CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Financial sector reform means gradual liberalization of financial market and its players and opening of all types of depository and non-depository financial institutions to the private sectors. Depository institutions include Commercial Banks, Development Banks, Finance Companies, Co-operative Banks etc. Other financial institutions include life and non-life insurance companies, mutual funds, credit unions, mortgage banks, money market mutual funds, deposit insurance corporation/company, pension fund/provident fund, unit trust, savings and loan associations and so on. In most developing transition economies, the financial sector is dominated by the banking sectors, which are the largest immobilizers of deposits and providers of credit (Shrestha, 2004).

Financial sector reforms have been initiated in several countries including Nepal. For many of them, the financial sector remains at a relatively early stage of development, and continues to display a number of weaknesses. Under the reform program of Nepal, the large state owned commercial banks are main targets on restructuring that still dominate the banking sector, in terms of total assets. These banks are gradually being restructured and put on a more stable financial footing. The reform also aims at doing away with government ownership and enhancing competitiveness of the financial sector. Accordingly, the reengineering of the central bank and capacity building programme for the financial sector as a whole are as well incorporated (Adhikary, Pant & Dhungana, 2007).

Financial sector reform also covers and includes the area of competition, transparency, financial deposits and governance. The process of financial sectors reform begins with deregulation of interest rates on deposits and lending, phasing out of margin rates, statuary reserve requirement and targeted credit programs, opening financial industry to private sector (domestic and foreign), permission to open foreign currency account to commercial banks, current account convertibility and it completes with free entry and exits barriers to foreign investors in banking. Security trading, insurance services and privatization of government owned banking and financial institutions are examples of financial sector liberalization (Shrestha, 2004).

Financial sector plays a vital role in the development of economy and actually works as a lubricator by providing financial resources. It operates as intermediary between financial surplus units and financial credit units i.e., lenders/savers and barrowers/spenders. The financial markets provide playing field to financial institutions and their customers (depositors, borrowers, investors etc.) with all types of financial instruments such as; deposits, loans and advances securities, insurance polices, share corporate bonds etc. It provides different avenues to savers to invest their saving in financial product and services in accordance with their needs and makes funds available to barrowers/ investors in most competitive prices. So, the financial sector is regarded as the backbone or engine of growth of any economy either developed or developing countries - in transition or emerging. It mobilizes and allocates financial resources most productively and efficiently and also induces investment, increases employment opportunity and productivity, maintains growth targets, and attains overall macro economic development.

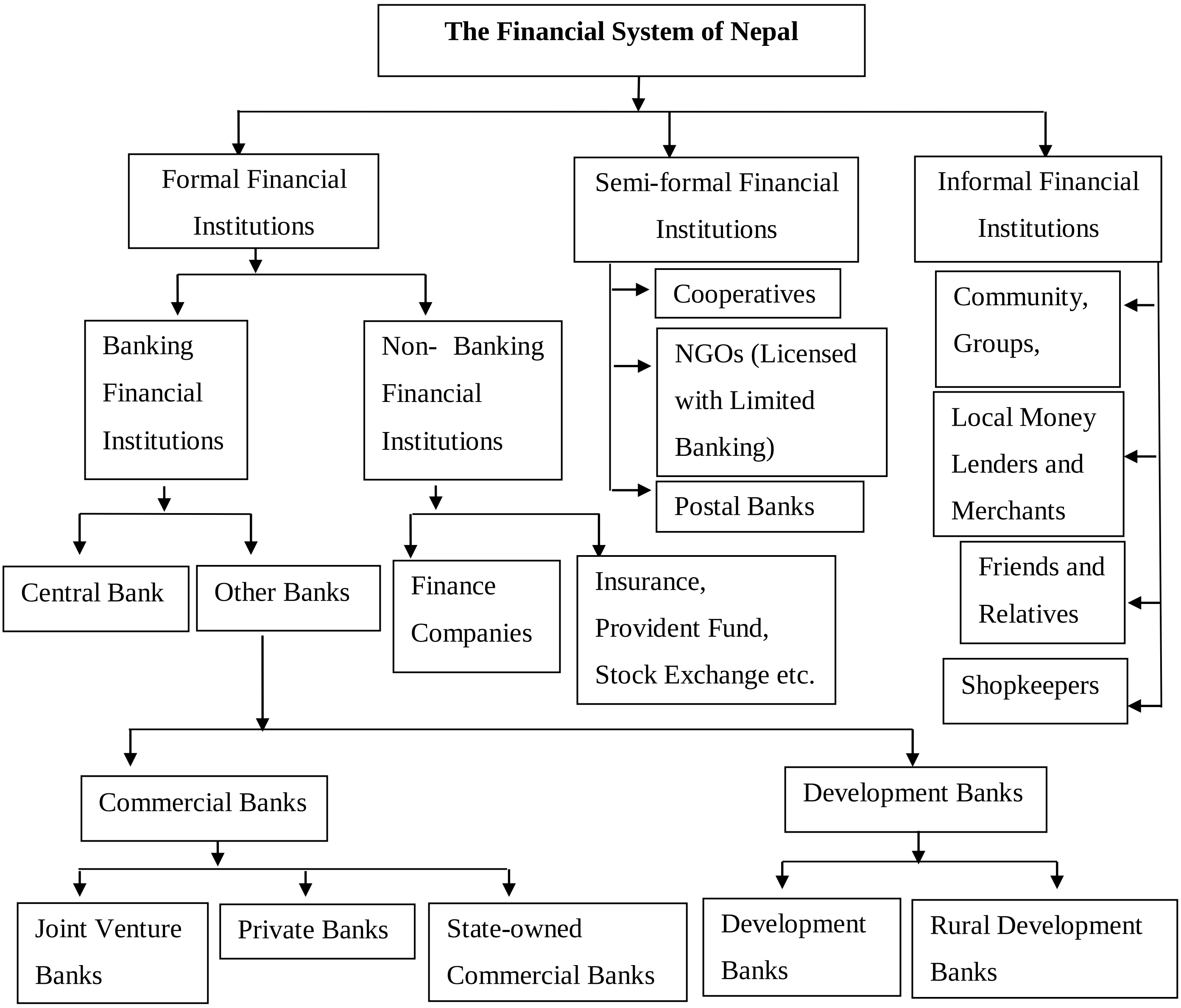
In Nepalese financial system and financial services, Nepal Bank Limited established in 1937 was the first commercial bank in Nepal. The establishment of Nepal Rastra Bank , the central bank of the country, was in 1956, and it was a major step towards the evolution and generalization of Nepalese Financial System (Acharya, 2003).

After promulgating NRB Act, 1956, NRB was become autonomous regulatory body on BFIs. NRB has power to issue policies, rules and directives against BFIs as per power and authority given to NRB as per point number 76-79 of the same act. So, decision of NRB on BFIs have vital role. NRB should research on regularly on financial sector and make and adopt new issue in its regulatory framework.

In July 2008, the financial networks of the country have been widened with the operation of the increased number of commercial banks up to 25, and numbers of its branches are 555. Prior to the financial sector reform, only two commercial banks were established. Even the insurance services sector has developed with the establishment of joint-venture insurance companies. There are all together 21 life and non-life insurance companies in the country. The number of listed companies in the Nepal Stock Exchange has reached 194. Till July 2008, the number of Development Banks are 58, and the number of Rural Development Banks are 5, number of financial companies are 78, number of co-operative societies (licensed by NRB) are 16, number of Micro-finance Non-governmental organizations (licensed by NRB) are 46 in the country. In July 2017, Commercial banks become 28, development banks become 40, finance company become 28 and micro finance company become 53 in number.

Figure: 1.1

Structure of the Financial System



(Source: Acharya, 2003)

1.2 Statement of the Problem

Till 1980s, there were only two commercial banks in the country and they were fully owned by state. But now the number of commercial banks has increased with majority of private and joint venture banks, and partially state owned. After many financial sector reforming programs such as SAP, CPBASS etc. by World Bank and IMF and ADB and their suggestions, Nepalese banking and financial sector have been running smoothly. Though banking and financial sector have been operated in good condition and increasing its volume and profitability simultaneously, many of other sectors financed through BFIs have not been developed in similar way. Many of other industry could not be developed in such a way as BFIs developed after financial sector reform in Nepal. In fact, banking and financial sector should be developed in accordance of development of other industry of market, however, industries that contribute major part in our GDP were not increased in such way however, financial sectors have been increased in higher rate.

The major industrial sector that majorly part our GDP and priority sectors declared by NRB such as Agricultural, Energy, Tourism and Small and Medium Industry etc. were not financed by BFIs in same line with financing in other sector from where BFIs get direct profitability such as trading of merchandised goods and beverage and real estate etc.

NRB has declared 14 districts which have lower presence of BFIs. People of such districts were served banking and financing facilities by lower numbers of BFIs. Deprived sectors were contributed by BFIs in the minimum line declared by NRB. So, NRB has playing vital role in developing priority and deprived sector lending. Also, real estate sector were controlled by NRB. Due to highly financing on the real estate sector many of the BFIs majorly finance companies were in endanger. So, as per financial sector reform program, privatization of BFIs are major issues on their study however, in case of Nepalese banking sector NRB has been playing three major role such as regulatory, supervisory and director.

While addressing the financial sector development in Nepal these are the main issues which needs to be addressed:

i. Does the development of Bank and finance company contribute to GDP and other priority sectors and deprived sector? Is development of BFIs proportionate to all over Nepal?
ii. What is the impact of Nepal Rastra Bank in Nepalese Financial Sector Development?
iii. What is the impact of FSR in Bank & Financial Institutions? Is the development of BFIs after financial sector contributed to development of other industrial sector of Nepalese market?

1.3 Objectives of the Study

The general objective of FSR is to help expanded economic activities. Obviously, an increase in economic activities accelerates the economic growth and it is pertinent to discuss the achievements of the FSR through the help of certain financial indicators. It is also important to note here that it is difficult to isolate the impact of FSR and other related variables on economic growth. This study is targeted at the impact of FSRs on banks and finance companies. The study concentrated on the trend and achievement of FSRs, for which the major variables considered are number of financial institutions, addition of financial services, deposit growth, credit to the private sector, interest rate spread and real interest rate, non-performing assets, cost and benefit of financial sector liberalization and other related variables.

The main objectives of the study are.

i. To assess the effectiveness & impact of Financial Sector Reform Program on financial sector development in Nepal.
ii. To analyze the proportionate development of BFIs after FSR in Nepal.
iii. To analysis the flow of lending of BFIs in different sector and its impact on growth of lending on GDP and different industrial sectors of Nepal that contribute on GDP.
iv. To analyze the Priority sector development and Deprived Sector Development in Nepal after FSR in Nepal.
v. To analyze the development of government owned banks (RBB, NBL and ADBL/N) in Nepal after FSR.

1.4 Limitation of the Study

This study is concerned on the trends and impact of the financial sectors development in Nepalese Market. Analysis has been made on the basis of availability of the data. Besides the above common limitations these are some important limitations of the study which needs to be addressed as below:

i. This study focuses on the BFIs in aggregate form but it does not cover the fields like manufacturing and non- manufacturing, mutual fund, capital market, postal saving services, insurance companies, employee's provident fund etc.

ii. Accuracy of the data used for evaluation in this study is depends up on the accuracy of the source of data.

iii. This study does not cover the all components/indicators of the financial sector development. Only major components like Liquidity/Deposit, Credit, NPA etc have been considered.

iv. GDP and its growth is only a part of Economic growth, however, the study focuses on the growth of GDP and impact of its components from lending of BFIs. The study does not analysis other parts of economic growth.

v. Only secondary data are used for the analysis of various component of financial sector.

1.5 Organization of the Study

This study is presented in five chapters. The organization of these chapters and content is as follows:

I. Introduction

This chapter deals about the introduction of background of the study, statement of the problem, focus of the study, objectives of study, Importance of the study and limitation of the study.

II. Review of Literature

This chapter deals with conceptual part of the FSR and also explores the review of previous literature, and the acts and ordinance relating to Banks and Finance Companies.

III. Research Methodology

This chapter deals about research design, selection of study area, types of data, data collection methods, sources of data, tools for analysis and so on.

IV. Data Presentation and Analysis

This chapter covers all the required data and its interpretations. Interpretations of data are solely based on secondary data and it is used to analyze the impact of some independent variable. The gathered data are tabulated and shown in charts, graphs and diagrams whenever relevant.

V. Summary, Conclusion and Recommendations

This chapter is the final chapter of the study and consist summary and conclusion of the study. Finally, some recommendations are made according to result of the study.

CHAPTER - II

LITERATURE REVIEW

2.1 Theoretical Concept

Financial sector is that part of economy concerned with the transaction of financial institutions. Financial institutions provide many transmission services and loan facilities and influence the working of the real economy by acting as intermediaries in channeling saving and other funds into investment uses. The financial sector together with corporate sector and personal sector constitute the private sector. The private sector, the public (Govt.), sector and foreign sector make up the national economy.

Nepal's financial sector is rather small comprising a small number of financial institutions. The Nepalese financial system comprises the banking and non-banking financial institutions. The banking system consists of Nepal Rastra Bank (NRB) which is the central bank and banks, where non-bank financial institutions includes Employee Provident Fund, Finance Companies, Insurance Companies, Credit Guarantee Corporative, Postal Saving Offices, Credit Guarantee Corporation, Civil Investment Trust, NIDC Capital Markets, Stock Exchange etc.

The Nepalese financial sector is dominated by the banking system, where banks are largest and important constituent. In the sphere of commercial banks two government controlled banks Nepal Bank Limited (majority private owned) and Rastriya Banijya Bank (100% government owned) together control about two-third of the banking business and thus dominate the arena of banks. The status and development of financial system in Nepal, thus largely depends upon the performances of these two governments controlled banks.

An act of liberalization pre-envisages that certain rigidities or fundamental disequilibrium persists in some or certain sectors of the economy. These rigidities be it on financial sector or in pure micro-economic sense, the economy including legal obstacles are shackles which have to be hammered down to free the undaunted task of enforcing market mechanism because economist has already agreed upon that it is intervention which is responsible for any distortion that the economy is burdened with.

Financial Sector Reform is related to establish a modern financial system capable of acting as the ‘brain of the economy’ and allocating the economy's savings in the most productive way among different potential investments (Williamson, 1999).

2.1.1 History of Financial Development in Nepal

The Nepalese financial system development has a very recent history, starting just from the early twentieth century. The full period, from initiation to the present, can be broken down into three distinct phases. The shifts in these phases are determined by different milestones. The first milestone is the establishment of the Nepal Rastra Bank , the Central Bank of Nepal in 1956, this determines the shift from the first to the second phase. Similarly, the second milestone is the promulgation of the current NRB Act 2002. This determines the shift from the second phase to the ongoing third phase (Maskey & Subedi, 2009).

The history of financial sector can be studied with different phase wise. Before establishment of NRB Act, 1956, there was only one commercial bank in Nepal i.e Nepal Bank Ltd. After establishment of NRB Act, 1955, there were somehow easy to establish BFIs in the Nepalese market. NRB Act, 1956 has been replaced by NRB Act, 2002 with making amendment and NRB has been given more supervisory and regulatory power. So we can study the financial history in Nepal with different phases.

I. Before Establishment of NRB

Before establishment of Nepal Rastra Bank, there was only one commercial bank i.e M/s Nepal Bank Ltd, which was formally established in 1937. The same bank was known as Tejarath Adda before its establishment as Banking company. Nepal's formal financial system had a late start and began less than one and a half centuries ago. The establishment of Tejarath Adda in 1880 can be conceived as the beginning of the process of credit mobilization in Nepal. However, this institution, although formally established, was not allowed to take public deposit and provide credit to public – the fund had been provided by the government for credit to their staff and landlords only. Therefore, it was not a bank before. Even the urban people in need of the financial support had to rely on Shahus (merchants) and landlords because of the limited activities of Tejarath Adda

(Pant, 1964). It was only with the establishment of Nepal Bank Limited (NBL) in 1937 that the financial services were made available to the general public. In this regard, the establishment of NBL was the epoch-making since it signified commencement of formal banking system in Nepal.

II. After Establishment of NRB

Nepal Rastra Bank was established in 1956 under NRB Act, 1955. With the establishment of NRB in 1956, the process was made easier for establishment of banks and financial institutions in the country. However, this phase can be further subdivided into two sub-periods: The first sub-period was a period of restriction where the Nepalese payment system was characterized as predominantly a cash-economy but, this period took a different turn with the establishment of Nepal Arab Bank Limited as the first joint-venture bank in 1984, under the Government's liberalized policy. The first sub-period saw more directed role of NRB in terms of credit control (including directed credit programs) and control of different categories of interest rates. In this sub-period, three institutions of diverse nature were established under the full ownership of the Government of Nepal. They were (i) Nepal Industrial Development Corporation in 1959 (ii) Rastriya Banijya Bank in 1966 and (iii) Agriculture Development Bank, Nepal in 1968 . The second sub-period witnessed greater financial liberalization that practically started from 1984 until the enactment of new NRB Act in 2002. This sub-period corresponds with the overall economic liberalization policy of GON after the nation underwent sustained balance of payment crisis in the early 1980s. This later sub- period saw major shifts in the policy measures such as: from a controlled to a deregulated framework of interest rate, from direct to indirect methods of monetary control, emphasizing open market operations as the main policy tool; and permitting market determined exchange rate of the Nepalese currency against convertible currencies and full convertibility of the Nepalese currency in the current account. During this sub-period, Nepal Indosuez Bank (later named as Nepal Investment Bank) and Nepal Grindlays Bank (now Standard Chartered Bank Nepal) were established in 1986 and 1987 respectively as the second and third joint-venture banks. However, no fully owned domestic-funded banks were established during this period. The entry of other development banks, finance companies, micro-credit development banks, savings and credit cooperatives and Non-government organizations (NGOs) for limited banking transactions started after 1992 under three major acts namely Finance Company

Act 1985, Company Act 1964, Commercial Bank Act, 1974 and Development Bank Act 1996. Before establishment of NRB, 2002 there were 13 commercial banks, 7 development banks and 45 finance companies in 2000.

III. After NRB Act, 2002

This act replaced the NRB Act 1955 and allowed NRB to be more autonomous in exercising decisions relating to formulation of monetary and foreign exchange policy as well as monitoring and regulating banks and financial institutions across the nation. However, it was felt that the existing situation of multiple numbers of acts under banking and financial institution sector made the process of regulation and monitoring system very cumbersome. As a result and as a process of financial sector reform program, all those diversified acts were grouped together under the 'Bank and Financial Institution Act (BAFIA), 2006. (Maskey & Subedi, 2009)

IV. After BAFIA, 2006

This Act, also known as Umbrella Act, categorized all the banks and financial institutions under four heads on the basis responsibility differences: Group A as commercial bank; Group B as development bank; Group C as finance company; and Group D as microcredit development banks. The other two forms of institutions, namely saving and credit cooperatives and Non-Government Organizations (NGOs), both allowed by NRB for limited banking transactions, are however not put in any of those groups and are being operated under specific directives and rules. The act replaces Finance Company Act 1985, Commercial Bank Act, 1974 and Development Bank Act 1996. Now, the act has been amendment in congruence with New Nepalese constitution (2072) and BAFIA, 2073 has been promulgated.

Now, In mid July 2017, the sector comprised of 28 commercial banks, 40 development banks, 28 finance companies, and 53 microfinance development banks. In addition, 15 savings and credit cooperatives and 31 microfinance and 27 nongovernment organizations (NGOs) are licensed by the central bank. Gradually development of Nepalese bank and financial institution has been presented in data presentation section.

2.1.2 History of Financial Sectors Reform in Nepal

Nepal has gradually experienced a series of economic reform measures since the mid 1980s. The reform measures have resulted in a widening and deepening of the financial system both in terms of the volume and the nature of financial business. Policies were introduced to reduce the high extent of government participation in the economy with private sector investment only after 1984. In addition, this decade is important for financial development because the government implemented several policies to ease private sector participation in the economy (Poudyal, 2005).

The reform or liberalization of financial sector is a continuous process. It takes a long period to complete the process of financial reform. Even in a most developed financial market, innovation in financial products and services takes place, which necessitates the changes in rules and regulations in the financial markets. The financial sector reform of Nepal was initiated in mid-1980s and it is still being continued (Shrestha, 2004).

In most of study papers, the financial sector reform process in Nepal has been analyzed in three phases, so financial sectors have been addressed in three phases here as well, which are as follows:

I. Phase-I (1984 to 1990)

While examining the period 1985-90, it is found that the policies adopted were extremely based on WB/IMF conditionalities included in the SAP, but the sine qua non of success was absent and a massive increase in poverty took place during the period. Structural Adjustment and economic restructuring policies in Nepal had been adopted after 1985 when macro- economic imbalances in the form of growing fiscal deficits and dwindling international reserves had become serious. Liberalization and privatization, thus, came into existence but were pursued more forcefully during the period of 1991-94 (Rimal, 2009).

In July 1985, commercial banks were allowed, for the first time, to accept current and fixed deposits on foreign currencies (U.S. dollar and sterling pound) Before May 26, 1986, the interest rates of commercial banks were totally controlled by Nepal Rastra Bank , the central bank of Nepal. Both deposits and lending rates were being heavily regulated by NRB. On May 26, 1986, NRB deregulated the interest rate regime and authorized commercial banks to fix interest rates at any level above its minimum prescribed levels. These bold steps of NRB had a far reaching impact in the development of the financial sector of the country, which was clearly evidenced in the growth of the assets and banking activities of commercial banks. Effective 29 May, 1986, the liquidity requirement was also lowered to 9 percent from 25 percent (NRB, 1996).

II. Phase-II (1990 to 2001)

The deepening economic crisis compelled the government to seek help from international donors. In 1985, the government entered into its first stand-by credit agreements with the International Monetary Fund and initiated reforms under the Economic Stabilization Program. In the same year, the government signed an agreement with the World Bank for the Structural Adjustment Program. The key focus of SAP was market-oriented reforms to reduce government interventions in the economy. SAP had two phases: SAP I (1986–1989) and SAP II (1989–1992). The finance sector reform was implemented under SAP II. The first reform was not fully successful in reforming RBB and NBL, SAP's primary objective. In1990, the government adopted the Commercial Bank Problem Analysis and Strategy Study's recommended restructuring actions for RBB and NBL, including recapitalization (Ozaki, 2014).

Under the financial sector reforms, 3 joint venture commercial banks were established and they started to provide modern banking services to their customers. They started to compete with Nepal Bank Limited and Rastriya Banijya Bank, one fully owned and another 51% owned by HMG/N and among them to provide modern and efficient banking services. As a result, they attracted most of the good clients/customers (depositors and borrowers) of the RBB and NBL. They were already ailing even before the establishment of joint venture commercial banks. Because of new developments, their financial, managerial and organizational problems became more serious. To study their financial, managerial and organizational problems and to prescribe necessary recommendations, NRB sought the financial and technical help of the UNDP and the study team presented the Commercial Banking Problem Analysis and Strategy Study (CBPASS) reports (Shrestha, 2004).

Taking into account the serious problems in the financial sector, HMG/N adopted the Financial Sector Strategy Statement in December 2000. It has clearly mentioned about the needs for the strengthening and autonomy of NRB so that it can regulate and supervise commercial banks and financial institutions. It has pointed out the needs for the enactment of new NRB Act to increase the independence and authority of NRB to supervise of financial institutions and take over the management of troubled banks and severely punish those financial institutions, which are found engaged in serious irregularities. It has also pointed out the need of having the Deposit Taking Institution Act, which is an umbrella act of all deposit taking institutions.

Based on the inputs from the Financial Sector Assessment, the government approved the Financial Sector Strategy Statement and publicly announced it in November 2000. FSSS committed specific reform agenda, including (i) reforming finance sector legislation, (ii) strengthening bank supervision and inspection, (iii) restructuring and privatizing NBL and RBB, (iv) establishing a banking training institute, (v) strengthening the Credit Information Bureau, (vi) establishing an asset reconstruction company, (vii) restructuring and strengthening ADBL, and (viii) establishing and strengthening rural development banks. Following FSSS, the World Bank approved a $16 million Financial Sector Technical Assistance Project (FSTAP) in December 2002. FSTAP's development objective was to focus on (i) helping restructure and reengineer NRB, (ii) commencing commercial banking reform in RBB and NBL by introducing stronger bank management that would protect the financial integrity of the two banks and take on a conservator role to prepare the banks for the next steps of restructuring and (iii) supporting a better environment for finance sector reform in areas such as enhanced credit information, better financial news reporting, and better training for staff in financial institutions (World Bank, 2002).

III. Phase-III (2001 to 2018)

NRB is the government bank of Nepal and lack of autonomy and weak supervision capacity of NRB was considered a core problem of the finance sector. For strengthening the capacity of NRB and legislative reforms NRB act, 2002 had been enacted. Similarly, HMG/N has enacted the NRB Act, 2002, the Debt Recovery Act, 2002 and the Banking and Financial Institution Ordinance, 2004. The Public Debt Act and the Foreign

Exchange Regulation Act were amended in 2002. The draft of the Secured Transaction Ordinance has been sent to HMG/N for its approval, which would address the weaknesses in the legal enforcement mechanism and judiciary capacity.

NRB Act, 2002 had replaced NRB Act, 1955 and it has amended first time on 2007 with congruence with change in Nepal Constitution Provisions and it had amended second time on 2010 as per Republic Strengthening and some Nepal Laws Amendment Act, 2010. Similarly, the act has been lastly amended in 2016 with congruence with Nepal Constitution (2016).

There were different kinds of regulatory acts and policies had been implemented in Nepalese financial sector. Since 1984, there were various kind of regulatory works has been implanted in Nepalese financial sectors. The Chronological legally financial sector reform activities can be presented as below:

Table 2.1 : Chronology of Financial Sector Reform Activities in Nepal Since 1984

Years	**Financial Sector Reform Activities**
1984	• Amendment of the Commercial Bank Act, 1974
1985	• Enactment of the Finance Companies Act
1989	• Establishment of the Credit Information Bureau
1991	• Establishment of Citizen Investment Trust
1992	• Amendment of the Security Exchange Act • Establishment of the Security Exchange Board
1993	• Abolishment of the statutory liquidity ratio • Establishment of five regional rural development banks
1996	• Enactment of the Development Bank Act
1998	• Enactment of the Financial Intermediary Act
2002	• NRB Act, 2002
2007	• BAFIA, 2007
2009	• Issue of NRB Directive, (2009 to 2017).
2016	• Amendment of NRB Act, 2002
2017	• BAFIA, 2017

Source: World Bank Paper, 2014 and Financial Stability Report of NRB.

2.1.3 Recent Financial Sector Policies and Regulatory Reform in Nepal

Nepal has become a member of WTO, so, there are many opportunity as well as competition threat for Nepalese financial sector. Nepalese Government has changes its policies through NRB for adopt the emerging changes of global economy. Some of recent change in policies and regulation are addressed below:

I. Implementation of BASEL in Nepal

The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters. The group regular studies on the field on Bank and financial sector and show the way for resolve the issue on the financial sector. The group has presented three types of thought till dated known as BASEL-, BASEL-II & BASEL-III. Nepal has already adopted BASEL-I & II and yet to be fully adopted BASEL-III. NRB has revised the thought of BASEL-III before implantation in Nepalese market as the study of BFIs by the group has made on their owned study sector which may not fully useful for Nepalese financial sector and also, Nepal does not have fully developed financial instruments and system yet.

II. Change in Liquidity Framework

Basel III introduced two ratios for liquidity monitoring and management in banks such as i. Liquidity Coverage Ratio and ii. Net Stable Funding Ratio. LCR is introduced to promote short-term resilience by requiring sufficient high-quality liquid assets to survive acute stress lasting for 30 calendar days. The bank which maintains the ratio more than hundred percent during the short period of time is considered to be the sound bank in terms of short-term liquidity. NRB has developed its own liquidity monitoring framework for the short-term liquidity monitoring of the banks. NRB will fully implement LCR by end of 2017 which requires Commercial Banks to maintain 100 percent LCR. NSFR is aimed at promoting resilience over longer term through incentives for banks to fund activities with more stable sources of funding. The ratio is developed to address the maturity mismatch between liabilities and assets in the financial sector and to make sure that banks have sufficient stable funding to withstand a yearlong liquidity crisis. NRB will introduce minimum standard based on BASEL III by end of 2017, and fully implement NFSR by 2019.

III. Crisis Management and Bank Resolution Framework

NRB has introduced policy provisions with the motive of enhancing public confidence towards the financial system, for insuring deposit up to Rs 0.2 million of small and medium size depositors. Deposit and Credit Guarantee Corporation, with the view to protecting the financial system of Nepal and contributing to financial stability, is committed to ensure the interest of the depositors by broadening the financial safety net which involves the provision of a deposit guarantee that protects depositors against the loss of their guaranteed deposits placed with BFIs in the case of unlikely event of the BFIs failure.

NRB has established a separate division as Problem Institution Resolution Division (PIRD) for the effective management of problem banks and financial institutions. After establishment of this division, it has helped to manage weak banks and financial institution in an objective, transparent and cost effective manner so as to ensure stability in the financial system. Effective bank supervision should include enforcement measures and allowances for early intervention before a bank‘s capital falls to a low level. ELA, used judiciously, may prevent a liquidity problem from turning into a solvency problem. NRB has issued policy on lender of the last resort in 2011 to develop an effective resolution regime for financial institutions. NRB provides LOLR to BFIs which need to be revived due to its systemic importance on economy and financial System.

IV. Capital Increment and Financial Stability

As far the capital increment of BFIs (except microfinance institutions) is concerned, the Central Bank had decided to increase the capital of BFIs up to four folds through Monetary Policy in the FY 2015/16. BFIs have to meet the capital requirement criteria by the end of this fiscal. NRB had made a six-fold increment in the paid-up capital requirement for MFIs involved in wholesale lending. The initiations will have to increase their capital to Rs. 600 million by mid-July 2018 from existing Rs100 million.

Through increasing minimum capital requirement of BFIs, NRB had expected many small BFIs to go for merger and acquisition to meet the required capital and become stronger one. However, only few banks merge and acquire to increase teir capital base, in contrast, even small and weak banks increases their capital through issuing right share which had adverse impact of financial stability. In addition, there would be challenges for the central bank to regulate possible credit expansion in unproductive sectors and haphazard lending to boost the profitability.

V. Relaxations in Branch Opening Policies

BFIs are exempted from taking prior approval of this bank to open branches outside Metropolitan and Sub-metropolitan areas and center of municipalities. In addition, BFIs are not required to take prior approval of this bank to relocate Bank branches in another area of the same district severely affected by earthquake except the Kathmandu valley. However, BFIs need to inform this bank on such developments.

VI. Other Changes in regulatory frameworks

NRB has regularly made research on the financial sectors and made new monetary policies, act and regulation. Beside, above mentioned changes, NRB has also made changes in policies in different sector such as in Deprived sector, Productive sector and Tourism sector, Consortium lending, Margin lending etc. The changes in regulation have direct effect on BFIs. So, NRB should always vital role on financial sector reform and development of Nepal.

2.1.4 Objective of FSR

The specific objectives of the FSR as highlighted in the policy paper on FSR prepared by His majesty's Nepal during 2002 included such as i. Create sound, stable and healthy financial system, ii. Broaden and deepen the financial system in the economy, iii. Enable and policymaker to fully and timely avail sound financial statistics, iv. Canalize adequate resources on lowest possible cost, to promote sustained, broad- based growth momentum, v. build the institutional capacity to identify and tackle the problems in the financial system, vi. Increase the autonomy and capacity of central bank and other regulatory institutions for making their respective policies institutions, supervisory and regulatory functions effective, vii. Improve and update the legal and judicial framework for the financial system, and viii. Drastically reduce the NPA, improve the financial intermediation efficiently and build a strong and stable financial system, there by promoting growth and reducing poverty (Pyakuryal, 2003).

The FSR represents the phase-wise program focusing on the three broad objectives such as 1. Strengthening and developing, regulatory and supervisory framework and the macro economic management capability of the central bank, 2. Reforming the commercial banking sector which is dominated by two large ailing commercial banks the fully stated-owned and controlled RBB and the recently majority-privatized or party state-owned, NBL 3. Reforming the development banking and other government-owned financial institutions like ADB, NIDC, etc. (NRB, January 2002).

The ultimate objectives of FSR in Nepal are not different from the theoretical propositions made above. However, when financial liberalization began, Nepal had typical problems with its typical stage of financial system. There were only two commercial banks operating in the government sector. The banks were tightly regulated and there was no competition. The non-performing loans were increasing and the quality of bank services was poor. Nominal interest rates were controlled real deposit rates were often negative. Financial saving mobilization was very low.

There were no non-bank financial institutions other then two specialized financial institutions Agricultural Development Banks (ADB/N) and Nepal Industrial Development Corporation (NIDC), and a few insurance companies and Employee provident Fund (Basyal, 2000).

The financial market was virtually in stage of monopoly. Against this background, the financial sector liberalization process was initiated onwards in the middle of 1980s. The intermediate objectives of FSR in Nepal are Competition, positive real deposit rate, reduction in interest rate spread, financial deepening, financial widening, promotion of private sector investment, and reduction of non-performing assets. Brief descriptions about the objectives on the FSR are given below:

I. Competition

Financial growth cannot take a desirable path unless financial institutions operate vibrantly. In order to grow the financial institutions vibrantly, new financial products have to be innovated and the quality of their services has to be improved. This can take place only when there is competition among the financial institutions. Financial institutions do not generally operate competitively if they are limited in numbers. Prior to reforms, there were only two state owned commercial banks and other few financial institutions, these institutions did not face any threat or challenge. The banks were enjoying 'duopoly' and thus had a secure market. In this context, Nepal had begun FSR by removing the entry barriers. For this purpose, the Commercial Bank Act 1974 was amended in 1984 and Finance Company Act was introduced in 1985. The objectives of introducing these measures were to open the entry for the private sector and create a competitive environment in the financial system *(*Upadhaya, 2005).

II. Positive Real Deposit Rates

In a least developed country with a poor economic growth rate and low per capita income, there is a greater need for investment both the public and private sectors. Higher investment can take palace only when savings are mobilized sufficiently, and savings can be more efficiently allocated only if the financial system is advanced. Such savings are highly affected by the ability and the willingness to save, which is determined by the real rate of interest on deposits. That is financial savings can be augmented if real deposits are positive. In the past, when interest rates were controlled, Nepal Rastra Bank attempted to keep the real deposit rates positive by frequent adjustments in the nominal interest rate, along with changes in inflation rate was not successful all the time.

III. Reduction in Interest Rates Spread

Interest rate spread indicates the cost of financial intermediation. Higher the interest rate spread, the higher is the intermediation cost. Persistent higher interest rate spread causes financial disintermediation and as a result, inhibits financial development. Therefore, liberalization of the interest rate spread is important aspects of FSR (Basyal, 2002).

IV. Financial Deepening

Financial deepening is measured as financial assets or border monetary aggregates to GDP ratio, involves the introduction and intensive use of new financial products for economic growth. Financial deepening would indicate greater financial resource mobilization in the formal sector, an ease in liquidity constraints of banks and enlargement of funds available to finance the projects. Thus, larger financial deepening provides a possibility for increased resources deployment in the economy. This enhances the change for accelerating economic growth was one of the objectives of financial liberalization in Nepal.

V. Financial Widening

It refers to the greater use of money while exchanging goods and services, thus facilitating financial deepening. Definitely, there had been a greater use of money following the establishment of NRB and two state-owned commercial banks. However, there was still scope for financial widening mainly because of the existence of vast non-monetized activities in rural areas in general and agriculture sector in particular. This prevents commercialization and hence specialization of economic activities and the economy lost its efficiency gain. Although the state-owned commercial banks extended their branches in the rural areas of the country to provide the required banking and financial services but it was not sufficient. Therefore, commercialization of the economic activities financial liberalization was initiated.

VI. Promotion of Private Sector Investment

One objective of FSR is to promote private sector investment. If the private sector is more efficient than public sector, the public sector can play a supporting role to accelerate economic growth. In a financially repressed economy, private sector investment is crowed out by the public sector investment, so it adversely affect in economic growth. In liberalized financial system, there would be higher level of saving mobilization enhancing deposits and lending that need for efficient financial system. More saving can be mobilized with a wide range of investment and activities and they are readily available for investment at competitive rates of interest. Private investment activities need not suffer from lack of capital.

VII. Reduction of Non- Performing Assets

Non-performing assets implies the bad quality of loans/debts that means the loans is not paid at maturity period and which is responsible to bring banking and financial crisis . Due to the mistake in lending or investment process by the various reasons the two big state-owned banks RBB and NBL have been facing the problem of increasing in NPA during its liberalization. And, not only these two banks, the joint venture banks and financial institutions also have the same problem. According to the NRB directive, the loan has been categories as good loan, sub-standard loan, doubtful and bad loan. Among these four categories, sub-standard, doubtful and bad loans are taken as non-performing loans. In this contest, the main objective of FSR is to improve the quality of loan portfolios of the financial institutions and thereby reduce their non-performing assets.

2.1.5 Financial Access to Nepalese People

Financial Access is understood as providing and ensuring reliable and affordable financial services to all segment of society. Although access to finance is necessary for all members of society, it is particularity more important for disadvantaged and low income segments of society, as it provides opportunities for them to save and invest, and protect themselves from various risks such as natural disasters, illness and loss of livelihoods. Access to finance will enable the poor and low income people to make self-reliant and give chances to break the vicious cycle of poverty. NRB in coordination with other donor partner's DFID, UNDP, UNCDF and Fin Mark conducted demand side study of financial inclusion for Nepal. The study reveals that about 40 percent of adult population is banked with their access to the services provided by cooperatives and other formal non-bank financial institutions; about 61 percent of adult population is formally served. Money lenders in Nepal still feature highest as a source of credit. 82 percent of the adults agree that money lenders are an important part of their community for borrowing funds. 28 percent of adult population said that they are aware of insurance, while only 11 percent claim to have a form of insurance.

Recognizing the need for inclusive growth policy for Nepal, NRB in coordination with the government of Nepal, has taken numbers of policy measures to ensure reliable and affordable financial services to the poor people in the country. Liberal licensing policy for establishing micro finance institutions, gradual increment in deprived sector lending requirement for licensed Banks and Financial Institutions (BFIs), mandatory requirements for them to invest certain percentage of their total credit in the productive sector, mandatory requirement for opening rural branches in order to open additional branches in urban areas, special refinance facility to cottage and small industries, interest free loan to extend. Bank branches in remote and rural areas, establishment of Rural Self Reliance Fund for subsidized credit to the poor and marginalized population, directives on consumer protection, simplified provision to extend financial services through branchless banking and mobile banking services, and policy regarding financial literacy are some of the policy measures directed towards ensuring financial inclusion and inclusive growth in the country. For the expansion of economic activity, financial access plays a vital role. In this connection Government of Nepal has announced a policy to motivate for opening a bank account for each household. In line with the government policies, it is said that NRB is introducing 'one account in one household' campaign soon.

Financial access has been increasing with the expansion of network of financial institutions. As of mid-July 2015, the branch network of commercial banks reached 1672 followed by development banks (808), Finance companies (242) and Micro Finance Development Banks (1116). The number of branches of the respective categories of BFIs accounted to 1547, 818, 239 and 852 respectively as of mid-July 2014. Due to the merger policy adopted by NRB, the number of branches of Development Banks (B Category) reduced by 10 to 808 after the merger of 5 Development Banks. However, the total number of bank branches of BFIs increased by 382 (11.1 percent) and reached to 3838 in mid-July 2015 from that of 3456 in mid-July 2014, 10160 in mid July, 2016.

2.1.6 Deprived Sector Lending

The monetary policy stance is designed to channelize financial resources towards productive sectors such as agriculture, energy, tourism, cottage and small industries as well as to the deprived sector. Thus, the policy is cautious on potential risk on financial stability that may arise from the expansion of credit to real estate and stock market. Monitoring the small and medium enterprises (SME) desk at BFIs will be made effective. This will ease the credit availability to the missing middle, those not in the targeted group of the BFIs and financially stronger than the deprived people. Monetary Policy for the fiscal year 2015/16 has been issued by NRB and the provision regarding to the deprived sector lending made in the policy can be listed below.

As per the provision of insuring bank deposits up to Rs. 2 hundred thousand, total deposits of Rs. 318.36 billion of 150 BFIs is guaranteed as of mid-June 2016. Similarly, credit of Rs. 2.41 billion has been guaranteed under micro and deprived sector credit guarantee program and Rs. 520 million under small and medium businesses. Thus, the total credit guaranteed amounts to Rs. 2.93 billion as of mid-June 2016. The budget

speech of the GoN for 2016/17 proposes to establish a challenge fund with an objective of providing seed capital to young entrepreneurs. BFIs will be encouraged to provide additional financial resource to youth receiving such facility from the challenge fund. Such lending of the BFIs will be counted as productive and deprived sector lending. The ratio of loan to be extended by the commercial banks to the deprived sector has been
Kept unchanged at 5 percent. Under such ratio, the commercial banks are required to invest minimum 2 percent of the loan directly. In addition, existing deprived sector lending ratio for the development bank and finance company has been kept unchanged.

A provision will be made to include project loan up to Rs. one million provided by BFIs against the collateral of commercial agriculture project under deprived sector lending.
Increase in limit of micro credit to the deprived or low income individuals against group guarantee for operating micro business from Rs. 1 hundred thousand to Rs. 3 hundred thousand and such limit is increased from Rs. 3 hundred thousand to Rs. 5 hundred thousand for group members classified as good borrowers for the last two years. Increase in credit limit against collateral to deprived and low income people for operating micro business from Rs. 3 hundred thousand to Rs. 5 hundred thousand, and such limit increased from Rs. 5 hundred thousand to Rs. 7 hundred thousand for group members classified under good category for the last two years. Group members who have been using deprived sector lending from the MFIs for the last two years and categorized as good borrowers will be entitled to borrow up to Rs. 300,000 up from the existing limit of Rs. 200,000. Increase in credit limit from Rs. 60 thousand to Rs. 3 hundred thousand for the deprived and low income people not associated with any group.

As per circular issued on 6 August 2015, the deprived sector lending requirement for BFIs will be increased by 0.5 percentage point. As per the provision, the commercial banks to be required to disburse 5 percent, development banks 4.5 percent and finance companies 4.0 percent of their total loan in the deprived sector. Commercial banks, development banks and finance companies have disbursed 5.46 percent, 6.35 percent and 4.3 percent respectively of their total loan to the deprived sector as of mid-April 2016.

2.1.7 Priority Sector Lending

Nepal Rastra Bank has raised the lending requirement for commercial banks toward productive sectors by 5 percentage points to 25 percent of their total lending. Unveiling the Monetary Policy for Fiscal Year 2017/18 in Kathmandu on Sunday, the central bank said that the 'A' class commercial banks must float 25 percent of their total loans to productive sectors by mid-July, 2018. By increasing productive sector lending requirement, the central bank has disseminated a message that it wants the banking industry to channelize more resources into priority sectors like agriculture, energy, tourism and small and medium enterprises, which are the major sector of economic activities, to support the economic growth target of the government.

According to the central bank, the 25 percent directed lending requirement includes 10 percent in agriculture sector, 5 percent in hydropower, 5 percent in tourism and remaining 5 percent in other sectors prescribed by the NRB as productive sectors. Commercial banks were earlier required to float 20 percent of their total lending in productive sectors, including 15 percent credits on agriculture and energy sector combined. In line with the demand of the banking executives and the private sector leaders, the central bank has also expanded the definition of productive sectors to accommodate pharmaceuticals, cement and garment, among other industries, as productive sectors. However, there are doubts on whether banks will be able to increase productive sector loans as they are struggling to meet the existing requirement of 20 percent.

2.1.8 Real estate sector

Real estate refers to the immovable property such as land, land and house or any type of building or infrastructure used for either residential or business or any other purposes. Until recently, investment in real estate sector was increasing in Nepal due to lack of alternative investment opportunity in the country. The increase in the demand for land, especially in urban areas, is attributed to the inelastic supply of land and absence of viable investment opportunity. The speculative assumption of people that price of real estate will never decline and it is the safest sector to invest, has played an instrumental role in increasing in the real estate price.

Directive Number 3 has Provisions Relating to Single Borrower and Limitation of the Sectoral Credit and Facilities. Licensed Institution may extend to a single borrower or group of related borrowers the amount of fund-based loans and advances Non-fund based Loan up to 25 percent of its Core capital fund. According to the provision, borrower can enjoy Loan limit not more than 50% of Fear market value of the collateral, however, in case of housing loan (residential Real Estate) it can be facilitated up to 60%. Similarly, any BFI can finance up to 25% of total loan to real estate sector and out of which financing to plotting sector should not be exceeded 10%.

2.1.9 Re-Engineering of Nepal Rastra Bank

Nepal Rastra Bank Act, 1995 was revised in 2001 and come into law in January 30, 2002 as Nepal Rastra Bank Act 2002. This act has made NRB an autonomous institution. The major difference between the new and old Nepal Rastra Bank Act, 1995 is the fact that the new act has accommodated number of provisions to the NRB's legal structure to establish and preserve the autonomy and accountability of the central bank. It is expected that this act serve the requirement of a modern central bank as part of the government's overall financial sector development and modernization program (Pyakuryal, 2003).

Nepal Rastra Bank is the central bank of Nepal established in 1956 under Nepal Rastra Bank Act, 1955 to manage, to control and to regulate the financial sector of Nepal. Since its inception, there has been a significant growth in both the number and the activities of the domestic financial institution. The deficiencies and inadequacies in terms of their roles for economic and financial development of Nepal, NRB was established on 26th April 1956 as the central bank of Nepal as per the NRB Act 1955. The act had set with the objectives of i. To ensure proper management in issuance of Nepalese currency notes and makes proper arrangements for circulation of Nepalese currency, ii. To stabilize exchange rates of the Nepalese currency, iii. To mobilize capital for development and encourage trade and industry in the Kingdom & iv. To develop the banking system in Nepal.

Basically there were three important measures for strengthening the regulatory and supervisory framework in Nepal. First was the strengthening of legal framework for the effective operation of banking in Nepal. Second was to introduce the world-class regulatory measures for the operations of banking in Nepal. And the third was to enhance the capability of NRB staff to carry out regulatory and supervisory functions effectively.

I. Improvements in the Legal Framework

Many Acts governed the Nepalese financial system, thus strengthening the legal framework became vital for developing a sound financial system. First of all, there was a necessity to amend the NRB Act 1955 so that sufficient autonomy in the conduct of inspection and supervision of banks and financial institutions, monetary policy and licensing of banks and financial institutions could be ascertained. NRB Act 1955 was therefore replaced with a new NRB Act 2002, which provided autonomy in the conduct of monetary policy, inspection and supervision and in the exercise of administrative power by the central bank. The new Act changed the objectives of NRB taking into account the new roles of a healthy central bank in a globalized economy.

II. Improvements in the Regulatory & Supervisory Framework

According to the NRB Act, 2002, Point number 79, NRB has supervisory power on the BFIs. The provision made on the act as i. The Bank shall have full powers to regulate the functions and activities of commercial banks and financial institutions, ii. For the purpose of the regulation under sub-section (1), the Bank may frame rules and bye-laws on the matters which the Bank deems appropriate and issue necessary order, directives and circular and it shall be the duty of the concerned commercial bank and financial institution to abide by such rules, bye-laws, order, directives and circular. On the basis of the same point, NRB has issue NRB unified directive each year which govern different part of BFIs such as capital, investment, interest rate, deposit and loan loss provision etc.

III. Developing capability of NRB staff

Developing capability of NRB staff was an important component of reengineering program. This project sought capability development in the areas of inspection and supervision, regulation, strategic planning, accounting and auditing. Accordingly, training requirements for the staff of these departments were identified.

NRB achieved some satisfactory results in these areas. NRB hired Chartered Accountants in an effort to bring fresh qualified people in the bank. Bank Supervision Department introduced new On-site Inspection manual. Similarly the Financial Institution Supervision Department also introduced Off-Site Inspection manual. Trainings were provided to the staff of Bank Supervision Department and Financial Institutions Supervision Department in the areas of inspections and supervisions. Laptop computers were provided to the staff of these two departments to enable them prepare inspection report at site and reduce the time taken in writing report. Training needs for the staff of supervision departments have been identified. It is expected that the second phase of reengineering program would continue developing capability of NRB staff.

2.1.9 RBB and NBL Reform Process

Considering the historical background of the state-owned commercial banks i.e RBB and NBL, they were already ailing even before the establishment of joint venture commercial banks. From that period they had financial, managerial and organizational problems. To study their financial, managerial and organizational problems and to prescribe necessary recommendations, Nepal achieved financial and technical help of the UNDP and the study team presented the Commercial Banking Problem Analysis and Strategy Study (CBPASS) reports in 1992. They provided two reports: CBPASS I and II addressing critical areas of RBB and NBL. The first report (CBASS I) recommended HMG/N to address critical areas. The CBASS II report identified four critical areas: Loan Recovery, Credit, Personnel and Branch Operations, where RBB and NBL had to make necessary improvements even though both reports were implemented to some extent but their management and organizational structures could not be improved (Shrestha, 2004).

Taking into account of these serious problems in the financial sector, HMG/N adopted the Financial Sector Strategy Statement in December 2000. It has clearly mentioned about the needs for the strengthening autonomy of NRB so that it can regulate and supervise commercial banks and financial institutions. It has pointed out the needs for the enactment of new NRB Act to increase the independence and authority of NRB to supervise the financial institution and take over the management of troubled banks and severely punish those financial institutions, which are found engaged in serious irregularities. It has also pointed out the need of having the Deposit Taking Institution Act, which is an umbrella act of all deposit taking institutions.

The World Bank's FSTAP and FSRP supported the restructuring of state-owned commercial banks NBL and RBB. The objective of the restructuring was to improve the two banks' corporate governance and reduce government ownership in the finance sector. FSRP placed an external management team at each bank. The management team was to (i) take management and financial control of the day-to-day running of the banks; (ii) help stabilize the operational and financial position of the banks; (iii) help strengthen the accounts of the banks; (iv) conduct training programs, the voluntary retirement scheme (VRS) program, and branch restructuring and improvement programs; (v) adopt appropriate remuneration packages for bank staff; and (vi) prepare the banks for privatization. The external management team was placed at RBB on 22 July 2002 and had carried out a series of organizational and operational restructuring. In the organizational restructuring, VRS programs were conducted and staff size was reduced from over 5,000 employees in 2002 to below 2,600 employees by 2009. To improve profitability, RBB reduced the number of bank branches from over 200 to 123during the same period. They upgraded the core banking system and installed new systems in a total of 64 branches. The computerization of RBB branches met targets, with 95% of deposits and 98% of loans automated and online. At NBL, the external management team was fielded on 16 January 2003 and had carried out similar restructuring activities. They conducted operational and business process restructuring, including VRS, branch reduction, and system upgrading. In addition, they standardized business processes, prepared various manuals, and strengthened accounting and auditing. Staff size was reduced through VRS from 5,652 to 2,960 in three phases. Branches were rationalized, reducing the number from around 200 to 114. IT systems were installed in 58 out of 107 branches, and 77% of deposit base and 88% of loans were covered by the IT platform (Ozaki, 2014).

According to the commitment of HMG/N to reform RBB and NBL, HMG/N and NRB established the Nepal Banking Reform Project and Started to work with funding assistance of World Bank (IDA) and DFID (UK). In this banking reform project, KPMG Barents Group, an international expert team was associated and started the reform project from 15 November1999. They completed their study in FY 1999-2000. They found that both banks RBB and NBL were deeply impaired in all areas of their operations such as i. Overall bank governance and management weak by modern standards, ii. Deep flaws in lending process, loan files and loan portfolio, iii. No business strategies, weak planning and budgeting process, lack in foundation, follow-up rewards and penalties, iv. Primitive financial accounting with large pockets of 'double counting' unsubstantiated assets, and major items that should be written off by international standards, v. Low morale of employees, low pay scales, low skills and counter-productive, union-oriented activities, vi. Primitive management information record keeping and control system (Shrestha, 2004).

2.2 Literature Reviews from Related Studies

For the study about the financial sector reform in Nepal, there are different types of study material that can be taken for review. Different types of books, journal, articles, magazines, NRB reports, NRB publication, act and regulation related to the financial sectors and unpublished thesis have been reviewed for study. Here are some of the important study materials presented as below:

2.2.1 Journal and Articles

Different kinds of journal and articles have been found in market related to the financial sector reform in Nepal. However, some of the related with financial sector reform in Nepal and liberalization and published with reference from NRB have been taken for study. Some of major articles and their conclusion have been addressed here.

Shrestha (2004) has study on financial sector reform in Nepal and the article made overview regarding financial sector reform in Nepal and study has been made from 1984 to 2003. Financial sector is the backbone or engine of growth of any economy. It mobilizes and allocates financial resources most productively and efficiently and induces investment, increases employment opportunities and productivity, achieves growth targets and attains overall macro-economic development. In a global financial system, each country has to reform its financial sector. The reform process should be properly sequenced. Nepal initiated financial sector reform in mid-1980s and HMG/N and Nepal Rastra Bank have been implementing comprehensive Financial Sector Reform Program since 2001. HMG/N has strongly committed for the reform of the financial sector in general and RBB, NBL, ADB/N and NIDC in particular. Much depends on the proper implementation of the Financial Sector Reform Program. The financial sector may invite financial crisis which may easily transfer to other sectors of the economy. As such, we have to be extra cautious for the financial liberalization and reforms of the financial sector.

Shrestha & Chowdhury (2006) has addressed about the financial liberalization on their study. The financial liberalization process in Nepal started in 1984. Since then, various liberalization measures have been implemented in order to widen and deepen the financial system. Some policy instruments were aimed at increasing the competition and efficiency in the financial market, which included removal of entry barriers to commercial banks, finance companies and development banks, and restructuring of two state-owned banks. In order to improve the efficiency of money and capital markets, measures such as auctioning of Treasury Bills and floor trading of securities were introduced. The policy instruments such as interest rate deregulation, reduction in reserve requirement and change in the monetary policy stance from direct to indirect were implemented. Similarly, introduction of prudential norms, establishment of Credit Information Bureau, revision of Nepal Rastra Bank Act, and enactment of Debt Recovery Act were aimed at ensuring the integrity of banks and maintenance of the stability of the financial system of Nepal. All of these policy instruments were expected to complement
each other in achieving the overall objectives of competition and efficiency, smooth functioning of money and capital markets, and attainment of stability in the financial sector of Nepal.

Maskey & Subedi (2009) have study on financial development in Nepal and they have presented the study since 1984 when the financial sector began in Nepal. The development of Nepalese financial system which is categorized into three different phases: the first phase is the pre-NRB period; the second phase starts with NRB Act of 1955, which is further disaggregated into two sub-periods at 1984, the start of domestic financial liberalization; and the third and ongoing phase starts after enactment of current NRB Act of 2002. After analyzing period aggregate data on the financial system, the paper concludes that despite significant financial deepening in the context of financial liberalization and integration with the external economy, there is still scope for geographically balanced financial development. For addressing these challenges in a comprehensive manner, the study proposes initiating the development of a Financial Sector Master Plan.

Bhusal (2012) has addressed about the policy changes that have no impact indicates that the policy reforms have no impact on financial indicators, such as on banking credit to private sector and liquid liabilities. This implies, the reduction of domestic credit supply could not be reflected in the private sector credit. The presence of some problems in the banking sector of Nepal is weakening the impact of liberalization. Among them, for instance, during the last two decades, banks suffer from a problem of a high ratio of non-performing loans and it is always discouraging banks from credit allocation. The expansion of commercial banks and their expansion seemed very low in comparison to other bank and non-bank financial institutions, and banks could not capture local savings. Similarly, commercial banks could not capture monetary activities held by the government and other service sectors. This research suggests that the government policy makers should implement policies strictly for financial sector development and to promote growth. Similarly, more investigations to examine the impact of financial development on the economic growth process in Nepal are needed because the presence of a unit root in real GDP, private credit and broad money provides a way of estimating a long run relationship between them.

Ozaki (2014) has presented the financial sector reform in Nepal and its work and effect in Nepal. Nepal is a small landlocked country with a per capita gross national income of $700 in 2012. Despite the small size of its economy, Nepal has a relatively diversified finance sector. Before reaching its current state, the finance sector went through two major reform programs. The first reform program began in 1985 when the country faced an economic crisis, which prompted the government to initiate a structural adjustment program with the International Monetary Fund. The second reform program was initiated in 2002 and was trigged by a political crisis—in particular the Maoist insurgencies in the late 1990s—which compelled the Government of Nepal to embark on broader economic reforms. International development agencies played a role in these reforms. Overall, the reform programs contributed to the finance sector’s growth and improved governance. The government decided to restructure and privatize the three major state-owned banks: Agricultural Development Bank Limited, Nepal Bank Limited, and Rastriya Banijya

Bank. However, privatization of these state-owned banks has yet to be completed. Nepal Rastra Bank's supervisory capacity has generally improved, but its independence and enforcing authority is still weak. The report identifies key success factors and constraints in Nepal's finance sector reforms. It finds continuous donor engagement and dialogues, Strengthening of the central bank's independence, and maintenance of sound finance sector policies to be key for successful reform outcomes.

Timsina (2014) has examined the impact of commercial bank credit to the private sector on the economic growth in Nepal from supply side perspectives. The study has applied Johansen co-integration approach and Error Correction Model using the time series data for the period of 1975-2014. The empirical results show that bank credit to the private sector has positive effects on the economic growth in Nepal only in the long run. Nevertheless, in the short run, it has been observed a feedback effect from economic growth to private sector credit. More specifically, the growth in real private sector credit by 1 percentage point contributes to an increase in real gross domestic product by 0.40 percentage point in the long run. The empirical results imply that, policy makers should focus on long run policies to promote economic growth & development of modern banking sector, efficient financial market and infrastructure so as to increase the private sector credit which is instrumental to promote growth in the long run.

Gautam (2015) has made study on Economic growth and financial development are closely related. The interaction between them is crucial and has attracted great attention of researchers. This study attempts to examine the relationship between economic growth and financial development in Nepal between 1975 and 2012. The paper has used Augmented Dickey-Fuller and Philips-Perron tests to test for the existence of unit root, Co-integration test to examine long run relationship and Granger Causality test to find out causal relationship. In addition, vector error correction method has been applied to find out the speed of adjustment and the dynamics of relationship. The empirical evidence confirms that the financial development causes economic growth. In fact, financial development is the cause for economic growth in terms of short-term dynamics, while economic growth sustains financial development in the long-run. Based on the empirical findings, this study recommends that it is necessary to launch the reform programs in the financial system to consolidate and improve the efficiency and effectiveness of the financial system as well as to cope with the emerging changes. Thus, it asks for the consolidation of the system not only for the positive reinforcement between economic growth and financial development but also for the post crisis resilience and sustainability.

2.2.2 Review of Existing Policies, Acts and Regulations Governing Financial Sector

There are various policies, acts and regulation to be known for study about the financial sector reform in Nepal. Policy, acts and rules regarding NRB, BFIs and financial markets which effect on financial sector should known for proper study about the financial sector reform. Some of major policies, act and regulation has been addressed here which is useful for study on financial sector reform.

I. Monetary Policy

Monetary policy is the process by which the monetary authority of a country, typically the central bank or currency board, controls either the cost of very short-term borrowing or the monetary base, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency.

As per monetary policy 2016/17, financial sector reform program has been set which has been presented here. 'Nepal initiated the first generation financial sector reform in 1985. The first generation reform introduced in 1980s commenced the opening up of the sector for private investment and let the market decide the interest rate and portfolio allocation. The primary objective of the reform at that time was to create a competitive environment in the financial sector. The second stage financial sector reform introduced at the beginning of the last decade prioritized NRB reengineering, Structural reform of the state-owned banks and capacity building of the financial sector. The second generation reform is credited for legal reform, financial structure development, macro prudential regulation, capital hike, and merger and acquisition. The major thrust of the second generation reform remains improving corporate governance and strengthening financial sector consolidation. The financial sector needs to develop essential foundation for further reform since the second generation reform is in the final stage. Preserving the reforms so far undertaken, the third generation reform should work on restructuring the financial sector in tune with the changing structure of the economy. The programs specified in the

Financial Sector Development Strategy (FSDS), after its approval, will be implemented in a sequential manner. Informant institutions including the BFIs will be required to send the anti-money laundering related details and reports electronically by developing necessary software. Risk based supervision in the area of anti-money laundering will be implemented gradually on the basis of the national risk evaluation report. This will enhance regulation, monitoring and supervision and help combat terrorism financing.'

II. NRB Act, 2002

The preamble of the act is 'Whereas, it is expedient to establish a Nepal Rastra Bank to function as the Central Bank to formulate necessary monetary and foreign exchange policies, to maintain the stability of price, to consolidate balance of payment for sustainable development of the economy of the Kingdom of Nepal, and to develop a secure, healthy and efficient system of payment; to appropriately regulate, inspect and supervise in order to maintain the stability and healthy development of banking and financial system; and for the enhancement of public credibility towards the entire banking and financial system of the country.'

According to the act, the objectives of NRB are i. 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, ii. To promote stability and liquidity required in banking and financial sector, iii. To develop a secure, healthy and efficient system of payment, iv. To regulate, inspect, supervise and monitor the banking and financial system and v. To promote entire banking and financial system of the Kingdom of Nepal and to enhance its public credibility.

According to the Point number 79, NRB has supervisory power on the BFIs. The provision made on the act as i. The Bank shall have full powers to regulate the functions and activities of commercial banks and financial institutions, ii. For the purpose of the regulation under sub-section (1), the Bank may frame rules and bye-laws on the matters which the Bank deems appropriate and issue necessary order, directives and circular and it shall be the duty of the concerned commercial bank and financial institution to abide by such rules, bye-laws, order, directives and circular.

III. BAFIA, 2017

The preamble of the act is “whereas, it is expedient to amend and consolidate forthwith the prevailing legislation relating to banks and financial institutions and make it timely in order to promote the trust of the general public in the overall banking and financial system of the country and protect and promote the rights and interests of depositors, provide quality and reliable banking and financial intermediary services to the general public through healthy competition among banks and financial institutions, minimize risks relating to the banking and financial sector, boost and consolidate the economy of the State of Nepal by liberalizing the banking and financial sectors and make necessary legal provisions relating to the establishment, operation, management and regulation of banks and financial institutions, the act has been enacted.”

The act has replaced BAFIA, 2007. Point number 55 of the act has made regarding provision on Credit to be supplied, Point number 56 has made provision regarding purpose of credit to be used in right way and Point number 57 has made provision regarding recovery of credit.

III. The Act on Recovery of Debts of Banks and Financial Institutions, 2002

The preamble of the act is ‘whereas, it is expedient to make provisions for the recovery of principal and interest of debts recoverable from borrowers by trying and settling cases relating to recovery of debts of banks and financial institutions in a speedy and prompt manner the act has been enacted.’

The act describes about the procedure of debt recovery of procedure in point number 25, liability of guarantor has been describes in point number 26. Similarly, provision regarding Debt recovery tribunal has been made in point number 27. The major provision of act is provision of tribunal, which helps the BFIs to recover the debts became bad since last 5 years.

IV. Unified Directives, 2017

NRB has issued annually revised Unified Directive as NRB act, 2058 gives regulatory and supervisory power to NRB. The latest unified directive, 2073 has contained 23 directives out of which Directive number 2, Directive number 12, Directive number 17 and Directive number 22 are directly related to Personal Lending, so they are shortly described hereunder.

Directive number 2 has Provisions Relating to Classification of Loans/advances and Loan Losses. Having exercised the powers conferred by Section 79 of the Nepal Rastra Bank Act, 2002, the following Directives have been issued with regard to classification of credit/advances and provisions to be made for its possible loss by the institutions obtaining licenses from this Bank to carry out financial transactions. Entire loans and advances extended by a licensed institution have to be classified as follows based on expiry of the deadline of repayment of the principal and interest of such loans/advances. According to the directive the loan category is as given here, i. Loans/advances which have not overdue and which are overdue by a period up to three months as pass loan, ii. Loans/advances which are overdue by a period from three months to a maximum period of six months as sub-standard loan, iii. Loans/advances which are overdue by a period from six-months to a maximum period of one year as doubtful loan and iv. Loans/advances which are overdue by a period of more than one year as Bad loan. The loans which are in pass class and which have been rescheduled/restructured are called as the performing loan, and the sub-standard, doubtful and loss categories are called non-performing loans.

Directive Number 3 has Provisions Relating to Single Borrower and Limitation of the Sectoral Credit and Facilities. Licensed Institution may extend to a single borrower or group of related borrowers the amount of fund-based loans and advances Non-fund based Loan up to 25 percent of its Core capital fund. According to the provision, borrower can enjoy Loan limit not more than 50% of Fear market value of the collateral, however, in case of housing loan (residential Real Estate) it can be facilitated up to 60%. Similarly, any BFI can finance up to 25% of total loan to real estate sector and out of which financing to plotting sector should not be exceeded 10%.

Directive no.12 has Provisions Relating to Credit Information and Blacklisting. Once the situation referred to in these Directives prevails, the concerned licensed institution may recommend the Credit Information Bureau Ltd. To blacklist the debtors, who have availed the credit, advances and facilities of whatsoever amount from that licensed institution but have not rapid that amount. The Credit Information Bureau Ltd. shall, within fifteen days, ascertain the name list recommended from the concerned licensed institution for blacklisting and put them in the blacklist. Once the situation referred to in these Directives prevails, the concerned bank may recommend the Credit Information Bureau Ltd. to blacklist the customers who have utilized the credit card facility to be provided by licensed banks but have not repaid any amount/credit for using the card. Once the recommendation to blacklist is received from the concerned bank, the name list shall be blacklisted within fifteen days and the procedures for delisting from the blacklist shall be according to the prevailing policy and procedural provisions. Licensed institution shall have to make recommendation for blacklisting the loan of any amount whatsoever only after getting a loan of more than 2.5 million rupees blacklisted first under the clauses relating to blacklisting. If the licensed bank and financial institution recommends, the Credit Information Bureau Ltd. shall have to blacklist the customer of any amount of loan.

Directive no.17 has Provisions Relating to Lending to Deprived Sector. The A class licensed institutions are required to lend at least 5 percent of their total outstanding loan and advances (including bills purchased and discounted), "B" class licensed institutions shall require to extend 4.5 percent of their total credit (including the bills purchased and discounted) and class C licensed institutions are required to lend 4 percent in deprived sector lending. For the purpose of these Directives, deprived means low income and especially socially backward women, tribal people, *Dalit*, blind, hearing impaired and physically incapacitated persons, marginalized and small farmers, craft-men, labour and landless squatters family. All micro-credits to be extended for the operation of self-employment oriented micro-enterprises for the upliftment of economic and social status of deprived sector up to the limit specified by this Bank is termed as "deprived sector lending.

Directive number 22 has provision regarding Financial Customer Security and Awareness. This part of directive makes provision related to Right to information of borrower, Simple language, Charges and interest rate levied by BFIs and Grievance of Customer, Financial awareness and date security etc.

2.2.3 Review from Related Thesis

Gupta (2004) has made on study on Current Financial Structure and Regulation of the Banking Sector: A Comparative Study of Nepal and Thailand and has the objectives to identify the overall performance of the overall commercial banks of Nepal and Thailand. This study has conducted to find out the recent performance of the Nepalese commercial banking industry and that of the Thailand, by comparing their performance in terms of profitability, non-performing loans (NPL), capital adequacy ratio (CAR), assets quality etc, including the regulations imposed by the central bank of each country. In this study he has analyzed overall performance of the commercial banks of both countries. The approach made in this study is qualitative in nature based in the findings and the data of some financial institutions.

Khatiwada (2006), in his study on Financial Sector Reform in Nepal an Assessment and Impact has the objectives to show the trend of FSR in Nepal and assess the impact of FSR in overall Nepalese financial system. In his study he has analyzed various secondary data using tools like ratio analysis etc. His major findings are as i. After FSR implemented the no of financial institutions increased as well as the no of their branches increased significantly, ii. After FSR commercial bank branches in rural area decreased significantly, iii. Deposit growth in banks and finance companies shows positive growth after implementation of FSR, iii. Growth rate of total deposit and total credit shows increasing trend than of GDP, iv. FSR shows positive impact on Agriculture and Industrial credit, v. NRB adopted effective regulatory role for financial sector of Nepal after FSR, v. Nonperforming loan and assets shows decreasing trend after FSR, vi. Percentage share of total financial assets and broad money (M2) in GDP increased significantly after FSR.

According to these findings he has made some recommendations such as i. NRB should motivate banks and finance companies to open their branches in rural areas more than urban areas, ii. Government should made effort to continue the priority sector credit programme for the upcoming fiscal year, iii. NRB should play decisional role in current interest rate structure due to the high interest rate spread, iv. Credit information Bureau and Credit Rating Agency should be more effective to reduce the bad assets v. NRB should Strengthened the regulatory and supervisory role towards the financial sector of Nepal.

Adhikari (2007), in the study on Financial Sector Reform in Nepal (A case study of Commercial Bank has the objectives to show the impact of Financial Sector Reform in Commercial Banks. In his study he has analyzed various secondary data regarding to the commercial banks using tools like capital adequacy ratio and other ratio analysis etc. His major findings were such as i. After FSR, no of Commercial Bank increased significantly as well as their branches and it seen that every district have al least one branches of commercial bank in their district capital, ii. Deposit collection of commercial banks shows rapid growth after few years of FSR implementation, iii. Deposit mobilization by the commercial bank has increased much faster than the GDP growth after FSR, iv. Total credit of commercial bank increased every year due to the high collection of deposit after FSR, v. Purpose-wise lending portfolio of commercial bank shows significant increase in industry and significant decrease in general use and social credit after FSR, vi. Priority sector credit of commercial bank increased every year over GDP percentage, vii. Interest rate spread was not decreased even after adopting the liberal interest rate policy and even after FSR viii. Non- performing assets of RBB and NBL shows decreasing trend after implementation of reform in these banks. But it is still higher than the joint venture banks of Nepal.

According to major findings of the study he has made some important recommendations such as i. Role of NRB should be increased to regulate the commercial banks for the maintaining sound liquidity as well as to direct commercial banks to increase the investment in agriculture sector and industrial sector, ii. High interest rate spread is always been a major problem for Nepalese banking sector. So, to reduce the interest rate spread NRB should play a vital role to change the interest rate structure of banking sector of Nepal, iii. Since Nepal has also register as member of WTO few years back but it seems like Nepalese banking sector still not fully prepared for full implementation of WTO norms. So, NRB should develop tools for Nepalese banking sector so that they can cope with the problem involving with the full implementation of WTO norms.

2.3 Research Gap

After the two decades of the initiation of FSR program in Nepal there has been few independent studies, and thesis written to asses the impact and progress. Some studies were conducted by the experts and economist, and some studies were conducted by the master's degree students. Since this research topic fall under the economics as well as in management, it seems relevant to review some of the relevant theses prepared by the economics students.

After reviewing some of similar theses, only three of them are relevant to this topic and these were considered here. The first thesis reviewed was of Gupta (2004), and the second was of Khatiwada (2006), and the third was of Adhikari (2007) and other. The focus and objectives of this study is different from above reviewed theses. Most of thesis was focuses on financial sector reform programme imposed by government in 2000. Now, the financial sector had been already imposed and implemented. So, this study focuses in what was the impact of banks and financial sectors after implementing those financial sector reform programmes in Nepalese market. Re-structuring of NRB, RBB, NBL and ADBL are taken in study. Mostly after re-structuring and empowering to NRB, what were the progress of Banks and financial institution and its market that has been studies in the report. So, the report focuses in NRB regulation and regulating power for financial sector reform of Nepalese market rather than field study of impacts of FSR.

After financial sector reform, BFIs have been increasing and financial activities have been also in increasing trend. Though financial sector has been developing other major industry, Hydroelectricity and agricultural sector have not been increasing same line. Though major industry division that contributed major part of GDP of country have not been developed in the line of BFIs, Bank and financial sectors seems in increasing trend. Most of investment part of BFIs seems to be focused on profitable sector like trading merchandised good, real estate sector etc. These practices should be dominated by NRB. Also, developments of BFIs are not proportionate all over Nepal. Priority sectors and deprived sectors should be controlled by NRB; only minimum levels of investment have been invested by BFIs in these sectors. Only increasing of volume and profitability are not part of development, it should give contribution on development of priority sector/industrial sectors of country and rural area of the country as well. So, the study has been made to analysis on those parts of BFIs which help to analysis internal part of development of the BFIs.

CHAPTER - III

RESEARCH METHODOLOGY

The chapter aims to present and reflect the methods and techniques that are carried out and followed during the study period. The research methodology that is adopted for the present study is mentioned in this chapter which deals with research design, Nature of Data, Sources of data, Data Collection procedure, Data Presentation and Analysis methods.

3.1 Research Design

This study is descriptive cum analytical in nature. It gives the descriptive of financial sector development in Nepal and impact of FSR on it. It also analyzes the effect of FSR on development of economic sector. Therefore, this study has been designed to assess the impact of the FSR on financial sector and economic development of Nepal.

3.2 Nature of Data

Purely secondary data has been used for this study and actual data are collected from locating appropriate areas that mainly include information on published journals and reports. At least five years data have been tabulated.

3.3 Sources of Data

Since financial sector development is a vague topic to deal with only Bank and financial companies are considered in this study, but the focus of the study is on Bank and Finance Companies. Whole data of the Banks and financial sector has been covered as an aggregated form of Nepalese financial sector.

This study is purely based on secondary source of data. The major sources of secondary data are from the publication of central bank (NRB) and from its web sight (www.nrb.org.np), which includes publications like Annual Economic Report, Banking and Financial Statistics, Quarterly Economic Bulletin, Monthly Reports, Main Economic Indicator, Nepal Rastra Bank Samachar, Economic Review Prashikshan, Mirmire, Airthik Minansa, other publication and economic survey of Nepal Government.

3.4 Data Collection Procedure

Secondary data are collected from the appropriate sources which mainly include information on published journals, reports and websites. So the study does not need for using any separate type of data collection procedure.

3.5 Data Presentation and Analysis Method

Collected data are comparatively analyzed and the outcome has been interpreted as required. For that, obtained data are presented in various tables, diagrams, charts, graphs and percentage with supporting interpretations. Data have been tabulated according to the nature of data on the basis of fiscal year in different columns and rows. Most of the data has been analyzed using mathematical tools like ratio analysis etc. These are some of the important tools used for data analysis:

i. Ratio Analysis: Ratio is comparative presentation of two figures available. It gives comparative analysis.

ii. Trend Analysis: Trend analysis is the widespread practice of collecting information and attempting to spot a pattern. In some fields of study, the term "trend analysis" has more formally defined meanings

iii. Bar Graphs: A bar graph (also known as a bar chart or bar diagram) is a visual tool that uses bars to compare data among categories. A bar graph may run horizontally or vertically. The important thing to know is that the longer the bar, the greater its value.Bar graphs consist of two axes. On a vertical bar graph, as shown above, the horizontal axis (or x-axis) shows the data categories. In this example, they are years. The vertical axis (or y-axis) is the scale. The colored bars are the data series.

iv. Line Graphs: A line graph, also known as a line chart, is a type of chart used to visualize the value of something over time. For example, a finance department may plot the change in the amount of cash the company has on hand over time.

The line graph consists of a horizontal x-axis and a vertical y-axis. Most line graphs only deal with positive number values, so these axes typically intersect near the bottom of the y-axis and the left end of the x-axis. The point at which the axes intersect is always (0, 0). Each axis is labeled with a data type.

v. Pie chart: A pie chart (or a circle chart) is a circular statistical graphic which is divided into slices to illustrate numerical proportion. In a pie chart, the arc length of each slice (and consequently its central angle and area), is proportional to the quantity it represents. While it is named for its resemblance to a pie which has been sliced, there are variations on the way it can be presented.

vi. Correlation Coefficient: A correlation coefficient is a numerical measure of some type of correlation, meaning a statistical relationship between two variables. The variables may be two columns of a given data set of observations, often called a sample, or two components of a multivariate random variable with a known distribution. Several types of correlation coefficient exist, each with their own definition and own range of usability and characteristics. They all assume values in the range from −1 to +1, where +1 indicates the strongest possible agreement and −1 the strongest possible disagreement. As tools of analysis, correlation coefficients present certain problems, including the propensity of some types to be distorted by outliers and the possibility of incorrectly being used to infer a causal relationship between the variables.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

4.1 Growth & Development of BFIs

The history of financial system of Nepal began in 1937 with the establishment of the Nepal Bank Ltd. as the first commercial bank of Nepal with the joint ownership of government and general public. Nepal Rastra Bank was established after 19 years since the establishment of the first commercial bank. A decade after the establishment of NRB, Rastriya Banijya Bank, a commercial bank under the ownership of Government Nepal was established.

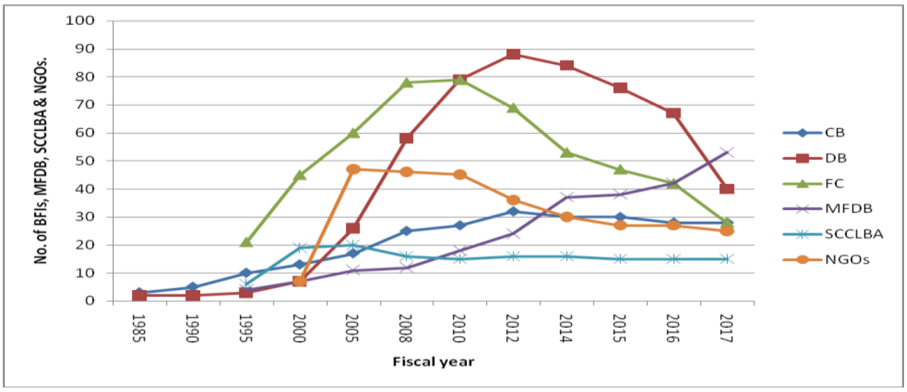
Consequently, by the end of mid – July 2017, altogether 189 banks and non- bank financial institutions licensed by NRB are in operation. Out of them, 28 are A class commercial banks, 40 B class development banks, 28 C class finance companies, 53 D class micro-credit development banks, 15 saving and credit co-operatives and 25 NGOs and 8 other institutions. Present development of financial institutions in Nepal is reflected in the table below.

Table No. 4.1: Growth of Bank and Financial Institutions

Date / FIS	At Mid-July											
	1985	1990	1995	2000	2005	2008	2010	2012	2014	2015	2016	2017
CB	3	5	10	13	17	25	27	32	30	30	28	28
DB	2	2	3	7	26	58	79	88	84	76	67	40
FC			21	45	60	78	79	69	53	47	42	28
MFDB			4	7	11	12	18	24	37	38	42	53
SCCLBA			6	19	20	16	15	16	16	15	15	15
NGOs				7	47	46	45	36	30	27	27	25
Total	**5**	**7**	**44**	**98**	**181**	**235**	**263**	**265**	**250**	**233**	**221**	**189**

Source: Banking and Financial Statistics, 2015, NRB Monthly report, 2016 & 2017.

Figure no. 4.1: Growth of Bank and Financial Institution



In 1985, there were only 5 BFIs operated in Nepal after a decade i.e in 1995, the no. of BFIs are increased to 44 and after that the no. of BFIs were increasing trend in Nepal. In 2000 there were 263 financial institution and NGOs licensed by NRB. They become 265 & 260 in 2012 & 2014 respectively. Now, the no. of BFIs are become 221 & 189 in 2016 & 2017 respectively. The reasons behind decreasing no. of BFIs are the merger and acquisition enforced by NRB to BFIs.

In the context of banking development, the 1980s saw a major structural change in financial sector policies, regulations and institutional developments. Government emphasized the role of the private sector for the investment in the financial sector. With the adoption of the financial sector liberalization by the government in 80's, the door opened for foreign banks to open Joint Venture Banks in Nepal. As a result, various banking and non-banking financial institutions have come into existence. Nabil Bank Limited, the first foreign joint venture bank of Nepal, started operation in July 1984. During two decades, Nepal witnessed tremendous increment in number of financial institutions. Nepalese banking system has now a wide geographic reach and institutional diversification.

4.1.1 Growth Trend of Aggregate Credit & Deposit of BFIs

Loan-deposit ratio, also known as the LTD ratio or LDR, is a ratio between the banks total loans and total deposits. If the ratio is lower than one, the bank relied on its own deposits to make loans to its customers, without any outside borrowing. If on the other hand, the ratio is greater than one, the bank borrowed money which it re-loaned at higher rates, rather than relying entirely on its own deposits. Banks may not be earning an optimal return if the ratio is too low. If the ratio is too high, the banks might not have enough liquidity to cover any unforeseen funding requirements or economic crises. It is a commonly used statistic for assessing a bank's liquidity. The aggregate deposit and Loan & advance since 2009 mid july have been taken for deposit credit ratio analysis as presented below:

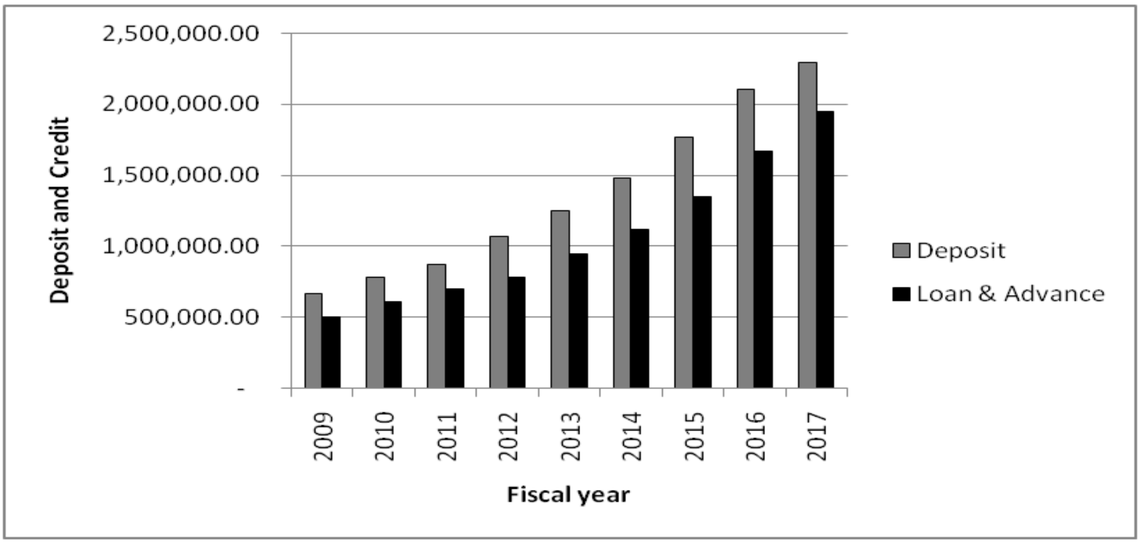
Table no. 4.2 : Growth of Aggregate Credit & Deposit

In Million

Fiscal year	Deposit	Loan & Advance	Credit to Deposit Ratio
2009, Mid July	668,679.50	499,892.60	75%
2010, Mid July	785,238.00	609,921.90	78%
2011, Mid July	869,951.43	698,778.98	80%
2012, Mid July	1,071,394.11	779,560.90	73%
2013, Mid July	1,250,061.98	945,698.45	76%
2014, Mid July	1,477,832.61	1,119,260.81	76%
2015, Mid July	1,771,946.15	1,345,671.32	76%
2016, Mid July	2,107,502.69	1,669,203.04	79%
2017, Mid June	2,292,956.70	1,948,238.58	85%

Source: Monthly & Quarterly Report of NRB (2009 to 2017)

Figure No. 4.2 : Growth of Aggregate Credit & Deposit



In 2009 mid july total deposit in Nepalese market is NPR668 million and credit is NPR499 million in aggregate. In point of view of deposit, the deposit is in increasing trend and credit is in same line as well. The increase in deposit and loan and advance indicate the expansion of financial market in Nepal and increase in financial turnover. Similarly, CD ratio was 75% in 2009 and it had been increased in 2011 but it had reduced to 73% in 2012 now it increased to 85%. On average Nepalese financial sector have enough fund to secure its loan and advance. As per NRB rule, Credit to Capital and Deposit (CCD) ratio should not be exceeded more than 80%. As increased in capital in 2074 in BFIs, Credit to increase on the base of capital amount with remaining deposit constant, to CD ratio has been increased to 85% in 2017.

4.1.2 Trend of Aggregate Loan Loss Provision

Loan loss provision is an expense set aside as an allowance for uncollected loans and loan payments. This provision is used to cover a number of factors associated with potential loan losses including bad loans, customer defaults and renegotiated terms of a loan that incur lower than previously estimated payments. Loan loss provisions are an adjustment to loan loss reserves and can also be known as valuation allowances.

provision no.9 of the unified directive describes about the loan loss provision to be maintained by BFIs. For the loans and bills purchase classified according to these Directives, the following loan loss provision shall be maintained based on the remaining amount of principal:

Table No. 4.3 : Loan Classification and Minimum Provision

SN	Loan Classification	Minimum Provision
1	Pass	1%
	i. Watch list (under pass category)	5%
2.	Sub- Standard	25%
3.	Doubtful	50%
4.	Bad debt (loss)	100%

Source: NRB Directive no2/2073

NRB classifies loan in two category performing loan and non performing loan. Pass category loan including watchlist is defined as performing loan and other such as Su-standard, doubtful and bad debts are defined as Non-performing loan. NRB always focuses on the reducing of Non-performing loan of BFIs. However, most of the BFIs have made investment in higher returnable assets that why they have higher risk as well and it causes increments in loan loss provision.

After provision relating to watch list on directive 2072, Loan loss provision seems to reduce in FY2072/73 & 2073/74. The data taken since 2009 are presented below for analysis of loan loss provision trend in Nepalese financial market.

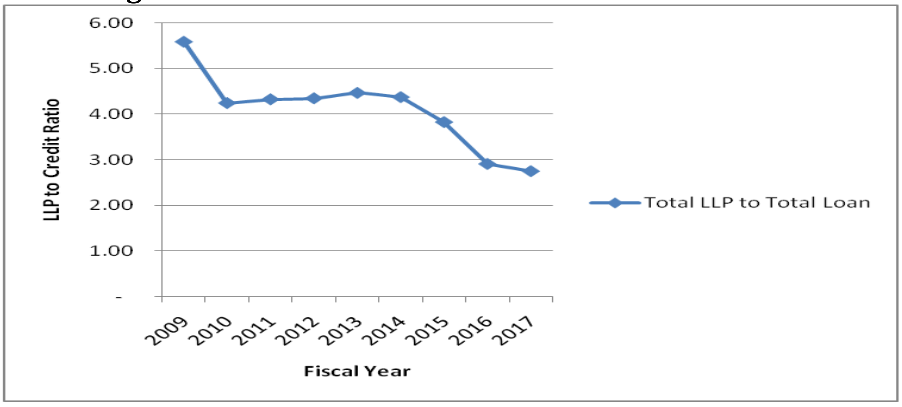
Table No. 4.4 : Loan Loss Provision to Total Loan

In Million

Fiscal year	Loan & Advance	Loan Loss Provision	Total LLP to Total Loan
2009, Mid July	499,892.60	27,897.50	5.58%
2010, Mid July	609,921.90	25,878.40	4.24%
2011, Mid July	698,778.98	30,215.83	4.32%
2012, Mid July	779,560.90	33,873.99	4.35%
2013, Mid July	945,698.45	42,223.77	4.46%
2014, Mid July	1,119,260.81	48,932.49	4.37%
2015, Mid July	1,345,671.32	51,482.56	3.83%
2016, Mid July	1,669,203.04	48,593.77	2.91%
2017, Mid June	1,948,238.58	53,626.55	2.75%

Source: NRB Monthly & Quarterly Reports.

Figure no. 4.3 : Loan Loss Provision to Total Loan



Loan loss provision is in decreasing trend, which is one of the positive for financial institution. The less provision means stronger performance of its good assets (loan & advance). So, it is one of one of the positive indicator for financial sector. We can see that loan loss provision has been decreased from 5.58% in 2009 to 2.75% in 2017. Similarly, Loan loss provision is on average 4.24% to 4.46% till 2014 but after provision issued by NRB regarding watch list category under Pass loan the provision seems to be in decreasing trend. The provision is 2.91% in 2016 and 2.75% in mid June 2017. The decreasing in loan loss provision is positive point for money market and commodity market as well i.e the repayment in time means the trading activities of the commodity market and cash flow of the customer routed smoothly, which indicate positive movement of the Nepalese market.

4.1.3 Growth of Commercial Banks in Nepal

As per Commercial Bank Act 2031, 'Commercial Bank means a bank which deals in exchange currency, accepting deposits, giving loans and doing commercial transactions' therefore, commercial banks are financial institutions which are engaged in the activities of collection scattered fund from different people and canalized that fund to the other people or investors or organization who need it as loan.

After the establishment of Nepal Rastra bank in 1956, the banking system and financial sector got motion. when NBL as only a commercial bank, that was hesitating to serve unprofitable sectors and poor population of the country to cope this, government set up Rastriya Banijya Bank in 1966, as fully government owned commercial bank. Nepal has started liberalized financial policy from 1984 to make strong financial system and to improve quality and competitive services. As a result, there are twenty three private and joint venture banks and two government owned banks operating in 2008. Total no. of commercial bank was increased to 32 in 2012 but it has been decreased to 30 in 2015 and now it becomes 28 in june 2017. The decreased in no. of commercial bank does not mean that the financial sector of Nepalese decline but it is because Capital plan imposed in monetary policy by NRB and focuses in merger of Bank & financial institution to increase capital investment capacity of the BFIs.

4.1.3.1 Branches of Commercial Bank

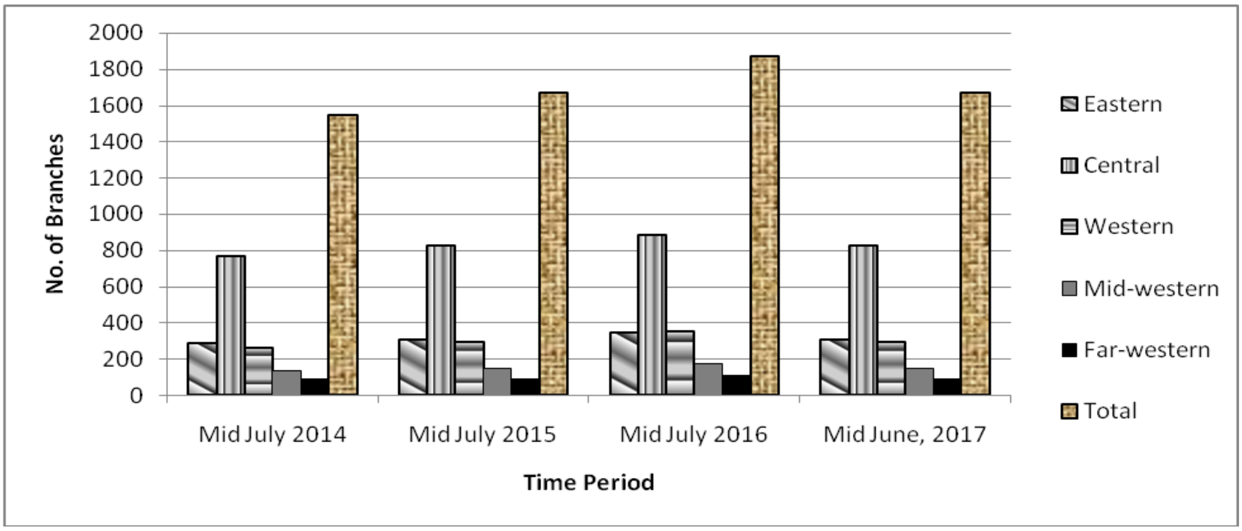
The central bank has been adopting the policy of merger and acquisition to attain its objectives of consolidating some FIs to efficient and strong FIs in the financial system. A stable financial system is determined by a sound and strong banking system which holds dominant role in the national economy. Though the no. of BFIs has been decreased in recent few fiscal years, performance of BFIs could not be ascertained by no. of BFIs as their service provided center i.e branches has not been decreased yet. So, to analyze financial sector efficiencies through no. of financial service center provided no. of branches should be studied. BFIs are extending branches in different parts of the country which helps to achieve the goal of inclusive growth of the nation. During the six months to the mid-January, BFIs have added significant number of branches to their portfolio.

Table No. 4.5: Regional Wise Branches of Commercial Banks

Region\Period	Mid July 2014	Mid July 2015	Mid July 2016	Mid June, 2017
Eastern	287	308	347	308
Central	770	827	888	827
Western	264	292	350	292
Mid-western	136	152	173	152
Far-western	90	93	111	93
Total	**1547**	**1672**	**1869**	**1672**

Sources: NRB Monthly reports from 2014 to 2017

Figure No. 4.4: Regional Wise Branches of Commercial Banks



Conclusion is that the total numbers of commercial bank branches are increasing but the percentage of banks branches in far western region are decreasing. That means rural commercial bank branches are decreasing after the financial liberalization in comparison to its urban counterpart. So, the formal financial system of Nepal is becoming urban biased and liberalization has helped to intensity this bias. BFIs are profit oriented companies and they always force to open branches in highly commercial area, so NRB rules should diverse the branches to ruler area that helps to financial sector reform of rural area as well.

4.1.3.2 Trend of Credit and Deposit of Commercial Banks

The loan-to-deposit ratio (LTD) is a commonly used statistic for assessing a bank's liquidity by dividing the bank's total loans by its total deposits. This number is expressed as a percentage. If the ratio is too high, it means that the bank may not have enough liquidity to cover any unforeseen fund requirements, and conversely, if the ratio is too low, the bank may not be earning as much as it could be. According to NRB Directive no.

5/073 commercial bank should maintain at least 80% of CCD ratio. CCD ratio is the ratio is Credit to Core Capital cum Deposit ratio i.e bank can add core capital in CCD ratio for assessing their liquidity ratio. However, simply credit to deposit ratio denotes the liquidity ability or coverage of credit by deposit. The aggregate deposit and Loan & advance since 2009 mid July have been taken for deposit credit ratio analysis as presented below:

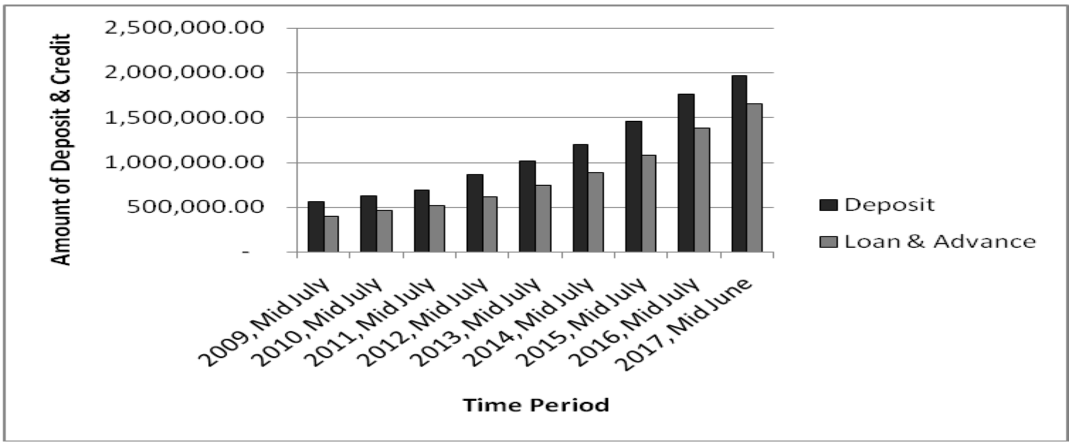
Table No.4.6: Trend of Credit and Deposit of Commercial Banks

In Million

Fiscal year	Deposit	Loan & Advance	CD Ratio
2009, Mid July	563,604.50	398,143.00	70.64%
2010, Mid July	630,880.80	467,107.20	74.04%
2011, Mid July	687,587.89	522,853.34	76.04%
2012, Mid July	867,978.25	612,322.64	70.55%
2013, Mid July	1,020,830.77	748,753.66	73.35%
2014, Mid July	1,204,463.40	891,629.91	74.03%
2015, Mid July	1,462,896.12	1,087,486.69	74.34%
2016, Mid July	1,764,592.44	1,380,358.68	78.23%
2017, Mid June	1,975,083.16	1,654,818.23	83.78%

Source: Monthly & Quarterly Report of NRB.

Figure No. 4.5 : Trend of Credit and Deposit of Commercial Banks



In 2009 mid July total deposit in commercial banks is NPR563 million and credit is NPR398 million in aggregate. In point of view of deposit, the deposit is in increasing trend and credit is in same line as well. The increase in deposit and loan and advance indicate the expansion of financial market in Nepal and increase in financial turnover. Similarly, CD ratio was 70.64% in 2009 and it had been increased in 2011 but it had reduced to 70.55% in 2012 now it increased to 83.78%. On average Nepalese financial sector have enough fund to secure its loan and advance. As per NRB rule, Credit to Capital and Deposit (CCD) ratio, which includes core capital as well, should not be exceeded more than 80%. As increased in capital at least NPR 8 Arab in 2074 in BFIs, Credit to increase on the base of capital amount with remaining deposit constant, and credit has been increased by Banks and CD ratio has been increased to 83.78% in 2017.

4.1.3.3 Loan Loss Provision on Total Credit of Commercial Banks

NRB Directive no. 2/073 has made provision relating to the loan loss to total loan & advance ratio. The provison 1 & 9 of the same directive made necessary rules regarding to the loan loss provision for commercial banks along with entire BFIs. After provision relating to watch list on directive 2072, Loan loss provision seems to reduce in FY2072/73 & 2073/74. The data taken since 2009 are presented below for analysis of loan loss provision trend in Nepalese financial market. The following table regarding the loan loss provision in Nepalese commercial bank presents data from 2009 to 2017.

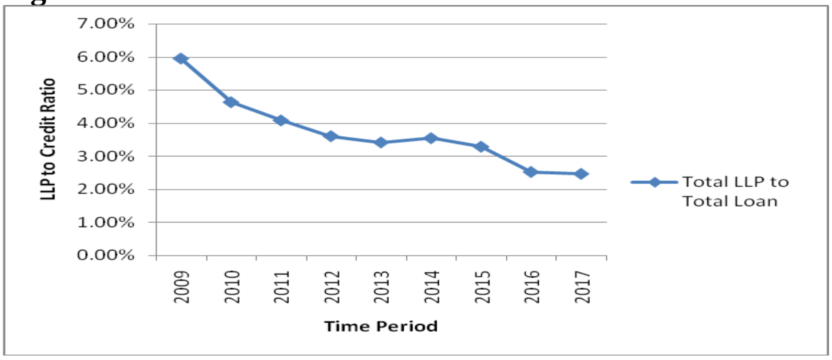
Table No.4.7 : Loan Loss Provision to Total Loan of Commercial Banks

In Million

Fiscal year	Loan & Advance	Loan Loss Provision	Total LLP to Total Loan
2009, Mid July	398,143.00	23,682.50	5.95%
2010, Mid July	467,107.20	21,631.80	4.63%
2011, Mid July	522,853.34	21,340.08	4.08%
2012, Mid July	612,322.64	22,093.98	3.61%
2013, Mid July	748,753.66	25,582.29	3.42%
2014, Mid July	891,629.91	31,622.89	3.55%
2015, Mid July	1,087,486.69	35,779.54	3.29%
2016, Mid July	1,380,358.68	34,894.47	2.53%
2017, Mid June	1,654,818.23	40,875.21	2.47%

Source: NRB Monthly & Quarterly Reports.

Figure No. 4.6: Loan Loss Provision to Total Loan of Commercial Banks



Loan loss provision is in decreasing trend, which is one of the positive for financial institution. The less provision means stronger performance of its good assets (loan &

advance). So, it is one of one of the positive indicator for financial sector. We can see that loan loss provision of commercial bank has been decreased from 5.95% in 2009 to 2.47% in 2017. Similarly, Loan loss provision is on 3.55% till 2014 but after provision issued by NRB regarding watch list category under Pass loan the provision seems to be in decreasing trend. The provision is 2.53% in 2016 and 2.47% in mid June 2017. The decreasing trend of loan loss provision is positive indicator for commercial banks and it performance of their assets.

4.1.4 Growth of Development Banks in Nepal

Before economic liberalization, there were two development banks, namely NIDC and ADB/N established under NIDC Act 1959, and ADB/N was under ADB/N Act 1967. In 1998, new development act was enacted which gave freedom to establish development bank. At present development banks are also permitted to reform various kinds of banking activities such as long and short term lending, deposit on saving account up to 11 times of core capital.

In figure no. 4.1 we can see the increasing trend in no. of development bank in Nepal. In 1990, there were only 2 development banks and in 2000 there were 7 development banks and 26 in 2005, 79 in 2010 and 76 in 2015. The no. of development banks in 2015 were decreased due to the NRB policy of merging and acquisition. Increase in capital there were almost trend among the merger between development banks and merger with commercial banks, so no. of development banks were decreased in 2015.

4.1.4.1 Branches of Development Banks

The no. of development banks has decreased in current fiscal year and the no. of branches of development banks decreases in same way is nominal matter. As branches are the service providing point of development banks, analysis of no. of branches is important point of view rather than analysis of no. of total development banks for financial sector analysis. Here are showing the no. of branches of last 4 fiscal year data for analysis of branches of development banks:

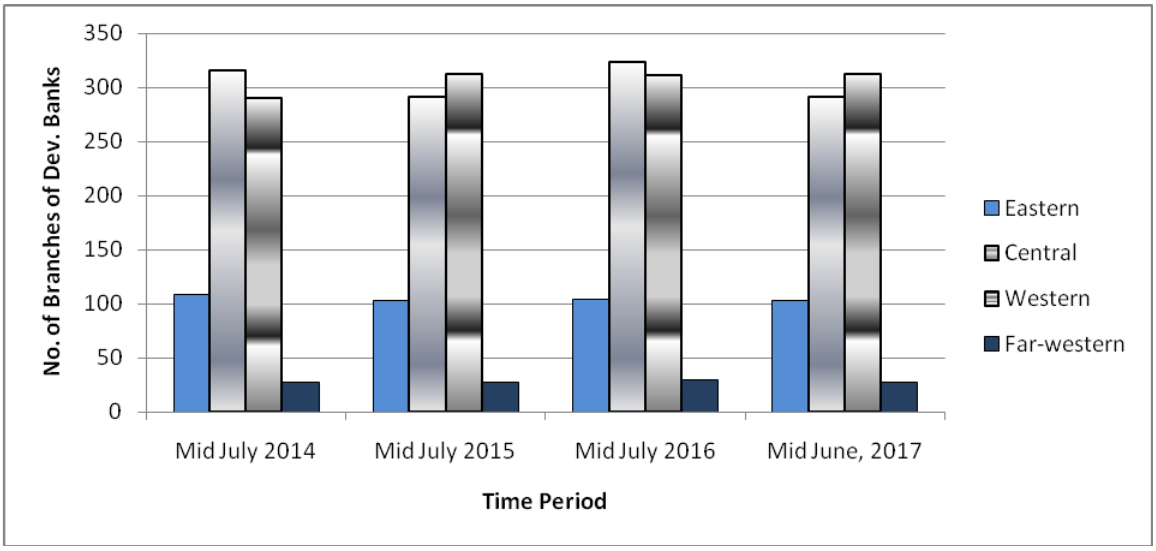
Table No.4.8: Region Wise Distribution of Branches of Development Banks

In million

Region\Period	Mid July 2014	Mid July 2015	Mid July 2016	Mid June, 2017
Eastern	109	103	104	103
Central	316	291	324	291
Western	290	312	311	312
Mid-western	75	74	83	74
Far-western	28	28	30	28
Total	**818**	**808**	**852**	**808**

Sources: Monthly Report of NRB from 2014 to 2017

Figure No.4.7: Region Wise Distribution of Branches of Development Banks



Total no. of branches of development bank (B category banks) are not in increasing trend in last four years. The no. of development banks have been acquisitioned by some of commercial banks, so no. of development banks is in decreasing trend and no. of branches of the development banks also is stable. The major concern of the analysis is how branches has been distributed in different part/region of Nepal. Most of branches of development banks has been operating in center and western region. As major objective of development banks should be development of certain infrastructure area and certain group of people of a state, however, most of development banks seem to be opened in developed area, so NRB should have adequate regulation regarding the spread of development banks in rural area as well so that certain group of rural area can enjoy the financial access in their business and agricultural sector as well.

4.1.4.2 Trend of Credit and Deposit of Development Banks

The loan-to-deposit ratio (LTD) is a commonly used statistic for assessing a bank's liquidity by dividing the bank's total loans by its total deposits. This number is expressed as a percentage. If the ratio is too high, it means that the bank may not have enough liquidity to cover any unforeseen fund requirements, and conversely, if the ratio is too low, the bank may not be earning as much as it could be. According to NRB Directive no. 5/073 Development bank should maintain at least 80% of CCD ratio. CCD ratio is the ratio is Credit to Core Capital cum Deposit ratio i.e bank can add core capital in CCD ratio for assessing their liquidity ratio. However, simply credit to deposit ratio denotes the liquidity ability or coverage of credit by deposit. The aggregate deposit and Loan & advance since 2009 mid July have been taken for deposit credit ratio analysis as presented below:

Table No.4.9: Trend of Credit and Deposit of Development Banks

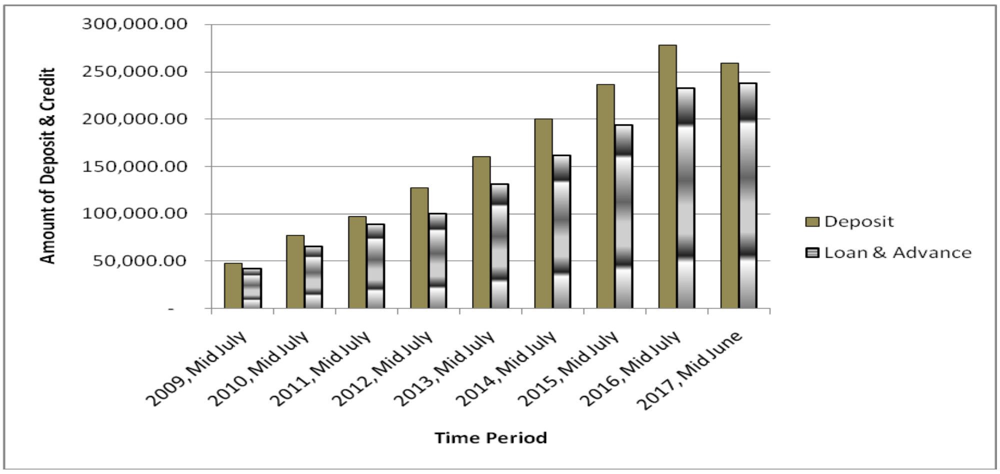
In million

Fiscal year	Deposit	Loan & Advance	CD Ratio
2009, Mid July	48,001.60	41,828.40	87.14%
2010, Mid July	76,950.80	65,827.90	85.55%
2011, Mid July	96,886.67	88,923.32	91.78%
2012, Mid July	127,300.11	100,611.07	79.03%
2013, Mid July	160,249.64	131,168.99	81.85%
2014, Mid July	199,932.80	161,799.22	80.93%
2015, Mid July	237,096.19	193,462.91	81.60%
2016, Mid July	278,631.25	232,993.26	83.62%
2017, Mid June	259,555.24	237,398.25	91.46%

Sources: Monthly & Quarterly Report of NRB from 2009 to 2017

Figure No.4.8: Trend of Credit and Deposit of Development Banks

In Million



In the last eight years, credit to deposit ratio seems in between 80 to 90% of the development banks that is, credit granted by development bank seems to be able to pay by it deposited amount. Also, deposit and credit both phenomenons are in increasing trend. In last fiscal year Mid, jun 2017 credit to deposit ratio has been increased to 91.46%. It is caused by increased in capital as guided by NRB. The increased capital of the development bank helps to maintain CCD ratio under 80%, that why, credit to deposit ratio become at higher side, however, credit seems to be under 100% of deposit.

4.1.4.3 Loan Loss Provision on Total Credit of Development Banks

NRB Directive no. 2/073 has made provision relating to the loan loss to total loan & advance ratio. The provision 1 & 9 of the same directive made necessary rules regarding to the loan loss provision for commercial banks along with entire BFIs. After provision relating to watch list on directive 2072, Loan loss provision seems to reduce in FY2072/73 & 2073/74. The data taken since 2009 are presented below for analysis of loan loss provision trend in Nepalese financial market. The following table regarding the loan loss provision in Nepalese Development bank presents data from 2009 to 2017.

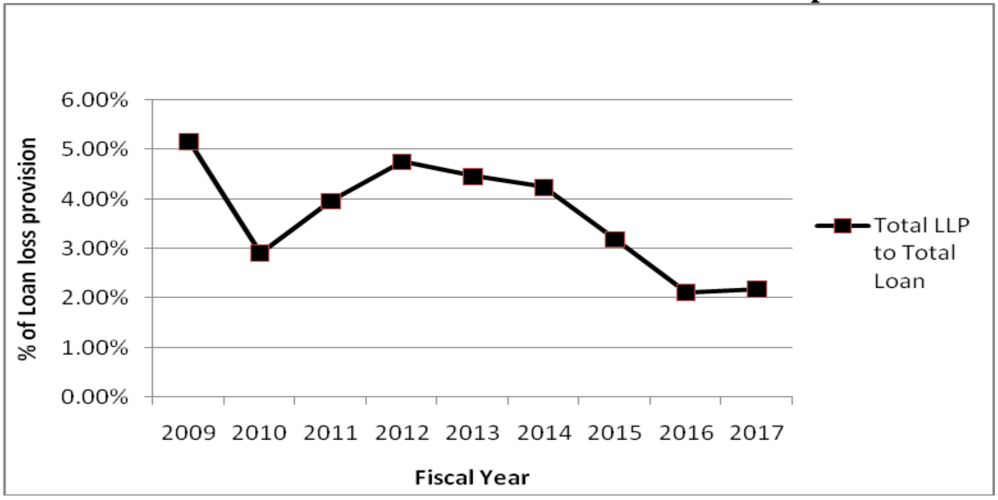
Table No. 4.10: Loan Loss Provision to Total Loan of Development Banks

In Million

Fiscal year	Loan & Advance	Loan Loss Provision	Total LLP to Total Loan
2009	41,828.40	2,162.10	5.17%
2010	65,827.90	1,921.50	2.92%
2011	88,923.32	3,520.41	3.96%
2012	100,611.07	4,781.47	4.75%
2013	131,168.99	5,847.74	4.46%
2014	161,799.22	6,860.14	4.24%
2015	193,462.91	6,171.65	3.19%
2016	232,993.26	4,936.93	2.12%
2017	237,398.25	5,197.73	2.19%

Source: NRB Monthly & Quarterly Reports.

Table No.4.9 : Loan Loss Provision to Total Loan of Development Banks



Loan loss provision is in decreasing trend, which is one of the positive for financial institution. The less provision means stronger performance of its good assets (loan & advance). So, it is one of one of the positive indicator for financial sector. We can see that loan loss provision of commercial bank has been decreased from 5.17% in 2009 to 2.92% in 2010, however, it has been again increased to 4.75% in 2012. Now it has been decreased to 2.19% in 2017. Similarly, Loan loss provision seems to be decreasing from after provision issued by NRB regarding watch list category under Pass loan. The provision is 2.12% in 2016 and 2.19% in mid June 2017. The decreasing trend of loan loss provision is positive indicator for commercial banks and it performance of their assets.

4.1.5 Growth of Finance Companies in Nepal

As the process of financial sector liberalization, His Majesty's Government of Nepal felt the need of finance companies to accelerate the economic development of the country and supposed that finance companies undertake the task of encouraging the flow of personal saving for productive purpose. So, the role of finance companies has become more important to transform gradually non-monetized sector into monetized sector and channelize the savings for capital formation and economic development.

4.1.5.1 Branches of Finance Companies

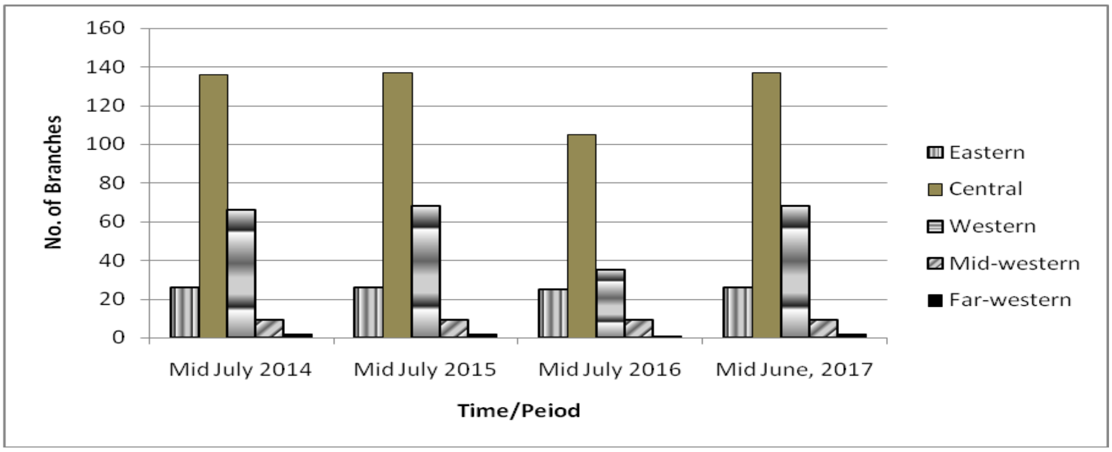
Finance companies are most popular among low-income and middle-income class people to make available hire purchase facility and other loans for the purchase of vehicles, machinery, tools, equipment and loans to individuals, firms companies or institutions in order to promote their economic benefit. But must of the finance companies are operating in Kathmandu valley and same urban areas. In the year 2008, number of finance company has reached 78 out of which 47 companies are operating in Kathmandu valley.

Table No. 4.11: Regional Wise Branches of Finance Companies

Region\Period	Mid July 2014	Mid July 2015	Mid July 2016	Mid June, 2017
Eastern	26	26	25	26
Central	136	137	105	137
Western	66	68	35	68
Mid-western	9	9	9	9
Far-western	2	2	1	2
Total	**239**	**242**	**175**	**242**

Sources: Monthly & Quarterly Report of NRB from 2009 to 2017

Figure No. 4.10: Regional Wise Branches of Finance Companies



The finance companies are most important financial institution to the middle and lower income level family. It has more important role of development of small and middle level industry of a country. However, as seen in data of last four fiscal year, most of the finance companies are opened it branches in central regional and only 1 to 2 branches have been opened in far western region yet. NRB seems to be regulate and emphasized to increase and open the finance institution in least developed area as well.

4.1.5.2 Trend of Credit and Deposit of Finance companies

As collection of deposit and granting loan are most important functions of the finance companies. Increase in deposit and credit means increasing the services/area of the finance companies, however, finance companies should maintain credit to deposit relationship in adequate level. If the ratio is too high, it means that the bank may not have enough liquidity to cover any unforeseen fund requirements, and conversely, if the ratio is too low, the bank may not be earning as much as it could be. According to NRB Directive no. 5/073 BFIs should maintain at least 80% of CCD ratio. CCD ratio is the ratio is Credit to Core Capital cum Deposit ratio i.e bank can add core capital in CCD ratio for assessing their liquidity ratio. However, simply credit to deposit ratio denotes the liquidity ability or coverage of credit by deposit.

Table No. 4.12: Trend of Credit and Deposit of Finance Companies

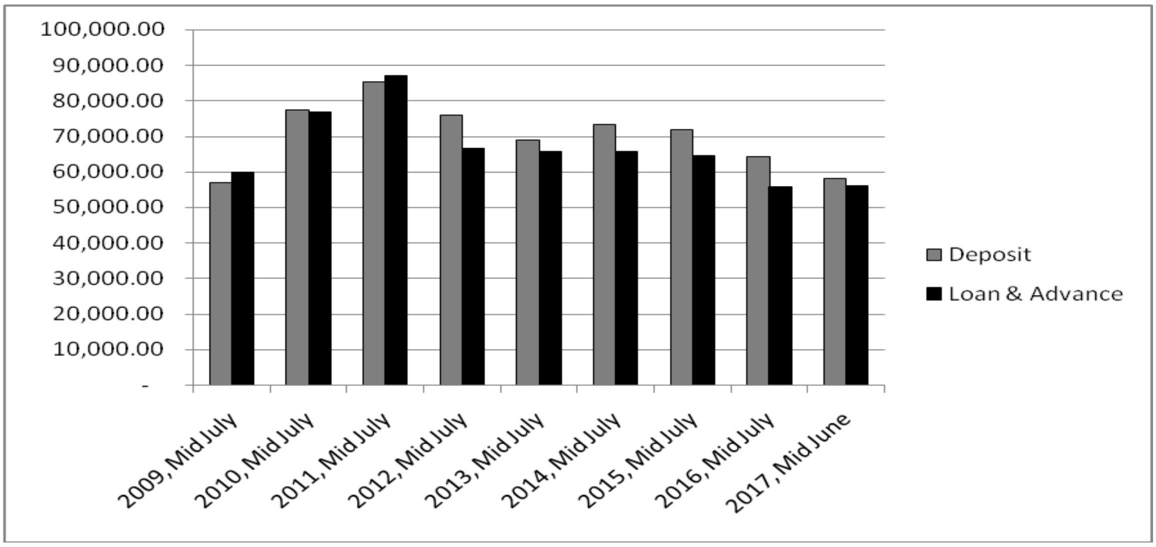
In Million

Fiscal year	Deposit	Loan & Advance	Credit to Deposit Ratio
2009, Mid July	57,073.40	59,921.20	104.99%
2010, Mid July	77,406.30	76,986.80	99.46%
2011, Mid July	85,476.88	87,002.32	101.78%
2012, Mid July	76,115.75	66,627.19	87.53%
2013, Mid July	68,981.56	65,775.79	95.35%
2014, Mid July	73,436.41	65,831.69	89.64%
2015, Mid July	71,953.84	64,721.71	89.95%
2016, Mid July	64,279.00	55,851.11	86.89%
2017, Mid June	58,318.30	56,022.10	96.06%

Sources: Monthly & Quarterly Report of NRB from 2009 to 2017

Figure No. 4.11: Trend of Credit and Deposit of Finance companies

In Million



The data extracted from last 9 fiscal year, the credit and deposit amount of finance company are increased till 2011 then they began to decrease. Most of the reasons that decreasing trend are easy service and availability to commercial bank in lower cost to the customer and riskier than commercial bank and decreasing no. of finance company due to merger with banks for increasing capital as guided by NRB.

Beside amounting figure of deposit and credit of the ratio between them also seems higher than 100% in FY2009 & FY2011. The higher than 100% of credit to deposit ratio shows higher liquidity risk in finance company. According to NRB Directive no. 5/073 Development bank should maintain at least 80% of CCD ratio. CCD ratio is the ratio is Credit to Core Capital cum Deposit ratio i.e bank can add core capital in CCD ratio for assessing their liquidity ratio. However, simply credit to deposit ratio denotes the liquidity ability or coverage of credit by deposit and it should be directly supervised by NRB.

4.1.5.3 Loan Loss Provision on Total Credit of Finance Companies

NRB Directive no. 2/073 has made provision relating to the loan loss to total loan & advance ratio. The provision 1 & 9 of the same directive made necessary rules regarding to the loan loss provision for commercial banks along with entire BFIs. After provision relating to watch list on directive 2072, Loan loss provision seems to reduce in FY2072/73 & 2073/74. The data taken since 2009 are presented below for analysis of loan loss provision trend in Nepalese financial market. The following table regarding the loan loss provision in Nepalese Development bank presents data from 2009 to 2017.

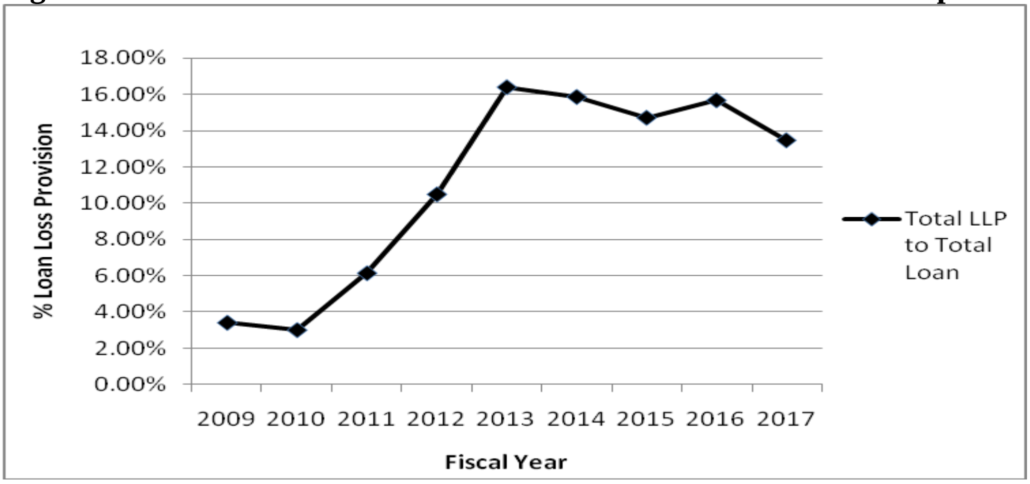
Table No. 4.13: Loan Loss Provision to Total Loan of Finance Companies

In Million

Fiscal year	Loan & Advance	Loan Loss Provision	Total LLP to Total Loan
2009	59,921.20	2,052.80	3.43%
2010	76,986.80	2,325.10	3.02%
2011	87,002.32	5,355.35	6.16%
2012	66,627.19	6,998.55	10.50%
2013	65,775.79	10,793.74	16.41%
2014	65,831.69	10,449.46	15.87%
2015	64,721.71	9,531.38	14.73%
2016	55,851.11	8,762.38	15.69%
2017	56,022.10	7,553.61	13.48%

Source: NRB Monthly & Quarterly Reports (2009 to 2017)

Figure No. 4.12 : Loan Loss Provision to Total Loan of Finance Companies



After analysis of loan loss provision of Finance companies of the Nepalese financial sector, the performance of financial companies does seem to be in stronger position. Since 2011, loan loss provision seems to be increasing trend and it became 16.41% in 2013, which is highest point during observation period of 9 years. Main reasons behind increasing loan loss provision are huge investment in real estate sector without proper assessment of cash flow and sources of income.

4.2 Proportionate Growth of BFIs and Financial Access to People

Financial inclusiveness is understood as providing and ensuring reliable and affordable financial services to all segment of society. Although access to finance is necessary for all members of society, it is particularity more important for disadvantaged and low income segments of society, as it provides opportunities for them to save and invest, and protect themselves from various risks such as natural disasters, illness and loss of livelihoods. Access to finance will enable the poor and low income people to make self-reliant and give chances to break the vicious cycle of poverty.

Financial access has been increasing with the expansion of network of financial institutions. As of mid-July 2015, the branch network of commercial banks reached 1672 followed by development banks (808), Finance companies (242) and Micro Finance Development Banks (1116). The number of branches of the respective categories of BFIs accounted to 1547, 818, 239 and 852 respectively as of mid-July 2014. Due to the merger policy adopted by NRB, the number of branches of Development Banks (B Category) reduced by 10 to 808 after the merger of 5 Development Banks. However, the total number of bank branches of BFIs increased by 382 (11.1 percent) and reached to 3838 in mid-July 2015 from that of 3456 in mid-July 2014, 10160 in mid july, 2016.

In mid-July 2016, on an average, a BFI branch has been serving approximately to 10,160 people; excluding the branches of "D" class financial institutions. The banking service served population comes down to 7206 people per branch when branches of "D" class also included.

Table 4.14: Zone Wise Allocation of BFI Branches & Population per Branch

Zone	Class A	Class B	Class C	Total	Population	Pop. Per Branch
Mechi	116	33	8	157	1,503,647	9,577
Koshi	210	43	7	260	2,479,066	9,535
Sagarmatha	93	9	3	105	2,138,681	20,368
Janakpur	118	27	1	146	3,015,286	20,653
Narayani	218	96	14	328	3,288,905	10,027
Bagmati	707	134	56	897	4,239,030	4,726
Gandaki	175	147	15	337	1,587,191	4,710
Lumbini	232	141	15	388	3,024,054	7,794
Dhaulagiri	57	30	1	88	550,832	6,259
Rapti	80	41	4	125	1,554,156	12,433
Karnali	20	2	-	22	422,531	19,206
Bheri	112	36	4	152	1,867,168	12,284
Seti	84	17	2	103	1,715,355	16,654
Mahakali	52	13	-	65	1,045,592	16,086
Total of BIFs (A,B & C)	**2,274**	**769**	**130**	**3,173**	**28,431,494**	**8,960**
Total Including D				**5,610**	**28,431,494**	**5,068**

Sources: NRB Monthly Report, Mid-July, 2017

From the above date, there are 897 branches of BFIs in Bagmati zone which is the highest number of branches among the other zone whereas population per branches is only 4,726 only. Similarly, Karnali zone has lowest numbers of branches of BFIs among other zones whereas population per branch is 19,206. Similarly, Janakpur zone has 146 branches whereas population per branch is 20,653 and it is the highest population per branch among other zone. So, distribution of branches and development of BFIs all over Nepal does not seem proportionately to all areas.

NRB has declared 14 districts which has lower presence of branches. In the districts one branch should serve many of the people and most of people are not facilitated by BFIs service. So, we should look the comparative study between these district with most developed district of Kathmandu valley.

Table no. 4.15: Comparative Study of Distribution of Branches in District Having Lower Presences of BFIs Declared by NRB and Inside Valley

Districts	No. of Branches	Population	Population per Branches
A. Districts Having Lower BFIs Declared by NRB			
Bojpur	13	169139	13011
Okhaldunga	11	150428	13675
Manag	5	6444	1289
Rukum	13	220092	16930
Salyan	11	259309	23574
Jumal	7	117958	16851
Mugu	3	60109	20036
Humla	3	55261	18420
Kalikot	6	149371	24895
Dolpa	3	39832	13277
Jajarkot	6	186375	31063
Bajhang	6	210122	35020
Bajura	4	146338	36585
Darchula	8	139712	17464
Total	**99**	**1910490**	**19298**
B. Inside Valley			
Kathmandu	559	2011978	3599
Bhaktapur	55	340066	6183
Lalitpur	119	525211	4414
Total	**733**	**2877255**	**3925**

Sources: NRB Monthly Report, Mid-July, 2017

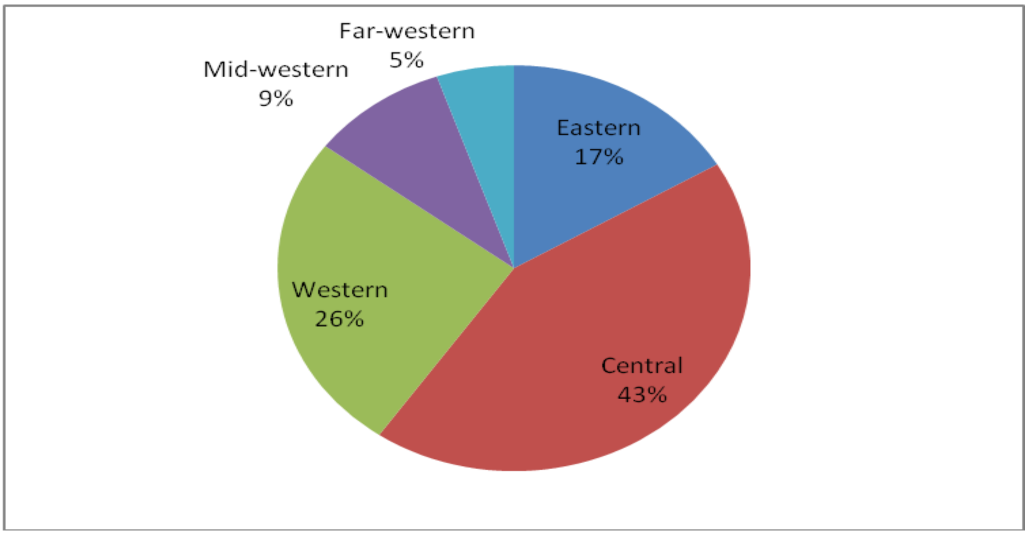
From the above data, population per branch to be served in lower developed district is 19,298 on average and in Kathmandu valley 3,925 people will served by a branch of any one of the BFIs. So, Bank and financial services are not developed in rural area as developed in Kathmandu valley. Jumla, Mugu and Dolpa have lowest branches of BFIs and Kathmandu has highest numbers of BFIs. So, Government should make necessary policy for proportionate development of rural area. NRB has issued directive which allowed opening one branch in valley only after opening one branch in the lower presence district and one out-side valley. However, though presence of infrastructure and road development most of financial development in the area seems to be harder. However, government should emphasis on those areas for financial development. The re-financing upto 1 crore for opening branches in 14 district seems lower side and development of BFIs without infrastructure also harder matter, so development of rural area along with banking sector is necessary.

Table 4.16: Regional Allocation of BFI Branches & Population per Branch

Region/BFI Class	A	B	C	Total
Eastern	419	85	18	522
Central	1043	257	71	1371
Western	464	318	31	813
Mid-western	212	79	8	299
Far-western	136	30	2	168
Total	**2274**	**769**	**130**	**3173**

Sources: NRB Monthly Report, Mid-July, 2017

Figure 4.13 Regional Allocations of Branches



Increase in number of branches indicates the increase in financial outreach or financial access, which is also considered as one of the indicators of financial inclusion. Banking industry occupies a bigger chunk in the financial system; despite the growth in number of BFIs and their branches; financial service providers are still mainly concentrated in urban or semi- urban areas where geographical access is relatively easy. Looking upon the region wise distribution, the majority branches of BFIs are situated in the central development region totaling of 1255 (46.1 percent), followed by western development region 672 (24.6 percent) and eastern development region 437 (16.0 percent). Kathmandu is highly concentrated district in terms of number of BFIs presence, followed by Rupendehi and Kaski. Despite continuous efforts from the NRB in increasing the outreach of financial services in remote areas, the result is still not satisfactory in terms of branch expansion in Far western region. Bajura and Mugu have still 2 bank branches only. Manang, Humla, Kalikot, Dolpa and Bajhang have only 3 branches, similarly Darchula and Jajarkot have 4 branches and Okhalghunga has 5 branches.

4.3 Sector Wise Distribution of Flow of Credit of BFIs

As per directives issued to BFIs, No BFIs can flow its fund to only one profitable sector. BFIs should diversify their credit to different sectors as advice by NRB. As per Directive issued by NRB, no BFI can finance its credit to only one sector more than 25% of its core/primary capital; however, one can finance its credit to hydro power sector more up to 40% of its core/primary capital. The major benefits of the diversification of credit of BFIs into different sectors are that it arise the equilibrium and simultaneous development of different financial sectors of the country and other hand the BFIs may decrease its risk assets by its diversification.

As per directive no. 9/074, BFIS should report different types of lending to different types of sector. As per same directive issued by NRB, BFIs should report with classification of the lending (loan and advance) on the basis of product/purpose in form no. 9.3 (ka) similarly, BFIs should report lending with classification on the basis of lending to different sectors in form no. 9.3. As per sector wise classification by NRB there are 15 different sectors that may finance by BFIs their assets. Here is date presented of aggregate credit financed by BFIs during last five years, we can see which part of sectors of the country is mobilized by credit of BFIs more and which is lesser.

Table No. 4.17: Sector Wise Distribution of Credit of BFIs

In Million

SN	Sectors	Mid-July					
		2012	**2013**	**2014**	**2015**	**2016**	**2017**
1	Agricultural and Forest Related	28,575.00	39,147.82	48,152.08	61,783.87	76,816.32	87,899.16
2	Fishery Related	1,828.00	657.8	2,747.06	3,355.59	1,980.46	2,328.51
3	Mining Related	2,712.60	3,897.30	3,580.05	3,525.74	3,404.03	3,950.19
4	Agriculture, Forestry & Bevarage Production Related	46,508.60	190,575.19	222,489.70	255,534.57	296,097.02	329,835.00
5	Construction	82,307.20	96,067.34	118,632.87	152,480.40	182,851.94	213,028.75
6	Electricity,Gas and Water	14,210.50	20,694.25	25,606.61	34,540.43	46,417.77	63,520.59
7	Metal Products, Machinary & Electronic Equipment & Assemblage	10,851.60	13,050.42	13,994.97	16,208.31	19,473.46	25,044.82
8	Transport, Communication and Public Utilities	39,374.60	41,298.89	43,707.55	48,451.67	67,489.25	76,264.31
9	Wholesaler & Retailer	159,507.00	198,319.29	243,966.15	297,286.58	374,322.54	436,442.74
10	Finance, Insurance and Real Estate	80,169.50	84,683.50	90,353.77	107,293.66	135,000.17	166,374.23
11	Hotel or Restaurant	20,941.30	25,087.38	32,909.63	44,028.90	54,426.26	66,900.15
12	Other Services	38,895.20	46,718.82	54,154.23	63,957.60	72,146.41	90,250.94
13	Consumption Loans	49,308.10	69,436.96	87,003.21	101,450.14	120,843.49	158,359.29
14	Local Government	1,356.00	1,255.49	1,182.73	1,714.14	1,654.98	1,568.65
15	Others	103,354.00	124,829.52	141,309.64	169,740.36	228,955.74	272,881.84
	TOTAL	**789,729.50**	**955,719.96**	**1,129,803.67**	**1,361,351.97**	**1,681,879.83**	**1,994,649.17**

Source: Monthly Statistics Mid July 2016 & 2017 NRB.

As per data available, here is presenting the sector wise date during last five years. As per date most of the sectors are increasing trend. However, sector of fishery seems decreasing trend; however, total agriculture sector is in increasing trend. Mostly, there is hydro electricity, hotel, wholesale & retailing (trading) etc are increasing during this review period. As all sectors are possible to present in figure, there are taken four most directly effective and relative sector financial as below:

Table No. 4.18: Four Sector Wise Distribution of Credit of BFIs

In Millions

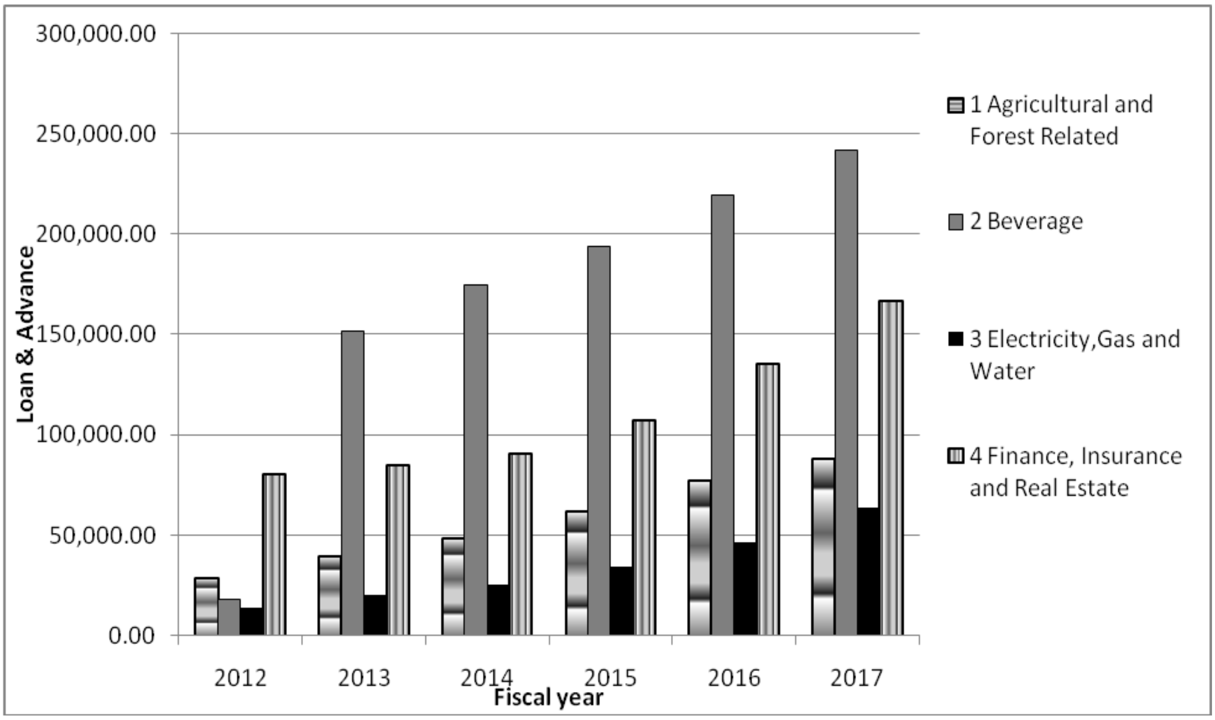
SN	Sectors	Mid-July					
		2012	2013	2014	2015	2016	2017
1	Agricultural and Forest Related	28,575.00	39,147.82	48,152.08	61,783.87	76,816.32	87,899.16
2	Beverage	17,933.60	151,427.37	174,337.62	193,750.70	219,280.70	241,935.84
3	Electricity,Gas and Water	14,210.50	20,694.25	25,606.61	34,540.43	46,417.77	63,520.59
4	Finance, Insurance and Real Estate	80,169.50	84,683.50	90,353.77	107,293.66	135,000.17	166,374.23

Source: Monthly Statistics Mid July 2016 & 2017 NRB.

As Nepal is one of the agriculture based country and it has huge natural resources, Agriculture, Hydro electricity and Hotel/ Restaurant sectors are most important part for development. As we can see hydro electricity is not developed rather than real estate, finance and insurance sector. It is drawback of our economy. The date can be presented in figure as below:

Figure No. 4.14: Sector Wise Distribution of Credit of BFIs

In Million



As per data above, the total loan and advance of the BFIs have been seen in increasing trend. All sectors are in increasing trend. However, Financing on the sector of agricultural is 76,816.32, Beverage is 296,097.02, electricity, water and gas is 46,417.77 in 2016. Nepal has potential economic development through hydro electricity however, somehow, financing under the topics by BFIs seem in lower side. Beside, another negative point is financing under sector of Beverage is 296,097, which is also an unproductive sector and financing under the sector is highest among the other sector. So, NRB should be restricted under these sectors. As Per NRB Directive no.3/074, there are huge facilities availed to the BFIs for making investment under hydro electricity, however, the investment under hydro electricity has not been increased as we expected. The projects are in big in nature and could not be finance by only one BFIs, so consortium among the BFIs is required for it. NRB has emphasis on the merger is one of the positive point for the matter as well.

4.4 Relationship between GDP and Lending of BFIs

Commercial banks constitute a major chunk of total assets in the banking system in Nepal and extension of credit is one of the major functions of banking institutions. If banks are not efficient in their lending behavior, it may not contribute to economic growth. On the other hand, their inefficient and imprudent banking practices may lead to riskier financial instability. Simple regression co-efficient is used for analysis about the GDP and lending by BFIs. The lending or investment in market obviously increases the revenue/outpur of National. So, to analysis of lending and GDP relationship, here is presenting 9 years of data as below:

Table No. 4.19 : Relationship between GDP and Lending of BFIs

In Million

Fiscal Year	Gross Domestic Product (GDP)	Bank & Financial Assets (BFA)
2008/09	988,272	499,892.60
2009/10	1,192,774	609,921.90
2010/11	1,366,954	698,778.98
2011/12	1,527,344	779,560.90
2012/13	1,695,011	945,698.45
2013/14	1,964,540	1,119,260.81
2014/15	2,130,150	1,345,671.32
2015/16	2,247,427	1,669,203.04
2016/17	2,599,234	1,948,238.58

Sources: Monthly report mid July, 2009 to 2017 and National Accounts of Nepal, 2009 to 2017

Correlation between GDP and BFA= 0.9771

(Calculation has been presented in Annex-i)

The relationship between GDP and Bank and financial assets is in highly positive. The increased in Bank and financial sector will contributed to GDP is positive in Nepal. In FY 2016/17 GPD becomes NPR2,599,234 million whereas BFA is NPR1,948,238 in the same year. GPD in fy 2008/9 is NPR988,272 whereas BFA in the same year is NPR499,892. The GPD and BFA both are increasing trend which is positive factor for economy.

However, more in-depth analysis sector wise contribution of BFA in Gross Domestic Output (GDO) should be analysis. The most important industrial sector/division of GDO should be priority sector for Bank and financial sector. What is the actual status of the lending to different sector and contribution of same sector to GDO can be analysis. Here is date presentation sector wise of GDO and BFA:

Table No. 4.20: Relationship between Different Sectors of GDO and Lending of BFIs

Industrial Classification	**2016/17**	**% of Output on Gross Output**	**Mid July 2017**	**% of financing at Each Sector**
Agriculture and forestry	924,720.06	24.67	87,899.16	4.41
Fishing	12,982.71	0.35	2,328.51	0.12
Mining and quarrying	18,968.52	0.51	3,950.19	0.20
Manufacturing	485,159.04	12.94	329,835.00	16.54
Electricty gas and water	68,465.68	1.83	63,520.59	3.18
Construction	344,493.13	9.19	213,028.75	10.68
Wholesale and retail trade	387,601.58	10.34	436,442.74	21.88
Hotels and restaurants	145,936.49	3.89	66,900.15	3.35
Transport, storage and communications	329,639.01	8.80	76,264.31	3.82
Financial intermediation & Real estate, renting and business activities	494,259.96	13.19	166,374.23	8.34
Other	535,725.32	14.29	548,105.54	27.48
Gross Output at basic prices	**3,747,951.50**	**100.00**	**1,994,649.17**	**100.00**

Sources: *Monthly report Mid july, 2017 and National Accounts of Nepal 2017*

Correlation Co-efficient= 0.4394

(Calculation has been presented in Annex-II)

Though relationship between BFA and GDP are highly correlated, sector wise distribution of BFA and Gross Domestic Output are not highly co-related. Most of important sector of GDP such as agricultural, production and energy have not been equally contributed by BFIs. Contribution of agricultural sector is 24% in gross domestic output but only 4.41% of total lending of BFIs has been financed in this sector. Similarly, BFIs have financed to 21.88% trading of merchandised goods whereas contribution from the same sector on Gross Domestic Sector is only 10.34%. If financial lending has been increased in the same sectors from which GDP will increase then definitely GDP will be increased accordance with Banking sector development. NRB has highly controlled for financing on priority sectors such as productive and agricultural sector lending. BFIs has always focused on profitable sector and their own profit so NRB should again legally directed to BFIs and also monitor regularly for simultaneous development of economy as well.

4.5 Deprived Sector Lending

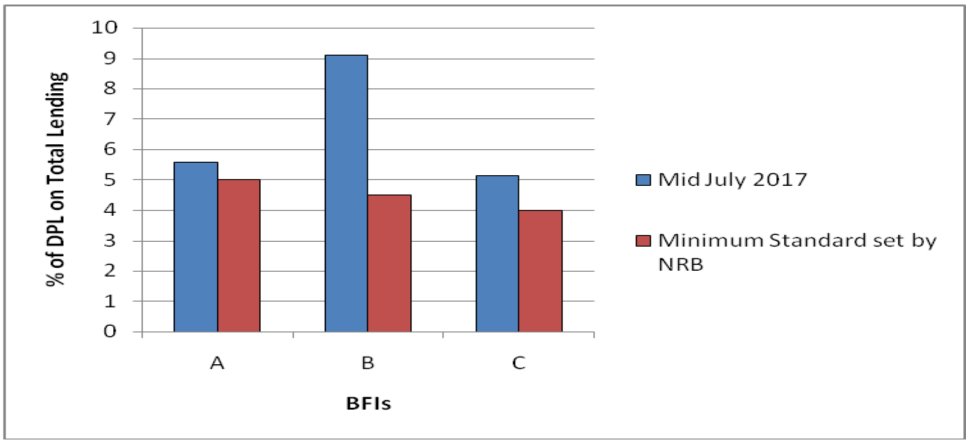
As per circular issued on 6 August 2015, the deprived sector lending requirement for BFIs will be increased by 0.5 percentage point. As per the provision, the commercial banks to be required to disburse 5 percent, development banks 4.5 percent and finance companies 4.0 percent of their total loan in the deprived sector. Commercial banks, development banks and finance companies have disbursed 5.59 percent, 9.11 percent and 5.15 percent respectively of their total loan to the deprived sector as of mid july 2017.

Table No. 4.21: Deprived Sector Lending by BFIs

Particulars \ Years (Mid July)	2012	2013	2015	2016	2017	Standard as per Monetary Policy 2015/16
A	3.70	4.70	5.11	5.52	5.59	5.00
B	4.10	4.30	5.96	6.77	9.11	4.50
C	2.50	3.10	3.74	4.57	5.15	4.00
Overall Financing	**3.70**	**4.50**	**5.16**	**5.65**	**6.26**	**NA**

Source: NRB Monthly Reports of July, 2012 to 2017

Figure No 4.15: Deprived Sector Lending by BFIs



As per data , the deprived sector lending has been met by the BFIs as guided by NRB. The deprived sector lending in 2017 are 5.59, 6.77 & 4.57% for A, B and C categoried BFIs. The NRB strictly regulated regarding Deprived sector lending, on aggregate the deprived sector lending is found as guided by NRB. The monetary policy stance is designed to channelize financial resources towards productive sectors such as agriculture, energy, tourism, cottage and small industries as well as to the deprived sector. It is one of the important part of economic development of Nepal.

4.6 Priority Sector Lending

According to the central bank, the 25 percent directed lending requirement includes 10 percent in agriculture sector, 5 percent in hydropower, 5 percent in tourism and remaining 5 percent in other sectors prescribed by the NRB as productive sectors. Commercial banks were earlier required to float 20 percent of their total lending in productive sectors, including 15 percent credits on agriculture and energy sector combined. In line with the demand of the banking executives and the private sector leaders, the central bank has also expanded the definition of productive sectors to accommodate pharmaceuticals, cement and garment, among other industries, as productive sectors. However, there are doubts on whether banks will be able to increase productive sector loans as they are struggling to meet the existing requirement of 20 percent.

Table No. 4.22: Priority Sector Lending by Banks

S. No.	Banks	Productive Sector (In %)	Agricultural and Energy (In %)
1	Nepal Bank Ltd.	38.51	13.33
2	Rastriya Banijya Bank Ltd.	18.86	10.00
3	Agriculture Dev. Bank Ltd.	33.58	28.39
	Sub Total (a)	**30.32**	**17.24**
4	Nabil Bank Ltd.	31.09	17.79
5	Nepal Investment Bank Ltd.	31.17	18.25
6	Standard Chartered Bank Nepal Ltd.	23.96	13.64
7	Himalayan Bank Ltd.	28.99	20.46
8	Nepal SBI Bank Ltd.	23.70	15.83
9	Nepal Bangladesh Bank Ltd.	21.26	9.00
10	Everest Bank Ltd.	22.12	13.82
11	Bank of Kathmandu Lumbini Ltd.	33.54	23.05
12	Nepal Credit and Commerce Bank Ltd.	19.86	13.81
13	NIC Asia Bank Ltd.	25.31	16.71
14	Machhapuchhre Bank Ltd.	25.44	22.23
15	Kumari Bank Ltd.	20.55	15.11
16	Laxmi Bank Ltd.	20.11	15.84
17	Siddharth Bank Ltd.	23.01	15.69
18	GlobalIME Bank Ltd.	15.59	15.59
19	Citizens Bank International Ltd.	16.76	16.76
20	Prime Commercial Bank Ltd.	10.90	10.90
21	Sunrise Bank Ltd.	17.18	17.18
22	NMB Bank Ltd.	22.21	22.21
23	Prabhu Bank Ltd.	17.30	17.30
24	Janata Bank Nepal Ltd.	19.12	19.12
25	Mega Bank Nepal Ltd.	22.91	12.35
26	Civil Bank Ltd.	23.99	15.93
27	Century Commercial Bank Ltd.	33.43	20.29
28	Sanima Bank Ltd.	21.96	14.61
	Sub Total (b)	**22.86**	**16.54**
	Grand Total (a+b)	**23.66**	**16.61**

Source: Key Financial Indicators FY 2073/74, NRB.

As per above table, RBB, Prime commercial bank and Nepal Credit and Commerce Bank are required to increase their financing on both Productive sector and Agricultural and Energy Sector. Most of the banks seems fulfill their requirement under the priority sector lending however, some of the BFIs still needs to be increase their lending on the priority sectors prescribed by NRB.

The four years data of priority sector lending has been presented below for analysis of trend of lending on priority sector:

Table No. 4.23: Trend of Lending on Priority Sector

Fiscal Year	Productive Sector Lending		Agricultural Energy	
	Financing in Actual (%)	Requirement by NRB (%)	Financing in Actual (%)	Requirement by NRB (%)
Mid July 2014	13.54	20	8.43	10
Mid July 2015	22.5	20	14.42	12
Mid July 2016	23.66	20	15.32	12
Mid July 2017	23.66	20	16.61	**12**

Source: *Key Financial Indicators FY 2070/71 to FY 2073/74, NRB and NRB Directives 2070 to 2073.*

As per NRB directive number 17/073, minimum requirement for lending on productive sector is 20% whereas minimum requirement of lending on agricultural sector is 12%. In 2014, the requirement has been prescribed in directive number 03/2070. However, same has been described in directive number 17/2073 now. In 2014, Banks are directed to increase their lending on priority sector as guided by NRB within three years, however, now it has been changed. As per new Directive, 2074, the requirement has been increased to 20% and 15% on productive and Agro cum energy sector. As per guided by NRB, most of years, Banks has fulfill their requirement.

4.7 Changes in NBL, RBB and ADBL after Control of Management.

Rastriya Banijya Bank is government owned bank and Nepal Bank Ltd. And ADBL are the partially government owned banks. After different type of study on financial sector reform these banks were suggested through different kinds of reform. After a long period of time, the banks have been coming in the position of positive way and their financial have also been seen in positive. The analysis of these three banks have been presented blow:

4.7.1 Progress of Nepal Bank Ltd.

Nepal Bank Limited is the first commercial bank of Nepal. It was established in 1937 which marked the beginning of an era of formal banking in Nepal. On November 15, 1937 (Kartik 30, 1994), the then King Tribhuvan inaugurated Nepal Bank Limited. For analysis of progress of NBL here 13 years data have been dated for study which includes Deposit, Credit and Loan Loss provision.

Table No. 4.24: Progress of Nepal Bank Ltd *In Million*

Fiscal year	Total Deposit	Total Gross Loan	NPL	NPL to Total Loan (%)
2003	34,737.40	18,132.33	10,964.91	60.50
2004	36,288.50	17,937.66	9,640.08	53.70
2005	34,744.20	16,866.50	8,372.00	49.60
2006	35,444.90	12,441.59	2,262.18	18.20
2007	38,715.20	13,756.60	1,856.00	13.50
2008	41,451.70	15,770.70	1,410.80	8.90
2009	44,346.10	19,482.25	1,151.40	5.90
2010	42,129.90	25,086.80	573.20	2.30
2011	46,804.20	26,709.90	1,410.73	5.30
2012	56,042.60	29,698.86	1,731.63	5.80
2013	62,988.90	37,855.28	1,714.84	4.50
2014	69,341.20	41,195.99	2,397.48	5.80
2015	78,007.20	53,374.54	2,069.64	3.90
2016	89,410.02	63,512.85	1,980.30	3.12
2017	93,944.01	74,364.93	2,566.14	3.45

Sources: NRB Quarterly Financial Highlights and Monthly Report of July 2003 to 2017

NBL has huge amount of NPL in fiscal year 2003. 60.50% of loan was provisioning in fiscal year 2003 that was huge loss for not only bank buy also for economy of Nepalese Banking Sector. The staffing was effected by political powers and management was not sufficiently controlled. As per financial sector reform programme also advise of different committee formed for study of Nepal Bank Ltd., advices for change in management system and different prompt action. They also recommended for 3 years or more of technical assistance required to fully address operational weaknesses of NBL and RBB to make them healthy and effective banking institutions. They also cautioned the concerned authorities to continue the institutional process in the near future to avoid another government sponsored financial restructuring program.

After 15 years of progress of Nepal bank Ltd, it become at break even point. In 2017, deposit and loan and advance arrived at NPR93,944.01 and NPR74,364.93 respectively. Moreover, loan loss provision is brought at 3.45% 2017 from 60.5% in 2003. It is very positive improvement. As per quarterly report of fiscal year 2017, NBL has become in breakeven point i.e all negative reserve and retained loss has been recovered, so Net-worth of the bank is now positive.

4.7.2 Progress of Rastriya Banijya Bank

Rastriya Banijya Bank (RBB) (translation: National Commercial Bank is fully government owned, and the largest commercial bank in Nepal. RBB was established on January 23, 1966 (2022 Magh 10 BS) under the RBB Act. RBB provides various banking services to a wide range of customers including banks, insurance companies, industrial trading houses, airlines, hotels, and many other sectors. RBB has Nepal's most extensive banking network with 161 branches. For analysis of progress of RBB here also 15 years data have been dated for study which includes Deposit, Credit and Loan Loss provision.

Table No. 4.25: Progress Report of RBB *In Million*

Fiscal year	Total Deposit	Total Gross Loan	NPL	NPL to Total Loan (%)
2003	39,308.60	26,608.80	16,005.30	60.20
2004	40,313.60	25,105.70	14,470.50	57.60
2005	43,489.20	27,000.90	13,689.30	50.70
2006	45,700.70	23,100.90	8,045.50	34.80
2007	50,192.60	24,871.40	6,876.50	27.70
2008	57,990.80	27,494.60	5,951.80	21.60
2009	67,976.30	31,607.00	4,956.00	15.70
2010	68,623.20	35,692.50	4,085.00	11.40
2011	73,924.10	36,866.10	4,024.60	10.90
2012	87,775.00	40,448.40	2,940.40	7.30
2013	91,093.90	49,044.90	2,604.80	5.30
2014	107,270.10	60,854.90	2,402.80	3.90
2015	124,221.70	75,836.50	2,562.00	3.40
2016	146,207.63	85,412.60	3,705.86	4.34
2017	153,575.99	106,373.59	4,316.65	4.06

Sources: NRB Quarterly Financial Highlights and Monthly Report of July 2003 to 2017

As NBL has huge amount of NPL in FY 2003, RBB has also huge amount of NPL in 2003. 60.20% of loan was provisioning in fiscal year 2003 that was huge loss for not only bank buy also for economy of Nepalese Banking Sector because RBB capture huge market of Nepalese banking sector at the time. The staffing was effected by political powers and management was not sufficiently controlled. As per financial sector reform programme also advise of different committee formed for study of RBB, advices for change in management system and different prompt action. They also recommended for 3 years or more of technical assistance required to fully addressing operational weaknesses of NBL and RBB to make them healthy and effective banking institutions. They also cautioned the concerned authorities to continue the institutional process in the near future to avoid another government sponsored financial restructuring program.

After 15 years of progress of RBB, deposit and loan and advance arrived at NPR 153,575.99 and NPR 106,373.59 respectively. Moreover, loan loss provision is brought at 4.06% in 2017 from 60.2% in 2003. It is very positive improvement.

4.7.3 Progress of Agricultural Development Bank

Agricultural Development Bank Limited is an autonomous organization largely owned by Government of Nepal. The bank has been working as a premier rural credit institution since the last three decades, contributing a more than 67 percent of institutional credit supply in the country. Hence, rural finance is the principal operational area of ADBL/N. Besides, it has also been executing Small Farmer Development Program, the major poverty alleviation program launched in the country. Furthermore, the bank has also been involved in commercial banking operations since 1984.

The enactment of Bank and Financial Institution Act in February 2004 abolished all Acts related to financial institutions including the ADBN Act, 1967. In line with the BAFIA, ADBL/N has been incorporated as a public limited company on July 14, 2005. Thus, ADBL operates as a A category financial Institution under the legal framework of BAFIA and the Company Act, 2063.

To analysis of progress of ADBL, 12 years data have been taken for study. The data show improvement in performance of ADBL in the last 12 years of period.

Table No. 4.26: Progress report of ADBL/N

In Million

Fiscal year	Total Deposit	Total Gross Loan	NPL	NPL to Total Loan (%)
2006	29,990.20	33,310.80	6,859.00	20.60
2007	32,406.90	34,440.40	6,185.30	18.00
2008	32,553.80	36,585.40	4,256.20	11.60
2009	35,154.80	32,566.50	2,875.60	8.80
2010	32,463.00	39,375.30	3,235.90	8.20
2011	34,398.60	40,389.30	3,491.50	8.60
2012	43,239.00	45,337.60	2,880.60	6.40
2013	54,397.10	54,959.30	3,211.50	5.80
2014	65,828.30	62,454.90	3,332.50	5.30
2015	76,921.30	72,215.50	3,269.70	4.50
2016	87,263.49	83,349.44	3,597.58	4.32
2017	99,952.07	92,715.81	4,418.92	4.77

Sources: NRB Quarterly Financial Highlights and Monthly Report July 2006 to 2017

ADBL/N is one of most big part of bank and financial institution market. After it becomes public limited in 2005, 10 years of data has been presented in above table. After liberalization in ADBL/N, what were the progress we can see in the table. Deposit and credit of the bank have been increasing year by year. Total deposit becomes NPR99,952,.07 in 2017 from 29,990 in 2006. Similarly, credit of NPR33,310 becomes NPR92,715.81 in 2017. The increasing in deposit and credit show positive increment in performance of the bank and similarly, NPL of the bank also in decreasing trend. NPL of 20.6% in 2006 has decreased to 4.77% in 2017. That’s why; overall performance of ADBL/N seems in satisfactory after privatization.

4.8 Major Findings

This study was conducted to study the impact of FSR in the financial sector development with the focusing on Bank and Financial Institutions. NRB has been re-engineered via NRB act, 2058. After empowering NRB, there are huge developments in financial sector of Nepal. The Bank and financial institution have been increased rapidly. However, the focus of the study has been made on the development of production sector of the economy and effect of privatization and supervisory role of the NRB on Banks and financial sectors. The study has been made to analysis on financial development after FSR in Nepal, proportionate growth of BFIs and flow of BFIs and it impact on GDP.

Similarly, the study also tries to analysis on the development of state owned three banks as well. The major findings on after data collection and analysis have been presented below.

4.8.1 Development of BFIs in Nepal after FSR

In 1985, there were only 5 BFIs operated in Nepal after a decade i.e in 1995, the no. of BFIs are increased to 44 and after that the no. of BFIs were increasing trend in Nepal. In 2000 there were 263 financial institution and NGOs licensed by NRB. They become 265 & 260 in 2012 & 2014 respectively. Now, the no. of BFIs is become 221 & 189 in 2016 & 2017 respectively. The reasons behind decreasing no. of BFIs are the merger and acquisition enforced by NRB to BFIs.

Loan loss provision has been decreased from 5.58% in 2009 to 2.75% in 2017. Similarly, Loan loss provision is on average 4.24% to 4.46% till 2014 but after provision issued by NRB regarding watch list category under Pass loan the provision seems to be in decreasing trend. The provision is 2.91% in 2016 and 2.75% in mid June 2017. The decreasing in loan loss provision is positive point for money market and commodity market as well i.e the repayment in time means the trading activities of the commodity market and cash flow of the customer routed smoothly, which indicate positive movement of the Nepalese market.

Commercial banks, Development Bank and Financial Institutions have been increasing trend and their credit and deposit have been increasing trend similarly, the loan loss provision are also in decreasing trend which are positive for Nepalese financial sector.

4.8.2 Proportionate Development of BFIs in Nepal and Financial Access to People

From the above data, population per branch to be served in lower developed district is 19,298 on average and in Kathmandu valley 3,925 people will served by a branch of any one of the BFIs. So, Bank and financial services are not developed in rural area as developed in Kathmandu valley. Jumla, Mugu and Dolpa have lowest branches of BFIs and Kathmandu has highest numbers of BFIs.

Most of bank and financial institutions are operated in central region and only 93 banks, 28 development banks and 2 finance companies are operated in Far-western regions. It concludes that financial sectors are not well developed in far western region. Similarly, the population in far western region is less than center region so, for comparative study we need data of population served per branch. As per data available, there is more branches in central regions with comparative to far-western region. In Mid-western and Far-western region, one branch serves 15,851 people and 21,769 people respectively.

4.8.3 Sector Wise of Flow of Lending of BFIs and Impact on GDP and Different sector of Industrial Sector

As Nepal is one of the agriculture based country and it has huge natural resources, Agriculture, Hydro electricity and Hotel/ Restaurant sectors are most important part for development. As we can see hydro electricity is not developed rather than real estate, finance and insurance sector. It is drawback of our economy. Though emphasis made by NRB to finance toward Hydroelectricity which can be found in directive no. 3/074, the finance under the product sector Electricity, water and Gas is in lower side than beverage. So, NRB should bring innovative programme toward the electricity and facilitates to BFIs for consortium financing. Also, Merger and acquisition will somehow help to big project like hydroelectricity in future.

Though relationship between BFA and GDP are highly correlated, sector wise distribution of BFA and Gross Domestic Output are not highly co-related. Most of important sector of GDP such as agricultural, production and energy have not been equally contributed by BFIs. Contribution of agricultural sector is 24% in gross domestic output but only 4.41% of total lending of BFIs has been financed in this sector. Similarly, BFIs have financed to 21.88% trading of merchandised goods whereas contribution from the same sector on Gross Domestic Sector is only 10.34%. If financial lending has been increased in the same sectors from which GDP will increase then definitely GDP will be increased accordance with Banking sector development. NRB has highly controlled for financing on priority sectors such as productive and agricultural sector lending. BFIs has always focused on profitable sector and their own profit so NRB should again legally directed to BFIs and also monitor regularly for simultaneous development of economy as well.

4.8.4 Priority Sector Lending and Deprived Sector Lending Analysis

The deprived sector lending has been met by the BFIs as guided by NRB. The deprived sector lending in 2016 are 5.52, 6.77 & 4.57% for A, B and C categorized BFIs. The NRB strictly regulated regarding deprived sector lending, on aggregate the deprived sector lending is found as guided by NRB. The monetary policy stance is designed to channelize financial resources towards productive sectors such as agriculture, energy, tourism, cottage and small industries as well as to the deprived sector. It is one of the important part of economic development of Nepal.

As per NRB directive number 17/073, minimum requirement for lending on productive sector is 20% whereas minimum requirement of lending on agricultural sector is 12%. In 2014, the requirement has been prescribed in directive number 03/2070. However, same has been described in directive number 17/2073 now. In 2014, Banks are directed to increase their lending on priority sector as guided by NRB within three years, however, now it has been changed. As per new Directive, 2074, the requirement has been increased to 20% and 15% on productive and Agro cum energy sector. As per guided by NRB, most of years, Banks has fulfill their requirement.

4.8.5 Development of Government Owned Banks

After 15 years of progress of Nepal bank Ltd, it become at breakeven point. In 2015, deposit and loan and advance arrived at NPR78,007.20 and NPR53,374.54 respectively. Moreover, loan loss provision is brought at 3.9% 2015 from 60.5% in 2003. It is very positive improvement. As per quarterly report of fiscal year 2017, NBL has become in breakeven point i.e all negative reserve and retained loss has been recovered, so Net worth of the bank is now positive. After 15 years of progress of RBB, deposit and loan and advance arrived at NPR124,221.70 and NPR75,836.50 respectively. Moreover, loan loss provision is brought at 3.4% 2015 from 60.2% in 2003. It is very positive improvement. ADBL is one of most big part of bank and financial institution market. After it becomes public limited in 2005, 10 years of data has been presented in above table. After liberalization in ADBL, what were the progress we can see in the table. Deposit and credit of the bank have been increasing year by year. Total deposit becomes NPR76,921.30 in 2015 from 29,990 in 2006. Similarly, credit of NPR33,310 becomes NPR72,215 in 2015. The increasing in deposit and credit show positive increment in performance of the bank, similarly, NPL of the bank also in decreasing trend. NPL of 20.6% in 2006 has decreased to 4.50% in 2015. That’s why; overall performance of ADBL seems in satisfactory after privatization.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

There is very crucial role of financial sector reform in development of financial development in Nepalese financial market. The study has been made on the financial sector reform programs and reforms of policy, rules and regulation and made analysis on their effects in financial sector development and economic development of Nepal. The study has been made with four major objectives such as to analysis of development of financial sector of Nepal after FSR, to analysis of effects of FSR on proportionate development of BFIs, to analysis effect of flow of lending on different industrial sectors which contributes on GDP, to analysis on priority sector and deprived sector lending and to analysis of progress of NBL, RBB and ADBL/N after financial sector reform in Nepalese market.

The research is based on secondary source of data. To make this study more effective, related literatures have been reviewed. This section includes theoretical review and review of related studies. In theoretical review includes concept of financial sector reform, development of bank and restructuring, factor motivating financial sector reform, financial sector reform in Nepal as well as reform and management. In the review of related studies includes financial sector reform context related national and international, unified NRB directives, review of books articles and journals and review of previous thesis as well.

Research methodology has been described in third chapter, which is a way to solve the research problems with the help of various tools and techniques. This chapter includes the various financial as well as statistical tools to analyze the data in order to come to the decisions. This chapter includes the research design, population and sample data collection procedure, data period covered and methods of analysis. This study is mainly conducted on the basis of secondary data collected from annual reports, official report, economic journal, financial statement etc. and authorize web site of concern bank and Nepal stock exchange. The five to thirteen years financial statement has been examined for the purpose of the study.

The presentation and analysis of data has been made comparative analytical and their interpretation has done in chapter four by applying the wide varieties of methodology as stated in chapter three. Mainly correlation co-efficient has been calculated for relation analysis between flow of lending to different sector and output of the Gross Domestic Output from the same sectors, similarly, other different data presentation methods have been used. Various statistical tools such as arithmetic mean, coefficient of correlation, trend analysis have been applied to fulfill the objective of this study. The major findings of the study are also included in the final section of the presentation and analysis chapter. In this fifth chapter, summary conclusion and recommendation are included. All the summary and conclusion are made according to obtained data from analysis. Recommendation has made which would be beneficial for all stakeholders of Nepal financial sectors and NRB.

Financial sector reform plays a vital role in the economic growth of the country. Financial system is regarded as the engine of growth. It works as the lubricator for the economic machinery. Nepal's financial sector has witnessed rapid expansion over the past three decades, mainly due to the liberalized policy adopted by the government. In fact the financial sector has grown faster compared to other sectors in the process of economic liberalization. It has resulted in the increasing role of the private sector. Growth of flow of credit has contributed towards increased economic activities. Innovative banking technology, products and services have been introduced in the financial market. Financial Sector Reform through different phases has helped the financial sector grow in many ways.

NRB has play important role in Nepalese financial sector reform and development, it has supervisory and regulatory role in financial sectors of Nepal. After financial sector reform in Nepal stated owned banks and other private banks as well seems in increasing trend. Similarly, priority sector as well as deprived sectors lending has been analysis as part of financial sector. The flow of lending form BFIs will certainly effect on industry division which contribute GDP, so, relation of contribution of sectors on GDP and flow of lending in the same sectors has been analyzed.

5.2 Conclusion

This study was focused to assess the impact of FSR on financial sector development in Nepal. The purpose of this study is to study the recent initiation and commitments in the field of financial development, and to assess the direct or indirect effect of FSR in BFIs, proportionate development of BFIs all over Nepal, flow of credit to different sectors and relation of flow of credit and contribution of the sector to GDP. Also, the study has been made to analysis about the deprived sector lending and priority sector lending as part of financial sector.

During the past few years, a positive impact of FSR programs and regulation has been observed in various components of financial sector of Nepal. The number of commercial banks, development banks and finance companies increased in greater extent as well as their branches. High percentage of NPA was always been challenges for the banking sector of Nepal especially to the finance companies, NBL, RBB and ADBL. The regulation of NRB and programs helped these banks to reduce their NPA. After initiation of financial sector reform, amount of deposit collection has been increased rapidly and total credit of banks also increased significantly. Priority Sector Credit (PSC) also increased in all the review periods but higher liquidity of commercial banks, which was problem before FSR, is now under control. Credit deposit ratio increased after FSR but capital- total deposit ratio has been within in guided by NRB.

As Nepal is one of the agriculture based country and it has huge natural resources, Agriculture, Hydro electricity and Hotel/ Restaurant sectors are most important part for development. As we can see hydro electricity is not developed rather than real estate, finance and insurance sector. It is drawback of our economy. Though emphasis made by NRB to finance toward Hydroelectricity which can be found in directive no. 3/074, the finance under the product sector Electricity, water and Gas is in lower side than beverage. So, NRB should bring innovative programme toward the electricity and facilitates to BFIs for consortium financing. Also, Merger and acquisition will somehow help to big project like hydroelectricity in future.

Similarly, FSR helps to grow BFIs and financial system immensely. Deposit of finance companies is increasing tremendously and the cause behind this growth is the increased number of BFIs. The reform initiated by the government viz. NRB has positive effect to the credit of finance companies. The number of BFIs as well as credit and lending has been increased. Low liquidity is life threatening to finance companies and high liquidity reduces profit. So, for the past few years, finance companies succeeded to maintain appropriate liquidity according to NRB norms. Loan loss provision and none performing loan is still in increasing trend which is of some concern for finance companies. Capital to total deposit ratio of finance companies had shown a decreasing trend initially but from past few years it is increasing trend. Profit of finance companies witnessed increment in their volume which was the due to the cause of reform initiated by NRB and GON though few were in loss.

After financial sector reform in Nepal stated owned banks and other private banks as well seems in increasing trend. Similarly, priority sector as well as deprived sectors lending has been analysis as part of financial sector. The flow of lending form BFIs will certainly effect on industry division which contributes GDP, so, relation of contribution of sectors on GDP and flow of lending in the same sectors has been analyzed. The flow of sector wise distribution does seem satisfactory and also proportionate development of BFIs was not found during review time period.

5.3 Recommendations

Following recommendations are made on the basis of the study and analysis of collected data in order to make sound financial sector development:

i. As a reform package could change the development trend of the Nepalese financial sector, Nepal Government and NRB should analysis properly time to time for new issues and initiate new FSR programs to motivate and development of financial sector in Nepal. To strengthen and develop the regulatory, supervisory role, the framework of NRB should be built as autonomous body without interference of the government in conducting monetary policy, regulation, supervision, (onsite and offsite) and licensing of financial institutions.

ii. The distribution of branches of BFIs and increasing trend of BFIs in rural area is not satisfactory. Nepalese government should emphasis on the opening of BFIs in rural area and to develop the economic part of the rural area of Nepal. The priority sector credit and deprived sector lending are directly related to poverty alleviation effort. So, government should made effort to continue this. Portion of productive and agricultural sector should be increased gradually and monitored by NRB regularly.

iii. As Nepal is one of the agriculture based country and it has huge natural resources, Agriculture, Hydro electricity and Hotel/ Restaurant sectors are most important part for development. As we can see hydro electricity is not developed rather than real estate, finance and insurance sector. It is drawback of our economy. Though emphasis made by NRB to finance toward Hydroelectricity which can be found in directive no. 3/074, the finance under the product sector Electricity, water and Gas is in lower side than beverage. So, NRB should bring innovative programme toward the electricity and facilitates to BFIs for consortium financing.

iv. NRB has highly controlled for financing on priority sectors such as productive and agricultural sector lending. BFIs has always focused on profitable sector and their own profit so NRB should again legally direct to BFIs and also monitor regularly for simultaneous development of economy as well.

v. NRB should emphasis for increment of lending of BFIs on the sector that contributes on Gross Domestic Output directly for economic development. Also, directly supervise and monitor about the lending which should be increased in the sectors that give Gross domestic Output and employment to people.

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APPENDIX-I

Questionnaires

We have used pearly secondary data to asses the impact of FSR in Commercial Banks and Finance Companies. However to collect primary data a questionnaire was developed and used. In this context, some relevant questions were developed and administered to the officials from different financial institutions like NRB, NBL, RBB, and other private commercial banks and finance companies. Following are the questions asked to them:-

1. Do you think that FSR programe was necessary for the overall reform of financial sector of Nepal?

   (a) Yes (b) No

   (c) I don't know

2. Have you observed any changes in overall performance of Commercial Banks and Finance companies due to the implementation of FSR programme in Nepal?

   (a) Yes (b) No

   (c) I don't know

3. Does there any improvement observed in the interest rate spread of CBs, after deregulation of interest rate?

   (a) Increased (b) Decreased

   (c) Unchanged

4. What was the cause behind the deposit and credit growth in Commercial Banks and Finance Companies?

   (a) Due to Implementation of FSR programme.

   (b) Due to increase in number of Commercial Banks and Finance Companies, and quality of service offered.

   (c) All the above

5. Does the liquidity position of Commercial Banks and Finance Companies improved after the implementation of FSR program?

   (a) Increased in both (b) Decreased in both

   (c) Unchanged

6. What is the major cause behind the growth of Finance Companies in Nepal?
   (a) Implementation of FSR Programme (b) Lack of Commercial Bank Growth
   (c) Above two

7. What kind of changes have you observed on NBL and RBB after the management contract to foreign company?
   (a) More Improved (b) Little Improved
   (c) Unchanged

8. What kind of competition has been observed in financial sector after adopting the FSR?
   (a) Healthy Competition (b) Unhealthy Competition
   (c) I don't know

9. Why has the relative position of market share of commercial banks decreased recently?
   (a) Due to increase in market share of development banks.
   (b) Due to increase in market share of finance companies.
   (c) Both the above

10. How far do you agree that the re-engineering process has increased the autonomy and accountability of NRB?
    (a) Agree (b) Disagree
    (c) I don't know

11. To make FSR program successful…………………… has to play a vital role.
    (a) Financial Institution (b) NRB & Government
    (c) All the above

12. What will be the role of private sector on financial sector reform of Nepal?
    ……………………………………………………………………………………
    ……………………………………………………………………………………
    ……………………………………………………………………………………

Thanking you for your kind cooperation.

Annex-II

Calculation of Correlation coefficient between GDP and Financial Assets of BFIs:

Fiscal Year	**Gross Domestic Product (GDP)-X**	**Bank & Financial Assets-Y**	x=**X-Ẍ**	y=**Y-Ȳ**	x.y	X^2	y^2
2008/09	988,272	499,892.60	-757,473	-568,577.40	4.30682E+11	5.73766E+11	3.2328E+11
2009/10	1,192,774	609,921.90	-552,971	-458,548.10	2.53564E+11	3.05777E+11	2.10266E+11
2010/11	1,366,954	698,778.98	-378,791	-369,691.02	1.40036E+11	1.43483E+11	1.36671E+11
2011/12	1,527,344	779,560.90	-218,401	-288,909.10	6.30982E+10	47699188994	83468468063
2012/13	1,695,011	945,698.45	-50,734	-122,771.55	6.22868E+09	2573928609	15072853489
2013/14	1,964,540	1,119,260.81	218,795	50,790.81	1.11128E+10	47871063861	2579706380
2014/15	2,130,150	1,345,671.32	384,405	277,201.32	1.06557E+11	1.47767E+11	76840571810
2015/16	2,247,427	1,669,203.04	501,682	600,733.04	3.01377E+11	2.51684E+11	3.6088E+11
2016/17	2,599,234	1,948,238.58	853,489	879,768.58	7.50873E+11	7.28443E+11	7.73993E+11
Total	**15,711,703**	**9,616,227**	**-2**	**-3**	**2,063,528,190,341**	**2,249,064,455,099**	**1,983,052,609,518**
Average	1,745,745	1,068,470	0	0	229,280,910,038	249,896,050,567	220,339,178,835
					Square root of $\sum x^2 or \sum y^2$=	**1499688.119**	**1408209.008**

Pearson Correlation Co-efficient between two variable (X,Y), R= $\frac{\sum x.y}{\sum x^2 . \sum y^2}$

=(2063528190341)/(2249064455099*1983052609518)

=**0.9771**

Annex-II

Calculation of Correlation coefficient between different components of Gross Domestic Output and Lending of BFIs on the same sector has been presented below:

Industrial Classification	**GDO (X)**	**BFA (Y)**	x=**X-Ẍ**	y=**Y-Ȳ**	x.y	x2	y2
Agriculture and forestry	924,720.06	87,899.16	583,997.20	(93,432.58)	-54564364779	3.41053E+11	8729647005
Fishing	12,982.71	2,328.51	(327,740.15)	(179,003.23)	58666545745	1.07414E+11	32042156350
Mining and quarrying	18,968.52	3,950.19	(321,754.34)	(177,381.55)	57073283954	1.03526E+11	31464214280
Manufacturing	485,159.04	329,835.00	144,436.18	148,503.26	21449243848	20861810592	22053218231
Electricty gas and water	68,465.68	63,520.59	(272,257.18)	(117,811.15)	32074931784	74123973505	13879467064
Construction	344,493.13	213,028.75	3,770.27	31,697.01	119506374.1	14214956.86	1004700443
Wholesale and retail trade	387,601.58	436,442.74	46,878.72	255,111.00	11959276235	2197614057	65081622321
Hotels and restaurants	145,936.49	66,900.15	(194,786.37)	(114,431.59)	22289713836	37941729278	13094588790
Transport, storage and communications	329,639.01	76,264.31	(11,083.85)	(105,067.43)	1164551217	122851642.8	11039164847
Financial intermediation & Real estate, renting and business activities	494,259.96	166,374.23	153,537.10	(14,957.51)	-2296532752	23573641962	223727105.4
Other	535,725.32	548,105.54	195,002.46	366,773.80	71521793774	38025959949	1.34523E+11
Gross Output at basic prices	**3,747,951.50**	**1,994,649.17**	**0.04**	**0.03**	**219,457,949,236.79**	**748,853,985,208.04**	**333,135,526,803.76**
Average=	340,722.86	181,331.74					
					Square root of $\sum x^2 or \sum y^2=$	865363.4989	577178.9383

Pearson Correlation Co-efficient between two variable (X,Y), R= $\frac{\sum x.y}{\sum x^2.\sum y^2}$

= 219,457,949,236.79/(865363.4989*577178.9383)

=0.44