A STUDY ON CREDIT MANAGEMENT AND ANALYSIS OF COMMERCIAL BANK

(A Case Study of Everest Bank Limited)

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CHAPTER I

INTRODUCTION

1.1 Background of the Study

Nepal has adopted mixed and liberal economic policy with the implicit objective to help the state and the private sector. Especially after restoration of the democracy, the concept of the liberalization policies has been incorporated as directive principal and state policies. This liberalization has helped in establishing may companies, banks, finance companies and manufacturing industries. Thus these establishments help the county for its development. Credit is regarded as the main income generating assets especially in commercial banks. Credit is regarded as the heart of the commercial banks in the sense that; it occupies large volume of transaction; it covers the main part of investment; the most of the investment activities based on credit; it is the main factor for creating profitability; it is the main source of creating profitability; it determines the profitability. It affects the overall economy of the country. In today's context, it also affects on national economy to some extent. If the bank provides credit to retailer, it will make the customer statue. Similarly, it provides to trader & industry, the government will get tax from them and help to increase national economy. It is the security against wealth maximization derivative. However, other factors can also affect profitability and wealth maximization but the most effective factor is regarded as credit. It is the most challenging job because it is backbone in commercial banks. Thus, effective management of credit should seriously be considered.

Management is the system, which helps to complete jobs effectively. Credit management is also the system, which helps to manage credit effectively. In other words, credit management refers management of credit exposures arising form loans, corporate bonds and credit derivatives. Credit exposures are the main source of investment in commercial banks and return on such investment is supposed to be main source of income. Credit management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that borrower will fail to meet its obligations in accordance with the agreed terms and conditions credit risk is not restricted to lending activities only but includes off balance sheet and inter-bank explores. The goal of the credit risk management is to maximize a bank's risk adjusted rate of return by maintaining the credit risk exposure within acceptable parameters. For most banks, loan are the largest and most obvious sources of credit, however, other sources of credit risk exist through out the activities of a bank, including in the banking book, and in the trading book, and both increasingly facing credit risk in various financial instruments other than land, including acceptances, inter bank transactions and guarantees and the settlement of transactions.

The government of Nepal adopted liberal economic policy to accelerate country's growth and development. Foreign investment and participation of private sector were encouraged. The government then enacted "Joint Venture Banking" policy. People are offered valuable services and nation as a whole beginning to take benefit. Commercial banks should operate under the Commercial Bank Act 2031, Nepal Rastra Act 2058 and Company Act 2053 and Contract Act 2056. Nepal Arab Bank Ltd. (currently known as NABIL) is the first bank established in joint investment in Nepal in 2041 B.S. A year later Nepal Indosuez Bank Ltd. currently renamed as Nepal Investment Bank Ltd. was set up. With the passage of time several other joint venture and private bank has been established. Nepal Industrial Development Corporation (NIDC) and Agricultural Development Bank (ADB) were only two development banks established before the enactment of Nepal Development Bank Act in 2052 B.S. After the introduction of Nepal Development Act 2052 many development banks have been set up. Establishment of financial institutions and banks in Nepal has taken a tremendous speed over the past ten years with the evolution of globalization and liberal economic policies. 25 Commercial banks, 79 Finance companies, 58 Development banks, 12 Micro Credit Development Banks, 34 Co-operatives, 47 NGOs authorized by NRB to perform limited banking activities have been recorded (NRB, 2008).

"There are 25 commercial banks in the country as of mid- July 2008. The number of commercial bank branches operating in the country reached to 574 including 45 commercial bank branches and 102 other non commercial bank branched of ADB/N in mid July 2008. Of the total bank branches more than 46 percent bank branches are concentrated in the central region. By the end of mid July 2008, 254 branches are being operated in this region. In the Eastern, Western, Mid-western and Far Western region 119, 114, 36 and 29 bank branches are in operation respectively (NRB, 2008:7).

As an increment of number and business of commercial bank contributed to impressive growth in the size of total assets i.e. sources of fund. In the mid July 2007, the total sources of fund of commercial bank increased by higher rate of 14.45 percent compared to 4.84 percent in preceding year. The total sources of fund of the commercial banks reached to Rs. 490638.1 million in mid July 2007. It was Rs. 428706.2 million in 2007 (NRB, 2008:12).

Loans and advances, the major component of assets, constituted the 46.66 percent of total assets in mid July 2007. Similarly, investment and liquid funds, another component of assets, registered the 19.06 percent and 8.98 percent of total assets in the same year. In the preceding year the respective share of loan and advances, investment and liquid funds were 40.44 percent, 19.15 percent and 9.06 percent. In the current year the loan and advances increased by higher rate of 32.05 percent compare to 8.61 percent in the last year. By the end of mid July 2007 the total outstanding amount of loan and advances of commercial bank reached to Rs.228951.9 million. It was Rs. 173383.4 million in mid-July 2006.

In the current fiscal year deposit mobilization of commercial bank marginally increased by 15.88 percent compare to 15.39 percent growth in the previous year. By the end of mid July 2007 it reached to Rs. 337497.2 million from Rs. 291245.6 in the last year. Of the component of deposit, current deposit celebrated by higher rate of 20.45 percent compared to 7.91 percent in last year. Fixed deposit increased slightly higher of 13.89 percent compared to 13.75 percent in the previous year. However, saving and call deposit growth rate slipped to 15.23 percent and 18.62 percent compare to 16.65 percent and 28.51 percent respectively.

Liquid funds increased by 14.45 percent and reached to Rs.44089.7 million in mid-July 2007 from Rs. 38842.1 million in mid-July 2006. In the current fiscal year the net profit of the banking system grew by slower rate of 10.20 percent compared to 53.38 percent in the last year. By the end of mid July 2007 the net profit amounted to Rs. 8797.9 million from Rs 7983.5 in mid July 2006.

The credit policy of a firm provides the framework to determine whether or not to extend credit and how much credit to extend. The credit policy decision of a bank has two broad dimensions; credit standards and credit analysis. A firm has to establish and use standards in making credit decision, develop appropriate sources of credit information and methods of credit analysis.

1.2 Overview of Everest Bank Limited (EBL)

Everest Bank Limited is highly successful commercial bank of Nepal established on 18th October 1994 under the company Act 1964 and licensed by Nepal Rastra Bank as an “A” class commercial bank,. United Bank of India Ltd, under technical services agreement signed between it and Nepalese promoters was managing the bank from very beginning till November 1996. Later on, it was handed over the management to Punjab National Bank Ltd. India (PNB). PNB is the largest Public Sector Bank of India having 109 years of banking history with more than 4400 offices all over India and is known for its strong systems and procedures and a distinct work culture. PNB is providing the top management services to EBL under a technical services agreement signed between the two institutions. EBL thus has advantage of the banking expertise and financial strength of its partner. Drawing its strength from its joint venture partner, EBL has been steadily growing in its size and operations and established itself as a leading Private Sector Bank. EBL is ranked as No. 2 bank by NRB as per Capital

Adequacy, Assets Quality, Management, Earning Capability, and Liquidity Position (CAMEL).

Everest Bank Limited has authorized capital of 1 billion and 718 million of paid up capital. Its main branch is located at New Baneshwor, Kathmandu, and Corporate/Head office is situated at Lazimpat, Kathmandu. It provides all the general services to its customers throughout the 26 branches of the bank. The branches are spread from Mechi, eastern part of Nepal to Kailali, Dhangadi, western part of Nepal.

1.3 Statement of the Problem

This study is conducted to obtain overall view of credit management of the sampled bank. It is one of the most important and complicated functions performed by the bank. Each bank has credit department and loan administration to conduct, monitor and supervise credit operation. The administration of a particular loan ends when it is recovered. But the process never ends until the bank exists.

Commercial banks act as an investment intermediary linking the savers and users of capital. Capital formation is thus regarded as one of the indispensable functions executed by any commercial bank. Capital formation is done through credit advancement and its management. Credit disbursement and credit recovery is the prominent feature of credit management.

Efficient and effective credit management can strengthen bank's position. At present, slow down in economic activities due to prevailing internal and external factors has declined the transaction of commercial banks affecting in loan demand and its recovery leading to low profitability posture. Ineffective credit management is a major problem of banks in Nepal.

It can be concluded that effective and persistent investment towards the most benefiting sector is one of the prerequisites for the development of the nation. The quality and return of the investment depends upon the existing credit policy and its proper implementation. Thus, how far these things are applied in the banks and financial institutions and whether the existing credit policy is suitable as per the requirement of the country becomes a prominent issue in the present context.

The problem of the study has been laid on the issues related to the strength and weakness of bank pertaining to its credit policies and its implementation. For the sake of simplicity and due to limited time allocated for the research only one bank- Everest Bank Limited has been taken for the study.

The purpose of the study is to analyze and examine how far the present investment policy and procedure of joint venture bank is effective in encouraging the entrepreneurs to invest in different industrial and business sectors in different regions. In this regard, however, experience of bank reveals not encouraging relationship between investment policy and industrial development of the country. The problems being studied are presented in the form of following research questions:

i) Whether the bank has right level of liquidity?

ii) How far EBL is able to use its resources in credit and advances?

iii) What is the impact of growth in deposit on liquidity and lending practices?

iv) Is their efficiency in lending?

v) Has the bank been able to earn profits?

vi) What is method and mechanism for loan approval?

vii) What is the level of non performing loan/loan loss provision?

viii) How far EBL is able to collect credit and advances through loan recovery process?

ix) What are financial indicators of the bank?

x) Has the bank been able to mitigate risk through appropriate risk management technique?

1.4 Objectives of the Study

The main objective is to familiarize with the overall credit management practice in Everest Bank Limited. The specific objectives can be outlined as under:

a) To study the credit policy and credit analysis systems prevailing in the bank.

b) To gain acquaintance of loan recovery process regarding credit management.

c) To examine lending efficiency and its contribution to profit.

d) To make suitable suggestions based on the findings of this study.

1.5 Significance of the Study

The success of commercial bank highly depends on the efficient management of credit as per environment. The economy of country is already in the recession due to slowdown of global economy and unstable internal environment leading to adverse affect in business and industrial sector. Such phenomenon has unfavorable affect on banking sector. A crisis in bank is the indicator of crisis in the economy. Hence, the quality of management of credit is considered an important topic as it directly influences the performance of the bank. This study is an attempt to get insight on credit operation and management practiced in the sampled bank. It encompasses credit policy, loan approval, loan administration and loan repayment including the credit risk and its mitigation. This information will help to determine the efficiency and effectiveness of the bank’s credit management practice.

Joint venture bank are going a wide popularity through their efficient management and professional service and playing an eminent role in the economy. Considering the economic structure of the country, the banks do not have sufficient investment opportunities. Rapidly increasing financial institutions are creating threats to the joint venture banks. In this context, the study would analyze strengths, weaknesses, opportunities and threats of selected commercial banks. The research will be helpful for joint venture banks to formulate strategies to face the increasing competitions. Besides, it also helps to identify the importance of shareholders, policy formulators, professionals and outside investors.

1.6 Limitations of the Study

Every study is restricted with certain limitations and the present study report is not an exceptional. So, it has also common limitations. The following are the major limitations of the present study:

- The study only focuses on loan management practices.
- It does not give any idea about other functions of the bank.
- The report is prepared on the basis of available data and information provided by the bank.
- The study covers the period of last five years of data only.
- The data that are collected are mainly from secondary sources and there are interpreted as accordingly.

1.7 Organization of the Study

The present study is organized in such a way that the stated objectives can easily be fulfilled. The structure of the study will try to analyze the study in a systematic way. The study report has presented the systematic presentation and finding of the study. The study report is designed in five chapters which are as follows:

Chapter-I: Introduction

This chapter describes the basic concept and background of the study. It has served orientation for readers to know about the basic information of the research area, various problems of the study, objectives of the study and significance of the study. It is oriented for readers for reporting giving them the perspective they need to understand the detailed information about coming chapter.

Chapter II: Review of Literature

The second chapter of the study assures readers that they are familiar with important research that has been carried out in similar areas. It also establishes that the study as a link in a chain of research that developing and emerging knowledge about concerned field.

Chapter-III: Research Methodology

Research methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view. It describes about the various source of data related with study and various tools and techniques employed for presenting the data.

Chapter-IV: Presentation and Analysis of data

This chapter analyses the related with study and presents the finding of the study and also comments briefly on them.

Chapter-V: Summary, Conclusion and Recommendation

On the basis of the results from data analysis, the researcher concluded about the performance of the concerned organization ion terms of credit management. It also gives important suggestions to the concerned organization for better improvement.

CHAPTER II
REVIEW OF LITERATURE

2.1 Conceptual Review

This thesis mainly focuses on the credit operation practice and procedure of Nepal’s joint venture commercial banks (i.e. Everest Bank Limited). Hence, it is rational to state these articles and reports those may make a clear concept to understand the said topic.

“Banks and financial institutions are the vehicles through which public deposits are mobilized in various development activity i.e. Agricultural, Industry. Trade, Commercial Institution like commercial banks, development banks, financial companies and various micro-financing institution with different model.”(Johnson, 1940: 130)

Credit administration involves the creation and management of risk assets. The process of lending takes into consideration about the people and system required for the evaluation and approval of loan request, negotiation of terms, documentation, disbursement, administration of outstanding loans and workouts, knowledge of the process and awareness of its strength and weaknesses are important in setting objectives and goals for lending activities and for allocating available funds to various lending functions such as commercial, installment and mortgage portfolios (Johnson, 1940: 132).

“The investor or whether banks, financial institutions, individuals, private or government sector, must not take the proposal by making decision without having adequate judgment because sometimes they perform out of norms, related studies, policies and techniques. A project appraisal will best viable only if it has accessed through conscious analysis as well as through thoroughly investment decisions to make its macro and micro level viability effective.” (NRB, 2058: 125)

He added some test of tips before and after financing:

- Rationality of short fall of funds (requirement of the funds) and goodness of the project proposal.
- The banker also before making any funding should prepare appraisal report by analyzing and assessing the components of project cost and the overall viability.
- The gravity of the capital.
- The banker should try to receive the appropriate financial segments (Loan characteristic) i.e. through overdraft, acceptance facilities, mortgage, and syndicate of through personal efforts.
- The Loan may be secured with the project itself or with clean collateral of on guarantee. The financial task may be facilitated in one currency or number of currencies.
- The interest rate in the loan may be fixed floating or simple calculated or discounted rate based.
- Borrowings and lending activities are based on the rate of cash flow coming from the assets, from financed funds and based also on general strength, security cleanliness and on credit worthiness.
- The borrowers should fulfill some convenience such as to safety the regulation of lenders, to maintain a certain financial rations or to produce essential information on time for the lenders.

"A Loan is Financial Assets resulting from the delivery of cash or to the assets by a lender to a borrower in return for an obligation repay on specified date or dates or on demand." (Johnson, 1940: 45)

Usually Loan Comprise:

- Consumer installments, overdrafts and credit card loan.
- Residential mortgages.
- Non personal loans such as commercial loans to business, financial institution, governments and their agencies.
- Direct financing lease

- Other financial arrangements that are in substance loans.

A web site report of Basel Committee- A banking supervision committee, the group of ten countries established in 1975 AD.

The Base Committee adds “when a bank becomes a party to the contractual terms comprising a loan and as consequence has legal right to receive principal and interest on the loan, it controls the economic benefits associated with loan. Normally, a bank becomes a party to the contractual provision that comprise a loan (i.e. acquire legal ownership of the loan) or the date of the advances of funds or repayment to a third party. As a result, a commitment to lend funds neither is nor recognized as an asset on the balance sheet. In certain jurisdictions, the acquisition of legal ownership is viewed more as a process than a discrete event. However providing consideration (the advancement of funds) is typically one of the more important factors constituting ownership.”

Bodhi B. Bajracharya (1991), in his article "Monetary policy and deposit mobilization in Nepal" has concluded that mobilization of the domestic saving is one of the prime objectives of the monetary policy in Nepal. And commercial banks are the most active financing intermediary for generating resources in the form of deposit of private sector and providing credit to the investors in different sectors of the economy (Bajracharya, 1991: 93)

Book named "Banking Management" says that in banking sector or transaction, an unavoidable ness of loan management and its methodology is regarded very important. Under this management, many subject matters are considered and thought. For example, there are subject’s matters like the policy of loan flow, the documents of loan flow, loan administration, audit of loan, renewal of loan, the condition of loan flow, the provision of security, the provision of the payment of capital and its interest and other such procedure. This management plays a great role in healthy competitive activities (Bhandari, 2003: 170).

It is very important to be reminded that most of the bank failures in the world are due to shrinkage in the value of loan and advances. Hence, risk of non-payment of loan is known as credit risk or default risk (Dahal, 2002: 114).

Portfolio management helps to minimize or manage the credit risks by spreading over the risk to various portfolios. This method of managing credit risk is guided by the saying do not put all the eggs in a single basket (Bhandari, 2004: 300).

2.1.1 Credit Policy and Its Parameters

Credit is financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for an obligation of repay on specified date on demand. Credit is the amount of money lent by the creditor (bank) to the borrower (customers) either on the basis of security or without security. Sum of the money lent by a bank, is known as credit (Oxford Advanced Learners Dictionary, 1992: 279). Credit and advances is an important item on the asset side of the balance sheet of a commercial bank. Bank earns interest on credits and advances, which is one of the major sources of income for banks. Bank prepares credit portfolio, otherwise it will not only add bad debts but also affect profitability adversely (Varshney and Swaroop, 1994: 6)

In fact, it is a very sensitive subject that what sort of credit policy a bank should have. So, it should pay more attention to the loan, advances that it provides. The commercial banks are inspired with the motive of gaining profit. To fulfill these objectives, they should manage and improve its banking sector. They must give more attention to the flow of loan. Regarding loan policy, it should be clear and follow such policy which would match the economic policy of the nation.

Credit policy of EBL is the approved methodologies for conducting its lending operations with an objective to maximize profit of the bank and serve its best to the nation. The general assembly is the sole authority to approve such policy. Normally, the Board of Directors is authorized to approve such policy on the recommendation of the management. The general assembly in its annual general meeting or special meeting may initiate the approve changes or can guide the Board management to implement, suggest, renew or cancel the existing policies.

Credit management in EBL basically covers loan approval process, credit analysis, method and mechanism, lending documentation, disbursement and administration of loan including credit audit. As there is a saying "*Precaution is better than cure*" bank should be more analytical and farsighted while disbursing loan in order to prevent loan flow in unproductive sector and non-performing assets.

Types and Nature of Loan:

Based on time factor, EBL advances loan of the following types:

1. **Short Term Loan:**

   This loan is given up to the period of 1 year to those who have lower requirements than other types. EBL grants this loan to agricultural sector, small industrial sector, small projects etc.

2. **Mid term loan:**

   These types of loans are sanctioned for the period of 5 to 10 years.

3. **Long term loan:**

   Long term loans are granted for the period of more than 10 years. Generally these types of loan are sanctioned to the big industries whose requirements are large. These types of loans are provided for financing fixed assets.

Nature of Loan:

EBL with increment in services provides different natures of loans to its customers as per their requirement.

1. The loans and advances under Fund based:

a. **Term Loan:**

   Term loans are given for the purpose of financing fixed assets. The interest rates for prime sectors are 8 to 10% and for others are 10 to 11%.

b. Working Capital short term Loan:

EBL provides this loan to meet the day-to-day transactions of the companies, industries. The interest rates for primary sectors are 7 to 9% and for other sectors are 9 to 10%. It is essential for running any companies, businesses, industries etc.

c. Overdraft Loan:

This loan facility is provided to those clients who are regular customers of the bank for a long period of time. They have built up strong and trustworthiness relationships with the bank for which they can overdraw money from their account as per their requirement and approval from the bank. The rate is at 8 to 10.15% for prime sector whereas 10.5 to 11% for other sectors.

d. Trust Receipt Loan (import loan):

This type of loan is mainly provided for importers against letter of credit. The bank provides 80% of loan to their valued client for the credit period of 90/120/150/180 days. Importers then repay their loan amount to bank after sell of particular goods. The rate is at 6.75 to 8% for prime sector whereas 8 to 10% for other sectors.

e. Hire Purchase Loan:

This loan is provided for the purchase of automobiles, vehicles etc. to professionals, companies, business executives etc. The interest rate charged is 8.5 to 10.5%.

f. Housing Loan:

The bank also provides this type of loan to its customers where the interest rate is 9% for the maturity up to 5years and for above 5 years it is 9.75%.

2. **Under Non-funded loan, EBL has classified the followings**:

a. Exports credit:

i. Pre-shipment:

This type of loan is mainly provided for exporters. Exporters have to send goods to the importer as requested. Then, for the production of the certain quantity of goods, exporter without money asks the bank for loan. Importer after receiving goods, clears the amount of the exporter, exporter then clears his loan amount along with the interest of the bank.

ii. Post-shipment:

This type of loan is mainly provided for exporters. When goods are produced as asked by the importer, exporter needs to send it. But exporter without any amount to meet operating expenses occurred on shop and loading goods on shop asks for loan with the bank.
The interest rate fixed on these loans is 7 to 8%.

b. Bank Guarantee:

EBL takes guarantee on behalf of its customer to the third party to make payment up to a specified amount. The third party feels assured that in case of default, bank will clear the due amount. The bank provides various types of bank guarantee to its customers such as bid bond, performance bond, advance payment guarantee, custom guarantee, and credit guarantee.

Principles Included In Credit Policy

- Principles of Safety of funds:
- Principle of Liquidity:
- Principal of purpose of Loan:
- Principles of profitability:
- Principal of Security:
- Principal of National Interest:

2.1.2 Objectives of Sound Credit Policy

Considering the importance of lending to the individual bank and society it serves, it is imperative that the bank meticulously plans its credit operations.

- To provide guidance to lending officers
- To make quality credit decisions
- To establish a standard for control
- To provide authority to different level of management
- To comply with the regulations.
- To avoid unnecessary risks.
- To have performing assets.

2.1.3 Prudence in Lending

The primary business of the bank is creating and delivering quality financial services to its customers throughout Nepal. Its customer base consists of individual, corporations, other financial institution, public sector companies, and co-operatives. The financial services presently provided by the bank include commercial banking, retail banking and treasury services.

General policy guidelines shall govern the implementation of the business strategy of the bank with respect to credit extensions.

- The bank shall adhere to all Regulatory Guidelines and all amendments including those provided by NRB.
- The bank shall not make any credit facility available to anyone whose moral integrity is questionable. Fundamental rule is "*Know Your Customer*".
- Credit officers must thoroughly understand the lending rationale for any credit request.
- Credit officers must acquire information about borrower's purpose, source of repayment and repayment plan.

- Borrowers whether or not related to bank must provide complete, accurate and up-to-date financial information.
- Credit extensions to borrowers shall be in accordance to NRB directives.
- The bank will not lend to investment companies that are not listed in the Stock Exchange.

2.1.4 Credit Analysis

There is practice of analyzing 7C's of credit about borrower by the bank before approving proposal:

- **Character:**

  Character refers to personal traits such as ethics, honesty, integrity, reliability of borrower's, which is significant for lending decision. The actual purpose, trustworthiness in answering the queries, responsibility and seriousness in making efforts to repay loan is observed by the bank.

- **Capacity:**

  The bank views two aspects. Firstly, the bank sees whether the applicant possess legal capacity to borrow loan. Secondly, whether the applicant has capacity to generate sufficient income to repay the loan amount or not. If the borrower has high capacity, quality management and good market value then the capacity of the client is said to be high and bank grants loan on that basis. Hence, suitable ratios (liquidity, leverage, profitability, efficiency) are analyzed based on historical and projected financials.

- **Capital:**

  Capital refers to net worth of the borrower. Leverage ratio will be high if the borrower has low capital. A bank gives loan only when it finds leverage ratio acceptable to it or if the borrower has enough capital.

- **Collateral:**

  To safeguard its risky assets in case of default, bank asks for securities or collateral from the borrower, no matter how prosper the financial position of the borrower is. Collateral can be fixed in nature- land, building, machinery or working capital like inventories and account receivables.

- **Condition:**

  Condition refers to the general economic condition beyond the control of borrower such as security, political and other social condition affects the business. Loan is given to the borrower if lending official feels general condition is favorable for that type of business.

- **Cash Flow:**

  The credit officials usually check the cash flow of the business to ascertain repayment of the loan amount taken with interest. If the figure shows positive response then they advance loan to such clients.

- **Credit Information:**

  The bank should confirm the type of loan the borrower requires and should provide all the credit information beforehand.

2.2 Procedure for Application, Appraisal, Sanction/Disbursement of Loan

The various steps involved in the loan appraisal, approval and disbursement process are set out below:

2.2.1. Business Plan

A borrower interested in taking a loan should approach the Marketing and Planning Division at the bank and make an application by filling out the project information sheet available with the above division regional offices. In this the prospective borrower has to furnish the flowing:

–Technical details;

–Proposed financial structure;

-Expected raw material requirement and

–Certain legal information relevant to the proposed project.

The project information sheet (PIS) is to be submitted along with a project feasibility report and documents certifying the legal status of the company.

2.2.2. Processing of Business Plan

In the event of processing of business plan at the branch, the plan is scrutinized by the branch officials related to credit department. They prepare the loan proposal, which includes the feasibility of the plan.

At the central office business plan along with the loan proposal submitted by the branch well recommended by branch in-charge /credit in-charge is scrutinized by a project screening committee headed by the general manager and consisting of deputy general managers' sectoral division chiefs and chiefs of the bank.

2.2.3. Screening the Business Plan

The duly filled out PIS along with detailed feasibility report will be processed by credit department and then referred to the project screening committee for review as to the desirability of the project in the context of national priorities legal obligations, national and international policies and banks own credit policies.

After analysis of the internal and external factors the credit in charge focuses to the security against the lending. Such credits are extended by bank against security of properties. Security may be collateral of fixed asset/ stock of the unit or both. Credit in-charge observes the sight of the properties. The parameters for good security define the approaches of road, electricity water and other civil amenities. Importance is given to the property situated in the urban areas.

If the proposal is accepted, the applicant will be advised to file the formal loan application form for financial assistance.

2.2.4. Loan Application

In the event of processing the loan application at the office, the application is forwarded by the credit department to the concerned sectoral division. Each sectoral division is entrusted with the following functions:

The concerned sectoral division appraises the project, and decides its viability on the basis of technical and financial soundness of the loan proposal, the marketability of the products as well as the proposal credit worthiness of the applicant borrower. Once the viability of the project is ascertained, the credit division at central office takes a decision as of whether the project will be financed solely by concerned bank or by a consortium formed with some other banks.

Age Criteria for co-applicant is 21 years at the time of application received and not older than 75 years at loan maturity. Subsequent to appraisal an appraisal report is tabled before the sanctioning authority for final decision and approval.

2.2.5 Loan Sanction

Upon proper scrutiny of the loan appraisal the sanctioning authority approves the proposal and prepares a loan sanction letter. The sanction letter spells out the details of the loan, the amount and its purpose, the manner of disbursement the securities to be pledged against the loan (usually, the entire fixed assets of the project are pledged; extra collateral is taken for working capital loan is for those term loans which are intended to finance a movable assets like machinery) the repayment schedule, and other terms and conditions of financing.

Upon receipt of the approval from sanctioning authority at the branch the credit department issues a credit facility offer letter to the borrower. This letter spells out the details of the loan, the amount and its purpose, details of charges, the manner of disbursement the securities to be pledged against the loan and other terms and conditions to be implemented by the bank and the borrower.

The loan documentation charges taken by the banks is

- NPR 1,500 upto NPR 1 million loan

- NPR 3,000 upto NPR 10 million loan
- NPR 5,000 above NPR 10 million loan
- Or minimum NPR 1,000 or 1% of the loan amount whichever is higher

If the borrower is satisfied with the offer the borrower signs the offer letter and the agreement is made. Upon acceptance of the offer of the bank the borrower is required to adhere to the terms and conditions stipulated in the offer letter.

2.2.6. Execution of Legal Formalities

When the memo is approved from the top level, some legal formalities are obtained before sanction of loam. The legal formalities are obtained in accordance to the nature of securities and loan. Now, let us discuss about the type of securities and methods of execution.

- **Moveable securities**

Moveable securities include Current Assets, Business Stock, Merchandise Items, Shares, Debentures, Government Bond, Treasury Bills, Fixed Deposits Receipts, Vehicles under Hire Purchase and Export Documents.

- **Immovable Securities**

Immovable Securities are fixed properties such as land and building, heavy plant and machines installed within factory premises. Such types of security can not be replaced from one place to other place; therefore it is called immovable securities.

So the way of charging according to various types of movable and immovable securities is different. Generally the major way of charging are as mentioned below:

- **Mortgage**

The fixed properties of immovable properties are taken as a security by way of mortgage. Mortgage formality shall be done by preparing mortgage deed. Required information is carried out from Title Deed and valuation report.

Mortgage is the transfer of an interest in specific immovable property for the purpose of securing bank's finance. There are two kinds mortgage as mentioned below:

- **Equitable Mortgage**

Equitable Mortgage is an agreement, express or implied where the interest of property shall pass to the bank as security for a debt due or to become due. It is created by a simple deposit of original title deed with an intent letter of property owner.

- **Legal Mortgage**

In legal Mortgage the property owner transfer his legal title in favor of bank under "Dristi Bandhak" where the bank gets legal estate in the property and he will endow with all sorts of right and remedies if required.

- **Pledge**

Various types of merchandise items and the business stocks can be considered as security for short term credit facilities by way of pledge arrangement. In this arrangement, bank has effective control over the security and the customer cannot allow transacting over the security before clearing dues outstanding. Furthermore, various types of Government Bond, Treasury Bills and Development Bonds where the lien from the issuing authority is not possible (as observed from the present practice) is also considerable as a pledge item to provide bank advances to its customers. In this situation customers are required to simply pledge the certificates to the bank and bank will make necessary arrangement.

- **Hypothecation**

Banks can make hypothecation fixed assets and current assets of their customers for the purpose of availing loans and advances against the security of the same. Hypothecation documents are duly signed by authorized person of Loan Company. Goods under hypothecation is under control of customers itself and he is allowed to do the transaction on goods solely, however he is also required to adjust the liability created against hypothecation according to change in the level of stocks/ goods. Under hypothecation there is also an arrangement by which bank can convert the hypothecated item into pledge, if required.

- **Lien**

Various types of documents security such as share certificates of listed company, Fixed Deposit receipt of different banks and other negotiable instruments can also be considered as a security for loans and advances under lien arrangement of the same. It can be done with request to issuing authority by making lien over the same under permission of owner of such documents. The owner of such documents will provide such documents. The owner of such documents will provide such certificates duly discharge in favor of bank along with letter of lien signed by him.

- **Hire Purchase**

Hire Purchase transaction is a kind of bailment where the hirer pays money in consideration of the use of goods yet the ownership continues to remain with the bank and who gives the commodities/ goods on hire purchase finance.

After being finalized to grant the loan, bank obtains/ executes various documents to make legally liable to lone for repayment of sanctioned loan. This process is called documentation. Since, different documents are required to be executed accordance to the nature of loan, normally following documents are necessary.

- Promissory Note
- Letter of Request
- Letter of Continuity (it is filled up for the continue use of those facilities as provided)
- Letter of Arrangement (it is the commitment to the bank by the borrower to arrange the repayment of loan)
- Letter of Disbursement
- Hypothecation of entire current assets and fixed assets.

- Personal guarantee of all the directors and the property owners.
- Mortgage Deed.

2.2.7. Loan Disbursement

Usually, loan is disbursed maintaining a 75:25 loan/equity ratio at any stage of the project. For example, the first disbursement may be made against land and building to the extent of 75% of the total cost of the land and building and the disbursement is made only when the promoter has purchased the land and completed the construction of the building at least up to plinth level through equity financing. Similarly, the bank may disburse loan for the purchase of machinery by opening a letter of credit, ensuring however that out of the total investment, including that to be made for the machinery, 40% is out of once operation are about the start, the concerned sectoral division appoints a team to prepare a project completion report (PCR). At the time of disbursement of loan bank charges 1% as the service charge of loan amount.

2.3 Loan Recovery Procedure

After the client enjoys the facility they have to return the fund within the purposed time period. The working capital loan is given for the one-year period and has to be renewed every year on the request of the client. The repayment schedule of the loan has different methods as mention below:-

- Term loans are granted for a maximum period of 15 years, depending on the nature and debt-servicing ability of the project. And whole amount of principal as well as interest must be settled within the given time period.
- Principal dues are payable in monthly installments where as interest is payable on quarterly basis.
- A grace period (moratorium) for repayment of principal is granted on the basis of the time required for the project to come in to operation and interest dues during the construction period are capitalized. And this moratorium period up to 1 year is in the practice of the commercial bank.

- Short-term loans of working capital loans may be granted for a period of 1 to 3 years and are subject to renewal.
- Repayment of interest become due on quarterly basis, as follows:

  - End of Chaitra (Mid April)
  - End of Ashad (Mid July)
  - End of Ashwin (Mid October)
  - End of Poush (Mid January)

- In the event of failure of payment of interest, the interest charged on Ashad (mid-June to mid July) and Paush (Mid December to mid January) will automatically be capitalized after one month and the capitalized interest will carry the same interest rate as on the pertinent loan.
- The payment of the retail lending is based in the EMI (Equal Monthly Installment) basis where the principal and the interest is paid every end of the month. In this method of repayment of the loan the borrower have to pay equal installment every month for the given time period
- If the borrower want to pay the loan before the maturity of the granted loan then the bank charges panel of additional 1% charged form the sanctioned loan as the premature settlement of the loan. And in generally practice of the commercial banks the prepayment charges are:

i) 2% of amount prepaid before 1 year
ii) 1% of amount prepaid after 1 year
iii) Partial payment allowed after 1 year only
iv) Service Charge: 1% of loan amount of loan sanction

2.4 Nepal Rastra Bank Directives

2.4.1 Directive Relating To the Single Borrower

Nepal Rastra Bank has issued the directive regarding the single borrower limit. The main purpose of the directives is to divers if the commercial banks' lending rather than focusing to the particular borrowers. The directive regarding single borrower limit is as follow:

2.4.2 Limit on Credit and Facilities

- Funded based credit upto 25% of core capital
- Non funded based facilities upto 50% of core capital

Core capital shall be included with the following:

- Paid up capital
- Share premium
- Non Redeemable preference share
- General Reserve Fund

2.4.3 Directives Relating Loan Loss Provision

A bank should identify and recognize impairment in a loan or a collective assessed group of loans when it is probable that the bank will not be able to collect, or there is no longer reasonable assurance that the bank will collect all amount due accruing to the contractual term of the loan agreement. The impairment should be recognized by reducing the carrying amount of loans through and allowance or charge off and charging the income statement in the period in which the impairment occurs. A Bank should measure an impaired loan at its estimated revocable. A bank should adopt a sound system for managing credit risk. To be able to prudently value loans and to determine appropriate allowances, it is particularly important that banks have a system in place, where established by the institution itself or by the supervisor, to ratable classify all loans on the basis of risk. A credit risk classification system may include categories or designation that refers to varying the degree of credit deterioration such as substandard loans, designation that refers to varying the degree of credit deterioration such as substandard loans, doubtful loans and irrecoverable loans. A classification system typically takes into account the borrower's current financial condition and paying capacity, the current value and reliability of collateral and other factors that affect the prospects for collection of principle and interest. Hence, Bank should maintain reserve of fund as loan loss provision against the loan disbursed. Nepal Rastra Bank has issued the directive relating the provision of loan loss. We have many examples that most of the banks are taken into liquidation due to bad debt or not repayment of the loan by the borrowers. Hence, to relief from this situation NRB has issued the directives by which commercial bank should make some provision against the loan disbursed by them. For this purpose loan categorized as follow and required the certain percentage of reserve in accordance with the classification. Now, let us discuss the classification of loan and percentage required to maintain the provision as directive issued by the NRB.

1. Pass (Performing Loan)

No recovery problem, if the principal and interest is not past due for a period of three months.

2. Substandard

Past due during the period of three months to six months.

3. Doubtful debt

Past period for the period of six months to one year

4. Loss

Past due for a period of more than one year as well as advances which have least possible of recovery or considered uncollected and having thin possibility of even partial recovery in future. All loans and advances classified under substandard, doubtful and loss are categorized as Non performing loan.

2.4.4 Loan Loss Provision

As Nepal Rastra Bank is the central bank of Nepal, all the commercial banks in the country are required to follow the directives and instruction of Nepal Rastra Bank. Various directives are issued by NRB to regulate commercial banks. Credit and purchase and discount of bills have been classified as secured, less secured, doubtful and bad for the purpose of adequate provisioning. The following are the NRB regulation on classification and provisioning of loans:

Loan Loss Provision

Types of Loan	Provision Requirement
Pass	1%
Substandard	25%
Doubtful	50%
Bad	100%

Pass loan is called “Performing” and others are called “Non-performing” assets. Provision requirement in case of loan given against personal guarantee only is additional 20% for Standard, Substandard and Doubtful loans. Provision for restructured, rescheduled and swapped loan is 12.5% only. Non-compliance of such directives will not be tolerated by the central bank and as the consequence commercial banks are penalized.

2.5 Risk Assessment

Meaning of Risk:

Risk is defined in Webster’s as “a hazard; a peril; exposure to loss or injury. Thus, risk refers to the chance that some unfavorable event may occur. No investment will be undertaken unless the expected rate of return is high enough to compensate the investor for the perceived risk of investment.

Bank invests much of their funds in assets that are subject to change in value due to changing market conditions or credit quality of such assets. Risk represents uncertainty that the assets will earn an expected rate of return or that a loss may occur. In other words, it is borrower's inability to payback the facility extended.

Credit Risk:

This report is mainly focused on credit management of the bank thus credit risk is explained in brief:

Credit risk is the risk of non-repayment of loan. It is that risk in which a borrower will not settle its obligations in accordance with agreed terms. "Credit risk is the risk of loss that may occur from the failure of any party to abide by the terms and conditions of any financial contract with the bank, principally the failure to make required payments on loans due to the bank."

Factors Affecting Credit Risk:

There are mainly two factors that affect credit risk i.e. internal and external factors:

Internal Factors:

- Lack of transparency in financial statement of borrower
- Excessive importance in mortgage lending against land and building
- Dearth of efficient human resources
- Lack of internal credit rating system and risk base pricing
- Name lending
- Inadequate financial analysis of borrower while lending
- Lack of detailed credit policy of the bank
- External influences from high-ranking officials while sanction or recovery
- Multiple banking arrangements on current assets of borrower
- Non-application of sophisticated credit risk model
- Increase in interest arrears
- Others

External Factors:

- Political instability
- Economic environment
- Fluctuation of market interest rate
- Fluctuation of foreign exchange rate
- Fluctuation of commodity price
- Absence of credit rating agency
- Inefficiency of Credit Information Bureau
- No mechanism for submission of transparent and accurate financials.
- Inefficiency of Company Registrar Office
- Lack of adequate legal framework

Risk Mitigation:

Risk is inevitable in all enterprises, organizations or companies. It arises both from change and human shortcoming so avoiding risk is not an option but should be managed and handled carefully. *Risk can be mitigated by the bank using:*

- Frequent monitoring
- Prompt action on early warning signals
- Effective problem loan management
- Deal with borrowers who meet the target market criteria
- Monitor industry condition
- Insurance assigned to bank
- Professional valuation of security

2.6 Review of Previous Studies

2.6.1 Review of Articles

Khatiwada (1987) stated that the organized financial system is only a small segment of the overall financial system and in the informal financial system interest rates are neither determined by the free market forces, nor by the authorities but by the monopoly market condition where there exists a few suppliers of credit in relation to a large number of borrowers. Since interest rates are administered and have remained sticky for quite a long period, the statistical relationship between demand for money and the interest has remained insignificant in Nepal (Khatiwada, 1994:4; Poudyal, 1987; Sharma, 1987).

Bonomo and Schotta (1970) stated that presented evidence on the nature of open market operations used regression analysis to determine the fraction of changes in factors affecting free reserves and total reserves which have been offset by defensive open market operations. The principal hypothesis of their study is based on the feeling among the monetary economists that Open Market Operations (OMO) had the effect of increasing the variation in reserves or in monetary base. The authors take the sample period September, 1931 to August 1968.The estimating procedure employed in their study makes use of the following equations.

$\zeta R\ \mathrm{X}\sim_1 \Gamma\ \ _1 \zeta R^* \Gamma \mu_1$ *and* $\zeta FR\ \mathrm{X}\sim_2 \Gamma\ \ _2\ \Gamma\ \ _2 \zeta FR^* \Gamma \mu_2$

Where ζR X week-to-week change in total reserves,

ζFR X week-to-week change in free reserves,

ζR^* X week-to-week change in factors affecting total reserves other than open market operations,

ζFR^* X week-to-week change in factors affecting free reserves other than open market operations,

$\sim_1, \sim_2$ X estimates, allegedly, of net of other factors influencing open market operations, i.e., dynamic objectives; and

$\hat{}_1, \hat{}_2$ X estimates of $(1+k_1)$ and $(1+k_2)$

The authors' findings on their investigations are:

The authors find that proper characterization of OMO as defensive or dynamic should occur on the basis of free reserves and not total reserves. In addition, the authors find no support for the view that the net effect of OMO has been to increase the variation in the monetary base. This latter finding was based on a year-by-year comparison of the actual variance of reserves and free reserves with the estimates of the variance in these series which would have been obtained in the absence of OMO.

The study finds that the variance effect of OMO over the sample period examine indicates that the variance reduction attributable to OMO is quite sizable.

The results show the relative magnitudes of the variances of the series, illustrating the variance reduction effects of OMO. Moreover, the more favorable results with respect to an objective of reducing the variability of free reserves rather than of total reserves suggest an interpretation that the Federal Reserve has viewed short-run control of free reserves as its proximate objective in its quest for control of the cost and availability of credit.

The authors have claimed that the findings of their study with respect to reserves and free reserves would, in general, apply to the usual and the extended monetary base since week-to-week changes in reserves and free reserves constitute the dominant element of week-to-week changes in the other base measures. Extended monetary base is equal to usual monetary plus imputed reserves released (or bound) by reduction (or increases) in the reserve requirement against member bank deposit liabilities.

In an article published in New Business Age by Mr. Kamal Subedi entitled "Growth in Major Commercial Banks" has compared between the first six month of the fiscal year 2002/03 and 2003/04, which shows that there has been noticeable increase in credit outflow by the commercial banks except of Nepal Bank Ltd (NBL) and Rastriya Banijya Bank (RBB) (the government owned banks). There has been increase in credit-deposit (CD) ratios of all commercial banks except of NBL and RBB in which case it has gone down by 10.41% and 5.99% respectively. It may be because their concentration was only on recovery of the huge Non Performing Assets (NPA). However, Mr. Subedi pointed out that no matter what the size of NPA is and the circumstances are, each bank has to collect the deposit in order to create a lending and to invest in the new ventures. Except RBB all banks have increment in deposit collection (Subedi, 2004: 47-48).

A decrease in CD ratio (the percentage of the deposit mobilization over the credit) signifies the presence of high liquidity and comparatively lower fund mobilization and vise versa. High liquidity and idle funds will result in lower profits. HBL has the highest growth of 18.47% in CD ratio over the last year. Similarly, NABIL, Everest Bank Ltd (EBL) and Nepal SBI Ltd (SBI) have recorded growth rates of 6.28%, 11.83% and 7.45% respectively in their CD ratio. However, this ratio of other commercial banks has declined, largely due to factors external to the banks.

As per the NRB directives, all commercial banks have to maintain Loan Loss provision according to the size of overdue loans. Nepal Credit and Commerce Bank (NCCB) were able to decrease its loan loss provision by 27.63% as compared to the previous year indicating a good recovery of interest as well as principal. In case of Nepal Investment Bank (NIBL), growth in loan loss provision (which in fact decreased by 6.73%) was much less than the growth of the total credit (which in fact decreased by 6.73%) was much less than the growth of the total credit (which increased by 53%). Similarly, NBL and HBL were able to maintain a healthy composition of loan loss provision (decreased by 9.49% & 0%) and credit (increased by 3.70% and 26.78%), again signifying good results form their loan recovery efforts. In case of remaining banks, the situation is not satisfactory as the growth of loan loss provision is higher than the growth of credit (Subedi, 2004: 48-49).

A bank’s stability depends on the reserve it maintains. NABIL’s reserve growth is very good i.e. 1400% on retained earning and 67.86% on other reserves. Similarly, all other banks have except NCCB and BOK made noticeable increment in it. The major yardstick to measure the status of the bank (which is the prime concern of shareholders) is the profitability of the banks-the spread between what the banks has earned and expensed. In this regard, KBL has made the significant growth of 181.25% in profit as compared to the previous year. Similarly Standard Chartered Bank (SCBL), NABIL, HBL, BOK, EBL, NIB, NSBI, NICB and NCCB have the growth percentage of 7.72%, 6.33%, 43.73%, 29.83%, 61.8%, 62.76%, 29.76%, 37.89% and 4.03% respectively (Subedi, 2004: 49-51).

Government of Nepal has promulgated Bank and Financial Institutions Act 2063 to replace several existing laws related to the banks and financial institution like Commercial Bank Act 2031, Finance Act etc related to financial institutions. The major highlights of the Act 2063 are universal banking that makes all the banks and financial institutions governed by a single act making the legal process much efficient and with less confusion and it have protected the rights and welfare of the depositors and investors.

However this act has lots of unclear issues, which has created confusion to the existing banks and financial institutions. The act has classified the financial institutions into categories replacing the present terms as commercial, development of finance companies. The act has classified the category, as “Ka” category can mention itself as a Bank, the rest of the category should name itself only as a financial institution. The act has created confusion to the existing development banks and finance companies as what category they belong to? The positive aspect of this act is that the financial institutions which fall under the “Kha” category will also be allowed to carry out several financial activities that were previously allowed to only commercial banks, such as opening current accounts, issuing drafts and traveler’s cheques, dealing in foreign exchange and issuing Letter of Credits. Even the financial institutions, which falls under the category “Ga” are permitted to handle current account, saving account and to some extent, foreign currency transactions. Due to these changes, the consumer will benefit due to the competition among these banks and financial institutions (Bank and Financial Institutions Act, 2063).

In an article published in New Business Age written by Mr. Sudir Khatri, has analyzed the Act (ordinance) Pros and Cons, in general speaking termed as Umbrella Act. He has expressed his disagreement in the ordinance regarding the qualification of the Board of director's composition. The qualification set is out of the total number of directors, two thirds have to be graduates in specified disciplines-management, commerce, economic, accounting, finance, law, banking and statistics. Another requirement is five years work experience either in banking or public limited companies or in a gazette level government posts. He argues why a science graduate or someone with engineering background cannot be the director, it is not justifiable to question on the capacities of the people with these background as the in the past some successful General Manager and Directors in Nepal Industrial Development Corporation (NIDC) were engineers. He further writes that activities like project financing and asset valuation require engineers and similarly that there cannot be any reason for the position of director in banks to be graduates in some specified fields only. CEO of the "Ka" category qualification required is Masters Degree in the chosen few subject and the term would be four year. The act however does not mention the renewal of the CEOs term. The Board or AGM of the institution should be decided the CEO's tenure (Khatri, 2004: 18-20).

Similarly, he points out argument in the requirement of five years work experience. The performance of the public limited companies is so poor that the efficiency of the staff is questionable. In such situation how can one hire some one with the experience in public limited companies? As per the act, it is mandatory to appoint a professional director in the Board chosen from the list of professional experts enlisted by NRB. Such director will not have voting right; it is questionable that can be contribute significantly towards the development of a bank or financial institution without the voting right (Khatri, 2004: 18-20).

For the existing banks and other financial institutions a two-year period has been granted to apply for the license. Entirely new Memorandum of Association and Articles of Association have to be prepared and a special general meeting of shareholder has to be called. If any institution fails to obtain the license on the said period their license will be seized. However, there is no clear information on whether the institutions can prepare Memorandum of Articles in their own format or are there any prescribed format available or will be made available by the central bank-Nepal Rastra Bank for this purpose.

This ordinance has given the full authority to NRB for monitoring, inspection, supervision etc. NRB is vested with the power to fix interest rates in lending and deposits and the Act also states that NRB can also delegate this authority to the individual banks themselves. However, such delegated authority can be taken bank. This makes banking more risky; it indicate that NRB is interest to take control on fixation of interest rates as when required.

In an article published written by Mr. Atma Shrestha in Business Age entitled “Entrepreneur-Friendly Credit Policy” has reviewed the present credit policy with main focus of the credit decision being based on the collateral. He argues that only collateral should not be considered as the basis of the credit decision (Shrestha, 2003: 33-34).

Access to finance is vital element for entrepreneurship development in the country. Without it one cannot think of starting business of any sort. It’s mainly due to this reason; most of the students after completing there single-mindedly look for employment opportunity. No other options, mo matter how lucrative and attractive it would be entering into their mind. It has created huge pressure in the labor market. In the absence of entrepreneurial activities in the country, employment opportunity will be very limited and even qualified and competent people do not get job. The established very limited and even qualified and competent people do not get job. The established very limited and even qualified and competent people do not get job. The established notion of the Nepalese bankers that money lent to the wealthy people based on collateral is safe. But is not actually a safe assumption in the face of greater difficulty in loan recovery form these people. Also, this particular segment of market is already over-banked. With the worsening business performance of the Nepalese corporate sector mostly due to the poor management compounded by other factors like sluggish economic conditions and political instability, banks must now explore newer market segment for their sustained growth and success. Under this backdrop, Nepalese commercial banks must change their policy and must understand that event the people living in the low and middle level of economic pyramid can potentially be lucrative market. They can ignore them only at their peril, especially at the time when the competition in the market consisting of people at upper level of economic pyramid can potentially be lucrative market. They can ignore them only at their peril, especially at the time when the competition in the market consisting of people at upper level of economic pyramid is very intense and has already saturated. In this context, potential entrepreneurs armed with skills, knowledge and readiness to take plunge in the business word can form a formidable market opportunity for the Nepalese banking industry-only if it can come out of the cocoon of traditional collateral-driven lending approach (Shrestha, 2003: 34-36.).

At the time when Nepalese banking industry is confronting with the increasing NPA, it might seem unwise and untimely to suggest that commercial banks extend loan to the potential entrepreneurs without collateral. It is not that they must ignore the collateral altogether while making credit decision. Collateral may be one of the important elements of the credit decisions. But this should not be a pre-condition for any credit decision. Lesson should be learned from the past experience of this credit policy that collateral alone does not ensure quality of credit decision. The fluctuation and stagnancy in the real state business has further reinforces this view. More important, Nepalese bankers must themselves have to have entrepreneurship spirit which means, they should not hesitate to take educated risk by giving more weight to the entrepreneurship dimension of the credit proposals while making credit decision. The ability of lending is identifying and investing a distinct competitive advantage in the crowded market. However it's essential that any government rules and regulations that inhibit the promotion of entrepreneurship in the country must be abolished.

Entrepreneurship development is one of the important conditions for the economic growth of a country. There must be the sprout of entrepreneurship activities in the country for rapid economic growth and progress. However it does not happen automatically. We must create necessary conditions and environment where people with skills, knowledge and hunger to make money by starting their own business ca get easy access to capital.

The act relating to banks and financial institutions has been promulgated that has been bought into existence effective February 4, 2004. The banks and financial institutions Ordinance, 2004 has replaced the existing Agricultural Bank Act, 2024. Commercial Bank Act, Development Bank Act, and Nepal Industrial Development Corporation Act and Finance Companies Acts and ha bought all such institutions under the preview of a single Act. Though this ordinance came as an achievement in the financial sector reform program, it's being a matte of debate among the various finance experts that the ordinance having six months existence time should be enacted? At this time since there is no parliament in the country and the parliament is authorized to enact permanent law. It is obvious that the financial sector must go through uncertainty in the future. The ordinance, popularly called as Umbrella Act (Bank and Financial Institutions Act, 2063).

The act divided into 12 chapters and contains altogether 93 sections. The first chapter defines the various terms used in the Ordinance but has conspicuously omitted to define" security" and "collateral" among some important terms. These words have been frequently used in relation to lending activity but in the absence of universally acceptable definition the ongoing anomalies owing to the ambiguity are expected to continue though it ha been clarified that the financial institutions henceforth can lend against personal or corporate guarantees.

Second chapter specifies the procedures for establishing a bank or financial institution and has brought transparency in licensing procedure. The authority has to either issue the license within 120 days of application or notify the reason of refusal within the said period. Further, a foreign bank's presence in Nepal either though a joint venture or branch banking is legally mandated. This provision will probably meet the long outstanding demand of the donors and conforms to Nepal's entry to WTO. Buying back of its share by a financial institution, a unique provision is legal slated by this ordinance, and that could be considered progressive. But it has failed to explain the objective of such provision and at the same time appears to be too restrictive to implement. The ordinance h failed to prescribe condition for enhancing the stake of joint venture partner, fresh issue of shares to strategic partner, issue under Employees Stock option plan and preferential issue that is vital from the investor's perspective(Bank and Financial Institutions Act, 2063).

Chapter 3 deals with the constitution and Board of Directors and appointment of CEO. Henceforth, in addition to directors appointed by the shareholders, meeting, the FIs must have one independent director in its Board appointed from amongst the names in a roster maintained by NRB. Also, the academic qualification of remaining directors has been prescribed that requires that 2/3rd of all directors must possess required academic qualification and experience but it has failed to ensure that people of requisite qualification are elected by the general meeting. Similarly, academic qualification for a position of CEO is also prescribed and his /her tenure is limited to four years. But the intention for limiting the tenure of such paid executive remains unexplained. It might prevent young and dynamic person from taking this leadership position. Further, the authority and responsibility specified are not commensurate to the potion of a CEO. As the law does not guarantee vesting of executive authority on CEO, it may be played down at the hands of unscrupulous directors and might inconsistent with the principle of divesting management from investor to professional managers (Bank and Financial Institutions Act, 2063).

Chapter 4 places restriction on using bank of FI's name or carrying out financial transactions by institutions other than those licensed by NRB as per the Ordinance.

Chapter 5 deals with capital adequacy, reserves and provisioning for NPA's. But the more it has tried to be transparent, the more it has vested discretionary powers with NRB. To protect the interest of depositors, the prime concern of legislatures in drafting the law should be continued maintenance of adequate capital and such an important matter should not be left to the discretion of NRB. The lesson should be learnt from the past experiences where NRB's leniency sent two largest banks technically bankrupt. In this regard, it may be pertinent to remind why the Basel Committee recommendation on capital adequacy (that is universally acceptable) is not being made mandatory obligation on the part o the promoters is not created to meet the capital gap within specified time. Such an obligation is vital for protecting the depositor's interest as has been the case with the two largest banks (i.e. Nepal Bank Ltd. And Rastriya Banijya Bank) and a few other private sector banks in Nepal, continued flouting with NPA's has eaten away not only their equity but the depositor's money as well.

Chapter 6 prescribes the financial transactions that banks and FIs are empowered to undertake. It has attempted to include all types of traditional financial transactions hitherto undertaken by a bank or FI but has failed to visualize the requirement of a modern banking like debt securitization swap and hedge transactions and dealing in other financial derivatives. The finance company will be benefited with this Act as they are now authorized to accept interest free deposit (Bank and Financial Institutions Act, 2063).

Regulatory, inspection and supervision responsibility with regard to FIs continue to remain with NRB. The new provision has enlarged the scope of NRB's regulatory role. Banks set up with foreign shareholding will now be required to submit to NRB the inspection reports prepared by their headquarters. Severe penalty including suspension of Board or taking over the management of FIs has been prescribed if the result of NRB inspection indicates non-compliance with its directives or if the FIs are found to be guilty of engaging in activities that are detrimental to the interest of the shareholders or the depositors.

The deregulated interest rate regime appears to be drifting away as the Ordinance has empowered NRB to intervene in rate fixation but it does not specify the conditions that would oblige NRB to do so. Looking at the current rate of interest offered on deposit on FIs that has gone below the inflation rate, NRB intervention could bring relief to thousands of small depositors especially old, disabled and pensioners whose lifetime saving is at stake.

Loan disbursement and its recovery procedures are covered under Chapter 8 that re-establishes the NRB's authority to regulate lending and minimize the chances of loan going to an unscrupulous borrower or diversion of the funds. The Ordinance has specifically provided for the compulsory registration of all charges on assets pledged as collateral but the agency responsible for such registration (other than real estate) is not identified. The authority of FIs in loan recovery has been extended and it may now reach to other assets of the borrower in case the security for loan falls short or becomes inadequate. The hitherto requirement of disposal of non-banking assets within seven years has been done away with. It may result in accumulation of significant unproductive assets in FIs balance sheet. The role of Loan Recovery Tribunal has been undermined and no role is envisaged for Asset Management Company that is in the offing.

The role of the auditor of FIs has been extended and it goes beyond the scope of expertise of accounting profession. Auditors shall require among others, to certify whether FIs have acted (or failed to act) to protect the interest of depositors or investor and whether the business of FIs has bee conducted satisfactorily. Basis of such opinion is not outlined and accordingly it will serve o purpose other than becoming a ritual.

Chapter 10 deals with merger that permits FIs to merge with other FIs only. This is a new provision but does not prescribe the circumstances when such merger will be permitted. The missing part on merger is the safeguard of interest of minority shareholders. It does not entitle shareholders opposed to the merger to ask for compulsory acquisition that is vital for promoting foreign investment.

Chapter 11 prescribes penalty for various offences that could be both various offences that could be both civil and criminal. Chapter 12 has laid down procedures for voluntary winding up of FIs, arbitration and miscellaneous administrative and operational procedures. The client confidentiality is guaranteed but with so many restrictive sub-clauses it is doubtful if the objective would ever be met. Similarly depositor's right is clearly protected by reiterating that there would be no other claimant on deposit kept with FIs other than the depositor himself of his nominee but with such right. The state may interfere in one or other pretext defeating the intension of law and lessening the confidence in the banking system (Bank and Financial Institutions Act, 2063).

For the first time, the law has taken cognizance of international terrorism and NRB is empowered to suspend operation of account related to organization of account related to organization or individual associated with such activity. But it has omitted any anti-money laundering provision. Probably, a separate Act is being envisaged to deal with such transaction.

In conclusion, it could be said that the Ordinance is comprehensive and deals with significant aspect of operation of FIs. However, attempts should be made to limit NRB's discretionary power by framing transparent, prudent and unambiguous policies and regulations. Further work would be necessary to integrate the country's financial sector with international financial sector with international financial market and effort should be directed to encourage adoption of international bet practices like International Financial Reporting Standards (IFRS), International standards on Auditing (ISA), Bassel Committee Recommendation etc.

In an article “Comments on Umbrella Ordinance 2004” by Mr. Tirth Upadhyay, President of ICAN has expressed clearly described the Ordinance along with his views. The Ordinance is comprehensive and prescribes in detail the provisions for licensing, incorporation, governance and merger and dissolution procedures for banks and financial institutions (FIs). This is a significant improvement over the existing Acts but apprehension is expressed about the discretionary power that the Ordinance has vested on Nepal Rastra Bank (NRB). (Upadhyaya, 2004:16-17)

Atreya (2005) described that the regulatory framework in South Asian Association for Regional Co-operation (SAARC) countries. Author says that the financial systems across the SAARC region show considerable diversity calling the need for harmonization of policies. The author efforts made towards harmonizing the banking policy has explored. The aim of his paper is to describe the regulatory framework in SAARC countries.

The author from his academic analysis concluded that the effectiveness of intermediation role played by the banking sector ultimately contributes to the economic development of a country. No doubt, the monetary and regulatory policies adopted by central banks to regulate and supervise the banks and financial institutions determine the extent of banking sector development. The trend thus far has been towards a more open and liberal policies that help the banking sector grow and flourish. Results visualized are increased competition, internationalization of banking business, economic cooperation and innovation in financial instruments. Banking is no longer a national phenomenon now. The banking business has crossed the national boundaries and this has created more risks and challenges to the regulatory framework in the SARRC countries and this call the needs for harmonization of banking policies to mange the banking business in this globalizes world.

The establishment of SARRC, economic cooperation initiatives through SAPTA and SAFTA, establishment of SAARC Finance, the concepts of SADB and SAEU are all geared towards building mutual cooperation and development in the

SARRC countries. Although some efforts have been made in this direction, more efforts are needed to strengthen the banking environment in SARRC countries. SARRC countries must develop their human resources to make them capable to implement Basel Accord II, strengthened corporate governance system, develop regulatory framework to manage cross-boarder banking operations, forge partnerships and economic cooperation for better understanding and development and establishment and establish system for learning from the rich experience of each other.

2.6.2 Review of Thesis

Lila Prasad Ojha, (2002) has conducted a research on,"Lending Practices: A Study of Nabil Bank Limited, Standard Chartered Bank Nepal Limited and Himalayan Bank Limited"

His research objectives of the study are as follows:

i) To determine the liquidity position, the impact of deposit in liquidity and its effect on lending practices.

ii) To measure the banks lending strength. The lending strength shall be measured in absolute measures also to analyze the volume of contribution made by each bank in lending.

iii) To analyze the portfolio behavior of lending and measuring the ratio and volume of loans and advances made in agriculture, priority and productive sector.

iv) To measure the lending performance in quality, efficiency and its contribution in total income.

v) To measure the growth rate and propensity of growth based on trend analysis.

Based on the above objectives of the study, his research findings of the study are as follows:

The measurement of the study revealed that the mean current ratio of all three banks is not widely varied. All the banks are capable in discharging their current liability by current assets. The ratio of liquid fund to current and total deposits has some degree of deviation among the banks as compare to current ratio. Cash and bank balance to interest sensitive liability has measured the liquidity risk arising from fluctuation of interest rate in the market. The measurement of lending strength in relative term has revealed that the total liability to total assets of SCBNL has the highest ratio. The steady and high volume of loans and advances throughout the years has resulted Nabil's ratio to be the highest. Nabil has deployed the highest proportion of its total deposits in earning activities and this ratio is significantly above the ratios of other two banks. This is the indicative of that in fund mobilizing activities Nabil is significantly better than SCBNL.

Upendra Shrestha, (2002) has conducted a research on,"Investment Practice of Joint Venture Banks in Nepal". He has selected three joint venture banks i.e. Nabil Bank Limited, Standard Chartered Bank Limited and SBI Bank Limited for the study of lending and investment practice.

Mr. Shrestha has the following objectives:

i) To highlight the features and problems of investment lending procedure in foreign commercial banks and their implementation in practical life
ii) To study priority sector investment and repayment rate of commercial banks in Nepal through intensive banking program.
iii) To show the repayment position of the sector of the three commercial banks.

The major findings of this thesis are as follows.

Commercial banks are more emphasized to be making loan on short term basis against movable merchandise. Commercial banks have lots of deposits but very little investment opportunities. They are even discouraging people by offering very low interest rates and minimum threshold balances.

He has concluded that since the liquidity position of Nabil and SCBNL have not found satisfactory. It is therefore, suggested them to improve cash and bank balance to meet current obligations. SCBNL's loan and advances to total deposit ratio is lower at all, therefore it is recommended to follow liberal lending policy for enhancement of lend mobilization.

It was found that SBI had not invested its fund on share and debenture of other companies. It is suggested to enhance off balance sheet transactions, diversifying investment, open new branches, play merchant banking role and invest their risky assets and shareholders fund to gain higher profit margin. Nabil and SCBNL are recommended to increase cash and bank balances to meet current obligations and loan demand.

The above finding showed that there are some conflicting statements, which are obviously not matching with his statements of the problems. This study ignored the industry average and also failed to figure out what is right industry like banking among the excess of investment and advances. Again, he thought liberal lending policies to solve the problem to increase the level of loans and advances. But somewhere in his recommendation, he has warned commercial banks to increase the level of investment to government securities or other safe instrument just to avoid risk arising from lending. From this, it can be concluded that Mr. Shrestha has made his entire conclusion absolutely and he has not made any relative analysis of the pros and cons of the entire factor, affecting the study.

Sabitri Shrestha, (2003) in her study entitled "Impact and Implementation of NRB Guidelines (Directive of Commercial Banks- A study of NABIL Bank Limited and Nepal SBI Bank" have been fully implantation the NRB's directives.

The main objectives of the study are as follows:

i) To analyze the significance and impact of Nepal Rastra Bank's directives on commercial banks;
ii) To examine the capital adequacy of selected banks.
iii) To examine the relation of capital funds to the other stakes of bank

iv) To make necessary suggestions and recommendations.

The major findings of the study are:

Capital adequacy Ratio of NABIL and Nepal SBI are 13.40% and 12.86% respectively, which are more than 9%. Banks are following the directives but in same cases such like supplementary capital and balance at NRB there is shortfall. The excurses amount of total deposit in balance of NRB there is shortfalls. The banks have categorized the loan amount into four diffident categories as per NRB's directives. The increasing loan loss- providing amount decreased the profit of the banks. The charge in the single borrower limit has brought down the limits of the fund based and non-fund based loans which have resulted to reduced loan exposure to banks.

In her thesis she found that both NABIL and SBI banks has not increased supplementary capital as it has shortfall in comparison witt NRB guidelines and to meet the supplementary capital adequacy ratio even though it can be compensated by the excess amount of core capital. The supplementary capital needs to be increased by Rs.122.74 million in NABIL Bank and Rs.125.57 million in Nepal SBI Bank. She says liquidity and profitability are like two wheels of one cart so banks cannot run in the absence of any one of them. One can be activated only at the cost of the other. Only liquid banks can attract loan core deposit, which helps in reducing interest expenses and give loan to good customer at lower rate, which results in requirement of less provision and high net profit. So banks should increase their primary reserve now to maintain the liquidity risk due to scrap out the secondary reserve. On the basis of findings, NABIL Bank has a shortfall of Rs.140.74 million thus NABIL has to increase its balance at NRB by such amount for better performance even after adding 1% excess amount of ash of total deposit.

Primary data has been used in order to get the view of banks on the directives issued by NRB. Question related to NRB directives 1.5 are used to collect for the study and implementation of directive by commercial bank. Secondary data are also used for the analysis this study the general directives issued in 2001 and 2002 are considered for the study. In issued directives of 2001 and 2002 there are 10 directives but only five directives i.e. (1-5) are highlighted and taken in the study.

Hari Karki, (2004) has conducted a research on “A Study of Investment Policy in Nepal Arab Bank Limited”, in comparison other joint venture banks in Nepal.

His research objectives of the study are as follows:

i) To measure the banks investment policy. The lending strength shall be measured in absolute to analyze the volume of contribution made by each bank.

ii) To determine the liquidity position, the impact of deposit in liquidity and its effect on lending practices.

iii) To analyze the portfolio behavior of lending and measuring the ratio and volume of loans and advances made in agriculture, priority and productive sector.

iv) To measure the impact of investment in quality, efficiency and its contribution in total income.

Based on the above objectives of the study, his research findings of the study are as follows:

The steady and high volume of loans and advances throughout the years has resulted Nabil’s ratio to be the highest. Nabil has deployed the highest proportion of its total deposits in earning activities and this ratio is significantly above the normal ratios. This is the indicative of that in fund mobilizing activities Nabil is significantly better. In that topic he had recommended that in order to become success in competitive banking environment, bank should be able to utilize depositor’s money as loans and advances. Since the largest items in bank’s asset side is loans and advances, negligence of administering this could be the main cause of a liquidity crisis in the bank and also one of the main reasons of bank failure.

Niva Shrestha (2004) conducted a study on the topic ‘A study on non-performing loans and loan loss provisioning of commercial banks’ revealed that SCBNL had risk averse attitude o the management or they have policy of investing low in the risky assets i.e. loans and advances as compared to NBL AND NABIL because the loans and advance to total asset ratio of NBL, NABIL & SCBNL during the study period was appeared to be 52.3%. 47.0% and 29.34% respectively. The SCBNL has higher proportion of the investment in risk free or nominally risky asset like treasury bills, National Saving bonds etc.

Similarly, the loans and advances to total deposit ratio of NBL, NABIL and SCBNL during the study period was found to be 57.63%, 56.35% and 35.94% respectively. It indicates that SCBNL has the most consistent and variability during the study period where as the NBL has the higher consistent and variability as comparison to other two banks. NABIL has the moderate level of consistent and variability (Shrestha, 2004).

In the same way, the proportion of non-performing loan with regard to total loans of NBL, NABIL & SCBNL was found to be 48.37%, 10.67% & 4.38% respectively. That means 51.63%, 89.33% & 95.62% of total loan of NBL, NABIL & SCBNL was found to be performing loan. Not only the public sector bank, even private sector bank like NABIL has higher proportion of non-performing loan. However, in recent years NABIL has shown significant decrement in non-performing asset, which are the result of effective bank credit management and its efforts of recovering bad debts through the recovery of establishment of recovery cell (Shrestha, 2004).

In the same way, proportion loan loss provision of NBL was found to be significantly higher (i.e. 40.17%) as compared to other two commercial banks. The proportion of NABIL and SCBNL was found to be 5.69% and 4.49%.

The average ratio of provision held to non-performing loan of NBL, NABIL & SCBNL was found to be 80.03%, 57.85% and 122.32% respectively shows that the SCBNL has maintained adequate level of provision against non-performing loan where as NABIL was found to be comparatively lower. The NBL was found to be an average position (Shrestha, 2004).

Ram Prasad Kafle, (2005) in his study entitled “Non-performing Loans of Nepalese commercial banks.”

The researcher’s mean objectives of the study are:

i) To know the problems of the non-performing loans and its effect in the ROA and ROE of the Nepalese commercial banks

ii) To find out whether the Nepalese commercial banks are following the NRB directives regarding loan loss provision for non-performing loan or hot.

iii) To make necessary suggestions and recommendations.

The major findings of the study are:

Through the research he has found that the no banks have been following NRB’s directives regarding the loan loss provision. He also conclude that the return on assets (ROA) and return on equity (ROE) of the bank deposed upon the NPLs. The high degree of negative correlation between NPL and ROA and the NPL and ROE clearly indicates that there is inverse relation between them. He has recommended that for the smooth operation of the commercial banks, the NPLs should be controlled for this bank should provide necessary training regarding loan management to the manpower’s. In order to remove, the NPLs, banks should take enough collateral so that banks can recover its loan amount. For the loan loss provision as per the NRB directive and to reduce the NPL, the bank management should be effective and the NRB’s monitoring and regulation is necessary.

Rajan Subedi, (2006) entitled “A Comparative Study of Financial Performance between Himalayan Bank limited and Everest Bank Limited” of the period from 2000 to 2005

The objectives are specified as below:

a) To anlyze the financial performance of Himalayan Bank Limited & Everest Bank Limited through the use of appropriate financial tools.
b) To highlight various aspect relating to financial performance of Himalayan Bank Limited & Everest Bank Limited for five year.
c) To perform trend analysis of these selected banks and make a projection of coming year.
d) To suggest and recommend both the banks to improve their financial performance.

He has outlined his major finding as follow:

The mean and total loans and Advances to total saving deposit ratio of EBL is greater than that of HBL and the coefficient of variation between the ratios of HBL is less than EBL. It means that the ratio of HBL is less than EBL is more uniform than EBL. According to analysis, it found that EBL is more employing its saving deposit in term of loans and advances than that of HBL. So, loans and advances to total saving deposit ratio appear better in EBL than HBL.

The mean total investment to total deposit ratio of EBL is significantly greater than that of HBL but the coefficient of variation between the ratio of HBL but the EBL. It means that the variability of the ratios of HBL is more consistent than that of EBL. According to analysis, it if found that EBL is more successful in utilizing its resources an investment.

However, he failed to give his overall conclusion regarding the superiority of the financial performance of these two banks during the period of the study (2000-2005). He has also put several recommendations out of which few important recommendation are outlined here.

The liquidity of a bank many of affected by external as well as internal factors such as the interest ratio, supply and demand position of loans, saving to investment situation, central bank requirements and the growth or slackening tending policies management capability. HBL has maintained the ratio of cash and bank balance to total deposit considerably lower than that of EBL. So, EBL is recommended to increase cash and balance to meet loan demand.

Prem Krishna Shrestha, (2007) in his thesis entitled "Profitability Analysis of Standard Chartered Bank Nepal Limited and NABIL Bank Limited"

The objectives are specified as below:

i) To anlyze the profitability analysis of Standard Chartered Bank Nepal Limited and NABIL Bank Limited.

ii) To highlight various profitability ratios relating to financial performance.

iii) To perform trend analysis of profitability of these selected banks and make a projection of coming year.

iv) To suggest and recommend both the banks to improve their profitability.

The major findings are as follows:

- SCBNL had more consistent operating efficiency ratio than NABIL bank limited during the study period.
- Both of the banks data showed that more than 90% of their total liabilities paid interest. These banks showed that smaller portion of their interest bearing interest bearing liabilities paid as interest expenses.
- Both the banks' weighted average cost of deposit ratio was found to be at decreasing rate.
- NABIL bank had lower EPS than SCBNL, which indicated that the performance of SCBNL was better than NABIL.
- SCBNL was paying more dividend than NABIL bank limited during the study period. The amount of dividend was almost double for SCBNL than NABIL. It meant that NABIL was in need of fund, so it was paying fewer dividends and adding more amounts under the head of retained earnings.
- Among the total income, more than 75% of the income came from interest sector. That indicated the main source of income was interest for both the banks.

- The operating expenses ratio over total expenses comprised of more than 40% for both the banks.
- NABIL had fluctuating return on total assets than SCBNL. SCBNL had higher return on equity than NABIL. Return on equity of NABIL was more fluctuating than that of SCBNL. SCBNL had higher return on equity ratio than that of NABIL.
- SCBNL had also higher interest earned to total asset ratio than NABIL.
- The total interest income to total earning assets ratio of both the banks were found decreasing over the years, which indicates a negative sign to the bank's performance.
- NABIL bank's net profit margin ratio was higher than that of SCBNL. Similarly, net interest margin of NABIL was also higher than that of SCBNL (Shrestha, 2007: 76-77).

2.7 Research Gap

This continuity in research is ensured by linking the present study with the past research studies. It is clear that the new research cannot be found on that exact topic, i.e. Credit management of Everest Bank Limited. Therefore, to fulfill this gap, this research is selected. To complete this research work: many books, journals, articles and various published and unpublished dissertations are followed as guideline to make the research easier and smooth. In this regard, here it is going to analyze the different procedure of credit management, which is considered only on EBL bank. Therefore, this study is useful to the concern bank as well as different persons: such as shareholders, investors, policy makers, stockbrokers, state of government etc.

CHAPTER III
RESEARCH METHODOLOGY

Research methodology refers to the systematic and meticulous study and investigation on the particular subject matter. The fundamental purpose of this study is to provide an overview on the credit management and analysis of the Everest Bank Limited.

3.1 Research Design

The main objective of this study is to provide an overview on credit management and analysis of Everest Bank Limited. This study describes and explores the credit policy and its implementation by EBL toward diversification of investments. So, descriptive, exploratory and analytical methods are combined, as the study demands, for the best result. The research design is thus an integrated frame of descriptive study and exploratory study.

3.2 Population and Sample

The entire number of commercial banks functioning is the population of this study. There are 25 commercial banks operating in the country. For the analysis of credit management and analysis only one bank i.e. Everest Bank Limited is taken purposively as the sample.

3.3 Sources of Data

The main sources of data for this study are secondary data. According to the requirement, published balance sheets, profit and loss A/C and other related statements of account as well as annual report of the bank have also been collected for the last five years. For the purpose of study, various related books, booklets magazines, journals, newspapers and thesis made in this field have been referred. Personal queries, discussion and consultations are also done.

3.4 Data Collection Technique

Both the primary and secondary data were used for the preparation of this report. Necessary and required data were collected from the corporate department of EBL. Concerned personnel of the respected department were in contact. For primary data interview, field visit, and personal observation have been considered for gathering the information. And for secondary data, annual report of EBL, related academic books and literature, bank's internal reports, files and others have been considered for making this report authentic and more realistic. The concerned personnel provided all the consolidated data records as per the requirement of the report. The data compiled were classified and tabulated to the need of the study.

3.5 Data Analysis Tools

Relevant statistical tools and financial tools are used to find out the best appropriate outcomes as per designed objectives of the present study. The present research has used mix of following tools in the analysis.

3.5.1 Financial Tools

Financial ratios have been systematically used to analyze and interpret the financial statements of the company. The ratios used are summarized as follows:

Credit deposit ratio: It shows that the deposit collected from the customers are efficiently used or mobilized in advancing loan.

$$\text{Credit deposit ratio} = \frac{\text{Total Credit}}{\text{Total Deposit}}$$

Net Profit to Loan and Advances Ratio: This ratio denotes net profit earned by the bank while advancing loan to different sectors.

$$\text{Net Profit to Loan and Advances Ratio} = \frac{\text{Net Profit}}{\text{Loan and Advances}} \times 100$$

Loan Loss Coverage Ratio: The above ratio indicates to ascertain the percent of the total lending and loan loss provision maintained by the bank.

$$\textit{Loan Loss Coverage Ratio} = \frac{\textit{Total Loan Loss Provision}}{\textit{Total Lending}} \times 100$$

Current Ratio: It measures firm's short-term solvency and indicates the ability of current assets to meet current obligations.

$$\textit{Current Ratio} = \frac{\textit{Current Assets}}{\textit{Current Liabilities}}$$

Debt-Equity Ratio: This ratio is used to analyze long-term solvency of a firm and indicates the extent to which debt financing has been used in the business.

$$\textit{Debt-Equity Ratio} = \frac{\textit{Total Debt}}{\textit{Net worth / Total Shareholder's fund}}$$

Return on Equity (ROE): This ratio reveals the true picture of the ability of the bank to utilize its owner's fund.

$$ROE = \frac{\textit{Profit After Tax}}{\textit{Net Worth or Shareholders Fund}}$$

Net Profit Margin: This ratio is the overall measure of the firm's ability to turn each Rupee sales into Net Profit.

$$\textit{Net Profit Margin} = \frac{\textit{Net Profit}}{\textit{Sales}} \times 100$$

3.5.2. Statistical Tools

Brief explanations of the statistical tools used in this study are given below.

- **Arithmetic Mean (Mean)**

The simple or arithmetic average in which all the observations are treated equally, is the sum of all the individual numbers divided by the number of observations.

$$\text{Mean } \left(\bar{X}\right) = \frac{X_1 + X_2 + X_3 \,..........X_n}{n}$$

Where $\bar{X}$ = mean

X1, X2, X3 to Xn are given set of observations up to the period n

n = number of items observed.

- **Standard Deviation**

In order to indicate the variability of the individual observations, standard deviation is used in this study. Standard deviation is a function of the differences between each individual score and the overall mean score. Standard deviation measures the dispersion or variability around the mean. Standard deviation is always a positive number and is superior to the mean deviation.

The equation for the computation of the standard deviation (σ) is

$$\sigma = \sqrt{\frac{\sum (X - \bar{X})^2}{n - 1}}$$

$\bar{X}$ = The average (mean)

Xn = The individual observation

n = Total number of observation

- **Coefficient of Variation (CV)**

When two frequency distribution have the same arithmetic mean, the variability of these two distributions may be compared by calculating their respective standard deviations. The one with the higher standard deviation will be more variable. CV is used for comparing the homogeneity, uniformity and variability of two or more distributions.

Coefficient of Variation is a relative measure of dispersion and is defined as the ratio of the standard deviation divided by the mean. That is,

$$CV = \frac{\sigma}{\bar{X}} * 100$$

It is usual for the risk/return model. It shows the return per unit of risk.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

This study has been prepared by personally indulging in the daily working of the bank. This study is conducted to obtain overall view of Credit Management and Analysis of the Bank. It familiarizes EBL's functions at the corporate level as well as in branch level along with the credit policies procedures, appraisals and credit analysis including practical observations pertaining to the bank. Credit management in EBL basically covers loan approval process, credit analysis, method and mechanism, lending documentation, disbursement and administration of loan including credit audit.

4.1 Financial Analysis

4.1.1 Liquidity Ratio

Liquidity ratio measures the ability of a firm to meet its obligation in the short-run, usually one year. A firm should ensure that it does not suffer from lack of liquidity and also that it does not have excess liquidity. Lack of sufficient liquidity, will result in poor credit worthiness, loss of creditors confidence.

A) Current Ratio:

Current ratio is a measure of firm's short-term solvency. It is the test of liquidity. It measures short-term debt paying ability of the firm. It indicates the ability of current assets for meeting current liabilities.

Current Assets include cash in hand, cash at bank, current investment, debtors, inventories, loan & advances, prepaid expenses, money at call and short notice.

Current Liabilities include creditors, bills payable, accrued expenses, deposits, borrowings and other liabilities that mature within a year.

The current ratio is calculated by dividing current assets by current liabilities:

$$\text{Current Ratio } X \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Table: 4.1

Current Ratio

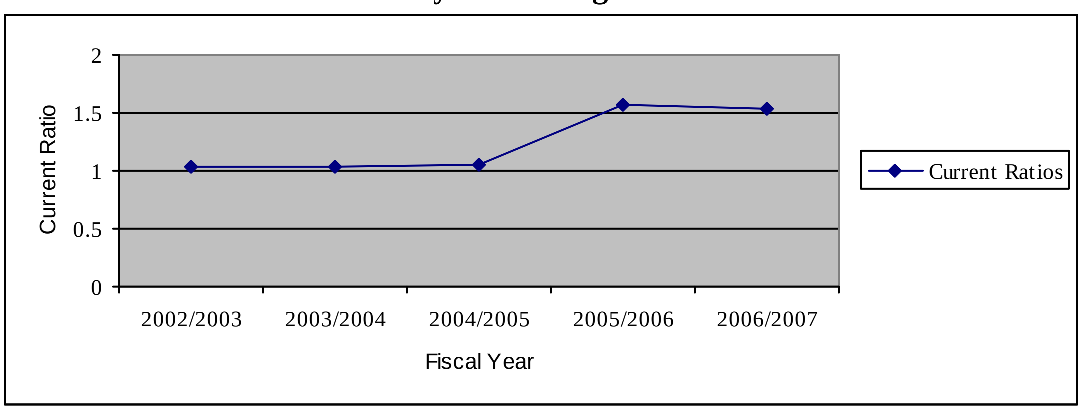
(NRs. in million)

Fiscal Years	Current Assets	Current Liabilities	Ratios
2002/2003	3334.59	3204.27	1.04
2003/2004	5049.85	4874.79	1.04
2004/2005	6359.66	6063.87	1.05
2005/2006	9473.3	6011.4	1.57
2006/2007	11638.8	7577.5	1.53

Source: Annual Report of EBL

The current ratio of EBL can be depicted from the table 4.1. The current ratio of the bank in the FY 2005/06 was 1.57. How ever there is slight decrease in the year 2006/07 to 1.53. As a conventional rule, current ratio of 2 to 1 or more is considered satisfactory. Higher the ratio, greater the margin of safety i.e. the larger the amount of current assets in relation to current liabilities, the more the firm's ability to meet its current obligation. The bank's current ratio is below 2:1 which may be interpreted to be insufficiently liquid as it represents the margin of safety to the creditors.

Figure: 4.1
Trend Analysis Showing Current Ratio



The above trend analysis indicates the current ratio of EBL for the last four years. It shows that the trend has been decreasing from the year 2005/06 to 20006/07 which is considered unhealthy for the bank.

4.1.2 Debt- Equity Ratio

Debt ratio is used to analyze long term solvency of a firm. Debt equity ratio shows the extent to which debt financing has been used in the business. It shows the relative contribution of creditors and owners. The loan agreements may require a firm to maintain a certain level of working capital, minimum current ratio, restrict the payment of dividend or fix limits to the staff salaries and so on. Heavy indebtness leads to creditor's pressure and constraints on management's independent functioning and energies. Debt-equity ratio is directly computed by dividing Total debt by Net worth:

$$\text{Debt-Equity Ratio } X \frac{\text{Total Debt}}{\text{Net worth / Total Shareholders fund}}$$

Table: 4.2

Debt-Equity Ratio

(NRs. in million)

Fiscal years	Total debt	Net worth	Ratios
2002/2003	4574.5	319.3	14.3
2003/2004	5548.4	582.8	9.5
2004/2005	6695	612.8	10.9
2005/2006	8063.9	680.4	11.8
2006/2007	10397.7	769	13.5

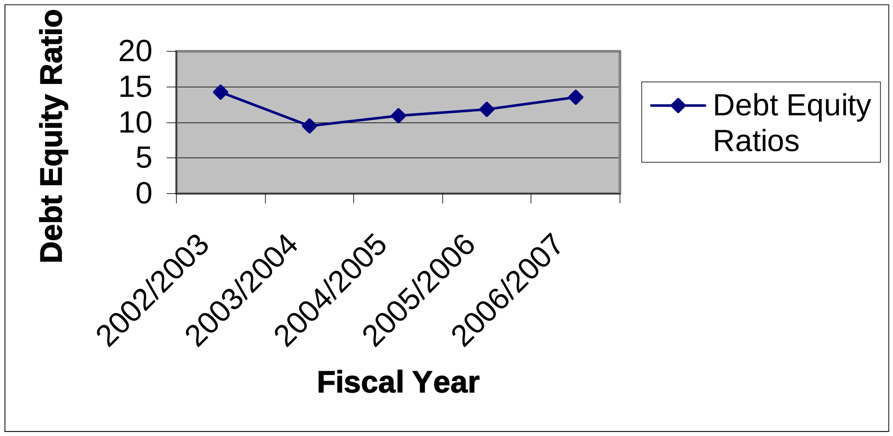
Source: Annual Report of EBL

The above table indicates that in FY 2002/2003 the debt-equity ratio was 14.3 and in 2003/04 it declined to 9.5. But, it increased to 10.9 in the FY 2004/05, 11.8 in 2005/06 and 13.5 in 2006/07.

A high ratio means that claims of creditor are greater than those of owners. A low debt-equity ratio implies greater claim of owner than creditors. High proportion of equity provides a larger margin of safety for them.

The Debt-equity ratio falls to higher side, which is unfavorable for the bank as it shows that claims of the creditors are greater than those of owners. During period of low profit, a highly debt-financed company cannot even pay the interest charges of creditors.

Figure: 4.2
Trend Analysis Showing Debt-Equity Ratio



The trend analysis represents the debt-equity ratio of EBL for the last five years.

4.1.3 Profitability Ratio

Profit is an indispensable factor in any business organization. It is the amount of profit that nay institution can make which decides its continuity in the future. For banking institution profit becomes a must because it has to cover different types of expenses on one hand and also make some payment in the form of dividends to their shareholders. It is the excess of income over expenditure. It is the key factor that measures how effectively the firm is being operated and managed.

4.1.3.1 Return on Equity (ROE)

Return on Equity measures the profitability of equity funds involved in the firm. ROE indicates how well the firm has used the resources of owners. It reveals the clear picture of the capacity of the bank to utilize its owner fund. ROE can be mathematically expressed as follows:

$$\text{ROE X} \frac{\text{Profit After Tax}}{\text{Net Worth or Shareholders Fund}}$$

The numerator of this ratio is equal to profit after Tax less Preference Dividends. The denominator includes all the contribution made by equity shareholders.

Table: 4.3

Return on Equity Ratio

(NRs. in million)

Fiscal years	Profit after tax	Net worth	ROE
2002/2003	69.71	319.3	21.8
2003/2004	85.35	582.8	14.6
2004/2005	94.18	612.8	15.3
2005/2006	143.57	680.4	21.1
2006/2007	170.80	769.6	22.1

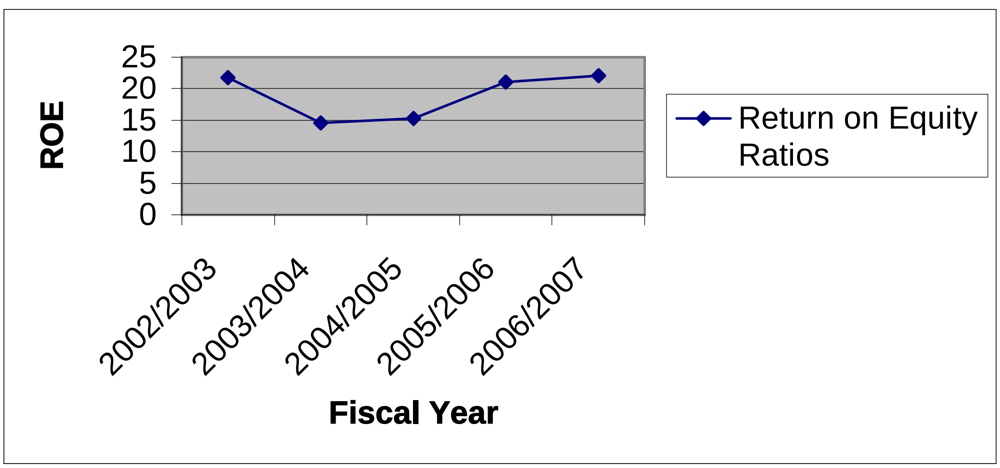
Source: Annual Report of EBL

The above table depicts the ROE ratio of five fiscal years. The ratio is in a fluctuating situation as in FY 2002/2003, the ratio was 21.8%, in the next year 2003/04, it was 14.6% followed by 15.3% in FY 2004/05, in FY 2005/06 and 2006/2007 it increased to 21.1% and 22.1% respectively.

This shows that the bank has been able to mobilize their equity shareholders fund efficiently and effectively as the present scenario show greater ratio compared to previous years i.e. 22.1%. It also reveals the strength of a company in attracting future investment and clear picture to the creditors.

Figure: 4.3

Trend Analysis of Return on Equity Ratio



The trend line indicates the growing pace of ROE of EBL since 2004/05 for the last five years and has reached to 22.1%, which is considered as a better performance.

4.2 Financial Position of Everest Bank Limited

4.2.1 Total Credit Position of Everest Bank Limited

Advancing loan is one of the vital functions of all commercial banks. Total credit disbursed is undeniably major income earning asset for the commercial banks. Total credit investment i.e. total lending of EBL for 5 years from 2002/2003 to 2006/2007 are tabulated as under.

Table: 4.4
Total Credit Position

(NRs. in million)

Fiscal year	Total credit	Differential amount	Annual growth
2002/2003	3334.59	3204.27	–
2003/2004	5049.85	4874.79	34.55%
2004/2005	6359.66	6063.87	24.86%
2005/2006	9473.3	6011.4	20.72%
2006/2007	11638.8	7577.5	29.60%

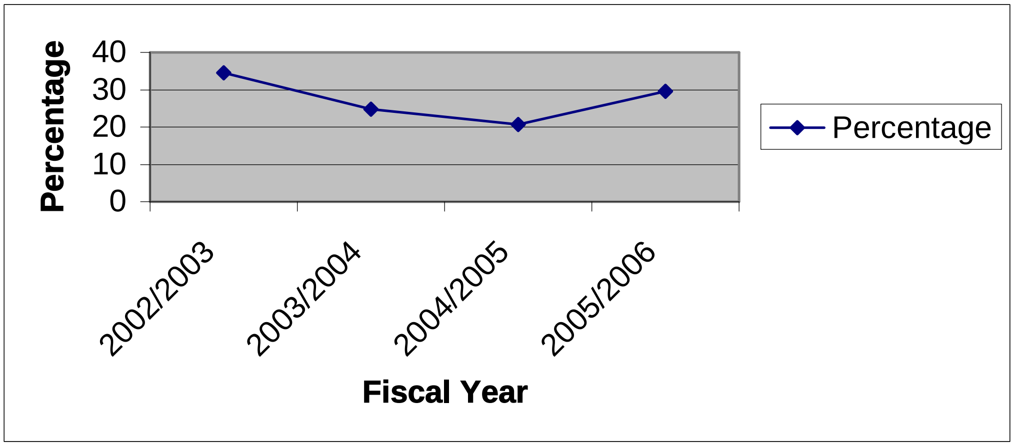
Source: Annual Report of EBL

The table indicates total credit position including discounted and purchased bills for period of five years. In other words, it depicts total lending/ credit advanced by the bank. In FY 2002/2003, total credit amounted to NPR 3005.70 million, which increased by 34.55% in the following year and total lending stood at NPR 4044.20 million. However in FY 2004/05, the lending position grew by 24.86% amounting to NPR 5049.50 million. Moreover, credit growth reached to 20.72% in FY 2005/06. In the subsequent year it amounted to NPR 7900 million with the growth rate recorded at 29.6%.

However total loan is growing at diminishing rate recorded at 24.86% and 29.6% in FY 2004/05 and 2006/07 respectively. Bank can deliberate its effort to increase total credit by adopting new credit facilities, restructuring existing credit facilities, charging competitive interest rate in loan etc. The diagrammatic representation of total credit position of EBL has been presented below:

Figure: 4.4

Trend Analysis of Total Credit Position



The trend shows that the total credit is increasing but at diminishing rate.

4.2.2 Credit Deposit Ratio

Credit deposit ratio is one of the methods or mechanism applied to measure adequacy of bank capital. Amount collected in the form of deposit is regarded as one of the source for advancing loan. Banker's strength depends considerably on quality of its loan and proportion they bear to the total deposits. This ratio can be obtained as follows:

$$\text{Credit deposit ratio } X \frac{\text{Credit deposit ratio}}{\text{Total Deposit}}$$

Table: 4.5
Credit Deposit Ratio

(NRs. in million)

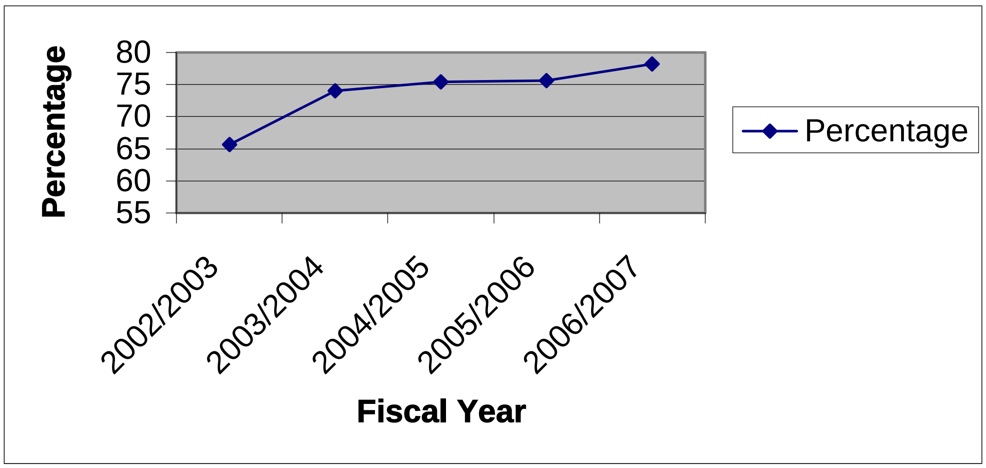
Fiscal Year	Total Credit	Total Deposit	Credit Deposit Ratio (%)
2002/2003	3334.59	3204.27	65.7
2003/2004	5049.85	4874.79	73.98
2004/2005	6359.66	6063.87	75.42
2005/2006	9473.3	6011.4	75.59
2006/2007	11638.8	7577.5	78.23

Source: Annual Report of EBL

The table shows that, in FY 2002/2003, credit deposit ratio was 65.7%. In other words, 65.7% of total deposit was invested as credit. The Credit deposit ratio increased to 73.98%, 75.42%, 75.59%, and 78.23% in succeeding year. The trend analysis of credit deposit ratio has been presented in the graph for better understanding:

Figure: 4.5

Trend Analysis of Credit Deposit Ratio



The figure depicts trend of credit deposit ratio for the study period over five fiscal years. The Credit Deposit Ratio has increased to 78.23% in FY 2006/07.

The average loan to deposit ratio is;

$$\text{Average Ratio} = \frac{(65.71\,\Gamma\,73.98\,\Gamma\,75.42\,\Gamma\,75.59\,\Gamma\,78.23)}{5} = 74.78\ \%$$

Thus, the total loans to total deposits ratio shows that EBL has been lending in an average 74.78 % of total deposits during the last five Fiscal Years.

4.2.3 Net Profit to Loan and Advances Ratio

A company should earn profit to survive and grow over a long period of time. Profitability reflects the final result of business operations. The main objective of any business is directed towards one definite term profit. Before advancing loan, profit margin of the bank needs to be identified as bank has to cover various operating and miscellaneous expenses. This ratio can be obtained by applying following formula:

$$\text{Net Profit to Loan and Advances Ratio } X \frac{\text{Net Profit}}{\text{Loan and Advances}}$$

Table: 4.6

Net Profit to Loan and Advances Ratio

(NRs. in million)

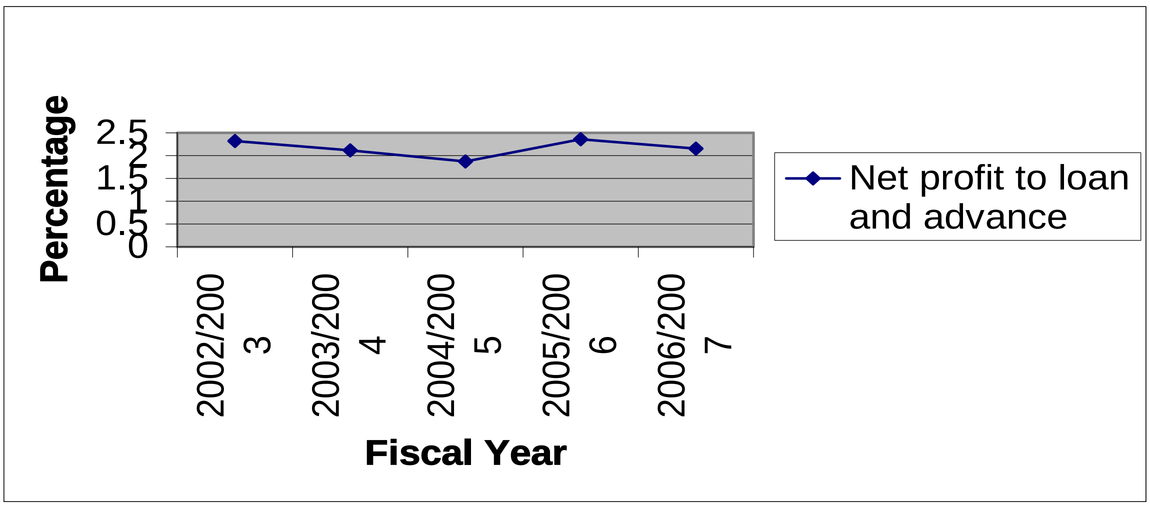
Fiscal years	Net profit	Loan & advances	%
2002/2003	69.7	3005.7	2.32
2003/2004	85.3	4044.2	2.11
2004/2005	94.2	5049.6	1.87
2005/2006	143.6	6095.8	2.36
2006/2007	170.8	7900.00	2.16

Source: Annual Report of EBL

Thus, the bank has earned certain amount of profit from advancing loan, which would contribute in the expenses incurred.

Figure: 4.6

Trend Analysis of Net Profit to Loan and Advances Ratio



The trend above gives the view that net profit earned form granting loan to the clients are fluctuating i.e. in the year 2003/04, it has slightly fallen down to 2.11% from 2.32% and it has drastically fallen down to 1.87% in FY 2004/05.Then it made a continuous progress in FY 2005/06 and FY 2006/07 by 2.36% and 2.16% respectively.

4.2.4 Collateral/Security

A bank is a legal institution that doesn't provide loan without security. Bank analyzes various financial statements like balance sheet, profit & loss account, cash flow statement for the assessment of borrower's credit worthiness. To safeguard bank's interest, bank asks for security which proves to be cushion in case of default.

Collateral refers to an assets pledged against the performance of an obligation. If a borrower defaults on a loan, the bank takes the collateral and sells it. There are two kinds of collateral/ security:

1. Primary Security:

The security deposited by the borrower himself is known as primary security that includes promissory note and tangible securities like land and building, machinery, finished goods, fixed deposit receipts offered by the borrower.

2. Collateral Security:

Collateral security is the additional or secondary security, which the banker may insist upon as it helps to realize his dues in case the primary security defaults.

EBL has been extending credit facilities to its customer against various securities such as Fixed and movable assets, local or foreign banks Guarantee, Government guarantee, International Rated Bank's Guarantee, Export documents, Fixed deposit receipts, Government Securities, Counter Guarantee, Personal Guarantee and other securities. They are tabulated as under:

Table: 4.7

Securities against Loan and Advances

(NRs. in million)

Particulars	2005/2006	2006/2007	Difference
Fixed and movable assets	3334.59	3204.27	1.04
Local or Foreign banks Guarantee	5049.85	4874.79	1.04
Government guarantee	6359.66	6063.87	1.05
International Rated Bank's Guarantee	9473.3	6011.4	1.57
Export documents	11638.8	7577.5	1.53
Fixed deposit receipts a) Own Fixed Deposit Receipts b) Other banks Fixed Deposits	3334.59	3204.27	1.04
Government Securities	5049.85	4874.79	1.04
Counter Guarantee	6359.66	6063.87	1.05
Personal Guarantee	2.40	2.40	-
Other securities	344.70	715.93	371.23
Secured	**6087.87**	**7892.13**	**1804.26**
Unsecured	**7.97**	**7.97**	-
Total	**6095.84**	**7900.10**	**1804.26**

Source: Annual Report of EBL

The above table reveals that there is an increment in secured loan by NRs 1804.26 million in FY 2006/07. The bank advances loan against the above-mentioned securities. The amount lend against collateral of movable and immovable assets increased from NRs 5330.49 million in FY 2005/06 to NRs 6621.82 million in FY 2006/07 by NRs 1291.33 million.

In case of Guarantees, the Bank accepts Local or Foreign banks Guarantees, Government, International Rated Bank's Guarantee, Counter Guarantee & Personal Guarantee. In FY 2006/07, the bank advances loan against Local or Foreign banks guarantee increased by NPR. 125.59 million as compared to previous year i.e. NPR 74.58 million in 2005/06, whereas, Government guarantee as well as Counter Guarantee are nil in both the years. However there is change in leading against personal guarantee in both the years.

Similarly, there is considerable decline in leading against Export document. The figure leaped to NPR 6.08 million in 2006/07 from NPR 9.27 million in 2005/06. Further the Government Bonds declined to NPR 131.47 million in 2006/07 from NPR 186.20 million 2005/06. Whereas lending against other securities like gold and silver increased to NPR 715.93 million from NPR 344.70 million in 2006/07.

As for Unsecured loan, there is no change i.e. NPR 7.97 million. Thus, the total lending provided to customer against these securities made progressive increment by NPR 1804.26 million from NPR 6095.84 million in 2005/06 to NPR 7900.10 million in FY 2006/07. Thus, quality and characteristics of good collateral maintained by the Bank is highly valuable, durable, marketable, with stable value and reliable.

4.3 Sources and Uses of Everest Bank Limited at A Glance

Despite fragile law and order situation especially during last 2-3 years, the Bank has doubled its deposits, advances as profits during the period. Its operating profit have grown by 55% during the financial year 2006/07, the net profit has increased by 52%.

Table: 4.8

Performance of EBL at A Glance

(NRs. in million)

Sources	2002/03	2003/04	2004/05	2005/06	2006/07
Capital Reserve	3334.59	3204.27	1.04	3334.59	3204.27
Deposit	5049.85	4874.79	1.04	5049.85	4874.79
Loan	6359.66	6063.87	1.05	6359.66	6063.87
Other Liabilities	9473.3	6011.4	1.57	9473.3	6011.4
Total	11638.8	7577.5	1.53	11638.8	7577.5
USES	3334.59	3204.27	1.04	3334.59	3204.27
Cash & Bank	5049.85	4874.79	1.04	5049.85	4874.79
Credits (Including Bills Purchase)	6359.66	6063.87	1.05	6359.66	6063.87
Investments	9473.3	6011.4	1.57	9473.3	6011.4
Money at Call	11638.8	7577.5	1.53	11638.8	7577.5
Other Assets	3334.59	3204.27	1.04	3334.59	3204.27
Total	5049.85	4874.79	1.04	5049.85	4874.79
Total Income	465.5	540.9	635.3	785.1	858.9
Total Expenses	318.6	364.6	438.6	468.7	483.8
Operating Profit	146.9	176.3	196.7	316.4	375.1
Net Profit	69.7	85.3	94.2	143.6	170.8
No. of Branches	12	13	14	14	16
No. of Staff	188	217	239	250	257

Source: *Annual Report of Everest Bank Limited*

4.4 Deposit and Lending Scenario of EBL

In the history of EBL, there was a drastic change in the financial position of the bank in the year 2004/05 mainly in case of lending and deposit.

Table: 4.9

Total Deposit and Lending

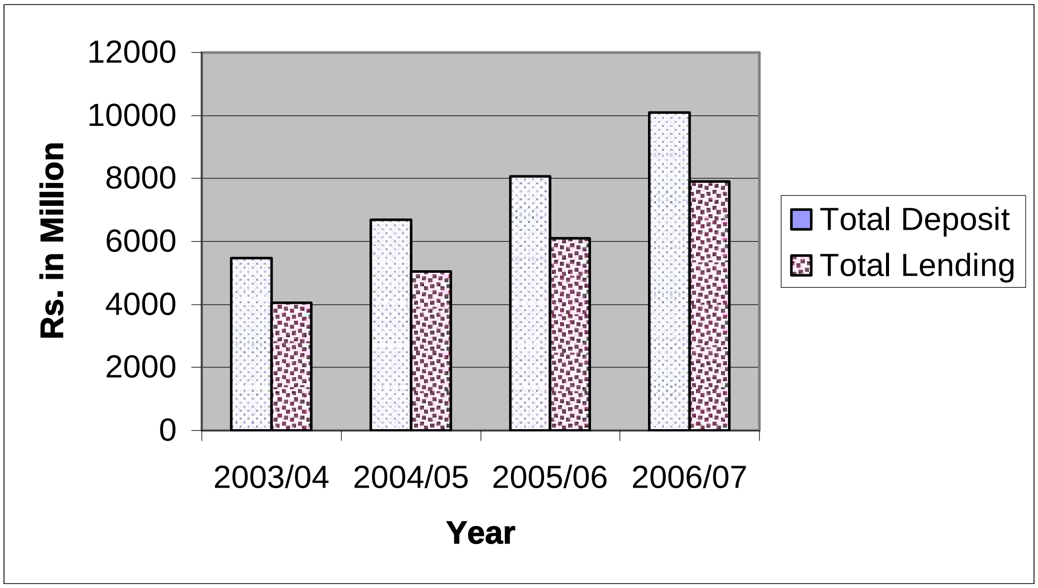
(NRs. in million)

Particulars	Financial Year				Percentage Change		
	2003/04	2004/05	2005/06	2006/07	2004/05	2005/06	2006/07
Total Deposit	5466.61	6694.96	8063.90	10097.69	22.47%	20.45%	25.22%
Total Lending	4044.23	5049.58	6095.84	7900.00	24.86%	20.72%	29.60%

Source: Annual Report of EBL

Figure: 4.7

Lending and Deposit



The above figure shows that in both the cases of deposit and lending, EBL has far exceeded the overall growth in the banking sector. Bank's deposits increased by 25.22 % to NPR 10097.67 million compared to previous fiscal year. On the lending side, the bank's total loans increased by 29.6% to NPR 7900 million

4.5 Sectoral Credit Mix

EBL has been providing different types of credit facilities to the customers. While disbursing loan it should consider directives issued by NRB and bank's own credit policy. Concentration of credit in particular sector must be avoided to minimize risk. Sectored credit mix i.e. sector wise detail of loan and advances of EBL are tabulated as under.

Table: 4.10

Sectored Credit Mix for FY 2006/07

(NRs. in million)

Investment sectors	Amount	Percentage (%)
Agriculture	30.1	0.38
Mining	4.0	0.05
Manufacturing	2249.7	28.47
Construction	1098.0	13.89
Metal Products, Machinery and Electronics Tools & Fittings	27.5	0.34
Transportation Equipment Production & Fitting	89.6	1.13
Transportation, Communications & Public Services	764.0	9.67
Wholesalers and Retailers	2120.9	26.84
Finance, Insurance and Fixed Assets	213.3	2.69
Service Industries	525.2	6.64
Consumable Loan	115.8	1.46
Others	662.2	8.38
Total	**7900.1**	**100**

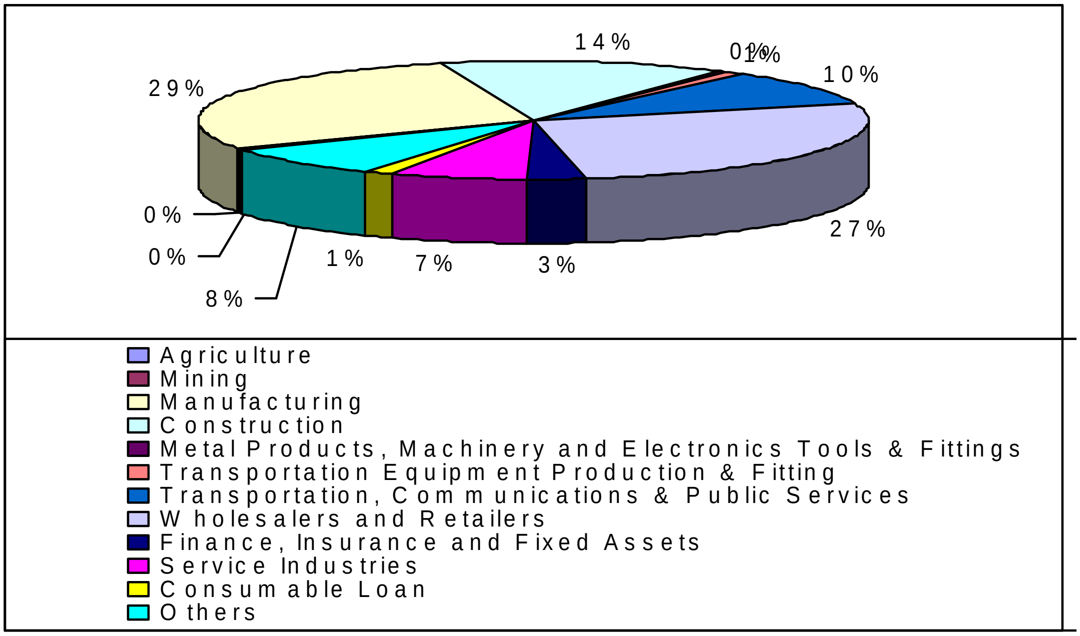
Source: Annual Report of EBL

The table 4.10 depicts that out of total credit of NPR 7900.1, 0.38% and 0.05% has been disbursed for agriculture and mining respectively. Next manufacturing constituting largest amount i.e. 28.47% of total loan portfolio compared to other sectors amounting to NPR 2249.7 million. Whereas Construction, Metal products machinery and electronics equipment and Transportation equipment Production & Fittings holds 13.89%, 0.34%, 1.13% respectively. 26.84% i.e. NPR 2120.9 million of the total credit has been allocated in Wholesalers and Retailers.

Similarly 2.69% i.e. NPR 213.3 million, 6.64% i.e. NPR 525.2 and 1.46% i.e. NPR 115.8 are allocated to Finance, Insurance and Fixed Assets, Service industries and Consumable loans. And 8.38% are allocated to Other Loans. Sectored credit mix for the year 2006/07 has been presented in a pie- chart as under:

Figure: 4.8

Sectored Credit Mix for FY 2006/07



The figure 4.8 clearly shows the loan composition for the year 2006/07. From the total loan portfolio agriculture, mining, manufacturing, construction, metal products machinery and electronics equipment and production and assemble of transportation equipment, transportation, communication and public services, wholesalers and retailers, finance, insurance and fixed assets, service industries, consumable loan and other loans constitutes 0.38%, 0.05%, 28.47%, 13.89%, 0.34%, 1.13%, 9.67%, 26.84%, 2.69% and 6.64%, respectively.

4.6 Non-Performing Loans of EBL

Loans that are 90 days (180 days for consumer loan) past due or more are described as non-performing loans by banks and bank examiners. No accrual loans are loans switched to a cash basis – unless payments are received before they are not recorded. Bank regulators usually allow a 29 days grace period before a loan is required to be classified as a past due.

Asset quality is a major – risk factor of great concern to banks, bank investors and bank regulators. In recent years, non-performing loans have become an increasing important when evaluating assets quality.

The assets quality rating is based on the examiner's classification of assets – substandard, doubtful and bad. Weights of 25%, 50% and 100% are applied to those classes, respectively. This weighted amount is compared to the sum of banks loan – loss reserve and equity capital to determine the bank's ability to absorb potential losses related to the adversely classified assets. CAMEL rating and rupees amount of banks classified assets are considered confidential information by the banking agencies.

The following table shows the loans and advances including bills purchased and discounted allocated as performing and non-performing loans:

Table: 4.11

Performing and Non-Performing Loans

(NRs. in million)

Particular	2002/03		2003/04		2004/05		2005/06		2006/07	
	Amount	%	Amount	%	Amount	%	Amoun	%	Amount	%
a) Performing loan	3334.59	3204.27	1.04	3334.59	3204.27	1.04	7771.28	98.3	8913.5	98.7
i) Good	5049.85	4874.79	1.04	5049.85	4874.79	1.04	*7771.28*	*98.3*	*8913.5*	*98.7*
b) Non performing	6359.66	6063.87	1.05	6359.66	6063.87	1.05	128.81	1.7	112.6	1.3
i) Substandard	9473.3	6011.4	1.57	9473.3	6011.4	1.57	*4.41*	*0.06*	*3.22*	*0.03*
ii) Doubtful	11638.8	7577.5	1.53	11638.8	7577.5	1.53	*1.98*	*0.03*	*2.18*	*0.03*
iii) Bad	*13.33*	*0.33*	*31.18*	*0.62*	*53.18*	*0.87*	*122.42*	*1.54*	*107.2*	*1.24*
Total	4044.23	100	5049.58	100	6095.84	100	7900.09	100	9026.1	100

Source: Annual Report of EBL

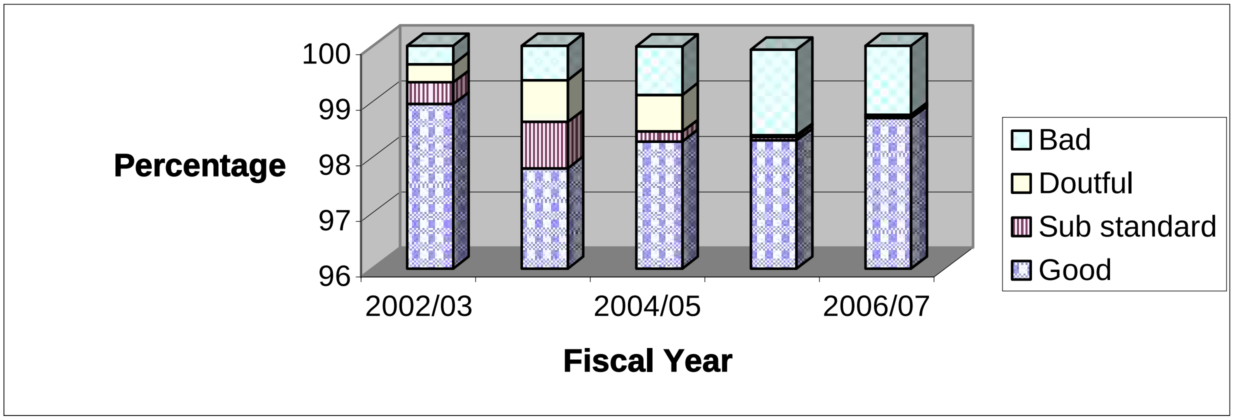
Above table gives insight on total lending including bills purchased and discounted bills advanced in different sectors that have been categorized in four classification. It can be observed that Good loan has increased to NRs 8913.5 million in FY 2006/07 from NRs 7771.28 million of last year.

There are three categories under non- performing loan as sited in the table. Sub-standard loan has declined from NPR 11.08 million to NPR 4.41 million in 2005/06. Doubtful loan has also decreased to NPR 1.98 million from NPR 40.49

million in 2004/05. Whereas Bad loan is in increasing trend in 2005/06, i.e. NPR 122.42 million as compared to NPR 53.18 million in the year 2003/04.

In FY 2005/06 there is increase in Good loan (performing assets) by NPR 1780.2 million and decline in sub-standard loan and doubtful loan by NPR 6.67 million and NPR 38.51 million respectively as compared to FY 2004/05 which can be interpreted as a positive sign. However Bad loan has increased by NPR 69.24 million. Therefore Bank must focus and concentrate in reducing such bad loan. The total amount loaned, categorized as performing and non-performing, can be shown in the following figure:

Figure: 4.9
Performing and Non Performing Loan of EBL



4.6.1 Loan Loss Provisions

EBL has maintained the following amounts of loan loss provision against its loans and advances.

Table: 4.12
Loan Loss Provisions

(NRs in million)

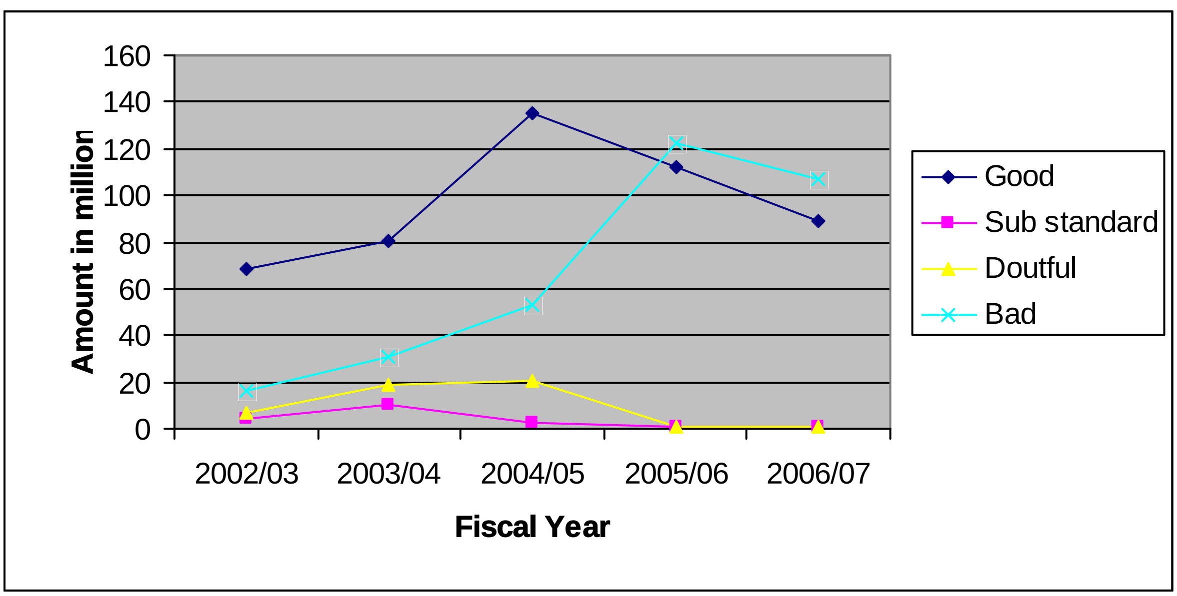
Loan Loss Provision	2002/03		2003/04		2004/05		2005/06		2006/07	
	Amount	**% against loan**	**Amount**	**% against loan**	**Amount**	**% against loan**	**Amount**	**% against loan**	**Amount**	**% against loan**
Good	68.66	1.72	80.42	1.63	135.52	2.26	112.26	1.44	89.13	0.99
Substandard	3.93	25	10.49	25	2.77	25	1.10	25	0.80	25
Doubtful	6.66	50	19.03	50	20.25	50.01	0.99	50	1.09	50.0
Bad	16.50	123	31.18	100	53.18	100	122.42	100	107.2	100
Total	**95.75**		**141.12**		**211.72**		**236.77**		**198.22**	

Source: Annual Reports of EBL

Loan Loss Provision is made on the basis of classification of Loans and advances in accordance with the directives issued by the Nepal Rastra Bank. The provisions appear to be adequate as per the Central Bank directives.

The trend of loan loss provision can be shown in the following figure:

Figure: 4.10
Loan Loss Provision



4.6.2 Loan Loss Coverage Ratio

There are two types of loan good and bad. Good loan is the one, where the borrowers pay back the amount within stipulated time. Bad loan are such where debtors do not pay back the loan amount within time limit. Bank has to make certain kind of provision in order to safeguard from the solvency of bankrupt of the bank

This type of ratio is calculated in order to ascertain the percent of total lending and loan loss provision maintained by the bank. Every commercial bank has to maintain loan loss provision as per the instruction of NRB. Such provision is maintained with the objective of bank's own safety and security. Since bank's fund is tied up in loan loss provision bank must attempt to minimize proportion of loan loss provision to total lending credit investment.

Mathematically:

$$\text{Provision to total lending } X \frac{\text{Total Loan Loss Provision}}{\text{Total Lending}}$$

The proportion of loan loss coverage ratio has been tabulated as under:

Table: 4.13

Loan Loss Coverage Ratio

(NRs. in million)

Fiscal Year	Total Lending	Loan Loss Provision	Provision to Total Lending (%)
2002/2003	3334.59	3204.27	2.08
2003/2004	5049.85	4874.79	2.37
2004/2005	6359.66	6063.87	2.79
2005/2006	9473.3	6011.4	3.63
2005/2007	11638.8	7577.5	3.55

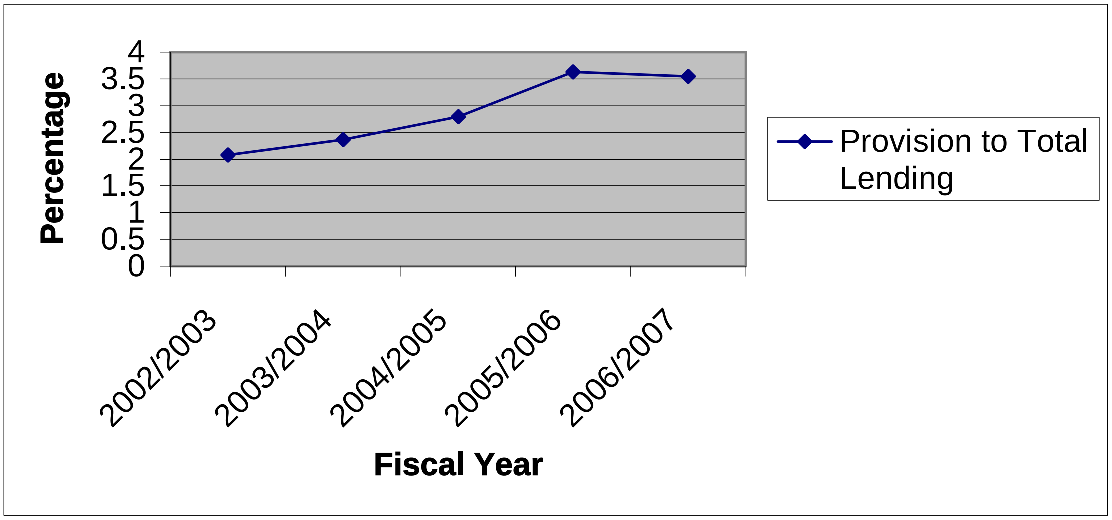
Source: Annual Report of EBL

The sited table shows percent of loan loss provision to the total lending.

Trend analysis of loan provision set aside out of total lending has been presented in the following graph.

Figure: 4.11

Trend Analysis of Loan Loss Coverage Ratio



The figure shows that percent of loan loss coverage in FY 2002/2003, 2.08% of the total lending was set aside as loan loss provision. From FY 2003/04 to FY 2006/07 ratio of loan loss coverage increased to 2.37%, 2.79%, 3.63% & 3.55% respectively.

The figure shows that percent of loan loss coverage was high in the year 2006/07 by 3.87%, which is favorable for the bank. Thus, provision for possible loan losses appears to be adequate.

4.7 Method and Mechanism for Loan Approval

Loan/project appraisal refers to the critical evaluation of the project in lights of various types of risks and returns. Thus, EBL doesn't lend to anyone who is in need of money. A prudent banker denies giving or extending credit facilities unless he is convinced that the project is viable i.e. the loan amount is repaid along with interest from the proceeds of project. The primary considerations for EBL to sanction the loan amount are as follows:

- **Technical Appraisal:**

  Under technical appraisal, assessment of the various requirements for the production process together with their quality and availability are made. Various factors like location, legal aspects, and technology for production, plant and equipment efficiency for the project are cautiously analyzed.

- **Commercial Appraisal:**

  It focuses on the position of repayment of debt along with interest, if the product cannot be sold at the estimated price. Hence, the bank considers nature of products, style; perish ability, quality, company sales methods, distribution pattern, promotional activities, competitive advantage, government regulations and economic conditions. Moreover the bank also considers quality and types of customers, aging schedule, credit terms and policies. Thus, the bank examines commercial viability of the product.

- **Managerial Appraisal:**

  The quality and integrity of management plays a deciding role to forge ahead of competitors and to ensure repayment of the loan. The bank evaluates management on the basis of quality, performance, philosophy and capability and decided to lend it is satisfied.

- **Financial Appraisal:**

  Financial appraisal is related to cost benefit analysis because only paying concern can repay the loan. Bank makes financial analysis based on projected data such as cost of the project and production, earnings, benefits, cash flow statement and Performa balance sheet.

4.7.1 Lending Documentation

Lending process will not be carried on until the borrower submits necessary documents to the bank. The need of documents depends on the nature of loan and type of borrower. Documents should be recognized under the prevailing law and rules. Common documents are listed below:

1. Request letter:

This is the letter prepared by the borrower for requesting the amount of loan to be sanctioned as per their requirement. They make a proposal to the bank for acquiring loan for their business or other personal purpose. After this letter is received the bank forwards its activities toward the valued clients.

2. Security Documentation:

Bank undertakes certain steps to secure the credit. One of the major actions involved is obtaining tangible collateral such as land, building, and machinery. The credit department ensures that the security terms of credit are executed prior disbursement of approved credit facilities. Different types of facilities obtained by the bank are:

- **Mortgage deed/title deed documents:** The value of fixed assets such as land, building, plant and machineries are commonly called as collateral or mortgage. Official valuators estimate these properties. It is prepared as a valuation report consisting of market and distress value and given to the bank. The ownership of mortgage or particular assets, which is called as title deed also, should be submitted to the bank.
- **Guarantee:** Guarantee is an obligation to pay when the initial borrower refuses or is unable to meet the debt. Bank requires guarantee form reputed person/firm or company to take guarantee to pay the required amount in case of borrower's default. There are three forms of guarantee:
  - Personal guarantee
  - Cross guarantee
  - Corporate guarantee
- **Hypothecation and pledge**: Hypothecation is a general charge over the assets for debt where neither ownership nor possession is passed to the banker. The bank requires documents as hypothecation of stocks, equipments, machinery, and assignment of receivables. Pledge is the bailment of the property as security for payment of debt. Pledged property is in possession of bank.

3. Firm/company registration: Sole trading, partnership or joint stock company must submit registration certificate issued by Company Registrar to the bank. An institution should mention the name of the firm, location, capital, etc.

4. Income tax registration certificate: An individual or an institution or a firm must routinely clear the income tax imposed by the government. The Xerox copy of such certificate should be submitted to the bank.

5. Memorandum of association: a public company must submit memorandum of association to the bank, which includes capital structure i.e. authorized capital, issued capital, paid-up capital, subscribed capital, organizational structure, name of Board of Directors and authorized persons.

6. Article of association: Article of association is another important document to be submitted by a corporate borrower, which contains overall rules and regulations regarding transactions, authority and responsibility of board directors, important deeds and agreements etc.

7. Other documents: Some of the other documents to be obtained as per the nature of the client are as follows:

- Board/partnership resolution
- Credit Information Bureau (CIB) report
- Renewed registration certificate
- Valid tax clearance certificate
- Site visit report of the properties
- Family consent of all properties
- Insurance policy
- Copy of citizenship certificate
- Black list consent of the parties
- Family details of shareholders

4.7.2 Disbursement and Administration of Loan

Upon approval of credit facilities and the completion of documentation i.e. when all the collateral/security are obtained arrives to a phase of disbursement. Disbursement means actual releasing of cash i.e. agreed amount of loan or credit facility is allowed to the clients. Disbursement process involves:

- Satisfying with the documents i.e. all the required pre-conditions is met.
- Obtaining clearance or instructions of the concerned department i.e. clearance of legal cell and the instruction of the related loan officer.
- Obtaining related documents from the customer such that their operating account can be created.

- Since a tremendous amount of deterioration can take place in a short time, it is preferable to receive statements from firms on a quarterly basis by the loan officer.
- Creating of loan account and disbursement as per the terms agreed.
- The loan officer should verify timely that the borrower is not violating any requirements of the loan agreement. Breach of any terms and conditions will constitute default.
- Periodic review of loan document is necessary.
- Finally there is settlement i.e. every credit has a fixed maturity. If the loan is not repaid in time then the bank takes legal action against the borrower for disposal of securities to liquidate the loan.

Further after disbursement of funds the loan has to be continuously administered i.e. monitored for checking if it is compliance with the terms of approval. Administration of loan involves:

- Realizing principal and interest as and when it becomes due.
- Ensure submission of related documents by the obligor. Such documents may be the stock and debtor's statement, firm renewal certificate, tax renewal certificates etc.
- Conducting periodic site visits to see the funds are utilized for the purpose.
- Ensuring compliance with the credit terms by the obligor.
- Compliance to NRB issued guidelines and bank's credit policy.
- Assemble records and analyze the credit information in order to ascertain the degree of risk associated with the loan.

4.8 Loan Recovery Process

The loan arrangement is prepared with description lf the terms and conditions with recovery of the interest and the principal of the loan provided by the bank. The loan repayment process depends upon the bank's consideration, kind of credit facilities enjoyed by the concerned customer, nature of the business, etc. Loan deed is drafted after analyzing and evaluating different considerations. Condition and restrictions are prepared by mutual discussion and understanding between the bank and the borrower(s).

1. **Repayment of debt:** In each credit / loan facility, modalities for repayment are mentioned that is affected by nature of such facility. The bank basically uses the following methods and processes for recovering the debt.
   - **Installment Method:** Under this method, payment is received in the form of installment (principal + interest) as per pre-fixed schedule. The bank fixes the paying method, both the interest and principal together, or fixing the interest up to the date of installment recovered. The bank may recover interest separately. In paying such installment, a bank may go on the basic conditions written in loan deed, which is made by the mutual understanding between bank and debtors.
   - **Lump Sum Payment Methods: I**t is traditional method to recover loan from the debtor. Under this method, the bank recovers lump sum amount of interest and principal summing up interest up to the date on which a debtor has come to pay loan. In alternative, interest can be paid on monthly, tri-monthly and quarterly basis and principal is paid at any time before expiry of the facility. This method is appropriate for short-term loan such as overdraft.
2. **Payment of interest:** Bank sets the interest rate and the interest payment date in the loan deed and the debtor should pay accordingly. Interest is paid at the given frequency that can be annually, semi-annually, tri-monthly etc. depending upon their understanding.
3. **Monitoring loan:** A post assessment of the loan is equally important in bank and it is considered as one of the major task of the credit service department. This department is responsible to supervise and maintain close contact with the borrower and follow up his financial activities. Loan is monitored regularly with the objective to secure repayment through the transaction being financed rather than through forced sale of mortgaged properly and resorting to legal proceedings.

4. **Handover of securities:** If the borrowers fulfill all their responsibilities and pay the interest and principal in the time fixed, at the expiry of loan period the bank must return the mortgaged property will be released. If bank has taken securities from the third party in the form of guarantee, the third party will be discharged from such liability. The guarantee documents will become void. Thus, the bank should handover the security to the debtor and the surety after the loan is recovered.
5. **File management:** All the vital information regarding credit should be properly filed in their respective case file. It aids in monitoring and reviewing stats of the borrower. It is useful for future reverences as well.

4.8.1 Process of Recovering the Expired / Problematic Loan

Non-repayment of any installment or interest or principal on due time to the bank, leaves no option than exercising legal action. This is because bank and its customers share a contractual relationship. Non-fulfillment of any terms and conditions mentioned in loan deed and the bank will not tolerate other relevant document and EBL undertakes the following process for loan recovery:

1. **Follow up:** Bank, as said earlier, is responsible to monitor loan repayment process periodically till owned loan is recovered with interest. If bank finds non-payment of any due amount verbal request through telephone and personal visits are initiated. If still clients do not cooperate bank will formally write letters to remind to make payment. With the passage of time those reminder letters become more severe and strong. If the borrower then also does not show any interest in paying within maximum limit of 90 days (3 months) bank can default all the facilities provided to the concern clients.
2. **Call bank of the credit facilities:** Failure to make payment of installment after several requests is reported to the concerned bank management. Bank management can take decision to call back to credit facility. Concerned customer is informed about such decision as well. Customers might be provided with additional month to pay the accrued interest and due principal, depending on the customer's condition.

3. **Publish of 35 days notice:** Bank shall publish a 35days notice in any prominent daily newspaper of national level. Such publication informs the customer to settle the entire loan outstanding and due interest within 35 days, otherwise customer has to face the legal consequence.
4. **Blacklisting the customer:** Non-response from customer's side will then compel bank to black list the defaulter. In case customer is a firm or and corporate body, their shareholders and the sister concerns are as well blacklisted. Bank needs to inform such course of action to Credit Bureau of Nepal Rastra Bank, unless loan is fully paid the blacklisted customers cannot obtain new loan from any other commercial banks.
5. **Publish of 15 days auction notice:** Obligor if still does not respond to nay of above actions, bank will publish a 15 days auction notice informing he general public to participate in auction. Interested person(s) can bid the auction on the appointed date. Auction notice may be published 3 times in case nobody come bid the auction. Bank usually encourages customers to sale the mortgaged property themselves, In such case customers can have control over the price and even save some portion for themselves after settling due amount
6. **Take over of Property in bank's favor:** If the bank fails to recover the outstanding balance of the bad customers despite of above-mentioned legal process, ownership of the mortgaged property is transferred in the name of bank at the Land Revenue Office (LRO). This property is shown as **non-banking assets** in the balance sheet. Then it becomes bank's responsibility to sell of the mortgaged property within 7 years.
7. **Authority over the borrower's other property:** Some times mortgaged property alone cannot recover the debt. This may be result of depreciation factor and decline in real estate prices prevailing in that particular locality. In the second comes, realizing deficit amount from guarantee. Bank accepts guarantee from reputed, well established and reliable corporate bodies and persons. Bank guarantee is considered the best. Bank can still dace deficit. In such situation bank can claim shortfall from the other personal property of borrower. For hiss, bank can register the case against the borrower before court issues stay order in his favor. Before moving to litigation process, bank must be aware of the existing properties of the borrower.

4.9 Risk Assessment

Meaning of risk:

Risk is defined in Webster's as "a hazard; a peril; exposure to loss or injury. Thus, risk refers to the chance that some unfavorable event may occur. No investment will be undertaken unless the expected rate of return is high enough to compensate the investor for the perceived risk of investment.

Bank invests much of their funds in assets that are subject to change in value due to changing market conditions or credit quality of such assets. Risk represents uncertainty that the assets will earn an expected rate of return or that a loss may occur. In other words, it is borrower's inability to payback the facility extended.

4.9.1 Credit Risk

This study is mainly focused on credit management of the bank thus credit risk is explained in brief:

Credit risk is the risk of non-repayment of loan. It is that risk in which a borrower will not settle its obligations in accordance with agreed terms. "Credit risk is the risk of loss that may occur from the failure of any party to abide by the terms and conditions of any financial contract with the bank, principally the failure to make required payments on loans due to the bank."

Factors Affecting Credit Risk

There are mainly two factors that affect credit risk i.e. internal and external factors:

Internal factors:

Lack of transparency in financial statement of borrower

Excessive importance in mortgage lending against land and building

Dearth of efficient human resources

Lack of internal credit rating system and risk base pricing

Name lending

Inadequate financial analysis of borrower while lending

Lack of detailed credit policy of the bank

External influences from high-ranking officials while sanction or recovery

Multiple banking arrangements on current assets of borrower

Non-application of sophisticated credit risk model

Increase in interest arrears

Others

External factors:

- Political instability
- Economic environment
- Fluctuation of market interest rate
- Fluctuation of foreign exchange rate
- Fluctuation of commodity price
- Absence of credit rating agency
- Inefficiency of Credit Information Bureau
- No mechanism for submission of transparent and accurate financials.
- Inefficiency of Company Registrar Office
- Lack of adequate legal framework

4.9.2 Credit Risk Analysis of EBL

There are four major types of risk that fall under credit risk:

1. Business risk
2. Management risk
3. Security risk
4. Financial risk

1. Business risk:

The factors that affect the business risk and are analyzed by the bank are as follows:

- Supply risk
- Demand risk
- Competition
- Production risk
- Business environment

- Economic downturn
- Tariff changes
- Technology change

2. Management risk:

Management risk analyses the following factors:

- Labor dispute
- Fraud
- Change of ownership
- Management incompetence
- Succession risk
- Management change

3. Security risk:

Under security risk following factors are included:

- Liquidation risk
- Security document lost
- Security document not completed correctly
- Fraudulent valuation

4. Financial risk:

Financial risk undertakes the following factors in analyzing the risk:

- Increased interest rate
- Transaction risk
- Collection risk
- Repayment risk
- Decreasing profit margin
- Declining sales
- Cost overruns

- Obsolescence of inventory

4.9.3 Risk Mitigation

Risk is inevitable in all enterprises, organizations or companies. It arises both from change and human shortcoming so avoiding risk is not an option but should be managed and handled carefully. Risk can be mitigated by the bank using:

Frequent monitoring

Prompt action on early warning signals

Effective problem loan management

Deal with borrowers who meet the target market criteria

Monitor industry condition

Insurance assigned to bank

Professional valuation of security

4.10 SWOT Analysis

The success of the organization significantly depends upon the internal environment of the organization. The future course of action depends upon various tools such as SWOT analysis, which can be used to find out the internal and external changes in the environment.

S stands for Strength

W stands for Weakness

O stands for Opportunity

T stands for Threats

Strengths and weakness are internal factors i.e. they are internal attributes of the company itself.

STRENGTHS:-

EBL has a good overall reputation.

EBL has maintained a sound and healthy relationship with the existing clients.

Bank has been continuously trying to explore different possibilities to develop the activities of the bank.

EBL has been trying to strengthen its financial condition to face the challenges and competition.

Bank has been improving and getting advanced in the technologies.

Bank has been able to provide credit facility to various clients, which led to improvement in credit situation.

Bank has also gained position in recovering possible amount at the time of lending.

Due to quality service provided, there have been an increasing number of depositors, which is a great source of income to the bank.

Bank has implemented various innovative programs like career development and training of the employees.

Bank has adequately maintained the liquidity position as per Nepal Rastra Bank directives.

Bank has been working with specialist technology and marketing expertise.

WEAKNESS:-

Bank has not been able to open more branches throughout the country.

The customers demand for more services and facilities, which the bank may not be able to meet.

The ATM machines are still not accessible to customers.

Opportunities and threats are external factors, which can affect the company positively or negatively.

OPPORTUNITIES:-

There is an opportunity to improve in terms of saving mobilization and deposit schemes.

EBL could take up the advantage of weak and ineffective competitors and try to capture and get hold of the market before they do. This would help bank to establish the market and maintain the market share.

Bank in the name of its goodwill can stand ahead in the market leaving others behind by launching newer schemes.

Bank can concentrate more on credit control and credit investment.

EBL can always have a strategic planning to adopt the changes in the market.

There is possibility for bank to enter a new market segment through proper marketing mix by launching Visa debit card and credit card system.

There is chance of high progress and prosperity where competitors are slow in adopting new technology.

Mergers, joint ventures or strategic alliances could be one of the opportunities for the bank.

THREATS:-

The biggest threat for banks and other financial institution is competition, which is ever increasing.

Political instability in the country, which has hampered strongly in the economic condition resulting in poor banking transaction.

Due to cutthroat competition, clients would have more bargaining power.

Change in needs, tastes and preferences of customers can be one of the highest threats.

Abrupt changes in Central Bank directives related to provision might be an immediate threat to the bank.

Economic recession or depression also influences the banking sector due to fluctuation.

Increment in tariff is also a huge threat for banking sectors.

Competitors can have better access to channels of distribution, which the bank may not reach.

Competitors of the bank may have or use better technology to gain the top position.

4.11 Major Findings of the Study

Major findings of the study of credit management analysis of EBL are forwarded as follows:

- Total credit of FY 2005/06 and FY 2006/07 has been divided into performing and non-performing assets. Increment in performing assets by NPR 1780.2 million and decline in sub-standard loan and doubtful loan by NPR 6.67 million and NPR 38.51 million respectively as compared to FY 2005/06 which can be interpreted as a positive sign. However Bad loan has increased by NPR 69.24 million. Therefore Bank must focus and concentrate in reducing such bad loan**.**
- Trend of loan loss coverage ratio i.e. loan loss provision to total lending has increased from 2.08% to 3.87% from FY 2002/03 to FY 2006/07 which cannot be regarded as a positive sign.
- Liquidity of EBL is not adequate. It is unable to maintain its liquidity position at standard level as the current ratio in last two years is below the required standard level i.e. 2:1.
- Debt equity ratio of EBL shows that it is moving towards higher trend, which indicates owners are investing less resource of their own. This reveals danger to the creditors, as during period of low profit, a highly debt-financed company cannot even pay the interest of creditors.
- 8) Return on equity of EBL is the highest in the year 2006/07 i.e. 22.1 which means the effectiveness of the bank and also depicts that bank has been successful in mobilizing its owner's fund in an efficient manner.
- EBL has experienced increment in credit position. In FY 2003/04, the annual growth rate is increased by 34.55% in following year, but in FY 2004/05, FY 2005/06 & FY 2006/07 the lending position grew by 24.86%, 20.72% & 29.60% respectively at a diminishing rate.
- EBL credit deposit ratio shows improving bank's performance. It shows that the bank has been utilizing most of its deposits in advancing loans as the credit and

deposit amount has increased to NPR 7900 million and NPR 10097.7 million in FY 2006/07 respectively.

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- EBL credit deposit ratio shows improving bank's performance. It shows that the bank has been utilizing most of its deposits in advancing loans as the credit and deposit amount has increased to NPR 7900 million and NPR 10097.7 million in FY 2006/07 respectively.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

This study has been prepared by personally indulging in the daily working of the bank. This study is conducted to obtain overall view of credit management and analysis of the Bank. It familiarizes EBL’s functions at the corporate level as well as in branch level along with the credit policies, procedures, appraisals and credit analysis including practical observations pertaining to the bank. Credit is regarded as the most income generating assets especially in commercial banks. Credit is regarded as the heart of the commercial banks in the sense that; it occupies large volume of transaction; it covers the main part of investment; the most of the investment activities based on credit; it is the main factor for crating profitability; it is the main source of creating profitability; it determines the profitability. It affects the overall economy of the country. In today's context, it also affects on national economy to some extent. If the bank provides credit to retailer, it will make the customer statue. Similarly, it provides to trader & industry, the government will get tax from them and help to increase national economy. It is the security against wealth maximization derivative. However, other factors can also affect profitability and wealth maximization but the most effective factor is regarded as credit. It is the most challenging job because it is backbone in commercial banks. Thus, effective management of credit should seriously be considered. This study has been prepared by personally indulging in the daily working of the bank. This study is conducted to obtain overall view of Credit Management and Analysis of the Bank. It familiarizes EBL’s functions at the corporate level as well as in branch level along with the credit policies, procedures, appraisals and credit analysis including practical observations pertaining to the bank.

Liquidity of EBL is not adequate. It is unable to maintain its liquidity position at standard level as the current ratio in last two years is below the required standard level i.e. 2:1. Debt equity ratio of EBL shows that it is moving towards higher trend, which indicates owners are investing less resource of their own. This reveals danger to the creditors, as during period of low profit, a highly debt-financed company cannot even pay the interest of creditors.

Return on equity of EBL is highest in the year 2004/05 i.e. 22.1 which means the effectiveness of the bank and also depicts that bank has been successful in mobilizing its owner's fund in an efficient manner.

EBL has experienced increment in credit position. In FY 2003/04, the annual growth rate is increased by 34.55% in following year, but in FY 2002/03, FY 2003/04 and FY 2004/05 the lending position grew by 24.86%, 20.72% & 29.60% respectively at a diminishing rate. EBL credit deposit ratio shows in bank's performance as there is increasing trend. It shows that the bank has been utilizing most of its deposits in advancing loans as the credit and deposit amount has increased to NPR 7900 million and NPR 10097.7 million in FY 2004/05 respectively.

Profits must be earned to sustain the operations of the business, to be able to obtain funds from investors for expansion and growth, to cover the expenses incurred and to contribute towards social overheads for the welfare of the society. Net profit earned from the loan and advances shows favorable condition due to its positive attitude of growth rate except there was a slight decrease in the FY 2002/03 to 1.87 but it again rises to 2.36 in the year 2003/04. EBL grants credit facilities against movable and immovable collateral, guarantees, fixed deposit receipts, export documents, bonds. There is an increment in the loan comparatively by NPR 1804.26 million for the year 2003/04 to 2004/05.

Credit operation in EBL basically covers loan approval process, credit analysis, method and mechanism, lending documentation, disbursement and administration of loan including credit audit. As there is a saying “Precaution is better than cure” bank should be more analytical and farsighted while disbursing loan in order to prevent loan flow in unproductive sector and non-performing assets

EBL has adopted flexible credit policy. It has basic guidelines regarding credit disbursement and administration. It revises and updates its credit policy to maintain compatible with nation’s economic policy and NRB directives.

Detailed approval process is conducted to ensure secure loan flow by analyzing the 7C’s and methods and mechanisms. The required lending documentation is thoroughly analyzed and reviewed in EBL depending upon nature of loan.

Total credit of FY 2003/04 and FY 2004/05 has been divided into performing and non-performing assets. Increment in performing assets is NPR 1780.2 million and decline in sub-standard loan and doubtful loan by NPR 6.67 million and NPR 38.51 million respectively as compared to FY 2003/04 which can be interpreted as a positive sign. However bad loan has increased by NPR 69.24 million. Therefore Bank must focus and concentrate in reducing such bad loan.

Trend of loan loss coverage ratio i.e. loan loss provision to total lending has increased from 2.08% to 3.87% from FY 2002/03 to FY 2006/07 which cannot be regarded as a positive sign.

5.2 Conclusion

After conducting detailed loan approval process and satisfying with lending documentation especially concerning security and financials, loan is disbursed. Continuous loan administration and credit audit are conducted to confirm customer’s compliance to credit condition. The characteristics of good collateral are also considered by the bank to overcome any default loan. Credit risk that arises depending upon nature and type of loan are also handled and managed carefully. Credit management is a major function of any commercial bank. Recent economic downturn, recession in industrial and trading activities and stiff competition in banking industry have resulted in deteriorating investment opportunities and increase in risk in loans and advances.

EBL is one of the leading banks among 25 commercial banks established, which has been conferred the NICCI Excellence Award during the 9th, 10th and 11th Annual General Meeting of Nepal India Chamber of Commerce & Industry (NICCI). Significant portion covering 118.2% increment in credit disbursement in various sector contributed in income of EBL in the year 2004/05. Thus, credit management became major concern for bank's income.

Appropriate credit policy has been formulated considering country's economic policy, NRB directives and banks own objectives and rules. EBL has followed stepwise loan approval process initiating with submission of loan application form led by direct interview, field visit and loan appraisal. Proper lending document inclusive of security documentation, borrower's citizenship certificate, income tax registration certificate etc depending upon the nature of borrower are demanded to secure the credit and attain legal validity.

Upon approval of credit and lending documentation, actual disbursement takes place. The bank has experienced total loan growing at diminishing rate. The credit growth rate reached 29.6% in FY 2004/05. Nonetheless, credit deposit ratio over the study period has been recorded in excess of 74.74% on average that can be considered sufficient from profitability aspect.

Credit department continuously administer the loan and maintains contact with the borrower to ensure credit terms have been complied. As per NRB directives, EBL has to classify loan into 4 categories namely standard, sub-standard, doubtful and bad loan and has to maintain adequate loan loss provision of 1%, 25%, 50% and 100% respectively. EBL has been offering variety of credit facilities such as agriculture, mining, manufacturing, construction, metal products machinery and electronics equipment, production and assemble of transportation equipment, wholesalers and retailers, finance, insurance and real estate, service industries and other loans. It has been introducing new credit facilities such as loan against gold and silver as per market demand.

EBL accepts various collateral/ securities before sanctioning the loan amount considering its durability, reliability, marketability and stability of value so that the bank becomes able to recover the principal and interest of loan.

EBL, before granting credit facility to any of the clients verifies the financial position. The bank calculates various ratios such as profitability, liquidity and debt-equity ratio in order to be secured of the client financial status and their repayment capacity.

Despite fragile law and order situation especially during last 2-3 years, the Bank has doubled its deposits, advances as profits during the period. Its operating profit have grown by 55% during the financial year 2004/05, the net profit has increased by 52%. On the other hand, credit deposit ratio is in fluctuating trend. It also depicts that the bank has been able to mobilize its deposit efficiently in the year 2004/2005 as the ratio of that year is higher as compared to others i.e.78.23%. Thus, most of the deposits collected are deployed as loans and advances and remaining amount for investment in securities and purchase of assets.

EBL has been advancing different types of credit facilities to the customers. In last five years i.e. from FY 2002/03 to FY 2006/07, the figure reveals that bank has deployed into numerous sectors which has risen over the years. In conclusion, we can say that the bank has been able to mobilize their deposits accumulated efficiently in various sectors that help them generate income as interest. As for classification of loan the bank has maintained its standard, sub-standard and doubtful level as per NRB directives but bad loan has extremely increased by NPR 122.42 million, therefore Bank must focus and concentrate in reducing such bad loan. The good quality and correct features of security that bank undertakes should be greatly valuable, durable, marketable and reliable. The proportion of collateral has increased by NPR 1804.26 million in comparison to previous FY 2003/04.

As for net profit to loan and advances ratio, the figures explain consistent behavior of the bank except decrease in FY 2002/03 by 1.87%, but increased in 2005/06 and 2006/07. Therefore the trend shows that there is quite an amount of profit earned through deploying it into various productive sectors. Bank has been able to maintain the provision of total lending to quite a reasonable ratio. The bank has maintained adequate provision for loan loss which is favorable for the bank. During five fiscal years the bank's current ratio is below 2:1 which may be interpreted to be insufficiently liquid as it represents the margin of safety to the creditors. During five fiscal years debt equity ratio show steady rise and fall in the bank's financial performance. Profitability trend is not steady; the ratio is in a fluctuating situation.

Finally, this report has been prepared by personally indulging in the daily working of the bank. It familiarizes EBL's functions at the corporate level as well as in branch level, along with the credit policies procedures, appraisals and credit analysis including practical observations pertaining to the bank.

5.3 Recommendations

The study on credit operation of EBL has revealed various credit performance and functional aspects of bank. The following recommendations can be used to improve and promote positive image of the bank:

- EBL should formulate different plans and policies to retain its present customers and to attract new and potential customers.
- EBL has been serving its customers by introducing various types of loans and deposit schemes. It should introduce further innovative schemes which will help to satisfy its customers.

- EBL should continue to consider principles of good lending while formulating credit policy and revise and amend them as per Nepal Rastra Bank directives, bank's own policy and objectives.
- Bank should follow entrepreneur- friendly credit policy to tap new market segment consisting of the people with great entrepreneurship spirit and potential. Further credit decision of the bank should weigh viability of the project and credit worthiness to ensure recovery of the loan.
- Bank should make effort to increase total credit investment by adopting new credit facilities, restructuring existing facilities, charging competitive interest rate in loan.
- EBL also advances loan against gold, silver and other jewelries so it should continue in this matter since this provision can help increase potential customers.
- EBL should be confirmed about authenticity and legal validity of lending documentation to avoid fraud and misrepresentation.
- EBL should further increase its services and lending rates to priority and deprived sectors as well. Lending in such sectors increases the economic condition of the general public.
- The bank should protect and build up its deposit base so that it can withstand with major competition within commercial banks.
- EBL should adjust its interest rates so as to encourage saving and investment.
- EBL should widen its scope of investment. It should discover new and fresh areas of investment.

For the Borrowers:

- From the case study analysis the borrower has opted for NRs. 30 lacs which is not sufficient to cover the working capital requirement of NRs. 39.33 lacs. So, I believe the borrower should request for more loan amount as per the need making the proposal stronger.
- The credit period given by the bank is 1 year but subject to review and renewal for continuance. Looking at the financial structure like sales turnover and

profitability, it seems that the borrower can meet with the time period given to them.

- The financial ratios computed such as sales turnover, current ratio, net profit margin and debt-equity ratio shows satisfactory financial position of the enterprise. This analysis depicts that the borrower has the capacity to request such huge amount of loan to the bank.
- From the above risk analyzed, we can suggest that it can manage the risk of labor problem by hiring workers from different regions to reduce the problem of emerging union which is the utmost hindrance that any enterprises suffer.

For the Bank:

- The banking structure as read by me shows that the bank is rigid and conservative in nature and it should relax its lending policy and should opt for new ways of lending.
- As the client has good reputation and relation with the bank and their activity is importing of chemicals, bank can provide non-funded facility such as Letter of Credit and Bank Guarantee.

    - Letter of Credit, because, it is a letter by the bank on behalf of buyer in favor of seller. This could enhance confidence in the mind of both the buyer and seller as it guarantees payment.
    - Bank takes guarantee on behalf of its customer to the third party to make payment up to a specified amount. The third party feels assured that in case of default, bank will clear the due amount. The need of bank guarantee rises in business and naturally business customers enjoys this service.
    - After computing and analyzing financial ratios, it shows that the bank would be in safer side to advance the full requested amount as the financial condition of the borrower is in growing trend.

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