

# CHAPTER- 1

## Introduction

### 1.1 Background of Study

Nepal is an underdeveloped country. Most of the people are in poverty line. In the developing countries like Nepal mixed economic system may play vital role to boost up national economy effectively.

Financial institutions can be considered as the economic growth of a country. The development process of a country involves the mobilization and deployment of resource and a financial institution can play the role of financial intermediary. In the present economic context, the financial institutions have become much more significant than ever. Their activities like lending towards priority sector deprived sector and there by helping in income generating activities for the poor can be considered as the major role played by them for the endeavor toward poverty alleviation.

The Goldsmith used to store people's gold and other valuable goods and charge nominal charges against the deposit. That time people deposited their gold and valuable goods for the sake of securities rather than earning interest. The term bank emerged in USA. The bank means institute, which deals with money. A bank performs several financial monetary and economic activities that are very essential for economic development of any country. Broadly speaking bank collects surplus money from the people who are not using it at present and hoarding for the future and supplies loan to those who are in the position to use in for productive purpose. Basically banks perform various types of services i.e. collection of deposits from the public supply loans to those invest in business industry and other sectors, overdraft, letter of credit, bills discounting, promissory notes, selling of other shares to general public agency function of tasks, guarantee against any disable of payment (guarantee services) etc.

In Nepal there are several kinds of financial institutions such as Commercial Banks, Development Banks, Rural Development banks, financial Companies Co-operatives involving in saving and credit activities etc. Most of the financial institutions are under regulation of Nepal Rastra Bank (NRB), the central bank of Nepal. The history of modern financial system in Nepal was begun with the establishment of Nepal Bank Ltd. as a first Commercial Bank in Nepal under the Banking Act 1993. The government provided 51%

equity of the bank and the promoters shared the rest. Nepal Rastra Bank the central bank emerged in 2013 B.S. under Rastra Bank Act 2012. Since then it has been providing policies and guidance to the financial sectors in one hand and monitoring and controlling them on the other. Realizing the need of adequate banking services for the integrated and specially development of industrial sector. Rastriya Banijya Bank comes into existence in 2022 B.S. with 100% government equity.

After the establishment of Agricultural Development Bank in 2024 B.S. growth of banking institutions remained almost stagnant till 2040 B.S. No new banks opened in this period through some branches of previously established bank were extended. Liberalization policy of government formulated in 2038 B.S. allowed private sectors to open joint venture banks in foreign collaboration. Nepal Arab Bank Ltd. established in 2041 became first joint venture bank. As a result, through the economic liberation policies have relatively succeeded in raising the non-agricultural sector growth the overall development problem of Nepal yet remain complex and challenging. Besides resources available for the government have also become scarcer in view of the revenue growth not being able to keep place with the raising expenditure in the recent years.

Banking concept existed even in the ancient period when the goldsmith and rich people used to issue the common people against the provides of safe keeping of their valuable items on the presentation of receipt. The depositors would get bank their gold and valuables of the playing small amount for the safekeeping and saving.

At present thirty four (34) commercial banks are helping not only in the sector of deposit mobilization and lending but also to the areas like different product and service development and employment generation etc. Now Nepal can take pride in the remarkable growth and progress in the banking sector.

## **1.2 Commercial Bank**

“Commercial Banks are those institutions that perform all kind of banking functions such as accepting deposits, advance loans, creating and advancing loan agency functions etc. They provided short-term, medium term and long term loans to trade and industry.”

With regards of commercial bank a writer has concluded that Commercial Bank under takes the payment of subscriptions, premium, rents and collection of cheques, bills

promissory notes etc, on behalf of its customers. It also acts as correspondent or representative of its customers other banks and financial operations.

Commercial bank is a corporation which accepts demand deposits subject to check and makes short-term loan to business enterprises regardless of the scope of its other services.

The commercial bank act 2031 B.S. has further pointed out that “Commercial Bank dept whenever necessary for trade the commerce. They take deposits from public and grant loans in different forms. They purchase and discount bills of exchange promissory note and exchange foreign currency. They discharge various function behalf of their customers provided that they are paid for their services.

Summary of the above definition the commercials banks are those financial institutions which perform widest range of economics and financial function of any business firm in the economy more over they also provide technical help and suggestion relating to administration suggestion and safe keeping of valuables. Collection of bill, cheques, over draft facilities and provide modern banking facilities to industries and commerce are also carried out by these banks.

**Functions of commercial Banks:-**

- ) Creating money
- ) Deposit accepts
- ) Facilitating for the financing of foreign trade
- ) Payment mechanism
- ) Safe keeping of valuables
- ) Extension of credit
- ) Trust service

In the present context the role and importance of the commercial banks loomed larger. In this connection Nepalese economy has witnessed several changes in financial system in the last few years due to financial liberalization policy of government. The operations commercial Banks record the economy their transaction reflect the economic happening in the country. Commercial Bank has played a vital role in giving that direction in economic growth over the time by financing the requirements of industries and trade in the country. By encouraging think among the people, banks have fostered the process of capital

formation in the country. In the context of deposit mobilization, commercial banks induce the savers to hold their savings in the form of bank deposits thus help bringing the scattered resources in to the organized banking sector, which can be allocated to the different economic activities. In the way they help in country's capital assets formation of income out of which further saving by the community and further growth potential emerges for the good of the economy. In a planned economy, banks make the entire planned productive process possible by providing funds to the public sector, Joint sector or private sector for any type of organization. All employment, income distribution and other objectives of the plan as far as possible subsumed in to the production plan which banks finance.

The important of commercial banks in directing the economic activities in the system is immense. Not only in the highly developed economies where the commercial and industrial activities are paralyzed in the absence of banks, even in the developing countries economy most of the economic activities particularly of organized sectors are bank based. There fore, in a nutshell it can be said that the growth of the economy is tied up with the growth of the commercial banks in the economy. Three are following commercial Banks:- Nepal Bank Ltd, Rastriya Banijya Bank, Babil Bank Ltd., Nepal Investment Bank Ltd., Standard Chartered Bank Nepal Ltd., Himalayan Bank Ltd., Nepal SBI Bank Ltd., Nepal Bangladesh Bank Ltd., Everest Bank Ltd., Bank Of Kathmandu Ltd., Nepal Credit and Commercial Bank Ltd., Nepal Industrial and Commercial Bank Ltd., Lumbini Bank Ltd., Machapuchhere Bank Ltd., Kumari Bank Ltd., Laxmi Bank Ltd., Siddhartha Bank Ltd., KIST Bank Ltd., Agriculture Development Bank Ltd., Global Bank Ltd., Citizens Bank International Ltd., Prime Commercial Bank Ltd., Bank of Asia Nepal Ltd., Sunrise Bank Ltd., Development Credit Bank Ltd., NMB Bank Ltd., Janata Bank Ltd., Mega Bank Ltd., Century Commercial Bank, Civil Bank, Commerze and Trust Bank etc.

Nepal Investment Bank Limited (NIBL), Previously Nepal Indosuez Bank Limited, was established in 1986 as a joint venture between Nepalese and French Partners. The French partner (holding 50% of the capital of NIBL) as credit Agricole Indosuez, a subsidiary of one of the larger banking group in the world with the decision of credit Agricole Indosuez to disinvest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50 % of shareholding of credit Agricole Indosuez Bank Ltd. The name of the bank has been changed to Nepal Investment Bank Ltd.

Upon approval of banks Annual General Meeting, Nepal Rastra Bank and company Registrar's office with the following shareholding structure.

- ) A group of companies holding 50% of the capital.
- ) Rastriya Banijya Bank holding 25% of the capital.
- ) Rastriya Beema Sansthan holding 15% of the capital.
- ) The remaining 20% being held by the General public. This Nepal Investment

**Bank Limited provide the following services :-**

- ) Trade finance
- ) Remittances
- ) Export Credit
- ) Bills purchase
- ) Loans and advances
- ) Telebanking services
- ) ATM with any branch banking
- ) Vehicle Loans
- ) NTC's mobile bill payment (March 29, 2004)
- ) Accept Deposits
- ) Funds transfer
- ) Bank Guarantee
- ) Clearing collection
- ) Locker facility
- ) Any Branch banking
- ) EZEE saving scheme
- ) 365 days banking
- ) Debit card
- ) Credit Card

**Area of Investments:**

The bank shall make investments in the following areas:-

**1) Short- term Investments**

- a. Treasury Bills

- b. Other Nepal Government's securities and securities issued by NRB.
- c. Inter-Bank placement of funds.

**2) Long-term Investments**

- a. Nepal Government Securities
- b. Shares and securities of listed companies
- c. Obligatory share investment as requested/required by NRB.

**3) Other Investment**

- a. As decided by the Board.

**Conditions Precedence to investments.**

**1) Short- Term Investments**

- a. The Bank must have excess liquidity over the compulsory Cash Reserve Ratio.
- b. The return on investment should be analyzed and be in line with prevailing market rate.
- c. There should not be immediate necessity of funds for lending or other core banking activities.
- d. Ready convertibility.
- e. In case of Inter-bank lending or placement of funds, limits assigned to individual banks should be strictly adhered.

**2) Long –Term Investment**

- a. The bank must have excess long-term deposit or core (stable) deposits over requirement of funds for lending or other core banking activities.
- b. Critical analysis should be made in terms or risk and return on such investments.
- c. Such investment must yield relatively high and stable rate of return over cost of fund of the bank.
- d. In case of investment in the shares and securities of a company, the following factors should be considered while analyzing the risk and return on such investments.

) Management quality

) Business risk

- ) Profitability of the company
- ) Expected return
- ) Limitation and restriction as per NRB directives.

**Approving Authority:**

The Board delegates the authority for making investments as specified in this policy to the Chief Executive Director (CED) and General Manager (GM) of the Bank as under:

**1) Long-Term Government Bonds and Securities.**

- a. The CED shall have the authority of investing up to Rs.100 million.
- b. The GM shall have the authority investing up to 50 million.
- c. The Board's approval shall be obtained or and investment of above Rs.100 million.

**2) Treasury Bills and other short-term government securities**

- a. The CED and GM shall have the authority of investing without limit subject to the requirement in managing the funds.
- b. The CED and the GM may sub-delegate authority to his/their subordinates with specified limitation. Such subordinates shall not re-delegate or otherwise allow his/her sub-ordinate officers to exercise his/her authority.
- c. Inter-bank lending and placement
  - ) The CED or GM shall fix the limit on individual bank for inter-bank lending and placement on the basis of or financial position and other strengths of relative bank.
  - ) The Treasury Manager or in his/her absence the Deputy General Manager shall be authorized to transact within assigned limit.
  - ) Approval shall be obtained from CED or GM for all transaction above assigned limit.

**3) Investment in share and securities of the company.**

Upon recommendation of the CED, the Board shall approve investments in shares and securities of companies.

**4) Obligatory investment in shares and securities.**

### **1.3 Conceptual Framework of Profit Planning**

The profit planning & Control mechanism is being widely practiced in manufacturing industry but it is relatively new in non-manufacturing/service industries. Profit is the lifeblood of a business organization, which not only keeps it alive but also assures the future and makes it sound. The success or the failure of the business firm depends upon the margin of profit because profits are the primary requirement for its success. The main objects of planning in business are to increase the chance of making profit. The budget is the primary planning operating document committed to performance in this sense; budget is also called a profit plan.

Profit planning & control (PPC) is the latest invention in the field of modern management. A comprehensive profit planning & control is viewed as a process design needs to help management effectively perform significant phases of planning and controlling functions.

#### **Specifically, PPC model of involves:-**

- © Development & application of broad & long range objectives of enterprises.
- © Specification of enterprises goals.
- © Development of a strategic long range profit plan in broad terms.
- © Specification of a tactical short-range profit plan detailed by assigned responsibilities (Division, Departments & Projects)

### **1.4 Statement of Problem**

Profit planning & control (PPC) model provides a tool for more effective. The concept of profit planning hasn't even been familiarized in the most of the business by proper profit planning a business can be managed more effectively & efficiently. Commercial banks play vital role in economic growth of a country. As a being a commercial institution, a commercial bank must make profit out of its operations for its survival & fulfillment of the responsibilities assigned. The study has analyzed & examined the PPC side of commercial bank taking a case of Nepal Investment Bank Ltd.. Further more the study are answered the following research questions:-

- © Does NIB Ltd. has appropriate profit planning system ?
- © Does NIB Ltd. mobilize the deposit & other resources at optimum cost?
- © Does the bank deploy the resources generating satisfactory yield?

- © Does the bank giving proper attention towards no funded business activities there by generation satisfactory amount of other income?
- © What are the overall PPC problems of NIB Ltd. & what suggestions can be recommended for their proper solution?

### **1.5 Objectives of the study**

The basic objective of this study is to apprise Nepal Investment Bank Ltd. appropriately for the application of comprehensive PPC system. Thus the major objectives are:-

- © To highlight the current profit planning premises adopted and its effectiveness in NIB Ltd.
- © To analyze the variances of budgeted and actual achievements.
- © To study the growth of the business of the bank over the periods.
- © To provide suggestion & recommendation for improvements of the overall profitability of the bank

### **1.6 Limitations of study**

The researcher has however tried to eliminate the limitations to the best possible extent, yet it will suffer from the following limitations :-

- © The study will be made for partial fulfillment of the requirements of Master in Business Studies (M.B.S.), therefore only NIB Ltd. will be for this study.
- © Only the profit planning aspect of the bank has been analyzed leaving other area uncovered.
- © The study covers the related data of the bank F/Y 2006/2007 to 2010/2011.
- © Based on the data available from the management of NIB Ltd., the various published documents of the bank and the response made by the respondent during the discuss.

### **1.7 Significance of the study**

The researcher study is concerned with the profit planning in commercial banks with a case study NIB Ltd. with the major objectives of examining the proper applicability of profit planning system in the bank. Profit Planning process significantly contribution to

improve the profitability as well as the over all financial performance of an organization by the best utilization resources.

## **1.8 Design of the study**

In this study only five chapters are included, which are as follows:-

- Chapter 1:-** Includes the introduction & general background of the study , focus of the study, statement of the problems, objectives of the study, significance of the study and limitations of the study.
- Chapter 2 :-** Includes review of literature. In this chapter the review from books, journals, thesis and independent studies are taken.
- Chapter 3 :-** Is research methodology. It includes the research design, data collection procedures, tools for analysis, method of analysis and presentation.
- Chapter 4:-** Is data presentation and analysis part. It is the main body of our research, it includes data presentation, interpretation and analysis.
- Chapter 5 :-** Includes the summary and conclusions of the research and finally suggestions and recommendation are given.

## **CHAPTER- 2**

### **Review of Literature**

#### **2.1 Introduction**

Literature has means the related printing materials about the subject matter of the researcher work it may be in various forms like books, thesis, journals etc.. Research Literature includes the studies made earlier which are similar to the one proposed and conceptual literature includes the concepts and theories about the subject. Review of literature is vital while doing research work as it given the findings of the previous study, it can be used as a secondary data and it given the valuable information about the subject. Accordingly this chapter has been divided into two parts as :-

- © Conceptual review or conceptual framework of profit planning and control.
- © Review of earlier studies regarding NIB Ltd.

#### **2.2 Conceptual Framework of Profit Planning and Control**

##### **2.2.1 Profit**

Profit is the primary objectives of a business. Profit is the signal for the allocation of resources and yardstick for judging managerial efficiency. The reliable measure of the effective performance of a business is profit. Profit the primary is measured of success of the business enterprises. Profits are the acid test to business enterprise performance. Simply, profit is the excess of income over cost of production.

A business firm or industry is an organization designed to make profit and profit are the primary measure of its success. It is generally accepted that a business firm aims at making profit.

Simply stating profit is the excess of income over cost of production. But the term “Profit” is very controversial and there are several different interpretation about this. An economist will say that profit is the reward of entrepreneurship for risk taking. A labour leader might say that it is a measure of how efficiency labour has performed and that is provides a base for negotiating a wage increase. An investor will view it as a gauge of the return on his or her money. An internal revenue agent might regard it as a base for determining income taxes. The accountant will define it simply as the excess of firm’s revenue over expenditure of producing revenue in given fiscal period.

Using the accountant measuring stick, management thinks of profit as:-

- © A tangible expression of the goals it has set for the firm.
- © A measure of performance toward the achievement of its goals.
- © A means of maintaining the health, growth and continuity of the company.

A view of profit states that, the entrepreneur is special type of labour and profit is a special form of wages. The entrepreneur earns profit for organizing and coordination the other of production. Land, labour, capital are used for the purpose of producing goods or services.

Several economists have their different views in respect of the term profit. According to F.B. Howely, Profit is the reward for risk tasking in business. Schumpeter expressed that an entrepreneur earn profit as rewards for his introducing innovation. Robinson & Chamberlain opined that greater the degree of monopoly power, the greater the profits made by the entrepreneur.

At last it should be noted that profit are resident income left after the payment of the contractual to other factors or production.

**Economics theory of profit may be put into the three broad groups.**

- © Profit is the reward for bearing risk and uncertainties.
- © Profit as the consequence of frictions and imperfection in the competitive adjustment of the economy's dynamic change.
- © Profit as the reward for successful innovation.

It clearly shows the variation between economists in regard the meaning of profit. In general there are four types of production factors i.e. land, labour, capital and organization. The factors of production help to produce goods and services. But in exchange of their assistance in production process they need incentives. Then the excess of revenue over such incentives is known as profit and profit is always given to organization. Profit is excess if income over cost of production. The expenses made on raw material, labour, interest on borrowed capital, fuel, power are included in cost. The non-production cost item such as salary that entrepreneur would earns are excluded from conventional accounting profits because these opportunity costs do not appear the book of accounts. But the economists hold the view that these factors should be considered of subtracted to arrive at a net profit. The

word “Profit” implies a comparison of operation of business between the specific dates, which are usually separated by an interval of one year.

The difference between the outflow and inflows is profit, the inflow means the sales price and outflow means cost of production and selling that product.

### **2.2.2 Planning**

Planning is the first essence of management and all other functions are performed within the framework of planning. Planning means deciding in advance what is to be done in future. Planning starts from forecasting and predetermination of future event. Planning is the whole concept of any business organization. No firm can achieve its predetermined goals and objective in the absence of proper plan. Hence it is lifeblood of any organization which makes efficient run towards the competitive environment.

Planning is essential to accomplish goals it reduces uncertainty and provides direction to the employees by determining the course of action in advance. Budgeting compels management to plan in a comprehensive and coherent way. It is essentially a formalized that planning indicates the responsibility of management and provides. It should be realized that budgeting is not merely a forecast although forecast forms the basis of budgeting.

Planning is the process of developing enterprises objectives and selecting a future course of action to accomplish them. It includes (a) establishing enterprise objectives (b) developing premises about the environment in which they are to be accomplished (c) selecting a course of action for accomplishing the objectives (d) initiating activities necessary to translate plans into action and (e) current re-planning to correct current deficiencies. (Welsh, Glenn; ‘Budgeting’ 1990)

The planning processes both short and long term is the most crucial component of the whole system. It is both foundation and the bond for the other elements because it is through the planning process that we determine what we are going to do, how are going to do it and who is going to do it. It operates as the brain control of an organization.

The fundamental purpose of management planning is to provide a feed forward process for operations and for control. Planning is generally recognized as the most difficult task facing the manager and it is one that is very easy to procrastinate. Feedback is also an important ingredient of both re-planning and control. Planning rests upon the view that the future success of an entity can be enhanced by continuous management actions. Planning is

partitioned conformably with the operational or organizational subdivisions of the entity. Therefore, planning must encompass an evaluation because they will have significant impacts on the planning of realistic objectives and goals. The development of enterprises objectives is the most fundamental level of decision making in the planning process. The next planning level is known as goal with broad objectives brought in to focus by explicitly specifying.

- © Time dimensions for attainment.

- © Quantitative measurement

- © Subdivision of responsibilities.

The most detailed level of planning occurs when management's operational objectives, goals and strategies are established by incorporation in to the profit plan. Planning begins with the setting on general goals proceeds to cost volume profit analysis of various alternatives and ends with the proportion of a detailed quantitative plan of action, the budget.

### **2.2.3 Planning and Forecasting**

Planning and forecasting are not the same things. A forecast is a prediction of future events, condition or situation, where as plan includes a program of intended future action and desired results. Forecasting predicts the future in such a way that the planning process can be performed more accurately. Forecasting is the best thinking about what will happen to us n the future. In forecasting we define situation and recognize problem and opportunities. In planning we develop our objectives in practical detail and we correspondingly develop schemes of action to achieve these objectives. Forecasting is the best tools to use for proper planning. After formulation of company policy and forecast, strategy and tactics to be used in achieving the objectives should be based on forecast and policy.

Forecasting is an integral part of decision-making activities of management. An organization established goals and objectives and seeks to predict the environmental factors than selects action that it hopes will result I attainment of goals and objectives. The need forecasting is increasing as management attempts to decrease its dependence on chance and become more scientific in dealing with its environment. Since each area of organization is related to all other a good or bad forecast can effect the entire organization. Planning or budgeting is not nearly forecasting although forecast forms the basis for budgeting?

#### **2.2.4 Control**

Control can be defined as a process of measuring and evaluating accrual performance of each organization component of an enterprises and initiating corrective action when necessary to ensure efficient accomplishment of enterprise objectives, goals, polices and standards. Planning establishes the goals, objectives, polices and standards of an enterprise.

In former pages we have defined the meaning of “Profit Planning” and “Control” separately. But in specific sense “Profit Planning & Control” has a synergetic meaning rather the integrated from of the word “Profit” and “Control”. Now we are going to search the synergetic meaning of subject matter.

#### **2.2.5 Profit Planning and Control (PPC)**

Profit Planning or budgeting is forward planning and involves the preparation on advance of the quantitative as well as financial statements to indicate the intention of the management in respect of the various aspects of the business. In fact, profit planning is a managerial technique and a business budget is such a written plan, in which all aspects of business operations with respect to a definite future period are included. It s a formal statement of policy, plan, objective and goal established by the top management in respect of some future period. It acts as business barometer as it is a complete program of activities of the business for the period covered.

Profit planning is a predetermined detailed plan of action developed and distributed as a guide to current operations and as a partial basis for the subsequent evaluation of performance. Thus we can say that profit planning is a tool, which may be used by the management in planning the future course of actions and controlling the actual performance. It includes:-

- © Development and application of broad and long range objectives of the enterprise goals. Specification, development of a strategic long-range profit plans on broad terms.
- © Specification of tactical short range profit planned detailed by assigned responsibilities (Divisions, Departments, Projects).
- © Establishment of a system of periodic performance reports detailed by assigned responsibilities, and
- © Development of follow up procedures.

Profit plan one of the important managerial devices that plays key role for the effective formation and implementation of strategic as well as tactical plans of an organization. Profit planning system requires the effective co-ordination between various functional budgets of an organization like as sales plan, production plan and material requirement budget, labour cost budget, cash budget and capital expenditure budget. A profit planning and control program can be one of the more effective communication networks in an enterprise. Communication for effective Planning and control requires that both the executive and the subordinate have the same understanding of responsibilities and goals. Profit plans, if developed through full participation and in harmony with assigned responsibilities, ensure a degree of understanding not otherwise possible. Full and opened reporting in performing reports that fouls on assigned responsibilities like wise enhances the degree of communication essentials to sound management.

Profit planning is a part of an overall and is an area in which finance function plays major role, profit planning is now an important responsibility of financial manager. While activities of these short require an accounting background, they also require the knowledge of business principles, economics and mathematics. Hence, profit planning represents an overalls plan of and operation, covers a definite periods of time and formulates the planning decision of management. It consists of the operation budget, the financial budget and appropriation budget.

Profit planning which is an example of short range planning focuses on improving the profit especially from particular product over a relatively short period of time. Therefore as used here, it is not the same as corporate planning of a cost rendition program.

Profit planning involves streamlining activities in order to get employees profit mined and secure maximum benefit from minimum effort and expenditure. Best results seem to be obtained by assigning a profit planning to investigate all the account affecting the profit obtained from a single product. The planner is given the right to prove the economics, the organization, the mode of operations, the pricing. The concentration of profit efforts upon one product and the fight of the planner to cross traditional functional boundaries of the enterprise to translate needs from one group to another and to obtain concurred profit

building efforts among these who can effects profits are the fundamental factors that contribute to the success of profit planning.

A profit is an advance decision of expected achievement based on the most efficient operating standards in effect or in prospect of time. It is established against which actual accomplishment is regularly compared.

Profit planning through volume of cost analysis, however is a modern concept of management planning, a tool designated primarily for industrial enterprises. It involves a study of what a business cost and expenses should be and will be at different level of operations and it includes a study of the resultant effect upon profit due to this hanging relationship between volume and cost. The primary aim of the profit plan is to assist in assuring in establishing the financial control polices, including fixed assets, additions, inventories and the cash position. The adaptation of a correctly constructed profit plan provisions provide opportunity for a regular and systematic analysis of incurred and anticipated expenses, organized future planning, fixing of responsibilities and stimulation effect. In short, it provides a tool for more effective supervision of individual operations and practical administration of the business as a whole.

### **2.3 Fundamental Concepts of Profit Planning**

Fundamental concepts of PPC includes the under using activities or tasks that must generally be carried out to attain maximum usefulness form PPC. These fundamentals are:-

- a) Management involvement and commitment
- b) Organization adaptation
- c) Responsibility accounting
- d) Full communication
- e) Realistic Expectation
- f) Timeliness
- g) Flexible application
- h) Zero Base Budgeting
- i) Activities costing
- j) Behavioral view point
- k) Management control using PPC
- l) Management by expectation

m) Follow up

Each of these fundamentals is discussed briefly in the following paragraphs. And it is tried to prove to what extent they are playing the role to make PPC, a meaningful and comprehensive approach.

**a) Managerial Involvement and Commitment**

Managerial support, confidence participations and performance orientations include marginal involvement all levels of management specially top level management should consider following points in order to make PPC program successful.

- © Understand the nature and characteristics of profit planning and control.
- © Be convinced that this particular approach to manage is preferable for their situation.
- © Be willing to devote the effort required to make it possible.
- © Support the program in all its ramifications
- © View the results of the planning process as performance commitments.

For the comprehensive profit planning and control (PPC) program to be successful it must have the full support of each a member of management. Starting with the president the impetus and direction most come from the very top.

**b) Organization Adaptation**

In the world of Welsch a success of the PPC program must rest on sound organizational structure, for the enterprises, and a clear-cut designation of lines enterprise. The responsibility of or the obligation of each department manager should be well clarified whatever may be the nature and success of organizational structure can be taken as ends or tools to attend the goal.

In conclusion the organizational involvement includes:

- © Delegation of authority and responsibility to each functional sub units.
- © Sub-divide the whole organization in to different functional sub units.
- © Each sub units should prepare its own annual or periodic plan.
- ©) Based upon plan prepared by subunits a master plan is to be prepared by higher management.

**c) Responsibility Accounting**

The accounting system of any organization should build the responsibility structure of the firms. This is called responsibility accounting. An organization planning is based on historical data which are largely generated by the accounting system and control includes the measurement of actual results against objectives goals and plans by a account. Therefore, PPC requires responsibility accounting system.

**d) Full Communication**

Communication can be defined as “An interchange of thought or information to bring about a mutual understanding between two or more parties.”

Communication can be either of dialogue message or understanding from working together. Although most of the management gives least importance on communication but it is the most important thing for any organization observation and control. Most of the organization faces cost or problem due to bad communication system.

The goals and objectives set by management should be well communicated in all levels management PPC program can only be successful when the communication is done in fully manner.

**e) Realistic Expectation**

In PPC the management must be realistic and avoid either undue conservation or irrational optimism. The care with which budget goals and objectives are set for such items as sales, production, cash flow and so on determines the success of PPC program. So, far PPP purpose a realistic approach reared with time dimension and external and internal environment that will prevail during the time span should be considered. This is called realistic expectation.

**f) Timelines**

Time and tide wait for none’ whether an individual or an entity is idle or busy time passes at the same rate, If the planning function is to be effectively carried out, on relation is to the concept of planning horizons and the other is to the timing of planning activities.

Planning horizons refers to the period of time in to the future for which management should plan. Decision made to the organization obviously can affect. Only the future, no present decisions can effects or change the past, since all managerial decision are futuristic each management is faced with the basic question of time dimension. The effective

implementation of PPC concepts requires that the management of establish a definite time dimension for certain types of decision. And timing of planning activities suggest that there should be a definite management time schedule established for initialing and completing certain phase if the planning process.

**g) Flexible Application**

“This stress that a PPC program must not dominate the business and that flexibility is applying the plan must be forthright management policy. So that strait tackiest and not imposed and all favorable opportunities are seized even through. They are not covered by the budget. Rightly in practically will be the harmful boundary in an association an occasion for the enterprise. So such boundary should be avoided which mean there should be flexibility in PPC so that the unseen golden opportunity should be grasped in future for the betterment of that organization.

**h) Zero Base Budgeting**

“Under Zero base budgeting, every budget is constructed on the promise that every activity in the budget must be justified. It starts with the basic premise that the budget for next year, is zero and that every expenditure, old and new, must be justified on the basic of its costs and benefits. The discipline of zero base budgeting takes a different approach in fact a reverse approach to this problem of justifying everything. What it says, begin with where you are and establish a business as usual budget for next year the same way and the same things you would do if you weren’t concerned about constraint and total justification.”

**i) Activity Costing**

“Responsibility accounting system generally accumulates costs by department and product costing system associate costs with units of product or service organization also frequently finds it useful to associate costs with activities. By decomposing an organization production process in to discrete set of activities, and then associating cost with each of those activities. Moreover, by systematically identifying the activities through out the organizations managers can identify redundant activities.”

**j) Management Control Using PPC**

The primary purpose of control is to ensure attainment of the objectives, goals and standards of the enterprises. Control has many facts such as direct observation oral express, policies and procedures, reports of actual results and performance reports. PPC focuses on

performance reporting and evaluation of performance to determine the cause of both high and low performance. The essential characteristics of a PPC performance reports are as follows:-

- © Performance is classified by assigned responsibilities.
- © Controllable and non-controllable items are designed.
- © Timely reports and issued.

Emphasis is given to a comparison actual result and planned results, the performance results should be designated the responsible manager and show actual result.

**k) Behavioral View Point**

“An ounce of behavior is better than a quintal of the theorem” what to ever be the theory and theorem, the organization only when it improves its behavior, is best or in another way welsh has suggested that the motivation of human resources through dynamic leadership is control to effective management. Many psychologist and educators and businessmen find that, there are many known and unknown, misconception and speculations concerning the responses of the individual and group in the varying situation. So the PPC programs bring many of this behavior problem is the sharp focus and trying to resolve.

**l) Management by Exception**

A comprehensive profit planning and control program facilities in many ways, underlying there s the measurement of actual performance against planned objectives goals and standards and the reporting if that measurement in performance reports. This measurement and reporting extends to all area of operations and to all responsibility centers in the enterprises. It involves reporting.

- © Actual results
- © Budgets on planned results and
- © The difference between the two.

This type of reporting represents an effective application of the well-recognized management exception principle. The exception principle holds that the manager should concentrate primarily a on exceptional or unusual item that appears in daily, weekly and monthly reports, thereby living sufficient managerial time for overall policy and planning considerations. It is the “out of line” that needs immediate managerial attention to determine causes and to take corrective action. The items that and not out of the line need not utilize

expensive management time, however they shall trigger “rewards” in appropriate ways. To implement the exception principle, techniques, procedures must be adopted to call the manager attention to the out of control items performance reports because they include a comparison of actual results with plans by areas of responsibility, emphasize in a relevant ways performance variation. The out of line items stands out. It is with respect to these items that the busy executives should investigate, determine the corrective action and take corrective active.

**m) Follow up**

This fundamental hold that both goal and substandard performance should be carefully investigated the purpose being three folds.

- © In the case of substandard performance to lead in a constructive manner to immediate corrective action.
- © In the case of outstanding performance, to recognize it and perhaps provide for a transfer of knowledge to similar operation and
- © To provide a basis for better planning and control in the future.

**2.4 Requirements of Effective Planning**

**a) Support of top management**

The Budget program can only be successful when top management offers the whole hearted support and when all managers are motivated about the implementation of budget program.

**b) Clearly defined organization**

Business organization should be defined so as to provide maximum benefits. There should be sound plan with well-defined and adequately maintained responsibilities. Records should be clear, consistently departmentalized and established in such a manner as well as indicate definite responsibilities on each unit or section of the business.

**c) Accurate accounting system**

Accounting system should be developed so far to hold each part of the organization to its responsibilities. The budget fosters coordinated action and when ever this is broken down or interfered with: the responsible factor should be unmistakably revealed.

**d) Unambiguous Policy**

A budget programmed is always based on certain fundamentals, the collection of which is called the “policy” of the business. Naturally, therefore, no programmed can be prepared with out the knowledge of the business policy to be adopted during the period covered by two budgets.

**e) Preparation by responsible executives**

Formulation of budget in the participation of executives who are entrusted with the performance and implementation is one of the essentials of effective budgeting.

**f) Logical Sequence in the budget preparation**

It is essential that proper procedures should be enveloped for the preparation, submission, examination and review of budget figures in logical sequence.

**g) Constant vigilance**

An effective system of budgetary control requires that provision must be made for the comparison of budgeted and actual result at frequent intervals. As soon as unfavorable trends are detected, immediate action should be taken to remedy them.

**h) Continuous budget education**

An essential condition for the success at budgeting is that it must be able to sustain the interest at these who shoulder the responsibility of putting budget proposal into effect. This needs continuous budget education, which is concerned with briefing the employees of the undertaking on the objectives, potentials and techniques of budgeting as well as making them understand its use and limitation.

**i) A degree of flexibility**

Flexibility for both possible and unforeseen and unforeseen circumstance requires essentially in Budgeting.

## **2.5 Profit Planning and Control Responsibility Center**

According to Welsch, Hilton and Gordon, A responsibility center (decision center) is an organization unit or subunit headed by manager with specified authority and responsibility. Thus the company as a whole is a responsibility center, as is each division, department and sales district. Responsibility centers are classified in respect to the extent of responsibility as follows:-

### **a) Cost Center**

A responsibility center for which a manager is responsible for the controllable costs incurred in the subunit but is not responsible, in a financial sense, for profit or investment in the center.

### **b) Revenue Center**

A responsibility center for which the manager is responsible for revenue.

### **c) Profit Center**

A responsibility center for which the manager is responsible for revenue, costs and profit of the center.

### **d) Investment Center**

A responsibility center, for which the manager is responsible for revenue, costs and profit and the amount or resources, invested in the assets used by the center. Planning and controlling focuses on the return on investment earned by the center.

## **2.6 Establishing the Function for PPC**

Establishing a sound foundation is necessary to successful implementation of the profit plan program. For this the enterprise should have to take some steps. They are as follows:-

- © Commitments by the top management to the broad concept of PPC.
- © Identification and evaluation of the controllable and uncontrollable variables of the environment.
- © Evaluation of the organizational structure and assignment of managerial responsibilities and implementation of the changes deemed necessary for effective planning and control.

- © Evaluation or reorganization of the accounting system to ensure that in transferred to the organizational responsibilities.
- © Policy determination about time dimensions.
- © Development of budget education program.

## **2.7 Components of Profit and Planning and Control Program**

A PPC program should have all its components that are required to fulfill the objectives, which are supposed to be fulfilled by PPC program have presented the following components of PPC program:-

### **a) The Substantive Plan**

It is represented by the broad objectives, specific and strategies and program of the organization and by the current commitment of management to long accomplishment of these objectives and plans. This substantive plan may be characterized as the prose part of the plan rather the numbers part of the plan. It gives the foundation for the financial plan. It is represented by followings:-

- © Board objective of the enterprise.
- © Specific enterprise goal.
- © Enterprise strategies.
- © Executive management planning premises.

### **b) The Financial Plan**

It quantifies the planned financial results of planning implementing managerial objective, planned strategies and policies. The financial plan represents a translation in to financial terms of objectives, goals and strategies of management for specific periods of time. It includes:-

#### **i) Strategic long-range profit plan**

- © Sales, cost and profit projections.
- © Major projects and capital additions.
- © Cash Flow and financial.
- © Personal requirement.

#### **ii) Tactical short-range plan**

- © Operating Plan

- Sales plan
- Production plan
- Distribution expenses budget
- Appropriation position plan
- Administrative expenses plan

© Financial Position Plan

- Assets
- Liabilities
- Owner's equity
- Cash flow plan

**iii) Variable Expenses Budget**

© Output expenses formula

**iv) Supplementary Data**

(e.g. Cost Volume profits analysis and ration analysis)

**v) Performance Report**

(Including any special analysis each months end as needed)

**vi) Follow – up, corrective action and re-planning reports.**

**2.8 Process of Profit Planning and Control**

Consistence between the process and components of PPC and this is repeated in each budget year. The purpose of repeating the process on an annual basis is to review and evaluate the basic steps annually.

A comprehensive profit planning and control program encompasses the application of a number of management concepts, approaches and techniques. Basic components of comprehensive profit planning and control program as follows:-

- a) Evaluation of relevant variables.
- b) Development of broad objectives of the enterprise.
- c) Establish specific goals for the enterprise.
- d) Development and evaluation of enterprise strategies.
- e) Preparation and evaluation of planning premises.
- f) Preparation and evaluation of project plans.
- g) Development and approval of strategies and tactical profit plans.

- h) Implementation of profit plans.
- i) Development, dissemination and utilization of performance reports.
- j) Follow up procedures.
- k) Line and staff responsibilities related to PPC.
- l) The profit planning and control manual.

**a) Evaluation of relevant variables**

Relevant variables that will have direct and significant impact on the enterprise. The variables may differ on the basis of the market scope. For a large firm with a national market, the relevant variables obviously would be broad in scope, whereas a small firm would be concerned primarily with regional and local variables operating within the narrow environment of the enterprise. An analysis and evaluation of the environmental variables are a matter of continual concern to the manager. An evaluation of relevant variables should involve all the members of executive management who in turn should expect various staff groups to provide analytical data recommendations.

**b) Development of broad objectives of the enterprise**

“The statement of broad objectives should express the mission, vision, and ethical tone of the enterprise. It tends to provide identity, continuity of purpose and definition. The purposes of the development of the broad objectives of the enterprise are as follows:-

- i) To define the purpose of the company.
- ii) To clarify the philosophy character of the company.
- iii) To create particular “climate” within the business.
- iv) To set down a guide for managers so that the decisions they make will reflect the best interest of the business with fairness and justice to those concerned.

Thus, the statement of broad objectives has as its primary purpose to serve as the basic foundation or building block to develop respect in and pride for the company by management other employees, owners, customers and other firms who have commercial contacts with it.”

**c) Establish Specific Goals for the Enterprise**

The purpose of this step is to bring the statement of board objectives into sharp focus and at the same time to move from the realm of general information to the confines of internal management. This component of comprehensive profit planning and control program details specific short-range and long-range goals for the enterprise. This step provides definite and measurable goals for the whole enterprise and for each of the major sub divisions. Executive management should exercise leadership and operation of enterprise should be conducted for the attainment of common goal and it will be the basis for the measurement of performance. Both strategic and tactical profit plan should define operational goals for the expansion or contraction of product and service lines, growth trends, production goals, geographic areas, share of the market by major product or service lines, profit margins and return on investment.

**d) Development and Evaluation of Enterprise Strategies**

Development of enterprise long range and short range objectives requires management to find the best available alternatives for attending the broad specific objectives already established. Strategies focus on the “how”, they represent the plan of action. Executive management continually must be involved in the development of new strategies and in the adoption of currently on going strategies in harmony with the relevant variables with which management must cope.

Although strategy formulation is of continual concern to executive management, better managed companies have found that periodic reassessment of the strategies is essential in light of a careful analysis of all relevant variables and their future potential impacts.

**e) Preparation of Planning Premises**

Top management leadership is fundamental to develop and articulate this planning foundation, including the formulation of relevant strategies. At this in the planning process, the foundations have been established and communicated the broad and specific objectives of the enterprises. Thus, the instructions and formal guidelines as communicated by the top management at this point in the planning process have come to be generally identified as the planning premises. It

is prepared as executive management instructions and is disseminated in order to initiate a sophisticated and potent move from broad corporate planning to the development of profit plans by each major responsibility center in the enterprise. It is simply a communication step from executive management to the lower levels of management.

**f) Preparation and Evaluation of Project Plans**

The internal environment should be conducive to the submission of project proposals from any source within the enterprise on a continuing basis. Management should be involved, evaluate and decide upon the projects to be planned for each project in process and to select those projects to be initiated during time dimensions covered by the strategic and tactical profit plans preparation and evaluation of current and future project plans are the essential part of profit.

**g) Development and Approval of Strategic and Tactical Profit Plans**

Strategic and tactical profit plans suggest that these two plans should be developed concurrently, for all practical purposes, and that the executives in charge of each of the responsibility centers throughout the firm should participate in their development in harmony with the planning premises. Meaningful participation on the planning process generates positive behavioral effects. Each manager in charge of major responsibility center will immediately initiate activities within his own functional spheres to develop a strategic long range profit plan and harmony with the tactical short range profit plan depending upon the receipt of the planning premises and procedural instructions.

**h) Implementation of Profit Plans**

Implementation of management plans that have been developed and approved in the planning process involves the management function of directing subordinates in the accomplishment of enterprise objectives and goals. Especially, communication is an important aspect of direction. Meaningful participation and control programs are bases for the implementation of profit plans.

**i) Using of Periodic Performance Report**

Periodic performance reports are necessary for dynamic control in harmony with the assigned responsibilities. The accounting department on a monthly basis prepares performance reports. These reports are useful to compare actual results with planned performance and to show difference as a favorable or unfavorable performance variation. A clear distinction should be made between external and internal financial reports. Periodic performance reports focus on dynamic and continuous control tailored to the assigned responsibilities.

**j) Implementation of follow up Action**

Follow up action is an important factor of effective control and re-planning. Performance reports indicate the status of performance by responsibility, which is the basis for follow up action. It is also important to distinguish cause and effect. Analysis should be done to determine the favorable and unfavorable performance. Identifying the unfavorable causes that opposes to the results should be corrected. Follow up procedure should be designed continuously to determine the effectiveness of the prior corrective actions and to provide a basis to improve future planning and control procedures.

### PPC Process

Management Function	Available Resources	Primary Responsibilities
<p style="text-align: center;">↑</p> <p style="text-align: center;">Planning</p> <p style="text-align: center;">↓</p> <hr style="width: 20%; margin: auto;"/> <p style="text-align: center;">↓</p> <p style="text-align: center;">Leading</p> <p style="text-align: center;">↑</p> <hr style="width: 20%; margin: auto;"/> <p style="text-align: center;">↓</p> <p style="text-align: center;">Controlling</p>	<ol style="list-style-type: none"> <li>1. External relevant variable identify and evaluate.</li> <li>2. Broad objectives of the business develop or revise.</li> <li>3. Specific enterprises goals develop consistent with item 2 above.</li> <li>4. Enterprise strategies-specify major thrusts to attain the objectives and goals.</li> <li>5. Executive management planning instructions-specify planning premises (or guidelines) for managers (based on item 1-4 above)</li> <li>6. Project plans-develops and evaluate for each project.</li> <li>7. Strategic profit plan (Long range)-develop for 3, 5 or 10 years.</li> <li>8. Tactical profit plan (short range) – develop for upcoming years.</li> <li>9. Implementation of profit plans – implement through out the budget year.</li> <li>10. Performance reports – prepare monthly reports by responsibility.</li> <li>11. Follow up – provide feedback take</li> </ol>	<p style="text-align: center;">↑</p> <p style="text-align: center;">Executive Management</p> <p style="text-align: center;">↓</p> <hr style="width: 20%; margin: auto;"/> <p style="text-align: center;">↑</p> <p style="text-align: center;">Middle Management</p> <p style="text-align: center;">↓</p> <hr style="width: 20%; margin: auto;"/> <p style="text-align: center;">↑</p> <p style="text-align: center;">All Management</p> <p style="text-align: center;">↓</p>

## **2.9 Principles and purpose of Profit Planning and Control**

The Main Principles and purpose of profit planning are as follows:

- i) To provide a realistic estimate on income and expenses for a period and the financial position at the close of the period detailed by areas of management responsibility.
- ii) To provide a coordinated plan of action, which is designed, to active the estimates reflected in the budget.
- iii) To provide a comparison of actual results with those budgeted and an analysis and interpretation of deviation by areas of responsibility to indicate courses of corrective action and to lead to improvement in procedures in building future plan.
- iv) To provide a guide for management decision in adjusting plans and objectives an uncontrollable conditions change.
- v) To provide a ready basis for making forecasts during the budget periods to guide management in making day to day decision.

## **2.10 Preliminaries of Good Profit Plan**

The fundamentals concerns with effective implementation of the management process. Responsibility sophisticated, considerable management, organization, activities and approach necessary for proficient and application of comprehensive profit planning. A comprehensive profit plan for being good, it must contain the following preliminaries.

### **a) Management Process**

The five function of manager collectively consulate the management process because they are continuously performed in managing an enterprises. The function and management process are as follows:-

- i) Planning
- ii) Organizing
- iii) Leading
- iv) Staffing & Human Resources Management
- v) Interpersonal influence

**b) Management Influence**

Managerial involvement entails managerial purport confidence, participation and performance orientation in order to engage competently in comprehensive profit planning all level of management especially top management.

- i) Understanding the nature characteristics of planning and control.
- ii) Be willing to devote the effort required to market and its operations.
- iii) Be convinced that particular approach to managing is preferable for their situations.
- iv) Support the program in all its ramifications and
- v) View the result of the planning process as performance condiment.

A comprehensive Profit-planning program will be successful. If it has the full support of each number of management starting with the president. The impetus and direction must come from the top. Management involvement and commitment in PPC is directly related to the confidence that top management has in its ability to influence the future course of certain events significantly and hence the success of enterprise.

**c) Full communications**

Communication is necessary activity in facts of management. It is an interchange of thoughts or information that brings about a mutual understanding between two or more practice. It may be accomplished by a combination of words, symbols message and subtleties of understanding that come from working together, day in and day out by two or more individuals, sender message and receiver involves in communication. It is the link that brings together the human elements in an enterprise. Management decision and leadership are accounted by communications. To often communication is taken for granted. Consequently information flows are inadequate. There must be three primary information in an entity, down-ward, upward and laterally in the organization. For profit planning effective communication means development of well defined objectives,

specification of goals, development of profit plans and reporting and follow up activities related to performance evaluation for each responsibilities center.

**d) Responsibility Accounting**

Profit planning system requires a responsibility accounting system that is one tailored to organization responsibility within this primary accounting structure. Relevant financial data may use to meet the need of the enterprise. A responsibility accounting system can be designed and implemented regardless of the features of the accounting system.

**e) Organization Adoption**

The profit planning program must rest upon sound organization structure and the assignment of authority must establish within a framework which enterprise objectives may be attained in a coordinate and effective way on a continuing basis. The scope and interrelationship of the responsibility of each individual manager are specified. To increase management and operational efficiency, particularly all enterprises, except perhaps the very smallest on, should be structurally divided into organization sub-units. The manager of each subunit would be assigned specific authority and responsibility for the operational activities of that sub-unit. These sub-units are often referred to as decision centers. Responsibility centers are rather classified in respect to the extent of responsibility as follow:-

- i) Cost center
- ii) Revenue center
- iii) Profit center
- iv) Investment center

**f) Realistic Expectations**

In profit planning management must be realistic and avoid being either unduly conservative or irrationally optimistic. The care with which budget goals are set for such items are sales, product costs, capital expenditure, cash flow and productivity determines the usefulness of a profit planning program. For profit purpose, enterprise objectives and specific budget goals should represent realistic expectations. To be realistic expectation it must be related (i) To their specific

time dimension and (ii) To an assumed external and internal environment that will prevail during that time span. Within these two constraints realistic expectation should be assume a high level of overall efficiency. However the objectives and goal should be attainable enterprise objectives and specific goals, in order to constitute realistic exceptions must represent a real challenge to managers. The Top management of the enterprise has the direct responsibility for defining the level of challenge that should be represented by realistic expectations.

**g) Time Dimension**

Effective implementation of the profit-planning concept requires that the management of enterprises establishing the definite time dimension for certain types of decision. In viewing time dimension perspectives in managerial planning a clear-cut distinction should be made between historical consideration and future consideration. Historical and results of operation in the past constitute the launching for platform futurists determinations. Periodic planning is the environmental necessity for management to plan evaluates operations within relatively short and consistent interim periods of time such as one year.

**h) Flexible Application**

The fundamental stress that a profit-planning program must dominate the business and that flexibility in applying the plans must be a forthright policy so that strait jackets are not imposed and all favorable opportunities are seized even though they are not covered by the budget. The profit planning program administered in an enlightened way permits greater freedom at all levels of management are brought into the decision making when plans are developed. Simply, the profit planning and control approach focuses on such exception and anticipates exception adjustments and re-planning as situations involve. The prior profit plan provides an area for evaluating the broader impact on the total financial for the enterprise.

**i) Behavioral View Point**

The behaviors aspects of the Management process have been accorded extensive and intensive investigation by psychologist, educators and businessman. The attention is increasing in scope and intensity in recognition that there are many

unknown, misconceptions and speculations concerning the responses of the individual and the group in vary in situation. The comprehensive profit planning approach to managing brings many these behavioral problems into focus. A sophisticated view of profit planning focuses on appositive approach to resolve certain behavioral problem. Clearly the approach cannot resolve behavioral problems. But in many respects it can provide an effective approach to their partial resolution.

**j) Follow Up**

The fundamental holds that good and sub-standards performance should be carefully investigated the purpose being there fold.

- In case of sub-standards performance, to lead in a constructive manner to immediate corrective action.
- In the case of outstanding performance, to recognize it and perhaps for a transfer of knowledge to similar operations.
- To provide a basis for better planning in the future.

**k) Zero Base Budgeting**

Under Zero budgeting, every budget is constructed on the premise that every activity in the budget must be justified. ZBB is defined as an operative planning and budgeting process which require each and shift the burden of proof to each manager to justify why he should spend money at all. It envisages a review of this total expenditure with a view to justify this entire budget. The entire program is to be reviewed and justified from base zero. It involves three phases of management planning, budgeting and review. In traditional, budgeting generally on review is required for on going activities as in ZBB.

**2.11 Long Range Vs Short Range Profit Plan**

“The executive management or the chief financial executives will develop the strategic and tactical profit plans”. Management should plan the future activities with referring to the periods of time.

“Two concurrent profit plans typically are developed: One strategic (long range) and one tactical (short range). The strategic plan is broad and it usually encompasses three or

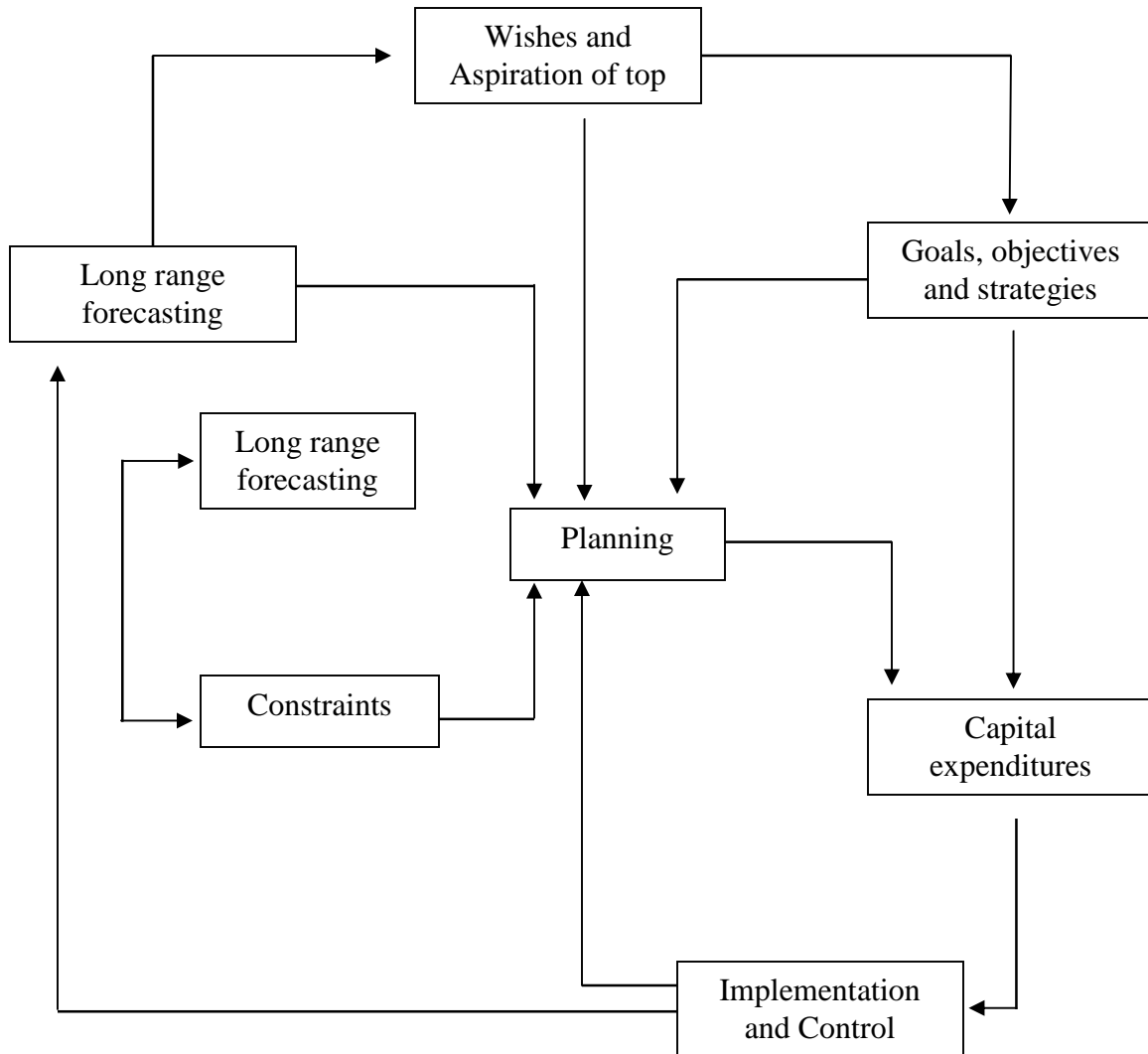
more years in future. The tactical profit plan is detailed and encompasses a one year time horizon, the upcoming year.”

In fact, short-range profit plans are prepared by taking the bases of long range profit plans. Therefore, short range profit plans should be compatible with long range profit planning.

Long range profit planning is more important for broad long run business enterprises: it is closely concern with the concept of the cooperation as long run enterprises. Long range planning is varying 5 to 10 years, long range planning is one of the most difficult time spans involved in planning. The long range profit planning involves in the continuous, systematic and effective organization process of making present risk taking decision. Therefore, long-range plan is a decision making procedure and such decision will be related as the following:

- a) The addition of new sources of fund
- b) Determination of goals, objectives and strategies
- c) Organization, design and structure
- d) The level of direction of capital expenditure etc.

## A Long Range Planning Model



### 2.12 Advantage/Important and Disadvantage of Profit Planning & Control

“A profit planning is financial and narrative expression of the expected result forms the planning decisions. It is called the profit plan (or budget) because it explicates or states the goal in terms of time of them expectations and expected financial results (return on investment profit costs) for each major segment of the entity.”

Many benefits are derived from budgeting although it is a means not an end it itself. PPC is a feed forward process; it makes an evaluation of the variables likely to affect future operation of the enterprises. It predicts future with reasonable precision and removes

uncertainty to great extent. Then main advantage or important of comprehensive profit planning and control are:-

- 1) PPC forces basic policies to initiatives.
- 2) It set responsibilities of employees in relation to each function.
- 3) It creates the feeling of co-operation and understanding between different departments of enterprises.
- 4) It leads to maximum and most economical utilization of materials labour, capital and other resources with a view to ensure maximum return.
- 5) It forces the management to keep adequate and correct historical data in the business.
- 6) In compels management to plan future. The budgeting process forces management to look a need and become more effective and efficient in administrating the business operations.
- 7) It forces the management to take necessary steps for getting satisfactory results.
- 8) It improves the quality of communication. The enterprises objectives, budget goals, plans authority and responsibility and procedure to implement plans are clearly written and communicated through budget to all individual in the enterprises. This result in better understanding and harmonies relations among managers and subordinates.
- 9) Develop an atmosphere of profit mindedness and cost consciousness.
- 10) It highlights up the efficiency or lack of it in the business and thus helps the management to take remedial actions.
- 11) It tends to remove the cloud of uncertainly that exists in many firms especially among lower levels of management relatives to basic policies and enterprises objectives.
- 12) Profit planning necessitates a periodical and critical appraisal of every elements of a business.
- 13) Identification of charge.
- 14) Budgeting increase the mortal and thus the productivity of the employees by seeking their meaningful participation in the formulation of plans and policies,

bringing a harmony between individual goals and enterprise objective and by providing incentives to perform more effectively.

- 15) It helps in preventing waste, reducing expenses and attaining the desired return on investments.
- 16) It creates among the members of management, a habit of considering timely and carefully all the related factors before reaching on a decision.
- 17) It permits to focus management attention on significant matters through budgetary reports thus, if facilities management by exception and there by saves management time and energy considerably.
- 18) It is a process of self-examination and self-evaluation and indicates the progress in attaining the enterprise objectives.
- 19) It promotes understanding among member of management of their co-worker problems.

The following main arguments are usually given against profit planning & control:-

- 1) It is difficult, if not possible, to estimate revenue and expenses in our company realistically.
- 2) Our management has no interest in all the estimate and schedules. Our strictly informal system is better and works well.
- 3) It is not realistic to write out and distribute our goals, policies and guidelines to all the supervisors.
- 4) Budgeting places too great a demand on management time, especially to revise budget constantly. Too much paper work is required.
- 5) It takes away management flexibility.
- 6) It creates all kind of behavioral problems.
- 7) It places the management in a straitjacket.
- 8) It adds a level of complexity that is not needed.
- 9) It is too costly, aside from management time.
- 10) The managers, supervisors, and other employees have hate budgets.

### **2.13 Basic Assumption and Limitation of Profit Plan**

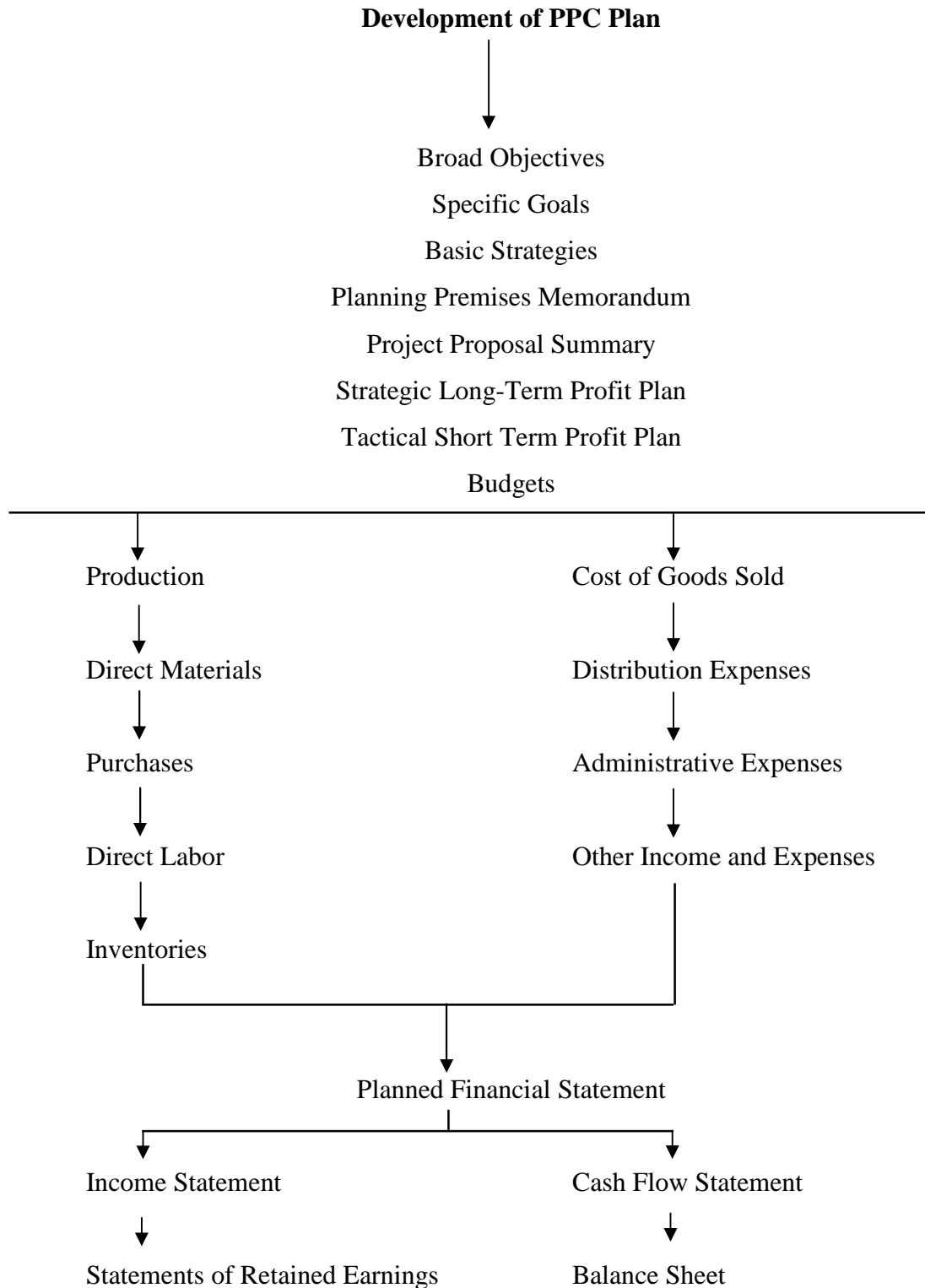
There are so many assumptions for using Profit-planning programs. First of all it required to measure the basic plan in terms of money. Secondly, co-coordinating every aspect of the business towards optimum profit goals. Thirdly, profit to give guideline about what to do?

In developing and using a profit planning and control program, the following additional limitations should be kept in mind,

- 1) The profit plans are based on estimates.
- 2) A PPC program must be continually adopted to fit changing circumstances.
- 3) Execution of profit plan will not occur automatically.
- 4) The profit plan is not a substitute of management.

## 2.14 Development of Profit Plans through Functional Budget

Welsch, Hilton and Gordon have developed of PPC Plans as the following:-



## **2.15 Budgeting As a Tools of Profit Planning**

Profit does not emerge on their own accord. They have to be influenced by management. The quality of management is often judged by the size of the profit figures at the end of financial year. For its own protection in the interest of the business management must plan to make profit the accepted basis for this is the annual budget properly supported by long term strategic planning and operational planning. Functional budgets are the tools for planning and controlling the profit of any enterprises. In budgeting we plan the desired profit and in the time of execution the performance is verified and controlled by the budget. “Budgeting is a realistic statement of income and cost objective for a year. It is a plan against which the ensuring actual performance is compares to as to achieve control by directing and correcting of standard performance.”

Budgeting as a tool of planning and control is closely related to the broader system of planning and control in an organization. Planning involves the specification of the basis objectives that will guide it. In operational terms it involves the step of setting objectives, specifying goals formulating strategies and expressing budgets. A budget is a comprehensive and coordinated plan for the operations and resources of an enterprise for some specific period in future.

A budget is a written plan for the future. The managers for firms which use budgets are forced to plan ahead. Thus, these firms tend to do well because they anticipate problem before they occur. A firm without financial goals may find it difficult to make proper decisions. A firm with specific goals in the form of budget makes many decisions ahead of time. A budget helps a firm to control its costs by setting guidelines for spending money. If cost exceed the budget cost an explanation will be required. A budgets help to motivate employees help in setting up budget. The master budget consists of many functional budgets. These budgets include a sales budget, a production budget, an expenses budget, an equipment purchase budget and a cash budget. Once all of those budgets are completed, the master budget for the entire firms is prepared.

The concept of comprehensive budget covers its use in planning organizing and controlling all the financial and operating activities of the firm in the forth-coning period. Budgeting summarizes the estimated results of future transaction for the entire company in

much the same manner as the account in process records and summarizes the results of completed transactions.

The budget is a detailed quantitative expression of management plans for the near future: the budget involves the statement of plans. While originally the budget constituted financial documents, it is now concerned with devising a coordinated program of operation producing an effective means of communication among managerial personnel for the purpose of evaluating goals, proposed plans of action, directing the diverse activities towards the accomplishment of predetermined goals and obtaining all requisite approvals. Thus, there is an increasing trend towards extending the frontiers of business budgets to include planning, coordinating and controlling of the entire operations of business. This has transferred budgets and budgetary control into a valuable tool of a purposeful management.

**a) Essential Elements of Budget**

A Budget is defined as a comprehensive and coordinated plan, expressed in financial terms, for the operations and resources of an enterprise for some specified period in the future. The following are the essential elements of a budget.

**1) Plan**

A budget is itself a plan. The term "Plan" with reference to budgeting has a specific connection. It induces two aspects, which have a bearing on the operation of an enterprise. One set of factors, which determine a firm's future operating is wholly external beyond its control. The second set of factors affecting future activities are within the firm's control and discretion. Budgeting, as a plan covers both these aspects. In other words budgeting not only suggests what will happen but should also make things happen.

**2) Operations and Resource**

A budget is a mechanism of plans of the firm operations and resource. The operations are reflected in revenue and expenses. This means that a budget should quantify the revenues to be realized from products/service and the expenses to be incurred on goods/services used in generating revenues.

The plan also covers resources of the firm. The planning of resources means the planning of the various assets and the sources of capital to finance these assets. The assets could be fixed assets as well as current assets.

**3) Financial Terms**

Budgets are prepared in financial terms, i.e. in terms of monetary value such as the rupee and dollar and so on. The reason is that the monetary unit a common denominator. The various activities and operations are expressed in different units e.g. material in terms of weight, labour in terms of number man hours, and sales in terms of territories advertisement in terms of magazine space and so on.

**4) Specified Future Period**

A budget relates to specified of tie, usually one year. If it is not related to time horizon, it will be meaningless. Planning merely for a given amount say, sales/profit will not constitute a budget unless a time dimension is added i.e. the budget sales/profit is planned to be achieved in a predetermined time frame work.

**5) Comprehension**

A budget should be comprehensive. The term comprehensive here means that all the activities and operations of an organization are included in it. It covers the organization whole and not only some segments.

**6) Co-ordination**

Budgets are prepared for the different components/segments/division/facets/activities of an organization to as to take care of the situation and problems of each component. The budgets for each of the components are prepared in harmony with each other. This is called coordination.

**b) Objectives of Budgeting**

The main objectives of budgeting may be summarized as under:-

- 1) To forecast and to plan for the future to avoid losses and to maximize profits, i.e. to help planning
- 2) To bring about coordination between different functions of an enterprise i.e. to help in coordination.
- 3) To control actual actions by ensuring that actual are in tune with targets, i.e. to help in controlling.

The main purpose of budget is to ensure the planned profit of the enterprises. So it is considered as a tool for planning and controlling the profits. One of the primary objectives of an annual budget is to measure the profits expectations for the next financial year with due regard to all the circumstances favorable and unfavorable that can influence the trading prospects.

Different experts have expressed their view differently regarding the purpose of budget. But the main theme is not differing too greatly. Some writer's expression is as follows:

***According to Rathham, purpose of budget is follows:***

- 1) It is plan of action and serves as means for a delegation of policies.
- 2) It defines the objectives for all the executives.
- 3) It provides a means of coordination and communication.
- 4) Budget facilitates centralized control with delegated authority and responsibilities.
- 5) It provides comparison of actual performance with budgets.
- 6) Only the exceptions are reported to the management so that corrective action can be taken in order to achieve to objectives laid down by the management.

***Halsall describes the main purpose of an operating budget as follows:***

- 1) It is a plan, which reflects the policy of a business in financial terms.
- 2) It is a control document by which management can monitor actual performance.
- 3) It acts to motivate of employees.
- 4) It is a measure against which to evaluate the quality of management.
- 5) It is means of forecasting future financial positions.
- 6) It is a means of giving information of an organization's future intention.

“The purpose of budgeting in the context of an annual budget is to project as accurately as possible the sales, expenditure income and profit for the year. It is a principle objectives and all other requirements of budgeting are derived form it.”

**c) Terminology of Budget**

The main terminologies of budget are as under:

- 1) Forecast
- 2) Budget period
- 3) Budget centers

- 4) Budget manual
- 5) Budget officer
- 6) Budget committee
- 7) Budget key factor

**d) Classification of Budget**

Budget may be classified under different based as required. Some bases to classify budget are as follows.

**1) On the Basis of Time**

**(i) Long term budget**

These budgets are prepared on the basis of long term forecasts and such budget covers the plan, which extends from five to ten years. They are mostly prepared in terms of physical quantities rather than n rupee value.

**(ii) Short Term Budget**

These are usually operation budget for one to five years and expressed in rupee value.

**(iii) Current Budget**

These budgets are usually prepared for one month to twelve months and are the short-term budgets adjusted by current conditions or prevailing circumstances.

**On the Basis of Function**

Budget for a period may also be classified according to the function carried on in business concern. The various forecast for individual functions are coordinated then consolidated to show the total effects of all the functions. The number of functional budget depends upon the size and nature of the business. Some of functional budget are as follows:

**(iv) Sales Budget**

This is a forecast to total sales classified according to group of products, salesman and geographical locations.

**(v) Selling and Distributions Cost Budget**

It is concerned with estimates of the cost, selling and distribution of goods.

**(vi) Production Budget**

It estimates of total volume of production with the scheduling of operations by days, weeks and month. It is a forecast based on sales, productive capacity and requirements of inventories etc.

**(vii) Production Cost Budget**

Production cost budget is related to cost of production including all the direct and indirect cost i.e. labour, material and expenses.

**(viii) Personal Budget**

A personal budget can be prepared from data given in the production budget and other activity. It is a reference to utilization of manpower in organization activity.

**(vi) Research Budget**

Research budget related to improvement in the quality of the product or research or new products, for the purpose of satisfying the customers.

**(vii) Cash Budget**

Cash budget is a total of the requirement of cash in respect of various functional budgets as well as of anticipated cash receipts.

**(viii) Plant Utilization Budget**

Plant utilization budget covers the plant and machinery requirements to meet the budgeted production during the budget period. Schedules will be prepared showing the available load in each department expressed in standards hours or unit.

**(ix) Office and Administration Budget**

Offices and administration budget presents cost of all administrative expenses such as managers salary directors salary staffs salary and expenses of the office management like, light, power, water clearing etc.

(x) **Capital Budget**

Capital budget is a forecast of outlay for fixed assets. It is used interchangeably with capital expenditure decision, capital expenditure management, long term investment decision, and management of fixed assets and so on.

(xi) **Master Budget**

Master budget is a summary budget that incorporated all functional budgets and it may take the form of profit and lost account and balance sheet as the end of budget period.

**2) On the Basis of Flexibility**

Budget may also be classified on the basis of flexibility i.e. ability to change the budget target according to the volume of activity. From this point of view, budget may be of two types.

(i) **Flexible Budget**

The budget is designed in such a way as to charge with the level of activity attained. In case of such budgets, revenues and cost target are set the respect of different level of activity even from zero to hundred percent of product volume.

(ii) **Static Budget**

The budgets are prepared for a fixed or standard volume of activity, they are called static budget. They do not charge in accordance with the change in volume of activity. Such budgets are usually prepared form one to three months in advance of the fiscal year to which they are applicable.

**3) On the Basis of the Business Activity**

Budget may also be classified on the basis of nature of business activity.

According to this point of view there are two types of business activity:-

- Creation of facility
- Carrying out the operation. If this view is taken as the basis than the budget may be as follow.

(i) **Capital Expenditure Budget**

All budgets, which are related to the plans, aiming at creating manufacture facilities is known as capital expenditure budgets. Such budgets assure to be more significant in the case of large and progressive manufacturing concerns.

(ii) **Operating or Revenue Budget**

When budgets deal with the plans for routine activities, they are called as operating budgets. These budgets are based on forecast respect of routine budgets. These budgets are based on forecast respect of routine activities like, sales, production cost revenue, etc. and thus the principal part of master budget.

e) **Development of Profit Plan through Functional Budget**

Profit plans are developed with the help of functional budgets. But before going to this process we have to have a general knowledge about budgeting, its purpose and procedure.

A budget is a comprehensive and coordinated plan expressed in financial terms for the operations resources of an organization for some specified period in the future. So a budget is a plan of the firm's expectations in the future. The word budget is used of many kinds of statement of future plan and expenditures, varying enormously in their form and content, the use to which they are put, and even their very names.

A Budget is generally understood to mean one of serried to similar statement prepared as a regular procedure and not as on isolate exercise. It is a statement of objectives as well as a forecast or an estimate. In budgeting the company predicts what will happen. Budgets are quantitative and usually financial expression of plan and they allocate resource to activities.

The preparation of comprehensive budgets begins with planning of sales and this planning will establish the basis for the detail planning of production. With the help of production plan, material usage and purchase budget, direct labour budget, expenses budget are derived in an appropriate sequences. The budget culminates in a projection of the income statement and balance sheet at the end of the budget period of the company as whole.

So the “budget is the detailed estimate of the cost of stated policy and the expected income to be raised for it.”

**f) Master Budget**

Master budget is a summary, which incorporates all functional budgets, and it may the form of profit and loss account and balance sheet as at end of the budget. The complete budget for a firm is often called the master budget. This budget includes a sales budget, expenses budgets an equipment purchase budget and a cash budget. Once all these budgets are completed the master budget of the entire firm is prepared. A master budget is summary of functional budgets plan and profit and loss during the budget period.

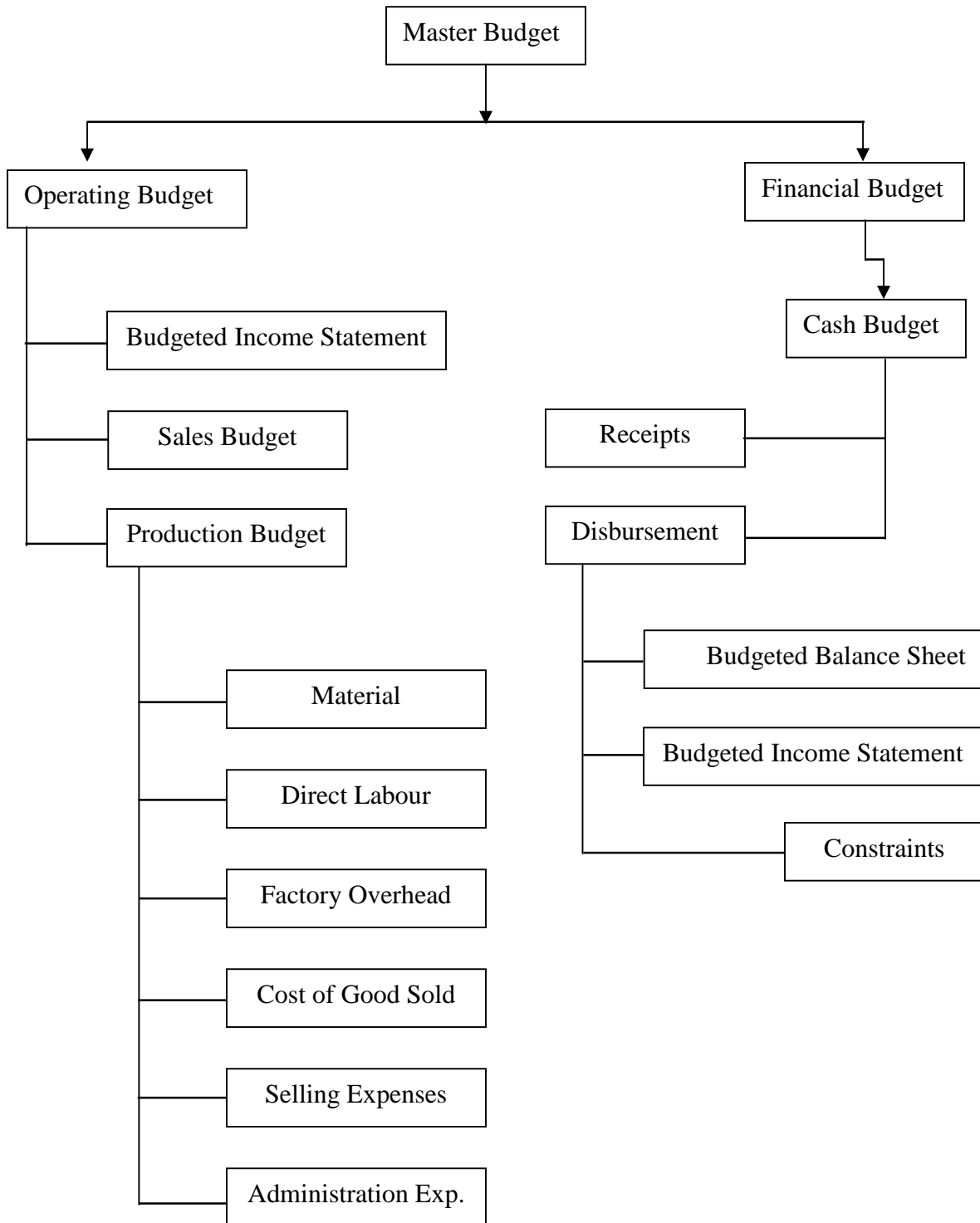
It is the profit and loss statement for the next finical year or other period covered by the budget.

The covered budget is the organization’s primary short-term budgetary device. The preparation of master budget is a complex process and it involves the effect of many people from all levels of management. There are 12 basic steps in preparing a master budget. These are as follows:-

- 1) Forecasting demand
- 2) Identify cost of responsibility center
- 3) Estimate production costs
- 4) Specify operating objectives
- 5) Develop a sales budget
- 6) Develop a production budget
- 7) Develop a purchase budget
- 8) Develop budget for responsibility centers
- 9) Formulate a profit plan
- 10) Compare profit plan with operating objectives
- 11) Formulate a projected cash budget
- 12) Prepare a projected statement of financial position.

We have already defined that “the budget is a tool of profit planning” so, it is impossible to prepare profit plan with out the help of budget. That’s why budget is an integral part of profit plan. A detailed profit plan can be formulated only with the help of

various functional budgets. This process starts with the preparation of sales budget and ends with the completion of budgeted profit and loss account and balance sheet.



## 2.16 Sales Budget

### 2.16.1 Meaning

Preparation of sales budget is the starting point for the development of profit plan to those organizations, which are operating, in competitive environment. After having the planning premises of the organization the sales plan is developed. Sales plan is the starting point in the preparation of the comprehensive profit planning and control. All the other plans and budget are dependent up on the sales budget. The budget is usually presented both in units and rupee of the sales revenue or sales volume. A variety of methods are used to forecast the sales for the planning period. Because the preparation of sales plan is based up on the sales forecast.

Sales planning process is a necessary part of PPC because:

- i) It provides for the basic management decisions about marketing and
- ii) Based on those decision it is an organized approach for developing a comprehensive sale plan. If the sales plan is not realistic, most if not all of the other parts of the overall profit plan also are not realistic.

*The sales plan has three distinct parts are as follows:*

- i) The planned volumes of sales at the planned sales price per unit for each product.
- ii) The sales promotional plan and
- iii) The sales (or distribution) expenses plan.

The sales budget itself is an estimate of three main figures:

- i) The income that will be earned from sales.
- ii) The cost and expenses of making sales
- iii) The sales surplus

The Income from sales will depend on the quantity and the price of goods, which will be sold.

*The primary purpose of sales plan is as follows:-*

- i) To reduce uncertainty about future revenue.
- ii) To incorporate management judgment and decisions in to the planning process.

- iii) To provide necessary information for developing other elements of comprehensive profit plan and
- iv) To facilities management control of sales activities.

### **2.16.2 Components of Sales Plan**

WELSCH HILTON and GORDEN have mentioned the major four components for a comprehensive sale plan. They are:-

- 1) Management policies and assumption.
- 2) Marketing plan (Sales and Service revenue)
- 3) Advertising and Promotion Plan
- 4) Distribution (Selling expenses) plan

### **2.16.3 Sales Plan Vs Forecasting**

Sales planning and forecasting are not same. A forecasting is just a statement of future conditions. Sales planning and forecasting often are confused. Although related, they have distinctly different purpose. Forecast is not a plan rather it is a statement and or a quantified assessment of future conditions about a particular subject based on one or more exploit assumption. A forecast should always viewed as only one input in to the development of a sales plan. The management of a company may accept, modify or reject the forecast. In contrast, a sales plan incorporate management decisions that are based on the forecast, other inputs, and management judgment about such related items as sales volume, price, sales efforts, production and financing. A sales forecast has to be translated in to a sales budget and here a number of factors have to be taken in to consideration. A sales planning is the function of top management where a sales forecasting is a technical staff function.

### **2.16.4 Strategic Vs Tactical Sales Plan**

A comprehensive sales plan includes two separate but related plans, the strategic and tactical sales plan. The strategic sales plan is a long-term sales plan and it usually covers a 5 to 10 years time horizons. Where as tactical sales plan has shorter time horizons and usually covers one-year period. Long-term sales plans are usually developed as annual amounts and use broad groupings of products. Long-term sales plans usually involve in depth analysis of future market potentials, which may be build up from a basic foundation such as population changes, state of the economy, industry projections and finally company objectives. Short term sales plan or tactical sales plan is prepared to plans sales for twelve months in to the

future, detailing the plan initially by quarters through out the years, the sales plan in restudied and revised by adding a period in the future and by dropping the period just ended. The short-term sales plan includes a detailed plan for each for major product and for groupings of minor products. Short-term sales plan must also have structured by making responsibility for planning and controlling purpose. The short-term sales plans may involve the application of technical analysis. However, managerial judgment plays a large part in their determination.

### **2.17 Production Budget**

When the sales plan is completed, the next step in comprehensive profit planning and control is the formulation of production plan. A production budget is an estimate of the number of units of each product that will be production in the budget. The production plan involves determining the number of units of each product that must be manufactured to meet planned sales and maintain the planned inventory levels of finished goods.

It is an estimate of how cheaply the goods required by sales can be made. Once sales and inventory requirements have been established, the logical first step in the production plan is a facility survey. This survey should determine that all planned products can be produced on existing or contemplated equipment and that they can be made in the volumes required. In this initial stage, availability labour supply and skills are considered. Bottlenecks or to reduce planned volume.

Production plan must consider for each product the quality which is now on hand in inventory, the quantity required to meet projected sales and the quantity which it is desired to have in inventory at the end to the budget period. The desired inventory quantity plus the quantity required meeting the projected sales yield the quantity, which must be mad available for the sale during the planning period. The quantity to be made available for the sale during the planning period yield the quantity to be produced during the planning period or the production budget in term of units that product.

Production must be planned to allow sufficient time to manufacture the products before the estimated data of sale, production budget should be planned and based on estimated sales: It is prepared on the basis of (i) Sales budget (ii) Plant capacity (iii) Opening inventory of finished goods (iv) Required closing inventory of finished goods and (v) Policy of the management. Production budget is divided into monthly budgets for the purpose of

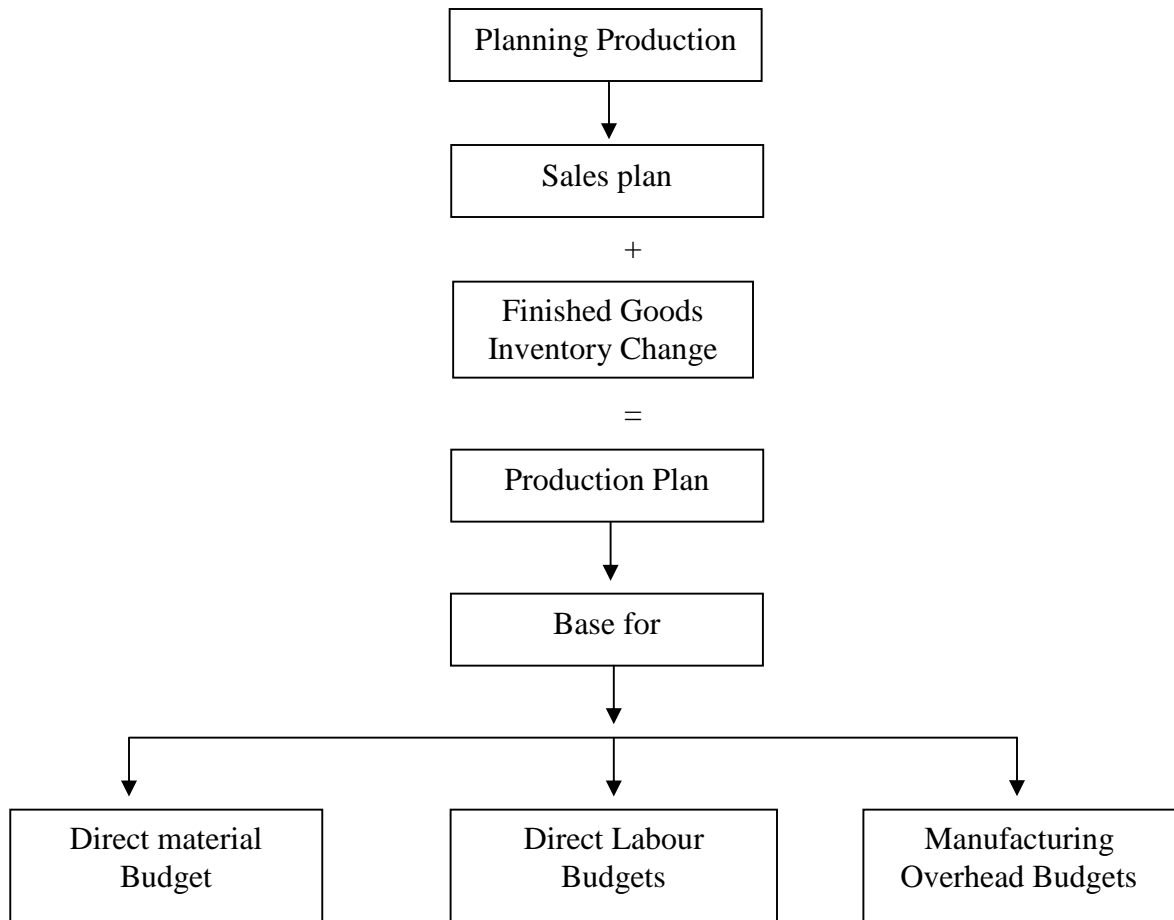
production planning. In production planning the following factors are considered : 9i) Economic batch quantity (ii) Delivery schedule (iii) Seasonal conditions (iv) Optimum utilization of plant capacity (v) Optimum utilization of labour without much over time and idle tome (vi) Reduction of bottlenecks such as shortage of man, materials etc. (vii) Stock requirements and (viii) Work in progress.

“The annual sales budget and the inventory requirement provide the frame work for the production budget.”

The production budget can be presented in the following formula:-

$$\text{Production Requirements} = \text{Sales Volume} \pm \text{Finished Goods Inventory Change}$$

The planning of production or manufacturing operations can be depicted as followings:-



While developing and planning the production budget, the inventory policy is to be fixed first and then the total quantity of each product to be manufactured during the budget period should be planned. After doing that, the planned production schedule should be made for interim period. The production budget is the initial step in budgeting manufacturing operations. In addition to the production budget, three other principal budgets are relevant to manufacturing.

- 1) The direct material and purchased components budget, which specifies the planned material and components requirements.
- 2) The labour budget, which shows the planned quantity and cost of direct labour and
- 3) The manufacturing expenses or factory overhead budget, which includes the plans for all factory costs other than direct material and direct labour.

A complete production plan should show budget data classified by (i) products to be manufactured (ii) interim time periods and (iii) activities of each responsibility center in the manufacture process.

To plan production effectively, the manufacturing manager must develop information about the manufacturing operations necessary for each product. The manager should develop information. The managers must provide historical data about production quantities cost and the availability or resource. The director of profit planning and control should provide staff assistance when needed.

When the production manager has completed the production plan, it should be given to the executive committee for evaluation and then to the resident for tentative approval prior to its use as a basis for developing the direct materials, direct labor and the factory overhead budgets.

#### **2.17.1 Objectives of Production Plan**

Following are the objectives of the production plan

- i) To bring to a common focus all the factors necessary to establish polices and to determine operations.
- ii) To project these established policies into the future by an analysis of past performance.

- iii) To plan and control operations being carried out to implement policies decided upon.
- iv) To make provisions for materials at right time and place.
- v) To plan the sequence of operation required for economical production.
- vi) To coordinate the various aspects of factory operations to make them a vital link in the chain of profitable programme.

### **2.17.2 Responsibility for Production Planning**

The completed marketing plan should be given to the manufacturing executive who is responsible for translating it into a balanced production program consistent with managerial policies and subject to certain internal limitations, Planning, scheduling and dispatching of the actual production throughout the year function of production department. So it is essential that responsibility for planning and controlling of these functions should be performed by production executive. These executives have first hand knowledge of plant and personal capacities, availability of materials and the production situation. Although responsibility rests directly upon the production executives, top management policies must be considered in such matters as inventory levels, stability of production and capital additions.

The overall responsibility of production manager is to prepare the production budget on time. On the basis of the sales plan, he should prepare the production plan and this production plan should be consistent with managerial policies such as inventory level, stability of production, capital additions and so.

### **2.17.3 General Consideration in Planning Production**

There must be needed coordination between sales plans, production plans and inventory policies and the production budgets give guidelines to obtain the coordination between them.

The production plan represents the implications of planned sales volume for planned production volume as a basis for planning various aspects of the manufacturing function plant capacity requirements, direct material and component requirements, timing of purchase direct labour requirements and costs and factory overhead.

Other decisions should be made on the basis of production plan therefore there should be serious consideration in preparing production plan. Welsch, Hilton and Gordon have

mentioned the following eight points to be considered is planning production and inventory levels.

- i) Total production requirements (by products) for the budget period.
- ii) Inventory policies about the level of finished goods: work in process and the cost of carrying inventory.
- iii) Plant capacity policies, such as the limits of permissible departures from a stable production level throughout the year.
- iv) Adequacy of direct materials purchased components and labour.
- v) Availability of direct materials purchased components and labour.
- vi) Length of the processing time.
- vii) Economic lots or runs.
- viii) Timing of production throughout the budget periods by product and by responsibility centers.

#### **2.17.4 Developing the Production Plan**

Generally there are three major steps to be followed while developing a production plan.

- i) Establishing policies for inventory levels.
- ii) Planning that is to be manufacturing during the budget period.
- iii) Scheduling this production by interim periods.

Production schedule for interim time period is required because to

- i) Provide sufficient goods to meet interim sales requirement.
- ii) Keep interim inventory levels with in policy constraints, and
- iii) Manufacturing goods as economically as possible.

An efficient production plan should represent the optimum coordinates between sales requirements, essentials inventor levels and stable production levels.

Planned sales units	xxx
Needed ending inventory	xxx
Total requirement	<u>xxx</u>
Beginning inventory in hand	xxx
Planned Production	<u>xxx</u>

### **2.17.5 Consideration in Developing inventory Policies**

The main objectives of inventory policies to maintain the optimum level of investment in inventory. In most of the manufacturing enterprise inventory represent relatively high investment, which must have to control by appropriate inventory policy. Unnecessary investment in inventory will result per unit production cost high. Welsch and Hilton have suggested the result per unit production cost high. Welsch and Hilton have suggested the following points that should be considered while developing inventory policy:

- a) Quantity needs to meet sale requirements.
- b) Perish ability of items
- c) Length of the production period
- d) Storage facilities
- e) Adequacy of capital to finance inventory
- f) Distribution time requirements
- g) Cost of holding inventory
- h) Protection against materials and parts prices increases
- i) Protection against direct material a component shortages
- j) Protection against labour shortage
- k) Risk involved in inventory:
  - (i) Price decline
  - (ii) Obsolescence of stock
  - (iii) Casualty loss and theft
  - (iv) Lack of demand
  - (v) Customers return policies.

### **2.17.6 Responsibility**

- a) **Executive**
  - (i) Production Policy
    - Stable
    - Manufacturing
- b) **Sales Manager**
  - (i) Provides sales budget to production manager

- c) **Production Manager**
  - (i) Preparation of Production Budget
- d) **Financial Manager**
  - (i) - Provide Standard rate and Historical data
  - Providing information of financial position
- e) **Personnel Manager**
  - (i) Providing data regarding manpower

#### **2.17.7 Long Range Vs Short Range Production Plan**

To develop a long-range, broad estimates of production levels are necessary. With help of estimated broad production level, plan regarding plant capacity requirements, cash flow and other are possible. For long-range production planning purpose only major increase or decrease in inventories need to be taken in to account. But the short-range production plan should be an annual production plan, which should details by products and by months or quarters. Also the production activities should be planned by responsibility centers within the manufacturing divisions.

#### **2.18 Material and Purchase Plan or Budget**

After the preparation of sales and production budget, the next step is to prepare material purchase budget. When the production budget is completed, the requirement of raw materials and components can be estimated. Production budget also helps to prepare materials uses budget. It s through the material uses budget one can determine the time and quantity of material to be purchased. A purchased budget gives the details of materials purchase to be made in the budget period.

Raw materials which are to be processed for conversion into finished product are shown in this budget. It will show the units or quantity of different materials to be issued to production centers during the budget periods form store. It may also contain information about levels of stock of raw material and their estimated price. This will ensure the purchase of right quality of material.

Material is generally defined to include all materials and parts that are internal part of the finished product and can be directly identified with the unit costs of the finished products.

Material and parts purchase budget has great significance in cost control program. Any surplus and bottleneck of material, both lead to cost maximization. But if there is material purchase budget that the question of excess and shortage of material does not arise. Material plan requires the proper coordination between.

- a) Requirements of material and parts for production
- b) Raw material and parts for production
- c) Purchase of raw materials

Required unit of materials = (Production units  $\times$  Required unit of material for each unit of production + closing stock of material). To ensure that the appropriate amount of raw material and components parts will be on hand at the required and to plan for the cost of such materials and parts, the tactical short term profit plan should include (i) a detailed budget that specifies the quantity and cost of such material and parts and (ii) a related budget of materials and parts usually require the following four budgets.

a) ***Materials and parts budget***

This budget specifies the planned quantities of each material by time by product and by using responsibility.

b) ***Material purchase budget***

This material budget specifies the quantities and timing of each raw material needed for. A plan for material purchase must be developed. This budget specifies the estimated to be purchased and the estimate a cost for each raw material and the reflected delivery dates.

c) ***Material inventory budget***

This budget reports the estimated cost of the material inventory in terms of quantities and cost. The difference in units between material budget and the purchase is reflected as increase or decrease in the inventory budget.

d) ***Cost of material used budget***

This budget reports the estimated cost of the materials planned for in the materials budget.

### **2.18.1 Purchasing Policy Developing Material Plan**

In developing the policy with respect to purchase and inventory the basis two questions should be answered.

- i) How much to purchase at a time and
- ii) When to purchase

The first question is determined by economic order quantity (EOQ) and can be calculated by using the following formula:-

$$EOQ = \sqrt{\frac{2AO}{C}}$$

Where,

A = Annual quantity requirement units

O = Average annual ordering cost

C = Annual carrying cost

The second question: when to purchase is determined by re-order point is the time when a purchase is made. The re-order point is reached when inventory level is equal to the quantity needed to sustain production for a period equal to the time to reorder and received the replenishments and desired safety stock.

Re-Order Point = Replacement Stock + safety stock

### **2.18.2 Materials and Parts Inventory Policies**

The primary considerations in setting inventory policies for materials and parts are:-

- a) Timing and quantity of manufacturing needs
- b) Economies in purchasing through quantity discounts
- c) Availability of materials and parts
- d) Lead time (delivery time)
- e) Perish ability of material and parts
- f) Storage facility needed
- g) Capital requirement to finance inventory
- h) Cost of storage
- i) Expected changes in the cost of material and parts
- j) Protection against in shortages
- k) Risk involved in inventories
- l) Opportunity cost

**Just-In time purchasing:**

A recent development in materials and parts inventory control is called just in time (JIT) purchasing and manufacturing. Its primary objective is to minimize inventory levels and the resulting costs. In this approach, material and parts are not purchase until needed for production, thereby minimizing inventory-holding costs. In such an approach, it is critical to anticipate exactly when the materials and parts will be needed for production so that the acquisition can be reflected in the materials and parts will be needed for production so that the acquisition can be reflected in the materials and parts budget for profit planning purposes.

**2.19 Direct Labour Costs Plan**

Planning labour cost refers the area of personnel needs, recruitment, training, job description and evaluation, performance evaluation, union negotiation and wages and salary administration.

Direct labour cost occupies a significant portion of total production cost. So that the labour cost needs systematic planning. The basic reasons for preparing a separate direct labour budget are to provide planning data about the direct labours requirements number of direct labour employees needed, labour cost of each product unit and investment requirements.

Labour costs include all expenditure for employees, top executives, middle managements, and unskilled employees. To plan labour costs effectively, the different types of labour cost must be separately considered. The responsibility for preparing the direct labour budget should be assigned to the executive responsible for the manufacturing function. The cost accounting and personnel department provide support and supplementary information when the manufacturing managers prepare the direct labour budget. It should be given to the budget manager for review and next submitted to the executive committee. When the direct labour budget is tentatively approved it becomes part of the profit plan.

**2.19.1 Developing the Direct Labour Budget**

Welsch, Hilton and Gordon have mentioned three approaches that are basically used to develop the direct labour budget. These are:-

- a) Estimate the standard labour hour for each unit of each product. Then estimate average wages rate. The multiplication of standard labour hour per unit and estimated average wages rate per hour will give the direct labour cost per unit

of output for the department cost center or operation. And the multiplication of planned units of output and the direct labour costs per unit will result the total direct labour cost by product.

- b) Estimate ratios of direct labour cost to some measure of output that can be planned realistically.
- c) Develop personnel tables by enumerating personnel requirement for direct labour in each responsibility center.

Generally these are certain approaches to develop standard labour times for each product. These are time studies, motion studies, standard costs and direct estimate by supervisors and statistical estimate by staff group.

## **2.20 Expense (Overhead) Budget**

### **2.20.1 Meaning**

The next step in PPC is overhead plan. The need for overhead plan arises because to maintain overhead expenses at reasonable level. There are various technique and basis to classify overhead. Among them functional and behavioral classification are most important. Overhead classification is important to plan overhead properly and also to control them.

In general, controlling and planning direct cost is simple than controlling and planning of overhead. It is because direct costs are directly related to level of activity and one can easily trace out the direct cost form total cost. The overhead is resulted from the total of indirect cost. That's why it is impossible to trace out overhead cost from total or per unit cost. So the overhead budget should be planned on department and responsibility centre wise. Only with the help of proper planned overhead budget, it is possible to control overhead cost.

One should have to understand that there is different between overhead cost control and overhead cost reduction. The prime responsibility of management is to control over the head cost and not to reduce the overhead cost. Cost control means the optimum utilization of limited resource in order to minimize per unit cost by enhancing production level under the same cost burden overhead cost control is possible only after the preparation of overhead budget by responsibility centre wise.

### **2.20.2 Planning Expenses**

Manager should view expenses planning a necessary to maintain reasonable expenses levels to support the objectives and planned programs of the enterprises. Expenses planning

should focus on the relationship between expenditure and the benefits derived from that expenditure. The desired benefits should be viewed as goals and sufficient resources must be planned to support the operating activities essential for their accomplishment. Following are the main kind of expenses:

- a) Manufacturing expenses
- b) Product quality expenses
- c) Distribution or selling expenses
- d) General administration expenses
- e) Financial and other expenses

### **2.20.3 Cost Versus Expenses**

Two terms, cost and expenses are often used in the same sense. For financial accounting purpose cost is defined as an expenditure that is entirely recorded as an asset and becomes an expense when it is “used up” in the future. Thus, a cost account is an asset accounts. An expense is defined as an expenditure that is correctly consumed or a cost that has been used up. For management accounting purposes, these terms are not rigidly defined. They are used to mean something as asset and sometimes and expense.

#### **Fixed Cost**

Those items of cost that tend to remain constant in total form month to month regardless of fluctuation in output or volume or work done. Because any cost can change this concept must be applied (i) to a realistic or relevant range of output and (ii) in relation to a given set so conditions.

#### **Variable Cost**

Those items of cost that change in total directly with changes in output or volume of work done. The work must be measured in terms of some activity base, such as units completed, direct labour hours worked, sales dollars, and number of services calls depending on the work organizational unit.

#### **Semi – Variable Cost**

Those item of cost that is neither fixed nor variable, that is, they posses some characteristics of both. As output changes, semi – variable cost change in the same direction but not in proportion there for.

## **2.21 Manufacturing Overhead Budget**

Ordinary manufacturing overhead costs are given considerable attention. Individual cost classification are examined closely to see the costs react to change in volume or in relationship to other factors. Past record may show that a cost will generally follow a certain pattern of activity. One company may find the certain overhead costs are influenced by indirect labour hours, while another company will base estimates of overhead on direct labour hours of even on materials cost or machine hours.

Manufacturing overhead is a part total production cost. It is not directly traceable to specific products and jobs manufacturing overhead consists of (i) Direct (ii) Direct labour (including salaries (iii) all other miscellaneous factory expenses such as taxes, insurance repair supplies and depreciation.

While developing the manufacturing overhead the following steps should be taken:

- i) Translate the requirement specified in the production plan into activity in each department.
- ii) Plan departmental overhead expenses.
- iii) Allocate the planned departmental overhead expenses to the production.
- iv) Allocate the production department expenses to the products.

These four steps help to compute overhead rate per unit. By adding per unit overhead cost, material cost and labour cost, material cost and labour cost, per unit cost of goods manufactured could be computed.

It is a problem in the allocation of manufacturing overhead to produce because it includes many dissimilar expenses. Control responsibility is widely diffused. There are two distinct types of responsibility centers producing and service. Producing centers are those manufacturing a department that works directly on product. But services department do not work on the product rather they furnish service to the producing department and to the other service department.

### **2.21.1 Selection of Activity Base**

The following measure of output (activity) based for two basic types of factory department are frequently used.

- a) **Producing Department**
  - (i) Unit of output (if only kind of output)

- (ii) Direct labour hours
  - (iii) Direct machine hours
  - (iv) Direct labour dollar
  - (v) Raw material unit consumed
  - (vi) Process time
- b) Service department**
- (i) Repair and maintenance - Direct repair hours (DRS)
  - (ii) Power department - Kilowatt hours (KWH)
  - (iii) Purchase department - Net purchase dollars (NPD)
  - (iv) General factory administration - Total Direct Labour Hour or  
No. of employees in the factory

## **2.22 Selling and Distribution Overhead Budget**

Selling and distribution expenses include all costs related to selling, distribution and delivery of products to customers. In many companies, this cost is significant percentages (%) of total expenses. Carefully planning of such expenses affects the profit potential to the firm.

Fundamental the top marketing executive has the direct responsibility for planning the optimum economic balance between sales, advertising, and distribution expenses budget. Because of inter relationship between them, sales, advertising and distribution expenses should be viewed as are basic problem.

## **2.23 Administrative Expenses Budget**

“Administrative expenses include those expenses other than manufacturing and distribution. They are incurred in the responsibility center that provide supervision of and service to all functions. As large portion of administrative expenses are fixed rather than variable, the notion persists that they cannot be controlled, direction, controlling and administration expenses are included under this budget.”

## **2.24 Capital Expenditure Budget**

The investment decision of the firm is commonly known as the capital budgeting or capital expenditure. Capital budgeting decision may be defined as the firms decision to invest its current funds most efficiently in long term activities in anticipation of an expected flow of future benefits over a series of year. Capital project are those that are expected to generate

returns former than one year. Capital budgeting refers to the process of planning capital projects. A capital expenditure is the use of funds to obtain operational assets that will help earn future revenue or reduces future cost. Capital expenditure budget is the firm's formal plan for his expenditure of money to purchase fixed assets. In profit planning capital budgeting is the process of planning and controlling the strategic and tactical expenditure for expansion and contraction of investment in operating assets.

In fact capital budgeting is a multifaceted, it involves the search for new and more profitable investment proposal, investigating and predicting the effect of accepting the proposal, and making profitability analysis of each and every project. The budget emerging out of this process is known as capital expenditure budget. The top executives working with the other members of executive management has the primary responsibility for the capital expenditure budget. However, the primary responsibility for projects and other proposals should include divisional and departmental managers. Policies and procedures should be established to encourage idea and proposal for capital additions from sources with in and even outside the company.

A capital expenditure budget provides many benefits from the management planning and controlling viewpoint. The capital expenditure budget enables executives' management to plan to satisfy customer demand, meet competitive demands and ensures growth. The budget process for capital additions is essential for management to avoid (i) Idle operating capacity (ii) excess capacity (iii) the funds invested.

#### **2.24.1 Method of alternative evaluation**

There are several methods available for making the comparison between or among alternatives. Some widely accepted of alternatives evaluation are as follows:

##### **1. Simple Method / Traditional Method**

The methods that does not consider the time value of money is denoted as simple method of measuring capital expenditure decision. There are two major methods under this category.

##### **a) Payback Period Method (PBP)**

Pay back period is the simplest and frequently used method for evaluating capital expenditure decision. PBP is the minimum time required to recover the initial cash outlay from the annual cash

inflows. We should accept the capital expenditure decision of low length of PBP and reject of higher length of PBP. It is very easy to evaluate.

**(i) In case of even earning**

$$PBP = \frac{I}{EC}$$

Where,

PBP = Payback Period

I = Investment (Original)

EC = Economic cash flow

**(ii) Uneven earning**

$$BP = N + \frac{I - \text{Cumulative EC at } N}{\text{EC of } (N+1) \text{ year}}$$

Where,

N = Minimum No. of year when cumulative EC is very near to investment.

**b) Accounting Rate of Return Method**

Accounting rate of return is also known as average rate of return on investment. Average rate of return on investment is the percentage of annual net return before depreciation and but after taxes to the initial investment. We have to select the project having higher average rate of return vice versa.

Formula:

**(i) Even Earning**

$$ARRI = \frac{EC \hat{I} 100}{I}$$

Where,

ARRI = Average rate of return on investment

**(ii) Uneven Earning**

$$ARRI = \frac{\text{Average EC}}{1} \hat{=} 100$$

**2. Discounted Cash Flow Method**

The time value money is considered in this method. The process of adjusting the face value of future cash flows to their present value by means of an imputed interest rate is known as discounting rate.

Therefore this method takes the time value of money into accounting using discounting rate and is defined as discounted cash flow method. For example the amount received today Rs. 100 is more valuable than the amount received after 1 year Rs. 100.

**a) Net present Value**

In this the discounting rate is used to discount the cash flow. If the NPV of the project is positive, the investment is profitable. Therefore, we should accept the project. If the NPV is negative, investment is non-profitable.

**(i) Even Earning**

$$NPV = (EC \hat{=} Pn) - 1$$

Where,

Pn = Present value discounting factor of a year

**(ii) Uneven Earning**

$$NPV = (EC1 \hat{=} Pn1 + EC2 \hat{=} Pn2 + \dots + ECn \hat{=} Pn) - 1$$

**b) Profitability Index**

The benefit at present value of Rs. 1 invested is known as P.I. It is a ratio between total present value and investment, P.I is calculated in following ways:

$$P.I. = \frac{TPV}{I}$$

**c) Internal Ratio of Return**

It is an important method of evaluating capital expenditure decision, IRR is that cost of capital, which is applied to assess a series of future cash flows that origins the sum of their present values to the same levels as the original investment. The project should be accepted, if the

IRR is more than the cost of capital and rejected, if IRR is less than the cost of capital.

The equation for calculating IRR is:

$$IRR = LR + \frac{P_nLR - P_b}{P_aLR - P_nHR} \hat{I} (HR - LR)$$

Where,

LR = Lower discount

P<sub>n</sub>LR = Discounting factor in lower rate

P<sub>b</sub> = Payback Period

P<sub>n</sub>HR = Discounting factor in higher rate

An analyzing the above stated methods to measure capital investment the following decision criteria can be summarized.

Method	Acceptance Criteria
NPV	Higher the NPV
IRR	Higher the IRR i.e. higher than cost of capital
PBP	Lower the PBP
ARR	Higher the ARR

#### 2.24.2 Process for planning and controlling capacity expenditure

The process for planning and controlling capital expenditure is as follows.

- a) Identify and generate capital additions projects and other alternatives.
- b) Develop and define capital additions proposal.
- c) Analyze and evaluate all capital additions proposals and alternatives
- d) Make capital expenditure decisions to accept the best alternatives and the assignment of project designations to selected alternatives.
- e) Develop the capital expenditure budget strategic and tactical
- f) Establish control of capital expenditure during the budget year by using periodic and special performance reports by responsibility centers.
- g) Conduct post completion audits and follow up evaluation of the actual result from capital expenditure in periods after completion.

Usually, capital expenditure budget is developed by responsibility center and by time period.

### **2.24.3 Capital Expenditure Decision**

Capital expenditure decisions are the choices of management from the competing capital expenditure alternatives. Such decisions must focus on:

- a) Investment Decision:- Selecting the best alternatives based on their economic worth to the company.
- b) Financial Decision:- Determining the amounts and sources of funds needed to pay for the stated alternatives.

### **2.25 Flexible Expense Budget**

Flexible expenses budget relate only to expenses or costs. They are also called dynamic, activity or output adjusted expenses budget. It is complementary to tactical profit plan. They help to provide expense plan for tactical profit plan and expenses plan adjusted to actual output for comparison with actual expenses in periodic performance report.

The fundamental concept of flexible budget for expenses is that all expenses are incurred because of (a) the passage of time (b) output or productivity or (c) a combination of time and output or activity. If these premises are reasonable in a business the expenses can be computed for planning and control. Application of this concept means that (i) Expense must be identified as to their fixed and variable component when related to output or productive activity (ii) Expenses must be reasonably related to productive activity (iii) Output or Productive activity must be reliably measurable. (iv) Flexible budget for each expense must be for a specified time periods and for a specified relevant range of output or productive activity (v) For planning and control purpose, flexible, budget formula must be developed for each expense in each responsibility center in an enterprise.

#### **2.25.1 Classification of Expenses or Cost**

The expenses can be classified into three categories.

##### **a) Fixed Costs**

Fixed cost does not change in short-term periods with in a relevant range. They accrue primarily with the passage of time. Fixed costs are caused by holding of assets and other factors or production in a state of readiness to produce.

**b) Variable Costs**

Variable costs are based on activity. The variable costs should be zero at zero activity. They change directly with change in activity level in a responsibility center. Therefore if output increase, the variable expenses, also increases in the same percentage and if output is zero the variable cost is also zero.

**c) Semi – Variable Cost**

Semi variable expenses changes as output or activity change but not change in activity or output. Semi-variable expense has some of the characteristics of both variable and fixed costs.

There are three types of flexible budget formats.

- i) Table format
- ii) Formula format
- iii) Graphic format

## **2.26 Cash Flow Budget**

Cash budget depicts the estimated cash and payments during the budget periods. It will ensure that sufficient cash is available when required. If any shortage of cash is revealed during a specified period arrangement can be made with the bank for an overdraft or loan in time. Planned cash requirements earn a respectability for the firm, when approached to bank for loan. The cash budget will commence with the cash and bank balance in the beginning of the budget periods.

A cash budget is a composition of estimated cash inflows and outflow for a particular period such as day week month quarter or a year. A cash budget is a forecast of expected cash inflow, outflow and ending position by interim time periods for a specific time periods.

In annual profit plan, a short term cash budget is to be included. Basically cash budget includes two parts (i) the planned cash receipt (in flows) and (ii) the planned cash disbursement (outflow) planning for cash inflow and outflow gives the planned beginning and ending cash positions for the budget periods. It will indicate (i) need for financing probable cash deficit (ii) need for investment with other budget such as sales budget expenses budget and capital expenditure budget etc. In this way we know about cash inflow outflow with help of cash plays vital in the business.

We can present the cash position of business enterprises in the table as following.

**Anticipated Cash Composition**  
**For the year ending**  
**Cash Receipt & Disbursements**

Item	January	February	March	Total
A. Beginning Balance				
B. <u>Cash Receipts</u>				
Account Receivables Notes				
Receivables Loans Royalties &				
Commissions Investments interest				
New capital Issues				
Disposal of Asset Other Sources				
Cash Sales				
B. Total Receipts				
C. Total Cash Available (A+B)				
D. <u>Cash Disbursements</u>				
Cash purchase Accountant Payable				
Wages Salaries and Commissions				
Royalties Advertising Rent				
Rates and Taxes Dividends and				
Interest New Assets Loan				
Redemption Other Expenses				
D. Total Disbursement				
E. Surplus / Deficit (C-D)				
F. Desired Closing Balance				
G. Addition Finance Required to Maintain Cash Balance or Surplus Fund Availability for Investment				

### **2.26.1 Technique for improving Cash Flow**

The management of the business enterprises should focus on the cash collection process, cash payment process investment policies to improve cash flow. A number of methods have been employed to speed up the collection process of cash and maximize available cash. These methods are designed to do one or all the following.

- a) Speed the mailing time or payment form customers to the firm.
- b) Reduce the time during which payment received by the firm remain uncollected funds and
- c) Speed the movement of funds to disbursement banks.

Welsch, Hilton and Gordon have mentioned the following ways often used to improve the efficiency of cash collection process.

- i) Review the lag from the date of sales of goods and services on credit or the mailing of (a) invoices and (b) the first billing.
- ii) If cash discounts are given to customers for early payment, review their effect on early cash collections and whether the discount is too high or too low.
- iii) Review the credit granting process to determine whether bad credit risks are being screened out. Also are delinquent receivables being identified early and collection action taken before the receivables becomes a non-collection i.e. bad debts.
- iv) Consider ways to decrease the time between the dates that customer pay by cheque and date the cash is available for use in the company's bank account.

Similarly, they have suggested the following ways often to improve the efficiency of the cash payment process.

- i) Make all payments on latest non-penalty day. Do not pay early.
- ii) Make all payments by cheque, preferably on Friday.
- iii) Take all cash discount allowed for early payment.
- iv) Establish a policy of no cash advances.
- v) Establish policies and a payment process to minimize the possibility of fraudulent payments by company employees.

### **2.26.2 Approaches to Develop a Cash Budget**

**a) Cash receipt and disbursement budget**

It is simple to develop. It is used for short-term cash planning as a part of the annual profit plan. This approach is based on detail analysis of the increase or decrease in the budget cash account that would reflect all cash inflows and outflows from such budget as sales, expenses and capital expenditure.

**b) Financial accounting approach**

It is some time referred to as the indirect income statement approach. Basically net income is converted from accrual basis to a cash basis. Its starting point is planned net come. It requires less supporting detail and provides less detail about the cash in flow and it is useful for making long-range cash plan.

### **2.26.3 The Primary Purpose of Cash Budget**

- a) Give the probable cash position at the end of period as a result of planned operations.
- b) Identify the cash excess of shortage by time period.
- c) Establish the need for financing and the availability of idle cash for investment
- d) Co-ordinate cash with
  - i) Total working capital
  - ii) Sales revenue
  - iii) Expenses
  - iv) Investments
  - v) Liabilities

### **2.27 Profit Planning & Cost Volume Profit Analysis**

There is a close relationship between budgeting and cost volume profit analysis. Although the analysis may be applied to historical data, its application suggests its importance in comprehensive profit planning and control and its best application is to budget estimates. It is important to realize that break-even analysis rest upon a called identification of cost variability that is an identification of the fixed and variable cost components.

A more descriptive term of the underlying concept is cost volume profit analysis. The break-even point defined as that volume level at which revenue exactly equal to total cost, is somewhat incidental to the broader scope of cost volume profit analysis. This analysis is directly concernment with the effect on profit of changing (i) Fixed costs (ii) Variable cist (iii) Sales quantities (iv) Sales mix. An analysis offering relevant insights into these and their interrelationship in the entries has obvious merit. If break-even analysis can be made with reasonable accuracy, its important tool, cannot be overlooked by the controller, budget director, by management in general.

The analysis of relationship between cost volume and profit is known as cost volume profit analysis, which is an important tool, used for profit planning in business. Cost Volume Profit analysis should be noted that the formal profit planning and control involves the use of budgets and other forecast and CVP analysis simply provides s overview of the profit planning process. CVP helps to evaluate the purposes and reasonableness of such process. CVP helps to determine the minimum sales volume at which profit goals of the firm will be achieved.

## **2.28 Planning of Non Manufacturing Concern**

Instead of converting raw materials into finished products a merchandising business purchase goods and resells them in essentially the same form. A non-manufacturing business would not develop budgets covering production, raw materials purchase and direct labour or manufacturing overhead. Alternatively non-manufacturing companies focus o the merchandise budgets. However the effective profit planning for wholesale and retail companies the same basic procedures as for manufacturing companies.

- a) The development of realistic profit plan.
- b) Continuous effort to assure attainment of the goal expressed in the profit plans
- c) The development of a controls system based on performance report for the various responsibility centers.

### **2.28.1 Merchandise Budget**

The term merchandise budget is frequently used in non-manufacturing situations. If usually include planning of sale, reduction, mark downs, employee discount, stock shortage, purchase and gross margin.

### Purchase Plan

The following formula is usually employed to compute the required purchase at retail values.

$$\text{Planned Purchase} = \text{Planned net sales} + \text{Planned reductions} + \text{Planned EOM Stock} - \text{Planned BOM stock.}$$

#### 2.28.2 Open to Buy Planning

Open to buy is the term generally used in non-manufacturing enterprises to refer to that amount that a budget can spend for goods during a specified time period.

#### Open to Buy Format

S.N.	Particular	Amount	Amount
<b>A.</b>	Stock needed:		xxx
	EOM stock		
	Planned sales for whole period	xxx	
	Less:- Actual sales to date	xxx	xxx
	Planned sales for remaining period		
	Less: Actual reduction to date	xxx	
	Planned reduction for remaining period		xxx
	<b>Total Stock needed (A)</b>		
<b>B.</b>	Stock Available:		xxx
	BOM stock		xxx
	Merchandise received to date	xxx	
	Less: Actual sales to date	xxx	
	Actual reduction to date		xxx
	Add: Merchandise ordered for month delivery.		xxx
	<b>Total stock available (B)</b>		
	Open to buy stock at retail (A-B)		xxx
	Open to buy cost = Open to buy retail X		xxx
	$I = \frac{\text{Initial Markup}}{100}$		

## **2.29 Control Process of Profit Plan**

### **2.29.1 Performance Report**

Management has to devote the valuable time and effort for the achievement of the planned profit. So the evaluation of effectiveness and efficiency of plans operations and performance are the essentials fields of managerial activities. Controls are the process of getting conformity of actual performance with planned course of action. Planning is incomplete if no system for control is developed.

Evaluation of performance and reporting it to concerned plans are the necessary aspects of comprehensive planning and control programme. “Performance reporting for internal management use is an important part of comprehensive profit planning and control system. Performance reports are usually prepared on monthly basis. It facilitates internal control by the management. Performance reports are reports in which actual results are compared with goals and budget plans. Such reports are designed to pin point both efficient and inefficient performance.”

Performance reports play as an important tool to provide necessary information as it reports the performance of every responsibility center to the management. The efficiency of the management depends upon the achievement of desired result. The main objectives of the performance reports are the communication of performance measurements, actual results and the related variances.

The performance or budget is the management report that reflects the operating manager’s effort to live and beat his budgets allowances.

Performance reports should distinguish between controllable and non-controllable items. The actual results should be compared with plans, objectives and standard and the management should analyze the differences. Careful attention should be given while designing the performance reports format. Titles and heading should be descriptive, column heading and side captions should clearly identify the data and technical jargon should be avoided. It should not be long and complex tabulation and nonessential data should be avoided. Report should be relevant.

Another important aspect of performance report is to minimize the time gap between the decision and report. Unfavorable situation should not be continued for a long time before

making correction: otherwise the business enterprises should have to bear greater financial loss. Another important part is to follow up management procedures.

When reports give the favorable and unfavorable variances between actual performance and planned performance on monthly basis such variance requires immediate concern as well as continuous follow up by management for the betterment of the enterprises. Follow up procedures should analyze both unsatisfactory conditions and correct decision should be made. The main purpose of performance reports is to show variances between planned and actual. Such variance should be expressed in amounts as well as, percentage of the planned and budget amount. Statistical control units should also be implemented to determine the significance of variances. Monthly performance reports should generally show variances for the period being reported and cumulative variances to date, such reports are usually prepared for each responsibility centers.

### **2.29.2 Essential features of performance reports**

Welsch, Hilton and Gordon described that the performance reports should be prepared in such a way that it will fulfill the following criteria.

- i) Tailored to the organizational structure and locus of controllability (i.e. by responsibility centers)
- ii) Designed to implement the management by exception principle.
- iii) Repetitive and related to short time periods.
- iv) Adopted to the requirements of the primary users.
- v) Simple, understandable and report only essential information.
- vi) Accurate and designed to pin point significant distinction.
- vii) Prepared and presented promptly
- viii) Constructive in tone

The extent to which the various managers use their performance reports depends on many factors, some behavioral and some technical. One important factor is the extent to which the performance reports serve the measurement and decision-making needs of the users communication is a subtle management problem and it is facilitated by performance reports if the different needs and experience of the users are taken in to account. A department supervisor responds, differently than a vice-president.

Top management personnel needs reports that give a complete and readily comprehensible summary of the overall aspects of operations and an identification of major events. The summaries must be supported in sufficient detail to facilitate tracing deviations to their source.

Middle management is usually defined as those members of management in charge of the major subdivision of the business, such as sales, production and finance. Middle management is responsible for carrying out the responsibility assigned to the subdivision within the broad policies and objectives established by top management. Middle management is closer to and more concerned with operation than top management, although it also has important planning functions. Performance reports for middle management although including summary data are also characterized by detailed data on day to day operations.

Lower-level management (department supervisors) is principally concerned with coordination and control of day to day operations. There, control reports should be detailed, simple, understandable and limited to items that are directly related to the supervisor's operational responsibilities.

### **2.29.3 Other Aspects of Performance Reports**

Welsch, Hilton and Gordon mentioned the following aspects of performance reports should be kept in mind:

In the design and preparation of performance reports, it should be kept into mind that the user generally is not an accountant and that the report is to serve as user other than the report maker. Careful attention to form is important. Titles and heading should be descriptive, column headings and side captions should clearly identify the data and technical jargon should be avoided. Performance reports should not be too long, complex tabulations should be avoided.

Reports should be carefully screened to eliminate all non-essential information. It should be standardized and must be relevant. Consistent with the cost of detailed record keeping and reporting, performance reports should be available on a timely basis. To achieve a realistic balance between immediate reporting and the cost of detailed reporting monthly performance reports are widely used by industry.

#### **2.29.4 Management Follow-Up Procedures**

Well-managed companies use monthly performance reports covering all aspects of operations. These reports give favorable and unfavorable variances between actual performances and planned performance for the month just ended and cumulatively for the year to date. Managers should analyze these monthly reports carefully to be fully knowledgeable about both high and low performance should be given immediate priority to determine the causes. However the process should not stop at this point. Follow up is a key phase of effective control. Some companies require written explanations of significant variances to discuss the causes and corrective actions to be taken. Follow up procedures should begin at the top-management level to discuss and analyze both unsatisfactory and satisfactory conditions. Decisions should be made about the ways and means to correct unsatisfactory conditions. Favorable variances should also be analyzed (i) to determine whether the goals were realistic (ii) to commend those responsible for high performance and (iii) to transfer some “know-how” to other responsibility centers.

Group and individual conference should be held at various management levels to initiate corrective actions. Follow up procedures should embody constructive action to correct unfavorable conditions rather than punitive action for failure, the result of which obviously can not be erased. Another important aspect is that follow up action is strictly a line is responsibility. The budget director, controller or other staff officer should not undertake, or be assigned the responsibility for enforcing the budget.

#### **2.29.5 Analysis of Budget Variances**

Comparison of actual results with planned or budget goals has been emphasized as an integral part of the control process. A basic feature of performance reports is the reporting of variances between actual results and planned goals. If variance is significant a careful management study should be made to determine the underlying causes. The underlying causes, rather than the actual results, should lead to remedies through appropriate corrective action by management. There are numerous ways to study variances to determine the underlying causes. Some of the primary approaches are as follow:-

- a) Conference with responsibility center managers and supervisors and other employees in the particular responsibility center involved.

- b) Analysis of the work situation including the flow of work, coordination of activities, effectiveness of supervision and other prevailing circumstances.
- c) Direct observation
- d) Investigation by line manager on the spot
- e) Internal audit
- f) Special studies
- g) Investigation by staff groups
- h) Variance analysis

Variance is the deviation between actual and budgeted results. Following are the basis steps in analyzing variances:

- i) Setting standards
- ii) Measurement of performance
- iii) Analyzing variances
- iv) Taking corrective action

Variance should be broadly grouped under two categories favorable and unfavorable. Unfavorable variance classified as controllable and non-controllable. If unfavorable variances are arises due to the controllable causes, then the concerned managers should made responsible for it.

#### **2.29.6 Performance Evaluation**

To indicate the extensive reporting requirements, a business must fulfill and to focus on performance reporting, the following classification of reports is presented and farley explained.

##### **a) External Reporting**

These are reports to government agencies, regulation commission creditor's investigative agencies and other groups external to the active management. Frequently, these reports are quite extensive and compromise a significant portion of the overall reporting activities of the business.

##### **b) Reports to Owners**

These are the traditional annual reports to the owners and other special reports prepared of the owners concerning special problems or items of interest.

These by and large, are based up on “Generally Accepted Principles”, and generally report that have been subjected to audit by an independent C.P.A.

**c) Internal Reports**

These are reports prepared within the company for internal use only. They may be considered confidential reports. They do not have to meet the needs of external groups, not the text of “Generally Accepted Accounting”, but rather the text of internal management needs.

All companies, regardless of size have reporting requirements for all the categories listed above. In the smaller company most of the basic reporting needs may be accomplished with a single general-purpose report. However, as the size and complexity of the company increase, there is greater need for regimentation of the reporting as suggested above.

**2.30 Review of Reports**

Under this topic the annual reports of concerned bank are reviewed in under to highlights the brief profile of the bank separately.

**2.30.1 Reports related to Nepal Investment Bank Ltd. (NIBL)**

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world. With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, had acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd. The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank’s Annual General Meeting, Nepal Rastra Bank and Company Registrar’s office. NIBL, thus has advantage of the banking expertise and financial strength of its partner. Currently with 39 branches in various parts of the Kingdom of Nepal.

The main objective of the Nepal Investment Bank Ltd is to develop a customer oriented service culture with special emphasis on customer care and convenience, to increase our market share by following a disciplined growth strategy, to leverage our technology platform and pen scalable systems to achieve cost-effective operations, efficient MIS, improved delivery capability and high service standards, to develop innovative products and services that attracts our targeted customers and market segments, to continue to develop

products and services that reduce our cost of funds, to maintain a high quality assets portfolio to achieve strong and sustainable returns and to continuously build shareholders' value, to explore new avenues for growth and profitability. It provides loan to increase the economical condition of general public for investing in the fields like agriculture, Industry and trade by the acts like Nepal Rastra Bank Act 2012, commercial Bank Act 2031, Foreign Exchange Act 2019 and other related acts of Nepal.

### **2.30.2 Review of Relevant Acts**

Commercial Bank Act 2031 was formulated to facilitate the smooth run of commercial banks. All the commercial banks are functioning under this act. This act defines the banks as “A commercial bank is one which exchange money, deposits money, accepts deposit, grants loan and performs commercial banking function and which is not a bank meant for cooperative agriculture industry or for specific purpose.

Commercial Bank Act 2031 also pointed the functions of commercial banks – “Commercial banks provide short debts necessary for trade and commerce. They take deposits from the public and grant loan in different forms. They purchase and discount bills for exchange promissory note and exchange foreign currency. They discharge various functions on behalf of their customers provide that they are paid for their services.”

As mentioned in this act, commercial banks will help the banking business by opening its branches in the different parts of the country under the direction of NRB the main function of commercial banks established.

Under this act will be exchange of money to accept deposits and provide loans to commercial and business activities to mobilize banks deposits in different sectors of the different part of the nation to prevent them from the financial problems.

The preamble of Rastra Bank Act 1994 clearly states the need of commercial bank in the country. “The absence of the bank in Nepal the economic progress of the country was being hampered and causing inconveniences to the people and therefore with the objective of fulfilling that need by providing services to the people and for the betterment of the country, this law is hereby promulgated for the establishment of the bank and its operation.

### **2.30.3 Review of Articles**

After reviewing the books, certain useful journals on domestic market, baking, financial statement analysis and monetary credit situation of Nepal are studied.

An article written by Radhakrishna Paudel on “Banking Challenges ahead” focuses in the potential areas where banks should invest to fight the prevailing economic recession. Currently growth in the profitability of JVBs has been mainly due to external factors such as the foreign exchange rate but not to the growth in the real sector of the economy. Therefore, to sustain the current financial position in the long run, banks should enter new areas by marketing their credit in important sub sectors such as hydro electricity, tourism, irrigation etc.

Mr. Poudel further writes that, “Saving collections is another factor which is necessary for banks to balance their operations and generate sufficient surplus in their cash-flows. In recent years growth rate for bank deposits has declined to about 16 percent compared against 23 percent of the past. Mobilization for internal resources in the country demands that banks attract more financial resources from the public.”

Another useful contribution made by Narayan Prasad Poudel in his article called “Financial Statement Analysis” published in Nepal Rastra Bank Samachar on 2053 is reviewed.

According to Mr. Poudel, Balance Sheet, Profit and Loss A/C and the accompanying notes are the most useful aspects of the bank. We need to understand the major characteristics of bank’s balance sheet and profit and loss a/c. The bank’s balance is composed of financial claims as liabilities in the form of deposits and as assets in the form of loans. Fixed assets accounts form a small portion of the total assets. Financial innovations, which are generally contingent in nature, are considered as off-balance sheet items.

Interest received on loans & advances and investment and paid on deposit liabilities are the major components of profit and loss account. The other sources of income are fee, commission, discount and service charges.

The users of the financial statement of a bank need relevant, reliable and comparable information which assists them in evaluating the financial position and performance of the bank and which is useful to them in making economic decisions. The disclosure requirement of bank’s financial statement has been expressly laid down in the concerned act. Commercial Banking Act 1974 requires the audited balance sheet and profit and loss account to be published in the leading newspaper for the information of general public.

According to Poudel, the principle objectives of analyzing financial statement are to identify:-

- © Financial Adaptability (Liquidity)
- © Financial Performance (Profitability) and
- © Financial Position of Bank (Solvency)

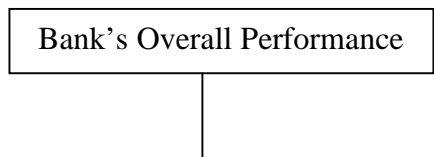
Most of the users of the financial statements are interested in assessing the bank's overall performance i.e. profitability which is affected by the following factors:-

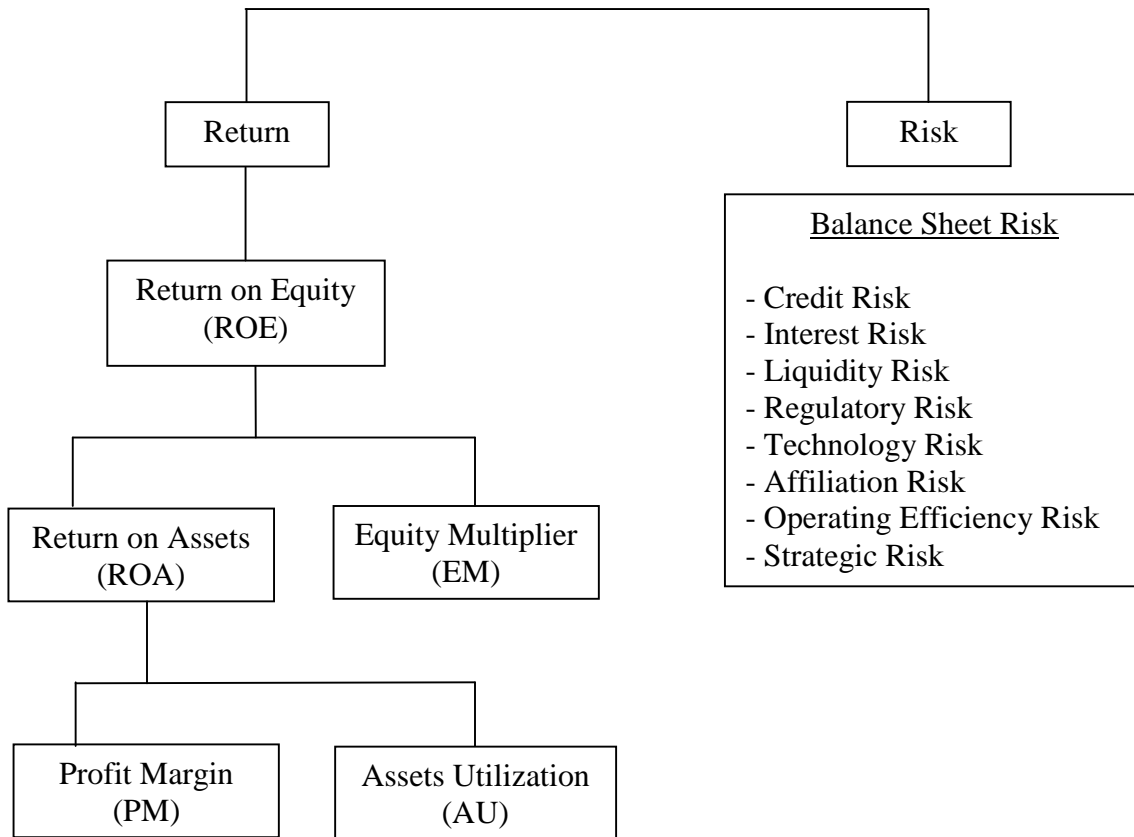
- a) The structure of Balance sheet and profit and loss account.
- b) Operating efficiency and internal management system.
- c) Managerial decisions taken by top management regarding interest rate, exchange rate, lending policies etc.
- d) Environmental changes (technology, government competition, economy)

According to Mr. Poudel, the other factors, to be considered in analyzing the financial statements of bank is to assess the capital adequacy ratio and liquidity position. In the line of the norms set by Bank for International Settlement (BIS), capital adequacy of a bank is assessed on the basis of risk weighted assets. It indicates a bank's financial strength and solvency. Presently the capital fund of a bank should not be less than 8% (at least 4% should be in the form of tier-1 capital or core capital) of its risk weighted assets as capital fund. Banks facing with capital adequacy problem may increase capital or reduce assets or reallocate the existing assets structure in order to maintain the desired level of capital base.

Liquidity is measured by the speed with which a bank's assets can be converted into cash to meet deposit withdrawals and other current obligations. It is also important in view of survival and growth of a bank.

He has laid down an approach to evaluate the bank's overall performance through balancing between the risk and return components of the bank which is explicitly shown in the chart below.





$ROE = ROA \times EM = \text{Net Income} / \text{Average Equity}$

$ROA = PM \times AU = \text{Net Income} / \text{Average Assets}$

$EM = \text{Average Assets} / \text{Average Equity}$

$PM = \text{Net Income} / \text{Total Income}$

$AU = \text{Total Income} / \text{Average Assets}$

Dr. Manohar Krishna Shrestha, in this work “Commercial Bank’s Comparative Performance Evaluation” stresses on a proper risk management. He believes in the appropriate classification of loans under performing and non performing category. In this context he writes, “Adequate provisioning is the surest way to get relief from sinking loan after careful consideration of portfolio risk. A clear out criteria is necessary to treat interest suspense account and it is advisable that all interest unpaid for more than six month need to be treated as unearned income.”

Regarding the risk management of the bank Dr. Shrestha’s other suggestions include:-

- © Any customer having overdue loan of two years or more in his account should not be given other loan facilities.

- © Strong provisioning or reservations are required in restructuring portfolio relating to overdue loans.
- © All credits including overdrafts should be given a maturity date and should be subjected to revision at that date and consequently categorize as good, substandard or doubtful loans.
- © Financial credit worthiness of the borrower must be evaluated properly before granting the loans.

The above journals focus in the various aspects of the bank's economic environment. NRB press communiqué shows the current domestic market scenario, article by Radha Krishna Poudel concentrates in the challenges of the banking sector. Narayan Prasad Poudel's work stresses in effective way of evaluating the financial performance and Dr. Shrestha's suggestions are focused towards proper risk management. Whatsoever, aspects of the bank the above journals target, they all have to be combinable assessed and kept in strict consideration for effective and efficient financial performance of the banks in the Nepalese economy.

#### **2.30.4 Review of Previous Research Work**

Research in an on-going process main purpose of the literature review is to find out what who works have been done in the field of research study being undertaken as far as possible some of the thesis submitted by master level students have been reviewed.

##### **a) Mr. Uday Kishor Tiwari**

Mr. Uday Kishor Tiwari has submitted his research report on the topic of "Profit Planning in Commercial Bank – A case study of standard chartered bank ltd. Nepal." He has tried to examine whether the SC Bank is applying profit planning system or not properly. The study covered only eight years period of time from F/Y 1994/1995 to 2001/2002. The data along with other information were taken from sources, primary and secondary. The basic objective of this study is to appraise SC Bank appropriately for the application of comprehensive profit planning system.

Some major findings pointed by Mr. Tiwari are as follows:-

- a) SC Bank is adopting a policy to keep minimum number of employees as possible.

- b) The top level executive are only involved in decision making and lower level participation is not encouraged but top management takes the feedbacks. For annual planning and strategies making through conferences and strategic meeting organized twice in a year at the head office from manager level employees.
- c) Bank has the policy to recruit the highly qualified fresh candidates.
- d) Lack of advance training to the personnel.
- e) Absence of skilled and partly academic manpower.
- f) Absence of skilled and partly academic manpower in budgeting section of the authority.
- g) The authority is suffering from high fixed costs.
- h) Specific goals and objectives are not conveyed to level staff and it denoted the absence of MBO Principle of management.
- i) There is lack of proper co-ordination among the various responsible departments.
- j) Deposit mobilized by the bank is bound to SC considerably growing every year with an average growth over the period of last 8 years being high as 33.93%.
- k) From regression analysis of the budgeted and actual deposits, remaining the trend same for the coming too, the deposit to be mobilized by the bank by the end of F/Y 2002/2003 shall reach up to Rs.1,707,2056.
- l) LABP of the bank has found to the considerably increasing every year with average growth, is over the period of last 8 year is a high as 19.87%.
- m) CD ratio (Credit Deposit Ratio) of LABP on total deposit expressed in Percent term of the bank is high. The data analysis of deposit and LABP with more variable than the deposits.
- n) Outstanding guarantee liability of the bank is fluctuating up to maximum growth rate is 42.39% and minimum growth rate is negative 50%.
- o) The total deposit of the bank is found increasing each year corresponding to the increase in interest expenses. The total deposit is perfectly and positively and positively correlated with total interest expenses.

- p) Interest income amount of the banks is the highest among other income items of the total revenue.
- q) The amount of interest income is decreasing each year corresponding to increase in LABP.
- r) The current ratio, debt equity ratio, debt to assets ratio, profitability ratio and cost-volume-profit analysis of the SC Bank is positive and perfectly correlated.

**b) Mr. Binod Kumar Sharma**

Binod Kumar Sharma has studied the profit planning in commercial Bank with a case study of Nepal Bangladesh Bank. He has studied the profit planning aspect of Nepal Bangladesh Bank. His major findings are:-

- a) It is observed that the Bank is adopting a policy to keep minimum number of employees as possible. But it has unnecessary long ladder at various levels without specific job description.
- b) Bank has the policy to employ academically highly qualified (first class MBA) fresh candidates at management trainee, which may be considered as good aspect for future manpower planning.
- c) Nepal Bangladesh Bank is currently operating with its 15 branch offices making its presence at almost all of the cities of the country. It is one of the bank's having highest branch network among the joint venture/private Banks in Nepal.
- d) Objectives of the Bank are expressed in literary form, and not specified clearly, therefore there is a danger of it being misinterpreted in the ways of one's benefit by the concerned.
- e) Major concentration of resources mobilization of Nepal Bangladesh Bank is at deposit mobilization. In this respect they are incurring cost toward deposit mobilizations.
- f) Bank's resources development for non-yielding liquid assets (cash and bank balance) is increasing every year which is determinate to profitability objectives, but it is supportive to meeting liquidity requirement of the bank.

- g) Outstanding, letter of credit liabilities of the bank are increasing every year however the growth is not constant.
- h) Interest expense amount is the highest among total expenses items of the Bank every year.
- i) Interest income amount of the bank is the highest among other income items I the total Revenue.
- j) An average current ratio of the bank has found to be always higher than standard ratio of 2:1, which shows satisfactory liquidity position of the bank.

Binod Kumar Shrestha has recommended following major point be in his study for the consideration to improve the existing situations.

- a) Bank management should adopt the policy of appropriate authority delegation at all of management. In order to, save the valued of the chief executive officer for other productive use.
- b) It is suggest to the bank to form a specific planning and research department, which shall be responsible for developing new innovative products, further development and up-gradation of existing product, which is turn ensure better profitable business for the bank.
- c) Branch monitoring and controlling mechanism should be made at the regional level also in order to ensure the better functioning of the branch offices located at such locations, which are for from the head office.
- d) The average cost of deposit to the bank is high. Therefore, bank should try to lower it by mobilizing more and more low cost or cost free deposits. Thereby, reducing the interest cost because due to the high cost of deposit, bank is forced to invest its fund more on high yielding assets, which are generally not liquid and obviously risk for the bank.
- e) Objective of the bank should be clearly defined in order to avoid the risk of it being misinterpreted.
- f) LDO of the bank has incurring significantly but the port of proper loan assessment and monitoring aspect are not well developed and the infrastructures required (such as trained manpower logistics etc) are not adequate. Therefore, with such poor infrastructures, it is not advisable to go

aggressively in LDO. The bank should keep adequate required infrastructure to support its objectives.

- g) The Nepal Rastra Bank has put the restriction on the difference of an average rate of interest income and average rate of interest expenses of the bank (i.e. spread) not to exceed 5%. Therefore, the bank has to put more focus on the other kind of non funded activities by which it shall increasing income from other sources than interest to increase its profitability.
- h) Expenses cannot be avoided an always are growing with increasing activities, but it should be optimize and should be related with the income generating activities. Bank should minimize, those expenses, which are not related to income earning. Other expenses than interest from a burden to the gross profit margin (Interest margin) of the bank. Therefore, lowering the other expenses the bank shall enhance its profit.
- i) Net profit of the bank is the amount, which is obtained by subtracting the amount of net burden from the amount of gross interest margin. Therefore, Nepal Bangladesh Bank shall attempt to lower the burden cost, by increasing the other income and decreasing the other expenses. At the sometime it should take a policy to make the interest margin at the maximum extent as allowed by the central banks norm.

**c) Miss Abha Subedi**

Abha Subedi has studies the profit planning aspect of Rashtriya Banijya Bank. Her major finding are:-

- a) The rate of expansion of branches of RBB was increased after introduction of priority sector program in 2031 but the growth could not be as desired. Concentration of the branches is more in urban areas than in rural areas.
- b) Most of the investments made against the security of land, gold and silver
- c) Banking costs are relatively utilized.
- d) No specific and clear investment policy, and functioning without any definite direction.
- e) Deposit mobilized is not properly utilized.

- f) The rate of changes in interest has no effect in business growth in deposit side or in investment side.
- g) Social objectives are met but, Commercial spirit is lacking in RBB.
- h) RBB tried to manage in true, professional way but the political environment in bureaucratic approach has compromised the commercial environment.
- i) RBB has not been publishing its annual reports, balance sheet and profit and loss accounts and related schedule along with the audited report.

Abha Subedi has recommended following major points in her study for the consideration to improve the existing situations.

- a) Performance of every branch is needed to be evaluated and those having performance below satisfactory level should be closed down.
- b) Reduce interest rate in deposit so as to reduce the same in lending.
- c) Banking business should be free from undesirable interference from politicians and high ranking officials.
- d) Adequate training should be given to the personnel and make the operation computer system based to make the service prompt.
- e) The investment policy of RBB should be in accordance with the goal of economic upliftment of the nation and it should also accommodate long and medium term credit demands besides the short-term loans.
- f) Bank should look for new sectors of investments as well for its growth.
- g) Bank may generate profit only, when maximum part of deposit is invested in good parties, thereby minimizing bad debt. Therefore, clear-cut policy has to be setup and implemented along with adequate power delegation.

Mr. Adhikari in his thesis “A comparative study of financial performance of NSBIBL and EBL” conclude that EBL is found superior regarding the liquidity, quality assets they possessed and capital adequacy overall capital structure of NSBIBL appears more levered than that of EBL. But NSBIBL is found superior in terms of profitability and turnover comparatively interest remained more dominant in the total income and expenses of NSBIBL than that of EBL. Regarding the test of hypothesis is (at 5% level of significance) the performance of the sampled banks significantly different with respect to the ratios, loans and

advances to saving deposits. Loan loss provision to total deposit interest earned to total assets and tax per share correlation analysis signifies that EBL is successful to utilize its resources more efficiently than NSBIBL.

The review of the above mentioned bunch of research writes have definitely enrich my vision to elaborate analysis to come to the meaningful conclusion in realistic term and thereby come with some conclusion, few key suggestions that help in improvement of commercial banks.

### **2.31 Research Gap (Different between previous research & this research)**

Most of the past research studies about profit planning systems are basically related to the profit planning system of manufacturing organization or production oriented activities. The research could find two studies so far that have been related to profit planning system of a commercial bank i.e. Rastriya Banijya Bank, Standard Chartered Bank and Nepal Bangladesh Bank respectively. All the dissertations have pointed out that there is no proper profit planning system and recommend for the effective implementation of profit planning system in the concerned institution.

This study is shall be a new one in his field as no study has been made so for in the profit planning system in particularly Nepal Investment Bank Ltd. (NIBL). This study has tried to indicate the role of budgets for effective formulation and implementation of profit planning system as well as to see now for the bank is practicing. This study has analyzed the financial position of Nepal Investment Bank Ltd. (NIBL) by applying the tool is of ratio analysis and other mathematical and statistical tools finally it concludes the various finding of research and recommend for immediate and long-term improvement and correction.

## **CHAPTER – 3**

### **Research Methodology**

#### **3.1 Introduction**

The term ‘Research’ is believed to be defined from the French word ‘Researcher’ meaning to search again. The research is original and planned investigation undertaken with the prospect of gaining new scientific and technical knowledge and understanding.

Research Methodology refers to the various sequential steps to be adopted by researcher in studying a problem with certain objectives in view. Therefore this chapter deals with the following aspects of methodology.

- © Research Design
- © Population and Sample
- © Hypothesis
- © Nature and Sources of Data
- © Data Collection Procedure
- © Research Variable
- © Time Period of Profit Plan
- © Methods of Data Analysis
- © Method of Presentation

#### **3.2 Research Design**

Research Design is the plan structure and strategy of investigation conceived so as to obtain answer to research questions and to control variance. The plan is the overall scheme of program of the research. It includes as outline of what the investigator will do from writing the hypothesis and their operational implication to the financial analysis of data.

The Research Design is a plan to obtain the answer of research questions through analysis of data. The research design of this study is analytical and descriptive as this study is an examination and evaluation of budgeting procedure in the process of profit plan of Nepal Investment Bank Ltd. (NIBL). The study is closely related with the various functional budgets and other accounting statements as well as the actual results of the budgets. These information are used to analyze and evaluate the profit planning systems of Nepal Investment Bank Ltd. (NIBL).

### **3.3 Population and Sample**

34 commercial banks are operating in Nepal. All the commercial banks that are opening in Nepal are considered as the population. It is not possible to study all the data because of the limited time period and case taken in to consideration of the partial fulfillment of the Master's Degree. Thus one Nepal Investment Bank Ltd. (NIBL) has been selected as sample for the present study.

### **3.4 Hypothesis**

In the light of the objective of the study, following null and alternative hypothesis have been developed for this research:

Null hypothesis,  $H_0: u_1 = u_2$  there is no significant difference in Profit Planning and Control of Nepal Investment Bank Ltd. (NIBL).

Alternative Hypothesis,  $H_1: u_1 \neq u_2$  there is significant different in Profit Planning and Control of NIBL (Two-tailed).

### **3.5 Nature and Sources of data**

Although, present study is basically conducted on secondary data. Primary sources have been used in few cases. Depending on the nature of data and information, following sources have been utilizing for the research purpose.

- i) Primary sources:- Basically direct interview and supplementary questionnaire have been used.
- ii) Secondary sources:- Secondary sources used in this research are listed below.
  - ) Official records and publication of NIBL.
  - ) Published and unpublished reports.
  - ) Magazines publication.
  - ) Personnel dialogues.

### **3.6 Data Collection Procedure**

Secondary data have been collected from the annual reports of NIBL. Similarly other necessary data have been collected from the publication of coordination council of ministry of finance, central bureau of statistic, National planning commission, official accounting and planning records of NIBL, publication of the Nepal Rastra Bank, the Central Bank of Nepal and related publication. For the reference of materials, the researcher visited Central library of T.U.

### **3.7 Data Processing**

Data obtained from the various sources cannot be directly used in their original form. Further they need to be verified and simplified for the purpose of analysis. Data, information, figures and facts so obtained need to be checked, rechecked, edited and tabulated for computation.

According to the nature of data, they have been inserted in meaningful tables. Homogenous data have been sorted in one table and similarly various tables prepared in understandable manner, odd data excluded from the table using financial and statistical tools, data have been analyzed and interpreted.

### **3.8 Research Variable**

Loans/Advances, overdrafts and bill discounted (LDO), Customer deposits, total resources, total deployment, outstanding balance of letter of credit and bank guarantees, interest expense, interest income, other income etc. of NIBL are the research variables of present study.

### **3.9 Time period of Profit Plan**

As per NRB, directives all the commercial banks have to follow the accounting year of twelve months. Beginning from first Shrawan to end of Asadh which covers the last nine months of year (B.S.) to the first three months of succeeding year (B.S.) NIBL prepares the profit plan for twelve months of upcoming year which includes the business budget, expenditure and Profit Plan for the Year.

This study covers 5 years period from fiscal year 2006/2007 to 2010/2011 for this analysis.

### **3.10 Methods of Data Analysis**

Data collected from different sources are in raw form and in the initial stage as judging independently does not help much. Thus these data are converted by the help of various financial and statistical tools to achieve the objectives.

#### **Financial Tools**

Under this heading following financial ratios are calculated.

#### **a) Liquidity Ratios**

(i) Current Ratio

(ii) Cash and bank balance to current assets ratio

- (iii) Investment on government securities to current assets
- (iv) Loan and advance to current assets
- (v) Cash and bank balance to total deposit ratio
- b) Activity Ratio**
  - (i) Loan and advances to total deposit ratio
  - (ii) Total investment to total deposit ratio
  - (iii) Loan and advances to total assets employed ratio
- c) Profitability Ratio**
  - (i) Return on equity
  - (ii) Interest earned to total assets employed ratio
  - (iii) Interest paid to total assets employed ratio
  - (iv) Interest earned to opening income ratio
  - (v) Return on total assets employed ratio
  - (vi) Return on loan & advances ratio
  - (v) Earnings per share

### **Statistical Tools**

Under this heading, statistical tools such as coefficient of correlation between different variables and trend analysis of important variables have been used.

### **3.11 Method of Presentation**

The techniques of presentation used herein are most of descriptive and analytical nature and the data have been presented basically in tabular form thereafter some of important tabulated information of the data has be graphically represented.

## CHAPTER – 4

### Presentations and Analysis of Data

The whole research is based on the analysis and interpretations of collected data. Without analysis, interpretations and presentations of the primary and secondary data the thesis don't give any meaning.

This chapter presents the analysis, calculations, interpretations and presentations of the related to NIBL. Some secondary data are calculated on the basis of financial and statistical ratios. The ratios calculating have been done through statistical program of the computer.

#### 4.1 Analysis of Financial Ratios

The techniques of ratio analysis in of considerable significance in studying the financial stability, liquidity, profitability and the quality of management of the business and industrial concern, the important ratios that are studied for this purpose are given below.

##### 4.1.1 Liquidity Ratio

Liquidity ratios measure the ability of the firm to meet its current obligations. A commercial bank must maintain its satisfactory liquidity position to meet the credit need of community. Liquidity provides honor, strength, health and prosperity to an organization. It is extremely essential for an organization to meet its obligations as they become due. A firm should ensure that it has no lack of liquidity and also that it is not much highly liquid. The following ratios are evaluated and interpreted under liquidity ratios:-

##### i) Current Ratio

Current ratio indicates whether the concern has instant ability to pay out the current liabilities as they mature. This ratio is the yardstick to judge the soundness of the short-term financial position of the business unit or industry. Standard of current ratio is 2:1.

We have,

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

Where,

Current Assets = Cash and bank balance, money at called credit.

It is assumed that current assets include the above items due to non ability of information. We are unable to define the investment and other assets as current assets so, both the assets are categorized as long term asset.

Current liabilities = It is assumed that current liabilities includes the above items. Similarly, due to the non-availability of information. We are assets are categorized as loan as current liabilities.

**Table 1**  
**Current Ratio**

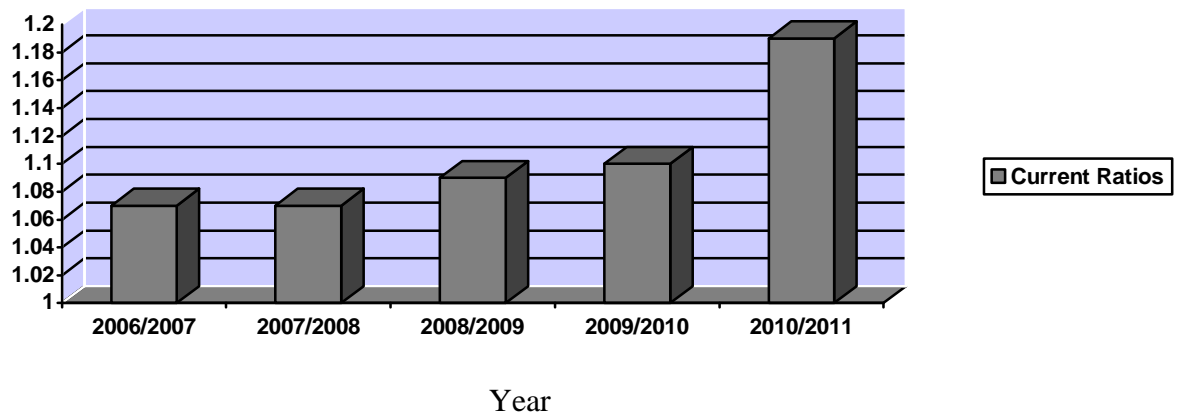
(Rs. In Millions)

<b>Fiscal Year</b>	<b>Current Assets (Rs.)</b>	<b>Current Liabilities (Rs.)</b>	<b>Current Ratio (Times)</b>
2006/2007	27,070.26	25,283.86	1.07 : 1
2007/2008	38,158.27	35,501.73	1.07 : 1
2008/2009	52,144.97	47,786.90	1.09 : 1
2009/2010	56,399.86	51,182.04	1.10 : 1
2010/2011	57,601.17	51,468.88	1.19:1

(Source : Annual Report of NIBL.)

The above table no. 1 shows that current ratios are fluctuation trend from FY 2006/2007 to 2010/2011. As the current ratio is below the normal standard however we cannot conclude the liquidity position is poor as it is only quantitative measures not qualitative and the situation of the bank is quite different than that of general business enterprise.

**Graph 1**  
**Graphical Presentation of Current Ratios**



**ii) Cash and Bank Balance to Current Assets Ratio**

Cash and bank balance to current assets ratio reveals the position of cash and bank in to cash and bank balance in total of current assets.

In the present study cash and bank balances includes cash on hand including foreign cheques other cash item and balance with domestic bank and abroad. Cash and bank balances are highly liquid assets than other current assets. So these ratios can higher liquidity position than current ratio.

We have,

$$= \frac{\text{Total cash and bank balance}}{\text{Total current assets}}$$

Following table shows the data relating to cash and bank balance to current assets.

**Table 2**  
**Cash and Bank Balance to Current Assets ratio**

(Rs. In Millions)

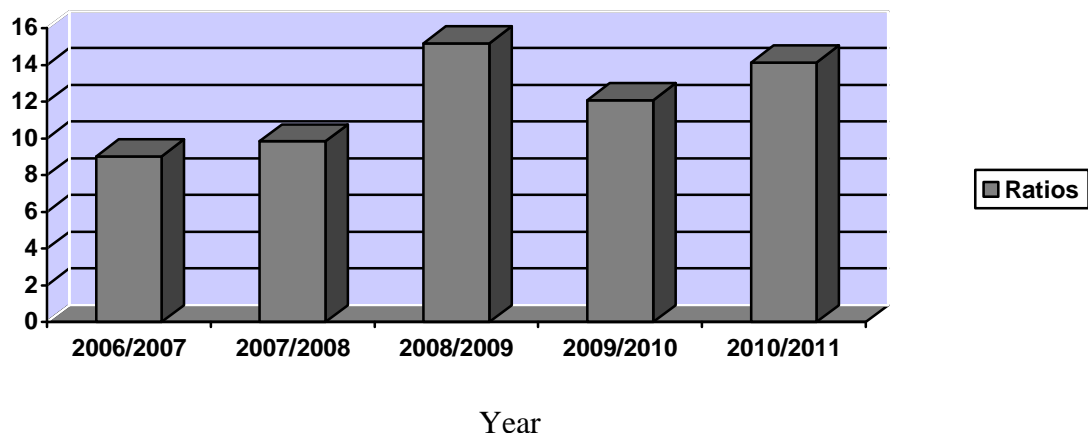
<b>Fiscal Year</b>	<b>Cash and Bank Balance (Rs.)</b>	<b>Current Assets (Rs.)</b>	<b>Ratios (%)</b>
2006/2007	2,441.51	27,070.26	9.02
2007/2008	3,754.94	38,158.27	9.84
2008/2009	7,918.00	52,144.97	15.18
2009/2010	6,815.89	56,399.86	12.08
2010/2011	8,140.38	57,601.17	14.13

(Source : Annual Report of NIBL.)

The table no 2 depicts that cash and bank balance to current assets ratio is better as it shows the ability to manage the deposit withdraws from the customers. The data have followed fluctuating trends through out the study period i.e. from the year 2006/2007 to 2010/11.

**Graph 2**

**Graphical Presentation of Cash and Bank Balance to Current Assets Ratios**



**iii) Investment of Government Securities to Current Assets Ratio**

Government security is slightly liquid assets as well as confidential investment until the state is living. So it is also a very important and very near cash items of current assets ratio visualizes the proportion of investment o government security to current assets.

We have,

$$= \frac{\text{Investment on government securities}}{\text{Current assets}}$$

Following table shows the figure of this ratio

**Table 3**  
**Investment on Government Securities to Current Assets Ratio**

(Rs. In Millions)

<b>Fiscal Year</b>	<b>Investment on Government Securities (Rs.)</b>	<b>Current Assets (Rs.)</b>	<b>Ratios (%)</b>
2006/2007	3,256.40	27,070.26	12.03
2007/2008	3,155.00	38,158.27	8.27
2008/2009	2,531.30	52,144.97	4.85
2009/2010	4,201.85	56,399.86	7.45
2010/2011	4,294.60	57,601.17	7.46

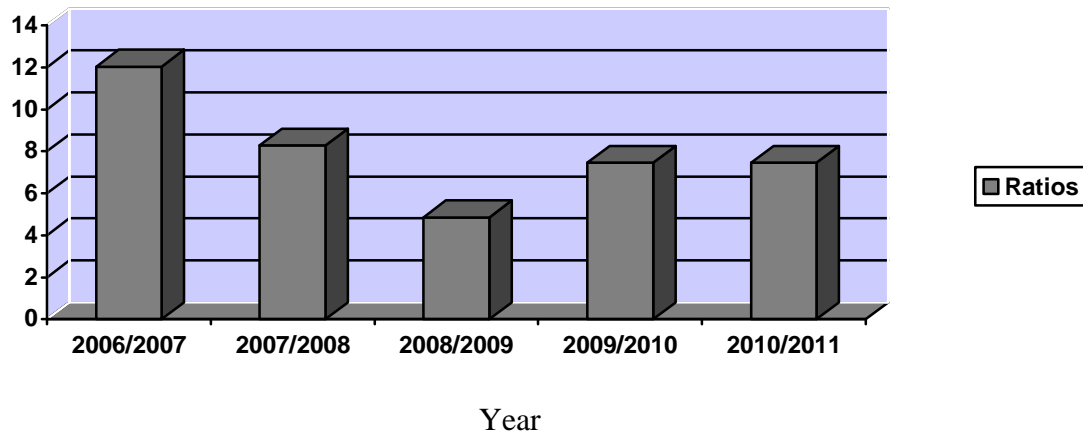
(Source : Annual Report of NIBL.)

The above table no. 3 reveals that NIBL’s investment on government securities to current ratio is in increasing trend in FY 2006/07 and continued decreasing this trend to at the 2009/2010 and increasing end of the study period.

Investment on government securities is the more safe investment than current assets. In addition to can earn additional interest income by investing instead of keeping ideal cash. In conclusion, it can be regarded that NIBL has invested its remarkable portion of currents assets on government securities.

**Graph 3**

**Graphical Presentation of Investment on Government Securities to Current Assets R.**



**iv) Loan and Advance to Current Assets Ratio**

Loan and advance to current assets ratios reflects the capabilities of bank discounting and purchasing the bills, loans and overdraft facilities to the customer to make a high profit mobilizing its fund in the best way a commercial bank should not keep its all collected funds as cash and bank balance but they should be invested as loan and advances to the customers.

We have,

$$= \frac{\text{Loan and Advances}}{\text{Current assets}}$$

The table below shows the ratio of loan and advance to current asset ratios.

**Table 4**  
**Loan and Advance to Current Assets Ratio**

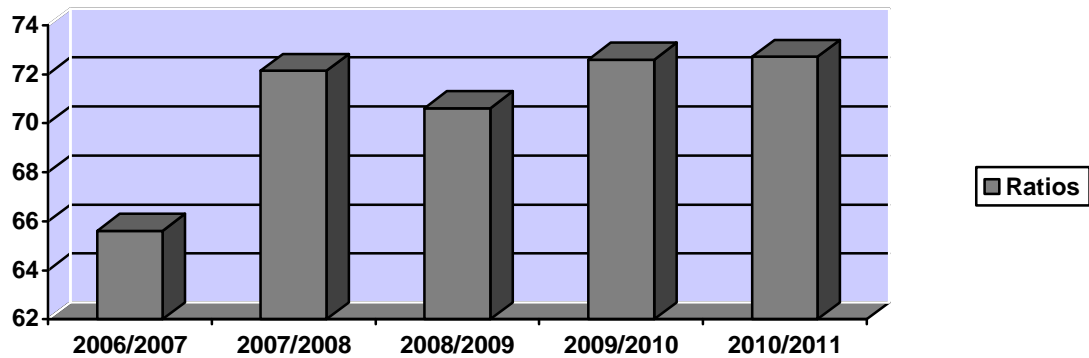
(Rs. In Million)

<b>Fiscal Year</b>	<b>Loan and Advances (Rs.)</b>	<b>Current Assets (Rs.)</b>	<b>Ratios (%)</b>
2006/2007	17,760.10	27,070.26	65.61
2007/2008	27,529.31	38,158.27	72.15
2008/2009	36,827.16	52,144.97	70.62
2009/2010	40,948.44	56,399.86	72.60
2010/2011	41,887.69	57,601.17	72.72

(Source : Annual Report of NIBL.)

The above table no.4 shows that the loan and advance to current assets ratio has followed the fluctuating trend in positive manner through out the study periods. The above discussion helps to conclude that the bank is successful to mobilize its current deposit on loan and advances.

**Graph 4**  
**Graphical Presentation of Loan and Advances to Current Assets Ratios**



Year

v) **Cash and Bank Balance to Total Deposit Ratio**

Cash and Bank Balance is said to be the first defense of every banks. The ratio between the cash and bank balance and total deposit measure the ability of bank to meet the unanticipated cash and all types of deposit.

We have,

$$= \frac{\text{Cash and Bank Balance}}{\text{Total Deposit}}$$

The following table shows the ratio measurement years.

**Table 5**  
**Cash and Bank Balance to Total Deposit Ratio**

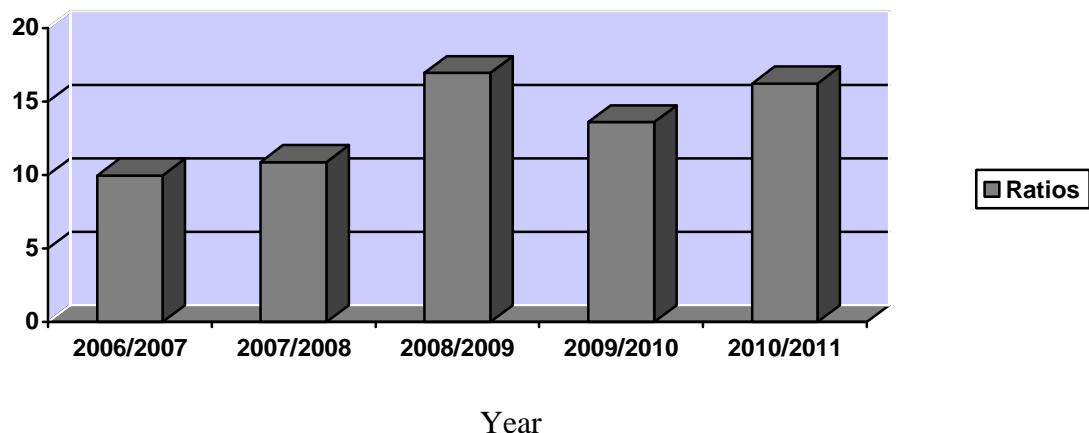
(Rs. In Million)

Fiscal Year	Cash and Bank Balance (Rs.)	Total Deposit (Rs.)	Ratios (%)
2006/2007	2,441.51	24,488.90	9.97
2007/2008	3,754.94	34,451.70	10.90
2008/2009	7,918.00	46,698.00	16.96
2009/2010	6,815.89	50,094.00	13.61
2010/2011	8,140.38	50,138.10	16.24

(Source : Annual Report of NIBL.)

The table no.5 shows fluctuating trend on cash and bank balance to total deposit ratio during the study period, in average it has maintained remarkable cash and bank balance to total deposit ratio. It shows that the improve or execute modification on the satisfactory position regarding the meeting of demand of its customers on their deposit at any time. That means it operates in higher risks. Through high ratio indicates its high ability but very high ratio shows the inefficiency.

**Graph 5**  
**Graphical Presentation of Cash and Bank Balance to Total Deposit Ratios**



#### 4.1.2 Activity Ratio

Activity or turnover ratio measures the efficiency of the bank to manage its assets in profitable and satisfactory manner these ratio are employed to evaluate the efficiency with the firm manages and utilize its assets. A commercial bank must manage its asset properly to earn high profit. Under this chapter following ratios are studied.

##### i) **Loan and Advances to Total Deposit Ratio**

This ratio measures the extent to which the banks are successful to mobilize their total deposit on loan and advance.

We have,

$$= \frac{\text{Loan and Advance}}{\text{Total Deposit}}$$

The table below shows the ratio of loan and advances to total deposit ration.

**Table 6**  
**Loan and Advances to Total Deposit Ratio**

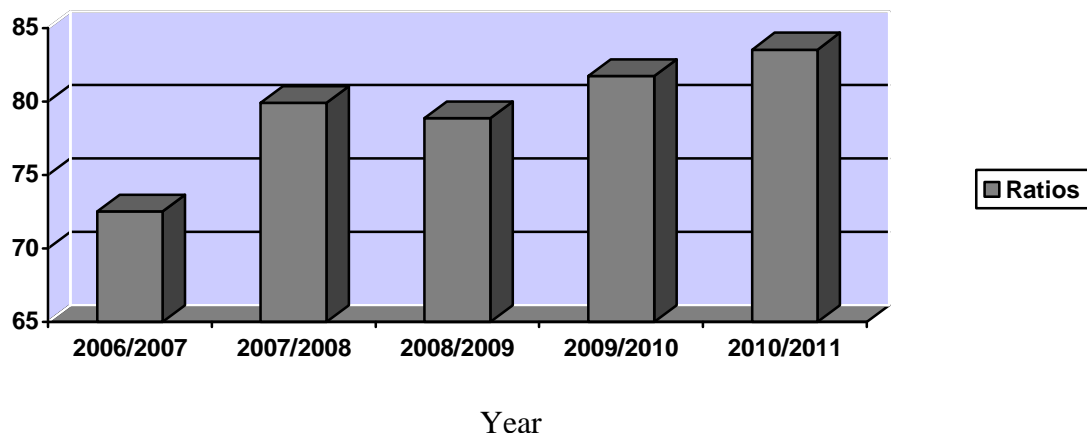
(Rs. In Million)

<b>Fiscal Year</b>	<b>Loan and Advances (Rs.)</b>	<b>Total Deposit (Rs.)</b>	<b>Ratios (%)</b>
2006/2007	17,760.10	24,488.90	<b>72.52</b>
2007/2008	27,529.31	34,451.70	<b>79.91</b>
2008/2009	36,827.16	46,698.00	<b>78.86</b>
2009/2010	40,948.44	50,094.00	<b>81.74</b>
2010/2011	41,887.69	50,138.10	<b>83.54</b>

(Source : Annual Report of NIBL.)

The above table no. 6 shows that the ratio in different year have fluctuating trend. It has highest 83.54% in FY 2010/2011 and lowest ratio is 72.52% in the FY 2006/2007. In conclusion, the bank has strong position regarding the mobilization of total deposit on loan and advance and acquiring higher profit.

**Graph 6**  
**Graphical Presentation of Loan and Advances to Total Deposit**



**ii) Total Investment to Total Deposit Ratio**

This ratio measures the extent to which a bank is able to mobilize its deposits for investment in various securities. A high ratio indicates the success in mobilizing deposits in securities and vice-versa.

We have,

$$= \frac{\text{Total Investment}}{\text{Total Deposit}}$$

Total following table exhibits the ratio of total investment to deposit.

**Table 7**  
**Total Investment to Total Deposit Ratio**

(Rs. In Million)

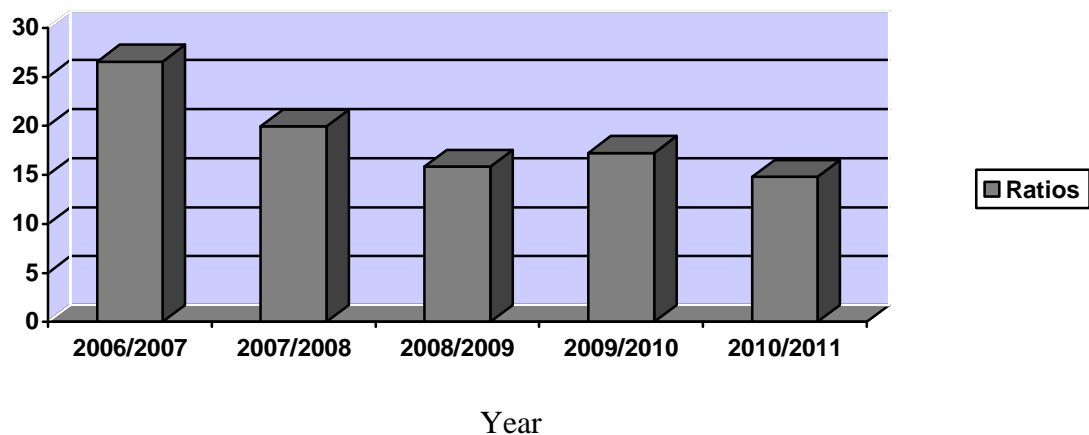
Fiscal Year	Total Investment (Rs.)	Total Deposit (Rs.)	Ratios (%)
2006/2007	6,505.68	24,488.90	26.57
2007/2008	6,874.03	34,451.70	19.95
2008/2009	7,399.81	46,698.00	15.85
2009/2010	8,635.53	50,094.00	17.24
2010/2011	7,423.11	50,138.10	14.81

(Source : Annual Report of NIBL.)

In the above table the ratio is fluctuating trend. First FY 2006/07 is 26.57% then decreasing trend and again increasing and decreasing trend. The analysis shows that the investment in various securities should be increased to utilize its deposit.

**Graph 7**

**Graphical Presentation of Total Investment to Total Deposit Ratio**



### iii) Loan and Advance to Total Assets Employed

This ratio reflects the extent to which the commercial banks are success in mobilization their assets as loan advances for the purpose of income generation. A high ratio indicates better in mobilization of fund as loan and advance and vice-versa.

We have,

$$= \frac{\text{Loan and Advance}}{\text{Total Assets Employed}}$$

Total working fund is the total assets. It is composed up of capital and reserves, deposit, loan and other liabilities.

The Following table exhibits the ratio of loan and advance to total assets employed.

**Table 8**  
**Loan and Advances to Total Assets Employed**

(Rs. In Million)

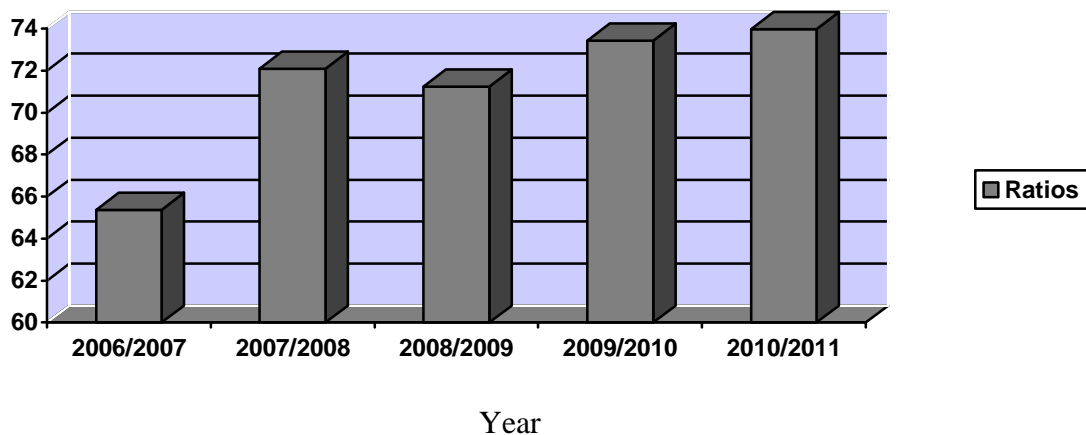
Fiscal Year	Loan and Advances (Rs.)	Total Assets Employed (Rs.)	Ratios (%)
2006/2007	17,760.10	27,167.17	65.37
2007/2008	27,529.31	38,188.52	72.09
2008/2009	36,827.16	51,694.73	71.24
2009/2010	40,948.44	55,767.43	73.43
2010/2011	41,887.69	56,628.65	73.97

(Source : Annual Report of NIBL.)

Referring to the above table no. 8 the loan and advance to total assets employed ratios exhibit increasing trend except 71.24 % in FY 2008/2009 and remains to 73.97% at the end of the study period.

**Graph 8**

**Graphical Presentation of Loan and Advances to Total Assets Employed**



### 4.1.3 Profitability Ratio

Profitability ratios indicate degree of success in achieving desired profit level. Profitability ratios, which measure as management overall effectiveness, are shown by the returns generated on sales and investment. A bank should be able to earn profit to survive and grow over a long period of time profit is the indicator efficient operation of a Bank. The banks acquire profit by providing different services to its customers or by making investment of different kinds. Profitability ratios measure the efficiency of bank. Higher profit ratio shows higher the efficiency of the bank. The following profitability ratios are related to study in this heading.

#### i) Return on Equity

If bank can mobilize its equity capital properly, they can earn high profit. The return on equity capital measures extend to which a bank is successful to mobilization its equity.

We have,

$$= \frac{\text{Net Profit}}{\text{Total Equity Capitals}}$$

Equity capital includes paid up equity, Profit and loss account, Various Reserves, General loan, Loss provision etc.

The table below shows the ROE in different year during the study period.

**Table 9**  
**Return on Equity Ratio**

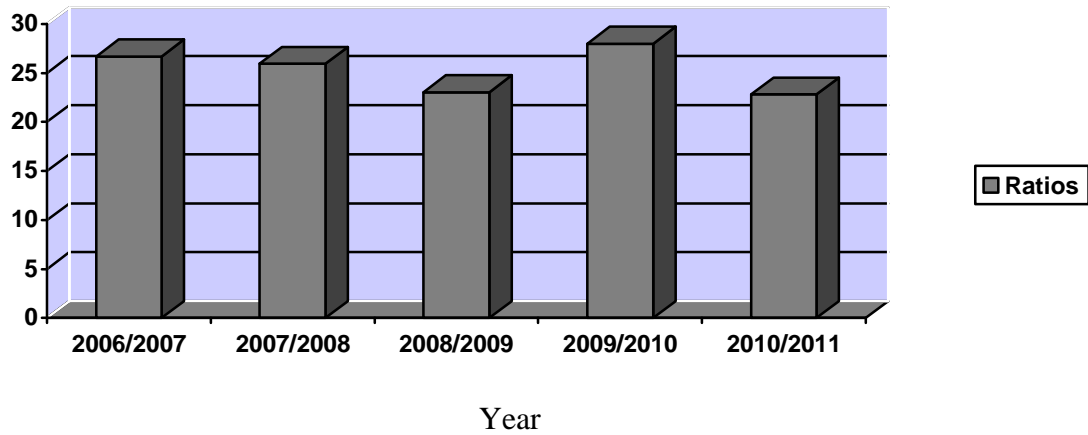
(Rs. In Million)

Fiscal Year	Net Profit (Rs.)	Total Equity Capital (Rs.)	Ratios (%)
2006/2007	501.00	1,877.81	26.68
2007/2008	697.00	2,688.01	25.93
2008/2009	901.00	3,908.89	23.05
2009/2010	1,265.00	4,517.86	28.00
2010/2011	1,177.00	5,159.76	22.81

(Source : Annual Report of NIBL.)

The above table exhibits that the ratio has followed the fluctuating trend and decreasing from FY 2007/2008 to 2008/09 and increasing trend in FY 2009/10 but again increased in FY 2010/2011. The bank seems to be having lack of sound investment policy for the mobilization of its equity capital.

**Graph 9**  
**Graphical Presentation of Return on Equity**



**ii) Interest Earned the Extent to Total Assets Employed**

This ratio reflects the extent to which the bank is successful in mobilizing its total assets to generate high income as interest. A high ratio is indicator of high earning power of the bank on its assets employed and voice-versa.

We have,

$$= \frac{\text{Interest Earned}}{\text{Total Assets Employed}}$$

**Table 10**  
**Interest Earned to Total Assets Employed**

(Rs. In Million)

Fiscal Year	Total Interest Earned (Rs.)	Total Assets Employed (Rs.)	Ratios (%)
2006/2007	1,584.99	27,167.17	5.83
2007/2008	2,194.28	38,188.52	5.75
2008/2009	3,267.94	51,694.73	6.32
2009/2010	4,653.52	55,767.43	8.34
2010/2011	5,803.44	56,628.65	10.25

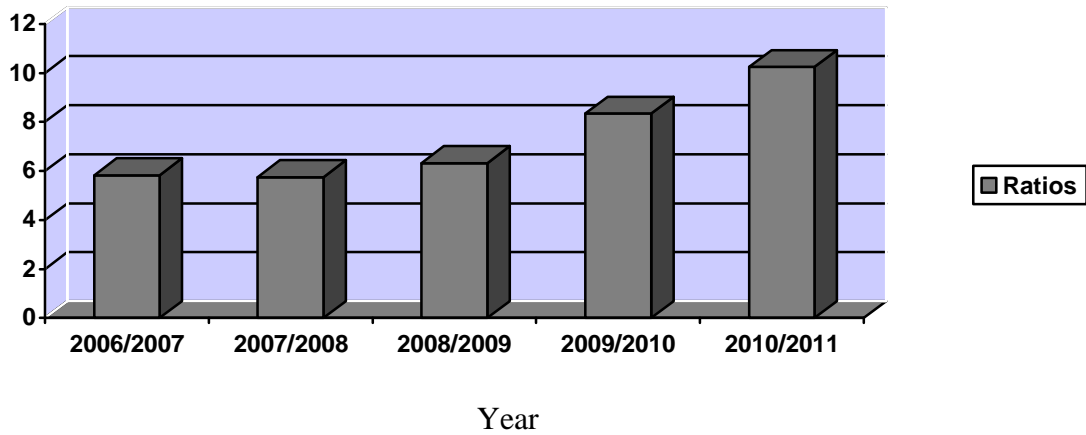
(Source : Annual Report of NIBL.)

The above table no. 10 shows that the ratio exhibits increasing trend. It has the highest ratio of 10.25 % in FY 2010/2011 and the lowest of 5.75 % in FY 2007/2008.

From the above table it can be concluded that the ratio of total interest earned to total assets employed satisfactory. That means bank is successful in earning interest income.

**Graph 10**

**Graphical Presentation of Interest Earned to Total Assets Employed**



**iii) Interest Paid to Total Assets Employed**

This ratio measures the percentage of total interest paid against the total assets employed. A high ratio indicates the higher interest expenses on total assets employed and vice versa.

We have,

$$= \frac{\text{Interest Paid}}{\text{Total Assets Employed}}$$

The following table shows the figures of this ratio

**Table 11**  
**Interest Paid to Total Assets Employed**

(Rs. In Million)

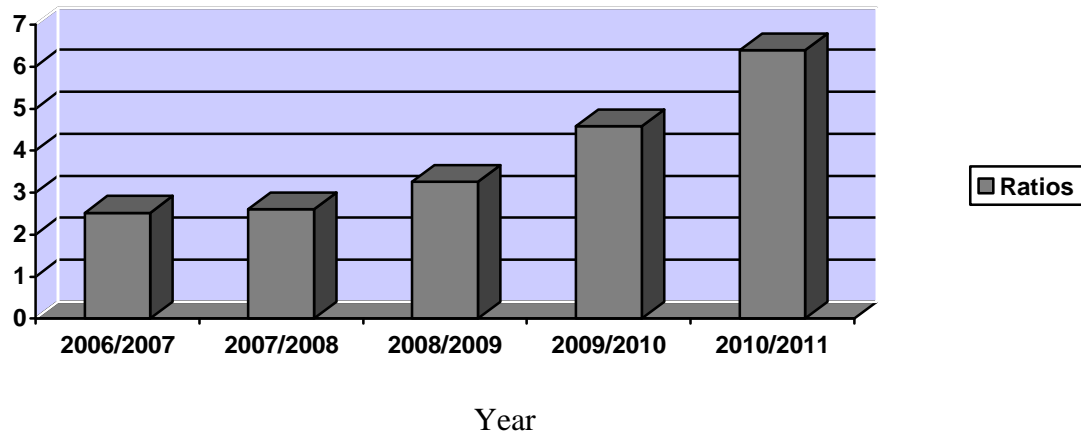
Fiscal Year	Total Interest Paid (Rs.)	Total Assets Employed (Rs.)	Ratios (%)
2006/2007	685.53	27,167.17	2.52
2007/2008	992.16	38,188.52	2.60
2008/2009	1,686.97	51,694.73	3.26
2009/2010	2,553.85	55,767.43	4.58
2010/2011	3,620.34	56,628.65	6.39

(Source : Annual Report of NIBL.)

The above table no. 11 shows that the total interest paid to total assets employed ratio is in increasing trend. The ratio ranges from 2.52% to 6.39% which lies on the FY 2006/07 and FY 2010/11 respectively.

In conclusion we can say that bank is in good position from payment of interest point of view. It seems to be successful to collect its working fund from less expensive sources.

**Graph 11**  
**Graphical Presentation of Interest Paid to Total Assets Employed**



**iv) Return on Total Assets Employed**

It measures the profit earning capacity by utilizing available resource i.e. total assets. Return will be higher if the banks working fund is well managed and efficiently utilized.

We have,

$$= \frac{\text{Net Profit}}{\text{Total Assets Employed}}$$

Where,

Net profit includes the profit that is left to the internal equities after all costs, charge and expenses. Following table shows the figure of this ratio.

**Table 12**  
**Return on Total Assets Employed Ratio**

(Rs. In Million)

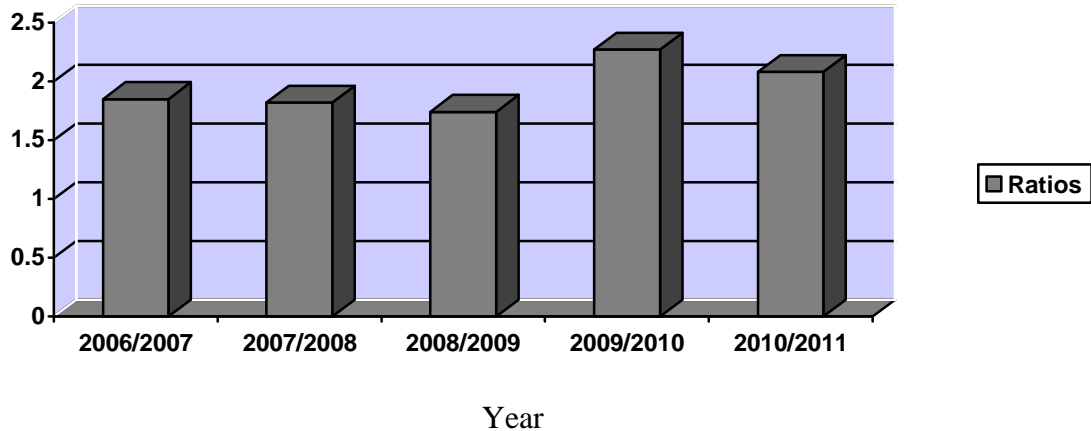
Fiscal Year	Net Profit (Rs.)	Total Assets Employed (Rs.)	Ratio (%)
2006/2007	501.40	27,167.17	1.85
2007/2008	696.73	38,188.52	1.82
2008/2009	900.62	51,694.73	1.74
2009/2010	1,265.95	55,767.43	2.27
2010/2011	1,176.64	56,628.65	2.08

(Source : Annual Report of NIBL.)

The above table shows that the profitability ratio of bank is not consistent. It has the fluctuating trend. It has maintained net profit in the year 2006/07 to 2010/11. Which are on the ratios of 1.85%, 1.82%, 1.74%, 2.27% and 2.08% respectively.

From the above analysis, it can be concluded that the profitability with respect to financial resources investment of the bank asset is not satisfactory as well as unstable.

**Graph 12**  
**Graphical Presentation of Return on Total Assets Employed**



v) **Return on Loans and Advances Ratio**

It measures the earnings capacity of commercial banks on its deposits mobilized on loan and advances.

We have,

$$= \frac{\text{Net Profit}}{\text{Loans and Advances}}$$

The following table shows in the figure of this ratio.

**Table 13**  
**Return on Loans and Advances Ratio**

(Rs. In Million)

Fiscal Year	Net Profit (Rs.)	Loans and Advances (Rs.)	Ratio (%)
2006/2007	501.40	17,760.10	2.82
2007/2008	696.73	27,529.31	2.53
2008/2009	900.62	36,827.16	2.45
2009/2010	1,265.95	40,948.44	3.09
2010/2011	1,176.64	41,887.69	2.81

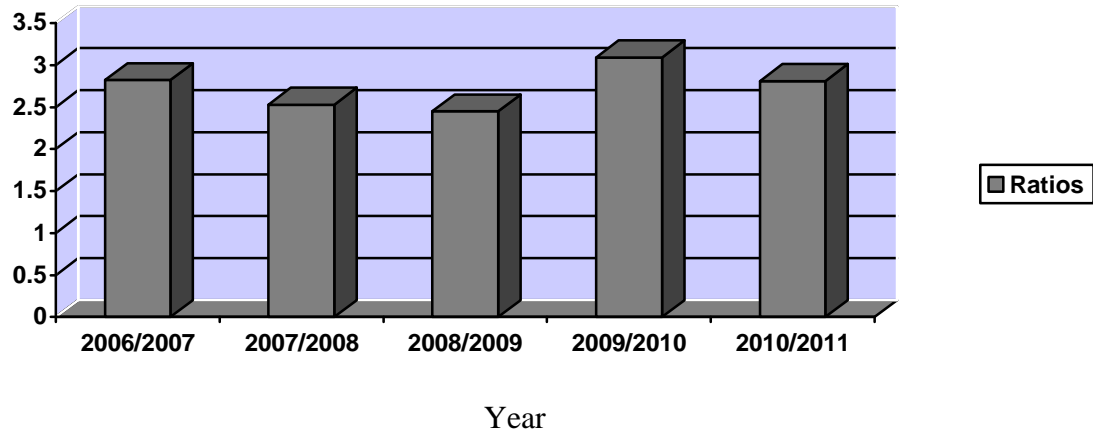
(Source : Annual Report of NIBL.)

The above listed table reveals that NIBL's return on loans and advances ratios have fluctuating trend. In the study of five years it has positive but volatile trend during the FY 2006/07 to FY 2010/11.

Thus it can be concluded that the bank is not able to earn on loan and advances.

**Graph 13**

**Graphical Presentation of Return on Loans and Advances Ratio**



**vi) Earning Per Share (EPS)**

EPS measure the profitability of common shareholder. The earning may be on a per share basis.

We have,

$$= \frac{\text{Net Profit}}{\text{Total No. of Shares}}$$

The following table shows the EPS.

**Table 14**  
**Earning Per Share (EPS)**

(Rs. In Million)

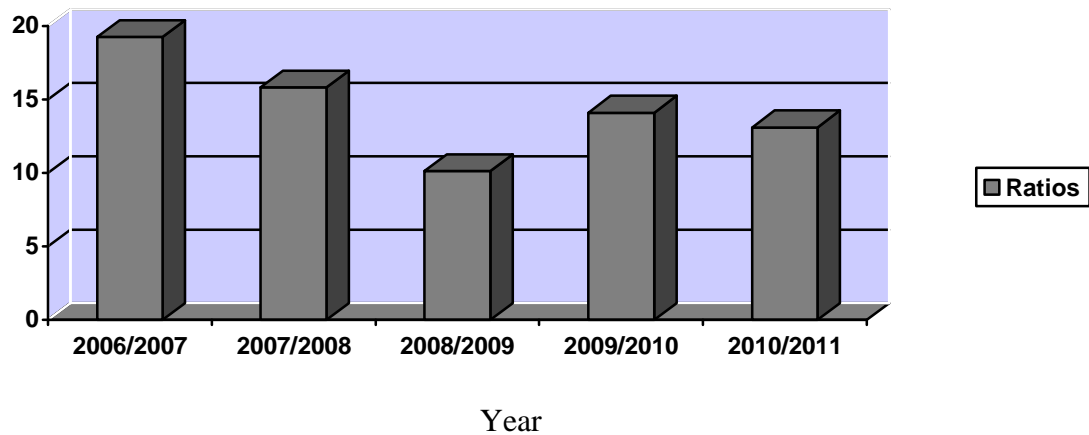
Fiscal Year	Net Profit (Rs.)	No of Shares (Rs.)	Ratio (%)
2006/2007	501.40	26.03	19.26
2007/2008	696.73	44.08	15.81
2008/2009	900.62	88.97	10.12
2009/2010	1,265.95	89.80	14.10
2010/2011	1,176.64	89.80	13.10

(Source : Annual Report of NIBL.)

From the above table we can see the EPS of the bank in fluctuating trend. The EPS of FY 2006/07 is Rs. 19.26 and Rs. 15.81 in FY 2007/08 and Rs. 10.12 in FY 2008/09 but again increased to Rs. 14.10 in FY 2009/10 and Rs. 13.10 in FY 2010/11.

It is not very good of operation performance of the bank.

**Graph 14**  
**Graphical Presentation of Earning Per Share**



**Performances Highlights of NIBL**  
**Table 15**

(Rs. In Million)

<b>SOURCES</b>	<b>2006/2007</b>	<b>2007/2008</b>	<b>2008/2009</b>	<b>2009/2010</b>	<b>2010/2011</b>
Capital and Reserves	1,878.12	2,686.79	3,907.84	4,585.40	5,159.76
Deposits	24,488.86	34,451.73	46,698.10	50,094.73	50,138.13
Loan	800.00	1,050.00	1,088.80	1,087.31	1,330.76
Other Liabilities	423.87	684.79	1,316.07	1,537.98	1,728.18
<b>USES</b>					
Cash and Bank	2,441.51	3,754.94	7,918.00	6,815.89	8,140.37
Credits	17,286.43	26,996.65	36,241.21	40,318.31	41,095.51
Investment	6,505.68	6,874.03	7,399.81	8,635.53	7,423.11
Money at Call	362.97	-	-	-	150.00
Other Assets	994.26	1,247.69	1,451.79	1,535.69	1,547.84
<b>Operating Profit</b>	<b>727.51</b>	<b>1,310.85</b>	<b>1,310.85</b>	<b>1,928.43</b>	<b>1,783.66</b>
<b>Net Profit</b>	<b>501.4</b>	<b>696.73</b>	<b>900.62</b>	<b>1,265.95</b>	<b>1,176.64</b>

The bank has not been able to augment its net profit remarkably Rs. 1,176.64 Million as compared to Rs. 1,265.95 million posted last year. The growth in credit, portfolio continued to remain subdued on account of lack of lending opportunity in variable projects.

In the depressed market and overall economic scenario, the bank's concentration remained at consolidation of the existing credit portfolio. Total investment of the bank raise to the level of Rs. 8,635.35 million.

Likewise, during the year 2010/11 the deposits and credits increased by 0.09% and 1.93% respectively bur operating profit and profit decreased by 7.51% and 7.05% respectfully.

The bank has been consistently increasing its exposure to the priority sector and the deprived sector of the economy in keeping with the guidelines of Nepal Rastra Bank.

## 4.2 Statistical Tools

Under this heading some statistical tools such as coefficient of correlation analysis between different variables, trend analysis of deposit and loan and advances net profit are used to achieve the objectives of the study.

### 4.2.1 Coefficient of correlation analysis

Under this chapter Karl Pearson's coefficient is used to find out the relationship between deposit and loan & advances, deposit and total investment and outside asset and net profit.

#### i) Coefficient of correlation between deposit and Loan & advances

Deposits have played a very important role in performance of a commercial bank and similarly loan advances are important to mobile the collected deposits. Coefficient of correlation between deposit and loan & advances measures the degree of relationship between these two variables.

In this analysis, deposit is independent variable (X) and Loan & advances is dependent variables (Y). The main objective of computing 'r' between these two variables is to justify whether deposits are significantly used on loan and advances in a proper way or not. The following table shows the value of 'r', 'r<sup>2</sup>', probable Error (P.Er) and 6 P.Er between deposit and loan & advances for the study period 2006/07 to 2010/11.

**Table 16**  
**Correlation between Deposit and Loan & advances**

<b>Evaluation Criterious</b>			
<b>r</b>	<b>r<sup>2</sup></b>	<b>P.Er.</b>	<b>6 P.Er.</b>
0.9972	0.9944	0.0017	0.0102

( The details of calculation is in Annexure – 1)

The above table no. 16 shows the coefficient of correlation between deposit and loan and advances is 0.9972, which shows higher positive correlation between these two variables. Similarly the value of coefficient of determination ( $r^2$ ) is to be found 0.9944, which shows that 99.44% in the dependent variable has been explained by the independent variable. More over by application of P.Er. i.e. 0.0017, which means the relation between deposit and loans and advances is significant. In other words NIBL is successful to mobilize its fund in proper way in loan and advances. Similarly considering the value of (r) i.e. 0.9972 and comparing it with 6 P.Er. i.e. 0.0102, we can say that the value of r is more than 6 P.Er., which reveals that there is significant relationship between deposit and loan and advances.

**ii) Coefficient of correlation between deposit and total investment**

Coefficient of correlation between deposit and total investment measure the degree of relation between these two variables. Here deposit is independent variable (X) and total investment is dependent variable (Y). The purpose of computing co-efficient of correlations between deposit and total investments to find whether deposit is significantly used as investment or not.

The following table shows the variable of r, ( $r^2$ ), P.Er. and 6 P.Er. between deposit and total investment for the study period 2006/2007 to 2010/2011.

**Table 17**  
**Correlation between Deposit and Total Investment**

<b>Evaluation Criterious</b>			
<b>r</b>	<b><math>r^2</math></b>	<b>P.Er.</b>	<b>6 P.Er.</b>
0.8123	0.6598	0.1026	0.6157

( The details of calculation is in Annexure – 2)

From the above table no. 17, we find that coefficient of correlation between deposits (independent) and total investment (dependent) value of r is 0.8123. It shows positive relationship between two variables however by application of coefficient of determination the value of ( $r^2$ ) is 0.6598, which indicates that the 65.98% of the variation of the dependent variable (total investment) has been explained by the independent variable (deposits) moreover by considering the probable error since the value of r is i.e. 0.8123 is more than six times of P.Er. i.e. 0.1026. So we can say that there is significant relationship between total deposit and total investments.

Lastly it can be said that the bank has followed the policy of maximizing the investment of their deposits.

**iii) Coefficient of correlation between deposit and net profit**

Coefficient of correlation ‘r’ between deposit and net profit measures the degree of relationship between these two variables. Here deposit is independent variable (X) and net profit is dependent variable (Y). The purpose of computing coefficient of correlation between deposit and net profit is to find out whether the net profit is significantly with respective deposit or not.

The following table shows the value of r, r<sup>2</sup>, P.Er. and 6 P.Er. between deposit and net profit for the study period 2006/07 to 2010/11.

**Table 18**  
**Correlation between Deposit and Net Profit**

<b>Evaluation Criterious</b>			
<b>r</b>	<b>r<sup>2</sup></b>	<b>P.Er.</b>	<b>6 P.Er.</b>
0.9478	0.8983	0.0307	0.1840

(The details of calculation is in Annexure – 3)

From the above table no. 18 it has been found that the coefficient of correlation between deposit (independent) and net profit (dependent) is 0.9478, which indicates positive correlation between these two variables. Considering the value of coefficient of determination is r<sup>2</sup> i.e. 0.8983 indicates that 89.83% of the variation in the dependent variables (net profit) has been explained by the independent variable (Deposit) moreover by considering the probable error we can further say that there is significant relationship between deposit and net profit because the value of r i.e. 0.9478 is greater than six times P.Er. i.e. 0.0307.

It indicates that NIBL is capable of earning net profit by mobilizing its total deposits.

**4.2.2 Trend Analysis and Projection for next five years :**

The measurement used in financial management analysis may be classified into two groups those who measure in the relation among the items. Insight set of statements and those who measure the analysis in these items in successive statement. The first is a static analysis measuring position at a point of time of for a period and the second is a dynamic measuring change of position. Both types of analysis are necessary for a comprehensive

interpretation, since it is important to know not only the proportion as on a certain date but also the trends on the enterprise.

Here in this study the trend analysis of the financial condition are presented which is objected to provide the insight of the bank position.

In this study, the method of least square is used for the analysis of the bank's total deposit trend, net profit trend and loan and advances trend.

The projects are based on the following assumptions:

- ) The main assumption is that other things being will remain uncharged.
- ) The bank will run in the present stage.
- ) The economy will remain in the present stage.
- ) The forecast will be true only when the limitation of least square method is carried out.
- ) Nepal Rastra Bank will not change its guidelines to commercial banks.

**i) Trend Analysis of Total Deposit**

Under this topic, an effort has been made to calculate the trend value of deposit for five years from 2006/07 to 2010/11 and forecast for next four years till next 2015/2016

The following table shows the trend value of 10 years from 2006/07 to 2015/2016

**Table 19**  
**Trend Line of Total Deposit**

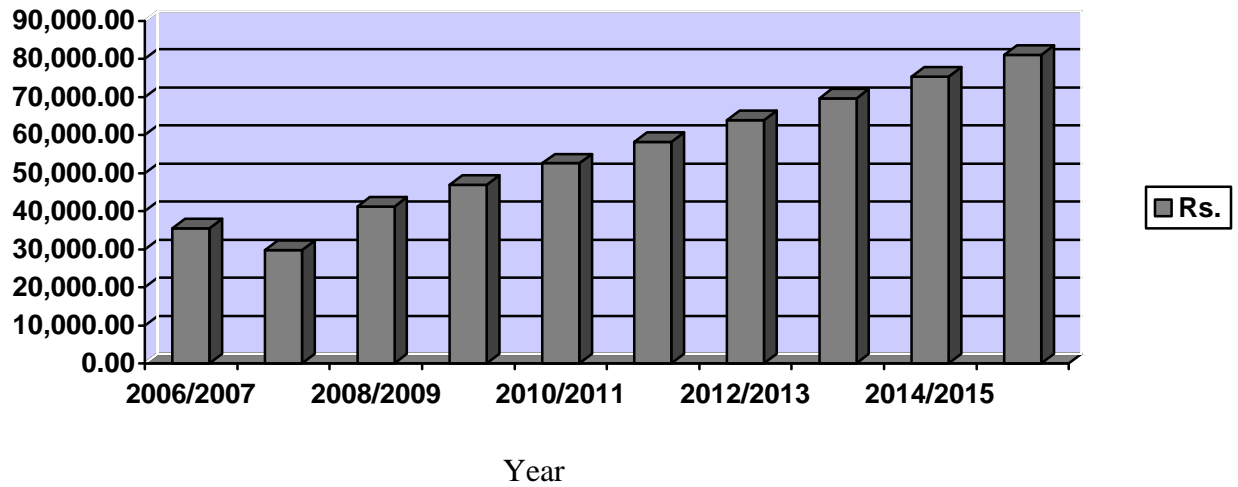
(Rs. In Million)

Fiscal Year	Trend Value
2006/2007	35,476.35
2007/2008	29,778.56
2008/2009	41,174.14
2009/2010	46,871.93
2010/2011	52,569.72
2011/2012	58,267.51
2012/2013	63,965.30
2013/2014	69,663.09
2014/2015	75,360.88
2015/2016	81,058.67

(The details of calculation is in Annexure – 4)

**Graph 15**

**Graphical Presentation of Trend Value of Total Deposit**



**ii) Trend Analysis of Net Profit**

Under this topic the trend values of net profit have been calculated for five years from FY 2006/2007 to 2010/2011 and the forecast for next five years up to 2015/2016.

The following table shows the trend value of 10 years from 2006/07 to 2015/2016

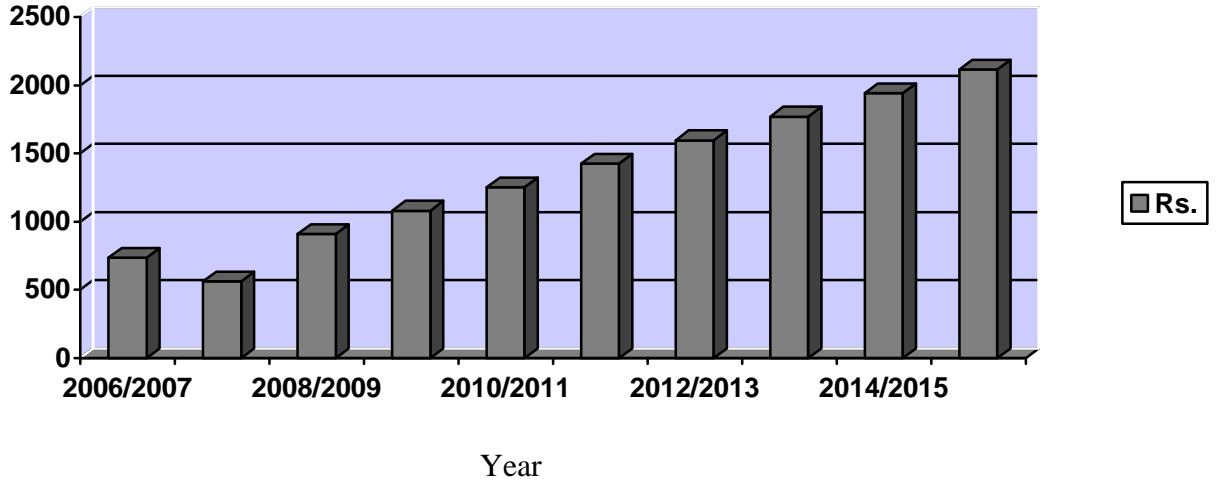
**Table 20**  
**Trend Line of Net Profit**

(Rs. In Million)

Fiscal Year	Trend Value
2006/2007	735.83
2007/2008	563.39
2008/2009	908.27
2009/2010	1,080.71
2010/2011	1,253.15
2011/2012	1,425.59
2012/2013	1,598.03
2013/2014	1,770.47
2014/2015	1,942.91
2015/2016	2,115.35

(The details of calculation is in Annexure – 5)

**Graph 16**  
**Graphical Presentation of Trend Value of Net Profit**



**iii) Trend Analysis of Loan & Advances**

Under this topic the trend values of loan & advances have been calculated for five years from FY 2006/2007 to 2010/2011 and the forecast for next five years up to 2015/2016.

The following table shows the trend value of 10 years from 2006/07 to 2015/2016

**Table 21**  
**Trend Line of Loan & Advances**

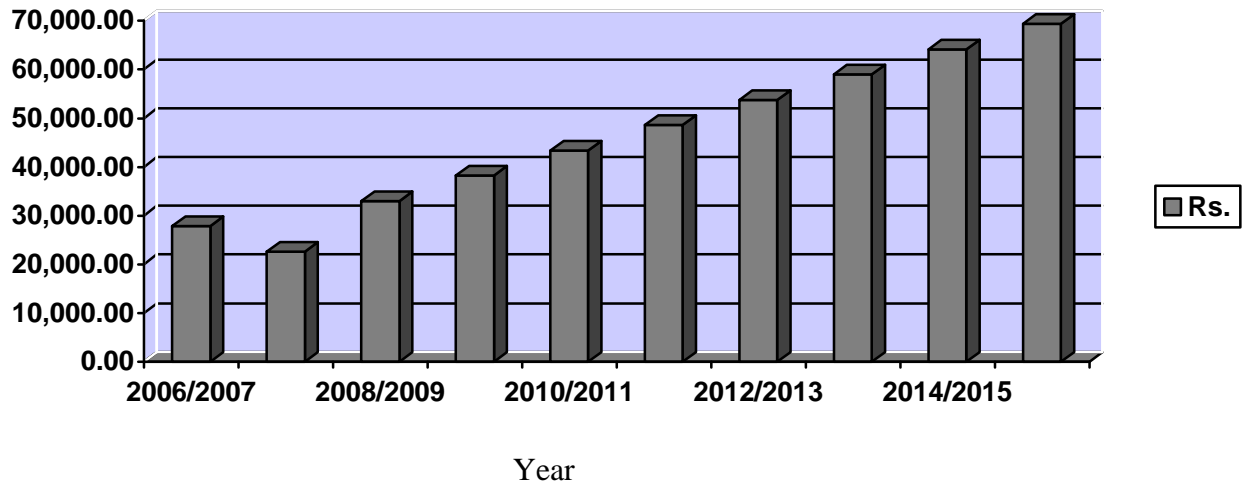
(Rs. In Million)

Fiscal Year	Trend Value
2006/2007	27,800.03
2007/2008	22,609.52
2008/2009	32,990.54
2009/2010	38,181.05
2010/2011	43,371.56
2011/2012	48,562.07
2012/2013	53,752.58
2013/2014	58,943.09
2014/2015	64,133.60
2015/2016	69,324.11

(The details of calculation is in Annexure – 6)

**Graph 17**

### Graphical Presentation of Loan & Advances



### 4.3 Test of Hypothesis

Under this topic, effort has been made to test the significance regarding the parameter of the population on the basis of sample drawn from the population.

Some main hypothesis tests are calculated and decisions are made.

Null Hypothesis,  $H_0 : \mu_1 = \mu_2$  there is no significant difference in profit Planning and Control of NIBL.

Null Hypothesis,  $H_0 : \mu_1 \neq \mu_2$  there is significant difference in profit Planning and Control of NIBL (Two-tailed)

#### t-test :

The calculated value  $t = -0.29679$

The tabulated value of 't' (two-tailed test) at 5% level is 2.306.

Since, the calculated value  $t = -0.29679$  is less than tabulated value = 2.306.

The Null Hypothesis is accepted i.e., there is no significance difference in profit planning and control of NIBL.

If we draw a large number of smaller i.e. ( $n < 30$ ) & compute the mean for each sample and then plot the frequency distribution of these means, the resulting sampling distribution would be t-test. On these study sampling are taken only for five years i.e. ( $5 < 30$ ). The total calculation has been done through computer so, the decision are only analyzed here.

#### **4.4 Analysis of Primary Data**

The primary data analysis has been done through the interview and questionnaires basis. The interpretation of the primary data is presented in this section of the study. The analysis has been presented in the paragraph from to give the clear idea of the analysis.

##### **i) Factors that should be considered while making investment decision :**

The basic principals of lending are normally based on availability of resources. Depending on whether the resources are to supplement a borrower, the following factors are taken into account while lending by the bank. The most important factors contributing to success or failure of a lending is the promoters or person behind the investing project. The experience and the qualification of the promoter.

The government's economic policies can make certain ventures. It is very important to do a sensitivity analysis for a industry/business vis-à-vis the particular industry/business to be financed. The certain industries like cement where proximity to raw materials in important or in a labor intensive industry proximity to source of cheep labour is essential. A demand supplies position analysis for the industry must be carried out. Thus, economic policies and industries scenario must be analyzed before investing.

The availability of transportation, roads, power, water, labour etc have a major bearing on viability of the unit. Governmental restrictions like antipollution measures etc may also be understood.

The specific products that an enterprise wants to launch needs to be examined. The technology to be used to be used manufacture of the product may be an obsolete one high cost of maintenance. Similarly a technology which a latest and cannot be maintained indigenously, may cut into profit margins. All these aspects should be studied carefully.

The factor that should weight is the security available to them in case of failure of business proposed. It is preferable to option for collateral, which appreciates and is easily marketable. Government bonds, property are some of the collateral that are acceptable and which satisfy the requirements. Banks are not expected to finance high-risk ventures and should prefer commercial and established venture.

It is essential that money should be use an invested for safe and viable ventures, as it is public money that is being invested on their behalf.

Some additional grounds to be measured for lending are:

- ) Liquidity
- ) Profitability / Economical Project
- ) Borrower's Integrity
- ) Appropriate Amount
- ) Market Viability

**ii) Bank is maintaining its target deposit or not :**

The bank has maintained its target deposits and it has excess than the expectations. But due to the limitations of the productive investment sectors it is avoiding its interest bearing deposits, which may reduce its target deposit. From the deposit of NIBL during the study period it is clear that it has increased trend deposit in FY 2006/2007 to 2010/2011. It is clear that the bank is mandating its target deposits.

**iii) Bank is using its deposits properly or not :**

In using the deposit funds the bank is trying its best but it is not getting the secure productive opportunities to invest. The invest opportunities for the bank is very limited due to the external economic factors, unclear guidelines of NIBL and improper management of bank which is the result of changing government policies.

It is investing its excess funds in other investments rather than in loans and advances. It is better than keeping money idle for nothing.

**iv) The gap between deposits and credit is increasing rather than decreasing :**

Commercial banks were cautious in extending loans. The rising non-performing assets in their portfolio and a bit pessimistic view about the economy following the Asian crisis guided such behavior of banks.

The corporate sector was not happy with the commercial bank's lending rates at a time business slackness was observed in the economy.

The business community also played a role for relatively low demand for bank credit observes the problem with the introduction of VAT.

**v) Major portion of deposit are invested in loans & advances :**

Major portion of bank's deposits are invested in loan and advance because it is the only profitable sector for long-term investment. The bank doesn't get much profit from other investments. If they failed in recovering loan they get profit from the margin rate in the collaterals securities kept against the loans and advances.

**vi) Margin rate of securities**

The bank while placing the collateral keeps the margin for the bank in the total value of goods, movables, assets and other securities. The banks determine the actual market value of the securities than fixes its margin and determine the value the collateral by the remaining percentage.

**vii) Major problems that commercial banks are facing while investing in loan and advances :**

A number of factors can be attributed to a lower bank credit off-take in recent years.

- ) High Lending rate
- ) Real Estate Crash
- ) Problem in Carpet Industry
- ) New Economic Policy
- ) NRB's Policies

**viii) Nepal Government's Measures against this problem :**

Nepalese government is still not showing any strong activities to solve this problem. The internal crisis of Nepal has not been solved yet, which is disturbing the whole economy of Nepal.

**ix) Bank's Management :**

The Nepalese commercial banks are also responsible for this problem of credit deadlock as there is very less cooperation is seen between all the commercial banks. They are not moving in same path, each and every bank is performing differently with respect to deposit and loan activities. The second problem is lack of proper managerial power also affecting their lending activities.

## **CHAPTER- 5**

### **Summary, Conclusion and Recommendations**

#### **5.1 Summary and Conclusion**

Today, joint venture banks have played significant role in the economic development of the country. They have introduced new technology in the banking system mobilized the saving of community. They have focused their services on Commerce, trade and industry along with general public. But the intense competition and lack of sufficient investment opportunities have created threats to the banks. Therefore, the study has been conducted for profit planning and control of Nepal Investment Bank Ltd in order to find out it's strengths and weakness.

This research is related to the profit planning aspects, the financial strengths and weakness of NIBL has been measured on the basis of Balance Sheet, Income and Expenditure Account and Profit and Loss A/C. In that course different tools have been used. Moreover, many related pilot works along with their objectives have been studied for removing the chances of duplication. The various textbooks and the published journals have also been reviewed.

Every corner of the main city you can see the hoarding board with loan facilities and new scheme of each bank mainly to attract the customer. Today's competitive days each and every bank is competition with one another by introducing similar product or different than other product in the market specially focusing the demands of the customer for loan facilities with low interest rates and service rates.

It is the true that marketing department of each bank is playing a vital role in analyzing the market trend and customer needs and desire. Any product, service, idea, form or organization needs exposure. These days bank are aggressively introducing new product in the market

Each and every bank in Nepal is offering competitive schemes to its customers. Every possible facility is being offered to the market. In market consumer loan services has reality become competitive. There are many banks with different facilities and services to the customers. It is no doubt that customer have many options to choose. They can move

anywhere they like. To become successful in such market situation, each and every marketer is trying to provide as much facilities as it can be offered.

Today's important facility is being provided bank to the customer is consumer loan facilities. Banks don't want to freeze their bulk of amount in only me product so they introduces different product with different facilities with low interest rates, low service charge and moreover to make ease for customer they accept monthly installment. Knowing these requirement banks is offering schemes to customer and is trying to diminish the interest rates and down payment.

Customers are motivated by offering necessary product to them. Banks marketing department attract customers. Only bank provides consumer loan as when required fulfilling their demands and desires.

The effectiveness of consumer loan is increasing day by day. If you can see today's context banks are unable to invest their budget in tourism sector so they even find more beneficiaries to invest in these products. As far as it concern bank it is advantageous to both the parties. These days bank secured investment is in consumer loan schemes.

Bank has always brought effective and appropriate scheme to the customers. In the view point of security, a bank should always know that why a customer is in need of loan. If a borrowers misuses the loan granted by the bank. He can never repay therefore in order to avoid this situation each and every bank demand all the essential detailed information about the scheme of the project or activities. Bank should be very careful not to grant loan in only one sector. To minimize risk, a bank must diversity its investment on different sectors. Diversification of loan helps to sustain loss according to the law of average, If a security of a company is deprived of, there may be an appreciation in the securities of other company is deprived of, there many be an appreciation in the securities of other companies. In this way loss can be covered.

Loan and advances are the main sources of income for a bank. Bank deposits can cross beyond a desired level but the level of loans, advances and overdraft will never cross it. The facilities of granting loans and advances are the main service in which customers of the bank can enjoy.

Funds borrowed from banks are much cheaper than those borrowed from unorganized money lenders. The demand for loans has excessively increased due to cheaper interest rate.

Furthermore, an increase in an economic and business activity always increases the demand of funds. Due to limited resources and increasing loans, there is some fear that commercial banks and other financial institutions too many take more preferential collateral while granting loans causing unnecessary botheration to the general customers. Such loan from these institutions would be available on special request only and there is a chance of utilization of resources in economically less productive fields. There lies the undesirable effect, of low interest rate.

In addition to this, some portion of loan and advances includes that amount which is given to staff of the bank for house loan, vehicle loan, personal loan and others, in mobilizing of commercial banks fund: loan and advances have occupied a large portion.

Liberal economic policy of the government has encouraged the establishment and growth of commercial banks in the country with in short span of time. In Nepal there are 34 registered commercial banks and branches all over the country but now some branches are reduce and merge with other branches due to lack of proper security.

The commercial banks in Nepal are doing well but they are not giving satisfactory results due to some internal and external factors. The deposits and its reinvestment in productive sectors by commercial banks are not stable. They are not earning more profit for commercial banks. The increasing deposits are idle in the banks and in turn they are investing these funds in other sectors as government securities but it is better than nothing for the commercial banks. A decline in overall business market, sluggish performance of industry and slowdown in tourism sector accounted for such a declaration in the commercial bank activities.

The commercial banks in Nepal are facing the problem in investing in loan and advances. Due to various internal and external factors the banks are not making open investments. Deposits are being excess and idle in these banks.

Therefore, these banks should formulate new investment strategies. They should launch the intensive programs to encourage. The commercial banks should talk to NRB to make clear and new policies keeping in view the problem these banks are facing. These banks should take this problem seriously.

There is no significance difference between deposit and loan & advances and between deposit and investment of bother the banks. The commercial banks in Nepal are facing the

problem in investing in loan and advances. Due to various internal and external factors the banks are not making open investments. Deposits are being excess and idle in these banks.

Strengthening and the institutionalization of the commercial banks are very important to have a meaningful relationship between commercial banks and national development through shift of credit to the productive industrial sectors. At the same time the series of reforms such as consolidation of commercial banks, directing attention to venture capital financing, appropriate risk return trade off by linking credit to timely repayment schedules, avoiding imperfection, allowing flexibility in lending, one window service from NRB, need of strong supervision and monitoring from NRB, diversity scope of activities for commercial banks, professional culture within commercial banks, etc. All these are necessary to ensure better future performance of commercial banks that have already been established and growing in Nepal.

The commercial banks in Nepal must work hard to prove that they are really efficient and viable agencies for mobilization of saving and its channelization into productive into productive sectors, are professionally managed and competent enough to ensure adequate rate of return on investment and are tragically well planned to be competitive.

## **5.2 Findings**

Based on the analysis of data, the main findings are given below :

### **5.2.1 Liquidity Ratio:**

From the analysis of liquidity ration, it is found that the bank is able to maintain its liquidity position to meet the daily cash requirement. It has made enough investment on government securities, but it has maintained moderate investment policy on loan and advance. Overall it has indicated the unstable liquidity position as the data shown lower consistency.

### **5.2.2 Activity Ratio:**

From the analysis of various activity ratios, the following findings are categorized.

- ) Bank has strong position regarding the mobilization of total deposit as loans & advances.
- ) Bank has normal position and decreasing trend regarding the mobilization of total deposit as investment.

- ) The bank has average position towards the utilization of working fund on loan & advances.

### **5.2.3 Profitability Ratio**

From the analysis of various profitability ratios, the following findings can be categorized.

- ) Return on equity is found unsatisfactory, as it has not efficiently utilized its equity capital.
- ) The ratio of total interest earned to total assets employed is not satisfactory as it is decreasing of interest earned every year.
- ) The ratio of total interest paid to assets employed is satisfactory position, as it seems to be successful to collect its working fund from less expensive source.
- ) The ratio of interest earned to operating income shows the magnitude of interest income is high as the bank seems to be successful to mobilized interest bearing assets such as loan, advances and investment.
- ) From the analysis of return on total assets employed ration, it is found that the profitability with respect to financial resources investment of the banks assets is unsatisfactory as well as unstable.
- ) From the analysis of return on loan and advance ratio, it is found that the bank is not able to earn satisfactory income on loan and advances.

### **5.2.4 Co-efficient of Correlation Analysis**

Co-efficient of correlation analysis between different variables reveals that:

- ) Co-efficient of correlation between deposit and loans & advances indicates satisfactory position in mobilization of deposit as loan and advances.
- ) Co-efficient of correlation between deposit and total investment indicates satisfactory position in mobilization as an investment.
- ) Co-efficient of correlation between deposit and net profit indicates that the banks is moderately successful in mobilization of fund and earn return i.e. net profit from such mobilized fund.

### 5.2.5 Trend Analysis

The trend analysis of deposit, net profit, loan and advances shows the increasing trend throughout the study period and forecasting for next five years has also seen increasing trend.

### 5.3 Recommendation

On the basis of analysis, findings, issues and gaps of the study, following suggestions or recommendations can be advanced to overcome weakness, inefficiency and to improve present fund mobilization and investment policy of bank. Here are some recommendation points, which are found to be considered to increase the marketing performance of bank to achieve the banks goals for betterment of future.

- ) The bank is suggested to maintain to its liquidity position in normal standard i.e. 2:1 as their liquidity position is below the normal standard and also recommended to follow consistency liquidity policy.
- ) As joint venture commercial bank is private sector, NIBL cannot keep its eyes off from the profit motive. It should be always careful in increasing profit in a real sense to maintain to confidence of shareholders, depositors and its customers. So the bank is strongly recommended to utilize its risky assets and shareholders fund to gain profit margin. Similarly, it should reduce its expenses and should try to collect cheaper fund being more profitable.
- ) In regard, investment and government securities, it has been revealed the NIBL has given more priority to invest its fund in government securities than other investment sector. Though securities issued by government are considered to be free risk of default, but such securities yield the lower interest rate of a particular maturity due to low risk feature. So, NIBL is recommended not to give much of important to the government securities and diversity the investment policy on more yield base funds.
- ) To get success in competitive banking environment, depositors' money must be utilized as loan and advances. The largest item of the bank in the assets side is loan and advances. If it is neglected, then it could be the main cause of liquidity crisis in the bank and one of the main reasons for a banks failure. It has been found from the study of Nepal Investment Bank Ltd. Loan and advances loan and advances to total deposits ratio is higher than of the other

studied banks but its stability is not consistent than of others. To overcome this situation Nepal Investment Bank Ltd. Is strongly recommended to follow liberal lending policy and invest more and more percentage of total deposit in loan and advances and similarly, maintain more stability on the investment policy.

- ) Lack of information, whereas banks must inform customer about their product in the market through different media such as: brochures, pamphlets, interest access and respects but it is difficult to get.

It is recommended to increased cash and bank balance to meet current obligation and loan demand.

- ) In terms of loan loss recovery NIBL is not so good so, it is recommended to NIBL to recover there loan by selling the collaterals or doing auctions.
- ) Once of the main objectives to operate joint venture banks i.e. especially Nepal Investment Bank Ltd. is to boost foreign investment. However NIBL does not seem to be successful in this aspect. Therefore, NIBL is recommended to activate himself towards increasing foreign investment in Nepal by means of their wide international banking network.
- ) It will be more informative if bank provide all the detail information in the website. So that if anybody needs information they can visit in the website.
- ) At the time of collecting data's it has been very difficult to get yearly data. Because they count in total. If they maintained to keep record in yearly basis it will be helpful to marketing department of banks.
- ) To make very clear to the customer bank should make transport in service charge and interest rate.
- ) The promotional scheme should be brought according to the changing needs and desire of the customers.
- ) Marketing department must be well trained about the competitors.
- ) Interest rate and service charge should be minimum to as per acceptable by customers.
- ) For the benefits of the bank, they have to offer new schemes in the market.

- ) Should keep update information of the competitors and its product?
- ) This product is applicable within the Kathmandu Valley only must run outside the valley ratio.
- ) For smooth operation of the bank there must be proportional increase or decrease on credit according to deposit, this can be achieved either by discouraging certain deposit or aggressively marketing its loan able funds to existing or potential customers.
- ) To get success in competitive banking environment deposited money must be utilized as loan and advances. The largest side of the bank in assets side is loan and advances. In case of, negligence in administrating, this asset could be the main cause of liquidity crisis on the bank and one of the main reasons of bank's failure.
- ) Through loan and advance to total asset of Nepal Investment Bank Limited is better it seems that is necessary to make more improvement in coming days. Sound and liberal lending policy would help in this regard.
- ) Profitability position of NIBL is much weaker. It is not in almost satisfactory level to avoid the poor profitability pattern. Therefore, NIBL is suggested to improve overall efficiency by investing in appropriate areas after the proper risk analysis and optimum use shares holders' fund.
- ) Activity ratios of the fund raised from the outside appear less satisfactory in NIBL. So, NIBL has a challenge to allocate the deposit in income generating sectors. It will be better for both the banks, especially for NIBL to open the branches in other cities and rural areas in order to find the profitable investment opportunities.
- ) Capital adequacy position revealed weaker in NIBL. Therefore, it is suggested to improve its capital adequacy by investing the assets and deposits in highly returnable sector.
- ) More specially, NIBL suggested to review its overall capital structure and investment portfolio to make better mix in capital structure as well as investment portfolio.

- ) The bank should encourage small, medium and higher level of customers for enjoying deposits, borrowing and other service.
- ) The bank suggested to improve in social responsibility by investing apart of profit on social activities.
- ) Looking at current trend of banking business, a bank must be careful while formulating marketing strategies to serve customers. The marketing strategies should be innovative so that it would attract and retain the customers. It is recommended that NIBL should develop innovative approach t banks marketing for its well being and sustainability in the market upgrade the banking facilities as per the changing need of the customers.
- ) Commercial banks are the profit movie banks, they cannot keep their eyes closed from profit. They should be careful in increasing profit in a real sense to maintain the confidence of share holders, depositors and their customers. So, it is strongly recommended to utilize its risky assets and shareholders's fund to gain highest profit margin.
- ) Though the government securities issued by government are free of risk of default, such securities yield the lowest interest rates of a particular maturity due to low risk feature. So, it is recommended to invest in some profitable sectors like providing loan to developing industries as tourism industry etc.
- ) Portfolio condition of the bank should be examined from time to time and attention should be made to maintain equilibrium in the portfolio condition as far as possible. The bank should make continuous effort to explore new, competitive and high yielding investment opportunities to optimize their investment portfolio. Nepalese commercial banks should invest in different projects, finance developing industries like tourism with the help government, which provides security to them.
- ) The commercial banks should go for some new avenues of investment in consortium like hydro-electricity and infrastructure development of the country etc. This will help in the development of economy as well as bank's operation.

- ) The commercial banks are supposed to boost foreign investment in the country. However, these bank's do not seem to be successful in this aspect. Therefore, all these banks are recommended to activate for increasing foreign investment in Nepal by means of their wide international banking network.
- ) In the context of commercial banks in Nepal, for speedy development of the kingdom. Nepal Government and NRB as well as the commercial banks are suggested to follow decentralization policy and formulate new plans and policies to develop bank's credit operation like formulating policies regarding investments in small scale industries, tourism industry, and hydroelectricity projects. The Nepalese Government should make policies regarding salaries, various types of incentives for the commercial banks to avoid internal corruptions in the banks.
- ) The government before issuing license for the commercial banks should make a market study for the background and reputation of the people establishing a bank, this will help in avoiding the corrupt banking in the country and existing commercial banks will also get benefit from this policies because they do not have to false competition policies launched by the corrupt banks.
- ) In context of commercial banks in Nepal, for the speedy development of the kingdom. Nepal Government and NRB as well as the commercial banks are suggested to follow decentralization policy in order to extend the modern and computerized banking facilities to the remote areas and the lower level people of the kingdom.
- ) Lastly, the financial sector has become full competitive especially in the joint ventures banks. Therefore, the banks should improve and change their servicing and operational behavior and should invite modern technologies accord to the situation. For this purpose, a research department should be built, keeping skilled and efficient manpower. It helps to analyze market of the banks form different dimensions. It also helps in improving management, operation and investment policy.

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Annexure (Questionnaire)

**SUPPLEMENTARY QUESTIONNARE**

**Name of Respondent** : .....

**Position** : .....

**Department** : .....

Please Tick as ( ) on the one more boxes and fill in the blanks as per requirement.

1. Would you please mention the long-range objectives of your organization ?  
.....
2. What are the specific goals targeted for the F/Y 2011/12 ?
  - a) Growth objective ( )
  - b) Return on the capital employed ( )
  - c) Net profit margin on sales ( )
  - d) Total Cash inflow ( )
  - e) Others ..... ( )
3. To what level, planning premises are communicated ?
  - a) From top to lower ( )
  - b) From top to middle ( )
  - c) Top level only ( )
4. Which department has the overall responsibility of profit planning ?  
.....
5. Who evaluates the relevant variables ?
  - a) Budget Committee ( )
  - b) Planning Department ( )
  - c) Top Management ( )
  - d) Consultants ( )
  - e) Others ( )
6. Sales are on :
  - a) Cash ( )
  - b) Credit ( )
  - c) Both ( )

7. If there are credit sales, what is the average collection period ?  
 .....
8. What pricing method has been accepted ?
- a) Cost-Plus pricing ( )
  - b) Marginal Cost Pricing ( )
  - c) Subsidized pricing ( )
9. What is the activity measurement base ?
- a) Production unit ( )
  - b) Sales unit ( )
  - c) Sales (Rs.) ( )
  - d) Others ( )
10. What evaluation criteria are used to evaluated major capital expenditures ?
- a) Net present value ( )
  - b) Internal rate of return ( )
  - c) Payback period ( )
  - d) Average rate of return ( )
  - e) Others ( )
11. How are the excess funds utilized ?
- a) Bank deposit ( )
  - b) Purchasing Securities ( )
  - c) Purchasing Government Treasury ( )
  - d) Others ( )
12. Would you please, mention the name of items related to fixed and variable expenses?
- | <u>Fixed Expenses</u> | <u>Variables Expenses</u> |
|-----------------------|---------------------------|
| a) .....              | a) .....                  |
| b) .....              | b) .....                  |
| c) .....              | c) .....                  |

13. What are the tools used to measure performance ?
- a) Ratio analysis ( )
  - b) Variance analysis ( )
  - c) Flexible Budget ( )
  - d) Others ( )
14. Would you please highlight in brief, the basic problem faced by your organization in formulating and implementing profit plans ?
- .....
15. What impact do you feel from interference of the Nepal Government ?
- .....
16. What major steps should be taken to improve the profit planning system in your organization ? Would you please state briefly ?
- .....

**Calculation of Correlation Between Deposit and Loans & Advances**

(Rs. In Million)

Fiscal Year	Deposit (X) (Rs.)	dx = X- 41,174.14	dx <sup>2</sup>	Loan and Advances (Y) (Rs.)	dy = Y- 32,990.54	dy <sup>2</sup>
2006/2007	24,488.90	-16,685.24	278,397,233.86	17,760.10	-15230.44	231,966,302.59
2007/2008	34,451.70	-6,722.44	45,191,199.55	27,529.31	-5461.23	29,825,033.11
2008/2009	46,698.00	5,523.86	30,513,029.30	36,827.16	3836.62	14,719,653.02
2009/2010	50,094.00	8,919.86	79,563,902.42	40,948.44	7957.9	63,328,172.41
2010/2011	50,138.10	8,963.96	80,352,578.88	41,887.69	8897.15	79,159,278.12
<b>Total</b>	<b>205,870.70</b>	<b>0.00</b>	<b>514,017,944.01</b>	<b>164,952.70</b>	<b>0.00</b>	<b>418,998,439.26</b>

X mean = 41,174.14

Y mean = 32,990.54

Now, We have

N = 5

dx = 0

dx<sup>2</sup> = 514017944.012

dx \* dy = 462766340.068

dy = 0

dy<sup>2</sup> = 418998439.2634

Correlation of coefficient can be calculated by following formula,

$$r = \frac{N \sum dx * dy - (\sum dx) (\sum dy)}{[\sum dx^2 - (\sum dx)^2 / N] [\sum dy^2 - (\sum dy)^2 / N]}$$

$$r = \frac{5(462766340.068) - 0*0}{[5*514017944.012 - 0] [5*418998439.2634 - 0]}$$

$$r = \frac{2,313,831,700.34}{50696.05 * 45771.08}$$

r =	0.9972
r <sup>2</sup> =	0.9944

P. Er. = 0.6745 x (1-r<sup>2</sup> / N)

P.Er. = 0.6745 x (1-0.9944) / 2.2361

P.Er. = 0.0017

6 P.Er. = 6 x 0.0017

6 P.Er. = 0.0102