CHAPTER - 1

INTRODUCTION

1.1 Background of the Study:

A Bank is an institution, which deals with money and credit. It accepts deposits from the public and mobilizes the fund to productive sectors. Generally, Bank accepts deposits from business institutions and individuals which are mobilized into productive sectors mainly business and consumer lending. Therefore, Bank is known as a dealer of money. Bank may be engaged in different types of functions such as remittance, exchange currency, joint venture guarantee, discounting bills etc. Banks are essential financial Institution in an economy. They are the principle source of credit that provide most important source of short term working capital for business and is increasing active in recent years in making long-term business loans for new plants and equipment.

The Banks generate their income in a different way. They collect money from savers and lend it to borrower's .Banks also generate income by providing other services for which they charge fees and commissions. Such services include trust administration, safety deposit, account services and others. Therefore, Banks play a vital role in developing the economy of any country. The level of overall development of a country is the level of economic growth characterizes it social, cultural, political or economical and the crux of the economic growth lies in the development of well-managed Banking system. Hence, Banks can be considered as extremely necessary aspect for the healthy and perennial progress of our country. By creating and mobilizing the capital and rendering various financial service Banks are contributing to the establishment and development so many small and large-scale industries and domestic as well as international trade and commerce. Through Bank refers to the transaction of money. Modern Banks are established with facilities the channeling of fund from the surplus units (savers) to the deficit spending units (investor) in the economy.

A Bank is any financial institution that receives, collects, transfers, pays, exchanges, lends, invests, or safeguards money for its customers. To accept money as deposits from its customers and to lend such collected fund to individuals, businesses and industrial communities are two major functions of a Bank. This thesis paper has chiefly focus in investment function and portfolio management of Nepal Credit and Commerce Bank Limited, which is one of thirty one commercial Banks operating in Nepal with a history of first joint venture Bank whose headquarter is outside the Kathmandu valley in Nepal.

Generally Investment means sacrifice of present money for future financial gains (Francis, 2003, P-1). It is a general term and it has specific meanings for different specific investors. To invest means to allocate resources into numbers of assets category. For an individual, investment might include the purchase of financial assets, such as stocks, bonds, mutual funds or life insurance policies. Investment might also include the purchase of real assets such as precious metals, housing or a car or even collectibles which include diamonds, fine arts or numismatic coins and stamps. For an economist, investment refers to the increase in real capital in an economy, such as an increase in factories and machinery, or in its human capital—that is, a skilled and educated labor force. Economists restrict investment to “real” investment of the sort that increases national output in future. For Bankers, investment means lending money to borrowers and allocating remaining funds in capital and money market.

In addition to keeping its money in own vault, a typical commercial Bank employs its fund in the following headings:

1) Money at call and short notice
2) Bills discounted
3) Investments
4) Loans and advances.

In the annual financial statements, Nepalese commercial Banks disclose their fund employed in stocks, debentures, treasury bills, etc. in the heading “investment”. However, investment in its broadest sense covers the financing of all items appearing in the “assets” side of balance-sheet. All these items construct a portfolio of a Bank. Each portfolio component serves its own purpose.

Cash at vault and Money at call and short notice serves the purpose of liquidity. Whereas, investment under loans and advances fulfills the objective of profitability.

Remaining portfolio items such as investment in stocks, governmental securities and bills discounted serves both the purposes of liquidity and profitability.

"The business of Banking is one of collecting funds from the community and extending credit (making loans) to people for useful purposes." (Edmister, 1980, P.73) Loaning money has always been a basic function of commercial Bank. After providing for its cash need, a Bank normally seeks to loan as large a portion of its deposit and excess capital as it prudentially can. The remaining portion of its investible fund is placed in suitable securities. (American Banking Association, 1966, P.163*)*

“By accepting money deposits from savers and then lending the money to borrowers, Banks encourage the flow of money to productive use and investments. This in turn allows the economy to grow. Without this flow, savings would sit idle in someone’s safe or pocket, money would not be available to borrow, people would not be able to purchase cars or houses, and businesses would not be able to build the new factories the economy needs to produce more goods and grow. Enabling the flow of money from savers to investors is called financial intermediation, and it is extremely important to a free market economy” (Microsoft Encarta Reference 2005, 1993-2004).

Unfortunately, the loans and advances which constitute a heavy proportion in the assets side of balance sheet of a commercial Bank are exposed to various risks such as default risk, market risk, liquidity risks, counterparty risks, etc. Hence, investment operation of commercial Banks is very risky. For this, they have to pay due consideration while formulating their investment policy. Healthy development of any commercial Bank depends upon its investment policy. A good investment policy attracts both borrowers and lenders, which helps to increase the volume and quality of deposits, loans and investment. Wisely formulated investment policy builds up high yielding portfolio of Bank’s assets.

This study mainly focuses on the investment policy and portfolio behavior of private-sector commercial Bank, Nepal Credit and Commerce Bank Limited (NCCBL) Published annual reports of this Bank signal the accumulation of non-performing assets which is not only a major problem of NCCBL but also of all the commercial Banks of Nepal.

List of licensed commercial Banks are given as follow:

S. N.	Commercial Banks	Operation Year (A.D.)	Head Office
1.	Nepal Bank Ltd.	1937/11/15	Kathmandu
2.	Rastriya Banijya Bank Ltd.	1966/01/23	Kathmandu
3.	Agricultural Development Bank Ltd.	1968/01/02	Kathmandu
4.	NABIL Bank Ltd.	1984/07/16	Kathmandu
5.	Nepal investment Bank Ltd.	1986/02/27	Kathmandu
6.	Standard-Chartered Bank Nepal Ltd.	1987/01/30	Kathmandu
7.	Himalayan Bank Ltd.	1993/01/18	Kathmandu
8.	Nepal SBI Bank Ltd.	1993/07/07	Kathmandu
9.	Nepal Bangladesh Bank Ltd.	1994/06/05	Kathmandu
10.	Everest Bank Ltd.	1994/10/18	Kathmandu
11.	Bank of Kathmandu Ltd.	1995/03/12	Kathmandu
12.	Nepal Credit and Commerce Bank Ltd.	1996/10/14	Siddharthanagar
13.	Lumbani Bank Ltd.	1998/07/17	Narayangadh
14.	Nepal Industrial and Commercial Bank Ltd.	1998/07/21	Biratnagar
15.	Machhapuchhre Bank Ltd.	2000/10/03	Pokhara
16.	Kumari Bank Ltd.	2001/04/03	Kathmandu
17.	Laxmi Bank Ltd.	2002/04/03	Birgunj
18.	Siddhartha Bank Ltd.	2002/12/24	Kathmandu
19.	Global Bank Ltd.	2007/01/02	Birgunj, Parsa
20.	Citizen Bank Ltd.	2007/06/21	Kathmandu
21.	Prime Commercial Bank Ltd.	2007/09/24	Kathmandu
22.	Sunrise Bank Ltd.	2007/10/12	Kathmandu
23.	Bank of Asia Ltd.	2007/10/12	Kathmandu
24.	DCBL Bank Ltd.	2008/05/25	Kathmandu
25.	NMB Bank Ltd.	2008/06/05	Kathmandu
26.	Kist Bank Ltd.	2009/05/07	Kathmandu
27.	Janata Bank (Nepal) Ltd.	2010/04/05	Kathmandu
28.	Mega Bank Nepal Ltd.	2010/09/17	Kathmandu

29.	Commerz and Trust Bank Nepal Ltd.	2010/09/29	Kathmandu
30.	Civil Bank Limited	2011	Kathmandu
31.	Century Bank Limited	2011	Kathmandu

(Sources: NRB, Mid-July, 2010)

1.2 Focus of the Study

Nepal Credit and Commerce Bank Ltd. is the first joint venture commercial Bank having its Head Quarter outside the Kathmandu valley. At the time of establishment, it has authorized capital of NPR 100.00 million. It is joint venture partner with Bank of Ceylone Ltd., Sri Lanka, is internationally recognized governmental Bank of Sri Lanka. The management of the Bank was handled by this Bank under Technical and Management Service Agreement (TMSA). As per the TMSA, Bank of Ceylone could appoint up to five emigrant employees including Chief Executive Officer.

Banks should follow a sound investment policy and form an efficient portfolio to meet its profitability objectives. In this thesis paper, researcher has focused his effort in analyzing the investment policy of NCCBL and its portfolio's efficiency as a case study.

1.3 Statement of the Problem

The investing planning of the commercial Bank in Nepal heavily depends on the rules and regulations provided by the Central Bank. So the composition of the assets portfolio of the Bank is influenced by the policy of the central Bank .Hence this is the major problem for the investment in portfolio by Banks.

In the present scenario of Nepal, the complex political and economic situation, lack if infrastructural facilities and down fall of lots of industries (private or government) have also become the major problems for the portfolio management for the Banks as these all factors have obstructed the investment opportunities for the Banks

Formulation of investment policy and construction of ultimate portfolio are two major steps in investment process. Entire investment leads to failed portfolio management if there is weakly designed investment policy.

Clarifying the commercial Banks investment policy, Diana Mc Naughton says, "Investment policy should incorporate several elements such as regulatory environment, the availability of the funds, the selection of the risk, loans portfolio balance and term structure of the liabilities."

A long term and published policy about their operation is not found in many Banks. In case of Nepal Credit and Commerce Bank, investment policy announced through Credit Strategy 2061, Credit policy guidelines 2061, Credit and Trade Finance Manual 2003 and many such announced in annual general meetings (AGMs) are the major investment guidelines.

The investment policy creates portfolio. Thus sound policy leads into portfolio with desired results. Commercial Banks are 'for profit' making organization, earning power of their assets should always be high. Assets quality of Banks is directly related with their credit policy and its implementation. So, it must follow a sound credit policy to achieve highly profit making portfolio.

The portfolio performance of many Nepalese Banks is not satisfactory. NCCBL is not also the exception of that. For NCCBL, financial performance reported in annual financial reports is not satisfactory till date.

Thus, this study is made to sort out the answers to the following questions of Nepal Credit and Commerce Bank Ltd:-

a) What are the investment policies of NCCBL?

b) Is the investment policy of the Bank well designed?

c) Does the Bank follow the investment policy as per NRB directives?

d) What is the existing situation of financial position of NCCBL?

e) What is the liquidity position of Bank's portfolio?

f) What is the profitability position of Bank's portfolio?

1.4 Objective of the Study

The primary objective of this study is to identify the investment policy of NCCBL and to evaluate its portfolio as well.

The specific objectives of this study are:

g) To evaluate the investment policy of the Bank for loans and advances and that for investment on securities.

h) To analyze how efficiently the resources have been utilized in Bank.

i) To analyze the investment portfolio of Bank in term of portfolio's liquidity, portfolio management, portfolio performance and portfolio's profitability.

j) To evaluate changes in the financial position of Bank after the taking-over of management by Nepalese entrepreneurs.

1.5 Significance of the Study

This study has multidimensional importance in the particular areas of the concern Banks. Financial executives as well as those other policy making bodies which are concern with Banking would also find this study as a useful reference. This study will provide to benefits to the management, shareholders, policymaking and public Shareholders are true owner of the company. This study mainly fills a research gap on the study of investment policy and portfolio of NCCBL. This study evaluates the investment policy of NCCBL and finds its loopholes and significantly contributes to make the policy sound.

On the other hand, portfolio of a Bank is the result of investment policy. In this thesis, portfolio behavior of the Bank has been analyzed and its portfolio performance has been evaluated. This will be beneficial to all the Bankers and policy makers to evaluate their own portfolio.

1.6 Limitations of the Study

This study is limited with resources and it may be difficult to explore researcher to find out new aspect. Reliability of statistical tools used and lack of research experience are the major limitation and some other limitations can be enlisted as follows:

k) This study is simply a partial fulfillment of MBS degree and prepared within time constraint which weakened adequacy of the study.

l) The study is mainly based on secondary data collected from the Bank, which may not be far from limitation due to inherent characters.

m) The whole study is based on limited data and information.

n) Among many factors affecting investment decision, only certain factors such as liquidity, profitability, etc. have been considered.

1.7 Organization of the Study

This study has been organized into five chapters, each chapter committed to some aspects of study on investment policy and portfolio management of NCCBL. The titles of these chapters are summarized below:

Chapter-I	:	Introduction
Chapter-II	:	Review of Literature
Chapter-III	:	Research Methodology
Chapter-IV	:	Data Presentation and Analysis
Chapter-V	:	Summary, Conclusion and Recommendations.

The **chapter I** deal with introduction, which includes background of study, focus of the study, and statement of the problem, objective of the study, significance of the study and limitations of the study.

The **chapter II** deals with Review of literature, which mainly focused with literature review that includes a discussion on the conceptual framework on investment analysis and review of major-studies relating with portfolio management.

The **chapter III** is mainly focus the research methodology used to conduct the present research. It deals with research design, sources of data, data processing procedures, population and sample, period of the study, method of analysis, financial and statistical tools and limitation of the methodology.

The **chapter IV** deals with data presentation and analysis, which includes the presentation and analysis of the data and major findings of the study.

Finally, the **chapter V** describes the major findings and conclusion of the study which deals about the main theme of study and portfolio analysis and investment policy of NCCBL with recommended for improvement of investment policy.

The bibliography and annexes are also incorporated at the end of the study.

CHAPTER – 2

REVIEW OF LITERATURE

This chapter deals with the review of literature that is relevant to the investment policy and portfolio of commercial Banks. For this study basic academic course books journals, articles, annual reports and some research paper related with this topic have been reviewed. Every possible effort has been made to grasp knowledge and information that is available from libraries, document collection centers, other information managing bureaus and concerned commercial Bank.

2.1 Conceptual Framework

Commercial Bank is a corporation, which accepts demand deposits subject to check and makes short-term loans to business enterprises, regardless of the scope of its other services (American Institute of Banking, 1972: 345).

A Commercial Bank is business organization that receives and holds deposits of fund from others, makes loans or extends credits and transfers funds by written order of deposits (Grolier Incorporated, 1984).

Thus, accepting money as deposits and lending it to borrowers are two major functions of commercial Banks. But to carry out later category of function, Bank has to set sound policy. Sound policy creates most favorable portfolio of investment. In the following sections, investment policy and portfolio have been dissected to arrive at a clear concept.

2.1.1 Investment policy

Sharpe, Alexander and Bailey (2003) said that setting investment policy involves determining the investor's objective and the amount of his/her investible wealth. Setting investment policy is the initial step in entire investment process. This step in the investment process concludes with the identification of the potential categories of financial assets for inclusion into the portfolio. For active management of investment policy, a written 'investment policy statement' should be prepared. This statement should include 'mission statement' which is nothing but long-run financial goals.

‘Investment objectives’ should also be well cited in the statement. The amount of risk that an investor is willing to bear should be well incorporated in such document.

Investment policy is a form of long range strategic planning. If investment started without policy and clear-cut objective, investing may result in disaster. However, for knowledgeable, the investment process can be financially rewarding. Optimal investment decision plays a vital role in each and every organization. But especially for the commercial Banks and other financial institutions, the sound knowledge of investment is the must because this subject is relevant to all surrounding that mobilize funds in different sectors in view of return. Advance sound knowledge is also required because investment function of Banks creates portfolio of highly risky assets

2.1.2 Investment policy: Banking perspective

Diana Mc Naughton (1994) in her research paper 'Banking institution in developing markets' stated that investment policy should incorporate several elements such as regulatory environment, the availability of funds, the selection of risk, loan portfolio balance and term structure of the liabilities.

According to S. P. Singh and S. Singh (1983), "The investment (credit) policies of Banks are conditional, to great extent, by the national policy framework; every Banker has to apply his own judgment for arriving at a credit decision, keeping, of course, his Bank's credit policy also in mind".

They further stated, "The field of investment is more challenging as it offers relatively greater scope to Bankers for judgment and discretion in selecting their loan portfolio. But this higher degree of freedom in the field of credit management is also accompanied by greater risk, particularly during recent years; the credit function has become greater complex."

James B. Bexley, (1987) expressed his views as, "Investment policy fixes responsibilities for the investment disposition of the Banks assets in terms of allocating funds for investment and loan, and establishing responsibility for day to day management of those assets."

According to Chandler L. V. (1973), "A Banker seeks optimum combination of earning, liquidity and safety while formulating investment policy".

"A sound investment policy of a Bank is such that its funds are distributed on different type of assets with good profitability on the one hand and provides maximum safety and security to the depositors and Banks on the other hand. Moreover, risk in Banking sectors tends to be concentrated in the loan portfolio. Therefore the Banks investment policy must ensure that it is sound and prudent in order to protect public funds. Bank makes a variety of loans to a wide variety of customers for different purposes. Therefore no uniform rules can be laid down to determine a portfolio of a Bank. The environment in which it operates influences the investment policy of the Bank. The nature and availability of funds also differ widely from one region to another within the country. For example scope of a Bank operating in Kalikot will be different from the scope of Bank operating in Kathmandu. Therefore, the investment policy to be applied in Kathmandu may not be applicable to the Bank operating in Kalikot (Baidhya, 1999: 46-47).

Emphasizing the importance of investment policy, H. D. Crosse (1963) puts his view in this way, "Lending is the essence of commercial Banking, and consequently the formulation and implementation of sound policies are among the most important responsibilities of Bank directors and management. Well conceived lending policies and careful lending practices are essential if a Bank is to perform its credit creating function effectively and minimize the risk inherent in any extension of credit".

The formulation of sound lending policies for all Banks should have adequate and careful consideration over community needs, size of loan portfolio, character of loan, credit worthiness of borrower and asset pledged to security borrowing , interest rate policy, etc.

Investment policy provides the Bank several inputs through which they can handle their investment operation efficiently ensuring the maximum return with minimum exposure to risk, which ultimately leads the Bank to the path of success.

According to Edward W. Reed, Richard V. Cotter, Edward K. Gill and Richard K. Smith (1980: 1-5), "Commercial Banks still remain the heart of our financial system holding the deposits of millions of persons, governments and business units. They make funds available through their lending and investing activities to borrowers, individuals, business firms and governments. Commercial Banks are the most important type of financial institutions in the nation in terms of aggregate assets." The primary function of commercial Banks is the extension of credit to worthy borrowers. In making credit available, commercial Banks are rendering a great social service. Through their actions, production is increased, capital investments are expanded, and a higher standard of living is realized. Although the investment activities of commercial Banks are usually considered separately from lending, the economic effects and social results are the same.

Reed Italic, (1980) added that "The rate of return on assets is a valuable measure when comparing the profitability of one Bank with another or with the commercial Banking system. A low rate might be the result of conservative lending and investment policies or excessive operating expenses. Banks could, of course, attempt to offset this by adopting more aggressive lending and investment policies to generate more income"

Investment policies include credit analysis and its principal purpose is to determine the ability and willingness of a borrower to repay a requested loan in accordance with the terms of the loan contract. Factors considered in credit analysis are capacity to borrow, characters (honesty, integrity, industry, morality, ability to create income, ownership of assets, economic conditions, etc. Loans are the most important assets held by Banks and Bank lending provides the bulk of Bank income (Reed et al, 1980: 203, 235).

Thus generalizing the above arguments, the investment operation of Bank includes lending money to borrowers and investing in different types of securities. We can say lending is the primary investment activity and investment in different types of securities is the secondary investment activity of the commercial Banks.

To comply with NRB’s directive for framed accounting, Nepalese commercial Banks disclose their fund employed in stocks, debentures, treasury bills, etc. in the heading “investment”. However, investment covers financing of all items appearing in the “assets” side of balance-sheet. All these items construct a portfolio of a Bank. Each portfolio component serves its own purpose.

Cash at vault and Money at call and short notice serves the purpose of liquidity, whereas, investment under loans and advances fulfills the objective of profitability.

Remaining portfolio items such as investment in stocks, governmental securities and bills discounted serves both the purposes of liquidity and profitability.

However, loans/advances and investment in securities dominate heavily the investment operation of Banks. These contribute more than 80 percent in the income of Banks.

Thus, a sound investment policy of Banks should address the following assets categories for inclusion into the ultimate portfolio.

a) Loans and advances

b) Investment in securities

2.1.2.1 Loans and advances policy:

This policy is also known as **credit policy** of the Bank. Credit policy guides the Bank’s overall credit operation. Since the largest proportion of a Bank’s assets portfolio is taken by loans and advances, healthy development of any Bank depends heavily upon its credit policy. A sound and viable investment policy can attract both borrowers and lenders, which helps to increase the volume and quality of deposits, loans and investments. The loan provided by commercial Bank is guided by several principles such as length of time, their purpose, profitability, safety, etc. These fundamental principles of commercial Banks’ investment are fully considered while making investment policy. Investment through loans and advances to borrowers is risk inherent. For this, commercial Banks have to pay due consideration for risk management while formulating investment policy. Emphasizing upon Bank’s investment policy H.D. Crosse stated, "The investment policy should be carefully analyzed". Commercial Bank should be careful while performing the credit creation function. Investment policy should ensure minimum risk and maximum profit from lending.

The factors that Banks must consider for sound lending and investment policies are explained as under:

a) Safety and security:

The credit policy formulated by Banks should be capable enough to secure its investment. The Banker should ensure that the borrower has the ability and will try to repay the advances as per the agreement. In this connection, before granting a secured advances, Bank should ensure carefully consider the margin of safety offered by security concerned and possibilities of fluctuation in its value. Credit policy should be devised in such a way to keep the higher margin of safety for secured loans. The Bank should never invest its funds in the collateral of those securities which are too volatile i.e., which are subject to too much depreciation and fluctuations because a little difference may cause a great loss. Security means adequate collateral having good value, which can be easily sold off if required at any point of time. The Bank should accept such type of securities, which are commercial, durable and marketable having fair market value. For this purpose, 'MAST' should be applied while reaching an investment decision, where MAST stands for,

M = Marketability,

A = Ascertainability,

S = Stability,

T = Transferability.

If it is an unsecured loan, its repayment depends on the creditworthiness of the borrower. As such, cardinal principle which the Banker should consider in case of unsecured loans and advances are to look into the following credit component of a borrower and or guarantor:

- Capital,
- Character
- Capacity

(Popularly known as 3 ‘C’s of credit), or

- Reliability,
- Responsibility
- Resources

(Popularly known as 3 ‘R’s of credit).

All these components should be included in the credit policy guidelines for credit operation of a Bank.

b) Liquidity

Liquidity is the ability of a firm to satisfy its short-term obligations when they become due for payment. It implies the ability to produce cash on demand. People deposit money at the Bank in different account with confidence that the Bank will repay their money when they need. Such deposits are repayable on demand or on the expiry of a specified period. In either case, the Banker must be ready to meet these liabilities. Otherwise, he will suffer in his credit, which is the very foundation of his business.

Nevertheless, a Bank utilizes its deposit liabilities for the purpose of granting loans and advances. To maintain depositors' confidence towards Bank, the Bank must grant such loans and advances which are as liquid as possible. That is why commercial should grant loans and advances of short-term nature. Discounting first class bill of exchange, financing customer's current assets through Overdrafts and Cash Credit facilities generally fulfils this liquidity principle. Investment on industrial fixed assets under term loans is illiquid in nature. Matching the maturity of loans and deposits will assist in managing the loan portfolio's liquidity position. So, a Bank's credit policy should pay due attention towards the liquidity of loans and advances.

c) Profitability

As already stated Banks are 'for profit' organization. To fulfill the stakeholders' expectations, it must meet sufficient profit. Main contributor towards a Bank's profit is 'interest income' derived by granting loans and advances. Hence, the credit policy of a Bank should be aimed at yielding higher interest income. However, such income should be reasonable. Interest rate levied on different loan headings is an indicator of the profitability level of loan portfolio.

Banks credit operation should be profitable due to following reasons:

1. Strong operating profits allow for full prudential provisioning
2. High net profits allow for allocation to capital and reserves, which is essential for any Bank to maintain its competitive viability and expand its lending operations.
3. High net profit entitles shareholders to reasonable dividends.
4. To compensate the depositors with reasonable return on their money, Banks should earn profits.

All this indicates that it is necessary for the Banks to make sure that their lending operations are sufficiently profitable.

The interest levied on the borrowers account is cost for them. Thus, it is true that excessive and unjustifiable profits can only be at the cost of the customer. So, higher lending rates push up production costs, and in the ultimate analysis, adversely affect the society in general. Hence, a credit policy should make a balance between profitability and social costs.

d) Purpose of Loan

Loans and advances policy of a Bank should clearly cite the purposes for which it will advance credit facilities. Unsocial and Banks should carefully examine the purpose for which the advance has been applied for. From the viewpoint of security, a Banker should always be known that why a customer needs loans. If a borrower misuses the loan granted by the Bank, it can never repay and Bank will possess heavy bad debts. Therefore in order to avoid this situation each and every Bank should demand and examine all the essential detailed information about the scheme of the project or activities, before lending. NRB directive no. 2 has required 100% provision for such loans which are diverted for the purposes other than that indicated by the borrower at the time of application. Hence, Banks should develop post credit supervision practices to monitor the use of loans and advances.

e) National Interest

Bank’s credit policy should not contradict the national interest. In addition to its own profitability objective, the Bank should also consider the national interest. Even though the Bank cannot get maximum return from such investment, it should carry out its obligation towards the society and the country. The Bank is required to invest on such sectors as per the Government and Nepal Rastra Bank's instruction. Investment on government bonds, priority and deprived sector lending are the examples of such investments.

f) Diversification

The principle of diversification is guided by the fact: “Do not put all eggs in a single basket”. The credit policy should avoid excessive concentration of loans and advances in single sector of economy, single geographical area and single borrower or group of borrowers. It should aim at spreading the advances as widely as possible over the different industries and different localities. Thus would enable Banks to compensate any losses which might arise as a result of unanticipated factors adversely affecting particular industries and/or particular localities. In this respect, Banks having wide branches network can well exercise the credit diversification. It is also advisable for a Banker to advance moderate sums to large number of borrowers than advance large sums to a small number of borrowers.

Nepal Rastra Bank has also directed Banks not to avail fund based credit facilities to a single borrower exceeding 25 percent of core capital. This limit is called single obligor limit (SOL) of a Bank. The central Bank has also circulated instruction to regulate concentration of credit to such borrowers who are operating in a single economic sector.

2.1.2.2 Policy for Investment on Securities

It is not unusual for commercial Banks to invest its fund in stock exchange securities like governmental securities, semi-governmental securities, industrial securities, etc. In Nepalese Bank's formatted accounting system, these investments are disclosed in the assets heading 'Investment' of the balance sheet.

Investment on securities enables Banks to obtain more earning assets than afford by money at call and short notice in order to more secure in its lending as well as to maintain liquidity. Investment on securities serves the purposes of both liquidity and profitability. Factors that influence a Bank in rating securities to include them into ultimate portfolio are: (1) Safety of capital, (2) Easy marketability, (3) Stability of price and (4) Stability of income. The Banker should always bear in mind that in buying these securities is not its primary objective to gain by a possible rise in the prices of these securities. Consideration should be given to this factor only if it is satisfied with the safety and stability of capital. Generally commercial Banks prefer governmental securities to the shares and stocks of joint stock companies, which is very comfortable to get back of their investments in stipulated time frame. The reasons are various as per the following table:

Table – 2.1: Comparison of govt. securities with joint stock companies' securities:

S.N.	Governmental securities	Joint stock companies' securities
1	Repayment of capital is ensured because this depends upon the creditworthiness of whole nation.	In case of ordinary stock exchange securities, safety of investment is entirely dependent on the creditworthiness of a single unit.
2	The yield from a governmental security is steady and reasonable.	The yield fluctuates with income stream of the joint stock company under consideration.
3	Governmental securities are easily saleable without causing a glut in their market prices.	In case of ordinary industrial securities, sale of a large block of shares is likely to depress their prices.

(Source: Shekhar, 2005, P-14)

According to KC Shekhar and Lekshmy Shekhar (2005), a sound investment policy should aim at attaining the following objective:

1. Investment should be as liquid as possible. Inclusion of government bonds with various expiries into the portfolio will satisfy this objective
2. Portfolio should be profitable.
3. It should ensure the security of capital.
4. Gain through price appreciation should not be taken as prime standard of investment.

2.1.3 Portfolio structure

The portfolio of a Bank can be thought of as a mix of money market and capital market and instruments. In addition to keeping its money in own vault, a typical commercial Bank employs its funds in following headings:

(1) Money at call and short notice,

(2) Bills discounted,

(3) Investments in securities &

(4) Loans and advances,

This is a general picture of entire portfolio of a Bank marshaled on the basis of liquidity. However, this thesis intends to cover two major portfolio categories:

(1) Investments and loans and advances including bills purchased and discounted

(2) Investment on securities.

It is because being ‘for profit’ organization, whole target of profitability rests on these assets.

2.2 Review of NRB directives

As the central Bank, Nepal Rastra Bank has regulatory authority to monitor and influence the credit policy and portfolio of commercial Banks operating in Nepal. Nepal Rastra Bank Act, 2058 has empowered Nepal Rastra Bank, the central Bank of Nepal, to regulate, monitor and control the overall functions of Banks and financial institutions of Nepal. Using this empowerment, NRB issues directives, circulars and instructions to the Banks and financial institutions.

One of the major tools that influence the investment policy and there by portfolio of a Bank is monetary policy which is announced every year. It influences the amount of fund available in Bank for investment.

On Ashadh end 2067, NRB has issued 21 ‘unified directives’ to all Banks and financial institutions of Nepal. They became effective since 01/04/2067 BS. They are called unified directives because prior to this, NRB used to issue separate directives to commercial Banks, development Banks and finance companies and micro finance companies separately. These directives have consolidated the functions of overall financial institutions of Nepal.

Nepal Rastra Bank introduced new consolidated directives in accordance with the BFI Act. The consolidated directives are guided under NRB Act 2058 and Basel II principles as well. The new Directives included regulatory measures of international standards and practices in the areas of: Capital adequacy; loan classification and provisioning; credit concentration and single obligor limits; accounting policies and formats of financial statements; management and minimization of risks; good corporate governance; policies relating to compliance with the directives issued after the inspection and supervision; investment policies; reporting requirements; provisions for the purchase and sale of promoter shares; regulation on consortium financing; regulations on credit information and blacklisting; provision for statutory reserve requirements; policies on branch expansion; policies on interest rates; and policies on financial resources generation. It is hoped that adherence to these directives would ensure financial stability and discipline thereby helping Nepalese Banking industry to flourish in the country. Banks & financial institutions are responsible for comply these directives according to NRB Act 2058.

Mainly, following directives are related with investment policy and portfolio matters of commercial Banks.

Directive no. ***Subject***

2. Classification of loans and advances and provision for loan loss.

3. Provision regarding single obligor limit and loans limit for single sector of economy.

8. Investment

13. Mandatory cash reserve

15. Provision relating to interest rate

Main extracts of the directives are as discussed below:

2.2.1 Directive no. 2: Classification of loans and advances and provision for loan loss:

According to directive no. 2, Banks have to classify the loans and advances as follows on the following basis:

Pass: Loan principal not past due and past due upto 3 months.

Sub-standard: Loans and advances past due more that 3 months and upto 6 months.

Doubtful: Principal past due more than six months and upto 1 year.

Loss: Principal past due more than 1 year.

Pass loans are called performing loans where as sub-standard, doubtful and loss loans are categorized as non-performing loans.

The loans and advances classified as above are required to be provisioned with the following percentages of outstanding principal:

Loan class	Required loan loss provision
Pass	1%
Sub – standard	25%
Doubtful	50%
Loss	100%

Loan loss provision derived so far are deducted form the operating income of the Banks. Financial institutions have to be maintained the provision as per classification of loan. It measures the quality of assets in reference of loan and advances and contraction of profit as well. Quality of assets is decreases, when the credit of financial institutions diversifies in to NPA. Such losses, from quality of assets, can be compensated by debiting the profit and can be harmonized the financial strength of those financial institutions.

2.2.2 Directive no. 3: Provision regarding single obligor limits and loan limit for single sector of economy.

According to this circular, Banks can finance funded advances upto 25% of their core capital fund to a single borrower or a group of related borrowers. However, non-fund based facilities like letter of credit, guarantee, acceptance; commitments can be extended upto 50% of their core capital to such a single obligor.

Large sectorial concentrations constitute a source of risk. Through this directive, central Bank has directed commercial Banks to develop internal policies and measures to monitor the concentration of funded and non-funded facilities in different sectors of economy. If, in case, a commercial Bank provides facilities to a single obligor or to a single sector of economy more that a prescribed limit, the Banks are compelled to provision additional loan loss provision for such additional loan or facility amount.

For the purpose of this directive, NRB has identified following; each as a sector of economy:

1. Agriculture
2. Mines
3. Production
4. Construction
5. Metallic production, machinery and electronic tools fabrication
6. Electricity, Gas & water
7. Transportation equipment production
8. Transport, communication, and public utilities
9. Whole and retail trading
10. Finance insurance and real estate
11. Services: Tourism and Hotel
12. Other services
13. Consumer loans
14. Local government
15. Other

Thus, this directive has directed commercial Banks to develop their own policies to diversify the loans and advances as far as possible. However, in case Nepal Rastra Bank directs, the Banks shall provide cent percent additional loss provisioning to minimize the concentration risks. The directive has directed commercial Banks to exercise principle of diversity while advancing loans.

2.2.3 Directive no. 8: Investment policies

This directive is related to the investment of financial of financial institutions in shares, bonds and debentures. Following are the major provisions laid in this directive:

1. Banks may invest their resources on government bond, NRB bond, shares and debentures of organized companies under the circumstances of such investment policy produce from board of directors.

2. There is no restriction to invest on government bond and Nepal Rastra Bank bond.

3. Investment is allowed to be made on the shares and debentures of those companies whose shares are sold to public and listed in Nepal Stock Exchange.

4. Banks may invest in shares and securities of any organized institutions not exceeding 10% on own core capital and not exceeding 30% of core capital in the portfolio of shares and debenture investment.

5. Banks shall arrange for half-yearly review of investment portfolio. With respect to such review, a statement from the internal auditor of the Bank certifying that the investments are made as per the existing investment policy and as per this directive shall be obtained and shall be approved by BOD within one month.

6. Banks may invest in shares and securities of any organized institutions not exceeding 10% on own core capital and not exceeding 30% of core capital in the portfolio of shares and debenture investment after prior approval from NRB.

7. Banks are prohibited to invest in securities and hybrid capital instruments of other Banks and financial institutions except in micro-finance companies.

To mobilize the financial resources Bank should prepare its investment policy under this directive.

- Investment Policy should be implemented after getting NRB Approval
- Special Directives issued regarding to investment on NRB Board and Government Board.
- Provision regarding to investment on shares & securities of organized institutions.
- Review of Investment.
- Valuation of shares & debentures.

2.2.4 Directive no. 13: Mandatory cash reserve

Mandatory cash reserve determines the amount of investible fund that is available with a Bank. This directive has directed commercial Banks to reserve 5.5% of their total deposit liabilities on ordinary account maintained at NRB.

2.2.5 Directive no. 15: Provision relating to interest rate

This directive is related with product pricing. This directive related with Fixation of interest rate.

The major arrangement regarding the interest rate and interest income in this directive as follows:

1. Banks are free to fix their interest rate to be paid on deposits and to be levied on loans and advances.
2. Any changes made on such interest rates should be made public through national daily newspaper.
3. The interest income should be recognized on the basis of cash receipt only. Interest earned but not collected in cash should be transferred into interest suspense account but not into interest income account. Such suspended interest should be recognized as income in the year when it is realized.

2.3 Review of related studies

For achieving the objective of this thesis paper, research papers, articles, journals, master degree thesis, thesis has been consulted to find the research gap. The review of such related studies has been presented in the following sections.

2.3.1 Review of research papers

Shrestha (1998) has given a short indication on the "Portfolio management in commercial Banks; theory and practice". Shrestha (1998) has highlighted following issues in the article. The portfolio management becomes very important both for individuals as well as institutional investors. Investors would like to select a best mix of investment assets subject to the following aspect:

- Higher return, which is comparable with alternative opportunities available according to the risk class of investors.
- Good liquidity with adequate safety of investment.
- Maximum tax concession.
- Economic, efficient and effective investment mix.
- Flexible investment.
- Certain capital gains.

In view of above aspect, following strategies can be adopted:

- Do not hold any single security i.e.; try to have a portfolio of different securities.
- Do not put all the eggs in one basket i.e.; to have a diversified investment.

- Choose such a portfolio of securities, which ensures maximum return with minimum risk or lower return but with added objective of wealth maximization.

However, Shrestha (1998) has also presented following approach to be adopted for designing a good portfolio and its management:

- To find out the investible assets (generally securities) having scope for better returns depending upon individual characteristics like age, health, need, disposition, liquidity, tax liability, etc.
- To find out the risk of the securities depending upon the attitude of investor toward risk.
- To develop alternative investment strategies for selecting a better portfolio that will ensure a trade-off between risk and return, so as to attach the primary objective of wealth maximization at lower risk.
- To identify securities for investment to refuse volatility of return and risk.

Shrestha (1998) has presented two types of investment analysis techniques ie; fundamental analysis and technical analysis to consider any securities such as equity, debentures or bonds and other money and capital market instruments. He has suggested that the Banks having international network can also offer access to global financial markets. He has pointed out the requirements of skilled manpower, research and analysis team and proper management information system (MIS) in any commercial Bank to get success in portfolio management and customer's confidence.

According to Shrestha (1998), the portfolio management activities of Nepalese commercial Banks at present are in nascent stage. However, on the other hand, most of the Banks are not doing such activities so far because of following reasons: -

- Unawareness of the clients about the service available.
- Hesitation of taking risk by the clients to use such facility.
- Lack of proper techniques to run such activities in the best and successful manner.
- Less developed capital market and availability of few financial instruments in the financial market.

Shrestha (1993) in her research, "Investment planning of commercial Banks in Nepal", has made remarkable efforts to examine the investment planning of commercial Banks in Nepal. On the basis of the study she concludes that Bank portfolio (loans and investment) of commercial Banks has been influenced by the variable securities rates. Investment planning of commercial Banks in Nepal is directly traced to fiscal policy of government and heavy regulatory procedure of the central Bank (Nepal Rastra Bank). So the investments are not made in professional manner. Investment planning and operation of commercial Banks in Nepal has not been found satisfactory in terms of profitability, liquidity, safety, productivity and social responsibility. To overcome this problem, she has suggested, "commercial Banks should take their investment function with proper business attitude and should perform lending and investment operation efficiently with proper analysis of the projects".

Thapa (1994: 29-37) has expressed his view that the commercial Banks including foreign joint venture Banks seem to be doing pretty well in mobilizing deposits. Likewise, loans and advances of these Banks are also increasing. But compared to the high credit needs particularly by the newly emerging industries, the Banks still seem to lack adequate funds. The Banks are increasing their lending to non-traditional sectors along with the traditional sectors. Out of the different commercial Banks, Nepal Bank Ltd. and Rastriya Banijya Bank are operating with a nominal profit and also turning towards negative from time to time. Because of non-recovery of accrued interest, the margin between interest income and interest expenses is declining. These Banks have not been able to increase their income from commission and discount, through traditional off-balance sheet operations. On the contrary, they have got heavy burden of personnel and administrative overheads. Similarly, due to accumulated overdue and defaulting loans, profit position of these Banks has been seriously affected.

On the other hand, the foreign venture Banks have been functioning in an extremely efficient way. They are making huge profit year after year and have been distributing large amount of loans and dividends to its employees and shareholders. Because of their effective persuasion for loan recovery, overdue and defaulting loans have been limited resulting in high margins between interest income and interest expenses. Similarly, concentration of these Banks to modern off-balance sheet activities and efficient personnel management has added to the maximization of their profits.

2.3.2 Review of articles

In this section, effort has been made to examine and review of some related articles in different economic journals, World Bank discussion papers, magazines, newspapers and other related books and publications.

Bhattarai (2003) has presented an article about the "Non Performing Assets (NPA) Management". According to him, a loan is very easy term for a borrower when he has already taken and for a lender not availed. It is equally difficult for a borrower to avail and for lender to recover. From a Banker's view, it is just like a stone to roll down from the top of the hill while sanctioning, but too difficult to roll back the same stone to the top of the hill while recovering. A loan not recovered within the given time frame either in the form of interest servicing or principal repayment is called non-performing loan (NPL). There are other parameters as well to quantify an NPL. Security not to the extent of loan amount with specified safety margin, value of security not realizable, possession not as per the requirement of Bank, conflict of charges are the other reason which causes difficulties while recovering the loan.

According to him NPL for a Bank is like a developing cancer in a human body, which will collapse the whole Bank if not managed in time. This is an important discipline in banking to prevent whole NPL or avoid situations for a loan to turn into NPL. The loan for a Bank is most important to generate revenue for operational expenses as well as to provide return to the shareholder.

When a loan advanced from good money turns into a bad loan the chance of shareholders return as well as survival of a Bank stands in a stake. Ailing Bank can't portray its better image in the public. And no Bank can operate its business without the deposit from the public. When public start losing their confidence on the Bank and don't keep their deposit in the Bank, that Bank will start counting its finger for collapse. A loan disbursed as good loan doesn't turn into bad over the night. It has certain course to turn into bad. An efficient Bank management can recover the loan before turning it into bad and can save itself from the un-unwanted debacle.

A general survey reveals following reasons why a good loan turns into bad:

Situational Problem

- Poor analysis of project and its capital requirement leading to a situation of over/under capitalized.
- Faulty evaluation of loan and security.
- Problem in managing the unit.
- Actual modus operandi is totally different than the projection and unit unable to cope with the situation.
- Sudden change in internal and external environment and project not being run according to its plan.
- Mismatch in demand and supply leading over inventory or under inventory.
- Collection of receivables un-necessarily delayed resulting delay in re-order and chances of business penetration by other competitors.

Intentional Problems

- Intention to cheat the Bank.
- Intention to flee without settling the loan.
- Malicious act of both the Bank-staff and borrower.
- Intention to auction the property, which is in least requirement, borrower.
- To show other creditors to his Bankruptcy, this is unmanageable.
- To relieve from other debts.
- To waive interest/ penal interest or avail discount on loan if paid in latter stage when Bank offer such facilities.

A borrowing may reflect one or all above signals causing harm to the Bank's business. There are few chances of cure to protect Bank from an intentional defaulter. But for the defaulter caused by situations we can re-schedule, re-structure their facilities and help them to meet their debt obligation as per the cash flow they are having.

For a genuine loan which was disbursed with all good spirit may turn into bad if it is not monitored properly and corrective measures are not taken in time. The signals of such failure appear to borrower first and then consequences fall upon the shoulder of a Bank. When a good loan, with all effort to protect it, turn into bad and borrower ability is not enough to serve from other source, then borrower also tries to hide the information from the Bank and wants to be relieved temporarily. Such situations give some signals to the Bank and these signals are called danger signals.

He added that a formula Know Your Customer (KYC) is to be always taken into consideration. A Bank must be clever and must collect information greater then a borrower require for commencement of business and to be more rigid to give the loan than to give his own money without any security. When a borrowing unit is not able to serve the debt from the source explored, the documentations are merely a decree to enforce legal action against him. But what gets realized when everything is lost. A jail and punishment doesn’t satisfy the interest of Bank.

A basic know how of NPL management is to prevent a loan to turn into loss. Therefore every possible measure is to be implemented to keep a loan portfolio intact. Periodic meeting with the borrower and market information is must to check the exposure against a particular business sector.

Similarly, if it is due to changes in the business environment and other factors a rescheduling and restructuring approach to be followed to protect both the Bank and borrow. A Bank never wants to make a borrower, a squatter. The Bank equally tries to protect its interest by any means.

The security given by a borrower may be ample for the exposure. But the borrower from other source of business may not be able to generate substantial earning to service the debt. Bank has all options to auction the property and liquidate the loan. While doing so, realization from the auction of property is always less than the value of an asset. This neither serve the purpose of Bank nor the borrower, additionally will cause loss both the Bank and borrower. A well doing family may turn to squatter if all the assets so auction at low value.

Pradhan (1996: 9) has presented a short glimpse on investment in different sectors, its problem and prospects, through his article "Deposit mobilization, its problem and prospects". On his article he has expressed that, "Deposit is the life blood of any financial institution, be it commercial Bank, finance company, co-operative or non-government organization". He also added, in consideration of 10 commercial Banks and nearly three dozens of finance companies, the latest figure does produce a strong feeling that a serious review must be made of problems and prospects of deposit sector. Except few joint venture Banks, other organizations rely heavily on the business deposit receiving and credit disbursement.

In the light of this, Pradhan (1996: 9) has pointed out following problems of deposit mobilization in Nepalese perspective:

1) Due to the lesser office hours of Banking system people prefers for holding the cash in the personal possession.
2) Unavailability of the institutional services in the rural areas.
3) No more mobilization and improvement of the employment of deposits in the loan sectors.
4) Due to the lack of education most of Nepalese people do not go for saving in institutional manner. However, they are very much used of saving, be it in the form of cash, ornaments or kind. Their reluctance to deal with institutional system are governed by their lower level of understanding about financial organizations, process requirements, office hours withdrawal system, availability of depositing facilities and so on.

Pradhan (1996: 9) mentioned that deposit mobilization carried out effectively is in the interest of depositors, society, financial sector and the nation. Lower level of deposit raising allows squeezed level of loan delivery leaving more room to informal sector. That is why higher priority to deposit mobilization has all the relevance.

2.3.3Review of Thesis paper

Prior to this, several thesis works has been attempted by previous students regarding various aspects of commercial Banks like financial performance, lending policy, investment policy, resource mobilization, capital structure etc. Among them some research those that were found relevant for this study are presented below:

- Khadka (1998) in his thesis work entitled "A study on the Investment Policy of Nepal Arab Bank Ltd in comparison to other joint venture Banks of Nepal" has tried to examine and interpret the investment policies adopted by NABIL and other joint venture Banks of Nepal.

The objectives of the research were:

a) To evaluate the liquidity, asset management, efficiency and profitability position.
b) To discuss fund mobilization and investment policy of NABIL with respect to its fee based off-balance sheet transaction in comparison to other JVB's.

c) To evaluate the growth ratios of loan and advances and total investment with respective growth rate of total deposits and net profit of other JVB's.

d) To find out the relationship between deposit and total investment, deposit and loan and advances and net profit and outside assets of NABIL comparison to other JVB's.

e) To evaluate the trends of deposit utilization and its projection for next five years of NABIL compared to other JVB's.

His major findings were:

a) The liquidity position of NABIL is comparatively worse than other JVB's. NABIL has utilized more portions of current assets as loan and advances and lesser portions in government securities.

b) The profitability position of NABIL is comparatively better then that of other JVB's.

c) There is significant relationship between deposit and loan and advances as well as outside assets and net profit where as there is no significant relationship between deposit and total investment in case of other JVB's.

d) The trend values of loan and advances to total deposit of NABIL and other JVB's are in increasing trend. The trend value of total investment to total deposit of NABIL and other JVB's are in increasing trend.

e) NABIL is seen to be more successful in increasing its sources of fund for deposit mobilization and granting loan and advances and maintain a good investment but it has failed to maintain its high growth rate of profit in comparisons with other JVB's.

➢ Tuladhar (2000) has conducted a thesis research on " A study of investment policy of Nepal Grindlays Bank Limited in comparison to other JVB'S of Nepal".

The basic objectives of this study were:

a) To study the fund mobilization and investment policy with respect to fee based off-balance sheet transaction and fund based on balance sheet activities.

b) To evaluate the liquidity, efficiency, assets management and profitability position.

c) To evaluate the growth ratios of loan & advances and total investment with respective growth rate of total deposit and net profit.

d) To evaluate the trends of deposit utilization towards total investment and loan advances and its projection for next five years.

e) To perform an empirical study of the customer's views and ideas regarding the existing service and adopted investment policy of the joint venture Banks.

f) To provide suggestions and recommendation on the basis of this study.

His major findings were:

a) NGBL has maintained adequate liquidity than other JVB's. It is in a better position to meet current obligation.

b) NGBL has successfully maintained and managed its assets towards different income generating activities.

c) The profitability position of NGBL is higher than other JVB's.

d) NGBL has invested higher portion of total working fund in government securities than other JVB's. NGBL's loans and advance to total deposit ratio is less than other JVB's.

e) NGBL has the largest profit margin in comparison with other JVB's.

- Thapa (2001) has conducted a thesis research on "A comparative study on investment policy of Nepal Bangladesh Bank and other JVB's (NABIL Bank Limited and Nepal Grindlays Bank Limited)"

The research study was based on the following specific objectives:

a) To evaluate the liquidity, assets management efficiency, profitability and risk position of NBBL in comparison to NABIL and NGBL.

b) To analyze the relationship between loan and advances and total investment with other financial variables of NBBL and compare them with NABIL & NGBL.

c) To examine the fund mobilization and investment policy of NBBL through off-balance sheet and on balance sheet activities in comparison to the other two Banks.

d) To study the various risks in investment of NBBL in comparison to NABIL & NGBL

e) To analyze the deposit utilization trend and its projection for next five years of NB Bank and compare it with that of NABIL & NGBL.

The major findings of the study were as follows:

a) NBBL has good deposit collection, enough liquidity, it has sanctioned enough loan and advances, but it has made negligible amount of investment in government securities.

b) NBBL is in a weak position regarding its on balance as well as off balance sheet activities.

c) Profitability position of NBBL is comparatively worse than that the NABIL & NGBL.

d) The credit risk ratio, interest risk ratio, capital risk ratio of NBBL is higher than NGBL & NABIL. It is exposed to more risk.

e) NBBL has been successful in increasing its sources of funds and its mobilization. The growth ratio of total investment of NBBL is comparatively worse than the other two JVB's.

f) There is significant relationship between deposit and loan and advance, outside assets and net profit of NBBL but there is no significant relationship between deposit and investment of NBBL.

g) The position of NBBL in regard to utilization of fund to earn profit is not better in comparison to NABIL & NGBL.

h) The cost of fund of NBBL is competitively higher than NABIL & NGBL.

➢ Bohara (2002) has conducted a research entitled "A comparative study on Investment policy of Joint Venture Banks and Finance Companies of Nepal".

The objectives of the study were as follows:

a) To find out the liquidity position and profitability position of above mentioned JVB's in comparison with finance companies.

b) To find out the relationship between profitability and asset structure.

c) To analyze the deposit utilization trend and its future projections for next five years for JVB's and finance companies.

d) To study the various risks in investment of JVB'S in comparison with finance companies.

e) To analyze the relationship between deposits and investment, deposits and loan & advances, net profit and total assets of JVB'S in comparison with finance companies.

f) To provide suggestion and recommendation on the basis of findings.

The major findings of the study were as follows:

1) Liquidity position of JVB's is comparatively better than that of finance companies. Finance companies have made nominal amount of investment in government securities.

2) Finance companies have mobilized their deposits smoothly in comparison with JVB's. The average loan and advance to total deposit ratios of finance companies is higher than JVB's.

3) Profitability position of JVB's except for BOKL is better than that of finance companies, but profitability position of finance companies in terms of return on total assets is better. Interest income in relation to proportion of total assets and operating income is higher in finance companies in comparison to JVB's.

4) The growth ratios of deposits, net profit, loan and advances are higher than that of JVB's and are increasing every year, which indicates good performance of the finance companies.

5) The risk ratios of finance companies are less variable than the JVB's. The interest risk ratios of finance companies are higher where as the capital risk ratios of JVB'S are comparatively higher than that of finance companies.

6) JVB'S are in a better position in mobilizing deposits as loan and advances, but so far finance companies have been successful in utilizing their sources of funds and in their mobilization.

- Thapa (2002) has conducted a research entitled "Investment Policy of Commercial Banks in Nepal.

The objectives of the study were:

a) To discuss fund mobilization and investment policy of EBL in respect to its fee based off-balance sheet transaction and fund based on balance sheet transaction of NABIL and BOKL.

b) To evaluate the liquidity, efficiency, profitability and risk position.

c) To evaluate the growth ratios of loans and advances and total investment with other financial variables.

d) To analyze the trends of deposits utilization towards total investment and loan and advances and its projection for next five years.

e) To conduct hypothetical test to find out whether there is significant difference between the important ratios of EBL, NABIL & BOKL.

f) To provide packages of workable suggestions and possible guidelines to improve investment policy of EBL and other Banks.

His major findings are enumerated below:

a) EBL is comparatively better than NABIL and BOKL in terms of liquidity.

b) EBL has been less successful than NABIL and BOKL in its on balance sheet operation as well as off balance sheet activities.

c) The profitability position of EBL is worse than NABIL and BOKL.

d) EBL is exposed to more credit risk and capital risk, but lower interest rate risk than NABIL and BOKL.

e) EBL has maintained high growth rates in total deposit, loan and advances but it has moderate position in investment.

g) There is significant relationship between deposit and loan and advances and outside assets and net profit of EBL.

Shrestha (2003) has conducted a research entitled "Investment Analysis of Commercial Banks" (A Comparative Study of Nepal Bank Limited and Nepal State Bank of India Limited).

The objectives of the study were:

a) To analyze percentage of investment made by HBL and NSBIL in total investment made by commercial Banks.

b) To analyze investment trend, deposits trend and total income and their projection for next five years of HBL and compare then with that of NSBIL.

c) To identify investment sector of HBL and NSBIL.

d) To evaluate the liquidity, assets management efficiency, profitability and risk position of HBL in comparison to that of NSBIL.

e) To study the relationship between investment and deposits of Bank.

The major findings of the study were as follows:

a) Percentage of HBL's investment to total commercial Banks investment in extremely higher than NSBIL.

b) Both HBL and NSBIL have invested mostly on government securities but HBL has invested in NRB bonds also as well as in other productive sectors.

c) NSBIL is better than HBL from liquidity point of view.

d) HBL has higher profitability position than NSBIL.

e) HBL is exposed to more risk than NSBIL.

f) HBL has maintained higher growth rate in net profit in comparison to NSBIL.

- Roy (2003) has conducted a research entitled "An Investment Analysis of RBB in comparison with NBL".

The specific objectives of the study were.

a) To evaluate liquidity, activity and profitability ratios of RBB in comparison with NBL and industry average.

b) To analyze relationship of loan and advance and total investments with total deposit and net profit of RBB and to compare it with that of NBL and industry average.

c) To use trend analysis to compare loan and advance, total investment, total deposit and net profit of RBB and compare the same with other two.

d) To examine the loan loss provision of RBB and NBL.

e) To provide suggestion and recommendation on the basis of findings.

The major findings of the study were:

a) RBB has good deposit collection, enough loan and advance and investment in government securities. It has comparatively better liquidity position than NBL.

b) RBB is in comparatively better position regarding issue of loan and advance but it does not have good position regarding investment in shares and debentures of other companies, off balance sheet operation. Loan Loss ratio shows low quality of loan and advance.

c) The profitability position of RBB is worse. RBB needs to take immediate steps to increase its profitability.

d) RBB's fund collection and fund mobilization is satisfactory in comparison to NBL.

e) There is significant relationship between deposit and loan and advance. There is insignificant relationship between deposit and investment, and outside assets and net profit.

➢ Khaniya (2003) has conducted a thesis research entitled "Investment portfolio Analysis of JVB's".

The specific objectives of the study were:

a) To analyze the risk and return ratios of commercial Banks.

b) To evaluate the financial performance of JVB's.

c) To provide suggestion package based on the analysis of data.

d) To study existing investment policies taken by NABIL in various sectors.

e) To study portfolio structure of NABIL in investment as compared to other JVB's.

f) Preference given by NABIL for investment between,

- Loan Investment.
- Investment in real fixed assets.
- Investment in financial assets.

The main findings of the study were:

a) SCBNL has the highest return on shareholders’ fund and total assets. It has also been successful in mobilizing its deposits as investments. NABIL and EBL have invested high amounts of deposits as loan and advances in comparison to SCBNL, NABIL and HBL.

b) Among the JVB's, looking at the investment portfolio, EBL has investment highest amount of funds in government securities, NBB has invested highest amount of funds on shares and debentures and NABIL has invested highest amount of funds in NRB bonds in comparison to other JVB's.

c) SCBNL has the highest EPS and EBL the lowest EPS among the JVB's

- Joshi (2003) in his thesis entitled "A comparative study of Investment policy of SCBNL & EBL" has made an endeavor to examine and interpret the Investment policy adopted by SCBNL in comparison to EBL.

The objectives of the research were:

1) To compare the investment policy of concerned Banks and discusses the fund mobilization of the sample Banks.

2) To find out empirical relationship between total investment, deposit & loan & advance and net profit and outside assets and compare them.

3) To analyze the deposit utilization & projection for next five years of SCBNL and EBL.

4) To evaluate comparatively the profitability & risk position liquidity asset management efficiency of SCBNL & EBL.

5) To provide a package of possible guidelines to improve investment policy, its problems and way to solve some problems and provide suggestions and recommendation on the basis of the study.

The main findings of the study were as follows:

1) Both the Banks have good deposit collection. EBL has higher but fluctuating liquidity position. It is in a good position to meet daily cash requirement and current obligation.

2) SCBNL has successfully maintained and managed its assets towards different income generating activities. SCBNL has invested high portion of total working fund in government securities and share and debentures of other companies.

3) The profitability position of SCBNL is comparatively better than EBL.

4) The liquidity risk ratio, credit risk ratio of SCBNL is lower than that of EBL.

5) SCBNL has not been successful to increase its sources of funds and its mobilization i.e., loans and advances and total investment.

- Raya (2003) has conducted a thesis research entitled "Investment Policy and Analysis of commercial Banks in Nepal (A comparative study of SCBNL with NIBL & NBBL)

The following objectives were considered in the study:

a) To discuss fund mobilization and investment policy of SCBNL in respect to its fee based off balance sheet transaction with NIBL & NBBL.

b) To evaluate the liquidity, efficiency, profitability and risk position of the sample Banks.

c) To evaluate the growth ratios of loan and advances, total investment with other financial variables.

d) To analyze the trends of deposit utilization towards total investment and loan and advances and its projection for next five years.

e) To find out whether there is significant difference between the various important ratios of SCBNL with the ratios of NIBL and NBBL.

f) To provide package of workable suggestions & possible guidelines to improve investment policy of the sample Banks.

The findings of the study were:

a) SCBNL has good deposit collection, has made enough investment in government securities, but has provided less advances and loans to total deposits ratio.

b) SCBNL has been successful in its on balance sheet operations but NIBL and NBBL have been more successful in off balance sheet operations.

c) The profitability position of SCBNL is higher than the other JVB's in the sample.

d) The credit risk ratio, capital risk ratio of SCBNL is lower than NIBL & NBBL.

e) SCBNL has maintained higher growth in investment and net profit and moderate growth in loans and advances, and deposits.

f) There is significant relationship between deposits and loans and advances and between outside asset and net profit of SCBNL.

- Dhital (2005) has conducted a thesis research on "A comparative study on Investment policy of SCBNL and BOKL".

The major objectives of the research were:

a) To find out relationship between total investments, deposits, loan and advances, net profit and outside asset and compare them.

b) To compare investment policies of concerned Banks and discuss the fund mobilization of sample Banks.

c) To analyze the risk position of SCBNL & BOKL.

d) To analyze the deposit utilization trend and its projection for five years of SCBNL & BOKL.

e) To provide package of a workable suggestion & possible guidelines to improve investment policy, its problems and way to solve some problems and provide suggestion and recommendation on the basis of the study.

The major findings of the study were:

a) SCBNL has better liquidity position than BOKL, but BOKL is in a better position to meet daily cash requirement. SCBNL has invested more in government securities than BOKL. SCBNL has utilized lesser portion of deposits and current assets as loans & advances.

b) SCBNL has invested a high portion of total working fund in government securities and shares & debentures of other companies.

c) The profitability position of SCBNL is better than BOKL.

d) SCBNL has lower liquidity risk, and credit risk than BOKL.

e) The growth rate of deposits and loans and advances of SCBNL is less than that of BOKL, but SCBNL has witnessed high growth in investment and net profit over the period of study in comparison to BOKL.

f) There is a significant relationship between deposit and loan and advances, deposit and total investment, deposit and interest earned, total working fund and net profit for both the Banks. There is also a significant relationship between outside asset and net profit deposit and net profit, total working fund and net profit for SCBNL, but the same are not significant in the case of BOKL.

➢ Pandit (2004) has conducted a research entitled "Investment policy Analysis of Joint Venture Bank (with special reference to NSBIL & EBL)"

The objectives of the study were as follows:

a) To evaluate the liquidity management, assets management efficiency, profitability position, risk position and investment practices of NSBIL, BOKL & EBL)

b) To find out the relationship between deposit and total investment, deposit and loan and advance, and net profit and outside asset.

His major findings are enumerated below:

a) NSBIL has better liquidity position. It is in a good position to meet its daily cash requirement and current obligation. Liquidity position of EBL & BOKL has not been satisfactory.

b) NSBIL's loan and advance to total deposit ratio is lower than EBL & BOKL. It does not seem to follow any definite policy regarding the management of its assets.

c) The profitability position of all the Banks is not satisfactory. The Banks have not adopted sound investment policy in utilizing their surplus funds.

d) BOKL & EBL are exposed to high credit risk and capital risk.

e) NSBIL & BOKL has not been successful to increase their sources of fund. EBL has been successful in maintaining its higher growth rate of total deposit.

f) There is significant relationship between deposits and total investment of BOKL & EBL but the same is not significant in case of NSBIL.

Commercial Banks have huge deposit collection. These deposits need to be properly utilized. Effective utilization of collected fund is possible only through implementation of sound investment policy. NABIL and SCBNL are the best examples of JVB's in Nepal that have been able to mobilize the funds in an effective manner and achieved phenomenal growth and profit year after year by formulating and implementing sound investment policy.

2.4 Research Gap

While looking into the past studies, it is found that investment policy was evaluated on the basis of portfolio behavior and financial performance of the Banks. None of the researchers have taken policy statements directly to study the investment policy.

Predicting investment policy on the basis of financial statements may lead into false interpretation. Investment policy aims at creating high yielding portfolio structure. So, portfolio structure should be analyzed side-by-side to evaluate the policy’s effectiveness. This type of study is not found in the past.

Furthermore, there is not any comprehensive research regarding the investment policy and portfolio structure of Nepal Credit and Commerce Bank Limited. Here, investment policy and portfolio structure are two separate sections for comprehensive study. However, researcher has tried to include both topics in this thesis paper so as to bridge the research gap.

This study covers the more recent financial data, literature and NRB directives/circulars and literature so that the recent issues and scenarios can be picturized.

CHAPTER – 3

RESEARCH METHODOLOGY

Research is the way of finding solution systematically. A research is an in-depth study and advancement of existing knowledge about subject matter. It is a method of serious thinking by defining problems, formulating hypothesis or suggested solution, collecting organizing, evaluating, manipulating data and making conclusion to determine whether they fit the formulation of hypothesis. Thus, the term “Research refers to a critical careful and exhaustive investigation, inquiry, examination, or experimentation having as its aim the revision of accepted conclusion, in the light of newly discovered facts. Research methodology is the style, framework or way of defining the solution for specific research problem systematically.

The topic of the problem has been selected as "Investment Policy and Portfolio Analysis of Nepal Credit and Commerce Bank Limited". The sole objective of this study is to evaluate the investment policy of Nepal Credit and Commerce Bank Limited and to analyze the existing portfolio. In order to reach and accomplish the objectives of the study, different activities are carried out and different stages are crossed during the study period. For this purpose, this chapter aims to present and reflect the methods and techniques those are carried out and followed during the study period. This chapter deals with research design, sources of data, data collection, processing and tabulating procedure and methodology.

3.1 Research Design

Research design is a strategic approach to be proactively maintained probable cause and effects. A researcher also develops a framework or design of strategy to get solution of research problem. Research design is a brief structure design of strategic investment conceived to get research objectives. Some financial and statistical tools have been applied to examine facts and descriptive analysis techniques have been adopted to evaluate investment policy and its influences on the loan portfolio of Nepal Credit and Commerce Bank Limited.

3.2 Population and Sample

The population refers to the industries of same nature and its services and product in general. This is a case study research of Investment policy and portfolio analysis of NCCBL. So, an extensive study of a single unit NCCB has been conducted.

There are thirty one commercial Banks operating in Nepal. The reason for selecting NCCBL for our study has been justified in statement of problem section of chapter-I and research gap section of chapter-II.

3.3 Sources of Data

Data are collected from secondary sources. The secondary sources of data are those that have been used from published sources or used by someone previously. To study the investment policy, written policy statements, strategies and other related documents from the Bank has been used. Formal and informal talks with the officials of the Bank were also helpful to obtain the additional information of the related problem. The annual reports of NCCBL are the major sources of data for the analysis of portfolio. However, besides the annual reports of the subjected Bank, the following sources of data have also been used in the course of the study:

- Annual General Meeting (AGM) reports
- NRB reports and bulletins.
- The Nepal Stock Exchange reports.
- Various publications dealing in the subject matter of the study.
- Various articles published in the news papers etc.

3.4 Data collection technique:

The information and data needed to conclude this thesis are of two types:

(1) Information about investment policy, and

(2) Historical data to analyze the investment portfolio.

Information about the past and current investment policy of NCCBL has been obtained directly from the Bank. Information about policy related matters which are not mentioned in the written policy statement have been gathered after conducting informal interview of the Bank officials. These steps constituted the primary sources of data and information.

The analysis of portfolio is dependent on secondary data. Such data are obtained from:

(1) The annual reports of NCCB for the period of ten years from fiscal year FY 2057/58 to FY 2067/68

(2) Credit Policy - 2002, Credit policy guidelines- 2061 (2004), Credit Strategy – 2061 (2004) of NCCBL.

(3) NRB publications such as Quarterly Economic Bulletins, Banking and Financial Statistics, Economic report, etc.

(4) Websites of Nepal Stock Exchange Ltd.

(5) Websites of NCCBL

Some supplementary data and information and literature review have been collected from Central library, Kirtipur and magazines. Other published and unpublished reports documented by the concerned authorities have been used.

3.5 Data processing and analysis procedure:

Presentation and analysis of the collected data is the core of the research work. The collected raw data are first presented in systematic manner in tabular forms and are then analyzed by applying different financial and statistical tools to achieve the research objectives.

As already stated, the thesis paper has concentrated itself to analyze the investment policy and appraise the investment portfolio of NCCBL.

3.5.1 Analysis technique of investment policy:

The investment policies and strategies of the Bank have been collected and reviewed. Based on the review of all such documents relating with the credit policy, credit guidelines, credit strategy and investment policy for investment in securities following questionnaire has been filled up to appraise the credit policy and investment in securities policy separately:

Assessment of Credit policy

1. Is there investment policy in written form for loans and advances?
2. Were there such policies since the commencement of Bank?
3. Have the objectives been defined in precise terms?
4. Has the policy addressed encouraged and discouraged credit?
5. Has the policy limited the sectoral loan portfolio exposure?
6. Has the policy stipulated geographical diversification of credit?
7. Has the policy mentioned risk dispersion methodology?
8. Has the policy quantified the desired mix of loan portfolio?
9. Does the policy encourage liquid loans such as working capital loan, discounting of bills, etc.?
10. Does the policy state the amount of collateral margin required for loans and advances?
11. Are lending authorities defined?
12. Are loan products defined of the policy?
13. Are responsibilities and procedures for appraisal of credit defined?
14. Has the policy addressed clear-cut provisions regarding the renewal, extension, restructuring, rescheduling of loans?
15. Is recovery of loans included in the policy?

Score '1' have been assigned to each 'YES' answer and '0' to each 'NO'. All scores have been totaled and converted into percentage. Based on the percentage scores obtained so far, the investment policy has been appraised as follows:

Scores(%)	**Policy category**
0 to 40	Poor
41 to 60	Satisfactory
61 to 80	Very good
81 to 100	Sound

Assessment of policy for investment in securities

16. Is there investment policy in written form for investment in securities?

17. Are there any provisions regarding limits of investment in governmental securities, NRB bonds and ordinary stock exchange securities?
18. Has the policy tried at matching maturities of investments with liabilities?
19. Does the policy address mitigation of risks associated with each investment?
20. Does the policy encourage liquidity and profitability of the securities investment?

Score '1' have been assigned to each 'YES' answer and '0' to each 'NO'. All scores have been totaled and converted into percentage. Based on the percentage score obtained so far, the investment policy has been appraised as follows:

Scores(%)	Policy performance
0 to 40	Poor
41 to 60	Satisfactory
61 to 80	Very good
81 to 100	Sounds

3.5.2 Analysis technique for investment portfolio:

Investment portfolio has been analyzed on the following ground:

1. Portfolio's liquidity,
2. Portfolio management,
3. Portfolio performance,
4. Portfolio's profitability.

It has been appraised using the following tools:

1. Financial tools
2. Statistical tools

3.5.2.1 Financial Tools

Financial tools basically help to analyze the financial strength and weakness of a firm. Ratio analysis is one of the important financial tools that have been used in the study. A ratio is simply one number expressed in term of another and as such it expresses the quantitative relationship between any two numbers. Ratio can be expressed in terms of percentage, proportion and as coefficient. Logarithmic graph and break-even chart are the graphic forms of expressing a ratio. Financial ratio is the mathematical relationship between two accounting figures. For commercial Banks, ratio analysis is a part of the whole processes of analysis their financial position assessment. Even though there are many ratios to analyze and interpret the financial statement, only those ratios that are related to the investment operation of the Bank are have been covered in this study. Different types of ratios have been used in this study.

3.5.2.1.1 Liquidity Ratios:

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 (Scott, 1992).

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 (Van Horne, 1999).

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. As a financial analytical tool, following four liquidity ratios has been used to come into the facts and findings of the study.

(i) Cash Reserve Ratio (CRR):

Cash Reserve Ratio (CRR) is the one which the Banks have to maintain with itself in the form of cash reserves or by way of current account with the Nepal Rastra Bank (NRB), computed as a certain percentage of its deposit liabilities.

There is mandatory provision to maintain the CRR at certain level under the direction of the central Bank. The objective is to ensure the safety and liquidity of the deposits with the Banks.

This ratio measures ready availability of cash in relation to total deposits collected from the customers. It is obtained by dividing cash in hand plus cash deposited at NRB by total deposits liabilities. As of the Basel- II, Banks are to maintain the 5% cash reserve with central Bank at their current account as compulsory reserve.

(ii) Current Ratio:

This ratio shows the Bank's short-term solvency. It shows the relationship between current assets and current liabilities. It is obtained by dividing current assets by current liabilities. This ratio can be calculated using the following formula:

$$\boxed{\frac{\text{Current assest}}{\text{Current Liability}}}$$

The widely accepted standard of current ratio is 2:1. But accurate standard depends on the circumstances of the business and the nature of business. But for commercial Banks operating in developing countries like Nepal, the standard 2:1 is quite high to measure the liquidity performance.

<u>Current assets include:</u>

1. Cash (Local currency and Foreign currency)
2. Balance with Nepal Rastra Bank
3. Balance with other domestic Banks
4. Balance held abroad
5. Inter-Bank lending
6. Bills purchased and discounted
7. 40% of loans, advances and interest receivable on loans and advances (assumption)
8. Investment on governmental securities
9. Advance payments and receivables/sundry debtors
10. Interest receivables on investment
11. Prepaid expenses
12. Staff loans and advances
13. Advance tax payment

<u>Current liabilities include:</u>

1. Current deposit liabilities
2. 60% of savings deposit liabilities
3. Fixed deposit of more than year (if data available maturity-wise) or 40% of fixed deposit liabilities, in case the data is not available maturity-wise (assumption)
4. Other deposits
5. Bill payable
6. Borrowing
7. Expenses payable
8. Bonus payable
9. Proposed Dividend
10. Income tax payable

(iii) Liquid loan to total loan ratio:

It is the proportion of liquid loan in total loan portfolio. For calculating this ratio, total of liquid loan is divided by total loan portfolio. In liquid loans means pass loans. The “pass loan” category as per the NRB’s directive consists of such loans which are not past due and past due upto three months only. On the other hand, sub-standard, doubtful and loss loans are categorized as illiquid loans. Total loans include all loans and advances including bills purchase and discounting.

Liquid loans to total loan ratio = ‘Pass’ loans and advances including bills purchase and discounting ⌉ ‘sub-standard’, ‘doubtful’ and ‘loss’ loans including bills purchase and discounting.

(iv) Liquid investment to total investment ratio:

This ratio is calculated as Liquid investment on securities is divided by total investment on shares, bonds and debentures. Here, liquid investments refer those investments on securities which can be traded in money market or in Nepal Stock

Exchange. Numerator is taken at face value of the investment and denominator is taken at cost.

Liquid investment to total investment = Investment on marketable securities ⌉ Total Investment on securities.

3.5.2.1.2 Portfolio Management Ratios:

Portfolio management ratio measures the proportion and effectiveness of various assets and liabilities in balance-sheet. The proper management of assets and liability ensures its effective utilization of resources. The Banking business converts the liability into assets by way of its lending and investing functions. Asset and liability management ratio measures its efficiency by multiplying various liabilities into performing assets. The following are the various ratios relating to asset and liability management, which are used to determine the efficiency of the subjected Bank in managing its assets and efficiency in portfolio management

(i) Loan & Advances to Total Deposit Ratio (C/D ratio)

This ratio is also called credit-deposit ratio (CD ratio). It is calculated to find out how successfully the Banks are utilizing their total deposits on loan and advances for profit generating purpose. Loans and advances are the highest yielding assets in a Bank's portfolio. Greater ratio implies better utilization of total deposits at the cost of liquidity. This ratio can be obtained by dividing loan and advances by total deposit as under,

C/D ratio = Total loans advances including bills purchase and discount ⌉ Total deposit liabilities

Total loans include all loans, advances, bills purchase and discount. And total deposit all deposit liabilities as shown in the balance-sheet

(ii) Loan and Advances to Total Assets Ratio:

Loan and advances is the major component in the total assets, which indicates the ability of Bank to channelize its deposits in the form of loan and advances to earn high return. This ratio is computed to assess credit proportion in the total assets.

This ratio is computed by dividing loan and advances by total assets, that is as stated hereunder,

Loan and advances to total assets ratio = Loan and advances ⌉ Total assets

Here, the denominator includes all assets of on-balance sheet items excluding off-balance-sheet items like letter of credit, letter of guarantee etc. And numerator includes all loans, advances, bills purchase and discount.

(iii) Investment on Securities to Total Assets Ratio:

This ratio shows the Bank's investment in governmental securities, shares and debenture of the subsidiary and other companies. This ratio can be derived by dividing total investment on governmental securities, shares and debentures by total assets.

Investment on securities to total assets ratio = Investment on securities ⌉ Total assets

(iv) Investment on Government Securities to Total Assets Ratio:

This ratio shows that Bank's investment on government securities in comparison to the total assets. Investment on governmental securities gives second line of defense for liquidity next to cash and Bank balance. This ratio signifies the Bank’s portfolio management in relation to liquidity. This ratio is calculated by dividing investment on government securities by total assets.

Investment on securities to total assets ratio = Investment on securities ⌉ Total assets

(v) Total Off-Balance sheet items to Total Loans and Advances Ratio:

The off balance sheet operation (OBS) shows the Bank's efficiency in conducting modern off-balance sheet transaction in comparison to total loans and advances. Off-balance sheet operation includes issuance of letter of credit, letter of guarantee, irrevocable loan commitment, etc.. This ratio shows the proportion of fee-based off-balance sheet activities to fund based loan and advances of the Bank. Now a days, fee-based off-balance sheet activities play an important role for the better performance of a Bank. This ratio is calculated by dividing total OBS operations by loan and advances, which is stated as hereunder,

Total Off-Balance sheet operation to Loan & Advances ratio = Total OBS items

⌉

Loan and advances

3.5.2.1.3 Portfolio Performance Ratios:

Portfolio performance ratios are activity ratios. Performance activity ratio measures the performance efficiency of an organization from various angles of its operations. These ratios indicate the efficiency of activity of an enterprise to utilize available funds, particularly short-term funds. These ratios are used to determine the efficiency, quality and the contribution of the assets included in the ultimate total portfolio towards profitability. The following activity ratios have been calculated to measure the performance efficiency of the Bank to utilize its funds.

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

The ratio of loan loss provision to total loans and advances describes the quality of assets that a Bank is holding. Nepal Rastra Bank has directed the commercial Banks to classify its loans & advances into the category of pass, sub-standard, doubtful and loss on the basis of the maturity of principal, to make the provision of 1, 25, 50 & 100 percentage respectively. The provision for loan loss reflects the proportion of non-performing loans in the volume of total loans and advances. This ratio is calculated by dividing the loan loss provision by total loans and advances as presented hereunder.

Loan loss provision to total loan = Loan loss provision ⌉ Total loans and advances

(ii) Non-performing Loans (NPL) to Total Loans & Advances Ratio:

This ratio measures the proportion of non-performing loans on the total volume of loans and advances. It is also called the NPA level. This reflects the quantity of quality assets that the Bank have. Higher ratio reflects the bad performance of the Bank in mobilizing loans and advances and bad recovery rate and vice versa. This ratio is computed by dividing the non-performing loans by total loans and advances as under.

Non-performing loans to total loans & advances ratio = Non-performing loans ⎤ Total loans and advances

Here the numerator includes the loans categorized as substandard, doubtful and loss loans which require 25, 50 & 100 per cent provision respectively as per NRB directives.

3.5.2.1.4 Portfolio Profitability Ratios:

Profitability ratios are used to indicate and measure the overall efficiency of a firm in terms of profit and financial performance. For better performance, profitability ratios of firms should be higher. Following ratios have been computed to study the portfolio's profitability:

(i) Interest Income to Total Income Ratio:

This ratio measures the volume of interest income in total income of the Bank. The high ratio indicates the high contribution made by the lending and investing activities and vice versa. This ratio can be computed by dividing interest income to total income presented as under:

Interest income to total income ratio = Interest income ÷ Total income

The higher the ratio, the greater is the dependency of Bank towards risky assets for profitability.

(ii) Interest Expenses to Total Expenses Ratio:

This ratio measures the portion of total interest expenses in the volume of total expenses. The high ratio indicates the low operational expenses and vice versa. This ratio is computed by dividing interest expenses by total expenses:

Interest expenses to total expenses ratio = Interest expenses ÷ Total expenses

(iii) Yield Rate of Loan Ratio:

This ratio is calculated to find out the percentage of interest earned from total loans and advances. Higher ratio implies better performance of the Bank in terms of interest earning on its loans and advances. It is calculated by dividing total interest income by average of opening and closing balances on loans and advances account. Thus;

Yield rate of loans = Total interest income ÷ Yearly moving average of balances of loans and advances.

Here, loans and advances included bills purchase and discount.

(iv) Cost of Deposit Ratio:

This ratio is calculated to find out the percentage of interest paid on deposit liabilities. This ratio can be calculated by dividing total interest expenses by yearly moving average of all deposit liabilities;

Total interest paid to total deposit ratio = Total interest paid ÷ Yearly moving average of total deposit liabilities.

(v) Return on Total Assets Ratio (ROA):

This ratio measures the overall profitability of all total assets. It is also known as return on assets (ROA). This ratio is calculated by dividing net profit/ (loss) by total assets. This can be mentioned as,

Return on total assets ratio (ROA) = Net Profit (Loss) ÷ Total assets

(vi) Return on Equity Ratio (ROE):

This ratio measures how efficiently the Bank has used the funds of the owners. This ratio is calculated by dividing net profit/loss by total equity capital (net worth). This can be stated as,

Return on equity ratio (ROE) = Net Profit (Loss) ÷ Total equity capital

Here, total equity capital includes shareholder's reserve including profit and loss account and share capital i.e. ordinary share and preference share capital.

(vii) Earnings per Share (EPS):

EPS refers to net profit divided by total number of shares outstanding. The amount of EPS measures the efficiency of a firm in relative terms. This ratio is computed by dividing total net profit (loss) by total number of shares outstanding.

Earning Per Share (EPS) = Net Profit (Loss) ÷ Total number of shares outstanding

3.5.2.2 Statistical Tools

Some important statistical tools are used to achieve the objective of this study. In this study statistical tool such as mean, standard deviation, & coefficient of variation.

3.5.2.2.1 Mean

A mean is the average value or the sum of all the observations divided by the number of observations and it is denoted and given by the formula:

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

Where, $\overline{X}$ = Mean of the values.

N = Number of Pairs of Observations.

During the analysis of data, mean is calculated by using the statistical formula 'AVERAGE' on excel data sheet on computer.

3.5.2.2.2 Standard Deviation

Standard deviation is a statistical measure. It is widely used to measure risk from expected rate of returns. The standard deviation represents dispersion of return. Standard deviation is the square root of deviation taken from actual mean of the distribution in simple and it is denoted by **σ** (read as sigma).

The formulas to calculate the standard deviation are given below:

$$\pm \text{X}\sqrt{\frac{x^2}{N}}$$

Where, x = ($\overline{X}$ - X)

During the analysis of data, standard deviation is calculated by using the statistical formula 'STDEV' on excels data sheet on computer.

3.5.2.2.3 Coefficient of Variation

We know that standard deviation is the absolute measure of dispersion of rate of return. The relative measure of dispersion based on the standard deviation is known as the coefficient of standard deviation. Hence, where the mean value of the variables is not equal, it is not appropriate to compare two pairs of variables based on standard deviation only. The coefficient of variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

The formulas to calculate coefficient of variation (C.V.) is given below:

Coefficient of variation (C.V.) $= \frac{\pm}{\bar{X}}$ x 00

This gives in percentage.

These three statistical tools have been used side-by-side along with financial ratio analysis to measure trend and consistency.

3.5.2.2.4 Trend Line

Trend lines have been inserted to in the graph of major financial ratios analysis. These lines help understand the trend followed the selected variables. These lines have been inserted with the help of Microsoft Excel (spread sheet) software of computer. Some of the lines are linear and some are two degree polynomial.

CHAPTER – 4

PRESENTATION AND ANALYSIS OF DATA

This chapter deals with the presentation, analysis and interpretation of relevant data & information of Nepal Credit and Commerce Bank Limited in order to fulfill the objectives of this study. To obtain best result the data have been analyzed according to the research methodology as mentioned in third chapter. The chapter includes main two parts. The first part includes the presentation and analysis of secondary and primary data while second part includes major findings of the study.

With the help of this analysis, efforts have been made to highlight the Investment policy and the portfolio management of Nepal Credit And Commerce Bank Limited as well as the drawbacks of investment policy of Bank. For analysis, the researcher uses the different types of analytical methods and tools such as financial ratio analysis and other statistical analysis.

4.1 Analysis of investment policy

In this heading Investment policy analysis has been carried out in three steps. Firstly, investment policy has been appraised using appraisal score. Secondly, policy analysis has been carried out by studying the content of policy related documents. Thirdly, Bank’s policy has been compared with the directives issued by Nepal Rastra Bank.

4.1.1 Policy Appraisal Score:

As mentioned in chapter III of the report, different components of the investment policy have examined to see whether the investment policy includes minimum necessary issues or not.

Table – 4.1: Appraisal score of investment policy

Policy	Score obtained	Maximum possible score	Percentage	Result
Loans and advances policy (credit policy)	13	15	87%	Sound
Policy for investment on securities	1	5	20%	Poor
Aggregate score	**14**	**20**	**70%**	**Very good**

(Source: Appendix 1)

Based on the review of policy related documents, credit policy of NCCBL scored 13 points out of 15. Thus the loans and advances policy falls under sound category.

Similarly, the investment in securities policy of Banks scored 20% score indicating poor status. It was found that the Bank is not using any written policy guideline for investment in securities.

Thus out of total 20 points, overall policy obtained 14 points which is 70% of total score. The overall investment policy is classified as very good.

4.1.2 Analysis of Credit Policy

It is found that Bank used credit policy 2002 as major investment policy for investment on loans advances, OBS items, bills purchase and discounting. The objective of this policy was to define clear-cut policy of Bank on credit and trade finance matters so as to enhance quality of assets. It also aimed at developing common understanding on the issue on credit and trade finance related matters to develop uniformity amongst all the branches and departments of the Bank.

Later on 2004, the Bank announced Credit policy guidelines – 2061 (2004), which is more precise and has wider coverage. To support in realizing the goal of the Bank and to improve quality of services for developing and maintaining image are objectives of the policy. In addition to the objectives of Credit policy – 2002 and 2004, NCC Bank again re-announced a latest credit policy and guidelines in the year 2067 (2010) with more expandable as well as covering all the potential risk management of the lending system of the Bank. Major contents of these policy guidelines are objectives, strategies, credit products, product pricing, credit operation, risk dispersion, audit and compliance focus. To support objectives of credit policy guidelines, Credit strategy – 2067 (2010) has been made effective for implementation.

The content of the policies with regard to the principles of liquidity, profitability, safety, purposive, national interest, and diversity is as analyzed as under

1. Credit policy for liquidity:

The credit policy of the Bank encourages lending to trade finance. Investment under this sector of economy is of short-term nature and thus supports liquidity of portfolio. As per the credit policy 2010, Bank aimed at reducing long term loan outstanding from 22% to 15%. Long term loans are not current assets for Banks. To improve liquidity and thereby increase proportion of performing loans, credit policy 2010 aimed at increasing trade finance from 25% to 35% of total loan portfolio.

2. Credit policy for profitability:

Return to the Bank is a major objective of this credit policy because it is the essence of making a Bank financially viable. (NCCB, Credit policy guidelines 2067). To ensure the profitability, policy is designed such that credit products yield high. According to credit policy guidelines 2067, pricing is generally determined considering cost of funds, extent of risk, business condition, tax implication, volume of business in productive sector and so on.

For Banks, major pricing decision is related to the determination of interest rate in loans to be levied to borrowers and that to be paid to depositors. Similarly commissions and charges for Bank guarantees, letter of credit, remittance, collections, bills purchase etc. are another aspects of pricing policy.

3. Credit policy for safety or security:

Amount and quality of collateral securities required to obtain credit facilities from Bank is clearly spelled out in the policy. Normally, funded facility should be covered by at least 167% of the distress value (obtained by the panel valuators of the Bank) of acceptable collateral security or project, fixed assets, current assets, personal guarantees as well. Collateral coverage requirement for prime clients who intend to use non-funded facilities of Bank guarantees is being fixed according to the nature of the business/project as well as facility amount.

Collateral valuation procedure is also cited in the policies. Professional property valuators will be assigned for the valuation job. As per the credit strategy 2067, to arrive at the distress value of the landed collateral, 60% weightage shall be provided to the privileged market value and 40% weightage shall be assigned to the value fixed by governmental authorities. However, valuation method of current assets is not incorporated in the document.

Thus, Bank has made such policy which will sufficiently cover its lending.

4. Purposive credit policy:

Principle of purposive while extending lines of credit emphasizes on proper utilization of Bank's credit. Loans and advances policy of a Bank should clearly cite the purposes for which it will advance credit facilities. For NCCBL, its policy statement has clearly mentioned the encouraged and discouraged credit facilities. As prescribed by central Bank 'Know Your Customer (KYC)', Credit Information Centre (CIC) details and Net-worth Declaration Sheet of every individual borrowers practice quoted the policy documents will help Bank to identify customers who may misuse its credit facilities.

5. Principle of national interest:

As per the credit policy guidelines – 2067, the Bank shall put effort to support the cottage and small industries in the field of Handicraft base business that are being encouraged by government as a means to increase employment, to improve living standard and to acquire business and technical skills to grow into larger enterprises. Recently Bank has been carried out with new policy regarding to promote Small and Medium scale Enterprises (SMEs) in order to encourage them by giving some leverage on interest rate and other compliances.

While pricing the products, Bank has set lower interest rate in priority sector and deprived sector lending as advised by central Bank of Nepal. Similarly to encourage export, exporters can borrow from Bank at the lowest interest rate. Thus Bank's policy has also tried to address national interest as much as it can.

6. Credit policy for diversification:

To reduce the risks inherent in lending, loans and advances should be diversified as much as possible. Economic sector wise diversification, geographical diversification, maturity wise diversification are some methods of diversification.

Credit policy guidelines – 2067 has quoted the provisions regarding industry exposure ceiling in the loan portfolio. The policy is such that Bank may impose credit-ceiling towards a particular sector of economy to attain and maintain a loan portfolio that is well diversified. This policy is in line with NRB directive.

Geographical diversification policy is lacking in the Bank.

4.1.3 Compliance of Bank's policy with NRB's Directives

The central Bank has motivated to commercial Banks to formulate their own credit policy and implement it effectively. The role of the central Bank in policy formulation is limited within the regulatory framework only. There is no representation of NBR in the BOD of the commercial Bank, which is ultimate authority for policy formulation. NRB is following open market policy and encouraging healthy competition amongst commercial Banks. This is due to liberalization policy of the state.

However, the policy of the Banks should be in line with the NRB directives. In the credit policy guidelines – 2067, it is clearly stated that the Bank will comply the relevant and applicable provisions of central Bank's directives, company act, Bank and financial institutions act or any other acts and directives in force. This is the conformity commitment of the Bank.

1. Directive no. 2: Classification of loans and advances and provision for loan loss

As on NRB directive No. 2 requires classification of loans and advances into pass, sub-standard, doubtful and loss category on the basis of expiry time. Such policy is also included in the Banks policy guide lines. The annual financial statements also contain such classification from FY 2057/58 onwards. However, it could not ascertain whether the classification is done on the basis of expiry. This directive also requires additional loan loss provision of 20% for loans and advances secured by personal guarantees. Similarly, it is also requires to make additional provision of 12.5% for all types of rescheduled and restructured term loans until its regularity within 2 year from the date of such rescheduled and restructured. Hence, Bank's policy of accepting personal guarantees as security is deteriorating profitability policy.

2. Directive No. 3: Provision regarding single obligor limits and loan limit for single sector of economy

As on Directive No. 3, requires credit diversification in simple term. Through this directive, central Bank has directed commercial Banks to develop internal policies and measures to monitor the concentration of funded and non-funded facilities in different sectors of economy. It also has imposed ceiling to the amount of loans that can be extended to a single borrower. This Bank has been using Credit policy 2002, 2004 and latest revised credit policy guidelines 2067, and credit strategy 2010 as policy guidelines to meet the NRB directive principle.

3. Directive No. 8: Investment

The investment policy could not be compared rationally with NRB directive because of the written policy for investment on securities was not available. However, based on the practices developed on the Banks, it can be concluded that the investment policy is not at acceptable level because there is huge proportion of unmarketable securities. NRB has restricted to invest on shares of those companies which can not be traded in open market. But Bank's portfolio still includes such shares.

Due to inclusion of poorly performing companies' shares in investment portfolio, its performance is very poor. As per the financial statement of FY 2066/67, Bank's investment on shares was NPR 9, 92, 25,394/- at cost. However, market value of the same was NPR 6, 57, 56,182/-, a depreciation of 33.73 % in value. As per NRB's directive, the shortfall in value should be provisioned by debiting the profit loss account. However, Bank's investment on NRB treasury bills and NRB bond is satisfactory. Such investment is fulfilling both the purposes of liquidity and profitability. To improve the performance of investment portfolio, Bank needs to follow a written policy guideline.

4. Directive no. 15: Provision relating to interest rate

According to the directives, Banks are free to fix their interest rate to be paid on deposits and to be levied on loans and advances. Any changes on such rates should be made public through national daily newspaper. In line to this provision, NCCBL publishes the changes notification in news papers.

This directive also has directed Banks to recognize interest income in cash basis only. Any unrealized interest income should be parked into interest suspense account.

4.2 Investment portfolio analysis

After analyzing the investment policy, investment portfolio has been studied. While appraising the portfolio, all the items appearing in the balance-sheet and profit loss statement are taken into consideration. The investment portfolio has been evaluated on the basis of the following aspects:

1. Portfolio's liquidity,
2. Portfolio management,
3. Portfolio performance and
4. Portfolio's profitability,

4.2.1 Portfolio's Liquidity:

Liquidity ratio measures the ability of the firm to meet its current obligations. A commercial Bank must maintain its satisfactory liquidity position to meet the credit need of the community, to meet demands for deposits, withdrawals, pay maturity obligation in time and convert non-cash assets into cash to satisfy immediate needs without loss to Bank and consequent impact in long run profit. To measure the liquidity position of the Bank, the following measures of liquidity ratio has been calculated and a brief analysis of the same has been done as below.

4.2.1.1 Cash Reserve Ratio (CRR)

Cash Reserve Ratio (CRR) is the one which the Banks have to maintain with itself in the form of cash reserves or by way of current account with the Nepal Rastra Bank (NRB), computed as a certain percentage of its deposit liabilities. The objective is to ensure the safety and liquidity of the deposits with the Banks.

This ratio measures ready availability of cash in relation to total deposits collected from the customers. It is obtained by dividing cash in hand plus cash deposited at NRB by total deposits liabilities. There is mandatory provision to maintain the CRR at certain level as imposed by the central Bank. From this fiscal year 2062/63, Banks are to maintain the 5%.

The CRR of NCCBL has been tabulated below:

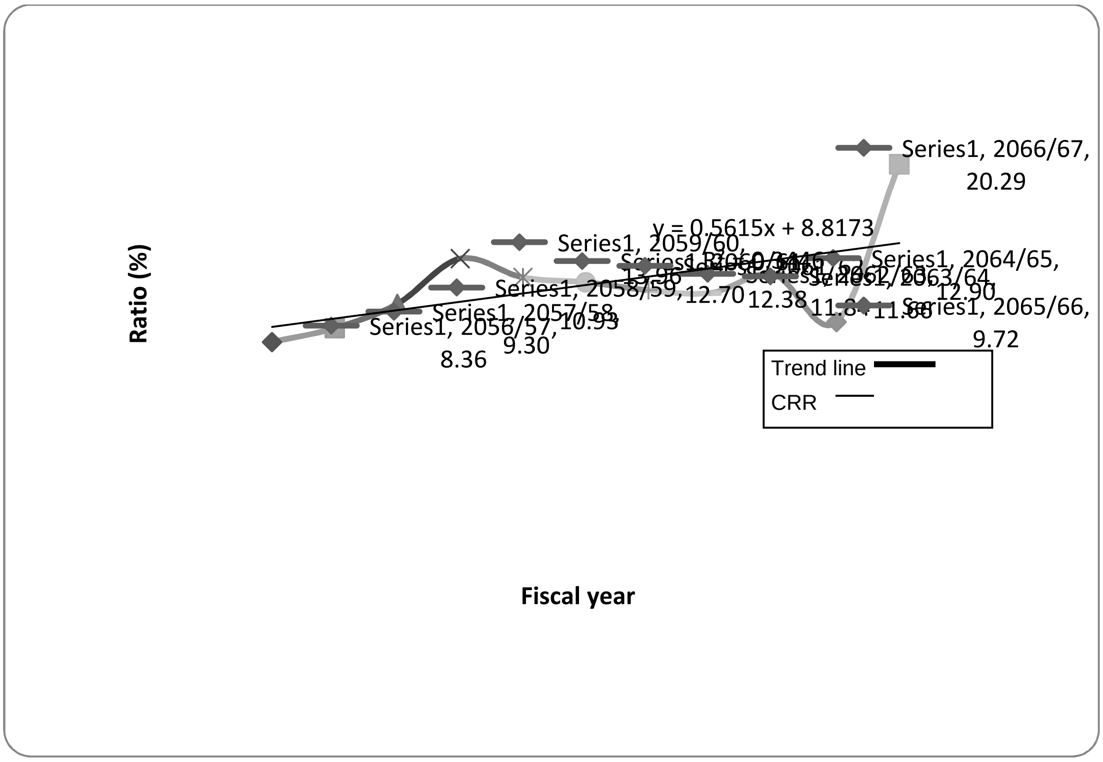
Table: 4.2 – Cash reserve ratio

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	56/57	59/60	61/62	62/63	63/64	64/65	65/66	66/67			
8.36	9.30	10.93	13.96	12.70	12.38	11.84	11.66	12.90	9.72	20.29	12.19	3.17	26.04

(Source: Appendix 2)

To derive the CRR, we divide cash at hand and at central Bank by total deposit liabilities. Table 4.2 suggests that the Bank is holding cash and Bank balances more that mandatory provision. 12.19% average CRR with 3.17 S.D implies sufficient level of liquidity to meet urgent obligation. Current mandatory requirement is 5.5%.

Figure: 4.1: Trend line for Cash reserve ratio.



Trend shows upward tendency. Increasing tendency is due to lack of investment opportunities.

4.2.1.2 Current ratio

This ratio indicates the ability of Bank to meet its current obligation. This is the broad measure of liquidity position of the Bank's portfolio. This ratio shows the Banks short-term solvency. It shows the relationship between current assets and current liabilities.

The current ratios of NCCBL are given in the following table

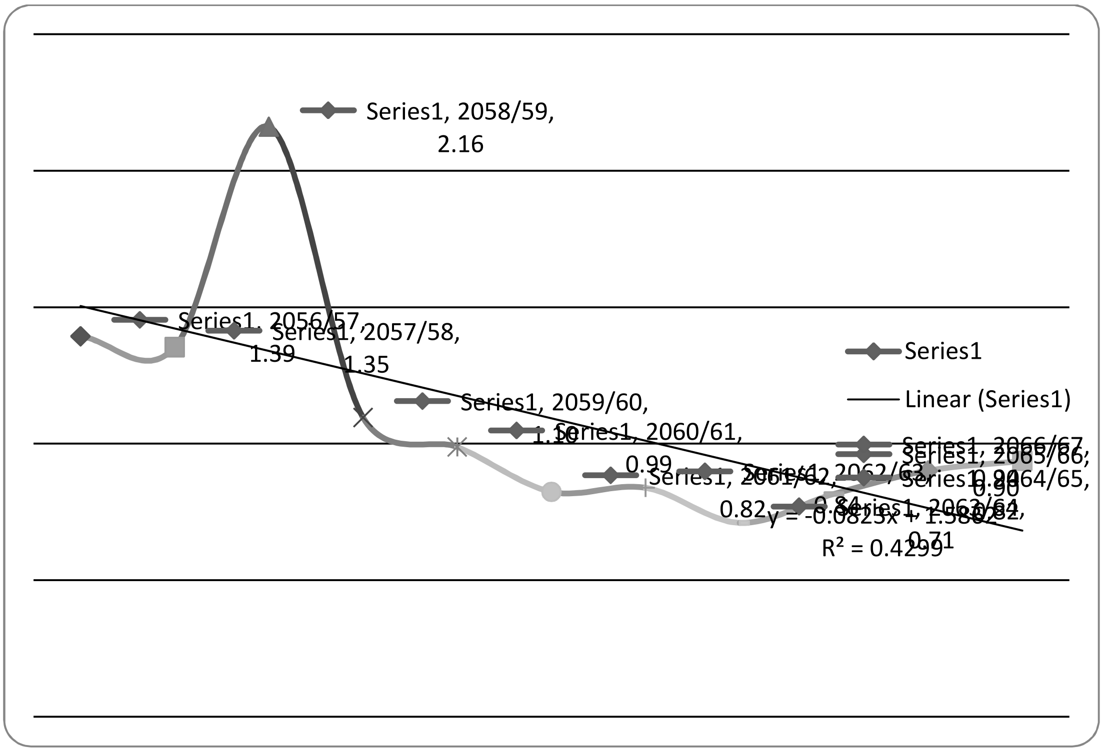
Table – 4.3: Current ratio

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
1.39	1.35	2.16	1.10	0.99	0.82	0.84	0.71	0.82	0.90	0.94	1.09	0.42	38.08

(Source: Appendix-3)

The above table 4.3 shows that the current assets of NCCBL have exceeded current liabilities during the study period from FY 2056/57 to 2066/67 and onwards. The highest ratio is 2.16 in 2058/59 while the lowest ratio is 0.71 in the year 2063/64 with an average ratio of 1.09 during the study period. The ratio shows the decreasing trend during the period. The coefficient of variation (C.V.) between the ratios for the study period is 38.08%, which shows the inconsistency of current ratios during the study period. In general, the current ratio analysis of the Bank over the relevant year's period indicates that the Bank has been able to meet its short-term obligations and has satisfactory liquidity position. But its capacity to meet such obligation is decreasing. Though the optimal standard of current ratio should be 2:1, the conventional measure of liquidity is not applicable in Banking business.

Figure: 4.2: Trend line for Current ratio.



4.2.1.3 Liquid loans to total loans ratio:

Liquid loans consist of those loans which are categorized under 'pass' loans as per NRB's directives. Total of 'pass' loans is divided by total loans to analyze the liquidity of loan portfolio. The following table shows the ratio:

Table 4.4: Liquid loans to total loans ratio:

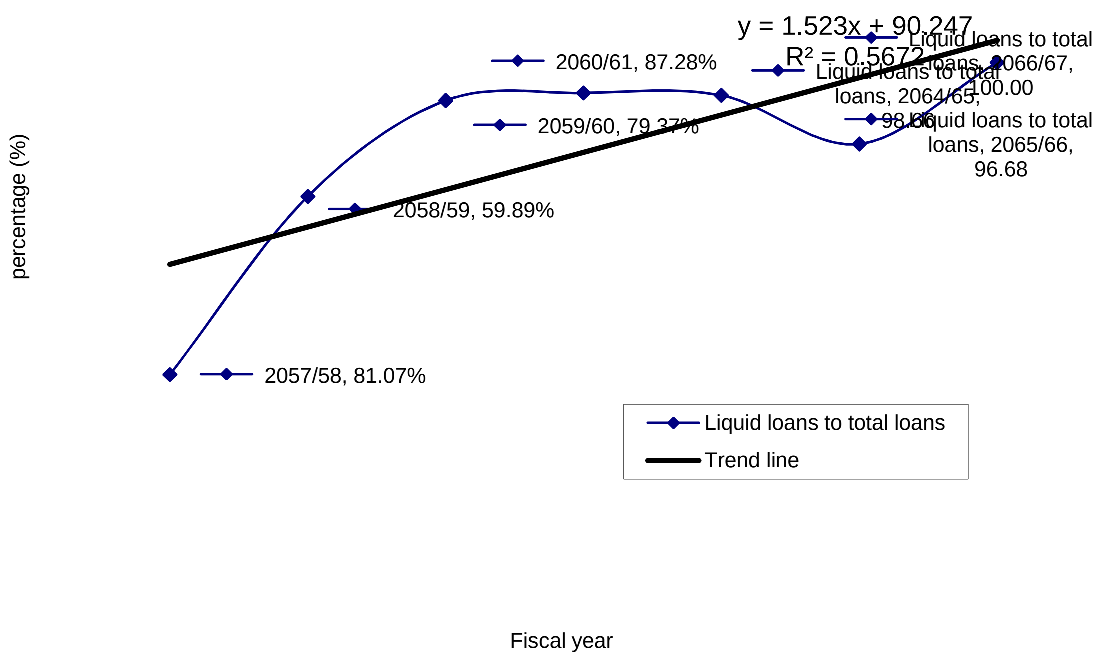
Fiscal Year	Mean	S.D	C.V.

2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			(%)
84.91	81.07	59.89	79.37	87.28	94.54	98.45	98.76	98.66	96.68	100	89.06	12.29	13.80

(Source: Appendix: 4)

From the above table, it can be inferred that proportion of liquid loans to total loans remained at 89.06% at an average. The lowest ratio is 59.89 on FY 2058/59 and highest is on 2066/67 with value 100%.

Figure: 4.3 Trend line for liquid loans to total loans



Liquid loans to total loans ratio shows poor liquidity position of the loan portfolio. Commercial Banks are to deal with short term loans and the liquidity of their loan portfolio should always be higher such as above 90% at all times for developing countries like Nepal. Table 4.5 shows that the liquidity of loan portfolio did not remain satisfactory in initial days. However, it is showing an improving trend (figure 4.2) because proportion of liquid loan increased from 59.89% at FY 2058/59 to 100% at the FY 2066/67.

4.2.1.4 Ratio of investment on marketable or liquid securities to total securities

Liquid investment on securities is divided by total investment on shares, bonds and debentures to arrive at this ratio. Liquid investment refers to investment on those securities which can be traded easily in money market or in NEPSE. Value of investments is taken as per NRB's directive: net of provision. Following table shows the proportion of liquid securities to total securities.

Table 4.5: Ratio of investment on marketable or liquid securities to total securities

Fiscal Year											Mean	S.D	C.V.
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			(%)
75.68	70.79	79.08	82.45	93.42	91.35	85.99	99.23	95.53	94.86	96.41	87.16	3.5	4.02

(Source appendix 5)

The lowest of the ratio was 70.79% during FY 2057/58 and the highest was in 2066/67with value 96.41%. Mean of the ratios is 87.16% with standard deviation of 3.5%.The trend shows improving liquidity of investment on securities.

4.2.2 Portfolio management ratios:

This ratio measures the efficiency of a commercial Bank in its fund mobilization. A commercial Bank must be able to manage its assets properly to earn high profit maintaining the appropriate level of liquidity. Asset management ratio measures the efficiency of the Bank to manage its assets in profitable way satisfactorily. By the help of following ratios, asset management ability of Nepal Credit and Commerce Bank Limited has been analyzed.

4.2.2.1 Loan & Advances to total deposit ratio (C-D ratio):

This ratio measures the extent to which the Bank is successful to mobilize its total deposit on loan and advances for the purpose of income generation. A high ratio indicates better mobilization of collected deposits and vice versa. But it should be noted that too high ratio might not be better from liquidity point of view. This ratio is calculated by dividing loans and advances by total deposits (detail in Appendix-7).

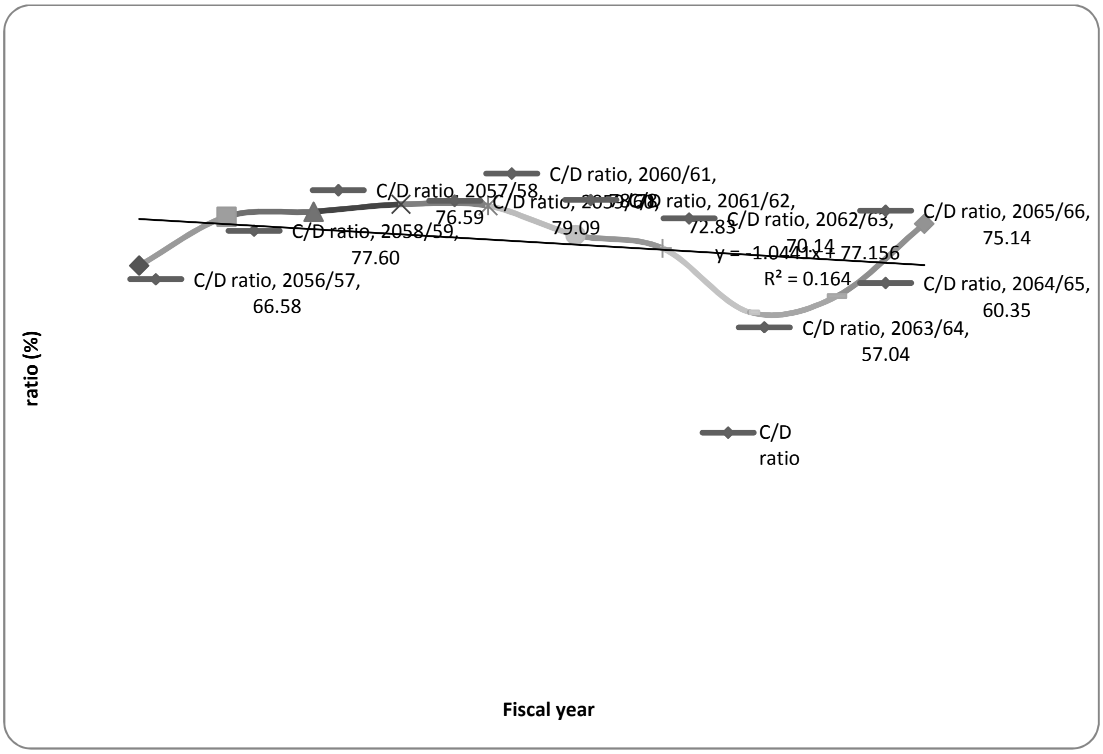
Table – 4.6: Loans & advances to total deposit ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
66.58	76.59	77.60	79.09	78.78	72.83	70.14	57.04	60.35	75.14	73.86	71.41	7.81	10.93

(Source: Appendix-6)

Figure 4.4: Trend line for C/D ratio

Following figure shows the trend followed by Bank's CD ratio. Trend line is second degree polynomial



The above table 4.6 and figure 4.4 show that loan & advances to total deposit ratio of the Bank was highest 79.09% during fiscal year 2059/60.The mean of the ratios is 71.41% with 10.93 % C.V. between them, which shows that the ratios are moderately consistent over the study period.

The optimum level of C/D ratio differs from country to country. 70 % of C/D ratio is taken as standard for Banks operating in developing countries. From this point of view, the loan & advances to total deposit of the Bank is satisfactory. Loan and advances is the proportion of Bank's investment into the most risky assets. High level of risk is not desirable for commercial Banks as any default can create the liquidity problem.

4.2.2.2 Loan and advances to total assets ratio:

Loan and advances of any commercial Bank represent the major portion in the volume of total working fund. This ratio measures the volume of loans and advances in the structure of total assets. The high degree of this ratio indicates the good performance of the Bank in mobilizing its funds by way of lending function. However, in its reverse side, the high degree of this ratio is representative of low liquidity ratio either. Granting the loans and advances always carries a certain degree of risk. Thus this asset of Banking business is regarded as risky assets. This ratio measures the management's attitude toward risky assets. The low ratio is indicative of low productivity and high degree of safety in liquidity and vice versa. The interaction between risk and return determines this ratio.

This ratio also shows the credit risk taken by the Bank towards mobilizing is funds into different types of assets. This ratio reflects the extent to which the Banks are successful in mobilizing their total assets on loans and advances for the purpose of income generation. This ratio is computed by dividing loan and advances by total assets i.e. total working fund

Table 4.7: Loans & advances to total assets ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
52.84	60.40	70.28	70.28	70.82	71.75	72.23	61.42	53.61	64.76	62.65	64.64	7.10	10.98

(Source: Appendix-7)

Above table 4.7 shows that the ratio ranges from the minimum of 52.86% in 2056/57 to the maximum of 72.23 percent in 2062/63. The mean of the ratio is 64.64% and the C.V. between them is 10.98%, which shows the ratios are moderately consistent over the study period. This shows that loan and advances took 64.64% in average of the total asset of the Bank.

Loan and advances is the most risky and most productive asset of the Bank. High ratio suggests high risk and eventually high return of the Bank. So, NCCB has taken optimum risk towards the mobilization of its fund to risky assets.

4.2.2.3 Investment on government securities to total assets ratio:

This ratio measures the contribution made by investment on government securities in total assets of the Bank. Besides mobilizing its major portion of funds in the form of loans and advances, Banks invests their funds in purchasing different types government securities. They do so mainly to utilize the excess funds for income generation without taking more risk and to maintain the adequate level of liquidity since these securities are more liquid assets than loans and advances. A high ratio indicates better mobilization of fund as investments on government securities and vice versa. This ratio is calculated by dividing investment on government securities by total assets.

Table 4.8: Investment on government securities to total assets ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
5.51	4.13	4.88	6.52	7.69	7.97	8.11	19.22	21.06	13.48	13.80	10.22	5.82	57.02

(Source: Appendix-8)

Table 4.8 shows that the ratio has various magnitudes with mean of 10.22% and standard deviation of 5.82% throughout the study period. The ratio has an increasing trend.

Investment on government securities is the risk free investment for the commercial Banks. It is the lowest yielding assets. However, it supports liquidity. This ratio shows the proportion of risk free assets in the total asset of Bank. Analysis shows that Bank has invested less into low productive and risk free sector however it is in increasing trends.

4.2.2.4 Total Off-Balance sheet items to loan & advances ratio:

This ratio shows the proportion of fee-based off-balance sheet activities to fund based loan and advances of the Bank. Now a day fee-based off-balance sheet activity plays an important role for the better performance of a Bank. These fee based activities are very much dependent on mode of operation, management strategy, Banking network with foreign Banks, etc. A commercial Bank should not concentrate only on fund-based activities such as loan and advances, investment on different sectors and so on. But it should pay its attention to increase fee-based off-balance sheet activities. Income generated through the fee-based off-balance sheet activities constitutes a significant proportion in the total income of most of the commercial Bank's income statement. A high ratio indicates the higher OBS transaction and vice versa. This ratio is computed by dividing total OBS outstanding by total loan and advances.

Table 4.9: Total Off-Balance sheet operation to Loan & Advances ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
36.29	46.56	27.72	21.70	21.24	20.42	24.49	19.18	24.27	13.88	9.99	24.22	10.10	41.71

(Source: Appendix- 9)

Table 4.9 shows that the mean ratios is found to be 24.22 % with 10.10% standard daviation and 41.17% C.V. between them, which indicates that the ratios are not consistent during the study period and has shown fluctuating trend however it is the lowest 9.99% in 2066/67.

Smaller ratios mean lesser focus of management team over the non-funded business. The analysis of the ratios shows that off -balance sheet operation of the Bank is on decreasing trend. It may be due to increasing competition in the Banking sector or Bank is not getting enough attention towards non-funded business. This category of business is not satisfactory.

4.2.3 Portfolio's performance Ratios:

In this section, the lending efficiency in terms of quality and turnover is measured. Here different ratios are used to analyze the lending efficiency of the Bank. For this purpose the relationship of different variables of balance sheet and profit and loss account have been established. The following ratios are analyzed for this purpose.

4.2.3.1 Loan loss provision to total loans and advances ratio:

The ratio of loan loss provision to total loans and advances describes the quality of assets that a Bank is holding. NRB has directed the commercial Banks to provision pass, sub-standard, doubtful and loss loans 1, 25, 50 & 100 percentages respectively from the income. Loan loss provision set aside for performing loans is defined as General Loan Loss Provision and loan loss provision set aside for non-performing loan is defined as Specific Loan Loss Provision. Loan loss provision on the other hand signifies the cushion against future contingency created by the default of the borrowers. The low ratio signifies the good quality of assets in the total volume of loans and advances. The high ratio signifies the relatively more risky assets in the volume of loans and advances. These ratios show how efficiently the Bank manages its loans and advances and makes effort for timely recovery of loans. This ratio is calculated by dividing the loan loss provision by total loans and advances.

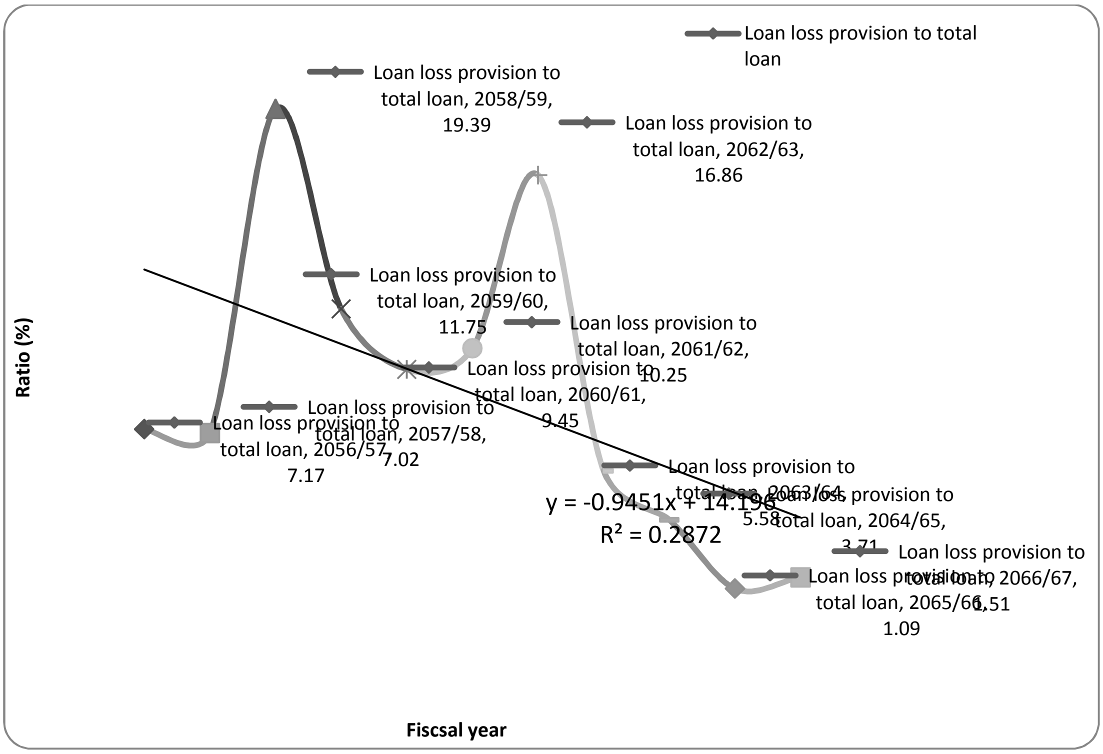
Table 4.10 Loan loss provision to total Loans & Advances ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
7.17	7.07	19.39	11.75	9.45	10.25	16.86	5.58	3.71	1.09	1.51	8.52	5.85	68.61

(Source: Appendix-10)

Table 4.10 shows that the C.V. between ratios is 68.61%, which indicates that the ratios are variable and not consistent with the increasing trend. The mean ratio stood at single digit 8.52%. The loan loss provision is the cushion against future defaults by borrowers. But in short-term, it affects on the profitability of the Bank. Higher ratio is the indicative of the lower quality of productive asset. Ratio of more than 1% indicates that the Bank has alarming proportion of non-performing loan

Figure: 4.5: Trend line of loan loss provision to total loans



The above figure 4.5 exhibits that the ratios for the study period have increasing trend at first and then decreasing. It reached maximum at FY 2058/59 and lowest to 1.09% in 2065/66. Decreasing ratios indicate efficiency of management in managing loan loss provision.

4.2.3.2 Non-performing loans to total loans and advances ratio:

This ratio indicates the NPA level of the Bank. This ratio measures the proportion of non-performing loans on the total volume of loans and advances. This reflects the quantity of quality assets that the Bank have. Higher ratio reflects the bad performance of the Bank in mobilizing loans and advances and bad recovery rate and vice versa. A high level of non-performing assets is a sign of problems. However, this needs to be looked at in the context of the type of lending being done - some Banks lend to higher risk customers than others and therefore tend to have a higher proportion of non-performing debt but will make up for this by charging higher interest rates to borrowers. This ratio is computed by dividing the non-performing loans (loans under category substandard, doubtful and loss) by total loans and advances and bills purchase

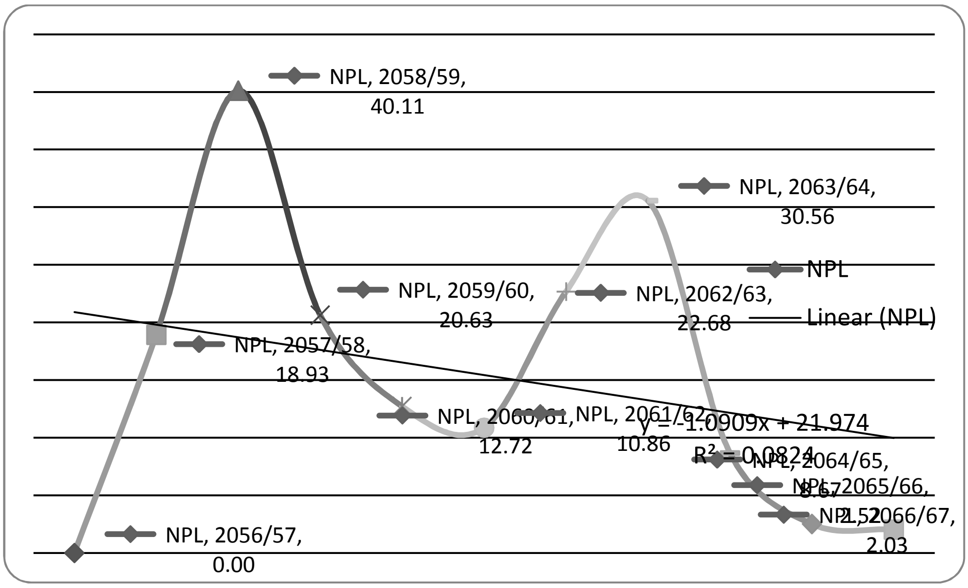
Table 4.11: Non-performing loans to total loans & Advances ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
0.0	18.93	40.11	20.63	12.72	10.86	22.68	30.56	8.67	2.52	2.03	12.86	10.45	81.27

(Source: Appendix-11)

The above table 4.12 explains that the ratios are at increasing trend in the initial years of operation reached maximum of 40.11% at the FY 2058/59 and then afterwards show decreasing trend during the study period. Standard deviation is 10.45% with 81.27% C.V. which suggest the inconsistency of the data. Mean of the ratio is 12.86%.

Figure - 4.6: Graph/trend line of Non-performing loans to total loans ratio



The trend line suggests the decreasing pattern of ratio. Decreasing NPL level means increasing recovery and efficient management of Bank.

4.2.4 Profitability ratios:

The main objective of a commercial Bank is to earn profit by providing different types of banking services to its customers. No Bank can survive without profit. Profit is the indicator of efficient operation of a Bank. Profitability ratios are the best indicators of overall efficiency. Higher profitability ratio shows the higher efficiency of a Bank and vice versa. Through the following ratios, effort has been made to measure the profit earning capacity of Nepal Credit and Commerce Bank Limited.

4.2.4.1 Interest income to total income ratio:

This ratio measures the volume of interest income in total income of the Bank. This ratio helps to measure the Banks performance on how well they are mobilizing their fund for the purpose of income generation. This ratio also helps to measure the Banks performance on other fee-based activities, since after investing functions fee based activities are the major source of Banks income generation. The high ratio indicates the high contribution made by the lending and investing activities and vice versa. This ratio can be computed by dividing interest income by total income.

Table 4.12 Interest income to total income ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
92.17	84.51	87.46	94.28	89.07	88.14	88.75	86.51	81.78	83.31	88.88	87.71	3.66	4.17

(Source: Appendix-12)

The above table 4.12 exhibit the ratios are consistent over the study period ranging from the minimum of 81.78% in 2064/65 to the maximum of 94.28 % in 2059/60. The mean of the ratios is 87.71 % and the C.V. between them is 4.17%, which shows the consistency of the ratios over the study period. Mean ratio of 87.71% suggests that Bank generated an average 12.29% other income during the study period. Other incomes are based on risk-free assets and on the services rendered by the Bank. So, these ratios are not satisfactory on risk aversion point of view. However, decreasing C/D ratio of the Bank will help decrease this ratio.

4.2.4.2 Interest expenses to total expenses ratio:

This ratio measures the portion of total interest expenses in the volume of total expenses. The high ratio indicates the low operational expenses and vice versa.

Interpreting in other way the high ratio can be due to the costly sources of funds. This ratio is computed by dividing interest expenses by total expenses.

Table 4.13: Interest expenses to total expenses ratio (%):

Fiscal Year											Mean	S.D	C.V.
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			(%)
73.16	67.17	36.83	67.01	57.86	64.96	72.81	66.0	61.84	65.01	72.83	64.13	10.22	15.94

(Source: Appendix – 13)

Table 4.13 shows that the mean ratios of 64.13% with S.D. 10.22% and C.V. 15.94between them. Higher ratios indicate lower operational cost and vice versa. The table suggests that, for NBBCL, interest expenses constitute lower proportion in total expenses implying higher operational cost. Interest paid to the depositors is the main expenses for the commercial Banks. Another implication of this ratio is decreasing cost of fund.

4.2.4.3 Yield rate of loans ratios:

This ratio is computed to study the loan portfolio's earning rate. Total interest earned during each financial year is divided by yearly moving average of loans and advances. Denominator is taken as moving average of loans and advances to find the average loan outstanding throughout the year.

Table – 4.14: Yield rate of loans

Fiscal Year											Mean	S.D	C.V.
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			(%)
16.27	12.46	9.93	13.93	12.0	13.03	11.93	12.64	12.88	10.69	13.04	12.62	1.65	13.09

(Source: Appendix 14)

This ratios computed in table 4.14 is indicative of earning power of the loan assets. The Bank earned at an average rate of 12.62% with 13.09% C.V. during the study period. During FY 2055/56, NCCBL earned at the rate of 16.27% . Similarly during FY 2058/59, Bank earned at the rate of 9.93% which was the lowest yield rate during study period.

4.2.4.4: Cost of deposit ratio

This ratio measures the cost of deposit as a percentage of total deposit. A total of interest expenses is divided by moving average of total deposit to calculate these ratios. The calculation is tabulated below:

Table – 4.15 Cost of deposit ratio:

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
8.55	7.81	7.37	6.40	6.11	6.10	6.05	6.14	5.50	5.34	8.49	6.71	1.75	17.06

(Source: Appendix :15)

The average of the ratios is 6.71% with SD 1.15%, C.V. 17.06%. The ratios are showing decreasing trend till F/Y 2065/66 of study period.

4.2.4.5 Return on assets ratio (ROA):

Return is the result of investment and it measures the profit earning capacity of the investible resources into different types of assets. If the Banks total asset is well managed and efficiently utilized, return on such assets will be higher and vice versa. This ratio is calculated by dividing net profit/(loss) by total assets (detail in appendix no.). The following table shows the profitability position of NCCB with respect to total assets for the study period.

Table 4.16 Return on total assets ratio (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
0.16	0.43	-9.70	1.69	0.05	-5.14	-8.62	-1.92	6.05	3.92	3.32	-0.08	4.93	-6106.19

(Source: Appendix - 16)

Table 4.17 explains that the ratios are highly fluctuating during the study period. The Bank incurred losses during the study period. Bank suffered drastic loss during FY 2058/59. Mean of the ratios is negative i.e. Bank is suffering accumulated loss till now.

4.2.4.6 Return on Equity (ROE):

This ratio measures the amount profit that a rupee of shareholders fund has generated. The high ratio is indicative of high return to shareholders equity and vice versa. Positive ratios mean profit and negative ratios measure the quantum of loss suffered by the shareholders. This ratio is calculated by dividing net profit/(loss) by total shareholders fund

Table 4.17: Return on equity (%)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
1.63	5.92	-113.48	16.69	0.57	-50.38	-79.36	-16.58	35.64	29.69	30.28	-4.18	41.95	-1002.94

(Source: Appendix-17)

Table 4.18 shows Return on equity (ROE) ratios are fluctuating during the study period. The ratio ranges between -113.48% in 2058/59 to 35.64% in 2064/65 with the mean ratio of -4.18%. C.V. between them is -1002.94%, which shows that the ratios are more variable and inconsistent during the study period.

4.2.4.7 Earning Per Share (EPS):

EPS refers to net profit divided by total number of shares outstanding. The amount of EPS measures the efficiency of a firm in relative terms. The figure is the indicative of the overall good or bad performance of an organization. How far an organization is able to use its resources to generate profit is determined by the profit it has earned. This ratio is computed by dividing total net profit by total number of shares.

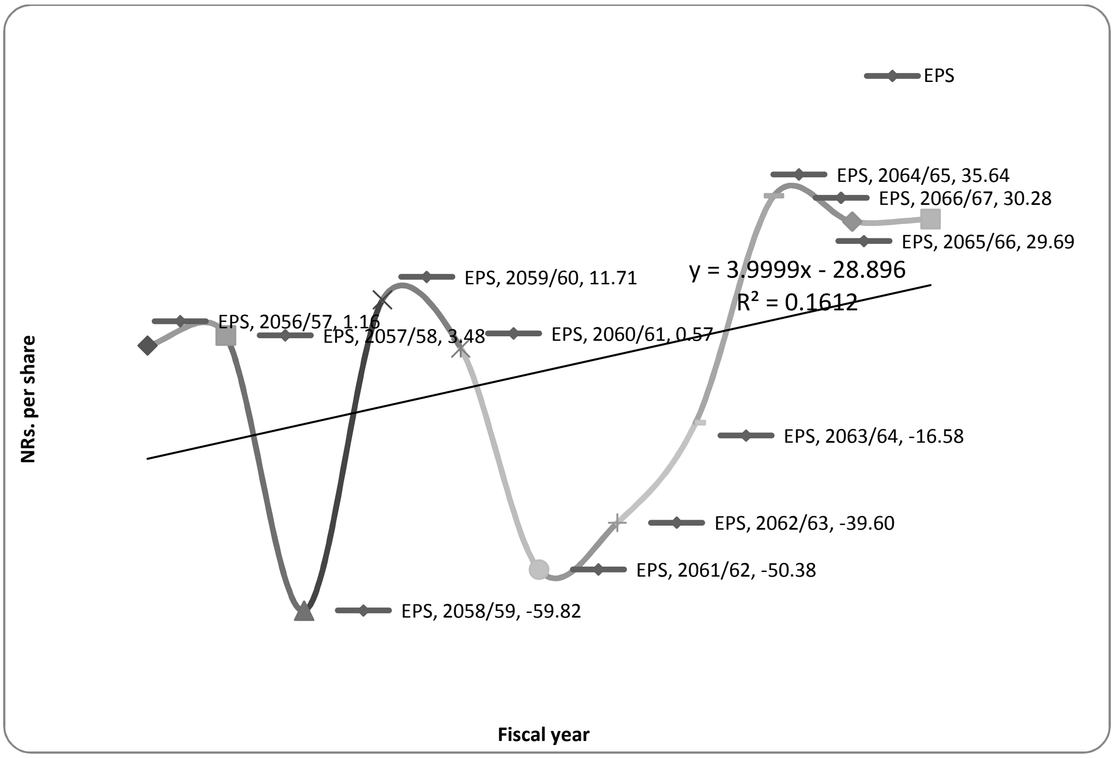
Table 4.18: Earning per share (in Rs.)

Fiscal Year											Mean	S.D	C.V. (%)
2056/57	57/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67			
1.16	3.48	-59.82	11.71	0.57	-50.38	-39.60	-16.58	35.64	29.69	30.28	-4.90	33.04	-6747.7

(Source: Appendix- 18)

Above table shows the Mean ratio of the EPS is -4.90. It can be said share holders suffered loss of NRs. 4.90 per share with SD of 33.04 and C.V. is -674.76% between them.

Figure 4.7 Graph/trend line for EPS



Most of the times the graph remained below X axis. EPS decreased sharply on FY 2061/62 however the Trend in showing improving trend line.

4.3 Major Findings of the Study

The preceding chapters have discussed and explored the facts and matters required for the various parts of the study. Analytical part, which is the heart of the study, makes an analysis of various aspects of the investment policy of commercial Banks by using some important financial as well as statistical tools.

Having completed the basic analysis required for the study, the final and most important task of the researcher is to enlist findings issues and gaps of the study and give suggestions for further improvement. This would be meaningful to the top management of the Bank to initiate action and achieve the desired result. The objective of the investigator is not only to point errors and mistakes but also to correct them and give directions for further growth and improvement.

The main findings of the study that are derived on the basis of financial data analysis of Nepal Credit and Commerce Bank Limited are presented below.

4.3.1 Findings from the analysis of investment policy:

Investment policy was studied and contents included in it had been checked. For simplicity of analysis, investment policy was categorized into two parts: investment policy for loans and advances and that for investment on securities. Major findings are as listed blow:

- It was found that Bank has formulated a satisfactory loans and advances policy. Most of the credit related matters were found well incorporated in the policy documents. However due to lack of written and clear-cut policy statement since the commencement of the Bank, the investment portfolio deteriorated in terms of profitability. Formal credit policy was made effective on 2002 (2059 BS) in the name of Credit Policy – 2002. After this, the portfolio also appeared improving

- There was not investment policy for investment on shares, bonds and debentures. So, this category of investment operation was not well managed in the Bank. As a result of this, there was significant proportion of unmarketable, illiquid and unyielding assets in securities portfolio of Bank. Such assets were hampering the liquidity and profitability of Banks.

- Though there was not investment policy for investment on shares, bonds and debentures, the existence of clear-cut policy for credit operation has kept the overall investment operation as guided by acceptable policies

- Thus, to sum up, the study on invest policy suggested that the Bank is following a **"very good"** investment policy to conduct its investment function as suggested by policy scores.

4.3.2 Findings from the analysis of investment portfolio

Investment portfolio was analyzed with the help of financial ratio analysis and statistical tools. Different types of financial ratios have been calculated to analyze the following aspects of the portfolio:

1. Portfolio's liquidity,
2. Portfolio management
3. Portfolio performance
4. Portfolio's profitability

4.3.2.1 Findings from the liquidity ratios analysis

Liquidity of the portfolio was checked in three aspects (1) liquidity to meet daily cash requirement (2) liquidity of loan portfolio and (3) liquidity of investment on securities. Over all liquidity was checked with the help of current ratio. Major findings of the liquidity ratio analysis are pointed out below

- From the analysis of the cash reserve ratio, it can be said that the Bank has maintained sufficient cash reserve to meet daily cash need. The amount of cash reserve ratio is guided by mandatory reserve ratio to be maintained by commercial Banks as per the NRB's directive.

  For our study period, the mandatory CRR lies between 5% - 6%. Bank's CRR appears always above the mandatory provision. It is showing upward trend which indicates narrow investment opportunity in the country.

- Current assets of NCCBL have exceeded current liabilities in average of the study period from 2056/57 to 2066/67. However, current liabilities exceeded current assets from the year 2060/61. The ratio shows the fluctuating trend during the period. The coefficient of variation (C.V.) between the ratios for the study period is 38.08%, which shows that the current ratios during the study period are not consistent.

In general, the current ratio analysis of the Bank over the eleven years period indicates that the Bank has been able to meet its short-term obligations and has satisfactory liquidity position. Standard current ratio of around 1:1 (for Banks) was met all the times till the year 2059/60.however the ratio start to decline there on. However, the trend was imposing threat in the current ratio. It can be inferred that the management has improved the portfolio's liquidity during 2058/59. However, then onwards, the trend of liquidity shows deteriorating position.

- Liquid loans to total loans ratio showed poor liquidity position of the loan portfolio. Table 4.4 showed that the liquidity of loan portfolio did not remain satisfactory in initial days. However, it is showing an improving trend as proportion of liquid loan stood at 98.76% at the FY 2063/64. The trend line also supported this fact. The proportion of liquid loans was 59.89% only during FY 2058/59. But it progresses up to 98.76% on the last year of study. Thus management has improved liquidity position of loan portfolio.

- Financial ratio of marketable or liquid securities to total securities indicated improving situation. Balance-sheet of NCCBL contained the following share investment as illiquid investment:

1. Ordinary shares of Nepal Bank Limited
2. Ordinary shares of Rural microfinance development center
3. Ordinary shares of Shangrila housing and development Co. ltd.
4. Ordinary shares of Nepal Sri Lanka Merchant Bank Ltd.
5. Ordinary shares of N.B Insurance Co.Ltd.
6. Bond on Nepal Bidhut Pradhikaran.
7. Ordinary Shares of Credit Information Center Ltd.

4.3.2.2 Findings from the portfolio management ratios analysis

- Loans and advances to total deposit ratio was calculated to study how well the loans and advances assets and deposit liabilities have been managed. 70 % of C/D ratio was taken as standard for Banks operating in developing countries. From this point of view, the loan & advances to total deposit of the Bank was satisfactory. Loan and advances is the proportion of Bank's investment into the most risky assets. High level of risk is not desirable for commercial Banks as any default can create the liquidity problem.

- The loan and advance to total assets ratio ranges from the minimum of 52.84% in 2056/57 to the maximum of 72.23% in 2062/63. The mean of the ratio is 64.64% and the C.V. between them is 10.98 %, which shows the ratios are inconsistent over the study period. This shows that loan and advances comprises 64.64% in average of the total asset of the Bank. Loan and advances is the most risky and most productive asset of the Bank. High ratio suggests high risk and eventually high return of the Bank. So, NCCB has taken optimum risk towards the mobilization of its fund to risky assets.

- Investment on government securities to total assets ratio showed decreasing and then increasing trend during the study period. The mean of the ratio was found to be 10.22% with 57.02% C.V. between them, which indicated that the ratios were highly inconsistent over the study period. This ratio showed the proportion of risk free assets in the total asset of Bank. Analysis indicated that the Bank had mobilized less amount of fund on government securities. This asset is less productive also. So, NCCBL had invested less into low productive and risk free sector.

- The ratios of total off-balance-sheet items to total loans and advances were average mean stood at 24.22% with C.V. of 41.71% and S.D. of 10.10%.This indicate that the ratio is inconsistence. It might be due to increasing competition in the Banking sector or Bank was not paying enough attention towards non-funded business.

4.2.2.3 Findings from the portfolio performance ratios analysis:

- The Loan loss provision to total loans & advances ratios for the study period showed two types of trend. During study period, it showed increasing and then again decreasing trend, value decreased from 19.39% to 1.09%. However, on FY 2058/59, it drastically rose to 19.39%. Then again it was showing decreasing trend.In 2062/63, it goes to 16.86% and next year fall to 5.58%. The ratio with an average of 8.52%. The C.V. between them is 68.61%, which indicated that the ratios are variable and not consistent with the increasing trend.

  As discussed in the research design, single digit ratio is acceptable for the study. Banks ratio remained 8.52% showing acceptable position. Decreasing trend suggested further improvement and recovery of ill-performing loans. The drastic increase during FY 2058/59 and FY 2062/63 might be due to lower amount of provision set aside in the previous years

- Ratio of non-performing loan to total loans during study period show very fluctuating trends. Mean of the ratios was 12.86% with standard deviation 10.45%. The C.V. between them was 81.27%, which indicated that the ratios are very inconsistency.

  The ratios showed the proportion of non-performing asset of commercial Bank and NPA was major problem in recent years. The mean NPA level of NCCBL was 12.86%, which is higher than the standard. The ratios showed increasing trend which indicated that the management of the Bank is not giving due attention towards NPA management sufficiently. Thus, although the Bank's NPL proportion is relatively high it seems the fluctuating trend due to lack of proper provision of loan and good monitor over the loan.

4. Findings from the profitability ratios analysis

Profitability ratio analysis showed poor profitability position of Bank. The ratio analysis is presented below:

- The Interest income to total income ratios were less consistent over the study period ranging from the minimum of 81.78% in 2064/65 to the maximum of 94.28% in 2059/60. The mean of the ratios was 87.71% and the C.V. between them is 4.17%, which showed the consistency of the ratios over the study period.

Due to lower off-balance-sheet items to total loans and advances ratios, Contribution of the fee-based income, commissions, and foreign exchange trading gains was very low in the total income. Higher ratios indicated greater dependency of the income over risky assets such as loans and advances.

- Interest expenses to total expenses ratios were found to be fluctuating a lot. The lowest of the ratio was 36.83% on F/Y 2058/59 and the maximum was 73.16% on F/Y 2056/57 during study period. Pre-operating expenses and other similar heavy operation expense caused lower ratio. The mean of the ratios is 64.13 % with C.V 15.94%, which showed the ratios were inconsistent over the study period.

- Yield rate of loan ratio was computed by dividing interest income be yearly moving average of loans and advances. This ratio was computed to assess earning rate of the loan assets. The Bank earned at an average rate of 12.62% during the study period. During FY 2063/64, Bank earned at the rate of 12.64%.The lowest yield rate was during FY 2058/59 when Bank earned at the rate of 9.93%.

- Cost of deposit ratio was calculated by dividing interest expense by moving average of deposit liabilities. The mean of this ratio is 6.71 with S.D. 1.75 and CV 17.06%.

  The rate of overall of interest paid for all interest bearing deposits. The cost of deposit ratio was compared with interest rate structure of commercial Banks. It was found that Bank was paying rate higher than the interest for one year fixed deposit. Cost of deposit is very higher than the market rate. However, ever decreasing ratios signaled improving position.

- Return on assets (ROA) ratios was fluctuating during the study period with average of negative 0.08%. The ratio ranged from -9.70% in 058/59 to 6.05% in 2064/65. The C.V. between the ratios was -6106.19%, highly inconsistent.

The return on assets of the Bank is bad in average. It indicates the poor earning capacity of the Banks assets and poor utilization of its assets.

- Return on equity (ROE) ratios was fluctuating during the study period with average of negative value 4.18%. The ratio ranged between (113.48)% in 2058/59 to 35.64% in 2064/65 with the mean ratio of -4.18%. C.V. between them is -1002.94% negative, which showed that the ratios were more variable and inconsistent during the study period. The ratios indicated that the shareholders were suffering loss from their investment. Fiscal year 2058/59 was a black year for shareholders during which they suffered loss of 113.48%.
- Earning per share of NCCBL was found to be fluctuating during the study period. Poor investors suffered a lot in terms of EPS. During study period, F/Y 2058/5 they lost Rs. 59.82 per 100 rupees investment while on F/Y 2064/65 they gain Rs. 35.64 per 100 rupees investment. The EPS was clearly reflected in the share market as well.

CHAPTER - 5
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter highlights the result of the study derived from the analysis of Bank's mainly secondary data .The analysis of the data is carried out with the help of varies financial and statistical tools. This chapter includes three major aspects of the study. Firstly, this chapter will summarize the entire research and analysis process. Secondly, recommendations have been made on the basis of analysis. Recommendations have been justified as and where necessary. At last, conclusions of the research have been drawn in line to the objectives of the study.

5.1 Summary

Out of Thirty one commercial Banks operating in Nepal, researcher has taken Nepal Credit and Commerce Bank Ltd. as the subject of study. Investor has confined his study to evaluate and analyze the investment policy and portfolio of the Bank. It is because the investment function is the major profit generating function of Banks which aids national capital formation.

The major stair in investment function is to set an appropriate investment policy. Implementation of the investment policy creates a portfolio. After creation of portfolio, its performance revision is necessary. Performance revision and performance evaluation can be conducted on the basis of financial ratio analysis. Hence in this thesis paper, researcher has first analyzed the investment policy and then evaluated the investment portfolio.

The study was based on secondary data obtained from Bank's annual reports and financial statements, official records, official circulars, periodicals, journals and bulletins, various published reports and relevant unpublished master's thesis.

Investment policy was evaluated on the basis of appraisal score. Its analysis was carried out by deep study of contents of policy related documents. It was found that credit policy of the Bank was sound and investment policy for investment in securities was poor. Aggregate policy was evaluated as very good. It was also found that policy was well formulated after 2002.

Financial as well as statistical tools were used to analyze and interpret the data and information regarding investment portfolio. Under financial analysis, various financial ratios such as liquidity ratio, asset management ratio, performance ratio and profitability ratio were analyzed and interpreted. Mean, standard deviation and coefficient of variation were the statistical tools used in analysis.

Ratio analysis suggested poor performance of Bank in terms of portfolio performance and portfolio's profitability. Liquidity ratios were acceptable. Portfolio management ratios indicated moderate position. Investment portfolio analysis indicated improving position of Bank after FY 2059/60.

5.2 Conclusion

Based on the analysis and interpretation, following conclusions have been drawn:

Investment policy

- Bank is following a sound credit policy and for investment on securities. In total, the existing investment policy is acceptable. Had the policies been formulated and well complied since the beginning of Bank, it would have led the Bank as a leading commercial Bank in Nepalese Banking market. However, this Bank has not put effort to formulate entire investment policy which guides entire investment function of Bank.

Investment portfolio:

- **Portfolio's liquidity:**

  Higher ratios of CRR and acceptable level of current ratio indicate the strong ability of Bank to meet short term and mid-term liquidity position. Whereas, decreasing trend of current assets and high level of illiquid loan and securities imposes threat in long term liquidity position.

Generally, Bank loans are deemed as payable on demand. If Bank needs to revise its portfolio structure, loans and advances should be called back Lower value of liquid loans to total loans ratio indicates lower probability of repayment of loans in time. Thus, portfolio restructuring will not be possible at such cases. This is also the case for NCCBL. So, Bank should try to improve the liquidity of entire portfolio.

- **Portfolio management:**

  The portfolio management ratios indicate satisfactory portfolio management. The CD ratio of the Bank is shows the Bank's aggressiveness in lending. Proportion of loans is increasing in total assets portfolio of the Bank which is indicative of management's concentration towards profitability. On the other hand, the low yielding and risk free governmental securities also constitute a major proportion in total portfolio. It can also be concluded that management is not paying attention to increase OBS transaction.

- **Portfolio performance:**

  Portfolio performance of the Bank is very weak during the past years. However, the trend shows the fluctuating trends of non-performing assets. It is due to lack of adequate provision by management. NPL is the chief factor that deteriorated the performance of Bank. So management has to focus on to reduce the NPL.

- **Portfolio Profitability:**

  The weakest part of entire portfolio is its profitability. Parking of interest income as interest suspense and high provisions for NPL have deteriorated the profitability of Bank. Another factor that is adversely affecting the profitability is higher cost of deposits. All the profitability ratios like ROA, ROE and EPS are negative. This has reduced the confidence of investor in share market and consequently helped to lower the share price below in stock exchange. However, at the end of study period there is a positive symptom.

It also can be concluded that Bank has not utilized the resources efficiently during the study period. However, decreasing level of non-performing loans suggests management's efficiency in managing non-performing assets. Similarly, on the basis of total portfolio analysis, it can be said that the financial performance of Bank appears improving after the changes in ownership and management during FY 2059/60.

5.3 Recommendations

On based on the analysis and finding of the study, the following recommendations have been made as suggestions to make the existing investment policy and portfolio of NCCBL effective and efficient:

1) Formulate investment policy for investment on securities:

It is advised to Bank to design policy for investment on securities. Due to lack of such clear-cut written policy, Bank's securities portfolio contains illiquid and unyielding securities. It is recommended to dispose such existing securities as soon as possible.

2) Observe credit policy while making investment decisions:

It was found the Bank's credit policy has addressed most of the credit related issues. On the other hand, the portfolio analysis indicated that portfolio is poor. Poor portfolio is the result of poor implementation of policy. Hence, is advised to comply all the provisions laid down in the credit policies while extending credit facilities to borrowers.

3) Timely revision of investment policy:

If Bank's portfolio fails to perform well, revision is necessary in policy level. It is recommended to revise the credit policy so as to make consistent with Banking market.

4) Revise portfolio structure:

Since, profitability position of Bank is poor, it can be concluded that existing portfolio is not optimum. Hence, Bank is advised to revise existing portfolio structure and construct high yielding portfolio. For this recovery of non-performing loans should be speed up and such recovered amount should be re-invested exactly as per the policy

The Bank is also advised to examine carefully the portfolio management strategies to maintain equilibrium in the portfolio of loans and investment and make continuous efforts to explore new, competitive and high yielding investment opportunities to optimize the return. Bank must develop new lending products. Banking sector is going in consumer credit all over the world by financing the consumer goods. So, NCCBL is recommended to focus on credit products like housing loan, education loan, car loan etc. The Bank must concentrate on customer oriented lending policy to sustain in the competitive Banking business

5) Increase low cost deposit

Before mobilizing fund well, NCCBL is recommended to increase the low cost deposit to lower the interest expenses. The Bank has to promote existing low cost deposit schemes such as Mahila Suraksha Khata, Bal Suraksha Khata and Jestha Nagarik Khata. For this Bank should lunch the additional features on existing products like medicine benefits, free debit card services etc.. As the competition on the Banking sector is increasing, Bank should follow the innovative approach to Bank marketing.

6) Increase off balance-sheet transactions

Interest income from loan and advances and investment has dominance to the total income of the Bank. Income from other fee-based transactions has lower proportion. The portion of OBS transactions is found decreasing in comparison to loans and advances. Now a day, most of the commercial Banks are getting more benefits and increasing their earnings through the enhancement of the fee-based OBS transactions. So the Bank is recommended to give more priority to increase the fee-based OBS transactions to generate more income.

7) Focus on NPA management:

The non-performing loan of the Bank is very high and it is above the acceptable level. So, the Bank management is recommended to give due consideration towards the NPA management in time. The Bank has to give its effort towards the recovery of the loan. For this Bank has to form a strong task force for monitoring and recovery of bad loans which keeps the updated database of total loan and advances and its repayment trend. Bank is recommended to adopt the aggressive loan recovery and follow-up policy. Similarly, the improper project appraisal also increases the chances of default of the loan and advances. So, the Bank is recommended to follow-up the scientific project appraisal approach and train the employee in the loan section accordingly.

8) Increase profitability to retain stakeholders' confidence:

The Bank should be careful in increasing net profit to maintain the confidence of shareholders, depositors, customers and the general public. As commercial Banks are for 'profit' organizations, their overall performance is judged on the basis of profitability. The overall profitability of the Bank has been deteriorated during the periods of study and resulted into the sharp loss in the return to the shareholders. The return on total assets, return on equity, earning per share all are negative. Main reasons for this are high proportion of non-performing assets and high cost of fund. High level of non-performing assets has created heavy loan loss provisioning and interest suspense. Therefore the Bank is recommended to reduce NPL, decrease the cost of fund and lower the operating expenses. It is also recommended to increase the income by enhancing the fee-based OBS transactions as well as utilizing the excess liquid funds such as cash and Bank reserves in the form of investments.

9) Development innovative products

The Bank is recommended to adopt innovative approach to marketing. In the light of growing competition in the Banking sector, the business of the Bank should be customer oriented. It should strengthen and activate its marketing function, as it is an effective tool to attract and retain the customers. For the purpose, the Bank should develop an innovative approach to Bank marketing and formulate new strategies of serving customers in a more convenient and satisfactory way by optimally utilizing the modern technology and offering new facilities to the customers at competitive prices. The Bank is also required to explore the new market areas. For these purpose, the Bank should form a strong marketing and research department in its central level to deal with the Banking products, places, price and promotion.

10) Develop strong internal control system.

Lack of policy compliance is due to poor internal control system. Poor internal control system results into increased operational risk and credit risk. It is observed that the performance of Bank after taking ownership and management by Nepalese entrepreneurs is improving in certain areas like policy formulation and portfolio management. This management is advised to concentrate on management consolidation and internal control to improve portfolio performance and profitability.

Proportion of loans is increasing in total assets portfolio of the Bank which is indicative of management's concentration towards profitability. On the other hand, the low yielding and risk free governmental securities also constitute a major proportion in total portfolio. Lower proportion. It can also be concluded that management is not paying attention to increase OBS transaction.

- **Portfolio performance:**

  Portfolio performance of the Bank is very weak during the past years. However, the trend shows the fluctuating trends of non performing assets. It is due to lack of adequate provision by management. NPL is the chief factor that deteriorated the performance of Bank. So management has to focus on to reduce the NPL.

- **Portfolio Profitability:**

  The weakest part of entire portfolio is its profitability. Parking of interest income as interest suspense and high provisions for NPL have deteriorated the profitability of Bank. Another factor that is adversely affecting the profitability is higher cost of deposits. All the profitability ratios like ROA, ROE and EPS are negative. This has reduced the confidence of investor in share market and consequently helped to lower the share price below face value in stock exchange.

It also can be concluded that Bank has not utilized the resources efficiently during the study period. However, decreasing level of non performing loans suggests management's efficiency in managing non performing assets. Similarly, on the basis of total portfolio analysis, it can be said that the financial performance of Bank appears improving after the changes in ownership and management during FY 2059/60.

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www.nccbank.com.np

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APPENDIX 1

Assessment of credit policy

S.no.	Questions	Yes /No	Score
1	Is there investment policy in written form for loans and advances?	Yes	1
2	Were there such policies since the commencement of bank?	No	0
3	Have the objectives been defined in precise terms?	Yes	1
4	Has the policy addressed encouraged and discouraged credit?	Yes	1
5	Has the policy limited the sectoral loan portfolio exposure?	Yes	1
6	Has the policy stipulated geographical diversification of credit?	No	0
7	Has the policy mentioned risk dispersion methodology?	Yes	1
8	Has the policy quantified the desired mix of loan portfolio?	Yes	1
9	Does the policy encourage liquid loans such as working capital loan, discounting of bills, etc.?	Yes	1
10	Does the policy state the amount of collateral margin required for loans and advances?	Yes	1
11	Are lending authorities defined?	Yes	1
12	Are loan products defined in the policy?	Yes	1
13	Are responsibilities and procedures for appraisal of credit defined?	Yes	1
14	Has the policy addressed clear-cut provisions regarding the renewal, extension, restructuring, rescheduling of loans?	Yes	1
15	Is recovery of loans included in the policy?	Yes	1
		Sub total (A)	**13**
		Percentage score	**87**
Assessment of investment in securities policy			
S.no.	**Questions**	**Yes/ No**	**Score**
1	Is there investment policy in written form for investment in securities?	No	0
2	Are there any provisions regarding limits of investment in governmental securities, NRB bonds and ordinary stock exchange securities?	Yes	0
3	Has the policy tried at matching maturities of investments with liabilities? *	No	1
4	Does the policy address mitigation of risks associated with each investment?	No	0
5	Does the policy encourage liquidity and profitability of the securities investment?	No	0
		Sub-total (B)	**1**
		Percentage score	**20**

Total aggregate score [(A) + (B)] = 14
Total maximun score = 20
Aggregate percentage = 70%

* Score has been assigned on the basis of practices developped in the bank.