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Factors Influencing the Lending Behavior of Commercial Banks in Nepal

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Abstract

This study examines the major factors affecting the lending behavior of commercial banks in Nepal. It is based on analysis of the data from five investing banks encompassing the ten-year period from 2014/15 to 2023/24. The research employed both descriptive and causal-comparative research designs. The study is based on the secondary data extracted from annual reports and financial statements. Statistical analysis was carried out using SPSS version 27. The sampled banks are Prabhu Bank, Nepal Investment Mega Bank, NMB Bank, NIC Asia Bank, and Kumari Bank Limited. The analysis is concerned with how several independent variables Cash Reserve Ratio (CRR), Capital Adequacy Ratio (CAR), Interest Rate Spread (IRS), Total Deposits (TD), and Inflation Rate (INF) are related to the dependent variable, Loans and Advances (LA). The results disclose a moderate negative association between CRR and LA, implythat higher reserves reduce investing activity. In counterpoint, CAR shows a strong positive connection with

investing, involving that well-capitalized banks are more capable of amplifying credit. IRS displays only a poor relationship, while TD has a strong positive influence, meaning banks with larger deposit bases attend to issue more loans. Similarly, inflation (INF) is moderately negatively related to investing, indicating that higher inflation can diminish credit growth. Overall, the findings show that CAR significantly enhances investing, whereas IRS has a negative effect. Total deposits have a strong positive impact, while CRR and inflation are not statistically significant predictors. The study concludes that CRR, IRS, TD, and INF play major roles in creating the investment behavior of Nepalese commercial banks.

Keywords: *Loans and advances, cash reserve ratio, capital adequacy ratio, total deposit, inflation rate.*

Introduction

Investing is focus to the day –to- day operations of commercial banks and considered the central of their business activities. It helps economic growth by financing individuals, businesses, and governments. However, it also presents significant risks to the stability of financial institutions due to their exposure to credit defaults and market volatility (Yitayaw, 2021). Investing behavior refers to how banks make decisions regarding credit and advances, which are influenced by macroeconomic situations, regulatory requirements, and market indicator. These loans, offered in very short, short, medium, or long terms, enable recipients to engage in productive investments, ultimately fostering national development (Olokoyo, 2011). Through general procedures, banks assess credit applications and allocate financial resources accordingly, strengthening their role in helping diverse economic areas.

In developing economies, bank lending is necessary for sustainable development as it mobilizes funds that fuel investment and industrial expansion (Alkhazaleh, 2017). investing constitutes the primary income-creating activity for commercial banks (Isa et al., 2019), and its behavior is determined by both demand and supply side influences. These coverage the interest rates, liquidity, inflation, exchange rates, GDP, and capital levels, as well as internal indicator such as management efficiency and credit machanism (Timsina, 2016). Perfect investing practices are crucial for ensuring a stable and strong financial system. Weak credit distribution can lead to instability, while accountable credit growth can inspire economic movement. Thus, managing credit portfolios and loan risks is fundamental to achieving an optimal balance between profitability, liquidity, and solvency.

Commercial banks also serve as mediators, collecting household savings and reallocating them as credit to different sectors of the economy. Lending forms a major portion of banks' assets and is a primary revenue source (Malede, 2014). To make certain asset quality and reduce credit risk, banks establish prearranged credit policies that guide lending actions. These policies involve wide-ranging loan assessments, considering factors such as borrower creditworthiness, collateral value, and broader economic trends (Adhikari, 2009). Internal decisions, such as board-approved policies, interact with external services like central bank regulations and macroeconomic shocks to form lending practices. The efficient management of these unified elements ensures financial system flexibility and fosters enduring economic development.

Several international and national study have explored the determinants of commercial banks' lending manners. Globally, research has well-known key influences such as bank size, interest rate spread, inflation, and liquidity (Moussa & Chedia, 2016). In Nepal, studies have emphasized the position of total deposits, interest rates, GDP, and regulatory requirements in influential lending decisions (Bhattarai, 2020). However, findings remain incompatible, with some prominence liquidity and capital adequacy as key in drivers while others downplay their consequence. Given these miscellaneous outcomes, The purpose of this study is to assess how cash reserve ratios (CRRs), capital adequacy ratios (CARs), interest rate spreads, total deposits, and inflation influence the loaning behavior of commercial banks in Nepal. This study will evaluate how CRRs and CARs can affect banks' loan decisions and evaluate how interest rate spreads can help shape banks' lending behavior. This research will also evaluate how total deposits affect the ability of banks to lend and will assess how inflation affects the lending behavior of banks. As such, this study answers the questions about how CRRs, CARs, interest rate spreads, total deposits, and inflation affect commercial banks' loaning behavior within Nepal and identifies macroeconomic factors, as well as bank-specific factors, that can affect the investing behavior of commercial banks in Nepal.

A lot of people are curious about how banks in Nepal decide who gets loans, but there's still a lot we don't know. Most earlier studies only looked at five years of data, usually stopping around 2020 or 2021. That's not enough to really see what's changed lately especially with all the new rules and shifts in how banks work. Plus, those studies often stuck to basic financial methods and didn't really

sort out what comes from inside the banks and what's happening in the bigger economy. One big thing that's missing? No one's really dug into how new regulations and inflation work together to shape bank lending. On top of that, since the wave of bank mergers and acquisitions, the whole industry in Nepal looks different, but we don't know much about how lending has changed because of it. Most research treats these issues separately, so we don't get the full picture or see how all the moving parts interact. Another problem: past studies don't explain why they picked the banks they looked at. They rarely talk about things like market share or whether those banks matter most for the whole system. This study tries to fill those gaps. It uses a full ten years of data, right up to 2023/24, and brings in more advanced financial and statistical tools. It also sorts out what's happening inside the banks from bigger economic trends, and zeroes in on the most important and successful commercial banks. A clearer, more complete look at what really drives bank investing in Nepal today.

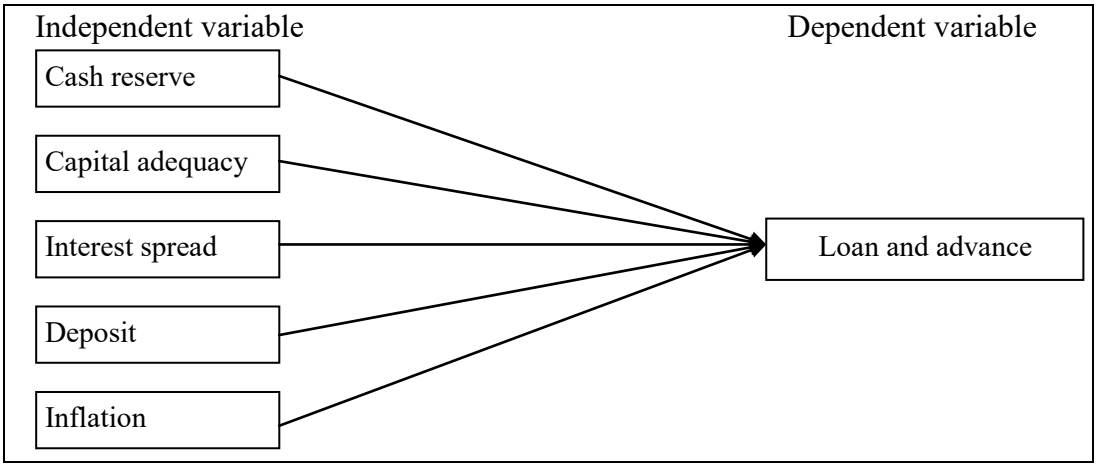
Literature Review

The purpose of this section is to review previous studies on the factors that influence commercial banks' lending behavior. This review provides a foundation for the current study and connects it with existing research and findings. Ghimire and Bhandari (2023) highlighted the need to consider default risk when setting loan interest rates. They argued that ignoring the chance of default could lead to mispriced loans, lower profitability, and greater credit risk exposure. They also recommended using larger samples and longer study periods in future research. Chhetri (2023) looked at how bank-specific and macroeconomic factors affect loans and advances. He found that bank size, capital adequacy ratio, and deposit volume positively and significantly influence lending. In contrast, liquidity ratio, lending interest rates, and inflation negatively impact loan volume. This shows the joint effect of internal financial strength and external economic conditions on lending behavior. Niroula and Gnawali (2023) reported that deposit interest rates, return on assets (ROA), and inflation positively and significantly affect lending interest rates. This indicates that profitability and macroeconomic factors influence borrowing costs. Sapkota and Bhattarai (2023) suggested that policy measures focused on increasing bank size and optimizing interest rate spreads can boost lending and improve financial intermediation. Bhuiyan (2021), using data from 1998 to 2019, discovered that deposit interest rates and the ratio of non-performing loans (NPLs) significantly affect lending rates in both the short and

long term. This demonstrates the ongoing importance of deposit costs and credit quality in setting loan prices. Behre (2020) concluded that higher interest rates, greater capital adequacy, improved asset quality, and higher deposit volumes tend to lower loan volumes. He emphasized the need to balance financial stability with lending growth. Finally, Alsaket and Ekski (2020) found that bank size does not significantly impact loan volume. This suggests that regulators and policymakers should concentrate on more influential factors instead of assuming that larger banks necessarily lend more than smaller ones.

Research Framework

This study develops a research framework to explore the factors influencing the lending behavior of commercial banks in Nepal. The framework is based on both theoretical foundations and findings from previous research. It examines how the growth rate of loans and advances (dependent variable) is affected by several key independent variables: Cash Reserve Ratio (CRR), Capital Adequacy Ratio (CAR), Interest Rate Spread, Total Deposits, and Inflation Rate. These variables reflect core principles from banking regulation, financial risk management, monetary policy, and broader macroeconomic theory. By organizing these components within a clear structure, the framework helps to systematically analyze how internal banking policies and external economic conditions impact lending decisions in the Nepali banking sector,



a) Cash Reserve Ratio (CRR)

The Cash Reserve Ratio (CRR) is the part of total deposits that commercial banks in Nepal must keep with the Nepal Rastra Bank (NRB), the central bank.

This rule helps control the amount of money in the banking system and can influence possessions like inflation. The NRB changes the CRR from time to time based on the country's economic circumstances.

Hypothesis (H1) -: Cash reserve has a significant positive impact on the loan and advance in commercial banks of Nepal.

b) Capital Adequacy Ratio (CAR)

The Capital Adequacy Ratio (CAR) shows how well a bank can hold financial risks and protect itself from losses. It is set by regulators to make sure banks have sufficient capital. CAR is calculated by separating a bank's total capital (Tier 1 and Tier 2) by its risk-weighted assets. A higher CAR means the bank is stronger and better arranged for tough times.

Hypothesis (H2) -: CAR has a significant positive impact on the loan and advance in commercial banks of Nepal.

c) Interest Rate Spread

Interest rate spread is the difference between the interest a bank earns from giving loans and making investments and the interest it pays to customers on their deposits or borrowed money. This gap is an important source of profit for banks. A larger spread usually means the bank is making more profit, while a smaller spread could mean less profit or more competition in the market. It is affected by things like market interest rates, risk levels, and how much it costs the bank to run its operations.

Hypothesis (H3) **-:** Interest Rate Spreadhas the significant positive impact on loan and advance in commercial banks of Nepal.

d) Total Deposit

Total deposit refers to the total money customers keep in a bank through unusual types of accounts like savings, current, fixed deposits, and recurring deposits. This money is very important for the bank, as it is used to give loans, invest, and run day- to - day operations. The amount of deposits can go up or down depending on things like customer behavior, the economy, interest rates, and opposition among banks. Regulators keep an eye on deposit levels to make sure banks have enough money available and are managing risks appropriately.

Hypothesis (H4) -: Total deposit have a significant positive impact on loans and advances in commercial banks of Nepal.

e) Inflation Rate

The inflation rate shows how much the prices of goods and services increase over time. When inflation is high, the cost of living goes up and money loses value, meaning you can buy less with the same amount. Central banks and governments watch inflation narrowly to keep the economy stable. It is affected by things like supply and demand, government policies, and global events. Keeping inflation under control supports the people, businesses, and investors in planning and making better financial choices.

Hypothesis (H5) -: Inflation Rate has a significant positive impact on loans and advances in commercial banks of Nepal.

Model specification

In this model the dependent variable is loan and advance, which is influenced by several independent variables. The model is represented as:

$$LnLA = \alpha + \beta 1CRR + \beta 2CAR + \beta 3IRS + \beta 4LnTD + \beta 5INF + \varepsilon it$$

Where:

α = Constant term
LnLA = Natural logarithm of loan and advance
CRR = Cash reserve ratio
CAR = Capital adequacy ratio
ISR = Interest spread rate
LnTD = Natural logarithm of the total deposit
INF= Inflation rate
εit = error term
Betas (β) are the parameters of the model

Research Methods

This section outlines the methodological framework are adopted to observe the factors of influencing the lending activities of Nepalese commercial banks. The study employs to the both descriptive and causal-comparative research designs for analyze to the lending patterns and determine of the nature, strength, and way of relationships between loans and advances respectively (dependent variable) and key independent variables are Cash Reserve Ratio (CRR), Capital

Adequacy Ratio (CAR), Interest Rate Spread (IRS), Total Deposits (TD), and Inflation Rate (INF). The research focus to the population consists of all 20 commercial banks in Nepal up to March 2024, from which a purposive sample of five leading banks Prabhu Bank, Nepal Investment Mega Bank, NMB Bank, NIC Asia Bank, and Kumari Bank was selectedthe sample on the basis of financial performance and national recognition, including the Bank of the Year awards. The study is completely based on secondary data collected from annual reports, publications of the Nepal Rastra Bank (NRB), financial statements, and other believable economic sources covering the period from fiscal year 2014/15 to 2023/24. Data analysis the combines descriptive and inferential statistical techniques and tools. Descriptive statistics tools such as mean, standard deviation, and variation are used to summarize and describe data tendency and unpredictability, while inferential tools like Karl Pearson's correlation coefficient and multiple regression analysis (performed using SPSS Version 27) are employed to assess the relationship, significance, and impact of the independent variables on the investing behavior of the selected commercial bank in Nepal.

Result

This section of the results analyzes the factors influencing the lending behavior of leading commercial banks in Nepal by applying both descriptive and inferential statistical methods. Descriptive statistics, including measures like the mean, standard deviation, and variance, are used to summarize and present the overall characteristics of the data. Inferential statistics, such as Karl Pearson's correlation and multiple regression analysis, are employed to examine the relationships between variables and assess how various factors affect lending behavior.

Table 1

Descriptive Statistics of all Variables of Sample Banks

Variables	N	Minimum	Maximum	Mean	SD	Variance
CR Ratio	50	2.80	27.86	11.23	7.4459	62.349
CA Ratio	50	7.56	14.93	10.6442	0.9866	1.3289
IRS	50	2.84	5.30	3.1242	0.5283	0.3937
Deposit	50	9.11	11.68	10.4720	0.6172	0.4781
Inflation	50	2.54	8.14	5.6290	1.8724	3.256
Loan and Advance	50	8.65	11.59	10.2953	0.6228	0.452

Table 1 Descriptive statistics provide a comprehensive picture of how six important financial factors are distributed and how they vary across 50

observations. This helps to understand how Nepalese commercial banks manage their lending activities.

The Cash Reserve Ratio (CR Ratio) exhibits a wide range, from 2.80 to 27.86, with a standard deviation of 7.45 and a variance of 62.35. These statistics indicate significant differences in how banks manage their liquidity. In contrast, the Capital Adequacy Ratio (CARatio) has a mean of 10.64 and a low standard deviation of 0.99, suggesting that banks maintain a relatively steady capital level in accordance with regulations.

The Interest Rate Spread (IRS) ranges from 2.84 to 5.30, with a mean of 3.12 and low variability, reflecting stable practices in interest margin management. The deposit variable which represents the total deposits are fairly consistent across banks, with a mean of 10.47 and a standard deviation of 0.62, indicating similar deposit collection patterns.

Inflation rates range from 2.54 to 8.14, with a standard deviation of 1.87, showing moderate levels of change that may reflect economic fluctuations affecting lending activities. Lastly, the Loan and Advance variable has a mean of 10.30 and a standard deviation of 0.62, indicating a consistent level of lending amounts among the sample banks.

Table 2

Karl Pearson's Correlation Analysis of Study Variables

Variables	CR Ratio	CA Ratio	IRS	Deposit	Inflation	Loan and Advance
CR Ratio	1					
CA Ratio	-0.167	1				
IRS	0.018	-0.145	1			
Deposit	-0.187	0.265	0.102	1		
Inflation	0.268	-0.287	-0.013	-0.403	1	
Loan and Advance	-0.219	0.432	0.073	0.837	-0.487	1

Table 2 show the correlation matrix, illustrating how six important variables Cash Reserve Ratio (CRR), Capital Adequacy Ratio (CAR), Interest Rate Spread (IRS), Log of Total Deposits (TD), Inflation (INF), and Log of Loans and Advances (LA) are interconnected. The correlation coefficients range from -1 to +1. A positive value indicates that the variables move in the same direction, while a negative value signifies they move in opposite directions.

The CRR has significant negative correlations with LA (-0.219) and TD (-0.187). This suggests that when banks are required to hold more cash reserves, they tend to have fewer deposits and lend less. The CAR shows a strong positive relationship with both LA (0.432) and TD (0.265), implying that banks with higher capital levels are better able to lend and attract more deposits. Additionally, the CAR has a significant negative correlation with inflation (-0.287), indicating that higher inflation makes it harder for banks to maintain strong capital positions.

Inflation is negatively linked with both TD (-0.403) and LA (-0.487), showing that higher inflation can lead to lower deposits and reduced lending activity. The strongest connection is between TD and LA (0.837), indicating that as deposits increase, loans tend to increase as well. Meanwhile, the interest rate spread (IRS) does not exhibit strong correlations with any of the other variables.

Table 3

Regression Analysis for Dependent Variable Ln Loan and Advance

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-0.487	0.134		-2.563	<0.001
CR Ratio	-0.001	0.001	-0.009	-1.976	0.289
CA Ratio	0.017	0.004	0.037	2.023	<0.001
IRS	-0.031	0.009	-0.029	-2.156	0.002
Deposit	1.023	0.011	0.896	84.362	<0.001
Inflation	-0.005	0.003	-0.018	-1.301	0.06 8
R			0.94		
R Square			0.92		
Adjusted R Square			0.90		
Std. Error of the Estimate			0.04587		

Table 3 shows the regression results, explaining how different factors influence the amount of loans and advances issued by banks. These factors include the Cash Reserve Ratio (CRR), Capital Adequacy Ratio (CAR), Interest Rate Spread (IRS), the natural log of total deposits (Deposit), and inflation. The constant term, which is -0.487, is highly significant ($p<0.001$), indicating that even when all other factors are zero, there is still a baseline level of loans being made. Among all the factors, deposits have the greatest and most positive effect on loans. Its coefficient is 1.023, and the standardized Beta is 0.896, meaning that for every unit increase in deposit size, the loan amount increases substantially. The t-value for this variable is very high (84.362), confirming its strong influence on lending.

The CAR also shows a positive effect (B=0.017, p<0.001), suggesting that banks with higher capital levels tend to lend more. Conversely, IRS has a negative effect (B=-0.031, p=0.002), implying that when the difference between lending and deposit interest rates widens, banks tend to lend less, possibly due to higher risks or tighter lending conditions. Both CRR and inflation have negative coefficients, indicating that higher values of these factors are associated with lower loan amounts. However, their p-values (0.289 and 0.068) suggest that these effects are not statistically significant at conventional levels. The regression model's summary indicates that it is a very strong and well-suited model for analyzing factors influencing bank loans and advances in Nepal. The correlation coefficient (R) is 0.94, signifying a very strong positive relationship between the actual values of the dependent variable (Loans and Advances) and those predicted by the model.

The R-squared value is 0.92, meaning that 92% of the variation in bank investing can be explained by the independent variables CRR, CAR, IRS, log of total deposits, and inflation. This shows the model accounts for most factors influencing lending. The adjusted R-squared is 0.90, indicating that the model remains reliable even when considering the number of predictors, and that the results are not overestimated due to too many variables. The standard error of the estimate is 0.04587, which is close to the actual data range, demonstrating that the model's predictions are accurate and errors are small. Overall, these results suggest that the regression model is strong, reliable, and appropriate for studying the determinants of bank lending in Nepal.

Table 4

Empirical Results of Hypotheses Testing on Factors Affecting Loans and Advances

Hypothesis	Statement	p-value	Result	Significance
H1	Cash Reserve has a significant positive impact on loan and advance	0.289	Not Supported	Insignificant
H2	Capital Adequacy Ratio (CAR) has a significant positive impact on loan and advance	<0.001	Supported	Significant
H3	Interest Rate Spread has a significant positive impact on loan and advance	0.002	Not Supported	Insignificant
H4	Total Deposit has a significant positive impact on loan and advance	<0.001	Supported	Significant
H5	Inflation Rate has a significant positive impact on loan and advance	0.068	Not Supported	Insignificant

Discussion

This study digs into what really shapes how commercial banks in Nepal invest money. The numbers make it clear: total deposits and the capital adequacy ratio (CAR) matter most for loan and advance growth. Basically, banks with bigger deposit bases can hand out more loans no surprise there. The data backs this up ($B=1.023$, $p<0.001$), and it lines up with what Chhetri (2023) and Sapkota and Bhattarai (2023) found before liquidity drives lending. On top of that, a higher CAR ($B=0.017$, $p<0.001$) means banks aren't just safer, they're also in a better spot to lend more. Bhuiyan (2021) pointed this out too: stronger capital gives banks the cushion they need to keep lending steady. On the flip side, the Cash Reserve Ratio (CRR), interest rate spread (IRS), and inflation all show negative links with lending, though these aren't statistically significant. Still, the patterns make sense. A higher CRR ties up more funds, so banks can't lend as much. A wider interest spread seems to slow down lending too, maybe because borrowers get turned off or banks are just being more cautious. Inflation's pullback on lending is there, but pretty minor in this case. Looking at the correlations, deposits stand out they have the strongest positive link with lending ($r=0.837$). So, while things like CRR, IRS, and inflation do play a part, the real engine for lending in Nepal's banks is their own financial muscle, especially deposits and capital strength. What does all this mean? If banks and policymakers want to keep credit growing in a healthy way, they need to focus on building up deposits and keeping capital buffers solid. That's where the real leverage lies.

Conclusion

This study looked at what drives lending behavior in a handful of commercial banks in Nepal, focusing on both the banks' own characteristics and the bigger economic picture. Turns out, total deposits and capital adequacy ratio (CAR) really matter banks with more deposits and stronger capital are better at expanding their loans and advances. On the flip side, cash reserve ratio (CRR), interest rate spread, and inflation seem to hold lending back, though their impact isn't strong enough to be statistically significant. The model explains a lot ($R^2 = 0.92$), so these factors do a pretty good job of capturing what's going on with bank investing in Nepal. Bottom line: a bank's financial strength makes a bigger difference in lending decisions than the broader economy, at least in this study. For bank managers and policymakers, this means it's smart to focus on building

up deposits and keeping capital levels healthy if they want steady credit growth and a stable financial system.

The study only looked at five banks, so it might not tell the whole story for the entire sector. Plus, it relied on secondary data and a static regression model, which doesn't really show how things change over time. Next time, researchers should look at more banks, bring in other big-picture variables like GDP growth, exchange rates, and unemployment, and use more advanced methods like fixed effects, random effects, or dynamic panel models to get a deeper, more accurate look at what's driving bank lending in Nepal.

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