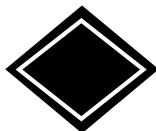
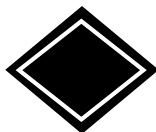


**DETERMINANTS OF INTEREST RATE IN NEPALESE FINANCE
COMPANIES**



Submitted By:
Anurag Kumar Ranjit
Shanker Dev Campus
T.U.Registration No: 8122-90
Campus Roll No: 1022/061



Submitted To:
Office of the Dean
Faculty of Management
Tribhuvan University

In partial fulfillment of the requirements for the degree of
Master of Business Studies (MBS)

Putalisadak, Kathmandu,
July, 2009

RECOMMENDATION

This is to certify that the thesis submitted by

Mr. Anurag Kumar Ranjit

Entitled:

DETERMINANTS OF INTEREST RATE IN NEPALESE FINANCE COMPANIES

has been prepared as approved by this department in the prescribed format of the Faculty of Management and is forwarded for examination.

Shree Bhadra Neupane
Thesis Supervisor

Prof.Dr. Kamal Dip Dhakal
Campus Chief

Achyut Raj Bhattarai
Thesis Supervisor

VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis presented by

Anurag Kumar Ranjit

Entitled:

DETERMINANTS OF INTEREST RATE IN NEPALESE FINANCE COMPANIES

and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirements for the degree of Master's in Business Studies (MBS)

Viva –Voce Committee:

Chairperson (Research Committee): _____

Member (Thesis Supervisor): _____

Member (Thesis Supervisor): _____

Member (External Expert): _____

DECLARATION

I hereby declare that all the work reported in this thesis entitled '**Determinants of Interest Rate in Nepalese Finance Companies**' submitted to Research Department of Shanker Dev Campus, Putalisadak, Faculty of Management, T.U., is my research work done in the form of partial fulfillment of Master of Business Studies under the supervision of Lecturer Shree Bhadra Neupane and Associate Professor Achyut Raj Bhattarai, Shanker Dev Campus.

Anurag Kumar Ranjit

Researcher

Roll No: 1022/061(MBS)

T.U. Regd. No. : 8122/90

Date:.....

ACKNOWLEDGEMENT

This research work is prepared for the partial fulfillment of Masters of Business Studies from Shanker Dev Campus under Tribhuvan University of Nepal. This could not have been possible without significant contribution of many individuals and organizations to bring this thesis report in complete format. Let me take this as a great opportunity to acknowledge sincerely to all of them for their valuable support. The thesis report has been prepared with the motive of analyzing determining factors of interest rate in Nepalese finance companies by choosing certain sample organizations and to make some recommendation as far as possible.

I would like to express my heartiest gratitude and thanks to all of my thesis supervisors Lecturer Shree Bhadra Neupane and Associate Professor Achyut Raj Bhattarai, without their remarkable guidance and cooperation the research work would not have come in such condition.

I want to thank all of them whose assistance has been a great relief for me to complete this thesis. Those directly and indirectly helping hands, Mr. Namra Kumar Chhetri, Mr. Ram Krishna Sharma (Asst. Manager Credit Dept. of NMB), Mr. Shakha (Credit Head of UFCL) and other concerned persons of sample finance companies for the valuable data they provided. I want to thank a lot to Narendra Sejuwal for his valuable suggestion.

Anurag Kumar Ranjit

TABLE OF CONTENTS

LETTER OF RECOMMENDATION

VIVA-VOCE SHEET

DECLARATION

ACKNOWLEDGEMENT

TABLE OF CONTENTS

LIST OF TABLES

LISTS OF FIGURES

LIST OF ABBREVIATIONS

PAGE

CHAPTER-ONE INTRODUCTION

1.1 GENERAL BACKGROUND -----	1
1.2 FINANCE COMPANIES IN NEPALESE FINANCIAL SYSTEM----- ----2	
1.3 INTEREST RATE -----	6
1.4 BRIEF HISTORY OF INTEREST RATE IN NEPAL-----	8
1.5 FOCUS OF THE STUDY-----	8
1.6 STATEMENT OF THE PROBLEM-----	9
1.7 OBJECTIVES OF THE STUDY-----	9
1.8 SIGNIFICANCE OF THE STUDY ----- -----10	
1.9 LIMITATIONS OF THE STUDY -----	11
1.10 ORGANISATIOS OF THE STUDY-----	11

CHAPTER-TWO REVIEW OF LITERATURE

2.1 CONCEPTUAL REVIEW-----	13
2.1.1 Meaning of Interest Rate-----	13
2.1.2 Interest Rates as the Allocation Mechanism-----	14
2.1.3 Functions of the Rate of Interest in the Economy-----	14
2.1.4 Theories of Interest-----	15
2.1.5 Interest Rate Movements and Its Relevance-----	24
2.1.6 Economic Factors That Affect Interest Rates -----	24
2.1.6.1 Impact of Economic Growth on Interest Rates-----	24

2.1.6.2	Impact of Inflation on Interest Rates-----	25
2.1.6.3	Impact of Price Deflation----- 26	
2.1.6.4	Impact of Money Supply on Interest Rates-----	26
2.1.6.5	Impact of Budget Deficit on Interest Rates-----	26
2.1.7	Term Structure of Interest Rates-----	27
2.1.7.1	Pure Expectation Theory-----	27
2.1.7.2	The Liquidity Premium View of the Yield Curve-----	27
2.1.7.3	The Segmented-Markets or Hedging- Pressure Argument -----	28
2.1.7.4	Preferred Habitat Theory-----	28
2.1.8	Risk and Cost Factors Affecting the Interest Rate-----	29
2.1.9	How Open market Operations Affect Interest Rates? -----	31
2.2	REVIEW OF RELATED STUDIES-----	32
2.2.1	Review of Journal and Articles-----	32
2.2.2	Review of Thesis -----	34

CHAPTER –THREE RESEARCH METHODOLOGY

3.1	INTRODUCTION-----	39
3.2	RESEARCH DESIGN-----	39
3.3	POPULATION AND SAMPLES-----	40
3.4	SOURCE OF DATA AND COLLECTION PROCEDURE-----	40
3.5	DATA PROCESSING AND PRESENTATION-----	40
3.6	TOOLS TO ANALYZE THE DATA-----	41

CHAPTER- FOUR DATA PRESENTATION AND ANALYSIS

4.1	INTRODUCTION-----	44
4.2	QUANTITATIVE (SECONDARY DATA) ANALYSES: -----	44
4.2.1	Union Finance Company Limited (UFCL) -----	45
4.2.2	United Finance Company Limited (UFC) -----	45
4.2.3	Nepal Merchant Bank and Finance Company Limited (NMBF) -----	49
4.3	QUALITATIVE (PRIMARY-DATA) ANALYSIS-----	54
4.3.1	Maturity Period and Interest Rate-----	54

4.3.2	Competition and Interest Rate-----	55
4.3.3	Sector Wise Difference/Risk Factor-----	55
4.3.4	Political Instability and Violence-----	56
4.3.5	Nepal-India Border and Interest Rate-----	57
4.3.6	NRB and Interest Rate -----	58
4.3.6.1	NRB’s Directives and Interest Rate-----	59
4.3.6.2	Finance Companies’ Experience-----	62
4.3.7	Foreign Employment, Remittance Income and Interest Rate-----	62
4.4	MAJOR FINDINGS-----	63

CHAPTER -FIVE SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1	SUMMARY-----	65
5.2	CONCLUSION-----	66
5.3	RECOMMENDATIONS-----	70

BIBLIOGRAPHY

APPENDIX- A-----	I
APPENDIX- B-----	II-
XVII	
APPENDIX- C-----	
XVIII	
APPENDIX – D -----	XIX

<u>Figure No.</u>	<u>Title and List of Figure</u>	<u>Page No.</u>
Figure No. 1-1	Liabilities composition of finance companies as on Mid -July 2008	5
Figure No. 1-2	Assets composition of finance companies as on Mid -July 2008	5
Figure No. 1-3	Growth of assets/Liabilities components of finance companies as on Mid -July 2008	6
Figure No. 1-4	Credit Deposit Ratio of Finance Companies as on Mid -July 2008	6
Figure No. 2-1	The substitution effect relating to saving & interest rates	17
Figure No. 2-2	The Investment demand schedule	17
Figure No. 2-3	The equilibrium interest rate in classical theory of interest rate	18
Figure No. 2-4	The total demand for money	19
Figure No. 2-5	The supply of money in liquidity preference theory	19
Figure No. 2-6	The equilibrium rate of interest in the liquidity preference theory	20
Figure No. 2-7	The demand for loanable fund	21
Figure No. 2-8	The supply of loanable funds (credit)	22
Figure No. 2-9	The equilibrium rate of interest in loanable funds theory	22
Figure No. 2-10	The expected demand for and supply of loanable funds under the rational expectations theory.	23
Figure No. 4-1	Relationship between the rates of UFCL	46
Figure No. 4-2	Relationship between the rates of UFC	48
Figure No. 4-3	Relationship between the rates of NMBF	50
Figure No. 4-4	Deposit amount of sample organization	51
Figure No. 4-5	Loan disbursed by sample organization	52
Figure No. 4-6	Interest rate on deposit of sample organizations	53
Figure No. 4-7	Interest rate on lending of sample organization	54
Figure No. 4-8	Impact of political instability and violence	57
Figure No. 4-9	Open boarder with India and interest rate	58
Figure No.4-10	Finance companies' experience	62

<u>Table No.</u>	<u>Title and List of Table</u>	<u>Page No.</u>
Table 1-1	Growth of financial institutions	4
Table 4-1	Amount of deposit and lending, interest rate on deposit and lending of UFCL and inflation and risk free rate.....	45
Table 4-2	Correlation analysis (UFCL).....	45
Table 4-3	Amounts of deposit and lending, interest rate on deposit and lending of UFC and inflation and risk free rate	47
Table 4-4	Correlation analysis (UFC)	47
Table 4-5	Amounts of deposit and lending, interest rate on deposit and lending of NMBF and inflation and risk free rate.....	49
Table 4-6	Correlation analysis (NMBF)	49
Table 4-7	Deposit amounts of sample organizations	51
Table 4-8	Amount of loan disbursed by sample organizations	52
Table 4-9	Interest rates on deposit of sample organizations	53
Table 4-10	Interest rates on lending of sample organizations.....	54
Table 4-11	Maturity and Interest rate.....	55
Table 4-12	Interest rate structure of NMBF.....	55
Table 4-13	Impact of political instability and violence.....	57
Table 4-14	Impact of open border with India.....	57
Table 4-15	NRB Interest rate	59
Table: 4-16	Finance companies' experience	62

ACRONYMS AND ABBREVIATIONS

Amt.	Amount
B.S.	Bikram Sambat (Nepali Date)
Co.	Company
CRR	Cash Reserve Ratio
d.f.	Degree of freedom
Dr.	Doctor
etc.	etcetera
FDR	Fixed Deposit Rate
FY	Fiscal Year
GDP	Gross Domestic Product
GN	Government of Nepal
i.e.	That is
Ltd.	Limited
MBS	Master of Business Study
NA	Not Available
NADF	Nepal Awash Development Finance Company Limited
NG	Non Government
NMBF	Nepal Merchant Bank and Finance Company Limited
No.	Number
NRB	Nepal Rastra Bank
p	Page
pp	Pages
Pvt. Ltd.	Private Limited
TU	Tribhuvan University
UFC	United Finance Company Limited
UFCL	Union Finance Company Limited
UNO	United Nation Organization
UNMIN	United Nation Mission In Nepal
Viz.	Namely
WTO	World Trade Organization
%	Percentage
&	And