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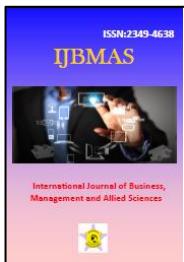
A STUDY OF OPERATIONAL PERFORMANCE OF NEPALESE COMMERCIAL BANKS

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ABSTRACT

The Nepalese financial system consists of different types of banks and financial institutions which are responsible for the development of the country's economy. Commercial banks are the major financial institutions which play an important role in the mobilization and allocation of resources in an economy. The performance of the financial sector in a larger prospective affects the growth of the economy. The financial sector reform program initiated in Nepal since 1980's have very strong far reaching impact in the development of banking sector and economy. This paper attempts to study the working and operational performance of the Nepalese commercial banks from period 2009 and 2015. The indicators selected for study are aggregate deposits mobilized by commercial banks, credits and investments made by the commercial banks, credit-deposits ratios, investment-deposits ratios, and the share of Commercial Banks in the Priority Sector Lending. This study concludes commercial banks of Nepal have been significantly performing satisfactory and contributing to the national growth of the country.

Keywords: Commercial banks, Aggregate Deposits, Credit-Deposits Ratios, Investment-Deposits Ratios, Priority sector lending, Nepal Rastra Bank (NRB), etc.

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1. Introduction

The Nepalese financial system comprises a vast network of banks and financial institutions. The banking sector is the core segment in deciding the progress of the entire economy of the country. The activities of a modern economy are significantly influenced by the functions and services of banks and became an indispensable part of socio-economic life of the people. The banking sector has also become an important segment of Nepalese economy for money market dynamics. Financial sector controlled and managed by banking industry works as a source for generating money supply. The commercial banks play a dominant role in the economic development of the country. The rapid growth in the various sectors of the economy can be brought through efficient, effective, disciplined banking system. The banking sector in Nepal has played a pivotal role in the Nepalese economy. Financial institutions in Nepal can broadly be classified into banking and non-banking institutions. Banking institutions are of different types; commercial banks, development banks,

finance companies, micro-finance banks, and cooperatives. Most active sector of the Nepalese money market is the commercial banking sector. Non-banking institutions are also of different types; employee provident fund, insurance board, securities and exchange board of Nepal.

This study is intended to analyze the working and operation of commercial banks. The indicators selected to study are Aggregate Deposits mobilized by commercial banks, credits and investments made by the commercial banks, credit-deposits ratios, investment-deposits ratios, and the share of commercial banks in the priority sector lending. This study covers the working performance of entire commercial banks which are operating in the country. The period of the study is seven years spanning from 2009 to 2015.

1.1 Overview of Nepalese Commercial Banks

1.1.1 Commercial Bank and its structure: Commercial banks are the oldest banks in Nepal. The history of commercial banking started in Nepal with the establishment of Nepal Bank Limited in 1937 A.D., the oldest bank of the country, which was established even before establishment of Nepal Rastra Bank, central bank of the country. Commercial banks established in Nepal can be categorized as public sector banks, private sector banks and foreign joint venture banks. The commercial banks are established as public limited company. At present, there are 29 commercial banks in Nepal.

1.1.2 Banking Sector Reforms in Nepal: Financial sector reform program was started in Nepal in mid 1980's.

The reform process was done on phase basis and first phase (1984-1990), second phase (1991-1998), and third phase (1999 – March 2004) has been concluded. In phase first, the financial sector of the country was opened for foreign investors. As a result, many banks were opened in Nepal with foreign investment. Examples of these banks include Nabil Bank, Nepal Indosuez Bank, Nepal Grindlays Bank, etc. Furthermore, central bank allowed commercial banks to fix interest rates on deposits and lending on their own which has a very far reaching impact in development of financial system of the country.

In second phase, after the restoration of democracy in 1990, the government comes up with more liberal economic and financial sector reform programs. As a result, the number of financial institutions increased dramatically. Very important institutions like Insurance board, Nepal Stock Exchange, Credit Information Bureau, Deposit Insurance and Credit Guarantee Corporation, etc. were established. The establishment of so many financial institutions has not only helped in competition of deposit and credit services of banks, but also helped in the development of capital market by listing of shares.

The third phase of the financial sector reform program was focused on providing more autonomy to Nepal Rastra Bank, Central bank of Nepal, so that it can effectively and efficiently supervise the financial institutions and transactions. Some major acts to regularize the financial sector were enacted as Nepal Rastra Bank Act, 2002, the Debt Recovery Act, 2002 and the Banking and Financial Institution Ordinance, 2004. The Public Debt Act and the Foreign Exchange Regulation Act were amended in 2002. Due to liberal policy adopted by NRB on bank establishment, there are 241 bank and financial institutions as of mid-July 2015. The increment of BFI's has brought several challenges and problems related to corporate governance, monitoring, etc. Several financial institutions have become problematic as supervision has become challenging task for NRB due to large number of banks. In order to reduce the number of BFI's, merger bylaws were first introduced in 2011 by Nepal Rastra Bank. In the beginning, merger bylaws failed to create immediate supervision, however later on, a large number of BFI's went on merger and many more are in process at present.

2. Review of Literature

Review of various literatures available on bank's operational performance reveals that operational performance is still a matter of debate. The performance of banks have become a major concern for policy makers since the economic development depend on how efficiently financial sector performs its intermediation function. With the increase in bank branches, the volume of deposit has increased which has forced banks to increase its credit and investment portfolios.

Thagunna & Poudel (2013) used data envelopment analysis to measure and analyze efficiency levels of banks in Nepal during 2007-08 and 2010-11. The study reveals that efficiency level is relatively stable and has increased overall. They found that both the ownership type and the asset size of a bank don't affect its efficiency.

Biwesh Neupane (2013) investigates the change in efficiency and productivity of banking industry during the period of 2007/08 to 2011/12 and analyzes the effects of various indicators on the efficiency of the twenty two commercial banks in Nepal. The results show that the productivity change of commercial banks in Nepal has improved over the sample period and that the increase in productivity change in Nepalese commercial banks is due to the technical progress rather than efficiency components. It also reports that the decline in efficiency change is due to decline in both pure efficiency change and scale efficiency change. Further, profitable banks with lower leverage and higher capital adequacy ratio are found to be more efficient and bank loans seem to be more highly valued than alternative bank outputs i.e., investments and securities.

Suvita Jha and Xiaofeng Hui (2013) compare the financial performance of different ownership structured commercial banks in Nepal based on their financial characteristics and identify the determinants of performance exposed by the financial ratios, which were based on CAMEL Model. The results show that public sector banks are significantly less efficient than their counterpart are; however domestic private banks are equally efficient to foreign-owned (joint venture) banks. Furthermore, the estimation results reveal that return on assets was significantly influenced by capital adequacy ratio, interest expenses to total loan and net interest margin, while capital adequacy ratio had considerable effect on return on equity.

Indra Kumar Kattel (2014) evaluate the financial soundness of joint venture banks and private sector banks in Nepal by using bankometer model for the period covering 2007- 2012. The study has found that all the private and joint venture banks are in sound financial position. The finding of the study reveals that private sector banks are financially sounder in comparison to joint venture banks. The study concludes that bankometer model will help the bank's internal management to mitigate the insolvency risk within proper control and supervision at the operational level.

Karan S. Thagunna and Shashank Poudel (2013) measure and analyze the efficiency levels of banks in Nepal during 2007-08 to 2010-11. The study reveals that efficiency level is relatively stable and has increased on overall. Additionally, it also breaks down the overall efficiency of banks into technical and scale efficiency. This study found no significant relationship with efficiency level and ownership structure of banks and there were no notable differences in the efficiency levels of banks according to their asset size.

To sum up, there has been very little research on operational performance of Nepalese commercial banks with aggregate deposits, credits and investments made, and loans and advances made to priority sector lending. Hence, the study is of importance and relevant.

3. Research Methodology

The present study makes the use of secondary data. The relevant secondary data has been collected mainly through the data bases of Nepal Rastra Bank (NRB), various reports and other studies. The study attempts to examine the operational performance of the commercial banks in Nepal for a period of seven years. The study is confined only to the specific areas such as deposits mobilized by commercial banks, credits and investments made by commercial banks, credit-deposits ratios, investment-deposits ratios, share of commercial banks in priority sector lending, for the seven years period starting from the year 2009 to the year 2015. In order to analyze the data and draw conclusions in this study, various statistical tools like descriptive statistics, f-test and co-relation test has been done using through EXCEL and SPSS Software.

3. Analysis and Interpretation of Data

3.1 Aggregate Deposits of Commercial Banks

Deposits are the basic raw materials for banks. The deposits are the main source of credit mobilization of the banks. It is highly required by the banks to maintain the adequate level of deposits in the bank. The more deposit a bank has, the more the lending it will have. The aggregate deposits comprises of the demand deposits and time deposits.

Table No-1 reveals the aggregate deposits of the commercial banks with their growth rate, which has increased over the period of time. The aggregate deposits have increased from 111.94% to 143.30% through 2009 to 2015. Similarly in the case of Demand deposit the growth rate in the year 2009 was 102.01% which has increased to 154.42% in the year 2015. For time deposits also it has decreased from 141.62% in the year 2009 to 121.56% in the year 2015.

Table 1: Aggregate Deposits of Commercial Banks in Nepal (Rs. Million)

Year	Aggregate Deposits	Growth Rate (%)	Demand Deposits	Growth Rate (%)	Time Deposits	Growth Rate (%)
2009	563,604.40	-	422,345.00	-	141,259.40	-
2010	630,880.84	111.94	430,822.34	102.01	200,058.50	141.62
2011	687,597.89	122.00	434,011.49	102.76	253,586.40	179.52
2012	867,978.25	126.23	569,142.55	131.14	298,835.70	117.84
2013	1,020,830.81	148.46	675,418.81	155.62	345,412.00	136.21
2014	1,204,463.40	117.99	839,414.90	124.28	365,048.50	105.68
2015	1,462,896.12	143.30	1,043,013.12	154.42	419,883.00	121.56

Source: *Banking and Financial Statistics, Nepal Rastra Bank, Mid-July 2015, No.61*

Correlation test was performed in order to test whether demand deposits mobilization by commercial banks has a linear relationship with the time deposits mobilized by commercial banks. The result obtained is tabulated below:

Table 2: Test results of correlation

	Demand Deposits	Time Deposits
DD	1	
TD	0.910934	1

The mobilization of demand deposits and the time deposits of the Nepalese Commercial Banks have a very strong positive correlation. The linear correlation co-efficient is 0.910934 which is very close to +1. This means that as the demand deposits increase the time deposits are also increasing.

3.2 Credits Deployed and Investment made by Commercial Banks

One of the important functions of the commercial banks is credit creation. The investments made by the commercial banks are the window of deployment of funds. The credit creations of the commercial banks are done from its deposits. Investments of Commercial Banks in Nepal include only investments in government securities and other approved securities. Table No-3 reveals the credit deployed and investment made by the commercial banks over the period of time and their growth rate.

Table 3: Credits Deployed and Investments made by commercial banks (Rs. Million)

Data Period	Credit Deployed	Credit Growth Rate (%)	Investments Made	Investments Growth Rate (%)
2009	398,143.00	-	130,856.90	-
2010	469,279.84	117.87	134,041.09	102.43
2011	528,023.14	112.52	149,557.36	111.58
2012	622,575.49	117.91	181,272.66	121.21
2013	757,207.55	121.63	209,926.28	115.81
2014	891,629.91	117.75	226,365.31	107.83
2015	1,103,153.25	123.72	282,160.39	124.65

Source: *Banking and Financial Statistics, Nepal Rastra Bank, Mid-July 2015, No.61*

The data in table-3 reveals that the Nepalese Commercial Banks have been successful in performing the credit function. The credits which were Rs.398,143 million in 2009 have gone up to Rs. 1,103,153.25 million in 2015. It is an encouraging sign that higher percentages of increase have been recorded from the year 2009 to the year 2015. The increase over the period of the study was 2.77 times.

In table-3, it's shown that Nepalese Commercial Banks have been quite successful as far as investment is concerned. During the period under reference, the banks have been able to mark a rising trend in investment with Rs.130,856.90 million in the year 2009 to Rs. 282,160.39 million in 2015.

3.3 Credit-Deposit Ratio and Investment Deposit Ratio

The Credit Deposit Ratio of the bank indicates the creation of credit out of the deposits .Investment-Deposit Ratio is calculated by investments made by banks, divided by the aggregate deposits of the banks.

Table 4: Credit-Deposit Ratio and Investment Deposit Ratio

Data Period	Credit Deposit Ratios (%)	Investment Deposit Ratios (%)
2009	70.64	23.22
2010	74.38	21.25
2011	76.79	21.75
2012	71.73	20.88
2013	74.18	20.56
2014	74.03	18.79
2015	75.41	19.29

Table no-4 reveals the credit-deposit ratio in the year 2009 was 70.64%, which has an increasing trend over the period and in the year 2015, it was 75.41%. In case of investment-deposit ratio, the year 2009 recorded the highest i.e. 23.22%, then it declined to 19.29% in the year 2015%.

A F test two sample for variances was performed to determine whether the credit deposit ratio of the commercial banks significantly differs from the investment deposit ratio of the commercial banks in Nepal. The hypotheses framed are as follows:

H₀: There is no significant difference in performance between credit deposit ratio and the investment deposit ratio;

H₁: There is significant difference in performance between credit deposit ratio and the investment deposit ratio; The test results are given in Table-5.

Table-5.

	CDR	IDR
Mean	73.88	20.82
Variance	4.38	2.2238
No. of observation	7	7
Degrees of freedom (df)	6	6
F	1.9696	
F Critical	4.28	

The above table no-5 reveals the F-Test Two-Sample for Variances result of credit- deposits ratio and investment- deposits ratio. Looking at the data of F-value (1.9696) was smaller than the critical value of F (4.28) that leads to the conclusion that H₀ is not rejected; hence there is no significant difference in credit-deposit ratio and investment-deposit ratio of the scheduled commercial banks.

3.4 Share of Scheduled Commercial Banks in the Priority Sector Lending

The priority sector includes the agriculture, deprived and rural sector of the country. The Nepal Rastra Bank prescribed guidelines and targets to all the banks operating in Nepal regard to priority sector services. The table no-6 below reflects the advance to priority sectors in the total advances of commercial banks.

Table 6: Share of Scheduled Commercial Banks in the Priority Sector Lending (Rs. Million)

Data Period	Priority Sector Lending Share	Share of Priority Sector Lending Share to Total Loans and Advances
2009	13,565.07	2.56%
2010	16,728.89	2.77%
2011	19,345.75	2.86%
2012	21,353.2	2.66%
2013	31,668.94	3.27%
2014	40,621.39	3.63%
2015	49,415.66	3.57%

Source: *Banking and Financial Statistics, Nepal Rastra Bank*

From the above table no-6, it has been found that the Advances to Priority Sectors have an increasing trend over the period. It was Rs. 13,565.07 million in the year 2009 and it became Rs. 49,415.66 million in the year 2015. Lending in priority sector is very low in Nepal as shown in the above table.

4. Conclusions

The present study reflects that the significant growth in the aggregate deposits, demand deposits and the time deposits of the commercial banks. Moreover there is strong positive correlation between demand and time deposits of the commercial banks. The credit-deposit ratio had an increasing trend through the years. Moreover there is no significant difference in credit-deposit ratio and investment-deposit ratio of the commercial banks. The Advances to Priority Sectors also had an increasing trend over the period. The overall working and operational performance of the commercial banks of Nepal was satisfactory over the period and it is growing contributing to the national growth.

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