

# CHAPTER I

## INTRODUCTION

### 1.1 Background

In most countries banking had its origin with gold smiths who accepted deposits from merchants and others for safe keeping of money and other valuables. With the change in time and function of bank the definition of bank has made broad.

Crowther has defined bank in an institution which collect money from those who have it spare or who are saving it out of their income and lender this money out to those who require it.

The primary functions of banks are exchange lending and deposition of money but now it performs so many functions and activities in numerous ways. Bank performs several financial monitory and regulating functions, which are very essentials for the economic development of the country. Bank draws idle money from the people who are not using at present and are hoarding for future and supplies loan to those who are in a position to use it for productive purpose. Modern banks are considered as evolved from the ancient gold smiths.

Bank provides proper facilities and can serve important contribution to develop different sectors of the economy so bank plays an important role in evaluating financial system of the economy and it is significant from the others financial institutions with respect to both pattern of resource mobilization and deposition. Thus, it is obviously true that bank is the backbone for the resource mobilization.

Oxford dictionary defines bank as “an establishment for the custody of money.”

Bank is an institution for receiving, lending, exchanging, and safeguard money and in some cases issuing notes and transacting other financial business.

## **1.2 History of Banking Development in Nepal**

Modern banks can be considered as evolved from of ancient gold smiths. Before 1848 B.S. the goldsmiths used to store peoples gold and other valuable goods and other charge nominal charges against the deposit. That time people deposited their gold and valuable goods for the sake of security rather than earning interest. In ancient Nepal historical record shows that Gunakama Dev, the king of Kathmandu, borrowed money to rebuild his kingdom in 723 A.D. some 57 years thereafter, a merchant Shankhadar introduced “Nepal Sambat” by clearing all the indebtedness of people in 880 A.D. After Jayasthiti Malla the people engaged in money lending business, were called Tanka Dhari money lending business became quite popular in Nepal. Thus the role of Tanka Dhari was similar to that of a banking agent. Still in the practice of Tanka Dhari was not free from problem. There were mal practices and frauds associated. Consequently with the growing consciousness and awareness of this Ranodip Singh, a Rana prime minister got interested in the problem and took concrete step by establishing a government financial institution known as Tejarath Adda at 1880 A.D. This Tejarath Adda helped the public and government staff by supplying easy and cheap credit at 5% interest on the security of gold and silver ornaments outside the Kathmandu valley also.

So the role of Tejarath cannot be ignored on the enlistment of Nepalese economy and it should be taken as the beginning of the banking development. Although, services provided by the Tejarath were extended in other parts of the country, its benefit was not available to the society as a whole. So the monopoly of local money lenders was stills on practices in the rural areas. To eliminate this drawback and monopoly in 1937 A.D. The Tejarath was replaced by a commercial bank called Nepal bank limited (NBL) which marked the beginning of a new era in history of modern banking in Nepal. Nepal has not experienced long banking transaction development of banking in Nepal lags much behind the development of banking system in the world. So the history of banking development in Nepal is very compared to the banking development of the world. Nepal bank act 1937 A.D.

allowed the commercial banks (CB) to extend loans and advances for a period not more than six months.

Thus the establishment of NBL solved the prevailing financial inconveniences of the people. As a result the numerous activities were increased especially in the field of trade and commerce. Till the establishment of Nepal rostra bank (NRB) the major functions of NBL was the function as a central bank also so it was serving two purposes that are of central and of commercial bank.

The Mulukikhana Adda established in 1945 A.D. at the central and the various mal Adda (revenue office) in the districts undertook the treasury functions of the government. Against this background an urgent need was felt for the establishment of central bank dedicated to the development of banking and finance to promote industry and trade to manage the circulation of national currency and maintain exchange rate stability.

In Nepal economic growth and development has been considered as a primary objective of economic planning since the beginning of the first five year plan in 1956 A.D. objectives of the plan was to increase production, employment and to improve the living standard of the people. To fulfill these objectives of planning it was necessary that banking activities especially the loan was to be regulated as per priority. Under this first five year plan NRB as the central bank of Nepal was established as a nonprofit organization which was subscribed by the government in April 26-1956 as per NRB act 1955 the objectives of the NRB are to facilitate and maintain economic interest of the general public by safeguarding the issue of paper currency. To mobilize capital for economic development and to stipulate in trade and industries to secure country wide circulation of Nepalese currency to achieve stability in its exchange rate and to develop banking system in the country.

The central bank plays a significant cant role in developing country to develop the banking system for the mobilization of resources and using them to the priority areas to match development plan. So NRB has been authorized to play this role.

Integrated and speedy development of the country is possible only when competitive banking service reaches nooks and corner of the country. Keeping this in

mind government set up Rastriya Banijya Bank (RBB) in 23 January 1966 as a fully government owned CB. It is necessary to mention here that the establishment of RBB definitely helps to supply the growing financial need of economy. Their underlying feature is to contribute to the development of banking system particularly in remote area lying in hilly regions. NRB has handed over most of its branches to this bank.

Besides NRB and RBB other CBS didn't come into existence until 1984 A.D. During this period of 1966 to 1984, NRB specially centralized its role for the expansion of CBS branches are over the country. For this purpose a banking development committee was formulated to advise for the increment and development of the existing bank branches in the nation to bring about co-ordination in the activities of the bank and financial institutions to open new branches and to expand the spheres of activities of activities in scientific way to mobilize internal resources, to maintain the flow of credit in priority sectors to simplify the rules of deposit and credit to improve the method of interest payable and receivable to train the employees on proper and planned way etc NRB itself started as broad feasibility study for expansion of branches and created banking development fund of Rs.25 lakhs in 1965/66.

Commercial banks are to carry out commercial transaction only. But they had to carry out the functions of all types of financial institutions. Hence, industrial development central (IDC) was set up in 2013 for industrial development in 2016, IDC was converted to Nepal industrial development corporation (NIDC) similarly, agriculture development bank Nepal (ADB/N) was established in 2024 Magh 7 to provide introducing modern agricultural technique could enhance finance for agricultures productivity. Moreover, securities exchange center was renamed Nepal stock exchange (NEPSE) in 1993 A.D. NEPSE opened its trading floor on 13 January 1994 with the establishment of RBB and ADB/N banking service spread to both the urban and rural areas NRB also gave incentive to NBL to expand their branches to rural. This helped the common people reduce their burden of paying higher rate of interest to moneylenders and absolved them from knowing before moneylenders it is natural expectations of customers keep on increasing once they got banking services they were expecting improvement and efficiency in the process of depositing and borrowing money however excess political and bureaucratic interference and lake

scientific managerial concept in these institutions were hurdles in this regard. Banking services to the satisfaction of customer was far cry. The inception of Nepal Arab bank limited as a first joint venture bank proved to be a milestone in the history of banking. Nabil bank gave a new ray of hope to sluggish financial sector. Because of liberal economic policy adopted by the successive governments following CBS came into being.

1. Nepal Indo-Suez Bank Ltd (Renamed as Nepal Investment Bank Ltd. on 30 May 2002)
2. Nepal Grind lays Bank Ltd (renamed as Standard Chartered Bank Ltd. on 13 July 2001)
3. Himalayan Bank Ltd.
4. Nepal SBI Bank Ltd.
5. Nepal Bangladesh Bank Ltd.
6. Bank of Kathmandu Ltd.
7. Everest Bank Ltd.
8. Nepal Bank of Ceylon Ltd. (Renamed as Nepal Credit and Commerce Bank Ltd. on 10th September 2002)
9. Lumbini Bank Ltd.
10. Nepal Industrial and Commercial Bank Ltd.
11. Machhapuchhre Bank Ltd.
12. Kumari Bank Ltd.
13. Laxmi Bank Ltd.
14. Siddhartha Bank Ltd.

Over the years the government has established and promoted the banking system and has used it as a vehicle for the mobilization of saving and allocate it to the needy. NBL and RBB are involved in rural saving mobilization. In addition to 17 CBS (with 399 branches), there are five regional rural development banks, 16 development banks 57 finance companies are operating in the financing market. There are also 34 co-operatives have got the permission from NRB for limited banking transactions and 44 non government organization (NGOs) are operating as a financial intermediates.

### **1.3 Statement of the problems**

Nepal is one of the least developed countries in the world with a per capital income of us \$220 per annum (would develop report 2002). It was estimated recently by the (UN) that 53% of population have an income of less than one dollar per day. One of the causes of pervasive poverty is the lack of economic resources for the growing population and slow rate of national economic growth.

Approx 85% people are living in rural areas and majority of them are poor. More than 80% of the borrowing household has still to depend on non-formal sources for their credit needs. Majority of the targeted credit programs has been unable to directly cater to the needs of the bottom 20% households because the poor lacks other resources and knowledge to benefit from the saving credit programs.

Being a developing country in the world, Nepal is facing with paucity of capital resources needed for economic development although, economic growth requires the conditioning of the whole environment ,capital is one of the prime factors for development. As for practicable, economic development should be finance from the country's resources itself .Capital can be mobilized through two main channels those of fiscal and monetary measures. In this process the creation of monetary arrangements and the financial institution is very important but in Nepal, banks have not succeeded much in mobilizing capital for productive use due to different reasons. Here, a large percentage of populations are illiterate and they do not have banking habit and do not know the importance of banking system. So, the main problem is lack of banking development itself because of these reasons people do not deposit their saving in bank. They prefer to hold and keep idle of their money rather than utilize in the productive way. The bank deposit per person in Nepal is much lesser as comparison to other countries. Consequently most of the people prefer to take loans from the unorganized moneylenders rather than from organized financial sector, paying higher rate than fixed by the financial institutions and banks because several bureaucratic hazels. The weak financial position of most of the government owned financial institution, negative is it worth and huge accumulated losses of the government owned CBS higher properties of nonperforming assets (NPA) and large interest rate spread between lending and borrowing rates in the formal financial

sector. Besides, there is predominance of the informal financial system with high interest rate differentials between the formal and informal sectors of the economy.

Depositors have not received attractive interest rates while the borrowers and investors have suffered from larger cost of capital. Small depositors are discouraged from opening their accounts and carrying out transactions in some of the banks that are giving less consideration to retail banking. The two large domestic banks are plagued by problems like operational inefficiencies, managerial deficiencies and poor clientele relations. This is also the problem presented by world bank reports. The reasons for this and identification of the problem are very important questions to answer these questions analysis of NRB's role is important one.

Despite the presence and expansion of banking network in the country, a large number of rural borrowers still have to depend on the informal sector for their credit need. Being the poorest country half of the population lives under the absolute poverty line, the trend of lending money from the riches of the village on the collateral of their lands and buildings is still on so the real challenge of the bank is to develop banking habit of the population of rural areas.

Saving mobilization and effective credit management system is the need of the country for economic development specially for a country like Nepal where the economic growth rate is very low and to add fuel to the fire it is going negative growth at present.

Due to different causes most of the CBS are centralized in urban part of the country the liberal economic policy of NRB cannot compel these banks to open new branches in rural areas. Due to the national and international constraint just like Maoist insurgency existing branches of banks has been closing day by day. In this context banking development of our country is a big problem so the present study focuses on the role of NRB for the development of commercial banking in Nepal.

## **1.4 Objective of the study**

Since its establishment in 1956, NRB has undertaken various activities for the banking and financial development of the country. There are many aspects for the development of commercial banking in Nepal. Out of these aspects, the researcher has selected these three are main factors for the development of commercial banking as follows.

1. To examine the role of NRB in expansion of banking services in Nepal
2. To estimate the relationship of interest rate with deposit mobilization and credit expansion of the CBS.
3. To examine the role of NRB in expansion of commercial banks. So the objective is to analyze and evaluate these factors of banking development.

## **1.5 Limitation of the Study**

This study is a partial requirement of MBS programs so this study will be limited by following factors.

1. The study periods covers only ten years i.e. from mid July 1993 to mid April 2009.
2. Although NRB has varieties of policies such as economic development, monetary foreign exchange etc. This study can't cover whole of financial system. It covers only on the policy of NRB related with the development of commercial banking facilities such as branch expansion, deposit collection and utilization interest rate etc. All others aspects of CBS are not included due to the constraint of time.
3. So for commercial banking branches of ADB/N are excluded where as other commercial banking activities according to the need of the study are included
4. Although there are 17 CBS, This study includes only 16 CBS because the researcher has included only those CBS, which have completed at least 1 year of functioning at the time of collecting material for the study.
5. The study is based on secondary data and degree of truth depends on the secondary information provided by the concerned institutions.

## **1.6 Research Methodology**

As aforesaid the main objective of this thesis is to study the role of NRB in the development of commercial banking in Nepal.

The study entirely is based on the secondary data. Therefore descriptive research design is more or less adopted.

Various financial and statistical tools have been used to achieve the objective of the study. Because of limited resources, mostly simple analytical tools are taken for the analysis. The different graphs and charts are also presented for the analysis process. For the findings of the results of this research more ever coefficients of correlation method is used to ascertain the extent to which two variables are related. Correlation procedures are used simple to describe relationship between variables. So correlation analysis is used as a part of the descriptive section and least square regression is also used the data are taken from different thesis books and other bulletins from different banks interpretation will be done where as necessary.

## **1.7 Chapter Plan**

This study is divided into the following five chapters. The first chapter incorporates backgrounds of the study development of banking system in Nepal, statement of the problem, objectives limitation of study, research methodology, chapter plan, and implication of the study. In the second chapter theoretical review, problem of banking in Nepal, development of central banking system, role function and need of central bank, regulation relating to commercial banking activities in Nepal, review of related studies and other relevant matters are reviewed.

In the third chapter the research method followed by the research in analyzing the problem has been outlined. It includes research design, sources of data, sample size, data processing procedures, and use of statistical methods.

In the fourth chapter data are presented and analyzed. In this chapter total numbers of commercial banks branches population per bank branch, training personal, interest rate structure deposit and credit, collection of deposit and investments it, total deposit and credit position and ratio, liquidity and capital adequacy and others related matters are presented and analyzed.

Finally summary, conclusions, findings and recommendation on the basic of analysis are presented along with appendices and bibliography.

## **1.8 Implication of the Study**

This research study is based on the role of NRB especially on commercial banking development in Nepal. For the development of all sectors of the economy such as agriculture, service, trade and industries etc banking of development is necessary. Without the development of commercial banks, no sectors of economy can flourish. In every country government determines financial policy and central bank regulate monetary policy that goes along with financial policy. Central bank issues directives .The directives of central bank occupy a central role in determining the success of monetary policy of the country. This analysis will help both NRB and CBS for the betterment and fast development of CB, which leads to the development of the country as a whole so this study though small in size but is expected to impart valuable insights at commercial banking development in Nepal several recommendation will be presented at the end of this research on the basis of analysis. After the analysis it will help and can provide data and information to different related sectors.

## **CHAPTER II**

### **Review of literature**

The review of literature is very important aspect of the research. This chapter highlights upon the previous literatures. For this several books, dissertations, reports, hands out and articles published in journals and newspapers are reviewed.

#### **2.1 Introduction**

The issue of development always rest upon the mobilization of available resources in the country. Investment is a means whereby, the foundation of resources mobilization is pillared. Banks are the sources for granting advance to the investors.

The researches have got the some special definitions of the bank at the book of Dahal and Dahal, which are:

As per Kent:- “Bank is an organization whose principle operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for expenditure.”

As per banking regulation act of India:-“Banking means the accepting for the purpose of lending or investment of deposit of money from the public repayable on demand or otherwise, and withdrawals by cheque, draft or otherwise.”

As per us law:-“Any institution offering deposit subject of withdrawal on demand and making loans of a commercial or business nature is a bank.”

Definitions given above are applicable to all types of financial intermediaries. In fact banks nowadays do a large number of financial transactions which financial institutions are authorized to do limited transactions only. Hence a bank can be defined a financial department store which renders a host of financial services besides taking and giving loans. Banking has crossed various phases to come to the modern

from. Some sort of banking activities had been carried out since time immemorial. Traditional forms of banking were traced during the civilization of Greek Rome and Mesopotamia.

The more developed financial system of the world characteristically faces into three parts. The central banks the commercial banks and other financial institutions. They are also known as financial intermediaries. The principles of fractional reserve are the foundation of modern banking as it enables banks to create credit. On the basis of function, bank can be classified as commercial bank, central bank, development bank, exim bank, cooperative bank hulk bachat bank etc.

### **2.1.1 Meaning of Commercial Banks**

“Commercial banks as an organization chartered either by the comptroller of the currency and known as a national bank or chartered by the state in which it will conduct the business of banking. A commercial bank generally specializes in demand deposits and commercial loans.”

“Commercial bank as a bank that concentrates on cash deposit and transfer services to the general public often to be found on the high street it may be joint venture bank or private bank.”

“Bank is an institution that deals in money and its substitutes and provides and provides other financial services. Banks accept deposits and make loans and derive a profit from the difference in the interest rates paid and charged respectively. Some banks also have the power to create money CB is a bank with the power to make loans that, at least in part eventually because new demand deposits. Because it is required to hold only a fraction of its deposits as reserves. It can use some of the money on deposit to extend loans. When a borrower receives a loan, use some of the money on deposit to extend loans. When a borrower receives a loan, his checking account is credited with the amount of the loan, total demand deposits are thus increased until the loan is repaid. As a group, then CBS are able to expand or contract the money supply by creating new demand deposits. “Banking the business of

providing financial services to consumer and business. The basic services a bank provides are checking accounts and time deposits that can be used to save money for future use loans that consumers and businesses can use to purchase goods and services and basic cash management services such as check cashing and foreign currency exchange. CBS are specializing in loans to commercial and industrial businesses CBS owned by private investors, caused stockholders or by companies called bank holding companies.”

The main objectives of CBS are to earn profit by collecting the fund scattered around the general public, and mobilizing it. Be the main functions of CBS happen to be collecting deposits from general public and lending loans to various economics sectors that require financing. The make profit by charging a bit higher interest rate in loans that they pay to depositors. So the main source of income of CBS is interest income.

### **2.1.2 Problem of Banking in Nepal**

At present, large numbers of banks are operating in Nepal. Naturally, they are rendering a wide range of services. They are keeping up with the change taking place in the world. While comparing present banking in Nepal with it of a two decade ago, we find a sea change nevertheless, the banking today is not hale and hearty. The banking in Nepal is still ailing with various problems the main problems are discussed as under.

Most of the people in Nepal live in rural areas and they are illiterate as well. Banks have opened their branches mainly urban areas. In the rural area people have no option but knock the door of “sahu mahajan” (money lenders) for loan. Charges against money lenders are high. They exploit the borrower by charging higher interest rate, compound interest rate and even by manipulating the principle amount.

Thus the poor have become the poorer. Unorganized sector is strong in the urban area as well because banks are not competent to render the efficient service.

NBL, NRB, ADB and NIDC have large market share. However they have suffered from problems like weak management, effective management information system, high operating cost, over staffing, red-tapism, high service cost or social cost etc. This warrants strong and effective supervision and monitoring of NRB. Inability of banking sector to bring a large chunk of urban and rural population to the banking net is a big problem of banking.

A bank is judged on the basic of capital adequacy, As best quality, management of efficiency, earning capacity, liquidity and sensitivity to market risks (CAMELS.)At most as the government banks are running at losses. Though almost all the private sector banks are showing profit it is very difficult to call them sound of appraised from(CAMELS) approaches .Some banks have very low capital adequacy ratio (CAR) while some banks have piled up NPA. Similarly it appears banks do not have proper system in place for management of market risks. Similarly there is an unhealthy competition among the banks to attract and retain the new and old customers respectively. In this regard, they have compromised on security aspects and sanctioned loans to customers beyond customer's real requirement. In the long run, it will prove very costly to both the borrowers and the bank.

RBB, ADB, NIDC and NRB are government banks government has a large share in NBL. Inefficiency of these banks knells the death toll of the economy. Though these banks are working as per existing acts, it is common to hear government interference in their functioning. These are seriously damaged their competitive strength and defeated the very purpose of their establishment. Health of NBL, RBB, NIDC some other private banks are not goods today. Though individual banks are to blame themselves for their sick health. Being supervisor of the financial institutions NRB should have played a proactive role so that current plight of them could be averted. Financial reforms being initiated by NRB deserves appreciation but such a one off costly reforms could be avoided if NRB supervised and mainforced financial institutions more effectively on a regular basis in past days.

Most of the banks do not have expert rending officials and loans/investments are being made without people analysis of risk. Since loan with risky asset, proper appraisal of the project is a must. Similarly, shrinkage in the value of investment

portfolio erodes capital of the bank. This problem can be removed by establishing an agency for credit rating of the borrower/securities.

Banks are not serious towards research and development. Sometimes, their loan portfolio is diversified while sometimes concentrated. They are unable to foresee the profitable areas and act accordingly. Moreover, banks in Nepal are copying the products of international marketing that too very late. Advancement in the field of IT has brought about revolution in banking sector elsewhere but in Nepal, it is still like a cry for moon. This scenario is not good for the healthy growth of banking.

### **2.1.3 Development of Central Banking System**

The clear concept of central banking is the product of 20<sup>th</sup> century. Before the establishment of central bank in a country we found that the CBS or such types of financial institutions performing the central operation to some extent. In such a time a systematic and consistent technique of central bank had not been developed or formulated.

The function of central bank is to be supervising, regulate and control CBS and other financial institution in such a way as to support the monetary policy directed by the state. It is the bank that works as the lender of money worked. It is the chief of all banks operating in the country. It means it is banker's bank. This means that the CBS looks at central bank as a lender of last resort in critical times.

In various countries, during the course of 19<sup>th</sup> century, the state either endowed an existing bank with the role or principle right of note issue, or caused a new bank of issue to be established with special power and privileges, accompanied by varying degree of state control and supervision.

In the past, there was no much difference in the meaning and definition between ordinary banks with the central bank except in some areas. But now the function of central bank is different from those of CBS. Both the central bank and CBs accept deposits keep reserves and possess capital, but the purpose for which

deposit are received and cash reserves are maintained are different. The CBs uses its reserves are maintained are different. The commercial banks are its reserves in such a way which do not contribute to inflation. Thus the central bank is established with unique and different phenomena from ordinary system yet having a determinate and important position in the banking area. The risks bank of Sweden is the first central bank which was established in 1656 and reorganized as a state bank in 1668. AD but the bank of England that was established in 1694AD are known as the mother of central bank due to first bank issue and assume the position of central bank. Risks bank of Sweden also began to follow the steps of the bank of England and gradually development into a central bank.

After the bank of England, the bank of finance was established in 1800AD similarly, bank of Netherlands, national bank of Austria bank of Norway, National bank of Denmark, national bank of Belgium bank of Russia and bank of Japan were established as central bank during 19<sup>th</sup> century. Similarly central bank of china established in 1928 Reserve bank of India in 1935, state bank of Pakistan in 1948 and central bank of Ceylon in 1950. NRB was set up in 1956 under NRB ACT 1955 as the central bank of Nepal. Today every country whether developed or developing has got a central bank of its own. Thus the concept of central bank was not development as once it is the result of gradual evolution for long period.

#### **2.1.4 Meaning of Central Bank**

A central bank is the government bank world over central bank is the head of monetary and banking sector in consonance with the government fiscal policy, Central bank formulation monetary policy. Bank of England 1694 and is the pioneer central bank. International monetary conferences held in Brussels in 1920 urged are the European countries to have a central bank. Likewise, international monetary fund (INF) 1944 has facilitated Asian and African nations to set up central banks.

A central bank may be defined as institution which is charged with responsibility of managing the expansion and contraction of the volume of money in

the interest of the general public welfare. It has also been defined as a banker's and holding bank reserve of a country and ultimate reservoir of credit.

The different scholars have given different meaning and definition about the central bank. Some famous scholars definitions are mentioned here under:

1. According to De Kock's :- "A central bank is a bank which constitutes the apex of the monetary and banking structure. It is the lender of last resort and has monopoly in note issue.
2. According to Prof. Somuelson:- "A central bank is a bank that the government sets up to handle its transaction to co-ordinate and control the commercial banks and most important to help and control the nations money and credit condition."
3. According to Prof. Kisch and Eikin:- "A central bank is that bank the essential duty of which is maintenance of stability of monetary standard.
4. According to bank of international settlement (BIS):- "Central bank is the bank to which has been entrusted the duty of regulating the volume of credit and currency in the country."

In generally we can say that central bank characterized with monopoly to constitute the monetary system and coin and note issue in the supreme institution, manage the monetary system for the national interest and mainly controlling and supervising and monitoring power over the commercial banks and financial institutions."

According to NRB act 2058, its objectives shall be as follows.

- a. To formulate necessary monetary and foreign exchange policies in order to maintain the stability of price and balance of payment for sustainable development of economy and manage it.
- b. To promote stability and liquidity requirement in banking and financial sector.
- c. To develop a secure, healthy and efficient system of payment.
- d. To regulate, inspect, supervise and monitor the banking and financial system.
- e. To promote entire banking and financial system of kingdom of Nepal and enhance its public credibility.

Thus, a central bank as an institution entrusted with the responsibility of safeguarding public interest by managing currency and credit for price stability and safety of public money.

#### **2.1.4.1 Functions of Central Bank**

Being a monetary authority, central bank has to discharge many functions. Major functions are note issue regulation, supervision and control of banking. Management of foreign exchange government bank banker's bank and clearing house which are discussed as under.

Generally central bank enjoys the monopoly of note issue. This power of central bank enables them to regulate and control money supply in the country. For the first time in Nepal the government issued paper currency from Sadar Muluki Khana at September 1946. NRB (2016-11-07) at 2040 marga 15 Hint department that way issuing coins transferred to NRB from HMG. It is the supervisor of the finance sector which makes regulations for operation of financial institutions, gives license to them for operations, make regulation regarding statutory liquidity Ratio (SLR), cash reserve ratio (CRR), capital adequacy, interest structure, foreign exchange, credit portfolio, loan classification and provisioning, in the interest of public guides, banking to move in the same direction. IT regulatory monitors to ensure proper implementation and its rules. In case of violation central bank is empowered even to

snatch the license of operation. It is entrusted with the responsibility of managing foreign exchange (forex.) of the country. In economically advanced countries, we see an uninterrupted movement of capital. Central bank in such countries let the market determine exchange rate but do not hesitate to intervene in the market if it does the prevailing exchange rate is inconsistent with economic fundamentals.

Country to this central bank in the development countries exercise control in all the aspects of foreign exchange but where liberalization has forced them to develop their power nevertheless, it should act like a watch dog to ensure that the country does not face balance of payment (BOP) problem it also works as the banker to the government and advise to them on various aspects of the economy, maintenance of accounts of government bodies, fund transfer LC Guarantee transaction for government bodies, raising of public debt and overdraft facility to government. It is the only organization that monitors the whole economy of the country. It acts as an economic advisor and agent of the government. In fact, it is not the bank of people but the bank of government. It does not pay interest on government deposit.

Central bank act as the clearinghouse, for clearance transfer and settlement of mutual claims different banks through a single window. NRB has recently started the clearinghouse for foreign current yield transactions as well which was earlier handled by standard chartered bank Nepal Ltd. The act of clearinghouse makes less expenditure and reveals the quantity of liquidity. There will be used risk and it also protects the monetary fund saves the times of the banks. CBS create credit by giving loans creation of credit means creation of money.

Other functions of central banks are collecting periodic data to know the fiscal and monetary condition of the country. They publish and provide periodic data with supply etc. They organize training for the employees of various financial institutions. Therefore central bank is an important financial institution in every foreign independent country in modern age. Central bank is the central arch of the monetary and fiscal framework in every country.

#### **2.1.4.2 Functions, Duties and Power of Nepal Rastra Bank**

1. In order to active the objectives referred by NRB act 2058 B.S., the function duties and powers of the banks shall be as follows.
  - a. To issue bank notes and coins
  - b. To formulate necessary monetary policies in order to maintain price stability and to implement or cause to implement them.
  - c. To formulate foreign exchange policies and to implement or cause to implement them.
  - d. To determine the system of foreign exchange rare.
  - e. To manage and operate foreign exchange reserve.
  - f. To issue license to commercial banks and financial institution to carry on banking and financial business and to regulate inspect supervise and monitor such transactions.
  - g. To act as a banker advisor, and financial agent of his majesty's government.
  - h. To act as a banker of commercial banks and financial institutions and to functions the lender of the last resort.
  - i. To establish and promote the system of payment clearing and settlement and to regulate these activities, and
  - j. To implement or cause to implement any other necessary functions which the bank has to carry out in order to activities the objective of the bank under this act.
- b) While exercising the power conferred by this act or any other prevailing law, the bank shall have power to carry out other functions and take actions which are incidental there to.
2. No one shall violate powers conferred on the bank under this act.

### **2.1.4.3 Role and Need of Central Bank**

A central bank is set up with the objective of monetary stability and economic development in the country. To active these objectives, they are required to play many roles. In Dahal and Dahal book the role of central bank has presented in this away.

A central bank has to create such an environment that economic activities flourish in the country. A central bank does so by making appropriate rules and regulations for the growth and expansion of banking sector. Similarly, a central bank plays a crucial role for the development of capital market mobilization of scattered capital for development activities(public debt) flow of credit to the priority sector deprived sector and the educated unemployed etc.

Being a central bank of Nepal, NRB has also played a development role by creating a congenial environment to establish CBS, development banks, financial companies and cooperation etc. Likewise, NRB made investment to set up security exchange center and citizen investment trust NRB provide refinance facility for the development of agriculture and industry it gives refinance at concessional rate to CBS to revive sick units and to invest in priority sector NRB has promoted rural development bank (RDB) and credit information bereave (CIB), NRB undertakes and economics research in the area of banking

Establishment of many financial institutions and formulation of good rules alone cannot ensure the healthy economic development. These institutions may not function as desired due to various factors. Hence, supervision of their functioning becomes essential.

As a supervisor, the central bank reviews and inspects functioning of financial institutions (on-site and off-site), guide for proper implementation of its rules, take necessary action in case of violation and suggests the way to strengthen their financial position. Thus the central bank plays an important rule for the heading development of the economy.

### **2.1.5 Regulatory, Supervisory and Monitoring System of Nepal Rastra Bank**

Central bank of a country is empowered to regulate, supervise and monitor the banking sector. It needs to have sound system so that these roles are discharged purposefully.

A central bank makes rules, issue instructions from time to time with regards to foreign exchange, credit control, interest rate, liquidity, capital adequacy, directive credit asset classification and provisioning, income recognition branch expansion, single borrower limit sector limit, asset liability management (ALM) off balance sheet activities etc.

When need of any new regulation or amendments in the existing regulation arise the officials of the concerned department (foreign exchange bank and financial institution dept. etc) discuss various aspects and determine whether such a need really exists. At that time they take feedback from financial institutions then one of the officials of the department is asked to prepare a memorandum of forwards it to higher authority with recommendation. The process continues till the final authority the approving authority different from case to case some instructions can be given to banking sector with the approval of department chief while some may require the approval of board of directors

Every central bank has got a separate supervision department staff of the supervision department adopts following procedures.

➤ **Off-site inspection :**

It is related to the financial analysis of the concerned financial institution on the basis of B/S P/L a/c and other data received by the central bank depending upon the nature of reports they are received on a weekly/monthly/quarterly/bi-annually basis this helps the central bank judge whether its instruction regarding issue have been complied with capital adequacy CRR requirement loan classification and provision profitability priority sector credit and deprived sector credit etc.

➤ Special inspection :

It refers to inspections for special purpose such an inspection is suddenly fixed for the special case.

➤ On-site inspection:

The inspector or the term of inspectors carries out on site inspection by visiting the office of financial institutions. They check various files and see whether they are in conformity with the existing rules. They check physical balance of cash and bullion's with record. If certain laps observed have to rectify immediately, the inspectors advise the concerned authority accordingly.

In Nepal NRB performs the task of inspections and supervision. It has both a regulator and supervisor responsible for safeguarding the soundness of bank and encouraging competition among them.

Based on the finding of inspection supervision department gives advice and instructions to the financial institutions to make their functions regular in a given deadline in order to see the compliance of these advices and instructions central bank need to monitor for which it set up a separate monitoring department or monitoring units under supervision department. Monitoring is called out through off site and on-site inspection on case to case basis.

## **2.2 Review of Previous Studies**

Under this segment is has tried to find out major conclusion and recommendation of the previous study made by the researcher. There are many studies related to the central bank. But some studies have been conducted regarding to role of NRB in economic development of Nepal. A few studies are concentrated on the NRB role for banking development in Nepal an attempt has been made to provide a comparative perspective for evaluating and interpreting the significance of one's finding.

Jagadeshwar Prasad Kayestha in his thesis has laid down the problem arises out of the branch expansion. He has concluded that the CBS have tagged behind the target in opening the new branches and existing branches were not distributed every all over the nation. He suggested that NRB should encourage the CBS to open its new branches.

In remote areas with more liberal attitude and policy this thesis was written in an atmosphere of controlled regime where banks are asked to establish certain branches every year and the losses arisen out of the operation were compensated by NRB for few years in certain percentage. However in the preserve competitive setting CBS are enjoying much freedom to open and close their branches where there is no financial viability.

The article by B.N. Rimal entitled policy issued and development in Nepalese banking system concludes that the central bank should instead drive for on approach towards indirect monetary control rather than loan and quantitative individual bank receiving indirect monetary policy through open market operation.

Example recent treasury bill auctions and opening up interbank market and targeting board financial variables like net foreign assets or for that matter net domestic assets should even out small instants in the banking system.

Ram Prasad Adhikari in his articles, Development of banking and financial sector in past 25 years states that during the go's the trend of CBS branches expansion seems low than past due to the liberal policy followed by government and also NRB. Thus it is necessary to change the present policy of NRB for rapid branch expansion of CBS.

Sewa Shrestha in her dissertation has observed that the establishments of CBS branches are guided by the profit. They were not interest to open their branches in remote areas where there are not adequate volume of business. However, Nepal is a least developed country of the world where about 38% of the population live below absolute poverty line and economy basically dependences upon agriculture. The

scattered measure saving of the rural people should be controlled through the creation of bank branches for this NRB should encourage the CBS to open their branches in remotes areas by adopting more liberal policy and loss arisen in the operation should be subsidized by NRB.

Jaya Sapkota has suggested that in order to provide adequate banking to the people in unbanked remote areas ADB/N should also get as a CB similarly in the place where there is no branches of ADB/N and where as a CBS branches exist the later should act as an of former to collect the deposit and mobilize it in needy. This consideration is irrelevant as NRB has already directed CBS to invest a certain percentage of their deposit in priority sector and ADB has been allowed to directly enter the general banking business with certain restrictions in selected urban areas to channelize funds to the agriculture sector from the beginning of 1984 A.D.

Uttam Bajra Bajrachaya has observed that NRB should encourage the CBS to extend long credit in addition to the short and medium term credit so that the amount of credit will increase on one hand and large industries will established on the other if the CBS find their resources inefficient for invest raising interest rate on deposits should collect more deposit. However in the present change context the CBS have invested for fairly long term. Due to the liberal economic policy followed by NRB interest rate are fixed by market mechanism. There is also high liquidity in the market and banks also have increased their NPA in their BS year by year.

Moti Lal Mistry in his dissertation has pointed that the deposit utilization in priority sectors are much less than statutory requirement. To increase the lending amount in priority sectors NRB has change the existing regulation and fixed the lending target at 12% of outstanding loans and advances since 1990 even yet commercial banks have been lagging behind in meeting the lending target so they are penalized for the shortfall. But now monitory of F.Y. 5059/60 B.S announced by NRB has pledged to phase out priority sector credit program within next 5 year.

Promod Shrestha in his articles the role of NRB in reference to the CBS has clearly viewed that all the CBS branches and financial institutions are established only in urban areas from where the huge population living in rural areas cannot get any

banking facilities on one side and on the other the higher number of institutions established in urban areas are facing caught tough competition which may lead to the question of their existence. He has viewed that CBS should establish branches as per need of the nation. He has emphasized that appropriate policy to establish branches in the rural areas should be followed CBS and the financial institutions carrying similar function should not be allowed to establish in close vicinity. To encourage the banks to establish branches in rural areas NRB should extend certain incentives to them.

Ram Singh Budhal (2001) in his studies Role of Sudur Paschimanchal Grameen Bikas for improving the earning of the villager the main objectives of Grameen Bikas Bank is to extend banking facilities to the poor men and women and eliminate exploitation of the poor by money lender. It helps to create opportunities for self employment for the country's vast unutilized and under-utilized manpower resources.

Santosh Pandey (2002) in his study concluded that change in NRB directive has lot of impact on commercial bank activities. Because of new directives commercial bank to increase the operational cost and dividend to shareholder and bonus to the employees are scaled down due to decrease in profit of the banks. He also said that the changes in directives would bring prosperity to the shareholders depositor employees and the economy to the country as whole in a long run. His suggestion to NRB is that the NRB should issue directives after doing proper homework. NRB must strengthen the functioning of its credit information bureau. NRB should be practical and should issue directives applicable in the context of Nepal and not only to meet the international standards. Otherwise complains from commercial banks may arise however in the present context the commercial banks have to comply such directives context the commercial banks have to comply such directives and maintain its policies.

Manoj Dumar Shrestha (2003) in his thesis stated that's raising and utilization of funds are the primary functions of commercial banks. Commercial banks collect a large amount of deposit from general public so in order to protect. Such deposits capital must be sufficient otherwise the banks will use all the money of depositors in their own interest and deposit will have to suffer loss. NRB being the central bank has to be responsible to give special attention to the interest of depositors. Capital adequacy norm is required to safeguard the money of the depositors as the banks are playing with the money they collected from the depositors.

He also added that depositors are not aware of the fact of the necessity of adequate capital fund to safeguard their deposits. They deposit their money to any banks regardless of adequate capital fund which may endanger safety of their money. Therefore NRB should initiate awareness program to make the depositors aware of such fact and think before depositing money in any commercial bank.

Sabitri Shrestha (2005) in her studies impact and implementation of Nepal Rastra banks guidelines on commercial banks. A study of Nabil Bank Ltd. and Nepal SBI Bank Ltd. has tried to find out the impact of NRB directives on commercial banks. She has also made effort to find out whether the directives are actually implemented and are being monitored by NRB or not. She has stated that both Nabil and Nepal SBI Bank are implementing the NRB directives.

In her study she finds out that out the changes in NRB directives made both positive and negative impact on the commercial bank. Even through the study is limited to only two samples it is cleared that new directives issued by NRB make good impact more than bad impact on the various aspects of the banks it can be seen that the provision has been changed and the increased provisioning amount has decreased the profitability of commercial banks.

Puskar Raj Karnikar (2006) in his studies supervisory role of Nepal Rastra Bank A case study of Laxmi Bank, Nepal Investment Bank and NCC Bank Ltd. Nepal Rastra Bank has issued different directives for the banking and financial development of the country. There are many aspect of supervisory role of NRB. This research is specifically based on the supervisory role of NRB the main objectives of this study is to examine the supervisory role of NRB as a central bank. To enumerate the norms and standards said by NRB relating to the following aspect of banking such as:

- Capital Adequacy
- Loan classification and provision
- Single borrower limit
- To find out whether the selected banks actually implement the directive issued by NRB.

## **Chapter III**

### **Research methodology**

#### **3.1 Introduction**

Research to common parlance that refer to a search for knowledge of per the Webster international dictionary, research is a carefully critical inquiry or examination in seeking facts and principles, diligent investigation in order to ascertain something.

Research methodology is a way to systematically solve the research problem. It is understood as a science of studying how the research is done scientifically in it we study the various steps that are generally adopted by a researcher, studying the research problem along with the logic behind them.

This chapter looks into the research design nature of and source of data, data collection procedure and tools and technique of analysis of research methodology helps us to find out accuracy validity and suitability.

This study is basically concerned with examining the role of NRB for the development of CBS through branch expansion deposit collection and utilization of deposit so the purpose of this chapter is to outline the method followed in the process of analyzing them.

#### **3.2 Research Design**

"A research design is the arrangement of continuous collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure."

As aforesaid the main objective of this dissertation is to the role of NRB for development of commercial banking in Nepal it is important to discuss jointly about

NRB and its commercial banking policies for this purpose descriptive as well as analytical research design has been followed data collected for this purpose of the study have been systematically analyzed. The selection of this type of research design has become necessary keeping in view the quantity and quality of information that are available

### **3.3 Source of Data**

This study is primarily based on the secondary source of data so the necessary data for the study are collected mainly from the concerned institution. The study is concerned with the role of NRB in commercial banking development on Nepal for this purpose commercial banking statistics annual report quarterly economic bulletins published by the NRB time to time the commercial banking bulletins published by the different CBS other secondary source of information compiled from the bank and financial institution regulation department previous studies and reports journals and other published and unpublished related document as well as report for central library of TU Shankar Dev Campus library NRB library are basic data source. A separate bibliography presented at the end would give a full idea of the sources consulted for this study.

### **3.4 Data Gathering Method**

Most of the research used two types of source of data collection which are primary data and secondary data

The primary data are those which are collected a fresh and for the first time and thus happen to original in chapter the secondary data on the other hand are those which have already been collected data by someone else and already been passed through the statistical process.

In this study the researcher has used mainly secondary data. Books on central banking publication of the NRB and many others related materials has been studied the collected data are arranged systematically in the particular tables from according to the need of the study.

Likewise for the purpose of the study data is also taken unstructured manner discussion among the personnel's of NRB commercial banks and related financial institution. The purpose of such interviewing was to drive primary information regarding their attitude towards existing policy on branch expansion deposit collection and deposit utilization and plans for the future. The decision made from the information meeting discussions and seminar held with other national and international financial community is also included in the study.

### **3.5 Data Processing Procedure of the Study**

To fulfill the objective of the study information concerning branch expansion deposit collection and utilization of deposits of commercial banks are reviewed and the data included here are from the mid July.....10 mid April...the trend of collected data are conceptualized and analyzed in the context of the changed NRB policies and other related factor the research has explained total quantitative positions of commercial banking branches and change in the position of branches exchanging ADB/N branches performing. Commercial banking activities commercial banks branches and population per bank branch are collected and presented on the geographical basis mainly Kathmandu valley, Terai region and remaining hill region considering the number of branches and population census report. Average deposit collection and average credit expansion per branches is also presented.

The research has included the data that the training provided by NRB, BTC only it has not included the training provided by particular bank. It has analyzed the deposit interest rate structure of deposit and the deposit amount by calculating correlation coefficient. This research has used correlation coefficient to analyze lending rate and loan and advances it is analyzed liquidity and capital adequacy position of CBS.

The researcher has shown C/D ratio to whole commercial banking sector. The comparative analysis capital funds, deposit liabilities and investment of CBS other related data are also presented for the trend analysis.

## **Chapter-IV**

### **Presentation and Analysis of Data**

#### **4.1 Introduction**

The main objective of this chapter is to present and analyze data and other available information concerning of policies of NRB regarding the commercial banking development in Nepal in this regard branch expansion deposit collection utilization and other relevant data collected from various published and unpublished reports of NRB and other CBS are analyzed. The institutionalized banking system in Nepal in not so old as computer to the other developed countries in the world.

#### **4.2 Number of Bank Branches in Nepal**

The number of commercial banks stood at 25 at the end of 2007/2008 compared to 20 years ago. Out of the five new commercial banks established in the review year three were new and two upgraded into "A" class licensed institutions one from "B" and another from "C" class.

The expansion of commercial banks branches in rural areas has been repaid after the initiation of peace process in the country following the peoples movement II in April 2006, the NRB has also issued new directives relating to the opening up branches by commercial banks which helped expand bank branches from a number of 452j in mid July 2007 to 555 in mid July 2008 excluding one hundred bank branches of agriculture development bank Nepal ADB/N involved in non banking transactions.

The expansion bank branches by commercial banks are concentrated in the urban areas. For e.g. The number of bank branches in Kathmandu valley increased by 24.6 percent in the review year from the total branches of 126 as at mid July 2007 to 1<sup>st</sup> as at mid-July 2008 followed by the expansion in the Terai region by 22.8 percent from 197 branches at mid July 2007 to 242 branches as at mid July 2008 realizing the

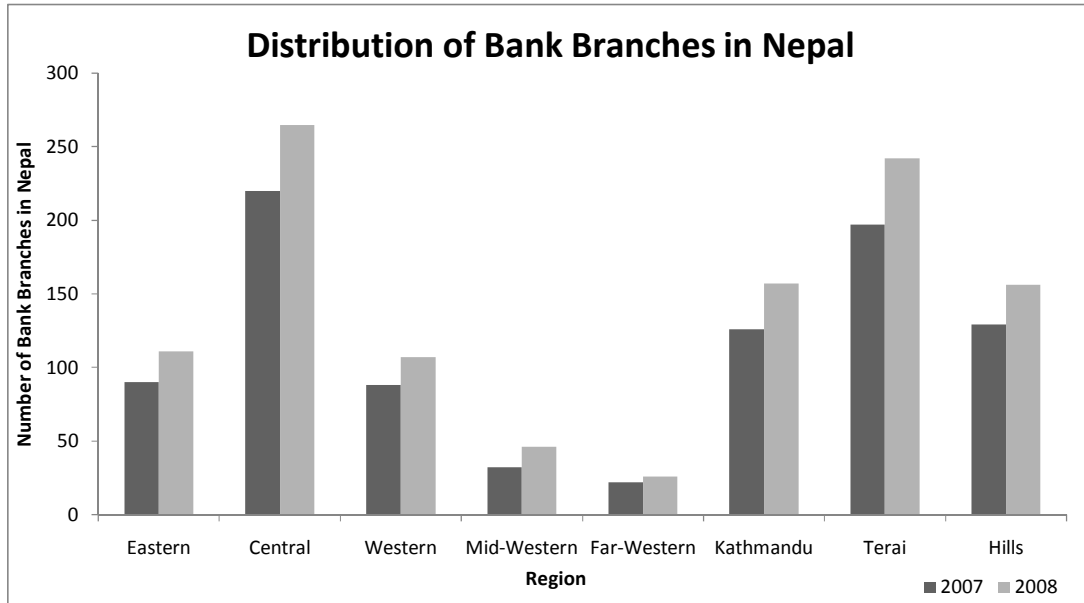
concentration of banks activities commercial banks to open a bank branches outside the Kathmandu valley for opening a branches within the valley.

**Table No 4.1**  
**Distribution of bank branches in Nepal**

<b>Regions</b>	<b>2007</b>	<b>2008</b>
Eastern	90	111
Central	220	265
Western	88	107
Mid-Western	32	46
Far-Western	22	26
Kathmandu	126	157
Terai	197	242
Hills	129	156

*Source: Banking and financial statistics, bank and financial institution regulation dept NRB and economic report annual report dept NRB Kathmandu*

The distribution of bank branches shows that financial services provided by A' class institutions licensed by the NRB are largely urban central as Kathmandu valley alone has 159 bank branches 23% compared to a meager number of 46 and 26 bank branches operation in the mid western and far western development regions respectively the central development region has the highest number of branches. Out of the total of 558 bank branches 267 branches 47.8% are operating in the central developments region as at mid-July 2008 followed by 111 bank branches in the eastern development region on the basis of the ecological regions the hilly regions with 52 districts have 156 branches where as the Terai zones with 20 districts have 243 bank branches.



*Fig No.4.1*

## 4.2 Total Number of Commercial Bank Branches

Until mid-January 2009 total number of commercial banks branches reached 617 but taking into consideration the growing needs of the country and the state of economy this number seems quite insufficient table no 4.2 shows the growth in number of CBS branches from Mid July 2001 to Mid January 2009.

**Table No.4.2**  
**Number of commercial bank branches**

<b>Fiscal year</b>	<b>Number of banks branches</b>	<b>Changes in bank branches</b>
2001	430	-
2002	413	-17
2003	447	34
2004	423	-24
2005	422	-1
2006	437	15
2007	470	33
2008	555	85
2009	617	62

*Mid January 2009*

*Source: Banking dept, NRB and financial statistic, bank and financial institution regulation dept, NR Band economic report and NRB annual report research dept NRB Kathmandu.*

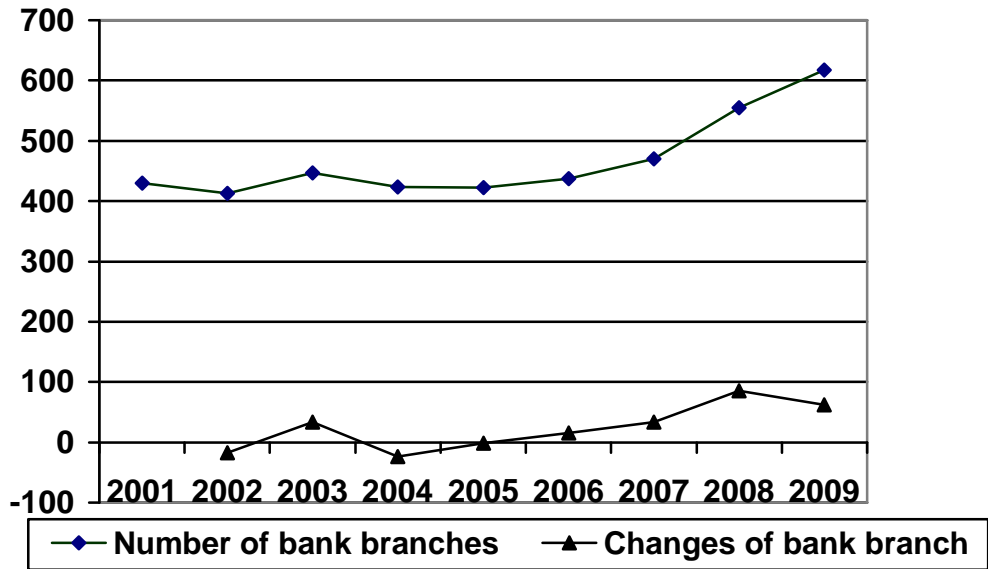
During the review period, the total number of commercial bank branches (except for ADB/N) reaches 617 out of this total number of commercial banks branches in 5development region is 99 of Nepal bank limited 119 in RRB 65 of ADB/N 28 of Nabil bank ltd 24 of Nepal investment bank ltd 12 of SCBNL 18 of NBL 22 of NSBIB 17 of NBBL,29 of EBL,25 of bank of Ktm.. 17 of NCCBL and NICBL of Lumbini bank ltd 23 of HBL is of KBL 16 of LABL 10 of SBL and BOA 9 of global and citizens bank 7 of prime bank ltd 12 of sunrise bank ltd and lastly 4 of NMBL

Above table no4.2 show that during the study period the branches of CBS has been increasing at beginning up to fiscal year 2003 and fiscal year 2004 the number of commercial bank is declining after F.Y. 2004 it has started increasing up to last of this study period mid January 2009 according to above data establishment of the CBS branches in the beginning of this study period is increasing.

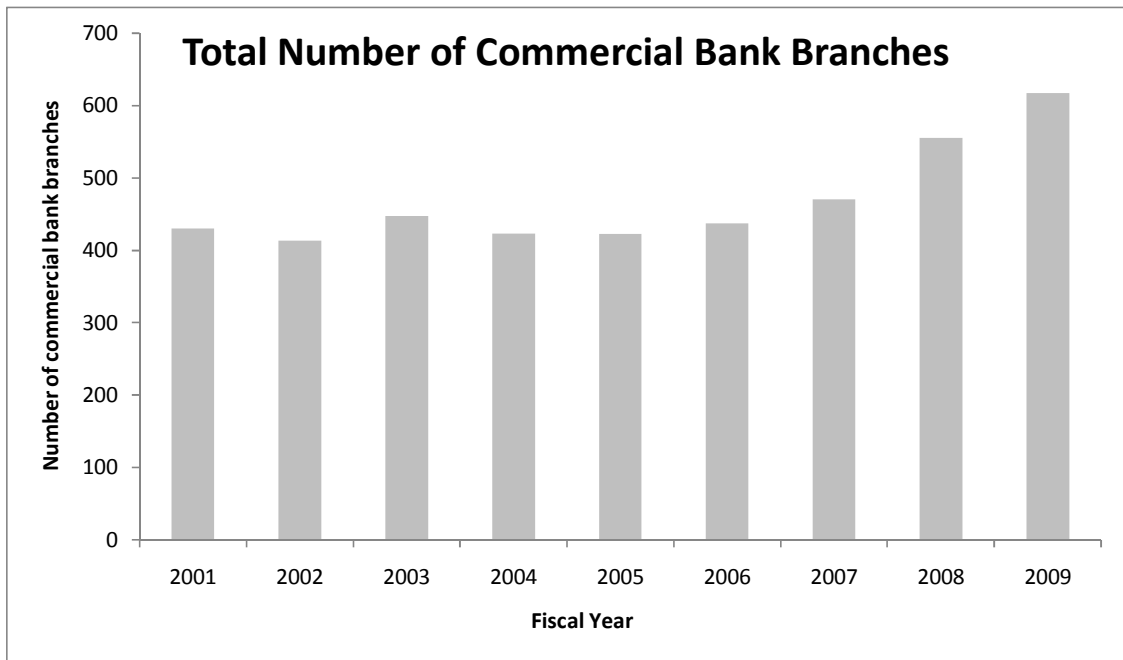
The position of CB branches can be shown clearly by following figure 4.2 and

4.3.

**Total number of commercial banks branches**



*Fig no 4.2*



*Fig No.4.3*

### 4.3 Number of Commercial Bank Branches in Ktm. Valley, Terai and Hilly Region

Nepal Rastra bank as a central bank of Nepal has been performing various activities since its establishment with a view to development banking system in the country. Deposit its efforts the expansion of bank branches are not uniformly distributes CBS are centralize in the urban areas mainly in Ktm. valley where they get a large volume of transaction.

It is necessary to see the number of CBS branches rendering the services to the Ktm. Valley, Terai and remaining hilly region wise distribution of bank branches is shown in the following table no.4.1

**Table No.4.3**  
**Number of commercial banks branches in Ktm. Valley, Terai and hilly region**

Fiscal year	Ktm. valley		Hill		Terai		Total
	No.	%	No.	%	No.	%	
2001	83	19.30	145	33.72	202	46.98	430
2002	82	20.50	130	32.5	188	47	400
2003	87	24.93	125	35.82	167	47.85	349
2004	89	23.73	119	31.73	167	44.5	375
2005	92	24.53	122	32.53	161	42.9	375
2006	94	24.10	126	32.50	170	43.59	390
2007	128	23.18	161	28.8	263	47.64	552
2008	160	28.62	158	28.26	241	43.11	559
2009	185	29.98	174	28.20	258	41.8	617

*Mid January*

*Source: Banking and financial statistics, bank and financial institution regulation dept NRB and economic report and NRB Annual report research dept NRB Ktm..*

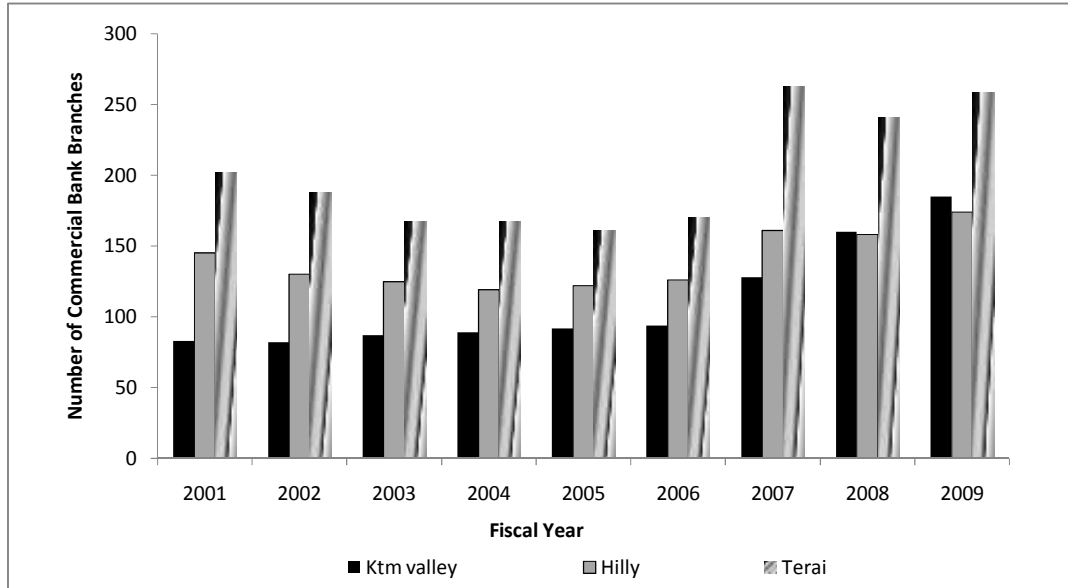
Above table shows fiscal year 2001 total no of CBS branches were 430. Out of the these branches 83 serving in Ktm. valley 145 in hilly region and rest 202 branches in Terai region in other words 19.30% branches located in Ktm. valley

33.72% in hilly region and 46.98 in Terai areas. Similarly total number of commercial branches in fiscal year 2002 were declining i.e. 400 out of these branches 80 were serving in Ktm. valley 130 in hilly area and 188 in Terai area. 20.50% branches are located in Ktm. valley 32.5% in hilly area and 47% Terai area and so on.

The above table 4.3 shows the number of commercial banks branches in Ktm. valley Terai and hilly area is increasing rapidly up to fiscal year 2001 after that the number of commercial bank branches in Ktm. valley Terai and hilly area is decreasing up to fiscal year 2006 lastly the number of commercial banks are increasing from the fiscal year 2007 up to fiscal year 2009.

The comparative distribution of CB branches according to are i.e. Ktm. valley Terai region and remaining hilly region can be shown clearly by the following figure or graphs.

### Number of Commercial bank Branches in Ktm, Hilly & Terai area



*Fig No.4.4*

NRB has been trying to make the branches distribution uniform through different restriction to open new bank and branches of exiting bank in Ktm. valley and providing facilities to open them in rural areas. Commercial bank has opened their

branches in urban areas rather than in the rural areas. Rural people are still deprived from banking facilities. NRB has issued following policies for the expansion of CBS branches.

- a) While opening a new bank branch within the areas of municipalities of Kathmandu, Biratnagar, Lalitpur, Pokhara, Bhaktapur, Birgunj and Narayangadh, CBS were required to open either at least two branches in adjoining semi urban area or at least one branches in rural areas which was not adjoining to any above municipalities.
- b) While seeking permission for the opening of new branches as per criteria (a) CBS needs to specify the details including the purposed place for semi urban or rural branch. Once approved by the NRB banks allowed opening new branches in urban areas only after opening their branches in semi urban or rural areas.
- c) Banks were not required to open their new branches in semi urban or rural areas if they opened new branches outside the several the seven municipalities mentioned above in (a).
- d) CBS established at a regional level also needed to comply with the above mentioned rules (a), (b) and (c) for the expansion of their branches.

#### **4.4 Interest rate structure of commercial banks**

Interest rate of CBS plays vital role in various deposit collection it is necessary to analyze the deposit rate of CBS in different year under review period following table. No 4.4 shows the interest rates structure of commercial banks including ADB/N commercial banking transaction office only from 2006 to 2008

**Table No 4.4**  
**Interest rate structure of commercial banks deposit**

	2006 July	2007july	2008july
1.deposit rare			
Saving deposit	2.0-5.0	2.0-5.0	2.0-6.50
One year fixed deposit	2.5-5.0	2.25-5.0	2.5-6.0
Two years fixed deposit	2.25-6.4	2.5-5.5	2.75-6.75
2.lending rates			
Industry	8.0-13.5	8.0-13.5	7.0-13.0
Agriculture	9.5-13	9.5-13	9.5-12
Export bills	5.0-11.3	5.0-11.5	5.0-11.5
Commercial loans	8.0-14	8.0-14.0	8.0-13.5
Overdrafts	6.5-14.5	6.0-14.5	6.50-13.5

*Mid July 2008*

*Source: various quarterly economic bulletins NRB research department Ktm..*

Commercial banks have to pay a certain percent of interest in saving and time deposit but not in current deposit. In above table N. 4.4 shows the interest rate structure in different year under the review period the year 2006 they have to paid 2.0-.50 percent interest in the year 2007 they have to paid same interest i.e. 2.5-5.0 percent it was increased by1.5 percent in upper limit and no percent change in lower limit in the year 2008

They accept another type of deposit that is fixed for certain period. Higher interest rate is paid for the long period deposit as shown in table No.4.4 in the year 2006 banks had fixed 2.25-5.0 percent for one year deposit when as in year 2007 fixed 2.25-5.0 percent in year 2008 banks had fix 2.75-6.75 percent for one year deposit.

Same as in the year 2006 banks had fixed 6.4 percent for 2years and above deposit. When as in year 2007 in had fixed 2.5-5.5 percent and lastly 2.75-6.75 percent for 2years and above deposit in year 2008.

#### **4.5 Non Performing Loans (NPLS) of Commercial Banks**

Compared to 10.3 percent as at mid July 2007 the ratio of nonperforming loan (NPL) to total loan has declined to 6.1 percent as at mid July 2008 percent. The NPL of Nepal bank ltd (NBL) came down to 8.9 percent as at mid July 2008 from 13.5 percent in the previous year. Similarly the level of NPL of Rastriya Banijya Bank Ltd. (RRR)dropped to 21.6 percent as at mid July 2008 from 27.6 percent as at mid July 2007 loan recovery along with a write off of Rs.2.87 billion by NBL and Rs.13.2 billion by RBB was instrumental in bringing down the level of the these banks in the review year.

The non performing loan of the private sector banks alone stands at 3.1 percent excluding the NPL of the commercial banks owned by the GON such as agriculture development bank the NBL and the RBB likewise the NPL of Nepal Bangladesh bank ltd and Nepal credit and commerce bank ltd also declined to 31.4and 16.4 percent respectively in the review year from that of 39.8 and 31.4 percent in the previous year. The NPL of Lumbini bank ltd also showed the improving trend as the NPL declined to 14.9 percent in mid July 2008 from 20.4 percent a year ago and 32.0 percent in mid July 2006.

**Table No. 4.5**  
**Non Performing loans of commercial bank**

*(In percentage of total loans and advance at mid July)*

	2002	2003	2004	2005	2006	2007	2008
1.Nepal Bank Ltd	56.3	60.5	53.4	49.6	25.1	13.5	8.95
2.Rastria Banijya Bank	55.1	60.2	57.6	53.0	45.3	27.6	21.63
3.NABIL Bank Ltd	7.1	5.5	3.4	1.3	1.3	1.1	0.79
4.Nepal Investment Bank Ltd	4.8	2.0	2.5	2.7	2.3	2.4	1.12
5.Standard Chartered Bank Ltd.	4.8	4.1	3.8	2.7	2.1	1.8	0.02
6.Himalayan Bank Ltd.	8.3	10.1	8.9	7.4	6.1	3.6	2.4
7.Nepal SBI Bank Ltd.	6.3	11.7	6.3	6.5	6.3	4.6	3.65
8.Nepal Bangladesh Bank Ltd.	15.8	12.7	10.8	19.0	12.3	39.8	31.38
9.Everest bank Ltd.	1.0	2.2	1.7	1.6	1.2	0.8	0.64
10.Bank of Kathmandu Ltd.	8.1	8.7	6.7	5.0	2.5	2.5	1.75
11.NCC Bank Ltd.	40.1	20.6	12.7	8.6	11.1	31.4	16.36
12.Lumbini Bank Ltd.	19.3	11.6	7.4	15.2	32.0	20.4	14.47
13.NIC Bank Ltd.	8.2	6.7	3.9	3.8	2.6	1.1	0.86
14.Machhapuchre Bank	10.5	2.1	1.0	0.4	0.3	0.7	1.04
15.Kumari Bank Ltd.	1.3	1.7	0.8	1.0	0.9	0.4	1.35
16.Laxmi Bank Ltd.	0.0	0.0	0.0	1.6	0.7	0.3	0.13
17.Siddhartha Bank Ltd.	-	0.0	1.6	2.6	1.3	0.3	0.6
18.Agriculture Development Bank	-	-	-	-	21.2	14.9	11.63
19.Developmenmt Credit Bank Ltd.	-	-	-	-	-	-	2.16
20. NMB Bank Ltd.	-	-	-	-	-	-	1.52
Total	30.4	288	22.8	18.9	14.2	10.25	6.1

Source: Economic report NRB 2007/08

## **Profitability**

In the review year the net profit of the commercial banks based on unaudited balance sheet of the respective commercial banks increased by 33.3 percent amounting to Rs.7.6 billion from a net profit of Rs.5.7 billion in the previous year. Except a loss borne by sunrise bank ltd all other banks earned net profit in the review year. The net profit of three government owned banks namely NBL RBB and ADB/N increased to Rs8.52 million 1.0 billion and 1.6 billion respectively as at mid July 2008 from Rs226.9 million Rs.1.7 billion and Rs1.1 billion respectively in the previous year. Likewise the bank such as NCC bank ltd. Nepal Bangladesh bank ltd. Global bank ltd and citizens bank ltd also earned net profit in the review year against a net loss in the previous year.4.6security wise outstanding credit of commercial banks as per security wise credit the outstanding credit against a security of land and house occupied a dominant share of 60.2% in the review year. Such outstanding credit against the collateral of house and land grew by 387% and stood at Rs.184.6 billion in mid July 2008 such credit had risen by 17.9%in the previous year such credit against the collateral of non government securities increased by 82.5% compared to a growth of 107.6% in the previous year likewise the outstanding credit against the collateral of government securities declined by 20.7% compared to a growth of 15.5%in the previous year. The outstanding credit against the security of gold and silver registered a slower growth of 41.5% amounting to Rs.4.1 billion in the review year compared to a growth of 57.9 percent in the previous percent in the review year compared to a growth of 20% in the previous year.

The outstanding credit against the collateral machinery export bills and loans against export bills increased in review yeas in contrast to a decline in the previous year.

**Table No. 4.6**  
**Security wise outstanding credit of commercial banks outstanding credit**

*(In millions)*

Type of Security	2006	2007	2008
Gold and silver	1820.8	2875.2	4069.5
Government securities	3118.2	3602.6	2857.1
Non government securities	1324.4	3602.6	5017.7
Jute and Hessians	8405	2749.4	118.5
Rice and paddy	1088	119.3	1341.5
Other agricultural products	1091.2	1307.2	1730.2
Cloth and yarn	793.7	1717	1590.7
Machinery	4708.1	860.2	5160.5
Other Goods	26536.2	4321.9	39256.6
Export bills purchase	938.9	30850.1	1018.3
Loans against export bills	249.4	207.4	244.5
Import bills and L/C	7480.5	6425.3	5206.7
Other foreign bills purchased	155.3	161.9	208.4
Domestic bills purchased	180.8	272.4	506.1
Overdrafts and guarantee	8533.7	9882.3	8959.7
House and land	112894.4	133060.1	184555.7
Miscellaneous	27850.5	32939.9	44685.0
<b>Total</b>	<b>198848.7</b>	<b>231844.7</b>	<b>306535.7</b>

*Source –NRB banking and financial*

*Statistic economic report various*

The security wise outstanding credit of commercial bank cab be shown more clearly by the following figure No4.5

In billion

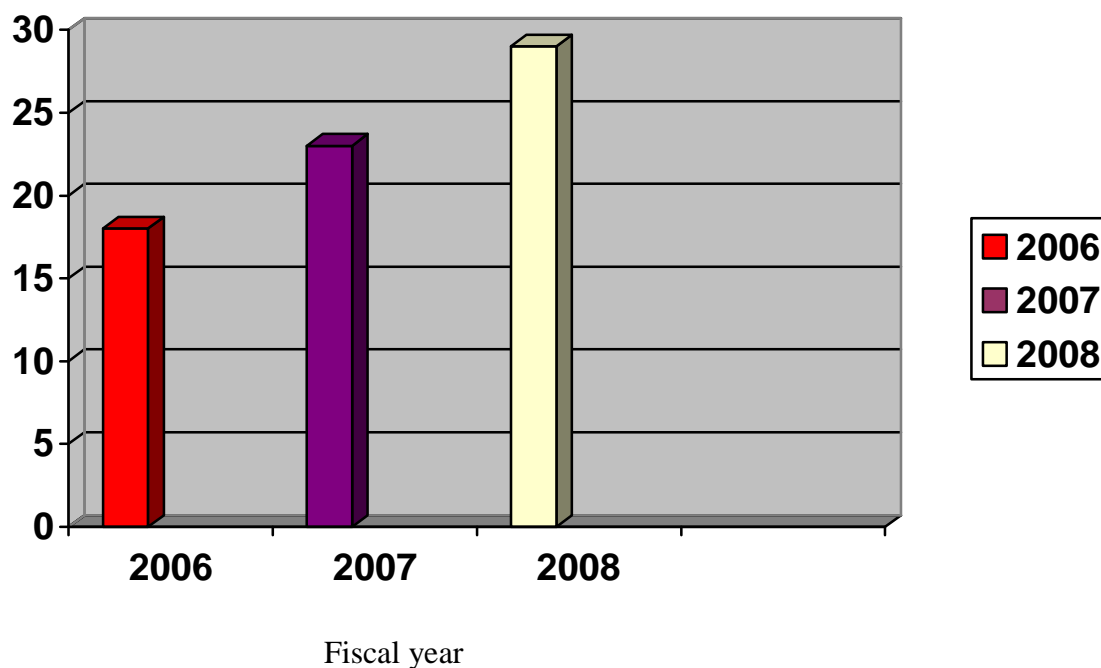


Fig No.4.5

#### 4.7 Sector wise outstanding credit of commercial bank

In 2007/2008 outstanding credit of commercial banks increased by 32.2% amounting to Rs.306.5 billion in the review year compared to a growth of 16.7% in the previous year. Commercial banks outstanding credit to agriculture sector marginally subdued in the review year compared to the previous year. Such credit declined by 0.01% Rs.1.7 million in the review year compared to decline of 12.1% Rs1.9 billion in the previous year. The outstanding credit to production sector increased substantially from Rs42.4 billion in 2006/07 to Rs74.9 billion in 2008/09. The review year witnessed a significant growth of credit to iron and steel based in and steel based industries and food production of production sector. The credit to the food production sub-sector increased by Rs.2.5 billion in the review year against a decline of Rs.0.32 million in the previous year likewise a credit to construction, metal productions, transportation equipment productions and fitting, wholesale and retail business and real estate increased significantly compared to that

of the previous year. The credit to the real estate expanded by Rs.8.2 billion in 2007/08 compared to an expansion of Rs.1.1 billion in 2006/07

**Table No. 4.7**  
**Sector wise outstanding credit of commercial banks outstanding credit**  
*(In millions)*

Heads	2006	2007	2008
1.Agriculture	1578.2	13882.0	13880.2
2.Mines	477.7	1315.0	1954.9
3.Productions	59771.8	62369.6	74889.7
4.Construction	13708.5	19770.6	32368.8
5.Metal productions, Machinery and electrical tools and fitting	1590.9	2919.4	5069.4
6.Tranportation equipment production and fitting	2658.7	3243.2	4340.2
7.Transportation,Communications public service	11694.5	13130.8	16129.4
8.Wholesaler and retailer	40555.2	45635.7	55732.9
9.Finance insurance and fixed assets	10024	13917.5	24913.5
10.Service industries	14163	18367.4	21163.3
11.Consumable loan	5848.4	8120.1	9437.2
12.Others	22571.7	29149.3	46656.3
Total	198849	231845	306535. 7

*Sources-NRB, Banking and financial*

*Statistic-Economic report NRB (various issue)*

### **Priority sector and deprived sector lending of commercial banks**

With a view to provide freedom to commercial banks in the selection of their loan portfolio, the Nepal Rastra banks phased out the priority sector lending program since 2007/08 However the NRB has continued deprived sector lending program in

order to outreach credit access to marginalized backward minorities dalit, scheduled last and deprived people. The outstanding loan disbursement of commercial banks under derived sector credit stood at Rs7.7 billion (an increase of 13.2%)in 2007/08 compared to Rs.6.8 billion in the previous year. Out of the total outstanding of the deprived sector credit, direct and indirect credit investment stood at Rs.1.1 billion and Rs.6.6 billion respectively as at July 2008

#### **4.8 Standing liquidity facility**

The NRB mopped up net liquidity amounting Rs.7.4 billion through outright sale action from the secondary market in the review period. In the same period last year a net liquidity of Rs.5.5 billion was mopped up through outright sale auction of Rs.3.5 billion and Rs.2.0 billion through reserve repo auction.

The NRB injected Rs.5.8 billion liquidity by purchasing USD 74.8 million from commercial banks through foreign exchange intervention in the review period. A net liquidity of Rs.5.4 billion was injected through the purchase of USD 79.1 million from commercial banks in the same period last year.

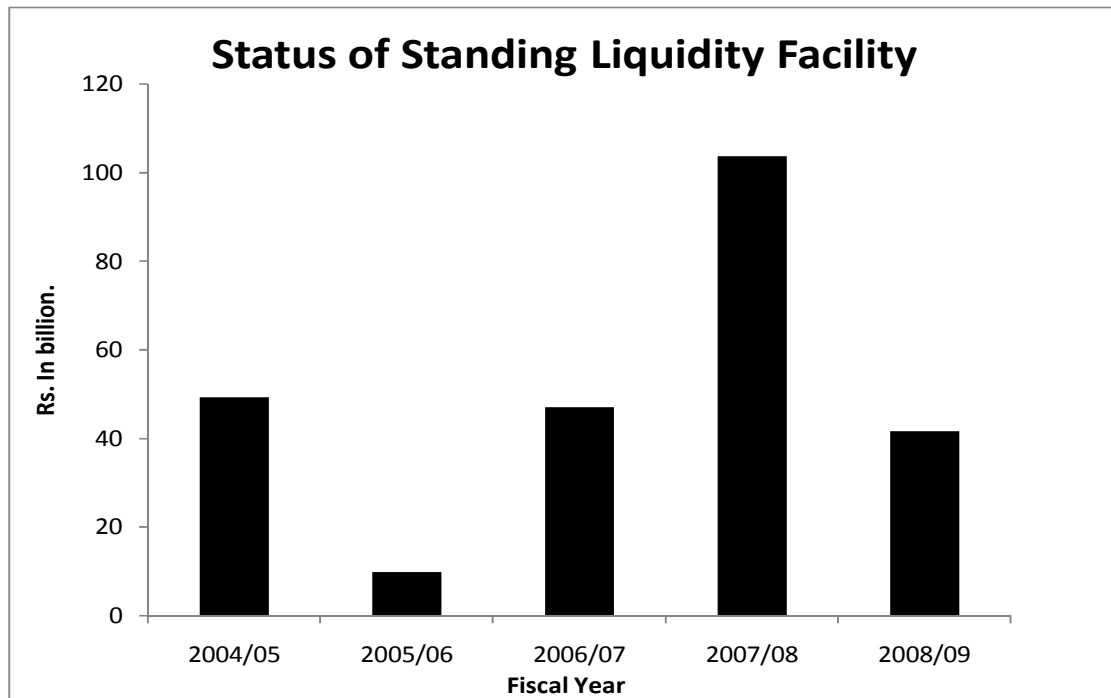
The NRB purchased Indian currency amounting to INR15.9 billion through the sale of USD 330 million in the Indian money market in the review period. Indian currency of 6 billion was purchased through the sale of USD 140 million in corresponding period of the previous year. Such a rise in purchase of IC is attributable to a higher trade defect with Indian.

**Table No. 4.8**  
**Standing Liquidity Facility (SLF)**

(In millions)

Fiscal Year	Total
2004/05	49307.34
2005/06	9883.50
2006/07	46979.20
2007/08	103832.0
2008/09	41535.0

From the above table no.4.8 as compared to FY 2004/05 FY 2005/06 commercial banks borrowed a total of Rs.49307.34 million and 9883.50 million as same as the commercial bank borrowed a total of Rs.46979.20 million under SLF in 2006/07 same as the bank borrowed Rs.103832.0 under SLF in 2007/08 and lastly. They borrow Rs.41535.0 under SLF in 2008/09 understanding liquidity facility.



**Fig. No. 4.6**

## 4.9 Interbank Transaction

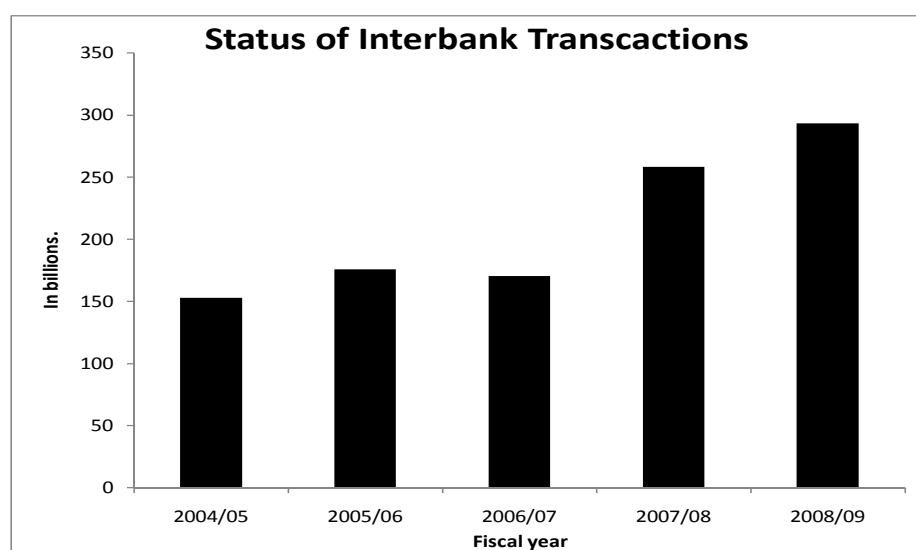
Commercial banks undertook interbank transaction of Rs.9.5 billions in the review period to Rs.22.43 billion in the same period of the previous year. Commercial banks have not used standing liquidity facility (SLF) from NRB in the review period where as total of Rs.18.2 billion had been used by commercial banks under this facility in the previous year.

**Table No. 4.9**  
**Interbank Transaction**

<b>Fiscal Year</b>	<b>Total amount</b>
2004/05	152837.8
2005/06	175750.2
2006/07	170184.0
2007/08	258319.1
2008/09	293418.6

*Source: Financial and banking statistic division NRB various issue*

In the above table 4.9 shows the interbank transaction increased in 2008/09 compares to that of the previous year. Interbank transaction which was Rs.258319 million in the previous year. Higher credit demand from the private sector contributed to increase interbank transaction in the review year. The interbank transaction can be shown in following figure.



*Fig. No.4.7*

## **Chapter -V**

### **Summary Conclusion and Recommendation**

#### **5.1 Summary**

Economic development implies the development of the sector of the nation in order to year up developmental process, high and sustainable economic growth is necessary. Banking development helps to develop the whole sector of the country. For this central bank has to play vital role. However, Nepal being one of the poorest countries of the world, NRB, central bank of Nepal has great liabilities to enhance economic development of the country. Joint adoption of monetary and fiscal policy is needed for the development country like Nepal to mobilize passive resource, to divert saving from speculative and unproductive activities to productive uses to enhance the effectiveness of public resource management, to accelerate economic reform program to alleviate poverty etc.

The existence and development of a good banking system is a reflection as well as an index of economic progress of a country. In the developing countries, central bank has been performing both the traditional as well as development function. The main in Nepal After establishment of NRB within a decade a numbers of institutions like NIDC, RBB, ADB/N employee provident fund etc. were established in public sector. Besides setting up new institutions NRB introduce banking development scheme in 1967 for banking development it helped to set up at least once commercial bank branch in un banked district NRB had been compensating the losses of CBS branches out of the banking development fund in a proportional rate but now that scheme is not existence. Banking promotion board was also set up to promote the banking activities through and banking development in Nepal in 1968 CBS tended to concentrate in urban area to avoid higher cost of rural operations so NRB had taken the policy of partially subsidization for their branch expansion between 1970 and 1979.

Commercial banks accepts mainly 3 types of deposits out of these deposits a/c they do not give interest in current a/c other type of a/c is saving account which is not interred elastic than fixed account. Most of the people deposit their idle money not for

interest but also for facility of the saving account drawing whenever necessary .so deposit amount and interest rate of saving account did not show the actual relationship between interest rate and deposit amount.

This study shows that deposit amount of CBS is in increasing trends. Main factors for the increasing trend are:

As the people lack entrepreneurship they hesitate to invest and they do not know properly how to invest their saving then only one alternative left to general public is to deposit the saving in the bank where they can get stable return with security. The increment in money supply also helped to increase bank deposits. The expansion of commercial banks branches in the country at previous few years also helped to accumulate more deposits the increased banking habit among the people and the new banking technology facilities which new comer banks initiated has also played an important role for increasing me overall deposit.

From the last few years inflow of remittance has been increasing tremendously but there is loan of investment opportunity in the country which compelled the investors to keep their money in bank accounts. Hence deposit decreasing interest rate deposit amount have also been increasing.

Commercial banks reduce their interest rate in fixed deposit at high rate and people seemed wait and see condition for new investment. Therefore also they kept their idle money in saving account. Beside after arrival of new CBS especially joint venture banks the terms and condition of saving accounts were also changed. Financial sector reform helped for the expansion of banking facility in the country.

For the balance development of our country NRB has directed to the CBS for the compulsory investment of their fund in the deprived priority and a productive sector which is regarded hindrance to the development of the bank by CBS. Now for the sound and competitive development of CBS NRB is withdrawing the statutory priority sector lending policy.

To protect the banks from being bankruptcy NRB has made a provision of single borrower limit that mean they cannot keep all their eggs in one basket. Similarly to make the CBS financial position strength NRB has increased the CAR. To protect the consumer and image of bank NRB has also set rate of CRR to be safe from the default of loan repayment all CBS are required to classify the nature of loan and the loss provision there to.

NRB has initiate international standard of auditing and accounting of forms so as to have accurate financial statement insuring adequate disclosure and competitive environment by entrancing transparency.

Nepal started financial liberalization process that has been implicating by NRB fresh competition in the financial sector was expected by the entry of joint venture bank after liberalization policy of competitive financial system the government granted permission to establish finances including CBS to wholly own by and operated by the private sectors. Because of financial liberalization prese3ntly numbers of banks and financial institution are working in different manner for overall economic development. Deposit its efforts the expansions of banking facilities are not uniformly distribution.

In Nepal there is no proper development of money market and capital market. So the NRB has followed the refinance scheme controls the CBS by implicating the bank rate policy for credit operating and encourage them more for credit to priority and productive sectors. Due to refinancing facilities to the CBS the NRB succeeded to divert their resources in more desirous lines.

There are 17 CBS their size both in terms of deposits as well as credit has been expanding. However per person deposits and credits are quite low and banking services are not early available in remote areas of the country in this context NRB has to play a crucial role.

## 5.2 Conclusion and Findings

Due to the policy of NRB the banking habit also had expanded banks were able to collect increased proportion of private saving and diverted it for investment in newer form of activities. The total resources with the CBS are remarkably increasing. This means that the capital funds along with the various categories of deposits with banks are increasing with time. The saving deposit which carries higher facility seems more attractive to the household sector.

There is dear indicating that the CBS are in a better position to extend of credit of varying terms without losing liquidity. It appears therefore that the banks using idle and scarce resources will be able to support the economic development of Nepal.

NRB is playing an effective role in control of the CBs credit with the increasing tendency of banking facilities as a result increasing the banking habit of the people resulting the increase in the amount of deposit and the loan operation of the CBs.

In this study increasing deposits means this may be the result of interest rates that is most influential and important factor for the collection of scattered idle saving of the people in the different part of the country. Although interest rate is relevant to the deposit collection the researcher find super singly in this study that interest rate is decreasing where as deposit is in increasing trend. We find even the number of other financial institutions or not bank financial institutions are in increasing trend the total deposit amount of CBs is in increasing trend people deposit their idle money not only for interest but also to save for losses keeping at home or security purpose.

There was not enough investment opportunity in the market and saving account has more facility than other account so interest rate is decreasing due to liberal banking policy of NRB and the saving amount is also increasing at that time due to increasing banking facilities in the country and increasing banking habit of the people.

The reform of interest rate deregulations by NRB was found to be effective. The interest rate spread did not fall to the desired level instead of it has increased reform initiated could not solve the problem of high liquidity in CBS liquid funds of CBS further investment in a slow pace after the liberalization process began and now pose a serious problems as they one still increasing their liquidity.

Form the data analysis it is found that quantity of CBS branches are increased when NRB had made policy for CBS to open at least one branch in rural areas before opening their branches in urban areas. When this policy discontinued and made more liberal policy for branch expansion then CBS branches are decreased in urban areas. This proves now the role of NRB is significant for the development of CBS.

This study finds the relation between total investment and pain-up capital of CBS is more prominent than its (investment) relation with fixed deposit of CBS.

Similarly, it is that claims on private sector's credit has strong relationship with both fixed deposit and paid up capital.

In conclusion it can be said that NRB is trying to development CBS it has even initiated but the actual succession has not been activated.

### **5.3 Recommendation**

NRB is expected to adopt a suitable policy for banking development which should ultimately lead to effective collection and utilization of deposit on the basis of the analysis and financings derived from the study following recommendation are made for augmenting.

While the capacity of the CBS the increase the flow of credit to various sectors depends on their ability to mobilize adequate deposits and when there still exists large idle money with the people in both urban and rural areas the bank should endeavor to collect more resources by expanding their branches even to the rural sector. The present practice of joint venture banks to discourage small saving should be rusticated

because Nepal is full of poor people where there is less saving. For this CBS have to keep the affordable minimum balance to open the account which will help to expand customer deposit amount and to increase banking habit NRB need to adopt liberal and suitable policy so that CBS are encourage to expand their branches in the remote areas of the country.

The banks should avoid the delay and red-tapism in processing the loan request through administrative reform. In the absence of such reform the position of CBS may deteriorate in view of the stiff competition not only the banks themselves but also between mushrooming non bank financial institutions and other lending agencies.

The BTC of NRB should impart practical .Field oriented and timely training to bank personal and should conduct workshop cum-seminars. They also should be sent abroad for special training in specific field. In this way the quality and quantity of training has to be increased.

The various financial institutions should not come into one another way. There should be proper co-ordination between banks and other financial institutions. NRB should create proper situation for co-ordination between banks and other financial institutions. The undue political and administrative pressure should be declared unlawful.

The NRB beside the existing facilities of refinance can introduces the subsidy scheme for the time being in case of industrial financing as well as it found in case of opening new branches in the unprofitable rural areas. In view of the several risks and uncertainty involved in industrial social service rural financial and the provision of subsidy may prove term lending attractive to the banks.

Life insurance scheme tied up to saving deposit fabulous gifts or lottery scheme introduction of new kinds of deposit publicity and propaganda to development the banking habit of people are some of the measures that can be taken to mobilize more saving in the rural areas.

NRB should motivate CBS to open their branches in rural areas by facilitating new broad reforms just providing and building guideline to open branches in deprived areas does not encourage or motivate the CBS to open their branches in rural areas.

A visible transparent as well as unbiased rating agency should be established. To strengthen and development the regulator and supervisory framework the management of NRB should be built as autonomous body without interfere of the government in conducting monetary policy regulation supervision and licensing of the financial institutions.

CIB must be strengthened just like by connecting network with bank and financial institutions so that they receive the detail of the black listed borrowers in quick time. This will reduce chance of creating had quality assets in their B/S.

NRB should take step to extend banking facilities to all parts of the country. By opening and operating branch offices of CBS in rural areas alone does not solve the problem of extending banking facilities. They have faced operating losses in the branch offices of less development areas. The main reason was that the banks stuck with their traditional policies of financing trade so they did not find sufficient borrowers and practices of these institutions with a view to promoting institutional credit to the productive sectors.

NRB should have provisioning to reward the bank that meet the standard higher than the directives or admit such banks for counseling as banking expert.

Now Nepal has been facing civil war since past few years, which is a major obstacle for the development activities. Banking sector is one of the highest security needed sector if there are lapses of security instead of developing banking activities bankers may reduce the banking services day by day .due to the lack of security and political instability CBS suffered a great loss from under utilization of accumulated resources. Therefore the only way open form the NRB is to taken step to utilize available financial resources at the maximum with a view to assisting growth process.

Political sector governs the whole sectors of the country if stable political sector does not exist in the country professionally effective banking sector cannot run successfully. Country's political situation influences the fiscal monetary and banking policies. So political stability as most necessary for the effective development of the commercial banking

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