

A Study on Role of Nepal RastraBank in the Development of Financial Market in Nepal

(A case study of major role of Nepal Rastra Bank in Nepalese Financial Markets)

ATHESIS

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RECOMMENDATION

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DECLARATION

I hereby declare that the work reported in this thesis entitled **“A Study on Role of Nepal Rastra Bank in the development of financial market in Nepal”** submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master’s of Business Studies (MBS) under the supervision of Suraj Tandan of Head of Research Department, Nepal Commerce Campus.

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LIST OF ABBREVIATIONS

A.D	=	Anno Domini
ADB/N	=	Agriculture Development Bank/Nepal
BIMSTEC	=	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
B.S	=	Bikram Sambat
CIA	=	Central Intelligence Agency
CPI	=	Consumer Price Index
CRR	=	Cash Reserve Ratio
d.f	=	Degree of freedom
e.g	=	Example
Et al.	=	ET alli (and others)
e.t.c	=	Etcetera
FDI	=	Foreign Direct Investment
Fig	=	Figure
FY	=	Fiscal Year
GDP	=	gross domestic product
HBL	=	Himalayan Bank Limited
i.e	=	That is
IMF	=	International Monetary Fund
LDC	=	Least development Country
LMFF	=	Liquidity Monitoring and forecasting framework
Ltd	=	Limited
MAS	=	Monetary Authority of Singapore
NCM	=	Nepal Capital Market
NEPSE	=	Nepal Stock Exchange
NGO	=	Non Government organization
NIDC	=	Nepal Industrial Development corporation
No.	=	Number
NRB	=	Nepal Rastra Bank
NYSE	=	New York Stock Exchange
OMO	=	Open Market Operation
p.p	=	pages
Pvt	=	Private
RBB	=	Rastriya Banijya Bank
RBI	=	Reserve Bank of India
RBS	=	Risk Based Supervision
Rs	=	Rupees
SAFTA	=	South Asian Free Trade Area
T.U	=	Tribhuvan University
T-Bill	=	Treasury bill
Viz	=	Namely
Vs	=	Versus
WTO	=	World Trade Organization
Y-o-y	=	Year wise Year

CHAPTER 1

INTRODUCTION

Trade in Nepal has been the regular phenomenon since long time and it is rising in the good pace. Poor performance of export and increasing tendency of imports (development, essential luxury goods, and raw materials) are the basic ingredients to raise the import. Per capita income is still low around 460 US\$ compared to least developed country. The low per capita express the low living standard and indicates poverty. Industrial activity mainly involves the processing of agricultural products including jute, sugarcane, tobacco, and grain. Security concerns with different coalition groups in the Terai had led the industry and tourism sector shed down ultimately resulting the declination of source to foreign exchange. Nepal has considerable scope of potential hydropower for revenue generation and country's prosperity by offering foreign investment. Prospect of foreign trade or investment in other sectors will remain poor, however because of the small size of the economy, its technological backwardness, remoteness, landlocked geographic location, people's civilization and its susceptibility to natural disaster.(The CIA World Fact Book....28)

After the Initiation of planning process in Nepal various sectors have been developed and different organizations established depending upon the foreign aid by the different developed countries mainly on agricultural, education, communication, transportation, electricity, health etc. There is still large flow of funds by the foreign organizations but the implementation being inefficient still keeps the quality of people's life low. The majority of people are still living in absolute poverty. Nepal still receives high amount of foreign aid from the bilateral as well as multilateral agencies.

Development of any country is only possible by its strong financial and economic indicators. The process of economic development depends upon various factors. Nepal has population of more than 28 million having growth rate 2.17 percent but it has per capita income of GDP 1400 US \$ only(The CIA World Fact Book). In economy dominance of agricultural sector still exist by about 39.2 percent but compared to the past 20 years data its dominance has been decreasing (Arunodaya; 2064:325).The financial

market is viewed as catalyst in the process of economic growth. The mobilization of domestic resources, capital formation and its proper utilization plays an important role in the economic development of country. Every financial institution big or small, be it a commercial bank or finance company or a co-operative bank plays an extreme crucial role in the development of country.

The financial market which occupy quite an important place in the economy because through the financial instruments they collect, they provide much needed capital for the Development of industry, trade and business and other deficit sectors there by contributing to the economic growth of the nation. Both neighbor giant economies enjoy higher rate of economic growth around 9.2 percent by India and 10.7 percent by China (Newsletter Nepal Rastra Bank 2066/67).

1.1 Background of the Study:

Development of any country largely depends upon the economic development and economic development is only possible through the development of financial system. The main responsibility of the financial sector is transmitting saving into productive investment. A well functioning financial system allocates saving to the best productive investment. This crucial role establishes the financial system to the brain of the economy. Both in developed and developing countries, it is empirically proven that the growth and stability of economy largely depends on the capacity and efficiency of her financial system, the capacity and efficiency of financial system largely depends on role played by central Bank in development & growth of financial market.

The NRB act provides more autonomy to the central bank in the spheres of financial sector policy formulation and increases its capacity for effective policy implementation. The Debt Recovery Act should help expedite the recovery process of the pending loans and contribute to reduce the share of the NPA of the banking system (NRB Newsletter 2006). There is 31 commercial bank, 87 development banks, 102 finance companies, 16 rural development banks, 16 Co-operatives and 40 NGO (NRB licensed) are established during June/July 2011.

1.2 Focus of the Study:

This study examines the role of NRB in development of financial market and relationship between the economic growth and financial market development in Nepal. This study also analyzes the gradual development of financial market in Nepal and role of NRB in it. This study mostly uses the statistical tools for analysis of role of NRB in financial market development and for analysis of present situation of financial market in Nepal. This also analyses the control system implemented by NRB and present controlling system. Lastly, it is not only the cornerstone for the future research but also the detailed analysis of role of NRB in development of financial market in Nepal and it analyzed both present existing situation of financial market and relationship between financial market and economic growth and recommends some useful facts to the concerned parties.

1.3 Introduction to Financial Market:

Financial market explains the trade of financial instruments such as share, bonds, debentures etc. Financial system provides a sound mechanism and incentives for pooling forth financial resources, So as to allocate them toward bearing productive purposes into mind the principles of risk, return and liquidity management. It thereby assists to improve, Strengthen and sustain the operations of the financial system while fostering saving, investment, productivity, employment and bring forth economy growth in the country. Developed financial markets foster financial sectors efficiency and promote financial intermediation that becomes crucial for the development of the real sector of the economy. Proper management of the financial institutions following prudent regulation and supervision of the economy system constitute the pre-requisites for making the financial system robust, strong and a reliable institution.

One of the indicators of the depth and strength of the financial system in the process of economic development of the country is the level of credit extended to the private sector, as this sector plays a potentially pivotal role in identifying and tapping the productive prospect of the economy. In parallel terms with public sector efforts, private investment, especially brought forth under competitive markets, would boost economic growth. According to the 2008 World Development Indicators (WDI), as published by the World

Bank, private markets are the engines for ushering into productivity growth creating productive jobs and rising in up income levels. A higher private sector credit ratio also signals the progress scaled in steering the economy towards the private sector led development strategy.

Capital markets also play a vital role in the national economy. Capital markets facilitate the allocation of longer term funds between the savers and borrowers. This allocation will be optimum if the capital markets have efficient pricing mechanism. If the capital market is efficient, the current share price of the company fully reflects the available information and there will be no question of the share price being over or under priced. Capital market is concerned with the long term finance. The fund collected in the market are raised and traded by long term financial instruments such as equities and bonds. Stock market is a market for long term capital where new capitals are raised by company and shares are bought and sold. The stock exchange also provides a market for government loans and securities and involved in trading in overseas market. New York Stock Exchange (NYSE), London Stock Exchange, Tokyo Stock Exchange, Paris Stock Exchange, Frankfurt Stock Exchange, Toronto Stock Exchange and Mumbai Stock Exchange are the biggest Stock Exchanges of the world. Nepal Stock Exchange (NEPSE) is the only organized stock exchange of Nepal. In the financial system, financial market is largely governed by central bank either directly or indirectly.

1.3.1 Introduction to Nepal Rastra Bank:

Central Bank is the bank of the all banks. It is the supreme body, which controls and stabilizes the economy of the country through various direct and indirect means of monetary policy. In direct means, it uses the selective credit control (Margin requirements) while extending loans against government securities as a tool to expand and control the economic activities of the country and in indirect means it uses tools like issuance of treasury bills, National Saving bonds, bank rates, SLR, CRR etc. Central Bank neither maintains accounts of public nor does it give loans to the public. Central Bank focuses on the monetary stability of the country and not on profit.

Nepal Rastra Bank (NRB) , the central bank of Nepal was established in 26th April 1956

to discharge the central banking responsibilities including guiding the development of the embryonic domestic financial sector. Since then, there has been a huge growth in both the number and the activities of the domestic financial institutions. To reflect this dynamic environment, the functions and objective of the bank has been recast by the new NRB act of 2002, the preamble of which lays down the primary functions of the bank as to formulate necessary monetary and foreign exchange policies, to maintain the stability in price, consolidate the balance of payments for sustainable development of the economy of the government of Nepal, to develop a secure, healthy and efficient system of payments, to make appropriate supervision of banking and financial system in order to maintain its stability and foster its healthy development and to further enhance the public confidence in Nepal's entire banking and financial system.

Besides above fact, Essence of NRB act 2001 comprises:

- Stability and development of Nepalese economy
- Stability of price levels
- Promote balance of payments
- Formulation of monetary and foreign policy
- Development of safe, healthy and capable payment system
- Regulation, inspection, and supervision of banking and fiscal system
- Develop confidence among the people for the entire banking and financial system.

The Bank is almost cautious, without the sustainable progress and continual reform of financial reform the above mentioned objective is not achieved. Continuously aware of this great responsibility, NRB is seriously pursuing various policies, strategies and actions, all of which are conveyed in the annual report on monetary policy which provides a comprehensive review and evaluation of the previous monetary policy and justification and the analysis of the following years monetary policy. The re engineering of the NRB itself is one of the critical components of the reform agenda. To improve the financial sector legislative framework, some new acts namely Bank and Financial Institution act 2008, Nepal Rastra Bank (first amendment) act 2008, Insolvency act 2008, Secured Transaction act 2008, company act 2008 has been enacted. Money laundering control and Deposit and Credit guarantee acts are expected to be soon materialized all with the goal of strengthening the financial sector through building on its healthy development and improved stability.

This activity conveys the commitment of NRB for addressing the present and future challenges of the financial system more competently. This dynamic and proactive approach to the financial system, especially with its increasing openness and competitive process in the context of growing global financial environment, should ensure a sustained progress and stability of the financial system under NRB guidance and leadership, for contributing substantially to the sustained development of the economy of Nepal.

1.3.2 Strategic Planning of NRB in Financial Development:

The Nepalese economy is observing a structural change due to internal and external economic shocks. In the context of rapid economic globalization, financial liberalization, integration and advancement in information and communication technology, NRB has to address the new issues and challenges emanating from changes in global economic environment in general and financial market in particular. The Nepal Rastra Bank act 2002 has provided it more autonomy in its policy and operations. It has already initiated the restructuring and re engineering process to meet the challenges of the twenty first century central bank. As per the legal mandate, it has to formulate and implement monetary, foreign exchange and financial sector policies, regulate and supervise banks and financial institutions, manage foreign exchange reserve, promote modern payments and settlement systems and build the confidence of the general public in the financial system of the country. It has to follow these best central banking practices to make its objectives clearer, activities more transparent and operations more credible and accountable.

In this context, the strategic plan has been formulated by specifying the banks core values and strategic objectives, reordering priorities, formulating strategies, determining annual action plans and performance indicators and optimizing resource use. The plan has envisaged a new corporate culture and corporate administration that strongly believes in corporate governance and builds credibility to the public through transparency and accountability. It has been prepared with wider consultations and participations of the bank management and other stake holders. As it is based on dynamic and flexible concept, it can be implemented as a rolling plan that can be modified and changed as per the changed circumstances. The plan will help the bank to accomplish its institutional vision, mission, core values and strategic objective and meet the bargaining policy and

manage challenges for the coming five years. Nepal Rastra Bank has done significant homework to set up a strong foundation for a healthy financial system. The reform actions envisaged to bring about the expected outcomes in the financial system are the introduction of the new NRB act and the Debt Recovery Act which has already been done.

The NRB act 2001 provides more autonomy to the central bank in the spheres of financial sector policy formulation and increases its capability for effective policy implementation. Also the supervisory and oversight function of the central bank is expected to be strengthened substantially. The financial institution owned and controlled by the government still capture a large chunk of commercial and development banking, insurance business, micro credit and other financial products. With the state owned financial institutions mostly incurring huge losses and their financial condition deteriorating over the years, restructuring them and their eventual privatization becomes inevitable to ensure a strong and competitive financial structure on the one hand and improving the public sector resources allocation efficiency on the other. So the government sector financial institutions need to be given utmost priority along the process of expediting the financial sector reform. The reform appropriately sequenced and effectively implemented under a conducive macroeconomic environment, holds the key to developing a strong, smooth, efficient financial sector and promotion of productive investment in the economy.

In order to reduce problems inherent in the financial system in general and the government owned financial institutions in particular, encouraging the competitive markets and the private sector investment, institutional restructuring along with the privatization process are considered to be the most viable alternative. Reform in the financial sector legislation, strengthening the bank inspection, monitoring and supervision process, restructuring of government owned commercial and development banks, encouraging more investments in the banking sector, reduction of the directed/subsidized lending and expansion of the capital and insurance markets comprise the important ingredients of the reform agenda in the financial sector. NRB has issued a set of nine directives to the commercial banks so as to strengthen the commercial banking institutions, ensure corporate governance, consolidate their financial situation, improve the people's confidence in them, and

contribute to the overall health and stability of the financial system. The directives relate to different areas of regulation as follows:

- Maintenance of minimum capital fund
- Loan classification and loan loss provisioning
- Limit of credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy
- Accounting policies and formats of financial statements
- Minimization of risk
- Good corporate governance
- Time frame for implementation of regulatory directives issued in connections with inspection and supervision of bank
- Investment in share and securities
- Statistics reporting by commercial bank to NRB

NRB has also issued 13 directives to the finance companies in order to improve there managerial and operating process so as to enhance their role in the financial and economic systems of Nepal. The directives cover

- Minimum capital fund
- Financial resource mobilization ceiling
- Liquid assets
- Loan classification and loan loss provision
- Single borrower limit
- Corporate governance
- Sector wise credit ceiling
- Investment requirements
- Interest rate
- Setting up branch office
- Sale of promoters share
- Audit

NRB is shortly issuing similar directives to the development banks and cooperatives with a view to bring about the desirable institutional growth and operational improvements in the non-bank financial structure. Paid-up capital requirement for the commercial banks,

development banks, finance companies and co-operatives is being raised in the near future. For the effectiveness of the inspection and supervision of the commercial banks and other financial institution, inspection manual has been prepared and training programs are implemented. As part of the financial sector reform, in-house central banking modernization activities are proceeding in full swing in NRB. IMF technical assistance has also been utilized for this purpose.

1.3.3 Financial Institutional Development in Nepal:

The development of financial sector in Nepal is relatively new. The establishment of “Tejarath Adda” during the year 1877 A.D was the first step in institutional development of banking sector in Nepal by Prime Minister Ranoddip Singh. Tejarath Adda did not collect deposit from public but granted loans to public against the collateral of bullions. Consequently the major parts of the country remain untouched from these limited banking activities. The development of trade with India and other countries increase the necessity of the institutional banker, which can act more widely to enhance the trade and commerce and to touch the remote non banking sector in the economy. Considering this situation, the Udhog Parishad was constituted in 1936 A.D. One year after its establishment, it formulated the company act and Nepal Bank act in 1937 A.D as first Commercial Bank of Nepal with authorized capital of Rs 10 million.

Modern banking practice emerged with establishment of Nepal Bank limited in 1934 A.D. However the stand of Nepal Bank Limited alone in total monetary and financial was not sufficient and satisfactory. Thus Nepal Rastra Bank was set up on 1956 A.D(2013.1.14) as a Central Bank under Nepal Rastra Bank act 1956 A.D (2010 B.S). Similarly on 1966 A.D. (2022.10.10) Rastriya Banijya Bank (RBB) was established as a fully government owned commercial bank. With the emergence of RBB, banking service spread to both the urban and rural areas but customers failed to have taste of quality and competitive because of excessive political and Beaucroatic interference. For industrial development, Industrial Development Center was set up in 19956 A.D. (2013 B.S) which was converted to Nepal Industrial Development Corporation (NIDC) in 1959 A.D. (2016 B.S). Similarly Agricultural Development Bank (ADB) was establishes in 1976 A.D. (2024.10.7) with an objective to provide agricultural products so that agricultural productivity could be enhanced through introduction of modern agricultural Techniques. As the country move d toward economic liberalization in 1980 A.D. foreign banks are

invited to operate in Nepal. The financial scenario has changed with the introduction of joint venture banks in 1984. The number of commercial banks has been increasing. Since then various financial institutions like joint venture banks, Domestic Commercial, Development Banks, Finance companies, Micro Finance companies, Credit Guarantee Corporation, employee provident funds, Citizen Investment trust, National Insurance Corporation, Nepal Stock Exchange, have come into existence to cater the financial needs of the country thereby assisting financial development of the country.

In 1990 A.D after the restoration of democracy in Nepal, the government highlights the agenda of economic liberalization and emphasized to invite Foreign Direct Investment (FDI) in banking sector of Nepal. Taking an overview of financial institution providing banking facility in Nepal, there are 31 commercial banks, 87 Development Banks, 16 Micro Credit Development Banks, 5 Rural Development Banks, 102 Finance Companies, 17 Co-Operative Societies and 47 NGOs (licensed by NRB for limited transaction.)

In Nepal commercial banks plays a vital role in the economic growth. Its investment range from small scale cottage industries to all types of social, commercial loans and large industries. Generally the investment of the commercial banks include the investment on government securities like treasury bills, Development bonds, National saving bond, foreign government securities, shares of government owned companies and non government companies and investment on debentures. Similarly the commercial banks use their major chunk of funds in loan and advances. The regional distribution of banks and financial institution as on January 2011 can be regarded as follows:

Table 1.1
Regional Distribution of Banks and Financial Institutions
(As of Mid –January 2011)

	Eastern	Central	Western	Mid Western	Far Western	Total
Commercial Bank Branches	122	266	117	38	31	574
Development Banks	6	27	19	4	2	58
Microfinance Development Banks	1	6	2	1	1	12

Finance Companies	4	63	10	1	1	79
Finance Cooperatives(NRB licensed)	1	9	2	2	2	16
Financial NGOs	10	21	8	7	1	47
Money changers	31	209	90	12	6	348
Money Transfer	-	38	-	-	-	38

Sources : NRB Research Department

Extended branches include Commercial, Finance companies, Financial NGOs and private sector commercial banks. Most often it is said that due to the security problem branches are retrenched from different area to the more secured cities. The structure of Nepalese financial system is presented in Annexure 1.

1.4 Statement of Problem:

Financial market plays significant & catalytic role in the economic development of each and every country. Efficient financial market paved the way to economic development. It is possible only after proper circulation of financial instrument and development of financial intermediaries in qualitative and quantitative manner. Central Bank Plays crucial & leading role in development of financial market. In Nepal, the financial sector contributes over 10% of the GDP. So by overlooking the study, it expresses that, Does Nepal Rastra Bank Plays significant role in development of Nepalese financial market? Or what is the actual condition of Nepalese financial market place? If the condition of the financial market is not at satisfactory level, what are the barriers and how it can be removed or mitigated? Focusing on the Nepalese context, the structure of the economy has still remained primarily agriculture with very small manufacturing base, so it is essential to divert and bring changes in agro based economy. Nepal has adopted mixed and liberal economic policy with the implicit objective to help the state and the private sector on the ground of open and liberal eco-system. Nepal is exporting raw materials instead of producing goods and services from this. If the efficient financial market is established many industries and factories can be established for the reduction of

unemployment, utilizing resources to reap benefits, product development and development of country economy and people's status.

1.5 Objectives of the Study:

The main objective of this study is to analyze how Nepal Rastra Bank is playing significant role in the development of financial market in Nepal. Being one of the regulatory bodies of Nepal, what sorts of rules, laws and guidelines has been introduced so far for the development of financial institutions in Nepal. The study aims to provide appropriate suggestion and provide strong recommendation on how NRB can play more crucial and accountable role in development of sound financial market in Nepal.

The study aims at fulfilling the following specific objectives:

- To study and analyze how sound financial system helps in the economic development and measure NRB role in this regard.
- To evaluate the current situation of financial market in Nepal.
- To examine how far NRB is rendering effective and successful role in the development of financial market or not.
- To provide appropriate suggestion to concerned parties for the development of Nepalese financial system based on the findings of the study.

1.6 Significance of the Study:

The study, the role of the central Bank is much significant for the development of financial market and the situation of financial system in Nepal. The effectiveness of existing role will be evaluated and the possibilities of implementing financial principles will be examined. This study provides significant because it relates to the overall role of NRB in Nepalese financial market growth and its existence today. This is also proved by research gap felt in the literature review chapter. The recommendation suggested at the completion of this study are more practicable and useful for the further improvement in role of NRB to make financial market more Sophisticated.

In developing countries like Nepal, most of the theories of financial market are determined by developed countries like USA and United Kingdom. So it is necessary to

conduct fair research study and develop facts for the role of central Bank in the development of financial markets in developing countries like Nepal.

1.7 Research Hypothesis:

Testing of hypothesis is one of the most important aspects of the research study. It is an assumption that is made about the population parameter and then its validity is tested. By testing the hypothesis we can find out whether it, deserves the acceptance or rejection of the hypothesis.

The acceptance of hypothesis means there is no any sufficient evidence provided by the sample to reject it and does not necessarily imply that it is true. The main goal of testing of hypothesis is to test the characteristics of hypothesized population parameter based on sample information whether the differences between the population parameter and sample statistic is significant or not. (Sharma & Choudhary, 2000:229)

The following hypothesis will be tested during study:

First Hypothesis

Null hypothesis $H_0: \rho = 0$. That is population correlation coefficient is zero. In other words, the variables (role of NRB and development of financial market) are uncorrelated in Nepalese context. or There are no correlation between role of NRB and development of financial market.

Alternative Hypothesis $H_1: \rho \neq 0$. That is population correlation coefficient is not equal to zero. In other words, the variables (role of NRB and development of financial market) are correlated.

Second Hypothesis

Null hypothesis $H_0: \rho = 0$. That is population correlation coefficient is zero. In other words, the variables (economic growth and financial market growth) are not correlated in Nepalese context.

Alternative Hypothesis $H_1: \rho \neq 0$. That is population correlation coefficient is not equal to zero. In other words, the economic growth and the financial market growth) are correlated.

1.8 Limitations of the Study:

Like any other research study, this study has some limitations either. This study is simply a partial study for the fulfillment of MBS degree which has to be finished within limited period. Hence, this study is not free from several limitations of its own kind, which weaken the scope of the study to the some extent.

Some of the limitations are as follows:

- This study only concentrates only on those factors, which are related with contribution of NRB in development of financial market in Nepal.
- Out of the numerous affecting factors, the study concentrates only on those factors which are related with contribution of NRB in development of financial market in Nepal and available in the form required for analyzing the different issue.
- The truthfulness of result is based on the data available from the different organizations and employee in the course of delivery and collection questionnaire.
- The equity of result is based on data available by the employees of different organizations.
- Due to the wide range of data deficiencies only simple techniques have been used for analysis of data.
- This study is based on the five years data .

1.9 Organization of the Study

The whole study has been divided into five chapters. First is introduction chapter, which includes general background, brief introduction about financial market, its roles and function and details introduction about Nepal Rastra Bank, statement of the problem and objectives of the study, significant of the problem, limitation of the study and the chapter plan.

Second chapter deals with review of available literatures in the field of the study being conducted. This includes review of the theories of the concerned topic, review of books and review of various empirical studies.

Third chapter explains the research methodology employed to conduct the study and tools and techniques used in analysis of the data as well. This chapter includes research design, source of data, population and samples, methods of data analysis and various financial and statistical tools.

Fourth chapter is devoted to presentation, analysis and interpretation of the study through define course of research methodology. The chapter also contains major findings of the study.

Fifth and the last chapter is conclusive and suggestive chapter. It includes summary of the study, conclusion of the main findings and recommendations for further improvement.

Besides these, bibliography and appendices are also presented at the end of the thesis. Similarly acknowledgement, table of content, list of tables, list of diagram, acronyms used are included in the front of the thesis report.

CHAPTER - II

REVIEW OF LITERATURE

2.1 Introduction:

This chapter focuses on the roles, importance and principles of NRB. Also, concept of financial market, financial instruments traded in Nepal, its development trends and development of financial intermediaries in Nepal. Linkage between financial market and role of NRB in its development has been explained in this chapter. Some academic course book of finance, banking journals and articles related to Nepalese financial market and related published and unpublished theses have been reviewed here details. In the context of Nepal, where the financial market is in growing trend there are very few financial research based journal. There are very limited business magazines, which hardly publish the topic related to role of NRB.

2.2 Theoretical Review:

Before getting in to the core concept of role of NRB in financial market development, it is logical to be familiar with some technical terms, types of financial market, functions of financial market, role of NRB etc. which are essential to know when analyzing role of central bank in financial market developments.

2.2.1 Types of Financial Market:

It is easy to classify the financial market in two various types and categories. In fact, there is no any hard and fast rule to classify the financial market. Even then for the purpose of simplification and make it understandable, financial market is classified in the following order.

i. Open vs. Negotiated Market

The distinction between markets in the financial system that is often useful focus on open markets vs. negotiated markets for some corporate binds are sold in open market to the highest bidder and bought and sold only number of times before they mature and are paid off. In constraints, in the negotiated market for corporate bonds securities generally sold

to one or few buyers under private contract. An individual who goes to his/her local bankers to secure a loan for a new car enters major stock exchanges which represents the open markets. Operating at sometimes, however, is the negotiated market for stock in which is corporation may sell its entire stock issue to one or handful to buyers.

ii. Primary vs. Secondary Market

The primary market is for the trading of new securities never before issued. Its principal function is raising financial capital to support new investment in building, equipment and inventories. You engage in a primary market transaction when you purchase share of stock just issued by a company or borrow money through a new mortgage to purchase a home. In contrast, the secondary market deals in securities previously issued. Its chief function is to provide liquidity to security investor i.e. to provide an avenue for converting financial instruments in the ready cash. If you sell stocks or bonds you have been holding for some time to a friend a call a broker to place an order for shares currently being traded on the Nepal Stock Exchange or in the other Stock Exchanges you are participating in the secondary market transaction.

iii. Spot vs. Future, Forward, Option Market

A spot market is one which securities or financial securities or financial services are traded for immediate delivery (Usually with in one or two business day). If you pick up a telephone instruct your broker to purchase Telecom Corporation's share at today's price this is spot market transaction. You expect you acquire ownership of Telecom share with n matter of minutes or hours. A future or forward market, on the other hand is designed to trade contract calling for future delivery of financial instruments. For example, you ma call your broker and ask to purchase a contract from another investor calling for delivery to you of Rs One Million in T-bonds for Six months from today. The purpose of such contract would e to reduce risk by arranging on a price today rather that waiting Six months when T-bonds prices might have risen. Option market also offers investors in the money and capital market on opportunity to reduce risk these markets make possible the trading of option on selected stocks and bonds which are agreements that given an investor the right to either by from or sell designated securities to the writer of the option at guaranteed price at any time during the life of the contract.

iv. Money vs. Capital Market

On the basis of life span financial market can be divided in to money market and capital market. In the money market financial instrument with the maturity of typically one year or less than one year are traded. The primary function of money market is to provide liquidity to an economy unit. These functions are providing short-term loan to the business, government and individuals. The deficit business unit like government and business fulfill their short term needs by issuing money market instruments like government T - Bills, commercial papers etc. These instruments are purchased by surplus generating economic unit to supply their saving in needed areas. Generally, households, commercial banks and some non financial business co-operation with temporary surplus is the provided of surplus funds to the money market. Examples of money market instruments. T- Bill, Negotiable Certificate of Deposits, Bankers' Acceptance and Commercial Paper, Federal Funds, Euro Currencies.

Capital market is a market in which financial assets with maturity period of more than one year are traded. The long-term financial instruments like Stocks; Bonds etc. are traded in the capital market. All the household, business and government are the borrower of funds in capital market families and individuals need long term funds for residential purpose, government requires such types of funds to make expenditure on policy related facilities like construction of schools, hospitals, roads etc. The business firms rely on capital market for funds to purchase equipment and other constructions. The financial institutions like insurance companies pension funds etc. are the primary suppliers of long-term fund on the capital market. Examples of capital market instruments are Corporate Stocks, Corporate Notes, Bonds, Mortgage loan, Tax Exempt Bonds, Consumer Loans, Euro Bonds and Euro Notes etc.

2.2.2 Function of Financial Market:

No one can deny the crucial functions of financial market in the economy because financial market channelise the saving to those individuals and institutions needing more funds for spending than are provided by their current incomes. So, the financial market is the heart of the global system attracting and allocating savings and setting interest rate and the prices of financial assets. The basic functions of financial markets are presented in different category. They are as follows.

i Saving Function

Financial system performs the saving function by providing public saving towards productive uses. This is possible through purchase of financial assets like bond and stock sold on money and capital market. These savings flow through financial market into investment and such investment are used for producing more goods and services which increases the living standards and contrast of society.

ii. Liquidity Function

Financial system performs the liquidity function by providing a means of raising funds by converting securities and other financial assets into the spendable cash balances whenever the saver needs money.

iii. Credit Function

Credit is the loan amount supplied by lender to the user. In return, borrower promises to make future payments. Financial system performs the credit functions and credit is needed by various units in the economy to support consumption and investment.

iv. Payment Function

The financial system provides a mechanism for making payment for goods and services, basically the cheque account serves as the medium of exchange of making payments.

v. Risk Function

The financial market provides the means to protect business firms, consumers, and government against risk to life, health, property and income. Such function is performed by selling the various types of insurance policies through the financial market. It also reduces the risk by contract the future and forward contract.

vi. Policy Function

The financial market is the medium for implementing government policy with a view to achieve stability economic growth to generate more employment opportunities. The

borrowing and lending plans of property are affected by availability of credit and interest rate that influence the creation of job and production.

vii. Wealth Function

The term wealth is the sums of values of all assets hold by individuals, business firm or government units. Any economic unit in the financial system can store their wealth either in financial instruments or in things like real assets. When the funds are not needed for spending but choosing to store wealth in real estate, subjects more risk of losses and depreciation. There fore the financial market provide o excellent way to store wealth in financial market provide on excellent way to store wealth in financial instruments because these assets do no wear out overtime.

2.2.3 Role of Central Bank in the Financial System:

Central bank appear to influence the spending saving and borrowing decision of millions of individuals and businesses through at least five interrelated channels the cost and availability of credit, the volume and rate of growth of the money supply, the market value of assets held by the public, the relative price of world currencies and the public's expectations regarding domestic and international economic conditions. Beyond these the main roles performs by central bank as an autonomous body are cited below.

1. Control of Money Supply

The first and most important function of central bank is the control of money supply because changes in the money supply appear to be closely linked to changes in economic activity. A number of studies in recent years have found a statistically significant relationship between current and lagged changes in the money supply and changes in nominal gross domestic product. Central bank is the principal source of currency and coin because it has monopoly right assigned by government to issue notes and coins. So, if the central bank can control the rate of growth of money it can influence the nominal growth rate of the economy as a whole.

2. Stabilizing the Money and Capital Market.

Another vital function of central banking is stabilization of the money and capital markets. The financial system must transmit savings to those who requires funds for

investment so the economy can grow. If the system of money and capital market is to work efficiently, however, the public must have confidence in financial institutions and be willing to commit its saving to them. If the financial markets are unruly, with volatile fluctuations in interests and security prices, or if financial institutions are prone to frequent collapse; public confidence in the financial system might well be lost. The flow of investment capital would dry up, resulting in a drastic slowing in the rate of economic growth and a rise in unemployment.

All central bank play a vital role in fostering the mature development of financial markets and in ensuring a stable flow of funds through those markets. Pursuing this objective, a central bank may, from time to time, provide funds to major securities dealers or depository institutions when they have difficulty financing their portfolios or providing an adequate supply of credit so that buyers and sellers may easily acquire and sell securities and borrowers interested in making investment can find adequate funding. When the money supply and interest rates rise or fall more rapidly than seems consistent with economic goal and the desired volume of saving and investment in the economy, a central bank may again intervene in the financial market place.

3. Lender of Last Resort

Another essential function of many central banks is to serve as a lender of last resort. This means providing liquid funds to those financial institutions in need, especially when alternative source of funds have dried up. The central bank can supply large amounts of emergency funds very quickly, as occurred.

4. Maintaining and Improving the Payment Mechanism

Finally, central banks have a role to play in maintaining and improving the payment mechanism. This may involve the central bank helping to clear checks, providing an adequate supply of currency coin, wiring funds, and preserving confidence in the value of the fundamental monetary unit. A smoothly functioning and efficient payments mechanism is vital for business and commerce. If checks or electronic payments cannot be cleared in timely fashion or if the public cannot get the currency and coin it needs to

carry out transaction, business activity will be severely curtailed. The result might well be large scale unemployment and a decline in the nation's rate of economic growth.

2.2.4 Objectives of NRB:

Nepal Rastra Bank Act 2002 replaced Nepal Rastra Bank Act 1955, NRB shall have powers to regulate the functions and activities of commercial banks and financial institutions and it may inspect and supervise them. In the new enacted law, objectives of the NRB are clearly incorporated which are as follows:

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

NRB has paid full attention to be accountable and to fulfill these objectives by standing incorporated principles. Nepal Rastra Bank Act 2002 has clearly defined the core principles of NRB which are cited as below;

- a) It is an autonomous body;
- b) It safeguards public interest and contributes to economic development; and
- c) It ensures economic stability by introducing monetary policy in consonance with the fiscal policy of the government.

2.2.5 Financial Instruments Prevailing in Nepalese Market:

Everybody put consent on the fact that is Nepalese financial market growing at a tortoise speed. Number of financial intermediaries is a bit little and types of financial instruments traded in the market are also low. Financial instruments include both money market instruments and capital market instruments. In the Nepalese context, not all the globally

accepted instruments are practiced that's why some financial instruments practiced in Nepalese market are described below.

1. Money Market Instruments: Money market instruments are those instruments which have maturity of one or less than one year. It is for short-term credit, it is used to help corporation or government to pay wages and salary for their workers, make repair, purchase inventories, pay dividend and taxes and satisfy other short-term obligations. Money market also provides channel for exchange of financial assets for money to meet purely short-term needs. This is the mechanism through which "holders of temporary cash deficits". We must remember money is one of the most perishable of all commodities, holding idle surpluses is expensive to all due to its opportunity cost that's why money market instruments are emerged. Money market instruments frequently practiced all over the globe and also traded in the Nepalese market are as follows.

A) Treasury Bills

Treasury bills are an obligation issued by government, sold at a discount from the face value. T-bills are the most marketable of all money market instruments. It represents the simplest form of borrowing to the government. T-bills are extremely liquid, short-term notes that mature in 13, 26 or 52 weeks from the date of issue. Treasury bills are sold using 'auction' technique. Regular bill issue is announced on Tuesday by NRB. The minimum value of T-bills in Nepal is Rs. 25,000/-.

B) Banker's Acceptance

Generally, importers to secure trade credit for exporters use it. The accepting bank guarantees payment by the importer. In general, acceptance is a promise to pay. The promise is made by the person or entity that will actually make the payment - promissory - to the person or entity who will receive the payment the payee or beneficiary. The promise to pay document is called a draft. Payment of the draft will be made on a specified future date, so the draft is called a time draft. To seal the promise, the promissory signs the draft and stamps or writes the word "Accepted" above his signature and adds the date on which the amount is written. The formally accepted draft becomes a legal obligation to the parties. If the acceptor is the bank, the acceptance is called a banker's Acceptance. The

promissory then becomes obligated to pay the bank the amount financed in full with interest on or before the maturity date, and the bank becomes the primary entity obligated to pay the amount due to the payee. Banker's Acceptances are used in the foreign trade by commercial banks frequently.

2. Capital Market Instruments

Capital market instruments are those instruments which have maturity of more than one year. It is for long term capital needs like enhancement of land, building, installation of plant, development of human resource etc. that's why capital market instruments provide capital to meet purely long term capital requirements. Among all some instruments practiced in Nepal are described below:

A) Common Stock

The common stock represents equity, or an ownership position in a corporation. It is a residual claim, in the sense that creditors and preferred stockholders can receive any payments. Common stocks have one important investment characteristic and one important speculative characteristic. Their investment value and average market price increase regularly but persistently over the decades as their network builds through the reinvestment of undistributed earnings. ... However, most of the time common stocks are subject to irrational and excessive price fluctuation in both directions, as the consequence of the ingrained tendency of most people to speculate or gamble i.e. to give way to hope, fear and greed (P. Chand, *The Investment Game*, 1995:45). The common stock investment comes from either of two sources - the periodic receipt of dividend rights, assets rights, preemptive right and voting rights etc. Common stock is a popular investment alternative in Nepal. Only the common stocks of listed companies are traded in Nepal Stock Exchange.

B) Preferred Stock

Preferred stock, also known as preference share is a hybrid form of capital market instrument with combined features of both common stock and long-term debentures. The investor receives preference dividend which is discretionary. Failure to pay such dividend will not result in a default of a company's obligation or insolvency of the company. The

market of preferred stock in Nepal is very lean. Just a few companies have issued only redeemable preferred stocks. Preferred stocks are traded in NEPSE.

C) Long Term Government Securities

Government securities are the fixed income securities issued by government. These securities are among the safest of the investments, as the government is unlikely to default on interest or on principal repayments. They are of three types, treasury notes, treasury bonds, saving bonds. NRB issues long-term government securities. Development bonds, national saving bonds and citizen savings bonds are the long-term government securities issued by NRB on behalf of the government. Long-term government bonds are listed in NEPSE.

D) Corporate Bonds

A corporate bond is a long term promissory note issued by a corporation. A corporate bond has more risk and return than that of government bonds. Bondholders receive a fixed return and the principal amount at the maturity date and have priority before common stock and preferred stock in the event of liquidation. It is traded in organized stock exchanges like NEPSE and in the over the counter markets. The debentures by Everest Bank have been listed on 2062/04/25 B.S.

Besides this, there are two mutual funds available in Nepal. One of them Nepal Capital Market (NCM) mutual fund is traded in NEPSE. These all limited number of financial instruments and their limited number reflect the childhood of financial market in Nepal. Total outstanding debt of government of Nepal can be presented as follows.

Table No. - 2.1
Total Outstanding Debt of Government of Nepal

	2005/06	2006/07	2007/08	2008/09	2009/10 R
Domestic	80473.6	81411.4	82842.0	89955.0	99303.8
Treasury Bills	48860.7	49429.6	51383.1	62970.3	74445.3
Development Bonds	16059.2	17549.2	19999.2	17959.2	19177.1
National Saving Certificate	9629.8	9029.8	6576.8	3876.8	1516.9
Citizen Saving certificate	931.1	1178.9	1428.9	1678.9	1391.0
Special Bonds	4992.8	4223.9	3454.0	3469.8	2773.5
Foreign	223433.2	232779.3	219641.9	233968.6	216628.9
Domestic Debt/GDP (%)	16.3	15.2	14.1	13.9	13.8
Foreign Debt/GDP (%)	45.4	43.4	37.3	36.2	30.1
Total Debt/GDP (%)	61.7	58.5	51.3	50.1	43.9

Excluding overdraft borrowing in the GON from NRB and IMF promissory note

Foreign outstanding debt for 2009/10 is preliminary estimate

(Source: Economic survey NRB and FCGO)

2.3 Review of Roles Played by Foreign Central Banks:

Every central bank must have prudent role in financial market development in respective country so, since history most of the central banks have been bearing such responsibility successfully. Let us, review development and some important roles played by some selected Asian Central Banks. Those banks include Reserve Bank of India, Bank of Korea, Bank Negara Malaysia, State Bank of Pakistan and Monetary Authority of Singapore.

A) Central Bank of India

The Reserve Bank of India is entrusted with the supervision of India's banking system under the provisions of the Banking Regulation Act, 1949 and the RBI Act 1934. In order to provide focused supervision of financial entities, board for financial supervision was

constituted in November 1994, as a committee of the central board of directors of the reserve bank with the objective of supervising commercial banks, select financial institutions, non banking financial companies, cooperative banks and primary dealers (<http://www.wss.rbi.org.in>). A major element of financial sector reforms has been a set of prudential measures aimed at imparting strength to the banking systems as well as ensuring safety and soundness through greater transparency, accountability and public credibility (Unpublished Article of Department of Economic Analysis and Policy of RBI). Consolidated accounting for banks has been introduced along with a system of Risk-Based Supervision (RBS) for intensified monitoring of vulnerabilities. The Reserve Bank, in close and continuous consultation with the Government, has played a major role in institution building since independence (www.rbi.org.in) Efforts in this direction encompass Reserve Bank's contribution in the form of development of commercial banking, development finance institutions for different segments of the economy, and specialized institutions for development of financial markets. Since the onset of economic reforms in the early 1990s, the role of Reserve Bank in the area of developing the various financial markets have come to the fore. Furthermore, in a global environment, with increasing integration of the international economy, the Reserve Bank's role as the regulator and supervisor of commercial banks and financial institutions has assumed a central place in promoting transparency and credibility of institutions and monetary and financial policies (<http://www.reservebank.com/>)

B) Central Bank of Korea

The Bank of Korea was established on June 12, 1950 under the Bank of Korea Act, as the country's central bank. For more than 50 years since its establishment the Bank has gone through many adjustments in respect of its independence and functions, in according with changes in the financial and economic environment and government economic policies. At the time of its foundation, the Korean economy was in turmoil suffering server and chronic inflation with adequate monetary and financial systems not in place. This situation of the times could explain the fact that the primary purposes of the Bank of Korea included, besides securing price stability as the central bank's traditional objective, preserving the soundness of the banking and credit systems and managing the country's foreign reserves. The bank of Korea was empowered to perform not only the orthodox

functions of a central bank, but also given the exclusive authority to carry out banking supervision and formulate foreign exchange policy. In order to ensure the independence of the Bank of Korea, its policy - making body (Monetary Board) was to be made up of experts with ample experience and extensive knowledge concerning finance, economy and industry (<http://www.bok.or.kr/>).

The newly installed Government set out growth-oriented policies. Accordingly, it strengthened its influence over the central bank to support the government's economic program. During the 30 years after this transition, there were no significant changes in the Bank's institutional aspects. There were technical improvements including the supplementing of monetary and credit policy instruments (1968), an increase in the number of officers in charge of banking supervision (1977) and abolition of the government's prior approval for the Bank's budget (1982). During this period, there were several legislative attempts to enhance the independence of the Bank, but they failed to be passed. The Bank of Korea underwent significant institutional change and financial reform initiated following the financial crisis at the end of 1997, on the one hand the Bank was granted more autonomy in its monetary policy; on the other hand the authority for banking supervision was stripped from the Bank and assigned to a new integrated financial supervisory body. There were substantial changes in the functions of the Bank of Korea (<http://www.bok.or.kr/>). The transfer of its banking supervision authority to the integrated financial supervisory body was partially balanced by the maintenance of its right to request information from financial institutions for monetary policy implementation, to require the financial supervisory body to examine banking institutions and to participate on a joint basis in the examination of banking institutions. In addition, the Bank took on a new responsibility for the oversight of the payment and settlement systems, an area which has recently attracted greater attention globally. Meanwhile, the Bank's accountability was also heightened, as it now has to report on its conduct of monetary policy implementation to the National Assembly at least twice a year (Unpublished Article Office of the Governor, The Bank of Korea).

C) Financial Sector Development in Malaysia

In addition to the traditional role of central banks in promoting monetary and financial stability, a key objective of Bank Negara Malaysia (the Central Bank of Malaysia) has been to influence the credit situation to the advantage of the nation. A well functioning and efficient financial system is vital to achieve these objectives. Indeed the development of an effective and effective financial system that is sound and resilient is an essential pre-requisite to achieve balanced economic growth and social development. Bank Negara Malaysia has consciously and systematically sought to develop a modern and sophisticated financial system. During this period the financial system has had an important role in effectively mobilizing and Bank Negara Malaysia allocating resources for productive use to contribute towards the rapid economic transformation and changing financing requirements of the Malaysian economy. During the formative years a key priority of the Central Bank was the creation of the basic financial infrastructure, including the development of domestic banks to complement the already strong foreign banking presence in the economy (<http://www.economywatch.com/banks/centralbanks/bank-negara-malaysia/html>). The creation of the basic infrastructure of the financial system, notably the development of a wide network of domestic banks, was considered an important pre-requisite for ensuring access to banking service for all segments of society, regions and economic activities, thus the financing requirements for economic diversification. During 1980s, the Bank's attention was focused on further strengthening the regulatory and supervisory framework for the banking system to reduce the economy's vulnerability to external shocks. This involved a process of prudential re-regulation an significant structural changes to strengthen the banking system. These measures were instrumental in maintaining the soundness and resilience of the Malaysia banking system in weathering the difficulties which arose when Asian financial unfolded in 1997(Unpublished Article Office of the Governor, Bank Negara Malaysia).

The over-riding objective of the Financial Sector Master Plan was to develop a more competitive, resilient and dynamic financial systems, benchmarked against international best practices and standards, which was able to meet the increasingly sophisticated and demanding requirements of the domestic economy. It was also envisaged that the system would be able to adapt and adjust to the technological advances and financial innovations.

Central to this process, was the development of a core of strong and forward looking domestic financial institutions that were more technology-driven and able to face the challenges of globalization and liberalization. The central bank launched financial sector master plan in March 2001. The initiative that had been implemented thus far had resulted in a financial sector that was stronger, more resilient and better placed to face greater competition. The ability of the domestic financial institutions to continue to register strong financial results despite the increasingly competitive environment reflects their enhanced strength and capabilities. At the same time, the regulatory framework had also been further strengthened commensurate with the challenges of the increasingly complex financial markets. Financial institutions had adopted better risk management practices in their business operations, which accorded them greater flexibility and capacity to respond to the increasing consumer demands and expectations. The creation of robust financial institutions that were able to withstand any potential shocks, and that possessed the agility and adaptability to embrace future challenges were keys in ensuring their long-term sustainability in a more competitive environment, as well as in preserving financial stability (Unpublished Article Office of the Governor, Bank Negara Malaysia).

The over-riding objective of the Financial Sector Master Plan was to develop a more competitive, resilient and dynamic financial system, benchmarked against international best practices and standards, which was able to meet the increasingly sophisticated and demanding requirements of the domestic economy. It was also envisaged that the system would be able to adapt and adjust to the technological advances and financial innovations. Central to process, was the development of a core of strong and forward looking domestic financial institutions that were more technology-driven and able to face the challenges of globalization and liberalization. The central bank launched financial sector master plan in March 2001. The initiatives that had been implemented thus far had resulted in a financial sector that was stronger, more resilient and better placed to face greater competition. The ability of the domestic financial institutions to continue to register strong financial results despite the increasingly competitive environment reflects their enhanced strength and capabilities. At the same time, the regulatory framework had also been further strengthened commensurate with the challenges of the increasingly complex financial markets. Financial institutions had adopted better risk management practices in their

business operations, which accorded them greater flexibility and capacity to respond to the increasing consumer demands and expectations. The creation of robust financial institutions that were able to withstand any potential shocks, and that possessed that agility and adaptability to embrace future challenges were keys in ensuring their long-term sustainability in a more competitive environment, as well as in preserving financial stability (Unpublished Article Office of the Governor, Bank Negara Malaysia).

D) Progress of Central Bank of Pakistan in Financial Market Development

The State Bank of Pakistan (SBP) is the central bank of Pakistan. The main objectives of SBP are defined in the strategic direction it set for it in the year 2000 included ensuring the soundness of the Financial Sector, maintaining price stability with growth. Prudent management of the Exchange Rate and strengthening of the Payment System. In addition to these primary functions, the SBP is also engaged in various non-traditional of training facilities to bankers, and provision of credit to priority sectors. The SBP has also been playing an active part in the process of Islamization of the banking system. Liberalization of the financial sector has been the major policy agenda of all Governments since the late 1980s (<http://www.sbp.org.pk/>). Since then, various reforms have been undertaken to enhance efficiency of the financial system to keep pace with global to enhance efficiency of the financial system to keep pace with global developments. These reforms were aimed at reducing segmentation of financial markets, introducing competition in the financial sector, encouraging product development and innovation, and switching over to indirect, market-based and relatively more efficient monetary and credit policy (<http://www.sbp.org.pk/>).

Financial sector has made significant progress in the last five years by transforming itself into a market oriented, predominantly privately owned sector performing efficient intermediation. The reforms implemented in the banking sector consists various components like privatization of nationalized commercial banks, corporate governance and enhanced disclosure, capital strengthening improvement of assets quality, strengthened supervision and regulatory capacity and liberalization of foreign exchange regime etc. thorough reducing market segmentation financial markets, introducing competition in the financial sector, encouraging product development and innovation and switching over the

indirect market based and relatively more efficient monetary and credit policy. The banking supervision and regulatory capacity of the Central Bank has been strengthened through merit - based recruitment, competency - enhancing training, performance - linked promotion, technology - driven process, induction of skilled human resources and greater emphasis on values such as integrity, trust, team work have brought about a structural transformation in the character of the institution. (<http://www.sbp.org.pk/>).

E) Central Bank of Singapore

The Monetary Authority of Singapore is the central bank of Singapore. The concentration of functions within MAS runs contrary to the global trend toward separating the supervision function from central banks. While we are mindful of the arguments that call for a separation of functions, our own experience has shown that there are any synergies to maintaining the present structure of housing central banking and integrated supervision under the same roof. The priority then was to strengthen the financial system, particularly the domestic institutions, in order to increase confidence in Singapore as a financial centre. Regulations were imposed to limit foreign banks' penetration into the domestic banking business. This was to allow local banks sufficient time to strengthen their operations so that they would be in a better position to withstand further economic upheavals (Unpublished Article of Office of Managing Director, Monetary Authority of Singapore). As MAS liberalized the Singapore financial sector, it had to put in place a more robust framework for supervising financial institutions while allowing greater risk taking and financial innovation. MAS also had to reinvent it as it took on new challenges. New ideas and new staff entered the institution's ranks, while management adopted an open-minded approach to ensure that the core of existing talent was not alienated and morale remained high. MAS had played crucial role in development of financial market through Liberalizing the Banking Industry, Risk focused and Integrated Supervision, Liberalizing the Banking Industry. Greater Emphasis on Market Discipline , Higher standards of Corporate Governance and Raising the Financial Literacy of the public etc. Going forward, the challenge ahead will be for MAS to keep pace with the continuous evolution and revolution in the financial landscape.

(<http://www.economywatch.com/banks/central-banks/monetary-authority-of-singapore.html>). The international interlink ages of capital flows have meant that financial shocks are spread both quickly and widely worldwide. Central banks must remain vigilant and stand ready to deal with these situations swiftly and decisively.

2.4 Review of Previous Studies:

There are very limited study relating to the role of NRB and development of financial market in Nepal. Neither there is any material about this topic in the library as dissertation nor any article or books etc. About development of financial market in Nepal there is no clear-cut definition and indication in terms of figure that's why it lies under shadow. Due to various limitations in this study some studies and reports finagling relating to the financial market and role played to central banks are reviewed below.

A study doe by Narayan Prasad Paudyle (2006) entitle with “Development of Nepalese Stock Market and Share of Commercial Banks and Concluded Overall in This Manner”

Number of listed companies in the Nepal Stock Exchange increased to 144 in Mid November 2008 compared to 141 a year ago. Among the currently listed companies, 113 are banks and financial institutions.(including insurance companies)

Paid up capital of listed companies stood at Rs 46.6 billion in Mid November 2008 with a y-o-y increased of 95.6 percent. This increase was due to the listing of additional securities in the stock market.

Nepalese commercial banks play vital role in determining stock market indicators. NRB directives, rules and regulations are seems to be oriented towards the development of sound financial system but Nepalese financial market is not matured yet because market value of share drive Random Walk rather than financial indicators of an organization, financial and managerial efficiency etc.

A study doe by Shiba Raj Shrestha (2007) entitle with “Emerging Issues on the Strategic Planning” and concluded that: as the Nepalese economy is getting rapidly integrated with

the global economy, the country needs institutional restructuring and good governance. The policies and operations of the NRB, are critical in creating conducive environment for sustainable macroeconomic development. However, being the central bank of one of the least developed countries with vast poverty, high income inequality, vulnerability to external shock and weak financial system, its roles and responsibilities go beyond the central bank of a matured economy is supposed to deliver. Close integration with the Indian economy and fixed exchange rate regime with Indian currency had added challenges to autonomous operation of its central banking functions. The management of NRB should address this issue while implementing strategic planning. The proper implementation of strategic planning could be the panacea for overcoming probable banking and financial crisis. Hence, during implementation of the plan, the progress and status of the implementation should be reviewed at least on a quarterly basis by the board and should be amended as required.

A study done by Ms. Reshmi Manandhar (2008) entitled with "Problem and Prospects of Banking Sector in Nepal". This study critically analyzed the prevailing situation and problems in development of banking sector in Nepal. This study concluded that the interest rate of deposit is decreasing every year because of lack of investment opportunity; however, deposit collection is increasing which makes commercial banks more strong. Moreover consumer believed to government owned bank rather than non-government banks. Commercial banks have to face many problems in micro financing. Such as, low income, higher risk, higher transaction costs etc. even though it is seen that commercial banks are successful to flow credit in priority sector credit as NRB rules. In gist, there are many problems in commercial banking sector, however, it has also prospect to growth in Nepal. Mainly semi-government banks have higher prospect to growth as consumer prefer this bank to other.

Ms. Manandhar has recommended to NRB to make compulsory provision to those commercial banks in order to open one urban branch need to open one semi urban and rural branch compulsorily.

A study done by Niraj Parajuli (2009) entitled with “Financial System and Economic Development” of Nepal and the researcher critically analyzed the current status of Nepalese financial system and economic development in this way. In maintaining the overall stability of the financial system, the role of the NRB as a regulator and supervisor needs to be further strengthened. Broader and deeper reforms are required in the central bank to ensure strong regulatory and supervisory body capable of leading the financial system only an effective and prudent regulatory and supervisory system can tackle the vulnerabilities to the likely instability and other uncertainties affecting the evolving financial system. In a liberalized economy, the role of regulating and supervising agencies is supposed to be more vital in maintaining financial stability and thereby facilitating the pace of economic development. Though the Nepalese financial system has grown rapidly over the period, it still lacks competitive environment. The lack of competition is reflected in high interest rate spread of commercial banks. At present, all the banks and financial institutions licensed by the NRB are free to fix their interest rates. The un-weighted interest rate spread of commercial banks has remained in the range of 8.75 to 9.0 percent over the last few years.

And Mr. Paudyal concluded and recommended that an efficient, sound and healthy financial system is essential for ensuring high and sustainable economic growth in the country. Weaknesses in the financial system create obstacles in achieving the objective of macroeconomic policy. Globalization and liberalization of financial markets have further broadened the nature and the effects of emerging issues. Financial liberalization, if managed properly, can produce desired results in developing the financial system. The nature of issues maybe country-specific and strategies or policies to address them must be adapted to fit into the country’s circumstances. In order to stabilize the financial system and to restore public confidence, the central authority is, sometimes, required to adopt some forceful measures. Financial system soundness has become crucial for restoring macroeconomic stability and most of the IMF-supported programs on financial sector policies are directed towards re-establishing efficient financial system through implementing broad reform measures.

The IMF focuses on this area as part of its surveillance, technical assistance and policy development work. The broad based corrective actions should include setting up appropriate institutional frameworks, removing no-viable financial institutions from the system, strengthening viable institutions, dealing with value impaired assets, improving prudential regulations and supervisions and promoting transparency in financial market operations. In a bank-dominated financial system, the banking sector has to play a vital role in the economic development process of the country through mobilizing and allocating limited resources. The banking system must be prudent with commercial orientation. The organization and financial health of the two state-owned banks have been deteriorating and for the efficacy and efficiency of the banking sector, these two state owned banks must be restructured as a first step in dealing with the issues of the Nepalese financial system. The financial system still lacks competitive environment and the non banking sector is yet to grow in terms of size, structure and the volume of business. Lack of competent, qualified and experience managerial team has remained as one of the serious concerns in the system. The role of central bank as a regulatory and supervisory body needs to be further strengthened. The banking services targeted to the poor and deprived sector people are not adequate.

Looking from these perspectives, these issues can be broadly classified into three categories. The first set of issues is microeconomic in nature and includes poor banking practices such as inadequate capital, failure of loan policy, inadequate assessment of credit, insufficiently diversified loan portfolio, lending to connected borrowers and excessive maturity. Overstaffing and the existence of trade unions have also been chronic problems, particularly in state owned commercial banks and financial institutions. The second set of issues includes the degree of volatility due to the movements in assets prices and the exchange rates. The third category is system related, indicating that the environment is not conducive to the development of an efficient financial system. System related issues in the financial system include lack of competition, excessive government intervention, inadequate legal framework, under-developed securities market and inadequate regulatory and supervisory mechanism. The corrective actions and policy options should, therefore, address these issues and challenges. The broad thrusts of policy options should aim at the following: creating a sound, stable and healthy financial system,

broadening and deepening the financial system, adequate information disclosure, efficiently mobilizing financial resources to promote sustained and broad-based growth momentum, building the institutional capacity to tackle the problems in the financial system by improving the legal and judicial frameworks and increasing the autonomy and capability of the central bank's regulatory and supervisory roles. To sum up, the corrective actions and policy options should cover the following major issues.

- Improve the organizational and financial health of state-owned banks and financial institutions.
- Facilitate the new entry of financial institutions in the private sector.
- Make the debt recovery system effective and improve the quality of assets.
- Strengthened the rural credit delivery mechanism
- Build up the capacity of the financial sector by improving legal, judicial and institutional base
- Enhance the regulatory and supervisory capacity of the central bank
- Make the financial system competitive, broad-based and growth induced

2.5 Review of Journals and News Papers:

Board of Directors of NRB, Prof. Dr. Parthibeshwar Prasad Timilsina (NRB News Volume III, March 2007:6) opines on the query about the role of NRB in financial sector reform “It is found that NRB has endeavoured but it has not been able to achieve as envisaged. In my opinion it is due to poor progress in real sector. Without congenial investment climate in real sector, it becomes difficult to bring effective reforms in financial sector.” He also clarified about the role of NRB in the present context that NRB in the present context has to play promoting as well as regulatory role. The real sector needs to be supported by financial sector. Spatial dimension in banking sector development is to be focused to meet the needs of the region and area to create market or demand centers. Mapping of banking and financial institution is to be done to develop new areas, with the availability of fund the investment opportunities are created in the real sector. Domestic and external sources of fund need to be matched in the growing context of remittances inflow. More inflow of money from other countries can come with

the help of non-resident Nepali. Real sector development is possible inhuman resources by matching with the needs of international market. The market for the type of human resources in the developed market economies can be assessed by NRB in cooperation with the diplomatic mission of Nepal and the business organizations operated by the Nepalese entrepreneurs. This can also be matched with the marketing of our tourist products in such economics.

Executive Director of the SEACEN Centre, Dr. A.G. Karunasena (NRB News Volume II; February 2007:6) is rating the supervisory role of NRB in the present context in this way “my understanding is very limited. Financial sector problems are not limited to Nepal only. It is common for LDCs and we have also sought bank failures n the past. What is important is whether the political leadership and central banks are moving in the right direction or not. The speed may be different and sequence could be different. Speed and sequences has to be decided based on the situation in the country concerned. Change in the legal system is a long process. So it takes time. We should not decelerate this process”.

Dr. Karunasena added about the growth of financial sector in Nepal that when we compare with other countries, that depends upon two factors one is the number of institutions and other is deepening of the financial sector. Expansion and development of the financial sector is higher or lower depending on which factor we are considering. Some have more but catering to different segments. The questions comes if relative is large or not. Rationalizing the number of financial institutions is important but it does not mean that the sector has overgrown. The financial assets to GDP ratio provide simple intra-country comparison of financial deepening. WE take M2 (broad money) is 56 percent to GDP. IT is the competition that determines if we can sustain the number of financial institutions and provide quality services. Dr. Karunasena also said that about the autonomy of NRB in working and need of FDI that autonomy is not something that is given but it has to be taken. Autonomy has to show in actions not limiting it to paper only. So, I wish NRB would be able to enjoy functional autonomy in monetary as well as financial management. In case of Nepal, domestic and national saving may be 30 to 40 percent of GDP. This is sufficient to get desirable growth. All are looking for a long-term

growth of 6 to 8 percent; to get that level of growth rate we may need at least 30 to 35 percent. It depends upon capital output ratio. Domestic saving may increase the output but it takes time, if we can get foreign direct investment (FDI), we can quickly start that and automatically generate more domestic saving. The FDI not only comes with the capital but also with technology. They also bring management skills. But we have to be careful selecting the areas for FDI and for giving facilities and subsidies.

2.6 Research Gap:

The purpose of this research study is quite different and relevant from those studies made by above researches (related to Nepal Rastra Bank and Nepalese financial market). The researcher focuses only on either the overall role of NRB or in the development of financial market in Nepal. The method of analysis is quite different because all those studies are completed using only secondary data for analysis purpose and limited number of sample size has been taken. This helps in analyzing the present condition and problem faced by Nepalese financial market. This study may be first research study on the field of financial market regarding to role of NRB in it. This study has tried to explore the actual position of Nepalese financial market and role of NRB in its development.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Introduction:

Research methodology is a systematic way to solve the research problem. In other words, research methodology describes the methods and process applied in the entire aspect of the study. Research methodology refers to the various sequential steps (along with a rationale of each step) to be adopted by a researcher in studying a problem with certain objectives in view (Kothari, 1994:9). Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, sample size and selection process, data collection procedure and data processing techniques and tools.

3.2 Research Design:

A research design is the specification of methods and procedures for acquiring the information needed. It is an overall operational pattern or framework for the project that stipulates what information is to be collected, from which sources and by what procedures. Thus a research design is a plan for the collection and analysis of data. For research there exist different types of research design like; Historical research, Descriptive research, Case study research and so on. This study is an examination and evaluation of the development of financial market in Nepal and role of NRB but also explore the role of financial market in economic development. It evaluates the development pace of financial market in Nepal, its contribution in economic development and role of NRB in its development. Finally, it also recommends some useful recommendations to the concerned parties. That's why, this study is mainly concerned with historical research. If applicable, sometime descriptive and analytical approach may also be used.

3.3. Population and Sample:

The term "population" or universe for research means the universe of research study in which the research is based (Wolf & Pant, 2000:75). The population for the study

comprises 31 commercial banks, 78 development banks , 102 finance companies, and 5 rural development banks, 16 micro credit development banks, 17 co-operatives and 47 NGOs (NRB licensed) are established during April 2011. Among the total population only some selected institutions are taken as sample on stratified sampling basis. For selecting the samples, stratified sampling method is used here among different methods. Among above specified population, only ten institutions are chosen as sample under stratified sampling method. Among ten, including single government owned commercial bank, four commercial banks, three finance companies, two development banks which are in business, one insurance company are chosen.

3.3.1 Basis of Selecting Sample:

Stratified sampling method is used when we have to select samples from a heterogeneous population (Wolff and Pant, 2005:173). In this research study stratified sampling method is used due to selecting samples from a heterogeneous population. To represent different types of financial. Institutions i.e. banks development banks, financial institutions and insurance company stratified sampling method seems appropriate and used. In this sampling method, entire population is divided into subgroups or strata and a sample random are taken from each such sub-group. All the representative of financial market divided into banks, developments banks, finance companies and insurance company for primary data collection. From each stratum the units are picked up together constitute a stratified sample. Among 31 private sector commercial banks only 3, among 3 governments owned commercial banks only single commercial banks are chosen in sample under random sampling method from each sub-group. Among 102 finance companies only 3 are chosen, among 78 development banks only 2 are chosen and among 19 insurance companies only one insurance company are chosen under random sampling method. From all, there are 10 institutions representative chosen of entire population. Organizations under study are as follows;

1. Commercial Banks

- A) Kumari Bank Limited
- B) Siddhartha Bank Limited
- C) Machapuchhre Bank Limited
- D) Nepal Bank Limited(government owned)

2. Finance Companies

- A) United Finance Limited
- B) Goodwill Finance Limited
- C) Prudential Finance Limited

3. Development Banks

- A) Corporate Development Bank Limited
- B) Sanima Development Bank Limited

4. Insurance Company

- A) Gurans Insurance Company Limited

3.4 Sources of Data and Collection Procedures:

Data are crucial for every research work. The sources of data used in this study are as follows:

I) Primary Sources:

Primary data are those, which are collected for the first time, and thus happen to be original in character. In primary sources, consultation with personnel directly related to the role of NRB in development of financial market in Nepal, and the officers of NRB head office baluwatar, structured questionnaire and frequent visit and contact to the central bank head office are made for the study purpose. The entire set of structured questionnaire is presented at the end of this report at Annexure 2.

II) Secondary Sources:

The secondary data are those, which have already been collected and passed through the statistical process. For this study, secondary data are also used. These secondary data are collected mainly from published sources like Economic survey, annual report, prospectus, balance sheet, newspaper, journal, Internet and other sources. Secondary data published on annual report of concerning organizations are also taken in consideration and like development pace of organization, interest rate as well as amount and their organizational profile are collected through personal visit of respective organization as well as from their websites. Some secondary data like capital, investment contribution in economic

development of respective organization are collected from different sources of respective organization comparative study and from publication of Nepal Rastra Bank.

3.5 Data Processing and Presentation:

The information or data obtained from the different sources are in raw form. From that information, direct presentation is not possible. So it is necessary to process data and converts it into required form. After then only, the data are presented for this study. This process is called data processing. For this study, only required data are taken from the secondary source (organization's publication) and presented in this study. For presentation, different tables are used. Similarly, in some case graphical presentation is also made. For reference, the photocopies of raw data are attached in the last portion of this thesis. So far as the computation is concerned, it has been done with the help of scientific calculator and computer software program as well.

3.6 Methods and Tools of Analysis:

In order to get the concrete results from this research, data are analyzed by using different types of tools. The data collected from different sources are processed and presented in tables and graphs in a simple and proper way. Analysis is done as per the requirement of study. As per topic requirements, emphasis is given on statistical tools rather than financial tools. So for this study following statistical tools are going to use.

I) Arithmetic Mean:

It is the sum of the observations divided by the number of observations. In such a case all the items are equally important (Pant & Chaudhary, 1999:91). As arithmetic mean is most common and popular tools for data analysis, here in this study also, arithmetic mean is used. It is computed by using following formula.

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

where $(\bar{X}) = \text{Mean}$

$\sum X = \text{Sum of the entire Variable}$

$n = \text{Variables involved}$

II) Standard Deviation:

The standard deviation is the best tools to study fluctuation in any data. It is usually denoted by the letter sigma (δ). Karl Pearson suggested it as a widely used measure of dispersion and is defined as the positive square root of their arithmetic mean of squares of the deviation of the given observation from their arithmetic mean of a set of value (Gupta, S.P. 1995: E 8.18). It can be computed by using following formula.

$$\text{S.D. } (\delta) = \sqrt{\frac{1}{n} \sum (X - \bar{X})^2}$$

Greater the magnitude of standard deviation, higher will be the fluctuation and vice versa.

III) Correlation and Regression:

By this statistical tool, the degree of relationship between to variables is identified. In other words, this tool is used to describe the degree to which one variable is linearly related to other variables. Two or more variables are said to be correlated if change in the value of one variable appears to be linked with the change in the other variables. The correlation analysis refers the closeness of the relationship between the variables (Sharma, & Chaudhary, 2000:420). Correlation may be positive or negative and ranges from -1 to +1. Simple correlation between financial market development and economic development is computed for this study. For example, let's say that the correlation between financial market growth and economic development is positive. It indicates that when financial market growth increases, economic growth also increases in same direction and vice versa. For our study following reference is used (Pant & Chaudhary, 2053:306)

Correlation maybe positive or negative and ranges from -1 to +1. When $r = +1$, there is positive perfect correlation; when $r = -1$, there is perfect negative correlation; when $r = 0$, there is no correlation and when $r < 0.5$ then there is low degree of correlation.

When 'r' lies between 0.7 to 0.999 (or -0.7 to 0.999), there is high degree of positive (negative) correlation.

When 'r' lies between 0.5 to 0.699, there is a moderate degree of correlation.

The simple correlation coefficient, r, is calculated by using following formula:

$$\text{Simple Correlation Coefficient } r = \frac{n \sum X_1 X_2 - (\sum X_1)(\sum X_2)}{\sqrt{n \sum X_1^2 - (\sum X_1)^2} \sqrt{n \sum X_2^2 - (\sum X_2)^2}}$$

Alternatively,

$$R = \frac{\text{Cov}(X_1, X_2)}{\text{Var}X_1, \text{Var}X_2}$$

Where,

$$\text{Covariance } (X_1, X_2) = \frac{1}{n} (X_1 - \bar{X}_1)(X_2 - \bar{X}_2)$$

n = Total number of observations.

X1 and X2 = two variables, correlation between them are calculated.

IV) Time Series Analysis

A time series consists of statistical data, which are collected, recorded observed over successive increments. The analysis of time series is more important in all sectors due to following reasons; it helps in planning future operations, it helps in evaluating current accomplishment and it facilities comparison.

V) T-test

By this statistical tool, the authentic degree of formulated hypothesis is identified. Hypothesis testing refers to the process of selecting and using sample statistic to draw inference about a population parameter based on a subset of it – the sample drawn from the population. A hypothesis is a supposition made as a basis for reasoning (Gupta, S.P., 1995: A 3.3). The main goal of testing hypothesis is to test the characteristics of hypothesized population parameter and sample statistic is significant or not. Under certain procedures of testing hypothesis alternatives are already set in the first chapter. At the time of dealing with small samples the main interest is not to estimate the population values as is true in large samples, so, T-test is selected under setting a test criterion. Small samples means when sample size is less than 30 ($n < 30$) deal for testing of hypothesis concerning population means, difference between two population means and on observed sample correlation coefficient, new technique and tests of significance known as exact sample tests. The main assumptions of T-distribution are – the parent populations from

which the samples are drawn are normally distributed and the samples are random and independent of each other. The properties of T-distribution are as follows (Sharma & chaudhary, 2058:279);

T-distribution is a continuous distribution having symmetrical and bell shaped. The value of t ranges from minus infinity to plus infinity.

The T-distribution is flatter than the normal distribution and there is a different T-distribution for every possible sample size.

A T-distribution is lower at the mean and higher at the tails than a normal distribution.

The T-distribution can be used even in case of large sample but the sample theory can not be used for small sample.

T-distribution can be defined as;

$$T = \frac{\bar{X} - \mu}{\sqrt{\frac{S^2}{n}}}$$

Where, $\bar{X} = \frac{\sum x}{n}$ i.e. sample mean, n refers the size of sample and variance of sample (S^2) is computed as;

$$S^2 = \frac{1}{n-1} \sum (X - \bar{X})^2$$

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction:

This chapter consists of various calculation made for the analysis of role of NRB in development of financial market in Nepal, the relationship between financial market development and economic growth. To make our study effective and precise as well as easily understandable, this chapter is categorized in three parts; presentation, analysis and interpretation. The analysis is fully based on both primary as well as secondary data available. In presentation section data are presented in terms of table, graph chart of figures, according to need. The presented data are then analyzed using different statically 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) but the arrangement of writing is made by aforementioned way. Similarly it is also noted that both primary and secondary sources of data are used frequently for the analysis purpose.

For our simplicity, in this thesis, presentation analysis and interpretation of data are made according to the nature. In words, at first current situation of financial market in Nepal is explored. After then, relationship of financial market with economic growth is presented. Lastly, role of NRB in development of financial market in Nepal is analyzed. While analyzing, different statistical tools like arithmetic mean, standard deviation, correlation coefficient, t-statistics for significance test are employed.

4.2 Historical Scenario of Banks and Financial Institutions in Nepal:

The banking system in Nepal is greasing up for another round of competition with second phase of financial sector reform and international standard oriented reform underway. Nepal Government and Nepal Rastra Bank are working to develop transparent, competitive and strong financial sector on the one hand and on the other hand want government dominated banking system to survive and run smoothly, The Nepalese economy is rapidly integrated with the global economy with its outward oriented policies

followed by membership of WTO, SAFTA and BIMSTEC. The country is in process of institutional restructuring of financial sector. The face of banking has changed tremendously after the adoption of financial liberalization policy since 1980s. Hence Nepal is in process to make banking system more transparent and international delivery standard. We can observe that progressive liberalization of the banking system has brought out, among others, a sea change in the banking and financial activities.

The Nepalese economy is getting rapidly integrated with the global economy due to the adoption of liberal economic policies and the accession to the international and regional trading agreements. The country needs institutional restructuring in the spectrum of fiscal, financial, and external sectors to enhance competitiveness of the economy, promote policy credibility for attracting long-term foreign investment and maintain macro-economic and financial stability to sustain the economic development.

Policies and activities of Nepal Rastra Bank (NRB) that practices modern central banking and strategic management principles are critical in creating sound economic environment that fosters sustainable economic growth of the economy in general and financial industry in particular. The gradual development of banks and financial institutions is presented below.

Table 4.1

Changing Glimpse of Banks and Financial Institutions in Nepal**Growth of Financial Institutions**

Types of Financial Institutions	Mid - July											
	1980	1985	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011
Commercial Banks	2	3	5	10	13	17	18	20	25	26	27	31
Development Banks	2	2	2	3	7	26	28	38	58	63	79	87
Finance Companies				21	45	60	70	74	78	77	79	79
Micro-finance Development Banks				4	7	11	11	12	12	15	18	21
Saving & Credit Co-operatives Limited (Banking Activities)				6	19	20	19	17	16	16	15	16
NGOs (Financial Intermediaries)					7	47	47	47	46	45	45	38
Total	4	5	7	44	98	181	193	208	235	242	263	272

* With limited Banking Business, NRB licensed.

*Source: Annual Bank Supervision Report, 2011
Banking and Financial Statistic (Mid-July 2011),*

The Nepalese financial system is dominated by banking sector (Pokhrel, NRB Newsletter, 2064:124). There were only two commercial banks (both governments owned) and only two development banks in year 1983. Ten years hence, commercial banks with foreign joint venture entered in the Nepalese financial market, the number was doubled four times in total, and there were eight commercial banks, four development banks and four financial companies. At the starting of new millennium private sector also entered in increasing order the total number of institutions reached to 79 in total. Then after five years later the number reached to 175 and total number exists 239 in 2011, out of them 31 commercial banks, 78 development banks, 102 finance companies, 16 co-operatives and

other 47 non government financial institutions licensed under limited banking operations. The opening trend of financial institutions seems increasingly increasing in till 2005, the number increased year by year but the ratio decreased in the last two years. In the context of Nepal being 147th member of WTO it is necessary to enhance quality rather than number.

4.3 Current Structure of Financial Market in Nepal:

With the vast network of bank branches spread across the length and breadth of the country, the scope for bank and financial institutions growth is beyond imagination. This arises from the fact that banks especially those with government dominated are still one of the most trusted institutions in the country. Recently the overall financial system in Nepal is presented in the tabular form as follows:

Table 4.2
Construction of Financial System of Nepal

S. N.	Name/Category	Number
1.	Nepal Rastra Banks	1
2.	Commercial Banks	31
3.	Other Banking Institutions (OBIs)	
	i) Development Banks	87
	ii) Finance Companies	79
	iii) Micro-Finance Development Banks	21
	iv) Financial Co-operatives	16
	v) Financial Non-Government Organization	47
4.	Other Financial Institutions	
	i) Postal Saving Banks	117
	ii) Nepal Stock Exchange	1
	iii) Insurance Companies	25
5.	Others	
	i) Employee Provident Fund	1
	ii) Citizen Investment Trust	1

(Source: Nepal Rastra Bank Publications)

There are 31 commercial banks doing business in the Nepalese financial market out of them eight are with foreign joint venture and remaining seventeen are fully domestic banks. Other banking institution includes 78 development banks, 102 finance companies, 16 micro finance development banks, 17 financial co-operatives and 47 non government financial organizations. Other financial institutions include 117 postal saving banks, single Nepal Stock Exchange for organized stock transaction and 19 insurance companies. There is only one employee provident fund and single citizen investment trust. NRB categorized all the institutions in four groups 'A', 'B', 'C' and 'D' for their institutional development based on their capital, investment and limited banking business.

4.3.1 Ownership and control of Nepalese Commercial Banks:

On the basis of ownership, the commercial banks in Nepal can be categorized as public and private banks. As of mid July 2010 there are 3 Public Sector Banks and 24 Private Sector Banks. Rastriya Banijya Bank is the largest bank of Nepal in terms of deposit mobilization is fully owned by the government of Nepal. In Nepal Bank Limited, the Nepal Government owns 40 percent ownership. The Government of Nepal has owned 78.22 percent shares of Agriculture Development Bank that was initially established as a development bank and later on upgraded to commercial bank in 2006 mainly due to the structure of paid up capital. Moreover, Nepal Government invested Rs. 6.4 billion in irredeemable preference shares and Rs.2.3 billion in redeemable preference shares issued by Agriculture Development Bank. The financial health of the public banks was very poor and thus a reform program was initiated in these banks under the Financial Sector Reform Project with the aid of the World Bank and DEID.

The private sector banks in Nepal can be further re-grouped into the local private banks and foreign Joint-Venture Banks. The banks with the local private investment are Local Private Banks while the banks with joint investment of both foreign institutions and local investors are Joint-Venture Banks. As at mid July 2010, there were 7 private joint venture banks and 17 locally owned banks in Nepal.

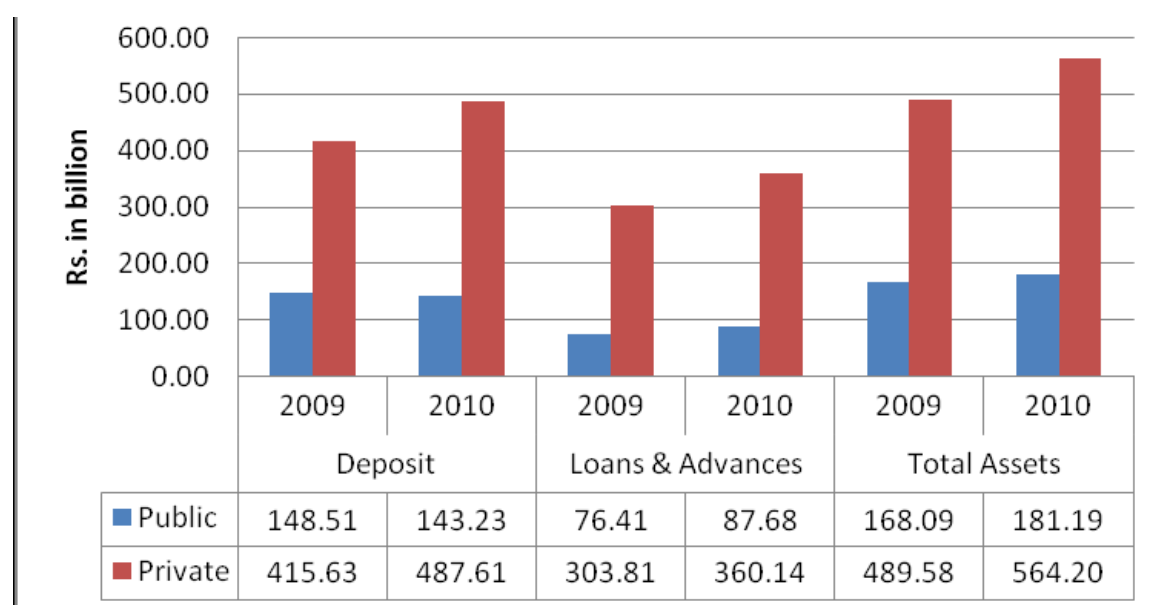
4.3.2 Scope of operations: Public vs. Private:

The public sector banks have still a sizable chunk of deposits, loans and advances and total assets of the banking industry. The number of their branches is also increasing

despite the heavy increase in number of private banks. The total deposits of the banking industry increased by 11.8 percent to Rs. 630.83 billion in mid July 2010, compared to a deposit of Rs. 564.14 billion in the previous year. Similarly, the loans and advances of the banking industry increased by 17.78 percent to Rs. 447.82 billion compared to Rs. 380.22 billion previous year. The total assets of the banking industry in mid July 2010, increased by 13.3 percent to Rs. 745.32 billion compared to Rs. 657.67 billion last year. The growth rates of all variables mentioned above were higher in private banks relative to the public sector banks in the review year. The chart below presents the banking operations in terms of deposits, loans & advances and total assets of the banking industry with separation of public and private sector banks.

Figure 4.1

Banking Operations: Public vs. Private (Mid July 2010)



(Source: Bank and Financial Institutions Regulation Department, Nepal Rastra Bank (Mid-July 2010))

4.3.3 Access of Banking Services and Branch Network

The service networks of the banks are spread around the country with the rapid increase in number of private bank branches. Despite the rapid growth in number, their scope of operation is yet limited to urban and suburb areas and still a big chunk of population deprived from access to the banking services. However, in recent days banks have started exploring the market in distant parts of the country, which is indeed a good sign.

The total number of bank branches increased to 1137 in mid July 2010. It was 752 last year. Out of total 1137 branches, 455 branches were of 3 public sector banks and remaining 682 branches belonged to 24 private sector banks.

Table 4.3

Branches of Commercial Banks (Mid July 2010)

Name of Banks	2008	2009	2010
Nepal Bank Limited (NBL)	99	100	110
Rastriya Banijya Bank Limited (RBBL)	114	123	126
NABIL Bank Limited (NABIL)	26	32	36
Nepal Investment Bank Limited (NIBL)	19	31	41
Standard Chartered Bank Nepal Ltd. (SCBN)	13	13	15
Himalayan Bank Limited (HBL)	17	23	31
Nepal SBI Bank Limited (NSBI)	17	33	42
Nepal Bangladesh Bank Limited (NBBL)	17	17	17
Everest Bank Limited (EBL)	26	30	37
Bank of Kathmandu Limited (BOK)	22	30	37
Nepal Credit and Commerce Bank Ltd. (NCCBL)	17	17	17
Lumbini Bank Limited (LBL)	5	5	13
Nepal Industrial & Commercial Bank Ltd. (NIC)	16	21	26
Machhapuchhre Bank Limited (MBL)	18	31	41
Kumari Bank Limited (KBL)	12	15	28
Laxmi Bank Limited (LXBL)	13	19	22
Siddhartha Bank Limited (SBL)	7	10	30
Agriculture Development Bank (ADBL)	65	86	232*
Global Bank Limited (GBL)	7	16	28
Citizens Bank International Limited (CtzBL)	9	10	33
Prime Commercial Bank Limited (PCBL)	1	8	17
Sunrise Bank Limited (SRBL)	6	21	48
Bank of Asia Nepal Limited (BOA)	5	21	29
DCBL Bank Limited (DCBL)	3	5	12
NMB Bank Limited (NMB)	1	9	15
Kist Bank Limited (Kist)	-	26	51
Janata Bank Nepal Limited (JBNL)	-	-	3
Total	555	752	1137

** Also includes branches with development banking functions.*

(Source: Bank and Financial Institutions Department, Nepal Rastra Bank (Mid-July 2010))

From the table above, it is clear that, the banks with the largest number of branches were public banks: Agriculture Development Bank, Rastriya Banijya Bank and Nepal Bank Limited seemed to have 232, 126 and 110 branches respectively. The number of branches of private banks is also increasing in the developing parts of the country to rip the benefits of the market outside the Kathmandu valley. Large concentration of the branches is seen in Kathmandu. Most banks are waiting to expand their branches in Kathmandu, which is a

major economic hub of Nepal. The districts with highest number of bank branches are Kathmandu, Kaski and Rupandehi.

Table 4.4

Region wise distribution of Branches (mid July)

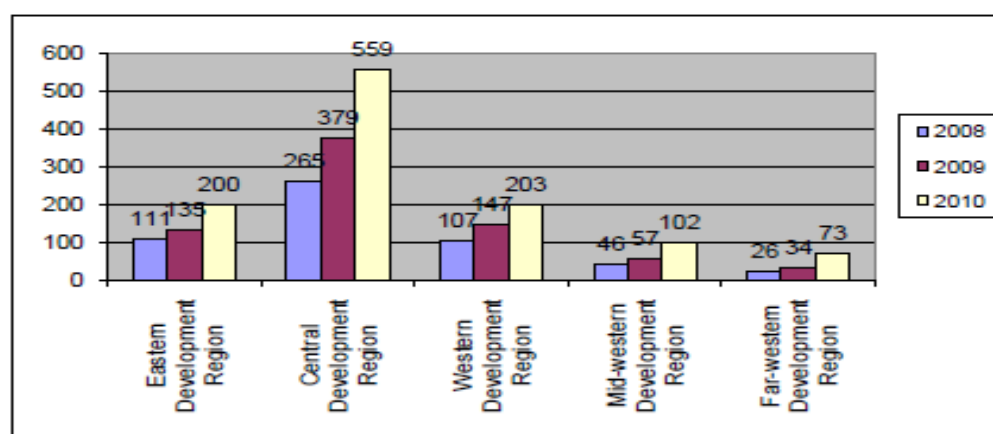
S. N.	Development Region	2008	2009	2010
1	Eastern Development Region	111	135	200
2	Central Development Region	265	379	559
3	Western Development Region	107	147	203
4	Mid-western Development Region	46	57	102
5	Far-western Development Region	26	34	73
	Total	555	752	1137

(Source: Bank and Financial Institutions Regulation Department, Nepal Rastra Bank (Mid-July 2010))

Similarly the development region with largest number of bank branches is Central Development Region with 559 bank branches followed by Western Development Region and Eastern Development Region with 203 and 200 branches respectively. The region with lowest number of bank branches is Far Western Development Region with 73 bank branches. The number of bank branches is presented in the picture below.

Figure 4.2

Number of Bank Branches (Region wise)



(Source: Bank and Financial Institutions Regulation Department (Mid-July 2010))

4.3.2 Structure of Nepalese Financial System:

The macro economic indicator, Gross Domestic Product (GDP) can be taken as one of the most powerful tool of disclosing economic situation. Developing countries like Nepal suffers deficit trade balance and formulate deficit budget to invest in physical infrastructure. Money circulation in the economy largely depends on sound financial

system. Investment in development of financial system and their growth determines the economic development. That's why, the ratio of total assets/liabilities of financial sector to GDP helps to evaluate the contribution of financial market to economic growth. As of mid-July 2010, commercial banks' share is 54.6 percent followed by a 21.6 percent share of Nepal Rastra Bank. The share of other financial institutions is low. However, contractual savings institutions have a remarkable share of 12.2 percent in 2010. As shown in the table, a total share to financial assets is 88.4 % and if the total share 11.6% is added to 88.4% then the total are 100 at mid July 2009.

Table 4.4
Structure of Nepalese Financial System

(Rupees in Million)

Particulars	2008/09			2009/10		
	Total assets/ Liabilities (Unaudited)	Percentage share in total	Ratio of total assets to nominal GDP (%)	Total assets/ Liabilities (Unaudited)	Percentage share in total	Ratio of total assets to nominal GDP (%)
Financial institutions	1272332.7	89.8	128.8	1332769.1	88.9	113.7
Nepal Rastra Bank	282328.4	19.9	28.6	296625.6	19.8	25.3
Commercial banks	812165.9	57.3	82.2	787300.9	52.6	67.2
Finance companies	87430	6.2	8.8	115462	7.7	9.9
Development Banks	69134.9	4.9	7.0	108723.8	7.3	9.3
Cooperatives	5834.7	0.4	0.6	6975.2	0.5	0.6
Micro credit financial institutions	15438.8	1.1	1.6	17681.6	1.2	1.5
Micro credit non-governmental Organizations	2382.6	0.2	0.2	2382.6	0.2	0.2
Contractual Savings institutions	141513.3	10.0	14.3	160798.1	10.7	13.7
Employees Provident Fund	79119.6	5.6	8.0	90390.3	6.0	7.7
Citizen Investment Trust	25379.4	1.8	2.6	22647.8	1.5	1.9
Insurance companies	37014.3	2.6	3.7	47760	3.2	4.1
<i>Postal Saving Bank</i>	1025	0.1	0.1	1085.9	0.1	0.1
Total	1417253.6	100.0	143.4	1497035.7	100.0	127.7
Nominal GDP (Rs Million)	988053.0			1171905.0		
Market capitalization of Stock Exchange (Rs million)	512939.0			376871.4		
Ratio of stock Market capitalization to GDP (%)	51.91			32.16		

*Excluding ADB/N and Nepal Industrial Development Corporation in 2010

(Source: Nepal Rastra Bank Annual report 2010)

4.4 Key Macro Economic Indicators, Situation of First Four Months of 2008/09:

There have been ups and downs in the key macro economics indicators because of the global economic recessions though it had no influenced yet in Nepal. Several Situation needs to be focused for its study. Based on the first four months data several studies must be highlighted.

Monetary Situation:

Money Supply: Broad money (M2) grew by 6.8 percent in the first four months of 2008/09 compared to a growth of 7.3 percent in the corresponding period of the previous year. Despite a significant growth of net foreign assets and expansion of non-monetary liabilities, decline in net claims on government by 5.8 percent in the review year compared to a growth of 4.7 percent in the previous year contributed to lower the growth of M2 in the review period.

Narrow money (M1) grew by 3.1 percent in the review period compared to a growth of 3.7 percent during the corresponding period a year ago.

Net foreign assets NFA (after adjusting for foreign exchange valuation gain/loss) increased by Rs 11.9 billion (6.9%) in the review period against a decline of Rs 3.6 billion (4.2%) in the same period of previous year. A significant growth of NFA was attributed to an elevated level of remittance inflows accompanied by an expansion in the foreign assistance of the review period.

Domestic Credit:

In the first four months of 2008/09, domestic credit expanded by 6.5 percent compared to a growth of 8.1 percent in the corresponding period last year. The government has cash deposit of Rs 6.3 billion with Nepal Rastra Bank (NRB) in the review period. This was accumulated on account of a higher resource mobilization relative to the government expenditure.

Private sector credit increased by 9.4% in the review period compared to a growth of 8.3 percent in the previous year. In the review period, the private sector credit to agriculture, transportation equipment, production and fitting, wholesale and retail trade and consumable sectors remained high. In addition, the claims on non-government financial institution increased in the review period on account of an increase in commercial banks short term investment in finance companies and other financial institutions.

Claims on non financial government enterprises increased by 14.9 percent (Rs 843.7 million) in the review period in contrast to a decline of 9.6 percent (Rs 490.5 million) in the corresponding period of the previous year. A higher use of credit by Janakpur Cigarette factory ltd, Nepal Oil Corporation, Nepal Airline Corporation and Nepal Electricity Authority contributed to such an increase in the claims on such enterprises in the review period.

Deposit Mobilization and Credit Flow of Commercial Banks:

In the first four months of 2008/09 deposit mobilization of commercial banks increased by Rs 26.8 billion (6.4%) amounting to Rs 448.4 billion. Notwithstanding the significant inflows of remittances, an increase in the currency in circulation accompanied by a higher level of revenue mobilization of the government relative to expenditure, contributed to the slowdown in the rate of deposit mobilization during the review period.

In the review period, credit to private sector expanded by Rs 32.7 billion (9.7%) compared to an increase of Rs 23.8 billion (9.0%) in the same period of the previous year.

Liquidity Management:

In the first four months of 2008/09, the NRB injected net liquidity of Rs 42.2 billion by net purchase of 569.6 million US dollar from commercial banks through foreign exchange intervention. A net liquidity of Rs 20.6 billion had been injected in the corresponding period of the previous year through the net purchase of 321.5 million US dollar from commercial banks.

Security Market:

Total numbers of companies listed at the NEPSE increased to 144 in mid November 2008 compared to 141 a year ago. Among the currently listed companies 113 are banks and financial institutions (including insurance companies). Moreover production and processing industries, hotels, business entities, hydropower and other companies remained at 18,4,4,3 and 2 respectively.

Consumer Price Inflation:

The y-o-y inflation as calculated by the consumer price index rose to 14.5% in mid November 2008 from 6.3% in the previous year. The inflation in the review period was driven both by the significant rise in food and beverages (17%) as well as non food and services (11/7%) group.

Region wise the price in Kathmandu valley was 16.8% followed by 14.2% in hills and 13.3% in Terai. Last year the respective rates were 6.1%, 5.7% and 6.6%.

National Salary and Wage Rate:

The overall y-o-y salary and wage rate index rose by 10.0% in the Mid Nov 2008 compared to a rise of 10.1% a year ago. Wages of agriculture, industrial and construction laborers increased by 20.2%, 2.5% and 15.2% respectively in the review period. Last year these wage rates had increased by 6.8%, 14.6% and 10.3% respectively.

Budget Deficit/Surplus:

In the first four months of 2008/09 the government budget remained at a surplus of Rs 1.3 billion in contrast to a deficit of Rs 7.4 billion in the corresponding period of the previous year. An increase in revenue and foreign cash grants accounted for such a budget surplus in the review period.

Government Expenditure:

In the first four months of 2008/09 the total government spending increased by 7.3% to 37.1% billion compared to an increase of 34.5% in the corresponding period of previous year.

Government Revenue:

In the first four months of 2008/09 revenue mobilization of the government grew by 35.4% to Rs 33 billion compared to an increase of 13.2% in the corresponding period of the previous year. Such an impressive revenue mobilization was scribed on the high growth of income tax, VAT revenue, custom, excise, vehicle tax and registration fee as well as a high growth of non tax revenue.

Foreign Cash Loan and Grants:

The government received foreign cash loan of Rs 1.2 billion and foreign cash grants of Rs 3.4 billion in the first four months of 2008/09. The government had received foreign cash grants of Rs 2.3 billion in the corresponding period of the previous year.

Foreign Trade:

Exports soared by 39.9% in the first four months of 2008/09 in contrast to a decline by 3.3 % in the corresponding period of the previous year. The rise of exports to India was attributed to the upsurge in the exports of readymade garments, shoes and sandals, G.I pipe, toothpaste and copper wire rod. Similarly the rise the exports to other countries can be attributed to the increase in the exports of pulses, woolen carpets pashmina, readymade garments and herbs.

In the first four months of 2008/09 total **imports** rose by 38.9% compared to a lower increase of 6.3% in the corresponding period of the previous year. An increase in the imports of petroleum products, vehicles, spare parts, machinery parts etc. Gold, Ms Billet, Other machinery parts, electrical goods, computer and parts etc from other countries were responsible for a significant growth of total imports in first four months of 2008/09.

Balance of Payments:

In the first four months of 2008/09 the overall BOP recorded surplus of Rs 11.9 billion in contrast to a deficit of Rs 3.6 billion in the corresponding period of the previous year.

Foreign Exchange Reserves:

In mid Nov 2008, the gross foreign exchange reserves stood at Rs 231.3 billion an increment of 8.8 % compared to the level as at Mid July 2008. Such reserves had fallen by 1.2% in the corresponding of the preceding year.

Price of Oil and Gold in the International Market and Exchange Rate Movement:

The price of oil (crude oil Brent) in the international market plummeted by 39.0% to US \$ 57.04 per barrel in Mid Nov 2008 from US\$ 93.53 per barrel in Mid Nov 2007. Likewise the price of gold fell by 5.3% to US\$ 747.50 per ounce in Mid Nov 2008 from US \$ 789.75 per ounce a year earlier.

Compared to Mid July 2008, the Nepalese currency vis-à-vis the US dollar depreciated by 12.96% in the Mid Nov 2008. It had appreciated by 2.85 percent in the corresponding

period of the previous year. The exchange rate of One US Dollar stood at Rs 78.70 in Mid Nov 2008 compared to Rs 68.50 in Mid July 2008.

Table 4.5
Macro Economics Indicators of
First Four Months of 2008/09 can be Presented Below:

Descriptions	Year 2007/08(% of increment/decrement)	Year 2008/09(% of increment/decrement)
Broad Money(M2)	7.3	6.3
Narrow Money(M1)	3.7	3.1
Time Deposits	8.9	8.5
Net Foreign Assets(NFA)	6.9 (Rs 11.9 billion)	4.2 (Rs 3.6 billion)
Domestic Credit	8.1	6.5
Private Sector Credit	8.3	9.4
Claim on Non Fin govern Enterprises	9.6 (Rs 490.5 million)	14.9 (Rs 843.7 million)
Deposit mobilization of Commercial Banks	-	6 (Rs 448.4 billion)
Liquid Fund	2.1	12.1
Commercial bank balance with NRB	13.1	15.3
Net liquidity	Rs 20.6 billion	Rs 42.2 billion
Net purchasing	321.5 million US \$	569.6 million US &
Tot No. of company listed at NEPSE	141	144
Consumer price index	6.3	14.5 at Nov
Price Inflation:	8.4	17
Food & beverages		
Non food & services	4.1	11.7
Sugar & Sugar related	18	37.6
Oil & ghee sub groups	14.8	31.6
Grains & Cereal products	11.4	19.1
Rice & Rice products	13.00	22.3
Pulses, restaurant meals, meat, fish eggs, milk & milk products, beverages & spices	14.1, 4.5, 7, 5.8, 0.7, 3.3	26, 22, 20.1, 17.1, 12.5, 11.5
Salary & wage rate	10.1	10
Wages of agricultural,	6.8, 14.6, 10.3	20.2, 2.5, 15.2

industrial & construction		
Budget/Deficit Surplus	Deficit Rs 7.4 billion	Surplus of 1.3 billion
Total government expenditure	34.5	7.3 (Rs 37.1)
Recurrent expenditure	26.1	2.5 (Rs 23.8 billion)
Government Revenue: Revenue	13.2	35.4 (Rs 33 billion)
VAT revenue	13.4	31.2 (Rs 12 billion)
Custom revenue	9.4	22.7 (Rs 7.2 billion)
Excise revenue	32.3	32.4 (Rs 4.2 billion)
Income tax revenue	15.4	25.9 (Rs 3.7 billion)
Foreign cash loans	Rs 1.4 billion	Rs 1.2 billion
Foreign cash grants	Rs 2.3 billion	Rs 3.4 billion
Foreign Trade: Exports	3.3	39.9
Imports	6.3	38.9
Balance of Payments	Deficit of Rs 3.6 billion	Surplus of 11.9
Foreign Exchange reserves	1.2	8.8 (Rs 231.3 billion)
Price of oil & gold: Crude Oil	(US \$ 93.53 per barrel)	39 (US \$ 57.04 per barrel in Nov)
Gold	(US \$ 789.75)	5.3 (US \$ 747.50 per ounce)
Nepalese currency vis a vis US\$	Appreciated 2.85 (US\$ 1=Rs 68.50)	Depreciated 12.9 (US \$ 1=Rs 78.70)

Source: NRB current Macroeconomic situation

4.5 Foreign Bank and Challenges to Emerging Market Supervisors:

During the course of negotiating for accession to WTO, Nepal made commitments for bank branches. However, three aspects are worth mentioning. First, there is a transition period where foreign bank branches are only allowed as of January 1, 2010. Second, entries of financial institutions are limited to a rating of at least “B” by Credit Rating Agency e. g. MOODI, Standard & Poor etc. Lastly, establishment of foreign bank branches are subject to the domestic laws, rules and regulation and terms and conditions of the Nepal Rastra Bank.

The increased presence of foreign banks in a country’s domestic banking system necessitates the development of effective cross-border prudential supervision where the

consolidated supervision is the essential element. It is said that the presence of foreign-owned banks grows, the complexity of the tasks facing supervisory authorities increases. The challenges for emerging market supervision include;

- (i) Choosing of licensing policy and fitness and propriety test for management and owners of a complex holding company or investment funds;
- (ii) Effectively monitoring the local establishment of large international banks of complex financial institutions;
- (iii) Upgrading their supervisory capacity to oversee complex financial products of foreign banks;
- (iv) Dealing with the issue of the parent bank support in case of difficulties of a branch or subsidiary in normal as parent bank support in case of difficulties of a branch or subsidiary in normal as well as systemic crisis situations;
- (v) Handling consolidated supervision in the event the market is heavily dependent on foreign banks;
- (vi) More effective exchange of information with the home supervisors in the case of bank holding companies or other complex financial institutions;
- (vii) Dealing with increasing concentration in the banking system by foreign banks; and
- (viii) Improving the governance structure of complex international banking groups while, among other things enhancing the integrity standards in the financial markets.

These challenges should be resolved through more enhanced cooperation between home and host country supervisory authorities, as well as development of additional international best practices.

4.6 Analysis of Nepalese Monetary Policy and Financial Stability:

Financial stability refers the stable situation of financial system. A financial crisis is a disruption to financial market. There are many factors that can trigger financial instability in the economy such as; decline in asset price (used for collateral). Heavy inflow of short-term capital, unanticipated depreciation of appreciation of exchange rate, pegged

exchange rate system, increase in interest rate, stock market crash, liquidity mismatch, currency mismatch heavy lending to real estate business, explicit and implicit government guarantee on loan flow, weak supervisory and regulatory measures.

Financial stability has emerged as one of the objectives of monetary policy recently after the various financial crises observed in many countries, for example Mexico 1994-1997, East Asia 1997, Russia 1998-1999 and Argentina 1999, Monetary policy and financial stability are interlinked to each other,. However there is still no clear consensus on how one affects the other i.e. trade off or synergies between them. The main job of the financial system is to channel funds from surplus units or savers to investors (deficit units), i.e. intermediation function, there by facilitating economic growth. However, it is the financial market where asymmetric information leads to two basic problems: adverse selection and moral hazard. Hence it is more prone to crisis due to imperfectness of this market. Monetary policy has nexus with financial system through different channels. First, monetary policy of the central bank regulated money stock in the economy, while the financial sector performs intermediary function by doing business in money. Second, central bank has authority of formulating and implementing monetary policy. This has the implications in monetary policy operation. Third, since monetary policy transmitted through financial system there should be sound financial sector for the effective transmission of monetary policy. Fourth, if monetary policy is too lax, inflation may increase and become more volatile. It redistributes real wealth from lenders to borrowers. And on the other hand, very tight monetary policy leads to very low inflation level. Fifth, financial instability can lead to in-efficient resources allocation, as well as major economic and social disruption in the economy.

Monetary policy, by credibly maintaining price stability, can provide the economy with and environment of predictable interest rate. This would lower the interest rate risk in the economy and helpful to attain financial stability. There can be financial instability even incase of price stability like in Japan in the 1990s. So, the monetary policy needs to be cautious enough about the development in financial system even in case of price stability in the economy. Another way to maintaining financial stability by monetary policy is by lowering intermediation cost. A high intermediation cost would deteriorate the balance

sheet of financial institutions. In case of high intermediation cost due to high cash reserve ratio or statutory reserve ratio, interest rate on lending would be high which aggravates the adverse selection problem. At a higher interest rate, only riskier investors would come to borrow fund. Then, the probability of repayment would be lower. Hence, a higher interest rate leads to even greater adverse selection, increasing to likelihood of default. Third way through which monetary policy can maintain financial stability is through timely and appropriate management of liquidity in the banking system.

It is the liquidity that the financial system trades in the economy. Both excess and shortage of liquidity are inimical to financial health of financial sector. Monetary policy, by using open market operations (OMO), manages the liquidity in the financial system. Such a management of liquidity smoothes the payment system in the economy on the one hand and lowers the cost of excess liquidity holding in the financial system on the other hand.

As per NRB Act, 2002, monetary policy in Nepal has been conducted with a view of attaining price stability and a reasonable BOP surplus for the sustainable development of economy. At the same time, monetary policy has been helping maintain financial stability in the economy as well. Hence, Nepal has not experienced the financial crisis as observed in other countries as far, although maintaining financial stability is now challenging to the NRB in the context of growing financial instructions and due to become 147th member of WTO in the global village. As of mid-January 2007, there are almost 200 financial institutions all together in Nepal. The NRB has also taken over the management of few financial institutions recently, e.g. Lumbini Bank, Nepal Bangladesh Bank, United Development Bank. In the last one and a half decade, monetary policy in Nepal has lowered the cash reserve ratio (CRR) from 12 percent in 1990 to 5 percent (in 2004). Such a lowering of CRR has reduced the intermediation costs of the financial system and become supportive to have profitability in the financial system.

Moreover, there is also a decline in interest's rate in the economy, which is supportive to the financial stability. In addition, overall inflation is also on reasonable level, for example average inflation for last five years stood at 4.80 percent only. Monetary policy,

in recent years actively uses the open market operations for liquidity management. Based on the Liquidity Monitoring and Forecasting Framework (LMFF), OMOs are being conducted every week. Appropriate management of liquidity is very useful to maintain financial stability in the economy i.e. no liquidity overhang and no liquidity crunch. Moreover, coordinating OMOs with foreign exchange intervention is also helping to generate profitability in the banking system against the weak real sector due mainly to a decade long internal conflict (civil war) in the past few years. Against the low private sector credit off-take, managing liquidity of the financial system for monetary policy has been a tough job in the recent years.

A high level of non performing loans (NPL) in the Nepalese banking system, though it is declining, indicates the fragility of the Nepalese system. Even after a huge credit write off by government owned commercial banks (Rs. 27 Billion recently), NPL of Nepalese banking system stood at 10.50 percent as at mid January 2007. Weak real sector owing to non-economic factor is also posing threat to financial sector. Without the growth of real sector, the profitability of financial sector would be at risk in the long run. Adopting pegged exchange rate with Indian currency has also helped maintaining stability in the economy. Moreover, monetary policy in Nepal manages money supply on the basis of monetary aggregate targeting framework in line with the economic activities. In this way, monetary policy in Nepal is achieving financial stability in the economy so far.

The monetary policy for fiscal year 2007/08 (lastly announced) has focused on managing high liquidity and maintaining fiscal stability. It has also vowed to limit the inflation at 5.5 percent and achieve surplus balance of payment of at least rupees eight billion during this fiscal year. To strengthen institutional investment to the deprived sector, the policy has raised single borrower limit for micro finance institutions to rupees 60,000 for individuals and rupees 150,000 for micro enterprises. In the same manner, now onward commercial banks are required to extend three percent of their total loan investments for deprived sector. There will be no need of 20 percent additional loan loss provision on the loans extended to the deprived sector. The policy has also announced that commercial banks dealing with such loans are not allowed to charge an interest rate of more than 4.5 percent. Likewise, in order to check possible misuse of short-term loans being provided to

development banks and finance companies by commercial bank, the NRB has raised penal interest on such loans.

4.7 Financial Sector Growth in Nepal:

The banking habit expanded banks were able to mobilize increased proportion of private savings and direct them for investment in newer forms of activities\}. Between 1960 and 1970, both deposits with the banking system and total credit expanded rapidly. NRB started its intervention in the credit market for the first time in 1966. In early years, interest rates were used primarily as instrument for mobilization of financial resources and directing credit to specific activities, in 1975, the interest rates were drastically revised upwards with the objective of monetary management.

Table 4.6
Selected Indicators of Financial Sector Growth

Description	1975	1980	1985	1990	1995	1999	2008	2009	2010
Population (in Million)	12.90	14.60	16.30	18.10	20.30	22.40	22.90	25.87	26.45(as 2.25% growth rate)
Overall Financial Sector:									
Total Financial Assets (Rs. in Million)	2322	5594	13011	32426	109597	230238	277281	364824	395320.6
Total Financial Assets GDP (%)	14.00	24.00	29.30	32.50	52.20	69.80	75.90	71.5	75.6
Commercial Banking									
Total Bank Branches Number	216	241	380	442	444	481	478	390	552
Propn./Comm. Bank Branch (in '000)	59.58	60.58	42.89	40.95	45.72	46.57	47.91	63.33	47.91
Deposit (RS. in Million)	1166	2330	8536	21885	61046	125834	154530	289975.9	334453.3
Credit (Rs. in Million)	1222	2798	5489	15335	46915	103845	118008	322683.8	360558.1
Bank Assets(in million)	2006	4542	10535	26854	83971	172458	210894	395965.1	439735.4
Bank Asset/ GDP (%)	12.10	19.50	23.70	26.90	40.00	52.30	57.70	77.7%	84.1%
Deposit/ GDP (%)	7.00	10.00	19.20	22.00	29.10	38.40	42.30	36.2	37.3
Credit/GDP (%)	104.80	120.40	64.30	70.10	76.90	78.30	76.40	49.9	62.3
Pvt. Sec. Credit/Total Credit (%)	64.10	68.50	73.50	76.20	89.40	91.40	92.70	37.7	38.0
Financial Deepening									
Money (M1)/GDP (%)	8.10	12.10	12.30	14.30	15.70	15.50	16.70	17.5	17.6
Broad Money (M2)/GDP (%)	12.40	22.60	27.70	31.60	38.60	46.30	50.90	53.6	54.9

1. Deposit exclude inter-bank deposit and government deposits, but includes foreign deposits.
2. Credit excludes both investment in Government securities and includes foreign bills purchased and discounted.

2010(Macro economics indicators of Nepal)

(Source: Acharya and Khatiwada, 2003)

The above table reflects the holistic overview of financial sector development since 1975 to 2007. The ratio of all financial assets to gross domestic product indicates financial deepening in the economy. Total financial assets as of mid July 2010 estimated at more than Rs. 395320.6 million, which is accounted for nearly 75.6 percent of GDP. The ratio was 32 percent in 1990 and 29 percent in 1985, the year when the door for foreign participation in banking industry was opened. These figures indicates role of financial sector in the Nepalese economy.

The commercial bank deposit and credit ration to GDP measure the importance of the banking system in the economic activities of the country. The deposit/GDP ratio surged up to 37.3 percent as of mid July 2010, which was only 10 percent in 1980 and 22 percent in 1990. The growth in credit/GDP ratio has been slower. This ratio reached 62.3 percent in 2007 from 12 percent in 1980 and 70 percent in 1990. Comparing the growth during 1980s and 1990s, it is clearly seen that, while GDP ratio was much faster during the nineties. Increasing credit to GDP ratio indicates that the role of credit is expanding fast as a source of funding for economic activities in the country. This is quite in consonance with the increasing role of non-agricultural sector in the economy, which depends more on bank credit than agriculture in developing countries.

The ratio of private sector credit to total credit indicates the degree of privatization of organized sector economic activities. In recent years, almost total bank credit has been channeled to the private sector indicating an increasing privatization of the economy. During the 1980s, about one third of the bank credit had gone to the government sector. Overdue loans and inefficiency had been aggravated in the 1990s. The older and larger of the commercial banks with their wide rural network have been made to compete with the

new trim banks with no rural operations. On the one hand, it has allowed the new banks to make huge profits as their operating costs are much lower than that of the older banks are eroding faster as all their lucrative business such as low cost donor transactions and export financing have been cornered by the private sector banks while high cost rural operations remain with them. Financial liberalization process, it seems should have been preceded by a thorough overhauling of the older banks and decision to infuse private sector capital and management in the same. The two older banks have a high proportion of non performing loans, which was around 18 percent of the total loans in 2000 (Article IV Consultation report of IMF, 2001).

Since after the management of two government banks are undertaken by the foreign company, bad loans have been recovered and profit, bonus has been shared by the employees of the two banks. The commercial banks, domestic or joint venture, have shown little innovation and positive attitude in identifying new areas of savings and investment opportunities. They have rather preferred to cater the traditional larger urban savers and invest in safe and gilt-edge government securities and treasury bills. This kind of investments involves no additional administrative cost and is easily convertible in ready cash in the secondary window operated by NRB. With above reference some other relevant indicators relating to Nepalese financial system are presented in the annexure 2

4.7.1 Socio-Economic Indicators and Distribution of Financial Institutions:

Despite the financial reforms measures introduced in the country, the level of financial development indicates that it is still beyond the access of the people of the backward regions. Regions they are far behind in a number of dimensions of economic development are under-banked. The indicators explaining the level of financial access: population per branch of commercial bank or population per financial institution, are showing that there are relatively under h an ked regions in the country. This table 4.6, shows that population per branch of commercial bank is very high in both Mid-Western and Far-Western Development regions compared to other Development Regions in the country. It also clears that financial widening is very low in Mid-Western and Far-Western Development Regions compared to other Regions.

Financial access to poor and backward regions is a challenge for the Nepalese financial system that is expanding over the years. This is also highlighted by the recent World Bank Study (Access to Financial Services in Nepal: 2007) the study mentions access to financial services remains limited for many people in many parts of Nepal and in recent years has been declining. Despite government efforts access to formal financial services is declining. While the banks serve mainly the urban areas and the wealthiest, rural area and poor section of the society largely depends upon informal sources of financing.

Table 4.7

Socio-Economic Indicators and Regional Distribution of Financial Institutions

Indicators	Eastern	Central	Western	Mid-Western	Far Western	Total
Population/Branch of Commercial Banks	58098	38592	53151	87330	99235	52030
Population/Total No of Financial Institution	47629	24886	39748	61528	77971	36732
Poverty Incidence	29.3%	27.1%	27.1%	44.8%	41.0%	30.8%
Secondary School Net Enrollment	28.4%	28.4%	28.0%	16.0%	15.4%	25.5%
Literacy Rate	55.7%	52.9%	59.3%	49.4%	48.7%	54.1%

(Source: Central Bureau of Statistic, 2010)

In the table, some indicators of socio-economic development are compared with the population per branch of commercial bank since these banks have the largest share in the total financial system of the country. But a comparison is also made taking the number of all the financial institutions into account. Even from this perspective, there is a limited access of financial services to the people in the backward regions. Regions that are behind in the dimensions of economic development such as poverty and secondary school enrollment do also have limited access to financial services. The two poorest regions: Mid-western and Far Western as shown by the poverty incidence are significantly behind in access to financial services. This suggests that socio-economic development and

financial outreach are correlated. Thus, there is a need of regulatory reform to assist the process of socio-economic development of the country through financial inclusion.

4.8 Overview of Nepalese Economy:

Nepal's financial system has witnessed numerical strength as well as operational growth over the years. Even in a period of political transition, and the related disturbances the ranges of service delivery and its competitive ness character have changed for the better benefiting the service seekers and the economy as a whole. The static published by Nepal Rastra Bank exhibit large expansion in different monetary aggregates in FY 2009/10. The broad money which has increased by 14 percent in FY 2008/09 oversaw a growth of 25.2 percent in FY 2009/10. Similarly, the narrow money which had recorded an increment of 12.2 percent in FY 2008/09 rose by 21.6 %. Time deposit which had increased by 14.9 % in FY 2008/09 rose by 27%. Domestic credit of the banking system went up by 20 % in comparison to the rise of 16.7% in FY 2008/09. Credit of private sector which had recorded an increment of 18.8% in FY 2008/09 grew by 22.9%. The share of private sector in the total outstanding credit reached 78.7% from 76.9 % in FY 2008/09.

Some of the important economic indicators are presented in this table;

Table 4.8
Some Important Macro-Economic Indicators
As % of Gross Domestic Product (Nominal GDP at Producers Price)

Description	(2005/06)	(2006/07)	(2007/08)	(2008/09)	(2009/010)
Total Consumption	91.4	88.3	88.4	92.1	90.6
Total Investment	21.4	24.5	26.5	26	25.03
Gross National Saving	23.8	27.3	28.4	28.2	28.6
Gross Domestic Saving	8.6	11.7	11.6	7.9	9.4
Gross Fixed Capital Formation	19.9	20.3	19.9	20.9	20.3
Gross National Disposable Income	115.2	115.5	116.9	120.3	119.2
Money Supply(M1)	17.0	17.5	17.0	17.5	17.6

Broad Money(M2)	50	51.7	51	53.6	54.9
Domestic Credit	45.5	45.9	47.5	49.9	62.3
Domestic Credit to Private sector	30.7	32.1	33.4	37.7	38.0
Time Deposit	32.9	34.2	34.0	36.2	37.3
Total Exports	10.1	10	10	9.3	8.5
Total Imports	25.3	25.4	25.4	26.9	26.6
Trade balance	-15.1	-15.3	-15.4	-17.6	-18.2
Current account balance	2.4	2.7	2	2.2	.5
Gross Forex Reserves	22	24.3	22	25.5	22.9
Government revenue	11.4	11.6	11.9	11.2	12.2
Government Tax revenue	8.7	9	9.2	8.9	9.9
Government Expenditure	17.1	16.7	17.4	17.2	18.3
Government Budgetary Deficit	3.3	2.9	3.1	3.8	4.1
Gross Domestic Borrowing	1.8	1	1.5	1.8	2.5
Net Domestic Borrowing	1.07	0.07	0.49	0.69	1.15
Per Capita GDP US\$	261	293	328	350	383
Per Capita GNI US\$	301	339	383	420	456

(Source: Central Bureau of Statistics and Nepal Rastra Bank)

From the above table, all economic development indicators are moving in the same direction that means the ratio of investment to GDP increased to 24.5 percent from 21.4 percent in fiscal year 2006/07 and increased to 26.5 percent in the following year and decreased in the last years 2009/10 by 25.3 percent. In the same manner per capita income as per GNP or as per GDP increased in fiscal year 2006/07 compared to previous year and started to increase in coming years. It clearly advises that there is positive correlation between investment to GDP ratio and per capita income. Ratio of gross domestic saving to GDP in the fiscal year 8.6 percent in fiscal year 2005/06 and increased to 11.7% and 11.6% in 2006/07, 2007/08 and increased to 9.4% in 2008/09 compared to 7.9% decreased in previous year 2009/10.

The above table and analysis reflects that the economic indicators are stronger in the second two fiscal years 2006/07, 2007/08 rather than in the fourth one 2008/09. The process of recouping economic strength has been started in the fiscal year 2008/09. All the macro economic indicators decreased in the fiscal year 2006/07 and it reflects that the national economy had been victimized by the national issue.

Various researches advise that Nepalese economy has lost economic growth due to civil war, Maoist insurgency and different coalition groups in the terai(Madhesis). Total investment remained increased at 2007/08, 2008/09 at 26.5%, 26% respectively. Increment in investment shows a bit economic growth but decline with 25.3% in 2009/10 shows an economic deepening. Without investment and increment in saving with 28.4%, 28.2%, 28.6% in the year 2007/08, 2008/09, 2009/10 economic growth is not possible in the country. With an increment in domestic credit by 45.5%, 45.9%, 47.5%, 49.9% and 62.3% in 2005/06 to 2009/10 and credit to private sector by 32.1%, 33.4%, 37.7%, 38.0% in 2006/07, 2007/08, 2008/09, 2009/10 showed a bit privatization and establishment of industrialization but the un recovered loans often affected the banking sector. Even though, the banking sector growth in Nepal shows positive indications. Total exports decreased by 9.3%, 8.5%, on 2008/09, 2009/10 shows a deepening of country economy and even clearly express the economic recession by the increments of imports by 25.4%, 26.9%, 26.6% on year 2007/08, 2008/09, 2009/10 respectively. Besides above indicators global economic recession has shown some impacts in Nepalese market. Banking, financial sector shows the positive indicators and the remittances has contributed the increment of GDP so far. Even still with the closure of industries in Terai by different coalition groups and load shedding had badly affected industrial sector resulting worse in the country economy.

A study conducted by ADB has predicted that Nepal will lose 8.3 percent in GDP growth in five years (New Business Age, February 2006:7) The study has found that the loss in GDP growth rate due to the conflict during the period 2001-2004 was 3 percent. It also says that the loss in the GDP growth will be higher in the later years than in earlier years due to the cumulative effect of reduction in the development expenditure in the earlier years.

4.9 Relationship between Financial Development and Economic Growth:

In examining the level of financial development in Nepal, one needs to rely on monetary survey (monetary authorities and commercial banks). Lack of access to complete set of time series data has forced this study to focus on banking system indicators only. DEPTH, the first measure, equals broad money (M2) divided by GDP and it measures the size of financial intermediaries. Broad money (M2) plus time deposit of the banking system represents the liquid liabilities in the financial system. Broad money to GDP ratio, a typical measure of financial depth captures both monetization and penetration of the banking system in mobilization savings. Over the period 1975-2010, broad money as a percentage of GDP increased from 12.4 percent to 60.32 percent, indicating that the overall size of the financial intermediary as well as monetization of the economy is deepening. However, this may not accurately reflect the provision of financial services in the economy. BANK measures the degree to which commercial banks versus central bank are allocating credit in the economy. During the sample period, BANK increased from 57.1 percent in 1975 to 97.21 percent in 2010.

The increasing trend of this ratio implies that commercial banks are more likely to provide financial functions of saving mobilization, resources allocation, exerting corporate control, managing risk and facilitating the trading of goods and services than the central bank. However, this ratio has some weakness because commercial banks may not be the only financial intermediaries in providing efficient financial functions in the system and they may also lend to the government or government owned enterprises. PRIVATE measures more accurately the role of financial intermediaries in channeling funds to the private sector and, therefore, it is favored as a preferred measure of financial development. PRIVATE showed an upward trend, with the ratio reaching 69.99 percent in 2007 from 40.3 percent in 1975. PRIVY, the fourth measure, partially accommodates concerns about the allocation of credit to private sector. During the period, credit to private sector as a percentage of GDP rose from 4.7 percent in 1975 to 38.41 percent in 2007. These four indicators of financial development were widely recognized. Some early researches also focused on using narrow money (M1) to GDP ratio as an indicator of

financial development. M1/GDP ratio increased from 8.1 percent in 1975 to 22.67 percent in 2010. This ratio indicates the degree of monetization. The indicators based on monetary aggregates advocates the ability of the financial system to provide transaction services.

In a country like Nepal where the economy is not fully monetized, board money to GDP ratio does matter in measuring the level of financial development. Among all these measures, credit issued to private sector is considered to be the most important indicator of financial development from economic development perspective. Increased credit to private sector leads to promote economic activities. Productive firms and enterprises used to access bank credits only where they have profitable investment opportunities in hand. Private sector can make the best use of credits it obtains from hanks and financial intermediaries. A high ratio of private sector credits to total credit indicates that hanks are able to channel their loan able funds in more productive ways. Over the period covering 1975 through 2010, commercial banks' credit to private sector as a percentage of total credit increased from 57.6 percent to 77.82 percent. This indicates that the major portion of commercial banks' credit portfolio is being utilized in extending credit to private sector. The indicators DEPTH and PRIVY are averaged to yield an index called FINDEX, which measures the significance of the banking sector in our sample period. This indicator has been used in studying the effect of the financial sector on the growth of the economy (Kunt and Maskimovic, 1996:351)

Table 4.9

Indicators of Financial Intermediary Development in Nepal, 1975-2010

Mid July	DEPTH	BANK	PRIVATE	PRIVY	M1/GDP	Pvt./Total	FINDEX
1975	12.40%	57.10%	40.30%	4.60%	8.10%	57.60%	8.50%
1976	14.50%	63.90%	35.30%	4.10%	8.401%	52.90%	9.30%

1977	18.70%	69.10%	36.10%	5.00%	10.70%	48.80%	11.80%
1978	19.10%	61.30%	33.30%	5.40%	10.40%	50.00%	12.30%
1979	17.30%	62.50%	33.60%	5.10%	9.60%	50.30%	11.20%
1980	22.60%	63.90%	40.80%	8.20%	12.10%	58.90%	15.40%
1981	24.70%	66.10%	45.60%	9.80%	12.60%	62.10%	17.20%
1982	24.10%	66.20%	42.30%	8.50%	11.70%	61.00%	16.30%
1983	27.30%	58.60%	30.90%	8.00%	12.90%	51.10%	17.60%
1984	26.60%	56.40%	31.50%	8.10%	12.60%	53.40%	17.30%
1985	26.40%	56.30%	31.20%	8.70%	11.80%	51.60%	17.50%
1986	27.20%	55.30%	32.80%	9.30%	12.60%	53.40%	17.30%
1987	27.40%	57.10%	34.30%	9.80%	12.70%	57.00%	18.60%
1988	27.90%	62.60%	39.10%	10.80%	12.50%	58.70%	19.30%
1989	29.80%	63.30%	38.20%	11.60%	13.20%	58.40%	20.70%
1990	30.50%	62.00%	38.40%	11.30%	13.80%	60.90%	20.90%
1991	31.30%	68.50%	39.60%	11.70%	13.50%	55.50%	21.50%
1992	30.60%	73.70%	41.60%	12.10%	13.00%	54.80%	21.30%
1993	34.00%	71.00%	42.00%	12.60%	13.90%	57.60%	23.30%
1994	35.00%	73.40%	50.10%	15.20%	14.30%	67.00%	25.10%
1995	36.90%	74.90%	57.40%	19.60%	15.00%	75.40%	28.30%
1996	37.20%	75.10%	60.70%	22.30%	14.70%	79.10%	29.80%
1997	37.00%	75.90%	62.50%	23.10%	13.70%	80.50%	30.00%
1998	42.00%	79.10%	64.80%	25.50%	15.00%	80.60%	33.80%
1999	44.70%	81.40%	66.00%	26.50%	14.90%	79.90%	35.60%

2000	49.00%	84.80%	68.20%	28.80%	16.10%	78.80%	38.90%
2001	52.20%	84.80%	66.80%	30.90%	17.20%	76.70%	41.50%
2002	53.00%	82.70%	63.90%	31.60%	18.30%	75.10%	42.30%
2003	54.10%	87.40%	65.60%	33.20%	18.40%	73.40%	43.60%
2004	56.40%	92.60%	68.30%	32.10%	19.10%	72.70%	44.30%
2005	57.29%	93.45%	69.77%	33.97%	19.97%	73.80%	45.63%
2006	58.60%	94.67%	65.89%	35.67%	21.38%	75.29%	47.13%
2007	60.32%	97.21%	69.99%	38.40%	22.67%	77.82%	49.36%
2008	60.48	97.98	70.55	38.60	22.95	77.98	49.70
2009	60.92	98.20	70.95	38.90	23.10	78.20	49.95
2010	61.20	98.30	71.25	39.25	23.65	78.85	50.25

Where,

FINDEX-averages the ratio of broad money to GDP (DEPTH) and the ratio of commercial banks credit to private sector to GDP (PRIVY).

DEPTH –Liquid Liabilities to GDP (M2/GDP)

BANK- Bank credit divided by bank credit plus central bank domestic credit

PRIVATE –Credit allocated to private sector to total domestic credit (excluding credit to banks)

PRIVY –Commercial banks' credit to private sector divided by GDP.

Pvt. /Total- The ratio of private sector credit to total credit issued by commercial banks.

A flourishing body of empirical work aiming at testing the positive relationship between financial development and economic growth find that financial development indicators explain a significant portion of economic development. Different models are based on regression analysis. The basic model proposed by Khan and Senhadji (2000) has the following from:

$$Y = B_0 + B_1 FDi + B_2 X_1 + e_i$$

Where Y is the rate of growth of country, FDi is an indicator of financial depth. S_1 is a set of control variables and e_1 is the error term. A similar model described by Levine et al. (1999) takes the following form:

$$GROWTH = a + B_{FINANCE} + Y(conditioning\ set) + e_i$$

Where the dependent variable, $GROWTH$, equals real per capita GDP growth $FINANCE$ equals indicators of financial intermediary development $CONDITIONING\ SET$ represents a vector of conditioning information that controls for other factors associated with economic growth and e_1 is the error term

The case of developed countries is quite different and this indicator ($FINDEX$) appears to be above 100 percent. In many developing countries banks are the significant financial intermediaries and this situation equally prevails in the context of Nepal. Over the sample period 1975 to 2010, the trend of $FINDEX$ is increasing and it goes up from 8.5 percent in 1975 to 49.36 percent in 2010. With these few observations it can be revealed that the direction of financial development in the Nepalese context shows the right and positive track. However, the level of financial development is much more below as against that of other developed economies. In the following sections, we will try to explore the effect of financial development on economic growth based on some of the models previously applied by different authors in their respective studies.

The effect of financial development indicators on economic growth in Nepal is examined through the estimation of the ordinary least square (OLS). The sample range of the estimated equation 1975-2010 and most of the data in this study are taken from the publications of the NRB and government of Nepal. The regression equation is specified as:

$$Y = a + BFD + u$$

Where, Y is the economic growth indicator (dependent variable),
 FD is the financial development indicator and
 U is the error term.

However, this linear function has the chance of non-stationary of the variables. Hence, the equation is converted into the log-linear form so that the slope coefficients indicate the constant percentage changes in dependent variables as a result of a one percent changes in independent variable. We obtain the following log linear equation assuming that the error term, u , tends to zero.

In $Y = a + B$ in FD

Real GDP (RGDP), nominal GDP (NGDP), per capital real GDP and per capita nominal GDP have been used as the economic development indicators or the dependent variables in the model. The financial development indicators or the independent variables include narrow money (M1), board money (M2), commercial banks total credit and commercial banks' credit to private sector. A priori or the theoretical expectation is that the level of economic development as measured by different growth indicators is explained by financial development indicators. The statistical results of the regression equations are summarized in the table 4.8 below.

Table 4.10
Complicated Regression Result

Dependent Variables: In RGDP						
Eqn	Independent Variable	Constant	slope	r	r²	Adjusted r²
1	In M1	9.3137 (203.5859)	0.2855 59.3012*	0.9960	0.9921	0.9918
2	In M2	9.4265 (208.8026)	0.2513 (57.6196)	0.9958	0.9916	0.9913
3	In (total credit to com/ Bank)	9.7026 (269.2898)	0.2340 (62.5054)	0.9967	0.9933	0.9931
4	In(Credit to pvt)	9.9934	0.2151	0.9963	0.9926	0.9924

	sector Com bank)					
		(300.8745)	(61.4832)			
Dependent Variable NGDP						
5	In M1	3.3565	0.8589	0.9977	0.9954	0.9952
		(31.8650)	(77.4832)*			
6	In M2	3.7018	0.7555	0.9967	0.9934	0.9931
		(30.6555)	(64.7575)*			
7	In(Total credit to com/bank)	4.5464	0.7030	0.9970	0.9939	0.9937
		(44.0242)	(67.6411)*			
8	In(Credit to pvt sect.com.bank)	5.4160	0.6455	0.9955	0.9911	0.9908
		(49.3057)	(55.7953)			
Dependent Variable: In (per capita GDP)						
9	In M1	5.8253	0.1416	0.9823	0.9650	0.9637
		(49.1334)	(27.7774)*			
10	In M2	6.1188	0.1245	0.9810	0.9623	0.9609
		(54.5162)	(26.7324)*			
11	In(Tot Cred to com/bank)	6.3732	0.1160	0.9828	0.9658	0.9646
		(65.2509)	(28.1195)*			
12	In(cred to pvt sect com/bank)	6.6405	0.1068	0.9843	0.9689	0.9678
		(79.0891)	(29.5369)*			
Dependent Variable: In (Per capita NGDP)						
13	In M1	-8.0535	0.7150	0.9959	0.9918	0.9915

		(-28.1891)	(58.2164)*			
14	In M2	-6.5716	0.6287	0.9945	0.9891	0.9887
		(-21.8225)	(50.3184)*			
15	In(Tot cred to com/bank)	-5.2664	0.5850	0.9949	0.9898	0.9894
		(-19.7845)	(52.0328)*			
16	In(cred to pvt sect com/bank)	-3.8830	0.5372	0.9936	0.9873	0.9868
		(-14.5107)	(46.6024)*			

* Indicates Statistical significance at 0.1 percent.

Figures in parentheses are t-values

Number of observations are 30.

Calculated from annexure 3 and 4, as per annexure 5.

In establishing the relationship between per capita real GDP, the third indicator of economic development, and other financial development indicators it has been found that the slope coefficients are in the range of 0.11 to 0.14. Hence, a one percent increase in these financial development indicators will cause real per capita GDP to grow by 0.11 to 0.14 percent. M1 appears to have the largest slope coefficient of 0.14 as compared to that of other financial development indicators. In regression model, the fourth indicator of economic development is per capital nominal GDP. M1, the first indicator of financial development, has an estimated slope coefficient of 0.72. Hence a one percent increase in M1 will cause per capita nominal GDP to increase by 0.72 percent. The slope coefficient of 0.63 associated with M2 implies that per capita nominal GDP will go up by 0.63 if M2 increases by one percent. Similarly, total credit and credit to private sector issued by commercial banks have estimated slope coefficients of 0.59 and 0.53, implying that a one percent increase in commercial banks' credit caused per capita nominal GDP to increase by more than a half percent.

Both the coefficient of determination (r^2) and the unbiased coefficient of determination (Adjusted r^2) are reasonably high and remain in the range of 0.95 to 0.99. The coefficient

of determination measures the overall goodness of fit of the estimated regression model. It shows that more than 95 percent of the variation in economic development indicators (dependent variables) has been explained by financial development indicators (independent variables). Though, r^2 or adjusted r^2 is a meaningful measure of the extent to which the variation in one variable determines the variation in the other, this criterion should not be overemphasized. In explaining the parameters we cannot attach any economic meaning of the intercept. However, the signs of the slope coefficients are in accordance with the theoretical or prior expectation.

The slope coefficients measure the percentage change in dependent variable with respect to given change in independent variable. Examining the results we observe that the slope coefficient in each of the equations is positive. One interesting thing to be examined here is whether the slope coefficients on independent variable are zero. Do the results conclude that there is relationship between financial development indicators and economic development indicators? A one-tailed test can be carried out to test the significance of the slope coefficients. The null hypothesis can be postulated that financial development indicators provide no information on economic development ($H_0=0$). The alternative hypothesis is that financial development indicators provide information on economic development ($H_1>0$). Applying t-test, the calculated t-values are found to be more than the tabulated value of t-statistic at 0.1 percent level of significance ($t_{0.001} = 3.408$ for 28 d. f.) Therefore, the t-static's for the slope coefficients are statistically significant. We may reject the null hypothesis in favor of the alternative hypothesis and it can be said that independent variables add significantly to the predictive power of the model.

From these results it is seen that the slope coefficients are positive, implying that for a constant percentage increase in the financial development indicators. The economic development indicators increase by some positive values. Real GDP has been chosen as the first indicator of economic development. M1, the independent variable, has an estimated slope coefficient of 0.29, which indicates that a one percent increase in M1 is associated with 0.29 percent increase in real GDP. Similarly M2 has a coefficient of 0.25, indicating that with a one percent increase in M2, real GDP, on the average, increases by 0.25 percent. Total credit and credit to private sector issued by commercial banks have

beta values of 0.23 and 0.21 respectively. If the total credit and private sector credit issued by commercial banks increase by, say one percent, real GDP will increase by 0.23 percent and 0.21 percent respectively. Nominal GDP has been introduced as the second indicator of economic development. Nominal GDP will increase by about 0.86 percent if M1 increases by 1 percent. M2 has an estimated coefficient of 0.76 percent. Compared to that of the slope coefficients of monetary aggregates, total credit and private sector credit issued by commercial banks have relatively smaller slope coefficients of 0.70 and 0.65 respectively.

4.10 Critical Review of Regulatory Role of NRB:

Nepal Rastra Bank Act, 2002 has given full authority to the Nepal Rastra Bank regarding regulation, inspection and supervision of the banks and financial institutions. Bank and Financial Institution Ordinance, 2060, which is popularly known as Umbrella Act, has been enacted in unified form. Agricultural Development Bank Act 1967, Commercial Bank Act 1974, Finance Company Act 1986, Nepal Industrial Development Corporation Act, 1901 and Development Bank Act 1996 have been repealed with the promulgation of this ordinance. The critical review of regulation, inspection and supervision roles of NRB has been analyzed as follows:

4.10.1 Existing Supervision Relating to the Banking Sector:

Promotion of financial stability, development of safe and efficient payment systems, regulation and supervision of banking and financial system and the promotion of healthy and competitive financial system are some of the objectives of functioning of Nepal Rastra Bank. To attain the above objectives Section 84 of the Nepal Rastra Bank Act 2002 has entrusted Nepal Rastra Bank with the necessary powers to perform inspection and examination of any commercial banks or obtain necessary information for the purpose of supervision of the commercial banks. Currently the Bank Supervision Department in Nepal Rastra Bank carries out the function of supervision of all commercial banks in Nepal. Since foreign banks have their presence only in the form of Joint Venture establishments – that is in collaboration with the local entrepreneurs – Nepal Rastra Bank supervises foreign establishments in the same manner as it supervises

other local banks. For the purpose of supervision, the department is required to prepare annual supervision plan for onsite examinations as well off site surveillance of the commercial banks. The same is to be approved by the Governor of the Bank. The Bank Supervision Department carries out both onsite examinations as well s off site surveillance of the commercial banks as per its annual supervision plan.

i. On Site Examination

The Bank Supervision Department can carry out onsite examination of commercial banks in Nepal by sending examination team to the commercial banks. Onsite examination can be corporate level inspection covering all aspects of functioning of commercial banks of can be targeted branch level inspection. The department also performs follow up of the earlier examination reports by visiting the branches to ensure necessary compliance of the NRB instructions. If information as to functioning of commercial banks against the interest of depositors' or some serious irregularity is received, the Department can perform special onsite examination in such cases. The Bank Supervision Department is required to carry out corporate level examination of all commercial banks at least once in a year as per its annual plan but the gap between two inspections at any time should not exceed two years. As per current policy of the Department, corporate examination of all commercial banks is carried out once in a year. For the guidance of the onsite examination, "On site inspection manual' is in force. On completion of the onsite examination examiners perform CAMELS rating of the bank which is exclusively used for the supervisory purpose and is not revealed to general public.

ii. Off Site Supervision

Off site supervision is a supplement to the onsite examination and s designed to act as an early warning system to identify banks with potential problems so that appropriate policies and action can be determined. Off site division of the bank Supervision Department is carried out in quarterly frequency as well as annual off site review based on the reports and returns submitted by the commercial banks quarterly off site review. Off site division reviews performance of all commercial banks of quarterly basis which is submitted to the Governor of Nepal Rastra Bank. Such review involves assessment of the financial information as well as compliance of applicable rules regulations and legal

provisions including NRB directives. Based on the review internal rating which is called CAMELS Off Rating (COR) is assigned to the banks.

iii. Annual Balance Sheet Review

The Department's off site division reviews the balance sheet of the commercial banks at the end of each financial year and issues necessary instructions based on such review; this is then published in their annual report. In the course of such review the auditor's report, audited financial statements, long form audit report preliminary, audit report and banks reply thereon are studied. For the guidance of the offsite surveillance off site supervision manual is in force. Till now there is no difference in the supervision methods used for the banks with foreign investment and other commercial banks.

4.10.2 Domestic Legal Provisions Regarding Banking Sector:

Bank and Financial Institution Ordinance 2060, governs the functional aspect of banks and financial institutions. Some of the important provision in the ordinance regarding the banking sector has been analyzed in this chapter as follows:

Any person wishing incorporate a bank or financial institution to carry on financial transactions should incorporate a bank or financial institution as a registered public limited company under the prevailing law of Nepal with prior approval of NRB by fulfilling the conditions prescribed in section 4 of the ordinance. The individual desiring for the incorporation of such entity is required to submit an application to NRB for prior approval with the prescribed documents. The NRB is required to conduct necessary investigation and grant permission to establish a bank or financial institution with or without terms or conditions if all the criteria are met and information of disapproval with reason is also to be given to the concerned person in case the application is denied.

Similarly, any foreign hank or financial institution wishing to establish a bank or financial institution by making joint venture investment with a corporate body incorporated in Nepal or with a Nepali citizen or as a subsidiary company with 100% share is eligible to furnish the application to establish a bank or financial institution. However, the ordinance is silent about the percentage of equity investment in joint venture; such foreign corporate

body can invest. It has been regulated by regulation till now as 75%. The ordinance prohibits anybody to conduct financial transaction except an established bank or financial institution and no bank or financial institution can use the proposed name for the purpose of carrying financial transaction without obtaining license from NRB.

The bank or financial institution desiring to conduct financial transaction must submit an application for license to the NRB in the prescribed form including the prescribed fees, documents and description. NRB will granted license if it is satisfied with the basic physical infrastructure of the bank or financial institution; if the issuance of license for operating financial transaction will promote healthy and competitive financial intermediary and protect the interest of the depositors, the applicant is competent to operate financial transaction in accordance with the provision of this ordinance and its regulation, directives, order or provisions of Memorandum and Article of Association and there are sufficient grounds to believe that the entity is competent to operate financial transaction. The NRB will classify the institutions into “A” “B” “C” “D” groups on the basis of the minimum paid-up capital and provide the suitable license to the bank of financial institution. The authorized, issued and paid up capital of a license holder institution will be as prescribed by NRB from time to time. The NRB can issue directives to the license holder entity to increase its authorized, issued and paid-up capital if it deems necessary.

Similarly, the license holder entity must maintain a capital fund according to ratio prescribed by NRB based on the basis of its total asset or risk weighted assets, and other transactions. At the same time, the license holder entity must maintain a risk fund according to ratio prescribed by NRB based on the basis of liability relating to its total asset and the other risk to be borne from off balance sheet transaction. The license holder entity must maintain general reserve fund regularly every year till the amount becomes double of the paid up capital of such entity. The bank or financial institution can be upgrade if the authorized capital is enough for upper class, the institution has been able to make profit for last five years and the nonperforming asset is within the prescribed limit. Similarly, the bank of financial institution can be degraded if it fails to meet prescribed capital within the time period, it has been making loss for last five years, it has violated

the directives of Rastra Bank time and again and it fails to maintain Risk Management Fund as prescribed by it. Provision for upgrading or degrading the class of licensed institution:

The bank or financial institution can be upgraded if:

- The authorized capital is enough for upper class
- The institution has been able to make profit for last five years.
- The non- performing asset is within the prescribed limit.

The bank of financial institution can be degraded if:

- It fails to meet prescribed capital within the time period
- It has been making loss for last five years.
- It has violated the directives of Rastra Bank time and again
- It failed to maintain Risk Management Fund as prescribed by the NRB.

The NRB will make necessary investigation and avail opportunity to clarify before taking such decisions.

The NRB is full power to deny license for financial transaction if the conditions stipulated in ordinance are not met and it is also authorized to impose necessary conditions taking into account the existing financial position of the bank or financial institution, the interest of depositors and healthy operation of financial transaction. Similarly it may increase, decrease or modify the terms and conditions time to time. The NRB can suspend the license of the license holder for a specific period of time issued for the purpose of carrying financial activities or it may order the bank of financial institution to close the operation of their office partially or fully if such a license holder acts against the provisions of the Nepal Rastra Bank Act 2002, of the regulation made there under of fails to act in accordance with the order or directives issued by it or fails to act for the welfare and in the interest of the depositors. The NRB may cancel the license issued under this ordinance to carry on the financial transactions of the license holder under the following circumstances, if:

- The license holder itself submits an application for the cancellation of its license.
- Fails to conduct the business of financial transaction even after 6 months of issuance of license.
- If it stops financial transaction for more than one month continuously.
- Operates financial transaction against the welfare and interest of the depositors.
- Acts in contravention of NRB Act 2002 or the regulation or byelaws made there under.
- Violates the terms and conditions prescribed by the NRB.
- Fails to act in accordance with the order or directives issued by the NRB.
- Has been declared insolvent.
- The applicant Bank or Financial institution is found to have obtained license by providing false particulars.
- If a bank or financial institution is merged with the other Bank or Financial institution.
- Application is submitted by Bank or Financial institution to Rastra Bank for the cancellation of its license, the NRB must decide on such application within 45 days of receiving the application.

A foreign bank or financial institution desiring to open its office within the Kingdom of Nepal must submit an application to NRB in the form as prescribed along with the fees and particulars as prescribed. The NRB may issue a license to foreign bank or financial institution to carry on financial transaction by allowing them to open an office within the kingdom of Nepal taking into account the situation of competition existing in the banking sector, the contribution that could be rendered in the Nepalese banking sector and the reputation of such foreign bank or financial institution. The NRB may specify necessary terms and conditions in the course of granting transaction license and it shall be the duty of the foreign bank or financial institution to comply with such terms and conditions.

The section 34(4) of the ordinance reiterates that the provisions of the ordinance are to be complied with by such foreign bank or financial institution. The foreign bank or financial institution, which has been issued license to operate financial transaction by opening its

office within the Kingdom of Nepal, can not open another bank or financial institution in joint venture within the Kingdom of Nepal. However, the provision for the contact or representative office of any foreign bank or financial institution will be as prescribed by NRB. Some of the important issues such as relationship with parent bank in case of liquidation and supervisory role of the different institutions (parent bank and parent bank's supervisory authority) have not been adequately addressed in this ordinance. Provision relating to capital requirement is also silent in ordinance. However, it can be fixed by regulation. The section 47 of the ordinance prescribes functions of the bank or financial institutions, the entities functioning under sub-section (1) only can keep their name as bank of class "A" category. The functions of such bank are as follows:

- To accept deposit with or without interest and make payment of such deposit amount.
- To provide loan as prescribed by NRB only.
- To operate transactions in foreign exchange, subject to prevailing laws of Nepal.
- To operate loan for hire purchase, hypothecation, leasing, housing and service oriented business.
- Subject to the directives of Nepal Rastra Bank, to carry on Merchant Banking Transaction
- To provide loans on the basis of co-financing according to the agreement concluded among the license holding entity so as to divide the collateral on paripassu.
- To issue Bank guarantees on behalf of its customers, have such customers execute necessary bonds in consideration thereof obtain security, and acquire their movable or immovable assets as collateral or on mortgage, or the assets of their individuals as collateral.
- To provide loans against the guarantee provide by any local or foreign bank or financial institution.
- To issue, accept, redeem, endorse discount, purchase or deal in letter of credit, bill of exchange, promissory notes, cheques, drafts, traveler's cheques or any other financials instrument.

- Subject to the directives of NRB, to accept, make payment or transfer deposit through telephone, telex, fax computer or magnetic tape or any other types of electronic devices or instrument.
- Subject to the directives of NRB, to issue and accept credit card, debit card, charge card including other financial instruments and to appoint an agent to perform such activities
- To accept, make payment or provide loan by using automated teller machine or cash dispensing machine.
- To grant overdraft to the person trusted by it
- To provide a fresh loan in the lump sum or in installments against the security of the same movable or immovable assets which have already been pledge with itself or other license holding entity, to the extent of the total value of such security.
- Subject to condition specified by NRB, to work as an agent of the NRB to perform government transaction and similar other transactions on behalf of Government of Nepal.
- To remit or transmit amount to different places within or outside of the Kingdom of Nepal through bill of exchange, cheques, or hundis through other electronic device or arrange for the sale or purchase of bullion, shares, debenture and bond etc, and collect dividends accruing on the shares and interest on promissory notes, debentures, bonds etc.
- To accept and arrange for the sale or purchase of shares, debentures, securities and collect interest, dividends of securities of limited company in the capacity of a commission agent on behalf of customers, and remit or transmit such interest, dividends to places within or outside of the Kingdom of Nepal
- To purchase, sale or accept the securities issued by the Government of Nepal or Nepal Rastra bank.
- To arrange for safe deposit vaults.
- To undertake off balance sheet operations subject to the conditions specified by the NRB.

- To provide loans not exceeding the amount specified by the NRB to low income families, poor class, and natural disaster-affected people with the provision of individual or collective responsibilities.
- To exchange between the NRB and license holding entity the particulars, information or notices regarding debtors or customers who have obtained loans or any other facilities from the license holding entity.
- To provide bank guarantee for loans to be made available by other license holding entity to its clients.
- Subject to the limitation set by NRB, to mobilize capital through shares, debentures, loan bond, saving bond or any other financial instrument.
- To obtain refinance loans from NRB, or supply loan to other license holding entity or obtain loan from them, according to need.
- To conduct or make arrangements for conducting studies, research, and surveys in respect to the establishment, operation and evaluation of projects, and training or consultancy service and other information.
- To distribute in the form of loans, fund received from the Government of Nepal or any other domestic or international agency for the purpose of promoting project.
- To prescribe conditions and conclude agreement according to need so as to protect its interest while conducting transaction with or advancing loan to any entity or transacting with any individual
- To obtain loans against the security of its movable or immovable assets
- Subject to by laws made by the committee, to underwrite the loan
- To make proper arrangements of its assets or to sell them.
- To perform any other functions as prescribed by NRB.

In this ordinance functions which license holding entity can not perform are also incorporated as below. No License Holding Entity shall perform any of the following function:

- To purchase or sell goods with commercial motives or make investment in immovable property unless required holding for such property for its own use. However, license holding entity of class "B" and "C" may purchase or sell immovable asset or managing such property for the purpose of performing their business.

- To provide loans against the security of its own shares.
- To provide loans of facilities of any kind to Promoter, Director, person holding more than 1 percent of shares, Executive chief of any member of undivided family of such person or any firm, company or corporate body which is entitled to nominated Director.
- To provide loans of facilities of any kind to any firm, company or corporate body in which the Promoter, Director or any member of his undivided family of Executive Chief functioning as Director or Managing Agent, or person holding more than 1 percent of shares or in which any such person or form, company, corporate body or individual who is entitled to nominate Director, has financial interest.
- To provide loan, guarantee or facilities for an amount exceeding the percentage of its capital fund specified by the Rastra Bank to a single customer, company or companies belongs to one group, partnership firm except as permitted by the Rastra Bank.
- To provide loan against the personal guarantee of promoter, director or chief executive officer.
- To invest against the security of shares of any entity who has obtained license from Rastra Bank to perform financial transaction.
- To invest money on the share of other license holding entity exceeding the limit imposed by Rastra Bank.
- To carry on those functions in collaboration among or between the license holding entities for the purpose of creating their monopoly and business under their control.
- To engage in manipulative devices or practices to create artificial paucity in the competitive environment of financial sector for unfair advantage for them.
- To work against the business prohibited by the NRB.
- To work anyway for saving or in favor of the person/institution earning money illegally so that he could be saved from punishment or blame.

As per Nepal's commitments foreign bank branches are only allowed for wholesale banking functions. So all of the provisions stipulated in subsection (1) will not be relevant to the foreign bank branches. According to the ordinance, NRB has authority to make necessary regulation in this aspect.

In course of analyzing the data, here is not only analyzed the secondary data. To make this research work more effective and accurate, the researcher has also collected some valuable primary data through the means of questionnaire by the help of company's employee having different corporate post i. e. branch manager, operation in charge, loan officer etc. This primary data are taken as the supplementary source of data to proven the effectiveness of this research work.

4.11 Analysis of Primary Data:

The primary data are collected through structured questionnaire the entire presentation of respondent answers is cited below;

Table 4.11
Analysis of Respondent Answer:

Question Number	Number of Respondents				
	Option of Answer				
	Yes	No	A	B	C
1			6	4	0
2			4	5	1
3	10				
4			2	6	2
5			3	4	3
6			3	5	2
7			3	5	2
8			3	2	2
9			6	4	0
10	7	3			
11	8	2			
12			3	2	5
13			3	2	5
14	7	3			
15			4	3	3

(Source: Details of questionnaires see Annex 6)

Except some exception, there seems to be homogeneity in answer for the questionnaire. All the answers of respondents are categorized in different groups for analysis purpose as below:

- A) **Awareness of Respondent:** Set of questionnaires is distributed for officer staffs of simple organizations. According to answer of total ten respondents sixty percent are highly aware, forty percent are well known and none is unknown about financial market in Nepal. The authentication of data can be verified by the answer of highly aware respondent.
- B) **Current Situation of Financial Market in Nepal:** There is mixed answer about the situation of financial market in Nepal and its cause as well. Forty percent respondent argued Nepalese financial market is highly developed; fifty percent argued its moderate situation and only ten percent said Nepalese financial market is under developed. About the cause of being current situation of market in Nepal, Thirty percent in favor of civil war, forty percent in favor of Nepalese agro based economy and thirty percent in favor of low literacy in Nepal. Almost one third of them thought that Nepalese financial system is victimized by civil war, forty percent thought that Nepalese financial system could not develop due to agro-based economy and only remaining respondent thought that it is due to low literacy in Nepal.
- C) **Relationship Financial Market and Economic Development;** All the respondent put consent on sound financial system contributes in economic development. About the role of financial market in economic development, twenty percent argued that there is fundamental role; sixty percent argued that there is important role and only twenty percent argued that there is not important role of financial market in economic development. Thirty percent respondent gave first priority in production, fifty percent gave first priority in investment and twenty percent gave first priority in employment for the economic development.
- D) **Financial Improvement:** To develop financial market in Nepal sixty percent of respondent focused on make people aware and forty percent focus on enhancement of investment. After 2010, in the context of Nepal being WTO member, foreign banks will enter in Nepalese financial market, seventy percent argued that it is beneficial for Nepalese financial market development and thirty percent argued that it is not

beneficial. In the same context, after 2010, about the strategy of national commercial banks to compete with international banks, thirty percent argued that there should be consolidation among national commercial banks; twenty percent argued that there should co-operative strategy with other international commercial banks and rest fifty percent argued that there should be enhancement of internal competencies of national commercial banks. NRB has circulated a directive that commercial banks should increased paid up capital by double, eighty percent of the respondent argued that it is necessary but the twenty percent think that it is not necessary. Among all, seventy percent of the respondent has accepted the concept of global village as opportunity and rest thirty percent has taken the concept of global village as threat for the Nepalese financial market.

- E) **Role of NRB in the Development of Financial Market in Nepal:** Respondent gave mixed answer about the role played by NRB in financial market development; thirty percent said that NRB is playing satisfactory role and twenty percent said that NRB is playing unsatisfactory role in financial market development in Nepal; out of those seven respondent (NRB is not playing effective role in Nepalese financial market development) three respondent argued that there is leakage in planning, two argued that there is leakage in implementation and two argued that there is leakage in control system of NRB. To decentralize the banking and financial services from urban to rural area, NRB has circulated a directives for that thirty percent of respondent said that this directive highly decentralize the banking service, fifty percent said satisfactory and twenty percent said that this directive decentralize the banking service low. For the further improvement of the role of NRB in development of financial market in Nepal forty percent suggest that NRB should focus on planning, thirty percent in implementation and last thirty percent said that NRB should focus on control for further development of financial market in Nepal now.

4.12 Major Findings:

This study is conducted to identify the role of NRB in development of financial market in Nepal. With this motive, this study is mainly focused on three objectives. First one is to analyze how sound financial system helps in economic development. Similarly, next objective is to explore current situation of financial market in Nepal. And lastly, the next objective is to evaluate how successfully NRB is playing role in development of financial market in Nepal.

Based on the analysis of both primary and secondary data in this chapter, different facts are found, they are as follows.

Findings From Secondary Data

- Nepalese banking system has changed tremendously by adopting liberalization policy since 1980s. On the other hand, Nepalese economy is rapidly integrated with the global economy.
- Numbers of financial institutions are growing day by day in different territories. It adds central bank's more responsibility and accountability to improve and operate financial sector well.
- The ratio of stock market capitalization to GDP is increasing to 16.6% in year 2006 from 11.60% in year 2005. It proven that role of Nepalese financial system in economic development is increasing significantly.
- After being a member of WTO, Nepal has made different commitments to welcome foreign bank branches. In this context, Nepalese economy got more opportunities and threats and role of NRB seems more vital for smooth operation of financial intuitions and economic development.
- Monetary policy has been helping maintain financial stability that's why Nepal has not experience the financial crisis. But after year 2010 it seems more complicated when foreign bank branches will establish.
- Monetary policy in Nepal manages money supply on the basis of monetary aggregate targeting framework in line with the economic stability in the economy so far.
- Since 1980s, banks deposit and credit ratio increased, its increasing trends clarify the importance of banking system in deposit collection and mobilization, this ratio surged up to 42.00% in year 2000 from 10.00% in 1980s.

- Equal regional socio economic development is necessary for overall economic growth. Population per branches of commercial banks is very high in both mid-western (87330) and far-western (99235) development region compared to other. It suggests that financial widening is very low these regions. Both NRB and government seems failure to enhance their presence and to operate task toward economic growth. Literacy rate poverty indicants are very high; number of financial institution is very low.
- Ratio of consumption to GDP is very high (90.6%) in f/y 2009/10, it shows domestic saving (9.4%) and total investment is very low 25.33% in f/y 2009/10. Total Import 26.6% exceeds 8.5% exports in 2009/10. Moreover; per capita income is increasing in small growth rate.
- Over the period of 1975 to 2010, commercial banks credit to private sector as a percentage to total credit increased from 57.60% to 77.82% so, the major portion of commercial banks credit portfolio is being utilized in extending credit to private sector.
- Slope of coefficient between financial indicator and economic growth indicators are positive. It implies that there is proportional relationship between financial development and economic growth.

NRB bank supervision department has carried out corporate level on site examination of all commercial banks at least once of year as per its annual plan. Off site supervision carried out quarterly bas on reports of commercial banks.

Findings From Primary Data

- Nepalese financial system is moderately developed now. Agro-based economy is the main barrier in Nepalese Financial market development and than civil war.
- Everyone put consent on sound financial system clearly contributes in economic development.
- Financial sector has important role in economic development sixty percent of respondent argued financial development and economic development has positive relation.

- Enhance in investment is crucial in economic development first, then in production and lastly, in employment.
- Financial market can developed after making people aware first then by enhancing investment in the economy.
- Concept of global village is opportunity, concern parties should try to reap benefits by reducing threats.
- It is beneficial to enter foreign bank branches in Nepal; it brings more opportunities. Strategy of Nepalese commercial banks should enhance their internal competencies first to compete with foreign banks, then consolidation between/among national banks lastly may be co-operative strategy between foreign and national banks.
- To circulate financial development in rural areas NRB directives is very necessary and more important; banks should focus their attention toward rural areas. To strengthen Nepalese financial institutions it is necessary to increase paid up capital gradually.
- NRB has been playing satisfactory role in development of financial market in Nepal and should try to be effective. There is leakage in planning that make NRB inefficient that's why NRB should focus on planning first then in implementation and control system.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter is important chapter for the research because this chapter is the extracts of all the previously discussed chapters. This chapter consists of mainly three parts: Summary, conclusion and recommendation. In summary part, revision or summary of all four chapters is made. In conclusion part, the result from the research is summed up and in recommendation part, suggestion and recommendation is made based on the result and experience of thesis. Recommendation is made for improving the present situation to the concerned parties as well as for further research.

5.1 Summary:

Nepal is orienting towards the development. Natural resources of the country remain unused and utilized due to the lack of financing and technical know-how. In order to mobilize the limited capital, the government of Nepal adopted the Liberalization policy. The financial system is a mechanism that transfers funds from the surplus to deficit units. It consists of institutional and legal structure, financial instruments and individuals. As result to now 31 commercial banks, 78 development banks, 102 finance companies, Micro finance Development Banks 16, one employee provident fund, 19 insurance companies and other 17 financial co-operative societies licensed by NRB for limited transaction are established within the financial system of Nepal. Financial system is hoped to develop the economy and help to raise the living standard of the people. Financial intermediaries mobilize the fund by collecting the scattered resources from the savers and provide the collected funds to the users. The intermediaries of financial systems sustain by lending the fund on higher interest rate and paying the deposit holder a little interest.

NRB is an agency of government of Nepal that does not ordinarily deal directly with the public. It has prime responsibility of developing a secure, healthy, efficient financial system in Nepal. NRB has already initiated the restructuring and re-engineering process to meet upcoming challenges. Banks are supervised in order to achieve both long-term

financial stability and sectoral efficiency. A weak regulatory framework and poor supervision provide backgrounds for inefficient and unsafe banking practices, which increase the risk of bank failure. Preventing systemic risk, protecting small depositors, and containing financial crimes are concrete steps in attaining these objectives. They require the supervisors enforce regulations and the presence of strong in-house supervisory expertise. The side in practice on the part of NRB, the only Monetary Authority of the country, is support from government of Nepal as well as the judiciary system of the country are also very necessary so as to strengthen NRB's supervisory effectiveness and enhance financial discipline and good corporate governance in the financial system of the country.

In a bank dominated financial system, the banking sector has to play a vital role in the economic development process of country through mobilizing and allocating limited resources. The banking system must be prudent with commercial orientation. The financial system still lacks competitive environment and the non banking sector is yet to grow in terms of size, structure and volume of business. Lack of competent, qualified and experience managerial teams has remained as one of the serious concern in the system. The role of central bank as regulatory and supervisory body needs to be further strengthened. The banking services targeted to the poor and deprived sector poor and deprived sector people are not adequate. Looking from these perspectives, these issues can be broadly classified in to three categories. The first set of issues is micro economic in nature and includes poor banking practices such as inadequate capital, failure of loan policy, inadequate assessment of credit, insufficiently diversified loan portfolio, lending to connected borrowers and excessive maturity, over staffing and existence of trade unions have also been chronic problems, particularly in state owned commercial banks and financial institutions. The second set of issues includes the degree of volatility due to the movement in the assets price and the exchange rate. The category is system related, indicating that the environment is not conducive to the development of an efficient financial system. System related issues in the financial system included lack of competition, excessive government intervention, inadequate legal framework, underdeveloped securities market and inadequate regulatory and supervisory mechanism.

The corrective action and policy options should therefore, address these issues and challenges.

This study set the objective of analyzing the role of NRB in development of financial market in Nepal and provides necessary suggestions of concern parties. It also explores the current situation of financial market in Nepal and the relationship between financial growth and the economic development although it has not practiced to use different tools in evaluation. This study is based on both primary as well as secondary data which clearly able to analyze the predetermined objectives. This study segregated in five different chapters. The first chapter deals about introduction subject matters, objective of study, and significance of study as well as chapter plan of the study. The second chapter presents the theoretical framework of role of central bank in financial market development and review of previous studies relating to role of central banks, financial markets and economic developments. Third design, population and samples, data collection procedure and tools and techniques applied in the study. The fourth chapter analyzes the variable and data of the study. It applies the financial and statistical tools in analyzing the data. The major findings are also presented. The fifth chapter presents the summary, conclusion and recommendations strictly based on the study.

Although this study, draws some conclusion based on the analysis done in the fourth part of this study it becomes immature to conclude that the study about role of NRB in development of financial market in Nepal is enough by applying financial and statistical aspects in achieving the target. It is the starting point for analyzing the principles and roles of central banks in financial market development. For further study purpose, the recommendations are presented in the last of this study may become useful and can assist in finding the direction of study. This study may be useful for Nepal Rastra Bank to improve role in development of financial market in Nepal.

5.2 Conclusion:

From the above study some major facts are found these findings are cited as follows:

- ⇒ There is positive relationship between financial development indicators and economic development indicators i.e. $\beta_1 = 0.29$ when M_1 Keeping independent

which refers that one percent increase in M_1 refers to 0.29 % increase in RGDP, on the same way, $\beta_2 = 0.25$ which shows when M_2 increase by one percent the RGDP will increase by 0.25%. By analyzing primary data it can also be concluded that financial market development helps in economic growth. There is positive correlation between them. Economic development is only possible through sound financial market operation. First priority should give to investment in financial market for economic development.

- ⇒ NRB has categorized all the financial institutions in four groups for institutional development. There are 31 commercial banks, 78 development banks, 102 finance companies, 16 micro finance development banks, 17 financial cooperatives, 47 Non government financial organizations, 117 postal saving banks, one stock exchange, 19 insurance companies, one employee provident fund and one citizen investment trust. Regional distribution of financial institutions seems more deviation, they are urban oriented, that's why financial institutions should improve their service quality and decentralize to the rural area.
- ⇒ Investment of private sector in financial reform seems increasing. There was only 6% share of private sector in year 2000 and increased to 20.19% in year 2006. Share of joint venture banks also increased from 36.66% to 38.64% from year 2000 to 2006. It results the government investment in financial sector decreased to 41.07% from 57.17% in respective period. IT reflects the synergic effect of privatization and consciousness of private sector in financial development. By analyzing primary data it is found that enhance in investment is the major key of economic development.
- ⇒ NRB has been formulating proper monetary policy that's why Nepal has not experienced any economic crisis yet. Institutional development has been growing but it should give attention toward deprived and remote area. Lastly announced monetary policy focused on managing high liquidity and maintaining fiscal stability. Now onward, commercial banks are required to extend three percent of their total loan investment for deprived sector.
- ⇒ Supervisory rules and guidelines of NRB are satisfactory but the implementation system is loose which results NRB's in efficiencies. Regulation and supervision of

international banks is challenging job, that's why NRB should deploy taskforce in planning and making clear vision that can create opportunities and brings more FDI for deprived sector.

⇒ NRB has been playing satisfactory role in development of financial market in Nepal till now rules regulations and guidelines need to edit time to time for further improvement.

5.3 Recommendations:

Based on the analysis, interpretation & conclusions, certain recommendation can be made here so that the concerned authorities, future researchers, academicians, bankers can get some insights on the present conditions on above topics. It is considered that this research will fruitful for them to improve the present condition as well as for further research.

The NRB directives should aim at the following creating a sound, table and healthy financial system, broadening the financial system, adequate information disclosure, efficiently mobilizing financial resources to promote sustained and broad based growth momentum, building the institutional capacity to tackle the problems in the financial system by improving the legal and judicial frameworks and increasing the autonomy credibility and capability of central bank's regulatory and regulatory roles. The organization and financial health of the two state owned banks have been deteriorating and for the efficacy and efficiency of the banking sector, these two state owned banks should be restructured as a first step in the dealing with the issue of the Nepalese financial system.

To sum up;

- ⇒ NRB should focus on institutional development of finance in the deprived sector and rural people to increase economic activities and thereby facilitate the task of alleviating poverty.
- ⇒ Make the debt recovery system effective and improve the quality of assets.
- ⇒ Strengthen the rural credit delivery mechanism.
- ⇒ Build up the capacity of the financial sector by improving judicial, legal framework and fine tuned on an up to- date basis.

- ⇒ NRB should focus and build stringent supervisory rules to set for Bank behavior in order to protect depositors, creditors and financial system as a whole.
- ⇒ NRB supervision in Nepal must aim to promote and maintain the safety, soundness and integrity of the Nepalese banking and financial system and of each institution within the system.
- ⇒ Make the financial system competitive, broad-based and growth induced.
- ⇒ NRB should persuade in practice of new financial instruments' transaction that can make Nepalese financial market broad base.
- ⇒ NRB should ensure of making modern and technological banking service of two Governments owned commercial bank to compete with the growing modern private banks operations.
- ⇒ NRB should formulate policies (financial and monetary) to be compatible to each other to maintain macroeconomic stability, to keep inflation at a desirable level and achieve higher growth rate making it sustainable.
- ⇒ NRB must control over the inflation by maintaining liquidity and Cash Reserve Ratio (CRR) of the banks and financial institution.
- ⇒ NRB should recruit highly skilled human resources to cope with the emerging challenges to perform in an overall function.
- ⇒ NRB must ensure for the promotion of institutional good governance, accountability and financial discipline. Appropriate policy guidelines need to be formulated and brought into effect strictly.

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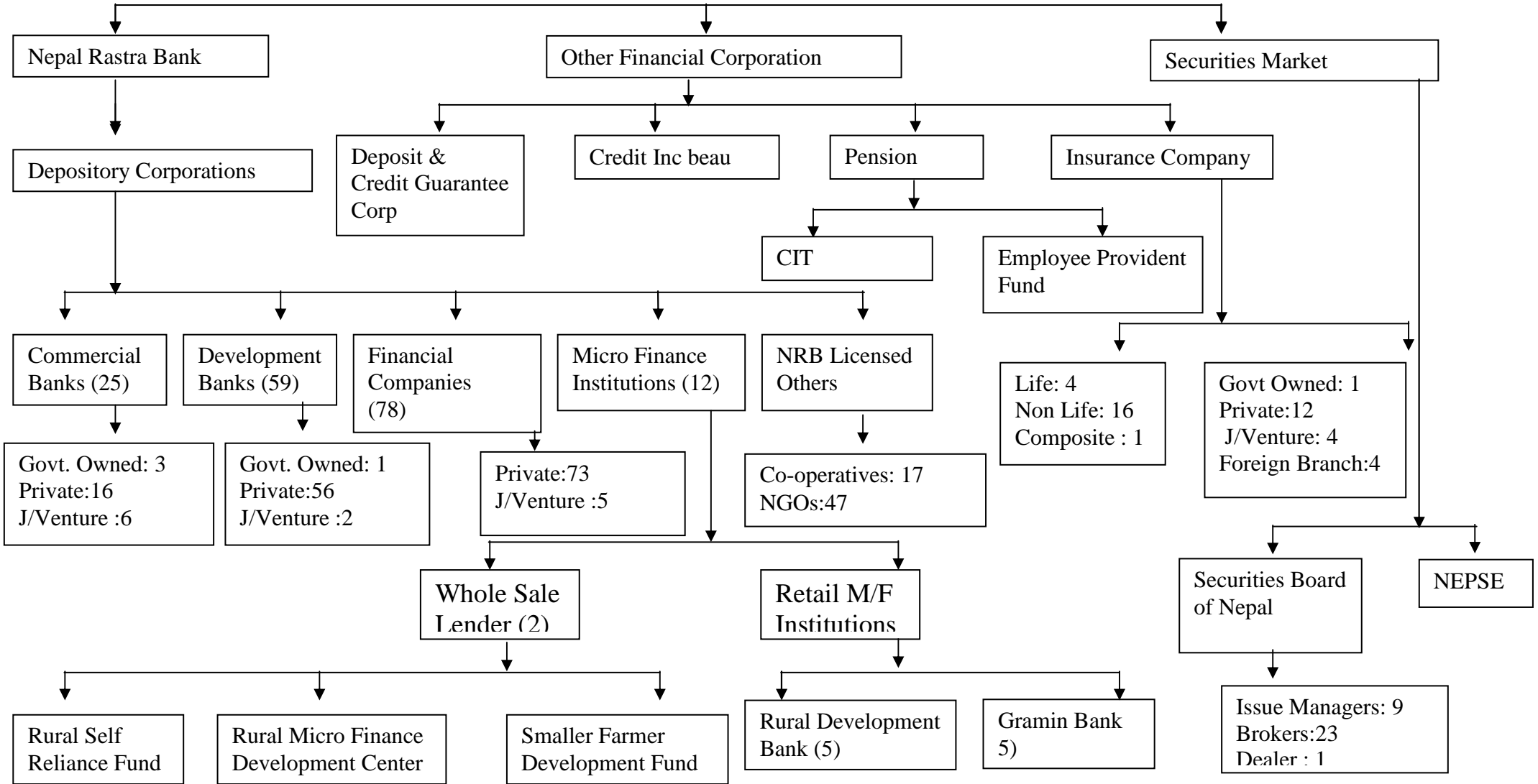
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Annexure 1 Nepalese Financial System



Annexure; 2
Indicators Relating to Nepalese Financial System
As at Mid –July 2007 (Rupees in Million)

Particular	Commercial Banks	Development Banks	Finance Company	Micro Finance Bank	NRB Licensed		Insurance Company	EPF	CIT	Total
					Cooperatives	NGOs				
Capital Fund	-17742.1	4782	4314.8	830.4	324.8	0	19872.5		85.81	12468.21
Of which paid up capital	10571.7	3135.8	3356.7	570.9	228.4		1680		39.99	19583.49
Borrowings	9519.6	5226.2	1154.8	932.5	70.7	541.8	-		0	17445.6
Deposits	291245.6	35902.6	24332.5	5324.9	2011	0	-	48177	6376	413369.3
Others	134410.4	14289.4	8481.96	989.9	408	292.6	2815.1	2880		164567.4
P/L A/C	11272.7	-	572.10	119.7	62.8	59.9	-			12087.24
Total	428706.2	60200.2	38856.2	8192.4	2877.3	894.3	22687.6	51057	6847.2	620323.1
Liquid Funds	38842.1	5240.9	5386.7	1338.1	493.1	131.9	2125	0	0	53547.8
Total Investment	82173.8	2119.1	963.2	1672.6	161.5	50	16704	23550	5189.5	132583.7
Loans and Advance		31224.2	27078.9	4303	1665.4	439.8	-	26393	628.55	265116.1
Other	173383.4	20440.7	5348.9	672.7	557.3	272.6	3858.6	1113.9	1029.2	154917.6
P/L A/C	121623.7	1175.3	78.5	221	-	0	+-	0	0	14157.96
Some Ratios:										
Capital Find/GDP	-3.04	0.82	0.74	0.14	0.06	0.00	3.41	0.00	0.01	2.14
Paid up Capital/GDP	0.81	0.54	0.58	0.10	0.04	0.00	0.29	0.00	0.01	3.36
Deposits/GDP	49.96	6.16	4.17	0.91	0.34	0.00	0.00	8.26	1.09	7.91
Liquid Find/GDP	6.66	0.90	0.92	0.23	0.08	0.02	0.36	0.00	0.00	9.19
Total Investment/GDP	14.10	0.36	0.17	0.29	0.03	0.01	2.87	4.04	0.89	22.74

Loan and Advance/GDP	29.74	5.36	4.65	0.74	0.29	0.08	0.00	4.53	0.11	45.48
Total Assets/GDP	73.54	10.33	6.67	1.41	0.49		3.89	8.76	1.17	106.41
Credit/GDP	59.53	86.97	111.29	80.81	82.81					64.14
Per capita Assets	16945	23.78	1536	324	114					24518.7
Per capital Deposits	11512	1419	962	210	79					14182.47
Per capita Credit	6853	1234	1070	170	66					9410.858
NPL/Total Loan (%)	14.22	5.29	7.66							
Number of Institutions & Branches	574	58	79	12	16	47	22	1	1	
Population/Branch & Financial institution	57895	722857	351389	2300000	1265000	538298	1204762			

Annexure: 3
Banking and Financial Development Indicators

(Rupees in Million)

				Central Bank's Claim				Commercial Banks' Claim				
Mid July	M1	M2	Govt.	Govt. Ent	Comm. Bank	Private Sec	Total	Govt.	Govt. Ent	Private Sec	Foreign	Total
1979	1337.7	2064.4	466.2	1362.2	368.9	21.6	992.90	100.4	432.5	761.8	27.3	1,320.0
1980	1452.5	2524	578.2	1161	24.1	22.6	741.00	119.6	451.2	693.6	46.5	1,310.9
1981	1852.9	3223	482.9	178.2	55.4	39.5	456.00	479.9	322.8	824.7	54	1,691.4
1982	2060.6	3722.1	844.4	259.4	174.1	33.5	1,311.4	351.5	609.3	1037.6	78.8	2,077.2
1983	25.4.9	4511.34	994.9	354.1	168.9	31.7	1,549.60	371.8	725.8	1299.9	185.2	2,582.7
1984	2830.4	5285.3	1104.6	372.1	564.4	48.9	1,790.00	371.2	758.9	1867.6	171.5	3,169.2
1985	3207.8	6307.7	1091.3	398.7	468.1	58.8	2,016.90	324.8	1001.9	2439.9	162	3,928.0
1986	3611.5	7458	1504.6	499.8	137.8	61.9	2,154.10	641.8	893.6	2576.3	111.6	4,223.3
1987	4348.9	9222.4	3016.7	489.1	74	64.3	3,644.10	1611	1213.1	2634.8	143.5	5,152.4
1988	4931.5	10455.2	3639.7	576.4	152.1	94.8	4,463.00	1482.9	1045.4	3079.2	163	5,770.5
1989	5480	12296.9	4577.3	708	388	159.6	5,832.60	2108.3	1314.2	3877.3	297.4	7,507.2
1990	7029.3	15159	5820.2	794.3	533.9	123	7,271.40	1818.7	1865	5044.9	269	8,997.6
1991	8120.2	17498.2	6544.6	845.4	520.3	161.8	8,073.10	2326.8	1965.7	6447.9	329.7	10,730.1
1992	9596.6	21422.6	6479.4	879.1	357.4	367.5	8,883.40	3222.2	2022.5	7941.2	337.6	13,523.5
1993	11775.4	26605.1	8773.9	809.5	160.1	277.2	10,020.70	3771.4	3072.7	10079.8	340.6	17,264.5
1994	14223	31522.4	10583.2	778.9	50.5	160.4	11,573.00	3582.34	3254.9	11537.2	552.6	18,917.1
1995	1628.3	39912.5	9901	130.6	37.2	555.6	11,224.40	343.1	2830.74	13553.1	683.6	244105
1996	19457.7	45670.5	10155.5	747.6	34	510.9	11,448.20	9198.6	4079.5	17633.2	1247.4	32458.7
1997	23833	58322.5	13836.7	559.9	47.8	514.2	14,958.6	9998	4189.9	21115.8	1339	36.642
1998	28510.4	69777.1	15002.2	495.3	29.2	539.3	16,066.00	8894.1	4243.9	29653	1445.3	44,236.2
1999	32985.4	80984.7	17446.2	731.7	15.4	633.9	18,824.50	8197.8	4318.7	42379.2	1286.6	56,182.5
2000	36498	92652.2	20442.9	1149.3	364.6	940	22,896.80	7548.4	5060	54584.8	18212	69,014
2001	38460.3	3720.6	21934.7	1495.3	6.6	1498	24,925.70	7746.25	5533.1	63169	2062.4	78.511.7
2002	45163.8	26426.6	21986.9	1621.8	5.5	118/6.2	24,800.40	10280.7	5607.1	75645.9	2266	93.797.7
2003	51062.4	52800.1	22776.1	1450.9	5.5	1367.4	25,599.90	12659.1	7463.1	89433.1	2413.5	11,968.41
2004	60979.8	86120.9	20598.3	1626.6	45.1	2104.5	24,374.50	18176.7	8684.3	107343.1	1980.7	136,184

2005	70576.9	14454.1	20598.3	1681	5.5	3340.5	28,825.10	25393	10225.4	1234417.4	1883.6	160,919
2006	77156.2	23988.3	23798.1	1670.6	1043.7	3226.9	36,373.90	29143.8	12760.5	130088.4	13326.5	173,319.5
2007	83754.1	45911.3	30432.7	1557.5	947.4	2883.7	29,206.00	39469.3	13104.4	148073.2	1175.6	201,822.2
2008	94291.7	79125.1	23817.4	1494	572.1	1914.6	171744.70	422662.7	15161.3	157089.8	1242.7	216,156.5
2009	126887.9	395518.2	15616.1	661.4	1870.8	8116.8	26265.1	65850.0	5106.4	265360.6	1112.6	337429.6
2010	154343.9	495377.1	18925.8	438.1	660.7	3053.2	23077.8	72100.2	5635.5	336781.0	1480.5	415997.2

(Source Quarterly Economic Bulletin, Vol. XXVII No. 1 & 2, Nepal Rastra Bank)

Annexure: 4
Economic Development Indicators (Rs in million)

July	RGDP	NGDP	Population in Million	Per Capita RGDP	Per Capita NGDP
1978	91237.10	16601.00	12.84	7108.20	1293.37
1979	95254.00	17394.00	13.18	722.86	1320.04
1980	98123.70	17280.00	13.53	7253.70	1277.41
1981	102443.20	19727.00	13.89	7376.79	1429.51
1982	104871.80	26128.00	14.26	7356.00	1832.69
1983	102443.50	23351.00	14.64	6999.49	1595.46
1984	110990.50	25530.00	15.02	7389.51	1699.73
1985	115179.00	30988.00	15.33	7512.12	2021.08
1986	111755.10	33821.00	15.65	7140.29	2160.90
1987	122569.60	39290.00	15.98	7671.69	2459.18
1988	130172.10	46587.00	16.31	7981.51	2856.49
1989	136239.90	55734.00	16.65	8183.35	3347.70
1990	138933.60	63834.00	16.99	8174.46	3757.87
1991	148405.00	76906.00	17.35	8554.49	4433.08
1992	156478.00	89270.00	17.71	8836.05	5040.93
1993	163893.00	103416.00	18.08	9066.18	5720.74
1994	174908.00	120370.00	18.49	9459.60	6510.01
1995	183371.00	149487.00	18.91	9699.08	7906.84
1996	188780.00	171474.00	19.33	9765.45	8870.23
1997	204397.00	199272.00	19.77	10340.65	10081.37
1998	209976.00	219175.00	20.21	10389.14	10844.28
1999	221930.00	248913.00	20.67	10738.97	12044.65
2000	233040.00	280513.00	21.13	11028.43	13275.05
2001	240816.00	300845.00	21.61	11145.65	13923.96
2002	251758.00	342036.00	22.09	11395.67	15482.05
2003	267096.00	379488.00	22.59	11823.90	16799.30
2004	279749.00	41078.00	23.15	12084.19	17744.67
2005	278848.00	422301.00	23.67	11780.22	17840.53
2006	286480.00	454935.00	24.20	11836.32	18796.27
2007	296459.00	494883.00	24.75	11979.09	19965.85
2008	299334.60	499386.40	25.30	11831.40	19738.50
2009	302238.10	504180.50	25.86	11687.47	19496.50
2010	305169.80	509020.60	26.44	11541.97	19251.91

Annexure: 5
Growth Rate

				Commercial Banks Credit			Per Capita	
Mid July	M1 (%)	M2 (%)	Total (%)	Private Sector (%)	RGDP (%)	NGDP (%)	RGDP (%)	NGDP (%)
1982	8.60	22.30	-0.80	-9.00	4.40	4.80	1.70	2.10
1983	27.60	27.70	29.00	18.90	3.00	-0.70	0.30	-3.20
1984	11.20	17.00	22.80	25.80	4.40	14.20	1.70	11.20
1985	21.60	19.60	24.30	25.30	2.40	32.40	-0.30	29.00
1986	13.00	17.20	22.70	43.70	-2.30	-	-4.80	-
1987	13.30	19.30	23.90	30.60	8.30	9.30	5.60	6.50
1988	12.60	18.20	7.50	5.60	-3.00	21.40	1.70	18.90
1989	20.40	23.70	22.00	2.30	9.70	9.10	-4.90	6.90
1990	13.40	13.40	12.00	16.90	6.20	16.20	7.40	13.80
1991	11.10	17.60	30.10	25.90	4.70	18.60	4.00	16.20
1992	28.30	23.30	19.90	30.10	2.00	19.60	2.50	17.20
1993	15.50	15.40	19.30	21.30	2.00	14.60	-0.10	12.30
1994	18.20	22.40	26.00	29.80	6.80	20.40	4.60	18.00
1995	22.70	24.20	27.70	26.90	5.40	16.10	3.30	13.70
1996	20.80	18.60	9.60	14.40	4.70	15.80	2.60	13.50
1997	14.50	19.50	29.00	17.60	6.70	16.40	4.30	13.80
1998	19.50	21.10	31.70	30.10	4.80	24.20	2.50	21.50
1999	22.50	27.70	13.90	19.80	2.90	14.70	0.70	12.20
2000	19.60	19.60	20.70	40.40	8.30	16.20	5.90	13.70
2001	15.70	16.10	27.00	42.90	2.70	10.00	0.50	7.60
2002	15.60	14.40	22.80	28.80	5.70	13.60	3.40	11.10
2003	5.40	11.90	13.80	15.70	5.00	12.70	2.70	10.20
2004	17.40	21.90	19.50	19.70	3.30	7.20	1.10	4.90
2005	13.10	20.80	19.40	18.20	4.50	13.70	2.20	11.20
2006	19.40	21.80	21.60	20.00	6.10	10.90	3.80	8.50
2007	15.70	15.20	18.20	15.00	4.70	8.20	2.20	5.60
2008	9.30	4.40	7.70	5.40	-0.30	2.80	-2.50	0.50
2009	8.60	9.80	16.40	13.80	2.70	7.70	0.50	5.40
2010	12.60	13.50	7.10	6.10	3.50	8.80	1.20	6.40
AVERAGE	15.80	18.40	19.20	20.20	4.10	12.40	1.80	9.90

Questionnaire

Dear Sir/Madam

I hereby request you to fill up the questionnaire prepared by me for collecting the precious data from you, which will be prepared for facilitating the research conduct for the partial fulfillment of the requirement of the MBS degree. This research topic is related to the “Role of NRB in the Development of Financial Market in Nepal”. The views taken will be used for the purpose of this study only. The views will be kept confidential and will not be published anywhere. I would like to request to provide your valuable answer to the research problems. Some questions do have possible answers but some others call for a bit explanatory. While filling the questionnaire please put the tick mark (√) on the box. Your kind cooperation will be helpful to complete this study successfully.

Thank you very much

.....

(Researcher)

Master of Business Studies

Nepal Commerce Campus. T. U.

About the Respondent

Office

Address

Date

Name

Date

1. How you are aware about financial market?

Highly Well Unknown

2. What is the status of financial market in Nepal?

Highly Developed Moderate Undevelopment

3. Does sound financial system contribute in economic development?

Yes No

4. What is the role of financial market in economic development?

Fundamental Important Not Important

5. What is the main reason of being current situation of financial market in Nepal?

Civil war Agro based Economy Low Literacy

6. What is the first priority of financial market in economic development?

Production Investment Employment

7. How NRB plays roles in financial market development?

Effective Satisfactory Unsatisfactory

8. If not effective, where is the leakage?

Planning Implementation Control

9. How can financial market being developed?

Make People aware Enhance Investment

10. Foreign banks will enter in Nepalese financial market form 2012, is it beneficial for Nepalese financial market development?

Yes No

11. Is it necessary to increase paid up capital by double for financial institution?

Yes No

12. What should be the strategy for financial institutions to compete with international banks?

Consolidation among Nation Banks

Co-operative Strategy with Other International Banks

Enhancement of Internal Competencies

13. How extent branch opening directives of NRB decentralize the banking service to the rural area at one to one ratio?

Highly Satisfactory Low

14. What the concept of 'Global Village' is opportunity or threat to Nepalese financial market?

Opportunity Threat

15. Now, NRB should focus on-

Planning Implementation Control

The end