CHAPTER - I

Introduction

1.1 Overview of the Nepalese Banking System

Financial intermediation is the main function of financial institutions and financial markets. Financial institutions need to better satisfy various financial demands of customers and enhance profitability by continually improving the ways in which they manage risks and their business operations. Through intermediary channels, funds should be efficiently channeled from depositors and investors to borrowers. Though the function of financial intermediaries is also performed through unorganized sectors, the Nepalese organized financial sector is composed of banking sector and nonbanking sector. Besides commercial banks, there are sizeable numbers of development banks, finance companies, micro-credit development banks, co-operative, NGOs and postal saving offices that undertake limited banking and near banking financial services. Non-bank financial sector comprises saving funds and trusts like Employee Provident Fund, Citizen Investment Trusts, and Mutual fund. The growth of financial sector in Nepal is much better compared to other sectors in the country.

The economic reforms initiated by the Government more than one and half decade ago have changed the landscape of several sectors of the Nepalese economy including the financial sector. Despite the decade's conflict and political insurgency, this sector has continued to grow. Over the past 20 years, Nepal's financial sector has become deeper and the number and type of financial intermediation has grown rapidly. Within this period, the Nepalese financial sector has grown significantly both in terms of business volume as well as size of assets and market. Nepal has a reasonably diversified financial sector, as evidenced by the number a variety of institutions that play an active role in this sector, relative to Nepal's small and underdeveloped economic base.

Nepal Rastra Bank (NRB), the central bank of Nepal, established in April 26, 1956, under the NRB Act 2012 is the sole authority for licensing

and supervising banks and financial institutions in Nepal. The Act has empowered Nepal Rastra Bank to grant license to banks and financial institutions as well as to monitor, inspect and supervise them. The Act also empowers NRB to undertake resolution measures in order to protect the interest of depositors. NRB has the authority even to revoke licenses incase of violation of prudential norms and relevant laws and regulations. NRB's regulatory and supervisory regime is limited to the commercial banks, Development banks, Finance companies, Micro-credit development banks, saving and credit co-operatives and non-government organizations licensed by Nepal Rastra Bank.

1.2 Background of the study

Bank is an organization, the major functions of which are to deal in money and credit. The main business of a bank is to pool the scattered idle deposits in the public and channel it for productive use. It collects deposits and invests or lends to those who stand in need of money. Bank, in other words, is a custodian of money received from the depositors. Hence, its responsibility towards the general public is pretty different than those who are involved in other types of trades and service. Modern day banks exhibit the trait more of a department store with a wide range of financial products to offer.

Banks can be person, a company or a firm, with a place of business, and must be involved in credit creation. The business of modern day bank is not confined in borrowing deposits and lending advances only. It performs a host of other financial activities which has immensely contributed to achieve industrial and commercial progress of every country.

As per **R.S sayers, "A bank is an institution whose whole debts are widely accepted in settlement of other people's debts"**

As per **kent, "A bank is an organization whose principal operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to others for expenditure."**

As per **Crowther, "The banker's business is to take the debts of other people to offer his own in exchange and thereby create money."**

The banking sector is an important part of the national economy. Banks take deposits, support the payment system and provide the largest source of funds on the market. Safe and sound banking system is of crucial importance for the financial stability and sustainable development. Nepal has a special characteristic of bank dominated financial sector. As the domestic capital and stock markets are in the initial stage of development, the banking sector largely dominates the entire financial sector.

Financial institutions play very important role in the process of economic growth of the developing country. Among the financial institutions, commercial banks are important enterprises that serve as primary means of intermediations for financial resource mobilization. A developing country must maintain high and sustained rate of economic development. It must invest the available resource for requisite high level of investment.

Mobilization of the resource in developing countries should focus on two main parts. First of all, developing countries should exert massive effort to increase the rate of domestic savings especially in the face of difficult access and harder term of commercial borrowing as well as the bleak prospects for confessional assistance. The institutionalization of household savings is crucial to the rapid growth of saving. Secondly, developing countries should improve

the allocate efficiency of the investment to maximize the return on capital and yield highest possible economic benefit.

1.3 History of Banking

The Lombard's, who were originally from the plains of Lombardy of Northern Italy, introduced banking practice to England. These Lombard bought this business to the city of London and their home, the Lombard Street, is still the center of British Banking. The Lombard's, after a century or so of business in London, were eventually bankrupted because they lent money to kings who did not repay them.

After the Lombard's, the goldsmiths practiced banking as sideline to their normal activities in the bullion and jeweler fields. The early goldsmiths used to have large vaults, which were soundly built and heavily guarded. The person who deposited his surplus funds with the goldsmith became as a 'Depositor' and naturally paid for the privilege of having his money defended this way. These payments were called 'Bank Charges'. The depositors who needed funds to pay wages or debts, could call at the bank and collect such sums as required.

In the east, it is believed that banking was practiced at the time of **'Manu'** as it is referred in Manusmirti. There is an opinion that it was practiced during Chanakya's too, as banking has been mentioned in **"Kautilya's Arthasastra"** which is the first book on economics. In the west history of banking begins in ancient Greece, Rome and Mesopotamia. The history of modern banks begins from bank of Venice established in 1157 A.D, Bank of Barcelona established in 1401 A.D, Bank of Genoa established in 1407 A.D, Bank of Amsterdam established in 1609 A.D and Bank of England, which

was established in 1694 A.D. The ancestors of modern day banks have been attributed to the merchants, the goldsmiths and the money-lenders.

1.4 History of Banking in Nepal

It is assumed that the regular history of coinage in Nepal began form the 5th century A.D. The advent of 12th century marked a new period in economic history of Nepal. Silver Coinage was introduced in this period, which widened the scope for trade. The second major logical order of development was found in the innovation of interest bearing private debt such as bonds, mortgages and loans.

In the year 879/80 A.D a low cast merchant named **'Sankhadar Shankhwa'** introduced a new era after paying all the debts that existed in the country. The term **'Tanka Dhari'** meaning '**Money Dealer'** was used at the end of the 14th century. **'Tanka Dhari'** was one of the 64 castes classified on the basis of a profession by section of people in Nepal at that time. For many years, the indigenous individuals, wealthy agricultures, landlords, merchants and traders conducted some banking activities as a side business to their normal business activities.

In 1877 A. D Prime Minister Ranoddip Singh introduced many financial reforms. The **'Tejarath Adda'** was established at that time. The basic purpose of establishing this '**Tejaratha Adda'** was to provide credit facilities to the general public at a very concessional interest rate. The '**Tejaratha Adda'** disbursed credit to the people on the basis of collateral of gold and silver. All employees of government were also eligible for this type of loan, which was settled by deducting from their salary. Under Prime Ministership of Chandra Shamsher, '**Tejaratha Adda'** extended its services outside of the Kathmandu Valley. Legal provision was made to prevent the practice of capitalization of

interest on loans extended by private dealers. Hence, the establishment of '**Tejaratha Adda'** is regarded as the foundation of modern banking in Nepal. However, '**Kaushi Tosh Khana'** established during the regime of **King Prithivi Narayan Shah** is also considered as the first step towards initiating banking development in Nepal.

'**Tejaratha Adda'** extended credit only; it did not accept deposits from the public. Hence, the Adda finally faced financial crisis making it impossible to meet the credit need of the general population of the country.

Prior to the establishment of Nepal Bank Limited, people relied on borrowings from the corrupt moneylenders, who charged very high interest rates and added other dues. These money lenders extended loans on the collateral of land, house and precious metals like gold and silver. With the cooperation of Imperial Bank of India, Nepal Bank Ltd. came into exercise under the Nepal Bank Act 1937. The preamble of the Nepal Bank Act 1937 states the objectives of setting up the Nepal Bank Ltd. as follows.

"In the 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 for the people and for the betterment of the country, this law is hereby promulgated for the establishment of the bank and its operation".

Nepal Bank Ltd. Played a dual role of a commercial bank and the central bank. Until the establishment of Nepal Rastra Bank on 26th April 1956, it carried all the functions of a central bank. Nepal bank was a semi-government bank so it was unwilling to go to many sectors where government felt the need of providing banking services. Hence, Rastriya Banijya Bank, a fully government owned bank was established on 23rd January 1966.

Until 1984, the Nepalese financial sectors were dominated by the above two commercial banks. Commercial banking Act 1974 was amended in 1984 to increase competition among commercial banks. Hence, provision was made to allow private sectors including foreign investments to open commercial banks. As a result, Nepal Arab Bank Ltd. (Nabil Bank) was established on July 12, 1984 with the partnership of Dubai Bank Ltd., Dubai. The numbers of commercial banks operating in the country are increasing everyday and many more are in the pipeline to commence their business.

1.5 Commercial Bank

Banks undertaking business with the objective of earning profits are commercial banks. Commercial banks pool scattered fund and channel it to productive use. Commercial banks can be of various forms such as Deposits banks, Savings banks, Industrial banks, mixed banks, Exim banks etc. Commercial banks render a variety of services. In the absence of commercial banks, it will be impossible to meet the financial needs of the country. Commercial Bank Act 1974 defines commercial banks: 'A commercial bank means bank which deals in exchanging currency, accepting deposits, giving loans and doing commercial transactions.

An institution which accepts deposits, makes business loans, and offers related services. Commercial banks also allow for a variety of deposit accounts, such as checking, savings, and time deposit. These institutions are run to make a profit and owned by a group of individuals, yet some may be members of the Federal Reserve System. While commercial banks offer services to individuals, they are primarily concerned with receiving deposits and lending to businesses. With establishment of a development bank, the total number of banks and financial institutions reached 173 as in mid-January 2009. In the first six months period of 2008-09, commercial banks opened a total of 62 new branches, thus making 617 commercial bank branches overall presently

operating in Nepal. A Commercial bank is a financial institution, which accepts the demand and time deposits from the business, institutions, and individuals and engages in both business and customer lending. It must uses fund raised form the public deposit providing loans to agriculture, commerce and industries with the prime objectives of profit maximization . It also provides technical and administrative assistant to the industries, trade and business.

Commercial banks play the important role in directing the affairs of the economy in various ways. The operations of commercial banks record the economy pulse of the economy. The size and composition of their transactions mirror of commercial during the 1930's reflected the phenomenon of reserve global depression in the world. Commercial banks have played a vital role in giving a direction for the trade and industry in the nations.

Upadhaya and Tiwari(1998) stresses that the commercial bank is established with a view to provide short term debt necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surplus in the form of deposit, lending debts by discounting bills of exchange, accepting valuable goods in security , acting as an agent of the client etc.In the same way , Abrol and Gupta(2002) explain that principally a commercial bank accepts deposits and provides loans primarily to business firm. On the other hand, the broad concept of commercial bank holds that the commercial bank is the only institution other than central bank. The commercial bank is the only institution other than central bank permitted to accept demand and time deposits (Crosse, 1963)

Commercial banks induce the savers in the community to hold their savings in the form of socially useful assets of which bank deposits constitute the most important element. Commercial banks draw the community savings into the organized sector, which can be allocated among the different economic

activities according to the priority laid down by planning authorities in the country.

1.6 Functions of a Bank

A Bank is a financial institution, which provides financial services from producing and selling the professional and prudent management of the public's fund as well as performing many other roles in the economy. Their successes and failures hinge on their ability to identify the financial services. The competition between commercial banks produces the financial services efficiently.

Kohn (2004) states that the basic business of banking is a combination of two functions – payments and financial intermediation and has however, changed and continues to change along three dimensions: entry of new institutions into banking, as well as new of lending and borrowing are developing the intermediation function is evolving; and other related functions the basic ones are being added. We can present an overview of a full service bank as follows:

a) Accepting Deposits: This is the oldest function of a bank in which the banker charged commission for keeping the money in its custody. Now a day a bank accepts three kinds of deposits from its customers. The first is the saving deposits on which the bank pays interest relatively at low rate to the depositors. Depositors are allowed to withdraw their money by cheque up to a limited amount during a week or a year. Businessmen keep their deposits in current known as demand deposits. They can withdraw any amount available in their current account by cheque withdraw notice. The bank does not pay interest on such accounts. A bank accepts fixed or time deposits from savers who do not need money for a stipulated period from one month to loner periods ranging up to ten years or more.

b) Loans and Advances: One of the primary functions of a commercial bank is to advance loans to its customers. A bank lends a certain percentage of the cash lying in deposits at a higher interest rate then it pays on such deposits. This how it earns profits. The bank advances loans in the following ways:

c) Cash credit: The bank advances collateral based loans to businessmen. The amount of the loans is credited to the current account of the borrower.

d) Term Loans: These are long term loans and repayable monthly or quarterly in equal installment.

e) Call Loans: These are very short-term loans advanced to the bill brokers for not more than fifteen days. They are advanced against first class bills or securities. Such loans can be recalled at a very short notice.

f) Overdraft: A bank allows the borrower to overdraw his current account up to a sum equal to the loan sanctioned.

g) Discounting bills of exchange: Banks purchase bills of exchange after discounting i.e charging rate of interest for the time to maturity, if the holder wants its proceeds before maturity. Banks is reimbursed by the accepting bank on maturity.

Credit Creation: Credit creation is one of the most important functions of the commercial banks. When a bank advances a loan, it opens an account in the name of the customer and does not pay him in cash but allows him to draw the money by cheque according to his needs. By granting a loan, the bank creates deposit.

h) Foreign Trade Operation: A commercial bank finances foreign trade of its customers by accepting foreign bills of exchange and collecting them from foreign banks. It also transacts other foreign exchange business buying and selling of foreign currency.

I)Agency Services: A banks acts as an agent of its customers while collecting and paying cheque, bills of exchange, drafts, dividends etc. It also buys and sells shares, securities, debentures etc. for its customers. Further, it pays subscriptions, insurance premium, utilities bills and other similar charges on behalf of its clients. It also acts as a trustee and executor of the property and will of its customers. Moreover, the bank acts as consultants to its clients. For these services, the bank charges a normal fee while it renders others free of charge.

j) Miscellaneous Services: Banks also act as custodian of valuables of the customers by providing locker facility where they can keep their jewelry and valuable documents. It issues various forms of credit instruments, such as cheque, drafts, and travelers' cheque etc., which facilitate transactions. It renders underwriting services to companies and helps in the collection of funds from the public. Lastly, it provides statistics on money market and business trends of the economy.

1.6 Kumari Bank Ltd.

Kumari Bank Ltd (KBL) was established in December 10, 1999 as the fifteenth commercial bank in Nepal and started its operation from March 3, 2001. The head office of KBL is located at Putalisadak in Kathmandu. The bank has paid up capital of Rs 750 million,which comprises 70 % promoter's shares and 30 % public shares including staff share. The bank has planned to increase the capital as per statutory requirement of Rs. 2 billion by 2012/13.The bank has 7 branches including its head office in different urban areas of the country. The main mission of the bank is to provide world-class service to the customer at a higher satisfaction level, practice total quality management, and embrace good governance and optimization of the assets to achieve sound business growth. Kumari bank Limited (KBL) is the growing bank of Nepal. The bank has the paid-up capital of Rs. 625 million, with total deposit of 7,768.96 million and Rs. 7,007.79 million worth of loans, advances and bills in

fiscal year 2005/06. The bank has the non-performing loan of 0.92 % of total loan in fiscal year 2005/06. The bank has adopted computerized system in banking. The bank has the Any Branch Banking System (ABBS). The bank also provides different services such as ATM and electronic banking etc. The bank has been providing loans and advances in various sectors such as agriculture, manufacturing, deprived sector, industry and consumer financing etc. Based on the personal interview with key personnel, it is found that risk is considered as the major threatening factor in KBL and mainly the credit risk, which is given high priority by the top management. For its proper management, the bank has developed well defined polices and procedure with structured organizational layers for management of credit risks.

1.7 Kumari Bank's Vision

- We are customer oriented. Client is always our first priority.
- Employees have direct input and control over work processes.
- Employees are treated equitably, with respect and good faith.
- We are transparent in our dealings and conduct.

For this, we identify the core purpose and value of our business. Our traits hold true, when it comes to customer orientation, concern for people, value creation, superior service, innovation and fostering accountability, besides team spirit, transparency in all our dealings and integrity is paramount to our business philosophy. We very well understand our customers' need for a better and efficient services, a better working environment for our employees and sound strategies that enables us to achieve organizational goal

1.8 Statement of Problem

The main target of a commercial bank is to maximize the profit. There are so many financial institutions in Nepal. They are competing each other. Nepal Rastra Bank has mandated the commercial banks to open one branch in rural area while opening branches in urban areas. However this policy is not

found implemented effectively. The commercial banks which are concentrated in major cities of the country are able to focus their activities around big industries, but small entrepreneurs have not been able to enjoy benefits from these commercial banks.

The Challenges of the country is to direct these commercial banks to provide services to small and middle class entrepreneurs. Although, the rural branches of commercial banks are not able in resource mobilization and loan disbursement because most of the people are in poverty line in rural areas. They have no more income sources and savings. So they can not deposit in the bank. On the other hand, when nobody can deposit money in the bank, the bank can not able to mobilize money/resources. Also there are no industries in the rural areas. In this way the rural branches of the commercial banks can not earn profit easily.

Therefore, the competition is the burning issue of time in the country due to emergence of financial institutions. It has threatened all the banking institutions. It has warned to Kumari Bank Ltd. and to improve and manages its activities and services.

The research study seeks to find out financial soundness and weakness of Kumari Bank Ltd. with analysis of this bank's financial statements. The attempts will be made to sort out the answers for the following questions.

a) How far have KBL been able to transfer monitory resources from savers to users?
b) How far have this bank been managing their positions in relation to liquidity and capital structure?
c) Which bank has the largest degree of financial risk measured in terms of financial leverage?
d) What is the operational result in relation to its profitability?

1.9 Objectives of the study

The proposed study will highlight the important activities and progress of Kumari Bank Ltd. with justification. But the researcher wants to be more specific in his study to reflect what objectives have guided to undertake the study. The commercial banks can run easily and efficiently if they are able to mobilize the deposits in right sector and realize these amounts in time. Otherwise it would be difficult to run their banking business in the competitive market. Therefore, the main objectives of this study are focusing how far Kumari Bank Nepal Ltd. is able to fulfill their objectives. The study will try to collect various opinions from various sectors such as how to run the bank effectively? What should the management do to run the bank in the present competitive market? The study will also try to look the resource mobilization trends of these banks for five years and collect the opinions of financial experts and present suggestions by analyzing the financial statement.

The specific objectives of the study are as follows.

a) To analyze Capital Adequacy & Liquidity Position of KBL and compare with regulatory minimum capital requirement.
b) To analyze management soundness and quality of assets and evaluate Risk Weighted Assets of KBL
c) To evaluate the level, trend and stability of KBL's earning.

1.10 Significant of the study

Apart from aiming to gain knowledge, research itself adds new to the existing literature. The significance of this study lays mainly in identifying problem or deteriorating FI, as well as for categorizing institution with deficiencies in particular component areas. Further, it assists in following safety and soundness trends and in assessing the aggregate strength and soundness of the financial industry. The research is prepared in order to

supplement present examination procedures applicable to FIs of Nepal. Also the study assists the stakeholders in fulfilling their collective mission of maintaining stability and public confidence. It would helpful for the senior management involved in day to day operations. Bankers, individuals and examiners can use this report to further their understanding in the context of Nepal; the scholars will find it a literature for their future research works.

1.11 Limitations of Study

The limitation is another important aspect of the study. It is realized that the financial institutions including commercial banks are responsible for internal resource mobilization in the country. Although, there are so many commercial banks and financial institutions in Nepal, the study will be concentrated only on one bank Kumari Bank Nepal Ltd.

Other limitations are as follows:

a) This study is carried out to fulfill the partial requirement course of Master's Degree in Business Studies of Tribhuwan University.
b) This study is conducted and completed with in a short period. As a result all the concerned areas might not be covered.
c) This study is mainly based on the secondary data. Therefore, the accuracy of results and conclusions on the reliability of published secondary data.
d) The published data of various agencies are not sometimes tallying. So the best estimates and more weightage are given to published data of Nepal Rastra Bank and KBL. The study will use financial data and statistics up to the fiscal year/accounting year (2002/03 to 2006/2007).

1.12 Organization of the Study.

This study is organized into five chapters, Introduction, Review of Literature, Research Methodology, Data Processing and Analysis and Summary, Conclusion and Recommendation. Introduction chapters includes Overview of Nepalese Banking and Financial System, Background of the study, History of Banking , History of banking in Nepal, Commercial bank, Functions of bank , Kumari Bank Ltd. , Statement of problem , Objectives o f the study, Significance of the study, Limitation of the study and Organization of the study. Similarly, the second chapter deals with conceptual review and review of related studies. Research methodology describes the methodology adopted in this study. In the same way, Presentation and Analysis of data is included in Chapter IV. Finally, the Summary, Conclusions and Recommendation of the work are given in Chapter V. At the end of the study, Photography, Bibliography and Appendices are in-corporate.

Chapter- II

Review of Literature

2.1 Conceptual Review

In this study, many search works have been conducted by the various researchers regarding the various opinions of banking sectors. Such that persons/researcher regarding commercial banks and their activities, magazines ,journals, booklets and other related important and publications which had been published by various sectors.

Now, in this chapter, what others have related is important to know for better guideline and the fed back to serve purpose of the study. So, the researcher has referred the relevant to the field of this study which is traced below.

2.2 Concept of "CAMEL" Bank Rating System

CAMEL was originally developed by the FDIC for the purpose of determining when to schedule an on-site examination of a bank(Thomson,1991; Whalen and Thomson, 1988).The FFIEC is revised in January 1997, the UFIRS, which is commonly referred to as the CAMEL rating system. This system was designed by regulatory authorities to qualify the performance and the financial condition of the banks which it regulates.

The present supervisory system in banking sector is a substantial improvement over the earlier system in terms of frequency, coverage and focus as also the tools employed. Nearly one-half of the Basel Core Principles for effective Banking Supervision has already been adhered to and the remaining is at a stage of implementation. Two Supervisory Rating Models, based on CAMELS and CACS factors for rating have been worked out on the lines recommended by the Padmanabhan Working Group (1995). These rating

would enable the central bank to identify the banks whose condition warrants special supervisory attention. The **CAMEL rating system** is a method of evaluating the health of credit unions by the National Credit Union Administration. .Federal Reserve Bank of New York (1997) has defined the component of CAMEL as rating system which produces a composite rating of an institution's overall condition and performance by assessing five components .The rating is based upon five critical elements of a credit union's operations: capital adequacy, asset quality, management, earnings and asset/liability management. This rating system is designed to take into account and reflect all significant financial and operational factors examiners assess in their evaluation of a credit union's performance. Credit unions are rated using a combination of financial ratios and examiner judgment. In banking, **CAMELS** is a bank-rating system where bank supervisory authorities rate institutions according to six factors aegis management tool to manage interest rate risk and liquidity risk faced by Banks, other financial services companies and corporations.

The six factors are represented by the acronym "CAMELS."

The six factors examined are as follows:

C - Capital adequacy

A - Asset quality

M - Management quality

E - Earnings

L - Liquidity

S - Sensitivity to Market Risk

Benchmarks for each component of CAMEL are provided, but they are guidelines only, and present essential foundations upon which the composite rating is based. They do not eliminate consideration of other pertinent factors by the examiner. The uniform rating system provides the

groundwork for necessary supervisory response and helps institutions supervised by supervisors to be reasonably compared and evaluated. Ratings are assigned for each component in addition to the overall rating of a bank's financial condition .Bank supervisory authorities assign each bank a score on a scale of one (best) to five (worst) for each factor. If a bank has an average score less than two it is considered to be a high-quality institution, while banks with scores greater than three are considered to be less-than-satisfactory establishments. The system helps the supervisory authority identify banks that are in need of attention. The CAMEL ratings are commonly viewed as summary measures of the private supervisory information gathered by examiners regarding banks' overall financial conditions, although they also reflect available public information.

The most important criteria for determining the appropriateness of FIs to act as a financial intermediary are its solvency, profitability, and liquidity. In this respect, the BCBS of the Bank of International Settlements (BIS), since 1988, has recommended using capital adequacy, assets quality, management quality, earnings and liquidity (CAMEL) as criteria for assessing FI.

The cornerstone of supervisory review is thorough, regularly scheduled, on-site examinations. During an on-site bank exam, supervisors gather private information, such as details on problem loans, with which to evaluate a bank's financial condition and to monitor its compliance with laws and regulatory policies. A key product of such an exam is a supervisory rating of the bank's overall condition, commonly referred to as a CAMEL rating. CAMEL rating system is used by the three federal banking supervisors [the Federal Reserve, the FDIC, and the Office of the Controller of the Currency (OCC)] and other financial supervisory agencies to provide a convenient summary of bank conditions at the time of an exam. In Nepal, the NRB plays the supervisory role

for evaluating bank's financial condition in accordance with CAMEL in its initial phase.

2.3 CAMEL components

Each of the component rating descriptions in the FFIEC press release (1996) is divided into three sections: an introductory paragraph; a list of he principal evaluation factors that relate to that component; and a brief description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship between components. The listing of evaluation factors for each component rating is in no particular order of importance. The description of the CAMEL components are made as under based on the FFIEC press release (1996)

2.4 Capital Adequacy

Regulators try to ensure that banks and other financial institutions have sufficient capital to keep them out of difficulty. This not only protects depositors, but also the wider economy, because the failure of a big bank has extensive knock-on effects. The risk of knock-on effects that have repercussions at the level of the entire financial sector is called systemic risk. Capital adequacy requirements have existed for a long time, but the two most important are those specified by the Basel committee of the Bank for International Settlements.

Basel 1 defined capital adequacy as a single number that was the ratio of a banks capital to its assets. There are two types of capital, tier one and tier two. The first is primarily share capital, the second other types such as preference shares and subordinated debt. The key requirement was that tier one capital was at least 8% of assets. Each class of asset has a weight of between zero and 1 (or 100%). Very safe assets such as government debt have a zero

weighting, high risk assets (such as unsecured loans) have a rating of one. Other assets have weightings somewhere in between. The weighted value of an asset is its value multiplied by the weight for that type of asset.

The Basel 1 accord is to be replaced, in stages, by new rules (Basel 2). Basel 2 is based on three "pillars": minimum capital requirements, supervisory review process and market forces.

The first "pillar" is similar to the Basel 1 requirement; the second is the use of sophisticated risk models to ascertain whether additional capital (i.e. more than required by pillar 1) is necessary.

The third pillar requires more disclosure of risks, capital and risk management policies. This encourages the markets to react to the taking of high risks.

In addition to specifying levels of capital adequacy, most countries (including the UK) have regulator run guarantee funds that will pay depositors at least part of what they are owed. It is also usual for regulators to intervene to prevent outright bank defaults.

Capital is necessary for the bank to operate. While many areas of a bank are important and subject to security, capital adequacy is the area that triggers the most regulatory action. This action is largely based on the three major ratios used in the assessment of capital adequacy, which are

a) The core Capital Ratio.

b) The Supplementary Capital Ratio.

c) The Total Capital Ratio.

The efficient functioning of markets requires participants to have confidence in each other's stability and ability to transact business. Capitals rules help foster this confidence because they require each member of the financial community to have, among other things, adequate capital. This

capital must be sufficient to protect a financial organization's depositors and counterparties from the risks of the institution's on- and off-balance sheet risks. Top of the list are credit and market risks; not surprisingly, banks are required to set aside capital to cover these two main risks. Capital standards should be designed to allow a firm to absorb its losses, and in the worst case, to allow a firm to wind down its business without loss to customers, counterparties and without disrupting the orderly functioning of financial markets.

Minimum capital standards are thus a vital tool to reducing systemic risk. They also play a central role in how regulators supervise financial institutions. But capital requirements have so far tended to be simple mechanical rules rather than applications of sophisticated risk-adjusted models, although moves are afoot to change this by 2002.Further, there is a difference in the capital requirements of banks.

The capital adequacy of an institution is rated on the basis of bank size, volume of quality of assets, growth plans & prospects of the bank, retained earning and access to capital market.

Non-ledger assets and sound values not shown on books (real property at normal values, charge offs with firm recovery values, tax adjustments).

The FDIC improvement Act of 1991, which created a link between enforcement actions and the level of capital, held by a bank. This supervisory link is commonly known as Prompt Corrective Action (PCA) and aims to resolve banking problems early and at the least cost to the bank insurance fund.

2.5 Basel Accord

Capital Basel Accord is a capital adequacy framework developed by the Basel Committee. In 1998, the Basel Committee decided to introduce a capital measurement system commonly referred to as the Basel

Capital Accord. This system provided for the implementation of a credit risk measurement framework with a minimum capital standard of 8% by the end - 1992, which is also known as "Basel-I". Since 1988, this framework has been progressively introduced not only in member countries but also in virtually all other countries.

Basel-II is also a capital adequacy related standard framed by Basel committee. After the successful implementation of 1988 accord in more than 100 countries, the Basel committee on Banking Supervision reached an agreement on a number of important issues for promoting best and uniform banking practices as well as setting standards and guidelines for supervisory function. The following extensive interaction with banks, industry groups and supervisory authorities that are not members of the committee, the revised framework was issued on 26 June 2004. The latest revision on the framework was issued on November 2005.

The Basel-II aims to replace Basel-I and to make the capital framework more risk sensitive. Basel-II has recommended major revision on the international standard on bank's capital adequacy, which requires banks to implement risk management policies that align capital adequacy assessment with underlying credit risk, market risk, and operational risk. The Basel-II has been introduced basically for the protection of depositor's interest by preserving the integrity of capital in Banks.

The Basel Committee, established by the central bank governors of the group of ten countries (G-10) at the end of 1974, meets regularly four times a year. It has about twenty-five technical working groups and task forces, which also meet regularly.

The committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States. Countries are represented by

their central bank and also by the authority with formal responsibility for the supervision of banking business where this is not the central bank.

The Basel Committee provides a forum for regular cooperation on banking supervisory matters. Over recent years, it has developed increasingly into a standard-setting body on all aspects of banking supervision, including the Basel-II regulatory capital framework. The committee encourages contacts and cooperation between its members and other banking supervisory authorities. It circulates to supervisors throughout the world both published and unpublished papers providing guidance on banking supervisory matters.

The committee does not possess any formal supranational supervisory authority, and its conclusions do not, and were never intended to, have legal force. Rather, it formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements-statutory or otherwise- which are best studied to their own national systems. In this way, the committee encourages convergence towards common approaches and common standards without attempting detailed harmonized of member countries' supervisory countries.

Basel-II has been designed to provide options for banks and banking systems worldwide, the Basel Committee acknowledges that moving towards its adoption in the near future may be the first priority for all central banks in all non-G10 countries in terms of what is needed to strengthen their supervision.

Basel-II aims to build on a solid foundation of prudent capital regulation, supervision, and market discipline, and to enhance further risk management and financial stability. As such, the committee encourages each national supervisor to consider carefully the benefits of the new framework in the context of its own domestic banking system and in developing a timetable

and approach to implementation. Given resource and other constraints, these plans may extend beyond the committee's implementation dates. That said, supervisors should consider implementing key elements of the supervisory review and market discipline components of the new framework even if the Basel-II minimum capital requirements are not fully implemented by the implementation date. National supervisors should also ensure that banks that do not implement Basel-II are subject to prudent capital regulation and sound accounting and provisioning policies.

Nepal Rastra Bank will have the flexibility of choosing one of the above approaches. Based on the local circumstances, we have selected most simple and appropriate approaches from the Basel framework that shall be practicable and workable in our industry. It is decided to purpose that commercial banks in Nepal will initially adopt following approaches.

a) Simplified Standardized Approach for Credit Risk.

b) Basic Indicator Approach for Operational Risk.

c) Net Open Position Approach for Market Risk.

We understand that the new framework developed by the Basel committee is a product of long exercise in the globe. It is mainly the outcome of sophistication in to developed economy and complex product introduced in to the global market. The approach to Basel-II in Nepal is to confirm to best international standards and in the process emphasis is on harmonization with local context. We plan to adopt more advance approaches gradually as the market attains maturity and emerge as more sophisticated. Those banks planning for the advance approaches are requested to collect loss data and also adhere to the sound practice for risk management. Banks will be encouraged to move along the advance approaches as they achieve increasing sophistication in their risk management systems and processes. However, banks must obtain

prior approval of the Nepal Rastra Bank if they intend to use any one of the advanced approaches namely Standardized Approach, IRB Approach, Advanced Measurement Approach.

The true Basel-II is almost impracticable for the numbers of years in our context. However the journey should be started and should keep in touch to the international developments and be prepared to capture the principle in full when the need is arises. It is encouraged by the different simplest options available in the framework. The simplest approaches are practicable and it is proposed to start from them. The destination to advance approaches is really a long one in our context.

2.6 Capital Adequacy Norms by NRB

NRB has from time to time stipulated minimum capital fund to be maintained by the banks on the basis of risk weighted assets. The total capital fund is the sum of core capital and supplementary capital. According to the NRB unified directives for banks and non-bank FIs issue number E. Pra. Ni. No 01/061/62 (Ashar 2062 BS), the capital funds of a bank comprise the following.

a. Core Capital (Tier 1)

The key element of capital on which the main emphasis should be placed is the Tier 1 (core) capital, which comprises of equity capital and disclosed reserves. This key element of capital is the basis on which most market judgments of capital adequacy are made; and it has a crucial bearing on profit margins and a bank's ability to compete. The BCBS has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way, which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings.

In order to rank as Tier 1, capital must be fully paid up, have no fixed servicing or dividend costs attached to it and be freely available to absorb losses ahead of general creditors. Capital also needs to have a very high degree of permanence if it is to be treated as Tier 1.

ELEMENTS OF TIER 1 CAPITAL:

a. Paid up Equity Capital.

b. Irredeemable non-cumulative preference shares which are fully paid- up and with the capacity to absorb unexpected losses. These instruments should not contain any clauses whatsoever, which permit redemption by the holder or issuer upon fulfillment of certain condition. Banks should obtain prior approval of NRB for this kind of instruments to qualify as a component of core capital.

c. Share Premium

d. Proposed Bonus Equity Share

e. Statutory General Reserve.

f. Retained Earnings available for distribution to shareholders.

g. Un-audited current year cumulative profit, after all provisions including staff bonus and taxes. Where such provisions are not made, this amount shall not qualify as Tier 1 capital.

h. Capital Redemption Reserves created in lieu of redeemable instruments.

i. Capital Adjustment reserves created in respect of increasing the capital base of the bank.

j. Dividend Equalization Reserves.

k. Any other type of reserves notified by NRB from time to time for inclusion in Tier

1 capital

b. Supplementary Capital

The Supplementary (Tier 2) Capital includes reserves which, though unpublished, have been passed through the profit and loss account and all other capital instruments eligible and acceptable for capital purposes. Elements of the Tier 2 capital will be reckoned as capital funds up to a maximum of 100 percent of Tier 1 capital arrived at, after making adjustments referred to in 2.4. In case, where the Tier 1 capital of a bank is negative, the Tier 2 capital for regulatory purposes shall be considered as zero and hence the capital fund, in such cases, shall be equal to the core capital.

ELEMENTS OF TIER 2 CAPITAL:

a. Cumulative and/or redeemable preference shares with maturity of five years and above.

b. Subordinated term debt fully paid up with a maturity of more than 5 years; unsecured and subordinated to the claim of other creditors, free of restrictive clauses and not redeemable before maturity. Since, subordinated term debt is not normally available to participate in the losses; the amount eligible for inclusion in the capital adequacy calculations is limited to 50% of core capital. Moreover, to reflect the diminishing value of these instruments as a continuing source of strength, a cumulative discount (amortization) factor of 20% per annum shall be applied for capital adequacy computations, during the last 5

Years to maturity. The banks should obtain written approval of NRB for including any subordinated debt instruments (like Debenture/Bonds) in supplementary (Tier-2) capital.

c. Hybrid capital instruments. Those instruments which combine certain

Characteristics of debt and certain characteristics of equity. Each such

instrument has a particular feature, which can be considered to affect its quality as capital. Where these instruments have close similarities to equity, in

particular when they are able to support losses on an ongoing basis without triggering liquidation, they may be included in Tier 2 capital with approval from Nepal Rastra Bank.

d. General loan loss provision limited to a maximum of 1.25% of total Risk Weighted Exposures. General loan loss provision refers to the provisions created in respect of Pass Loans only and it does not include provisions of rescheduled/restructured and classified loans. The additional loan loss provisions created in respect of Personal Guarantee loans and loans in excess of Single Obligor Limits are specific provisions and hence cannot be included under this category. Such provisions however can be deducted from the gross exposures while calculating risk weighted exposures for credit risk. However, provisions created in excess of the regulatory requirements or provisions which is not attributable to identifiable losses in any specific loans shall be allowed to be included in the General Loan Loss Provision and shall be eligible for Tier II capital subject to a maximum of 1.25% of total risk weighted exposures.

e. Exchange equalization reserves created by banks as a cushion for unexpected losses arising out of adverse movements in foreign currencies.

f. Investment adjustment reserves created as a cushion for adverse price

movement in bank's investments falling under "Available for Sale" category.

g. Revaluation reserves often serve as a cushion against unexpected losses but may not be fully available to absorb unexpected losses due to the subsequent deterioration in market values and tax consequences of revaluation. Therefore, revaluation reserves will be eligible up to 50% for treatment as Tier 2 capital and limited to a maximum of 2% of total Tier 2 capital subject to the condition that the reasonableness of the revalued amount is duly certified by the internal auditor of the bank.

h. Any other type of reserves notified by NRB from time to time for inclusion in Tier2 capital

Banking & financial Institution Ordinance (2061) also assimilates the same things, which were included and explained in NRB Act 2058, in regard of bank capital. NRB act is effective from 1st Shrawan 2058(July 16th 2001), According to the NRB directive minimum paid-up capital requirement for establishment of commercial bank is under.

All existing commercial banks are required to raise base to Rs. 1000 million by mid July, 2009 through minimum 10 Percent paid-up capital increment every year.

Generally, the capital measurement tool is basically represented by a ratio of primary capital to assets utilized three measures, including a more complex weighted measure, but found the simple measures of capital were relatively good explanatory power over short time horizons, while risk-weighted ratios provided relatively better explanatory power over longer horizons. Eccher etal (1996), Thomson (1991), Whalen (1991) and Sinkey (1978) employed an analogous ratio definition, but with a refinement to adjust for loan losses, which theoretically would account for some portion of related risk in the asset portfolio (Cantor, 2001)

2.7 Assets Quality

Assets quality is one of the most critical areas in determining the overall condition of bank. The primary factor effecting overall asset quality is the quality of the loan portfolio and the credit administration program. Loans are usually the largest of the asset items and can also carry the greatest amount of potential risk to the bank's capital account. Securities can often be a large portion of the assets and also have identifiable risks. Other items which impact a comprehensive review of asset quality are other real

estate, other assets, off-balance sheet items and to a lesser extent, cash and due from accounts, and premises and fixed assets.

Management often expends significant time, energy, and resource on their asset portfolio, particularly the loan portfolio. Problems within this portfolio can detract from their ability to successfully and probably manage other areas of the institution. Examiners need to be diligent and focused in their review of the various asset quality areas, as they have an important impact on all other facts of bank operations.

2.8 Evaluation of Asset Quality

The evaluation of asset quality should consider the adequacy of the Allowance for Loan and Lease Losses (ALLL) and weigh the exposure to counter-party, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including, but not limited to, operating, market, reputation, strategic or compliance risks should also be considered. Prior to assigning an asset quality rating, several factors should be considered. The factors should be reviewed within the context of any local and regional conditions that might impact bank performance. In addition, any systematic weaknesses, as opposed to isolated problems, should be given appropriate consideration. The following are main affecting factors of asset quality.

a) The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices.

b) The level, distribution, severity and trend of problem, classified, on accrual, restructured, delinquent and non-performing assets for both on-and off-balance sheet transactions.

c) The adequacy of the allowance for loan and lease losses and other asset valuation reserves.

d) The credit risk arising from or reduced by off-balance sheet transactions, such as un-funded commitments, credit derivatives, commercial and standby letters of credit , and lines of credit.

e) The diversification and quality of the loan and investment portfolios.

f) The extent of securities underwriting activities and exposure to counter-parties in trading activities.

g) The existence of asset concentrations,

h) The adequacy of loan and investment policies, procedures, and practices.

i) The ability of management to properly administer its assets, including the timely identification and collection of problem assets.

j) The adequacy of internal controls and management information systems.

k) The volume and nature of credit documentation exceptions.

As with the evaluation of other component ratings, the above factors, among others, should be evaluated not only according to the current level but also considering any ongoing trends. The same level might be looked on more or less favourably depending on any improving or deteriorating trends in one or more factors.

2.9 Non-performing assets (NPAs)

Non-performing assets, also called non-performing loans, loans are made by a bank or finance company, on which repayments or interest payments are not being made on time and overdue for more than 90 days. A loan is an asset for a bank as the interest payments and repayment of the principal create a stream of cash flows. It is from the interest payments than a bank makes its profits. Bank usually treats assets as non-performing if they are not serviced for some time. If payments are late for a short time a loan is classified as past due. Once a payment becomes really late (usually 90 days) the

loan classified as non-performing assets. A high level of non-performing assets compared to similar lenders may be a sign of problems. However this needs to be locked at in the context of the type of lending being done. Some banks lend to higher risk customers than others and therefore tend to have a higher proportion of non-performing debt, but will make up for this by charging borrows higher interest rate, increasing spreads, assets than a credit card specialist, but the latter will have higher spreads and may well make a bigger profit on the same assets, even if it eventually has to write off the non-performing assets.

The loans given by the banks are classified into performing and non-performing assets on the following basis.

Performing Assets: Also known, as standard assets are loans where the interest and /or principal are not overdue beyond 90 days at the end of the financial year. Such loans do not carry more than the normal business risk.

Non-performing Assets: Any loan repayment, which is overdue beyond 90 days, is considered as NPA. NPAs are further classified in to sub-standard, doubtful and loss assets.

Loans and advances of FIs need to be serviced by either the principal or the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. NRB unified directives E. Pra. Ni.No. 02/061/62(Ashar2062 BS) for banks and non-banks FIs, defines non-performing loans as loans classified as substandard, doubtful and loss or loans which are past due by principal for more than 3 months. Dhungana (2006) in his column states that the details and classification of standards of non-performing loans may vary from country to country depending upon their own banking system requirement norms. He further states that unlike Nepal, countries like Korea, Indonesia, Philippines, India have classified the loan into five categories on which normal and special categories are classified as performing loans whereas

sub standard, doubtful and estimated loss categories are considered as non-performing loans. The study conducted by World Bank highlights that all commercial banks of South Asian countries except Nepal and Sri Lanka classify loans as non-performing only after it has been in arrear for at least six months (Pernia, 2004). NRB unified directives for banks and non-banks FIs through directive number E. Pra. Ni. No.02/061/62 (Ashar 2062 BS) classifies NPL, according to international practice, into three categories depending on the temporal position of loan default. Substandard, doubtful and loss Assets are the categories on the basis of the time barred to repay either interest or the principal. The degree of NPA assets depend solely on the length of time the asset has been in the form of non-obliged by the loanee. The more time it has elapsed the worse condition of assets is being perceived and such assets are treated accordingly.

2.10 Factors causing NPAs

Dhungana (2006) in his column broadly categorized into internal and external factors for high level of NPA in Nepalese banking system. The following factors can also be the reason for causing NPA:

a) Monitoring of projects in time provide insurance against failure of enterprises through rectification of minor flaws that appear during the course of operation. Inability of sound monitoring system can also lead to failure of the project.

b) The resources of FIs collected through deposits from people may be mis-utilised. Recklessness or negligence on the part of the officials while approving the loan will turn into default.

c) Attitude of the officials that does not amount to sincere corporate culture also leads to breed drawbacks in the payment of dues to FIs.

d) NPAs may arise due to failure of business for which loan was used. Whatever may be the reasons for failure of business, it obstructs the carrying out timely payments of financial obligations.

e) On the other part of appraising institutions, the defect in appraising projects breed mismatch not only in investment planning but also in receivables due to defective projection of returns. Large portion of NPAs in developing countries arise due to defective and standard credit appraisal system.

f) The credit programs sponsored by the government are regarded as the source of NPAs. For political benefits government, without assessing the financial feasibility of the credit program, announces and compels the credits agencies to go along with the declared policies.

g) Moreover, dishonest politicians often want free ride of on the amounts of loan delivered by credit agencies under government designed programs. Such loans are hardly recoverable. The fact is evidenced from the experience in Nepal and India by the manifestation of higher percentage of NPAs found in priority sector loans.

Quite often the definition of the NPAs and accounting norms adopted by concerned agencies also amount to higher or lower magnitude of such assets. Each institution may have different norms to declare the assets whether it is not-performing. The income cycle of the project and amount of loan involved, set the instalments of loan repayment. The nature of project also determines the level of NPAs. Slow down in economy, global as well as domestic particularly in industrial sector, contributed to adversely affect the bottom line of units and their capacity to service the debt (Taori-1999). Recession debars the economic activities to run smoothly which affect the performance of FIs.

2.11 NRB Directives related to Assets quality.

The effect of global financial crisis is likely to transmit from the real sector to financial sector of Nepal. The NRB has been continuously monitoring the likely impact of global financial crisis on financial sector. As the financial crisis is likely to have its immediate impact on those banks and financial institutions having weak capital structure and inadequate liquidity situation, the NRB advises banks and financial institutions to continuously monitor their loan portfolio and maintain the asset quality. The banks and financial institutions need to be aware of improving their asset quality following the advancement of the financial sector reform program

NRB unified directive for Banks & Non-bank FIs (Ashar 2062 BS) through directive number E. Pra. Ni. No. 02/2061/62, requires the banks to classify outstanding loans and advances on the basis of aging of principal amount. As per the directive the loans and advances should be classified into the following four categories:

Pass: Loans and Advances whose principle amount are not overdue over for 3 months included in this category. These are classified and defined as performing loans.

Sub-standard Loans: Loans and advances, which are remained non-performing for more than three months and not exceeding six months are classified as sub-standard loans.

Doubtful loans: Loans and advances, which have remained non-performing for more than six months and not exceeding one year and also not classified as loss assets by the management or the internal/external auditor appointed by Bank.

Loss Loans: Loans and advances, which have remained non—performing for more than one year and thin possibility of recovery or considered unrecoverable shall included in this category. Besides these, loans and advances where loss has

been identified by the internal/external auditor of the bank or the central bank also considered loss loans.

The directive further requires banks to provision for loan loss, on the basis of the outstanding loans and advances and bills purchased classified as above. Loan loss provision set aside for performing loans is defined as general loan loss provision and that set aside for non-performing loan as specific loan loss provision. As per NRB directives provision for such loan category as mentioned above are as follows.

Loan Class	**Loan Loss Provision**
Pass	**1%**
Sub-standard	**25%**
Doubtful	**50%**
Loss	**100%**

With the objectives of lowering the concentration risk of bank loans to a few big borrowers and to increase the access of small and middle size borrowers to the bank loans, NRB through directive number E. Pra. Ni. No.03/061/62 limits commercial banks to extend credit to a single borrower or group of related borrowers up to 25% of its core capital for non fund based credit facilities like letters of credit, guarantees, acceptances, commitments.

The facilities extended against bank's own fixed time deposit, NG securities, NRB bonds, counter guarantees of World Bank/Agricultural Development Bank/ International A^+ rated banks(as per list of top 1000 Banker"), are excluded from the restriction. Likewise advances and facilities to be used for the purpose of importing specified merchandise by the following public corporation are also excluded:

2.12 Management Quality

Sound management is the most important pre-requisite for the strength and growth of any financial institution. If management is a weak link, the chain isn't strong, so the agencies weight the management component the heaviest. Since indicators of management quality are primarily specific to individual institution, these cannot be easily aggregated across the sector. In addition, it is difficult to draw any conclusion regarding management soundness on the basis of monetary indicators, as characteristics of a good management are rather qualitative in nature. The capabilities of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a FI's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Nevertheless, the total expenditure to total income, operating expenses, earnings and operating expenses per employee, and interest rate spread are generally used to gauge management soundness. In particular, a high and increasing expenditure to income ratio indicates the operating inefficiency that could be due to flaws in management.

Depending on the nature and scope of an institution's activities, management practices may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance, legal, liquidity, and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls taking into consideration the size and sophistication of the institution; maintenance of an appropriate audits program and internal control environment; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is

involved. The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors;

a) The level and quality of oversight and support of all institution activities by the board of directors and management.

b) The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products.

c) The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.

d) The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and risk profile.

e) The adequacy of audits and internal controls to promote effective operations and reliable financial and regulatory reporting, safeguard assets, and ensure compliance with laws, regulations, and internal policies.

f) Compliance with laws and regulations.

g) Responsive to recommendations from auditors and supervisory authorities.

h) Management depth and succession.

i) The extent that the board of directors and management is affected by susceptible to , dominant influence or concentration of authority.

j) Reasonableness of compensation policies and avoidance of self-dealing.

k) Demonstrated willingness to serve the legitimate banking needs of the community.

l) The overall performance of the institution and its risk profile.

2.13 Earning Quality.

Strong earnings and profitability profile of a bank reflect its ability to support present and future operations. More specially, this determines the capacity to absorb losses by building and adequate capital base, finance its expansion and pay adequate dividends to its shareholders. Although there are various measures of earning and profitability, the best and widely used indicator is returns on assets (ROA), which is supplemented by return on equity (ROE) and net interest margin (NIM)

Under the UFIRS, in evaluating the adequacy of a FI's earnings performance, consideration should be given to:

a) The level of earnings, including trends and stability,

b) The ability to provide for adequate capital through retained earnings,

c) The quality and sources of earnings.

d) The level of expenses in relation to operations,

e) The adequacy of the budgeting systems, forecasting processes, and management information systems in general,

f) The adequacy of provisions to maintain the ALL and other valuation allowance accounts,

g) The earnings exposure to market risk such as interest rate, foreign exchange, price risks.

From a bank regulator's standpoint, the essential purpose of bank earnings, both current and accumulated, is to absorb losses and augment capital. Earnings are the initial safeguard against the risks of engaging in the banking business, the represent the first line of defence against capital depletion resulting from shrinkage in assets value. Earnings performance should also

allow the bank to remain competitive by providing the resources required to implements management's strategic initiatives.

2.14 Evaluation for Earning Performance

Generally, analysis of earnings begins with the examiner reviewing each component of the earnings analysis trail. The earnings analysis trail provides a means of isolating each major component of the income statement for individual analysis. The earnings analysis trail consists of the following income statement components: net income, non-interest income, non-interest expense, provision for loan and lease losses, and income taxes. Each component of the earnings analysis trail is initially reviewed in isolation. Typically, ratios are examined to determine a broad level view of the component's performance. The level of progression along with the analysis trail will depend on a variety of factors including the level and trend of the ratio(s), changes since the previous examination, and institution's risk profile.

Earnings Ratio Analysis: Several key ratios used in the earnings analysis are used as shown below:

a) Net income to Average Assets Ratio [Return on Assets (ROA) ratio]

b) Net interest income to average earnings Assets Ratio

c) Non-interest income to average assets ratio

d) Non-interest expense to average assets ratio

e) Provision for loan and lease losses (PLLL) to average assets ratio

f) Realized gains/losses on securities to average assets ratio.

Earning quality is the ability of a bank to continue to realize strong earnings performance. It is quite possible for a bank to register impressive profitability ratios and high volumes of income by assuming an unacceptable degree of risk. An inordinately high ROA is often an indicator that

the bank is engaged in higher risk activities. For example, bank management may have taken on loans or other investments that provide the highest return possible, but are not of a quantity to assure either continued debt servicing or principal repayment. Seeking higher rates for earning assets with higher credit risk will boost short-term earnings. Eventually, however, earnings may suffer if losses in these higher-risk assets are recognized.

In addition, certain bank adversely classified the loan as non-performing assets, especially those loan which will not yield any interest payments in future and are not anticipated, may need to be reflected on a non-accrual basis status, earnings will be overstated. Similarly, material amounts of troubled debt restructured assets may have an adverse impact on earnings.

An institution's asset quality has a close relationship to the analysis of earnings quality. Poor asset quality may necessitate increasing the PLL to bring ALL to an appropriate level and must be reviewed for impact on earning quality.

2.15 Liquidity

Liquidity is the capacity of organization to meet short-term obligations/liabilities. In addition to liquidity problems banks faced other risks as well as. For example, a large investment in volatile assets would make banks more vulnerable to fluctuations in the prices of those assets. Similarly, a concentration of advances in few sectors would increase default risks if these sectors do not perform well. Furthermore, interest rate and foreign exchange risk tend to have significant impact on financial institutions' assets and liabilities.

According to **I.M Pandey, 'financial management is that managerial activity which is concerned with planning and controlling of the firms'** financial resources. He believes that among the most crucial decisions of

the firms, which relates to finance and an understanding of the theory of financial management provides the conceptual and analytical insights to make the decision skilfully.

In evaluating the adequacy of a FI's liquidity position, consideration should be given to the current level and progressive sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfil the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. Liquidity is rated based upon, but not limited to, an assessment of the following evaluation factors.

a) The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operation or condition.

b) The availability of assets readily convertible to cash without undue loss.

c) Access to money markets and other sources of funding.

d) The level of diversification of funding sources, both no-and off-balance sheet.

e) The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer-term assets.

f) The trend and stability of deposits.

g) The ability to securitize and sell certain pools of assets.

h) The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, management information system, and contingency funding plans.

2.16 NRB Directives related to liquidity

Nepal Rastra Bank had given the instruction to the commercials banks since 2023 B.S. to deposit the amount ration of 8 % from their deposit liability. In the beginning of 2047 B.S. the increase in the quantity of internal credit was very high and began to show negative effect on economy. The deflation grew up to 21%. So, high liquidity appeared in the economy, hence, control of the negative effect that may fall on economy to improve the growth of price rate and improvement of the position of loss or running account and control the capacity of the flowing the loan of the of the commercials banks, was necessary and the NRB second time prescribed liquidity ratio. It made compulsory to invest 24 % of the total deposit of the commercial bank in NG bond, treasury bills, or NRB bonds. With some signs of improvement of economy, the investment ratio was revised accordingly, since Poush 2049 B.S. Since the beginning of 2050 B.S., the economy showed improvement and the rate of deflation fell down to 8.8%. With this, the provision of investing in the government securities was removed. Cash reserve ratio has been kept unchanged at 5.5 percent, which is the fraction of the total domestic currency deposit liability required to be maintained by bank and financial institutions with the NRB.

Commercials banks were required to maintain liquidity of 8% of the total current & saving deposits and 6 % of the fixed deposits, in addition to 3% of total deposit in cash at vault with effective from 2054,

Chaitra 31st,. Since then the NRB reserve requirement has been changed. To ensure adequate liquidity, following arrangements have been put into force by NRB effective from 22 July 2002(2059/04/06).

CASH RESERVE RATIO REQUIREMENT

a)	Balance at NRB	7 % of current & Savings deposit liabilities. 4.5% of fixed deposit liabilities.
b)	Cash at vault	2% of total deposit liabilities.

Currently, Nepal Rastra Bank has revised cash reserve ratio to 5% of total deposit.

The compliance of liquidity maintenance, the NRB applies following procedures.

a) The CRR maintained by the banks will be examined on the basis of average weekly balance of deposit liability immediately preceding 4th week. A week shall comprise from each Sunday.

b) CRR will not be calculated for the week which is fully off.

c) Weekly statement of deposit balances to be submitted to NRB inspection and supervision department within 15 days from the date of end of the week.

d) Weekly average of Monday to Friday of total deposit, cash in vault and NRB balance is calculated by dividing by5.

e) Penalty will be levied for failing to maintain the adequate liquidity as above under any of the following conditions.

f) In the case of shortfall in maintenance of NRB balance but cash at vault is exactly by 2%.

g) In case of shortfall in NRB balance but cash at vault is more than 2% then up to 1% excess cash of total deposit is added in the balance with NRB then on such shortfall account(after adding up to 1% excess)

h) In case of shortfall in cash in vault as well as shortfall in NRB balance then on total shortfall amount.

The applicable rate of penalty is as follows:

First time shortfall = Equivalent to bank rate/highest refinance rate.

Second time shortfall= Equivalent to 2 times of bank rate.

Third time shortfall and all subsequent shortfalls= Equivalent to 3 times of bank rate.

2.2 Review of Related Studies and Papers.

2.2.1 Review of Relating Books and Articles

According to Weston & Brigham, risk returns trade off as one of the major financial function. They believe that the maximization of the value of the firm can be achieved through maximization of return 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 return from investment in firms.

An article of Mr. Gyawali(2055) on deposit mobilization refers to the collection of small and scattered savings of the people and directing them for investment in the productive purposes thereby contributing to the further increase of saving through improvement of the income level of the savers.

“A comparative Performance Study of Rastriya Banijya Bank" by Mr. Bajracharya (2047), concluded that deposits growth of commercial bank is not so consistent; there is low growth in local/non-joint venture banks than that in joint venture banks. It is better on credit deposit ratio in joint venture banks than the non-joint venture banks/local banks. Non-performing loan was greater in non-joint venture banks and profitability was greater in joint venture bank. Local banks were forced to open their branches at the rural areas but joint venture banks were not forced in this rule. Therefore, the competition among the local banks and joint venture banks is not healthy.

Another article of Mr. Bajracharya(2047) on "Monitory Policy & Deposit Mobilization in Nepal", from "Rajat Jayanti Smarika opines that mobilization of domestic saving is one of the prime objectives of the most active financial intermediary for generating resources in the forms of the private sector and providing credit to investors in different sectors of the economy.

Next article of Mr. Shrestha(2047) on "Commercial Banks Performance Evaluation" concluded that joint venture banks are new operationally more efficient having superior performance while comparing with non joint venture banks. Better performance of joint venture banks is due to their sophisticated technology, modern banking, and method, via computerization, prompt customers’ service and skills. Their better performance is also due to the burden the banks facing governments branching policy in rural areas and financing public enterprises. Local banks are efficient and in rural sectors, but having numbers of deficiencies. So, local banks have to face growing constraint of social, economical, political system on one spectrum and that of issues and challenges of joint venture banks commanding significant banking business on other spectrum.

In the same way, an article by Mr. Thakur(2052) on "Performance of Nepalese Commercial Banks," stated that the joint venture

banks are successful not in only penetrating the market but also consolidating their position over the year. It is due to its customer orientation and strong marketing strategy.

Mr. Shrestha (2045) made a study on “A study on Deposits and Credits of Commercial Banks in Nepal", which revealed that in 2004 AD the credit deposit ratio would be 51.3, other things remaining the same, which was the lowest under the period of review. So, he had strongly suggested that the commercial banks should try to provide more facility lunching new banking product otherwise product otherwise they could not be able to absorb even its total expenses.

2.2.2 Review of relevant unpublished thesis

Prior to this several thesis works have been conducted by various researchers regarding different aspects of commercial banks like financial performance, capital structure, investment policy, interest rate structure, and resources mobilization. The excerpts from the findings of some of these research works are presented which are relevant for this study.

Mr. Joshi (1989 A.D) studied the performance of commercial banks and concluded that the liquidity position of commercial banks was sound. But debt equity ratio of commercial or non-joint venture banks was higher than the joint venture banks. He also said that the commercial banks had low profit margin but satisfactory return on net worth. Similarly, Mr. Dhungana(1994 AD), conducted " A study of the Joint venture bank's Profitability" covering the period of five years from 1987/88 to 1991/92 with the main objectives of accessing the profitability of joint venture banks in Nepal. His study concluded the interest income of Nepal Grindlays Bank Ltd.(present Standard Chartered Bank Ltd.) was highest than the other joint venture banks, Nepal Indosuez Bank Ltd's(present Nepal Investment Bank Ltd.) commission and discount earning

and foreign exchange income were higher than both Nepal Grindlays Bank Ltd(NGBL) and Nepal Arab Ltd.(NABIL). NABIL's other operating income was appeared higher than the other banks. NGBL had highest earning per share and cash dividend per share in the average.

Mr. Kaini (1997) has done a comparative study of financial performance of Nepal Arab Bank Ltd. (at present NABIL Bank Ltd.) and Nepal Grindlays Bank Ltd. (present Standard Chartered Bank Ltd.) with the help of primary and secondary data. He concluded that liquidity ratio of both banks are below the normal standard though profitability ratios of both banks are able to maintain the standard.

Mrs. Shrestha (1990) conducted a research work on portfolio behaviour for commercial banks in Nepal, concluded the debt to equity ratio of commercial banks highly leveraged and highly risky. Further, researcher argued that the capital adequacy ratio explains the strength of the capital base of commercial banks. Higher the capital adequacy ratio, higher is its internal sources and vice versa.

Bhora (1992) has conducted a study on financial performance of Nepal Arab Bank Ltd (NABIL) and Nepal Indosuez Bank Ltd. (NIBL) with main objectives of evaluating the comparative financial performance of NABIL, and NIBL. Different ratios-liquidity, activity, coverage, leverage, profitability and other indicators like earning per share, dividend per share, market value to book value ratio, have been used to evaluate the performance of NABIL and NIBL and finally, concluded that performance of NABIL is better than that of NABIL.

Adhikari (1993) has done a study on evaluation of the financial performance of Nepal Bank Ltd with main objective of the study to evaluate the financial performance of Nepal Bank Ltd. The major indicators of financial performance used were financial ratios-current, loan to deposit, return on capital, return in net worth, return on total assets, earning per share, dividend

per share, pay out and net worth per share vs. market price per share. Finally, the researcher concluded that the bank had not managed investment portfolio efficiently. Operational efficiency was not satisfactory. During the study period, except liquidity position all other financial indicators were not satisfactory.

Joshi done(1993) done a study on commercial banks of Nepal with reference to financial analysis of Rastriya Banijya Bank.The objective of this study was to provide conceptual framework of commercial banks, and to analyze and interpret these financial variables of Rastriya Banijya Bank(RBB) on qualitative and quantitative performance basis. The study was based on the financial data of FYs2042 B.S through 2046 B.S. Researcher has used various financial ratio like-current. Liquidity, funded debt to total capitalization, and funded debt to equity in this study. The researcher had drawn the conclusion that performance of RBB was not satisfactory during the study period. Further, the researcher concluded that bank had not been managed in true professional approach but had managed in bureaucratic approach to sustain with political environment rather than commercial environment.

Shakya(1995) performs a study on financial analysis of joint venture banks in Nepal. The objective of this study was to carry out the comparative financial performance evaluation of Nepal Arab Bank Ltd.(at present NABIL) and Nepal Grindlays Bank Ltd.(at present SCBNL). The researcher has found that in spite of the increase in loans and deposits of both banks, their performance measured in terms of deposit utilization rate is not satisfactory. Further, the study concluded that financial performance of NABIL is better than that of NGBL.

Gurung(1995) conducted a research on " A Financial study of joint venture banks in Nepal". The objective of this study was to examine the financial strengths and weaknesses of Nepal Grindlays Bank Ltd. (at present SCBNL) and Nepal Indosuez Bank Ltd.(at present NIBL). The researcher has,

on the basis of different financial indicators; found that performance of SCBNL is better than that of NIBL.

Likewise, Deoja(2001) conducted study entitled "A comparative Study of the Financial Performance between Nepal State Bank of India Ltd. and Nepal Bangladesh Ltd." The researcher's main objective of study was to evaluate the trend of deposits and loan and advances of NSBIL and NBBL and to evaluate the liquidity, profitability, capital structure, turnover and capital adequacy position of NSBIL and NBBL. Through researcher found that the cash and bank balance to current assets, saving deposit etc. of NSBIL are higher while fixed deposit to total deposits, loan and advances to current assets of NBBL are higher. Similarly, NBBL has better turnover than NSBIL in terms of loan and advances to total deposits ratio and loan and advances to fixed deposit ratio. Through the study of the different ratios has concluded that both banks are highly leveraged.

Bhandari(2006) used descriptive analysis in his research work of evaluating financial performance of Himalayan Bank in the framework of CAMEL. The analysis revealed adequate capital of the bank. The non-performing loan though in decreasing trend is still a matter of concern. The bank is still with better ROE however it is in decreasing trend. The decreasing trend of net interest margin shows management slack monitoring over the bank's earning assets. The liquid funds to total deposit ratio is above than the industrial average ratio. NRB balance and cash in vault to total deposit ratio are below the industrial average ratio during the study period.

In the same way, Mr. Chand (2006AD) conducted “A Financial Performance Analysis of NABIL Bank Ltd. In the frameworks CAMELS" with main objectives of evaluating capital adequacy, Assets quality, management efficiency, Earning quality, Liquidity and sensitivity to market risks and concluded that NABIL bank Ltd has maintained the capital adequacy with NRB boundaries, Assets composition of NABIL is mainly focused on Loan and Advances, Earning efficiency of the bank is sound and in case of liquidity the bank has not followed the NRB norms effectively.

CHAPTER-III

3.1 Research Methodology

This chapter includes research design, justification for the selection of study unit, nature and sources of data, methods of data collection, data analysis tools and limitations of methodology. The above research procedures are dropped comprehensively to accomplish the objectives set in Chapter I

a) Research Design

The evaluation of the performance is design to reflect and assessment of the financial condition of Kumari Bank Ltd. based on the CAMEL perspectives prescribed by UFIRS/UBPRS in the line with the BASEL II accord. Hence, the research is conducted on the historical and analytical study basis. Therefore, descriptive-cum analytical research methodology has been followed, to achieve the desired objectives. In order to evaluate the financial performance of selected two banks, some financial and statistical tools and descriptive techniques are applied.

b) Nature and Sources of Data

Basically the research is based on secondary information data. The annual reports of the banks are the major sources of data. The regulatory data were collected from NRB directives and reports the basic conceptual information was collected through BASEL, FDIC and NRB publication and work papers. The information related to the past and current works conducted in the research field were collected from the following sources:

a) NRB reports and bulletins and its official websites.

b) BASEL committee publication through its official websites.

c) Various research papers and Dissertations

d) Various articles published in journal and financial magazines.

e) Nepal Stock Exchange reports

f) Official websites of Banks.

g) Formal and informal discussions with the senior staff of the banks were held which was helpful in understanding and obtaining additional information.

c) Data collection Procedure

The required information was collected by conducting visits to the branch office of Kumari Bank Ltd. at Birtamode consulting library at Kankai Campus, internet suffering and related text books. The annual reports of Kumari Bank Ltd. for the study period were obtained from its Birtamode branch through personal approach and internet surfing to the bank's official websites. NRB regulatory directives, statistics of the commercial banks of Nepal and other related publications were obtained through internet surfing to NRB's official websites and periodicals. Existing literature on the subject matters was collected from various research papers placed in Eastern regional library (T.U), Biratnagar. Likewise, the review of working paper conducted by various international scholars on the related matter was done through internet surfing to various websites.

d) Data Processing

The financial data from the published documents and audited financial statements were manually extracted into the computer files of Microsoft excel program which acted as master data base files. The data was refined further into spread sheet to carry out financial ratio calculation and

graphical illustrations through mathematical functions and chart program of excel program.

e) Data analysis tools

Financial ratios are the major tools used for the descriptive analysis of the study. In addition to the financial tools, simple statistical tools are also use.

Financial Ratio analysis tools

Financial ratio analysis tools are used to determine the performance of the banks in the framework CAMELS components. These ratios are categorized in accordance of the CAMEL components following categories of key ratios are used to analysis the relevant components in terms CAMEL:

Risk based capital adequacy ratio: Risk based capital ratio can be defined as the numerical expression of total capital fund to total risk adjusted assets. It measures the adequacy of capital. Risk based capital ratio is used to measure the adequacy of capital in the banks which is determined in the following way:

$$\text{Risk based capital ratio} = \frac{\text{total capital fund}}{\text{total risk adjusted assets}} \times 100$$

Where,

Total capital fund = (core capital + supplementary capital.)

Total risk adjusted assets= (on-balance sheet risk adjusted assets+ off-balance sheet risk adjusted assets)

Risk based core capital adequacy ratio: Core capital adequacy ratio is the expression of numerical relationship between the total core capital and total risk adjusted assets. It measures the adequacy of core capital. The ration is expressed as:

$$\text{CCAR} = \frac{\text{core capital}}{\text{total risk adjusted assets}} \times 100$$

Where,

CCAR = Core Capital Adequacy Ratio

Core Capital = (Paid-up capital+ Share premium+ Non-redeemable Preference share+ General Reserve+ Cumulative Profit)

Risk Based Supplementary Capital Ratio: Supplementary capital ratio is the expression of numerical relationship between supplementary capital and total risk adjusted assets of a bank. It measures the proportion of supplementary capital in total risk adjusted assets. The ratio is used to analyse the supplementary capital adequacy of the banks and determined in the given way:

$$\textbf{SCR} = \frac{\text{Supplementary Captial}}{\text{Total Risk adjusted Assets}} \times 100$$

Where, **SCR** = Supplementary capital ratio

Supplementary Capital = (Loan loss provision + Exchange Equalization reserve + assets revaluation reserve+ hybrid capital instrument+ unsecured sub-ordinate term debt+ interest rate fluctuation fund+ other free reserves.)

3.2 Assets Quality

The following ratios are used to assets the quality of assets of the bank:

Past Due Loans to Total Loans: It is the ratio which expresses the relationship between past due loans and total loans and advances of the bank. Lesser the portion of past due loans in total loans can be regarded as the better assets quality. This relationship can be measured by using the following relation:

$$\text{Past Due Loans/Total loans} = \frac{\text{Past due loans}}{\text{Total Loans}} \times 100$$

Loans classified as Substandard, Doubtful or Loss to Total Loans: The ratio of standard, doubtful and loss loans to total loans indicates the relationship between the substandard loans to total loans, doubtful loans to total loans and loan loss to total loans. The lesser the percentage the better would be the quality of assets. It is worked out using following relation:

Loans Classified as Substandard, Doubtful or Loss/total loans

$$= \frac{\text{Total Sub-standard,Doubtful or loss loan}}{\text{Total Loans}} \times 100$$

Provisioning for Substandard Loans to Total Substandard Loans: Provisioning for substandard loans to total substandard loans ratio is the expression of numerical relationship between loan loss provisions for substandard loans to total substandard loans. It measures the proportion of substandard loans to total substandard loans. The percentage of provision for substandard loans to total substandard loans is 25% according to NRB directives. This ratio can be calculated by using following formula.

Provisioning for substandard loan to Total Substandard Loans

$$= \frac{\text{Provision for Sub-standard loan}}{\text{Total Sub-standard loans}} \times 100$$

Provisioning For Doubtful Loans to Total Doubtful Loans: Provision for doubtful loans to total doubtful loans is the expression of numerical relationship between loan loss provision for doubtful loans to total doubtful loans. The proportion of provision for doubtful loans to total doubtful loans, according to NRB, should be at least 50%. This ratio can be calculated using following relation:

Provision for Doubtful Loans to Total Doubtful Loans

$$= \frac{\text{Provision for Doubtful loans}}{\text{Total Doubtful Loans}} \times 100$$

Provisioning for Loss Loans to Total Loss Loans: Provisioning for loss loans to total loss loan is the expression of numerical relationship between loan loss provision for loss loans to total loss loans. The proportion of the provision for loss loans to total loss loans, according to NRB, should be at least 100%. This ratio can be calculated by using following model:

$$\text{Provisioning for loss loans to Total Loss Loans} = \frac{\text{Provision for loss loans}}{\text{Total Loss Loans}} \times 100$$

3.3 Management Soundness

The following ratios can be used to determine the efficiency of bank's management:

Total Expenses to Total Incomes Ratio: The total expenses to total incomes ratio is the expression of numerical relationship between total expenses and total incomes of the bank. It measures the proportion of total expenses to total incomes. A high or increasing ratio of expenses to total revenues can indicate that FIs may not be operating efficiency. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability (IMF, 2000). It can be calculated using the following model:

$$\text{The Expenses to Total Incomes Ratio} = \frac{\text{Total Expenses}}{\text{Total Incomes}} \times 100$$

Earning Per Employee: Earning per employee is the numerical relationship between net profit after taxes to total numbers of employees. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing in terms of profitability (IMF, 2000). It is calculated using the following model:

$$\text{Earning Per Employee} = \frac{\text{Net Profit After taxes}}{\text{Total Number of Employes}}$$

3.4 Earnings

The following Ratios can be used to assets the quality of the bank's earnings.

Net Income (after tax) to Total Assets: Return on assets: Return on assets is the numerical relationship between net incomes after taxes to total assets of a bank. It is primarily an indicator of the quality of assets, managerial efficiency to utilize the institution's assets into net earnings (Rose, 1999). Higher the ROA, higher is the quality of assets and efficient asset utilization. It is calculated by using the following model.

$$\text{Net Income (after tax) to Total Assets} = \frac{\text{Net income(after tax)}}{\text{Total Assets}} \times 100$$

Net Earnings (after tax) to Core Capital: Net earnings after tax to core capital shows the relationship between net earnings after tax to core capital of the bank. It measures the rate of return flowing to the bank's shareholders. Minimum of 8% of this ratio can be considered as satisfactory. The following mode can be used to calculate this ratio:

$$\text{Net Earnings (after tax)/Core Capital} = \frac{\text{Net income(after tax)}}{\text{Core Capital}} \times 100$$

Net Interest Margin: Net Interest Margin indicates the relationship between the difference of interest income and interest expenses to total assets. It measures how large a spread between interest revenues and interest cost. At least 4% of this ratio can be considered as fair. It can be calculated by using following ratio:

$$\text{Net Interest Margin} = \frac{\text{Interest Income} - \text{Interest Expense}}{\text{Total Assets}} \times 100$$

Earnings Per Share (EPS): Earning Per Share provides a direct measure of the returns flowing to the bank's owners-its stakeholders-measured relative to the numbers of shares to the public (Rose, 1999). It gives the strength of the share in the market. Following is the expression of earning per share:

$$\text{EPS} = \frac{\text{Net Income After Tax}}{\text{Number of Shares Common Stock}}$$

3.5 Liquidity

The following Ratios can be used to assess the bank:

Loan to Deposit Ratio: Loan to deposit ratio is the proportion of total loans and advances (before deduction of loan loss provision) to total deposit. It can be calculated using following model:

$$\text{Loan to Total Deposit Ratio} = \frac{\text{Total Loan and Advances}}{\text{Total Deposit}} \times 100$$

NRB Balance to Total Deposit Ratio: It is the minimum amount of reserve a bank must hold in the account with NRB. NRB balance to total deposit ratio is numerical relationship between NRB balance and total deposits of a bank. It measures the adequacy of NRB balance held by the bank. It can be calculated using following model:

NRB balance to Total Deposit Ratio= $\frac{\text{Total NRB Balance}}{\text{Total Deposit}} \times 100$

Cash in Vault to Total Deposit Ratio: Cash in vault to total deposits ratio is derived dividing total cash in vault by total deposit of the bank. It shows the percentage of total deposit maintained in vault of the bank. It can be calculated by using following model:

Cash in Vault to Total Deposit Ratio = $\frac{\text{Total Cash in Vault}}{\text{Total Deposit}} \times 100$

Liquid Assets to Total Deposits Ratio: Total liquid assets to total deposits ratio is a numerical relationship between total liquid assets and total deposits of a bank. The higher ratio implies better liquidity position. It is calculated by using the following model:

Total Liquid Assets to Deposits Ratio = $\frac{\text{Total Liquid Assets}}{\text{Total Deposits}}$

Where, Total liquids assets= Cash in hand+ NRB balance+ Domestic bank balance+ Foreign Currency bank balance+ Placements+ Investment in Government securities.

3.6 Statistical Tools

Average: A simple arithmetic average is used to summarize the data as a representation of mass data. A simple arithmetic average is a value obtained by dividing the sum of the values by their numbers (Kothari, 1989). Thus, the average is expressed as:

$$\bar{X} = \frac{\Sigma X}{N}$$

Where,

$\bar{X}$ = Mean of the values

N = Number of pairs of observation

During the analysis of data, mean is calculated by using the statistical formula average on excel data sheet on computer.

3.7 Limitation of the methodology

The research is conducted to fulfil the academic requirement of Master of Business Degree. It is focused on the financial analysis of Kumari Bank Ltd in the frame work of all five components of CAMEL system and are based on reliable disclosure of audited financial reports the bank during the period 2004/05 to 2008/09. Since the research work on all five components is little been done in Nepalese environment, the study may not reveal reliability and validity in every field. The basic limiting conditions within which the research work is conducted as:

a) The evaluation made herein of one sample unit of Kumari Bank Ltd. only, hence cannot be reasoned for similar condition of the whole industry. However, it gives a particular direction to the industry if not actual.

b) The study remains largely in the realms of Offsite Monitoring System hence qualitative assessment may not be reflected by the study. However, the proxy financial tools are helpful to give a close picture of such factors.

c) The quarterly financial reports of the bank are not publicly available or if available not adequate whereas the effectiveness of CAMEL assessment requires quarterly financial reports. However, Cole and Gunther

(1998) examined that a statistical model using publicly available financial data is a better indicator of bank failure than CAMEL ratings that are more than two quarters old.

The data figures from different other sources may not be congruent with the bank's published data. However, audited data published by the bank are treated as authentic. The study is carried out within the framework of case study research design. So, it is difficult to eliminate the limitations of the case study research design, in which the study as well as the methodology is bounded. Only a single unit is taken for the study, therefore, the study may not be able to represent the whole banking industry.

CHAPTER –IV

PRESENTATION AND ANALYSIS

This chapter deals with presentation ad analysis of data collected from annual reports of the bank. The raw data collected has been organized and processed using various tools discussed in the previous chapter-"Research Methodology". In this chapter data and information are presented and analyzed using different financial and statistical tools in order to achieve the objectives of the study. In the presentation and analysis, the study is focused on CAMEL components.

4.1 Capital Adequacy

Capital adequacy determines how well banks can manage with shocks to their balance sheets. For the purpose of capital adequacy measurement, bank capital is divided in to core/primary capital and supplementary capital. Risk based capital ratio, core capital adequacy ratio, supplementary capital ratio, past due loans/total loans, total loans to a single Borrower/ total loans, total loans to a single borrower/core capital and actual provisioning to require provisioning are the ratios used to analyze the capital adequacy ratio.

Commercial bank should have adequate capital to support its risks assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities. Adequacy and inadequacy of bank capital directly affects the banking transaction. The adequacy of bank capital is the most important aspect of a bank. If there is inadequacy of capital, the bank should take step for the adequacy of capital as per legal requirement because its financial health can't be regarded capable and healthy without having adequate capital.

4.2 Analysis of Total Capital Adequacy Ratio

Total capital adequacy ratio is the measure of financial strength of a commercial bank. Specially, the capital adequacy ratio measures the adequacy of capital for smooth operation of a bank. A bank should maintain adequate capital adequacy ratio as set by NRB. NRB has fixed a minimum standard capital adequacy ratio of 9 percent in2004/05 , 10 percent in 2005/06, and 11 percent in 2006/07, 2007/08 and 2008/09 respectively. It is measured as the ratio of total capital fund to total risk adjusted assets of the bank.

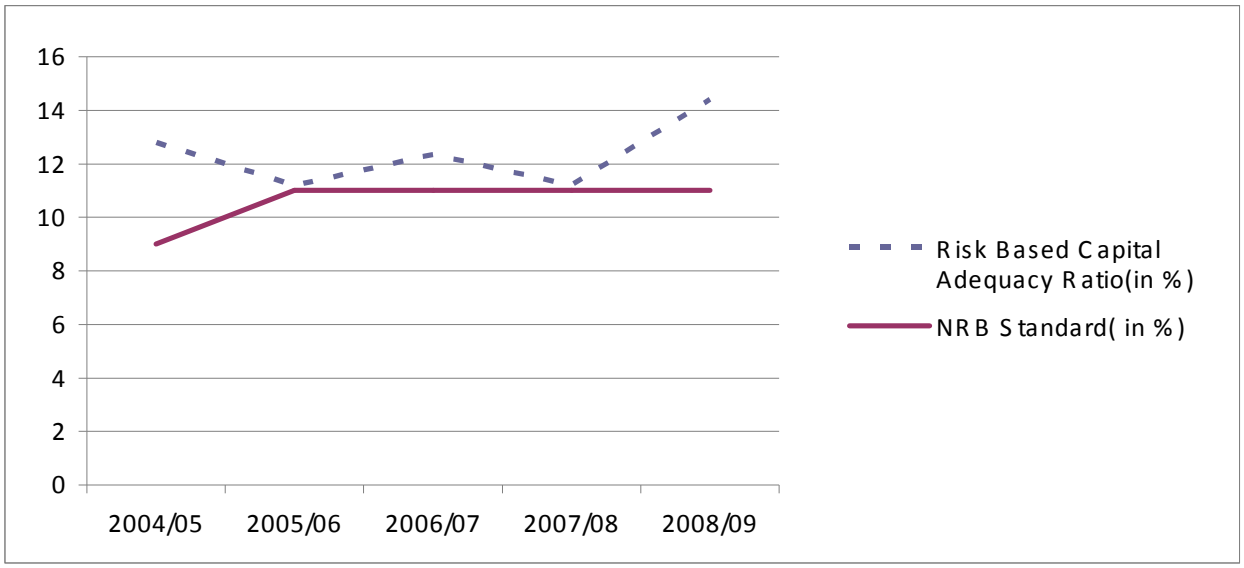
Table 4.1: Total Capital Adequacy Ratio

(Rs. In million)

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Total Capital	**570.15**	**705.53**	**940.98**	**1115.20**	**1882.92**
Total Risk Based Assets	**4449**	**6292**	**7,625**	**9959.91**	**13070.37**
Risk Based Total Capital Adequacy Ratio.	**12.81**	**11.21**	**12.34**	**11.19**	**14.40**
NRB Standard (%)	**9**	**10**	**11**	**11**	**11**
Excess/(Short)	**3.81**	**1.21**	**1.34**	**.19**	**3.4**

The total capital fund of the bank is in increasing trend. It has slightly increased throughout the study period. Whereas the total risk based assets has more increasing trend rather than capital fund of the banking during study period. Which caused decreasing trend of Risk based total capital fund ratio. Compared to the NRB standard, the risk based capital ratio shows an excess 3.81, 1.21, 1.34, .19and 3.4 respectively during the study years, which is continuously decreasing trend except year in 2008/09. The bank has been maintaining capital adequacy as per the NRB guideline in all the years.

Fig 4.1 Comparing Risk Based Capital Adequacy Ratio With NRB



As shown in Fig. 4.1, the risk based capital adequacy ratio of KBL is above NRB standard in all the year. The graph further shows that bank has met NRB standard in all the years. It implies that the bank has maintained an adequate risk based capital adequacy ratio in each year of the study period. Hence KBL has strictly followed the NRB directives and its capital adequacy requirements.

4.2.1 Core Capital Adequacy Ratio

Core Capital is the primary capital of the bank. It includes the paid-up capital, share premium, non-redeemable preference share, general reserves, accumulated profit and loss amount and goodwill deductible if any. Thus, core capital is the amount of shareholders' fund. Core capital adequacy ratio is calculated as a percentage of total core capital to risk based assets of the bank. NRB has set the minimum standard of 5 %, 5.5 %, 5.5%, 5.5 % and 5.5 % in fiscal year 2004/05, 2005/06, 2006/07, 2007/08 and 2008/09 respectively.

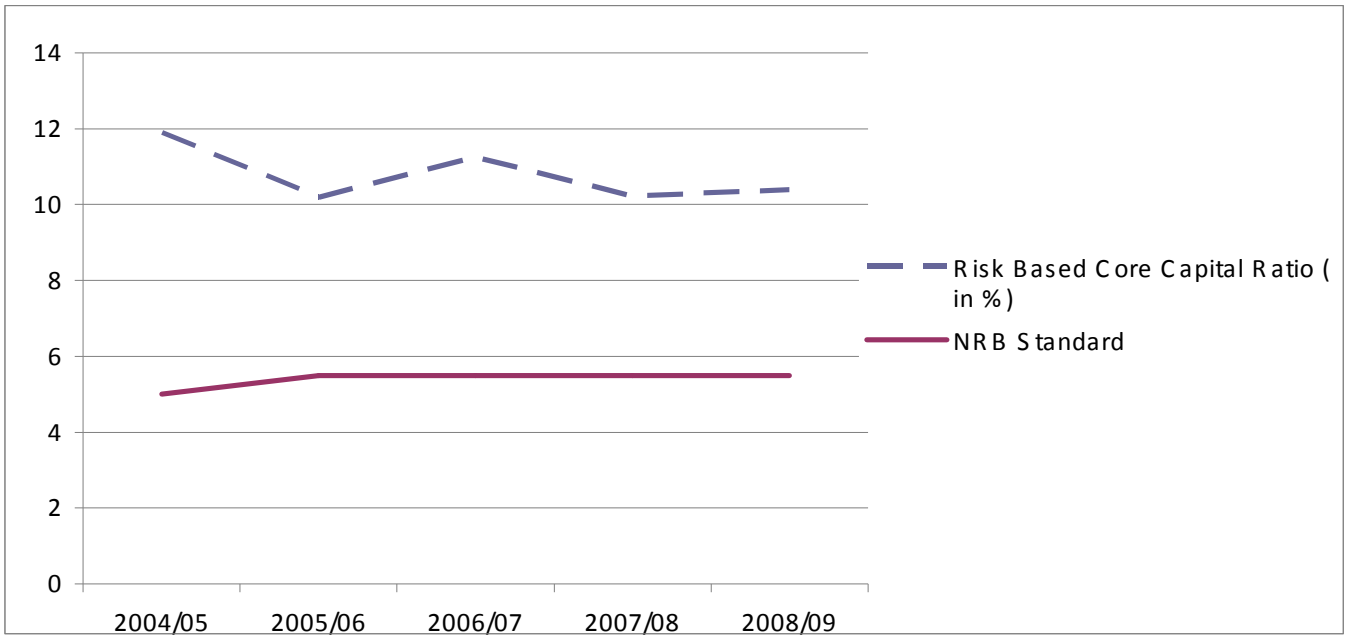
Table4.2 Core Capital Adequacy Ratio

(Rs. In million)

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
Total Core Capital	**529.68**	**641.72**	**858.52**	**1019.89**	**1359.03**
Total Risk Based Assets	**4449**	**6292**	**7,625**	**9959.91**	**13070.37**
Risk Based Core Capital Ratio %	**11.9**	**10.19**	**11.25**	**10.23**	**10.39**
NRB Standard	**5%**	**5.5%**	**5.5%**	**5.5%**	**5.5%**
Excess (short)	**6.19%**	**4.69%**	**5.75%**	**4.73%**	**4.89**

Table 4.2 shows the relationship between core capitals to total risk adjusted assets of the bank. The core capital of the bank has increased from 529.68 million to 1359.03million in the study period. However, total risk based assets also is in increasing trend. Thus, the ratio of risk based core capital is in fluctuating over the study period. The risk based core capital is maximum in the fiscal year 2004/05 and minimum in the fiscal year 2007/08. There is an excess in the ratio of the risk based core capital compared with the NRB standard over all the study period.

Fig. 4.2 Comparing Risk Based Core Capital Adequacy Ratio with NRB Standard



As per Fig. 4.2, the above graph shows core capital ratio of the bank is over of the NRB during the study period. First, the line goes down in FY 2005/06 then again it goes up gradually after all the years. Thus, the risk adjusted core capital adequacy ratio of KBL is adequate as prescribed by NRB.

4.2.2 Supplementary Capital Adequacy Ratio

Supplementary capital is the amount of capital that is transferred in reserve and provision fund using the hybrid capital instruments. It includes loan loss provision, exchange equalization reserve, assets revaluation reserve, hybrid capital instruments, unsecured sub-ordinate term debt, interest rate fluctuation fund and other free reserves. NRB has set a standard of supplementary capital to be maintained by the commercial banks as not more than the core capital of the bank.

Table 4.3: Total Supplementary Capital to Total Risk Based Assets

(Rs. In million)

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Total Supplementary Capital	**40.47**	**63.81**	**82.46**	**95.31**	**523.89**
Total Risk Based Assets	**4449**	**6292**	**7,625**	**9959.91**	**13070.37**
Risk Based Supplementary Capital Ratio (%)	**.91**	**1.014**	**1.08**	**.95**	**4.008**

4.3 Assets Quality

Loans and advances dominate the asset side of the balance sheet of the bank's. Similarly, earning from such loans and advances occupy a major space in income statement of the bank. Hence assets are the critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio; mix of risk assets and credit administration system. The quality of assets are measured in terms of ratio of past due loans to total loans and loan classified as substandard/doubtful/loss to total loans. Provision made for NPAs and loan provided to single Borrower are also the measuring rods used to analyze the assets' quality of the bank.

4.3.1 Past Due Loans to Total Loans

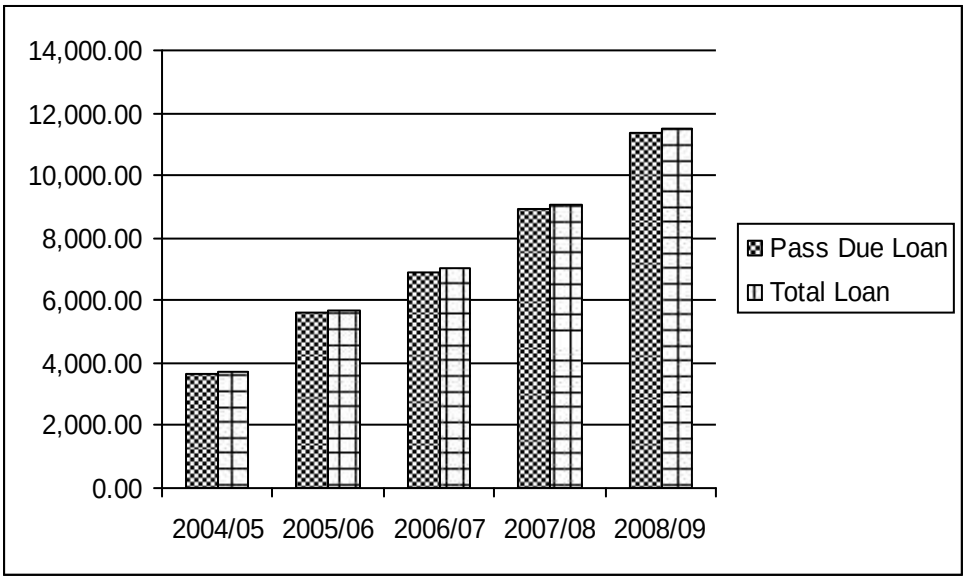
In the table the ratio of past due loan to total loan is presented. The total loan of the bank has gone up throughout the study period. Whereas the portion of the total past due loan in total loan is decreasing. The ratio of the past due loan to total loan is 99.23 in the year FY 2004/05 which is maximum throughout the study period and then it continuously decreasing during the study period and it goes down to 98.34 in FY 2008/09, which is the evidence of

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
Pass Due Loan	3,669.79	5,627.02	6,876.56	8,957.70	11332.15
Total Loan	3,697.98	5,681.01	7,007.78	9,062.43	11,522.38
Ratio of Pass Due Loan to Total Loan	99.23	99.04	98.12	98.84	98.34

satisfactory level of past due loan on total loan. Furthermore, the asset quality of the bank is satisfactory as indicated by this ratio.

Table 4.4: Past Due Loan to Total Loan (in millions)

Fig. 4.3 Ratio of Past due Loan to Total Loan



4.3.2 Ratio of Loans Classified as Substandard, Doubtful, or Loss to Total Loans.

Table exhibits the ratio of standard loan to total loan, doubtful loan to total loan and loss loan to total loan. The percentage of substandard loan

to total loan rages from .5061 percent to .0811 percent in the study period. It has decreased from FY 2005/06 to 2007/08 continuously and increased in FY 2008/09 than FY 2004/05. As the total loan is in increasing trend, percentage of substandard loan to total loan is in decreasing trend except FY 2008/09. This can be considered as satisfactory in quality of assets of the bank in the terms of proportional increment.

Similarly, total doubtful loan is in increasing trend as increment in total loan. When we analysis the doubtful loan to total loan in term of percentage it is in fluctuating form with maximum increment in FY 2008/09. As whole, it can be considered as a satisfactory level because the result is below 5 percent.

Whereas, the percentage of loan loss to total loan ranges from maximum .3677 % and minimum level with .0886% , the result varies between these level which is below 5 percent it means the quality of assets is strong over the study period.

4.5 Ratio of Loans Classified as Substandard, Doubtful, or Loss to Total Loans.

Fiscal Year	**Total Loan**	**Total Sub-standard loan**	**% of Sub-standard loan to Total loan**	**Total Doubtful loan**	**% of Doubtful loan to Total loan**	**Total loan loss**	**% of loan loss to Total loan**
2004/05	**3,697.98**	**14.01**	**.3785**	**10.89**	**.2944**	**3.28**	**.0886**
2005/06	**5,681.01**	**4.61**	**0.0811**	**28.47**	**.5011**	**20.89**	**.3677**
2006/07	**7,007.78**	**12.23**	**.1745**	**32.74**	**.4671**	**19.37**	**.2849**

2007/08	**9,062.43**	**10.37**	**.1144**	**38.63**	**.4262**	**17.10**	**.1886**
2008/09	**11,522.38**	**58.32**	**.5061**	**78.96**	**.6852**	**15.18**	**.1317**

(In millions)

4.3.3 Ratio of Provision for Substandard Loan to Total Substandard Loan

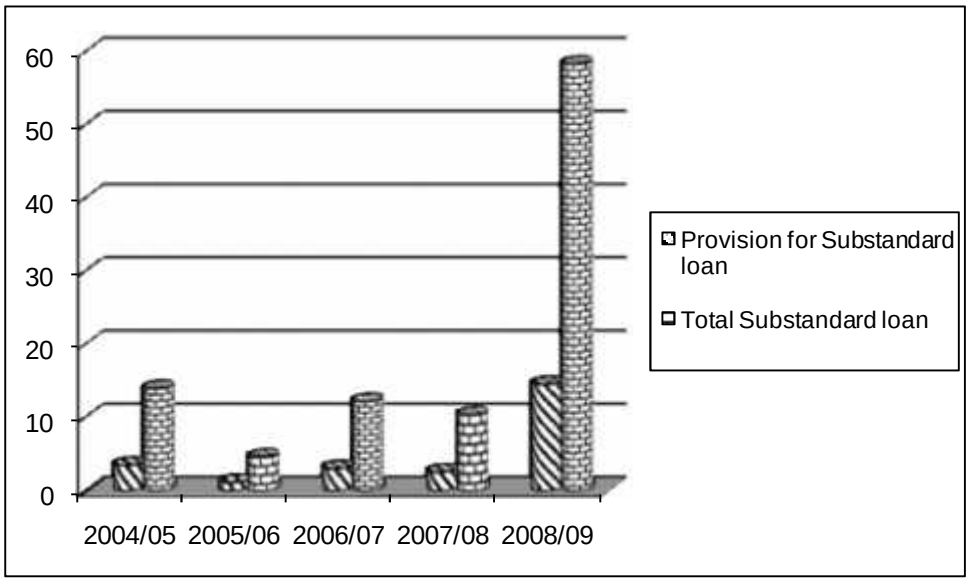
The table 4.6 and fig. 4.4 exhibit the ratio of provision for substandard loan to total loan standard loan. The ratio is constant during the study period. The highest provision is in the year 2005/06 which is 25.02% .In the rest of study period it is not less than 25% or about 25% which means that the bank has made adequate provision for substandard loan. As per the NRB guidelines, provision for standard loan should be at least 25 % of the total substandard loan. And the bank has met standard in every year during the study period.

Table 4.6 : Provision for substandard Loan to Total Substandard Loan

(In millions)

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Provision for Substandard loan	**3.50**	**1.15**	**3.06**	**2.59**	**14.58**
Total Substandard loan	**14.01**	**4.61**	**12.23**	**10.37**	**58.32**
Ratio of provision of substandard loan to total substandard loan	**24.98%**	**24.94%**	**25.02%**	**24.97%**	**25%**

Fig. 4.4: Provision for Substandard loan to Total Substandard Loan



4.3.4 Ratio of Provision for Doubtful Loan to Total Loan

Table shows that the ratio of provision for the doubtful loan to doubtful loan. As per the table the ratio rages from maximum of 49.37 percent to minimum of 16.33 percent. During the study period, ratio of doubtful loan to total loan is in increasing trend but which have not met the standard of NRB. In all the years the ratio is below 50%. As per the NRB standard the provisioning for doubtful debt over the study period is not satisfactory.

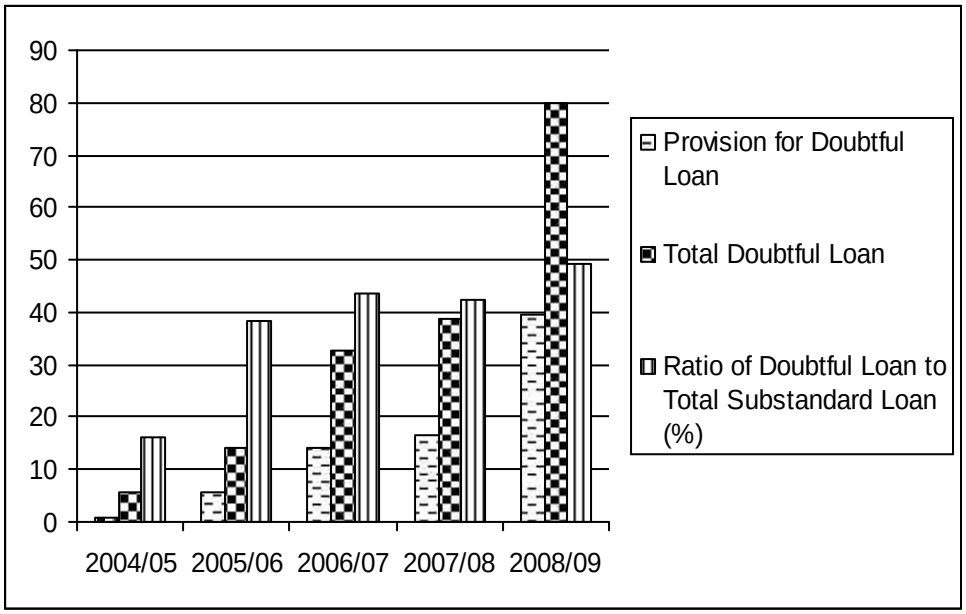
Table 4.7: Ratio of Provision for Doubtful Loan Total Doubtful Loan

(in millions)

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Provision for Doubtful Loan	**0.89**	**5.45**	**14.24**	**16.37**	**39.48**
Total Doubtful Loan	**5.45**	**14.24**	**32.75**	**38.64**	**79.97**
Ratio of Doubtful Loan to	**16.33**	**38.27**	**43.48**	**42.36**	**49.37**

Total Substandard Loan (%)					

Fig.4.5: Ratio of Provision for Doubtful Loan to Total Doubtful Loan.



4.3.5 Ratio of Provision of Loss Loan to Total Loss Loan

Table 4.8: Ratio of Provision of Loss Loan to Total Loss Loan

(Rs. in Millions)

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Provision for Loss Loan	**48.98**	**90.09**	**115.93**	**133.42**	**187.29**
Total Loss Loan	**3.28**	**20.89**	**19.37**	**17.10**	**15.18**
Ratio of Loss Loan to Total Loss Loan (%)	**6.70**	**23.19**	**16.71**	**12.82**	**8.10**

4.4 Management Soundness

Soundness management is a key to financial institution's performance. Although several indicators can be used as proxies for the soundness of management, such evaluation is still primarily a qualitative exercise, particularly when it comes to the evaluation of the management of operational risk, that is, the functioning of internal controlling systems. The productivity of employees is used as a measuring rod for evaluation. Likewise sustainability of earning shows the efficiency of management.

Expenses ratio and earning per employee are the ratios used as proxy of the management quality. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. Similarly, low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with similar repercussions in terms of profitability.

4.4.1 Total Expenses to Total Income Ratio

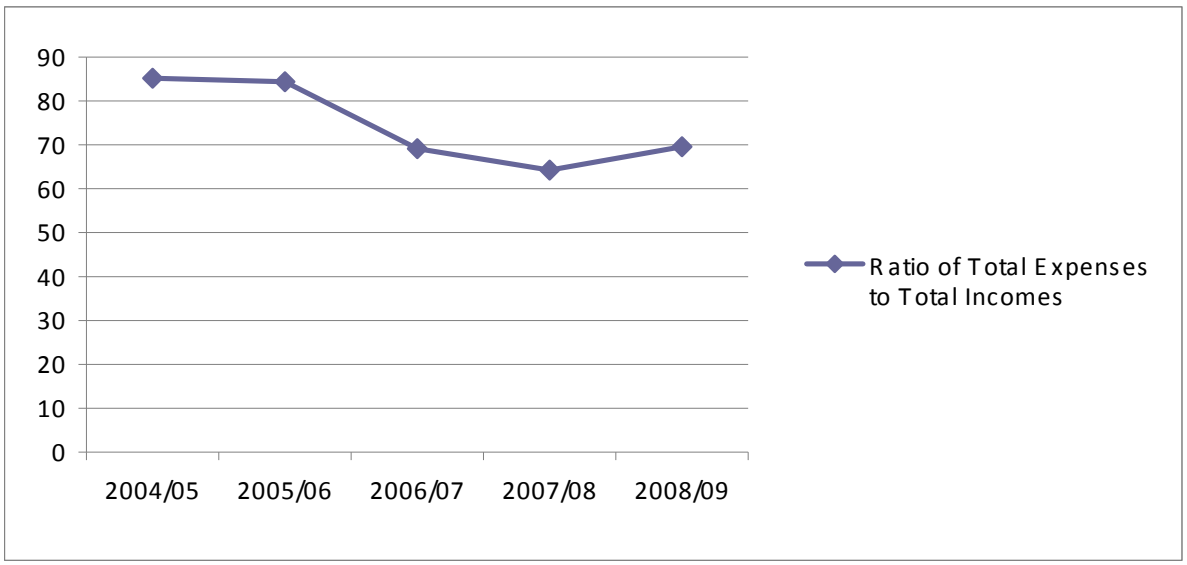
Below table exhibits the ratio of total expenses to total income ratio. The total expenses of the bank is the highest in the fiscal year 2005/06 or Bank's total expenses is in fluctuating trend likewise the total incomes is in also fluctuating trend with maximum profit in the FY 2008/09. While the ratio of total expenses to total income is in decreasing trend except FY 2008/09. The overall ratio implies that the bank has decreasing income with respect to expenses.

Table 4.9 : Total Expenses to Total Income Ratio

(in millions)

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
Total Expenses	292.05	456.40	232.53	306.42	409.98
Total Incomes	342.84	540.6	336.20	476.69	589.44
Ratio of Total Expenses to Total Incomes (%)	85.19	84.42	69.16	64.28	69.55

Fig. 4.6 Ratio of Total Expenses to Total Income



The above graph represent the ratio of total expenses to total income, it is in declining trend, as per the graph it is slightly decreasing up to FY 2005/06 but it dramatically decreased in FY 2006/07 which implies that more increase in expenses of the bank with respect to income of the bank.

4.4.2 Earning Per Employee

Table 4.10: Earning Per Employee

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
NPAT(in million)	**48.68**	**84.20**	**103.67**	**170.26**	**174.93**
Total No. Of Employees	**115**	**143**	**177**	**212**	**256**
Earning Per Employee (in Rs.)	**.423**	**.588**	**.585**	**.801**	**.683**

The above table shows the earning per employee of the bank. The net profit after tax of the bank is increased over the study period. It ranges with minimum 48.68 in FY 2004/05 to 174.93 in FY 2008/09. It is in increasing trend and number of staff of the bank is also in increasing trend so the earning per employee is also in increasing trend but earning capacity of the bank's staff is not so satisfactory.

4.4.3 Earning

Earning is a yardstick indicating the management, shareholders and depositors to evaluate the performance of the banks, sustainability of heavily relies upon the efficiency of its management to drive the bank to earn good profits. Net profit is the major yardstick to measure such profits. A required level of profit is necessary for the firm's growth and survival in the competitive environment. Profitability is vitally more important for assuring that a bank stays in business or activity. Net profit of any bank decreases resulting from high non-performing loans, lack of avenues for earning fee based income and operating-in-efficiencies.

Net income (after tax) to total assets , net earnings (after tax) to core capital, net spread , net interest margin and net operating margin are used to asses the earning performance of the bank.

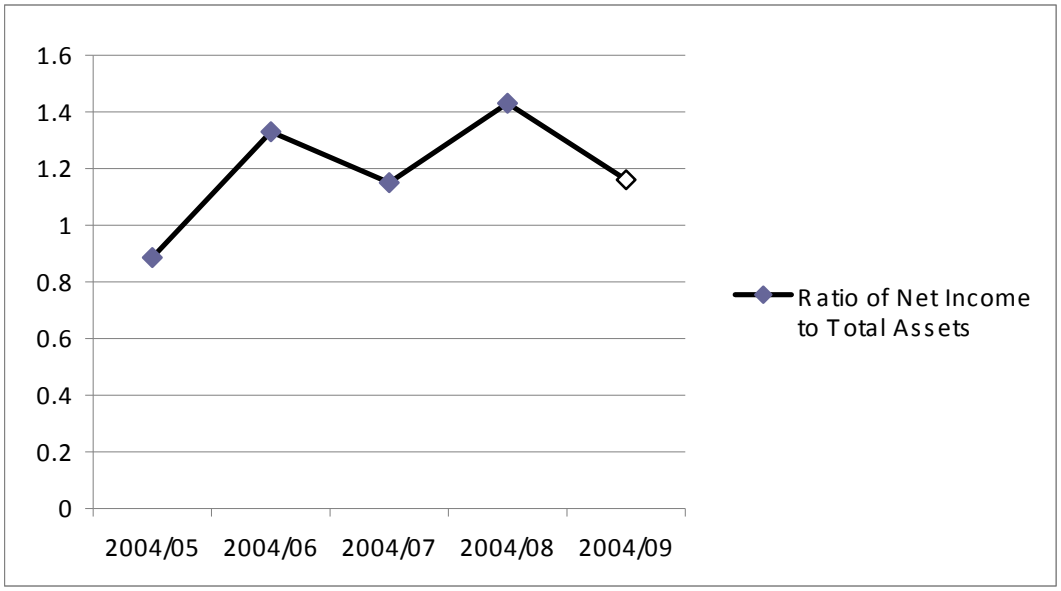
4.4.4 Net Income to Total Assets Ratio

Below table exhibits the ratio of net income to total assets of the bank in the study period. The net income of the bank is in increasing trend. Similarly, total assets of the bank is also increasing trend. The ratio of net income after tax to total assets varies from the minimum of .886 in FY 2004/05 to 1.428 in FY 2007/08. The ratio of net income after tax to total assets is increasing trend except in FY 2006/07 the ratio of net income after tax to total assets is above than 0.5 percent during study period, which can be considered as a fair income and this ratio is more than 0.5 percent that can be considered as satisfactory level of income comparing with the total assets of the bank.

Table 4.11: Net Income to Total Assets Ratio

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
NPAT (in million Rs.)	**48.68**	**84.20**	**103.67**	**170.26**	**174.93**
Total Assets	**5494.17**	**7428.30**	**9010.27**	**11918.311**	**15026.59**
Ratio of Net Income (after tax) to Total Assets (%)	**.886**	**1.33**	**1.1505**	**1.428**	**1.164**

Fig 4.7: Ratio of Net Income to Total Assets



The above graph represents the ratio of net income after tax to total assets of the bank during the study period from FY 2004/05 to 2008/09. It is in fluctuating trend which shows more change in total asset with respect to net income of the bank.

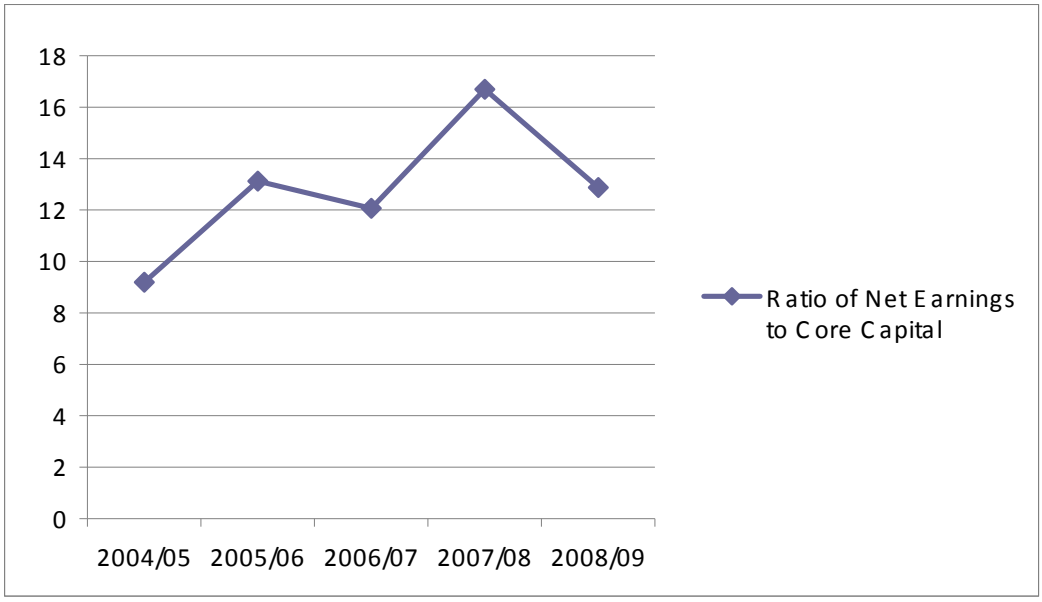
4.4.5 Net Earnings to Core Capital Ratio

Table exhibits the ratio of net earnings to core capital of the bank in the study period. Unlike with the net income, core capital of the bank rose up throughout the study period. The ratio of net income after tax to core capital of the bank varies from the minimum of 9.19 percent in FY 2004/05 to maximum in FY 2007/08 with 16.69 percent. Analyzing the data it seems that the ratio of NPAT to Core Capital is satisfactory in all the years, since it is above 8 percent. However, the ratio is fluctuating over the study period it is because unbalanced changes in NPAT with respect to core capital of the bank throughout the study period.

Table 4.12 Ratio of Net Earnings to Core Capital

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
NPAT (in million Rs.)	48.68	84.20	103.67	170.26	174.93
Total Core Capital	529.68	641.72	858.52	1019.89	1359.03
Ratio of Net Earning (after tax) to Core Capital (%)	9.19	13.12	12.07	16.69	12.87

Fig 4.8: Ratio of Net Earnings to Core Capital



4.4.6 Net Interest Margin

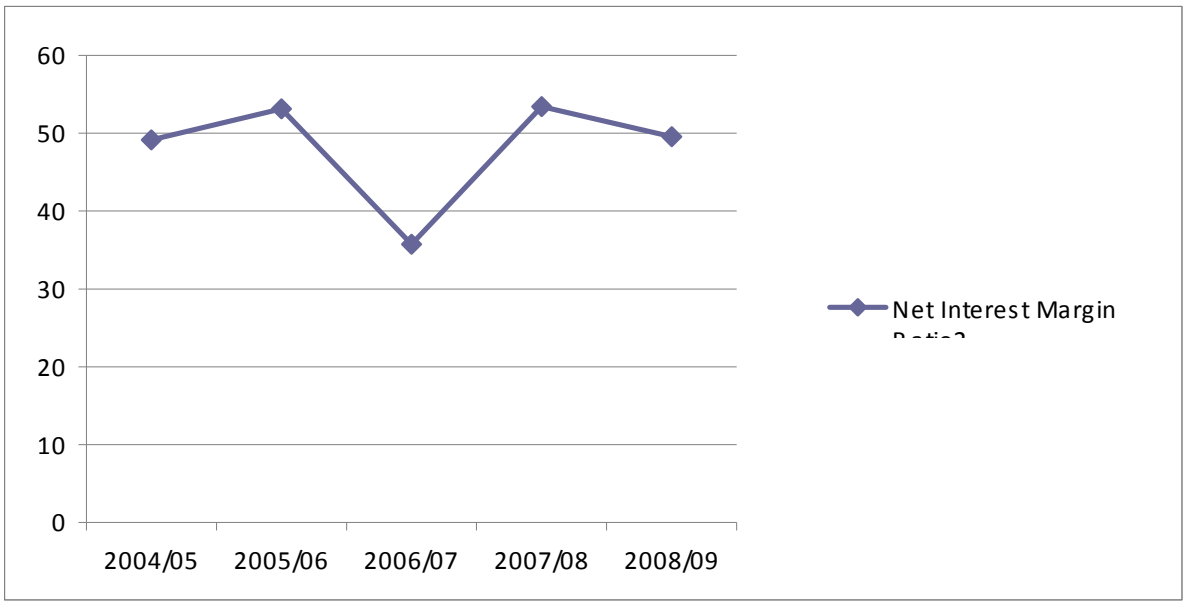
The net interest margin measures how large a spread between interest income and interest expenses management has able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sources of funding. Net interest margin is calculated dividing net interest income (interest income minus interest expenses) by total interest earning assets. Earning assets include loans and advances, bill purchased and discounted and investment made in securities (T-bills, bonds). A negative or declining ratio is an indicator of lack of treasury management skill and needs attention. The net interest margin ratio between 3 to 4 percent can be considered as better in banking industry (World Bank, 1996)

The table shows the net interest margin of the bank. The interest income of the bank is in increasing trend during the study period where as the interest expenses is also in increasing trend during the study period. The total interest earning assets of the bank showed increasing trend in the entire study period. The net interest margin calculated in the table shows the minimum figure of 35.75 in the FY 2006/07 and the maximum of 53.42 in the FY 2007/08. The net interest margin of the bank is in fluctuating trend but it is recorded above 3% in all fiscal year. Thus, the data shows that the net interest margin between 3 to 4 % is supposed to be better. The average net interest margin is found 48.22 % during the study periods, which is found to be very sound earning.

Table: 4.13 Net Interest Margin Ratios

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
Interest Income	310.22	499.92	605.53	791.28	957.24
Interest Expenses	163.90	240.13	337.06	397.05	498.73
Total Interest Earning Assets	297.70	488.86	583.14	738.02	925.38
Net interest Margin (%)	49.15	53.14	35.75	53.42	49.55

Fig 4.9: Net Interest Margin Ratio



The above graph shows the trend line of net interest margin of Kumari Bank Ltd. for FY 2004/05 to 2008/09. The line first is in increasing trend for first two yrs and again declined in FY 2006/07 and increased in FY 2007/08 and again declined in FY 2008/09 or the graph shows the Net interest margin ratio is in fluctuating trend but after all, the net interest margin ratio of the bank is sound because it remains above than 3% over the entire study periods.

4.5 Liquidity

Banks need to maintain reasonable level of liquidity to pay cash to its depositors so it is of prime importance. Liquidity ratios are used to judge a banks ability to meet short-term obligation. It is the comparison between short-term obligations and short-term resources available to meet such obligations. Commercial banks are directed by NRB to maintain five percent of their deposit as CRR in NRB's account to ensure adequate liquidity. As per NRB regulations banks has to maintain CRR on a weekly basis. Therefore, rather than disclosing the CRR of year-end , banks should report the exact CRR ratio maintained during the week, in which year-end falls.

Cash and bank balance to total deposit ratio is used to measure the bank's ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower ratio indicates that banks might face a liquidity crunch while paying its obligations, where as a very high ratio points out that the banks have been keeping idle funds and not deploying them properly.

4.5.1 Total Loan to Total Deposit Ratio

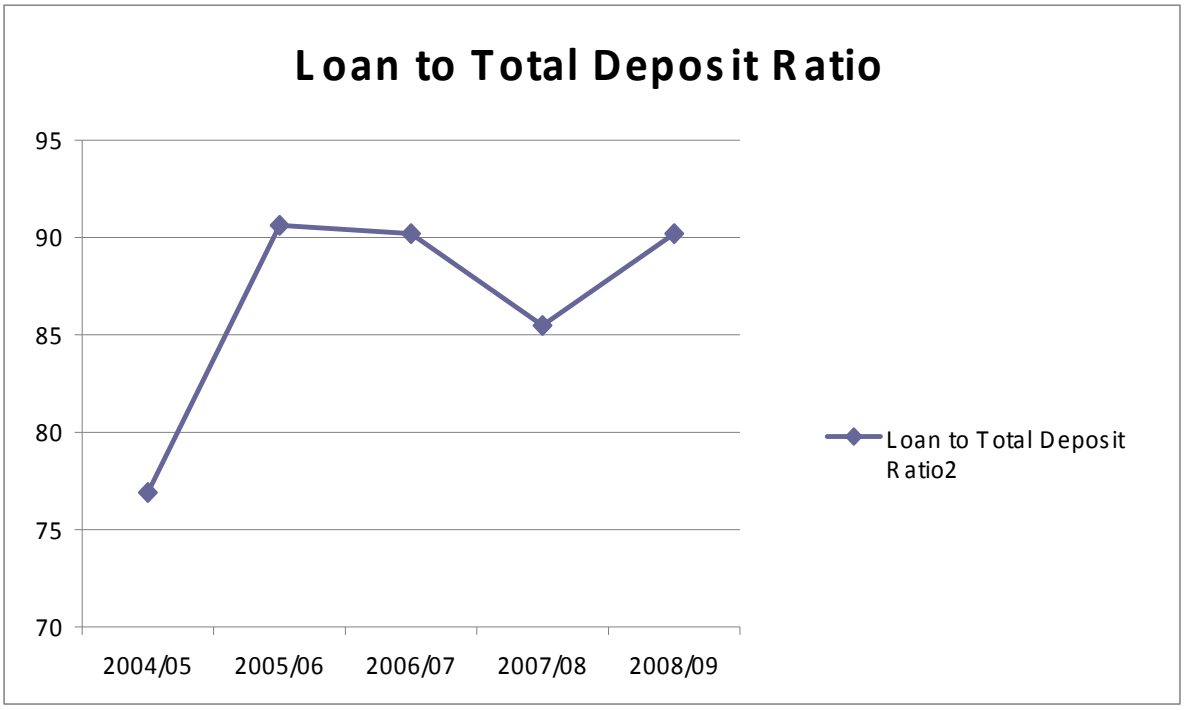
Table shows the loan to deposit ratio of the bank in the study period. The total loan and advances of the bank has increased in the entire study period from the 3697.98 million to 11522.38 million whereas total deposit of the bank is increasing trend. The loan to deposit ratio of the bank has increased until FY 2005/06, and again in FY 2006/07 and 2007/08, finally it has increased in FY 2008/09. Although the loan to total deposit ratio of the bank is in fluctuating over the study period. It can be considered the ratio of the bank shows that the bank has maintained reasonable liquid position of its fund.

Table 4.14: Total Loan and Advances to Total Deposit

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
Total Loan and Advances	3,697.98	5,681.01	7,007.78	9,062.43	11,522.38
Total Deposit	4808	6269	7769	10557	12774
Loan to Total Deposit Ratio (%)	76.91	90.62	90.20	85.48	90.20

The given graph shows the trend line of total loan to total deposit ratio of the bank during the study five periods. It seems fluctuating over the study period, first it started increasing and started decreasing, and finally it increased. Whatsoever, the overall ratio of the bank can be considered sound.

Fig 4.10 : Loan to Deposit Ratio



4.5.2 NRB Balance to Total Deposit Ratio

The table exhibits the NRB balance to total deposit ratio of the bank. The bank has maintained the minimum balance of Rs. 210.55 million in FY 2006/07 and maximum balance of 524.63 in FY 2004/05 and the NRB balance to total deposit ratio of Kumar Bank Ltd. is maximum of 10.91 in FY 2004/05 and minimum of 1.91 in FY 2008/09. Total NRB balance to total deposit ratio of the bank is optimum except in the year 2008/09 and 2006/07

Table 4.15: NRB Balance to Total Deposit Ratio

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
NRB balance	**524.63**	**219.83**	**210.55**	**384.84**	**244.58**
Total Deposit	**4808**	**6269**	**7769**	**10557**	**12774**
NRB balance to Total Deposit Ratio (%)	**10.91**	**3.51**	**2.71**	**3.64**	**1.91**

4.5.3 Cash in Vault to Total Deposit Ratio

The table depicts the cash in vault to total deposit ratio. The total cash in vault of the bank varies from minimum of Rs. 111.25 million in FY 2005/06 to maximum of Rs.684.72 million in FY 2004/05 in the study period. Total deposit of the bank shows the increasing trend during the study period. Cash in vault to total deposit ratio of Kumari Bank Ltd. has fluctuated during the study period. It varies from the minimum of 1.75 % in FY 2006/07 to maximum of 14.24 % in FY 2004/05. The cash in vault to total deposit ratio of

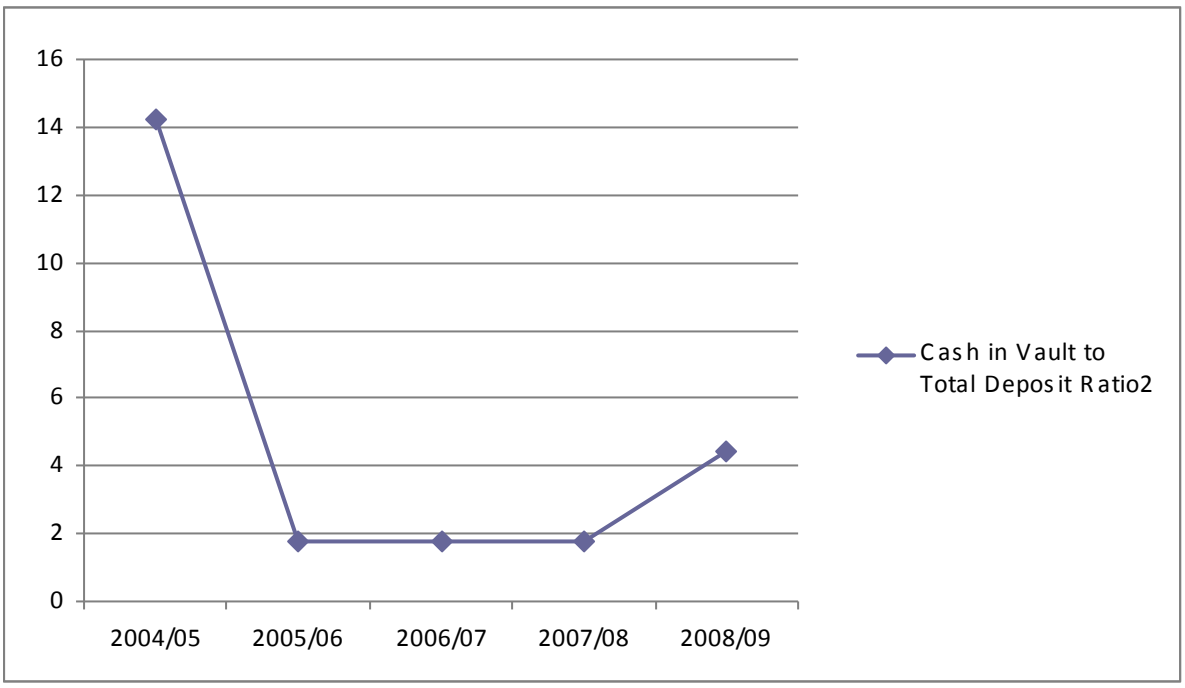
Kumari Bank Ltd. is adequate as it has maintained average of 4.79 % liquidity in vault which is supposed to be adequate liquidity.

Table 4.16: Cash in Vault to Total Deposit Ratio

Fiscal Year	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**
Total Cash in Vault	**684.72**	**111.25**	**135.79**	**190.74**	**565.64**
Total Deposit	**4808**	**6269**	**7769**	**10557**	**12774**
Cash in Vault to Total Deposit Ratio (%)	**14.24**	**1.77**	**1.75**	**1.80**	**4.43**

The below chart represent the trend line of cash in vault to total deposit ratio of Kumari Bank Ltd. over the five years study period. Which seems in decreasing trend till FY 2006/07 then it starts to rise for the following two fiscal years. According to the average data of cash in vault to total deposit ratio, the bank has maintained adequate cash in vault to satisfy the immediate cash requirement.

Fig 4.11: Cash in Vault to Total Deposit Ratio



Major Findings

This section includes the key findings of the study obtained from the analysis of the data. Conclusion derived from the findings is presented in the next chapter.

1. The both of core capital and supplementary capital ratio of Kumari Bank Ltd. Are found fluctuated entire the study periods. The core capital ratio is above the NRB standard in the entire study period. Thus it is found that the core capital ratio of Kumari Bank Ltd. is adequate and sufficient. The risk based supplementary ratio of Kumari Bank Ltd. as prescribed by NRB, which should not exceed the core capital, showed that Kumari Bank Ltd. has not met the requirement of NRB during the study period.
2. The ratio of past due loan to total loan is found decreasing trend during the study period except in the year 2006/07. The total loan of the bank has gone up throughout the study period. The ratio of past due loan is

continuously decreasing trend and below than 100% throughout the period, which is not the evidence of satisfactory level of past loan on total loan. Furthermore, it is found that the asset quality of the bank is not satisfactory as indicated by this ratio.

3. The percentage of substandard loan to total loan ranges from .3785 to .5061 in the study period. While the total loan is in increasing trend. Where the portion of the substandard loan is about nil. It is also fond that the percentage of substandard loan is below 5 percent throughout the study period. On the other hand, portion of doubtful loan is in decreasing trend except in year 2009. Similarly, the percentage of loss loan to total loan is generally decreasing trend in all the study period. It is below 5 percent in all the fiscal years.

4. The ratio of provision for substandard loan to total substandard loan has fluctuated in the study period. The highest provision made was in the year 2009. In rest of the study period it is less than the 25%. During the study period ratio of doubtful loan to total loan is increasing trend. Which are adequate provisions as per the NRB rules and regulations? Similarly, the amount of loss loan is fluctuating over the study period. The provisioning for loss loan is above 100 % during the study period.

5. The ratio of total expenses to total income is in decreasing trend during the study period. The total expense of the bank has increased throughout the study period except in the year 200 7. Whereas, the ratio of total expenses to total income is in decreasing trend over the study period.

6. The earning per employee of the bank has increased in all the years of the study period except in the year 2009. The net profit after tax of the bank is increased over the study period. Whereas, the total number of employees is also in increasing trend throughout study period. Net profit of the bank is also in increasing trend and total number of staff of the bank is in increasing trend so the earning per employee is in increasing trend slowly.

7. The net income of the bank is in increasing trend. Similarly, the total assets of the bank are increasing trend. The ratio of net income to total asset of the bank is in fluctuating trend that means the first two years started increasing and decreased in fiscal year 2006/07 and increased in fiscal year 2007/08 and finally decreased in the fiscal year 2008/09. The ratio of net income to total assets is above than 0.5 percent during the study period.
8. The ratio of NPAT to core capital is satisfactory in the all years, since it is above 8 percent. However, the ratio is fluctuating over the study period it is because unbalanced changes in NPAT with respect to core capital of the bank throughout the study period.
9. The ratio of net interest margin of the bank is in fluctuating trend over the study period. The net interest margin ratio of bank is in increasing trend except in the fiscal year 2006/07 and 2008/09.
10. The total loan to total deposit ratio of the bank is in increasing trend except in the fiscal year 2007/08 over the study period. Similarly, the NRB balance to total deposit ratio of KBL is found decreased except in the fiscal year 2007/08 and total deposit of the bank shows increasing trend. Cash in vault to total deposit ratio of the bank has decreased till FY 2006/07 and again increased in the flowing two fiscal years. Cash in vault to total deposit ratio of Kumari Bank Ltd. is adequate as it has maintained average of 4.79 % liquidity in vault which is supposed to be adequate liquidity.

CHAPTER –V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The research study is focused on assessing the financial performance of Kumari Bank Ltd. in the framework CAMEL, by using descriptive and analytical research design, prescribed by UFIRS and in accordance to BASEL accord. The study scrutinizes the financial performance of KBL as regards to its capital adequacy, level and trend of risk weighted assets, asset composition and quality of loan assets, management of revenues and expenses, level and trend of earnings & liquidity position. The bank's audited annual reports of condition for the period 2004/05 to 2008/09 are the primary source of information and treated as authentic. As CAMEL has little been researched in Nepal, this research would be beneficial to forewarn risk.

As commercial banks are now introducing complex and innovative banking products, they are exposed to many risks and therefore have amplified as well as diversified the functions performed by the bank Supervision Department. A key product of such supervision is a rating of the bank's overall condition, commonly referred to as a CAMEL rating. CAMEL rating system is used by the three federal banking supervisors [the Federal Reserve, the FDIC, and the Office of the comptroller of the currency (OCC)] and other financial supervisory agencies to provide a convenient summary of bank conditions at the time of an exam. Various studies have been conducted in the past on financial analysis of commercial banks in the US and other regions were found done. In context of Nepalese banking environment, there are only few researchers found conducted in the framework of CAMEL (Baral, 2005; Bhandari, 2006 and Gurung, 2007). The study analyzes the level, trend and analysis of Capital adequacy, Non-performing loans, Loan loss provision, asset composition, Management quality ratio, Earning capacity and liquidity position components

of the bank during a 5 years period from 2003/04 to 2007/08 A.D. Various material were reviewed in order to build up the conceptual foundation and reach to the clear destination of research. During the research the areas that formed part of the research review were; Functions of Commercial bank, Concept of the bank supervision, Concept of CAMEL rating system and component evaluation system, Basel Capital Accord, NRB guidelines. Besides these, review of research papers, work papers, dissertations and related reports were conducted.

The research was conducted within the framework of descriptive and analytical research design. For the study purpose, Kumari Bank Ltd. was chosen as a study unit applying convenience sampling technique out of 28 commercial banks. The required data and information were collected from secondary sources. Financial ratios, simple mathematical and statistical tools have been applied to get the meaningful result of the collected data in this research work.

The analysis has been made to analyze the bank's ratios with NRB standard, industrial average and analyze the trend of ratios. The capital adequacy ratios of the banks are generally above than NRB standard in all the years which leads to conclude that the bank is running with adequate capital. The capital adequacy ratios above the NRB standard of the Kumari Bank Ltd. bank shows additional protection and security to stakeholders and financial soundness of the bank. The assets are mainly composed of Loans and advances, Investments. The non-performing loans to loan ratios are well below the industrial and the industrial standard. The loan loss provision of KBL is decreasing over the study period except in FY 2004/05. The ratio of total expenses to total income is in decreasing trend during the study period, The earning per employee of the bank has increased in all the years of the study period except in the year 2008 which indicates effective management of KBL. The cash in vault to total deposit ratio and NRB balance to total deposit ratio of

KBL are fluctuated in all the years. There is limitation in CRR ratio calculation as it is based on year end volume only rather than weekly average and hence cannot be justifiable when compared with NRB norms. Overall the liquidity position of the bank is in good if we look at the composition investment in government securities.

5.2 Conclusions

Based on the findings, the performance of KBL in the framework of CAMEL is concluded as under:

1. The Core Capital Adequacy ratio of the bank is maintained positively with NRB standard during the review period. Supplementary capital ratio of the bank is not with the boundary of NRB regulation over the study period. The total capital adequacy ratio is above NRB norms and industry average as well. This means the bank has adequately maintained its internal sources during the past five years. The bank is running with adequate capital and the capital fund of the bank is sound and sufficient to meet the banking operation as per NRB standard.
2. The decreasing trend of non-performing loans and advances ratio of the bank helps to conclude that the bank is aware of non-performing loans and adopting the appropriate policies to manage this problem and to increase the quality of asset. The performing loans are decreasing steadily and conversely the NPL are increasing during the review period. The NPL ratio speaks of NPL ratio not well in control. It can therefore, concluded that bank has not placed efficient credit management and recovery efforts. Whereas, decreasing trend of loan loss provisioning ratio of KBL indicates that the quality of loans becoming upgrading year by year i.e it seems that amount of non-performing loans and possibilities of default in future is decreasing.

3. The bank is managed and operating efficiently since the total expenses to total revenues ratios are in decreasing trend. This could be, but is not limited to management efficiencies. In any case, the decreasing trend will positively affect the bank's profitability in future. The increasing trend of earning per employee of KBL depicts management capacity to control overheads expenses due to overstaffing with similar repercussions in terms of profitability. In overall it can be concluded that the management decisions must be focused related to operation and investment have assisted in controlling control and recovery of bad debt.
4. The bank's return on assets is continuously fluctuating trend during the study period. The bank has net interest margin above benchmark in all years. Based on these findings it can thus be concluded that bank is trying to establish investor's and public faith. It has good quality of assets and efficient enough to generate increasing return in future. The management has been able to control the interest spread and cost effective sources of funds. This has helped the bank in increasing the market strength but in case of fluctuating trend the ratio of bank should be concentrating to make few new policy and strategy to make it better in future.
5. The NRB balance to total deposits ratio is below the industrial average during the study period. The NRB balance is however in volatile trend throughout the study period. However it does not imply inadequate NRB CRR requirement. The cash in vault to total deposit ratio is below the industrial average ratio during the study period. The ratio is fluctuating over the study period. However, the calculations are based on year end balances whereas NRB takes average weekly balances for cash at vault calculation which is a limitation of the study.

Recommendations

The following recommendations are made based on the conclusions as regard to financial performance of KBL

1. The proportion of both Core and Supplementary Capital of KBL has fluctuated over the entire study period. Furthermore, at the final period of the study period, the ratio is in decreasing trend although it is above the NRB standard, hence the management should address about this. So, the recommendation is provided to maintain stable capital adequacy ratios in the bank and strictly follow the NRB directives.
2. Although the bank has been increasing the proportion on non-performing loans to loans and advances of KBL during the study period, the bank requires checking this tendency before they are ultimately written-off from the books. The loan loss provision to loan loss and advances is in fluctuation over the entire study period which is not a good sign. The bank needs to give attention in recovering the doubtful and loss loans and lower the provision accordingly. So the bank is recommended to lower the proportion of loan loss provision by increasing the quality of assets by strengthening the credit appraisal and follow-up measures.
3. Total expenses to total revenue of KBL during the study periods is decreasing trend. The bank needs to generate additional operating revenues in the coming years and to maintain the current level. On the other hand, earning per employee of the bank is in increasing trend over the study period, which indicates the sound earning power of the staffs of the bank. So, the bank is recommended to maintain the stable earning per employee and generate more revenues in the coming years.
4. During the study period, the earning quality ratios i.e return to core capital , return on assets , net interest margin of KBL are in unbalanced

state. Return in total assets is in increasing which shows the sound utilization of the assets by the management. Whereas, the ratios of return to core capital and net interest margin are in increasing trend in the initial years, which indicates the good sign but the bank needs to maintain this level. The bank needs to increase the revenues and further control the operating expenses which would cushion in competitive environment.

5. KBL has maintained adequate liquid assets to deposit over the study period. Hence it is recommended to explore new investments opportunities for proper utilization of the idle liquid assets. Additional, the bank has maintained adequate cash balance at NRB and cash at vault during the study period, though, ratios over the entire study periods are in volatile state. And the bank's vault to total deposit ratio and NRB balance to total deposits ratio are above the minimum requirement during the study periods so, the bank has followed the NRB directions in respects to the balance should be maintained at NRB and vault is better for regulatory mandatory.

BIBLIOGRAHY

Adhikari, Dev Raj(1993) **"Evaluating the financial performance of Nepal Bank Ltd."**. An unpublished Master's Degree Dissertation Submitted to Central Department of Management T.U.

Bajracharya , B.B (2047), **Monetary Policy & Deposit Mobilization in Nepal**. Rajat Jayanti Smarika, p93-97.

Bajracharya , Ratna Raj (2047), **A Comparative Performance Study of Rastriya Banijiya Bank.** Rajat Jayanti Smarika, pp 125-33

Baral, Keshar J. (2005). Health Check-up of Commercial Banks in the Framework of CAMEL: A case Study of Joint Venture Banks in Nepal. **Journal of Neplease Business studies,** Vol 2, No.1

Barker, D, and D. Holdsworth (1993). **The causes of Bank Failures in the 1990s.** Federal Reserve Bank of New York: Research Paper No. 9325.

Basel Committee on Banking Supervision (1988). **International Convergence of Capital Measurement and Capital Standards.** Basel: Bank for International Settlements(BIS)

Basel Committee on Banking Supervision(2000, January). **The New Basel Capital Accord.** Consultative Document. Bank for International Settlements, Basel, Switzerland.

Basel Committee on Banking Supervision(2004). **Implementation of Basel II: Practical Considerations.** Basel: Bank for International Settlements(BIS).

Basel Committee on Banking Supervision(2005). **International Convergence of Capital Measurement and Capital Standards.** Basel: Bank for International Settlements (BIS)

Berger, A.N., and S.M. Davies (1994). The Information Content of Bank Examinations. **Journal of Financial Services Research**14 , pp 117-144

Berger . Alien N., Sally M. Davies. And Mark J. Flannery (1998). **Comparing Market and Regulatory Assessments of Bank Performance: Who Knows What When?** Federal Reserve Board of Governors FEDS Working Paper.

Bhandari, Krishna Ram(2006). **" The Financial Performance of Himalayan Bank Ltd.in the framework of CAMEL "** . Masters diss.. Tribhuvan University.

Bhatt, Gunakar (2061).Need for Macro prudential Appraisal of the Financial System Soundness **Nepal Rastra Bank Samachar,** 49th Anniversary, pp57-62

Bohara, Bhoj R. (1992). **"A comparative Study of the Financial Performance of Nepal Arab Bank Ltd. and Indosuez Bank Ltd."** Master diss., Tribhuvan University.

Cantor, R. (2001). A New Capital Adequacy Framework. **Journal of Banking and Finance,** 25: 171-185

Chand, Digendra(2006). "Fiancial Performance Analysis of NABIL Bank Ltd. In framework of CAMELS rating systems". Masters diss.. Tribhuvan University.

Cole, Rebel A. , and Jeffery W. Gunther (1998, April). Predicting Bank Failures: A comparison of On-and Off-site Monitoring Systems**. Journal of Financial Services Research,** 13: 103-17.

Crosse, H.D. (1963). **Management Policies for Commercial Banks**. USA: Prentice Hall Inc.

Deoja, S. (2001). " A comparative Study of the Financial Performance between Nepal State Bank of India Ltd. And Nepal Bangladesh Bank Ltd." Master diss.., Tribhuvan University.

De Young , R., M.J. Flannery, W.W Lang, and S.M Sorescu(1998). The information Advantage of Specialized Monitors: **The Case of Bank Examiners. Working Paper** No. 98-4, FRB of Chicago.

Dhungana, Promod (1994) " A study of the Joint Venture Banks Profitability"An unpublished Master's Degree Dissertation submitted to Central Department of Management T.U in 1994.

Dziobek, C., J.K Hobbs, and D. Marston (2000). Toward a Framework for Systemic Liquidity Policy. **IMF Working Paper.** 00/34(Washington: International Monetary Fund.)

Flannery, M.J. (1998). Using Market Information in Prudential Bank Supervision: A Review of the U.S. Empirical Evidence. **Journal of Money, Credit and Banking** 30, pp. 273-305

Gilbert, R.A., and M.D Vaughn (1998). **Does the Publication of Enforcement Actions Enhance Market Discipline?** Manuscript , Research Department, Federal Reserve Bank of St. Louis .

Gurung. V.C, (1995). " A Financial Study of Joint Venture Banks in Nepal" Master diss., Tribhuvan University.

Gyawali, Hari Lal (2055), "Prashichan" published by Nepal Rastra Bank, Poush 2055 P.88-100

Heyliger, W.E., and D.P Holdren (1991). Predicting Small Bank Failure. **The Journal of Small Business Finance,** 1 (2): 125-140

Hirtle, B.J., and J.A. Lopez (1999**). Supervisory Information and the Frequency of Bank Examinations.** Federal Reserve Bank of New York: Econamic Policy Review5, pp.1-20

Hlbers, P., Kruegar, R., and Moreti, M.(2000). New Tools for Assessing Financial System. **Finance & Development**, Vol. 37, No. 3

J. Fred Weston & Eugene, **Managerial Finance**. Holt Sainders International Editors

Jackson, W. (1975, June). Commercial Bank Regulation Structure and Performance. **The Journal of Finance**, XXX(III): 917-920

Jordan, J.S., J. Peek , and E.S Rosengren (1998). **The Impact of Greater Bank Disclosure Amidst a Banking Crisis**. Working Paper No.99-1, Federal Reserve Bank of Boston.

Joshi, Keshvav Raj (1989), "A Study on Financial Performance on Commercial Banks". An unpublished Master's Degree Dissertation submitted to Central Department of Management T.U. Kritipur, in 1989.

Joshi.D. (1993). "A study on Commercial Banks of Nepal With Special Reference Financial Analysis of Rastriya Banijiya Bank". Master diss.,Tribhuvan University .

Kaini, Bichchyu Kailash(1997), "A Comparative Study of Financial Performance of Nepal Arab Bank Ltd. and Nepal Grindlays Bank Ltd." An unpublished Master's Degree Dissertation submitted to T.U in 1997.

Mukherjee, S. (1998). NPAs of Banks to Go Up. **The Economics Times**.

Nepal Rastra Bank (1996), "**Nepal Rastra Bank Publication**". Page 33

Nepal Rastra Bank (2004, July). **Banking & Financial Statistics**. 43: 10-14

Nepal Rastra Bank (1996), "**Forty Years of Nepal Rastra Bank**" Page30

Pandey, I.M., "**Financial Management**" Vikash Publishing House Pvt.Ltd.

Shakya , D.R. (1995). "Financial Analysis of Joint Venture Banks in Nepal".Master diss., Tribhuvan University.

Shrestha Ramesh Lal, **A Study on Deposits and Credits of Commercial Banks in Nepal.** NRB Samachar, NRB, KTM Baisakh 14, 2045 B.S. English section p.1-10.

Shrestha, M.K. (2047**), Commercial Banks Comparative Performance Evaluation.** Karmachari Sanchaya Kosh Publication, (2047)

Shrestha, S.(1990). Portfolio Behaviour for Commercial Banks in Nepal. Ph.D. diss., University of Delhi.

Sinkey, Joseph (1975, March). A Multivariate Statistical Analysis of the Characteristic of Problem Banks. **Journal of Finance** 30: 21-36

Kumari Bank Ltd. Annual Reports (FY 2003/04 to 2007/08). Kathmandu

Kumari Bank Ltd. Website **(http//:www.kumaribank.com)**

Tam, K. and M. Y. Kiang (1992). Managerial Applications of Neural Networks: The Case of Bank Failure Predictions. Management Science 38(7): 926-947

Thakur, Ashwini Kumar(2052), "Performance of Nepalese Commercial Banks" Prashikshan Journal of Bankers' Training Centre, NRB, KTM Vol. 35, 2052 B.S, P.81-86

Thapa, Samiksha (2001). "A comparative Study on the Financial Performance of Nepal Arab Bank Ltd. and Nepal Indosuez Bank Ltd." Masters dis... T.U

Thomson. J.B. (1991, January). Predicting Bank Failures in the 1980s. **Economic Review**, Federal Reserve Bank of Cleveland, 9-20.

Van den Bergh, Paul & Sahajwala, Ranjana (2000, December). **Supervisory Risk Assessment and Early Warning Systems, December 2000.** Basel Committee on Banking Supervision Working Papers.

Van Horne, J.C **Financial Management and Policy**. 12th ed. New Delhi Pearson Education, 2003

Shrestha, Madhu Sundar, **Fundamentals of Banking** , 2nd ed. KTM , Buddha Academic Enterprises, 2007

Appendix I

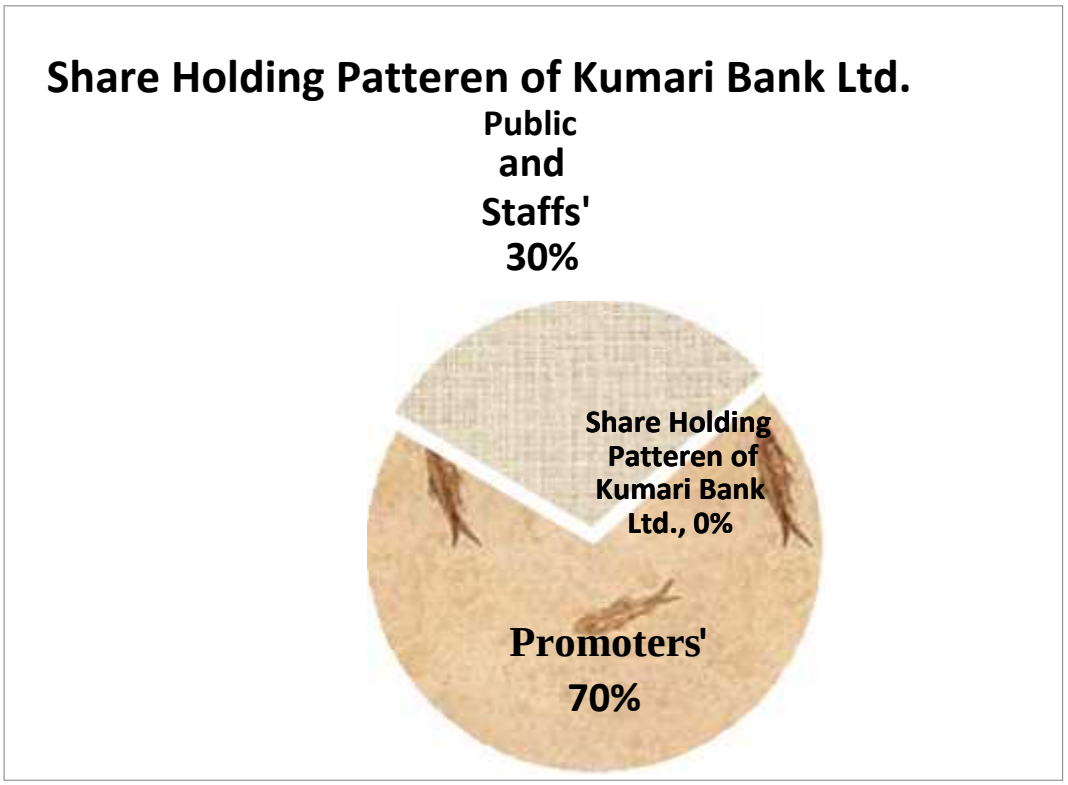
S.N	Name of the Banks	Estd. Year
1	Nepal Bank Limited	1994
2	Rastriya Banijiya Bank	2022
3	Agriculture Development Bank	2027
4	NABIL Bank Limited	2041
5	Nepal Investment Bank Limited	2042
6	Standard Chartered Bank Nepal Limited	2043
7	Himalayan Bank Limited	2049
8	Nepal SBI Bank Limited	2050
9	Nepal Bangladesh Bank Limited	2050
10	Everest Bank Limited	2051
11	Bank of Kathmandu Limited	2051
12	Nepal Credit and Commerce Bank Limited	2053
13	Lumbini Bank Limited	2055
14	NIC Bank Limited	2055
15	Machapuchre Bank Limited	2056
16	Kumari Bank Limited	2057
17	Laxmi Bank Limited	2058
18	Siddhartha Bank Limited	2058
19	Global Bank Limited	2064
20	Citizen Investment Bank Limited	2064
21	Sunrise Bank Limited	2064
22	Prime Bank Limited	2064
23	Bank of Asia	2064

Source:http://www.nrb.org.np

Appendix II

Capital Structure of Kumari Bank

The bank has paid up capital of Rs 750 million, which comprises 70 % promoter's shares and 30% public shares including staff share. The bank has planned to increase the capital as per statutory requirement of Rs. 2 billion by 2012/13.



Source: Annual Reports FY2007/08

APPENDIX III

KUMARI BANK LIMITED

COMPARATIVE BALANCE SHEET

Liabilities	2003/04	2004/05	2005/06	2006/07	2007/08
Share Capital	500,000,000	500,000,000	625,000,000	750,000,000	1070000000
Reserve & Surplus Funds	33,403,180	141,762,737	238,850,557	275,630,159	294885269
Debentures & Bonds	0	0	-	-	400000000
Borrowing Outstanding		401,761,328	251,400,000	212,970,000	100000000
Deposit Liabilities	4,807,936,964	6,268,954,481	7,768,957,276	10,557,416,461	12774281014
Bills Payable	14,637,391	7,339,236	11,918,835	16,554,384	65296714
Proposed Dividend Payable	0	0	6,578,947	-	0
Income Tax Liabilities	0	0	296,343	11,006,805	-9650253
Other Liabilities	138,199,043	111,775,797	107,274,226	94,733,620	331786431
Total Liabilities & Capital	**5,494,176,578**	**7,431,593,579**	**9,010,276,184**	**11918311429**	**15026599175**
Assets					
Cash Balance	68,471,908	111,249,095	135,794,991	190,748,210	565641118
Balance with Nepal Rastra Bank			210,552,637	384,844,510	244576115
Balance with Banks/Financial Inst	617,006,003	332,122,274	43,282,117	96,520,231	123624444
Money at Call and Short Notice		90,000,000	145,000,000	372,215,000	55360000
Investment	983,504,403	1,190,271,012	1,394,947,754	1,678,418,415	2138797590
Loans, Advances and Bills Purchas	3,649,008,723	5,584,637,111	6,891,855,426	8,929,013,115	11335087939
Fixed Assets	57,152,223	82,984,150	91,932,957	189,323,741	222000872
Non Banking Assets	0	0	3,592,027	2,394,684	3140779
Other Assets	119,033,318	40,329,937	93,318,276	74,833,523	338370318
Total Assets	**5,494,176,578**	**7,431,593,579**	**9,010,276,185**	**11,918,311,429**	**15026599175**

APPENDIX IV

KUMARI BANK LIMITED

COMPARATIVE PROFIT & LOSS A/C

Table 1

Liabilities	2003/04	2004/05	2005/06	2006/07	2007/08
Share Capital	500,000,000	500,000,000	625,000,000	750,000,000	1070000000
Reserve & Surplus Funds	33,403,180	141,762,737	238,850,557	275,630,159	294885269
Debentures & Bonds	0	0	-	-	400000000
Borrowing Outstanding		401,761,328	251,400,000	212,970,000	100000000
Deposit Liabilities	4,807,936,964	6,268,954,481	7,768,957,276	10,557,416,461	12774281014
Bills Payable	14,637,391	7,339,236	11,918,835	16,554,384	65296714
Proposed Dividend Payable	0	0	6,578,947	-	0
Income Tax Liabilities	0	0	296,343	11,006,805	-9650253
Other Liabilities	138,199,043	111,775,797	107,274,226	94,733,620	331786431
Total Liabilities & Capital	**5,494,176,578**	**7,431,593,579**	**9,010,276,184**	**11918311429**	**15026599175**
Assets					
Cash Balance	68,471,908	111,249,095	135,794,991	190,748,210	565641118
Balance with Nepal Rastra Bank			210,552,637	384,844,510	244576115
Balance with Banks/Financial Inst	617,006,003	332,122,274	43,282,117	96,520,231	123624444
Money at Call and Short Notice		90,000,000	145,000,000	372,215,000	55360000
Investment	983,504,403	1,190,271,012	1,394,947,754	1,678,418,415	2138797590
Loans, Advances and Bills Purchas	3,649,008,723	5,584,637,111	6,891,855,426	8,929,013,115	11335087939
Fixed Assets	57,152,223	82,984,150	91,932,957	189,323,741	222000872
Non Banking Assets	0	0	3,592,027	2,394,684	3140779
Other Assets	119,033,318	40,329,937	93,318,276	74,833,523	338370318
Total Assets	**5,494,176,578**	**7,431,593,579**	**9,010,276,185**	**11,918,311,429**	**15026599175**

APPENDIX V

KUMARI BANK LIMITED

Risk Weighted Assets

(Rs. In million)

S. No.	Particulars	2004/05		2005/06		2006/07	
		Asset	RWA	Asset	RWA	Assets	RWA
1	On Balance Sheet Asset	5543	4049	7528	5817	9,126	7,217
2	Off Balance Sheet Items	855	400	1140	475	881	408
	Total Assets	**6398**	**4449**	**8668**	**6292**	**10,007**	**7,625**

2007/08		2008/09	
Asset	RWA	Assets	RWA
12051.73	9401.58	15218.13	12309.29
1414.09	558.32	1881.88	761.08
13465.82	**9959.91**	**17100.01**	**13070.37**

APPENDIX VI

KUMARI BANK LIMITED

Total Capital Fund of KBL for Last Five Years

(In million)

S. No.	*Particulars*	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
1	**Primary Capital**	347.29	359.54	529.68	641.72	858.52	1019.89	1359.03
2	**Supplementary Capital**	16.18	31.37	40.47	63.81	82.46	95.31	523.89
	Total Capital Fund	363.47	390.91	570.15	705.53	940.98	1115.20	1882.92