CHAPTER-I
INTRODUCTION

Nepal is among the world's 50 least developed countries (LDC's). Sluggish economic growth, a low level of industrialization, underdeveloped production structure with limited commodities to export, unbridled production growth, high concentration of labour force in agriculture etc are some of specific characteristics that indicates Nepal's undeveloped economic structure.

Nepal is an undeveloped country with per capita income of US $ 370 and with 31% of people is under poverty line. Many features are there for slow pace of the development such as land locked position, lack of vagaries and misuse of resources, poor economic policy and institutional weakness.

Capital accumulation plays an important role in accelerating the economic growth of a nation, which in terms is basically determined among others, by saving and investment propensities. But the capacity to save in the developing countries is quite low with a relatively higher marginal propensity of consumption. As a result, such countries are badly entrapped into the circle of poverty. So the basic problem for the developing country is raising the level of saving and thus investments.

1. Financial Service

Finance, the art and science of managing money, affects the lives of every aspect of every person and every organization. Finance is concerned with the process, institution market and instructions involved in the transfer of money among and between individuals, business and government. Financial market is the place where money lender and borrowers are busy to act and react. All the facilities that are provided by the financial market are financial services. Financial services cover all banking and non-banking institution. The establishment of Nepal Bank Limited (NBL) in 1937 marks the beginning of financial services in Nepal. This was followed by Nepal Rastra Bank (NRB) in 1986; Rastriya Banijya Bank (RBB) in 1986 and Agricultural Development Bank (ADB) in 1968. At present 574 branches of commercial bank, 58 Development banks, 12 Micro finance Development banks, 79 Finance Companies16 financial cooperatives, 47 Financial NGO's and 22 Insurance companies are working under the heading of financial institutions.(NRB Report, April 2008)

1.1. Banks

Bank is a financial institution that accepts deposits and invests the amount in the leading activities. It is a financial intermediary between depositors and entrepreneurs. Bank by accepting deposits, play a vital role of custodian. Bank plays a great role that it helps investors to invest in different sector by giving a loan. Bank are expected to support their local communities with an adequate supply of credit for all legitimate business and consumer financial needs to price that credit reasonably in line with competitively determined interest rates. How well a bank performs its lending function has a deal to do with the economic health of its region because bank loans support the growth of new business and jobs within the bank's trade territory and promote economic activities.

Moreover, bank loans often seem to convey the positive information to the market place about a borrower's credit quality, enabling a borrower to obtain more and for different purposes-from purchasing automobiles and buying new furniture, taking dream vacations or pursuing college educations to construct homes and office buildings.

1.2. Commercial Banks (CBs)

Financial intermediaries play significant role in the development of national economy. They influence savings and surpluses considerably which results investments. Financial intermediaries collect financial resources and supply them to the productive sectors that boosts the trade and industry and at last the development of the country's economy.

Commercial banks are also financial intermediaries. They mediate people who save money and who want to secure the use of money by accepting the deposits, borrowing funds and advancing loans. In addition to these primary functions, commercial banks collect cheques and bills, open letter of the credit, guarantee on behalf of customers, undertake capital and exchange foreign currencies etc. At present, there are 25 commercial banks.

1.3. Nepal Bank Limited (NBL)

NBL is oldest bank of the country which was established under the Nepal Bank Act (NBA) in 1937. It will not be an exaggeration to state here that banking culture in Nepal primarily began with the establishment of NBL. The bank started its activity with 12 employees from Kathmandu in 1938. Currently, the bank is providing its services through its more than 218 branches in 75 districts of Nepal where more than 2932 employees are employed in different post. Initially, it was established with an authorized capital of 10 million rupees and a paid up capital of 842 thousand rupees. But at present it has an authorized capital of more than 378 millions rupees and paid up capital of more than 377 million rupees.

Presently, 40.49% of its share is held by the government, 4.92% by 'A' class financial institutions, 3.42% by NRB licensed financial institution, 0.52% by other institution, 49.94% by General Public and 0.71% by others. "To remain the leading financial institution of the country" is vision statement of NBL.

1.4. Himalayan Bank Limited (HBL)

Himalayan Bank Limited was established in 1922 with an authorized capital of Rs 240 million by the distinguished business personalities of Nepal in partnership with Employees Provident Habib Bank Limited, one of the largest commercial bank of Pakistan. It is the first commercial bank of Nepal with maximum shareholding by the Nepalese private sector. Besides, commercial activities, the bank also offers industrial and merchant banking services. Its composition of the ownership capital is- 51% of share owned by Nepalese Promoters, 20% by Habib Bank Limited Pakistan, 14% by Employees Provident Fund and 15% by general Public.

The bank at present has five branches in Kathmandu Valley, namely Thamel, New Road, Maharajgung, Pulchowk (Patan) and Nagarkot. It's outside branches are in Birgunj, Bharatpur, Tadi , Bhairahawa and Nepalgunj. The bank is also operating a counter in the premises of Royal Palaces. The bank has a very aggressive plan of establishing more branches in different parts of the kingdom in the near future. Himalayan Bank's policy is to extend quality and personalized service to its customers as promptly as possible. All customers are treated with utmost courtesy as valued clients. The Bank as far as possible offers facilities to its clients based on the unique needs and requirements. To extend more efficient services to its customers, Himalayan Bank has been adopting innovative and latest banking technology. This has not only helped the bank to constantly improve its service level but is prepared for future adoption of new technology. It is committed to be a "Bank with differences".

1.5. Nepal State Bank of India (SBI) Bank Limited

SBI bank is a joint venture bank which was incorporated in1993and started its operation on 18th July 1993 under the technical service agreement with the State bank of India. Registered under the Company Act of Nepal, the bank has to operate as per the Nepal Rastra Bank (NRB) Act, Commercial

Bank Act, Foreign Exchange Act and the other current Nepalese Laws. The bank has similar objectives as other joint venture banks registered under the company Act on Nepal.

State Bank of India (SBI), holds 50% shareholding. The local promoters are Employees Provident Fund and Agricultural Development Bank /Nepal. The management team and the Managing Director who is also the CEO of the bank are deputed by SBI. SBI also provides management support as per the Technical Services Agreement. 50% of bank share, set up in 1933, is held by the State Bank of India, 15% by the Employees Provident Fund, 5% by the Agricultural Development Bank Nepal and 30% by the General Public. Nepal SBI bank's paid-up Capital is Rs 64.78 crore. The bank currently crossed the level of Rs1100 crore in Deposits, Rs1000 crore in Loans and Advances and Rs 361 crore in investments.

1.6. An Overview of Credit

Credit is the provision of resources (such as granting a loan) by one party to another party where that second party does not reimburse the first party immediately, thereby generating a debt, and instead arranges either to repay or return those resources(or materials) of equal value at a later date. The first party is called a Creditor, also known as a 'Lender', while the second party is called a Debtor, also known as a 'Borrower.'

Any movement of financial capital is normally quite dependent on credit, which in turn is dependent on the reputation or creditworthiness of the entity who takes the responsibility for the funds.

The term credit is used similarly in commercial trade, known as "Trade Credit" refers to the approval for delayed payment for purchased goods. Sometimes, credit is not granted to a person who has financial instability or difficulty. Companies frequently offer credit to their customers as per -the terms of a purchase agreement. Organizations that offer credit to their customers frequently employ a credit manager. Credit is denominated by a unit of account. Unlike money (by a strict definition), credit itself cannot act as a unit of account. However, many forms of credit can readily act as a medium of exchange. As such, various forms of credit are frequently referred to as money and are included in estimates of the money supply.

Credit is also traded in the market. The purest form is the credit default swap market, which is essentially a traded market in credit insurance. A credit default swap represents the price at which two parties exchange this risk- the protection "seller" takes the risk of default of the credit in returns for a payment, commonly denoted in basis (one basis point is 1/100 of a percent) of the notional amount to be referenced, while the protection "buyer" pays this premium and in the case of default of the underlying (a loan, bond or other receivable) delivers this receivable to the protection seller and receives from the seller the par amount (that is made whole). Borrowing money or money equivalent instrument through formal or informal lender is known as credit. Informal Lenders consists traditional type of borrowing (borrowing through Shahu, Mahajan etc) but formal sector consists legally valid procedures. Borrowing through Bank or Financial institution which is established by obeying the government legal framework is known as formal lenders. In this study, researcher will test the credit of formal lenders. In credit rendering process, Bank or Financial Institution follows various guidelines/credit policies, which are provided by NRB as the main directives along with their own credit policies that are made within the boundary of NRB guidelines. The credit policy of the bank provides the framework to determine whether or not to extend credit and how much credit to be extended. The credit policy decision of a bank has two broad dimensions; credit standard 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.

Credit Management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that a 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 inters bank exposures. 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 source of credit risk, however other sources of credit risk exist throughout the activities of a bank, including in the banking book and in the trading book and both on and off balance sheet. Banks are increasingly facing credit risk in various financial instruments other than land including acceptances; inter bank transactions, trade financing, foreign exchange transactions, guarantees and the settlement of transactions. In Nepalese market various types of loan can be found against gold and silver, loan against first class bank guarantee, loan against mortgage of government security, demand loan, margin lending, overdraft pledge loan hypothecation, auto-loan, personal loan, structure demand loan etc.

In this study credit test will be made on the following headings.

- Sector wise Loans and Advances of Commercial Banks.
- Security- wise Loans and Advances of Commercial Banks.
- Priority and Deprived Sector Loans of Commercial Banks.
- Commercial Banks Loans to Public Enterprises.

1.7. Statement of the Problem

Trends of bank expansion, operations and establishment are in apex growth condition in Nepal. Recent political changes are also adding fuel to grow the financial sector. Daily various news are broadcasted by media in the concern of merge, upgrade, new establishment, branch expansion etc .Recent activities of banking sector are also unique, some of them are busy to introduce new deposit product in high interest rate, some other are trying to catch attention of client by lowering interest rate on loan. So competition is high enough but Nepal Rastra Bank is lowering various services by adding various circular (restriction on margin lending, gift/prizes distribution, revised capital adequacy etc). Thus study aim to answer following problem and has tried to analyze how the banks are performing in credit sector and how they stand in comparison to one another. Looking the increased interest rate on deposit of commercial Bank, every one says that bank are getting sufficient fund for their operation. So the matter of concern is to find out the movement of bank credit during the recent five year period. Normally, following problem of commercial Bank will be solved by this study:

- How Commercial Banks (CBs) are responding on loan and advances in volume during recent five years?
- Which Commercial Banks is more Consistent than other?
- What is their interest pattern on credit at present?
- What is their Credit mix?

1.8. Objectives of the Study

The primary concern of this study is to evaluate the performance of selected commercial banks (CBs) of Nepal and to recommend for the improvement of state of affairs .The following specific objective are as follows:

- To examine sector wise loans and advances of selected Commercial Banks.
- To evaluate priority and deprived sector loans of selected Commercial Banks.
- To evaluate status of non performing loans of selected Commercial Banks.

1.9. Significance of the Study

Credit performance analysis of any banking sector is very important because it is only one measure to evaluate prosperity or recession of organization. After having the real knowledge of indicators of financial performance any stakeholder can decide what they ought to do. Similarly any concerning bodies will be benefited to study whole organization. So this study will be fruitful for those who want to know about NBL, HBL and SBI bank in financial concern. Moreover this study can also be used by government bodies, investors, competitors.

1.10. Limitation of the Study

Every study has its own limitation. All the data may not be available due to business secrecy. Its limitation is as follows:

- This study will be concentrated only on few performance related factors that are related with credit practices.
- This study has focused on the credit behavior between three banks.
- Whole study is based on data of five year period (2002/2003 to 2006/2007).
- Some of the financial tools of comparison shall be used in this study. Hence the drawbacks and weakness of those tools may adversely affect the outcomes of the study.
- Standard Performance level may not be available especially in Nepalese context. In thesis context, concerned experts are also consulted. Secondary sources of data will be taken for the study.
- The source of data will be published annual report and internet website which is assumed to be correct.
- Lack of sufficient time and resources.

1.11. Organization of the Study

This study "Comparative Credit Performance analysis of Nepalese Commercial Banks" has been divided into five Chapter viz. Introduction, Review of Literature, Research Methodology, Presentation and Analysis of Data and Summary, Conclusion and Recommendation.

Chapter 1: Introduction

This chapter deals with introduction parts of the study. It includes background, history of bank, statement of problem, need of study, objectives of study, scope of study, limitation of the study.

Chapter 2: Review of Literature

The second chapter contains conceptual framework, review of books, review of bulletins, journals and annual reports published by banks, review of related articles and studies and previous thesis as well.

Chapter3: Research Methodology

This chapter is most important part of the study. It explains about the research methodology that has been used to evaluate the financial performance of the bank under consideration. It consists of research design, sample and population, sources of data, financial and statistical tools and techniques to measure the financial performance of NBL, HBL, SBI bank.

Chapter 4: Presentation and Analysis of Data

In the fourth Chapter, the data required for the study has been presented, analyzed and interpreted by using various tools and techniques of financial management, accounts and statistics to present the result relating to the study in a very lucid manner.

Chapter 5: Summary, Conclusion and Recommendation:

This is the last chapter of the study which provides summary of the research, conclusion derived on the basis of date analyzed, suggestions and recommendations for improving the future performance of the Sample banks. Finally an extensive bibliography and annexes are also presented at the end of the thesis work

CHAPTER-II
REVIEW OF LITERATURE

Introduction

The review of Literature is the important aspects of planning of the study. “Review of Literature means reviewing research studies of other relevant preposition in the related area of the study so that all parts, studies, their conclusions and deficiencies may be known and further research can be concluded”(Panta and Wolf,1999:6).This chapter deals with the review of materials related with ‘credit management’ in more detail and descriptive manner. It provides the basis for developing a comprehensive framework. In this chapter, an emphasis is given to the review of major related literature on the credit management and its analysis. This chapter is divided mainly into two parts, which are as follows:

2.1. Conceptual Review

2.1.1 Development of Bank

Generally the organization that transacts money is called bank. It accepts deposits and invests the amount in the productive sector. Bank plays a great role that it helps investors to invest in different sector by providing loan. So, banking is a major need for developing activities and for other various developments. Development of trade and industry is dependent upon the development of banking facilities. So it is said that the bank is back bone of economic development in modern society. There are different types of bank focusing on different types of services to their customers but the basic principle is same i.e. mobilize idle resources in productive sector for the growth of trade, industry and commerce.

The present advanced form of banking has come through various stages. Traditional forms of banking were traced during the civilization of Greek, Rome and Mesopotamia. But modern banking originated in medieval Italy, despite strong Christians prohibition against charging of interest. Bank of Venice was established in 1157 A.D as a first modern Bank. Bank of Barcelona(1401A.D), Bank of Geneva(1407A.D), Bank of Amsterdam(1609A.D), Bank of England(1694 A.D), Bank of Hindustan(1779A.D) were others milestones in the development of banking system. The growth of bank accelerated only after the introduction of the banking Act 1883 in United Kingdom as it allowed opening Joint Stock Company Banks.

2.1.2 Historical Development of Banking System in Nepal:

2.1.2.1. Commercial Bank

Commercial bank deals with other people's money: commercial bank alone holds deposit to drawn upon by cheque. It has power of creation and application of money, within limits through the use of loan and deposit.

According to Dr. Herbert L.Hat, "A banker is one who in the ordinary course of business honors cheque drawn upon him by persons from and for whom it receives money on current Account".(IBD.P-514)

The Banking companies Act,1949 defines a banking company in India as "one which transacts the business of banking, which means the accepting, for the purpose of lending or investment of deposits of money from public, repayable on demands or otherwise, and withdrawn by cheque,draft and order or otherwise."(Sethi, 2001:173)

Commercial Bank Act, 1975 AD 2013 B.S defined "A commercial banks is one which exchange money, deposits money, accepts deposits, grant loans and performs. Commercial banking functions which are not a bank meant for co-operative, agriculture, industries or for such specific purpose."

The history of banking in Nepal can be described as a component of gradual and economic sphere of the Nepalese life. The financial system is still in evolutionary phase. Though establishment of banking industry was very recent, some crude bank operation was in practice even in ancient times. In Nepalese chronicles, it was recorded that the new era known as “Nepal Sambat” was introduced by “Shankhadhar” a merchant from Kantipur in 880A.D after having paid all the outstanding debt of the country. This shows basic of money lending practice in ancient Nepal. In 11^{th} century, during Malla regime there was an evidence of professional money lenders and bankers. It is further believed that money lending business; particularly for financing the foreign trade with Tibet became quite popular during regime of Mallas. However, in the absence of any regulatory measures the unscrupulous money lenders known to have charged exorbitant rate of interest and other extra dues on loans advanced.

The establishment of the “Tejarath Adda” by Prime Minister “Ranoddip Singh” during the year 1877 AD was fully subscribed by government of Kathmandu valley which played vital role in the banking system, was regarded as the father of the modern banking institution. The prime task of “Tejarath Adda” was granting of loans and safeguarding of total national deposits. At that time, Indian currency was commonly used in most part of Terai. The primary task of the “Tejarath Adda” was to attract the deposits in government exchequer at the beginning but later on general public was allowed to take the loan at the same rate of interest with gold and silver ornaments as securities and collateral. Although the institution did not accept any deposits, it had played an important role in development process of banking system in Nepal.

The main defects of this institution showed that there was no further financial institution set-up and there was no effort to expand the services.

Above all of the defects, this institution did not accept any deposit from the public. In the absence of saving mobilization the “Adda” faced financial problems making it impossible to charter to the credit and service need of general population throughout the country. Udyog Pairshad Industrial Development Board was constituted in 1936 A.D. One year after its establishment, it formulated the "Company Act" and "Nepal Bank Act" in 1937 A.D.

In the year 1994 B.S. the establishment of Nepal Bank Limited, with the Imperial Bank of India came into existence under "Nepal Bank Act1937A.D." as the first commercial bank of Nepal with 10 million authorized capital. At that time Nepalese economy was characterized by the existence of dual currency system (Indian and Nepalese), which was effecting economic stability and development of nation. Thus, the need of establishment of the central bank required great urgency. As a result, Nepal Rastra Bank was established as a central bank of country on 13th Kartik 2013(1956A.D) under NRB Act 2012.

Integrated and speedy development of the country is possible only when the competitive banking services reaches nooks and corners of the country. To cope this situation, government setup Rastriya Banijya bank (RBB) in 2022 B.S. as a fully government owned commercial bank. With the come up of RBB, banking services spread to both urban as well as rural area. Agriculture Development Bank was established in1976A.D for the promotion of agriculture sector in country. When the government adopted liberal and market oriented economic policy in the mid 80's Nepal allowed the entry of foreign banks of joint venture based with foreign capital, technology and experience. Nepal Arab Bank Ltd. (NABIL) was the first joint venture bank established in 2041 B.S. under the commercial bank act 2031. With the opening of NABIL the door of opening joint venture banks was opened to the private sector.

2.1.2.2 Function of Commercial Banks

Regarding the function of commercial bank Commercial bank act state that a commercial bank is one that exchanges money, accept deposits, grants loans, and performs commercial banking functions. The functions and services of modern commercial banks are classified under the following headings.

(i) Accepting Deposits

Commercial bank accepts deposits from customers in the forms of current, saving and fixed deposits. These deposits are repayable on demand. The depositors other than current A/c are paid interest.

(ii) Granting Loans and Deposits

The second main function of the commercial bank is to grant loans and advances to businessman, the industrialist, the individuals, the different organizations etc. in the forms of term loans, cash credit, overdraft, trust receipts, hire purchase loans etc. Banks charges interest on such loan and advances, which is the largest source of total income.

(iii) Agency Service

A modern commercial banks act as an agent of individual's customers, business institutions and different organization. The agency services of banks may involve collection of interest and dividends on debt and share capital. A bank buys and sells securities on behalf of the customers. Bank also collects cheques, draft promissory notes etc and receives their payments. Sometimes, it makes payments of insurance premium, bills of electricity, telephone etc. It takes commission for the services rendered.

(iv) Guarantee on Behalf of Customers

The need of bank guarantee arises in business. Generally, business customers enjoy this service. Sometimes, personal customers may also need a bank guarantee. A guarantee is a definite and irrevocable under taking by a bank on behalf of its customers to make payments up to a specified sum of money to the beneficiary on demand incase of default by its customers.

(v) Issuance of Traveler's Cheque

The people traveling outside the country want to reduce the fear of getting money stolen during the travel. Bank sells the traveler's cheque. The unique feature of the traveler's cheque is that unless the purchaser of traveler's cheque signs for encashment it cannot be encashed.

(vi) Opening Letter of Credit

Today letter of credit has become very popular in foreign business. The letter of credit is established/ opened by the bank on the request of the customers.

(vii) Remittance Function

Sending and receiving fund to/from various places is the necessity of today's life. The remittance service of bank has benefited both business and personal customers. Funds transfers are made through various modes like demand drafts, telegraphic payment order, swift, and fax and mail payment orders.

(viii) Other Services

Modern commercial banks are equally important in undertaking safe custody of important valuable documents. Banks also offer some of the bank services at the door of highly valued customers. Few large banks conduct research and survey about the economic conditions and they supply trade statistics and information. In addition to these, banks also inform their customers about the credit standing.

2.1.3 Credit

Credit is the amount of money lends by Creditor (bank) to the borrower (customer) either on the basis of security or without security.

"Sum of money lent by a bank, credit and advances is an important item on the assets side of the balance sheet of a commercial bank. Bank earns interest on loan 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 Swamy, 1979:6)

"In Economics, The term credit refers to a promise by one party to pay another party for money or goods on demand at some future date**".** (Jhingan, 1997:171)

2.1.3.1 Types of Credit

- **Cash Credit**

The credit is not given directly in form of cash but deposit account is being opened in name of creditor and amount credited to that account. In this way, every bank loan creates deposits.

- **Term Credit (Loan)**

It is principal form of medium term debt financing having maturities of 1 to 8 years. Term loans are usually repaid in level amounts over the period of the loan, either a large final or just a single payment at maturity.

- **Overdraft**

It is an agreement by which bank allows the customer to draw over and above the current account balance. Interest on overdraft is charged on debit balance on daily basis.

- **Working Capital Credit**

It is granted to the customers to meet their working capital gap for supporting production process. A natural process develops where in funds moving through the cycle are generated to repay a working capital.

- **Credit against Fixed Deposit**

Fixed deposit is specified for fixed period of time. Depositor can use it as collateral for loan received before the maturity period.

- **Hire Purchase Financing (Installment Credit)**

Hire Purchase loan refers to specifically periodic repayment of Principal and interest over the maturity of the loan.

- **Housing Financing (Real-estate credit)**

Financial institution adopts this policy as residential building commercial complex, construction of warehouse etc. It is given to those who have regular income or can earn revenue from housing project itself.

- **Project Credit**

It is granted to the customers as per project viability. Construction credit is short-term credits made to developers for the purpose of completing proposed projects.

- **Consortium Credit**

No single financial institution grant loan to the project due to single borrower limit or other reason and two or more such institutions may consent to grant credit facility to the project of which is baptized as consortium loan.

2.1.4. Credit Management

Credit management includes the sound credit policy and practices, loan approval and disbursement process, credit appraisal, credit audit etc. The goal of credit management is to maximize the bank's risk adjusted rate of return by maintaining the credit risk exposure within acceptable parameters. Credit management strongly recommends analyzing and managing the credit risks. Credit risk is defined as the possibility that a 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 inters book exposures. For most banks, loan are the largest and most obvious source of credit risk, however other sources of credit risk exist throughout the activities of bank including in the banking bank, in the trading book and both on and off balance sheet.

"Loan and advances dominate the assets side of balance sheet of any bank. Similarly earnings from such loans and advances occupy a major space in income statement of the bank. Lending can be said to be the raision d'etre of a bank. However, it is very important to be remind that most of the bank failures in the world due to shrinkage in the value of loan and advances. Hence, loan is known as credit risk or default risk**.**"**(**Dahal, 2002:55)

2.1.4.1. Credit policy

Credit policy is essential part of credit management. Formulating and implementing sound policy is important to find the deviation between practice and policy and to establish a standard for control. "The credit policy of a firm provides the framework to determine (a) whether or not to extend credit to a customer and (b) how much credit to extend. Credit policy decision of a firm has two broad dimensions: (i) credit standards and (ii) credit analysis. A firm has to establish and use standards in making credit decisions, develop appropriate sources of credit information and methods of credit analysis**.** (Jain, 1988:696)

2.1.4.2. Objectives of Sound Credit Policy

The main purpose of Credit Policy is:

1. To have performing assets

Performing assets are those loans that repay principal and interest to bank from the cash flow it generates. Loans are risky assets though a bank invests most of it resources in granting loan and advances. If an individual bank has around 10% non performing assets/loans (NPAS), it sounds the death knell of that bank ceteris paribus (all other thing remain constant).The objectives of sound loan policy is to maintain the financial health of the bank which results in safety of depositors' money and increase in the returns to the shareholders. Since the loan is a risky asset there is inherent risk in every loan. However, the bank should not take risk above a certain degree irrespective of returns prospect.

2. To contribute to economic development

Sound credit policy is required to ensure that loans are given to the productive sector which contributes to the society and economic development of a country.

3. To give guidance to lending officials

A borrower should be assured that there will be no discrimination whether he deals with one officer or another and one branch or another .A sound credit policy is imperative to achieve a uniform standard procedure throughout the organization. In the absence of a sound credit policy it is likely that individual loan officers make judgment inconsistent from each other and also inconsistent with the organizational goal.

4. To establish standard for control

Every policy requires periodic follow up to ensure its proper implementation. A sound policy helps to determine the variance between actual performance and practices and to take corrective actions. A sound policy is always flexible and works as a guideline rather than as a straitjacket. However, if the deviation between the practice and policy is observed, proper education to lending officers or amendment of the policy becomes inevitable. These objectives can be summarized as the sound policies that help commercial banks to maximize quality and quantity of investment and thereby achieve the own objectives of profit maximization.

Formulation of sound policies and coordinated planned efforts pushes forward the forces of economic growth. Sound policy is also important to find the deviation between the practice and policy and establish a standard for control.

2.1.5 Investment Policy-Concept

The income and profit of the bank depends upon its investment policy, lending policy and investment of its fund in different securities. In the investment procedures and policies it is always taken in mind that "the greater the credit created by the bank, the higher will be the profitability." A sound lending and investment policy is not only the pre-requisite for bank's profitability, but also crucially significant for the promotion of commercial savings of a financially backward country like Nepal.

The bank and finance companies are such type of institutions, which deal in money and substitute for money. They also deal with credit and credit instruments. To collects fund and mobilize them in a productive sector is a difficult task for any institutions. An investment of fund may be the question of life and death of the bank as there is various risk associated with it. Thus the banker must think seriously before making an investment decision. The investment policy of a bank consists of earning high returns on its un- loaned resources. But it has to keep in view the safety and liquidity of resources so as to meet the objectives of profitability which conflicts with each other. and investment policy strikes a judicious balance among them. Therefore a bank should lay down its investment policy in such a manner so as to ensure the safety and liquidity of its funds and at the same time maximize its profit.

"The investment objective is to increase systematically the individual wealth, defined as asset minus liabilities. The higher the level of designed wealth the higher it will be received. An investor seeking higher return must be willing to face higher level of risk."(Chery and Moses, 1988:595)

"Credit and investment command number first and number second positions and investment at times serves as substitute of loan. That is why when loan demands weakens; a bank increases securities in investment portfolio. Similarly banks start shedding securities from investment portfolio when loan demand increases to entertain loan request. This warrants careful management of investment portfolio so that net interest income/spread (excess of interest income over interest expenses) can be maximized."(Dahal, 2002:88)

Every bank manager should have awareness about the major risks associated with the securities. Because price of securities are affected by the some kind of risk like credit risk, interest rate risk and liquidity risk. These are the sources of investment risk. "The policy should specify what rated securities it wants to held in the portfolio. If unrated, whether it buys or not. Since risk is overpriced during recession and under priced during boom, banks prefer buying medium grade and high grade securities during recession and boom respectively. Normally banks buy investment rated securities only."(Dahal, 2002:92)

2.1.6. Consideration for Sound Lending and Investment

The major source of income and profit generation of every banks and financial institution is its loan -investment in different sectors .If loans are not distributed properly and cautiously then it may be the main cause of the failure of the company .As prescribed by Hrishikes Bhattacharya in his book "Banking strategy, credit appraisal and lending decisions, a Risk-Return Framework," the important consideration which the finance company should review and analyzed is briefly illustrated below.

(A) Principle of Sound Lending

- Safety

Every finance company must invest in those opportunities which are safe against losses and risky. Collateral should be accepted which is not so depreciable and whose value hold constancy.

- Security

Finance company should accept that kind of security which is commercial, durable, marketable and high market price. In those cases, “MAST” should be applied for the investment.

Where,

M = Marketability

A = Ascertain ability

S = Stability

T = Transferability

- Profitability

Financial institution can maximize its volume of wealth through maximization of return on their investment and lending .So, they must invest their fund where they gain maximum profit. The profit of these companies mainly depends on the interest rate, volume of loan, its time period and nature of investment in different securities.

- Liquidity

People deposit money at these companies with confidence that they will repay their money when they need it. To maintain such confidence of the depositors, the company must keep this point in mind while investing its excess fund in different securities or at time of lending in different sectors so that it can meet short-term obligation when they become due for payment.

- Purpose of Loan

Why does a customer need a loan? This is very important question for any banker. If borrower misuses the loan granted by these companies they can never repay and company will passes heavy bad debts. Detailed information about the scheme of the project or activities should be examined before lending.

- Diversification

"A financial institution should not lay all its eggs on the same basket." In order to minimize risk, diversification on its investment on different sectors should be adopted which helps to sustain loss according to the law of average because if securities of a company is deprived, there may be appreciation in the securities of other companies, so the loss can be recovered.

- Legality

Illegal securities will bring out many problems for the investor. The financial institution must follow the rules and regulations as different directions issued by Nepal Rastra Bank and other concerning bodies while mobilizing its funds.

- Tangibility

Though it may be considered that tangible property doesn't yield an income apart from direct satisfaction of possession of property, many times, intangible securities have lost their finance company, so they should prefer tangible security to intangible one.

- National Interest

"Even if an advance (loan) satisfies all the aforesaid principles, it may still not be suitable. The lending program may run counter to national interest.

Central Bank may have issued directives prohibiting finance companies to allow particular types of advances."(Bhattacharya, 1998:660)

(B) Major information for analyzing the potential of borrower for lending

- Payment record and credit information from concern field
- Income level and its source
- Residence (local or migrates)
- Marital status (single ,married, widowed or divorced)
- Age factor
- References
- Reserves, assets and collateral

(C) Basic of granting loan and analysis of credit risk

- World is surrounded by certain risk associated with the related field of task. The risk is vital factor which can be seen in the field of lending and investing money by financial institution. It is true that "There is no return without risk." But by using certain criteria's they can minimize some portion of risk associated with it. With respect to this ,financial institution approach the loan request by analyzing five 'Cs' of credit risk as illustrated by Hrishikes Bhattacharya
- Character of the applicant
- Capacity of qualification and work experience
- Capital of the proposed plan
- Collateral for security and its safetyness
- Conditions of credit environment and credit information
- Additionally, external factor also directly and indirectly affect on loan granting decision. They can be political crisis, national and international economic condition, policy and practice, cultural practice etc.

(D) Basic requirement in a borrower / lending documentation

Commercial Banks cannot lend money to just anyone blindfold. It should be confident regarding the trustworthiness and intentions of the probable beforehand. The borrower, on the other hand, should provide all pertinent documents that the company seeks to build confidence on borrower. There are some requirements that should be fulfilled by the client to stand him as a probable borrower. The basic requirement that the borrower should submit with loan proposal are as follows:

- **If applicant is an individual**
  a) Applicant should be Nepali citizen. Citizenship certificate should be submitted.
  b) Should have good knowledge about work they intend to commence.
  c) Normally the applicant should not have taken loan from any other institutions previously.
  d) Applicant should present the job planning scheme with perfect business plan.
  e) Personal information is also required.
  f) Business and income tax registration certificate with renewal.
  g) Quotation and personal guarantee with reference of well recognized personal.
  h) Certificate of ownership.
  i) Driving license if required.
  j) Description of securities with full proof evidence.
  k) Other documentation as per company rules whichever required

- **If the applicant is partnership firm**
  a) The firm should be registered in related department.
  b) The person dealing with the borrowing of the firm should specify in the partnership contract.
  c) Income Tax Registration certificate with renewal.

- **If the applicant is private limited company or public limited company**
  a) Company should be registered.
  b) Working place, project place should be specified and all the assets should be in the name of company.
  c) Audited Balance sheet, profit and loss account, and other required financial statement.
  d) Documents of at least of one year should be presented.
  e) If the work place or project place is leased the lease contract should be presented
  f) The authorized person should apply for the loan.
  g) Loan amount applied must be within the limit of memorandum of the company or must be decided by the board.
  h) Decision of the promoters.
  i) Personal information of the main person is required.
  j) Written personal guarantee of the proprietors is required.
  k) Citizenship of promoters and proprietors is required.

(E) Basic feature of collateral

Collateral is the most important item for granting loan. Loan should be granted by analyzing details related to collateral. Generally in Nepalese practice- land and building; gold silver and some classified document are accepted as safe and reliable collateral, but there are some features which must be analyzed .They are

a) Market availability

b) Price stability

c) Durability

d) Storing facility

e) Transportation

f) Profitability

Guidelines of Assessing Risk

Risk is dependent upon the quality found in each 'c' and the combination of these five 'C_s'. Assuming the same conditions prevail, the following guideline is generally suggested.

Guidelines of Assessing Risk

Applicant characteristics	**Credit risk**
Character +capacity	Very low
Character + capacity without capital	Low to moderate
Character + capacity but insufficient capital	Low to moderate
Capacity + capital but impaired character	Moderate
Capacity + capital without character	High
Character + capital without capacity	High
Character + no capital + No capacity	Very high
Capital + No character + No capacity	Very high
Capital + No character + No capital	Fraudulent

Source: Book by Hrishikes Bhattacharya, 1998

2.1.7 Lending procedures

According to Bhuwan Dahal and Sarita Dahal, lending procedures include loan approval and disbursement process (Dahal, 2002:115)

- **Loan approval process**

Loan is approved by approving authority only after being convinced that the loan will be repaid together with interest. There are many processes involved to approve the loan which has been listed below:

1. Application

A borrower is normally required to submit an application to the bank along with required documents: project proposal, historical financial statements and documents pertaining to company’s legal existence.

2. Conducting the interview

During the loan rendering process respective clients are asked by the respective credit officer of banks about the financial strength to know the creditworthiness of clients. Documents that are submitted by the borrowers also give detail information about the borrowers which plays great important role to know the borrowers. Normally, such interview takes place at the bank premise.

3. The credit analysis

During the credit analysis phase various aspects are evaluated by the banks which is broadly included under the heading of $5c_s$ which are presented below.

a) Character

b) Capacity

c) Condition

d) Collateral

e) Capital

4. Forecast and risk rating system

Based on the findings of historical analysis, and in light of present and foreseeable future environment, the analyst has to forecast impending major risks. The analyst should also highlight to what extent inherent risks will be mitigated and how unmitigated risks can be covered.

5. Return

The amount of loan has got inherent cost as it is obtained from either shareholder or depositor or creditor. The analysis should be made to calculate total return and compare whether it meets banks standard.

6. Liquidation

The analyst should ascertain bank's ability to recover loan in case of liquidation of the borrower. If liquidation analysis reveals insufficient security, additional security may be asked for.

7**. Credit worthiness and debt structure**

If analyst finds the borrower creditworthiness and decides to extend loan, he should structure the debt facility to be extended.

2.2 Review of Rules, Regulation and Directives of NRB Regarding Credit Management of Commercial Banks

Various rules, regulation, acts and directives are reviewed while preparing the concept of this study. Different types of directives, which are issued for the commercial banks to manage credit in a proper way, obviously play the great role for the comparative analysis of credit management of the commercial banks.

NRB is the leader of the money market. It is the chief of all the banks operating in the country. It supervises, regulates and controls the functions of commercial banks and other financial institutions. Various directives have direct or indirect impact while making decisions to discuss those rules and regulations which are formulated by NRB in terms of investment and credit to- priority sector, deprived sector, other institutions, single borrower limit, CRR, loan loss provision, capital adequacy ratio, interest spread, productive sector investment etc. A commercial bank is directly related to the fact that how much fund must be collected as paid up capital while being established at a certain place of the nation, how much fund needed to expand the branch and counters, how flexible and helpful the NRB rules are important. But only those, which are related to credit aspect of commercial banks, are described in the study. The main provision established by NRB in the form of prudential norms in above relevant are briefly discussed here:

2.2.1 Regulation to Maintain Minimum Capital Fund by the Commercial Bank as per NRB Directive.

Capital adequacy ratio (CAR) is the relationship between capital funds to total risk weighted assets of the bank. The higher the CAR, the less levered the bank and safer from depositor's point of view because the proportion of shareholders' stake to the risk weighted assets is also high.

Risk weight is assigned to various assets and off balance sheet items of the bank to arrive at the risk weighted assets. Banks in Nepal are required to have minimum 6% core capital and 12% total capital fund of total risk weighted assets.

Fund Required on the basis of WRA (%)

Core capital	Capital fund
6	12

Source: NRB directives 2004/2005

- **Classification of Capital:**

To calculate the capital fund, commercial banks should classify the capital in two parts;

a) Core capital

b) Supplementary capital

And,

Capital fund= core capital + supplementary capital

Provision for pass loan made up to 1.25% of total risk weighted assets is treated as supplementary capital.

$$\text{Capital fund ratio} = \frac{\text{core capital} + \text{supplementary capital}}{\text{Sum of weighted risk assets}} \times 100$$

Where, sum of weighted risk assets (WAR) = Total WRA appeared in balance sheet+ Total WRA appeared outside the balance sheet

2.2.2 Loan Classification and Loan Loss Provisioning

A bank is required to classify their loan on the basis of overdue ageing schedule and provide on a quarterly basis as follows:

a. Pass loan

All loan and advances whose principal amount is past due for period up to three months should be included in this category. These loans are classified as performing loans.

b. Substandard

All loans and advances that are past due for a period up to six months should be included in this category. Sub standard loan is classified as non performing loan.

c. Doubtful

All loan and advances that are due for a period of six months to one year should be included in this category. Doubtful loan is also from the category of non performing loan.

d. Loss

All loan and advances which are due for a period of more than one year should be included in this category.

Provision for loss loan:

Loan should be classified as loss in the following cases,

a. No security or security not as per contract.

b. Borrower as been declared as bankrupt.

c. In case of borrower not found.

d. Purchased or discounted bill are not repayable within 90 days from due date.

e. Loans amount has not been used for taken purpose.

f. Loan provided for blacklisted borrowers.

2.2.3 Loan Loss Provision

The loan loss provision on the basis of outstanding loans and advances and bills purchased classified as per directives, which is as follows:

Classification of Loans

Classification of loans	Loan loss provision
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Source: NRB Directives 2004/2005

- Bank can reschedule and restructure loan if nonperforming loan receiver submit the external/internal reasons. If loan is restructured and rescheduled, provision requirement for such loan is minimum 12.5%.
- If priority and deprived sector loan is restructured and rescheduled, such loan will have to be provisioned at 25% of the provision percentage to loan loss.
- Provision requirement in case of loan given against personal guarantee only is additional 20% for pass, substandard and doubtful loans.
- Loss provision for performing loan is called general loan loss provision and loss provision for non performing loan is called specific loan loss provision.

2.2.4 Directives Relating to Single Borrower Credit Limit

With the objectives of lowering the risk of over concentration of bank loans to a few big borrowers and also to increase the access to small and middle size borrowers to the bank loans, NRB has directed commercial bank to set an upper limit for single borrower limit. According to the directive, commercial banks may extend credit to single borrower or group of related borrowers in such a way that the amount if fund based loan(overdraft, trust receipt, term loan etc) and advances up to 25%of core capital and non fund off the balance sheet facilities like letter of credit, guarantees, acceptances, commitments is up to 50%of its core capital fund, but in case of advances and facilities to be used for the purpose of importing specified merchandize by the following public corporations, the exemption in the limit of credits and facilities is not applicable:

Public Corporation and their Specified Merchandize

Name of corporation	**Merchandize**
Nepal oil corporation	Petrol, Diesel, Kerosene and LPG gas
Agriculture Input corporation	Fertilizers, seeds
Nepal food corporation	Cereals

Source: NRB Directives 2004/2005

2.2.5 Directives Regarding Investments in Shares and Securities by Commercials Banks

1) Arrangement as to implementation of investment K policy under approval of the board of directors

Banks should prepare written policy relating to investments in the shares and securities of organized institutions. Such policies should be implemented only under the approval of restrictions as to investment by the banks securities by NRB.

2) Arrangement relating to investment in shares and securities of organized institutions

a) Bank may invest in shares and securities of any organized institution not exceeding 10% of the paid up capital of such organized institution. Any amount of investment made in excess of this limit for the purpose of calculation of the capital fund, should be deducted from the core capital fund.

b) The total amount of investment should be restricted to 30% of the paid up capital of the bank. Any amount of investment made on excess of 30% of paid up capital of the bank, for the purpose of calculation of the capital fund, should be deducted from the core capital fund.

c) Banks should invest in the X shares and securities of organized institutions, which are already listed in the stock Bank exchange.

d) Where the shares and securities are not listed within the period prescribed, provisioning equivalent to the whole amount of such investment be provided and credited to investment adjustment reserve. The outstanding amount in such reserve should not be utilized for any other purpose till the sold shares and securities of the organized institution are listed. The outstanding amount in investment adjustment reserve should be included supplementary capital.

e) Banks should not invest in any shares, securities and hybrid capital instruments issued by any banks and financial institutions licensed by NRB where such investment exists prior to issuance of this directive such investment should be brought within the strives limitations imposed by this directive within 3 years.

2.2.6 Directives Regarding Interest Rate Spread

The interest rate spread is the difference between the interest taken from loan and advance or investment and the interest given to the depositor. As NRB direction lending rate and deposit rate should not exceed 5%. Such rates are calculated as under:

WALR= Interest income for a month/Total interest-earned asset

WADR= Interest expense for a month/Total deposit outstanding

Interest spread= WALR-WADR

Where;

WALR= Weighted average lending rate

WADR=Weighted average deposit rate

2.2.7 Requirements to Extend Loans and Advances to Productive and Priority Sector (Including Deprived Sector)

Commercial banks are required to extend loans and advances in the productive, priority and deprived sector as follows:

Distribution of total loan and advances on said heading

- 40% to productive sector, including
- 12% to priority sector, including
- 0.25-3% to deprived sector

Productive sector credit

Productive sector credit includes advances to priority sector and other productive sector. Priority sector in turn includes deprived sector.

Priority sector credit

Priority sector is defined to include micro and small enterprises which help to increase production, employment and income as prioritized under the national development plans with an objective to uplift the living standard of low income people and progressively reducing the prevalent unemployment, poverty, economic inequality and backwardness. Micro and small enterprises are classified as agriculture enterprises, cottage and small industries and services. In addition, other businesses specified by NRB from time to time are also included under micro and small enterprises. All credit extended to priority sector up to the limit specified by NRB are termed as priority sector credit. .Commercial banks extend credit under priority sector programs specified by NRB time to time.

Deprived sector credit

Deprived sector includes low income and particularly socially backward women, tribes, lower caste, blind, hearing impaired and physically handicapped persons and squatter family. All credit extended for the enticements of the economic and social status of deprived sector into the limit specified by NRB is termed as “Deprived Sector Credit.”

Examination of the fulfillment of priority or deprived sector lending shall be made at the end of each quarter (i.e. mid Jan, mid April and mid July) on the basis of total outstanding loan and advances(except investments) as of immediately preceding six months. On the failure of fulfilling such lending, penalty in shortfall amount at the maximum prevailing lending rate of the bank during the examination period shall be imposed under sub section 2 of section 32 of NRB act, 2012. If the priority sector lending is fulfilled, but the deprived sector is not, the penalty is imposed on shortfall amount and if both sector lending is not fulfilled, then the penalty is imposed on greater shortfall amount for one sector only.

2.3 Review of Previous Studies

Several studies have been conducted on the field of credit management, within the country and aboard. So, under this section, the available literatures related to credit management are divided into two parts i.e. Review from international context and Review from Nepalese context.

2.3.1 Review from International Context

In International context, various studies have been done on the field of credit management and a different article has been presented to clarify the topic. Among these articles and book, some of which are reviewed in the following way:

2.3.1.1 Meir Kohn's Study

"The gain to borrower is obvious, if these investments are sufficiently productive, you will be happy to pay interest on the loan to pay back in the future more purchasing power than you received. Lending is to gain from trade. The interest you pay gives lender a better return than they could achieve otherwise, what are their alternatives? They could make productive investment themselves. But finding productive investment is difficult .Some people are much better at it than others. Typically savers do better by lending their money to that highly productive use for it than by making investment themselves."(Meir, 1996:49)

The committee examined the existing system of lending and recommended the following broad changes in the credit system.

- The credit needs of borrowers are assessed on the basis of their business plans.
- Bank credit only is supplementary to the borrower's resources and not is replacement of them, i.e. banks not to finance one hundred percentage of borrower's requirement.
- Borrowers are required to hold inventory and receives according to norms prescribed by reserve bank of India from time to time.
- Credit be made available in different components only, depending upon the nature of holding of various current assets.
- In order to facilities a close watches on the operations of borrowers, they are required to submit at regular intervals, data regarding their business and financial operations both for past and future period.

2.3.1.2 H.D Crosse's Study

"Lending is the essences of commercial banking, consequently the formulation and implementation of sound policies are among the most important responsibilities of bank directors and management. Well conceived lending policies and careful lending practices are essential if a bank is to perform its credit creating function effectively and minimize the risk inherent in any extension of credit.” (Crosse, 1963:60)

Credit creating function or lending is very important for all commercial banks. But doing credit function without applying policies and practices is not enough to lead the success. So to manage the different kind of credit function, to maximize return and to minimize credit risk, every bank should be conscious about formulation and implementation of credit policies and practices.

2.3.1.3 Peter S. Rose’s Study

Peter S. Rose has emphasized on the factors affecting default risk and interest rates. He opines that “Another important factor causing one interest rate to differ from another in the global market place is the degree of default risk carried by individual assets. Investors in financial assets face many different kinds of risk, but one of the most important is default risk the risk that a borrower will but make all promised payments at the agreed upon times. All debts except some government securities, subject to varying degrees of default risk.” (Rose, 2003:206)

Default risk is one kind of investment risk, which is created from non payment of interest and principal by the security issuer at the fixed future date. A bank management should have awareness about such risk. Approving authority should consider that the loan will be repaid together with interest, for this loan approval process should conduct in better way.

2.3.2 Review from Nepalese Context

In Nepalese context, here are some independent studies which are presented in the following ways:

a. Review of relevant studies from report and articles

b. Review from unpublished thesis

In the first section, effort has been made to examine and review some related articles and reports published in different journals, magazines, newspaper and books while in second section, unpublished thesis work conducted by various students have been presented.

"Deposit is the life blood of any financial institution i.e. commercial banks, financial companies and co-operative or non government organization."(Pradhan, 2053:24)**.** In consideration of ten commercial banks, nearly three dozens of finance companies, the latest figure produce a strong feeling that a serious review must be made on problems and prospects of deposit sector .Beside few joint venture banks, other organizations rely heavily on the business deposits receiving and credit disbursement.

In the light of this, Pradhan (2053) has pointed out following problems of deposits mobilization in Nepalese perspective.

1. Due to lack of education, most of Nepalese people do not go for saving in institutional manner, however they have saving as from cash and ornament. Their reluctance to deal with institutions system are governed by their lower level of understanding about financial organization, process requirement, office hour withdrawals system, availability of depositing facilities and so on.
2. Due to the lesser office hour of banking system people prefer for holding the cash in the personal possession.
3. Unavailability of the institutional services in the rural area.
4. No more mobilization and improvement of the employment of deposits in the loan sectors.

Pradhan (2053) has not only pointed out the problems but also suggested for the prosperity of deposit mobilization. They are given as:

- By adding service hours system will definitely be an appropriate step.
- If deposit mobilizations materialize by providing sufficient institutions service in rural area, the generated fund can be used somewhere else by the bank which can be taken as major achievement. NRB could be endorsing this deposit collection by continuing to subsidize overhead cost for little longer period .A full scale of field office system could be taken back and made manpower strength deputed to cut down overhead cost.
- NRB also organize training program to develop skilled manpower.
- By spreading co-operative to the rural areas, mini- banking services are to be launched.

Lastly, Pradhan mentioned, deposit mobilization carried out effectively is in the interest of depositors, society, financial sector and the nation. Lower level of deposit rising allows squeezed level of loan delivery leaving more room to informal sectors. That is why higher priority to deposit mobilization has all the relevance.

In an article, Mahesh Bhattarai (2060) is trying to indicate the problems of bank bad debt and non performing assets. According to him, “If a bank cannot recover its loan lending, banks cash flow will be badly affected. Similarly it can affect the close relationship between depositors.”(Bhattarai, 2060:62)
“Why does loan become defaulter”? This study finds out the causes that makes loan default. “When the due date is over the loans become default. But why do the due dates be over?

“Generally increase in interest rates; decreases in economic activities cause decrease in the capacity of debtor and sometimes the debtor knowingly do not pay back the loan. Other than these reasons in the context of Nepal lack of credit policy, lack of information about the loan holder (three c’s: capacity, character, and capital), unhealthy competition and small market area, causes loan defaults. Default loan increases the resources mobilization cost and reduces the profit earning capacity of a bank. Therefore increases in default loans are the indicator of problematic situations to the bank.” (Neupane, 2052:87)

In an article, “challenges of non-performing loan management in Nepal”, Uma Karki (2053) has mentioned the causes of increasing trend of non-performing loan. She identifies “the major causes such as poor loan analysis, guarantee oriented loan system, depreciation of valued assets, misuse of loan, lack of regular supervision of loan.”**(**Karki, 2053:87)

In Nepalese context, when interest rate is increased it causes the decreases in economic activities as well as capacity of borrower. Sometimes debtors knowingly do not pay back the loan, and invest the loan in unproductive sector. Such kind of activities occurs continuously, if there is lack of sound credit policy, improper credit analysis, lack of information about loan holders and lack of regular supervision. So banks should formulate and implement sound credit policy. Loan approval and disbursement process should be conducted in better way. Proper credit analysis and regular supervision can control the credit risk.

Another article entitled “lending operation of commercial banks of Nepal and its impact on GDP.” Dr. Sunity Sharma (2052) has found “all the dependent variables (i.e. agriculture, industrial, commercial, general and social sectors) except service sector; she found correlation between GDP and lending of commercial banks in various sector of economy except through service sector investment."(Sharma, 2052:23-27)

"The bank gives loan to various sectors. This is necessary for long term survival of the bank. Even if any sector is doing very well, the bank does not put its total money in that sector. If the bank concentrates its lending only in one sector, failure of the sector may cause bankruptcy of the bank."**(**Dahal, 2002:116)

Loan mix is components of established credit policy. It is a kind of strategy in credit management for banks to be success. In context of Nepal, here are different sectors in economy such as priority sector, deprived sector, productive sector, government sector etc. So, there should be diversification in investment of every commercial bank. Making investment or lending to various sectors is necessary for the long term survival of banks.

2.3.2.2Review from Thesis

a) Ojha (2002) conducted a study; "Lending practices**-** A study of NABIL, SCBNL and HBL" has outlined his major **finding** as follows:

SCBL's contribution in loans and advances is the lowest and this has low degree of variation and low growth rate as compare to NABIL and HBL.

Recommendation

- He has recommended SCBNL to give extra priority on productive and priority sector loan.
- SCBL, NABIL and HBL to follow the NRB directives strictly. The ratio of total income to total expenses of NABIL and HBL is below than SCBL and below the combined mean of three banks. This ratio trends to be unfavorable due to the comparatively higher operating cost of these banks also. The

productivity of the expenses in SCBL is significantly higher than NABIL and HBL.

- These banks to improve their operational efficiency and increases the productivity of expenses made. He has also recommended lowering gap in interest charged and interest offered. Lowering gap results in high volume and advances and helps in increasing sustainable lending practices.

b) Dhugana (2002) conducted a study “A comparative study on investment policy of Nepal Bangladesh bank limited and other joint venture banks” .His **finding** were:

- NBBL has not good deposit collection it has not made enough cash and negligible amount of investment in government securities.
- NBBL has highest loan and advances to total deposit ratio, loan and advances to total working fund ratio, lowest loan loss ratio and higher investment on share and debenture to total working fund ratio.
- NBBL has followed stable policy. NBBL is not in better position on regarding off-balance transaction. NBBL is able to manage its assets regarding its on balance transaction. Lending position, investment position and net profit position of NBBL is not better in compare to HBL. But it has better position in comparison to NSBL.

Recommendation

- He has suggested increasing the liquidity of NBBL, to invest in government securities instead of keeping idle fund. He has also suggested providing project oriented approach. He has suggested NBBL for developing effective portfolio management.
- He has suggested in developing innovative approach for bank marketing upgrades the banking facility, liberal lending policy and effective cost management cost.

c) Mr. Satish Raj Regmi (2004) in his thesis entitled "Credit practices of joint venture banks with reference to Nepal SBI bank Ltd and Nepal Bangladesh Bank Ltd" has emphasized to analyze the credit practices of concerned joint venture commercial banks

Findings:

- This study is based on five years data 1988-2002 of concerned banks.
- He has found that liquidity position of both banks is satisfactory, on the basis of asset management ratio; NBBL is in better position than NSBL.
- In credit portfolio, both banks have invested more in private sector than other sector.
- NBBL has better lending efficiency than that of NSBL. Deposit mobilization per branch ratio and credit mobilization per branch ratio of NSBL is higher than NBBL. At last, he has found that the profitability position of NBBL is better than that of NSBL.

Recommendation:

- NBBL should give focus on it liquidity position. Both banks should follow the NRB directives which help them to reduce credit risk. He has also recommended that the both bank should adopt sound credit collection policy and the marketing strategies should be innovative.

2.4 Research Gap

There are various factors that affect the lending practices. The directives of NRB change over time and commercial bank should adopt their policy with the changing time. So, up-to-date study over the change of time frame is major concern for the researcher and concerned organization as well as whole. This study covers the more recent financial data, NRB circulars and guidelines than that of studies previously conducted.

It is major concern of shareholders to know portfolio behavior of the bank; this study puts its effort to find out the factors that are related with investment of the banks. Analysis of lending efficiency shows the efficiency of the bank. No case study has yet been conducted about credit management of NBL, HBL and SBI bank. This study tries to show how government owned bank stands in term of investment policy with leading commercial banks i.e. HBL and SBI. Hence, this study fulfills prevailing research gap about the in-depth analysis of lending efficiency, investment in priority and deprived sector by the banks,

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Introduction

Research Methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. It is study of various steps that is generally adopted by a researcher, studying his research problem among with the logic behind them. “Research is the process of systematic and in-depth collection, presentation and interpretation or relevant detail or data”. (Michael,1985:57).

In other words, research methodology is a systematize way to solve the research problem. The prime objective of this study is to compare, evaluate and assess the credit performance of selected commercial Banks i.e. NBL, SBI, HBL. This chapter contains the methods that make convenience for comparison of the performance made so far by these banks by analyzing the strength and weakness of the financial performance of these three sampled banks.

“Research Methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view.” (Kothari,1994:19). A research methodology helps us to find out accuracy, validity and suitability. The justification on the present study, the applied methodology will be used. The research methodology used in the present study is briefly mentioned below.

3.2 Research Design

Research design is the planned structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances. In other words research design is the frame work for a study that helps the analysis of data related to study topic.

A research design is the arrangement of conditions for collecting and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. Research design is very important for scientific investigation. Research design gives the investigator a systematic direction to research work. Actually, Research design is a plan for data collection analysis. It presents a series of guideposts to enable the researcher to process in the right direction in order to achieve the goal. A research design is the overall operational pattern of framework of the project that stipulates what information to be collected from which sources by what procedures. There are various approaches of research design .This study depends on the secondary data. It includes all the process of collecting, verifying and evaluating of past evidence systematically and objectively to reach final conclusion. Some financial and statistical tools have been adopted to examine factors in this study.

3.2.1 Sources of Data

This study is mainly based on secondary data. Secondary data are collected from respective annual report especially from profit and loss account, balance sheet and other publications made by the banks. Also some data has been gathered from Nepal Stock Exchange's website. Similarly, articles, journals, bank bulletins, newspaper related to financial performance study, previous research report etc, have also been taken into account while collecting information.

3.2.2. Population and Sample

The population in most studies usually consists of large groups. Because of its large size it is fairly difficult to collect detailed information from each member of population. Rather than collecting information from each member, a sub-group is chosen which is believed to be representative of Population. This sub group is called a Sample. The total commercial banks shall constitute the population of the data. So, among the various commercial banks in the banking industry-SBI, HBL and NBL are taken as sample for the study.

3.3. Method of Data Analysis and Presentation

Data itself give no meaning. They should be analyzed and interpreted by using different tools and techniques. These tools and techniques may either be statistical or may be other. Various financial ratios and statistical tools will be used to draw conclusion of the study. Besides some charts and tables have been presented to analyze and interpret the finding of the study.

3.4 Financial Tools

Financial tools basically help to analyze the financial strength and weakness of a firm. Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concerned especially to take output and credit decisions. Ratio analysis is used to compare firm's financial performance and status with of the other firm's. Even though there are many ratios to analyze and interpret the financial statement following ratios are calculated and analyzed.

3.4.1. Credit /Loan related ratios

In this study followings tools of ratio analysis have been used

a) Loan and advances to total assets ratio

Loan and advances is an important part of total assets (total working fund). Total working fund play important role in profit earning through fund mobilization. So bank should carefully mobilize the total assets. The ratio of loan and advances to total assets measures the volume of loan and advances in the structure of total assets. A high ratio indicates better in mobilization of funds as loan and advances and vice-versa.

$$\text{Loan and advances to total assets } X \frac{\text{Loan and advances}}{\text{Total assets}}$$

b) Total investment to total deposit ratio

Commercial bank may mobilize its deposit by investing its fund in different securities issued by government and other financial and non-financial companies. Efforts have been made to measure the extent to which the banks are successful in mobilizing the total deposit on investment. A high ratio is the indicator of high success to mobilize the banking fund as investment and vice-versa.

$$\text{Total investment to total deposit ratio } X \frac{\text{Total investment}}{\text{Total deposit}}$$

c) Loan and advances to total deposit ratio

This ratio is calculated to find out how successfully the banks are utilizing their deposit on loan and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits

$$\text{Loan and advances to total deposit ratio } X \frac{\text{Loan and advances}}{\text{Total deposit}}$$

d) Investment to loan and advances ratio

This ratio measures the contribution made by investment in total amount of loan and advances and investment. The proportion between investment and loan measures the management attitude towards risky assets and safety assets. Investment and loan and advances in whole do not provide the quality of assets that a bank has created. The ratio indicates the mobilization of funds in safe area and vice-versa.

$$\text{Investment to loan and advances and investment ratio X} \frac{\text{Investment}}{\text{Loan and advances and investment}}$$

e) Liquid Fund to Loan and Advances Ratio

This ratio is calculated by dividing loan and advances to liquidate ratio. The liquid fund includes-cash balance, money at call, etc whereas Loan and advances includes short term loan and advances, overdraft, cash credit etc

$$\text{Liquid Fund to loan and advances ratio} = \frac{\text{Loan and advances}}{\text{Liquid Fund}}$$

3.4.2 Credit Efficiency Ratio

It measures the performance efficiency of an organization from various angles of its operations. These ratios indicate the efficiency of activity of an enterprise to utilize available funds, particularly short term funds. These ratios are used to determine the efficiency, quality, and the contribution of loan and advances in the total profitability. The efficiency of a firm depends to a large extent on the efficiency with which its assets are managed and utilized. This ratio also shows the utilization of available fund. The following ratio measures the performance efficiency of the bank to utilize funds.

a) Loan Loss Provision to total loans and advances ratio

NRB has directed the commercial banks to classify its loan and advances into the category of pass, substandard, doubtful, and loss. NRB has classified the pass and substandard loan as performing loan and other two types of loan as non-performing loans. The provision created against the pass and substandard loan is called the general loan loss provision and provision created against the doubtful and loss loan is called specific loan loss provision. The provision of loan loss reflects the increasing probability of non performing loan. The provision of loan mean the net profit of the banks will come down by such amount. Increase in loan loss provision decreases profit that result to decreases in dividends but its positive impact is that it strengthens the financial conditions of the banks by controlling the credit risk and reduces the risks related to deposits. Loan loss provision to total loan and advances ratio is calculated by dividing loan loss provision by total loan and advances. The low ratio indicates the good quality of assets in total volume of loan and advances. High ratio indicates more risky assets in total volume of loan advances.

$$\text{Loan loss provision to total loan and advances } X \frac{\text{Loan loss provision}}{\text{Total loan and advances}}$$

b) Non Performing loan to total loan and advances ratio

Non performing loans to total loan and advances ratio shows the percentage of non recovery loan in total loan and advances. This ratio is calculated as dividing non-performing loan by total loan and advances.

$$\text{Non - performing loan to total loan and advances } X \frac{\text{Non - performing loan}}{\text{Total loan and advances}}$$

3.4.3 Loan and Advance Portfolio

a) Priority Sector credit to total credit ratio

Priority sector includes micro and small enterprises. Micro and small enterprises are classified as agriculture enterprises, cottage, small industries and services. This ratio is calculated by dividing priority sector credit by total credit.

b) Sector wise credit to total credit ratio

Sector wise credit to total credit ratio can be calculated by dividing sector wise credit by total credit of selected commercial banks. Mainly following heading are found in the sector wise credit-Agriculture, Mining, Productions, Construction, Metal Productions, Machinery and Electrical, Tools and Fittings, Transportation, Equipment Production and Fitting, Communications and Public Service, Wholesalers and Retailers, Finance, Insurance and Fixed Assets, Service Industries, Consumable Loan, Local Government, Others.

c) Mix of security wise loan and advance

Under the security of loan and advances comparison, security status of selected bank is taken into consideration. Mainly following headings are found under the heading of security in the Nepalese scenarios-Gold/Silver, Government Securities, Non Government Securities, Fixed A/c Receipt, Asset Guarantee, on bills Guarantee.

d) Deprived sector to total credit

Deprived sector credit includes low income and particularly socially backward women, tribes, lower caste, blind, hearing impaired and physically persons and squatter family. Deprived sector credit to total credit ratio can be calculated by dividing deprived sector credit by total credit.

3.4.4 Profitability Ratio

In this regard following tools are taken for the effectiveness of credit mobilization:

a) Operating Profit to loan and advances ratio

Operating profit to loan and advances ratio measures the earning capacity of commercial banks. This ratio is calculated dividing operating profit by loan and advances.

$$\text{Operating profit to loan and advances ratio X} \frac{\text{Operating profit}}{\text{Loan and advances}}$$

b) Net profit to Loan and Advances ratio

This ratio measures the earning capacity of commercial banks through its fund mobilization as loan and advances. Higher ratio indicates greater success to mobilize fund as loan and advances and vice-versa. Mostly loan and advances includes loan cash credit, overdraft, bill purchased and discounted.

$$\text{Return on loan and advances X}\frac{\text{Net profit}}{\text{Loan and advances}}$$

c) Interest Income to Total Loan and Advances Ratio

Interest income is the major source of bank revenue. Interest incomes are the functions of mobilized loan and advances which are mobilized under the different headings of credit. Higher interest income shows higher revenue for the bank.

d) Interest Expenses to Deposit ratio

Interest expenses are the functions of deposit products under the various headings, which is corporate, individuals, saving, fixed deposit, call etc. Since bank pays interest on the deposit fund, it is the cost or expenses of the bank which is a major part of the total expenses of the bank. But the cost of deposit and interest income of a loan is determined by market movement. So, bank does not have strong control over interest expenses.

e) Spread Analysis

Gap between interest income and interest expenses is known as spread hereunder. Generally, banks are trying to maintain high spread either collecting lower costing deposit or lending high interest earning credits. In aggregate widening spreads are the indicators of banks profitability and vice versa.

f) Loan to public Enterprise ratio

Commercial banks grant various types of loans to different Corporation. These Corporation includes Industrial, Trading, Financial, Service Oriented and Other Government Corporations. This ratio is calculated as dividing Corporation wise loan by total loan.

3.5. Statistical Tools

For supporting the study, statistical tools such as -Mean, Standard Deviation, Coefficient of Variation tools have been used.

3.5.1. Arithmetic Mean

Averages are measures that condense a huge mass of data into single value representing whole data. Average is statistical constants which enable us to comprehend in a single effort the significance of the whole. It is calculated as

$$\overline{X} = \frac{\phi x}{N}$$

Where ,

$\overline{X}$ = Mean value or Arithmetic mean

ϕx =Sum of the Observation

N = Number of Observations

3.5.2. Standard Deviation

The standard deviation is the square root of mean squared deviations from the arithmetic mean and is denoted by standard deviation .It is calculated as

$$\exists = \sqrt{\frac{\phi x^2}{N} - \frac{\phi x}{N}^{2}}$$

Where ,

$\exists$ = Standard Devitation

$$\frac{\phi x^2}{N} = \text{Sum of Squares of Observation}$$

$$\frac{\phi x}{N}{}^{2} = \text{Sum of Square of mean|}$$

3.5.3 Co-efficient of variation

The coefficient of variation (C.V) is the relative measure based on standard deviation and is defined as the ratio of standard deviation to mean expressed in percent. It is calculated as

$$\text{C.V.} = \frac{\exists}{\overline{X}} \times 100$$

Where ,

C.V. = Coefficient of Variation

$\exists$||||||| =Standard Deviation|

$\overline{X}$ = Mean

It is independent of units. Hence, it is suitable measure for comparing variability of two series with same or different units. A series with smaller coefficient of variation is said to be less variable or more consistent or more homogenous or more uniform or more stable than others and vice-versa.

CHAPTER-IV
DATA ANALYSIS AND PRESENTATION

This chapter deals with the presentation, analysis and interpretation of relevant data of sampled commercial bank in order to fulfill the objectives of this study. To obtain best result, data have been analyzed according to the research methodology as mentioned in third chapter. The purpose of this chapter is to introduce the mechanism of data analysis and interpretation. With the help of this analysis, efforts have been made to highlight comparative credit management status of selected Commercial banks (CBs). For analysis, different types of analytical methods and tools such as financial ratio analysis and statistical tools are used to draw the conclusion of the study. Similarly analyzed results are graphically represented for the visibility and simplicity of conclusion.

4.1 Financial Tools

Various financial tools are used to draw the meaningful conclusion of the study. Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concerned especially to take output and credit decisions. Ratio analysis is used to compare firm's financial performances and status that of the other firm's. Even though there are many ratios to analyze and interpret the financial statement those ratios that are related to the investment and credit operation of the bank have been covered in this study

4.1.1 Credit/Loan related ratios

In this study we have used following ratio analysis.

4.1.1.1 Liquid Fund to Loan and advances.

Loan and advances are the major component in total assets, which indicates the banks ability to mobilize its deposit in the form of loan and advances to earn high return. If sufficient loan and advances cannot be granted it should pay interest on those utilized deposit funds and may lose earning. This ratio is calculated by dividing loan and advances to liquidate fund. Loan and advances includes short term loan and advances, overdraft, cash credit, local and foreign bills purchased and discounted. Similarly cash balances, bank balances money at call etc are included under the heading of liquid funds

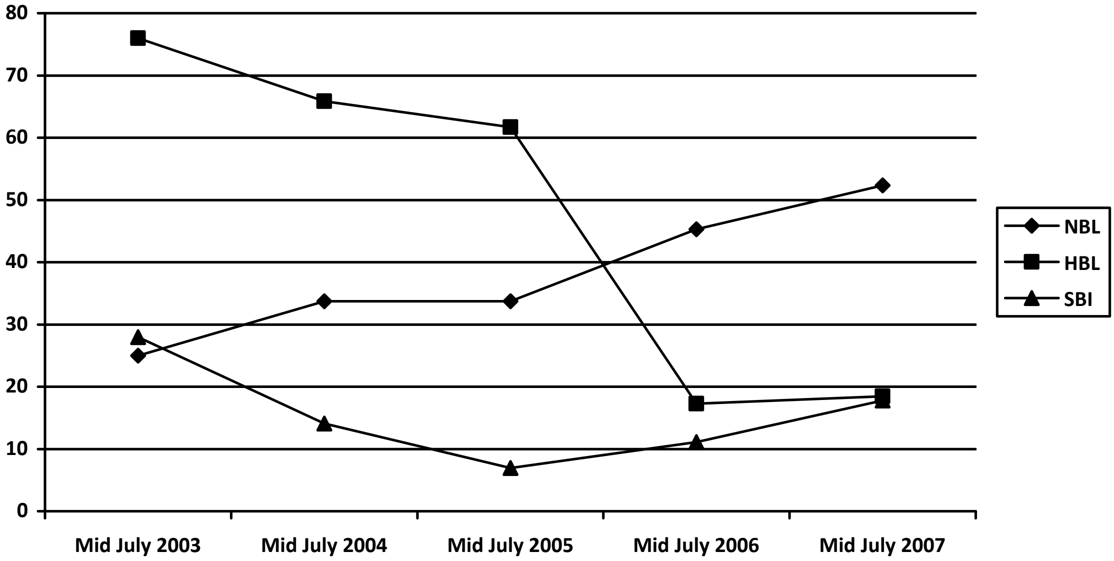
Table 1

Liquidity Funds to Loan and Advances Ratio

Year	NBL	HBL	SBI
Mid July 2003	25	76	27.96
Mid July 2004	33.72	65.84	14.11
Mid July 2005	33.72	61.70	6.94
Mid July 2006	45.29	17.25	11.09
Mid July 2007	52.35	18.44	17.81
Mean	38.06	47.84	15.58
S.D	9.64	24.93	7.14
C.V	25.36	52.11	45.84

Figure No. 1

Liquidity Funds to Loan and Advances Ratio



The above table and graph present, liquidity fund of NBL is in upward trend because respective graph is increasing slowly. However movement of NBL is almost same during the period of 2004 and 2005. After the period of 2005 liquidity of NBL is increasing significantly. Similarly, liquidity of HBL is in peak during the period of 2003 but than after it is in declining form. Till the period of 2005, liquidity of HBL has declined slowly but after the said period liquidity has declined significantly. In case of SBI, liquidity seems less volatile because it has not significant movement as NBL and HBL but comparatively, liquidity of SBI has decreased significantly after the period of 2003. The average mean, standard deviation and coefficient of variation of HBL are comparatively more than NBL and SBI.SBI would be in liquidity crunch if heavy withdrawal is made.

4.1.1.2 Loan and advances to total assets ratio

Loan and advances is the major part of total assets for the bank. This ratio indicates the volume of loan and advances out of total assets. A higher degree of ratio indicates that the bank has been able to mobilize its funds throughout lending function but not better from the point of liquidity.

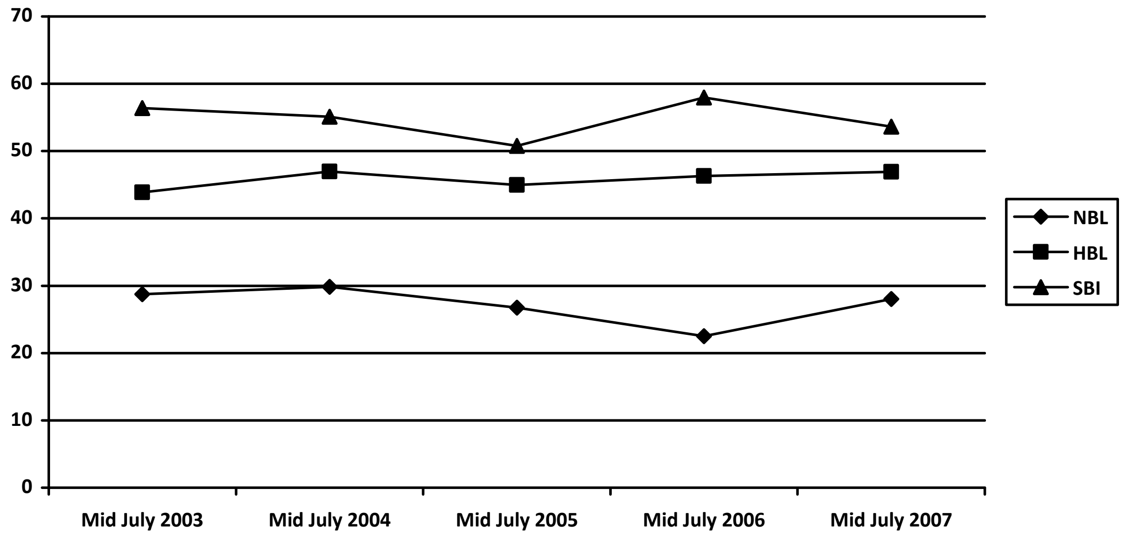
Table 2

Total Loan and Advances to Total Assets Ratio

Year	NBL	HBL	SBI
Mid July 2003	28.76	43.89	56.40
Mid July 2004	29.82	46.98	55.11
Mid July 2005	26.74	44.95	50.77
Mid July 2006	22.50	46.28	57.98
Mid July 2007	28.04	46.93	53.61
Mean	27.17	45.80	54.77
S.D	2.54	1.20	2.46
C.V	9.34	2.62	4.5

Figure 2

Total Loan and Advances to Total Assets Ratio



Looking at the trend of selected CBs in above table and graph, SBI has higher weight to loan and advances in form of the total assets, which means SBI is massively or aggressively rendering credit to the clients. Higher credit mobilization helps to reap interest income, which ultimately cause to raise profit of the bank. Total weight of credit on total asset is more or less same in the case of SBI during the study period. Similarly, HBL is deploying moderate level of credit to the clients because its weight of credit is scattered around 45% to 55%. NBL is lowering the weight of credit till the period of 2006, however for the year 2007 weight of credit is up warded. So, comparatively SBI is deploying credit aggressively, HBL is moderately deploying credit and NBL is in very defensive form in the concern of credit deployment.

On the other hand, the mean ratio of SBI is higher than the NBL and HBL i.e. 54.777>45.80 and 22.17.It seems that SBI is strongly mobilizing its total loan and advances with regard to total amount of NBL and HBL. The standard deviation of NBL, HBL and SBI are 2.54%, 1.20% and 2.46% respectively

4.1.1.3 Total investment to total deposit ratio

Commercial Banks (CBs) may mobilize its deposit by investing its fund in different securities- issued by government and other financial and non-financial companies. High ratio is the indicator of high success to mobilize the banking fund as investment and vice-versa.

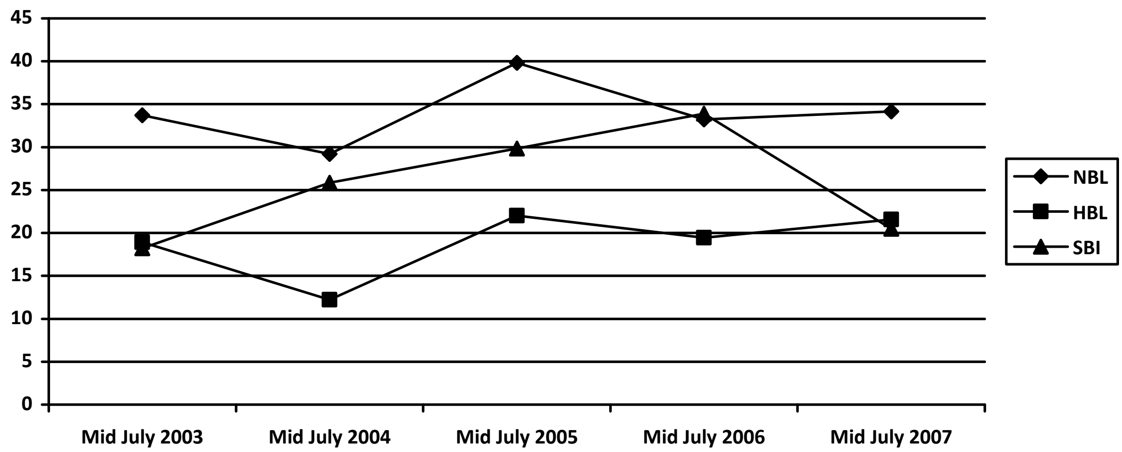
Table 3

Total Investment to Total Deposit Ratio

Year	NBL	HBL	SBI
Mid July 2003	33.73	18.94	18.23
Mid July 2004	29.19	12.22	25.87
Mid July 2005	39.82	22.02	29.83
Mid July 2006	33.22	19.44	33.91
Mid July 2007	34.16	21.58	20.49
Mean( )	34.02	18.84	25.66
S.D	3.39	3.51	5.78
C.V	9.96	18.63	22.52

Figure 3

Total Investment to Total Deposit Ratio



NBL is mobilizing higher deposit to investment during the period of the study however trend of investment seems fluctuating. During the period of 2005 high investment is made than after it seems in down trend. Similarly, trend of SBI is in increasing till the period of 2006 but than after SBI has lowered its investment. In the concern of HBL investment tends seems more or less same during the period. So, NBL is mobilizing higher deposit to investment, SBI is in moderate condition and HBL is in lower level. However, during the period of 2007 investment ratio of HBL has exceeded the SBI. Since calculated mean of NBL is higher than of HBL and SBI, it is mobilizing higher deposit to investment.

4.1.1.4 Loan and advances to total deposit ratio (C/D Ratio)

This ratio is calculated to measure the banks success in utilizing their deposits on loan and advances for profit generating activities. Greater ratio indicates the better utilization of total deposits but may cause to face liquidity crunch. Similarly lower indicators may defenses the liquidity crunch but restrict to reap interest income from the potential credit mobilization.

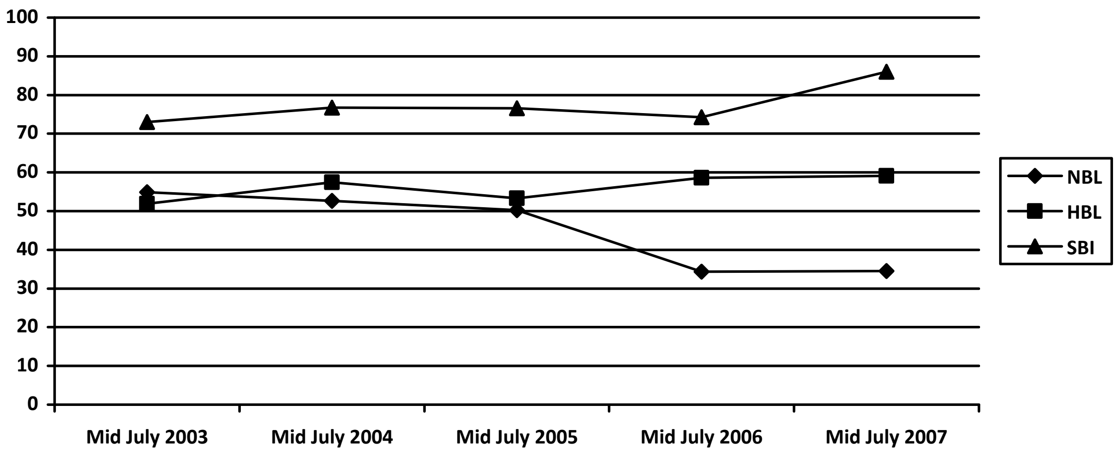
Table 4

Loan and advances to Deposit Ratio

Year	NBL	HBL	SBI
Mid July 2003	54.92	51.87	72.99
Mid July 2004	52.65	57.47	76.77
Mid July 2005	50.24	53.34	76.55
Mid July 2006	34.36	58.64	74.26
Mid July 2007	34.55	59.09	86.04
Mean( )	45.34	56.08	77.32
S.D	9.01	2.92	4.58
C.V	19.87	5.20	5 .9 2

Figure 4

Loan and advances to Deposit Ratio



Looking at the above table and graph, SBI is mobilizing higher deposit on credit, which is almost same during the period of 2003 to 2006 but after this period it has raised the ratio. Similarly HBL is mobilizing approximately one half of its total deposit during the period however it is also in increasing trend after the period of 2006. During the starting of sampled period HBL and NBL has mobilized more or less percentage of credit. But after the period of 2004 NBL is lowering its credit significantly. So, comparatively, deposit mobilization of SBI is in higher side, HBL is moderately mobilizing its deposit on credit and NBL is mobilizing slightly lower credit. The average ratio in study period of NBL, HBL and SBI is 45.34%, 56.08%, 77.32%. It shows that SBI seem to be strong to mobilize its total deposit as loan and advances in comparison to NBL and HBL. On the basis of coefficient of variation, SBI loan and advances ratio is more consistent than NBL and HBL because of its lower C.V

4.1.1.5 Investment to Loan and advances ratio.

This ratio measures the contribution made by investment in total amount of loan and advances .The proportion between investment and loan and advances measures the management attitude towards risky assets and safety of assets. Investment and loans and advances in whole do not provide the quality of assets that a bank has created. The ratio indicates the mobilization of funds in safe area and vice-versa.

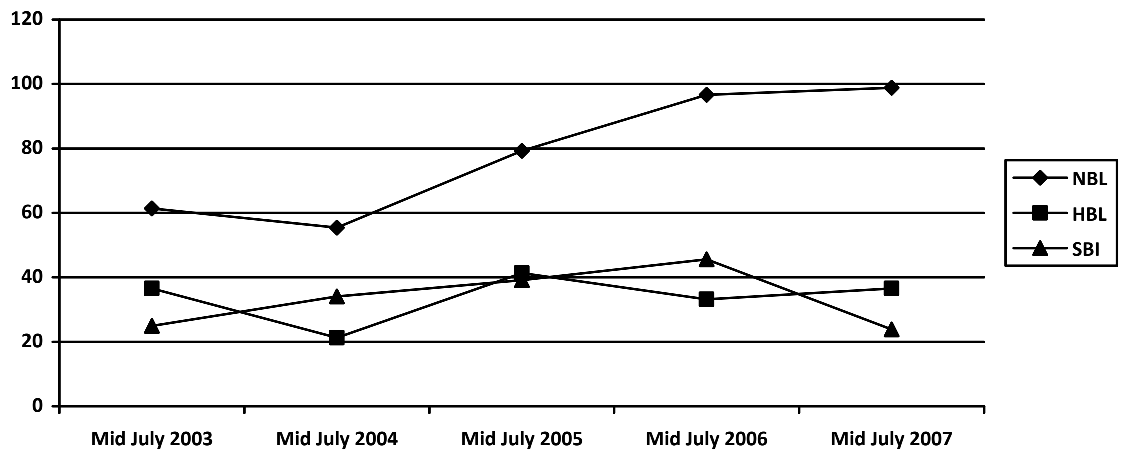
Table 5

Investment to Loan Advance Ratio

Year	NBL	HBL	SBI
Mid July 2003	61.44	36.53	24.98
Mid July 2004	55.44	21.26	34.08
Mid July 2005	79.27	41.29	39.10
Mid July 2006	96.69	33.15	45.62
Mid July 2007	98.86	36.52	23.81
Mean( )	78.34	33.75	33.51
S.D	17.71	6.76	8.3
C.V	22.60	20.02	24.76

Figure 5

Investment to Loan Advance Ratio



Investment proportion of NBL is in increasing trend however it was declined during the period of 2004. Similarly, ratio of HBL is higher than

SBI during the starting year but trend of SBI is higher after 2003 and again has declined lower than HBL in the year 2007. Investment is known as defense of liquidity so NBL is trying to make liquid investment than other loan. Similarly other two CBs are mobilizing higher loan and advances than investment. Ratio of investment to total loan and advance is in higher side for NBL than other. Similarly HBL has moderate ratio and SBI has lower ratio. The average of NBL is 78.34% and standard deviation is 17.71% and coefficient of variation is 22.60 which mean consistency in this ratio is 77.4% during the research period. Similarly, average ratio of HBL is 33.75 and standard deviation is 6.76 and consistency ratio is 79.98. For SBI average is 33.51 and coefficient of variation is 24.76

4.1.2 Credit Efficiency Ratio

This ratio indicates the efficiency of activity of an enterprise to utilize available funds, particularly short term funds. These ratios are used to determine the efficiency, quality and the contribution of loan and advances in the total profitability. This ratio also shows the utilization of available fund. The following activity ratios measures the performance efficiency of the bank to utilize funds

4.1.2.1 Loan loss provision to total loans and advances ratio

The provision for loan loss reflects the increasing profitability of non performing loan .Increase in loan loss provision decreases profit which results to decrease in dividend. But its positive impact is that it strengthen the financial condition of banks by controlling the credit risk and reduces the risk related to deposit .The low ratio indicates the good quality of assets in total volume of loan and advances. High ratio indicates more risky assets in total volume of loan and advances.

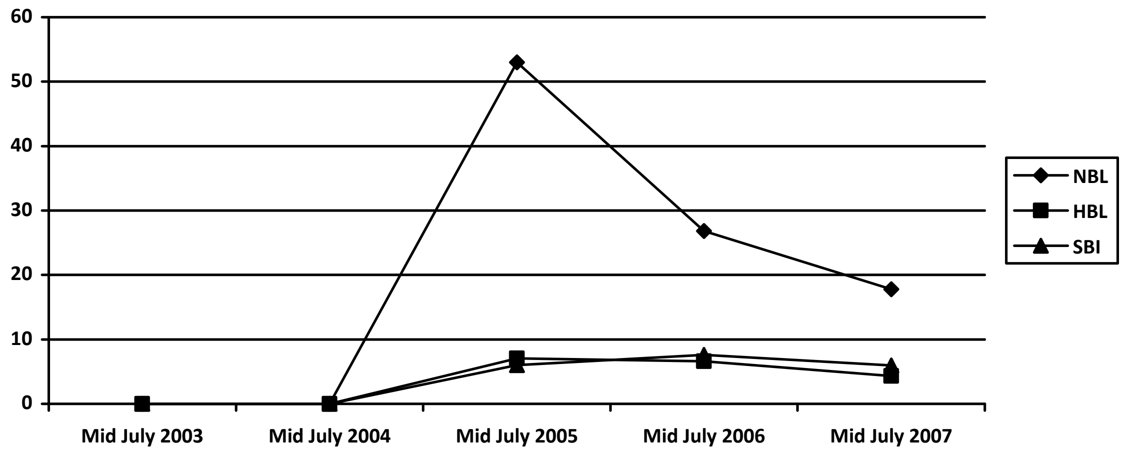
Table 6

Loan Loss Provision to Total Loan and Advances Ratio

Year	NBL	HBL	SBI
Mid July 2003	0	0	0
Mid July 2004	0	0	0
Mid July 2005	52.98	7.07	6
Mid July 2006	26.83	6.63	7.61
Mid July 2007	17.76	4.3	5.98

Figure 6

Loan Loss Provision to Total Loan and Advances Ratio



Looking at the above table and graph, loan loss provision of NBL is higher than HBL and SBI. However the ratios of three CBs are same at the starting period. Similarly ratios of HBL and SBI are more or less same. Higher loan loss provision cause to lower the profit of the banks. NBL has higher loan loss provision so profit of NBL is directly affected by the said provision. SBI and HBL has more or less same ratio which is also affecting the profit moderately.

4.1.2.2 Non performing loan to total loan and advances ratio

Non performing loans to total loan and advances ratio shows the percentage of non-recovery loans in total loan and advances. This ratio is calculated as dividing non-performing loan by total loan and advances. Loan loss provision is the function of substandard credit which is also known as non performing loan (NPL). Higher the NPL, higher would be deduction on profit because of provision.

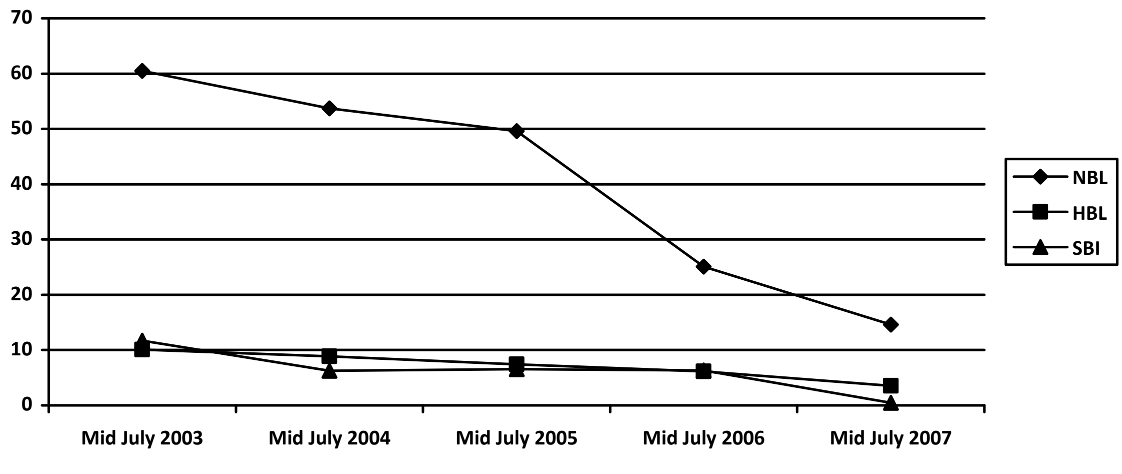
Table 7

Non-Performing Loan and Advance Ratio

Year	NBL	HBL	SBI
Mid July 2003	60.47	10.07	11.71
Mid July 2004	53.74	8.88	6.25
Mid July 2005	49.63	7.44	6.54
Mid July 2006	25.10	6.13	6.31
Mid July 2007	14.59	3.53	0.46

Figure 7

Non-Performing Loan and Advance Ratio



NBL has higher NPL during the year of 2003 but after this period NBL is lowering the percentage of NPL. Declined NPL is the indicator of recovered or restructured loan so NBL is trying to make good credit at present by recovering the past due credits. HBL and SBI are also lowering the NPL at present than the past performance. So, all three CBs are tying to lower the NPL than past however ratio of NBL is higher than other two banks.

4.1.3 Portfolio of Loan and advances

For the purpose of analyzing the portfolio behavior of loans and advances of the bank during the study period, various credits related analysis is done as under.

4.1.3.1 Priority sector credit to total credit ratio

Priority sector includes micro and small enterprises. Micro and small enterprises are classified as agriculture enterprises, cottage, small industries and services. This ratio is calculated by dividing priority sector credit by total credit.

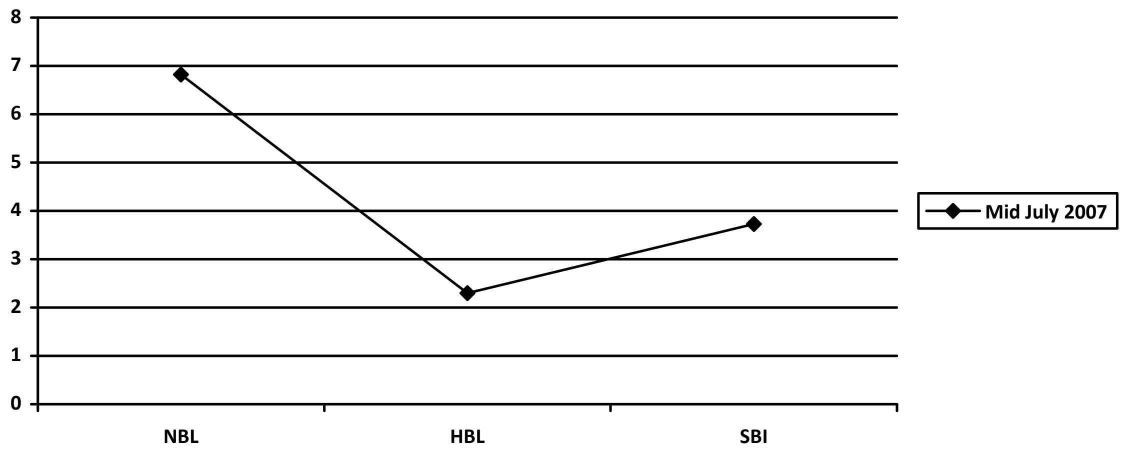
Table 8

Priority Sector Credit to Total Credit

Year	NBL	HBL	SBI
Mid July 2007	6.82	2.30	3.73

Figure 8

Priority Sector Credit to Total Credit



In the above table and graph, NBL is mobilizing only 7% credit in priority sector of total credit and HBL is mobilizing 2% and SBI is mobilizing 4%. Comparatively NBL is mobilizing higher fund to the priority sector, SBI is moderately mobilizing priority sector credit and in the case of HBL said credit to priority is lower than other CBs.

4.1.3.2 Deprived sector credit to total credit ratio

Deprived sector credit includes low income and particularly socially backward women, tribes, lower caste, blind, hearing impaired and physically persons and squatter family. Deprived sector credit to total credit ratio can be calculated by dividing deprived sector credit by total credit.

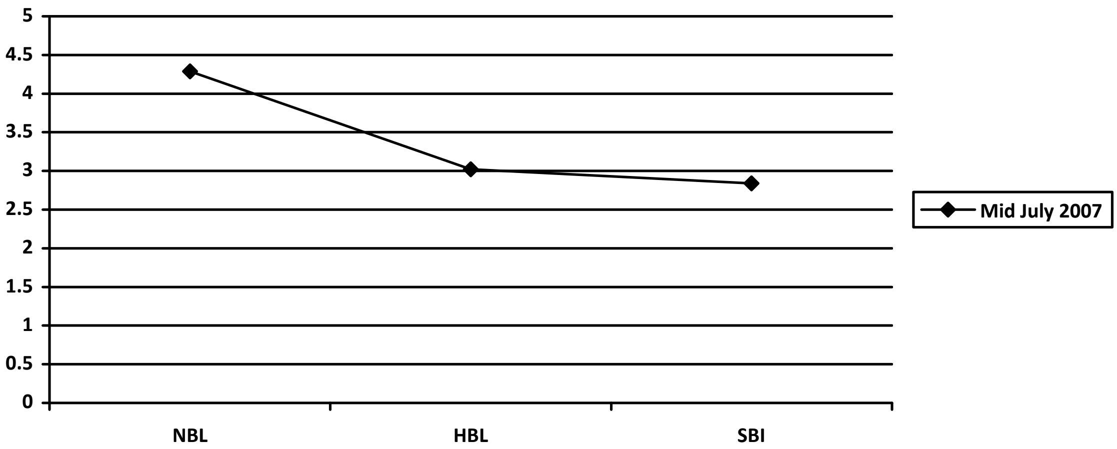
Table 9

Deprived Sector Loan to Credit ratio

Year	NBL	HBL	SBI
Mid July 2007	4.29	3.02	2.84

Figure 9

Deprived Sector Loan to Credit ratio



Above diagram and table depicts, deprived sector credit ratio of NBL is higher enough than other two CBs. For the calculation, till the date total deprived sector credit is taken. So, till the date NBL is mobilizing higher credit under this heading than other CBs.

4.1.3.3 Sector wise loan and advances of NBL, HBL and SBI

Sector wise lending means there are various sectors that the bank has opportunity to invest. NRB have issued in its directives that commercial banks have to invest certain percentage in the deprived and priority sector so that the backward sector will also get benefit from financial facility.

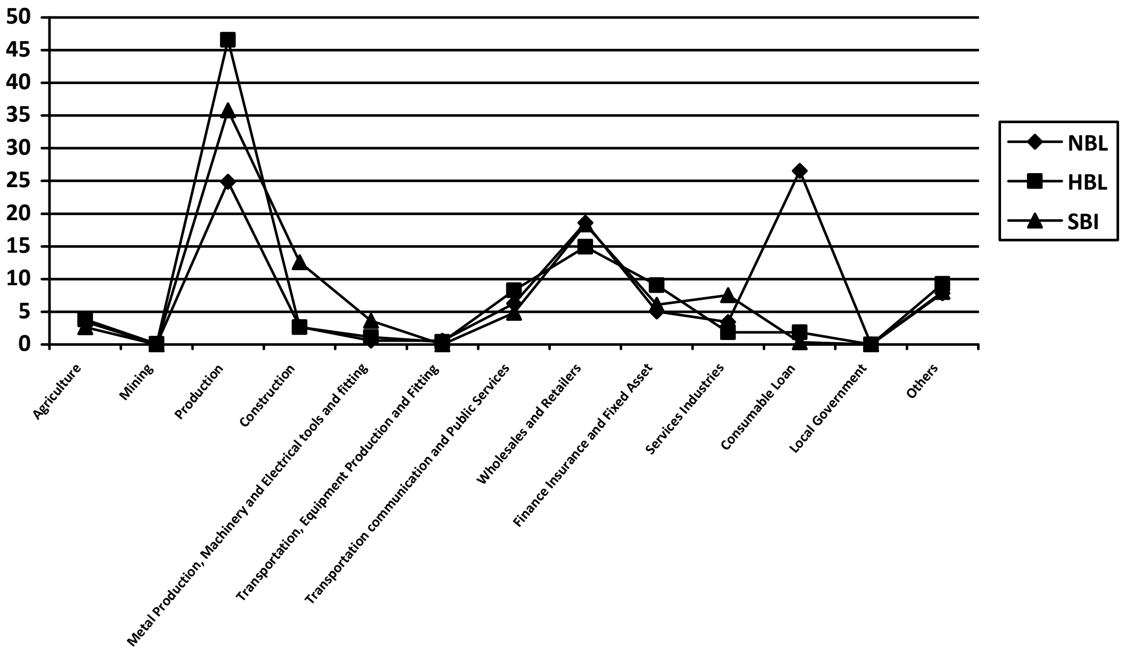
Table 10

Sector wise loan and advances and ratio (%) out of total lending

Sector	NBL	HBL	SBI
Agriculture	3.48	3.80	2.64
Mining	0.05	0.11	0.01
Production	24.88	46.59	35.81
Construction	2.71	2.66	12.61
Metal Production, Machinery and Electrical tools and fitting	0.58	1.11	3.62
Transportation, Equipment Production and Fitting	0.61	0.41	0
Transportation communication and Public Services	6.28	8.28	4.86
Wholesales and Retailers	18.62	14.95	18.38
Finance Insurance and Fixed Asset	5.04	9.08	6.05
Services Industries	3.42	1.86	7.56
Consumable Loan	26.52	1.86	0.36
Local Government	0	0	0
Others	7.85	9.24	8.05

Figure 10

Sector wise loan and advances and ratio (%) out of total lending



Three CBs are equally deploying more or less same volume of credit on agriculture sector till mid July 2007. Under the heading of mining a small volume of amount is invested. Similarly HBL is mobilizing more weight to production credit on the total credit mix, than after SBI is mobilizing moderately and NBL has lower weight to production credit. In the case of construction, credit with of SBI is higher than NBL and HBL however weight of construction credit is same for NBL and HBL. Metal production credit of SBI is higher than other. Transportation equipment heading has more or less equal weight of three banks. Under the heading of transportation communication HBL has assigned higher weight and NBL is assigning higher than SBI and lower than HBL. Weight of wholesale and retail loan is more or less for SBI and NBL however weight of HBL is lower than NBL and SBI. Weight of finance insurance and fixed asset is higher for HBL and weight of SBI appears as moderate and weight of NBL is lower than other. Under the heading of service credit, weight of SBI is higher where as weight of NBL is moderate and weight of SBI is lower than other. Weight of consumable loan is higher for NBL but SBI and HBL is assigning very few funds for this sector. Under the local government heading more or less same fund is allocated by the selected CBs. Similarly NBL, HBL and SBI are also allocating tentatively equal fund for other heading.

4.1.3.4 Security wise Loan and advances of NBL HBL and SBI

None of the banks invest without the security. Holding security means to be assured that the bank will recover the lending amount if client did not pay back the principal and interest in the due course of time.

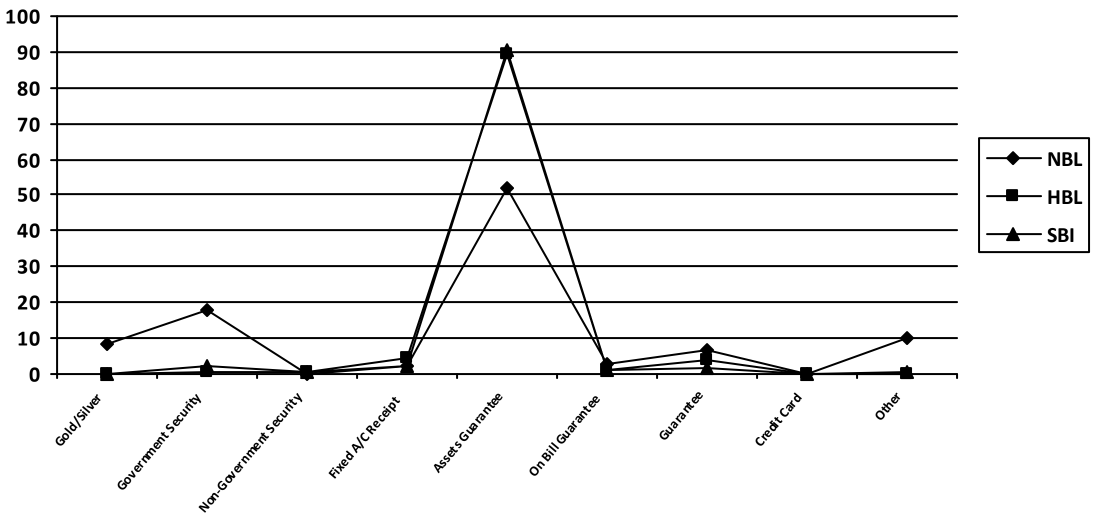
Table 11

Security Analysis

Security	NBL	HBL	SBI
Gold/Silver	8.35	0	0
Government Security	17.62	0.78	2.51
Non-Government Security	0.04	0.37	0.58
Fixed A/C Receipt	2.16	4.2	2.46
Assets Guarantee	52	89.2	90.68
On Bill Guarantee	2.77	0.94	1.30
Guarantee	6.77	4.08	1.72
Credit Card	0	0.26	0
Other	10.06	0.14	0.71

Figure 11

Security Analysis



Above graph and table represents, NBL is maintaining higher security on gold and silver where HBL and SBI have almost zero security. In the case of government security NBL is in higher side, SBI has a very few amount and HBL is almost nil. Three CBs has more or less same security under the heading of non government securities. SBI and HBL have more or less same security under the heading of asset guarantee. However NBL has lower security under this heading. On bill guarantee case NBL, SBI and HBL have more or less same level of security. Under the heading of guarantee NBL has higher security; security of HBL is lower than NBL and higher than SBI. Security under credit card is almost zero for three banks. NBL higher security under other heading, SBI and HBL has more or less same level of security.

4.1.4 Profitability Ratios

Profit is the outcome of monetary or non monetary efforts that the bank has made from the clients. Main source of bank income is credit and main sources of expenses are deposit. So, the proper trade off should be made between this two variables. Besides this two components, various services generates income to the bank, similarly staffs, advertisement etc impose the cost of the bank. So, study deals with the overall operating income, net income, interest expenses, interest income and spread analysis

4.1.4.1 Operating profit to loan and advances ratio

Operating profit to loan and advances ratio measures the earning capacity of commercial banks. This ratio is calculated dividing operating profit by loan and advances.

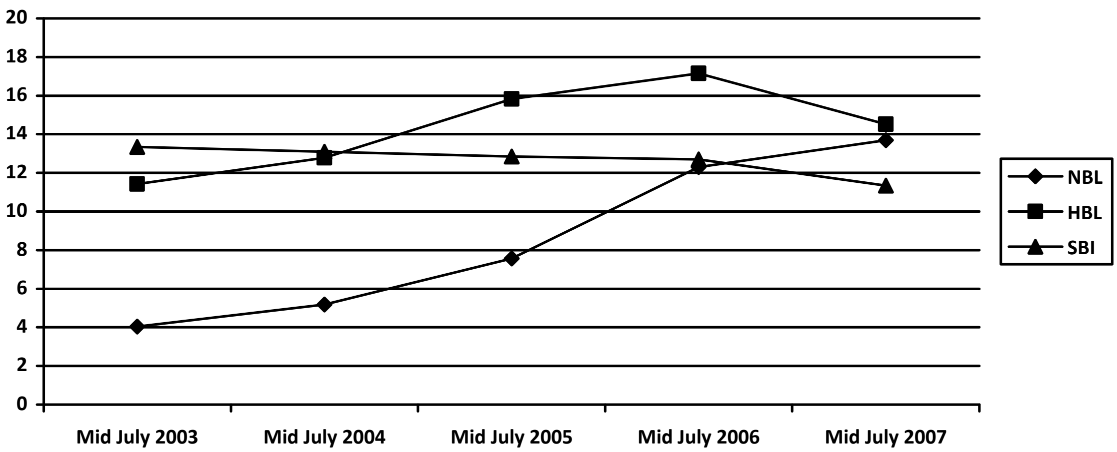
Table 12

Operating Profit to loan and advance ratio

Year	NBL	HBL	SBI
Mid July 2003	4.04	11.43	13.35
Mid July 2004	5.18	12.78	13.09
Mid July 2005	7.57	15.83	12.85
Mid July 2006	12.30	17.15	12.70
Mid July 2007	13.70	14.52	11.34
Mean	8.55	14.34	12.66
S.D	3.82	2.04	0.69
C.V	44.67	14.22	5.45

Figure 12

Operating Profit to loan and advance ratio



Operating profit of SBI seems more or less unvarying during the period of 2003 to 2006 but it has been in decreasing trend. Similarly, trend of HBL is up-ward trend till the period of 2006 but it is also in declining shape than after. Operating profit of NBL is growing in steady growth but the motion of the growth is little bit slower in the year 2007. Comparing mean ratio HBL has higher ratio than NBL and SBI. It seems that HBL is success in maintaining its higher return on loan and advances in comparison with SBI an NBL. Similarly the coefficient of variation of NBL is higher than HBL and SBI

4.1.4.2 Net profit to Loan and Advances ratio

This ratio measures the earning capacity of commercial banks through its fund mobilization as loan and advances. Higher ratio indicates greater success to mobilize fund as loan and advances and vice-versa. Mostly loan and advances includes loan cash credit, overdraft, bill purchased and discounted.

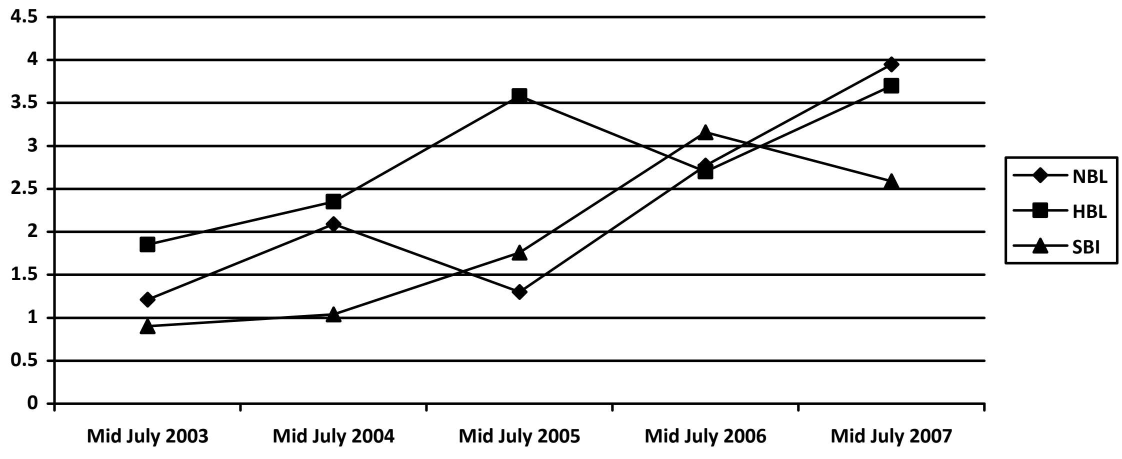
Table 13

Net Profit to loan and advance ratio

Year	NBL	HBL	SBI
Mid July 2003	1.21	1.85	0.90
Mid July 2004	2.09	2.35	1.04
Mid July 2005	1.3	3.58	1.76
Mid July 2006	2.77	2.70	3.16
Mid July 2007	3.95	3.70	2.59

Figure 13

Net Profit to loan and advance ratio



The above table and diagram shows relationship between net profit and loan advance seems more fluctuating. Ratio of HBL is more or less fluctuating. Ratio of NBL seems moderate till the period of 2004 but after the period of 2005 ratio of NBL is in increasing trend, motion of increment is sharp so, it has higher relation between net profit and loan and advances. Ratio of SBI is in increasing trend till the period of 2006 but than after the ratio has declined.

4.1.4.3 Interest income to Total Loan and advance ratio

It tells income as interest from total credit and advances. It is useful to know the fact that whether credit has given good return or not. One can increase interest income by taking good issuing and recovering of credit policy. High return show the soundness of credit policy

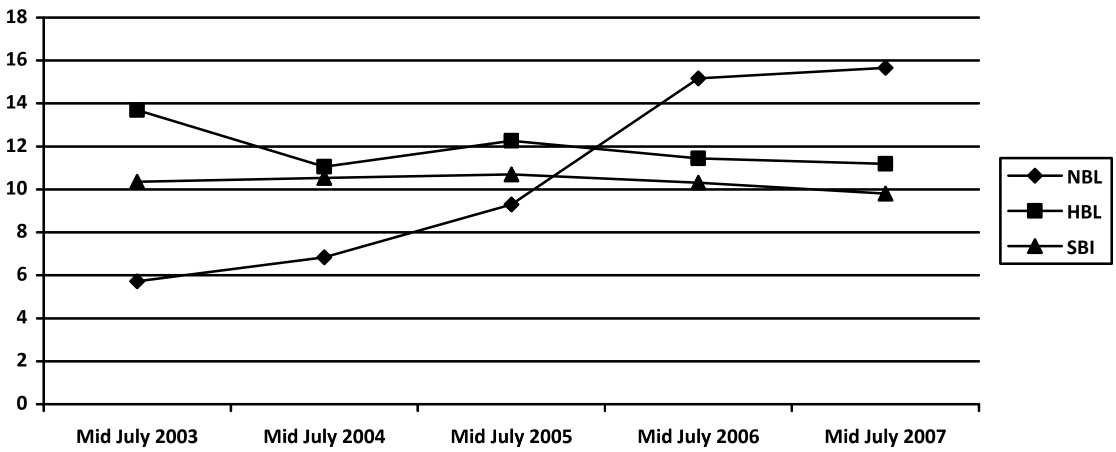
Table 14

Interest Income to loan and Advance ratio

Year	NBL	HBL	SBI
Mid July 2003	5.72	13.69	10.36
Mid July 2004	6.84	11.05	10.53
Mid July 2005	9.30	12.27	10.70
Mid July 2006	15.17	11.44	10.31
Mid July 2007	15.66	11.19	9.81
Mean	10.53	11.92	10.34
S.D	4.14	0.97	0.3
C.V	39.31	8.17	2.90

Figure 14

Interest Income to loan and Advance ratio



Interest income ratio is in increasing trend for NBL, which is good because interest income is one of the major sources of banks revenue. Similarly income ratio of SBI has declined after the period of 2006 however before this period ratio seems more or less same. Ratio of HBL is in fluctuating trend. So, HBL has more or less same level of income from the loan deployment. From the mean point of view the interest income to total loan and advances of HBL is slightly higher than that of other sampled banks.

4.1.4.4 Interest expenses to Deposit ratio

This ratio measures the percentage of total interest paid against total deposit. A high ratio indicates higher interest expenses on total deposit. Commercial bank is dependent upon its ability to generate cheaper fund. The cheaper fund has moved profitability of generating loans and advances and vice-versa.

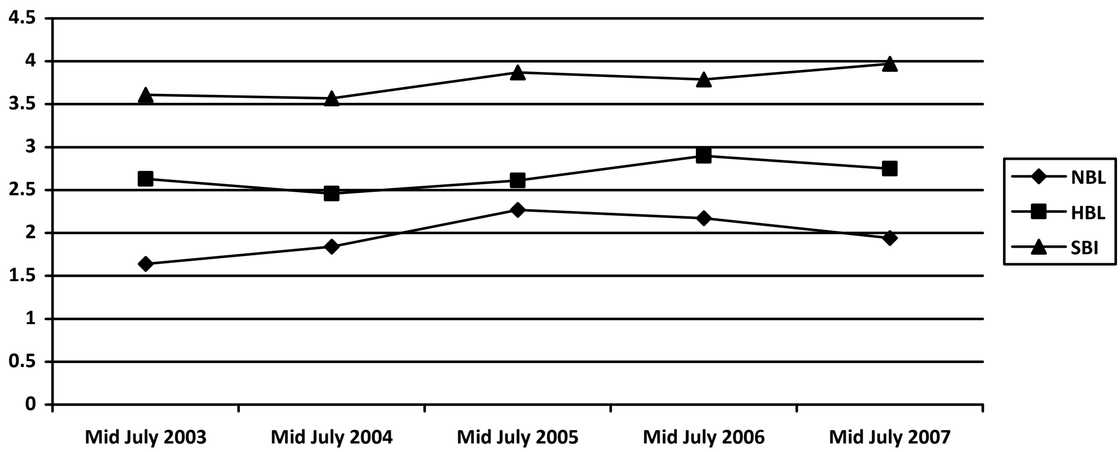
Table 15

Interest Expenses to Deposit ratio

Year	NBL	HBL	SBI
Mid July 2003	1.64	2.63	3.61
Mid July 2004	1.84	2.46	3.57
Mid July 2005	2.27	2.61	3.87
Mid July 2006	2.17	2.90	3.79
Mid July 2007	1.94	2.75	3.97
Mean	1.97	2.67	3.76
S.D	0.22	0.15	0.14
C.V	11.31	5.76	3.93

Figure 15

Interest Expenses to Deposit ratio



An interest expense of SBI is in increasing trend but the motion of growth is slow which is the indication of market competitiveness and charm of deposit for the BFIs. Similarly NBL has also increasing trend till the period of 2005 but than after it has declining ratio. Cost of fund or interest expenses ratio of HBL is lower than SBI. HBL is getting cheaper deposit and mobilizing to the higher yielding credit which would definitely helps to raise the profitability of the bank. SBI mean ratio is 3.76% which is higher than the HBL and NBL and it shows that it has higher interest expenses on total deposit.

4.1.4.5 Spread Analysis.

Gap between interest income and interest expenses is known as spread. Generally, banks are trying to maintain high spread either collecting lower costing deposit or lending high interest earning credits. In aggregate widening spreads are the indicators of banks profitability and vice versa. Net spread of a particular year may not provide proper information about the profitability because previous year credit mobilization also affects the profitability of the bank due to loan loss provisions, non performing loans etc. But after knowing the figure of particular year one can estimate, how bank is trying to maintain its spread higher.

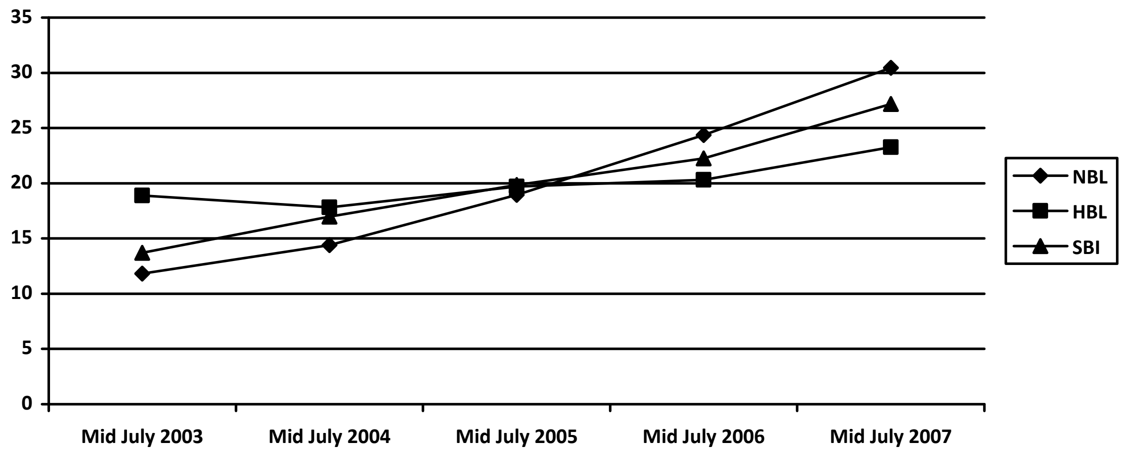
Table 16

Spread Analysis

Year	NBL	HBL	SBI
Mid July 2003	11.81	18.88	13.70
Mid July 2004	14.41	17.82	16.99
Mid July 2005	18.94	19.69	19.86
Mid July 2006	24.38	20.31	22.24
Mid July 2007	30.44	23.26	27.19

Figure 16

Spread Analysis



Looking at the figure and table, interest income and interest expenses ratios of HBL are moving in parallel trend so, HBL is maintaining similar level of gap or spread during the study period. In other words HBL is getting the deposit from the market and deploying the credit. So, present scenarios of growing BFIs are not affecting the HBL. Similarly interest expenses trend of SBI is also moving in as usual trend but trend of interest income is increasing trend. f So SBI is also not facing difficulties on credit deployment in the present scenarios. Looking at the movement of NBL, trends of interest income are in increasing trend than past but cost of deposit is more or less same than past. So, NBL is seems strong in the case of credit deployment. Being the first bank NBL may have get time to render the credit to other BFIs in higher interest rate due to apex competition of BFIs for the resources.

Loan to Public Enterprises Ratio

Commercial bank provides various types of loan to different corporation. These Corporation include-Industrial, Trading, Financial, Service Oriented and Other corporation. Loan to Public Enterprises ratio can be calculated by dividing corporation wise credit by total Credit.

To earn high profit most of commercial banks avoids extending loan on this area.

Table 17

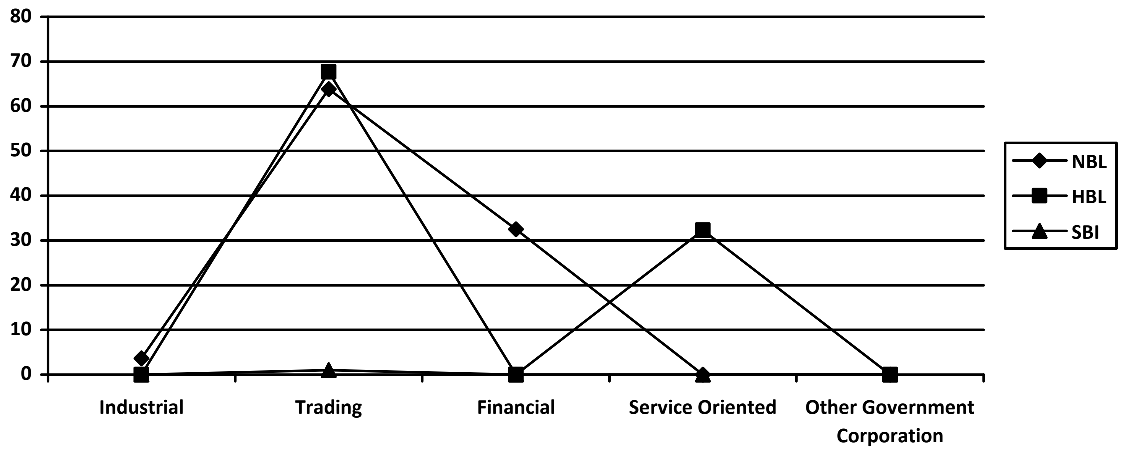
Loan to Public Enterprises Ratio

(As of mid July 2007)

Year	NBL	HBL	SBI
Industrial	3.67	0	0
Trading	63.83	67.68	1
Financial	32.48	0	0
Service Oriented	0	32.30	0
Other Government Corporation	0	0	0

Figure 17

Loan to Public Enterprises Ratio



NBL has provided higher loan to Industrial Corporation whereas HBL and SBI has almost nil credit supply to the industrial corporation. The weight age of credit to Trading Corporation of HBL is comparatively more than NBL and a very low credit is provided by SBI. SBI and HBL are providing low credit (almost Zero) to financial Corporation and NBL is providing higher to this Corporation. NBL and SBI are providing no credit to Service oriented Corporation. All the three banks are providing no credit to other Government Corporation.

Major Findings

- HBL is safe form the side of liquidity similarly SBI and NBL would be in liquidity crunch if heavy demand is made (withdrawal) from the depositors.
- Comparatively SBI is aggressively deploying credit, trend of credit mobilization of HBL is moderate and NBL seems very defensive for credit mobilization.
- Comparatively NBL is mobilizing higher deposit to investment, SBI is moderate condition and HBL is in lower level. However, during the period of 2007 investment of HBL has exceeded the SBI.
- Deposit mobilization on credit of SBI is in higher side, HBL is moderately mobilizing its deposit on credit and NBL is mobilizing slightly lower credit.
- Ratio of investment to total loan and advance is in higher side for NBL than other. Similarly HBL has moderate ratio and SBI has lower ratio.
- NBL has higher loan loss provision, SBI and HBL has more or less same ratio.
- CBs are tying to lower the NPL than past however ratio of NBL is higher than other.

- Comparatively NBL is mobilizing higher fund to the priority sector, SBI is moderately mobilizing priority sector credit and in the case of HBL said credit is lower than other CBs.
- Deprived sector credit ratio of NBL is higher enough than other two CBs.
- Looking at the aggregate figure as of mid July 2007, credit deployment under the heading of agriculture is more or less same for HBL, SBI and NBL. Mining sector seems ignored by selected three CBs. Credit of HBL seems production credit oriented, where SBI and NBL are in second and third position respectively. SBI is focusing construction credit however weight of construction credit is same for NBL and HBL. Metal production credit of SBI is higher than other. Transportation equipment heading has more or less equal weight of three banks. Under the heading of transportation and communication HBL has assigned higher weight and NBL is assigning higher than SBI and lower than HBL. Weight of wholesale and retail loan is more or less same for SBI and NBL however weight of HBL is lower than NBL and SBI. Weight of finance insurance and fixed asset is higher for SBI and weight of NBL appears as moderate and weight of HBL is lower than other. Under the heading of service credit, weight of SBI is higher where as weight of NBL is moderate and weight of HBL is lower than other. Weight of consumable loan is higher for NBL but SBI and HBL is assigning very few funds for this sector. Under the local government heading more or less same fund is allocated from the selected CBs. Similarly NBL, HBL and SBI are also allocating tentatively equal fund for other heading.
- NBL is maintaining higher security on gold and silver where HBL and SBI have almost zero security on this heading. NBL is in higher side on the heading of government security, SBI has a very few amount and HBL is almost nil for this heading. Three CBs has more

or less same security under the heading of non government securities. SBI and HBL have more or less same security under the heading of asset guarantee. However NBL has lower security under this heading. On bill guarantee case NBL, SBI and HBL have more or less same level of security. Under the heading of guarantee NBL has higher security; security of HBL is lower than NBL and higher than SBI. Security under credit card is almost zero for three banks. NBL higher security under other heading SBI and HBL has more or less same level of security

- HBL and SBI are losing the operating profit after 2005 however NBL is in increasing trend.
- Relationship between net profit and loan advance for three CBs seems fluctuating. Till the period of 2007 NBL and HBL has crossed the line of 3% but SBI is under this line.
- Interest income and interest expenses ratios of HBL are moving in parallel trend. Similarly interest expenses trend of SBI is also moving in as usual trend but trend of interest income is declining form 2005. Looking at the movement of NBL, trends of interest income are in increasing trend than past but cost of deposit is more or less same than past
- Interest income to loan and advances of NBL, HBL has increasing trend after mid July 2005 but the SBI has decreasing trend.
- Loan to Public enterprises of NBL is higher in the Industrial, Trading and Financial Corporation. No credit is provided to other Government Corporation.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATION

This is the last chapter of the study which includes summary, conclusion and Recommendation. In this study, analysis of various aspect of the credit management of the commercial banks is done by using some important financial tools and statistical tools. The task of researcher is to summarize the study after completing basic analysis and recommend for further importance. It would be meaningful to the concerned banks to initiate the action and achieve the desired results.

5.1 Summary and Conclusion

Being the first chapter, as an introduction, this study basically provides the brief background of the bank regarding its establishment, its capital composition and its vision. As there are many commercial banks only three commercial banks-NBL, HBL, SBI are taken for sample study. This study gives brief view of credit aspect and tried to analyze sector wise loans and advances, security wise loans and advances, study of priority and deprived sector loans, evaluation of non performing loans, issues of profitability, liquidity position which is set as an objective of the study.

Chapter second deals with the overall review of credit related issues of other relevant studies in related areas so that all part of studies can be conducted. This study deals with major review of literature related to credit management in more descriptive and detailed manner. It consists of review from other articles, books, journals, research studies and conceptual review of overall banking sector and its growth in Nepal, legal frame work, guidelines and directives of Nepal Rastra Bank etc.

Chapter third consists of research methodology designed to solve the research problems. In this study among many tools of analysis, financial tools and statistical tools are used to draw out conclusion. All the data are taken from the secondary sources-Annual reports of banks, reports form SEBON, etc so accuracy of data depends upon the publisher. Only five years data are taken so the results may not be fully applicable. Since only sample bank-HBL, SBI, NBL are taken for study, this study may not be applicable to other bank and financial institution.

Fourth Chapter shows the presentation, analysis and interpretation of relevant sampled data of selected commercial bank. Various types of ratio and statistical tools are calculated and presented in proper diagram to show the real picture of the banks.

HBL is safe from the side of liquidity similarly SBI and NBL would in liquidity crunch if heavy demand is made (withdrawal) from the depositors. In other word HBL is keeping higher liquidity which is restrictive to garner additional earning. While other two are aggressive in the concern of loan deployment which may cause to lower the strength of liquidity of the bank. Comparatively SBI is aggressively deploying credit, trend of credit mobilization of HBL is moderate and NBL seems very defensive for credit mobilization. Comparatively NBL is mobilizing higher deposit to investment, SBI is moderate condition and HBL is in lower level. Deposit mobilization on credit of SBI is in higher side, HBL is moderately mobilizing its deposit on credit and NBL is mobilizing slightly lower credit. Ratio of investment to total loan and advance is in higher side for NBL than other. Similarly HBL has moderate ratio and SBI has lower ratio. NBL has higher loan loss provision, SBI and HBL has more or less same ratio. CBs are tying to lower the NPL than past however ratio of NBL is higher than other. Comparatively NBL is mobilizing higher fund to the priority sector, SBI is moderately mobilizing priority sector credit and in the case of HBL said credit is lower than other CBs. Deprived sector credit ratio of NBL is higher enough than other two CBs. Looking at the aggregate figure as of mid July 2007, credit deployment under the heading of agriculture is more or less same for HBL, SBI and NBL. Mining sector is seems ignored by selected three CBs. SBI is focusing on construction credit however weight of construction credit is same for NBL and HBL. Metal production credit of SBI is higher than other. Transportation equipment heading has more or less equal weight of three banks. Under the heading of transportation communication HBL has assigned higher weight and NBL is assigning higher than SBI and lower than HBL. Weight of wholesale and retail loan is more or less same for SBI and NBL however weight of HBL is lower than NBL and SBI. Weight of finance insurance and fixed asset is higher for HBL and weight of SBI appears as moderate and weight of NBL is lower than other. Under the heading of service credit, weight of SBI is higher where as weight of NBL is moderate and weight of HBL is lower than other. Weight of consumable loan is higher for NBL but SBI and HBL is assigning very few funds for this sector. Under the local government heading more or less same fund is allocated from the selected CBs. Similarly NBL, HBL and SBI are also allocating tentatively equal fund for other heading.

NBL is maintaining higher security on gold and silver where HBL and SBI have almost zero security on this heading. NBL is in higher side on the heading of government security, SBI has a very few amount and HBL is almost nil for this heading. Three CBs has more or less same security under the heading of non government securities. SBI and HBL have more or less same security under the heading of asset guarantee. However NBL has lower security under this heading. On bill guarantee case NBL, SBI and HBL have more or less same level of security. Under the heading of guarantee NBL has higher security; security of HBL is lower than NBL and higher than SBI. Security under credit card is almost zero for three banks. NBL higher security under other heading SBI and HBL has more or less same level of security.

HBL and SBI are losing the operating profit after 2005 however NBL is in increasing trend. Relationship between net profit and loan advance for three CBs seems fluctuating. Interest income and interest expenses ratios of all three commercial banks are in increasing trend. NBL has more fluctuating trend than other two banks. Looking at the movement of NBL, trends of interest income are in increasing trend than past but cost of deposit is more or less same than past. Interest Expenses to Deposit ratio shows that SBI has higher ratio, HBL has moderate and NBL has lower ratio Interest income earned for loan mobilization is fluctuating for HBL and NBL while the interest income earned for loan mobilization for SBI is consistent. Loan to Industrial and Financial Corporation is almost nil for the HBL and SBI. Other Government Corporation is completely ignored by the three banks.

5.2 Recommendations

- HBL is maintaining enough liquidity which can be mobilized under the heading of credit to garner the extra profit. Similarly NBL and SBI should seriously think about the liquidity other wise bank will be in liquidity crunch.
- Deprived and priority sector credit should be effectively monitored and mobilized by the SBI and HBL because such credit helps to develop the country in sustainable manner.
- Effective mechanism should be prepared by NBL to lower the NPL (non –Performing Loan) and LLP (Loan Loss Provision) for the sustainable and successful operation of the bank.
- Credit relating to agriculture sector should be focused by the CBs and production sector should be promoted form NBL and SBI.

- Major part of security is depended on assets guarantee; all other security related heading should be promoted to make the credit approachable for mass population.
- Cost of deposit should be revised as the time other wise upcoming bank would target the low cost deposit which would be terrible for the CBs in the concern of resources collection.
- Industrial, Trading and Service oriented enterprises should be provided more loans by the banks in order to promote trade and industry.

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Annex-1

Liquidity Funds to Loan and Advances Ratio

NBL (Rs.in Million)

Year	Liquid Fund(Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	4770.60	19078.10	25
Mid July 2004	6444.00	19108	33.72
Mid July 2005	5886.20	17456	33.72
Mid July 2006	5517.4	12180.4	45.29
Mid July 2007	7003.6	13377.7	52.35

HBL (Rs in Million)

Year	Liquid Fund(Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	8281.7	10894.2	76
Mid July 2004	8613.5	13081.7	65.84
Mid July 2005	8173.2	13245	61.70
Mid July 2006	2677.6	15515.7	17.25
Mid July 2007	3259.6	17672	18.44

SBI (Rs in Million)

Year	Liquid Fund(Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	1331.6	4761	27.96
Mid July 2004	775	5491	14.11
Mid July 2005	459.6	6619	6.94
Mid July 2006	894.5	8060	11.09
Mid July 2007	1754.5	9847	17.81

Annex-2

Total Loan and Advances to Total Assets Ratio

NBL (Rs in Million)

Year	Loan (Rs)	Total Assets(Rs)	Ratio (%)
Mid July 2003	19078.1	66329.50	28.76
Mid July 2004	19108	64063.80	29.82
Mid July 2005	17456	65259.20	26.74
Mid July 2006	12180.4	54133	22.50
Mid July 2007	13377.5	47707.1	28.04

HBL ` (Rs in Million)

Year	Loan (Rs)	Total Assets (Rs)	Ratio (%)
Mid July 2003	10894.2	24817.36	43.89
Mid July 2004	13081.7	27844.6	46.98
Mid July 2005	13245	29460.39	44.95
Mid July 2006	15515.7	33519.14	46.28
Mid July 2007	17672	37648.34	46.93

SBI (Rs in Million)

Year	Loan (Rs)	Total Assets (Rs)	Ratio (%)
Mid July 2003	4761	8440.40	56.40
Mid July 2004	5491	9963.02	55.11
Mid July 2005	6619	13035.84	50.77
Mid July 2006	8060	13901.20	57.98
Mid July 2007	9848	18366.86	53.61

Annex-3

Total Investment to Total Deposit Ratio

NBL (Rs in Million)

Year	Total Investment (Rs)	Total Deposit(Rs)	Ratio (%)
Mid July 2003	11722.80	34737.4	33.73
Mid July 2004	10593.90	36288.5	29.19
Mid July 2005	13838.60	34744.2	39.82
Mid July 2006	11776.9	35444.9	33.22
Mid July 2007	13226.3	38715.2	34.16

HBL (Rs in Million)

Year	Total Investment (Rs)	Total Deposit(Rs)	Ratio (%)
Mid July 2003	3980	21002.9	18.94
Mid July 2004	2781.7	22760.9	12.22
Mid July 2005	5469.7	24831.1	22.02
Mid July 2006	5144.4	26456.2	19.44
Mid July 2007	6454.8	29905.8	21.58

SBI (Rs in Million)

Year	Total Investment (Rs)	Total Deposit(Rs)	Ratio (%)
Mid July 2003	1189.4	6522.8	18.23
Mid July 2004	1871.5	7232.1	25.87
Mid July 2005	2588.2	8645.8	29.83
Mid July 2006	3680.4	10852.7	33.91
Mid July 2007	2345.6	11445.2	20.49

Annex-4

Loan to Deposit Ratio

NBL (Rs in Million)

Year	Loan (Rs)	Deposit(Rs)	Ratio (%)
Mid July 2003	19078.1	34737.4	54.92
Mid July 2004	19108	36288.5	52.65
Mid July 2005	17456.0	34744.2	50.24
Mid July 2006	12180.4	35444.9	34.36
Mid July 2007	13377.5	38715.2	34.55

HBL (Rs in Million)

Year	Loan (Rs)	Deposit(Rs)	Ratio (%)
Mid July 2003	10894.2	21002.8	51.87
Mid July 2004	13081.7	22760.9	57.47
Mid July 2005	13245	24831.1	53.34
Mid July 2006	15515.7	26456.2	58.64
Mid July 2007	17672	29905.8	59.09

SBI (Rs in Million)

Year	Loan (Rs)	Deposit(Rs)	Ratio (%)
Mid July 2003	4761	6522.8	72.99
Mid July 2004	5491	7232.1	76.77
Mid July 2005	6619	8645.8	76.55
Mid July 2006	8060	10852.7	74.26
Mid July 2007	9848	11445.2	86.04

Annex-5

Investment to Loan Advance Ratio

NBL (Rs in Million)

Year	Total Investment (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	11722.80	19078.10	61.44
Mid July 2004	10593.80	19108	55.44
Mid July 2005	13838.60	17456	79.27
Mid July 2006	11776.9	12180.4	96.69
Mid July 2007	13226.3	13377.5	98.86

HBL (Rs in Million)

Year	Total Investment(Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	3980	10894.2	36.53
Mid July 2004	2781.7	13081.7	21.26
Mid July 2005	5469.7	13245	41.29
Mid July 2006	5144.4	15515.7	33.15
Mid July 2007	6454.8	17672	36.52

SBI (Rs in Million)

Year	Total Investment(Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	1189.4	4761	24.98
Mid July 2004	1871.5	5491	34.08
Mid July 2005	2588.2	6619	39.10
Mid July 2006	3680.4	8060	45.62
Mid July 2007	2345.6	9847	23.81

Annex-6

Loan Loss Provision to Total Loan and Advances Ratio

NBL (Rs in Million)

Year	2003	2004	2005	2006	2007
Loan and Advances(Rs)	19078.1	19108	17456	12180.4	13377.5
Loan loss Provision(Rs)	0	0	9249.89	3268.6	2376.3
Ratio (%)	0	0	52.98	26.83	17.76

HBL (Rs in Million)

Year	2003	2004	2005	2006	2007
Loan and Advances (Rs	10894.2	13081.7	13245	15515.7	17672
Loan Loss Provision(Rs)	0	0	937.1	1029	760.1
Ratio (%)	0	0	7.07	6.63	4.3

SBI (Rs in Million)

Year	2003	2004	2005	2006	2007
Loan and Advances(Rs)	4761	5491	6619	8060	9847
Loan Loss Provision(Rs)	0	0	397.3	613.6	589.2
Ratio (%)	0	0	6	7.61	5.98

Annex-7

Non-Performing Loan and Advance Ratio

NBL (Rs in Million)

Year	Total Gross Loan (Rs)	Non performing Loan (Rs)	Ratio (%)
Mid July 2003	18132.33	10964.91	60.47
Mid July 2004	17937.66	9640.08	53.74
Mid July 2005	16866.55	8372.11	49.63
Mid July 2006	12879.22	3233.9	25.10
Mid July 2007	13750.7	2007.5	14.59

HBL (Rs in Million)

Year	Total Gross Loan (Rs)	Non performing Loan (Rs)	Ratio (%)
Mid July 2003	10844.6	1092.84	10.07
Mid July 2004	12919.63	1147.46	8.88
Mid July 2005	13451.17	1001.35	7.44
Mid July 2006	15939.63	978.69	6.13
Mid July 2007	17841.60	629.80	3.53

SBI (Rs in Million)

Year	Total Gross Loan (Rs)	Non performing Loan (Rs)	Ratio (%)
Mid July 2003	4795.84	561.67	11.71
Mid July 2004	5531.83	345.82	6.25
Mid July 2005	6739.35	441.02	6.54
Mid July 2006	8232.11	520.26	6.31
Mid July 2007	10065	45.8	0.46

Annex-8

Priority Sector Credit to Total Credit

NBL (Rs in Million)

Year	Priority Sector Credit (Rs)	Loan (Rs)	Ratio (%)
As of mid July 2007	913.65	13377.5	6.82

HBL (Rs in Million)

Year	Priority Sector Credit (Rs)	Loan (Rs)	Ratio (%)
As of mid July 2007	407.4	17672	2.30

SBI (Rs in Million)

Year	Priority Sector Credit (Rs)	Loan (Rs)	Ratio (%)
As of mid July2007	367.3	9847	3.73

Annex-9

Deprived Sector Loan to Credit ratio

NBL (Rs in Million)

Year	Deprived Sector Credit (Rs)	Loan (Rs)	Ratio (%)
As of mid July 2007	574.18	13377.5	4.29

HBL (Rs in Million)

Year	Deprived Sector Credit (Rs)	Loan (Rs)	Ratio (%)
As of mid July 2007	533.7	17672	3.02

SBI (Rs in Million)

Year	Deprived Sector Credit (Rs)	Loan (Rs)	Ratio (%)
As of mid July2007	280.5	9847	2.84

Annex-10

Sector Wise Credit

(As of Mid July 2007)

NBL (Rs in Million)

Sector	Sector wise Credit (Rs)	Ratio (%)
Agriculture	478.3	3.48
Mining	7.4	0.05
Production	3419.1	24.88
Construction	372.9	2.71
Metal Production, Machinery and Electrical tools and fitting	80.2	0.58
Transportation, Equipment Production and Fitting	84	0.61
Transportation communication and Public Services	864.2	6.28
Wholesales and Retailers	2558.6	18.62
Finance Insurance and Fixed Asset	693.3	5.04
Services Industries	470.1	3.42
Consumable Loan	3644.1	26.52
Local Government	0	0
Others	1078.5	7.85
Total	13740.7	

HBL (Rs in Million)

Sector	Sector wise Credit (Rs)	Ratio (%)
Agriculture	660.2	3.80
Mining	19.6	0.11
Production	8083.2	46.59
Construction	462.4	2.66
Metal Production, Machinery and Electrical tools and fitting	192.9	1.11
Transportation, Equipment Production and Fitting	72.3	0.41
Transportation communication and Public Services	1436.5	8.28
Wholesales and Retailers	2595	14.95
Finance Insurance and Fixed Asset	963	9.08
Services Industries	1575.8	1.86
Consumable Loan	322.7	1.86
Local Government	0	0
Others	1603.7	9.24
Total	17347	

SBI (Rs in Million)

Sector	Sector wise Credit (Rs)	Ratio (%)
Agriculture	266.1	2.64
Mining	1.1	0.01
Production	3605.3	35.81
Construction	1269.3	12.61
Metal Production, Machinery and Electrical tools and fitting	364.4	3.62
Transportation, Equipment Production and Fitting	0	0
Transportation communication and Public Services	489.6	4.86
Wholesales and Retailers	1850.1	18.38
Finance Insurance and Fixed Asset	609.9	6.05
Services Industries	761.6	7.56
Consumable Loan	36.5	0.36
Local Government	0	0
Others	811.2	8.05
Total	10065.1	

Annex -11

Security Analysis

NBL (Rs in Million)

Title of Security	Security(as of mid July 2007)	Volume of Security	Ratio (%)
1.	Gold/Silver	1148.3	8.35
2.	Government Security	2424	17.62
3.	Non-Government Security	6.5	0.04
4.	Fixed A/C Receipt	298.2	2.16
5.	Assets Guarantee	7177.0	52
6.	On Bill Guarantee	381.2	2.77
7.	Guarantee	930.9	6.77
8.	Credit Card	0	0
9.	Other	1384.8	10.06
	Total	13750.8	

HBL (Rs in Million)

Title of Security	Security(as of mid July 2007)	Volume of Security	Ratio (%)
1.	Gold/Silver	0	0
2.	Government Security	141.2	0.78
3.	Non-Government Security	68.3	0.37
4.	Fixed A/C Receipt	757.1	4.2
5.	Assets Guarantee	16048.3	89.2
6.	On Bill Guarantee	169.6	0.94
7.	Guarantee	735	4.08
8.	Credit Card	47.2	0.26
9.	Other	20.6	0.14
	Total	17987.3	

SBI (Rs in Million)

Title of Security	Security(as of mid July 2007)	Volume of Security	Ratio (%)
1.	Gold/Silver	0	0
2.	Government Security	252.9	2.51
3.	Non-Government Security	58.6	0.58
4.	Fixed A/C Receipt	248.2	2.46
5.	Assets Guarantee	9127.9	90.68
6.	On Bill Guarantee	131.6	1.30
7.	Guarantee	173.7	1.72
8.	Credit Card	0	0
9.	Other	72.2	0.71
	Total	10065.1	

Annex -12

Operating Profit to loan and advance ratio

NBL (Rs in Million)

Year	Operating Profit (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	772.23	19078.1	4.04
Mid July 2004	990.00	19108	5.18
Mid July 2005	132.20	17456	7.57
Mid July 2006	1498.21	12180.4	12.30
Mid July 2007	18330.48	133777.5	13.70

HBL (Rs in Million)

Year	Operating Profit (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	1245.405	10894.2	11.43
Mid July 2004	1672.430	13081.7	12.78
Mid July 2005	2097.920	13245.	15.83
Mid July 2006	2661.030	15515.7	17.15
Mid July 2007	2566.110	17672	14.52

SBI (Rs in Million)

Year	Operating Profit (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	635.65	4761	13.35
Mid July 2004	718.99	5491	13.09
Mid July 2005	850.92	6619	12.85
Mid July 2006	1024.03	8060	12.70
Mid July 2007	1117.17	9847	11.34

Annex -13

Return on loan and Advance ratio

NBL (Rs in Million)

Year	Net Profit (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	232.320	19078.100	1.21
Mid July 2004	399.500	19108	2.09
Mid July 2005	226.953	17456	1.3
Mid July 2006	338.512	12180.4	2.77
Mid July 2007	528.652	13377.5	3.95

HBL (Rs in Million)

Year	Net Profit (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	202.3	10894.20	1.85
Mid July 2004	308.28	13081.70	2.35
Mid July 2005	475.46	13245.00	3.58
Mid July 2006	419.82	15515.70	2.70
Mid July 2007	654.39	17672.00	3.70

SBI (Rs in Million)

Year	Net Profit (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	43.02	4761	0.90
Mid July 2004	57.39	5491	1.04
Mid July 2005	117.0	6619	1.76
Mid July 2006	254.91	8060	3.16
Mid July 2007	255.12	9847	2.59

Annex -14

Interest Income to loan and Advance ratio

NBL (Rs in Million)

Year	Interest Income (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	1092.32	19078.10	5.72
Mid July 2004	1307.02	19108	6.84
Mid July 2005	1625.02	17456	9.30
Mid July 2006	1848.61	12180.4	15.17
Mid July 2007	2095.94	13377.5	15.66

HBL (Rs in Million)

Year	Interest Income (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	1491.55	10894	13.69
Mid July 2004	1446.47	13081.7	11.05
Mid July 2005	1626.47	13245	12.27
Mid July 2006	1775.58	15515.7	11.44
Mid July 2007	1978.29	17672	11.19

SBI (Rs in Million)

Year	Interest Income (Rs)	Loan (Rs)	Ratio (%)
Mid July 2003	493.59	4761	10.36
Mid July 2004	578.37	5491	10.53
Mid July 2005	708.72	6619	10.70
Mid July 2006	831.12	8060	10.31
Mid July 2007	966.91	9847	9.81

Annex -15

Interest Expenses to Deposit ratio

NBL (Rs in Million)

Year	Interest Expenses (Rs)	Deposit(Rs)	Ratio (%)
Mid July 2003	570.80	34737.4	1.64
Mid July 2004	670.80	36288.5	1.84
Mid July 2005	788.90	34744.2	2.27
Mid July 2006	772.64	35444.9	2.17
Mid July 2007	752.44	38715.2	1.94

HBL (Rs in Million)

Year	Interest Expenses (Rs)	Deposit(Rs)	Ratio (%)
Mid July 2003	554.12	21002.9	2.63
Mid July 2004	561.96	22760.9	2.46
Mid July 2005	648.84	24831.1	2.61
Mid July 2006	767.41	26456.2	2.90
Mid July 2007	823.76	29905.8	2.75

SBI (Rs in Million)

Year	Interest Expenses (Rs)	Deposit(Rs)	Ratio (%)
Mid July 2003	235.64	6522.80	3.61
Mid July 2004	258.43	7232.1	3.57
Mid July 2005	334.77	8645.8	3.87
Mid July 2006	412.26	10852.7	3.79
Mid July 2007	454.92	11445.2	3.97

Annex -16
Spread Analysis

NBL (Rs in Million)

Year	Interest Income(Rs)	Interest Expenses(Rs)	Difference	Ratio (%)
Mid July 2003	1092.32	570.80	521.52	11.81
Mid July 2004	1307.02	670.80	636.22	14.41
Mid July 2005	1625.02	788.90	836.12	18.94
Mid July 2006	1848.61	772.64	1075.97	24.38
Mid July 2007	2095.94	752.44	1343.5	30.44
Total			4413.33	

HBL (Rs in Million)

Year	Interest Income(Rs)	Interest Expenses(Rs)	Difference	Ratio (%)
Mid July 2003	1491.55	554.12	937.43	18.88
Mid July 2004	1446.47	561.96	884.51	17.82
Mid July 2005	1626.47	648.84	977.63	19.69
Mid July 2006	1775.58	767.41	1008.17	20.31
Mid July 2007	1978.29	823.76	1154.53	23.26
Total			4962.67	

SBI (Rs in Million)

Year	Interest Income(Rs)	Interest Expenses(Rs)	Difference	Ratio (%)
Mid July 2003	493.59	235.64	257.95	13.70
Mid July 2004	578.37	258.43	319.94	16.99
Mid July 2005	708.72	334.77	373.95	19.86
Mid July 2006	831.12	412.26	418.86	22.24
Mid July 2007	966.91	454.92	511.99	27.19
Total			1882.69	

Annex-17
Loan to Public Enterprises Ratio
(As of mid July 2007)

NBL (Rs in Million)

Corporation	Loan (Rs)	Ratio (%)
Industrial	27.3	3.67
Trading	474.1	63.83
Financial	241.3	32.48
Service Oriented	0	0
Other Government Corporation	0	0
Total	742.7	

HBL (Rs in Million)

Corporation	Loan (Rs)	Ratio (%)
Industrial	0	0
Trading	475.4	67.68
Financial	0	0
Service Oriented	226.9	32.30
Other Government Corporation	0	0
Total	702.4	

SBI (Rs in Million)

Corporation	Loan (Rs)	Ratio (%)
Industrial	0	0
Trading	206	1
Financial	0	0
Service Oriented	0	0
Other Government Corporation	0	0
Total	206	