

Financial Performance of Standard Chartered Bank Nepal Ltd.

By

Rashita Awale

Patan Multiple Campus

TU. Reg. No: 7-2-256-303-2001

Campus Roll No.: 149/062

Exam Roll No.: 1497/064

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तमसोमा ज्योतिर्मय

क्याम्पस प्रमुखको कार्यालय
Office of the Campus Chief
Ph.: 5-547510

पत्र संख्या/Ref. No

त्रिभुवन विश्वविद्यालय
TRIBHUVAN UNIVERSITY
पाटन संयुक्त क्याम्पस
PATAN MULTIPLE CAMPUS

फोन	Phone
५-५२९३९८	5-529911
५-५२२०७६	5-522076
५-५२६३९८	5-526394

पाटनढोका, ललितपुर, नेपाल
Patandhoka, Lalitpur, Nepal

मिति / Date:

RECOMMENDATION

This is to certify that the thesis

Submitted by:

Ms. Rashita Awale

Entitled:

**Financial Performance of
Standard Chartered Bank Nepal Ltd.**

has been prepared as approved by this Campus in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

.....
Mr. Bijay Gopal Shrestha
Thesis Supervisor

.....
Mr. Bishnu Gopal Khimbaja
Coordinator-MBS Programme

.....
Mr. Babu Ram Singh Thapa
Asst. Campus Chief

Date:



तमसोमा ज्योतिर्मय

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पाटनढोका, ललितपुर, नेपाल
Patandhoka, Lalitpur, Nepal

मिति/Date:

VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis

Submitted by:

Ms. Rashita Awale

Entitled:

**Financial Performance of
Standard Chartered Bank Nepal Ltd.**

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

Master of Business Studies (M.B.S.)

Viva-Voce Committee

Head, Research Department:

Member (Thesis Supervisor):

Member (External Expert):

Date:

DECLARATION

I hereby declare that this study entitled “**Financial Performance of Standard Chartered Bank Nepal Ltd.**” submitted to the Office of the Dean, Faculty of Management, Tribhuvan University, is my original research work carried out to satisfy the partial fulfillment of the requirements for the degree of Master of Business Studies (M.B.S.) under the supervision of Associate Professor Mr. Bijay Gopal Shrestha, Patan Multiple Campus.

Rashita Awale

Roll No.: 149/062

T.U. Registration No: 7-2-256-303-2001

Exam Roll No.: 1497/064

February, 2012

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TABLE OF CONTENTS

CHAPTER – 1: INTRODUCTION.....	1
1.1 General Background.....	1
1.2 Profile of Standard Chartered Bank Nepal Limited.....	4
1.3 Focus of the Study.....	8
1.4 Statement of the Problem.....	8
1.5 Objectives of the Study.....	9
1.6 Limitations of the Study.....	10
1.7 Significance of the study.....	10
1.8 Organization of the study.....	11
CHAPTER – 2: REVIEW OF LITERATURE.....	12
2.1 Conceptual Review.....	12
2.1.1 Bank.....	12
2.1.2 Commercial Bank Concept.....	13
2.1.3 Joint Venture Banks.....	14
2.2 Review of Legislation Related to Commercial Bank.....	15
2.2.1 Concept of Commercial Bank.....	15
2.2.2 Company Act 2021 (Amended to company Act 2053).....	15
2.2.3 Commercial Bank Act 2031 (Amended to Commercial Act 2049).....	15
2.2.4 Nepal Rastra Bank Act 2012 (Amended to NRB Act 2049).....	17
2.2.5 Other policies.....	18
2.3 Review of Books and Journals.....	21
2.3.1 Review of Books.....	21
2.3.2 Review of Journals.....	25
2.3.3 Review of thesis.....	28

CHAPTER – 3: RESEARCH METHODOLOGY	37
3.1 Introduction	37
3.2 Research Design.....	38
3.3 Population and Sample.....	38
3.4 Data Collection Procedure	40
3.5 Data Analysis Procedure	40
3.5.1 Financial Variables, Tools and Models Used:	40
3.5.2 Outlines of the variables used and corresponding models:.....	43
3.5.3 Statistical Tools used:	46
CHAPTER – 4: PRESENTATION AND ANALYSIS OF DATA	47
4.1 Profitability Analysis using Du Pont Approach:.....	47
4.1.1 Analysis of ROA and ROE with composite factors:.....	50
4.2 Analysis of Descriptive Statistics:	61
4.3 Correlation between leverage and ROE.....	63
4.3.1 Test of assumptions for Parametric Statistics:	65
4.3.2 Spearman’s Rank Correlation coefficient:	66
4.4 Major Findings of the Study	67
CHAPTER – 5: SUMMARY AND CONCLUSION.....	70
5.1 Summary	70
5.2 Conclusion	72

BIBLIOGRAPHY

ANNEXURE

LIST OF TABLES

Table 4.1	Net Profit (NP), Total Operating Revenue (TOR), Total Assets (TA) and Total Equity (TE) of SCBNL with Percentage Relative.....	48
Table 4.2	NPM, AU, EM, ROA and ROE of SCBNL and Percentage Relatives.....	51
Table 4.3	ROA Details: Ratios of Costs and Revenues against Common Denominator, Total Asset	54
Table 4.4	Descriptive Statistics of Variables used in Du Pont Model to Analyze Profitability of SCBNL	61
Table 4.5	Descriptive Statistics of Breakdowns of ROA of SCBNL.....	62
Table 4.6	Financial Leverage measured as equity multiplier [EM] and Return on equity [ROE] of SCBNL.....	64
Table 4.7	Test of Association between Leverage and ROE.....	66

LIST OF FIGURES

Figure 4.1	Movements of NP and TOR over the years	49
Figure 4.2	Movements of TA and TE over the years	50
Figure 4.3	NPM and AU of SCBNL over the years.....	52
Figure 4.4	Interest income to TA and Interest Margin to TA of SCBNL over the years	56
Figure 4.5	Interest expenses to TA and Interest margin to TA of SCBNL over the years	56
Figure 4.6	Non-interest income, Non-interest expenses to TA and Net Non-interest margin to TA of SCBNL over the years.....	58
Figure 4.7	Box and whisker plot of ROE showing outlier	65

LIST OF ACRONYMS

A/C	–	Account
AD	–	Anno Domini
ATM	–	Automatic Teller Machine
AU	–	Assets utilization
BIS	–	Banks for International Settlement
BS	–	Bikram Sambat
CV	–	Coefficient of Variance
DPS	–	Dividend per share
EM	–	Equity Multiplier
EPS	–	Earning per share
Exp.	–	Expenses
FY	–	Fiscal year
GoN	–	Government of Nepal
HBL	–	Himalayan Bank Limited
i.e.	–	that is
Inc.	–	Income
JVB	–	Joint Venture Bank
Ltd.	–	Limited
NBBL	–	Nepal Bangladesh Bank Limited
NBL	–	Nepal Bank Limited
NGOs	–	Non-government Organisations
NP	–	Net profit
NPM	–	Net Profit margin
NPR	–	Nepali Rupees

NRB	–	Nepal Rastra Bank
NSBIBL	–	Nepal State Bank of India Bank Limited
P/L	–	profit and Loss
ROA	–	Return on Assets
ROE	–	Return on Equity
SBI	–	State Bank of India
SCBNL	–	Standard Chartered Bank Nepal Limited
SD	–	Standard Deviation
TA	–	Total Assets
TE	–	Total Equity
TOR	–	Total Operating Revenue
TU	–	Tribhuvan University
USD	–	US Dollar

CHAPTER – 1

INTRODUCTION

1.1 General Background

The need to improve the strength of financial systems has attracted growing international concern. Banking as a vital section of total financial system, it has greater importance in overall economic development. Rose (2002) points out that as banker work within the financial system to supply loans, accept deposits, and provide other services to their customers, they must do so within a climate of extensive regulation, designed primarily to protect the public interest. So banking is one of the most heavily regulated businesses in the world. As quoted in Encyclopedia a bank is a business organization that receives and holds deposits of funds from others and makes loans or extends credits and transfers funds by written orders of deposits.

Banking in Nepal started with the inception of Nepal Bank Limited on 30th Kartik 1994 B.S. (1937 A.D.) with 51 percent government's equity. Rights from the inception, it is carried out function of the commercial bank. Having felt the need for the development of the banking sector, government formulated monetary policies and Nepal Rastra Bank was established on 14th Baisakh B.S. (1956 A.D.) under NRB act 2012. Since then it has been functioning as the government bank and has contributed to the growth of financial sector. As highlighted in NRB Banking and Financial Statistics (2006), there is a tremendous growth in the number of financial institution in Nepal in the last two decades. At the beginning of the 1980's when financial sector was not liberalized, there were only two commercial banks, and two development banks performing banking activities in Nepal. There were no micro credit development banks, finance companies, cooperatives and NGOs with limited banking transactions. After the liberalization of the financial sector, financial sector has made a hall-mark progress both in terms of the number of financial institutions and beneficiaries of financial services. By mid-July 2006, NRB licensed bank and non-bank financial institutions totaled 194. Out of them, 18 are commercial banks, 29 development banks, 70 finance companies, 11 micro credit development banks, 19 saving and credit co-operatives, and 47 NGOs.

As survival, development and prosperity of any organization depend on number of factors. Every organization should give prime concern to those factors. However one of the major determinants for effective running of a business entity is its financial operation system. Optimum utilization of the organizations financial resources, leads the organization to the ultimate target fulfillment. So, it is very important to analyze the accounting and financial statements to know whether the financial position is sound and what kind of measures should be applied.

Effective planning and control are central to enhancing enterprise value. Financial plans may take many forms, but any good plan must be related to the firm's existing strengths and weakness. The strength must be understood if they are to be used to proper advantage, and the weaknesses must be recognized if corrective action is to be taken.

Financial analysis is the process of identifying the financial strengths and weakness of the firm by properly establishing relationships between the items of the balance sheet and the profit and loss account. It can be undertaken by management of the firm, or the parties outside the firm, viz, owners, creditors, investors and other stakeholders.

In financial analysis, a ratio is used as a benchmark for evaluating the financial position and performance of a firm. The absolute accounting figures reported in the financial statements do not provide a meaningful understanding of the performance and financial position of a firm. An accounting figure conveys meaning when it is related to some other relevant information. The relation between two accounting figures, expressed mathematically, is known as a financial ratio. It helps to summarize the large quantities of financial data and to make qualitative judgment about the firm's financial performance of the firm.

A method of performance measurement that was started by the DuPont Corporation in the 1920s and has been used by them ever since. With this method, assets are measured at their gross book value rather than at net book value in order to produce a higher return on equity (ROE) which is also known as "DuPont Identity". Therefore, this study is conducted to appraise the financial performance of the Standard Chartered Bank Nepal Limited with DuPont approach.

Commercial banks play a vital role in the economic development of the country. In recent years due to liberal economic policy of the government, many private banks are coming into operation. The foreign joint venture banks are enjoying competitive advantageous factors like highly skilled personnel, modern and advanced banking technology, and customer oriented modern banking services, management expertise and global banking network. So, banking sector is becoming more dynamic and subject to rapid changes. It is not enough to analyze operating performance. Financial analysis must also include consideration of the strategic and economic development to which bank must relate for the long run success.

Whether the banks are well moving or not is reflected through their performance. Especially profitability position, liquidity position, turnover, dividend payment over shares, earning per share, position of reserve, capital structure policy etc are major concern.

To meet the objectives, the overall performance of the bank should be soundly adjusted with each other. Only the well-combined factors assist in well performance. When performance will be well, the output will generally be sound. It helps bank to proceed in its track. The commercial banks perform various functions. The primary function of commercial bank is the extension of credit of worthy borrowers. Bank lending contributes a lot to the economy in terms of financial, agricultural, commercial, social services, and industrial. One of the major functions of commercial banks that differentiate them from other institutions is their ability to create money through lending and investing activities. The power of commercial banking system to create money is of great economic significance as it helps to create credit system that is necessary for economic progress. Payment mechanism is a part and parcel of commercial banks, which makes use of cheques and credit cards facilitating safe and efficient transaction. The commercial banks render very important service to all sectors of the economy, by providing facilities for the pooling of saving to be used for socially desirable purposes and the saver is paid with interest on his deposits. The pooled fund is made available to others in the form of loans for some productive purpose. These banks efficiently arrange the amount of foreign exchange required by business organizations. Moreover, the issue of letter of credit has facilitated foreign trade transactions. And safe keeping of is one of the oldest services rendered by commercial banks. They provide locker facilities to keep valuable and they are accepted by commercial banks.

In the present context the role and importance of the commercial bank has loomed large. In this connection Nepalese economy has witnessed several changes in the financial systems in the few years or so, for example, financial liberalization.

As there has been number of commercial banks established the present aims to appraise the financial performance of SCBNL just to be assured whether they can put contribution in the economic growth of the country or not.

Financial analysis may be of two types viz vertical analysis and horizontal analysis. When a financial statement like a Balance sheet or a Profit and Loss account of a certain period is analyzed, the analysis is called vertical analysis. Since, it measures position of the business at a point of time; it is also known as static analysis. In horizontal analysis a series of statement relating to a number of years are reviews and analyzed. It is also known as a dynamic analysis because it measured the change of position or trend of the business over a number of years. This study is based on horizontal analysis.

1.2 Profile of Standard Chartered Bank Nepal Limited

The bank was originally established as a joint venture of Grindlays Bank Private Limited Company and Nepal Bank Limited in 1987 with the shareholding ratio of ANG Grindlays Bank Limited 50 percent, Nepal Bank Limited 33.34 percent and General public 16.64 percent. Along with the change of ownership to SCBNL, the banking area of SCBNL saw the rise of a new dawn changing the general image of the Bank. With this acquisition, SCBNL now the Bank is an integral part of Standard Chartered Group having an ownership of 75 percent in the company with 25 percent shares owned by the Nepalese public. The Bank enjoys the status of the largest international bank currently operating in Nepal.

An integral part of the only international banking Group currently operating in Nepal, the Bank enjoys an impeccable reputation of a leading financial institution in the country. With the mission statement "To be the leading international bank in our principal markets", the bank operates through 14 branches and 23 ATM centers spread throughout Nepal and focuses mainly on corporate, consumer and commercial banking, providing services for international firms as well. SCBNL is in a position to serve its customers through a large domestic network. In addition to which the global network of Standard

Chartered Group gives the Bank a unique opportunity to provide truly international banking in Nepal. Further it's been a major contributor to the governmental offices as the highest private corporate taxpayer in the kingdom.

The bank has 400 staffs as on 15th July 2011, they all are enough qualified, trained and dedicated to provide quality service to the consumers of the bank. Moreover, the bank is still trying to improve skills and knowledge of the staffs by providing various trainings and development works. With the current slowdown in the economy due to domestic and international factors, and recently introduced changes in the Nepal Rastra Bank directives, the bank has taken following strategies:

Follow the standard banking practices.

- To have the largest deposit base among the private sector banks.
- Increase the profitability and shareholders wealth.
- Dominate cards acquiring market.
- Expand delivery channels to stimulate additional fee revenue.
- Increase consumer bank contribution – ATM, Consumer loans, Mortgages, Personal loans, etc.
- To become bigger, more profitable and efficient to compete with biggest competitors.

Products and Services

- **PERSONAL BANKING**
 - ❖ **Deposits**
 - Saving accounts
 - Current accounts
 - Fixed deposits
 - Kiddy Bank account
 - Access bank Account
 - Diva Bank
 - Amulya Bachat Khata

- ❖ **Cards**
 - Rupees Credit Card (Visa & Master)
 - Prepaid Cards (NPR & USD)
 - USD Credit Cards
 - Instabuy
 - Reward Scheme
- ❖ **Loans**
 - Home Loan
 - Auto Loan
 - Personal Loan
 - Cash/Near cash backed loan
- ❖ **Priority Banking**
- ❖ **Insurance**
 - Secured Life Insurance
 - Secure Assets (Home / Vehicle Insurance)
- ❖ **Other services**
 - Automatic Teller Machines
 - Online Banking
 - Safe Deposit Lockers
 - Remittances
- **SME BANKING**
 - ❖ **Deposit Management**
 - ❖ **Credit facilities**
 - Overdraft
 - Short Term Loan
 - Demand Loan
 - Term Loan
 - Letter of Credit
 - Trust Receipt Loan/Importer's Loan
 - Export Credit
 - Bank Guarantees

- **WHOLESALE BANKING**
 - ❖ **Transaction Banking**
 - **Cash Management**
 1. **Payments**
 - Cross Border Payments
 - a. Telegraphic Transfers
 - b. International Bank Cheques/Drafts
 - c. Quick Payment Services to Beneficiaries in India
 - Domestic Payments
 - a. Local Bank cheques /drafts/Cashier's order
 - b. Local Bank Transfers
 - c. Book Transfers (account transfers between SCBNL accounts)
 - d. Payment through Correspondent Banks
 - Payroll Management
 - a. Managing Payroll for Large Corporate and Institutional Clients
 - Payment System Integration
 - a. Straight2Bank Channel (Internet channel)
 2. **Collections**
 - Extensive Clearing Network
 - Guaranteed Credit
 - Quick Collection Services (QCS)
 - Domestic Collection Services
 - Comprehensive MIS
 - Outsourcing of Collection
 3. **Liquidity Management**
 - **Trade Solutions:**
 1. **Imports:**
 - Letter of Credit
 - Import Bills for Collection
 - Shipping Guarantees
 - Import Financing (Loan Against Trust Receipt/imports)
 - Import Invoice Financing
 - Performance Bonds and Other Guarantees

2. Exports:

- Export Letter of Credit advising
- Export Letter of Credit Safe keeping
- Export Letter of Credit Confirmation
- Pre-shipment export Financing
- Export Bills for collection
- Export Invoice Financing
- Supply Chain Financing (Buyer Financing)
- Letter of Credit Reimbursements

❖ Corporate and Institutional Lending

❖ Financial Markets

1.3 Focus of the Study

The focus of this study is to analyze the financial performance of Standard Chartered Bank Nepal Limited with DuPont Approach. Financial performance covers the financial analysis and other portfolios of the SCBNL. Financial analysis is the process of determining the significant operating and financial characteristics of a firm from accounting data and financial statements. The goal of financial analysis is to determine the efficiency and the performance of the firms' management as reflected in the financial records and reports. Besides the financial analysis, the study is also focused on Income and expenditure analysis and statistical analysis.

Financial ratio has helped the researcher to make a qualitative analysis about the financial performance of the bank. The income and expenditure analysis is the percentage in relation to total assets or total sales, which has helped the researcher to study trends in financial statements over time. The statistical analysis refers either to quantitative information or to a method of dealing with quantitative information.

1.4 Statement of the Problem

Nepal, as an economically back pushed country, most of the resources of the country are remained unused due to lack of financing. This inadequacy of financing can be removed by participation of foreign investors in the commercial banks to some extent. With this view welcomed the joint venture banks in Nepal. Joint venture foreign commercial banks

are operating in Nepal after the GoN adopted the open liberal and market oriented economic policy, the financial sectors has not been enough to meet the growing resource need to the economy.

Financial performance and conditions are important to judge bank operations. Strong financial performance and sound financial conditions are critical to a bank's ability to provide necessary services. The essence of the financial soundness of a company lies in balancing its goals, commercial strategy, product market choices and resultant financial and statistical tools such as financial ratios, income and expenditure statement analysis etc. Ratio analysis is a very useful analytical technique to raise pertinent questions on a number of managerial issues. Many questions relating to company overall profitability, liquidity position and long term solvency, operating efficiency, inter-firm comparison, assets utilization should be answered while assessing the financial condition of the company.

Various issues are to deal for the purpose of this study. Present study attempts to answer the following research questions.

- a. What is the position of profitability of SCBNL?
- b. What is the status of operating activities of SCBNL?
- c. What is the intensity of association between financial structure and return to the equity holders?

1.5 Objectives of the Study

The basic objective of this study is to analyze and examine the financial performances of SCBNL by applying Du Pont approach. The specific objectives of the study are presented as follows.

- a. To examine the profitability position of the bank.
- b. To evaluate the operating activities of the bank.
- c. To observe the association between leverage and return to equity holders of SCBNL.

1.6 Limitations of the Study

For the completion of this study, the following facts are the basic limitation.

- a. The study is based on secondary data. So accuracy depends upon the data collected and provided by the organization.
- b. Non-availability of the various reference or sources acts as constraint for the study.
- c. This study covers certain period data (7 years) for the analysis; result is based on this data.
- d. The data available in published annual reports have been assumed to be correct and true.
- e. Time and money are also constraints for the study.
- f. Although there are many commercial banks, the study limits to only SCBNL.

1.7 Significance of the study

Since this study has been attempted to make synthesis of Du Pont model in analyzing financial performance of banking business with special reference to SCBNL, it will be very interesting and informative to the concern academicians and practitioners.

The present study will be more helpful to aware the shareholder and other stakeholders regarding financial performance of this bank. Besides that other beneficiaries of the study can be categorized as follows:

- a. Lenders and borrowers of this bank
- b. Management of this bank
- c. Policy maker of this bank
- d. Academicians/ Researchers
- e. All other interested individual and parties
- f. Nepal Rastra Bank - Central Bank of Nepal.

1.8 Organization of the study

In this study five chapters are included which are as follows.

First chapter deals with the introduction that includes background of the study, profile of the concerned bank, focus of study, statement of problem, objectives of study, limitation of the study, significance of the study and organization of the study.

After the introduction part, the second chapter deals with the available literature review. It includes review of books, review of legislations related to commercial banks, review of other relevant books, review of bank's reports and review of previous thesis.

Whereas the third chapter explains the research methodology used in the study, which includes research designs, sampling design that includes nature and sources of data, population and samples, methods of data analysis.

The third chapter is linked with the fourth chapter which is presentation and analysis of data. This chapter is the heart of the study. It includes presentation and analysis of data using financial and statistical tool. To assess the banking business and financial performance of the selected bank, this chapter analyzes the data using Du Pont approach and other financial ratios with relevant statistical tool i.e. descriptive statistics and correlation.

And fifth and last chapter revolves with the suggestions, which include the summary of main findings and conclusions of the study.

CHAPTER – 2

REVIEW OF LITERATURE

This chapter highlights and deals with the literature relevant to this study. It comprises review of books, previous studies received, article review and review of policy documents. It is divided into following headings.

2.1 Conceptual Review

2.1.1 Bank

The word “Bank” is derived from the Italian word “BANCO”, which means a counter tables or bench used by medieval money exchange. Oxford dictionary defines banks as “an establishment for the custody of money”

A bank is an institution, which deals in money, receiving it on deposit from customers, honoring customer’s drawings against such deposit on demand, collecting cheques for customers and lending or investing surplus deposits until they are required for repayment.

The roles of commercial bank were seriously in the growth and development of national economy, as a result they grew rapidly in number.

Generally, an institution established by law, which deals with money and credit is called bank. It is obvious that in a common sense, an institution involved in monetary transaction is called bank. A bank simply carries out the work of exchanging money, providing loan, accepting deposit and transferring the money. Section 2(a) of the Nepal Rastra Bank Act 2058 (2002) defines bank as follows: -

“Bank” means the Nepal Rastra Bank established under section 3 of this Act. Like-wise, according to section 2 (b) of the Commercial bank established under this Act.” Though the banks established by both of these acts are called bank, we do not find clear definition of it. In addition to this, Section 2(a) of the Negotiable Instrument Act 2034 (1977) defines that a bank, which is established under the existing law shall be called bank.

It is very difficult to give definition to any particular subject matter. It is really a difficult task to express and give meaning of any subject in few words. So, different scholars have presented the definition or meaning of the same subject matter in different ways. There is no similarity to all scholars. There is different saying by different scholars. Sayer (1951) believes that the facts, the banks are not merely purveyors of money, but also in an important sense manufacturer of the money. Oxford Dictionary defines banks as an establishment of the custody of money received from or on behalf of its customers. Its essential duty is to pay their draft on it, its profit arise from its use of the money left unemployed of them. Halsbury's law of English of opinion that a banker is an individual, partnership or corporation, whose sole or predominating business is banking, i.e., the receipt of money on current or deposit account and the payment of cheques paid in by a customer. A person or company carrying on the business of receiving moneys and collecting draft, for customers subject to the obligation of honoring cheques drawn upon them from time to time by the customers to the extent of the amount available on their current accounts.

Ram (1969) stated that "Banking means accepting: for the purpose of lending or investing, the deposits of money from the public, repayable by cheques, drafts, order or otherwise."

Sayers (1951) "Ordinary banking business consists of changing cash for bank deposits and bank deposits from one person to corporation (one depositor to another) giving bank deposits in exchange for bills or exchange: governments bonds. Secured and unsecured promises businessmen to repay."

2.1.2 Commercial Bank Concept

Commercial banks are the heart of the financial system. They hold the deposits of many persons, government establishment and business units. They make fund available through their lending and investing activities to borrowers, individual business firms and services from the producers to customers and the financial activities of the government. They provide a large portion of the medium of exchange and they are media through which monetary policy is affected. These facts show that the functioning of the economy."

The American Institute of Banking (1972) has laid emphasis on the four functions of commercial bank as “receiving and handling deposits of money (deposit function), handling payment of money (payment function), making loans and investments (loan function) and creating money by extension of credit (money function).”

2.1.3 Joint Venture Banks

According to Gupta (1983), “A joint venture is joining of forces between two or more enterprises for the purpose of carrying out specific operations (industrial or commercial investment production or trade”.

In the context of Nepal, JVBs plays very important role to national economy. Since, Nepal is follower of mixed economic policy, JVBs plays very important role in national economy. They bring foreign capital, skill, art, technique and experience. JVBs pose a serious challenge to the existence of the inefficient native banks as an opportunity to modernize themselves and sharpen their competitive zealous.

According to K.C. (2048), “A county to be benefited from venture capital should have a favorable investment climate. In Nepal, three of the dramatic reforms were carried out in 1980’s. The major are allowing the foreign banks to operate as a joint venture banks lifting a control on interest rate and introduction of the auctioning of government securities.”

Shrestha (1991) in his article “Commercial banks comparative performance evaluation concludes that: JVBs are new, operationally more efficient, having superior performance while comparing with local banks, better performance of JVBs is due to their sophisticated technology, modern banking methods and skill. Their better performance is also due to the government branching policy in rural areas and financing Pes.”

Shrestha (1980) has concluded that “The bank has sufficient liquidity meet the claim of depositors (excluding fixed deposits). The bank has a highly geared capital structure and is more depending on borrower funds. The bank has been able to meet the interest on deposits out of its profit. The rate of return on ownership capital is favorable. He further suggest that operational efficiency should be enhance to achieve its higher profit goal for better performance.”

2.2 Review of Legislation Related to Commercial Bank

2.2.1 Concept of Commercial Bank

Commercial Bank Act 2031 was formulated to facilitate the smooth run of commercial banks. All the commercial banks are functioning under this act. This act defines the banks as, “A commercial bank is one which exchange money, deposits money, accepts deposits, grants loans and performs commercial banking function and which is not a bank meant for cooperative, agriculture, industry or for specific purpose.”

“The commercial bank Act 2031 also pointed the function of Commercial banks commercial banks provide short term debts necessary for trade and commerce. They take deposit from the public and grant loans in different forms. They purchase and discount bill of exchange, promissory note, and exchange foreign currency. They discharge various functions on the behalf of their customers provided that they are aid for their services.”

The preamble of Nepal Bank Act 1994 clearly states the need of commercial bank in the country, “In absence of any bank in Nepal the economic progress of the country was being hampered and causing inconvenience to the people and therefore with the objective of fulfilling that need by providing services the people and for the betterment of the country, this law is hereby promulgated for the establishment of the bank and its operation.”

2.2.2 Company Act 2021 (Amended to company Act 2053)

The Commercial Bank Act 2031 states that Commercial Bank including JVBs in Nepal can be established only as a company with limited liability under the Company Act, 2021 on the recommendation of Nepal Rastra Bank. The provision mentioned in the Act strictly regulates the commercial banks in all the aspects, starting form the incorporation to the winding up of the bank.

2.2.3 Commercial Bank Act 2031 (Amended to Commercial Act 2049)

The precision requires under this act for the establishment of the commercial banks are mentioned below.

Establishment of Bank

- a. A bank shall be established under the Company Act with the recommendation of the Nepal Rastra Bank. For obtaining such recommendation, an application shall be filed, along with the particulars by the Nepal Rastra Bank. Only in case the Nepal Rastra Bank so recommends shall such bank be registered according to the company Act for working under this Act.
- b. The Nepal Rastra Bank may prescribe necessary conditions while recommending the establishment of a bank under sub section (1), and it shall be the duty of the concerned bank to fulfill the conditions so prescribed.
- c. The bank may determine the location of its head office with the approval of the Nepal Rastra Bank.
- d. The bank shall be an autonomous corporate body with the perpetual succession. It may sue or be sued in its own name.
- e. Subject to this Act and other current Nepal Law, the bank may acquire, use and sell movable and immovable property.
- f. Any bank may open or shift the location of, or close branches depots or other offices with the approval of NRB.

Establishment of Branches of Joint venture foreign banks

- a. In case any foreign commercial bank desires to open a branch, representative office or liaison such branch under the company Act with the approval of NRB, and provisions of the act shall apply to such foreign bank.
- b. The NRB shall obtain the consent of Government of Nepal before granting approval under sub-section 1.
- c. While granting approval under sub-section (1), the NRB may prescribe condition according to the need, and the foreign bank shall comply with the conditions thus prescribed by the NRB.

2.2.4 Nepal Rastra Bank Act 2012 (Amended to NRB Act 2049)

As per the provision of NRB Act 2012, NRB may issue directives from time to time to commercial banks regarding banking, currency and credit. It shall be the duty of commercial banks to comply with the following directives.

- a. Developing of Banking system and supply of credit to commercial banks.
 - NRB shall make all the possible efforts to develop and regulate the banking system in Nepal.
 - With the consideration to the monetary situation, the NRB may provide loans for refinancing facilities on the conditions prescribed by it against collateral or guarantee, to any commercial banks, which supplies agricultural or industrial credit.
- b. Commercial banks must obtain the permission to accept deposits, supply loan or issue debentures.
- c. Determination of rate of interest.
- d. NRB can determine the rate of interest to be charged or paid by commercial banks on loans or deposits. But in the current circumstances where NRB has not prescribed any rate of interest under sub section 1, it has given authority to commercial banks itself, for fixing interest rate in lending and borrowing. But NRB always monitors the spread between the lending and borrowing rates.
- e. Liquidity

Commercial banks shall maintain liquid assets (also called cash reserve) in such proportion of the domestic deposits liabilities as the NRB may prescribe. The cash reserve Ratio requirement, after the amendment of NRB policy is fixed at 4.5 percent of their fixed deposits and 7 percent of other deposits, which should be balanced with NRB, along 2 percent of local currency deposits as the vault cash requirement.

- f. Fund to be maintained with NRB.

Commercial banks must maintain funds in NRB according to the percentage of total deposit liabilities prescribed by NRB. Total deposit liabilities refer to the liabilities refers to the liabilities of amount covered by the term deposits defined in the 2031 commercial Bank Act.

- g. Loans to be supplied to the prescribed sectors.

NRB has prescribed the priority and deprived sectors, for commercial banks to advance 3 percent of its total loans and advances to these sectors in order to flow the credit in rural areas of the country.

- h. Core capital to be increased to 50 million.

All the commercial banks, including JVBs are informed by NRB that they must make the core capital at least 50 million by 2057. Core capital includes paid up capital and statutory reserves. This provision has initiated all the banks in capitalizing that earning by suing bonus shares. Earning per share (EPS) and Dividend per share (DPS) of commercial banks is adversely affected by compulsion to issue bonus shares.

- i. Power of NRB to inspect, supervise, and Issue Directions.

The NRB may inspect and supervise any office of commercial banks at any time, or make arrangement for doing so. NRB may issue, after the inspection, the necessary directives to commercial banks in respect to matters considered necessary after the inspection and supervision.

2.2.5 Other policies

New arrange for interest rate

The Nepal Rastra Bank (Central Bank of Nepal) has made the following arrangement for the determination of interest rate:

- a. Commercial banks have to inform NRB and also communicate it to public through mass media about the interest rate offered on all types of deposit and interest charged on lending on different heading and for different purpose immediately after changes and regularly in every three months.
- b. Commercial banks can change up to 0.5 percent points plus minus in the published interest rate on the deposits and lending (including lending on the same head or for the same purpose based on the understanding reached with the customers.
- c. While issuing notices on interest rate, commercial bank cannot state the provision that the rate will be fixed on the bases of mutual understanding.
- d. Nepal Rastra Banks issued directives to all commercial banks to contain the spread interest rate regime within five percent of weighed difference in the deposit and credit portfolio to be effective from July 1998.

Amendment and adjustment to the bank rates

The prime rate, selective rate on the loan of last resort to be provided by NRB to the banks and other financial institutions under the refinancing/ rediscounting facility have been adjusted and unified. The unified bank rate has been reduced from 11.0 percent to 9.0 percent and the following amendments have been made on reporting procedures to be followed by the banks availing refinancing/rediscounting facility.

- a. These banks should compulsorily report to the credit information center on the regular basis and the report should include updated defaulter's list. The NRB will stop refinancing facility for the banks that are detected of not sending such report form the inspection. Beside NRB will act in accordance with NRB act.
- b. These banks will, be charged interest at 5.0 percent rate as penalty if they fail to repay the loan under refinancing facility on time.

New Arrangement for compulsory cash balance

NRB has cancelled all previous regarding compulsory cash balance necessary to maintain by the commercial banks. It has issued new regulations, which require commercial banks to deposit cash at NRB equivalent to 8 percent of the total current and saving account

deposit liabilities and 6.0 percent of the domestic fixed liability. Similarly, commercial banks have to maintain 3.0 percent cash balance of all domestic deposit liabilities in their own account.

Capital requirement for establishing new commercial bank/joint venture bank in Nepal

With a view to encourage opening of commercial bank outside the Kathmandu valley and also limiting the monopoly of single person, a group and a company in banking business / NRB made the following provisions effective from May 1, 1994. According to new provisions, a minimum paid up capital of Rs 250 million was required to open a new commercial bank with its headquarter to be Kathmandu valley and operative expanding throughout the country. A minimum paid up capital of Rs. 120 million is required for establishing a bank with it's headquarter in any municipalities or the kingdom and expanding its business all over the country except Kathmandu valley. Likewise, a minimum paid-up capital for Rs 50 million is required to open a bank with the headquarter to be stationed at the district level and limiting its areas of operation to five districts outside the Kathmandu valley. In addition to this NRB has also made some provisions regarding the ownership of new banks to be opened under the new regulations. According, any such banks are required to sell at least 30 percent of its share to the general public. However, no single person, firm, companies and a group of companies can purchase more that 10 percent of the issued capital of the bank. Similarly, such person, firm, companies or groups of companies (except Government of Nepal, Nepal Rastra Bank, Commercial banks and Government financial institutions) is not allowed to purchase more that 15 percent of issued capital of all other banks.

Financial Performance

It has already mentioned that this study relates to the evaluation of financial performance of SCBNL using Du Pont model. Financial appraisal focuses on financial statements and the significant relationship that exists among the variables contained. In this regard Metcalf and Tittard (1976) says, "Analyzing financial performance is a process of evaluating financial statements to obtain a better understanding of a firm's position and performance."

Profit is one of the basic indicators of sound financial performance. It is usually the results of sound business management, cost control, credit risk management and general efficiency of operation. Profit is essential for an enterprise for its survival, growth and maintains capital adequacy thorough profit retention.

Though profit is important for any business concern including joint venture banks but profit cannot be the sole objective, for example neither the bank nor the community will be best serve is the banker on reasonably sacrifice the safety of its fund or the liquidity of the banking is an effort to increase income”- (American Institute of Banking (1972)

Financial statements provide information about a firm’s position as well as its operation over same period. However, the real value of financial statement uses in the fact that they can be used to predict the firm’s financial position in the future, and to determine expected earnings and dividends. From an investors stand points, predicting the future is what financial statement analysis is all about, while managements stand points financial statement is useful to anticipate future conditions and for planning actions that will influence the future costs of events. Weston and Brigham (1996)

2.3 Review of Books and Journals

2.3.1 Review of Books

Finance is a broad field and there are various books written in this subject. The book of Khan and Jain (1992) mention that the term financial management in broad sense and provides a conceptual and analytical framework for financial decision making. According to them, “The finance function covers both acquisitions of funds as well as their allocation; hence apart from the issues of acquiring external funds, the main concern of financial management is the efficient and wise allocation of funds to various uses.” The three major financial decisions according to Khan and Jain are:

The investment decision;

- The financial decision and
- The dividend policy decision

Weston and Brigham (1996) stated that the Risk-Return trade off as one of the major financial functions. They believe that the maximization of the value of the firm can be achieved through maximization of returns in one hand and minimization of risk in the other. The relationship between the expected future state of the economy and the performance of individual firms enables a relationship to be set forth between the state of the economy and the returns from investment in firms.

Describing about the new areas of finance, James and Van (1998) stated on two broad functions, viz:

- Investment in assets and new products;
- Determining the best mix of financing and dividends in relation to a company's overall valuation.

According to him “Investment of funds in assets determines the size of the firm, its profits from the operations, its business risk and its liquidity. Obtaining the best mix of financing and dividends determines the firm's financial charges and its financial risk; it also impacts its valuation.” He further incorporated other core financial areas such as; creation of value, investment decision, financing decision, dividend decision and financial management.

The objective of the company must be to create values for its shareholders. Market price of company's stock represents its value and this can be maximized by firm's optimum investment financing and dividend decisions.

The capital investment decision is the allocation of the capital to investment proposals whose benefits are to be realized in the future. As the future benefits are not known with certainty, investment proposals necessarily involve risk. Consequently they should be evaluated in relation to their expected return and risk.

In the financing decision, the financial manager is concerned with determining the best financing mix or an optimum ‘capital structure’. If a company can change its total valuation by varying its capital structure, an optimal financing would exist, in which market price per share could be maximized.

According to him “The dividend decision includes the percentage of earnings paid to stockholders in cash dividends. The dividend payout ratio determines the amount of earnings retained in the firm and must be evaluated in the light of the objective of maximizing shareholder’s wealth.”

The Financial management involves the solution of the three major decisions. Together, they determine the value of a company to its shareholders. He believes that the objective of any firm is to maximize its value, and therefore, the firm should strive for an optimal combination of the three inter-related decisions, solved jointly. The main thing is that the financial managers relate each decision to its effect on the valuation of the firm.

Pandey (1992) defines financial management as that managerial activity which is concerned with the planning and controlling of the firm’s financial resources. He believes that among the most crucial decision of the firm are those, which relate to finance, and an understanding of the theory of financial management provides the conceptual and analytical insights to make the decisions skillfully.

He further identifies two kinds of finance functions; Routine and Managerial Finance functions.

The routine finance function do not require a great managerial ability to carry them out and they are chiefly clerical in nature. Managerial finance functions on the other hand are so called because they require skillful planning, control and execution of financial activities. According to him there are four important managerial finance functions:

- Investment or long term asset mix decision.
- Financing or capital-mix decision.
- Dividend or profit allocation decision
- Liquidity or short- term asset-mix decision.

Erich (2001) in his book has described financial analysis, as “Financial analysis is both an analytic and judgmental process that helps to answer the questions that have been properly posed to and therefore, it is a mean to an end. We can stress enough that financial analysis is an aid that allows those responsible for results to make sound decisions.” A summary of what I have reviewed in various books finance has been highlighted below.

Finance is defined as the acquisition and investment of fund for the purpose of enhancing the value and wealth of an organization. The various finance areas include investments, public finance, corporate finance and financial institutions. The basic function of finance is to manage the firm's balance sheet in most efficient way. The balance sheet reflects how a firm acquired financing through debt and equity resources, and it reflects the disposition of acquired financing among the various asset accounts according to Maness (1998). The major financial functions required for managing the banks balance sheet are summarized below.

- a. Analysis and planning
- b. Financial structure management and
- c. Asset management.

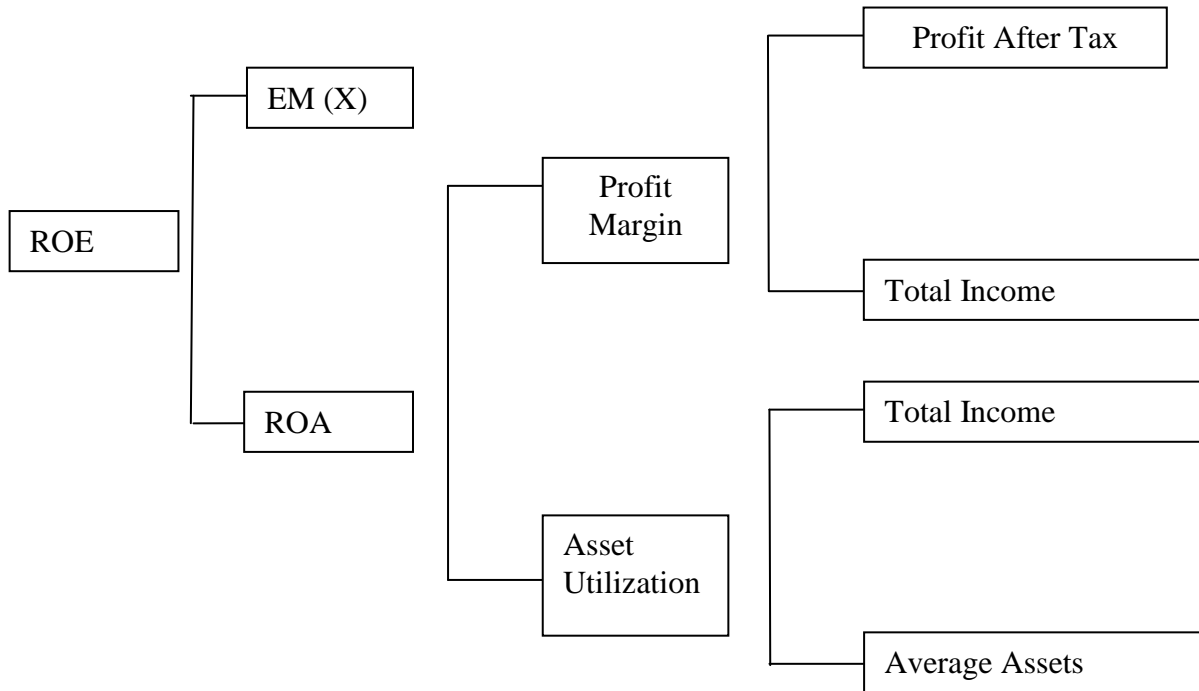
The first function financial analysis and planning, is to understand the bank's current financial condition and plan for its future financial requirement in different economic scenarios.

After analyzing the financial needs, the second function is to manage the financial structure of the bank, which can be done by optimizing the use of debt and equity in the capital structure. While deciding about this optimum structure, a financial manager must concentrate in minimization of cost of funds in one hand, and maximization of value of the firm in the other. Moreover financial structure management for a banking sector includes, a typical treasury function, which is also called 'funds management.' This function contributes a significant portion in profits earned by banks.

The final function is the management of asset structure of the bank. Advances of credit and investment in certain portfolios constitute the major portion of the bank's asset. The major financial function related to assets management is to decide for the least risky and most profitable alternatives of investments. This can be conducted by determining returns and risks associated with the loans and advances made by bank.

All the above financial decisions or functions as mentioned by different writers are instrumental toward effective handling of financial management, which includes activities beginning from raising of funds to efficient and effective use of funds; no matter either it is a banking or non-banking institution.

Golin (2001) states that the financial performance can be measured by DU Pont Analysis and explains as below:



2.3.2 Review of Journals

After receiving the books, certain useful journals on domestic market, banking, financial statement analysis and monetary credit situation of Nepal are studied.

An article written by Poudyal (2006) focuses in the potential areas where banks should invest to fight the prevailing economic recession. Currently growth in the profitability of JVBs has been mainly due to external factors such as the foreign exchange rate but not to the growth in the real sector of the economy. Therefore, to sustain the current financial position in the long run, banks should enter new areas by marketing their credit in important sub sectors such as hydroelectricity, tourism, irrigation etc.

He further writes that, “Saving collection is another factor which is necessary for banks to balance their operations and generate sufficient surplus in their cash- flows. In recent years growth rate of bank deposits has declined to about 16 percent compared against 23 percent of the past. Mobilization of internal resources in the country demands that banks attract more financial resources from the public.”

Another useful contribution made by Poudel (2053) in his article called ‘Financial statement analysis’ published in Nepal Rastra Bank Samachar on 2053 is reviewed.

According to him, balance sheet, profit and loss a/c and the accompanying notes are the most useful aspects of the bank. We need to understand the major characteristics of bank's balance sheet and profit and loss a/c. The bank's balance sheet is composed of financial claims as liabilities in the form of deposits and as assets in the form of loans. Fixed assets account forms a small portion of the total assets. Financial innovations, which are generally contingent in nature, are considered as off-balance sheet items.

Interest received on loans and advances and investment and paid on deposit liabilities are the major components of profit and loss account. The other sources of income are fee, commission, discount and services charges.

The users of the financial statement of a bank need relevant, reliable and comparable information which assists them in evaluating the financial position and performance of the bank and which is useful to them in making economic decisions. The disclosure requirement of bank's financial statement has been expressly laid down in the concerned act. Commercial banking act 1974 requires the audited balance sheet and profit and loss account to be published in the leading newspaper for the information of general public.

According to him, the principle objectives of analyzing financial statements are to identify:

- Financial Adaptability (Liquidity)
- Financial Performance (Profitability) and
- Financial Position of Bank (Solvency)

Most of the users of the financial statements are interested in assessing the bank's overall performance i.e profitability which is affected by the following factors:

- a. The structure of Balance sheet and profit and loss account.
- b. Operating efficiency and internal management system.
- c. Managerial decisions taken by top management regarding interest rate, exchange rate, lending policies etc.
- d. Environment changes (technology, government, competition, economy)

He stated that the other factors, to be considered in analyzing the financial statements of bank are to assess the capital adequacy ratio and liquidity position. In the line of the norms set by Banks for International Settlement (BIS), capital adequacy of a bank is assessed on the basis of risk-weighted assets. It indicates a bank's financial strength and solvency. Presently the capital fund of a bank should not be less than 8 percent (at least 4 percent should be in the form of tier-1 capital or core capital) of its risk-weighted assets as capital fund. Banks facing with capital adequacy problem may increase capital or reduce assets or reallocate the existing assets structure in order to maintain the desired level of capital base.

Liquidity is measures by the speed with which a bank's assets can be converted into cash to meet deposit withdrawals and other current obligations. It is also important in view of survival and growth of a bank.

Shrestha (1991) states on a proper risk management in his article. He believes in the appropriate classification of loans under performing and non-performing category. In this context he writes, "Adequate provisioning is the surest way to get relief from sinking loan after careful consideration of portfolio risk. A clear out criteria is necessary to treat interest suspense account and it is advisable that all interest unpaid for more than six month need to treated as unearned income."

Regarding the risk management of the bank his other suggestions include:

- Any customer having overdue loan of two years or more in his account should not be given other loan facilities.
- Strong provisioning or reservations are required in restructuring portfolio relating to overdue loans.
- All credits including overdrafts should be given a maturity date and should be subjected to revision at that date and consequently categorized as good, substandard or doubtful loans.
- Financial credit worthiness of the borrower must be evaluated properly before granting the loans.

In another empirical study Altman (1968) employed financial ratio to predict corporate bankruptcy through multiple discriminate analysis. Out of the twenty-two financial ratios examined, he selected the five that did the best combine job in predicting bankruptcy. There ratios were working capital to assets, retained earning to total assets, earning before

interest and taxes to total assets, market value of equity to total assets, market value of equity to book value of total debt and sale to total assets. Using these ratios, he found the discriminate model to be an accurate predictor of bankruptcy.

Pradhan (1991) pointed out some major issues in our local commercial banks against foreign joint venture banks. The study has grouped NBL, RBB under local banks and Nepal Arab Bank Limited, Nepal Grindlays Bank Limited and Nepal Indoseuz Bank Limited under foreign joint venture banks in his article.

The study focused the complete commercial banking system in Nepal in respect of their performance and profitability. His major findings are the deposit collection rate of local banks is very poor as compared to foreign joint venture banks. The pattern of deposit is also different between these two types of commercial banks. The foreign joint banks are in better position than local banks in profit making. In average, no foreign bank has suffered till now, but local banks have earned negative profits.

The above journals focus in the various aspects of the bank's economic environment. NRB press communiqué shows the current domestic market scenario, article by Poudyal (2006) concentrates in the challenges of the banking sector. Poudel (2053 B.S.) stated in effective way of evaluating the financial performance and Shrestha (1991) suggestions are focused towards proper risk management. Whatsoever, aspects of the bank the above journals target, they all have to be combinable assessed and kept in strict consideration for effective and efficient financial performance of the banks in the Nepalese economy.

2.3.3 Review of thesis

Various thesis works have been done in different aspects of commercial banks such as lending policy, interest rate structure investment policy, resource mobilization, and capital structure etc. The conclusion drawn on the different aspects of commercial banks will be relevant to justify to my study. Thus some previews thesis, which are relevant in this section.

Bhattarai (2001) has conducted a study of "Financial analysis of HBL and Nepal SBI Bank Ltd as a master's thesis. He has conducted the comparative study of HBL and Nepal SBI Limited The main source for the study is secondary data. The data are collected from the various sources such as published financial statements of HBL and NSBIBL, published and unpublished reports of the banks, books, magazines, newspaper and journals, annual

and periodical publications of Nepal Rastra Bank, banking directives issued from time to time by Nepal Rastra Bank, economic Surveys of FY 1997/98, 1998/99, unpublished official record and previous studies and reports. For the analysis and interpretation of the data and information, basically the financial and statistical tools are used. The main objective of the study is to evaluate the liquidity position of HBL and NSBIBL, to evaluate the earning position of HBL and NSBIBL, to evaluate the capital structure of both the banks. He has analyzed the ratios to evaluate the financial performance of the banks and to meet other objectives of the study. He has presented some results with the study which are discussed briefly. The overall liquidity position of HBL was stronger than that of NSBIBL and HBL can discharge its depositors' obligation more comfortably. By analyzing capital structure of the banks, he outlines that the HBL was found to have adopted aggressive strategy as suggested by its highly leveraged i.e. debt nominated capital structure. HBL earned quite higher profit than NSBIBL during the review period, which states that HBL had better competitive strength. He has outlined that return to the shareholders' equity was significantly higher in case of HBL and debt equity position of NSBIBL had lesser proportion of outsiders' claim in the capital structure.

With the above-mentioned conclusion, he has given some valuable suggestion, which is discussed briefly. NSBIBL is recommended to increase its liquidity strength in order to meet the obligations due to the increase in its turnover. HBL is recommended to arm itself to check the risk factor due to high leverage, keeping in mind the current economic recession in South Asia and in the nation. SBIBL is recommended to use its resources in high profit potential sectors.

Tripathee (2001) has conducted a study of "Financial performance of Nepal Bank Limited" as his master's thesis. The study is conducted on the basis of secondary data. The data are collected from the P/L Accounts, Balance Sheet of NBL. Data are tabulated in the ease to the study. Some primary data have also been taken into account to make the study more effective and meaningful. The primary data are provided from personal interview from the officer of the concerned department of the bank. Different types of accounting and statistical tools are used to analyze the study. The main objective of the study is to make comparatively analyze of the financial position of the Nepal Bank Limited for two different periods. The first period being from fiscal year 2047/2048 BS to 2051/2052 BS and the second period being from fiscal year 2052/2053 BS to 2056/2057 BS. The other

objective of the study is to analyze the annual financial position, to analyze the financial strength and weakness of the bank. After conducting and using various tools to study financial performance of the bank have drawn conclusions, which are discussed briefly. As compared to 2nd period with the first period, the bank seemed to be unable to utilize its high cost resources in high yielding investment portfolio. During the both period there are negative operating profit for two years and both the years of the 1st period enjoyed positive net profits due to the non-operating incomes. Hence there is lack of demarcation between operational and non-operational activities of the bank. The second period at an average shows negative net profit and bank had failed to collect interest earned and matured loan. The study shows the ratios of long term liabilities as well as of total liabilities to net worth during the first three years of 2nd period have decreased. The study shows the liquidity position of the bank is also not satisfactory during both periods and it is even worse during the 2nd periods. Thus it is concluded that the financial position of the NBL is worse during the second period due to its failure to utilize its resources efficiently and due to its inefficiency in risk management. The overall financial position of the bank is unsatisfactory during the both periods.

With the above stated conclusion, he has also suggested some valuable suggestion. He has suggested to make books of accounts up to date, to published the financial statements regularly, to make supervision and inspection aspects to be effective and functional, to make management more effective and independent from the political pressure and to implement and enforce policies to foster sound banking.

Bista (2002) has conducted on study of “A study on financial performance of Nabil Bank Ltd” as a master’s thesis. He has conducted the study on financial performance of Nabil Bank Limited and focused on financial analysis and other portfolio of the NABIL. The study has also focused on Income and Expenditure analysis and Bankruptcy Score analysis.

This study is conducted with the use of secondary data. The source of secondary data are the bank’s annual reports, financial statement of the bank and related publication of commercial banks and central bank as well as other useful publications from the financial institution and consultants. Likewise newspaper, journals, periodicals magazine, reports and unpublished thesis have been used as other source of data during the study. The tabulated data were analyzed with the help of various fundamental financial and statistical

tools. The basic objective of the study is to analyze the liquidity, Leverage, activity, profitability, and ownership ratios of the bank, to a study the income and expenditure statement of the bank, to analyze the bankruptcy score of the bank for the five years.

He has given conclusion from the analysis of Financial Ratios. It states the liquidity position of the NABIL is in normal standard, the cash and bank balance proportion with respect to the current assets is moderate, the loans and advances disbursement with respect to the current assets is high. In general, the liquidity position of the bank is good enough to meet the short- term obligations. The activity ratios of NABIL indicate that the bank has utilized its resources in the best possible way to maximize its wealth. The bank has the high debt equity ratio and debt to total assets ratio, which indicates the creditors have invested more in the bank than the owners. The interest earned by the bank is inadequate in comparison to the assets, the net profit earned in comparison to the total deposit is relatively low, the net profit earned in comparison to the total assets is fluctuating, the profit earning in relation with the shareholders' equity of NBL is better. In general the profitability ratios of the bank indicate that the overall performance of the bank is effective in maximizing its wealth. The EPS of NABIL is quite good, the dividend per share of NABIL is low and the shareholder' are being compensated very slowly, the dividend payout ratio of the bank is irregular and low. Overall, the ownership ratio of the bank is not encouraging, but is in increasing trend.

This draws conclusion from the income and expenditure statement analysis. It states as income aspects shows, the interest earning is the main sources of income of the bank, the second main sources of income is foreign exchange earnings and thirdly commission earnings is other source of income. Overall, the bank is generating maximum profit from interest earnings and the sale of foreign exchange as well as from commission. The expenditure aspects shows, interest expense, personnel expense and other operating and non-operating expenses are the major expenditure heads. Overall, the result of the expenditure of NABIL indicates that bank is making increasing the profit by reducing its operating expenses and managing better human resources in order to maximize the shareholder's equity.

His conclusion from the bankruptcy score analysis, which stated the bankruptcy score of the bank was found to be inconsistency over the past five years. The result of the score has put the researcher in different position to predict the existence of the bank. From the point of statistical analysis, the solvency position of the bank is better. So, it can be predicted that the chance of failure of NABIL is very remote.

On the basis of the study he had made some valuable recommendations. He has suggested the bank to focus more in credit cards, wealth management, global market, etc in order to get high returns, to venture new grounds in the financial sector such as investment banking and e-banking, to invest more in loan and advances as well as less in government securities, to formulate new strategies if serving clients in a satisfactory way and strengthen and activate its marketing function, as it is an effective tool of reaching at and retaining customers, to take care of inconsistency and irregularity in dividend payment, to adopt suitable margin rates which are influenced by interest rate, nature of goods, trade cycle etc., to publish and distribute booklets with all banking information as well as with general information of an economy and to invest in the deprived sectors of the nation.

Joshi (2003) has conducted the study of “Financial Performance of Nepal Bank Limited The study is made on the basis of secondary data. The main source of data are financial statements of NIBL, annual reports of NIBL, bulletin and reports periodically published by various government bodies and other published materials like newspaper, journals, magazine, text books etc. The financial ratios such as liquidity ratios, activity ratios, profitability ratios, leverage capital ratios and ownership ratios are used to analyze the data and statistical tools such as correlation and regression are used.

The main objective of the study is to examine the overall financial position of NIBL, to examine the overall liquidity ratio, profitability ratio and ownership ratios of the bank, to study the income and expenditure statement of the bank, to analyze the bankruptcy score of the bank for the period of different period. She has outlined various conclusions to her study, which are discussed briefly. After analyzing the liquidity ratio she outlined that the liquidity position of the bank is in normal standard, cash and bank balance proportion with respect to the current assets is moderate, the loan and advances disbursement with respect to current assets is high, the share of fixed deposit is higher in the total deposit and share of saving deposit is low in comparison to fixed deposit in the total deposit.

Hence in general she suggested the liquidity position of the bank is good enough to meet the short-term obligation. After analyzing the leverage ratio, she has suggested that the bank have high debt equity ratio, which means the creditors have invested more in the bank than the owners, the bank has the high debt equity ratio which again exhibits that the creditors have invested more in the bank than the owners. After analyzing the profitability ratio of the bank, she has suggested that the interest earned by the bank is inadequate in

comparison to the assets, net profit earned in comparison to the total deposits is relatively low, net worth earned in comparison to the total assets is fluctuating, net operating profit earned in comparison to the total assets is more or less constant.

In general she has concluded that the overall performance of the bank is effective in maximizing its wealth. After analyzing the activity ratio, she has suggested that, bank is mobilizing its total deposit in loans and advances effectively; bank has better mobilization of saving deposits in loans and advances for income generating purpose. Overall, bank has utilized its resources in the best possible way to maximize wealth.

After conducting various analyses and drawing conclusion, she has given some valuable suggestion and recommendations, which are discussed briefly. She recommends that to venture new grounds in the financial sector, install latest and hi tech software, The bank is recommended to try to increase non interest bearing deposits for increasing profit margin by investing the same as loans and advances, to focus more on non risky lending such as mortgages, housing loans and personnel loans, to focus on credit cards, wealth management, global markets and cash management. The bank is recommended to carefully examine safety of principal as well as sources of repayment, capital structure, requirement and credit worthiness of a borrower for providing credits. The bank is recommended to take care of inconsistent and irregular dividend payment practices, to invest more in loan and advances as well as less in government securities. The bank is recommended to activate for increasing foreign investment in Nepal by means of their wide international banking networks.

Luintel (2003) has conducted a study of "A study on financial performance of NBL" as a master's thesis. The main focus of his study is focused on financial performance of the selected period to know their impacts on the national economy as a whole. He has evaluated the relationship between component parts of financial statements to obtain a better understanding of a bank's position and performance. The study is based on the facts and figures collected from P/L Account and Balance Sheet of the NBL. Hence, most of data used in this work are secondary in nature and P/L and Balance sheet are main source of data. According to need and objective of the study, collected data are tabulated into various forms and formats. Some primary data have also been used to make the study more effective and meaningful. These data are based on the information provided by the officers of concerned departments of NRB during the personal interview. Different types

of accounting and statistical tools are taken into account to meet the purpose of the study. Simple analytical statistical tools such as arithmetic mean, percentage graph, standard deviation and trend analysis are used in this study. The objectives of the study made by him are to measure the comparative financial strength and weakness and to analyze the banks performance under priority sectors of government, to analyze the income and expenditure areas, to recommend necessary improvement for their effective and efficient financial performance by establishing the relationship between various components of assets and liability side of the bank's balance sheet, analyzing the different financial ratios and studying the operational aspects and the products offered by them.

After the study and analyze made, he has presented various conclusions which are discussed briefly. He concludes that there is lack of demarcation between operational and non operational activities of the bank and, performance wise, first period shows that the bank is more inclined towards non- operational activities. There is decrement in interest paid and earned to total assets ratios in the 2nd period, which indicates decreased operating activities of the bank during the period. The net worth of the bank for the last two years of the 2nd period is negative due to the heavy loss during the years. The ratio of long term liabilities as well as of total liabilities to net worth during the first three years of the 2nd period has decreased. The liquidity position of the bank is not satisfactory. It shows the lack of specific policy of holding various types of current assets. Long-term debts, total debts and total deposit ratios have gradually decreased. The bank has experienced negative EPS during the last to pay any dividend during the last three years of the 2nd period. P/E ratios have also heavily fluctuated during second period.

He has concluded the study drawing that the financial position of the NBL is worse during the second period due to the failure to utilize its resources efficiently and due to its inefficiency in risk management. Thus, he has also given some valuable suggestion and recommendations which are discussed briefly. He recommends to keep books of accounts up to date for the reduction of manipulation, gain trust of the customers and so on and to publish financial statement regularly. To make rational decision regarding the type of investment (especially advancing of loan) and the loan department should be target oriented. i.e. after advancing loan, there should be regular supervision and follow up for the proper utilization of loan to raise the standard of management, accounting standards, staffing and other aspects of banking and management for the foster of sound banking.

Joshi (2004) has conducted a study of “Financial performance of joint venture banks in Nepal with special reference to Nepal Bangladesh Bank Ltd” as a master’s thesis. The main focus of her study is financial analysis and other portfolio of NBBL. The main sources of data for this study are secondary data. According to the requirement, published balance sheets, profit and loss A/c and other related statements of accounts as well as annual report of the respective bank have also been the major source of data. Various related books, booklets, magazines, journals, newspapers and thesis are referred for the study of the topic.

For the purpose of the study, the data collected and arranged in proper form have been analyzed and interpreted through financial and statistical tools. Basically, four types of ratios are used to analyze data, which are liquidity ratio, capital structure ratio, activity ratio, profitability ratio and ownership ratio. The specific objectives of the study are to evaluate various financial ratios (liquidity, profitability, capital structure, turnover, ownership position of NBBL, to analyze bank’s deposits, mobilization and investment, to forecast future trends of deposit mobilization and loan and advances of NBBL, to make necessary suggestions and recommendation for effective financial performance in future on the basis of performance evaluation.

The major findings of her study are discussed briefly. She had concluded that the liquidity ratio of bank is considered satisfactory as the bank is trying to meet its short-term obligations. The result of analysis of activity ratio shows that the banks are efficient utilizing its outsider’s fund (i.e. total collection deposits) by extending loans and advances to generate profit. Overall, the activity ratio of NBBL indicates that the banks has utilized its resources in a best way to maximize the wealth and thus making an increment of profit for the organization, analyzing the capital structure ratio of the bank, it is concluded that incase of NBBL the shareholders stake in the banks is very low as the creditors have dominated in the bank financial mix.

She also concludes that Profitability ratio indicates the degree of success in achieving desired profit level. The result indicates that the banks has been able to generate profit by utilizing deposits but the generated profit is low, so additional efficiency is required to increase earnings. The analysis indicates that profit earning in relation to shareholders equality of NBBL in better position, which exhibits better utilization of shareholders equality. Overall, it is concluded that NBBL is able to earn a positive profit but not to a

satisfactory level. Again, after analyzing the ownership ratio, it is concluded that in case of NBBL, the shareholders are being compensated with good returns either in the form of cash dividend or bonus shares.

She has given some valuable suggestions, which are discussed briefly. She recommends the banks should try to come forward to increase the number of clients, develop the entrepreneurship, diversity their business with large number of clients, develop investors and come forward to meet the national objective of privatization by mobilization of more entrepreneurs. Most of the JVBs are found to be centralized in urban areas. So, it is suggested that the banks should extend their banking facilities even in rural and sub rural areas as well as mid-western region of the country. At present due to increase in transactions of security and capital market, higher taxes laid on heavy deposits and increase in number of joint venture banks as well as finance companies and insurance companies, these all have been creating pressures on deposit collection of NBBL. So, bank is recommended to quicken the reliable depositing process by provide attractive schemes for the depositors.

Since NBBL is not maintaining adequate liquidity position, the bank is suggested to increase its current assets. As the capital structure ratio of bank is highly leveraged, NBBL required to maintain and improve an optimum mix of debts and equity by increasing equity base in order to avoid financial risk. Lending continues to be a very important part of business but, is not a sole driver behind a corporate relationship. So, the bank should increase emphasis on cross selling and lending with higher value products in order to increase the overall value of relationship. NBBL should attract more low interest bearing saving and current deposits to minimize its cost of fund and increase profit margin by investing the same as loan and advances.

CHAPTER – 3

RESEARCH METHODOLOGY

3.1 Introduction

The different aspects of financial performance of Standard Chartered Bank Nepal Limited have already been mentioned in the previous chapters. An introduction relating to the thesis work is made in the first chapter and relevant literatures are reviewed in the second chapter. The 'research methodology', which is used to analyze for collection of data, are mentioned in this chapter.

Research method refers to the methods/way that is used for conduction of research or performing research operations. In other words, research methods are those methods, which are used by the researcher during the course of studying his/her research problem. Research methodology is a way to solve the research problem systematically. The research methodology is wider than that of research methods i.e. research methods are a part of research methodology. The research methodology considers the logic behind the methods used in the context of research study and explains why particular methods or technique is used. It also highlights about how the research problem has been defined, what data have been collected, what particular methods has been adopted, why the hypothesis has been formulated etc. "Research methodology" refers to the various sequential steps (along with a rationale, of each such step) to be adopted by a researcher in studying a problem with certain object/objects in view. So, it is the methods, steps, and guidelines, which are to be followed in analysis, and it is a way presenting the collected data with meaningful analysis. 'Research Methodology' is a way for systematically solving the research problem. In other words, research methodology indicates the methods and processes employed in the entire aspects of the study.

This chapter highlights about the methodology adopted in the process of present study. It also focuses about sources and limitations of the data, which are used in the present study.

3.2 Research Design

"Research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure." It is a framework or plan for a study that guides the collection and analysis of the data.

3.3 Population and Sample

The banks in Nepal have very unique characteristics. From an ownership standpoint, the commercial banks in Nepal can be broadly classified into two categories: Public banks and Private banks. The banks which are owned or controlled by the government are labeled as Public banks while the banks that are owned or controlled by the private sector are categorized as Private Banks. The Private Banks can be further regrouped into the Local Private Banks and Joint Venture Banks. The banks with the local private investment are Local Private Banks whilst the banks with the Investment of Foreign Institutions along with the local investment are Joint-Venture Banks.

In Nepal, we have 3 Public Banks and 28 Private Banks out of which 7 are Joint Venture banks. The financial health of the public banks was very poor and thus a reform program was initiated in these two banks under the Financial Sector Reform Project with the aid of the World Bank.

Banks

1. Agriculture Development Bank Ltd
2. Bank of Asia Nepal Ltd
3. Bank of Kathmandu Ltd
4. Century Commercial Bank Limited
5. Citizens Bank International Limited
6. Civil Bank Limited
7. Commerz and Trust Bank Nepal Limited
8. Development Credit Bank Limited
9. Everest Bank Ltd

10. Global Bank Ltd
11. Himalayan Bank Ltd
12. Janata Bank Nepal Limited
13. Kist Bank Limited
14. Kumari Bank Limited
15. Laxmi Bank Ltd
16. Lumbini Bank Ltd
17. Machhapuchhre Bank Ltd
18. Mega Bank Nepal Limited
19. Nabil Bank Ltd
20. Nepal Credit and Commerce Bank Ltd
21. Nepal Bangladesh Bank Ltd
22. Nepal Bank Limited
23. Nepal Investment Bank Ltd
24. Nepal SBI Bank Ltd
25. Nepal Industrial and Commercial Bank Ltd
26. NMB Bank Ltd
27. Prime Commercial Bank Limited
28. Rastriya Bannijya Bank
29. Siddhartha Bank Ltd
30. Standard Chartered Bank
31. Sunrise Bank Ltd

As mentioned above, there are 31 commercial banks operating in Nepal. The study is made on SCBNL the 7 years data is taken as the sample to examine the financial performance of the bank throughout the whole period.

3.4 Data Collection Procedure

This study is based on secondary data provided by SCBNL. It constitutes mostly the prospects of the company and audited annual reports that contain balance sheet and profit and loss a/c. Other supplementary data and information have been obtained from various sources such as Nepal Rastra Bank, TU central library, previous dissertations, other publications and web-sites. Other than above-mentioned sources, the information collected through verbal communications with the staff of the related banks has also been used in the research.

3.5 Data Analysis Procedure

Data collected from different sources will be in raw form and in the initial stage as judging independently does not help much. Those data are converted into meaningful figure by the help of various financial and statistical tools to analyze and achieve the objectives of this study.

3.5.1 Financial Variables, Tools and Models Used:

To evaluate the financial condition and performance of a company, the financial analyst needs data. The data frequently used is a ratio of index relating two pieces of financial data to each other. Analysis and interpretation of various ratios should give experienced and skilled analysis a better understanding of the financial condition and performances of the firm than obtained from the analysis of the financial data alone.

To examine the bank's performance over time, following indicators as indicated in Banking Supervision Annual Report of Nepal Rastra Bank (2001-2002) are taken as basic variables in this study.

Indicators of Financial Performance as indicated in Banking Supervision Annual Report of Nepal Rastra Bank (2001-2002)

1. Net profit
2. Operating profit
3. Total income
4. Total expenditure
5. Interest income

6. Interest expended
7. Interest spread
8. Other income
9. Operating expenses
10. Wage bill
11. Provisions and contingencies
12. Provision for loan loss
13. Provision for taxes
14. Other non-operating expenses

When the performance of the bank is examined, bank size - usually measured by total assets or total deposits – becomes a critical factor by Rose (2002). Broader gauges of profitability for banks include ratios for measuring performance returns on utilized assets and capital (A.M. Best - 2005).

There are some specific financial ratios that use to examine the financial performance of the bank. Specifically this study is based on the Du Pont analysis model of financial performance. So, to examine the bank’s performance over time, following basic models has been used:

$$ROA = (NPM) (AU) \dots \dots \dots (i)$$

$$ROE = (ROA) (EM) \dots \dots \dots (ii)$$

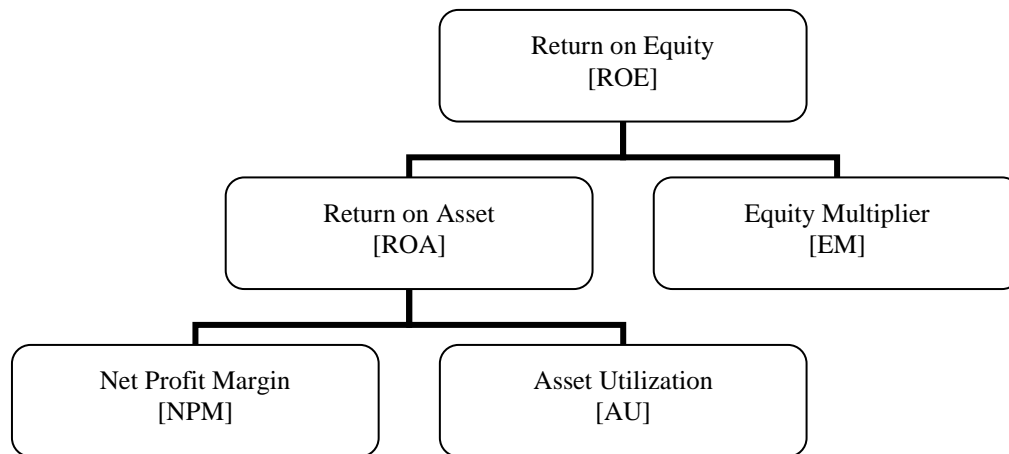
Combining the equations (i) and (ii), equation (iii) can be formed as extended Du Pont equation.

$$ROE = (NPM) (AU) (EM) \dots \dots \dots (iii)$$

Thus, specifically this study is based on the Du Pont approach model and the relationship of aforementioned equations (i), (ii), and (iii) is presented as following model drawing.

Again, aforementioned equation (iii) and model drawing thereof is elaborated as equation (iv) to analyze the performance of the bank in detail.

$$ROE = \frac{NP}{TOR} \times \frac{TOR}{TA} \times \frac{TA}{TE} \dots \dots \dots (iv)$$



As a telltale indicator of a different aspect of the banks' operations following break downs of equity returns and return on assets are considered to examine and analyze in this study. The breakdowns of return on equity and return on asset have been used as the fundamental ground for this research work, accordingly as the Du Pont approach model.

Break downs of equity returns for closer analysis:

- Net Profit Margin (NPM)
- Asset Utilisation (AU)
- Equity Multiplier (EM)

Break downs of return on assets for closer analysis:

- Interest income to total assets
- Interest expense to total assets
- Interest margin to total assets
- Non-interest income to total assets
- Employee and office expense to total assets
- Non interest margin to total assets
- Provision for loan loss expense to total assets
- Provision for staff bonus to total assets
- Provision for income tax to total asset

3.5.2 Outlines of the variables used and corresponding models:

[a] Return on Equity Capital [ROE]:

ROE is a measure of the rate of return flowing to the bank's shareholders. It approximates the net benefit that the stockholders have received from investing their capital in the bank. Equity capital includes paid up equity, profit and loss account, various reserve, general loan, loss provision etc. To predict and observe the ratio following equation is used:

$$= \frac{\text{Net income after taxes}}{\text{Total equity capital}}$$

As a breakdown analysis of a bank's Return on Equity, following equations are considered for specific ratios:

[i] Net Profit Margin [NPM]:

NPM reflects effectiveness of expense management (cost control) and service pricing policies. It is the ratio of net income to total revenues.

$$= \frac{\text{Net income after taxes}}{\text{Total operating revenues}}$$

[ii] Asset Utilisation [AU]:

It reflects portfolio management policies, especially the mix and yield on the bank's assets. The bank's degree of asset utilization is the ratio of operating revenues to total assets. It is the ratio of a bank's operating revenue to total assets.

$$= \frac{\text{Total operating revenues}}{\text{Total assets}}$$

[iii] Equity Multiplier (EM):

The bank's equity multiplier reflects leverage or financing policies. It explains the sources chosen to fund the bank. Equity multiplier is assets-to-equity-capital ratio. The multiplier is a direct measure of the bank's degree of financial leverage. It represents financial risk of the bank. However, the larger the multiplier, the greater the bank's potential for high returns for its stockholders.

$$= \frac{\text{Total assets}}{\text{Total equity capital accounts}}$$

[b] Return on assets [ROA]:

ROA is primarily an indicator of managerial efficiency; it indicates how capably the management of the bank has been converting the institution's assets into net earnings. As model specified above ROA is net profit margin times asset utilization. It is the ratio of a bank's net after-tax income to total assets. It indicates the earnings performance of a bank on its assets.

$$= \frac{\text{Net income after taxes}}{\text{Total assets}}$$

This study explains and compares the return on assets, by giving breakdowns. To analyze the contributions of different variables on return on assets, segregated models are used:

$$\text{ROA} = \frac{\text{Total revenues} - \text{Total expenses} - \text{Taxes}}{\text{Total assets}}$$

As a breakdown analysis of a bank's Return on Assets, following models are considered for specific ratios. So to examine core earnings trends and quality of the bank different ratios related with core earnings variables are considered. It is because healthy commercial banks usually have solid, sustainable earnings generated from normal banking activities, or core earnings.

If a bank has poor core earnings, then it is vulnerable to many adverse situations that could be weathered by a bank with good core earnings. Sustainable earnings are a source of capital to fund growth, to help maintain an adequate source of liquidity generation and to protect against a reasonable level of asset losses. Thus to assess these very factors of the selected bank i.e. SCBNL, following different relevant ratios are used to study.

[i] Interest income to total assets

The ratio is measured by dividing interest income to total assets. It is stated as:

$$= \frac{\text{Interest income}}{\text{Total assets}}$$

[ii] Interest expense to total assets

It is the ratio of Interest expense divided by total assets. It is calculated as:

$$= \frac{\text{Interest expense}}{\text{Total assets}}$$

[iii] Interest margin to total assets

Interest margin is an indicator of interest spread position of the bank. It reflects a return the bank earns from its credit quality. It is the ratio of interest spread to total assets.

$$= \frac{(\text{Interest income} - \text{Interest expense})}{\text{Total assets}}$$
$$= \frac{(\text{Interest spread})}{\text{Total assets}}$$

[iv] Non interest income to total assets

The ratio is measured by dividing non-interest income by total assets and is stated as:

$$= \frac{\text{Non interest income}}{\text{Total assets}}$$

Non-Interest Income is the sum of fee-based income, trading income, trust department income and other non-interest income.

[v] Employee and office expense to total assets

This ratio is measured by dividing total assets by employee and office expense. It is the expense made to the employee and office equipments.

$$= \frac{\text{Employee and office expense}}{\text{Total assets}}$$

[vi] Non interest margin to total assets

It reflects income from handling customer transactions and costs of operating the bank.

$$= \frac{(\text{Non interest income} - \text{Non interest expense})}{\text{Total assets}}$$

Special transactions affecting bank's net income are also taken to examine the performance. The ratios on assets regarding the special incomes and expenses items including provision for loan losses, taxes, securities gains or losses, and extraordinary income or losses are also used to analyze the performance of the bank.

[vii] Provision for loan loss to total assets

It is a non-cash expense that is used to create or increase the loan loss reserve on the balance sheet. The expense is calculated as a percentage of the value of the Gross Loan Portfolio that is at risk of default. It is calculated as:

$$= \frac{\text{Provision for loan loss}}{\text{Total assets}}$$

[viii] Provision for staff bonus to total assets

It is the ratio of staff bonus provision divided by total assets. This is the expenses made to staff bonus.

$$= \frac{\text{Provision for staff bonus}}{\text{Total assets}}$$

[ix] Provision for income tax to total assets

It is the ratio of provision for income tax divided by total assets. It is calculated as:

$$= \frac{\text{Provision for income tax}}{\text{Total assets}}$$

3.5.3 Statistical Tools used:

For the presentation, characterization of the collected data, and the estimation of a characteristic of a population different statistical tools have been used in this study. Thus during the process of data analysis, descriptive statistics and correlations analysis have been used. In this study, statistical parameters are calculated with the help of computer via data analysis tool pack of Microsoft Excel.

Descriptive Statistics

The descriptive statistics are pertinent tools to have an idea of distributions of the variables and it helps to characterization of a set of data. Thus some of the most commonly used descriptive statistics like minimum values, maximum values, mean, standard deviation, co-efficient of variations have been used in this study, along with different graph and charts. To identify the outliers in data Box and Whisker plot has been used.

In addition, as an inferential statistics Spearman's rank correlation coefficient has been used.

CHAPTER – 4

PRESENTATION AND ANALYSIS OF DATA

The main focus of this chapter is presenting and analyzing data according to research methodology to attain the objective of this study. Basically this chapter presents relevant financial data and analysis has been made with different financial ratios as well as statistical tools as proposed. Accordingly, this chapter has been divided into four basic sections: (1) Profitability analysis using Du Pont approach, (2) Analysis of Descriptive Statistics (3) Correlation between leverage and ROE analysis, and (4) Major findings of the study.

A section 1 is concentrated to analyze different financial ratios using the variables fixed by Du Pont model. Relevant financial ratios are computed from the collected secondary data of SCBNL to assess the financial performances. Percentage relatives (Indexes) and different graph charts has been used to proceed this section. Section 2 describes data with the help of descriptive statistics. Section 3 describes the model that attempt to explain financial leverage and its effect on return to the equity holders and the correlation results are also presented and interpreted in this section. Finally section 4 is allotted for listing and discussion of major findings of the study.

4.1 Profitability Analysis using Du Pont Approach:

To observe the profitability of SCBNL, this section is concentrated on analysis of different financial ratios based on Du Pont chart and equations. Weston and Brigham (1996) stressed that Du Pont approach of financial analysis shows the relationships between return on investment (assets), asset turnover, the profit margin, and leverage. To analyze the bank profitability, Rose (2002) has specified the notations for different composite parts to explain the relationship. Accordingly, the relationship is analyzed in this section with:

$$\text{ROA} = (\text{NPM}) (\text{AU}). \dots \dots \dots \text{(i)}$$

$$\text{ROE} = (\text{ROA}) (\text{EM}). \dots \dots \dots \text{(ii)}$$

Combining the equations (i) and (ii), equation (iii) can be formed as extended Du Pont equation. Again, equation (iii) is elaborated as equation (iv) to analyze profitability of the bank in detail.

$$ROE = (NPM) (AU) (EM) \dots \dots \dots (iii)$$

$$ROE = \frac{NP}{TOR} \times \frac{TOR}{TA} \times \frac{TA}{TE} \dots \dots \dots (iv)$$

The necessary figures, as demand in equation (iv), are extracted from the income statement and balance sheet of SCBNL for the selected years. Table 4.1 presents such basic data.

Table 4.1
Net Profit (NP), Total Operating Revenue (TOR), Total Assets (TA) and Total Equity (TE) of SCBNL with Percentage Relative

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Rs. in Millions							
NP	537.80 (100)	536.24 (100)	658.76 (122)	691.67 (129)	818.92 (152)	1025.11 (191)	1085.87 (202)
TOR	1264.90 (100)	1285.54 (102)	1418.25 (112)	1558.01 (123)	1774.15 (140)	2092.13 (165)	2297.71 (182)
TA	23642.06 (100)	21781.68 (92)	25767.35 (109)	28596.69 (121)	33335.79 (141)	40066.57 (169)	40213.32 (170)
TE	1495.74 (100)	1582.42 (106)	1754.14 (117)	2116.35 (141)	2492.55 (167)	3052.47 (204)	3369.71 (225)

Source: Financial Statements of SCBNL

Notes: 1) Figures in the parentheses are index or percentage relative.

2) Year 2003/04 is considered as base year to observe the percentage relative.

Table 4.1 exhibits simply the data required to observe net profit margin [NPM], asset utilization [AU], equity multiplier [EM] to analyze operating performances of SCBNL using Du Pont procedure and the corresponding value indices to measure change in a variable over a period of years selected. The time series data presented in Table 4.1 clearly indicates almost figures in increasing trend. As indicated in the table, percentage relative of net profit of SCBNL seems encouraging. An increment of net profit by 202 percent in 2009/10 relative to the year 2003/04 has been observed. Table 4.1 further presents the fact that, relative to the increasing index of total operating revenue, increments of net profit is

at high ratio. One of the causes behind this is effectiveness of expense management or cost control. An Increment of net profit has been identified by 202 percent whereas increment of total operating revenue is only with 182 percent in 2009/10 relative to the year 2003/04. However the row of percentage relative in Table 4.1 clearly shows gradual increment of both NP and TOR (Figure 4.1 follows). Growth of asset size and equity is a signal of growing size of the bank. It has been observed from the table that, relative to the base year 2003/04, total asset has been increased by 170 percent in 2009/10. An increasing trend of percentage relative of total asset has been identify by 170 percent and total equity by 225 percent in 2009/10 relative to the year 2003/04 (Figure 4.2 follows). It indicates the condition of leverage of SCBNL

Figure 4.1
Movements of NP and TOR over the years

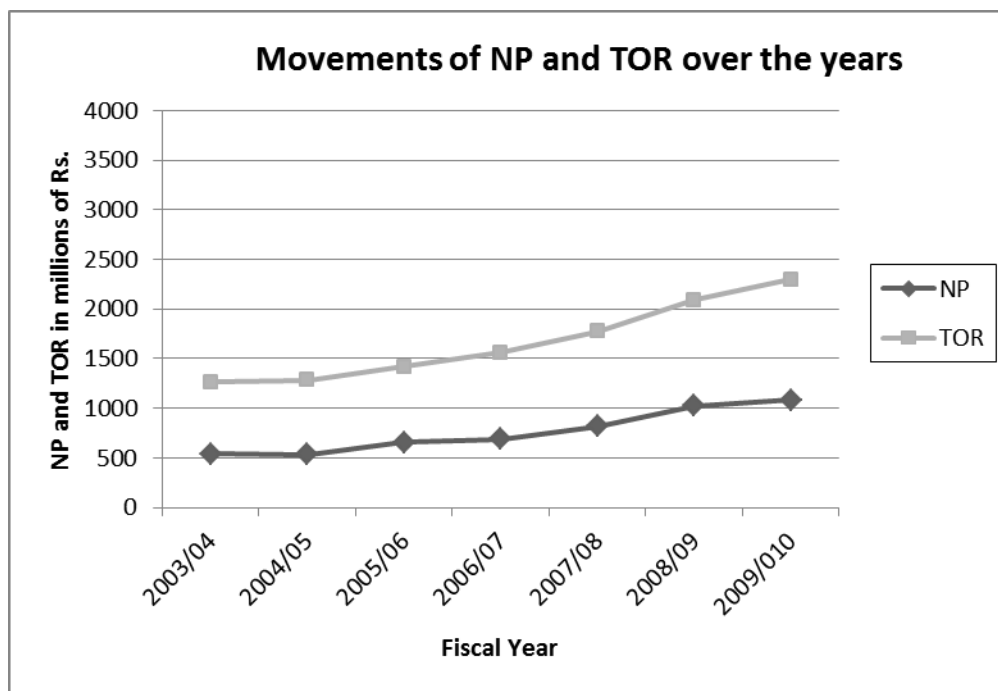
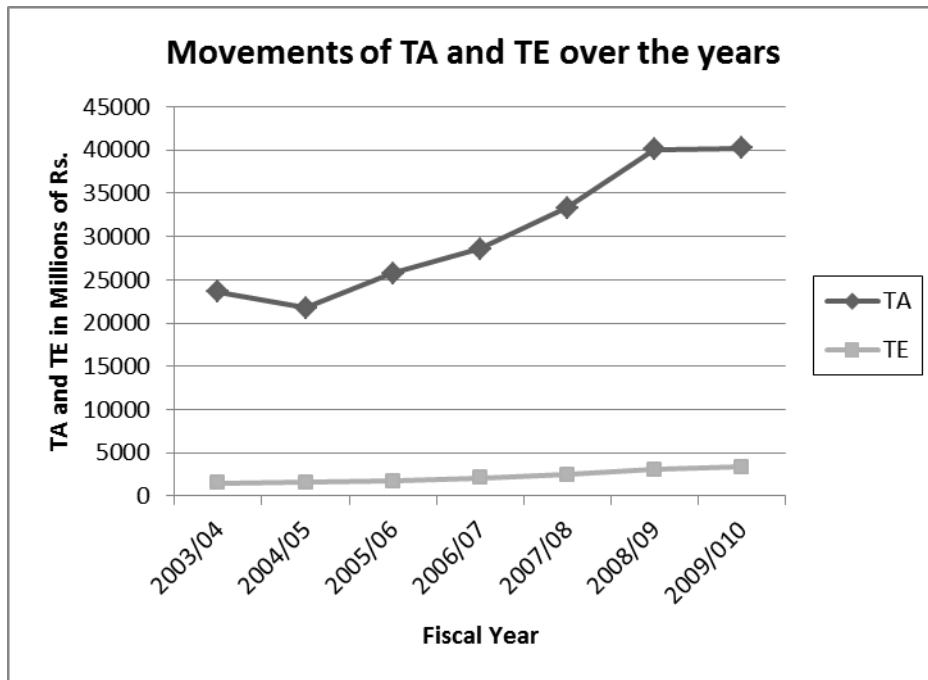


Figure 4.1 demonstrates clearly the gradual increment of net profit and total operating revenues. These are basics to observe net profit margin. Out of the four variables presented in Table 4.1, movement of the figures of total asset and total equity are highlighted in Figure 4.2. These are basics to observe leverage status of the bank.

Figure 4.2
Movements of TA and TE over the years



Data Source: Table 4.1

Using the equation (iv), data presented in Table 4.1 are processed and presented in Table 4.2 to analyze Net profit margin, asset utilization and equity multiplier. These ratios govern ROA and ROE of the bank.

4.1.1 Analysis of ROA and ROE with composite factors:

Return on asset [ROA] and return on equity [ROE] are the fundamentals of profitability analysis. NPM, AU, and EM are their determinants. NPM is the ratio of net profit to total revenues, AU is the ratio of total revenues to total asset, and EM represents the ratio of total asset to total equity. NPM times AU results ROA. It measures the profit earning capacity by utilizing available resources i.e. total assets. It shows the management's capability to generate profit on using assets. ROA times EM produces the result as ROE. It is a measure of the rate of return flowing to the bank's shareholders. It approximates the net benefit that the stockholders have received from investing their capital in the bank. These ratios are the basics of Du Pont system of financial analysis. Table 4.2 presents such fundamental ratios to measuring and evaluating bank profitability. NPM, AU, ROA and ROE are expressed in percentage whereas EM is expressed as times in the table.

Table 4.2**NPM, AU, EM, ROA and ROE of SCBNL and Percentage Relatives**

$$ROA = (NPM) (AU) = (NP/TOR) (TOR/TA)$$

$$ROE = (ROA) (EM) = (NPM) (AU) (EM) = (NP/TOR) (TOR/TA) (TA/TE)$$

Year	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Ratios							
NPM %	42.52 (100)	41.71 (98)	46.45 (109)	44.39 (104)	46.16 (109)	49.00 (115)	47.26 (111)
AU %	5.35 (100)	5.90 (110)	5.50 (103)	5.45 (102)	5.32 (99)	5.22 (98)	5.71 (107)
ROA %	2.27 (100)	2.46 (108)	2.56 (112)	2.42 (106)	2.46 (108)	2.56 (112)	2.70 (119)
EM x	15.81 (100)	13.76 (87)	14.69 (93)	13.51 (85)	13.37 (85)	13.13 (83)	11.93 (76)
ROE %	35.96 (100)	33.89 (94)	37.55 (104)	32.68 (91)	32.85 (91)	33.58 (93)	32.22 (90)

Source: Financial Statements of SCBNL

Notes: 1) Figures in the parentheses are index or percentage relative.

2) Year 2003/04 is considered as base year to observe the percentage relative.

4.1.1.1 Net Profit Margin [NPM]

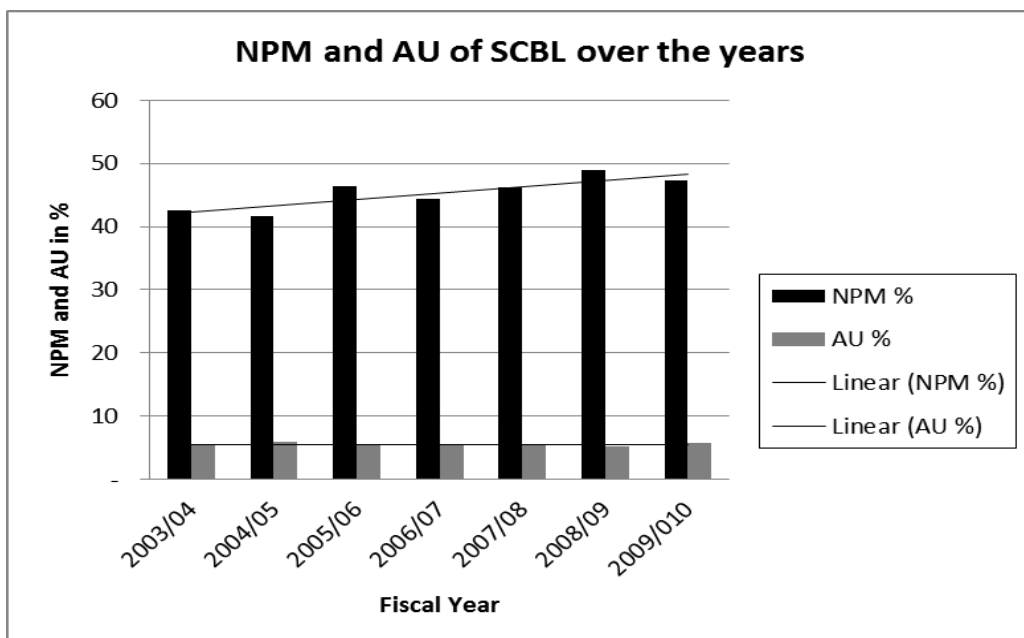
Among the financial ratios presented in Table 4.2, NPM is for measuring and evaluating the effectiveness of expense management or cost control and service pricing policies of the bank. As presented in table the higher ratio of NPM 49 percent has been observed in fiscal year 2008/09. Relatively poor performances have been observed for the fiscal year 2003/04 and 2004/05, 42.52 percent and 41.71 percent respectively. Since NPM is a ratio of net profit to total revenues, an increase or decrease in NPM represents overall aspect of income statement. Efficiency in expenditure management or cost control in one hand support to increase in NPM, on the other hand good management of revenue generating activities boosts for robust position. As presented in Table 4.2, the ratios of NPM in fiscal years 2007/08, 2008/09, and 2009/10 are encouraging for the bank in relative to previous years. To increase in return on asset and return on equity the ratio of NPM plays significant role. Increasing percentage relatives 109 percent, 115 percent, and 111 percent for the last three years demonstrates the thing as positive.

4.1.1.2 Asset Utilization [AU]

The bank's degree of asset utilization reflects portfolio management policies, especially the mix and yield on the bank's assets. So it is a measure of asset management efficiency. Using Du Pont approach it can be expressed as the ratio of total revenues to total asset. As net profit margin asset utilization also plays significant role to increase ROA and ROE. By carefully allocating the bank's assets to the highest-yielding loans and investments while avoiding excessive risk, management can raise the bank's average yield on its assets. SCBNL, in this regard, seems gradual falling down. The speed of increasing asset size relatively with operating revenue seems the main reason behind decreasing AU. It has been observed from Table 4.1. Table 4.2 clearly demonstrates the asset utilization ratio in decreasing trend during the study period. It has been observed 5.35 percent in fiscal year 2003/04 but with gradual downtrend the ratio arrived at 5.22 percent in 2008/09. Percentage relatives 110, 103, 102, 99, and 98 percent respectively for the fiscal years 2004/05 to 2008/09 also demonstrates clearly the thing as negative.

The financial ratios of NPM and AU, as presented in Table 4.2, give the picture in contrast. To build up ROA of SCBNL in sample years, NPM is playing supportive role in one hand on the other hand AU is in negative role. Figure 4.3 demonstrates the movement of the financial ratios of NPM and AU over the years.

Figure 4.3
NPM and AU of SCBNL over the years



4.1.1.3 Return on Asset: Analysis with decomposition of components

Return on asset is primarily an indicator of managerial efficiency; it indicates how capably the management of the bank has been converting the institution's assets into net earnings. Simply it is a ratio of a bank's net after-tax income divided by its total assets. One of the major sections of DU Pont approach of financial performance analysis is ROA analysis. According to the Du Pont approach ROA is simply a result of the multiplication of net profit margin and asset utilization. As presented in Table 4.2 it has been observed in between 2 percent to 2.7 percent in the sample seven years. Highest ratios 2.70 percent in the fiscal years 2009/10 and lowest 2.27 percent in 2003/04 have been observed. In addition Table 4.2 and Figure 4.3 clearly demonstrate that, to build up ROA of SCBNL, NPM has growing contributions over the years whereas contributions of AU seem decreasing. Bank's net after-tax income and total asset are the fundamentals of ROA analysis. So, entire income statement components and total asset of the bank have been used in this study to examine efficiency of SCBNL Table 4.3 presents segregated ratios for detail analysis of ROA.

Table 4.3
ROA Details: Ratios of Costs and Revenues against Common Denominator,
Total Asset

$$C = A - B$$

$$F = D - E$$

$$J = C + F - G - H - I$$

	Notations	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Interest Inc. to TA	A	4.41 (100)	4.86 (110)	4.62 (105)	4.94 (112)	4.77 (108)	4.71 (107)	5.08 (115)
Interest Exp. to TA	B	1.17 (100)	1.17 (100)	1.18 (101)	1.44 (124)	1.42 (121)	1.36 (116)	1.43 (123)
Interest Margin to TA	C	3.24 (100)	3.69 (114)	3.44 (106)	3.49 (108)	3.36 (104)	3.35 (103)	3.65 (112)
Non-interest Inc. to TA	D	2.11 (100)	2.21 (105)	2.06 (98)	1.96 (93)	1.96 (93)	1.87 (89)	2.07 (98)
Employee and Office Exp. to TA	E	1.75 (100)	1.86 (106)	1.51 (86)	1.50 (85)	1.37 (78)	1.32 (75)	1.51 (86)
Non Interest Margin to TA	F	0.36 (100)	0.35 (98)	0.55 (155)	0.46 (129)	0.60 (168)	0.55 (154)	0.55 (156)
Provision for Loan Loss to TA	G	0.10 (100)	0.13 (128)	0.19 (186)	0.13 (129)	0.21 (211)	0.14 (142)	0.19 (192)
Provision for Staff Bonus to TA	H	0.36 (100)	0.41 (112)	0.36 (100)	0.36 (98)	0.36 (98)	0.37 (101)	0.38 (105)
Provision for Income Tax to TA	I	1.00 (100)	1.20 (121)	1.09 (109)	1.13 (114)	1.12 (113)	1.10 (111)	1.12 (112)
Return on Asset	J	2.14 (100)	2.30 (108)	2.35 (110)	2.33 (109)	2.26 (106)	2.29 (107)	2.51 (117)

Source: Financial Statements of SCBNL

Notes: 1) Figures in the parentheses are index or percentage relative.
2) Year 2003/04 is considered as base year to observe the percentage relative.

Interest Income to Total Assets

Interest income is major revenue of banking business. Banks generate this revenue by lending and investment activities. Thus this ratio indicates an efficiency of deployment of deposits by the bank. Accordingly, Interest Income to Total Assets is the financial ratio which measures the capacity of generating major revenue against the assets. As presented in the table the higher ratio 5.08 percent has been observed in the fiscal year 2009/10. Relatively poor performance of 4.41 percent has been observed for the fiscal year 2003/04.

It has been observed from the table that the ratios are decreases in fiscal year 2005/06, 2007/08 and 2008/09 and increases in 2004/05, 2006/07 and 2009/10 in relative to previous years. It means that the income earning from the holding assets is not very satisfied. Decreasing percentage relatives from 110, 105, 112 and from 108, 107, 115 shows clearly that the thing is negative.

Interest Expenses to Total Assets

Interest expenses are treated as direct cost in the banking business. This cost is incurred for deposit collection function of the bank. Among the financial ratios presented in Table 4.3, Interest Expenses to Total Assets is for measuring the cost of funds for holding assets. Table 4.3 clearly demonstrates the ratio is in 2003/04 but with gradual uptrend the ratio arrived at 1.43 percent in 2009/10. It means that the bank is not in good position by supplying the cost of funds for their holding assets. Percentage relatives 100, 101, 124, 121, 116 and 123 respectively for the fiscal years 2003/04 to 2009/10 of the study period also demonstrates clearly the thing are in fluctuation trend. In absolute term it is not a good indicator of cost control efficiency of SCBNL

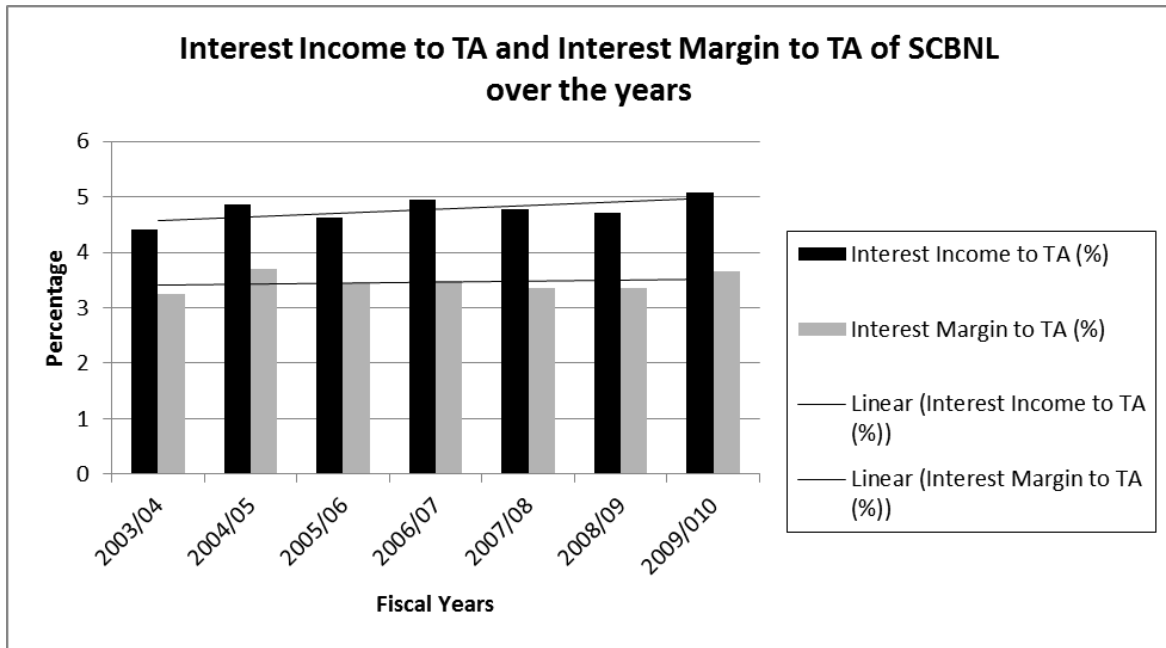
Interest Margin to Total Assets [Net interest margin]

Interest margin is a result of core banking business activities. The difference between interest income and interest expense is called as interest margin or interest spread. The ratio of interest margin to total assets is simply refers net interest margin. Net interest margin is one of the major devices that use for the appraisal of financial performances of the banking entity. The ratio of interest margin to total assets of SCBNL is in fluctuating trend as shown in the Table 4.3. As presented in the table the higher ratio is 3.69 percent has been observed in the fiscal year 2004/05 and relatively poor performances of 3.24 percent for the fiscal year 2003/04. The ratio of Interest Margin to Total Assets in fiscal year 2009/10 is encouraging for the bank. Increase percentage 112 demonstrates the thing as positive in relatives to fiscal year 2003/04.

The financial ratios of Interest Income to Total Assets, Interest Expenses to Total Assets and net interest margin as presented in Table 4.3, give the picture in contrast. Figure 4.4 and 4.5 clarifies the reason of increasing net interest margin of SCBNL over the years.

Figure 4.4

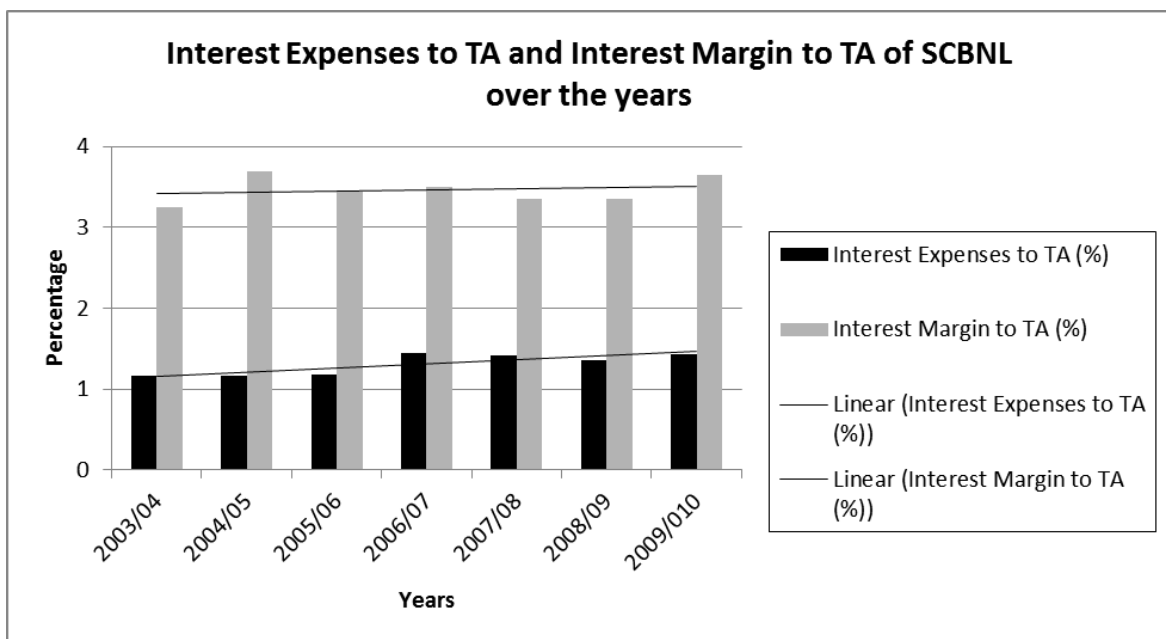
Interest income to TA and Interest Margin to TA of SCBNL over the years



As Figure 4.4 indicates by the linear that, the ratio of interest income to total assets and net interest margin, which is expressed as interest margin to total asset, both are increasing. This paradox has been clarified by the Figure 4.5.

Figure 4.5

Interest expenses to TA and Interest margin to TA of SCBNL over the years



As Figure 4.5 presents the linear of interest expenses to total assets is increasing over the years. The steepness of increasing linear of interest expenses to total assets is observed more than that of linear of interest income as observed in Figure 4.4.

Non-Interest Income to Total Assets

Non-interest income is revenue of the bank other than interest incomes. Commissions, fee incomes and other gains of operating banking activities are the sources of non-interest income. Thus, Non-Interest Income to Total Assets ratio measures the income earned from handling customer transactions against the asset size of the bank. Table 4.3 clearly demonstrates the non-interest income to total assets ratio is in decreasing trend during the study period. It has been observed 2.11 percent in fiscal year 2003/04 but with gradual downtrend the ratio arrived at 2.07 percent in 2009/10. Percentage relatives 105, 98, 93, 93, 89 and 98 respectively for the fiscal years 2003/04 to 2009/10 of the study period also demonstrates clearly the thing as negative. Based on these results it is concluded that, relative to the increasing speed of asset size of SCBNL, it is not in a position to increase its non-interest incomes.

Employees and Office Expense [Non interest expenses] to Total Assets

Non-interest expenses generally include salaries and wages, repair and maintenance costs on bank facilities, and other expenses. Thus, employees and office expenses to total assets are the financial ratio that represents different overheads incurred for holding and maintaining assets. As presented in the table the higher ratio of non-interest expenses to total assets is 1.86 percent. It has been observed in the fiscal year 2004/05. Relatively lower ratio of 1.32 percent has been observed for the fiscal year 2008/09. It is observed that the ratios are in decreasing trend during the study period. The percentage relatives 106, 86, 85, 78, 75 and 86 shows satisfactory control in non-interest expenses. It indicates that, in comparison to the increasing size of assets the overheads of SCBNL is in controlled state.

Non-Interest margin to Total Assets [Net noninterest margin]

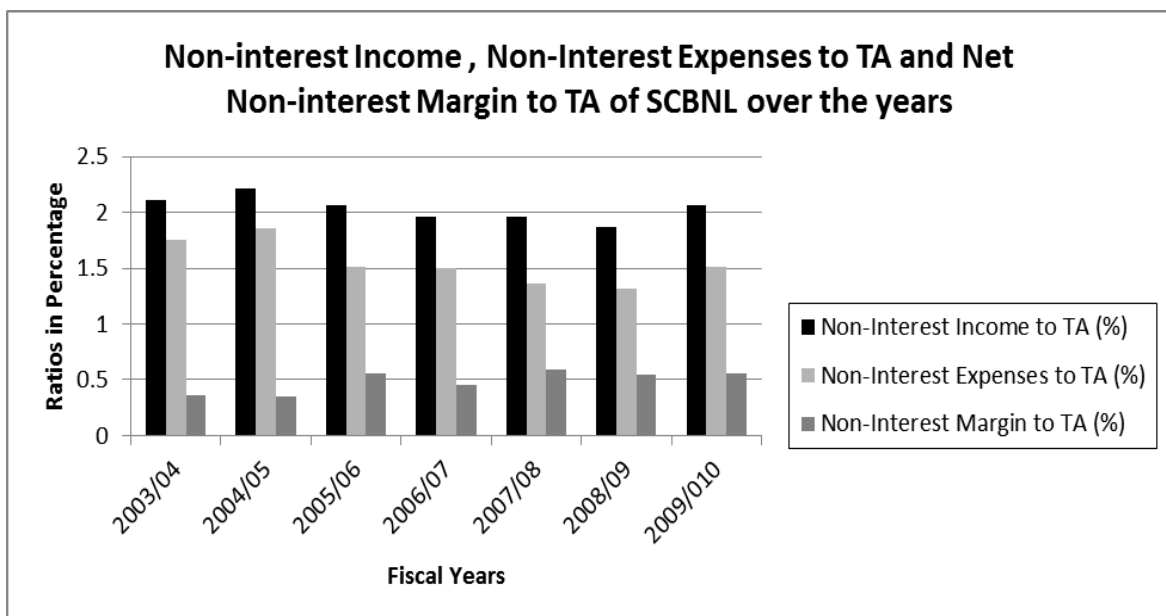
Non-interest margin is simply the difference in amount of non-interest revenues and non-interest expenses. Net non-interest margin is a result derived from 'non-interest revenues less non-interest expenses divided by a bank's total assets'. The net non-interest margin

measures the amount of non-interest revenues stemming from deposit service charges and other service fees the bank has been able to collect relative to the amount of non-interest costs incurred (generally, including salaries and wages, repair and maintenance costs on bank facilities, and other expenses). Rose (2002), in his book 'Commercial Bank Management', has mentioned that for most banks the non-interest margin is *negative*: non-interest costs generally outstrip fee income, though bank fee income has been rising rapidly in recent years as a percentage of all bank revenues.

The result presented in Table 4.3 indicates the net non-interest margin of SCBNL is in fluctuation ratios over the years. Further, it is deteriorating in the recent years. Highest margin 0.60 percent has been observed in the fiscal year 2007/08. Whereas the notable lowest margin 0.35 is observed in the fiscal year 2004/05. But in the rest of the years the margin is observed in between 0.36 percent to 0.55 percent. Thus it seems highly fluctuating net non-interest margin and it has been concluded in this part that, the strength of generating incomes other than interest (fees and commission income and other gains) of SCBNL is degrading relative to the bank's increasing investment in assets.

Figure 4.6 exhibits the status in non-interest income to total asset ratio, non-interest expenses to total assets ratio and net non-interest margin of SCBNL for the selected years.

Figure 4.6
Non-interest income, Non-interest expenses to TA and
Net Non-interest margin to TA of SCBNL over the years



Provision for Loan Loss to Total Assets

The accrual expense related with possible loan losses of the bank is measured by Provision for Loan Loss to Total Assets ratio. As observed in Table 4.3, the ratio is in fluctuating position. It has been observed from the table that the ratio increases from 0.10 percent to 0.19 percent in 2003/04 to 2005/06 then decreases from 0.19 percent to 0.13 percent and again increase to 0.21 percent in 2007/08. Then, from 2008/09 the ratio starts increasing from 0.14 percent to 0.19 percent in 2009/10. Therefore, there is no consistency in the accrual expense of the bank during the study period.

Provision for Staff Bonus to Total Assets

Provision for Staff Bonus to Total Assets measures the expenses made to the bonus for the staff from holding assets. As presented in the table the higher ratio is 0.41 percent in the fiscal year 2004/05. Relatively lower ratio of 0.36 percent for the fiscal year 2003/04, 2005/06, 2006/07 and 2007/08 has been observed. A percentage relative 112, 100, 98, 98, 101 and 105 clearly shows, it has been observed from the table that the ratios are increasing trend during the study period.

Provision for Income Tax to Total Assets

Provision for Income Tax to Total Assets is a financial ratio presented in Table 4.3 which measures the expenses made for tax. As presented in the table the higher ratio is 1.20 percent has been observed in the fiscal year 2004/05. Relatively lower ratio of 1.00 percent has been observed for the fiscal year 2003/04. It has been observed from the table that the ratios are in fluctuating trend but not so highly fluctuating during the study period. It means that the expenses made for the income tax are not in a consistent manner.

The Final row of the Table 4.3 consolidates the result as ROA. It presents the result about capability of the management of bank in converting the institution's assets into net earnings. Using total assets as a common denominator all the items and figures of income statements of SCBNL has been converted into ratios and presented in Table 4.3. Data presented in table indicates encouraging ROA in final two years of the study period. These are observed 2.29 percent and 2.51 percent in 2008/09 and 2009/10 respectively. It is found that the main reason behind this increment is due to significant increase of interest margin to total asset ratios in such years. Similarly low ROA 2.14 percent is observed in 2003/04 because of low interest margin. The low rate of non-interest margin in building

ROA is also observed from the table. Much disturbance to build up ROA because of lowest rate of non-interest margin i.e., 0.35 percent in fiscal year 2004/05 is found.

4.1.1.4 Equity Multiplier [EM]

The bank's equity multiplier reflects leverage or financing policies. It is asset-to-equity-capital ratio. The multiplier is a direct measure of the bank's degree of financial leverage. Because equity must absorb losses on the bank's asset, the larger the multiplier, the more exposed to failure risk the bank is. However, the larger the multiplier, the greater the bank's potential for high returns for its stock holders. It is presented in times (X) figure in Table 4.2 and computed as total assets divided by total equity capital. Larger the figure of equity multiplier implies that, there is relatively significant use of debt source to finance the bank's assets. It is obvious that banks are highly geared entities, and do not have much capital relative to their liabilities.

Table 4.2 shows the equity multiplier 15.81, 13.84, 14.69, 13.51, 13.37, 13.13 and 11.93 times respectively from the fiscal year 2003/04 to 2009/10. So it is observed multiplier in the range of 11 to 15 times. The equity multiplier is normally the largest, averaging about 15X or larger for most banks. The biggest banks in the industry often operate with multipliers of 20X or more (Rose: 2002). Thus, with this reference, the equity multiplier of SCBNL is observed as normal state.

4.1.1.5 Return on Equity [ROE]:

Du Pont equation, as presented earlier, explains ROE as a result of ROA times EM. Where, ROA is net profit margin times the asset utilization. Thus ROE consolidates the result of overall operating performances of an institution. ROE is a measure of the rate of return flowing to the bank's shareholders. Simply it is the ratio of a bank's net after tax income divided by its total equity capital. It approximates the net benefit that the stockholders have received from investing their capital in the bank. As Table 4.2 presents, within the study period, it is observed maximum 37.55 percent in the fiscal year 2005/06. The table clearly demonstrates the reason, of this encouraging ROE in that year, is highest equity multiplier i.e., 14.69X. Within the study period, it is observed minimum 32.22 percent in the fiscal year 2009/10. The reason of this poor ROE in that year is the lowest return on assets because of relatively low net profit margin in that year. It is justified from Table 4.2.

4.2 Analysis of Descriptive Statistics:

Since the descriptive statistics are pertinent tools to have ideas of distributions of the variables, some of the most frequently used statistics, like mean, standard deviation, coefficient of variations, minimum values, and maximum values have been used to support to attain the purpose of this study. Table 4.4 presents descriptive statistics of the variables that are used to analyze financial performances of SCBNL through Du Pont approach. Descriptive statistics results presented in Table 4.4 are computed from the 7 years respective data of SCBNL from the fiscal year 2003/04 to 2009/10.

Table 4.4
Descriptive Statistics of Variables used in Du Pont Model to
Analyze Profitability of SCBNL

Variables	Mean	SD	CV	Min	Max
NPM	0.454	0.026	0.058	0.417	0.490
AU	0.055	0.002	0.043	0.052	0.059
ROA	0.025	0.001	0.054	0.023	0.027
EM	13.744	1.225	0.089	11.934	15.806
ROE	0.341	0.019	0.057	0.322	0.376

Table 4.4 provides average values of the different major variables that are focused in this study along with standard deviation and coefficient of variations. In addition, the table also contains minimum and maximum ratios. The mean value of NPM (measured as the ratio of net profit to total operating revenue) is 0.454 percent, whereas AU (measured as the ratio of total operating revenue to total assets) is 0.055 percent. As a combined (multiplied) result of NPM and AU, the third row of the table ROA (measured as the ratio of net profit to total asset) is 0.025 percent. These mean ratios indicate that, to generate ROA of SCBNL, the role of NPM is observed more than double of AU. The mean value of EM (measured as the ratio of total asset to total equity and expressed as times) is 13.744. It is a financial leverage that magnifies ROE from ROA. The mean value of ROE (measured as the ratio of net profit to total equity or ROA times EM) is 0.341 percent. Thus from the table equity multiplier is found as strong determinant to build up significant ROE.

However, the minimum ROE 0.322 percent to a maximum of 0.376 percent have been observed in the study period. This can also be observed with the values of the standard deviation and coefficient of variations. The standard deviations of the distribution of ROE

is 0.019 and coefficient of variation is 0.057. This represents the state of earning risk of SCBNL. Similarly, the case of NPM is also observed in the same line. The minimum NPM 0.417 percent to a maximum 0.490 percent have been observed in the study period. The volatility can also be observed with the respective standard deviation and coefficient of variation. The standard deviations of the distribution of NPM is 0.026 and coefficient of variation is 0.058. This figure justifies the earning risk in the same manner as ROE whereas, the variations in other determinants of return on equity and AU have been observed lower than NPM. Coefficient of variations of AU and EM are observed 0.043 and 0.089 respectively. Thus, assets utilization part is observed relatively consistent. From the descriptive statistics as presented in Table 4.4, relatively more consistency is observed in ROA of SCBNL. The minimum ROA 0.023 percent to a maximum of 0.027 percent have been observed in the study period. This can also be observed with the values of the standard deviation and coefficient of variations. The standard deviations of the distribution of ROA is 0.001 and coefficient of variation is 0.054. Thus earning risk in respect of return on asset has been observed relatively lower than that of return on equity.

As the change in the figures of income statement variables and total assets over the years, return on assets of the bank use to change obviously. To analyze ROA with breakdown, as important part of Du Pont equation, Table 4.5 presents descriptive statistics of the relevant segregated data. Descriptive statistics results presented in Table 4.5 are computed from the 7 years respective data of SCBNL from the fiscal year 2003/04 to 2009/10.

Table 4.5
Descriptive Statistics of Breakdowns of ROA of SCBNL

Variables	Mean	SD	CV	Min	Max
Interest Inc. to TA	0.048	0.002	0.046	0.044	0.051
Interest Exp. to TA	0.013	0.001	0.101	0.012	0.014
Interest Margin to TA	0.035	0.002	0.047	0.032	0.037
Non-interest Inc. to TA	0.020	0.001	0.056	0.019	0.022
Employee and Office Exp. to TA	0.015	0.002	0.126	0.013	0.019
Non Interest Margin to TA	0.005	0.001	0.209	0.003	0.006
Provision for Loan Loss to TA	0.002	0.000	0.263	0.001	0.002
Provision for Staff Bonus to TA	0.004	0.000	0.049	0.004	0.004
Provision for Income Tax to TA	0.011	0.001	0.055	0.010	0.012

Table 4.5 provides average values of the different part and partials that are concerned with ROA of SCBNL along with standard deviation and coefficient of variations. In addition, the table also contains corresponding minimum and maximum ratios. The mean value of interest income to total asset is observed 0.048 percent, whereas Interest expenses to total asset is 0.013 percent. As a spread between these two, the mean value of interest margin to total asset is observed 0.035 percent. Thus excess of interest income to total asset over interest expenses to total asset is observed too much. It has important role to build up NPM of SCBNL and which support to increase ROA. The mean ratio of non-interest margin to total asset is 0.005 percent. It is excess of the non-interest income to total assets over non-interest expenses to total assets. The mean value of non-interest income to total assets is observed only 0.020 percent whereas it is 0.015 percent for non-interest expenses to total assets (Employee and Office Exp. to TA). Thus the results shows much burden on interest margin. In the same way, other burdens are observed 0.002, 0.004, and 0.011 percent of mean values for Provision for Loan Loss to TA, Provision for Staff Bonus to TA, and Provision for Income Tax to TA respectively.

The variation of Non Interest Margin to total assets is observed more. The minimum and maximum of 0.003 percent to a 0.006 percent have been observed in the study period. This volatility can also be observed from the coefficient of variations. In comparison to interest expenses, interest income has been observed consistent. Coefficient of variation in interest expenses to total asset is 0.101 percent whereas it is only 0.046 percent in interest income to total assets. As a result the coefficient of variation in interest margin to total asset is observed in balanced position. This is only 0.047 percent. Again, coefficient of variation of non-interest income to total asset 0.056 percent indicates the bank's non-interest income is relatively more volatile than interest income. Provision for loan loss to total asset has been observed next volatile issue. The coefficient of variation of this provision is observed 0.263 percent. Relative to other provisions it is much higher.

4.3 Correlation between leverage and ROE

Leverage ratio shows the proportion of debt capital and equity capital. The leverage ratios are calculated to measure the financial risk and the firm's ability if using debt for the benefit of shareholders. Thus, one of the objectives of using leverage by the business firms is to magnify the ultimate return to the common shareholders.

Equity Multiplier (EM) represents the financial leverage and specified as total assets divided by total equity. It is intended to measure the sensitivity or responsiveness of leverage to return on equity (ROE) of SCBNL. For the analysis, Table 4.6 presents financial leverage measured as equity multiplier and respective return on equity of SCBNL for the study period.

Table 4.6
Financial Leverage measured as equity multiplier [EM] and
Return on equity [ROE] of SCBNL

Fiscal year	Financial Leverage [Measured as EM]	Return on Equity [Percent]
2003/04	15.81X	35.96
2004/05	13.84X	33.89
2005/06	14.69X	37.55
2006/07	13.51X	32.68
2007/08	13.37X	32.85
2008/09	13.13X	33.58
2009/010	11.93X	32.22

The strength of a relationship or the association, between two variables is typically measured by the coefficient of correlation, whose range from -1 for a perfect negative correlation up to +1 for a perfect positive correlation. But in practical cases the coefficient lies in between aforesaid two extremes. Thus, the coefficient measures the degree of linear association between two variables (Levine, Krehbiel & Berenson, 2005).

Correlation looks at the relationship between two variables in a linear fashion. When the assumptions underlying correlation cannot be met adequately, a non-parametric alternative is Spearman's rank-order correlation (Coakes, Steed & Dzidic, 2007)

Assumptions

For parametric correlational analysis there are different underlying assumptions

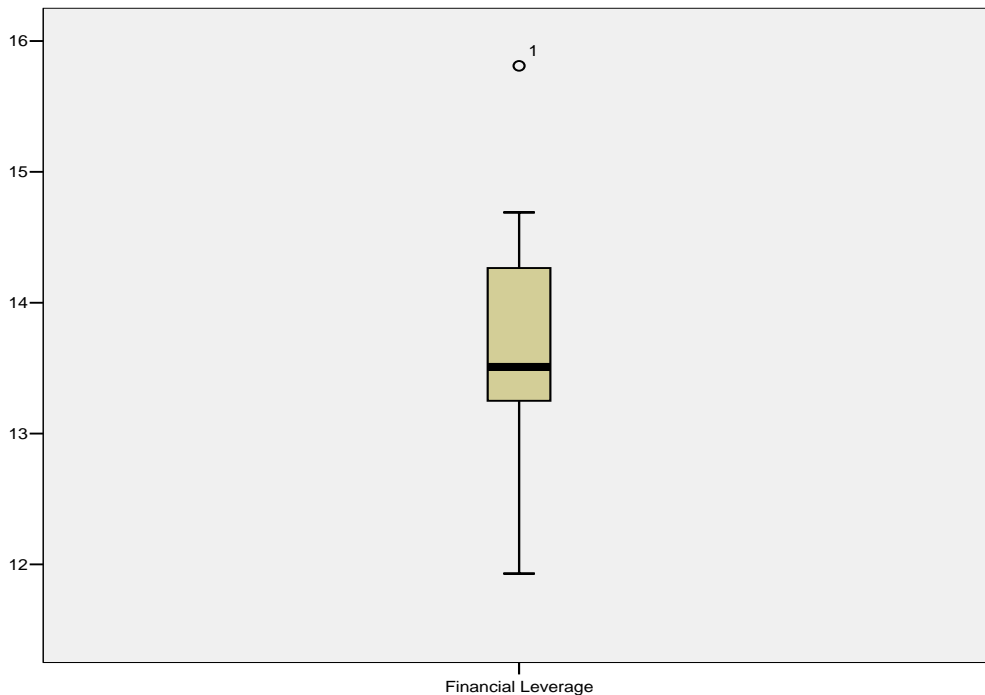
- i. Related pairs – data must be collected from related pairs: that is, if you obtain a score on an X variable, there must also be a score on the Y variable from the same participant.
- ii. Scale of measurement – data should be interval or ratio in nature.

- iii. Normality – the scores for each variable should be normally distributed.
- iv. Linearity – the relationship between the two variables must be linear.
- v. Homoscedasticity – the variability in scores for one variable is roughly the same at all values of the other variable. That is, it is concerned with how the scores cluster uniformly about the regression line.

4.3.1 Test of assumptions for Parametric Statistics:

To make safe from the error due to non-fulfillment of assumptions inherent with parametric test of correlation, it has been tested whether the corresponding data can satisfy the required prerequisite. Box and Whisker Plot has been used to verify.

Figure 4.7
Box and whisker plot of ROE showing outlier



While observing Box and whisker plot as shown in figure 4.7. Outlier has been observed in Financial Leverage (EM) data. Box and Whisker plot signifies that the parametric test procedure is not fit to test the association between leverage and ROE. Accordingly, as a non-parametric procedure, Spearman’s Rank Correlation Coefficient has been used to test the association. The core statistical reasons for using Spearman’s Rank correlation Coefficient are:

- a. For this method, variables need not be normally distributed and
- b. This method is not very sensitive to outliers.

4.3.2 Spearman's Rank Correlation coefficient:

In statistics, Spearman's Rank correlation coefficient or Spearman's rho, named after Charles Spearman and often denoted by the Greek letter ρ (rho) or as r_s is a non-parametric measure of statistical dependence between two variables. The Spearman correlation coefficient is considered as the non-parametric version of Pearson Correlation Coefficient.

Among others, one of the objectives of this study is to analyze the association between financial leverage and the returns to the firm's equity with special reference of SCBNL. Financial leverage is the extent to which a firm uses debt financing. As signified by the theory of financing function of financial management, the objective of financial structure, specifically the financial leverage decision, is to maximize the value of the firm's equity.

With respect to the aforesaid discussion, this section has attempted to signify the direction of relationship between leverage and ROE of SCBNL. So it has been used two tailed test of correlation coefficient under non parametric procedure. However, theoretically, the association has been expected to positive direction. Table 4.7 signifies the directions and strengths of relationships among the variables under study.

Table 4.7
Test of Association between Leverage and ROE

	Financial Leverage	Return on Equity	<i>p</i>-Value
Financial Leverage	1	0.82143	0.02345

This table demonstrate a test statistics of Spearman's rho to examine the direction of relationship between leverage and ROE of SCBNL. Spearman's rho is a rank order correlation-coefficient which measures association at the ordinal level. This is a nonparametric version of the Pearson correlation based on the ranks of the data rather than the actual values. The sign of the correlation coefficient indicates the direction of the relationship (Positive or negative). Theoretically the expectation of the relationship among leverage and stockholders' return must be in positive direction.

The result as presented in Table 4.7 indicates that the Spearman's correlation coefficient between Leverage and ROE is 0.82143. Since the coefficient is in positive figure, this indicates that leverage and ROE are positively correlated. The result of positive

correlations supports the theoretical perspective that the use of debt magnifies the value to the shareholders. The significance level (p -value) is 0.02345 and it is relatively smaller than 0.05 significant levels. Hence, the correlation is statistically significant and the two variables are statistically linearly related.

The result of correlation coefficient as per spearman's rho, as presented in Table 4.7 accepts the hypothesis that the association between financial leverage and ROE is positive.

4.4 Major Findings of the Study

The various output of the analysis done in chapter 4 is presented in this topic. The certain findings based on the analysis conducted under analytical section are going to be revealed in the following sections.

Net Profit Margin

The bank has a positive net profit margin which means that the bank has the good management over cost control or expenses and in pricing policies in an effective manner. Hence the increase or positive net profit margin helps to increase return on assets.

Asset Utilization

The allocation of the bank's assets to the highest-yielding loans and investments while avoiding excessive risk, management can raise the bank's average yield on its assets. SCBNL, in this regard, seems gradual falling down. The speed of increasing asset size relatively with operating revenue seems the main reason behind decreasing AU. The analysis shows that the asset utilization is demonstrating the things as negative.

Interest Income to Total Assets

The bank shows the poor capacity to generate revenue due to decreasing percentage relatives through the study period.

Interest Expenses to Total Assets

The bank is in average position by supplying the cost of funds for their holding assets. Hence, it is not a good indicator of cost control efficiency of SCBNL

Interest Margin to Total Assets (Net Interest Margin)

The ratio of interest margin to total assets of SCBNL is encouraging the bank.

Non-Interest Income to Total Assets

From the analysis, it is concluded that, relative to the increasing speed of asset size of SCBNL, it is not in a position to increase its non-interest incomes.

Employees and Office Expense [Non interest expenses] to Total Assets

The percentage relatives of the bank throughout the period show satisfactory control in non-interest expenses. It indicates that, in comparison to the increasing size of assets the overheads of SCBNL is in controlled state.

Non-Interest margin to Total Assets [Net noninterest margin]

The net non-interest margin of SCBNL seems highly fluctuating net non-interest margin and it has been concluded in this part that, the strength of generating incomes other than interest (fees and commission income and other gains) of SCBNL is degrading relative to the bank's increasing investment in assets.

Provision for Loan Loss to Total Assets

It is found that there is no consistency in the accrual expense of the bank during the study period.

Provision for Staff Bonus to Total Assets

It has been observed from the table that the ratios are increasing trend during the study period.

Provision for Income Tax to Total Assets

The ratios are in fluctuating trend but not so highly fluctuating during the study period. It means that the expenses made for the income tax are not in a consistent manner.

Return on Assets

To build up Return on Assets of SCBNL, Net Profit Margin has growing contributions over the years whereas contributions of Asset Utilization seem decreasing. The analysis done by putting total assets as a denominator, data presented in the table encourages ROA in final two years of the study period. It is found that the main reason behind this increment is due to significant increase of interest margin to total asset ratios in such years. Similarly low ROA percent is observed because of low interest margin. The low rate of non-interest margin in building ROA is also observed from the table. Much disturbance to build up ROA because of lowest rate of non-interest margin is found.

Equity Multiplier [EM]

The equity multiplier is normally the largest, averaging about 15X or larger for most banks. The biggest banks in the industry often operate with multipliers of 20X or more (Rose: 2002). Thus, with this reference, the equity multiplier of SCBNL is observed as normal state.

Return on Equity

ROE consolidates the result of overall operating performances of an institution as well as it measures the rate of return flowing to the bank's shareholders. Hence, SCBNL uses more funds and gives a good return to their owners.

Correlation result of leverage and return

Correlation coefficient between financial leverage and return on equity are positively correlated. The result of positive correlations supports the theoretical perspective that the use of debt magnifies the value to the shareholders. The correlation is statistically significant and the two variables are statistically linearly related.

From the analysis of the association between two variables, EM and ROE under 5 level of significance shows that there is a significant relationship between leverage and return on equity.

CHAPTER – 5

SUMMARY AND CONCLUSION

5.1 Summary

Since, few previous years, Nepal has been facing unstable economy due to various unfavorable situations in the country, which have created negative impact and threat to the banking sector. As a result, among various other JVBs, Standard Chartered Bank Nepal Limited is also facing same threat and impact. Despite the situation, SCBNL have been able to grow and develop in the complex economic environment. Thus, this study is conducted to know the financial performance of one of the leading bank in the nation.

A bank is an institution, which primarily deals with monetary transaction accepting public deposits, honoring customer's drawings against such deposits on demand, collecting cheques for customers and lending or issuing credit or investing surplus deposits until they are required for repayment. Present banking system is the result of the development of many centuries. When we talk of the wonderful scientific inventions, banking also comes to be as a wonder of the modern world. The study explores the importance and functions of banks.

Commercial banks plays vital role in the economic development of the country. In recent years due to liberal economic policy of the government, many private banks are coming into operation. The foreign joint venture banks are enjoying competitive advantageous factors like highly skilled personnel, modern and advanced banking technology, customer oriented modern banking services, management expertise and global banking network. So, banking sector is becoming more dynamic and subject to rapid changes. It is not enough to analysis operating performance. There should be proper financial analysis. Financial analysis is the key for financial decision-making and for making plans and program before using sophisticated forecasting and budgeting procedures. Optimum utilization of the organization to the ultimate target fulfillment, so it is very important to analyze the accounting and financial statements to know whether the financial position is sound and what kind of measures should be applied. The value of financial analysis is to form the quantitative relation, who can be used to diagnose strength and weakness in a firm's

performance; such analysis is considerable for the company's common stockholder, investors, bondholders and others. This study presents the financial performance of Standard Chartered Bank Nepal Limited.

The basic objective of this study is to analysis the financial performance of Standard Chartered Bank Nepal Limited. The specific objectives of the study is to examine profitability and operating efficiency of SCBNL, to evaluate core banking business activities and to observe the bank's financial structure and measure the effect of leverage on return to equity holders.

Financial analysis of SCBNL is done on the basis of financial statement from 2003/04/ to 2009/10. The study is based on the secondary data. To approach the study, various financial and statistical tools have been used. The financial ratios are analyzed with application of Du Pont approach. Analysis of descriptive statistics and correlation analysis to estimate the leverage and its effect has been used.

For the financial analysis of the bank, firstly Du Pont approach has been taken into consideration. The ratios analyzed under this approach are Return on equity and Return on assets. And to view clearly the Return on equity and Return on assets have been segregated into its composite parts. The ratios are net profit margin, assets utilization, equity multiplier, interest income to total assets, interest expense to total assets, interest margin to total assets, non-interest income to total assets, employee and office expense to total assets, provision for loan loss to total assets, provision for staff bonus to total assets, provision for income tax and non interest margin to total assets.

The descriptive statistics of variables used in DU Pont Model have been done to analyzed profitability of the bank. And also descriptive statistics of breakdown of ROA (interest income to total assets, interest expense to total assets, interest margin to total assets, non-interest income to total assets, employee and office expense to total assets, provision for loan loss to total assets, provision for staff bonus to total assets, provision for income tax and non interest margin to total assets) have been calculated.

Lastly, the financial leverage is measured as equity multiplier and return on equity of SCBNL. And correlation analysis is done to know the relationship between leverage and return on equity.

5.2 Conclusion

The overall performance of Standard Chartered Bank Nepal Limited is satisfactory and Nepal Rastra Bank has to play more active role to enhance the operation. The analysis of net profit margin of the bank is in satisfactory level. The ratios of NPM in fiscal years 2007/08, 2008/09, and 2009/10 has been encouraging for the bank due to the increasing ratio. Hence, the bank has efficiency in expenditure management or cost control in one hand to increase in NPM, on the other hand it has a good management of revenue generating activities boosts for robusting the position of the bank. The bank shows the decreasing trend of the asset utilization ratio throughout the study period. Therefore, the efficiency of asset management of the bank is not satisfactory and consistent.

In the context of interest income to total assets, the bank shows the inconsistency level of the ratio throughout the study period. It means that the income earning from the holding assets is not very satisfied. Interest expense to total assets ratio shows that the bank is not in a good position by supplying the cost of funds for their holding assets. The ratio shows the fluctuation trend throughout the study period. In the context of interest margin to total assets, relative performance of the bank shows the satisfactory position. The ratio of non-interest income to total assets of the bank has shown the decrement in the income earned from handling customers' transactions. Its ratio is in decreasing trend during the study period. The bank has not maintained its consistency level in the expenses made to the salary for employees and office expense from holding assets showing the decreasing trend in the ratio. The bank shows the ratio of provision for loan loss to total assets in a fluctuation position but in decreasing trend.

Therefore, there is no consistency in the accrual expense of the bank during the study period. In the context of provision for staff bonus to total assets, the bank has maintained its consistency level in the expenses made to the bonus for the staff from holding assets. Provision for income tax to total assets ratio of the bank shows the inconsistency level. It means that the expenses made for the income tax are not in a consistent manner. The ratios are not very highly fluctuated. The net non-interest margin measures the amount of non-interest revenues stemming from deposit service charges and other service fees the bank has been able to collect relative to the amount of non-interest costs incurred (generally, including salaries and wages, repair and maintenance costs on bank facilities, and other expenses). The analysis indicates the net non-interest margin of Standard Chartered Bank Nepal Limited is in fluctuation trends over the years.

The conclusion made is the strength of generating incomes other than interest (fees and commission income and other gains) of Standard Chartered Bank Nepal Limited is degrading relative to the bank's increasing investment in assets. The analysis of ROA shows that the bank has a good managerial efficiency which means that the management of the bank has a very powerful capability in converting its institution's assets into net earnings. The bank's equity multiplier reflects leverage or financing policies. However, the larger the multiplier, the greater the bank's potential for high returns for its stock holders. The equity multiplier of Standard Chartered Bank Nepal Limited is observed as normal state. And from the analysis of Return on Equity, it is drawn that the bank uses more funds and gives a good return to their owners.

Finally, the correlation analysis is used primarily to examine the relationship between EM and ROE of SCBNL. The analysis shows that there exists a positive relationship between return on equity and the leverage as the coefficient is found to be positive.

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Annex 1: Seven Years Financial Summary –Balance Sheet (2003/04 – 2009/10)

(figures in Rs. thousands)

PARTICULARS	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Assets							
Cash & Bank Balances	2,023,164	1,111,117	1,276,241	2,021,021	2,050,243	3,137,164	1,929,307
Money at Call and Short Notice	2,218,600	2,259,691	1,977,271	1,761,152	2,197,538	2,055,549	1,669,460
Investments	11,360,328	9,702,553	12,838,555	13,553,233	13,902,819	20,236,121	19,847,511
Loans, Advances & Bills Purchased	6,410,242	8,143,208	8,935,418	10,502,637	13,718,597	13,679,757	15,956,955
Fixed Assets	136,234	71,413	101,302	125,591	117,272	137,293	118,540
Other Assets	1,493,492	493,697	638,565	633,055	1,349,319	820,687	691,547
Total Assets	23,642,060	21,781,679	25,767,352	28,596,689	33,335,788	40,066,570	40,213,320
Liabilities							
Borrowings	78,283	27,551	-	400,000	-	300,000	-
Deposit Liabilities	21,161,442	19,363,470	23,061,032	24,647,021	29,743,999	35,350,824	35,182,721
Other Liabilities	906,596	808,243	952,181	1,433,315	1,099,242	1,363,277	1,660,889
Total Liabilities	22,146,321	20,199,264	24,013,213	26,480,336	30,843,241	37,014,101	36,843,610

(figures in Rs. thousands)

PARTICULARS	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Shareholders' Equity							
Paid up Capital	374,640	374,640	374,640	413,255	620,784	931,966	1,398,484
Proposed Capitalisation of profit	37,464	74,928	112,392	206,627	310,392	465,983	209,773
Reserves (General Reserves including Exchange Reserves)	866,048	881,511	896,522	991,746	1,178,084	1,415,025	1,731,489
Retained Earnings	217,586	251,336	370,585	504,725	383,287	239,495	29,965
Total Shareholders' Equity	1,495,739	1,582,415	1,754,139	2,116,353	2,492,547	3,052,470	3,369,710
Contingent Liabilities							
Letter of Credit	1,669,867	1,456,762	1,837,398	1,861,944	1,857,994	3,120,879	2,627,212
Guarantees	1,675,401	1,531,069	2,046,063	2,389,969	2,800,467	3,687,373	3,248,829
Forward Exchange Contracts	163,441	66,571	362,646	1,121,870	193,985	1,332,126	1,223,147
Other Contingent Liabilities	822,947	1,023,066	938,720	1,480,339	1,287,338	3,031,614	2,588,137
Total Contingent Liabilities	4,331,656	4,077,468	5,184,827	6,854,122	6,139,784	11,171,991	9,687,325

Annex 2: Seven Years Financial Summary –Profit & Loss Account (2003/04 – 2009/10)

(figures in Rs. Thousand)

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Interest Income	1,042,176	1,058,678	1,189,603	1,411,982	1,591,196	1,887,221	2,042,109
Interest Expenses	275,809	254,127	303,198	413,055	471,730	543,787	575,741
Net Interest Income	766,366	804,551	886,405	998,927	1,119,466	1,343,435	1,466,368
Commission and Discount	198,948	178,651	222,929	221,207	276,432	288,031	338,298
Other Operating Incomes	26,531	29,293	25,442	28,785	32,594	33,191	34,479
Exchange Fluctuation Income	273,050	273,044	283,472	309,087	345,653	427,468	458,564
Total Operating Income	1,264,895	1,285,539	1,418,247	1,558,006	1,774,145	2,092,125	2,297,709
Staff Expenses	134,685	148,586	168,231	199,778	225,256	253,056	312,964
Other Operating Expenses	279,694	256,649	221,087	228,451	230,571	276,327	295,305
Exchange Fluctuation Loss	-	-	-	-	-	-	-
Operating Profit Before Provision for Possible Loss	850,516	880,304	1,028,930	1,129,776	1,318,318	1,562,743	1,689,440
Provision for Possible Losses	23,517	27,726	47,730	36,809	69,885	56,635	76,974
Operating Profit	827,000	852,578	981,200	1,092,968	1,248,432	1,506,108	1,612,466
Non-Operating Income/ (Loss)	(10,756)	2,957	1,433	9,492	1,683	22,098	36,268
Provision for Possible Loss Written Back	43,304	33,685	53,090	20,160	90,635	101,075	58,293
Profit from Ordinary Activities	859,547	889,220	1,035,723	1,122,620	1,340,750	1,629,282	1,707,027

(figures in Rs. Thousand)

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Income/(Expenses) from Extra Ordinary Activities	-	(2,389)	(2,411)	(4,915)	(28,039)	(15,356)	(17,024)
Net Profit after considering all Activities	859,547	886,831	1,033,312	1,117,705	1,312,710	1,613,926	1,690,003
Provision for Staff Bonus	85,955	88,683	93,937	101,610	119,337	146,721	153,637
Provision for Income Tax	235,793	261,903	280,619	324,427	374,452	442,091	450,496
Net Profit/Loss	537,800	536,245	658,756	691,668	818,921	1,025,114	1,085,872
Accumulated Profit up to Previous Year	215,988	217,586	251,336	370,585	557,724	383,288	239,495
This Year's Profit	537,800	536,245	658,756	691,668	818,921	1,025,115	1,085,872
Capital Adjustment Fund upto Previous Year	-	-	-	74,928	-	-	-
Total	753,788	753,831	910,092	1,137,181	1,376,645	1,408,402	1,325,367
General Reserve Fund	70,183	-	-	77,229	163,784	205,023	217,174
Proposed Dividend	412,104	449,568	487,033	330,604	496,627	465,983	769,166
Proposed Issue of Bonus Shares	-	-	37,464	206,627	310,392	465,983	209,773
Exchange Fluctuation Fund	16,450	15,463	15,011	17,996	22,554	31,918	21,381
Capital Adjustment Fund	37,464	37,464	-	-	-	-	-
Other Appropriations	-	-	-	-	-	-	77,908
Accumulated Profit/(Loss)	217,586	251,336	370,585	504,725	383,288	239,495	29,965