chapter includes the presentation and analysis of data made available from HBL & EBL according to the need of the study. At the end, the major findings have been excerpted.

Chapter V: Summary, Conclusion and Recommendations

This is the last chapter of this study, which consists of summary of the study, conclusions drawn and the recommendation for improving the loan practices of in the selected banks.

Besides these chapters, Bibliography and Appendix are included in this study.

CHAPTER – II

REVIEW OF LITERATURE

This part of the study deals with making theoretical framework. So, it incorporates the review of concepts, review of journals and articles and review of thesis.

2.1 Conceptual Framework

“Effective management of the loan and the credit function is fundamental to a bank’s safety and soundness. Loan management (LM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LM process is so important, it is a primary supervisory activity. Assessing LM involves evaluating the steps bank management takes to identify and control risk throughout the credit process. The assessment focuses on what management does to identify issues before they become problems” (Rose; 2002: 47).

“Lending is the principal business activity for most commercial banks. The loan is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank’s safety and soundness. Whether due to lax credit standards, poor risk management, or weakness in the economy, loan problems have historically been the major cause of bank losses and failures” (Khan; 1982: 110).

For decades, good loan portfolio managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with oil and gas lending, agricultural lending, and commercial real estate lending in the 1980s, has made it clear that portfolio managers should do more. Traditional practices rely too much on trailing indicators of credit

quality such as delinquency, nonaccrual, and risk rating trends. Banks have found that these indicators do not provide sufficient lead time for corrective action when there is a systemic increase in risk.

2.1.1 Risks Associated with Lending

“Lending can expose a bank’s earnings and capital to all of the risks. Therefore, it is important that the examiner assigned LM understands all the risks embedded in the loan and their potential impact on the institution. Risk is the potential that events, expected or unexpected, may have an adverse impact on the bank’s earnings or capital. A key challenge in managing risk is to understand the interrelationships of the nine risk factors” (Gitman & Jochnk; 1990: 23).

a) Credit Risk

Credit risk arises due to possibility of payment default from the counter parties. For most banks, loans are the largest and most obvious source of credit risk. However, there are other pockets of credit risk both on and off balance sheet, such as the investment portfolio, overdrafts, and letters of credit. Many products, activities, and services, such as derivatives, foreign exchange, and cash management services, also expose a bank to credit risk.

“The risk of repayment, i.e., the possibility that an obligor will fail to perform as agreed, is either lessened or increased by a bank’s credit risk management practices. A bank’s first defense against excessive credit risk is the initial credit-granting process, sound underwriting standards, an efficient, balanced approval process, and a competent lending staff. Because a bank cannot easily overcome borrowers with questionable capacity or character, these factors exert a strong influence on credit quality. Borrowers whose financial performance is poor or marginal, or whose repayment ability is dependent upon unproven projections can quickly become impaired by personal or external economic stress. Management of credit risk, however, must continue

after a loan has been made, for sound initial credit decisions can be undermined by improper loan structuring or inadequate monitoring” (Gitman & Jochnk; 1990: 27).

b) Interest Rate Risk

The level of interest rate risk attributed to the bank’s lending activities depends on the composition of its loan portfolio and the degree to which the terms of its loans (e.g., maturity, rate structure, embedded options) expose the bank’s revenue stream to changes in rates.

“Pricing and portfolio maturity decisions should be made with an eye to funding costs and maturities. When significant individual credits or portfolio segments are especially sensitive to interest rate risk, they should be periodically stress-tested. If the asset/liability management committee (ALCO), which typically is responsible for managing the bank’s interest rate risk, is to manage all of the bank’s positions, it must have sufficient reports on loan portfolio and pipeline composition and trends. These reports might include a maturing loans report, pipeline report, and rate and repricing report.” (Francis; 1991: 52).

Banks frequently shift interest rate risk to their borrowers by structuring loans with variable interest rates. Borrowers with marginal repayment capacity may experience financial difficulty if the interest rates on these loans increase. As part of the risk management process, banks should identify borrowers whose loans have heightened sensitivity to interest rate changes and develop strategies to mitigate the risk. One method is to require vulnerable borrowers to purchase interest rate protection or otherwise hedge the risk.

c) Liquidity Risk

“Because of the size of the loan, effective management of liquidity risk requires that there be close ties to, and good information flow from, the lending

function. Obviously, loans are a primary use of funds. And while controlling loan growth has always been a large part of liquidity management, historically the loan has not been viewed as a significant source of funds for liquidity management. Practices are changing, however. Banks can use the loan portfolio as a source of funds by reducing the total dollar volume of loans through sales, securitization, and portfolio run-off” (Francis; 1991: 55).

In fact, banks are taking a more active role in managing their loan portfolios. While these activities are often initiated to manage credit risk, they have also improved liquidity. Banks increasingly are originating loans “for sale” or securitization. Consumer loans (mortgages, installment loans, and credit cards) are routinely originated for immediate securitization. Many larger banks have been expanding their underwriting for the syndicated loan market.

d) Price Risk

Most of the developments that improve the loan portfolio’s liquidity have implications for price risk. Traditionally, the lending activities of most banks were not affected by price risk. Because loans were customarily held to maturity, accounting doctrine required book value accounting treatment. However, as banks develop more active portfolio management practices and the market for loans expands and deepens, loan portfolios will become increasingly sensitive to price risk.

“Loans originated for sale as part of a securitization or for direct placement in the secondary market carry price risk while they are in the pipeline awaiting packaging and sale. During that period, the assets should be placed in a “held-for-sale” account, where they must be repriced at the lower of cost or market. The same accounting treatment can apply to syndicated credits and distressed loans. When a bank underwrites a larger portion of a syndicated loan than its “hold” position, the excess portion must be placed in a held-for- sale account. Once a sale strategy is adopted for distressed or otherwise undesirable credits,

those credits should also be placed in a held-for-sale account” (Gitman & Jochnk; 1990: 31).

e) Foreign Exchange Risk

“Foreign exchange risk is present when a loan or portfolio of loans is denominated in a foreign currency or is funded by borrowings in another currency. In some cases, banks will enter into multi-currency credit commitments that permit borrowers to select the currency they prefer to use in each rollover period. Foreign exchange risk can be intensified by political, social, or economic developments. The consequences can be unfavorable if one of the currencies involved becomes subject to stringent exchange controls or is subject to wide exchange-rate fluctuations” (Gupta; 1984: 213).

f) Transaction Risk

In the lending area, transaction risk is present primarily in the loan disbursement and credit administration processes. “The level of transaction risk depends on the adequacy of information systems and controls, the quality of operating procedures, and the capability and integrity of employees. Significant losses in loan and lease portfolios have resulted from inadequate information systems, procedures, and controls” (Gupta; 1984: 215). For example, banks have incurred increased credit risk when information systems failed to provide adequate information to identify concentrations, expired facilities, or stale financial statements. At times, banks have incurred losses because they failed to perfect or renew collateral liens; to obtain proper signatures on loan documents; or to disburse loan proceeds as required by the loan documents.

g) Compliance Risk

“Lending activities encompass a broad range of compliance responsibilities and risks. By law, a bank must observe limits on its loans to a single borrower, to insiders, and to affiliates; limits on interest rates; and the array of consumer

protection and Community Reinvestment Act regulations. A bank's lending activities may expose it to liability for the cleanup of environmental hazards. A bank may also become the subject of borrower-initiated "lender liability" lawsuits for damages attributed to its lending or collection practices. Supervisory activities should include the review of the bank's internal compliance process to ensure that examiners identify and investigate compliance issues" (Desai; 1967: 37).

h) Strategic Risk

"A primary objective of loan portfolio management is to control the strategic risk associated with a bank's lending activities. Inappropriate strategic or tactical decisions about underwriting standards, loan portfolio growth, new loan products, or geographic and demographic markets can compromise a bank's future. Examiners should be particularly attentive to new business and product ventures. These ventures require significant planning and careful oversight to ensure the risks are appropriately identified and managed. Both bankers and examiners need to decide whether the opportunities outweigh the strategic risks. If a bank is considering growing a loan product or business in a market saturated with that product or business, it should make sure that it is not overlooking other lending opportunities with more promise. During their evaluation of the loan management process, examiners should ensure that bankers are realistically assessing strategic risk" (Desai; 1967: 40).

i) Reputation Risk

When a bank experiences credit problems, its reputation with investors, the community, and even individual customers usually suffers. Inefficient loan delivery systems, failure to adequately meet the credit needs of the community, and lender-liability lawsuits are also examples of how a bank's reputation can be tarnished because of problems within its lending division.

"Reputation risk can damage a bank's business in many ways. The value of the bank's stock falls, customers and community support is lost, and business

opportunities evaporate. To protect their reputations, banks often feel that they must do more than is legally required. For example, some banks have repurchased loan participations when credit problems develop, even though these problems were not apparent at the time of the underwriting” (Francis; 1991: 60).

2.1.2 Loan Management Objectives

“Loan objectives establish specific, measurable goals for the bank. The board of directors must ensure that loans are made with the following three basic objectives in mind:” (Crosse; 1963: 73)

-) To grant loans on a sound and collectible basis.
-) To invest the bank’s funds profitably for the benefit of shareholders and the protection of depositors.
-) To serve the legitimate credit needs of their communities.

2.1.2.1 Strategic Planning for the Loan

“For most banks, meeting the aforementioned three objectives will require that senior management and the board of directors develop medium- and long-term strategic plans and objectives for the loan portfolio. These strategies should be consistent with the strategic direction and risk tolerance of the institution. They should be developed with a clear understanding of their risk/reward consequences. They also should be reviewed periodically and modified as appropriate. In drawing up strategic objectives, management and the board should consider establishing:” (Crosse; 1963: 85)

-) What proportion of the balance sheet, the loan should comprise?
 -) Goals for loan quality.
 -) Goals for portfolio diversification.
-) How much the loan should contribute to the bank’s financial objectives?
 -) Loan product mix.

-) Loan growth targets by product, market, and portfolio segment.
-) Product specialization.
-) What the bank's geographic markets should be?
 -) Targeted industries.
 -) Targeted market share.
 -) Community needs and service.
 -) General financial objectives (e.g., increase fee income).

The bank's loan policies, underwriting guidelines, and procedures should communicate and support the strategic objectives for the portfolio. MIS should be able to inform management about whether performance measures up to plans. Management should evaluate business, marketing, and compensation plans to ensure that short-term goals and incentives are consistent with strategic portfolio objectives and risk tolerances. In community banks without formal strategic plans, senior management should be able to articulate the bank's strategic objectives. It should be evident, as well, that the board of directors has endorsed those objectives.

2.1.3 The Loan Policy

The loan policy is the primary means by which senior management and the board guide lending activities. Although the policy primarily imposes standards, it also is a statement of the bank's basic credit philosophy. It provides a framework for achieving asset quality and earnings objectives, sets risk tolerance levels, and guides the bank's lending activities in a manner consistent with the bank's strategic direction. Loan policy sets standards for portfolio composition, individual credit decisions, fair lending, and compliance management.

“Loan policies vary in length, organization, degree of detail, and breadth of topics, there is no ideal format. Frequently, the bank's general lending policy

will be supplemented by more detailed underwriting standards, guidelines, and procedures. Within the same banking company, certain aspects of the policy may vary because of factors such as geographic location, economic conditions, personnel, or portfolio objectives. The format should be tailored to fit the needs of a particular bank, and the scope and detail should be commensurate with the complexity of the bank's lending activities" (William; 1960: 104).

In all but very small community banks, the loan policy will be written. "The policy should provide a realistic description of where the bank wants to position itself on the risk/reward spectrum. It needs to provide sufficient latitude for a bank to respond to good business opportunities while concurrently controlling credit risk. In normal circumstances, a bank should be able to achieve portfolio objectives and respond to changing market conditions without triggering a limit. Limits should not be so conservative that insignificant changes breach them, nor should they be so liberal that they have no practical effect" (Grywinski: 1991: 75).

"For the policy to be an effective risk management tool, it must clearly establish the responsibilities of those involved in the lending process. For example, who is authorized to approve a covenant violation, who arbitrates risk rating differences, can a credit-scored decision be overridden? Lenders must know what is expected of them. When policy is vague or too broad, credit standards may be unclear and virtually nothing may be regarded as an exception. If the policy states that a bank will extend credit to established businesses, almost any company would qualify. But a policy further requiring the business to be profitable, in operation for at least two years, and located within the bank's community is providing meaningful guidance" (Grywinski: 1991: 77).

When policy is too prescriptive and particular, exceptions to policy will become the rule and meaningless exception data will mask meaningful trends,

thereby diminishing the effectiveness of the policy. Because exceptions are so important, the policy should address them specifically; it should state when they are acceptable and how they should be identified, mitigated, and documented. Some lending standards, such as those that implement legal requirements or those whose violation quickly translates into losses, have greater significance than others. More substantive exceptions should have heightened reporting requirements to senior management and the board. Failure to comply with the provisions of loan policy concerning exceptions is generally regarded as a material weakness.

“Policies should be periodically reviewed and revised to accommodate changes in the bank’s strategic direction, risk tolerance, or market conditions. Policy review should consider the organizational structure, breadth and complexity of lending activities, capabilities and skills of lending personnel, and strategic portfolio quality and earnings objectives. Changes in regulations and business conditions also need to be considered. In addition to providing an opportunity for change, the review should evaluate how well the policy has guided lending decisions. For example, a high volume of exceptions indicates that many loan decisions are being made outside the policy. This could mean that the bank is assuming more risk than is desirable or that the policy is too restrictive. If the bank’s policy is too restrictive, easing it could increase business opportunities without unduly increasing risk. Conversely, the absence of exceptions may indicate that the policy is too vague, and a tightening of the policy could strengthen the controls on loan quality. All policy reviews should include the organizational unit responsible for assessing compliance with policy” (Reed, Edward, Cotter & Smith; 1980: 82).

2.1.3.1 Loan Policy Topics

“While the form and contents of loan policies and procedures will vary from bank to bank, there are some topics that should be covered in all cases. These are:” (Chopra; 1989: 17)

-) Loan authorities.
-) Limits on aggregate loans and commitments.
-) Portfolio distribution by loan category and product.
-) Geographic limits.
-) Desirable types of loans.
-) Underwriting criteria.
-) Financial information and analysis requirements.
-) Collateral and structure requirements.
-) Margin requirements.
-) Pricing guidelines.
-) Documentation standards.
-) Collections and charge-offs.
-) Reporting requirements.
-) Guidelines for loan participations.
-) Off-balance-sheet exposure.

The policy may also address insider transactions, affiliate transactions, conflicts of interest, the code of ethics, community support, appraisal requirements, environmental assessment requirements, relevant accounting issues (such as charge-off loans, nonperforming loans, and debt restructuring), and the allowance for loan and lease losses. Any administrative requirements for granting loans should be covered in the policy. Policies and procedures should also ensure compliance with laws and regulations.

2.1.4 Loan Approval Process

The loan approval process is the first step towards good portfolio quality. When individual credits are underwritten with sound credit principles, the credit quality of the portfolio is much more likely to be sound. Although good loans sometimes go bad, a loan that starts out bad is likely to stay that way. The foremost means to control loan quality is a solid loan approval process.

“Every loan approval process should introduce sufficient controls to ensure acceptable credit quality at origination. The process should be compatible with the bank’s credit culture, its risk profile, and the capabilities of its lenders. Further, the system for loan approvals needs to establish accountability.

Each method of loan approval has inherent strengths and weaknesses. The committee method is advantageous because knowledge can be shared, but it may diminish accountability and often slows a bank’s responsiveness. The individual signature authority system is more timely and establishes clear accountability, but it can create undue credit risk if a lender’s knowledge and experience are inadequate to his or her authority” (Diamond; 1960: 173).

Laddered or joint authorities, variations that some banks employ, combine elements of both systems. The involvement of an independent loan approval authority whose primary goal is quality (such authority might be invested in a senior credit officer or credit administrator) is also a method to introduce more objectivity to the loan approval process. Whatever approach or combination of approaches a bank uses, internal control mechanisms are necessary to ensure that the approval system produces sound credit decisions.

“An effective loan approval process establishes minimum requirements for the information and analysis upon which a credit decision is based. It provides guidance on the documents needed to approve new credit, renew credit, increase credit to existing borrowers, and change terms in previously approved credits. It will also designate who has the authority to approve credit or changes in credit terms. Loan authorities should be commensurate with the experience of the lender/credit officer and take into consideration the type of credit, the amount of credit, and the level of risk involved. Generally, underwriting document standards should include:” (Dahal & Dahal; 2007: 39)

) Financial information including:

- a. current and historical balance sheet and income data,
 - b. balance sheet, income, and cash flow projections, when appropriate, and comparative industry data when appropriate.
-) Financial analysis, including repayment capacity.
 -) Collateral identification and valuation.
 -) Guarantor support and related financial information.
 -) Summary of borrower and affiliated credit relationships.
 -) Loan terms, including tenor and repayment structure.
 -) Pricing information, including relationship profitability data.
 -) Covenants and requirements for future submission of financial data.
 -) Exceptions to policy and underwriting guidelines.
 -) Information fields to capture data for concentration reporting, identifying SNCs (shared national credits), etc.
 -) Risk rating or recommended risk rating.

The approval process for consumer loans may be more streamlined, but should still include sufficient information to support the credit granting decision, including, when applicable, scorecard data.

2.1.5 Loan Portfolio Management

To manage the loan portfolio effectively, the bank should consider the following factors.

2.1.5.1 Risk Identification

“Effective risk identification starts with the evaluation of individual credits. Rating the risk of each loan in timely credit evaluations is fundamental to loan portfolio management. Some banks apply risk ratings to relationships, others prefer to rate each facility, and still others rate both relationships and facilities. Risk ratings should also be applied to off-balance-sheet exposures like letters of credit and unfunded commitments that the bank is obligated to fund unless there is a default. These evaluations allow the prompt detection of changes in

portfolio quality, enabling management to modify portfolio strategies and intensify the supervision of weaker credits in a timely manner” (Joseph; 1998: 10).

2.1.5.2 Exceptions to Policy, Procedures, and Underwriting Guidelines

“Lending exceptions generally either relate to documentation or underwriting. Banks should have systems to analyze and control both types of exceptions. While it is advisable to identify, mitigate, and monitor all exceptions, the level of attention and reporting should correspond with the materiality of the exception” (Joseph; 1998: 10).

a) Documentation Exceptions

“Loan documentation” refers broadly to the documents needed to legally enforce the loan agreement and properly analyze the borrower’s financial capacity. When a document is missing, stale, or improperly executed, it becomes an exception. Common loan documents are promissory notes, note guarantees, financial statements, collateral agreements, and appraisals. The promissory note, guarantee, and financial statement must be properly prepared and signed; the financial statement must be received and analyzed in a timely manner by the bank; and the collateral agreement must be recorded in the appropriate jurisdiction” (Joseph; 1998: 11).

b) Policy and Underwriting Exceptions

“Policy and underwriting exceptions are conditions in approved loans that violate the loan policy or underwriting guidelines. Because underwriting guidelines are the primary means by which the bank steers lending decisions toward planned strategic objectives and maintains desired levels of risk within the portfolio, deviations from these guidelines should be well documented and justified” (Joseph; 1998: 11).

2.1.5.3 Aggregate Exception Tracking and Reporting

“Tracking the aggregate level of exceptions helps detect shifts in the risk characteristics of loan portfolios. In consumer lending, where such tracking is common, it has facilitated risk evaluation, strengthened portfolio liquidity, and helped management to identify new business opportunities. Similar benefits can accrue from tracking underwriting exceptions in commercial and real estate loan portfolios” (Joseph; 1998: 13).

2.1.5.4 Portfolio Segmentation and Risk Diversification

“Risk diversification is a basic tenet of portfolio management. Concentrations of credit risk occur within a portfolio when otherwise unrelated loans are linked by a common characteristic. If this common characteristic becomes a common source of weakness for the loans in concentration, the loans could pose considerable risk to earnings and capital” (Joseph; 1998: 13).

a) Identifying Concentrations of Risk

“Managing the loan portfolio includes managing any concentrations of risk. By segmenting the portfolio into pools of loans with similar characteristics, management can evaluate them in light of the bank’s portfolio objectives and risk tolerances and, when necessary, develop strategies for reducing, diversifying, or otherwise mitigating the associated risks” (Joseph; 1998: 14).

2.1.5.5 Evaluating and Managing Concentrations of Risk

“Each pool should be evaluated individually — that is, as a discrete pool of risk — and as part of the whole — that is, by how it fits into the portfolio and supports loan portfolio goals. A large exposure to one type of borrower or industry may well be less risky than a small exposure to another. The goal is to achieve the desired balance of risk and return for the portfolio as a whole.” (Joseph; 1998: 15).

a) Concentration Management Techniques

“Over the past decade, banks, especially large ones, have been adopting more active portfolio management practices. They are expanding their MIS capabilities and strengthening their credit risk management practices. There are a variety of techniques banks can use to manage portfolios and control concentration risk.

The most common tool is setting exposure limits, or ceilings, on concentrations. Diversifying away from a limit can be accomplished by reducing certain exposures or increasing the borrower base. The reduction of exposures begins with a reassessment of individual borrowers’ needs and requires considerable discipline. Nonetheless, it can be a useful tool to diversify risk over a larger customer base.

A bank can change the distribution of its assets by increasing the geographic diversification of borrowers; altering the bank’s product mix (for example, by reducing commercial lending and increasing consumer lending); or changing the risk profile of the bank’s target market (for example, by turning from middle-market, non-investment-grade customers to well-capitalized, investment-grade customers). Asset sales can also be used to manage concentrations. Banks sell whole loans, sell a portion of a loan into syndication, sell participations in a loan, and securitize certain types of loans. Each of these approaches entails risk/reward trade-offs that must be evaluated in light of the bank’s strategic objectives” (Joseph; 1998: 15).

Recently, banks have begun using credit derivatives to reduce the risk posed by concentrations. Although their usage is modest in all but the largest banks, credit derivatives are gaining acceptance.

2.1.5.6 Stress Testing

“In stress testing, a bank alters assumptions about one or more financial, structural, or economic variables to determine the potential effect on the performance of a loan, concentration, or portfolio segment. This can be accomplished with “back of the envelope” analysis or by using sophisticated financial models. The method employed is not the issue, rather the issue is asking that critical “what if” question and incorporating the resulting answers into the risk management process. Stress testing is a risk management concept, and all banks will derive benefits, regardless of the sophistication of their methods, from applying this risk management concept to their loans and portfolios” (Joseph; 1998: 16).

2.1.6 NRB Directives

The world has witnessed many financial crises and devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and their magnitude of losses was much larger than expected. The financial sector reform of Nepal was initiated in mid 1980s. Since then NRB has been playing pioneer role in regulation, supervision and monitoring of commercial banks by issuing directives.

2.1.6.1 NRB Directives Relating to Loan Classification and Loan Loss Provision

1. Classifications of Loan and Advances: Effective from FY 2058/59 (2001/02) banks shall classify outstanding principal amount of loan and advances on the basis of aging. As per the directives issued by NRB, all loans and advances shall be classified into the following four categories:

- a. Pass Loan:** - Loans and advances whose principal amount are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing loans.
- b. Sub-Standard Loan:** - All loans and advances that are past due for a period of 3 months to 6 months shall be included in this category.

- c. **Doubtful Loan:** - All loans and advances which are past due for a period of 6 months to 1 year shall be included in this category.
- d. **Loss:** - All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

Loans and advances falling in this category of sub-standard, Doubtful and loss are classified and defined as Non-performing loan. It is appropriate in the view of the banks management; there is not restriction in classifying the loan and advances from low risk category to high risk category. For instance, loans falling under substandard may be classified into doubtful or loss and loans falling under doubtful may be classified into loss category. The term loan and advances also includes bills purchased and discounted.

2. Additional Arrangement in Respect of Pass Loan: Loan and advances fully secured by gold, silver, fixed deposit receipts, credit cards and government securities shall be include under “pass” category. Loans against fixed deposit receipts of other banks shall also qualify for inclusion under pass loan. However, where collateral of fixed deposit receipt or government securities or NRB bonds is placed as extra security, such loan has to be classified on the basis of clause 1 to clause 7. While renewing working capital loan having maturity period up to one year can be classified as pass loan. If the interest of working capital nature loans and advance is not regular, such loan and advances should be classified on the basis of interest outstanding period.

3. Additional Arrangement in Respect of loss Loan: Even if the loan is not past due, loans having any or all of the following discrepancies shall be classified as “loss”.

- a. Security is not sufficient,
- b. The borrower has been declared bankrupt,

- c. The borrower is absconding or cannot be found,
- d. Purchased or discounted bills are not realized within 90 days from the due date and non fund based letter of credit and guarantees etc are not realized within 90 days from the date of conversion into fund based are not realized within 90 days,
- e. The credit has not been used for the purpose originally intended,
- f. Owing to non-recovery, initiation as to auctioning of the collateral has passed six months and if the recovery process is under litigation,
- g. Loan provided to the borrowers included in the blacklist of credit information center (CIC),
- h. Project or business is not in operative conditions, project or business is not in operation,
- i. Credit Card Loan is not written off within 90 days from past due date.

4. Additional Arrangements in Respects of Term Loan: In respect of term loans, the classification shall be made against the entire outstanding loan on the basis of the past due period of overdue installment.

5. Prohibition to Recover Principal and Interest by Overdrawing the Current Account and Exceeding the Overdraft Limit: Principal and interest on loans and advance shall not be recovered by overdrawing the borrower's current account or where overdraft facility has been extended, by overdrawing such limit. However, this arrangement shall not be constructed as prohibitive for recovering the principal and interest by debiting the customers' account. Where a system in the bank exists as to recovery of principal and interest by debiting the customers' account, and recovery is made as such resulting in overdraft, which is not settled within one month, such overdrawn principal amount shall also be liable to be include under the outstanding loan and such loan shall be downgraded by one step from its current classification. In respects if recognition of interest, the same shall be as per the clause relating to income recognition mentioned in directives no 4.

6. Letter of Credit and Guarantees: If letter of credit and guarantees and other contingent liabilities converted into fund based liabilities and have to be paid, in such condition such loan shall be classified as pass loan within 90 days from the date of conversion into fund based. After 90 days such loan shall be classified as loss loan.

7. Rescheduling and Restructuring of the Loan: If the bank is confident on the following bases of written plan of action submitted by borrower, it may reschedule or restructure the loans and advances. Clear bases of rescheduling or restructuring should be attached with loan files.

- a. If there is proof of adequate documents and collateral security relating to loan.
- b. If the bank is confident in recovery of restructured or rescheduled loans and advances.

In addition to written plan of action for rescheduling or restructuring of loan, payment of at least 25 percent of total accrued interest up to the date of rescheduling of restructuring should have been collected.

8. Loan Loss Provisioning: The loan loss provisioning, on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as follows:

<u>Classification of Loan</u>	<u>Loan Loss Provision</u>
Pass loan	1%
Sub-standard loan	25%
Doubtful loan	50%
Loss	100%

2.2 Review of Previous Studies

In this section, the previous studies, related to the loan management, have been reviewed. This section has been divided in two sections. The first section review journals and articles and the second sections reviews the Master's Degree thesis.

2.2.1 Review of Journals and Articles

Koirala, (2006), in well read article, “*Credit Culture of Commercial Banks in Nepal*”, concluded that the unorganized moneylenders in Nepal never loose. They used to assess the record of accomplishment of potential borrowers and innocent characters termed as the best borrower. The bank, on the other hand, is an institution established to support and improves development process of a nation. The politicians and the staff have been responsible for the existence of huge volume of NPA in state-owned commercial banks. In order to improve the situation, there is a need to evolve a more acceptable working system backed by cooperation and realization by the banks employees as well as the politicians and stakeholders, who can influence in banks operation.

Garg, (2006), in well read article, “*Principles of Lending and Credit Culture at Rastriya Banijya Bank*”, concluded that banks credit culture is the unique combination of policies, practices, experience, and management attitudes that defines the lending environment and determines the lending behavior acceptable to the bank. Loans are not be made unless there is a demonstrated capability for repayment. Lending culture can take cash flows as opposed to security. Every credit must be subject to rigorous analytical scrutiny of the customer's repayment capability prior to approval, and on an ongoing basis following approval. There can be no exceptions to the basics principles of lending.

Dhungana, (2006), in well 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 significance 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 competency on risk management 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.

He further states that it can be expected that the financial sector reforms will lower down the level of NPL from the existing level and strengthening the banks and financial institution internally to manage the credit portfolio efficiently and support will be continued to make a good credit culture in the system.

Bhandari, (2007), in well read article, “*Etiology and Strategy of Loan Repayment*”, has concluded that lending agencies should adopt several strategies for achieving their target of credit repayment. However, before enforcing coercive actions against entrepreneur and the enterprise, the banks and the lending agencies should follow a series of liberal strategies for recovering their loans.

Zerith (2008), in article well read article, “*Loan Portfolio Management*”, affirmed that to manage the loan portfolios, bankers must understand not only the risk posed by each credit but also how the risks of individual loans and portfolios are interrelated. These interrelationships can multiply risk many times beyond what it 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 loan portfolio in its segments and as a whole and consider the relationships among portfolio segments as well as among loans. These

practices provide management with a more complete picture of the bank's credit risk profile and with more tools to analyze and control the risk.

Zerith further concluded that effective loan portfolio management begins with oversight of the risk in individual loans. Prudent risk selection is vital to maintaining favorable loan quality. Therefore, the historical emphasis on controlling the quality of individual loan approvals and managing the performance of loans continues to be essential. But better technology and information systems have opened the door to better management methods. A portfolio manager can now obtain early indications of increasing risk by taking a more comprehensive view of the loan portfolio.

2.2.2 Review of Thesis

Paudel (2005), in "*Credit Policy of Commercial Banks in Nepal*", has the objective to provide the credit practices in NIBL and SBI bank. The specific objectives are;

- a. To examine the liquidity and assets management of NIBL and SBI.
- b. To evaluate the investment policy of NIBL and SBI.
- c. To study the growth ratio of loan and advances.
- d. To analyze the investment to total deposit and net profit NIBL and SBI.

The major findings of the study are;

- a. Both banks current assets have exceeded the current liabilities therefore the ratio is considered satisfactory. But the cash reserve ratios have fluctuated in high degree.
- b. NIBL has maintained both current ratio and cash reserve ratio better than that of SBI.
- c. The assets management ratio shows that deposit utilization of NIBL is less effective than SBI.
- d. NIBL has invested lower amount of government securities and share and debenture than that of NIBL.

- e. The growth ratio of total deposit, loan and advances, total investment and net profit of NIBL are less than that of SBI.

Bajracharya (2006), in “*A Study on Credit Management of Agriculture Development Bank Limited*”, has the main objective to evaluate the lending procedure of ADBL. In addition to this main objective, the study has other specific objectives;

- a. To evaluate the trend of loan investment, collection and outstanding.
- b. To show the achievement of purpose-wise and term-wise loan disbursement, outstanding and collection of ADBL.
- c. To study lending policy, loan recovery procedure, interest rate and discount of ADBL.

The major findings of the study are;

- a. The total investment of development financing increased from Rs. 7.13 billion in FY 057/58 to Rs. 12.85 billion in FY 063/64 registering an annual average growth trend of Rs.0.82 billion or 10.43%.
- b. The total collection of development financing increased from Rs. 5.34 billion in FY 057/58 to Rs. 11.84 billion in FY 063/64 registering an annual average growth trend of Rs. 0.93 billion or 14.22%.
- c. The total outstanding of development financing increased from Rs. 12.89 billion in FY 057/58 to Rs. 22.18 billion in FY 063/64 registering an annual average growth trend of Rs. 1.33 billion or 9.53%.
- d. Actual loan investment/disbursement, collection and outstanding of short-term is gradually increased every year. The lowest percentage of loan collection to disbursement is 76.46% in FY 060/61 and the highest is 87.33% in FY 063/64.

Sejuwal (2007), in “*A Comparative Study on Credit Management of Commercial Banks; with Special Reference to NABIL and SCBNL*”, has the main objective to explore the credit efficiency or inefficiency and its

management in commercial banks. The specific objectives of the study are;

- a. To assess credit practice of selected commercial banks.
- b. To explore the credit efficiency of selected commercial banks.
- c. To explore the relationship with loan and advances, non-performing loan and net profit of selected commercial banks.

The major findings of the study are;

- a. The credit practices of NABIL in terms of total loans to deposit ratio is found to be more than SCBNL (i.e. $0.6298 > 0.3660$). It indicates that NABIL has been strong to mobilize its total deposit as loan.
- b. In terms of interest income to loan and advances ratio, Nabil has mean score of 0.0932 and SCBNL has the mean score of 0.0858. From this point, NABIL Bank has the best performance in earning interest income.
- c. Lending policy of SCBNL with regard to non-performing loan to total loans and advances was found to be the lowest with the mean value with 0.0351 as compare to NABIL Bank. The result indicates that if non-performing loan increases, the overall banking business will be negatively affected.
- d. The ratio of loans and advances to total assets was found greater in NABIL in comparison with SCBNL which shows the good lending performance of NABIL, whereas in terms of loan and advances to current assets ratio, NABIL has highest mean than that of SCBNL, this meant that NABIL has relatively better practice in short term lending.
- e. Lending policy of SCBNL in terms of loan loss provision to total loans and advances was found relatively better than that of NABIL.

Adhikari (2008), in “*Credit Management of Siddhartha Vikash Bank Limited*”, has the main objective to analyze the credit management of the SVBL. The specific objectives of the study are;

- a. To analyze the trends of deposit collection and credit lending.
- b. To assess total amount of loan.

- c. To evaluate the performance of SVBL in terms of liquidity, profitability, sector wise loan, and non-performing loan.
- d. To analyze the capital adequacy of SVBL.

The major findings of the study are;

- a. Deposit collection of SVBL has significantly increasing trend. There is continuous increasing trend from 10 percent to 100 percent.
- b. In all year total fixed deposit has more contribution than other deposit. Then more contribution of saving deposit than that of current and call deposit.
- c. Correlation between deposit and loan disbursement is 0.99. This indicates that these two variables relation is highly positive.
- d. Capital adequacy of the SVBL has sufficient against NRB standard. It indicates that the lending capacity of SVBL is high.
- e. The highest risk of SVBL is in credit risk.

Neupane (2009), in “*Credit Policy Analysis of Commercial Bank with Special reference to Everest Bank Limited*”, has the main objective to find out the credit management position of Everest Bank Limited. The specific objectives of the study are;

- a. To evaluate the various financial ratios of the EBL.
- b. To determine the impact of deposit in liquidity and its effect on lending practices.
- c. To analyze trend of deposit utilization towards loan and advances and net profit.

The major findings of the study are;

- a. Cash and bank balance to current deposit of the bank shows the fluctuating trend during the study period. Similarly, cash and bank balance to interest sensitive ratio of EBL is also in fluctuating trend.
- b. Credit and advance to fixed deposit ratio of EBL is fluctuating trend.

The mean ratio is 2.26 times in the study period. However, non-performing assets to total assets of EBL is in declining trend, whose mean ratio is 0.978%.

- c. The debt to assets ratio of EBL is excessively high or in other words they have excessively geared capital structure. On an average 93% of assets is financed through debt capital that is outsiders cost bearing fund.
- d. Return on loan and advances of EBL is also in fluctuating trend. The mean ratio is 2.2%. This shows the normal earning capacity of EBL.

Satyal (2010), in “*Credit Practices: A Study on NABIL Bank Ltd., SCB Nepal Ltd. and Himalayan Bank Ltd.*”, has the major objective of examining the credit management in the selected banks. The specific objectives of the study are;

- a. To determine the liquidity position, the impact of deposit in liquidity and its effect on credit practices.
- b. To measure the bank's lending strength.
- c. To analyze the portfolio behavior of credit and measure the ratio and volume of lending made in agriculture, priority and productive sector.
- d. To measure the credit performances in quality, efficiency and its contribution in total income.

The major findings of the study are;

- a. The measurement of liquidity has revealed that the mean current ratio of all the three banks is not widely varied. All of them are capable in discharging their current liability by current asset.
- b. SCBNL's tendency to invest in government securities has resulted with the lowest ratio of loans and advances to total assets ratio whereas NABIL Bank Ltd. has highest due to steady and high volume of loans and advances throughout the years.
- c. The loans and advances and investment to deposits ratio has shown that NABIL Bank Ltd. has deployed the highest proportion of its total

deposits in earning activities. This is the indicative of that in fund mobilizing activities NABIL Bank Ltd. is significantly better.

- d. The portfolio analysis has revealed that the flow of loans and advances in agriculture sector is the lowest priority sector among these commercial banks. The contribution of all the banks in industrial sector is appreciable. The contribution made by Himalayan Bank Ltd. in industrial sector is the greatest and that of SCBNL is the least.
- e. The lending in commercial purpose is highest in case of NABIL Bank Ltd. and least in case of SCBNL. SCBNL has highest contribution in service sector lending. It has contributed 25.47 % of its total credit in general use and social purpose.

2.3 Research Gap

All of the above researches, although a good attempt for exploring the loan management, are mainly based on the quantitative analysis and thus ignored the qualitative analysis, which encompasses the difficulties and problems in loan management procedures. Thus, the study has detected this gap and in this study, the researcher tries to enlighten the qualitative factors, primary data analysis, that are essential for loan managements such as whether the borrowers experience paper harassment, the efficiency of bank in loan management and so on, along with the analysis of secondary data.

CHAPTER - III

RESEARCH METHODOLOGY

This chapter is related to the research methodology employed in the entire aspect of the study. Research methodology is a way to systematically solve the problem. In it the various steps that are generally adopted in achieving the objectives of the study are stated.

3.1 Research Design

Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The plan is the overall scheme or program of research. It includes an outline of what the investigator will do from writing the hypothesis and their operational implications to the final analysis of data.

Being an academic research, the purpose of this research is to answer the queries raised and control the variances. Analytical and descriptive research design, a fact finding approach, is followed for accessing the loan management of HBL & EBL. Regression analysis and coefficient of correlation techniques are applied for determining the relationship between the figures of loan and net profit.

3.2 Population and Sample

There exist 32 commercial banks operating in Nepal, which are assumed to be the population of the study. But, it is not possible to study all of these commercial banks within this study. So taking the total number of commercial banks as population of the study, only two commercial banks, namely Himalayan Bank Limited and Everest Bank Limited, have been taken as sample.

3.3 Nature and Sources of Data

To fulfill the predetermined objectives that are set up for the study, both primary and secondary sources are included. The secondary data have been obtained from mainly the annual reports of HBL & EBL. Further, brochures and the official website have also been extensively used to collect the secondary data. However, the primary data have been collected through making questionnaire containing 10 questions, and distributing it to the respondents. Apart from above mentioned sources, relevant data are collected from;

- a. Economic surveys of various years, published Ministry of Finance, Government of Nepal.
- b. Statistical records gathered from Central Bureau of Statistics.
- c. Banking and Financial Statistics published by Nepal Rastra Bank.
- d. Periodicals, bulletins, magazines and other published and unpublished reports of concerned authorities and research works.

3.4 Tools Used

For the processing of data collected, both the financial and statistical tools have been extremely used.

3.4.1 Financial Tools

Under this mainly the ratio analysis that is relevant to the loan management of the bank has been done.

a) Loan Investment to Loan Outstanding

This ratio measures the relationship between the loan investment per year and the total accumulated loan outstanding. A stable policy of loan investment considering the loan outstanding is crucial for sound loan management.

$$\text{Loan Investment to Loan Outstanding} = \frac{\text{Loan Investment}}{\text{Loan Outstanding}}$$

b) Loan Recovery to Loan Outstanding

This ratio measures the relationship between loan recovery and loan outstanding. The ratio reflects the efficiency of the bank in collecting the loan amount disbursed.

$$\text{Loan Recovery to Loan Outstanding} = \frac{\text{Loan Recovered}}{\text{Loan Outstanding}}$$

c) Growth Ratios

Under this, the growth of loan investment, loan outstanding and the loan recovery of RBB have been calculated. This ratio reflects the status of loan management of the bank.

$$\text{Growth Ratio} = \frac{\text{Current Value} - \text{Previous Value}}{\text{Previous Value}} \times 100$$

d) Non-Performing Loan (NPL) to Total Loan

NRB has directed all the commercial banks create loan loss provision against the doubtful and bad debts. But both of our concerned banks have not provided data on non-performing loan in balance sheet and profit & loss account. Non-performing loans to total loan and advances ratio shows the percentage of non-recovery loans in total loans and advances. This ratio is calculated as:

$$\text{NPL to Total Loan} = \frac{\text{Non Performing Loan}}{\text{Total Loan}}$$

e) Loan Loss Provision to Total Loan

Each bank has to keep the loan loss provision for loan and advances as per the direction of Nepal Rastra Bank. The loan loss provision to total loans and advances measures the aggregate percentage of loan loss provision kept by bank on loans and advances and thus eventually measures the security position.

$$\text{Loan Loss Provision to Total Loan} = \frac{\text{Loan Loss Provision}}{\text{Total Loan}}$$

f) Total Loan to Total Deposit

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

$$\text{Total Loan to Total Deposit ratio} = \frac{\text{Total Loan}}{\text{Total Deposit}}$$

3.4.2 Statistical Tools

The analysis could not have been done without using the statistical tools. The following statistical tools have been effectively utilized for data analysis.

a) Mean

Arithmetic mean or simply a mean of set observations is the sum of all the observations divided by the number of observations. Arithmetic mean is also known as the arithmetic average.

Let $x_1, x_2, x_3, \dots, x_n$ be the n values of the variable then their arithmetic mean be denoted by \bar{x} is defined by,

$$\bar{x} = \frac{x_1 + x_2 + x_3 + \dots + x_n}{n}$$

Where, n is the number of observations.

b) Standard Deviation

The standard deviation is the absolute measure of dispersion in which the drawbacks present in other measures of dispersion are removed. It is said to be the best measure of dispersion as it satisfies most of the requisites of a good measure of dispersion.

$$\text{s.d.} = \sqrt{\frac{\sum (x - \bar{x})^2}{N}}$$

c) Coefficient of Variation

The coefficient of dispersion based on standard deviation multiplied by 100 is known as the coefficient of variation (C.V.). Less the C.V., more will be the uniformity and more the C.V., less will be uniformity. If \bar{x} be the arithmetic mean and s.d the standard deviation of the distribution, then the C.V. is defined by,

$$\text{C.V. \%} = \frac{\text{S.D.}}{\text{Mean}} \times 100$$

d) Karl Pearson's Correlation Coefficient

Two values are said to have 'correlation', when they are so related that the change in the value of one variable is accompanied by the change in the value of the other. One of the widely used mathematical methods of calculating the correlation coefficient between two variables is Karl Pearson's correlation coefficient 'r'. It is calculated as;

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

where,

r = correlation coefficient

N = Number of observed years

X = Sum of X Series

Y = Sum of Y Series

if r is closer to +1, high degree of +ve correlation

if r is closer to -1, high degree of -ve correlation

if r is closer to 0, low degree of either +ve or -ve correlation

e) Probable Error

The probable error denoted by P.E. is used to measure the reliability and test of significance of correlation coefficient. Significance of relationship has been tested by using the probable error (P.E.) and it is denoted by the following model:

$$\text{Probable Error (P.E.)} = 0.6745X \frac{1 - r^2}{\sqrt{n}}$$

Where, r = the value of correlation coefficient

n = number of pairs of observations

if $r < \text{P.E.}$, it is insignificant, i.e. there is no evidence of correlation

if $r > 6 \text{ P.E.}$, it is significant

if $\text{P.E.} < r < 6 \text{ P.E.}$, nothing can be concluded

f) Regression Lines

The regression line is the line that gives the best estimate of one variable for any given value of the other variable. The simple regression equation of dependent variable (Y) on the independent variable (X) is given by;

$$y = a + bx$$

We shall get the normal equation for estimating “a” and “b” as.

$$\sum X = Na + b \sum Y$$

$$\sum XY = a \sum Y + b \sum Y^2$$

Where,

X = the value of independent variable

Y = the value of dependent variable

a = Y-intercept

b = slope of the trend line/coefficient of regression

N = number of pairs of observations.

g) Trend Analysis

A widely and most commonly used method to describe the trend is the method of least square. Let the trend line between the dependent variable y and the independent variable x (i.e. time) be represented by;

$$Y_c = a + bx \dots\dots\dots (i)$$

Where,

$a = y$ intercept or value of y when $x = 0$

$b =$ slope of the trend line or amount of change that comes in y of a unit change in x .

To find the value of x and y , the following equations should be solved;

$$y = na + b x \dots\dots\dots (ii)$$

$$xy = a x + b x^2 \dots\dots\dots (iii)$$

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

This section is the main part of the study and achieves the objectives set out in the first chapter. Further, both the statistical and financial tools stated in the third chapter are efficiently used in this chapter to accomplish the goal of the study. In this chapter, both the primary and secondary data collected have been analyzed and at the findings have been drawn at the end of this section.

4.1 Secondary Data Analysis

In this part of the study, the secondary data that are related to the loan and extracted from mainly the annual reports of the bank have been analyzed. Different ratios that reflect the loan management of HBL & EBL has been introduced. Further, the statistical relationship between loan and advances and other major financial indicators have been analyzed. In addition, the values of loan and advances and other have been estimated in the forthcoming four fiscal years.

4.1.1 Loan Investment to Loan Outstanding

This ratio measures the relationship between loan investment with loan outstanding and shows by how much extent the loan outstanding is greater than the loan investment. The ratio also signals the trend of loan investment and loan outstanding. The loan investment to loan outstanding of HBL & EBL is presented in the Table 4.1.

Table 4.1
Loan Investment to Loan Outstanding (Rs. in Millions)

HBL				EBL			
FY	LI	LO	Ratio	FY	LI	LO	Ratio
2006/07	52633.24	15761.98	3.34	2006/07	41745.00	10136.25	4.12
2007/08	61253.25	17793.72	3.44	2007/08	57544.40	14082.68	4.09
2008/09	83425.69	20179.61	4.13	2008/09	92397.50	18836.43	4.91
2009/10	127252.01	25519.52	4.99	2009/10	119966.50	24469.55	4.90
2010/11	153291.24	29123.75	5.26	2010/11	160383.50	28156.40	5.70
Mean			4.23	Mean			4.74
S.D.			0.78	S.D.			0.60
C.V.%			18.49	C.V.%			12.59

(Source: Appendix II)

The Table 4.1 showed the status of loan investment and loan outstanding of HBL and EBL in five-fiscal year periods. In HBL, the ratio of loan investment to loan outstanding was in increasing trend. This clearly indicated that the increment in loan investment is higher than the rise in loan outstanding. Clearly, the loan investment of the bank ranged from Rs. 52633.24 millions in the fiscal year 2006/07 to Rs. 153291.24 millions in the fiscal year 2010/11 and loan outstanding ranged from Rs. 15761.98 millions in the fiscal year 2006/07 to Rs. 29123.75 millions in the fiscal year 2010/11. Alike loan investment, the loan outstanding followed increasing trend in the five-fiscal year periods but not the same extent the loan investment has followed, thus indicating good loan recovery. Consequently, the ratio of loan investment to loan outstanding of the bank was 3.34 times, 3.44 times, 4.13 times, 4.99 times and 5.26 times in the fiscal year 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. In the five-fiscal year periods, the average loan investment to loan outstanding was 4.23 times and the coefficient of variation in the ratio is 18.49%, indicating inconsistency.

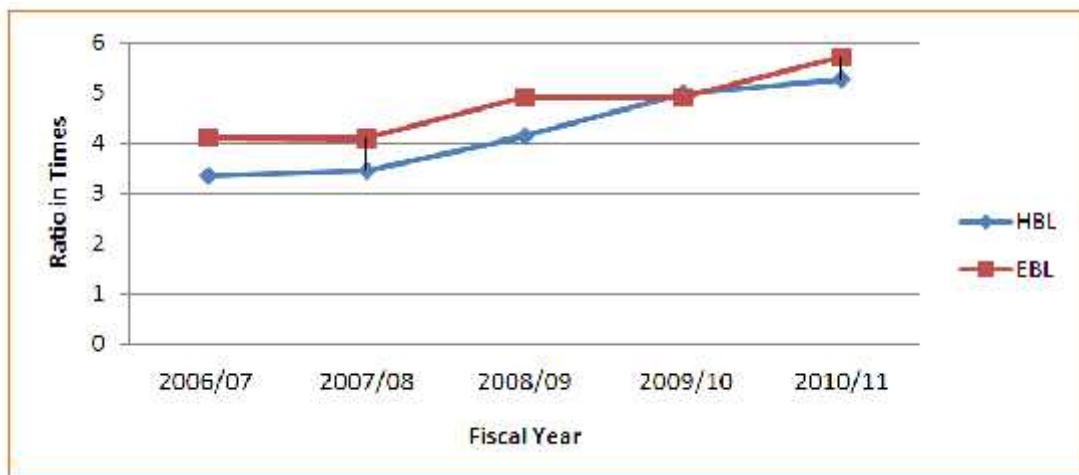
In contrast, both the loan investment and loan outstanding of EBL in the five-year periods was found to be in increasing trend. Thus, the loan investment

ranged from Rs. 41745.00 millions in the fiscal year 2006/07 to Rs. 160383.50 millions in the fiscal year 2010/11 and the loan outstanding was lowest, Rs. 10136.25 millions, in the fiscal year 2006/07 and highest, Rs. 28156.40 millions, in the fiscal year 2010/11. The ratio of loan investment to loan outstanding of EBL within these periods was, however, found to be in fluctuating trend. The ratio was 4.12 times, 4.09 times, 4.91 times, 4.90 times and 5.70 times in the fiscal year 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. The average ratio within these periods is 4.74 times and the coefficient of variation in the ratio is 12.59%.

Comparing two banks, it can be concluded that EBL disbursed more loan in proportion to loan outstanding in the five years periods than HBL did. Although the increment in loan outstanding due to the increment in loan investment is palpable, the trend of loan investment to loan outstanding of EBL was in fluctuating trend. This seemed that EBL lacks appropriate loan investment policy. Thus, a sound credit policy is germane to HBL & EBL to prevent the credit risk.

Figure 4.1

Loan Investment to Loan Outstanding



4.1.2 Loan Recovery to Loan Investment

The loan recovery to loan investment depicts the amount of the recovery made by the bank out of the total investment made in each fiscal year. This ratio measures the banks' efficiency in collection at speed. The loan recovery to loan investment of HBL & EBL is presented in the Table 4.2.

Table 4.2

Loan Recovery to Loan Investment (Rs. in Millions)

HBL				EBL			
FY	LR	LI	Ratio	FY	LR	LI	Ratio
2006/07	32269.81	52633.24	61.31	2006/07	39490.10	41745.00	94.60
2007/08	52424.35	61253.25	85.59	2007/08	53599.90	57544.40	93.15
2008/09	70124.87	83425.69	84.06	2008/09	87643.80	92397.50	94.86
2009/10	100291.35	127252.01	78.81	2009/10	114333.30	119966.50	95.30
2010/11	119253.68	153291.24	77.80	2010/11	156696.70	160383.50	97.70
Mean			77.51	Mean			95.12
S.D.			8.63	S.D.			1.48
C.V.%			11.13	C.V.%			1.55

(Source: Appendix II)

The Table 4.2 showed the efficiency of bank in recovering loan in proportion to loan investment within the observed periods. The table depicted that the loan recovered amount of HBL was in increasing trend. HBL recovered highest amount of Rs. 119253.68 millions in the fiscal year 2010/11 and lowest amount of Rs. 32269.81 millions in the fiscal year 2006/07. Unlike the loan recovered amount, the ratio of loan recovery to loan investment within the previous five year periods is in fluctuating trend, indicating that the bank could not recovered the loan in the same speed that it has granted loan. The ratio was 61.31% in the fiscal year 2006/07, which increased to 85.59% in the fiscal year 2007/08, then decreased to 84.06% in the fiscal year 2008/09, again decreased to 78.81% in the fiscal year 2009/10, and finally reached to 77.80% in the fiscal year 2010/11. In average, the bank recovered 77.51% of the total loan investment

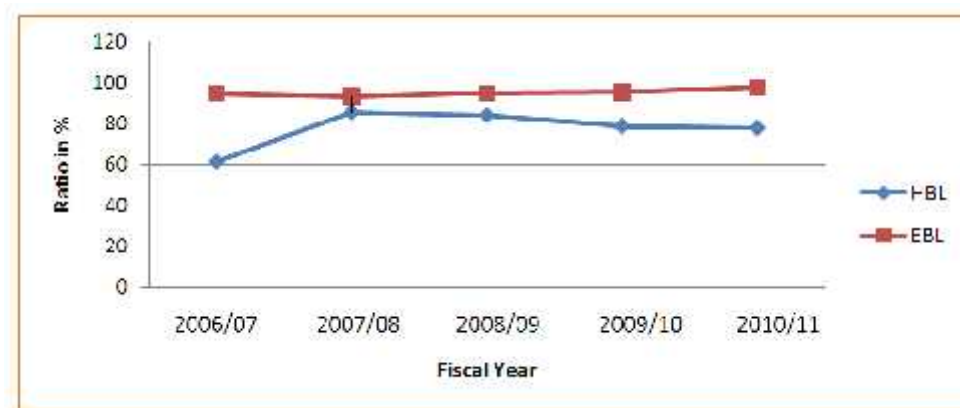
within these five year periods, and the coefficient of variation in the ratio is 11.13%, indicating quite consistency.

Similarly, the loan recovery amount of EBL in the five year periods was in increasing trend. EBL recovered Rs. 156696.70 millions, highest, in the fiscal year 2010/11 and Rs. 39490.10 millions, lowest, in the fiscal year 2006/07. Likewise, except in the fiscal year 2007/08, the ratio of loan recovery to loan outstanding of EBL within the five year periods was in increasing trend. The ratio was 94.60% in the fiscal year 2006/07, which decreased to 93.15% in the fiscal year 2007/08, then increased to 94.86% in the fiscal year 2008/09, again increased to 95.30% in the fiscal year 2009/10 and finally reached to 97.70% in the fiscal year 2010/11. In average, the ratio is 95.12%, and the coefficient of variation in the ratio is 1.55%, indicating uniformity in the ratio.

Comparing two banks, it can be concluded that the loan recovery position of EBL in proportion to loan investment was better than that of HBL. In other word, it can be undoubtedly said that the loan recovery policy of EBL is satisfactory, however, that of HBL needs to be amended. Thus, it is inevitably necessary for HBL to formulate a sound recovery policy to prevent the chances of default loan in great extent.

Figure 4.2

Loan Recovery to Loan Investment



4.1.3 Growth Analysis

To know the banks' efficiency in raising loan investment, raising loan recovery and lowering loan outstanding, the growth analysis have been done.

4.1.3.1 Loan Investment Growth

The higher the loan investment made by banks indicates higher interest earning capacity of the bank. So, the higher loan investment is considered better. The growth in loan investment made by EBL & HBL has been presented in the Table 4.3.

Table 4.3
Loan Investment Growth (Rs. in Millions)

HBL			EBL		
FY	LI	Growth %	FY	LI	Growth %
2006/07	52633.24	----	2006/07	41745.00	----
2007/08	61253.25	16.38	2007/08	57544.40	37.85
2008/09	83425.69	36.20	2008/09	92397.50	60.57
2009/10	127252.01	52.53	2009/10	119966.50	29.84
2010/11	153291.24	20.46	2010/11	160383.50	33.69
Mean		31.39	Mean		40.49
S.D.		14.27	S.D.		11.94
C.V.%		45.47	C.V.%		29.48

(Source: Appendix II)

The Table 4.3 showed the loan disbursement growth in the observed periods of two banks. The table depicted that the loan disbursement of HBL was initially Rs. 52633.24 millions in the fiscal year 2006/07, which increased by 16.38% in the fiscal year 2007/08 and thus reached to Rs. 61253.25 millions with the increment by 36.20% in the fiscal year 2008/09, and increased by 52.53% in the fiscal year 2008/09, amounting to Rs. 83425.69 millions, and finally increased by 20.46% in the fiscal year 2010/11, amounting to Rs. 153291.24 millions, within the previous five year periods. In average, the loan investment of HBL for the observed five year periods rose by 31.39% and the coefficient of variation in the loan investment growth for that period is 45.47%, indicating inconsistency.

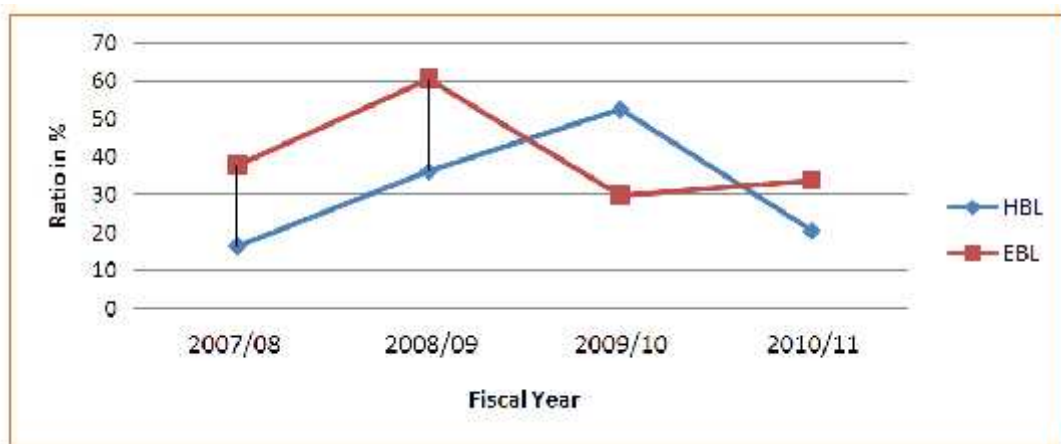
Further, the loan investment of EBL followed increasing trend. The loan investment of EBL was Rs. 41475 millions in the fiscal year 2006/07, which

increased by 37.85% in the fiscal year 2007/08, and thus amounted to Rs. 57544.40 millions, and then increased by 60.57% in the fiscal year 2008/09, amounting Rs. 92397.50 millions, again increased by 29.84% in the fiscal year 2009/10, amounting Rs. 119966.50 millions, and finally increased by 33.69% in the fiscal year 2010/11, amounting Rs. 160383.50 millions. Thus, the loan investment growth was highest in the fiscal year 2008/09 and lowest in the fiscal year 2009/10. In average, the loan investment of EBL grew by 40.49% within the five year periods.

Comparing the two distinct periods, it can be concluded that the growth of loan investment was greater in previous five year periods than in current five year periods. In overall, the loan investment of bank grew by 126.36% within the ten year periods, and the coefficient of variation in the growth was 188.28%. It would have been better if the bank had considered the greater chances of earning high interest along with the increment in loan investment.

Figure 4.3

Loan Investment Growth



4.1.3.2 Loan Outstanding Growth

The higher loan outstanding means higher possibility of turning bank loan into bad debt and the inefficiency of bank in recovering loan in time. So, lower the outstanding lower will be the risk of bad debt. The loan outstanding growth of HBL & EBL is presented in Table 4.4.

Table 4.4
Loan Outstanding Growth (Rs. in Millions)

HBL			EBL		
FY	LO	Growth %	FY	LO	Growth %
2006/07	15761.98	----	2006/07	10136.25	----
2007/08	17793.72	12.89	2007/08	14082.68	38.93
2008/09	20179.61	13.41	2008/09	18836.43	33.76
2009/10	25519.52	26.46	2009/10	24469.55	29.91
2010/11	29123.75	14.12	2010/11	28156.40	15.07
Mean		16.72	Mean		29.42
S.D.		5.64	S.D.		8.88
C.V.%		33.74	C.V.%		30.19

(Source: Appendix II)

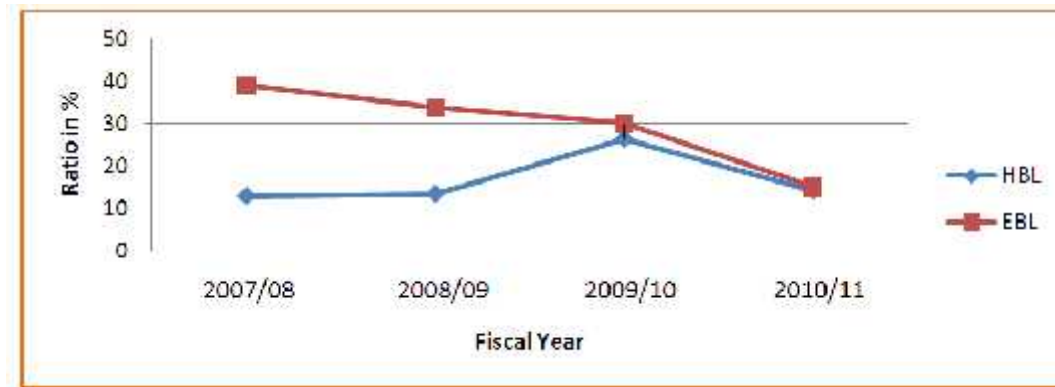
The Table 4.4 showed the growth of loan outstanding in HBL & EBL for the five year periods. The loan outstanding growth of HBL was in increasing trend. The loan outstanding of HBL was Rs. 15761.98 millions in the fiscal year 2006/07, which increased by 12.89% in the fiscal year 2007/08, again increased by 13.41% in the fiscal year 2008/09, 26.46% in the fiscal year 2009/10 and by 14.12% in the fiscal year 2010/11. The table depicted that the loan outstanding of HBL increased by 16.72% in average within the observed periods, and the coefficient of variation in such increment is 33.74%.

Similarly, the loan outstanding of EBL was also in increasing trend. The loan outstanding ranged from Rs. 10136.25 millions in the fiscal year 2006/07 to Rs. 28156.40 millions in the fiscal year 2010/11. The growth of loan outstanding in the five year periods is 38.93%, 33.76%, 29.91% and 15.07% in the fiscal year 2007/08, 2008/09, 2009/10 and 2010/11 respectively. In average, the loan outstanding of EBL increased by 29.42%, indicating inefficiency of the bank in recovering loan, and the coefficient of variation in the increment is 30.19%.

Comparing the two distinct periods on the basis of loan outstanding growth, it can be concluded that HBL was superior to EBL in controlling the growth rate

of loan outstanding, since the average growth of HBL was lower than that of EBL. However, both the banks need to have sound recovery policy to decrease the outstanding loan and increase the loan investment.

Figure 4.4
Loan Outstanding Growth



4.1.3.3 Loan Recovery Growth

The duty of bank does not end only by disbursing loan. The bank should do equal exercise in loan recovery and reduce the chances of bad debt. The higher loan recovery indicates higher efficiency on bank in loan management. The growth in loan recovery of HBL & EBL taken for study for the five year periods is presented in the Table 4.5.

Table 4.5
Loan Recovery Growth (Rs. in Millions)

HBL			EBL		
FY	LR	Growth %	FY	LR	Growth %
2006/07	32269.81	----	2006/07	39490.10	----
2007/08	52424.35	62.46	2007/08	53599.90	35.73
2008/09	70124.87	33.76	2008/09	87643.80	63.51
2009/10	100291.35	43.02	2009/10	114333.30	30.45
2010/11	119253.68	18.91	2010/11	156696.70	37.05
Mean		39.54	Mean		41.69
S.D.		15.78	S.D.		12.84
C.V.%		39.92	C.V.%		30.80

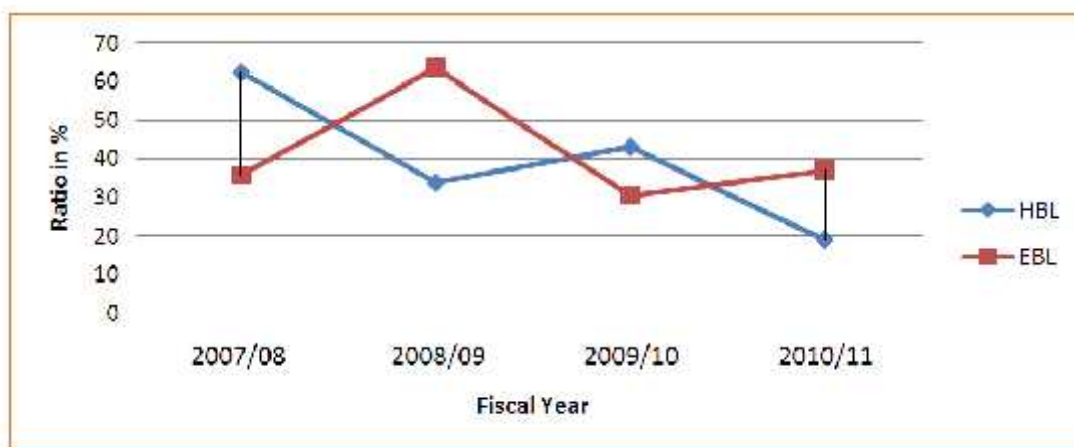
(Source: Appendix II)

The Table 4.5 showed the efficiency of HBL & EBL in recovering the disbursed loan. For the five year periods, the loan recovery amount of HBL was highest, Rs. 119253.68 millions, in the fiscal year 2010/11, and lowest, Rs. 32269.81 millions, in the fiscal year 2006/07. However, the growth rate of recovered loan amount is not uniform. The loan recovery drastically increased by 62.46% in the fiscal year 2007/08, and then increased by 33.76% in the fiscal year 2008/09, again increased by 43.02% in the fiscal year 2009/10 and finally increased by 18.91% in the fiscal year 2010/11. In average, the loan recovery for the five years of HBL grew by 39.54%, which is quite satisfactory, but the bank should also considered that in most of the year the loan recovery growth rate is lower than growth rate in previous year.

Similarly, the loan recovery amount for the five year periods of EBL ranged from Rs. 39490.10 millions in the fiscal year 2006/07 to Rs. 156696.70 millions in the fiscal year 2010/11. Unlike the loan recovery amount, the loan recovery growth rate has, however, fluctuated during the periods. The loan recovery growth rate was 35.73%, 63.51%, 30.45% and 37.05% in the fiscal year 2007/08, 2008/09, 2009/10 and 2010/11 respectively. Within these periods, the average collection growth is 41.69%, which was quite progressive.

Comparing the two banks, it can be concluded that EBL is more success in recovering the disbursed loan in the five year periods than HBL. Consequently, the average growth rate of loan recovery for the five year periods of HBL is higher than that of EBL. Thus, it implies that HBL needs a strong collection policy to compete in the market.

Figure 4.5
Loan Recovery Growth



4.1.4 Non-Performing Loan Analysis

Bad debt and non-performing loan do not have same meaning. They have some fundamental differences in their meaning. Non-performing loan can be debt but debt cannot be non-performing loan. Non-performing loan represents the loan that remained unpaid after loan due date. Greater the non-performing loan, the greater will be the credit risk.

4.1.4.1 Non-Performing Loan to Total Loan

The non-performing loan to total loan measures the credit risk of the bank. Higher the ratio indicates high coverage of non-performing loan on total loan and thus indicates high credit risk, which may jeopardize the sustainability of the bank.

Table 4.6**Non-Performing Loan to Total Loan (Rs. in Millions)**

HBL				EBL			
FY	NPL	LA	Ratio	FY	NPL	LA	Ratio
2006/07	1040.76	15761.98	6.60	2006/07	129.23	10136.25	1.27
2007/08	641.61	17793.72	3.61	2007/08	113.18	14082.68	0.80
2008/09	477.23	20179.61	2.36	2008/09	127.31	18836.43	0.68
2009/10	551.31	25519.52	2.16	2009/10	117.98	24469.55	0.48
2010/11	1024.83	29123.75	3.52	2010/11	43.71	28156.40	0.16
Mean			3.65	Mean			0.68
S.D.			1.59	S.D.			0.37
C.V.%			43.50	C.V.%			54.51

(Source: Appendix II)

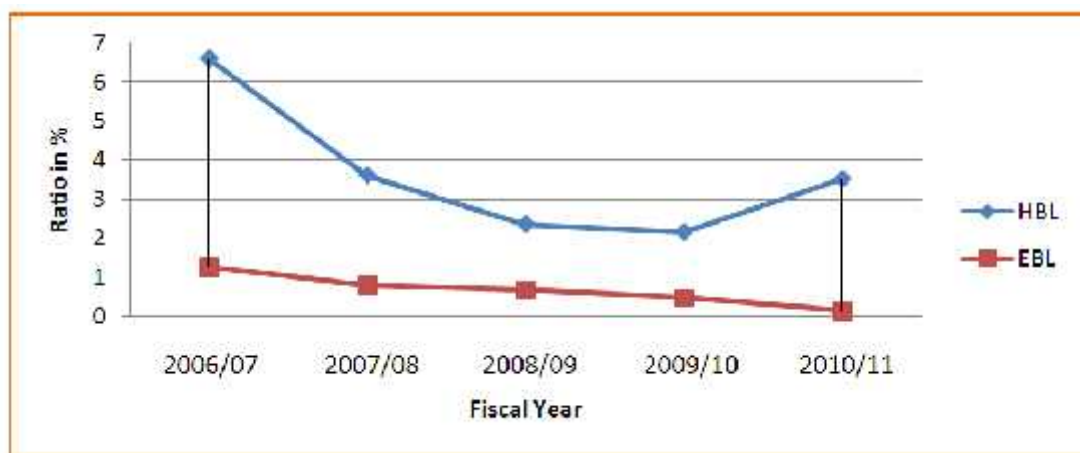
The Table 4.6 depicted the ratio of non-performing loan to total loan to measure the loan situation of the observed banks. The table showed that the non-performing loan of HBL is in fluctuating trend and thus ranged from Rs. 477.23 millions in the fiscal year 2008/09 to Rs. 1040.76 millions in the fiscal year 2006/07. However, the ratio of non-performing loan to total was in increasing trend for the first four years. The ratio is 6.60% in the fiscal year 2006/07, 3.61% in the fiscal year 2007/08, 2.36% in the fiscal year 2008/09, 2.16% in the fiscal year 2009/10 and 3.52% in the fiscal year 2010/11. From this it can be inferred that the portion of performing loan is in increasing trend and thus the loan of HBL is ameliorated. In average, the non-performing loan covered 3.65% of the total loan, which indicated low risk in the loan.

Similarly, the ratio of non-performing loan to total loan of for the five year periods of EBL was in decreasing trend, which is quite good. The non performing loan, along with the ratio of non-performing loan to total, also followed decreasing trend in most of the years and thus decreased to Rs. 43.71 millions in the fiscal year 2010/11 from Rs. 129.23 millions in the fiscal year 2006/07. Further, the ratio of non-performing loan to total loan of EBL was

1.27%, 0.80%, 0.68%, 0.48% and 0.16% in the fiscal year 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. The decreasing trend of both the non performing amount and ratio indicated an enhancement in the lending procedures of EBL in the five year periods. In average, the non-performing loan represented only 0.68% of the total loan.

Comparing the banks, it can be concluded that the lower portion of the loan turned to non-performing loan in EBL than in HBL. Hence, EBL ameliorated the composition of loan in greater extent than HBL did. As a result the credit risk in loan disbursed is lower in EBL in comparison to that in HBL.

Figure 4.6
Non-Performing Loan to Total Loan



4.1.4.2 Loan Loss Provision to Total Loan and Advances Ratio

As per the NRB directives, each commercial bank has to keep 1% of the performing loan, 25% of the sub-standard loan, 50% of the doubtful loan and 100% of the loss loan as loan loss provision. This loan loss provision to total loan and advances measures the credit risk of the bank. The higher the ratio, the greater will be the credit risk.

Table 4.7**Loan Loss Provision to Total Loan and Advances Ratio (Rs. in Millions)**

HBL				EBL			
FY	LLP	LA	Ratio	FY	LLP	LA	Ratio
2006/07	1119.42	15761.98	7.10	2006/07	334.94	10136.25	3.30
2007/08	795.72	17793.72	4.47	2007/08	418.60	14082.68	2.97
2008/09	682.09	20179.61	3.38	2008/09	497.34	18836.43	2.64
2009/10	726.36	25519.52	2.85	2009/10	584.88	24469.55	2.39
2010/11	1143.13	29123.75	3.93	2010/11	600.04	28156.40	2.13
Mean			4.35	Mean			2.69
S.D.			1.48	S.D.			0.42
C.V.%			34.09	C.V.%			15.45

(Source: Appendix II)

The Table 4.7 measured the credit risk of the sampled banks. The table showed that the loan loss provision kept in proportion to total loan and advance within the five years periods of HBL was in decreasing trend in the first four fiscal years. Clearly, the conversion of sub standard loan and doubtful loan to loss loan was in decrement within this period. The loan loss provision to total loan of HBL was 7.10%, 4.47%, 3.38%, 2.85% and 3.93% in the fiscal year 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. In average, HBL kept 4.35% of the total loan as loan loss provision within the first five year periods. And the loan loss provision amount in this period ranged from Rs. 682.09 millions in the fiscal year 2008/09 to Rs. 1143.13 millions in the fiscal year 2010/11.

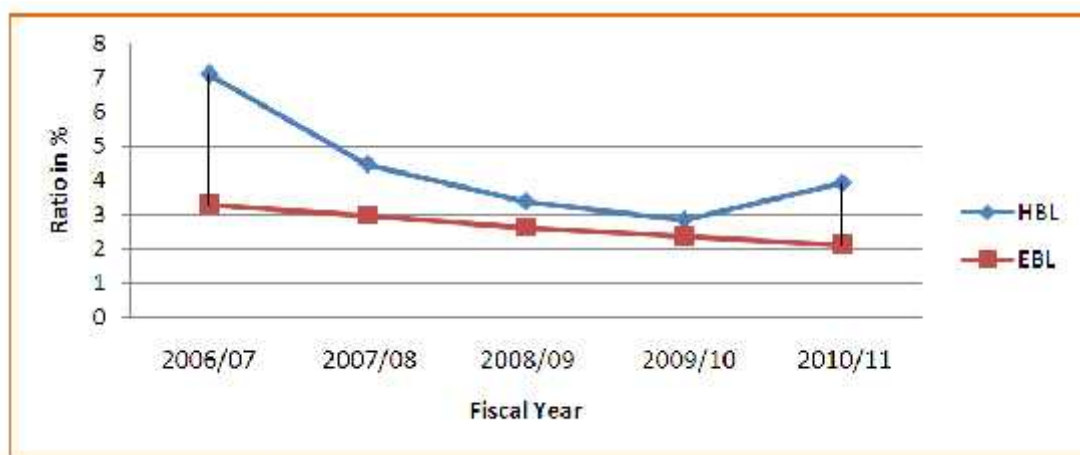
Likewise, the loan loss provision to total loan in the five year periods of EBL has persistently followed decreasing trend, which indicated the proportion of performing loan, sub standard loan and doubtful loan were in decreasing trend, and thus lowering the chances of default loan. Further, the loan loss provision amount ranged from Rs. 334.94 millions in the fiscal year 2006/07 to Rs. 600.04 millions in the fiscal year 2010/11. The loan loss provision to total loan was 3.30%, 2.97%, 2.64%, 2.39% and 2.13% in the fiscal year 2006/07,

2007/08, 2008/09, 2009/10 and 2010/11 respectively. And the average ratio within this period was 2.69%, and the coefficient of variation is 15.45%.

Comparing two periods, it can be concluded that the credit risk of EBL was lower in comparison to that in HBL. It would be worthwhile, if HBL adopts sound loan management policy to reduce the loss loan and to convert non performing loan to performing loan.

Figure 4.7

Loan Loss Provision to Total Loan and Advances Ratio



4.1.5 Deposit Mobilization on Loan and Advances

Loan and advances is considered as the major source of income of the bank. The greater the bank invests the funds in loan and advances, the higher will be the chance of earning interest, if the credit risk is low. Thus, to examine the mobilization rate of collected deposit in loan and advances the ratio has been calculated.

Table 4.8**Loan and Advances to Total Deposit (Rs. in Millions)**

HBL				EBL			
FY	LA	TD	Ratio	FY	LA	TD	Ratio
2006/07	15761.98	26490.85	59.50	2006/07	10136.25	13802.44	73.44
2007/08	17793.72	30048.42	59.22	2007/08	14082.68	18186.25	77.44
2008/09	20179.61	31842.79	63.37	2008/09	18836.43	23976.30	78.56
2009/10	25519.52	34681.34	73.58	2009/10	24469.55	33322.95	73.43
2010/11	29123.75	37611.20	77.43	2010/11	28156.40	36932.31	76.24
Mean			66.62	Mean			75.82
S.D.			7.50	S.D.			2.08
C.V.%			11.26	C.V.%			2.75

(Source: Appendix II)

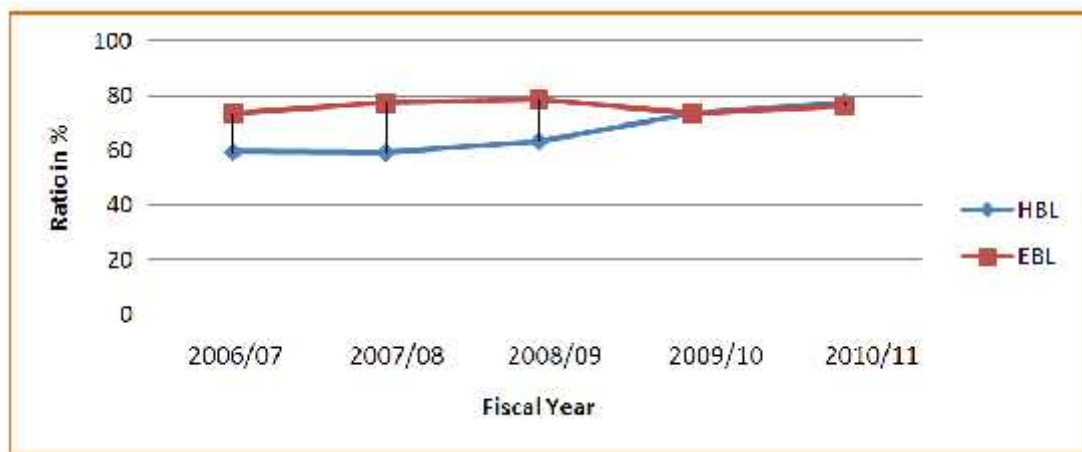
The Table 4.8 measured the mobilization of total deposit in loan and advances. The table showed that both loan and advances and the total deposit collection of HBL were in increasing trend. The deposit collection amount ranged from Rs. 26490.85 millions in the fiscal year 2006/07 to Rs. 37611.20 millions in the fiscal year 2010/11. Moreover, the mobilization of deposit in loan and advances of the bank had been in increasing trend in most of the years. The total loan and advances to total deposit of HBL in such period was 59.50%, 59.22%, 63.37%, 73.58% and 77.43% in the fiscal year 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. In average, HBL mobilized 66.62% of the total collected deposit in granting loan and advances. Also, the coefficient of variation in the ratio in the five year periods is 11.26%, indicating quite uniformity in the ratio.

However, the mobilization rate of total deposit in loan and advances increased for the first three years and then oscillated in the remaining years, although the deposit collection amount was in increasing trend, ranging from Rs. 10136.25 millions in the fiscal year 2006/07 to Rs. 36932.31 millions in the fiscal year 2010/11. The mobilization ratio was 73.44% in the fiscal year 2006/07, 77.44% in the fiscal year 2007/08, 78.56% in the fiscal year 2008/09, 73.43% in the

fiscal year 2009/10 and 76.24% in the fiscal year 2010/11. The lower ratio in the fiscal year 2009/10 compared to the previous fiscal year indicated that the bank gave more consideration to other investment sectors in that year. However, the coverage of loan and advances on total deposit was significant. As a result, EBL mobilized 75.82% of the total deposit in disbursing loan.

Comparing to two banks, it can be concluded that the deposit mobilization rate of EBL in loan and advances was more than that of HBL. Further, it can be inferred that lending loan is the major utilization of the collected deposit of both the banks.

Figure 4.8
Loan and Advances to Total Deposit



4.1.6 Statistical Analysis

In this part of the study, the simple correlation and regression analysis, and the trend value of variables, which reflect the loan management of the bank, have been determined.

4.1.6.1 Correlation Analysis

To investigate the synchronization of loan & advances with net profit, with total deposit, with total investment, and with non performing loan, the Karl Pearson’s correlation coefficient (r) has been determined.

4.1.6.1.1 Correlation Analysis between Net Profit & Loan and advances

To determine the relationship between net profit and loan and advances, the correlation between them has been calculated. Further, the relationship derived has been tested by using probable error.

Table 4.9

Correlation Analysis between Net profit & Loan & Adv.

Bank	r	r²	P.E.	6 P.E.	Remarks
HBL	0.4111	0.1690	0.2507	1.5039	Insignificant
EBL	0.9871	0.9744	0.0077	0.0464	Significant

(Source: Appendix III)

The Table 4.9 showed that the relationship between net profit after tax and loan and advances was positive. The correlation coefficient between these two variables was 0.4111 in HBL and 0.9871 in EBL. Similarly, the coefficient of determination was 0.1690 in HBL, which indicated that 16.90% change in the net profit of HBL was explained by the change in loan and advances, and the coefficient of determination of EBL was 0.9744, which indicated that 97.44% change in the net profit of EBL was reflected by change in loan and advances. Further, the calculated probable error in the relation was 0.2507 in HBL and 0.0077 in HBL. Since, the correlation coefficient between net profit and total loan was lower than the calculated 6 P.E., [i.e. $r (0.4111) < 6 \text{ P.E. } (1.5039)$] in HBL, the relationship between net profit and total loan was statistically insignificant and thus it was not necessary that net profit should increase with the increase in loan and advances and vice versa. However, the change in the loan and advance has statistically significant impact on the net profit, as the correlation coefficient between the aforementioned variables is higher than the calculated 6 P.E. [i.e. $r (0.9871) > 6 \text{ P.E. } (0.0464)$].

4.1.6.1.2 Correlation Analysis between Loan & Advances & Total Deposit

A bank needs to have good synchronization between loan and advances and total deposit to effectively mobilize the fund collected. To measure the degree

of relationship between these two variables, the correlation coefficient has been determined.

Table 4.10

Correlation Analysis between Loan & Advances and Total Deposit

Bank	r	r²	P.E.	6 P.E.	Remarks
HBL	0.9795	0.9594	0.0122	0.0734	Significant
EBL	0.9971	0.9942	0.0017	0.0104	Significant

(Source: Appendix III)

The Table 4.10 showed that there was high positive relationship between loan and advances and total deposit of HBL & EBL, since the correlation coefficient between these two variables was 0.9795 in HBL and 0.9971 in EBL. Further, the coefficient of determination indicated that 95.94% variation and 99.42% variation in loan and advance of HBL and EBL respectively was caused by change in total deposit. In addition, the calculated value of probable error and 6 P.E. were 0.0122 and 0.0734 respectively in HBL, and were 0.0017 and 0.0104 respectively in EBL. Moreover, the higher value of 'r' than the 6 P.E. in HBL ($r = 0.9795 > 6 \text{ P.E.} = 0.0734$) and in EBL ($r = 0.9971 > 6 \text{ P.E.} = 0.0104$) indicated that the relationship between total deposit and loan and advances was statistically significant. Hence, it can be concluded that the loan and advances is highly dependent on the collected deposit.

4.1.6.1.3 Correlation Analysis between Loan & Advances and Investment

A bank needs good investment policy and lending policy to reap greater amount of profit. Thus, to test whether these two variables are interrelated, the correlation between them has been tested.

Table 4.11

Correlation Analysis between Loan & Advances and Total Investment

Bank	r	r²	P.E.	6 P.E.	Remarks
HBL	-0.7358	0.5414	0.1383	0.8300	Insignificant
EBL	0.6799	0.4622	0.1622	0.9733	Insignificant

(Source: Appendix III)

The Table 4.11 presented the relationship between loan and advances and total investment. The correlation coefficient of -0.7358 indicated that there was negative relationship between these two variables in HBL and the correlation coefficient of 0.6799 indicated that there was moderate positive relationship between the variables in EBL. Since the absolute value of 'r' was lower than the 6 P.E. in HBL ($r = -0.7358 < 6 \text{ P.E.} = 0.8300$) and in EBL ($r = 0.6799 < 6 \text{ P.E.} = 0.9733$), the relationship between these two variables is statistically insignificant. Thus, loan and advances is not dependent on investment.

4.1.6.1.4 Correlation Analysis between Non-Performing Loan and Loan & Advances

Lower the non performing loan is considered better for the bank and to have sound earning capacity. To test whether there exist any relation between non-performing loan and loan and advances, the correlation coefficient has been calculated and tested through probable error.

Table 4.12
Correlation Analysis between Non-Performing Loan and Loan & Advances

Bank	r	r²	P.E.	6 P.E.	Remarks
HBL	0.0664	0.0044	0.3003	1.8019	Insignificant
EBL	-0.7158	0.5124	0.1471	0.8825	Insignificant

(Source: Appendix III)

Similarly, the Table 4.12 showed that non-performing loan had low positive relationship in HBL, indicating trivial impact of loan and advances on non performing loan, and inverse relationship with loan and advances in EBL, indicating NPL decreases/increases with the increase/decrease of loan and advances. The correlation coefficient between these two variables was 0.0664 in HBL and -0.7158 in EBL. However, since the absolute value of 'r' was lower than the 6 P.E. in both HBL ($|r| = 0.0664 < 6 \text{ P.E.} = 1.8019$) and EBL ($|r| = 0.7158 < 6 \text{ P.E.} = 0.8825$), the relationship between these two variables was insignificant. Hence, granting loan and advances is not the sole cause for non-

performing loan, and thus other factors are equally responsible for non-performing loan.

4.1.6.2 Regression Analysis

The regression analysis computes by what amount the dependent variable will fluctuate on per unit changes on the independent variable. Under this analysis, the regression line of net profit on loan and advances, loan and advances on total deposit, loan and advances on total investment, and non performing assets on loan and advances have been calculated.

4.1.6.2.1 Regression Analysis of Net Profit on Loan & Advances

Let net profit be the dependent variable on loan and advances disbursed, independent variable. Then the regression equation calculated by assuming this relation is presented in the table below.

Table 4.13

Regression Analysis of Net profit (Y) on Loan & Advances (X)

Bank	a	b	Regression Equation
HBL	371.68	0.01	$Y = 371.68 + 0.01 X$
EBL	-140.23	0.03	$Y = -140.23 + 0.03 X$

(Source: Appendix III)

The Table 4.13 shows the relationship of net profit on loan and advances. The table depicts that the net profit has positive relationship with the total loan, which clearly indicates the satisfactory management of HBL & EBL in loan, and thus the interest amount from the loan disbursed is the major source of income, and ultimately the interest increases the net profit of the bank. The regression line shows that if other thing remains constant, the net profit of the HBL increases by Rs. 0.01 and the net profit of EBL increases by Rs. 0.03 with per rupee increment in loan and advances. It can be inferred that the impact of loan and advances on the net profit is slightly higher in EBL than in HBL.

4.1.6.2.2 Regression Analysis of Loan and Advances on Total Deposit

Considering loan and advances as the dependent variable on total deposit, independent variable, the regression equation calculated between these two variables is presented in the table below.

Table 4.14

Regression Analysis of Loan & Advances (Y) on Total Deposit (X)

Bank	a	b	Regression Equation
HBL	-19168.39	1.27	$Y = -19168.39 + 1.27 X$
EBL	244.09	0.75	$Y = 244.09 + 0.75 X$

(Source: Appendix III)

The Table 4.14 represents the relationship between loan and advances and total deposit. The regression line of loan and advances on total deposit indicates that with per rupee increment in total deposit, the loan and advances of HBL increases by Rs. 1.27 and the loan and advances of EBL increases by Rs. 0.75. Thus, loan and advances has positive relationship with the total deposit collection of the bank. Further, it can be said that loan and advances is one of the major uses of total deposit of both the banks, and the impact of total deposit in loan and advances is higher in HBL.

4.1.6.2.3 Regression Analysis of Loan and advances on Investment

Let the disbursement of loan and advances depends upon the investment policy, independent variable, of the bank. Then the regression equation of loan and advances on total investment of HBL & EBL is presented below;

Table 4.15

Regression Analysis between Loan & Advances (Y) on Investment (X)

Bank	a	b	Regression Equation
HBL	16633.24	-0.28	$Y = 16633.24 - 0.28 X$
EBL	3944.75	0.06	$Y = 3944.75 + 0.06 X$

(Source: Appendix III)

The Table 4.15 presents the relationship between loan and advances and total investment. The regression line clarified that with per rupee increment in total investment led to Rs. 0.28 decreases in loan and advances of HBL, if the other variable, Rs. 16633.24, remains constant, and Rs. 0.06 increase in loan and advances of EBL, if other variable, 3944.75, remains uniform. Thus, loan and advances has negative relationship with total investment in HBL and positive relationship with total investment in EBL.

4.1.6.2.4 Regression Analysis of NPL on Loan & Advances

Assuming non performing loan is dependent on the loan and advances disbursed, the regression line of non-performing loan on loan and advances has been calculated, which is presented in the below table;

Table 4.16
Regression Analysis between Non-Performing Loan (Y) and Loan & Advances (X)

Bank	a	b	Regression Equation
HBL	677.70	0.003	$Y = 677.70 + 0.003 X$
EBL	172.57	-0.003	$Y = 172.570 - 0.003 X$

(Source: Appendix III)

Similarly, the Table 4.16 shows that non-performing loan had positive relationship with loan and advances in HBL, and hence NPL increases /decreases with the increase/decrease of loan and advances. In contrast, the non-performing loan had astonishingly negative relationship with loan and advances of EBL. The regression line indicated that with per rupee increase in loan and advances, the NPL of HBL increases by Rs. 0.003, if the variable, 677.70, remains stable, and the NPL of EBL decreases by Rs. 0.003, if the variable, 172.57, remains constant.

4.1.6.3 Trend Analysis

To estimate the value of loan and advances, deposit, investment, non performing loan and net profit in the forthcoming four fiscal years, i.e. in the

fiscal year 2011/12, 2012/13, 2013/14 and 2014/15, the trend analysis has been done. The loan and advances, deposit, investment, non performing loan and net profit have been considered dependent variables on the time. Then the regression line and predicted value calculated have been shown in the below tables.

4.1.6.3.1 Trend Analysis of Loan and Advances

To estimate the value of loan and advances in the next four fiscal year periods, the loan and advances has been considered as the dependent variable (Y) on the time period (X), independent variable. Then the trend value calculated using the trend analysis has been presented in table below.

Table 4.17
Trend Analysis of Loan and Advances

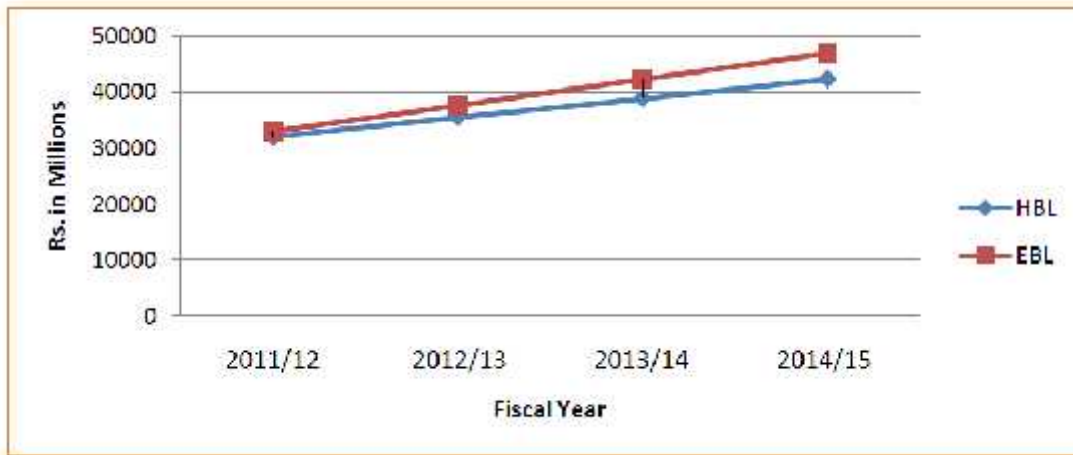
FY	HBL	EBL
2011/12	32010.52	33064.41
2012/13	35455.45	37707.13
2013/14	38900.39	42349.85
2014/15	42345.32	46992.56
Regression	$Y = 11340.91 + 3444.93 X$	$Y = 5208.11 + 4642.72 X$

(Source: Appendix – IV)

The Table 4.17 has estimated the value of loan and advances for the next four fiscal years. The table depicts that the loan and advances for the fiscal year 2011/12, 2012/13, 2013/14 and 2014/15 of HBL will be Rs. 32010.52 millions, Rs. 35455.45 millions, Rs. 38900.39 millions and Rs. 42345.32 millions respectively, and that of EBL will be Rs. 33064.41 millions, Rs. 37707.13 millions, Rs. 42349.85 millions, and Rs. 46992.56 millions respectively. The trend value of loan advances on time period, shown in the table, indicates that in each year, the loan and advances of HBL increases by Rs. 3444.93 millions and that of EBL increases by Rs. 4642.72 millions in the forthcoming four years. Hence, loan and advances has positive relationship with time period, and the pace of growth of loan and advances is higher in EBL.

Figure 4.9

Trend Analysis of Loan and Advances



4.1.6.3.2 Trend Analysis of Total Deposit

Let Y be the total deposit, dependent variable, and X be the time period, independent variable. Then the trend value of total deposit, using such relation, is presented in the table below.

Table 4.18

Trend Analysis of Total Deposit

FY	HBL	EBL
2011/12	40197.01	43662.98
2012/13	42884.37	49802.63
2013/14	45571.73	55942.27
2014/15	48259.09	62081.91
Regression	$Y = 24072.83 + 2687.36 X$	$Y = 6825.12 + 6139.64 X$

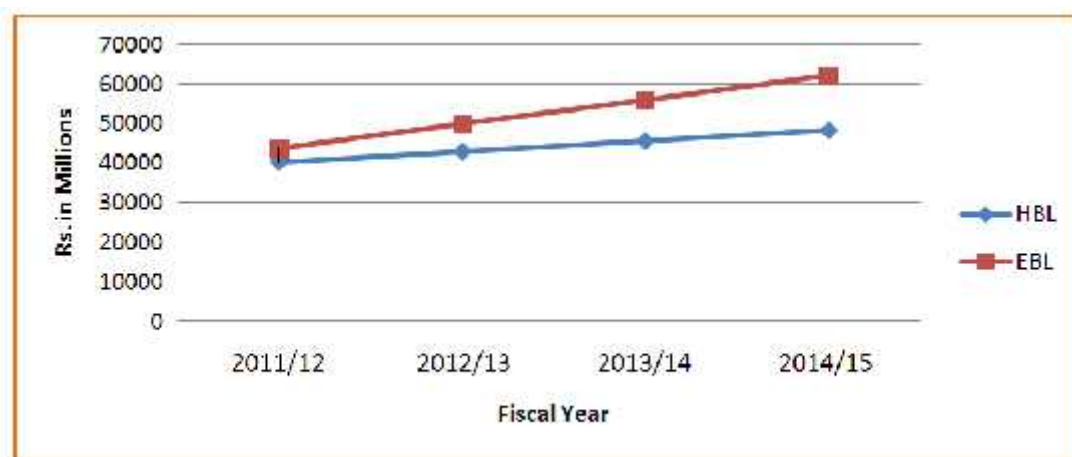
(Source: Appendix – IV)

The Table 4.18 clarifies that total deposit of has positive relationship with the time period in the forthcoming four fiscal years in both the banks, which is a good indication for HBL & EBL. The total deposit of HBL & EBL increases by Rs. 2687.36 millions and by Rs. 6139.64 millions per year in the future. The estimated value of total deposit by the end of the fiscal year 2014/15 of HBL will be Rs. 48259.09 millions and that of EBL will be Rs. 62081.91

millions. This indicates that EBL will be quite successful than HBL in collecting greater amount of deposit and in disbursing the loan as well.

Figure 4.10

Trend Analysis of Total Deposit



4.1.6.3.3 Trend Analysis of Total Investment

To calculate the trend value of total investment, the investment has been considered as the dependent variable on time period, independent variable. The calculated trend value of total investment has been presented below.

Table 4.19

Trend Analysis of Total Investment

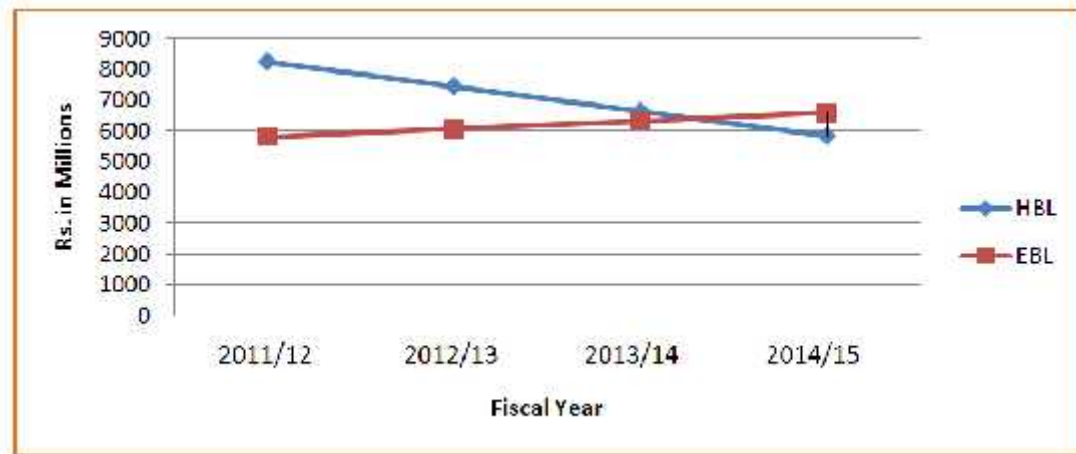
FY	HBL	EBL
2011/12	8241.40	5814.16
2012/13	7441.35	6072.14
2013/14	6641.29	6330.11
2014/15	5841.24	6588.09
Regression	$Y = 13041.72 - 800.05 X$	$Y = 4266.31 + 257.89 X$

(Source: Appendix – IV)

The table manifests that the total investment of HBL decreases and the total investment of EBL increases in the forthcoming years. The investment of HBL will decrease by Rs. 800.05 millions per year and that of EBL increases by Rs. 257.89 millions per year in the forthcoming four fiscal years. Thus, investment

will have inverse relationship with total deposit in HBL and direct relationship with total deposit in EBL. The trend value of investment for the fiscal year 2014/15 will be Rs. 5841.24 millions in HBL and will be Rs. 6588.09 millions in EBL.

Figure 4.11
Trend Analysis of Total Investment



4.1.6.3.4 Trend Analysis of Non-Performing Loan

Lower the non-performing loan reflects better loan management in the bank. Thus, to forecast whether the non-performing loan will decrease in the four forthcoming years, the non-performing loan has been considered as dependent variable on time.

Table 4.20
Trend Analysis of Non-Performing Loan

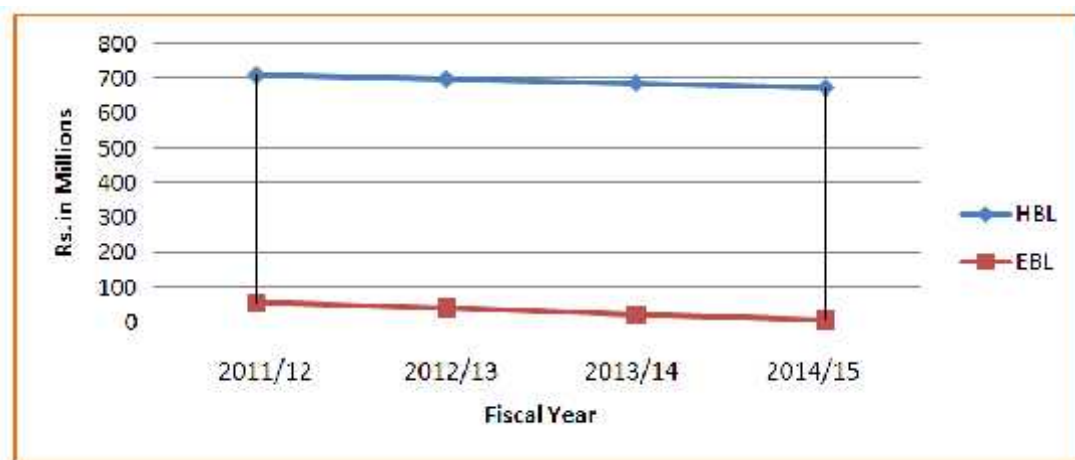
FY	HBL	EBL
2011/12	710.50	56.41
2012/13	698.28	39.79
2013/14	686.07	23.16
2014/15	673.85	6.54
Regression	$Y = 783.80 - 12.22 X$	$Y = 156.15 - 16.62 X$

(Source: Appendix – IV)

The table delineates that both the banks will be quite successful to decrease the non-performing loan in the forthcoming years. The non-performing loan of

HBL decreases by Rs. 12.22 millions per year and that of EBL decreases by Rs. 16.62 millions per year in the future. The table shows that the forecasted value of non-performing loan will be Rs. 673.85 millions in HBL and just Rs. 6.54 millions in EBL by the end of the fiscal year 2014/15. The table substantiates that in future as well, the EBL will be more efficient than HBL in lessening the non performing loan, since the rate of decrement of NPL is higher in EBL.

Figure 4.12
Trend Analysis of Non Performing Loan



4.1.6.3.5 Trend Analysis of Net Profit after Tax

Higher the net profit is favorable for any institution. So, to forecast whether, the net profit of HBL & EBL will increase in the forthcoming four years, the net profit has been considered as the dependent variable on time period. The calculated trend value of net profit is presented in the table below.

Table 4.21

Trend Analysis of Net Profit after Tax

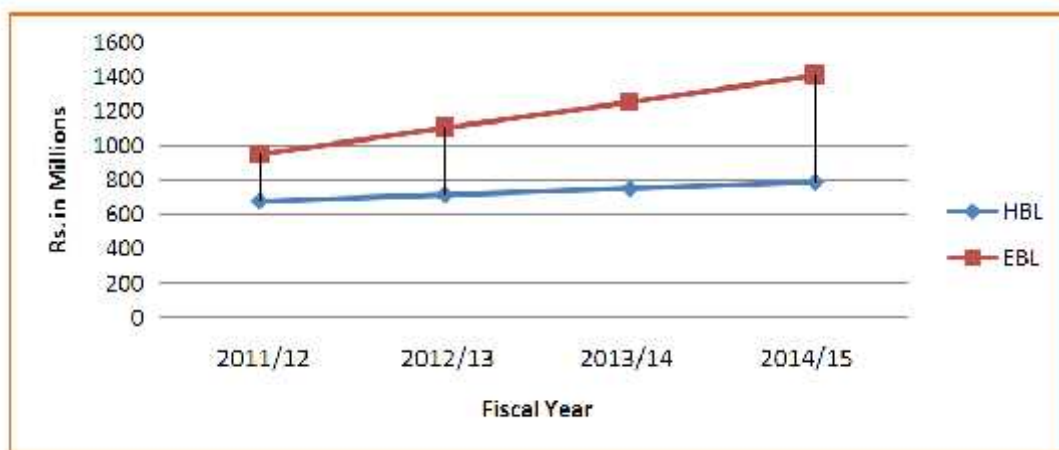
FY	HBL	EBL
2011/12	678.46	950.46
2012/13	714.83	1103.59
2013/14	751.20	1256.71
2014/15	787.57	1409.84
Regression	$Y = 460.25 + 36.37 X$	$Y = 31.70 + 153.13 X$

(Source: Appendix – IV)

Further, the net profit of HBL & EBL will have positive relationship with the time period, which means that net profit increases in each fiscal year by Rs. 36.37 millions in HBL and by Rs. 153.13 millions in EBL in the forthcoming four fiscal years. Consequently, the estimated value of net profit by the end of the fiscal year 2014/15 will be Rs. 787.57 millions in HBL and will be Rs. 1409.84 millions in EBL. Thus, EBL has better profitability prospect than HBL.

Figure 4.13

Trend Analysis of Net Profit after Tax



4.2 Primary Data Analysis

To examine the loan management situation, the primary data has also been undertaken. For the primary data collection, mainly the questionnaire containing 10 questions has been performed. The 30 respondents: 10 investors,

10 employees of banks, and 10 borrowers, have been chosen for the questionnaire purpose. The Investors are chosen randomly from the NEPSE floor, whereas the banks employees and Borrower are chosen by visiting the sampled banks.

4.2.1 Loan Management Efficiency

Granting loan is the major function of the bank and loan is considered as the major source of interest income. Thus, efficiency in managing loan is crux for the survival of bank. To know whether the HBL & EBL is efficient in loan management, the respondents were asked on this matter.

Table 4.22
Efficiency in Loan Management

Answer	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Yes	6	60	7	70	4	40	17	56
No	4	40	2	20	5	50	11	37
Don' Know	0	0	1	10	1	10	2	7
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.22 reveals that the majority of the respondents, i.e. 56% (17 out of 30), has opined that the commercial banks are efficient in loan management, while 37% of the respondents has said that the banks are not efficient in managing loan and 7% remained has said don't know. Looking each category, the majority of the Investors, i.e. 60% (6 out of 10), and bank employee, i.e. 70% (7 out of 10), has stated that the banks are efficient in managing credit, while the majority of borrower, 50% (5 out of 10), has opined that the banks are not efficient in managing credit. Hence, overlooking the overall majority, it can be concluded that the HBL & EBL is efficient in managing credit. However, it will be better, if the bank traces out the dissatisfaction of borrower in the management of loan by bank.

4.2.2 Loan Floatation Basis

To examine the most important basis that should be considered while disbursing loan, the respondents have been asked to express their view. The responses obtained from them have been presented in the Table 4.23.

Table 4.23
Loan Floatation Basis

Basis	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Borrower's Financial Strength	2	20	4	40	3	30	9	30
Collateral Value	4	40	5	50	5	50	14	47
Monitoring & Controlling	2	20	0	0	1	10	3	10
Nature of Guarantor	1	10	1	10	1	10	3	10
Portfolio Management	1	10	0	0	0	0	1	3
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.23 shows that the majority of the respondents have stated that the collateral value should be given more consideration while disbursing loan. Out of the 30 respondents, 14 respondents (47%), have supported this option. Besides collateral value, 30% of the respondents, 9 out of 30, have opined that evaluation borrower's financial strength should be the main basis while floating loan. Similarly, 10% of the respondents (3 out of 30), 10% of the respondents (3 out of 30) and 3% of the respondents (1 out of 30) have affirmed that nature of guarantor, monitoring and controlling and portfolio of loan management respectively should be the main basis for loan floatation.

4.2.3 Harassment in Paper Document

Before granting loan, the bank has to arrange various documents to ensure the payment back of principal and interest amount of loan granted. So to know whether the paper document maintain is harassing, the respondents are asked

on this regard. The responses obtained from them are presented in the Table 4.24.

Table 4.24
Harassment in Paper Document

Answer	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Yes	3	30	2	20	7	70	12	40
No	5	50	6	60	2	20	13	43
Don' Know	2	20	2	20	1	10	5	17
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.24 shows that the majority of the respondents, 43% (13 out of 30), has stated that there is no harassment in paper document maintained by bank while granting loan, while 40% of the respondents (12 out of 30) has affirmed that the paper documentation is harassing and 17% of the respondents (5 out of 30) has remained neutral. Gazing each category, the majority of Investors, i.e. 50% (5 out of 10), and bank's employees, 60% (6 out of 10), have said that the paper documentation is not harassing, while the majority of the Borrower, 70% (7 out of 10), has said that the paper documentation is harassing. Considering the overall responses, it can be concluded that the paper documentation maintained by commercial banks before granting loan is not harassing. However, the banks should not ignore the oppose opinion of Borrower and should make the paper documentation comfortable.

4.2.4 Satisfaction in Mortgage Value

To ensure the payment of loan by the Borrower, the bank keeps mortgage after the valuing it. So to know whether the valuation done by bank is satisfactory, the respondents are asked on this matter. The respondents obtained from them are presented in the Table 4.25.

Table 4.25
Satisfaction in Mortgage Value

Answer	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Yes	4	40	6	60	8	80	18	60
No	4	40	3	30	2	20	9	30
Don' Know	2	20	1	10	0	0	3	10
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.25 reveals that 40%, 40% and 20% of the Investor states that the mortgage valuation done by commercial banks is satisfactory, not satisfactory and don't know respectively. Similarly, 60% of the bank employees say that the valuation is satisfactory, 30% has said the valuation is not satisfactory and 10% has remained neutral. Likewise, 80% and 20% of the borrower has said that the valuation is satisfactory and not satisfactory respectively. In overall, 60% of the total respondents have state that the valuation is satisfactory, while 30% stated that the valuation is not satisfactory and 10% remained neutral. Considering the overall majority, it can be concluded that the valuation of mortgage value done by bank before disbursing loan is satisfactory.

4.2.5 Involvement in Valuation

To examine from whom the valuation of mortgage should be done before granting loan, the respondents are asked on this matter. The responses obtained from each category and in total have been presented in the Table 4.26.

Table 4.26**Involvement in Valuation**

Answer	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Related Specialist	8	80	4	40	6	60	18	60
Bank Staff	0	0	6	60	0	0	6	20
Independent Person	2	20	0	0	4	40	6	20
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.26 depicts that the majority of the Investors, 80%, has stated that the valuation should be done by the related specialist, while 20% of the Investors has said that the valuation should be done by the independent person appointed by the mutual agreement between bank and borrower. Similarly, 60% of the bank employee has stated that the valuation should be done by the bank staff and 40% has said that the valuation should be done by related specialist. Likewise, 60% and 40% of the borrower has opined that the mortgage valuation should be done by related specialist and the independent person respectively.

In overall, 60% (18 out of 30), 20% (6 out of 30) and 20% (6 out of 30) of the respondents has said that the mortgage valuation should be done by related specialist, bank staff and independent person respectively. Considering the overall majority, it can be concluded that the valuation of mortgage would be satisfactory, if it has been done by related specialist.

4.2.6 Time to Disburse Loan

The bank takes certain time for loan approval after it receives the application form. Thus, to know how many days will be the best time to disburse credit, the respondents are asked on this matter. The responses obtained from them are presented in the Table 4.27.

Table 4.27

Time to Disburse Loan

Answer	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
5-10 days	3	30	2	20	4	40	9	30
10-20 days	6	60	7	70	6	60	19	63
Above 20 days	1	10	1	10	0	0	2	7
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.27 reveals that the majority of the Investors, i.e. 60%, has stated that 10-20 days after the application received by the bank would be the appropriate time to disburse loan, while 30% and 10% of the Investors has opined 5-10 days and above 20 days as the appropriate time. Similarly, 20%, 70% and 10% of the bank employees has indicated 5-10 days, 10-20 days and above 20 days as the appropriate time to disburse loan after the receipt of application. Likewise, 40% and 60% of the Borrower has opined 5-10 days and 10-20 days as the appropriate time to disburse loan.

In overall, 30%, 63% and 7% of the total respondents has opined 5-10 days, 10-20 days and above 20 days respectively to be the appropriate time to disburse loan after the receipt of application. Hence, considering the overall majority of each group and overall, it can be concluded that 10-20 days would be the best time to disburse loan after receiving the application.

4.2.7 Degree of Effect of NPA on Banking Industry

To know the degree of effect that NPA has on banking industry, the respondents are asked to express their view. The responses obtained from them have been presented in the Table 4.28.

Table 4.28**Degree of Effect of NPA on Banking Industry**

Basis	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Not affected	0	0	0	0	0	0	0	0
Nominally affected	0	0	1	10	1	10	2	7
Moderately affected	6	60	6	60	3	30	15	50
Severely affected	4	40	3	30	6	60	13	43
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.28 demonstrates that 50% of the respondents, 15 out of 30, have stated that the banking industry has been moderately affected by the problem of NPA. Similarly, 43% of the respondents, 13 out of 30, have said that the problem of NPA has severe effect on the banking industry. Also, 7% of the respondents, 2 out of 30, have stated that the banking industry had been nominally affected by the problem of NPA. Looking each category, the majority of the investors, 6 out of 10 and the majority of the employees, 6 out of 10, have stated that banking industry has been moderately affected by NPA. However, the majority of the borrower, 6 out of 10, stated that the banking industry has been severely affected by the problem of NPA. Finally, considering the overall majority, 15 out of 30, it can be concluded that NPA has moderate effect on banking industry.

4.2.8 Best Time to Follow up after Due date

To examine the best time within which the bank should follow up for recovery after due date, the respondents have been asked on this regard. The responses obtained from them have been presented in the Table 4.29.

Table 4.29**Best Time to Follow up after Due date**

Basis	Investor		Employee		Borrower		Total	
	No.	%	No.	%	No.	%	No.	%
Within a week	2	20	3	30	1	10	6	20
Within two weeks	5	50	6	60	2	20	13	43
Within a month	3	30	1	10	5	50	9	30
After one month onwards	0	0	0	0	2	20	2	7
Total	10	100	10	100	10	100	30	100

(Source: Field Survey, 2011)

The Table 4.29 demonstrates that 43% of the respondents, 13 out of 30, are in the view that banks should follow up for the recovery within two weeks after due date. Similarly, 30% of the respondents, 9 out of 30, have opined that within a month after due date will be the best time that the bank should start for recovery. Also, 20% of the respondents, 6 out of 30 and 7% of the respondents, 2 out of 30, opined that within a week and after one month onward respectively will be the best time for follow up. Looking each category, the majority of investors, 5 out of 10 and the majority of employees, 6 out of 10, have supported within two weeks, whereas the majority of borrowers, 5 out of 10, have supported within a month for follow up after due date. Eventually, considering the overall majority, it can be concluded that within two weeks after the matured date of loan will be the best time for bank to follow up for recovery process.

4.2.9 Most Influencing Factor in Loan disbursement

To investigate what factor is the most influencing in granting credit, the respondents are asked on this matter. The responses obtained from them are summarized in the table in the rank form.

Table 4.30

Most Influencing Factor in Loan disbursement

Influencer	Basis	Rank					Total	Weight	Mean Wt.	Overall Rank
		1	2	3	4	5				
Paper Document	Investor	1	0	2	3	4	10	39	3.90	5
	Employee	1	2	1	3	3	10	35	3.50	4
	Borrower	0	1	2	4	3	10	39	3.90	4
	Total	2	3	5	10	10	30	113	3.77	4
Time Period	Investor	1	1	0	5	3	10	38	3.80	4
	Employee	2	2	2	1	3	10	31	3.10	3
	Borrower	0	1	4	3	2	10	36	3.60	3
	Total	3	4	6	9	8	30	105	3.50	3
Employee Behavior	Investor	0	2	3	2	3	10	36	3.60	3
	Employee	1	0	3	2	4	10	38	3.80	5
	Borrower	1	0	2	2	5	10	40	4.00	5
	Total	2	2	8	6	12	30	114	3.80	5
Interest Rate	Investor	5	3	2	0	0	10	17	1.70	1
	Employee	4	2	2	2	0	10	22	2.20	1
	Borrower	5	5	0	0	0	10	15	1.50	1
	Total	14	10	4	2	0	30	54	1.80	1
Collateral Value	Investor	3	4	3	0	0	10	20	2.00	2
	Employee	2	4	2	2	0	10	24	2.40	2
	Borrower	4	3	2	1	0	10	20	2.00	2
	Total	9	11	7	3	0	30	64	2.13	2

(Source: Field Survey, 2011)

The Table 4.30 shows that the interest rate charged on the loan amount is the most influencing factor while granting loans. The respondents have ranked 1 for interest rate chargeable, 2 for the collateral value, 3 for time period taken for granting credit, 4 for paper documentation required, and 5 for the behavior of bank's employee to the customer. In overall, the majority of the respondents, 14 out of 30, have opined that the interest rate is the most influencing factor in loan disbursement. Thus, it will be worthwhile if bank charges the appropriate interest rate for effective Loan management.

4.2.10 Suggestions for Effective Loan Management

At the end of the questionnaire, the respondents are asked to give their valuable suggestion for the effective Loan management. The responses obtained from them, in the rank form, have been presented in the Table 4.31.

Table 4.31
Suggestions for Effective Loan Management

Remedy	Basis	Rank				Total	Weight	Mean Wt.	Overall Rank
		1	2	3	4				
Careful Evaluation	Investor	4	3	3	0	10	19	1.90	1
	Employee	3	5	2	0	10	19	1.90	1
	Borrower	5	5	0	0	10	15	1.50	1
	Total	12	13	5	0	30	53	1.77	1
Appropriate Interest	Investor	3	4	3	0	10	20	2.00	2
	Employee	3	4	3	0	10	20	2.00	2
	Borrower	4	4	2	0	10	18	1.80	2
	Total	10	12	8	0	30	58	1.93	2
Consumer Awareness	Investor	0	1	3	6	10	35	3.50	4
	Employee	0	0	3	7	10	37	3.70	4
	Borrower	0	0	3	7	10	37	3.70	4
	Total	0	1	9	20	30	109	3.63	4
Timely Collection	Investor	3	2	1	4	10	26	2.60	3
	Employee	4	1	2	3	10	24	2.40	3
	Borrower	1	1	5	3	10	30	3.00	3
	Total	8	4	8	10	30	80	2.67	3

(Source: Field Survey, 2011)

The Table 4.31 depicts that the respondents ranked 1 for careful evaluation of loan proposal, 2 for appropriate interest rate to be charged, 3 for collection of loan at regular time interval and 4 for consumer awareness, as the suggestion for effective Loan management of the bank. Out of 30 respondents, 12 ranked 1 for careful evaluation. So, it can be concluded that the bank can have sound management of credit, if it evaluates the Loan proposal carefully. Also, the bank interest rate should not be high, as a result the Borrower feel burden while paying interest amount.

4.3 Major Findings of the Study

After careful analysis of both the secondary and primary data available, the following major findings have been drawn;

Findings from Secondary Data Analysis

1. EBL disbursed more loan in proportion to loan outstanding in the five years periods than HBL did. The average loan investment to loan outstanding of HBL was 4.23 times and that of EBL was 4.74 times.
2. However, the loan recovery to loan investment of both the banks has fluctuated during the periods, although loan recovery and loan investment of both banks have followed increasing trend. The average loan recovery to loan investment of HBL was 77.51% and that of EBL was 95.12%, indicating better recovery policy of EBL.
3. Loan and advances used to be the major uses of the collected deposit of both banks. As a result the loan and advances to total deposit of both the banks persistently increased in most of the years of both the banks. The average ratio of HBL was 66.62% and EBL was 75.82%.
4. The growth rate of loan investment of the banks was irregular and even decreased in most of the year. In average, the loan investment rose by 31.39% in HBL and by 40.49% in EBL. Similarly, the growth rate of outstanding loan and advances of both banks decreased in some years and increased in other years. Eventually, the outstanding loan grew by 16.72% in average in HBL and by 29.42% in average in EBL. Although, there was irregularity in growth rate of the recovery of outstanding loan, the growth rate in recovery of HBL was 39.54% and that of EBL was 41.69%.
5. The bank was able to decrease the presence of non-performing loan in total loan and advances. The non performing loan represented only 3.65% of the total loan in HBL and only 0.68% of the total loan in EBL. This indicated the greater concern of the bank in improving its assets structure by decreasing the credit risk.
6. Along with the non-performing loan, the loan loss provision kept the bank in relation to the total loan had been also decreased. The average loan loss provision to total loan of HBL was 4.35% and EBL was 2.69%.

7. The relationship between net profit and loan and advances was statistically insignificant in HBL and significant in EBL. The correlation coefficient calculated between them was 0.4111 in HBL and 0.9871 in EBL.
8. However, the relationship between loan and advances and total deposit of the bank was statistically significant in both banks, and hence the increment/decrement in total deposit directly affects the loan disbursement policy of the bank. The correlation coefficient between these two variables was 0.9795 in HBL and 0.9971 in EBL.
9. Also, the relationship between loan and advances and total investment, and non performing loan and loan and advances were insignificant. Hence, investment in other sector had no effect on the disbursement of loan, and the growth of non-performing loan was not totally dependent on the growth of loan outstanding.
10. The trend analysis depicted good financial position of the bank in future. Since, the loan and advances of the bank will be increased, the total deposit will be increased, the non performing loan will be decreased and the net profit after tax will be increased. The trend value indicated that loan and advances increases by Rs. 3444.93 millions in HBL and by Rs. 4642.72 millions in EBL, total deposit increases by Rs. 2687.36 millions in HBL and by Rs. 6139.64 millions in EBL, non performing loan decreases by Rs. 12.22 millions in HBL and by Rs. 16.62 millions in EBL, and net profit increases by Rs. 36.37 millions in HBL and by Rs. 153.13 millions in EBL in each forthcoming fiscal year.

Findings from Primary Data Analysis

1. As per the opinion survey, both the banks are efficient in loan management. About 56% of the respondents supported this opinion. Also, 43% of the respondents have said that there is no harassment in the paper document requirement by bank while disbursing loan.

2. The bank needs to have sound evaluation of the mortgage property kept as security while disbursing loan. 47% of the respondents are in the view that the collateral evaluation should be the main basis to be considered while disbursing loan.
3. Further the majority of the respondents, 60%, are satisfied in the mortgage valuation done by bank. Also, same percentage, 60%, has stated that related specialist should be involved in mortgage valuation rather than bank staff and independent person.
4. The majority of the respondents, 63%, have opined that 10-20 days will be the appropriate time to disburse loan after the bank receives application.
5. Similarly, 50% of the respondents, 15 out of 30, have stated that the banking industry has been moderately affected by the problem of NPA. And 41% of the respondents suggested within two weeks after the due date will be the best time to follow up for loan recovery
6. In ranking the most influencing factor in loan disbursement, interest rate chargeable got rank 1, while collateral value got rank 2. Thus, interest rate of the bank is the most influencing determinants of loan. Eventually, the respondents have suggested that careful evaluation of the loan proposal before granting loan.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The prosperity of banking system depends on the two major functions, viz, deposit collection and lending. At present situation, along with the difficulty in deposit collection, as liquidity of overall banking system is rising up, the lending function is also great challenge to the banks. The banks are facing two major challenges in lending. First of all, due to unfavorable political environment and violence, businessmen are reluctant to invest in business, so the volume of loan and advances is not in regular trend and if loan is given, the problem of turning loan to non-performing is another challenge that banks are facing. In addition, various risk like credit risk, interest rate risk, liquidity risk, price risk, foreign exchange risk, transaction risk and so on are associated with lending. So, to disburse loan in the most productive and secure sector has become the target of each bank. Thus, effective management of the loan and the loan function are fundamental to a bank's safety and soundness.

Loan management has always been the primary function of banking, and accurately assessing a borrower's loan worthiness has always been the only method of managing loan successfully. Apart from the resource mobilization and collection of sources of funds, the banks should have good loan policy to monitor its loan portfolio, analyze the loan process and handle the loan operations, so that the investments made provide them smooth return. Although each bank has its own loan policies, the management should be aware that the loan policies should be mandatory and followed strictly with compliance by the staffs within.

The study has been carried out to analyze the loan management in commercial banks of Nepal. Since, the encompassment of all these banks is almost

impossible in this study, only two banks, namely Himalayan Bank Limited and Everest Bank Limited, have been selected as sample from the population of thirty one commercial banks.

To achieve the objectives of the study, both the primary data and secondary data have been analyzed. The primary data has been collected by collecting the opinions of the respondents through questionnaire, while the secondary data have been extracted from the annual reports of the respective banks. Further, both financial tools and statistical tools have been effectively utilized to get the result.

5.2 Conclusion

On the basis of primary data analysis, it can be concluded that the commercial banks of Nepal are efficient in loan management and there is no harassment in the paper documentation required while disbursing loan. Further, the mortgage valuation done while granting loan and advances is satisfactory and such valuation should be done by related specialist, not by bank's staff and independent person. In addition, it can be concluded that ten to twenty days is the most effective time in disbursing loan and advances after the receipt of application. Eventually, it can be concluded that interest is the most influencing factor while granting loan, and to follow up the activities of loan debtor is the most remedy for loan default, and the bank should make careful evaluation before granting loan and advances to have sound loan management.

On the basis of secondary data analysis and major findings drawn, it can be concluded that EBL is more efficient than HBL in loan management, since both the average loan investment to loan outstanding and loan recovery to loan investment are higher in EBL than those in HBL. Moreover, EBL has disbursed higher section of the deposit in granting loan and advances than HBL has done. Also, the growth in loan investment and the growth in loan recovery are higher in EBL in comparison to those in HBL. The lower the loan risk in EBL,

measured by the low non performing loan to total loan and advances, than in HBL also substantiates this presumption.

The statistical analysis aid to conclude that the net profit of EBL is highly dependent on the loan and advances disbursed. The relationship of net profit to loan and advances of EBL only is perfectly correlated and the relationship is statistically significant. Furthermore, it can be avowed that the loan disbursement policy of both the observed banks is highly affected by the total deposit collection. However, investment in other sector had no effect on the disbursement of loan, and the growth of non-performing loan was not totally dependent on the growth of loan outstanding. The trend analysis helps to conclude that both the banks will have efficient loan management policy in the upcoming periods, since the loan and advances of the bank will be increased, the total deposit will be increased, the non performing loan will be decreased and the net profit after tax will be increased.

5.3 Recommendations

Embracing the major findings drawn in the previous chapter and the conclusion made, the researcher has given the following recommendations.

-) The interest income is considered the main source of income of bank. The loan and advances disbursed by HBL is comparatively lower than that of EBL. So, to give high competition, HBL should flow more loan and advances to gain more interest income.
-) The deposit mobilization in loan and advances ratio of EBL is higher than that of HBL. Also, the interest income earned to loan and advances ratio of EBL is higher. So, it would be better if HBL meticulously scrutinizes its loan and advances proposal before granting amount.
-) HBL has higher loan risk ratio than EBL, jeopardizing HBL's loan management policy. Thus, it would be better if HBL grants loan and advances in secured sector only.

-) Both the banks should make the valuation of mortgage from related specialist and only grant loan if the evaluation is satisfactory.
-) Both the banks should be consumer-oriented and should be prompt in making the evaluation, and granting loan and advances to meet the requirement of the customer.
-) The bank should charge the appropriate interest rate to compete in the market and allure the customer toward it. Further, follow up and counseling should be done to ensure the return and principal amount granted.
-) Although the majority of the respondents have stated that there is no paper harassment, the bank should trace out the reasons behind the dissatisfaction and should try to minimize if any to have sound loan management.

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