

# **CHAPTER: I**

## **INTRODUCTION**

### **1.1 Background of the study**

Revenue budget is also called as operating budget. Lawrence M. Matthews (1977) in his book “Practical Operating Budget” defines operating budget as a realistic statement of income and cost objectives for a year. It is a plan against which the ensuing actual performance is compared so as to achieve control by detecting and correcting off standard performance. The broad term “Budget” with its concept of a plan used to control is applied to many areas, such as inventory, capital investment and cash flow. However, we are concerned here specifically with the kind of budget that is used by an operation as a whole for a specified period of one year. The other types of budget are subsidiary to it.

An operating budget encompasses, for the one-year period, the entire prime operating aspects of the functions for which the enterprise exists. For example, a manufacturing company exists to design, manufacture, and sell a product or products. Therefore, its operating budget for a year will include sales, operating costs, research and development costs, and by deduction, profit. Operating costs include not only manufacturing and engineering but also selling and administrative cost. Therefore, all the costs are included required to perform the functions of the company.

The operating budget of a non- profit organization will include revenue and all operating costs. Frequently, this kind of budgeting situation is equated with budgeting in government because of its “no- profit” aspects. It seems to be a mistake. The principles that apply in budgeting in profit –making enterprise should be equally applicable to a non -profit enterprise.

In summary, the budget involves the statement of plans, the coordination of these plans into well-balanced programs and the constant watching of actual operations to ensure that they are kept in line with the predetermined plans. In this way, limits are set on expenditure, standards of performance are established, and forward thinking is made an essential part of the business management. "Care must be taken, however not to fall into the error of regarding the budget as an end in itself. It is a means to an end. It is not a method of business management, but an aid to clear thinking, and its fundamental object

is to enable considered intention to be substituted for opportunism in management" (Willsmore, 1960: 204).

The term and functions of budgeting were firstly developed for state purpose. As applied in the conduct of government affairs budget control implies a forecast of probable future expenses and an analysis of the sources from which income is to be raised to meet these expenses. This results in the establishment of desirable totals for expenditure and revenue, coupled with plans to be ensured that the actual operations are kept within these bounds. "The constant comparison of actual receipt and expenditure against the budget throughout the period then offers a current measure of the extent to which the perceived plans are being realized" (Willsmore, 1960: 2).

Nowadays, budgeting or profit planning system is especially familiar to business organizations but the practicability of it's depending upon the size of the business. "The common objective of profit planning and control system, whether applied to national finance or business administration, is to formulate policy aimed at an objective established after the consideration of the probable course of events in the future and to provide a means for the constant comparison of actual progress toward this goal against the preconceived results" (Willsmore, 1960: p3).

Since profit plan is flexible and depends upon the size of the firm, the formats and rules regarding profit plans also vary according to the nature of business organizations. Profit plan is prepared considering the strength and weaknesses of environmental factors of relevant variables.

## **1.2 Introduction to Commercial Banks**

Commercial bank is a type of bank which involves in promoting the commercial activities of the nation by providing various facilities like collecting the deposits, lending the money, remitting, involving in bank guarantee and letter of credit and such other activities. Nepal Rastra Bank Act (2058) defines commercial bank as "Commercial Bank" means a commercial bank established under the prevailing laws (p.1). It gives sense that there is a provision on commercial bank in Nepalese acts. Likewise, A commercial bank is an ordinary banking business consists of changing cash for bank deposits from one person or corporation to another, giving deposits in exchange for bills

of exchange government bonds, the secured or unsecured promises of businessman to repay etc (Vaidya, 2001, p. 38).

### 1.3 Commercial Banks in Nepal

SN	Name	Operation	Paid up capital (in million)
1	Nepal Bank Limited	15 November 1937	280.4
2	Rastriya Banijya Bank	23 Jan 1966	1172.3
3	Agricultural Development Bank	16 March 1968	10777.3
4	NABIL Bank Ltd	16 July 1984	965.8
5	Nepal Investment Bank Ltd	27 Feb 1986	2407.1
6	Standard Chartered Bank Nepal Ltd	30 Jan 1987	932
7	Himalayan Bank Ltd	18 Jan	1216.2
8	Nepal SBI Bank Ltd	7 July 1993	874.5
9	Nepal Bangladesh Bank	5 Jun 1993	1822.7
10	Everest Bank Ltd	18 Oct 1994	838.8
11	Bank of Kathmandu Ltd	12 March 1995	844.4
12	Nepal Credit and Commerce Ltd	14 Oct 1996	1399.5
13	Lumbini Bank Ltd	17 July 1998	1015.3
14	Nepal Industrial and Commercial Bank	21 July 1998	1140.5
15	Machapuchhre Bank Ltd	3 Oct 2000	1479.1
16	Kumari Bank Ltd	3 April 2001	1078.3
17	Laxmi Bank Ltd	3 April 2003	1098.1
18	Siddhartha Bank Ltd	24 December 2002	952.2
19	Gobal Bank Ltd	2 Jan 2007	1000
20	Citizens Bank International	21 June 2007	1000
21	Prime Bank Ltd	24 Sept 2007	700
22	Bank of Asia Nepal Ltd	12 October 2007	1000
23	Sunrise Bank Ltd	12 October 2007	875
24	DCBL Bank Ltd	25 May 2008	1107.5
25	NMB Bank Ltd	2 May 2008	1100
26	Kist Bank Ltd	7 May 2009	2000
27	Janta Bank Nepal Ltd	30 April 2010	2000
28	Mega Bank Ltd	23 July 2010	2330
29	Civil Bank Ltd	26 Nov 2010	1200
30	Commerz and Trust Bank Ltd	10 Sept 2010	3000
31	Century Commercial Bank Ltd	23 Jan 2011	2000

Source: NRB, 2012

## 1.4 Introduction Himalayan Bank

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

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

All branches of HBL are integrated into Globuls (developed by Temenos),the single banking software where the bank has made substantial investment .This has helped the bank provide service like ' Any branch banking facility', Internet banking . living up to the expectation and aspiration of the customers and other stakeholders of being innovative, HBL very recently introduced several new products and services. Millionaire deposit scheme , small business enterprises loan , pre-paid visa card , international travel quota credit card, customer finance through credit card and online TOEFL, SAT,IELTS, etc fee payment facility are some of the products and services , HBL also has a dedicated offsite' Disaster Recovery management system' . Looking at the number of Nepalese worker abroad and their need for formal money transfer channel, HBL has developed exclusive and proprietary online money transfer software HimalRemit . By deputing our staff with technical tie –ups with local exchange houses and banks, in the middle East and Gulf region, HBL is the biggest inward remittance handing bank in Nepal. All this only

reflects that HBL has an outside –in rather than inside-out approach where customer's needs and wants stand first .

### **The bank's vision**

Himalayan bank limited holds of a vision to become a leading banks of the country by providing premium products services to the customers, thus ensuring attractive and substantial returns to the stakeholder of the bank.

### **The Bank's mission:**

The Bank's mission is to become preferred provider of quality financial services in the country there are two components in the mission of the bank ;preferred provider and Quality financial services ; therefore we at HBL believe that the mission will be accomplished only by satisfying these two important component with the customer at focus. The bank always strives positioning itself in the hearts and minds of the customers.

### **The bank's objective:**

To become the bank of first choice is the main objective of the Bank

## **1.5 Statement of the problem:**

A few numbers of commercial banks in Nepal suffer from poor performance because of poor managerial knowledge and skill, shortage of capital, as well as the negligence of all shareholders. Comparatively private banks have good performance than government banks because government don't direct to them. To achieve their organizational goals and objectives Revenue budgeting is more fruitful. In Himalayan bank, I got good performance by analyzing profit, value of equity, return on asset, return on equity etc .

This study provides some information to analyze and evaluate the date which helps to fulfill the gap between the literature exploring to attain banking service specially HBL to apply comprehensive profit planning system and provides the management of HBL, the necessary theoretical as well as contemporary situational appropriate decision in this regard . Therefore this study is an importance to HLB, to scholars to policy maker and other concerned parties.

## **1.6 Objectives of the Study**

The main objective of the study is to explore the revenue budgeting of Himalayan Bank Limited which is a commercial bank of Nepal. There are other sub-objectives of the study as:

1. To explore the deposit mobilization status and variance of budgeted and actual achievement.
2. To explore the resources deployment practices of the bank.
3. To study the non-funded activities of the bank.
4. To study the growth of the business of the bank over the period.

## **1.7 Significance of the Study**

An effective budgeting system is vital to success and survival of a business organization. Without a fully co-ordinate budgeting system, management can't know the direction of business is taking out. Organizations that do not plan are likely to wonder aimlessly and ultimately succumb to the swirl of current events. Other benefits of Revenue Budgeting are:

1. Basic policies developed as the pre-requisites of profit planning & control show direction to the business.
2. It provides definite goals and objectives that serve as benchmarks for evaluating subsequent performance.
3. It compels and motivates management to make an early and timely study of its problems . It creates sense of caution and case, and adequate study among managers before they make decision

## **1.8 Limitations of the Study**

This study will consist of some limitations, which are as follows:

The study covers the data of five years only ie 2062/063 to 2066/067

- a. The focuses limit over the availability of data and sufficient literature.
- b. Analysis is concentrated in some managerial , financial and accounting aspect and it does not cover the areas of enterprises

- c. The comprehensive and she accuracy of the study are based on the data available from the management of HBL
- d. Being a researcher as a student and due to the limited resources constraints, the study is neither compressive nor extensive.
- e. The research is purely based upon the secondary data.

## **1.9 Organization of the Study**

This study will organize in five different chapters. The first chapter will introduction. In the same way literature review will mention in the second chapter and research methodology will mention in the third chapter. Similarly data presentation and analysis will put in the fourth chapter and summary, conclusion and recommendation will mention in the last chapter. Bibliography and annexes will submit at the end of this study.

### **Chapter One**

This chapter consists with the introduction, problem statement, purpose, research questions, rationale, limitations and chapter outlines of the research. The chapter sets the scene by putting the study in the context of current issues and challenges of Nepalese education system.

### **Chapter Two**

The second chapter consists with literature review. The past literature on revenue budgeting of bank is presented in this chapter which gives deep knowledge about the study. So it will be helpful to analyze the data and to conclude the research. This includes a thorough exposition of the meaning of revenue budgeting and different variables and theories related to this concept.

### **Chapter Three**

The third chapter gives attention on the design and research methodology employed in the study. It includes the research design, research approach, preparations for data collection, data collection tools that data collection exercises as well as the data analysis.

### **Chapter Four**

This chapter is based on presentation, interpretation and analysis of data by using the appropriate tools of data analysis.

### **Chapter Five**

This chapter presents the findings, conclusions and recommendation of the research. Findings and conclusions will be based on data presentation and analysis in chapter four.

## **CHAPTER TWO**

### **REVIEW OF LITERATURE**

Review of literature means reviewing research studies or other relevant proposition in the related area of the study so that all the past and previous studies, their conclusion and perspective of deficiency may be known and further researches can be conducted or done. It is an integral mandatory process in research works. It is a crucial part of all dissertations. In other words it's just like fact are finding based on sound theoretical framework oriented towards discovery of relationship guided by experience, resonating and empirical investigation. It helps to find out already discovered things. Review of relevant literature implies putting new spectacle in old eyes to think in new way by posting the problem with new data and information to see that what results are derived. The primary purpose of literature is to learn and it helps researcher to find out what research studies have been conducted in one's chosen field of study, and what remains to be done. For review study, the researcher uses different books and journal, reviews and abstracts, indexes, reports, and dissertation or research studies published by various institutions, encyclopedia etc.

#### **2.1 Development of Banks in Nepal**

Like many other countries, goldsmiths, merchants and money lenders were the ancient bankers of Nepal. Tejarath Adda established in 1880 during the tenure of the then Prime Minister Ranoddip Singh was the first step towards the institutional development of banking in Nepal (Dahal and Shah, 2010, p. 93). Some historians say Kausi Tosha Khana established during the time of King Prithvi Narayan Shah (1723 AD - 1755 AD) is the first banking institution but very little is known about it. Tejarath Adda did not collect deposits from the public but gave loans to public against the security of gold and silver and to the government employees against the security of their salary. Since, the interest rate of Tejarath Adda was just 5%, beneficiaries were very much relieved of exorbitant interest rate being charged by the traditional bankers. Tejarath Adda however had a narrow reach because of just few branches and resources crunch it used to face due to not



collecting deposits from the public. Thus, the larger section of deficit units of the society had no choice but to knock the doors of the traditional bankers to cover their deficit and the surplus units who were not traditional bankers had the Hobson's choice of keeping their surplus money in a large clay jar exposing themselves to the risk of theft and erosion in the value of money (Dahal and Shah, 2010, p. 94).

Savers and users of the society were always looking for an institution which offers relatively safe, convenient, liquid and accessible securities and at the same time accepts relatively risky, illiquid, inconvenient, long term and large denomination securities offered by the borrower. Such an intermediation encourages savings and entrepreneurship in the society by bringing together and resolving fundamentally variant financing requirement of households, business and governments (Dahal and Shah, 2010, p. 94).

Moreover, Nepal had gradually opened to the international trade and then Rana Rulers favored by British India wanted to keep their money in Nepalese banks instead of Indian banks because the independence movement against British Rule was gaining momentum in India. All these were the backgrounds for establishment of a modern bank. Banking in modern sense started with the inception of Nepal Bank Limited (NBL) on 15 November 1937 under Nepal Bank Act, 1937 though in Europe modern banks were set up in the 12<sup>th</sup> century itself. The preamble of NBL Act 1937 states the objective behind establishment of NBL as follows:

In the absence of any bank in Nepal, the economic progress of the country was being hampered and causing inconvenience to the people and therefore with the objective of fulfilling that need by providing services for the people and for the betterment of the country, this law is hereby promulgated for the establishment of the bank and its operation.

Nepal Bank had an extraordinary responsibility of attracting people towards banking sector from pre-dominant money lenders' net and of expanding banking services. Being a commercial bank, it was natural that NBL paid more attention to profit generating business and preferred opening branches at urban centers (Dahal and Dahal, 2002, p. 10-11). The government's realization of need for expanding banking services to the nook and corner of the country, ending dual currency system and stabilizing highly

volatile exchange rate gave birth to Nepal Rastra Bank (NRB) on 26<sup>th</sup> April 1956 as a central Bank.

Whereas it is expedient to ensure proper management of the issuance of Nepalese currency notes, to make arrangement for the circulation of Nepalese currency throughout the kingdom and to stabilize the exchange rates of the Nepalese currency in order to maintain comfort and economic interests of the general public.

Since then, NRB has been working as central bank and has contributed to the growth of various types of financial institutions across the country in addition to stabilizing exchange rates and ensuring circulation of Nepalese currency throughout the country. As the need of development bank of the country was felt, the government converted Industrial Development Centre (IDC) set up in 1957 to Nepal Industrial Development Corporation (NIDC) in 1959 at the initiative of NRB. Likewise, another commercial bank named Rastriya Banijya Bank (RBB) was set up on 23 January 1966 as a fully government owned commercial bank. In the same way in 1968, Agricultural Development Bank was established to provide finance for introducing modern agricultural techniques so that agricultural productivity could be enhanced. The government owned banks were not sufficient to develop the nation through banking service to the people. So, the private sector's banking service was realized. In 12 July 1984, Nepal Arab Bank limited was established as a first foreign joint venture bank. It was also the first private sector bank in Nepal.

After restoration of democracy in 1990, the numbers of financial institutions have established and operated. Now there are many banks and financial institution in Nepal. But almost of all are centralized in the city center. Now there are 27 commercial banks, 74 development banks, 78 finance companies, 16 NRB licensed cooperatives and NRB licensed NGOs are working in the sector of banking (Dahal and Shah, 2010, p. 96).

## 2.2. Concept of commercial Bank

Commercial bank is a corporate business venture which have certain paid up capital and provide loan, accept deposit, exchange money and other consultancy, agency, guarantee etc services are perform. Commerce is the financial transaction related to selling and buying activities of goods and services . Therefore commercial viewpoint . They perform all kinds of banking functions. They provide short-term credit , medium term credit and long –term credit as well as issuing guarantee, bonds , letter of credit , etc to trade and industry.

"A commercial bank is the which exchange money , accepts deposit transfers loan performs banking functions " (commercial Bank Act, 2031 B.S)

"Principally commercial bank accepts deposit and provides loans primarily to business firms there by facilitating the transfer of fund in economy " Rose,1989:9)

"The commercial bank has its own role and contribution in the economic development . It is a resource for the economic development. It is a resource for the economic development, it maintain economic confluence of various segments and extends credit to people "(Ronald 1999:87)

"A Bank is a business organization that's receives and holds deposits and funds from others, makes loans and extend credits and transfer funds by written order of depositors"(Grolier incorporation, 2000)

Commercial Banks function as an intermediary; accepting deposits and providing credits to the needy area. The primary resource of funds for commercial banks are capital (Shareholder Equity) reserve (retain earning) and other main source of the commercial bank is current deposit issue of commercial paper, bonds etc. Commercial banks are restricted to invest their funds in corporate a securities . They invest their funds in long-term as well as short-term needs of any trade and industry. They grant credits in the form of cash credits and overdraft.

Banks undertaking business with the objective of earning profits are commercial banks . commercial banks pool scattered fund and channels it to productive use , commercial banks apart from financing , they also render as variety of service like collection of bill and cheques , safe keeping of valuables , financing adverting agencies function , keeping of guarantee etc to their value customers.

## **2.3 Concept of Revenue**

The starting point in preparing profit plan is the sales plan, which displays the projected sales in units and Rupees. The sales planning process is an essential part of profit plan and control because, it provides for the basic management decisions, about marketing and based on these decisions it is an organized approach for developing a comprehensive sales plan. If sales plan is not realistic and relevant, most if not all of the other parts of overall profit plan are also not realistic. Therefore, if the management believes that a realistic sales plan cannot be developed, there is little justification for PPC, Similarly, if it were impossible to assess the future revenue potential of a business, there would be little or no incentive to investors and prospective investors, Hence, the sales plan is both ends and means of revenue planning.

The preparation of a sales plan requires forecasting of sales, the sales forecasting is one of the inputs in sales plan. A critical step in the budgeting process sales forecast as distinguished from a sales plan is a technical projection of the potential customer's demand for specified time horizon with specified underlying assumption. It is converted to a sales plan when management has brought to bear on its judgment-planned strategies, commitment of resources and the managerial commitment to aggressive action to attain sales goal. Sales plan provides standard for comparison with the result actually achieved thus it is an implement control device of management, where forecasting represents merely a probable events over which no control can be exercised.

## **2.4 Role of Revenue**

### **2.4.1 Roles of Operational (Revenue) Budgets**

Budgets can be called upon to play a variety of roles. We shall discuss five of these. Three are major roles; Planning, Motivation and Evaluation, two are minor: co ordination and education (Barrett et al., July-Aug., 1977:138).

## **(a) Planning**

Operational budgets are plans; they provide details of what management hopes to accomplish and how. Their value in the planning process comes from the fact that budgeting forces management to examine in detail both the general economic situation of which the company is a part and the economic interrelationships among all the company's various activities. Budgeting allows managers to explore how costs and revenues will behave under specific sets of operating assumptions.

The process often points out conflicts between management's objectives and the realities of the company's capabilities. Through budgeting management can both identify resources that will be necessary to achieve objectives and learn how these resources must be applied. If present resources cannot meet planned objectives, the process of operational budgeting may bring an examination of the financial implications of additions asset procurement.

## **2.5 Concept of Budgeting**

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

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

Budget as a tool of planning and control in clearly related to the broader system of planning and control in an organization. Planning involves the specification of basis objectives that will guide it, in operation terms. It involves the step of setting objectives,

specifying goals, formulating strategies and expressing budgets. A budget is a comprehensive and coordinated plan expressed in financial terms, for the operations and resources of an enterprise for some specified period in future (Khan and Jain, 1993: 296).

The concept of comprehensive budget covers its use in planning, organizing and controlling all the financial and operating activities of the firm in the forthcoming period. Budgeting summarize the estimated results of the future transaction for the entire company in much the same manner as the accounting process records and summarize the results of completed transactions.

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

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

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

## **2.7 Budgeting: a Tool of Profit Planning**

A budget is a detailed plan for acquiring and using financial and other resources over a specified period of time. It represents a plan for the future expressed in formal quantitative terms. The act of preparing a budget is called budgeting. The use of budgeting to control a firm's activities is called budgetary control (<http://www.accountingformanagement.com>). The concept of budgeting was originally

established with the function of an accountant. At its origin, the function of budgeting was assigned to the accountant. But in the modern day budgeting is given much more importance and is regarded as a way of management and in more important sense is regarded as a basic technique of decision-making and is given the name “profit planning and control program (Goet, Bhattarai and Gautam, 2062, p. 1.4).”

Budget may be defined as a financial plan which serves as the basis for decision making and central of expenditure and revenue for a specific period of time, normally a year in the case of a government (Uprety, Adhikari, Kharel and Poudel, 2007, p. 341). Budgeting in fact is a managerial technique and a business budget is such a written plan in which all aspects of business operations with respect to a definite future period are included. It is a formal statement of policy, plan objectives and goals established by the top level management in respect of some future period (Gupta, 1992, p. 521).

Budgeting is future plan and projection taking some managerial assumptions. Budgeting involves the preparation advance of the quantitative as well as financial statement to indicate the intention of the management in respect of the various aspects of the business. An effective budgeting system is vital to the success and survival of a business firm. Without a fully coordinated budgeting system, management cannot know the directions the business is taking out organizations that do not plan are likely to wonder aimlessly and ultimately give way to the swirl of current events. Proper planning is indispensable to achieve the goal of maximum profit. For the implementation of such plan, budget is regarded as the most effective device. A budget is effectively used for control purpose. It is a qualitative expression of a plan of action prepared advance for the period to which it relates. Budget is a statement showing the planned income and expenditure for a future period prepared in terms of money or quality or both (Dangol and Dangol, 2001, p. 266).

Thus, budget is an instrument of planning and financial controls. Budgets must be based on realistic statements of goals and objectives of organization. It serves as a powerful media of communication between various levels of managers, administrators, executives, supervisors and operatives in enterprises. Employees who are responsible for performance must clearly aware of long and short term objectives and goals to well perform their responsibilities.

## 2.9.1 Different Approaches of Budgeting

There are different approaches of budgetary theory which can be classified in two approach as:

### a. Classical Approach: Balance Budget

The essence of a budget, in classical writings, is the balancing of revenues and expenditures. This view was based on the analogy of behavior expected of an individual that he must not spend more than his income. H Dalton says that a balanced budget is often regarded, not only as an unquestioned precept of finance, but as a moral precept too. He raises three preliminary questions relating to a balanced budget.

They are:

- What should be included in expenditure?
- What should be included in revenue?
- What length of time should be chosen as the accounting period?

The classical budgetary theory of balanced budget was based on the assumption that full employment is the normal condition. In a condition of full employment, financing of budget deficits by public borrowing means withdraw of funds from private employment where they are more productively used. Secondly, financing of deficits by borrowing is a less painful method than taxes. Thirdly, their view of public debt was different from the modern approach.

### b. Modern Approach

The modern view is different from the classical standpoint which rules out the use of budgetary measures to attain such an objective. In the classical approach, the entire income received at full employment is always spent on either consumption or investment saving is automatically converted into investment. In such a system all public revenues, taxes or borrowing reduce private spending. This reduction will take the form of decline in consumption or investment (p. 342).



## **2.8 Budgeting in Non-Manufacturing concern**

According to Glenn (1990: 154) "In case of non-manufacturing enterprises as retailing and wholesaling entities, production budget, raw material budget, labour budget and manufacturing overhead budget are not formulated. Instead of converting material and component parts into finished goods, which are sold, wholesale and retail(i.e. merchandising) enterprises purchase goods and resale them in essentially the same form. Also non-manufacturing companies often sell services, sometimes related to the goods they sell and sometimes services only. Services companies include such enterprises as banks, insurance companies, airlines, hotels and restaurants. Such an enterprise would develop merchandising budget. It includes planned sales, inventory and purchase budgets".

## **2.9 Types of budget**

Explain the different types of budgets in detail, with the help of suitable examples. In every business planning is the most important function to perform. Planning of different firms depends upon so many factors. Planning is done for comparing the actual performance with standard performance. Budgets are also prepared in advance. Budgets are prepared to check the availability of finance according to the demand of project. So budgetary control is also essential tool of management to control cost and maximizes profits.

### **2.9.1 Functional basis of budgets.**

#### **a. Sales budget**

Sales budget is the primary budget. It is the most important budget to prepare and the other budgets are prepared on the basis of sales budget. In this budget the in charge or expert forecast the future expected sales of the firm. The sales manager is responsible for the accuracy of the budget. The sales budgets may prepare on basis of product, type of customers, salesman, locality etc. for the preparation of sales budget the following things

should be taken under care like past sales, sales man estimates, plant capacity, raw material, orders in hand, seasonal fluctuations, competition etc.

**b. Production budget**

After preparing sales budget the next budget will be production budget. In this budget works manager prepare schedule of production by breaking large production in small units to fulfill the target production. A properly operated budgets leads to inventory control, improved maintenance of production schedules and production targets. Suppose, if the estimated opening stock is 5000 units and estimated sales are 25000 units and closing stock of the product is 3000 units the estimated production will be  $25000 + 3000 - 5000 = 23000$  units (sales + closing stock – opening stock).

**c. Material budget**

In the production budget material is the first requirement to be considered. Materials are basically divided into two categories as direct and indirect material. It includes the preparation of estimates of different types of the raw materials needed for various products and purchasing raw material in required number at a required time. There are few factors which should be taken under care like requirement of raw material; company's stocking policies, price trend, and cost of raw material.

**d. Labor budget**

Labour is an important factor in every production organization. Labour plays an important role in converting raw material into finished product. The labour requirement budgets prepared on basis of production budget. Labour may be of two types direct and indirect labour. In this budget company has to budget the required number of hours and the expected pay scales of the employees. This budget gives information about personnel specifications for the job for which workers are to be recruited, the degree of skill and experience required and rates of pay.

**a. Manufacturing Overhead budgets:**

This budget gives the works overhead expenses to be incurred in a budget period to achieve the production target. The cost of indirect material, indirect labour etc can be calculated with the help of this budget. For making proper control it can be divided into departmental overhead budget. Variable expenses are estimated on the basis of the budgeted output because these expenses are bound to change with the change in output.

**f. Administration Expenses Budget**

The budget covers the expenses incurred in framing policies, directing the organization and controlling the business operations. In budget an estimate of expenses is prepared regarding central office and of management salaries. The budget may be prepared at department level for effectiveness in budgeting system. The budget can be prepared with the past experience and anticipated changes.

**g. Selling and Distribution Budgets**

This expense is related to the selling and distribution of material. In this budget experts have to plan for the expected selling and distribution expenses of the firm. Certain items of selling and distribution costs as cost of transportation, salesman salaries etc.

**h. Cash Budget**

This budget is prepared to predict the inflow and outflow of cash during the budget period. In cash receipt we consider cash sales, credit collection and other receipts in cash payments we consider cash payments, tax payable, dividend payable etc. Without cash organizations cannot work so prediction about cash is very important. A cash budget makes provision for a minimum cash balance which will be available at all times.

**2.9.2 On the basis of flexibility**

**a. Fixed budget**

This is the rigid budget and it is drawn on the assumption that there will be no change in the budgeted time period. A fixed budget will be helpful only when actual level of activity is equal to budgeted level of activities. According to chartered institute of

management accountants.” A fixed budget is defined as a budget designed to remain unchanged irrespective of activity actually attained.

**b. Flexible budget**

It is also called as variable budget. A flexible budget gives different budgeted costs for different budgeted costs for different levels of activities. This budget is applicable in where activity levels vary from period to period. Where the business is new and it is difficult to predict. Where industry is influenced by change in fashion. Where there are changes in sales.

**2.9.3 On the basis of period:**

**a. Long time budgets**

long-term budgets are prepared for those organizations, which deal in regular product line. Here organizations are not suppose to change their proceedings in short time periods.

**b. Short time budgets**

Short-term budgets are prepared for small time periods which work for seasonal product line. Here products may change in near future.

**2.10 Role of budgeting:**

An effective budgeting system is vital to the success and survival of business firm. Without a fully coordinated budgeting system, management cannot know the direction the business is taking out. Organizations that do not plan are likely to wonder aimlessly and ultimately succumb to the swirl of current events. Other benefits of budgeting or profit planning and control are :(Ojha & Gautam2011:3)

- Basic policies developed as the pre-requisites of profit planning and control show direction to the business.
- It provides definite goals and objectives that serve as benchmarks for evaluating subsequent performance.

- It compels and motivates management to make an early and timely study of its problems. It generates a sense of caution and care, and adequate study among managers before they make decisions.
- Managers at different levels have to participate in the development of the profit plan. This provides an excellent training ground for the managers to know the process of planning in detail.
- Profit planning and control co-ordinates the activities of the entire organization by integrating the plans and objectives of the various parts. By doing so, it ensures that the plans and objectives of those parts are consistent with the broad goals of the entire organization.
- It uncovers subsequent bottlenecks before they occur.
- It compels management to plan for the most economical use of labour, material and capital.
- It reduces cost by increasing the span of control because fewer supervisors are needed.
- It aids in obtaining bank credit; banks commonly require a projection of future operation of future operations and cash flows to support large loans.
- It provides a tool through which managerial policies and goals are periodically evaluated, tested and established as guidelines for the entire organization.
- It pinpoints efficiency and inefficiency. It reveals weaknesses, inefficiencies and deviations in the organization very promptly which can be checked immediately to achieve use of resources and create an environment of profit consciousness throughout the organization. It emphasizes how much should be spent to achieve a goal. It provides a valuable means of controlling income and expenditure of a business, as it is a 'plan for spending'.
- It provides a norm, basis or yardstick for measuring performance of departments and individuals working in organizations. Individual managers can evaluate their own decisions and achievements and take suitable steps to improve performance. It rewards high performance and seeks to correct unfavorable performance.

- It encourage productive competition, provides incentives to perform efficiently and gives sense of purpose to achieve individuals in organization. All these positive factors tend to higher output and increase employee's productivity.
- It helps one to distinguish between actual needs and wants. It enable the management to lay down an order of priorities and reflects some planning of long and short-term requirements in business.
- As decentralization of responsibility is a feature of profit planning, each manager workings critically in his own area of responsibility. Profit planning thus fixes the responsibility center for manager.
- It also promotes understanding among members of management on their co-workers' problems.
- It tends to remove the could of uncertainty that exists in many firms, especially among lower level of management, relatively to basic policies and enterprise objectives.
- Well-organize profit planning and control programmes enable the management to maintain a level of profits, which will ensure the existence of the business and the fulfillment of management responsibilities.

## **2.11 Tool of Budgeting:**

Planning for the future is an essential piece to the survival of our business. At the beginning of each year .we should have a sense of where money is going to come in form and where It is going to spend it. To this end, putting together an annual budget can help it's determine whether it has enough money to fund operations , expand the business and generate income . the annual budget process can be an onerous task so here are 12 tools to keep it efficient .

### **2.11.1. Revenue projection model**

A good place to start the budgeting process is with the Revenue projection model .It is used to forecast business revenue under different conditions. Our budget should reflect the anticipated dollar value of sales and services . The Revenue projection model provides a comprehensive Excel forecasting tool that analyzes and manipulates the price, quantity and percentage increase to give different possible outcomes.

It's can customize this tool to meet our company's needs.

### **2.11.2 Sales forecasting Guide**

If it has several revenue streams, its budgeting should include anticipated income from each of them. Categorizing each stream allows it to identify which parts of its business are profitable and which are not. If its business is a start-up, it may not be familiar with creating a sales forecast. This customizable power point presentation can help educate it and its managers on the process.

### **2.11.3 Sales forecasting Model**

As the saying goes, those who do not learn from the past are doomed to repeat it. The sales forecasting model is a form used by companies to predict future sales based on past sales performance and an analysis of expected market conditions. The sales forecasting model used to organize data, use, analyze, and future sales.

### **2.11.4 Sales plan template**

Once it has a sales forecast in place, it can use the sales plan template to implement the forecast. The sales plan template is a comprehensive template used by sales persons and organizations for creating a sales plan. The sales plan template includes descriptions for the necessary sections: sales targets, market potential, sales strategy, execution details, budget, sales force compensation, sales force training, and a time – line for execution.

### **2.11.5 Capital Budgeting Analysis with Excel Model**

The capital budgeting helps figure out how much money it needs to put in place for new equipment or procedures to launch new products or increase production or services. This budget estimates the value of capital purchases its business needs to grow and increase revenues. If its business involves jobs or projects, budgeting will probably include aspects of both product and service revenue budgeting. The capital budgeting analysis tool can be used to determine the cash flow of a project and how it will contribute to the firm's value. This tool provides an Excel spreadsheet model and allows you to organize different project metrics, such as payback period, profitability index, internal rate of return, and net present value.

### **2.11.6 Expenses Budget**

After it figure out how much it is making, it can determine how much it can spend. The Expenses budget is spreadsheet used to track expenses through out the calendar year. The expense budget lists the most common expense categories and allows you to enter monthly totals, which are then added for an annual total and monthly average. This document is used on an ongoing basis and is customizable to it's company's usage.

### **2.11.7 Twelve month cash flow spreadsheet template**

A cash flow budget details the amount of cash it collect and pay out. This is generally tallied on a monthly basis and twelve month cash flow spreadsheet is ideal to use for monthly tracking . In this budget, it track it's sales and other receivables from income sources and contrast spreadsheet template provides a comprehensive table plan to evaluate all expenditure categories. A positive cash flow is essential to grow it's business.

### **2.11.8 Cash Flow Forecast**

To prepare for the inevitable cash flow peaks and troughs that all businesses go through, it can turn to the cash flow forecast tool . it used to predict annual profits versus end of year debt. The cash flow forecast provides a guide for tracking which arms of it are most profitable, and show which creditor are various amounts of the company's future profits. The forecast helps set reasonable goals for the company's next fiscal year.

### **2.11.9 Depreciation calculator spreadsheet**

It's a sad fact, but many of the assets it has purchased for it business –computers machinery, vehicles-have a finite life. In order to account for this and plan ahead for replacing those assets- it need to calculate the depreciation expenses for all your assets . the Depreciation calculator spreadsheet contains formulas to help it through the process so it can factor this expenses it's budget.

### **2.11.10 Asset Depreciation schedule**

The Asset Depreciation schedule is used to calculate depreciation expense using straight-line depreciation this method mean the residual (salvage) value of the asset is first estimated .Thereafter the asset, minus salvage value, is divided by the useful life of the asset . the resulting value is deducted for each year of the asset's life. The asset



depreciation schedule is divided into major asset categories such as buildings, equipment, hardware, and software.

### **2.11.11 Month Profit and loss projection worksheet**

This profit and loss (P&I) projection is not intended to be a detailed financial statement. Instead, it's meant to act as a guide to help you forecast it's company's sales and expenses. This profit and loss projection worksheet is used to forecast profits and losses for up to 12 month in to future, making it an ideal tool for yearly budgeting planning

### **2.11.12 Profit and loss projection Model**

The profit and loss projection model is a planning tool to help it to predict sales and cost for the whole year in finer detail than the 12 – month worksheet. It is a comprehensive worksheet for monthly and quarterly sales and expenses based on all available data and information.(<http://www,inc ,com /tools/sales-forecasting - guide.htm>)

## **2.12. Preparation of Budgets**

This part of the study deals with the preparation of different components of budgets and considerations for the preparations of such budgets.

### **a. Sales Budget**

The sales budget is not a sales forecast. The distinction is important. A budget is a planning and control document, which shows what management, intends to accomplish. In this sense, it is active rather than passive. A sales forecast, however, is a projection or estimate of the available customer demand. A forecast reflects the environmental and competitive situation facing the company, where as the sales budget shows how management intends to react to this environmental and competitive situation. It is necessary to emphasize this, because good budgeting hinges on aggressive management control rather than on passive acceptance of what the market appears to offer. Many companies have failed to make that distinction; consequently, they have found the budget more of a figure exercise than a working tool. A good example of the distinction is reflected in the way budget revisions are handled. If the budget is revised casually and frequently because actual performance is not up to budget, then the budget is probably viewed as more of a forecast than a tool of management control.

According to Jones et al. (1971), sales budget preparation can be viewed as involving the following for interrelated steps;

- (1) The sales forecast.
- (2) The marketing plan.
- (3) The advertising and promotional budget.
- (4) The selling expense budget

Before examining each of these four steps individually, it will be helpful to discuss briefly their interrelationship.

As the first step in preparing the sales budget, the sales forecast expresses demand potential and open the way to intelligent marketing planning. To convert the forecast to a marketing plan, management must make certain policy decisions about such matters as pricing, share of market, size of sales force, level of promotional activity, and ability to and cost of manufacture. These decisions and management plans imprint management control on the passive sales forecast and thus add the vital element of creative sales planning. The marketing plan is based not only on the sales forecast but also on certain assumptions regarding the level of advertising and sales promotion expenses and regarding the level of selling expenses. Therefore, it is important to consider the budgets for those two types of expense as part of the overall sales budget.

Assume that the sales budget is prepared on an annual basis. This is the most usual situation, but it is possible that the planning process might be carried on more frequently. Even when the overall budgeting is done annually, sales forecasting and market planning may be accelerated to quarterly intervals in some industries. Where this is done, procedures will be much the same as when the process is carried out for the year as a whole. The responsibility for preparing the sales budget rests, of course, with the chief sales officer. The budget director provides technical assistance and assures that the budget process follows an established timetable and format, but the proposed sales budget must be the work of the sales department. This is a fundamental part of the responsibility concept. How the top sales officer carries out this responsibility depends on the organization of his department and on the type of business and its scope of operations. Except in the smallest companies, the budgeting effort can involve many people, and careful planning is necessary to assure a proper meshing of marketing talents.

Most companies are organized either by function, where all company sales activities report to a vice-president of sales or marketing, or by division, where each division has its own sales department. In the latter case, budgeting follows divisional lines; a sales budget, including a marketing plan, is prepared by each division. In this sense the division is like a company organized functionally

Within the sales or marketing department, there may be an organizational split between product management and field sales management. Where this is the case, specific responsibility for each of the four steps of sales budget preparation must be identified. Perhaps the most usual situation is;

1. To charge product manager with the requirement of developing the marketing plans and the advertising and promotional budgets, and
2. To secure field sales management coordination in developing sales forecasts and in preparing selling expense budgets.

Senior sales management must submit marketing objectives and policies to the president for his approval. Coordination with other parts of the business is important. Particularly important is the review of production capabilities and of any manufacturing problems that may exist. It would serve little purpose to suggest a dramatic increase in sales of product X if manufacturing is having difficulty in making product X in even limit quantities.

Because the marketing plan is a key document for budgeting, other phases of the business, sales budgeting occurs early in the overall budget timetable. The sales forecast, for example, may be started as early as August or September in a large company to allow sufficient budget lead-time on a calendar year basis.

When the sales budget is completed, sales management submits it for tentative approval; this step of securing tentative approval differentiates the sales budget from other budgets that fit into the overall corporate budget. No budget can be considered as finally approved by the president until the entire corporate budget has been put together and accepted. Nevertheless the marketing plan must receive yearly approval (usually on a tentative basis) so that other departments know the activity level expected and can plan accordingly. As explained latter, production and inventory planning are contingent on the marketing plan

To facilitate this tentative approval, which is usually based in large measure on the adequacy of the indicated profit, sales management should develop with the budget department a flash report summary showing the indicated level of profitability represented by the proposed marketing plan

#### **b. Inventory Budgeting**

According to Jones et al. (1971), "While it is often convenient in budgeting to assume that production over a three month's period, or whatever, will equal sales and that inventories will remain at- or return to – a constant level, this is seldom a good assumption. Inventory levels can change for a variety of reasons; perhaps they should be changed. In the course of budget preparation the need for or the likelihood of, changes in inventory levels should be explored. Almost invariably this brings to light the operating problems, which can significantly affect other phases of overall budget."(p61)

Further, he viewed that, because inventories serve a great variety of purposes, it is hard to generalize about them. However, one can identify the basic reasons for having inventories and outline some general approaches to their budgetary control. It is useful to think of inventories in terms of layers starting with a relatively permanent base level or minimum. Other inventory layers or fluctuation are added for various specific purposes at various times. As a minimum it is normally necessary to retain possession of goods for the length of time required to carry out whatever manufacturing, packaging, or distribution processes are involved. The amount of work-in-process inventory is directly related not only to the time during which the material is actually being worked on, tested, or transported but also to the waiting time between operations. In multi-step manufacturing- for example, in a job shop or a complex chemical synthesis operation- waiting time may substantially exceed operation time, and the overall in-process time will run into weeks or months. Material in process but not being worked on represents an inventory to guard against unforeseen equipment or process failures, quality or scheduling problems, and manpower or equipment under- utilization but, through poor control, the amount of in-process inventory may exceed what is really needed. This is particularly serious when goods are produced on a made-to-order basis, because excessive in-process inventories plug the pipeline and lead to delays in delivery.

Distribution or merchandising operations require very little process time. Only a few days are normally needed to receive goods, store them, and subsequently to move them out of storage or of the shelf for delivery to the customer. The inventories involved are generally not even classified as work-in-process but rather as finished goods. They serve primarily to assure availability for customer service. It is not unusual, however, to have both a high level of finished goods inventory and inadequate customer service because of stock imbalances- that is, too much of some items and too little of others. This again is a result of poor control.

Work-in-process inventories and maximum finished goods requirements to maintain customer services are two elements of the base inventory level. Another element results from the intermittent nature of most production processes. Fabrication and packaging operations often use the same equipment for producing in succession a variety of different products (or different varieties, colors, or size of the same product). Any one item is therefore produced intermittently, and sufficient inventory must be built up during each run to serve the customers while the equipment is turning out other items.

It is necessary in intermittent production to strike a balance between the cost of changing over from one item to the next and the costs of accumulating inventory. The shorter the individual runs, the greater is the number of equipment charge-over and therefore the greater the cost associated with down time and setting up. The inventory buildup, on the other hand, is less on a shorter run, and consequently the costs associated with storage and financing may be less. The proper balance for any individual item is generally determined by an economic- production quantity formula. ".(Thakur2008:)

Jones et al. (1971:65) states that, "inventory, controlled by economic- production-quantity formulas (usually finished goods inventory) fluctuate between a minimum and a maximum level. The minimum is often called safety stock and represents the average stock on hand just before each new production lot is received. The maximum level is the amount on hand just after receipt of a new lot. The average inventory, over a period of time, falls half way between the minimum and maximum levels, an amount corresponding to the safety stock (minimum) plus one-half of the economic production quantity. When no seasonal or promotional inventory peaks are involved, the aggregate inventory level for the group of intermittently produced items controlled by economic-

production- quantity formula, is equal to the sum of the safety stock levels of the various items in the group plus half the sum of the production quantities of those items”.

The same principles can be applied to raw materials, purchased parts, and maintenance stores. But we are concerned with economics of purchasing, not of production. Some items are procured one at a time as needed, but, more commonly, procurement involves periodic purchases of lot quantities. Again, the most economic amount to be ordered at one time is determined by striking a balance between ordering costs and inventory carrying costs. In principle, the ordering costs in purchasing are analogous to set-up costs in production and include those elements, which increase in direct proportion to the number of orders written per year, such as the costs of preparing and processing the orders and of handling accounts payable. Economic- order- quantity formulas, however, fail to take into account quantity price discounts or freight savings, which can be obtained by ordering in large quantities than the formula suggests or by combining several items on a single order. When these factors apply, appropriate adjustments must be made.

There are special situations, which do not lend themselves to the use of simple formulas. In chemical processing, for example: inventory is dependent upon batch sizes, which in turn are often fixed or limited by equipment capacity. In textile operation, production rates, and therefore inventory accumulation of individual items, can vary substantially depending on the number of spindles and looms assigned to an item. Many other special situations could be named.

Up to this point we have discussed inventory elements, which make up only the base level. Lets us briefly consider factors, which lead to the major fluctuations above the base level. One basic cause of such fluctuations is seasonality or more precisely, a difference in seasonality between demand for product and ability to purchase or produce. Many manufacturers of such highly seasonal items as toys, textile, or garden supplies generally find it desirable to produce substantial quantities in advance of the seasonal sales peak rather than try to maintain a production capacity sufficient to meet the demand on a current basis or to provide manpower for the seasonal peak through costly overtime or expensive- to- train temporary help.

Processors of food and other agricultural commodities, on the other hand, may enjoy relatively stable year-round demand for their products but must accumulate large quantities of raw materials at harvest time to assure their availability. For certain

agricultural products, as well as for some metals and minerals, expectation of commodity price fluctuations may lead to accelerated purchases and inventory accumulation in excess of real requirements. These purchases may in turn be hedged through the futures market; an operation too specialized to be treated here.

Fluctuations in demand are often self-imposed. For example, by the soap manufacturer who periodically gives his customers a limited- time, deal of two rupees off to the retail price of each cake of soap, all products for this deal must be specially labeled and distributed over a brief period. This necessitates a prior inventory buildup and is generally followed by a period of depressed sales because of overbuying, while the deal was in effect. The time during which the effects on inventory are apparent may be weeks or perhaps months

A similar situation occurs during the introduction of a new product, particularly when it is widely advertised. A substantial initial inventory must be provided in order to assure that the distribution pipeline is filled and that the demand generated when the product is put on the market will be met.

According to Jones et al. (1971:p67) "it is clear that no single formula or method for budgeting inventory requirements will work in all cases. Nevertheless there are some basic approaches to inventory analysis that merit consideration. We will focus attention not on controlling inventories but on budgeting for them. There is a relationship, by which budgets are established will raise questions about the adequacy of management controls, just as analysis of expenses or of sales will lead to questions about management controls in these areas".

The usual first step in analyzing any inventory situation is to segregate total inventories into-

- Raw materials-procured from others
- Work in process and intermediate products
- Finished goods- available for shipment
- Maintenance and supply stores.

Vertically integrated companies may make intermediate products both for sale to outside customers and for future processing internally. For example, a textile mill may provide yarn both to the weaving operation, which constitute the next step in the process, and to outside mills. In such a case, it is useful to consider the yarn not as an intermediate

product but as finished goods for which there are external and internal customers, the former being the outside mills and the latter being the weaving operation. However, the weaving operation is considered a customer that does not maintain an inventory of the basic raw material.

For budgeting purposes it is necessary to recognize that a minimum and maximum stock quantity should be defined, in units and in Rupees, for each item. Generally, the absence of such limits denotes a weakness in inventory control procedure and therefore in inventory budgets.

Jones et al. (1971) further states that, "usually, inventory controls are established not in terms of minimums and maximums but in terms of reorder points and reorder quantities, or order-up-to quantities. Thus to calculate the minimum and maximum levels, it is necessary to know the reorder lead time for each item (the time required from inventory depletion below the reorder point level to receipt of replenishment). Exhibit below shows the basic formulas that apply (minimum stock quantity is synonymous with safety stock quantity). To obtain an overall inventory budget, the average expected inventory levels for each individual item must be added up. If inventory minimums and maximums are revised or changed seasonally, the inventory budget should be adjusted correspondingly". (p68)

1. Lead time quantity: - lead time (weeks) X weekly usage (units/week).
2. Reorder point quantity: - lead time quantity + minimum stock quantity.
3. Order-up-to quantity: - reorder point quantity + reorder quantity.
4. Maximum stock quantity: - order-up-to quantity – lead-time quantity.
5. Average expected inventory level: -  $\frac{1}{2}$  (minimum stock quantity + maximum stock quantity) or [reorder point quantity – lead time quantity +  $\frac{1}{2}$ (reorder quantity)]

The above formulas cannot be strictly applied to items with a very low unit usage rate, such as a rate of only four to six per year. It is generally good practice, in establishing budgets for the stores, to review a listing of items in stock and to place them into three categories;



- (1) Items which should not be stocked because of insufficient usage, ready availability from others, or high likelihood of obsolescence. These have no budgeted quantities, and stocks on hand should be reviewed for possible disposal.
- (2) Items, which are stocked but have very, low usage. For these, the budget may be taken as equal to the minimum on-hand units.
- (3) Other items, for which minimums and maximums must be specified. The budget is the average of the minimums and maximums.

The approach to inventory analysis described above for a maintenance-parts and supply inventory will generally apply equally well to inventories of purchased parts, raw materials, or finished goods whenever stock is controlled by a reorder- point\Reorder-quantity procedure.

In case of a distributor, where items are purchased from an outside source rather than manufactured internally, only the finished goods inventory is involved. And the same basic control procedures described for no seasonal inventories can be equally applied to seasonal items. Inventory control by a reorder point and by an economic-order-quantity procedure will work effectively. In fact, if the seasonal fluctuations are relatively minor, they can be ignored with relatively little risk. The result will be more frequent ordering during the peak period and somewhat greater risk of running out of stock at, or directly after, the peak. Inventory levels would, however, be relatively unaffected.

Jones et al. (1971) viewed that, "with a strong pattern of seasonality, it is necessary to build up the inventory in anticipation of the seasonal demand. This involves the following steps, which are relatively typical of inventory budgeting procedure in wholesale and retail operations". (p69)

1. Identify the "season" as the time span comprised of consecutive periods (months) with above- average sales demand, average monthly demand being 8.33% of total annual demand.
2. Determine the total season demand for these periods.
3. Establish the purchasing procedure. If the season is short- two or three months- it is common practice to order the required quantity in a single shipment or in two shipments, of which the first is the larger; the second order may be reduced or omitted if the seasonal requirement proves to have been overestimated. In many

situations, there is not enough time to place a second order after the sales picture crystallizes.

Once the magnitude of planned orders and their probable timing have been established, the projected inventory balances can be calculated, using the month sales forecast. Safety stock requirements are determined separately and must be added on.

The determination of safety stock requirements is particularly critical for style- or fashion- oriented products, which are not only seasonal but also subject to a high degree of obsolescence. Because of the substantial costs, which may be incurred in disposing of leftover merchandise after the end of the season, it may be economical to accept a relatively high risk of stock- outs by providing little or no safety stock.

The next step of inventory budgeting is to determine the amount by which sales demand in each period exceeds production capacity- that is, the maximum operating rate to be planned for. Month- to – month seasonal inventory requirements are calculated by cumulating this difference. Starting with the last period in which demand exceeds capacity and working backward in time until the cumulative difference becomes negative.

### **c. The General and Administrative Budget**

Until now the focus has been given on the expenses directly connected with the manufacturing and distribution processes. This part concentrates on expenses connected with running the top offices in the company and with providing the necessary legal, secretarial, financial and related services. "This is an area of importance not only because most businesses have experienced increases in such expenses in recent years but also because the control of these costs is sometimes an elusive process" (Jones et al., 1971: p 99).

Considerable attention has been devoted to new concept of control relating to general and administrative expenses. New techniques are being developed to insure effective utilization of personnel in the G&A area; some of those techniques are mentioned later as they are fundamental to the concept of budgeting.

According to Jones et al. (1971)"for the purpose of analysis, it is identified the three types of work whose cost comprise G&A expenses". (p100)

- (1) Administrative work: - Which includes all the positions that exist because of the organization structure, for example, the administrative activity of a manager of a function.
- (2) Measurable work: - Which includes all jobs where a relatively repetitive and often routine type of work is performed and where the number of required personnel can be related to some measure of activity. The handling of bills for payment or the processing of invoices is examples of such jobs.
- (3) Program work: - Which includes research-related or other technically oriented jobs where the workload is related to programs undertaken by the company rather than to repetitive activity. Examples of such jobs are found in the areas of commercial and scientific research.

This break down is useful, because each type of work involves different techniques of cost control. For example, control of measurable activity may be exercised through the application of manning tables and flexible budgeting whereas control of administrative activity is dependent on the type of organization structure that exists. Program work is subject to still another control technique –a technique related to the use of program budgets, which state concrete objectives of the program and include (1) lists of task required to complete the program and (2) budgeted manpower and timing for each task. The three types of work just described are not restricted the G & A area. Actually, this same classification can be made of manufacturing and distribution activities. However, we shall concentrate on how the three categories of work relate to the G &A budget.

The expenses associated with G &A work are largely personnel costs including not only salaries, wages and fringe benefits but also space costs associated with personnel. Equipment costs can be another sizable item in a company with extensive data processing machinery. This fact takes on added importance because, while personnel costs may be somewhat variable, equipment costs are relatively fixed for the life of the lease or the contract. This shifts a substantial part of the control of equipment costs from a day to day or month to month basis to a longer- range basis- that is, control is effected

largely when the commitment is made or renewed. Some cost control exists, of course, in the day- to -day utilization rates of such equipment.

There are generally three problematic areas associated with G&A expenses.

- (1) Control of such expenses, including control of overtime and other "hidden" extras.
- (2) Maintenance of some balance between G&A expenses and other factors in the organization, such as sales or total costs. Some managers use a rule of thumb that G&A expenses should be never exceed, say 5% or 10% of sales,
- (3) Identification of G&A expenditures with an appropriate activity, such as a corporate subdivision (in the case of head quarters expenses) or a product line. Examples of the later are the application of underwriting and claims-service costs to various lines of insurance of a multilane carrier and the association of financial or statistical costs with a particular report produced.

Jones et al. (1971) further viewed that, "the reason that those areas present problems is precisely that they are separate and distinct, and the answers to the problems associated with one area do not necessarily apply to those of the other areas. Yet many businesses do not keep the three distinct. Thus one executive may feel that he is controlling G&A because it represents only 6% of total sales and has never been any higher or an accountant may feel that he is rendering a valuable service to his management by allocating all G&A to various product lines (on a completely arbitrary basis), even though he does not report the total amount for each area of responsibility. In the case of executive, the relative amount of G&A provides no assurance that the total amount is under control. The nature of the business may be such that normal relationships do not apply, 6% may actually be too high a figure. In any event, the danger of this approach is that, it perpetuates all prior operating inefficiencies and ignores the planning function of management". (p102)

In the case of the allocating accountant, a basic principle of cost control is that all costs incurred must be grouped and reported by areas of responsibility before any distribution or allocation is made. Otherwise there is no guarantee that the activity receiving the allocation is responsible for the incurrence of the cost or, in many cases even for the amount allocated. Therefore, it is meaningless to expect those who have no

responsibility for certain costs to exercise control over them. Secondly, the dissipation of a pool of costs puts the one responsible for that pool of costs in a diffused light rather than in the spotlight of accountability. For example, there is an engineering firm that accounts for various support activities by charging actual costs of these activities to job numbers, thus the total costs incurred in any one area of responsibility or office are not reported but only the total charges to each number from every source. Such a procedure makes it impossible to exercise cost control at the source, which is the home department of each of the support personnel who devotes his time to assigned jobs. In this particular firm it is also virtually impossible for the man controlling the job number to police charges to it effectively, since in many cases he does not even know some of the people charging the number (let alone approve in advance the charging of time to the job).

Until now we have not spoken specifically of budgeting G&A expenses. This is because, while budgeting is an effective tool for cost control, its effectiveness is limited by other general types of control already in existence. Conversely, the existence of these other controls, which we are about to discuss, greatly facilitates the implementation of budgetary controls and increases the possibilities for truly effective controls through the planning and budgetary process for this reason, we will touch upon some of these other control tools before discussing specific budgetary techniques.

The key to control in any business is organization- the process by which resources are allocated, responsibilities and authorities defined, and relationships established. "True organization descends to the lowest levels of authority in the business. Thus in the G&A area, it is not enough to outline the broad framework of authority. Sufficient detail must be added to insure that every group and section knows what their responsibilities are and to whom, they report" (Jones et al., 1971: p 103).

It is possible in many instances to economize on clerical costs by establishing pools or by shifting personnel to different departments on a temporary basis. Even in these cases, the organization must be clearly established so that there are no gray areas, which will permit a breakdown in control through overlapping responsibilities. Numerous examples could be cited of administrative areas where this concept of organization was entirely lacking and where any type of effective cost control was impossible. In one case, not only was it impossible to evaluate performance of the groups in a certain administrative category (a difficult enough task in itself), but also it was

equally impossible to find out who was responsible for what activity, what output should be expected of a particular group, or what level of staffing was realistic. Budgetary control in such a situation could result in nothing more than a perpetuation of past ways of setting the initial budget and of determining how much of the budget allowance was truly earned in a given period. Conversely, the establishment of an organizational framework incorporating position descriptions and tables of approval makes it possible to answer all such basic questions and provides realistic budgets to insure tighter controls on costs and performance.

The second element of basic control in the G&A area is the establishment of proper systems for performing the necessary work at reasonable cost. A critical review of a company often reveals startlingly poor methods, which slow down the progress of work and involve excessive overhead costs. In one company which exercise good control of methods in the factory, very poor methods were used in the office-for example, complete retyping of the same information several times in the processing of an order, detailed checking of every Rs.5 and Rs10 item on a vender's invoice, and meaning-less paper shuffling and duplication of effort. "All of this was taking its toll in poor customer service and excessive overhead costs. Upon the completion of elementary methods work and upon the use of new techniques, better customer service at lower cost resulted." (Jones et al., 1971: p105)

Closely related to methods work are the techniques of work measurement, that is, the determination of what a fair day's output should be. While the most obvious area of application is what was previously defined as measurable work, we should not overlook the fact that administrative work and program work can also be measured, although less formally. Management should ask itself how many functional managers-for that matter, how many separate functions- are required to accomplish the company's objectives- does it make sense, for instance, to establish within the legal department separate sections for patents, real estate, antitrust, and so forth when the job really requires the attention of only one or two men? To a great extent this type of work measurement is a part of general organization work- the basic question of both is, what is the best way to get the job done? The proper answer to this question involves an appraisal of what the job really is and how many people are required to do it the best way.

In measurable work, the measurement techniques involved a breakdown of work into basic functions- sorting, calculation, filling and the like- and a measurement of each

basic function. The purpose of such a measurement is to determine how much effort is required to handle a given workload. One can then determine what the proper staffing should be and what budget allowance should be credited for a particular period, given the level of productivity.

Work measurement can take one of several forms. It is possible to derive an engineered standard based on actual time studies. Or it is possible that predetermined standards are appropriate. But generally speaking, the most satisfactory way of measuring work is to use historical data, if available, or to sample various batches of current work. While the latter method may be less exact, it has the advantages of being simple and of measuring work being performed at the accustomed rate. Of course, work measurement will not make sense if the basic systems for processing work are unsound.

The final step is to express in rupees amount, the standards developed, this is done by applying average wage or salary rates, to which are added benefits or overhead. One then has, in effect, a standard cost system for the office, which provides a powerful productivity-related tool for cost control and a means of equitably charging other groups and product lines for services actually rendered- such a system is also an excellent vehicle for installing budgetary control, since the same rates used in costing are used in computing budget allowances.

Another basic feature of control is good supervision. It can be regarded as organization in action, since good supervision is just that- bringing to life the organizational relationships, which exist on paper. Supervision is necessary, especially in the area of measurable work, to insure that productivity is maintained at the required level. During the normal processing of work, imbalances in departmental workload are bound to occur, and supervisors must be there to restore balance through shifting the workload or personnel. Even in the same department, peaks and valleys will occur in the day-to-day workload, in the mail order business, for instance, Monday may be the busiest day of the week because of the accumulation of two day's mail, or Tuesday may be the busiest day because of newspaper advertising on Sunday, or it may not be possible to anticipate high volume days, so, variable is the workload. In any case, there must be good supervisors to level the peaks and valleys and to insure that each employee has enough

work in front of him to maintain overall productivity. Otherwise, the staff may work overtime on Tuesday to “finish up” and yet be practically idle on Thursday.

While some of the controls previously described are more applicable to large administrative departments than to smaller ones, one should not overlook the opportunity to apply some or all of them in a manner that will keep overhead costs under control without, at the same time, jeopardizing corporate objectives, for example, periodic reviews of work methods and the effectiveness or value of the output of organization units should be a continuing part of the control process.

Everything we have said until now provides a necessary backdrop for the discussion of budgeting G&A expenses. In the idle situation, budgeting proceeds as a natural outgrowth of the other control techniques described earlier. In fact budgeting and rate setting are, to some degree, inseparable, because to establish hourly rates for fixed or partially fixed costs, an assumption must be made about the level of activity. This assumption is very much like the one used for budgeting. The difference is that in addition to using rates to generate cost data, budgeting supplies a benchmark against which actual expenditures can be compared.

The fundamental step in preparing a departmental budget is to determine the level of operations. In the G&A area this level will largely be determined by the expected activity in other areas. For instance, in the accounting department the number of invoices prepared will vary to some degree with the level of sales, and the number of vendor's invoices paid will vary with the production and inventory plan. Similar correlations can be made for such departments as tabulating, credit and other services. It is not true that administrative activity in research departments will vary directly with the level of sales or production, instead, the level of activity in these departments will be set by a management decision based on what management can afford and what it feels will make the most important contribution to overall progress. Upon establishing the general level of activity, one should then proceed to a more precise statement of plans for the coming period. For administrative work and program work the most common planning vehicle is a manning table, which indicates the positions needed (with a statement of justification, including a description of duties to be performed and expected workloads) together with



the planned staffing and the salary for each position. Additional costs, such as those of overtime, space, and equipment, should be included in the same budget.

"While this may seem like a lot of detail, it is the only sure way of keeping overhead costs from continually creeping upward through the addition of a person here and there and too-generous salary adjustments. Some of the largest U.S. corporations apply this technique down to the lowest levels at the most far-flung locations. The paper work involved is easily systematized, and the little effort involved pays rich dividends in helping supervisors at all levels to keep their costs under control" (Jones et al., 1971: p106)

For measurable work, the manning table just described is also appropriate, but when work measurement has been performed it becomes a secondary step. The basic step is projections of the units of work expected for the period, based on such activity measures as are appropriate for the department. This forms the basis of a projection of the hours to be worked in a department during the budget period. This projection, in turn, is translated into a manning table, which reflects such factors as schedule requirements, overtime estimates, peak loads, and vacation periods. The manning table should be used in the same way as that for administrative and program work, with the work-measurement calculations added as supporting detail.

As with all budgets, the G&A budget should be built up from the grass roots. The first-line supervisors and others who will have to make the budget work should have a voice in it and should budget only expenses, which they can control. The overall budget should then be assembled and reviewed at each higher level of responsibility. When revisions are necessary, they should be made in such a way that lower-level supervisors still feel it is their budget. Finally, when the finished budget is assembled, it should be structured in a way to facilitate the reporting of actual results. Budget reports should be prepared each month; comparing actual results with those budgeted for the period. With variable budgeting, the budget allowance will vary not with time but with the level of activity. The application of this technique requires an understanding of the nature of costs and the way in which they vary.

Few costs are completely fixed, but it may be convenient to talk of certain ones—such as supervisory salaries, space and equipment costs, and certain overhead allocations—as fixed for purposes of this analysis. Budgeting for these is just a matter of prorating the total year’s cost over the months or over other budget periods and of providing an equal budget allowance for each period. As with fixed costs, few costs are truly variable with any measure of time or activity. But when flexible budgeting is used, it is helpful to make certain assumptions about variability. Where to draw the line between fixed and variable costs can be a difficult question. Generally it can be done only by assuming a normal level of activity and deciding what costs will be fixed, even at the bottom of the normal range, where gray areas still exist, it is generally better to consider questionable items as variable, rather than go through a detailed analysis of semi fixed and semi variable (or “step”) costs.

Costs, which are determined variable, should receive a budget allowance equivalent to the activity level actually attained. In simplest terms, if salaries and wages vary directly with hours worked (as in the case of an hourly office pay-roll), the budget for any period should relate to either the hours actually worked or the hours earned based on physical production (converted through work-measurement units into hours). Using the second choice, hours earned, makes it possible to identify an efficiency variance (where actual hours are more or less than earned hours) as well as a rate variance (where the amount for hourly wages differs from the budget allowance), for fixed expenses it is also possible to develop a volume variance (where the number of hours worked or earned is more or less than those budgeted for the period), which will indicate whether fixed costs have been over absorbed or under absorbed.

**a. Program Budgets**

A program budget represents the appropriation of a fixed sum of money to achieve a specific objective or set of objectives. This budgetary approach is most common in the “programmed” activities of a business such as research and development, marketing, engineering, preventive maintenance, training and public relations. The program or appropriation budget in these areas represents the total cost of undertaking a series of individual projects.

As in most budgeting process there is a top-down and bottom-up approach taken to establish the cost and content of these programs. In some organizations management will specify an overall investment limitation, which may relate to past spending, such as a percentage of sales. This upper limit may be derived from management's judgment as to a total amount necessary to remain competitive or to keep in step with current growth rates and future expectations.

On the other hand, there are those companies that arrive at a total budget based on a buildup of individual project "sold" to management by the respective department or functional managers. In these cases, since the company can not financially support an infinite number of projects, a budget limitation probably exist, but it is not preset in the same manner as in the top-down approach.

According to Jones et al. (1971:p113) "in both approaches to program budgeting, there is a distinct need to provide some mechanism to assist management in identifying a preferred choice among possible alternatives. Where a total budget is established initially, management must decide how to allocate the fund to individual project efforts, where many projects are, first being proposed at department levels. Management must decide-how to screen and select the projects to be worked on".

In recent years, considerable attention has been given to cost effectiveness analysis as a basis for this sort of management action. This analysis involves a comparison of alternative courses of action (which projects to work on) in terms of their cost and their effectiveness (output of the project effort) in attaining specific goals. Cost effectiveness analysis in program budgeting generally consists of an attempt to minimize the rupee appropriation required to meet a corporate mission (which may not be explicitly measurable in rupees) or, conversely, to maximize the output of the program (for example, number of new products from R&D) subject to an overall budget constraint.

Cost effectiveness analysis requires looking at the relationship among number of factors present in every analysis of choice. The overall framework for this analysis is management's objectives, since the rest of the process boils down to measuring the extent to which the objectives are being met by the selected alternatives. Then, of course, there

must be alternatives, which might be a set of project proposals. The projects need not be direct substitute for one another since there can be numerous alternatives which direct themselves to management's objectives.

Choosing a particular project means that the resources needed for that project can no longer be used for other purposes. Thus, for a given project, these are the costs to be considered in evaluating the proposal. The evaluation itself entails the use of an appropriate model to abstract the information relevant to reaching a decision to include a project in the program. An example of such a model might be a return-on-investment formula, which abstracts and relates the project costs to the project output (its measured economic payoff).

Having evaluated each alternative, it is then necessary to weigh costs against effectiveness. This is accomplished by applying a criterion or standard by which the evaluated projects can be ranked in order of desirability (for example, descending order of return-on-investment). This permits a selection of the most promising projects up to the overall budget limitation.

The quantitative nature of cost-effectiveness analysis often leads to a number of questions pertinent to its usefulness in decision-making. These questions relate to;

- The ability to identify the right company objectives,
- The clear-cut specification of these objectives,
- The influence of non-dollar factors, and
- The determination of an appropriate measure of project performance.

The last point is, of course, the cost-effectiveness measure, which must be relevant and measurable.

There are many examples of the problems in choosing effectiveness measures and the effects of maximizing on such measures. Consider as an extreme example, the plant manager of a nail factory whose initial measure of performance was stated in terms of the "total weight" of the factory's output. He then proceeded to maximize this explicitly stated objective with the result that the plant turned out only huge railroad spikes. Seeing a surplus of railroad spikes for which there was no demand, management revised the measure of the merit of the plant's output to the number of nails produced, whereupon the

plant manager switched entirely to producing tacks, brads, and staples. Management's measure of effectiveness in physical terms and its failure to evaluate the production output by market criteria led to activity and costs which obviously were inconsistent with long -range corporate interests.

Jones (1971:114) viewed that "the difficulties in making meaningful use of cost-effectiveness analysis do not, however, negate the role that budgeting can play in establishing program goals and controlling performance".

### **2.13 Revenue Budgeting**

Revenue budget is an operational budget for revenue operations generally prepared on an annual basis and are often broken down into shorter periods like quarters or months. It is operating master budget which forecast profit and loss statement showing the overall position of business operations in financial terms.

Revenue budgets cover diverse business activities relating to procurement of materials and facilities to sale or disposal of end- products. These covers activities like sales forecasts, market research, production programming, estimates of materials to be consumed, inventory levels of finished and raw materials to be maintained, recruitment, training and appointment of labor and staff, provisioning for various direct and indirect expenses concerning manufacture, administration, sales and distribution.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

This chapter includes the researcher's understanding on the research, research inquiry, preparations for data collection (including data collection tools), the data collection exercise as well as the data analysis. The researcher tried to address such questions like why the research study has been undertaken. How the research problem has been defined, what data has been collected and what particular method and techniques of analyzing data has been adopted?

#### **3.1 Research Design**

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Selltiz & others as cited in Kothari, 1985, p. 39). The research design is the conceptual structure within which research is conducted; it constitutes the blueprint for the collection, measurement and analysis of data. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data (Kothari, 1985, p. 39). This study is an examination and evaluation of revenue budgeting of Himalayan bank limited. Various functional budgets and other related accounting information's and statement of Bank are the materials to analyze and evaluate the Revenue system of the Bank. Descriptive as well as analytical research designs have been adopted in this research.

#### **3.2 Research Approach**

This research was based on quantitative research approach. Quantitative research intends with collection of numerical data, presentation and making the report by using different tools and techniques.

### **3.3 Sources of Data**

This research was based on secondary data. The data were collected through the annual report of HBL, reports of NRB and other financial institutions.

### **3.4 Research Variables**

Since revenue budgeting is a wide term there are many variables in this area like accounting statement of the bank such as customer deposits, loans advances and bill purchase, interest income and expenses, staff expenses and operating expenses was analyzed to address the research questions of this study.

### **3.5 Tools for Data Analysis**

Data in the research was analyzed by using tables, bar diagrams and line charts. Furthermore, the descriptive statistical method like standard deviation and variance analysis were used to analyze the data. Also some financial statements like ratio analysis and cash flow analysis was used in this research.

#### **3.5.1 The Mean**

The most popular and widely used measure of representing the entire data by one value is what most laymen call an average and what the statisticians call the arithmetic mean. Its value is obtained by adding together all the items and by dividing this total by the number of items (Gupta, 1985, p. 7.4).

#### **3.5.2 The Standard Deviation**

Standard deviation is denoted by small Greek letter  $\sigma$  (read as sigma). It measures the absolute dispersion or variability of a distribution: the greater the amount of dispersion or variability the greater the standard deviation. For the greater will be the magnitude of the deviations of the value from their mean. A small standard deviation

means a high degree of uniformity of the observations as well as homogeneity of a series; a large standard deviation means just the opposite. (Gupta, 1985, p. 8.19).

### **3.5.3 Variance**

The concept of variance is highly important in advanced work where it is possible to split the total into several parts, each attributable to one of the factors causing variation in their original series. Variance has relation with standard deviation. The variance shows the result as: the smaller the value of variance the lesser the variability or greater the uniformity in the population (Gupta, 1985, p. 8.33).

### **3.5.4 Karl Pearson's Correlation**

The degree of relationship between the variables under consideration is measured through correlation analysis. The measure of correlation called the correlation coefficient or correlation index summarizes in one figure the direction and degree of correlation. The correlation analysis refers to the techniques used in measuring the closeness of the relationship between the variables. Correlation has different types i.e. positive or negative correlation, simple, partial and multiple and linear and non-linear correlation. Of the several mathematical methods of measuring correlation, the Karl Pearson's method popularly known as Pearson coefficient of correlation, is mostly used in practice. The Pearson coefficient of correlation is denoted by  $r$ . It is one of the very few symbols that are used universally for describing the degree of correlation between two series. The value of the coefficient of correlation must be positive to be correlated each other. When  $r = 1$ , it means there is positive correlation between two variables. When  $r = -1$ , it means there is perfect negative correlation between the variables. When  $r = 0$ , it means there is no relationship between the two variables. However, in practice,  $+1$ ,  $-1$  and  $0$  are rare (Gupta, 1985, p. 10.12).



### **3.5.5 Ratio Analysis**

An arithmetical relationship between two figures is known as ratio. It is computed by dividing one item of relationship with the other. Ratio simply means one number expressed in terms of another. Ratio analysis is a technique of analysis and interpretation of financial statement through mathematical expression. To evaluate the different performances of an organization by creating the ratios from the figure of different accounts is termed as ratio analysis. Thus it is a financial analysis (Dangol and Dangol, 2004, p. 595).

### **3.5.6 Cash Flow Analysis**

A cash flow statement is a statement of changes in financial position on cash balance. It summarizes the cause of changes in cash position between dates of the two balance sheets. It indicates the sources and uses of cash. This statement analyses changes in non-current account (other than cash) to determine the flow of cash. We can find out the net change in the cash position from the income statement and comparative balance sheets by making the adjustments for non cash items e.g. cash from operations can be found out by adding depreciation to net profit. Similarly, gain on sale of non current assets should be deducted while loss should be added to net profit.

## **CHAPTER FOUR**

### **DATA PRESENTATION & ANALYSIS**

#### **4.1 Strategic Revenue plan of HBL**

The strategic revenue plan of HBL is reflected in its estimation of business activities to be achieved by the bank for particular period of time for which the budget is prepared. The practice of formulating formal business budget has been started only from F/Y 2054/055; The management group of the bank has been entrusted for this responsibility therefore the detailed recorded of business and Revenue/Expenditure budget could be found from 2055/056 and onwards only. But in this research study, research is based on from F/Y 2062/063 to 2066/067 B.S the business budget consists the total activities to be preformed broadly in terms of resource mobilization (collection) and deployment (use). The resource mobilization activities are generally the cost bearing activities and The Revenue are generated mostly from deployment of resources the surplus revenue generated over the expenditure involved is the net income. Therefore the strategic revenue of HBL consists the following plans.

1. Plan of resource mobilization.
2. Plan for deployment of the resources.
3. Plan for non-funded business activities.
4. Revenue plan.
5. Expenditure plan.

#### **4.2 Resource Mobilization plan of HBL**

- a) Deposit Collection.
- b) Capital fund.
- c) Debenture/Loan from other banks.
- d) Borrowing from other banks.
- e) Other liability.
- f) Reserve & Provision.
- g) Others

## 4.2.1 Deposit Collection

Among the seven sources the deposit collection is major source of resource mobilization that is in fact, one of the most important activity of a commercial bank. Loans and borrowing are obtained from local banks, Foreign banks, Central bank and other financial institutions generally for a short period of time. The capital fund is raised from share holder's equity. This is the net worth of the bank. Commercial bank's capital fund has been divided into two categories Viz. Core capital and supplementary capital other liability consists all liabilities not included in above headings provision for risk management has been classified in risk weighted exposure for credit risk, risk weighted exposure for operational risk and risk weighted exposure for market risk.

The following table shows the resources mobilized by the bank over the period of study.

**Table No. 1**  
**Status of resource mobilization**

(Rs in Lakh)

Fiscal year	Deposit	Debenture/ Loan	Borrowing	Capital fund	Other liability	Reserves & Fund	Total
062/063	264,909	3,600	1,446	22,428	3,868	9,940	306,191
063/064	300,485	3,600	2,360	26,514	4,941	13,357	351,257
064/065	318,428	8,600	832	32,535	4,917	14,995	380,307
065/066	346,823	5,000	832	38,452	7,333	19,037	417,477
066/067	376,112	5,000	-	42,184	7,611	14,392	445,299

Source : HBL, Annual Report 2062/063-066/067

From the above table , It is clear that customer deposit collection contributes the major share in resource mobilization 86.65%, 85.55%,83.73%,83.08% and 84.46% - 2062/063- 2066/067 respectively And the average of 5 year becomes 84.69%. All above shown data are calculated & shown in Appendix no 1. Deposit is collected from various sectors such as general public, business entities, NGOs Schools and trust etc. Which are qualified to open an account in the Bank.

Deposits are collected on customer's account, which are opened as per bank's policy. Generally customer deposit are two types.

- a. Interest bearing deposit accounts
  - i. Saving deposits

- ii. Fixed deposits
- iii. Call deposits
- iv. Certificate of deposits
- b. Interest free deposit account
  - i. Current A/c
  - ii. Margin A/c
  - iii. Others A/c

**Table No. 2**

**Status of budget of Actual deposit collection**

(Rs in Lakh)

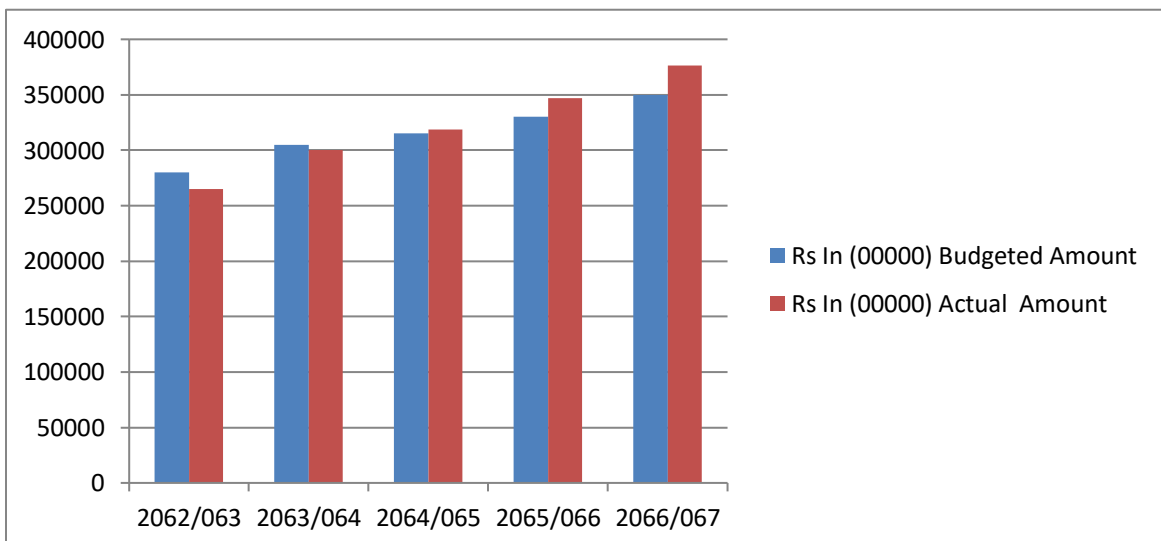
F/Y	Budgeted Amount	Actual Amount	Achievement %
2062/063	280000	264,909	94.61%
2063/064	305000	300,485	98.52%
2064/065	315000	318,428	101.09%
2065/066	330000	346,823	105.97%
2066/067	350000	376,112	107.46%

Source : HBL, Annual Report 2062/063-066/067

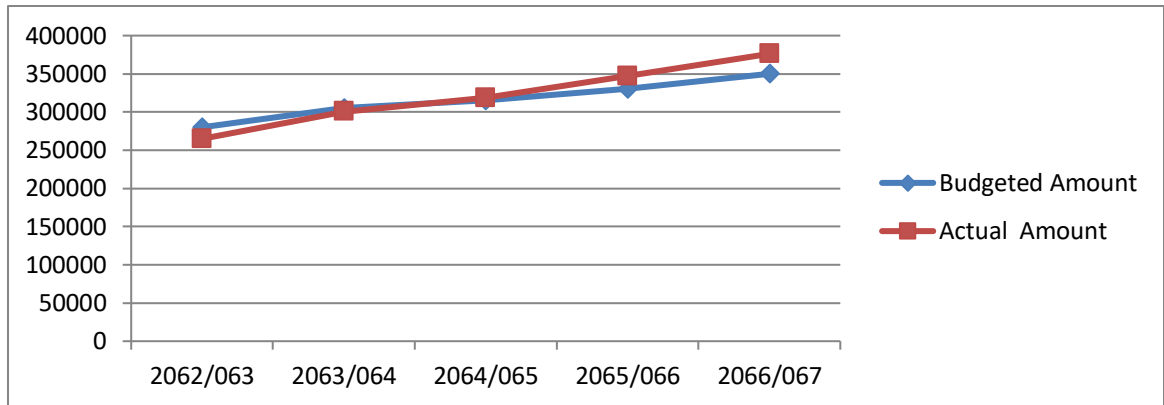
The yearly comparative status of budgeted deposit and actual achievement are shown in bar-diagram and scattered diagram.

**Figure No. 1**

**Bar-diagram showing budgeted deposit and actual deposit**



**Diagram 2**  
**scatter diagram showing budgeted deposit and actual deposit**



Above table shows that deposit collection target has not been achieved in first two year and achieved in last three year more target. This gives the picture of better achievement made by the bank towards deposit collection sector. The above bar diagram shows better achievement in deposit collection sector. Similarly in the better diagram actual line is running higher than budgeted line in three years over five year's performance. All the above picture give better performance of the bank in deposit collection during last three year. We can find the relationship between the budgeted deposits and actual collection for different year's by the help of statistical tools that arithmetic mean, standard deviation and co-efficient of variation . The detail calculation of these statistical tools is shown in **appendix 2**

**Table No 3. Summary of threes result can be presented below.**

Statistical tool's Name	Budgeted Deposit X(in Rs)	Actual Deposit Y (in Rs)
Mean	316	321.3511
Standard Deviation	23.537	38.1505
C.V	0.0745	0.1187

The above table shows that the actual deposit are more variable than budgeted deposits, since the both the both S.D and Co-efficient of variation are greater than budgeted deposit. A greater S.D and co-efficient of variation is said to be more

heterogeneous. Here HBL Bank's actual deposits are the natural of more variability than budgeted deposits.

We can use another statistical tools correlation co-efficient to analyze the relationship between budgeted deposit and actual deposits . There should be positive correlation between budgeted deposits and actual deposits .We can take the help of karl person's correlation co-efficient is denoted by 'r' we can examine whether positive correlation between budgeted deposits and actual deposit is or not the actual deposit will change in the same direction as the budgeted deposits for this purpose budgeted deposit is denoted by 'x' and assumed to be independent variable and actual deposits is denoted by 'y' is assumed to be dependent variable upon budgeted deposits . so that increase in budget is support to increase in actual achievement and vice-versa . This means there should be positive correlation between budgeted figure and achievement figure from the calculation shown in appendix 2 , we have obtained the karl person's co-efficient of correlation (r) between the budgeted deposit and actual deposit ie xy is 0.9985.

Similarly, here is presented the table of deposit growth of HBL.

**Table No.4 Deposit growth of HBL.**

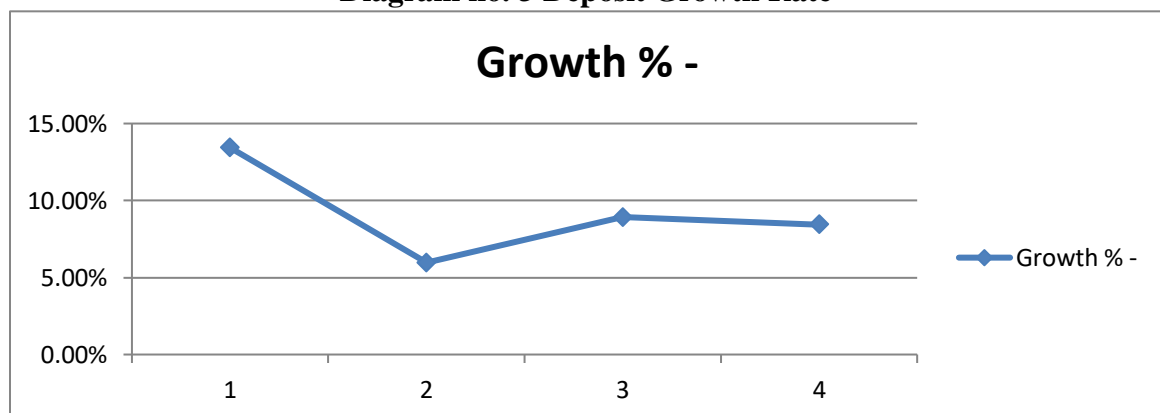
(Rs in Lakh)

Fiscal year	Deposit Amount	Growth Amount	Growth %
2062/063	264,909	-	-
2063/064	300,485	35576	13.43%
2064/065	318,428	17944	5.97%
2065/066	346,823	28395	8.92%
2066/067	376,112	29289	8.45%

Source : HBL, Annual Report 2062/063-066/067

Scatter Diagram showing deposit Growth

**Diagram no. 3 Deposit Growth Rate**



The above tables the data of actual deposit over the five years end of each fiscal years, The above table shows also deposit in increased every year considerably. Therefore , it can be said, bank has done better performance in deposit collection as resource mobilization.

#### 4.2.2 Capital fund, debenture /loan ,borrowing , other liability & reserve fund .

**Table No. 5 Five year summary in different heading**

(Rs in Lakh)

Fiscal Year	Capital Fund	Debenture/Bond	Borrowing	Other Liability	Reserve Fund
2062/063	22,428	3,600	1,446	3,868	9,940
2063/064	26,514	3,600	2,360	4,941	13,357
2064/065	32,535	8,600	832	4,917	14,995
2065/066	38,452	5,000	832	7,333	19,037
2066/067	42,184	5,000	-	7,611	14,392

Source : HBL, Annual Report 2062/063-066/067

Above table shows resource mobilization of the bank in different sectors which are followed by bank accept customer deposit role of customer deposit has the greatest in resource mobilization which is previously discussed therefore here others sector are discussed as a whole.

**Capita fund :** Capital fund increased with better rate over the 5 years . It is increased by more than 1.5 times by 2062/o63 is Rs. 2242843009 & in 2066/067 is Rs.4218361500.

**Debenture / Bond:** In five years period first two year constant then rapidly increase in third year and decrease trend in forth and afterwards constant in fifth year

**Borrowing:** Above table shows the borrowing increasing trend first into second year then rapidly decreased in third year afterword constant in forth year, in fifth year neither increased nor decreased ie Nil.

**Other liability:** Others liability over the 5 years period in increased by 2 times.

**Reserve fund:** furniture is uncertain, therefore there is a great change of being failure also bank has managed the provision for resource fund to minimize the risk in every year in increasing trend.

### **4.3 Resource deployment plan:**

Deployment of the Resource refers to reasonable allocation of the resources of making comfortable liquidity as well as investing in income generating sectors. Besides these, some investments have to be made in fixed assets and other operating assets for the bank. The deployment of available resources can be objectively categorized below.

#### **1. Development for liquidity :**

This is made for meeting expected withdrawal and other kind of payment obligations of the bank. The resource for this purpose is kept in liquid form such as cash in vault, cash at bank etc. Generally there is no yield on this type of deployment except in the case money placed in interest bearing account the central bank of Nepal , NRB has instructed commercial bank as mandatory to maintain approximately 10% of their total customer deposit liability in liquid form (cash in vault & cash at NRB ). For this study cash and bank balance is grouped in one development portfolio.

#### **2. Deployment for income Generating activities:**

Bank deploys the major portion of the resource for income generating activities popularly called as exposure. Fund based exposure are taken by the bank in following two portfolios.

- Loan, Discount, Advance & Overdraft (LAO)
- Other Investments.

LAO includes all loans, advance, overdraft, bills purchased/discounted and other types of loan available to the borrowing of the bank in return of which the bank earns interest income, other investment include investment in share, treasury bills placement of fund on call market etc.

#### **3. Deployment for other assets:**

Deployment for other assets includes the deployment of resource toward the non yielding assets such as fixed assets, other capital expenditure subject to write off in future course of time. Income receivable, advance payments sundry debtors etc.

Following table shows the status of resource deployed by the bank over the period of the study.



**Table No. 6 Status of resource deployment by HBL**

(Rs in Lakh)

F/Y	Cash Bank Balance	LAO	Investment	Other Assets	Net Fixed Assets
2062/063	17174	146426	108890	6436	5408
2063/064	17573	169980	118230	6439	5740
2064/065	14481	194975	133402	6247	7261
2065/066	30485	247932	87107	6223	9522
2066/067	38665	279806	84449	10544	10619

Source : HBL, Annual Report 2062/063-066/067

Above table shows the deployment of the bank available resource at various portfolios among which the LAO hold the greatest outlet of resource deployment.

**4.3.1 The following table shows the budgeted amount of LAO and actual achievement.**

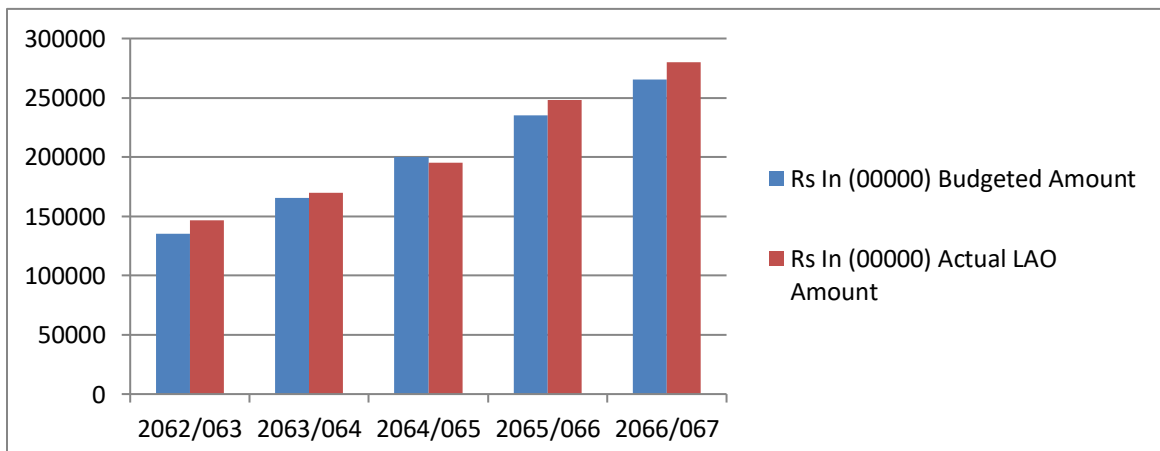
**Table No. 7 Status of budgeted & actual deployment of LAO**

(Rs in Lakh)

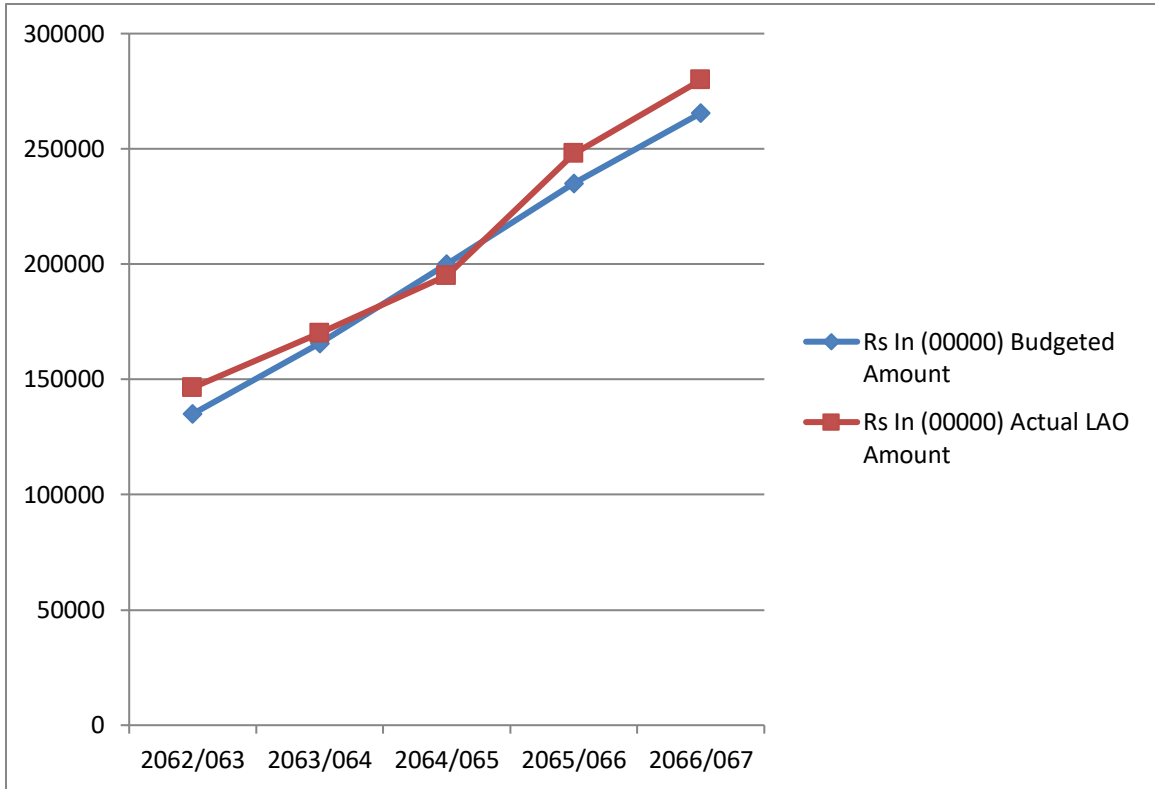
F/Y	Budgeted Amount	Actual LAO Amount	Achievement %
2062/063	135000	146426	108.46%
2063/064	165500	169980	102.71%
2064/065	200000	194975	97.49%
2065/066	235000	247932	105.50%
2066/067	265500	279806	105.39%

Source : HBL, Annual Report 2062/063-066/067

**Diagram No .4 Bar Diagram showing actual LAO & Budgeted LAO**



**Diagram No. 5 Scatter Diagram of actual LAO & Budgeted Amount**



The above (both diagram) Bar-Diagram & scatter diagram have presented the budgeted and actual LAO.

We can find the relationship between the budgeted LAO and actual achievement years by the help of statistical tools, they are Arithmetic mean, Standard deviation and coefficient of variation the detail calculation of these statistical tools are shown in appendix-3. Now, here is present summary of the result from appendix-3.

**Table No 8 Summary of LAO and Budgeted Amount.**

Statistical tool's Name	Budgeted in Rs X(00000000)	Actual LAO in Rs Y (00000000)
Mean	200.2	207.8237
Standard Deviation	46.7732	49.3094
C.V	23.35%	23.73%

The above table shows that actual LAO is more variable than budgeted LAO, since the co-efficient of variation of actual LAO is greater than that targeted LAO. On the other hand budgeted LAO are more consistent and homogeneous than actual LAO. A greater co-efficient of variation is said to be more heterogeneous. Here HBL's actual LAO is more variable in nature than budgeted LAO.

We can use another statistical tool correlation co-efficient to analyze the relationship between budgeted LAO and actual LAO. There should be positive correlation between budgeted LAO and actual LAO. We can take the help of Karl Pearson's co-efficient of correlation to find correlation and co-efficient between budgeted LAO and actual LAO. Karl Pearson's co-efficient of correlation is denoted by 'r'. By calculation 'r' we can examine whether positive correlation or negative correlation between budgeted LAO and actual LAO. The actual LAO will change in the same direction as the budgeted LAO for this purpose budgeted LAO is denoted by 'x' and is assumed to be independent variable and actual LAO is denoted by 'y' and is assumed to be dependent variable. So that increase in budget supports to increase in actual achievement and vice versa which meant that there should be positive correlation between budgeted figure and actual achievement, co-efficient of correlation (Karl Pearson's) 'y' is 0.99 which is show in detail in Appendix No 3.

The following table shows the data of actual LAO deployment at the end of each fiscal year.

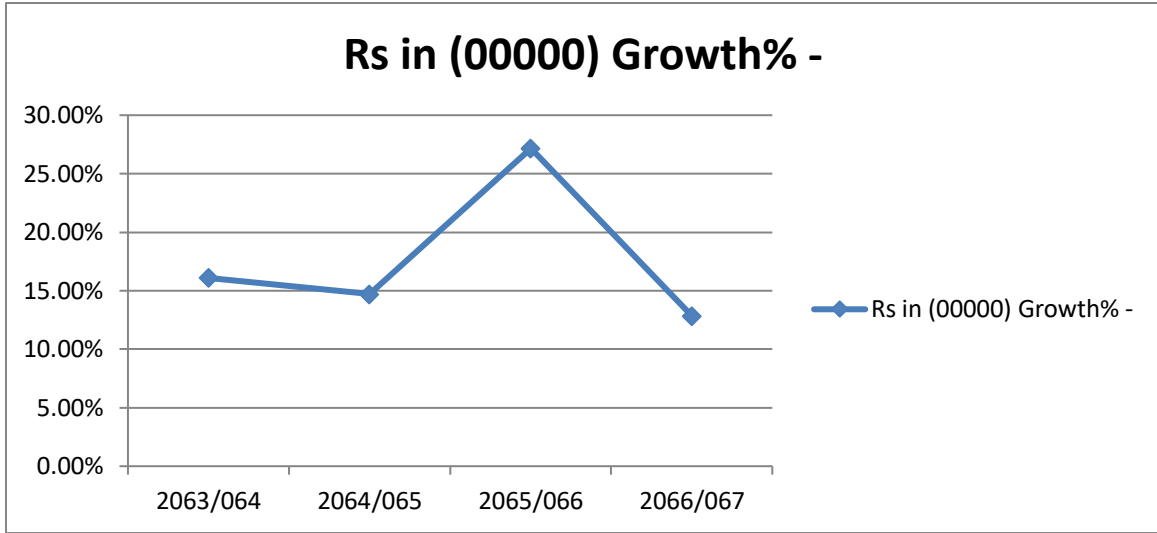
**Table No. 9 Actual LAO Growth**

(Rs in Lakh)

F/Y	LAO Amount	Growth (in Rs)	Growth%
2062/063	146426	-	-
2063/064	169980	23554	16.09%
2064/065	194975	24995	14.71%
2065/066	247932	52956	27.16%
2066/067	279806	31876	12.86%

The above table shows actual LAO deployment is in increasing trend with the help of percentage calculation in 2066/067 percentage is decreased than 2065/066.

**Diagram No. 6 Scatter Diagram of LAO Growth.**



The scatter diagram shows, actual LAO is increasing substantially through the year.

#### **4.4 Actual deposit collection Vs actual LAO status of HBL**

As it is understood that the major source of resource mobilization of any commercial bank is customer deposit and similarly major outlet for deployment portfolio is for loan and advance and overdraft, it is desirable to analyze the comparative status of the same for the study period following the table shows the actual balance of customer deposit and actual position of LAO and the ratio of LAO to deposit (CD Ratio) as of the year end of corresponding fiscal year .

**Table No 10 Status LAO versus actual deposit of HBL**

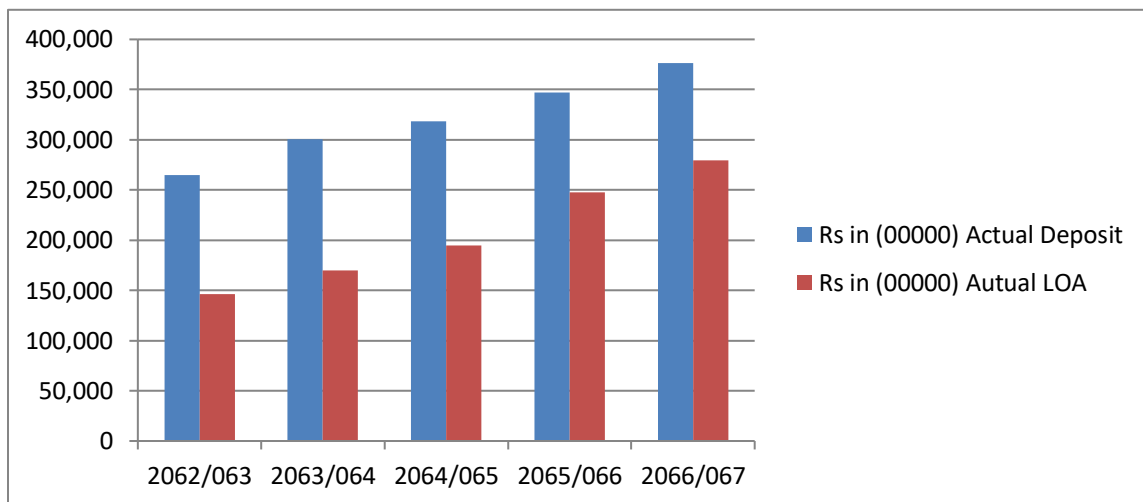
(Rs in Lakh)			
F/Y	Actual Deposit	Actual LOA	Ratio(CD Ratio LAO to Deposit)
2062/063	264,909	146426	55.27%
2063/064	300,485	169980	56.57%
2064/065	318,428	194975	61.23%
2065/066	346,823	247932	71.49%
2066/067	376,112	279806	74.39%

Source : HBL, Annual Report 2062/063-066/067

From the above it is found that both the deposit and LAO are increasing. The average CD ratio over the period of 5 years in (318.95/5 yr) 63.79%. It is significant to analyze the relationship between deposits and lending (LAO).

The above of actual deposits and LAOs can be presented in bar diagram. Below bar-diagram shows both are increasing trend bar diagram showing deposit and LAO

**Diagram No. 7 Bar diagram showing deposit and LAO**



#### 4.5 Revenue Planning of HBL

Himalayan Bank Limited generates its revenue from its income earning activities. Such activities are mostly fund based and generated out of deployment of fund and some portion from no-fund based activities. Income of HBL broadly can be classified into two types Viz interest income and another income than interest income is the interest earned from the loan and advance overdraft provided by the bank to the public and cooperate bodies investment government bonds etc.

Interest income holds major share in total income portfolio of the bank. Other income consists the following incomes

1. Income from commission and discount
2. Dividend received from investment
3. Income from foreign exchange transactions
4. Various kinds of service fees and charges.
5. Others.

**Table No. 11 Income structure of HBL**

(Rs in Lakh)

Sources of Revenue year	2062/063	2063/064	2064/065	2065/066	2066/067
Interest Income	16,265	17756	10637	23422	31486
Commission & Discount	1,655	1932	2029	2843	2703
Expenses Fluctuation Income	1,981	1516	1926	2500	1803
Other Operating Income	523	403	621	463	1124
Non- Operating Income	19	35	97	38	124
<b>Total Revenue</b>	<b>20,443</b>	<b>21,642</b>	<b>15,310</b>	<b>29,266</b>	<b>37,240</b>

*Source : HBL, Annual Report 2062/063-066/067*

The above table shows the revenues are increasing each year. Income from interest in the highest among the others in total revenue for each fiscal year. Income from interest covers 80% in total revenue. Therefore, we can say that interest income is a main income of commercial bank.

#### **4.5.1 Interest Income**

Interest income contributes the major portion of the total revenue, this study attempts to analyze the income amount with other relevant data. Interest income is generated out of loans, advances and overdrafts made by the bank, therefore, this is popularly called yield on fund (YOF). Now, we analyze the comparative status of total YOF with LAO with the help of following table, bar-diagram and scatter diagram.

**Table No. 12 Status of interest income to total LAO.**

(Rs in Lakh)

F/Y	Interest income	Total LAO	yield on LAO
2062/063	16,265	146426	11.11%
2063/064	17,756	169980	10.45%
2064/065	19,637	194975	10.07%
2065/066	23,422	247932	9.45%
2066/067	31,486	279806	11.25%

*Source : HBL, Annual Report 2062/063-066/067*

From the above table it is seen the early YOF HBL ranges from 9.45% to 11.25% in several years. The average of YOF for the period of the study is 10.46%.

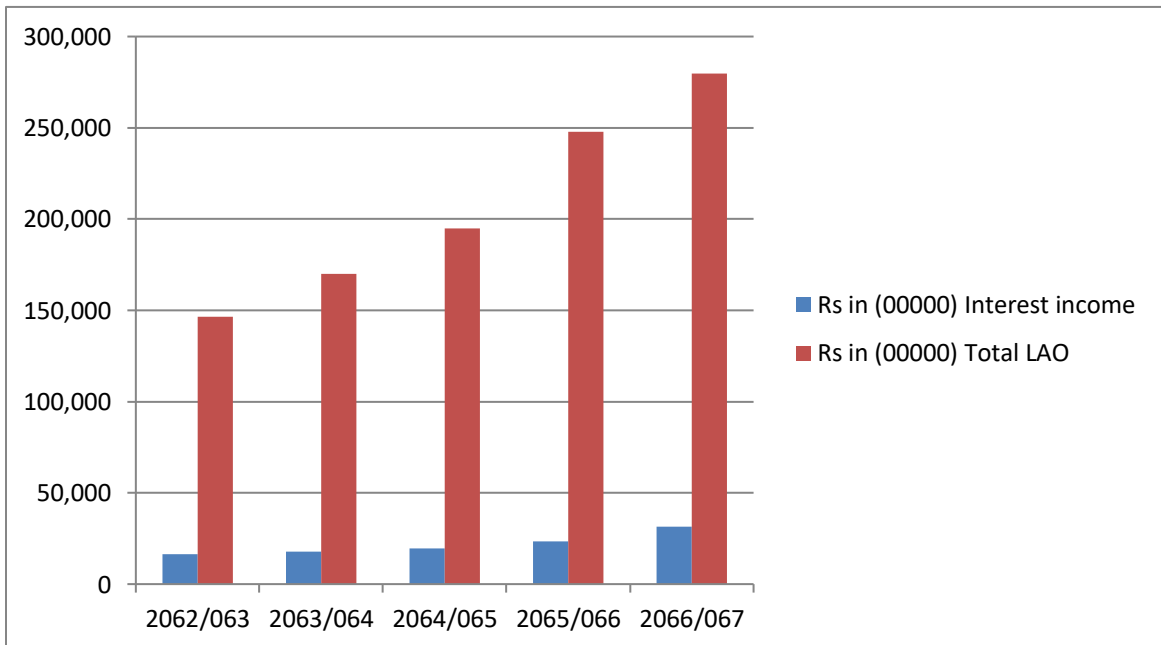
**Table No.13 Summary of LAO and Interest income**

Statistical tool's Name	LOA 'X'	Interest Income 'y'
Mean	207.7877	21.713
Standard Deviation	79.337	5.4422
C.V	23.74%	25.06%

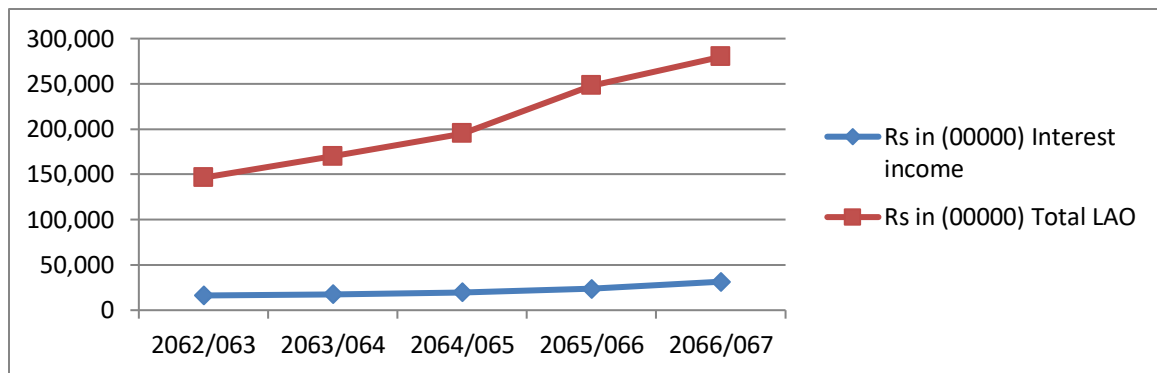
It is significant of analyze the relationship between LAO and interest income (yield on fund) YOF. The figures of LAO amount and interest income both have been presented in the tabular from above. In order to find out the variability of LAO and interest of different years have been calculated arithmetic mean, standard deviation , co-efficient of variation and correlation co-efficient. The detail calculation of these statistical tools are presented in Appendix No 4

Above result shows that LAO has more variable than interested income ( $\sigma_x > \sigma_y$ ) and co-efficient of variance LAO . Similarly, co-efficient of correlation (Karl Person' Co-efficient of correlation) r is 0.9562 where x is assumed as independent variance for interest income which are presented in above table also. The data of actual LAO and interest income can be presented in diagram as below.

**Diagram No 8 Bar diagram showing LAO and interest income**



The above diagram shows that LAO and interest income are in increasing trend.



#### 4.5.2 Other income than Interest income

Interest earned by the bank other than interest income are called other income. Most part of such income is earned from non-funded activities in the form of commission fees charges, profit on foreign exchange sale , revaluation gains commitment charges, remittance fees, service charge, ebanking charge etc. The amount of other income earned by the bank in various years are shown in table No 13.

#### 4.6 Expenditure planning of HBL

Planning for expenses is most essential to maintain reasonable levels to support the objectives and planned programmes of the bank expenses planning focus on the relationship between expenditure and benefits derived from this expenditure the following table shows the status of expenditure incurred by the bank in the study period.

**Table No 14 Yearly cost structure of HBL**

(Rs in Lakh)					
Expenses	2062/063	2063/064	2064/065	2065/066	2066/067
Interest Expenses	6488	7674	8237	9348	15535
Employee Expenses	2346	2722	3075	3610	4150
Operating Expenses	3297	3416	3290	3983	4791
Non Operating Expenses	-	-	-	-	-
Provision for Staff Bonus	672	717	949	1067	756
Reserve Fund	1452	907	584	688	6926
Tax Provision Expenses	2149	2256	3092	3408	2461

Source : HBL, Annual Report 2062/063-066/067



The above table shows that the each type of expenses are increasing in each year. We have to segregate total expenses in to interest expenses and expense other interest (other expenses) for this study.

#### 4.6.1 Interest Expenses

Generally interest expenses is the cost used money of other. Here interest expenses in incurred for making payment for customer deposit mobilized by the bank. As a customer deposit holds the major share on total resource of bank , interest expenses is also the highest expenses amount other in total expenses of the bank. Now, we analyze the interest expenses to total deposit mobilized by the bank in the following table.

**Table No. 15**  
**Yearly status of interest expenses to total deposit.**

(Rs in Lakh)

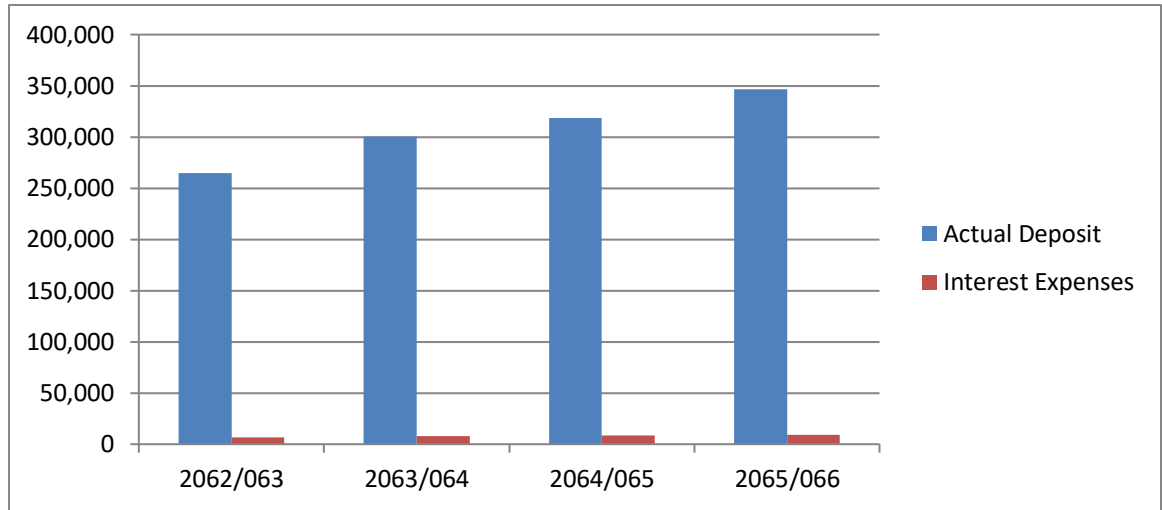
F/Y	Actual Deposit	Interest Expenses	Cost of Deposit
2062/063	264,909	6488	2.45%
2063/064	300,484	7674	2.55%
2064/065	318,428	8238	2.59%
2065/066	346,823	9348	2.70%
2066/067	376,112	15535	4.13%

*Source : HBL, Annual Report 2062/063-066/067*

The customer deposit is one the major source for resource mobilization for the commercial bank. For the deposit taken by the bank should play the interest. But there some of interests are free deposit account. Also, however bank pays the interest in large amount lower cost of deposit is considered as a better performance in the sector of deposit. Above table shows that increase in deposit and increase in interest expense. Cost of deposit percentage is also increased, but always such type of increasing percentage rate cannot be found. In earlier year bank collected large amount collected in interest free deposit and later year that type of deposit collected less. Therefore, in above the table COD percentage (costs of deposit %) is also increase. Average COD percentage for the five (5) years comes 2.88%.

**Diagram No. 10**

**Bar diagram showing yearly deposit and interest expenses**



In order to find out the variability of actual deposit and actual interest expenses, we have to calculate Arithmetic mean, Standard deviation, Co-efficient of variation and Correlation of Co-efficient. The details calculation of these statistical tools are presented in Appendix No 5. Now, summarizing the result from Appendix No 5.

**Table No 16 Summary of deposit collection and interest expenses.**

Statistical tool's Name	Actual Deposit(x)	Interest Expenses(y)
Mean	321.3351	9.4566
Standard Deviation	38.151	3.176
C.V	11.87%	33.59%

The above results show that actual deposit is less variable than actual interest expense incurred.

CV of actual deposit is 11.87% and CV of interest expenses is 33.59% other statistical tools correlation of co-efficient can be used to analyze the relationship between actual deposit and actual interest expenses also increase and Vice-Versa. To find out the correlation between actual deposit and actual interest expenses, we can use Karl Person's co-efficient of correlation and it is denoted by 'r' we can examine whether there is positive relation between them or not. For this purpose, actual deposit 'x' is assumed to

be an independent variable. So that increase in actual deposits will support to increase in interest expenses and Vice-versa, Co-efficient of correlation is 0.8828 which is calculated in Appendix No 5.

#### **4.6.2 Other expenses than interest expenses.**

Generally operating expenses refer to all the continuous nature of expense. Expenses other than interest expenses can be presented below.

1. Employee Expenses
2. Operating Expenses
3. Non-Operating Expenses
4. Loan Loss provision

Besides above profit appropriation toward staff bonus provision and income tax provision have been included in “other expense”. The amounts of other expenses in various years are shown in table no 16.

#### **4.7 Interest spread.**

Interest spread is the difference amount obtained by subtracting total interest expenses amount from total interest earned. In other word, it is the margin on interest net interest income.

The following table gives the status of interest income, expenditure and spread of the bank for the study.

**Table No. 17 Yearly status of interest income and interest expenses**

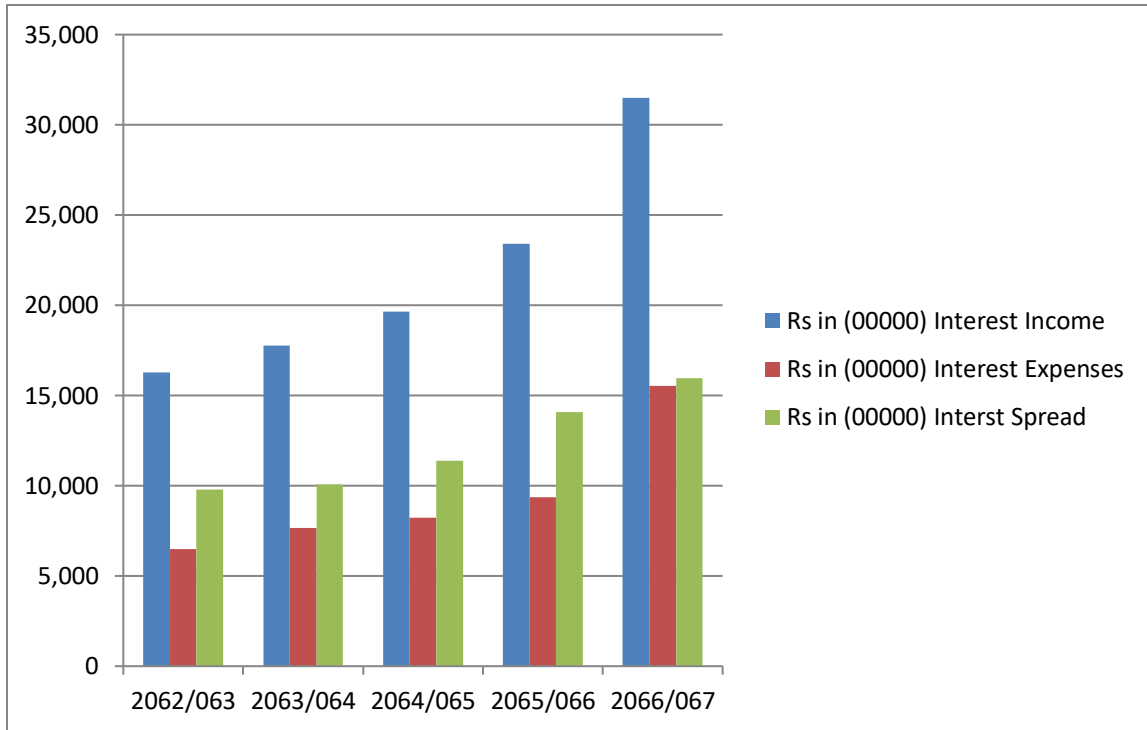
(Rs in Lakh)

<b>F/Y</b>	<b>Interest Income</b>	<b>Interest Expenses</b>	<b>Interest Spread</b>
2062/063	16,265	6488	9,777
2063/064	17,756	7674	10,082
2064/065	19,637	8237	11,400
2065/066	23,422	9347	14,075

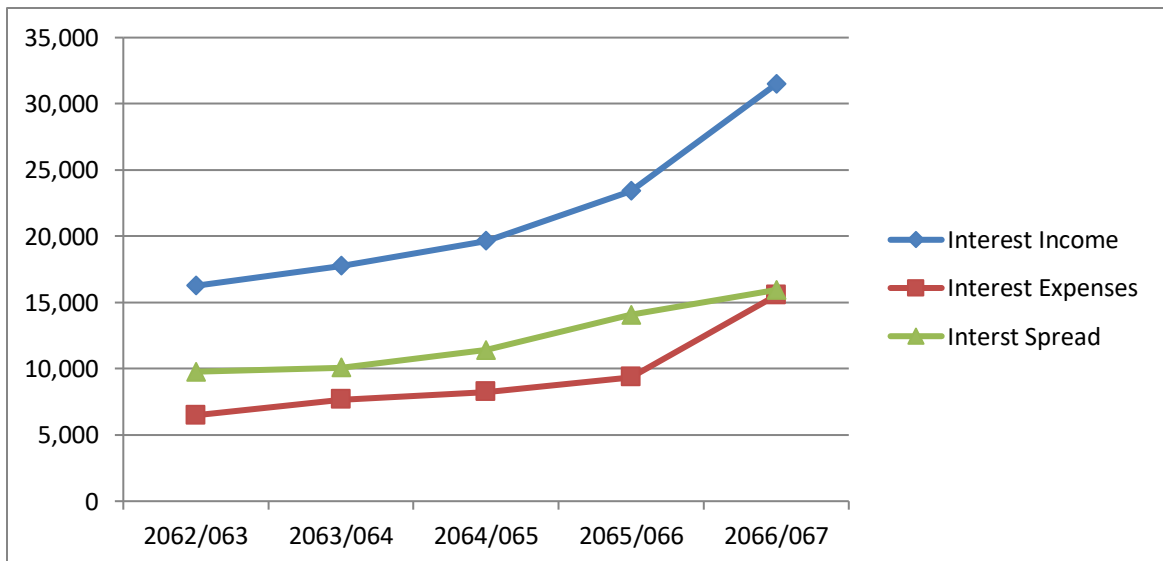
2066/067	31,486	15535	15,951
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Source : HBL, Annual Report 2062/063-066/067

**Diagram No. 11 Bar Diagram of interest income, income expenses and interest spread**



**Diagram No. 12 Scatter diagram of interest income, interest expenses and interest spread.**



Above table and diagram shows that interest spread is in less increasing trend than the other interest income and interest expenses.

#### **4.8 Performance evaluation of HBL**

Performance evaluation of the bank is very importance part of revenue . Almost all the companies must prepare their performance report to show their overall performance during a fixed period of time. Basically, performance of bank can be checked by studying the financial status . There are many tools and techniques to observe the performance of the bank among of them following are some criteria .

- i) Ratio analysis

##### **4.8.1 Ratio analysis**

An arithmetical relationship between two figures showing in the form of a:b where  $b \neq 0$  is called ratio. In other word, a way of comparison of physical quantities in the form of fraction is called ratio.

“A ratio is an expression of the quantitative relation two numbers” Wixom, kell & Bedford

“A ratio is the relationship of one amounts to another expressed as simple fraction integer (figure), decimal fraction or percentage”- Kohler

Ratio analysis is a financial position major strengths and weaknesses of firm. To evaluate the performance of an organization by creating the ratios from the figure of different account consisting in balance sheet and income statement is known as ratio analysis . Ratio can be classified for the propose of exposition into four broad groups.

- a) Liquidity ratio
- b) Capital structure ratio / leverage ratio
- c) Profitability ratio
- d) Activity/ turnover ratio

##### **A. Liquidity ratio**

The ability of a firm to meet its short term obligation is known as liquidity. It reflects the short-term financial strength of the firm . Here we use current ratio to measure the relationship of current assets and current liabilities of HBL .It is calculation by dividing to current assets by current liabilities .

$$\text{current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

And another liquidity ratio quick ratio

$$\text{Quick ratio} = \frac{\text{Quick Assets}}{\text{current liabilities}}$$

Here, we calculated only current ratio as a liquidity ratio

**Table No.18 Calculation of liquidity ratio**

(Rs in lakh)

Fiscal year	Current Assets	Current liabilities	Current Ratio
2062/063	3054	736	4.15:1
2063/064	1772	913	1.9:1
2064/065	2782	1027	2.7:1
2065/066	4738	1135	4.2:1
2066/067	5142	2162	2.3:1

Source : HBL, Annual Report 2062/063-066/067

Above table shows the details chart of liquidity ratio of HBL for the year 2062/2063 to 2066/067. The standard current ratio is 2:1 but the current ratio of the bank is more than it from this above ratio. It can be said the solvency position of the bank is not satisfactory.

#### B. Capital structure ratio / Leverage Ratio

To judge long term financial position of HBL the leverage ratio are calculated. The following two ratio are calculated in capital structure ratio .

- i) Debt to equity ratio
  - ii) Interest coverage ratio
- i) Debt to equity ratio

The relationship (ratio) between long term debt and owner's equity is known as debt equity ratio. It can be calculated by this way .

$$\text{Debt equity ratio} = \frac{\text{total long term debt}}{\text{owner's equity}}$$

Here is taken the amount of total deposit as long term debt for bank .

**Table no.19 Calculation of debt to equity ratio**

Fiscal year	Fixed deposit	Capital fund	Debt equity ratio
2062/063	63502	22428	2.8:1
2063/064	82011	26514	3.09:1
2064/065	64239	32535	1.97:1
2065/066	63771	38452	1.66:1
2066/067	113286	42184	2.68:1

*Source : HBL, Annual Report 2062/063-066/067*

From the above table equity shows high debts in comparison to capital fund. But as banker's one of the major function is acceptance of customer deposit that should not forget.

**ii) Interest coverage ratio :**

The ratio measure the interest payment capital of HBL. It is computed by dividing net profit before interest and tan by interest cost amount .

$$\text{Interest coverage ratio} = \frac{\text{net(PBIT)}}{\text{Interest expenses}}$$

**Table No. 20 Calculation of interest coverage ratio**

(Rs in Lakh)

Fiscal year	Net(PEIT)	Interest expenses	Times
2062/063	7396	6488	1.14
2063/064	7891	7674	1.03
2064/065	10437	8237	1.27
2065/066	11733	9348	1.26
2066/067	8313	15535	.54

*Source : HBL, Annual Report 2062/063-066/067*

Interest coverage ratio over the study period (for 5 years) 0.54 to 1.27 times . Which is good for the HBL . Average of interest coverage ratio of 5 year is 1.05 times .

### C. Profitability ratio

It shows the overall efficiency of the organization .The relation of the return of firm to either its sales or its equity of its assets known as profitability .

$$\text{Return on Assets} = \frac{\text{Net profit after tax}}{\text{Total assets}} \times 100$$

$$\text{Return on capital} = \frac{\text{net profit after tax}}{\text{total capital fund}} \times 100$$

**Table No.21 Calculation of profitability ratio**

(Rs in Lakh)

F/Y	Net profit after tax	Total asset	Return on assets	Total capital fund	Return on capital
2062/063	4575	294604	1.55%	22428	20.40%
2063/064	4918	335191	1.47%	26514	18.55%
2064/065	6359	361755	1.76%	32535	19.55%
2065/066	7528	393209	1.92%	38452	19.58%
2066/067	5088	427171	1.19%	42184	12.06%

Source : HBL, Annual Report 2062/063-066/067

The above table shows that the result of return on assets and return on capital fund of HBL, Return on assets is satisfactory and return on capital is very good because average rate of return on capital fund is 18.03%. It indicates the higher overall efficiency of the bank and optimum utilization of total available resource.



## 4.9 Cash flow statement

For the period July16, 2009 to July 15, 2010 (Shrawan1, 2066 to Ashad 31, 2067)

Previous Year (Rs)	Particular	Current Year (Rs)
978388741	<b>A. Cash Flow from operating activities</b>	<b>1,158,165,935</b>
2,909,793,503	<b>1. Cash received</b>	<b>3,725,806,343</b>
2,324,173,095	1.1 Interest Income	3,156,864,066
284,302,277	1.2 Commission & Discount Income	270,258,732
249,982,606	1.3 Income from foreign exchange & Transaction	180-,278,743
4,992,653	1.4 Recovery of loan written off	6,058,377
46,342,872	1.5 Other Income	112,346,425
(1,931,404,763)	<b>2. Cash Payment</b>	<b>(2,257,640,408)</b>
(832,463,329)	2.1 Interest expenses	(1,418,373,200)
(345,418,184)	2.2 Staff expenses	(401,203,232)
(305,661,329)	2.3 Office Overhead expenses	(366,232,241)
(352,978,035)	2.4 Income Tax Paid	(245,171,136)
(94,883,886)	2.5 Other expenses	(106,660,599)
(3,255,079,634)	Cash Flow before changes in working capital	(291,939,156)
(6,057,661,056)	(Increase)/Decrease in current Assets	(3,407,394,497)
(652,264,150)	1. (Increase)/Decrease in money at call and short note	861,953,650
-	2.(Increase)/Decrease in short term investment	(197,305,000)
(5,378,904,089)	3.(Increase)/Decrease in loan & Bills purchase	(3,647,325,111)
(26,492,817)	4. (Increase )/Decrease in other assets	424,418,063
2,802,581,422	(Increase/Decrease) in current liabilities	3,115,455,341
2,838,555,823	1. Increase /Decrease in Deposit	2,928,895,411
-	2. Increase /Decrease in certificate of Deposits	-
(83,177,973)	3. Increase /Decrease in short term borrowing	184,311,488

47,203,572	4.Increase /Decrease in other liabilities	2,248,442
4,385,907,130	<b>B. Cash flow from Investment activities</b>	<b>296,685,024</b>
(4,629,311,020)	1. (Increase /Decrease) in long term investment	1,168,469,288
(273,114,148)	2.(Increase /Decrease) in fixed Assets	(224,388,290)
19,719,773	3. Interest income from long term investment	23,166,496
3,442,800	4. Dividend income	6,996,002
6,547,685	5. Others	(677,558,472)
(508,832,339)	<b>C. Cash flow from financing activities</b>	<b>(344,947,907)</b>
(261,907,174)	1. Increase /Decrease in long term borrowing (Bond, Debentures etc)	(198,248,497)
-	2.Increase /Decrease in share capital	-
(246,925,165)	3.Increase /Decrease in other liabilities	(146,699,410)
-	4. Increase /Decrease in Refinance/Facilities received from NRB)	-
-	D. Income/Loss from changes in exchange rate in cash and Bank Balances	-
1600383897	E. Current Year's cash flow from all activities	817963896
1441142891	F. Opening Balance of Cash and Bank Balance Balance	3048526788
3048526788	G. Closing Balance of cash and Bank Balance	3866490684

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**Computation of ratio of deposit with total resource mobilization  
(collection)**

**Appendix-1**

<b>Fiscal Year</b>	<b>Ratio of deposit &amp; total resource mobilization</b>	<b>Percentage</b>
2062/063	$\frac{264909}{306191} \times 100\%$	86.65%
2063/064	$\frac{300485}{351257} \times 100\%$	85.55%
2064/065	$\frac{318428}{380307} \times 100\%$	83.73%
2065/066	$\frac{346823}{417477} \times 100\%$	83.08%
2066/067	$\frac{376112}{445299} \times 100\%$	84.46%

$$5 \text{ years average ratio} = \frac{\text{sum of ratios}}{5}$$

$$= \frac{86.65 + 85.55 + 83.73 + 83.08 + 84.46}{5}$$

$$= 84.69\%$$

Computation of Mean , standard deviation, co-efficient of variation and correlation co-efficient of budget and actual figure.

Appendix -2

Fiscal year	Budgeted deposit in Rs	Actual deposit in Rs	$X - \bar{X}$ = U X-316	$Y - \bar{Y}$ = V Y-321	$U^2$	$V^2$	UV
2062/063	280	265	-36	-56	1296	3186	2032
2063/064	305	300	-11	-21	121	435	230
2064/065	315	318	-1	-3	1	9	3
2065/066	330	347	14	26	196	649	357
2066/067	350	376	34	55	1156	2999	1862
Total	1580	1606	0	0	2770	7278	4484

Budgeted deposit is Assumed 'X'

Actual deposit is assumed 'Y'

i) Calculation of mean

for Budgeted deposit,

$$\text{Mean } (\bar{X}) = \frac{\sum X}{N} = \frac{1580}{5} = 316$$

ii) Calculation of standard deviation,

For budgeted (X)

$$\begin{aligned} \text{S.D.}(\sigma) &= \sqrt{\frac{1}{N} \sum (X - \bar{X})^2} \\ &= \sqrt{(1/5) \times 2770} \end{aligned}$$

$$= 23.54$$

$$\sigma_{x=Rs} 23.54$$

For actual deposit (Y)

$$\text{S.D.}(\sigma) = \sqrt{\frac{1}{N} \sum (Y - \bar{Y})^2}$$

$$\begin{aligned} &= \sqrt{\frac{1}{5} \times 7278} \\ &= 38.15 \end{aligned}$$

$$\sigma_y = \text{Rs.} 38.15$$

iii) Calculation of co-efficient of variance

For Budgeted deposit,

$$\begin{aligned} \text{C.v 'X'} &= \frac{\sigma_x}{\bar{X}} \times 100 \\ &= \frac{23.54}{316} \\ &= 0.0745 \end{aligned}$$

For Actual deposit,

$$\begin{aligned} \text{C.v 'Y'} &= \frac{\sigma_y}{\bar{Y}} \times 100 \\ &= \frac{38.15}{321.35} \\ &= 0.1187 \end{aligned}$$

iv) Calculation of Karl Pearson's correlation co-efficient (r) between X & Y.

$$\begin{aligned} r_{xy} &= \frac{\sum UV}{\sqrt{\sum U^2 \cdot \sum V^2}} \\ &= \frac{4484}{\sqrt{2770 \times 7278}} \\ &= 0.9985 \end{aligned}$$

Calculation of Mean standard deviation, co-efficient of variation & correlation co-efficient of budgeted and actual LAO.

Appendix -3

F/y	Budgeted LAO(X)	Actual LAO(Y)	$X - \bar{X} = U$	$Y - \bar{Y} = V$	$U^2$	$V^2$	UV
2062/063	135	146.43	-65.	-61.4	4251.04	3769.73	4003.16

			2	0			
2063/06 4	165.5	169.98	- 34. 7	- 37.8 4	1204.0 9	1432.15	1313.18
2064/06 5	200	194.98	-0.2	- 12.8 5	0.04	165.08	2.57
2065/06 6	325	247.93	34. 8	40.1 1	1211.0 4	1608.64	1395.75
2066/06 7	265.5	279.81	65. 3	71.9 8	4264.0 9	5181.49	4700.46
total	1001	1039.13	0	0	10930. 3	12157.0 9	11415.1 2

- i) Calculation of Arithmetic mean.  
For budgeted LAO

$$\bar{X} = \frac{\sum X}{N} = \frac{1001}{5} = 200.2$$

For Actual LAO

$$\bar{Y} = \frac{\sum Y}{N} = \frac{1039.13}{5} = 207.82$$

- ii) Calculation of standard deviation.  
For budgeted LAO (X)

$$\begin{aligned} \text{S.D.}(\sigma) &= \sqrt{\frac{1}{N} \sum (X - \bar{X})^2} \\ &= \sqrt{\frac{1}{5} \times 10930.3} \\ &= 46.76 \end{aligned}$$

$$\sigma_X = \text{Rs.}46.76$$

For Actual LAO (Y)



$$\begin{aligned} \text{S.D.}(\sigma) &= \sqrt{\frac{1}{N} \sum (Y - \bar{Y})^2} = \sqrt{\frac{1}{5} \times 12157.09} \\ &= 49.31 \end{aligned}$$

$$\sigma_Y = \text{Rs.} 49.31$$

iii) Calculation of coefficient of variation

For budgeted LAO (X)

$$\begin{aligned} \text{C.V.}(X) &= \frac{\sigma_X}{\bar{X}} \times 100 \\ &= \frac{46.76}{200.2} \times 100 \\ &= 23.35 \% \end{aligned}$$

For Actual LAO (Y)

$$\begin{aligned} \text{C.V.}(Y) &= \frac{\sigma_Y}{\bar{Y}} \times 100 \\ &= \frac{49.31}{207.82} \times 100 \\ &= 23.73\% \end{aligned}$$

iv) Calculation of Karl Pearson's correlation coefficient correlation between X&Y .

$$r_{XY} = \frac{\sum XY}{\sqrt{\sum U^2 \cdot \sum V^2}}$$

$$= \frac{11415.12}{\sqrt{10930.3 \times 12157.09}}$$

$$\begin{aligned} &= \frac{11415.12}{11527.39} \\ &= 0.99 \end{aligned}$$

$$\therefore r_{XY} = 0.99$$

Calculation of Mean standard deviation, co-efficient of variation & correlation co-efficient of budgeted and actual LAO.

Appendix -4

F/y	Total LAO(X)	Interest income (Y)	$X - \bar{X}$ =U	$Y - \bar{Y}$ =V	$U^2$	$V^2$	UV
2062/063	146.43	16.27	-61.40	-5.45	3769.96	29.70	334.63
2063/064	169.98	17.76	-37.85	-3.96	1432.62	15.68	149.85
2064/065	194.98	19.64	-12.85	-2.08	165.12	4.33	26.73
2065/066	247.93	23.42	40.1	1.7	1608.01	2.89	68.17
2066/067	279.81	31.49	71.98	9.77	5181.12	95.45	703.25
N=5	1039.13	108.58	0	0	12156.83	148.05	1282.62

i) Calculation of Mean

For total LAO

$$\bar{X} = \frac{\sum X}{N} = \frac{1039.13}{5} = 207.83$$

For interest income

$$\bar{Y} = \frac{\sum Y}{N} = \frac{108.58}{5} = 21.72$$

ii) Calculation of standard deviation.

For total LAO (X)

$$\begin{aligned} \sigma_X &= \sqrt{\frac{1}{N} \times (X - \bar{X})^2} \\ &= \sqrt{\frac{1}{5} \times 12156.83} \\ &= 49.30 \end{aligned}$$

For Interest income

$$\sigma_Y = \sqrt{\frac{1}{N} \times (Y - \bar{Y})^2}$$

$$= \sqrt{\frac{1}{5} \times 148.05}$$

$$= 5.44$$

- iii) Calculation of co-efficient of variation .  
For Total LAO

$$\text{C.V } x = \frac{\sigma_x}{\bar{x}} \times 100$$

$$= \frac{49.30}{207.83} \times 100$$

$$= 23.72\%$$

For interest income

$$\text{C.V } y = \frac{\sigma_y}{\bar{y}} \times 100$$

$$= \frac{5.44}{21.72} \times 100$$

$$= 25.05\%$$

- iv) Calculation of correlation co-efficient .

$$r_{xy} = \frac{\sum UV}{\sqrt{\sum U^2 V^2}}$$

$$= \frac{1282.62}{\sqrt{12156.83 \times 148.05}}$$

$$= \frac{1282.62}{1341.57}$$

$$= 0.9561$$

Calculation of Mean standard deviation, co-efficient of variation & correlation co-efficient of budgeted and actual LAO.

Appendix -5

F/y	Total Deposit (X)	Interest Expenses (Y)	$X - \bar{X}$ =U	$Y - \bar{Y}$ =V	$U^2$	$V^2$	UV
2062/063	264.91	6.49	-56.44	-2.97	3185.47	8.82	167.63
2063/064	300.48	7.67	-20.87	-1.79	435.56	3.20	37.36
2064/065	318.43	8.24	-2.92	-1.22	8.53	1.49	3.56
2065/066	346.82	9.35	25.47	-0.11	648.72	0.01	-2.80
2066/067	376.11	15.54	54.76	6.08	2998.66	36.97	332.94
total	1606.75	47.29	0	0	7276.94	50.49	538.67

i) Calculation of arithmetic mean

For Total Deposit (X)

$$\bar{X} = \frac{\sum X}{N} = \frac{1606.75}{5} = 321.35$$

For Interest expenses

$$\bar{Y} = \frac{\sum Y}{N} = \frac{47.29}{5} = 9.46$$

ii) Calculation of standard deviation

For Total deposit ( $\sigma_X$ )

$$\begin{aligned} \sigma_X &= \sqrt{\frac{1}{N} \sum (X - \bar{X})^2} \\ &= \sqrt{\frac{1}{5} \times 7276.94} \\ &= 38.15 \end{aligned}$$

For Interest expenses

$$\begin{aligned}\sigma_Y &= \sqrt{\frac{1}{N} \sum (Y - \bar{Y})^2} \\ &= \sqrt{\frac{1}{5} \times 50.49} \\ &= 3.18\end{aligned}$$

iii) Calculation of co-efficient of variation

For total deposit

$$\begin{aligned}\text{C.V } x &= \frac{\sigma_X}{\bar{X}} \times 100 \\ &= \frac{38.15}{321.35} \times 100 \\ &= 11.87\%\end{aligned}$$

For Interest expenses

$$\begin{aligned}\text{C.V } y &= \frac{\sigma_Y}{\bar{Y}} \times 100 \\ &= \frac{3.18}{9.46} \times 100 \\ &= 33.62\%\end{aligned}$$

iv) Calculation of correlation coefficient

$$\begin{aligned}r_{XY} &= \frac{\sum UV}{\sqrt{\sum U^2 \sum V^2}} \\ &= \frac{538.67}{\sqrt{7276.94 \times 50.49}}\end{aligned}$$

$$\begin{aligned}&= \frac{538.67}{606.12} \\ &= 88.87 \%\end{aligned}$$