# FACTORS AFFECTING CREDIT MANAGEMENT OF NEPALESE COMMERCIAL BANKS:

## A Comparative Study of Siddhartha Bank limited and Sanima Bank Limited

## A Proposal


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# INTRODUCTION

## 1.1 Background of the Study

Financial institutions play an important role in accelerating development of the country. These institutions mobilize savings to lend & make investment in different enterprises of the national economy that consequently provide opportunities and help developing the society and country as a whole. Thus, the development of the commercial banks or financial institutions has become one of the bases for measuring the level of economic development of a nation.

Commercial banks can play a vital role directing the economy's development overtime by financing the requirements of trade and industry in the country. They draw the community's scattered savings into organized sector and allocate among the different economic activities according to the priorities laid down by planning authorities in the country.

In this country, a bank is a financial institution, which plays a significance role in the development of a country. It facilitates the growth of trade and industry of national economy. However, bank is a resource for economic development, which maintains the self-confidence of various segments of society and extends credit to the people. Banking sector plays a vital role for the country's economic development opportunities to people. Such economy of the country secures proper growth. In this way, it is crystal clear that a sound banking system is must for the industrial development and creates employment and investment opportunities to people as well as overall economic development of the country.

### 1.1.2 Profile of Sample Bank

Siddhartha Bank Limited (SBL) is one of the largest private commercial bank in Nepal. It was established in 2002 and promoted by prominent personalities of Nepal, today stands as one of the consistently growing banks in Nepal.

Sanima Bank commenced its operation in 2004 as a National Level Development Bank. Since February 2012, Sanima has been functioning as an "A" Class Commercial Bank.

### 1.1.3 Credit Management

Credit management is implementing and maintaining a set of policies and procedures to minimize the amount of capital tied up in debtors and to minimize the exposure of the business to bad debts. (http://www.smallbusiness.wa.gov.au/assets/Small-Business-Briefs/small-business-brief-credit-management.pdf).

Credit Management, from a debtor's point of view, is managing finances especially debts so as not to have a tail of creditors lurking behind your back. Credit management is a responsibility that both the debtor and the creditor should seriously take (http://www.selfgrowth.com/articles/Tabije3.html). When it functions efficiently, credit management serves as an excellent instrument for the business to remain financially stable.

### 1.1.4 Process of Credit Management

The process of credit management begins with accurately assessing the credit-worthiness of the customer base and his/her business viability. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement. As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer.

When the process of credit management functions efficiently, everyone involved benefits from the effort. The financial institution such as banks has a reasonable amount of assurance that loans granted to a client will be paid back within terms, or that regular minimum payments will be received on credit account balances.

## 1.2 Statement of the problem:

Nowadays due to competition among banks, the interest rate change for loan is in decreasing trend. Non-performing assets have become a large problem in the commercial banks. Hence, the banks and financial institutions are competing among themselves to advance credit to limited opportunity sectors. Lack of good lending opportunities, banks is facing problems of over liquidity. It has been able to control and capture a remarkable leadership of Nepalese banking sector. Granting loan against insufficient deposits overvaluation of goods pledged, land and building mortgaged, risk–averting decision regarding loan recovery and negligence in recovery of overdue loans are some of the drawbacks of unsound investment policy. Similarly, loan supervision and follow-up mechanism is lacking in many commercial banks. Due to unhealthy competition among the banks, the recovery of the bank's credit is going towards negative trends. Non-performing Credits of the banks are increasing year by year. To control such type of state, the regulatory body of the banks and financial institutions, Nepal Rastra Bank has make certain criterion of loss provision of commercial bank.

In Nepal most of the commercial banks are focusing on consumer loan, vehicle loan, real estate loan etc. In Nepal it has been found that approval and lending decisions are made in favor of those persons who have personal network. So a new customer finds that loan providing process being very complicated and sometimes the documents submitted the loan sanctioning being fraudulent and for formally purpose only

## 1.3 Objectives of the Study

This study attempts to evaluate factors affecting loan management of Siddhartha bank ltd and Sanima bank ltd. Loan one of the most voluminous item among all the assets of the bank, the management need to be cautious while granting loan. The objectives for conducting the study can be:

1. To explore relationship between deposits, investment, income, borrowing on loan.
2. To identify key variables and examine magnitude of their affect on bank's loan.
3. To analyze the factors in order of the influence that they have on bank's loan.

## 1.4 Hypothesis

One thesis is that research is usually begins in an uncertain and ambiguous manner. The researcher comes to know gradually what has to be done (Khaki, 2000).

1. Null Hypothesis: There is no significant relationship between loan and deposit
2. Null Hypothesis: There is no significant relationship between loan and investment
3. Null hypothesis: There is no significant relationship between loan and total income
4. Null Hypothesis: There is no significant relationship between loan and borrowing

## 1.5 Significance of the Study:

Loan is a critical factor for the bank as it is a highest source of income for bank and affects profit and performance. Banks get highest return in the form of interest on loan. Growing competition and global financial crisis has had great impact in banking business. The loan risk has risen substantially. This has increased the importance of loan management and it is, therefore, a very current topic. Especially in the current economic situation, it is very important to have a clear and effective loan management function that can help in maximizing profits during these bad economic times. This study would be useful to all shareholders, investor and bankers. Further, this study would help other free researcher for conducting further research as it serves as a review of literature. Similarly finding of the study would be beneficial to other who is interested in knowing about this particular bank. This help to face challenges posed by other competitors and will help increase their reach by attracting new customers. Thus this study attempts to identify the determinants of bank in order to provide practical guides for improved loan management of the commercial banks.

## 1.6 Limitation of the study:

Despite of the sincere efforts made for arriving at meaningful conclusions from the study, there always exist some limitations. The major limitations of the study are as follows:

- This study is based on comparison between two commercial bank only.
- The primary information is based on the responses from two bank with total 120 respondents.

- Reliability of this study is based upon the accuracy of published data by NRB and the genuineness of respondent.
- The analysis of this study is based on the results obtained from simple regression model.
- The study concern only a period of five year from the year ended 2015/16 to 2019/20 and conclusion drawn confines only the above period.
- There are many factors that affect loan management. However only four factors will be considered in the study.

# 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 a way to discover what other research in the area of our problem has uncovered. The main purpose of literature review is to find out what research studies have been conducted in one's chosen filled of study and what remains to be done. Generally, in my thesis I am trying to describe the loan management system, practices and risk management in Siddhartha Bank Ltd. and Sanima Bank Ltd. I have made every possible effort to review the literature from the available sources like library, internet, books, journal, research papers and dissertations. It has been categorized into two groups:

- Conceptual Review
- Review of related Studies

## 2.1 Theoretical /Conceptual Review

Generally, in my thesis I am trying to describe the loan management system and practices in the selected sample bank. Rapid changes in banking services, high level of competition and increasing loan of commercial banks make it important to understand loan management practices in bank. The principal function of bank is to collect deposit from public and lend money to various users against specific rate of interest.

Diana Mc Haughton in her research paper” Banking institution in developing market states that loan policy should incorporate several elements such as regulatory environment, the availability of fund, the selection of risk, loan portfolio balances and term structure of liabilities. A considered view is that bank’s lending policy could have crucial influence on nonperforming loans (Reddy, 2004). Setting up a good credit control system is the starting point for both” (Directors Briefing 2006).

### 2.1.1 Types of credit/loan

Thapa and Rawal (2010) have mentioned in their book that Credit is a kind of product which can be developed on the basis of terms and conditions demanded by the credit agreement between bank and the borrower. It can be classified as:

1. Funded
2. Non-funded
3. Working capital
4. Consumer or corporate

### 2.1.2 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).

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

### 2.1.3 Credit limit

Credit limit is the maximum amount of credit a company allows its customers to owe it at any one time. (Credit Guru, 2010). Advantages of setting credit limit are:

- It frees up time for the credit managers to focus on other tasks.
- It speeds up the credit process.

- It reduces the risk and improves the credit collection activities.
- It serves as a account monitoring tool.

The procedure for setting a credit limit and changing a credit are defined in loan policy.

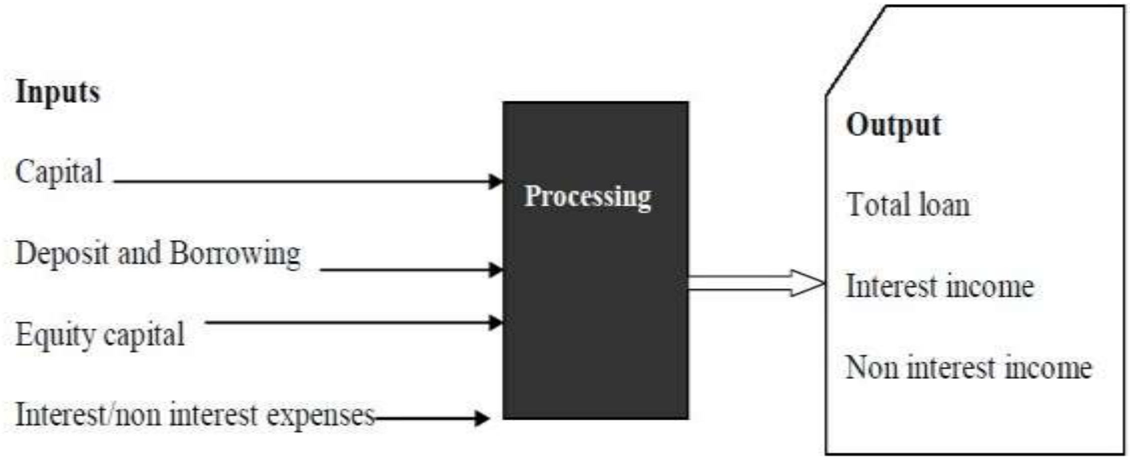


Fig 2.1.2.1 Loan management system of a commercial bank

Conceptual model of the study is:

Loan = f (Total deposit, Total investment, Total income, Total Borrowing)

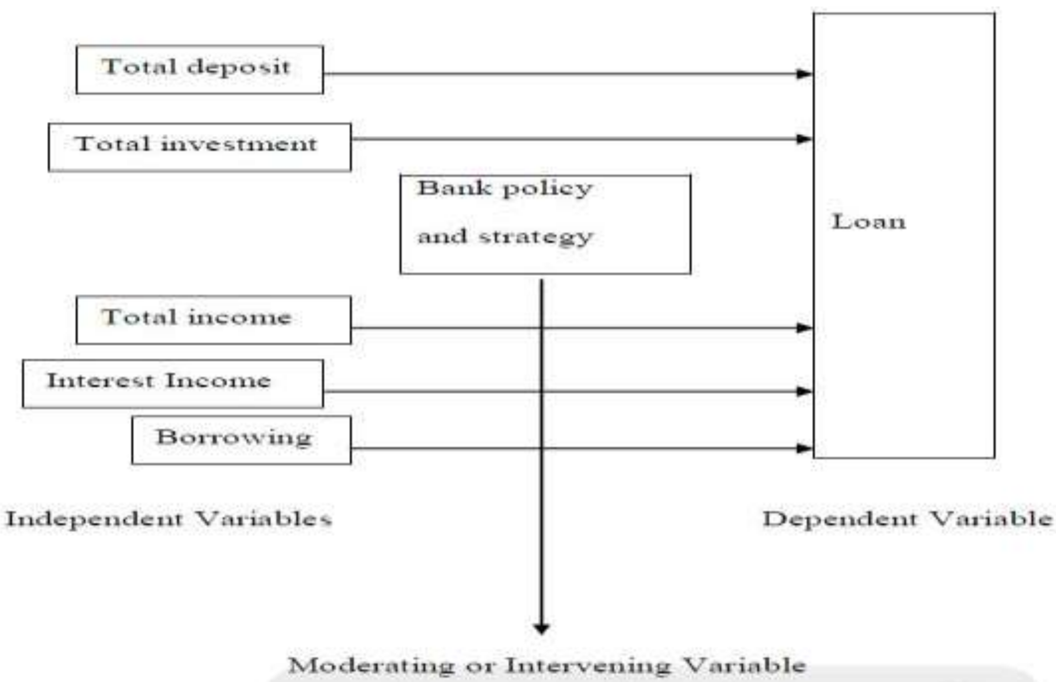


**Fig 2.1.3.2 Conceptual framework of the study**

Above figure shows that deposit, investment income, borrowing, interest incomes are independent variables whereas loan and advances is dependent variable

### 2.1.4 Objectives of the Sound Credit Policy

The purposes of a written credit policy are:

- To assure compliance by lending personnel with the bank's polices and objectives regarding the portfolio of credits.
- To provide personnel with a framework of standards within which they can operate.

### 2.1.5 The Loan Policy:

NRB has sent various directives, guidelines and a circular regarding credit and this is necessary so as to use fund received as per direction set by policies .NRB time to time gives directives and guidelines on credit for safe, sound and 41 profitable lending. So bank has to set the direction of use of fund received from stakeholders, depositors and others. The policies provide uniformity in lending activities.

### 2.1.6 Loan process:

The loan approval decisions are made by credit committee of a bank. Loan officer should consider purpose of loan, source of repayment, length of maturity, financial strength and character of borrower, adequacy of capital, quality of financial statements and accounting procedures, ability to meet current obligations, quality of management, completeness of documentation, references and past credit history, quality of collateral, if any, relationship with bank in lending process.

## 2.2 Review of Literature

This dissertation has been written after studying various books journals article website and previous thesis.

U. Adhikari and K. Jha (2020) in their dissertation "Lending practices of commercial banks in Nepal: A study of Siddhartha bank limited and sunrise bank limited" states that banks have been lending as per the directives of the NRB. Likewise, since, all the respondents were agreed upon the fact that deposits affect the lending practices, deposits can be considered as the main source for lending to the various individuals and business units. The various determinants that affect the lending practices of SBL and SRBL as per our research are deposits, borrowings, investments and net profits.

Thapa (2011) in his Thesis “Loan Management of Commercial Banks – A Comparative study of Everest And Nepal SBI Bank Limited” shows that there is a significant relationship between bank performance and loan management. Better loan management results in better bank performance. The availability of cash and loanable funds are important to the successful operations of a commercial bank.

(Benjamin M Tabak, 2009) in his paper mentioned that banks need to manage their credit by diversifying the credit. For this, banks need to maintain the credit portfolio and evaluate their performance and risk of diversification. However, many banks also prefer to lend in those sectors in which they earn more credit advantages. Brazilian banks’ loan portfolios are found to be, on average, moderately concentrated. Loan portfolio concentration seems to improve the performance of Brazilian banks in both return and risk of default. The concentration indices were found to be positively related to returns and negatively related to risks. The reason may be that loan portfolio concentration increases monitoring efficiency, since banks may have expertise in the sectors they lend, as affirmed by Winton [1999].

Pandey (2009) entitled her Thesis “Credit Risk management of Commercial Banks of Nepal” illustrate that proper risk management is required to remain competitive in the market & achieve the goals. The major banking risks include credit risk, market risk (i.e. liquidity risk, interest risk, operation risk etc). Among these risks, credit risk has the major impact on banking (i.e. more than 60 %). Because of the credit risk, the Non-Performing Loan (NPL) of bank will increase. With the increase in NPL, the loan loss provisioning will also increase simultaneously leading to decrease in profit. The decrease in profit results in low dividend to shareholder and bonus to employees.

Misra, S. (2007) entitled her Thesis “Credit management of Everest Bank Limited” illustrate 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.

Paudel, H. (2006) in his dissertation entitled “A Comparative Study on Siddhartha Bank Limited and Himalayan Bank Limited” states that interest income from loan and advances are the main sources of income, which will increases profit of commercial bank. The main ratio of interest income to total income of SBL is higher than that HBI. NRB has restricted the gap between the interest taken in loan and advances and interest offered in deposit.

Shrestha, S. (2005) in his dissertation “Credit management with special reference to Nepal SBI Bank ltd” illustrates that lending is one of the most important parts of function of a commercial bank and composition of loan and advances directly affects the performance and profitability of the bank. There is intense competition in banking business with limited market and less investment opportunities available. Every bank is facing the problem of default loan and there is always possibility of a certain portion of the loan and advances, profitability deposits position of Nepal SBI Bank Limited is analyzed and its contribution in total profitability has been measured.

Regmi, P. (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. They perform all kinds of banking functions such as, accepting deposits, advancing credits, credit creation and management of credit and advances. Portfolio management helps to minimize or manage the credit risks and spreading over the risks to various portfolios. Banks earn interest on credit and advances which is one of the major source of income for banks.

Parajuli, S. (2003) in his dissertation “Credit management of joint venture banks” states 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 bank established in the private sector.

Ojha, L. P. (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 find 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.

**2.4 Research Gap**

The review of above relevant literature has contributed to enhance the fundamental understanding and knowledge, which is required to make this study meaningful and purposeful.

In this study of Credit Management of Commercial Banks: A Comparative Study of Siddhartha and Sanima Bank Limited various trend analysis and various statistical tools are used for analyzing primary and secondary data. Since the researcher have used secondary data only five fiscal year but all the data are current and fact. This study tries to define credit management by applying and analyzing various statistical tools like coefficient of correlation, regression and trend analysis. The researcher here have considered the use of linear regression model which is different to that of the previous researches conducted which considered multivariate regression model, these model being free of multicollinearity problems. Probably this will be the appropriate research in the area of credit management of bank and financial institutions.

Most of the previous researches, Thapa (2011) shows that there is a significant relationship between bank performance and loan management through ratio analysis of credit deposit ratio, ROA, ROE, cash and bank balance to total deposit ratio, investment to deposit ratio. Adhikari and Jha (2020) have considered trend analysis of loan, deposit, investment, and interest income to show lending practice of two commercial bank for the purpose of the study whereas this research here has considered various factors with use of correlation, regression, probable error and trend analysis for the purpose of the study which are hardly considered by any of the previous researches made on this topic. Also previous researcher has consider only secondary data for the purpose of the study where as in this research both primary data and secondary data has been considered to analyse factors that affect the credit management of commercial bank.

# RESEARCH METHODOLOGY

## 3.1 Introduction

Research Methodology is a way to solve the research problem systematically. It may be understood as a science of studying how research is done scientifically.

## 3.2 Research Design

A research design is an overall framework or plan for the collection and analysis of data.

The design may be a specific presentation of the various steps in the problems, formulation of hypothesis, conceptual clarity, methodology, survey of literature and documentation, bibliography, data collection, testing of the hypothesis, interpretation, presentation and report writing. Generally, a common research design possesses the five basic elements viz. (i) selection of problem (ii) methodology (iii) data gathering (iv) Data analysis and (v) report writing.

## 3.3 Sources of Data

There are two sources of data collection. The research is based on primary as well as secondary source of data. Even though adequate data are collected from secondary sources.

a) Primary Source:

The primary source of data will be collected from the concerned bank. The way of data collection is by making questionnaire and distributed to the credit department of the concerned bank. Some data and fact are only possible due to frequent inquire and asking to the concern personnel.

b) Secondary Source:

Secondary data is the data that already exists which has been collected by some other person or organization for their use, and is generally made available to other researcher free. Secondary data has been downloaded from www.nrb.org.np, an official web site of NRB. This study is based on the historical data disclosed by annual reports of commercial banks and Nepal Rastra Bank. However, secondary data may not always answer that specific question of a research.

## 3.4 Population and Sample

Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate. The method of selecting for study a small portion of the population to draw conclusion about characteristics of the population is known as sampling.

Here, the total 27 commercial banks shall constitute the population of the data and two bank under the study constitute the sample under the study. So among the various commercial banks in the banking industry, Here Siddhartha bank ltd and Sanima bank ltd has been selected as sample for the present study. Likewise, financial statements of five years (beginning from 2015/16 to 2019/20) are selected as samples for the purpose of it.

## 3.5 Research Variables

For the sake of simplicity of entire research process only one independent variable i.e. loan has been considered for analytical purpose .Similarly deposit, investment, income, interest and borrowing have been taken as independent variables. In between these dependent and independent variables, bank policy and strategy is considered as moderating and intervening variables. Relationships between these variables are studied in correlation and regression analysis.

### 3.6 Data Analysis

Data analysis consists of categorizing data, coding them, tabulating and then drawing statistical inferences keeping in mind the objectives to be fulfilled. It includes closely related operations like summarizing the collected data and organizing in such a manner that they will yield answers to the research questions. SPSS software will be used for the results of correlation coefficient and regression.

#### 3.6.1 Primary data analysis

The primary data questionnaire comprises of ranking questions, single choice questions, multiple choice questions, likert scale questions. The questionnaire also included some variables that may have direct impact the loan management of commercial bank, which are not included in secondary data analysis. Once the data's were gathered, they were entered in SPSS. The analysis such as descriptive, pearson's correlation, percentage and frequencies were obtained from these data's. The output drawn from the SPSS were firstly copied to Ms- Excel for the effective presentation and later they were inserted into the report.

#### 3.6.2 Secondary data analysis

This study has used econometric models along with statistical tools to analyze the relationship among dependent and independent variable. The results were carried out in the SPSS software. All the dependent and independent variables are tested under the simple regression model.

### 3.7 Specification of model

Under this study, the econometric that researcher has followed is Linear Regression Model (Simple Regression) which is shown below

Y=$\alpha + \beta X + \varepsilon$

Where,

Y= Loan management (dependent variable)

$\alpha$= Intercept

$\varepsilon$= Residual Error

$\beta$= Coefficient of parameters

X= Independent variable

The definition of independent variable for this study is shown below

1. Deposit
2. Investment
3. Total Income
4. Borrowing

## DATA PRESENTATION AND ANALYSIS

Data collected from secondary sources are in raw form whereas data collected from primary sources are final data, just need to present in systematic way. It is necessary to arrange these data so that it can be interpreted and understood to the researcher and reader of this thesis. For this data are scanned, cleaned and organized. Different types of data need different method of representation. There are number of method which can be used to present and interpret the data. However the simple and easy way is to present data in the form of chart, graph and tables. Also, the analysis and interpretation of the information and data produced from questionnaire is also contained in this chapter and the data results of the study will be analyzed by determining their corresponding ratio, percentage, mean, correlation and regression. In addition Pie charts and line chart has been used to illustrate some of the analyzed data.

## ORGANIZATION OF THE STUDY

This study has organized into the following five chapters:

**Chapter I: Introduction**

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

**Chapter II: Review of literature**

This chapter reviews the existing literature on the problems and prospects of impact of motivation in Nepalese banking. It also contains reviews of journals and articles, related to the subject.

**Chapter III: Research Methodology**

This chapter expresses the way and technique of the study applied in the research process. It includes research design, population and sample, data collection procedure and processing, tools and method of analysis.

**Chapter IV: Analysis and Interpretation of Data**

In this chapter collected and processed data are presented, analyzed and interpreted with using financial tools as well as statistical tools.

**Chapter V: Summary, Conclusion and Recommendations**

In this chapter, summary of whole study, conclusions and recommendations are made.

At the end of the study, Bibliography and Appendices have also been incorporated.

# RERERENCES


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