CHAPTER I

INTRODUCTION

1.1 Background of the Study

Finance is the life blood of the economy of any country and the well managed finance institution are the vehicles which drive the country to the economic development. A proper financial system plays a vital role in both developed and developing countries. According to Peter E. Rose “A financial system encompasses the financial markets, institutions, laws, regulations and techniques through which financial assets are traded, interest rates are determined and financial services are produced and delivered around the world” (Shrestha & Bhandari, 2004: p.8). It carries saving wealth, liquidity, credit payments, and risk and policy functions. By increasing mobilization of financial resources and sustaining high investment levels, an efficient financial system contributes to greater accumulation of productive capital. It is bridge between savers and users. In other words it collects the scattered and idle savings and mobilizes it into productive channels for the maximization of wealth.

In financial economics, a financial institution acts as an agent that provides financial service for its clients. Especially financial institutions are depositary institution, loan providing institution, brokerage firms and insurance companies. They have been giving lots of financial services such as deposit collection, brokerage, consultancy, fund transfer, bank guarantee, letter of credit, loans, bill purchase, debenture issue, e-commerce and credit card and other allied services, etc. Financial institutions are the one which make the financial markets work. Without them, financial markets would not be able to move funds from people who save, to people who have productive investment opportunities. They, thus also have important effects on the performance of the economy as a whole. The question, “How are the financial institutions generating their financial services?” is the main concern for the development of the country. Although it play major role in the development of the country, it is affected by the open market and liberalization policies of government. Nepal Rastra Bank is the apex institution of the monetary and banking structure of the country. It plays a leading role in organizing, supervising, controlling, regulating and developing the monetary and financial system. Nepalese financial system can be looked into two broad categories i.e. banking and nonbanking institutions. All the commercial banks are considered as banking sector, while financial institutions other than banks are considered as nonbanking sectors. Similarly finance companies fall under nonbanking financial institution.

Finance companies are those intermediaries which link the savers and users of capital. Basically, finance companies collect scattered savings of the individuals and mobilize in the various productive sectors in the form of investment or lending such as hire purchase, purchase of land, housing loan, etc. In conceptual term, finance companies are non banking financial institutions and they are one of the large most diverse non depositary institutions that have developed world wide. They are different from commercial banks and other financial institutions in terms of their orientation for management risk taking, lending policies and practices, size and potentiality, service delivery mechanism and efficiency. Besides equity their main sources of fund are time deposit collection and issuance of debentures. They are allowed to invest in securities and invest securities and issue guarantee. They are also free to fix interest rates on deposits and loans but the spread on loan and deposit shouldn't exceed 6% (Gurung, 2005:p.3). In the context of under developed countries like Nepal, it is a new type of institution. The primary goal of developing countries like Nepal is to achieve rapid economic growth and development to uplift the welfare of the citizen and the country. Finance companies are regarded as the catalyst of economic development of a country because they help in mobilization of the domestic resources, produce loan and cause financial innovations to facilitate the trade and transaction.

Finance companies, licensed under the "Finance Companies Act 1985"are the third largest group of deposit taking financial institutions in Nepal. They are the creation of early 1990's. They were established as public limited companies mainly for providing loans to procure motor vehicles and other consumer durables on hire purchase loans, terms loans, land acquisition and building constructions and leasing plant and machinery. Finance companies lending operations have tended to complement the operations of the commercial banks, mainly in urban areas. But these companies are not allowed to accept demand and saving deposits from public and have thus concentrated in mobilizing funds through fixed deposits (NRB, 1996:p.45).

Finance companies came into existence under the Finance Companies Act 1986 but now are operating under the bank and Finance Ordinance 2004. Finance company can be registered as limited company in the office of Company Registrar and license for operation is granted by Nepal Rastra Bank. A finance company can accept time deposit of the maturity of minimum 3 months to maximum 6 years to a limit of twelve times of the core capital of the company (Economic Report, 2003/04:p.38). Finance companies advance loans to individuals, firms, companies or institutions .Such companies are allowed by the ordinance to undertake lease financing, offering credit for purchasing or construction of residential building. They can also perform merchant banking activities with prior approval of Nepal Rastra Bank. These companies are popular among low income and medium class people for financing hire purchases, vehicles, machinery tools, equipments, durable household goods, etc. As a consequence of the financial liberalization policy, finance companies are mushrooming in the Kathmandu valley, whereas their presence out of the valley is thin but growing gradually.

By various ways finance companies are playing a significant role in the whole economy of the country. Finance companies are those which help the financial markets work. Therefore it is relevant to study and find out the present status of the finance companies in Nepal. Finance companies perform a various activities. Among them, investing in different sectors is also considered as the important and risky one. For this, they have to pay due consideration while formulating investment policy. A sound and viable investment policy can be effective one for the economy to attain the economic objectives directed towards the acceleration of the pace of development. A good investment policy attracts both borrowers and lenders, which helps to increase the volume and quality of deposits, loans and investment. The loan provided by the finance companies is guided by different principles such as length of time, safety, their purpose, profitability, etc. In broad sense the investment operation of finance companies includes lending and investing in different types of securities. Lending is the primary investment activity and investing in different types of securities is the secondary investment activity. The main objective is to maximize the return and minimize risk. For this, sound and viable investment policy should be implemented and profitable areas of investment should be identified. In other words, the optimum portfolio should be used which helps in achieving goal of the company. Finance companies are really the portfolio of risky assets and liabilities, so portfolio theory is necessary to understand corporate finance.

Investment portfolio is the combination of the different types of assets through which the investor maximizes the return and minimizes the risk. It should insure minimum risk and maximum profit. The trend of banking and financial institution made difficult to survive each institution without proper planning. The combination of when to invest, where to invest, how to invest, how much to invest, falls under planning of investment. In this rapid age of 21st century, the financial sector is facing various challenges. High non-performing loan, unhealthy competition, low income level of people, high rate of liquidity position, poor and inadequate supervisory system, etc. are the challenges for finance companies. Till now 79 finance companies have been established in Nepal (http://www.nrb.org.np).

Om finance is one of the pioneer and leading finance companies of Pokhara. It was registered in 2054 B.S. by the group of highly reputed and skilled board of directors. In 29th Bhadra 2057 B.S. Nepal Rastra Bank provided the licesence of finance company, thus Om Finance Company started its operation from 1st Ashwin 2057 B.S. It was finally inaugurated on 9th Ashwin 2057, Monday by the Honorable Speaker of the House of Representative Mr. Tara Nath Ranabhat (http://www.omfinance.com).

The head office of this finance company limited is situated in Newroad Pokhara. From its starting phase Om Finance is trying to bring motivation in the economic condition of the country, establish economic favor to the every individual and utilize the freezed capital of the country, plan and invest in an ordered (step by step) manner and upgrade the economical policies of Nepal. Om Finance Limited is providing the cutting edge facilities to Pokhara and Kathmandu valley as per market demands to fulfill the basic to every level of customer demands. The services provided by the finance company are trustworthy, protective and easy financial services. Famous and successful industrialists, businessmen, social workers and people having years of experience in financial sector of Pokhara are in the Board of Directors. Om Finance provides the flexible, easy and secure environment for the customers with the slogan, "Save Money for the Better Future". The main activity of Om Finance is to collect the dispersed savings of the people, convert them into capital and lend them to the individuals or institutional borrowers. As a whole the main objective of Om finance is to uplift the national economy by considering financial and technical facility to general public. Similarly, to provide economic, technical and financial suggestions to industrialist and businessmen, to develop and encourage manufacturing company, business house, agriculture and tourism sector, to develop saving habit in people and to provide trustworthy, secured and easy service are the other objectives of OFL. Till today, Om Finance has expanded its activities in Kathmandu valley of the country.

At the starting period, Om Finance had authorized capital of Rs 40,000,000, issued capital of Rs 20,000,000 and paid up capital of Rs 20,000,000 and at present it has increased to Rs 300, 000,000, Rs 160,000,000 and Rs 84,000,000 respectively (Annual Report 2064/65, OFL). All the decisions are taken by the board of directors under the rules and regulations formulated by NRB as well as Finance Company Act 2042 B.S. The finance company is being handled by the well experienced, leading and reputed industrialists as the board of directors. Daily transactions are being handled by the dedicated, capable and skilled officers and all the transactions are being carried on by the Secured Computerized System for the better quality service and result oriented managerial decisions.

Om Finance collects deposits under various deposit schemes like fixed deposit, systematic deposits, provident fund deposit, Om saving account, etc and invests it in different sectors like hire-purchase, trade loan, housing loan, industrial loan, collateral loan, etc. It is the one among the various finance companies that has been able to earn profit from the very beginning of the company's operation and also it is one of the highest tax payer companies of the Gandaki zone. Thus it can be said that Om Finance Company Limited has been contributing a lot for the development and enlistment of the society people as well as economy of the nation.

1.2 The Statement of the Problem

Nepalese economy is facing serious problem due to imbalance between resource mobilization and expenditure, saving and investment, import and export and lack of control over population growth. Various financial institutions have been established to assist the process of economic development of our country. Finance companies have been playing role by accepting deposits and providing various types of loans and investing in different sectors. There are many commercial banks, development banks, finance companies and many more cooperative societies in existence within Pokhara valley as well. Every organization cannot accomplish their predetermined goals and objectives without efficient and proper planning in investment in the tough competitive environment between themselves. So the deep and brief study is required. This study which is only a partial fulfillment of MBS program will not be able to analyze all facts about the subject matter. However it has discussed the basic issues on investment portfolio especially concerned with OFL and has analyzed the following problems:

- What are the sources and level of fund of OFL for the investment?
- What is the trend of investment portfolio in OFL?
- How are loan and advances of OFL classified?
- What is the position of profitability, activity, asset management and liquidity of OFL?
- What are the problems faced by OFL in the investment process?

1.3 The Objectives of the Study

The general objective of the study is to analyze the investment portfolio of OFL. Other specific objectives are listed below.

- To determine the sources and level of fund of OFL for investment.
- To analyze the trend of investment portfolio in OFL.
- To analyze the classification of loan and advances of OFL.
- To evaluate the position of profitability, activity, asset management and liquidity of OFL.
- To ascertain the problems faced by OFL in the investment process.

1.4 Significance of the Study

Research itself has its own importance because it aims to gain knowledge and to add the new literature in existing field. Basically, the proposed study is important for the researcher to fulfill the academic requirement of master’s degree. Beside this, the study facilitates the different people in following ways:

- The study helps the management of OFL about the diversification of investment of the company
- It provides useful feedback to shareholders and general public to invest.
- It helps the entrepreneurs and businessmen by providing the information related with credit facilities.
- It can help the government by paying corporate income tax of its profit.
- It helps the researchers, students and other interested people for further study and research.

1.5 Delimitation of the Study

The study has got certain delimitations:

- Among many other financial institutions in Nepal, the study is only concerned with OFL of Pokhara.
- The study only covers only six years period beginning from the fiscal year 2059/60 to 2064/65.
- The whole study is based on secondary data i.e. financial reports, annual reports and the information provided by the company and other related sources.
- The study generally focuses on the investment portfolio of OFL, so doesn’t pay any attention towards the whole company pattern.

1.6 Organization of the study

The whole study is divided into five chapters. The first chapter deals with introduction which includes background, statement of problem, objectives of the study, significance of the study, the delimitations of the study and organization of the study. The second chapter deals with research methodology and it deals with research design, population and sample, nature and sources of data, data collection procedures and data analysis tools. The third chapter covers the literature review which includes history of financial institution in Nepal, conceptual review and review of the related studies. The fourth chapter deals with presentation and analysis of relevant data and information and major findings of the study. Finally the fifth chapter summarizes the whole study. It draws conclusions and forward recommendations for the improvement of investment in the future. At the end, Bibliography and Appendices are also included.

CHAPTER II

REVIEW OF THE LITERATURE

In this chapter the attempts have been made to review the useful topics of literature relevant to study area as they provide ideas and data which are very useful to the study. Every possible effort has been made to grasp the knowledge and information that is available from libraries, internet, the concerned finance company and other data collection centers. Conceptual foundation is the very essential thing for the better result of any kind of study. So this chapter is very helpful to complete the whole study and it also helps to avoid duplication. This chapter is further divided into two parts which are:

- Conceptual Review
- Review of the related studies

2.1 Conceptual Review

This section of the study consists of the terms and conditions related to the study and which are very helpful for the further study also. Here the attempt is made to review the conceptual aspects regarding the history of financial institutions in Nepal and investment portfolio. It presents the theoretical aspects of the study. It includes the history of financial institutions in Nepal, concept of investment, investment portfolio, factors to be considered while choosing among investment alternatives, portfolio management, objectives of portfolio management, portfolio diversification, sources of risk and features of sound lending and investment policy.

2.1.1 History of financial institution in Nepal

The economic development of the nation depends on agriculture, industries and commercial activities. Government has to formulate the strategy and policies and have to implement them effectively. The ninth development has been completed since 1958 A.D. (BS.2013) and the tenth plan is running for the development of the nation (Nepal Rastra Bank, 199

In our country Nepal, the history of finance company is not so very old. Goldsmith, merchants and money lenders were the ancient bankers of Nepal. In the 14^{th} century, King Jayasthiti Malla, the great ruler of Medieval Period, classified the people indifferent castes according to their occupation. Tankadhari was one of the categories of people who worked as a moneylender. They used to invest money to the needy persons by charging some percentage as interest.

"Tejarath Adda" was the first step towards the institutional development towards financial institution in Nepal. It was established at B.S.1933 during the period of Prime Minister Ranodip Singh. It granted loans to the people at 5% interest rate against gold, silver and ornaments. At the beginning the service was provided to the government service holders repayable in installment basis to their salary. Later, the service was extended to the normal people as well. During the prime ministership of Chandra Shamser, Tejarath Adda extended its services by opening its branches outside Kathmandu valley. The history of modern financial system began by the replacement of Tejarath Adda by Nepal Bank Limited, which was established in 1937 A.D. (B.S. 1994), as the first commercial bank in Nepal. Nepal Bank Limited had a responsibility of attracting people towards banking sector from predominant moneylenders and expanding banking services. It paid more attention to profit generating business and preferred to open branches in urban areas as it is a commercial bank.

One of the major responsibility of the government is to provide banking services everywhere in the country and also managing the financial system in a proper way. Thus Nepal Rastra Bank was established on 1956 A.D. (B.S.2013/01/14), as a central bank under Nepal Rastra Bank Act 2012. Since then it has been functioning as the government bank and has contributed to the growth of financial sector. Within a decade of establishment of Nepal Rastra Bank, many institutions such as Nepal Industrial Development Corporation (1959 A.D.), Employee Provident Fund (1962 A.D.), Rastrya Banijya Bank (1966 A.D.), Nepal Insurance Corporation (1969 A.D.), Agriculture Development Bank (1974 A.D.) and securities marketing Centre (1976 A.D.) were established.

The country is in the process of institutional restructuring of financial sector. The face of banking has changed tremendously after the adoption of financial liberalization policy since 1980s. The international wind of liberalization and the inadequacy and inefficiency service provided by the existing banks forced authorities to open up the financial sector to the private sector both domestic and foreign. Hence, Nepal, in the process to make banking system more transparent and international delivery standard, can be observed that progressive liberalization of the banking system has brought out, among others, a sea change in the banking and financial activities.

The process included the deregulation of interest rate, free entry for banks and financial institutions, removal of statutory liquidity ratio (SLR), enactment of “New Commercial Banks, Finance Company and Development Banks Act”, so as to encourage private sector including foreign bank and financial institutions, divestment of government shares in financial institutions, allowing cooperatives and non-governmental organizations (NGOs)for limited banking activities and freedom of portfolio management except in the priority sector lending, etc. As a consequence of these measures, Nepal Arab Bank Limited, the first joint venture commercial bank was established in 1984 A.D. (B.S. 2041/03/29) rename as Nepal bank Limited since 1st January 2002, Nepal Indo Suez Bank (converted as Nepal Investment Bank on 30th May, 2002) and Nepal Grindlays Bank Limited (changed to standard Chartered Bank Nepal Limited on 31st July, 2001) were established in1986 and 1987 A.D. respectively. Himalayan Bank Limited in 1988 A.D., Everest Bank Limited in 1995 A.D., Nepal SBI Bank Limited in 1995 A.D. were established. The process expanded in 1990 with more banking coming in the private sector. They are Nepal Bangladesh Bank Limited, Nepal Bank of Ceylon Limited (converted to Nepal Credit and Commercial Bank Iimited on 10th September 2002), Lumbini Bank Limited, Kumari Bank Limited and Laxmi Bank Limited (Sharma, 2005:p. 29).

There were few insurance companies and Karmachari Sanchaya Kosh working as non banking financial institution before enactment of Finance Company Act 2042 B.S. Need of Finance Company Act was felt because unorganized sector was collecting savings from the common public in the name of Uphar and Dhukuti programmes but they were cheated by most of the organizers of these programmes. Considering peoples interest in such programmes, benefit of mobilizing such savings in productive sector, banking sectors inability to carry out capital market activities and to meet the consumer need for finance companies, Finance Company Act was introduced in 2042 B.S. However no finance company was established till 2049 B.S. as the act came into existence only in 2049 B.S., with some amendment. In 2048 B.S., Nepal Rastra Bank authorized co-operative institutions to set up under Co-operative Act to accept deposit and provide credit.

Nepal Awas Bikas Bitta Company limited is the first finance company established in 2049 B.S. promoted by Rastriya Banijya Bank, Agriculture Development Bank and Nepal Arab Bank Limited. In the same year, Nepal Finance and Saving Company Limited was established from the private sector. The number of finance institutions has drastically grown up in a short time span. Now there are 79 finance companies in existence which are operating under Nepal Rastra Bank. The number of insurance companies, co-operatives and non-government organizations (NGOs) authorized for limited banking activities are also growing up. Till now the number of banks and the financial institutions has reached to 260 among which the number of financial institutions listed on NEPSE reached to 118 till Poush 2065 (http://www.nrb.org.np). The reason for their speedy growth is higher interest rate in on deposits low administration cost fast service fast decision less liquidity and high demand for consumer credit. To improve the financial legislative framework, some new acts, namely Bank and Financial Intuition Act, 2006; Nepal Rastra Bank (First Amendment) Act, 2006; Insolvency Act, 2006; Secured Transaction Act, 2006; Company Act, 2006 have been enacted. Money Laundering Control and Deposit and Credit Guarantee Acts are expected to be soon materialized, all with the goal of strengthening the financial sector through building on its healthy development and improved stability (http://www.nrb.org.np).

The number of banks and financial institutions in Nepal are as follows*:

1.	Nepal Rastra Bank	1
2.	Commercial Banks	25
3.	Other Financial Institutions	
	Development Banks	59
	Finance Companies	79
	Micro – finance Institutions	12
	Financial Co-operatives	16
	Financial Nongovernmental Organizations (NGOs)	47

4. Nepal Stock Exchange 1

5. Insurance Companies 22

*Nepal Government, Ministry of Finance. Economic Survey (2064/65), p. 59.

The historical scenario of banks and financial institutions is presented in the following table 2.1

Table 2.1

Historical Scenario of Banks and Financial Institutions**

Year	Commercial banks	Development banks	Finance Companies	Cooperatives & Microfinance Institutions	Financial NGOs	Total
1983	2	2	_	_	_	4
1993	8	4	4	_	_	16
2000	13	13	46	35	7	114
2005	17	31	60	39	47	194
2006	19	43	72	39	47	220
2008	25	59	79	50	47	260

** NRB 52nd Anniversary Special Issue (2064), p.74

** <http;//www.nrb.org.np>

2.1.2 Investment

Traditionally, investment is defined as the current commitment of resources in order to achieve later benefits. If resources and benefits take the form of money, investment is the present commitment of money for the purpose of receiving (hopefully more) money later. The transformation of present saving into different types of assets with the objective of earning more wealth in the future is known as investment. In another words the expenses created by the objective of earning extra profit in the future is called investment. Generally the present consumption is decreased and the savings created by it is spent to obtain the different types of assets is called investment. The service or the product which is available or consumed by the available savings in the present needs more in the future. Therefore to live like present in the future also or to raise the living standard, some part of the present income should be saved without spending all of it and should be invested in profitable areas. From the investment two types of advantages could be gained i.e. regular income and capital gain. Thus the expenditure of the savings with the objective of capital gain and regular income can be called as investment. In another words investment is the employment of funds with the objective of realizing additional income or growth in value at the future date. Investment is a word of many interpretations. There are basically three concepts of investment (Bhalla, 1999:p.3).

Economic investment that is an economist's definition of investment

Investment in a more general and extended sense, which is used by "the man on the street"

The financial investment – Financial investment is the form of this general or extended sense of the term. It means an exchange of financial claims like stocks and bonds (collectively termed as securities), real estate, mortgages, etc. The term financial investment is often used by investors to differentiate between the pseudo investment concept of the consumer and the real investment of the businessman. A distinction is often made between real and financial investments. Real assets generally involve a tangible (physical) assets such land, machinery or factories, etc but financial investment involve contracts written in paper, such as common stocks and bonds.

Alexander, Sharpe and Bailey (1999) defined investment in this way "Investment in its broadest sense, means the sacrifice of current dollars for future dollars. Two different attributes are generally involved: time and risk. The sacrifice takes place in the present and is certain. The reward comes later, if at all, and the amount of the reward is generally uncertain. In some cases the element of time predominates (for e.g., with government bonds). In other cases risk is the dominant factor (for example, with call options in common stocks). In yet others both time and risk are important (for example with shares of common stock).

Likewise Fischer and Jordan (2000) have defined "Investment is a commitment of funds made in the expectation of some positive rate of return. If the investment is properly undertaken, the return will be commensurate with the risk the investor assumes." Similarly according to Jack Clark Francis (1991) "An investment is a commitment of money, which is expected to generate additional money. Every investment entails some degree of risk; it requires a present certain sacrifice for future uncertain benefit."

V.K. Bhalla (1999) has defined investment in this way: "Investment is the sacrifice of certain present value for the uncertain future reward. It entails arriving at numerous decisions such as type, mix, amount, timing, grade, etc. of investment and disinvestment. Further such decision making has not to be continuous but rational too."

Broadly speaking, an investment decision is a tradeoff between risk and return. All investment choices are made at points of time in accordance with the personal investment ends and in contemplation of an uncertain future.

2.1.3 Investment Portfolio

The term portfolio simply means collection of investments. For an investor in stock exchange, the portfolio is the collection of different types of securities in different companies. For a property investor, portfolio is the collection of buildings and real assets. For a financial manager of an industrial company, the portfolio is the combination of capital projects. But generally investment portfolio is the combination of securities or assets. In another words, investment in more than one alternative with the objectives of gaining more is called investment portfolio.

Risk may be increased if all the money is invested in only one area. But if the investment is in more than one area the risk is decreased because if there is loss in one area, it may be covered by the gain in another area. The main assumption of portfolio is "the risk caused by the investment done in more than one asset is less or sometime zero than the risk produced by the investment done in a single asset". That's why; different investors, banks and financial institutions consider this assumption and give priority to investment diversification. Combinations of risky assets in the form of portfolios provide a set of investment opportunities for investors. Portfolios of assets usually offer the advantage of reducing risk through diversification.

Portfolio theory deals with the selection of optimal portfolios that is the portfolios that provide the highest possible returns for any specified degree of risk or the lowest possible risk for any specified rate of return.

2.1.4 Factors to be considered while choosing among investment alternatives

Investors do not invest in all investment alternatives available in the market. They choose a few among them. While choosing, they have to consider the following factors:

- Investment objective: All investors have some purpose of investing. These different purposes require investment in different types of investment alternatives. The objective of investment dictates the choice of investment alternatives.
- Expected rate of return: Different alternatives offer different rates of return. An investor begins his/her selection process by looking at the past rates of return of the alternatives. The rates may not continue in the future or new alternatives may not have past return. Therefore an investor should estimate the expected rate of return of the alternatives under consideration.
- Risk: In context of investment, risk is the chance of incurring losses. It is very high in some investment alternatives like commodity features while it is small in some other alternatives like short term government securities. Therefore proper risk analysis should be done according to the nature of investors themselves.
- Tax consequences: Government taxes income received from most investment alternatives. Further taxes to be paid also depend upon the tax status of the investor. Therefore taxes are important factors which directly or indirectly influence the investor while taking investment decisions.
- Investment horizon: Investment horizon means the length of time for which the investment is made, which is closely related to the investor's objective of investment. The nature and type of investment alternatives to be selected depends upon investment horizon.
- Investment strategy: It is the combination of selection, timing and diversification. It plays a vital role to take an investment decision.

2.1.5 Portfolio Management

Portfolio management is the process of managing money. It is also known as investment management. According to Sharpe, Alexander and Bailey, it may

- be active or passive
- use explicit or implicit procedures, and
- have a high risk level that is relatively controlled or uncontrolled.

The trend is toward highly controlled operations consistent with the notion that capital markets are relatively efficient. However approaches to investment management vary widely. The basic problem of portfolio management is to establish an investment objective or goal and then decide the best to reach the goal with the securities available. In other words, investor wants to obtain maximum return with minimum risk. Thus the process of portfolio management also involves logical steps common to any decision i.e. planning, implementing and monitoring. Various functions have to be performed in order to manage the investment properly which are as follows:-

I. Set investment policy: Identify the client's investment objectives, particularly as regards his/her attitude towards the tradeoff between expected return and risk.

II. Perform security analysis: Scrutinize individual securities or groups of securities in order to identify mispriced situations.

III. Construct a portfolio: Identify specific securities in which to invest, along with the proportion of investible wealth to be put into each security.

IV. Revise the portfolio: Determine which securities in the current portfolio are to be sold and which securities are to be purchased to replace them.

V. Evaluate the performance of the portfolio: Determine the actual performance of a portfolio in terms of risk and return, and compare the performance with that of an appropriate "benchmark" portfolio.

2.1.6 Objectives of Portfolio Management

Basically the main objective of the portfolio management is to maximize return with risk avoidance or the minimization of risk inherent in the portfolio. The other objectives of the portfolio management are as follows:

- Safety and security of an investment
- Liquidity
- Marketability
- Tax planning (capital gain tax, income tax and wealth tax)
- Increment in the shareholders wealth

2.1.7 Portfolio Diversification

Diversification is a combination of securities in such a way that it reduces relative risk. It is so because individual returns do not move in concert(Horne, 2005:p.70). The part of a risk that can be reduced through diversification is defined as unsystematic risk, while the part that can be reduced through diversification is defined as systematic risk or market related risk. Diversification is the process of adding securities to a portfolio to reduce the portfolios unique or unsystematic risk and there by portfolios total risk.

Simple Diversification

Simple diversification can be understood as "not putting all the eggs in one basket". That means, we can reduce investment risk simply by spreading our investment in different securities. It is not necessary to choose and include too many securities in the portfolio. Even the portfolio of randomly selected securities can reduce risk. A portfolio consisting of 10 to 15 randomly selected securities can eliminate almost all diversifiable risk (Shrestha, 2003:p.149).

Markowitz Diversification

Markowitz diversification is named after Harry Markowitz, who first explored it. It may be defined as combining assets which are less than perfectly positively correlated in order to reduce portfolio risk without sacrificing portfolio return. It is more analytical than simple diversification and considers assets correlation or covariance in portfolio formation. It shows that lower the correlation between assets, the more that the diversification will be able to reduce the portfolio risk. The essence of the Markowitz diversification is that we should combine assets having less than perfectly positively correlated securities.

2.1.8 Sources of Risk

All investments bear risk. Therefore the investors should aware of the types and the sources of risks. For an investment in securities, following types of risk are relevant (Shrestha, 2003:p.50) :

Financial Risk

Financial risk is the uncertainty about the rate if return from an investment caused by the firm's sources of financing or the capital structure. It arises because of the use of fixed cost capital like debt and preferred stock capital in a firm. The higher the financing charges (interest and preferred dividend), higher the degree of financial risk will occur in the investment. Firms exposed to high financial risk may incur heavy loss in spite of good operating profit.

Business Risk

Business risk refers to uncertainty about the rate of return caused by the nature of the business. It arises because of the fluctuations in firm's sales and operating expenses and affects operating profit.

Management Risk

Management may have to take decisions in various ways like launch new product, borrow heavily from the market, drop existing product line, etc. These management decisions severely affect the business; hence there is a risk to the existing securities holders.

Default Risk

Default risk is related to the security issuing firm's inability to meet its obligations. Therefore it is closely related to the financial condition of the firm. In case of default, investors are likely to lose some or all the initial investment made in that company. Default risk is assumed to be zero in the government securities.

Interest Rate Risk

As the present value of the return from investment moves inversely with the market rate of interest, fluctuation in the market interest rate causes fluctuation in the value of investment. This fluctuation in the value of investment induced by the changes in market interest rates is known as interest rate risk. The fluctuation in the market interest rate is an important source of investment risk.

Purchasing power Risk

Inflation erodes the purchasing power of a rupee as it has become a common phenomenon in a economy. The risk due to this erosion in the purchasing power of money is known as purchasing power risk. Investors in fixed income securities are exposed more to purchasing power risk.

Liquidity Risk

An asset is said to be liquid if it can be sold in the market in reasonably short period of time without losing the value of asset. The risk associated with the uncertainty created by the inability to sell an investment made in that company is known as liquidity risk.

2.1.9 Features of a Sound Lending and Investment Policy

Generally, the income and the profit of a finance company depend upon its lending and investment policy of its funds in different securities. The chance of profit earning for the finance company will be high if there is more credit creation. Since, it is a pre-requisite for the company's profitability and also for the promotion of financially backward country like Nepal, a sound lending and investment policy should be formulated.

There some factors which should be considered in order to have sound lending and investment policies for the finance companies, which are as follows:

a. Safety and security

A finance company should strongly consider the principle of safety, to follow the investment policy. If it invests its fund in those securities which are subjected to too much depreciation and fluctuation, then a little difference may cause a great loss which is not good for the financial institution. Therefore the finance company should accept such types of securities which are commercial, durable, marketable and high market price.

b. Liquidity

Liquidity is one of the most important factors of lending and the finance company should not forget the principle of liquidity while it is following its investment policy. Liquidity refers to the ability of the firm to repay the money when required. While investing its excess fund in different sectors, the finance company should keep in mind whether it can meet the current or the short term obligations, when they become due, in order to maintain the certainty of the depositors. Therefore, they should keep adequate liquid fund, which helps in moving the profit and liquidity together.

c. Diversification

Finance company should also take into consideration about the diversification of its investment. Diversification aims at minimizing risk of the investment of the company. According to the principle of diversification, a company should not invest all their funds only in one particular sector rather it should invest fund in the various sectors. By studying and analyzing the different sectors where it is possible to earn more from little investment it should extend its investment. By investing in more than one sector it becomes successful in keeping balance which helps the company to be competent itself. Therefore the popular saying "Do not put all eggs in the same basket." is justified.

d. Legality

The finance company should follow the rules and regulations as well as the directions granted by NRB and Ministry of Finance while mobilizing its fund otherwise securities may bring out various problems for the investors.

e. Profitability

Profitability should be the cardinal principle for making the investments. According to the principle of profitability, investments should in such sectors which ensures higher rate of return as they have to meet all expenses for daily administration, growth and expansion as well as payment of dividend to the shareholders. The profit and liquidity are two opposite principles. If a company pays its attention only to profit, the liquidity becomes less and if it pays attention only to liquidity, it can't be a long term investment and can't get profit. So, equality should be maintained in it i.e. there should be a proper check and balance between risk and return for an investment.

2.2 Review of the Related Studies

This sector consists of the review of the related past studies. It is found that different studies have been carried out regarding the investment of banks and finance companies. In this process the attempt have been done to grasp the required knowledge from the related studies, available in the libraries and internet.

Upadhyay (2004), has conducted a study on financial analysis of Pokhara Finance Company Limited and Annapurna Finance Company Limited comparatively. He has attempted to analyze the financial performance of Pokhara Finance Limited and Annapurna Finance Company Limited in his study paper. By using different financial tools for data analysis and he has concluded that the Pokhara Finance Limited is not able to meet the demand of depositors, the credit creation capacity is good in both companies in aggregate, the earning power in Pokhara Finance Company is sound and has retained its earning in productive sector than Annapurna Finance Company. He suggested the both to raise additional share capital and utilize in purchasing the fixed assets, to utilize their idle capital in more productive sectors, to do further effort for credit creation based on deposits, and the management, to adopt appropriate plans and policies based on the investors expectation and other realities.

Gurung (2005), has conducted a study on the hire purchase financing of finance companies of Pokhara and has attempted to analyze the current performance of finance companies in Pokhara on the field of hire purchase financing. He has used different financial and statistical tools for data analysis and concluded that hire purchase financing is one of the major and attractive investment schemes of finance companies in Pokhara in particular and country overall. The credit deposit ratios are very satisfactory. The relationship between total deposit collection and total loan to hire purchase loan is highly significant. The business person and professional users are predominantly rushing in utilizing the hire purchase financing due to the easy payment terms. The IRR on hire purchase loan is normally higher than their explicit rate of interest and service charge. Except in few cases there are defaulters in all finance companies. He further concluded that in general, the performance of finance companies in hire purchase financing is satisfactory.

Sharma (2005), has conducted a study on Finance companies in Nepal with major objective to present up to date study on the growth of finance companies in Nepal and to analyze the assets and liabilities structure of finance companies in Nepal. He used the different financial ratios to analyze and present the position of finance companies. He concluded that out of 58 companies, 56 are involved in deposit mobilization, 54 in hire purchase, 55 in housing loan, 56 in term loan and 4 in leasing finance. Against NRB regulation, 42 finance companies in term loan, 8 in housing loan and 5 in hire purchase loan have crossed the legal limit of investing in one sector. The public deposit remained the major source of fund of finance companies and the loan and advances are the major areas of investment.

Gurung (2005), has conducted a comparative study on lending services provided by Annapurna Finance company Limited and Pokhara Finance Company limited with the main objective to compare the lending services provided by both companies. The other specific objectives were to analyze the different types of loan provided to customers, to analyze the weighted ratio of different types of loan, to find out the most demanded loan and to analyze the situation of the income from lending service. By using different ratio analysis tools (financial tools), he concluded that both finance companies lending more on term loan rather than hire purchase, housing loan and fixed deposit loan. Both have different services charge and different interest rate based on loan amount, priority of client.

Similarly K.C. (2005), has conducted a study on investment policy of Nabil Bank Limited on comparison to Nepal Bangladesh Bank Limited with the major objective to find and compare the investment policy of Nabil Bank with Nepal Bangladesh Bank. The other specific objectives were to analyze the nonperforming assets position, to evaluate the investment on loan and advances portfolio, to analyze deposit mobilization and its relationship with total investments, loan and advances and net profit of Nabil Bank in comparison to Nepal Bangladesh Bank and to suggest and recommend some measures on investment to both banks. He has used the different financial and statistical tools to draw the conclusions that Nabil has not good deposit collection, not enough cash and bank balance but good investment in government securities .He further concluded that both the banks have enough assets to pay off their liabilities, Nabil has good loan loss recovery policy. Nabil bank's management is more focused for nonperforming loan than that of Nepal Bangladesh Bank .And Nepal Bangladesh bank found as risk averter and Nabil bank was found as risk taker. On the basis of his study, he recommended both banks to follow the new and very innovative approach to banking marketing. Nabil bank is recommended, not to give much of importance to the government securities and diversify the investment policy on more yield base funds. Both are recommended to control its operating expenses and overhead expenses to increase the profit considerably. They are recommended to invest their funds to the fixed income generating peoples which lowers the portfolio risk.

Likewise, Gurung (2005), in his study conducted in Planning and controlling of investment in Pokhara Finance Company limited, has made endeavor to examine the practice and effectiveness of investment pattern of Pokhara Finance limited by setting the objectives in terms of investment policy and sources of funds, reinvestments and fund generation along with other parameters. He has used different financial and statistical tools to analyze the data and concluded that Pokhara Finance company invest more in term loan rather than hire purchase and housing loan against fixed deposit loan. The company had not well diversified investment portfolio and had satisfactory liquidity and profitability position. He has further recommended that Pokhara finance company should expand lending areas, increase investments in government securities, bond, debentures and other company's shares, which help to balance risk. The services should customer oriented, capital fund should be increases and reformulation of new schemes and policies.

Karki (2005), has conducted his study on investment policy and practices of Nepal SBI bank limited. The researcher's main objective of the study was to review the investment policy adapted by the bank along with other specific objectives to analyze the relationship between various important variables of investment policy, portfolio behavior of loans and advances of the bank ,to evaluate the liquidity , asset management efficiency and profitability and risk position of SBI bank, to determine the proportion of loan loss provision and to access the nonperforming assets position and to analyze the investment trend of Nepal SBI bank limited. In his study, financial ratios were the major tools for the analysis. In addition other simple mathematical and statistical tools were used in the research. Through his research he draw the conclusion that, the bank is running with adequate liquidity, bank has stable policy of advancing most of the loans to the private sectors and only small portion to government sectors, service sectors and only small portion to the government sectors, service sectors and others, efficient mobilization of deposit in investment activities. He further recommends the bank to expand the credit area, to lower the proportion of loan loss provision, to concentrate on customer oriented lending policy, to maintain stable capital adequacy ratios in the bank and to diversify the investment activities to achieve the organizational goals.

Similarly Shrestha (2006), in her study conducted on the investment portfolio of Pokhara Finance Limited has tried to analyze the investment portfolio of Pokhara finance. The other objectives of the study were to analyze the deposit mobilization and investment trend of the company, to measure the liquidity position, profitability position and to analyze the risk and return of the company. By using simple financial and statistical tools, she has analyzed the data and concluded that Pokhara finance has been able to maintain a balance ratio among the deposit and investment. It is employing safe lending procedure for investment, there is strong positive relation between deposits, loans and advances and investment during the study. She recommended for the continuous effort to explore competitive and highly yielding investment opportunities to optimize its investment portfolio. She further recommended to expand its credit in those areas that in turn help to minimize idle fund and to launch or initiate new packages, programmes and strategies for collecting more deposits.

Baral (2007), has conducted a study on deposit collection and investment pattern of Machhapuchhre Bank Ltd. with the main objective to analyze the deposit collection and investment pattern of MBL along with the other specific objectives to analyze the general deposit and investment policy of MBL, to determine the trend of the deposit position of MBL, to measure the trend of investment composition of MBL, to analyze the different sector wise loan investment to evaluate the liquidity, assets management efficiency, profitability of MBL and to analyze the growth ratio of total deposit, loan and advances, total investment and net profit. In his study financial ratios and statistical tools were used to analyze the collected data. He has concluded that total deposit collection of MBL is satisfactory, major part of investment is on loan and advances, weak liquidity position, well mobilization of working fund in loan and advances, high credit risk and good growth ratio. He has recommended to increase the weight of fixed deposits, to apply the attractive policy to increase funds, to maintain reasonable amount of liquidity, to minimize credit risk and to keep stable and consistency growth ratio.

Similarly, Gurung (2007), has conducted her study on deposit collection and mobilization of Nabil Bank Limited. The researchers main objective of the study was to analyze deposit collection and analyze it's mobilization of Nabil, Pokhara branch. The other objectives were to analyze the current deposit collection position and it's composition, to access the sectors for mobilizing collected deposit, no measure the liquidity position of the bank and to measure trend of deposit collection. In her study financial ratio analysis and statistical tools were used for data analysis. Through her study she concluded that interest bearing deposits contributed major part of total deposit volume, high proportion of liquid funds than the proportion of income generating assets, lack of specific policy for investment, insufficient balance in NRB, inadequate liquidity to meet short term obligation, well management of assets and positive correlation between investment and deposit. She also recommended the management to maintain the international standards and increase quality of assets, to make appropriate investment portfolio, to look upon new areas of lending and investment and to carefully examine portfolio management strategies.

CHAPTER III

RESEARCH METHODOLOY

The study attempts to have an insight into the investment portfolio of Om Finance Company Ltd. and analyze investment performance. Research Methodology plays a vital role in research study as it aims to present and reflect the methods, techniques and process that are applied in the entire subject of the study. So, in order to fulfill the objectives, the following research methodology is applied:

3.1 Research Design

The research design is an organized and integrated system that guides the researcher in formulating and controlling the study. The study is designed within the framework of case study research design. A case study research seeks to explain several techniques and sources of data for examining the current aspects of the phenomenon under study.

3.2 Population and Sample

The term population for research means all the member of any well defined class of objects or events. It refers to the organizations of the same nature, its services and product in general. Similarly, sample is only the portion on sub-set of the universe population. For the study purpose, the total finance companies i.e. 79 finance companies are the population of the data and the finance company under the study constitutes the sample for this study. This study being a case study of a single unit Om Finance Company Ltd. has been selected as the sample for the study, even though there are 79 finance companies over the kingdom. Here convenience sampling method is used to select the sample.

3.3 Structure and Sources of Data

The study is based on secondary data collected for regular time intervals and analyzes the trend in the past. For this the data required for the analysis are directly obtained from balance sheet, P/L Account, etc. of the concerned finance company's annual reports. Supplementary data and information's are collected from number of related institutions, places and articles like:

- NRB reports and bulletins
- Nepal Stock Exchange Ltd. (NEPSE)
- Central Bureau of Statistics
- Various publications dealing in the subject matter of the study
- Published and unpublished articles and reports from the various related sources.
- Economics journals, periodicals, bulletins, magazines etc.
- Electronic data from various websites.

However, the primary data is also used wherever necessary. Observations of operating procedures of the company and structured questionnaires to the concerned people are the sources of primary data.

3.4 Data Collection Procedures

Mainly, the study is dominated by secondary data collected from the above mentioned sources. The needed primary data is collected by using both structured and unstructured interview with concerned personnel of OFL and the direct observations of operating procedures of the finance company.

3.5 Data Processing and Analysis

Presentation of the collected data is the basic organization and classification of the data for analysis. The analysis of data is done according to the pattern of the data available. The collected raw data are first presented in systematic manner in tabular form and processed manually as well as with the help of computer. In this study, mostly descriptive tools are used to get the meaningful result of the collected data and to meet the research objectives.

Financial ratios are the major tools for analysis. In addition to the financial ratios (tools) other simple mathematical and statistical tools are also used in this study. Beside these, tables and bar diagrams are also presented to analyze and interpret the findings of the study. The major tools applied in this study are discussed as follows:

3.5.1 Financial Tools

Financial tools are used to obtain better insight into a firm's position and performance. Financial tools basically help to analyze the financial strength and weakness of a firm by properly establishing relationship between the items of financial relationship between the items of financial statements. Ratio analysis is one of the powerful tools of financial analysis that have been used in the study. Among all, following ratios which are the determinants of investment portfolio of the finance companies have been used in this study:

Activity Ratios: Activity Ratio measures the efficiency of the finance company from various angles of its operations to utilize available funds, particularly short-terms funds. These ratios are used to find out the efficiency, quality and the contribution of loan and advances in the total profitability.

The following activity ratios measure the performance efficiency of the finance company to utilize its funds:

- Non-Performing Loans to Total Loans and Advances Ratio
- Loan Loss Provision to Total Loans and Advances Ratio

Liquidity Ratios: Liquidity is the important variable of investment decision. Liquidity ratios measure the short term solvency of the firm. They are used to judge the finance companies ability to meet short term obligations as its current liabilities. From them, much insight can be obtained into the present cash solvency of the finance company and its ability to remain solvent in the event of adversities by measuring the speed with which the assets can be converted into cash to meet deposit withdrawal and other current obligations. Following ratios are computed under liquidity ratios:

- Current Ratio
- Cash and Bank Balance to Total Deposit Ratio

Assets Management Ratios: Asset Management ratios help to disclose how efficiently the finance company manages the resources at its edge. It measures the proportion of various assets and liabilities in balance sheet. The following ratios are used in this study.

- Loan and Advances to Total Deposit Ratio
- Investment in Securities to Total Deposit Ratio

Profitability Ratio: The profitability ratios are used as the measure to judge the operating efficiency (success or failure) of an organization. They measure management effectiveness by the returns generated on sales and investment. The following ratios are used to study the profitability position of the finance company.

- Return on Total Assets Ratio
- Total Interest Earned on Total Assets Ratio
- Total Employee Expenses to Total Expenses Ratio
- Earnings Per Share
- Return on Loan and Advances Ratio

3.5.2 Statistical Tools

Some important statistical tools are also used to achieve the objectives of the study. In this study, statistical tools such as mean, standard deviation and coefficient of variation are used, which are as follows:

Mean: A mean is the average value or the sum of all the observations divided by the number of observations. It is denoted by $\bar{x}$ and calculated as follows:

$$\bar{x} = \frac{\sum x}{n}$$

Where, $\bar{x}$ = Mean of the values

n = Number of observations

$\sum$x= Sum of the observations

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

Standard Deviation: The Standard Deviation measures the absolute dispersion. The higher the value of standard deviation, the higher the variability and vice-versa. Karl Pearson introduced the concept of standard deviation in 1823 A.D. and is denoted by the small Greek letter σ (sigma). Here the standard deviation is used to find out the deviation in absolute term.

It is calculated by using the formula below:

S.D. (σ) = $\sqrt{\dfrac{\sum(\bar{x}-x)^2}{N}}$

Where, X = Values

$\bar{x}$ = mean of the values

N= Number of observations

Co-efficient of Variation: The Standard Deviation calculated in the above formulas gives an absolute measure of dispersion. The co-efficient of variation measures the relative measures of dispersion based on the standard deviation, hence capable to compare two variables independently in terms of their variability. It is the magnitude of deviation relative to the magnitude of the mean. It is undertaken to compare the variability in various data of the finance company. Symbolically, the coefficient of variation of defined as:

CV = $\dfrac{\sigma}{\bar{x}}$

Where, σ = Standard Deviation

$\bar{x}$ = Average or mean of the values

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

The finance company agrees with the change in investment structure according to the time or circumstances. The company honestly follows the directives issued by Nepal Rastra Bank. It determines the interest rates on the basis of the directions provided by the NRB and provide data to NRB from time to time. There is the timely visit of the liquidity inspection personnel from NRB. The company considers profitability, liquidity, safety and stability, variability, etc during the investment decision. It has no any special policy for investment. The main objective of the organization in investment is to collect the scattered and unused money and invest in the productive sector in the form of the loans and advances to the public and other investments.

4.1 Resources of fund for investment

A finance company needs fund for investment. Different companies could have different sources like capital and net worth, deposits, borrowing, issue of bond and debentures but OFL has the following sources of fund for investment:

4.1.1. Net Worth

Net worth is the basic source of the fund for OFL. Capital, general reserve, other reserve and undistributed profit altogether form the net worth of the company, which is presented clearly in table 4.1.

Table 4.1

Net worth of OFL (in thousands)

F/Y	Capital		General Reserve		Undistributed Profit		Other Reserve		Net Worth
	Amount (Rs)	%	Amount (Rs)	%	Amount (Rs)	%	Amount (Rs)	%	
2059/60	20,000	80.20	1,394	5.59	3,545	14.21	-	-	24,939
2060/61	20,000	64.66	2,892	9.34	8,039	26.00	-	-	30,930
2061/62	20,000	52.62	4,707	12.38	13,302	35.01	-	-	38,009
2062/63	50,000	62.62	6,884	8.62	2,957	3.80	20,000	25.05	79,842
2063/64	70,000	70.97	9,623	9.76	6,910	7.02	12,100	12.27	98,633
2064/65	70,000	60.23	13,359	11.50	6,753	5.81	26,100	22.46	116,212

Source: Annual report of OFL

Table 4.1 shows that the net worth of the company is increasing year after year. At the beginning of the study period it was Rs 24,939,000 and at the end it is Rs 116,212,000. The study shows that the amount of capital is in increasing trend but its ratio to the net worth of the company is in the decreasing trend. At the beginning of the study period it was Rs 20,000,000 which was 80.20 % of the total net worth. It reached to Rs 50,000,000 in FY 2062/63 and at the end of the study period it was Rs 70,000,000 which was 60.23 % of the total net worth of OFL. General reserve was 5.59% of the net worth in the FY 2059/60 but it was 11.50% in FY 2064/65 which shows that the proportion of general reserve to net worth is increasing. Another component of net worth is undistributed profit which was 14.21% of the net worth of the company in FY 2059/60 which has decreased to 5.81% in FY 2064/65. There was no any other reserve included in the net worth of the company till FY 2061/62, but FY 2062/63 onwards it has taken the second place on the total amount of net worth respectively. It was Rs 20,000,000 in FY 2062/63 and reached to Rs 26,100,000 in FY 2064/65 which is 22.46 % of the total net worth of the company. The trend of net worth is shown in the following figure 4.1.

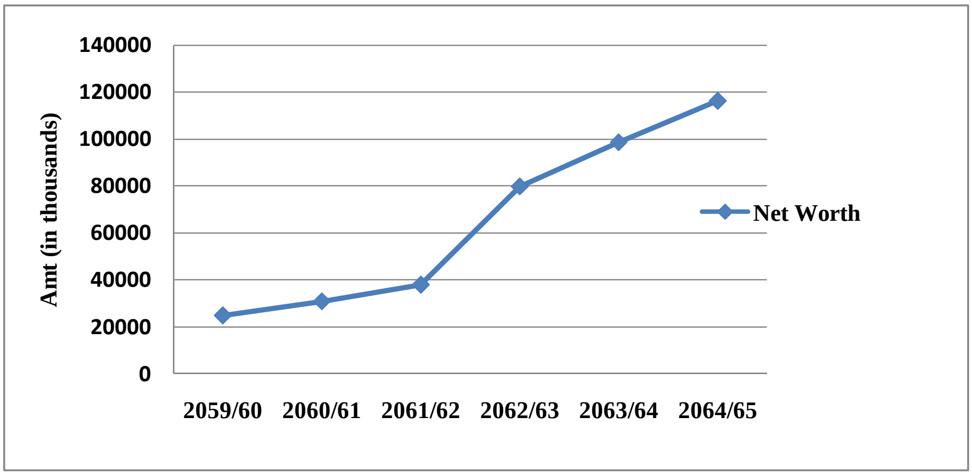

Figure 4.1

Net worth of OFL

Figure 4.1 clearly shows the increasing trend of net worth of OFL. It was Rs 24,939,000 in FY 2059/60, Rs 30,930,000 in FY 2060/61, Rs 38,009,000 in FY 2061/62 and Rs 79,842,000 in FY 2062/63. Similarly it increased to Rs 98,633,000 in FY 2063/64 and reached up to Rs 116,212,000 at the end of the study period i.e. FY 2064/65.

4.1.2. Deposit

Deposit is the main source of funds for the finance company for lending and investment operations. Higher volume of deposit result to higher volume of lending and investment, which again generate higher volume of income. So the finance company tries to mobilize as much deposits as possible by various devices. But the volume of deposit depends on net worth of the company according to the directives issued by NRB. Therefore, the higher volume of net worth lead higher volume of deposits and vice versa.

Like other finance companies OFL is performing under rules and regulation of NRB. OFL has the following types of deposit:

a. Fixed Deposit

Fixed deposit is the main source of finance company to advance loans and to invest on various sectors of the economy. The finance company can utilize the money of fixed deposit in various sectors. As the depositors deposit the money for fixed time period of 3 months to 5 years, they cannot refund the money before the due period. If the depositor wants to withdraw his /her money from fixed deposit before due date, the finance company charge certain percentage of the money. The interest rate will be 6.15% to 8.50% according to the situation. The minimum amount of Rs. 5,000 is required to operate this kind of deposit.

b) Saving Deposit

Finance company accepts the saving accounts from individuals and the institutions. The main purpose of the saving account is to encourage the habit of saving among the common people and institutions. The finance company can rise saving deposit up to 25% of their total financial resources. Minimum amount of Rs. 1,000 is required to operate saving deposits. Though saving accounts is meant for saving, the finance company has made it checking accounts allowing depositors to withdraw limited amount in certain period. Because of the withdrawal restrictions on saving deposits, the company can utilize the deposit for investment. In case of withdrawal beyond the restricted level, prior information is required. OFL provides 6% interest for this kind of deposit. The finance company applies interest on daily balance basis. Depositors can deposit any amount in their accounts in any time while finance company cannot lend/ invest the entire fund as and when desired in interest earning assets in this type of deposit. The company from time to time under the directives issued by NRB determines the interest rates.

c) Recurring Deposit

These kinds of deposits don't give the depositors option of liquidation before maturity. The concept of recurring deposit was developed to encourage being economical among the people of fixed regular earnings. In a recurring deposit scheme, the depositor is required to deposit the fixed amount in each installment and is repaid a fixed amount at maturity. Minimum balance of Rs 500 is required for this kind of deposit in OFL. OFL operates this kind of deposit for the due period of 42-72 months.

d) **Provident Fund Deposit**

In provident fund deposit, certain percentage of the salary of the employee of any organization is deposited by monthly continuously and after the retirement from job or leaving the job the employee get back the total amount with the interest. OFL provides 7% interest in such deposit.

e) **Other Deposit**

There are other deposits as well like, Om Special Saving Account and Om Nari Bachhat Yojana. To operate Om Special Saving Account, the minimum balance of Rs. 2500 is required. The company pays 6.5% interest rate to this type of account. The next one Om Nari Bachhat Yojana is especially for the women and the interest rate is 7% per annum.

Though there are 5 kinds of deposit in OFL, it is found that it is operating under only 4 kinds of deposits during the study period i.e. fixed deposit, saving deposit, recurring deposit and provident fund deposit. The deposit pattern of OFL on these 4 categories is shown clearly in table 4.2.

Table 4.2

Deposit Pattern of OFL (in thousands)

FY	**Fixed Deposit**		**Saving Deposit**		**Recurring Deposit**		**Provident Fund Deposit**		**Total**
	Amt (Rs)	**%**	**Amt (Rs)**	**%**	**Amt (Rs)**	**%**	**Amt (Rs)**	**%**	**Amt (Rs)**
2059/60	115,376	76.13	29,470	19.45	1,907	1.26	4,795	3.16	151,548
2060/61	198,568	73.39	63,329	23.41	3,136	1.16	5,521	2.04	270,554
2061/62	270,634	71.90	95,528	25.38	5,198	1.38	5,045	1.34	376,405
2062/63	337,489	69.71	132,419	27.35	9,351	1.93	4,878	1.01	484,137
2063/64	377,759	60.16	230,202	36.66	14,864	2.37	5,059	0.81	627,884
2064/65	466,893	50.62	427,664	46.37	21,915	2.38	5,801	0.63	922,273
Average		66.99		29.77		1.75		1.50	

Source: Annual report of OFL

It is clear from the table 4.2 that the main portion of the deposit is in fixed deposit. In the FY2059/60, the fixed deposit was 76.13% but in FY 2064/65 it is 50.62%, which shows that it is in the decreasing trend. In average fixed deposit during the study period is 66.99 %. The saving deposit occurs in the second place. In the first year of the study period it was 19.45 %. But at the end of the study period it was 46.37%, which shows that it is in an increasing trend. The other two kinds of deposit have not so much difference but in the previous years of the study period i.e. employee provident fund deposit was in second place and the recurring deposit was in the fourth place. But FY 2061/62 onwards recurring deposit has increased to the third position and employee provident fund has slide to the fourth position in terms of percentage on total deposit. The total deposit of OFL in FY 2059/60 was Rs. 151,548 thousands which has increased to 6.09 times in FY 2064/65 as compared to its deposit in FY 2059/60 and reached to Rs. 922,273 thousands.

The above mentioned figures of the table 4.2 can be further clarified by the following figure 4.2.

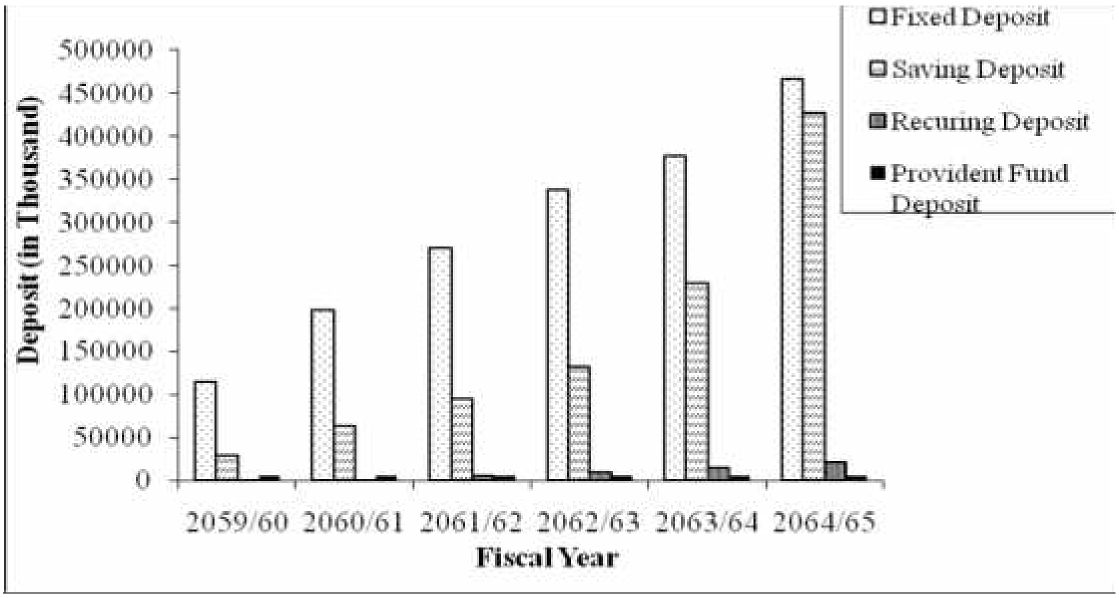

Figure 4.2
Deposit Pattern of OFL

Figure 4.2 shows the deposit pattern of OFL during the six years period from the FY 2059/60 up to the FY 2064/65. It shows that the major part of the deposit falls under fixed deposit and saving deposit. During the first two years of the study period provident fund deposit was in third position but since FY 2061/62 recurring deposit is in third position and provident fund has slide to the last position.

4.2. Investment Portfolio Analysis:

In this section the investment portfolio of OFL from the FY 2059/60 to 2064/65 is analyzed. Under this it is studied that how and in which percentage this finance company is investing its fund into different sectors such as in the loan and advances, government securities, shares and debentures of different companies and in other investment.

4.2.1 Investment pattern

All the finance institution including finance companies need fund for investment. The finance company collects fund for investment through share capital, borrowing, deposits and other liabilities. These funds then take the form of the following assets:

- Cash and bank balance
- Investment
- Loan, advances and bills purchased
- Fixed assets
- Other assets

Loans and advances dominate the asset side of the balance sheet of finance companies. Similarly earnings from such loans and advances occupy a major space in income statement of the finance companies. It is very important to be reminded that most of the banks and finance companies failures in the world are due to shrinkage in the value of loan and advances. Hence loan is known as risky asset. Risk of non repayment of loan is known as credit risk or default risk. If the loan is given to viable project, not only the lender and borrower but also the whole society gets benefits but society loses its scarce capital it loan is provided to a nonviable project. The investment is a very serious matter that’s why finance company should be careful for their investment. The finance company invests in government securities, other company’s share and bond, debenture, etc. the main investment of the finance company is loan and advance. The following structure of loan and advances exists in OFL.

i. Hire Purchase Loan

The finance company provides this type of loan for the purchase of different goods like vehicles (car, jeep, minibus, truck, van, tractor, motorcycle, etc.), machines, equipments and tools (photocopy machine, generator, computer, etc.), durable household goods and other movable property. The interest rate depends on the situation from 10 to 15 percent. The repayment of this type of loan is installment basis with interest. This type of loan is issued up to 5 years period. Like other finance companies this type of loan is one of the main loans for OFL.

ii. Housing loan

Under this type of loan, the finance company invests money in purchase of land and construction of house and warehouse for individuals and organizations. In context of this finance company the burrower use the money in purchase of land and construct house or warehouse for individual and institutions. This is also a major loan provided by OFL. The interest rate varies from 10% to 15% according to the economic situation of the country. It is issued in installment basis and the repayment of the loan is also in an installment with interest.

iii. Term loan

They are medium and long term loan. Under term loan, they invest in various sectors such as industry, trade, education, health, agriculture, remittance, consumer and tourism as business loan or working capital loan. According to the condition, in this type of loan also the interest rate fluctuates from 10% to 15%.

iv. Loan against fixed deposit

This type of loan is provided to those people or the organization that have certain amount on the fixed deposit in the finance company. If the fixed account holder needs the money within the fixed period they can get this type of loan in the basis of fixed deposit. The loan is provided up to 90% of the fixed deposit amount. The company charges plus 2% interest in this type of loan.

As other financial institutions, OFL has also invested its fund in government securities and shares of other companies. But the main portion of fund is invested in loans and advances. So the study really concerns with loan and advances and allocation of loan and advances is taken as investment pattern.

4.2.2 Allocation of loan and advance

During the study period, the loan disbursement of OFL was in hire purchase loan, housing loan, term loan and loan against fixed deposit. Hire purchase loan was further allocated in vehicles and machinery and housing loan was also further divided into two subsectors which are personal housing and institutional housing. Allocation of loan and advances from FY 2059/60 to FY 2064/65 is shown in table 4.3.

Table 4.3

Allocation of loans and advances of OFL (in thousands).

FY	Hire Purchase Loan		Housing Loan		Term Loan		Fixed Deposit Loan		Total
	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)
2059/60	30,342	20.50	44,397	29.93	71,585	48.26	2,003	1.31	148,327
2060/61	39,192	15.52	95,089	37.64	113,602	44.97	4,714	1.87	252,597
2061/62	52,705	14.48	144,388	39.67	160,183	44.02	6,674	1.83	363,950
2062/63	40,010	8.76	246,869	54.07	161,623	35.40	8,063	1.77	456,565
2063/64	53,507	8.23	336,320	51.70	252,083	38.76	8,542	1.31	650,452
2064/65	76,056	8.49	497,188	55.50	306,823	34.25	15,767	1.76	895,834

Source: Annual report of OFL

In these six years, the portfolio of loan and advances has been changed. Investment in hire purchase loan has been decreased from 20.5% to 8.49%. 29.93% of total loan was invested on housing in the FY 2059/60 but the amount has increased on the following years and reached up to 55.50% in FY 2064/65. As a whole it is in an increasing trend. Investment in the term loan was in decreasing trend till 2062/63. It was 48.26% in FY2059/60 and reached up to 35.40% in FY 2062/63 but in FY 2063/64, the trend has slightly increased and reached to 38.76%. But in the last year of the study period it has again decreased to 34.25%. So, we can say that the ratio is in decreasing trend. In terms of loan against fixed deposit, there is not so much difference in the amount of investment. In FY 2059/60, the company has invested 1.31% of its total loan in loan against fixed deposit and in FY 2063/64 also the percentage invested is the same. In FY 2064/65, it is 1.76% of the total deposit of OFL.

The above mentioned data in table 4.3 can be clarified by the following figure 4.3:

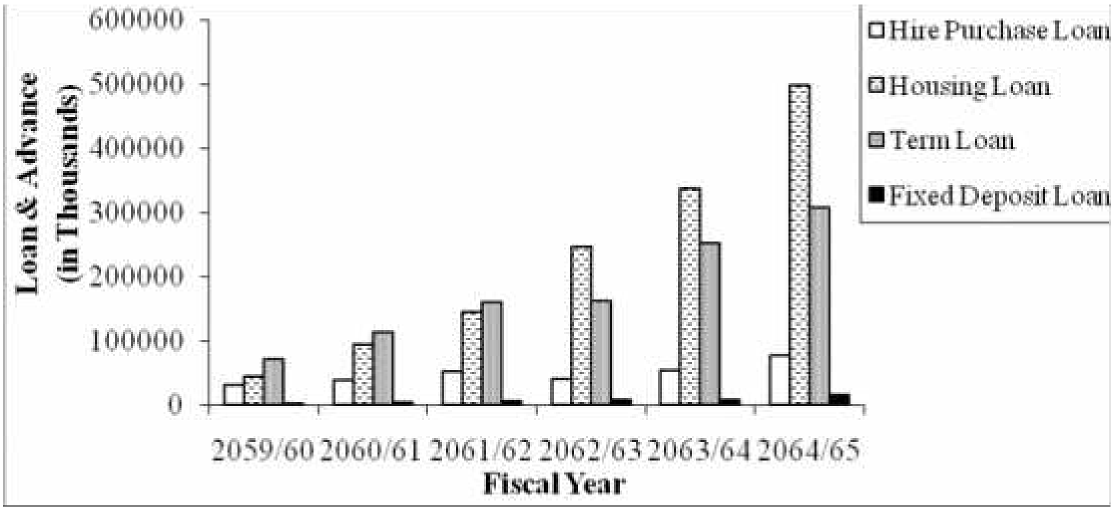

Figure 4.3

Allocation of loan and advance of OFL

Figure 4.3 shows the allocation of four kinds of loan and advances of OFL from FY 2059/60 to 2064/65. During the first three years of the study period, term loan had dominated the other three loans. Housing loan had got the second priority and hire purchase and loan against fixed deposit had got the third and fourth priority respectively in the first three years of the study period. But during the last three years housing loan is able to dominate the other loans. Term loan, hire purchase loan and loan against fixed deposit have got the second, third and fourth priority respectively.

4.2.2.1 Allocation of Hire Purchase Loan

The hire purchase loan was allocated into two subsectors which are vehicles and machinery. The loan was provided to purchase vehicles like car, jeep, minibus, truck, van tractor, motorcycle, etc. Machinery loan includes the loan provided for the purchase of machines, equipments tools, durable household goods and other movable properties. The allocation of hire purchase loan is shown clearly on table 4.4.

Table 4.4

Allocation of hire purchase loan (in thousands)

FY	Vehicle		Machinery		Total	
	Amount(Rs.)	%	Amount(Rs.)	%	Amount(Rs.)	%
2059/60	29,812	98.25	530	1.75	30,342	100
2060/61	39,117	99.80	574	0.20	39,192	100
2061/62	52,429	99.48	276	0.52	52,705	100
2062/63	39,922	99.78	87	0.22	40,010	100
2063/64	53,507	100	-	-	53,507	100
2064/65	76,056	100	-	-	76,056	100

Source: Annual Report of OFL

The table 4.4 shows that the major portion of the hire purchase loan is allocated on vehicle. In the FY 2059/60 vehicle loan was Rs. 29,812 thousands and machinery loan was Rs. 530 thousands which is 98.25 % and 1.75 % of the total hire purchase loan respectively. Later from FY 2063/64 onwards the hire purchase loan is only allocated to vehicle loan and the amount reached to Rs. 76,056 thousands which was 100% of the total hire purchase loan. The total amount of hire purchase loan is in increasing trend except in 2062/63, it has slightly decreased. Instead of expansion of the hire purchase loan it was limited only in vehicle at the end of the study period. The study shows that OFL is unable to expand its investment in hire purchase loan.

The data mentioned in table 4.4 is further clarified by figure 4.4 below:

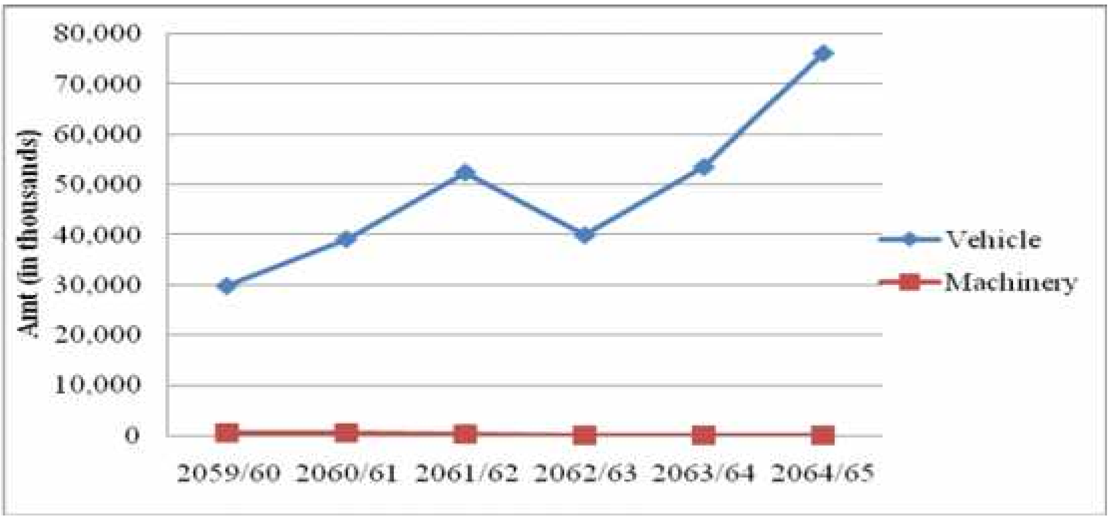

Figure 4.4

Allocation of hire purchase loan

Figure 4.4 clearly shows the allocation of hire purchase loan from FY 2059/60 to 2064/65. The amount of hire purchase loan has decreased in FY 2062/63 as there is decrease in allocation of loan and advances in both sectors i.e. vehicles and machinery. In the ending two years i.e. FY 2063/64 and FY 2064/65 there is increase in the allocation of loan and advances in vehicles but hire purchase loan for machinery has been totally decreased.

4.2.2.2 Allocation of Housing Loan

Likewise, housing loan was further classified into personal housing loan and institutional housing loan, which is presented on table 4.5.

Table 4.5

Allocation of housing loan (in thousands)

FY	Personal		Institutional		Total	
	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)	%
2059/60	42,790	96.38	1,607	3.62	44,397	100
2060/61	91,982	96.73	3,107	3.27	95,089	100
2061/62	142,985	99.03	1,403	0.97	144,388	100
2062/63	230,036	93.18	16,834	6.82	246,869	100
2063/64	318,767	94.78	17,552	5.22	336,320	100
2064/65	453,825	91.28	43,363	8.72	497,188	100
Average		95.23		4.77		

Source: Annual report of OFL

It is clear from the table 4.5 that personal housing loan dominates this kind of loan. Majority of this loan was for personal purpose and a little percentage of the total housing loan was for institutional purpose. In FY2059/60 Rs 42,790,000 was invested on personal housing and Rs 1,607,000 on institutional housing which were 96.38% and 3.62% of the total housing loan respectively. At the end of the study period, in FY 2064/65 it reached to Rs 453,825,000 and Rs 43,363,000 which were 91.28% and 8.72% respectively. In average 95.23% of the total loan was invested on personal housing and only 4.77% was invested on institutional housing. It shows OFL still have to further expand the housing loan. The trend of personal and institutional housing loan is shown in the figure 4.5 below:

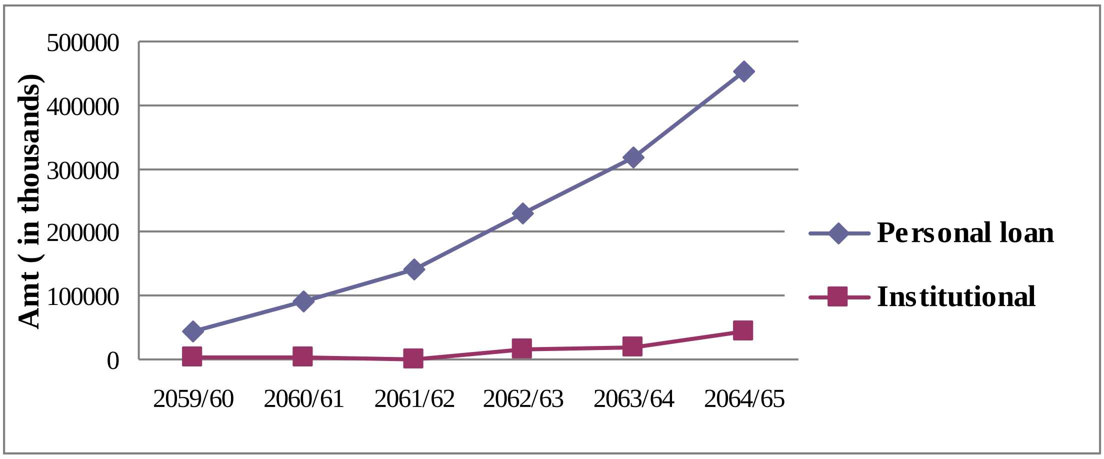

Figure 4.5

Allocation of housing loan

Figure 4.5 clearly shows the allocation of housing loan in two subsectors i.e. personal housing and institutional loan. It shows that the major part of the housing loan is for personal housing purpose and very little part for institutional housing purpose. In FY 2059/60 Rs 42,790,000 was allocated for personal housing which reached to Rs 453,825,000 in FY 2064/65. Likewise institutional housing loan was Rs 1,607,000 in FY 2059/60 and increased up to Rs 43,363,000 in FY 2064/65.

4. 2.3. Classification of loan and advances

The loan and advances of OFL are classified according to the payment of loan. They are divided into five categories. They are as follows:

Overdue period	Classification of loan
1. Not overdue (matured)	Good loan
2. Less than three month	Sign of substandard loan
3. Less than six month	Substandard loan
4. Less than one year	Doubtful loan
5. More than one year	Bad loan

Though the loans and advances are classified into 5 classes, OFL is working on only four types i.e. good loan, substandard loan, doubtful loan and bad loan which is shown on table 4.6.

Table 4.6

Classification of Loans and Advances (in thousands)

FY	Good Loan		Substandard Loan		Doubtful Loan		Bad Loan		Total
	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)	%	Amt (Rs)
2059/60	146,695	98.90	1,117	0.75	473	0.32	42	0.03	148,327
2060/61	249,410	98.74	1,261	0.50	578	0.23	1,348	0.53	252,597
2061/62	359,028	98.65	2,571	0.71	939	0.26	1,412	0.40	363,950
2062/63	451,228	98.83	_	_	_	_	5,337	1.17	456,565
2063/64	645,139	99.18	_	_	_	_	5,313	0.82	650,452
2064/65	892,458	99.62	_	_	_	_	3,376	0.38	895,834
Average		98.99		0.30		0.14		0.56	

Source: Annual Report of OFL

Table 4.6 clearly shows that OFL is efficiently managing its loan and advances and the ratio of good loan has increased at the end of the study period. In FY 2059/60 ratio of good loan was 98.90%, but in FY 2064/65 it has reached to 99.62%, which is a good sign of efficient management of loan advances. In average 98.99% of the total loan and advances falls under good category. Substandard and doubtful loan have been totally decreased during the last two years of the study period i.e. in the FY 2062/63 and 2063/64. In average, 0.30%and 0.14% of the total loan falls under substandard loan and doubtful loan respectively. There is slightly increase in the ratio of the bad loan in the FY 2062/63 i.e.1.17% with comparison to the beginning years of the study period. Anyway, 0.56% of the total loan and advance falls under bad loan in average. The study shows the well management of OFL in the area of loan and advances.

4.3. Investment Trend of OFL

Table 4.7 presents the investment trend of OFL from the FY 2059/60 to 2064/65.

Table 4.7

Investment Trend (in thousands)

FY	Total Investment		Loan and Advance		Securities	
	Amt(Rs.)	%	Amt(Rs.)	%	Amt(Rs.)	%
2059/60	152,343	100	148,327	97.36	4,016	2.64
2060/61	257,178	100	252,597	98.20	4,581	1.80
2061/62	369,500	100	363,950	98.50	5,550	1.50
2062/63	484,615	100	456,565	94.21	28,050	5.79
2063/64	681,029	100	650,452	95.50	30,577	4.50
2064/65	921,411	100	895,834	97.22	25,577	2.78
Average				96.83		3.17

Source: Annual report of OFL

It is clear from table 4.7 that amount of investment in loan and advance was Rs 148,327,000 in FY2059/60 and reached to Rs 895,834,000 in FY 2064/65. Investment on other securities was only Rs 4,016,000 in FY 2059/60 and reached to Rs 25,577,000 at the end of the study period. The highest ratio of investment in loan and advances is in FY 2061/62 with 98.50% and the lowest is in 2062/63 with 94.21%. The investment in other securities is highest in FY2062/63 with 5.79% and the lowest in FY 2061/62 with the ratio of 1.5%. The study shows that most of the investment is on loan and investment and only the very small part is on securities issued by government and other institutions. In average 96.83% of the total investment is in loan and advances and only 3.17% is in other securities.

The investment trend of OFL could be further understood by the figure 4.6:

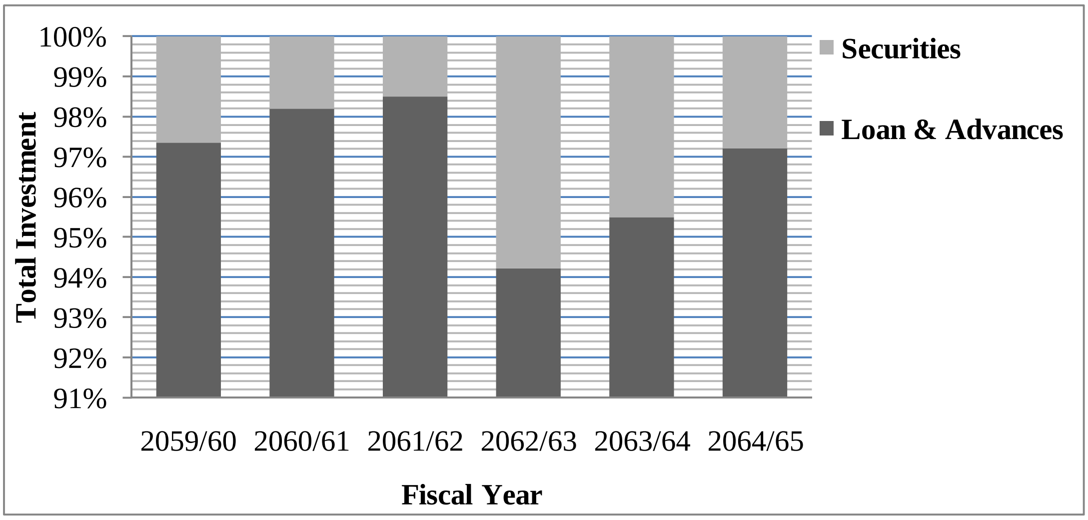

Figure 4.6

Investment Trend of OFL

Figure 4.6 shows the investment trend of OFL in percentage to total investment. It shows that major part of the investment is on loan and advances. It was 97.36 % in FY 2059/60. Later in FY 2062/63 it decreased to 94.21 %. Then after it again increased and reached to 97.22% in FY 2064/65. Investment in other securities was 2.64% in FY 2059/60 and 2.78% in FY 2064/65.

4.4. Asset Management Ratios

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

4.4.1. Loan and Advances to Total Deposit Ratio

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

Table 4.8 presents the loan and advances to total deposit ratio of OFL.

Table 4.8

Loan and Advances to Total Deposit Ratio (in thousands)

FY	Total Loan & Advances(Rs)	Total Deposit(Rs)	Ratio (%)
2059/60	148,327	151,548	97.87
2060/61	252,597	270,554	93.36
2061/62	363,950	376,405	96.70
2062/63	456,565	484,138	94.30
2063/64	650,452	627,885	103.60
2064/65	895,834	922,274	97.13
		Mean	97.16
		S.D.	3.60
		C.V.	3.71

Source : Annual report of OFL

Table 4.8 shows that loan and advances to total deposit ratio of the bank was highest in 2063/64 with 103.6 % and lowest at 2060/61 with 93.36%. The mean ratio is 97.16% which indicates the better mobilization of collected deposits but in FY 2063/64 the ratio was 103.6% which might not be good from the liquidity point of view. The standard deviation and coefficient of variation of the ratios is 3.60% and 3.71% respectively, which shows that the ratios are satisfactorily consistent over the study period.

4.4.2. Investment on Securities to Total Deposits Ratio

A finance company may mobilize its funds by investing in different securities issued by government and other financial or non financial institutions. This ratio measures the extent to which the finance company is able to mobilize its deposits on investment in various securities. In the process of portfolio management, various factors such as excess availability of fund, liquidity requirement, norms of central bank, etc should be considered in general. 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 to mobilize deposits in securities and vice versa. This ratio is calculated by dividing total investment on securities by total deposit.

Investment on securities to total deposit ratio of OFL from FY 2059/60 to FY 2064/65 is presented by the following table 4.9.

Table 4.9

Investment on Securities to Total Deposit Ratio (in thousands)

FY	Investment on Securities(Rs)	Total Deposit(Rs)	Ratio (%)
2059/60	4,016	151,548	2.54
2060/61	4,581	270,554	1.69
2061/62	5,550	376,405	1.47
2062/63	28,050	484,137	5.70
2063/64	30,577	627,884	4.87
2064/65	25,577	922,274	2.77
		Mean	3.17
		S.D.	1.73
		C.V.	54.45

Source : Annual report of OFL

Table 4.9 shows that very less amount of the total deposit is invested on securities. OFL is not successful in mobilizing deposits on securities. At the beginning year of the study period the ratio was 2.54% and at the end of the study period it was 2.77%. The highest ratio is 5.7% in FY 2062/63 and minimum is 1.47 % in FY 2061/62 with mean ratio of 3.17%. The S.D. is 1.73% and the C.V. of 54.45% between the ratios shows that the ratios are highly variable.

4.5. Profitability Ratios

An organization should earn profits to survive and grow over the long period of time but not at the cost of employees, customers and society. Obviously, organizations will have no future if it is unable to make reasonable profit from its operation. The profitability ratios are used as a measure to judge the operating efficiency (success or failure) of an organization. Profitability ratios are usually computed by relating it either with sales or investment as listed below. A high ratio indicates the better profitability position of the company and vice versa.

4.5.1 Return on Total Asset ratio

This ratio measures the rate of return earned by the finance company as a whole for all its investors. That is why this ratio equals net profit after tax divided by the total assets (exclusive of fictitious assets) as assets are financed by the pool of funds contributed by shareholders and lenders.

Table 4.10

Return on Total Assets Ratio (in thousands)

FY	Net Income(Rs)	Total Asset(Rs)	Ratio (%)
2059/60	2,935	182,311	1.61
2060/61	5,991	311,692	1.92
2061/62	9,079	432,345	2.10
2062/63	10,885	583,707	1.86
2063/64	13,691	761,784	1.80
2064/65	18,685	1,152,131	1.62
		Mean	1.82
		S.D.	0.19
		C.V.	10.27

Source: Annual report of OFL

Table 4.10 shows that OFL is operating with low return on total assets ratio. The highest ratio during the study period is 2.1% in FY 2061/62 when the net income and the total asset were Rs 9,079,000 and Rs432, 345,000 respectively. And the lowest ratio is 1.61% in FY 2059/60 with the net income of Rs 2,935,000 when total asset is Rs 182,311,000. The mean ratio of 1.82% shows that the return on total assets is not much better. The S.D. of the ratios during the study period is 0.19% and the C.V. between them is 10.27% which shows that ratios are satisfactorily consistent over the study period.

4.5.2. Total Interest Earned to Total Assets Ratio

This ratio measures the rate of interest earned by OFL as a whole for all its investors and is computed by dividing total interest earned by the total asset. Higher ratio reflects the better performance of the finance company in earning interest.

Table 4.11 presents the total interest earned to total assets ratio of OFL from FY 2059/60 to FY 2064/65.

Table 4.11

Total Interest Earned to Total Assets Ratio (in thousands)

FY	Interest Earned(Rs)	Total Assets(Rs)	Ratio (%)
2059/60	17,222	182,311	9.45
2060/61	31,884	311,692	10.23
2061/62	44,098	432,345	7.55
2062/63	56,615	583,707	9.70
2063/64	68,606	761,784	9.01
2064/65	92,214	1,152,131	8.00
		Mean	8.99
		S.D.	1.03
		C.V.	11.46

Source: Annual report of OFL

Table 4.11 shows that the interest earned has been increased from Rs 17,222,000 to Rs 92,214,000 and total assets from Rs 182,311,000 to Rs 1,152,131,000 during the study period. The highest ratio between them is in FY 2060/61 with 10.23% and the lowest ratio is in FY 2061/62 with 7.55%. The mean ratio is 8.99% which shows the satisfactory performance of the finance company. The S.D. is 1.03% and the C.V. of the ratios is 11.46% which shows that the ratios are less variable during the study period.

4.5.3. Total Employee Expenses to Total Expenses Ratio

This ratio measures the rate of total employee expenses to the total expenses conducted by the whole finance company and is computed by dividing the employee expenses by the total expenses of OFL. Higher ratio indicates the high expenses in employees and vice versa.

Table 4.12 shows the total employee expenses to total expenses ratio of OFL from FY 2059/60 to FY 2064/65.

Table 4.12

Total Employee Expenses to Total Expenses Ratio (in thousands)

FY	**Employee Expenses(Rs)**	**Total Expenses(Rs)**	**Ratio (%)**
2059/60	907	16,436	5.52
2060/61	1,257	28,665	4.38
2061/62	1,524	36,631	4.16
2062/63	1,858	48,376	3.84
2063/64	2,121	57,531	3.69
2064/65	3,807	76,263	4.99
		Mean	5.26
		S.D.	0.70
		C.V.	13.38

Source: Annual report of OFL

It is clear from table 4.12 that the total employee expenses were Rs 907,000 in FY 2059/60 and reached to Rs 3,807,000 in FY 2064/65. Total expenses of OFL were Rs 16,436,000 in FY2059/60 and increased to Rs 76,263,000 in FY 2064/65. The highest total employee expenses to total expenses ratio is 5.52% in the FY 2059/60 and the lowest ratio is 3.69% in FY 2063/64. The study shows that the total employee expenses to the total expenses ratio is in decreasing trend. In average 5.26% of the total expenses was spent over the employees. The S.D. of the ratios is 0.70% and the C.V. is 13.38% which show that the ratios are satisfactorily consistent over the study period.

4.5.4. Earnings per Share

Earnings per share are another measure widely used to judge the earnings potentiality of the common shareholder's investment in the finance company on a per-share basis. That is why this ratio equals net profit after tax divided by number of common shares. Higher ratio reflects more profitability enjoyed by the shareholders and the better performance of the finance company and vice versa.

Table 4.13

Earnings per Share

FY	Net Income(Rs)	No. of shares	EPS(Rs)
2059/60	2,935,253	200,000	14.68
2060/61	5,991,377	200,000	29.96
2061/62	9,079,381	200,000	45.40
2062/63	10,884,537	500,000	21.77
2063/64	13,690,979	700,000	19.56
2064/65	18,684,572	700,000	26.69
		Mean	26.34
		S.D.	10.76
		C.V. (%)	40.86

Source: Annual report of OFL

Table 4.13 shows that net income of OFL in FY 2059/60 was Rs 2,935,253 which reached to Rs 18,684,572 in FY 2064/65. Similarly the number of shares outstanding was 200,000 in FY 2059/60 and increased up to 700,000 in FY 2064/65. EPS had increased in the second and third years of the study period i.e. in FY 2060/61 and 2061/62 and had decreased in the following two years of the study period. It has slightly increased in the last year of the study period i.e. FY 2064/65 and reached to Rs 26.69. The highest rate of EPS is Rs 45.40 in FY 2061/62 and the lowest is Rs 14.68 in FY 2059/60. The mean ratio and the S.D. are Rs 26.34 and 10.76 respectively with the C.V. of 40.86% which shows that the ratios are less consistent over the study period. The study shows that the performance of the finance company in terms of profitability is not much better.

4.5.5 Return on Loan and Advances Ratio

This ratio is a measure of profitability of the finance company in respect of the total loan and advances and is computed as

Return on loan and advances = Net profit after tax / Total loan and advances

Higher ratio reflects the more profitability enjoyed by the finance company and vice versa. Return on loan and advances ratio of OFL is shown in the table 4.14.

Table 4.14

Return on Loan and Advances Ratio (in thousands)

FY	Net Income(Rs)	Total Loan &Advances(Rs)	Ratio (%)
2059/60	2,935	148,327	1.98
2060/61	5,991	252,597	2.37
2061/62	9,079	363,950	2.49
2062/63	10,885	456,565	2.38
2063/64	13,691	650,452	2.10
2064/65	18,685	895,834	2.09
		Mean	2.24
		S.D.	0.20
		C.V.	9.14

Source: Annual report of OFL

Table 4.14 shows that the highest ratio over the study period is 2.49% in FY 2061/62 and the lowest ratio is 1.98% in FY 2059/60. The mean ratio is only 2.24% which shows that the return on loan and advances of OFL is not good. The S.D. of the ratios is 0.20% and the C.V. of the ratios is 9.14% which shows that the ratios are satisfactorily consistent over the study period.

4.6 Activity or Performing Ratios

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

4.6.1 Nonperforming Loans to Total Loans and Advances Ratio

This ratio is a measure of the performance of the finance company with respect to the total loan and advances and is computed by dividing nonperforming loans by total loan and advances. The lower ratio reflects the better performance of the finance company in managing loan and advances and vice versa.

Table 4.15

Non Performing Loans to Total Loans and Advances Ratio (in thousands)

FY	Total Loan &Advances(Rs)	Nonperforming Loan(Rs)	Ratio (%)
2059/60	148,325	1,632	1.10
2060/61	252,597	3,187	1.26
2061/62	363,950	4,921	1.35
2062/63	456,565	5,337	1.17
2063/64	650,452	5,312	0.82
2064/65	895,834	3,951	0.44
		Mean	1.02
		S.D.	0.34
		C.V.	33.04

Source: Annual report of OFL

It is clear from table 4.15 that the highest ratio of nonperforming loan to total loans and advances is in FY 2061/62 with 1.35% and the lowest is in the FY 2064/65 with 0.44%. In FY 2061/62 the total loan amount is Rs 363,950,000 and the amount of nonperforming loan is Rs. 4,921,000 and in FY 2064/65 the total loan amount is Rs. 895,834,000 and the nonperforming loan is Rs. 3,951,000. The average ratio is only 1.02% which shows that company is efficient in managing loan and advances. The S.D. of the ratios during the study period is 0.34% with the C.V. of 33.04% which shows that the ratios are less consistent over the study period.

4.6.2 Loan Loss Provision to Total Loan and Advances Ratio

This ratio is the measure of the performance of the finance company in terms of the loan loss provision of the different classes of loan and is computed by dividing the loan loss provision by the total loan and advances.

Table 4.16

Loan Loss Provision to Total Advances Ratio (in thousands)

FY	Loan Loss Provision(Rs)	Total Loan &Advances(Rs)	Ratio (%)
2059/60	1,056	148,327	0.71
2060/61	2,307	252,597	0.91
2061/62	1,668	363,950	0.46
2062/63	3,735	456,565	0.82
2063/64	1,915	650,452	0.29
2064/65	1,112	895,834	0.12
		Mean	0.55
		S.D.	0.31
		C.V.	56.67

Source: Annual report of OFL

It was found that at OFL have maintained the loan loss provision according to the need and rules of NRB during the study period. It is clear from the table 4.16 that the highest loan loss provision to total loan and advances ratio was in the FY 2060/61 with 0.91% and the lowest was in FY 2064/65 with 0.12%. These ratios are fluctuated and going up and down through the whole study period. The mean and S.D of these ratios are 0.55% and 0.31% respectively. The coefficient of variance for these ratios is 56.67% which shows that the ratios are highly variable through the study period.

4.7 Liquidity Ratio

Liquidity ratios are the ratios that provide the quick measure of the liquidity position or the ability of the firm to meet the current obligation. In other words, liquidity ratios are the indicators of short-term solvency or financial or financial strength of the firm. The following ratios are analyzed for this purpose:

4.7.1 Current Ratio

Current ratio establishes the relationship between current assets and current liabilities. It is computed by dividing current assets by current liabilities. Current ratio has a standard measure of 2:1 or that the current assets should two times of current liabilities. Only with this cushion available, the organization might be able to pay its debt on time even if half of the current assets do not convert into cash timely.

Table 4.17

Current Ratio (in thousands)

FY	Current Asset(Rs)	Current Liabilities(Rs)	Times
2059/60	82,240	41,996	1.96
2060/61	130,941	82,194	1.59
2061/62	140,090	123,511	1.13
2062/63	427,264	162,389	2.63
2063/64	338,070	265,287	1.27
2064/65	304,938	568,567	0.54
		Mean	1.52
		S.D.	0.72
		C.V. (%)	47.49

Source: Annual report of OFL

Table 4.17 shows that the current ratio was highest in the FY 2062/63 with 2.63 times when current asset was Rs 427,264,000 and current liabilities of Rs 162,389,000. The current ratio was lowest in 2064/65 with 0.54 times when current asset and current liabilities were Rs 304,938,000 and Rs 568,567,000 respectively. There is increase in current liabilities but the current assets have decreased this year, which shows that the company is not able to maintain balance between current assets and liabilities. The mean of the current ratio of OFL is 1.52 times which shows that the liquidity position is satisfactory. The S.D. of the ratios is 0.72 and C.V. of the ratio is 47.49% which interprets that the ratios are highly variable during the study period.

4.7.2 Cash and Bank Balance to Total Deposit Ratio

Cash and bank balance are the most liquid assets so this ratio measures the percentage of most liquid fund with the finance company to meet short term obligation. This ratio is computed by dividing cash and bank balance by total deposits. Both higher and lower ratios are not desirable. The reason is that if a finance company maintains higher ratio of cash it has to pay interest on deposits and some earnings may be lost. In contrast if it maintains low ratio of cash, it may fail to make payment for the demands of the depositors. So, sufficient and appropriate cash reserve should be maintained properly.

Table 4.18

Cash and Bank Balance to Total Deposit Ratio (in thousands)

FY	Cash & Bank Balance(Rs)	Total Deposit(Rs)	Ratio (%)
2059/60	20,848	151,548	13.76
2060/61	54,511	270,554	20.15
2061/62	62,458	376,405	16.59
2062/63	13,782	48,41,38	2.85
2063/64	17,766	62,78,85	2.83
2064/65	38,400	922,274	4.16
		Mean	10.06
		S.D.	7.71
		C.V.	76.66

Source: Annual report of OFL

Table 4.18 shows that the cash and bank balance was Rs 20,848,000 in FY 2059/60 which reached to Rs 38,400,000 in FY 2064/65. Similarly total deposit was Rs 151,548,000 in FY 2059/60 and reached up to Rs 922,274,000 in FY 2064/65. Cash and bank balance to total deposit ratio of OFL has fluctuating trend. The highest ratio was 20.15% in FY 2060/61 and the lowest ratio was 2.83% in FY 2063/64. The mean of the ratio for the study period is 10.06% and S.D. is 7.71%. The C.V. of the ratios is 76.66% which shows that the ratios are highly variable. The above analysis helps to conclude that the cash and bank balance position of OFL is not much better to serve its customers deposit withdrawal demands. It implies that the liquidity position of OFL is not in better position. In the beginning year of the study period the ratio was 13.76% and has reached to 4.16% at the end of the study period.

4.8 Problems Faced by OFL in Investment Process

- In the process of investment in loan and advances, sometimes overvaluation of collateral, results in high changes of loan loss, which causes problem to OFL.

- Success of the investment on loan and advances also depend on the income of client. If there is no fixed income enough to repay the loan installment and variable cash flow of the client, this also causes problem to OFL.
- There is problem in documentation of client while providing loan and advances. Mostly people cannot provide required and complete document when needed which causes problem in the process of allocating loan and advances.
- There is problem in timely monitoring of investment due to time and resource constraints.
- Investment on shares and loans can't be more than 50% of the market value of the collateral, which also sometimes causes problems. In such cases sometimes investment cannot be done in the possible profitable areas also.
- In case of market fluctuation there is increase in risk which also becomes causes of problem to OFL.
- During the first two years of the study period there was a problem in investment due to political condition of the country.

4.9 Major Findings of the Study

- It was found that the major sources of fund OFL are net worth and deposit. Net worth consists of capital, general reserve, other reserve and undistributed profit and is in increasing trend. In the beginning three years of the study period, there was no any other reserve included in net worth of the company as the source of fund, till FY 2061/62, but FY 2062/63 onwards it has taken the second place on the total amount of net worth respectively. The ratio of capital and undistributed profit is in decreasing trend but the ratio of general reserve is in increasing trend.

- OFL is operating under four kinds of deposits and the main portion of the deposit falls under fixed deposit. The total deposit of OFL in 2059/060 was Rs. 151,548 thousands which has increased to 6.09 times in FY 2064/65 as compared to its deposit in FY 2059/60 and reached to Rs. 922,273 thousands. In average 66.99% of the total deposit falls under fixed deposit, 29.77% under saving deposit, 1.75% under recurring and 1.50% under the provident fund deposit respectively.

- It was found that the loan disbursement of OFL is in hire purchase, housing, term loan and loan against fixed deposit. During the first three years of the study period, term loan had dominated the other three loans. But during the last three years of the study period, housing loan is able to dominate the other three loans. Term loan, hire purchase loan and loan against fixed deposit have got the second, third and fourth priority respectively.
- Hire purchase loan was allocated into sub sectors i.e. vehicles and machinery and the major portion were allocated on vehicles. In FY 2063/064 and FY 2064/65 hire purchase loan was limited only on vehicles which shows that OFL is unable to expand its investment in hire purchase loan.
- Housing loan was further classified into personal housing loan and institutional housing loan. Personal housing loan dominate this kind of loan. In average 95.23% of the total loan was invested on personal housing and only 4.77% was invested on institutional housing. It shows OFL still have to further expand the housing loan. There is no practice of institutional warehouse loan.
- Loan and advances are classified into four classes which are good loan, substandard loan, doubtful loan and bad loan. In average 98.86% of total loan and advances fall under good category 0.47% on substandard loan, 0.27% on doubtful loan and 0.59% of bad loan. The ratio of good loan was increased which shows that OFL is managing its loan and advances efficiently.
- It was found that most of the investment is on loan and advances and only the very small portion is on securities issued by government and other institutions. In average 96.83% of the total investment is on loan and advances and 3.17% is on other securities.

- The loan and advances to total deposit ratio was highest in FY 2063/064 with 103.60% and lowest in FY2060/61 with 93.36%. The mean ratio is 97.16%. The S.D. of the ratio is 3.60% with 3.71% CV between them which shows that the ratios were consistent over the study period.
- It was found that Investment on securities to total deposit ratio was highest i.e. 5.7% in FY 2062/063 and minimum was 1.47% in FY 2061/062 with mean ratio of 3.17% which indicates that OFL is not successful in mobilizing deposits on securities.
- OFL is operating with low return on total assets ratio. The highest ratio during the study period was 2.1% in FY 2061/062 and the lowest was 1.61% in FY 2059/060 with the mean ratio of 1.82% and the ratios were satisfactorily consistent over the study period.
- The mean of total interest earned to total assets ratio was 8.99%, which shows the satisfactory performance of the finance company in terms of profitability. The CV of 11.46% shows less variability of the ratios during the study period.
- Total employee expenses to total expenses ratio was in decreasing trend till 2063/64 but in FY2064/65 it has slightly increased and reached to 4.99%. In average 5.26% of the total expenses was spent over the employees with the SD of 0.70%. The CV 13.38% shows that the ratios are satisfactory consistent over the study period.
- The earnings per share was highest in FY2061/62 with Rs 45.40 and lowest in FY 2059/60 with Rs14.68. The mean during the study period is only Rs. 26.34. The study shows that the performance of OFL in terms of profitability is not much better.
- Return on loan and advances ratio during the study period shows that the profitability is not much good. The mean ratio is 2.24% with SD of 0.20%. The CV of 9.14% shows that the ratios are satisfactorily consistent over the study period.
- Average of nonperforming loans to total loans and advances ratio is only 1.02% which shows the efficient management of loan and

advance. It was found that the ratios were less variable over the study period.

- It was found that OFL have maintained the loan loss provision according to the need and rules of NRB during the study period and the ratios are highly variable. The mean ratio is 0.55%.
- It was found that mean current ratio of OFL is 1.52 times which shows that the company is in satisfactory liquidity position but is operating in risk because ratios are highly fluctuating. The highest ratio is 2.63 times in FY 2062/63 and the lowest ratio is 0.54 times in FY2064/65. The SD and CV of the current ratio are 0.72 and 47.49 % respectively.
- Cash and bank balance position of OFL is not much better to serve its customers deposit withdrawal demands. In average, OFL has maintained 10.06% of cash and bank balance to total deposit ratio.
- Investment portfolio of the finance company seems risky. Most of the amount is invested in loan and advances, that is also more in term loan. The search of new sector for loan and investment reduces the portfolio risk.
- It was found that OFL is not facing with such major problems in the investment process. However, any organization is not so problem free, so OFL is also suffering some problems. Over valuation of collateral, lack of client's proper documentation and fixed income enough to repay the loan installment and the market fluctuation are the major problems faced by OFL.

CHAPTER V
SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Financial institutions are the one which make the financial markets work. They have important effects on the performance of the economy as a whole. Finance companies fall under non-banking financial institutions. OFL is one of the pioneer and leading finance companies of Pokhara. The main objective of the organization is to collect the scattered and unused money and invest in the productive sectors in the form of loans and advances to the public and other investments. Net worth and deposit are the sources of fund for investment. OFL collects deposit under various deposit schemes like fixed deposit, saving deposit, recurring deposit and other deposit OFL invests in four kinds of loan and advances i.e. hire purchase loan, term loan, housing loan and loan against fixed deposit. Term loan and housing loan dominate other two kinds of loan.

Loan and advances are classified into four classes i.e. good loan, substandard loan, doubtful loan and bad loan. The ratio of good loan is in increasing trend. The major part of investment is on loan and advances and very small portion of total investment is on security issued by government and other institutions. The loan and advances to total deposit ratio was highest in FY 2063/064 with 103.60% and lowest at FY 2060/061 with 93.36%. The mean of investment on securities to total deposit ratio is 3.17%, the highest ratio of investment on securities to total deposit was 5.7% in FY 2062/063 and minimum was 1.47% in FY 2061/062. The mean of return on total assets ratio was 1.82%. Total employee expenses to total expenses ratio was in decreasing trend till FY 2063/064 but in FY 2064/065 it has slightly increased. The mean earnings per share is Rs.26.34. Return on loan and advances ratio during the study period shows the profitability is satisfactory. Average of nonperforming loans to total loans and advances ratio is 1.02%. OFL has maintained the loan loss provision according to the need and rules of NRB. The mean current ratio is 1.52 times. But at the end of the study period i.e. in FY 2064/65 current ratio is only 0.54 times which shows that the company is operating in a great risk with low liquidity ratio. Cash and bank balance position of OFL is not much better to serve its customer's deposit withdrawal demands. In the process of investment OFL has to face some problems also such as, overvaluation of collateral, lack of client's proper documentation and fixed income enough to repay loan installments, market fluctuations, etc.

5.2 Conclusions

Based on the findings, following conclusions have been drawn as a concluding framework of the study on investment portfolio of OFL:

- As a source of fund for investment, net worth reflects that, OFL is increasing its fund for investment but the ratio of capital shows the OFL still don't have enough capital funds for investment.
- Deposit is the main source of fund for investment and is in increasing trend but the study shows that OFL is unable to attract the customer towards recurring deposit, provident find deposit and other different deposit schemes.
- Trend on allocation of hire purchase and housing loan reflects that the company is unable to expand its area of investment in these sectors.
- Loan and advances to total deposit ratio during the study period helps to conclude that the company is well mobilizing the collected deposits but, is operating in a totally risky environment and shows lack of specific policies for investment.
- Investment portfolio of the finance company seems risky because most of the investment is on loan and advances, that is also more in term loan.
- Investment on securities to total deposit ratio help to conclude that OFL is unable to mobilize deposits in various securities issued by government and other organizations.
- The profitability ratios help to conclude that the performance of OFL in terms of profitability is not much better.
- The decreasing trend of non-performing loans and advances ratio helps to conclude that the bank is aware of non-performing loans and adopting the appropriate policies to manage this problem and to increase the quality of assets.
- OFL has maintained the loan loss provision according to the need and rules of NRB during the study period.

- Liquidity ratios help to conclude that the liquidity position of OFL is not much better. Highly fluctuating ratios indicate the lack of efficient management of current assets and current liabilities. Cash and bank balance to total deposit ratios show that OFL is not much better to serve it's customer's withdrawal demands.
- The study on problem faced by OFL in the investment process helps to conclude that, overvaluation of collateral, lack of proper documentation and fixed income of client and market fluctuation are the major problems faced by OFL.

5.3 Recommendations

From the above study and analysis, the following recommendations are forwarded as suggestions to solve the problem and improve the performance of the company:

- There is necessity to increase the capital fund for long run. Deposit collecting and investment capacity depends on its capital funds.
- To provide efficient service for the customer, OFL should consider company management and marketing promotions which helps to increase deposit and investment.
- OFL should expand its lending areas and consider deprive sector loan.
- It should find potential areas and opportunities and determine secure loan investment policy. It is recommended to keep wide vision in investment while utilizing their resource and invest in the different profitable sectors.
- The company should increase the investment in government securities, bond debentures and other company's shares. It helps to balance the risk.
- There should be the continuous effort in income generating and cost controlling activities to strengthen the profitability position of the company.
- While allocating loan and advances, OFL should consider the liquidity position as well and should make continuous efforts to maintain balance between current assets and current liabilities. Sufficient and appropriate cash reserve should be maintained properly to meet the deposit withdrawal demands of the customers.

- The company should be more careful in valuation of collateral and proper documentation of the client. Valuation should be done by well experienced experts.
- The finance company should examine carefully from time to time the portfolio management strategies to maintain equilibrium in the portfolio of loans and investment and make continuous efforts to explore new, competitive and high yielding investment opportunities to optimize the return.

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Appendix

Questionnaire

Tick any one answer in each question:

1. Do your company invest in government securities and other registered share?

   a) yes ☐ b) No ☐

2. How long does your company invest in terms of years?

   a) 1-3 yrs. ☐ b) 4-6 yrs. ☐
   c) 7-10 yrs. ☐ d) none of them ☐

3. Which factors of the client are considered important while allocating loan and advances?

   a) Physical Condition ☐ b) Collateral and cash flow ☐
   c) Educational Status ☐ d) All of them ☐

4. Which percent of the collateral does your company approve as loans?

   a) up to 25% ☐ b) 25-50% ☐
   c) 50-75% ☐ d) 75-100% ☐

5. How is the valuation of collateral done?

   a) By external evaluator ☐ b) By internal evaluator ☐

6. What is the system of loan repayment?

   a) interest only ☐ b) installment with interest ☐
   c) total with interest ☐ c) None of the above ☐

7. Is the loan and advances allocated to the client who is already a borrower?

   a) Yes ☐ b) No ☐

8. Is there any provision for investment in deprived sectors?

   a) Yes ☐ b) No ☐

9. Is the fiscal policy of government suitable for investment?

   a) Yes ☐ b) No ☐

10. Do your company agree with change of investment structure according to time and circumstances?

   a) Yes ☐ b) No ☐

11. Does your company fix interest rate on the basis of bank rates?

a) Yes ☐ b) No ☐

12. Are there any directives of NRB in investment?

a) Yes ☐ b) No ☐

13. Is there timely visit of inspection team from NRB to your company?

a) Yes ☐ b) No ☐

14. Is your capital investment fund sufficient as per the directives of NRB?

a) Yes ☐ b) No ☐

15. Do your company classify and keep loan loss provision for loan and advances as per the directives of NRB?

a) Yes ☐ b) No ☐

16. Have you any special policies in investment?

a) Yes ☐ b) No ☐

17. Which sector is more risky for investment in your opinion?

a) Hire Purchase Loan ☐ b) Housing Loan ☐

c) Term Loan ☐ d) Loan against fixed deposit ☐

18. What is the effect of political condition of the country to your company?

19. Could you explain about the NRB policies which may be helpful in investment of finance companies?

20. What kind of problems do you face during the investment process?

Thank You!