

**EFFECTS OF INTEREST RATE ON FINANCIAL
PERFORMANCE OF COMMERCIAL
BANKS IN NEPAL**

By:

Rosha Shrestha

**Makawanpur Multiple Campus,
Hetauda**

T.U. Regd. No: 7-2-242-81-2001

A Thesis

Submitted to:

**Office of the Dean
Faculty of Management
Tribhuvan University
Kathmandu, Nepal**

**In the partial fulfillment of the requirements for the
Master's Degree in Business Studies (MBS)**

December, 2010

RECOMMENDATION

This is to certify that the thesis

Submitted by

Rosha Shrestha

Entitled

**EFFECTS OF INTEREST RATE ON FINANCIAL
PERFORMANCE OF COMMERCIAL
BANKS IN NEPAL**

has been prepared as approved by this department in the prescribed format of the faculty of management. This thesis is forwarded for evaluation.

.....
Mr. Vijay K. Sharma
Chairman of Research Committee

.....
Mr. Bachchu Ram Adhikari
Campus Chief

.....
Mr. Uddhab Pd. Sapkota
Thesis Supervisor

Date :

VIVA-VOCE SHEET

**We have conducted the Viva-Voce Examination of the
Thesis Presented**

**By
Roshia Shrestha**

**Entitled
EFFECTS OF INTEREST RATE ON FINANCIAL
PERFORMANCE OF COMMERCIAL
BANKS IN NEPAL**

and found the thesis to be the original work of the student and written according to the prescribed format. We recommended the thesis to be accepted as partial fulfillment of the requirement for

Master's Degree in Business Studies (MBS)

VIVA-VOCE COMMITTEE

Chairperson, Research Committee:

Member (Thesis Supervisor):

Member (External Expert):

Date :

DECLARATION

I hereby declare that the work reported in this thesis in titled **Effects of Interest Rate on Financial Performance of Commercial Banks in Nepal** submitted to office of the Dean faculty of management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master Degree in Business Studies under the supervision of Mr. Uddhab Pd. Sapkota, Lecturer of Makwanpur Multiple Campus, Hetauda, Makwanpur.

December, 2010

.....
Rosha Shrestha
Hetauda, Makawanpur

ACKNOWLEDGEMENT

It is an immense pleasure and of the same time great honor to accomplish this thesis work under the kind supervision of **Mr. Uddhab Pd. Sapkota, the lecturer of Makwanpur Multiple Campus, Hetauda**. I am immensely grateful for their impartial and intellectual direction supervision and inspiration of this thesis work. I must admit, it would not have been possible for me to complete this thesis work without their guidance.

I would like to extend my honest thanks to **Mr. Bachhu Ram Adhikari, Campus Chief, Mr. Bishnu Pd. Dahal, Department Head, staffs of Administration Department and Library of Makwanpur Multiple Campus** for providing me all necessary help to complete this thesis. Thanks are also due to Tribhuvan University for providing opportunity to conduct this research and manager of five banks i.e. NABIL, NIBL, SCBNL, NSBIBL and HBL for providing necessary data and information without which the completion of dissertation could be impossible.

Finally, I would like to thanks to Computer Science Education Center, Hetauda for typing, setting and designing of this thesis.

Last but not the least, I would like to pay my gratitude to my beloved family the most important persons who helped me a lot directly and indirectly to complete this study.

December, 2010

.....

Rosha Shrestha
Makawanpur Multiple Campus
Hetauda, Makawanpur

TABLE OF CONTENTS

RECOMMENDATION	II
VIVA VOCE SHEET	III
DECLARATION	IV
ACKNOWLEDGEMENT	V
TABLE OF CONTENTS	VI
LIST OF TABLES	IX
LIST OF FIGURES	XI
ABBREVIATION	XIII
CHAPTER - ONE: INTRODUCTION	1
1.1 General Background of the Study	1
1.1.1 Functions and Performances of Commercial Banks	3
1.1.2 History of Interest Rate in Nepal	5
1.1.3 Brief Profile of Sample	6
1.2 Focus of the Study	9
1.3 Statement of the Problems	9
1.4 Objectives of the Study	10
1.5 Research Questions	11
1.6 Research Hypothesis	11
1.7 Significance of the Study	12
1.8 Limitation of the Study	13
1.9 Organization of the Study	13
CHAPTER - TWO: REVIEW OF LITERATURE	14
2.1 Conceptual and Theoretical Review	14
2.1.1 Meaning of Interest	14
2.1.2 Meaning of Interest	15
2.1.3 Importance Functions of Interest Rate	15
2.1.4 Theories of Interest Rate	16
2.1.4.1 Classical Theory of Interest Rates	16
2.1.4.2 Liquidity Preference or Theory of Interest Rates	20
2.1.4.3 Loanable Funds Theory of Interest Rate	23

2.1.4.4	The Rational Expectations Theory	26
2.1.5	Determinants of Market Interest Rate	28
2.1.6	Factors Affecting the Interest Rate	30
2.1.6.1	Economic factors that affect interest rates	31
2.1.6.2	Risk and cost factors affecting interest rate	33
2.1.7	Interest Rate and its Linkage on Bank's Performance	35
2.2	Review of Relevant Studies	38
2.2.1	Review of Unpublished Thesis	38
2.2.2	Review of Articles	40
2.2.3	Review of Research Paper	41
2.2.4	Research Gap	41
 CHAPTER - THREE: RESEARCH METHODOLOGY		 43
3.1	Research Design	43
3.2	Population and Sample of the study	43
3.3	Sources of Data and Collection	45
3.4	Data Processing and Presentation Techniques	45
3.5	Necessary Tools and Techniques	45
3.5.1	Financial Tools and Techniques	45
3.5.2	Statistical Tools and Techniques	49
3.5.3	Variables	51
 CHAPTER - FOUR: DATA PRESENTATION AND ANALYSIS		 52
4.1	Majors Qualitative Factors in Determining Interest Rate	52
4.2	Presentation and Analysis of Secondary Data	54
4.2.1	Interest Rate Structure of Nepalese Commercial Banks	54
4.2.1.1	Interest Rate Structure of NABIL	54
4.2.1.2	Interest Rate Structure of NIBL	58
4.2.1.3	Interest Rate Structure of SCBNL	60
4.2.1.4	Interest Rate Structure of HBL	63
4.2.1.5	Interest Rate Structure of NSBIBL	66
4.2.2	The Relationship of Interest Rate with Deposit, Loan and Advance and Investment of Nepalese Commercial Banks	69

4.2.3	Analysis the Effect of Interest Rate on Deposit Mobilization of Nepalese Commercial Bank	82
4.2.4	Effect of Change in Interest Rate on Net Profit of Nepalese Commercial Banks	91
4.3	Presentation and Analysis of Primary Data	102
4.3.1	Suitability of Interest Rate Determining Process in Nepalese Commercial Banks	102
4.3.2	Trend Line of Interest Rate Structure of Nepalese Commercial Bank	104
4.3.3	Relationship of Interest Rate with Deposit Collection	105
4.3.4	Relationship of Interest Rate with Bank Investment	106
4.3.5	Relationship of Interest Rate with Loan and Advance	107
4.3.6	Impact of Interest Rate on Fund Management of Commercial Banks	108
4.3.7	Role of Interest Rate in Success of Commercial Banks	109
4.3.8	Effect of Interest Rate on Deposit, Loan and Advances and Investment of Commercial Banks	110
4.3.9	Effect of Interest Rate on Net Profit of Commercial Banks	111
4.3.10	Interest Rates Send a Price Signal to Depositor, Lenders, Investors and Borrowers	112
4.4	Major Findings of the Study	113
4.4.1	Findings from Secondary Data	113
4.4.2	Findings from Primary Data	115

CHAPTER - FIVE: SUMMARY, CONCLUSION AND

RECOMMENDATION 117

5.1	Summary	117
5.2	Conclusion	119
5.3	Recommendations	123

BIBLIOGRAPHY

APPENDIX I-IV

LIST OF TABLES

Table No.	Title	Page No.
Table No. 4.1	Interest Rate Structure on Deposit of NABIL As on Mid-July	55
Table No. 4.2	Interest Rate Structure on Loans and Advances of NABIL As on Mid-July	56
Table No. 4.3	Interest Rate Structure on Investment of Nepalese Commercial Banks as on Mid July	57
Table No. 4.4	Interest Rate Structure on Deposit of NIBL As on Mid July	58
Table No. 4.5	Interest Rate Structure on Loans and Advances of NABIL as on Mid July	59
Table No. 4.6	Interest Rate Structure on Deposit of SCBNL as on Mid July	61
Table No. 4.7	Interest Rate Structure on Loans & Advances of SCBNL as on Mid July	62
Table No. 4.8	Interest Rate Structure on Deposit of HBL as on Mid July	64
Table No. 4.9	Interest Rate Structure on Loan & Advances of HBL as on Mid July	65
Table No. 4.10	Interest Rate Structure on Deposit of NSBIBL as on Mid July	67
Table No. 4.11	Interest Rate Structure on Loans and Advances of NSBIBL as on Mid July	68
Table No. 4.12	Correlation Coefficient, Coefficient of Determinations and t-Statistics of NABIL	70
Table No. 4.13	Correlation Coefficient, Coefficient of Determinations and t-Statistics of NIBL	73
Table No. 4.14	Correlation Coefficient, Coefficient of Determinations and t-Statistics of SCBNL	75
Table No. 4.15	Correlation Coefficient, Coefficient of Determinations and t-Statistics of HBL	77
Table No. 4.16	Correlation Coefficient, Coefficient of Determinations and t-Statistics of NSBIBL	80
Table No. 4.17	Interest Rate and Funds Management Ratio of NABIL	83
Table No. 4.18	Interest Rate and Funds Management Ratio of NIBL	85
Table No. 4.19	Interest Rate and Funds Management Ratio of SCBNL	87

Table No. 4.20 Interest Rate and Funds Management Ratio of HBL	88
Table No. 4.21 Interest Rate and Funds Management Ratio of NSBIBL	90
Table No. 4.22 Change in Interest Rate and Net Profit of NABIL	92
Table No. 4.23 Change in Interest Rate and Net Profit of NIBL	93
Table No. 4.24 Change in Interest Rate and Net Profit of SCBNL	94
Table No. 4.25 Change in Interest Rate and Net Profit of HBL	94
Table No. 4.26 Change in Interest Rate and Net Profit of NSBIBL	95
Table No. 4.27 Profitability Ratio of NABIL	96
Table No. 4.28 Profitability Ratio of NIBL	97
Table No. 4.29 Profitability Ratio of SCBNL	99
Table No. 4.30 Profitability Ratio of HBL	100
Table No. 4.31 Profitability Ratio of NSBIBL	101
Table No. 4.32 Suitable of Interest Rate Determining Process	103
Table No. 4.33 Interest Rate Structure of Nepalese Commercial Banks	104
Table No. 4.34 Relationship between Interest Rate and Deposit	105
Table No. 4.35 Relationship between Interest Rate and Bank Investment	106
Table No. 4.36 Relationship between Interest Rate and Loan and Advances	107
Table No. 4.37 Impact of Interest Rate on Fund Management	108
Table No. 4.38 Role of Interest Rate in Success of Commercial Banks	109
Table No. 4.39 Effect of Interest Rate on Deposit, Lon and Advances and Investment	110
Table No. 4.40 Effect of Interest Rate on Net Profit	111
Table No. 4.41 Interest Rates Send a Price Signal	112

LIST OF FIGURES

Figure No.	Title	Page No.
Figure No. 1.1	Primary Function of Commercial Bank	3
Figure No. 2.1	The Substitution Effect Relating Saving & interest Rate	18
Figure No. 2.2	The investment Demand Schedule	19
Figure No. 2.3	The Equilibrium interest Rate in Classical Theory of interest Rate	20
Figure No. 2.4	The Total Demand for Money	21
Figure No. 2.5	The Supply of Money in Liquidity Preference Theory	22
Figure No. 2.6	The Equilibrium Rate of Interest in the Liquidity Preference Theory	22
Figure No. 2.7	The Demand for Loanable Fund	24
Figure No. 2.8	The Supply of Loanable Funds (Credit)	25
Figure No. 2.9	The Equilibrium Rate of Interest in Loanable Fund Theory	26
Figure No. 2.10	The Expected Demand for and Supply of Loanable Funds under the Rational Expectation Theory.	27
Figure No. 4.1	Interest Rate Structure of NABIL	57
Figure No. 4.2	Interest Rate Structure of NIBL	60
Figure No. 4.3	Interest Rate Structure of SCBNL	63
Figure No. 4.4	Interest Rate Structure of HBL	66
Figure No. 4.5	Interest Rate Structure of NSBIBL	69
Figure No. 4.6	Deposit Collection and Mobilization of NABIL	72
Figure No. 4.7	Deposit Collection and Mobilization of NIBL	74
Figure No. 4.8	Deposit Collection and Mobilization of SCBNL	77
Figure No. 4.9	Deposit Collection and Mobilization of HBL	79
Figure No. 4.10	Deposit Collection and Mobilization of NSBIBL	82
Figure No. 4.11	Funds Management Ratio of NABIL	84
Figure No. 4.12	Funds Management Ratio of NIBL	86
Figure No. 4.13	Funds Management Ratio of SCBNL	88
Figure No. 4.14	Funds Management Ratio of HBL	89
Figure No. 4.15	Funds Management Ratio of NSBIBL	91
Figure No. 4.16	Profitability Ratio of NABIL	97
Figure No. 4.17	Profitability Ratio NIBL	98
Figure No. 4.18	Profitability Ratio of SCBNL	99

Figure No. 4.19 Profitability Analysis of HBL	100
Figure No. 4.20 Profitability Ratio of NSBIBL	102
Figure No. 4.21 Suitability of Interest Rate Determining Process	103
Figure No. 4.22 Interest Rate Structure of Nepalese Commercial Banks	104
Figure No. 4.23 Relationship between Interest Rate and Deposit	105
Figure No. 4.24 Relationship between Interest Rate and Bank Investment	106
Figure No. 4.25 Relationship between Interest Rate and Loan and Advances	107
Figure No. 4.26 Impact of Interest Rate on Fund Management	108
Figure No. 4.27 Role of Interest Rate in Success of Commercial Banks	109
Figure No. 4.28 Effect of Interest Rate on Deposit, Loan and Advances and Investment	110
Figure No. 4.29 Effect of Interest Rate on Net Profit	111
Figure No. 4.30 Interest Rates Send a Price Signal	113

ABBREVIATIONS

A.D.	=	Anno Domini
B.S.	=	Bikram Sambat
CBS	=	Central Bureau of Statistics
F/Y	=	Fiscal year
GDP	=	Gross Domestic Production
etc.	=	Etcetera
d.f.	=	Degree of Freedom
HBL	=	Himalayan Bank Limited
i.e.	=	That is
Ltd.	=	Limited
NABIL	=	Nabil Bank Limited
NIBL	=	Nepal Investment Bank Limited
NRB	=	Nepal Rastra Bank
NSBIBL	=	Nepal SBI Bank Limited
OBS	=	On the balance sheet
OTC	=	Over the Counter
Rs.	=	Rupees
SCBNL	=	Standard Chartered Bank Nepal Limited
TUCL	=	Tribhuvan University Central Library
U.S.	=	United State
U.S.A.	=	United State of America
viz.	=	Videlicet (Namely)
&	=	And
	=	Therefore