CHAPTER I
INTRODUCTION

1.1 Background of the Study

The geographical location of landlocked country Nepal is 26° 22” to 30° 27” northern latitude and 80°04" to 88°12” eastern longitude that is between two large countries India and China. Nepal covers 0.3 percentage land of Asia and 0.03 percentage land of world which is 147181 square Km. Average length of eastern Mechi to western Mahakali is 885 Kms and average gap between Northern sides to southern side is 193 Km.

Nepal was country of peace but after Maoist revolutionary movement the status quo breaks down and peace of Nepal convert into pieces and it is still searching peace. Nepal has been facing too many big political changes form few decades. Too many political changes always break the progress of peace. Nepal converted into democratic country from the autocratic Rana rule in 2007 B.S. It again lost democracy in 2017 B.S. The democracy got back in 2046 B.S. In 2052 B.S Nepal Communist Party Maoists started revolutionary movement that movement created violence and fear in all sector of Nepal. This violence stopped after success of mass movement of 2062 – 2063 B.S. After movement the election of constitutional assembly was held. The first meeting of constitutional assembly declared Nepal as a republic country. After that Nepal get one new president and six new prime minister. The government of sixth prime minister is governing Nepal right now.

Most of Nepalese depend on agriculture. Recently, foreign employment is another attraction of Nepalese youths. The agriculture and foreign employment are major source of national income (NI). From economic point of view Nepal is the country of potentiality. Many national and international level surveys suggested that Nepal is rich in minerals resources and natural beauties. It is the second rich in water resource form these water resources large megawatt electricity can be generated and this electricity can sell in cheap price in world market. In other hand it can supply water in India for irrigation and drinking water for other countries. Potential remains in potential. Nepal fails to convert potential into possible. Therefore, it an underdeveloped country with very low per capita income and low economic growth.

Non achievement in logical conclusion in peace process, the poor development of industry, lack of capital and technology, poor political situation, illiteracy, small international investment, lack of will power of political parties, existing corruptions on government mechanisms, institutional weaknesses, poor economic policy, poor implementation of policies, lack of industrial securities, fear and negative motivation in private sector are the basic factor which block economic growth and business development in Nepal.

Economy prosperity is desire of any country but it is not easy to get prosperity. To get it the country must understands the formation of economic environment within is territory and how it is connected with world economy and make effective policy to grape world economic opportunities and prevent from world economic threats. Economic environment are made by combination of different sectors of county. Different sectors means different profession, business organizations, trade and credit institution, trade agreements, strategic alliance of different countries, economic partnership with other countries, trade movement, economic policy etc. are the major economic force of any county. Financial sector is the one of the major part of any economy. Under financial sector different national and international organization are performing their activities. In case of Nepal, financial institutions have played significant role in national economy.

Financial institutions use different policy to operate their functions. They have many policies such as investment policy, human resource policy, Credit policy, deposit policy etc. Financial Institutions are the means which create credit in economy. These take money from people and lend it to people. One of the most important principle under which these operate is “credit from people and credit to people”. This principle automatically explains how much credit management is important in financial sector. The study on credit management is one of necessary study to understand bank and its performance.

Evolution of Finance Company in Nepal

The history of finance institution is not very old. When banking sector started carryout current activities of finance company, large number of finance companies was established and they expanded at a rapid pace in developed countries, UK and USA in 1960s. Their growth was very rapid in comparison to commercial banks as they used to offer higher interest rates on deposits, lower interest rates on loan and swifter than commercial banks.

In the context of Nepal, there were few insurance companies and Karmachari Sanchaya Kosh working as non-banking financial institution before enactment of Finance Company Act, 2042. Need of Finance Company Act was felt because unauthorized sector was collecting savings from the common public in the name of Upahar and Dhukuti programs. People showed great interest and enthusiasm in these programs but they were cheated by most of the organizers of these programs. Considering peoples' interest in such programs, benefit of mobilizing such savings in productive sectors, banking sectors inability to carry out capital market activities and to meet customers need for credit, government felt the need of finance companies and introduced Finance Company Act 2042. However, no finance company set up till 2049 because the act came into being only in 2049 with some amendments. Wave of establishing finance company began only when NRB authorized Co-operative institutions set up under Co-operative Act, 2048 to accept deposit and give credit. "Nepal Awash Bikash Bitta Company Ltd" is the first finance company established in 2049, promoted by Rastriya Beema Sansthan, NBL, Rastriya Banijya Bank, ADBL and Nepal Arab Bank Limited. In the same year, Nepal Finance and Savings Company ltd was established from the private sector.

Some eight years later, the Merchant Banking Act 2050 allowed certain finance companies that met the regulatory requirements to acquire Merchant Banking License as well. As of 2007 data, there are 8 Non- Banking Financial Institutions (NBFIs) with merchant banking license. These has been beginning to till data, the only major differences between a commercial bank and finance company in terms of the activities allowed to them are; over draft, personal loans, foreign exchange transaction and opening letters of credit. Recently the finance companies are allowed to transact also in Indian currencies. Though, they are still restricted from transacting in other foreign currencies. In order to govern this sector more prudently, the Bank and Financial Institution Act, 2061 (as known as the Umbrella Act) was introduced by replacing all the other acts. Thus making this single act that governs all financial sectors from commercial banks to financial companies.

Today, the banking sector is more liberalized and modernized and systematic managed. There are various types of banks working in modern banking system in Nepal. It includes central, development, commercial, financial, co-operative and micro credit (Grameen) banks. Technology is changing day by day and changed technology affects the traditional method of service of bank. NRB will classify the institutions into ‘A’ ‘B’ ‘C’ and ‘D’ groups on the basis of the minimum paid-up capital and provide the suitable license to the bank and financial institution. Group ‘A’ is commercial bank, ‘B’ for the development bank, ‘C’ for the financial institution and ‘D’ micro finance development banks.

In may 2011, made announcement of the Merger Bylaws by NRB, the central regulatory body of Banks and Financial Institutions (BFIs) in Nepal. NRB’s move has opened doors for the country’s BFIs to go for mergers. The move came as a measure to check unhealthy competition and irregularities among BFIs. As per NRB report (mid August 2012) the country has 31 commercial banks, 87 development banks, 80 finance companies and 21 micro- finance companies. According to NRB, 22 financial institutions have acquired final approval from NRB to merge into 10 financial institutions. Besides the 23 have already got a letter of intent from NRB and more than 50 financial institutions are looking for suitable partners. Recently, two commercial banks NIC bank and Bank of Asia Nepal have merged. Merger is a golden opportunity for BFIs. Merger of two institutions enable BFIs to make profit and reduce cost in areas such as administration and infrastructure. NRB has implemented the merger policy as the best measure to deal with excessive number of financial institutions in a market the size of Nepal, which is unsustainable for the overall financial sector.

Om Finance Limited is one of the pioneer & leading finance company of Pokhara. It was registered in 2054 B.S. and In 29th Bhadra 2057 B.S. NRB provided the License as finance company, thus, OFL started its operation from 1st Ashwin 2057 B.S. The head office of this finance company is situated in Newroad, Pokhara. OFL is providing the cutting edge facilities to Pokhara Valley as per market demands to fulfill the basic to every level of customer demands. OFL has been performing to the best of their capacity in promotion of agriculture, industry, trade, and commerce and for overall economic growth of the country by providing various financial services. OFL is providing the following banking services:

i) Accept deposit

ii) Provide loan and advances

iii) Credit collection

iv) Remittance services

v) SMS Banking

vi) Locker Services

vii) ATM Service

1.2 Focus of the Study

The study aims to analyze the credit management of Nepalese finance companies with special reference of OFL. This study focuses on the sector wise credit providing by OFL, the effectiveness of credit management and also examine the relationship of credit with profitability.

1.3 Statement of the Problem

Trends of bank expansion, operations and establishment are in apex growth condition in Nepal. Recent political changes are also adding fuel to grow the financial sector. Daily various news are broadcasted by media in the concern of merge, upgrade, new establishment, branch expansion etc. Recent activities of banking sector are also unique, some of them are busy to introduce new deposit product in high interest rate, some other are trying to catch attention of client by lowering interest rate on loan. So competition is high enough but NRB is lowering various services by adding various circular (restriction on margin lending, gift/prizes distribution, revised capital adequacy etc). There are too many other challenges exist for banking industry. These challenges are because of poor political condition and instability of eco-political environment of Nepal. Therefore, focus of the present study is on credit management of finance companies in Nepal with special reference to OFL. The following specific objectives are as follows:

i) In which sector OFL is able to provide credit?

ii) Is the OFL credit management and mobilization effective and efficient?

iii) How this credit management affect the financial performance of OFL?

iv) Is credit of OFL has relation with the profitability?

1.4 Objectives of the Study

Each and every of the research study possess a certain objective. Research without any specific objectives will be worthless. This research study entitled “Credit Management of Om Finance Limited” highlights to attempt the following objectives.

i) To examine sector wise loans and advances of OFL.

ii) To analyze the effectiveness of credit management of OFL.

iii) To analyze the credit of OFL.

iv) To examine relationship of credit with profitability.

1.5 Significance of the Study

Credit management has become an integral part of almost every banking operation. It is indisputable that the loan and advances or credit are major sources for generating profit for banks and financial institutions. This study will be beneficial to the shareholder, researchers, students, banking sector, governments and other parties.

1.6 Limitations of the Study

This study is conducted for the partial fulfillment of Master of Business Studies. So, it posses some limitations of its own kind. The limitation of the study are as follows:

i) This study concentrates only on the credit management of OFL.

ii) The secondary data is used for presentation and interpretation.

iii) The study is based on data of seven year period.

iv) In this study, only selected financial and statistical tools are used.

1.7 Organization of the Study

This study has been organized into five chapters such as introduction, review of literature, research methodology, presentation and analysis of data and summary, conclusion and recommendation.

Introduction chapter includes background of the study, statement of the problems, objectives of the study, significance of the study, and limitations of the study.

Second chapter, Review of literature deals with conceptual review and review of related studies.

Third chapter, research methodology includes research design, nature and sources of data, data collection and data analysis technique and limitation of research methodology.

Forth chapter includes presentation and analysis of data using financial and statistical tools such as ratio analysis and statistical analysis and fifth chapter includes summary, conclusion and recommendation. Bibliography and appendix are attached at the end part of study.

CHAPTER II

REVIEW OF LITERATURE

Review of literature means reviewing research studies or other relevant proposition in the related area of the study so that all the past and previous studies, their conclusion and perspective of deficiency may be known and further researcher can be conducted or done. It is an integral mandatory process in research works. It is a crucial part of all dissertations. In other words it's just like fact are finding based on sound theoretical framework oriented towards discovery of relationship guided by experience, resonating and empirical investigation. It helps to find out already discovered things. Review of relevant literature implies putting new spectacle in old eyes to think in new way by posting the problem with new data and information to see that what results are derived. The primary purpose of literature is to learn and it helps researcher to find out what research studies have been conducted in one's chosen field of study, and what remains to be done. For review study, the researcher uses different books and journal, reviews and abstracts, indexes, reports, and dissertation or research studies published by various institutions, encyclopedia etc. We study the review of literature in dividing two headings:

Firstly, Conceptual Review and finally Review of related Studies.

2.1 Conceptual Review

In this section related literatures have been examined.

2.1.1 Concept of Credit

Credit is the sum amount of money lent by the creditor (Bank) to the borrower (Customers) either on the basis of security or without security. Sum of the money lent by a bank, is known as credit (Oxford Advanced Learners Dictionary, 1992).

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

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

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

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

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

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

2.1.2 Types of Credit

The credit provided by bank is divided into thirteen types they are;

I) Overdrafts

It denotes the excess amount withdrawn over their deposits. In other words bank provides some limit of money to their value customer according to believe on their customer and level of transaction and made by customer. Balance of overdraft account may fluctuate. It is increased by withdrawals by the customer makes payment into the account. It is the facility granted for meeting working capital requirement of the borrower i.e. to fulfill borrower’s short term needs.

II) Cash Credit

The credit is not given directly in cash but deposit account is being opened on the name of credit taker and the amount credited to that account. In this way, every credit creates deposit. Cash credit generally given to traders, industrialists, farmers for meeting their working capital requirement.

III) Term Credit

It refers to money lent in lump sum to the borrowers. It is principle form of medium term debt financing having maturities of 1 to 8 years. The firm agrees to pay interest based on the bank’s prime rate and to repay principle in the regular installments. Special patterns of principle payments over time can be negotiated to meet the firm’s special needs (Richard, 1996). It is granted for starting or expanding the new project industry, or any other venture requiring fixed assets investment .It is also meet the borrower’s long term fixed assets requirement.

IV) Working Capital Credit

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

V) Priority or Deprived Sector Credit

Priority or Deprived Sector lending refers to small loans that are provided to the poor and rural people for small projects. The governments of Nepal and Nepal Rastra Bank have considered deprived sector credit as an effective tool for reducing poverty. According to NRB directives, finance companies are required to lend 3% of their total loans to deprived sector.

VI) Hire Purchase Loan (Installment Credit)

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

VII) Housing Loan

Financial institution adopts this policy as residential building commercial complex, construction of warehouse etc. It is given to those who have regular income or can earn revenue from housing project itself. According to NRB, The amount of loan to extend against the security of housing loan and real estate shall not be more than 60% of the fair market value of the housing land and real estate under collateral security. The bank can lend up to 25% of their total loan exposure in housing and real estate. As for the real estate sector (which does not include the housing sector) the central bank has asked the lending banks to reduce exposure to 15 percent of total loan portfolio by the end of next fiscal year and to 10 percent by the end of fiscal year 2012/13.

VIII) Project Credit

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

IX) Consortium Credit

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

X) Credit Cards and Revolving Lines of Credit

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

XI) Off-Balance Sheet Transaction

In fact, bank guarantee and letter of credit refer to off balance sheet transactions of financial institution. It is also known as contingent liability. Contingent liability pinpoints the liability, which may or may not arise during the happening of certain event. Footnotes are kept as references to them instead of recording in the books of accounts. It is non-funded based remunerative facilities but more risky than the funded until adequate collateral are not taken. Lets its two varieties be described separately.

XII) Bank Guarantee

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

XIII) Letter of Credit (L/C)

It is issued on behalf of the customer (buyer/importer) in favor of the exporter (seller) for the import of goods and services stating to pay certain sum of money on the submission of certain documents complying the stipulated terms and conditions as per the agreement of L/C. It is also known as importers letter of credit since the bank of importer do not open separate L/C for the trade of same commodities (Jhonson, 1940).

2.1.3 Principle of Credit Policy

Good credit policy is essential to carry out the business of lending more effectively. Some policies are as follows:

- **Principle of Safety Fund:** Banks should look the fact that is there any unproductive or speculative venture or dishonest behavior of the borrower.
- **Principle of Liquidity:** Liquidity refers to pay on hands on cash when it needed without having to sell long-term assets at loss in unfavorable market (American Institute of Banking, 1972). A banker has to ensure that money will come in as on demand or as per agreed terms of repayment.
- **Principle of Security:** It acts as cushion to grant advances and credits. Adequate values of collaterals ensure the recovery of credit correctly at the right time. Accepted security should be readily marketable, handy and free from encumbrance.
- **Principle of Purpose of Credit:** Generally, credit request would be accepted for productive sector only, Bank should be rejected credit request for speculation, social functions, pleasures trips, ceremonies and repayment of prior credit as they are unproductive.
- **Principle of Profitability:** Profitability denotes the value created by the use of resource is more than the total of the input resources. Bank should provide to such project that can provide optimum amount of return. For such purpose, bank should take a little bit risk y providing credit to venturous project.
- **Principle of Spread:** Portfolio of credit advances is to be spread not only among many borrowers of same industry. It across the industries in order to

minimize the risk of lending keeping "Do not put your all eggs in the same basket" in mind.

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

2.1.4 Key Characteristics of Credit Policy

Every policy has its own characteristics. The credit policy has the following characteristics:

- **Approved by Top Management:** The credit policy is always prepared by the top management of an institution and is approved by the board of directors. It may be revised time to time.
- **Practical and Manageable:** The credit policy, prepared by the bank is not for theoretical rather it is for practical and manageable to apply.
- **Flexibility:** Rigid credit policy is not practical. It has to be flexible according to the demand of customer.
- **Compliance:** Credit policy is compliance with NRB policy as well as economic, political condition of the country.

2.1.5 System and Procedures of Credit Policy

A sound credit policy interact all the areas of credit effectively that ultimately helps to operate the organization successfully. Basically, banks and financial institutions have to follow the following system and procedures in credit policy:

a) Credit Origination

Banks and financial institutions must operate within a sound and well-defined criteria for new credits as well as the expansion of existing credits. The credits should be extended within the target markets and lending strategy of the institution. Before allowing a credit facility, the banks must make an assessment of risk profile of the customer transaction. This may include:

- Credit assessment of the borrower’s industry and macro economic factors
- The purpose of credit and source of repayment.
- The track record/repayment history of borrower
- Assess/evaluate the repayment capacity of the borrower
- The proposed terms and conditions and covenants
- Adequacy and enforceability of collaterals
- Approved form appropriate authority

In case of new relationships, consideration should be given to the integrity and repute of the borrowers or counter party as well as its legal capacity to assume the liability. Prior to entering into any new credit relationship, the bank must become familiar with the borrower or counter party and be confident that they are dealing with the individual or organization of sound repute and cordite worthiness. However, a bank must not grant credit simply on the basis of the fact that the borrower is perceived to be highly reputable, i.e. name lending should be discouraged. While structuring credit facilities, institutions should appraise the amount and timing of the cash flows as well as the financial position of the borrower and intended purpose of the funds.

Institutions have to make sure that the credit is used for the purpose it was borrowed. Where the obligor has utilized funds for purposes not shown in the original proposal, institution should take steps to determine the implications on creditworthiness. In case of corporate loans where borrower own group of companies such diligence becomes more important. Institution should classify such connected companies and conduct credit assessment on consolidated/group basis. In loan syndication, generally the lead institution does must of the credit assessment and analysis. While such information is important, institution should not over rely on that. All syndicate participants should perform their own independent analysis.

Banks and financial institutions should not over rely on collaterals/covenant. Although the importance of collaterals held against loan is beyond any doubt, yet these should be considered as a buffer providing protection in case of default, primary focus should be on obligor’s debt servicing and reputation in the market.

b) Limit Setting

An important element of credit risk management is to establish limits for single obligors and group of connected obligors. Institutions are expected to develop their own limit structure while remaining within the exposure limits set by NRB. The size of limits should be based on the credit strength of the obligor, genuine requirement of credit, economic conditions and the institution's risk tolerance. Institutions may establish limits for a specific industry, economic sector or geographic regions to avoid concentration risk.

c) Credit Administration

Credit administration function is basically a back office activity that support and control extension and maintenance of credit. A typical credit administration unit performs following function:

- Documentation: It is the responsibility of credit administration to ensure completeness of documentation (loan agreements, guarantees, transfer of title of collateral etc) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution ad receipt.

- Credit Disbursement: The credit administration function should ensure that the loan application has proper approval before entering facility limits into computer systems. Disbursement should be affected only after completion of covenants and receipt of collateral holdings. In case of exceptions necessary approval should be obtained from competent authorities.

- Credit Monitoring: After the loan is approved and draw down allowed, the loan should be continuously watched over. These includes keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.

- Loan Repayment: The obligors should be communicated ahead of time as and when the markup installment becomes due. Any exception such as non-payment or late payment should be tagged and communicated to the management. Proper records and updates should also be made after receipt.

- Maintenance of Credit Files: Institutions should devise procedural guidelines and standards for maintenance of credit files. The credit files not only include all correspondence with the borrower but should also contain sufficient information necessary to assess financial health of the borrower and its repayment performance. It need not mention that information should be filed in organized way so that external/internal auditors or NRB inspector could review it easily.

- Collateral and Security Documents: Institution should ensure that all security documents are kept in a fireproof safe under dual control. Registers for documents should be maintained to keep track of their movement. Procedures should also be established to tack and review relevant insurance coverage for certain facilities/collateral. Physical checks on security documents should be conducted.

2.1.6 Lending Criteria

While screening a credit application, 5Cs to be first considered supported by document.

i. Character

Character refers to personal traits such as ethics, honesty, integrity, reliability of borrower's, which is significant for lending decision. The actual purpose, trustworthiness in answering the queries, responsibility and seriousness in making efforts to repay loan is observed by the bank. It considers a borrower's past actions a strong indication of what he/she will do in the future. If a person has a history of defaults, he/she will be considered a far higher risk than a person with a clean record of on-time paybacks.

ii. Capacity

The bank and financial company views two aspects. Firstly, the bank sees whether the applicant possess legal capacity to borrow loan. Secondly, whether the applicant has capacity to generate sufficient income to repay the loan amount or not. If the borrower has high capacity, quality management and good market value then the capacity of the client is said to be high and bank grants loan on that basis. Hence, suitable ratios (liquidity, leverage, profitability, efficiency) are analyzed based on historical and projected financials.

iii. Capital

Capital refers to net worth of the borrower. Leverage ratio will be high if the borrower has low capital. A bank gives loan only when it finds leverage ratio acceptable to it or if the borrower has enough capital.

iv. Collateral

Loans can be split into two main types -- secured and unsecured. A secured loan is a loan that is backed by some form of collateral, an asset that the lender can seize in the event that the borrower defaults. Unsecured loans are loans that are not backed by collateral. To safeguard its risky assets in case of default, bank asks for securities or collateral from the borrower, no matter how prosper the financial position of the borrower is. Collateral can be fixed in nature- land, building, machinery or working capital like inventories and account receivables.

v. Condition

Condition refers to the general economic condition beyond the control of h as security, political and other social condition affects the business. Loan is given to the borrower if lending official feels general condition is favorable for that type of business.

2.1.7 Project Appraisal

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

- Is the project technically sound?
- Will the project provide a reasonable return?

- Is the project in line with the overall economic objectives of the country?

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

1 Financial aspect

2 Economic aspect

3 Management /organizational aspect

4 Legal aspect

Directives issued by NRB for the commercial Bank: (related to credit aspect only):

1. Credit classification and provisioning

Classification	Provision
Pass Credit	1%
Sub Standard Credit	25%
Doubtful Credit	50%
Bad Credit	100%

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

Substandard credit are those credit which are already crossed the repayment time schedule and are within 3-6 months delay of maturity date. Likewise, within 6-12 months from the time to be recovered are classified as doubtful credit. Those credits, which are not recovered yet after 1 year from maturity date, are known as bad credit. All the above 3 types of credits are classified as non-performing credit also. The credit loss provision for performing credit is termed as general credit loss provision whereas the credit loss provision for non- performing credit is termed as specific credit loss provision.

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

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

- Fund based credit and advances can be issued up to 25% (upper limit) of core capital to a single customer, firm, company and a group of related customer.
- Non-fund based (off-balance items) can be issued up to 50% of core capital to a single customer, firm, company and group of related customer.

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

2.1.8 Steps of Lending Process

Bank and financial institution issue loans but before issuing loans, they follow some steps of lending process.

- Loan Application: When a person need loan then he/she asks the loan procedure in the bank. If all the process and information is reasonable, then he/she makes loan application. It is also called loan proposal. For big business loan, it is appropriate to talk with loan officer. Loan officer can also contact to big account holder possessing business organization as ask it they are in need of loan. In developed country's bank, they search for probable debtors. Banks make report of economic activities and when they found good customer they contact with them and ask for loan necessity.

- Loan Interview: Second process involves the loan interview of applicants who apply for the loan. This interview helps to find out the loan applicant's nature, i.e. habit, obedient and also help to collect information about the purpose.

2.2 Review of Related Studies

In this section different pervious study article and publish materials related to study are examined.

2.2.1 Review of Article

In an article published in 'Souvenir' of Rastriya Banijya Bank Ltd., (Garg, 2064), titled "Principles of Lending and Credit Culture at RBB" has mentioned that the lending combines the science of obtaining and analyzing the facts of a loan request and the art of making judgments about that information, the feasibility of the business, and the credibility of the borrower.

The lender should make sure that he understands the various risks which affect it and wherever possible takes steps to manage the risks. First and foremost these include the major obvious risks such as the term and magnitude of the loan and what changes could affect the borrower's ability to repay the loan.

In view of Garg, lending primarily based on the Charisma, stature, reputation, market image of the borrower. All of us believe in something called –looks are deceptive, don't judge book by its cover, ever take anything at its face value etc. In the article he focused that the credit culture of RBB for the last several years is based on:

- Name Lending
- Collateral based Lending
- Limit based lending
- Universal Lending
- One time lending
- Attitude lending

In the article Garg has concluded that the successful banks have developed an internal credit culture that guides their banking operations .A bank's credit culture is the unique combination of policies, practices, experience and management attitudes that defines the lending environment and determines the lending behavior acceptable to the bank.

Crosby, French and Oughton (2007) in their article "Banking lending valuations on commercial property" elaborates that the banking community are trying to identify the value on which they can apply a loan value ratio and thus protect their loan in the future should the borrower default. A simplistic understanding the value therefore suggest that figure provided should be the figure which has a life for the length of the loan. However the very concept is economically impossible in any market with volatility. Values can only be snapshots in time. They do not have a shelf life.

For this reason EMLV is conceptually and practically redundant in real estate markets. It appears on the surface to be a solution to the banks' requirement for the reduced risk property lending. In reality, it may indeed transfer that risk by demanding a level of protection to the bank that the valuation cannot give. But if values agree to it, it could open the way to successful negligence claims in the aftermath of poor lending decisions. This is because the concepts appears the determinants of the virtually certain level of value below which the value will not fall for an indeterminate time into the future. Values are vulnerable to claims that their valuation was too high, should values fall below that level at any time during the loan. Sustainable value is predicated on having a shelf life but the application believes this fundamental requirement. Values must have a time point. The concept is redundant, the target unidentifiable and the definition ambiguous. It is little wonder that the application appears mechanistic. Market value is an obtainable and useful piece of information to the lender. Worth in the market sets this in context and gives the lender a view of whether market prices are at current sustainable levels. In obtaining worth, the value is obliged to carry out both quantitative and qualitative investigation into the future and this generates other analyses at different time points during the course of the loan.

EMLV appears to be another blind alley which will divert the appraisal profession from its more important task of improving pricing estimates, and thereby influencing market prices, and providing all clients, whatever the valuation purpose, with the information in reports which puts the limitations of valuation figure into perspective.

Mundul (2008) understanding of credit derivative Business Age September" emphases Credit derivative enable financial institution and companies to transfer credit risk to a third party and thymus reduce their exposure to the risk of an obligor's default. Credit enhancement technique, which helps reduce the credit risk of an obligation, play a key role in encouraging loans and investment in debts. In legal term credit derivative are privately negotiated bilateral contract to transfer credit risk from one party to another. Some credit enhancement methodologies have existed for the in debts. Some credit enhancement methodologies have existed for a longtime with the support of guarantee, letter of credit or insurance product. However such mechanism works best during economic upturns. As an alternative to commercial risk mechanism, various financial mechanisms have been developed over the past few decades. Such credit risks instruments are normally refer to as credit derivatives. Credit derivative helps to transfer credit risk away from the lender to some other party. Now credit derivative grew popular both as tools for hedging credit risk exposure as well as method of investing in certain types of credit risk.

Credit derivative not only helps corporation and financial institution to manage to their credit risk but also enabled a new set of individual retail client to invest in bonds and stocks previously unaffordable. Through credit derivative individual investor ca invest indirectly in foreign bonds at a lower price. Credit derivative helps investor isolated credit, and transfer it to other investor who are better suited to managing it or who finds the investment opportunity more interesting. There are many credit instruments in the market they are

- Total return swap (TRS)
- Credit default swaps (CDS)
- Credit linked notes (CLN)
- Credit spread option (CSO)

According to the behavior of the asset or deal above credit instrument can be used and minimizing the risk. In this way credit derivative provide protection against credit peril and risk.

2.3 Review of Thesis

This dissertation has been written after studying various books journals article website and previous thesis. I here comprise the some previous thesis review, which are mainly concerned about fund mobilization policy, lending practices and investment policy, credit management and loan management of commercial banks**.**

Chand (1988) has submitted his thesis entitled “Credit Disbursement and Repayment of Agriculture Development Bank Nepal. His research statement of problems are The Bank does not benefit small farmers (j.e. problem of balance development).The collection of credit is slow, so it hinders the flow of capital required to development economic growth. Objectives of the study are to see the repayment situation, find out the growth rate of investment, to explain possible causes of none and delay repayment. He finds that there is systematic relationship between credit disbursement and repayment. The coefficient of correlation value as calculated is 0.94 which shows significance relationship. Repayment situation is satisfactory on production and agro-based industry, warehouse and farm mechanization, irrigation, tea horticulture, livestock, poultry and fisheries is satisfactory. As a recommendation given by Chand, ADB/N should play a significant role in such direction as to fulfill the credit demands of rural areas. For effective credit recovery from the borrowers or clients, credit should be channeled through the borrower groups

Paudel (2001) has conducted a research on “A study on lending practices of joint venture commercial banks with reference to Nepal Bangladesh Bank Ltd (NBBL) and Himalayan Bank Ltd. (HBL)” has made comparative study of these two banks in different lending aspects and strategies. He has found the liquidity position of NBBL is comparatively better than HBL. NBBL is found slightly better to be maintaining between assets and liabilities. NBBL has high loan and advances to total assets ratio, loan and advances to total deposit ratio, but HBL has high investment to total loans and advances and investment and total investment to total deposit ratio. He has concluded that NBBL is able to manage its assets to complete in this competitive banking business than HBL. As per his findings the liquidity position of NBBL is better and hence HBL is recommended to increase its liquidity position. He has suggested both banks to strictly follow the NRB directives and adopt sound credit collection policy which will help to decrease Provision for Possible Losses.

Ojha (2002) in his dissertation about “Lending Practices” has written that the commercial banks have to expand their credit in the area if rural economy so as to compromise between the liquidity and credit need such economy. This helps in minimizing the idle fund in business and at the same time contribute to the national economy. The banks should also increase the volume of credit in the sector of agriculture as the ratio of contribution made by the banks in this priority sector is decreasing. Ojha has found that the high volume of liquidity reveals that a degree of lending strength has been prevailing in all of the commercial banks. The lack of reliable lending opportunities and fear of losing the principal in rural sector has been keeping these banks less oriented towards the lending function. Hence, the government should take appropriate action to initiate these banks to attract to flow credit in rural economy. Posing the compulsions by directives does not create long-term healthy lending practices unless the commercial banks are not self-motivated to flow credit in this sector.

Parajuli (2003) has submitted “Credit management of joint venture banks” stated that concept of financial reform emerged since 1980s with economic liberalization. Nepal Government and NRB published the economic and monitory policy to support such reform. As the result of these policies various jointed venture banks established in the private sector. The main statement of the problem of the study is government owned banks are in critical condition they are unable to recover the credit. Financial sector reform programs are not being able to achieve the expected target. Performance on the credit is poor in the government banks. Amount of non - performing assets is increasing. Generally, it is accepted If bank maintain low ratio, bank may not able to make the payment against cheque that disadvantage sector in the economy such as the farmer and the small business have been neglected by the banking industry. The main objectives of his research are: procedures of granting loans, examine the level of non-performing loan, relevancy of the financial sectors reform program, measure the comparative output of credit management in joint venture bank and government.

Regmi (2004) entitled Thesis “Credit Management of Commercial Banks with Reference to Nepal Bangladesh Bank and Bank of Kathmandu” states that commercial banks are those banks, which works from commercial view point. The objectives of this research are to analyze the functions, objectives, activities, credits and advances procedure and recovery status of the NB bank and BOK. On average 5 years of research period, cash and bank balance to total deposits of ratio of NB bank and BOK is 12.75% and 14.12% respectively. Likewise NB bank and cash and bank balance 1.584 times of current deposits and BOK has cash and bank balance 1.14 times of current assets. NB bank: most of the credit and advances almost 70% is provided an assets guarantee. The assets guarantee credit is increasing period by period. He has found that Nepal is being an agriculture country needs more investment in this sector. Commercial banks are rather concerned in industrial and foreign projects. As a result, the credit extended to this sector is unsatisfactory. Besides, they are not even fulfilling the NRB's regulation of 12% investment of their total loans to priority sectors like agriculture, cottage and small industries and services. .

Sedai (2007) in his dissertation "An analysis on lending policy and strength of Nepal Investment Bank Ltd" highlighted that aggregate performance of NIBL is satisfactory and pushing upward. The main objective and target of this study is to observe the loan disbursement of Nepal Investment Bank Ltd. its showed the actual lending position, strength and weakness. Lending strength of NIBL in term of exposure of loan and advances is good and appreciable. The contribution made by bank in industrial as well as agriculture sector of the economy is highly appreciable and its bust up towards national prosperity. The ratio of loan and advances to total asset, loan and advance to shareholder's equity indicate a good performance of NIBL in its lending activities. Looking at the asset management ratio the performance of NIBL seems good in the area of lending, productivity and impact on national economy. Thus looking at the various summaries and findings, Sedai recommended that extend their credit and branch in rural area, require the proper market analysis, diversify the investment sector and improve current position of lending portfolio etc.

Misra (2007) entitled her Thesis "Credit management of Everest Bank Limited" illustrated that liquidity position; cash reserve ratio shows the more liquidity position. Cash and bank balance to interest sensitive ratio shows the bank is able to maintain good financial condition. Cash and bank balance to current assets ratio shows that the bank's sound ability to meet the daily cash requirement of their customers deposit. That is why liquidity position of the bank is the better. In the aspect of profitability position, interest income to interest expenses ratio shows the more profitable salivation. Return on loan advances are showing position that is more profitable on of the EBL. Analysis of the assets management ratio, loan advances to total assets ratio shows the better performance. Whereas investment in loan and advances is safely and not taking more risk. The interest expenses to total deposit ratios shows the improving efficiency of the bank. This is to recommend that Cash and bank balance of EBL bank is high. Banks efficiency should be increased to satisfy the demand of depositor at low level of cash and bank balance does not provide return to the bank.

Basnet (2010) entitled thesis “A Study on Relationship Investment with Performance of NABIL” concludes that the non-performing loan has positive growth rate which is indicator of bad performance but total non-performing loan/ total investment ratio has average of negative growth rate it is indicator of good performance. From these facts the conclusion has drawn NABIL has increasing non-performing loan but the increment of non-performing loan is lesser then increment of total investment it is the clear picture of good loan mobility with respect to expansion in investment. The deposit mobilization ratio has positive growth rate and the loan loss provision to net interest income has excessive positive growth rate. From this, conclusion can be made that the bank is able to mobilize its deposit but on the other hand it is taking high credit risk and the credit risk has high degree positive correlation with financial investment.

Dhakal (2011) compared the credit management policy of HBL and NBIL in his thesis entitled “A Comparative Study of Himalayan Bank Ltd and Nabil Bank Ltd”. She has found out that the positive relationship between total loan and advances and net profit of both banks which help to increase the net profit of both banks. The loan and advance to total deposit ratio of both banks did not maintain this ratio but satisfactory. This ratio is up to 80% is good for NRB directives. NABIL has better lending policy than HBL. She found that HBL has kept high loan loss provision than NABIL. She suggested that both banks have high liquidity ratio. Higher these ratios indicate idle money, no efficient use of capital, less earning per share. So the banks should invest excess funds in income generating areas.

2.4 Research Gap

There are various factors that affect the lending practices. The directives of NRB change over time and bank and financial institute should accept their policy with the changing time. So up- to- date study over the change of time frame is major concern for the researcher and concerned organization as well as whole. The present study has been based on secondary data try to achieve its objectives by analyzing data. More findings, extensive testing and adjustment of necessary variable are needed in order to be more conclusive about credit management. The current study is a supplement to overcome the weakness and limitation of previous studies also.

CHAPTER III

RESEARCH METHODOLOGY

Research simply means to search again and again. It is a systematic activity to achieve truth or finding solution to a problem. It is a process of a systematic and in-depth study or research of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data. Methodology is the research method used to test the hypothesis. So the research methodology refers to the overall research process, which a researcher conducts during his/her study. "The purpose of research is to discover answers to questions through the application of scientific procedures. The main aim of research is to find the truth which is hidden and which has not been discovered at yet." (Kothari, 1990)

Research methodology helps us to find out accuracy, validity and suitability. The justification on the present study cannot be obtained without help of proper research methodology. The research methodology used in the present study is briefly mentioned below.

3.1 Research Design

Research design is the planned structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances. In other words research design is the frame work for a study that helps the analysis of data related to study topic. For the analysis of credit management of selected finance company descriptive design has been applied to achieve the objective of the research.

3.2 Population and Sample

The population in most studies usually consists of large groups. Because of its large size it is fairly difficult to collect detailed information from each member of population. Rather than collecting information from each member, a sub-group is chosen which is believed to be representative of population. This sub group is called a Sample. There are altogether 80 finance companies all over the country at present, which are taken as population of this study work. For the analysis of credit management, only one financial company i.e. Om Finance Ltd is taken deliberately as the sample.

3.3 Nature and Source of Data

In this study the secondary sources of data have been used. The required secondary are collected from Annual Report of OFL, NRB Directives, National Newspaper, Journals, Dissertation of Central Library of T. U. and P.U. and websites.

3.4 Tools of Data Analysis

For the purpose of the study all collected secondary data are arranged, tabulated under various heads and statistical analysis has been carried out to enlighten the study. To make the study more specific and reliable, mainly two types of tools have been applied:

- Financial tools
- Statistical tools

3.4.1 Financial Tools

In this study followings tools of ratio analysis have been used

I) Ratio analysis

Ratio analysis is a powerful and the most widely used tool of financial analysis. A ratio defined as "The indicated quotient of two mathematical expression" and as the relationship between two or more things (Webster's New Collection Dictionary, 1975).

It is defined as the systematic use of ratio to interpret the financial statements so that the strength and weakness of a firm as well as its historical performance and current financial condition can be determined. In financial analysis a ratio is used as an index or yardstick for evaluating the financial position and performance of a firm. Ratio helps to summarize the large quantities of financial data and to make qualitative judgment about the firm's financial performance (Pandey, 1979). For this study, ratios are categorized into the following major headings:

a) Credit Ratios

Credit ratio measures relationship of credit with different financial variables. This ratio is used to explain proportion of credit in different financial variables. To understand clear picture of credit management of any financial institution one must understand how the credit is formed and how is the relationship of credit with other variables. Following ratios provide enough analytical capability to understand to financial relation of credit with other variables.

b) Loan and Advances to Current Assets Ratio

Loans and Advances are the main assets used as a source of income in the banks and financial institutions. This ratio shows the proportion of current assets, which are invested as loans and advances to generate the income. It is expressed as:

$$\text{Loan and Advances to Current Assets Ratio} = \frac{\text{Loan and Advances}}{\text{Current Assets}}$$

c) Loan and Advances to Total Assets Ratio

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

$$\text{Loans and Advances to total assets ratio} = \frac{\text{Loan and Advances}}{\text{Total Assets}}$$

d) Total investment to total deposit ratio

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

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

e) Loans and Advances to Fixed Deposit Ratio

Loans and Advance clearly state that it is the assets of the bank and fixed deposit is the liability. So, this is the ratio between assets and liability. This helps to show the ratio of loan and advances to fixed deposit. We can also conclude that what part of the loan and advances is initiated against fixed deposit. It is calculated as:

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

f) Loan & Advances to Total Deposit Ratio

This ratio is calculated to find out how successfully the banks are utilizing their deposit on loan and advances for profit generating activities. Greater ratio indicates the better mobilization of collected deposit and vice-versa. However, it should be noted that too high ratio might not be better from liquidity point of view.

$$\text{Loans and advances to total deposit ratio} = \frac{\text{Loans and Advances}}{\text{Total Deposit}}$$

g) Investment to Loan & Advances Ratio

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

$$\text{Investment to Loan and Advances Ratio} = \frac{\text{Investment}}{\text{Loans and Advances}}$$

h) Liquid Fund to Loan & Advances Ratio

This ratio is calculated by dividing loan and advances to liquidate ratio. The Liquid fund includes-cash balance, money at call, etc. whereas Loan and advances includes short term loan and advances, overdraft, cash credit, local and foreign bills purchased, discounted etc.

$$\text{Liquid fund to loan and advances ratio} = \frac{\text{Loan and Advances}}{\text{Liquid Fund}}$$

II) Credit Efficiency Ratio

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

a) Provision for Possible Losses to total loans & advances ratio

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

Provision for Possible Losses to loans & advances ratio =

$$\frac{\text{Provision for Possible Losses}}{\text{Loans and Advances}}$$

b) Provision for Possible Losses to Net Interest Income Ratio (PPL/NII)

This ratio can obtain by dividing total Provision for Possible Losses by net interest income. This ratio measures the credit risk of bank. Higher ratio is the indicator of bad performance and positive growth rate of ratio is also indicator of bad performance and vice versa. This ratio is express as;

Provision for Possible Losses to net interest income ratio =

$$\frac{\text{Provision for Possible Losses}}{\text{Net Interest Income}}$$

c) Non-Performing loan to total loan & advances ratio

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

$$\text{Non-performing loan to total loan and advance ratio} = \frac{\text{Non Performing loan}}{\text{Loans and Advances}}$$

III) Loan & Advance Portfolio Analysis

These ratios help to measure the credit sector, portfolio and credit mix. Under this following ratios are used;

a) Priority Sector Credit to Total Credit Ratio

Priority sector includes micro and small enterprises. Micro and small enterprises are classified as agriculture enterprises, cottage, small industries and services. This ratio is calculated by dividing priority sector credit by total credit.

b) Sector Wise Credit to Total Credit Ratio

Sector wise credit to total credit ratio can be calculated by dividing sector wise credit by total credit of selected finance institution. Mainly following heading are found in the sector wise credit-Agriculture, Mining, Productions, Construction, Metal Productions, Machinery and Electrical, Tools and Fittings, Transportation, Equipment Production and Fitting, Communications and Public Service, Wholesalers and Retailers, Finance, Insurance and Fixed Assets, Service Industries, Consumable Loan, Local Government, Others.

c) Mix of Security Wise Loan and Advance

Under the security of loan and advances comparison, security status of selected institution is taken into consideration. Mainly following headings are found under the heading of security in the Nepalese scenarios-Gold/Silver, Government Securities, Non-Government Securities, Fixed A/c Receipt, Asset Guarantee, on bills Guarantee.

IV) Profitability Ratio

Profitability is one the way of firm’s performance. It measure effectiveness of any action of firm. Profitability ratio analysis is major analysis of any financial analysis. But for the credit management aspect profitability ratios which are related with credit are taken to examine credit management effectiveness. In this study following tools are taken for examine the credit.

a) Operating Profit to loan & advances ratio

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

$$\text{Operating profit to loans and advances ratio} = \frac{\text{Operating Profit}}{\text{Loans and Advances}}$$

b) Net profit to Loan & Advances ratio

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

$$\text{Net profit to loans and advances} = \frac{\text{Net Profit}}{\text{Loans and Advances}}$$

c) Net Interest Income to Total Loan & Advances Ratio

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

Net interest income to total loan and advance ratio

$$= \frac{\text{Net Interest Income}}{\text{Total Loan \& Advances Ratio}}$$

V) Analysis of Growth Rate

Growth rates of various variables are calculated for this analysis. These Growth rates are directly related to fund mobilization, investment and loan & advances management of banks. It represents how well the bank is maintaining its economic position.

To examine and analyze following growth ratios are calculated under this study.

- Growth rate of credit ratios
- Growth rate of credit efficiency ratio
- Growth rate of Profitability ratio

To evaluate the growth ratio of above mentioned ratios and variables following formula is used;

$D_1 = D_0 (1+g)$

$g = (D_1 / D_0) - 1$

Where,

D_1 = Total amount, percentage or times in 1st year

D_0 = Total amount, percentage or times in 0 year

g = Actual Growth rate

3.4.2 Statistical Tools

For supporting the study, statistical tool such as Mean, Standard Deviation, Coefficient of Variation, Correlation and diagrammatic cum pictorial tools have been used under it.

i. Arithmetic Means (average)

Arithmetic mean also called 'the mean' or 'average'. It is most popular and widely used measure of central tendency. Arithmetic Mean is statistical constants which enables us to comprehend in a single effort of the whole. Arithmetic mean represents the entire data by a single value. It provides the gist and gives the birds' eye view of the huge mass of a widely numerical data. It is calculated as:

$$\bar{X} = \frac{1}{n}\sum_{i=1}^{n} X_i$$

Where:

$\bar{X}$ = mean value or arithmetic mean

$\sum_{i=1}^{n} X_i$ = sum of the observation

N = number of observation

ii. Correlation Coefficient (r)

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

Formula

$$r_{xy} = \frac{N\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[N\Sigma X^2 - (\Sigma X)^2]}\sqrt{[N\Sigma Y^2 - (\Sigma Y)^2]}}$$

Whereas,

r_{xy} = Correlation between X and Y

$N\Sigma XY$ = No. of Product observation and Sum of product X and Y

$\Sigma X \Sigma Y$ = Sum of Product X and sum of Product Y

iii. Probable Error (P.E)

The probable error of the coefficient of correlation helps in interpreting its value. With the help of probable error, it is possible to determine the reliability of the value of the coefficient in so far as it depends on the conditions of random sampling. The probable error of the coefficient of correlation is obtained as follows:

$$P.E. = 0.6745 \frac{1 - r^2}{\sqrt{N}}$$

Here, r = Correlation coefficient

N = Number of pairs of observations

If the value of 'r' is less than the probable error, there is no evidence of correlation, i.e., the value of 'r' is not at all significant. Then, if the value of 'r' is more than six times of the probable error, the coefficient of correlation is practically certain, i.e., the value of 'r' is significant.

3.5 Limitation of the Research Methodology

The study is carried out in the framework of descriptive research design. So, it is difficult to illuminate the limitation of descriptive research designs, in which the study as well as the methodology is bounded. The major portion of the study has been done on the basis of secondary data and information so the consistency of findings and analysis are depend on the reliability of the secondary data and information.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

This chapter encompasses with the presentation, interpretation and analysis of relevant data of Om Finance Limited in order to fulfill the objectives of research study. To obtain better result, the data have been analyzed according to the research methodology as mentioned in third chapter. The purpose of this chapter is to introduce the mechanics of data analysis and interpretation. With the help of this analysis, efforts have been made to highlight credit management of OFl.

4.1 Credit Ratios

Credit analysis is done by applying various financial tools in order to clear picture on the OFL's credit composition from different aspect and its connection with different financial variables.

4.1.1 Loans and Advance to Current Assets Ratio

Loans and Advances is the major component in total assets, which includes the ability of bank and financial institution to canalize its current assets in the form of loan and advances to earn high return. If sufficient loan and advances can not be granted, it should pay interest on those utilize current asset funds and may lose earnings.

So, banks should provide loan and advances in appropriate level to find out portion of current assets, which is granted as loan.

Table 4.1

Loans and Advances to Current Assets Ratio

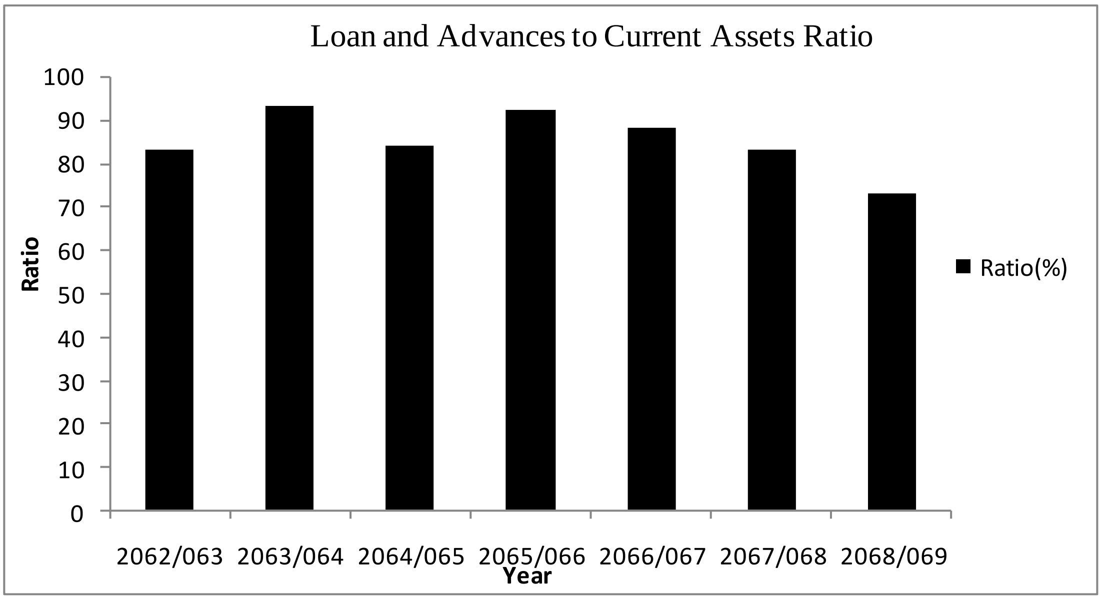
(Amounts in Millions**)**

Year	Loans and Advances	Current Assets	Ratio (%)
2062/063	456.57	550.56	83
2063/064	650.45	697.97	93
2064/065	895.83	1071.65	84
2065/066	1280.38	1381.97	92
2066/067	1466.75	1666.43	88
2067/068	1954.41	2344.92	83
2068/069	2521.09	3451.75	73
Mean			85

Source: Annual Reports of OFL

Table 4.1 shows that the total loan and advances to current assets ratio of OFL is in fluctuating trend. The highest ratio is 93% in year 2063/064 and lowest ratio is 73% in year 2068/069. The average mean ratio is 85% in the study period. High ratio indicates the good short term lending performance of OFL. Loan and advances to current assets ratio is also represented in figure 4.1.

Figure 4.1



4.1.2 Loan and Advances to Total Assets Ratio

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

Table 4.2

Loans and Advances to Total Assets Ratio

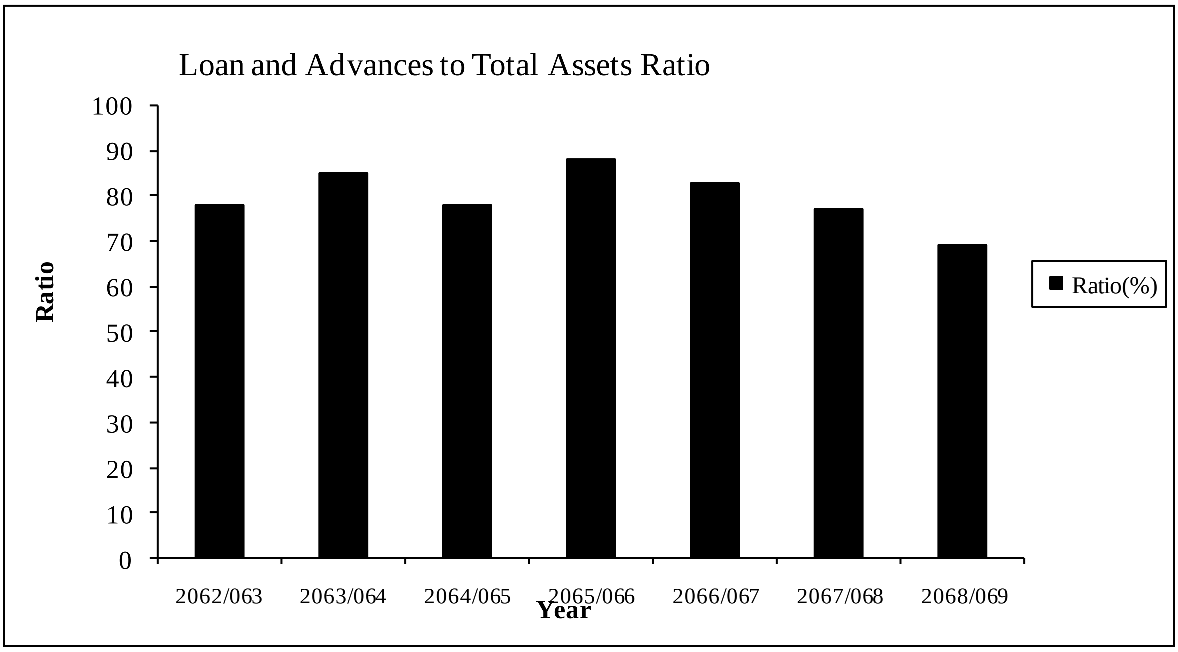
(Amounts in Millions**)**

Year	**Loans and Advances**	**Total Assets**	**Ratio (%)**
2062/063	456.57	586.71	78
2063/064	650.45	761.78	85
2064/065	895.83	1152.13	78
2065/066	1280.38	1452.81	88
2066/067	1466.75	1763.07	83
2067/068	1954.41	2543.43	77
2068/069	2521.09	3636.59	69
Mean			80

Source: Annual Reports of OFL

Table 4.2 shows the loan and advances to total assets ratio of OFL is in fluctuating trend during the study period. The ratios are 78%, 85%, 78%, 88%, 83%, 77% and 69% in their respective year. The highest ratio is 88% in the year 2065/066 and the lowest ratio 69% in the year 2068/069. High ratio of loan and advances to total assets shows the capability of OFL in utilizing total assets in form of loan and advances. Ratio is also represented in figure 4.2

Figure 4.2



4.1.3 Total Investment to Total Deposit Ratio

This ratio can be obtained by dividing total investment by total deposit. This ratio indicates the proportion of deposits utilized for the purpose of income generation as well as for maintaining liquidity in appropriate level. A high ratio is the indicator of high success of mobilizes deposits in securities and vice-versa. The seven year ratio is presented by table 4.2.3 and bar diagram.

Table 4.3

Total Investment to Total Deposit Ratio

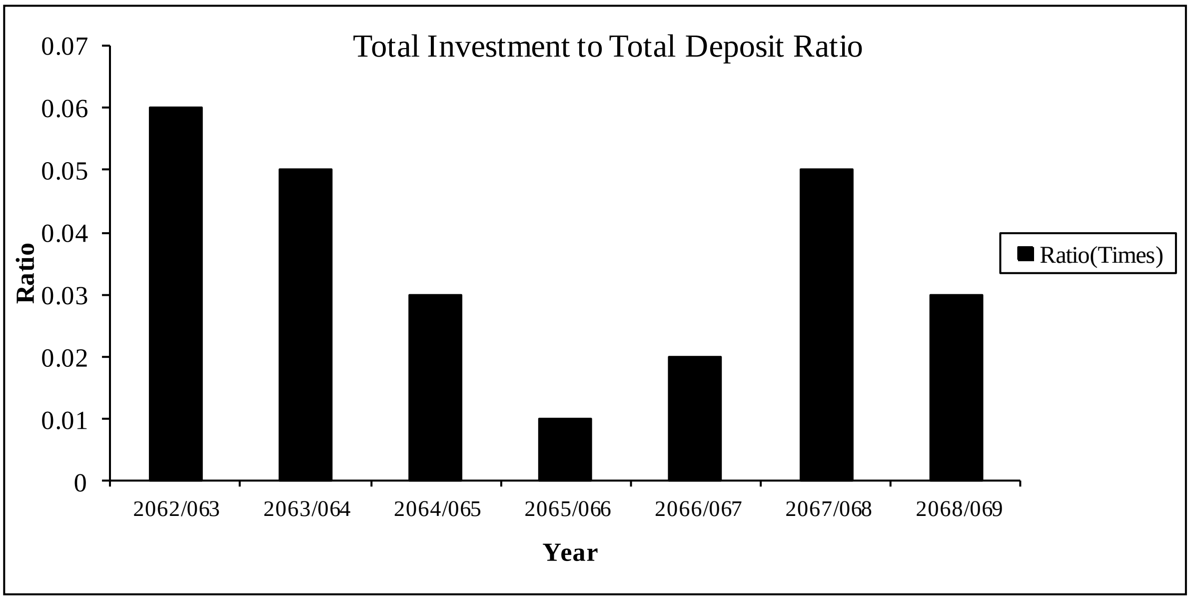
(Amounts in Millions)

Year	Total Investment	Total Deposit	Ratio (Times)
2062/063	28.05	484.14	0.06
2063/064	30.58	627.88	0.05
2064/065	25.58	922.27	0.03
2065/066	15.58	1168.34	0.01
2066/067	25.58	1527.28	0.02
2067/068	115.58	2162.36	0.05
2068/069	105.58	3227.57	0.03
Mean			0.04

Source: Annual Reports of OFL

Table 4.3 shows that the total investment to total deposit ratio of OFL is in more fluctuating trend. It may be due to slack in different sector of economy due to which OFL is unable to mobilize its fund in loan and advances and share and other securities. The Highest ratio is 0.06 times in year 2062/063 and lowest ratio 0.01 times in year 2065/066. High ratio shows the ability of mobilizing their deposits on investment in various securities. Total investment to total deposit ratio is presented in figure 4.3.

Figure 4.3



4.1.4 Loans and Advances to Fixed Deposit Ratio

Fixed deposits are the long-term interest bearing obligations and loan and advances are the major sources of investment to generate income. A high ratio indicates the high success to mobilize the fixed deposits as loan and advances and vice-versa.

Table 4.4

Loans and Advances to Fixed Deposit Ratio

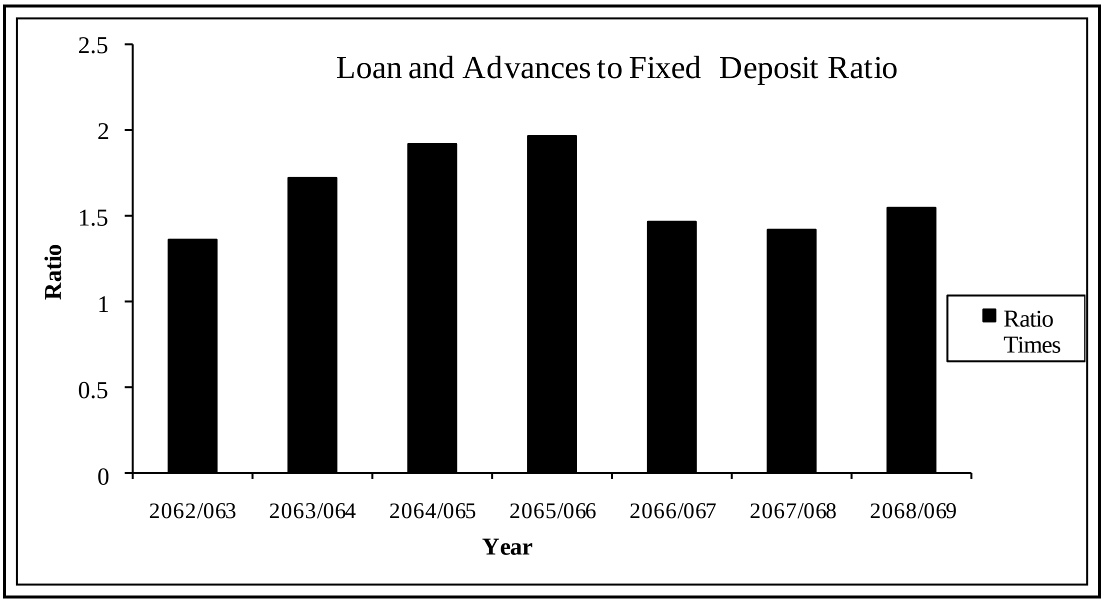
(Amounts in Millions)

Year	Loans and Advances	Fixed Deposit	Ratio (Times)
2062/063	456.57	336.11	1.36
2063/064	650.45	377.76	1.72
2064/065	895.83	466.89	1.92
2065/066	1280.38	649.76	1.97
2066/067	1466.75	1005.75	1.46
2067/068	1954.41	1373.82	1.42
2068/069	2521.09	1625.91	1.55
Mean			1.63

Source: Annual Reports of OFL

Table 4.4 shows that Loan and advances to fixed deposit ratio of OFL. During the study period, movements of ratios are first increasing then decreasing and again increasing trend. The ratio of OFL was 1.36 times in 2062/2063 and increased in 2065/066 up to 1.97 times after those ratios are in decreasing trend i.e. 1.46 and 1.42 times in the following year respectively and again increased up to 1.55 times in 2068/069. The mean ratio is 1.63 times at research period. Loan and advances to fixed deposit ration is represented in figure 4.4.

Figure 4.4



4.1.5 Loans and Advances to Total Deposit Ratio

Loans and advances is the investing activities of bank and total deposit is the deposit amount of the bank collected from its customer or depositor. This ratio is calculated to find out how successfully the selected banks or financial institutions are utilizing their total deposits on loan and advances for the purpose of income generation. A high ratio indicates better mobilization of collected deposit and vice –versa. However, it should be noted that too high ratio might not be better from the liquidity point of view.

Table 4.5

Loans and Advances to Total deposit Ratio

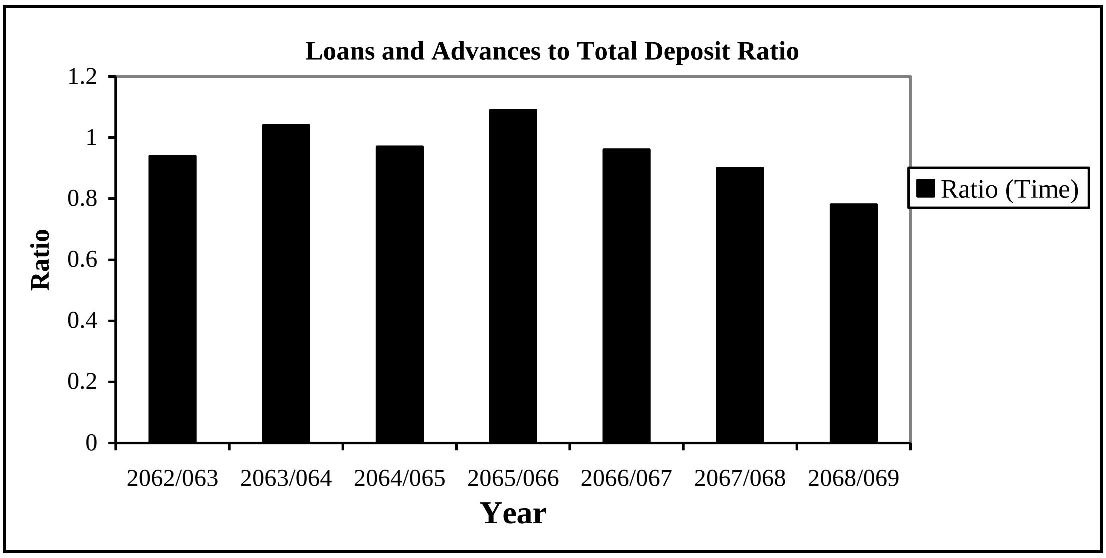
(Amounts in Millions)

Year	Loans and Advances	Total Deposit	Ratio (Times)
2062/063	456.57	484.12	0.94
2063/064	650.45	627.88	1.04
2064/065	895.83	922.27	0.97
2065/066	1280.38	1168.34	1.09
2066/067	1466.75	1527.28	0.96
2067/068	1954.41	2161.97	0.90
2068/069	2521.09	3227.52	0.78
Mean			0.95

Source: Annual Reports of OFL

Table 4.5 shows that the total loan and advances to total deposit ratio of OFL is in fluctuating trend up to 2065/066 and after that the ratios are decreasing trend. The highest ratio is 1.09 times in year 2065/066 and lowest in year 2068/069. The average mean ratio of OFL is 0.95 times in the study period. This means OFL is able to proper mobilization of collected deposit. The ratio is up to 80% is good for NRB directives. So all of the year OFL has utilized its deposit to provide loan. Loan and advances to total deposit ratio in presented in figure 4.5.

Figure 4.5



4.1.6 Total Investment to Loan and Advances Ratio

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

Table 4.6

Total Investment to Loan and Advances Ratio

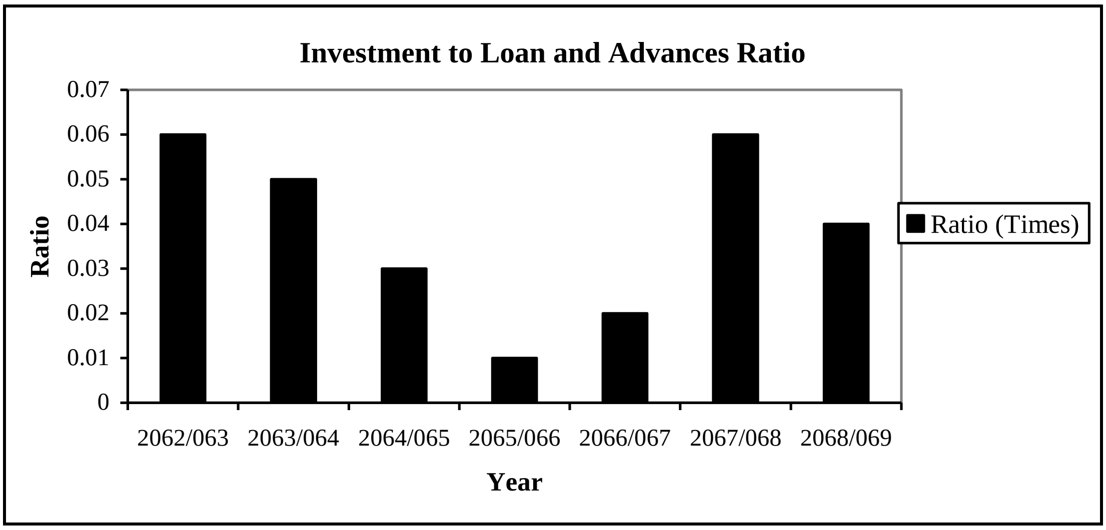
(Amounts in Millions)

Year	Investment	Loans and Advances	Ratio (Times)
2062/063	28.05	456.57	0.06
2063/064	30.58	650.45	0.05
2064/065	25.58	895.83	0.03
2065/066	15.58	1280.38	0.01
2066/067	25.58	1466.75	0.02
2067/068	115.58	1954.41	0.06
2068/069	105.58	2521.09	0.04
Mean			0.04

Source: Annual Reports of OFL

Table 4.6 shows total investment to total loans and advances ratio for seven years period. In 2062/063 ratio was 0.06 times and decreased by 0.05, 0.03 and 0.01 times in 2063/064, 2064/065, 2065/066 respectively. Again it reached to 0.02, 0.06 and 0.04 times in 2066/067, 2067/068 and 2068/069 respectively. It has a fluctuation trend. The mean ratio for the seven year period is 0.04 times. Total Investment to loan and advances ratio is also represented in figure 4.6.

Figure 4.6



4.1.7 Liquid Fund to Loan and Advances Ratio

This ratio is calculated by dividing liquid fund by Loan and advances. Liquid fund includes-cash balance, money at call, etc. whereas Loan and advances includes short term loan and advances, overdraft, cash credit etc.

Table 4.7

Liquid Fund to Loans and Advances Ratio

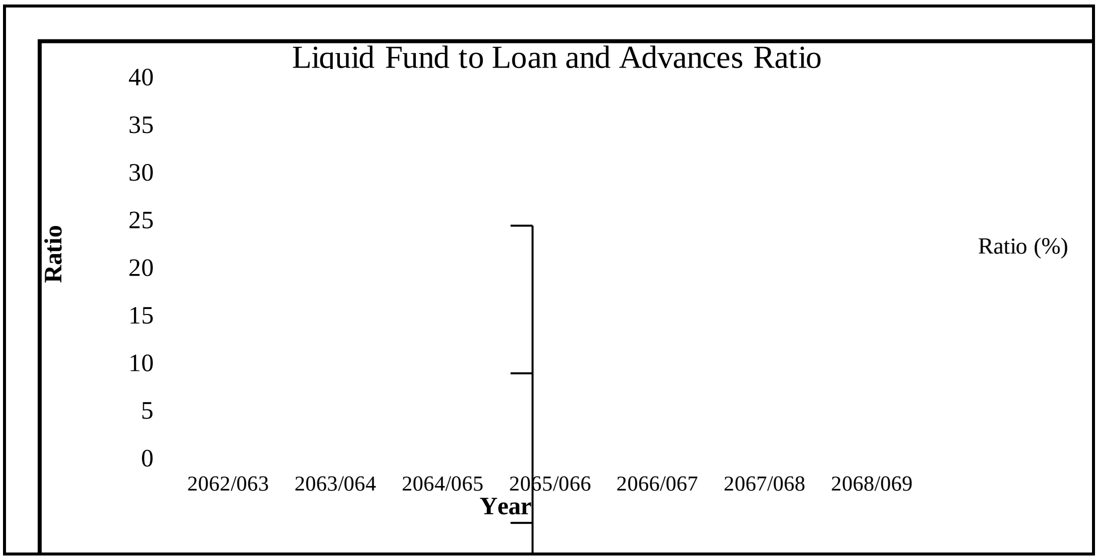
(Amounts in Millions)

Year	Liquid Fund	Loans and Advances	Ratio (%)
2062/063	103.85	456.57	23
2063/064	59.29	650.45	9
2064/065	188.69	895.83	21
2065/066	117.37	1280.38	9
2066/067	217.72	1466.75	15
2067/068	414.12	1954.41	21
2068/069	962.74	2521.09	38
Mean			19

Source: Annual Reports of OFL

Table 4.7 shows liquid fund to loans and advances ratio of OFL is in more fluctuating trend during the study period of seven years. In the fiscal year of 2068/069 the OFL has highest ratio 38% and the lowest of 9% in the fiscal year 2068/069 and 2063/064 respectively. It tells that OFL maintained average 19% of liquid fund of loans and advances. This ratio indicates increment of liquid fund is greater than increment in loans and advances which results increment in ideal cash. Increment in ideal cash is not good from the standpoint of investment aspect. Liquid fund to loans and advance ratio can be shown in figure 4.7.

Figure 4.7



4.2 Credit Efficiency Ratio

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

4.2.1 Provision for Possible Losses to Total Loans and Advances Ratio

Provision for Possible Losses to total loan and advances ratio is calculated by dividing Provision for Possible Losses by total loan and advances. The low ratio indicates the good quality of assets in total volume of loan and advances. High ratio indicates more risky assets in total volume of loan advances.

Table 4.8

Provision for Possible Losses to Total Loans and Advances Ratio

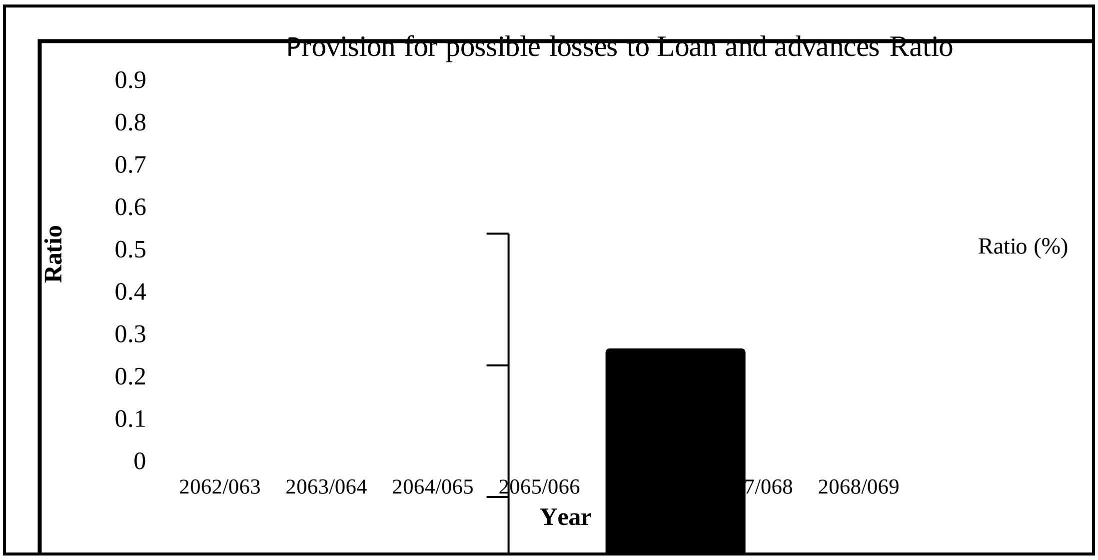
(Amounts in Millions)

Year	Provision For Possible Losses	Loans and Advances	Ratio (%)
2062/063	3.74	456.57	0.81
2063/064	1.91	650.45	0.29
2064/065	1.11	895.83	0.12
2065/066	2.81	1280.38	0.22
2066/067	2.35	1466.75	0.16
2067/068	5.56	1954.41	0.28
2068/069	8.48	2521.09	0.34
Mean			0.32

Source: Annual Reports of OFL

Table 4.8 shows total provision for possible losses to total loans and advances ratio of OFL is in fluctuating trend. In 2062/063 the OFL has highest ratio of 0.84% and the lowest ratio of 0.12% in 2064/065. The average ratio for seven year period is 0.32%. Provision for possible losses to total loan and advances ratio also represent in figure 4.8.

Figure 4.8



4.2.2 Provision for Possible Losses to Net Interest Income Ratio (PPL/NII)

PPL/ NII ratio can be calculated by dividing PPL by NII. This ratio measures the credit risk of bank. Higher ratio is the indicator of bad performance and vice-versa.

Table 4.9

Provision for Possible Losses to Net Interest Income Ratio

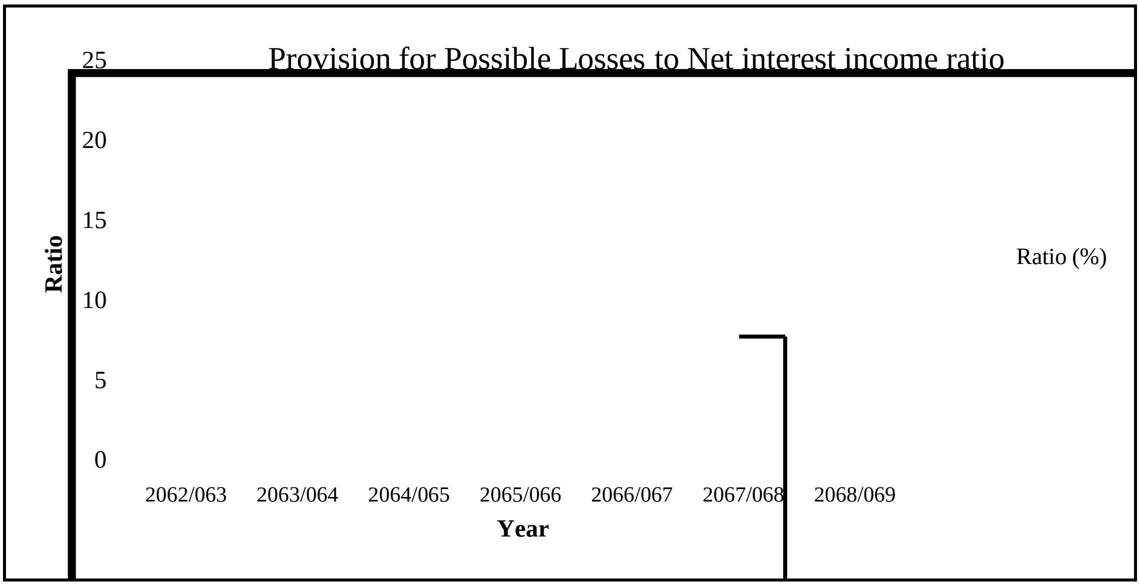
(Amounts in Millions)

Year	Provision For Possible Losses	Net Interest Income	Ratio (%)
2062/063	3.74	18.62	20.08
2063/064	1.91	20.85	9.16
2064/065	1.11	29.25	3.79
2065/066	2.81	45.69	6.15
2066/067	2.35	73.55	3.19
2067/068	5.56	102.77	5.41
2068/069	8.48	121.68	6.97
Mean			7.8

Source: Annual Reports of OFL

Table 4.9 shows the seven year PPL/NII ratio of OFL is fluctuating in nature. The highest ratio is 20.08% in year 2062/063 and lowest ratio 3.29% in year 2066/067. The average mean ratio of the study period is 7.8%. Provision for possible losses to net interest income is presented in figure 4.9.

Figure 4.9



4.2.3 Non-Performing Loan to Total Loan and Advances Ratio

Non-performing loans to total loan and advances ratio shows the percentage of non-recovery loan in total loan and advances. NPL are those loans that borrowers are delaying payments of installments and interest longer time. Generally, a loan is considered non-performing if the borrower hasn't made payments for 90 days. These types of loans are close to being considered in default, and on the verge of being written off and absorbed as a loss by the bank. If the borrower does start making payments on the loan, even after the 90 days have passed, the loan is considered re-performing. A re-performing loan is considered a risk as well, since it's possible that the borrower, having once stopped making payments, will stop making payments again. Increasing in NPL affects in overall banking business, loan loss provision amount will increase and profit will decrease. Higher ratio shows the low efficient operating of the management and vice-versa.

Table 4.10

Non- Performing loan to Total Loans and Advances Ratio

(Amounts in Millions)

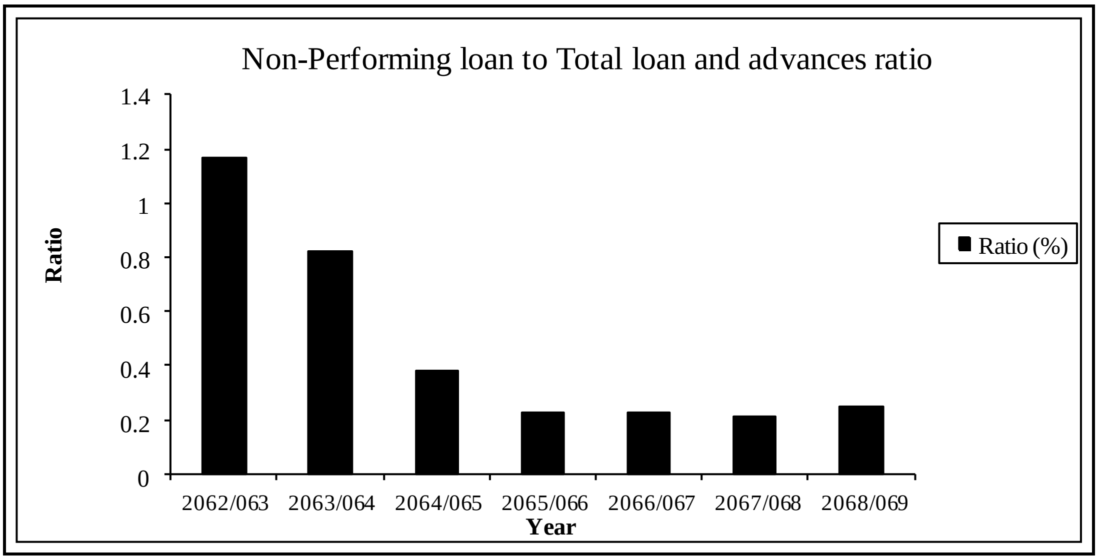
Year	Non-Performing Loan	Loans and Advances	Ratio (%)
2062/063	5.34	456.57	1.17
2063/064	5.31	650.45	0.82
2064/065	3.38	895.83	0.38
2065/066	2.91	1280.38	0.23
2066/067	3.40	1466.75	0.23
2067/068	4.09	1954.41	0.21
2068/069	6.18	2521.09	0.25
Mean			0.47

Source: Annual Reports of OFL

Table 4.10 shows that Non-Performing loan to total loan and advances of OFL. During the study period, movements of ratios are first decreasing and again slightly increased in year 2068/069. The highest ratio is 1.17% in year 2062/063 and lowest ratio is 0.21% in year 2067/068. The average mean ratio is 0.47% during the study period. This ratio indicates the more efficient operating of credit management.

Decreasing trend of ratios indicate the decreasing trend of non-performing loan. Non-performing loan to total loan and advances ratio is presented in figure 4.10.

Figure 4.10



4.3 Loans and Advances Portfolio Analysis

These ratios help to measure the credit sector, portfolio and credit mix. Under this following ratios are used;

4.3.1 Priority Sector Credit to Total Credit Ratio

Priority sector includes micro and small enterprises. Micro and small enterprises are classified as agriculture enterprises, cottage, small industries and services. This ratio is calculated by dividing priority sector Loan by total credit.

Table 4.11

Priority Sector to Total Credit Ratio

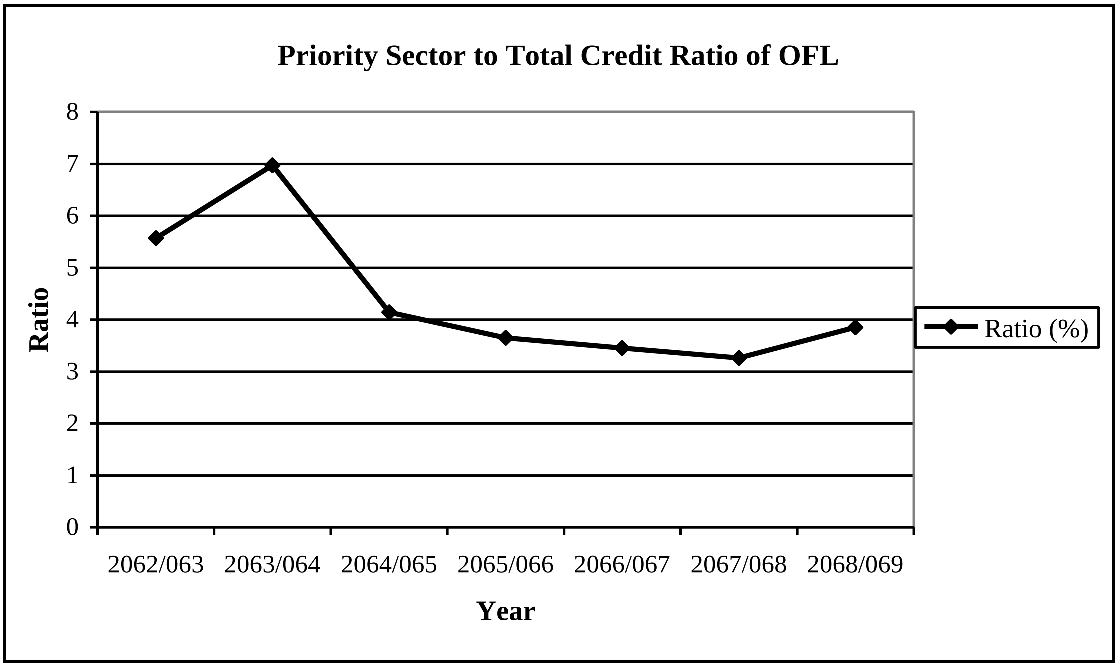
(Amounts in Millions)

Year	Priority Sector Loan	Total Credit	Ratio (%)
2062/063	25.46	456.57	5.57
2063/064	45.35	650.45	6.97
2064/065	37.08	895.83	4.14
2065/066	46.79	1280.38	3.65
2066/067	50.70	1466.75	3.45
2067/068	63.72	1954.41	3.26
2068/069	97.07	2521.09	3.85
Mean			4.41

Source: Annual Reports of OFL

Table 4.11 shows the OFL's credit on priority sector. OFL spent 5.57% credit on total credit in year 2062/063 and reached to 6.97% in year 2063/064. Thereafter it declined by 4.14%, 3.65%, 3.45% and 3.26% in the following years respectively and again in 2068/069 it increased by 3.85%. The average ratio for seven year period is 4.41%. OFL mobilized the highest fund of 6.97% in 2063/064 to the priority sector. Priority sector to total deposit is presented in figure 4.11.

Figure 4.11



4.3.2 Sector Wise Credit to Total Credit Ratio

Sector wise credit to total credit ratio can be calculated by dividing sector wise credit by total credit of OFL. Mainly following heading are found in the sector wise credit- Agriculture, Mining, Productions, Construction, Metal Productions, Machinery and Electrical, Tools and Fittings, Transportation, Equipment Production and Fitting, Communications and Public Service, Wholesalers and Retailers, Finance, Insurance and Fixed Assets, Service Industries, Consumable Loan, Local Government, and Others.

Table 4.12

Sector Wise Credit to Total Credit Ratio (%)

Sector	062/063	063/064	064/065	065/066	066/067	067/068	068/069	Mean
Agriculture	3.48	3.9	3.12	4.21	4.01	4.13	4.07	3.85
Mining	0.05	0.11	0.09	0.07	0.13	0.13	0.13	0.10
Production	24.88	29.74	26.34	25.24	27.73	29.27	28.90	27.44
Construction	2.71	2.96	3.91	4.61	2.96	2.12	3.30	3.22
Metal Production, Machinery and Electrical tools and fitting	0.58	1.11	1.71	1.42	1.17	1.24	1.30	1.22
Transportation, Equipment Production and Fitting	0.61	0.41	0.52	0.58	0.41	0.43	0.46	0.49
Communication and Public Services	6.26	8.28	7.46	9.26	7.28	6.69	7.11	7.48
Wholesalers and Retailers	18.62	14.95	16.29	17.32	18.09	19.10	17.16	17.36
Finance Insurance and Fixed Asset	5.02	9.16	11.06	9.16	8.73	9.22	8.73	8.72
Services Industries	3.42	1.86	2.26	2.74	1.97	2.08	2.13	2.35
Consumable Loan	26.52	18.23	18.93	18.47	20.13	20.25	21.43	20.57
Local Government	0	0	0	0	0	0.00	0.00	0.00
Others	7.85	9.29	8.31	6.92	7.39	5.35	5.28	7.20
Total	100	100	100	100	100	100	100	100

Source: Annual Reports of OFL

Table 4.12 shows seven year period loans and advances of OFL in different sector with their respective percentage. OFL is providing credit to more than 12 different sectors. Production, consumable loan and wholesalers and retailer loan seems major areas of providing credit. After that finance insurance and communication and public service, fixed assets and other sector are other areas of providing credit. It provides credit to agriculture, service industries and contractions industries less prefers then above mentioned two sectors. The sectors which OFL prefers less are Metal

Production, Machinery and Electrical tools, Fitting, Mining, Transportation, and Equipment Production and Fitting. Mean ratio of all sector wise credit is presented by figure 4.12.

Figure 4.12

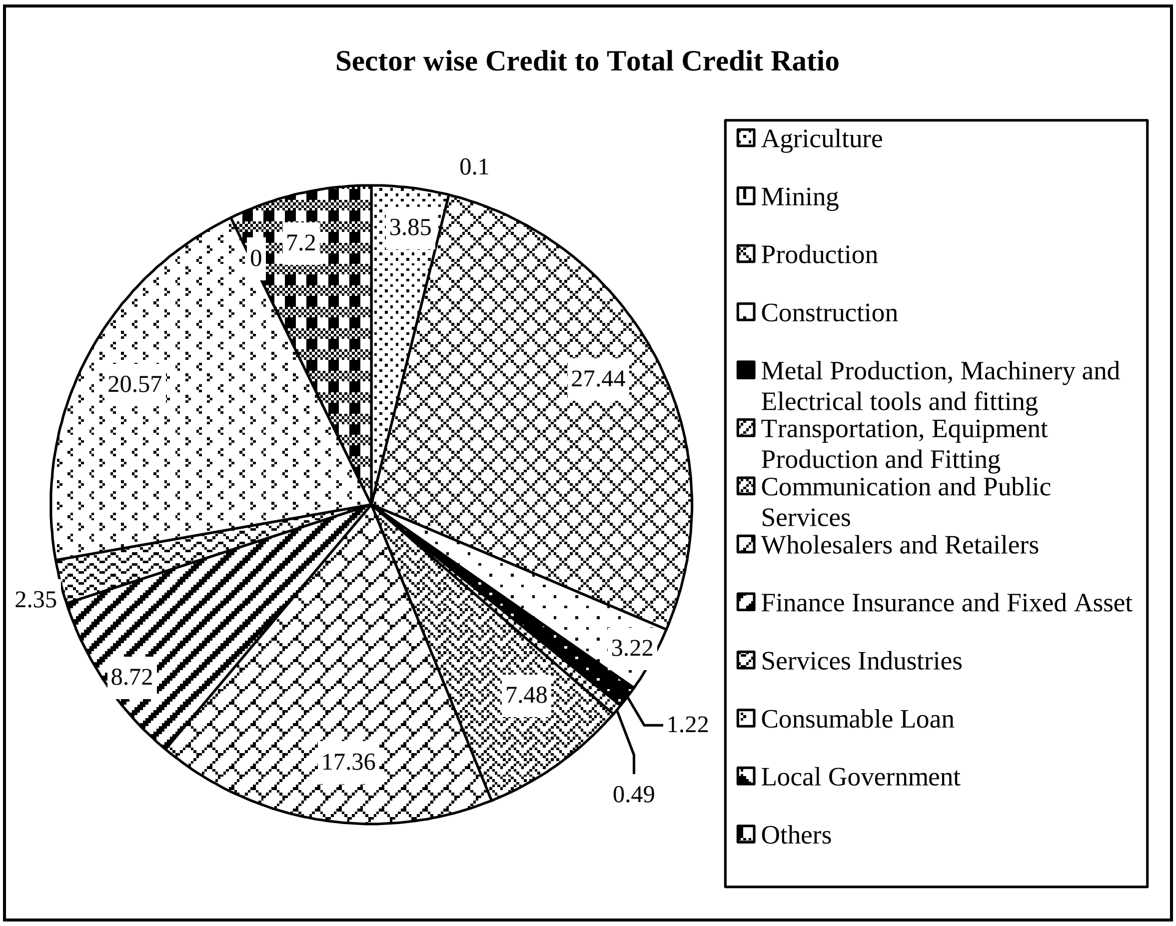


Figure 4.12 shows the mean percentage cover by different loan. The percentage cover by agriculture is hardly 4%. Another sector mining covers less than 1% loan for seven year period. Production sector seems major credit sector of credit it covers almost 27% of total loan. Construction sector covers around 3%, Metal Production, Machinery and Electrical tools and fitting sector is nearly one percent, transportation sector is very low then one percentage, telecommunication and public service sector slightly more than 7%, consumable loan covers slightly more than 20% of total loans, and wholesaler and retailer sector covers slightly more than 17%.

4.3.3 Mix of Security Wise Loan and Advance

Under the security of loan and advances comparison, security status of OFL is taken into consideration. Mainly following headings are found under the heading of security in the Nepalese scenarios-Gold/Silver, Government Securities, Non-Government Securities, Fixed A/c Receipt, Asset Guarantee, on bills Guarantee.

Table 4.13

Mix of Security wise Loan and Advances

(Amounts in Thousands)

Detail/Year	062/063	063/064	064/065	065/066	066/067	067/068	068/069
Movable/Immovable Assets	543,664	693,719	885,192	1,129,513	1,441,269	1,839,072	2,346,672
Guarantee of Local Licensed Institutions		0	0	0	0	0	0
Government Guarantee		0	0	0	0	0	0
Internationally Rated Bank Guarantee		0	0	0	0	0	
Export Documents		0	0	0	0	0	
Fixed Deposit Receipts Own	14,580	22,050	33,346	50,429	76,265	115,336	174,424
Fixed Deposit Receipts Other Licensed Institutions		0	0	0	0	0	
Government Securities		0	0	0	0	0	
Counter Guarantee		0	-	0	-	0	
Personal Guarantee		0	-	-	2,081,338	0	
Other Securities		0	-	-	-	0	0
Total	558,244	715,769	918,538	1,179,943	3,598,872	1,954,408	2,521,096

Source: Annual Reports of OFL

Table 4.13 shows seven year period security wise loan and advances. The security on moveable/immovable assets are 543,664 thousand, 693,719 thousand, 885,192 thousand, 1,129,513 thousand, 1,441,269 thousand, 1,839,072 thousand and 2,346,672 thousand in year 2062/063 to 2068/069 respectively. Similarly, in year 2062/063 to 2068/069 fixed deposit receipts own 14,580 thousand, 22,050 thousand 33,346 thousand, thousand 50,429 thousand, 76,265 thousand, 115,336 thousand, and

174,424 thousands respectively. Guarantee of Local Licensed Institutions, Securities hold on export documents are Export Documents, Security holds on fixed deposit. Security holds on fixed deposit, Security holds on government security and Security holds in counter guarantee are zero for the study period.

4.4 Profitability Ratios

Profit is an indispensable factor in any business organization. It is the outcome of monetary or non-monetary efforts that a bank or financial institution made from clients. Profitability ratios are very helpful to measure the overall operation efficiency of a financial institution. Profitability ratio analysis is major analysis of any financial analysis but for the credit management aspect profitability ratios which are related with credit are taken to examine credit management effectiveness. In this section major profitability ratios like Operating profit to loans and advances ratio, Net profit to loans and advances ratio and interest income to loans and advances ratios are examined in detail.

4.4.1 Operating Profit to Loan and Advances Ratio

Operating profit to loan and advances ratio measures the earning capacity of bank and financial institutions. This ratio is calculated dividing operating profit by loan and advances.

Table 4.14

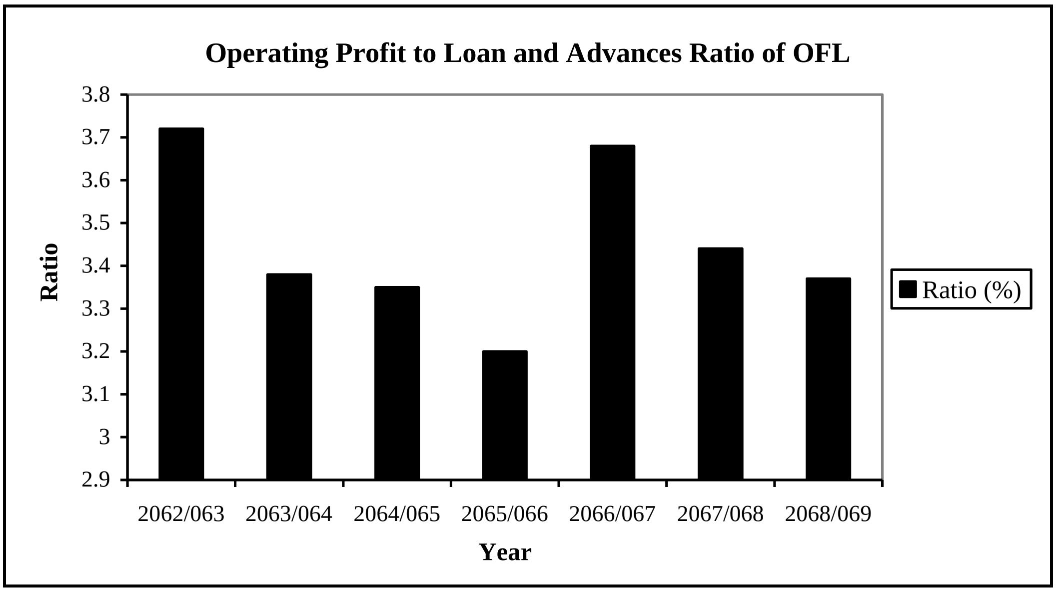
Operating Profit to Loans and Advances Ratio

Year	Operating Profit	Loans and Advances	Ratio (%)
2062/063	16.98	456.57	3.72
2063/064	21.98	650.45	3.38
2064/065	29.99	895.83	3.35
2065/066	41.02	1280.38	3.20
2066/067	53.96	1466.75	3.68
2067/068	67.15	1954.41	3.44
2068/069	85.08	2521.09	3.37
Mean			3.45

Source: Annual Reports of OFL

Table 4.14 shows that the operating profit to loan and advances ratio of OFL is in fluctuating trend. The highest ratio is 3.72% in the year 2062/063 and lowest ratio is 3.20% in the year 2065/066. The average mean ratio over the period is 3.45%. This shows the high profitability in 2062/063 and low profitability in 2065/066 through loan and advance of OFL. It is concluded that higher ratio indicates the success in maintaining its higher return on loan and advance. Operating profit to loan and advances ratio is also presented in figure 4.13.

Figure 4.13



4.4.2 Net Profit to Loan and Advances Ratio

This ratio measures the earning capacity of bank and financial institution through its fund mobilization as loan and advances. Higher ratio indicates greater success to mobilize fund as loan and advances and vice-versa.

Table 4.15

Net Profit to Loans and Advances Ratio

(Amounts in Millions)

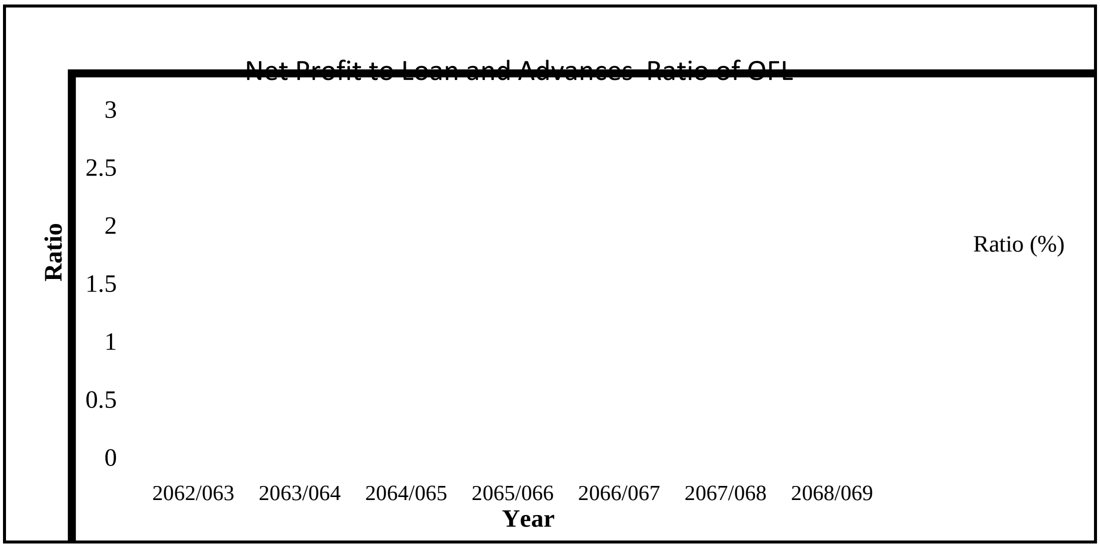
Year	Net Profit	Loans and Advances Ratio	Ratio (%)
2062/063	10.88	456.57	2.38
2063/064	13.69	650.45	2.10
2064/065	18.68	895.83	2.09
2065/066	26.14	1280.38	2.04
2066/067	28.46	1466.75	1.94
2067/068	40.32	1954.41	2.06
2068/069	60.15	2521.09	2.39
Mean			2.14

Source: Annual Reports of OFL

Table 4.15 shows net profit to loans and advances ratio of OFL is in not more fluctuating trend. The highest ratio is 2.39% in the year 2068/069 and lowest ratio

1.94% in the year 2066/067. The average mean ratio over the period is 2.14% which shows the normal earning capacity of OFL through loan and advance. Net profit and loan and advances is also represented in figure 4.14.

Figure 4.14



4.4.3 Net Interest Income to Total Loan and Advances Ratio

It tells the income as interest from total loan and advances. It is useful to know the fact that whether the loan has given good return or not. Interest can be increased by the help of good credit policy and its effective implementation. High returns show the soundness of credit policy and vice-versa.

Table 4.16

Net Interest Income to Loans and Advances Ratio

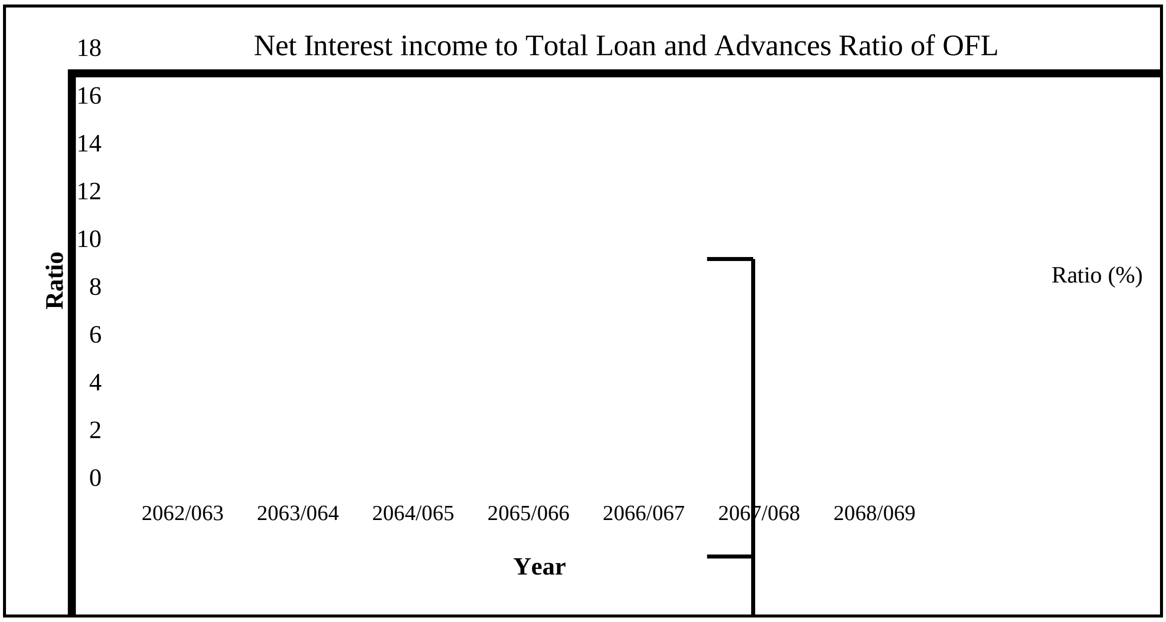
(Amount of Millions)

Year	Net Interest Income	Loans and Advances	Ratio (%)
2062/063	56.61	456.57	12.40
2063/064	68.61	650.45	10.55
2064/065	92.21	895.83	10.29
2065/066	132.27	1280.38	10.33
2066/067	205.47	1466.75	14.01
2067/068	327.30	1954.41	16.75
2068/069	426.33	2521.09	16.09
Mean			12.92

Source: Annual Reports of OFL

Table 4.16 shows the ratios of interest income to loan and advances of OFL over the seven years study period. The ratios are 12.40%, 10.55%, 10.29%, 10.33%, 14.03%, 16.75% and 16.09% in the year 2062/063 to 2068/069 respectively. The mean ratio remains 12.92% in the seven years study period. The ratio was in increasing trend after the year 2064/065 and slightly stepping downward in ending study period. High ratio means able to grant its credit in high interest earning area. Net interest income to loan and advances ratio is presented in figure 4.15.

Figure 4.15



4.5 Analysis of Growth Rate

In this section analysis of different loans and advances to relate variables have been made. These analysis gives to close information of credit policy and management. These informations are useful to draw concrete conclusions and provide suitable recommendations.

4.5.1 Growth Analysis of Loans & Advances

The growth of loans and advances for seven year period is presented by table 4.17.

Table 4.17

Growth Rate of Loans and Advances

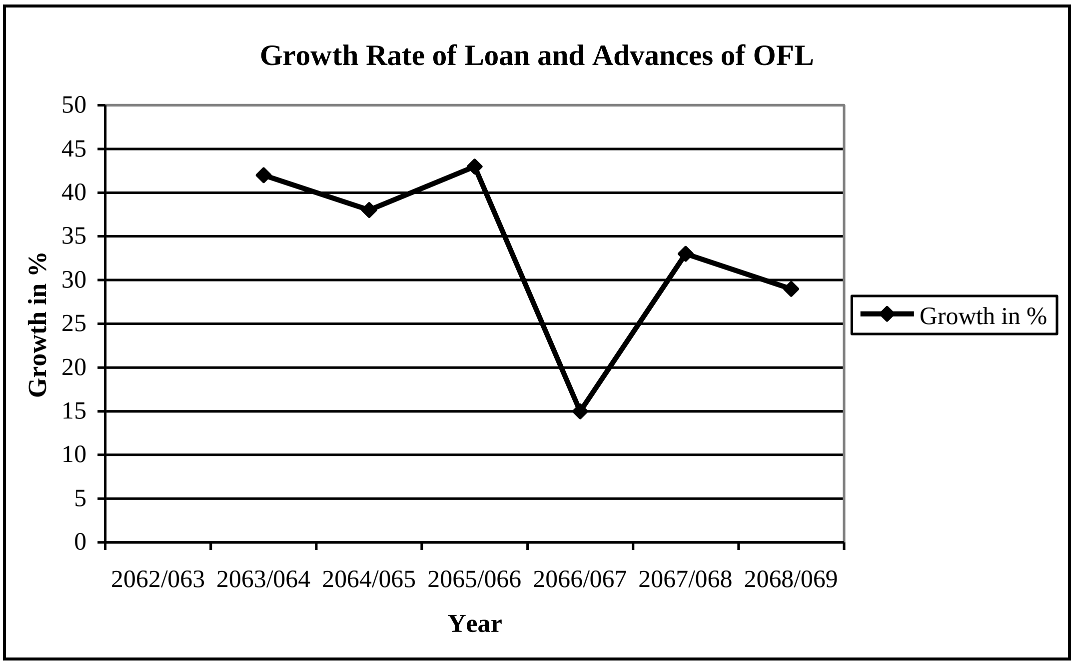
(Amount in Millions)

Year	Loans and Advances	Growth in %
2062/063	456.57	
2063/064	650.45	42
2064/065	895.83	38
2065/066	1280.38	43
2066/067	1466.75	15
2067/068	1954.41	33
2068/069	2521.09	29
Mean		34

Source: Appendix I

Table 4.17 shows growth rate of loans and advances of OFL is in fluctuating trend. The ratios are 42%, 38%, 43%, 15%, 33% and 29% in the year 2063/064 to 2068/069. The highest rate is 43% and lowest ratio is 15% in the year 2065/066 and 2066/067 respectively. The average mean rate is 34% in the study period. The continuous positive growth rate shows positive growth in loan and advances in the study period. Growth rate of loan and advances is also presented in figure 4.16.

Figure 4.16



4.5.2 Growth Analysis of Provision for Possible Losses

The growth of provision for possible losses for seven year period is presented by table 4.18.

Table 4.18

Growth Rate of Provision for Possible Losses

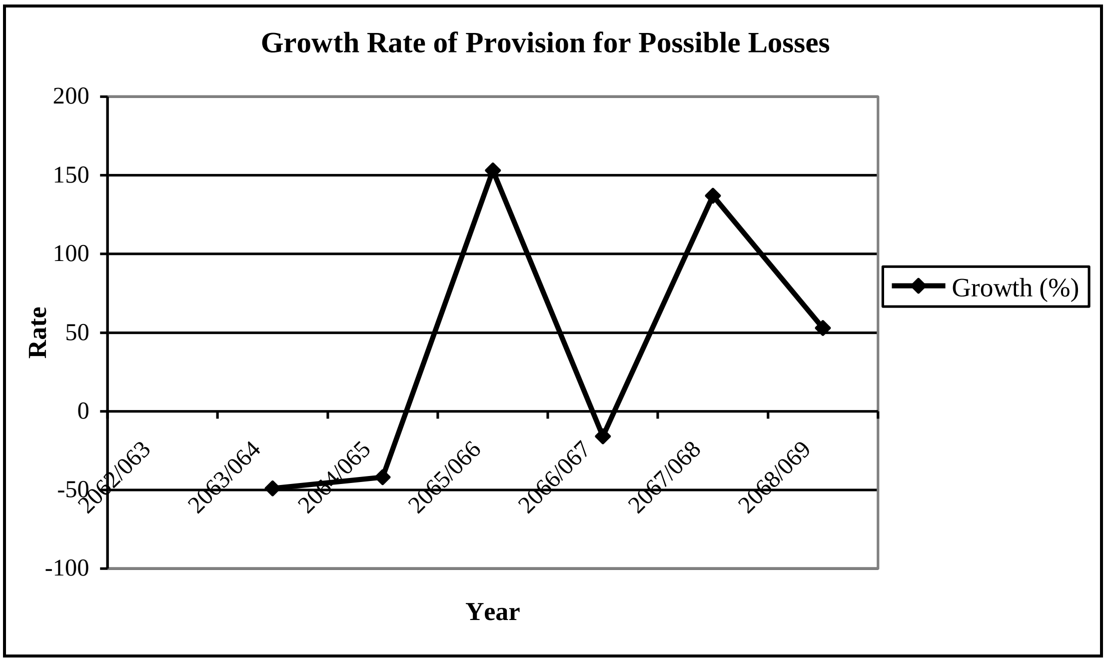
(Amount in Millions)

Year	Provision for possible losses	Growth (%)
2062/063	3.74	
2063/064	1.91	-49
2064/065	1.11	-42
2065/066	2.81	153
2066/067	2.35	-16
2067/068	5.56	137
2068/069	8.48	53
Mean		34

Source: Appendix I

Table 4.18 shows growth rate of provision for possible losses of OFL is in fluctuating trend. The negative growth rates are -49%, -42% and -16% in the year 2063/064, 2064/065 and 2066/067 respectively. Positive growth rate of provision for possible losses indicates increasing trend of doubtful debt. The average mean is 34% during the study period. Growth rate of provision for possible losses is presented in figure 4.17.

Figure 4.17



4.5.3 Growth Analysis of Net Interest Income

The growth of net interest income is shown by table 4.19.

Table 4.19

Growth Rate of Net Interest Income

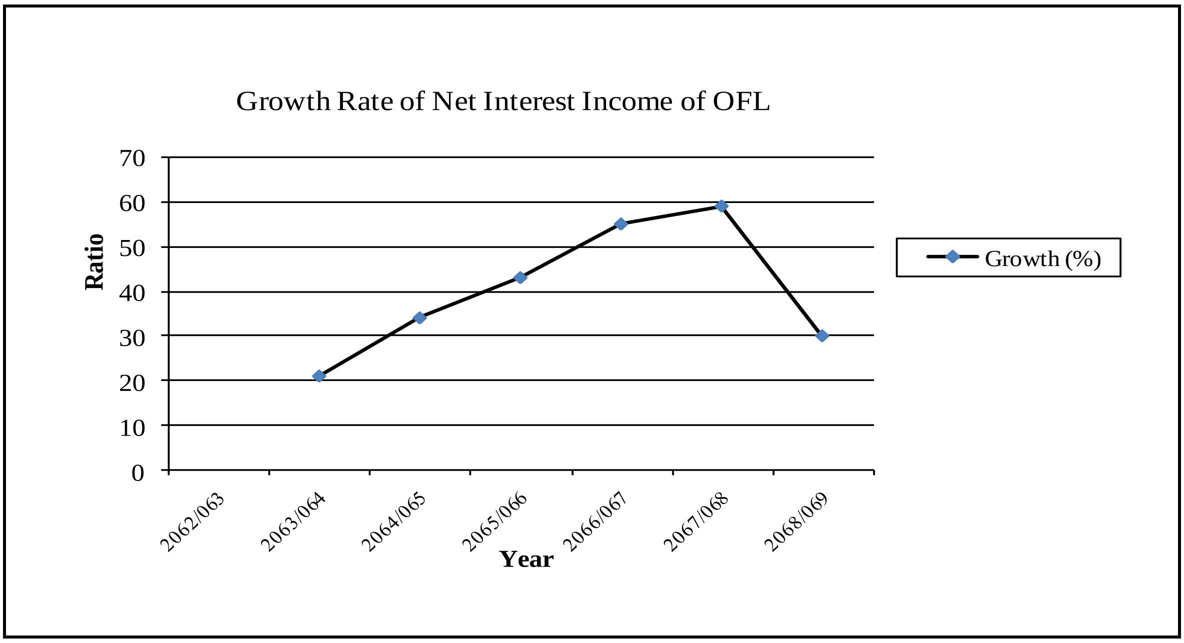
(Amounts in millions)

Year	Net Interest Income	Growth (%)
2062/063	56.61	
2063/064	68.61	21
2064/065	92.21	34
2065/066	132.27	43
2066/067	205.47	55
2067/068	327.30	59
2068/069	426.33	30
Mean		40

Source: Appendix I

Table 4.19 shows growth of net interest income of OFL during the seven year study period. Growth rate of net interest income is 21% in year 2063/064 and continuously increasing up to 2067/068 and decreased by 30% in year 2068/069. The average growth rate of 40% tells that OFL is success to increases interest income during study period. If other things remain constant the increment in net interest will be good indicator of loan management. Growth rate of net interest income is also represented in figure 4.18.

Figure 4.18



4.6 Coefficient of Correlation Analysis

This analysis identifies and interprets the relationship between two or more variables. It describes the relationship between variables is positive or negative. Under this topic, Karl Pearson's coefficient of correlation is used to find out the relationship between variables. In this section, correlation between total loans & advances and net profit, correlation between total loans & advances and net interest income, correlation between total deposit and loan & advances and correlation between non-performing loan and net profit of OFL have been analyzed.

4.6.1 Correlation between Loan & Advances and Net Profit

Total loan & advances is independent variable and net profit is dependent variable. The main objectives of computing 'r' between these two variables are to justify whether total loan & advances are significantly used to earn profit in a proper away or not. The value of 'r' explains whether a percentage change in total loan & advances contribute to change the same percentage of net profit or not. Following table shows the correlation between them.

Table 4.20

Correlation between Loans & Advances and Net Profit

	Correlation	P.E
Correlation between Loans & Advances and Net Profit	0.99	0.0050

Source: Appendix II

Table 4.20 shows that there is positive relationship between total loan & advances and net profit of OFL. That means, if total loan & advances is increased absolutely the net profit is also increased and vice-versa. The correlation between them is 0.99 and the P.E is 0.0050. Comparing the value of 'r' and 6 times P.E., we can say that there is significantly positive relationship between total loan & advances and net profit because 'r' is greater than 6 times of P.E. i.e. 0.99>0.03.

From the above analysis, it can be concluded that OFL has positive relationship with significant between total loan & advances and net profit. The relationship is significant, i.e. profit is increased as the portion increase in loan & advances in relation to 0.99 and vice-versa.

4.6.2 Correlation between Loan & Advances and Net Interest Income

Total loans & advances is independent variable and Net interest income is dependent variable. The coefficient of correlation between them measures the degree of relationship between total loan & advances and net interest income. In analysis, the main objective of computing 'r' between these two variables is to justify whether total loan & advances are significantly mobilized to earn interest in a proper way or not.

Table 4.21

Correlation between Loans & Advances and Net Interest Income

	Correlation	P.E
Correlation between Loans & Advances and Net Interest Income	0.98	0.01

Source: Appendix III

Table 4.21 shows the correlation between loans and advances with net interest income. The correlation between them is 0.98 and the P.E is 0.01. Comparing the value of ‘r’ and P.E., It can be concluded that there is significantly positive relationship between total loan & advances and net interest income because the value of ‘r’ is greater than 6 times P.E. i.e. 0.98 > 0.06. The relationship is significant i.e. net interest income is increased as the portion increase in loan & advances and vice – versa.

4.6.3 Correlation between Total Deposits and Loan & advances

Total deposits is independent variable and loan & advances is dependent variable. The coefficient of correlation between total deposit and loan & advances measure the degree of relationship between these two variables. The main objective of computing ‘r’ between these two variables is to justify whether total deposits are significantly used as total loan and advances in appropriate way or not. Following table shows the correlation between them.

Table 4.22

Correlation between Total Deposits and Loan & Advances

	Correlation	P.E
Correlation between Total deposits and Loan & Advances	0.98	0.01

Source: Appendix IV

Table 4.22 shows the correlation between total deposits with loan and advances. The correlation between them is 0.98 and the P.E is 0.01. Comparing the value of ‘r’ and P.E., It can be concluded that there is significantly positive relationship between total deposit and loan and advances because the value of ‘r’ is greater than 6 times P.E. i.e. 0.98 > 0.06.. That means, if the total deposit is increased absolutely the loan and advances is also increased and vice-versa

4.7 Major Findings of the Study

- Loan and advance to current assets ratio of OFL is in fluctuating trend. The highest ratio is 73% and lowest ratio is 93%. The average mean ratio is 85% during the study period. Loan and advance to total assets ratio fluctuates 69% to 88% which average is 80% in the study period. Total investment to total deposit ratio is in more fluctuating trend. The highest ratio is 0.06 times and lowest ratio is 0.01 times. The average mean ratio is 0.04 times. Similarly loan and advance to fixed deposit ratio fluctuates 1.36 times to 1.97 times which average mean is 1.63 times over the study period.
- Loan and advance to total deposit ratio is in fluctuating trend from 0.94 times to 1.09 times and after that ratios are in decreasing trend over the study period. The mean ratio is 0.95 times. Total investment to loan and advances ratio is also in fluctuating trends. The mean ratio is 0.04 times. Similarly, liquid fund to loan and advances is more fluctuating trend. The average mean ratio is 19% over the study period.
- Provision for possible losses to loan and advances ratio of OFL is in fluctuating trend. The mean ratio of the study period is 0.32%. This shows the good quality of assets in total volume of loan and advances. It indicates aggregate loan of OFL are safe. On the other hand, provision for possible losses to net interest income ratio is also in fluctuating trend. The average mean ration is 7.8% during the study period. Non-performing loan to loan and advances ratio shows continuously decreasing trend and then increased in the last year of study period. The average mean ratio is 0.47%.
- Priority sector credit to total credit ratio ranges from 3.26% to 6.97%. The average ratio is 4.41%. Loan and advances are disbursed into production sector in highest mean ratio i.e. 27% and mining sector in lowest ratio i.e. 0.10% during the study period. Under the security of loan and advances comparison, OFL is maintaining high security on Movable/Immovable assets and fixed deposit receipt.
- Profitability ratios are very helpful to measure the overall efficiency in operation of a financial institution. Operating profit to loan and advances ratio

of OFL is in fluctuating trend. There is highest ratio in 2062/6063 i.e. 3.72% and lowest ratio in 2065/066 i.e. 3.20%. The average mean ratio is 3.45% over the study period. Whereas, net profit to loan and advances ratio is not more fluctuating trend. The mean ratio is 2.14%. Net interest income to loan and advances ratio of OFL is also in increasing trend and stepping downward in ending study period. The average mean ratio is 12.92% during the study period.

- Growth rate of loan and advances ranges from 43% to 15%. The average mean rate is 34%. Growth rate of provision for possible losses is in fluctuating trend. The mean ratio is 34%. Growth rate of net interest income is 21% in year 2063/064 and continuously increasing up to 2067/068 and decreased by 30% in year 2068/069. The average growth rate is 40% during the study period.
- Coefficient of correlation between loan and advances to net profit is 0.99 which shows high degree of positive correlation. It can be concluded that increasing loan and advances will have positive impact towards net profit. Correlation between loan and advances to net interest income is 0.98, this indicates that these two variables have positive relation. Correlation between total deposit to loan and advances is 0.98. It indicates that there is positive relationship between these two variables

CHAPTER V

SUMMARY CONCLUSION AND RECOMMENDATION

The final chapter of the study, briefly explains the summary of the study, presents findings, conclusions based on the analysis of the data and attempts to offer recommendations to strengthen the financial position of the OFL.

5.1 Summary

This study has been conducted with the objective to find out about credit management of OFL. The collection of data was based on secondary data and these data were based on the annual report published by OFL. In this study, various financial and statistical tools like ratio analysis, mean and correlation coefficient have been used to get the meaningful result and to meet the research objectives. The study has been focused on the sector wise loans and advances provided by OFL, different credit efficiency ratios have been calculated to analyze the effectiveness of credit management. In addition, the profitability has also analyzed in the study with a view to find out the impact of credit management in the overall financial performance. After analyzing the credit ratio, Loan and advances to current assets ratio is in fluctuating trend. But in aggregate it shows the better performance. OFL is capable to use more than 80% of deposit on loan and advances. If maintained this, it helps to make consistency on the profitability but it should be noted that too high ratio might not be better from the liquidity point of view.

After analyzing the credit efficiency, provision for possible losses to loan and advances is in fluctuating trend and non-performing loan to loan and advances ratio is in decreasing trend and slightly increased in ending study period. The average mean ratio is 0.47%. This shows the more efficient operating of credit management. OFL has been providing loan to more than 12 different sectors. Highest loan is disbursed in production, consumable loan and wholesaler and retailers but lowest loan is disbursed in mining sector. In statistical analysis, correlation analysis has been calculated. Correlation between loan and advances and net profit is 0.99, which shows high degree of positive correlation. Correlation between total deposit to loan and advances has positive relationship i.e. 0.98. It can be concluded that increasing total deposit will have positive impact towards loan and advances.

5.2 Conclusions

The following conclusions have been derived by based on the major findings of this study.

- Ratio of loan and advance to total assets is in fluctuating trend. The mean ratio is 80%. This ratio shows good lending performance in utilizing total assets in form of loan and advances. However, lending always carries a certain risk of default. The study shows, loan & advances to fixed deposit ratio during the study period are 1.63 times. It shows that, fixed deposit shows clear increasing trend and loans and advances too. The average mean ratio of loan and advance to total deposit ratio is 0.95 times. This indicates the better utilization of total deposit.

- PPL to loan and advances ratio is in fluctuating trend. The low ratio indicates the good quality of assets in total volume of loan and advances. The provision for possible loss reflects the increasing probability of non- performing loan. NPL to loan and advances ratio is in decreasing trend and slightly increased in year 2068/069. The average mean ratio is 0.47% which indicates that the lending of OFL is good. In context of Nepalese banking industry a NPL of higher than 2% is not good, however central bank has made certain restriction on the bank and financial institutions only when the NPL goes above 5%.

- Average priority loans are 4.5% of total loans and advances. The percentage covered by agriculture loan is hardly 4%. Another sector mining covers less than 1% of total loan for seven year period. Production sector seems major credit sector of credit it covers almost 27% of total loan. Their major credit sectors are production, wholesale and retail sector and consumable sector and it provides relatively less credit to agriculture sector, electronic sector and mining sector.

- Relationship between operating profit to total loans & advances of OFL seems fluctuating. Average net profit to total loans and advances ratio and net interest income to total loans & advances ratio is 2.18% and 12.92% respectively. Looking at the movement of OFL, trends of net profit and interest income are in increasing trend.
- Correlation coefficient between loan & advance to net profit is 0.99 and correlation coefficient between loan & advance to net interest income is 0.98. It can be concluded that loan & advances has positive relationship with profit and net interest income. From this it can be concluded that increasing credit will have positive impact towards net profit and net interest income.

5.3 Recommendations

The findings of the study reflect both positive and negative results with respect to the credit management of OFL. On the basis of above analysis and findings of the study, following recommendations can be drawn out.

- Loan and advance to total deposit ratio is in fluctuating trends during the study period. The mean ratio is 0.95 times which indicates better mobilization of collected deposits. It is suggested that too high ratio might not be better from the liquidity point of view.
- Non-performing loan to loan and advances ratio and provision for possible losses to loan and advance ratio are in fluctuating trends. Therefore, recommendation has been made that OFL must revise its credit policy and it should avoid extending credits merely based on oral information presented at the credit interview. Historical financial and trade records should be obtained for proper assessment of the proposal.
- Diversification is basic principle that reduces risk and maintains satisfactory return. OFL must explore more new sector for credit which result reduction in credit risk and non-performing loan. Furthermore, in spite of investing large fund in few sector, it should explore different possible sector through its research and development.

- NRB directives help to reduce credit risk arising from defaulter, lack of proper credit appraisal, defaulter by blacklisted borrowers and professional defaulter. Government has established credit information bureau, which will provide suggestion to commercial bank. So, OFL is recommended to collect as much information about borrowers as possible and to decide its lending policy and lend to non-risky and non-defaulter.

- OFL should be fulfilling some social obligations by extending their resources to rural areas and promoting the development of poor and disadvantages group. In order do so; they should open their branches in the rural area with the objective to provide them the banking services.

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APPENDIX I

Sample Calculation of Growth Ratio of Total Loans & Advances

We have,

$D_1 = D_0 (1+g)$

$g = (D_1 / D_0) - 1$

Where,

D_1 = Total Loans & Advances in 1st year

D_0 = Total Loans & Advances in 0 year

g = Actual Growth rate

Here,

$D_1 = 650.45$

$D_0 = 456.57$

Now,

$g = (D_1 / D_0) - 1$

$= (650.45/ 456.57) – 1$

$= 0.4246$ i.e. 43%

Similarly other growth ratios have been calculated by performing same method which is mentioned above.

APPENDIX II

Karl Pearson's Correlation Coefficient(r)

Correlation Coefficient between Loan & Advances and Net Profit

(Amounts in million)

Year	X	Y	X^2	Y^2	XY
2062/063	456.57	10.88	208456	118	4968
2063/064	650.45	13.69	423085	187	8905
2064/065	895.83	18.68	802511	349	16734
2065/066	1280.38	26.14	1639373	683	33469
2066/067	1466.75	28.46	2151356	810	41744
2067/068	1954.41	40.32	3819718	1626	78802
2068/069	2521.09	60.15	6355895	3618	151644
N=7	$\Sigma X = 9226$	$\Sigma Y = 198$	$\Sigma X^2 = 15400394$	$\Sigma Y^2 = 7391$	$\Sigma XY = 336266$

Where,

X= Loan & Advances

Y= Net Profit

Now, $r = \dfrac{N\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[N\Sigma X^2 - (\Sigma X)^2]}\sqrt{[N\Sigma Y^2 - (\Sigma Y)^2]}}$

$= \dfrac{527114}{533189}$

$= 0.9886$

$= 0.9886 \simeq 0.99$

$P.E. = 0.6745 \dfrac{1 - r^2}{\sqrt{N}}$

$= 0.6745 \times \dfrac{1 - (0.99)^2}{\sqrt{7}}$

$= 0.00507$

APPENDIX III

Correlation Coefficient between Loan & Advances and Net Interest Income

(Amounts in million)

Year	X	Y	X^2	Y^2	XY
2062/063	456.57	56.61	208456	3205	25846
2063/064	650.45	68.61	423085	4707	44627
2064/065	895.83	92.21	802511	8319	82605
2065/066	1280.38	132.27	1639373	17495	169356
2066/067	1466.75	205.47	2151356	42218	301373
2067/068	1954.41	327.30	3819718	107125	639678
2068/069	2521.09	426.33	6355895	181757	1074816
N=7	ΣX =9226	ΣY = 1309	ΣX^2=15400394	ΣY^2=364826	ΣXY=2338301

Where,

X= loan & Advances

Y= Net Interest Income

Now, $r = \dfrac{N\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[N\Sigma X^2 - (\Sigma X)^2]}\sqrt{[N\Sigma Y^2 - (\Sigma Y)^2]}}$

$= \dfrac{4291273}{4365909}$

$= 0.98$

P.E. $= 0.6745 \dfrac{1 - r^2}{\sqrt{N}}$

$= 0.6745 \times \dfrac{1 - (0.98)^2}{\sqrt{7}}$

$= 0.01$

APPENDIX IV

Correlation Coefficient between Total Deposit and Loan & Advances

(Amounts in million)

Year	X	Y	X^2	Y^2	XY
2062/063	484.12	456.57	234372	208456	221035
2063/064	627.88	650.45	394233	423085	408404
2064/065	922.27	895.83	850582	802511	826197
2065/066	1168.34	1280.38	1365018	1639373	1495919
2066/067	1527.28	1466.75	2332584	2151356	2240138
2067/068	2161.97	1954.41	4674114	3819718	4225376
2068/069	3227.52	2521.09	10416885	6355895	8136868
N=7	ΣX =10119	ΣY =9226	ΣX^2=20267788	ΣY^2=15400394	ΣXY=17553937

Where,

X= Total Deposits

Y=Loan & Advances

Now, $r = \dfrac{N\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[N\Sigma X^2 - (\Sigma X)^2]}\sqrt{[N\Sigma Y^2 - (\Sigma Y)^2]}}$

$= \dfrac{29519665}{29925915}$

$= 0.9864 \simeq 0.98$

P.E. $= 0.6745 \dfrac{1 - r^2}{\sqrt{N}}$

$= 0.6745 \times \dfrac{1 - (0.98)^2}{\sqrt{7}}$

$= 0.01$