

**PROFIT PLANNING PRACTICE IN MACHHAPUCHCHHRE
BANK LTD.**

By:

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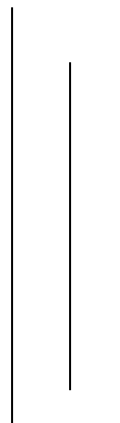
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Master of Business Studies (M.B.S)*

Kathmandu, Nepal

September, 2014

RECOMMENDATION

This is to certify that the Thesis

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Entitled:

**PROFIT PLANNING PRACTICE IN MACHHAPUCHCHHRE BANK
LTD.**

*Has been prepared as approved by this Department in the prescribed format of
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DECLARATION

I hereby declare that the work reported in this thesis entitled **PROFIT PLANNING PRACTICE IN MACHHAPUCHCHHRE BANK LTD** 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 Master's Degree in Business Study (M.B.S.) under the supervision of **Prof. Dr. Kamal Deep Dhakal** and **Joginder Geot** of Shanker Dev Campus.

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NISHAN SHRESTHA

September, 2014

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ABBREVIATIONS

A.D.	:	Anno Domini
B.S.	:	Bikram Sambat
BOD	:	Board Of Director
BOK	:	Bank Of Kathmandu
C.P.	:	Cost Price
Co.	:	Company
COD	:	Cast Of Deposit
DDC	:	Dairy Development Corporation
DOL	:	Degree of Operative Leverage
EBIT	:	Earning Before Interest Tax
EBL	:	Everest Bank Limited
F.Y.	:	Fiscal Year
G.D.P.	:	Gross Domestic Product
GC	:	GorakhaPatra Corporation
GNP	:	Gross National Product
GP	:	Gross Profit
GPMR	:	Gross Profit Margin Ratio
ICR	:	Interest Coverage Ratio
L/C	:	Letter of Credit
LDO	:	Loan, Discount and Overdraft
Ltd.	:	Limited
MBL	:	Machhapuchchre Bank Limited
MBS	:	Master of Business Studies
MOS	:	Margin of Safety
NBL	:	Nepal Bank Limited
NGO	:	Non-Government Organization
NIBL	:	Nepal Investment Bank Limited
NIDC	:	Nepal Industrial Development Corporation

NRB	:	Nepal Rastra Bank
OD	:	Overdraft
P/V Ratio	:	Profit Volume Ratio
PE	:	Probable Error
PPC	:	Profit Planning and Control
Pvt.	:	Private
SCBL	:	Standard Chartered Bank Limited
SP	:	Sales Price
TCM	:	Total Contribution Margin
TFC	:	Total Fixed Cost
TS	:	Total Sales
WTO	:	World Trade Organization

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

Nepal is one of the least developed countries with poorest economic condition of the world. Situated in northern hemisphere, known as land of Mt. Everest and the birthplace of lord Buddha, Nepal is a tiny landlocked country. Nepal remains as one of the 48 least developed countries in the world. It lies between India and China. It covers an area of 147181 square kilometres and runs all along 885 kilometres from the east to the west and 145 kilometres to 241 kilometres from the north to south. It has more than 30.85% people living below poverty line and its per capita income is only about \$311 or NRs 22540. It is placed among the countries having the lowest per capita income. The economic development of the country, which reflected by the annual GDP growth rate, is around 1.9% and it has in fluctuating trend. In the contest of Nepalese industrialization is in its infancy. Industrial sectors have contributed in the economy not more than 20% and more than 80 % people still depend on agriculture for the live hood (Population census 2068).

Every business or institution is established on the definite goals and objectives. All the tasks are performed by company according to their objectives. Mainly two types of institutions are established one is profit oriented and another is service oriented. The financial institutions act as mediators by transferring the resources from the surplus to the deficits, which provides fuel to economic development of the country. Economic activities of a nation can't be carried forward without support of the financial institutions.

1.2 Concepts of Profit Plan

A profit plan has an immense value in management; it helps in planning and coordinating, if used appropriately, but not a replacement for management. Profit planning is a comprehensive and coordinated plan expressed in financial

terms for the operations and resources of an enterprise for some specific period in the future. Profit planning is a comprehensive statement of intentions expressed in financial terms for the operation of both short and long period. It is a plan of the firm's expectation and is used as a base for measuring actual performance of managers and their units.

“Profit planning is predetermined detailed plan of action developed and distributed as a guide to current operations and as partial basis for the subsequent evaluation of performance. Thus it can say that profit planning is a tool which may be used by the management in planning the future course of actions and controlling the actual performance” (Gupta, 1997:141).

Every company or institution is established based on the definite goals and objectives. According to the objectives, the company performance is tasks. Mainly two types of institutions such as profit oriented and service oriented instructions are established, but most of them are profit oriented because profit is the lifeblood of the business which not only keeps it alive but also assures the future and makes it sound. Profit planning is an important tool of the firm to achieve the objectives.

“Profit do not just happened profits are managed” (Lynch & Williamson, 1989:30).

The management should follow various processes for profit planning because the management process and profit planning and control are related each other. A profit plan is an advance decision of expected achievement based on the most efficient operating standards in effect or prospect of time it is established against which actual accomplishment is regularly compared. Profit maximization is the basis objectives of a firm and to make it render reliable service to its customers. Profit is a device to measure efficiency of a firm. The term comprehensive profit planning and control it defined as a systematic and formalized approach for

performing significant phase of the management planning and control function. Especially it involves:

- The development and application of broad and long range objectives for the enterprises.
- The specification of enterprises goals.
- The development of strategic long range profit plan in broad terms.
- The specification of tactical short range profit plan detailed by assigned responsibility (division, products, projects).
- The establishment of a system of periodic performance reports detailed by assigned responsibility and follow up procedures.

In many of the better-managed companies, comprehensive PPC has been identified as a way of managing. It focuses directly up on a rational and systematic approach to management by objectives and realistic flexibility in performing the management process.

1.3 Meaning and Importance of Financial Institutions

"Financial Institution" means an institution established under the prevailing laws with the objectives of providing loans for agricultural cooperative, industrial or any other specific economic purpose or of collecting deposits from the general public and the word also includes an institution prescribed as financial institution by Government of Nepal by publishing notice in the Nepal Gazette. (NRB Act 2002).

Banking institution is inevitable for resource mobilization and all-round development of the country. It is resources for economic development; it maintains economic confidence of various segments and extends credit to people.

Bank is most important financial intermediaries which accepts the deposits from public and mobilize them in the productive sectors. Banks are the principal source of credit to household, individuals and family business all forms and

local units of government. Financial intermediation is advanced to other forms of financing because it fulfills expectations of both savers and users it is the most popular form of moving excessive money from savers to users. Among all financial intermediaries commercial bank is the most leading one.

"A bank is an organization whose major function is concerned with the collection of the provisionally idle money of general public for the use of advancing to other of disbursement. Banks nowadays do a large number of financial transactions while 'financial institutions' are authorized to do limited transactions only"(Dahal & Dahal, 2002:7).

1.4Development of Banks

"The history of bank started from the merchants, goldsmith, and money lenders they are called ancestors of modern banking. Before 1848 Goldsmith used to store people's gold and other valuable goods and charge nominal charges against the deposit. That time people deposited their gold and valuable goods for the sake of securities rather than earning interest. The term bank emerged in USA in 1848 BC"(Paul, 1996:12).

The bank means institute, which deals with money. A bank performs several financial monetary and economic activities that are very essential for economic development of any country. Broadly speaking bank collects surplus money from the people who are not using it at present and hoarding for the future and supplies loan to who are in the position to use it for productive purpose, Basically banks perform various types of services i.e. collection of deposits from the public supply loans to those investors who want to invest in business industry and other sectors, overdraft, letter of credit, bills discounting, promissory notes, merchant banking, agency function of tasks guarantee against any disable of payment , remittance services etc.

Nowadays banking sector is involving in the planning and construction of land housing. The history of modern financial system is not too long. In Nepal it was begun in 1937 with the establishment of Nepal Bank Ltd. as a first commercial bank in Nepal. The bank was established to render services to the people for the economic progress of the country prior to the establishment of Nepal Rastra Bank; it plays the role of central bank also with the establishment of NRB 1956 under the Nepal Rastra Bank Act 1955. The new Nepal Rastra Bank Act was brought out in 2002 by replacing the previous Act of 1955. This new Act has provided operational autonomy and independence to the Bank. Then after Government of Nepal and NRB has established the Nepal Industrial Development Corporation (NIDC) Capital market in 1959. The second commercial bank the Rastriya Banijya Bank was established in the public sector in 1966, with the equity participation of Government of Nepal and Agriculture Development Bank Act, 1967 by incorporating the assets and liabilities of the Co-operative Bank (Sharma, 2002:3).

Numbers of financial institutions were setup till now. The legislation of commercial bank Act, 1974 set out regulation for licensing supervision and cancellation of license of commercial banks and encouraged the establishment of other commercial banks in Nepal. The move towards financial liberalization encouraged the entry of joint venture and private commercial banks. In the context of banking development, the 1980s saw a major structural change in financial sector policies, regulations and institutional developments. Government of Nepal emphasized the role of the private sector for the investment in the financial sector. The financial sector liberalization, started already in the early eighties with the liberalization of the interest rates, encompassed further deregulation of interest rates, relaxation of entry barriers for domestic and foreign banks, restructuring of public sector commercial banks and withdrawal of central bank control over their portfolio management. The Nepal Arab Bank (NABIL) limited is the first joint venture commercial bank of Nepal was established in 1984. The Nepal Indosuez Banks Ltd (now

Nepal investment Bank limited). and Nepal Grindlays Bank Ltd.(Now Standard Chartered Bank ltd) two other joint venture commercial banks, were established in 1986 and 1987 respectively.

With the passage of time, functions of banks have increased manifold. Since banks are rendering a wide range of services to the people of different walks of life, they have become an essential part of modern society. Life without a bank is it brick bank or click bank (internet banking), is beyond imagination.

1.5 Profile of Machhapuchchhre Bank

Machhapuchchhre Bank Limited registered in 1998 as the first regional commercial bank from the western region of Nepal started its banking operations from its own head office located in the foothills of Machhapuchchhre Mountain peak in the picturesque town of Pokhara since year 2000. The Bank facilitates its customer needs by delivering the best of services in combination with the latest state of the art technologies and prudent international practices. The Bank is the pioneer in introducing the latest technology in the banking industry in the country. It was the first bank to introduce centralized banking software, GLOBUS BANKING SYSTEM of Temenos NV, Switzerland. The bank provides modern banking facilities such as Any Branch Banking, Internet Banking, Mobile (SMS) Banking, Safe Deposit Locker facilities, Utility Bill payment (Telephone & Mobile), ATM (VISA Debit Cards and Debit card associated with SCT Network) to its valued customers. Besides these, the Bank is providing 365 Days banking and Evening Counter services to the customers through many of its offices. The Bank had been promoted by individuals and companies with local roots but from different walks of life with a vision and dedication to provide the best financial products and services in the most efficient and professional manner.

With the merger of its own kind, in fact the first biggest merger of two independent groups of the existing Machhapuchchhre Bank Ltd. and the then Standard Finance Company with a paid up capital of above one billion rupees promoted by amongst other prominent local businessmen, the highly renowned Non Resident Nepalese, has given a big impetus to the Bank. With this merger, now with a paid up capital of over 2.47 billion rupees, 52 branch offices one extension counter and 62 ATMs spread all across the country, it is one of the biggest 31 full- fledged national level commercial banks operating in Nepal. It takes pride in having its own buildings for its Corporate Office in Lazimpat, Head Office in Naya Bazar, Pokhara, and Branch offices in Jomsom, Baglung and Damauli.

Corporate Values

The Bank bases itself on a set of superior values and moral principles. It aims to succeed and reach higher grounds by maintaining and adhering to its corporate values.

The corporate values governing Machhapuchchhre Bank's development include:

- Maintain the highest standards in all relationships with customers, suppliers, environment and community.
- Foster a climate which encourages innovation and diligence amongst staff and reward accordingly.
- Function with the principle of "Thinking Forward Moving Forward".

Vision

To become the most trusted bank by providing dedicated service and support to customers through thick or thin.

Mission

To become every Nepali's banking partner by extending all types of banking services.

Goal

To contribute directly/indirectly in the economic growth of the country by being a prominent player associated with all classes and sectors of society.

Objectives

- Prudent expansion
- Innovation
- Dedicated customer service
- Competitive human resource
- Vigilance

1.6 Statement of the Problems

Profit planning is the vital tool, which directs the organization achieving profit. Profit is the very basic primary short term and long-term objective of every business organization. Even increasing ratio of profit is a good symbol of organization. By nature profit is a yards tick judging of managerial efficiency in term of a means of measurement for the success.

“Profit is the primary measure of success of the business enterprises.” (Goyal, 1992:37).

The profit-planning tool is a newly developed concept as a crucial way in the business organization. The concept of profit planning has not even familiarized in the most of the business concern. By proper profit planning a business can be managed more effectively and efficiently. Every financial Institutions as a commercial bank must make profit out of its operations for its survival and fulfillment of the responsibilities assigned major activities of a commercial bank comprises mobilization of resources, which involves cost and profitable deployment of those resources, which generates income. The different interest income over the interest cost, which is popularly called as interest margin, can be considered the contribution margin in the profit of the bank. The

bank attempts to compensate the other operational expenses by generating other income out of non-found based business activities of the bank. The present studies have to analyzed and examine the application of PPC tool in the commercial banks taking a case of Machhapuchchhre Bank. The following are the major problems that have been identified for the purpose of this study. To what extent, the comprehensive profit planning has been applying in commercial banks?

- Do the banks deploy the resources generalization satisfactory?
- Do the banks mobilize the deposit and other resources?
- Does the prof it plan affect the actual performance of Machhapuchchhre Bank limited?
- What are the problems of profit planning in commercial banks?

1.7 Objectives of the Study

The basic objective of this study is to appraise Machhapuchchhre bank Limited appropriately for the application of comprehensive PPC system. Thus the major objectives are:

- To highlight the current profit planning premises adopted and its effectiveness in Machhapuchchhre Bank Limited.
- To analyze the variance of budgeted and actual achievements.
- To study the growth of the business of the Bank over the period.
- To provide appropriate suggestions.

1.8 Limitations of the Study

In this dynamic world nothing existing is free from information. This study also is not an exception. The researcher has however tried to eliminate the limitation to the best possible extent, yet it suffers from the following limitations.

- The study is made for partial fulfillment of the requirements of master in business study, in short duration of time. Therefore, Machhapuchchhre Bank Limited have been taken for this study.

- Only the profit planning aspect of the Bank has been analyzed, leaving other area uncovered.
- The study covers the related data of the Banks from 2008/2009 to 2012/2013.
- The data are primary as well as secondary but mostly secondary data has been used.
- The accuracy of this study is based on the data available from the managements of Machhapuchchhre Bank Limited.

The various published documents of the Bank and the response made by the respondent during the informal discussion.

1.9 Significance of the Study

The researcher study is connected with the profit planning in commercial Banks with a case study of Machhapuchchhre Bank Limited with the major objectives of examining the proper applicability of profit planning system in the Bank Profit planning process significantly contributes to improve the profitability as well as the overall financial performance of an organization by the best utilization of resources. Accomplishment of objective in every organization depends on the application of scarce resources most effectively. Also the functional performance of an organization depends purely on the use of its resources. Budgeting is the key, to productive functional planning. So all the organization running under commercial principles has to give regards these most important single tools while managing their physical and financial targets. If the planning process of an organization is effective and result oriented, the place of development naturally steps forwards.

Profit planning is the heart of management. It tells us profit is the most important indicator for judging managerial efficiency and do not fast happened for this every organization has to manage its profits. Various functional budgets are the basic tools for proper planning of profit control over them. Other research study may be useful for those who want to know PPC in

Machhapuchchhre Bank Limited. It may also helpful for future researchers as a reference material.

1.10 Organization of the Study

The study divides into following chapters.

Chapter-I: Introduction

First chapter deals with the background of the study, statement of problem, objective of the study, significance of the study, research hypothesis, limitation of the study, and scheme of the study.

Chapter-II: Conceptual Framework and Review of Literature

Second chapter deals with available literature review. It's include conceptual framework, review of the published and unpublished books, journals, articles, previous unpublished masters' degree thesis etc.

Chapter-III: Research Methodology

Third chapter explains the research methodology used in the study, which includes research design, sources of data, population and samples, data analysis tools etc.

Chapter-IV: Data Presentation & Analysis

Fourth chapter is the heart of the study. This chapter includes presentation and analysis of data using different financial and statistical tools, as well as major findings of the study.

Chapter-V: Summary, Conclusions & Recommendations

Last chapter revolves with suggestion, which includes the summary of the Major Findings conclusions of the study and recommendations. Bibliography & appendixes have been included at the end of the study.

CHAPTER- II

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 Introduction

A literature review is an account of what has been published on a topic by accredited scholars and researchers. A review may be a self-contained unit an end in itself or a preface to and rationale for engaging in primary research. A review is a required part of grant and research proposal and often a chapter in thesis and dissertations. The purpose of writing the literature review is to convey the reader what knowledge and ideas have been established on a topic and what their strength and weaknesses are.

This chapter presents the conceptual framework about the commercial banks, its activities, banking practices, the legal and regulatory framework, and profit planning concepts and its applicability in commercial banking activities. This chapter is also concerned with the review of literature relevant to the financial statement of commercial banks, specially the contents of the Balance Sheet and the Profit & Loss Account. The chapter also provides insight into the findings of earlier studies through the review of books, publications and previous studies.

This chapter devotes to review various literatures in the form of books written by various authors, published newspapers and journals, browsing materials from the concerned web sites, NRB regulation, commercial act, and Machhapuchhre Bank Ltd. old annual reports in the related subject matters. The first part of the chapter deals with the conceptual framework of the study and the second part is concern with review of previous article, journals and dissertation.

2.2 Concept of Commercial Bank

Meaning of 'Bank' in oxford dictionary says 'an establishment for keeping money and valuable safely, the money being paid out on the customer's order by means of cheques.

"Commercial banks as a bank which exchanges money, accepts deposits, funding loans and performs other commercial activities and which is not specially established with the objectives of co-operative, agricultural, industrial or any other of such kind of specified purpose" (Commercial Bank Act, 2031).

The major functions of commercial banks are as follows:

- Accepting various types of deposits
- Lending money in various sectors
- Letter of Credit
- Bank Guarantee
- Remittance
- Bills
- Others

The commercial bank act provided for the modalities of establishing a commercial bank, as per which , a commercial bank can be established under the company act as a limited company only with the recommendations of NRB , the central bank of Nepal . By the various definitions we can bring to a close that a commercial bank is set up to collect spread funds and employ them to creative sector.

2.2.1 NRB Regulation

Bank and financial institution regulation act 2063 has been introduced to supervision and control to bank and financial institution. This act was published in Nepal gazette on 2063/7/19 B.S. The main objectives of the act are as follows:

- To protect and promote the depositors rights by increasing attitude of public towards the bank and financial institutions.
- To provide qualitative services by the means of healthy competition among the banks.
- To provide guides lines about establishment, operation, management, rules, regulations and legal provisions.

2.2.1.1 Prescribed Regulations for Commercial Banks

a) Capital Adequacy

The capital adequacy is one of the major criteria to operate the commercial banks. National required capital will be as specified in the licensing policy.

b) Loan loss Reserves

The commercial banks have to comply and maintain loan classification and provisioning as per the NRB regulations.

c) Reserve Requirements

Banks and agencies of banks are required to maintain some reserves like cash in vault; balances with Nepal Rastra Bank.

d) Reporting Requirements

Commercial Banks have to submit final annual report to Nepal Rastra Bank within 90 days after fiscal year end. Unless and until specified, other requirements are to submit reports as per NRB regulations. Quarterly financial reports should be published in national newspaper.

e) Systems and Policy Documents

Transparent systems, credit policy guidelines, borrowing guidelines, operational guidelines, risk management guidelines and other appropriate policies and guidelines need to be prepared, approved and implemented.

f) Technology and Technical Service

Modern technology and technical services should be applied by commercial banks as approved by NRB.

2.2.2 Evolution of Commercial Bank

The word 'Bank' is derived from the word 'Banco', 'Bancus', or 'Banque' all meaning to a bench. This refers that early bankers transacted their money lending activities on benches in the marketplace exhibiting the coins of different countries in different denominations for the purpose of changing and or lending money. Some writers are of the opinion that the word 'Bank' came from the German word 'Banc' meaning joint stock fund. (Varshney,1993:145).

Money lenders in the streets of major cities of Europe used benches for acceptance and payment of valuables and coins. When they were unable to meet their liabilities, the depositors used to break their benches. The term "bankruptcy" is derived thereof. Banking is as old as is the authentic history and origins of the modern commercial banking are traceable in ancient times. In ancient Greece around 2000 A.D. The famous temples of Ephesus, Delphi and Olympia were used as depositories for people's surplus fund and these temples were the centers for money lending transaction. The priest of these temples acted as financial agents until public confidence was destroyed by the spread of disbelief in the religion. Later, however, for a few centuries, banking as an organized system of money lending receded because of the religious belief that the charging of interest was immoral. However, the banking as we know today, made its first beginning around the middle of 12th century in Italy. The bank of Venice, founded in 1157 A.D. was the first public banking institution. Following this, in 14th century, the bank of Barcelona and bank of Genoa were established in 1401 A.D. (www.bankinginnepal.com).

The ancient Hindu scriptures refer to the money lending activities in the Vedic period in India. During the Ramayana and Mahabharata eras, banking had

become a full-fledged business activity and during the Smriti period, the business of banking was carried on by members of Vanish community. Manu, the great law giver of the time speaks of the earning of interest as the business of Vishyas. The bankers in the smriti period performed most of those functions which the banks in modern times performs such as the accepting of deposits, granting loans, acting as the treasurer, granting loans to the king in times of grave crises and banker to the state and issuing and managing currency of the country (Vanish, 1996:183).

In Nepal goldsmiths, merchants and money lenders were the ancient bankers of Nepal like other countries. Tejarathe Adda established during the Prime Minister Ranoddip Sing B.S 1933, was the first step towards the institutional development banking in Nepal. Tejarath Adda did not collect deposits from public but gave loans to employees and public. Banking in modern senses started with the beginning of Nepal Bank limited (NBL) on B.S 1994. NBL had Heroic accountability of attracting people toward banking sector from pre dominant money lenders net and of increasing banking services. Nepal Rastraya Bank (NRB) was established on B.S 2013.01.14 as a central bank under the NRB act 2012 B.S the government had responsibility of stretching banking services to the corner of the country and also managing financial system in the appropriate system. NRB has been working as the government's bank and has contributed to the growth of financial sector. The major confront before NRB today is to make sure the health of financial institution. Accordingly, NRB has been trying to change them and has introduced as host of prudential measures to safe guard the interest of the public. NRB is yet to do a lot to prove themselves and efficient supervisor. NRB really requires strengthening their policy making, supervision and examination device. Government set up Rastriya Banijya Bank (RBB) in BS 2022 as a fully government owned commercial bank. The first private financial institution, Nepal Bank Limited, was established in 1937 with the only other major commercial financial institution, Nepal Industrial Development Corporation,

established in 1957 initially as the Industrial Development Board, but converted in 1959 to its present form. It should be noted that technically the first legal financial institution in Nepal was the establishment of the Tejarath Adda in 1877, however it faced problems catering to the general needs of the population as it had the sole objective of providing credit only, with no deposits mobilized (NRB, 1996). The growth of financial sector in Nepal is much better compared to the other sectors in the country. The decade long conflict has had its toll on every sector including the financial sector. Despite the conflict and political insurgency, financial sector continued growing. Nepalese Financial sector is comprised of organized and unorganized sector. The Nepalese organized financial sector is composed of banking sector and non banking sector. Besides commercial banks, there are sizeable numbers of development banks, finance companies, micro-credit development banks, cooperative, NGOs and postal saving offices that undertake limited banking and financial services. Non-bank financial sector comprises Funds, Trusts and thrifts like, Employee Provident Fund, Citizen Investment Trusts, and Mutual fund. Nepalese banking system has now a wide geographic reach and institutional diversification. Although, Nepalese financial sector is dynamic, a lot of scope for development of this sector exists. This is because the banking and non-banking sectors have not been able to capture all the potentialities of business till this time. It is evident from the Rural Credit Survey Report that the majority of rural credit is supplied by the unorganized sector at a very high cost – perhaps being at two or three time of the formal sector - suggesting that the financial sector is still in the path of gradual development. Overdue loans and inefficiency of the older and the larger of commercial banks have aggravated and have been made to compete with the new trim banks with no rural operations. Also, the commercial banks, domestic or joint venture have shown little innovation and positive attitude in identifying new areas of saving and investment opportunities. Following Table: reflects the present development of commercial banking institutions in Nepal.

2.2.3 Activities of the Commercial Bank

Traditionally, the primary activities of a bank are essentially accepting deposits and making loans and advance. Commercial banks are found to be having been defined by their as per the commercial Banking act 2031, a 'bank' is a commercial bank established under this act and 'banking' transactions are activities of accepting deposit from the others for the purpose of lending or investing repayable on demand or after some stipulated time period by means of generally accepted procedure (Commercial Bank Act, 2031).

A banker is one who in the ordinary course of his business honours cheques drawn upon him by person from and whom he reserves money in his current account. The functions of receiving money from his customs and repaying it by honouring their cheques as and when required is the function, above all function, which distinguish a banking business from any other kind of business.

Similarly, no person or body corporate or otherwise can be a banker who doesn't;(Gulshan, 1994:107)

- Take deposit accounts
- Take current account
- Issue and pay cheques drawn on himself and
- Collect cheques for his customer
- Mobilization of Resources
- Deployment of Resources

From above points, it is clear that a commercial banks primary activities are twofold viz. one that of accepting deposit from public, which is the major source of the resources of the bank and another making loans and investments, which is basically creating income yielding asset of the bank for fulfillment of its commercial objectives.

The primary activity of a commercial bank has been categorized in two folds as below:

2.2.4 Mobilization of Resources

Resources of a commercial bank constitutes, as like in other business institutions.

A) Owner's Fund or Capital Fund

Owners fund of the bank is the capital, which includes paid up capital, reserves, retained earnings, share premium, non-redeemable preference share Apart from those maintained above other reserves and provision items allocated out of profit of the bank are also considered as the supplementary capital fund owners fund is the most dependable source of bank's liquidity.

As per central bank (NRB) guideline, a commercial bank must have paid up capital of Rs. 500 million in order to be established as a national level commercial bank. Further the NRB has also prescribed the capital adequacy norms (the ratio of capital fund to the risk asset as per varying weighted assets) to be of at least 12% by the fiscal year 2060/61.

Similarly, the commercial banking act 2031 has made a mandatory provision for every commercial bank to build the general reserve out of the allocation of at least 20% of net profit amount each year until the amount becomes double the paid up capital.

The Borrowed fund of a bank constitutes the resources apart from the owners' fund. In a bank it is mostly contributed by customer's deposit and some part by the short term fund borrowed from other banks and central bank.

B) Customer Deposits

Customer deposits are the chief source of commercial bank's resources. It is so much important for a bank for its liquidity supply that banks are often engaged

in keen competition for deposit mobilization become the capacity of a bank to grant credit to its borrowers depends upon its capacity to mobilize deposits. Deposits in the banks are accepted from their customers in various types of account opened in the banks by the depositors. The total deposit of a bank is composed of demand and time deposits. The demand deposits are most volatile and can be withdrawn at any time by their depositors subject to the general rules of banks governing these deposits. Generally, no interests are paid in to these accounts.

Demand deposits are usually accepted in current accounts. A current account is running and active account which may be operated upon any number of times during a working day. As per commercial banking act of Nepal current account is the bank account having money, which is subject to repayable where ever demanded. Those accounts are suitable for businessmen, joint stock companies institutions, public authorities etc.

The time deposits consisting fixed deposit and partly of saving deposit are called so because these can be withdrawn only after the expiry of the stipulated period for which these have been made. Banks offer interest on these accounts varying the duration of deposit maturities. Time deposits are kept generally by individuals, educational institutions, charitable trusts and others having surplus fund for future saving and earning some regular return on it.

The saving deposits are accepted on saving accounts which are defined by commercial banking act 2031, as the bank account having money which is deposited for the purpose of saving (Commercial Bank Act, 2031). Banks generally impose certain restrictions on withdrawal from such accounts.

Fixed deposit account is opened by the bank, in the one of the depositors keeping fixed deposits. Amount in such accounts are called time liabilities of

the bank because the money is payable on the expiry of a fixed period of time which the depositors choose as per his convenience.

The commercial banking act 2031 defines fixed deposit account as the "bank account which is having money in it for specific period of time."

C) Other Liabilities

Resources other than the capital fund and customer deposits are the other liabilities of the bank. It includes short-term borrowed fund from other banks locally or foreign and central Bank, such borrowings are called inter bank borrowing which are normally obtained for a very short period and those are meant for meeting temporary liquidity crunch in the bank. The rate of interest on such borrowing depends on the prevailing interbank interest rate. Other liabilities also include to payables in the account of the bank, which has been arisen during the regular operation of the bank.

2.2.5 Deployment of Resources

Deployment of resources of the bank means utilization of the banks fund in such a way that it ensures liquidity as well as gives some earnings for meeting its operating expenses and optimum return on the shareholder's investment. Thus it is setting up of the best possible assets portfolio which meets above requirement in the best way. In fact the efficiency of a banker is reflected by this activity.

Every bank strives to maximum its earning by employing its surplus cash by lending it to the prudent borrowers in a manner which in no way impairs its capacity to pay on demand the acquitted fund to their owners.

Thus for banker, deployment of the available resources is a challenging job, because the liquidity and profitability are the opposing consideration to each other.

"The secret of successful banking consists in allocating the resources between various forms of competing assets in such a way that a proper balance is struck between the opposing consideration of liquidity and profitability. The sound balance will be achieved when the bank has sufficient (and no more than sufficient) cash in hand to meet every claim that is or likely to be made by its depositors on it and at the same time it earns enough income to pave its way and earns profit for its shareholders "(Vanish, 1996: 119).

Therefore, the deployment of resources or assets portfolio building of a bank should be guided by major two considerations viz. the liquidity and the profitability.

A) Assets Portfolio for Liquidity

Liquidity in a bank means its capacity to convert its deposit liabilities into cash. A major portion of a bank's resources constitute customer deposits which are subject to repayment on demand or after some time as the case may be, a banker cannot be offered to neglect his cash position so as to be always capable to meet withdrawal of the deposit. Therefore, a bank keeps an adequate amount of liquid assets in the form of cash in its vault and balance at its account in the central bank (NRB). As said earlier, maintenance of excess liquid assets that is required is detrimental to the profitability objective of the bank as the idle cash gives no return rather it involves the cost of carrying (insurance cost, guarantee cost etc.).

The central bank fixes the mandatory cash reserve ratio (CRR) from time to time. The current CRR fixed by NRB for commercial banks is as follows:

- Balance to be maintained at NRB Account. At least 7% of current and saving deposits amount and 4.5% of fixed deposit amount.
- Balance to be kept in Bank's vault. At least 3% of total deposit liability (NRB circular 2001/2002). (Nepal Rastra Bank, 2001).

B) Investments

Banking includes the fund invested for buying government and other stock exchange security treasury bills fund placement at call account with other bank etc. such investment can easily be liquidated if required this has a feature of liquid assets as well as giving some yield out of it also. Therefore, it is in second line in terms of liquidity from cash and balance at NRB.

C) Loans, Overdrafts and Discounts (LDO)

"Banking business essentially involves lending in fact the deposits are accepted for lending or investment. This is the most profitable activity of a commercial bank. Banks being a business proposition it must declare handsome dividends to its shareholders unless the profit outlook of a bank is bright, new funds will be difficult to obtain "(Vanish, 1996: 201).

Commercial banks generally tend for short-term commercial purpose to finance the need of trade and commerce. As the fund available for lending with the banks is mostly the fund mobilized from the depositors, a commercial, bank should carefully consider the safety margin before granting the loan. The banker should be extra careful in selection the borrowers. Generally banks lending is guided by their lending policies. General, principal of a sound lending policy of a bank are as follows (Gulshan, 1994: 179).

- **Safety:** Bank's lending should be secured by way of tangible securities or personal security (guarantee) of the borrower.
- **Liquidity:** As the bulk of fund in the bank are short term fund received As deposits it is prudent to confine into short term advances which can be repaid quickly.
- **Profitability:** The major income of a bank comes from the difference in interest earned from the borrower and interest paid to the depositors, which is termed as 'spread' the interest rate of lending depends upon the purpose of advance and the risk involved Greater the risk involved higher will be the rate of interest charged.

- **Risk Diversification:** The famous saying "don't put all eggs in one basket" is the fundamental base of the principle or risk diversification. As there is risk in every advance, bank should spread the risk by lending to larger number of borrowers.

Generally, banks make their advanced in the forms of loans, overdrafts, cash credits and bills discounting. In a loan discount the entire amount is disbursed to the borrower, which is repayable in instalment or in lump sum and expiry of loans. Interest is charged on the entire loan disbursed to the borrower. The types of loan may be pledge loan, demand loan. Hire purchase, import finance (transit loans), export Finance (packing credit), loan against shares etc.

Overdrafts are granted in current account of a customer. It is the permission given to overdraw from an account up to a certain limit allowed to the person on revolving basis. Interest is charged on daily outstanding overdrawn amount only. Normally such facility is given against the security of collectors, fixed deposit, government securities, shares, life insurance policies etc.

Cash credits are similar to overdraft in terms but it is provided to the borrower as working capital finance, normally to traders, industrialist, farmers etc. In cash credit facility unlike in loans, the borrower shall enjoy the flexibility of drawing the amount up to the sanctioned limit anytime they require fund during the validity of limit. As the interest is charged only to the actually utilized amount on daily basis, the borrower can repay instantly up on receipt of proceed in order to minimize their interest liability. Generally such facilities are availed against security of pledge or hypo the caption of stocks of trade commodities along with collaterals.

Discounting of bills by a bank actually is buying the bills of borrower, which are self-liquidating nature by means of endorsement on the documents. The title on the payment up on liquidity is transferred in favour of the bank that

discounts it. Bills may be clean or documentary. If it is a clean negotiable cheque, draft, bill of exchange payable at sight for after certain tenor, then it is called clean bill and if the instrument is accompanied with other trade documents (commercial invoices, transport documents etc.). It becomes the documentary bill. Bills discounting is short-term credit availed by the bank in which bank gives the value of the bill (called negotiation) deduction some amount (usually the interest unit the period of its possible realization) from the face value.

Concept of Spread

Deposit mobilization activity of banks is a costly affair. The bank has to incur expenses toward payment of interest on the interest bearing deposits accepted by the bank. Such expenses are called Interest Expenses. For a better Profitability a business concern should be careful in minimizing its cost. In case of a Bank also, as the interest expenses form a bulking total cost of the bank a successful banker says adequate attention toward lowering its interest cost by marketing low cost deposits and building optimum portion of interest free deposits in his deposit mix.

Deployment of resources in income generating assets (loans & investments) is the income yielding activities of the banks. Higher the proportion of loan and advances in the asset portfolio, higher will be the yield on fund. As the interest income is the major contributor income of a bank, the banker should be careful in realization of interest and enhance the profitability. The difference of interest earned from lending and interest expenses incurred in deposit is called the spread. In other words, spread is the net income of the bank from which banks have to meet their other operational costs and give out the dividends to the shareholders. Therefore, Banker attempt to maintain higher spread by minimizing the average cost of deposit and maximizing the average yield on funds. But as per the current regulatory provision of NRB, the interest spread of a Bank can be maximised by 5% only (BOD, NRB, 2002).

Loan Loss Provision

The central bank (NRB) has made a mandatory provision for the entire bank to classify their outstanding LABP the basis of aging into four grades viz. Pass loan, substandard, doubtful, and loss (BOD NRB 2002). The loans falling under the respective grades are identified on the basis of the overdue position from the date of maturity of the loan and the amount shall have to be allocated from net income in order to provided for against the loan loss at various rates (From 1% to 100% of loan amount depending on the grade in which a particular loan Accent falls). Such allocated amount is called loan loss provision amount and is treated as the expense items Therefore, in order to improve the profitability the bankers should be move attentive toward timely realization of dues so that the amount of loan provision may be maintained at the least possible extent.

Other Income Generating Activities of the Bank

Banks do some other kind of business, besides deployment of funds, which are popularly, bank guarantees transactions. Issuing letter of credit, cheques drafts collection, remittances, etc. In such activities banks do not have to involve their fund and may they are charging some fee as commission for such services provided. These transactions are called non-funded transaction. While issuing a Bank guarantee the banker is issuing a guarantee letter on behalf of his client guaranteeing the performance of the client and assuring the employer of paying him the amount of guarantee in case the client fail to perform. Bank guarantee liabilities are the contingent liabilities of bank, which shall become actual liability only when the client fails to perform as per the contract with the employer.

Letter of credit (LIC) is the instrument widely used in export import transactions. Banks issue L/C assuring the seller for making payment of the good (up to the value and currency of the L/C), provided the terms and conditions maintained in the LIC are fully complied with. By means of this

facility provided by the bank the international trade has been made possible in the country. UCPDC (Uniform custom and practices of Documentary Credit) published by ICC (International Chambers of Commerce) is the literature, which provides the uniformity in the L/C transactions worldwide. Besides this, the L/C transactions of commercial banks are largely guided by the directives issued by Nepal Rastra Bank, Foreign Exchange Department. Letter of Credit issuance is also a contingent liability for a bank. Banks earn income in the form of Commission while issuing L/C. Further, in case of foreign currency L/C, if the client does not have his own source of foreign currency for making payment under L/C, he has to buy the same from commercial banks, on which banks may earn profit on sale of FCY. Generally the banks have to maintain sufficient balance convertible FCY in order to meet their L/C payment in the currency stipulated. When the exchange rate is on upward trend, banks gain by revaluation on their FCY reserves.

Concept of Burden

During the establishment and operation of a bank, it has to incur various kinds of expenses. Besides the expenses are employees expense, administrative expenses, depreciation on fixed assets, other operating expenses, expenses for loan loss provision, interest suspense expenses, employees bonus expands, expenses for income tax provision etc. all such expenses other than interest expenses cumulatively form a burden to profitability. The speed earned by the bank must be at least enough to meet the burden in order to break even. However the other income (income other than interest income) earned by the bank from their other activities besides fund lending contributes to lowering the burden there by increasing the profitability of the bank. Therefore the net burden (other expense less other income) has been termed as burden.

2.3 Profit Planning as a Concept

Profit planning and control is also called comprehensive budgeting, managerial budgeting and budgeting only. The word profit planning and control has

recently introduced in the business literature. Most of profit oriented business concerns use profit planning and control as a managerial tools.

"A profit planning & control program can be one of the more effective communication networks in an enterprise. Communication for effective planning and control requires that both the executive and the subordinate have the same understanding of responsibilities ensure a degree of understanding not otherwise understanding of responsibilities and ensure a degree of understanding not otherwise possible. Full and open reporting in performing reports that, focus on assigned responsibilities likewise enhance the degree of communication essential to sound management" (Welsch, et al., 2001: 215).

"Profit planning is an example of short range planning. This planning focuses on improving the profit especially from a particular product over a relatively short period of time. Therefore as used here it is not the same as corporate planning of a cost rendition program"(Terry, 1968:245).

"Profit planning is a predetermined detailed plan of action developed and distributed as guide to current operations and as a partial basis for the subsequent evaluation of performance. Thus is can say that profit planning is a tool which may be used by the management in planning the future course of actions and controlling the actual performance"(Gupta, 1992:3).

"Profit planning is a comprehensive and co-ordinate plan expressed in financial terms for the operations and resource of an enterprise for some specific period in the future" (Fregmen, 1973:12).

"Comprehensive profit planning and control is a systematic and formalized approach for accomplishing the planning, co-ordination and control responsibilities of management (Welsch, et al., 2001:45).

Profit plan as an exact and rigorous analysis of the past and the probable and desired future experience with a view to substituting considered intention for opportunism in management the establishment of a system of periodic performance reports detailed by assigned responsibility and follow up procedures (International Management Institution Geneva Conference 1980). The role of profit planning and control is very important in profit oriented enterprises. Roles of PPC are as follows:

- To provide definite goals and objectives that serve as benchmarks for evaluation performance of business.
- To provide information to management timely.
- To point out efficiency and inefficiency.
- To reduce cost and make profit more.
- It provides a valuable means of controlling income and expenditure of a business, as it is a 'plan for spending'.
- It reflects weakness in the organization very promptly.
- To fix responsibility center for manager.
- It provides a tool through which managerial policies and goals are periodically evaluated tested and established as guidelines for the entire organization.

"Profit plan is estimation and predetermination of revenues and expenses that estimated how much income will be generated and how it should be spent in order to meet investment and profit requirements. In the case of institutional operation it presents a plan for spending income in a manner that does not result in a loss" (Ninemeier & Schmdgell, 1984:125).

Profit plan stand for an overall plan of accomplishment, covers exact period of time and prepares the planning decision of the management. It can be viewed as one of the major important approaches that have been developed to make easy successful presentation of the organization procedure. Now a day's profit planning system is mainly common to business organization but the viability of it depends upon the size of the business. The common objectives of profit planning system whether applied to business administration are to make policy as well as with the execution of policy. And a purpose established after the deliberation of the feasible courses of events in the future. In conclusion profit planning is directed towards the final objectives of the enterprises and generally includes all of its important elements. It has main objectives of achieving the most favourable profit in the enterprises.

2.4 Mechanism of Profit Planning

2.4.1 Profit as a Concept

Profit is the basic elements of profit plan so that concept of profit planning may not be complete and meaningful in absence of the clear-cut well-defined idea of profit. According to Oxford dictionary profit means:

- Financial gains
- Amount of money gained in business especially the difference between the amount earned and the amount spent.
- Advantage or benefits gained from something.

According to some theories, profit are the factor payment for taking the risk for agreeing to take what is left over after contractual out lays have been made.

In the second type of profit theory are viewed as a wage for the service of innovation. Profits in this theory are field to dynamic development.

Profits around which all enterprises activities directly or indirectly revolve play the significant role for judging the managerial efficiency. In absence of profit nobody can think about the long term survivability of the enterprises.

2.4.2 Long Term and Short Term Profit Planning

Strategic profit plan and tactical sales plan is known as long term short term profit planning. Strategic sales plan is prepared for 5 to 10 years. It is wide and universal in nature and developed by year and amount.

"The strategic profit plan is broad and it usually encompasses five or more years in the future. The tactical profit plan is detailed and encompasses one year time horizon the upcoming year. The development of strategic and tactical profit plans each year is a process that involves managerial decisions and ideally a high level of management participation "(Welsch, et al., 2006:173).

While preparing the strategic profit plan state of economy, political stability, population study etc are kept in considerations. Likewise, tactical profit plan is prepared for short period of time. By the time it is prepare for a month, quarter, half year and a year.

2.4.3 Concept of Planning and Control

Planning is the basic foundation of PPC. We should be clear in the concept of planning. According to Oxford Dictionary Planning means-

- (To do something) arrangement for doing or using something considered working in advance.
- Way of arrangement something especially when on a drawing scheme
- Go according to plan.

Planning is a method of a course of action to achieve a desired result. And it is a method of thinking out acts and purpose beforehand. Planning starts from forecasting and determination of future events. It is first functions of margent and all other function are performed with the framework of planning.

"Planning is the process of developing enterprises objectives and selecting a future course of action to accomplish them. It includes developing premises about the environment in which they are to be accomplished" (Welsch, 1999:132).

A plan is then a projected course of action. All planning involves anticipation of the future course of events and therefore bears element of uncertainty in respect to its success.

Management planning and control begins with the establishment of the fundamental objectives of the organization and continues as the process by which necessary resources are provided and employed efficiently towards the achievement of goals. Planning is essential to accomplished goals. It reduces uncertainty and provides direction to the employees by deterring the course of action in advance.

"Planning is the feed forward process to reduce uncertainty about the future. The planning process is based and conviction that management's can plan its activities and condition the state of the enterprises that determine its destiny" (Pandey, 1991:25).

Planning is a mental process requiring the use of intellectual facilities, imagination foresight sound, judgement etc. whether the manager is of top level, medium level or lower level, he cannot be separated from the planning task i.e. their commonality is planning but planning differs as the level.

"In planning the manager fixes the objectives of the organization as a whole and in the light of thus, the goals of the various department of the organization. Then he proceeds to prepare a kind of blue print mapping out ways of attaining

these objectives naturally then all other functions of the manager depend up on planning" (Bhusan, 1976).

- Planning is an intellectual process.
- Planning is a goal oriented task.
- Planning is a primary function of management.
- Planning pervades all managerial activities.
- Planning is directed towards efficiency.

2.4.3.1 Long Range and Short Range Planning

Long Range Planning is closely concerns with the concept of the organization as a long live institution. It is most important for aboard and long living enterprises. Long range planning varying five to ten years with the enterprises is sometimes extended to ten years. Strategic planning is one of the most difficult times span involved in planning as many problems in short range planning can be traced to the absence of a clear sense of direction and the practices which a comprehensive long range plan provides. The short term planning is limited time dimensions usually it covers one year's time period. Short-term planning is used by management as a substantial part of the long-range plan.

2.4.3.2 Corporate Planning

Corporate planning means the systematic process of setting corporate objectives and making strategic decisions and developing the plans necessary to achieve these objectives.

Corporate planning is one of the parts of profit plan. It was first started in the USA in 1950 and it is however being used in one form in another in many companies there.

- Before drawing up a plan which is designed to does something decide what you want it to do.

- In these days of rapid change it is necessary to look ahead as far as possible to anticipate these changes.
- Instead of treating a company as a collection of department, treat it as a corporate whole.
- Take full account of the company's environment before doing up any
- Plan

Long Term Planning is included in corporate planning. Corporate planning often is considered synonymous with long term planning. The main objectives of corporate planning are as follows:

- Achieving objectives
- Embodiment of goals and objectives in the enterprises.
- Formulating realistic and attainable objectives.
- Clarity and adequacy of goals and objectives.
- Communication of goals and objectives.

2.4.4 Forecasting

The forecasting is to take future decision at present form, by the analysis of relevant faucets of past and present. Forecasting is not only imagination or guess matter it is related with certain assumption. Its main aim is to reduce uncertainty and risk in future and attain conformity to achieve desired goals or objectives as far as possible.

"It should be realized that budgeting is not merely forecasting although, forecasting is the form of budgeting. Forecasting is estimate of the future environment with in which the company will operate. Budgeting or planning on the other hand involves the determination of what should be done, how the goals may be reached and what individual units are to be assumed responsible and be held accountable. Budget provides orderly way to attain goals and also

provides a time schedule for future action to produce measure result" (Pandey, 1991:35).

When an estimate of future conditions is made on the systematic basis the process is referred to as forecasting. Its aim is to reduce the areas of uncertainty that management decision making with respect to cost and capital investment.

2.4.5 Forecasting V/S Planning

Planning and Forecasting often are confusing of being the same but they are not same although related.

The nature that planning and forecasting have different functions deserves special mentions here. Forecasting is generally used to predict what will happen to given set of circumstances assumptions. Planning to other hand, involves the use of forecast, to help to make good decisions about most attractive alter natives for the organization. Thus a forecast seeks to describe what will happen where as a plan is based on the nation that by taking certain person how the decision maker can affect subsequent events in a given situation and thus influence the final results, in the direction. Generally speaking forecasting and forecasts are inputs to the planning process.

2.4.6 Control

After being clear about the concept of profit and planning we move towards the third component of profit planning and control i.e. control the dictionary meaning of control is-

- Have a power or authority over same body or same thing
- Regulate something
- Management, guidance, restriction
- Standard of comparison for checking the results of the experiment (Hornby, 1992:151).

Controlling can be defined as a process of measuring and evaluating actual performance of each organizational component of an enterprises and initializing corrective action when necessary to ensure efficient accomplishment of enterprises objectives goals, policies and standards. Planning establishes the objectives, goals, policies and standards of an enterprise. Control is exercised by using personal evaluation periodic performance reports and special reports.

"Control is an ambiguous word; it means the ability direct oneself and one's work. It can also mean domination of one person by another (management). Objectives are the basis of control in the first sense, but they must never become the basis of control as in the second for this would defeat their purpose, indeed one of the major contributions of management by substitute management. By objective is that it enables us to substitute management by self control for management by domination" (Drucker, 1954: 244).

An important aspect of control that is frequently overlooked is its relationship to the point of action or at the time or commitment. Effective control requires feed forward. In other words it is assumed that objectives plans polices and standard have been develop and communicated to those manager who have the related performance responsibilities.

Therefore, control must necessarily rest upon the concept of feedback, which requires performances measurement and triggers corrective action designed to ensure attainment of the objective. When plans become operational control must be exercised to measure progress. In some cases control also results in the revisions of prior plans and goals or in the formulation new plans changes in operations and reassignment of people. Control approach must be tailored to the characteristics of the operation and the organizational structure.

A control process designed to help monitor the periodic activities of business and of each responsibility center has the following phases.

- Compare actual performance for the period with the planned goals and objectives.
- Prepare a performance report that shows actual results, planned results and any differences between the two(i.e. variations above or below planned results)
- Analyze the variations and the related operations to determine the underlying causes of the variations.
- Develop alternative courses of action to correct any deficiencies and learn from the successes.
- Make a choice (corrective action) from the set of alternatives and implement it.
- Follow up to appraise the effectiveness of the correction. Follow with feed forward for re-planning.

The Comparison of actual result with planned goals and standard Constitutes measurement of the effectiveness of control during a specified past period. This provides the basis for effective feedback the facts shown in a performance report cannot be changed, however the historical measurement may lead to improve control in the future. The significant concept here is that objective policies and standards fulfill two basic requirements in the overall control process namely.

- Feed forward to provide a basis for control at the point of action.
- Feedback-to provide a basis for measurement of the effectiveness of control after the action was taken place more over feedback is instrumental in re-planning.

2.5 Development of Budgeting

2.5.1 Budgeting

Profit plans are developed with the help of functional budgets. A budget is comprehensive and coordinate plan expressed in financial terms for the operations and resources of an organization for some specific period in the future. So, the budget is the plan of the firm's expectation in the future. A broader definition recommended by the institute of cost and works accounts is as a financial or quantitative statement prepared prior to a definite period of time of the policy to be persuaded during that time for the purpose of attaining a given objectives.

A budget is a quantitative expression of a plan of action and an aid to coordination and implementation. Budget may be formulated for the organization as a whole or may submit. Budgeting includes sales, production, distribution and financial aspects of an organization. Budget programs are designed to carry out a variety of function, planning evaluating, performance, coordinating activities, implementations plans, communicating, motivate and authority actions (Horngren, 1976:720).

"Budget as a tool of planning and control in clearly related to the broader system of planning and control in an organization. Planning involves the specification of basis objectives that will guide it, in operation terms. It involves the step of setting objectives, specifying goals, formulating strategies and expressing budgets. A budget is a comprehensive and coordinated plan expressed in financial terms, for the operations and resources of an enterprise for some specified period in future" (Khan and Jain, 1993: 296).

The concept of comprehensive budget covers its use in planning, organizing and controlling all the financial and operating activities of the firm in the forthcoming period. Budgeting summarize the estimated results of the future

transaction for the entire company in much the same manner as the accounting process records and summarize the results of completed transactions.

The process of preparing budget is known as budgeting. This is the process of planning future business actions and expressing those plans in a formal manner is called budgeting. It serves to coordinate the organization's many activities.

Budgeting, if followed properly, can increase the chances of making profits within the given environment. A systematic budget should encompass the procedures of evaluation the business environment, setting objectives, setting specific goals, identify potential strategies, communicating the planning guidelines, developing the long term and short term plans, implementation of budgets, and periodic performance reporting and follow-up. The main objective of a business firm is to make excess of revenue over expenses so as to maximize profits.

Budgeting should be regarded, not as a master, but as a servant. It is one of the best tools yet devised for advancing the affairs of a company and the individuals in their various spheres of managerial activity. It is not assumed that any budget is perfect. The most important consideration is to make sure, by intelligent use of budget, that all attainable benefits are derived from the plans as rendered.

2.5.2 Objective of Budgeting

The main objective of budgeting is to ensure the planned profit of the enterprise. So, it is considered as a tax of planning and controlling the profit. One of the primary objectives of an annual budgets is to measure the profit expectation for the next financial year with due regard to all the circumstance favourable and unfavourable that can influence the trading prospect (Reginald, and Geage, 1982:17).

The main objective of budgeting may summarized as follows:

- It is a plan, which reflects the policy of a business in financial terms.

- It is a plan of action serves as a declaration of policies.
- It is a control document by which management can monitor actual performance.
- It is the plan to forecast for future to avoid loss and to maximize profit, i.e. to help in planning.
- It is a plan to state the firm's expectation (goals) in clear, formal terms to avoid confusion and to facilitate their attainability.
- It defined the objectives for all the executives' communications.
- It is a plan to bring about coordination between different functions of an enterprise, i.e. to help in coordination.
- It is a plan to communicate expectations to all concerned with the management of the firm so that they are understood, supported and implemented.
- It acts as a motivator of employees.
- It provides a means of coordination and communication.
- It is a measure against which to evaluate the quality of management.
- Budget facilities centralize control with delegated authority and responsibility.

2.5.3 Characteristics of Good Budgeting

The characteristics of good budgeting are as follows:

- Budgets may be formulated for the organization as a whole or for any sub-unit.
- A good system of accounting is also essential to make the budgeting useful.
- A budget is a quantitative expression of the plan of action and aid to coordination and implementation.
- A good budgeting system should involve persons at different levels while preparing the budget. The subordinate should not feel only imposition on term.

- Budgets are designed to carry out a variety of functions, planning, evaluating activities, implementation plans, communicating, motivating and authorizing actions.

2.5.4 Classification of Budgets

Budgets may be classified from various viewpoints depending upon various bases adopted for such classification. The following bases of classification are generally in use.

- On the basis of time
- On the basis of function
- On the basis of flexibility
- On the basis of nature of business activity

1. On the basis of time

On the basis of time, there are three types of budgets:

- **Long Term Budget:** These budgets normally cover a prospective of five to ten years.
- **Short Term Budget:** These budgets are usually for a period of one year to two. These are prepared for production and purchase of materials.
- **Current Budget:** Those budgets are usually for one to twelve months and are the short terms budgets adjusted to current conditions or prevailing circumstance.

2. On the basis of Function

According to the functions, budget may be classified for each function in a business concern. The various forecasts for individual functions are coordinated then consolidated to show the total effect of all the functions. Budgets correspond and are co-terminus, with the particular functions and integrated with the master budget of the business. These budgets whose number depends on the size and nature of the business are called functional budget.

Normally, following types of functional budgets are prepared:

- **Sales Budget:** It is primary budget of PPC. This is a forecast of total sales classified according to group of products, salesman and geographical locations.
- **Production Budget:** Production budget is transformation process of sales budget. It is forecast based on sales productive capacity requirements of investors, etc.
- **Production Cost Budget:** Production cost budget is related to cost of production including direct material cost, direct labour cost and expenses fixed, variable and semi variable.
- **Purchase Budget:** After having prepared the budget, the material usage and the purchase can be easily constructed. Purchase would include both direct and indirect materials and goods. Non-manufacturing company have to prepare purchase budget according to sales unit.
- **Personnel Budget:** It can be prepared from data given in the production/sales budget. This has reference to the utilization of men or labour employed in productive activity. It would be split up between direct and indirect labour.
- **Selling and Distribution Cost Budget:** It is concerned with an estimate of the cost of selling and distributions of goods.
- **Research Budget:** Research budget is related to improvement in the quality of the products or research for new products, of the purpose of satisfying the customers.
- **Plant Utilization Budget:** Plant utilization budget covers the plant and machinery requirements to meet the budgeted production during the budget period. Schedule will be produced showing the available load in each department expressed in standard hours or unit.
- **Cash Budget:** Cash budget is the planning of cash flows and cash requirement for the budgeted period.

- **Office and Administration Budget:** This budget represent cost of all administrative expenses such as managing director's salary, staff salary and expenses of office management like lighting and heating.
- **Capital Budget:** Capital budget is forecast of outlay on fixed assets as also sources of capital budget may differ from that of other budgets, as such expenditure in frequently planned a number of year in advance.
- **Master Budget:** Master budget is the systematically express of financial plan of the firm. It is the budget of all budget or summary budget of all budgets. It includes estimated profit and loss account for the future period and estimated balance sheet as the end of budget period.

3. On the basis of Flexibility

Flexibility refers to change the budget allocating amount according to the volume of activity. So, there are two types of budget from this point of views:

- **Static Budget:** It shows only one activity level at one. They don't be changed according to the volume of activity. Such budgets are usually prepared from one to three months in advance of the fiscal year to which they are applicable.
- **Flexible Budget:** It shows the series of activity level. The main objectives of flexible budget are to select least lost combination for the firm. In case of such budgets, revenue and cost targets are set in respect of different level of activity even from zero to hundred percent of production volume.

4. On the basis of nature of Business Activity

Budget may also be classified on the basis of nature of business activity. These are as follows:

- **Capital Expenditure Budget:** Capital expenditure budget is needed to compute or plan the cost of capital and appraise the project. Such

budgets assume more significance in the case of large and progressive manufacturing concerns.

- **Operating and Revenue Budget:** Operating and revenue budget deals with the plans for routine activities. These budgets are based on forecast like sales, reproduction costs, revenue etc.

2.5.5 Budgetary Control

Budgetary control is a system of controlling cost, which includes the preparation of budgets coordinating the departments and establishing responsibilities, comparing actual performance with the budgeted and outline upon results to achieve maximum profitability.

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

2.5.6 Problems and Limitations of Budgeting

Budgeting is not fast proof; it can suffer from certain problems and limitation.

The major problems of budgeting system are as follows:

- Developing meaning forecast and plant especially the sales plan.
- Seeking the support and involvement of all levels of management.
- Establishing realistic objectives, policies, procedures and standards of desired performance.
- Maintaining effective follow up procedures and adapting the budgeting system wherever the circumstances changes.

- Applying the budgeting system in a flexible manner.
- Educating all individuals to be involved in the budgeting process and joining their full participation.

The following are the limitation of budgeting system:

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

2.6 Basic Concept of Profit Planning

The concept of budgeting was originally established with function of an accountant. But in the modern day budgeting is given much more importance and is regarded as a way of management and in more important sense is regarded as basic technique of decision making and is given the name 'profit

planning and control program'. The basic concepts of PPC include the various activities that should be followed to attain maximum usefulness form profit planning and control. These activities are mentioned below.

a. Managerial Involvement and Commitment

Managerial involvement entails managerial support, confidence, participation and performance orientation. Top level of management should understand the nature and characteristics of PPC, Be convinced that particular approach to manage is preferable for their situation support the program in all its planning process as performance commitments.

b. Responsibility Accounting

A sound profit planning and control system must consist of responsibility accounting. Within the primary accounting structure secondary classification of costs, revenues, and other financial data that are relevant may be utilized in accordance with the needs of the enterprise.

c. Organizational Adaptation

A successful PPC program must test on sound organizational structure, for the enterprises and clear cut designation of lines of authorities and responsibilities of all the department of enterprises. The purpose of organizational structure and the assignment of authority is to establish a framework within which enterprise objectives may be attained in a coordinate and effective way on a continuing basis. The manager of each subunit would be assigned specific authority and responsibility for the operational activities of that subunit. These subunits are often referred to as decision centers or responsibility control responsibility is further classified by cost center, profit center, investment center.

d. Full Communication

Communication is transferring information from one to another. Communication can be defined as interchange of thought or information to

bring about a mutual understanding between two or more parties. For profit planning and control, effective communication means development of well defined objective, specification of goals, development of profit plan and reporting and follows up activities related to performance evaluation for each responsibility center.

e. Flexible Application

"This stress that a PPC program must not dominate the business and the flexibility in applying the plan must be forthright management policy. So that strait Jackets are not imposed and all favourable opportunities are seized even though they are not covered by the budget rigidity in practicability will be the harmful boundary in an association in an occasion of r the enterprise. So, such boundary should be avoided which mean there should be flexibility in PPC so that the unseen golden opportunity should be grasped in future for the betterment of the organization (Geot, et al., 2063: 1.5).

f. Realistic Expectation

Profit Planning and Control must be based on realistic approach or estimation. Management must be realistic assumption and must not take either irrational optimism or unnecessary conservation so for PPC purpose a realistic approach reared with time dimension and external and internal environment that will prevail during the time span should be considered. This is called realistic expectation.

g. Timeless

Time is going on it can't be stop whether an individual or organization busy or idle. The problem of the manager in one hand is to accomplish the planned activities in a given time and on the other hand is to prepare the plan itself. Phasing of the planning is of two types one is timing planning horizons and another is timing of planning activities.

h. Individual and Group Recognition

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

i. Zero-Based Budgeting

The budgeting which is always starting from Zero is called zero base budgeting. "Begin with where you are an establish a business as usual budget for next year the same way and the same things your would do if you weren't concerned about constraint a total justification" (Welsch, et al., 2006:43).

j. Follow Up

The important of follow up action on profit planning and control approach is more. A careful study s needed to correct the action of substandard performance in a constructive manner, to recognize and transfer the knowledge of outstanding performance to others and based on the study and evaluation to provide a sound basis for future profit planning and control program.

2.7 Merits and Demerits of Profit Planning and Control

Profit planning and control has both merits and demerits even though merits are dominant one. Merits of profit planning and control listed below.

- Profit planning and control brings organizational policy in to action.
- Organizational structure will be sound and effective by the means of PPC.
- Historical statistical and accounting data is used by PPC.
- It compels management to plan for the most economical use of labor material a capital.

- Efficiency and inefficiency can be measured by PPC.
- Management attention can be drawn by PPC for the general business condition.
- It reduced cost by increasing the span of control because fewer supervisors are needed.
- PPC creates understanding between management and their co-workers.
- PPC reduce the uncertainty and gives guidelines to achieve organizational goal.
- It provides to all level of management the habit of timely, careful, and adequate consideration of the relevant factors before receiving important decisions.

Profit planning and control model can't be assumed that it is free from problem.

Some of its demerits listed below.

- Preparing profit plan is a difficult task.
- Some of traditional types manager don't like to prepare profit plan.
- It is not realistic to whiteout and distributes goals, policies and guidelines to all the supervisors.
- It takes away management flexibility.
- It creates all kinds of behavioral problems
- It adds a level of complexity that is not needed.
- The manager's supervisors and other employees do not like the budget.

2.8 Profit Planning and Control Process

Profit planning and control has its own process from preparing plans to implementation and feedback.

"A PPC Program includes more than the traditional idea of a periodic or master budget Rather it encompasses the application of a number of related

management concept through a variety of approaches techniques and sequential steps " (Welsch, et al., 2006:71).

The process of PPC is listed below:

- Identification and Evaluation of External Variables: Organization is always affected by two variables i.e. internal and external. Management always is curious about the variables which are directly and indirectly impact to the enterprises. Variables, which have a direct and significant impact on the enterprises, re called relevant variable. Variables may have their different relevancy according to the market nature.
- Design of Goals and Objectives of the Enterprises: A major responsibility of management is to design the objectives & goals of the enterprise. Executive management can specify or re-state this phase of the PPC process based on realistic evaluation of the relevant variables. The management defines the purpose of the enterprise; clarify the character, environmental analysis, others decisions are taken in favor of the company.
- Strategy formulation and Implementation: Strategy should be set out for the betterment of the enterprises. Timely implementation and evaluation is major consideration of such strategy to achieve planed goals and objectives.
- Management Planning Instructions: Management planning instruction is communication between top management to lower level of management and it should adopt the basic of full communication. Top management establishes a planning foundation. On the basis of this planning foundation the statement of planning guidelines is set as executive management instructions.
- Project Plan Preparation & Evaluation: Project plans are different from periodical plan. It is a long term strategy. It is prepares and evaluated in the profit planning & control process. Consistent with this approach during the formal planning cycle, management must evaluated decide up

on the plan states of each project in process and select any new projects to be initiated during time dimension covered by the upcoming strategies and tactical profit plans.

- **Development of Long term and Short term Profit Plan:** In the profit planning and control process developing long term and short term profit plan is a major task of management executive. Certain information are collected from related sources, to develop profit plan general format is available to management Two profit plans completed , management should subject the entire planning payable to a careful analysis and evaluation to determine whether overall plans are the most realistic set that can be develop under the circumstances. When this point reaches the two profit plans should be formally approved by the top executive and distributed to the related managers.
- **Implementation of Profit Plan:** Formulation is one of the major tasks of manager whereas implementation is more and more important factor of profit planning & control. The profit plan should be implemented by every concern designation. Implementation of plans and strategy is a function of management. Effective management at all levels requires that enterprise objectives goals, strategies, and policy to be communicated and understood by subordinates.

2.9 Limitation of Profit Plan

Profit planning and control is an important tool for management. "Every planning is not out from limitation also profit plan is not free from limitation. So it is essential that the user of profit planning and control must be having a full knowledge of its limitations. In developing and using a profit planning and control program the following limitations kept in consideration (Goet, et al., 2063:1.6).

- The profit plans based on estimates.
- Execution is not automatic.
- Danger of inflexibility.

- Costly.
- Lower moral and productivity.

"The profit plan should regard not as a master but as servant. It is one of the best tools yet devised for advancing the affairs of a company and the individuals the affairs of a company and the individuals in their various spheres of managerial activity. It is not assumed that any profit plan is perfect. The most important consideration is to make sure, by intelligent use of profit plans that all possible attainable benefits are derived from the plans as rendered and to re-plan when there are compelling business reasons" (Welsch ,1999:265)

2.10 Profit Planning in Commercial Banks

Profit planning in manufacturing sector is common it has been started in organization like banking sector too. Development of profit plan in banking sector begins with the preparation of various functional budgets. A bank prepares budget for deposit collection, lending expenditure, income, investment , non fund base business etc. these budget are taken as functional budgets despite this budget now a day's bank also prepare for future plan this is called profit plan.

2.10.1 Planning for Resources

Planning for resources is functional plan for banking sector. This is also a starting function all the planning depends on resource planning. The major resources of bank share capital and deposit .The lending and investment plan depends on the resources plan. Deposit is a primary source of resources collection. There are various types of deposit in the bank some are interest free and some are with interest. A proper mix of cost free and costly deposits corresponding to short term and long term deposits are to be maintained by the bank in its deposit mix in order to minimize its average cost of deposit at the sometime having comfortable mix of income yielding assets. Besides the deposits other resources are borrowing by inter bank loan. Certain rate of

interest is directed by the NRB for inter bank loan the bank can fulfill short term requirement by taking inter bank loan too. Another resource is reserves and provision of banks. Collection of resources is one of the major functions of bank whereas deployment of such resource is also as important as this. The assets portfolio is determined by the planning for deployment. Bank can utilize their fund basically in three types of investment sector like liquid assets, lower income generating assets higher income generating assets. Liquid assets means banks should maintain certain percentage of total deposit for their short term fund requirement i.e. called liquid assets management. Secondly bank can invest in securities, treasury bills etc. i.e. lower income generating assets and last in higher income generating assets is interest generating sector like loan and advance. Most of the portion of deployment is in the loan and advance of a bank. Lending targets are fixed at various sector of economy for various kinds of trades and commercial activities and to various borrowers ensuring well diversification of the assets.

2.10.2 Non-Fund Consuming Income Plan

Income without investing of banks fund is called non funded income. They are LC, Bank guarantee payment of bills etc. A source of income which is generating without any investment is called non funded business activities.

2.10.3 Planning for Expenditure

Income can't imagine without expenditure so expenditure should be planned in proper way. The expenses planning and controlling are very essential for supporting the objectives and planned programs of the business concerns. The income after deducting all of expenditure is called profit so in the process of profit planning the expenditure planning plays the vital role. A bank always tries to control their expenses by preparing periodical budget. Expenditure minimization means that the profit maximization so the expenses must be planned carefully for developing a profit plan. In a bank there are generally following expenses.

- Administrative expenses.
- Interest expenses.
- Operating expenses.
- Loan loss provisions
- Bad debts
- Non-operative expenses.
- Expenses by the exchange fluctuation etc

Interest expenses in direct expenses for the financial institution. It is paid in to customer interest bearing deposit as per the bank's rules or agreed rate between bank and customer. Payment of interest is capitalized in same account of customer after deducting government tax prevailing rate of tax is 5 % for persons and 15% for corporate. The expenditure side of bank's income statement is covered by interest by the large amount than other expenses so interest expenses are major and direct expenses. In the total income after deducting the interest expenses rest amount called contribution margin. Other expenses are administrative expenses those are generally incurred by the bank during the course of its day to day operation. Other expenses depend of the volume of the transaction. Higher the volume of transacting higher will be operating expenses.

2.10.4 Planning for Revenue

The major expenditure of banks is interest and also major head of income is also interest. The main income source of bank or financial institution is interest margin. A bank lends their fund by taking some margin. The sources of income for bank is not only the interest other non funded sources are also can generate income whereas interest is dominant one. The major sources of revenue for a bank are listed below:

- Interest income
- Dividend

- Commission and Discount
- Miscellaneous income
- Foreign exchange income
- Remittance income
- Other non funded incomes

Income of a bank is basically activity based it depends of the volume of business. Higher the income generating activities of bank, higher will be the amount of its revenues. Therefore the bank develops its plans for various activities in such a way that it maximizes its income.

2.11 Application of Profit Plan in Banking Sector

Traditionally comprehensive profit planning and control was applicable only to large manufacturing and complex organization. But in the modern concept the profit planning and control is applicable non-manufacturing enterprises too, like service companies, financial institutions, hospitals, retail business, construction companies etc. The fact is that a company has peculiar circumstances or critical problem is frequently a good reason for the adoption of certain profit planning and control procedures. In respect to size, when operations are extensive enough to require more than one or two supervisory personnel, there may be a need for profit planning and control application. Now a day's banking sector are also curious about preparing profit plan budget. Functional budget only gives their operational plan where as PPC gives idea about profit maximization.

2.11.1 Execution of Profit Planning and Control

The only preparing profit is useless while it doesn't come in execution. The plan should be developed with the confidence that the enterprises are going to meet or exceed all major objectives. The final examination of whether the hard work and cost in developing a profit plan are worthwhile is its helpfulness to top management.

"The development of an annual profit plan ends with the planned income statement, the balance sheet and planned statement of changes in financial position. These three statements summarize and integrate the details of plans developed by the management for the period. They also report the primary impact of detailed plans on the financial characteristics of the firm. Before redistributing the completed profit plan it is generally desirable to recast certain budget schedules so that technical accounting mechanics and jargon are avoided as much as possible. The redesigned budget schedules should be assembled in on logical order, reproduced and distributed before the first day of the upcoming budget period. The profit plan completion date is important. Issuance of a profit plan after the beginning of the budget period is one sure way of destroying much of budget potential. Timely completion of the planning budget suggests the need for a budget calendar" (Welsch, 1999:265).

The manager of each responsibility center obtains an approved profit plan for his center and it becomes the basis for current operations and selection considerable coordinate and controlling belongings. After execution of profit planning the performance should be reported. Its phase of a comprehensive PPC program significantly influences the extent to which the organization's planned goals and objectives are attained. Performance reports deal with control aspect of PPC. The control function of management defined as "The action necessary to assure the objectives, plans, policies and standards are being attended." Performance reports are one of the vital tools of management to exercise its controls function effectively.

2.12 Components of Profit Planning and Control

Components of profit planning and control are bones of a business which help it operate properly, efficiently and effectively. The components of PPC are as follows:

1. The Substantive Plan

- Broad objectives, missions and short term goals of the enterprise.
- Specified enterprise goals, structure, responsibility, authority
- Enterprise policies and strategies
- Instructions and communication of executive management planning

2. The Financial Plan

a) Strategic Long-Range Profit Plan

- Sales, cost and profit projections
- Major projects and capital additions
- Cash flow and financing

b) Tactical Short-Range Profit Plan

- **Operating Plan:** It includes planned income statement, sales plan, production for merchandise purchase plan, administrative expenses budget and appropriation type budget
- **Financial Position Plan:** It includes planned balance sheet (i.e. Assets, liabilities, owner's equity).
- **Cash flow plan:** It includes flows from operating activities, flows from investing activities and flow from financing activities.

3. Variable Expenses Budgets(i.e. Output-Expenses Formula)

4. supplementary Data(i.e. CVP analysis, Ratio analysis)

5. Performance Reports

6. Follow up, Corrective Action and Preplanning Reports.

2.13 Major Tools used in Profit Planning and Control

Profit planning and control represent an overhaul plan of operations which covers a definite period and formulates a planning decision of management. It consists of three main budgets, which are:

1. Operating Budget

The operating budget covers revenue and expenses. In other words, operating budget relates to the physical activities or operations of a firm such as sales, production, purchased, labour and other different expenses budgets. In specific term an operating budget has the following term:

- (i) **Sales Budget:** The sales budget is a detailed schedule of expected sales for the coming period which is usually expressed in both amounts and units. Once the sales budget has been set, a decision can be made on the level of production that will be needed to support sales and the production budget can be set well. The sales budget is constructed by multiplying the expected sales in units by the sales price.
- (ii) **Production Budget:** After the sales budget has been prepared, the production requirements for the forth coming budget period can be determined and organized in the form of a production budget sufficient goods will have to be available to meet sales need and provides for the desired ending inventory. A portion of these goods will already exist in the form of beginning inventory. The remainder will have to be produced. Thus, production needs can be determined by adding budgeted sales units to be desired ending inventory and deducting the beginning inventory from the total.
- (iii) **Purchased Budget:** In case of merchandising firm, instead of preparing purchase budget showing the amount of goods to be purchased from its suppliers during the period. The merchandise purchase budget is in the same basic format as the production budget, except that, it shows goods to be purchased rather than goods to be produced.
- (iv) **Direct Material Budget:** After the production needs have been computed, a direct material budget should be prepared to show the materials that will be required in the production process. Sufficient raw materials will have to be available to meet productions needs and to provide for the desired ending raw material inventory for the budget period part of this raw

materials requirement will already exist in the form of a beginning raw material inventory. The remainder will have to be purchased from supplier.

(v) **Direct Labour Budget:** The direct labour budget is also developed on the basis of production budget. Direct labour requirements must be computed so that the company will know whether sufficient labour time is available to meet production needs. Just knowing in advance, the company can develop plan to adjust the labour forces as the situation may require. Direct labour requirement can be computed multiplying product to be produced by each period by the number of direct labour-hours required to produce a single unit. Many different types of labour may be involved. If so, then computation should be by type of labour needed. The hours of direct labour time resulting from these computations can then be multiplied by the direct labour cost per hour to obtain budgeted total direct labour cost.

(vi) **Manufacturing Overhead Budget:** The manufacturing overhead budget provide a schedule of all costs of production other than direct material and direct labour. These costs should be broken down by cost behaviour for budgeting purposes and a predetermined overhead rate developed. This rate will be used to apply manufacturing overhead to units of product throughout the budget period.

(vii) **Selling and Administration Overhead Budget:** The selling and administrative expenses overhead budget contains a listing of anticipated expenses for the budget period that will be incurred in areas other than manufacturing the budget will be made up of many. Smaller, individual budgets submitted by various persons having responsibility for cost control in selling and administrative matters. If the number of expenses item is very large, separate budgets may be needed for the selling and administrative function.

2. Financial Budgets

Financial budgets are concerned with expected cash receipts/disbursement financial position and result of operations. The components of financial budget are:

- (i) **Budgeted Income Statement:** The budgeted income statement is one of the key schedules in the budget process. It is the document that tells how profitable operations are anticipated to be in the forth-coming period. After it has been prepared, it stands as a benchmark against which subsequent company performance can be measured.
- (ii) **Cash Budget:** Cash budget is the detail of a statement showing cash receipt, cash disbursement and the balance cash. The cash budget is composed of four major sections. The receipts sections, the disbursement section, the cash excess or deficiency section, and the financial section. The receipts section consists of the opening balance of cash added to whatever is expected in the way of cash receipts during the budget period. The disbursement section consists of cash payment that is planned for the budget period. The cash excess or deficiency section consists of the difference between the cash receipts section. The financing section provides a detailed account of the borrowing and repayments projected to take place during the budget period. It is also includes a detail interest payment that will due as money borrowed.
- (iii) **Budgeted Balance Sheet:** Budgeted balance sheet is a statement of assets and liabilities prepared after the preparation of operating budgets and financial budget. It is based on functional or operating budgets, cash budget, projected income statement and the previous year's assets and liabilities. In other words, budgeted balance sheets develop by beginning with the current balance sheet and adjusting it for the data contained in the other budgets.

3. Appropriation Budget

The appropriation budget covers all types of expenditure on advertising and research sectors. A part from above budgets, PPC also has relationship with

following additional budgets, CVP analysis, and completion of profit plan and performance reports.

- **Flexible Budgets:** Flexible expenses budgets relate only to expenses or costs. They are also called dynamic, activity or output adjusted expenses budgets. The concept of flexible expenses budget is that all expenses are incurred because of passage of time, output, activity or combination of time and output or activity. Therefore, it is complementary to tactical profit plan which helps to provide an expenses plan. They should be adjusted to actual output for comparison with actual expenses in periodic performance report. Expenses or costs must be identified into fixed and variable expenses or costs in flexible budget.
- **Capital Expenditure Budget:** Capital expenditure budgeting is a process of planning and controlling of the long-term and short-term expenditure for expansion, replacement and contraction of fixed assets. Capital budgeting is useful to earn future profit and reduce future costs. The major elements of a capital expenditure budget are cash outflow and cash inflows. Cash outflow includes the cost of the project as cash outlays at different times during the life of a project. The cash outflows are affected by the provision of residual value of old equipment, tax position, additional working capital needed etc. cash inflows are expected cash revenue during the life of a project. The non-cash expenses like depreciation and tax position can affect the cash inflows.
- **Zero Base Budgeting:** Zero base budgeting is the method of budgeting in which managers are required to start at zero budget levels every year and to justify all costs as if the programmes involved were being initiated for the first time. No costs are viewed as being on-going in nature; the manager must start at the ground level each year and present justification for all costs in the proposed budget regardless of the type of cost involved. Zero base budgeting differs from traditional budgeting in which budgets are generally initiated on an incremental basis, the managers start with last year's budget and simply add to it according to

anticipated needs. The manager's doesn't have to start at the ground each year and justify ongoing costs for existing programmes.

- **Activity Based Budgeting:** Activity based costing can lead to improve decision making. Activity based budgeting focuses on the cost of activities to produce and sell products and services. It separates indirect costs into separate homogeneous activity cost pools. Management uses the cause and effect criterion to identify to cost drives for each of these indirect cost pools.
- **Cost Volume Profit Analysis:** The analysis of relationship between cost, volume and profit is known as cost volume profit analysis. It is an analytical tool for studying the relationship between volume, cost, price and profit. CVP analysis is great helpful in managerial decision making. Specially, cost control and profit planning is possible with the help of cost volume profit analysis.
- **Completion of Profit Plan:** The principal output of a budgeting is a comprehensive profit plan that ties together all phases of an organization's operations. The completion of profit plan is comprised of man separate budgets, or schedules, that are interdependent. In other words, completion of profit plan means the process of profit planning ends with the planned income statement and planned balance sheet.
- **Performance Report:** Performance report is an important portion of a comprehensive PPC system. The performance reporting phase of a comprehensive PPC programmed significantly influences the extent to which the organization's planned goals and objectives are attained. Performance reports deal with control aspect of PPC or management control function of management defined as "the action necessary to assure the objectives plan, policies and standards are being attend" or in other word, the objectives of control is to guarantee the achievement of the planned objectives of the management by introducing periodic systematic correction measure. Performance report is one of the vital tools of management to exercise its control function effectively.

2.14 Review of Previous Studies

Profit planning and Control played the vital role in overall profitability management which provides the guideline for the achievement of organizational goals and objectives. Various studies have been conducted for the behaviour of Profit planning. Regarding this various empirical studies have been conducted in related areas of profit planning. There are many researchers who have carried out research in this topic. The profit planning in the context of particularly commercial banks seems to be a new subject of study for research and analysis. So far this researcher could find some studies that have been made in this topic. Here are reviewed some theses in the manufacturing sector and some are related to the financial sector which can help us to understand about their objectives, used statistical tools and major findings about this topic.

2.14.1 Review of books

Koirala & Acharya, (2010) has written a book entitled *Cost and Management Accounting* which expresses the concept of Cost-Volume-Profit Analysis. The main objective of a business is to maximize profit. There are different internal and external factors which affect profit. Profit is maximized with the decrease in cost and increase in revenue i.e. sales. The costs of products are determined by the purchase of raw materials and other manufacturing and operational activities. Similarly, sales are dependent on selling price, demand and quality of product, competition level, advertisement and publicity etc. Profit planning is a function of selling price per unit of product, variable cost associated with it and total fixed cost. In this way, the analysis of cost, volume and profit is essential to earn the target profit and maximize it.

Purpose of Cost-Volume-Profit analysis

The main objectives of CVP analysis are given below:

- To forecast the profit by the analysis of cost and volume of sales.
- To calculate breakeven point.

- To help preparing flexible budget.
- To show the effects of the changes in price, cost and profit.
- To estimate the sales volume to earn a desired or expected profit.
- To measure the elements or factors that affect profit.
- To select the best alternate for maximizing profit.
- To select the optimum product mix for production.
- To help to make decision on manufacturing or buying.

Poudel, et al., (2010) *Cost and Management Accounting* has written book entitle to they examine the Concept of Budgeting the three important functions of management are planning, operating and control. Planning relates to the future, operating to the present and control to the past. For assisting the management in the functions of planning and control, two techniques are applied i.e. budget and standard costing system. Budgeting is usually operated with a system of standard costing therefore both the system are inter related but these systems are not inter dependence. Generally, the word budget is concerned with the limitation on spending. For example, government approves spending budgets for their various bodies. Then expect the bodies to keep their expenditures within the limit prescribed by the budgets. In contrast most business organizations use budget to focus alternation on company operations and finances. Not just to limit spending, budgets highlights potential problems and advantages early, allowing manager to take steps to avoid these problems or use the advantages wisely.

Goet and Shah (2012) *profit Planning and Control* has written book entitle to they express the Meaning of profit Planning and Control of Cash Flows. Planning of cash flow is an estimate of cash inflows, cash outflows and ending cash balance in each period of budgeted period. The basic essence of preparing cash budget is to determine cash defect or surplus of cash. A cash budget shows the planned cash inflows, cash outflows and ending position by interim

periods for a special time period. It is directly related with other budgets such as sales budget, expenses budget and capital expenditure budget.

The main objectives of preparing cash budget are as follows:

- To determine cash position at the end of each period as a result planned operations.
- To identify surplus or, deficit of cash by time periods.
- To establish the need for financing
- To establish the need of investment of idle cash
- To establish a sound basis for continuous monitoring of cash position.

2.14.2 Review of Previous Research works

Paudel (2006) has conducted a study on *Sales Budget of Profit Planning and Control in Manufacturing Public Enterprises: A Case Study of Dairy Development Corporation*. His objectives and some of major findings are as follows:

The Main objectives of the study were:

- To analyzed the sales budget prepared by DDC.
- To evaluate the variance between budgeted and actual achievement of DDC
- To compare the sales with profit of the DDC.
- To provide the suitable suggestion and recommendations for the improvement of planning system of DDC.

The major findings of the study were:

- DDC has fulfilled the national demand but sales achievement is below than targeted sales.
- DDC is following traditional budgeting approach.
- DDC has burden of staff, loan and other expenses which directly influenced the profitability.

- Different statistical tools show the positive relationship with actual and budgeted sales.
- DDC is adopted traditional pricing method to determine the selling price.
- Profit and Loss trend of DDC showed that it has huge loss but from F/Y 2059/60 losses in its decreasing trend.

Dahal (2006) is conducted a research entitled *Planning process and its impact on profitability: A Case Study of Gorkha Patra Corporation* his objectives and some of major findings are listed below.

The main objectives of the study were:

- To examine the present practice and effectiveness of profit planning in Gorkhapatra corporation.
- To evaluate the variance between target and actual performance of this corporation
- To analyze the preparation of various functional budget of Gorkhapatra corporation.
- To point out the suggestion and recommendation for improving the profit plan.

The major findings of the study were:

- GC does not prepare the long term strategic profit plan but it prepares tactical short term profit plan.
- GC has not adequately considered controllable and non-controllable variables affecting the corporation. They has no in depth analysis of the corporation's strength and weakness.
- The objectives of the corporation are not clear, with regard to profit making and market penetration.

- The plans are prepared from top level only. There is no letter communication between the top level and lower level management regarding the corporation's goals and objectives.
- GC has not a system of periodical performance reports. Corporation is not seriously conscious to its poor performance.
- Actual production is made in accordance with the actual sales. Therefore production activities are not done according to the budgeted production but this done according to the recent data of actual sales.

Thapa (2006) has study on *Profit Planning in Merchandising company: A case study of National Trading Limited* his objectives and major findings are as follows:

The main objectives of the study were:

- To examine the practical and effectiveness of profit planning in National Trading limited.
- To analyze the various functional budgets adopted by National Trading Limited.
- To evaluate the performance of budgeted and actual in NTL.
- To provide summary finding and recommendation.

The major findings of the study were:

- NTL does not take in account its weakness and strength to support planned activities.
- NTL fails to maintain its periodic performance report for the evaluation of performance to find the underlying causes of poor achievements.
- It seems that budgeted sales are higher than actual sales.
- Financial position of NTL is not satisfactory.
- There is low degree of positive correlation between sales and profit and negative correlation between profit and assets.
- There is not complete and comprehensive budgeting system.

- NTL is operating above BEP and enjoying profit but not appropriate.

Kharel (2008) has conducted a research on *Profit Planning of Commercial Banks in Nepal: A comparative study of Everest Bank limited, Nabil Bank limited, and Bank of Kathmandu Limited* his objectives and major findings are as follows:

The main objectives of the study were:

- To find out the relationship between total investment, loan and advances, deposit, net profit and outside assets.
- To identify the investment priority sectors of Commercial Banks.
- To assess the impact of investment on profitability.
- To analyze and forecast the trend and structure of deposit utilization and its projection for five years of commercial banks.

The major findings of the study were:

- The liquidity position of EBL is comparatively better than that of Nabil and Bok.
- In spite of the current ratio is average among the other two banks EBL has maintained the cash and bank balance to meet the customers demand.
- EBL has invested highest sectors like government securities than BOK and lesser portion than that of Nabil.
- From the analysis of assets management ratio it can be found that EBL is in better position as compared to that of Nabil and Bok.
- EBL has invested the highest portion of total working fund on government securities as compared to Nabil and BOK.
- Due to more efficient loan policy, Nabil suffers less from loan loss provision.
- BOK has higher investment on shares and debentures to total working fund ratio.

- The interest earned to total outside assets and return on total working fund ratio of EBL is lowest of all.
- The return on loan and advances ratio and return on assets of EBL is lowest of all.
- The ratio suggests that the earning capacity of the bank's loan and advances is satisfactory.
- The total interest paid to working fund ratio is less than the interest earned to total working fund ratio. So it is profitable position as it is getting higher return that is interest cost.
- The degree of risk is average on EBL. The credit risk ratio is higher than the compared banks. However the lowest C.V of credit ratio and average C.V of liquidity risk ratio and capital ratio over the study period provided for the assurance of consistency of the degree of risk.
- EBL has showing its good performance by increasing the total deposit loan and advances and investment in profitable sectors interested earnings by providing loan to clients.
- The trend of the total investment, total deposit loan and advances and net profit of EBL shows better position than that of Nabil and BOK.

Chetri (2010) has conducted a research on *Profit Planning of Commercial Banks in Nepal: with reference to Everest Bank Limited, Nabil Bank Limited and Bank of Kathmandu.*

The main objectives of the study were:

- To find out the relationships between total investment, loan and advances, deposit, net profit and outside assets.
- To identify the investment priority sectors of Commercial Banks.
- To assess the impact of investment on profitability. To analyze and forecast the trend and structure of deposit utilization and its projection for five years of Commercial Banks.
- To provide suggestions and possible guidelines to improve investment

policy and its problems.

The major findings of the study were:

- The liquidity position of EBL is comparatively better than that of NABIL and BOK.
- In spite of the current ratio is average among the other two banks EBL has maintained the cash and bank balance to meet the customers demand.
- All the three banks have met the normal standard current assets ratio to meet the short term obligation of its customers .
- EBL has invested highest sectors like government securities than BOK and lesser portion than that of NABIL.
- BOK had mobilized lots of its funds in order to gain the high profit.
- From the analysis of assets management ratio it can be found that EBL is in better position as compared to that of NABIL and BOK.
- The loans and advances to total deposit ratio, loan and advances to total working fund ratio of EBL lies In between those of NABIL and BOK.
- EBL has invested the highest portion of total working fund on government securities as compared to NABIL and BOK.
- Due to more efficient loan policy, NABIL suffers less from loan loss provision.
- It takes low credit risk and has sufficient deposits of none bearing interest which can be used in a creation period.
- Anyhow EBL has also trying to best in loan loss provision.
- Investment on shares and debentures to total working fund ratio is higher in BOK.
- The interest earned to total outside assets and return on total working fund ratio of EBL is lowest of all.
- But overall analysis of profitability ratios, EBL is average profitable: in comparison to other compared bank i.e. NABIL and BOK.
- To make the profit BOK is taking highest risk by providing the higher

portion of its deposit as a loan.

Nepal (2011) conducted a study on the topic of “*profit planning and control of Machhapuchchhre Bank limited*”. The time period covered by this research was five years i.e. 2062/63 to 2066/67. The data and other necessary information were collected by using secondary sources. In this research he has carried out some objective, finding and recommendations.

The main objectives of the study were:

- To examine the present profit planning measures adopted by MBL.
- To analyze the variance of budgeted and actual achievement.
- To analyze the financial performance of MBL.
- To analyze the various functional budgets and formulation and implementation of financial plans in MBL.

The major findings of the study were:

- Total revenue has been increasing every year. Interest income from loan and advance has been increasing every year. Revenue from commission and discount has been increasing every year. Revenue from foreign currency exchange and revenue from other income is in fluctuating trend.
- Total expenditure has been increasing every year. Interest expenses is the major part of the expenditure of MBL, it is increasing every year. Operating expenses and employee expenses has been increasing every year.
- Budgeted and actual deposit collection is achieved in FY 2062/63, 2063/64, 2065/66. In FY 2064/65, 2066/67 it is nearly achieved. Correlation coefficient is 0.97 which shows there is perfectly positive correlation between budgeted and actual deposit collection.
- Trends analysis shows the net profit decrease every year.
- Current ratio is 1.14, 1.59, 2.80, 2.24 and 1.69 times. This mean ratio is 1.89 times, S.D. is 0.64, C.V. is 33.91% and correlation coefficient is

0.87, shows the satisfactory condition of bank in terms of maintaining current ratio.

- Return on total assets ratio is decreasing every year except FY 2065/66.
- Return on total deposit ratio is decreasing order, which shows the bank is not able to mobilize total deposit ratio.
- The mean ratio of interest expenses to interest income is 66.38% shows the satisfactory condition of bank.
- Interest income on total assets is in increasing trend which is 6.21% in FY 2062/63 and 8.17% in FY 2066/67. Correlation coefficient is also perfect i. e. 1.0.

Rana (2012) had conducted a study on the topic of *profit planning and control of Standard Chartered Bank Nepal Limited*. The time period covered by this research was five years i.e. 2063/64 to 2067/68. The data and other necessary information were collected by using secondary sources. In this research he has carried out some objective, finding and recommendations.

The main objectives of the study were:

- To examine the profit planning adopted by SCBNL.
- To assess the financial position of SCBNL.
- To examine the resources mobilization and achievement of SCBNL.

The major findings of the study were:

- The total income from interest, discount and commission are increase in every year.
- The total interest expenses, operating expenses and personal expenses are in increasing trends.
- The net profit margin ratio is in fluctuating trend over the study period.
- The average return on total assets ratio is increasing trend except the FY 2066/67.

- Return on total equity ratio is in decreasing trend except the FY 2064/65.
- The % achievement of total Deposit of SCBNL is high but the achievement is decreasing trend each year except the FY 2067/68 over the study period.
- Correlation analysis shows that the positive relationship between total operating expenses and net profit.
- There is positive correlation between total assets and Net profit.
- The trend line of net profit of SCBNL is increasing with time it shows that the net profit increasing every year.
- The major sectors of investment are Nepal Govt. T-bills, Nepal Govt. saving Bonds and Nepal Govt. other securities, local licensed institution, foreign banks, corporate share and corporate debenture and bond.

2.15 Research Gap

Today's world is marketed by rapid changes and new developments, as such researcher's base, interpret and analyze events in the face of dynamism. Most of the past research studies conducted a few years back may not be adequate to explain current phenomena. Thus continuous attempt needs to be taken and new researcher and conducted to build our existing knowledge about profit planning system are basically related to the profit planning system of manufacturing organization or production oriented activities. The researcher could find some study so far that has been related to profit planning system of commercial bank in Rastria Banijya Bank, Nepal Investment Bank, Standard Chartered Bank, Nepal Bangladesh Bank. This study may be a new study in this field as no study has been made profit planning of MBL. In the past financial institution were depends only the interest margin in present economic dynamism only the interest margin is not sufficient to improve profitability so this researcher has tried to analyzed the extra ordinary items of income generation in financial institution. To find the new developments and to bridge

the gap between the past research and the present situation, I set out to conduct the research in this stimulating topic. I have been through many literature reviews and given my best to fulfill this work. In my research effort had been made to understand the Profit Planning and control in commercial bank and I hope this research will be fruitful for future researchers as reference.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Introduction

The term 'research' is believed to be derived from the French word 'Researcher' meaning to search again. The research work is undertaken following a systematic way, which is called Research Methodology. It is the way to solve systematically about the research problem.

This chapter refers to the overall research method comprising the theoretical aspect to the collection and analysis of data. This study covers quantitative methodology in a greater extent and also covers the descriptive part based on both technical aspect and logical aspect. This study has intense relation with the application of planning and control in a commercial bank with a specific reference to Machchhapuchre Bank regarding the objectives to analyze, examine and interpret the application of profit planning in the bank. The Research Methodology includes research design, data collection procedures and research variable and tools used.

3.2 Research Design

This study is a case study in nature. A true research design is basically concerned with various steps to collect the data for analysis and draw a relevant conclusion. Recommendation is another important aspect of design strategy. The research design allows the researchers to take an appropriate measure and direction towards the predetermined goals and objectives. A research design is the arrangement of conditions for the collection and analysis of data in a manner to combine relevance to the research purpose with economy in procedure. Research design is the plan, structure and strategy of investigation imagines obtaining answers to research questions and controlling various things. This study is an examination and evaluation of budget process in profit

planning program of Machhapuchchhre Bank Ltd. Various functional budgets and other related accounting information's and statement of Bank are the materials to analyze and evaluate the profit planning system of the Bank. Descriptive as well as analytical research designs have been adopted in this research. This is a case study research.

3.3 Population and Sample

As this research aims at studying the profit planning aspect of the commercial bank taking the reference of Machchhapuchhre Bank and data have been analyze for several years of its operation. Here, all the commercial banks are population of the study and Machchhapuchhre Bank have been selected as sample for the present study.

3.4 Sources and Collection of Data

Here secondary data only has been used for this study. The primary data can be taken from informal discussion with executives. But this study is mainly based on secondary data. The main sources of secondary data are quarterly and annual financial reports, official records, web site, brochures, prospectus and other relevant publications of Machhapuchchhre Bank Ltd, NRB, Central Bureau of Statistic and relevant publications. From these sources the relevant historical data are gathered for analysis purpose.

3.5 Study Variables

Share capital, Customer deposit, loan and advances, Overdrafts, total resources and deployment, LC, Bank Guarantees, Interest Expenses, Other Expenses, Interest Income, and Other Income of Machhapuchchhre Bank Ltd. are research variables of this study.

3.6 Analytical Tools

We have analyzed the data by using various statistical, Mathematical and financial tools in this study.

3.6.1 Statistical and Mathematical Tools

We have analyzed the data by using following statistical and mathematical tools.

- Percentile Increment
- Mean
- Standard Deviation
- Correlation of coefficient
- Coefficient of variation
- Probable Error
- Regression analysis
- Test of Goodness of fit of the Regression Estimate
- Coefficient of Determination

3.6.1.1 Percentile Increment

This statistical tool gives the percentage change of previous year to current year. This tool helps to find out the increment in the study variable. Simply, the word percentage means per hundred. In other word, the fraction with 100 as its denominator is known as percentage and numerator of this fraction is known as rate of percent.

3.6.1.2 Arithmetic Mean Average

The central values that represent the characteristics of the whole distribution or the values around which all items of the distribution tend to concentrate are called average. Arithmetic mean or arithmetic average is one of the important statistical measures of average. The arithmetic mean of a given set of observation is their sum divided by the number of observation.

3.6.1.3 Correlation of Coefficient

Correlation analysis is a statistical tool. It is used to find the relationship between variables. If two quantities vary in such a way that movement in one

are accompanied by movements in the other these quantities are correlated. It shows the effect on other variable due to the change in one variable. The degree of relationship between the variables under consideration is measured through the correlation analysis. Thus correlation is statistical device, which helps us in analysis the co-variation of two or more variables. Karl Pearson's Coefficient of correlation is widely used in practice. The Pearson's coefficient of correlation is widely used in practice. The Person's Coefficient of correlation is denoted by the symbol "r".

The formula for computing Person's "r" is:

$$r = \frac{\sum xy}{\sqrt{\sum x^2} \times \sqrt{\sum y^2}}$$

Where,

r= the correlation coefficient

x= X- \bar{X}

y= Y- \bar{Y}

X= Independent variable

Y= Dependent variable

Following general rules are applied to interpret the coefficient of correlation:
 When r= +1, it means there is a perfect positive relationship between the variables. When r= -1, it means there is a perfect negative relationship between the variables. When r= 0, it means that there is no relationship between the variables i.e. the variable are uncorrelated.

3.6.1.4 Regression Analysis

Regression is the statistical tool which is used to determine the statistical relationship between two or more variables and to make estimation of one variable on the basis other variables in other words regression is that statistical tool with the help of which the unknown value of one variable can be estimated on the basis of known value of the other variable.

3.6.1.5 Standard Deviation (σ)

The standard deviation is the absolute measure of dispersion. It is defined as the positive square root of the mean of the square of the deviation taken from the arithmetic mean. The greater the amount of dispersion or variability, the greater the standard deviation, the greater will be the magnitude of the deviation of the values from their mean. A small standard deviation means a high degree of uniformity of the observation as well as homogeneity of a series and a large standard deviation means just the opposite.

3.6.2 Financial Tools

Ratio Analysis has been used in this study as financial analytical tools. Ratio analysis is main focus as financial tools throughout the study as "Ratio analysis is such powerful tool of financial analysis that thought the help of it economic and financial position of business unit can fully X-rayed" (Kothari, 1971: 187).

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter deals with the presentation, analysis and interpretation of relevant data and information of planning system and budgeting procedure in a commercial bank with the specific context of Machhapuchchhre Bank Ltd. To accomplish these objectives, the various functional budgets analyze and related data are presented in a systematic way in tabular forms and graph charts. To obtain best result, the data and information have been analyzed according to the research methodology as mentioned in Chapter 3.

"The main purpose of analyzing the data is to change it from an unprocessed form to an understandable presentation. The analysis of data consists of organizing, tabulating and performing statistical analysis" (Wolff & Pant, 2004).

4.2 Mission Statement of Machhapuchchhre

To become a leading bank in Nepal by providing complete financial solutions to our customers, superior value to our shareholder and promising growth opportunities to our employees. Machhapuchchhre Bank Ltd. is committed to do this mission while ensuring the highest levels of ethical standards, professional integrity, corporate governance and regulatory compliance (www.Machhabank.com).

4.3 Resources Mobilization Planning

The resources have used for the fulfillments of its activities. Banks mobilizes its resources from the following sources.

- Deposit Accounts
- Loans and Borrowing

- Share Capital
- Others liabilities

Among the above four sources the Deposit accounts/collection is the major source of resources mobilization, which is in fact, one of the most important activities of a commercial bank. Loans and Borrowing are obtained from local banks, foreign banks, central bank and other financial institutions, generally for a short period of time. The capital fund is raised from shareholder's equity. This is the net-worth of the bank commercial banks. Commercial bank's capital fund has been divided into two categories viz. core capital and supplementary capital. Here the researcher going to present status of available resources of Machhapuchchhre Bank Limited in tabular and Figure: form.

Table: 4-1
Status of Resources Mobilization

(Amount

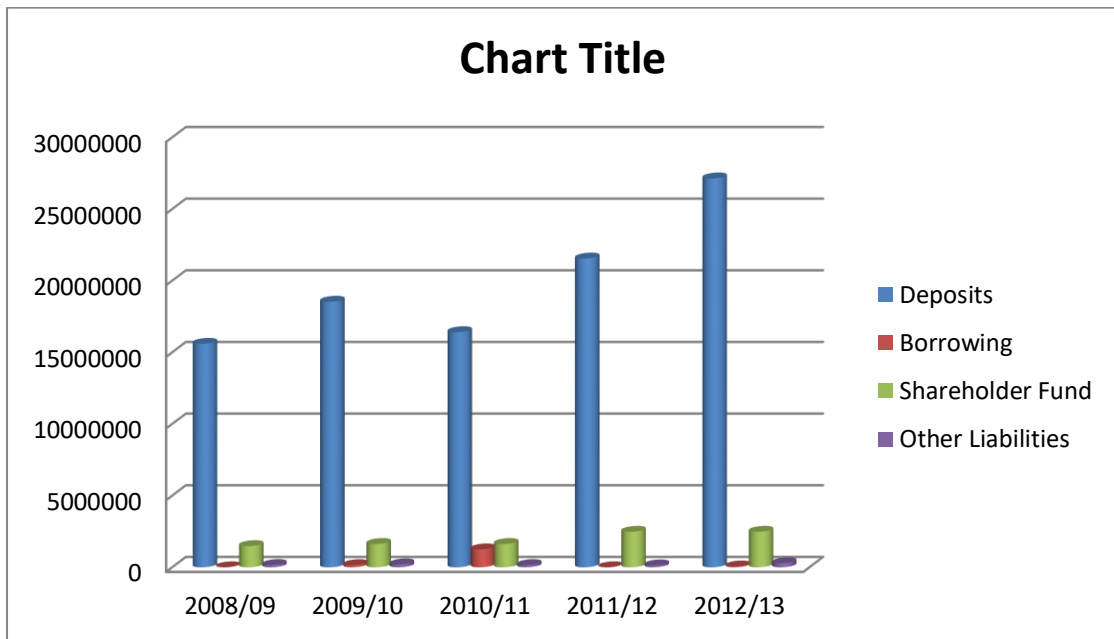
Rs....000')

F/Y	Deposits	Borrowing	Shareholder Fund	Other Liabilities	Total
2008/09	15,596,791	0	1,479,270	157,472	17,233,532
2009/10	18,535,917	150,000	1,627,197	203,961	20,517,074
2010/11	16,409,968	1,251,242	1,627,197	154,603	19,443,009
2011/12	21,546,397	0	2,478,795	131,482	24,156,673
2012/13	27,136,654	61,017	2,478,795	283,275	29,959,741
Total	99,225,727	1,462,259	9,691,252	930,792	111,310,029

Source: Annual Reports

Figure: 4-1

Bar diagram Showing Status of Available Resources



The above Table and bar diagram show deposit collection is the major source of resource collection so we have divided total resources in two parts one is deposit collection and another is other resources(other than deposit).

- Customer Deposit Collection
- Other Resources

4.4 Customer Deposit Collection

As deposit collection is major activities of commercial bank, it is important source of resource mobilization. As per the data F/Y 2008/09 to 2012/13 the customer deposit is high as 73.99%. These deposits are collected from different sectors that are individual and corporate customer. Deposits are collected as per the bank's rules. Some deposits are interest bearing and some are interest free. The Bank has categorized the deposit into two types which is as follows:

1) Interest Bearing Account

- Saving Account
- Call Deposit Account
- Fixed Deposit Account

- Certificate of Deposit
- 2) Interest Free Account
- Current Deposit Account
 - Margin Deposit Account
 - Other Deposit Account

Deposit Collection Budget of Machhapuchchhre Bank Ltd.

Machhapuchchhre Bank Ltd. prepares the plan for the deposit collection. The budgeted and actual deposit collection of Machhapuchchhre Bank Ltd. has presented in Table below:

Table: 4-2
Status of Budgeted and Actual
Deposit Collection

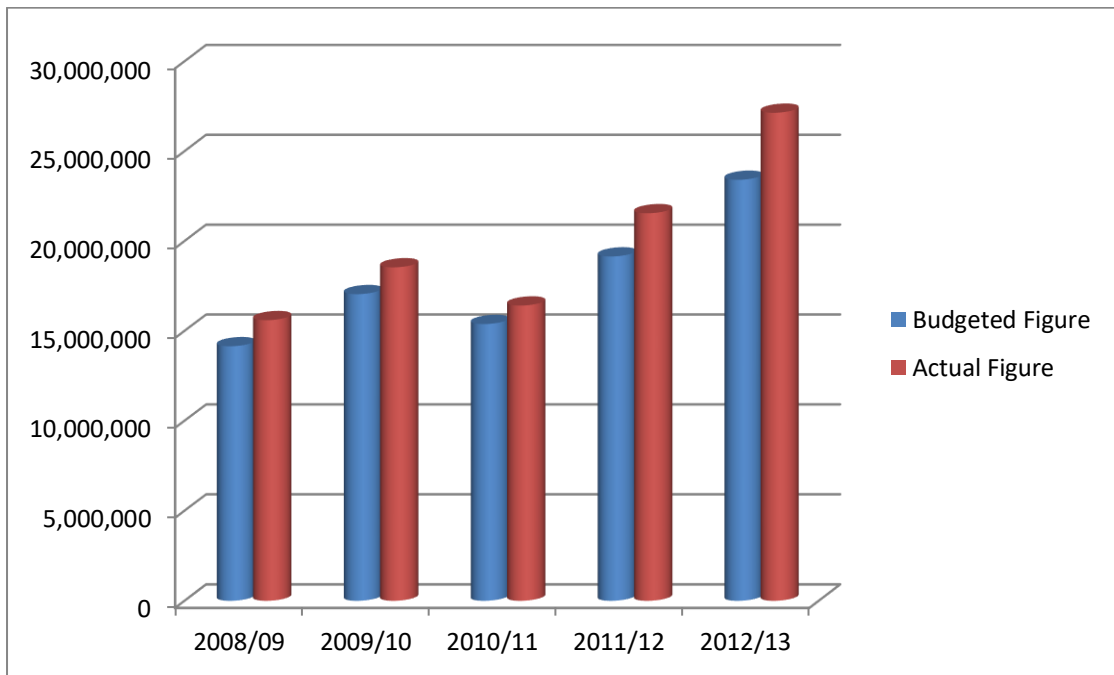
(Amount Rs....000')

Fiscal Year	Budgeted Figure:	Actual Figure:	Achievement
2008/09	14,146,700	15,596,791	110.25%
2009/10	17,044,500	18,535,917	108.75%
2010/11	15,382,400	16,409,968	106.68%
2011/12	19,142,100	21,546,397	112.56%
2012/13	23,405,700	27,136,654	115.94%

Sources: Annual Reports and Budgeted Statement

Figure: 4-2

Bar Diagram Showing Budgeted and Actual Deposit Collection



Above Table and Figure shows the deposit collection target has more than the budgeted amount. This gives the high level of achievement made by bank toward deposit collection sector. In the above bar diagram, it shows the achievement level higher than budgeted likewise scatter diagram shows actual collection is higher than budgeted amount. Machhapuchchhre Bank Ltd. is well performing in the deposit collection sector. The researcher finds the relationship and statistical results between budgeted and actual deposit collection by using some statistical tools like arithmetic mean, standard deviation, coefficient of variation, Correlation and regression and probable error.

Table: 4-3

Summary of Deposit Collection Budget and Actual Deposit

(Amounts in Rs. '000')

Statistical Tools	Budgeted Deposit (X)	Actual Deposit (Y)
Mean	17824280	19845145
Standard Deviation	3255283	4186249
Coefficient of Variation	18.26%	21.09%
Correlation of Coefficient (r)	0.998	
Probable Error (PE)	0.00121($r > 6PE$)	

Sources: Appendix – 1

The above Table shows that actual deposit is more variable than budgeted deposit since the CV of actual deposit is higher than budgeted deposit. Budgeted deposit is more consistent and homogeneous actual deposit is more variable in nature. A greater CV represents less homogenous. By using another statistical tool, correlation coefficient, to analyze the relationship between budgeted deposit and actual deposit, it is used Karl Pearson's coefficient of correlation which is denoted by (r). By calculating (r) can examine whether positive correlation between budgeted deposits and actual deposit is or not. Budgeted deposit is denoted by X and assumed to be independent variable and actual deposit is denoted by Y is assumed to be dependent variables. So that increased in budget is support to increase in actual achievement or vice versa, this meant that there should be positive correlation between, budgeted Figure: and achievement Figures. Significance of correlation of (r) tested with probable error (PE) by the calculation as per appendix 1. The researcher have found (r) is 0.998 and PE is 0.00121. The Figure: of 'r' shows that there is positive perfect correlation between budgeted deposit and actual deposit. The relation of PE with r is $r > 6PE$ so it is significant so the actual deposit going on same direction. Another statistical tools regression line can also be fitted to show the degree of relationship between budgeted deposits and actual deposit and to forecast the

achievement with given target so that the regression line of 'Y' on 'X' is as follows:

$$y - \bar{y} = r \times \frac{\sigma_y}{\sigma_x} (X - \bar{X})$$

$$y - 19845145 = 0.998 \times \frac{4186249}{3255283} (x - 17824280)$$

$$y - 19845145 = 1.271 (x - 17824280)$$

$$y = 1.271x - 2809515$$

From the above equation it is clear that actual deposit is in increasing trend. By the help of this equation we determine the expected deposits achievement with given value of budgeted deposit ($X=40000000000$) ascertain the expected deposits achievement for F/Y 2012/13.

When $X=40000000000$

The expected deposit for the year 2008/009

$$y = 1.271 \times 40000000 - 2809515$$

$$= 48030485(000)$$

The relationship between budgeted and actual amount deposit remains same the amount of deposit in F/Y 2012/13 will be Rs. 48030485000 stated by above regression line.

4.5 Resources Deployment Plan of Machhapuchchhre Bank Ltd.

Allocation of available resources into different sector is called deployment of resources plan. Resources can be used for maintain liquidity, investing in income generating activities, investing for fixed assets purchase and other assets. The available resources can be allocated in to three purposes these are listed below.

- To maintain the liquidity position
- To invest in income generating activity
- To purchase fixed and other assets

a) Deployment to Maintain Liquidity Position

Liquidity need to be maintained for the purpose of payment of withdrawals from deposit amount and payment for other liabilities and expenses. The liquidity can be maintained in terms of cash in vault and balance in bank. The return on such amount may be nominal or no return at all. The central bank of Nepal NRB has instructed to commercial bank to maintain certain liquidity as per their deposits. The liquidity position should be maintained as required higher the liquidity can't give effective return and lower the liquidity became failure to repay the deposit.

b) Deployment for Income Generating Activities

The major function of a commercial bank is to collection of deposit and invests them in different sector as loan Deployment of fund in income generating activities can divided in to two categories.

- Loan, Discount, Overdrafts (LDO)
- Other Investment

LDO refers loan, Advances, O\D, Bills Purchase & Discount & other loan which generates income in terms of interest other investment includes, investment in securities, Treasury bill etc.

Table: 4-4
Total Income Generating Deployment

(Amount Rs. '000')

F/Y	Other Investment		Loan & Advance		Total
	Amount	%	Amount	%	
2008/09	1,246,159	9.05	12,516,012	90.95	13,762,171
2009/10	2,096,792	12.80	14,289,793	87.20	16,386,585
2010/11	1,409,556	8.91	14,408,749	91.09	15,818,304
2011/12	1,705,425	9.85	15,602,701	90.15	17,308,126
2012/13	2,415,155	10.24	21,164,910	89.76	23,580,066

Source: Annual Report

The above Table shows the status of income generating deployment of Machhapuchchhre Bank Ltd. The major portion of deployment of the bank covers by the loan and advance. The range of loan and advance is 87.20 % to 90.95 % where as the range of other investment is 8.91 % to 12.80 %.

c) Deployment in Other Assets

Assets needs in the organization to show the performance of business such assets may be fixed or current. These assets can't give returns directly but without these others activities can't be run smoothly. Fixed Assets subject to written off at certain period of time as expenses.

4.5.1 Budgeted and Actual LDO

Since the LDO is a major sector of deployment of the bank the researcher going to analyze about the position of LDO of Machhapuchchhre Bank Ltd. Following Table: shows the budgeted amount of LDO and the same achieved actually.

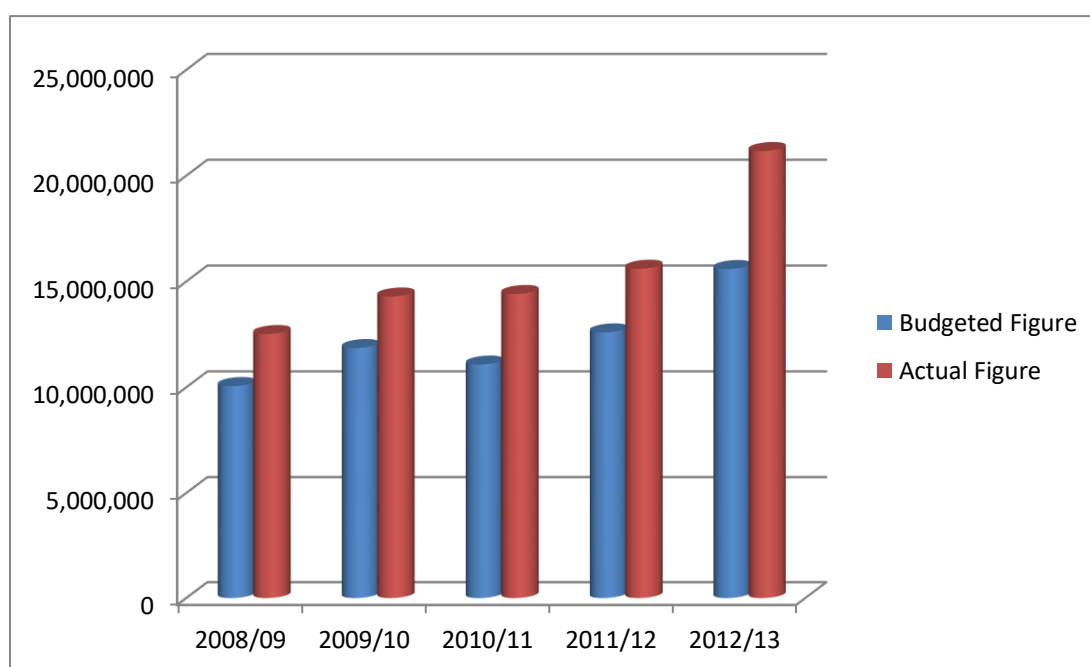
Table: 4-5
Budgeted and Actual LDO

(Amount Rs. '000')

Fiscal Year	Budgeted Figure:	Actual Figure:	Achievement
2008/09	10,057,859	12,516,012	124.44%
2009/10	11,852,853	14,289,793	120.56%
2010/11	11,073,394	14,408,749	130.12%
2011/12	12,593,995	15,602,701	123.89%
2012/13	15,587,642	21,164,910	135.78%

Source: Annual Reports and Budget Statement.

Figure: 4-3
Bar Diagram Showing Budgeted and Actual LDO



Above Table and figure shows that status of budgeted and actual LDO. The actual achievement of LDO is more than the 100 % in every year. The investment in LDO is increasing trend in terms of amount where as the achievement percentage with budgeted Figure is fluctuating trend. The range of achievement over the five year period is 120.56% to 135.78 % it shows that

Machhapuchchhre Bank Ltd. has meet the targeted investment in LDO in every year but the achievement trend is not same increment trend. For the study purpose the Figure of LDO are presented in Bar and scatter diagram and draw some conclusion accordingly.

Table: 4-6
Summary of Budgeted LDO and Achievement

(Amount in Rs '000')

Statistical Tools	Budgeted LDO(X)	Actual LDO(Y)
Mean	12,233,149	15,596,433
Standard Deviation	1876400	2953468
Coefficient of Variation	15.34	18.94
Correlation of Coefficient (r)	0.984	
Probable Error (PE)	0.00958 (r>6PE)	

Source: Appendix – 2

The above Table shows that budgeted LDO is less variable than actual LDO. Since the coefficient of variations of actual LDO is greater than that of budgeted LDO, actual LDO are more variable nature. On the other hand budgeted LDO more consistent and homogeneous than actual a greater coefficient of variation is said to be more heterogeneous. Here Machhapuchchhre Bank's actual LDO is the variable nature than budgeted LDO.

We can use another statistical tool correlation co-efficient to analyze the relationship between budgeted LDO and Actual LDO. There should be positive correlation between budgeted and actual LDO. We can take the help of Karl person's coefficient of correlation to find correlation between actual LDO and budgeted LDO. For this purpose budgeted LDO is denoted by X and actual LDO is denoted by Y. Here X is independent variable and Y is dependent variable. Here the correlation between budgeted and actual LDO is 0.984 it

means the relation between budgeted and actual LDO are perfectly correlated. Significance of r is tested with PE we have $r > 6$ PE this means the value of r is more significant. So it is no doubtful that actual LDO will go on same direction that of budgeted LDO.

From the calculation in appendix no 2, we have obtained the value of r being 0.9932. Now the coefficient of determination which explains the change in Y variable i.e. actual LDO by X variable i.e. budgeted LDO can be calculated as the square of r. $r^2 = (0.984)^2 = 0.968256$. Another statistical tool, regression line can also be fitted to show the degree of relationship between budgeted LDO and actual LDO and the forecast the achievement with given target. For this purpose, achievement Figure: have been supposed to be depended up on independent target. So that the regression line of achievement 'Y' on targeted 'X' or Y on X is as follows.

$$y - \bar{y} = r \frac{\sigma_y}{\sigma_x} \times (x - \bar{x})$$

$$y - 15,596,433 = 0.984 \times \frac{1876400}{2953468} (x - 12,233,149)$$

$$y - 15,596,433 = 0.625(x - 12,233,149)$$

$$y = 0.625x - 7950715$$

From the above equation, it is clear that actual LDO are in increasing trend. By the help of this regression equation, we ascertain the expected LDO achievement with the given value of target LDO say X for fiscal year 2012/13 = 30000000000

When X = 30000000000

Then expected LDO achievement

$$y = 0.625 \times 30000000 - 7950715$$

$$y = 10799285(000)$$

4.5.2 Resources Deployment in Other Sector (NLDO)

The portfolio of NLDO consists of liquidity in terms of cash and bank balance, investment, fixed and current assets. The budgeted and actual deployment in other sector listed in following Table: over the study period.

Table: 4-7

Status of Budgeted and Actual Deployment in Other Sector (NLDO)

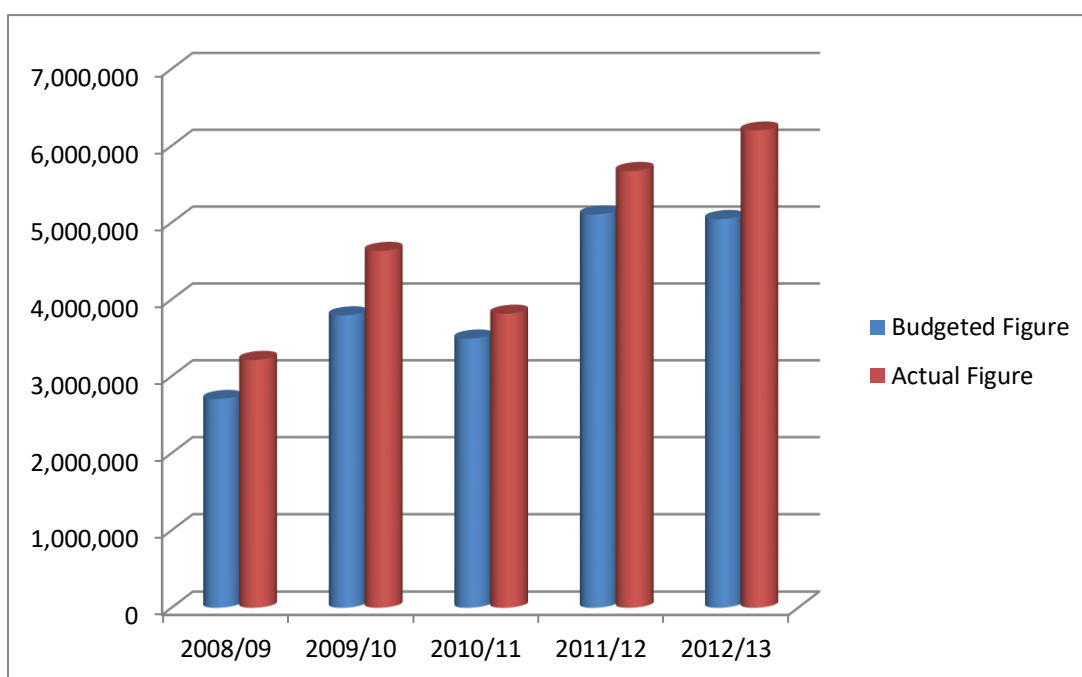
(Amount in Rs. '000')

Fiscal Year	Budgeted Figure	Actual Figure	Achievement
2008/09	2,705,930	3,214,288	118.79%
2009/10	3,793,983	4,632,770	122.11%
2010/11	3,491,869	3,815,028	109.25%
2011/12	5,106,144	5,672,726	111.10%
2012/13	5,047,419	6,199,255	122.82%

Source: Annual Reports and Budget Statement.

Figure: 4-4

Bar Diagram Showing Status of Budgeted and Actual NLDO



The above table shows the status of budgeted and actual deployment in other sector than LDO (NLDO). The actual achievement of investment in other sector has more than 100 % on each year. The rate of such achievement is fluctuating trend over the study period. The achievement is 118.79 % in F/Y 2008/09, it increased in F/Y 2009/10 to 122.11 %. And F/Y 2010/11 it decreases to 109.25 % and slightly fluctuating up to F/Y 2011/12. The average rate of achievement over the five year is 116.81 % this indicate that the bank achieved its target by 116 % approximately .For the analysis purpose the status of budgeted and actual NLDO is presenting in diagram . Above diagrams shows that more than 100% of achievement of targets in deployment of resources other than LDO that is NLDO. To show the relationship between budgeted and actual NLDO we have calculated some values by using statistical tool below.

Table: 4.8
Summary of NLDO

(Amount in Rs. '000')

Statistical Tools	Budgeted NLDO(X)	Actual NLDO (Y)
Mean	4029069	4706813
Standard Deviation	926464	1112543
Coefficient of Variation	22.99	23.64
Correlation of Coefficient (r)	0.976	
Probable Error (PE)	0.012(r>6P.E.)	

Source: Appendix – 3

The above Table shows the summary of investment in other sector (NLDO). The average investment in other sector is highest than the budgeted Figure. It means the target has been achieved. The actual NLDO is more variable in nature since it has higher C.V it means that the budgeted Figure: is more consistent a greater C.V. is said to be more heterogeneous. The correlation between budgeted and actual NLDO is denoted by r. The value of r is 1 so the

relationship between budgeted and actual Figure: is perfectly correlated. The significant of r can be measured by the probable error here the $r > 6PE$ so the r is significant.

4.5.3 Actual Deposit and Outstanding LDO

Customer deposit and deployment in LDO is major activities of a Machhapuchchhre Bank Ltd. As it is understood the major source of resources mobilization of Machhapuchchhre Bank Ltd. is the customer deposit and similarly the major outlet for deployment portfolio is for loan and advance and bills discount (LDO). It is desirable to analyze the comparative status of the same for the study period. Following Table shows actual balance of deposit and actual position of deployment toward LDO.

Table: 4-9
Status of LDO VS Actual Deposit

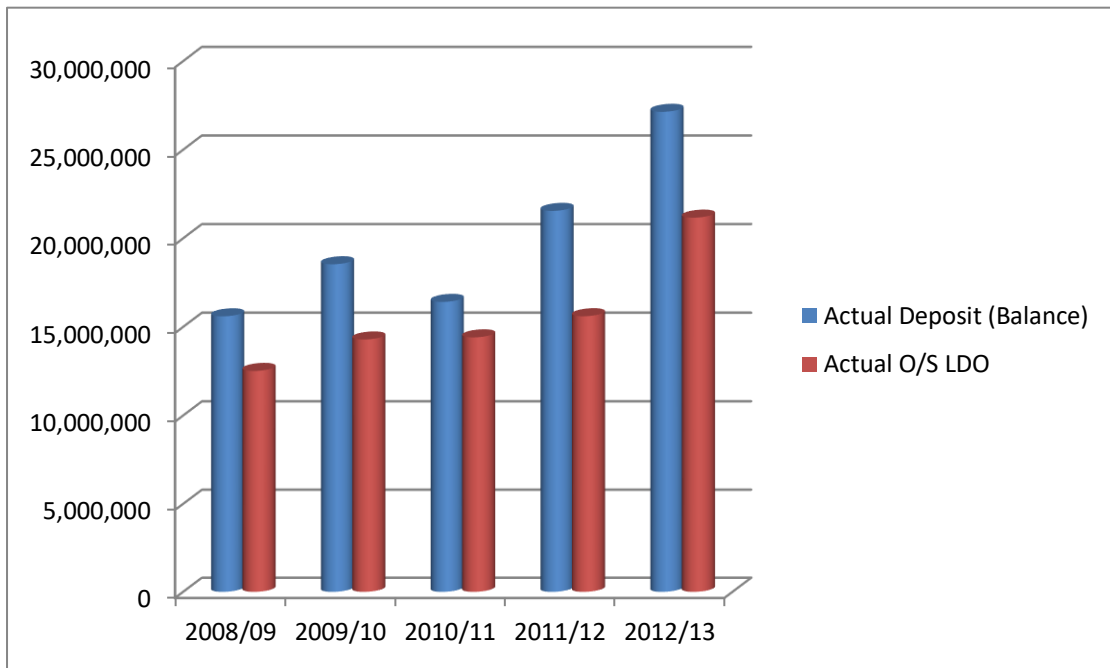
(Amount in Rs. '000')

Fiscal Year	Actual Deposit	Actual O/S LDO	LDO to Deposit Ratio
2008/09	15,596,791	12,516,012	80.25%
2009/10	18,535,917	14,289,793	77.09%
2010/11	16,409,968	14,408,749	87.80%
2011/12	21,546,397	15,602,701	72.41%
2012/13	27,136,654	21,164,910	77.99%

Source: Annul Reports

Figure: 4-5

Bar Diagram Showing Actual Deposit and Actual LDO



The above table shows the status of actual deposit balance and actual o/s LDO. The actual deposit balance and actual o/s LDO both are in declining trend up to 2009/2010, but increase in the year 2010/11. The utilization of deposit collection in terms of LDO is fluctuating trend in percentage. The range of LDO to deposit ratio is 72.41% to 87.80%.this indicate that the bank invest in LDO out of total deposit in the range of 72.41% to 87.80%.over the five year time period. For the analysis purpose the figure of actual deposit balance and actual o/s LDO is presenting in the figures. From the above table and figures it can be found that both the deposit and LDO is in increasing trend over the period. The average ratio of LDO to deposit is 79.12 %. It means that the bank invest in LDO 79.12 % in average. Now researcher is going to analyze by using some statistical tools to find the variability of deposit and LDO. We have to calculate arithmetic mean, standard deviation, coefficient of variation, correlation of coefficient, probable error.

Table: 4-10

Summary of Actual Deposit and Actual O/S LDO

(Amount in Rs '000')

Statistical Tools	Actual Deposit	Actual O/S LDO
Mean	19845145	15596433
Standard Deviation	4186249	2953468
Coefficient of Variation	21.09	18.94
Correlation of Coefficient (r)	0.9623	
Probable Error (PE)	0.0223(r>6PE)	

Source: Appendix – 4

The above Table shows that actual O/S LDO is more variable than actual deposit since it has higher C.V. On the other hand actual deposit more consistent than outstanding LDO it means the outstanding LDO is variable in nature. The relationship between actual deposit and actual outstanding LDO can be measured by co-relation between them. We can take the help of Karl Person's Co-efficient of correlation to find correlation between actual deposit and actual outstanding LDO. The correlation r is 0. 9623 this means it is perfectly correlated between actual deposit and actual outstanding LDO. Significance of correlation r is tested with probable error (PE) here the $6PE < r$ so the calculation of r is highly significance.

4.6 Interest Expenses

The bank collected from various sources. Among them some are non cost bearing and some are cost bearing sources. Interest expenses incurred for making payment of cost of such deposit amount which are interest bearing deposit. The interest holds highest percentage of expenses amount because deposit holds highest portion of total available resources. The bank may have different interest rate in different types of account. Here, the researcher going to analyze the average cost of deposit throughout the study period.

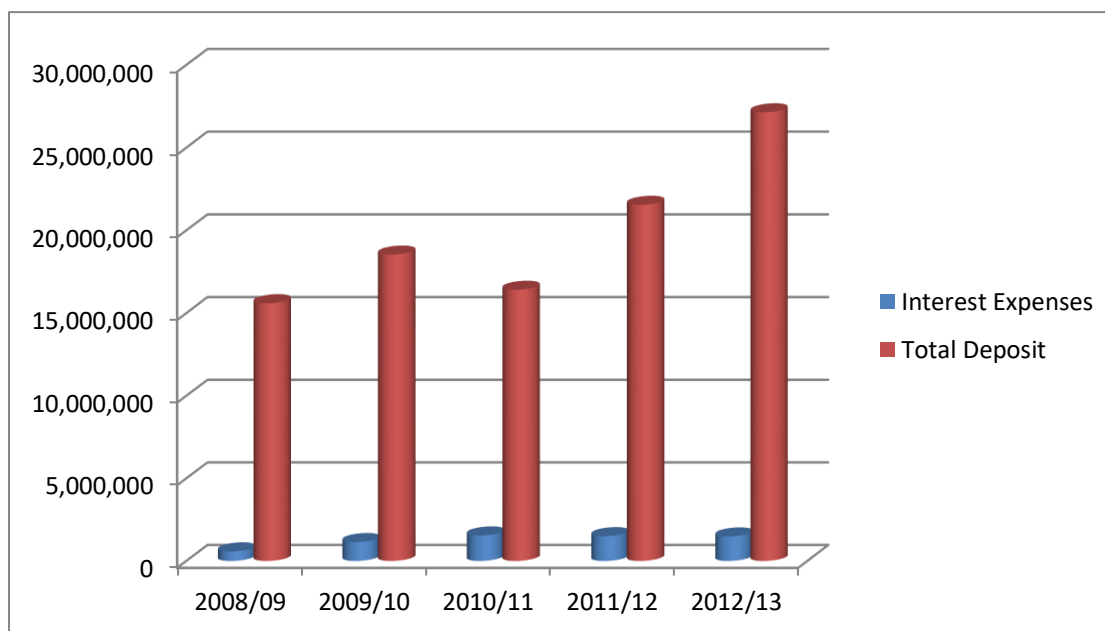
Table: 4-11
Status of Average Cost of Deposit

(Amount in Rs '000')

Fiscal Year	Interest Expenses	Total Deposit	Cost of Deposit
2008/09	580,036	15,596,791	3.72%
2009/10	1,144,808	18,535,917	6.18%
2010/11	1,544,728	16,409,968	9.41%
2011/12	1,500,772	21,546,397	6.97%
2012/13	1,485,592	27,136,654	5.47%

Source: Annual Reports.

Figure: 4-6
Bar Diagram Showing Average Cost of Deposit



The above Table shows the total deposit and interest expenses of respective year. The deposit amount is in increasing trend likewise the interest too. The Table shows the cost of deposit in percentage. The Machhapuchchhre Bank's cost of deposit (interest) range between 3.72% and 9.41% over the study period. The cost of deposit of the bank is increasing trend. The relation between COD and total deposit can shows on the bar diagram below.

The bar diagram shows the status of interest expenses and total deposit in respective fiscal year. The amount of total deposit is in increasing trend likewise interest is changing trend accordingly. The amount of interest expenses is increasing every year.

4.7 Interest Income

Interest income also called return of LDO contributes major portion of total revenue mix. Now, researcher is going to analyze the comparative status of total return on LDO with the help of table & diagrams.

Table: 4-12
Status of Average Return of LDO

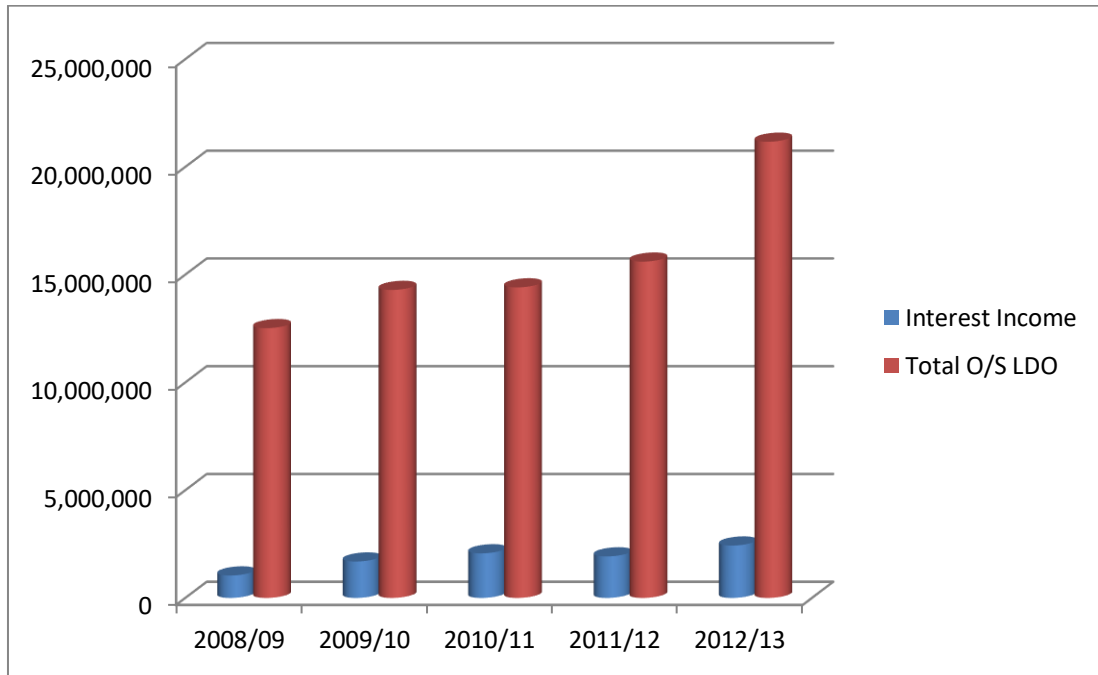
(Amount in Rs '000')

Fiscal Year	Interest Income	Total O/S LDO	Average Rate of Return
2008/09	1,041,473	12,516,012	8.32%
2009/10	1,688,618	14,289,793	11.82%
2010/11	2,067,746	14,408,749	14.35%
2011/12	1,926,128	15,602,701	12.34%
2012/13	2,429,629	21,164,910	11.48%

Source: Annual Reports

Figure: 4-7

Bar Diagram Showing Average Return of LDO



The above Table shows the comparative status of interest income with the o/s LDO and the return on same LDO. The interest income is in fluctuating trend as the LDO has increased whereas the rate of return on LDO is fluctuating trend. The range of rate of return lies between 8.32% and 14.35 %, in the five year period. It is effective to analyze the relationship between o/s LDO and interest income by using the statistical tools to find out the variability of actual LDO and actual income of different years we have to calculate arithmetic mean, standard deviation coefficient of variation, coefficient of determination and correlation of coefficient. The detail calculations of these statistical tools are presented in appendix no 6 now summary of calculation listed below.

For more analysis purpose the data of interest income and o/s LDO presenting in bar diagram. From the Figure researcher can find that the yearly interest income is in fluctuating trend in amount where as o/s LDO is in increasing trend. In the term of average rate of return is fluctuating trend.

Table: 4-13**Summary of Actual LDO and Interest Income**

(Amount in Rs '000')

Statistical Tools	Actual LDO(X)	Interest Income(Y)
Mean	15596433	1830719
Standard Deviation	2953468	461970
Coefficient of Variation	18.94	25.23
Correlation of coefficient(r)	0.8313	
Probable Error(PE)	0.0093(r>6PE)	

Source: Appendix – 5

The above results show that actual o/s LDO is more variable than interest income since CV of LDO is higher than of interest. There should be positive correlation between o/s LDO and interest income. In other words the interest income increases as the o/s LDO increase or vice versa. To find the correlation between interest income and actual o/s LDO we can take the help of Karl person's coefficient of correlation and it is denoted by 'r' we can examine whether there is positive correlation between interest income and actual LDO. The actual LDO (X) is assumed as independent variable and interest income (Y) is assumed to be dependent variable. So that increase in LDO will support to increase in interest income and vice versa. After this significance of 'r' is tested with the probable error of 'r'. The value of r is 0.8313 & P.E is 0.0093 since $r > 6PE$ the value of r is significant. From the calculation shown in appendix no 6 the value of r is 0.8313. Now the coefficient of determination which explains the change in Y variable i.e. interest income by x variable i.e. LDO can be calculated as the r^2 . $r^2 = (0.8313)^2 = 0.6911$

4.7.1 Interest Margin

The difference between interest income and interest expenses is called interest margin. Following Table: shows the movement in interest margin throughout the study period of Machhapuchchhre Bank Ltd.

Table: 4-14

Movements in Interest Margin

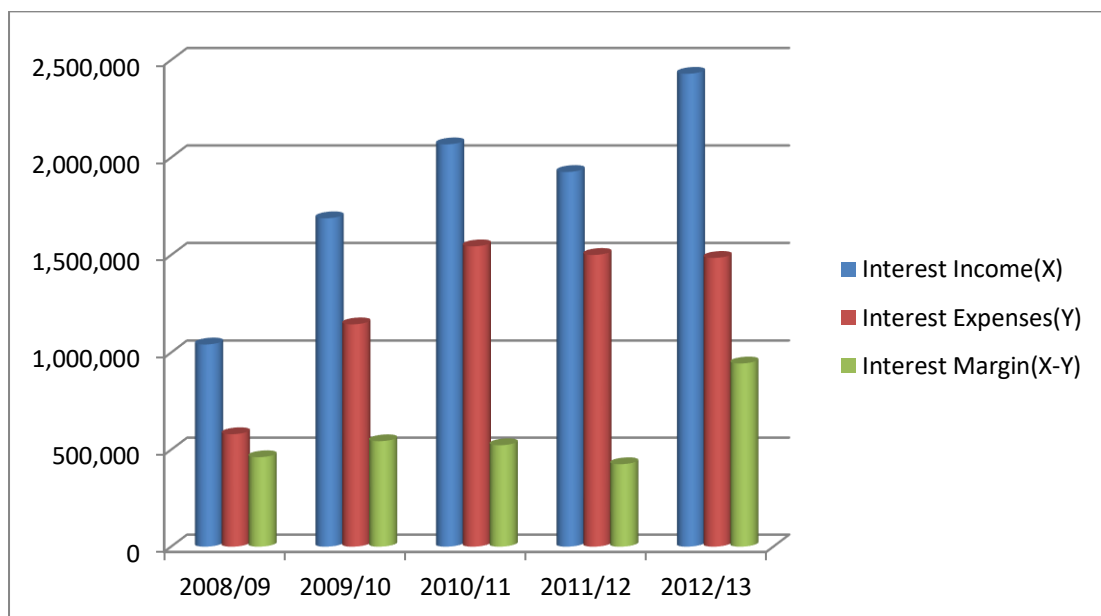
(Amount in Rs '000')

F/Y	Interest Income(X)	Interest Expenses(Y)	Interest Margin(X-Y)	Growth in Interest Margin
2008/09	1,041,473	580,036	461,437	-
2009/10	1,688,618	1,144,808	543,810	17.85%
2010/11	2,067,746	1,544,728	523,018	-3.82%
2011/12	1,926,128	1,500,772	425,356	-18.67%
2012/13	2,429,629	1,485,592	944,037	121.94%

Source: Annual Reports

Figure: 4-8

Bar Diagram Showing Interest Margin



The above Table shows the position of interest margin and its growth throughout the study period. The Figure of interest margin is fluctuating trend every year. The base year to calculate the interest margin is F/Y 2008/09. The

position of interest income, interest expenses and interest margin is presenting in the bar diagram.

The above bar diagram is showing the status of interest margin with comparison with interest income and interest expenses of Machhapuchchhre Bank Ltd. The fundamental purpose of this diagram is to show the relationship of interest margin so the trend of interest margin throughout the five years period is fluctuating.

4.8 Performance Evaluation of Machhapuchchhre Bank Ltd.

Performance evaluation can help to outline the strength and weakness of management and help to improve the weakness of management and to energize to accomplishment of organizational goal. Here researcher going to analyze by using various technique and criteria to evaluate performance of Machhapuchchhre some financial tools is as follows:

- Ratio Analysis
- Cost Volume Profit Analysis

4.9 Ratio Analysis

“Ratio refers to the numerical relation of component parts of financial statement to each other. Ratio relationships are computed to obtain information about various characteristics and conditions of firm” (Bagavati & Pillai, 2000: 1339). Ratio analysis is a technique of analysis and interpretation of financial statement through mathematical expression. It may be defined as the mathematical expression of the relationship between two accounting Figures. To evaluate the different performance of an organization by creating the ratios from the Figures of different accounts is termed as ratio analysis. Ratio used for financial analysis of business can be classified in to four categories.

- Liquidity Ratio
- Leverage Ratio
- Activity Ratio

- Profitability Ratio

4.9.1 Liquidity Ratio

The ability of a firm to meet its obligation in the short term is known as liquidity. It reflects the short-term financial strength of the firm. Now, we use current ratio to measure relationship of current assets and current liabilities of Machhapuchchhre Bank Ltd.

The current ratio, one of the most commonly cited financial ratio, measure the firm's ability to meet its short-term obligations. Current ratio is the ratio of current assets to current liabilities. Current assets are cash and other "nearness to cash" which can be converted into cash within one accounting period; whereas the current liabilities are those short term obligations which can be paid within a year.

Current assets represents cash and bank balance investment in treasury bills, money at call, loans and advances, bills purchased and discount inter branch account, other short term loans, receivables and repaid expenses.

Current liabilities refer to the short-term maturity objective, which includes all deposit liabilities, intra-bank reconciliation account, bills payable, tax provision, staff bonus, dividend payable, bank overdrafts, provisions, accrued expenses. The current ratio is expressed as follows:

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

4.9.2 Leverage Ratio

The leverage ratio also called capital structure ratio. The leverage ratio calculated to judge the long term financial position of a firm. These ratios measure the firm's ability to pay the interest regularly and to pay the principal on maturity. The following ratios are included in leverage ratio.

- Debt- Equity Ratio

- Interest Coverage Ratio

4.9.3 Debt-Equity Ratio

The relationship between long term debt and share holder's equity is called debt equity ratio. Debt-Equity ratio measures the long term financial solvency of a business concern. It is calculated by dividing to long term debt by Share holder's equity. The Debt-Equity Ratio can be calculated dividing to borrowings by share holder equity the details of borrowings and share holders equity shown on appendix No.6.

$$\text{Debt-Equity Ratio} = \frac{\text{Borrowings}}{\text{Shareholder's Equity}}$$

Table: 4-15
Debt-Equity Ratio

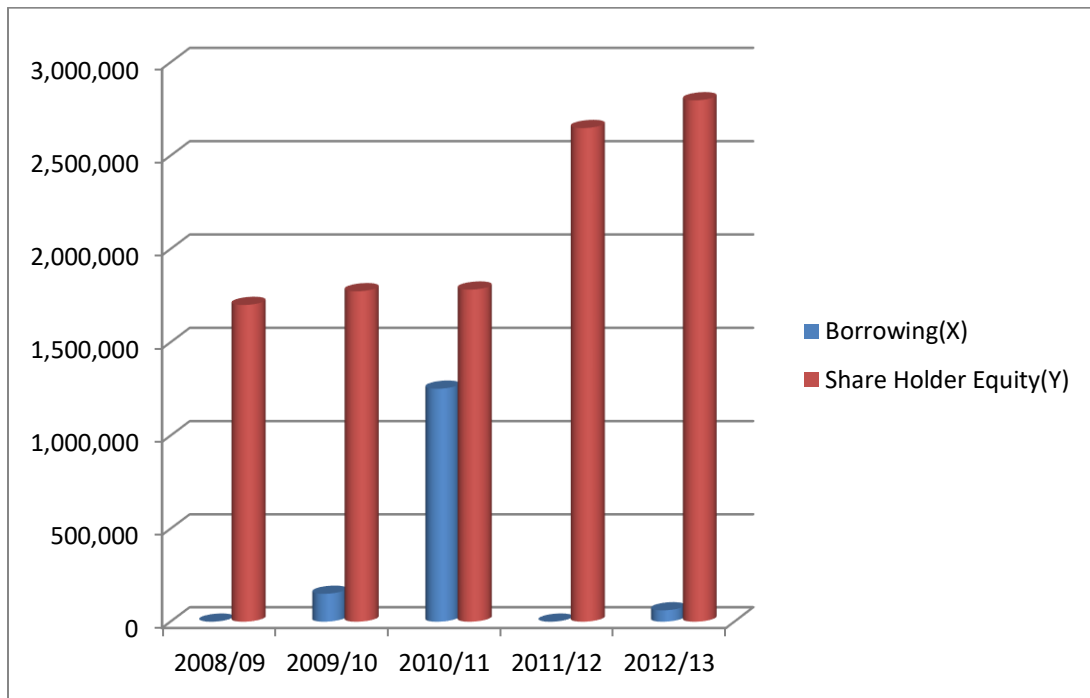
(Amount in Rs '000')

Fiscal Year	Borrowing(X)	Share Holder Equity(Y)	Debt-Equity Ratio(X/Y)
2008/09	0	1,700,198	0
2009/10	150,000	1,773,511	8.46
2010/11	1,251,242	1,782,434	70.20
2011/12	0	2,648,077	0
2012/13	61,017	2,796,676	2.18

Source: Appendix -6

Figure: 4-9

Bar Diagram Showing Borrowing and Shareholder's Equity



The above table shows the debt equity ratio of Machhapuchchhre Bank Ltd. The column X shows the Figure of borrowings and column Y shows the Figure of share holder's equity. By dividing the column X by Y is the result of debt equity ratio. Here the range of debt equity ratio of Machhapuchchhre Bank Ltd is 0 to 70.20. The trend of debt equity ratio is fluctuating every year. Machhapuchchhre Bank Ltd has high portion of equity than long term debenture where as for a banking sector fixed deposit is also considered as long term obligation but in above analysis researcher has calculated only borrowing as long term debt. The above Table shows that Machhapuchchhre's financial strength is strong because it has more internal fund to repay the borrowing capital. The figure of long term debt and share holder's equity is presenting in the bar diagram below.

From the diagram it shows the status of long term debt and share holder's equity. The long term debt is in fluctuating trend and shareholder equity is increasing rapidly over the five year's period. The position of shareholder

equity is higher than the long term debt. This indicates that the bank used more internal fund than external fund.

4.9.4 Interest Coverage Ratio (ICR)

ICR measures the capacity to pay interest expenses. This ratio is calculated by dividing Net Profit before Interest & Tax (EBIT) by Interest cost amount.

$$\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Interest Expenses}}$$

Table: 4-16
Calculation of Interest Coverage Ratio

(Amount in Rs '000')

Fiscal Year	EBIT(X)	Interest Expenses(Y)	Times
2008/09	1,232,511	580,036	2.12
2009/10	1,331,280	1,144,808	1.16
2010/11	1,923,003	1,544,728	1.24
2011/12	1,821,296	1,500,772	1.21
2012/13	1,485,992	1,485,592	1.00

Source: Annual Reports

The above Table shows the position of interest coverage ratio (ICR) of Machhapuchchhre Bank Ltd. The ICR is 2.12 times in F/Y 2008/09 this means EBIT is 2.12 times more than interest expenses. The ICR reached to 1.16 times in F/Y 2009/10. This result represents the Machhapuchchhre Bank Ltd has decreased its EBIT. Again the rate increased up to F/Y 2010/11 but it decreased in 2011/12 to 1.21. The interest coverage ratio of Machhapuchchhre Bank Ltd ranges between 1.00 to 2.12 times. It means that the bank sufficiently capable to pay the interest expenses.

4.9.5 Profitability Ratio

Profitability ratio is related to profit. It shows the overall efficiency of the business concern. The earning capacity of a business is measured by profitability ratio. Maximization of profit is the main objectives of each and every business concern. It is very necessary to earn maximum profit for the successful running of a business concern. Here researcher is going to measure of Machhapuchchhre Bank Ltd profitability by total assets & total capital fund to Net profit. It is computed by dividing to Net profit by Total Assets & Net Profit to total capital fund.

Table: 4-17

Profitability Ratio of Machhapuchchhre Bank Ltd

(Amount in Rs '000')

Fiscal Year	Net Profit after Tax(A)	Total Assets(B)	Return on Assets(C= A/B)	Total Capital Fund(D)	Return on Capital(E =A/D)
2008/09	203,251	17,490,782	1.16%	1,749,078	11.62%
2009/10	233,128	20,678,791	1.13%	2,067,879	11.27%
2010/11	292,300	19,605,874	1.49%	1,960,587	14.91%
2011/12	382,130	24,357,253	1.57%	2,435,725	15.69%
2012/13	348,599	30,296,203	1.15%	2,096,203	16.63%

Sources: Annual Reports

The above Table shows the status of return on assets and return on capital employed of Machhapuchchhre Bank Ltd. The ratio shows the relation of net profit after tax with the total assets and total capital employed. The rate of return of on assets is fluctuating trend and it is ranged between 1.13 % and 1.57 % throughout the five years period. Likewise the return on capital ratio presenting the relation of net profit with the capital employed. The range of

return on capital employed is 11.27 % to 16.63 % it is fluctuating trend through five years of study period.

4.10 Major Findings of the Study

- The bank has 89.14% average contribution of customer deposit in the resources mobilization as per the data F/Y 2008/09 to 2012/13 and uses the other resources of 11.86% in average.
- The bank is well performing in the deposit collection sector. Actual deposit is higher than the budgeted Figure. It is found (r) is 0.998 and PE is 0.00121. The Figure of 'r' shows that there is positive perfect correlation between budgeted deposit and actual deposit. The relation of PE with r is $r > 6PE$, it is significant so the actual deposit going on same direction. The relationship between budgeted and actual amount deposit remains same the amount of deposit in F/Y 2021/13 will be RS 48,030,485 thousand stated by the regression line.
- The major portion of deployment of the bank covers by the loan and advance.
- The statistical tool CV represents that actual LDO is the variable nature than budgeted LDO. The correlation between budgeted and actual LDO is 0.9836 it means the relation between budgeted and actual LDO are perfectly co-related. Significance of 'r' is tested with PE there is $r > 6 PE$ this means the value of r is more significant. So it is not doubtful that actual LDO will go on same direction that of budgeted LDO. The regression line shows the expected LDO for the F/Y 2012/13 will be 43103135 thousand.
- The researcher find that the 100 % of achievement of targets in deployment of resources other than LDO i.e. NLDO.
- LDO is in increasing trend over the period. The average ratio of LDO to deposit is 79.11 %.
- The relationship between actual deposit and actual O/S LDO is in fluctuating trend over the period.

- The interest holds highest percentage of expenses amount as deposit is the major resources of the bank. The COD of Machhapuchchhre Bank Ltd. is in the range of 3.72% and 9.41% it means the bank pays the interest 6.35 % in average over the period.
- The yearly interest income is in fluctuating trend in amount where the O/S LDO is increasing. In the term of average rate of return is fluctuating trend it is ranges of 8.32% and 14.35 %.The average rate of return over the study period is 11.66%.
- The amount of interest margin is in fluctuating trend where the increment percentage is also in fluctuating trend over the study period.
- Debt-Equity ratio shows that the bank's financial strength is very strong because it has more internal fund to repay the borrowing capital.
- The interest coverage ratio range between 1.00 to 2.12 times.
- The range of return on total assets is 1.13 % and 1.57 % and range of return of total capital fund is 11.27 % to 16.63 % over the period.

The cash flow analysis of the Machhapuchchhre Bank Ltd. shows that there is sufficient fund to repay the short term obligation and it has maintained the liquidity.

CHAPTER - V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

The last chapter of this study is summary, conclusion and recommendations developed from the analysis of various aspects of the Profit Planning of Machhapuchchhre Bank Ltd. This chapter is comprised of three sections, the first section deals with the summary of the study; the second section draws the conclusions of the study. Lastly, the third section proposes the suggestions to the problems observed on the basis of the findings. This would be meaningful to the top management of the concerned banks to initiate the action and achieve the desired results.

5.1 Summary

Nepal is a developing country, which started its economic development plans and policies more than four decades ago and has adopted the economic development plans through liberalization recently. The policy of liberalization that the government adopted after restoration of democracy in 1990 calls for primitive and facilitative role of the government together with its strict regulatory functions. There are 31 commercial banks operating in Nepal which are taken as population of the study among them Machhapuchchhre Bank Ltd. has been taken as a sample of the study and collected data has been analyzed by using various statistical and financial tools like ratio analysis, correlation coefficient, regression equation etc. The data obtained from annual reports of the concerned banks, likewise the financial statements of Five years (from 2007 to 2012) were selected for the purpose of evaluation. The main objective of the study is to focus the current profit planning adopted and its effectiveness in Machhapuchchhre Bank Limited (MBL). To study the variance of budgeted and actual achievements. To analyze the growth of the business of the bank over the period. To provide suggestion and recommendations for improvements of

the overall profitability of the Machhapuchchhre Bank Ltd. The study is mostly based on secondary data and required data have been collected by using various sources. Regarding the profit planning policies of commercial banks there are basically five basic principles of the bank follow while providing the loans i.e. liquidity, profitability, security and suitability diversification. Various process while making investment decision are applied in the study i.e. set investment process, security analysis, portfolio construction, revision, performance evaluation .

Machhapuchchhre Bank Ltd. is one of the well established commercial bank in Nepal. Machhapuchchhre Bank Ltd is able to maintain. Its position as a market leader in the banking sector and there is ongoing effort and commitment in enhancing its financial position.

5.2 Conclusions

On the basis of major findings of study some conclusion has drawn about the Machhapuchchhre Bank Ltd.

- Analysis concludes that growth of bank is significant. Machhapuchchhre Bank Ltd. is increasing its internal fund by increasing capital year by year this means strengthen their capability internally.
- The bank can use customer deposit as much as possible for competitive market to increase profit.
- There is variance in budgeted and actual performance but it has always crossed budgeted Figure, Actual deposit is also more than budgeted one.
- The bank is able to meet its targeted deposit collection, deployment of LDO. The relationship between budgeted and actual Figures is positively correlated
- There is more variable actual deployment in other sector than budgeted..
- The average cost of deposit (COD) of bank is normal it means the bank is able to collect cost free deposit.
- Actual o/s LDO is more variable than interest

- The major income source is interest margin the trend of interest margin is fluctuating trend every year but able to maintain interest expenses.
- The financial strength of the bank is strong since Debt equity ratio shows that the bank can use more internal fund to repay its borrowings.
- The interest coverage ratio is fluctuation but the bank can sufficiently capable to pay the interest expenses.
- The return on assets and return on capital is satisfactory of Machhapuchchhre Bank Ltd it shows the good earning capacity of the bank.
- The result of the study shows the overall performance of Machhapuchchhre Bank Ltd is satisfactory and progressive.

5.3 Recommendations

This researcher would like to provide some suggestion for the better improvement of bank in future. This recommendation based on the study on profit planning of Machhapuchchhre Bank Ltd these is as follows:

- The bank need to make their business plan and strategy accordingly which can convert challenges in to opportunities.
- Machhapuchchhre's major source of resources collection is deposit since this is the cost bearing sources the bank is suggest increasing cost free resources too, and reducing the burden of the bank.
- Financial institutions increasing day by day in Nepal it grows the competition with the banks so Machhapuchchhre Bank Ltd. should make some policy to keep its position as before among the Nepalese financial institutions.
- The bank should be conscious about the factors affecting the business like Global economic crisis, existing abnormal situation, political uncertainty etc.

- The bank should pay more attention about the changing technological environment and need to provide innovative products and services that reduce the cost of fund it give more growth and profitability.
- Every business concerns have one another obligation i.e. corporate social responsibility so its needs more involvement in social activities in the coming days.
- The bank needs to put more focus on the non fund consuming business activities like LC, Bank guarantee, foreign exchange and other. It supports in the overall profitability of the bank.
- Expenses grow as the volume of activities increases so it can't be avoided but can be controlled. The bank can minimize those expenses not related for income generating activities so the bank enhances its profitability.
- People in rural area of Nepal still out of banking services so the bank is suggested to take bold steps to expand and upgrade its network to reach such area with their products and services.
- The 'Global Economic Crisis' started from banking sector of USA and UROPE this crisis affects to Nepalese financial sectors too so the Machhapuchchhre Bank Ltd suggested to make some policy to be safe from this crisis.

The size of Nepali banking market is increasing day by day. The increase in number of financial institutions indicates the increasing competition in financial market. To monitor with proper regulation this even more, the government had to bring new strategies. Moreover, foreign banks are allowed to operate in Nepal from 2010 A.D there will be more challenge for Nepalese financial institutions. The central bank of Nepal (NRB) should make some policies toward the banking sector to comfort and able to compete with this ever increasing financial institutions. Nowadays, the central bank of Nepal (NRB) published

The research report is concluded with the above mentioned major findings, summary, conclusions, and recommendations.

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APPENDICES

Appendix – 1

Deposit Collection Budget of MACHHAPUCHCHRE Bank Ltd.

Amount in Rs (0,000,000)

Fiscal Year	X	Y	$x = X - \bar{X}$	$y = Y - \bar{Y}$	xy	x^2	y^2
2008/09	1415	1560	-368	-425	156,237	135,246	180,485
2009/10	1704	1854	-78	-131	10,209	6,081	17,141
2010/11	1538	1641	-244	-344	83,883	59,628	118,004
2011/12	1914	2155	132	170	22,419	17,366	28,943
2012/13	2341	2714	558	729	406,970	311,522	531,661
	$\sum X = 8$ 912	$\sum Y =$ 9923	$\sum x = 0$	$\sum y = 0$	$\sum xy = 67$ 9718	$\sum x^2 = 52$ 9843	$\sum y^2 = 87$ 6234

$$\bar{X} = \frac{\sum x}{N} = \frac{8912}{5} = 1782.0$$

$$\bar{Y} = \frac{\sum y}{N} = \frac{9923}{5} = 1985$$

$$\sigma_x = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2} = \sqrt{\frac{529843}{5} - 0} = 325.53$$

$$\sigma_y = \sqrt{\frac{\sum y^2}{n} - \left(\frac{\sum y}{n}\right)^2} = \sqrt{\frac{876234}{5} - 0} = 418.63$$

$$r_{xy} = \frac{\sum xy}{\sqrt{\sum x^2} \times \sqrt{\sum y^2}} = \frac{679718}{\sqrt{529843} \times \sqrt{876234}} = 0.998$$

$$CV_x = \frac{\sigma_x}{\bar{x}} \times 100 = \frac{325.53}{1782} \times 100 = 18.26\%$$

$$CV_y = \frac{\sigma_y}{\bar{y}} \times 100 = \frac{418.63}{1985} \times 100 = 21.09\%$$

$$PE = 0.6745 \times \frac{1-r^2}{\sqrt{n}} = 0.6745 \times \frac{1-0.998^2}{\sqrt{5}} = 0.00121$$

$$6PE = 6 \times 0.00121 = 0.00723 (r > 6PE)$$

Appendix – 2

Summary of Budgeted LDO and Achievement

Amount in Rs

(0,000,000)

Fiscal Year	X	Y	$x = X - \bar{X}$	$y = Y - \bar{Y}$	xy	x^2	y^2
2008/09	1,006	1,252	-218	-308	67,008	47,319	94,890
2009/10	1,185	1,429	-38	-131	4,969	1,446	17,073
2010/11	1,107	1,441	-116	-119	13,774	13,450	14,106
2011/12	1,259	1,560	36	1	23	1,302	0
2012/13	1,559	2,116	335	557	186,794	112,526	310,079
	$\sum X =$ 6117	$\sum Y = 77$ 98	$\sum x = 0$	$\sum y = 0$	$\sum xy =$ 272,568	$\sum x^2 = 1$ 76044	$\sum y^2 = 436$ 149

$$\bar{X} = \frac{\sum X}{N} = \frac{6117}{5} = 1223$$

$$\bar{Y} = \frac{\sum Y}{N} = \frac{7798}{5} = 1560$$

$$\sigma_x = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2} = \sqrt{\frac{176044}{5} - 0} = 187.64$$

$$\sigma_y = \sqrt{\frac{\sum y^2}{n} - \left(\frac{\sum y}{n}\right)^2} = \sqrt{\frac{436149}{5} - 0} = 295.35$$

$$r_{xy} = \frac{\sum xy}{\sqrt{\sum x^2} \times \sqrt{\sum y^2}} = \frac{272568}{\sqrt{176044} \times \sqrt{436149}} = 0.984$$

$$CV_x = \frac{\sigma_x}{\bar{x}} \times 100 = \frac{187.64}{1223} \times 100 = 15.34\%$$

$$CV_y = \frac{\sigma_y}{\bar{y}} \times 100 = \frac{295.35}{1560} \times 100 = 18.94\%$$

$$PE = 0.6745 \times \frac{1-r^2}{\sqrt{n}} = 0.6745 \times \frac{1-0.984^2}{\sqrt{5}} = 0.0142$$

$$6PE = 6 \times 0.0142 = 0.0852 (r > 6PE)$$

Appendix – 3

Budgeted and Actual NLDO of MACHHAPUCHCHRE Bank Ltd

Amount in Rs

(0,000,000)

Fiscal Year	X	Y	$x = X - \bar{X}$	$y = Y - \bar{Y}$	xy	x^2	y^2
2008/09	271	321	-132	-149	19,748	17,507	22,276
2009/10	379	463	-24	-7	174	553	55
2010/11	349	382	-54	-89	4,791	2,886	7,953
2011/12	511	567	108	97	10,404	11,601	9,330
2012/13	505	620	102	149	15,198	10,370	22,274
	$\sum X =$ 2015	$\sum Y =$ 2353	$\sum x = 0$	$\sum y = 0$	$\sum xy =$ 50315	$\sum x^2 =$ 42917	$\sum y^2 =$ 61888

$$\bar{X} = \frac{\sum x}{N} = \frac{2015}{5} = 403 \quad \bar{Y} = \frac{\sum y}{N} = \frac{2353}{5} = 471$$

$$\sigma_x = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2} = \sqrt{\frac{42917}{5} - 0} = 93$$

$$\sigma_y = \sqrt{\frac{\sum y^2}{n} - \left(\frac{\sum y}{n}\right)^2} = \sqrt{\frac{61888}{5} - 0} = 111$$

$$r_{xy} = \frac{\sum xy}{\sqrt{\sum x^2} \times \sqrt{\sum y^2}} = \frac{50315}{\sqrt{42917} \times \sqrt{61888}} = 0.976$$

$$CV_x = \frac{\sigma_x}{\bar{x}} \times 100 = \frac{93}{403} \times 100 = 22.99\%$$

$$CV_y = \frac{\sigma_y}{\bar{y}} \times 100 = \frac{111}{471} \times 100 = 23.64\%$$

$$PE = 0.6745 \times \frac{1-r^2}{\sqrt{n}} = 0.6745 \times \frac{1-0.976^2}{\sqrt{5}} = 0.0212$$

$$6PE = 6 \times 0.0212 = 0.127 (r > 6PE)$$

Appendix – 4

Summary of Actual Deposit and Actual O/S LDO

Amount in Rs

(0,000,000)

Fiscal Year	X	Y	$x = X - \bar{X}$	$y = Y - \bar{Y}$	xy	x^2	y^2
2008/09	1,560	1,252	-425	-308	130,867	180,485	94,890
2009/10	1,854	1,429	-131	-131	17,107	17,141	17,073
2010/11	1,641	1,441	-344	-119	40,799	118,004	14,106
2011/12	2,155	1,560	170	1	107	28,943	0
2012/13	2,714	2,116	729	557	406,026	531,661	310,079
	$\sum X =$ 9923	$\sum Y =$ 7798	$\sum x = 0$	$\sum y = 0$	$\sum xy =$ 5 94906	$\sum x^2 =$ 8 76234	$\sum y^2 =$ 43 6149

$$\bar{X} = \frac{\sum x}{N} = \frac{9923}{5} = 1985 \quad \bar{Y} = \frac{\sum Y}{N} = \frac{7798}{5} = 1560$$

$$\sigma_x = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2} = \sqrt{\frac{876234}{5} - 0} = 419$$

$$\sigma_y = \sqrt{\frac{\sum y^2}{n} - \left(\frac{\sum y}{n}\right)^2} = \sqrt{\frac{436149}{5} - 0} = 295$$

$$r_{xy} = \frac{\sum xy}{\sqrt{\sum x^2} \times \sqrt{\sum y^2}} = \frac{594906}{\sqrt{876234} \times \sqrt{436149}} = 0.962$$

$$CV_x = \frac{\sigma_x}{\bar{x}} \times 100 = \frac{419}{1985} \times 100 = 21.09\%$$

$$CV_y = \frac{\sigma_y}{\bar{y}} \times 100 = \frac{295}{1560} \times 100 = 18.94\%$$

$$PE = 0.6745 \times \frac{1-r^2}{\sqrt{n}} = 0.6745 \times \frac{1-0.962^2}{\sqrt{5}} = 0.0224$$

$$6PE = 6 \times 0.0224 = 0.1350 > 6PE$$

Appendix – 5

Summary of Actual LDO and Interest income

Amount in Rs

(0,000,000)

Fiscal Year	X	Y	$x = X - \bar{X}$	$y = Y - \bar{Y}$	xy	x^2	y^2
2008/09	1,252	104	-308	-79	24,312	94,890	6,229
2009/10	1,429	169	-131	-14	1,857	17,073	202
2010/11	1,441	207	-119	24	-2,815	14,106	562
2011/12	1,560	193	1	10	6	0	91
2012/13	2,116	243	557	60	33,350	310,079	3,587
	$\sum X =$ 7798	$\sum Y =$ 915	$\sum x = 0$	$\sum y = 0$	$\sum xy =$ 56710	$\sum x^2 =$ 6149	$\sum y^2 =$ 10671

$$\bar{X} = \frac{\sum x}{N} = \frac{7798}{5} = 1560$$

$$\bar{Y} = \frac{\sum Y}{N} = \frac{915}{5} = 183$$

$$\sigma_x = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2} = \sqrt{\frac{436149}{5} - 0} = 295$$

$$\sigma_y = \sqrt{\frac{\sum y^2}{n} - \left(\frac{\sum y}{n}\right)^2} = \sqrt{\frac{10671}{5} - 0} = 46$$

$$r_{xy} = \frac{\sum xy}{\sqrt{\sum x^2} \times \sqrt{\sum y^2}} = \frac{56710}{\sqrt{436149} \times \sqrt{10671}} = 0.831$$

$$CV_x = \frac{\sigma_x}{\bar{x}} \times 100 = \frac{46}{183} \times 100 = 25.13\%$$

$$CV_y = \frac{\sigma_y}{\bar{y}} \times 100 = \frac{295.35}{1560} \times 100 = 18.94\%$$

$$PE = 0.6745 \times \frac{1-r^2}{\sqrt{n}} = 0.6745 \times \frac{1-0.831^2}{\sqrt{5}} = 0.09334$$

$$6PE = 6 \times 0.09334 = 0.56 (r > 6PE)$$

Appendix – 6**Calculation of Burrowing and Shareholder Equity of MACHHAPUCHCHRE Bank Ltd**

Fiscal Year	Burrowing	Paid up Capital	Retained Earnings	P/L	Shareholder Equity
2008/09	0	1,479,270	220,928	123,251	1,700,198
2009/10	150,000	1,627,197	146,314	73,313	1,773,511
2010/11	1,251,242	1,627,197	155,237	8,923	1,782,434
2011/12	0	2,478,795	169,282	38,213	2,648,077
2012/13	61,017	2,478,795	317,881	148,599	2,796,676