

# CHAPTER ONE

## INTRODUCTION

### **1.1. General Background:**

Human activities are normally directed towards the well being of the people. Energy and efforts devoted by people of the society aim at enhancing material benefits to the community. To enable people to enjoy the material benefits is possible only when production base is expanded. In other words this requires economic growth. In order to contribute in the process of economic development of the country banking industry has been established and operating to provide the financial resources to the economic activities.

Industrialization of the country is regarded as a precondition for providing employment opportunities to the people. This leads to the active participation of the people in the national development and the upliftment of their present economic condition. To improve the economic condition, the government needs to focus itself in formulation and implementation of the proper strategies for overall industrializations of the nation and the integrated and speedy development of industrial sectors of the country.

Bank in general means an institution that deals with money. A bank performs several financial monetary and economic activities which are essential for the economic development of a country. It is a monetary institutional vehicle for domestic resource mobilization of the country that accepts deposits from various sources and invests such accumulated resources in the field of agriculture, trade, commerce etc.

Generally the term "bank" refers commercial banks. Commercial banks are the dominant institution in the financial sectors and are the foundation of the national economy. They transfer monetary sources from savers to users. They involve in various functions like creation money, facilitating credit, and facilitating foreign trade, safe keeping of the values etc. The activities of commercial banking sector have contributed to eliminate poverty and reduce unemployment. Modern commercial banks are different in many respects than the banks operated in the past periods. The banks, which operated in the past, were concentrated both on the central bank functions, such as issue of currency and on commercial banking functions like accepting deposits and financing business. In course of time this practice was abandoned and specialized institutions for the central banking functions were created. Now, a central bank can be easily distinguished from a commercial bank due to their objective and unique functions.

The commercial bank has its own role and contribution in the economic development; it is a source for economic development and it maintains economic confidence of various segments and extends credit to people.

Modern commercial banks can be identified by different names such as Business banks, Retail banks, Clearing banks, Joint Venture banks, Merchant banks, etc. No matter what name we give to banks, they all perform the same basic function: i.e. they provide a link between lenders, those who have surplus money and do not wish to spend immediately with borrowers, those who do not have surplus money but wish to borrow for investment in productive purpose. Basically, by charging a rate of interest to borrowers slightly higher than they pay to lenders, the banks make their profit. This is known as financial intermediations. Commercial Banks provide the following major products and services:

- > Acceptance of Deposits
- > Granting of Advances
- > Remittances
- > Collections
- > Cash Management
- > Issuance of Letters of Credit and Guarantees
- > Merchant Banking Business
- > Credit Cards
- > Technology Based Services-Internet Banking Services
- > Dividend Warrants
- > Safe Keeping Services/Lockers
- > Handling Government Business
- > Automated Teller Machines (ATMs)

### **Functions of Commercial Bank:**

The primary functions of Commercial bank in Nepal are concentrated on accepting deposit from general public and advancing loans to industrialist, businesspersons and others. Besides that, it also executes banking activities. All commercial banks are authorized to transact various businesses, which are considered as the main function of Commercial Bank. Commercial Bank has significant role in transferring idle money of General Public to industrialist or businessperson who generally use such amounts in productive sectors. This Major function of commercial bank plays a vital role in the overall development of economy and nation too. Despite that, Commercial bank provides wide range of agencies and other miscellaneous services by the means of branch expansion at different parts of the country, which can be listed as follows.

#### **a) Accepting Deposits**

Commercial bank accepts deposits in different types of account. The different types of deposits are:

##### **➤ *Saving Deposit***

It is one of the deposits, generally collected from the people having low level of income. The bank usually pays a small rate of interest to the depositors against the deposit. The main purpose of this account is to increase saving habit of public. Under this account, the depositor has to maintain amount, as prescribed by the bank to open this accounts.

The depositor is allowed to withdraw money by cheques up to the amount prescribed by bank. Amount collecting under this account should be invested in purchasing marketable securities and short-term investment.

➤ ***Current Deposit***

Another account provided by commercial bank to deposit amount of traders and businesspersons is current deposit. The bank should pay on demand of the client therefore; it is called as demand deposit. There are no restrictions regarding the number of deposits and withdrawals. The bank does not pay any interest on such amount.

➤ ***Fixed Deposit***

A fixed deposit is such type of account where the customer is required to keep the amount to the bank for long period. Those who do not need for stipulated time open such account. The bank, on such amount, provides a high rate of interest. The customers are not allowed to withdraw money before the matured period. In case of urgent need of money the customers are permitted to borrow money from the bank on the security of fixed deposit.

**b) Advancing loan**

The major function of commercial bank is to invest and lend of its funds collected by means of different accounts into productive sectors. Enough consideration should be given in choosing the project that ensures the receiving of interest regularly and recoverable of loans after the matured period. Mainly loans are granted in four forms: overdraft, cash credit, and direct loan and discounting of bills of exchange.

**c) Credit creation**

Credit creation is one of the most important functions of commercial bank. Commercial bank's main objective is to earn profit. Bank creates credit by advancing loan in different sectors. They do not provide hard cash but open an account on the loaner's name.

Bank creates credit by flowing or advancing loan in different productive sectors. Commercial bank charges certain amount of money as interest. Sometimes commercial bank may advance loan beyond their capacity and they may feel difficulty. In such case central bank controls credit by changing the cash reserve ratio (CRR), interest rate in loan or deposited and lending policy of commercial bank.

According to directive of central bank, i.e. Nepal Rastra and Commercial Bank of Nepal should keep 20% of their profit as reserve, until it reaches double of its paid up capital. Similarly the spread rate should be between 4 – 4.5 % in all commercial banks, this spread rate is not being practiced in bank of Nepal.

#### **d) Financing foreign trade**

Foreign trade refers to trading activity with parties outside the country. This trade is done in foreign currencies, which are financed by banks. Some of the major products of foreign trade are Letter of Credit Guarantee, Advance payment, Draft and Collection. In case of Nepal, when we say Letter of credit we normally refer it with import because there is not much exporting in Nepal. In letter of credit also there is limited amount allocated according to the financial position of the firm or individual. Letter of credit is provided against collateral.

Similarly, bank also finances foreign trade against 'Trust receipt'. Trust receipt is like an indemnity. Loan against 'Trust receipt' is normally provided for import of goods. When the importer cannot pay the exporter within short period, the importer provides the bank with 'Trust Receipt' against which bank provides loan to the importer not exceeding the 90% of the receipt. In addition, the importer is supposed to repay the bank within 120 -180 days with interest.

#### **e) Agency functions**

A bank performs a number of services on behalf of its customer as an agent. Mainly commercial bank undertakes the payment of subscriptions, insurance premium, rent collection of cheques, bills, salaries, pensions, dividends, remittance of money from one place to another etc on the behalf of customers. For these different services provided by commercial bank it charges a small amount of commission.

#### **f) Miscellaneous Services**

Commercial banks provide other services to other customers provide lockers where important documents, gold and silver are kept for security and underwriting services shares issues, statistical information money market and business trend.

The first public bank "The Bank of Venice" was established in Italy in 1357 A.D. Different countries in the world followed the footsteps of this bank to incorporate banking institutions in their countries. The evolution of "The Bank of England" in this kingdom of 1694 A.D. brought remarkable changes in the process of establishing banking institutions in the world. The establishment of this bank was a big milestone in the history of banking development. It is believed that the idea of commercial banks rapidly spread all over the world only after the inception of this bank.

In Nepal development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture life. Landlord and rich merchants had acted as lender in the unorganized money market. At the end of 8th century, Gunakam Dev had borrowed money to rebuild the Kathmandu valley. In 11th century, during Malla regime there was an evidence of professional money lenders and bankers. However, due to the absence of regulatory bodies, the money lenders used to charge high rate of interest and other extra dues on loans extended.

After the establishment of "Tejarath Adda" during the year 1877 A.D. by the government of Kathmandu valley, the banking system was flourished which helped

general public to provide credit facilities at very low interest rate. The Tejarath Adda extended the loan to the public against the collateral of gold and silver. Hence the establishment of Tejarath Adda could be taken as pioneer foundation of banking in Nepal. The Tejarath Adda could not run and extend the advance required to general public due to the lack of financial support, as no other financial institutions were set up. Again the unorganized money lender became active.

In the meantime government started to establish trade relationship between Tibet and India. The need for banking institution was realized when there was a need of finance for the reconstruction of work on 1934 AD's earthquake. Considering this, Industrial Development Board was formed in 1936 AD, which formulated the "Company Act" and "Nepal Bank Act" in 1937 AD.

Nepal Bank Limited (NBL) was established in 1937 AD as the first commercial bank of Nepal. At that time limited industrial undertaking and trading activities were created in the economy and NBL was set up for their financial needs. With the growth of diverse economic activities in the country other commercial banks were felt necessary at a later stage, as a result the Rastriya Banijya Bank (RBB) was set up in 1966 with full public (government) ownership, In 1956 the Central Bank of Nepal, Nepal Rastra Bank was established with the mission of developing banking system in the country to promote industry, trade and agriculture in addition to its main function of circulating Nepalese currency all over the country.

Considering the role of commercial banks in the financial system for the promotion of industry, trade and business sectors, Government permitted to run the joint venture commercial banks in the country in late 1980s. Commercial banks work as the intermediary between the depositors and lenders and facilitate in overall development of the economy, with major thrust in industrial development. Accordingly, Nepal Rastra Bank has given approval to" operate following 18 commercial banks.

It is obvious that economic development is impossible without the development of different sectors like Agriculture, Industry, and Trade etc. of the country. So, development of these sectors needs a regular supply of financial resources. In developing countries there is always shortage of the capital for the development activities. It is not possible to handle and develop all the sectors by the Government alone at a time. Private people also can not undertake large business because per capita income of the people is very low while their propensity to consume is very high. Due to low income their saving is very low and capital formation is very low. So their saving is not sufficient for carrying on development works.

"Economic development demands transformation of savings or investible resources into the actual investment. It is the financial institution that transfer funds from surplus spending units to deficit units" (Nepal Rastra Bank, 1996: 43)

Capital formation is one of the important factors on economic development. The capital formation leads to increase in the size of the national output, income and development, solving the problem of inflation and balance of payment and making the economy free from the burden of foreign debt. Domestic capital formation helps in making a country self-sustainable. Profit made by business community constitutes the major part of the saving of the community and what is saved is assumed to be invested.

Banking sector plays an important role in the economic development of the country. Commercial Banks are one of the vital aspects of this sector, which deals in the process of channeling the available resources in the needed sector. It is the intermediary between the deficit and surplus of financial resources. Financial institutions like banks are necessary to collect scattered saving and put them into productive channels. In the absence of such institutions it is possible that the saving will not be safely and profitably utilized within the economy. It will be diverted abroad or channeled into unproductive conspicuous consumption including real estate speculation.

"The business of banking is one of collecting funds from the community and extending credit (making loans) to people for useful purposes." (Edmister, 1980:73) Lending money has always been a basic function of commercial bank. After providing for its cash need a bank normally seeks to loan as large a portion of its deposit and excess capital as it prudentially can. The remaining portion of its investible fund is placed in suitable securities (American Institute of Banking, 1966:163)

Loans are an essential aspect of commercial bank. "First, income from loan contributes substantially to the revenues and profit of the bank. Second, lending money to people in the community strengthens the community-bank relationship. Third, lending money spurs business development and supports a growing economy" (Edmister, 1980: 82). Credit being the most important function of commercial banks, affects overall development is considered, it is directly related to the quality and quantity of the credit, which is derived from various financial institutions, especially commercial banks in Nepal.

Investment operation of commercial banks is very risky one. For this, commercial banks have to pay due consideration while formulating Investment Policy. A healthy development of any commercial bank depends upon its investment policy. A good investment policy attracts both borrowers and lenders, which helps to increase the volume and quality of deposits, loans and investment.

## **1.2. Brief Introduction of Selected Commercial Banks:**

### **1.2.1. Nabil Bank:**

Authorized Nabil Bank Limited, the first foreign joint venture bank of Nepal, started operations in July 1984. Nabil was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 47 points of representation across the kingdom and over 170 reputed correspondent banks across the globe.

Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business.

Highly qualified and experienced management team manages operations of the bank, including day-to-day operations and risk management. Bank is fully equipped with modern technology, which includes ATM's, credit cards, state-of-art world-renowned software from Infosys Technologies System, Bangalore, India, and Internet banking system and Tele-banking system.

Share Capital of Nabil Bank as on 2067/68

Authorized Capital	NPR 2,100,000,000
Issued Capital	NPR 2,029,769,400
Paid-Up Capital	NPR 2,029,769,400

### **1.2.2. Himalayan Bank Limited:**

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in the Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities- Loans and Deposits.

Legacy of Himalayan lives on in an institution that's known throughout Nepal for its innovative approaches to merchandising and customer service. Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Other financial institutions in the country have been following our lead by introducing similar products and services. Therefore, we stand for the innovations that we bring about in this country to help our Customers besides modernizing the banking sector. With the highest deposit base and loan portfolio amongst private sector banks and extending guarantees to correspondent banks covering exposure of other local banks under our credit standing with foreign correspondent banks, we believe we obviously lead the banking sector of Nepal. The most recent rating of HBL by Bankers' Almanac as country's number 1 Bank easily confirms our claim.

All Branches of HBL are integrated into Globus (developed by Temenos), the single Banking software where the Bank has made substantial investments. This has helped the Bank provide services like 'Any Branch Banking Facility', Internet Banking and SMS Banking. Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative, HBL very recently introduced several new products and services. Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa Card, International Travel Quota Credit Card, Consumer Finance through Credit Card and online TOEFL, SAT, IELTS, etc. fee payment facility are some of the products and services. HBL also has a dedicated offsite 'Disaster Recovery Management System'. Looking at the number of Nepalese workers abroad and their need for formal money transfer channel; HBL has developed exclusive and proprietary online money transfer

software- Himal Remit TM. By deputing our own staff with technical tie-ups with local exchange houses and banks, in the Middle East and Gulf region, HBL is the biggest inward remittance handling Bank in Nepal. All this only reflects that HBL has an outside-in rather than inside-out approach where Customers' needs and wants stand first.

Share Capital of Himalayan Bank Limited as on 2067/68

Authorized Capital	NPR 3,00,00,00,000
Issued Capital	NPR 2,00,00,00,000
Paid-Up Capital	NPR 2,00,00,00,000

### **1.2.3. Nepal Bank Limited:**

The modern banking system started in Nepal after the establishment of Nepal Bank Limited (NBL), which commenced its operations on 30th Kartik, 1994 B.S. (1938) during the period of Prime Minister Randip Singh under the Nepal Bank Act 1994 B.S. (1938). As NBL is the first bank in Nepalese banking history, it was established as joint venture between the government and private sector and replaced by Tejarath Adda by taking over its operation and overcoming its limitation. Accordingly, NBL had a Herculean responsibility of attracting people towards banking sector from predominant Sahu Mahajan's transaction and of introducing other banking services as well

In opening ceremony, late King Tribhuvan inaugurated the NBL. It is the bank with the largest number of branches reaching every part of urban and rural areas of the country.

The NBL established its banking operations from the initial authorized capital of Rs.10 million, issued capital 25 lakhs, and paid up capital of 8 lakhs 42 thousand out of 51% of the shares were from GON and remaining 49% from equity partition of the public. At the time of establishment, the deposits and loan of Nepal Bank Limited were Rs.17 lakhs and 20 lakhs respectively.

After suffering huge loss & facing many problems by NBL, that time GON decided to give the bank in the foreign management team. At the same time, World Bank decided to give loan of U.S\$24 million on 1st phase & U.S. \$75 million on 2nd phase under highly popular Financial Sector Reform Program (FSRP). The agreement was done between that time GON & the World Bank on Oct. 28th 1999. From July 22nd, 2002(2059 Ashad 17), NBL was taken on contract for two years with an agreement to improve financial position .As per contract the agreement was extend for plus one year in August, 2004. As per agreement, International Development Agency (IDA) provide loan amounting to U.S. \$ 550000 toward the restructuring & privatizing. The contract period of the management team, which expired on 21 July 2004 was renewed initially for one more year. Later, the contract period has been extended up to 21 July 2007.

The management contractor of NBL:

The International Chamber of Commerce (I.C.C.)-Management Team- Bank of Scotland-Ireland

International Business & Technical Consultant Inc.-U.S.A

R.Bajracharya & Co. (Chartered Accounts)-Nepal

P.P. Pradhan & Co. (Chartered Certified Accounts)-Nepal

Human Resource Development Center HURDEC(Pvt.) Ltd.-Nepal

After unilateral termination of contract by ICCMT with the NRB and GON on 2007/07/27, NRB again took over the management of NBL. On the same date, the central bank, NRB sent three officers to look after the top-level management of NBL. On the leadership of Dr.Binod Attarya with Mr.Laxmipant Niraula and Mr. Numnath Poudyal took over the management of NBL & started to do day-to-day activities as the top-level management.

Under the Financial Sector Reform Program (FSRP), ICCMT was given the management of the NBL for the restructuring. From 2007/07/22, after the ICCMT left the bank, there was no top-level management in NBL. NRB had agreed to extend the contract for further 6 months but the CEO from the ICCMT, Mr. J. Craig McAllister put the opinion that they did not get the sufficient cooperation from NRB in the restructure program of NBL.

At the same World Bank had also threatened the GON that if it does not call back the foreign management in NBL it will block the grant & loan amount of U.S.\$15 crore under the FSRP for Nepal. In the process of computerization of NBL, it has installed LIVE NEWTON system in its 44 branches until July 2006.

Of the total Rs.7 Arab loan & grant from World Bank to Nepal, the cost of Rs.6 Arab has been already spent on FSRP.

Share Capital of Nepal Bank as on 2067/68

Authorized Capital   NPR 1,000,000,000

Issued Capital        NPR 500,000,000

Paid-up Capital       NPR 380,383,000

#### **1.2.4. Lumbini Bank Limited:**

Lumbini Bank Limited is offering a wide range of banking solutions and services meticulously customized to the needs of the customers. Established in 1998, this is the first regional commercial bank in Nepal, which started its operation from Narayangarh spreading its wings to further fourteen more places at Hetauda, Butwal, Naxal, Biratnagar, Parsa Bazaar, Indrachowk, Baneshwor, Bardhghat, Parasi, Suryabinayak, Gwarko, Damauli , Mangail Bazaar and Lanku of Chitwan district.

Bank is highly committed to assure of the standard and excellence in the services it offers. Our team is guided towards obtaining new challenges and opportunities. Backed by state-of-the-art technology and experienced professionals adept in modern banking management, we strive to make banking simple, fast and customer.

Bank has restructured various products, as a part of an ongoing process, to cater to the retail segment. The newly structured products in retail segment cover Personal Loan, Home Loan, Auto Loan, Mortgage Loan, Educational Loan, Time loan. Our commitment extends further, from our customers, investors, stakeholders and employees to society at outsized. By focusing on sustainability and corporate social responsibility, we aspire to be a role model institution in responsible Banking. Our foundations have been inscribed with stringent Corporate Governance measures, whereby transparency, disclosure, instruction norms and accountability have paramount importance, in order to safeguard the trust and wealth of each and every stakeholders and customers.

Share Capital of Lumbini Bank as on 2067/68

Authorized Capital	NPR 2,000,000,000
Issued Capital	NPR 1,300,000,000
Paid-up Capital	NPR 1,300,000,000

### **1.3. Focus of the Study:**

The focus of study is on the NRB directives to the commercial banks operating within Nepal. The study entitled “Impact of NRB Directives in Commercial Banks of Nepal” with respect to capital adequacy ratio, CD Ratio, CRR, etc in mainly focused on directives issued by NRB to the commercial banks. This study tried to find out the impact & implementation of the directives by CBs of Nepal.

The study also focus from the NRB perspective as the central banking functioning as the banker’s bank giving necessary directives to the CBs for the benefit of the country economy as well as for the CBs themselves.

### **1.4. Statement of the Problem:**

Nepal is a least-developing country of the world. The economy of the country is at the primitive situation. The economic growth rate of the country is very poor. At present, commercial banks and financial institutions are as the backbone of Nepalese economy. The establishment of joint venture banks in the kingdom has added more bricks in the up liftmen of Nepalese economy. The existence of the joint venture banks in Nepal was possible only when the ‘Financial Sector Reforms’ was introduced in 1980A.D.

As outcome of the reforms in the year 1987-88, the government allotted liberalization in interest rate structure directing only for interest spread. This led increment in commercial banks and financial institutions. Similarly, the responsibilities of the central bank, NRB also have been increased tremendously in the past decade. As bankers' bank, NRB has to look after the commercial banks operating within the country. For the smooth operation of these CBs, NRB used to flow the necessity rules, regulations & especially directives time-to-time. However, every time the functioning of the activities does not goes well. Therefore, according to the requirement of the changing economic situation, market trend, etc, the central bank has to circular new directives according to the necessity & suitability of the business & economic environment.

### **1.5. Objectives of the study:**

The main objectives of the study are as follows:

To find out the effectiveness of directive of NRB.

To examine the implementation of NRB directives by commercial banks of Nepal.

To find out the impact of NRB directives on commercial banks.

To make necessary recommendations as far as possible.

### **1.6. Limitations of the study:**

The report is for the partial fulfillment of Master of Business Studies. The efforts have been made to present & analyze the fact clearly, truly & within the boundary. However, reliability of tools, lack of research experience, and lack of data are the primary limitation of this report. Other limitations are:

This study is focused on only the few directives (of the total 21 directives issued 2068B.S) issued by the NRB to the commercial banks of Nepal time-to-time.

This study is based on direct interview & secondary data only received from NRB & the concerned commercial banks.

Data are taken from the Mid-July 2006 to Mid-July 2011 are only taken into consideration for analysis.

Of the total 32 commercial banks operating in the country, only four CBs are taken as a sample for research purpose.

### **1.7. Organization of the study:**

Chapter one : Introduction

Chapter two : Review of Literature

Chapter three: Research Methodology

Chapter four :Data Presentation and Analysis

Chapter five : Summary, Conclusion and Recommendations

First chapter will describe about the research itself by defining various aspects of NRB directives concerning to commercial banks of Nepal. This will help to develop the conceptual framework about the research problem and subject matter.

Review of literature will advance the knowledge about the subject matter as well as general method of doing research in directives on some requirements, which are also defined by the finance, & banking expertise.

Research methodology is policy and framework not within, which we will find the best alternative for making the research effective to analyze on the topic.

Data presentation and analysis will evaluate & examine the impact & situation of directives on different section of commercial banks in Nepal.

Moreover, the last chapter will be the summary and conclusion of this research and remedial measures to be applied for further advancement and effectiveness of the directives of the central bank, NRB to the commercial banks of Nepal.

## **CHAPTER TWO**

### **REVIEW OF LITERATURE**

This Chapter is related to review of literature concern with the study. Review of literature begins with the conceptualizations of persisting theories and search of research studies in this topic. It deals with the existing volumes/situations of selected or similar topics. It eliminates the duplication of the topics.

#### **2.1. History & Need of a Central Bank:**

The concept of central banking is of recent origin. Prior to the commencement of 20<sup>th</sup> century, there had been clearly defined concept of central banking. However, as the time changed, there is no country in the world, which does not have a central bank. The bank works as the leader of the money market. The bank works as the leader of the money market. It is the chief of all banks operating in a country. It supervises, regulates & controls the functions of commercial banks & other financial institutions. The central bank also works as the banker to the government & advises the government on several matters. It is the only organization, who monitors the whole economy of the country.

Therefore, central bank is an important financial institution in every sovereign independent country in modern times. It is an apex of economy is banking system. Central bank is the central arch of the monetary & fiscal framework in every country of the world & its functions are indispensable for proper functioning of the economy & fiscal operations of the government. The objective of the central bank is also to control monetary circulation, manage debt, etc.

The history of central banks is very old. In 12<sup>th</sup> century, most of the banks in England, France, Sweden, etc. were assuming more power but not considered them central

banks. They were enjoying the right of note issue & were acting as the banker for the government & sometimes work as an agent for the government & sometimes work as an agent for the government as well in the financial matters. However, they were not known as central banks but referred as the banks of not issue or national banks. The oldest central banks in the world are Risk Bank of Sweden, which was established in 1656. The Bank of England came in 1694. Being originated from Europe, International Conference held in Brussels during 1920 agreed with common agenda of establishing central bank in most of the European countries. Likewise, European central bank has been developed. In the political business cycle, the independent central bank is proving very important but questionable & doubtful. (*M.K. Shrestha & e al., 2007*)

The Bank of England is the first bank to work as the position of central bank and to develop all the fundamental of central banking which are under operation. The fundamentals, principles & tools & instruments developed by the Bank of England were universally accepted by all the banks all over the country. The successful functioning of Bank of England forced other countries to think about the concepts & principles of the central banks. The Bank of England is the United Kingdom's central bank, & has broad responsibilities for the organization & operation of government monetary & financial policies. The bank was formed with the purpose of raising funds for the British Government, but it only came into public ownership in 1946. Nevertheless, since the middle of the 19<sup>th</sup> century the bank has been undertaking the majority of functions, which are normally associated with a central bank. According to the provision of the Bank of England Act 1946, the bank has a legal duty to carry the wishes of the Treasury (Finance Ministry) in respect of the implementation of the government's policies on financial, monetary & related matters. (*Jhalak Sharma Acharya, 2055*)

As the British ruled India as a colony, the ruling company, East India Company established three banks: The Bank of Bengal in 1809, The Bank of Bombay in 1840 & The Bank of Madras in 1843. These banks were known as Presidency Banks. After the independency of the India, several banks established & collapsed. However, the Reserve Bank of India as a central bank of India was originally constituted as a shareholders' bank in 1935 under the Reserve Bank of India Act, 1934, to regulate the issue of bank notes & the keeping of reserves with a view to securing monetary stability in India & generally to operate the currency & credit system of the country to its advantage. The Banking Companies Act, 1949 of India, the bank is vested with large powers of supervision, control, direction & inspection of scheduled & non-scheduled banks of India. (*Jhalak Sharma Acharya, 2055*)

### **2.1.2. Meaning of Central Bank:**

Central bank is an important financial institution in every sovereign independent state in modern times. It is the apex body of banking system. There are many types of banks. Of the various banks most or the supreme bank is the central bank. The central bank plays an important role in the economic development of a country. This bank is

established to develop banking through strategy on its own to issue the notes, to control the credit, to act as the bank of the banks, advisor of the government in each country.

Within banking system, central banking is also a vital component. There are different logics enhanced on the definition of the central banking. Either V Smith has said that the primary definition of the central banking system in which a single bank has complete or residuary monopoly in the note issue. But, R.D. Hawtrey regarded that the central banking is basically related with the lender of the last resort function. On the other hand, A.W. Shaw was more concerned with credit control function while defining the concept of central banking. The Bank of International Settlement (BIS) has urged that the central bank is the bank to which has been entrusted the duty of regulating the volume of currency & credit in the country.

The meaning of central bank has been defined in different ways according to situation & need. Different authors have given different definition for central bank. Therefore, it is very difficult to give a precise definition of central bank. The momentum took place when it started to work as the banker's bank much later not as the privately owned bank as discussed above. That is why, the meaning of central bank varied according to time & situation. In this context, De Kock observes, "central banks have developed their own code of rules & practices, which can be described as the art of central banking but which, in a changing world, is still in the process of evolution & subject of periodical readjustment." In the past, there was no much difference in the meaning & definition between ordinary banks with the central bank except in some areas.

De Kock further defines, "A central bank is a bank, which constitutes the apex of the monetary & banking structure. It is the lender of the last resort & has monopoly in note issue."

R.P. Kent defines, "Central bank as an institution which is charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare."

### **2.1.3 Introduction to Nepal Rastra Bank:**

Nepal Rastra Bank is the supreme bank of a country. It is a banker of banks & government's bank. It has monopoly to issue currency. Nepal Rastra Bank as a central bank of Nepal was established in 2013 B.S. Baishak 14 (April 26, 1956) NRB Act 2012. Prior to this bank there was no such formal organization who controls and regulates the monetary system in the country. It is an autonomous body & fully owned by the Government of Nepal, who works for the development of banking system in the country. It has also the responsibility to observe, evaluate & regulate the economy of the country. It has also the responsibility & authority to make the monetary policy of the country.

More power & authorities to control & responsibility for supervision over the financial institutions of the country came over after the enactment of the Nepal Rastra Bank Act,

2058 & Nepal Rastra Bank Act, 2058(First Amendment, 2063/7/23/5) to the central bank. Currently also the central bank is doing its functions & other related activities standing on this act.

The organizational structure of the bank is just like in other countries. The top body of the bank is its Board of Directors who sets goals & objectives & defines policies. The Board of Directors is comprised of four representatives from the government, two deputy governors and the governor is the chairperson of the board. In order to achieve its goals & objectives, it can develop its own policies.

The central bank, NRB is also in the process of the restructuring for its effective role in the economy of the country with the help of the World Bank under the Financial Sector Reform Program (FSRP).

### **2.1.4 Organizational Structure of Nepal Rastra Bank:**

To achieve the objectives mentioned in the Preamble of NRB Act, 2058 & to run the bank smoothly & effectively, the following provisions have been made in the Act:

The entire responsibility including the management of the bank & the performance of all acts to be executed by the bank under this Act & other Nepal laws shall be present in the Board of Directors.

The Board shall make rules for the conduct of business mentioned in sub-section (2) as above. The Governor shall exercise all the powers vested in the Board, under the supervision & direction of the Board of Directors, in accordance with such rules. The Governor may, in order to carry out the business of the bank smoothly, delegate his powers to Deputy Governors & other employees of the Bank, on his own responsibility. Thus, the Board of Directors is the supreme policy maker body of NRB. In line with the policies & programs of the GON, the Board mainly formulates & executes the monetary policies that ensure adequate availability of money & credit in the economy. (*Hriday Bir Singh, 2007*)

The BOD of the bank constitutes seven members comprising the Governor, four Directors nominated by the GON & the two Deputy Governors of the bank. The Governor & the two Deputy Governors too are appointed by the GON. The person holding the post of Director in any CB is not eligible to become the Bank's Director. However, this regulation does not apply in the case of the Governor & the Deputy Governors. Similarly, no two persons who are partners of the same firm or directors of the same corporate body are qualified for directorship in the Board. Traditionally, 2 out of 4 directors are senior, the GON officials at Secretary level usually from the Ministry of Finance & Ministry of Industry. Beside, high-level officials from other Ministries or institutions are invited to take part in the meetings of the Board as & when necessary.

The Governor convenes the meeting of the BOD. The Board meeting should be held compulsorily at least 6 times a year & once every 3 months. Similarly, if at least two Directors, having voting rights, make written request together with the agenda to be

discussed, the Governor convenes the meeting in accordance with such request. The Governor presides over the meetings. However, if the Governor, for any reason, is unable to attend the meeting of the Board, he can authorize one of the Deputy Governors to preside over the meeting. In such a circumstance, the Deputy Governor so authorized is entitled to exercise his voting power. To form a quorum, the presence of at least two among the four directors nominated by the GON, apart from the Chairman, is necessary. The decision of the meeting with such a quorum is deemed the decision of the Board. In the event of equality of votes for & against a resolution, the Governor or the person presiding over the meeting may cast the decisive vote. The Deputy Governors as members of the BOD take part in the discussion in the meeting of the BOD. However, these officials are not entitled to vote on any subject put to vote in the meeting.

In NRB, various departments, divisions, branch & sub-branch offices have been set-up for conducting the bank's day-to-day operations smoothly & effectively. The bank has to accomplish a number of objectives consistent with other national economic objectives. Therefore, while designing the organizational structure, special attention has been paid to ensure that the bank's dimensions & dynamic role are clearly reflected in it. Over the years, the bank's responsibilities have expanded in sound reputation with the increase in numbers of banks & financial institutions. Additional regulatory framework has been designed & the number of employees has been increased to provide the needs of monitoring & follow-up of the changed financial system.

## **2.2 Regulatory Measures followed by NRB for CBs:**

With a view to maintaining financial stability, a number of regulatory measures were adopted in F/Y 2005/2006. An integrated directive for CBs, development banks, finance companies & micro-credit development banks was issued on 13 July 2005. The umbrella act "Bank and Financial Institution Ordinance 2005" has been made effective by scraping all then acts governing these banks & financial institutions. This ordinance has been converted into "Bank & Financial Institution Act 2006" in 2006 with necessary amendment. Likewise, a draft of "Assets Management Company" & "Anti-money Laundering Act" has been submitted to the GON.

The umbrella directives incorporates 16 directives relating to capital adequacy, classification of loan & advances & loan loss provisioning, sectoral credit limit, accounting policy & structure of financial statement, risk minimization, investment, statistical returns to be submitted, sale of promoters shares, consortium lending, credit information & black listing arrangement, cash reserve ratio, branch office opening, interest rates & financial; resources collection.

### **2.2.1 Legal Framework of Establishing Commercial Bank:**

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

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

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

Share capital

Bank establishment policy

Functioning definition of bank formation of board of director

Formation of board of directors

Disqualification for the directors

Operational criteria of establishment

Function, which the bank may perform

Capital and provision of general reserve

Branch Expansion Policy

### **2.2.2. Bank Capital Structure Requirements:**

One of the most critical of all banking problems in recent years centers on raising and maintaining sufficient capital. A CB has access to there source of funds: capital, deposits & borrowing. Therefore, the term capital has special meaning in the balance sheet of a bank. Capital refers to those funds contributed by the bank's owners, consisting mainly of stock, reserves & earnings that are retained in the bank rather than paid out to the stockholders. Capital performs several important functions of a bank such as supplying resources to get operate a new bank, further to expand & defend against risk. It also assists in maintaining public confidence in the bank's management & shareholders.

Bank capital cannot be treated as a single & homogenous item. Choice of the form of capital, of the amounts needed in each form, and of the way of raising it have important implications for bank profitability, it is therefore, the study of capital management has become significant in the banking management.

In general sense, "Money is needed to establish & operate a bank is called bank capital." It is not possible to establish & operate a bank without capital. In this way, "the amount received by the bank from different sources to establish the bank, to operate the banking system is called bank capital."

Hence, The NRB has ultimate power or right to decide how much capital is needed for a bank & non-bank financial institutions. According to the new provision implemented by NRB under BAFIA 2063, the financial institution should be as:

**Table No.1.1.  
Capital Structure Requirements**

<b>Description</b>	<b>Prior to 27 March, 2007</b>	<b>At present</b>
<b>Paid-up Capital</b>		
CBs	Rs.1000 million	Rs.2000 million
Regional CB Concept		Eliminated
Development Bank(National Level)	Rs.320 million	Rs.640 million
Development Bank(1-3 districts)	Rs.50 million	Rs.100 million
Development Bank(4-10 districts)	Rs.100 million	Rs.200 million
Development Bank (Leasing transactions)	Rs.150 million	Rs.300 million
Finance Companies(National Level)	Rs.100 million (Rs.150 million for leasing companies)	Rs.200 million
Finance Company(1 district)	Rs.50 million	Eliminated
Finance Company(1-3 districts)		Rs.100 million

Micro-finance Development Bank		Changed
National Level	Rs.100 million	
Regional	Rs.60 million	
1-3 districts	Rs.10 million	
		Continued.... Continued...
<b>Description</b>	<b>Prior to 27 March, 2007</b>	<b>At present</b>
4-10 districts	Rs.20 million	
<b>Provision for Capital</b>		
Proposal for Capital		To comply by June/July 2010
Operating financial institution		To comply by June/July 2013
<b>Bank with more than 50% investment</b>	20% share to general public	15% to general public
<b>Treated as capital</b>		80% paid-up & 20% primary capital as other capital

*Source: NRB*

### **2.2.3. Capital Requirement Criteria for Establishing New Bank:**

As discussed above the need & importance of the bank capital, the central bank of the country, NRB has made the capital requirement criteria for establishing new bank also.

With a view to encourage people to open commercial banks outside the valley and also limiting the monopoly of a single person, a group and/or company in banking business, NRB announced the following measures under new BAFIA 2063:

A minimum paid-up capital of Rs 500 million required to establish a commercial bank with the headquarter to be stationed in Kathmandu valley and operation expanding throughout the country.

A minimum paid up capital of Rs. 50 million required for establishing a bank with its headquarter to be stationed in the district level and limiting its area of operation only up to 5 districts other than Kathmandu valley.

A minimum paid up capital of Rs.120 million required for establishing a bank with its headquarter in any municipality expanding business in all parts of the country except the Kathmandu valley.

In addition to above requirement NRB also made some provision in connection with the ownership pattern. Accordingly, the bank, which is to be opened, is required to sell at least 30% of its share to the general public. However, no single person, firm,

company and/or a person could purchase more than 10% of issued capital of bank. Similarly, such person, firm, company and group of person (except GON, Nepal Rastra Bank, commercial banks and government financial institution) could not purchase more than 15% of issued capital of all other banks.

However, the above capital structure is still prevailing in the country but as the GON & NRB has decided to let the foreign banks to operate within Nepal since 2010 as promised while being the member of WTO. So, viewing this scenario, the central bank may decide in the capital structure required for the CBs to be established in the coming days.

**Table No.1.2**  
**Actions on Non-compliance of Minimum Capital Requirement**

S. No.	Timeframe for compliance	Type of action
1.	F/Y 2064/65	Restriction on dividend
2.	F/Y 2065/66	Restriction on dividend/deposit collection
3.	F/Y 2066/67	Restriction on dividend/deposit collection/loan disbursement
4.	F/Y 2067/68	Restriction on all transaction, except loan recovery & paying back matured deposits
5.	F/Y 2067/68 onwards	Initiation of the process of revoking license

**Source: Mirmire Vol.36 No.264**

In context of capital adequacy requirements in a banking institution, the core principle # 6 of the Basel Committee on Banking Supervision (revised in October 2006) states: "Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the banks undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in Basel capital requirements." (*Bhola Ram Shrestha: Mirmire, 2007*)

#### **2.2.4. CRR for CB:**

The CRR too can be taken as criteria of measuring bank liquidity. The CBs should maintain the CRR as fixed by the central bank by opening an account in central bank and should maintain the statutory liquidity ratio, in its own treasury. It changes from time to time. CRR was used even before 1990s. NRB, first time introduced CRR in December 1966. At that time, CBs were required to maintain CRR of 8% of total deposit liabilities. Since then, NRB changed CRR a dozen times until to date, and sometimes, variable rates for different deposits, and sometimes, single rate. In 1990, NRB directed the CBs even to maintain cash in vault of 4% of deposit liabilities. Such a provision was taken away in August 2003. At present; the level of CRR is 5% of total domestic deposit liabilities of the CBs in Nepal. Demand, savings, and fixed deposits denominated in

rupee are subject to the provision of CRR. The following table shows the CRR used by the NRB in past.

**Table No.1.3**  
**CRR at Different Time Period**

<b>Date</b>	<b>Rate(% of domestic deposit liabilities)</b>
1966 December	8%
1974	5% including statutory liquidity ratio(SLR) 32%
1978	7%
1981	9% (Cash in Vault 4% & Bal. with NRB 5%)
1989 September	9%
1989 October	12%
1990 April	12% (Cash in Vault 4% & Bal. with NRB 5%)
1998 April	Cash in Vault 3% & 8% for current & saving deposits, 6% for fixed deposits
2001 December	Cash in Vault 3% & 7% for current & saving deposits, 4.5% for fixed deposits
2002 August	Cash in Vault 2% & 7% for current & saving deposits, 4.5% for fixed deposits
2003/04	6%
2004/05	5%
2005/06	5%
2006/07	5%
2007/08	5.5%
2008/09	5.5%
2009/10	5.5%
2010/11	5%

**Source: NRB**

### **2.2.5. Credit Classification & Loan Loss Provision for CB:**

The commercial banks of Nepal have to classify its credit/loan as prescribed by the central bank of the country, NRB. The loans are classified as per their recovery performance. Generally, the principle of loan classification & provision for loan loss should be arranged in accordance with the directives of central bank. In Nepal, at present loans/credits are classified into two types, which further have been sub-divided. They are:

Performing Loans  
Pass (Good) Loan  
Restructured Loan

Non-performing Loans

Sub-standard Loan  
Doubtful Loan  
Bad Loan (Loss)

The loan loss provision must be arranged according to the classification of loan. So, the provision should also be maintained according to each type of loans. Every commercial banks of Nepal should mention the report of credit under *Schedule 13 Classification of Loans, Advances and Bills Purchased & Provisioning* in every F/Y Report as per the directive of the central bank, NRB.

According to the directive, the loan loss provision should be maintained as follow by CBs:

**Table No.1.4.**  
**Credit Classification & Loan Loss Provision for CB**

<b>Classification of Credit</b>	<b>Loan Loss Provision</b>
Pass (Good) Loan	1%
Sub-standard Loan	25%
Doubtful Loan	50%
Bad Loan (Loss)	100%

**Source: NRB**

The provision for the performing loans has been maintained as “General Loan Loss Provision” & for the non-performing loans as “Specific Loan Loss Provision”.

### **2.2.6. Black listing Provision:**

CBs & the finance companies have been issued directives on black listing & credit information for transparency & relevancy in their loan options & to regulate the process of black listing of loan defaulters. The directive will also enable accessing information from one single source. More power & authority, similarly responsibilities have been added to the Debt Recovery Tribunal by this directives which is established by GON.

### **2.2.7. Protective Provision for CB:**

Provision of up to Rs.10.0 million has been made to protect small & medium industries through the Deposit Insurance & Credit Guarantee Corporation.

### **2.2.8. Protective Provision for CB:**

Provision of up to Rs.10.0 million has been made to protect small & medium industries through the Deposit Insurance & Credit Guarantee Corporation.

### **2.2.9. Imposition of Restriction:**

Restriction on inter-bank transaction in Indian currency has been removed recognizing to fact that such a restriction has caused inter-bank market to remain partially inactive. Commission charged to CBs for the purchase of Indian currency from NRB has also been waived which, in turn, is expected to help banks to reduce commission charged to customers. Furthermore, individuals are also licensed to purchase Indian currency.

### **2.2.10 Promoters' Qualification:**

The NRB would not proceed with further actions of the application if any of the promoters was legally charged in the past for not being able to repay the debt to the bank or finance company & his collateral was proposed for auction, if he was recorded in the blacklist of CIC. The application would be immediately cancelled if such evidence were provided irrespective of the stage of its processing.

One third of the total promoters should have taken either economics as a major or taken accounts, finance, law, banking or statistics the graduate level or a degree in chartered accountancy from TU or any university recognized by TU & at least 25% of the promoters should possess working experience in a bank or financial institution or similar professional experience.

The promoters of a bank or finance company shall not be promoters of another bank or finance company that has been granted license by the NRB.

Stockbrokers, market-makers, & persons or institutions involved in auditing the accounts of the bank cannot be the directors of the bank or finance company.

## **2.3. Bank Supervision in Nepal:**

S.M. Pradhan points out that supervision of banks & financial institution is one of the prime responsibilities of the supervisory authority. Effective supervision of these institutions is an essential component of a strong economic environment. The task of supervision is to ensure that banks operate in a safe & sound manner & that they hold capital & reserves sufficient to support the risks that arise in their business. Strong & effective banking supervision contributes in enhancing effective banking supervision contributes in enhancing effective macroeconomic policy along with financial stability in any country. While the cost of banking supervision is high, the cost of poor supervision has proved to be even higher.

Banks are supervised in order to achieve both long-term financial stability & sector efficiency. This is done through the promotion of safe & efficient banking practices & institutions- to support sound private business development & meet individual bank

customer needs. A weak regulatory framework & poor supervision provide grounds for inefficient & unsafe banking practices, which increase the risk of bank failure.

Preventing systematic risk, protecting small depositors & containing financial crimes are concrete steps in attaining these objectives. They require that the supervisors enforce fundamental discipline in the banking system with the support of well-crafted laws & regulations & the presence of strong in-house supervisory expertise. Like most banking supervisory authorities the world over, at the backdrop of the inspirations of the above-mentioned supervisory motives, NRB has adopted a two-prong approaches to monitor & supervise the financial health of the financial institutions under its purview through off-site surveillance & on-site inspections. However, NRB's main approach to supervising banking institutions is to concentrate on corporate governance, market discipline & management oversight.

NRB Act 2001 ensures whether CBs are operating prudentially & complying with regulatory requirements. The ultimate objective of the supervision lies in the protection of the depositors' interest. NRB is heading towards successful implementation of Basel II in our country. For this, we have already formed an accord implementation group for proper analysis & formulation of necessary directives. This will again enhance our strength in the course of supervision.

### **2.3.1. Introduction to Financial Analysis:**

The types of analysis vary according to the specific interests of the party involved. Trade creditors are interested primarily in the liquidity of an institution. Their claims are short term, & the ability of a financial institution to pay these claims is best judged by means of a thorough analysis of its liquidity. The claims of bondholders, on the other hand, are long term. Accordingly, they are more interested in the cash-flow ability of the firm to service debt over the long run. The bondholder may evaluate this ability by analyzing the capital structure of the financial institution, the major sources & uses of funds, its profitability over time, and projections of future profitability.

Investors in a company's common stock are concerned principally with present & expected future earnings & the stability of these earnings about a trend, as well as their covariance with the earnings of other financial institutions. As a result, investors might concentrate their analysis on a company's profitability. They would be concerned with its financial condition insofar as it affects the ability of the company to pay dividends & to avoid bankruptcy. In order to bargain more effectively for outside funds, the management of a firm should be interested in all aspects of financial analysis that outside suppliers of capital use in evaluating the firm. Management also employs financial analysis for purposes of internal control. In particular, it is concerned with profitability on investment in the various assets of the company & in the efficiency of assets management.

Financial ratios are the main tool for the financial analysis. They can be derived from the balance sheet & the income statement. They are categorized into five types: liquidity, debt, coverage, profitability, & market value. Each type has a special use for

the financial analyst. The usefulness of the ratios depends on the ingenuity & experience of the financial analyst who employs them. By themselves, financial ratios are fairly meaningless; they must be analyzed on a comparative basis. (*James C. Van Horne, 2005*)

### **2.3.2 Review of Articles & Journals**

**Pandey,(2003) NRB's effort to reform commercial banks: The Rising Nepal,p.4**(2003,June 10) stressed that one of the main objective of a commercial bank is to safeguard the money of depositors. With the low capital adequacy rate, the banks were previously lending from the money of the depositors because the capital comprised a very small portion of the total risk-weighted assets. However, the returns the shareholders or promoters were reaping were quite high. The risk of the depositors was too high ,Pandey further put forward that a good banking system is, therefore, a sine qua non for maintaining financial equilibrium in the country. And, NRB's efforts in this direction are really praise worthy.

**Lamsal,(2003) NRB Directives: Bankers plea for lighter structures. New Business Age, 1(3),pp.31**( 2001, July) stated that the commercial banks with seven directives issued in two installments asking banks to start complying with the new structures by mid July 2001 or face grave consequences.NRB claims that these are based on the internationally accepted banking norms of Basel committee. Lamsal has opined that banks are expected to be disparate to meet the targets of capital adequacy norms since the consequence that banks have to face in case of non-compliance are very strict. And for this purpose they will have to issue additional shares, which is not possible for them in the short-run. Or they do not prefer to go for additional share issue simply because they will also have to pay the same dividend as the past to the holders of shares so issued. This becomes the more difficult as the business is not going to expand commensurately. The difficult is understandable now when every banker is complaining of the lack of new investment projects.

**Rajbhandari (2009) conducted his article on the topic of “ The impact of Interest rate structure on investment portfolio of Commercial Banks In Nepal”.**

The objective of the study is given below:

In his analysis two commercial banks and three joint venture banks are taken for the purpose of the study. Most of data and information and data have been collected from discussion and interview; both the financial and technical tools are used for the analysis of data. Finally he has concluded follows:

- ) Rates of commercial banks have been fluctuating. Deposit and lending rate were increased immediately after linearization of the interest rate on August 31, 1989, but however started to decline which have helped in increasing the credit flow.
- ) Most of the banks are having similar interest rate structure, which lesions the importance of linearization of interest rate.

**Kayestha(2008)**, in his thesis has laid down the problem arisen out of the branch expansion. He has concluded that the CBs have lagged behind the target in opening the new branches & existing branches were not distributed evenly all over the nation. He suggested that NRB should encourage the CBs to open its new branches in remote area with more liberal attitude & policy. This shows the strict directives on the CBs from the NRB at that time.

**Sapkota(2009)** has suggested that in order to provide adequate banking to the people in un-banked remote areas, ADB/N should also act as a CB. Similarly, in the place where no branches of ADB/N & where as a CB's branches exist the later should act as an agent of farmer to collect the deposit & mobilize it in needy. At present ADB/N is also working as an "A" class CB of the country & works under the supervision of NRB. Similarly, in the past few years NRB has also directed CBs to invest certain percent as a priority sector loans to the deprived sector.

**Shrestha(2009)** has observed that the CBs are still following their traditional lending policies. They extended the loans on the basis of securities. However, the people in our country are unable to provide sufficient securities. Therefore, The NRB should change the traditional lending policies. At the present, CBs are offering varieties of credit facilities. This proves NRB has already made an effort to avail credit the people without precious securities. But at present the CBs have been given strict direction by the NRB in context to the flow of the credit & the provision for losses.

**Mistry,(2010)** in his dissertation has pointed that the deposit utilization in priority sectors are much less than statutory requirement. To increase the lending amount in priority sectors, NRB has changed the existing regulation & fixed the lending target at 12% of outstanding loans & advance since 1990. Even yet, CBs have been lagging behind in meeting the lending target so they are penalized for the shortfall. But as per the monetary policy of F/Y 2059/60 announced by NRB to phase out the compulsion of priority sector loan investment due to the low return & poor performance level., at present there is no compulsion to CBs to invest in priority sector.

**Pandey(2010)** recommended in his dissertation that even the concerned authority of NRB urged the CBs were implementing the directives. He observed that NRB undertakes both on-site & off-site supervisions to ensure that the directives are properly & fully followed. The monitoring aspect has been strengthened by various types of penalties laid down by NRB for the non-compliance of the directives.

**Pokharel (2011)** on the topics "Determinants of interest Rates in Nepalese Financial Markets", also give some ideas about the interest rates in Nepalese markets. Though, this thesis tried to identify the factors that shape the interest rates in Nepalese markets, it also tried to explore the relationship between the interest rate, deposits, credit rated and inflation. Among different objectives, some objective that match to this study are : to identify the effort of inflation on interest rate charged and offered by various Nepalese financial institutions. During the study Mr. Pokharel found similar result as discovered by the Mrs. Bhatta.

### **2.3.3. Review of the Previous Research:**

In this thesis an attempt has been made to review some thesis following are few of them

**Pandey(2005) “Nepal Rastra Bank Directives, their implementation and impact on the commercial banks-a case study of Himalayan Bank Ltd. (HBL).”** The main objective of the research is to examine the implementation of NRB Directives by the selected Commercial Bank related to Capital Adequacy, Loan Classification and Provisioning in their activities.

The major findings of his study are:

Has given conclusion regarding the capital adequacy of HBL during his study period, i.e., as of Poush end 2058 as the capital fund stood at Rs.1070 million comprising of Rs. 756 million core capital and Rs. 314 million of supplementary capital. The total risk weighted assets of HBL is equal to Rs. 12690.6 million. Therefore, the capital adequacy of the bank stood 8.43% of the total risk weighted assets. Core capital is 5.96% and the supplement capital is 2.47% of total risk weighted assets. Hence, Pandey has concluded that HBL has surplus of Rs. 184.92 million of core capital and a shortfall of Rs.257.08 million of supplement capital. The standard required to be maintained by HBL as per NRB by July 16, 2002 is 4.5.% in each case totaling 9% in all. However, according to the Directives, a shortfall in the supplementary capital can be fulfilled by the surplus in core capital. Therefore, in case of HBL, the bank can use excess of Rs. 184.92 million core capital to compensate for the shortfall. But still the bank requires another Rs. 72.6 million to meet the requirement of supplement capital. Pandey has suggested that HBL should try to increase its supplementary capital as it falls short by Rs. 73million. The bank should increase its core capital in order to expose itself to more credit risk.

**Karmacharya,(2006)” Study on capital structure of joint venture commercial banks and NRB Directive issued in regards to thereof”** The main Objective that the financial soundness as well as its strength of the company depends upon the large extent on the composition of the capital structure and assets. Capital structure of the company presents its resource capacity and ability of its present worthiness.

The major findings of his study are:

He has found that all the banks in his study follow the requirements of NRB Directives regarding capital adequacy. The capital structure of studied banks is highly leveraged. Thus, Karmacharya has recommended that the proportion of debt and equity base i.e., issuing more equity capital, expanding general reserve and retaining more earnings. With this improvement, it will compromise among the conflicting factors of cost and risk. As mandated by NRB, for the operation in overall Nepal, A commercial bank should have capital base of Rs. 500 million. Hence, the banks should raise its paid-up capital to Rs.500 million as soon as possible.

**Shrestha (2007) has study on “Impact and Implementation of NRB Guidelines of Commercial Banks “which has the following objectives**

NRB Directive has made both positive and the negative impacts on the commercial banks.

The new directives of NRB have more good output than the negative on various aspects of the banks.

To make necessary recommendations as far as possible

The major findings of his study are:

The changed directive of Single Obligor limit, the loan exposure has been cut down to customers which resulted decrease in the interest income resulting decrease in the profit of commercial banks and less dividends could be given to the shareholders and bonus to the employees of the banks.

The need for the increment in the core capital increased the expenses of the commercial banks and the banks are facing the problem of increasing operating cost with the decreasing loan amount, restricting the increase in the profit of the banks.

The restriction of borrowing limit to a single party is done with a view of reducing the bad loans to a minimum level, protecting the banks from bankruptcy as well as protection of deposits of the depositors.

**Barahi(2008) In the thesis on “A Comparative Study on NRB Directives and its Implementation In Nepalese Commercial Banks”,** The main objective of the research is to examine the implementation of NRB Directives by the selected Commercial Bank related to Capital Adequacy, Loan Classification and Provisioning in their activities.

Specific objectives are as follows:

To conclude the impact of NRB Directives on safety of general public’s deposit and on enhancement of the situation of commercial bank’s situation.

To make a comparative study between Everest Bank Ltd., Lumbini Bank Ltd. and Nepal Bangladesh Bank Ltd. with respective to Capital Adequacy, Loan Classification and Provisioning as given in the directives of NRB.

The major findings of his study are:

In terms of capital adequacy EBL is in a much better position than of NBBL and LBL. The bank is heading forward with a healthy growth. However, LBL is in recovering stage but the position of NBBL in terms of capital adequacy is deteriorating.

Comparatively, despite of highest deposits, loan and advances and income spread, EBL stood second to NBBL in case of Net Profit. LBL is the one with lowest deposits, loan and advances and income spread and so with the net profit.

EBL has been doing exceptionally well than by LBL and NBBL in increasing its’ loans and advances. LBL has been improving and increasing its market rapidly. NBBL though, is ahead of LBL in figure of Loan Extended, is lying behind LBL in the growth rate of loan extended.

**Shrestha (2009) In the thesis on “Raising and utilization of funds are the primary functions of commercial banks”.**

The major objectives of his study were:

Analysis the source of the fund of the bank.

Analyses the interest of depositors Commercial banks collect a large amount of deposits from general public.

To make necessary recommendations as far as possible

The major findings of his study are:

NRB should consult to the various bank officials before setting or resetting standards on capital adequacy norms.

The complaints and criticisms of bank officials should be considered accordingly. Consequently, an optimal standard will ensure which will satisfy almost everyone.

depositors are not aware of the fact of the necessity of adequate capital fund to safeguard their deposits. They deposit their money to any banks regardless of adequate capital fund which may endanger safety of their money.

**Pandey(2010), In the thesis “Impact and Implementation of NRB Directive” The main objectives of his study were:**

To examine the implementation of NRB directives by commercial banks of Nepal.

To find out the impact of NRB directives on commercial banks.

To make necessary recommendations as far as possible.

The major findings of his study are:

The researcher has observed about the protection of the deposits of public because of the reduction in the loan exposure to the single unit, the reporter states that due to the new directives

The reporter laid down about the changes in the directives will bring prosperity to the shareholders, depositors, employees and the economy of the country as a whole.

NRB that the NRB should issued directives only after doing the proper homework. NRB must strengthen the functioning of Credit Information Bureau.

NRB to try to avoid ambiguity in the directives that are found there in the present directives and to come up with straightforward directives leaving no loopholes that can be manipulated.

## **2.4 Research Gap**

All the above mentioned reports have derived more or less universally acceptable conclusions and have been proved to be significant to different sectors in their own places. But the studies are related only with either the impact of NRB directives on commercial banking or the compliance of the capital adequacy maintained by

commercial banks with the guidance of NRB Directives. But it is not sufficient to discover whether directives do have positive or negative impact on commercial banking. It is equally important to check whether the issued directives are being followed properly or not. If despite of following the directives, commercial banks are not able to enhance their situation or their situation worsens instead of enhancing, we can conclude that the directives are not user friendly. Hence along with the impact of NRB Directives, it is also necessary to study the implementation part of NRB Directives. In another hand, directives are not just related to capital adequacy. At present the number of guidelines issued by

Nepal Rastra Bank to commercial bank reaches eleven. Hence it is necessary to include other sectors of the directives in order to know whether the directives do have positive impact on banks or whether the directives are actually being followed by the banks. Finally none of the researches have studied the strictness in monitoring and supervision of commercial banks by NRB which is the main important aspect in impact and implementation of directives. Current research will include both impact and implementation of NRB Directives in its study. The study has included different time periods during which the amendments have been brought in directives of NRB. Also, three different sectors of Directives: Capital Adequacy, Loan Loss Provision and Supervision and Monitoring have been included. Hence the researcher claims the study to be more broad and significant in comparison to the former ones.

## **CHAPTER THREE**

### **RESEARCH METHIODOLOGY**

This chapter presents the short outline of the methods applied in the process of analyzing the capital structure is a systematic method of finding out solution to a problem whereas research methodology refers to the various sequential steps to adopt by a researcher in studying a problem with certain objective in view.

### **3.1 Research Design**

For the analysis of the capital structure of selected joint venture banks, analytical as well as descriptive designs are applied to achieve the objective of the research.

### **3.2 Population and Sample**

#### **3.2.1 Population**

Mainly the commercial banks or “A” class financial institutions as categorized by NRB are the population samples considered for the study. The list of CBs is at Annex-I.

#### **3.2.2 Sample**

The sample used in this research is purposive in nature. Thus, four commercial banks cover 12.5 %β13% of the population as sample ( $\frac{4}{32} | 100\%$ ). They are:

Nabil Bank Ltd.  
Himalayan Bank Ltd.  
Lumbini Bank Ltd.  
Nepal Bank Ltd.

Of the above four CBs, NBL & NBL covers about 50% banking transactions of Nepal.

### **3.3 Sources of Data**

This research is based on secondary data. Required data is collected from Economic Survey (NRB) financial statement of listed companies, Quarterly Economic Bulletin (NRB), Banking and Financial Statistics (NRB), Bulletin & Reports of Periodically Published by various organizations, previous thesis and dissertation and Published by various organizations. The basic sources of data used are as follows:

Annual Reports  
Published materials from concerned CBs  
Financial statements of concerned CBs  
Related books and journals

### **3.4 Methods of Data Analysis**

Mainly financial methods are applied for the purpose of this study. Appropriate statistical tools are also used. Among them correlation analysis regarded as major one is used for this research.

### **3.5 Tools Used**

#### **3.5.1. Credit Deposit Ratio (C.D Ratio)**

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

#### **3.5.2. Capital Deposit Ratio**

A bank carries out its transaction through the medium of ownership & borrowed capital. Naturally, the function of a bank requires a lot of capital it is known based on deposit in the bank, whether a bank has an adequate ownership capital or not. If there is 8-10% ownership capital of the total deposit of the bank, it is considered good. However, the ratio is to change according to the movement of the economy.

#### **3.5.3. Cash Reserve Ratio (CRR)**

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

#### **3.5.4. Arithmetic Mean (A.M)**

The mean is the figure we get when the total of all the values in a distribution is divided by the number of values in the distribution. The arithmetic mean is also known as the average. It should, however, be remembered that the mean can only be calculated for numerical data. The mean is an appropriate term than saying average. The mean of data is biased toward extreme values. The mean is suitable when the scores are distributed symmetrically about the center of the distribution. This is calculated by using following formulae:

$$\text{Mean (A.M.) } \bar{X} = \frac{\sum X}{n}$$

#### **3.5.5. Standard deviation (S.D)**

The measurement of the scatter ness of the mass of figure in a series about an average is known as the dispersion. The standard deviation measures the absolute dispersion.

The greater amount of dispersion, greater the standard deviation. A small standard deviation means a high degree of uniformity of the observation as well as homogeneity of a series: a large standard deviation means just the opposite. This is calculated as follows:

$$\text{Standard deviation (S.D.) } X \sqrt{\frac{\sum (X - \bar{X})^2}{n}}$$

### 3.5.6. Coefficient of Variation (CV)

The coefficient of variance is the relative measure of dispersion, comparable across distribution, which is defined as the ratio of the standard deviation to the mean expressed in percent. It is calculated as follows:

$$\text{Coefficient of Variation (CV) } X \frac{S.D.}{\text{Mean}} | 100$$

### 3.5.7 Test of Hypothesis

Under this topic, an effort has been made to test the significance regarding the parameter of the population based on drawn from the population. Generally, the following steps are followed for the test of hypothesis.

Formulation of Hypothesis

Null Hypothesis

Alternative Hypothesis

Test of Hypothesis on CD Ratios of Nabil, NBL, LUBL & HBL:

Null Hypothesis ( $H_0$ ):  $\bar{X}_1 = \bar{X}_2 = \bar{X}_3 = \bar{X}_4$  i.e. there is no significant difference among mean CD Ratio of Nabil, NBL, LUBL & HBL i.e. CD ratio of CBs are homogenous.

Alternative Hypothesis ( $H_1$ ):  $\bar{X}_1 \neq \bar{X}_2 \neq \bar{X}_3 \neq \bar{X}_4$  i.e. there is a significant difference among mean CD Ratio of Nabil, NBL, LUBL & HBL.

Test of Hypothesis on CRR of Nabil, NBL, LUBL & HBL:

Null Hypothesis ( $H_0$ ):  $\bar{X}_1 = \bar{X}_2 = \bar{X}_3 = \bar{X}_4$  i.e. there is no significant difference among mean CRR of Nabil, NBL, LUBL & HBL

Alternative Hypothesis ( $H_1$ ):  $\bar{X}_1 \neq \bar{X}_2 \neq \bar{X}_3 \neq \bar{X}_4$  i.e. there is a significant difference among mean ratio of CRR of Nabil, NBL, LUB & HBL.

### 3.5.8. Line Graphs

Similarly, graphical presentation support has been also taken to elaborate the collected data. For this purpose, line graph has been used in the report to present the calculated values.

# CHAPTER FOUR

## DATA PRESENTATION AND ANALYSIS

### 4.1 Introduction

The data, after collection by different methods has to be processed and analyzed in accordance for the purpose of the research plan. The main purpose of analyzing data is to change it from an unprocessed form to an understandable presentation which consists of organizing, tabulating and performing the statistical data. The presentation of data is the basic organization and classification of the data for analysis. This is the section where, the filtered data are presented and analyzed. This is one of the major chapters of this study because it includes detail analysis and interpretation of data from which concrete result can be obtained. This chapter consists of various calculation made for the analysis of credit risks of the sample bank. To make our study effective, precise and easily understandable, this chapter is categorized in three parts; presentation, analysis and interpretation. The analysis is fully based on secondary data. In presentation section, data are presented in terms of table and charts. The presented data are then analyzed using different statistical tools mentioned in chapter three. At last the results of analysis are interpreted. Though there is no distinct line of demarcation for each section (like presentation section, analysis section & interpretation section).

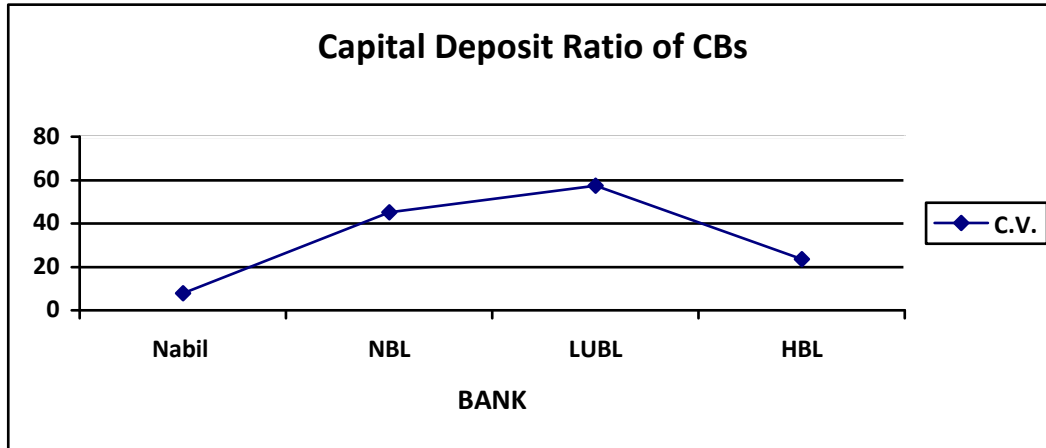
### 4.2 Capital Deposit Ratio of the CBs:

**Table No.4.2.**

**Capital Deposit Ratio of CBs**

<b>F/Y</b>	<b>Nabil</b>	<b>NBL</b>	<b>LUBL</b>	<b>HBL</b>
2007	10.16	29.78	13.06	5.35
2008	8.57	28.4	2.22	5.83
2009	8.38	12.42	12.44	8.99
2010	8.26	12.51	25.24	9.14
2011	9.19	10.65	27.30	9.76
<b>A.M.</b>	<b>8.91</b>	<b>18.75</b>	<b>16.05</b>	<b>7.81</b>
<b>S.D.</b>	<b>0.70</b>	<b>8.47</b>	<b>9.21</b>	<b>1.84</b>
<b>C.V.</b>	<b>7.85</b>	<b>45.17</b>	<b>57.38</b>	<b>23.55</b>

*Source: NRB \*till Mid-July 2011*



**Figure**

#### **No. 4.2**

Capital Deposit ratio is one of the major indicators of the performance of the CBs. It helps to know the capital deposit position of the CBs. From the above table we see that the average Capital Deposit ratio of the NBL 18.75% which is highest among other sample CBs and standard deviation and CV are 8.47% and 45.17% respectively. However the mean Capital Deposit ratio of the HBL is 7.81% which is the lowest among the other sample banks & the S.D. is 1.84% and CV is 23.55%.

Higher the Capital deposit ratio better will be the performance of CBs. If capital deposit ratio is high the CBs can maintain good Capital Adequacy Ratio. As per NRB directive commercial bank should maintain at least 10% capital Adequacy. Considering this NBL has maintained good capital deposit ratio. If the capital ratio reaches below 10% no CBs can flow the loan and can't expand the branch, hence in line to this high capital deposit ratio is favorable. (For detail calculations see Annex -II]

#### **4.3 Credit Deposit Ratio of the CBs:**

**Table No.4.3  
CD Ratio of CBs**

<b>FY</b>	<b>NABII</b>	<b>NBL</b>	<b>LUBL</b>	<b>HBL</b>
2007	68.13	35.26	82.07	59.22
2008	68.18	37.69	94.1	63.37
2009	73.87	43.28	88.15	73.58
2010	71.17	54.94	95.23	77.43
2011	78.29	57.06	91.73	80.57
<b>AM</b>	<b>71.92</b>	<b>45.64</b>	<b>90.25</b>	<b>70.83</b>
<b>SD</b>	<b>3.82</b>	<b>8.87</b>	<b>4.75</b>	<b>8.20</b>
<b>CV</b>	<b>5.31</b>	<b>19.43</b>	<b>5.26</b>	<b>11.57</b>

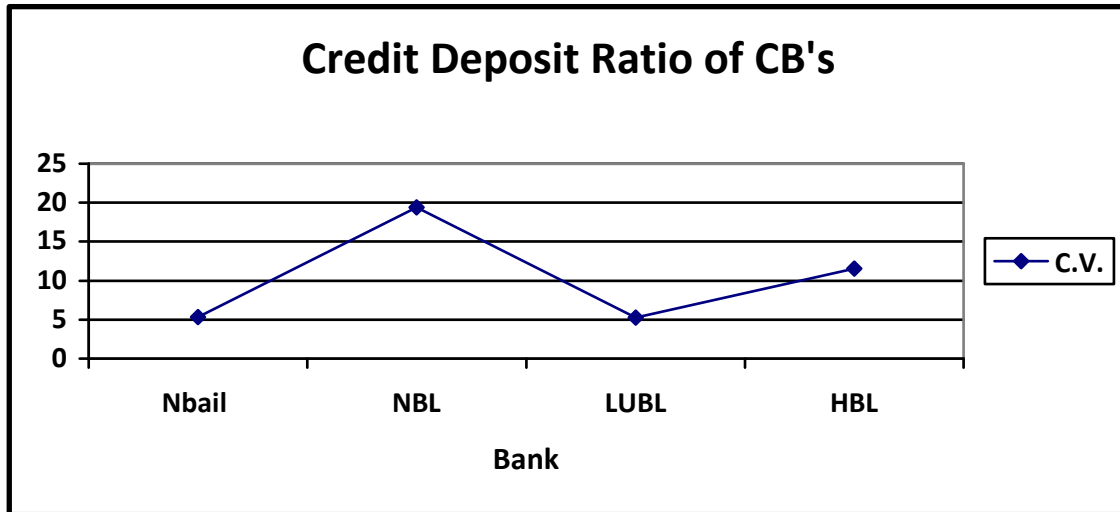


Figure No. 4.3

CD ratio is one of the major indicators of the performance of the CBs. It helps to know the liquidity position of the CBs. From the above table we see that the CD ratio of the LUBL is seen very high than the other sample CBs. The mean CD ratio of the LUBL is 90.25%. The mean CD ratio of the NBL Bank is 45.64%, which is lowest among sample CBs. Similarly, the mean CD ratio of Nabil Bank is 71.92%. Likewise HBL has kept the moderate level of CD ratio maintaining at the mean of 70.83%. And HBL has also maintained a good level of mean CD ratio than that of NBL. Its CD ratio is seen consistent as well.

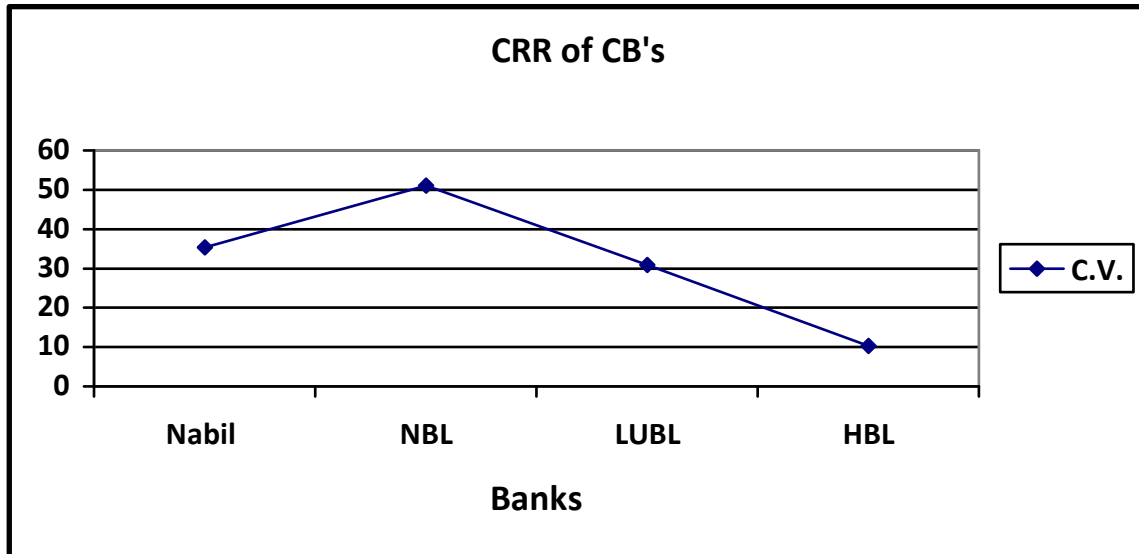
From above study we can conclude that CD ratio of Nabil bank is more consistent as CD ratio of 71.92% is regarded as favorable calculation sees Annex-III)

#### 4.4 Cash Reserve Ratio of the CBs:

Table No.4.4.1  
CRR of the CBs

F/Y	Nabil	NBL	LUBL	HBL
2007	6	19	4.83	5.92
2008	8.37	18.24	7.38	5.13
2009	9.03	14.64	12.9	6.76
2010	3.02	17.47	8.80	6.76
2011	4.90	0.00	10.64	5.75
<b>A.M.</b>	<b>6.26</b>	<b>13.87</b>	<b>8.91</b>	<b>6.06</b>
<b>S.D.</b>	<b>2.21</b>	<b>7.08</b>	<b>2.75</b>	<b>0.62</b>
<b>C.V.</b>	<b>35.30</b>	<b>51.04</b>	<b>30.86</b>	<b>10.23</b>

Source: NRB \*till Mid-july 2011



**Figure No.4. 4**

The mean CRR of NBL is seen the highest among the sample CBs. It is 13.87%. It is more than the requirement as directed by the central bank, NRB. Theoretical, higher the level of CRR, higher the liquidity of the CBs, which directly affects in the profitability level of the CBs. Therefore, the trade-off between the liquidity & profitability should be reached as far as possible.

NBL has been maintaining the CRR in the uniformity level than the other sample CBs. The C.V. of the NBL is the highest among the CBs. It is just 51.04%. Similarly, LUBL has also has good mean CRR with 8.91% & CV of 30.86%. Though these two CBs were suffering with huge problems, it has been maintaining the good & effective CRR level consistency.

The mean CRR level of the Nabil Bank is seen the least with just the average of 6.26%. This shows the non-uniformity in the CRR level maintained by Nabil Bank. This is point to be remarked as being the renowned CB of the country it has not following the directive on CRR by NRB LUBL is another CB, which is seen not maintaining the CRR level in consistency level. Its C.V. is also very high than of the HBL. The C.V. of HBL is 10.23% . (For detail, calculations see Annex-IV)

#### **4.5 Capital Fund to Risk Weighted Assets of the CBs:**

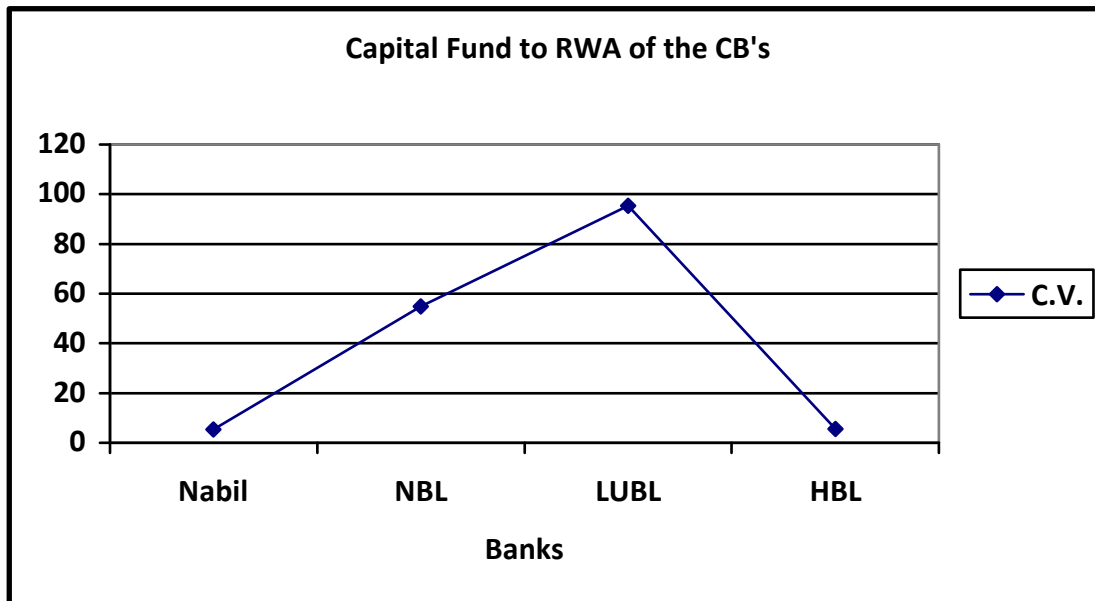
Until the F/Y 2061/62 the ratio for the RWA ratio should be maintained 11 %( includes 5.5% Core Capital) which was changed in the F/Y 2062/63. From F/Y 2062/63, the CBs have to maintain 12% of risk weighted assets & 6% of core capital in the composition of the total capital. This provision is applied for the "A", "B", "C", & "D" class financial institutions respectively. For the "D" class financial institution the composition was 6% capital fund of which 3% core capital & changed to 8% capital fund of which 4% as core capital. As per the NRB directives, until & unless the financial

institutions do not fulfill the requirement of the capital, they could not distribute the dividend & bonus shares to the shareholders.

**Table No. 4.5.**  
**Capital Fund to RWA of the CBs**

F/Y	Nabil	NBL	LUBL	HBL
2007	12.04	-38.83	-7.8	11.13
2008	11.1	-27.55	6.0	12.42
2009	10.7	-13.94	17.78	11.02
2010	10.50	-11.76	24.63	10.72
2011	11.75	-9.66	24.22	10.68
<b>A.M.</b>	<b>11.21</b>	<b>-20.34</b>	<b>12.96</b>	<b>11.19</b>
<b>S.D.</b>	<b>0.59</b>	<b>11.15</b>	<b>12.37</b>	<b>0.63</b>
<b>C.V.</b>	<b>5.26</b>	<b>54.81</b>	<b>95.44</b>	<b>5.63</b>

*Source: Banking & Financial Statistics, NRB \*till Mid-July 2011*



**Figure No. 4.5**

The capital fund to RWA ratio of the fully government-owned NBL & semi-government CB. The ratio is seen negative. The A.M. of NBL ratio is -20.34% . This have made the NRB to took over the management of these to CBs. They were not working efficiently with the expectation of the shareholders. This CBs is operating in full risk recording huge losses with the near future to be liquidated.

Among the positive capital fund to RWA ratio among the sample CBs, NBL is suffering from the huge problem in the uniformity in maintaining the ratio. It has the highest C.V. among the CBs having positive capital fund to risk weighted assets ratio. As per the NRB directive, the CBs should maintain at least 12% of this ratio. Only Nabil Bank , LUBL & HBL has been following the NRB directive & has maintained the required ratio.

Nabil Bank has maintained the average ratio of 11.21 % with 5.26% of C.V. showing more uniformity. LUBL has maintained the average ratio is 12.96 % with 95.44%. Similarly, HBL has also maintained the required level of average ratio of 11.19% with 5.63% of C.V. (For detail calculation see Annex-V)

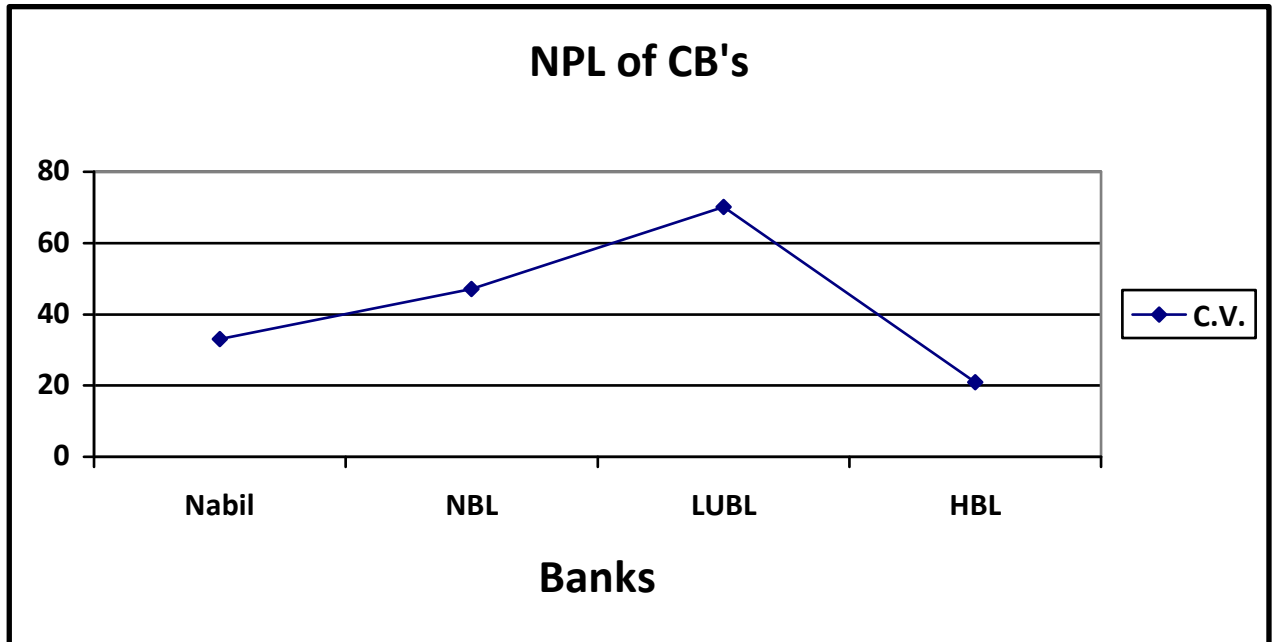
#### **4.6 Classification of Credits of CBs in percentage:**

The major attention in the Nepalese banking sector, more attention should be done in the credit policy by the central bank, NRB. Regarding loan policy, it should make clear to its policy & view. In fact the CBs should follow the credit policy, which would match the economic policy of the NRB or country to gain more & more profit. For this purpose, & as per the performance level of the credit of the CBs, the central bank, NRB, they are classified as PL & NPL. As discussed earlier, the PL is also divided as Pass (Good) Loan & Restructured Loan. And similarly, the NPL is also divided as Sub-standard Loan, Doubtful Loan & Bad Loan (Loss). Due to the data & time limitation, the percentage of the PL & NPL of the sample CBs are presented in next page:

**Table No.4.6  
NPL of CBs**

<b>F.Y</b>	<b>Nabil</b>	<b>NBL</b>	<b>LUBL</b>	<b>HBL</b>
2007	1.12	13.49	20.37	3.61
2008	0.74	12.38	14.92	2.63
2009	0.80	4.94	9.06	2.16
2010	1.48	4.98	4.53	3.52
2011	1.77	5.29	0.96	3.92
<b>A.M</b>	<b>1.18</b>	<b>8.21</b>	<b>9.96</b>	<b>3.16</b>
<b>S.D.</b>	<b>0.39</b>	<b>3.87</b>	<b>6.98</b>	<b>0.66</b>
<b>C.V</b>	<b>33.05</b>	<b>47.13</b>	<b>70.08</b>	<b>20.88</b>

*Source: Banking & Financial Statistics, NRB\*till Mid-Jul 2011*



**Figure No. 4.6**

The mean NPL of CBs, Nabil Bank & HBL is good as compared with Lumbini and NBL. The mean percentage of NPL of Nabil Bank is 1.18% & of the HBL 3.16%. LUBL is the government-owned CB, its NPL mean percentage is seen the highest among the sample CBs. Its mean ratio is seen only 9.96%. C.V is higher value of LUBL 70.08% .

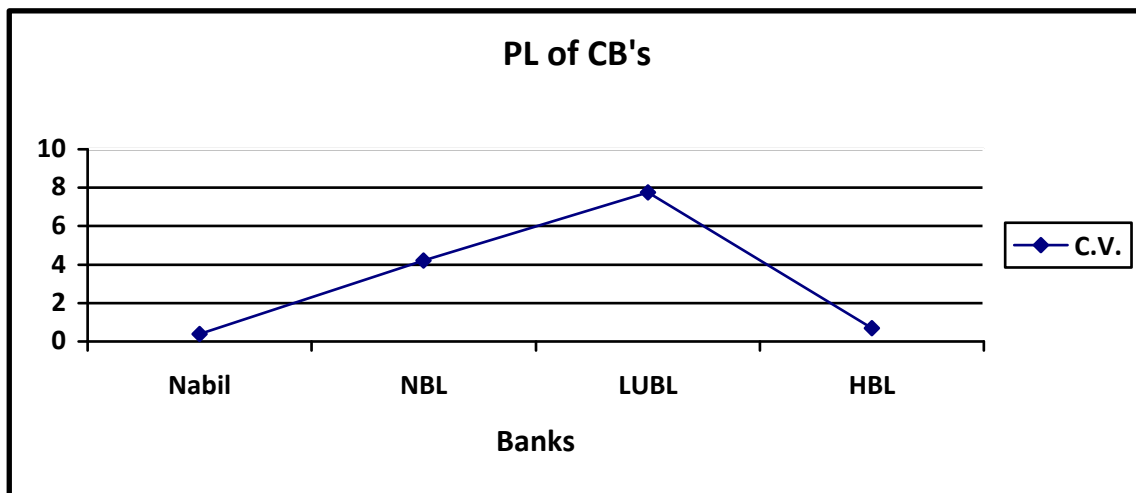
As the C.V. of the Nabil NPL is the lowest, there is the consistency in the flow of the credit in the past F/Y. Nabil has the lowest average percentage of the NPL among the sample CBs. Similarly, LUBL government owned bank has highest NPL among the sample CBs. This shows the lower the NPL the better is the credit, which is beneficiary to the CBs.

From above we can see that private sector CBs have maintain good ration of NPL as compared with government owned CBs. (For detail calculation sees Annex-VI)

**Table No.4.7**  
**PL of CBs**

F.Y	Nabil	NBL	LUBL	HBL
2007	98.88	86.51	79.63	96.39
2008	99.26	87.62	85.08	97.37
2009	99.2	95.06	90.94	97.84
2010	98.52	95.02	95.47	96.48
2011	98.23	94.71	99.04	96.08
A.M	98.81	91.78	90.03	96.83
S.D	0.4415	3.87	6.98	0.66

C.V	0.398	4.216	7.75	0.68
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**Figure No. 4.7**

The mean PL of CBs, Nabil Bank & HBL is seen excellent. The mean percentage of PL of Nabil Bank is 98.81% & the PL of HBL 96.83%.

As the LUBL is the government-owned CB, its PL mean percentage is seen the lowest among the sample CBs. Its man ratio is seen only 90.03%. C.V is higher value of LUBL 7.75 and lower CV of 0.398 of Nabil.

Huge improvement is seen in the loan performance of the semi-government owned oldest CB, NBL. As with the direct intervention of the central bank, NRB & management took over by the foreign management team & their strict follow-up in the recovery of the non-performing loans, NBL recorded this positive indicator in past 3-4 F/Y. This is the impact of the stick action against the loan defaulters by the joint actions by government, central bank, NRB & the CB itself.

As the C.V. of the HBL is the lowest, there is the consistency in the flow of the credit in the past F/Y. HBL is has the high average percentage of the PL among the sample CBs. Similarly, HBL recorded the lowest C.V. in the NPL among the sample CBs. This shows the consistency in maintaining the low amount of the NPL, which is beneficiary to the CBs. (For detail calculation see Annex-VI)

## 4.7 Test of Hypothesis

Under this topic, an effort has been made to test the significance regarding the parameter of the population based on drawn from the population. Generally, the following steps are followed for the test of hypothesis.

Formulation of Hypothesis

Null Hypothesis

Alternative Hypothesis

Computation of test statistic

Fixing the level of significance

Finding the criteria region

Deciding the two tailed or one tailed test

Making decision

#### 4.7.1. Test of Hypothesis on CRR of Nabil, NBL, LUBL & HBL:

Null Hypothesis ( $H_0$ ):  $\bar{X}_1 = \bar{X}_2 = \bar{X}_3 = \bar{X}_4$  i.e. there is no significant difference among mean CRR of Nabil, NBL, LUBL & HBL

Alternative Hypothesis ( $H_1$ ):  $\bar{X}_1 \neq \bar{X}_2 \neq \bar{X}_3 \neq \bar{X}_4$  i.e. there is a significant difference among mean ratio of CRR of Nabil, NBL, LUBL & HBL .

Note: For detail calculation see Annex-VIII

**Table No.4.7.1**  
**One-way AVOVA Table for CRR**

Source of Variation	Sum of Square	D.F.	Mean Square	F ratio= $\frac{MSC}{MSF}$
Between samples	SSC=198.16	k-1=4-1=3	MSC= $\frac{198.16}{3}$ =66.05	F= $\frac{MSC}{MSF} = \frac{66.05}{19.73}$
Within samples (Error)	SSE=315.68	n-k=20-4=16	MS= $\frac{315.68}{16}$ =19.73	
Total	TSS=513.84	n-1=19		F=3.347

Critical Value: The tabulated value of F at 5% level of significance for 3 & 16 d.f. is 3.24.

Decision: Since calculated F is greater than the tabulated value, the null hypothesis,  $H_0$  is rejected & hence the alternative hypothesis,  $H_1$  is accepted. Therefore, we conclude that there is significant difference among mean CRR of Nabil, NBL, LUBL & HBL i.e. CD ratio of CBs are homogenous.

## **4.8 Major findings of the study**

In the interest of financial stability, inactive loan amount should be below 5% of total loan if it exceeded the NRB has restricted an expending of branch. Similarly NRB has instructed commercial bank to maintain minimum capital adequacy ratio of 10%. If CBs failed to maintain capital adequacy NRB has restricted to give loan as well.

In Nepal, inactive loan amount is high in the banking sector particularly because of some clients being delinquent. Victims of high inactive loan amount are the government-owned banks. Among the measures taken so far to reduce the level of inactive loan, blacklisting has proved more effective.

The capital fund to risk weighted assets (Total Capital Fund) of the CBs should be positive principally. Among the calculations of the sample CBs, the ratio of the huge & old CBs, NBL was negative which shows the risk in the operation of these banks. Similarly, the ratio of one of the private sector CB, LUBL was also in the risk as, its ratio was also been recording negative since F/Y 2008.

CRR helps to know the liquidity position of CBs. Nepal Rastrya bank had issued circular on 2067B.S regarding the provision of CRR of commercial banks. All commercial bank should maintain at least CRR of 5.5% of total deposit. As per our finding all the sample banks have maintained CRR above average. The CRR of NBL is 13.87%, CRR of LUB 8.91% CRR of Nabil is 6.26% and CRR of HBL of 6.06%

The CD ratio of the sample CBs was in good position. The CD ratio of LUBL was seen extremely high with the average of 90.25%. Other CBs were maintaining somewhat good level of CD ratio. This ratio is one of the important indicators to find out the exact liquidity position of the CBs.

The NPL of the NBL & LUBL has not been improved yet. The mean ratio of NPL has remained 9.96% and 8.21% respectively of LUBL and NBL. Similarly NPL of HBL is 3.16%. which is highest among sample private sector commercial bank

The PL of private sector CBs is excellent as compared with government owned RBB. The mean ratio of PL of Nabil Bank is 98.81% the mean ratios of PL of HBL is 96.83% & mean ratio of PL of LUBL is 90.03% and mean PL of NBL is 91.78%. .

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMENDATION**

#### **5.1 Summary**

The main reason of the business fluctuation of modern times is the expansion and contraction of money and credit. In modern economics, there is the circulation of credit money many times more than the volume of bank note and coins. The central bank, the highest monetary authority of the country should, therefore, control the volume of money and credit for business stability. Since the bank notes are issued by the central bank, it can directly control the volume of money. However, the central bank controls credit through indirect measures. Hence, in an ordinary sense, the policy of the central bank related to the control of money and credit is known as monetary policy. Based on this policy, the central bank of every country makes & gives directives to the different types of financial institutions for their effective & smooth operation for the economic benefits of the country.

NRB has also updated the financial institution establishment policy with changes where necessary to ensure financial sector stability. Directives have been served to these institutions to increase their paid-up capital base with a view to ensure bank's capacity to bear possible risks of their banking transactions & to encourage merges when necessary. Accordingly, the new licensing policy in place requires having paid-up capital of Rs.2 billion for new commercial banks ("A" class financial institutions) to open. The concept of regional banks has been eliminated. Paid-up capital base for development banks & finance companies has also been raised. Such capital requirement for micro-finance companies to open, however, has not been changed with a view to encourage micro-finance companies to expand. According to the new licensing policy, providing proof of mandatory paid-up capital base by June/July 2012 is a pre-condition for those which have submitted proposals to open new finance institutions. This provision has been made considering the entry of Nepal in WTO. In case of operating financial institutions, they are required to comply with this provision by June/July 2015. Provisions such as individuals intending to invest in these institutions require to proof of tax clearance, & they are not blacklisted by the CIC been made effective.

As a regulator of country's financial & banking institutions, NRB always directly & indirectly advised banks & financial institutions to increase their financial base. The plan for capital enhancement is one of the best solutions to increase capital strength of banks & complying Basle Accord. The global mantra of facing competition lies in growing big. This is not survival of the fittest alone, survival of "biggest & fittest" is the new theory formed under globalization of world finance.

Banks should pump billions, & still better if they can pump it in hard foreign currencies. This idea of curious policy makers is an example of how the whole banking system is dragged up for competition. The volume of competition & the way it could take place in future are just a matter of guess now. The government & the NRB as a

banker's bank want all public banks, private banks & joint venture banks to be financially strong & healthy because there are lot of challenges & opportunities in coming days.

To maintain financial stability, inspection & supervision system has been made more effective in addition to the updated regulatory works. The time-to-time different directives to the financial institutions by the NRB have been also an effective tool. Following this, a separate monitoring committee has been established to cater for the banks in problem & in-depth supervision & monitoring of such banks has been started. As per the policy of preparing annual reports timely inspection & supervision is done by NRB. To improve the weaknesses & shortcomings observed in the course of supervision, timely directives based on the inspection reports are being issued to the concerned banks & financial institutions. Providing preliminary clearance to the banks prior to approval of their financial statement publication has also been started. Provision of compensation payment for failure to maintain the mandatory cash reserve level & failure to provide deprived class loans has been enforced.

Banks & financial institutions are the backbone of the economic development of a country. They have promoted industrialization & economic development by channeling the public deposit into these sectors. The establishment of the new bank & financial institutions leads more competition in the banking market. To win the competition, banks provide more facilities to the customers with modern technology. At the same time, the probability of loss becomes significant to banks, which are running behind in the competition. In case of insolvency, the public depositors as well as the shareholders of the bank may suffer significantly. It will adversely affect the overall banking sector. Therefore, the supervisory & monitoring of banks & financial institutions is essential to find out the solvency position & take corrective action in time when needed. For this purpose, the central bank of the country, NRB monitors & gives directives to CBs & financial institutions after supervision & inspection.

## **5.2 Conclusion**

Banks & financial institutions in Nepal will have to benchmark themselves against some of the best in the world, for a strong & resilient banking & financial system. Therefore, banks need to go beyond peripheral issues & tackle significant issues like improvements in profitability, efficiency & technology, while achieving economies of scale through available cost effective solutions. These are some of the major issues that need to be addressed by banks in recent scenario, for their success & not just survival, in the changing milieu.

Adequate capital reserve is necessary for financial institutions to minimize risks. Financial crisis faced by the Southeast Asian countries in 1997-98 due to inadequate capital reserve is a living memory. BASEL II guides the capital-structuring requirement, which is yet to be implemented. Accordingly, the banks & finance institutions are required to maintain capital adequacy at 11.0% starting from F/Y 2008/2009.

Another directive of NRB to licensed banks & financial institutions deals with the financial statement. Starting from F/Y 2008/2009, they are required to open capital adjustment fund to meet mandatory minimum paid-up capital by allocating a minimum of 10% of paid-up capital from their profit. For financial institutions not earning profit, they are required to comply with this provision by managing resources from whatsoever sources at their disposal.

In the interest of financial stability, inactive loan amount should be below 5% of total loan. In Nepal, inactive loan amount is high in the banking sector particularly because of some clients being delinquent. Victims of high inactive loan amount are the government-owned banks. Among the measures taken so far to reduce the level of inactive loan, blacklisting has proved more effective.

The capital fund to risk weighted assets (Total Capital Fund) of the CBs should be positive principally. Among the calculations of the sample CBs, the ratio of the huge & old CBs, NBL was negative which shows the risk in the operation of these banks. Similarly, the ratio of one of the private sector CB, LUBL was also in the risk as, its ratio was also been recording negative since F/Y 2008.

The CD ratio of the sample CBs was in good position. The CD ratio of LUBL was seen extremely high with the average of 91.73%. Other CBs were maintaining somewhat good level of CD ratio. This ratio is one of the important indicators to find out the exact liquidity position of the CBs.

The NPL of the NBL & LUBL has not been improved yet. The mean ratio of NPL has remained 8.21% & 9.96% respectively of NBL & LUBL. The mean ratio of NPL was seen excellent of Nabil Bank & HBL with 1.77% & 3.16% respectively.

CRR is one of the important indicators to know the exact liquidity position of the CBs. It is also a compulsory to maintain the CRR as per the directive of the central bank, NRB by all the CBs. Among the sample CBs, NBL has maintained the highest mean CRR level with 13.87% then the LUBL has the mean CRR of 8.91%.

### **5.3 Recommendation**

1. NRB has to encourage the simultaneous growth of a sound & competitive financial system in the country. Such objective supports the promotion of momentum policy with stabilization driving economic development of the country.
2. The central bank of the country, NRB has to review its directives time-to-time according to the requirement of the economic situation of the country.
3. Strict action should be taken by the NRB to the CBs who have not followed the directives as prescribed by it.
4. The loan defaulters should be taken into strict legal action in the joint effort of the NRB, Loan Recovery Tribunal, GON & the concerned CBs.

5. As, Nepal has entered into WTO, & government has decided to let the foreign banks to enter into the Nepalese market, the capital requirement for the establishment of new CBs should be strictly follow-up by the local CBs also.
6. Information-technology aid should also be taken by the central bank to make the effective & efficient flow of information to the financial institutions.
7. Proper provision of collection of capital fund required should be made by the central bank. The mode of collection should also be properly mentioned in the act by the central bank.
8. Loan loss provision & the classification of the loans by the CBs should be continued in the coming days to protect from the crisis.
9. Consistency in the indicators should be made among the CBs as far as possible by the central bank, NRB using its authorities & flowing effective directives.
10. Proper implementation of bills & acts namely: Bankruptcy Act, 2063, Credit Rating Institution Bill, Assets Management Corporation Bill, Trustee Bill, Anti-Money Laundering Bill should be passed as soon as possible by GON & also be implemented with the co-ordination of NRB.
11. NRB should not only issue directives for the sake of issuing them but a proper homework needs to be done to combat the problems associated with the directives. It should not happen as the directives related to L/C, where prior study was not done & within a few days of the issuance of the directives, they had to be amended.
12. NRB should be more practicable while issuing the directives to the CBs. Directives should be straight forward, reasonable & with no loopholes with context to the country & not just to fulfill the duty of the central bank only but also as the care-taker of the economy of the country.

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## ANNEX-I

### List of Commercial Banks:

SN	Names	Date of Operation	Head Office
1	Nepal Bank Limited	15-Nov-37	DDharmapath,Kathmandu
2	Rastriya Banijya Bank	23-Jan-66	Singhadurbar,Kathmandu
3	Agriculture Development Bank	2-Jan-68	Ramshahpath Kathmandu
4	Nabil Bank Limited	16-Jul-84	Kamaladi, Kathmandu
5	Nepal Investment Bank Limited	27-Feb-86	Durbar marg, Kathmandu
6	Standard Chartered Bank Nepal	30-Jan-87	New Baneshwor, Kathmandu
7	Himalayan Bank Limited	18-Jan-93	Thamel, Kathmandu
8	Nepal SBI Bank Limited	7-Jul-93	Hatisar, Kathmandu
9	Nepal Bangladesh Bank Limited	6-May-94	Bijulibazar, Kathmandu
10	Everest Bank Limited	18-Oct-94	Lazimpath, Kathmandu
11	Bank of Kathmandu Limited	12-Mar-95	Kamaladi, Kathmandu
12	Nepal Credit and Commerce Bank	14-Oct-96	Siddharthanagar,Rupendehi
13	Lumbini Bank Limited	17-Jul-98	Narayangadh,Chitawan
14	NIC Bank Limited	21-Jul-98	Biaratnagar,Morang
15	Machhapuchhre Bank Limited	3-Oct-00	Pokhara, Kaski
16	Kumari Bank Limited	3-Apr-01	Kathmandu
17	Laxmi Bank Limited	3-Apr-02	Birgunj, Parsa
18	Siddhartha Bank Limited	24-Dec-02	Kamaladi, Kathmandu
19	Global Bank Ltd.	2-Jan-07	Birgunj, Parsa
20	Citizens Bank International Ltd.	21-Jun-07	Kamaladi, Kathmandu
21	Prime Commercial Bank Ltd	24-Sep-07	Newroad, Kathmandu
22	Bank of Asia Nepal Limited	12-Oct-07	Tripureshwor, Kathmandu
23	Sunrise Bank Ltd.	12-Oct-07	Gairidhara, Kathmandu
24	Grand Bank NepalLtd.	23-Jan-01	Kamaladi, Kathmandu
25	NMB Bank Ltd.	26-Nov-96	Babarmahal, Kathmandu
26	Kist Bank	21-Feb-03	Anamnagar, Kathmandu
27	Janta Bank Nepal Limited	5-April -2010	Sankhamul, Kathmandu
28	Mega Bank limited	23-July-10	Kantipath, Kathmandu
29	Commerz and Trust Bank Nepal Ltd	20-September-10	Kamaladi, Kathmandu
30	Civil Bank Limited	26-November-10	Kamaladi, Kathmandu
31	Century Bank Limited	10-March-11	Putalisadak,Kathmandu
32	Sanima Bank Limited	15-February-2012	Nagpokhari, Kathmandu

*\*Segregated into two banks as development & commercial banks on July 14, 2005(2062/03/30).Est. on Jan.21, 1968(2024/10/7) as development bank.*

Source: Nepal Rasrtra Bank, Bank Management Dept., Thapthali, Kathmandu

## ANNEX-II

### Calculation of the Capital-Deposit Ratios of CBs

**Formula:** Capital Z Deposit Ratio  $\times \frac{\text{Total Capitals}}{\text{Total Deposits}} | 100\%$

**For Nabil:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>Capital- Deposit Ratio</b>	<b>10.16%</b>	<b>8.57%</b>	<b>8.38%</b>	<b>8.26%</b>	<b>9.19%</b>	$\bar{y}X=44.56$
					$\dots \bar{X} X \frac{X}{n}$	<b>8.91</b>
$f_x Z \bar{X} \bar{A}$	<b>1.5625</b>	<b>0.1156</b>	<b>0.2809</b>	<b>0.4225</b>	<b>0.0784</b>	$\bar{y} f_x Z \bar{X} \bar{A} = 2.4599$

$$\begin{aligned} \therefore \sigma &= \sqrt{\frac{1}{n} \sum (X - \bar{X})^2} \\ &= 0.70 \\ &= 0.70 \end{aligned}$$

$$\dots C.V. X \frac{\dagger}{X} | 100\% \times \frac{0.70}{8.91} | 100\% \times 7.85\%$$

**For NBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>Capital- Deposit Ratio</b>	<b>29.78%</b>	<b>28.40%</b>	<b>12.42%</b>	<b>12.51%</b>	<b>10.65%</b>	$\bar{y}X=93.76$
					$\dots \bar{X} X \frac{X}{n}$	<b>18.75%</b>
$f_x Z \bar{X} \bar{A}$	<b>121.66</b>	<b>93.12</b>	<b>40.06</b>	<b>38.93</b>	<b>65.61</b>	$\bar{y} f_x Z \bar{X} \bar{A} = 359.39$

$$\dots \dagger X \sqrt{\frac{1}{n} \sum f_x Z_{\bar{X}}^2} X 8.47 \dots C.V. X \frac{\dagger}{X} | 100\% X \frac{8.47}{18.75} | 100\% X 45.17\%$$

For LUBL:

Rs. in million

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
Capital- Deposit Ratio	13.06%	2.22%	12.44%	25.24%	27.30%	$\bar{y} X = 80.26$
					$\dots \bar{X} X \frac{X}{n}$	16.05%
$\sum f_x Z_{\bar{X}}^2$	8.9401	191.2689	13.0321	84.4561	126.562	$\bar{y} \sum f_x Z_{\bar{X}}^2 = 424.25$

$$\dots \dagger X \sqrt{\frac{1}{n} \sum f_x Z_{\bar{X}}^2} X 9.21 \dots C.V. X \frac{\dagger}{X} | 100\% X \frac{9.21}{1605} | 100\% X 57.39\%$$

For HBL:

Rs. in million

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
Capital- Deposit Ratio	5.35%	5.83%	8.99%	9.14%	9.76%	$\bar{y} X = 39.07$
					$\dots \bar{X} X \frac{X}{n}$	7.81%
$\sum f_x Z_{\bar{X}}^2$	6.0516	3.9204	1.3924	1.7689	3.8025	$\bar{y} \sum f_x Z_{\bar{X}}^2 = 16.9358$

$$\dots \dagger X \sqrt{\frac{1}{n} \sum f_x Z_{\bar{X}}^2} X 1.84 \dots C.V. X \frac{\dagger}{X} | 100\% X \frac{1.84}{7.81} | 100\% X 23.56\%$$

### ANNEX III

#### Calculation of the CD Ratios of CBs

**Formula:**  $CD\ Ratio \times \frac{Total\ Credits}{Total\ Deposits} | 100\%$

**For Nabil:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
CD Ratio	68.13%	68.18%	73.87%	71.17%	78.29%	$\bar{y}X=359.64$
$\dots \bar{X} X \frac{X}{n}$						71.92%
$f_x z \bar{x} \bar{A}$	14.36	13.98	3.80	0.56	40.57	$\bar{y} f_x z \bar{x} \bar{A} = 73.29$

$$\dots \dagger X \sqrt{\frac{1}{n}} f_x z \bar{x} \bar{A} X 3.82$$

$$\dots C.V. X \frac{\dagger}{X} | 100\% X \frac{3.82}{71.92} | 100\% X 5.32\%$$

**For NBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
CD Ratio	35.26%	37.69%	43.28%	54.94%	57.06%	$\bar{y}X=228.19$
$\dots \bar{X} X \frac{X}{n}$						45.63%
$f_x z \bar{x} \bar{A}$	107.53	63.04	5.52	86.67	130.64	$\bar{y} f_x z \bar{x} \bar{A} = 393.4$

$$\dots \pm \sqrt{\frac{1}{n} \sum f_x z \bar{x}^2} \times 8.87$$

$$\dots C.V. \times \frac{\pm}{\bar{X}} \mid 100\% \times \frac{8.87}{45.63} \mid 100\% \times 19.43\%$$

**For LUBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>CD Ratio</b>	<b>82.07%</b>	<b>94.1%</b>	<b>88.15%</b>	<b>95.23%</b>	<b>91.73%</b>	$\bar{y}X=451.28$
$\dots \bar{X} \times \frac{X}{n}$						<b>90.25%</b>
$\sum f_x z \bar{x}^2$	<b>66.91</b>	<b>14.82</b>	<b>4.41</b>	<b>24.80</b>	<b>2.1904</b>	$\bar{y} \sum f_x z \bar{x}^2 = 113.13$

$$\dots \pm \sqrt{\frac{1}{n} \sum f_x z \bar{x}^2} \times 4.75$$

$$\dots C.V. \times \frac{\pm}{\bar{X}} \mid 100\% \times \frac{4.75}{90.25} \mid 100\% \times 5.26\%$$

**For HBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>CD Ratio</b>	<b>59.22%</b>	<b>63.37%</b>	<b>73.58%</b>	<b>77.43%</b>	<b>80.57%</b>	$\bar{y}X=354.17$
$\dots \bar{X} \times \frac{X}{n}$						<b>70.83%</b>
$\sum f_x z \bar{x}^2$	<b>134.79</b>	<b>55.65</b>	<b>7.56</b>	<b>43.56</b>	<b>94.86</b>	$\bar{y} \sum f_x z \bar{x}^2 = 336.42$

$$\dots \pm \sqrt{\frac{1}{n} \sum f_x z \bar{x}^2} \times 8.20$$

$$\dots C.V. \times \frac{\pm}{\bar{X}} \mid 100\% \times \frac{8.20}{70.83} \mid 100\% \times 11.57\%$$

## ANNEX-IV

### Calculation of the CRR of CBs

**Formula:**  $CRR \times \frac{\text{Balance in NRB}}{\text{Total Deposits}} \times 100\%$

**For Nabil:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>CRR</b>	<b>6%</b>	<b>8.37%</b>	<b>9.03%</b>	<b>3.02%</b>	<b>4.90%</b>	$\bar{y}X=31.32$
$\bar{X} \times \frac{X}{n}$						<b>6.26%</b>
$\sum f_x z \bar{x}^2$	<b>0.067</b>	<b>4.45</b>	<b>7.67</b>	<b>10.49</b>	<b>1.84</b>	$\sum f_x z \bar{x}^2 = 24,51$

$$\dots \times \sqrt{\frac{1}{n}} \sum f_x z \bar{x}^2 \times 2.21$$

$$\dots C.V. \times \frac{\sum f_x z \bar{x}^2}{\bar{X}} \times 100\% \times \frac{2.21}{6.26} \times 100\% \times 35.30\%$$

**For NBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>CRR</b>	<b>19%</b>	<b>18.24%</b>	<b>14.64%</b>	<b>17.47%</b>	<b>0</b>	$\bar{y}X = 69.35$
$\bar{X} \times \frac{X}{n}$						<b>13.87%</b>
$\sum f_x z \bar{x}^2$	<b>26.31</b>	<b>19.09</b>	<b>0.59</b>	<b>12.96</b>	<b>192.37</b>	$\sum f_x z \bar{x}^2 = 251.32$

$$\dots \pm \sqrt{\frac{1}{n} \sum f_x z \bar{x}^2} \times 7.08$$

$$\dots C.V. \times \frac{\pm}{\bar{X}} \mid 100\% \times \frac{7.08}{13.87} \mid 100\% \times 51.04\%$$

**For LUBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>CRR</b>	<b>4.83%</b>	<b>7.38%</b>	<b>12.90%</b>	<b>8.80%</b>	<b>10.64%</b>	$\bar{y}X=44.55$
$\dots \bar{X} \times \frac{X}{n}$						<b>8.91</b>
$f_x z \bar{x}^2$	<b>16.64</b>	<b>2.34</b>	<b>15.92</b>	<b>0.0121</b>	<b>2.99</b>	$\bar{y} f_x z \bar{x}^2 = 37.90$

$$\dots \pm \sqrt{\frac{1}{n} \sum f_x z \bar{x}^2} \times 2.75$$

$$\dots C.V. \times \frac{\pm}{\bar{X}} \mid 100\% \times \frac{2.75}{8.91} \mid 100\% \times 30.86\%$$

**For HBL:**

**Rs. in million**

Particulars	F/Y 2007	F/Y 2008	F/Y 2009	F/Y 2010	F/Y 2011	
<b>CRR</b>	<b>5.92</b>	<b>5.13</b>	<b>6.76</b>	<b>6.76</b>	<b>5.75</b>	$\bar{y}X=30.32$
$\dots \bar{X} \times \frac{X}{n}$						<b>6.06%</b>
$f_x z \bar{x}^2$	<b>0.0196</b>	<b>0.8649</b>	<b>0.49</b>	<b>0.49</b>	<b>0.0961</b>	$\bar{y} f_x z \bar{x}^2 = 1.96$

$$\dots \pm \sqrt{\frac{1}{n} \sum f_x z \bar{x}^2} \times 0.62$$

$$\dots C.V. \times \frac{\pm}{\bar{X}} \mid 100\% \times \frac{0.62}{6.06} \mid 100\% \times 10.33\%$$

**ANNEX-V**

**Calculation of Capital Fund to Risk Weighted Assets of the CBs**

F/Y	Nabil		NBL		LUBL		HBL	
	X	$f_X Z \bar{X} \bar{A}$	X	$f_X Z \bar{X} \bar{A}$	X	$f_X Z \bar{X} \bar{A}$	X	$f_X Z \bar{X} \bar{A}$
2007	12.04	0.68	-38.83	341.88	-7.8	430.97	11.13	0.0036
2008	11.1	0.0121	-27.55	51.984	6	48.44	12.42	1.1090
2009	10.7	0.2601	-13.94	40.96	17.78	23.23	11.02	0.0289
2010	10.50	0.5041	-11.76	73.6164	24.63	136.18	10.72	0.2209
2011	11.75	0.2916	-9.66	114.06	24.22	126.78	10.68	0.2601
N=5 Yrs.	X= 56.09	$f_X Z \bar{X} \bar{A}$ = 1.74	X= - 101.71	$f_X Z \bar{X} \bar{A}$ = 622.50	X= 64.83	$f_X Z \bar{X} \bar{A}$ = 765.60	X= 55.97	$f_X Z \bar{X} \bar{A}$ = 1.6225
$\frac{\sum X}{n}$	11.21		-20.34		12.96		11.19	
$\sqrt{\frac{1}{n} \sum f_X Z \bar{X} \bar{A}}$	0.59		11.15		12.37		0.63	
$\frac{\sum X^2}{X} \uparrow  10\%$	5.26%		54.81%		95.44%		5.63%	

**ANNEX-VI**

**Calculation on Classification of Credits of CBs in percentage**

**For Nabil**

<b>F/Y</b>	<b>PL (X)</b>	<b>NPL (Y)</b>	<b>PL <math>\int_X Z \bar{X} \hat{A}</math></b>	<b>NPL <math>\int_Y Z \bar{Y} \hat{A}</math></b>
2007	98.88%	1.12%	0.0049	0.0036
2008	99.26%	0.74%	0.2025	0.1936
2009	99.2%	0.8%	0.1521	0.1444
2010	98.52%	1.48%	0.0841	0.09
2011	98.23%	1.77%	0.3364	0.3481
N=5 years	X=494.09	Y=5.91	$\int_X Z \bar{X} \hat{A} = 0.78$	$\int_Y Z \bar{Y} \hat{A} = 0.7797$
$\bar{X} = \frac{\sum X}{n}$	98.81%	1.18%		
$\sigma_X = \sqrt{\frac{1}{n} \sum X^2 - \bar{X}^2}$	0.394	0.39		
C.V. $X = \frac{\sigma_X}{\bar{X}} \times 100\%$	0.398%	33.05%		

**For NBL**

<b>F/Y</b>	<b>PL (X)</b>	<b>NPL (Y)</b>	<b>PL <math>\sum_{i=1}^n f_{X_i} z_{\bar{X}}^k</math></b>	<b>NPL <math>\sum_{i=1}^n f_{Y_i} z_{\bar{Y}}^k</math></b>
2007	86.51%	13.49%	27.77	27.87
2008	87.62%	12.38%	17.30	17.38
2009	95.06%	4.94%	10.75	10.69
2010	95.02%	4.98%	10.49	10.43
2011	94.71%	5.29%	8.58	8.52
N=5 years	X=401.37	Y=41.08	$\sum_{i=1}^n f_{X_i} z_{\bar{X}}^k = 74.89$	$\sum_{i=1}^n f_{Y_i} z_{\bar{Y}}^k = 74.89$
$\bar{X} = \frac{\sum_{i=1}^n X_i}{n}$	91.78%	8.21%		
$\sigma_X = \sqrt{\frac{1}{n} \sum_{i=1}^n f_{X_i} z_{\bar{X}}^2}$	3.87	3.87		
$C.V. = \frac{\sigma}{\bar{X}} \times 100\%$	4.216%	47.13%		

**For LUBL**

<b>F/Y</b>	<b>PL (X)</b>	<b>NPL (Y)</b>	<b>PL <math>\sum_{i=1}^n f_{X_i} z_{\bar{X}_i}^2</math></b>	<b>NPL <math>\sum_{i=1}^n f_{Y_i} z_{\bar{Y}_i}^2</math></b>
2007	79.63%	20.37%	108.16	108.36
2008	85.08%	14.92%	24.50	24.60
2009	90.94%	9.06%	0.8281	0.81
2010	95.47%	4.53%	29.59	29.48
2011	99.04%	0.96%	81.18	81
N=5 years	X=450.16	Y=49.84	$\sum_{i=1}^n f_{X_i} z_{\bar{X}_i}^2 = 244.25$	$\sum_{i=1}^n f_{Y_i} z_{\bar{Y}_i}^2 = 244.25$
$\bar{X} = \frac{\sum_{i=1}^n X_i}{n}$	90.03%	9.96%		
$\sigma_X = \sqrt{\frac{1}{n} \sum_{i=1}^n f_{X_i} (X_i - \bar{X})^2}$	6.98	6.98		
$C.V. = \frac{\sigma}{\bar{X}} \times 100\%$	7.75%	70.08%		

**For HBL**

<b>F/Y</b>	<b>PL (X)</b>	<b>NPL (Y)</b>	<b>PL <math>\sum_{i=1}^n \frac{X_i}{n}</math></b>	<b>NPL <math>\sum_{i=1}^n \frac{Y_i}{n}</math></b>
2007	96.39%	3.61%	0.1936	0.20
2008	97.37%	2.63%	0.2916	0.2809
2009	97.84%	2.16%	1.02	1
2010	96.48%	3.52%	0.1225	0.1296
2011	96.08%	3.92%	0.56	0.57
N=5 years	X=484.16	Y=15.84	$\sum_{i=1}^n \frac{X_i}{n} = 2.18$	$\sum_{i=1}^n \frac{Y_i}{n} = 2.18$
$\bar{X} = \frac{\sum_{i=1}^n X_i}{n}$	96.83%	3.16%		
$\sigma_X = \sqrt{\frac{1}{n} \sum_{i=1}^n (X_i - \bar{X})^2}$	0.66	0.66		
C.V. $X = \frac{\sigma_X}{\bar{X}} \times 100\%$	0.68%	20.88%		

## ANNEX-VII

### Test of Hypothesis on CRR of Nabil, NBL, LUBL, RBB & HBL

$X_1$	$X_2$	$X_3$	$X_4$	$X_{1_1}^2$	$X_2^2$	$X_3^2$	$X_4^2$
6	19	4.83	5.92	36	361	23.32	35.04
8.37	18.24	7.38	5.13	70.05	332.69	54.46	26.31
9.03	14.64	12.9	6.76	81.54	214.32	166.41	45.69
3.02	17.47	8.80	6.76	9.12	305.20	77.44	45.69
4.90	0.00	10.64	5.75	24.01	0.00	113.20	33.06
$X_1 =$	$X_2 =$	$X_3 =$	$X_4 =$	$X_{1_1}^2 =$	$X_2^2 =$	$X_3^2 =$	$X_4^2 =$
31.32	69.35	44.55	30.32	220.72	1213.21	434.83	185.79

$$T = X_1 \Gamma X_2 \Gamma X_3 \Gamma X_4 = 31.32 + 69.35 + 44.55 + 30.32 = 175.54$$

$$C.F. = \frac{T^2}{N} X = \frac{(175.54)^2}{20} = 1540.71458$$

$$\begin{aligned} T.S.S. &= X_{1_1}^2 \Gamma X_2^2 \Gamma X_3^2 \Gamma X_4^2 ZC.F. \\ &= 220.72 + 1213.21 + 434.83 + 185.79 - 1540.71 \\ &= 2054.55 - 1540.71 \\ &= 513.84 \end{aligned}$$

$$\begin{aligned} S.S.C. &= \frac{(X_1)^2}{n_1} \Gamma \frac{(X_2)^2}{n_2} \Gamma \frac{(X_3)^2}{n_3} \Gamma \frac{(X_4)^2}{n_4} ZC.F. \\ &= \frac{(31.32)^2}{5} \Gamma \frac{(69.35)^2}{5} \Gamma \frac{(44.55)^2}{5} \Gamma \frac{(30.32)^2}{5} Z1540.71 \\ &= \frac{980.94 + 4809.42 + 1984.70 + 919.30}{5} - 1540.71 \\ &= 1738.87 - 1540.71 \\ &= 198.16 \\ S.S.W. &= T.S.S. - S.S.C. = 513.84 - 198.16 = 315.68 \end{aligned}$$