

# Chapter – 1

## Introduction

### 1.1 Introduction off the Study

Every nation has come expectations from its financial infrastructure of that country. It is because; financial system can contribute a lot for accelerating the pace of economic growth through mobilization of resources. However, the magnitude of expectations from the financial system may vary within the various stages of economic development; the financial system is expected to be a good facilitator and a partner to achieve a sustained economic growth all the times. Banking systems constitute an important segment of financial infrastructure of any country.

The world business scenario has been changing very fast. Most countries around the globe have effectively eliminated the state of monopolies of business. The volume of international trade has been increasing year after year. Due to globalization many international companies have been actively doing their business across the national boundaries. In this competitive market terrier is becoming the major problem for the survival. Now due to these factors, financial institutions face significant change in a time of new alignments in domestic market and increase international competition.

With the development of communication economic progress and spread of science, and the growth of economic and political institutes, the use of money also expanded. To meet the expanded form of money finance became a powerful instrument for any change. Due to innovation of transport & communication, development of energy and manufacturing has resulted in innovation in the sphere of banking. So, Bank became the most convenient method of exchanging money.

“The fundamental economic objective of the state shall be to transform the national economy into an independent and self-reliant system by preventing the available means and resources of the country from being concentrated within a limited section of society, by making arrangement for the suitable distribution of economic gains on the basis of social justice, by making such provision as will prevent economic

exploitation of any class or individual, and by giving preferential treatment and encouragement to national enterprises, both private and public.”

Banking services serve two primary purposes. First, by supplying customers with the basic mediums-of-exchange (cash, checking accounts, and credit cards), banks play a key role in the way goods and services are purchased. Without these familiar methods of payment, goods could only be exchanged by barter system, which is extremely time consuming and inefficient. Second, by accepting money deposits from savers and then lending the money to borrowers, banks encourage the flow of money to productive use and investments. This in turn allows the economy to grow. Without this flow, savings would sit idle in someone's safe or pocket, money would not be available to borrow, people would not be able to purchase cars or houses and businesses would not be able to build the new factories the economy needs to produce more goods and grow. Enabling the flow of money from savers to investors is called financial intermediation and it is extremely important to a free market economy.

The central bank and the commercial bank play its significant role in the economic development of the country, as they are the main source of the capital for the most of the investment from one sector to another. Central bank monitors the spread rate i.e. deposit interest rate and loan interest rate and other bank rate, establishment of branches and many other aspect of financial institution. Central bank almost governs of the financial instructions. Unlike the central bank, commercial banks are the profit oriented financial institutions. Main stream function of the commercial bank is to mobilize the scattered saving of the public by providing credit to the needy firms, industries and people to get the productive use. Being a profit oriented financial service providing institution, certain percent interest rate is given to the depositor and the bank charges certain percent interest in the loan facility, which we called as the spread rate.

Lending is one of the most important functions of commercial bank. Lending in finance is the term used to denote transactions involving the transfer of money or other property on promise of repayment, usually at a fixed future date. The person who deposit money in the bank they becomes creditors and the person who borrows money from the bank they becomes debtor of the bank. The principal function of

credit is first to transfer property in the name of bank, which want to take loan. The transfer is temporary made for a loan price and interest. In present context, lending money has become one of the main sources of revenue to the bank. It plays an intermediary in channeling funds from lenders-savers to borrower's spenders. The quality of loan, quality of borrower and quality of securities determine the health of any banker. At the time of providing loan bank should follow some principles and practices. No banker would give loan, unless he has sufficient confidence in the borrower that will not be necessary to seek the help of court for recovery. Safety of funds purpose of loan, security for loan, profitability, spread of loan portfolio and compliance with national interest are some of the principles that banker should follow while granting loan. Besides that the character of person receiving credit, the capacity of borrower to utilize the fund, the percentage of borrowers stake in the business are the basic elements which measure the quality of borrower and ultimately the quality of loan. "The classical economic functions of bank and other financial intermediaries all over the world have remained virtually unchanged in modern times. What have been changed are the intuitional structure, the instruments and the techniques used in performing these functions."

Lending has its different forms. It can be divided into fund based and non-fund based lending. The fund based lending can be further divided into cash credit, overdraft, demand and term loans, bills purchased and discounted and export, packing credit, project finance, consortium finance, loan syndication, bridge loan etc. Similarly, non fund based credit can be classified into documentary credit, guarantees and bill co-acceptance facility. Besides the lending function, there is another function, which is related with mobilization of fund and have lesser but significant role in banks fund management. Investment is the secondary means of employing funds by Commercial Banks. Investment refers to buying shares, stocks, bonds and securities, which already exist in the stock market. In economy according to Keynesian terminology investment refers to real investment that leads to capital investment "Investment in its broadcast sense means the sacrifice of current dollars for future dollars. Two different attributes are generally involved time and risk. The sacrifice takes place on the present and is certain, the rewards come later, if at all and the magnitude is generally uncertain." Real investment calls for increment on total capital investment, movement of ownership or possession of capital is not counted as investment since it has to

significance in increasing the overall national income. Addition of capital goods is necessary. Real investment is production or acquisition of capital assets during any period.

## **1.2 Profile of Subjected Banks**

### **Himalayan Bank Limited**

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in the Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities- Loans and Deposits.

Legacy of Himalayan lives on in an institution that's known throughout Nepal for its innovative approaches to merchandising and customer service. Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Other financial institutions in the country have been following our lead by introducing similar products and services. Therefore, we stand for the innovations that we bring about in this country to help our Customers besides modernizing the banking sector. With the highest deposit base and loan portfolio amongst private sector banks and extending guarantees to correspondent banks covering exposure of other local banks under our credit standing with foreign correspondent banks, we believe we obviously lead the banking sector of Nepal. The most recent rating of HBL by Bankers' Almanac as country's number 1 Bank easily confirms our claim.

All Branches of HBL are integrated into Globus (developed by Temenos), the single Banking software where the Bank has made substantial investments. This has helped the Bank provide services like 'Any Branch Banking Facility', Internet Banking and SMS Banking. Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative, HBL very recently introduced several new products and services. Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa Card, International Travel Quota Credit Card, Consumer Finance through Credit Card and online TOEFL, SAT, IELTS, etc. fee payment facility are some of the products and services. HBL also has a dedicated offsite 'Disaster

Recovery Management System'. Looking at the number of Nepalese workers abroad and their need for formal money transfer channel; HBL has developed exclusive and proprietary online money transfer software- HimalRemitTM. By deputing our own staff with technical tie-ups with local exchange houses and banks, in the Middle East and Gulf region, HBL is the biggest inward remittance handling Bank in Nepal. All this only reflects that HBL has an outside-in rather than inside-out approach where Customers' needs and wants stand first. The Bank's business philosophy is **“The Power to Lead”**.

### **Kumari Bank Limited**

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 750 million, of which 70 % is contributed from promoters and remaining from public.

Kumari Bank Ltd has been providing wide - range of modern banking services through 9 points of representations located in various urban and semi urban part of the country, 5 outside and 4 inside the valley. The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, utility bill payment services, inward and outward remittance services, and various other banking services.

Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 11 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers.

The bank has been able to get recognition as an innovative and fast growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission.

The key focus of the bank is always center on serving unfulfilled needs of all classes of customers located in various parts of the country by offering modern and competitive banking products and services in their door step. The bank always prioritizes the priorities of the valued customers. The Bank's business philosophy is **“We do it”**.

### **1.3 Statement of the Problem**

Due to globalization and liberalization of economy, the number of commercial banks is increasing in Nepal. In 1990's the development of banking in both quality and quantity was satisfactory. However, subsequent development of commercial banks in quality has not satisfactory. The commercial banks are not interested in granting loan to the priority sector and deprived sector of the economy. Banking is not being easy accessibility of public in remote and village areas. Commercial banks have concentrated their operation mainly in town and capital of the country.

The main function of commercial bank is loan disbursement and collection. It is a very challenging task on the part of the bank because the bank has to disburse loan in the appropriate sector and recover it in time as well. In this competitive environment, it is very difficult to choose right and productive sector for granting loan. Hence, there is the chance of flowing bank's deposit in unproductive sectors. So, unsecured loan and investment to unproductive sectors increases the risk of bank collapse and may cause the liquidation of the banks.

Due to cut throat competition in the country, lending is divided into various sectors. Banks are switching over from project financing to consumer financing such as housing loan, education loan, vehicle loan, professional loan, personal loan etc. Consumer financing may result in high profit for bank but quantitatively the loans are

disbursed in low amount. So, the bank should not largely depend upon the consumer financing. Banking industries are facing the problem from the component of external environment such as political, legal, economics and social. The unstable politics is the main cause, which is hampering for the growth of banking sector. The corruptions made by the top-level management negligence, over staffing are the some reasons that are facing by the banks. The other common problems of both joint venture banks and state owned commercial bank is the cut through completion. Most people of Nepal are illiterate and people are unaware about the banking system. Due to the lack of effective human resources and trained manpower, growing brain is the serious problem for the existing healthy competition.

The banks are not interested in granting loan to primary and deprived sector of the economy. Banks are active only in urban sector because they see great opportunities for the minimization of profit. Rural areas are being neglected. There are only few rural development banks active in Nepal while Nepal is full of rural areas.

The problems faced by the banks can be pointed as follows:

- Liquidity is maximum
- Credit providing as the basis of particular banks policy
- Due to lack of investment sectors, banks are competing unfairly
- Due to poor credit administration, the credit recovery is ineffective
- Non performing loan is increasing highly
- The legal process of credit recovery is lengthy and ineffective

The research work intends to explore the following questions:

- What is the relationship of loan and advances, investment to total deposit and with loan loss provisioning?
- Does commercial bank follow NRB (Nepal Rastra Bank) Directive in terms of lending?
- What is the proportion of non- performing loan in total lending?

#### **1.4 Objectives of the Study**

- 1) To determine the impact of deposit in lending procedures.
- 2) To analyze the different credit facilities.
- 3) To measure the commercial banks lending strength.
- 4) To recommend some measures on the basis of findings of the study to the concerned bank to improve on lending performance.

#### **1.5 Scope of the Study**

There are 25 commercial banks functioning in our country at present. But there are only few researches in lending procedures of commercial bank. Lending is one of the main functions of commercial bank where the whole banking business is rested upon. Thus the study on two commercial bank and specially in their lending procedures carry a great significance to the shareholder of the banks, to the banking professional, to the student who want to know about lending procedures of commercial bank. The proposed bank namely HBL and KBL are significantly similar in many aspects of their volume and quality of operation. This study has proposed to measure the efficiency of both banks in their lending procedures. This study adds new idea and findings about concerned commercial bank.

This study will be useful to them for acquiring the answer to the following questions:

- How funds are utilized as loans and advances?
- To what extent they are gaining?
- Is the productivity of their limited satisfactory?

#### **1.6 Limitation of the Study**

This study is done for the partial fulfillment for M.B.S. degree in management. So this study has certain limitation and constraints which are given below:-

- This study is concentrates only on those factors that are related with lending procedures.
- The study is based on the available data and report is based on primary and secondary data.
- This study has covered only recent five fiscal years starting from 2059/2060 to 2063/2064.



- The study has taken only concerned bank. (Himalayan Bank Ltd. and Kumari Bank Ltd.)
- Some of the statistical as well as financial tools of comparison and analysis shall be used in the study. Hence the drawbacks and weakness of those tools may adversely affect the outcomes of the study.

### **1.7 Organization of the Study**

This study has been divided into five chapters and is organized as follows:-

#### Chapter 1

The first chapter is the introduction, which consists of background of the study, profile of concerned bank, statement of the problem, objective of the study, scope of the study, limitation of the study and finally organization of the study.

#### Chapter 2

The second chapter focuses on review of literature. It contains the conceptual framework and past research literature on lending procedures of banks.

#### Chapter 3

The third chapter deals with research methodology to be adopted for the study consisting research design, source of data, data gathering procedure, population and sample, research variables and data processing procedures.

#### Chapter 4

The fourth chapter deals with presentation, analysis and interpretation of data. It consist the analysis of primary as well as secondary data and major finding of the research. This is a most important part of the study.

#### Chapter 5

The fifth chapter presents summary, conclusion and recommendations of the study.

Bibliography and other annexes are also included in this chapter.

# **CHAPTER- 2**

## **RESEARCH METHODOLOGY**

### **2.1 Introduction**

“Research methodology is the way to solve systematically about the research problem” (Kothari, 1990). It helps to analyze, examine and interpret various aspects of research work. Research methodology is the process of arriving at the solution of the problem through planned and systematic dealing with collection, analysis and interpretation of facts and figures. Research methodology describes the methods and process applied in the entire aspect of the study. It refers to the various sequential steps to be adopted by researcher in studying a problem with certain objects in view.

“Research may be defined as the systematic and objective analysis and recording of controlled observations that may lead to the developments of generalization principles or theories, resulting in prediction and possibly ultimate control of events” (John, 1992:149)

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.

Research is common parlance refers to a search for knowledge .The Webster International Dictionary gives a very inclusive definition of research as “a careful critical inquiry or examination in seeking facts and principles; diligent investigation in order to ascertain something.”

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 the particular project. In order to accomplish the targeted objective of the study, a definite course of research methodology has been followed. A systematic methodology is considered as inevitable for true, better, fair and superior consequences. In fact, Research is a scientific inquiry about certain phenomenon or object.

A research methodology helps us to find out accuracy, validity and suitability .The justification of present study cannot be obtain without help of proper research methodology. For the purpose of achieving the objectives of the study the applied methodology are used.

“Research Methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with a certain objective in view. It is way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. It includes the various steps that are generally adopted by a researcher in studying his/her research problem along with logic behind them”(Kothari, 2001:39).

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. Design of the research project
6. Sample design
7. Collection of data| construction of questionnaires
8. Analysis of data
9. Arriving at generalizations and
10. Preparation of report [i.e. starting or writing down the result] (Kothari, 41)

The topic of the project has been selected as “Lending Procedures of HBL and KBL” with a tentative objective of highlighting and analyzing the lending procedures of HBL and KBL. The survey of literature has been conducted from various library and references and these have been mentioned in chapter -2. The problem of the study has been specified in the topic “statement of the problem” in chapter-1. The data has been collected in sources of data. The data have been mentioned in chapter-4. The major findings of the analysis have been mentioned in chapter-4. The summary, conclusion and recommendations have been kept in chapter-5.

Research methodology describes the methods and process applied in the entire studies. A research study can produce the fruitful results if an appropriate methodology is taken under consideration to highlight and evaluate the different aspects of the study. To achieve the purpose of the research, the following methodology has been adopted.

## **2.2 Research Design**

The main objective of this research study is to examine and evaluate the financial performance of the concerned banks (HBL and KBL). It is a framework or plan for

study that guides the collection and analysis of data. It is the arrangement of condition for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure.

“Research design is the task of defining the research problem” (Ibid). In other words, “A research design is the arrangement of conditions and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure”(Claire, 1967:50).

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. Infact, it 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, interpretation, presentation, report writing and bibliography.

To achieve the stated objective of the study, the study of books, booklets, financial act and other related acts, rules, directives, regulations have been carried out. For an empirical research opinions from the various officers have been conducted. For this study analytical and descriptive research design has been followed.

### **2.3 Source and Use of Data**

Both primary and secondary sources of data have been collected in order to achieve the actual data as far as available.

### **Primary data**

The primary data is itself collected data from the records of relevant concerned banks.

The primary data is collected from the field visit, questionnaire, and interview method.

In some particular cases response from the employees of related banks and responses from credit department of concerned banks (HBL and KBL) has been conducted.

### **Secondary data**

Secondary data are the information received from books, journals, newspapers, published reports, various articles and publications dealing in the subject method of the study. The major sources of secondary data are as follows:

1. Academic Books
2. NRB Directives
3. NRB Reports
4. Previous related studies
5. World Wide Web; the internet.

### **2.4 Period of the Study**

This study is based on five years financial data of HBL and KBL starting from 2059/2060 to 2063/2064 B.S. (2002/03 to 2006/07).

### **2.5 Tolls & Techniques**

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

#### **2.5.1 Financial tools**

“Financial analysis is the starting point for making plans before using any sophisticated and budgeting procedures”(Pandey, 1999:108).

Analysis and interpretation of financial statements is an attempt to determine the financial performance of any organization so that a forecast may be made of the prospects for future earnings, ability to pay interest, debt maturity and probability of a sound dividend policy.” Financial statement analysis is largely a study of relationship between among the various financial factors in a business as disclosed by a single set of statement and study of trends of these factors as shown in series of statement.”(J.C., 1961:4)

“Through the application of analytical tools, profitability and financial health of a concern is evaluated in a proper, legal and scientific manner” (P.Jain, 1999:36).

The various financial tools used in this study to analyze the collected data are as follows:

### **1. Ratio Analysis**

“A ratio is a quotient of two mathematical expressions. Establishment of quantitative relation of data furnished by the financial statement is called ratio analysis. In other words, a financial ratio is the mathematical expression of relationship of two accounting figures. It helps in taking decision since it helps to establish relationship among various ratios and interpretation thereon.

### **2.Assets\Liability Management Ratio**

Assets\Liability Management Ratio measures the proportion of various assets and liabilities in balance sheet. The proper management of assets and liability ensure its effective utilization. The banking business converts the liability into assets by way of is lending and investment function .Assets and liability management ratio measures its efficiency in multiplying various liabilities in performing assets.

### **3. Activity Ratio**

Activity ratio measures the performance efficiency of an organization from various angles of its operation. Activity ratio indicates the efficiency of activity of an enterprise to utilize available funds, particularly short –term funds.

### **4. Profitability Ratio**

Profit is the difference between the revenues and the expenditures over a period. Profit is the main element that makes an organization to survive. With out profit, a firm could not attract outside capital. Profitability includes the present and future earnings capacity. In other hand, the profit measures the management ability regarding how well they have utilized their funds to generate surplus.

### **2.5.2 Statistical Tools**

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

The various statistical tools used in this study to analyze the collected data are as follows:

#### **1. Correlation Analysis**

Correlation is the measure of relationship between two or more characteristics of a population or a sample. It simply measures the change 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 other variables .Simply stated, correlation is a statistical tool with the help of which we can determine whether or not two or more variables are correlated and if they are correlated, that is the degree and direction of correlation. Correlation analysis describes the relationship between variables i.e. positive and negative. It helps to determine the following:

- A positive or negative relationship exists
- The relationship is significant or insignificant
- Establish cause and effect relation if any

## **2. Probable Error**

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

## **3. Coefficient of Determination ( $r^2$ )**

It explains the variation percent derived in dependent variable due to the any one specified variable. It denotes the fact that the independent variable is good predictor of the behaviour of the dependent variable. It is square of correlation coefficient.

## **4. Regression Analysis**

The 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. These days there is growing tendency of the modern writers to use the term estimating line instead of regression line because the expression estimating line is more clarificatory in character. We can explain the few definitions of the term regression:

“Regression is the measure of the average relationship between two or more variables in terms of the original units of the data.” -Blair.

“The term regression analysis refers to the methods by which estimates are made of the values of variables from knowledge of the values of one or more other variables and to the measurement of the errors involved in the estimation process.” -Morris Hamburg.