

Chapter I

Introduction

1.1. Background of the Study

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

The banking sector is largely responsible for collecting household saving in terms of different types of deposit and regulating them in the society by lending different sectors of economy. The different sector has now reached to the most remote areas of the country and has experienced a good deal in the growth of the economy. By lending their resources in the small-scale industries under intensive banking program has enabled the banks to share in the economic growth of the economy.

Banking concept existed even in the ancient period when goldsmiths and the rich people used to issue the common people against the promised of safekeeping of their valuable items on the presentation of the receipt; the depositors would get bank their gold and valuables of the paying a small amount for safekeeping and saving.

In the emerging CBs working environment, NRB have to update its functions of issuing various directives regarding establishment,

capital adequacy, liquidity, credit classification, etc. Similarly, the directives regarding the provisions & reserves to be fulfilled by the CBs are followed or not?

As the government have adopted to allow the international banking institutions to establish their branches within Nepal from 2010 as per the agreement done to be a member of WTO, the load of NRB function in the coming days will be more challenging. NRB should do the functions of check & balance for looking after the CBs' capital adequacy under BASEL-II, which is really a challenging job. Similarly, the increase in the reserve provision for CBs as directed by NRB should be also follow-up time-to-time. Whether the NRB would be capable to handle the changing environment in the coming days?

1.2. Introduction of Commercial Banks

Commercial banks are those financial institutions which are established for promoting trade, commerce, industries in the country. Commercial bank performs the commercial activities like, accepting deposit from the public & institutions & grants loan to the parties against the security. It performs various agency functions by taking commission from its client. Thus commercial bank is a profit seeking financial institution. It provides loan to depositors & charges interest on loans. It also helps its clients by issuing drafts, L.C., T.T., credit cards, Traveller's cheque, safe custody of deposit & locker facilities. In the Banking History of Nepal, Nepal Bank Limited is the first commercial bank which was established in 30th Kartik 1994 B.S. with an authorized capital of 10 million & a subscribed capital of 2.5 million. A second commercial bank, Ratriya Banijya Bank, was

established in 2022 B.S. under Rastriya Banijya Bank Act, 2021. Again, Agriculture Development Bank, which was established in 2024, has also been allowed to serve commercial functions from 2041 B.S. Other commercial banks established in Nepal are Nepal Arab Bank Ltd, Nepal Indosuez Bank Ltd. & Grindleys Bank Ltd. Again after the restoration of democracy in the country, the government adopted liberal economic policy & as a result, many other commercial banks came into existence. Himalayan Bank, Bank of Kathmandu., Nepal Sri Lankan Merchant Bank etc. are other commercial banks established in the country after the restoration of democracy.

According to Commercial Bank Act, 2031 B.S., Commercial Banks are those banks which are established under this act to perform commercial functions except those which are established for specific purpose like development Banks, Co-operative etc.

1.2.1. Functions of Commercial Bank

Commercial banks perform various functions which are as follows:

1. **Accepting Deposits:** Receiving deposit is the first function of commercial bank. It accepts idle and scattered saving of the public and institutions as deposit under the following three accounts :
 - (a) **Current Account:** - It is an account under which the account holders can deposit and withdraw their money at any time according to their requirement. This account is mainly open for those traders and business organizations that need money frequently. This account is open for safety of money and no interest is provided to depositors by the bank. There is no

restriction of the number of withdrawals and deposits for depositors. But minimum balance should be maintained as per the rule of the bank for withdrawals.

- (b) **Saving Account:** - It is an account in which depositors can deposit their amount frequently but with limited withdrawal facility. Saving account is managed by bank to collect small and scattered amounts of savings of the people. To encourage saving the bank provides a certain percent of interest per annum.
 - (c) **Fixed Deposit Account:** - Under this account, the deposits the amount for a fixed period of time. The depositor cannot withdraw the amount before the expiry of the specified time period. The bank provides higher rate of interest to the depositors than saving account.
2. **Granting Loans:** - Commercial banks provide loan to the traders' investors, industrialists, and farmers against the security deposit of valuable properties. They provide short-term, mid-term and long-term loan by charging certain rate of interest. Thus, the commercial bank utilizes the collected deposit amount from the depositors into profitable and productive sectors as loan.
 3. **Transfer of Money:** - Commercial bank provides the service of transferring the fund from one place to another place as per the request of its customers. Commercial bank issues cheque, demand draft, mail transfer, T.T., L.C., credit cards, traveller's cheque, etc., for remittance of money from one place to

another. Bank charges a certain amount of service charge, i.e. commission for its services.

4. **Exchanging Foreign Currencies:** - To fulfill the requirements of foreign traders regarding foreign currency, the commercial banks exchange foreign currencies on the direction of the central bank of the nation. This promotes foreign trade.
5. **Opening L.C. and Issuing Credit Instruments:** - Commercial bank helps the importer to import goods from foreign countries by opening L.C. account. L.C., i.e. letter of credit is the guarantee given to the exporter on behalf of the local trader or importer to pay the value of goods imported. Beside this, the commercial bank issues traveller's cheque, credit cards, bank draft and demand drafts for the purpose of making easy and safe payment.
6. **Buying and Selling Shares and Debentures:-** On the request of customers, commercial bank helps in issuing of shares, purchase and sell of the securities like, shares, debentures through stock exchange and capital markets. Thus, it helps to issue capital which helps to promote trade and industries.
7. **Creating Credit:** - Commercial bank has its own lending policy. So, it creates credit, i.e. advance more amount of loan than the deposits it has at a given point of time. It is one of the important functions of the commercial bank.
8. **Agency Functions:** - Commercial bank is the agent of its customers. It performs a number of agency functions on behalf of its customers taking commission. The main

objective of Good such agency functions are to attract the customers. Some agency functions are as follows :

-) Remittance of money on behalf of customers.
-) Purchase and sale of securities on the request of clients.
-) Collection and acceptance of credit instruments.
-) Receiving and making payment of incomes and expenses on behalf of customers.
-) ATM facilities.
-) Debit card and credit card facilities.

9. Other Miscellaneous Functions :- Besides the above mentioned functions, commercial bank provides the following services :

-) Safety of valuable goods/properties,
-) Locker facilities for its clients,
-) Issue of guarantee and work as referee of its clients to third parties,
-) Issue of gift cheques and vouchers, etc.

1.3. Statement of the Problem

After the restoration of democracy and the adaptation of liberalization economy, new commercial banks established in Nepal. Many joint venture banks arrived in the market. Similarly, the Nepalese investors also became eager to establish the commercial banks.

But the competition in the banking industry saw very high. After the arrival of the new banks in the market, the banks felt difficult to

manage their funds. Attracting the depositors by using various schemes was the main motto for the commercial banks. But at the same time due to the unstable political situation, the economy of the country was not moving in the right direction. There was a less opportunity and scope for the mobilization of the funds collected.

1.4. Objectives of the Study

The main objectives of the study are:

- i. To find out the major sources and uses of the funds of the commercial banks of Nepal.
- ii. To find out the actual proportion of the funds of the commercial banks of Nepal.
- iii. To see the relationship between the credit and deposit relationship of the commercial banks.
- iv. To provide necessary suggestions & recommendations for future research.

1.5. Limitations of the Study

The following limitations exist in the study:

- i. The study is fully focused on the sources and uses of the funds of the commercial banks of Nepal.
- ii. The study is fully based on the historical data.
- iii. Further depth study on the fund mobilization has not been done in the study.

1.6. Organization of the Study

The study is divided into five major chapters as:

❖ Chapter One :- Introduction

First chapter has been describe about the research itself by defining sources and uses of funds of commercial banks of Nepal. This will help to develop the conceptual frame work about the research problem & subject matter.

❖ Chapter Two :- Review of Literature

Review of Literature has been advance the knowledge about the subject matter as well as general method of doing research in sources & uses of funds of commercial banks, which are also defined by the finance & banking expertise.

❖ Chapter Three :- Research Methodology

Research Methodology is policy & frame work not within, which we will find the best alternative for making the research effective to analyze on the topic.

❖ Chapter Four :- Analysis of Data

Data Presentation & Analysis has been evaluate & examine the sources and uses of funds of commercial banks in Nepal.

❖ Chapter Five :- Summary, Conclusion & Recommendations

Moreover, the last chapter has been the summary & conclusion of this research & remedial measures to be applied for further advancement to the commercial Banks of Nepal.

Finally bibliography and appendices is included in prescribed form.

Chapter II

Review of Literature

2.1 Conceptual Framework

2.1.1 Concept of Bank

Different persons have expressed numerous views and opinions about the Commercial Banks and their activities published on journals, booklets, magazines, etc. To support this study, some of the relevant studies are traced below:

Banking means accepting for the purpose of lending. Thus, a bank is an institution that deals with money by accepting various types of deposit, disbursing loan and rendering other financial services.

A bank is a business organization that receives and holds deposits of fund from other, makes loans or extend credits and transfer funds by written orders of depositors. (*Encyclopedia Americana, 1984, Vol.3*)

A bank is a government regulated, profit making business that operates in competition with other banks and financial institutions to serve the saving and credit needs of its customers. The primary business of the bank is accepting deposit and lending money. Banks accept deposits from customer who wants the safety and convenience of deposit service and the opportunity to earn interest on their excess funds. Banks put their depositors fund to other individuals to business and to federal, state and local government. (*Halter, 1999*)

The business of banking is one of collection funds from the community and extending credit to people for useful propose. Banks play a pivotal role in making money from lenders to borrowers. Banking is a profit seeking business, not a community charity profit seeker. It is expected to pay dividend and otherwise, add to the wealth of shareholders.

Therefore summarizing the above, banks are those financial institutions that offer the widest range of financial services-credit, saving and payment services-and perform the widest range of financial functions of any business firm in the economy. This multiplicity of bank services and functions has led to banks being labeled “financial super markets” and such familiar slogans as “Your Bank-Full Service Financial Institution.”(Vaidya, 2001)

2.1.2 Concept of Commercial Bank

As per Commercial Bank Act 2031 “A commercial bank means bank which deals in exchanging currency, accepting deposit, giving loans and doing commercial transaction.” (*Ministry of Law and Justice, 2031*)

Commercial banks are organization on a joint stock company system, primarily for the purpose of earning profit. They also operate off balance functions such as issuing guarantee, bonds, letter of credit etc.

Commercial banks are those banks that pool together the savings of the community and arrange for their productive use. They supply the financial needs of modern business by various means. They accept deposits from the public in the condition that they are repayable on demand on short notice.

Ordinary banking business consists of changing case of bank deposits and bank deposits form one person to corporation (one depositor to another) giving bank deposit in exchange for bills of exchange, governments bond, secured and unsecured promises businessman to replay. (Sayers, 1976)

Commercial bank is a corporation which accepts demand deposits, subject to check and makes short term loans to business enterprises, regardless of the scope of its other services. (*American Institute of Banking, 1972*)

The American institute of Banking has laid down the four major functions of commercial banks such as receiving and handling of deposits, handling payments of its clients making loans and investments and creating money by extension of credit. (*American Institute of Banking, 1972*)

The commercial bank has its own role and contribution in the economic development. It is a resource for the economic development, it maintain economic confluence of various segments and extends credit to people. (*Ronald, 1991*)

Nepalese Commercial Banks are profit making limited companies established under commercial bank act 2031 and may be promoted by government, semi-government, private and joint venture sectors.

Nepal Rastra Bank, recommends, directs and controls the establishment, operations and dissolutions of all the commercial banks in Nepal.

Commercial banks are the heart of the financial system. They hold the deposits of many persons, government establishment, and business units. They make funds available through their lending and

investing activities to borrowers, individuals, business firm, and government establishment units.

2.1.3 Functions of Commercial Bank

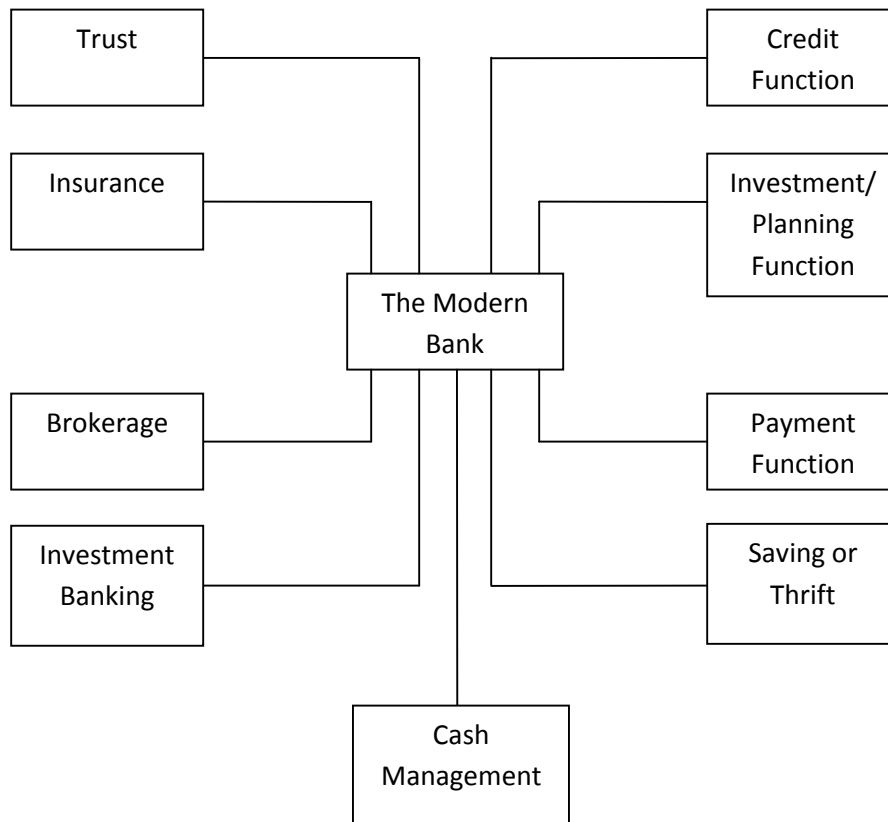
Traditional functions of commercial banks only concerned with accepting deposits and providing loans. However their functions have now increased manifold. All types of the banks are corporate bodies and they are established and operated under the law specified by the act of the country. In the context of Nepal commercial banks are operated within the parameter of BAFIA, 2063.

Cox (1990) in his book named 'Success in Elements of Banking' stresses in three major functions to be performed by the commercial banks:

-) To accept and safeguard deposit of money from customers.
-) To permit money to be withdrawn or transferred from one accounts to another.
-) To lend the surplus of deposit money to suitable customers who to borrow.

Figure No.2.1

Vital Functions Performed By Full Service Banking Institutes Today



2.1.3.1. Functions of Commercial Bank as per BAFIA, 2006
(Regmi, 2007)

Subject to this act and its memorandum and articles of association, a class 'A' licensed institution may conduct the following types of financial transaction:

- a. Accept deposit with or without interest, and refund such deposit.
- b. Supply credit as prescribed by the Rastra Bank.
- c. Deal in foreign exchange subject to current law.
- d. Supply credit for hire-purchase, hypothecation, leasing housing and service companies.

- e. Engage in merchant banking business subject to the directives of the Rastra Bank.
- f. Arrange for jointly supplying credits on the basis of co-financing by joining hands with other licensed institutions according to the agreement concluded for the purpose so as to divide the collateral pari passu.
- g. Issue guarantees on behalf of its customers, have such customers execute necessary bonds in consideration thereof, obtain security, and acquire their movable or immovable assets as collateral or on mortgage or the assets of third individuals as collateral.
- h. Supply credit against the guarantee provided by any local or foreign bank or financial institution.
- i. Issue, accept, pay, discount, or deal in letters of credit, bills of exchange, promissory notes, cheques, travelers-cheques, drafts or other financial instruments.
- j. Accept deposits, make payments and transfer funds through telephones, telex, fax, computers, magnetic tapes or similar other electronic means or equipment, subject to the directives issued by the Rastra bank.
- k. Issue and accept credit cards, debit cards, charge cards other financial instruments, and appoint agents to discharge functions relating thereof, subject to the directives issued by the Rastra Bank.
- l. Accept; make payments and supply credit through automated teller machines and cash dispensing machines.
- m. Grant overdraft to persons trusted by it.
- n. Supply a fresh credit in a lump sum or in installment against the security of the same movable or immovable assets which

have already been pledged with it or with any other licensed institution, to the extent covered by the total value of such security.

- o. Work as an agent of the Rastra Bank on conditions prescribed by it, and conduct governmental and other transactions on behalf of Government of Nepal.
- p. Remit or transmit funds to different places within or outside Nepal through bills of exchange, cheques or other financial instruments, deal in gold and silver bullion, shares, debentures, bonds, etc, and collect dividends accruing on shares, and interest on promissory notes, debentures, bonds, etc.
- q. Act as a commission agent of its customers, take custody of and arrange for the sale or purchase of shares, debentures or securities, collect interest, dividends, etc accruing from shares, debentures, or securities, remit or transmit such interests or dividends to places within or outside Nepal.
- r. Purchase, sell or accept loan-bonds issued by GON or NRB.
- s. Arrange for safe-deposit vaults.
- t. Undertake off-balance sheet transactions subject to the conditions prescribed by the Rastra Bank.
- u. Supply credits not exceeding the amount prescribed by the Rastra Bank to ensure the economic upliftment of the destitute class, low-income families, and victims of natural calamities and inhabitants of any area of the country with the provision of individual or collective guarantee.
- v. Exchange with the Rastra Bank or any other licensed institution particulars, information or notices regarding

- debtors or customers who have obtained credits from it or any other licensed institutions.
- w. Provide guarantee to arrange for the supply of credits to the customers by any other licensed institution.
 - x. Mobilize capital through shares, debentures, bonds, loan-bonds, saving-bonds or other financial instruments subject to the limit prescribed by the Rastra Bank.
 - y. Obtain refinance credit from the Rastra Bank according to need, or obtain or supply credits to or from other licensed institutions.
 - z. Conduct or arrange for conducting studies, research and surveys, relating to the establishment, operation and evaluation of projects, and impart training and provide consultancy and other information.
 - aa. Supply funds received from GON or other local or foreign agencies as credit for the promotion of projects, or manage such credits.
 - bb. Prescribe conditions according to need in order to protect its interests while supplying credits to any individual or institution or conducting any transaction with him/her/it.
 - cc. Obtain credits by pledging its movable or immovable assets as collateral.
 - dd. Write-off credits subject to the bye-rules framed by the Board.
 - ee. Properly manage or sell its assets.
 - ff. Perform such other functions as are prescribed by the Rastra Bank.

This list of the ACT includes all the functions of the banking companies and Nepalese commercial banks are allowed to do all such functions. Though this Act allowed the commercial banks to do above-mentioned functions, presently no any bank is performing all these functions. Need of strengthening the institutional capacity and diversity in the business and product are some of the challenges for Nepalese commercial banks.

2.2. Legal Framework of Establishing Commercial Bank

Only on the recommendation of Nepal Rastra Bank, a commercial bank is established as a company with limited liability under the company Act. For obtaining, such recommendation of the NRB and only in case NRB so recommends such bank should be registered according to the company act to functioning under the Act.

The Nepal Rastra Bank may specify necessary condition, while recommending the establishment of a bank pursuant to sub recommending the establishment of a bank pursuant to subsection (1) and it shall be the duty of the concerned bank to fulfill the condition so specified.

Therefore, various legal provisions with regard to bank establishment are already being spelled out in Act, and those are being guided by the act itself. Provisions regarding the basic legal requirements in this regard are as following:

Share capital

Bank establishment policy

Functioning definition of bank formation of board of director

Formation of board of directors

Disqualification for the directors
Operational criteria of establishment
Function, which the bank may perform
Capital and provision of general reserve
Branch Expansion Policy

2.3. Sources and Uses of Funds of Commercial Banks

The sources of funds for commercial banks are the same as traditional funds for all banks. Although there may be some direct investment by the bank, its primary income comes from fees and interest. Banks charge fees for most transactions. In addition, banks make loans with money that is deposited and collect interest on the loans. In the case of a purely commercial bank, these would include business loans, lines of credit and commercial real estate loans.

Banks keep a portion of their funds on hand for daily needs such as customer withdrawals and purchases. Commercial banks primarily use funds collected or deposited with them primarily for loans and then collect interest on those loans to pay their own expenses and realize profits. As publicly traded companies, part of their funds also go to pay dividends to shareholders. (*Beach, 2011*)

2.4. Sources of Funds in Commercial Bank

A commercial bank is a retail financial institution that helps community members open checking and savings accounts and manage money market accounts. It also provides customers with deposit, withdrawal and transfer services. Bank customers can also carry out retail banking business through an automatic teller

machine (ATM) or online. Beyond the everyday services, commercial banks also offer customers loans to buy a house, an automobile or a boat. And the banks help business owners manage their accounts, including checking, savings and loans. The sources of funds in commercial banks are varied. (*Quentin, 2010*)

2.4.1. Deposits

Deposits remain the main source of funds for a commercial bank. The money collected can go toward paying on interest-bearing accounts, completing customer withdrawals and other transactions. In June 2004 the total money supply from deposits held at commercial banks and other banking institutions in the U.S. totaled more than \$1.3 billion.

Savings account deposits are especially important to banks as the Federal Regulation Law limits the amount of times a savings account holder can withdraw money. Currently, the law mandates that account holders can perform six transfers per month in the form of online, telephone or overdraft transfers. This allows banks to use the accounts' funds and still meet the withdrawal needs of the customer.

2.4.2. Reserve Funds

A commercial bank builds a reserve fund with deposits so it can pay interest on accounts and complete withdrawals. Ideally, a bank's reserve fund should be equal to its capital. A bank builds its reserve fund by accumulating surplus profits during healthy financial years so that the funds can be used in leaner times. On average, a bank tries to accumulate approximately 12 percent of its net profit to build and maintain its reserve fund.

2.4.3. Shareholders Capital

Some commercial banks that trade on the stock exchange can use shareholders' capital to receive the money it needs to stay in business. For example, if a company sells shares on the market, it increases both its cash flow and its share capital. This process is also known as equity financing. Banks can only report the amount of capital that was initially on their balance sheet. Appreciation and depreciation of shares do not count toward the total sum of a shareholder's capital.

Each time a bank makes a profit it can generally make two choices that include paying dividends to their shareholders or reinvesting the money back into the bank. Most banks utilize both options as they will retain a portion of the profit and pay the remainder to their shareholders. The amount reinvested into the bank typically depends on the company's policy and the condition of the stock market.

2.4.4. Retained Earnings

A lot of commercial banks earn retained earnings or fees to help fund their business. A retained earning can be collected through overdraft fees, loan interest payments, securities and bonds. Banks also charge fees for providing customers with services such as maintaining an account, offering overdraft protection and also monitoring customers' credit scores.

2.4.5. Meaning of Deposit

Deposits are the funds collected by bank from account holders for the security and transaction motives. It is the amount of money or a valuable item that is received into a bank as security against

possible loss. Deposits are the foundation upon which banks thrive and grow. They are a unique item on a bank's balance sheet that distinguishes it from other types of business firms. The ability of a bank's management and staff to attract checking and saving accounts from business and consumers is an important measure of the bank's acceptance by the public.

Deposit provides most of the raw material for bank loans. It represents the ultimate source of banks profits and growth. Deposits generate cash reserves fund. Maintaining required cash reserve, the excess cash fund, a bank holds is lent to borrowers. Thus, deposits create loans. The management should be able to use the deposit efficiently.

Utilization of the bank deposits indicates effectiveness of management. The management should be able to raise deposit fund in the lowest possible cost and use maximum portion of deposits safely into loan advancement to maximize portion of deposits safely into loan advancement to maximize profitability. There are two key issues that every bank must deal with in managing its deposits:

-) Where can the bank raise funds at the lowest possible cost?
-) How can management ensure that the bank always has enough deposits to support the desired volume of loans and other financial services demanded by the public?

In today's intensely competitive, increasingly deregulated banking market, it is hard to raise funds at the lowest cost and use effectively to optimize bank revenue and security. Both the cost and amount of

deposits that the banks can sell to the public are heavily influenced by the interest rate schedules and competitive maneuverings of the bank.

Recently, non-bank institutions also offer similar services, such as:

-) Saving and loans facilities from finance company and cooperative firms
-) Share account in money market and mutual funds
-) Cash management account offered by brokerage
-) Cash management and investment opportunities offered by insurance companies
-) Interest-bearing checkable accounts offered by credit unions

In such a competitive banking market, it is really very hard for all banks to survive and make adequate profit. Bankers, who fail to stay on top of changes in their competitors' deposit pricing and marketing programs, stand to lose both customers and profits.

There are three major types of deposits: demand/current deposits, saving deposits & time/fixed deposits. What distinguish one type from another are the conditions under which the deposited funds may be withdrawn. (*Singh, 2005*)

2.4.6. Types of Deposit

Receiving deposit is the first function of commercial bank. It accepts idle and scattered saving of the public and institutions as deposit under the following three accounts:

- (a) Current account
- (b) Saving account
- (c) Fixed deposit account.

2.4.6.1. Current Account: - It is an account under which the account holders can deposit and withdraw their money at any time according to their requirement. This account is mainly open for those traders and business organizations that need money frequently. This account is open for safety of money and no interest is provided to depositors by the bank. There is no restriction of the number of withdrawals and deposits for depositors. But minimum balance should be maintained as per the rule of the bank for withdrawals.

2.4.6.1.1. Features of Current Account: (*Bhandari, 2003*)

1. Under this deposit, the customer can get the payment until there is balance (amount) in his account as many times as cheques are sent to the bank while the banking time in a day. In addition to it, he can also deposit amount.
2. A bank should keep enough balance because the bank should pay the large amount at the time of account holder's demand.
3. No interest is given on demand deposit.
4. There can be a special contract between the bank and the customer, under which a customer may get such facility in excess of balance in his account and the bank can give him payment.
5. If the customer has a less amount in his account than required by banking rule, the bank can take some certain amount from the customer's account for handling charge.

2.4.6.2. Saving Account: - It is an account in which depositors can deposit their amount frequently but with limited withdrawal

facility. Saving account is managed by bank to collect small and scattered amounts of savings of the people. To encourage saving the bank provides a certain percent of interest per annum.

2.4.6.2.1. Features of Saving Account:

1. Usually, the interest is given every six month in this deposit.
2. Generally, the banks provide 5 to 8% interest in this deposit but this percent may charge.
3. If the bank goes into liquidation more priority is given to the saving deposit than current and fixed deposits in the payment of liability.
4. If the customer wants to withdraw more money from the bank, which is not allowed by it but if he gives pre-information to the banks, in this situation he can withdraw more money.
5. In the absence of pre-information, the bank may refuse to give the payment. If it does not refuse, it may take some charge as a fine to give the deposit.
6. The saving account holder does not have the same facility of withdrawn money as the current account holder.
7. Generally, he can submit only one cheque in a day or two or three in a week.
8. The bank fixes the minimum and maximum amount withdrawable through a cheque in this deposit.

2.4.6.3. Fixed Deposit Account: - Under this account, the deposits the amount for a fixed period of time. The depositor cannot

withdraw the amount before the expiry of the specified time period. The bank provides higher rate of interest to the depositors than saving account.

2.4.6.3.1. Features of Fixed Deposit Account:

1. The amount (money) can't be withdrawn by check in this deposit like in other current and saving deposits.
2. Usually, the interest is awarded every 3 month in this deposit.
3. The customer can renew the fixed period deposit after the expiry of the fixed time.
4. In fixed period deposit, the interest is provided minimum 3.5% to maximum 13.5%, according to the duration of time.
5. Though the fixed period deposit can be opened in a bank for a period of more than five years, no more interest than 13.5% can be gained in it.
6. The bank can invest the money (amount) of the fixed period deposit in another sector.
7. The fixed period deposit opened for a certain time. Such duration of time can be from 7 day to 5 years or more than time.
8. The rate of interest in the fixed period deposit is higher than that of other deposits.
9. The principal amount with interest must be returned to the customer after expiry of fixed time.
10. The customer can't deposit more money again in this deposit, before the fixed time.
11. Both the bank and the customer can be benefited from this deposit.

2.5. Loans Made by Banks

Loan is the sum lent to others for certain time period with the agreement to charge interest on principal. The interest is charge calculating certain percentage on the principal. When money belonging to one is advanced to another to be used for certain time period, it is called loan. The basic objective of loan advancement is to earn interest as the reward for lending the sum for specific period.

Commercial banks are organized institutes providing loans for the needed. The loan advancement is the main function of commercial banks. Similarly, interest on loan has become their main sources of income. Banks do deposit accepting and lending business. Lending is a risky business. Loans are provided to earn interest. However, sometimes, it may be difficult even for the repayment of principal. In this situation, interest earning becomes far awaited business to be dealt. To get rid of such situation there is proper loan management in banks.

Indeed, making loans is the principal function of banks-to fund consumption and investment spending by businesses, individuals and government office. The fact how well a bank performs its lending function has a great deal to do with the economic health of the country. Bank loans support the growth of new businesses and jobs and promote economic vitality.

Loan advancements account for more than half of bank's total assets and about two-thirds of their revenues. More risk in banking tends to be concentrated din the loan portfolio. When a bank gets into serious financial trouble, its problems usually spring from loans. Generally loan problems emerge from the following reasons:

-) Loans have become uncollectable due to mismanagement
-) Illegal manipulation of loans
-) Misguided lending policies
-) Unexpected economic downturn. (*Singh, 2005*)

Loans and advances are the most profitable assets of banks. The extent to which these assets could be deployed is usually governed by the policy parameters enunciated by the central banking authorities. Out of the total funds and to some extent that the composition of the loans is determined by the central bank. Subject to these overall directives, the banks extend credit facilities with a view to maximize their earnings.

Commercial banks usually have a credit portfolio dominated by short-term lending with reasonably sound assets held as securities. The security-oriented lending approach is being gradually replaced by the purpose-oriented approach, in consonance with the developments taking place in the developing countries. Demands are being increasingly made on the banks to lend more than short-term working capital. The banks including other financial institutions provide medium term loans to industries. (*Shrestha & Bhandari, 2007*)

2.6. Cash Reserves of the Commercial Banks

(*Singh, 2005*) has defined the central bank of the country is also termed as bankers' bank. As a custodian of the cash reserves of commercial banks, the central bank maintains the cash reserves of the commercial banks. Every commercial bank has to keep a certain percentage of the deposit collected as CRR in the central bank. These cash reserves can be utilized by the commercial banks in the

time of emergency. The centralization of cash reserves in the central bank has the following advantages:

- a) Centralized cash reserve provides the basis of a large and more elastic credit structure than the amounts scattered among the individuals banks.'
- b) Centralized reserve can be used in the most effective manner during the periods of seasonal strains and financial emergency.
- c) In fact, the central bank functions as the lender of last resort, central reserves enable the central bank to provide financial accommodation to the commercial banks in difficulties.
- d) Centralized cash reserve inspires confidence of the public in the banking system of the country.
- e) The system of centralized cash reserve enables the central bank to control the credit creation by commercial banks. Central bank can influence credit creation by increasing and decreasing the cash reserve ratio (CRR).
- f) The cash reserves in the central bank can be used to promote national value.

2.6.1. Cash in Hand and at Bank

Besides the day-to-day needs of customers, the withdrawal vulnerability of large deposits necessitates the maintenance of a portion of the bank assets in the form of cash. As this is a non-earning asset, banks plan to keep this amount to a minimum. The wider geographical spread of bank branches especially in the inaccessible rural areas has a tendency to increase the proportion of

the idle cash with the branches. The establishment of currency chests managed by the banks in different parts, however, has a salutary effect on reducing the idle cash balances with the banks, in and around selected centers. (*Shrestha & et. al., 2007*)

2.7. Investment

Investment in short-dated government securities, though low yielding, is necessary from the liquidity angle of asset management. The volatility of demand deposits and unpredictability of demand for credit induces the banks to prefer some liquid assets even though the yield is lower. Superimposed on this need is the statutory liquidity requirements stipulated by the monetary authorities from time to time. The Statutory Liquidity ratio is sometimes being used as a means of creating a captives market for the government and semi-government loans. In the Nepalese context, certain percent of the total demand and time liabilities of the banks have to be invested in government-approved securities. The average yield of these securities, depending upon their maturity pattern, would be either equal to or less than the cost of funds to the banks. Compliance with the statutory requirements on a weekly basis during a period of credit restraints becomes a difficult task for banks having an extended credit portfolio. (*Shrestha & et. al., 2007*)

2.8. Central Bank as Sources of Fund

As the supreme bank of the country and the bankers' bank, the central bank acts as the lender of the last resort. In case, the commercial banks are unable to meet their financial requirements from other sources, they can approach the central bank for financial

accommodation to commercial banks by rediscounting their securities and bill of exchange. (*Shrestha & et. al., 2007*)

The main advantages of the central bank's functioning as the lender of the last resort are:

- a. It increases the elasticity of overall economy.
- b. It increases the elasticity of the whole credit structure of the economy.
- c. It provides financial help to the commercial banks in times of emergency.
- d. It enables the commercial banks to carry on their activities even with their limited cash resources.
- e. It enables the central bank to exercise its control over banking system of the country.

In Nepal, Nepal Rastra Bank, as the central bank of the country, acts as the lender of the last resort for the commercial bank. Commercial banks, in general, maintain normal cash balance in vault. Such cash balance can meet only the regular cash demand predicted by the bank authority. Future is uncertain. If there is unexpected increase in cash demand by any reason, bank may be unable to meet cheque payments. In this condition, the help of Nepal Rastra bank is essential as the lender of the last resort.

The primary aim of the "lender of last resort" facility is therefore not to save the bank in distress, but rather to consider the effect that the failure might have on the system and what should be done to protect the system from contagion. Section 49 of the NRB Act entrusting NRB power of lender of the last resort makes following provision: (*Regmei, 2008*)

1. The Bank may, subject to the terms and conditions prescribed by it, make available loan and refinance to commercial banks and financial institutions for a maximum period of six months against the security of the following assets;
 - a. International negotiable instrument referred to in clause 9e) of sub-section (1) of section 66.
 - b. The debt bond issued by GON payable within Nepal.
 - c. The deposits accumulated in the Bank or the gold and precious metals, which the bank may transact under this Act.
 - d. The bill of exchange or the promissory notes referred to in sub-section (1) of section 48.
 - e. Other securities as prescribed.

2. Notwithstanding anything contained in sub-section (1) of section 48, the bank may provide any type of credit to a commercial bank and financial institution for a maximum period of one year in cases where GON has, for the sake of public interest and welfare, deemed it appropriate to provide loan and has requested the Bank therefore and GON has given a guarantee of securities of prevailing market rate for such loan or in extraordinary circumstances where the Bank has to work as a lender of the last resort.

2.9. Bills Purchased by Bank

Bills, clean or documentary, are sometimes purchase from approved customers in whose favor regular limits are sanctioned. In the case of documentary bills, the drafts are accompanied by a documents of title to goods such as railway receipts or bills of lading. Before granting a limit, the banker satisfies himself as to the

creditworthiness of the drawer. Sometimes banks verify the financial standing of the drawees of the bills, particularly when the bills are drawn from time to time on the same drawees and/or the amounts are large. Sometimes, overdraft or cash credit limits are allowed against the security of bills. A suitable margin is usually maintained.

Although the term “bills Purchased” seems to imply that the bank becomes the purchaser/owner of such bills, it will be observed that in almost all cases, the bank holds the bills (even they are endorsed in its favor) only as security for the advance. In addition to any rights the banker may have against the parties liable on the bills, he can also fully exercise a pledgee’s right over the goods covered by the documents. *(Bedi & Hardikar, 1993)*

2.9.1. Bills Purchased Practice in Nepal

In bill purchased accounts, the bills can either clean or documentary, demand or usance. This facility is provided to those customers who are in the list of banks as valued customer. Bills discount facilities are always against usance bills where the date of maturity is known. In Nepal, banks are easily providing such loans on the bills like National Development Bonds, Promissory Notes, Saving Bonds, etc. issued on by NRB on behalf of GON. In addition to this government bonds banking companies are providing loan against the bills issued by other banking companies or normal companies or foreign banking companies and institutions. Loan against Fixed Deposit Receipt, Loan against Government Bonds & Bonds of Bank, loan against foreign and domestic bills, etc comes under this category.

2.10. Meaning of Interest

Perhaps interest has been the most controversial topic in the whole theory of distribution. Economists have differed regarding the nature of interest as well as how it is determined. In fact, the subject of interest is still an unsettled question of Economics.

The very definition of interest depends on the interest theory which one accepts. Those, who believe in the classical or real theory, regard interest as payment for the use of capital goods. They also believe that interest is necessary to induce people to save. The followers of liquidity preference theory believe that interest is a price for surrendering liquidity preference. Still others who accept the loanable funds theory hold interest is the price paid for the use of loanable funds. (*Dewett & Chand, 1988*)

The demand deposit is the composition of both interest-bearing demand deposits and non-interest bearing demand deposit. The maintenance costs of these deposits are major expenses items. The absence of an interest payment and low interest rate (in interest-bearing demand deposit) help to keep the cost of these deposits down relative to the cost of these deposits down relative to the cost of time and saving deposits and other bank's sources of funds.

Moreover, the cost of demand deposit should move substantially lower in the period ahead as demand loan services become more readily available from the central reserve banks. Paper cheques will, gradually, be replaced by electronic images. It permits more storage and much faster banking process, cutting bank costs and improving customer services. (*Singh, 2005*)

2.10.1. Loanable Funds Theory of Interest

The loanable funds theorists believed in the Time Preference explanation of how interest arises. According to Loanable Funds Theory, also called the Neo-classical Theory, interest is the price paid for the use of loanable funds. (*Dewett & Adarsh, 1988*)

Like the Classical and Keynesian theories of interest, it is also a demand and supply theory. It asserts that rate of interest is determined by the equilibrium between demand and supply of loanable funds in the credit market. There are several sources of both supply and demand of loanable funds which we discuss below:

2.10.1.1. Supply of Loanable Funds

The supply of loanable funds is derived from four basic sources, namely, (a) savings, (b) dishoarding, (c) bank credit, and (d) disinvestment.

(a) Savings:

Savings by individuals or households constitute the most important source of loanable funds. In the loanable funds theory, savings are looked at in either of these two ways, firstly, as ex-ante savings, i.e. savings planned by individuals at the beginning of a period in the hope of expected incomes and anticipated expenditures on consumption; or secondly in the Robertsonian sense savings of the difference between the incomes of the preceding period and the consumption of the present period. In either case, the amount saved varies at various rates of interest. Savings by individuals and households primarily depend upon the size of their incomes. But, given the level of income, savings vary at various rates

of interest. More savings will be forthcoming at higher rates of interest, and vice versa.

Like individuals, businesses also save. A part of the earnings of a business concern is consumed as declared dividends; the undistributed part constitutes business or corporate savings. Such savings depend partly upon the current rate of interest. A high rate of interest is likely to encourage business savings as a substitute for borrowings from the loan market. But these business savings are often demanded for investment purposes by the firms themselves and, therefore, they do not enter the market for loanable funds.

(b) Disharding:

This is another source of loanable funds. Individuals may dishoard money from the hoarded stock of the previous period, become active balances in the present period and are available as loanable funds. At higher rate of interest, more will be dishoarded. At very low rates of interest, there is a greater tendency to hold on to money.

(c) Bank Credit:

The banking system provides a third source of loanable funds. Banks, by creating credit money, can advance loans to the businessmen. Banks, by creating credit money, can advance loans to the businessmen. Banks can also reduce the amount of money by contracting their lending. The new money created by the banks in a period adds greatly to the

supply of loan funds. The supply curve of fund provided by banks is to some degree interest-elastic, i.e., it varies with various rates of interest. Generally speaking, the banks will lend more money at higher rates of interest than at lower ones, other things remaining the same.

(d) Disinvestment:

Disinvestment is the opposite of investment and takes place when, due to the structural changes or bad venture, the existing stock of machines and other equipment is allowed to wear out without being replaced or when the inventories are drawn below the level of the previous period. When this happens, a part of the revenue from the sale of the products, instead of going into capital replacement, flows into the market for loanable funds. "Disinvestment is encouraged somewhat by a high rate of interest on loanable funds. When the rate is high, some of the current capital may not produce a marginal revenue product to match this rate of interest. The firm may decide to let this capital run down and to put the depreciation funds in the loan market". Thus, disinvestment adds to the supply of loanable funds.

2.10.1.2. Demand of Loanable Funds

The demand for loanable funds comes mainly from three fields: (i) investment, (ii) consumption and (iii) hoarding.

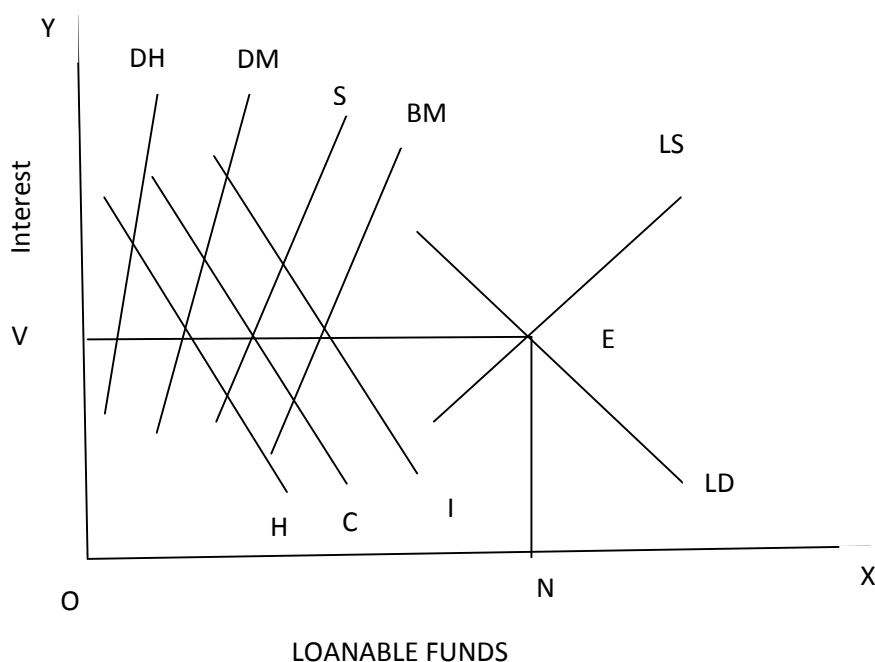
The bulk of demand for loanable funds comes from business firm which borrow money for purchasing or making new capital goods, including the building up of inventories.

Demand for loanable funds for investment purposes by business firms is the most important constituent of total demand for loan funds. The price of the loanable funds required to purchase the capital goods is obviously the rate of interest. It will pay businessmen to demand loanable funds up to the point at which the expected net rate of return on the capital goods equals the rate of interest. Businessmen will find it profitable to purchase larger amounts of capital goods, when the rate of interest (i.e., the price of the loanable funds) decline.

Thus, the demand for loanable funds for investment purposes is interest-elastic and slopes downwards to the right. The demand for loanable funds for investment purposes is represented by curve I in Figure No.2.2.

Figure No.2.2

Demand and Supply Equilibrium of Loanable Funds



The second big demand for loanable funds comes from individuals or households who want to borrow for consumption purposes. Individuals or households demand loanable funds when they wish to make purchases in excess of their current incomes and cash resources. Generally, the loans for consumption are demanded for buying durable goods like automobiles, refrigerators, radios, television sets, etc. Lower rates of interest will encourage some increase in consumer borrowing. Demand for loanable funds for consumption purposes is shown by the curve 'C' in Figure No. 2.2., which is interest-elastic and slopes downward to the right.

Lastly, the demand for loanable funds may come from those who want to hoard money, i.e., to satisfy the liquidity preference. Hoarding signifies the people's desires to hold their savings as idle cash balances. An important point to be noted here is that the one who supplies the loanable funds is the same person who demands the loanable funds for hoarding. A saver who hoards his savings can be said to be supplying loanable funds and also demanding them to satisfy his liquidity preference.

Demand for hoarding is shown by curve H in Figure No. 2.2. The demand for hoarding money is interest-elastic and slopes downwards to the right. At higher rates of interest, people will hoard or hold less money, because much of the money will be lent to take advantage of the higher interest rates. Similarly, at lower rates of interest, people will hoard more money, because the loss incurred by hoarding in this case is not very much. (*Dewett & Chand, 1988*)

2.11. Review of the Past Studies

Shrestha (1979) upon the title of *Interest Rate and its Impact upon Resource Mobilization and Utilization* is also seems relevant to review here. Since his study is too old, interest rate at that time was purely the central bank's phenomenon. He, in his study, has concluded that the frequent change in interest rates was disliked by customers except changing the interest rates as directed by NRB. Shrestha has suggested that the commercial banks to quote stable rate as far as possible. He also recommended that the method of calculating interest should be used in such a way that the previous customers and depositors who are already involved in banking transaction should not be affected adversely. He also suggested charging high interest rate on loan to luxury goods as in unproductive sectors and a lower rate on productive and small scale industries.

Bhandari (1998) in his study entitled *The impact of interest rate structure on investment portfolio of commercial banks of Nepal* has concluded followings:

- i) Rates of commercial banks have been fluctuating. Deposits and lending rates were increased immediately after liberalization of the interest rate on August 31, 1989 but however, started to decline which have helped in increasing the credit flow.
- ii) Interest rate structure has direct influence on profitability of commercial banks. Decreasing lending rate helps to increase the profitability through increasing the credit.

iii) Deposits are more interest rate conscious and positively co-related.

iv) Loans and advances of commercial banks have been found to be continuously increasing with the decline in interest rates.

v) Effective interest rate structure helps in proper utilization of resources as measured by loan to deposit ratio.

vi) Most of the banks are having similar interest rate structure which lessens the importance of liberalization of interest rate.

Pant (2056) in his article *Taralta byawastapan kina ra kaasari? Nepalko sandarva* has stated that the lending to the CBs by the central bank, NRB is done on the three basis i.e. basic rate, selective rate and the lender of the last resort rate. He has also stated the central bank; NRB has been revising the rate of interest and the rediscount rate time to time as per the market necessity. Similarly, the provisions of the CRR for the commercial banks have been revised. He also found that the huge portion of the liabilities of the CBs was deposits & that of assets is the loan and advances disbursed by them. He also concluded that the improper management of the sources and uses of funds by the commercial banks will bring the economic situation volatile, thus NRB should inspect and check the situation time-to-time.

Neupane (2008) carried out a study entitled *Interest Rate Structure and Its Influence on Deposit and Lending of Joint Venture Banks in Nepal* has shown the influence of interest rate on deposit and lending in Nepalese Joint Venture Banks. He concluded:

o The interest rate of all sample banks are found to be in decreasing trends.

- o Analysis of sample banks shows that interest rates on lending are far higher than deposit rates.
- o Analysis of samples banks concludes that interest rate on deposit is to be found so low which does not attract the depositor.
- o Lending interest rate of sample banks have decreased every year which provide better opportunities for the borrowers" investor.
- o Sample Banks under study show weak on mobilization of collected deposit.

Jha (2068) in his article *Assets liabilities management in commercial banks* has pointed out the area of asset liability management extends to management of various risks like market risk, interest rate risk, and liquidity risk. It has a greater role to play in areas like, product planning, review of balance sheet composition, interest rate outlook, etc. Besides covering various balance sheet risks, asset liabilities management plays a crucial role in safeguarding the overall solvency of a bank. He stated it a continuous and day-to-day matter which has to be carefully managed and preventive steps taken to mitigate the problems associated with it. It may cause irreparable damage to the banks in terms of liquidity, profitability and solvency, if not monitored properly.

Chapter III

Research Methodology

3.1. Research Design

This research is belongs to sources and uses of the funds of the commercial banks operating in Nepal so the research is based on recent historical data of last ten years.

Since the given time to finish the research is very limited, more part of the research is analytical rather than descriptive.

3.2 Population and Sample of Data

The populations of the study are the all the commercial banks operating in Nepal. The study has taken the sample data regarding only the sources & uses of funds of 'A' class commercial banks on Nepal licensed by the central bank of Nepal, Nepal Rastra Bank.

3.3. Sources of Data

The data required for the preparation of this report are collected both from the secondary sources. For the collection of the secondary data, the official website of the Nepal Rastra Bank has been visited.

3.4. Data Collection Procedures

The collected data have been collected from the respective official websites of the NRB.

3.5. Tools Used

The tools used in the analysis of the secondary are mainly financial & statistical. The major tools used in the study are:

3.4. 1. Cash Reserve Ratio (CRR)/Bal. with NRB

It is the proportion of the deposit liabilities that commercial banks are required to keep as a cash deposit with the NRB. The level of CRR influences the commercial banks' credit creation capacity. If there is a higher rate of CRR, then the CBs need to keep the higher portion of deposits for CRR purpose with the central bank. As such, they have less deposit for lending purpose. Hence, the higher CRR squeezes the money expansion in the economy. Conversely, the low CRR rate means CBs need to keep less of the deposits so that they can lend more, resulting in the expansion of money supply in the economy. Moreover, CRR also serves as a measure for smoothing payment system as a prudential measure by avoiding sudden liquidity crunch in the banking system.

3.4.2. Credit-Deposit Ratio

If 75% of amount deposited by the customers are invested in various sectors, it is considered satisfactory. It is good sign. This ratio shows the efficiency of the CB to use the liquidity during a particular time. The ratio helps to find out the liquidity position as well as the prediction for the need of additional capital for the CBs. If the given ratio is not maintained by the CBs, there is a scarcity of cash & there is a lack of capital.

3.4.3. T-test

To test the validity of our assumption, if the sample size is less than 30, t-test is used. For applying t-test in context of small sample the t-value is calculated first and compared with the t-value on table at certain level of significance for given degree of freedom. If calculated value of "t" exceeds the table value (say 0.05) we can say that the

difference is significant at 5% level, but if calculated value is less than the concerning values the difference is not treated as significant. The value is calculated by using following formula:

$$..tX \frac{r}{\sqrt{1-r^2}} \sqrt{n-2}$$

where, r= Correlation Coefficient

Chapter IV

Analysis of Data

4.1. Total Sources & Uses of Funds of Commercial Banks

The study is fully focused on the sources & uses of funds of the commercial banks operating in Nepal. The data interpreted in the chapter are of secondary in nature. The amount of total sources and uses of fund of commercial banks are tabulated below and are presented and interpreted below.

In order to investigate the sources & uses of funds of commercial banks, the NRB Quarterly Economic Bulletin has been reviewed.

Table No.4.1
Total Sources and Uses of Fund of Commercial Banks

In Rs.10000000

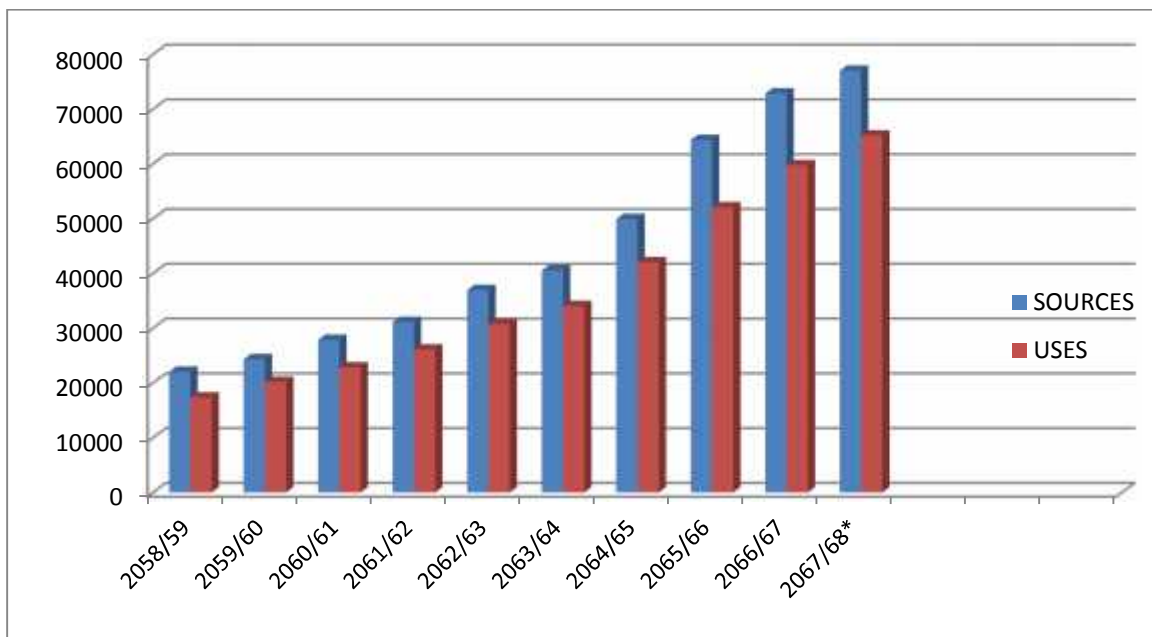
F/Y	SOURCES[^]	USES	RATIO in %
2058/59	22027.12	17331.92	78.68%
2059/60	24315.25	20182.25	83.00%
2060/61	27862.00	22823.49	81.92%
2061/62	31109.00	26086.76	83.86%
2062/63	36940.10	30758.39	83.27%
2063/64	40528.50	34035.49	83.98%
2064/65	49925.30	42024.26	84.17%
2065/66	64329.30	52063.46	80.93%
2066/67	72840.00	59734.85	82.01%
2067/68*	76995.40	65159.14	84.63%

Source: NRB Quarterly Economic Bulletin

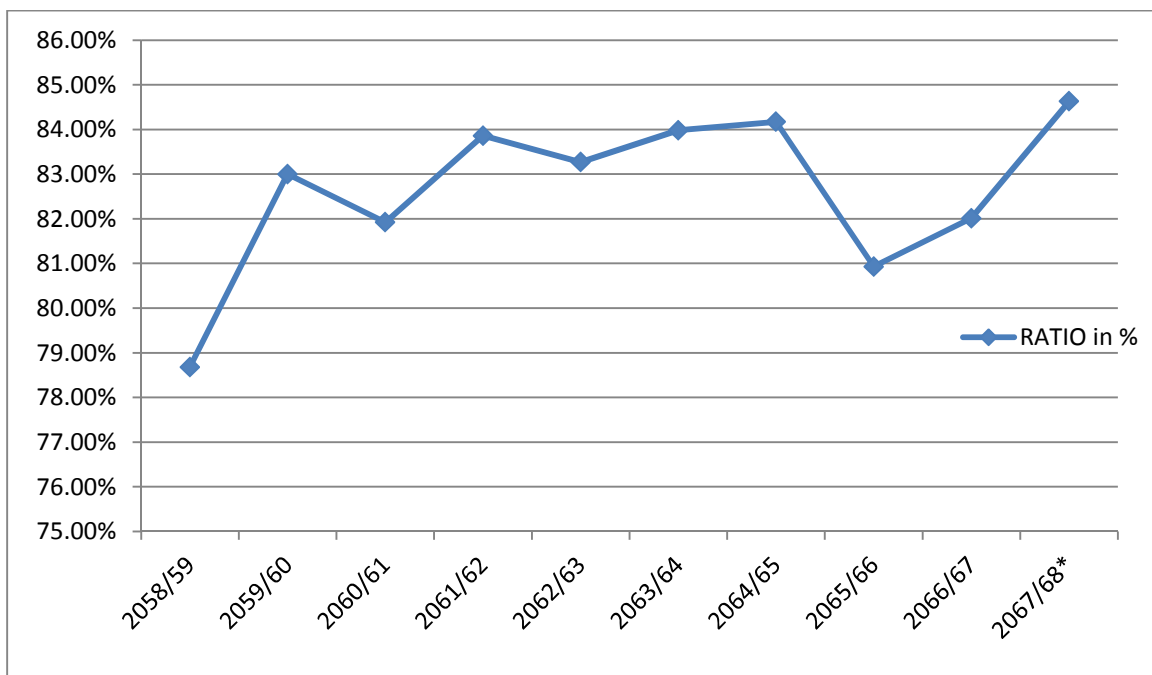
[^]Capital Funds not included

***First Eight Months**

**Figure No.4.1
Total Sources and Uses of Fund of Commercial Banks**



**Figure No.4.2
Total Sources to Total Uses Ratio of Fund of Commercial Banks**



The amount of sources and funds of the Nepalese commercial banks are seen increasing continuously in the past years. The total amount is seen increasing is due to the increasing number of the CBs in the Nepalese market as well.

According to the new NRB Directives, the CBs could not use their capital funds as the sources of fund. After adapting the BASEL-II for the capital adequacy for the CBs as directed by NRB, they could not consider the capital funds as the sources of funds.

The amount of the sources of funds of CBs was at Rs. 22027.12 crore in the F/Y 2058/59. The amount touched Rs. 31109.00 crore in the F/Y 2061/62.

The ratio was seen dropped in the F/Y 2065/66 to 80.93% but the amount was seen constantly increasing every year.

More than 80% of the total sources of funds of commercial banks in Nepal has used for various purposes. Slight decline was seen in the F/Y 2065/66 but again the increment in the ratio is seen.

In the first eight moth of the F/Y 2067/68* the ratio is seen at 84.63%. The ratio was at 78.68% in the F/Y2058/59.

As the number of banks and financial institutions increased as well as the branch expansion of the existing institution continued in the past few years, the sources & uses of funds are also seen increasing. This shows the positive sign for the development of the banking industry but at the same time the unfair competition is also seen increasing.

4.2. Sources of Funds of Commercial Banks

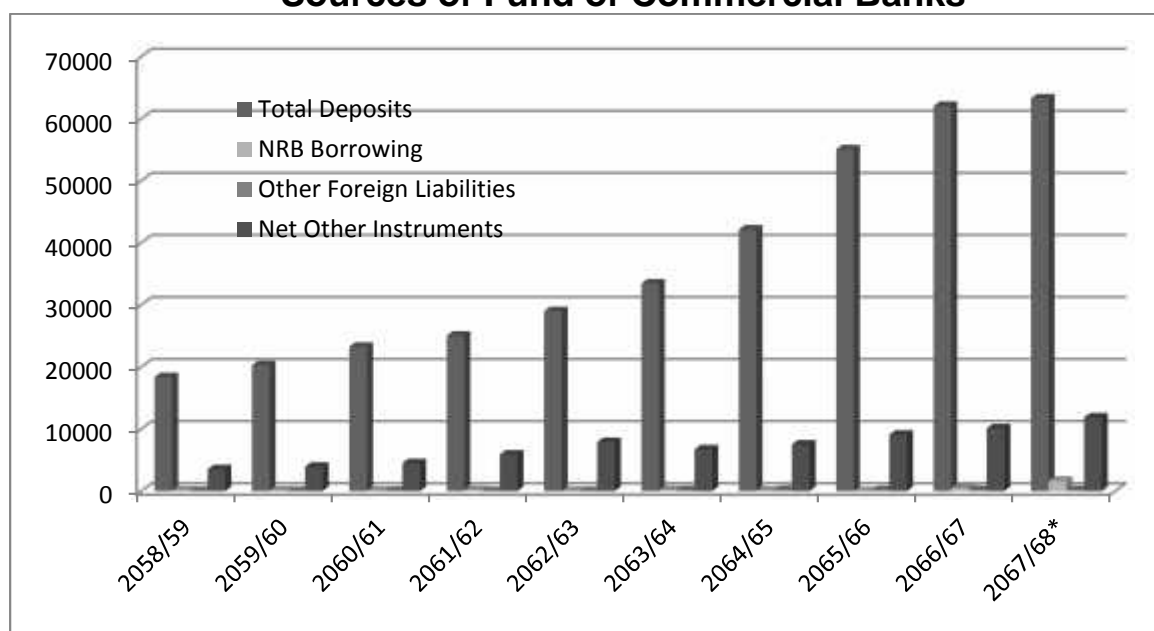
Table No.4.2
Sources of Fund of Commercial Banks

In Rs.10000000

F/Y	Total Deposits	NRB Borrowing	Other Foreign Liabilities	Net Other Instruments
2058/59	18372.81	104.37	22.84	3527.10
2059/60	20273.38	94.74	13.42	3933.71
2060/61	23257.63	47.79	52.14	4504.44
2061/62	25046.50	172.40	2.80	5887.40
2062/63	28997.60	32.90	0.80	7908.90
2063/64	33445.30	187.10	162.80	6733.30
2064/65	42152.40	66.10	191.20	7515.70
2065/66	55067.70	0.00	167.10	9094.60
2066/67	62060.90	478.30	193.30	10107.50
2067/68*	63274.90	1669.30	184.30	11866.90

Source: NRB Quarterly Economic Bulletin

Figure No.4.3
Sources of Fund of Commercial Banks



Among the total sources of funds of the CBs of Nepal, total deposit collection covered the huge amount. The product diversification in the deposit and banking services of the emerging CBs in the market also increased the amount of the total deposit collection of the CBs in the recent years.

Similarly, the awareness among the general public and lack of investment diversification facilities in the market also made the Nepalese to deposit in the CBs. The amount is also seen increasing every year. The amount reached Rs. 63274.90 crore in the F/Y 2067/68*. The amount of deposit collected in the F/Y 2058/59 was at Rs.18372.81 crore.

After the restoration of the peace in the country, the branch expansion of the existing CBs and the entry of the new CBs in the market helped to increase the amount of the total deposit collection of the country.

The NRB borrowing was seen nil in the F/Y 2065/66. But the amount is seen heavily increased in the F/Y 2067/68* and reached amounted to Rs. 1669.30 crore. As the central bank is considered as a lender of last resort, in case the CBs is unable to meet the funds, they can approach the central bank, NRB for financial accommodation.

The amount related to the net other instruments of the sources of the funds of the commercial banks is also seen heavily increased in the F/Y 2067/68*.

The net foreign liabilities of the Nepalese CBs was seen declining reaching below to the amount of Rs. 0.80 crore in the F/Y2062/63 but again jumped to Rs. 193.30 crore in the F/Y 2066/67.

4.3. Proportion of Sources of Funds of Commercial Banks

Table No.4.3

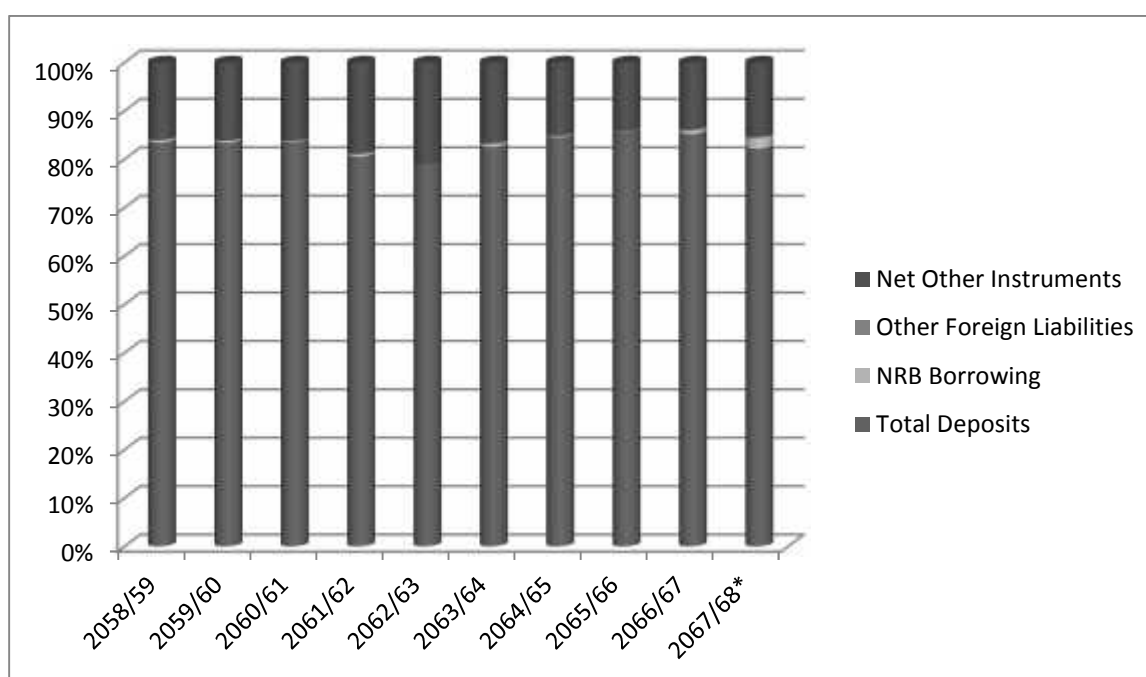
Proportion of Sources of Fund of Commercial Banks

F/Y	Total Deposits	NRB Borrowing	Other Foreign Liabilities	Net Other Instruments	Total
2058/59	83.41%	0.47%	0.11%	16.01%	100%
2059/60	83.38%	0.39%	0.05%	16.18%	100%
2060/61	83.47%	0.18%	0.18%	16.17%	100%
2061/62	80.51%	0.55%	0.01%	18.93%	100%
2062/63	78.50%	0.08%	0.01%	21.41%	100%
2063/64	82.52%	0.46%	0.41%	16.61%	100%
2064/65	84.44%	0.13%	0.38%	15.05%	100%
2065/66	85.60%	0.00%	0.26%	14.14%	100%
2066/67	85.20%	0.66%	0.26%	13.88%	100%
2067/68*	82.18%	2.17%	0.24%	15.41%	100%

Source: Table No.4.2

Figure No.4.4

Proportion of Sources of Fund of Commercial Banks



In the total proportion of the total sources of the fund of the commercial banks of Nepal, the total deposit amount collected covered the largest portion. It covered more than 80% of the total sources of funds. Under the total deposits collected also normally two types of deposits are collected by the CBs namely, interest-bearing deposits and non-interest bearing deposits. The non-interest bearing deposit consists of the current account only which the CBs are only allowed to collect by the central bank of Nepal, Nepal Rastra Bank.

Due to the liquidity crunch in the F/Y 2067/68, the amount of the NRB borrowing is also seen heavily increased to 2.17% of the total sources of funds. In the past, its portion was seen below 1%. In the F/Y 2062/63, the proportion of the net other instruments was also seen increased to 21.41% of the total sources of funds.

4.4. Uses of Funds of Commercial Banks

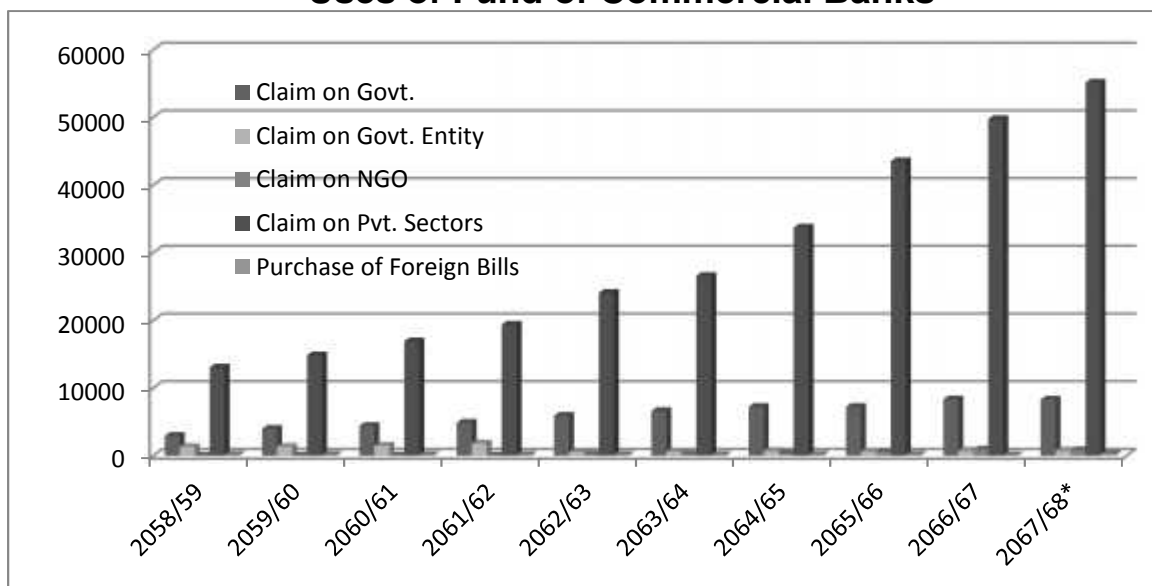
Table No.4.4
Uses of Fund of Commercial Banks

In Rs.10000000

F/Y	Claim on Govt.	Claim on Govt. Entity	Claim on NGO	Claim on Pvt. Sectors	Purchase of Foreign Bills
2058/59	2914.38	1276.05	0.00	13008.84	132.65
2059/60	3946.93	1310.44	0.00	14807.32	117.56
2060/61	4379.63	1469.07	0.00	16869.28	105.51
2061/62	4855.10	1799.40	0.00	19327.00	105.30
2062/63	5886.20	538.10	171.40	24036.20	126.40
2063/64	6585.00	616.10	187.00	26539.10	111.30
2064/65	7210.00	687.40	300.70	33678.10	148.00
2065/66	7194.90	625.90	595.30	43491.30	156.10
2066/67	8299.60	724.30	922.80	49714.00	74.10
2067/68*	8264.30	735.10	813.20	55087.70	258.80

Source: NRB Quarterly Economic Bulletin

**Figure No.4.5
Uses of Fund of Commercial Banks**



The huge amount of fund is used for the claim from the pvt. sectors. The amount of the claim is also seen increasing heavily in the recent years. The amount of claim on pvt. sector was Rs. 13008.84 crore in the F/Y 2058/59 but it increased heavily in the recent years and reached to Rs. 55087.70 crore in the first eight months of F/Y 2067/68.

Similarly, the claim on govt. is also seen increased in the past decade. The amount was at Rs. 2914.38 crore in the F/Y 2058/59 and touched at Rs. 8264.30 crore in the first eight months of F/Y 2067/68.

The claim on NGO was seen nil till the F/Y 2061/62 but reached Rs. 922.80 crore in the F/Y 2066/67. The least amount of fund used in the purchase of foreign bills was Rs. 74.10 crore in the F/Y 2066/67 but it heavily increased in the first eight months of F/Y 2067/68 with the record amount of Rs. 258.80 crore.

4.5. Proportion of Uses of Funds of Commercial Banks

Table No.4.5

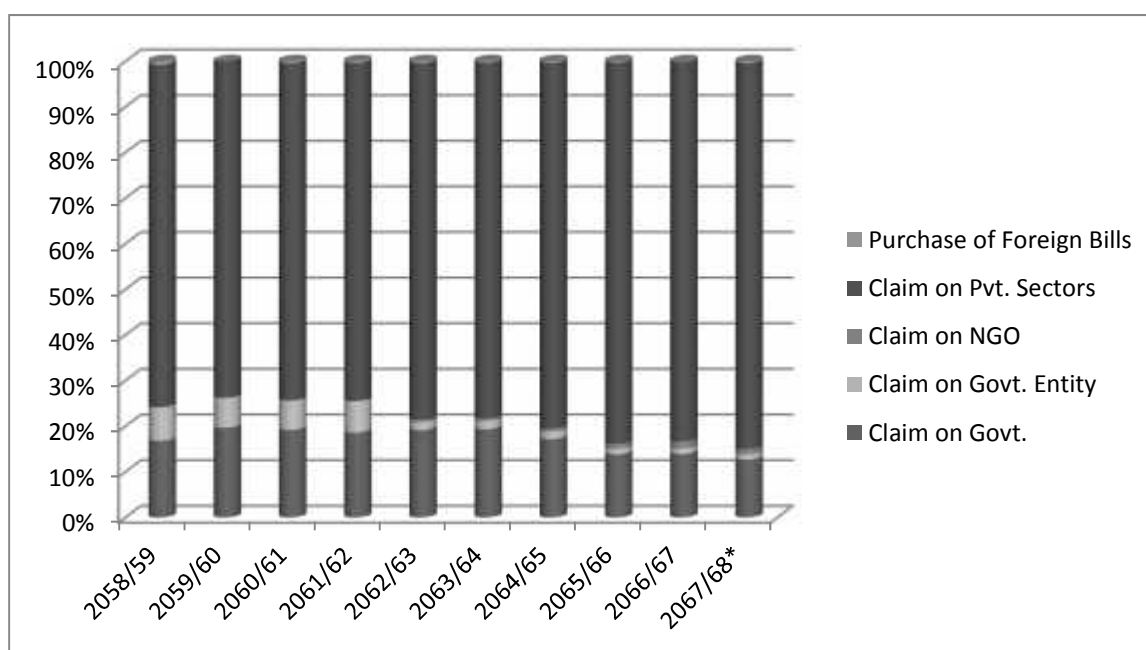
Proportion of Uses of Fund of Commercial Banks

F/Y	Claim on Govt.	Claim on Govt. Entity	Claim on NGO	Claim on Pvt. Sectors	Purchase of Foreign Bills	Total
2058/59	16.81%	7.36%	0.00%	75.06%	0.77%	100%
2059/60	19.57%	6.49%	0.00%	73.36%	0.58%	100%
2060/61	19.19%	6.44%	0.00%	73.91%	0.46%	100%
2061/62	18.61%	6.90%	0.00%	74.09%	0.40%	100%
2062/63	19.14%	1.75%	0.55%	78.15%	0.41%	100%
2063/64	19.35%	1.81%	0.54%	77.97%	0.33%	100%
2064/65	17.17%	1.64%	0.70%	80.14%	0.35%	100%
2065/66	13.82%	1.20%	1.14%	83.54%	0.30%	100%
2066/67	13.89%	1.21%	1.54%	83.22%	0.14%	100%
2067/68*	12.68%	1.13%	1.25%	84.54%	0.40%	100%

Source: Table No.4.4

Figure No.4.6

Proportion of Uses of Fund of Commercial Banks



Huge portion of the funds of CBs are used in the claim on pvt. sectors. More than 70% of the total composition of the uses of funds of commercial banks is covered by claim on pvt, sectors. The ratio is seen increasing every year as well. It reached to 84.54% in the first eight month of F/Y 2067/68.

No claim on NGO was to be paid by the CBs till the F/Y 2061/62. Still the ratio is seen below 2%. The uses of funds for the purchase of foreign bills were also seen below 1%. The highest level of portion was 0.77% in the F/Y 2058/59.

The claim on govt. entity of the CBs was also seen declining in the recent years. The portion was at 7.36% in the F/Y 2058/59 but declined to 1.13% in the first eight month of F/Y 2067/68.

4.6. Cash & Bank Balance of Commercial Banks

Table No.4.6

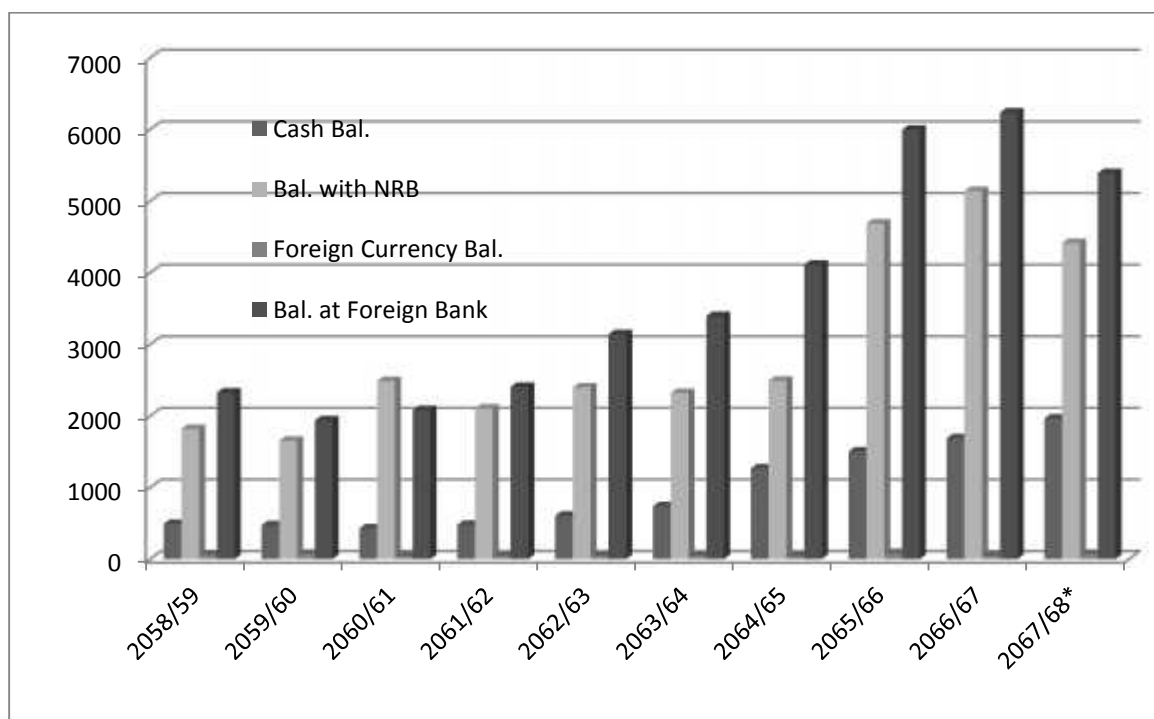
Cash & Bank Balance of Commercial Banks

In Rs.10000000

F/Y	Cash Bal.	Bal. with NRB	Foreign Currency Bal.	Bal. at Foreign Bank
2058/59	490.89	1816.78	61.69	2325.83
2059/60	472.33	1651.90	72.16	1936.61
2060/61	428.38	2486.71	43.51	2079.86
2061/62	477.30	2103.00	37.50	2404.50
2062/63	605.40	2396.20	39.90	3140.20
2063/64	736.00	2318.40	45.40	3393.30
2064/65	1265.20	2489.90	35.90	4110.10
2065/66	1501.60	4685.90	82.30	5996.10
2066/67	1686.40	5139.30	43.70	6235.70
2067/68*	1963.90	4412.40	70.70	5389.30

Source: NRB Quarterly Economic Bulletin

Figure No.4.7
Cash & Bank Balance of Commercial Banks



All commercial banks have to maintain certain cash balance as cash reserve in central bank. It is called CRR. The minimum balance should be maintained by law. Such ratios are determined according to the ratio of deposit collected by banks. Similarly, there should be a certain cash balance in the bank vault as well.

The cash & bank bal. of the CBs shows the actual picture of the liquidity position.

The Nepalese CBs have also been keeping their cash in the foreign banks as well. Huge amount of the funds is kept in the foreign banks by the CBs of Nepal.

Similarly, as the CBs have the permission to exchange the foreign currencies of certain countries by laws, they use to keep the cash balance

in foreign currencies as well. The foreign currencies as prescribed and directed by NRB are only uses as the bal. of cash in foreign currencies.

4.7. Proportion of Cash & Bank Balance of Commercial Banks

Table No.4.7

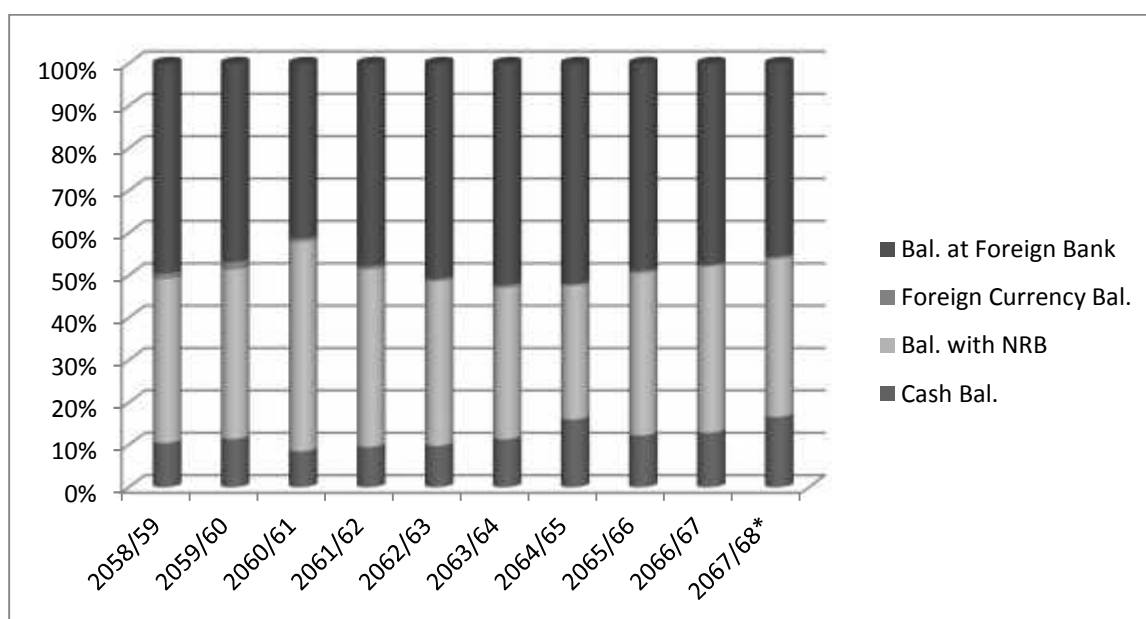
Proportion of Cash & Bank Balance of Commercial Banks

F/Y	Cash Bal.	Bal. with NRB	Foreign Currency Bal.	Bal. at Foreign Bank	Total
2058/59	10.45%	38.70%	1.31%	49.54%	100%
2059/60	11.44%	39.96%	1.74%	46.86%	100%
2060/61	8.50%	49.35%	0.87%	41.28%	100%
2061/62	9.50%	41.87%	0.75%	47.88%	100%
2062/63	9.79%	38.76%	0.65%	50.80%	100%
2063/64	11.34%	35.70%	0.70%	52.26%	100%
2064/65	16.01%	31.52%	0.45%	52.02%	100%
2065/66	12.24%	38.20%	0.67%	48.89%	100%
2066/67	12.87%	39.22%	0.33%	47.58%	100%
2067/68*	16.59%	37.27%	0.60%	45.54%	100%

Source: NRB Quarterly Economic Bulletin

Figure No.4.8

Proportion of Cash & Bank Balance of Commercial Banks



As per the directives of the central bank, every CBs have maintained the cash balance with NRB. To fulfill the CRR as prescribed by NRB also the CBs have to maintain the bal. with NRB. Of the total proportion of cash and bank bal., the CBs have kept above 30% of the total amount at NRB.

Huge portion of cash and bank bal. of Nepalese CBs have been maintaining at the foreign banks. Mainly the joint venture banks which are operating in Nepal are keeping the bank balance at foreign banks. In the last decade the bal. at foreign banks of CBs was above 40%.

The cash balance with themselves has been increased in the recent years to more than 12%. The ratio touched 16.59% in the F/Y 2067/68*.

The CBs has been keeping the least amount of foreign currency bal. in the total portion of cash and bank bal. The portion was above 1% till the F/Y 2059/60. But after that the proportion remained below 1%.

4.8. Balance with NRB of Commercial Banks

Table No.4.8

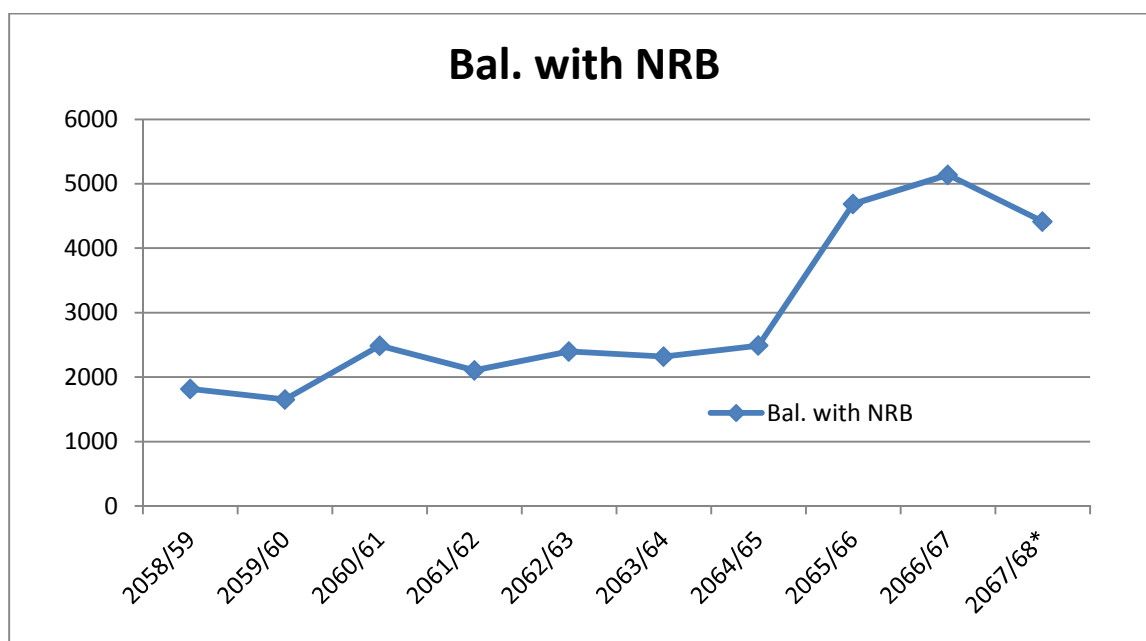
Balance with NRB of Commercial Banks

In Rs.10000000

F/Y	Balance with NRB
2058/59	1816.78
2059/60	1651.90
2060/61	2486.71
2061/62	2103.00
2062/63	2396.20
2063/64	2318.40
2064/65	2489.90
2065/66	4685.90
2066/67	5139.30
2067/68*	4412.40

Source: Economic Survey

Figure No.4.9
Balance with NRB of Commercial Banks



To maintain the CRR in the central bank as prescribed by the directives, the CBs keep the bal. with NRB. The CRR also helps to manage as well as measure the liquidity position of the CBs. The CBs should maintain the CRR as fixed by the central bank by opening an account in central bank and should maintain the statutory liquidity ratio, in its own treasury. It changes from time to time. NRB, first time introduced CRR in December 1966. At that time, CBs were required to maintain CRR of 8% of total deposit liabilities. Since then, NRB changed CRR a dozen times until to date, and sometimes, variable rates for different deposits, and sometimes, single rate.

Thus, the bal. with NRB is also seen somewhat constant till the F/Y 2064/65. The value of CRR was around Rs. 2000 crore but reached the

double value in the F/Y 2065/66. In the first eight months of F/Y 2067/68 the bal. with NRB reached Rs. 4412.40 crore.

4.9. Credit-Deposit Ratio (CD Ratio) of Commercial Banks

Table No.4.9

Credit-Deposit Ratio of Commercial Banks

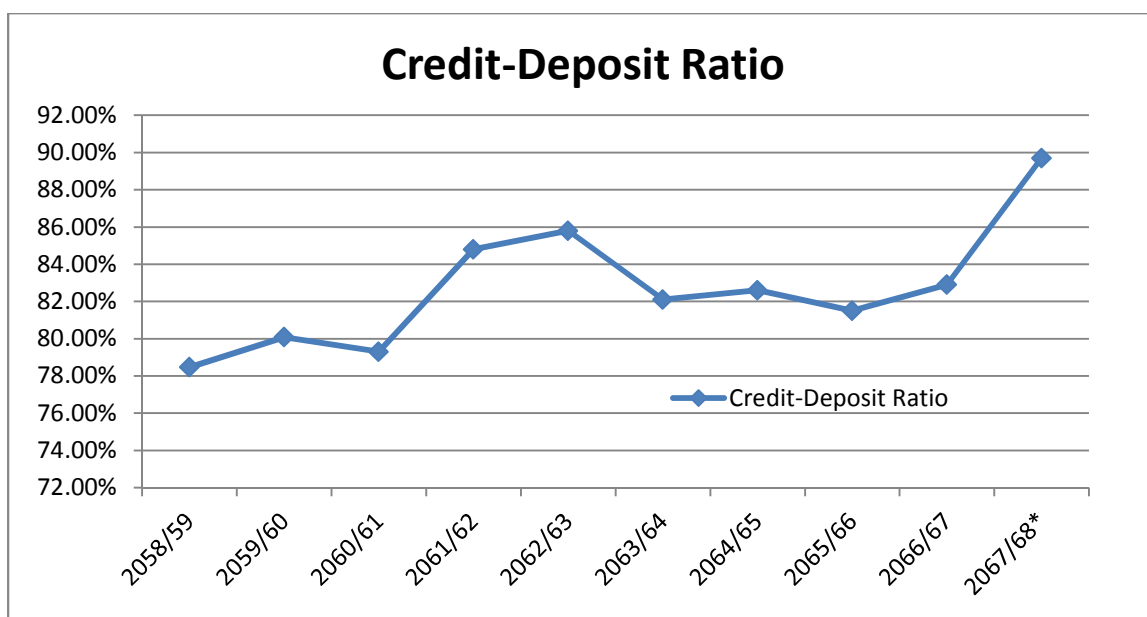
F/Y	Credit-Deposit Ratio[#]
2058/59	78.47%
2059/60	80.08%
2060/61	79.30%
2061/62	84.80%
2062/63	85.80%
2063/64	82.10%
2064/65	82.60%
2065/66	81.50%
2066/67	82.90%
2067/68*	89.70%

Source: Economic Survey

#Claim on govt. not included

Table No.4.10

Credit-Deposit Ratio of Commercial Banks



The CD ratio is the major indicators to measure the liquidity position of the commercial banks. This ratio is considered as a principal indicator of the performance of the commercial bank in Nepal.

If the ratio is 75%, it is considered satisfactory. It is a good sign. The ratio of the CBs of Nepal is seen in very good position. But increasing heavily in the CD ratio will bring the reverse effect in the profitability of the CBs. Thus, the CD ratio of the CBs should be maintained as per the necessity of the market and to trade-off between profitability and liquidity.

The CD ratio was at 78.47% in the F/Y 2058/59 of the CBs of Nepal. It dropped slightly in the F/Y 2060/61 but increased to 85.80% in the F/Y 2062/63. Again it dropped to 81.50% in the F/Y 2065/66. The ratio is seen up high to 89.70% in the first eight month of the F/y 2067/68*.

4.10. Test of Hypothesis

4.10.1. Test on Correlation between the Sources & Uses of Funds of CBs

For the purpose of relation between the sources & uses of funds of CBs, the following hypothesis is done.

Variable:

Let Sources be 'X' & Uses be 'Y'

Null Hypothesis (H_0): $=0$ i.e. the variables in the population are uncorrelated.

Alternative Hypothesis (H_1): $\neq 0$ i.e. the variables in the population are correlated. (two-tailed test)

Decision: Since, the calculated value of 't' is greater than the tabulated value of 't', the null hypothesis is rejected and alternative hypothesis is accepted, Hence, the sources & uses of funds of CBs are correlated. (**Source: Annex-I**)

4.11. Major Findings

The major findings of the study are:

1. More than 80% of the total sources of funds of commercial banks in Nepal has used for various purposes. Slight decline was seen in the F/Y 2065/66 but again the increment in the ratio is seen.
2. Among the total sources of funds of the CBs of Nepal, total deposit collection covered the huge amount. The amount reached Rs. 63274.90 crore in the F/Y 2067/68*. The amount of deposit collected in the F/Y 2058/59 was at Rs.18372.81 crore.
3. Due to the liquidity crunch in the F/Y 2067/68, the amount of the NRB borrowing is also seen heavily increased to 2.17% of the total sources of funds.
4. The claim on NGO was seen nil till the F/Y 2061/62 but reached Rs 922.80 crore in the F/y 2066/67. The least amount of fund used in the purchase of foreign bills was Rs.74.10 crore in the F/Y 2066/67 but it heavily increased in the first eight months of F/Y 2067/68 with the record amount of RS. 258.80 crore.

5. More than 70% of the total composition of the use of funds of commercial banks is covered by claim on pvt. sector. The ratio is seen increasing every year as well. The claim on govt. entity of the CBs was also seen declining in the recent years.
6. CBs have the permission to exchange the foreign currencies of certain countries by laws; they use to keep the cash balance in foreign currencies as well. The foreign currencies as prescribed and directed by NRB are only used as the bal. of cash in foreign currencies.
7. The cash balance with commercial banks has been increased in the recent years to more than 12%. The ratio touches 16.59% in the F/Y 2067/68*.
8. The bal. with NRB is also seen somewhat constant till the F/Y 2064/65. The value of CRR was around Rs.2000 crore but reached the double value in the F/Y 2065/66.
9. The CD ratio of the commercial banks is seen increasing heavily. The ratio is seen up high to 89.70% in the first eight months of the F/Y 2067/68*.
10. The sources & uses of funds of CBs are correlated.

Chapter V

Summary and Conclusion

5.1. Summary

Banks have, today, gained paramount trust in the public. The functions of banks are not confined to just accepting deposit and giving loans. These have been the sources of funds and uses of funds for them for long time. Now they render a wide range of services covering various sector of the society.

In today's intensely competitive, increasingly deregulated banking market, it is hard to raise funds at the lowest cost and use effectively to optimize bank revenue and security. Both the cost and amount of deposits that the banks can sell to the public are heavily influenced by the interest rate schedules and competitive maneuverings of the bank. The situation for the Nepalese commercial banks' market has been also facing the same situation. There has been a tough competition among the bankers in the market. From the single commercial bank before a half century ago, the numbers of banks with other types of financial institutions have increased rapidly.

The fund management of the commercial banks has been the tough job. They also have to follow the strict regulation of the central bank and at the same time they have to satisfy their customers to exist in the market. Recently managing the sources and uses of funds of CBs has been walking in the sword edge.

The major sources of fund for the CBs have been the deposit collection from the general depositors. So, there has always been

the interest rate war among the banks and financial institution in the Nepalese market. Similarly, on the other hand the main users of the funds are the pvt. sector. So, the flow of funds from the CBs goes to the pvt, sector.

5.2. Conclusion

The commercial banks in Nepal have been capable to mobilize properly their funds collect from the depositors. More than 80% of the total sources of funds of commercial banks in Nepal has used for various purposes. Mainly the three types of deposits namely; current, saving and fixed deposit have been collecting by the CBs of Nepal. The current deposit is a non-interest bearing and the remaining two are the interest bearing deposits.

The CBs has mainly done the product diversification in the saving deposit with various levels of interest rate and on various name to attract the various types of depositors. But due to the liquidity crunch in the F/Y 2067/68, the amount of the NRB borrowing is also seen heavily increased to 2.17% of the total sources of funds.

The CBs of Nepal have been maintaining a good level of cash balance. The ratio of cash balance in the sources of funds has been more than 12%. The ratio was high about 17% in the first eight months of F/Y 2067/68.

The balance with NRB of the CBs as also seen in good position. Similarly, the major indicator of the liquidity position of the CBs, the CD ratio was also seen increased heavily. The ratio is seen up high to 89.70% in the first eight month of the F/Y 2067/68*.

5.3. Recommendations

The following recommendations have been made:

1. The central bank of the country, NRB should make the rules and regulations as per the necessity of the market.
2. Regular supervisions & inspection in the CBs should be done to check the activities of the CBs.
3. The monetary policy issued by the NRB should be a facilitation to make a good investment environment of the CBs.
4. Good investment policy from the government side should be brought to use the sources of funds of CBs.
5. The concept of the public-private partnership should be implemented effectively in the development activities of the country which helps to uses the funds of the CBs in the productive sectors.
6. There is a recent need of diversification of the uses of funds by CBs to minimize the risk associated.

Annex-I

Test on Correlation between the Sources & Uses of Funds of CBs

Null Hypothesis (H₀): $\rho = 0$ i.e. the variables in the population are uncorrelated.

Alternative Hypothesis (H₁): $\rho \neq 0$ i.e. the variables in the population are correlated. (two-tailed test)

F/Y	SOURCES(X)	USES(Y)
2058/59	22027.12	17331.92
2059/60	24315.25	20182.25
2060/61	27862.00	22823.49
2061/62	31109.00	26086.76
2062/63	36940.10	30758.39
2063/64	40528.50	34035.49
2064/65	49925.30	42024.26
2065/66	64329.30	52063.46
2066/67	72840.00	59734.85
2067/68*	76995.40	65159.14

$\therefore r = +0.99$

$$t = \frac{r}{\sqrt{1-r^2}} \sqrt{n-2}$$

$$t = \frac{0.99}{\sqrt{1-0.99^2}} \sqrt{10-2} = 140.79$$

Degree of freedom = $n-2 = 10-2 = 8$

Critical Value: The tabulated value of t at 5% level of significance for two tailed test and for 8 d.f. is 2.306.

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