CHAPTER - I

INTRODUCTION

1.1General Background of Nepalese Economy

Nepal is situated in the east of the globe and south of Asia continent. It is a landlocked country surrounded by two largest countries of the world, China to the North and India to the remaining directions. Therefore, the nearest sea port is located at Bay of Bengal, 1,126 km far from the country through India, which has greatly hindered foreign trade of the country. Nepal is the steepest country in the world descends from the height of Mount Everest (8,848 m) to the lowest point of Nepal i.e. Musharnia of Dhanusa District, (59 m) and the deepest valley of the world, Arun Valley. It has total area 147181 sq.km extended from East to west with a length 885 km and with an average of 193 km from North to South. Total area of Nepal is about 0.3 percent of Asia and 0.3 percent of whole world. Nepal is divided into three regions on the basis of physical features, namely Himalayan Regions covering 15% area of the country with 7.39% population and Hilly region covering 68% of total area with 44.5% population and Terai region with 17% area with 44.3% population. However, population of Himalayan and Hilly regions is in decreasing trend and Terai region is in increasing trend, due to internal conflict and security, lack of physical infrastructure, education, transportation, market as well as scarcity of agricultural land. 15% of total population stays in urban area and remaining at remote area. Literacy rate is about 54% in Nepal. Most of the people on average 79.91% population engaged in agriculture and 20.09% population engaged in industrial and service sector. *(NBL Sr. Assistant Digdarshan 2062).*

Though Nepal is gifted by natural beauties, it is one of the developing countries of the world. According to CBS report 2007, per capita income is US$383 only, which is very low in comparison to other south Asian countries. Nepal has an agro-based economy; most of the people are engaged in agriculture. This sector contributes about 40%-44% of GDP and remaining from non-agriculture. The main reason for its agro- based economy is attributed to its geographical sitting where a major portion of the country is composed of hills and Terai (plain land) very suitable for agriculture. The other reason is due to its low literacy rate, which has restricted people to primitive and traditional form of occupation. About 32%of total population lives below absolute poverty line. Since per capita income, saving and capital formation is very low; the living standard of people is in decreasing trend.

The real agriculture GDP, one of the key sectors for Nepali economy is expected to record a growth of 65 for 2007/08. The growth in real agricultural GDP was 0.7% in 2006/07 according to the current macroeconomic situation based on first nine month (Q_3) data of fiscal year. The agriculture growth could push the GDP to 4%. Based on the performance of agriculture inch trial tourism and other service sector, the overall real GDP is expected to lower about 4% in 2007/08. The real GDP growth was 2.5% in 2006/07 *(The Himalayan Times, Wednesday July, 2008).*

How the characteristics of Nepalese economy can be summed up as follows:

- Mass Poverty
- Dependence on agriculture
- Under utilization of natural resources
- Unfavorable foreign trade
- Dual economy
- Unemployment and disguised unemployment
- Low level of saving &investment
- Dependence on foreign aid

- Mixed economy
- High population growth
- Land locked country
- So no cultural features
- Lack of technical
- Lack of entrepreneurship

  (NBL Sr. Assistant Digdarshan 2062)

1.2 General Concept of Banking

Though there is much controversy as to the origin of the words ‘Bank’; some believe that it originated from the Latin word ‘bancs’ means a bench. Similarly some believe that it originated from the France word ‘Benque’ and some to Italian word ‘Banca’, all meaning bench. Some have stronger belief that it originated from the German word ‘Banck’ meaning collective fund. Ancient money dealer used to deal on a bench. Sometimes when the dealer failed to meet the depositors clam, the depositor used to break the dealer bench from which the word ‘Bankruptcy’ seems to be derived.

Thus a bank is an organization, the major function of which is to deal in money and credit. The main business of a bank is to pool the scattered idle deposit from the public and channel it for productive use through needy parties

As per R.S. Sayers “A Bank is an institution whose whole debts are widely accepted in settlement of other people’s debits.”

As per Kent, “A Bank is an organization whose principal operations are concerned with the accumulation of the temporally idle money of the general public for the purpose of evincing to other for expenditure.”

As per Crowther, “The lenders business is to take the debts of other people to offer his own in exchange and thereby create money” *(Shrestha, Madhu Sundar, 2007).*

As per Prof. Kenly, “Bank is an establishment which makes to individuals such advances of money as may be required and safely made to and to which individuals interest money when not required by them for use.”

1.3 Development of Banking Sector in Nepal

It is assumed that the regular history of coinage in Nepal began from the 5th century A.D. The advent of 12th century marked on new period in economic history of Nepal. Silver coinage was introduced in this period, which widened the scope for trade. The second major logical order of development was found in the innovation of interest bearing private debt such as bonds, mortgages, and loans.

In the year 1879/80 A.D, a low cast merchant named “Sankhadhar Sakhwa’’ introduced a new era offer paying all the debts that exist in country. The term “Tanka Dhari” meaning “money dealer” was used at the end of the 14th century. “Tanka Dhari” was one of the 64 casts classified on the basis of occupation by King Jaystithi Malla indicating money changing was adopted as profession. At that time for many years, the indigenous individuals, wealthy agriculturists, landlords merchant and traders conducted some banking activities as a side business to their normal business activities.

In 1877 A.D, Prime Minister Ranodeep Singh introduced many financial and economic reforms. The ‘Tejarath Adda’ was established at that time. The basic purpose of establishing this “Tejarath Adda” was to provide credit facilities to the general public at a very concessional interest rate. The ‘Tejarath Adda’ disbursed credit to the people on the basis of collateral of gold and silver. All employees of government were also eligible for this type of loan, which was settled by deducting from this salary. Under the Prime Minister ship Chandra Shamsher, Tejarath Adda extended its services outside the Kathmandu Valley. Legal provision was made to prevent the practice of capitalization of interest on loans extended by private dealers. Hence, the establishment of Tejarath Adda is regarded as the foundation of modern banking in Nepal. However, 'Kaushi Toshakhana' established during the regime of King Prithivi Narayan Shah is also consider as the first step towards initiating banking development in Nepal.

Tejarath Adda extended credit only, it did not accept deposits from the public and utilize. Hence, the Adda finally faced financial crisis making it impossible to meet the credit need of the general population of the country.

Prior to the establishment of Nepal Bank limited, people relied on borrowings from the corrupt money lenders, who charged very high interest rate and added other charge. These money lender extended loan on the collateral of land house and precious ornament.

With the co-operation of Imperial Bank of India, Nepal Bank Ltd came into existence under the Nepal Bank Act 1937. The preamble of the Nepal Bank Act 1937 states the objectives of setting up the Nepal Bank Ltd. as follows:

"In the absence of any bank in Nepal, the economic progress of the country was being hampered and casing inconvenience to the people and therefore, with the objectives of fulfilling that need by providing services for the people and for the betterment of the country this law is here lay promulgated for the establishment of the bank and its operation."

Nepal Bank Ltd. played dual role of a commercial bank and a central bank. Until the establishment of NRB on 26th April, 1956, it carried all the functions of a central bank. NBL was a semi government bank so it was unwilling to go to many sectors where the government felt the need of providing banking services. Hence, RBB a fully government owned bank was established on 23rd January 1966.

Until 1984, the Nepalese financial sector were dominated by the above two commercial banks. Commercial Bank Act 1974 was amended in 1984 to increase competition among commercial banks. Hence provision was made to allow private sectors including foreign investments to open commercial banks. As a result, Nepal Arab Bank Ltd. (now Nabil Bank) was established on July12, 1984 with the partnership of Dubai Bank Ltd. Then, on 27 February 1986 Nepal Grindlays Bank (now Standard Chartered Bank Nepal Ltd.) were established. The numbers of commercial Banks operating in the country are increasing everyday and many more are in the pipeline to commerce their business.

Before 1985, only public enterprises such as two development banks; NIDC and ADB and in the form of non-bank financial institution; Employee Provident Fund and National Insurance Corporation were established. So to increase the financial activities of the country, Finance company Act 1985 was introduced which prompted people to established many financial institution in the country *(Shrestha, Madhu Sundar, 2007:2,3)*.

1.4 Meaning Of Commercial Banks

Generally bank refers to a commercial bank at present. Banks undertaking business with the objective of earning profits are commercial banks. Commercial banks pool scattered fund and channel it to productive use. Commercial banks are those banks which performs all kind of banking functions such as accepting deposits, advancing loan, credit creation, agency function etc. They provide short term, medium term and long term credit for trade and industry. They also operate off-balance sheet function such as issuing guarantee bonds, LC etc.

Commercial Bank Act 1974, defines a commercial bank: "A commercial banks mean bank which deals in exchanging currency, accepting deposits, giving loans and doing commercial transactions."

Without the developing of sound commercial banking, under developed countries cannot hope to join the rank of advance countries. If industrial development requires the use of capital, then it will not be possible without the existence of the banks to provide the necessary capital. Industrial development will not be possible without the existence of markets of the goods produced. On the other hand, the services of the commercial banks will help to extend the markets.

The commercial banks play an important role for business expansions, for encouragement for the right type of trade and industrial and for transfer of surplus funds to needy regions.

However, the functions of commercial banks can be summed up as follows:

Primary Functions

- Collect deposits in various types of accounts.
- Provide credit in the forms of various loans.
- Remit fund.

Subsidiary Functions

- Invest in government security, treasury bills.
- Deal in foreign exchange
- Provide agency functions such as collection of bills, cheques, promissory notes etc.
- Executive standing instructions such as payment of rent, insurance premium, income tax etc. on behalf of their customers.

- Involved in collections of dividend and interest on shares and debentures.
- Purchase or sale of securities.
- Act as trustee when so nominated.
- Act as customer's correspondent of representative in dealing with other banks.
- Underwrite shares floated by government bodies and public bodies.
- Supply trade information and statistical data.
- Involve in LC and guarantee issuance, purchase or sale of TC and Circular notes etc.
- Act as a referee with regards to the financial status of the customers.

  (Madhu Sundar Shrestha, 2007:32-33)

1.4.1 Commercial Banks Operating in the Country

Along with the increment of financial transactions in the country, numbers of commercial banks are also increasing. The commercial banks operating in the country are as follows:

- Nepal Bank Ltd
- Rastriya Banijya Bank
- Nabil Bank
- Agricultural Development Bank
- Nepal Investment Bank
- Standard Chartered Bank Nepal
- Himalayan Bank Ltd
- Nepal SBI Bank
- Nepal Bangladesh Bank
- Everest Bank Ltd
- Bank of Kathmandu
- Nepal Credit and Commerce Bank

- Lumbini Bank Ltd
- Nepal Industrial and Commercial Bank
- Machhapuchhre Bank Ltd
- Kumari Bank Ltd
- Laxmi Bank Ltd
- Siddhartha Bank Ltd
- Global Bank Ltd
- Citizens Bank International Ltd
- Sunrise Bank Ltd
- Prime Commercial Bank
- Bank of Asia
- DCBL Bank Ltd.
- NMB Bank Ltd

1.5 Profile of the Bank Under Study

Kumari Bank Ltd. is the bank which is taken as a sample bank for this research purpose.

1.5.1 Introduction of KBL

KBL is the 15th commercial bank of the nation which was established on 10th December1999. The bank started its operation only from 3rd April 2001. The bank has an authorized capital of Rs. 1 billion and paid up capital of Rs 750 million till the end of FY 2063/64. The promoters of the bank hold 70% while the general public has subscribed to 30% of the shares. The registered head office of the bank is in Putalisadak. At present the corporate office has been shifted to Durbar Marg.

1.5.2 Mission Statement, Mission and Vision of the Bank

Mission Statement

"We shall be the preferred provider of financial services to our target clients by embracing good governance, service excellence and professional culture in order to achieve sound business growth and maximize shareholder value."

Mission

- Provide world class service to our customers at a higher satisfaction level.
- Practice total quality management and embrace good governance.
- Optimize our asset to achieve sound business growth.

Our mission as listed above provides us a source of direction to mobilize and integrate our diverse human resources for excellent delivery of services and products by practicing good governance.

Vision

- We are customer oriented. Client is always our first priority.
- Employees have direct input and control over work processes.
- Employees are treated equitably with respect and good faith.
- We are transparent in our dealings and conduct.

For this we identify the core purpose and value of our business. Our traits hold true, when it comes to customer orientation, concern for people and value creation superior services, innovation and fostering accountability besides team sprit, integrity, thrive to achieve success and professionalism. We recognize our customer need, a better working environment for our employees and strategies we need to implement to strategies the organization goal.

1.5.3 Products and Services Offered by KBL

KBL in a short period of time has been successful in positioning itself as one of the preferred providers of complete financial services in Nepal.

Embracing the latest IT services, the bank has been able to deliver various innovative products and services. New produces and services are being continuously assessed to meet customer’s expectation. Beside traditional bank services, new product and services that are currently being offered are:

VISA Electron Debit Cards

Enables withdraw of cash, payment for goods and services at any VISA accepted ATMs and POS within Nepal and India. Dollar VISA debit card is accepted globally.

Internet Banking

Access to easy banking from any corner of the world. However, it is to be notify that KBL is the first bank to introduce internet banking in Nepal

SMS Banking

Updated account balance at any time on fingertips.

E-Pay

Payment from home for purchase of goods and services, utility bill payment.

Super Saving Accounts

Besides normal savings in LCY and FCY, KBL offers attractive interest rate and other personalized services in super saving account. Saving Plus and Advantage Plus are two types of accounts under super saving accounts.

Retail Loan

KBL provides loans to match personal requirements such as auto loan, home loan, education loan, personal loan etc.

ABBS

The bank is proving any branch banking services (ABBS) from its 12 branches located in different part of the country. The locations are within Kathmandu valley are Putalisadak, Newroad, Gongabu and Kumaripati Lalitpur and cooperate office at Durbarmarg Kathmandu. Outside valley at Pokhara, Narayangarh, Birjung, Dryport, Biratnagar, Itahari, Birtamod and extension counter at National Medical Collage.

Remittance Services

KBL is providing remittance services from Qatar, UK, Israel and Malaysia now. In near future, it is also providing remittance services from Saudi Arabia, Bahrain, Oman and Korea. KBL has launched its own online remit ‘Kumai Remit’ so that customers can remit money in easy, simple and at low cost. It is providing remittance services from all its branches and more than two hundred eighty agents.

1.5.4 Innovations of KBL

- **Internet Banking**

KBL is the first commercial bank in the country to provide ‘internet banking service’ to its customers. The service has allowed the bank to streamline the services it offers to customers. It allows the customers the flexibility to take control of banking activities via the internet. Further, it has enabled their core customers to transact with them from any corner of the world and made job simpler.

- **Mobile Banking**

KBL takes pride to be the first bank in the history of Nepal to start a mobile banking service. The bank has facilitated this service to their customers with the sole objective of being an additional channel with a crucial role of responding to customers’ enquiries and transactional information via SMS messaging.

- **Auto Sweep**

KBL introduced a revolutionary concept for the first time in Nepal with a growth option to the checking account holder of transferring their excess balance to Time/Call deposit account.

1.6 Statement of the Problem

Profit is the life blood of any business organization. Success in not a matter of chance. Profit does not just happen, it has to be plan and manage properly. Profit is the most for a bank to survive in the competitive market. Banks have been globalizing with their services and the technology has knocked to the worldwide net working of the banking. Banks can generate revenues by rendering banking and non-banking services. Today banks have emerged many trustee and agency roles, off balance sheet transactions and other near bank services by which banks have minimized the risk and gained fees and commission. The fee based income compromise a major source of profit.

Since, the study is focused on revenue management and its impact on profitability, the study deals with following issues.

- Does KBL have appropriate profit planning system?
- Does the bank mobilize the deposit or other resources at optimum cost to generate adequate revenue?
- Does the bank gives proper attention to non-funded business activities thereby generating satisfactory amount of other income?

1.7 Objectives of the Study

The major objective of the study is to analyze the effectiveness of revenue management and its impact on profitability of the bank. To achieve this objective, side by side other objectives have to be set such as:

- To evaluate the soundness of the profitability and operating efficiency of the bank.

- To study and analyze revenue i.e. fund based income and fee based income by proper utilization of resources.
- To evaluate cost of deposits of the bank with regards to the profitability.
- To provide suitable suggestions and recommend to take proper action to increase profitability of the bank.

1.8 Significance of the Study

The research study is concerned with the revenue management and its impact on profitability of commercial bank with the major objective of examining the proper applicability of profit planning system of the bank. So certainly the reference bank will be benefited from this study; as well as other commercial bank also can take advantage from this study. This study aims to find out the current situation and tendency of profitability through revenue management, so there may be various parties, from stockholders to stakeholders, general public to government bodies, employees of the bank to research students and foremost the esteemed customers who may be seeking financial information for the interpretation of their own. All these parties can be benefited from this study to take right decision. The management of the bank will be provided information from this study to take corrective action, the shareholders can take right decision to make investment, the employees of the bank will be familiar with the profitability position of the bank, general public and customers can take decision to transact with the bank, importance to government bodies of policy makers such as the central bank. And the research students can take this study as a reference for their study.

1.9 Limitations of the Study

Although the researcher has tried utmost care to cover most of the important sector, the study is still subject to following limitations:

- The study is basically based on secondary data.

- The study is only with KBL, so this study may not be fully applicable to all commercial banks.
- The study is based on the data of 6 years from 2001/02 to 2006/07 and conclusion drawn confines only to the above period.
- The study is analyzed only with the help of financial tools and very few statistical tools.
- The study is focused on revenue management and it impacts on profitability of the bank leaving other areas uncovered.

The study is made for partial fulfillment of the requirements of Masters of Business Study.

1.10 Organization of the Study

The study covers the following five chapters.

Chapter -I Introduction

This chapter includes general background of Nepalese economy, general concept of banking, development of banking sector in Nepal, meaning of commercial bank and total number of commercial banks operating in the country, profile of the bank under study, statement of problem, objective of the study, significance of the study, limitations of the study and organization of the study.

Chapter -II Conceptual Framework and Review of Literature

This chapter includes conceptual framework and review of related studies.

Chapter- III Research Methodology

This chapter includes research design, data collection and methods of analysis and research variables.

Chapter- IV Data Presentation and Analysis

This chapter includes data presentation, analysis and their interpretation. Major findings are also included in this chapter.

Chapter- V Summary, Conclusions and Recommendations

This chapter includes summary of the whole study, its conclusion and major recommendations.

CHAPTER - II

REVIEW OF LITERATURE

This chapter is basically concerned with the conceptual framework with relevant terminologies and review of literature.

This chapter is divided into two parts; one is conceptual framework and the other is review of literature. In conceptual framework, the relevant terminologies regarding profit and profitability, profit planning and control process, budgeting and other financials terms of commercial financial institutions are studied. However, there are some core concepts and specific terminologies used in the financials of commercial banks that may be used in the specific sense and practice in the banking sector. In review of literature, the past researches and studies are reviewed in order to set the foundation of the study. Because every study is very much based on past knowledge, study and experiences. The past knowledge or the previous studies should not be ignored as it provides the basis for the present study. Review of literature is a way to discover what other researches in the area of stated problem has uncovered. It helps to minimize the costly effort and reveals areas of needed research. It enables the researcher to know about what research has been done in the subject, what techniques and tools have been advanced by the former researcher and so on. Thus, this chapter helps as adequate feedback to broaden the information and to support the inputs of the study. Therefore, the review of literature has its own importance.

2.1 Conceptual Framework with Relevant Terminologies

2.1.1 Profit Planning and Control (PPC)

Profit planning and control is an important approach, mainly in profit oriented enterprises. Profit planning is merely a tool of management. It is not an end of management or substitute of management. It facilitates the managers to accomplish managerial goals in a systematic way. Profit planning and control is composed of profit, planning and control. To get the meaning of PPC as a whole, we go through them individually.

2.1.1.1 Profit

Profit is the ultimate goal of every business entities. They involve in business for making profit. Profit cannot be achieved easily. It should be managed well with better managerial skills. So profit is the planned and controlled output of management. Continuity in proper managerial manipulation of outflows and inflows can secure the generation of profit. By element, profit is the difference of revenue and cost. Profit plan, thus, refers to the planning of revenue (i.e. increase the revenue) and planning of cost (i.e. increase the efficiency of cost).

There are different views regarding the definition of profit. In accounting context, profit denotes the excess of out flow (revenue factors) over the inflows (cash factor). The essential inflows are people, capital and material, methods and they are generally cost incurring factors. On the other hand, the planned outflows are products, services and social contribution that the enterprises generate. The planned outflows, products & services, are generally revenue generating factors. The excess of enterprises revenue earned over its cost spent for producing revenue within a definite accounting period is called profit. In other sense, return on investment is profit. In economic context, economists have propounded several theories to explain it.

- Theory of risk & uncertainty bearing.
- Dynamic theory of profit.
- Innovation theory of profit.

Theory of Risk & Uncertainty Bearing

It was F.B. Hawley who first developed the theory of risk bearing and concluded that profit is a reward of the entrepreneurs for bearing risks. But, the theory was picked up by Professor F.H.K night who divided risks into insurable and non-insurable risks and concluded that profit is a rewarded for bearing non-insurable risks and uncertainties. Thus, according to Knight Profit is a rewarded of the entrepreneur for his non-transferable function of non-insurable risks and uncertainties.

Dynamic Theory of Profit

This theory was propounded by J.B. Clark. According to this theory, ‘dynamic changes’ in the economy are the basic causes of emergence of profits. There is no profit in a static economy as no changes take place. In a dynamic economy there are constant changes in population, capital, methods of production and industrial set up. These changes multiply wants of consumers, which earn profits to the entrepreneur.

Innovation Theory of Profit

Joseph Schumpeter singled out ‘innovation’ from the dynamic theory of profits and developed the innovation theory of profits. According to Schumpeter changes take place in a dynamic economy and innovation in the changing world gives rises to profits. In his views, the entrepreneur plays an important role of introducing innovation in an economy and profits are the rewards for his role as an innovator. The innovation could be changes or techniques that reduces cost of production or increases demand for the product.

2.1.1.2 Need of Profit

Profit is a most for the following reasons:

1. Measurement of Performance

Profit is only one factor to measure the management efficiency, productivity and performance. Profit is the most widely used yardstick to see what really is to be achieved and where the firm is to go in the future.

2. Premium to Cover Costs of Staying in Business

Business environment is full of risks and uncertainties. To gasp the globally changing technologies, to stay in the market uncertainties, to replace and acquire assets and enhancing business scope etc. require a profit margin.

3. Ensuring Supply of Future Capital

Profit is necessary to plough back in the investments like innovations, business expansion and self-financing. It o attracts investors for further investment.

2.1.1.3 Profit and Profitability of Commercial Banks

Profit is an essential fuel to drive business ahead and survive business effectively, efficiently and economically. No business enterprises can self survive in the absence of profit for long time. That’s why; profit is the prime goal of every type of business enterprises. Unlike any other business organizations, commercial banks also have to survive with the help of profit. Banks incur large administrative expenses in the course of maintaining service efficiency and attractive premises. The daily expenses, the operational expenses, staff expenses, returns to the stakeholders, all are ensured by profit alone.

Profit is earned by the banks largely through financing activities, in the form of loans and advances to the customers, placement in other banks, investment in government securities, non-fund activities like issuing L/C, guarantee etc. Revenue is earned through non-exposure functions by the way of commission and fees, but its contribution in the overall profit remains in the lower side. Hence, banks earns major portion of their income through lending money, which it acquires through various means such as collecting deposits in various accounts, by issuing shares, debentures etc. without profit, bank would not be in a position to meet all the expenses as mentioned above. Hence, profit is the main factor for the existence of a bank.

The majority of the needs of the stakeholders are related with the profitability of banks. For example, in case the banks earn profits, the investors get dividends, employees get bonus, government gets benefits in the forms of taxes etc. Thus, the foremost objective of the banks is the maximization. The major source of funds of the bank is the public deposit. The bank in most of the cases has to pay certain rate of interest to the public if their deposit. Thus, the banks have to mobilize these funds in the profitable sectors, which derive the maximum return on the assets. Hence, the investment or granting of loan and advances by them are highly influenced by profit margin. The profit of the bank is dependent on the interest rate, volume of loan and time period of loan. However, the bank at the same time has to ensure that their investment is safe from default.

Although the banks have to invest in order to earn profits. But, at the same time have to set aside some of its fund in order to maintain their liquidity. As we all know the major source of bank’s fund is public deposits, the bank has to be able to allow the depositors to withdraw their deposit in terms of need. Thus, the bank cannot invest all its funds in the profitable sectors. Thus, a successful bank is one who invests most of its funds in different earning assets standing safely from the problem of liquidity i.e. keeping cash reserves to meet the daily requirements of the depositors. Lower the liquidity, higher the profitability and higher the liquidity, lower the profitability. So, profitability and liquidity maintain a highly negative co-relation. Since both are equally important, banks cannot afford to ignore any of them. So, the management has to make a crucial decision regarding a mixture of liquidity and profitability.

2.1.1.4 Profitability and Liquidity of Commercial Banks

Profitability and liquidity both are equally important to the bank. Liquidity means the capability of the bank to meet the demand on the customer's deposits. Liquidity is the status and part of the assets which can be used to meet the obligation. The degree of liquidity depends upon the relationship between cash assets plus those assets which can be quickly turned into cash and the liability awaiting payment. Banks maintain liquidity in various forms like ready cash at its disposal, certain percentage at Central Bank (NRB) as a statutory requirement, makes placements in other banks and some percentage is utilized in investment on government securities.

Banks pay the depositors their money when demanded, and if this is not met, it damages the banks image. The confidence of the public will be lost and this leads the bank towards its downfall. So, banks should not invest all the money it has on exposure based assets only, as it will not be repaid when required. Therefore, banks keep a certain percentage o their fund on such assets that can be utilized as need arises, which is known as liquid assets.

As per Manning Decay, "An asset is completely liquid, if its owner can count with absolute certainty on turning it into cash at a very short notice and without loss." This means, the asset should be easily converted into cash at a short notice without any loss.

Banks have to maintain liquidity to meet the depositors claim. For this, they have to maintain sufficient fund in liquid assets. Funds invested only in government securities and other liquid assets do not earn sufficient income to meet all its expenditure. Banks have to pay a large amount as interest to its depositors and have to spend a lot of amount in its daily operational activities. To meet such expenses, banks have to invest in assets that generate maximum revenue. However, banks cannot lend all the money in possession with it, on assets like loans and advances, which generate optimum revenue.

Hence, a balance of assets must be stroked to ensure both profitability and liquidity. These paradoxical principles of liquidity and profitability are reconciled to the maximum benefits of the bank. In order to avoid difficulty in meeting the various commitments, (depositor's claim, payment of redeemable preference shares and debentures, regular interest payment etc), bankers strike a balance by arranging their assets in different proportions of liquidity and profitability *(Shrestha, Madhu Sundar, 2007:205)*.

2.1.1.5 Planning

Planning is the first essence of management and all other function are performed within the framework of planning. Planning is the cornerstone of effective management. Planning starts with forecasting and predetermination of further events. Planning consists in setting goals for the firm both immediate and long range, considering the various means by which such goals may be achieved, and deciding which of any available alternative, means would be best suited to the attainment of the goals sought under the conditions expected to prevail. Planning is deciding in advance what to do, how to do it, when to do it and who is to do it. It provides the ends to be achieved.

Planning is the process of developing enterprises objectives and selecting a future course of action to accomplish them. It includes:-

- Establishing enterprise objective and goals,
- Developing premises about the environment in which they are to be accomplished,
- Selecting a course of action for accomplishing the objectives,
- Initiating activities necessary to translate plans into an action, and
- Current re-planning to correct current deficiencies.

Management planning involves uncertainty and reliable forecast can help reduce the uncertainty in planning. Planning is the first function of management and is performed continuously because the passage of time demands both re-planning and making new plans. Management planning provides the basis for performing the four other functions.

Strategic and functional, Short range and long range formal and informal, adhoc and standing planning, administrative and operational planning are the various types of managerial planning. Mainly two types of planning i.e. strategic and Tactical is the prime aspects in planning of profit planning and control.

2.1.1.6 Control

Control is a function in the management process and one of the prime parts of profit planning and control. As with planning, controlling is performed continuously. Therefore, there is a control process that should be always operating in an enterprise. Controlling can be defined as a process of measuring and evaluating actual performance of each organizational component of an enterprise initiating corrective action when necessary to ensure efficient accomplishment of enterprise objective, goals, policies, and standards. Planning establishes the objective, goals, policies, and standards of an enterprise. Control is excused by using personal evaluation, periodic performance reports and special reports. Another view identifies the types of control as follows:

A. Preliminary Control (Feed Forward)

Used prior to action to ensure that resources and personnel are prepared and to start activities.

B. Concurrent Control (Usually Periodic Performance Reports)

Monitoring (by using personal observation and reports) of current activities to ensure that are being met and policies and procedures are being followed during action.

C. Feedback Control

Expost -action (preplanning) focusing on past results to control future activities. Beside these controls, other types of control are internal and external control, formal and informal control, systematic and adhoc control, activities control, physical and financial control etc.

Planning and control is the base-camp of profit planning and control system.

After defining about profit, planning, and control individually, now, it is going to present holistic theoretical concept of profit planning and control.

2.1.1.7 Meaning of Profit Planning and Control (PPC)

Profit planning and control is a new term in the literature of business, not an end and substitute of management. Though it is a new term, it is not a new concept in management. The other terms which can be used in same context are comprehensive budgeting, managerial budgeting or simply budgeting. The PPC can be defined as process or technique of management that enhances the efficiency of management.

Every enterprise is established with its definite objectives to be achieved. An enterprise is a successful enterprise if its management is efficient to accomplish the objectives of the enterprise. The management is effective, when it accomplishes the objectives with minimum effort and cost. In order to attain long-range efficiency and effectiveness, management must chart out its course of action in advance. A systematic approach that facilitates effective management performance is profit planning and control, or budgeting. Budgeting is therefore an integral part of management. In a way, budgetary control system has been described as a historical combination of a goal-setting machine for increasing an enterprises profit, and “goal-achieving, machine for facilitating organizational co-ordination and planning while achieving the budgeted targets.”

Some definitions given by various scholars are as follow:
According to Glen A. welsh, “Comprehensive profit planning and control is a systematic and formalized approach for accomplishing the planning, co-ordination and control responsibilities of management”.

According to R.M. Lynch and R.W. Williamson, “The concept of a comprehensive budget covers its use in planning, organizing and controlling all the financial and operating activities of the firm in the forth coming period”.

According to I.M. Pandey, “A profit plan or budget is the formal expression of the enterprise plans and objectives stated in financial terms for a specified future period of time”.

Profit planning and control involves development and application of:

- Broad and long range objectives for the enterprise,
- Specification of goals,
- Long range profit plan in broad terms,
- Tactical short range profit plan detailed by assigned responsibilities(division, department, project),
- A system of periodic performance reports detailed by assigned responsibilities,
- Control system,
- Follow up procedures.

Hence, profit planning and control represents an overall plan of operations, providing guidelines to management and acting as single light for the management. It enables the management to correct its policy. Profit planning and control covers a definite period of time and formulates the planning decision of management *(Goet J, Bhattarai I, Gautam A, 2062:1.1-1.2).*

2.1.1.8 Role of Profit Planning and Control or Budgeting

The role of PPC or budgeting is vital to the success and survival of a business firm. Without a fully coordinated budgeting system, management cannot know the direction the business is taking out. Organizations that do not plan are likely to wonder aimlessly and ultimately succumb to the swirl of current events. The roles of PPC or budgeting are pointed as follows:

- It helps to set definite goals and objectives that serve as benchmarks for evaluating subsequent performance and to show the direction of business.
- It uncovers subsequent bottlenecks before they occur and compels management to plan for the most economical use of labour, material, and capital.

- It compels and motivates management to make an early and timely study of its problems. It generates a sense of caution and case, and adequate study among managers before they makes decisions.
- Profit planning and control co-ordinates the activities of the entire organization by integrating the plans and objectives of the various parts. By doing so, it ensure that the plans and objectives of those parts are consistent with the broad goals of the entire organization.
- It rewards high performance and seeks to correct unfavorable performance.
- It provides a valuable means of controlling income and expenditure of a business, as it is a plan for spending.
- It provides a tool through which managerial policies and goals are periodically evaluated, tested and established as guidelines for the entire organization.
- It reveals weakness, inefficiencies and deviation in the organization very promptly which can be checked immediately to achieve a desired goal.
- It develops an attitude of cost consciousness, stimulates the effective use of resources, and creates an environment of profit conscious through out the organization. It emphasizes how much should be spent to achieve a goal.
- It provides norms, basis or yardstick for measuring performance of departments and individuals working in organizations. Individual managers can evaluate their own decisions and achievements and take suitable steps to improve their performance.
- It encourages productive competition, provides incentives to perform efficiently and gives sense of purpose to achieve individuals in organization. All these positive factors lend to higher output and increase employee’s productivity.

- It helps one to distinguish between actual needs and wants. It enables the management to lay down an order of priorities and reflects some planning of long and short-term requirement in a business.
- As decentralization of responsibility is a feature of profit planning, each manager works critically in his own area of responsibility. Profit planning thus fixes the responsibility center for manager.
- It also promotes understanding among members of management on their co-workers' problems.
- It tends to remove the cloud of uncertainty that exists in many firms, especially among lower level of management, relatively to basic policies and enterprise objectives.

Thus the well organized profit planning and control programs enable the management to maintain a level of profits, which will ensures the existence of the business and the fulfillment of management responsibilities *(Goet J, Bhattarai I, Gautam A, 2062:1.2-1.3).*

2.1.1.9 Fundamental of Profit Planning and Control

The concept of budgeting was originally established with the function of an accountant. At its origin, the function of budgeting was assigned to the accountant. But in modern day budgeting is given much more importance and is regarded as a way of management and in more important sense as a basic technique of decision-making and is given the name "profit panning and control program".

Managerial Involvement and Commitment

Managerial involvement entails managerial support, confidence, participation, and performance orientation. In order to engage competently in comprehensive profit planning and control, all levels of management, especially top management, must (1) understand the nature and characteristics of profit planning and control, (2) be convinced that this particular approach to managing is to devote the effort required to make it operative, (3) support the programme in all its planning process as performance commitments. For a comprehensive profit planning and control programme each member of management, starting from the president, the impetus and direction must come from the very top.

Organizational Adaptation

A profit planning and control programme must rest upon sound organizational structure for the enterprise and a clear-cut designation of lines of authorities and responsibilities. The purpose of organizational structure and the assignment of authority are to establish a framework within which enterprise objectives may be attained in a coordinated and effective way on a continuing basis. The scope and interrelation-ship of the responsibilities of each individual manager are specified. To increase management and operational efficiency, particularly all enterprises, except perhaps the very smallest ones, should be structurally disaggregated into organizational subunits. The manager of each subunit would be assigned specific authority and responsibility for the operational activities of that subunit. These subunits are often referred to as decision centers or responsibility centers. Responsibility centers are further classified in respect to the extent of responsibility as follows:

1. Cost center
2. Profit center
3. Investment center

Responsibility Accounting

In order to set-up profit planning and control on a sound basis, there must be a responsibility accounting system, that is, one tailored first and foremost to the organizational responsibilities. Within this primary accounting structure, secondary classification of costs, revenues, and other financial data that are relevant may be utilized in accordance with the needs of the enterprise. A responsibility accounting system can be designed and implemented on a relevant basis regardless of the other features of the accounting systems standard cost systems, direct costing system, and so on. When the accounting system is established on a responsibility basis, the historical data generated become especially pertinent for planning and control purpose.

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 of dialogue, message or understanding from working together. Although, the management gives least importance to communication, it is most important thing for any organizational observation and control. Most of the organizations face lot of problems due to bad communication system. Communication is needed for both the feed forward and feed backward process, which is most important for operation of any organization. Role of communication can be justified in all aspect of management. It is needed either for decision-making or for supervision or for evaluation. Flows of information must be adequate in all side (downward, upward and laterally).

For profit planning and control, effective communications means development of well-defined objective, specification of goals, development of profit plans and reporting and follow up activities related to performance evaluation for each responsibility center. Communication for effective planning and control requires same understanding of responsibilities and goals in both the executives and subordinates.

Realistic Expectation

Profit planning and control must be based on realistic approach or estimation. Management must use realistic assumption and must not take either irrational optimism or unnecessary conservatism.

Perfection on setting goal or objectives of the future sales, production levels, costs, capital expenditures, cash flow and so on determines the success of profit planning and control programme. So, for profit planning and control purpose, a realistic approach reared with time dimension and external environment that will prevail during the time span should be considered. This is called realistic expectation.

Before preparing comprehensive profit planning and control programme, management has to take a good care that the goal or objective which is going to be determine neither should be too low nor should be too high but should be attainable with high level of efficiency. This is because goals set very low will destroy motivation as it does not require efforts and goal set high will discourage the implementer as it would not be attained with existing capacity of the units, but the goal which will be of challenging nature, will be of real value and will keep the organization alert which is the main objective of the realistic expectation.

Flexible Application

Profit planning and control programme or any other management techniques should not dominate slowly. Any of such techniques of management must not be flexible or rigid. These are the techniques or means, which is not only the end of management itself because the main end or aim of the management is to use the resources in the most effective way earn high return on investment and for this purpose profit planning and control or other techniques are used as means only.

Timeless

Whether an individual or an entity remains idle or busy, time passes at the same rate. The problem of the manager in one hand is to accomplish the planned activities in a given time and on other hand is to prepare the plan itself. Phasing of the planning is of two types: one is (a) timing of planning horizons and (b) timing of planning activities.

Planning horizons is the time for which planning is done or we can call it life span of the plan. For any enterprise, there used to be many planning horizons to maintain the continuity of planning activities. The decision made by the manager for future activities reflects the managerial planning. In other words, managerial decision, which reflects planning activities, always effects on future activities only. It does not have any effects on present or past. Major decision should be made on the basis of adequate supporting study, analysis, evaluation, and consolation.

For effective implementation of planning, management of an enterprise must establish a definite time dimension for each activity. In other word, for each activity related with planning would be given definite time for implementation, followed by other activities. This is called planning activities.

From the view point of time dimension, a manager should maintain clear-cut distinction between historical and future consideration. Because the result derived from historical activities should be consider as platform for deciding plan.

Individual and Group Recognition

Behavioral aspects of human being are of the field of study of the psychologist, educators and business man, and finding was that can be so many unknown misconception and speculations which has to be considered for an efficient management. A good and dynamic leadership can resolve this problem by integrating all the group efforts for betterment of the organization. This fact also has been well considered under profit planning and control approach and focuses have been given to resolve the behavioral problems.

Follow up

The importance of follow up on action on profit planning and control approach is more. Follow up action after a careful study is needed to:

- Correct the action of substandard performance in a constructive manner.

To recognize and transfer the knowledge of outstanding performance to others and based on the study and evaluation to provide a sound basis for future profit planning and control program. *(Goet, J., Bhattarai, I. and Gautam, A., 2062:1.4, 1.5, 1.6)*

2.1.1.10 Purpose of Profit Planning and Control

A comprehensive profit planning and controlling is a systematic and formularized approach for stating and communicating the firm's expectation and accomplishing management in such a way to maximize the use of a profit plan and to achieve the maximum benefit from the resources available to an organization over a particular span of time. It serves as a tool for management control. The maximum objective of profit planning and control is to assist in systematic planning and in controlling the operations of the enterprise. In fact, it is the best sources of communication and an important tool in the hand of management. The purpose of budgeting or profit planning and control may be summarized as follows:

- To state the firm's expectation (goal) in formal terms clearly to avoid confusion and facilitates their attainability.
- To communicate expectation to all concerned with the management to the firm so that they are understood, supported and implemented.
- To provide a detailed plan of action for reducing uncertainty and for its proper direction of individual and group efforts to achieve goals.

- To co-ordinate the activities and efforts in such a way that the use of resources is maximized.

To provide a means of measuring and controlling the performance of individuals and units and to supply information based on which the corrective action can be taken *(Goet, J., Bhattarai, I., & Gautam, A., 2062:1.6).*

2.1.1.11 Time Factor on Profit Planning and Control

Whether an individual or an entity is idle or busy, time passes at the same rate. We selfdom, if ever, have time to do many things that we would like to do, nor do we have time to do many things as much as we would like. The problem of the manager in one hand is to accomplish the planned activities in a given time and on the other hand is to prepare the plan itself. Thus, the planning function often suffers. Two important timing issues require careful attention if the planning function is to be carried out effectively. Among these timing issues, one relates to the concept of a planning horizon, and the other relates to the timing of planning activities.

Planning Horizon

Planning horizon refers to the period of time into the future for which management should plan. We can call it life span of the plan. For all enterprise, many planning horizons are needed to maintain the continuity of planning activities. The decision made by the manager for future activities reflects the managerial planning. In other words, managerial decision, which reflects planning activities, always effects on future activities only. It does not have any effects on present or past. Major decision should be made on adequate supporting study, analysis, evaluation and consolation.

Timing of Planning Activities

For effective implementation of planning, management of an enterprise must establish a definite time dimension types of activities. In other word, for each activity related with planning would be given definite time for implementation followed by other activities. This is called planning activities. From the view point of time dimension, a manager should maintain clear-cut distinction between historical and futuristic consideration. Because the result derived from historical activities should be considered as platform for deciding plan *(Goet, J., Bhattarai, I., & Gautam, A., 2062:1.3).*

2.1.1.12 Limitation of Profit Planning and Control

Profit planning and control is an important tool for management. However, each tool suffers some limitation and its use is fruitful within these limits. Profit planning and control is also not a limitless tool, so it is essential that the user of profit planning and control must be having a full knowledge of its limitations. The limitations of budgeting are as under.

Based on Estimates

Profit planning is not an exact science. Its source depends upon precision of estimates. The success of profit planning and control depends to a large degree on the accuracy with which the basic estimates will be made. Therefore, estimates should be made on the basis if of all the facts available. Using correct and modified statistical techniques and management can make the accurate estimates.

Danger of Rigidity

Profit planning is an estimation and quantitative expression of all relevant data. So, there can be the tendency to attach some sort of rigidity or finality to them. However, rigidness makes profit planning and control useless. For usefulness, the profit planning and control must be flexible. Various techniques must be tried, improved discard and replaced with others. In other words, a profit planning and control programme must be dynamic in every sense of the word.

Application for Long Period

The installation of a complete profit planning and control is not possible in a short period. It should be continuously used in the business, and should be revised and modified with the changed situation in the business.

Execution is not Automatic

A skillfully prepared profit planning and control will not itself improve the management of an enterprise, unless it is properly implemented. For the success of profit planning and control it is essential that all the related persons inside the enterprise should understand it. It is mostly required that each executive must feel the responsibility and should make efforts to attain the budgeted goals. Department leader should seriously think that it is their individual responsibility to fulfill the target set up in their departmental budget. The success of a budgeting system totally depends upon the efficient management and administration.

Not a Substitute for Management

Profit planning and control is a management tool. It is not a substitute for the management. It is totally wrong to think that the introduction of profit planning and control is alone sufficient to ensure success and to guarantee future profits. It is only for achieving the end.

Costly Affairs

The installation of a profit planning and control system is an elaborated process involving to much time and costs. Normally it is so costly that small column can not afford to it. Even for a large concern, it is suggested that there should be some correlation between the cost of operating a budgeting system and benefits derived from it. The system should be adapted only when benefit exceeds the cost.

Proper Evaluation

For finding out the inefficiencies, proper evaluation should be made. In the absence of proper evaluation, budgeting will hide inefficiencies. So there should be continuous evaluation of the actual performances, standards also should be re-examined regularly.

Lower Morale and Productivity

Unrealistic targets should not be set and used as a pressure tactic. By doing it profit planning and control will lower morale and productivity. To some extent, profit planning and control may be used as pressure device but its extent must be carefully determined *(Goet, J., Bhattarai, I., & Gautam, A., 2062:1.6-1.7).*

2.1.1.13 Application of Profit Planning and Control to Various types of Organizations

Some people say that comprehensive profit planning and control is applicable only to large and complex organizations. Usually it is commented that "comprehensive budgeting is a fine idea for most business, but ours is different," or "it is impossible to project our revenues and expenses," and so on. Sometimes specific industries are viewed as not amenable to profit planning and control. These views are common regarding non-manufacturing enterprise- service companies, financial institutions, hospitals, certain retail business, construction companies, and real-estate enterprises. To the contrary, profit planning and control can be adapted to any organization (profit or non-profit, service or manufacturing, regardless of size, special circumstances, or conditions). The fact that a company has peculiar circumstances or critical problem is frequently a good reason for the adoption of certain profit planning and control procedures. In respect to size, when operations are extensive enough to require more than one or two supervisory personnel, there may be a need for profit planning and control applications. The smaller company certainly has different needs in this respect than a larger one. As with accounting, a single profit planning and control system that is appropriate for all enterprise cannot be designed. A profit planning and control system must be tailored to fit the particular enterprise, and it must be continually adapted as the enterprise and its environmental change *(Goet, J., Bhattarai, I., & Gautam, A., 2062:1.7).*

2.1.1.14 Areas of Profit Planning and Control

Comprehensive profit planning and control (profit planning and control) is the new term, modified, modern and comprehensive approach of same traditional budgeting. Therefore all the budgets are covered by PPC or area of PPC. Budgets may be classified from various view points depending upon various bases adopted for such classification i.e. on the bases of time; long term (up to 5 or 10 years) and short term (1 month 1 year), current budget on the basis of flexibility. Static and flexible budget; on the basis of nature of business transaction; capital expenditure and operating or revenue budget[44]; on the basis of function; sales budget, selling and distribution cost budget, production budget, purchase budget, labour budget, research budget, plant utilization budget, office and administration budget, capital budget, cash budget and master budget etc. Mainly, PPC consists of three main, budgets are briefly explained as follows:-

1) Operating Budget

Budget related with revenue and expenses such as sales budget, production budget etc is called operating budget. These budgets deal with plans for routine activities. The main operating budgets are as follows:

a) Sales Budget

The sales budget is a forecast of total sales of all the products expressed in terms of physical quantities, prices and values in respect of each product for a future budget period. Sales budget is usually prepared according to product or product groups, territory or area, types of customers etc. It is a primary budget of PPC.

b) Production Budget

The production budget is concerned with estimating the probable output of each product in the forthcoming budget period. The production plan involves determining the number of units of each product that must be manufactured to meet planned sales and maintain inventory levels of finished goods that are to be planned. Thus, the production budget is developed using planned sales. This includes production unit and production cost.

c) Purchase Budget

After having prepared the production budget, the material usage and the purchase budget can be easily constructed. Purchase would include both direct and indirect materials and goods. Non-manufacturing company have to prepare purchase budget according to sales unit.

d) Direct Labour Budget

Direct labour budget is the budget which provides planning data about the direct labours requirement, number of direct labours, employees needed, labour cost of each product and investments.

e) Overhead Cost or Other Expenses Budget

The overhead/cost budget or other expenses budget is related with the formal estimation and planning & controlling with regarding three board categorized expenses: factory or manufacturing, selling & distribution and general administrative expenses. To accomplish planning and controlling objectives, expenses should be classified by responsibility, designated as controllable and non controllable, and estimated with respect to their cost behavior pattern.

2) Financial Budget

The budgets which are concerned with financial implication of operating budgets or financial statements such as: cash budget, income statement, balance sheet and changes in financial position. The main financial budgets are briefly explained as follow:

a) Cash Budget

A cash budget shows the planned cash inflows, outflows and ending position by interim periods for a specific span. This method is based on detailed analysis of the increases and decreases in the budgeted cash account that would reflect all cash inflows and outflows from such budgets as sales, expenses and capital expenditures.

b) Capital Expenditure Budget

A capital expenditure is the use of funds (e.g. cash) to obtain operational assets that will help earn future revenues or reduce future costs. The capital expenditure budget is directly, related to a company's operating assets and cash.

c) Budgeted Income Statement

Income is concerned with determining the total income of the planned period. It is to be prepared under accrual basis rather than cash basis on the basis of other preceding budget.

d) Statement of Changes in Financial Position

Other statements which show the changes in financial position are includes in financial budget. Such as: funds flow statement, cash flow statement etc.

e) Budgeted Balance Sheet

Budgeted balance sheet is concerned with forecasting total assets and properties capital and liabilities or financial position of the company by time period. Budgeted balance sheet is prepared on the basis of all budget and prepared at last of the period.

3) Appropriation Budget

Budget which deals with certain specification such as: a dvertising, publicity, research, expenditure, salary etc is called appropriation budget.

2.1.2 Budgeting

The various types of activities within a company should be coordinated by the preparation of plans of actions for future periods. These details plans are usually referred to as budgets. A budget is a detailed plan outlining the acquisition and use of financial and other resources over a given period of time. It represents the plan for the future expressed in formal quantities terms. A budget is a numerical plan of action, which generally covers the area of revenues and expenditures. A budget is a quantitative expression of a plan and an aid to co-ordination and control. A budget may be formulated for an organization as a whole or for its sub-units. Budgets, basically, are forecasted financial statements – formal expressions of managerial plans. They are targets that encompass all phases of operation including sales, production, purchasing, and manpower and financing.

A budget is a comprehensive and coordinated plan, expressed in financial terms, for the operations and resources of an enterprise for some specified period in the future. Budget is estimation and predetermination of revenues and expenses that estimate how much income will be generated and how it should be spent in order to meet investment and profit requirements. It is such type of plan which shows a clear way of spending income that does not result in a loss because all the expenditures will be compared to the budget. If real costs exceed the budgeted costs, an explanation will be required. A firm with specific goals in the form of budget helps a firm to control its costs by setting guidelines for spending money for needed items.

The complete budget for a firm is often called the master budget, which includes a sales budget, a production budget, a purchase budget, an expense budget and cash budget. Once all of these budgets are completed, the master budget for the entire firm is prepared. Budgets basically are forecasted financials statements – formal expressions of managerial plan. They are targets that encompass all phases of operations - sales, productions, distributions and financials.

Some definitions of budgets are:

"A budget is a detailed plan expressed in quantitative terms that specifies how resources will be acquired and used during a specified period of time. The procedures used to develop a budget constitute a budgeting system" (*Hilton, 2000)*

"A budget is the quantitative expression of a proposed plan of action by management for a future time period and is an aid the coordination and implementation of the plan" (*Horngren Foster and Dater, 1999).*

The process of preparing and using budgets to achieve management objective is called budgeting. In other words, the entire process of preparing the budget is called budgeting. According to I.M Pandey, one systematic approach for attaining effective management performance is profit planning or budgeting. Budgeting is the numerical planning for profits covering the areas of future revenues and costs.

2.1.2.1 Scope and Application of Budgeting

Budget is a pervasive phenomenon, which applies in every kind of organization. The terms and functions of budgeting were firstly developed for a state's purposes but, nowadays, it has become an especially to business organizations whose practicability depends upon the size of the business. The common objective of profit planning and control system or budgeting, whether applied to national finances or business administrations is to formulate polices aimed at an objective established after consideration of the probable course of events in the future, and to provide a means for the constant comparison of actual progress toward this goal with the pre-conceived results. Since, budget is flexible and depends upon the size of the firm, the formats and rules regarding profit planning also vary according to the nature of business organizations. A budget is prepared within the environment of relevant variables and strengths and weaknesses of an organization.

2.1.2.2 Objectives of Budgeting

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

The main objectives of budgeting can be summarized as follows:

- It reflects the policy of a business in financial terms and serves as a declaration of policies.
- It forecasts for future to avoid loss and to maximize profit by serving as a financial document for management to control and monitor actual performance.
- It states the firm's expectation (goals) in clear formal terms to avoid confusion and to facilitate their attainability.
- It brings about coordination between different functions of an enterprise i.e. to help in coordination and communication so that the management expectations are understood and supported for proper implementation.
- It is a measure against which the quality of management is evaluated.
- It facilitates centralized control with delegated authority and responsibility.

2.1.2.3 Budgetary Control

Budgetary control is a system of controlling cost, which includes of budgets coordinating the departments and establishing responsibilities, comparing actual performance with the budgeted and outing upon the results to achieve maximum profitability. In short, the uses of budget to control a firm's activities are known as budgetary control.

Budgetary control is the establishment of budgets relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of the policy or to provide a basis for its revision.

Budgetary control involves the followings:

- Preparing budgets.
- The business is divided into various responsibility centers for preparing various budgets.
- The actual figures are recorded.
- The budgeted and actual figures are compared for studying the performance of different cost centers.
- If actual performance is less than the budgeted norms, then a remedial action is taken immediately.

2.1.2.4 Purposes of Budgeting

The main purposes of budgeting can be summarized in the following points:

- To provide a realistic estimate of income and expenses for a period and of the financial position at the close of the period, detailed by areas of management responsibility.
- To provide a coordinated plan of action, that is designed to achieve the estimates reflected in the budget.
- To provide a comparison of actual results with those budgeted and an analysis and interpretation of deviations by areas of responsibilities to indicate courses of corrective action and to lead to improvement in produces in building future plans.
- To provide a guide for management decision in adjusting plans and objectives as conditions change.
- To provide a ready basis for making forecasts during the budget period to guide the management in making day to day decisions.

2.1.2.5 Problems and Limitations of Budgeting

The followings are the major problems of budgeting system.

- Seeking the support and involvement of all levels of management.
- Establishing realistic objectives, polices, procedures and standards of desired performance.
- Developing meaningful forecast especially the sales plan.
- Maintaining effective follow up procedures and adapting the budgeting system wherever the circumstances changes.
- Applying the budgeting system in a flexible manner.
- Educating all individuals to be involved in the budgeting process and joining their full participation.

The followings are the main limitations of budgeting system.

- Budgeting is not exact science. Its success links upon the precision of estimates.
- The installation of a perfect system of budgeting is not possible in a short period. Budgeting has to be a continuous exercise. It is a dynamic process.
- The success of budgetary programmed is to understand by all and the managers and subordinates put concerned effort for accomplishing the budget goals.
- Budgeting will be ineffective and expensive if it is unnecessary detailed and complicated. It should be flexible and rigid in application.
- The presence of a budgeting system should not make management complacent. To get the best results of management, management should use budgeting with intelligence and foresight. It cannot replace management.
- The purpose of budgeting will be defeated if budget goals carelessly conflict with enterprise objectives.
- Budgeting will hide inefficiencies through a proper evaluation system.
- Budgeting will lower moral and productivity if unrealistic targets are set and if it is used as a pressure tactic.

2.1.2.6 Sales Budget or Sales Plan

The sales plan is the foundation for periodic planning in the firm because all other enterprise's planning is built on it. Sales budget or plan is the starting point of preparing profit plan, which displays the projected sales in units and rupees. The sales planning process is an essential part of profit plan and control because it provides for the basic management decisions about marketing and based on these decisions, it is an organized approach for developing a comprehensive sales plan. The sales plan must be realistic and relevant because all of the other parts of profit plan are depended on sales plan.

The sales budget is the forecast of total sales of the entire product expressed in terms of physical quantities, prices, and values in respect of each product of a future budget period. The need of capital addition, the plan of expenses, the manpower requirement, production level and other important operational aspects depend on the volume of sales or revenue. A comprehensive sales plan includes two separate but related plans- the strategic and the tactical sales plan. A comprehensive sales plan incorporates such management decisions as objectives, goals, strategies and premises. Both long- term/strategic and short- term/ tactical plans must be developed in harmony with comprehensive profit plan. The primary purposes of sales plan are as follows:

- To reduce uncertainty about future revenues.
- To incorporate management judgment and decisions into the planning process.
- To provide necessary information for developing other elements of comprehensive profit plan.
- To facilitate management control of sales activities.

2.1.2.7 Sales Planning and Sales Forecasting

Sales planning and sales forecasting are usually used synonymously but they have distinctly different purposes. A 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 explicit assumptions. A forecast should always state the assumptions upon which it is based. A forecast should be viewed as only one input for the development of sales plan. The management of the company may accept, modify or reject forecast. In contrast, sales plan incorporates the management decisions that are based on the forecast, other inputs and management judgments about such related items as sales volume, prices, efforts, production and financing. It is important to make a distinction between the sales forecast and sales plan primarily because the internal technical staff should not be expected or permitted to make the fundamental management decisions and judgments implicit in every sales plan. Major differences between sales forecast and sales budget can be attributed as follows:

- The sales forecast is merely the initial estimate of future sales, where as sales plan is the projection approved by the budget committee that describes expected sales in units and rupees.
- Sales forecast is a merely well educated estimate of future expected demand of a specific product whereas sales budget is the quantitative expression of business plan and policies to be pursued in future.
- A sales plan provides standard for comparison with the result actually achieved, thus, it is an important control device of management, whereas forecasting represents merely a probable events over which no control can be exercised.
- Sales plan begins where and when sales forecast end. Sales forecast is the input to sales plan; sales plan is the foundation to profit planning and control.

2.1.2.8 Strategic and Tactical Sales Plan

Time dimension is an important consideration in planning. Planning range over a time spectrum that runs from the current day to a period sometimes as far as more than twenty years in the future. Practice on this score differs considerably. Generally, there are two types of planning which are as follows:

a) Strategic or long range planning

b) Tactical or short range planning

a) Strategic or Long Range Planning

Strategic sales plan is the long range sales plan of an enterprise. When plans are prepared for more than five to ten years basis, then they are called long range or strategic planning. It is broad and general. It is usually developed by year and annual amount. It is prepared by considering future market potentials, population changes, state of economy, industry projections, company objectives and long term strategies because they affect in such areas as pricing, development of new product line, innovation of product, expansion or distribution channel, cost, pattern etc. Long range as a means of planning for the future is frequently done by and is useful for government planning agencies and economic studies.

b) Tactical or Short Range Planning

Tactical sales plan is the short range sales plan of an enterprise. Generally, it is developed for a short period of time usually a year, initially by quarters and by months for the quarters. The tactical sales plan includes a detailed plan for each major product and for groupings of minor products. Tactical sales plan are usually developed in terms of physical units and in sales rupees. Short term sales plan must also be structured by marketing responsibility for planning and control purposes. Short term sales plan may involve the application of technical analysis; however, judgment plays a large part in their determination.

2.1.2.9 Sales Budgeting as a Tool of Profit Planning

An enterprise should adopt number of budgets for the application of comprehensive profit plan. One of them is sales budget. Budgeting means deciding or estimating in advance the course of action to achieve a particular target or objectives in a given period of time along with the numerical expression of the inputs required and outputs expected.

Sales planning or budgeting provides basic management decisions about marketing. Marketing decisions are the basic approaches for developing comprehensive sales plan and profit plan. Therefore, sales budgeting is a necessary part of PPC for every business enterprise either they are manufacturing or non-manufacturing and either public or private enterprises. If sales plan is not realistic, most other parts of overall profit plan will not be realistic. Management should develop a realistic sales plan. If management cannot develop realistic sales plan, it will be little justified. If it is difficult to assess the future revenue of business, there will be little incentives for investment.

The prime objective of business enterprise is to generate profit. So, first consideration of sales plan must be made from profit plan. To attain planned profit, sales should be properly budgeted or planned. In today's modern business production as well as inventory is also for sales. All cost or expenses are planned according to sales budget. So, sales budget is the foundation of all budgets.

The sales or revenue budget forms the fundamental basis on which all the other budgets are built up. All budgets except sales budget are related with cost. On the basis of sales budget, production budget or planning is made. This planning depends on the capacity of the plant; an all other functional budgets are prepared on the basis of the production budget. In this way, sales budget is first prepared and it is variously termed as commencement of the budgeting, a nerve center or backbone of the enterprise, foundation budget or corner stone of budgeting, initial or preliminary budget etc. By reducing the clouds of uncertainty, removing the risk of future revenues and present investment, a proper or appropriate or systemic sales budgeting directly or indirectly forms foundation for all the other budgets and ensure to receive the planned profit of the enterprise. Therefore, sales budgeting is as a tool of profit planning.

2.1.2.10 Revenue Planning

A sales plan is appropriate in the manufacturing company but it is inappropriate in the service and non manufacturing company. For the service organization, revenue planning is suitable. Revenue planning involves the overall assets utilization to ensure the optimum revenue; enhance the revenue areas and increase the revenue amount from the existing revenue heads. So, revenue plan is the developed form of sales plan. Bank being the service organization, revenue planning is the most essential for the overall growth of the business. Service organization mainly emphasizes the service commission as their main source of revenue. The revenue heads of the bank are segregated and individual heads are analyzed in the revenue planning. Revenue heads of the bank are interest income, commission and discount, exchange gain and non operating profit and other income. Interest income mainly depends upon the optimum utilization of the deposit and search of the profitable investment. Commission and discount depends upon the non funded business of the bank. Exchange gain is the banks right decision to utilize the foreign currency at the right time.

2.2 Review of Literature

Review of literature is the review of studies which are related and helpful to the present study. Many studies have been done about the profitability analysis and revenue planning of commercial banks. So, some of the related researches are presented below:

Shila Chhetri (2002) submitted a thesis on *"Profitability Position of Nabil Bank Ltd."* The major objectives of the study were:

- To evaluate the trend of deposits and loans and advances of Nabil and SCB.
- To evaluate the liquidity, profitability, capital structure, activity and capital adequacy position of Nabil and SCB.
- To study the strengths and weaknesses of Nabil and SCB. To study the opportunities and threats in terms of financials tools.
- To suggest and recommend some measures for the improvement of financial performance of Nabil and SCB in future.

Her major findings were:

- Loans and advances as well as total deposits of Nabil and SCB are increasing each year. (study period)

- There exists positive correlation between total deposits and loans and advances of both banks.
- SCB's liquidity position is comparatively better than that of Nabil.
- Nabil's capital structure position is more risky than that of SCB in average.
- SCB's profitability position is more satisfactory than that of Nabil.

Her major recommendations were:

- To overcome deposit problem, the researcher has recommend to simplify present complicated and lengthy depositing process, set a more convenient minimum balance requirement to open a account, provide incentives for attracting new fixed depositors.
- To follow liberal lending policy for loans and advances.
- To operate new branches in non representing urban areas for more deposit collections and more utilization of the same as well as to increase their transactions and to provide financial services and facilities to more customers.
- All profitability ratios of Nabil are in fluctuating trend and SCB's profitability position is comparatively better than that of Nabil. So, Nabil is recommended to utilize its risky assets, shareholders fund and total assets more efficiently for generating more profit margins. Both SCB and Nabil should reduce their expenses for being more profitable.

Sachin Jung Rayamajhi (2004) submitted a thesis on *"Profitability of NB Bank Ltd. with Comparison to Other JV Banks."* The major objectives of the study were:

- To find out the profitability position of the JV banks and to disseminate quality information.
- To analyze the profit trend of JV banks.
- To investigate the profit trend of NB Bank Ltd.

- To ascertain the comparative position of profitability of NB bank with respect to other JV banks.

His major findings were:

- The bank has not been able to perform well in most of the criteria defined like ROE, EPS, net profit margin, loan loss provision, NPA to Credit and others as well during study period.
- The other contributing factors for the decline of performance of NB bank are high interest spread, low staff motivation and others like unable to provide additional services such as ATM, ABBS, credit card services, e-banking; negative publicity of its promoters, frequent changes in top level management.

His major recommendations were:

- A serious effort has to be made towards the NPA management. The asset (loans and advances) quality is the serious issue in the organization and the sincere effort of the management is to be concentrated in that matter.
- The bank seems to be lacking in the conduct of detailed and proper credit appraisal and monitoring process.
- NB bank has not been renowned for coming up with new innovative products and services. One of the weak links in the NB Bank Ltd. has been its marketing department. The marketing department has been primarily focused on the routine activities like publishing auction notices, tender notices and interest rates. So, NB bank needs to devise appropriate marketing strategies, plans and polices and revitalize the efforts of the marketing department.

Prem Krishna Shrestha (2004) submitted a thesis on *"Profitability analysis of SCBL and NABIL."* The major objectives of the study were:

- To evaluate the soundness of profitability and operating efficiency of Nabil comparison with that of SCBL.
- To compare and analyze fund based interest income with fee based income of Nabil with SCBL in light of interest earnings assets.
- To compare the cost of deposits of two banks with the profitability.

His major findings were:

- Nabil bank has fluctuating return on total assets than SCBL. SCBL has higher ROE than Nabil bank.
- Nabil bank has more consistent interest earned to LDO ratio than SCBL throughout the study period. Similarly, the ratio of return on total LDO of SCBL is higher than Nabil bank.
- Both of the sample banks interest income to total earning assets ratio are decreasing. Earning spread rate of both of the banks ratios are also decreasing. Both of them are negative sign to the banks' performance.
- Sample banks' net profit margin is decreasing every year. Nabil bank's net profit margin is more than that of SCBL.

His major recommendations were:

- The study reveals that Nabil bank has not adopted any cost management strategy to have control over its cost of funding. Nabil has paid very higher interest to deposits and other working funds than SCBL. The cost management strategy would be ideal to reduce the various costs and increase the profitability.
- The bank should follow the strict investment policy to avoid the non performing assets.

- To cope the changing environment in the banking business, Nabil bank is suggested to enhance its existing facility of ATM, ABBS, credit card facility etc. throughout the branching network from the limited service of the valley.
- An emphasis should be given on planning, research and development for the proper planning and controlling purposes. Proper and regular internal audit system can help the management in regards the cost control strategy and avoid unnecessary leakage in the expenses.

Bishnu Hari Koirala (2007) submitted a thesis on *"Revenue Planning and its impact on Profitable Operation of Nepal SBI Bank Limited."* The major objectives of the study were:

- To highlight the current revenue planning processes adopted and its effectiveness in NSBI Bank.
- To analyze revenue structure and major revenue sources of the bank.
- To study the growth of the revenue business of the bank over the period.
- To provide suggestion and recommendation for improvement of the overall profitability of the bank.

His major findings or conclusions were:

- Bank has no proper revenue plan.
- Incomes from off-balance sheet items are not given proper attentions.
- Bank has given attention to increasing interest income by giving best effort in utilization of the deposit and decreasing the risk from on balance sheet items by investing more in deposits.
- Income from loans, investment has major role in interest income. Bills purchase is playing major role in commission and iscount income. Remittance fee is major in commission income. Similarly, LC and BG contribute more in commission income.

His major recommendations were:

- Interest income from loan and advances and investment has dominance to the total income of the bank. Income from other fee based transactions has low proportion. The proportion of OBS transactions is found decreasing in comparison to loans and advances.
- Proper attention should be given on revising bills purchase and discount rate so that amount of commission would not be lower than the previous year for long time.
- Remittance income must be given priority. Tie up with other bank and agents should be done for easy remit of money from foreign countries.
- The bank should give high emphasis on goodwill and its proper marketing. Customer satisfaction should be center point for goodwill.
- Bank must focus on its able and efficient human resources. The outflow of able and experienced employees must be checked for long term profitability.

CHAPTER - III

RESEARCH METHODOLOGY

Research, in common sense, represents to a search for knowledge. It can be defined as a scientific and systematic search for information on a specific topic. In fact, research is an art of scientific investigation. Methodology means process or technique or method adopted for research purpose. Thus, research methodology refers to the various sequential steps or processes to be adopted by a researcher in studying a problem, with certain objectives in view. In other words, research methodology describes the methods or processes applied in the entire subject matter of the study. Research methodology is a way to systematically and scientifically solve the research problem.

The research methodology adopted for the present study are research design, sources and types of data, population and sample, data collection procedures, data analysis tools which are discussed in this chapter.

3.1 Research Design

Research design means drawing an outline of planning or arranging details and in an economic, efficient and relevant manner before the data collection and analysis. It is a process of making decisions before the situation arises in which the decision has to be carried out. Thus, research design is purely and simply the framework or plan for study that guides the collection and analysis of data. Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variances. A true research design is basically concerned with various steps to collect the data for analysis and draw a relevant conclusion. It guides the researcher to progress in the right direction in order to achieve the goal. It is the arrangement of conditions for collection and analysis of data that aims to combine relevance to the research purpose with economy in procedure. In short, the design of research is concerned with making controlled scientific inquiry. This study is basically based on descriptive and analytical research. Descriptive research uses different kinds of surveys and fact finding approaches to search adequate information. Generally, it is conducted to assess the opinions, behaviors or characteristics of a given population and to describe the situation and events occurring at present. And analytical research uses facts or information readily available and analyzes these to make a critical evaluation of the material.

3.2 Population and Sample

The population refers to the industries of the same nature and its services and products in general. Thus, the total number of commercial banks constitutes the population of data and the bank under study constitutes the sample for the study. So, from the population of 25 commercial banks operating in the country, Kumari Bank Ltd. has been selected as the sample bank for the study.

3.3 Sources or Types of Data

There are mainly two types of sources of data. They are primary sources and secondary sources. Primary sources or data are those which are collected by investigator or researcher from field by himself or herself. These data have never been used for any purpose earlier. Secondary sources or data are those which had been collected by some individual or agency previously and now same data are used and analyzed to extract some other information.

Most of the data presented in this study are of secondary type. The annual reports of the concerned bank are the major source of data for the study. However, besides the annual reports of the concerned bank, the following sources of data have also been used in the courses of the study.

- NRB reports and bulletins.

- Various publications dealing in the subject matter of the study.
- Various articles published in the newspaper.

Formal and informal talks or discussions with the concerned authorities of the bank were also helpful to obtain the additional information of the related problems.

3.4 Data Collection Procedures

This study is mainly based on secondary data obtain from various sources as mentioned above. The required annual reports of KBL have been obtained from its main branch Putalisadak. The data on some aspects have been obtained from the publications and websites of NRB, NEPSE, and CBS etc. Some supplementary data and information and literature review have been collected from the library of Shanker Dev Campus, different journals, magazines, newspapers and other published and unpublished reports and documents by the concerned authorities. Such data information and facts have been processed by editing, tabulating, calculating prior to their analysis in order to obtain proper results and shown in the form of ratios, percentages, averages, graphs etc. for clear presentation.

3.5 Data Analysis Tools

Data are collected from various sources for the purpose of research and they are presented and analyzed which is the core part of the research work. The collected data are first presented in a systematic manner and are then analyzed by different financial and statistical tools to achieve the research objectives. Besides these, some graph charts and tables have been presented to analyze and interpreted the findings of the study. The applied tools are:

a) Financial Tools
b) Statistical Tools

3.5.1 Financial Tools

The evaluation of financial performance involves a series of techniques that can be used to help identify the strengths and weaknesses of a firm. Financial tools basically help to analyze strengths and weaknesses of a firm. Financials ratios which use data from a firm’s balance sheet, income statement, statement of cash flow and certain market data are often used when evaluating the financial performance of a firm.

Ratio analysis is a widely used technique to evaluate the financial position and performance of a firm. A ratio is simply one number expressed in terms of another and such it expresses the quantitative relationship between any two figures. Ratio analysis is a part of the whole process of analysis of financial statements of any business of industrial concern especially to take output and decisions.

Even though there are many ratios to analyze and interpret the financial statements, only those ratios which are related to revenue management of the bank have been analyzed and interpreted in this study.

3.5.2 Statistical Tools

Some important statistical tools are used to achieve the objectives of the study. In this study, statistical tools such as mean, standard deviation, coefficient of variance, coefficient of correlation, and trend analysis have been used.

3.5.2.1 Mean

A mean is the average value or the sum of all the observations divided by the numbers of observations and it is denoted by $\overline{X}$ and given by the formula:

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

Where,

$\overline{X}$ = mean of the value

N = number of pairs of observations

During the analysis of data, mean is calculated by using the statistical formulas ‘AVEARGE’ on excel sheet on computer.

3.5.2.2 Standard Deviation

The standard deviation is the absolute measure of dispersion in which the drawbacks present in other measures of dispersion are removed. It is said to be the best measure of dispersion as it satisfies most of the requisites of a good measure of dispersion. It is denoted by a Greek letter ‘±’ read as sigma and given by the formula:

$$\pm = \sqrt{\frac{x^2}{N\,Z1}}$$

Where,

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

N = no. of observations

The standard deviation is calculated by “nonbiased” or “N-1” method. During the analysis of data, standard deviation is calculated by using the statistical formula ‘STDEV’ on excel sheet on computer.

3.5.2.3 Coefficient of Variance

The coefficient of dispersion based on standard deviation multiplied by 100 is known as the coefficient of variation (C.V). It is given by the formula:

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

It is independent of the unit. So, two distributions can betterly compared with the help of C.V for their variability. Less the C.V; more will be the uniformity, consistency etc. and more the C.V; less will be the uniformity, consistency etc.

3.5.2.4 Correlation Coefficient

The two variables are said to have ‘correlation’, when they are so related that the change in the value of one variable is accompanied by the change in the value of the other. The measure of correlation called the ‘correlation coefficient’ summarizes in one figure, the degree and direction of movement. But the important thing that is to be noted here is that correlation analysis only helps in determining the extent to which the two variables are correlated but it does not tell us about cause and effect relationship. Though, there is a high degree of correlation between two variables one cannot say that which one is the cause and which one is the effect.

Karl Pearson’s correlation coefficient is denoted by ‘r’ and is given by the formula:

$$\text{Coefficient of correlation (r)} = \frac{\sum xy}{\sum \sigma x \sigma y}$$

Where,

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

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

σx = standard deviation of series X

σy = standard deviation of series Y

N = number of pairs of observations

This formula may be tedious when the arithmetic means will be in fraction.

The correlation coefficient is independent of change of origin and scale i.e. $r_{xy} = r_{uv}$

Where $u = \frac{x - a}{h}$, $v = \frac{y - b}{k}$; a and b are assumed means and h and k are common factors for x-series and y-series respectively. So, we can conveniently change the origin or scale or both for the variables and then the formula for the correlation coefficient takes the following form:

$$r_{xy} = \frac{N\sum UV - \sum U \sum V}{\sqrt{N\sum U^2 - \left(\sum U\right)^2}\sqrt{N\sum V^2 - \left(\sum V\right)^2}}$$

Where, $u = \frac{(x - a)}{h}$, $v = \frac{(y - b)}{k}$

During the analysis of data, correlation coefficient is calculated by using the statistical formula ‘CORREL’ on excel sheet on computer.

The value of ‘r’ must lie between -1 to +1. After getting the value of ‘r’, care should be taken to interpret; otherwise wrong conclusion may be obtained. However, the following general rules are mentioned for interpreting the value of ‘r’.

i. When r = 1, there is positively perfect correlation between the two variables.
ii. When r = -1, there is negatively perfect correlation between the two variables.
iii. When r = 0, the variables are uncorrelated.
iv. Nearer the value of r to 1, closer will be the relationship between two variables and nearer the value of r to 0, lesser will be the relationship.

Probable Error of the correlation coefficient denoted by P.E is the measure of testing the reliability of the calculated value of r. If r be the calculated value from a sample of n pairs of observations, then P.E is given by:

$$P.E = 0.6745 \times \frac{1 - r^2}{\sqrt{N}}$$

It is used in interpretation whether calculated value of r is significant or not.

i. If $r < P.E$, it is insignificant. So, perhaps there is no evidence of correlation.

ii. If $r > 6\ P.E$, it is significant.

In other cases, nothing can be concluded.

3.5.2.5 Trend Analysis

Among the various methods of determining trend of time series, the most popular and mathematical method is the least square method. Using this method, it has been estimated the future trend values of different variables. For the estimation of linear trend line, following formula has been used.

$$y = a + bx$$

Where,

y = dependent variable

x = Independent variable

a = y intercept

b = slope of the trend line

To make the calculation easier, the deviation of the independent variable (i.e. time) are taken from the middle of the time period so that $x = 0$. Then, the above two equations change to:

$$y = na \qquad \cdots a = \frac{y}{n}$$

$$\text{and,} \qquad xy = b \quad x^2 \qquad \cdots b = \frac{xy}{x^2}$$

A gives the average of y and b, the rate of change.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

Data collected from various sources are presented and analyzed in this chapter to measure the various dimensions of the problems of the study. The major findings of the study are also presented in this chapter.

4.1 Profitability Ratio

Profitability ratios are used to measure the efficiency of operation of a firm in term of profit. It is the indicator of the financial performance of any institutions. This implies that higher the profitability ratio, better the financial performance of bank and vice-versa.

4.1.1 Total Interest Income to Total Income Ratio

This ratio measures the volume of interest income to total income of the bank. This ratio helps to measure the bank’s performance on how well they are mobilizing their fund for the purpose of income generation as interest. The high ratio indicates the contribution made by the lending and investing activities and vice-versa. This ratio can be computed by dividing total interest income to total income.

Table 4.1

Total Interest Income to Total Income Ratio

(Rs. In Million)

FY	Interest Income	Total Income	Ratio (%)	Mean (%)	S.D	C.V
2001/02	96.35	109.56	87.94			
2002/03	185.09	202.23	91.52			
2003/04	310.21	342.85	90.48	90.69	1.53	1.69
2004/05	499.92	540.60	92.47			
2005/06	605.52	668.14	90.62			
2006/07	791.28	868.29	91.13			

Source: Annual Reports

The above table 4.1 shows that they are fluctuating over the study period ranging from minimum of 87.94% in FY 2001/02 to maximum of 92.47% in FY 2004/05. The mean of the ratio is 90.69% and S. D and C.V are 1.53 and 1.69 respectively which shows that the ratios are fluctuating over the study period.

The data show that the bank is generating maximum income i.e. 90.69% as interest income from its total income. This means that the bank is generating large proportion of income from mobilizing the funds to loans and advances and investment activities.

4.1.2 Total Interest Income to Total Outside Assets Ratio

The main assets of a commercial bank are its outside assets in the form of loans and advances and investments employed for income generation purpose. This ratio reflects the extent to which the bank is successful to earn interest as major income from outside assets. A high ratio indicates high earning power of total assets and vice-versa. This ratio is computed by dividing total interest income to total outside assets.

Table 4.2

Total Interest Income to Total outside Assets Ratio

(Rs. In Million)

FY	Interest Income	Outside Assets	Ratio (%)	Mean (%)	S.D	C.V
2001/02	96.35	1,366.56	7.05			
2002/03	185.09	2,528.89	7.32			
2003/04	310.21	4,632.51	6.7	7.20	0.28	3.89
2004/05	499.92	6,781.19	7.37			
2005/06	605.52	8,286.8	7.31			
2006/07	791.28	10,607.43	7.46			

Source: Annual Reports

The above table 4.2 shows that the ratios are slightly fluctuating during the study periods ranging from minimum of 6.70% in FY 2003/04 to maximum of 7.37% in FY 2004/05. The mean of the ratio is 7.20% and S.D and C.V are 0.28 and 3.89 respectively which shows that the ratios are slightly fluctuating.

The banks are liberal to quote interest rate. As a result, the banks went on unhealthy competition of interest rate. KBL also could not isolate itself from this. This caused low interest spread which fluctuate interest income. The interest suspense for the year also caused fluctuation in interest income.

4.1.3 Total Interest Expenses to Total Expenses Ratio

This ratio measures the portion of total interest expenses in the volume of total expenses. The higher ratio indicates the low operational expenses and vice-versa. Interpreting in other way, the higher ratio can be due to the costly sources of funds.

In simple sense, high interest expenses mean high interest rates given on deposits. This ratio is computed by dividing total interest expenses to total expenses.

Table 4.3

Total Interest Expenses to Total Expenses Ratio

(Rs. In Million)

FY	Interest Expenses	Total Expenses	Ratio (%)	Mean (%)	S.D	C.V
2001/02	48.16	108.23	44.49			
2002/03	92.94	189.76	48.98			
2003/04	163.90	294.16	55.72	52.97	5.40	10.19
2004/05	240.13	452.72	53.04			
2005/06	337.06	569.63	59.17			
2006/07	397.05	703.48	56.44			

Source: Annual Reports

The above table 4.3 shows that the ratios are fluctuating over the study period. ranging from 44.49% in FY 2001/02 to 59.17% in FY 2005/06. The mean of the ratios are 52.97% and S.D and C.V are 5.40 and 10.19 respectively which shows that the ratios are little bit not consistent over the study period.

After NRB's deregulation of control over the interest limit and spread, the banks are liberal to quote interest rate. Interest rates of all the banks on deposits and lending are not same. Also, the initial periods of the study periods were the bank's starting period. The bank seems to have offered higher interest rates on deposits. This may be due to stiff competition among the commercial banks on offering higher interest rates to attract deposits. So, the bank offered higher interest rate to attract deposits from the market, which ultimately caused increase in interest expenses. This shows that the bank is utilizing its fund on costly manner.

4.1.4 Total Interest Income to Total Assets

This ratio reflects the extent to which the bank is successful in mobilizing its total assets to generate high income as interest income. A high ratio is an indicator of high earning power of the bank's total assets and vice versa. This ratio is calculated by dividing total interest income by total assets of the bank.

Table 4.4

Total Interest Income to Total Assets

(Rs. In Million)

FY	Interest income	Total Assets	Ratio (%)	Mean (%)	S.D	C.V
2001/02	96.35	1592.76	6.05			
2002/03	185.09	2986.17	6.2			
2003/04	310.21	5494.17	5.65	6.33	0.44	6.95
2004/05	499.92	7437.88	6.72			
2005/06	605.52	9010.27	6.72			
2006/07	791.28	11918.31	6.64			

Source: Annual Reports

The table 4.4 shows that the ratios are ranging from minimum of 5.65% in FY 2003/04 to the maximum of 6.72% in FYs 2004/05 and 2005/06. The mean of the ratios are 6.33%. The S.D and C.V are 0.44 and 6.95 respectively. This means that the ratios are consistent over the study period.

The ratios are consistent over the study period. This means that the bank is mobilizing its total assets satisfactorily to generate high income as interest income.

4.1.5 Total Interest Expenses to Total Assets

This ratio measures the percentage of total interest expenses against the total assets of the bank. A high ratio is an indicator of low earning power of the bank's total assets and vice versa. This ratio is calculated by dividing total interest expenses to total assets.

Table 4.5

Total Interest Expenses to Total Assets

(Rs. In Million)

FY	Interest Expenses	Total Assets	Ratio (%)	Mean (%)	S.D	C.V
2001/02	48.16	1592.76	3.02			
2002/03	92.94	2986.17	3.11			
2003/04	163.90	5494.17	2.98	3.24	0.28	8.64
2004/05	240.13	7437.88	3.23			
2005/06	337.06	9010.27	3.74			
2006/07	397.05	11918.31	3.33			

Source: Annual Reports

The table 4.5 shows that the ratios are almost consistent over the study period. The ratios are ranging from 2.98% in FY 2003/04 to 3.74% in FY 2005/06. The mean of the ratios are 3.24%. The S.D and C.V are 0.28 and 8.64 respectively which means that the ratios are in consistent level.

The data show that the ratios are low during the study period. This means that the bank has given proper attention to minimize the interest expenses. Low interest expenses means the bank has given low interest rates on deposit which ultimately reduces the interest expenses. Offering low interest rates was due to high liquidity in the market.

4.1.6 Total Income to Total Expenses

The comparison between total income and total expenses measures the productivity of expenses in generating income. The amount of income that a unit of expenses generates is measured by total income and total expenses. The higher ratio is indicative of higher productivity of expenses and vice-versa. This is calculated by dividing total income by total expenses.

Table 4.6

Total Income to Total Expenses

(Rs. In Million)

FY	Total Income	Total Expenses	Income Generation Ratio	Mean (%)	S.D	C.V
2001/02	109.56	108.23	1.01			
2002/03	202.23	189.76	1.07			
2003/04	342.85	294.16	1.17	1.23	0.25	20.32
2004/05	540.60	452.72	1.19			
2005/06	668.14	569.63	1.73			
2006/07	868.29	703.48	1.23			

Source: Annual Reports

The above table 4.6 shows that the relationship of total income to total expenses is fluctuating trend ranging from 1.01 in FY 2001/02 to 1.73 in FY 2005/06. This means that per unit of expenses is generating higher income every year until FY 2005/06 but in FY 2006/07, it has been decreased. In other words, one rupee of expenses has generated one paisa in FY 2001/02 where as it has generated seventy three paisa in FY 2005/06 which has decreased to twenty three paisa in FY 2006/07. The average income of total expenses to total income is only twenty three paisa. S.D and C.V are 0.25 and 20.32 respectively, which means the ratios are little bit variable during the study period.

The bank increased interest rates on deposit but could not increase on lending. Also, the banks operating cost is in increasing trend along with interest expense which increased in total expenses. Comparing the total expenses, total income could not increase. So, it is in fluctuating trend.

4.1.7 Total Income to Total Assets

This ratio measures how efficiently the assets of the bank are utilized to generate total income. It also measures the quality of assets in income generation. This ratio is calculated by dividing total income by total assets.

Table 4.7

Total Income to Total Assets

(Rs. In Million)

FY	Total Income	Total Assets	Ratio (%)	Mean (%)	S.D	C.V
2001/02	109.56	1592.76	6.88			
2002/03	202.23	2986.17	6.77			
2003/04	342.85	5494.17	6.24	6.98	0.44	6.30
2004/05	540.60	7437.88	7.27			
2005/06	668.14	9010.27	7.41			
2006/07	868.29	11918.31	7.28			

Source: Annual Reports

The above table 4.7 shows that the ratios are almost consistent over the study period which range from minimum of 6.24% in FY 2003/04 to maximum of 7.41% in FY 2005/06. The mean of the ratios are 6.98%. The S.D and C.V are 0.44 and 6.30 respectively that means the ratios are almost consistent over the study period.

Consistent ratios means the bank has given sincere attention to generate high income by utilizing its total assets. Though the study periods were not so good due to political disputes, the bank is able to earn stable income from its total assets.

4.1.8 Net Interest Margin

Net interest margin in general is the difference between the interest earned from granting loans and advances and interest paid on deposits collected by the bank. It shows the bank's efficiency to earn high profit to meet various expenses and to provide attractive return to the shareholders. Hence, the difference between interest earned and interest paid i.e. net interest margin is analyzed below.

Table 4.8

Net Interest Margin

(Rs. In Million)

FY	Interest Income	Interest Paid	Net Interest Margin	Increased Amount	Growth Rate (%)
2001/02	96.35	48.16	48.19	-	-
2002/03	185.09	92.94	92.15	43.96	91.22
2003/04	310.21	163.9	146.31	54.16	58.77
2004/05	499.92	240.13	259.79	113.48	77.56
2005/06	605.52	337.06	268.46	8.67	3.34
2006/07	791.28	397.05	394.23	125.77	46.85

Source: Annual Reports

The table 4.8 shows that the net interest margin is increasing every year during the study periods. But the growth rate of net interest margin is highly fluctuating. The growth rate for FY 2001/02 is not presented due to not considering previous year. The growth rate in FY 2002/03 is 91.22% which is very high. This is because when the precious year is nil even the little growth will be higher in next year. The growth rate is continuously decreasing to the minimum of 3.34% in FY 2005/06. But in FY 2006/07, the growth rate has increased to 46.85%.

During the initial period of opening the bank, interest rate on deposit was offered high to attract the deposit. So, the growth rate was high. In the successive years of study periods, due to excess liquidity in the market, the bank lowered interest rate on deposit. When the interest rate on deposit is low, the bank also lowers its interest rates on lending and vice versa which will cause changes in interest spread. This ultimately makes changes in net interest margin.

4.2 Off-Balance Sheet Transactions to Total Loans and Advances Ratio

The off balance sheet transactions such as letter of credit (L/C), bank guarantees like performance bond, bid bond etc. are fee and commission based transactions. They generate fee based income to the bank. This ratio shows the proportion of fee based off balance sheet transactions to total loans and advances.

Nowadays fee based off balance sheet transactions play an important role for the better performance of the bank. These days the banks are increasing interest rates on deposit which ultimately decreases interest income. So, to increase the volume of income, the bank must focus on fee based off balance sheet transactions. These fee based transactions are very much dependent on mode of operation, management strategy, banking networking with local and foreign banks etc. The bank should not concentrate only on fund based activities such as loans and advances, investment on different sectors but also should pay attention to increase fee based off balance sheet activities. Because fee based activities are bank's contingent liabilities and are less risky than fund based activities. Income generated from the fee based off balance sheet transactions constitutes a significant proportion in the total income of most of the commercial bank's income statement. A high ratio indicates the higher off balance sheet transactions and vice- versa. This ratio is computed by dividing total off balance sheet transactions to total loans and advances.

Table 4.9

Off-Balance sheet Transactions to Loans and Advances Ratio

(Rs. In Million)

FY	OBS Transactions	Loans and Advances	Ratio (%)	Mean
2001/02	165.10	1111.56	14.85	
2002/03	339.65	2105.74	16.13	
2003/04	855.31	3649.01	23.44	17.24
2004/05	1139.61	5590.93	20.38	

2005/06	880.84	6891.86	12.78	
2006/07	1414.09	8929.01	15.84	

Source: Annual Reports

The table 4.9 shows the ratios between total off balance sheet transactions and total loans of the bank. The ratios range from minimum of 12.78% in FY 2005/06 to maximum of 23.44% in FY 2003/04. The ratios are in fluctuating trend. The mean ratio is 17.24% which indicates that the off balance sheet transactions are low in comparison to total loans of the bank. This means that the bank seemed to have invested more on fund based income rather than fee based income. So, the bank must focus on increasing fund based income as these are less risky than fund based transactions.

4.3 Income Structure or Income Sources

Total income of a bank comprises of five sources of income including incomes from both fund based and non fund based items. Generally, revenue income of a bank constitutes the income from fund based and non fund based items. The bank should not only be concentrated to increase the interest income though it is the major income of the bank because the income from non fund based items also play vital role on the stability and profitability of the bank in the long run. The image of the bank, the customer satisfaction and tie up with other banks for its transactions play the major role in increasing the non fund based items. The public relation and social welfare done by the bank also counts for non fund based income.

The five major sources of income of a bank are as follows:

1. Interest Income

- On loans, advances and overdraft
- On investment
- On agency balances
- On money at call and short notice

- On others (certificate of deposit, inter-bank loan)

2. Commission and Discount

- Bills purchase and Discount
- Commission
- Others

3. Other Income

- Safe deposit locker rental
- Issue and renewals of credit cards
- Issue and renewals of ATM cards
- Telex/T.T/Swift
- Service charges

4. Exchange Fluctuation Gain/Loss

- Revaluation gain
- Trading gain (except exchange fees)

5. Non Operating Income/Loss

- Profit (Loss) on sale of investments
- Profit (Loss) on sale of assets
- Dividend
- Subsidies received from NRB

The income structure is shown as the percentage of income of the individual sources to the total income earned by the bank during the fiscal years.

Table 4.10

Sources of Income Showing on Percentage Individually to Total Income

Sources	Fiscal Years						Mean
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	
Interest Income	87.95	91.53	90.48	92.48	90.62	91.20	90.71
Commission & Discount	3.14	4.65	4.80	4.27	3.93	4.70	4.25
Other Income	0.56	0.29	0.52	0.48	1.50	1.76	0.85
Exchange Gain/Loss	8.35	3.53	4.20	2.77	3.95	2.34	4.19
Non-Operating Income Loss	-	-	-	-	-	-	-
	100	100	100	100	100	100	100

Source: Appendix-1

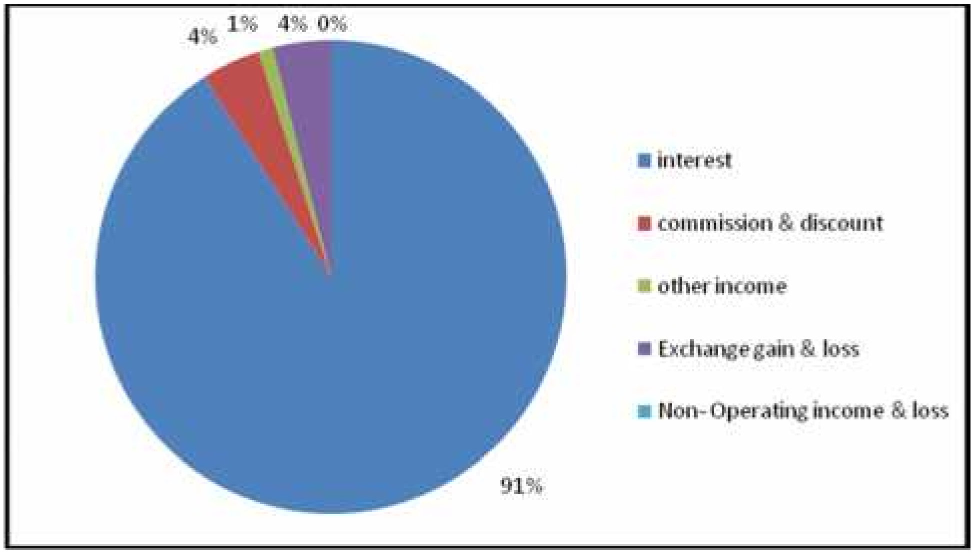
The table 4.10 shows that interest income of the bank is consistent over the study periods and covers almost 90% of total income of the bank. Interest income ranges from minimum of 87.95% in FY 2001/02 to maximum of 92.48% in FY2004/05. Considering the percentage of other sources of income, it seems that the bank has focused on interest income. The table also shows that the commission and discount income of the bank is also consistent over the study periods ranging from minimum of 3.14% in FY 2001/02 to the maximum of 4.80% in FY 2003/04. But considering its percentage over the total income, it has been considered low. So, the bank must focused on commission receiving activities like bills purchased, issuance of L/C, guarantees, collection and remittance fees etc. The table shows that the exchange income is in fluctuating trend ranging from minimum of 2.34% in FY2006/07 to maximum of 8.35% in FY2001/02. This shows that the bank has not given importance to exchange income.

The value of non operating income and loss is unseen on the table because of less value while expressing in Million. But the bank has gained non operating income in FY 2002/03, 2004/05 and 2006/07 of Rs.3650, Rs.5442 and Rs.669885 respectively and also has suffered from loss in FY2005/06 by Rs.38957. The income and loss has occurred due to sale of assets.

The sources of income are presented in the figure below for more clarification.

Figure 4.1

Sources of Income



The figure shows that the interest income occupies around 91% of total income of the bank. Similarly, income from commission and discount and exchange gain is equal of 4% each. Since the bank has very less non operating income in fiscal years 2002/03, 2004/05 and 2006/07 and has suffered loss in FY2005/06, it is nil while expressed in percentage in the figure.

4.3.1 Composition of Interest Income

The bank investments its fund in different sectors from which it gains income as interest income. It is necessary to understand where the bank invests its fund. The segregation of the interest income into different sub-sectors helps to clarify the actual position of the bank on planning its revenue and the weaknesses that has occurred in the poor side of the composition of interest income. This part of analysis shows that which sub-sector of interest income has been affected resulting in less volume of interest income and thus suggests to take corrective actions. The compositions of interest income are as follows:

- Interest income from loans, advances and overdraft
- Interest income from investment
- Interest income from agency balance
- Interest income from money at call and short notice
- Interest income from others (certificate of deposits, inter bank loan)

The composition of interest income is shown as the percentage of individual composition of interest income to total interest income earned by the bank.

Table 4.11

Composition of Interest Income Showing on Percentage

Composition of Interest Income	**Fiscal Year**						**Mean**
	2001/02	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	
Loan & Advances	87.60	91.39	90.49	92.56	88.14	87.34	89.59
Investment	5.44	4.24	5.38	5.23	7.95	5.67	5.65
Agency Balances	1.22	0.97	0.25	0.02	0.05	0.16	0.44
Money at call & short notice	2.03	-	-	2.19	3.80	6.83	2.48
Other	3.71	3.40	3.88	-	0.06	-	1.84
Total	100	100	100	100	100	100	100

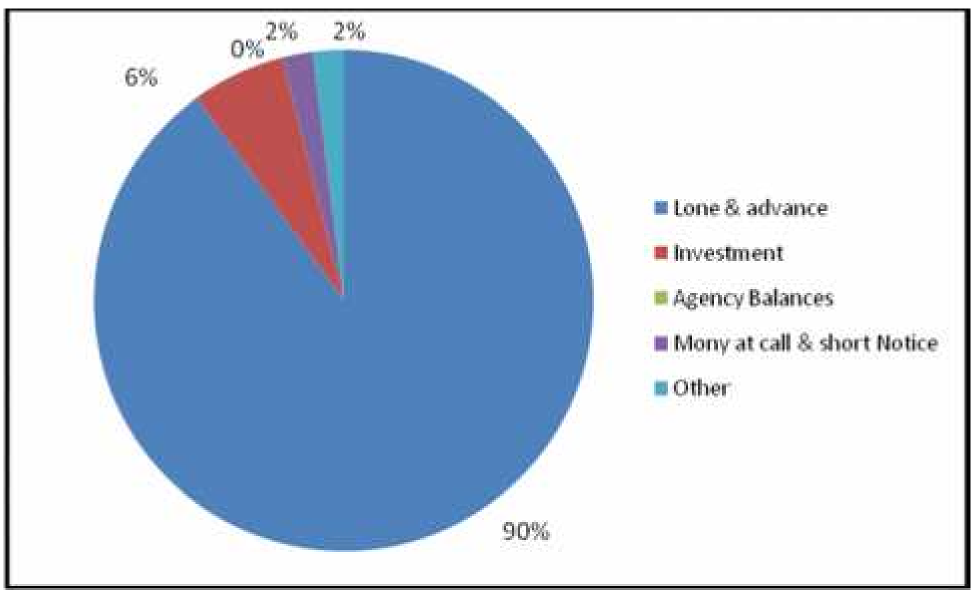
Source: Appendix 2

The table 4.11 shows that though the interest income from loan and advances of the bank is fluctuating over the study periods, covers almost 90% of total interest income of the bank. Interest income from loans and advances ranges from minimum of 87.34% in FY 2006/07 to maximum of 92.56% in FY2004/05. Considering the percentage of other composition of interest income, it seems that the interest income from loans and advances has occupied highest position. The table also shows that the interest income of the bank from investment is also fluctuating over the study periods ranging from minimum of 4.24% in FY 2002/03 to the maximum of 7.95% in FY 2005/06. Interest income from agency balance, money at call and short notice and other interest income are very low and in fluctuating trend over the study periods. The bank keeps adequate security covering whole risk while providing loans and advances and investments in risk free government securities and treasury bills and bonds. The data show that the bank has focused on interest income from loans and advances and investment. Since agency balance, money at call and short notice and other sources are also equally important sources of interest income, the bank must focused on these sources of interest income too.

The composition of interest income is shown on the figure below for more clarification.

Figure 4.2

Composition of Interest Income



The figure shows that the loan and advances occupies almost 90% of the total interest income. The second major composition of interest income i.e. investment occupies around 6% of total interest income and other occupies 2% each while agency balance is nil when expressed in percentage in the figure.

4.3.2 Composition of Commission and Discount Income

Commission and discount is one of the important revenue heading of commercial banks. It is the second major income of commercial banks among sources of income. A bank always focuses its effort to increase its commission and discount income. Commission income being the non-funded income is less risky than interest income. This income has no ceiling and hence despite being largest income heading, it gains the equal attention as that of interest income. Some banks earn more profit due to the highest amount of commission income. This income is equally important for providing the budget to the branch and divisions. So the effort of the bank can be identified if this income remains higher. The composition of commission and discount income is as follows:

- Bills purchased and discount
- Commission income from letter of credit
- Commission income from bank guarantees
- Collection fees
- Remittance fees
- Credit cards
- Share underwriting and issue
- Government transactions
- Agency commission
- others

The composition of commission and discount income is shown as the percentage of individual composition to total commission and discount income earned by the bank.

Table 4.12

Showing Composition of Commission and Discount Income on Percentage

Composition of Commission Income	Fiscal Year						Mean
	2001/02	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	
Bills Purchased	-	-	1.94	-	5.05	4.87	1.98
L/Cs	31.36	18.66	34.27	31.67	28.89	24.31	28.19
Bank guarantees	17.42	16.89	15.75	18.12	16.10	13.05	16.22
Collection fees	3.68	1.18	3.24	1.97	1.89	0.61	2.10
Remittance fees	7.57	9.10	7.52	6.34	7.15	5.85	7.26
Credit cards	-	-	-	-	-	-	-
Share underwriting/issue	2.18	-	-	-	-	-	0.36
Government transactions	-	-	-	-	-	-	-
Agency commission	-	1.21	2.77	2.21	2.11	1.38	1.61
Others	37.79	52.96	34.51	39.69	38.81	49.93	42.28
Total	100	100	100	100	100	100	100

Source: Appendix 3

The table 4.12 shows that the commission income from **other** sources is higher than other composition of commission and discount income. It covers almost 43% of total commission and discount income. It ranges from minimum of 34.51% in FY 2003/04 to the maximum of 52.96% in FY 2002/03. Similarly, commission from issuance of letter of credit (LC) occupies the second position in the contribution of commission income and covers almost 28%. The income from LC is in fluctuating trend ranging from 18.66% in FY 2002/03 to 34.27% in FY2003/04. Further, commission from issuance of bank guarantees occupies the third position in the contribution of commission income and covers almost 16%. The income from bank guarantee is in decreasing trend which ranges from maximum of 18.12% in FY 2004/05 to minimum of 13.05% in FY 2006/07. Similarly, commission income from remittance occupies the fourth position in the contribution of commission income and covers almost 8%. It is also in fluctuating trend ranging from minimum of 5.85% in FY 2006/07 to maximum of 9.10% in

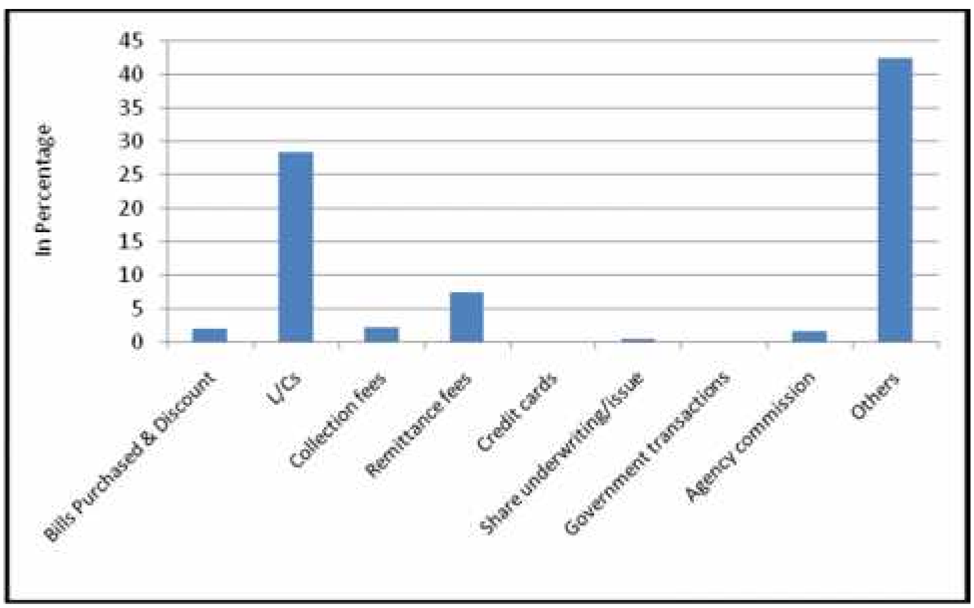
FY 2002/03. Other composition of commission and discount incomes like bill purchased, collection fees, and share underwriting and agency commission occupy low shares on percentage as compared to others.

In fact, all the incomes from commission and discount are in fluctuating trend. Neither of them is in increasing trend. This shows that the bank has not properly evaluated on individual composition of commission and discount income. Remittance income must have covered high position because most of the people of our country have been to abroad but unfortunately it has covered low position. Since, the bank does not deal with credit cards; it has no credit card commission.

The composition of commission and discount income is shown on the figure below for more clarification.

Figure 4.3

Compositions of Commission income



The figure shows that the income from other sources occupies almost 42% of the total commission and discount income. The second major composition of commission and discount income i.e. letter of credit (LC) occupies around 28%.

The third major composition of commission and discount income is bank guarantees which occupy around 16% of total commission and discount income. The most important composition of this income is income from remittance but unfortunately remittance income occupies only around 7%. Bills purchased, collection fees, share underwriting and agency commission occupies low percentage as compared to above mentioned compositions of commission and discount income.

4.3.3 Composition of Other Income

Other income is also one of the important revenue heading of commercial banks. A bank always needs to focus its effort to increase its income from other sources also like locker charges, renew of ATM cards etc. Other income being the less risky income, it heavily depends upon the services it provides to the customers. More and sophisticatedly the bank provides the services, more is the volume of this income. So the bank always needs to give reliable and efficient services to the customers. This income has also no ceiling and hence despite being important income heading, it should gain the equal attention as that of other sources of income. Some banks earn more profit due to the highest amount of service charge, renewal and other income. The composition of other income is as follows:

- Safe deposit lockers rental
- Issue and renewals of ATM cards
- Telex/TT/SWIFT charges
- Services charges
- Loss provision written back
- Others

The composition of other income is shown as the percentage of individual composition to total other income earned by the bank.

Table 4.13

Showing composition of other income on percentage

Composition of other income	**Fiscal Years**						**Mean**
	2001/02	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	
Lockers rental	9.08	7.08	6.73	7.47	2.24	2.69	5.88
ATM cards	-	-	-	-	1.96	25.45	4.57
TT/SWIFT	55.22	79.62	89.12	80.67	16.7	15.12	56.07
Service charges	35.70	13.30	4.15	11.86	43.41	21.79	21.70
Loss provision written back	-	-	-	-	33.84	29.07	10.49
Others	-	-	-	-	1.85	5.88	1.29
Total	100	100	100	100	100	100	100

Source: Appendix 4

The above table 4.13 shows that the income from TT/SWIFT is highest among other income which covers almost 56% of total other income. It ranges from minimum of 15.12% in FY 2006/07 to maximum of 89.12% in FY 2003/04. Similarly, the income from service charges occupies the second position in the contribution of other income by 21.70% ranging from minimum of 4.15% in FY 2003/04 to maximum of 43.41% in FY2005/06. Loan loss provision written back occupies around 10.49% in the contribution of other income. Though the income from ATM cards started only from FY 2005/06 and locker rental income from FY 2001/02, both incomes occupy around 5% in the total income of other income.

In fact, the income from lockers rental is in decreasing trend. It has been decreasing to the least of 2.24% from 9.08%. Similarly, the income from TT/SWIFT and service charges are in fluctuating trend. Only the income from ATM cards has increased from 1.96% to 25.45% in FY2006/07 than its previous years. This is due to the increment in the number of customers using ATM cards.

Loan loss provision written back ratio has decreased from 33.84% in FY 2005/06 to 29.07% in FY 2006/07. Loan loss provision is the fund allocated for the purpose of safeguarding possible losses from various loans. In other words, it is a cushion against possible losses and it reflects the actual picture of assets (loan) quality of the bank. Loans must be classified into Pass, Substandard, Doubtful and Loss and the risk must be provisioned accordingly. The loans which fall in the category of Pass are defined as Performing Assets and rests are defined as Non Performing Assets. Loan loss provision written back is the recovery of non performing assets (loans).

The composition of other income is shown on the figure below for more clarification.

Figure 4.4

Composition & Other Income

The above figure shows that the income from TT/SWIFT is highest among other types of income. The income from service charges is in second position in the contribution of other income, and then comes loan loss provision written back.

Lockers rental income and ATM cards income covers almost same position in the contribution of other income.

4.4 Growth Analysis of Major Revenue Heads

This part of the analysis helps to make clear vision over the major revenue heads of the bank. The bank's effort on increasing the revenue can be clearly judged from this analysis. Whether the bank's revenue is increasing, decreasing or consistent during the study period is analyzed in this section.

The major revenue sources of the bank are as follows:

a) Interest Income
    I. Income from loans and advances and overdraft
    II. Income from investment
b) Commission and Discount Income
    I. Bills purchased and Discount
    II. L/Cs commission
    III. Guarantees fees
    IV. Remittance Fees
    V. Collection Fees
c) Other Income
    I. TT/SWIFT Charges
    II. Service Charges
d) Exchange Gain/Loss

4.4.1 Interest Income

Among various sources of income of the bank, interest income of the bank is the main and important source. Hence, steady increase in interest income is the positive sign for the bank and vice versa. Interest income during the study period is analyzed below.

Table 4.14

Interest Income

(Rs. In Million)

FY	Interest Income	Increased Amount	Growth Rate (%)
2001/02	96.35	-	-
2002/03	185.09	88.74	92.1
2003/04	310.21	125.12	67.6
2004/05	499.92	189.71	61.15
2005/06	605.52	105.6	21.12
2006/07	791.28	185.76	30.68

Source: Annual Reports

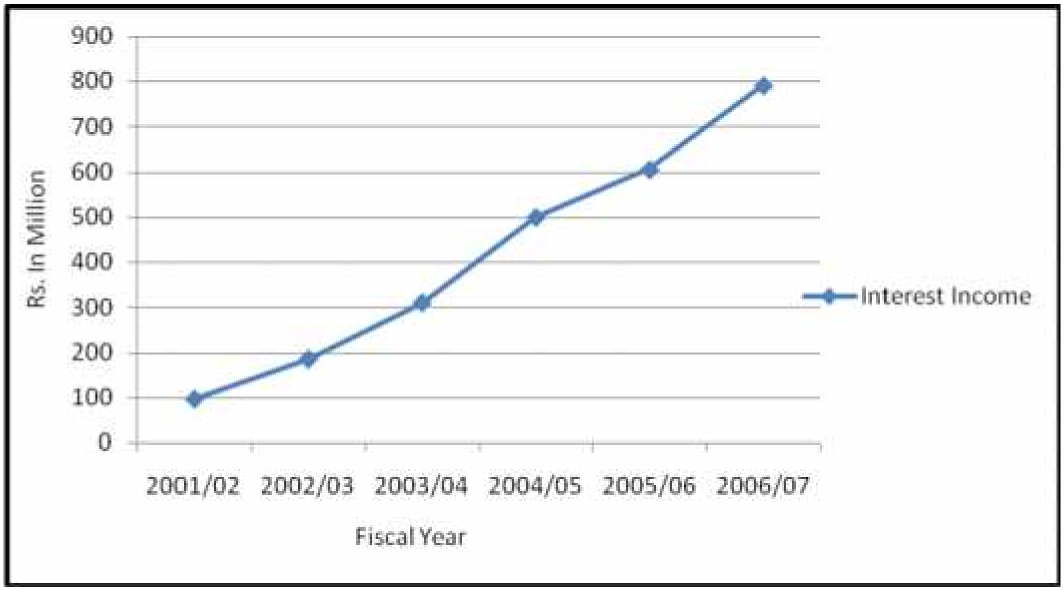
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The growth rate in FY 2002/03 is very high i.e. 92.10%. This shows that the bank excessively focused on marketing for deposit which ultimately helps the bank to flow fund for loans and advances through which the bank could earn high interest income. The growth rate in FY 2003/04 decreased as compared to its previous year. The bank has lowest growth rate of 21.12% in FY 2005/06 but again the bank was able to achieve growth rate of 30.68% in FY 2006/07.

There was massive marketing effort during the initial periods of the study since the periods were initial periods of the bank opening. So, the bank achieved high growth rate. But since market scenario always does not remain same and has to follow market trend, the bank could not sustain itself for longer time. So, there is fluctuation in the growth rate of interest income of the bank. Fluctuation in the growth rate means inefficiency of management to achieve same level of growth.

Following figure helps to analyze the growth rate of interest income.

Figure 4.5

Growth of Interest Income



The above figure shows that the interest income of the bank is in increasing trend. The bank is able to earn interest income every year.

4.4.1.1 Interest Income from Loans and Advances and Overdraft

The main business of the bank is to provide loans and advances to the customers. The bank provides loans and advances from the deposits it collects from them. The interest income from this category depends upon the quality of loans and advances it provides to the customers. The steady increase in interest income from loans and advances shows that the bank is able to earn sufficient interest income from this category of lending. Interest income from loans and advances and overdraft is analyzed below.

Table 4.15

Interest Income from Loans and Advances and Overdraft

(Rs. In Million)

FY	Income from Loans & Advances	Increased Amount	Growth Rate (%)
2001/02	84.40	-	-
2002/03	169.13	84.73	100.39
2003/04	280.71	111.58	65.97
2004/05	462.71	182	64.83
2005/06	533.69	70.98	15.34
2006/07	691.14	157.45	29.5

Source: Annual Reports

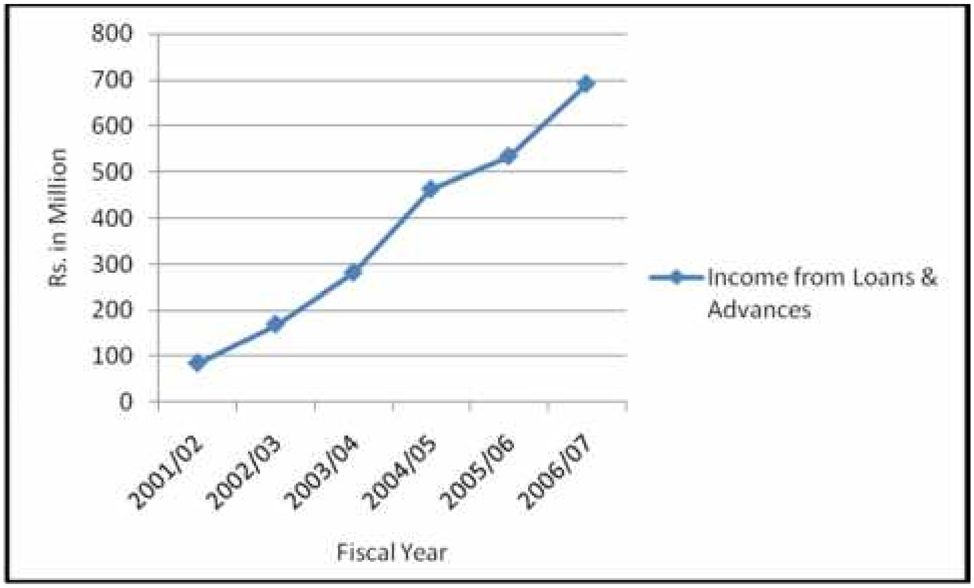
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above table 14 shows that the bank is able to earn 100% interest income from loans and advances and overdraft in FY 2002/03. This shows that the bank focused on providing loans and advances and also in recovery of interest. This means there was no interest suspense in this year. The growth rate of interest income decreased to around 65% in FY 2003/04 and 2004/05 which is lower than the previous year. The growth rate in FY 2005/06 is 15% which is very low as compared to the previous years. This might be due to the adverse situation of the country which resulted high interest suspense. The growth rate in FY 2006/07 showed little progress of 29.5% than previous year.

Since, the bank has just started its operation and grabbed the market by massive marketing; the growth rate was 100% in first year. Then slowly due to change in market scenario and entry of new banks, customers were diversified to other banks which offered low interest rate on lending. So, growth rate of interest income from loans and advances went on decreasing trend. Decreasing trend means management is not sensitive and efficient to increase growth rate.

Following figure helps to analyze the growth rate of interest income from loans and advances and overdraft.

Figure 4.6

Growth of Interest Income from Loans & Advance



The above figure shows that the interest income from loans and advances and overdraft is in increasing trend. But the growth percentage is in decreasing trend.

4.4.1.2 Interest Income from Investment

Income from investment is the second major source of interest income of the bank. Banks utilize its money in the secured and profitable sectors of investment. Banks generally invest in treasury bills, development bonds, national saving certificates, foreign securities, NRB bonds and licensed institutions from NRB. Investments in these sectors are considered as risk free. So, interest income from investment is considered to be more secured than interest income from loans and advances. The growth of investment income is analyzed below.

Table 4.16

Interest Income from Investment

(Rs. In Million)

FY	Investment Income	Increased Amount	Growth rate (%)
2001/02	5.24	-	-
2002/03	7.84	2.6	49.62
2003/04	16.68	8.84	112.75
2004/05	26.13	9.45	56.65
2005/06	48.12	21.99	84.16
2006/07	44.90	-3.22	-6.69

Source: Annual Reports

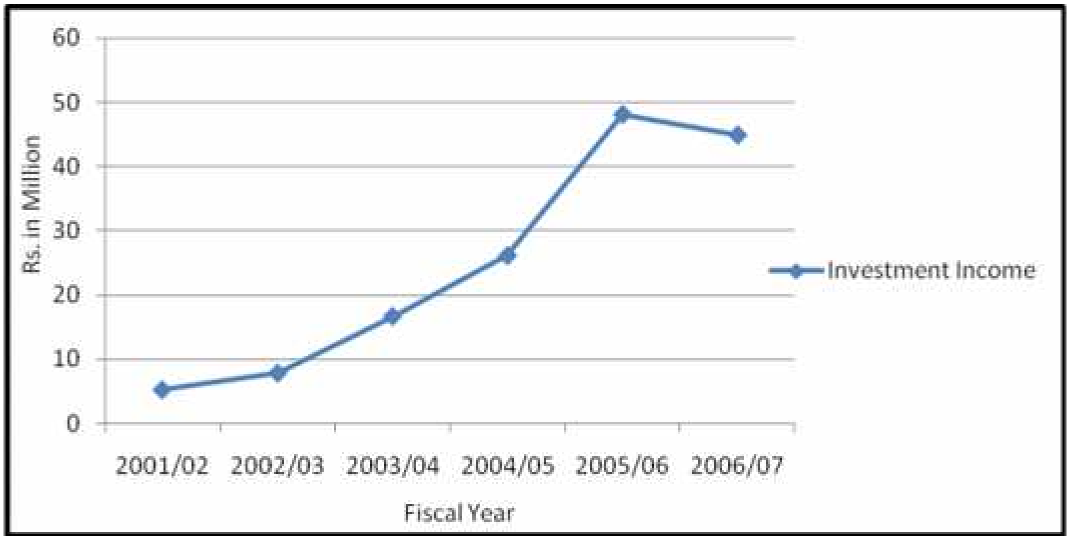
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The growth rate in FY 2002/03 is almost 50% which has increased to 112.75% in the following year. This shows that the bank was successful in investing in secured sectors. But in FY 2004/05, the growth rate decreased to 56.65% with recovery of 84.16% in growth rate in FY 2005/06. But unfortunately, the growth rate in FY 2006/07 is negative of 6.69%. This means the investment income in this year was less than previous year.

The bank invested more in high risk high gain sector i.e. loans and advances. The bank decreased on investing above mentioned sectors which caused decreased in interest income from investment. Even it led to negative growth rate in FY 2006/07.

Following figure helps to analyze the growth rate of investment income.

Figure 4.7

Growth of Investment Income



The above figure shows that the investment income is increasing every year till 2005/06 but it has reduced in FY 2006/07. Therefore, the bank must be sincere to investment in secured and risk free sectors.

4.4.2 Income from Commission and Discount

Commission and discount income is also one of the important sources of bank's income. Hence, income from commission and discount is analyzed below.

Table 4.17

Income from Commission and Discount

(Rs. In Million)

FY	Commission and Discount Income	Increased Amount	Growth Rate (%)
2001/02	3.44	-	-
2002/03	9.41	5.97	173.55
2003/04	16.44	7.03	74.71
2004/05	23.08	6.64	40.39
2005/06	26.28	3.2	13.86
2006/07	40.76	14.48	55.1

Source: Annual Reports

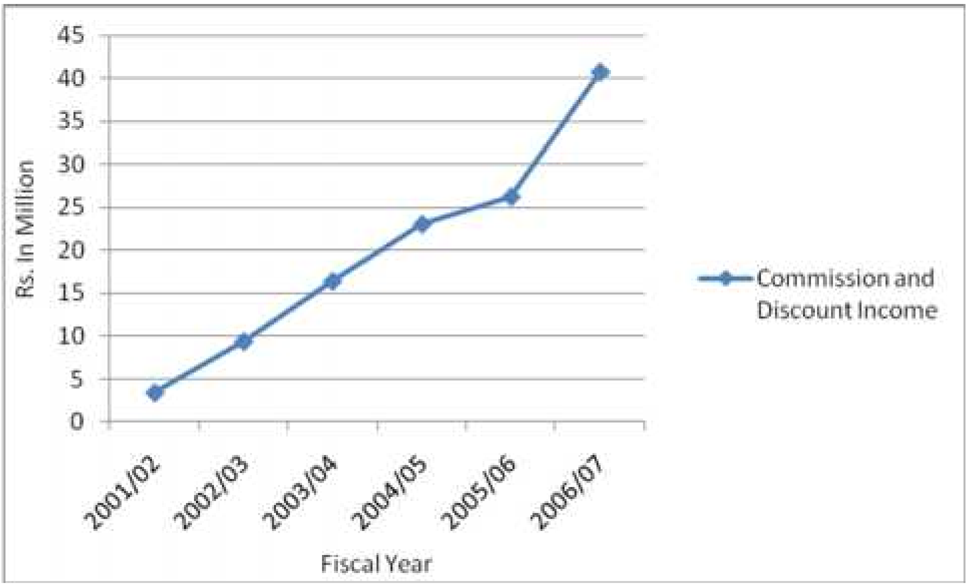
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The bank was able to earn 173% commission and discount income in FY 2002/303 than its previous year. The growth rate has been gradually decreased since then till FY 2005/06. The lowest growth rate is 13.86% in FY 2005/06. Improvement of growth rate of 55.10% has been noticed in FY 2006/07. The above data show that though the commission and discount income has been increased every year but the growth rate shows that it is in decreasing trend. So, the bank must be alert to increase this income.

The bank started its operation on 2001. So, at initial stages, it excessively focused on marketing. As a result, income from commission and discount also increased heavily. But after market saturation, the bank could not earn as previous resulting decreasing trend on the growth rate of this income.

Following figure helps to analyze the growth rate of commission and discount income.

Figure 4.8

Growth of Commission & Discount Income



The above figure shows that the commission and discount income has been increased every year but gradually. So, the bank must give proper attention to provide services to the customers to receive this income in increasing growth rate.

4.4.2.1 Commission from Bills Purchased and Discount

When proceeds of cheques or drafts or say bills drawn on same or some other bank are paid immediately, the instrument is said to be purchased. Suppose the account holder of KBL received a cheque that is drawn on Nabil. If the account holder wants KBL to provide the proceeds immediately and KBL provides the cash immediately after deducting some purchase charges, then the process is known as bills purchased. Bills which mature within a certain period, say 60 days or 90 days, after date or sight are discounted by banks. For example, suppose a bill of Rs.50, 000 payable in 90 days sight is discounted today at 20% per annum, the customer is paid Rs.47, 500 only. However, the bank collects Rs.50, 000 upon maturity. Rs.2, 500 is the earning of the bank. The processing is known as discounting of bills. Commission from bills purchased and discount is also one of the important sources of bank's income. KBL purchases and discounts both local and foreign bills. Hence, income from bills purchased and discount is analyzed below.

Table 4.18

Commission from Bills Purchased and Discount

(Rs. in Thousand)

FY	Income from Bills Purchased and Discount	Increased Amount	Growth Rate (%)
2001/02	-	-	-
2002/03	-	-	-
2003/04	319.42	319.42	-
2004/05	-	-319.42	-100
2005/06	1326.16	1326.16	-
2006/07	1983.74	657.58	49.59

Source: Annual Reports

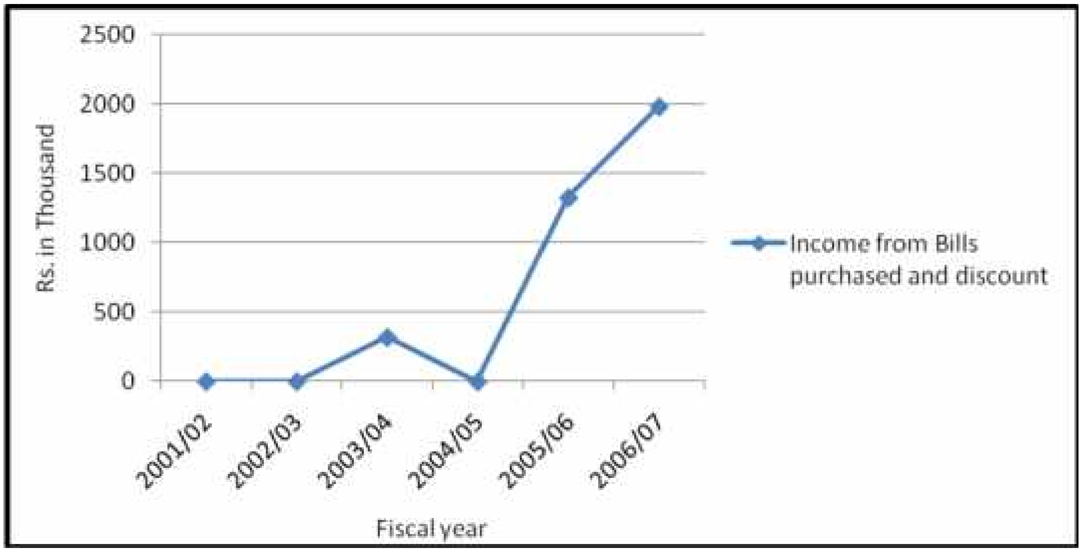
The above table shows that the bank has not made any income from bills purchased and discount in FYs 2001/02 and 2002/03. The bank has made income of Rs.319.42 (Rs. In Thousand) in FY 2003/04 but again in the following year the bank could not make any income. In FYs 2005/06 and 2006/07, the bank has made income of Rs.1326.16 and Rs.1983.74 (Rs. in Thousand) respectively. This shows that the income from bills purchased and discount is not regular.

Due to stiff competition among the commercial banks on offering lower rate of commission on bills purchase and discount, the bank could not sustain and retain major business parties. As a result, the growth rate is not regular and even in minus. So, one of the sources of income is not regular for which the bank should give proper attention.

Following figure helps to analyze the growth rate income from bills purchased and discount.

Figure 4.9

Growth of Bills Purchase and Discount Commission



The above figure shows that the bank was not successful to receive the commission from bills purchased and discount regularly and in increasing trend. So, the bank must focus on receiving this income regularly.

4.4.2.2 Commission from Letter of Credit (L/C)

Bank and Financial Institutions Ordinance, 2003 defines a Letter of Credit (L/C) as: "Letter of credit (L/C) means a letter written by one bank or financial institutions to another bank or financial institutions authorizing the latter to accept cheques, drafts, hundies or bills of exchange of any specified person within the limit of the amount specified therein." So, Letter of credit (L/C) is a non funded business of the bank. It is a contingent liability of the bank. Thus, L/C is a kind of facility provided by the bank to their customers, by way of which the customer can import the goods from foreign seller for which the bank undertake the guarantee for payment under which the terms and conditions and documents of L/C is compiled with. Against the contingent liabilities borne by the bank, it charges certain fee or commission which is the income of the bank. Hence, income from L/C is analyzed below.

Table 4.19

Income from L/C

FY	Commission from L/C	Increased Amount	Growth (%)
2001/02	1079	-	-
2002/03	1756	677	62.74
2003/04	5635	3879	220.9
2004/05	7310	1675	29.72
2005/06	7592	282	3.86
2006/07	9910	2318	30.53

Source: Annual Reports

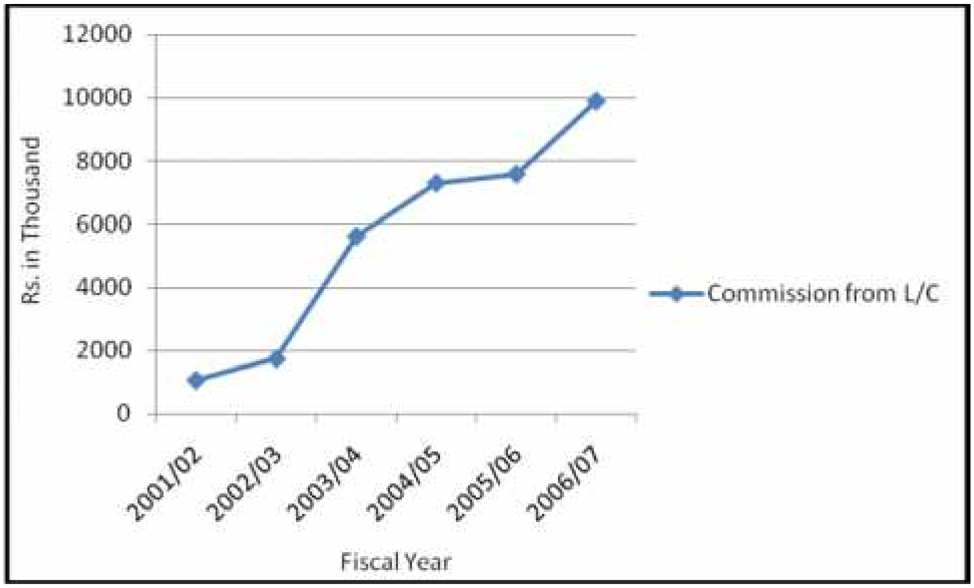
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The data show that the bank was able to increase the commission from L/C every year but the growth rate is not consistent. The growth rate in FY 2003/04 is 220% which is maximum than its previous year's growth rate of 62%. The growth rate is around 30% in FY 2004/05. There is stiff fall in the growth rate in FY 2005/06. The growth rate is around 4% in this year. Again growth rate rose to 30% in FY 2006/07. This shows that there is not consistency in the growth rate. Inconsistency is the inability of the bank to find the right and regular big L/C customers.

Though the income in amount has increased every year, the growth rate has highly fluctuated. At the initial stages of opening of the bank, it found more and big L/C parties through excessive marketing from which the bank earned high income. But the bank could not achieve same level due to competition and entry of new banks. Hence, the growth rate went on high fluctuation. Therefore, the bank must find the big and regular L/C parties for consistence growth level.

Following figure helps to analyze the growth rate of income from L/Cs.

Figure 4.10

Growth of Commission from L/C



The above figure shows that the income from L/C has been increased every year during the study periods. There is stiff increment in FY 2003/04 and highest income in FY 2006/07.

4.4.2.3 Commission from Bank Guarantees

A guarantee is an undertaking on behalf of the third party to make payment or fulfill the contractual obligations in case of default. In other words, a guarantee can be defined as an undertaking by a surety (guarantor) on behalf of the debtor (applicant) to the creditor (beneficiary) for payment up to a certain amount within a stipulated period for breach of contract or non fulfillment of obligations by the debtor. For this contingent liability borne, the bank charges certain commission which is the income of the bank under this revenue head. Hence, income from bank guarantee is analyzed below.

Table 4.20

Income from Bank Guarantee

(Rs. In Thousand)

FY	Income from Bank Guarantee	Increased Amount	Growth (%)
2001/02	599	-	-
2002/03	1590	991	165.44
2003/04	2590	1000	62.89
2004/05	4183	1593	61.5
2005/06	4231	48	1.12
2006/07	5321	1090	25.76

Source: Annual Reports

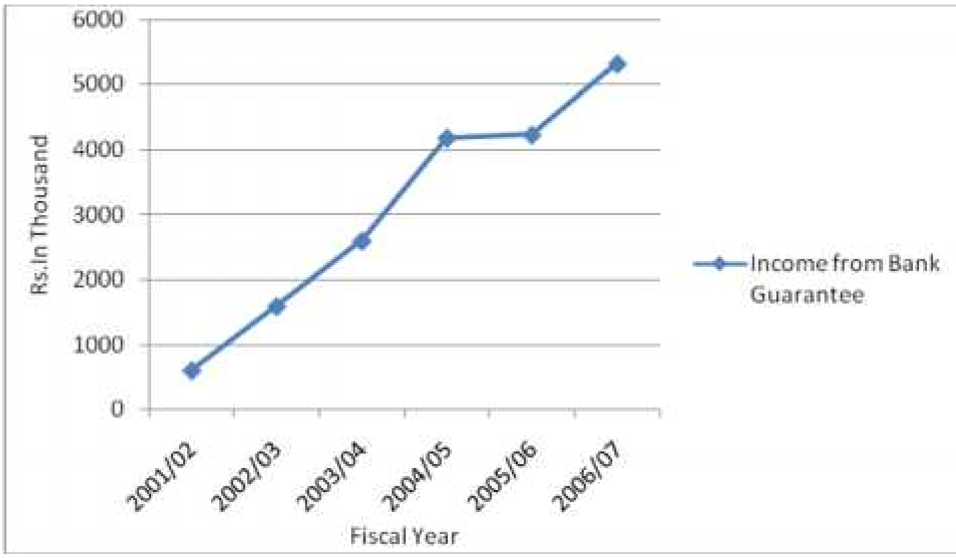
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above data show that the bank was able to increase its income from bank guarantee every year during study period. But the growth rate is in descending order. The growth rate in FY2002/03 is 165% which is highest. After then, the growth rate has been continuously decreased reaching to the growth rate of 1% in FY 2005/06. In FY 2006/07, the growth rate has been improved reaching at 25%. The bank must be alert upon the decreased growth rate of this income. Though the improvement has been noticed in FY 2006/07, the same case of decreasing trend can be revised if not given proper attention.

The bank guarantee income in amount has increased every year but the growth rate has highly fluctuated. At the initial stages of opening of the bank, it found more customers through excessive marketing from which the bank earned high income. But the bank could not achieve same level due to competition and entry of new banks which offered low commission. Hence, the growth rate went on high fluctuation.

Following figure helps to analyze the growth rate of income from bank guarantee.

Figure 4.11

Growth of Bank Guarantee Income



The above figure shows that the income from bank guarantee has been increased every year during the study period. But the in FY 2005/06, the growth level is lower as compared to previous years and the income is highest in FY 2006/07.

4.4.2.4 Income from Remittance

Remittance is the process of transferring or receiving fund from one place to another through various modes of payment such as draft, payment through fax message, pay order, electronic money transfer etc. Outward remittance is the process of sending fund to some other branch or bank within or out of the country. Inward remittance is to receive fund from some other branch or bank. The bank charges certain fee or commission for outward or inward remittances. The income received by the bank for this purpose is included in the remittance income. Hence, remittance income is analyzed below.

Table 4.21

Income from Remittance

(Rs. In Thousand)

FY	Remittance Income	Amount Increased	Growth Rate (%)
2001/02	260.35	-	-
2002/03	855.75	595.4	228.69
2003/04	1236.19	380.44	44.46
2004/05	1462.88	226.69	18.34
2005/06	1879.52	416.64	28.48
2006/07	2382.81	503.29	26.78

Source: Annual Reports

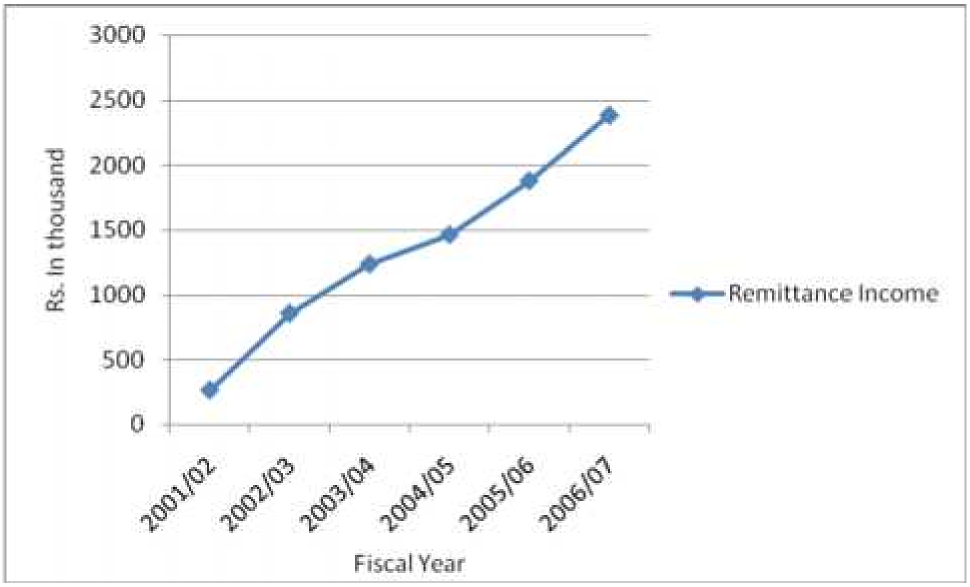
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above table shows that the bank was able to increase remittance income every year during the study period but the increasing rate is fluctuating. The growth rate in FY 2002/03 is 228.69% which is higher as compared to other years. After then, the growth rate has decreased to 44.46% in FY 2003/04 and to the lowest growth rate of 18.34% in FY 2004/05. Improvement of growth rate of 28.48% in FY 2005/06 has been observed which has decreased to 26.78% in FY 2006/07.

Though the remittance income has been increasing every year, it is in fluctuating trend. At the initial stages, the bank showed its total efforts on marketing. As a result, it showed high growth rate. But after market saturation, the growth rate has decreased. Also the bank has limited channels for remitting money inside and outside the country. So, the bank must give proper attention to increase this income.

Following figure helps to analyze the growth rate of income from remittance.

Figure 4.12

Growth of Remittance Income



The above figure shows that the bank was able to increase the remittance income every year. The figure shows that the highest income was in FY 2006/07.

4.4.2.5 Income from Collection

Collection is the process of obtaining proceeds against instruments payable at any other bank which is not a member of a clearing house and/or which is normally not in the local area or in the country. In other words, when cheques or drafts drawn on outstation banks (other than local bank in the local area, it can be a foreign bank also) is presented, the cheques are sent to the drawee bank either directly or through some correspondent bank in that city or country for realization of the proceeds. This is known as collection. The bank charges certain fee or commission for such services provided to the customers covering all its cost incurred. Hence, the income from collection is analyzed below.

Table 4.22

Income from Collection

(Rs. In Thousand)

FY	Income from Collection	Increased Amount	Growth Rate (%)
2001/02	126.74	-	-
2002/03	111.27	-15.47	-12.21
2003/04	532.76	421.49	378.79
2004/05	455.81	-76.95	-14.44
2005/06	496.77	40.96	8.98
2006/07	247.42	-249.35	-50.19

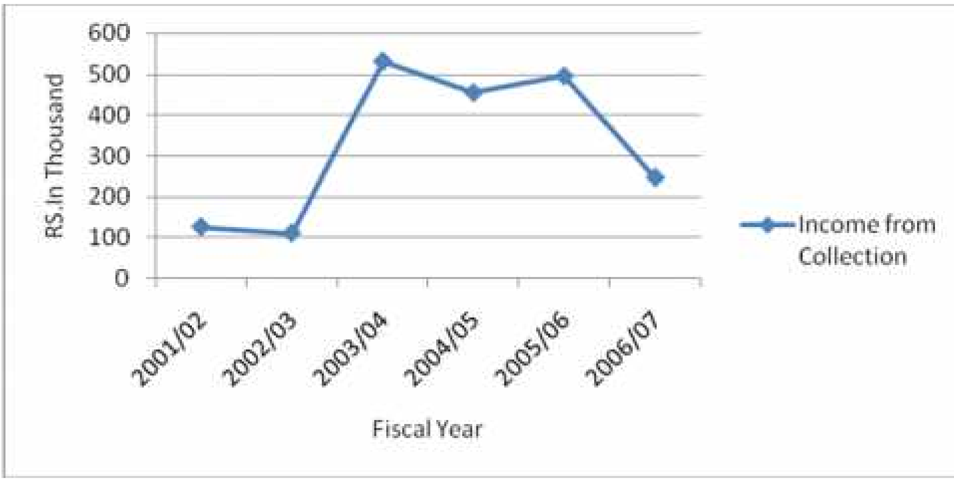
Source: Annual Reports

The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above table shows that the income from collection is not satisfactory, because the growth rate is neither consistent nor increasing. The income has negative growth rate of 12.21% in FY 2002/03. But unnaturally, it has increased by 378.79% in FY 2003/04. Again, in FY 2004/05, it has negative growth rate of 14.44 % showing little improvement of 8.98% in FY 2005/06. But, again it has negative growth rate 50.19% in FY 2006/07. The high fluctuation and negative growth rate of income from collection shows that the bank has less sincerity. The bank has not revised collection charges since its opening. Other new banks have offered low and competitive charges for collection. Thus, the data show that the bank was not able to receive income from collection consistently.

Following figure helps to analyze the growth rate of income from collection.

Figure 4.13

Growth of Income from Collection



The above figure clearly shows that the income from collection is not consistent. The growth figure is in the shape of ‘M’ which means the sudden rise and fall in the income. The lowest income is in the FY 2002/03 and the highest income is in the FY 2003/04. The income in the last year of the study period i.e. FY 2006/07 has been decreased than its previous year.

4.4.3 Income from Exchange Fluctuation Gain

Exchange fluctuation gain income is also one of the important sources of income of the bank. Bank sales the foreign currency and gains the exchange income. It buys the foreign currency in the lower rate and sells in the higher rate. The difference is the income of the bank. Hence, Exchange fluctuation gain income of the bank has been analyzed below.

Table 4.23

Income from Exchange Fluctuation Gain

(Rs. In Thousand)

FY	Exchange Fluctuation Gain Income	Increased Amount	Growth Rate (%)
2001/02	9151.99	-	-
2002/03	7143.62	-2008.37	-21.94
2003/04	14413.97	7270.35	101.77
2004/05	14988.83	574.86	3.99
2005/06	26373.74	11384.91	75.96
2006/07	20294.44	-6079.3	-23.05

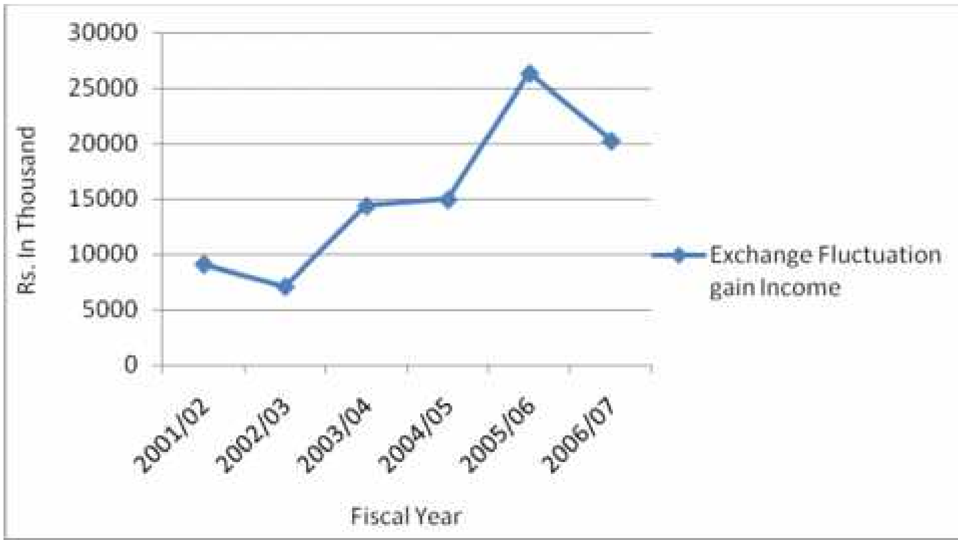
Source: Annual Reports

The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above table shows that the growth rate of exchange fluctuation gain is also not satisfactory; because in the FY 2002/03, the growth rate is negative of 21.94%. Again, it has been raised by 101.77% in FY 2003/04 which is unjustified and by 3.99% and 75.96% in FY 2004/05 and 2005/06 respectively. It has negative growth rate of 23.05% in FY 2006/07. This shows that the growth rate is not consistent and it is fluctuating. When the bank offers low exchange rates than other bank, the customers are forced to move to the bank which offers high exchange rate. So, while publishing exchange rates, the bank must consider other bank's exchange rate too and publish high and competent exchange rates. Thus, the bank must give proper attention for consistent income from exchange fluctuation gain.

Following figure helps to analyze the growth rate of income from exchange fluctuation gain.

Figure 4.14

Growth of Exchange Fluctuation Gain



The above figure shows that the income from exchange fluctuation gain is not consistently growing but it is in fluctuation trend. The lowest income was in FY 2002/03 and the highest income was in FY 2005/06. The income of the last year of the study period i.e. FY2006/07 is lower than its previous year.

4.4.4 Income from Others

Other income is also one of the important sources of income of the bank. Hence, other income of the bank is analyzed below.

Table 4.24

Income from Others

(Rs. In Thousand)

FY	Other Income	Increased Amount	Growth Rate (%)
2001/02	616.46	-	-
2002/03	582.72	-33.74	-5.47
2003/04	1772.93	1190.21	204.25
2004/05	2608.40	835.47	47.12
2005/06	10003.00	7394.6	283.49
2006/07	15280.95	5277.95	52.76

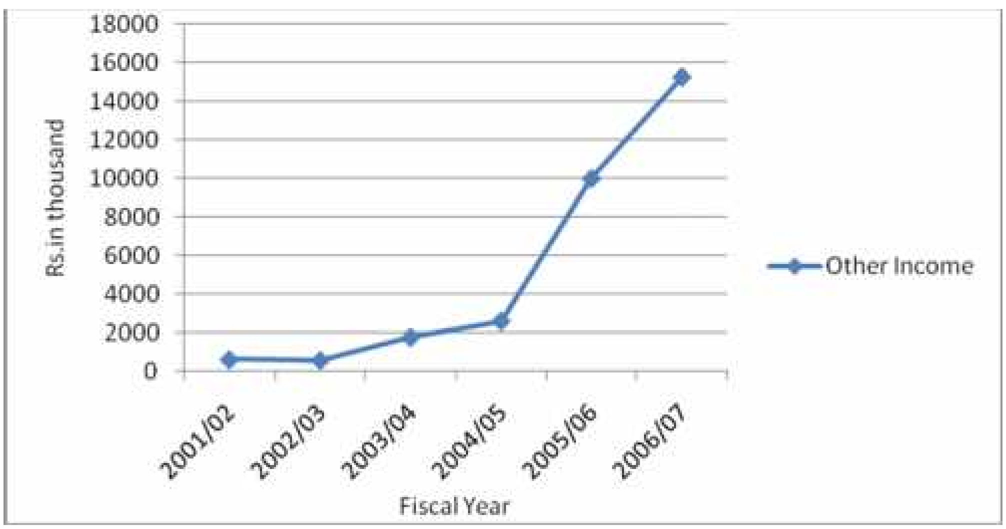
Source: Annual Reports

The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above table shows that the other income of the bank was in fluctuating trend and has negative growth rate of 5.47% in FY2002/03. But unnaturally, it has been increased by 204.25% in FY2003/04. The reason is due to high increment on locker and Telex/TT charges of this fiscal year. It has been increased by 47.12%, 283.49% and 52.76% in FYs 2004/05, 2005/06 and 2006/07 respectively. The high increment on FY 2005/06 is due to high increment on locker, Telex/TT and service charges.

Following figure helps to analyze the growth rate of other income of the bank.

Figure 4.15

Growth of Other Income



The figure shows that the other income of the bank has been increased regularly from FY 2002/03. The lowest income was in FY 2002/03 and the highest income was in FY 2006/07.

There are different revenue headings under other income of the bank such as safe deposit locker rent, SWIFT/TT charges, service charges etc. These revenue heads are analyzed below in detail.

4.4.4.1 Income from Safe Deposit Locker Rent

Bank provides the locker facility to the customers for safe custody of valuable ornaments and jewelries. For the service provided, bank charges certain fees as locker rent which is the income of the bank. Hence, income from safe deposit locker rent has been analyzed below.

Table 4.25

Income from Safe Deposit Locker Rent

(Rs. In Thousand)

FY	Safe Deposit Locker Income	Increased Amount	Growth Rate (%)
2001/02	56.00	-	-
2002/03	41.25	-14.75	-26.34
2003/04	119.34	78.09	189.39
2004/05	194.90	75.56	63.31
2005/06	338.20	143.3	73.52
2006/07	578.70	240.5	71.11

(Source: Annual Reports)

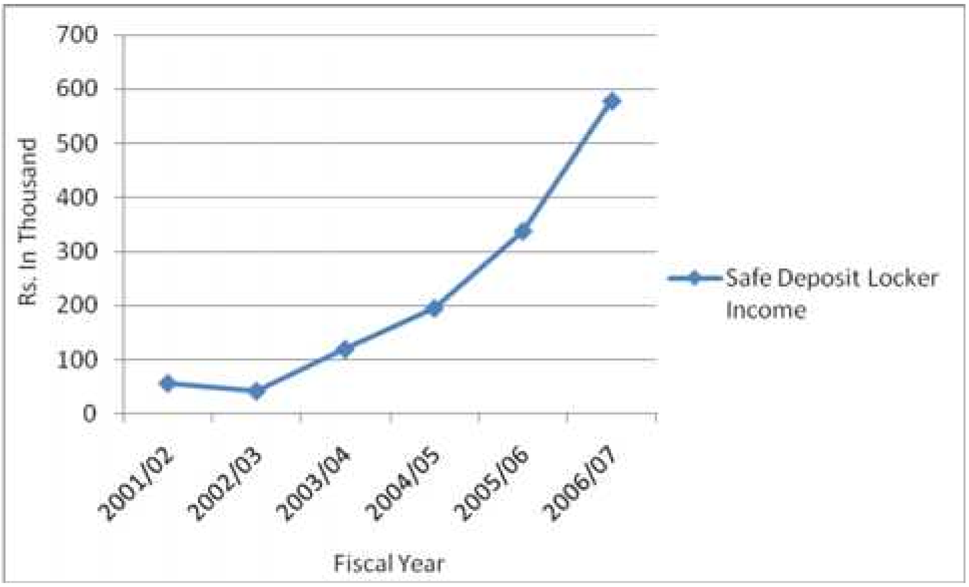
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The table shows that the income from safe deposit locker was satisfactorily increased after FY 2002/03. But in FY 2002/03, it has negative growth rate of 26.34% It was increased by 189.39 % in 2003/04. Though the income was higher in FY 2004/05 than FY 2003/04, the growth rate was only 63.31% in this year. The growth rate was 73.52% and 71.11% in FYs 2005/06 and 2006/07 respectively.

Though the income from locker rent is increasing except in FY 2002/03, the growth rate is fluctuating. Fluctuating growth rate affects in the profit of the bank. Many other banks offer discount on locker rent charges on different schemes and they attract more customers. But the bank has failed to do so.

Following figure helps to analyze the growth rate of safe deposit locker income of the bank.

Figure 4.16

Growth of safe Deposit Locker Income



The above figure shows that the income from safe deposit locker has been increased gradually from FY 2002/03. The lowest income was in FY 2002/03 and the highest income was in FY 2006/07.

4.4.4.2 Income from SWIFT/TT

SWIFT is the acronym of Society for Worldwide Interbank Financial Telecommunication which was established in 1973 with the objective of creating a global international transaction processing and transmission system. TT stands for Telegraphic Transfer which is also a mode of payment from one bank to another through telex message. Bank collects the commission on sending and receiving the amount through SWIFT which is the income of the bank. Hence, income from SWIFT/TT is analyzed below.

Table 4.26

Income from SWIFT/TT

(Rs. In Thousand)

FY	SWIFT/TT Income	Increased Amount	Growth Rate (%)
2001/02	340.44	-	-
2002/03	463.98	123.54	36.29
2003/04	1579.95	1115.97	240.52
2004/05	2104.23	524.28	33.18
2005/06	2524.37	420.14	19.97
2006/07	3257.26	732.89	29.03

Source: Annual Reports

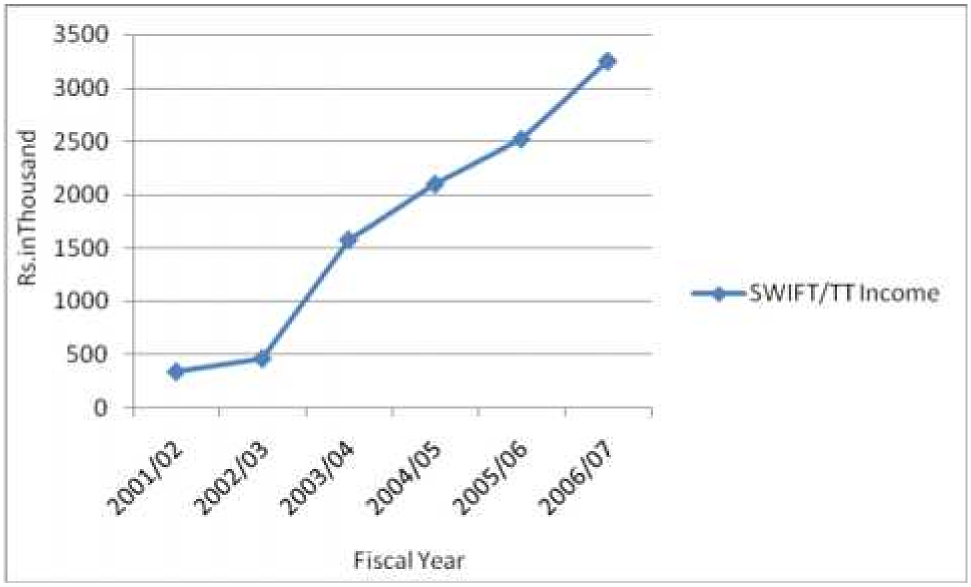
The growth rate for the FY 2001/02 is not presented due to not considering previous year. The above table shows that the income from SWIFT/TT was satisfactorily increased from initial period of the study. The income was increased by 36.29% in FY 2002/03 but in FY 2003/04, the growth rate was 240.52% which is highest among other growth rates. Then, the growth rate decreased to 33.18% in FY 2004/05 and again decreased to 19.97% in FY 2005/06. The growth rate increased to 29.03% in FY 2006/07. The amount of SWIFT/TT income was increased every year during the study period though the growth rate doesn't show this fact.

At the initial stages of opening of the bank, even with coordination with few corresponding banks due to excessive marketing, the income from SWIFT/TT showed high growth rate. But since the bank cannot remain at the same level due to changes in the marketing scenario, the growth rate has decreased. So, the bank should properly coordinate with corresponding banks and provide information to customers to transmit money through SWIFT/TT so that the bank can earn this income at consistent level.

Following figure helps to analyze the growth rate of SWIFT/TT income of the bank.

Figure 4.17

Growth of SWIFT/TT Income



The above figure shows that the income from SWIFT/TT has been increased every year during the study period. The lowest income was in FY2001/02 and the highest income was in FY 2006/07.

4.4.4.3 Income from Service Charges

Bank charges certain fees as services charges for various services provided to the customers. Bank charges 1% service charge of total loan sanctioned to the customers' account, outstation cheque service charges, counter slip (cheque) to the card account customers and many more services which need to take service charge.

Hence, income from service charges is analyzed below.

Table 4.27

Income from Service Charges

(Rs. In Thousand)

FY	Income from Service Charge	Increased Amount	Growth Rate (%)
2001/02	220.02	-	-
2002/03	77.49	-142.53	-64.78
2003/04	73.63	-3.86	-4.98
2004/05	309.27	235.64	320.03
2005/06	6563.23	6253.96	2022.16
2006/07	4694.95	-1868.28	-28.46

Source: Annual Reports

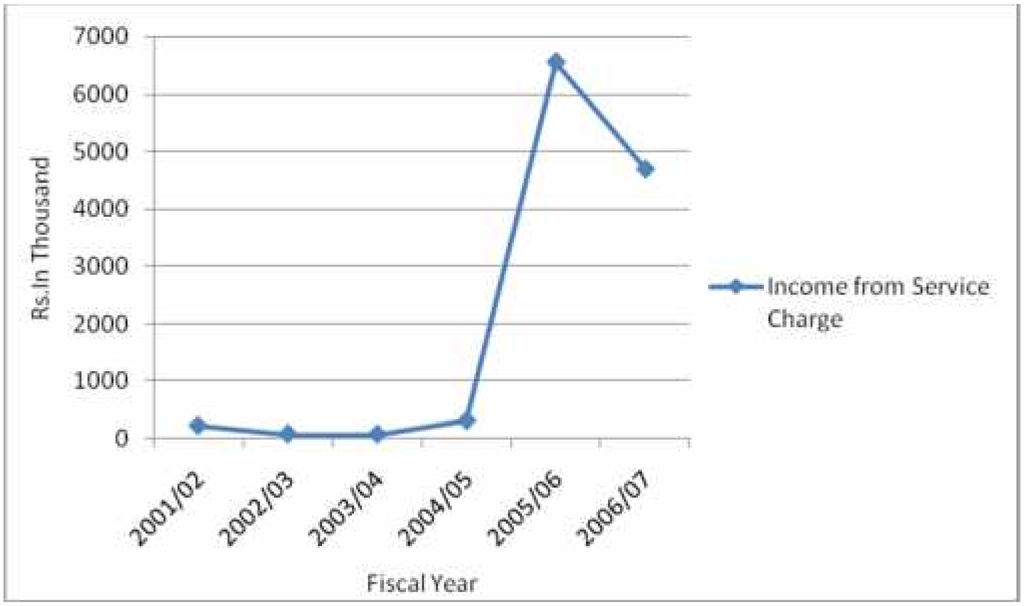
The growth rate for the FY 2001/02 is not presented due to not considering previous year. Considering the above table, the income from service charges of the bank is not satisfactory, because the growth rate is negative of 64.78% and 4.98% in FYs 2002/03 and 2003/04 respectively. In FY 2004/05, the growth rate is 320.03%. In FY 2005/06, it has increased by 2022.16% which is unnaturally high. Again, in FY 2006/07, the growth rate is negative by 28.46%.

The bank has failed to receive regular income from service charges. In FY 2005/06 and 2006/07, the income is more in comparison to previous years. The bank showed its effort on lending from which it received huge amount of income as service charges. The bank receives 1% service charge of sanctioned loan. The bank also received income from service charges like cheque return, outstation cheque etc.

Following figure helps to analyze the growth rate of income from service charges of the bank.

Figure 4.18

Growth of Income from Service Changes



The figure shows that the bank has very low income from service charges till the FY 2004/05 and in FY 2005/06, the income has suddenly increased to the highest level and again in FY 2006/07, it has decreased. Thus, the income from service charges is not consistent and satisfactory.

4.5 Net Burden

Net burden is the overall expenses of the bank except interest expenses incurred for the payment of deposit funds. That is the operating cost of the bank except cost of the deposit. Nature of this cost is semi fixed where as interest cost is variable cost. Net burden is net amount of burden cost obtained from the difference between other expenses and other income except interest expenses and incomes.

Following table shows the status of net burden of the bank during the study period.

Table 4.28

Net Burden

(Rs. In Thousand)

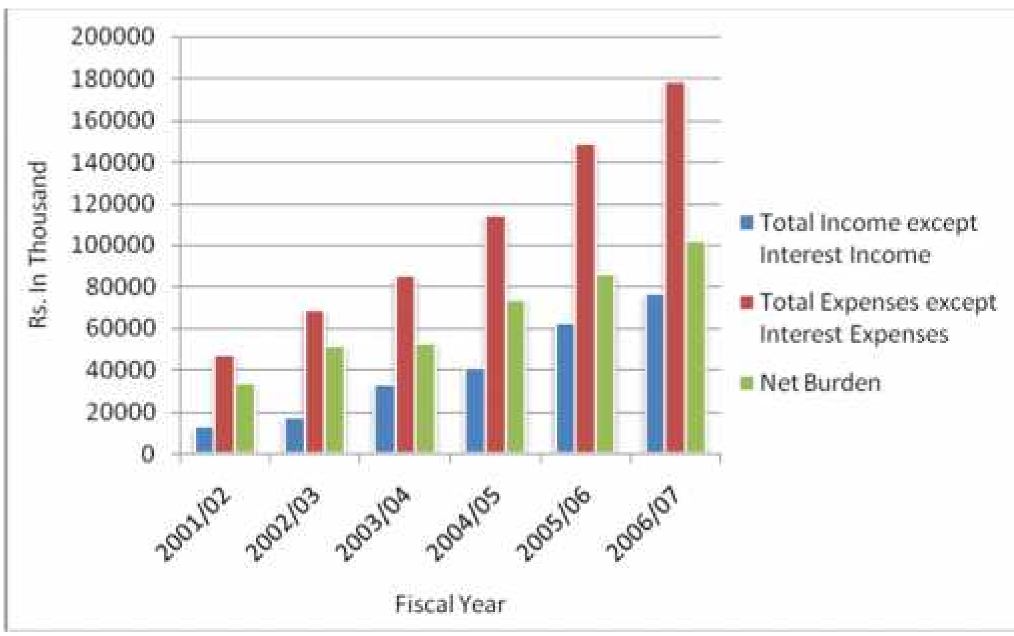
Fiscal Years	Total Income except Interest Income	Total Expenses except Interest Expenses	Net Burden
2001/02	13209.65	46749.62	33539.97
2002/03	17139.45	68757.69	51618.24
2003/04	32633.03	85017.45	52384.42
2004/05	40680.23	114207.01	73526.78
2005/06	62657.75	148502.60	85844.85
2006/07	76339.52	178323.10	101983.6

Source: Annual Reports

Following figure helps to clarify the net burden of the bank more clearly.

Figure 4.19

Net Burden of KBL



The above figure shows that along with the increment of income and expenses, net burden of the bank has also increased. The bank had low net burden in FY 2001/02 and highest in FY 2006/07. This means that every year net burden of the bank has been going increasingly. Increase in net burden means increase in semi fixed cost of the bank which deteriorates the strength of the bank in making more profit.

Comparing to other expenses, other income of the bank is very low. To minimize the net burden of the bank, it must focus on increasing the income locker charges, service charges, ATM cards, commission and discount. These income heads have contributed less on other income. The bank is also lacking to increase non fund based income. The bank is unable to minimize expenses. Increase in net burden also means inefficiency of the bank in managing expenses.

4.6 Cost Volume Profit Analysis

Cost volume profit (CVP) analysis is the process of examining the relationships among revenues, costs and profit for a relevant range of activity and for a particular time frame. It is an analytical tool to show the relationship between the elements of profit planning. Profit planning is the function of the selling price of product, demand, variable cost, fixed cost etc. The whole picture of profit planning is associated with cost-volume-profit interrelationships. CVP analysis is helpful in managerial decisions managing especially cost control and profit planning.

CVP analysis is based on assumptions such as it is based on data on FY 2006/07. Also, net burden of the bank is taken as fixed cost which is calculated on the basis of total other cost and other income of FY 2006/07 and interest margin (spread) is calculated on the basis of total interest income and total interest expenses of FY 2006/07.

Total interest income	791284.21
Total interest expenses	397053.12
Total other income	76339.52
Total other expenses	178323.10

Net burden = Total Other Expenses – Total Other Income

= 178323.10-76339.52

= 101983.58

Interest margin (spread) = Total Interest Income – Total Interest Expenses

= 791284.21- 397053.12

=394231.09

A popular technique to study cost-volume-profit relationships is break even analysis (BE analysis). We can calculate BE income with reference to interest income as follows.

$$\text{BE Income} = \left(\frac{\text{Net Burden}}{\text{Spread}}\right) \times \text{Interest income}$$

$$= \left(\frac{101983.58}{394231.09}\right) \times 791284.21$$

$$= 204697.19$$

It means that other things remaining the same; the interest income required for the bank to be in break even level is Rs.204697.19. Here, bank's interest income is almost four times higher than required break even level.

Margin of Safety = Actual – BE level

= 791284.21- 204697.19

= 586597.02

Margin of Safety ratio= 586597.02 / 791284.21=74.13%

Further, margin of safety ratio is also higher. So, the chance of bank going on loss is very low.

4.7 Correlation between Different Variables

The two variables are said to be correlated with each other when the change in the value of one variable is accompanied by the change in the value of another variable. Thus, the correlation between important variable are studied below.

4.7.1 Correlation between Interest Income from Loans to Total Loans

The correlation between interest incomes from loans to total loans describes the relationship between these two items. How a change in the unit of loans makes impact in the volume of interest income is measured by this correlation. Here, loan is the independent variable and the interest income is the dependent variable.

Table 4.29

Correlation between Interest Income and Total Loans

Correlation Coefficient (r)	**P .E (r)**	**6* P.E (r)**	**Remarks**
0.9986	0.0008	0.0048	r > 6* P.E (r)

(Source: Appendix 5)

The above table shows that the correlation coefficient (r) between interest income and loans and advances of the bank is 0.9986 and probable error multiplied by 6 is found to be 0.0048. Since, r>6*P.E (r), and r is positive and near by 1, it can be interpreted that there is strong positive correlation between interest income from loans and advances and total loans and advances of the bank during the study period.

4.7.2 Correlation between Interest Income from Investments to Total Investments

The correlation between interest income from investments to total investments describes the relationship between these two items. How a change in the unit of investments makes impact in the volume of interest income is measured by this correlation. Here, investment is the independent variable and the interest income from investments is the dependent variable.

Table 4.30

Correlation between Interest Income from Investment and Total Investment

Correlation Coefficient (r)	P .E (r)	6* P.E (r)	Remarks
0.9342	0.0351	0.2106	r > 6* P.E (r)

Source: Appendix 6

The above table shows that the correlation coefficient (r) between interest income from investment and total investment of the bank is 0.9342 and probable error multiplied by 6 is found to be 0.2106. Since, r>6*P.E (r), and r is positive and near by 1, it can be interpreted that there is strong positive correlation between interest income from investment and total investment of the bank during the study period.

4.7.3 Correlation between Income from Commission and Discount and Off Balance Sheet Transactions

The correlation between income from commission and discount and off balance sheet transactions describes the relationship between these two items. How a change in the unit of off balance sheet transactions makes impact in the volume of income from commission and discount is measured by this correlation. Here, off balance sheet transactions is the independent variable and the income from commission and discount is the dependent variable.

Table 4.31

Correlation between Income from Commission and Discount and Off Balance Sheet Transactions

Correlation Coefficient (r)	P .E (r)	6* P.E (r)	Remarks
0.9413	0.0314	0.1884	r > 6* P.E (r)

Source: Appendix 7

The above table shows that the correlation coefficient (r) between income from commission and discount and off balance sheet transactions of the bank is 0.9413 and probable error multiplied by 6 is found to be 0.1884. Since, r>6*P.E (r), and r is positive and near by 1, it can be interpreted that there is positive correlation between income from commission and discount and off balance sheet transactions of the bank during the study period.

4.7.4 Correlation between Exchange Income and Foreign Currency Reserve

The correlation between exchange income and foreign currency reserve describes the relationship between these two items. How a change in the unit of foreign currency reserve makes impact in the volume of income from exchange gain is measured by this correlation. Here, foreign currency reserve is the independent variable and the income from exchange gain is the dependent variable.

Table 4.32

Correlation between Income from Exchange Gain and Foreign Currency Reserve

Correlation Coefficient (r)	P .E (r)	6* P.E (r)	Remarks
0.1819	0.2662	1.5972	r < 6* P.E (r)

Source: Appendix 8

The above table shows that the correlation coefficient (r) between income from exchange gain and foreign currency reserve of the bank is 0.1819 and probable error multiplied by 6 is found to be 1.5972. Since, r<6*P.E (r), and r is positive and nearer to 0, it can be interpreted that there is insignificant relationship or say no relationship between income from exchange gain and foreign currency reserve of the bank during the study period. This means that increase in foreign currency reserve will cause decrease in foreign currency exchange gain.

4.8 Trend Analysis

Trend analysis helps to understand the past behavior of a variable in the time series and also to forecast and plan for future with the help of past and present data. It helps in evaluating the present accomplishment. The actual performance can be compared with the expected performance and analyze the causes of such variations.

4.8.1 Trend Analysis of Interest Income

Interest income is the main revenue head of the bank. So, an attempt has been made to analyze the trend values of total interest income of the bank for next five years till FY 2011.

Table 4.33

Trend values of Total Interest Income

Years	Trend Values
2007	907.32
2008	1048.06
2009	1188.8
2010	1329.54
2011	1470.28

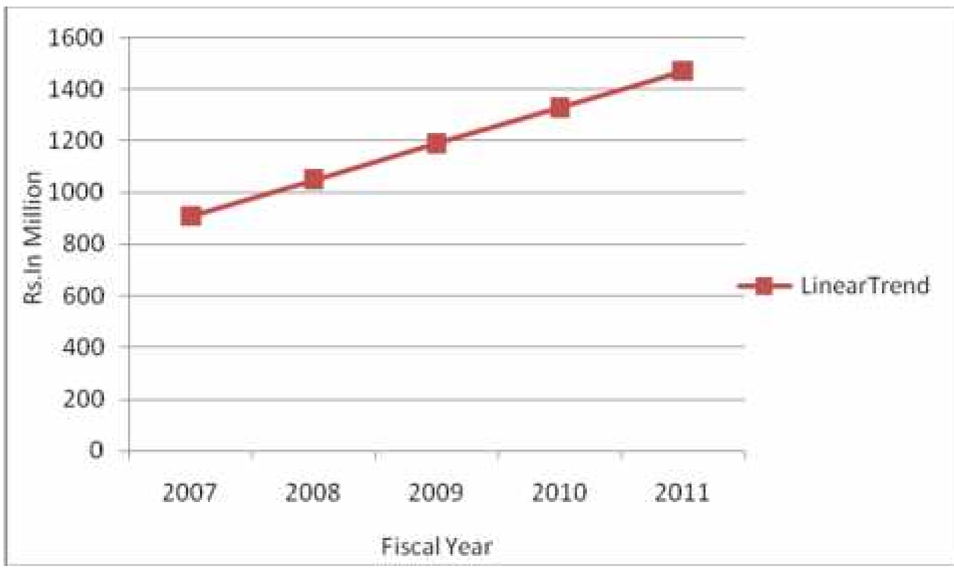
Source: Appendix 9

From the above table 32 it is clear that the interest income of the bank is in increasing trend. Other things remaining same, total interest income of the bank will go on increasing till FY 2011 which will be Rs.1470.28 million and which is the highest during the study periods and the periods taken for projection.

The trend values are shown in the figure below for more clarification.

Figure 4.20

Liner Trend of Interest Income



The above figure shows that the linear trend line of interest income has been increasing till the FY 2011.

Here, an attempt has been made to find the reason for deviation of actual and trend values of FY 2006/07.

Actual value of FY 2006/07 = 791.28 million.

Trend value of FY 2006/07 = 414.73+70.37x = 414.73+70.37*5 = 766.58 million.

The actual interest income of FY 2006/07 is more than the trend value of interest income by 24.70 million. This means the bank was able to manage loans, advances and overdraft properly and earn high interest income.

4.8.2 Trend Analysis of Net Profit

The success of the bank is sown by the net profit earned by it. So, an attempt has been made to analyze the trend values of net profit of the bank for next five years till FY 2011.

Table 4.34

Trend Values of Total Net Profit

Years	Trend Values
2007	186.43
2008	219.49
2009	252.55
2010	285.61
2011	318.67

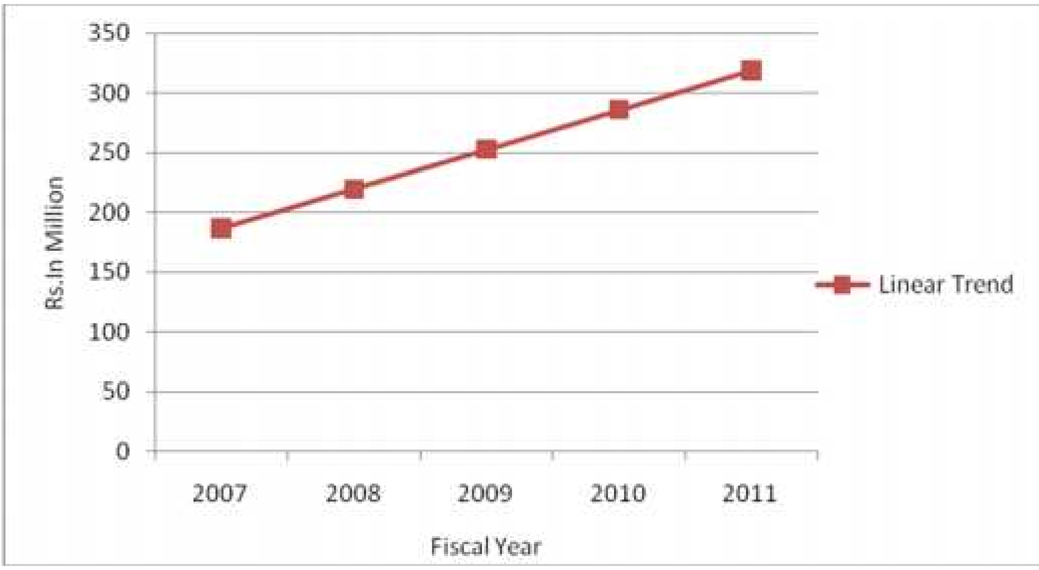
(Source: Appendix 10)

From the above table 33 it is clear that the net income of the bank is in increasing trend. Other things remaining same, net profit of the bank will go on increasing till FY 2011 which will be Rs.318.67 million and which is the highest during the study periods and the periods taken for projection.

The trend values are shown in the figure below for more clarification.

Figure 4.21

Linear Trend of Net Profit



The above figure shows that the net profit of the bank is in increasing trend.
Here, an attempt has been made to find the reason for deviation of actual and trend values of FY 2006/07.

Actual value of FY 2006/07 = 170.26 million.
Trend value of FY 2006/07 = 70.72+16.53x = 70.72+16.53*5 = 153.37 million.

The actual interest income of FY 2006/07 is more than the trend value of interest income by 16.89 million. This means the bank was able to manage loans and deposits from which it earned high net interest income. Also, the bank earned high income from other sources like commission and discount, other operating income and loan loss provision written back. The bank was able to maintain staff and other expenses properly. All these effective management of the bank caused higher actual value of net income than forecasted value of FY 2006/07.

4.9 Major Findings of the Study

After the analytical study of subject matter of the study, it is the major responsibility of the researcher to find out the major facts of the study. Only the analytical part of the study is not the complete study of the research. The researcher must point out the findings of the study so that it will be meaningful and helpful to take corrective actions.

Here, the researcher has made effort to point out some major findings of various aspects of revenue planning of KBL by using important financials as well as statistical tools. The objective of the researcher is not only to study and analyze the subject matter but also to find some major facts and to provide suggestions which will be helpful to the concerned parties to take corrective actions.

The major findings of the study that are derived from preceding sections of this chapter are presented below.

4.9.1 Findings from the Profitability Ratio Analysis

1. Total interest income to total income ratios are fluctuating over the study period ranging from minimum of 87.94% in FY 2001/02 to maximum of 92.47% in FY 2004/05. The mean ratio is 90.69% and S.D and C.V are 1.53 and 1.69 respectively. Interest income constitutes almost 91% of total income. From this we can say that the bank is generating higher profit by mobilizing the funds to loans and advances and investment activities.

2. Total interest income to total outside assets ratios is slightly fluctuating during the study periods. The bank has low interest income of 6.70% in FY 2003/04 to maximum of 7.37% in FY 2004/05. The mean of the ratio is

7.20% and S.D and C.V are 0.28 and 3.89 respectively which shows that the ratios are slightly fluctuating.

The bank is satisfactorily generating interest income from investing its funds in outside assets.

3. Interest expense to total expenses ratios are in fluctuating trend ranging from 44.49% in FY2001/02 to 59.17% in 2005/06. The mean of the ratio is 52.97% and S.D and C.V are 5.40 and 10.19 respectively. Interest expenses cover more than 50% of total expenses of the bank. Interest expenses are the major expenses of the bank. Increase in interest expense means increase in cost of funds.

4. Total interest income to total assets ratios are ranging from minimum of 5.6% in FY 2003/04 to the maximum of 6.72% in FY 2004/05 and 2005/06. The mean of the ratios is 6.33% and S.D and C.V are 0.44 and 6.95 respectively.

   This means that the earning power of total assets of the bank is found satisfactory.

5. Total interest expenses to total assets ratios are ranging from 2.98% in Y2003/04 to 3.74% in FY 2005/06. The mean of the ratios is 3.24% and S.D and C.V are 0.28 and 8.64 respectively. Total interest paid to total assets is less than total interest earned. This means that the bank is getting higher income as interest income by mobilizing the funds as outside assets.

6. Total income to total expenses ratios ranges from 1.01 in FY 2001/02 to 1.73 in FY 2005/06. The mean of the income generating ratio is 1.23 and S.D and C.V are 0.25 and 20.32 respectively. Since the nature of both total income and total expenses are in increasing trend, per unit of expenses is able to generate sufficient income that covers the expenses.

7. Total income to total assets ratios are almost consistent over the study period which range from minimum of 6.24% in FY 2003/04 to maximum of 7.41% in FY 2005/06. The mean of the ratios are 6.98%. The S.D and C.V are 0.44 and 6.30 respectively. Though the study periods were not so good due to political disputes, the bank was able to earn consistently.

8. Net interest margin is increasing every year during the study periods but the growth rate of net interest margin is highly fluctuating. The growth rate in FY 2002/03 is 91.22% which is very high after then this is continuously decreasing to the minimum of 3.34% in FY 2005/06. But in FY 2006/07, the growth rate has increased to 46.85%.

When there is excess liquidity in the market, the bank lowered interest rate on deposit, and when there is deposit crunch, it raised interest rate. As a result, the bank also fluctuate interest rate on lending which caused high fluctuation in the growth rate of net interest margin.

Most of the ratios are in fluctuating trend. The management of the bank is unable and inefficient to maintain the high growth ratios.

4.9.2 Finding from Off Balance Sheet Transactions to Total Loans and Advances

OBS transactions to total loans and advances ratios range from minimum of 12.78% in FY 2005/06 to maximum of 23.44% in FY 2003/04. The ratios are in fluctuating trend. The mean ratio is 17.24% which indicates that the off balance sheet transactions are low in comparison to total loans of the bank.

OBS transactions such as L/C, bank guarantee are fee and commission based transactions which play an important role to increase the volume of bank's profit. These are also less risky than fund based transactions. But the bank has focused more on fund based risky transactions.

4.9.3 Findings from Income Structure

Income structure of the bank consists of interest income, commission and discount, other income, exchange gain and non operating income. Interest income of the bank is consistent over the study periods and covers almost 90% of total income of the bank. Commission and discount covers 4.25%, exchange gain covers 4.19% and other income covers only 0.85% of total income.

Comparing to interest income of the bank, other income sources or structure contributes very low to total income of the bank.

4.9.3.1 Findings from Composition of Interest Income

The interest income from loan and advances of the bank is fluctuating over the study periods which cover almost 90% of total interest income of the bank. Interest income from loans and advances ranges from minimum of 87.34% in FY 2006/07 to maximum of 92.56% in FY2004/05. The interest income of the bank from investment is also fluctuating over the study periods ranging from minimum of 4.24% in FY 2002/03 to the maximum of 7.95% in FY 2005/06. Interest income from agency balance, money at call and short notice and other interest income are very low and in fluctuating trend over the study periods.

Considering the percentage of other composition of interest income, it seems that the interest income from loans and advances has occupied highest position and second position has occupied by investment. It seems that the bank has focused more on interest income from loans and advances and investment.

4.9.3.2 Findings from Composition of Commission and Discount Income

The commission income from other sources is higher than other composition of commission and discount income. It covers almost 43% of total commission and discount income. Similarly, commission from issuance of letter of credit (LC) occupies the second position in the contribution of commission income and covers almost 28%. The income from LC is in fluctuating trend. Further, commission from issuance of bank guarantees occupies the third position in the contribution of commission income and covers almost 16%. The income from bank guarantee is in decreasing trend. Similarly, commission income from remittance occupies the fourth position in the contribution of commission income and covers almost 8%. It is also in fluctuating trend. Other composition of commission and discount incomes like bill purchased, collection fees, and share underwriting and agency commission occupy low shares on percentage as compared to others.

4.9.3.3 Findings from Composition of Other Income

The income from TT/SWIFT is highest among other income which covers almost 56% of total other income. Similarly, the income from service charges occupies the second position in the contribution of other income by 21.70%. Loan loss provision written back occupies around 10.49% in the contribution of other income. Though the income from ATM cards started only from FY 2005/06 and locker rental income from FY 2001/02, both incomes occupy around 5% in the total income of other income.

4.9.4 Findings from the Growth Analysis of Major Revenue Heads

- The growth rate of interest income is fluctuating. The bank has been able to increase the interest income amount every year.

- Only the growth rate of interest income from loans and advances is in decreasing trend but the bank has been able to increase interest income amount from loans and advances every year.
- The growth rate of interest income of investment is in decreasing trend and even in minus in FY 2006/07. This means that the bank is failing to invest and to earn desired income from secured sectors.
- Though the income from commission and discount has been increased every year but it is in fluctuating trend. The highest is in FY 2002/03 because it was the initial period of the bank and the lowest is in FY 2005/6.
- The income from bills purchased and discount is not regular and also not satisfactory. There is no income at all in FY 2002/03 and 2004/05 while it is the highest in FY 2006/07.
- The growth rate of income from L/C is highly fluctuating. The growth rate is 220.9% in FY 2003/04 while it is only 3.86% in FY 2005/06. But the income in amount has been increased every year.
- The growth rate of income from bank guarantee is also highly fluctuating. But the income in amount has been increased every year. The growth rate is 165.44% in FY2002/03 while it is only 1.12% in FY 2005/06.
- The growth rate of income from remittance is highly fluctuating. The growth rate is 228.69% in FY 2002/03 while it is only 18.34% in FY 2004/05. But the income in amount has shown little increment every year.
- The income from collection is found not satisfactory. Also the growth rate is on minus in FYs 2002/03, 2004/05 and 2006/07. The growth rate of 378.79% is unexpectedly high in FY 2003/04. The growth rate of 8.98% in FY 2005/06 shows that the bank has made effort to increase income from collection but again the income of FY 2006/07 shows that it is still less.

- The growth rate of income from exchange fluctuation gain is highly fluctuating and also in minus in FYs 2002/03 and 2006/07. The growth rate of 101.77% is highest in FY 2003/04 while it has decreased to 3.99% in FY 2004/05.
- The growth rate of income from safe deposit locker rent is also found fluctuating. It is on minus in FY 2002/03 while unnaturally it has risen to 189.39% in FY 2003/04 and has gone down to 63.31% in FY 2004/05.
- Though the income from SWIFT/TT in amount has increased every year but the growth rate is not satisfactory because it is highly fluctuating. The growth rate is very high i.e. 240.52% in FY2003/04 while it is only 19.97% in FY 2005/06.
- The growth rate of income from services charges is unnaturally and highly fluctuating. The growth rate is on minus in FYs 2002/03 and 2003/04 while it has shown sudden increment of 320.03% in FY 2004/05 and 222.16% in FY 2005/06. Again, the growth rate has gone minus in FY 2006/07.

Most of the growth rates of revenue heads are highly fluctuating. Highly fluctuating means the management of the bank is not giving proper attention to increase the income from revenue heads of the bank.

4.9.5 Findings from Net Burden

Total income except interest income and total expenses except interest expense both have increased every year. Consequently net burden of the bank has also increased. The bank had low net burden in FY 2001/02 and highest in FY 2006/07. The figure of the net burden clearly shows that the bank has less effort in fee based and commission based transactions. Increase in net burden is increased in semi fixed cost of the bank which is bad signal for the efficiency of the bank. The bank is unable to track the other expenses and increase the fees from non fund based transactions.

4.9.6 Findings from CVP Analysis

Other things remaining the same, interest income required for the bank to be in break even level is Rs.204697.19 (In Thousand). Here, bank's interest income is almost four times higher than required break even level. Margin of safety is also higher. So, the chance of bank in going loss is very low.

4.9.7 Findings from Correlations

Correlation between interest income from loans and total loans is positive and strong. Similarly, correlation between interest income from investment and total investment is also positive and strong. Also, correlation between income from commission and discount and OBS transactions is positive. But, there is insignificant relationship or no correlation between income from exchange gain and foreign currency reserve.

4.9.8 Findings from Trend Analysis

Trend analysis of interest income shows that it is in increasing trend. There will be Rs.1470.28 million interest income in FY 2011 which is the highest among study periods. Similarly, trend analysis of net profit shows that it is also in increasing trend. Other things remaining the same, there will be net profit of Rs.318.67 million in FY 2011 which is the highest among the study periods.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This is the last chapter of the study. This chapter is divided into three sections viz. summary, conclusions and recommendations. The study in brief is presented in first section. In other words, the summary of whole study is presented in this section. Then in second section, what conclusions have been derived from the study is presented. And in the last section, some useful suggestions and recommendations are made so that the bank can increase revenue income. The conclusion and recommendations are made based upon the findings from the study.

5.1 Summary

Nepal is one of the developing countries of the world. Though it is very rich in natural resources and hydro power, it is not developed as expected. This is because of lack of technical ability, entrepreneurship, capital and skilled manpower. Also mass poverty, dependency on agriculture and foreign aid, unemployment, high population growth, unfavorable foreign trade are characteristics of Nepalese economy. To overcome these characteristics, the country must develop its economic environment. The development of any country heavily depends upon the economic development. Nepalese economy is also highly correlated with the economy of two largest countries India and China.

Financial sectors play an important role in the economic development of the country. It is the financial sector which pools scattered funds and channels it to productive uses. Financial institutions are the intermediaries between the surplus and deficit sectors of the economy. Financials institutions like banks play an important role in proper utilization of the funds in the economy. Financial institutions which are monitored and controlled by NRB generate income from various revenue heads like interest income, commission and discount and service charges. So, the banks must have proper revenue planning system.

The study is related with revenue management of KBL. The study is basically based on secondary data. The data are collected from annual reports, journals, magazines, newspapers and relevant unpublished master’s thesis. Besides, personal contacts with bank’s personnel have also been made. The main objective of the study is to evaluate the soundness of profitability and operating efficiency of the bank which have been constraints by various limitations. The data have been analyzed by financial as well as statistical tools and interpreted accordingly. Under financial tools, profitability ratios have been used. And under statistical tools, coefficient of correlation and trend analysis have been used. The analysis and interpretation of data and major findings give clear picture of the performance of the bank with regards to its revenue management.

5.2 Conclusion

Total interest income to total income ratio is consistent over the study periods. Interest income covers almost 91% of total income. Though the interest income to total outside assets is slightly fluctuating, the interest income is satisfactory. Interest expense covers more than 50% of total expenses of the bank. Increase in interest expense means increase in cost of deposit. The earning power of total assets i.e. total interest income to total assets is found satisfactory. The total interest paid is found to be less than total interest earned. Per unit of expense is satisfactorily generating income that covers expense. Though the study periods were not so good due to political instability, total income to total assets ratio is found consistent. Net interest margin is increasing every year but the growth rate is fluctuating. The ratio of OBS transactions to total loans and advances is in fluctuating trend.

Interest income dominates the income structure of the bank. It covers almost 90% of total income of the bank. In comparison to this income, commission and discount and exchange gain cover very low in income structure of the bank. They cover 4.25% and 4.19% respectively. Other income covers only 0.85% of total income. Even in interest income, interest income from loans and advances covers almost 90%. Issuance of L/C and bank guarantee covers 28% and 16% respectively in commission and discount income. Income from TT/SWIFT covers almost 56%; service charges cover 21.70% of other income. Loan loss provision written back, ATM cards and locker rental cover very low position in other income.

The growth rate of interest income is fluctuating while the growth rate of interest income from loans and advances is in decreasing trend. The growth rate of interest income of investment is in decreasing trend and even in minus in FY 2006/07. The bank is failing to invest and to earn desired income from secured sectors. The income from commission and discount has been increased every year but in fluctuating trend. The income from bills purchased and discount is not regular and also not satisfactory. The growth rate of income from L/C and bank guarantee is highly fluctuating. The growth rate of income from remittance is highly fluctuating. The income from collection is found not satisfactory. The growth rate of income from exchange fluctuation gain is highly fluctuating The growth rate of income from safe deposit locker rent is also found fluctuating Though the income from SWIFT/TT in amount has increased every year but the growth rate is not satisfactory because it is highly fluctuating. The growth rate of income from service charges is unnaturally and highly fluctuating.

Net burden of the bank is in increasing trend. CVP analysis shows that the income of the bank is more than break even level. Margin of safety is also higher. Net profit of the bank is also increasing every year.

The researcher has come to conclusion that interest income dominates total income of the bank. Interest income from total loans and advances occupies more in interest income. The bank is giving more emphasis on fund based income rather than fee based income. The low ratio of OBS transactions to total loans shows that the bank is focusing less on fee based transactions. The ratios of major revenue heads are neither consistent nor increasing. Most of them are in fluctuating trend while some are in decreasing trend. This means that the bank is not giving proper attention to manage the revenue. The continuous increase in net burden means the bank is unable to manage its expenses.

5.3 Recommendations

On the basis of analysis and findings of the study, following recommendations are made to increase revenue of the bank.

1. The proportion of OBS transactions with loans and advances is very low. This means that the bank is getting more income from fund based transactions only. The bank is lacking its focus on fee based transactions from which bank can earn higher income as fees and commission. So, the bank is recommended to give more priority to increase fee based transactions.
2. Nepalese economy is sustained by the help of remittance that comes from abroad. But the contribution of remittance income is very low. It is recommended that the bank should increase number of local and international channels to attract customers to remit money. The bank can tie up with other banks and money transfer agents.
3. The bank is recommended to revise its fee and commission charges and rates as per demand in the market. When other banks are offering low charges and

rates, the bank also can offer competitive rates to attract customers so that commission and discount income will increase.

4. Regarding high demand and easy processing, it is recommended to start credit cards business also.
5. The income from locker facility is very low. Regarding security problem, people do not want to keep at home. So, it is recommended to have locker facility at almost all branches.
6. Along with interest expenses, other expense of the bank is also increasing every year. Therefore, the bank can adopt control mechanism to lower net burden.
7. Unsatisfied customers are bad signals for the growth of the bank. So, it is recommended that the bank must have proper policy of maintaining satisfied customers and retaining unsatisfied customers.
8. The bank has not analyzed or revised revenue income till now. The revenue income is highly fluctuating. The management is not sincere and has given less attention to manage revenue heads of the bank. Though overall budget is prepared by Strategic and Planning Department with coordination of other departments and individual branches, it has no separate revenue management system. Therefore, the bank is recommended to have revenue management system to analyze revenue income. The bank must have proper policies and plans to increase revenue of the bank.
9. Because of innovation of internet and mobile banking for the first time in the country, the bank is always known as innovative bank in the market. So, it is recommended to be always focused on innovative sectors and be a leading financial institution in the market.

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