

**CREDIT MANAGEMENT OF NEPALESE
COMMERCIAL BANKS**
(With Reference to BOK & NIBL)

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RECOMMENDATION

This is to certify that the thesis

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Entitled

Credit Management of Nepalese Commercial Banks

(With Reference to BOK & NIBL)

has been prepared as approved by this department in the prescribed format of faculty of management. This thesis is forwarded for evaluation.

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DECLARATION

I hereby proclaim that the thesis work entitled 'Credit Management of Nepalese Commercial Banks (With Reference to BOK & NIBL)' submitted to Balkumari College, faculty of Management, Tribhuvan University is my original work for the partial fulfillment of the requirement for the Master's Degree of Business studies (MBS) under the supervision of Mr. Baburam Panthi lecturer (Chair Person Research Committee) of Balkumari College Narayangarh Chitwan.

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ABBREVIATIONS

AD	-	Anno Domini
BOK	-	Bank of Kathmandu
BS	-	Bikram Sambat
CA	-	Current Assets
CR	-	Current Ratio
CV	-	Coefficient of Variation
FD	-	Fixed Deposit
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
Gov. Sec.	-	Government Securities
NIBL	-	Nepal Investment Bank Limited
NPA	-	Non Performing Assets
NPAT	-	Net Profit After Tax
NRB	-	Nepal Rastra Bank
PBT	-	Profit Before Tax
PE	-	Probable Error
r	-	Correlation
r^2	-	Coefficient of Determination
RBB	-	Rastriya Banijya Bank
ROE	-	Return on Net worth
Rs.	-	Rupess (Nepali Currency)
SD	-	Standard Deviation
TD	-	Total Deposit
TU	-	Tribhuvan University

INTRODUCTION

Background of the Study

Commercial bank refers that bank, which deals with accepting deposits, advancing loans and accelerating money exchanges facilities etc. Lending is the most important functions of a commercial bank. For lending procedure, bank has to make some banking practices such as transferring property in banks name. The transfer s temporarily made for a loan price and interest. Lending money is nowadays becoming main resources of revenue to the bank and also involves high risk too. Bank will not provide loan unless it has sufficient sources to the borrower that will be needed in case of future recovery.

The source of finance is the most essential for the establishment and operation of any profit and not profits institutions. Profit oriented institutions usually obtain these sources through ownership capital, public capital through the issues of shares, and through financial institutions such as banks, in the form of credits of various nature. It is during these stages for the establishment and operations of any organization, the role of banks come into effect in providing these sources, in the form of credit, other nature of direct and indirect investments and various consultancy services. The history of banking system in Nepal in the form of money lending can be traced back in the reigning period of Gunkam Dev, "The king of kathmandu".

Tankadhari 'a special class of people' was established to deal with the lending activities of money toward the end of fourteen century at the ruling period of King Jayasthiti Malla. During the Prime Ministerial period of Rannodip Singh, one financial institution was established to give loan facilities to the government staff & enforced loan facilities to

the public in general in the term of 5% interest but Tejarath' did not accept money from public.

On 30th Kartik, 1994, Nepal Bank limited was established for the first time to provide banking facilities in organized manner. Up to 2012, NBL was the only banking service provider to general public and other government and non-government and non-government bodies as an organized banker. Later, NRB act 2012 was prepared and issued to establish NRB as a central bank to manage, control and develop monetary system in Nepal. NRB was formally established on 14th Baisakh 2013 & its capital at the starting time was NRs. 10 million. Similarly, Rastriya Banijya Bank was established in 2022 Magh 10 as 100% state owned bank to fulfill the growing needs of the economy. The birth of this bank brought a new landmark in the history of banking facility in the Nepal. Like other developed countries, Nepal also took the policy of open economy to develop good competition in the banking field. Hence, the private sector Banking Company policy is taken for study. Today, 29 commercial banks are operating to provide modern banking services & facilities to boost the economics condition of the country.

The financial sector reform was initiated in mid-1980s under the liberal economic policy of GON Under this policy, GON first opened the banking sectors to foreign investors. In July 1985 commercial banks were allowed, for the first time to accept current and fixed deposits on foreign currency (U.S. dollar and sterling pound). On May 26, 1896, NRB deregulated the interest rate regime and authorized commercial banks to fix interest rate at any level above its minimum prescribed levels.

Banking plays significant role in the economic development of a country. Bank is a resource for the economic development which maintains the self- confidence of various segments of society and extends credit to the

people. So, commercial banks are those financial institutions mainly dealing with activities of the trade, commerce, industry and agriculture that seek regular financial and other helps from them for growing and flourishing, the objectives of commercial banks is to mobilized idle resources into the most profitable sector after collecting them from scattered sources commercial bank contributes significantly an the formation and mobilization of internal capital and development effort.

The concept of the banking has been developed from the ancient history with the effort of ancient goldsmiths who developed the practice of storing people's gold and valuables under such arrangement the depositors would leave their gold for safekeeping would get back their gold and valuable after paying a small amount as fee for safekeeping and serving.

The role of money in an economy is very important. Proper and well-planned management of money directs, determines and enhances the health and productivity of total financial sector and the performance of financial sector affect the growth of economy. Hence, Money is the topic to manage and banks are the manager. The existence of a bank is for the change in every aspect of human being and its presence is for the upliftment of people. Banks are the back bone of the economy. They act as intermediaries to channel funds to productive business companies and projects.

The financial institutions are:

- Commercial Banks
- Development Banks
- Finance companies
- Savings and Credit Associations

- Mutual Saving Banks
- Credit Unions
- Insurance Companies
- Pension Funds
- Investment Companies
- Investment Bankers
- Securities Brokers and Dealers

Banks grants loan and advances to industries, people and companies that result in the increase in the productivity of nation. For example: The loan against to agricultural sector enhances the agricultural product on. The loan amount can be used by the farmers as per their need to produce their product that will promote the agriculture product on. Similarly the loan and advances to different people and corporate bodies help to increase their income and profits. They can use the amount as per their need at right place at the right time. Bank is a business organization where monetary transaction occurs. It creates fund from its clients saving and lends the same to needy person or business companies in term loans, advances and investment. So proper financial decision making is more important in banking transactions for its efficiency and profitability. Most of the financial decision making loan management it plays the vital role in the business succession, so efficient management of lending policy is needed.

The source of finance is the most essential element for the establishment and operation of any profit and non-profit institutions. Profit oriented institutions usually obtain these sources through ownership capital, public capital through the issues of shares and through financial institutions such

as banks, in the form of credits, overdrafts etc Commercial banks, others banking institutions (OBIs), Non Bank Financial Institutions occupy important role in mobilizing financial resources. There are about 17 insurance companies including deposit -Insurance and Credit Guarantee Corporation, one Employee Provident Fund and one Citizen Investment Trust belong to this type of financial institutions. Apart from this, securities such as corporate shares debentures and bonds.

Banking plays a significant role in the economic development of a country. Nepal Bank Limited (NBL) is the first commercial bank of the country. Commercial banks are the heart of the financial institutions. They hold the deposits of many persons, government establishments and business units. They made funds available through their lending and investing activities to borrowers, individuals, business firms and government establishments. In doing so, they assist both the flow of goods and services from the producers to consumers and financial activities of the government, they provide a large proportion of the medium of exchange they are the media through which monetary policy is affected. These facts show that the commercial banking system of the nation is important to the functioning of the economy. Bank is a resource for the economic development, which maintains the self-confidence of various segments of society and extends credit to the people.

The more, developed financial systems of the world characteristically fall into three parts. The central Bank, The Commercial Banks and other financial institutions. They are known as financial intermediaries. The banking business its genesis from its function of lending. Lending is the most fundamental function of a bank. The importance of Lending in banking business is undoubtedly unchanged and remains vital as it was early days of this business. Lending has its different forms. It can be

divided into fund based and non-fund based Lending. The fund based Lending can be further divided into cash credit, Overdrafts, demand and term credits, bills purchased and discounted and export packing credit, project loan, etc. Similarly, non- fund based credit can be classified into documentary credit, guarantees and bill co- acceptance facility.

Objectives of the Study

The main objective of this study is to analyze the credit practices of BOK and NIBL. The specific objectives are as follows:

- i. To analyze of liquidity, efficiency & profitability position of sample commercial banks.
- ii. To analyze the effectiveness of credit risk of the sample Commercial Banks.
- iii. To analyze relationship between Loan & Advance, Deposit & Net Profit of BOK and NIBL.
- iv. To examine the trend of deposit, loan and advance, net profit and investment of sample commercial bank.

Research Questions

This study is focused to solve the following research questions:

1. What are the conditions of liquidity, profitability of sample commercial banks?
2. What is the effectiveness of credit term of the sample Commercial Banks?
3. What is the relationship between Loans, Deposit & Net profit?
4. What are the Trend of Deposit and Credit of Commercial Banks?

Organization of the Study

The study will be organized in to five chapters. Which are:-

Chapter I: Introduction

Chapter one deals with introduction, problem of the study, objective of study, research questions, limitations of study, need of the study and organization of the study.

Chapter II: Review of Literature

Chapter two consists of review of literature. This chapter is subdivided into various functions as conceptual framework, review from different studies, review from journal, article and review from master's thesis for the concerned topic and research gap.

Chapter III: Research Methodology

Chapter three present methodologies adopted or the research. It comprises research design, sources of data method of analysis and its descriptive presentation.

Chapter IV: Presentation and Analysis of Data

Chapter four deals with the techniques used in analyzing the collected data and its presentation in the descriptive and analytical manner.

Chapter V: Summary, Conclusions and Recommendations

Chapter five consists of summary, conclusion and recommendation about the topic concerned.

At the bibliography and appendix are attach in back of this dissertations.

Population and Sample

There are altogether 31 commercial banks functioning all over the country at present, which are taken as a population of this study work. Among them, this study only two commercial banks namely; Bank of Kathmandu Ltd. and Investment Bank Ltd, which have been selected as a sample for this research study. Similarly financial statements of two banks for five years from 2005/06 to 2009/10 have been taken as samples for same purpose.

Introduction of Sample Organization under Study:

- **Bank of Kathmandu Ltd. (BOK)**

Bank of Kathmandu Ltd. was incorporated in 1993 and came into operation in March 1995 as a joint venture bank with Siam Commercial Bank of Thailand. The head office of the bank is situated at Kamalpokhari, kathmandu, Nepal. Its authorized capital is 1,00,00,00,000 issued capital is 50,00,00,000.00 and paid up capital is 46,35,80,900.00. At the beginning, this bank was managed by Siam commercial bank of Thailand and later on Siam commercial bank divests their share holding and now it is fully owned and managed by Nepali professional. The majority of the shares are owned by general public which is 57.73%. (Annual Report, BOK, 2011)

Bank of Kathmandu, since its inception, has been using information technology for its mainstream banking activities. All its branches including rural areas are interconnected to the bank's intranet system providing online real time Any Branch Banking system to its valued customers. Continuous updates, upgrades and replacements of it equipments and software have become one of the major focuses of the

bank to stand up to the challenges posed by the fast changing environment.

Bank of Kathmandu has well-developed correspondent relationships with over 150 banks globally to help its customers to carry out their business worldwide promptly and conveniently. Bank of Kathmandu have maintained accounts in major currencies in the internationally renowned banks as well tied up with various Instant Money Transfer Companies (IMTC) like X-press Money Service Ltd., Money Gram, International Money Express P. Ltd etc for efficient execution of international banking business and also enables inflow of foreign exchange earnings to the country with high security. This bank came into operation with a objectives of catering new business yet not identified and offering new banking products and services with a modern look by adopting modern banking technology.

Bank of Kathmandu has just entered into the eleventh year of successful operation. During its tenth year of operation, it has become one of the leaders in the banking sector and was able to establish a good banking image in the banking history of Nepal. It has gain lot of popularity among its customer, due to its pioneer service provided to its customer.

- **Nepal Investment Bank Ltd. (NIBL)**

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world.

With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and

businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd.

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

The Shareholding Structure Comprises of:

i. A Group of Companies	50%
ii. Rastriya Banijya Bank	15%
iii. Rastriya Beema Sansthan	15%
iv. The General Public	20%

Major Findings

- The mean current ratio of BOK is 0.81 and NIBL is 1.08, the current ratio of NIBL is higher than BOK. It is indicate better liquidity position of NIBL.
- Cash and bank balance to current assets ratio of NIBL is lower than BOK i.e. 12.18% > 11.28%. Regarding the analysis, it can be said that BOK has a better ability to meet daily cash requirements of their customers but it should be noted that BOK has excess cash due to the low investment opportunities.
- Cash and bank balance to total deposit ratio of NIBL has higher than BOK i.e. 12.50% > 9.52% which indicates that the bank has higher liquidity of NIBL as compare to BOK.
- Investment on government securities to current assets of BOK has higher than NIBL i.e. 25.84% > 19.74%. It shows BOK has invested more fund in government securities.

- The loan & advances to total deposit ratio of BOK is higher than NIBL $77.37\% > 74.91\%$. It indicates the better mobilization of deposit by BOK. So, BOK has more efficiently utilizing the outsiders' funds in extending credit for profit generating sectors.
- The investment to total deposit of NIBL is little high than BOK i.e. $21.84\% > 21.61\%$. It shows the NIBL is mobilizing its funds on investment in various securities efficiently.
- The loan & advances to total assets ratio of BOK is greater than NIBL i.e. $67.33\% > 66.14\%$. It refers BOK has utilized its total assets more efficiently in the form of loan & advances with more risk because it has greater variability in the ratio.
- Investment on government securities to total assets ratio of NIBL is higher than BOK i.e. $19.31\% > 18.73\%$. This indicates that NIBL has invested more portions of total assets on government securities.
- The credit risk ratio shows the proportion of non-performing loan in total Loan & Advances. Average credit risk ratio of NIBL is lower than BOK i.e. $1.34 < 2.03$. NIBL has efficient operating of credit management than that of BOK from the mean point of view.
- The liquidity risk of the bank defines its liquidity need for deposit. The average mean ratio of NIBL is greater than that of BOK (i.e. $12.50\% > 9.52\%$).
- Both banks BOK and NIBL has mostly used its funds in Industrial and commercial sector. In average, lending in industrial, commercial, priority and deprived sectors.
- Both BOK and NIBL have high positive co-relation between total deposit and loan & advances because BOK and NIBL have 0.989

and 0.983 of co-relation coefficient between deposit and loan & advances.

- There is positive correlation between loan and advance and net profit of BOK and NIBL. Both banks are high positive degree of co-relation i.e. 0.98 and 0.97 respectively. BOK has little high degree positive correlation then that NIBL. Both bank's correlation coefficient is significant because the correlation coefficient is more than 6PE.
- The correlation of total deposit between BOK and NIBL is positive correlation i.e. 0.991. It implies that the total deposit of both banks move in the same direction but less proportionately. Correlation coefficient of bank is significant.
- The degree of relationship of investment between the BOK and NIBL is negative correlation because correlation coefficient between investments of these two banks is -0.183. It means investment of these two banks moves in the negative direction. Correlation coefficient is insignificant due to less than 6PE.
- The correlation of loan and advance between BOK and NIBL is highly positive i.e. 0.995. It implies that the loan and advance of both banks move in the same highly direction. The relationship between two banks is significant because its correlation coefficient is higher than 6PE.
- The correlation of net profit between BOK and NIBL is highly positive i.e. 0.968. It implies that the net profit of both banks move in the highly positive direction. The relationship between two banks is significant because its correlation coefficient is higher than 6PE.

- The trend line of total deposit for both banks is increasing trend. It refers that both the banks are increasing in collection of deposits. The trend line of deposits for NIBL seems high growing than BOK. It refers that NIBL is more aggressive in collection its deposits.
- The trend line of loan & advances for both banks is upward trend. It refers that both the banks are increasing in disbursement of loan & advances. The trend line of loan and advances for NIBL seems high growing than BOK. It refers that NIBL is more aggressive in mobilizing its loan and advance.
- The investment trend line of NIBL is upward slopping and BOK is decreasing trend. Where as NIBL has aggressive upward slopping of investment trend line. It refers that NIBL has better increasing trend of investment than BOK.
- The trend line of Net profit for BOK and NIBL is upward slopping But NIBL has aggressively and BOK has smoothly. The position of NIBL is better in order to generate profit than BOK.
- Above analysis reveals that both the banks have well their ratio. Trend of Both bank has increasing trend. In comparison to both bank every ratio of NIBL is higher than the BOK. It indicates better performance of NIBL rather than BOK.

Summary

Credit management is the formulation and implementations of lending policies are among the most important responsibilities of directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit. The researcher has identified that research problem and set objectives to solve research problems about credit management of Bank of Kathmandu and Nepal Investment Bank Limited. The main objective of the study is to analyze the credit management of BOK and NIBL. The specific objectives of the study are: to examine the credit position of the selected commercial banks in Nepal (BOK and NIBL), to analyze the credit management system and practices of BOK and NIBL, to compare the liquidity management, asset management efficiency, credit risk position, to determine the trend of deposit in liquidity and its effect on lending practices and to offer suitable suggestions based on findings of this study. The significance of the study proper management of credit for the growth and development of this sector, by considering the return is required. In today's competitive scenario, several macro economic factors such as political, economical, social and technological factors have increased the challenges to the banking sector. The success of any organization is largely dependent on how properly the organization can manage the risk. Banking sector involves several risks, which need to be handled promptly for the survival and growth.

Research methodology has been described in third chapter, which is a way to solve the research problems with the help of various tools and techniques.

The presentation and analysis of data has been made comparative analytical and their interpretation has done in chapter four by applying

the wide varieties of methodology as stated in chapter three. It provides an effective payment and credit system, which facilitates the channeling of funds from the surplus (savers) units to the deficit units (investors) in the economy. Credit practice of commercial banks is a very risky one.

Conclusions

Thus this research is conducted with the major objective of highlighting credit management of two commercial banks. The observation and conclusion is derived by analyzing calculated various ratio like liquidity, asset management and risk ratio as well as relevant financial and statistical ratios of commercial banks.

Generally banks have to maintain more liquid assets but the current ratios of all banks are below the standard of 2:1. The mean current ratio of BOK is 0.81 and NIBL is 1.08 the current ratio of NIBL is higher than BOK. It indicates better liquidity position of NIBL. Cash and bank balance to total deposit ratio of NIBL is lower than BOK. The loan & advances to total assets ratio of NIBL is lower than BOK. Investment on government securities to total assets ratio of BOK is little lower than NIBL i.e. $21.61\% < 21.84\%$. This indicates that NIBL has invested more portions of total assets on government securities.

Coefficient of correlation Both BOK and NIBL have high positive correlation between total deposit and loan & advances i.e. BOK is 0.989 and NIBL have 0.983. The correlation coefficient of both banks is significant. There is positive correlation between total deposit and total investment of BOK and NIBL. Correlation between Loan and advance and net profit of BOK is 0.98 and NIBL is 0.97. Correlation coefficient of total deposit between BOK and NIBL is 0.991 and correlation coefficient of investment between BOK and NIBL is negative relation i.e. -0.183. The relationship between Loan and advance and net profit of BOK has

significant and NIBL has also significant. Correlation coefficient of loan & advance and net profit between BOK and NIBL shows high positive correlation i.e. 0.99, 0.96 respectively. Correlation coefficient is also significant.

The trend analysis of deposits, loan and advance, investment and net profit of BOK and NIBL is increasing trend in study period. NIBL is more aggressive increasing trend then BOK.

Recommendations

Based on the analysis and finding of the study, the following recommendations can be made as suggestions to make the credit management of BOK and NIBL effective and efficient. This would help to draw some outline and make reforms in the respective banks.

- **Maintain Sound Liquidity Position**

The liquidity position affects external and internal factors such as prevalent investment situations, central bank requirements and so on. Considering the growth position of financial market, the lending policy management capabilities, strategic planning and fund flow situation, bank should maintain enough liquid assets to pay short-term obligations. So, it is recommended to maintain sound liquidity position to BOK and NIBL.

- **Lending their Funds on Risk Free Assets**

In this research study, it has found that both banks, BOK and NIBL have made some amount of fund in Government securities. But BOK and NIBL are recommended to invest more funds in Government securities instead of keeping them idle.

- **Evaluate the Lending Opportunities and Alternatives**

It has been found that loan & advances to total deposit ratio of NIBL is lower than that of BOK. BOK and NIBL have a possible risk

because there is large amount of doubtful loan & advances and risky investment. So it is recommended to evaluate the investment opportunities and alternatives using statistical, capital budgeting and other financial tools to avoid large amount of doubtful debt and risk.

- **Meet Require Level of Profitability**

Both banks should be careful in increasing profit of the bank to maintain the confidence of shareholders, depositors and all its customers. NIBL profitability position is not better than that of BOK. So, NIBL is strongly recommended to utilize risky assets and shareholders fund to gain high amount of profit.

- **Should Make Investment on Public Utilities as well as follow the NRB Directives**

Both banks have earned profit from profitable and private sector. So, they are recommended to strictly follow up the directives issued by NRB and should make investment on public utilities sector like health, sanitation, education, drinking water, agriculture etc.

- **Priority should given to Economic Sectors**

Bank loan & advances is decreasing in this sector. So banks should give priority to these sectors as well as banks should create new investing sector to mobilize deposit.

- **Form a Strong Credit Recovery Department in Central Level**

It should strengthen and activate its lending and recovery function as it is an effective tool to attract and retain the customers. For this purpose, it is recommended to form a strong credit recovery department in its central level, which deals with the default credit customers and take necessary action to recover their non performing loan.