DETERMINANTS OF LENDING INTEREST RATE OF FINANCE COMPANIES IN NEPAL

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RECOMMENDATION

This is to certify that the thesis

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Has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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DECLARATION

I hereby declare that the work reported in this thesis entitled " **Determinants of Lending Interest Rate of Finance Companies in Nepal** " submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies (MBS) under the supervision of Dr. Binita Manandhar of Shanker Dev Campus, T.U.

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ABBREVIATIONS

AGR	:	Assets Growth Rate
APR	:	Annual Percentage Rate
Co.	:	Company
CD	:	Certificate of Deposit
DPR	:	Deposit Rate
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
i.e.	:	That is
ICT	:	Information and Communication Technology
INF	:	Inflation
IRS	:	Interest Rate Spread
LDR	:	Lending Deposit Rate
LR	:	Liquidity Rate
Ltd.	:	Limited
MFL	:	Manjushree Finance Limited
NADF	:	Nepal Awash Development Co. Ltd.
NGO	:	Non-Government Organization
NPM	:	Net Profit Margin
NRB	:	Nepal Rastra Bank
GFL	:	Goodwill Finance Limited
PFL	:	Pokhara Finance Limited
NPL	:	Non-Performing Loan
P.E.	:	Probable Error
r	:	Correlation
ROA	:	Return on Assets

ROE	:	Return on Equity
SD	:	Standard Deviation

CHAPTER I
INTRODUCTION

1.1 Background of the Study

Finance companies in Nepal are the institutions that provide a range of financial services to individuals, businesses, and organizations. These services encompass loans, deposits, investment products, and various other financial offerings. They are vital contributors to the economic development of Nepal, facilitating access to credit and financial solutions. Regulated by the Government, Nepal Rostra Bank, the central bank of Nepal, these entities serve as crucial sources of funding for small and medium-sized enterprises, which are fundamental to the Nepalese economy's foundation. In essence, finance companies in Nepal play a pivotal role in fostering the growth and advancement of the country's financial sector and overall economy.

Interest rate is indeed a crucial factor in the lending decision process for all financial institutions. The lending interest rate represents the percentage of the loan amount that the lender charges for lending money. The lending interest rate not only reflects the expense of borrowing money from banks for business purposes but also plays a pivotal role in driving economic expansion within a country. While it's clear that the lending rate is vital for fostering growth across various entrepreneurial endeavors, it's essential to identify the factors influencing the lending rate within a well-established and interconnected banking sector regulated by a central bank (Ali et al., 2011).

The lending interest rates of financial companies are influenced by various factors. According to the classical theory, the interest rate is determined by two main factors: the supply of savings, primarily from households, and the demand for investable capital, mainly from the business sector (Rose, 2003). Additionally, the loanable funds theory views the interest rate as dependent on four variables: savings, investment, the preference for holding money, and the supply of money. The rational expectation theory suggests that the most accurate prediction for future interest rates is the current spot rate, and changes in interest rates are primarily driven by unexpected information or changes in economic factors (Irungu, 2013).

Interest rates play a critical role in finance, influencing borrowing, lending, investment decisions, and overall economic activity. They represent the cost of borrowing or the return on investment, typically expressed as a proportion of the principal sum, the overall interest accumulated varies depending upon several factors:

- **Principal Sum:** The initial amount of money lent, deposited, or borrowed.
- **Interest Rate:** The proportion of the principal amount charged by the lender as interest over a specific period.
- **Compounding Frequency:** The frequency at which interest is added to the principal amount. It can be annually, semi-annually, quarterly, monthly, or even daily.
- **Length of Time:** The timeframe during which the principal amount is loaned, deposited, or borrowed.

The annual interest rate is the most commonly referenced rate, but interest rates can apply over different periods, such as monthly or daily. These rates are often annualized for easier comparison. For lenders, interest rates represent the return on the funds they provide. Higher interest rates typically indicate greater risk or higher inflation expectations, while lower rates can stimulate borrowing and spending. For borrowers, interest rates determine the cost of borrowing money. Lower interest rates make borrowing cheaper, encouraging investment and consumption, while higher rates may affect borrowing and slow economic activity. Central banks, governments, and monetary authorities often adjust interest rates as a tool to influence economic conditions. Lowering rates can stimulate borrowing and economic growth, while raising rates can cool inflationary pressures or prevent asset. Understanding interest rates and their impact is crucial for individuals, businesses, and policymakers in managing financial decisions and navigating economic conditions effectively.

The Nepalese financial sector is composed of both diversified banking sector and non-banking sector. Banking sector comprises with the central bank i.e. Nepal Rostra Bank (NRB) and commercial banks. The non-banking sector includes development banks, micro-credit development banks, finance companies, co-operative, financial institutions, non-government organizations (NGOs),which relatively performs limited

banking activities. Banks and finance companies are categorized based on their capital, which determines the range of services they offer. Commercial banks, with the highest capital, are classified as class "A" institutions. Development banks fall under class "B," while finance companies are in class "C." Micro-financing institutions and cooperatives are classified as class "D" entities.

Finance companies are experiencing rapid growth in Nepal and are playing a significant role in the country's financial landscape. The first finance company, Nepal Awash Development Finance Co. Ltd. (NADF), was established in 1992. Finance companies are licensed by Nepal Rastra Bank under 'Class C'. They play a vital role in advancing Nepal's economic status, with both nationalized and private finance companies operating across the country. There are altogether 17 licensed finance companies by Nepal Rastra Bank and 15 out of 17 are national level finance companies. The number of finance company branches increased to 284 in Mid–July 2023 compared to 267 in Mid-July 2022. Thus, finance companies are fastest growing and the most important business entities incorporated under company act to provide financial services for its clients or the members regulated by the government and lending operation be liable to commercial banks.

Finance companies are non-depository financial institutions that differ from commercial banks as they do not accept deposits. Typically, they are established to extend credit to households or businesses, often to facilitate the acquisition of appliances or equipment. These entities, known as non-banking financial institutions, offer credit facilities to households and businesses alike. They provide loans and leases to households for the purchase of consumer goods like automobiles, furniture, and household appliances. Additionally, they offer short and intermediate-term credit, including leases, to businesses for purposes such as acquiring equipment, vehicles, and financing inventories (Dhungana 2011).

The determinants of lending interest rates in financial institutions have been a topic of intense debate in Nepal. The primary concern revolves around the relatively high loan rates charged by Nepalese finance companies for an extended period, which has limited access to capital and hindered economic growth. A comparison of lending rate trends reveals that there is typically a much wider range of increases in lending rates

compared to reductions. Although there has been a trend towards lower lending rates and narrower spreads in recent years, they are still relatively high. However, the achievement to reduce lending rates will depend on how finances determine the interest rates that they charge. Therefore, the main purpose of this study is to analyze the financial data of finance company of 10 Fiscal Years in order to investigate the determinants of finances lending rate and analyze their significance and impact on the lending rates by categorizing such factors into company specific and macroeconomic variable.

1.2 Statement of Problem

The role of credit is considered to be the key to economic growth and financial stability of the economy. Credit is the aggregate amount of funds provided by finance company to individuals, business organizations and government as well. Finance company performs the act of financial intermediation that collects money from the surplus sector in the form of deposits and lends it to various sectors of the economy. The rapid growth in financial institutions has led a sharp competition among each other. The financial industry is one critical component of the financial system in developing countries capable of facilitating capital accumulation and economic processes. This is possible through efficient financial intermediation (Diamond & Rajan, 2001).

While it is evident that the lending interest rate is crucial for the progress and development of all types of entrepreneurial activities, the most important thing is to distinguish the determinants of the lending interest rate in an established and integrated financial sector regulated by a national bank. Lending represents the heart of the investment industry and economic growth of the country (Amano, 2014). There is variation in results as the countries differ with their economic size, financial regulatory and operating environments. Further, empirical evidence could provide additional insight about the determinants of lending interest by using much recent data set and it needs further investigation in Nepalese context. To the knowledge of the researcher, there is no empirical studies done regarding determinants of lending interest rates of Nepalese finance sector.

To conduct a complete researched analysis effectively, This investigation aims to address the following queries:

- What are the factors influencing determinants of lending interest rate?
- What is the relationship between profitability and lending interest rate?
- How do Nepalese financial sector impact on the pricing strategies and interest rate?
- What factors influence lending, collateral, and prevailing market condition?

1.3 Objectives of the Study

The objectives of the study are as follows:

- To identify the factors influencing determinants of lending interest rate of finance companies.
- To evaluate the relationship between profitability and lending interest rate of finance companies.
- To examine the pricing strategies of finance companies and the interest rate they offer.
- To evaluate the factors influencing lending, collateral, and prevailing market condition.

1.4 Significant of the Study

This study will try to analyze the various determinants of interest rate and try to develop some ideas to know whether it influences deposit & lending. This being an important aspect for the economic development of the country has not much been emphasized that means very few numbers of researcher work has been found in this topic. Hence, it is hoped that the finding of the study to some extent will help the policy makers to make strong policy regarding interest rate determinants of lending in Nepalese financial market. Similarly, it can be fruitful resource for teachers, students, researchers and academicians in abstracting some useful information about interest rate & lending.

1.5 Limitations of the study

The study has following limitations:

- This study is concentrated on determinants of lending interest rate of finance companies.
- Manjushree Finance Limited, Goodwill Finance Limited and Pokhara Finance Limited are taken for the study.
- This study relies on secondary data for its analysis.
- This study includes data of ten fiscal years from 2070/2071 to 2079/2080.

1.6 Organization of the Study

The proposed study divided into five chapters. The titles of these chapters are as follows:

Chapter: I Introduction

This chapter deals with the general background of the study, overview of interest rate policy and financial development, Statement of the problem, objective of the study, significant of the study, limitations of the study and organization of the study.

Chapter: II Review of Literature

Chapter two deals with the review of available literature. It includes conceptual or theoretical review and empirical review of related studies.

Chapter: III Research Methodology

Chapter three explains the research methodology, in which it includes research design, population and sample of the study, nature and source of data, data collection techniques, methods of data analysis and relevant to the study.

Chapter: IV Result and Discussion

Chapter four deals with the presentation and analysis of data which mainly concerns with the analysis of secondary data collected by the researcher and relating it with the parameters set by Nepal Rastra Bank (NRB) and generally results of all three finance companies.

Chapter: V Summary and Conclusion

This final chapter includes the suggestive framework, which comprises the implications, conclusions, and recommendations derived from the study.

CHAPTER II
REVIEW OF THE LITERATURE

2.1 Theoretical Review

Under this heading, effort has been made to examine and review some of the related articles and journal published in different economic journal, dissertation papers, magazines, newspapers and other related books. Conceptual research is defined as a methodology wherein research is conducted by observing and analyzing already presented information on a given topic. Conceptual research doesn't involve conducting any practical experiments. It is related to abstract concepts or ideas.

2.1.1 Interest Rate

The interest rate is the aggregate amount a lender charges a borrower, usually expressed as a percentage of the loan amount. It's commonly referred to as the annual percentage rate (APR) and applies to most lending or borrowing transactions. Individuals borrow money for various purposes such as buying homes, funding projects, starting businesses, or paying for education. Similarly, businesses take out loans to finance capital projects or expand operations by purchasing assets like land, buildings, and machinery. Borrowed funds are repaid either as a lump sum by a specified date or in regular installments. When repaying loans, the interest rate is applied to the principal amount borrowed. This rate represents the cost of debt for the borrower and the return for the lender. Typically, the amount repaid exceeds the borrowed sum because lenders require compensation for the loss of use of the money during the loan period. They could have invested the funds elsewhere to generate income. The difference between the total repayment amount and the original loan is the interest charged (Banton, 2021).

An interest rate is the fee, expressed as a percentage of the principal amount, that a lender charges a borrower for using assets. These rates are typically annualized and known as the annual percentage rate (APR). Borrowed assets can range from cash to consumer goods to large assets like vehicles or buildings. Interest is essentially a rental or leasing charge for the use of the asset. In the case of large assets, the interest rate may be referred to as the "lease rate." Typically, low-risk borrowers are charged lower interest rates, while high-risk borrowers face higher rates (Vane Horne, 2001).

Simple Interest Rate

Simple interest is a straightforward method for calculating the interest on a loan. It's calculated by multiplying the daily interest rate by the principal amount by the number of days between payments. When making a payment on a simple interest loan, the payment initially covers the interest for that month, with the remainder going towards reducing the principal. This means that each month's interest is fully paid off, preventing it from accumulating. In contrast, compound interest involves adding a portion of the monthly interest back onto the loan each month. This results in paying interest on both the original principal and the accumulated interest, known as interest on interest (Banton, 2021).

Compound Interest Rate

Some lenders choose for the compound interest method, which results in borrowers paying more in interest. Compound interest, also known as interest on interest, is applied not only to the principal amount but also to the accumulated interest from previous periods. With compound interest, the bank assumes that by the end of each year, the borrower owes the principal plus the interest accrued for that year. As a result, the interest owed when compounding is higher compared to the simple interest method. Under compound interest, interest is charged monthly on the principal, including any accrued interest from previous months. For shorter timeframes, the interest calculation may be similar for both methods. However, as the lending period extends, the disparity between the two types of interest calculations becomes more pronounced (Banton, 2021).

2.2 Theories of Interest Rate

Productivity Theory of Interest

This theory was propounded by J.B. Clark and F.H. Knight. In this theory, interest is compensated aimed at the effectiveness of capital. Wicksell, "interest is the compensation given by the borrower of capital because of its productivity." Capital is productive because when combined with labor, it yields more output compared to labor alone. For instance, a fisherman using a fishnet can capture extra fish than one exclusive of it. Similarly, agronomic labor using a tractor can harvest more than without it. Hence, capital is just as beneficial as other production factors.

Abstinence or Waiting Theory of Interest

N.W. Senior, Classical economists advocate the abstinence theory of interest. According to J.S. Mill, interest is the payment for simply refraining from consuming. This theory, focusing on the supply side, explain interest as compensation for saving. On the other hand, the productivity theory, from the demand side, explains interest as a reward for the productivity of capital. Senior describes saving as a sacrifice, or "abstinence," explaining that capital results from saving, which in turn results from abstaining from immediate consumption. People usually spend all their income but save some by abstaining from immediate consumption. Therefore, saving is seen as foregoing consumption. Since abstaining from consumption is considered difficult, rewarding those who save rather than consume is necessary. Hence, interest is seen as the reward for choosing to save rather than spend.

The Austrian or Agio Theory of Interest

This theory was initially proposed by John Rae and later expanded by Bohm Bawerk of the Austrian School of Economics. According to this theory, interest exists because people value present goods more than future ones. If people prefer present goods, there would be no savings or capital accumulation. To encourage people to save and build capital, a premium or price must be offered, known as Agio, which essentially is interest.

The Agio represents the compensation for forgoing present consumption. People generally prioritize present goods over future ones for three main reasons. First, they tend to undervalue the future purchasing power compared to the present, especially considering the uncertainty of the future. Second, present needs are often felt more strongly than future needs. Lastly, individuals anticipate an improvement in their economic situation in the future, leading to a decline in the marginal utility of their income. Therefore, they prefer to use their income when its marginal utility is higher, which is usually in the present. As a result, a premium or Agio must be paid to incentivize lenders to part with their income in the present. This premium is known as interest.

Fisher's Time Preference Theory

The theory is associated with Irving Fisher, whose main idea is that he talks about time preferences. It focuses on how people value income and their preferences regarding current and future income. In this perspective, interest is viewed as an opportunity cost.

"Interest is a measure of people's preference for a dollar of income now rather than in the future," Fisher said. Most people prefer to have something now rather than later, this is called time preference. According to Fisher, this means that people value the present over the future and tend to underestimate the future. They also adjust their spending by saving or borrowing. Interest is the cost of withdrawing money now rather than waiting to withdraw it in the future. Changes in interest rates depend on whether people prefer the present to the future. (Fisher).

The preferred period is affected by many factors: the amount of income, how much the income is distributed over time, the nature of the income, the future reliability of the income, the person's desires and habits, and life expectancy. When people have more income, they tend to be more satisfied with current needs and less optimistic about the future. Income can be divided in three ways: equal throughout life, increasing with age, or decreasing with age. If the income is stable, the preferred period depends on the size of the income and the personality of the individual. When income increases with age, people care less about the future because they expect financial security later in life. Conversely, if income decreases with age, people rely on future income.

Time preference is lower when people are confident that they will earn income in the future, and higher when they are uncertain. A person's behavior also affects time preferences: Visionary people are less interested in the future than in spending money. Also, people with longer life expectancy have a less favorable time than people with shorter life expectancy. These factors determine a person's time preferences. If the interest rate is higher than the market rate, people go into debt; If it is low, they will take out a loan.

The Classical Theory of Interest

The classical theory of interest, developed by scholars such as Marshall, Pigou, Walras, Taussig and Knight, argues that interest rates are determined by the balance of capital supply and demand. The interest rate is determined when investment demand equals savings. Essentially, the interest rate depends on the amount of savings and investment, hence the term savings-investment interest rate theory.

Classical interest theory, also known as real theory or non-financial theory, focuses on real saving and real investment. Real saving includes goods that are capitalized rather than consumed, while real investment includes manufactured goods such as machinery and buildings. In this way of thinking, money is not important. According to classical economists, the interest rate is determined by savings demand and savings supply in capital markets.

Demand for Capital

The demand for capital arises from its efficiency because the economy needs capital to produce goods. The marginal revenue productivity curve shows the additional income obtained from each additional unit of capital. As the investor acquires more capital, the profit from additional units decreases. In perfect competition, the company will invest until its price equals the profit it makes from the product. Investors need capital until the expected return becomes interest-like.

When interest rates rise, the demand for capital decreases and when interest rates fall, it increases, creating a positive relationship and a downward trend in demand. Other factors affecting the demand for capital include population growth, technological progress and the quality of life in society.

Supply of Capital

Funds come from communities willing and able to save. Some people save regardless of the interest rate, or even without interest. Some save because current interest rates support them, while others save only when interest rates rise. Depositors include individuals, mutual fund depositors, institutions such as banks and insurance companies, and governments. Saving, which involves sacrifice and waiting, must stop taking now and therefore must be paid.

Therefore, as interest rates increase, social savings also increase, which causes income to increase. This exhibits itself as an upward sloping investment curve, indicating that more money will be saved and given away at a higher price.

Determination of Rate of Interest:

Rate of interest is determined at the point where demand and supply of capital are equal, in other words, equilibrium saving and investment determined rate of interest. This can be shown with the help of the following diagram:

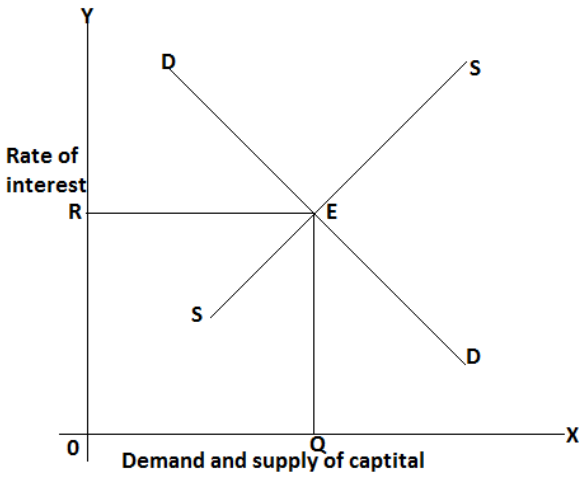


Fig 2.1

Source: The Classical Theory of Interest (2021)

The point of equilibrium is E at which investment demand is equal to saving. OR is the equilibrium rate of Interest which is determined at the point at which the supply of savings curve intersects the investment demand curve, so that OQ amount of savings is supplied as well as invested. This implies that the demand for capital OQ is equal to the supply of capital OQ at the equilibrium rate of Interest OR. At the lower rate of interest, people will save less but the demand for investible funds will increase which will raise the rate of interest to the equilibrium level.

Loanable Funds Theory of Interest

Credit theory, also known as neoclassical theory, explains the determination of interest rates according to the supply and demand for credit. This theory was first proposed by Swedish economist Knut Wicksell and later developed by Swedish economists Bertil Ohlin, Gunnar Myrdal and Eric Lin. Other economists such as Eric Lindahl and British economists such as Pigou and Robertson also contributed. Loans represent all income and demand in the market. According to this theory, the interest rate represents the price

paid for the use of this money, and many factors affect the supply and demand of the loan.

Supply of Loanable Funds

The supply of loanable funds comes from four basic sources namely, Savings Dishoarding, Bank Credit and Disinvestment.

Savings

Both personal and corporate savings are important in mortgage loans. Savings are divided into planned (in advance) and unplanned (post). Preliminary savings are planned according to income and consumption at the beginning of the period. According to Robertson, post-expenditure saving is the difference between past income and current consumption. Savings fluctuate with interest rates; High interest rates encourage more savings. Businesses also save, and retained earnings are business savings. Like personal savings, business investments are affected by current interest rates; High interest rates encourage more savings.

Dishoarding

Waiving results in the granting of credit. When people stop hoarding, the cash they previously saved will become available as a loan. Funds that were initially inactive became active funds in the current period and increased the loan amount. Higher interest rates encourage more loans.

Bank Credit

Banks facilitate the provision of loans by creating loans and providing loans to businesses. The provision of loans fluctuates with interest rates, and banks often lend at higher interest rates.

Disinvestment

Sometimes mortgage lending increases when loans flow into the capital market. There will be no change in machinery and other equipment due to the change in structure. Therefore, no part of the proceeds from the sale should be used to replace or repair the machine. On the contrary, credit opportunities will increase. When interest rates are high,

investment increases. The components of this credit are represented by savings (S), disposable funds (DH), investments (DI) and bank loans (BC).

Demand for Loanable Funds

Demand for credit comes mainly from three sectors: government, business and consumer, investment, storage and consumption. The government borrows money to provide public goods, housing, or war preparations. Loan requests usually come from loan companies to buy or build new property and start investing. This is the most important part of the loan requirement. Interest is the cost of the loan required to purchase the product. When interest rates are low, investors find it profitable to buy large-cap stocks. Therefore, the demand curve for loanable funds is interest rate elastic and slopes downward to the right. Consumers need credit to buy durable goods such as motorcycles, houses, refrigerators and televisions, and low interest rates will encourage them to borrow more. Therefore, the demand curve for consumer loans also slopes downward. Funds must be held in liquid form in nonprofit accounts.

This is to quench their thirst for business growth. It should not be forgotten that the person giving the loan is also the person requesting the loan for savings purposes. For example, an investor saves money, borrows money, and hopes the money will cover his income. Hoarding is also a kind of elastic flower. The interest rate is determined according to the balance between the loan request and the total loan amount.

Mortgage loan theory has more methods than classical theory. Classical theory ignores the effect of money on interest. The bank loan will be used to account for the equipment of the bank loan. This theory considers supply to be a barrier to economic demand.

Liquidity Preference Theory

Keynes introduced the economic theory of interest in his famous book "The General Theory of Employment, Interest and Money". He believes that satisfaction is a reward for investing in business. His theory is known as Interest Rate Liquidity Preference Theory. Liquidity preference refers to the need to hold money or the public's desire to hold cash. According to Meyer, “To choose is to choose to have more cash than is needed for the same amount.”

Keynes believed that interest rates were the result of money because interest rates were determined by money. Money is the most valuable asset and people want to keep their assets in cash. They need a lot of money to generate income. This reward is paid out in the form of liquidity. The greater the demand for liquidity, the higher the interest rate for liquidity to function as it should. This theory has the characteristics of the theory of interest and is different from the real theory of classical economists.

Factors Determining Liquidity Preference

Liquidity tends to depend on many factors. According to Keynes, the desire for money, or people's desire to hold cash arises with respect to following motives:

1. The transaction motives,
2. The precautionary motive and
3. Speculation motive.

Transaction Motive

The transaction motive relates to the need for money for everyday transactions in both personal and business exchanges. It's divided into two parts: the income motive and the business motive. The income motive helps cover the time between receiving income and spending it. The business motive covers the time between incurring business expenses and receiving money from sales.

When there's a short gap between spending money and receiving income, people tend to hold less cash for daily dealings, and the other way round. Since many people accept income daily, weekly, quarterly or monthly but need to spend money daily, it's essential to keep some cash on hand for immediate payments.

Likewise, business owners and entrepreneurs also need cash readily available to cover their current costs, such as purchasing raw materials, paying for transportation, wages, salaries, and other expenses. The amount of capital required for this business generally depends on the volume of business the company does. Changes in demand are affected by income.

The Precautionary Motive

Saving money refers to people's desire to keep cash for emergencies. Both people and business owners set aside money to cover anticipated needs such as illness, accidents, travel, unemployment, and other unforeseen circumstances. Money held for precautionary purposes is similar to keeping water in backup in a container. The requirement for precautionary money be contingent on factors like income level, business activity, individual characteristics, convenience of cash, the total of holding liquid assets, economic stability, and approach to credit.

Speculative Demand for Money

Cash held for unpredictable purposes is aimed at profiting from having better insight than the marketplace about potential developments. In simpler terms, it's about holding resources in liquid form to capitalize on market movements, particularly regarding expected changes in interest rates. Individuals and business owners, once they have set aside enough money for transactions and precautionary needs, seek to benefit by financing in bonds.

Supply of Money

Among the two factors affecting the interest rate, the supply of money indicates to the aggregate amount of money available for total transactions at any given period. It's fixed on externally by financial specialists. Therefore, the amount of change is set by these authorities, making the supply curve of money perfectly fixed. The money supply includes coins, notes, and bank deposits.

Determination of the Rate of Interest

According to Keynes, the rate of interest is determined by the interaction of two factors: the demand for money, known as liquidity preference, and the supply of money. Similar to how the price of a commodity is determined by the balance of supply and demand, the rate of interest is set at a point where the demand for money matches the supply of money.

2.3 Empirical Review

The literature has been studied to present an overview of bank lending, lending behavior followed by an analysis of its determinants which directly or indirectly affects it.

Ali Mustafa and Qudah (2021) analyzed the determinants of lending interest rates of Jordanian listed commercial banks. This study analyzed the factors influencing the lending interest rates of commercial banks listed on the Amman Stock Exchange. This study used descriptive statistics for the analysis of data. The study discovered that Return on Assets (ROA) and bank size had a significant negative impact on lending interest rates, while liquidity had a minor negative impact. Furthermore, the study implied that deposit interest rates and inflation had a significant positive impact on the lending interest rates of Jordanian commercial banks, while the operating cost ratio had a minor positive impact. As a result, the research suggested that Return on Assets (ROA), bank size, deposit interest rates, and inflation were effective determinants of the lending interest rates for Jordanian listed commercial banks. In conclusion, the study emphasized that banks could utilize profitability and bank size as strategies to lower lending interest rates, recognizing their importance as factors that could contribute to further reductions in lending interest rates.

Mbowe et.al (2020) investigated determinants of bank lending interest rates in Tanzania. The study examined the determinants of bank lending interest rates in Tanzania, largely focusing on identifying the key determinants and their relative importance. The study used descriptive and correlation statistics for the analysis of data. The study found the main drivers of lending interest rates were operating costs, non-performing loans; and costs of funds (deposits interest rates). Whereas the econometric estimation confirmed that the operating costs, non-performing loans, and cost of funds were significant factors of bank lending rates. The research concluded that, the operating costs, cost of funds, and inflation had a statistically significant positive effect on bank lending rates, while bank size and level of liquidity had a negative influence. The research further concluded to focus on improving operational efficiency to reduce operating costs and suggested for the improvements to be made on employee's salaries and benefits, as well as rental and depreciation and advancement in Information and Communication Technology (ICT) and digital banking to reduce costs.

Ojha (2020) reviewed the determination of interest rate in Nepalese finance companies.The objective of the study was to investigate the effects of inflation and loan interest rate on deposit interest rates in finance companies. Also, the study examined the influence of inflation and deposit interest rates on loans and advances in Nepalese finance companies. The research used regression analysis model to analyze the data. Based on the analysis, the study revealed that the interest rate on deposits exhibited a significant negative association with the inflation rate, while showing a significant positive relationship with the interest rate on loans and advances of the company. Similarly, the interest rate on loans and advances of the company demonstrated a significant positive relationship with both the interest rate on deposits and the inflation rate. The study concluded that in both finance companies, the interest rate on deposits were significantly influenced by the inflation rate and had a positive relationship with the interest rates on loans and advances. The study suggested that, the interrelation between inflation and the deposit and interest rate on loans are crucial factors in the determination of interest rate in Nepalese finance companies.

CB Karki (2018) studied the impact of interest rate spread on profitability in Nepalese commercial banks. The objective of the research was to evaluate the relationship between interest rate spread and the profitability of commercial banks. The study examined how fluctuations in the interest rate spread (IRS) impact the return on assets (ROA) and net profit margin (NPM). The study used descriptive statistics and multiple regression model for the data analysis. The study discovered that when there's a high interest rate spread, profitability tends to be high, including a high return on equity and a high net profit margin. Further the study found increase in interest rate spread leads to increased profitability for commercial banks. Higher interest rate spreads were associated with higher profitability for the banks. The study recommended that all Nepalese commercial banks should carefully manage deposit and lending rates to maintain an optimal interest rate spread, which would attract both depositors and borrowers. The research concluded that there is a clear positive correlation between interest rate spread and bank profitability. When the interest rate spread widens, profitability increases, resulting in higher returns on equity, assets, net profit margin, earnings per share, and vice versa.

Maigai and Mouni (2016) analyzed the influence of interest rates determinants on the performance of commercial banks in Kenya. The study investigated how raising inflation

and exchange rates influence the success of commercial banks in Kenya. It explored how reserve requirements and discount rates impact their performances. The study used multiple regression model to analyze the data. The study discovered that inflation rates and reserve requirements have a significant impact on the performance of commercial banks in Kenya. There is a negative correlation between inflation rates and bank performance, meaning that as inflation rates rise, the performance of banks tends to decrease. Similarly, the study found that increases in reserve requirement rates also lead to decreased performance of commercial banks. Higher reserve requirement levels result in lower bank performance. The study concluded, the discount rate positively impact banks performance by enabling higher lending rates but exchange rate negatively impact banks performance by reducing banks return on assets. Therefore, in order to help grow the banking industry in Kenya, the study recommended prompt management of the inflation reserve requirements, and exchange rates to boost commercial banks performance while leveraging higher discount rates for improved profitability in Kenya.

2.4 Research Gap

The banking industry plays an important role in the economic development of Nepal, and finance companies are the crucial players to support Nepalese economy. Finance company plays a competitive role with commercial banks, enhancing the overall financial stability, savings, lending, inflation, etc. In line with the above theoretical reviews, numerous empirical studies have been conducted on the determinants of lending interest rates across developed, emerging, and developing countries, focusing on various sets of factors such as bank-specific factors, industry-related factors, and macroeconomic factors. These studies employ different methodologies including time series and descriptive analysis, depending on the type and frequency of data available.

The findings of these empirical studies suggest that the determinants of lending interest rates vary significantly across countries. Factors influencing lending interest rates can differ based on the economic environment, financial system structure, regulatory framework, and other country-specific characteristics. Therefore, understanding the unique determinants of lending interest rates in each country is crucial for policymakers, financial institutions, and researchers aiming to analyze and forecast interest rate dynamics.

Some studies claimed that the main determinants of lending interest rates are bank specific factors whereas others claimed the macroeconomic factors are the major one to impact the lending interest rate. Hence, an ongoing debate is emerging regarding the primary determinants of lending interest rates for banks across various economies. In developing countries like Nepal, banks play a pivotal role in directing funds from surplus sectors to deficit sectors.

One of the primary research gap is that, though the previous studies have broadly analyzed banking sectors, but there is limited research done on finance companies in Nepal, leaving a gap in understanding their unique challenges and dynamics. There is a gap in comparative analysis between the determinants of lending rates in finance companies and commercial banks within Nepal, which can provide valuable perceptions into sector-specific factors.

However, the research focused on examining the determinants of finance liquidity, performance, profitability and its lending behavior. This research helps understanding how consumer demand and behavior impact the lending interest rates in finance companies, highlighting a need for focused studies. Thus, this study tries to fulfill the gap by conducting empirical study in Nepal to analyze the impact of various banking specific factors and macro-economic factors on the lending interest rates of finance companies of Nepal.

CHAPTER III
RESEARCH METHODOLOGY

3.1 Research Design

This study has followed descriptive and casual research design. The key objective of the study is to analyze the determinants of lending rate of finance companies, a case study of Manjushree Finance Limited (MFL), Pokhara Finance Limited (PFL) and Goodwill Finance Limited (GFL). This research is conducted under 3 sample finance companies out of 17 finance companies. Sample was taken under the judgmental sampling methods and based on secondary data taken from annual report, NRB directives, and related articles. It emphases on descriptive and analytical analysis of the gathered measurements from the profit and loss account and balance sheet i.e. financial statement over a period of time. Descriptive causal relationship research design is a scientific method which involves observing and describing the behavior of a subject without influencing it in any way. This study tries to describe the relationship among dependent and independent variables, so descriptive research design is used for the study. Information of data of a 10year period collection from the finance company is tabulated. Analysis with different statistical and financial tools has been conducted to find out the necessary result also.

3.2 Sources of Data

The report uses secondary information. Every part of the information is gathered from the yearly reports of the finance company, primarily from profit and loss accounts, balance sheet and other journals by the finance company. Similarly, additional associated information is collected from institutions and organizations like Nepal Rastra Bank, Nepal Stock Exchange Limited and Central Bureau of Statistics. Several information and reports are collected from journals, articles, periodical bulletins, magazines, internet and websites.

3.3 Population and Sample

The population for this study includes all 17 national-level finance company in the country. A list of these finance companies is obtained from NRB. There are total of 17 finance companies operating in Nepal, three finance companies were chosen as samples

for the study using judgmental sampling method based on different sized of finances. In this research, the specific focus revolves around precisely examining the

financial performance within the framework of Lending Rate, Deposit Rate, Return on Assets(ROA), Liquidity Rate, Assets Growth Rate/Log of Assets(AGR) Inflation and Gross Domestic Product(GDP) and their complete analysis of Descriptive Statics and Inferential Statics based on report from 2070/71 to 2079/80 fiscal year.

1. Manjushree Finance Limited (MFL)
2. Goodwill Finance Limited (GFL)
3. Pokhara Finance Limited (PFL).

The population includes records circulated by the relevant expert or organization for the descriptive and analytical analysis. For the methodical segment, a sample set of data needs to be considered from enquiry and evaluation. For this determination, the research has acquired a sample of financial statement from the past ten fiscal years.

3.4 Data Collection and Processing Procedures

Information's are collected from the secondary data from yearly reports of sample finances. And the surveys included economic survey, online portals, available books-thesis and articles etc. The gathered evidence were organized into simple illustrative paragraphs, tables showing data over time and figure liable on what kind of information it was.

3.5 Data Analysis Tools and Technique

The grouped report was organized according to the requirement of the investigation. Following statistical and financial methods are used to analyze the study.

a. Financial Analysis

1. Ratio Analysis

b. Statistical Analysis

1. Mean
2. Standard Deviation
3. Coefficient of Correlation
4. Regression Analysis

3.5.1 Ratio Analysis

Non-performing Loan Ratio

Asset quality measured by the non-performing ratio. A nonperforming loan is a loan in which the borrower is default and hasn't made any scheduled payments of

principal or interest for some time. In banking, commercial loans are considered nonperforming if the borrower is 90 days past due. The ratio signifies the proportion of nonperforming loans within a bank's loan portfolio relative to the total outstanding loans held by the bank. It is measured by,

Non-Performing Loans (Value or the number of loans) / 100 = The NPL Ratio (%)

Return on Assets

Return on Assets is a type of return on investment metric that measures the profitability of a business in relation to its total assets. This ratio indicates how well a company is performing by comparing the profit it’s generating to the capital it’s invested in assets. It is given by,

ROA =Net Profit/Total assets

Liquidity Ratio

Liquidity ratios are vital financial indicators that assess a debtor's capability to settle existing debts without seeking external funding. These ratios evaluate a company's ability to meet debt obligations and its financial cushioning through metrics like the current ratio, quick ratio, and operating cash flow ratio (Hayas, 2021).

Liquidity Ratio = Current Assets / Current Liabilities

Log of Assets

Log return is a method for calculating returns that assumes returns are compounded continuously rather than across sub-periods. It's computed by taking the natural logarithm of the ending value divided by the beginning value. Assets is the Algorithm of total assets. SIZE is equal Natural Algorithm of total assets. Size: we use the natural Algorithm of total assets. Firm size is measured using the Algorithm of total assets (Davis, 2021).

3.5.2 Arithmetic Mean

The mean or average value is a single value within the range of the data that is used to represent all the value in the series. Since an average is somewhere within the range of the data. It is also called a measure of central value. It is calculated by

Where,

Mean (x) = $\sum xi/N$, where I vary from 1 to N

x= arithmetic mean

$\sum xi$ = addition of cost of all times N= number of all items

3.5.3 Standard Deviation

Standard deviation is a common way to show how spread out data is. It's like a rough estimate of how much individual observation differ from the average. Usually it is represented with the Greek Letter Sigma (σ). Standard deviation helps to compare if the average is as good representation of the data. It is calculated as:

Standard deviation,

Where,

$\sigma = \sqrt{(\sum(x-\bar{x})^2/N)}$, where n = total number of observations.

$\sum(x-x)^2$= addition of squares of the deviation from arithmetic average

N = number of all items

3.5.4 Coefficient of Variation

The coefficient of variation is a number that shows how much the standard deviation s compared to the average in a sample . It's mostly used to see how spread out the data is relative to the average. It can also be used to measure how risky something is compared to some other data.

$$CV = \sigma/\mu \times 100$$

Where,

CV = coefficient of variation σ= standard deviation

μ = arithmetic mean

3.5.5 Correlation Analysis

Correlation means how two things are connected: one that depends on the other. If changing one thing causes the other to change too, they're said to have a correlation. For instance, when income goes up, spending often goes up too(Shrestha and Silwal, 2060). So, income and expenditure are positively correlated. For instance, when people earn more money each month, they often spend more too. So, the amount they earn (which doesn't depend on anything else) and what they spend (which depends on how much they earn) are positively linked.

Correlation helps figure out if two or more things are connected, and if they are, how strongly and in what direction. The correlation coefficient (r) can be between -1 and +1. A positive r means the variables move in the same direction, while a negative r means they move in opposite directions. In this study, the correlation between the lending rate and deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), logarithm of assets (AGR), and gross domestic product (GDP) are observed.

The formula for calculating the correlation coefficient between these variables is as follows:

$$r = \frac{N\sum XY - \sum X \sum Y}{\sqrt{N\sum X^2 - (\sum X)^2}\sqrt{N\sum Y^2 - (\sum Y)^2}}$$

Where,

n= number of observations in series x and y

$\sum x$= Sum of observation in series x

$\sum Y$= Sum of observation in series Y

$\sum x^2$= Sum of squared observation in series x

$\sum y^2$= Sum of squared observation in series Y

3.6.6 Multiple Regression Analysis

Under the statistical model, regression analysis is a method to figure out the connection between different variables. It involves various techniques to analyze multiple variables, with one or more independent variables. Regression analysis helps measure the distinctive association among two or many variables in the new units of data. Multiple regression aims to understand how several independent variables relate to a single dependent

variable. In this research, regression analysis has been done taken dependent variable is Lending rate and independent variables are deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), log of assets (AGR) and gross domestic products (GDP). The regression equation is showing below,

The line of regression is Y= A+BX Multiple Regression Model

$\hat{Y}_{LDR} = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5$

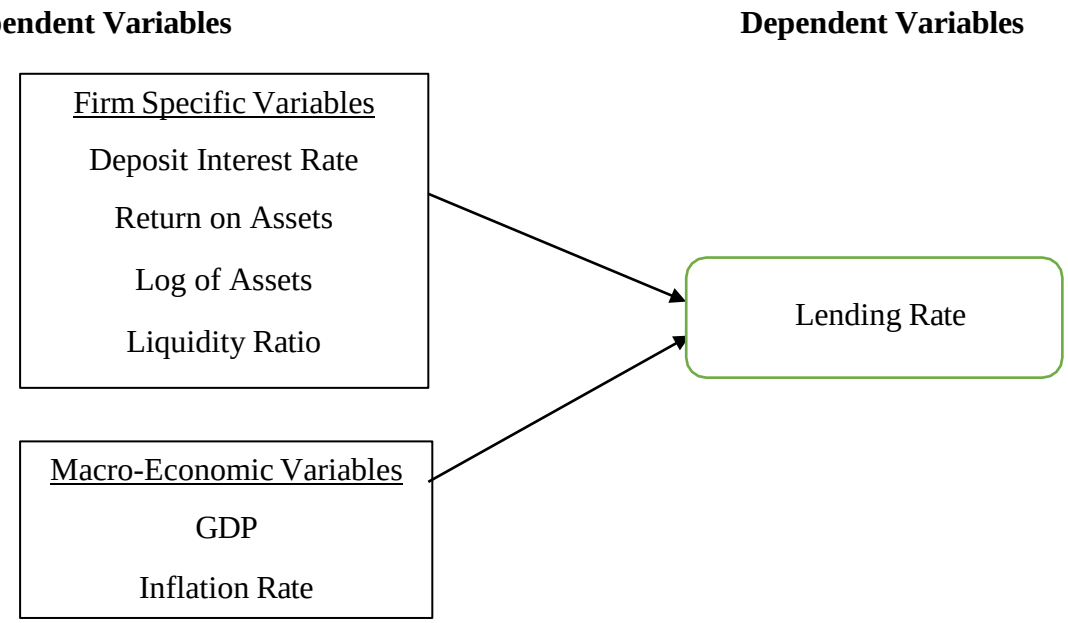
Where, $\hat{Y}$= regression line (LDR) α = Constant

$\beta_1, \beta_2, \beta_3, \beta_4$= Coefficient X_1= Deposit rate

X_2 =Inflation rate X_3 =Liquidity rate X_4=Log of assets X_5= GDP

3.5.7 Research Framework

The research framework describes the relationships among the variables, and the nature and direction of the relationship. Based on the literature review seven variables had taken into consideration that had influenced the lending rate analysis. The dependent and independent variables are as follows:



Source: Gautam (2018)

Figure 3.1: Research Framework of the Study.

3.5.8 Definition of Variables

Lending rate

The lending rate, or interest rate, is the extra money lenders charge for borrowing a certain amount over a period, shown as a percentage of the loan. How much interest is paid overall depends on how long the money is borrowed for. Most loans work with simple interest, but some use compound interest, where interest is paid on both the original amount and the interest already accumulated. Loans seen as low-risk usually have lower interest rates, while riskier loans have higher rates. Lenders determine risk by checking the borrower's credit score. So, having a good credit score is vital to get the best loan deals (Jha, 2022).

Deposit interest rate

The deposit rate is the interest rate paid by finance companies or all kinds of financial institutions on cash deposits of account holders. Deposit accounts include certificates of deposit (CD), savings accounts, and other investment accounts. For instance, a deposit interest rate will often be paid for cash deposited into savings and Money Market accounts. Savings accounts earn a rather low rate of interest, but cash deposited in certain other account types are also paid a deposit rate by banks and financial institutions. Deposit interest rates can be either fixed for a certain period of time with a minimum amount of money on deposit, or it can be variable, which fluctuates and is not usually subject to early withdrawal penalties (Jha, 2021).

Return on assets

The term return on assets (ROA) refers to a financial ratio that indicates how profitable a company is in relation to its total assets. Corporate management, analysts, and investors can use ROA to determine how efficiently a company uses its assets to generate a profit. The metric is commonly expressed as a percentage by using a company's net income and its average assets. A higher ROA means a company is more efficient and productive at managing its balance sheet to generate profits while a lower ROA indicates there is room for improvement (Hargrave, 2021).

Liquidity rate

Liquidity ratios are key financial measures that assess a debtor's capacity to settle current debt obligations without resorting to external funding. These ratios measure a company's

ability to meet debt commitments and its financial safety margin, calculated through metrics such as the current ratio, quick ratio, and operating cash flow ratio (Hayas, 2021).

Assets Growth of Bank

Log Return is a method for computing returns, assuming that returns are compounded continuously rather than across sub-periods. It's determined by taking the natural logarithm of the ending value divided by the beginning value. Assets is the Algorithm of total assets. SIZE is equal Natural Algorithm of total assets. Size: the natural Algorithm of total assets is used. Firm size is measured using the Algorithm of total assets (Davis, 2021)

Inflation

Inflation refers to the decline of purchasing power of a currency over time. It's quantitatively measured by the increase in the average price level of a selected basket of goods and services in an economy over a specific period. A rise in the general price level, usually expressed as a percentage, indicates that a unit of currency can purchase fewer goods and services compared to previous periods (Frenando, 2021).

Gross Domestic Product (GDP)

Gross domestic product (GDP) is the total value of all the goods and services made in a country during a certain time, measured in money. It's like a big report card showing how well a country's economy is doing overall. The numbers in this report are adjusted for changes in prices, so they're not affected by inflation (Frenando, 2021).

CHAPTER IV
RESULT AND DISCUSSION

4.1 Presentation and Analysis of Data

The objectives of the study are to analyze the determinants that impacts on the lending interest rate. This research conducted to fulfill the objectives by using annual report of Manjushree Finance Limited (MFL), Pokhara Finance Limited (PFL) and Goodwill Finance Limited (GFL) since 2070/71 to 2079/80 and other important data from various organizations have been presented in tabular format.

4.1.1 Lending rate

The lending rate, or interest rate, is what lenders charge for borrowing money, shown as a percentage of the loan. How much interest paid depends on how long the money is borrowed for. Many loans use simple interest, where the interest is paid on the original amount. But some use compound interest, where the interest is paid on both the original amount and the interest already added. Loans seen as safe usually have lower interest rates, while riskier loans have higher rates. Lenders decide how risky a loan is by checking the borrower's credit score. So, having a good credit score is key to getting the best loan deals (Jha, 2022).

Table 4.1

Lending Rate (in percentage)

FY	MFL	GFL	PFL
2070/71	13.64	14.51	13.78
2071/72	11.72	16.46	15.19
2072/73	12.70	14.97	12.74
2073/74	12.31	11.26	12.42
2074/75	14.64	15.22	14.69
2075/76	18.27	16.53	14.38
2076/77	18.93	15.96	15.25
2077/78	15.24	14.24	15.94
2078/79	15.10	14.93	12.94
2079/80	18.70	18.68	19.08
AVG	15.02	15.34	14.64
SD	3.13	2.26	2.83

Source: Annual Report of Selected Finance Company

Table 4.1 presents the lending rate of the selected finance company. The fiscal year 2070/71 to 2079/80 taken as research period. The average lending rate of GFL is higher than the others i.e. 15.34%. Similarly, the lowest average lending rate is PFL which is 14.64%. The SD of GFL is lower and higher is MFL, so the higher SD represents higher variation on lending interest rate. Among the sample finance company GFL has lower lending interest showing it has lower cost of fund and operating cost.

4.1.2 Deposit Interest Rate

The deposit rate refers to the interest rate offered by financial institutions on cash deposits made by account holders. Deposit accounts encompass various types such as certificates of deposit (CDs), savings accounts, and other investment accounts. For example, a deposit interest rate is typically paid for cash deposited into savings and Money Market accounts. While savings accounts generally earn lower interest rates, certain other account types may also offer deposit rates. Deposit interest rates can be either fixed for a specific duration with a minimum deposit requirement, or variable, fluctuating without early withdrawal penalties (Jha, 2021).

Table 4.2

Deposit Interest Rate (in percentage)

FY	MFL	GFL	PFL
2070/71	10.89	8.37	7.75
2071/72	6.71	7.69	6.70
2072/73	6.27	6.74	5.93
2073/74	10.75	8.03	5.91
2074/75	11.00	9.29	8.07
2075/76	14.04	9.49	8.30
2076/77	12.31	9.48	8.10
2077/78	7.50	7.47	6.75
2078/79	9.73	8.95	7.69
2079/80	11.07	11.87	10.36
AVG	10.02	8.62	7.51
SD	1.63	1.95	1.83

Source: Annual Report of Selected Finance Company

Table 4.2 presents the lending rate of the selected finance company. The fiscal year 2070/71 to 2079/80 taken as research period. The average deposit rate of MFL is higher than the others i.e., 10.02%. Similarly, the lowest average deposit rate is PFL which is 7.51%. The SD of MFL is lower and higher is GFL, so the higher SD represents higher

variation on deposit interest rare. Among the sample finance company PFL has lower deposit interest showing it has higher amount of liquidity.

4.1.3 Return on Assets

Return on Assets (ROA) is a financial metric that shows how profitable a company is relative to its total assets. It's a valuable tool for corporate management, analysts, and investors to assess how effectively a company utilizes its assets to generate profit. Typically expressed as a percentage, ROA is calculated using a company's net income and average assets. A higher ROA suggests that a company efficiently manages its balance sheet to generate profits, while a lower ROA indicates potential for improvement (Hargrave, 2021).

Table 4.3

Return on Assets (ROA)

FY	MFL	GFL	PFL
2070/71	0.79	1.67	2.22
2071/72	0.80	1.13	4.66
2072/73	1.09	2.85	2.31
2073/74	1.08	1.61	1.92
2074/75	1.29	0.88	1.76
2075/76	0.74	1.69	1.32
2076/77	2.85	1.05	0.82
2077/78	3.63	1.46	1.08
2078/79	0.75	0.97	0.68
2079/80	1.46	(0.62)	0.17
AVG	1.49	1.19	1.71
SD	0.60	0.92	1.72

Source: Annual Report of Selected Finance Company

Table 4.3 presents the ROA of the selected finance company. The fiscal year 2070/71 to 2079/80 taken as research period. The average return on assets of PFL is higher than the others i.e., 1.71%. Similarly, the lowest average return on assets is GFL which is 1.19%. The SD of MFL is lower and higher is PFL, so the higher SD represents higher variation on return on assets. Among the sample finance company PFL has higher ROA showing it has higher amount of profitability and better utilization of assets.

4.1.4 Liquidity Rate

Liquidity ratios play a crucial role as financial indicators, assessing a debtor's capability to settle present debt obligations without needing external funds. These ratios analyze a company's capacity to meet debt commitments and its financial safety net, calculated using metrics such as the current ratio, quick ratio, and operating cash flow ratio (Hayas, 2021).

Table 4.4

Liquidity Rate (LR)

FY	MFL	GFL	PFL
2070/71	29.24	18.78	5.04
2071/72	27.70	24.62	1.74
2072/73	28.54	31.99	2.44
2073/74	7.77	21.84	4.09
2074/75	22.51	18.22	1.05
2075/76	17.96	13.93	0.99
2076/77	11.29	11.75	17.35
2077/78	1.45	8.10	15.54
2078/79	17.23	5.31	11.24
2079/80	5.98	4.85	12.46
AVG	16.93	15.97	7.23
SD	9.66	7.02	4.64

Source: Annual Report of Selected Finance Company

Table 4.4 presents the liquidity rate of the selected Finance Company. The fiscal year 2070/71 to 2079/80 taken as research period. The average liquidity rate of MFL is higher than the others i.e., 16.93%. Similarly, the lowest average liquidity rate is PFL which is 7.23%. The SD of PFL is lower and higher is MFL, so the higher SD represents higher variation on liquidity rate. Among the sample finance company GFL has higher liquidity rate showing it has higher amount of liquidity and has lower level of risk for short term obligation.

4.1.5 Assets Growth of Bank

Log Return is a method for computing returns, assuming that returns are compounded continuously rather than across sub-periods. It's determined by taking the natural logarithm of the ending value divided by the beginning value. Assets is the Algorithm of total assets. SIZE is equal Natural Algorithm of total assets. Size (SIZE): we use the natural Algorithm of total assets. Firm size is measured using the Algorithm of total assets (Davis, 2021).

Table 4.5

Assets Growth Rate of Bank (AGR)

FY	MFL	GFL	PFL
2070/71	9.21	9.53	9.47
2071/72	9.39	9.57	9.53
2072/73	9.48	9.68	9.58
2073/74	9.68	9.78	9.66
2074/75	9.85	9.85	9.76
2075/76	9.99	9.94	9.89
2076/77	9.97	10.04	9.95
2077/78	10.14	10.12	10.04
2078/79	10.20	10.18	10.13
2079/80	10.23	10.17	10.14
AVG	9.82	9.84	9.77
SD	0.42	0.31	0.29

Source: Annual Report of Selected Finance Company

Table 4.5 presents the assets growth rate of the selected Finance Company. The fiscal year 2070/71 to 2079/80 taken as research period. GFL's average assets growth rate is higher than the others i.e. 9.84%. Similarly, the lowest average log of assets is PFL which is 9.77%. The SD of PFL is lower and higher is MFL, so the higher SD represents higher variation on log of assets. Among the sample finance company MFL has higher log of assets showing it has higher growth of total assets.

4.1.6 Inflation and GDP

Inflation refers to the decline of purchasing power of a currency over time. It's quantitatively measured by the increase in the average price level of a selected basket of goods and services in an economy over a specific period. A rise in the general price level, usually expressed as a percentage, indicates that a unit of currency can purchase fewer goods and services compared to previous periods (Frenando, 2021). Gross domestic product (GDP) is the total value of all the goods and services made in a country during a certain time, measured in money. It's like a big report card showing how well a country's economy is doing overall. The numbers in this report are adjusted for changes in prices, so they're not affected by inflation (Frenando, 2021). The data sets in this study are given in real terms, meaning they've been adjusted for price changes and does not include inflation.

Table 4.6

Inflation and GDP

FY	Inflation Rate	GDP in Million
2070/71	9.10	14.50
2071/72	7.20	15.30
2072/73	9.90	19.10
2073/74	4.50	24.10
2074/75	4.20	18.00
2075/76	4.60	11.00
2076/77	6.50	16.80
2077/78	2.90	4.70
2078/79	7.10	14.90
2079/80	7.40	19.00
AVG	6.34	15.74
SD	1.37	2.03

Source: Nepal's Economic Data (Online Portal)

Table 4.6 presents the inflation and gross domestic product of Nepalese economy. The fiscal year 2070/71 to 2079/80 taken as research period. The average inflation and gross domestic product are 6.34% and 15.74 million respectively. Similarly, the standard

deviation of inflation and gross domestic product is 1.37% and 2.03 million respectively. The highest inflation rate occurring in FY 2072/73 and lower is in FY 2077/78.

4.1.7 Descriptive Statics

Descriptive statistics are brief descriptions that show a set of data that is representative of the entire population or a sample of the population. They are divided into two: average trend measures and variance measures (distribution). Mean measures include mean, median, and mode, while variance measures include standard deviation, number of variables, and minimum and maximum. Descriptive statistics consists of two basic categories of measures: measures of central tendency and measures of variability (or spread). In this study, the table showing below Lending rate, deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), log of assets (AGR) and gross domestic products (GDP).

Table 4.7

Descriptive Statics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
LDR	100	11.26	19.08	14.67	2.74
DPR	100	6.27	14.04	8.71	1.80
AGR	100	9.21	10.23	9.81	0.34
LR	100	0.99	31.99	13.38	7.10
ROA	100	0.17	4.66	1.46	1.08
INF	10	2.90	9.90	6.34	1.37
GDP	10	4.70	19.10	15.74	2.03

Source: Annual report of sample finance company and result are drawn from SPSS

Table 4.7 displays the descriptive evaluation of the study. The average LDR is 14.67 percentage with standard deviation 2.74 percentage. The minimum LDR is 11.26 percentage and maximum is 19.08 percentage. The average DPR is 8.71 percentage with standard deviation 1.80 percentage. The minimum DPR is 6.27 percentage and maximum is 14.04 percentage. The average AGR is 9.81 percentage with standard deviation 0.34 percentage. The lowest liquidity rate (LR) is 0.99%, while the highest is 31.99%. The average return on assets (ROA) is 1.46%, with a standard deviation of 1.08%. The lowest

ROA is 0.17%, and the highest is 4.66%. The average inflation rate (INF) is 6.34%, with a standard deviation of 1.37%.The minimum INF is 2.90 percentage and maximum is 9.90 percentage. The average GDP is 15.74 million rupees with standard deviation 2.03 million rupees. The minimum GDP is 4.70 million rupees and maximum is 19.10 million rupees.

4.1.8 Inferential Statics

Inferential statistics use measurements from the sample of subjects in the experiment to compare the treatment groups and make generalizations about the larger population of subjects. There are many types of inferential statistics and each are appropriate for a specific research design and sample characteristics.

Correlation Analysis

The correlation coefficient is a statistical measure that quantifies the strength and direction of the relationship between two variables. It ranges from -1.0 to 1.0. A value of 1.0 indicates a perfect positive correlation, meaning that as one variable increases, the other also increases in a perfectly linear fashion. Conversely, a value of -1.0 indicates a perfect negative correlation, where an increase in one variable corresponds to a decrease in the other in a perfectly linear manner. A correlation coefficient of 0.0 signifies no linear relationship between the variables, implying that changes in one variable do not predict changes in the other. Any value outside the range of -1.0 to 1.0 indicates an error in the calculation (Frenando, 2021). In this study, analysis has been made between Lending rate and GDP, deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), assets growth rate (AGR) and gross domestic products (GDP).

Table 4.8

Correlation Analysis

	LDR	DPR	AGR	LR	ROA	INF	GDP
LDR	1.000						
DPR	0.527	1.000					
AGR	0.538	0.423	1.000				
LR	-0.066	0.087	-0.301	1.000			
ROA	-0.117	-0.416	-0.349	-0.328	1.000		
INF	0.214	0.158	-0.076	0.112	-0.264	1.000	
GDP	-0.208	-0.050	-0.125	0.081	0.045	0.024	1.000

**.Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The correlation reflects the relationships among seven economic variables: Lending Rate (LDR), Deposit Rate (DPR), Assets Growth Rate (AGR), Liquidity Rate (LR), Return on Assets (ROA), Inflation (INF), and Gross Domestic Product (GDP). Positive correlations exist between LDR and DPR (0.527), and LDR and AGR (0.538). Negative correlations include LDR and ROA (-0.117), and AGR and ROA (-0.349). ROA has a negative relationship with DPR (-0.416) and LR (-0.328). Overall, these correlations suggest varying degrees of association among these economic factors.

Regression Analysis

The Regression Coefficient is the constant ‘b’ in the regression equation that conveys about the difference in the price of dependent variable corresponding to the unit difference in the independent variable. In this study, regression analysis has been done taken dependent variable is Lending rate and independent variables are deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), assets growth rate (AGR) and gross domestic products (GDP).

Regression Coefficient

Regression coefficients are estimates of the unknown population parameters and describe the relationship between a predictor variable and the response. In linear regression, coefficients are the values that multiply the predictor values.

Table 4.9

Regression Coefficient

Model	Unstandardized Coefficients		Sig.
	B	Std. Error	
(Constant)	7.821	2.213	0.002
DPR	0.594	0.161	0.001
AGR	2.814	0000	0.054
LR	0.449	0.349	0.211
ROA	-0.090	0.060	0.148
INF	0.213	0.147	0.160
GDP	0.003	0.037	0.941
R^2	0.594	F- value	1.541

a. Dependent Variable: LDR

b. Predictor: (Constant), DPR, AGR, LR, ROA, INF, GDP

The regression model evaluates the impact of six variables on the Lending Rate (LDR). The model's R^2 value is 0.594, indicating that 59.4% of the variation in LDR explains a portion of the regression equation, with the remaining 40.6% being attributed to other factors. Significant predictors include the Deposit Rate (DPR) with a coefficient of 0.594 and a p-value of 0.001, showing a strong positive effect on LDR. The Assets Growth Rate (AGR) also has a positive effect with a coefficient of 2.814 and a p-value of 0.054, though it is marginally significant. Other variables, including Liquidity Ratio (LR), Return on Assets (ROA), Inflation (INF), and Gross Domestic Product (GDP), do not show significant impacts on LDR, as indicated by their higher p-values. The constant in the model is 7.821. The overall F-value of 1.541 suggests that while the model explains a good portion of the variability, it is not a very strong fit. This analysis highlights the key determinants of LDR and their statistical significance.

The Regression Equation is:

$$LDR=7.821+0.594\times DPR+2.814\times AGR+0.449\times LR-0.090\times ROA+0.213\times INF+0.003\times GDP$$

H_1:relationship between LDR and DPR of selected finance company.

The regression analysis suggests that Lending Rate (LDR) is positively influenced by Deposit Rate (DPR), with a coefficient of 0.594. This indicates that for every unit increase in DPR, LDR is expected to increase by approximately 0.594 units, holding other variables constant. The relationship implies that higher DPR tends to correspond with higher LDR in the model.

H_2:relationship between LDR and AGR of selected finance company.

According to the regression analysis, Lending Rate (LDR) experiences a positive association with Asset Growth Rate (AGR), indicated by the coefficient of 2.814. This suggests that for every unit increase in AGR, LDR is anticipated to increase by approximately 2.814 units, assuming other variables remain constant. Thus, higher AGR corresponds to a higher LDR in the model.

H_3:relationship between LDR and LR of selected finance company.

In the regression analysis, Lending Rate (LDR) exhibits a positive relationship with Liquidity Ratio (LR), indicated by the coefficient of 0.449. This suggests that for every unit increase in LR, LDR is expected to increase by approximately 0.449 units, holding other variables constant. Therefore, higher LR tends to correspond with a higher LDR according to the model.

H_4:relationship between LDR and ROA of selected finance company.

In the regression model, Lending Rate (LDR) shows a negative association with Return on Assets (ROA), with a coefficient of -0.090. This suggests that for every unit increase in ROA, LDR is anticipated to decrease by approximately 0.090 units, assuming other variables remain constant. Thus, higher ROA tends to correspond with a lower LDR according to the analysis.

H_5:relationship between LDR and INF of selected finance company.

In the regression analysis, Lending Rate (LDR) demonstrates a positive relationship with Inflation (INF), indicated by the coefficient of 0.213. This implies that for every unit increase in INF, LDR is expected to increase by approximately 0.213 units, holding other variables constant. Thus, higher inflation rates tend to correspond with higher LDR values in the model.

H_6:relationship between LDR and GDP of selected finance company.

According to the regression analysis, Lending Rate (LDR) exhibits a positive correlation with Gross Domestic Product (GDP), with a coefficient of 0.003. This suggests that for every unit increase in GDP, LDR is anticipated to increase by approximately 0.003 units, assuming other variables remain constant. Therefore, higher GDP tends to correspond with a slightly higher LDR in the model.

4.2 Discussion

The objective of the study is to evaluate the impact of deposit rate on lending rate. Objectives are: to identify the determinants of lending interest rate, to evaluate the relationship between lending interest rate and its determinants and to analyze the impact of factors of lending interest on lending interest rate. Form the above analysis the average lending rate of GFL is higher and the lowest average lending rate is PFL. The SD of GFL is lower and higher is MFL, so the higher SD represents higher variation on lending interest rare. The average deposit rate of MFL is higher and the lowest average deposit rate is PFL. The SD of MFL is lower and higher is GFL, so the higher SD represents higher variation on deposit interest rare. The average return on assets of PFL is higher and the lowest average return on assets is GFL. The SD of MFL is lower and higher is PFL, so the higher SD represents higher variation on return on assets. The average liquidity rate of MFL is higher and the lowest average liquidity rate is PFL. The SD of PFL is lower and higher is MFL, so the higher SD represents higher variation on liquidity rate. The average log of assets of GFL is higher and the lowest average log of assets is PFL. The SD of PFL is lower and higher is MFL, so the higher SD represents higher variation on log of assets. The average inflation and gross domestic product is 6.34% and 15.74 million respectively. Similarly, the standard deviation of inflation and gross domestic product is 1.37% and 2.03 million respectively. The highest inflation rate occurring in FY 2069/70 and 2072/73 and lower is in FY 2077/78.

It shows the relationship between Lending Rate and Deposit Rate, Liquidity Rate, Return on Assets, Inflation, Log of Assets and Gross Domestic Products. The LDR correlation between DPR,AGR, LR, INF, GDP are positively correlated and ROA are negatively correlated. The correlation shows the LDR is increasing when positively correlated variable increase and decreasing with negatively correlated variable increased.

Mustafa and Qudah (2021) found that ROA and bank size had significant negative impacts on lending interest rates, while liquidity had a negative but insignificant impact. Conversely, the deposit interest rate and inflation had significant positive impacts on lending interest rates. The operating cost ratio also had a positive but insignificant impact. Thus, the results indicate that ROA, bank size, deposit interest rate, and inflation were reliable determinants of the lending interest rates of Jordanian listed commercial banks. Ndungu,(2003 found that the Discount rates strongly influence performance of commercial banks in Kenya. That is there is a positive relationship between the discount rates and the performance of commercial banks in Kenya.

From the regression line for LDR, the constant is 7.821, DPR is 0.594 percentage, AGR is 2.814 percentage, LR is 0.449 percentage, ROA is -0.090 percentage and INF is 0.213 percentage and 0.003 million responsible for the change a point of LDR. Asamoah and Adu (2016) found a long-run equilibrium relationship between the average lending rate charged by commercial banks and its determining factors in Ghana. In the long run, bank lending rates are positively influenced by nominal exchange rates and the Bank of Ghana's monetary policy rate, but negatively influenced by fiscal deficit, real GDP, and inflation. Additionally, they observed that bank lending rates depend positively on exchange rates and the monetary policy rate both in the short and long run. Khan (2014) found a strong and positive correlation between lending interest rates and the profitability of commercial banks.

Were and Wambua (2013) concluded that bank specific factors play a significant role in the determination of interest rates in the context of commercial banks of Kenya. These include bank size based on bank assets, credit risk as measured by non-performing loans to total loans ratio, liquidity risk, return on average assets and operating costs.

CHAPTER V
SUMMARY AND CONCLUSION

5.1 Summary

The lending rate, also known as the interest rate, is the fee charged by lenders for borrowing money, usually shown as a percentage of the loan amount. The total interest paid on the loan depends on how long the money is borrowed for. Lending interest rate is the major source of income of every financial institutions. The study is based on to explore the determinants of lending interest rate, to evaluate the relationship between deposit rate and lending interest rate and to analyze the impact of factors of lending interest on lending interest rate. The objective of the study is to evaluate the impact of deposit rate on lending rate. Objectives are: to identify the determinants of lending interest rate, to evaluate the relationship between lending interest rate and its determinants and to analyze the impact of factors of lending interest on lending interest rate.

This research conducted under 3 sample finance company out of 17 finance companies. Sample was taken under the judgmental sampling method and based on secondary data taken from annual report, NRB directives, and related articles. Sample are Manjushree Finance Limited (MFL), Pokhara Finance Limited (PFL) and Goodwill Finance Limited (GFL). It focuses on a descriptive and analytical examination of the gathered data from the profit and loss account and balance sheet (i.e., financial statement) over a duration of time. Descriptive research design is a scientific method which involves observing and describing the behavior of a subject without influencing it in any way. In this study, ratio analysis is used as financial tool and correlation and regression analysis statistical tools are used for analysis.

The relationship between Lending rate and deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), log of assets (AGR) and gross domestic products (GDP) are the findings of this research. Lending Rate (LDR) demonstrates positive correlation with Deposit Rate (DPR), Asset Growth Rate (AGR), Liquidity Ratio (LR), Inflation (INF), and Gross Domestic Product (GDP). Conversely, LDR shows a negative correlation with Return on Assets (ROA). This implies that higher values of DPR, AGR,

LR, INF, and GDP tend to coincide with higher LDR, while higher ROA corresponds to lower LDR.

5.2 Conclusion

The objective of the study is to evaluate the impact of deposit rate on lending rate. Objectives are: to identify the determinants of lending interest rate, to evaluate the relationship between lending interest rate and its determinants and to analyze the impact of factors of lending interest rate. The rate of interest is an important part of the banking sector. This study has investigated the determinants of lending interest rates among three national-level finance companies listed on the Nepal Stock Exchange. Adopting a descriptive research design, panel data from three finance companies spanning the period from 2070/71 to 2079/80 were collected from annual reports for analysis. This research examined the impact of deposit rate (DPR), liquidity rate (LR), return on assets (ROA), inflation (INF), log of assets (AGR) and gross domestic products (GDP) to the Lending interest rate (LDR).

The relationship between LDR and DPR and AGR, LR, INF, GDP are positive and ROA are negative. The correlation shows the LDR is increasing when positively correlated variable increases and decreasing with negatively correlated variable increased. The regression line for LDR, is positively impacted by DPR, INF, ROA and GDP and negatively impacted by AGR for the responsible for the change a point of LDR.

Form the analysis, the most profitable finance is Pokhara Finance, charging lower level of interest and has higher ROA. But Manjushree Finance has higher deposit ratio as well as higher ability to pay liquidity. And while comparing from the aspects of assets growth rate of all three finances, they have similar AGR growth determining their similar total assets of the company(firm size). The default rate is the major factor influencing the determination of the lending interest rate.

5.3 Implications

According to the results of the empirical analysis, the study provides suggestions on how to enhance financial institutional management practices and play a more effective role in boosting the profitability of finance companies.

Some recommendations are,

- Managers should pay more attention to maintain effective LR, ROA and DPR, its optimum portion positively enhances profitability while over ratio leads to underutilized assets and under ratio face higher risk in the marketplace.
- Managers should get prompt information about components effects to the interest rate.
- Stakeholder should find information about factor affecting rate of interest charged by finance company.
- Managers should know about the relationship between profitability and rate of lending.
- Managers should focus on change in Inflation and GDP growth.
- Non-performing assets, rate of treasury bills, market interest rate, GDP growth rate should be taken for the factor affecting lending interest rate for the further study.

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