CREDIT MANAGEMENT IN NEPALESE COMMERCIAL BANKS
(With reference to NIBL & NIC Bank Limited)

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A Thesis Submitted to:
Office of the Dean
Faculty of Management
Tribhuvan University

In partial fulfillment of the requirement for the Degree of Master of Business Studies (M.B.S)

Kathmandu, Nepal
April, 2010

CHAPTER -1

INTRODUCTION

1.1 Background of the Study

As Nepal is one of the least developed countries in the world, it has been adopting mixed and the liberal economic policy to help the state and the private sector. After restoration of the democracy, the concept of the liberalization policies has been incorporated as directive principle and state policies. This liberalization has helped in establishing many companies, banks, finance companies and manufacturing industries. Thus these establishments help the country for its proper development. Integrated and speedy development of the country is possible only when competitive banking service reaches every corner of the country and the people. The growth of the banking is not so long. In comparison with the other developing or developed countries, the institutional development in banking system of Nepal is far behind. Even through the specific date of the beginning of money and banking deal in Nepal is not obvious, it is speculated that during the reign of the king Manadeva the coin "*Manank*" and "*Gunank*" during the reign of the King Gunakamadeva were in use. *Tankadhari* 'a special class of people' was established to deal with the lending activities of money toward the end of fourteen century at the ruling period of King Jayasthiti Malla. After the unification of Nepal, Prithivi Nararyan Shah, the Great King, had used coin "*Mohar*" in his name. An institution called "*Takasr*" was established in 1989 BS and it started to issue the coin scientifically. Official name "*Tejarat*" established in Kathmandu (1993 BS) during the reign of Ranoddip Singh, used to provide loans to the government officials and the people against deposit of gold and silver. It had also extended its branch outside Kathmandu valley for providing loans but this office had no rights to accept the deposits of public and it had no characteristics of modern banks.

On 30th Kartik, 1994 BS, Nepal Bank Limited was established for the first time to provide banking facilities/services in organized manner. Up to 2012 BS, NBL was the only banking service provider to general public and other government/non-government bodies as an organized banker. Later, NRB act 2012 BS was prepared and issued to establish NRB as a central bank to manage, control and develop monetary system in Nepal. NRB was formally established on 14th Baisakh 2013 BS & its capital at the starting time was NPR 10 million. Similarly, Rastriya Banijya Bank was established in BS 2022 Magh 10 as 100% state owned bank to fulfill the growing needs of the economy. The birth of this bank brought a new landmark in the history of banking facility in the Nepal. Like other developed countries, Nepal also took the policy of open economy to develop good competition in the banking field. Hence, the private sector Banking Company policy is taken for study. Today, 26 commercial banks are operating to provide modern banking services & facilities to boost the economic condition of the country.

The financial sector reform was initiated in mid-1980s under the liberal economic policy of GON. Under this policy, GON first opened the banking sectors to foreign investors. In July 1985 AD, commercial banks were allowed, for the first time to accept current and fixed deposits on foreign currency (U.S. dollar and sterling pound). On May 26, 1986 AD, NRB deregulated the interest rate regime and authorized commercial banks to fix interest rate at any level above its minimum prescribed levels.

Credit is regarded as the most income generating assets especially in commercial banks. Credit is regarded as the heart of the commercial banks in the sense that; it covers the main part of the investment; the most of the investment activities based on credit; it is the main factor of creating profitability. It is the main source of creating profitability: it determines the profitability. In today context, it also affects on national economy to some extend. If the bank provides credit to retailer, it will make the customer status> similarly, It provides to trader and industry, the Govt. will get tax from then and help to increase the national economy. It is the security against depositors. It is proved from very beginning that credit is the shareholders wealth maximization derivative. However, other factors can also affect profitability and wealth maximization but the most effective factor is regarded as credit. It is the most challenging job because it is backbone In Commercial Banks. Thus, effective management of credit should seriously be considered.

Management is the system of, which helps to complete the every job effectively. Credit management is also the system, which helps the manage credit effectively. In other words, credit management refers management of credit exposures are the main source of investment in Commercial Banks and return on such investment is suppose to be main source of income.

Credit Management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that the borrower will fail to meet its obligations in accordance with the agreed terms and conditions credit risk is not restricted to lending activities only but includes off balance sheet and inter bank explores. The goal of the credit risk management is to be maximizing a banks risk adjusted rate of return by maintaining the credit risk exposure with in acceptable parameters. For most banks, loans are the largest and most obvious sources of credit risk, however, other source of credit risk exit through out the activities of the bank, including the banking book, and in the trading book, and both increasingly facing credit risk in various financial instruments other than land, including acceptances, inter bank transactions and guarantees and the settlements of transactions.

The credit policy of a firm provides the framework to determine whether or not to extend credit and how much credit to extend. The credit policy decision of a bank has to broad dimensions; credit standards and credit analysis. A firm has to establish and use standards n making credit decision, develop appropriate sources of credit information and methods of credit analysis.

1.2 Introduction of Sample Organizations under study.

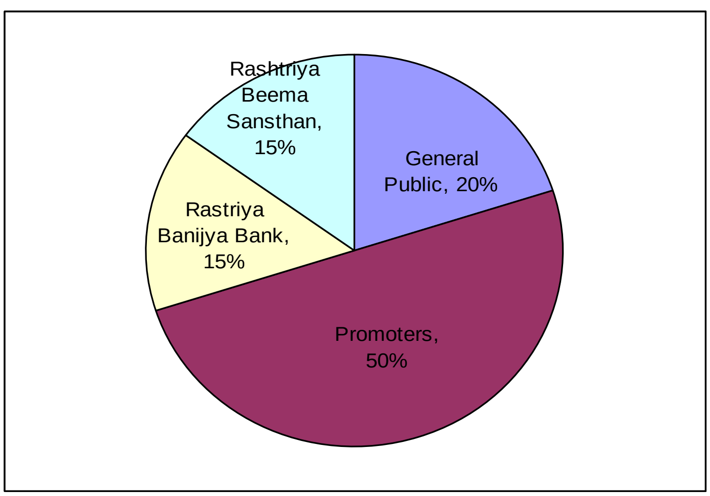
1.2.1 Nepal Investment Bank Limited (NIBL)

Nepal Investment Bank Limited (NIBL) is one of the leading banks of Nepal. It was established in 1986 AD as a joint venture between Nepalese and French partners and was previously known as Nepal Indosuez Bank Ltd. NIBL was established with the vision to bet the most preferred provider of financial services in Nepal. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world. With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd. In 2003, 2005 and 2008 AD the Bank was rated “Bank of the Year” among Banks in Nepal.

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank’s Annual General Meeting, Nepal Rastra Bank and Company Registrar’s office with the following shareholding structure.

- A group of companies holding 50% of the capital
- Rastriya Banijya Bank holding 15% of the Capital.
- Rashtriya Beema Sansthan holding the same percentage of 15% of the capital.
- The remaining 20% being held by the General Public (which means that NIBL is a Company listed on the Nepal Stock Exchange).

Capital Structure of NIBL



<u>Services offered</u>

Deposits	E-zee saving	E-Banking
Premier Banking	ATM	NTC Mobile Bill Payment
Loans and Advances	Vehicle Loans	Credit Card
Debit card	Safe deposit lockers	365 Days Banking

NIBL offers full-fledged Commercial Banking facilities and services to its customers such as: Loan and Advances, Consortium Finance, Working Capital Credit, Term Credit, Demand Credit, Trade Finance (Import Export), Hire Purchase Credit and Letter of Credit, Bills Purchase, Bank Guarantee, Letter of Credit, Housing and Vehicle loans & others.

1.2.2 Nepal Industrial & Commercial Bank Limited (NIC)

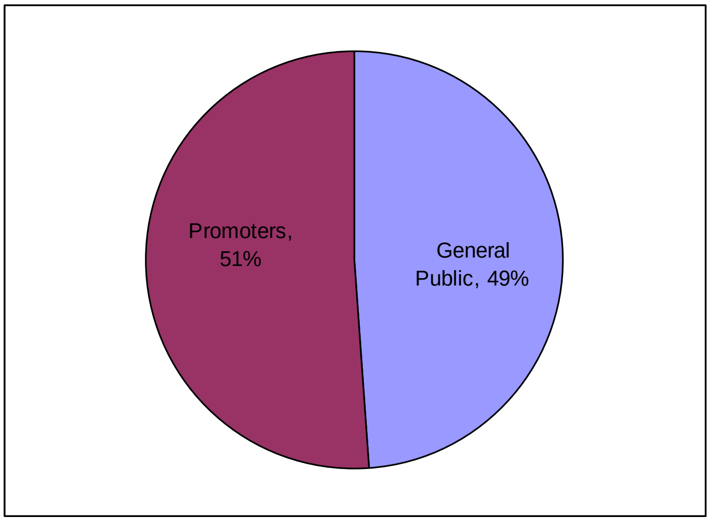
Nepal Industrial & Commercial Bank Limited (NIC Bank) commenced its operation on 21 July 1998 AD from Biratnagar. The Bank was promoted by some of the prominent business houses of the country. The current shareholding pattern of the Bank constitutes of promoters holding 51% of the shares while 49% is held by the general public. NIC Bank has over 34,000 shareholders. The shares of the Bank are actively traded in Nepal Stock Exchange with current market capitalization of about NPR 10,493 million.

The Bank has grown rapidly with 24 branches throughout the country while several branches are planned to be opened this year. All branches are inter-connected through V-Sat and are capable of providing real time on-line transactions. The Bank is the first commercial Bank in Nepal to have received ISO 9001:2000 certification for quality management system. Furthermore, NIC Bank became the 1st Bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its Global Trade Finance Program, enabling the Bank's Letter of Credit and Guarantee to be accepted/ confirmed by more than 200 banks worldwide.

Capital Structure

NIC Bank has an Authorized Capital of NPR 1,600 million with paid-up capital of NPR 1,140.48 million. The promoter group holds 51% of paid-up capital amounting to NPR 581.65 million and remaining 49% amounting to NPR 558.83 million is held by the general public. The shares are listed with Nepal Stock Exchange.

Capital Structure of NIC Bank



Services Offered

- Current, Savings, Call and Fixed Deposit Accounts - both in LCY & FCY
- Funds Transfer (Draft, T.T. & Fax, Western Union Money Transfer etc.)
- Purchase & Sale of Traveller's Cheques
- ATM / Debit Card
- Bank Guarantees
- Letters of Credit / Bills Purchases
- Corporate Finance / Consumer Loans
- Clearing / Collection
- Safe Deposit Lockers
- Any Branch Banking System
- Extended Counter Services
- Banking services on SWIFT
- Other Allied Services

1.3 Statement of the problem

Nepal is a small country with small market. Economic condition of the country is degrading due to conflict since 2052 B.S. Overall economic sectors either manufacturing or commercial sectors have undergone heavy losses. But in recent past the economic condition of the country has revived by some margin. Despite conflict situation, the financial institutions are increasing regularly. Liquidity is maximizing day to day with the financial institutions. Hence, the banks and financial institutions are competing among themselves to advance credit to limited opportunity sectors. Due to unhealthy competition among the banks, the recovery of the banks credit has gone negative and overall performance is deteriorating. Non-performing Assets of the banks are increasing. To control such type of state, the regulatory body of the banks and financial institutions NRB has tightened up and has issued strong directives. In this scenario, two oldest government banks have decreased their non-performing loans however some of the newly established banks have gone to problematic situation due to poor quality of loans and inadequate recovery efforts. Most banking problems have been caused by weaknesses in credit Management.

Banks should now have to be ware of the need to identify measure, monitor and control credit as well as to determine that they hold adequate capital against it. These risk that they are adequately compensated for risks incurred. So, to establish creditability position is a major issue in commercial banking sector during these days. There maybe no debate that high profitable or successful organization can easily fulfill the every need have the organization, customers and can serve to the society. To improve the profitability situation of the bank, it is necessary to establish the higher creditability position of the bank. Thus the creditability is the major assets and building better creditability is the major strategy of every commercial bank.

Therefore it is necessary to analyze the 'Credit Management' consisting of Credit disbursement, Credit Monitoring, Credit Supervision, Loan Review, Loan Recovery, Loan Loss provision and Loan Write Off procedures of the Banks. Credit management concept has appeared as a major research gap in Nepalese commercial banking sector. There is a lack of such scientific and empirical research that could identify the issues of credit management in Nepalese commercial bank. In this regard, the performances of Nepalese commercial bank are to be analyzed in terms of their credit, Liquidity position, industrial environment, management quality and organization climate etc. As the samples of commercial banks, NIBL and NIC Bank have been selected, the problems faced by the banks can be pointed out as follows:

- What is the Liquidity position and investment position of commercial banks in Nepalese economy?
- How are the commercial banks in Nepal providing credits despite the availability of credit rating companies? What is the basis of judgment of credit clients?
- Is the poor credit recovery process, because of poor credit administration?
- Is the Non-performing credit going upward because of poor judgments in investments to different economic sectors of country?
- Is clear-cut objectives and policy of the credit management lacking?
- Is writing off the non-performing assets not satisfactory?
- Are the legal processes in the recovery of credit lengthy and ineffective?

1.4 Objectives of the Study

There is no doubt that the role of the commercial banks is significant in the development of the country. Banks help in the development of the country by providing credit to the necessary sectors. Basic objective of the present is explored the efficiency of inefficiency and its management in commercial banks. It is also aimed to find the relationship between credit practices and profitability situation. The breakdown of the objectives of the study is as follows:

1 To see the procedures of loan disbursement of commercial banks.

2 To see the position of credits and advances provided by the commercial banks.

3 To analyze the recovery status of the credit disbursed.

4 To assess credit practices of selected Nepalese commercial banks.

5 To explore the relationship of the loan and advances, non performing loan and net profit of selected Nepalese commercial banks.

6 To recommend for the improvement on the basis of finding of the study of the analyzing the credit management.

7 To see the financial conditions of Nepalese commercial banks

8 To see credit practices of selected commercial banks

9 To see credit efficiency of selected commercial banks.

10 To explore the impact of loans and advances to net profit of the selected commercial banks

11 To explore the trend analysis of loan and advances of selected commercial banks.

1.5 Significance of the Study

Commercial banking sector is considered as successful area in financial sector of Nepal. In today’s context, commercial banks have to be more organic and sincere to establish better creditability position due to vast competition among them the present concept deals with how commercial banks managed credit position and how do it affect to organizational effectiveness.

Present study is very important from the point of view of bank management. The main strategy of every commercial bank is to establish the better creditability position, which has directly impacted the financial performance of an organization. Beside it helps to build positive attitude and perceptions non customer that helps to make the organizational successes in terms of better transaction, better turnover and better profitability. At present the private sector and joint venture banks are gaining a wide popularity through their efficient management and professional cum personalized services and playing important role in domestic and foreign trade. This study is expected to have importance to various groups but in particular is directed to a certain groups of people/organizations, which are:

a. Importance to shareholders of the respective banks,

b. Importance to the management bodies of these banks for the evaluation of the performance of their banks, and in comparison which other banks,

c. Importance to "outsiders" which are mainly the customers, financing agencies, stock exchanges,

d. Importance to the government bodies or the policy makers such as the central bank

e. Interested outside parties such as- investors, customers (depositors as well as Borrowers), and competitors, human resource of the banks, stockbrokers, dealers, and market makers.

f. Fellow researchers on the same / similar subject

So, this study helps these banks to identify its hidden weakness regarding financial cum credit management and necessity of the present study is justified.

1.6 Focus of the Study

This study confirms the analysis of credit, loan and advances (i.e. new credit disbursement and recovery of existing) of two commercial banks. The present study analytically discloses the strengths and weaknesses of the commercial banks in relation to credits disbursed and their recovery.

1.7 Limitations of the Study

The scope of the study is limited only commercial banks because of time and resources constraints. Most of the analyses are descriptive in present study. This study is very basic attempt to address the researches issues; therefore, it might not be able to show casual linkage or effect. Instrument used for the data collection is not standardized questionnaire.

Although this study will try its utmost care to cover mist of the important sectors, it is still subject to the following limitations, which are as follows:

- This research study largely depends on published documents such as Balance Sheet, Profit and Loss Account Statements, which are circulated at the close of the financial year.

- The study is associated only to the financial performance of Nepal Investment Bank Limited and Nepal Industrial & Commercial Bank Limited.
- In this study, only selected financial and statistical tools and techniques are used.
- The other limitation is the lack of sufficient time and resource because the purpose of this thesis is only to fulfill the partial requirement for the Master of Business Studies (MBS) of the management faculty, Tribhuvan University.
- The study will base on only the past five years periods since 2004/05 to 2008/09.
- The study deals mainly with secondary data.

1.8 Organization Structure of the Study

The present study is organized in such a way that the stated objectives can easily be fulfilled. The structure of the study will try to analyze the study in a systematic way. The study report has presented the systematic presentation and finding of the study. The study report is designed in five chapters which are follows:

Chapter-I Introduction

Chapter I describes the basic concept and background of the study. It has served orientation for readers to know about the basic information of the research are, various problems of the study, objectives of the study and need or significance of the study. It is oriented for readers for reporting giving them the perspective they need to understand the detailed information about coming chapter.

Chapter-II Literature Review

The second chapter literature review of the study assures readers that they are familiar with important research that has been carried out in similar areas. It also establishes that the study as a link in a chain of research that is developing and emerging knowledge about concerned field.

Chapter-III Research Methodology

Research methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view. It describes about the various source of data related with study and various tools and techniques employed for presenting the data.

Chapter-IV Data Presentation and Analysis

The presentation and data analysis the data related with study and presents the finding of the study and also comments briefly on them. The major data presented is obtained through websites, thus the data available can be considered to be as secondary data.

Chapter-V Summary, Conclusion and Recommendations

Summary, conclusion and recommendation on the basis of the results from the data analysis, the researcher concluded about the performance of the concerned organization in the terms of credit management. It also gives important suggestions to the concerned organizations fort better improvement.

CHAPTER II

LITERATURE REVIEW

The review of literature is a crucial aspect of planning of the study. The main purpose of literature review is to find out what types of works and researches have been done in past in the area of the research problem under study and what has not been done in the field of the research study being undertaken with reference to the study, Credit management in Nepalese commercial banks. For review study the researcher uses different books, reports, journals, and research studies published by various institutions, unpublished dissertations submitted by master level students have been reviewed.

It is divided into two headings:

- Conceptual Review
- Review of different studies

2.1 Conceptual Review

The review of textbooks and other reference materials such as: newspapers, magazines, research articles, journals and past thesis have been included in this topic.

Review from Books:

"Banking is the business of collecting and safeguarding money as deposits and lending of same. The banker's business is them to taken the debt of other people to offer his own in exchange and thereby to create money. He may be a dealer in debts, but in distress is only the observe of wealth and it would be equally permissible to describe the banker as a liquefies of wealth" (Crowther, 2001:81).

Credit management involves the creation, processing, monitoring, review, control and management of risk assets. The process of lending takes into consideration the people and system required for the evaluation and approval of loan requests, negotiation of terms, documentation, disbursement, administration of outstanding loans and workouts, knowledge of the process and awareness of its strength and weaknesses are important in setting objectives and goals for lending activities and for allocating available funds to various lending functions such as commercial, installment and mortgage portfolios. (Johnsan et.all. 1940: 132)

Review from Articles:

Bodhi B. Bajracharya, in his article "Monetary policy and deposit mobilization in Nepal" (Bajracharya; 1991:3) has concluded that mobilization of the domestic saving is one of the prime objectives of the monetary policy in Nepal. And commercial banks are the most active financial intermediary for generating resources in the form of deposit of private sector and providing credit to the investors in different sectors of the economy.

Review from previous Thesis:

In banking sector or transaction, an unavoidableness of loan management and its methodology is regarded very important. Under this management, many subject matters are considered and thought, For example, there are subject matters like the policy of loan flow, the documents of loan flow, loan administration, audit of loan, renewal of loan, the condition of loan flow, provision of security, the provision of the payment of capital and its interest and other such procedures. This management plays a great role in healthy competitive activities. *(Bhandai; 2003:107)*

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

Portfolio management helps to minimize or manage the credit risks by spreading over the risk to various portfolios. These methods of managing credit risk is guided by the saying do not put all the eggs in a single basket. *(Bhandari; 2004:125)*

A frequently neglected but an important role is the provision of credit. Credit policy is sometimes, omitted entirely from an analysis of marketing mix by academics. This is despite empirical findings that although the credit package is unlikely to be the primary factor in determining overall patronage success. It may serve to clinch a contract when suppliers' offering are otherwise equally attractive. The credit policy cannot be sound unless it is based on clear knowledge of the cost of credit. The cost is determined by the quantity of all the credit sales, average collection period and the opportunity cost of capital. Capital and its interest and other such procedures. This management plays a great role in healthy competitive activities.

2.2 Concept of Commercial Banking

"A banker or bank is a person or company carrying on the business of receiving moneys, and collecting drafts, for customers subject to the obligation of honoring cheques drawn upon them from time to time by the customers to the extent of the amount available on their customer." *(Vaidya; 1992:3)*

Sir Jon Paget states that no one can be a banker who does not take deposits accounts, take current accounts, issue, pay cheques, crossed and uncrossed, for his customers. He further adds that if the banking business carried on by any person is subsidiary to some other business; he cannot be regarded as a banker. (*Paget; 1966:37)*

Commerce is the financial transactions related to selling and buying activities of goods and services. There fore commercial banks are those banks, which works from commercial viewpoint. They perform all kinds of banking functions as accepting deposits, advancing credits, credit creation, and agency functions. They provide short-term credit, medium term credits and long terms credit to trade and industry. They also operate off balance sheet functions such as issuing guarantee, bonds, letter of credit, etc.

The banks pool together the savings of the communities and arrange for their productive use. They supply the financial need of the modern business by various means. Commercial banks act as an intermediately accepting deposits and providing credits to the needy area. The main source of the commercial bank is current deposit, so they give more importance to the liquidity of investment and as such they specialize in satisfying the short- term credit needs of business other than the long-term. Commercial banks are restricted to invest their funds in corporate securities. Their business is confined to financing the short-term needs of trade and industry such as working capital financing. They cannot finance in fixed assets. They grant credits in the form of cash credits and overdrafts. Apart from financing, they also render services like collection of bills and cheques, safe keeping of valuables, financial advising, etc to their customers. (Vaidya, 1999:24)

Commercial banks are organized as a joint stock company system, primarily for the purpose of earning a profit, They can be either of the branch banking types as we see in most of countries, with a large network branches like in Nepal or of the unit banking type, as we see in the United States where a banks operations are confined to a single office or to a few branches within a strictly limited area. (Shekhar and Shekhar; 1999:24)

The income and profit of the bank depend upon the lending procedure applied by the bank. And, lending policy and investment in different securities also affect the income and profit. In the investment procedures and policies is always taken in mind that "the greater the credit created by the bank, the higher will be the profitability." A sound lending and investment policy is not only prerequisite for bank's profitability but also crucially significant for the promotion of commercial savings of a developing country like Nepal.

Commercial banks as financial institutions perform a number of internal functions. Among them, providing credit is considered as most important one. "Commercial banks brings into being the most important ingredient of the money supply, demand deposit through the creation of credit in the form of loan and investment." The sound policies help commercial banks maximize quality and quantity of investment and there by, achieve the own objective of profit maximization and social welfare. Formulation of sound investment policies and coordinated and planned efforts pushes forward the force of economic growth.

2.3 Functions of Commercial Bank

"The business of commercial banks is primarily is to hold deposits and make credits and investments with the object of securing profits for its shareholders. Its primary motive is profit; other considerations are secondary." (Sudarshanam; 1976: 23)

The major functions of commercial banks are as follows.

Accepting Deposit, Advancing Credits, Agency Services, Credit Creation, Financing of Foreign Trade, Safekeeping of Valuables, Making Venture Capital Credits, Financial Advising**,** Offers Security Brokerage Services.

Assist in Foreign Trade:

The bank assist the traders engaged in foreign trade of the country. He discounts the bills of exchange drawn by exporters on the foreign importers and enables the exporters to receive money in the home currency. Similarly, he also accepts the bills drawn by foreign exporters. (Vaidya; 1999:29)

Offers Investment Banking and Merchant Banking Services:

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

2.4 Concept of Credit

Credit is the amount of money lent by the creditor (bank) to the borrower (customers) either against security or without security for various business and non business, fixed capital or working capital, institutional or personal uses.

"Sum of the money lent by a bank, etc" .Credit and advances is an important and one of the major volume holding items on the asset side of the balance sheet of a commercial bank. "Bank earns interest on credits and advances, which is one of the major sources of income for banks. Bank prepares credit portfolio, otherwise it will not only add bad debts but also affect profitability adversely" *(Varshney and Swaroop; 1994:256)*

Credit is financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for an obligation repay on specified date on demand.

Banks generally grants credit on four ways:

1. Overdraft
2. Cash Credit
3. Direct Credit
4. Discounting of Bills

2.5 Types of Credit (Funded and Non-Funded)

<u>Funded Credit Facilities</u>

<u>Business Credit</u>

Working Capital Credit: Working capital denotes the difference between current assets and current liabilities. The working capital credit is provided to the customers to meet their working capital gap for supporting manufacturing, trading or service business. A natural process develops wherein funds moving through the cycle are generated to repay a working capital credit. However banks normally don't provide working capital credit based on difference between current assets and current liabilities only. The normal working capital credit is based on bankable working capital i;e (inventory + trade receivables – trade payables). The working capital credit is provided under different headings described as under;

Overdraft (Cash Credit): Conceptually it is the excess amount withdrawn by a customer over their deposits from current account maintained with the Bank. However in current banking practice overdraft is provided as loan only and limit is provided to the client. Banks thus prefer to call it cash credit. The credit is not given directly in cash but current account is opened on the name of credit taker and the loan amount is credited to that account. The borrower deposits and withdraws amount in this account. Normally it is a revolving credit. It is provided for a period of 12 months only and may be renewed annually.

Hypothecation: This credit is similar to overdraft considering the operation procedure of accounts. However, inventory/stock is a must security in this credit. Credit amount is fixed by maintaining a certain percentage of margins on inventory value. It is also a revolving line of credit. It is provided for a period of 12 months only and may be renewed annually.

Short-Term Loan: This credit has a fixed maturity within 365 days. Banks normally provide this credit for 3, 6 and 12 months. This credit is provided to meet the instant demand of funds or seasonal fluctuations in the business. It is also called demand loan and can be of either revolving or non-revolving nature.

Trust Receipt Loan (TR): It is a specific type of credit. It is created to support L/C transactions of a client. When L/C has to be paid, the client has to deposit cash in the Bank. In stead of depositing cash, the client can request to debit his TR account and pay the L/C amount. TR loans are specific in nature because those are booked on the basis of value of L/C document. There may be a single TR limit but it may contain more than one loan having normal maturity dates of 90, 120, and 150 or 180 days depending upon the nature of business the credit taker is in.

Although there may be other types of credit facilities under different loan headings as working capital credit, but the basic nature is that all have maturity within 365 days and are usable for fulfilling working capital gap.

Fixed Capital / Long-Term Credit: It refers to money lent in lump sum to the borrowers having maturity of more than 365 days. It is principal form of medium term debt financing having maturities depending upon the nature of assets created from the credit. However, normal period is within 1 to 10 years. Normally these credit facilities are provided to create fixed asset and for capital expenditure. As per the purpose of credit facility to add fixed assets having longer maturity, maturity period is devised beyond 1 year.

Barely and Myers urge that bank credits with maturities exceeding 1 years are called term credits. The firm agrees to pay interest based on the bank's prime rate and to repay principal in the regular installments. Special patterns of principal payments over time can be negotiated to meet the firm's special needs.

Project Credit: Project Credit is granted to the customers as per project viability. This is a mix of both fixed capital and working capital credit. This type of credit facility is generally availed by the business having high capital expenditure and working capital requirement for business operation. The project is financed under a specified or agreed debt equity ratio. Manufacturing units, hotels, mills and other large projects are financed under project credit.

"Construction Credits are short -term credits made to developers for the purpose of completing proposed projects. Maturities on construction Credits range from 12 months to as long as 4 to 5 years, depending on the size of the specific project". The basic guiding principle involved in disbursement policy is to advance funds depending against progress of project.

Consortium Credit: Consortium is a group of banks and financial institutions created to finance a huge project. Consortium credit may include all funded and non-funded credit facilities. No single financial institution grant credit to huge projects due to following reasons

- Single obligor limit (maximum limit for lending to an individual / institution / group as approved by Central Bank) it is 25% and 50% of core capital of financial institutions in case of funded and non-funded limits in Nepal

- Risk associated: A single financial institution may not take entire risk on project. So it may create a consortium to finance a project even though loan amount is within single obligor limit

In this case the decisions are implemented as per consortium meeting decision. A bank having largest exposure in project takes the charge and is called lead bank. Lead bank acts on behalf of other banks/financial institutions as well. The security is charged by way of pari paasu agreement between borrower and lenders (on pro rata basis).

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

Charge cards and credit lines tied to demand deposit accounts are the two most common revolving credit agreements. It can be further divided into credit cards, automatic overdrafts lines and large credit lines.

Hire Purchase Financing (Installment Credit): Hire-purchase credits are characterized by periodic repayment of principal and interest over the maturity of the credit. Hirer agrees to take the goods on hire at a stated rental including their repayment of principal as well as interest with an option to purchase. This credit is generally provided for commercial vehicles. Hire purchase credit taken for personal use falls under consumer credit.

Consumer Credit:

Financial institutions also extend personal credit to their customers. It is given to those who have regular income and can serve loan installment with ease. These types of credit facilities are of longer term and higher rate is charged with increment in repayment period. The loans are to be paid in Equated Monthly/Quarterly Installments.

Housing loan: To construct, repair, or purchase residential building

Vehicle loan: To purchase private car, jeep etc

Educational Loan: To finance the education and accommodation cost of student

Personal loan: For personal use of the client without any specific purpose. It may be revolving as well

Priority or Deprived sector Credit:

Commercial banks in Nepal were required to extend advances to the priority and deprived sector.12 % of the total Credit was a must towards priority sector including deprived sector but this requirement has now been discontinued by NRB. Rs 2 million for agriculture cum service sector and Rs 2.5 million for single borrowers were limit sanctioned to priority sector. Institutional support to' Agriculture Development bank' and 'Rural Development Bank' are also considered under this category. Deprived sector lending includes:

- Advances to Poor/downtrodden/weak/ deprived people up to Rs 30,000 in generating income or employment.
- Institutional Credit to Rural Development Bank and credits to NGOS which are permitted to carryout banking transactions for lending up to Rs 30,000.

Non-Funded Credit Facilities

Those are the credit facilities where fund of lending institution is not involved. These facilities are in use to facilitate the clients in due course of business. In fact these are off Balance sheet transactions of financial institution and fall under contingent liability. Contingent liability pinpoints the liability, which may or may not arise during the happening of certain event. Footnotes are kept as reference to them instead of recording in the books of accounts.

It is non-funded based remunerative facilities but more risky than the funded until adequate collateral are taken. The generally used non funded facilities are.

Bank Guarantee: It is the commitment given by a bank, in request of its customer (applicant), in favor of other party (beneficiary) that in event of default from the applicant, the bank will pay to the beneficiary a certain specified amount instantly when the guarantee is invoked. Generally bank takes a certain percent of committed amount as bank guarantee commission. Further cash margin or security back up is also required by the bank to issue a guarantee.

Letter of Credit (L/C): It is issued on behalf of the customer (buyer) in favor of the exporter (seller) in international trade stating to pay certain sum of money on the submission of certain documents complying the stipulated terms and conditions as per the agreement of L/C. Generally there are four parties involved in a L/C transaction, Buyer, Buyer’s Bank, Seller and Seller’s Bank. Apart of those, there may be introduction of confirming bank as well.

Buyer’s Bank opens L/C upon presentation of sellers pro-forma invoice by buyer stating that upon receipt of full documents it will pay to seller’s bank the committed sum of amount. Seller dispatches goods and asks its Bank for payment of amount. Seller’s Bank sends the documents to Buyer’s Bank for payment of L/C amount. Buyer’s Bank makes payment to Seller’s Bank and asks for reimbursement from Buyer. On reimbursement of amount, Bank releases the documents and buyer releases goods and takes possession.

2.6 Factors affecting Credit Policy

Generally, the following factors are to be considered to make effective loan management. It is also called the factors of credit policy. It helps to get effective credit worthiness.

Industry Environment

It determines the nature of the industry structure, its attractiveness and the company's position within the industry, structural weakness of a company, which is disadvantaged, theaters first way out and security value.

Financial Condition

It determines the borrower's capacity to repay through cash flow as the "First way-out". The strength of "second way-out" i.e.: through collateral liquidation is also assessed. Further the possibility to fall back on income of sister concerns in case of financial crunch of the company conditions theaters repayment capacity.

Management Quality

It determines the integrity, competence and nature of alliances of borrower's management team. Weakness in replacements needs to be evaluated.

Technical Strength

It determines the strength and quality of the technical support required for sustainable operation of the company in terms of manpower and technology used. Appropriate technical competencies of the manpower, the viability of the technology uses, availability of after sales service, cost of maintenance and replacement need to be evaluated.

Security Realization

It determines the control over various securities obtained by bank to secure the loan provided excitability of the security documents and present value of the properties mortgaged with the bank. Weakness in security threatens the banks second way-out.

2.7 Objectives of the Sound Credit Policy.

The purposes of a written credit policy are:

1. To assure compliance by lending authority/officials with the bank's policies and fulfillment of objectives regarding the portfolio management

2. To provide personnel with a framework of standards within which they can operate.
3. To maintain uniformity in practice of lending within an institution

For getting support, the leader personnel should write the loan policy from subordinates and associates. For establishing this policy, it is necessary to get approval about this board of directors after discussion. Better performance of loan extends multiple benefits to the society and country where as non-performing erodes even existing share capital.

2.8 Lending Criteria

For every disbursement of credit, well defined and approved procedure must follow, such well establish criteria for disbursing advances and loan is the most essential for the survive, thrive and succession of the commercial bank. For such launching process: systematic, scientific, throughout study and analysis must be followed. While screening a credit application 5-cs to be first considered supported by documents.

1 Character:

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

- Memorandum and Articles of Association
- Registration Certification
- Tax registration certificate (Renewed)
- Resolution to borrow
- Authorization-person authorizing to deal with the bank
- Reference of other lenders with whom the applicant has dealt in the past or bank A/C statement of the customer.

2 Capacity:

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

- Certified balance sheet and profit and loss account for at least past 3 years
- Reference or other lenders with whom the applicant has dealt in the past or bank A/C.
- Net worth statement of the client
- Documents showing client's sources of income other than the business shown

3. Capital:

This indicates applicant's capacity to inject his own money. By capacity analysis, it can be concluded that whether borrower is truing to play with lender's money only or is also injecting his own fund to the project. For capital analysis financial statements, like certified balance sheet, profit and loss account is the data required. Availability of other liquid funds to the client and details of liquid investments may be helpful in analyzing the capital factor.

4. Collateral:

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

Right over shares, debentures and bond owned by the client may be additional collateral. Further, personal, joint and corporate / cross guaranteed act as an additional security.

5. Conditions:

Once the funding company is satisfied with the character, capacity, capital, and collateral then a credit agreement (sanction letter) is issued in favor of the borrower stating conditions of the credit to which borrower's acceptance is required. Non-compliance with any of the condition by the client must give bank right to trigger recovery action.

2.9 Principle of Credit Policy

Good credit policy is essential to carry out the business of lending more effectively. Some policies are as follows: (Source: www.creditguru.com)

1. **Principle of Safety Fund:** Banks should look the fact that is there any unproductive or speculative venture or dishonest behavior of the borrower.

2. **Principle of Liquidity:** Liquidity refers to pay on hands on cash when it in ceded without having to sell long-term assets at loss in unfavorable market. A banker has to ensure that money will come in as on demand or as per agreed terms of repayment.

3. **Principle of Security:** It acts as cushion to grant advances and credits. Adequate values of collaterals ensure the recovery of credit correctly at the right time. Accepted security should be readily marketable, handy and free from encumbrance.

4. **Principle of Purpose of Credit;** Generally, credit request for productive sector only be accepted rejecting credit request for speculation, social functions, pleasures trips, ceremonies and repayment of prior credit as they are unproductive.

5. **Principle of Profitability;** Profitability denotes the value created by the use of resource is more than the total of the input resources. Bank should provide to such project that can provide optimum amount of return. For such purpose, bank should take a little bit risk by providing credit to venturous project.

6. **Principle of Spread:** Portfolio of advances is to be spread not only among many borrowers of same industry by across the industries in order to minimize the risk of lending keeping" Do not put your all eggs in the same basket" in mind.

7. **Principle of National Interest:** In lending and granting advances, interest of nation should not be distorted (if undermined). Priority and deprived sector of economy and other alarming sector should be given proper emphasis while extending advances.

2.10 Project Appraisal.

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

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

Generally, the project appraisal involves the investigation from the following aspects:

a. Financial aspect
b. Technical aspect
c. Management/Organizational aspect
d. Commercial aspect

1. Financial Aspect

Bank agrees to finance only in the viable and profitable project which have high degree of recovery. The following documents revels the cleared picture here in:-

Cash flow Statement

Cash Flow Statement is prepared by the cash from financing, investing and operating activities. In such figure, opening and closing cash balance shows either surplus or deficit of the project. This helps in taking decision to credit sanction.

Performa Balance Sheet

Balance Sheet shows the clear picture about the financial status of the project. Cash flow statement is also prepared with reference to balance sheet and profit and loss account.

Cost of Project

About the cost picture of the project, working capital cost is necessary. Management needs the fixed assets and daily expenses. So bank needs to study both precisely and prepares document about the disbursement.

2. Technical Aspect

For technical viability of the business, proper location plant and equipment, legal aspect (Govt. policy) and technical competence must. Appropriate location must be fulfillment of transport facility, infrastructure, peace and silence as well as accessibility of the market. Further more newly invented technology with high productive efficiency must require. In other hand government should provide the adequate support and useful policy must adopted.

3. Management / Organizational Aspect

Management is one of the must prime aspect of the project operation, which function as the body structure. There must be honest, hardworking, competent, qualified and result oriented staff for the guarantee successes. Only dedicated team with management by objective can lead the organization.

4. Commercial Aspect

For the viability of the project commercial feasibility is the most essence, present and future prospect of the projects are to be analyzed and lending decision must undertaken. Only profitable and future glorious projects are viable for which following aspects must be present:

- Nature of product / service
- Quality and quantity of product
- Competitive advantages and market reliability
- Selling and distribution system
- Promotion and buyer's analysis
- Advertising and sales order meet

Also, bank consider the further more:

- Quality and types of customers

- Credit terms and policy
- Aging Schedule.

Directives Issued by NRB for the Commercial Bank: (related to credit aspect only):

1. Credit Classifications and Provisioning:

Classification	Provision
1. Pass Credit	1%
2. Sub standard Credit	25%
3. Doubtful Credit	50%
4. Bad Credit	100%

Those credits that have not crossed the time schedule of repayment and are within 3 months delay of maturity date fall under the classification topic 'pass credit'. It is also known as performing credit.

Sub standard credit are those credit which are already crossed the repayment time schedule and are within 3-6 months delay of maturity date. Likewise, within 6-12 months delay from the time to be recovered are classified as doubtful credit. Those credits, which are not recovered yet after 1 year from maturity date, are known as bad credit All the above 3 types of credits are classified as non-performing credit also.

The credit loss provision for performing credit is termed as general credit loss provision whereas the credit loss provision for non-performing credit is termed as specific credit loss provision.

Auditor has to correctly rate the credit and ensure that accurate credit loss provision has been made. The auditor should examine whether the bank has obtained complete documentation so that banks interest is secured. In addition audit is made to inspect compliance of terms and conditions laid down. Credit audit is required to check whether credit given is within authority, drawing power, etc. Credit audit helps the bank to know quality of its credit, its weaknesses and strengths. This, in turn, helps the bank to adopt corrective measures where weaknesses have been pointed out and to focus further on strengths. General guidelines whether to reject or renew the credit can be establish with the help of credit audit.

2. Limit of Credit and Advances in a Particular Sector:

I. Fund based Credit and advances can be issued up to 25% (upper limit) of core capital to a single customer, firm, company and a group of related customer.

II. Non-fund based (off-balance items) can be issued up to 50% of core capital to a single customer, firm, company and group of related customer.

Note: The core capital includes {paid up capital + share premium + non-redeemable preference share + general reserve fund + accumulated profit (loss) -goodwill (if any included)}

Group of related customer:

- If a company takes 25% or more share of another company.
- Member of board of directors of company shareholders of private limited company and such members and shareholder with others in a single house, even if husband, wife, son, daughter, daughter in law, unmarried daughter, adopted son, adopted unmarried daughter, father, mother, stepmother and brothers & sisters whom be should look after. And the above members personally or combined take 25% or more share of another company.
- Firm, company and members as a related group.
- Members of board of directors, shareholders and other relatives as stated in serial number 'b' takes less than 25% of board of directors of the company solely or combined but have control on the other company by the following ways:
- Being president of board of directors of the company
- Being executive directors of the company.
- Nominating more than 25% of members of board of directors of the company.

- If cross guarantee is given by one company to another company.

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

- **Productive Sector**

Productive Sector include advances to Priority Sector and Other Productive Sector which includes advances and investment in shares and debentures of small, medium and large industries as defined in industrial enterprises act; pre-shipment credit like purchase of merchandise, processing, assembling, packaging etc.; export bill financing, advances for purchase of public transport like truck, bus, tempo etc. and agricultural/farm equipment; investments on shares and debentures of government/semi-government or private sector agricultural insurance, go-down, banking or like companies etc.

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

- **Priority Sector Credit Program**

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

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

Table No. 1

NRB Requirement of Priority Sector Investment

Fiscal Year	**Minimum percent of Total Credit to be invested in Priority Sector**
2004/05	4%
2005/06	2%
2006/07	2%
2007/08	4%
2008/09	4%

Source: NRB Directives 2009

Effective from FY 2007/08, investment in Priority Sector shall not compulsory. Before FY 2002/03, the commercial banks were directed to invest 8% of their total credit to priority sector.

- **Deprived Sector Lending**

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

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

- Agriculture and Agro-bases business
- Cottage and small industries

- Services
- Other business

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

Deprived sector credit is advances up to Rs.50, 000 per borrower family meant for weak, poor and deprived people extended in the following manner by the commercial banks shall qualify to be included under deprived sector credit:

- Direct investment made by the commercial banks themselves in income generating employment oriented programs.
- Investments made by commercial banks in share capital of Rural Development Banks, Rural Micro Finance Development Center and other Development Banks established with an objective to extend credit to deprived sector.
- Advances to the Rural Development Banks and other Development Banks engaged in the similar poverty alleviation programs.
- Advances to Cooperatives, Non-governmental Organization and Small Farmers Cooperatives approved by NRB for carrying out banking transactions.
- Advances to Micro-Finance Institutions/ (Rural Development Banks and other financial institutions, cooperatives and non-governmental organizations approved by NRB for intermediation) stipulating the condition to disburse such credit to deprived sector only.
- Loans extended by commercial banks to development banks engaged in micro credit activities with stipulated condition to disburse the credit only to the deprived sector up to Rs.30,000 a family shall be eligible for the purpose of inclusion under Deprived Sector Credit.

Effective from FY 2000/01, Nabil and HBL shall compulsorily extend advances to the deprived sector by 3% of its total outstanding credit while new commercial banks are required to invest 0.25% of total outstanding credit to the deprived sector.

- **Regulation relating to Loan Classification and Loan Loss Provisioning**

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

- **Classification of Outstanding Loan and Advances on the Basis of Aging**

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

2.11 Review of Relevant Articles and Journals

Ganesh Shrestha, (1998) in his article *"Lending Operations of Commercial banks of Nepal and its Impact on GDP"* presented the objectives to make an analysis of contribution of commercial banks' lending to the Gross Domestic Product (GDP) of Nepal. She has set a hypothesis that there has been a positive impact of lending of commercial banks to the GDP.

In research methodology, she has considered GDP as the dependent variable and various sectors of lending viz. agriculture, industrial, commercial, service, general and social sectors as independent variables. A multiple regression technique has been applied to analyze the contribution.

The multiple analyses have shown that all the variables except service sector lending have positive impact on GDP. Thus in conclusion, she has accepted the hypothesis, i.e. there has been positive impact on GDP by the lending of commercial banks in various sectors of economy, except service sector investment."

Rabindra Bhattarai, (2002) in his article "*Something is Rotten with the State of Commercial Banking in Nepal*" starts with words like NPA, conflict of interest, merky offshore ownership, well connected defaulter, loan swapping and political obstruction to describe the commercial banks in Nepal. Mr. Bhattarai quoted the words of the Governor to describe the state of banking sector as 'terrible'. Also, he quotes one of the donor representatives involved in financial reform as "Nepal has the weakest central bank in the developing world." As per the author, bankers with patronage could get away with getting anything they wanted approved by the regulator. He quotes Mr. Himalaya SJB Rana, the first governor of NRB, "only 3 out of 12 Governors actually completed their five year terms in its entire history because they were sacked for undefined exigencies." He also quotes Mr. Shovan Dev Pant, the then Executive Director of Nabil, "The financial sector is in appalling state."

Mr. Bhattarai says that all the evidences gathered for his article point to one direction-the regulatory body, NRB not doing its job properly. He explains that the malaise with the financial sector was deep. As an instance, he presents Nabil Bank and its ownership. He bets on the fact that even Nabil Bank Shareholders do not know of the Bank's owners of the major block of shares. The author expects NRB to disclose this fact if they know about it.

Another example Mr. Bhattarai presents is on the profitability of the banks in the very first year. He questions their profit figures with the given state of ailing economy, where each sector is showing heavy losses. Also, the increasing trend of Non-performing Assets (NPAs) is explained by him is a result of scam. A scam process as explained to him by an NRB official goes like this, "You put in Rs.50 million to promote a bank and then borrow Rs.500 million from it. They are not opening banks to do banking but to siphon loans for themselves." However, the author is of a view that the new directives issued on October 2001 shall improve the situation.

Here, the author has not clearly mentioned of the research methodology. The conclusions are not well supported by data. The article reflects a one sided biased view of the author and the view of NRB on this has not been taken. The conclusion made by the author has not been tested.

2.12 Review of Past Thesis (Dissertation)

A study done by **Mr. Ganesh Bahadur Chand (2004)** entitled with *"Credit Disbursement and Repayment of Agriculture Development Bank Nepal"* has following objectives, major findings & recommendations:

Objectives:

- ✓ To see the repayment situation.
- ✓ To find out the rate of growth of investment.
- ✓ To explain possible causes of non-and delayed repayment.

Major findings:

- ✓ There is systematic relationship between credit disbursement and repayment. The coefficient of correlation value as calculated is 0.94 which shows significance relationship.
- ✓ Repayment situation is satisfactory on production inputs and agro-based industry, warehouses and marketing percentage of repayment to due to the farm mechanization and irrigation and tea horticulture and livestock, poultry and fisheries in much less satisfactory.

Recommendation

For effective credit recovery from the borrowers or clients, Credit should be channeled through the borrower groups.

A study done by **Mr. Biraj Shrestha (December 2008)** entitled with *"Effective Implementation of Credit Policy in Nepalese Commercial Banks"* has following objectives, major findings & recommendations:

Objectives:

- ✓ To study the relationship between deposits & lending.
- ✓ To study the classification, provision for loan/advances & its effect in profitability.

- ✓ To examine the sector wise and security wise lending
- ✓ To identify and analyze the problems and prospects of lending practice of Nepalese Commercial Banks

Major findings:

- ✓ Flow of lending depends upon the availability of low cost deposit in the market
- ✓ Consumer financing and loan to manufacturing units are more secured than other sectors
- ✓ First preference of the Banks for security to loan is fixed assets collateral followed by Government Bonds
- ✓ Lengthy procedure in loan processing and tedious legal procedures is the key factor affecting growth of lending.
- ✓ Lack in follow ups and irregular site visits lead to generation of NPA.

Recommendation

- ✓ Lending procedure should be short
- ✓ Need to invest in small entrepreneur's Development program
- ✓ Need to invest in productive areas that utilize natural resources
- ✓ Need to diversify lending in various sectors and explore un-banked sectors
- ✓ Target agriculture based sector for long term sustainability

A study done by **Ms. Manita Shrestha (April 2009)** entitled with *"Credit Risk Management of Joint Venture Banks"* has following objectives, major findings & recommendations:

Objectives:

- ✓ To determine and analyze credit risk of joint venture banks in Nepal.
- ✓ To evaluate strength, weakness, opportunity and threats in credit management in commercial banks
- ✓ To provide suggestions & recommendations about credit risk management

Major findings:

- ✓ Lending in one lucrative sector and concentration in urban areas only is increasing the risk of loss for the Bank
- ✓ Credit policies and practices were found satisfactory. Bank has opportunity to explore the virgin village market and SMEs.
- ✓ Most of the customers are satisfied with the Joint Venture Banks in terms of service and counseling regarding credit facilities.

Recommendation

- ✓ Banks should depend on written information for credit analysis.
- ✓ Name lending shall be stopped
- ✓ Credit officers must be competent enough to find out the all possible credit risks to minimize the possible loss.
- ✓ Banking services and lending shall be extended to rural areas and new untouched sectors as well.

A study done by **Ms. Suraksha Nepal (June 2009)** entitled with *"Credit Management of Commercial Banks in Nepal"* has following objectives, major findings & recommendations:

Objectives:

- ✓ To assess the credit practices of selected Nepalese commercial banks.
- ✓ To explore the credit efficiency, analyze the industry environment and management quality in terms of credit practices
- ✓ To explore the relationship with loan & advances, NPA and Net profit

Major findings:

- ✓ Repayment is satisfactory in agro based industry and production sector compared to other sectors.
- ✓ Management quality and credit efficiency of selected banks found satisfactory as they have standard credit practices

- ✓ Credit disbursement and repayment has significant relationship. Flow of new credit depends upon the recovery status

Recommendation

- ✓ Low cost deposits shall be increased and NPA shall be decreased to increase the profitability.
- ✓ Credit policies and procedures shall be tightened to ensure no further losses due to flow of new loans.

A study done by **Mr. Narendra Sejuwal (2007)** entitled "*A Comparative Study on Credit Management of Commercial Banks*" a case study of commercial banks (Standard Chartered Bank, NABIL). His research statement of problem:

Because of high interest rate of non-institutional series, people are unable to pay their credit at fixed unable to pay their credit at fixed time. These institutions compel them to transfer their property to the moneylender resulting himself or herself as a landless person.

Commercial banks are the major financial institutions supporting for the people for the different purpose like agro, industries, tea, coffee, livestock farming etc. They provide the credit for individual and cooperative sector to all region of the country. Credit outstanding amount is increasing day by day but the collection amount is not good. However commercial banks have increased its effort to collect its credit. It is said that those people who really need do not receive sufficient amount of credit from the commercial banks.

Major Findings

- ✓ Actual credit disbursement, collection and outstanding are increasing in decreasing rate.
- ✓ Yearly increase in credit disbursement is higher than that of collection.
- ✓ Positive relation between credit disbursement and collection that is 0.996
- ✓ Targeted credit collection and disbursement fixed by planning and project department is not significantly different than the actual.

- ✓ Most of the customers are unaware of the policy of the bank.

Recommendations

- ✓ The borrowers should be informed about the credit, its use and its payment procedures and schedule.
- ✓ Greater attention should be given to increase the credit collection and to collect old outstanding amount of credit and renewal of it.
- ✓ To accelerate the collection, credit should be followed continuously in a regular interval of time.
- ✓ The behavioral of the personal should be strictly supervised in granting credit in proper investment proposal because of most of the bad credit disbursement is due to weak decision of the personnel.

2.13 Research Gap

The purpose of this research is to develop some expertise in one's area, to see what new contribution can be made and to receive some ideas, knowledge and suggestion in relation to credit management of selected commercial banks (i.e.: NIBL and NIC). Thus, the previous studies cannot be ignored because they provide the foundation to the present study. In other words, there has to be continuity in research is ensured by linking the present study with the past research studies. Here, it is clear that the new research cannot be found on that exact topic, i.e. a comparative study on credit management of commercial banks in Nepal. Therefore, to fulfill this gap, this research is selected. To complete this research work, many books, journals, articles and various published and unpublished dissertation are followed as guideline to make the research easier and smooth. In this regard, here we are going to analyze the different procedure of the credit management, which is considered only on NIBL and NIC. To achieve these objectives, various financial and statistical tools are used. Similarly trend analysis of investment and profit are reviewed to make this research complete. Therefore, this study is useful to the concern banks as well as different person, Such as Shareholders, investors, policy makers, state of government etc.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Introduction

Research is common parlance refers to a search for knowledge. The Webster International Dictionary gives a very inclusive definition of research as "a careful critical inquiry or examination in seeking facts and principles; diligent investigation in order to ascertain something. Reman and money define research as "systematized effort to gain new knowledge ".Some people consider research as a movement, a movement from the known to the unknown. It is actually a voyage of discovery; we all posses the vital instinct of inquisitiveness makes us prose and attain full and fuller understanding of the unknown, which man employees for obtaining the knowledge of whatever the unknown, can be termed as research.

3.2 Research Design

A research design is the arrangement of condition for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. Descriptive and analytical research designs have been used to this study. Research design serves as a framework for the study, guiding the research instruments to be utilized, and the sampling plan to be followed. In other words research design describes the general plan for collecting, analyzing and evaluating data. For research there exist different types of research design like Historical research, Analytical research, Descriptive research, Case study research, Field study research and so on. This study mainly concerned with commercial banks historical data is used. The relevant and needed data can collected from various publications of different commercial banks.

Decision regarding what, when, how, by what means concerning an enquiry of a research design. "A research design is the arrangement of conditions for the collection and analysis of data in manner that aims to combine relevance to the research purpose with economy in procedure." In fact, the research constitutes the blueprint of the collection, measurement and analysis of data. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data. A research design bears the techniques and systemic steps of research writing or any investigation. In the lack of which helps to collect various information required to researcher for thesis, the research design, the functional process on research is never achieved. "After the research study has been formulated, the next logical steps are to construct the research design which refers to the entire process of planning and carrying out a research study. The research design asks what approach to the problem should be taken. What method will be used? What strategy will be must effective? Identification, selection and formulation of research problem may be considered as the planning stage of a research. Both exploratory and descriptive research designs are to be followed in the study. This type of design has become necessary keeping in view the quantity and quality of information and data that is available.

3.3 Source of Data

The research is based on primary as well as secondary source of data. For research purpose, published financial statement (i.e. annual report) of concerned banks was collected. Similarly, financial statement of selected commercial bank and various markets related information were collected and tabulated in spread sheet. Such secondary information was gathered from the related department of commercial banks.

Carefully designed research instrument (questionnaire) used for primary data analysis. The researchers has carefully designed questionnaire by considering various influencing factor of industry environment, management qualities. The factor derived from various and from previous research findings on related area are to support credit management. Basic sources of primary information were employees of concerned banks. In addition, an answer on certain queries and discussions were also being conducted for clarification and verification of collected data and for recommendation.

3.4 Population and Sample Techniques

26 commercial banks are operating in Nepal. In this scenario, two commercial banks, Nepal Investment Bank Limited and Nepal Industrial & Commercial Bank Limited have been selected as sample for the present study. Similarly, financial statements of these two banks for 5 years from 2004/05 to 2008/09 have been taken as samples for the same purpose.

3.5 Data Collection

The researcher uses two type sources of data collection.

a) Primary Data and

b) Secondary Data

The primary data are those which are collected a fresh and for the first time and thus happen to be original in character. The secondary data, on the other hand are those, which have already been collected by some one else and already, been passed through the statistical process.

In some cases primary data are also taken as personal interview, face to face and telephone interview but the study is mainly based on secondary data. So, the major sources of secondary data for this study are as follows:

a) Annual reports of the banks

b) Published and unpublished bulletins, reports of the banks

c) Published and unpublished bulletins, reports of the Nepal Stock Exchange

d) Previous studies and reports

e) Unpublished official records

f) "Banking and Financial Statistics" report of Nepal Rastra Bank Magazines

g) Journals and other publish and unpublished related documents and reports for Central Library T. U., Nepal Commerce Campus Library, Nepal Rastra Bank Library

h) Various Internet Websites

i) Other published materials

3.6 Data Collection Procedure:

As the study will also be based on primary data, information will be collected developing a scheduled questionnaire and distributing these to employees of the banks and clients. Question of open end (i.e. yes or no) will be included in questionnaire. Besides this, junior employees and clients are also being observed and responses have been drawn from them about relevant questionnaires.

3.7 Methods of Data Analysis

To make the study more specific and reliable, the researcher uses two types of tool for analysis,

a) Financial Tools

b) Statistical Tools

3.7.1 Financial Tools

For the sake of analysis, various financial tools were used. The basic tools used were ratio analysis. Beside it income and expenditure analysis and cash flow analysis have been used

3.7.1.1 Ratio Analysis:

Ratio analysis is a powerful and the most widely used tool of financial analysis. A ratio defined as "The indicated quotient of two mathematical expression" and as “The relationship between two or more things.

A ratio is a figure or a percentage representing the comparison of one-dollar amount with some other dollar amount as a base. Ratio analysis is a widely used tool of financial analysis. It is defined as the systematic use of ratio to interpret the financial statements so that the strength and weakness of a firm as well as its historical performance and current financial condition can be determined. In financial analysis a ratio is used as an index or yardstick for evaluating the financial position and performance of a firm. Ratio helps to summarize the large quantities of financial data and to make qualitative judgment about the firm's financial performance.

A large number of ratios can be generated from the components of profit and loss account and balance sheet. They are sound reasons for selecting different kinds of ratios for different types of situations. For this study, ratios are categorized into the following major headings:

A. Liquidity Ratio:

Liquidity refers to the ability of a firm to meet its short- term or current obligations as and when they fall due for payment. So liquidity ratios are used to measure the ability of a firm to meet its short-term obligations and from them the present cash solvency as well as ability to remain solvent in the event of adversities of the same can be examined.

Inadequate liquidity can lead to unexpected cash short falls that must be covered at inordinate costs, thus reducing profitability. In the worst case, inadequate liquidity can lead to the liquidity insolvency of the institution. On the other hand, excessive liquidity can lead to low asset yields and contribute to poor earnings performance.To find -out the ability of banks to meet their short-term obligations, which are likely to mature in the short period, these ratios are calculated. The following ratios are developed under the liquidity ratios to identify the liquidity position.

i. Cash and Bank Balance to Total Deposit Ratio:

This ratio shows the ability of banks immediate funds to cover their deposit. Higher the ratio shows higher liquidity position and ability to cover the deposits and vice versa. It can be calculated by dividing 'cash and bank balance' by deposits. This ratio can be calculated using the following formula.

$$\text{Cash and Bank Balance to Total Deposit} = \frac{\text{Cash and Bank Balance}}{\text{Total Deposits}}$$

ii. Cash and Bank Balance to Current Deposits Ratio:

This ratio computed to disclose the soundness of the finance company to pay total calls made of current deposits. It can be expressed as:

$$\text{Cash and Bank Balance to Current Deposits} = \frac{\text{Cash and Bank Balance}}{\text{Current Deposits}}$$

B. Activity/Efficiency Ratio:

It is also known as turn over or efficiency ratio or assets management ratio; measures how efficiently the firm employs the assets. Turn over means the number of times and assets flow through a firm's operations and into sales. Greater rate of turnover or conversion indicates more efficiency of a firm in managing and utilizing its assets, being other things equal. Various ratios are examined under this heading.

i) Credits and Advances to Total Deposits Ratio:

Commercial banks utilize the outsider's fund for profit generation purpose. Credits and advances to deposit ratio shows whether the banks are successful to utilize the outsiders funds (i.e. total deposits) for the profit generating purpose on the credit and advances or not. Generally, a high ratio reflects higher efficiency to utilize outsider's fund and vice-versa. The ratio can be calculated by using following formula.

$$\text{Credits and Advances to Total Deposits Ratio} = \frac{\text{Credits and Advances}}{\text{Total Deposits}}$$

ii) Credits and Advances to Fixed Deposit Ratio:

Fixed deposits are the long-term interest bearing obligations and credits and advances is the major sources of investment to generate the income by the commercial banks. This ratio measures how many times the amount is used in credits and advances in comparison to fixed deposit for the income generating purpose. The ratio is slightly differ with the former one, because it only includes the fixed deposits, where as the former on includes all the deposits. The following formula is used to obtain this ratio.

$$\text{Credits and Advances to Fixed Deposit Ratio} = \frac{\text{Credits and Advances}}{\text{Fixed Deposits}}$$

iii) Credit and Advances to Total Assets Ratios:

It measures the ability in mobilizing total assets into credits and advances for generating income. A higher ratio is considered as and adequate symbol for effective utilization of total assets of bank to credit and advances of which creates opportunity to earn more and more. It is calculated as:

$$\text{Credit and Advances to total assets ratio} = \frac{\text{Credits and Advances}}{\text{Total Assets}}$$

iv) Performing Assets to Total Assets Ratio:

It tells the percent of performing assets on total assets. It is useful to know the fact that whether the good credit is increasing or not. We can generate more earning by increasing good credit and reducing bad and inferior credit. It teaches us to invest sources of final only on good credit (i. e. profitable venture). It is computed as:

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

v) Credit Loss Provision to Credit and Advances ratio:

It measures the percentage of credit loss provision on credit and advances. Credit loss provision on credit is given to reduce risk of non-payment of released credit. As per directives to bank and finance companies by NRB (2058 B.S.), 1% of good credit can be provisioned as credit loss provision to reduce risk that may arise due to no recovery of disbursed credit. It is computed as:

$$\text{Credit Loss Provision Ratio} = \frac{\text{Total Credit Loss Provision}}{\text{Total Credit Due}}$$

vi) Overdue Credit to Total Credit Ratio:

It shows the percentage of non-performing credits to total credits. Banks performance is good if the percentage is low and vice versa. It also shows the credit recovery efficiency of the bank. Credit loss provision should be provisioned on the basis of overdue credit classification. It is computed as:

$$\text{Overdue Credit to Total Credit} = \frac{\text{Overdue Credit}}{\text{Total Credit}}$$

C. Leverage Ratio:

The use of finance is refers by financial leverage. When a firm borrows money, it promises to make series of fixed payments, which create financial leverage." These ratios are also called solvency ratios or capital structure ratio. These ratios indicate mix of funds provided by owners and lenders. As a general rule, there should be an appropriate mix of debt and owner's equity in financing the firm's assets. To judge the long-term financial position of the firm leverage ratios are calculated. This ratio highlights the long-term financial health, debt servicing capacity and strength and weaknesses of the firm. Following ratios are included under leverage ratios.

i) Long-term Debt to Net Worth Ratio:

Long-term debt to net worth ratio measures the relative proportion of outsiders and owner's funds employed in the total capitalization. Here, long-term debt includes the amount of fixed deposits and credits of the bank and net worth includes paid up capital, reserve and surplus and undistributed profit. The formula used to determine the ratio is:

$$\text{Long term Debt to Net Worth ratio} = \frac{\text{Long Term Debt}}{\text{Net Worth}}$$

ii) Total Debt to Net Worth Ratio:

The ratio is calculated to find out the proportion of the outsider's fund and owner's fund to finance for the total assets. It also called the proportion of outsider's claim and insider's claim on total assets of the bank. Generally very high the ratio is unfavorable to the business because the debt gives third parties legal claims on the company these claims are for interest payments at regular intervals, plus repayment of the principal by the agreed time. On the other hand, very low ratio is also unfavorable from the shareholders point of view. They want this ratio to be high so that they can have better returns with smaller capital. It is calculated as follow:

$$\text{Total Debt to Net Worth ratio} = \frac{\text{Total Debt}}{\text{Net Worth}}$$

iii) Total Debt to Total Assets Ratio:

It examines the relationship between borrowed funds (i.e. total debt) and total assets. It shows the relative extent to which the firm is using borrowed money. A lower ratio is preferable since it reduces the distress of the creditors by using more amount of equity on total assets. It is computed as:

$$\text{Total Debt to Total Assets} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

D. Profitability Ratios:

Profit is the difference between revenues and expenses over a period of time. A Company should earn profit to survive and to grow over a long period of time. So profits are essential, but profit earning is not the ultimate aim of company and it should never be earned at the cost of employees, customer and society.

"Profitability ratios are the indicators of degree of managerial success in achieving firm's overall goals." It shows the overall efficiency of the business concern. The following ratios are calculated under the profitability ratios:

i. Net Profit/Loss to Total Assets Ratio:

The ratio is useful to measure how well management uses all the assets in the business to generate an operating surplus. Higher the ratio indicated the higher efficiency in the utilization of total assets and vice-versa. The ratio is low due to low profit. In other words, it is low utilization of bank assets and over use of higher interest bearing amount of debt and vice-versa.

In this study, Net Profit/Loss to total assets ratio is examined to measure the profitability of all the financial resources in bank-assets and is calculated by applying the following formula:

$$\text{Net Profit Loss Total Assets} = \frac{\text{Net Profit/Loss}}{\text{Total Assets}}$$

ii. Interest Income to Total Credit and Advances:

It tells the income as interest from total credit and advances. It is useful to know the fact that whether the credit has given good return or not. We can increase interest income by taking good issuing and recovery credit policy. High return shows the soundness of credit policy. It is calculated by using the following formula:

$$\text{Interest Income to Total Credit} = \frac{\text{Interest Income}}{\text{Total Credit and Advances}}$$

E. Other Ratios:

i. Earning Per Share (EPS):

EPS is one of the most widely quoted statistics when there is a discussion of a company's performance or share value. It is the profit after tax figure that is divided by the number of common shares to calculate the value of earnings per share. This figure tells us what profit the common shareholders for every share held have earned. A company can decide whether to increase or reduce the number of shares on issue. This decision will automatically alter the earnings per share. The profits available to the ordinary shareholders are represented by net profit after taxes and preference dividend. Symbolic expression of EPS is given below.

$$\text{EPS} = \frac{\text{Net Income after Taxes}}{\text{Number of Common Stocks Outstanding}}$$

ii. Price Earning Ratio (P/E Ratio):

The P/E ratio is widely used by the security analysts to value the firm's performance as expected by investors. It shows the price currently paid by the market for each rupee of currently reported earning per share. It is also called multiplier. Here, the expression takes place as follows:

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earning Per Share}}$$

iii. Capital Fund Ratio:

It shows how much the bank is sound on the basis core capital fund and secondary capital fund. Bank should maintain the directives given by NRB on capital fund. It is calculated by the formula:

$$\text{Capital Fund Ratio} = \frac{\text{Primary Capital + Supplementary Capital}}{\text{Weighted Average Assets}}$$

Note: (Weighted Average Assets = Risk Weightage on Balance Sheet Items + Risk Weightage on off-balance items.)

3.7.2 Statistical Tools Used:

For supporting the study, Statistical tool such as Mean, Standard deviation, Coefficient of Variation, Correlation, trend analysis, hypothesis and diagrammatic cum pictorial tools have been used under it.

i. Arithmetic Mean (Average):

"Average is statistical constants which enables us to comprehend in a single effort the significance of the whole." It represents the entire data by a single value. The mean is the most commonly-used type of average and is often referred to simply as the average. The term "mean" or "arithmetic mean" is preferred in mathematics and statistics to distinguish it from other averages such as the median and the mode. It provides the gist and gives the bird's eye view of the huge mass of unwieldy numerical data. It is calculated as:

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

Where:

$\overline{X}$ = Arithmetic mean

N = Number of observations

X = Sum of observations

ii. Standard Deviation (S.D.):

"The standard deviation is the square root of mean squared deviations from the arithmetic mean and is denoted by S.D. or σ." It is used as absolute measure of dispersion or variability. It shows how much variation there is from the "average" (mean). A low standard deviation indicates that the data points tend to be very close to the mean, whereas high standard deviation indicates that the data are spread out over a large range of values. It is calculated:

$$\sigma = \sqrt{\frac{\phi\varepsilon^2}{N} - \left(\frac{\phi\varepsilon}{N}\right)^2}$$

Where,

σ	=	Standard Deviation
$\frac{\phi\varepsilon^2}{N}$	=	Sum of Squares of Observation
$\left(\frac{\phi\varepsilon}{N}\right)^2$	=	Sum of Squares of Mean

iii. Coefficient of Variation (C.V.):

"The Co-efficient of variation (C.V.) is the relative measure based on the standard deviation and is defined as the ratio of the standard deviation to the mean expressed in percent". It is independent of units. Hence it is a suitable measure for comparing variability of two series with same or different units. A series with smaller C.V. is said to be less variable or more consistent or more homogeneous or more uniform or more stable than the others and vice versa. It is calculated as:

$$C.V. = \frac{\sigma}{X}$$

Where,

$\overline{X}$	=	Mean
σ	=	Standard Deviation
C.V.	=	Coefficient of Variation

iv. **Correlation Coefficient (r):**

Correlation may be defined as the degree of linear relationship existing between two or more variables. These variables are said to be correlated when the change in the value of one results change in another variable. Correlation is of three types. They are Simple, Partial and Multiple correlations. Correlation may be positive, negative or zero. Correlation can be classified as linear on non- linear. Here we study simple correlation only." In simple correlation the effect of others is not excluded rather these are taken as constant considering them to have no serious effect on the dependent variable." It is calculated as:

$$r_{x1x2} = \frac{N\Sigma X_1X_2 - (\Sigma X_1)(\Sigma X_2)}{\sqrt{[N\Sigma X_1^2 - (\Sigma X_1)^2]}\sqrt{[N\Sigma X_2^2 - (\Sigma X_2)^2]}}$$

Where,

r_{x1x2} = Correlation between X_1 and X_2

$N \Sigma X_1X_2$ = Product of No. of observation and Sum of product of X_1 and X_2

$\Sigma X_1 \Sigma X_2$ = Product of Sum of X_1 and sum of X_2

v. **Coefficient of Determination (r^2)**

It explains the variation percent derived in dependent variable due to the any one specified variable; it denotes the fact that the independent variable is good predictor of the behavior of the dependent variable. It is square of correlation coefficient.

3.8 Limitations of the Research Methodology:

- Only the selected financial and statistical tools have been used in this thesis.
- Researcher mainly depends on the secondary data i.e. Balance Sheet of the banks and data provided by the NRB and web sites of respective banks.
- Sample taken by the researcher is only two.
- In the process of taking primary data from the bank, only 'yes or no questionnaires have been used by the researcher.
- Only the five years data (2004/05 to 2008/09) have been collected to analyze the credit management position of the bank.

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

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

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

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

4.1 Financial Condition of selected Nepalese Commercial Banks

Financial analysis assists in identifying the major strengths and weaknesses of a firm. It indicates whether a company has enough cash to meet its obligations ability to utilize properly their available resources. Financial analysis can also be used to assess the company's liability as an ongoing enterprise and determine whether a satisfactory return is being earned for the risks return. This is necessary to find out the comparative financial condition of the banks in terms of credit practices necessary to find out the comparative credit practices in those banks.

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

4.2 Credit Practices in NIBL and NIC

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

4.2.1 Total Loan and Advances to Total Deposit ratio

The main source of bank's lending depends on its deposit. This ratio is calculated to find out how successfully the banks are utilizing their deposits on loan and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits. The ratios are presented in the following table.

Table 4.1

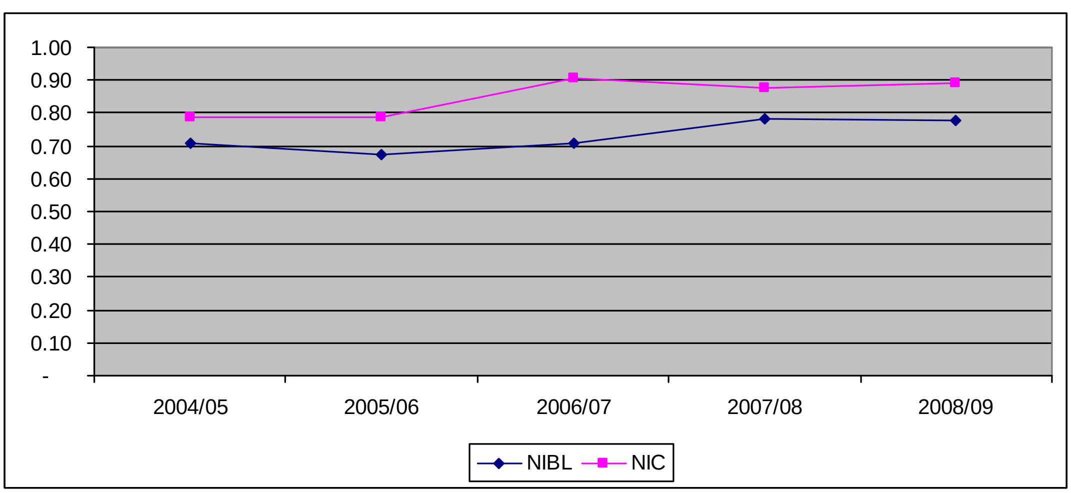
Total Loan and Advances to Total Deposit Ratio (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.71	0.68	0.71	0.78	0.78	0.73
NIC	0.79	0.79	0.91	0.88	0.89	0.85

Source: Annual reports of NIBL and NIC (Appendix – I)

Diagram 4.1:

Total Loans to Total Deposit Ratio



The table 4.1 shows that the ratio of credit deposit ratio in NIBL was 0.71, 0.68, 0.71, 0.78 & 0.78 respectively. Similarly the ratio of NIC is 0.79, 0.79, 0.91, 0.88 & 0.89. In overall comparison, NIBL has the highest ratio in F/Y 2007/08 and FY 2008/09 i.e. 0.78 and lowest ration in FY 2004/05 and FY 2006/07 i.e. 0.71. Similarly, NIC has observed the lowest ratio in F/Y 2004/05 and FY 2005/06 with 0.79 and highest ratio in FY 2006/07 with 0.91.

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

4.2.2 Interest Income to Loans & Advances Ratio

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

Table 4.2

Interest Income to Loan & Advances (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.0876	0.0918	0.0917	0.0813	0.0902	0.09
NIC	0.0932	0.0840	0.0795	0.0812	0.0922	0.09

Source: Annual reports of NIBL and NIC (Appendix – II)

Diagram 4.2

Interest Income to Loan & Advances

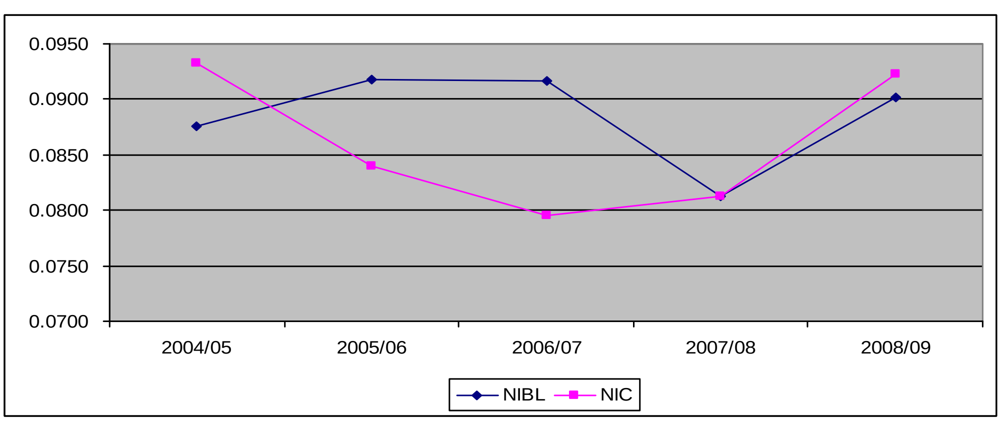


Table 4.2 shows the ratio of interest income to loan and advances of the selected sample banks over the study period. Interest income to loan and advances ratio of NIBL ranges from highest of 0.0918 times and lowest of 0.0876 times in the fiscal year 2004/05 and 2003/04 respectively. Mean ratio is 0.09. The mean interest income to loan and advances of the NIC is 0.09. Ratio of NIC does not show clear direction. Highest ratio is in the fiscal year 2003/04 and lowest in the fiscal year 2005/06. Mean interest income to loan and advances is equal in both the cases of NIBL and NIC bank. So, both the bank can be considered to have good performance from interest income point of view.

4.2.3 Non-performing Loans to Total Loan and Advances Ratio

NRB has directed all the commercial banks to create loan loss provision against the doubtful and bad debts. But our concerned banks have not provided data on no-performing loan in Balance Sheet and Profit & Loss A/C. To measure the volume of non-performing loan to total loan & advances the main indicator of NIBL and NIC has been used. This ratio shows the percentage on non-recovery loans in total loan & advances.

Table 4.3

Gross Non-performing Loan to Total Loan and Advances (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.028	0.021	0.024	0.011	0.006	0.018
NIC	0.038	0.026	0.011	0.009	0.009	0.019

Source: Annual reports of NIBL and NIC (Appendix-III)

Diagram 4.3

Gross Non-performing Loan to Total Loan and Advances (in times)

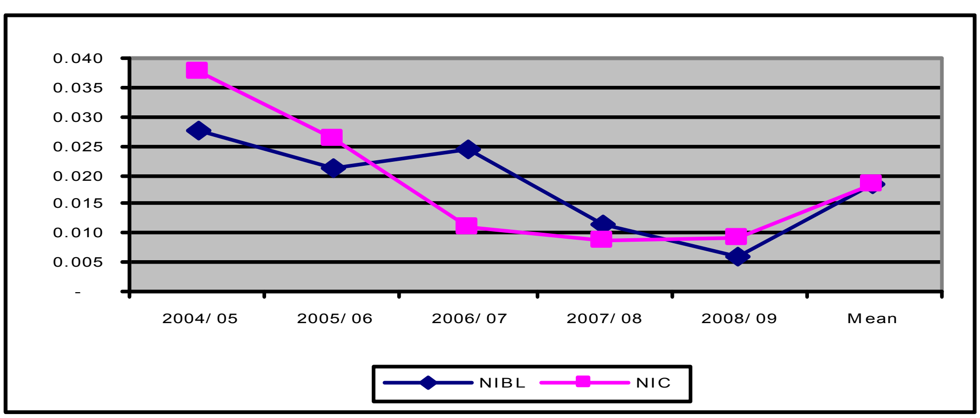


Table 4.3 shows the Non- performing loan to total loan and advances over the study period. Ratio of NIBL ranges highest of 0.028 and lowest 0.006, it shows decreasing trend in subsequent years. Likewise the ratio of NIC ranges highest of 0.038 and lowest 0.009, it is in decreasing trend in comparison with the fist two year of the study. Mean Non-performing loan to loan and advances of NIBL and NIC are 0.018 and 0.019. Ratio of NIBL in the fist three year is above the average and below the average in the last two fiscal years. Ratio of NIC in the fist three years are above the average and ratio of last two years is below the average. It shows that the non performing loan of both the sample banks is decreasing. NIBL has lowest non performing loan to total loan and advances, thus NIBL is best performer than NIC.

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

4.2.4 Loans and Advances to Total Assets Ratio

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

Table 4.4

Loans & Advances to Total Assets Ratio (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.62	0.60	0.63	0.69	0.68	0.65
NIC	0.65	0.66	0.78	0.75	0.74	0.72

Source: Annual reports of NIBL and NIC (Appendix- IV)

Diagram 4.4

Loans & Advances to Total Assets Ratio

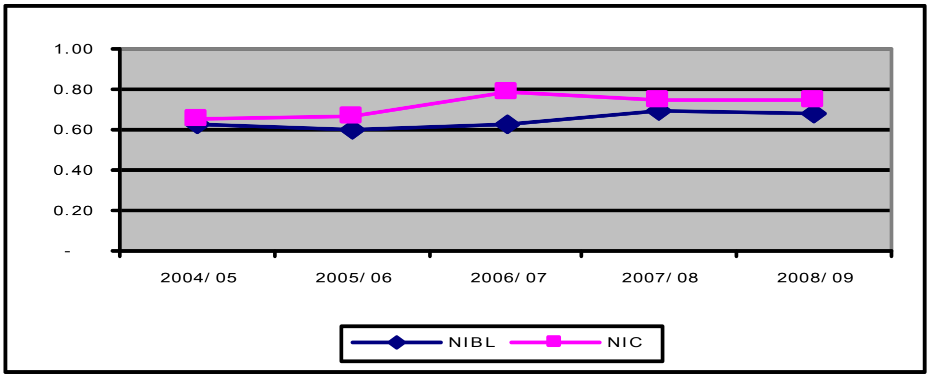


Table 4.4 shows that the ratio of loans & advance to total assets in five years for the sample commercial banks. Loans and advances to total assets ratio of NIBL ranges highest of 0.68 times in the fiscal year 2008/09, and lowest of 0.60 times in the fiscal year 2005/06. Here, this ratio doest not show any clear direction. Ratio of the NIC is highest in the fiscal year 2007/08 with 0.78 times and lowest in the fiscal year 2004/05 at 0.65 times. From the mean point of view, it can be said that mean ratio of NIC has highest among the selected commercial banks for the study. It can be concluded that the higher mean ratio indicates the good lending performance. Here NIBL and NIC should focus to increase loan and advances to total assess ratio to increase lending performance.

4.2.5 Loan and Advances to Current Assets Ratio

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

Table 4.5

Loan & Advances to Current Assets Ratio (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.63	0.61	0.64	0.71	0.70	0.66
NIC	0.66	0.67	0.79	0.76	0.75	0.73

Source: Annual reports of NIBL and NIC (Appendix-V)

Diagram 4.5

Loan & Advances to Current Assets Ratio

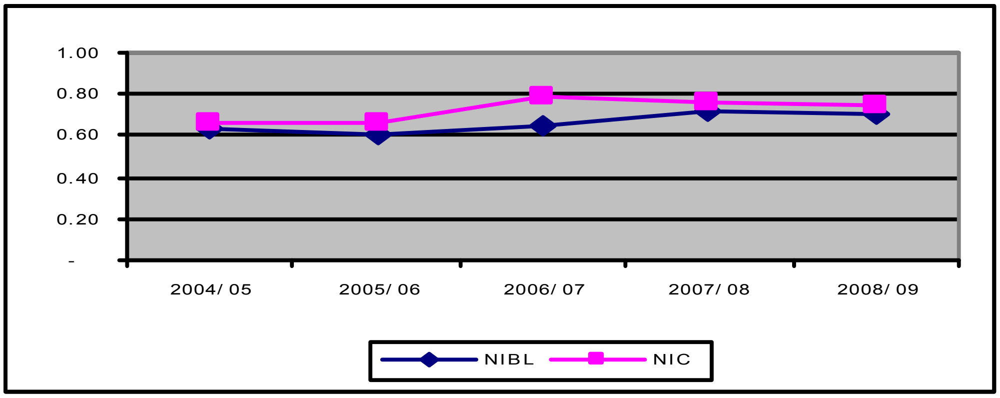


Table 4.4 shows the loan and advances to current assets of selected companies over the study period. Loans and advances to current assets ratio of NIBL ranges highest of 0.71 times in the fiscal year 2007/08 and lowest 0.61 times in the fiscal year 2005/06. Loan and advances to current assets ratio of NIBL in the fiscal year 2004/05 to 2006/07 is below the average and above the average in the rest of the fiscal years. This shows the increasing trend on loan and advances to current assets ratio of NIBL. Ratio of NIC is highest in the fiscal year 2006/07 with 0.79 times and lowest at 0.66 times in the fiscal year 2004/05. The mean Loan and advances to current ratio of NIC is 0.73 times which is high in comparison with the average ratio of NIBL. From the mean point of view, it can be said that mean ratio of NIC is higher than NIBL. It can be concluded that the higher mean ratio indicates the good short term lending performance. Here NIBL should focus to increase loan and advances to current assets ratio to increase short term lending performance.

4.2.6 Loans Loss Provision to Total Loan and Advances Ratio

The provision for loan loss reflects the increasing probability of non-performing loan. Increase in loan loss provision decreases in profit result to decrease in dividends. But its positive impact is that strengthens the financial conditions of banks by controlling the credit risk and reduces the risks related to deposits.

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

Table 4.6

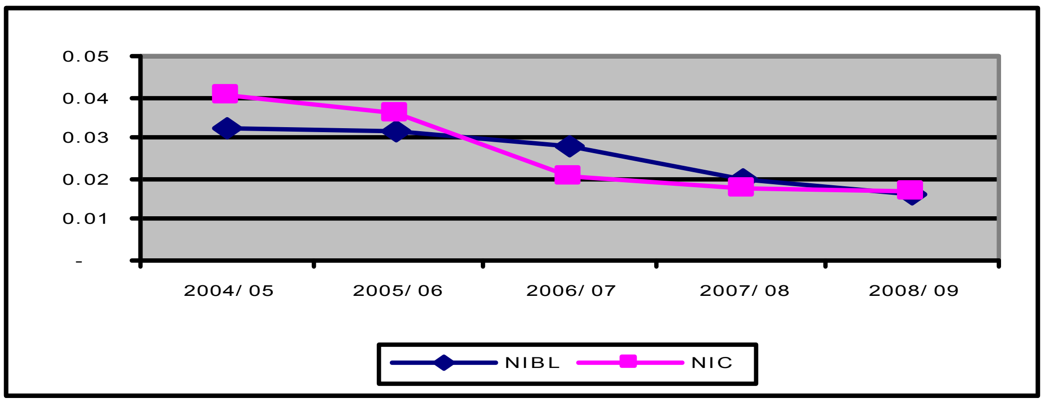
Loan Loss Provision to Total Loan & Advances (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.032	0.031	0.028	0.020	0.016	0.026
NIC	0.040	0.036	0.021	0.018	0.017	0.026

Source: Annual reports of NIBL and NIC (Appendix-VI)

Diagram 4.6

Loan Loss Provision to Total Loan & Advances



Above table 4.6 shows the loan loss provision to total loan and advances of selected commercial banks over the study period. Ratio of NIBL ranges highest 0.032 in the fiscal year 2004/05 and lowest 0.016 in the fiscal year 2008/09. Average ratio of NIBL is 0.026, ratio in first three fiscal years is above the average and ratio in last two fiscal years is below the average. The ratio does not give the any clear trend. Ratio of the NIC is highest among the selected companies for the study. It has highest ratio of 0.040 in the fiscal year 2004/05 and lowest 0.017 in the fiscal year 2008/09. It has mean ratio of 0.026. Here average loan loss provision to loan and advances ratio of NIC and NIBL is the same. Increased ratio indicates the increased volume of non-performing loans and vice versa. Loan loss provision of both the NIC and NIBL is decreasing trend, so the decreasing loan loss ratio indicates efficient credit policy and gradual increment on the performance of the company. Here loan loss provision to total loan and advances of NIBL and NIC is in decreasing trend, which indicates decreased volume of non-performing loans of the banks. It can say this is due to the effective credit policy and good performance of the companies.

4.3 Credit Efficiency in NIBL and NIC Bank

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

4.3.1 Interest Expenses to Total Deposit Ratio

This ratio measures the percentage of total interest paid against total deposit. A high ratio indicates higher interest expenses on total deposit. Commercial Banks are dependent upon its ability to generate cheaper fund has moves the probability of generating loans and advances and vice versa.

Table 4.7

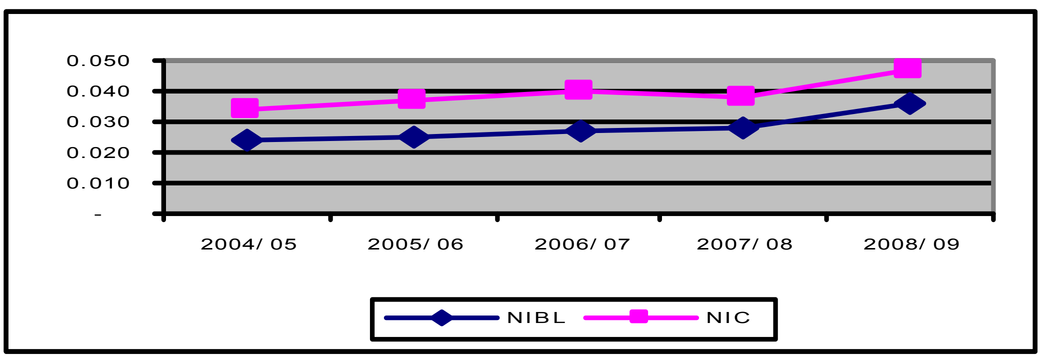
Interest Expenses to Total Deposit Ratio (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.024	0.025	0.027	0.028	0.036	0.028
NIC	0.034	0.037	0.040	0.038	0.047	0.039

Source: Annual reports of NIBL and NIC (Appendix-VII)

Diagram 4.7

Interest Expenses to Total Deposit Ratio



Above table 4.7 shows the cost of deposit of selected commercial banks over the study period. Ratio of NIBL ranges highest 0.036 in the fiscal year 2008/09 and lowest 0.024 in the fiscal year 2004/05 Average ratio of NIBL is 0.028, ratio in the first three fiscal years are below the average and ratio in last two fiscal year are above the average. The ratio shows the increasing trend over the study period. Ratio of NIC ranges highest 0.040 in the fiscal year 2006/07 and lowest 0.034 in the fiscal year 2004/05. Its average ratio is 0.039 and higher among the selected banks for the study. Here average interest expenses to total deposit ratio of NIC is higher than of NIBL ratio. Increase ratio indicates the increased cost of deposit..

4.3.2 Interest Expenses to Total Expenses Ratio

This ratio measures the percentage of interest paid against total expenses. The high ratio indicates the low operational expenses and vice versa. The ratio indicates the costly sources of funds.

Table 4.8

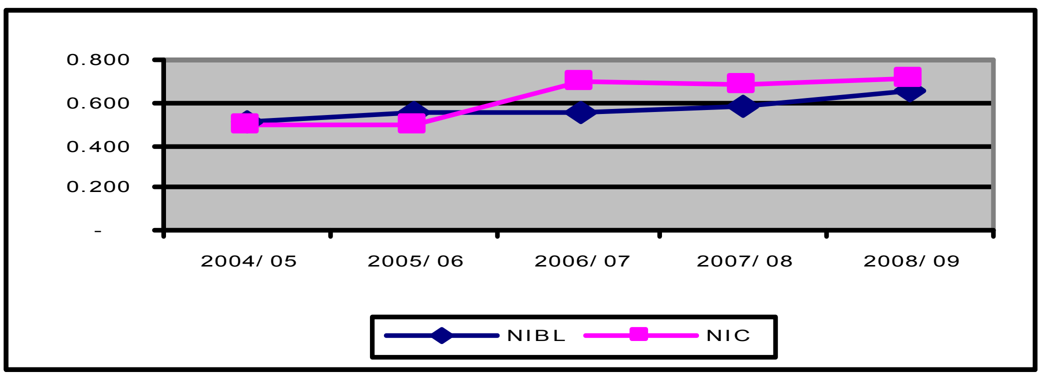
Interest Expenses to Total Expenses Ratio (in times)

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.503	0.547	0.551	0.581	0.651	0.567
NIC	0.491	0.498	0.698	0.681	0.717	0.617

Source: Annual reports of NIBL and NIC (Appendix-VIII)

Diagram 4.8

Interest Expenses to Total Expenses Ratio



Above table 4.8 shows the interest expenses to total expense ratio of selected companies over the study period. Ratio of NIBL ranges highest 0.651 in the fiscal year 2008/09 and lowest 0.503 in the fiscal year 2004/05. Average ratio of NIBL is 0.567. Ratio of NIBL shows the increasing trend. Ratio of NIC ranges highest 0.717 in the fiscal year 2008/09 and lowest 0.491 in the fiscal year 2004/05. Average ratio of NIC is 0.617. Here average interest expenses to total expenses ratio of NIC is higher than NIBL. NIBL has low interest expenses to total expenses ratio, it shows that decrease in cost of deposit as decrease in the interest expenses to total expenses ratio decrease.

4.3.3 Non-interest Bearing Deposits to Total Deposit Ratio

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

Table 4.9

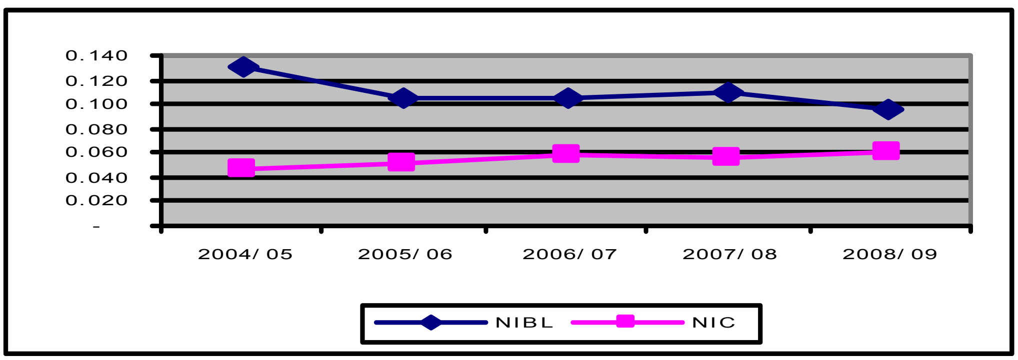
Non-interest Bearing Deposits to Total Deposit Ratio

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.131	0.105	0.104	0.109	0.096	0.109
NIC	0.048	0.051	0.059	0.056	0.060	0.055

Source: Annual reports of NIBL and NIC (Appendix-IX)

Diagram 4.9

Non-interest Bearing Deposits to Total Deposit Ratio



Above table 4.9 shows non- interest bearing deposits to total deposit ratio of selected commercial banks over the study period. Ratio of NIBL is in fluctuation trend, ranges highest 0.131 in the fiscal year 2004/05 and lowest 0.096 in the fiscal year 2008/09. Average ratio is 0.109. Non – interesting bearing deposits to total deposit ratio of NIC ranges highest 0.060 in the fiscal year 2008/09 and lowest 0.048 in the fiscal 2004/05. Average ratio of NIC is 0.055. From the mean point of view, it can be said that NIBL has highest mean ratio .In this way; the deposit mixture of NIBL carries the highest level of interest bearing deposits in its deposit mixture. This major portion of non-interest bearing deposit consists of current deposits and this deposit is particularly maintained by business enterprises.

4.3.4 Interest Income to Total Income Ratio

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

Table 4.10

Interest Income to Total Income Ratio

Bank/F.Y	2004/05	2005/06	2006/07	2007/08	2008/09	Mean
NIBL	0.773	0.809	0.821	0.831	0.859	0.818
NIC	0.874	0.872	0.882	0.869	0.871	0.874

Source: Annual reports of NIBL and NIC (Appendix-X)

Diagram 4.10

Interest Income to Total Income Ratio

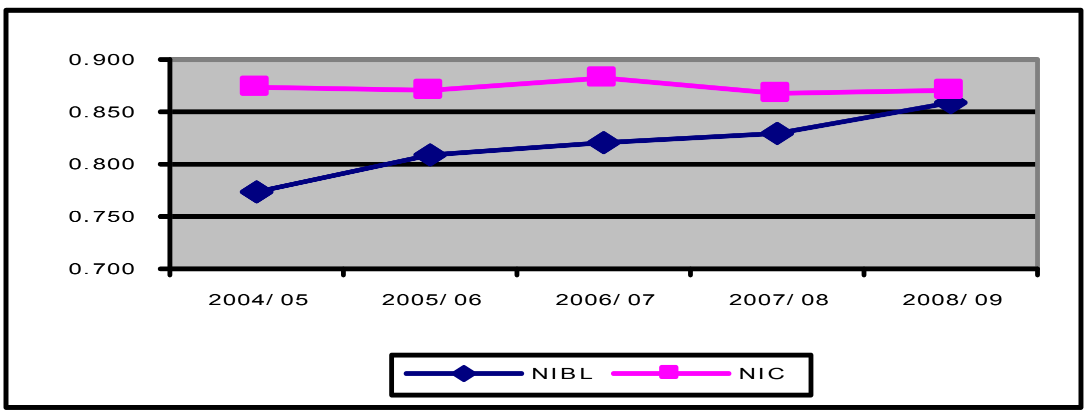


Table 4.10 shows the interest income to total income ratio of selected commercial banks over the study period. Ratio of NIBL ranges highest 0.859 in the fiscal year 2008/09 and lowest 0.773 in the fiscal year 2004/05. Average ratio of NIBL is 0.818. Ratio of NIC ranges highest 0.882 in the fiscal year 2006/07 and lowest 0.871 in the fiscal year 2008/09. Average ratio is 0.874.

From Average point of view, it can be said that NIC has high interest income to total income. This shows that in total income of NIBL and NIC, interest income contributes 81% and 87% respectively. The lowest ratio of NIBL indicates its low dependency in fund-based activity. The highest ratio of NIC indicates greater dependency on fund-based activities.

4.4 Relationship of Loans and Net profit

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

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

Table 4.11

Relationship between Loan and Advance and Net Profit in NIBL: Correlation Matrix

		Loans	**Net profit**
Loans	Pearson correlation	1	0.9916
	N	5	5
Net profit	Pearson correlation	0.9916	1
	N	5	5

Source: Appendix and SPSS Program (Appendix-XI)

The table 4.11 presents the correlation coefficient between loans and net profit during study period. The calculated Pearson's Correlation Coefficient was found 0.9916, which shows high degree of correlation. It indicates that loans and net profit were found highly correlated. That means, increasing loans helps to increase the net profit and vice versa. Coefficient of determination was found to be 0.9833 which indicates that 98.33% of total change in profit has been determined by the loans. Loans have high influence on net profit of the NIBL. Effective loans management helps to increase and stable the net profit of the NIBL. No exception is found in case of NIBL. Thus, it is logical to review the impact of various components of credit in net profit of the NIBL.

Table 4.12

Relationship of Loan and Advance and Net Profit in NIC: - Correlation Matrix

		Loans	**Net profit**
Loans	Pearson correlation	1	0.9543
	N	5	5
Net profit	Pearson correlation	0.9543	1
	N	5	5

Source: Appendix and SPSS Program (Appendix-XII)

The table 4.12 presents the correlation coefficient between loans and net profit during the study period. The calculated Person's correlation coefficient was found 0.9543, which shows high degree of positive correlation. It indicates that loans and net profit were found high related with each other. That means, increasing loans helps to increase the net profit whereas increase in loans decreases the net profit. Similarly, coefficient of determination was found to be 0.9108 which indicates that 91.08% of total change in profit has been determined by loans. Loans have high influence on net profit of the NIC Bank. Effective loans management directly affects to net profit of the NIC bank. No exception is found in case of NIC Bank. Thus, it is logical to review the impact of various components of working on net profit.

4.5 Relationship of Loans and Non-Performing Loans

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

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

Table 4.13

Relationship between Loan and Non-Performing Loans in NIBL:-Correlation Matrix

		Loans	**Non-performing loan**
Loans	Pearson correlation	1	-0.3845
	N	5	5
Non- performing loan	Pearson correlation	-0.3845	1
	N	5	5

Source: Appendix and SPSS Program (Appendix-XIII)

The table 4.13 presents the correlation coefficient between non-performing loan and loans during study period. The calculated Person's correlation coefficient was found -0.3845, which shows moderate, negative correlation. It indicates that non-performing loans and loans were moderately, negatively related with each other. That means, decreasing on performance in loans management. Coefficient of determination was found 0.1478 which indicates that 14.78% of total change in loans management has been negatively determined by non-performing loans.

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

Table 4.14

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

		Loans	**Net profit**
Loans	Pearson correlation	1	-0.7168
	N	5	5
Net profit	Pearson correlation	-0.7168	1
	N	5	5

Source: Appendix and SPSS Program (Appendix-XIV)

The table 4.14 presents the correlation coefficient between non-performing loan and loans during study period. The calculated Person's correlation coefficient was found -0.7168, shows low negative correlation. It indicates that non-performing loans and loans were negatively related with each other. That means, decreasing on performance in loans management. Coefficient of determination was found 0.5138 which indicates that 51.38% of total change in loans management has been negatively determined by non-performing loans.

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

4.6 Impact of Loan and Advances on Net profit

Loans have high implication for determining net profit. Effective loans directly affect the net profit of the banks. It means that the net profit of the banks is largely depended by the loans management. Thus, it is more significance to know the impact of loans in net profit.

4.7 Trend Analysis Least Square Method

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

Trend of Loan and advances of NIB Limited.

Computation of straight line trend analysis of loan and advance of Nepal Investment Bank Limited

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

Loan and advances on the 6^{th} year

Y = 3596.27 + 6528.81 * 6

= 42769.13

Loan and advances for the 7th year

Y = 3596.27 + 6528.81 * 7

= 49297.94

Loan and advances for 8th year

Y = 3596.27 + 6528.81 * 8

= 55826.75

Table 4.15

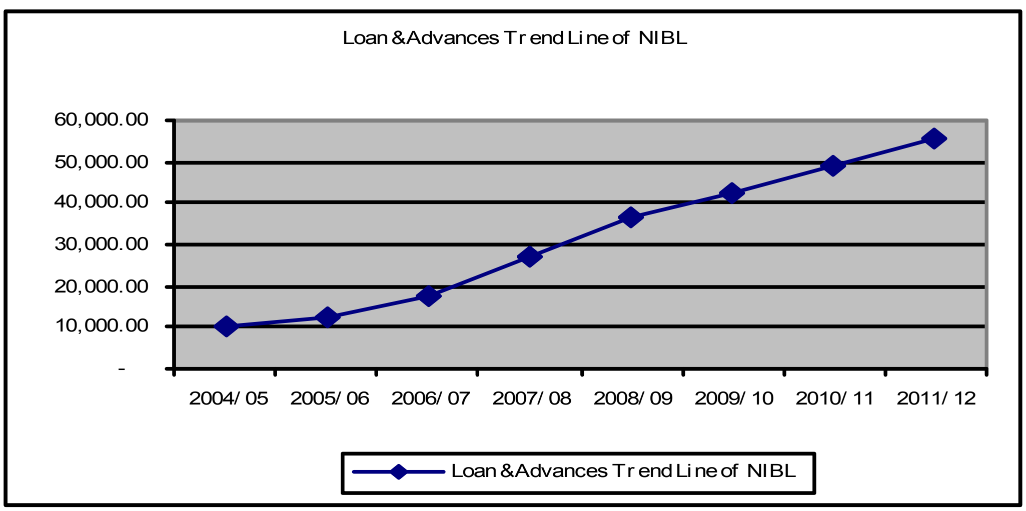
Nepal Investment Bank Limited (NPR in Million)

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Loan & Adv.	10,125.08	12,775.29	17,285.58	26,995.69	36,240.33	42,769.13	49,297.94	55,826.75

Source: Annual reports of NIBL and NIC and Regression Equation (Appendix-XV)

Diagram 4.11

Loan and Advances Trend Line of Nepal Investment Bank Limited



Based on analysis presented table that concludes loan and advances has been increasing by 909.57 million on financial year 2008/09. The expected loan and advances is 28438.87 million, 33091.19 million and 37743.5 million in the fiscal year 2008/09, 2009/10 and 2010/11.

Trend of Loan and advances of NIC Bank Limited.

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

Now, Regression equation Y = a + b X

Loan and advances on the 6th year

Y = 2657.73 + 2251.62 * 6

= 16167.02

Loan and advances for 7th year

Y = 2657.73 + 2251.62 * 7

= 18418.64

Loan and advances for 8th year

Y = 2657.73 + 2251.62 * 8

= 20670.26

Table 4.16

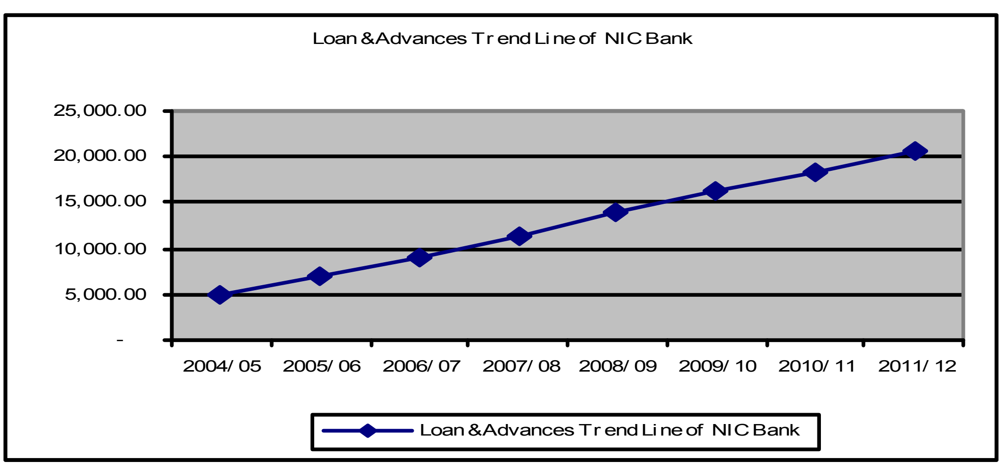
NIC Bank Limited (NPR in Million)

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Loan & Adv.	4,909.36	6,902.12	9,128.65	11,465.33	13,915.85	16,167.02	18,418.64	20,670.26

Source: Annual reports of NIBL and NIC and Regression Equation (Appendix-XVI)

Figure 4.12

Loan and Advance Trend Line of NIC Bank Limited



Based on analysis presented table that concludes loan and advances has been increasing by 3182.02 million on financial year 2008/09. The expected loan and advances is 14647.32 million, 16035.35 million and 17423.38 million in the fiscal year 2008/09, 2009/10 and 2010/11.

4.8 Test of Hypothesis:

To test the significance of different ratio between NIBL and NIC, here the researcher uses small 't' test.

Table No. 4.17

Calculated Values of 't' under different Assumptions

S. N.	Assumption of Null Hypothesis and Alternative Hypothesis.	$t_{calculated}$	$t_{tabulated}$ at 5% l.s. for 8 d.f.
1.	H_0: There is no significance difference in Credit and advances to total assets ratio between NIBL bank & NIC. H_1: There is significance difference in Credit and advances to total assets ratio between NIBL bank. & NIC.	1.213	2.306
2.	H_0: There is no significance difference in Performing assets ratio between NIBL bank and NIC. H_1: There is significance difference in Performing assets ratio between NIBL bank &. NIC	0.987	2.776
3.	H_0: There is no significance difference in Interest income to total credit and advances ratio between NIBL bank & NIC H_1: There is significance difference in Interest income to total credit and advances ratio between NIBL bank & NIC	0.538	2.306
4.	H_0: There is no significance difference in provision for Credit loss ratio between NIBL bank. & NIC H_1: There is significance difference in provision for Credit loss ratio between NIBL bank. & NIC	2.712	2.306

Note: l.s. : - level of significance, d.f :- degree of freedom, ⋆ :-d.f. is 6.

Decision:

S.N.1: The calculated value is less than tabulated value. Calculated value of 't' is 1.213 and tabulated value of 't' is 2.306. It means H_0 is accepted at 5% level of significance for 8 degree of freedom. H_1 is rejected. There is no significance difference in credit and advances to total assets ratio of NIBL Bank and NIC.

S.N.2: The calculated value is less than tabulated value. Calculated value of 't' is 0.987 and tabulated value of 't' is 2.776. It means H_0 is accepted at 5% level of significance for 6 degree of freedom. H_1 is rejected. There is no significance difference in performing assets ratio of NIBL Bank and NIC.

S.N.3: The calculated value is less than tabulated value. Calculated value of 't' is 0.538 and tabulated value of 't' is 2.306. It means H_0 is accepted at 5% level of significance for 8 degree of freedom. H_1 is rejected. There is no significance difference in Interest income to total credit and advances ratio of NIBL Bank and NIC.

S.N.4: The calculated value is higher than tabulated value. Calculated value of 't' is 2.712 and tabulated value of 't' is 2.306. It means H_0 is rejected at 5% level of significance for 8 degree of freedom. H_1 is accepted.. There is significance difference in provision for credit loss ratio of NIBL Bank and NIC.

4.9 Analysis of Responses by Credit Customer of Banks:

Table 4.18

Frequencies of Responses of Credit Customers of NIBL Bank

Particulars:	Yes		No		No clear responses		Total
	No.	%	No.	%	No.	%	No.
1. Are you satisfied with the bank?	7	70	3	30	-	-	10
2. Does any bank officer visit your project site at the time of granting credit?	8	80	1	10	1	10	10

3. Do you know all information about bank policies?	5	50	5	50	-	-	10
4. Are you satisfied with the bank interest rate?	2	60	8	40	-	-	10
5. Do you want to take further credit from the bank?	7	70	1	10	2	20	10
6. Have you received any notice before credit expiration date?	7	90	1	10	2	20	10
7. Do you feel that you have got full cooperation from the bank officer?	6	60	4	40	-	-	10
8 Is the services charge taken by the bank satisfactory?	5	50	4	40	1	10	10
9. Have you utilized the entire credit to the same sector as specified at the time of taking credit?	9	90	-	-	1	10	10
10.Are you thinking to switch the bank in the future?	1	70	7	10	2	20	10

- 70% of sample customer of the bank told that they were satisfied with the bank and the remaining percentage said no.
- 80% of the sample customer said bank officer visited their project site at the time of granting credit.1 customer said 'no' and the remaining customer was unknown about the bank officer visit, he said he was the representative of the credit taking group.
- Only the 50% of the customer said they were up to date with the banking polices.
- Eight customers out of ten customers were unsatisfied with the bank interest rate. Only two customers said," We are more or less satisfied".

- 7 out of 10 customers responded that they would take credit from the same bank in the near future, 1 said 'no ', and the remaining 2 customers did not responded clearly.
- 70% of the customer of the bank received information of repaying credit from the bank, 20% customer were uncooperative with the researcher, and remaining 10% said 'no', he said he would need credit no more.
- 5 out of 10 customers were satisfied with the bank officers' cooperation, 4 customers were unsatisfied.
- Services charge taken at the time of issuing credit is high from the view point of 50% customers.40% customers said they were more or less satisfied with the service charges. One customer was unaware of that service charge.
- 90% of the sample customers said they utilized the credit for the same sector as specified at the time of taking loan. One customer did not response clearly. Nobody said 'no'.
- Only one out of ten responded clearly that he would change the bank next time. Two customers did not want to response the question. Seven customers said they would attach with the bank.

Table 4.19

Frequencies of Responses of Credit Customers of NIC

Particulars:	Yes		No		No clear responses		Total
	No.	%	No.	%	No.	%	No.
1. Are you satisfied with the bank?	5	50	5	50	-	-	10
2. Does any bank officer visit your project site at the time of granting credit?	7	70	1	10	2	20	10
3. Do you know all information about bank policies?	7	70	3	30	-	-	10
4. Are you satisfied with the bank interest rate?	4	40	6	60	-	-	10

5. Do you want to take further credit from the bank?	8	80	1	10	1	10	10
6. Have you received any notice before credit expiration date?	7	70	1	10	2	20	10
7. Do you feel that you have got full cooperation from the bank officer?	7	70	3	30	-	-	10
8 Is the services charge taken by the bank satisfactory?	5	50	3	30	2	20	10
9. Have you utilized the entire loan to the same sector as specified at the time of taking loan?	8	80	1	10	1	10	10
10.Are you thinking to switch the bank in the future?	1	10	9	90	-	-	10

- 50% of sample customer of the bank told that they were satisfied with the bank and the remaining 50 %percentage said 'no'.
- 70% of the sample customer said bank officer visited their project site at the time of granting credit.1 customer said 'no' and the remaining 2 customers were unknown about the bank officer visit.
- 7 out of 10 customers said they were up to date with the banking polices.
- Six customers out of ten customers were unsatisfied with the bank interest rate. Four customers were not satisfied with the bank interest rate.
- 8 out of 10 customers responded that they would take credit from the same bank in the near future, 1 said 'no ', and the remaining 1 customers did not responded clearly.
- 70% of the customers of the bank received notice of repaying credit from the bank, 20% customers said, "This is our first time."
- 7 out of 10 customers were satisfied with the bank officers' cooperation, 3 customers were unsatisfied.

- Services charge taken at the time of issuing credit is high from the view point of 50% customers.30% customers said they were more or less satisfied with the service charges. 20% customers were unaware of that service charge.
- 80% of the sample customers said they utilized the credit for the same sector as specified at the time of taking credit. One customer did not response clearly. One customer (10%) said he had not utilized all the credits as purpose.
- Only one out of ten responded clearly that he would change the bank next time. Nine customers said they would attach with the bank.

4.10 Analysis of Responses to Questionnaire by Employees of NIBL Bank & NIC Bank:

Table 4.20

Frequencies of Responses from Employees of Banks (No. of responses = 10)

Particulars	NIBL		NIC	
	Yes	No	Yes	No
1. Are you satisfied with the bank?	6	4	5	5
2. Is there customer related problem in the bank?	10	-	10	-
3. Is there NRB related problem in the bank?	7	3	9	1
4. Is there credit policy related problem in the bank?	10	-	10	-
5. Do you know about interest rate on credit?	5	5	6	4
6. Do you see any changes needed in the process of recovering loan?	8	2	8	2
7. Is your organization obeying 'NRB Directives' sincerely?	10	-	10	-
8. Are you satisfied with the incentive offered by the bank to employees?	6	4	7	3
9. If you get the opportunity, would you like to switch the bank for the same post?	10	-	10	-
10. Are you satisfied with the promotion policy of the bank?	3	7	5	5

- NIBL Bank: 6 employees out of 10 are satisfied with the bank where as 4 employees are dissatisfied. Regular payments of salary, working facilities are causes of their satisfaction. Main causes of dis-satisfied respondents are ' not getting promotion' as well as the bonus scheme of the bank.

- NIC: Five employees are satisfied and five employees are dissatisfied with the working institution. Quality of work life, leave facilities, automation were the main causes of their satisfaction. Dissatisfied employee said the overload of the work as the main cause of dissatisfaction.

- NIBL Bank: All the employees of the bank said there was customer related problem. At the time of evaluation of project, at the time of recovering loan, bank should face problems. Lack of good customer is another major problem

- NIC: 10 out of 10 employees said they should face the customer related problem.

- NIBL Bank: 7 employees said there is NRB related problem whereas 3 employees said 'no'. Frequent changes in rules, regulation, provisions and directives are main causes of problem.

- NIC: 9 employees said there is NRB related problem whereas 3 employees said 'no'. The reason is same as said by the NIBL Bank that is frequent changes in rules; regulation, provisions and directives are main causes of problem.

- NIBL Bank: All the sample 10 employees taken as sample said there is credit related problem in the bank. No repayment of credit in time by customer, slow in the legal process, increasing amount of non-performing credit are the main causes of the credit related problems.

- NIC: All of them said there is customer related problem in the bank. The causes of problem for this bank are also the same as faced by the NIBL Bank.

- NIBL Bank: 50% (5 out of 10) employees know the interest rate of credit of the bank, 50 %(5 out of 10) employees do not know the interest rate of credit of the bank. Most of the employees who work in the credit department said they were up to dated with the interest rate of the bank.

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

- 8 out of 10 employees of the both banks said there is necessary to change in the process of recovering loan. Lengthy and weak legal process of recovery is the main cause of the problem.

- All respondents of both banks are agreed about that their bank is obeying the 'NRB rules and directives' sincerely.

- NIBL Bank: 6 employees out of 10 say that they are satisfied with the incentive in the bank. 4 employees are dissatisfied with the incentive provided by the bank. They are satisfied as they compare to low incentives paying bank and dissatisfied when they compare their incentives with the high incentives paying bank.

- NIC: 7 employees out of 10 say that they are satisfied with the incentive in the bank. 3 employees are dissatisfied with the incentive provided by the bank. Newly appointed employees are more satisfied than the old one.

- Both of the banks' all sample employees answered that they will shift the bank, if and only if, they get the chance to go to high public image and more facilities providing bank. That kind of bank in their mind was Standard Chartered Bank Limited and Nepal Arab Bank Limited.

- NIBL Bank: Three employees are satisfied with the bank promotion policy. The remaining seven out of ten is dissatisfied with the bank promoting policy. Main reason of dissatisfaction is nepotism, favoritism, open recruiting policy etc.

- NIC: Fifty percentages are satisfied and fifty percentages are dissatisfied with the bank's promoting policy.

4.11 Major Findings of the Study

Major findings of the study are as follows:

- Average loan and advances ratio to Total Deposits of NIBL and NIC is 0.73 and 0.85 respectively. NIC has maintained higher loan & advances to total deposit. In this way, it shows that NIC seems to be strong to mobilize its total deposit as loan & advances. However higher ratio does not mean it is always better from the point of liquidity. All banks are capable to use more than 50% of deposit on loan and advances. If maintained this, it help make consistency on the profitability of the banks.

- The Average interest income to loan and advances of the NIBL is 0.089. Ratio of NIBL does not show clear direction. Average interest income to loan and advances ratio of NIC is 0.086 and, in terms of the average ratio NIBL has best performance.

- NIBL has lowest non performing loan to total loan and advances, this NIBL is best performer than the NIC. Banking sector is seriously affected by the non-performing loan. All banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected. So provision amount will increase and profit will decrease. So, it is suggested that both the banks (NIBL and NIC) to be sincere while granting loan and to do effective follow up for recovery of non-performing loan.

- Average loan and advances to total assets of NIBL and NIC is 0.645 and 0.719. It can be concluded that the higher mean ratio indicates the good lending performance. Here NIBL should focus to increase loan and advances to total asset ratio to increase lending performance. Loan and advances to current assets ratio of NIBL is in increasing trend. From the mean point of view, it can be said that mean ratio of NIC has highest than others. It can be concluded that the higher mean ratio indicates the good short term lending performance.

- Loan loss provision of NIBL and NIC is in fluctuating trend, so the fluctuating loan loss ratio indicates inefficient credit policy and gradual decrease on the performance of the company. Here loan loss provision to total loan and advances of NIBL is in decreasing trend, which indicates decreased volume of non-performing loans of NIBL; we can say this is due to the ineffective credit policy and poor performance of the company. Average interest expenses to total expenses ratio of NIC is higher than NIBL.

- Correlation Coefficient between the loans and advances to net profit of NIBL is 0.9916; it indicates high degree of positive relationship between loans and net profit. This means. Increasing loans helps to increase the net profit. Loans have high influence on net profit of the NIBL. Effective loans management helps to increase and stable the net profit of the NIBL. Correlation Coefficient between the loan and advances to net profit of NIC is 0.9543; it indicates high degree of positive relation between loan and net profit. Loans have high influence on net profit of the NIC Bank. Effective loans management directly affects to net profit of the NIC Bank.

- Correlation coefficient between non-performing loan and loans of NIBL is -0.3845, which shows moderate, negative correlation. It indicates that non-performing loans and loans were moderately, negatively related with each other. That means, decreasing on performance in loans management. Effectively loans management helps to decrease the non-performing loans.

- Correlation coefficient between non-performing loan and loans of NIC is -0.7168; it indicates that non-performing loans and loans were negatively related with each other. Coefficient of determination was found 0.5138 which indicates that 51.38% of total change in loans management has been negatively determined by non-performing loans. Loan management has been negatively influenced by non-performing loans. Effectively loans management helps to decrease the non-performing loans.

- Least square trend line shows the loan and advances of NIBL have been increasing with a constant growth rate. Based on analysis presented table that concludes loan and advances has been increasing by 6,528.80 million on financial year 2009/10. The expected loan and advances is 42769.13 million, 49297.94 million and 55826.75 million respectively in the fiscal years 2009/10, 2010/11 and 2011/12.

- Least square trend line shows the loan and advances of NIC have been increasing with a constant growth rate. The expected loan and advances is 16,167.02 million, 18,418.64 million and 20,670.26 million respectively in the fiscal years 2009/10, 2010/11 and 2011/12.

CHAPTER –V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

As the final chapter of the study, this chapter briefly explains the summary of the study, tries to fetch out findings and conclusions and attempts to offer suggestions and recommendations for strengthen the financial position of the sample banks. Which contains summary conclusion of the finding and actionable plans. This would be meaningful to the top management of the banks to indicate an action and achieve the desire result. The present study has been designed to overcome the issues relating to credit management in commercials banks. It was aimed to find out comparative credit management in NIBL and NIC bank. The prime components of credit management is the financial condition in terms of leading practices, industrial environment of that bank and the management quality in terms of credit management, designed for to meet the objectives. Present study successfully explored the financial condition in terms of credit management of selected banks, industry environment of these banks and management quality to support credit management. It is clear evident that the bank having good financial position or condition has good industrial environment and high quality of management.

5.1 Summary

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

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

At present, 25 commercial banks have been operating in Nepal. After the adaptation of liberal policy by the government in 1990 number of banks and financial institutions are increasing day by day. They have been rendering high quality banking services to the people. There is cut throat competition between banks and financial intuitions.

5.2 Conclusion

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

Average loan and advances to total deposits ratio of NIBL and NIC is 0.73 and 0.85. NIC has maintained higher loan & advances to total deposit. In this way, it shows that NIC seems to be strong to mobilize its total deposit as loan & advances. However higher ratio does not mean it is always better from the point of liquidity. All banks are capable to use more than 50% of deposit on loan and advances. If maintained this, it help make consistency on the profitability of the banks.

The Average interest income to loan and advances of the NIBL is 0.089. Ratio of NIBL does not show clear direction. Average interest income to loan and advances ratio of NIC is 0.086 and, in terms of the average ratio NIBL has best performance.

NIBL has lowest non performing loan to total loan and advances, this NIBL is best performer than the NIC. Banking sector is seriously affected by the non-performing loan. All banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected. So provision amount will increase and profit will decrease. So, it is suggested that both the banks (NIBL and NIC) to be sincere while granting loan and to do effective follow up for recovery of non-performing loan.

Average loan and advances to total assets of NIBL and NIC is 0.65 and 0.72. It can be concluded that the higher mean ratio indicates the good lending performance. Here NIBL should focus to increase loan and advances to total asset ratio to increase lending performance. Loan and advances to current assets ratio of NIBL is in increasing trend. From the mean point of view, it can be said that mean ratio of NIC has highest than others. It can be concluded that the higher mean ratio indicates the good short term lending performance.

Loan loss provision of NIBL and NIC is in fluctuating trend, so the fluctuating loan loss ratio indicates inefficient credit policy and gradual decrease on the performance of the company. Here loan loss provision to total loan and advances of NIBL is in decreasing trend, which indicates decreased volume of non-performing loans of NIBL; we can say this is due to the ineffective credit policy and poor performance of the company. Average interest expenses to total expenses ratio of NIC is higher than NIBL.

Correlation Coefficient between the loans and advances to net profit of NIBL is 0.9916; it indicates high degree of positive relationship between loans and net profit. This means. Increasing loans helps to increase the net profit. Loans have high influence on net profit of the NIBL. Effective loans management helps to increase and stable the net profit of the NIBL. Correlation Coefficient between the loan and advances to net profit of NIC is 0.9543; it indicates high degree of positive relation between loan and net profit. Loans have high influence on net profit of the NIC Bank. Effective loans management directly affects to net profit of the NIC Bank.

Correlation coefficient between non-performing loan and loans of NIBL is -0.3845, which shows moderate, negative correlation. It indicates that non-performing loans and loans were moderately, negatively related with each other. That means, decreasing on performance in loans management. Effectively loans management helps to decrease the non-performing loans.

Correlation coefficient between non-performing loan and loans of NIC is -0.7168; it indicates that non-performing loans and loans were negatively related with each other. Coefficient of determination was found 0.5137 which indicates that 51.37% of total change in loans management has been negatively determined by non-performing loans. Loan management has been negatively influenced by non-performing loans. Effectively loans management helps to decrease the non-performing loans.

Least square trend line shows the loan and advances of NIBL have been increasing with a constant growth rate. Based on analysis presented table that concludes loan and advances has been increasing by 6,528.80 million on financial year 2009/10. The expected loan and advances is 42,769.13 million, 49,297.94 million and 55,826.75 million respectively in the fiscal years 2009/10, 2010/11 and 2011/12. Least square trend line shows the loan and advances of NIC have been increasing with a constant growth rate. The expected loan and advances is 16,167.02 million, 18,418.64 million and 20,670.26 million respectively in the fiscal years 2009/10, 2010/11 and 2011/12.

5.3 Recommendations

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

- Both of the banks should try increase the loan and advances to deposit; here they have maintained more the 50%. High ratio shows the capability of bank on mobilizing its total deposit as loan and advances.
- Banking sector is seriously affected by the non-performing loan. All banks are not far from this above fact. If non-performing loan increases, the overall banking business will be affected Banks should sincere while granting loan and to do effective follow up fro recovery of non- performing loan.
- Average loan and advances to total assets of NIBL is below 50%. So, NIBL should focus to increase loan and advances to total asset ratio to increase lending performance.
- Banks should do lot exercise in more credit creation and reducing the interest rate for loan and advances. This helps them to maintain more competitive.
- Banks could do better by offering modern banking facilities and new product for the development of banking industry.
- Provision on doubtful loan should to be maintained as per the directives of Nepal Rastra bank.
- Other recommendations