

**Reforms in the Activities of Commercial Banks in Nepal:  
An Overview**

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**1. INTRODUCTION**

The first commercial bank (Nepal Bank Ltd.) was established in 1937 followed by the second (Rastriya Banijya Bank) in 1966. In 1984, Nepal Arab Bank Ltd. came into existence in collaboration with a foreign bank and, at later dates, Nepal Indo-Suez Bank and Nepal Grindlays Bank were established on similar pattern. As on mid-July 1987, there were 409 commercial bank branches operating in the country. In addition, there were 34 branches of the Agricultural Development Bank performing commercial banking business. The average population per bank branch was 43,000, and if the Agricultural Development Bank branches performing commercial banking business were also taken into account, the figure would be 39,000. The target is 30,000 population per commercial bank branch by mid-July 1990. The numbers of branches of Nepal Bank Ltd. and Rastriya Banijya Bank form the bulk, viz. 213 and 190, respectively. Therefore, reforms in the activities of these institutions are all the more urgent.

The present study is confined to the following areas of commercial banking activities:

**Deposit Aspect**

- a. Reforms in the deposit procedures
- b. Reforms in the system of depositing amounts and making payments, and
- c. Suggestions regarding introduction of new deposit instruments.

**Credit Aspect**

- a. Reforms in gold and silver loans
- b. Reforms in pledge loans
- c. Reforms in hypothecation loans
- d. Reforms in documentary credit
- e. Reforms in large and medium-sized project loans, and
- f. Reforms in priority sector loans.

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### **Miscellaneous Aspect**

- a. Reforms in government transaction activities
- b. Introduction of management information system
- c. Reforms in personnel administration
- d. Improvements in physical facilities
- e. Introduction of planning
- f. Reforms in reporting system
- g. Reforms in fund management, and
- h. Reforms in reconciliation system.

## **2. DEPOSIT ASPECT**

### **2.1 Deposit Mobilization**

The total deposits with the commercial banks as at mid-July 1986 stood at Rs 10,315.4 million. The total deposits with the banks on mid-July 1957 were just Rs 34.6 million. Unification of the currency system, higher rates of interest, increased tendency on the part of the people to keep their assets in the financial form and the increased number of bank branches have been the more important factors responsible for the upsurge in bank deposits. The growth rate of deposits has outpaced the increase in the level of consumer prices. While the consumer price index increased from 100 to 361.7 during the period 1972/73 - 1985/86, the index of deposits went up from 100 to 1238.8 during the corresponding period. The ratio of current deposits to total deposits has come down from 67.1 per cent on mid-July 1957 to just 20.7 per cent on mid-July 1986. The ratio of current deposits to total deposits started to plummet more steeply after the hike in time deposit rates in April 1975. From one viewpoint, it is advantageous if the ratio of current deposits to total deposits remained high. But the commercial banks can not plan their credit operations on a reliable basis if they were to depend heavily on current deposits. So, another viewpoint is that commercial banks can plan their credit operations with reasonable self-assurance if they were to rely more on time deposits. Commercial banks should strive to strike a balance between the cheaper deposits in the form of current deposits and costly deposits in that of time deposits. The ratio of current to total deposits is far higher in the newly-established commercial banks than in the other commercial banks. As no interest is payable on current deposits, the choice of bank on the part of current account-holders is mainly determined by the quality of customer service.

The ratio of deposits to gross domestic product is an indicator of banking development. In 1974/75, the ratio of total deposits to gross domestic product stood at 7.08 per cent and that of time deposits to gross domestic product at 4.16 per cent. The ratio of total deposits to gross domestic product stood at 20.68 per cent and that of time deposits to gross domestic product at 15.87 per cent in 1985/86. The trend of higher growth of time deposits in comparison with current deposits can be cited as an example of contribution of the banking system towards the mobilization of savings. Banks can do a lot more in this regard. For example, in India the ratio of aggregate deposits to gross domestic product is 36.66 per cent and that of time deposits to gross domestic product 32.4 per cent.

In September 1985, deposits per bank employee amounted to Rs 649 thousand. In comparison, deposits per employee in New Bank of India were Rs 1717 thousand. There is thus strong need for introduction of modern work practices and on-going reforms in order to improve the per employee deposit figure to a satisfactory level.

Commercial banks are the repositories of the confidence of numerous depositors. A commercial bank that invites even the slightest doubt of the depositors invites troubles for itself. Therefore, improvement on measures to mobilize deposits by inspiring confidence in the new and existing customers of commercial banks should be a continuous process. Accordingly, the higher management of a commercial bank should inspire confidence in the mind of depositors.

The capital-deposit ratio is an important indicator to determine the position of a bank. It was time when in the USA capital-deposit ratio of 10 per cent was regarded as necessary. In India, the general notion that the capital-deposit ratio should be adequate has been widely accepted. The overall capital-deposit ratio in Nepal is 2.7 per cent. This ratio is high in respect of newly-opened banks, but low in that of other banks. Individual banks with inadequate capital-deposit ratio should stop distributing dividends until the ratio goes up to respectable levels. They should also take recourse to general capital increase by augmenting share capital.

Deposit insurance is another important measure to inspire confidence in banks and augment deposits. In the United States, deposits upto 100 thousand dollars are insured. In the Philippines, the coverage by deposit insurance is upto Peso 40,000. The comparable figure in India is Rs 30,000. In Nepal, it has not been possible to attract non-resident deposits partly because of the absence of deposit insurance. In view of these considerations, it is essential

to initiate deposit insurance scheme as early as possible. It was found that 20 per cent of the fixed deposits in two main Kathmandu branches of Nepal Bank Ltd. and Rastriya Banijya Bank was accounted for by deposits amounting upto Rs 50,000. Similarly, deposits upto Rs 40,000 accounted for 7.13 per cent of the total deposits in the main (Kantipath) branch of Nepal Arab Bank Ltd., Nepal Indo-Suez Bank and Nepal Grindlays Bank. Considering these factors, it is suggested that Rs 40,000 - 50,000 be fixed as the cut-off point for deposit insurance. In some countries such as India, central banks have opened subsidiaries to insure deposits. In other countries such as the United States, independent institutions have been established to perform this function. In Nepal, there is an organization called the Credit Guarantee Corporation. Its capital base should be strengthened if the business of deposit insurance were to be assigned to this institution. However, it is better if Nepal Rastra Bank and commercial banks acted in unison and established a separate deposit insurance corporation. The premia on deposit insurance should be paid by deposit-accepting banks as is the practice all over the world. The premia should be assessed at a rate of 0.04 per cent of the total deposits (including uninsured deposits) as is the practice in India.

There is now at least one commercial bank branch in each of the 75 districts of the country. But the spread of bank branches is sparse in mountainous areas of the country. Similarly, rural areas are less endowed with bank branches. In such areas, banks themselves should try to reach the people. Mobile bank units should be established in those rural areas where there is availability of transport facilities. Such mobile units can perform deposit acceptance function. In those rural areas where there is no transport facility, banks can hire commission agents who would be paid on the basis of deposit accounts opened by the public on account of their efforts. These agents should be appointed by branch managers on the basis of guidelines issued by central offices of the banks.

People are quite cautious and particular about money matters. They prefer banks that maintain secrecy to banks that are lax in such matters. There is a legal provision for secret accounts in Nepal also. There is a possibility of deposit inflow from abroad if bank secrecy is strictly maintained.

Rate of interest is an effective measure for mobilization of resource in the form of bank deposits. There was a considerable increase in deposits in respect of savings and fixed accounts following the hike in interest rates in April 1975. The deposit rate at one time was upto 16 per cent in respect of two year deposits. However, there was a downward revision in interest rates in 1977 and the rate of interest on such deposits was lowered to 13 per cent. In 1983, this rate was

slightly raised and placed at 13.5 per cent. Frequent changes in interest rates in developing countries such as Nepal are undesirable and should be avoided.

Customer service is also an important factor in the mobilization of deposits. It takes much time to deposit money in the banks. It takes still more time to withdraw funds from them. Besides, banks established in collaboration with foreign banks have to make further effort in attracting interest-bearing deposits. However, the Agricultural Development Bank is showing aggressiveness in respect of deposit mobilization. This bank has been offering more interest on savings deposits than what is being offered by other banks.

Advertisement is also an effective measure for deposit mobilization. Promotional measures have a bearing on time deposit mobilization. In urban areas, all means of communications can be utilised for deposit mobilization. Personal contact by bank employees in general and branch managers in particular can be more effective than any other means of communication in the rural areas. The higher management of a bank should create conditions that would enable branch managers to participate in the promotional activities for deposit mobilization.

Another means of deposit mobilization is tax exemption on interest from bank deposits. Presently, interest earnings upto Rs 5,000 are exempt from taxation. If the exemption limit is raised further up, it will boost deposits.

## **2.2 Deposit Procedures**

Since May 1986, Nepal Rastra Bank granted some autonomy to commercial banks in regard to deposit rates and other conditions of deposits. Nepal Rastra Bank has prescribed the minimum rate of interest on savings account at 8.5 per cent, and commercial banks are free to offer interest above this rate. But only the Agricultural Development Bank has offered interest above this minimum rate. In the case of fixed deposits, Nepal Rastra Bank has prescribed that the rate of interest on three-month, six-month and nine-month deposits should not be less than 8.5 per cent, the rate of interest on one-year deposit should not be less than 12.5 per cent and the rates of interest on deposits with more than two-years' maturities should not be less than interest payable on one-year deposits. Accordingly, commercial banks have fixed interest on three-month, six-month and nine-month deposits at 8.5 per cent and more, interest on one-year deposits at 12.5 per cent and interest on two-year deposits at 13.5 per cent. The highest rate of interest on deposits is 14 per cent which is applicable to five-year maturity deposits. Agricultural Development Bank offers interest on fixed deposits at the same rates as offered by commercial banks but it does not accept

deposits for more than two-years. There are also variations among the banks regarding the amounts of permissible daily and weekly withdrawals from the savings accounts and the maximum amount on which interest is payable on savings accounts. There are also variations in regard to minimum sums required to open fixed deposit accounts. These variations between the banks regarding terms and conditions of deposits could be narrowed down and the rates of interest on deposits with more than two years' maturities could be higher than at present so that depositors are provided with further incentives to place their deposits in accounts with longer maturities. The Agricultural Development Bank may also accept deposits with longer than two-year maturities. The Bankers Association is also in a position to suggest harmonization of terms and conditions of deposits among the member banks.

The existing rules of the banks do not allow for free transfer of deposits from savings to fixed deposit accounts. Because of the existing rules, savings account holders have to wait for specified periods only after which they can withdraw from their savings accounts and transfer the sums into fixed deposit accounts. Otherwise, they have to forego interest on account of such transfers. Banks should allow free transfer of deposits from savings to fixed accounts.

The Commercial Banking Act, 1974 has prescribed that particulars of accounts that have remained inoperative for ten years or more should be sent to Nepal Rastra Bank. To implement this provision of the Act, every depositor should be intimated about his account at an interval of six months. If accounts remain inoperative despite such intimations, the particulars of such accounts should be sent to Nepal Rastra Bank after which such accounts should be treated at closed.

The number of depositors in banks established with foreign collaboration is not large. Nepal Arab Bank Ltd., for example, has been able to attract only 8421 depositors in its two and a half years' operation. The clients of banks opened with foreign collaboration are confined to richer and more educated strata of the society. Recognizing this constraint, they should try to refurbish their image by adapting themselves to the Nepalese environment through modifications in their deposit procedures (primarily, requirement of higher sums for opening of accounts) and removal of language barrier (primarily, transaction of business in English). Cleanliness and attractiveness of the premises of the partly foreign-owned banks should not be allowed to act as a barrier, through stepped up public relations.

The average amount per deposit account is Rs 9,000 for all the commercial banks taken together. But the amount is less in fully domestic-owned banks and,

conversely, it is higher in respect of partly foreign-owned banks. Banks in the former category have been able to cover wider sections of the people and this has been the reason for the average deposit with them to be smaller in size. But in respect of partly foreign-owned banks, the reason for larger average size of deposit is the result of their deliberate policy of keeping the smaller depositors out of their reach.

### 2.3 Banking Operations

The operation of making deposit to, and withdrawing from, the accounts is particularly long in fully domestic-owned banks and relatively quick in partly foreign-owned banks because the latter have installed micro-computers for banking operations. To quicken deposit and withdrawal operations, all the major branches of the banks should be provided with computer facilities and the rest of the branches should undergo major reforms in their operations even without resorting to computerization.

Nepal Bank Ltd. had tried for some time a system of making immediate payment of cheques upto the amount of Rs 200 in its principal Kathmandu branch. Similarly, Rastriya Banijya Bank had introduced a new system of payments which was popularly known as "teller system" in all the urban branches of the bank. But both of these banks discarded these innovations and returned to the traditional system of banking operation. Regarding computerization, two branches of the Agricultural Development Bank, one branch of Nepal Bank Ltd. and all branches of partly foreign-owned banks have computer facilities. There is no computer facility in Rastriya Banijya Bank.

According to the prevalent practices, a customer desirous of depositing money in a bank account has to wait all along the time his deposit slip passes through assistant to the cashier, cash assistant, posting assistant, checker and ultimately to the depositor in the form of counterfoil. Because of long wait involved in depositing sums, smaller depositors are not interested in depositing money in banks. More employees have to be employed by the banks because of complicated procedures. In this way, the present system of depositing money in banks is neither advantageous to the customers nor to the banks.

The procedures of cheque payments are equally cumbersome. The cheques presented by payees pass through counter assistant, ledger assistant, checker, signature verifier, payment authorization officer and finally to the cash department where cash assistants make payments to the payees. It takes days to

get payment of cheques drawn on other bank offices. For this reason, people generally decline to accept cheques and insist on cash in settlement of dues.

The existing system of banking operations has been made complicated owing to more than due concern shown for security. Modern banking operations demand efficient, service-oriented and economical banking services along with security safeguards. Fully domestic-owned banks are particularly beset with banking operation problems and it is in their case that reforms in banking operations are urgently called for.

Commercial bank branches should be classified on the basis of transactions, and reforms in the banking operations should be introduced gradually from the higher to the lower order of branches. As a first step, branches with more than Rs 2000 million credits and deposits taken together should be selected for full fledged computerization. In the second step, bank branches with outstanding credits and deposits exceeding Rs 200 million should be selected for the introduction of micro-computers. Finally, by the end of 2000 A.D., almost all bank branches should be provided with computers and the system of making payments from different branches on the basis of deposit account opened in one branch should be introduced gradually.

Pending computerization, some changes in the procedures of existing banking operations should be effected for meeting the needs of customers and economy in bank expenditures. Presently, the system of depositing money is complicated mainly because cash and general departments are separated and placed in different rooms. To overcome this difficulty, one of the two alternatives suggested here should be considered. One way of improvement is to give a copy of the deposit slip after duly signing it immediately after accepting deposit along with the slip in duplicate at the counter. One of the two copies of the slip which would be retained in the bank can be sent to different sections in due course of time. Alternatively, cash counter can be set up in the general department itself. In this case, slip in triplicate can be used and one of the copies be provided to the customer immediately after receiving deposit at the counter. Of the rest two copies of the slip, one will be sent to the general department for posting in the control chart or long-book. If additional step is deemed necessary from the viewpoint of security, signature of an authorised person in the general department can be added before a copy of the deposit slip is duly presented to the customer.

In respect of payments to the customers, persons of the cash department should be placed in the general department itself. Once a cheque is received in the counter and a token given to the payee, the cheque should pass through a

peon to the balance verifier, signature verifier, payment authorizer, posting personnel and finally to the cash assistant at the counter who will effect payment of cash to the payee in return of the token issued earlier. Then the cheque can be sent to control chart for posting. When the transaction of the day is over, the ledger can be checked and verified at ease. Still quicker payment can be effected if the payee is paid immediately after verifying signature and balance in the account.

In order to accept deposits and effect payments as quickly as possible in the above-described manner, some pre-requisites such as suitable accommodation, improved sitting arrangements, trained personnel, modern gadgets for signature verification, cash insurance or special allowance for risk-undertaking, legal protection in case of fraud and provision of personnel in keeping with work load should be fulfilled.

#### 2.4 Savings Instruments

The level of savings depends on income and the desire to save for the future. Banks should strive for bringing even the smallest of the small savers into the savings net by offering suitable savings instruments tailored to the needs of various categories of prospective depositors.

At present, banks have offered to the public only current, savings and fixed deposit accounts. Domestic savings accounts and recurring deposit accounts introduced in 1970/71 were neglected later to the extent of stagnation in the case of the former and altogether termination in that of the latter.

Frequency of interest payments also affects the saving mobilization efforts. Interest payment at an interval of three months instead of six months has exerted a positive impact on increasing the fixed deposits with Rastriya Banijya Bank. The Agricultural Development Bank has been mobilizing deposits with considerable success through measures such as daily interest calculation on savings deposit accounts, monthly interest payment on fixed deposit accounts, higher rate of interest on savings deposit accounts and lottery in respect of savings and current accounts. Similarly, the Bank has been offering Agricultural Savings Certificates which carry 10 per cent interest and are free of income tax.

According to the Agricultural Credit Review Survey concluded in 1980/81, the demand for agricultural credit was assessed at Rs 5906.0 million. Because of changed circumstances, the present requirement of credit for agriculture alone can be estimated at Rs 15,000 million in the minimum. As at October 1986,

commercial banks had had outstanding deposits to the tune of Rs 10,420.0 million. Obviously, there is need for further mobilization of deposits for satisfying the growing demand of credit for agriculture and other sectors of the economy. Banks should therefore come forward with newer instruments of deposits. Recently, one of the business companies was able to raise deposits from the public by offering 18 per cent interest. Banks should also not lag behind in innovations in deposit mobilization. They should offer various instruments of savings tailored to the varying needs of diverse categories of prospective depositors.

In this connection, suggestion can be made to revitalize the domestic saving accounts, revive recurring deposit accounts and introduce small savings schemes, deposit reinvestment certificates, fixed income deposit schemes and long-term savings schemes. These instruments of deposits will cater to the needs of various categories of prospective depositors.

#### 2.5 'Teller' System of Payment

Some years back, Rastriya Banijya Bank had introduced 'teller' system of payment in its urban branches. This system of payment had considerably reduced the time required for making cheque payments at the counters. However, this system was discontinued and the same traditional system as it existed before was allowed to relapse. The failure of the 'teller' system is attributed to inadequate rewards for taking extra risks, unsuitable bank premises for proper counter installation, personnel problems, uncooperative attitude of the payees and discontinuity in the system of daily verification of control charts.

The 'teller' system of payment can be a useful device for improving cheque payments if some pre-requisites are fulfilled. Cash insurance or an allowance of 15 to 25 per cent of salary to the employees involved in such transactions, placement of payment counter at general department, provision of adequate number of personnel in accordance with work load, trained personnel and daily verification of accounts on the basis of maintenance of control chart are some of important pre-requisites for the success of the 'teller' system. But these problems can be obviated if each teller is provided with a computer so that each teller will be in a position to pay a specified amount (say upto Rs 1000) with signature and balance verifications at the counter itself.

### 3. CREDIT ASPECT

#### 3.1 Overall Credit Situation

Credit operation is a major function of commercial banks. Credit-deposit ratio is one of the important indicators in the operation of commercial banking functions. The ratio as at mid-July 1986 was 67 per cent. If investment is also included in the calculation of this ratio, the figure comes to 85 per cent.

The outstanding credit as at mid-July 1986 stood at Rs 5974.2 million. The total credit increased by 767 per cent during the past 12 years. Of the total outstanding credit of Rs 5974.2 million as on mid-July 1986, 39.1 per cent was accounted for by trade, 29.1 per cent by industry and 25.4 per cent by consumption and social purposes. These three major purposes preempted 93.6 per cent of the total credit.

The credit per employee is one of the indications of efficiency in the banking system. The credit per employee in Nepal amounted to Rs 511 thousand. As compared to this, the credit per employee in New Bank of India came to Rs 1 million. This means that the banking system in Nepal should be more efficient in respect of credit operation too. There are 563 thousand credit accounts in Nepal.

There is the system of limit sanctions prior to actual credit disbursements in respect of pledge and hypothecation loans. The practice of commitment charge is an important device for credit planning. This practice first started in 1978 as a compensation for the loss sustained by commercial banks following interest tax imposed on them by His Majesty's Government. All loans other than staff loans, loans against fixed deposit receipts, priority sector credit and loans against gold and silver are subject to commitment charge at the rate of 0.15 per cent per annum.

Credit should be provided on the basis of creditworthiness of borrowers. Credit information can be an useful guide for credit managers. At present, there is no system of regular exchange of credit information among the banks. But such a system is necessary and should be introduced on the basis of understanding among the banks; if not, by providing specific provision in the Commercial Banking Act. This system can be introduced also by establishing a separate institution for the purpose by Nepal Rastra Bank in collaboration with the commercial banks. Such an institution should obtain information from all the commercial banks and store it with a view to disseminating it to the

requesting commercial banks. Pending the establishment of such an institution, banks should obtain credit information through the interview of prospective customers, financial analysis, scrutiny of own records pertaining to customers and other sources, including other banks.

There is the system of sanctioning credit by different authorities. Bigger loans are sanctioned at the level of boards of directors of the concerned banks. In many countries, prior authorization of central banks is needed in cases of very large loans. The cut-off point in this respect is Rs 100.8 million (Indian Rs 60 million) in India. In Nepal, the system of prior credit authorization from Nepal Rastra Bank should be introduced and the amount of credit above which a reference to Nepal Rastra Bank has to be made should be decided by Nepal Rastra Bank in consultation with the commercial banks. The operation of credit authorization scheme can be performed in Nepal Rastra Bank by its Banking Operations Department.

Except in Nepal Arab Bank Ltd., there is no system of classification of debtors into one obliger group. But it is necessary that credit should be sanctioned to the customers taking into account the relationships among the different borrowing individuals and firms. A limit should be fixed beyond which no credit should be advanced to a related group of individuals and firms. Such a limit is fixed at 10 per cent of capital funds in the U.K. and 15 per cent of the capital funds in the United States. In Nepal, as banks are under-capitalized, a bank should be empowered to extend credit to one obliger group upto the amount equivalent to capital funds of the concerned bank. If any group of individuals or firms needed more than this limit of credit, it should approach a consortium of banks for its loan requirement.

Commercial banks should establish separate divisions within their loans and advances departments in order to fully concentrate on the recovery or writing off of overdue loans.

### **3.2 Gold and Silver Loans**

Bank loans for consumption and social purpose ranged between 16.3 per cent and 34.7 per cent of the total loans during the 1974-1986 period. Loans against gold and silver were an important constituent of consumption and social purpose loans. Loans against this purpose ranged between 8.08 per cent and 24.93 per cent during the 1965-1986 period. Gold and silver loans in a way are an innovation of the Nepalese banking system, meeting the social and economic needs of the common people. Despite the prominent position occupied by gold and silver in the banking system, bankers and monetary authorities have not attached

importance that is due to gold and silver loans. In the large majority of branches of commercial banks, priority sector and gold and silver are almost the exclusive avenues of credit, and the commercial banks are fulfilling the felt need of the people by extending gold and silver loans. Despite this reality, Agricultural Development Bank and partly foreign-owned commercial banks are not providing loans against gold and silver which, for many people, could be the only asset to offer as security against loans.

The role of gold-tester is pivotal in the scheme of gold and silver loans. Despite this fact, gold-testers are placed on a level at par with the lowest level of assistants. But, in view of the importance of the function performed by gold-testers, they should be placed at a level immediately below the cashiers or in a position at par with senior assistants, whichever is applicable.

There is a system of dual rate of interest in respect of gold and silver loans - 17 per cent for loans upto Rs 10,000 and 18 per cent for loans above this limit. In the urban areas, this dichotomy could be obviated by splitting the loans by approaching more than one bank branch to get loans at 17 per cent. There is no variation in the rate of interest according to variation in loan amount in respect of other loans. There is therefore no justification for resorting to this kind of progressivism in regard to the gold and silver loans alone.

Gold and silver loans are provided for a year. But banks usually wait for two years after which the assets pledged as security are disposed of through auction. As there is no worthwhile market for gold and silver in the majority of rural bank centres, gold and silver from such centres should be brought to the nearest market centres and disposed of at comparatively higher prices.

There are numerous bank branches in the Kathmandu valley. The distance between bank branches in some places is hardly of some metres. In such a situation, no inconvenience would be caused to the public if some urban bank branches in the Kathmandu valley ceased to transact gold and silver loan business altogether and thereby effect economy in their expenditures.

### **3.3 Pledge Loans**

Pledging of goods in order to obtain credit is as old a practice as the history of the Nepalese banking system. On perusal of mid-July 1979 to mid-July 1986 figures, it was found that the ratio of pledge loans to total credit varied

between 21.2 per cent and 31.1 per cent. It is therefore natural that the concentration of attention is prominently centred on this category of credit to the almost exclusion of other loans. The end-use of pledge loans can't be ascertained and, for this reason, banks should not encourage such loans more than that is necessary for the smooth conduct of trade. Commercial banks opened in foreign collaboration do not provide such loans. But they should not boycott this category of loans. All the commercial banks should try to reform it in order to remove its defects.

The main problems associated with pledge loans are connected with over-valuation of pledged goods, inferior quality of pledged goods, retention of godown keys by the debtors, misarrangement in the storage of goods, unsuitability of godowns, storage of goods pertaining to more than one loan in a single godown and, sometimes, claims of more than one bank on the same set of goods stored in a godown, total reliance on lowly-paid godownkeepers, etc. To obviate these problems, the following measures should be undertaken:

- (1) All the commercial banks should join together and float a godown company which would operate godowns in the urban areas and they should provide loans against goods on the strength of receipts issued by this company.
- (2) Pending the operation of the proposed godown company, the responsibility of storage of goods in the godowns should be entrusted to the higher officials in the banks.
- (3) Processes and procedures described as essential in credit manuals or guidelines should be strictly followed.
- (4) Officials entrusted with godown responsibilities should be rotated periodically so that defects, if any, would come to the notice of branch management for rectification in time.
- (5) Commercial banks should be cautious about businessmen, who are over-ambitious and who have started business for the first time. Businessmen involved in particular business for long should be given priority in providing pledge loans.
- (6) Both creditworthiness and security should be considered in advancing pledge loans as in any other type of loans.
- (7) Commercial banks should be careful of those businessmen who want to borrow from bank branches away from the areas of their business.

- (8) Provision of loans in excess of credit limits is one of the main problems besetting the fully domestic-owned commercial banks. These banks should be strict in such a matter and stringent punishment should be meted out to those who indulge in such acts of indiscipline.
- (9) Commercial banks should insist on cash memoes from the customers to ascertain the true price of the goods to be pledged in the banks and it should also be insured that no goods bought on credit are pledged with the banks.
- (10) Pledge loans should be classified into standard, sub-standard, doubtful and bad loans and separate strategies should be adopted in respect of each of these categories of loans.
- (11) Commodities to be pledged at the banks should be specified at the very time of credit limit sanction so that the higher management is in the know regarding the goods that would be pledged by the customers, at the time of disbursements of loans which actually take place at the branch level.

#### **3.4 Hypothecation Loans**

Hypothecation loans came into existence in Nepal in 1984 when the newly-opened Nepal Arab Bank Ltd. started to provide such loans. Later in the year, the Commercial Banking Act, 1974 was amended to enable the commercial banks to provide such loans. According to the system of this credit, commercial banks take goods as security, but the goods in question are allowed to be in possession of debtors. Regular inspection and replenishment of goods or repayment of loans in case of shortage of goods are the essential part of this system of credit. Hypothecation loan was the felt need of industrial establishments, but there is the possibility of misuse of this loan by industry and trade. The following measures should be taken to make this loan practical for the clients and secure for the banks:

- (1) Hypothecation of goods without offering extra security in the form of real property upto Rs 100 thousand should be allowed by fully domestic-owned banks as against the limit of Rs 25 thousand (Nepal Bank Ltd.) at present.
- (2) Industrial enterprises which have mortgaged their fixed assets to long-term financial institutions should be allowed to offer those assets as second mortgage as additional security for hypothecation loans. The second mortgage as security against hypothecation loan can be acceptable only if the property has a value over and above the mortgaged value.

- (3) As hypothecation loans are almost insecure loans, credit information should be obtained prior to sanctioning of loans, and post-loan supervision should be maintained.
- (4) Nepal Rastra Bank should periodically review this system of credit and introduce changes, if necessary.
- (5) All the industrial enterprises should be allowed this loan facility.
- (6) Hypothecation loans should be provided by the commercial bank branches within their command areas. They should not provide loans outside such areas.

### **3.5 Documentary Credit**

Documentary credit is a safer credit system as the customs and practices of such credits are determined by the provisions of the Uniform Customs and Practices of Documentary Credit prepared by International Chambers of Commerce. Even then some problems exist between the commercial banks and their customers relating to import credits. These problems may be enumerated as below:

- (1) Commercial banks do not maintain registers for recording expiry dates of credits. They should maintain such registers in order to avoid problems arising from oversight.
- (2) Commercial banks should allow 15 days as the period necessary for document clearance from the banks. If the customers do not clear documents within this period, they should be charged with penal rate of interest for the excess period.
- (3) There is an unhealthy competition among the commercial banks regarding the concession to the importers who are provided with foreign exchange certificates to be submitted to the concerned customs offices prior to obtaining documents from the clearing and forwarding agents. Similarly, transport carriers deliver goods to the importers directly bypassing the commercial banks who are the legal owners of the imported goods until the importers pay their dues to the banks. Such unhealthy competitive practices based on the fear of losing customers should be done away with by all the commercial banks.

- (4) All the importers should be advised to clear their documents after paying their banks the value of goods and bank charges after adjusting the margin amounts deposited at the time of opening of credits. In case the importers fail to clear the documents in time, banks themselves should clear the goods and place them in their own godowns as security for the dues from the importers. In such cases, the practice is to place the dues from the importers on A.O.C. accounts without adjusting the margin accounts. When dues are placed in A.O.C. accounts, the margin accounts should be adjusted in order to avoid duplication of accounts.
- (5) Commercial banks should open import credits only when they are fully satisfied with the customer's capacity to pay customs duties when the goods arrive in the country.
- (6) Negotiation certificates should be asked and provided by the commercial banks when customers of one bank want to open letters of credit from another bank. This practice will lessen the risks to the banks to some extent.

### **3.6 Large and Medium-Sized Project Loans**

According to the British tradition, commercial banks should deal only in short-term loans. There is the German tradition which permits commercial banks to finance term loans. The third model is provided by American commercial banks for whom both short and long-term loans are legitimate activities of the commercial banks. In Nepal, an amendment to the Commercial Banking Act in 1985 enabled the commercial banks to extend loans upto a period of 12 years. Large and medium-sized project loans are being provided by all the commercial banks except Nepal Bank Ltd. which has limited its activities to joint financing in so far as large and medium-sized project loans are concerned.

The question as to whether large and medium-sized project loans should be financed by all the financing agencies should be answered in the affirmative. Consortium approach should be preferred in this regard. Nepal Industrial Development Corporation and the commercial banks should jointly finance large and medium-sized projects and the lead should be provided by the institution which finances the largest amount among the participating institutions. As far as commercial banks are concerned, they should commit only upto ten times their capital funds in regard to financing of large and medium-sized project loans.

### 3.7 Priority Sector Credit

Commercial banks started to extend priority sector credit since 1974. But this type of activity of the commercial banks took a concrete and effective shape since 1981 when the Intensive Banking Programme was launched at the initiative of Nepal Rastra Bank. Since 1982, Cottage and Small Industry Project has been launched in nine districts with financial assistance of the World Bank. Commercial banks are the participating institutions in respect of the Intensive Banking Programme. In the case of Cottage and Small Industry Project, Nepal Bank Ltd., Rastriya Banijya Bank and Agricultural Development Bank are the participating institutions. At present, commercial banks are directed to fulfil the target of extending eight per cent of the total credit to the priority sector through these two schemes. Twelve per cent of the total credit to the priority sector is the target set for the Seventh Plan. Commercial banks at present have been able to fulfil only six per cent of the credit to the priority sector.

During mid-November 1981 to mid-January 1986, 31,760 people have been provided with priority sector loans to the tune of Rs 323.2 million under the Intensive Banking Programme, generating employment for about 100 thousand people. Because of over-emphasis on security, group loans to the poor people have amounted to only about Rs 10 million so far. About 80 per cent of the loans have been utilized on intended purposes and more than 70 per cent of the loans have been recovered in time. As the rate of interest on priority sector loans have been favourable to banks, they should not hesitate to provide adequate amounts to the priority sector. Training on priority sector credit should be stepped up and the banks should utilize the trained manpower to the utmost extent. There should be a better coordination among the governmental agencies, organizations involved in voluntary activities and the commercial banks. Apart from the coordination committees at the district level, regional and central level co-ordination committees should be established to give additional boost to the Intensive Banking Programme. Branch managers of the commercial banks should be further involved in this programme. Branches of the banks should be provided with suitable means of transportation to enable the bank personnel to visit the field as frequently as possible. Owing to the lack of adequate training facilities, increased employment in cottage and small industry sector has mostly benefitted non-Nepalese people. In order that such a situation be rectified, conditions should be imposed on the loanees to employ Nepalese citizens to the extent possible. Animal husbandry loans should be given in such a way that the number of livestock increases and the mere transfer of ownership of livestock is avoided. The premia to be paid to the Credit Guarantee Corporation for credit insurance should be paid by the banks as they,

and not the loanees, are the beneficiaries of the credit insurance. The procedures regarding claims of compensation should be further simplified. His Majesty's Government, Nepal Rastra Bank and the commercial banks should join together and set up a crop and livestock insurance corporation or, alternatively, the capital of the Credit Guarantee Corporation should be increased and the Corporation entrusted with this task. Commercial banks should be convinced of the need for priority sector credit and a target of 40 per cent of the total credit should be fixed for the year 2000 A.D. In order to fulfil this target, the provision regarding the deposit in the Nepal Rastra Bank of the shortfall amounts should be implemented rigorously. As bank branches opened in the rural areas can not cover all the village panchayats in the foreseeable future, the system of a field office for every four village panchayats should be the target for the year 2000 A.D. If the commercial banks are unable to recover priority sector loans, His Majesty's Government should exercise its powers to recover such loans taking these amounts as good as government dues. The spread between the rate that the commercial banks can realise from the loanees and the rate at which the banks can get refinance from Nepal Rastra Bank should be as wide as under the Cottage and Small Industry Project.

During the 1982 to 1987 period, about Rs 250 million was sanctioned and about Rs 210 million disbursed to 3,369 industrial projects, generating employment opportunities for 40,691 people under the Cottage and Small Industry Project. During the period, 66.8 per cent of the total loans was recovered and the outstanding amount of credit under the project at the end of the period stood at Rs 168.1 million. The project, which was confined to nine districts, has now been extended to additional 18 districts. The need is to step up training. The participating banks should supplement the training that is being provided by Nepal Rastra Bank through its Bankers Training Centre. The credit insurance under this project is being covered by Nepal Rastra Bank. As there is a separate Credit Guarantee Corporation to carry out such insurance activities, Nepal Rastra Bank should hand over the credit insurance business to the Corporation.

As lack of knowledge has been found to be the main stumbling block, an institution to impart industrial training should be set up and its activities extended upto the district level. Agencies responsible for supply of raw materials and marketing of finished products have not been so successful in the functions entrusted to them; they should be strengthened. There are some discrepancies between the Cottage and Small Industry Project and the Intensive Banking Programme regarding the contribution to be made by the loanees in the form of working capital for industrial loans; such discrepancies should be done away with. Wherever both Cottage and Small Industry Project and Intensive

Banking Programme are being implemented through the same branch, only the programme under the former should be implemented regarding the cottage and small industry credit. In a district where there is more than one bank branch disbursing cottage and small industry loan under the Cottage and Small Industry Project, areas should be specified and the bank branches should confine credit activities within the specified areas.

#### 4. MISCELLANEOUS ASPECT

##### 4.1 Government Transaction Activities

Nepal Rastra Bank is the banker to His Majesty's Government. Nepal Rastra Bank directly fulfils this function in nine places where it has its own branches and in other places this function is being conducted through Rastriya Banijya Bank (65 branches) and Nepal Bank Ltd. (59 branches). About 30 per cent of the commercial bank branches are involved in this way in the government transaction functions. Most of the commercial bank branches which are involved in such functions accept government deposits as well as effect payments and a smaller number of branches accept government deposits only. Commercial banks get commissions from Nepal Rastra Bank at the rate of Rs 80,000 per branch in the case of the former category of branches and at the rate of Rs 20,000 per branch in that of the latter.

There are two problems involved in the government transaction functions of the commercial banks. One of these relates to commission amount which the commercial banks regard as inadequate. The other problem is connected with the blockage of commercial bank funds as reconciliation of accounts takes long to take place. Regarding the commission payable to the commercial banks, the sums of Rs 80,000 and Rs 20,000 for the above-mentioned two categories of branches are inadequate and therefore need revision. In revising the rates, the present system of lump sum amounts payable to each of the two categories of bank branches should be replaced by a system of payment of commission based on the categorization of bank branches into 3-4 classes taking into account the intensity of transactions involved in each category of branches. Nepal Rastra Bank and the concerned commercial banks should constitute a committee to determine the categorization of branches and fix the commission after taking all the relevant aspects into consideration. In regard to the blockage of funds for reasons of late reconciliation, the system of daily wireless message introduced recently has relegated this problem to the realm of insignificance. It is the estimate of Nepal Rastra Bank that amounts not more than Rs 20-30 million in the case

of Rastriya Banijya Bank and Rs 10-20 million in that of Nepal Bank Ltd. are involved in the blockage of funds following the introduction of reconciliation based on wireless messages. Even then, Nepal Rastra Bank should expedite release of refund by way of quick reconciliation by augmenting the work force in its Central Accounts Section from the present 16 persons.

#### **4.2 Management Information System**

Commercial banks are poor as far as the management information system is concerned. They do not collect information to the desirable extent. Whatever management information they collect is obtained very late and they do not adequately and appropriately use such information in the decision-making process in the banks. They should therefore install computers for obtaining up to date information in all the offices where transactions of a respectable order usually take place. In the rest of the offices where transactions are small, management information system should be introduced without the involvement of computers.

#### **4.3 Personnel Administration System**

Fully domestic-owned commercial banks should be as free as partly foreign-owned commercial banks regarding the recruitment of bank employees. The banks in the former category should be subjected to the broad policy guidelines of the Public Service Commission and they should be free in devising recruitment procedures befitting the particular needs of individual banks. Bank employees should be trained before they are posted in respective offices. For this purpose, each bank should have its own training centre to impart training to the newly recruited employees as well as employees working already in the bank. Each employee should be posted in a office for a minimum period of three years. The tendency on the part of the employees to stay in the Kathmandu valley should be discouraged. Employees who have their homes located in the Kathmandu valley should be compelled to work at least for three years outside the valley. Generally, an employee working in a place of his residence does not like to go outside the place of his residence for lack of suitable accommodation and low outstation and housing allowances. Those commercial banks which have many branches should attend to these aspects in order to solve the problems of personnel administration. The pay-scales of the employees of the commercial banks should be delinked from those of the government servants. There is no harm if some commercial banks are able and willing to give more remuneration to their employees on the basis of the productivity of the bank

employees. The pay-scales of the bank employees should be lined with the consumer price index. Job description of the departments, divisions and sections in the central and regional offices should be prepared and implemented. Similarly, job description of each category of employees should be prepared and implemented in all other bank offices, including branches. Regional offices of the banks should be established on the basis of regions established by His Majesty's Government, but there can be more than one regional office in a development region if the work load permits it to do so. Regional offices are mostly regarded as extensions of inspection department at the central office level, but they should be treated as instruments of decentralization and the work load regarding day-to-day management at the central office level should be allowed to be reduced so that central offices of the commercial banks could concentrate on policy aspects on the running of the banks. The powers of the regional offices should be enhanced by delegating most of the routine work of the central offices to these regional offices. Recruitment of all assistant level employees should be made at the regional office level and the lowest level employees such as the peons should be recruited at the branch level itself. Such a policy has dual advantage. On the one hand, local people will get employment opportunities and, on the other, banks will be relieved of the problems connected with the posting of employees outside the Kathmandu valley. Manpower planning should be part and parcel of personnel administration in the banks.

#### **4.4 Physical Facilities**

A good part of the capital of the commercial banks is employed in the acquisition of buildings and other physical facilities. Most of the bank offices in Nepal are established in rented buildings which are, in most of the cases, unsuitable to the banks. Banks should have their own buildings as far as possible and the rented buildings should be made more suitable before bank offices are established in such buildings. Besides buildings, other physical facilities such as typewriters, calculating machines and computers should be adequately provided in the urban branches in keeping with work loads in different branches. Similarly, congenial work environment should be created with the provision of properly furnished work rooms, heaters and fans, filing cabinets, telephones, electric facilities, etc. Bank counters should be particularly designed with a view to expediting deposit and payment transactions. Local offices should be empowered to acquire physical facilities required by them on the basis of budget sanctions and only in matters like arrangement of cheque-books, pass-books, ledger-books and safe-boxes should the central office step in to supply these items to the branch offices. Repairs and maintenance

should be emphasized and only those items which can be repaired locally should be supplied to the rural branch offices.

#### **4.5 Planning System**

There is the system of annual budgeting and annual programming in the case of the banks opened under foreign collaboration. In the case of the fully domestic-owned banks, there is neither budget nor programming system (in Nepal Bank Ltd.) and there is only overall budget system (in Rastriya Banijya Bank). At present, there is no planning department or division in any commercial bank. There should be a separate planning department in each of the commercial banks and this department should be entrusted with the task of budget preparation, in addition to the preparation of five-year plans and annual programmes. Planning should cover deposit, credit, profit and loan recovery and the five-year plans in banks should synchronize with the corresponding national plans.

Planning in the commercial banks should start from below in the case of annual programme and from above in that of longer-term planning, such as the five-year plan. In planning deposits, credits, profits and loan recovery, trends witnessed in the previous years should be qualified by new developments, and annual targets fixed accordingly. Programming at the branch level should be finished by the end of ninth month of the previous fiscal year. Programmes prepared at the branch level should be discussed at the regional level and finalized and sent to the central offices two months prior to the expiry of the previous fiscal year. The central offices should discuss over the regional programmes and finalize the national programme one month prior to the expiry of the previous year. By the end of the previous fiscal year, the national programme along with regional and branch level programmes should reach the lower levels of management for implementation. At each level of planning, lower tiers of management should be involved in the finalization of the programmes. There should be progress review at an interval of every quarter of the fiscal year. Prompt corrective measures should be taken as a follow-up of each progress review. The success or failure in programme implementation should be followed by reward or punishment if the success or failure in any programme has had an origin in managerial success or failure. The aim for each rural branch should be the attainment of the minimum target at 50 per cent credit-deposit ratio. Bank personnel achieving more than 80 per cent credit-deposit ratio should be suitably rewarded and those not achieving even 50 per cent similarly penalized.

Initially, commercial banks should limit themselves to annual planning or programming. Five-year planning in commercial banks should start with the Eighth Plan. The intervening period between now and the Eighth Plan should be utilised in posting and training of personnel required for planning. Planning department at the central level should have officers entrusted with each region in the country. The aim should be to achieve according to policy inducement as distinct from the present position where it just happens without any policy decisions and programmes.

#### **4.6 Information System**

Banking statistics and information are useful not only for the concerned banks but also for the economy as a whole. Banking statistics and information should be utilized to the fullest possible extent in making policy decisions in the commercial banks. Timely availability of statistics and information should be ensured in the commercial banks for their own benefit and also the benefit of Nepal Rastra Bank. Unlike in partly foreign-owned banks where computerization has solved much of the information problem, information gathering in fully domestic-owned commercial banks has been a very slow and tedious process. Modern gadgets such as electronic calculators should be provided to all the branches for information compilation. Persons posted in statistics section should be trained and suitably rewarded considering the unattractive nature of their jobs. Fully domestic-owned commercial banks hardly use modern information system and collection of statistics is considered as an extra obligation imposed by Nepal Rastra Bank. Such an attitude should give way to positive one. Commercial banks should utilise all the statistics supplied to Nepal Rastra Bank for their own purpose too. In addition, they should gather information for the benefit of themselves by way of utilizing it in the policy-making and day-to-day decisions.

Commercial bank branch with more than Rs 200 million deposits should be provided with mini-computers for collecting and processing of statistics. It is the general complaint of the employees at the branch level that they have been overloaded with information collection. This sort of complaint will disappear if the information provided by branches is consolidated and sent to them in the form of statistical compilations. More than one central department is engaged in information gathering from the branches. Except for specific information required for other departments, research and statistics department should be the one responsible for the collection of economic statistics and this department should supply economic statistics and information required by other departments.

#### 4.7 Fund Management

Commercial banks should strive to strike a balance between liquid funds required for transactions and legal obligations, and funds utilized in credit extension and investment. After setting aside five per cent and four per cent of the deposits for maintaining balance in Nepal Rastra Bank and cash in vault, respectively, commercial banks have to extend credit to the productive sector, including eight per cent of credit to priority sector, to the tune of 25 per cent. Thus more than one-third of the credit from the commercial banks has been pre-empted by statutory obligations. Commercial banks should try to utilize the rest of the resources on purposes which result in highest return for them, including investment on government securities which provide profitable avenues for the deployment of resources in the case of tax-free categories of bonds, and source of earning interest in lean season in that of other categories of government securities. At present, funds held by commercial banks are also placed abroad for transaction purposes. Banks should economize on funds maintained at different banks abroad by different branches. Only one main branch should hold accounts in banks abroad and other branches should have facility to draw on the strength of accounts maintained by the main branch. This suggestion is particularly germane to Rastriya Banijya Bank. Commercial banks should get fund position statistics on weekly basis from the main branches through the quickest means of communications such as air-document and wireless message. Such information should be utilized for quick decision on deployment of funds according to the dictates of circumstances.

There are 67 currency chests maintained by Nepal Rastra Bank at commercial bank branches (46 in Rastriya Banijya Bank and 21 in Nepal Bank Ltd.) and 16 Indian currency chests. Some additional currency chests in remote bank branches with substantial transactions even if outside the district headquarters should be opened by Nepal Rastra Bank by way of closing of some of the existing currency chests at easily accessible places.

Commercial banks sometimes maintain excess funds with Nepal Rastra Bank while, at other times, they are at default regarding maintenance of statutory balances with Nepal Rastra Bank. This is due to lack of expertise in fund management. Similarly, sometimes they borrow funds at higher interest rate from Nepal Rastra Bank when they have had funds locked in investment in government securities which they could have disposed of without loss.

#### **4.8 Accounts Reconciliation System**

There is no problem of inter-branch reconciliation in newly-opened banks because of their small size, computerization and emphasis on prompt reconciliation. The problem of reconciliation is staggering in the case of the two big banks. There are 20 heads of accounts at head office in the case of Nepal Bank Ltd. and the different heads overlap one another in the nature of transactions. This not infrequently leads to mistakes, particularly by new employees. There is need to reduce the number of head office accounts to manageable numbers by combining accounts of similar nature into single heads. Accounts of even a decade are pending reconciliation in this bank. Similar is the position regarding Rastriya Banijya Bank in the matter of reconciliation of accounts. There is a computer in this bank for branch accounts reconciliation, but it is not in operation for long. Accounts of even a decade are pending reconciliation in this bank too. Both of these fully domestic-owned commercial banks should constitute task force in each of them to reconcile the pending old accounts. These two banks should frame rules in this regard and solve the reconciliation problem of the pending accounts. If reconciliation fails to materialize in the case of any account despite efforts, such an account should be adjusted treating it as receipt or expenditure on the basis of nature of account, and the matter then closed.

We have thus discussed various issues concerning the deposit, credit and miscellaneous aspects of the commercial banking functions in Nepal. It is believed that the reforms in the lines as suggested above would go a long way in making the commercial banking functions more efficient and in tune with the changing requirements of the economy.