CHAPTER I

INTRODUCTION

1.1 General Background:

The extent of development of any country is demonstrated by the development of the financial sector of the country. The financial sector of any country comprises of banks, co-operative societies, insurance companies, finance companies, stock markets, foreign exchange markets, mutual funds, provident funds etc. And stock exchanges via primary markets, banks & financial companies via short-term and other types of loans are recognized as the main sources of much needed capital input for industries and business.

Finance companies play very dominant role in the economic development particularly in consumer financing, leasing and asset based lending, with strong preference on short-term debt. The main liabilities of the finance companies are fixed type deposit borrowings from banks and agencies and the comparatively substantial amount of equity capital. In general, finance companies can be defined as a firm that loans money to people who promise to repay the loan with interest over a specified period of time. “Finance Company is a financial institution which is a company, a non-banking institution, whose principle business is to receive the deposits under any scheme or arrangement or in any other manner and lending in any manner”[1]

"Finance Companies, licensed under the Finance Company Act 2042 BS are the second largest group of deposit taking financial institutions in Nepal.” "Though the finance companies act was published in gazette in

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[1]Baidya, Shakespeare, ***"Financial Markets and Institutions"***, Taleju Prakashan, Kathmandu, Nepal, First Edition, 2056

2042BS, the real establishment and functioning come only after the economic liberalization policy of the government in the 8th plan (2049BS- 2053BS)."

Nepal Rastra Bank has been acting as the father figure of the finance companies. NRB is the central supervisory authority that has every control over the running finance companies. All the transactions finance companies make are directed by the NRB. All the activities that finance companies are authorized to do or restricted to do are listed out by the NRB. It is like the boundary of activities of finance companies is set by the NRB. There are NRB directives propounded by NRB for finance companies to guide them through and to restrict their activities. The NRB directive for finance companies set out matters as;

- Capital Structure
- Collection of deposits
- Minimum liquidity requirement
- Per customer loan limits
- Classification of loans and provision for loan loss
- Interest rates etc.

Finance companies were borne by NRB to perform mere some functions of commercial banks. The objective being reducing some burden from commercial banks and getting some prompt services to the general public. "Finance companies are typically organized to handle some specialized financing problem that is not adequately handled by banks and other institutions. They engage in all types of loan activities and specialize in handling problems and risks that other institutions would not accept. Their interest rates reflect their costs and risks."[2] Finance companies, thus, handle the essential functions of commercial banks i.e. accepting deposits and lending money, discarding other specialized services provided by the commercial banks.

[2] Baidya, Shakespeare, ***"Financial Markets and Institutions"***, Taleju Prakashan, Kathmandu, Nepal, First Edition, 2056

"The two essential functions of commercial banks may best be summarized as the borrowing and lending of money. They borrow money by taking all kinds of deposits. Then it provides money to those who are in need of it by granting overdrafts to fixed loan or by discounting bills of exchange or promissory notes. Thus, the primary function of a commercial banker is that of a broker and a dealer in money. By discharging this function efficiently, a commercial bank renders a valuable service to the community by increasing the productive capacity of the country and thereby accelerating the pace of economic development." Thus, being an essential function operator of commercial bank, finance companies do all above mentioned borrowing and lending of money and act as a dealer of money. But it is to be noted that finance companies cannot borrow money or lend money under all different types of categories commercial banks are authorized to. "Unlike commercial banks which are engaged mainly in long term loans to customers for whom they can offer current account, overdraft facilities, these finance companies can operate only fixed deposits from 3 months to 6 years."[3] However, finance companies are rendering their services directing towards the economic development of the country via increasing the productive capacity of the country.

The NRB's Non-banking Operations Unit supervises the Finance companies in respect of their activities as deposit-takers and lenders. As issue managers, underwriters or market-makers on the stock exchange, finance companies have to be registered with the Securities Board and the NEPSE. Not only do Finance companies have to ensure that they have adequate capital to engage in the securities business as dealer, market-makers and underwriters, but they must ensure that both client monies and deposits are kept separately from the firm's capital and cash flow. They have to provide the central bank with financial information on a regular basis. According to the World Bank, although the Finance companies provide financial information to the central bank – but they are not adequately supervised by the central banking authorities. Lack of discipline and proper

[3] Nepal Rastra Bank Regulation

prudential oversight could well emerge as a serious problem at some point in the future. In the first instance, developing a robust system of off-site supervision by the NRB is felt to be particularly important, followed eventually by a reinforcing system of on-site supervision.

Accepting deposits and lending money is the playing of money finance companies do to reap the profit along the side. Certain rate of interest is provided to the customer for the deposit made in the company. These kinds of deposits are generally invested. Investment, in finance companies, is made in the sense of lending the same money in higher interest rate and purchasing government securities. Thus, the main operation of a finance company can be recognized as taking money from public giving them some interest and lending the money to the public charging some interest. Generally, the interest charged is higher than the interest paid and this is how the company manages to make some profit to distribute dividend to the shareholders.

The finance companies have their genesis from the function of Lending. Lending is the most fundamental function of any finance company. However diversified the functions of finance companies might get but the core function remains the same because the lending function is the origin of finance companies. “The classical economic functions of bank and other financial intermediaries all over the world have remained virtually unchanged in modern times. What has been changed are the institutional structure, the instruments and the techniques used in performing these functions.”[4]

Lending has its different forms. It can be divided in to fund based and non-fund based Lending. Leasing, hire purchase, bills discounting, term loans, housing loans, floating mutual funds, bridge financing, loan participation, loan syndication etc come under fund based Lending. Similarly, investment management, portfolio management services for individuals and corporate, issue management, underwriting, trust receipts, arranging trading market for

[4] Bhattacharya, Hrishikes, Banking Strategy, Credit Appraisal and Lending Decisions-A Risk –Return Framework, First Edition, Ocford Univrsity Press, Delhi, 1998.

buying and selling securities, private placement of shares and debentures etc fall under the category of non-fund based Lending. In practice, most of the Finance Companies activities are fund based.

Borrowers are required to offer some guarantee against the loan they are getting such as lien on their salary or personal possession. “Loans or guarantee means loans or guarantee advanced with any movable or immovable asset as collateral, or with any other necessary security or guarantee, on conditions stipulated by the company.” Good collateral is essential for the quality of loan. The quality of loan, quality of borrower and quality of securities determines the health of any financial institution. The efficiency of finance company lies in how it multiplies the deposits of its depositors. Hence, Lending should be accompanied by some basic principles and practices. No finance company would be willing to give loan unless it has sufficient confidence in the borrower that it will not be necessary to seek the help of court for recovery.

Principles of Good Lending

Needless to say, lending is the major income generating activity of any finance company and it is also one of the main functionalities of the finance company. Even though, finance company cannot just go on giving out loan to just anyone and any institution. Income generating it is but if loans are not distributed properly and cautiously then it may be the main cause of the failure of the company. In case loans were advanced carelessly and the borrower fails to pay out their debts, company can be history. Flow of money is the life blood of finance company and these like of bad loans interrupt the flow. Thus, it should be well analyzed beforehand to give out any loans. Below given are the factors whereupon any prospect loan should be analyzed;

1. <u>Safety</u>:

The finance company should ensure that the money lent by them foes to the right type of borrower and is utilized in such a way that it will not only be safe at the time of lending but will remain so through out, and after serving a useful purpose in the trade of industry where it is employed, is repaid with interest.

2. Liquidity:

Besides 'safety' factor, it is also necessary that the money lent out must be repaid in accordance with agreed terms of repayment. In order to achieve this, the borrower must have reliable sources of sufficient income.

3. Purpose:

The purpose of lending should be productive so that money not only remains safe but also provides a definite source of repayment.

4. Profitability:

Financial institution should generate sufficient income to cover the expenses. Such expenses are interest expenses on deposits, staff expenses, office operating expenses, provision for depreciation on their fixed assets, provision of bad or doubtful debts; to pay bonus for staffs, income tax to government and of course dividend to its shareholders and plough back returns to expand its business volume. Considering these costs, financial institute should decide upon lending rates.

5. Security:

The primary objective of finance company is not to lend against security. It should lend on the basis of character, capacity and capital of the borrower. However, security is considered as an insurance or a cushion to ball back upon in case of failure to repay the loan and interest dues b the borrower due to various reasons.

6. Spread:

Diversification of lending is another important principle of good lending an element of risk is always present in every advance however secure it might appear to be. In face, the entire lending business is one of the taking calculated risk and a successful financer is an expert in assessing such risk.

Thus, company should diversify its lending program in various sectors of economy, business and industry and geographical areas.

7. National interest, suitability:

Even if an advance satisfies all the aforesaid principals, it may still not be suitable. The lending program may run counter to national interest. Central bank may have issued a directive prohibiting finance companies to allow particular types of advance.

Credit Granting Policy

Credit Analysis

Credit investigation is primarily historical based on available credit information, it is complied to make a prediction of future behavior. In fact, credit analyst believes that history is a clue to the future.

Credit information for consumer lending

1. Payment record:

Past payment habits regarded as the most important factor judging credit quality. Regular payments of installments of previously taken loan, telephone bills, and electricity bills are some of the examples of regular payment records.

2. Income:

Income consists of wage/salary, rentals and business income if self employed. These incomes are verified with employer/industry average – comparing with wage and salary of other employer's of similar nature. In the case of business income, nature of business, sales turnover, profit margin etc are verified.

Similarly, household expenditures and other fixed obligations are verified to access the estimation of net income that would be enough to reply the loan.

3. Residence:

An address check is a routine part of the verification. The size and types of residence are also indicative of the applicant’s housing expense, social responsibilities and wealth. Plus, if the customer is a permanent local resident, it is likely that he’d pay his dues in time and there is less probability that he has any intentions of fraud.

4. Marital Status:

Information about single, married, widowed, divorced or separated marital status is some times sought of all applicants and considered important while accessing consumer credit. Marital relationship may affect income and obligations as well as person’s happiness. Loan default and collection problems repeatedly arise from marital adjustments. Besides it is important that while granting loans, the spouse is taken as a personal guarantee.

5. Age:

Age of the applicant may be another factor in accessing credit risk. Too young and old applicants may be regarded as high credit risk. Too young applicant are usually not established financially and often considered transient and uncommitted. Older persons are recipients of limited income and prone to illness. Thus, people who are aged within the working period os life should be more preferred to others.

6. References:

References from previous creditors, friends and business associates, persons who have treated others fairly and loyally are likely to give the same consideration to a new credit relationship.

7. Reserves, assets and collateral:

Assets and income that may be liquidated provide a backup means of payment when the income stream stops. Securities and real estate without heavy debt payment are good reserve assets.

Commercial Credit Information

In addition to similar kinds of information as consumer application, commercial credit information contains the following:

1. Financial Statement
    a. Usually balance sheet, income statement and cash flow statement certified by management and auditors.
    b. Shows the position, trend and flow of applicant's business.
2. Customers and creditors listing
    a. Provide means and authorization to make inquiries with those doing business with the applicants.
3. Credit bureaus
4. Credit application/interview etc.

Analysis of Credit Risk

Five 'C's of Credit

1. Character:

The quality of willingness to repay debts when due is ranked all other considerations. The good character and intentions of the borrower is very important and thus should be seriously considered. Information about the character of the client can be gathered from his working place, references, neighbours and other places he is associated with. This job is tedious but should be carried out for secure investment.

2. Capacity:

The ability to repay debts as scheduled. The gross income, expenses and net income of the client/borrower should be analyzed whether the borrower lives on salary/wages or any other forms of income source. Whether the borrower has some extra income source other than salary/wages; any other source of income which can be used to repay the scheduled installments should be considered. It should be analyzed beforehand whether the borrower has enough income to pay the scheduled installments.

3. Capital:

Capital provides a cushion to absorb operating and asset losses that might otherwise impair debt repayment. This, in fact, is the insurance against the loans granted to the borrower.

4. Collateral:

Sufficiency of collateral is necessary to ensure the recovery of loan. In case of default, by any cause, the collateral kept should have value enough to recover the loan granted and interest borne by it. It is recommended that only 50% of the value of collateral is granted as loan. But considering other factors like character of borrower and his credit worthiness, this percentage can be made flexible.

5. Conditions:

Borrowers may be subject to unfavorable economic conditions beyond their control. Repayment depends not only upon character, capacity and collateral but those factors over which the borrower exercise little or no control. As for example: natural calamities or drastic economic crisis.

Basic requirements in a borrower

According to NRB Directive regarding Loan information and provision of blacklisting, Directive No: 12/066, Section (2) subsection (3) any organization receiving permission letter under NRB should collect basic information regarding the burrower, if the burrowed amount is Rs.25, 00,000 or more documents such as copy of citizenship, permanent/temporary address, and information the family members is required. In case of proprietorship firm information regarding properties is most along with agreement papers. But NRB keep the organization or the lenders under black list if the lend money and interest is not returned within one year. If the bank notices that there is misutilization in the facilities provided or the burrower went to bankruptcy according to prescribed law , if it comes to notice of the bank that lender is involved in any sort of criminal activities or if the balance seems to insufficient on the side of burrower.

Moreover in case of finance companies there are some basic requirements that should be fulfilled by the client to stand himself as a probable borrower. Finance companies can not lend money to just anyone blindfold. It should be confident regarding the trustworthiness and intentions of the probable borrower beforehand. The borrower, on the other hand, should provide finance company with all pertaining documents that the company seeks to build confidence on borrower. The basic requirements of borrowers are as follows;

1. If the applicant is an individual
   a. Applicant should be a Nepali citizen
   b. Should have good knowledge about the work they intend to commence
   c. Normally the applicant should not have taken loan from any other institutions.
   d. Applicant should present the job planning scheme.
   e. Personal Information
   f. Business registration certificate and income tax.
   g. Quotation and personal guarantee.
   h. Driver's license
   i. others

2. If the applicant is partnership firm
   a. The firm should be registered in related department.
   b. The person dealing with the borrowing of the firm should be specified in the partnership contract.
   c. Income tax registration certificate.
   d. And other required and possible items from point 1.

3. If the applicant is private limited company or public limited company
   a. Company should be registered.

b. Working place, project place should be specified and all the assets should be in the name of company.
c. Audited Balance Sheet, Profit & Loss Accounts and other required financial documents, at least of one year, should be presented.
d. If the work place and/or project place is leased, the lease contract should be presented.
e. The authorized person should apply for the loan.
f. Loan amount applied must be within the limit of memorandum of the company or must be decided by the board.
g. Decisions of the promoters.
h. Personal information of the main person.
i. Written personal guarantee of proprietors.
j. Citizenship of promoters and proprietors.
k. And other required and possible items from points 1 and 2.

Recovery of Loans and Advances

Mobilization of funds collected from deposits is very important. Inability of doing so is a total loss to the company. Giving out Loans and Advances is one of the main and very crucial segments, where the collected funds are invested. Being more practical, the position and status of finance companies are read via Loans and Advances it has mobilized. But a profound thought highlights that only giving out Loans and Advances to the maximum extend is not the only important thing. The more crucial part is the recovery of such invested funds.

All the invested time and work foes in vain if finance companies fail to recover what they had invested in Loans and Advances. The money mobilized in Loans and Advances is borrowed from public via deposits, which are liability of the company. Besides, interest from Loans and Advances is one of the main source of income of finance companies. If the finance company is not able to recover its Loans and Advances, it's a failure of the company. Thus, finance companies pay special attention in the recovery part.

The finance company should regularly watch the repayment of each and every loan it has mobilized. It should be best tried that none of the borrowers miss their single scheduled repayments. Reminding each borrower prior about the upcoming due date should be made the regular function of the respective department in the company. The function continues as sending reminder letter at different time intervals as the requirement, as according to the regulations of the company. This is very crucial section and thus, it should be well observed and inspected. The company should try all possible legal techniques to collect the repayments.

In case the borrower, defying the company's schedule, does not pay the due installment, the company can use the last weapon of recovering its investment via liquidation of the security against which, the loan was mobilized. Thus, company should collect quality security while giving out Loans and Advances to be in the safe side. "Loans to be supplied only against security. The company must not supply loans without taking any collateral or other necessary securities and guarantees acceptable to it."

1.2 History of Finance Company

"Historically Finance companies were the creation of early 1960s and the real need for the creation of these finance companies were felt when commercial banks (CB) were unable to serve sectors of economy other than big business houses. The small savings were ignored so were their smaller credit requirements. Need of those institutions serving the deprived sectors were felt and it was that need which gave birth to institutions like finance companies."

The infrastructure development, especially industrial, is almost impossible without the mobilization of scattered funds with the public. However, Nepal has been late in recognizing the fact. So, the history of formal and commercial banking and finance companies is relatively short.

The first commercial bank of Nepal, Nepal Bank Limited was established in 1937 under Nepal Bank Act, 1937. Prior to the establishment of Nepal Bank Limited, a Government financial institution called Tejarath operated in the country. Tejarath used to extend credit to the people but it did not accept deposits from them. It performed banking function partially. With the establishment of NBL, Tejarath was abolished and inconveniences caused by the absence of formal banking sector were finally removed.

Even after the establishment of NBL, there was no general banking legislation in Nepal up to 1964 and the Nepal Bank Act, 1937 itself required thorough revision to suit the changed circumstances. Hence, a new commercial bank act was enacted in 1964 and it replaced the Nepal Bank Act, 1937 in April 1965. Since, the private sector did not take any initiative to establish another commercial bank, the Govt. established a public sector Rastriya Banijya Bank in January 1966 under Rastriya Banijya Bank Act, 1965. The General Commercial Bank Act, 1965 and the Rastriya Banijya Bank Act, 1965 were repealed and was replaced by a new Commercial Banking Act enacted in 1974.

During the mid 80s, the joint venture banks also come into the fray in Nepal, namely Nepal Arab Bank Ltd., Nepal Grindlays Bank Ltd. And Nepal Indo-Suez Bank Ltd. The two national banks, NBL and RBB, had then extended their area of operation to every nook and corner of the country under Banking Development Scheme, 1967 of Nepal Rastra Bank, which entailed a scheme of bank branch expansion.

Through the speedy expansion of bank branches, helped the access of banking services to the rural and remote areas, the rural sector could not benefit much because of operational procedures of the commercial banks. The benefit was limited to the urban sector only.

The Govt. then realizing such a state of rural sector and mounting operational losses of branches of commercial banks, which it had to compensate (certain percentage) through NRB, enacted Finance Company Act in B.S. 2042.

The main logic behind the enactment of the Finance Company Act was to motivate the private sectors in the field of formal banking. Govt. by then had realized the fact that the development of any country is not possible without the active involvement of the private sectors. Besides, this step of Govt. would boost the establishment of the private finance companies, which are likely to be opened on localized basis, that would cut down the operational losses of commercial banks' branches.

Need of Finance Company Act was also felt because unorganized sectors like Upahar and Dhukuti programs were collecting savings from the common public, who were very interested and taking part with enthusiasm. But these programs failed public hopes and ran away. As is the saying "every act has its react", govt. realized about the benefit that could be attained if only all such collected fund were utilized in some productive way. Considering such interest, benefit of mobilizing such savings in productive sector, banking sector's inability to carry out capital market activities and to meet consumers need for credit, government introduced Finance Company Act 2042BS. However, no finance company was set up till 2049BS as because the act came into being only in 2049BS with some amendments.

"Nepal Awash Bikash Bitta Company Ltd" is the first finance company established in 2049 BS promoted by Rastriya Beema Sansthan, Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBB), Agricultural Development Bank (ADB) and Savings Company Limited was established from the private sector. And then there was no looking back. Today we have finance companies in the number of 54. And many more individuals and organizations are interested in starting finance company. Considering this, to control over the mushrooming of finance companies, NRB has made some amendments in the act such that it's not that easy in establishing finance company now. It's much more organized. Beside in recent years we had some news about failure and running away of finance companies. To control over this also NRB came up with much more stricter rules.

1.3 Statement of the Problem

Keeping pace with today's up growing economy itself is a hazardous task. And with that, finance companies are facing tough competition too and the fact that the present situation of Nepal has made the investments insecure to high extend. As a result, investments are being very challenging today. Finance companies have to look for secure and productive investment opportunity which definitely is tuff job. The table below has tried to picture out the situation of finance companies in last five years, with simple relation of Loans and Advances with Total Deposits and Loan loss Provision.

Table 1 : Relations of Loans and Advances with Total Deposit and Loan Loss Provision of all finance companies as a whole (in Lakh)

Particulars	2060/61	2061/62	2062/63	2063/64	2064/65	Mean
N-No. of Finance co.	45	60	70	74	78	
A-Total deposit	193917	223416	243325	345147.1	522821.7	305725.36
B- Loans and Advances	175408	212233	270789.5	356164.6	514941.5	305907.32
C- Loan Loss Provision	9926	12278	12060.2	21693.4	25100.1	16211.54
% B to A	90.46	94.99	111.29	103.19	98.49	99.68
% C to B	5.66	5.79	4.45	6.09	4.87	5.37
B to N	389795.56	353721.67	386842.14	481303.51	660181.41	454368.86

At a glance, in above Table 8, it seems the total deposits and loans and advances are increasing along with loan loss provision. But upon profound observation, the facts reveals that the deposits and loans and advances are increasing but in diminishing marginal rate. The increasing numbers of finance companies suggest that the lucrative business of finance company is attracting the business persons here in high extend. But considering the quality aspect, keeping aside the quantity aspect, jumping into this business with blindfold can be questioned. The percentage of Loans and Advances to Total Deposits had gradual increase till 2064/65, this probably is due to the lot of investment opportunities.

Another eye opening fact is the gradual increase in percentage of Loan Loss Provision to Loans and Advances. This percentage has increased from 90.46 % in the year 2060/61 to 98.49% in 2064/65. This basically is the result due to increasing trend of Non-Performing Loans. Increase in Non-Performing Loans is very serious problem facing by finance companies. Increase in Non-Performing Loans can be the result of present condition of the country. Due to instable political condition, insecurity and lot many factors, industries of Nepal are closing down and thus are the investments. This has also arson another problem. Loan mobilization in hire purchase and housing loans are increasing than that in term loan. Term loans are more productive and contribute more to the economy than hire purchase and housing loans. These kinds of situations reduce the income generation level in the economy which again affects the timely repayments of the due installments of Loans and Advances.

1.4 Objectives of the Study

In today's context, finance companies play very important role in the economic growth of a country. Today, economy also opens the door for various investments. In today's diversified economy, finance company is playing the role of money dealer between savers and investors, thus, diversifying its functions according to different needs of depositors and borrowers. This study aims at analyzing the various aspects of lending in various sectors of economy, the performance of finance companies regarding lending quantity and quality. It is expected that this study will provide some relevant findings, which may help the interested.

The objectives of this study are as follows:

1. To measure the finance companies' lending strength. The lending strength shall be measured in absolute terms also to analyze the volume of contribution made by each finance company under study.

2. To analyze the portfolio behavior of lending and measuring the ratio and volume of Loans and Advances made in Performing and non performing Loan.
3. To measure the lending performances in quality, efficiency and its contribution in profitability.
4. To measure the relation between different elements of Balance Sheet and Profit & Loss Account, analyzing if they have healthy relation.
5. To make the regression analysis between the industrial data relating to lending of finance companies.
6. To measure the Propensity of Growth on trend analysis.

1.5 Importance of the Study

Finance companies are emerging as vital part of our economy and moreover, Lending is one of the most essential and main function of finance company. Thus, this study on five finance companies viz. Lalitpur Finance , Lumbini Finance, Peoples Finance, Union Finance & NIDC Capital Market is going to play a significant role for all other researchers who wish to study on finance companies. More than that, this can provide adequate information about studied five finance companies and overall trend of finance companies to the shareholders, investors, professionals and also to the students and teachers of commerce.

The presentation of this study will also help to clear out the misconceptions people have about finance companies regarding their trustworthiness. Besides, this comparative study of Lending practices of finance companies is probably going to be of an important value for the people interested in this field.

More than all, myself being a commerce student and interested in career in finance companies, this study will prove to be very important in my individual level, for my career in the up growing and challenging field of finance companies.

1.6 Limitations of the Study

There were numerable limitations for the study. Some very prominent limitations of the study as listed as follows;

1. The period of the study will be limited. The study will be made from the 2060/61 to 2064/65 only.

2. The study will be conducted amongst five finance companies out of the total. Hence, it might not reflect the real status of all the finance companies neither it can represent the lending practices of whole finance companies of the country.

3. The data used will be all secondary. The annual reports published by the respective companies will be the major data used for the analysis in the study. Besides those, reports published by NRB, articles, journals, and news published will be used as the source of data. Thus, any mispresentations, mistakes and omissions will affect the outcome of the study.

4. Since the study will be made for 5 years only and the performances of others years ignored, this might not give the accurate picture. And the trend analysis might not be correct too.

5. Statistical tools will be used for analysis. Hence, the drawbacks and weakness of those tools may affect the outcome of the study.

1.7 Organization of the Study

The whole study is divided into five different chapters as follows:

Chapter 1 Introduction

Chapter 2 Review of Literature

Chapter 3 Research Methodology

Chapter 4 Presentation and Analysis of Data

Chapter 5 Findings, Conclusions and Recommendation

CHAPTER II
REVIEW OF LITERATURE

2.1 Review of Relevant Studies

Review of different relevant sections is made in this chapter. For this study, study of previous thesis reports made on related subject matter, related books and published articles were made. Some of the relevant studies and other literature relating to the topic have been reviewed below.

2.1.1 Conceptual / theoretical review

The origin of word'Bank' is linked to Latin word'bancus', Italian word 'banca' and French word'banque', all which means one word that is bench. "Money lenders in the streets of major cities of Europe used benches for acceptance and payments for valuables and coins. When they were unable to meet their liabilities, the depositors used to break their benches."thus there is difficult to say whether the bank has been derived from "bancus", "banca", "Banque".

"A bank is a government regulated , profit making business that operates in competition with other banks and financial institutions to serve the saving and credit needs of its customers. The primary business of banks is accepting deposit and lending money. Bank accepts deposits from customer who wants the safety and convenience of deposits service and the opportunity to earn interest on their excess funds. Banks put their depositors 'fund to other individuals to business and to federal, state and local government." (Halter, 1999)

Whereas "Financial institution refers to any institutions established with objective of providing loan to agriculture, co-operative, industry or any other specific economic sector or of accepting deposits from the general public. The team also refers to any other institution called financial institutions by HMG/N by publishing a notice in Nepal Gazette. However, the term does not signify commercial bank." (Dahal, 1999:168).

Finance Companies growth and profitability are the result of carefully forecasting funding needs, competitively attracting funds, efficiently borrowing funds, effectively investing funds in safe but profitable earning assets. .According to ‘Bank and Financial Institutions Act 2006, Finance Companies fall under “C” Class financial institutions operating these days. Depending on company’s size and location and on local and national economic conditions, a finance company may have adequate, relatively stable sources of low cost funds, or it may have to compete regularly and aggressively for funds at high market prices. For an increasing number of finance companies, the second situation is becoming the norm, as more and more finance companies face increase in pressure to attract adequate funds at reasonable costs. The main business of finance companies consists of providing credit to manufacturers, traders engaged in inland business and export and import business, in the form of loan and credit. For purposeful lending, eyes and ears are equally important.[5] The lending process may vary according to size and types of loans. However there is certain lending process followed by most of the financial institutions. The principal lending process has the following steps in general:

i. **Loan Application:**

Most individual loans arise from a direct request from a customer who approaches a member of the finance company’s staff and ask to fill out a loan application.

ii. **Loan interview:**

Once a customer decides to request a loan , an interview with a loan officer usually follows right away, giving the customer the opportunity to explain his/her credit needs. That interview is particularly important

[5] Singh , Hriday Bir., Banking & Insurance, Asia Publication Pvr. Ltd, Bagbazar, Kathmandu, First edition 2062.

because it provides an opportunity for the company's loan officer to assess the customer's character and sincerity of purpose.

iii. Site Visit:

If a business or mortgage loan is applied for, an officer of the finance company usually makes a site visit to assess the customer's location and the condition of the property. Site visit helps to verify the accuracy of information provided by the applicant. It also reveals the degree of customer‘s sincerity and character.

iv. Reference Check:

The loan officer may contact other creditors who have previously loaned money this customer to see what their experience has been. This payment record often reveals much about the customer's character, sense of responsibility in making use of the loan amount.

v. Documentation:

It everything up to this point is favorable, the customer is, then, asked to submit several crucial documents in order to full evaluate the loan request, including complete financial statements.

vi. Credit analysis:

Once all documents are on file, the credit analysis division of the finance company conducts a thorough financial analysis of them aimed at determining whether the customer has sufficient cash flow and back up assets to repay the loan .In case, of larger loans, member of credit analysis division gives an oral presentation, and discussion will ensue between staff analysis and the loan committee over the strong and weak points of a loan proposal.

vii. Perfecting collateral:

When the loan committee approves the customer's loan request, the loan officer or the credit committee will usually check on the property to be pledged as collateral in order to ensure that the finance company immediate assess to the collateral .Once the loan officer and the company's loan's committee are satisfied that both the loan and the collateral are sound, the note and other document are made up for a loan agreement. Then all parties to the agreement sign on loan deal.

viii. Monitoring:

After advancing loan to the loan to the customer, it seems to be the end of lending process. For larger commercial credits, the loan officer will visit the customer's business periodically to check on the firm's progress and to see what other services the customer may need.

2.1.2 Review of Journals

An article titled "Present Position and Future Challenges of Finance Companies in Nepal" written by Mr. Prem Shanker Shrestha was published in Banking Prawardhan Vol.8. The theme of the article is drawn in the following points.

1. Despite the existence of numbers financial institution, local lending and borrowing transaction has covered about 80% of total credit demand of Nepal.
2. In past costumers used to approach to financial institution. But now a day here came a condition that the institutions need to go to the clients for providing financial services. Thus finance companies need to modify their working style as demanded by time and should concentrate in quick and practical services.
3. Taking the example of financial crises in some of the countries in Southeast Asia. Nepal should also learn the lesson from the countries in the context of increasing numbers of finance companies in the country.
4. There should be debt recovery act on Nepal.

5. Finance companies are seen not getting able to collect long-term deposit satisfactory. So they need to try to increase public confidence towards them.

Dr.D.P. Poudel, Economic Advisor Research Department NRB, wrote an article in 2054 on the topic "Finance companies in Nepal and overview "He mainly focused on the performance of finance companies. According to him, " In the year 1966, the ratio of capital funds to deposits has been increasing over the time but on top of this, it is substantially below than the authorized level of deposit mobilization, which is 10 times of capital base. Nevertheless, some of the finance companies have even mobilized the deposits by more than ten times of their capital base by violating the regulatory norms issued by the NRB. The credit /deposit ratio has remained quite high leaving room for doubt about the quality of loan especially in the absence of repayment schedule. The loan diversification has been improved however, during a short span of time. As such, the hire purchase, housing and term loans are the major sectors, which all together received more than 95% of the total loan and advances in mid July 1996. Because of the mushrooming growth of the number of finance companies, the average sources of funds for each company are natural to decline. Since the very tin Aging factor, it is too early to evaluate the performance of the finance companies in Nepal but equally important factor is that the regulatory and authority should keep close eyes o monitor their activities.

"Regulating depository Institution in Nepal" the article written by Mr. Ghimire has attempted to suggest a board of framework for regulating depository institution. In this article four important regulations are discussed. They are licensing requirement, minimal capital requirement, investment restriction and, capital adequacy requirement.

Regulatory Discretion on Licensing:

NRB has the discretionary power on who should not be allowed to open or own a company. NRB is supposed to take its decision after evaluating the potential owner's background. This regulation stops every third person walking on the street to start owning or running a company and stopping the probability of misuse and fraud in functioning of the system.

Minimum Capital Requirement for Licensing:

Current regulation stipulates minimum amount of equity capital that the company should have to get license in operating and mobilizing deposits. This will definitely put bar in new entrances and lower the current competition by allowing already operating institution to operate freely. Since the concentration activity has been on capital only, there has been geographical sanction too.

According to Mr. Ghimire the restriction on capital requirement geographical location should be scrapped off. Minimal capital requirement should be substituted by minimum infrastructure, the company should possess and there should be regulation that portion of owner's capital must be required in every risky investment. A far as geographical restriction is concerned, capital can freely move from one geographical area to other, so there is no need of this restriction.

Investment Restriction:

This regulation restricts how and where an institution can invest for example, limit to any one sector, to any borrower, on any one category etc.
Productive investment by the company affects the nation's productivity. Restriction on investment on single borrower avoids the risk of failure of any single borrower adversely affecting the intervention on their issues as companies have been smartly violating these regulations.

Capital Adequacy rate:

Commercial banks are primarily controlled by capital adequacy requirement whereas finance companies are controlled by the maximum amount of deposit fixed at a certain multiple of the net worth. Capital indicates degree of owner's commitment on these institution and cushion against shrinkage of the assets of company in event of default. Since capital indicates degree of owner's commitment, capital as a percentage of risky investment should be enforced.

In the end, he further presents some of conclusion remarks and recommendations:

- The regulation to be resorted must be carefully examined, analyzing the marginal cost and benefit.
- Depositing institutions engaged in the function of mobilizing deposits should be subject to uniform rules.
- Regulatory intervention in enhancing the overall efficiency is required.
- Minimum capital requirement for opening any financial institution should be scrapped.
- Regulation that doesn't make economic sense and that cannot be enforced should be scrapped.

Another research oriented article, titled "Development Required in Policy and Legal Aspects of Finance Companies" was found to be published in Banking Prawardhan Vol. 9. Mr. Volaram Shrestha and Mr. Lokbahadur Khadka, the writer of the article, have try to put forward some recommendations as the measures for the better running of finance companies in Nepal. The major part of the article is summarized in the following points:-

1. Under the existing regulation, a new finance company could issue common share to public within 3 years of its establishment. A company in loss should go to public as soon as it starts getting profit. But it is seen that some companies are not seen to issue public shares eve after completing 4 or 5 years of operation. So, NRB should make such companies issue public share by circulating regulations like not allowing a company to provide dividends to its promoters if it fails to issue public share within a specific period of time.
2. Promoters should not be allowed to sale their share unless the company issue public share. Moreover, there should be standards of eligibility of the buyers to purchase, thus sold shares, as there is a great role of promoter in planning and monitoring of a company.

3. There is a requirement of credit information system among all the financial institutions. Finance companies association of Nepal should play its role in this regards.
4. Under current regulations, a finance company cannot grant loan to a single section more than 60% of the total loans and advances. And if it exceeds the limit, additional 25% of the final exceeding the limit should be maintained as loan loss provision. This provision should be increased as 25% is not enough to control a company to exceed the limit.
5. As there is not any credit rating agency in Nepal, depositors or investors are facing problem of choosing appropriate finance company to deposit or invest their savings. So NRB should develop a system of ranking finance companies on the basis of capital structure, profit/loss condition, issuance of public shares, quality of management, amount of bad debt, service diversification, service quality etc. The companies in high rank should be slightly relaxed from restrictions regarding various aspects.

"With more deregulation setting in, evaluation of risk appraisal is assuming more importance. Absolute quantitative credit deposit ratio has no relevance if the assets are not performing ones. Hence, it is felt that appraisal techniques of bank lending in competitive areas have to be more attuned towards risk evaluation. A major aspect of this work has been the development of more advanced methods for the quantitative measurement of market risk; the extensive trading in financial instruments provides a good supply of price statistics and this is a considerable help when it comes to estimating market risks. Much work is now being done in many places to construct models for a better management of credit risks, which are still by for the largest risk category for banks. The difficulties here, however, are for greater than in the case of market risks. The estimation of key parameters for models is obstructed by a lack of statistics. Moreover, some advances have been made in the estimation of operational risks, i.e., the risk of losses arising from technical problems or inadequate internal controls. Previously, operational risks had attracted less attention than credit and market risks. It changes in the nature of banking operations that have brought them more to the fore.

Financial legislation and regulation need to be sufficiently flexible to accommodate the rapid pace of developments in the financial sector. It tends to take considerably longer to amend rules than it vows to create new financial products. But there has to be a foundation of minimum requirements for risk management .in addition, the authorities must be increasingly involved in ensuring that institutions themselves possess a basic competence in and understanding of the risks that have to be managed, as well as adequate systems for their management, rather than issuing details risk management instructions. In other words, it has become more important to inspect system, defining in a wide sense, then to scrutinize particular commitment or market risk. Some supervision can be carried out with the market assistance. The authorities prescribe as well as encourage a more open presentation of the institutions risked and profitability in different operation such a transparency emphasize the banks demand on each other as well as what customers requires of their banks.

Effective credit risk management allows a bank to reduce risks and potential NPAs. It also offers other benefits. Once banks understand their risks and their costs, they will be able to determine their most profitable businesses and, thus, price products according to the risks. Therefore, the banks must have an explicit credit -risk strategy supported by organizational changes, risk measurement technique and fresh credit processes and systems. There are five crucial areas that credit risk management should focus on.

(a) Credit sanctioning and monitoring process.
(b) Approach to collateral.
(c) Credit risks arise from new business opportunities.
(d) Credit exposures relative to capital or total advances.
(e) Concentration on correlated risk factors.

Apart from these, the bank management should regularly review all asset quality issues including portfolio composition, big borrower exposures and development in credit management policy and process. Improving risk management will not be easy or quick. However, Nepalese bankers have little choice. Hopefully, the banks adopt good risk management practices and will be able to reap both strategic and operational benefits."

“Some of the clauses in the directives are not practical. For example, NRB has told the finance companies to maintain a list of single clients. It is not easy to collect the identity of all the relatives of our clients. I think, these things are very funny. Barring such few things, I fully agree with the policy of the NRB as they are trying to make the guidelines to conform to the international standard.”

“The challenge is the lack of a kind of the trust or faith between the clients and the financial institutions. Sometimes I see some kinds of the moral hazards in this country. Many times I have been asked by our clients why do we ask for too much collateral and keep too many clauses in the contract. I think that perception should be changed. Some clients even tell me that if the has offered a high collateral value compared to the loan amount the borrower has to obey what the bank or the finance company dictates. And if the bank extends a loan without any collateral then the bank will have to obey its clients. That is totally wrong. You know why do such kinds of things happen here? Because there is no system to keep a track record of the borrower. If somebody is bankrupt or fails to repay loan in time he should not be allowed to do any other business. But here, such person can easily start a new company and gets the loan from other banks. These types of things are prevailing here. First of all, these things should be changed”

“In Nepal, if a cheque is bounced nothing happens to the issuer. But it becomes a criminal case in Korea. In case of promissory note it is not a criminal case, it is just a civil case. In case of cheque however, cheque issuer should go behind the bars. It is only with such a strong social system that the credibility among the financial institutions and the clients and the government is established. Except in Japan and Korea I don’t think that even the western countries have such kind of strong social system. The reason for them may be that they grew in such a kind of environment that if somebody fails to pay his promises he couldn't survive in the society. They should go somewhere else. That's why they don't need to develop such systems. In the case of Japan and Korea, the history of their industrialization is not that long. Japan's may be about 150 years long and Korea's about 50 years long. Therefore, they could not import the system within that time. Therefore, without any severe penalty one doesn't necessarily follow the rules. In western countries if someone's cheque is bounced, no bank will again issue the cheque for that client. Therefore, the clients are more alert about it. But in Nepal the bank doesn't seem to care even if the cheque may have bounced three or four times. Sometimes, the clients intentionally issue the cheques on empty account even if they know that they don't have the balance in that account. This happens very frequently. Therefore, these things should first be addressed. In this kind of environment how can we work? Because of this attitude, many times we are very scared to provide the loans to even a very big company"

"The profit shown by companies and certified by auditors largely depends on the amount of loan loss provision provided as required by Nepal Rastra Bank directives. There is often disagreement between Company Management and Auditors over the loan categorization necessary fort the loan loss provision. Nepal Rastra Bank's Directive Section 7 gives detailed regulations on how loans should be classified as (1) Good (2) Indicative to Feeble (3) Feeble (4) Doubtful and (5) Bad against which 1%, 5%, 25%,50% and 100% loan loss provision should be provided respectively. It is worth mentioning that there is confusion over the meaning of installment. Does the installment mean installment of interest or installment of principal? The Directive is not clear about the definition of installment, causing confusion to both Auditors and Company Management, which normally entails application of the subjective judgment of Auditors and the Management of the Company for the classification of loans.

NRB Directive Section 7(f) allows companies to restructure/ reschedule/ capitalize interest when the loanee cannot pay back money in time. But the NRB Directive does not mention the condition for doing such things. It does not state whether or not a company should fully recover interest due. Details of the documents to be obtained by the Company Management to reschedule/restructure are however required as per New Directives Issued by NRB to commercial banks effective from the 1st quarter of FY 2058/59. The NRB Directive to Finance Companies also does not say anything about how many times Finance Companies can reschedule/restructure loans and capitalize interest within a "Loan Period" or within a "Fiscal Year". In the absence of such regulation, there may be a malpractice of rescheduling/restructuring the same loan many times even within the fiscal year passing off a worse quality loan as a better quality loan.

Section 5 of the NRB Directive pertains to the definition of the single group disbursement limit of credit facilities that can be disbursed. Nepal Finance Company Act 2039 Section 16 prohibits finance companies disbursing loans to directors. This section also contains other activities that a Finance Company must not conduct. Here the question arises whether or not a Company can flow a loan to somebody by pledging/keeping the collateral of the Director of that Company. NRB Directives are really silent on this matter. Although there is an "International Accounting Standards" IAS 24 for "Related Party Disclosure" requiring detailed disclosure of transactions with the related party of an entity in the Notes to the Account, these are almost not practiced in the Nepali Financial Reporting Environment by either Management or Auditors.

The definition of scheduled and non-scheduled loans and the amount of such loans in any finance company is immensely important for the "Risk Management" and overall Fund/Financial Strategy of the Finance Company. NRB Directive Section 8 merely addresses "Loan Policy, Procedures, and Period of Scheduled Loans. But the NRB directive fails to define the meaning of scheduled loan. What percentage of the total loan portfolio could be disbursed in the form of non-scheduled loan? These terms should be explicitly defined. Otherwise finance companies may disburse whole/majority of loans as non scheduled loans to show short term profit at the cost of the long term sustainability of companies. The disbursement of maximum non-scheduled loans calls for a liquidity crisis, which hazards the companies business and creditworthiness.

NRB Directives do not contain any section relating to the closure of loan/credit facilities enjoyed by the loanee. In the absence of such a regulation the company management can close the loan at the year-end and disburse the loan after year-end in order to show the best financial position of the company. "Events after the Balance Sheet Date" prohibits an entity from creating artificial transactions to provide window dressing for the financial position of the company. However these standards are also not strongly followed for External Financial Reporting purposes.”

“It is normal act of Nepal Rastra Bank to in act directives, time to time, to such institutions that collect deposit from public, for the safety of depositors. It should not be questioned otherwise. But directives should be such that, they are conveniently applicable. Directive should not be as such that they are perfect from the view point of NRB but inapplicable whence seen from the shoes of finance company. If directives are lengthy and whose application might arise question in the existence of the company itself, consequently turn out to be ineffective. It is not compulsory that strict directives increase the efficiency of finance company. Efficiency of managers and board of directors, who make rule and regulations, bring effectiveness ad efficiency in finance companies.”

2.1.3 Review of Relevant NRB Directives

Funds used by finance companies for the purpose of advancing of loans and leased assets are that of public. Finance co. collects deposits from public and it is the very same fund the finance companies use to make profit and give back to the public. Thus, to prevent this public fund being misutilized and to protect the savings of public, NRB has given directives to the finance companies regarding investment of public fund along with the directives to perform all other jobs of finance companies. Since loan and advances and leased assets is the first and the main sector of investment, to minimize the risk here, NRB has specifically given guidelines relevant to loan and advances and leased assets in NRB directives for finance companies 2058 No. 4, 5, 7 and 9.

NRB Directive No. 4

Under this directive, using the authority of Nepal Rastra Bank act 2058 section 79, NRB has given criteria for classification of loan and advances and leased assets and accordance calculation of loan loss provision. The main objective of doing this, as specified by NRB, is to minimize the risk of bankruptcy of finance companies ultimately leading to endowment of public fund due to incautious investment in bad loan and advances.

There are 8 guidelines provided by the NRB in NRB directives for finance companies 2058 No. 4. these guidelines are regarding classification of loan and advances and leased assets and loan loss provision, additional loan loss provision for loan granted against personal guarantee, rescheduling and restructuring of non-performing, provision of transferring amount to income from loan loss provision account, repayment of loan and advances, loan and advances and leased assets policy, punishment for violating the directives regarding classification and loan loss provision.

As guidelines provided by the directives of NRB, according to the aging of repayment of loan and advances, the loan and advances are to be categorized bi-yearly in every fiscal year i.e. at the end of Poush and Aashad. The criteria for the classification of loan and advances are given below;

Table 6 : Loan Categorization as according to NRB Directives

S. No.	Loan Categorization	Repayment Due Period	Loan Loss Provision (%)
1.	Good	No due and maximum due of 3 months	1%
2.	Sub-standard	Due from 3 months to 6 months	25%
3.	Doubtful	Due from 6 months to 1 year	50%
4.	Bad Loan	Due of more than 1 year	100%

In the directives given by NRB, loan and advances are initially categorized as performing loan and non-performing loan. Good loan and advances are defined as performing loan where as Sub-standard, doubtful and bad loan fall under the categorization of non-performing loan. Loan cases like loan granted to the project which is not presently working or misutilization of loan or whose loanee has run away are also treated as bad loan and classified as non-performing loan even if they are within the due dates.

Along with the comply of above guidelines, there are certain other guidelines regarding performing, non-performing loans and loan loss provision that has to go in synchronize with the given one. For the general outlook on loan policy of finance companies those guidelines, in brief, are listed below;

1. Any loan and advances that are granted under the criteria of repayment in installments are categorized as accordance to the due of repayment installments and treated as discussed above. But if any installment is due for more than a year, then the whole amount of loan is categorized as bad loan and 100% loan loss provision is to be made.
2. Regarding long term project financing, only the principle dues are categorized but if 25% or more of the total loan amount of these long term project are due the whole balance amount so categorized under loan categorization and loan loss provision is made.

3. Inter finance company financing can be dome for the time span of 3 weeks. If these loans are not realized within 3 weeks then the loan amount is categorized under loan categorization and loan loss provision is made accordingly.
4. Company can categorize its loans against its own fixed deposit receipts as good loan and loan loss provision is to be made accordingly.
5. No loan loss provision is to be made for the loan against HMG treasury bills and NRB securities.

This directive was imposed by NRB to minimize the risk that can arise due to concentration of loans and advances, lease financing and services to one customer.

NRB Directive 5

I. Limitation for loans and advances and lease financing

1. per customer loan limit

Company can provide loan and advances, lease finance and services to one person, family, customer, industry, project, firm or company at the most to the percentage of primary capital as given below;

I. Company can give out fund based loans and advances and lease finance up to 25%
II. In case on non-fund based loans and advances, it can give out up to 50%
III. For the portfolio of loans and advances and lease finance constituting of both fund based and non-fund based loans and advances, if the portion of fund based loans and advances is 25%, then 50% loans and advances can be given for the portfolio.
IV. But in case originally taken non-fund based loans and advances is later converted to fund based loans and advances then it has the provision of 'I'.

2. Related customers will be treated as a single group

For the purpose of drawing limits in granting loans and advances, lease financing and giving other services, customers with personal relations are categorized in to a single group under the following conditions:

a. In case one company has acquired 25% or more shares of another company then those both companies are considered as a single group.
b. In case a director of a company is a shareholder of another company or his/her relative; spouse, son, daughter in law, unmarried daughter, adopted son, adopted unmarried daughter, parents, step mother and younger dependent siblings residing under the same roof or the companies whose 25% or more share are owned by above mentioned relatives individually or jointly.
c. In case the firms, companies are legally connected in a group or members of such groups
d. If relatives mentioned in point (b) do not, individually or jointly, own 25% or more shares of a company but hold the following positions:
    i. Chairperson of BOD
    ii. Managing Director of the company
e. In case one customer or company has given cross guarantee to another customer or company.

3. Extra Loan Loss Provision:

In case the company has mobilized funds in loans and advances and in lease financing more than authorized, company has to make provisions of exceeded amount by 100%

II. <u>Mark Down in Limitation</u>

For the mobilization of safe Loans and Advances viz. loans against government securities, NRB securities and fixed deposits maintained in the very same company, the limitations of point 'I' is not applicable.

NRB Directive 7

Under the directive no. 7, using the authority of Nepal Rastra Bank act 2058 section 79, NRB has given criteria for classifying loan and advances under different sectors and sub-sectors and also determined the amount of loan finance companies are authorized to disburse under the given sectors and sub-sectors. The main objective of doing this, as specified by NRB, is to minimize the risk and to make sure the distribution of loan and advances into various sectors of economy.

I. Sector wise loan disbursement limit

NRB Directive No. 7 has defined sectors and sub-sectors for finance companies under which they can disburse loan. The sectors and sub-sectors under which finance companies are allowed to give out loan on as follows:

1. Hire Purchase Loan
1.1. Vehicles
1.2. Machinery, equipments and plants
1.3. Consumer durable goods and other movable goods
2. Housing Loan
2.1. Purchase of land and purchase/construction of building, god own for an individual
2.2. Purchase of land and purchase/construction of building, god own for an organization
3. Lease Financing
3.1. Vehicles
3.2. Plants, machinery & equipments
3.3. Consumer durable goods and other movable assets.
4. Term Loan – Medium and Long Term only
4.1. Agriculture and agro-based business
4.2. Industry
4.3. Business
4.4. Education
4.5. Health
4.6. Tourism
4.7. Hydro-power

4.8. Others

5. Fund Based Merchant Banking Activities

5.1. Venture capital

5.2. Bridge financing

5.3. Other merchant banking transaction

6. Non- Fund Based Merchant Banking Activities

6.1. Corporate counseling

6.2. Project counseling

6.3. Issue management

6.4. Share underwriting

6.5. Portfolio management

Notes:

1. Finance companies are allowed to flow 75 percent of total loan portfolio in term loan, 60 percent in lease financing and 40 percent each in hire purchase, housing and fund based merchant banking activities. However, the exposure in any sub-sector under the main sector of term loan shall not exceed 40 percent of total loan.
2. Prior approval from non-banking operations department has to be obtained to conduct fund-based merchant banking activities.
3. Company shall issue financial guarantee of medium and long term nature only.

II. <u>Additional loan loss provision</u>

An additional provision has to be made at the end of Poush and Ashad every fiscal year if the limit on sector or sub-sector wise loan amount is violated. Provision should be made of 25 percent of the exceeded loan amount.

III. <u>Time frame to bring loan amount under the sector wise limit</u>

Finance companies shall bring the loan exposure which exceeded the limitation as mention above until 2060 end of Ashad.

NRB Directive 9

NRB has stated this directive no 9 regarding the interest rates of finance companies, with the objective of creating a healthy competition between interest paid on deposits and interest gained from loans.

1. Provision of interest rate declaration:

Company can decide up the interest rate to be given on deposits and the interest rates collected on loans by itself. The earlier rule of maintaining the interest spread had been withdrawn.

2. No flat rate:

Company cannot charge the interest on loans and advances under flat rate system.

3. Interest rates should be decided:

Interest rates of deposits and loans and advances, interest calculation system, penalty system, service charge and commission rate used by the company should be decided by the board meeting or by other sub-committee authorized by the board or by the managing director of the company.

4. Information regarding interest rates:

While in acting the interest rates mentioned above for the first time or after any change in any time span, the detailed information should be forwarded to NRB Non-Banking Regulation Department and NRB Non-Banking Control and Supervision Department within 7 days of the change.

5. Publication of interest rates:

Interest rates given in deposits and charged in loans and advances by the company should be published in every half yearly closing (Shrawan and Magh) within the period of one month, compulsorily in National Daily Paper.

   a. Interest income and expenses:

      a. Due interest from loans and advances can be transferred to interest income only under cash basis. Interest of 3 months due but not paid can be shown as interest income under Interest Receivable Account. In case this due is not received in cash within 3 months, it should be transferred to Interest Suspense Account as expenses. And this interest amount transferred to Interest Suspense Account can be recorded as Interest Income only when it is collected in cash.

b. Interest income from Govt. securities, NRB securities, debentures and other investments should be treated as according to commitment basis. But dividends from share investments should be treated on cash basis.

2.1.4 Review of Unpublished Desertions

Mr. Anil Maharjan had made a study on the topic"A Comparative Study of Lending Practices and performance of the Commercial Banks" on 2009. The major findings of his study are as follows:

1) Measuring the liquidity positions of the banks, current ratio of the four banks shows slightly fluctuating behavior. All the banks could not maintain the conventional standard of 2:1.The combined ratio is 9.4. However, the average ratio appears to be high in EBL which signifies that EBL is more capable of meeting immediate liabilities in contrast to other banks. The ratio was more consistent in NIBL. The HBL has the least ratio of liquid fund to total deposit. i.e 0.10.

2) Measuring the Lending Strength, The combined ratio of Loans & Advances to Total Deposit ratio is 0.6741. EBL has mobilized 76.03% of it total deposit, which is highest among all. The HBL has mobilized least ratio of deposit to loan, i.e. 0.5665 The combined ratio of loan & advance and investment to total deposit is 1.013 The NABIL has the highest mean ratio and the NIBL has lowest, i.e. 1.0369 and 0.9818.

3) The sampled commercial banks have jointly generated loan & advances 8.7435 times of total shareholders equity. EBL has the highest ratio of all, i.e. 9.7877 and the NABIL has the lowest ratio of all, i.e. 6.6721. The combined ratio of non-interest bearing deposit to total deposit is 0.1616. HBL has highest ratio of 0.2057, which means HBL uses low cost fund Interest income to total income ratio of EBL is highest over the year

2003/04 to 2007/08, which reveals the EBL invested the fund rose from more successfully to earn the interest.

4) The combined ratio of Interest expenses to total deposit ratio is 2.6368%, which reveals that the average cost of deposit of four banks is 2.6368%. NABIL uses cheapest fund and EBL uses most expensive fund. The combined ratio of interest income to interest expenses shows that the sampled banks generating Rs. 2.6133 interest income from a rupee of interest expenses. The HBL has the highest ratio, 3.5322, of interest income to interest expenses. The interest suspense to interest income of HBL is 0.2776, which is far higher than combined mean ratio, i.e. 0.1305.

5) The Loan loss provision to total loan & advances of HBL is highest and NIBL has the lowest. It reveals that the quality of loan of NIBL is better than others'. The combined ratio is 0.0409. It was found that Loan Classification and provisioning of all the banks are followings directives from NRB to classify loan and making provision for default. The combined mean ratio of NPL and total loans & advances is 3.2942. HBL has the poorest quality of loan among them as the mean ratio of NPL to total loan & advance is 6.6598. The EBL has the lowest ratio of NPL to total loan and advances i.e. 1.5218. NABIL substantially decreased the ratio over the period from 6.16 to 1.122.

6) Growth ratio of total deposit of NIBL is highest of all by analysis over the study period, so it seems better performance of NIBL in total deposit. EBL is in second position. It can be said the performance of NIBL is outstanding.

The research recommends to search for new area of investment , to strictly follow NRB Directives, to avoid more risky area of investment, reduce cost of funds, adopt sound recovery policy , decrease non – performing loans and loan loss provision., reduce interest suspense account, . Increase the growth rate of business, Develop Innovative approach of marketing and competitors' analysis, Acknowledge grievances & complains and carry out regular follow-up of credit customers. Finally, it also suggests that the new standards should be designed to make the bank management more accountable for lending policy. Besides, it should investigate what are the reasons of lending inefficiency.

Ms. Runu Kushum Gautam had made a study on the topic "Investment Analysis of the Finance Companies in Context of Nepal". The major findings of trend analysis of the study are as follows:

1. From the aggregate data it is shown that the investment on government securities was increasing rapidly. The highest investment is that of Nepal Merchant Banking and Financing Limited and lowest is that of General Finance Company.
2. The capital range of the Finance companies mainly lies in the range of 100-500 lakhs. The major source of fund of finance companies is utilized in loan and advances. The maximum, minimum and average percentage of utilization on loan and advances are, above 50% respectively.
3. There are 38 companies having investment on hire purchase loan. The study clearly shows the use of funds towards the hire purchase loan is decreasing rapidly. The ratio of the loan and total loan and advances was also above 50% respectively. This shows there is gradual increase in this sector.
4. All the companies have investment on housing loan. The use of fund towards housing loan is almost linear .
5. Except few companies, all other companies have investment on term loan. The use of funds towards the term loan is also gradually increasing .
6. There are only few companies having investment on lease loan.
7. The interest rate structure of loans and advances of almost all of the finance companies are the same. It is varying from 17% to 22% with an average interest rate of around 20%. Recently, the interest rate has been decreased .

8. As the direct data of good and bad loan was not available, the loan loss provision is used to analyze the loan quality. As the minimum of 1% loan loss provision is mandatory, the percentage of loan loss provision for his period was satisfactory.
9. The loan loss provision of some companies is more alarming on individual analysis.
10. The ratio of interest earning assets and interest paying liabilities is decreasing gradually. However, it is very satisfactory as the interest spread rate is 6%, minimum of 30% of interest income will go to gross profit.

11.

CHAPTER III
RESEARCH METHODOLOGY

Research is essentially a systematic inquiry seeking facts through objectives verifiable methods in order to discover the relationship among them and to deduce from them broad principles or laws. It is really a method of critical thinking by defining and redefining problems, formulating hypothesis or suggested solution, collecting, organizing and evaluating data, making decisions and making conclusions to determine whether they fit the formulated hypothesis.

“Research is the process of a systematic and in-depth study or search of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data. It is a careful search or inquiry in to any subject matter, which is an endeavor to discover or find out valuable facts which will be useful for further application or utilization.”

Research Methodology depends on the various aspects of the research project. The size of the project, the objective of the project, importance of the project, time frame of the project, impact of the project in various aspects of the human life etc. are the variables that determine the research methodology of that particular project. “However, the following steps provide a useful procedural guidance so far as research methodology is concerned:

1. Tentative selection of the problem (i.e. topic of research)
2. Initial survey of literature
3. Defining or selecting the research problem
4. Extensive literature survey
5. Specification of the information required: formulating the hypothesis

6. Design of the search project
7. Sample design
8. Collection of data/ construction of questionnaires
9. Execution of the project
10. Analysis of data
11. Testing of hypothesis
12. Arriving at generalizations and
13. Preparation of the report (i.e. stating or writing down the result)"

The topic of the project has been selected as "Lending Practices of Finance Companies of Nepal (With Special Reference to Five Finance Companies in Nepal)" with a tentative objective of highlighting and analyzing the lending practices of finance companies. The survey of literature has been conducted from various library and references and these have been mentioned in chapter two. The problem of the study has been specified in the topic "Statement of Problem" in chapter one. Five finance companies out of 78 till today are selected for the study namely Lumbini Finance & Leasing Co. Ltd., Lalitpur Finance Co. Ltd., Peoples Finance Cc. Ltd., Union Finance Co. Ltd. and NIDC Capital Markets Ltd. The data has been collected from various sources as specified in sources of data. The data has been processed and presented in chapter four. The major findings of the analysis have been mentioned in chapter five. The conclusion and recommendations have been put in the same chapter.

3.1 Research Design

Research design is a plan for the collection and analysis if data. "A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework, of the project that stipulates what information is to be collected from which sources by what procedures. If it is a good design, it will ensure that the information obtained is relevant to the research questions and that it was collected by objective and economical procedures."

Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research objectives through analysis of data. The first step of the study is to collect necessary information and data concerning the study. Therefore, research design means the definite procedure and techniques, which guides the study and the ways to do the study.

This, in fact, is the specific presentation of the various steps in research process. These steps include the selection of a research problem, presentation of the problem, formulation of hypothesis, methodology, survey of literature and documentation, data collection, interpretation, presentation, report writing and bibliography.

This research covers three major finance companies of Nepal, particularly in their practices if lending and recovery. The research has its basic objective to figure out the problem therein and provide them wit some recommendation. The literature has been reviewed from past thesis, books and published articles. The data for the research are of secondary type.

3.1.1 Source of Data

Secondary data is used to conduct this research. The annual reports of the subjected finances companies are the main source of the data for the study. However, besides the annual reports other sources of data listed as below are also used;

1. NRB reports
2. NRB Directives
3. Academic Books
4. Various Publications concerning the subject matter
5. World Wide Web; the internet.

Besides the above mention sources, remarks of specialists or any other material found relating to the study are used as valuable data for the study.

3.1.2 Population and Sample

When it is impossible or very difficult to study the whole population, a part of the population is selected in order to draw conclusion of the whole population, this process is sampling and the part selected is called sample.
Here, regarding to this study, the whole of finance companies, with 59 in total number, is the population of the study. And the selected five finance companies viz. Lalitpur Finance Co. Ltd., Lumbini Finance Co. Ltd, Peoples Finance Co. Ltd., Union Finance Co. Ltd and NIDC Capital Markets Ltd. are the samples for the study. For this particular study, the sample was collected by random selection of major finance companies.

3.1.3 Data Collection Procedures

The annual reports of respective finance companies were collected from their respective offices websites. NRB reports were collected from Research department of NRB. The numerical data collected from different sources were used in whole numbers for the convenience of the study. The internet proved to be a very good source of data. Various sites were used for the collection of data. The sites used are listed in the bibliography.

3.2 Analysis of Data

The data presented in the study are analyzed by the following tools.

3.2.1 Financial Tools

1. Ratio Analysis

"The relationship between two accounting figure, expressed mathematically, is known as financial ratio (or simply as ratio). A ratio is simply one number expressed in terms of another and as such it expresses the quantitative relationship between any two numbers. Ratio can be expressed in terms of percentage, proportion, and as a coefficient. “The technique of ratio analysis is a part of the whole process o analysis of financial statements of any business of industrial concern specially to take output and credit decisions. --- Through this technique, a comparative study can be made between different statistics concerning varied facets of a business unit. Just as the blood pressure, pulse and temperatures are the measures of the health of an individual, so does ratio analysis measure the economic of financial health of a business concern. ---Thus, the technique of ratio analysis is of a considerable significance in studying the financial stability, liquidity, profitability and the quality of the management of the business and industrial concerns.”

As far as we are concerned about the financial ratio, a ratio between two relevant figures, which provide a certain relation, and have negative or positive correlation between them will only be studies. Since comparing two incomparable figures and their ratios give no idea and judgment on analysis and it remains as an absurd figure only. This section has been divided into following sub-sections.

Asset/Liability Management Ratio

Asset/Liability Management Ratio measures the proportion of various assets and liabilities in Balance Sheet. The proper management of assets and liability ensures its effective utilization. The banking business converts the liability into assets by way of is Lending and Investment functions. Assets and Liability management ratio measures its efficiency in multiplying various liabilities in performing assets. The following are the various ratios relating to Asset Liability management, used to determine the Lending Strength of the subjected finance companies.

1. Investment to Loans & Advances and Investment Ratio
2. Loans & Advances and investment to Total Deposit Ratio

3. Loans and Advances to Shareholder’s Equity Ratio
4. Loans and Advances: Portfolio

Activity Ratio

Activity ratio measures the performance efficiency of an organization from various angles of its operations. These ratios indicate the efficiency of activity an enterprise to utilize available funds, particularly short-term funds. The following ratios are used in this study to determine the efficiency, quality and the contribution of Loans and Advances in the total profitability.

1. Loan Loss Provision to Total Loans and Advances Ratio
2. Non-Performing Loans to Total Loan & Advances Ratio
3. Interest Income from Loans and Advances to Total Income Ratio
4. Interest Suspense to Total Interest Income from Loans & Advances Ratio
5. Loans and Advances to Total Deposit Ratio
6. Interest Income to Interest Expenses Ratio

Profitability Ratio

Profit is the difference between the revenues and the expenditures over a period. Profit is the main elements that make an organization to survive. The profit, in other hand, measures the management ability regarding how well they have utilized their funds to generate surplus. The given ratios are used to determine the efficiency of the lending, its quality and contribution on total profitability.

1. Net Profit to Shareholder’s Equity Ratio

3.2.2 Statistical Tools

Statistical methods are the mathematical techniques used to facilitate the analysis and interpretation of numerical data secured from groups of individuals or groups of observations from a single individual. The figures provide detailed description and tabulate as well as analyze data without subjectivity, but only objectivity. The results can be presented in brief and precise language and complex and complicated problems can be studies in very simple way. It becomes possible to convert abstract problems into, figures and complex data in the form of tables.

The various statistical tools used in this study to analyze the collected data are s follows;

Standard Deviation

Standard deviation is the most popular and most useful measure of dispersion and gives uniform, correct and stable results. The chief characteristics of standard deviation are that it is based on mean, which gives uniform and dependable results. Further more, a standard deviation is always a positive number and is superior to the mean deviation, quartile deviation and the range because t is used for further mathematical treatment.

Karl Pearson introduced the concept of Standard Deviation in 1823 and this is denoted by the small Greek letter σ (read as sigma).

The formula to calculate the Standard Deviation is given below;

$$\sigma = \sqrt{\frac{\Sigma x^2}{N}}$$

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

$$\sigma = \sqrt{\frac{\Sigma fx^2}{N}}$$

Where x = $(\overline{X} - X)$ and f = frequency

$$\sigma = \sqrt{\frac{\Sigma dx^2}{N} - \left(\frac{\Sigma d}{N}\right)^2}$$

Where d = $(\overline{X} - A)$ and A= assumed mean.

Coefficient of Variation

The percentage measure of coefficient of Standard Deviation is called Coefficient of Variation (C.V.). The Standard Deviation calculated in the above formulae gives an absolute measure of dispersion. Hence, where the mean value if the variables is not equal, it is not appropriate to compare two pairs of variables based on Standard Deviation only. The Coefficient of Variation measures the relative measures of dispersion, hence capable to compare two variables independently in terms of their variability.

The Coefficient of Variation (C.V.) is given by the following formula;

$$\text{Coefficient of Variation (C.V.)} = \frac{\sigma}{\overline{X}} \times 100$$

Correlation

Correlation is the measure of relationship between two or more characteristics of a population or a sample. It simply measures the changes between the phenomenons. The correlation coefficient between two variables describes the degree of relationship between those two variables. It measures the increase or decrease in one variable due to increase or decrease in another variable. “Simply stated, correlation is a statistical tool, with the help of which, we can determine whether or not two or more variables are correlated ad if they are correlated, what is the degree and direction of correlation.”

Karl Pearson’s method, popularly known as Pearsonian Coefficient of Correlation, is most widely used in practice. The Pearsonian Coefficient of Correlation is denoted by the symbol ‘r’ and is calculated as follows;

$$\text{Coefficient of Correlation (r)} = \frac{\Sigma(xy}{N\,\sigma_x\,\sigma_y}$$

Where,

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

$y = (\overline{Y} - Y)$

σ_x = Standard Deviation of series x

σ_y = Standard Deviation of series y

N = Number of pairs of observations

The Karl Pearson Coefficient of Correlation 'r' always fall between -1 to +1. the value of correlation in minus signifies the negative correlation and in plus signifies the positive correlation. As the value of correlation coefficient reaches near to the value of zero, it is d\said that there is no significant relationship between the variables.

The reliability of the value of Coefficient of Correlation can be judged by its Probable Error. Probable Error is denoted by 'P.Er.' and is calculated as below;

$$\text{Probable Error of 'r' (P.Er.)} = 0.6745 \frac{1 - r^2}{\sqrt{N}}$$

If the value of Correlation Coefficient is greater than 6 times the value of Probable Error, the Correlation Coefficient is seemed as significant and reliable. If the value of Correlation Coefficient is less that the Probable Error, the Correlation Coefficient is said to be insignificant and there is evidence of correlation.

Regression

The literal meaning of the word "regression" is stepping or returning back to the average value. The term was first developed by Sir Francis Galton in 1877.

"Regression is the statistical tool with the help of which we can estimate or predict the unknown value of one variable from the known value of any other variable. Assuming that the two variables are closely related, we can estimate the value of one variable from the value of another. The variable whose value is given is called “independent variable” and the variable whose value is to be predicted is called “dependent variable”. “

The regression equation of y on x is expressed as;

$$Y_c = a + bX$$

Where,

Y_c = value of Y computed from the relationship for a given X.

“a” and “b” are constants and also known as the parameters of the line. The parameter “a” determines the distance of the line directly above or below the origin, while parameter “b” determines the slope of the line i.e. the change in y with per unit change in x. X is an independent variable and Y is dependent variable.

This analysis is done of the industrial data covering all the finance companies till Asar, 2059.

Time Series

“Economist and business experts have often to deal with variates (quantities) which change in value with time. Variation of such quantities with time can be systematically studied and analyzed by presenting on the graphs. For obtaining knowledge about the nature of variation of a quantity along with time, time series can be used.” When a series of data pertaining to a series of continuing periods should be studied, its characteristics and its future directions best estimated by the time series. Time series analyses a series of data keeping in mind the various short term and long term fluctuations.

The Least Square Method of trend analysis has been adapted to measure the trend behaviors of the subjected finance companies in this study. “Method of Least Square is mathematical method of obtaining trend that uses the concept of least square method. Simply the technique of fitting regression equation.” This method is widely used in practices. The straight line trend of a series of data is represented by the following formula;

$$Y_c = a + bX$$

Where, Y_c is used to designate the trend values and to distinguish them from the actual Y values, a is the Y intercept or the computed trend figure of the Y variable when X=0, b represents the slope of the tend line of the amount of change in Y variable that is associated with a change of one unit in X variable. The X variable in time series analysis represents time.

In this study, the data of last 5 year i.e. 2057 to 2062 has been used in measuring the tend analysis. In case of NIDC, 4 years data is used, 2054 to 2058, for the data of 2059 and 2062 was not available. While analyzing the Time Series, the Propensity of Growth and Growth Rate have been examined based on the value of trend value of Least Square Method.

3.2.3 Qualitative Analysis

Recovery is very important part of Lending Practices. Due to the reason that no quantitative data regarding recovery of Loans and Advances was available, qualitative analysis is done on the segment. This analysis has been built under the grounds of data collected from the respective organizations stated above.

Chapter IV
Presentation and Analysis

4.1 Measuring the Lending Strength

Lending strength is that important aspect of any finance company, which if not kept in track while performing the functions, can lead to very critical situation. This, in fact, shows the situation of finance company in terms of investments in loans and advances. Whether the company is lending in accordance with the deposits it is collecting and the investments made by the shareholders or not should be analyzed regularly. Any idle deposit is loss to the company. Here, under this topic, an attempt is made to analyze the lending strength of the finance companies under study in relative terms as well as absolute terms.

4.1.1 Measuring the Lending Strength in Relative Terms

The lending strength of finance companies under study is measured in relative terms in this section. The relationship between various assets and liabilities of the balance sheet has been established to show the relative strength of lending strength of each finance company comparatively.

4.1.1.1 Investment to Loans and Advances and Investment Ratio

This ratio measures the contribution made by Investment in total amount of Loans and Advances and Investments. The proportion between Investment and Loans and Advances depicts the management attitude towards risk assets and safety assets. This also measures the risk the company is taking in its investment. The high ratio indicates the mobilization of funds in safe area and vice versa. However, safety does not provide with satisfactory return, as is said “no risk no gain”. Thus, a compromising ratio between risk and profit should be maintained.

Table 2 : Investment to Loans and Advances and Investment Ratio

	2060/61	2061/62	2062/63	2063/64	2064/65	Mean
Lalitpur	0.32	0.19	0.14	0.10	0.07	0.16
Lumbini	0.03	0.05	0.04	0.08	0.08	0.06
Peoples	0.09	0.02	0.01	0.01	0.02	0.03
Union	0.17	0.26	0.09	0.02	0.02	0.11
NIDC	0.14	0.11	0.12	0.08	0.10	0.11
Combined Mean						0.09

Table 2 shows the ratios of Investment to Loans and Advances and Investments. The ratios are ranged from 0.01 of Peoples to 0.32 of Lalitpur in. The ratios of Lalitpur are the highest throughout the study period. On the contrary, Peoples has the least ratio throughout the study period keeping aside the least ratio 0.03 of Lumbini in the year 2060/61. Analyzing the 5 year data of all five finance companies, it is noted that only Lalitpur has a steady increase in the ratio throughout. Despite being highest, the ratios of Lalitpur are in decreasing trend. The ratios of Lalitpur are in increasing trend till year 2061/62 and in decreasing trend since 2062/63. Union too has ratios in decreasing trend. Its ratios were decreasing from year first to year last from 0.17 to 0.02 respectively. Ratios of Peoples are fluctuating from rise to fall and again rise.

The combined mean ratio of all five finance companies is 0.09. The mean ratios of Lalitpur, Lumbini, Peoples, Union and NIDC are 0.16, 0.06, 0.03, 0.11 and 0.11 respectively. Only Lalitpur, Union and NIDC have registered the higher ratio than the Combined Mean. This indicates that Peoples has lowest degree of investment in risk assets. And similarly, Lumbini has the lowest ratio meaning it has high degree of investment in risky assets.

4.1.1.2 Loans and Advances and Investment to Total Deposit Ratio

Loans and Advances and Investments are the major area of fund mobilization. This is the major area where the funds collected as deposits are channeled. The first part, Loans and Advances is more crucial and also bears more risk than Investments but also gives the higher return. Whereas, the second half, Investments has lesser risk and gives lower return in compare to Loans and Advances. Loans and Advances and Investments to Total Deposits ratio indicates the firm's fund mobilizing power in gross. Total Deposits collected, against giving interest to the customers, is the total amount available for investments. Loans and Advances and Investments are the major areas where the companies can mobilize the funds with some returns. Any idle deposits mean loss to the company. Thus, this ratio measures how well the deposits have been mobilized. In other words we can say that this ratio measures what part of deposits are generating income for the company to give out interest to the deposits and also make profit.

Table 3 : Loans and Advances and investment to Total Deposit Ratio

	2060/61	**2061/62**	**2062/63**	**2063/64**	**2064/65**	**Mean**
Lalitpur	1.04	1.10	1.07	1.00	1.22	1.09
Lumbini	0.85	0.94	0.92	0.99	1.25	0.99
Peoples	1.07	1.04	1.01	1.04	1.09	1.05
Union	0.50	0.61	0.77	0.89	1.00	0.75
NIDC	1.10	1.03	1.21	0.99	0.80	1.02
combined Mean						0.98

Table 3 shows the ratio of Loans and Advances and Investments to Total Deposits. This means the portion of deposit being mobilized to generate income. The ratios range from 0.50 of Union in 2060/61 to 1.25 of Lumbini in 2064/65. Lalitpur is with the highest ratios followed by NIDC and Peoples respectively in different years. Lumbini has highest ratio of 1.25 in 2064/65, Lalitpur has the highest ratio of 1.22 in 2064/65, Peoples has the highest ratio of 1.09 in 2064/65, Union has the highest ratio of 1 in 2064/65.Whereas NIDC has highest ratio of 1.21 in 2062/63. Union has the lowest ratio throughout the study period. The ratios of Lalitpur have increasing trend except for decrease in 2063/64 from 1.07 to 1. None of the companies showed a steady increasing trend of the ratios except Lumbini and Union.

The Combined Mean ratio of all five finance companies is 0.98. The mean ratios of Lalitpur, Lumbini, Peoples, Union and NIDC are 1.09, 0.99, 1.05, 0.75, and 1.02 respectively. Lalitpur has the highest mean ratio and except for Union, all the companies have their ratios higher than the

Combined Mean. This shows Lalitpur, Peoples and NIDC have been doing best in mobilizing the funds collected in income generating way. And since the ratio is above 1, it refers that none of the deposit is idle. There is maximum utilization of the collected funds.

4.1.1.3 Loans and Advances to Shareholder's Equity Ratio

The ratio between Loans and Advances to Shareholders Equity shows how far the Shareholder's Equity has been able to generate assets to multiply its wealth. Shareholder's Equity is the investment made by shareholders in the company and Loans and Advances means mobilization of that invested funds in profit generating sector. Thus, this ratio measures size of the business and their success in converting liability into assets.

Table 4 : Loans and Advances to Shareholder's Equity Ratio

	2060/61	**2061/62**	**2062/63**	**2063/64**	**2064/65**	**Mean**
Lalitpur	11.42	16.02	14.59	15.01	21.26	15.66
Lumbini	10.33	9.82	10.93	11.89	10.74	10.74
Peoples	5.79	8.56	11.75	8.20	6.50	8.16
Union	3.56	4.06	2.78	8.08	9.76	5.65
NIDC	6.44	6.94	8.78	7.55	7.09	7.36
combined Mean						9.51

Table 4 shows the ratios of Loans and Advances to Shareholder's Equity. The ratios range from 3.56 of Union in 2060/61 to 11.42 of Lalitpur in 2060/61. Except for Lalitpur, none of the companies has their ratios in increasing trend. The ratios of all four companies are fluctuating. This fluctuation is probably due to increase in the shareholder's equity of the companies in different times.

The Combined Mean ratio of all the finance companies is 9.51. The mean ratios of Lalitpur, Lumbini, Peoples, Union and NIDC are 15.66, 10.74, 8.16, 5.65, and 7.36 respectively. Lalitpur has the highest mean ratio whereas Union has the lowest. Since the ratios of Peoples, Union and NIDC are below the Combined Mean, it can be concluded that they have not succeeded in increasing Loans and Advances in proportion to the size of their capital.

4.1.2 Measuring the Lending Strength in Absolute Terms

In this topic, the various variables in their absolute values are measured. Unlike ratio analysis, different variables are measured individually. the value of individual variables enables to measure the gross contribution of respective fiancé companies in those aspects. The ratio analysis merely describes the ratio between he two variables but does not tell about the absolute value of those variables. Thus, in this section, some of the important individual variables in their absolute value of Mean and Standard Deviation is examined. At the same time, to measure the relative measure of variability of data, the Coefficient of Variation is also measured.

4.1.2.1 Loans and Advances

The main function of finance company is to create credit from its borrowed fund. Doing so it converts its liability into assets. The high volume of Loans and Advances is indicator if good performance in credit sector. In other words to say, the volume of Loans and Advances is taken as one crucial element of measuring the performance of any finance company.

Table 5 : Loans and Advances (in millions)

	mean	S.D	C.V
Lalitpur	700.22	260.27	0.37
Lumbini	690.31	169.54	0.25
Peoples	426.25	160.8	0.38
Union	433.54	214.07	0.49
NIDC	519.79	135.24	0.26

Table 5 shows mean standard deviation and coefficient of variance of all five finance companies under study. The mean Loans and Advances of Lumbini is highest of all i.e 700.22 and Peoples has the least of 426.25. Similarly, standard deviation of Lalitpur is the highest with 260.27 and that of NIDC is lowest with 135.24. Thus, the performance of Lalitpur is more consistence regarding giving out loans and advances in comparison of other finance companies. Whereas coefficient of variance is highest of Union i.e. 49% and the lowest is of Lumbini.i.e 0.25%.

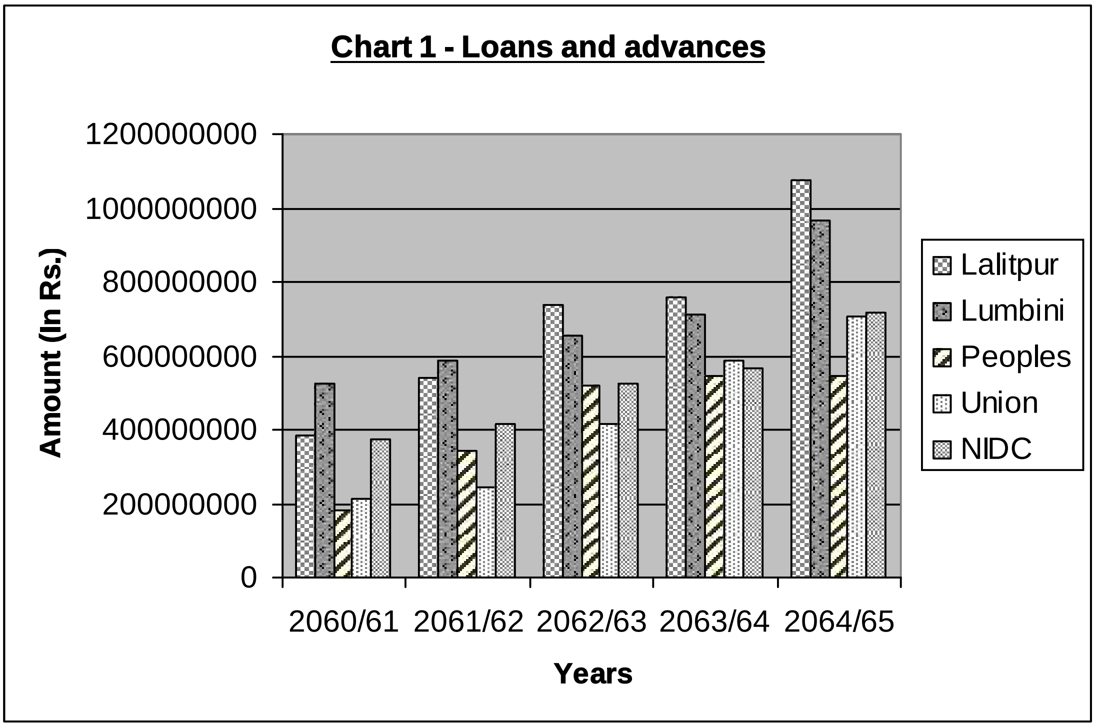


Chart 1 graphically presents the Loans and Advances of all five finance companies throughout the study period. Lalitpur, Lumbini, Peoples, Union, and NIDC have increasing trend with 1076 million as the highest amount registered of Lalitpur in 2064/65. The least Loans and Advances disbursed is 181 million by Peoples in 2060/61. However, there is an overall increasing trend in Loans and Advances. Starting from the year 2060/61, when the companies have come to the year 2064/65 they have high growth in their Loans and Advances.

4.1.2.2 Non-Performing Loan

Non-Performing Loan is consists of Loans and Advances except for good loans. It is that part of Loans and Advances that should be looked upon carefully for the timely recollection of the repayments. According to NRB directive no. 4, Sub-standard, doubtful and bad loans are categorized under Non-Performing Loans. Non-Performing Loans are, in fact, very crucial problem to finance companies. They not only require extra effort for collection of repayments but as according to the NRB directions for Loan Loss Provision, they also create large amount of Loan Loss Provision cutting down the profits and making the amount idle.

Table 6 : Non-Performing Loan (in millions)

	mean	S.D	C.V
Lalitpur	32.58	18.87	0.58
Lumbini	64.73	17.83	0.28
Peoples	12.28	4.26	0.35
Union	12.56	5.53	0.44
NCML	486.35	291.74	0.6

Table 6 shows the Non-Performing Loan situation of all five finance companies under study. Mean, Standard Deviation and Coefficient of Variance of all five finance companies are depicted in table 5. The Mean Non-Performing Loan of NCML is highest of all and the lowest of that is of Peoples. The highest Standard Deviation of Non-Performing Loan is that of NIDC, 291.74 and lowest is that of Peoples, 4.26. This means Union is performing well regarding the management of Non-Performing Loans. Deviation of NIDC is very high; this might call for problems in future if not controlled in time. Similarly, the highest Coefficient of Variance is of Lalitpur with 58% and the lowest is that of Lumbini with 0.28%.

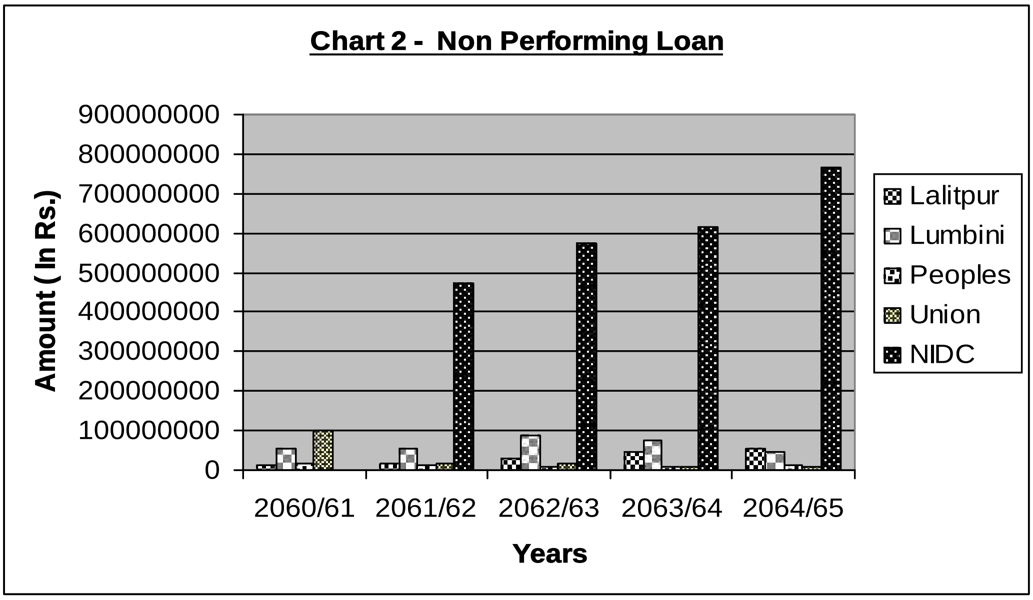


Chart 2 presents the Non-Performing Loans of all five finance companies graphically. The maximum Non-Performing Loan registered is 767 million of NIDC in 2064/65. However, NIDC has managed to cut down its Non-Performing Loan in the year 2060/61 to nil which is a positive approach. This, even not much of a problem now, can lead to a serious situation in future. The values of Lumbini, Peoples and Union seem to be fluctuating but the value of final year is lesser than the previous year showing bright sight in collection of repayments. According to the data, NIDC seem to be much into problems with Non-Performing Loans increased in 2064/65 as compared to previous year.

4.1.2.3 Interest Income from Loans and Advances

Interest Income form Loans and Advances is one of the main sources of income of finance companies. This is only a sub sectional part of Profit and Loss Account but is the most voluminous thus very crucial. This presents the pure income from the funds mobilized for Loans and Advance only.

Table 7 : Interest Income from Loans and Advances (in millions)

	mean	S.D	C.V
Lalitpur	92.9	30.69	0.33
Lumbini	108.09	19	0.18
Peoples	52.93	18.92	0.36
Union	57.47	28.51	0.5
NIDC	86.04	33.5	0.39

Table 7 shows the Mean, Standard Deviation and Coefficient of Variance of Interest Income from Loans and Advances of all five finance companies under study. The highest Mean register of Interest Income from Loans and Advances is 108.09 of Lumbini and the lowest is that of Peoples, 52.93. At a glance, it can be said that Lumbini is the most income making finance company among the five. But while considering the Standard Deviation, which is registered highest of NIDC too i.e 33.5, it can be said that even if NIDC has the maximum volume of Interest Income from Loans and Advances, it is not steady. On the contrary, Peoples has the least Mean but also the least Standard Deviation, which means the least deviation from mean, result of much steady and regular collections from Loans and Advances. The Mean of Lalitpur, Lumbini and Union are 92.9, 108.09 and 57.47 respectively and their respective Standard Deviation are 30.69, 19 and 28.51. Lumbini as pretty much larger volume of Mean 108.09 and at the same time much lesser Standard Deviation of 19. The highest Coefficient of Variance 39% of NIDC and the least is that of Union with 5%.

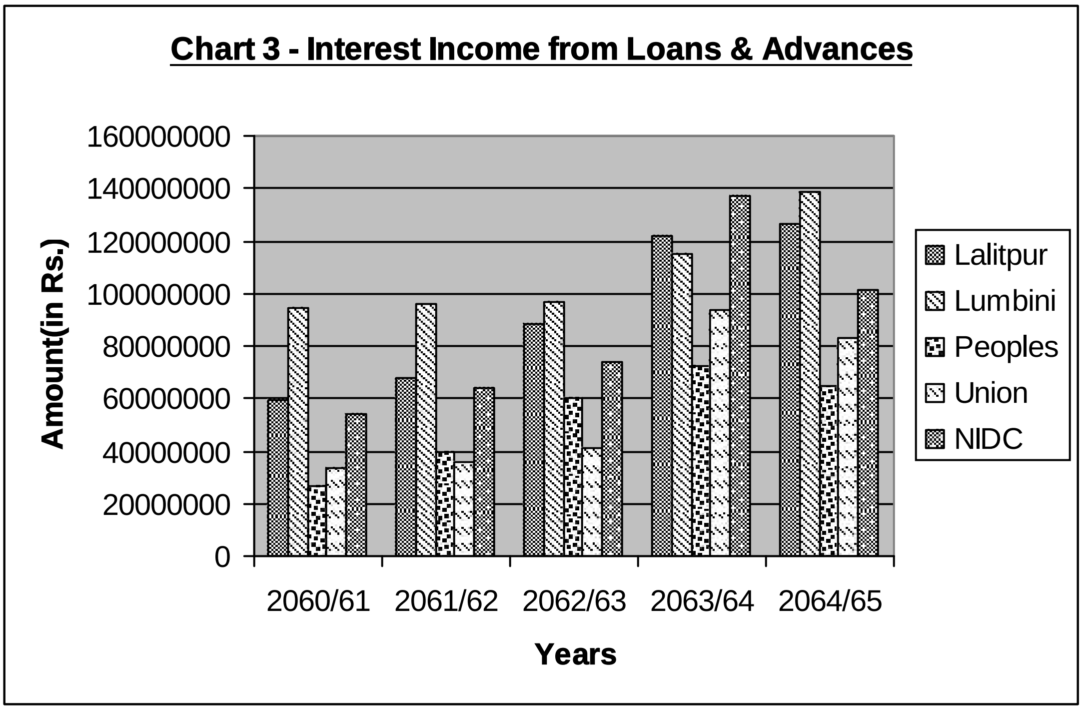


Chart 3 has the graphical presentation of Interest Income from Loans and Advances. This very distinctively shows the high income of Lumbini in the year 2064/65 which amounts to Rs.138 million followed by Lalitpur, NIDC, Union & Peoples in the same year. From the figure above it is clear that all the finance companies have the increasing trend in interest income from the loans and advances.

4.1.2.4 Loan Loss Provision

Loan Loss Provision shows the figure that is the summation of provision made against all types of loans as per the NRB directives. The NRB directives directs to make the provision of 1%, 25%, 50% and 100% for good loans, sub-standard loans, doubtful loans and bad loans respectively. This

Loan Loss Provision occupies the larger share in the total provision presented in the Profit & Loss Account and definitely decreases the profit of the company. The more the Loan Loss Provision, it suggests two definite things, more of total loan and or more of bad loan. Since, according to the NRB directives, 1% provision is to be provided fro all good loans too, it does acquire a huge portion of the total Loan Loss Provision. Thus, just by looking at mere Loan Loss Provision it cannot be said if the company has all good loans or voluminous bad loans.

Table 8 : Loan Loss Provision (in millions)

	mean	S.D	C.V
Lalitpur	52.28	16.97	0.32
Lumbini	87.77	11.87	0.14
Peoples	12.99	9.92	0.76
Union	14.55	3.01	0.21
NCML	41.25	23.41	0.57

Table 8 presents the Loan Loss Provision of the finance companies under study. The above table shows that Lumbini has the highest Mean of 87.77 meaning it had allocated the highest amount in provision for Loan Loss in comparison to other finance companies under study. Similarly, Union has the least of Mean 14.55 and at the same time it also has the least Standard Deviation of 3.01. Thus, Lumbini is most likely to have highest volume to risky assets and Union the lowest.

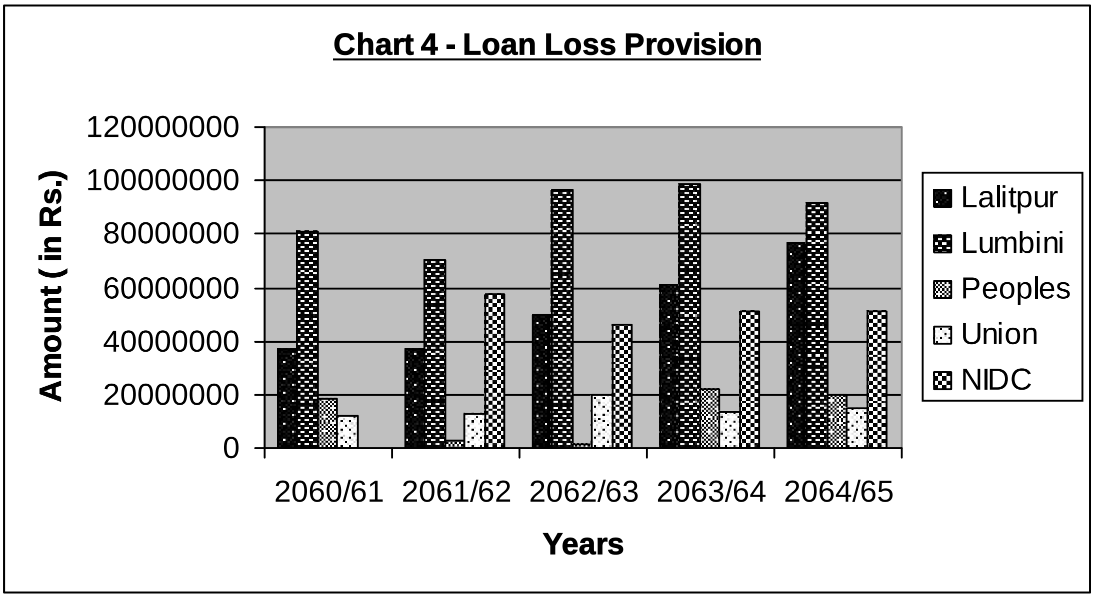


Chart 4 shows the graphical presentation of Loan Loss Provision of the finance companies under study. Lalitpur has the least Loan Loss Provision in the first year of study of Rs33.75 million but from the third year Union has maintain the least provision through out the study period. Whereas provision of Lumbini increased from Rs.51 million in 2060/61 to 90 million in 2064/65. Similarly, in case of peoples also there is an increment in the amount of loans and advances as compared to year 1st and year 5th, including NIDC and Union. The highest provision recorded is of Rs. 98 million of Lumbini in 2063/64. The overall trend of this liability is increasing in all five finance companies.

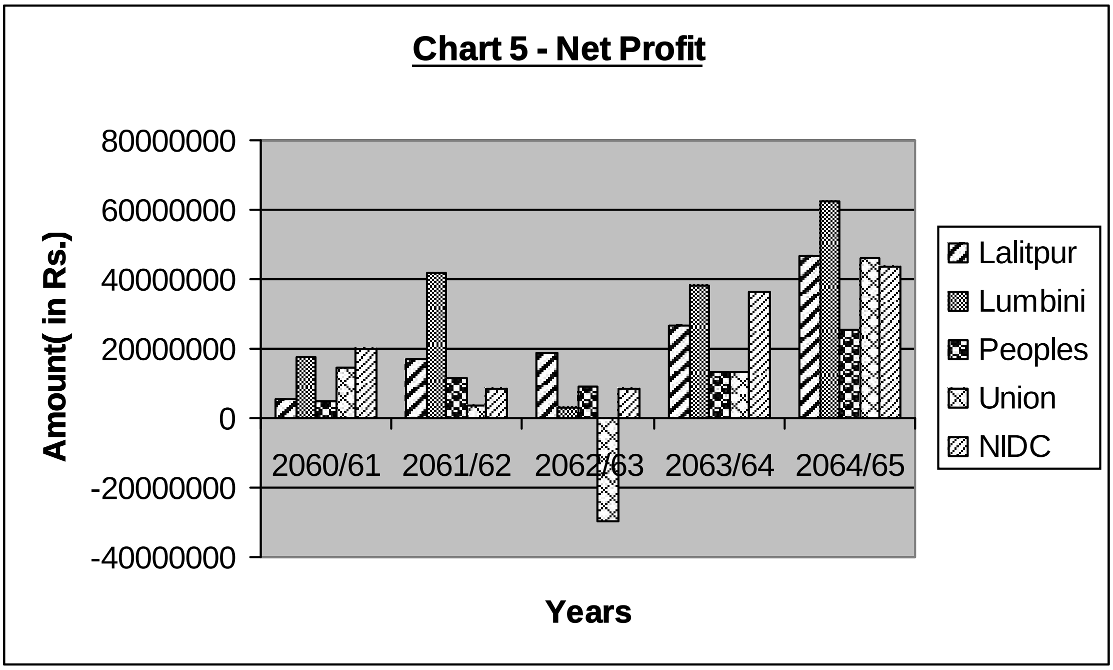
4.1.2.5 Net Profit

This Net Profit is the Net Profit before Appropriation. Bonus for employees and taxes are deducted and retained earning of previous year is also adjusted in the Net Profit for the study. Besides all the elements that count and questioned, the volume of Net Profit is the main factor that measures the success of the firm in every aspect.

Table 9 : Net Profit (in millions)

	mean	S.D	C.V
Lalitpur	22.99	15.25	0.66
Lumbini	32.65	23	0.7
Peoples	12.83	7.89	0.61
Union	9.46	27.14	2.87
NIDC	23.49	16	0.68

Table 9 shows Lumbini has the highest Mean of 32.65 with the variability of 7%. The Mean Net Profits of Lalitpur, Peoples, Union and NCML are 22.99, 12.83, 9.46 and 23.49 respectively and their respective Standard Deviation are 15.25, 7.89, 27.14 and 16. Under this analysis it can be said that Lumbini has the best performance. But it can be seen that NIDC is catching up with Lumbini with its next close Mean value with Lalitpur and Peoples almost the same variability, in fact a little higher.



The graphical presentation of Net Profits of all five finance companies is shown in Chart 5. This chart shows that the Net Profits of Lumbini is mostly higher than other finance companies. And besides Union with negative profits, Peoples always had the least Net Profits amongst all, despite; Union has an increasing trend of Net Profits. Besides Union and Peoples all the finance companies have Net Profits in increasing trend.

4.2 Analyzing the portfolio behaviors of Loans & Advances

So far, we have analyzed the relationship of Loans and Advances with various relative elements of Balance Sheet and Profit & Loss Account. In this section, we examine the portfolio management of Loans and Advances. Finance companies invest in various sectors of economy and to various types of borrowers. Besides, NRB, in its directives, has created boundaries for finance companies to invest in different sectors of the economy. That is to say, NRB has given certain limits to the finance companies to invest in certain sectors. So, in this chapter we'll be analyzing the portfolio behaviors of finance companies in terms of performing loan & non-performing loan.

4.2.1 Category wise Loan Classification

Here in this section, Loans and Advances made by the finance companies is different sectors as classified by the NRB is studied. This study shows the Lending trend of finance companies under performing and non performing loans.

Lalitpur Finance Co. Ltd.

Table 10 : Category wise Loan Classification – Lalitpur Finance Co.

(in million)

	2060/61	**2061/62**	**2062/63**	**2063/64**	**2064/65**
Performing Loan	363606498	548223220	752537763	773278361	1096851961
Non Performing Loan	49462843	18201774	28594516	47554039	56323930

Table 10 shows the Lending portfolio of Lalitpur Finance Company. The portfolio here is observed in relative terms, in millions. Lalitpur had its maximum Loans and Advances mobilized in the year 2064/65, Rs.1153 million. Whereas it could give out the minimum value of Loans in the year

2061/62 amounting to Rs. 182.00 million under non performing loans. The amount of performing loans is in increasing trend starting from year 2060/61 to 2064/65. Whereas the amount of non performing loans is fluctuating but is in increasing trend in last three years

Lumbini Finance & Leasing Co.

Table 11 : Category wise Loan Classification – Lumbini Finance & Leasing Co. (in millions)

	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	508719972	608538494	662187133	736272902	1011640544
Non Performing Loan	87932558	50945725	89895896	76336644	46606886

Table 11 depicts the category wise loan classification of Lumbini Finance & Leasing Company. The total investment in Loans and Advances is in increasing trend and the maximum amount given out for Loans and Advances amounts to Rs. 966 million in the year 2064/65. Every year the most amounts given out for loans is under performing loan, which is in increasing trend and amounts to Rs.1011 million in the year 2064/65. Whereas non performing loan is fluctuating throughout the study period.

People's Finance Ltd.

Table 12 : Category wise Loan Classification – People's Finance Ltd. (in million)

	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	162710943	345165031	520776259	557761177	551427172
Non Performing Loan	18728884	11125894	8549943	8806305	14198697

The above Table 12, shows the category wise loan classification of People's Finance Limited. The maximum funds mobilized for Loans and Advances is of Rs.545 million in the year 2064/65. Whereas the funds mobilization in non performing loan is maximum in year 2060/61 i.e 18 million.

Union Finance Co. Ltd.

Table 13 : Category wise Loan Classification – Union Finance Co. Ltd.

(in million)

	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	386378579	225294855	417766117	592869932	7152913523
Non Performing Loan	15849043	31152065	18423873	6676137	7447177

The above Table 13 presents the category wise classification of loans of Union Finance Company. The overall Loans and Advances are in increasing trend and has increased from 213 million in 2060/61 to 707 million in 2064/65. The classified loan category is in increasing trend but from the figures above can be analyzed that Union has concentration in performing loan for it has given out loans maximum under this category through out the years.

NIDC Capital Markets Ltd.

Table 14 : Category wise Loan Classification – NIDC Capital Markets Ltd.

(in million)

	2060/61	2061/62	2062/63	2063/64	2064/65
Performing Loan	276848107	404446453	513770638	572929647	730977336
Non Performing Loan	74662202	69612986	59296965	43904204	36830209

Table 14 portraits the category wise loan classification of NIDC Capital Markets Ltd. NIDC has Performing Loan in increasing trend and non performing Loan in fluctuating trend. However, Performing Loan has been the highest Loan granting category through out the study period.

4.2.2 Performing Loan to Total Loan and Advances Ratio (%)

This ratio presents the portion of performing loan to total loans and advances in the specific periods,

Table 15 : Performing Loan to Total Loan and Advances Ratio

	2060/61	2061/62	2062/63	2063/64	2064/65
Lalitpur	0.94	1.01	1.02	1.02	1.02
Lumbini	0.97	1.03	1.01	1.03	1.05
Peoples	0.90	1.01	1.01	1.02	1.01
Union	1.81	0.92	1.00	1.01	10.11
NIDC	0.74	0.97	0.98	1.01	1.02

Table 15 shows the portion of performing loan in the total loan released. Union has the highest ratio in performing loan of 10.11 in 2064/65. whereas the ratio is low in NIDC i.e. 0.74 in 2060/61. All the finance companies have the ratios in increasing trend through out the different study period.

4.2.3 Non Performing Loan to Total Loan and Advances Ratio

Table 16 : Non Performing Loan to Total Loan and Advances Ratio

Lalitpur	0.13	0.03	0.04	0.06	0.05
Lumbini	0.17	0.09	0.14	0.11	0.05
Peoples	0.10	0.03	0.02	0.02	0.03
Union	0.07	0.13	0.04	0.01	0.01
NIDC	0.20	0.17	0.11	0.08	0.05

The Table 16 above presents the ratios of non performing loan to total loans and advances of all finance companies under study. The maximum ratio is that of NIDC in the year 2044/65 i.e 0.20. The lowest ratio recorded is that of Union in the year 2063/64, 2064/65 i.e 0.01. Union had the lowest ratios amongst all the finance companies throughout the study period

4.3 Analyzing the Lending Efficiency and its contribution in Total Profitability

In this section, the Lending Efficiency I terms of its quality and turnover is measured. For this purpose, the relationship of different variables of Balance Sheet and Profit & Loss Account is established.

4.3.1 Loan Loss Provision to Total Loans and Advances Ratio

The ratio of Loan Loss Provision to Total Loans and Advances descries the quality of assets that the finance company is holding. NRB has directed the finance companies to categorize its Loans and Advances into good, substandard, doubtful and bad loans and to make the provisions of 1%, 25%, 50% and 100% respectively as Loan Loss Provision. Loan Loss Provision, in fact, is the cushion against future contingency created by the default of the borrowers. The lower ratio signifies the good quality of assets in the total volume of Loans and Advances. Similarly, the higher ratio signifies relatively more risky assets I the volume of Loans and Advances and also possibility of increment of Non-Performing Loans in future.

Table 17 : Loan Loss Provision to Total Loan & Advances Ratio

	2060/61	**2061/62**	**2062/63**	**2063/64**	**2064/65**	Mean
Lalitpur	0.09	0.07	0.07	0.08	0.07	0.08
Lumbini	0.15	0.12	0.15	0.14	0.10	0.13
Peoples	0.10	0.01	0.00	0.04	0.04	0.04
Union	0.06	0.05	0.05	0.02	0.02	0.04
NCML	0.00	0.14	0.09	0.09	0.07	0.08
Combined Mean						0.07

The tabulated figures of Table 17 shows the Loan Loss Provision to Total Loans and Advances ratio of all five finance companies during the specified study period. The least ratio registered is that of Peoples throughout the study period whereas it was nil on years 2062/63 which is also shared by PAFICOL in the very same year. Comparing their mean ratios, Lumbini has the highest amongst all, calculated as 013. The combined mean ratio of all five finance companies is 0.07 and the mean ratio of Lalitpur, Lumbini &

NCML is higher than the combined mean. These three finance companies have always been provisioning higher than the combined mean. Provisions of Peoples and Union have never crossed the combined mean. Generally, increase in this ratio suggests the increase in the Non-Performing Loans, which might result in questioning about the effectiveness in the credit policy of the company. The highest ratio of Lumbini vaguely depicts the portion of Non-Performing Loans in the total Loans is higher than in other finance companies.

4.3.2 Non-Performing Loans to Total Loan and Advances Ratio

As the NRB directives given to the finance companies, substandard, doubtful and bad loans are categorized under Non-Performing Loans. Increase in Non-Performing Loans increases Loan Loss Provision and Interest Suspense too, which ultimately results in profit deduction. “The banking sector is severely affected by the NPL (Non-Performing Loans) problem. It is estimated that the NPL of the Nepalese banking system is around 16 percent. Therefore, there is no doubt that it has a serious implication on economic performance of the country.” Even though shown as banking problem, it is as equal the problem of any finance companies in Nepal. And if the 16 percent as given is true; and the calculated mean of the finance companies under study also come around this percentage, we have finance companies whose Non-Performing Loans is higher than the industrial average of banks.

Table 18 : Non-Performing Loans to Total Loan and Advances Ratio

	2060/61	**2061/62**	**2062/63**	**2063/64**	**2064/65**	Mean
Lalitpur	0.03	0.03	0.04	0.06	0.05	0.04
Lumbini	0.11	0.09	0.14	0.11	0.05	0.10
Peoples	0.10	0.03	0.02	0.02	0.03	0.04
Union	0.06	0.07	0.04	0.01	0.01	0.04
NIDC	0.00	1.14	1.09	1.09	1.07	0.88
Combined Mean						0.22

Table 18 exhibits that the combined mean of Non-Performing Loans to Total Loans and Advances of five finance companies under study is 0.22.

That is to say, in the total volume of Loans and Advances the Non-Performing Loans represents 22 %. Similarly, Lalitpur has 4% of its Loans and Advances as Non-Performing and to continue observing this ratio we see that Lumbini, Peoples, Union and NIDC have their Non-Performing Loans 10%, 4%, 4%, and 88% respectively. This shows how the remaining finance companies are gradually being engulfed by the Non-Performing Loans. The ratio of NIDC is very alarming high. Increasing trend and high percentage of this ratio questions the good performance of finance companies.

4.3.3 Interest Income from Loans and Advances to Total Income Ratio

Needless to say, income is the most vital part of any business. Besides, in the companies dealing in lending business Interest Income occupies a greater portion of the Total Income. This ratio, Interest Income from Loans and Advances to Total Income, measures the volume of Interest form Loans and Advances in Total Income. This ratio also helps to measure performance of the finance company on the grounds of its lending policy. The high ratio indicates the high contribution in profits is made by the lending practices than in other risk free investments and vice versa.

Table 19 : Interest Income from Loans and Advances to Total Income

	2060/61	2061/62	2062/63	2063/64	2064/65	Mean
Lalitpur	0.89	0.82	0.91	0.83	0.72	0.83
Lumbini	0.91	0.77	0.84	0.92	0.81	0.85
Peoples	0.79	0.81	0.95	0.97	0.86	0.88
Union	0.28	0.31	0.38	0.76	0.48	0.44
NIDC	0.60	0.77	0.63	0.70	0.70	0.68
Combined mean						0.74

The combined mean ratio of all five finance companies is 0.71. This is indicative of the fact that Interest Income from Loans and Advances contributes 71% in the Total Income. These mean ratios of Lalitpur, Lumbini, Peoples, Union and NIDC are 0.72, 0.81, 0.86, 0.48, and 0.70 respectively. Except for Union, all the finance companies have their ratios higher than the combined mean ratio. This clears the fact that, except for Union, Interest Income from Loans and Advances have much higher contribution in the Total

Income and thus profit of the finance companies. This also clarifies that the finance companies are pretty much aggressive in investment and have invested their funds comparatively much less in risk free investments which bear much lesser return than risky investments. This is an exception for Union, which has only 48% contribution of Interest Income from Loans and Advances in the Total Income.

4.3.4 Loans and Advances and Investment to Total Deposit Ratio

Deposits are those funds that the finance company collects from different individuals and investors to that has to given back after certain time period with some interest. Whereas, Loans and Advances is that mobilized part of deposit amount that brings back additional income as interest from the borrowers. Thus, Deposits are liabilities which when converted to assets are called Loans and Advances. Deposits when are idle in company, it is loss to the company. Company can make profits only when deposits, which take away interest of certain rate are mobilized by giving away loans and advances, which bring back interest at higher rates.

Table 20 : Loan and Advances and Investment to Total Deposit Ratio

	2060/61	**2061/62**	**2062/63**	**2063/64**	**2064/65**	**Mean**
Lalitpur	1.04	1.10	1.07	1.00	1.22	1.09
Lumbini	0.85	0.94	0.92	0.99	1.25	0.99
Peoples	1.07	1.04	1.01	1.04	1.09	1.05
Union	0.50	0.61	0.77	0.89	1.00	0.75
NIDC	1.10	1.03	1.21	0.99	0.80	1.02
combined Mean						0.98

Table 20 shows the ratios of Loans and Advances to Total Deposits of all five finance companies under study. The combined mean is 0.98. The minimum ratio is of Union, which is 0.75. That means Union has not been able to invest in Loans and Advances even half the amount of deposits collected. Union has the least ratio amongst all five finance companies throughout the study period. This means maximum portion of deposits of Union are idle in the company or else they are invested in riskfree investments, which normally do not give lucrative returns. This directly affects the income and ultimately the profits of the company. Whereas Lalitpur seem to be doing the best according to this ratio of 1.09, meaning its investment in Loans and Advances are more than the total deposits collected. Finance companies can afford to invest in Loans and Advances more that they collect Deposits because they also have Shareholder's Equity to be invested apart from the deposits alone. The remaining companies Lumbini, Peoples and NCML have their mean ratios way above the combined mean, registered 0.99, 1.05 and 1.02 respectively. So it can be said that, comparatively, they are doing equally well investing almost 100% of its deposits.

4.3.5 Interest Income to Interest Expenses Ratio

The ratio of Interest Income to Interest Expenses measures the gap between interest rates offered and interest rate charged. NRB has canceled the restriction it had on finance companies regarding the interest rate spread. Thus, the interest rate spread in finance companies, now, is driven by the competition in the market. The spread between Interest Income and Interest Expenses is the main foundation of profit of finance company.

Table 21 : Interest Income to Interest Expenses Ratio

	2060/61	2061/62	2062/63	2063/64	2064/65	Mean
Lalitpur	1.44	1.64	1.79	1.81	1.77	1.69
Lumbini	1.96	2.08	2.16	2.27	2.46	2.18
Peoples	2.11	1.79	1.68	1.74	1.60	1.78
Union	0.92	0.87	1.08	1.49	1.53	1.18
NIDC	1.79	1.95	1.82	1.72	1.77	1.81
Combined Mean						1.73

Table 21, above, shows the ratios of Interest Income to Interest Expenses of finance companies under study with the combined mean 1.73, which indicates that a rupee of expense in deposits generates 1.73 rupees of interest income in average. Lumbini has the highest degree of gap between Interest Income and Interest Expenses. Union has the least mean ratio and also has the least ratio through out. The least ratio of Union is result of its heavy investment in risk free assets than in Loans and Advances, which generates higher interest income.

4.3.6 Net Profit to Shareholder's Equity Ratio

This Net Profit to Shareholder's Equity ratio measures the amount of profit that a rupee of shareholders' fund has received. The Net Profit here is the Net Profit before Appropriation. The high ratio is the high return to shareholders and vice versa.

Table 22 : Net Profit to Shareholder's Equity Ratio

	2060/61	2061/62	2062/63	2063/64	2064/65	Mean
Lalitpur	0.17	0.50	0.38	0.53	0.92	0.50
Lumbini	0.34	0.70	0.05	0.63	0.70	0.48
Peoples	0.15	0.29	0.20	0.20	0.31	0.23
Union	0.24	0.06	- 0.20	0.18	0.63	0.18
NIDC	0.35	0.14	0.15	0.49	0.43	0.31
Combined Mean						0.34

The above table shows the ratio of Net profit to the Shareholder's Equity of all the finance companies under study. Lalitpur has the highest mean ratio of 0.50. Lumbini is just behind Lalitpur wit mean ratio 0.48. Other all the finance companies have their mean ratios less than the combined mean of 0.34. Only Union has a negative mean ratio of -0.20 in the year 2062/63. Peoples, Union and NIDC have the mean ratio of 0.23, 0.18 and 0.31 respectively.

4.3.7 Earning Per Share (EPS)

EPS refers to Net Profit divided by the total number of shares outstanding. The amount of EPS measures the efficiency of a firm in relative terms. This figure is the indicative of the overall good or bad performance of an organization. How far an organization if able to use its resources to generate profit is determined by the profit it has earned. Thus, EPS determines the market value of a share, determines the attitude of outsiders.

Table 23 : Earning Per Share (EPS)

	2060/61	2061/62	2062/63	2063/64	2064/65
Lalitpur	16.57	50.36	37.53	52.69	92.24
Lumbini	34.09	69.99	5.44	63.19	69.68
Peoples	14.89	28.66	20.17	20.34	30.53
Union	23.98	6.26	-19.98	18.38	63.14
NIDC	35.00	14.02	14.63	48.51	43.09

Table 23 shows that EPS of Lalitpur is the highest throughout the years. The lowest EPS is that of Peoples i.e.30.53. Lumbini has the second highest EPS with 69.99 in the year 2061/62. EPS of Lalitpur has sharply decreased by 52.77% in 2055/56 from 2054/55.

4.4 Measuring Correlation between Different Variables

In this section of presentation and analysis, relation between variables of Balance Sheet and Profit & Loss Account are analyzed. For this, Correlation Coefficient (r) and Probable Error (P.Er) are calculated. And for the purpose of analyzing the significance and reliability of Correlation Coefficient, 6 times of Probable Error is also calculated. If the value of Correlation Coefficient is greater than 6 times the value of Probable Error, the Correlation Coefficient is deemed as significant and reliable.

4.4.1 Correlation between Deposits and Loans and Advances

The correlation between Deposits and Loans and Advances describes the degree of relationship between these two items. What is the impact on Loans and Advances with a unit increase in Deposit is measured here.

Table 24 : r, P.Er and 6xP.Er between Deposits and Loans and Advances

	r	P.Er	6 x P Er	Impact
Lalitpur	0.97	0.0177	0.10678	Significant
Lumbini	0.92	0.0463	0.2775	Significant
Peoples	1	0	0	No conclusion
Union	1	0	0	No conclusion
NIDC	0.95	0.0294	0.1762	Significant

The above Table 24 shows the relation between Deposits and Loans and Advances, which seem to have high degree of positive relation. All the finance companies, except for have almost 1 Correlation Coefficient. The value of 'r' if highest in Peoples and Union i.e.1 The relation of Deposits and Loans and Advances is lowest in Lumbini and NIDC. In case of all finance companies a percentage increase in Deposit is likely to bring the same percentage of change in the value of Loans and Advances. To be more specific, there is highest probability of this happening in Peoples & Union. Besides, Peoples and Union the value of 'r' in all companies is more than six times the P.Er, which concludes that the correlation between Deposits and Loans and Advances is certain and significant in all five finance companies.

4.4.2 Correlation between ShareHolder's Equity and Loans & Advances

The correlation between Shareholder's Equity and Loans and Advances shows the degree of impact of increase in Loans and Advances by change in Shareholder's Equity.

Table 25 : r, P.Er and 6xP.Er between ShareHolder's Equity and Loans and Advances

	r	P.Er	6 x P Er	Impact
Lalitpur	0.83	0.0937	0.5621	Significant
Lumbini	0.96	0.0236	0.1416	Significant
Peoples	0.78	0.1179	0.7075	Significant
Union	0.12	0.2968	1.7807	Insignificant
NIDC	0.92	0.0463	0.2775	Significant

Table 25 explains the degree of correlation between Shareholder's Equity and Loans and Advances in different finance companies under study. Lumbini, and NIDC have positive high degree of correlation depicting every increase in Shareholder's Equity increased Loans and Advances, which also showed well mobilization of funds collected. Lalitpur & Peoples have a positive degree of correlation whereas Union has low positive degree of correlation. The analysis of 6 times P.Er says that the correlation of Union can't be taken relied on confidently, since their Correlation Coefficient is lesser than the value of 6 times of P.Er.

4.4.3 Correlation between Investments and Loans & Advances

This correlation measures the degree of relationship between Investments and Loans and Advances. This measure of correlation explains whether the finance companies have a rigid policy to maintain a consistent relationship between two assets or other factors such as seasonal opportunities, economic demand, NRB directives etc. have impact on the volume of these two variables. The volume of Investment does not have any impact on Loans and Advances as every finance company, or most of them, has first priority on Loans and Advances to Investments. Theoretically, increase or decrease in the volume of Loans and Advances directly reduces or increases the level of idle funds and this idleness of funds increases the Investments. Thus, it is expected to have negative correlation in between these two variables.

Table 26 : r, P.Er and 6xP.Er between Investments and Loans and Advances

	r	P.Er	6 x P Er	Imapct
Lalitpur	-0.89	0.0626	0.3756	Insignificant
Lumbini	0.91	0.0518	0.3108	Significant
Peoples	-0.67	0.1659	0.9954	Insignificant
Union	-0.84	0.0886	0.5316	Insignificant
NIDC	0.64	0.1777	1.0662	Insignificant

Table 26 shows the Correlation Coefficient between Investments and Loans and Advances of all five finance companies under study. Lumbini only, has a high degree of positive correlation of 0.91. This means Lumbini has maintained a steady ratio between Investments and Loans and Advances. NIDC has moderate positive correlation highlighting their seasonal character, which other finance companies seem to be missing. As further explanations given by the Table 37, Lalitpur , Peoples and Union have negative correlations, that of Lalitpur being high degree. This clearly shows that these companies invest in Loans and Advances by cutting down their volume in their Investments, depicting that probably they do not have idle fund. They do not keep idle fund but invest in risk free assets which can be realized immediately as and when required for investing in Loans and Advances. Besides analyzing the correlation, glancing upon the 6 times of P.Er., it can be said that the correlations registered in above Table 26 are not much reliable and significant.

4.4.4 Correlation between Total Income and Loans and Advances

The degree of relation of Total Income and Loans and Advances is measured by the correlation of these two variables. The value of ‘r’, here shows whether change in Loans and Advances changes the volume of Total Income i.e. is to say whether Loans and Advances contribute to increase the income of the company or not.

Table 27 : r, P.Er and 6xP.Er between Total Income and Loans and Advances

	r	P.Er	6 x P Er	Impact
Lalitpur	0.93	0.0407	0.2442	Significant
Lumbini	0.96	0.0236	0.1416	Significant
Peoples	0.98	0.0119	0.0714	Significant
Union	0.72	0.145	0.87	Insignificant
NIDC	0.67	0.1659	0.9954	Insignificant

Table 27 shows the correlation between Total Income and Loans and Advances of the finance companies under study. Peoples have the highest degree of positive relation with 0.98 as the value of 'r'. After that Lumbini & Lalitpur have the high degree positive correlation. In comparison to these four companies with more than 95% correlation, Union and NIDC have only moderate degree positive correlation between Total Income and Loans and Advances, which probably shows that they are not being able to generate all income from the Loans and Advances they had invested to. In case of other finance companies, Total Income is increasing in almost equal percentage with Loans and Advances. The deviation of percentage change is due to unpaid installments of Loans and Advances. Except for NIDC and Union, the value of 'r' is very reliable and significant since it is greater than 6 times of P.Er.

4.4.5 Correlation between Loan Loss Provision and Loans & Advances

The correlation between Loan Loss Provision and Loans and Advances measures the relation between Loan Loss Provision and Loans and Advances. In fact, Loan Loss Provision is the product of Loans and Advances, these variables are co-related. Increase in Loans and Advances is likely to increase the volume of Loan Loss Provision.

Table 28 : r, P.Er and 6xP.Er between Loan Loss Provision and Loans and Advances

	r	P.Er	6 x P Er	Impact
Lalitpur	0.96	0.0236	0.1416	Significant
Lumbini	0.49	0.2288	1.3728	Insignificant
Peoples	0.06	0.3	1.8	Insignificant
Union	0.28	0.2775	1.665	Insignificant
NIDC	0.53	0.2165	1.299	Insignificant

Table 28 shows that except for Lalitpur all the other finance companies have low degree positive correlation between Loan Loss Provision and Loans and Advances. They are all insignificant except Lalitpur for their values of 'r' is less than that of 6 times P.Er.

4.4.6 Correlation between Interest Income and Net Profit

Interest Income contributes the major portion of Total Income and thus Net Profit of any finance company. This correlation between Interest Income and Net Profit measures the degree of relation of these two variables. Its is most likely to have that Net Profit increases with the increase in Interest income.

Table 29 : r, P.Er and 6xP.Er between Interest Income and Net Profit

	r	P.Er	6 x P Er	Impact
Lalitpur	0.89	0.0626	0.3756	Significant
Lumbini	0.79	0.1132	0.6792	Significant
Peoples	0.62	0.1854	1.1124	Inignificant
Union	0.55	0.21	1.26	Insignificant
NIDC	0.74	0.1362	0.8172	Insignificant

Above Table 29, shows the correlation of Interest Income and Net Profit. The highest degree of correlation recorded is that of Lalitpur with 0.89. Besides Lumbini too have high degree of correlation whereas Peoples, Union &NIDC have insignificant correlation because its 6 times P.Er. is greater than the value of ‘r’. This implies that, Net Profit of Peoples, Union &NIDC doesn’t depends on their Interest Income.

4.5 Measuring Regression of one variable on the other

In this section, regression analysis is used to describe the average relationship between two variables. The regression line of one variable on other estimates the most probable value of first variable for the given value of the second variable. Under this section we shall calculate the regression line of Loans and Advances on Deposit and Loan Loss Provision on Loans and Advances.

4.5.1 Regression Analysis of Loans and Advances on Deposit

Loans and Advances and Deposits are very significant items of Balance Sheet of any finance company. The Deposit collected so is mobilized in Loans and Advances. This is how from the fund circulation finance companies make profits. Here, regression analysis if Loans and Advances on Deposit is done of the industrial data.

Table 30 : Regression Equation of Loans and Advances on Deposit

	deposit(x)	loan(y)	xy	x2
2060/61	19,391.70	17,540.80	340145931.4	376038028.9
2061/62	22,341.60	21,223.30	474162479.3	499147090.6
2062/63	24,332.50	27,078.95	658898550.9	592070556.3
2063/64	34,514.71	35,616.46	1229291788	1191265206
2064/65	52,282.17	51,494.15	2692225904	2733425300
	152,862.68	**152,953.66**	**5,394,724,653.95**	**5,391,946,181.99**

The above Table 30 presents the industrial figures of Deposits and Loans of finance companies from the year 2055 through 2059 and the requisite data for calculation of regression equation. The regression equation obtained from the calculation is “y = 18.32 +1.x “. The slope of this line is 1, i.e. the change in Loans and Advances with per unit change in Deposits. This brings up the fact that with a unit change in Deposit, Loans and Advances also changes in the same direction with a little less than the equal proportion.

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4.5.2 Regression Analysis of LLP on Loans and Advances

Loan Loss Provision is a kind of by-product of Loans and Advances. Every Non-Performing Loan increases Loan Loss Provision. Loan Loss Provision decreases the profits of the company. Thus, company should try to control over the Loan Loss Provision.

Table 31 : Regression Equation of LLP on Loans and Advances				
	loan(x)	LLP(y)	xy	x2
2060/61	17,540.80	992.6	17410998.08	307679664.6
2061/62	21,223.30	1227.8	26057967.74	450428462.9
2062/63	27,078.95	1206.02	32657755.28	733269533.1
2063/64	35,616.46	2169.34	77264211.34	1268532223
2064/65	51,494.15	2510.01	129250831.4	2651647484
	152,953.66	**8,105.77**	**282,641,763.88**	**5,411,557,367.79**

The above Table 31 presents the industrial figures of Loan Loss Provision and Loans and Advances of finance companies from the year 2060/61 through 2064/65 and the requisite data for calculation of regression equation. The regression equation obtained from the calculation is "y = 173.01+ 0.05x ". The slope of this line is 0.05., i.e. the change in Loan Loss Provision with per unit change in Loans and Advances. This explains that with a unit change in Loans and Advances, Loan Loss Provision also changes in the same direction but with small magnitude.

4.6 Measuring the Propensity of Growth based on Trend Value

So far we have calculated various measures of relative financial tool and absolute measures of statistical tools. In this chapter we shall examine the trend analysis of Loans and Advances and Earning Per Share (EPS). The measures of trend analysis exhibits the behaviour of given variables in series of time. The performance of any finance company does not carry consistency over all the period and several factors cause the increase or decrease in the volume of various items. The trend of any variable and the slope of trend line relating with the compound interest discount factor measures the Growth Rate of the variable. Thus, along with the analysis of trend line the Growth Rate has also been measures in this chapter.

4.6.1 Trend analysis and Propensity of Growth of Loans and Advances

Table 32 : Trend Equation and Propensity to Growth of Loans and Advances				
	Linear Eq^{n}s (2061=1)	2061	2065	Propensity to Growth
Lalitpur	y=219.94+160.09x	380.03	1020.39	160.09
Lumbini	y=389.16+100.38x	489.54	891.06	100.38
Peoples	y=147.07+93.06x	240.13	612.37	93.06
Union	y=34.18+133.12x	167.3	699.78	133.12
NIDC	y=268.89+83.63x	352.52	687.04	83.63
Combined Mean				114.056

From the Table 32 above, shows the linear equation based on Y=a + bX of respective finance companies with respect to their Loans and Advances. The third and fourth column represents the amount of Loans and Advances based on the equation in second column for the year 2061 and 2065 respectively. The fifth column represents the Propensity to Growth i.e. an amount of Loans and Advances that is likely to be increased in one year period based on the linear equation.

It can be seen that Lalitpur has the highest Propensity to Growth in Loans and Advances. It is likely to increase by Rs. 160.09 million in one year period. The Propensity to Growth in NIDC is the least; in fact it has negative growth. The Propensity to Growth of Lalitpur is higher than the average of Rs. 114.056 million. Lumbini, Peoples & Union are likely to increase their Loans and Advances by Rs. 100 million, Rs.93 million and Rs.133 million in one year period, though below average.

The above Chart 6 shows the trend lines representing Lending behaviors of six finance companies and the average representing the performance of the six finance companies in Lending. The trend line of Lumbini and PAFICOL have always been above the average line. The trend line of Lalitpur almost coincides with the average. The trend line of other three finance companies viz., PEFIL, Union and NCML are below the average line.

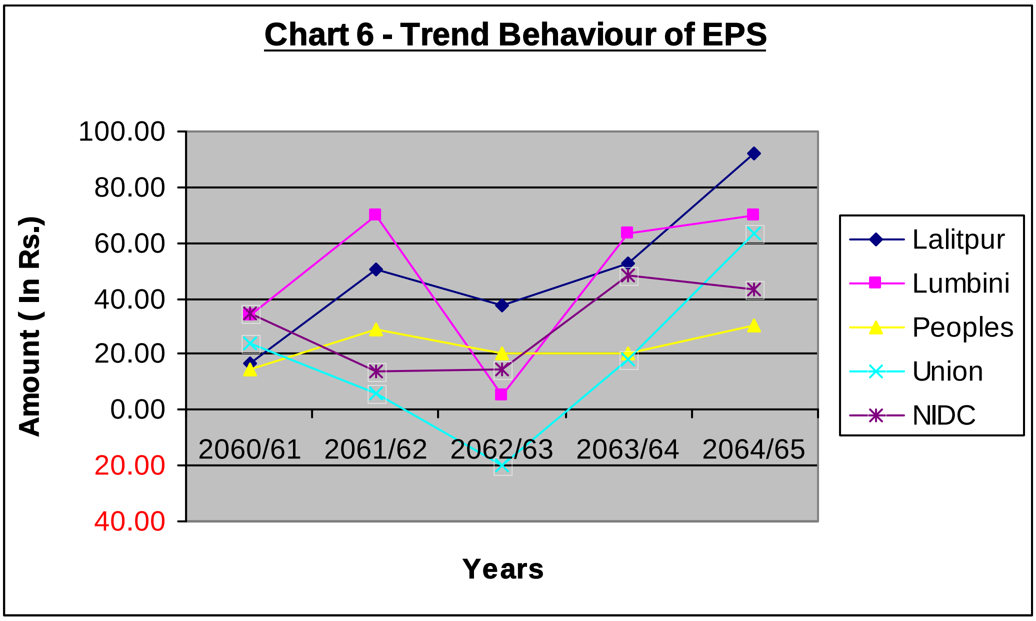
4.6.2 Trend analysis and Propensity of Growth of Earning Per Share

EPS and its trend reflect the overall efficiency of a finance company. The measures the efficiency of overall performance and checks the financial health of an organization.

Table 33 : Trend analysis and Propensity of Growth of Earning Per Share

	Linear Eq^{n}s (2061=1)	2061	2065	Propensity to Growth
Lalitpur	Y=3.78+15.37X	19.15	80.63	15.37
Lumbini	Y=16.03+2.30X	18.331	27.535	2.3
Peoples	Y=29.16+6.44X	35.6	61.36	6.44
Union	Y= -8.78+9.04X	0.26	36.42	9.04
NIDC	Y= 15.85+5.07X	20.92	41.2	5.07
Combined Mean				7.644

The Table 33 above, shows the linear equation based on Y=a + bX of respective finance companies with respect to their EPS. The third and fourth column represents the amount of Earning Per Share based on the equation in second column for the year 2061 and 2065 respectively. The fifth column represents the Propensity to Growth i.e. EPS that is likely to be increased in one year period based on the linear equation.



It can be seen that Lalitpur has the highest Propensity to Growth; way above the average of Rs. 15.37million. In the present environment, it is pretty dubious that Lalitpur could keep the expectation of growth of its EPS by Rs. 15.37 million in another year. Union has near about average growth and Lumbini and Peoples and NIDC are likely to have their EPS increased by Rs. 2.3 million, 6.44 and Rs.5.07 million respectively, which is quite below the average.

The above Chart 7 shows the overall increasing trend of EPS of all the finance companies. The average line is in increasing trend. Trend line of Union is decreasing rapidly and has crossed the average line in the year 2062/63. The slope of increasing trend of Peoples is near about to that of the average. Whereas the slope of Lumbini and NIDC is quite low but dramatically the slope of Lalitpur is very high. It has crossed all the lines and reached the highest peak in the year 2064/65.

4.7 Qualitative analysis of Recovery of Loan

Recovery is a vital part of distribution of Loans and Advances. It is the recovery part that brings income to the company and keeps its fund moving, which is an essential requirements of earnings of finance companies. In the present context, recovery is one of the main problems to the finance companies rather than distribution of credit.

The analysis of Recovery of Loan is basically done on the basis of the informal interviews taken. It is seen that, people are willing to take the loans but have hard time while set out paying them. The increasing of Non-Performing Loans and Loan Loss provision too point towards it. In many cases, especially in business loans, it is seen that people are ready to pay penalty rather make timely payments. It is very normal for the borrowers to keep couple of dues unpaid. And when some very harsh reminder is given, the borrowers clear their dues such that they do not fall under further actions. Once the loan is given, it is more like the company has to, literally chase the borrower to recover its investment. It probably is the lack of government support, from the regulations it makes, that the borrower normally dominates the company; provided that the borrower is a known of the regulations. It is seen that loanee who has some knowledge about regulations regarding loan granting procedure and recovery can manipulate it to his benefit.

Liquidity of the collateral, as said the guarantee of recovery, is not as easy part. Once the names of borrowers are published in papers in different notices, they tend to be more reluctant to pay. They probably deduce that since they are exposed they need not fear of it again. And after the long processing when company finally sets out liquidating the property, the borrower can come along and pay some part of the debt which will stop the liquidation and the debt continues. More than that if the borrower continues to pay couple of dues, his loan comes in the list of good loans and all the actions fades out. The most disturbing part is that the whole process might continue again and again for there are no such directives regarding recovery of loans. It was said that the directives regarding recovery of loans were made but is not circulated till date. There was news that the directives and regulations regarding the recovery of loans will come into action immediately but no such actions were attempted till the completion of this thesis.

Chapter V

SUMMARY, FINDINGS, CONCLUSION AND RECOMMENDATION

This chapter contains the results of the study. It is divided into summary, findings, conclusion and recommendations.

5.1 Summary

Finance companies play very important role in this up growing economy. With its history, in Nepal, starting form B.S 2042, it has come up a very long hike to today status. Regardless the various services they provide today, in general, finance companies can be defined as a firm that loans money to people who promise to repay the loan with interest over a specified period of time. Nepal Rastra Bank is the father figure of finance companies. NRB created them and it guides them all the way as how to work. More than that, NRB has full control over the functions of finance companies established all over the country. It has provided guidelines to the finance companies, which is more or less like a boundary drawn by the NRB for the functions of the finance companies which basically is for the security of depositors, who deposit their savings in the finance companies.

An attempt of studying the lending practices of the finance companies of Nepal is made in this thesis report. Five finance companies were taken as the sample for the study and the study is made around those five finance companies namely Lalitpur Finance Co. Ltd, Lumbini Finance co. Ltd, Peoples Finance Co. Ltd, Union Finance Co. Ltd., and NIDC Capital Markets Ltd. The quantitative and qualitative analysis, for the findings and conclusion, were made of the data collected from these five finance companies.

The findings were drawn analysis the five years data of above mentioned five finance companies. Different ratios were calculated to get the results for conclusions. Since the topic of the study revolves around the lending practices, the distribution of loans and advances, their recovery, and the ratios of those items that are related to the distribution and recovery of loans and advances are calculated.

5.2 Findings and Conclusion

The measurement of Lending strength in relative terms has revealed that Lalitpur has the highest Investment to Loans and Advances and Investment ratio. This ratio gives the portion of riskfree investment out of total Loans and Advances and Investment. Only Lalitpur Union and NIDC exceed the average ratio. However, Peoples & Lumbini seem to tilt over to risky investments. The mean ratios range from 0.03 to 0.16 and the combined mean ratio is 0.09.

Lalitpur has the highest Loans and Advances and Investment to Total Deposit ratio referring that it has the maximum mobilization of deposits than others. The mean ratio ranges from 0.75 of Union to 1.09 of Lalitpur. This ratio let us know what parts of deposits have been mobilized in total investments combining Loans and Advances and Investments.

It seems that Lalitpur is making investments in high extend than any other finance companies. This ratio also tells about the success of finance companies to convert their liabilities into assets, in which Lalitpur has overrun all other two companies. After that Peoples, NIDC, Lumbini & Union is in the run.

Loans and Advances to Shareholder's Equity ratio has gained the significant importance in measuring the capital fund and corresponding contribution if Loans and Advances. The highest Loans and Advances to Shareholder's Equity ratio is that of Lalitpur being 15.66 followed by Lumbini with the ratios 10.74, while the combined mean ratio is 9.51. The ratio of Union is the least being 5.65 and is highly deviated from the combined mean ratio.

The absolute measures of lending strength reveals that Lalitpur has the highest mean in Loans and Advances with an increasing trend but has the high standard deviation too. The lowest mean in Loans and Advances recorded is that of Peoples of Rs.426.25 million. Amazingly, Lumbini has the highest mean in Interest Income from Loans and Advances, Rs.108.09 millions. But when deeply seen, the highest mean of Lumbii is due to the extraordinary increase in Interest Income from Loans and Advances. Where as Lalitpur, who has the highest mobilization of Loans and Advances has Rs.92.9 millions. Lalitpur & Lumbini seem to be best doing since it had data in increasing trend and the increasing pace is higher too.

Lumbini has the highest Loan Loss Provision whereas Peoples has high C.V. in compared to others which means the deviation is the highest.

The portfolio analysis has revealed that most of the finance companies under study have emphasis more in performing loan than in non-performing loans through out the study period. Lalitpur & peoples have increasing trend in its performing as well as non performing loans whereas rest have the increasing trend in performing loans as compared to non performing loans.

The measurement of efficiency in Lending has revealed that Loan Loss Provision to Total Loan & Advances Ratio is pretty satisfactory since according to NRB directives Loan Loss Provision indicates provision against both Performing and Non-Performing Loans. Thus, even the increase in good loan increases the Loan Loss Provision. However, all the finance companies have exceeded this combined mean ratio at some times in the years individually.

The ratio of Interest Income from Loans and Advances to Total Income explains the contribution of Interest Income from Loans and Advances in the Total Income. From the analysis, it is known that there is maximum contribution of Interest Income from Loans and Advances to the Total Income of the company. The combined mean ratio being 0.74, the mean ratios of all finance companies are above it except for Union & NIDC who has the ratio of

44% & 68 % only. The mean ratio of the five finance companies ranged from 0 .44 to 0.88.

The measurement of ratio of Loans and Advances to Total Deposits shows the high capability of Lalitpur to convert its liabilities into assets. NCML has the mean ratio of 1.09, the highest amongst all. Lumbini and Union being just behind. Union has the least ratio of 0.75 which shows that Union has its tilt less towards investment in risky assets. The ratio of Interest Income to Interest Expenses of is pretty interesting. Lumbini, Peoples & NIDC have been able to maintain their mean ratios above the average.

The correlation analysis has shown high degree correlation between Deposits and Loans and Advances in all finance companies. This means mobilization of Loans and Advances is in high degree in respect to the Deposits collected. This is indicative of availability of good lending opportunities. Peoples and Union have the highest degree of positive relation between Deposits and Loans and Advances. And significance of their relation is proved by the six times of P.Er.

There is no uniformity in correlation of two variables in different finance companies. All the finance companies have a positive correlation between Shareholder's Equity and Loans and Advances where as, except for Union; others have high degree of positive correlation which indicates good performance; the highest being that of Lumbini. Lumbini seems to have high positive correlation here too interpreting that it has good balance over investing both in risky and riskfree assets.

Loans and Advances is one of the main sources of Income in finance companies. This is what is also shown by the high degree positive correlation between Total Income and Loans and Advances. All the finance companies have have high degree of correlation for they are more inclined towards riskfree assets, all other finance companies have very high degree positive correlation between these two variables and are significant too. Correlation between Loan Loss Provision and Loans and Advances is also high degree positive except for Peoples & Union. Loan Loss Provision is like a by-product of Loans and Advances thus, with Loans and Advances Loan Loss Provision does increase in synchronize. Similarly, with Interest Income, Net Profit increases thus, there's high degree positive correlation between Interest Income and Net Profit in all finance companies.

The trend analysis of Loans and Advances has revealed that, Lalitpur has the highest trend line and thus is the best amongst five finance companies in accordance to giving out Loans and Advances. The trend line of Lumbini lies just below that of Lalitpur, demonstrating the good performance of the company. The Loans and Advances of Lalitpuri are likely to increase by Rs.160.09 million in one year period. The trend analysis of EPS, that checks the financial health of an organization, shows that Union is the only finance company with a decreasing trend. Along with the average line, all the other finance companies have an increasing trend of EPS. The trend line of Lalitpur has the highest slope and has peaked quite high. This might be the result of its unnatural increase in EPS in the final years.

The average Propensity of Growth of Loans and Advances is Rs. 38.67 million and that of EPS is Rs. 7.64 million. The highest Propensity of Growth of EPS is that of Lalitpur.

Qualitative analysis of Recovery of Loan has revealed the practical problems in collection of mobilized Loans and Advances. Once the loan is given, it is more like the company has to, literally chase the borrower to recover its investment. It probably is the lack of government support, from the regulations it makes, that the borrower normally dominates the company, provided that the borrower is a known of the regulations such that he can manipulate it to his benefit.

Liquidation of collateral, as regarded as security against the loan advanced, is one very tedious job. Realization of default loan via the liquidation of collateral does not turn out to be as simple as it sounds. . The most disturbing part is that there are no such directives regarding recovery of loans. It was said that the directives regarding recovery of loans were made but is not circulated till date.

5.3 Recommendation

Based on the findings and conclusions, the following recommendations have been forwarded;

Investment to Loans and Advances and Investment mean ratio of Lumbini and Peoples are way to below the combine mean. Investment in riskfree assets is also important. Thus, they should increase in their riskfree assets at least to the combined mean. It is also seen from Loans and Advances and Investment to

Total Deposit ratio that both of them have not been investing whole of Deposits it is collecting. Besides Deposits, it also has Shareholder's Equity to invest. This insufficient investment may result in insufficient income to cover all the expenses. Thus, they should concentrate on increasing its investment in risky or riskfree assets.

In overall, Loans and Advances of finance companies are increasing and so are Non-Performing Loans and Loan Loss Provision. Extra efforts should be enforced to control over NPL, especially in the case of Lumbini, Lalitpur and NIDC. All the finance companies have increasing Loan Loss Provision. So they have to take extra care for this too .

Interest Income from Loans and Advances to Total Income ratio reveals that Union is very less inclined towards investment in risky assets. Contribution of interest income from Loans and Advances to the Total Income of Union is very low, mean being only 44% in comparison to combined mean of 74%. This side of investment is risky but has high return than that of riskfree investment. Thus, Union should make more investment in Loans and Advances than in others also because lending is one of the main and significant functions of finance companies.

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