

CHAPTER - ONE

INTRODUCTION

1.1 Background of the Study

Financial institution can be considered as the catalyst to the economic growth of a country. The development process of a country involves the mobilization and deployment of resources. Development of trade, commerce and industry are the prime requisite for the attainment of the economic political and social goals. To fulfill the purpose of planning, financial functions more often dominate the other functions. There is always lack of finance in underdeveloped economy because natural resources are either underutilized or utilized in non-productive sectors. Likewise, underdeveloped countries are not efficient in mobilization of financial resources.

So in these countries for the rapid development of the economy, there should be proper mobilization of resources. Due to various difficulties or even ignorance of the people, such resources have not been properly utilized. Hoarding could be one of the reasons for this. So, financial institutions play a vital role to encourage thrift and discourage hoardings by mobilizing the resources and removing the habit of hoarding. Banks are the heart of the financial system, they pursue rapid economic growth, developing the banking habit among the people, collecting the small-scattered resources in one bulk and utilizing them in further productive purposes and rendering other valuable services to the country. Thus, this gives the individuals an opportunity to borrow funds against future income, which may improve the economic well-being of the borrower.

In a country like Nepal, banking consciousness is lacking as well as majorities of the people are economically and financially immobile. So, the country is facing great problem to get economic prosperity. Sustainable economic growth requires intermediary channels for efficient allocation of funds. Through intermediary channels such as financial institutions and financial markets, funds should be efficiently channeled from depositors and investors to borrowers in need of funding, for example, to expand their business or buy a house. By mobilizing the scattered idle resources from the savers, intermediary channels pools up the funds in a sizable volume in order to feed the fund requirement of productive sector of the economy.

The role played by financial institutions and financial markets in this process is referred to as the function of financial intermediation. Financial institutions as important financial intermediary channels need to maintain sound business operations. 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 and to remain as the major contributing factors to the growth of the nations economy, they themselves have to have sustainable existence and growth of themselves for which profitability is a must.

Profitability is a deviation of the term profit, which explains the ability to make the profit. Profit is primary a measuring rod of a success of a business enterprises. Profit is essential for the survival of the business. It is the difference between revenue generated and expenses occurred over the period of time but the term profit has several different interpretations. It is a basic test of the performance of any business concern. Without profit a firm could not attract the outside capital. Moreover, the owners and creditors would become concerned about the companys future and attempt to recover their funds. Owner creditors and management pay close attention for boosting profit due to the great importance placed on earning the market place. Profitability is a technical term, used to compare performances analysis of different trading systems or different investments within one system. This is computed for each system or investments being compared over the same period long enough to include significant "ups" and "downs". So analysis of the profitability of the business is very essential which can be used to measure the overall efficiency of the business.

Profitability of the business can be analyzed through the financial analysis which refers to the assessment of the viability and stability of the business. Profitability of a company is usually based on the income statement. A properly conducted profitability analysis provides invaluable evidence concerning the earnings potential of a company and the effectiveness of management. While analyzing profitability different profitability ratios are calculated. Profitability ratios provide a definitive evaluation of the overall effectiveness of management based on the returns generated on sales and investment. The most widely used profitability measurements are profit margin on sales, return-on-investment ratios, and earnings per share.

1.1.1 Banking in Nepal

In the context of Nepal, the history of modern banking system is not very lengthy. This becomes explicit when one compares Nepalese banking system with the banking system of other countries of the world but this doesn't mean that there was the complete absence of banking activities in Nepal in ancient period. The banking in the form of money lending can be traced back in the reign of Gun Kam Dev towards the end of eighth century. According to the historical evidence in 723 Gun Kam Dev, the King of Kathmandu, had borrowed money to rebuild and to rule Kathmandu.

Another historical example as to the pre-modern banking system is found when Rana Prime minister Randip Singh was administering Nepal in 1880 AD. During his regime one financial institution named by 'Tejarath Adda' was established to give loan facilities to the governmental staff and to afford loan facilities to the public in general in the term of 5% interest. 'Tejarath Adda' may be regarded as the father of modern banking institution in Nepal. During the Prime Minister ship of Juddha Shamsheer in 1994 B.S. the 'Tejarath Adda' was replaced by a commercial bank, 'Nepal Bank Ltd.' which marked the beginning of the new era in the history of modern banking in Nepal. Nepal Rastra Bank was established in 2012 B.S. to do the function of a central bank. Rastriya Banijya Bank, as a second commercial bank, was established in 2022 B.S.

After the establishment of Nepal Arab Bank Ltd. in 2041 B.S. under the commercial bank act 2031 B.S., with the allocation of 50% share of Emirates Bank Ltd., Dubai, 20% share of Nepalese financial institutions and 30% share of general public, the new phase of development of the commercial bank started. Nepal Indosuez Bank Ltd. (now Nepal Investment Bank) emerged in 2042 B.S. as the second and Nepal Grindlays Bank Ltd. (now Standard Chartered Bank Nepal Ltd.) established in 2043 B.S. as the third joint venture bank in the country.

After that, there was a gradual increase in the number of joint venture commercial banks in Nepal. Now, there are 31 commercial banks, 87 development banks, 80 finance companies, 21 micro credit development banks, 16 saving and credit cooperatives (limited banking) and 45 NGOs, 25 insurance companies in operation at present, (NRB, List of banks and non-bank financial institution as of Mid-April 2011

A.D.). The open and liberal policy in the financial sector has helped in establishment of commercial and financial institutions in the country.

1.1.2 Commercial Banks

Commercial banks are those banks, which perform all kinds of banking functions accepting deposits, advancing loans, credit creations and agency functions. Their main objective is to earn maximum profit. In Nepal, commercial banks play vital role by providing different facilities and services. They also provide services like collection of bills and cheques, safe keeping of valuables, financial advising etc. To their customers. Thus, the main objective for the establishment of commercial bank is to help the business sector, industrial sector & agricultural sector develop. Hence, this type of bank provides loans to such sectors at a very reasonable interest rate. However, at present a bank performs numerous functions that generate income for the bank. The key success of a commercial bank lies in its ability to raise funds & use it for investing purpose, acting as an intermediary between debtors & creditors.

In order to operate the commercial banks incorporated in Nepal, various laws have been consolidated. Commercial Bank Act 2031 B.S. (1947 A.D.) has also been amended quite several times in accordance to the need. After 1955 A.D., HMG/N & NRB permitted the establishment of other Commercial Banks, Finance Companies, Gramin Bikas Banks, Co-operative Societies & NGOs.

1.1.3 Functions of Commercial Bank

Commercial Bank is said to be the financial wheel of an economic system. Nepal Commercial Bank Act 2063 B.S. has defined commercial bank as stated earlier and it has also emphasized on their functions. The major functions of commercial bank are as follows.

- To accept custody of the funds with or without interest and open fixed account and saving accounts in the name of depositions.
- To supply loans (short-term debt as well as long term debts whatever necessary for trade and commerce) or make investment.
- To help to issue shares and debentures of any company or any others corporate body, guarantee or underwrite such shares or debentures and undertake any agency business but not become a managing agent.

- To conduct transactions in bonds, provisional notes or bills of exchange foreign exchange relating to commerce or corporation as are redeemable within the kingdom.
- To grant overdraft.
- To issue letter of credit, draft and traveler's cheque.
- To remit or transit fund to different place within or outside the kingdom.
- To purchase, sell or accept the securities of Government of Nepal.

Beside this, the commercial bank arranges the amount of foreign exchange required by various organization and travelers. Moreover, foreign trade transactions are facilitated through the issuance of letter of credit. Bank also provides locker facilities to the customers to keep valuable ornaments and documents. Bank also makes payments, pays and collects rent, pay insurance premium, etc. on behalf of its clients. In case of joint venture commercial bank, it issues internationally valid credit cards, ATM cards, telebanking etc. Beside, bank has many more functions and roles in the development of national economy.

1.1.4 Role of Commercial Bank

Commercial bank plays vital role by providing different facilities and services. The important roles of commercial bank are as follows:

- Capital formation
- Monetization of economy
- Price stability
- Control in interest rate
- Availability of credit
- Development of neglected and deprived sectors
- Promotion of saving
- Implementation of monetary policy
- Long term loan
- Transfer of funds

1.2 Brief Introduction of Nepal Bank Limited

Nepal Bank Limited, the first commercial bank of Nepal, was established in 1994 B.S. Nepal Bank Limited is the pioneer financial institution of Nepal. From the very

inception and its creation, Nepal Bank Ltd, came in the form of public and private partnership. Out of 2500 equity shares of Rs.100 face value, 40% was subscribed by the government and the remaining i.e. 60% was offered for the subscription to private investor.

The bank stands its operation with the authorized capital of Rs.10 million with only 10 shareholders when the bank first started. In that era, very few understood or had confidence in this new concept of formal banking. Raising equity shares were not easy and mobilization of deposits even more difficult. This was evident when the bank floated equity shares worth Rs.25,00,000, but could raise only Rs.8,42,000. At present, it has an authorized capital of Rs.2,000 million and the issued capital of Rs.500 million and paid up capital of Rs.380.4 million. The inception of the bank helped to remove dual currency system and circulating the Nepalese currency throughout the country gradually.

During the past 7 decades, the bank experienced many ups and downs, but it has remained the leading financial institution in Nepal. It has helped vastly in by accumulating the scattered money in small amount in each and every nook and corners of the country and granting loans and advances in various ways.

At present the bank is operating 109 branches in 55 districts of the country with 2,976 staffs. The bank plays great role to develop the economic condition of country by providing different facilities and services to their customers like collection of bills and cheques, safe keeping of valuables, financial advising etc.

1.3 Brief Introduction of Rastriya Banijya Bank

Rastriya Banijya Bank (RBB), the fully government owned bank and commonly accredited as the people's Bank in Nepal, established in 1996 B.S., has completed glorious 42 years of it's service. The Bank's slogan "Its Your own Bank" signifies the importance of RBB in the socio-economic development of the country. Since its establishment, RBB has remained an indispensable financial institution of the Nepalese society and economy.

Although RBB ranks No.1 position in terms of total deposits (Rs.50.34 billion) and in the terms of loan/investment portfolio (Rs.38.10 billion), as of 16 July 2007 A.D. The Bank's performance has been irregular in past years necessitating the government of

Nepal to contract a team of 19 banking professionals to restructure the Bank with financial assistance of the World Bank and DFID. The new Management Team, of whom 16 are Chartered Accountants, joined RBB in January, 2003 A.D. under a two year contract and in January 2005 A.D., the Team was extended for an additional year until December, 2007 A.D. Key elements of the Team are expected to be retained for an additional period until the restructuring is sustainable.

RBB has the largest branch network in Nepal, covering 48 branches in the mountainous region, 46 in Terai region, and 19 in the Kathmandu Valley. . The Branch Operations Department is responsible for supervising all 113 branch network. The Internal Audit Department monitors the work of the branches and regional offices. With the corporate office located at Singhadurbar plaza, RBB has a staff of 3,500 and maintains 113 branches located throughout the country enabling the bank to provide banking products and services to all segments of the national economy accompanying the rural and agricultural needs as well as the largest industrial and commercial enterprises.

1.4 Statement of the Problem

Commercial Banks play vital role in economic growth of the country. As being a commercial institution, a commercial bank must make profit out of its operation for its survival and fulfillment of its responsibilities. The major activities of the commercial banks include mobilization of resources, which involves cost, and profitable deployment of the resources, generating income. The excess return income over expenses is the main source of profit to the bank. In case the bank fails to generate sufficient returns on the resources deployed, it makes a drain on the company's resources and country's resources as well.

Till the early 1980s A.D., the financial sector was not opened up for private sector. Only two commercial banks - Rastriya Banijya Bank and Nepal Bank Limited, that are government controlled, are functioning in Nepal. 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. The Nepalese banking industry is no exception. As a result of this policy, large number of banks and financial institutions mushroomed across the country. Both the government owned and privately incorporated banks co-exist in Nepalese economy. However, the performance of the

privately incorporated banks is doing better than those with the government control. Because of the tailor-made product and services provided by the private institutions, they have been able to perform significantly well in the market.

The last five years was also the period of financial sector reform and restructuring. Various programs related to strengthening of the NRB, the restructuring of the Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) and enhancing the capacity of the whole financial sector were implemented during this period. Under the financial sector reform program, human resource development and institutional restructuring of this bank were also carried out to make the regulation and supervision system effective. In addition, the policy of gradually phasing out the non-core activities of the bank has been adopted.

To improve the financial situation of the two government owned banks, NBL and RBB, by restructuring them, the management of these banks was handed over to the foreign consultants. After the foreign consultants took over the management, from 2003/04 to mid- April 2007 A.D., RBB and NBL earned net profit of Rs 4.93 billion and Rs 4 billion respectively. In this period, RBB and NBL recovered Rs 10.64 billion and Rs 8.03 billion of their non-performing loan (NPL) in cash respectively. As a result, NPL, which is taken as an indicator of the financial health of the commercial banks, declined from 12.38 percent in mid-July 2011 to 4.99 percent. The NPL ratios of NBL and RBB, though improving, are still high. (Economic Survey, 2010/011,Part I, P51)

In the period of reform and restructuring, these two banks (NBL and RBB) have gradually improved its performance, recovered drastically from the NPL as well as started increasing the level of net profit steadily. In this context, the comparative profitability analysis of NBL and RBB will provide an insight to the banks performance with respect to profitability.

1.5 Focus of the Study

Every country needs to give emphasis on upliftment of economic conditions. The upliftment of economic conditions of a nation needs mobilization of its own domestic resources through banking. But the financial situation of Nepalese banking sector is in a very poor condition. Apart from other measures required to improve their performance, the banking sector is expected to have better prospects with effective

profit planning and control. So the main focus of this study is the financial performance and profitability analysis of commercial banks in the context of Nepal. Since profit is not only factor to analysis the financial performance, some other factors need to be considered while evaluating the profitability of Nepalese commercial banks. In this study, the profitability analysis of Nepal Bank Ltd. And Rastriya Banijya Bank was made.

1.6 Objective of the Study

The specific objectives of the study are as follows;

1. To analyze the profit and loss trend and growth of the bank over the period.
2. To evaluate the profitability and operating financial efficiency of Nepal Bank Ltd. and Rastriya Banijya Bank
3. To compare and analyze fund based interest income with fee based income of Nepal Bank Ltd. and Rastriya Banijya Bank in light of interest earning assets.
4. To provide suggestions and recommendations for the improvements of the overall profitability of the banks.
5. To provide the information to investor, creditors, stakeholders.

1.7 Significance of the Study

The profitability analysis is an effective managerial evaluation of performance. It studies the effect on the shareholders' return and risk. Consequently, the effect on market value of the share can be verified with profitability analysis. A proper profit planning considerably contributes to improve the overall financial performance and leads the organization toward success. In this study, an attempt was made for drawing the overall picture of the selected commercial banks of Nepal. Data of five fiscal years were presented systematically and analyzed.

- This study will be helpful to management of the selected commercial banks of Nepal to make effective profit planning strategy for future. This also will be valuable for researcher, students who want to investigate into the profitability of the selected commercial banks of Nepal. It will also be important to the bank, investors and stakeholders concerned.

- The study will compel the management of Nepal Bank Ltd. and Astrya Banijya Bank Ltd. for self assessment of what they have done in the past and provides guidance for their future plans and program.
- The study enlightens the shareholders, depositors, creditors, NRB, Tax office etc. about the financial performance of the bank.
- The financial agencies including stock exchanges and stock traders interested in the performance of the bank as well as the customer, depositor and debtors can identify the better bank to deal with in terms of profitability, safety and liquidity.
- Policy makers, the government and NRB at the macro level will be benefited regarding the formulation of further policies to facilitate economic development of the country.

1.8 Limitations of the Study

This study is not free from certain limitations. The major limitations of the study are as follows:

1. The study was concerned with Nepal Bank Ltd. and Rastriya Banijya Bank.
2. The study was only to analyze profitability aspect. It ignored other aspects like assets management, risk management and other activities like investment policy of bank.
3. The whole study was based on the data of 5 fiscal years period from the F.Y. 2062/63 B.S. to 2066/67 B.S. and conclusions were confined to the above period.
4. This study was based on the financial statements like balance sheet, profit and loss account and cash flow statement which provided the quantitative information.
5. This study is mainly based on secondary data.

1.9 Organization of the Study

The study is classified into five different chapters, the first chapter dealt with introduction of the study. It includes introduction, general background, statement of the problem, objectives, significance, limitation of the study and organization of the study.

The second chapter dealt with the review of literature which included review of related books, journals, articles and previous unpublished Master Level Dissertation etc.

The third chapter explained the research methodology used in the study. It included research design, population and sampling, types and source of data, data collection procedure, method of analysis and analytical tools used.

Data presentation and analysis contained in the fourth chapter dealt with presentation of the data collected through various sources and analysis of data as well as major findings of the study.

The fifth is the last chapter of the study covered the summary of the study and the main conclusion drawn from the study and some recommendations as well as suggestions on the basis of the study.

CHAPTER - TWO

REVIEW OF LITERATURE

This chapter is basically concerned with review of literature relevant to the topic profitability analysis. The purpose of reviewing of literature is to develop some expertise in one's area, to see what new contribution has made and to receive some ideas for developing a research design. Thus, previous studies cannot be ignored as they provide the foundation of the present study. This chapter highlights the literature that is available in concerned subject as to my knowledge, research work, and relevant study on this topic, review of journals and articles and review of thesis work performed previously.

2.1 Conceptual Framework

Conceptual framework deals with the theoretical aspects of working profit, profitability, liquidity, theory of profit, need for profit, tradeoff between profitability and liquidity, financial statement of commercial bank, profit and loss a/c, income statement etc.

2.1.1 Profit & Profitability

Generally profit is defined as the excess of revenue over cost. In other words, profit is the residual income, which is equal to sale proceeds minus costs. Profit is the resources left to the firm for future growth and expansion or reward to be distributed to the entrepreneurship in the form of dividends etc. In a simple term, profits mean the

residual balance of earning expected to be available with the firm that is obtained after deducting entire expenses, costs, charges and provision from total revenue of a period of time.

It is lifeblood of each type of business. Every business organization should earn profits to survive and grow over the long period of time. Obviously, organization will have no future if it is unable to make reasonable profit from its operation. As a matter of fact, the overall efficiency of an organization is reflected in its profits. Profits to the managements are the test of efficiency and a measurement of control: to the owners, a measure of worth of their investment; to the creditors, the margin of safety to the employees; a source of fringe benefits to the Government, a measure of fixed paying capacity and the basis of legislative action; to customers, a hint to demand for better quality and price cuts; to a bank, less burden some source if finance existence and finally to the country, profit are index of economic progress. Thus, if an organization fails to make profit, capital invested erodes and if this situation prolongs it ultimately cease to exist.

Profit has been universally recognized and accepted as a measure of business efficiency. Thus, the larger the profits, the more efficiency and profitable the business organization is deemed to be. This criterion has the greater advantage that it provides a common standard of measuring the efficiency if different bank. Regarding this, Laxmi Narayan clearly states, “Profit is the simple, convenient and the most popular yardstick of juggling the efficiency of private and public business enterprises. Profit helps in judging the overall efficiency and is easy to calculate. Even through profit maximization, unlike private enterprise, is not objective of public enterprises, yet profit services as a well accepted criterion for the judging the overall efficiency of public enterprises too.” (Narayan, 1980 A.D., P.260).

The profit is the ultimate measure of effectiveness. A profitable company is likely to offer not only security of employment but also promotion prospects, job opportunities and the intense personnel motivation that comes from being associated with success. John Argent observes, “Profit is the barometer of the success of business. It is, indeed, a magic eye that mirrors all aspects of entire business organizations including the quality output.” (Argent, 1968 A.D., P.34)

The term 'profitability' is composed of two words profit and ability. It reflects the capacity of a business organization to earn profit. It is also referred to as earning capacity or earning power of the concern investment. Thus, the term profitability may be taken as the ability to earn profit. According to Howard and Upton, "The word profitability may be defined as the ability of a given investment to earn return on its use."

It may be mentioned that the term 'profitability' is distinguished from the word profit. Profit refers to the absolute quantum of profit whereas profitability alludes to the ability to earn profit. The former is an absolute measure in itself while the latter is a relative one. According to W.M. Harper, the profitability is a relative measure. It indicates the most profitable alternative. The profit, on the other hand is an absolute measure. It indicates the overall amount of profit earned by transaction. As the profitability is the relative measure, it is used to judge the degree of operational efficiency of management. Furthermore, it is essentially employed to measure the relative efficiency of different trading systems or different investments within one system. In the profitability analysis, the profit making ability of an organization is measured in terms of size of investment in it or its sales volume. Such an analysis of profitability reveals how particularly such a position stand as a result of transactions made during the year. It is particularly interesting to the suppliers of funds who can evaluate their investment and take necessary decision thereon.

The state of profitability is a variable thing like the temperature and humidity of a day. The determination of profitability by an accountant or analyst is very much similar to temperature reading and study of humidity by a meteorologist. A meteorologist records the weather on daily basis with an intention to forecast its future prospects. Likewise, an analysis records yearly profit of a bank with a view to make prediction of the future prospects.

The purpose of profitability measurement is to see whether a bank has effectively used its resources to achieve its profitability objectives. The profitability objectives refer not to the maximum profit the business can produce but to the minimum it must produce. The minimum profit is the profit at the minimum rate required for the desired type of investment in the bank. However, there mustnt be enough profit to yield the capital in the market rate of return on money, which is already sunk in

business, but also to provide additional capital needed to cover the cost of staying in business.

2.1.2 Meaning of Profit

Profit, from Latin means “to make progress”. It is defined in various ways. In economics, profit is the concept of reward of the entrepreneur for risk taking and management. In business operations, it is the gain from manufacturing, merchandising and selling operations after all expenses are met. Since profit is added to net worth, it may be measured by the increase in net worth over that of the previous accounting period. The amount of concerns profit thus may be determined not only through the profit and loss statement but also by the comparison of the earned surplus or net worth in the balance sheet which, however, is the residue of profits after dividends and any other appropriations and does not reveal details of sources of income and expenses, which are found in profit and loss account. In speculative transactions, profit is the excess of the net selling price over the costs (including all charges) of the security or commodities traded in. (Woelfel, 1999 A.D., P.540)

Profit is a motivating factor behind many managerial activities. Much has been written about the role (as opposed to the method of calculation) of profit. Profit plays three roles in the capitalistic society. Profit is the financial reward of risk taking; profit is the financial reward for having monopoly power; profit is the financial reward for the efficient management. The promise of profit provides a strong incentive to owners and managers to act efficiently. "Profit is essential for every enterprise to survive in the long run as well as to maintain capital adequacy through retained earning. It is also necessary to accept market for both debts and equity to provide funds for increased assistance to the productive sectors." (Robinson, 1951 A.D., P.21-22)

Account and economics are two disciplines in which profit is viewed in different concept. Pure economic profit is the increase in wealth that an investor has from making an investment, taking into consideration all costs associated with that investment including the opportunity cost of capital. Accounting profit is the difference between retail sales price and the costs of manufacture. A key difficulty in measuring either definition of profit is in defining costs. Accounting profit may be positive even in competitive equilibrium when pure economic profits are zero.

In economics, a firm is said to be making an economic profit when its revenue exceeds the total (opportunity) cost of its inputs. According to Adam Smith (The father of economics), “Profit is the sum remaining after the payment of all wages (wage) in economics includes payments to officers of corporations, to proprietors, to partners and to farmers, as well as to what we today term (labor), and rent on the unimproved value of land, as the return to capital.”

Profit in the accounting sense is the net figure of difference between all types of measurable revenues and all measurable costs. In accounting, profit is expressed only on explicit and measurable accounting terms and on the book value basis. However, in economics, profit is measured in the realizable terms. “Profit in the accounting sense is the excess of revenue receipts over the costs incurred in producing this revenue. This concept of profit is also known as residual concept. But, in economics, both implicit and explicit costs are deducted from total sales revenue in determining profits.” (Cauvery, 1997 A.D., P.122-123) As a matter of fact over the years there has been quite an evolution as to what particular items should be deducted from gross income to arrive at an “accounting” profit. Thus, “accounting” profit is a concept of man-made legislation, of the courts, of the Security of Exchange Commission, of accounting organizations; a concept, which has always been in evolution. “Economic” profit on the other hand, is a concept of a natural law of economics, and like the law of gravitation has remained and will remain unchanged over the ages. However, the profit under discussion is concerned with accounting profit, which in a simple language, is the positive and fruitful difference between two revenues and total expenses over a period of time, Multiple meaning of the word "profits" have always been troublesome. Accountants have made energetic efforts in recent years to discard the word for that purpose and to refer to the conventional concept as business income a natural term at avoids any overlap with economic theory. The most important points of difference between the economists and accountants are as follows:

- The inclusiveness of costs i.e. what should be subtracted from revenue to get profit.
- Meaning of depreciation
- The treatment of capital gains and losses
- The price level basis of valuation of assets and liabilities

- Although there may be arguments in favor and against profit generating almost all firms require earning it. Their rate of earning differs from firm to firm and time to time.

2.1.3 Theories of Profit

Economists have propounded several theories of profits to explain profits of entrepreneurs. Most of the theories are centered on the controversy about the role of the entrepreneur. In the following section some of the fundamental theories of profit have reviewed in brief.

1. **Theory of Risk and Uncertainty Bearing:-** It was F.B. Hawley who first developed the theory of risk bearing and concluded that profit is a reward of the entrepreneurs for bearing risks. But, the theory was picked up by Professor F.H. Knight who divided risk into insurable risk and uncertainties. Thus according to Knight, profit is a reward to the entrepreneur for his non-transferable function of bearing non-insurable risk and uncertainties.
2. **Dynamic Theory of Profit:-** This theory was propounded by J.B. Clark. According to this theory, 'dynamic changes' in the economy are the basic causes of emergence of profits. There is no profit in the static economy as no changes take place. In a dynamic economy there are constant changes in population, capital, methods of production and industrial set up. These changes multiply wants of consumers, which earn profits to the entrepreneur.
3. **Innovation theory of profit:-** Joseph Schumpeter singled out 'innovation' from the dynamic theory of profits and developed economy and innovation in the changing world gives rise to profits. In his views, the entrepreneur plays an important role of introducing innovation in an economy and profits are the rewards for his role as an innovator. The innovation could be changes or techniques that reduces cost of production or increases demand for the product.

2.1.4 Need For Profit

Profit is necessary for the following reasons:

1. **Measurement of Performance:-** Profit is only factor to measure the management efficiency, productivity and performance. Profit is the most

widely used yardstick to see what really is to be achieved and where the firm is to go in the future.

2. **Premium to cover costs of staying in Business:-** Business environment is full of risks and uncertainties. To grasp the globally changing technologies, to stay in the market uncertainties, to replace and acquire assets and enhancing business scope etc. require a profit margin.
3. **Ensuring Supply of Future Capital:-** Profit is necessary to plough back in the investments like innovations, business expansion and self-financing. It also attracts investors for further investment.
4. **Return to the investors:-** Shareholders provide equity capital to the business because they expect the entity will provide return to their funds at least equal or above market rate of return. To maintain the shareholders expectation, it is most important that a firm should earn sufficient profit so that it can distribute dividends.

2.1.5 Profitability of Commercial Banks

Banks today are under great pressure to perform to meet the objectives of their stockholders, employees, depositors, and borrowing customers, while somehow keeping government regulators satisfied that the banks policies, loans, and investments are sound.” (Rose, 1991 A.D, P.155) The majority of the needs of the stakeholders are related with the profitability of the banks. For example, in case the bank earns profits, the investors get dividends, employees get bonus, government gets benefits in forms of taxes etc. Thus, the foremost objective of the banks is the profit maximization. As other types of business entity, commercial banks are also inspired by the profit.

The major source of funds of the bank is the public deposit. Commercial banks invest public deposits on those sectors where they can attain the maximum income or higher rate of return as the bank is liable to pay certain rate of interest to the public in their deposit. Hence the investment or granting of loan and advance by them are highly influenced by profit margin. Generally the profit of commercial bank depends upon the interest rate of the bank, volume of loan provided, time period of loan, and nature of investment in different securities. However, the bank at the same time has to ensure that their investment is safe from default.

Aspiration of profit to commercial banks seem reasonable as the bank has to cover all the expenses as interest to the depositors and other administrative costs, they should make payment in the form of dividend to the shareholders who contributed to build up the banks capital and keep aside for the provision and reserves. For this the bank calculates the cost of fund and likely return, if the spread is enough irrespective of risk involved and absorbs its liquidity obligations, it will go ahead for investment.

A successful bank is one who invests most of its funds in different earning asset standing safely from the problem of liquidity i.e. keeping cash reserve to meet day-to-day requirements of the depositors. After all the commercial bank is simply a business corporation organized for the purpose of maximizing the value of the shareholders wealth invested in the firm at an acceptable level of risk. So bank has to make a crucial decision regarding a mixture of liquidity and profitability cause lower the liquidity higher the profitability and higher the liquidity lower the profitability and both are equally important, banks cannot afford to ignore any of them.

2.1.6 Liquidity

In banking, liquidity is the ability to meet obligations when they come due without incurring unacceptable losses. In other words, the capacity of bank to pay cash against any upcoming obligations is called liquidity. Managing liquidity is a daily process requiring bankers to monitor and project cash flows to ensure adequate liquidity is maintained. Maintaining a balance between short-term assets and short-term liabilities is critical as the commercial banks have liability to the deposits collected and they immediately should give it in the time when the depositors asked. Banking is the business of financial dealing whose major source of financing is the public deposit. Deposit accounts represent the primary funding in traditional commercial banks, and the loan portfolio represents the primary asset. The investment portfolio represents a smaller portion of assets, and serves as the primary source of liquidity. Investment securities can be liquidated to satisfy deposit withdrawals and increased loan demand. Banks have several additional options for generating liquidity, such as selling loans, borrowing from other banks, borrowing from a Central Bank and raising additional capital. Most banks are subject to legally-mandated reserve requirements intended to help banks avoid a liquidity crisis.

A large part of bank deposits are withdrawn on demand and hence the bank must be prepared with sufficient degree of liquidity of its assets. Once the confidence is lost in depositors eye, they may withdraw all the deposits within the brief period when the bank is unable to generate adequate cash without incurring substantial financial losses since most of assets of the bank are attached in the loan and advances. Even the best bank can hardly survive in such a situation. Confidence depends upon the ability of bank to meet the readily demand for cash made by customers. Commercial banks maintain liquidity in all or any forms of following:

1. Cash in self vault and in other banks-specially in NRB (First Line of Defense).
2. Overnight placements, moony at call or short notice or any other very short term placements (Second Line Defense).
3. Investment in marketable securities like government securities, which can be easily sold and readily convertible into cash (Third line of Defense,Dahal & Dahal, 1996 A.D., P.41).

2.1.7 Trade off between Profitability and Liquidity

Profitability of commercial banks is highly dependant on the optimum utilization of available resources and invests the deposit collected in safe and profit generating assets like loan, and advances and investments. However, banks can not ignore the necessity of maintaining a portion of the deposits in their cash vault, or in the immediate approach like in the account of central banks or in any highly liquid assets like government treasury bills, other government bonds that can be easily sellable without loosing and further value.

A sound liquidity position of the bank satisfies the demand of the deposit holder, which maintains the goodwill of the banks. Since, banks are faithfully considered as the last resort for monetary needs of the public, the incapability of fulfilling their demands will loose the faith of the depositors/ public. Once any signaling effect is negatively attached in the perception of the depositors, they tend to doubt in the banks dependability and that can consequent in the bank run. Further, banks must maintain the certain portion of deposits in the vault and in NRB.

However, liquid assets are almost all idle. They do not generate any profits. The cash in the vault meets any upcoming obligations immediately but banks will not be able to

generate any returns in such a case. Further, banks do not get any interests or other returns in the accounts maintained in the central banks, NRB in our case.

Profitability and liquidity maintain a highly negative co-relation. Since both are equally important for commercial banks, banks cannot ignore any of them. So, the crucial decision for the management of the banks is to trade-off between them. The more liquidity the less will be the profitability and vice versa.

2.1.8 Financial Statement of a Commercial Bank

The financial statement of a commercial bank includes balance sheet, profit and loss account, cash flow statement and other relevant disclosures. Merely presenting the financial statement does not satisfy the aim of the study as financial statements are just of financial information to this analysis. Thus, the focus of the study will go to the analysis of the financial statements of the bank, especially on profitability of the bank. This will make some attempts to identify the financial position of the bank and to give necessary suggestions thereto.

❖ Balance sheet

Balance sheet is not an account but it is a statement of assets and liabilities of business enterprises at the given date. It is a statement summarizing the financial position of the firm. The balance sheet is prepared at the end of accounting period. Bank's balance sheet is composed of shareholder's fund, borrowings, debentures and other liabilities and provision on the liabilities side and cash and bank balance, stock, debtors, loan and advances, branch accounts, investment and fixed assets on the assets side. The brief explanation on accounting heads of the balance sheet is provided below:

A. Capital and Liabilities Side

1. **Share Capital:-** The amount of paid up capital of the bank should be mentioned under this head. The amount received against calls made should be credited in this share capital account.
2. **Reserves and Funds:-** This accounting head shall contain the amount of reserves appropriated from profit, as well as created through any other process and accumulated profit. Generally, this account shall be credited by debit to profit & loss appropriation account and utilization of such reserves shall be

debited to the concerned reserve and fund accounts. The following account heads fall under this heading.

- **General reserve fund:-** This is a stationary reserve. Under this head, only the amount appropriated from profit as per Commercial Banking act shall be credited. Currently, 20% of the net profit should be transferred to this account. Distribution of dividend by utilizing this fund is restricted and approval of Nepal Rastra Bank shall be obtained for the use of this fund for any other purposes. (NRB, 2062 B.S., P.29).
 - **Capital Reserve Fund:-** Profit on revaluation of assets and capital assets received in grant from other shall be accounted under this head.
 - **Share Premium:-** This represents the amount of money collected on issue of shares in excess of its face value. The outstanding amount in this account shall not be considered eligible for distribution of dividends. However, it may be used for issue of bonus shares under approval of Nepal Rastra Bank.
 - **Other Reserves:-** Funds and reserves, other than those mentioned above shall be included under this head.
 - **Accumulated Profit/Loss:-** Under this head, the balance of the accumulated profit or loss as per shown in the Profit and Loss Appropriation account shall be shown.
3. **Borrowing:-** The borrowed funds of the bank shall be disclosed under this head. Bank borrowings, placements, overnight placements, borrowing from central banks, foreign banks falls under this heading.
 4. **Deposits:-** The principal liability of a commercial bank is its deposits collected from general public, business and government agencies. Deposits received from the depositors as well as the interest payable on the deposits shall be credited to the account of the depositors. The deposit liabilities accepted by the bank shall be exhibited under this head.
 5. **Bills Payable:-** Under this head, the outstanding amounts pertaining to draft, telex transfer. Payment orders issued by one branch to another branch of the bank, as well as bills drawn on the bank by other local and foreign banks shall be accounted.
 6. **Other Liabilities:-** Other than the capital and liabilities mentioned above, all other liabilities of whatsoever nature shall be included under this heading.

Any other accounting heads that could not be exhibited elsewhere may be included under this head as required.

B. Assets Side

1. **Cash Balance:-** The most liquid assets held by any commercial bank is cash. This heading shall be used for showing the total amount of cash-in-vault, consisting of local and foreign currency. Since cash is the most liquid asset, it is used to cover deposit withdrawals, handle credit demands from customers, and to meet all regular and emergency expenses.
2. **Balance with banks:-** The balances of amounts in non-interest bearing accounts maintained by the bank with Nepal Rastra Bank as well as with other local and foreign banks shall be exhibited under this head.
3. **Money at call or short notice:-** The amount of all interest bearing placement with other banks with maturity of less than 7 days with stipulated condition for payment at call or at short notice (48 hours) shall be exhibited under this head.
4. **Investments:-** As a line of defense to meet demands for cash and serve as a quick source of funds, banks invest certain proportion of funds in the liquid assets. These typically include holding of shorter-term government bonds like treasury bills, development bonds etc. and other securities purchased in the open market and readily convertible into cash in the financial market. Other forms of investment include investment in the shares and debentures of other companies. These investments are mainly made for their ability to generate income. The investments are to be valued at market price or cost price whichever is lower.

Commercial banks invest the funds to the shares, debenture and bond of the other company. They generally do so when there is excess of funds than required and there are no alternative opportunities to make investment in the profitable sector. Now-a- days the commercial banks of Nepal have purchased share and debenture of regional development bank, NIDC and other development banks etc. these type are mainly held for their income-generating power and for other advantage like tax shelter etc. The investments are to be valued at market price or cost price whichever is lower.

5. **Loan Advances and Bill Purchased:-** This is a primary source of income and most profitable asset to a bank. The sum outstanding of all loans and advances extended to the customers as well as bills purchased and discounted bills less the amount of provisions made shall be exhibited. However, the loans extended to the staffs shall not be disclosed under this head and should be shown under other assets.
6. **Fixed Assets:-** All assets of long-term nature owned by the bank (land & buildings, machinery, vehicles, office equipments etc) shall be accounted under this head and be exhibited in the balance sheet at written down value after deducting the depreciation from the total cost.
7. **Other Assets:-** The heading shall be used for accounting of any other tangible or intangible assets, not mentioned above. Stationery stock, accrued interest on investment, accrued on loan, sundry debtors, assets in transit, non-banking assets, expenses not written off etc.

❖ **Profit & Loss Account**

The bank's profit & loss account is composed of interest, administrative expenses, provision for possible losses, bonus provision, tax provision, investment provision, etc. as expenses and interest, discount, commission, charges etc, as incomes. The summary of the heads of account in the profit and loss account in the profit and loss account of a commercial bank is given below.

A. Expenses Side

1. **Interest Expenses:-** Payment of interest on deposits accepted by the bank and on the borrowings is shown under this head. Interest is regularly expensed off for various deposits; inter bank borrowings, central bank borrowings and other external obligations.
2. **Employee expenses:-** All expenses related to the employees of the bank for the specific period shall be included under this head. Expenses included are salary, allowances, pension, gratuity, training expenses, uniform expenses etc.
3. **Office Overhead Expenses:-** All expenses related to the office overhead of the bank during the specific period shall be included under this head. Some of the expenses under this head are house rent, insurance, audit expenses, newspapers and magazines, advertisement etc.

4. **Exchange loss:-** The negative balance in exchange fluctuation gain/loss account shall be exhibited under this head.
5. **Non-Operating Expenses:-**These are the expenses that have no direct relationship with the operation of banking transaction. Some of the examples are loss on sale of investment and loss on sale of assets.
6. **Bad debts written off:-** Where the bank has written off loans on account of being unrecoverable, such written off amount to the extent not covered by loan loss provision shall be charged to profit and loss account under this head.
7. **Provision for Possible Loss:-** This is one of the most important heads of account related to the profitability of the bank. As per the directive of the Nepal Rastra Bank, the banks are required to make provision for loan losses. The provisions are to be made on the basis of the expiry dates on the principal amount of the loans and advances. As per the directive the provisions to be made is as follows.

| Category | Provision required | Criteria |
|-------------|--------------------|---------------------------|
| Pass | 1% | due upto 3 months |
| Substandard | 25% | due upto 3 - 9 months |
| Doubtful | 50% | due for 9 months - 2 year |
| Loss | 100% | due for more than 2 years |

However, in case of bills purchased items, provision is to be provided at 1% if it stands due for 90 days and in case it remains due for more than 90 days 100% provision is required. (NRB, 2062 A.D, 36)

8. **Provision Staff Bonus:-** The amount of bonus set aside for payment to staffs is disclosed under this head. As per the Nepal Rastra Bank directives the bank is entitled to make provision for the staff bonus at 10% on the net profit after adjustment for loan loss provision.
9. **Provision for Income Tax:-** The amount of income tax on net taxable profit for the period shall be determined through this head. Taxable profit has to be determined considering the allowable and disallowable expenses as per the prevailing income tax act and finance bill.

10. **Net Profit:-** This figure represents the excess of total income over total expenses of the bank during the period.

B Income side

1. **Interest Income:-** This is the primary source of income of any commercial bank. Under this head the interest received from the customers on behalf of the loans and advances and on the investments of the bank is exhibited. However, Nepal Rastra Bank has established several criteria for the recognition as interest income.

- The interest income should be recognized on cash basis.
- The amount of interest accrued but not received, have to be credited to the interest suspense account.
- In case of the interest accrued is realized within one month from the date of closure of fiscal year, such amount may be recognized in the income of the earlier fiscal year.
- The interest on loans and advances should not be recovered by overdrawing the borrower's current account or where overdraft limit has been extended by overdrawing such limit.

2. **Commission and Discount:-** The total amount of commission, service charges and discount earned by the bank from the transactions during the period shall be exhibited under this head. Some examples are commission on issue of guarantees, commission on issuance of L/C etc.

3. **Exchange Gain:-** Banks deal with foreign currencies. Foreign currencies are remitted outwards and inward. Banks involve in trade while dealing this transaction. Banks make trading gain while selling and buying foreign currency stocks for their trade as well as banks gain from revaluation the stock whenever the exchange rates are in their favor. Both the trading gain and revaluation gain are exhibited under this head.

4. **Non-Operating Income:-** Income or profit that has no direct relationship with the operation of banking transaction has to be recognized into profit and loss account under this head. These incomes are casual source of income and are not from regular course of business but from other sources where the business entity can be involved legally as prescribed by the directives of related government authority. Nepalese commercial banks are allowed to invest in the

share of another entity like other commercial banks, rural development banks, financial institution and other government institutions. The investing bank receives dividend income and other income.

5. **Other income:-** Receipts of all other income not specifically provided under the income heads as above shall be booked under this head e.g. rental income of safe deposit boxes, income from telex, service charge, renewal charges etc.
6. **Net loss:-** The figure represents the excess of total expenses over total income of the bank during the period.

2.2 Review of Journals and Articles

Bajracharya (2047 B.S.), “*Rastriya Banijya Bank: A comparative performance study*” published in Rajat Jayanti Smarika, RBB, 2047 states, Despite the growth of commercial banks is not consistent, low growth of local banks and JVBs. The mobilization of rural savings is better in case of local banks. Credit expansion is decreased in local banks than JVBs. Credit deposit ratio is better in JVBs. Non performing loan is greater in local banks and profitability is greater in JVBs. Local banks are forced to open and continue their branches at rural areas therefore the competition among the local banks and JVBs is not healthy.

Dhungana (2053 B.S.), “*Problem encountered by the Nepalese financial system*”, NRB Samachar, Annual Publication, 2053 B.S., highlighted the major weakness of the banking sector, mainly of RBB and NBL. According to the writer, the financial sector is dominated by banking sector and which in turn, is dominated by two old government owned banks. These two banks constitute the largest component of total deposit of banking system. These two banks suffer from various problems, which results the unsound health of the banking industry of Nepal. The major weaknesses of these banks are.

- Concentration of loan to limited borrowers
- Large number of branches with limited transaction
- Inefficient staff and absence of manpower development and planning
- Poor supervision and follow up after credit disbursement
- Insufficient records and bookkeeping
- No application of modern banking equipments in bank branches

- To improve the productivity and quality of banking sector the authorities have created a new environment given raise to JVBs.

Poudel (2058 B.S.), “*Financial statement Analysis: An Approach to Evaluate Bank’s Performance*” NRB Samachar, Annual Publication, 2053 B.S., pointed on the importance of balance sheet and profit & loss account. The banks balance sheet is composed of financial claims as liabilities in the form of deposits and as assets in the form of loans. Interest received on loans and investments are the major components of income. Fees, commissions, discounts and service charges are other source of income. According to him the principle objective of analyzing financial statements are to identify liquidity, profitability and solvency of the bank. The other factors to be considered in analyzing the financial statements of banks are to assess to the capital adequacy ratio and liquidity position.

Demirgüç-Kunt and Harry Huizinga (1999 A.D.) in the journal, World Bank Policy Research Working Paper No. 1900. under the topic “*Determinants of Commercial Bank Interest Margins and Profitability: Some International Evidence*”, says that differences in interest margins and bank profitability reflect a variety of determinants: bank characteristics, macroeconomic conditions, explicit and implicit bank taxation, deposit insurance regulation, overall financial structure, and underlying legal and institutional indicators. A larger ratio of bank assets to gross domestic product and a lower market concentration ratio lead to lower margins and profits, controlling for differences in bank activity, leverage, and the macroeconomic environment. Foreign banks have higher margins and profits than domestic banks in developing countries, while the opposite holds in industrial countries. Also, there is evidence that the corporate tax burden is fully passed onto bank customers, while higher reserve requirements are not, especially in developing countries.

In the report and recommendation of the president of Asian Development Bank to the board of directors on a Proposed loan and technical assistance grant to the Nepal for the corporate and financial governance project published in 2000 A.D. clearly discussed on the financial difficulties of State-Owned Financial Institutions. The report states that all state-owned financial intermediaries face financial difficulties, although the extent of the problems is difficult to assess in the absence of reliable financial information. The poor performance can be attributed to deficiencies in

governance, lack of commercial orientation and managerial skills, as well as inadequate policies. Financial record keeping and auditing are not of international standards. Internal monitoring, evaluation, and supervision are weak, as is the system of appraisal and follow-up on loans. The problems are most acute for the two government-controlled commercial banks, RBB and NBL, which dominate the banking system with about 70 percent of total assets. A recent international audit indicates that both banks suffer serious, critical shortfalls in all key areas, and that both are technically insolvent, with negative worth estimated at up to 7 percent of GDP. Although deposits are presumed to be implicitly guaranteed by the Government, a systemic banking or fiscal crisis could emerge if problems remain unaddressed. World Bank assistance in this area has been requested.

Dhungana (2005 A.D.), “Financial sector reform program (FSRP) in Nepal” RBB Newsletter Vol 6. September 2005, has concluded that Nepalese financial sector is being strengthened under the financial reform program. The expediting of the liberalization and privatization processes within the financial reform programs has succeeded to place the private sector rather than the government in charge of determining who gets credit and at what price. The FSRP has also been able to establish the system of prudential regulation and supervision design to restrain the private actors so that we can reasonably sure that their decisions will also be broadly in the general social interest. Many Acts are being promulgated to obtain and maintain a strong legal environment required for the system. It is also equally and important that the enforcement aspect in all respects plays a vital role, which is continuously improving. Within this reform program the two largest commercial banks NBL and RBB are being restructured, institutional building program are being lunched, greater autonomy and responsibility have been provided to the central bank, entry and exit norms are being prepared, laws are being prepared, laws are being prepared for the banking sector. These all are positive aspects to boost up the system. It has been widely recognized that less government involvement in the financial sector, a strong central bank, a strong banking environment, adequate banking services to the poor, adequate legal frame work and enforcement of law are six basic pillars for the development of the healthy financial architecture. The government has launched this program to eliminate financial problems. Except some aspects, the progress made within the FSRP seems are satisfactory.

Panthi (2005 A.D.), *“The importance of human resource management”*, RBB Newsletter Vol 6. September 2005, highlights that the human resources management always plays key role in a commercial bank like RBB where the banking services are only made by human skills. If the size of the employees is suitable and skillful, the optimum objectives of the bank will be nearer to achievement. The objectives of the profitability and the liquidity of the bank may be fulfilled if and only if its human resources are perfect in and suitable in quality. So, the selecting process of human resources should go through the straight way of identifying workforce requirement, Recruiting-Selecting-Placement-Promotion-Appraising-Training and Retirement.

An article published in **Kantipur Daily, July 06, 2007 A.D.**, *“Results of FSR are Encouraging: NRB Governor”* the governor of Nepal Rastra Bank (NRB) Bijaynath Bhattarai has said that the achievements of financial sector reform programs till now are encouraging. He informed that reforms in Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL) have resulted in profits there. Till the end of 2006, NBL has earned operating profit of Rs 3.84 billion while RBB has earned operating profit of Rs 5.3 billion. Government had invited foreign management to look after these financially bankrupt state-owned banks. They were running in loss before the foreign management took over. Bhattarai said data will help better understand the importance of reforms. On Wednesday, senior political leaders had said the reforms were unsuccessful and said the foreign management should not be renewed. In the four year period, Rs 824.3 million and Rs 480 million have been spent on foreign management group in NBL and RBB, respectively.

An article published in **New Business Age, August 2008 A.D.**, *“Banks & Profit”*, highlights about the increase in reserve and surplus of all the banks with the exception of Nepal SBI, Global and NB Bank. Overall deposits in the banking sector have increased by 25 percent with increase in deposits of all the banks except Lumbini. Government banks such as RBB, NBL and ADB have the highest deposits followed by Nepal Investment Bank Ltd. (NIBL), Himalayan Bank Ltd. (HBL), Nabil Bank and SCBN. NIBL has surpassed the deposit of ADB in the current fiscal year 2007-08. Deposits in Laxmi, Siddhartha, Global and Citizens Banks have substantially increased by 43 percent, 55 percent, 142 percent and 295 percent respectively. There has been an increase in overall interest income because of overall increase in loans and advances. ADB, RBB, NBL, Nabil, NIBL, and HBL have the highest interest

income. Among these banks, NBL has lowest loans and advances but have highest interest income. NBL, RBB, and NB Bank have negative capital adequacy ratio (CAR) but it has improved compared to last year in NBL and RBB while it deteriorated in NB Bank. NPL to total loan ratio of all these banks has reduced. Laxmi, Siddhartha, Everest, Nabil, NIC, and SCBNL have the lowest NPL to total loan ratio while NB Bank, RBB, NCC Bank and Lumbini Bank have the highest ratio.

An article published in **New Business Age, September 2009 A.D.** entitled “*All Banks in Profit*”, focused that in general all banks for the fiscal year 2003-2004 A.D. are bullish in their performance. During the year all the banks were in profit but in the previous year two commercial bank, NBL and RBB were in a loss of 202 million and 3246 million respectively. NBL, RBB, Siddhartha Bank, Laxmi Bank, Kumari Bank and Machapuchhre Bank have increased their operating profit in substantial amount. Also the old banks with huge losses in the previous years NBL and RBB have succeeded to improve their performance.

2.3 Review of Previous Thesis

Khadgi (2006), conducted the study on “*Investment Policy Analysis of NABIL Bank Ltd.*” and submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies.

The main objectives of the study are:

- To study the resource mobilization and investment policy of NABIL Bank.
- To find out the relationship between deposit and investment trends of the bank.
- To evaluate profitability, risk, liquidity and assets management of the bank.
- To find out the current and future investing strategy of NABIL Bank.
- To provide suggestions to improve investment policy and performance of NABIL Bank based on the findings of the study.

The study concluded that,

- The current ratio of the bank over five years is 0.90 times on an average during the study period. Although the current ratio 2:1 is considered as standard, acceptability of the value depends upon the industry. For the banks,

a current ratio of 1:1 or above would be considered acceptable. Therefore the liquidity position of NABIL bank is below the normal level. The return on assets ratios has a fluctuating trend with mean ratio of 2.02% on an average. The C.V. of 32.67% shows that the ratio seems inconsistent and variable during the study period.

- The return on loan and advances ratios is in increasing trend with the mean value of 4.34% in an average. The ratio seems to be less variable and consistent.
- The interest earned to total assets ratios is in decreasing with mean of 6.47% in an average. The ratio during the study period seems to be consistent and less variable.
- The interest earned to total outside assets ratio of found to be 8.37% in an average during the study period. The C.V. of 23.17% indicates that the ratios are consistent. The analysis shows that the NABIL Bank has average 8.37% income margin from outside assets. If the margin is higher than cost of fund, the bank will be on profit.
- The interest paid to working fund ratios is in decreasing trend with 2.54% in an average during the study period. The ratio seems to be consistent and less variable.

The study recommends that:

- Current ratio shows the banks ability to meet the current obligations. Generally 2:1 is considered as the standard current ratio but for the banks and financial institutions, 1:1 is considered as the standard current ratio. The current ratio of NABIL. Bank seems to be less than 1, so it is suggested to increase the banks current ratio as soon as possible as it could impose bad impact on depositors. Once the depositors confidence is lost, it hard to bring it back.
- The mean credit deposits ratio of NABIL Bank during the study period is 54.72% which seems to be lesser than the standard ratio. The 70% of CD ratio is considered as standard ratio, so it suggestion than NABIL should increase the CD ratio.

- The mean of loan and advances to working fund ratio is only 46.41% which shows that NABIL Bank is not efficient using its working funds. So it is suggested to lend more in the productive sectors to get income from the working fund.
- The bank has very nominal investment on shares and debentures of other companies. The mean investment is 0.12% during the study period. Banks may invest in shares and securities of any one organized institution not exceeding 10% of the paid up capital of such organized institution. Any amount of investment made in excess of this limit, for the purpose of calculation of the capital fund, shall be deducted from the core capital fund. So NABIL Bank is suggested to invest more amount in shares and debentures of other companies so it can get either dividend from the existing shares and capital gain after selling those shares and debentures in capital market after holding for some time.
- The growth rate of the deposits is very low, so it is suggested to attract depositors through variety of deposit schemes and facilities like cumulative deposit scheme, prize bonds scheme, gift cheques scheme, recurring deposit scheme, monthly interest scheme etc.
- The trend of investment of NABIL Bank is increasing in satisfactory level. NABIL Bank is recommended to keep wide vision in investment while utilizing their resources and invest in different areas.

Sapkota (2007), completed the study “*Profitability Benchmarking of NB Bank*” and submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies. The main objectives of the study are as follows.

- To examine the profitability situation of the JV bank industry as a whole and sample banks.
- To analyze the profitability trend of NB Bank and the JV bank industry over the last five years.
- To ascertain the comparative position of profitability of NB Bank with respect to other JV Banks.

The study concludes that, It is identified from the analysis that NB Bank is performing not well below of the industry standard but also has least performance

among all players in the JV Bank industry in Nepal. In conclusion, NB Banks past and present earning generating potential is assessed as low in many parameters of profitability in comparison to the industry as well as other joint venture banks in the country.

The study recommends that:

- A serious effort has to be made towards the NPA management. The assets quality is the most serious issue in the organization and the sincere effort of the management is to be concentrated in the matter if the bank is to sustain and performs well in the forthcoming days.
- The increasing NPA indicates that the bank seems to be lacking in the conduct of detailed and proper credit appraisal and monitoring process. The bank before extending the facilitates needs to make detailed analysis about various aspects like feasibility of the party, creditworthiness of the client, collateral offered and previous performances.
- The risk inherent in the loans and advances is high. So, the complete dependence on the interest income is not an appropriate strategy. The contribution of interest income to total income in year 2062/63 is 78.59% while the rest contribute only 21.4%. So, the bank should look to increase the fee-based income as it provides safe and good returns.
- NB Bank Ltd. has always been at the top in cost of deposits. The high cost of deposits not only incurs additional interest expenses but have other indirect effects. The banks in order to make a return have to set interest rate on loans and advances at a higher level than the market. So, the risk of potential NPAs at a future data is high.
- Interest payout ratio refers the proportion of interest expenses to the interest income. Higher the ratio, lower is the profitability. The interest payout ratio of NB Bank is at 68.34%, the highest of the lot. Therefore the bank should look to minimize this ratio preferably by obtaining low cost funds.
- The credit deposit ratio of the bank stands at 75% in the year 2062/63. Although this is good from the profitability aspect, there could be potential problems of liquidity. So, the bank should look to lower this ratio either by increasing deposits or lowering credits.

- The net profit of the NB Bank had registered significant growth in the early years posting increases upto 8.6% in the first two years. However, in the previous three years, it decreases sharply. All other banks have followed slow and steady growth pattern, which seems to have paid off. So, rather than looking to achieve rapid growth it would be feasible to look to achieve and sustain steady rates of growth, thereby minimizing the risk of volatile environment.

Dhungana (2008) has conducted thesis entitled “*Investment & Liquidity Management of Insurance Companies*”. The main objective of the research is to analyze the investment pattern, liquidity management, trend of profit of the insurance companies. He has found that most of the insurance companies are found investing in government securities & debenture, share of other companies' securities, bank & finance companies' fixed deposit a/c; they are found not investing in real estate and mutual fund. So, he suggests insurance companies to search for new area of profitable investment like in real estate and mutual fund, which are other profitable sectors. He further states that all insurance companies seem to be risk avoiding while making their investment. Therefore they are making secured investment with lower rate of return. Thus they are suggested to change their investment policy. Finally, he recommends the insurance companies to introduce the portfolio management system to increase their earning from investment without increasing the degree of risk but through the diversification of risk.

Maharjan (2009), completed the study “*Liquidity Management of Commercial Bank of Nepal (A comparative study with reference to NIBL, HBL and NABIL)*” and submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies. The main objectives of the study are as follows.

1. To analyze financial ratios, liquidity trend and Correlation of HBL and NABIL,
2. To analyze Liquidity profile of HBL and NABIL,
3. To analyze the problem of liquidity management in Nepalese commercial banks,

4. To identify factors affecting the liquidity position and its management in Nepalese commercial banks,
5. To examine the effectiveness of liquidity management in Nepalese commercial banks,
6. To provide suggestions and recommendations about liquidity management in commercial banks.

From the analysis of cash and bank balance to current deposit ratio, it is seen that the liquidity position of NIBL is very strong and almost triple than HBL and NABIL. From the analysis of liquidity fund to total deposit ratio, it is found that HBL and NIBL have strong capacity to meet the short term obligations. NABIL has moderate with high variation over study period. HBL has utilized 18.41% of its deposit in short term investment. NIBL and NABIL have utilized their fund lower than HBL. Almost half of the investment by NIBL has made in short term investment. So, NIBL can convert its short term investment into cash i.e. liquid fund to meet the requirement of payment. Thus, it is the most efficient to manage liquidity among other banks. HBL are moderate and NABIL is poor to do it. HBL has invested significant portion of deposit to total investment and followed up by NABIL and NIBL respectively. All the sampled banks have invest the total deposit to loans and advances efficiently. NIBL and HBL have adequate balance with NRB but NABIL has not sufficient.

From this study, it is seen that NIBL and HBL have ready cash for maintain liquidity. As per the standard prescribed by NRB, the CRR should be 5.5%. During the study, it is found that all banks have maintained the CRR above 5.5%. So, based on the CRR, all banks are in strong liquidity position. From the analysis of balance with NRB and cash in Vault to current deposit ratio, it is found that NIBL has adequate reserve in NRB and maintained cash balances to meet the obligation of current deposit but NABIL and HBL are in moderate. From the analysis Current Ratio, it is found that all the sampled banks has maintained considerably sufficient to meet the obligation of current liabilities which is just below than 2:1 Ratio. But in FY 2064/65, it is rapidly decreased. From the trend analysis, it is found that total deposit, investments and loans an advances of all banks are in increasing trend. It implies that all the banks are increasing their effectiveness in deposit collecting and investing them by maintaining the liquidity position. Current ratio is in decreasing trend. In FY 2064/65 it is

almost half than in FY 2060/61. The coefficient of Correlation shows the relationship between Investment and deposit, loans & advance to Deposit and Current Assets to Current Liability is significant. Commercial banks have been adopted a banking tool called liquidity profile from 2002. From the analysis of liquidity profile, it is found that NIBL is in strong liquidity position having surplus asset over liability over the period matching properly. HBL is improving the liquidity mismatch problems over the period above one year. NABIL is also matching its net assets over the long period.

The following points are recommended to NIBL:

- Cash and bank balance to current deposit ratio should be reduced.
- Liquid fund should be increased to 20%.
- Short term investment to total investment is high and should be decreased.
- Total investment to total deposit ratio should be increased.
- Reserve with NRB to total deposit ratio should be decreased in comparison to other banks
- CRR should be reduced upto 5.5%.
- Since positive liquidity profile, it is recommended to reduce short term assets and improve matching between assets and liabilities.
- The deposits, investments and loans & advances are in increasing trend, but cure must be given to safe investment and profitability, not only to liquidity position. There should be trade off between profitability and liquidity.

The following points are recommended to HBL:

- Short term investment to total investment should be slightly decreased
- The portion of investment to total deposit should be decreased in order to increase in loans and advances.
- Cash in vault to total deposit ratio should be increased upto 3%. CRR should be increased up to 5.5%, since in FY 2064/65, it is below than NRB's requirement.
- Cash in vault to current deposit should be increased; otherwise, it may suffer from liquidity crisis.

- Negative difference in liquidity profile should be improved by reducing short term liabilities or by increasing short term assets by analyzing liquidity profile

The following points are recommended to NABIL:

- Short term investment to total investment ratio should be increased.
- Reserve with NRB to total deposit ratio should be increased.
- Cash in vault to total deposit ratio should be increased upto 3%.
- Balance with NRB to current deposit should be increased.
- Maturity mismatch problem should be improved by using liquidity profile analysis properly.
- The ratios are found to be highest variation during the study period which may be risky and recommend making effort for managing effectively.

Based on the findings of the research, following points are suggested to all commercial banks.

- Liquidity profile analysis and GAP analysis with IRC should be prepared quarterly basis and send to NRB within stipulated time period.
- An effort should be made on human resource development on the risk analysis management and liquidity management.
- An effort should be made on the development of market for the liquidity generating assets like; T-bills, Options and Bank CDs etc.
- Satisfied employees are the backbone of the bank. So, necessary steps should be step forwarded to develop satisfied and obedient employees, which may reduce the problems of bank defaulters and corruptions.
- Rules and regulations are the guidelines of things to do or not to do. So, its effects can be seen after the implementations. In order to manage the liquidity effectively the existing regulation should be effectively put in practice.

Karki (2010), completed the study “*Liquidity Management of Commercial Bank of Nepal (A comparative study with reference to NIBL, HBL and NABIL)*” and submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies.

The main objective of the study is to examine the liquidity and profitability position of the commercial banks of Nepal. The other specific objectives of the study are;

- To analyze the trend of liquid assets maintained by the bank and the trend of net profit achieved.
- To evaluate the cash reserve ratio maintained by the selected banks.
- To analyze the profitability ratios, including return on shareholders equity, total assets and deposit, of the selected banks.
- To examine the relationship between net profit and cash and bank balance, and between net profit and total liquid assets.

The major findings of this study are

- The liquid asset of SCBNL (Rs. 16974.13 millions) was highest, and the liquid asset maintained by EBL (Rs. 5681.11 millions) was lowest in comparison with that maintained by NABIL (Rs. 10002.22 millions), HBL (Rs. 14019.13 millions) and NIBL (Rs. 7753.20 millions).
- The average current ratio maintained by SCBNL was 1.08 times, NABIL was 1.09 times, HBL was 1.07 times, EBL was 1.07 times and NIBL was 08 times. Thus, the liquidity position of NABIL was strongest in terms of current ratio.
- The representation of cash and bank balance in total deposit was highest in EBL and lowest in NABIL. The average ratio was 7.19% in SCBNL, 5.67% in NABIL, 6.82% in HBL, 10.75% in EBL and 10.65% in NIBL. In terms of CRR, the liquidity position of NIBL was most satisfactory, and the liquidity position of EBL was worst. Except in NABIL and EBL, the CRR in all the remaining banks CRR was more than that directed by NRB in each fiscal year.
- The average fixed deposit to total deposit ratio of SCBNL was 9.48% (lowest), NABIL was 19.65%, HBL was 23.49%, EBL was 31.64% (highest) and NIBL was 24.96%. Similarly, the current deposit to total deposit ratio of SCBNL was 22.10% (highest), NABIL was 16.88%, HBL was 18.35%, EBL was 9.40% (lowest) and NIBL was 10.23%. Both of these ratios demanded highest liquidity in SCBNL and lowest liquidity in EBL.

- The average net profit made by SCBNL was Rs. 648.68 millions (highest), NABIL was Rs. 606.22 millions, HBL was Rs. 431.30 millions, EBL was Rs. 259.34 millions (lowest) and NIBL was Rs. 386.70 millions. Similarly, the average net profit margin of SCBNL, NABIL, HBL, EBL and NIBL was 34.90%, 32.68%, 34.90%, 21.24% and 22.27% respectively. In terms of net profit achieved and net profit margin, SCBNL was most efficient. However, HBL was more efficient to optimally mobilize the loan and advances, since the interest income on loan and advances was highest in HBL (10.08%).
- The mobilization of shareholders equity by SCBNL was most effective than that of others. Since the average ROSE of SCBNL (34.59%) was highest in comparison with that of NABIL (31.88%), HBL (22.80%), EBL (22.82%) and NIBL (23.60%). NABIL was most successful to optimally mobilize the total assets, since the average ROA of NABIL was highest. The average ROA of SCBNL, NABIL, HBL, EBL and NIBL was 2.43%, 2.81%, 1.39%, 1.50% and 1.54% respectively. Further, the return on total deposit was highest in NABIL (3.06%) and lowest in HBL (1.56%). Since the average interest paid to interest income ratio was lowest in SCBNL (26.97%), SCBNL was more success in controlling interest cost. The ratio was highest in EBL (44.05%). Except in HBL, the cash and bank balance had positive relation with the net profit.
- The correlation coefficient between cash and bank balance and net profit in HBL was -0.9797. However, the liquid assets had positive relation with the net profit in all the banks. The correlation between net profit and liquid assets was highest in NIBL (0.9722) and lowest in HBL (0.7877). Similarly, the multiple correlation indicated that the relation of NPAT with loan and advances and investment was perfectly positive in all the banks. The correlation coefficient was highest in NIBL (0.9991) and lowest in NABIL (0.9551).

The following recommendations have been given for the enhancement of the liquidity and profitability position of the sampled banks;

- The liquid assets maintained by EBL was comparatively lowest than that of other banks. Thus, it would be better if EBL increases the liquid assets considering the short-term liabilities requirement.
- The current ratio of all the banks was lower than the benchmark of 2:1. Although, such benchmark is not most necessary in the banking sector, it would be better if all the sampled banks keep such ratio to ensure the sound liquidity position.
- The cash reserve ratio maintained by NABIL and EBL did not meet the CRR directed by NRB in most of the years. Thus, NABIL and EBL should be careful enough while maintaining CRR, and thus should not jeopardize the credibility of the bank.
- It would be better if all the banks focus on collecting the deposit through fixed deposit, which requires less liquidity in the bank and the bank can invest such money in productive sector.
- The net profit earned and the net profit margin of EBL were lowest. It would be better if EBL reengineers the portfolio of its investment to achieve higher profit. Although SCBNL earned highest profit within these five years period, the interest income to loan and advances of SCBNL was lowest. Thus, SCBNL should seek the high interest earning grant.
- To retain the existing shareholder and fascinate the potential investor, HBL need to generate more return on sharholders equity. Similarly, EBL needs effective mobilization of total assets to generate more income and effective control of interest expenses.

2.4 Research Gap

Lots of study has been conducted to analyze the profitability position of the commercial banks. But the main theme of this research is to analyze the profitability position and operating financial efficiency of Rastriya Banijya Bank and Nepal Bank Ltd. Recent data and information of both the banks have been used in this study. This research covers the five years period of the banks operation after the implementation of the FSRP and clarifies the progress operating under FSRP.

This study differs itself from others research by specially focusing on the profitability of Rastriya Banijya Bank and Nepal Bank Ltd. and covers the period of F.Y. 2052/63

B.S. to 2066/67 B.S. This research therefore will facilitate readers to identify the profitability position and operating financial efficiency of Rastriya Banijya Bank and Nepal Bank Ltd. which will help to evaluate past and present performance of both the banks as well as it will help to project future prospect of both the banks.

CHAPTER - THREE

RESEARCH METHODOLOGY

A systematic study needs to follow a proper methodology to achieve pre-determined objective. Research methodology may be defined as “a systematic process that is adopted by the researcher in studying problem with certain objective and view”. In other words, research methodology describes the methods and process applied in the entire aspect of the study focus of data, data gathering instrument and procedure, data tabulating and processing and methods of analysis. It is really a method of critical thinking by defining and redefining the problems, formulating hypothesis or suggested solution and collecting and organizing and evaluating data, making deduction and making conclusions.

Research methodology is a path from which we can solve research dilemma systematically to accomplish the basic objective of the study. It consists of a brief explanation of research design, nature and sources of data, method of data collection and methods of tools used for analyzing data.

3.1 Research Design

A research design is the arrangement of conditions for collection and analysis of data that aim to combine relevance to the research purpose with economy in procedure. Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to objective of this study. To achieve the objective of this study, descriptive and analytical research design has been used.

It is the process which gives us an appropriate way to reach research goal. It includes definite procedures and techniques which guide in sufficient way for analyzing and evaluating the study. This study is carried out by using both quantitative and qualitative analysis methods. Mostly, secondary data has been used for analysis, but the discussion and personal interview with the concerned employees of the selected bank is also used for qualitative analysis. Hence, research design of this study is based on descriptive and analytical method.

3.2 Source of Data

This study was conducted on the basis of secondary data. The data required for the analysis were directly obtained from the balance sheet and profit and loss account of the concerned bank's annual reports. Likewise newspapers, journals, periodicals, magazines, reports and unpublished thesis were taken as other sources of data during the study.

According to the need and objective, all the secondary data were compiled, processed and tabulate in the time series in order to judge the reliability of data provided by the banks and other sources. Formal and informal talks to the concern head of department of the banks were also conducted to obtain the additional information of the related problem.

3.3 Population and Sample

There are altogether 31 commercial banks functioning all over Nepal and most of their stocks are listed in the stock market and Nepal Bank Ltd. and Rastriya Banijya Bank, were selected from the total population. The total population are as follows.

Table: 3.1

Commercial Banks in Nepal

| S.N | Name of Banks | Date of Operation | Central Office |
|-----|------------------------------|-------------------|--------------------|
| 1 | Nepal Bank Limited | 1994-07-30 | Dharmapath, Ktm |
| 2 | Ristriya Banijya Bank | 2022-10-10 | Singha Darbar, Ktm |
| 3 | Agriculture Development Bank | 2024-11-17 | Ramshahpath, Ktm |
| 4 | Nepal Arab Bank Limited | 2041-03-29 | Kantipanh, Ktm |

| | | | |
|----|---------------------------------------|------------|----------------------------|
| 5 | Nepal Investment Bank Limited | 2042-11-26 | Darbarmarg,Ktm |
| 6 | Standard Chartered Bank Nepal Limited | 2043-10-16 | Newbaneshor,Ktm |
| 7 | Himalayan Bank Limited | 2049-10-05 | Themal,Ktm |
| 8 | Nepal Bangladesh Bank Limited | 2050-02-23 | Newbaneshor,Ktm |
| 9 | Nepal SBI Bank Limited | 2050-03-23 | Hattisar,Ktm |
| 10 | Everest Bank Limited | 2051-07-01 | Lajimpat,Ktm |
| 11 | Bank Of Kathmandu Limited | 2051/11/28 | Kamaladi,Ktm |
| 12 | Nepal Credit & Commerce Bank Limited | 2053-06-28 | Siddharthanagar, Rupandehi |
| 13 | Lumbini Bank Limited | 2055-04-01 | Narayangadh, Chitawan |
| 14 | NIC Bank Limited | 2055-04-05 | Biratnagar,Morang |
| 15 | Machhapuchhre Bank Limited | 2057-06-07 | Prithivichowk, Pokhard |
| 16 | Kumari Bank Limited | 2057-12-21 | Putakisadak,Ktm |
| 17 | Laxmi Bank Limited | 2058-12-21 | Adarsanagar,Birjung |
| 18 | Siddhartha Bank Limited | 2059-09-09 | Kamaladi,Ktm |
| 19 | Global Bank Limited | 2063-09-18 | Parsa,Birjung |
| 20 | Citizens Bank International Limited | 2064-01-07 | Kamaladi,Ktm |
| 21 | Prime Commercial Bank Limited | 2064-06-07 | New Road,Ktm |
| 22 | Bank of Nepal Limited | 2064-06-25 | Tripureshowar,Ktm |
| 23 | Sunrise Bank Limited | 2064-06-25 | Gairidhara,Ktm |
| 24 | Nepal Merchant Bank Limited | 2o53-08-11 | Babarmahal,Ktm |
| 25 | Development Credit Bank Limited. | 2057-09-07 | Newbaneshor,Ktm |
| 26 | Kist Bank Limited | 2066-01-24 | Kamaladi,Ktm |
| 27 | Janta Bank Nepal Limited | 2066-12-23 | Anamnagar,Ktm |
| 28 | Mega Bank Limited | 2067-04-07 | Kantipath, Kathmandu |

| | | | |
|----|-------------------------------|------------|------------------------|
| 29 | Commerce & Trust Bank Limited | 2067-06-04 | Kamaladi, Kathmandu |
| 30 | Civil Bank Limited | 2067-08-10 | Kamaladi, Kathmandu |
| 31 | Century Commercial Bank | 2067-09-07 | Putalisadak, Kathmandu |

Source: Nepal Rastra Bank

3.4 Method of Data Collection

It indicates the sources of data and how they collected. In this study data are collected through published sources. They were collected from the correspondent offices and their respective websites. The annual reports of NBL, RBB publications, the data regarding the profile of NBL & RBB and other related documents were collected from internet websites. Unpublished master's thesis, books, research papers, articles, journals have been collected mainly from Centre Library of Tribhuvan university, library of Shanker Dev Campus and NRB Magazines and newspapers were from concerned authorities.

After collecting data, as necessarily required, they were separated and analyzed. Presentation and analysis of the collected data is the main theme of the research work. Collected data were first presented in systematic manner in tabular forms and then analyzed by applying different financial and statistical tools to achieve the research objectives. Besides these, some graph, charts and tables have been presented to analyze and interpret the finding of the study.

3.5 Method of Data Presentation and Analysis

The data presentation and analysis were focal part of the study. Ranges of financial and statistical tools were used to analyze the collected data and to achieve the objective of the study. The analysis of the data were done according to the pattern of data available. Because of limited time and resources, simple analytical statistical tools such as graphs and technique of least square were adopted in this study. In the same way, some strong financial tools, ratio analysis and trend analysis, were used in the study. The data extracted from annual report, financial statement and other available information were processed and tabulated in various tables and charts under different headings according to the nature.

3.5.1 Financial Tools

Financial analysis is the process of identifying the financial strengths and weaknesses of the organization by properly establishing relationships between the items of the balance sheet and the profit and loss account.

Ratio analysis is a powerful tool of financial analysis. A ratio is designed as the indicated quotient of two mathematical expressions and as the relationship between two or more variables. In financial analysis, ratio is used as a benchmark for evaluating the financial position and performance of a firm. The financial tools used in this study are as follows.

A. Ratio Analysis

Financial ratio is the mathematical relationship between two accounting figures. Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concern especially to take output and credit decisions. Thus, ratio analysis is used to compare the firm's financial performance and status to that of other firms or to itself over time. The qualitative judgment regarding financial performance of a firm can be done with the help of ratio analysis.

Even though, there are many ratios used in various studies to evaluate different aspects of a business entity, the ratios are of different importance and used differently in various industry base. For example, it is not significant to analyze the quick ratio or current ratio in the context of commercial banks. Further, in the context of commercial banks the insider and outsider fund base cannot be interpreted as per the standard of production units since financial institutions are, by virtue, highly levered by outsiders' funds.

Similarly, in the banking industry, there is no significance to say deposits are current liabilities, or some of the studies have considered time deposits as fixed liabilities. Both of the interpretations are not viable since these liabilities should be considered as per their maturity schedules. In this study, various ratios from newly developed empirical studies have been used just to see the profitability position of commercial banks. This study contains the following ratios.

1. Profitability Ratios

Profitability ratios are used to measure the efficiency of operation of a firm in terms of profit. It is the indicator of the financial performance of any

institution. This implies that higher the profitability ratio, better the financial performance of bank and vice versa. The profitability of Nepal Bank Ltd. and Rastriya Banijya Bank is evaluated through following different ratios;

- Net Profit Margin
- Return on Total Assets (ROTA)
- Return on Equity (ROE)
- Operating Efficiency ratio
- Net Interest Margin
- Interest Payout Ratio
- Net Operating Margin

B. Income Expenses Analysis

- Interest Income to Total Income
- Fee and Commission Income to Total Income
- Interest Expenses to Total Operating Expenses
- Staff Expenses to Total Operating Expenses
- Office Operating Expenses to Total Expenses

3.5.2 Statistical Tools

Statistical tools are used to analyze the relationship between two or more variables and to find how these variables are related. Trend analysis is one of the statistical tools used for forecasts. Among various methods of trend analysis, a very popular least square method has been used in this study which has been used to analyze the trend of net profit and interest income of Nepal Bank Ltd. and Rastriya Banijya Bank and make the forecast for the next five years period.

CHAPTER - FOUR

PRESENTATION & ANALYSIS OF DATA

To find the answer of research problem, the collected data are necessary to present and analyze by processing. This chapter will present the data on table & figure. The main objective of the study is to present data and analyze them with the help of various financial and statistical tools. This chapter consists of analysis and presentation of empirical data. The important variables are very sensitive and taken into consideration, so this chapter will present the analysis of components of working capital. The major ratios for the study are liquidity ratios, assets management ratio, debt management ratios, profitability ratios and composition of working capital. The variables of the ratios indicated above are also tried to study in details. Firstly it is attempted to deal about the working capital policies followed by bank and then financial position of success/failure companies has been analyzed applying various methods.

4.1 Profitability Ratio

The ultimate objective of banks is to earn profit. Strictly speaking, no bank can survive without profit. Profit is the indicator of efficient operation of bank. The bank acquires profit by providing different services to its customers or by making investment of different kinds. Sufficient profit is a must to have good liquidity,

grab investment opportunities, expand banking transaction, finance government in need of development fund, overcome the future contingencies and meet fixed internal obligation for the bank. Profitability ratios measure the efficiency of a bank. The following profitability ratios, were used to evaluate the profitability of the selected commercial banks.

4.1.1 Net Profit Margin:- The ratio signifies the effectiveness of expenses management and cost control and gives the direction to the management for service pricing policies. It means how much of total revenue has been declared as net profit after all the charges are over up. The higher ratio means the management has been able to control its operational costs and maintain efficiency.

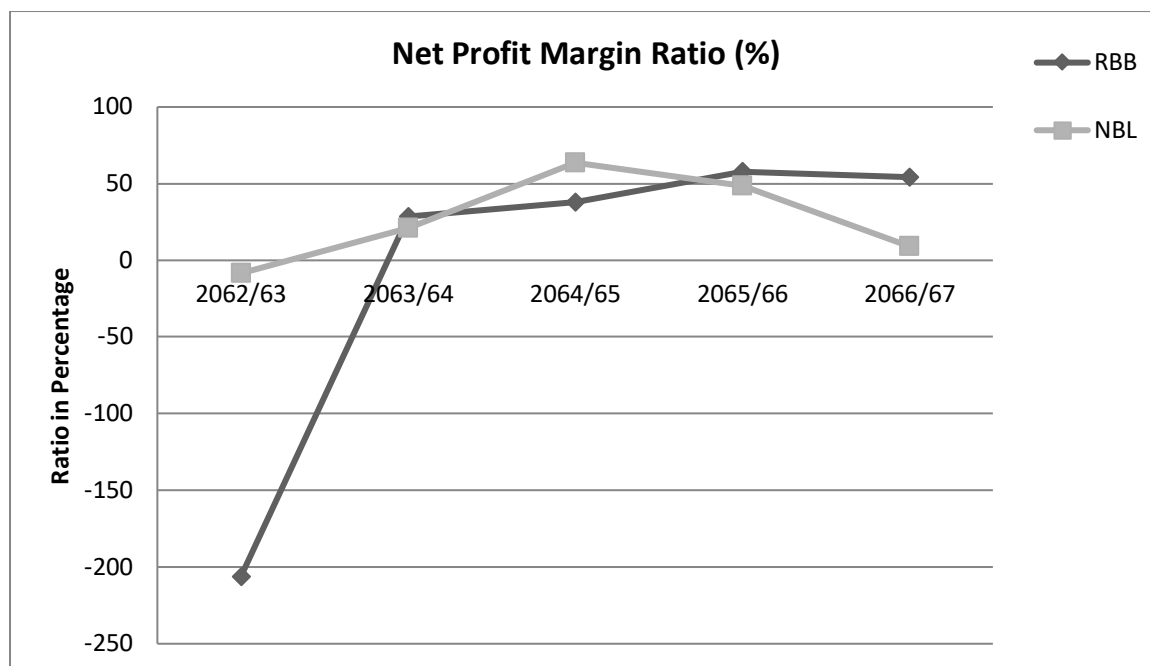
$$\text{Net Profit Margin} = \frac{\text{Net Profit After Tax}}{\text{Total Operating Income}}$$

Table 4.1
Net Profit Margin Ratio(%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | -206.13 | -8.44 |
| 2063/64 | 28.75 | 21.28 |
| 2064/65 | 38.17 | 63.65 |
| 2065/66 | 57.76 | 48.51 |
| 2066/67 | 54.30 | 8.89 |
| Average | -5.43 | 26.78 |

Source: Appendix II & IV

Figure: 4.1



The table and figure shows that both the banks net profit ratios were not in consistency. The ratio of RBB was highest of 57.76% in the FY 2065/66 where as the bank suffered heavy losses in the FY 2062/63. Similarly, the ratio of NBL was highest of 63.65% in the FY 2064/65 at but suffered heavy losses in the FY 2062/63. The table shows that although the banks were recovering from the heavy loss, the net profit generated by the banks are not consistent.

4.1.2 Return on Total Assets (ROTA):- The ratio is a primary indicator of managerial efficiency. It indicates how efficiently the assets were utilized by the bank. The ratio measures how far the management has utilized all the assets of the bank for profit generating activities. Higher ROTA indicates higher efficiency in the utilization of the total assets and vice versa.

$$\text{Return on Total Assets (ROTA)} = \frac{\text{Net Profit After Tax}}{\text{Total Assets}}$$

Table: 4.2

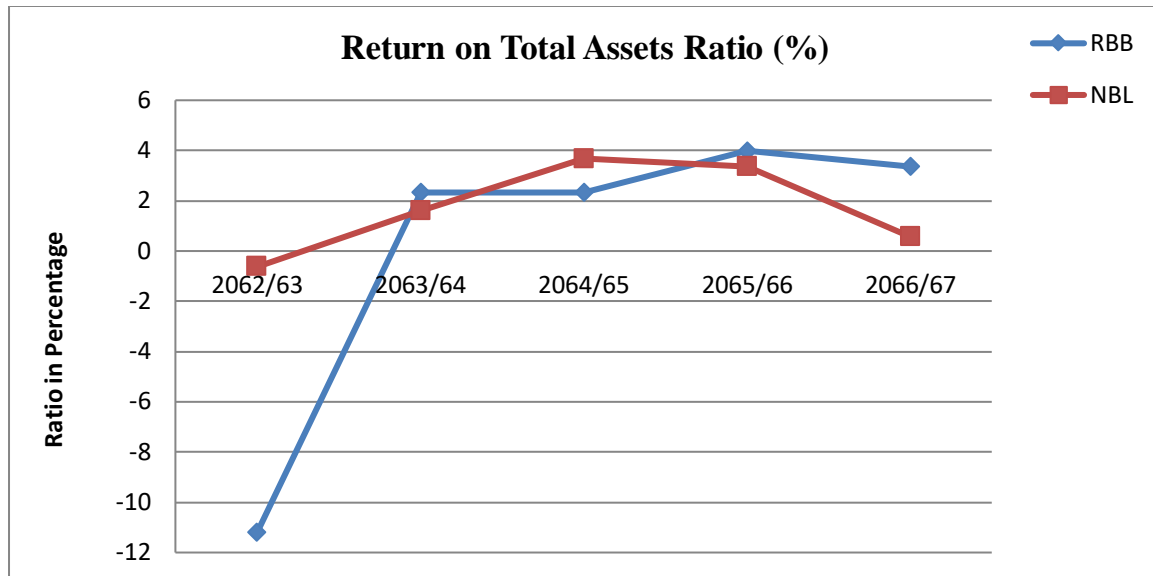
Return on Total Assets Ratio (%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | -11.21 | -0.63 |
| 2063/64 | 2.31 | 1.61 |

| | | |
|----------------|------|------|
| 2064/65 | 2.33 | 3.68 |
| 2065/66 | 3.99 | 3.36 |
| 2066/67 | 3.36 | 0.58 |
| Average | 0.19 | 1.72 |

Source: Appendix II & IV

Figure: 4.2



The above table exhibits that the ratio of RBB ranged between -11.21% in the FY 2062/63 to 3.99% in the FY 2065/66. Whereas, the ratio of NBL ranged from -0.63% in the FY 2062/63 to 3.68% in the FY 2064/65. This showed that both the banks could gradually recover from loss in the past years and has been improving its efficiency.

4.1.3 Return on Equity (ROE):- Equity refers to the owners claim of a bank. The excess amount of total asset over outsiders liabilities is known as shareholders equity. It is also known as net worth. This ratio measure how prudently the management has employed shareholders fund keeping the interest of shareholders and maximize their net worth. It is the measurement of the rate of return available to the banks shareholders. The ratio provides the company to deliver a good return on equity. This ratio is calculated by dividing net profit by total equity capital.

$$\text{Return on Equity (ROE)} = \frac{\text{Net Profit After Tax}}{\text{Shareholder Equity}}$$

Table: 4.3

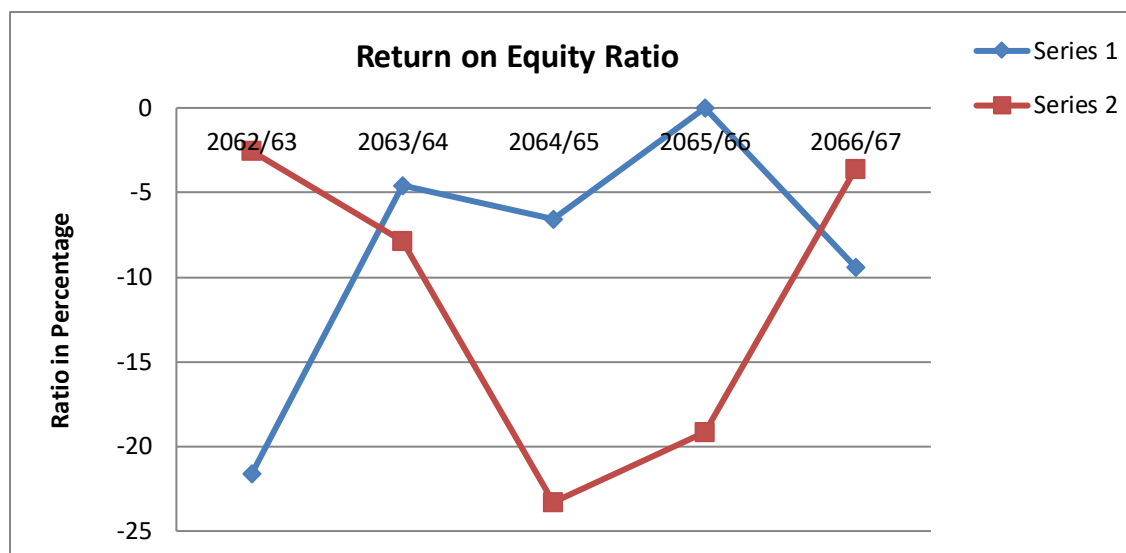
Return on Equity Ratio (%)

| Fiscal Year | Name of the Bank | |
|----------------|------------------|--------|
| | RBB | NBL |
| 2062/63 | -21.61 | -2.56 |
| 2063/64 | -4.58 | -7.87 |
| 2064/65 | -6.55 | -23.30 |
| 2065/66 | -8.5 | -19.16 |
| 2066/67 | -9.40 | -3.63 |
| Average | -10.18 | -11.30 |

Source: Appendix II & IV

The above table shows that the return on equity of both RBB and NBL is negative through out the five fiscal years. The negative ROE is due to the high amount of negative reserve maintained by both the banks.

Figure: 4.3



4.1.4 Operating Efficiency Ratio:-To maximize profitability and the value of the shareholder's investments in the bank, bank management must maintain efficiency in their operations. This usually means reducing their operating expenses and increasing the productivity of their employees. Since banks are to pay huge amount of the

interest costs for their funds, they like to reduce non-interest costs especially, staff costs, wages and overhead costs. Lower the ratio means greater the success of management.

$$\text{Operating Efficiency Ratio} = \frac{\text{Total Operating Expenses}}{\text{Total Operating Income}}$$

Table: 4.4

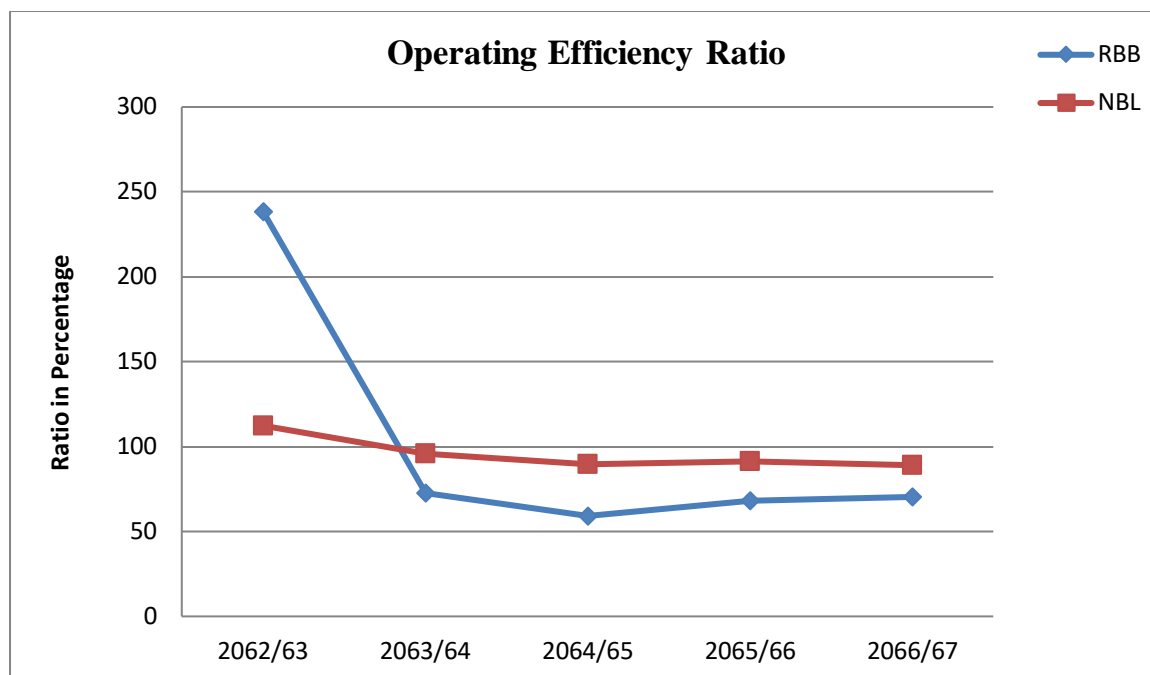
Operating Efficiency Ratio (%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|--------|
| | RBB | NBL |
| 2062/63 | 238.54 | 112.32 |
| 2063/64 | 72.72 | 95.68 |
| 2064/65 | 59.15 | 89.59 |
| 2065/66 | 68.36 | 91.24 |
| 2066/67 | 70.54 | 89.03 |
| Average | 101.86 | 95.57 |

Source: Appendix II & IV

The above table show that the ratio of RBB ranged from 59.15% in the FY 2064/65 to 238.54% in the FY 2062/63. Similarly, the ratio of NBL ranged from 89.03% in the FY 2066/67 to 112.32% in the FY 2062/63. Both the banks operating efficiency ratios were alarming indication of poor performance and management. But in comparison to the FY 2062/63 both the banks have been able to lower their ratio and improve their performance.

Figure: 4.4



4.1.5 Interest Payout Ratio:- The main function of a bank is to collect deposit and advance loans. The bank pays interest on the deposits and charges interest on the loans and advances. It also realizes income from the investments and call deposits. Similarly, the bank has to pay interest on its borrowings. Thus, this ratio provides the proportion of interest payment of the bank as compared to the interest income generated by the bank.

$$\text{Interest Payout Ratio} = \frac{\text{Interest Expenses}}{\text{Interest Income}}$$

Where,

Interest expense = Expenses on deposits and borrowings

Interest Income = Income on (loans and advances + investment + money at call + inter bank lending etc.)

Table: 4.5

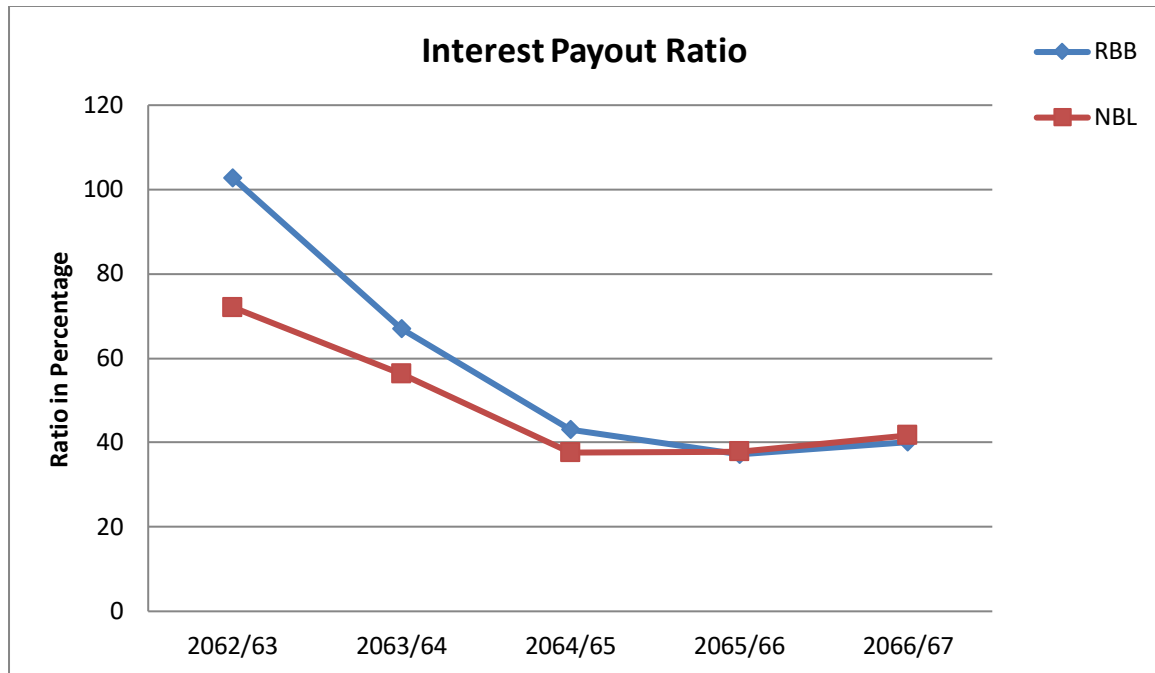
Interest Payout Ratio (%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | 102.78 | 72.09 |
| 2063/64 | 66.86 | 56.16 |

| | | |
|----------------|-------|-------|
| 2064/65 | 43.15 | 37.64 |
| 2065/66 | 37.23 | 37.77 |
| 2066/67 | 40.01 | 41.81 |
| Average | 58.01 | 49.09 |

Source: Appendix II & IV

Figure: 4.5



The interest payout ratio of RBB remained within the range of 37.23% to 102.78%. Whereas in NBL it remained within the range of 37.77% to 72.09%. Both the bank, RBB and NBL, had very high payout ratio of 102.78% and 72.09% respectively. The main reason was due to high volume of NPAs and high cost deposits. Gradually in the recent year both the banks were able to maintain favorable interest payout ratio. In the FY 2065/66 the RBB had the payout ratio of 37.23% and in the FY 2064/65 NBL had the payout ratio of 37.64% which was the lowest and most profitable through the study period.

4.1.6 Net Operating Margin:- This is also a ratio to measure operating efficiency of commercial banks. The net operating margin of commercial banks signifies what portion of operating profit remains after deducting all operating costs. And the net operating margin is expressed with total earning assets to find out what percentage of

net operating margin has contributed to total earning assets. Higher the margin, the better is the efficiency of the management.

Net Operating Margin =

$$\frac{\text{Total Operating Revenue} - \text{Total Operating Expenses}}{\text{Total Earning Assets}}$$

Table: 4.6

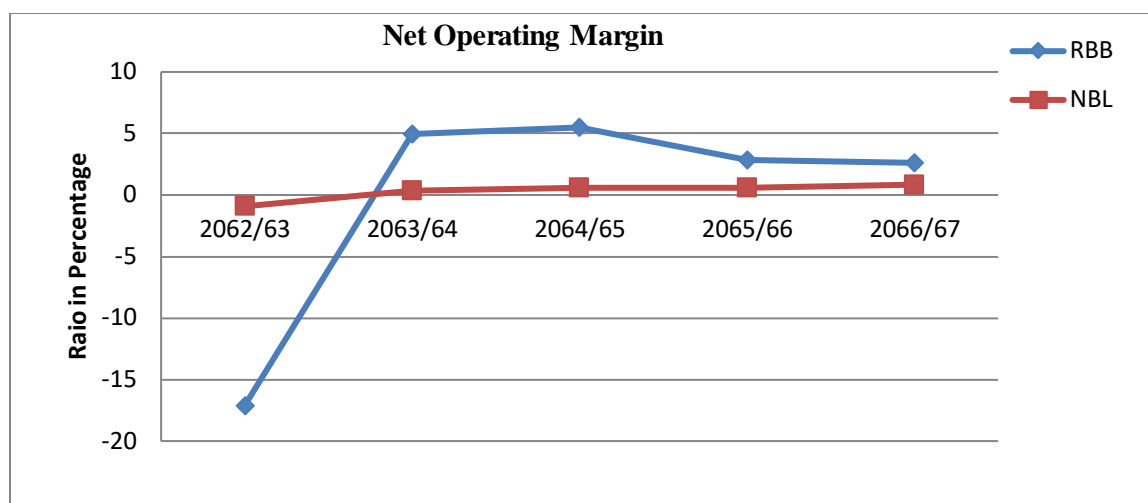
Net Operating Margin (%)

| Fiscal Year | Name of the Bank | |
|----------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | -17.10 | -0.92 |
| 2063/64 | 4.94 | 0.33 |
| 2064/65 | 5.49 | 0.60 |
| 2065/66 | 2.87 | 0.61 |
| 2066/67 | 2.59 | 0.84 |
| Average | -0.24 | 0.29 |

Source: Appendix II & IV

The above table exhibits that the ratio of RBB ranged from 2.59% in the FY 2066/67 to 5.49% in the FY 2064/65 except for the negative ratio in the FY 2062/63. Similarly, the ratio of NBL ranged from 0.33% in the FY 2063/64 to 0.84% in the FY 2066/67 except for the negative ratio in the year 2062/63. The above table showed that although the bank had suffered the negative ratio in the FY 2062/63, both the banks were able to gradually improve its ratio. Even though the ratio of RBB was better than NBL, the ratio of RBB is very inconsistent in comparison to NBL. But the ratio of NBL was very low and need to improve.

Figure: 4.6



4.2 Income Expenses Analysis

4.2.1 Interest Income to Total Income:- Total interest earned to total income ratio indicates the extend to which the bank has successfully mobilize its fund in interest earning asset. Interest earned to total income ratio measure the magnitude of interest income in total income. Generally, banks earn interest through the provision of loans and advances, overdrafts and investments in securities. This ratio can be calculated as follows,

$$\text{Interest Income to Total Income} = \frac{\text{Total Interest Earned}}{\text{Total Income}}$$

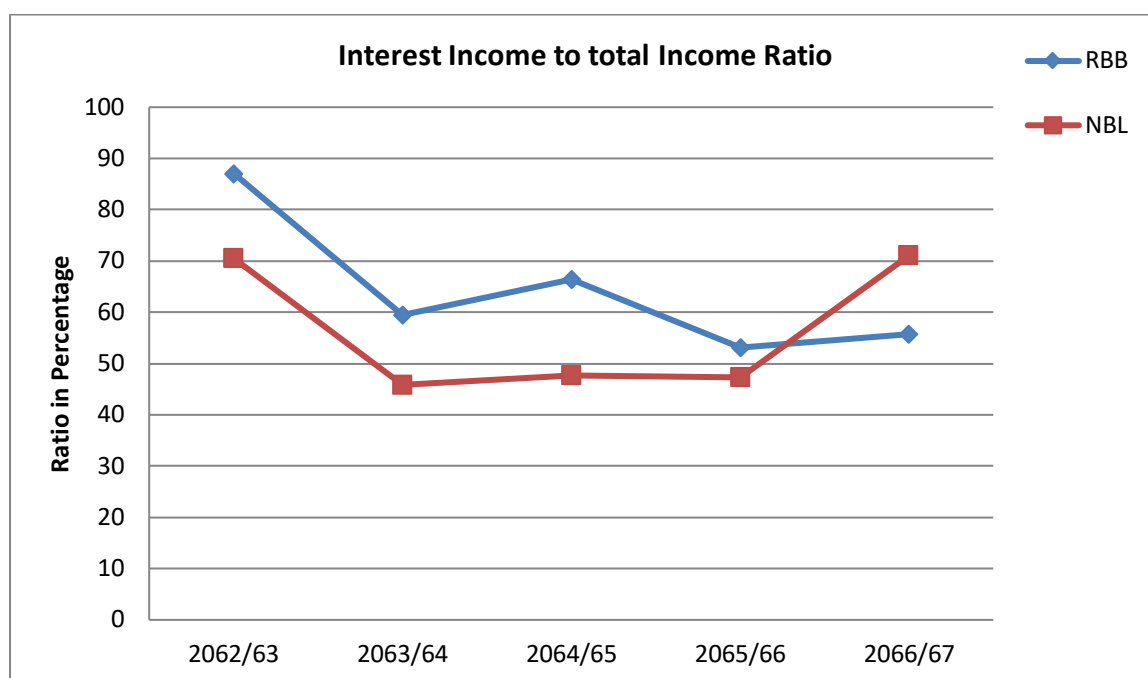
Table: 4.7

Interest Income to total Income (%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | 87.09 | 70.56 |
| 2063/64 | 59.39 | 45.84 |
| 2064/65 | 66.35 | 47.66 |
| 2065/66 | 53.11 | 47.39 |
| 2066/67 | 55.64 | 71.03 |
| Average | 64.32 | 56.05 |

Source: Appendix II & IV

Figure: 4.7



The above table exhibits that the interest income to total income ratio of RBB ranged between 55.64% in the FY 2066/67 to 87.09% in the FY 2062/63. Similarly, the ratio of NBL ranged from 45.84% in the FY 2063/64 to 71.03% in the FY 2066/67. This showed that both the bank were able to generate fair amount of interest income in its total income. The ratio of NBL had gradually improved in the FY 2066/67, where as the ratio of RBB was inconsistent.

4.2.2 Fee and Commission Income to Total Income:- The second measure source of income of the Nepalese commercial banks is fee income. Commercial banks now-a-days have moved towards the near banking agency services like under writings, counseling, various service charges, renewal fees and other consultancy functions. They have expose to non-funded fee based services like LC, guarantee, bills/clearing, safe deposit, credit card, ATM, etc. form these services banks earn fees and commission.

$$\text{Fee \& Commission Income to Total Income} = \frac{\text{Fee \& Commission}}{\text{Total Income}}$$

Table: 4.8

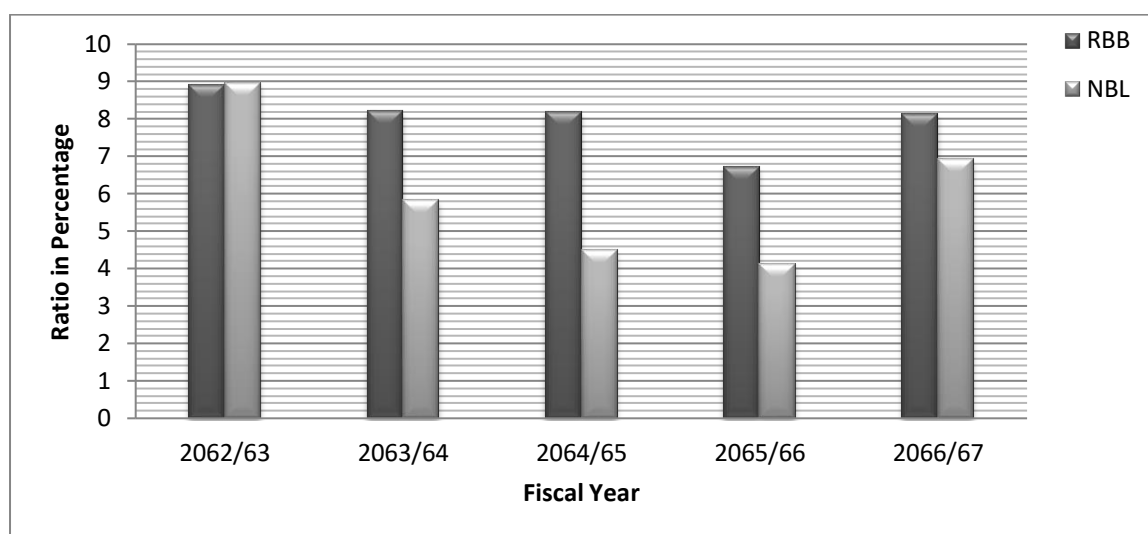
Fee and Commission Income to Total Income (%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|------|
| | RBB | NBL |
| 2062/63 | 8.92 | 8.98 |
| 2063/64 | 8.23 | 5.83 |
| 2064/65 | 8.21 | 4.51 |
| 2065/66 | 6.72 | 4.12 |
| 2066/67 | 8.12 | 6.95 |
| Average | 8.04 | 6.08 |

Source: Appendix II & IV

Figure: 4.8

Fee and Commission Income to Total Income (%)



The above table exhibits that the ratio of RBB ranged between 6.72% in the FY 2065/66 to 8.92% in the FY 2063/63. Similarly, the ratio of NBL ranged from 4.12% in the FY 2065/66 to 8.98% in the FY 2062/63. The ratio of RBB was better than NBL in each year except 2062/63.

4.2.3 Interest Expenses to Total Operating Expenses:- The major expenses head of commercial banks is the interest expenses. Interest expenses occur on various

deposits, inter bank borrowers, borrowing from NRB and from other foreign banks. Since deposits are the raw materials inputs for the banks to produce loans, banks management should be able to screen up the various deposits, obtain an economic deposit mix and minimize the cost of deposit so that a higher spread gap remains to contribute in the profitability. In fact, the lower the cost of spread gap remains to contribute in the profitability. In fact, the lower the cost of deposits, the higher the profitability margin and vice versa.

Interest Expenses to Total Operating Expenses =

$$\frac{\text{Interest Expenses}}{\text{Total Operating Expenses Before Provision \& Tax}}$$

Table: 4.9

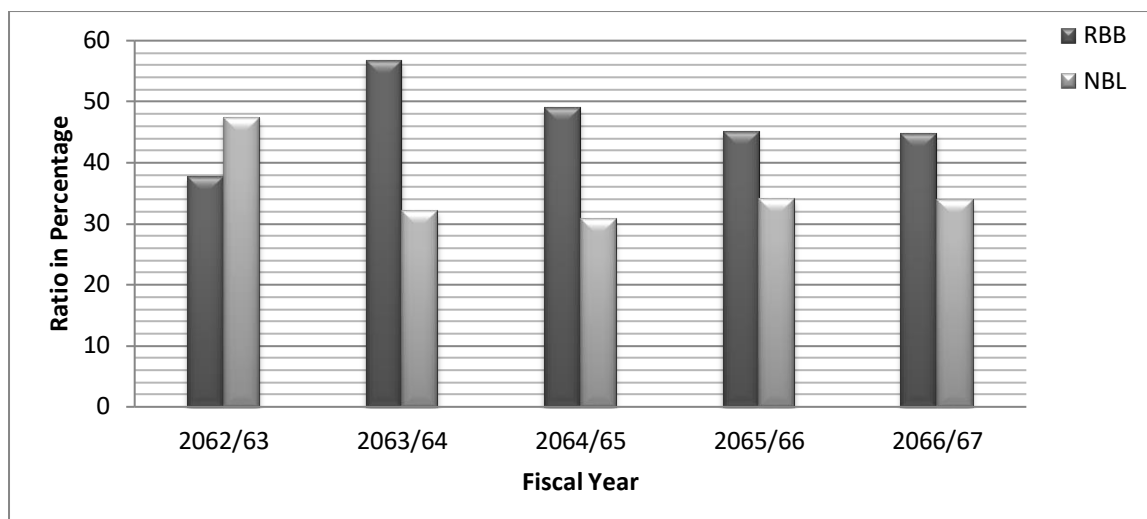
Interest Expenses to Total Operating Expenses (%)

| Fiscal Year | Name of the Bank | |
|----------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | 37.64 | 47.29 |
| 2063/64 | 56.82 | 32.11 |
| 2064/65 | 49.02 | 30.72 |
| 2065/66 | 45.12 | 34.10 |
| 2066/67 | 44.86 | 34.01 |
| Average | 46.69 | 35.65 |

Source: Appendix II & IV

Figure: 4.9

Interest Expenses to Total Operating Expenses (%)



The above table exhibits that the ratio of RBB ranged from 37.64% in the FY 2062/63 to 56.82% in the FY 2063/64. Similarly the ratio of NBL ranged from 30.72% in the FY 2064/65 to 47.29% in the FY 2062/63.

4.2.4 Staff Expenses to Total Operating Expenses:- One of the major expenses of banks administration and operation is staff expenses. Staff expenses comprises of salary, allowances, provident fund and other incentives. In average, the staff expenses comprises share in total operating expenses is more than 15% of average Nepalese commercial banks.

Staff Expenses to Total Operating Expenses =

$$\frac{\text{Staff Expenses}}{\text{Total Operating Expenses Before Provision \& Tax}}$$

Table: 4.10

Staff Expenses to Total Operating Expenses (%)

| Fiscal Year | Name of the Bank | |
|-------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | 57.99 | 45.97 |
| 2063/64 | 34.44 | 57.93 |
| 2064/65 | 39.56 | 53.59 |
| 2065/66 | 39.54 | 47.00 |
| 2066/67 | 37.54 | 49.49 |

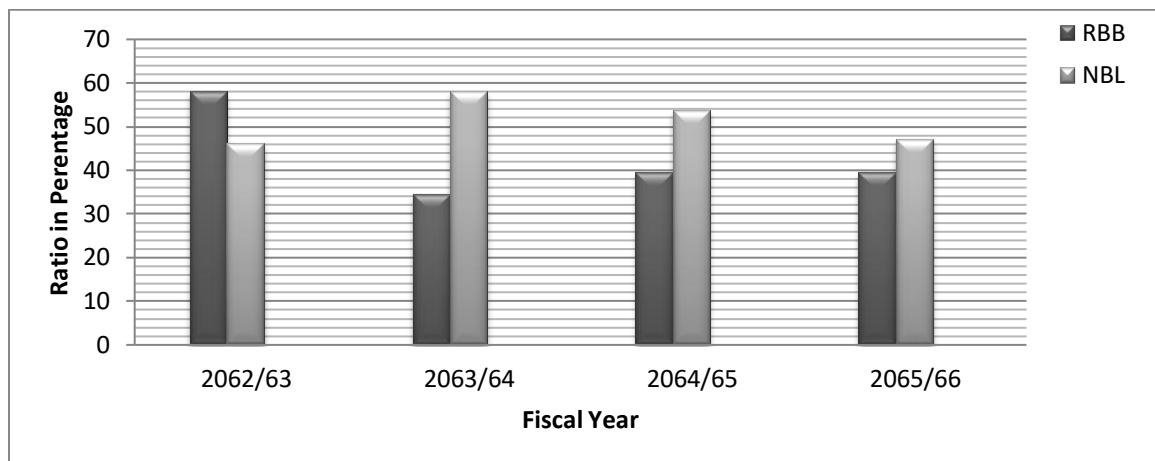
| | | |
|----------------|-------|-------|
| Average | 41.81 | 50.80 |
|----------------|-------|-------|

Source: Appendix II & IV

The Above table shows that the average staff expenses is 41.81 percentage of RRB and 50.80 Percentage of NBL on total Operating Expenses. It means staff expenses in NBL is high than RBB over the study Period. It is shows in the following figure.

Figure: 4.10

Staff Expenses to Total Operating Expenses (%)



4.2.5 Office Operating Expenses to Total Expenses:- Office operating expenses comprises rents of office building and premises, electricity, water, repair and maintenance of various fixed assets, insurance, stationary, telex, telephone, advertisements, legal expenses, expenses relating to board of directors, expenses relating to board of audit, depreciation, amortization, professional service fee, security expenses, commission and discount and others.

Office Operating Expenses to Total Expense =

$$\frac{\text{Office Operating Expenses}}{\text{Total Operating Expenses Before Provision \& Tax}}$$

Table: 4.11

Office Operating Expenses to Total Expense (%)

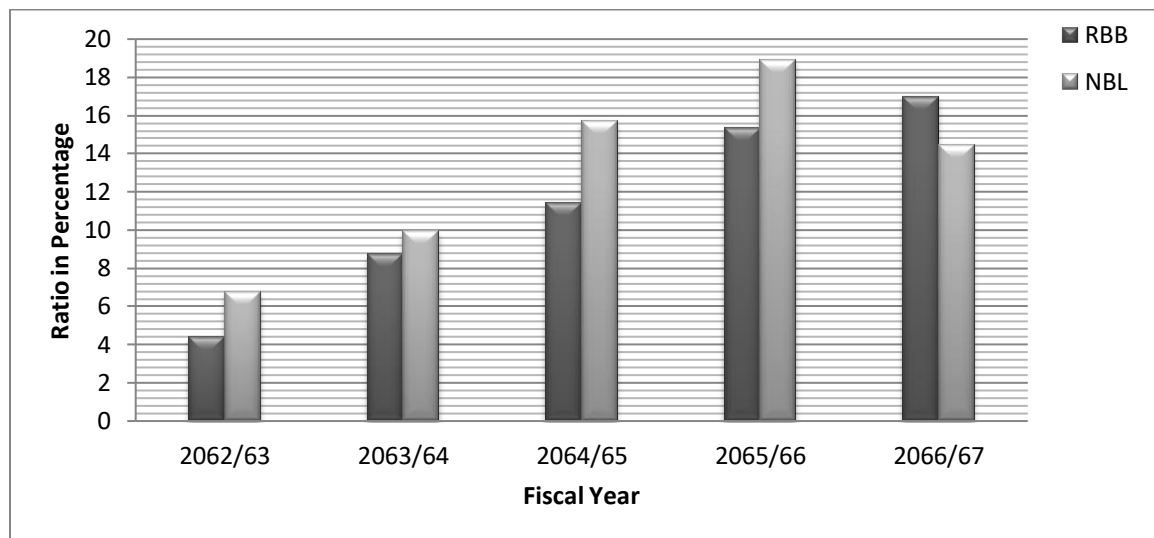
| Fiscal Year | Name of the Bank | |
|----------------|------------------|-------|
| | RBB | NBL |
| 2062/63 | 4.37 | 6.74 |
| 2063/64 | 8.74 | 9.96 |
| 2064/65 | 11.41 | 15.69 |
| 2065/66 | 15.34 | 18.90 |
| 2066/67 | 16.98 | 14.47 |
| Average | 11.37 | 13.15 |

Source: Appendix II & IV

The above table and figure shows that the proportion of office operating expenses to total expenses. The NBL has 13.15% office operating expenses of total operating expenses and that of RBB is 11.37% on an average Over the Study Period.

Figure: 4.11

Office Operating Expenses to Total Expense (%)



4.3 Statistical Analysis

Statistical tools help to find out the trends of financial position of the bank. It also analyzes the relationship between variables and helps banks to make appropriate decision. In this study, the least square linear trend was used to achieve the objective of the study. This topic analyzes the trend of net profit of RBB and NBL

from the FY 2062/63 to 2066/67 and makes the forecast for the next five fiscal years till 2072/73.

4.3.1 Trend Analysis of Net Profit and Projection for next 5 years

The profit is the universal measurement tool of the performance of profit earning institution. Likewise, it also serves as an important yardstick to measure the performance of the banks. Profit is important to various parties like management, employees and the government. The employees may use it to validate their claim for better recommendations and the government to receive taxes.

Here the trend analysis of net profit of RBB and NBL was done. The forecast was made for the next five fiscal years. The forecast was based on the following assumptions:

1. The main assumption is that other things remain constant and the forecast will be only when the limitations of least square method are carried out.
2. The bank will run in present position.
3. The economy will remain in the present trend.
4. Nepal Rastra Bank will not change its guidelines to the commercial banks.

The following table shows the trend values of net profit of RBB and NBL for 5 fiscal years from 2068/69 to 2072/73.

Table 4.12

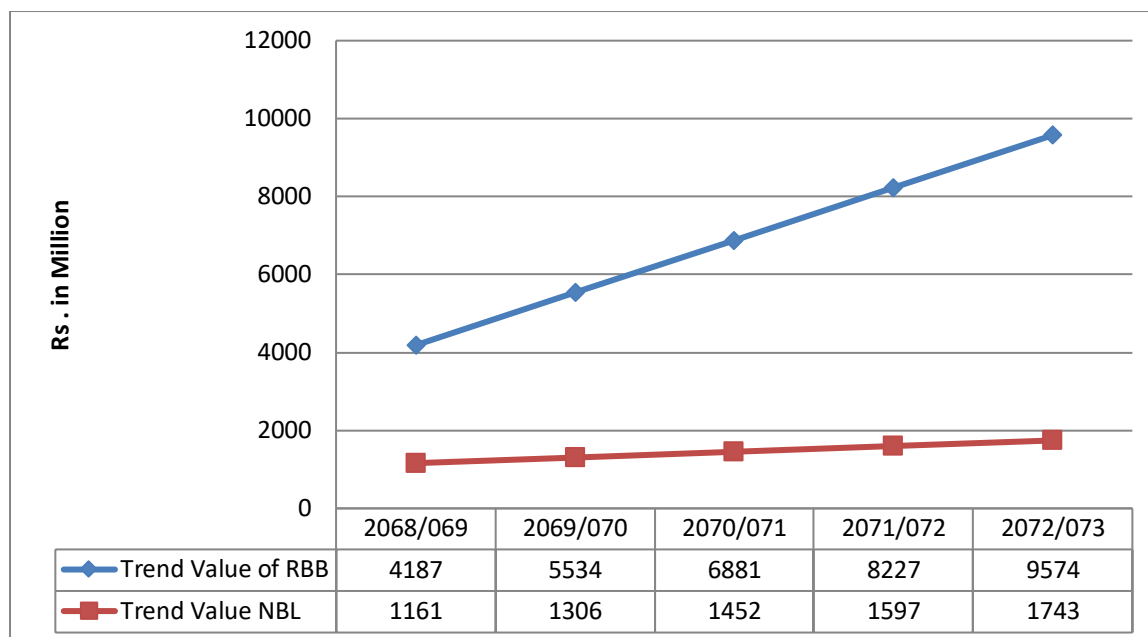
Trend Value of Net Profit of RBB and NBL(Rs. in million)

| Fiscal year | Trend Value of RBB | Trend Value NBL |
|--------------------|---------------------------|------------------------|
| 2068/069 | 4187 | 1161 |
| 2069/070 | 5534 | 1306 |
| 2070/071 | 6881 | 1452 |
| 2071/072 | 8227 | 1597 |
| 2072/073 | 9574 | 1743 |

Source: Appendix V & VI

Figure 4.12

Trend Value of Net Profit of RBB and NBL



The above table and below figure shows that the net profit of both the banks have the increasing trend for the forecasted period. If other things remaining the same, the total net profit of Rastriya Banijya Bank and Nepal Bank Ltd. will be Rs.9574 million and Rs.1743 million for the F.Y. 2072/73. The calculated trend values of net profit of both the banks have been diagrammatically presented in the trend line below.

4.4 Major Findings of the Study

As the bank has been recovering from the past heavy loss, the net profit margins of both the banks were not consistent. The net profit margins of NBL were in decreasing trend from last two years where as the net profit margins of RBB also decreased in the last year. Similarly, the ROTA of both the bank was in fluctuating trend but in last two year the ROTA of RBB was better than the NBL. Although the ROTA of RBB was in fluctuating trend during the study period due to the negative return in the FY 2062/63.

ROE of both RBB and NBL were negative through out the five fiscal years period. The negative ROE was due to the high amount of negative reserve maintained by both the banks and also due to the heavy loss suffered by the bank in the past year from which the bank has been still recovering.

Both the banks showed poor performance. But in comparison to the FY 2062/63 both the banks have been able to lower their ratio and improve their performance. But the ratio showed that the NBL has high operating ratio than RBB which indicates the poor

performance of NBL as the ratio of operating expenses was higher than the operating income.

RBB and NBL has very low net interest margin. Although the net interest margin of RBB is higher than NBL.

RBB and NBL had very high interest payout ratio of 102.78% and 72.09 respectively. The main reason was due to high volume of NPAs and high cost deposits. Gradually in the recent year both the banks have been able to maintain favorable interest payout ratio.

The net operating margin of RBB was better than NBL but the ratio of RBB was very inconsistent in comparison to NBL. But the ratio of NBL was very low and needed to be improved. Although the bank had negative ratio in the FY 2062/63, both the banks have been able to improve its ratio.

The interest income to total income ratio of RBB ranged between 55.64% in the FY 2066/67 to 87.09% in the FY 2062/63. Similarly, the ratio of NBL ranged from 45.84% in the FY 2063/64 to 71.03% in the FY 2066/67. This showed that both the banks were able to generate fair amount of interest income in its total income. The ratio of NBL has gradually improved from the FY 2064/65 to 2066/67, where as the ratio of RBB was inconsistent.

Fee and Commission Income to Total Income ratio of RBB ranged between 6.72% in the FY 2065/66 to 8.92% in the FY 2062/63. Similarly, the ratio of NBL ranged from 4.12 in the FY 2065/66 to 8.98 in the FY 2062/63. The ratio of RBB has been better than NBL except in the FY 2062/63.

Interest Expenses to Total Operating Expenses ratio of RBB ranged from 37.64% in the FY 2062/63 to 56.82% in the FY 2063/64. Similarly the ratio of NBL has ranged from 30.72% in the FY 2063/64 to 47.29% in the FY 2062/63. The RBB has higher interest expenses ratio than NBL except for the FY 2062/63, which indicates that RBB has maintained high cost deposit than NBL.

Both the banks had very high staff expense ratio. The ratio of RBB ranged from 34.44% in the FY 2063/64 to 57.99% in the FY 2062/63. Similarly, the ratio of NBL ranged from 45.97% in the FY 2062/63 to 57.93% in the FY 2063/64. The staff

expense ratio of NBL was higher than RBB through out the study period except for the FY 2062/63.

CHAPTER – FIVE

SUMMARY, CONCLUSION & REOCMMENDATION

In this chapter, summary and conclusion of the research as well as recommendations are presented separately. After summarizing and concluding the research, recommendations are suggested for the effective liquidity Management of Nepalese Commercial Banks. The researcher has tried to give suggestions and recommendations to the commercial banks based on this research.

5.1 Summary

The economic development of every country is always measured by its economic indicators. Therefore, every country has given emphasis on the development of its economy. Nowadays the financial institutions are viewed as catalyst in the process of the economic growth. The mobilization of domestic resources is one of the key factors in the economic development of a country. Banking sector plays an important role in the economic development of the country. Commercial banks are one of the vital aspects of this sector, which deals with the process of channeling the available

resources in the needed sector. It is the intermediary between the deficit and surplus of financial resources. Financial institutions like banks are necessary to collect scattered savings and put them into productive channels. In the absence of such institutions it is possible that the saving will not be safely and profitably utilized within the country.

Banks today are under great pressure to meet the objectives of their stockholders, employees, depositors, and borrowing customers, while somehow keeping government regulators satisfied that the bank's policies, loans, and investments are sound. The majority of the needs of the stakeholders are related with the profitability of the banks. Thus, the foremost objective of the banks is the profit maximization. As other types of business entity, commercial banks are also inspired by the profit. In this age of great competition, only the profitable banks can sustain for a long time. Financial policies of any concern are directly or indirectly influenced by its profitability. Thus, it is a base for a bank's survival, growth and expansion.

Due to the inefficient management and the poor performance of those two banks, NRB regulated the Financial Sector Reform Program (FSRP). The Financial Sector Reform Program (FSRP) is in operation in order to make the financial system healthier and efficient. It was launched to improve the financial position along with steer the managerial reform of the two state-owned commercial banks, namely, RBB and NBL and to strengthen the capacity of NRB as a central bank to ensure financial stability along with the expansion of the system. There are mainly three components of FSRP implemented under the loan and grant assistance of the World Bank and Department for International Development (DFID) of the British government as well as the GON. The reform program includes: (a) reengineering of NRB, (b) restructuring of NBL and RBB, and (c) capacity building of the overall financial sector.

Profitability analysis is one of the key tools for financial decision and assist in making plan before using sophisticated forecasting and budgeting procedure. The value of this approach is the quantitative relation, which can be used to diagnose strengths and weakness in a bank performance. Such analysis is considerable things for the bank's common stock holders, investors, bondholders and others. The objective of the study

is to find out and analyze the profitability Position in Nepalese Commercial banks. To fulfill the main objectives following specific objectives are formulated.

1. To analyze the profit and loss trend and growth of the bank over the period.
2. To evaluate the profitability and operating financial efficiency of Nepal Bank Ltd. and Rastriya Banijya Bank.
3. To compare and analyze fund based interest income with fee based income of Nepal Bank Ltd. and Rastriya Banijya Bank in light of interest earning assets.
4. To provide suggestions and recommendations for the improvements of the overall profitability of the banks.
5. To provide the information to investor, creditors, stakeholders.

In the first chapter, brief introduction of Profitability management, focus of the study, significance of the study, research objectives, brief introduction of the sampled banks, limitation of the study and research scheme are included.

In the second chapter, theoretical review has been made. Different theories, policies, rules and regulations about Profitability management are reviewed. During the study different books, journals, previous studies, websites, reports are viewed and visited to different professionals to know the profitability management. During the literature review, it is found that there is a few research have been made on this topic.

Research design, population and sample and analysis tools are included in the third chapter. The data are collected from secondary source for the study. The secondary data are collected from annual papers of sampled banks, SEBON, and Nepal Rastra Bank. After collecting the data from different source, it is analyzed by using financial and statistical tools and techniques.

An attempt has been made to fulfill the objectives of the research work in chapter four. In this chapter all the secondary data are compiled, processed and tabulated as per the necessity and figures; diagrams are also used to present it clearly.

In the chapter five, the summary, conclusion and recommendations are included. The summary of the study, conclusion drawn from the study are presented and necessary

suggestions are given to the concern authorities, sampled banks as well as Nepalese commercial banks for the betterment of Profitability management.

This study suffers from different limitations; it considers two banks for the sampled of total commercial banks in Nepal. Time and resources are the constraints of the study. Therefore, the study may not be generalized in all cases and accuracy depends upon the data collected and provided by the organizations and respondents.

5.2 Conclusion

The research and analysis revealed many interesting issues with respect to the latest profitability condition of NBL and RBB. It was identified from the analysis that the FSRP is in operation in both the bank and also reduced the negative capital funds during this period.

Before the FSRP, RBB suffered from inefficiencies of a state-owned enterprise and political pressures (rather than commercial considerations) to approve loans. It has not been run like a real commercial bank. Where as NBL's issues were slightly different. Basically, it suffered from insider lending. Powerful private shareholders, who became majority shareholders by 1998 A.D., took benefit of loan by themselves or borrowers closely associated with them. When the borrowers make the lending decisions, the discipline of a hard-nosed banker goes out the door. But because people feel that their deposits are implicitly guaranteed by Government of Nepal, both banks continued to receive new deposits and hence did not have any problem meeting day-to-day needs for cash. The central bank (NRB) was not entirely innocent. The weak supervision by NRB was of course not an accident. The larger political environment clearly found it convenient to keep NRB weak and hence made it easier to facilitate misuse of RBB and NBL deposits.

But after the implementation of the FSRP, both the bank has been able to earn profit and has made the better performance. The management teams in both of these banks have introduced a number of plans, policies and manuals in order to strengthen the internal system. These include, among others, credit policy and guidelines in order to reform the credit management and formulate directive for the asset liability management. Also, new accounting directive, internal audit directive, accounts head classification directive, human resource plan, skill enhancement plan, portfolio status

and plan, budget plan, strategic plan and anti-money laundering directive, and trade and finance directive have been implemented. Both the banks have started to write-off their bad debts after the preparation of credit write-off by laws.

5.3 Recommendation

Suggestion is the output of the whole study. It helps to take corrective action in their activities in future. Different analyses are done to arrive at this step. On the basis of above analysis and findings of the study following suggestions and recommendations may be referred to overcome weakness, inefficiency to profitability management and for corrective action for the concern authorities and other researchers.

Both the banks have high level of negative net worth. So a capital plan needs to be worked out and the shareholders of these banks need to employ the capital.

Both the banks have very high potential of earning high profit than they are making in the recent years so both the banks have to utilize its resources more efficiently for generating more profit margins. If resources held idle, bank faces high cost and causes the low profit margin.

Both the banks need to improve the reporting system as well as quality of reporting. The auditing of these banks was in pending for some years. But after the take over of the new management team it has been regulated in the recent year.

The operating efficiency ratio of both the banks is very unfavorable during the study period due to the huge amount of operating expenses in compare to the operating income. Although, both the banks efficiency ratio has lowered in the recent year it has not come to the fair level. So both the banks need to improve its operating efficiency by reducing the non-interest costs especially, staff costs, wages and overhead costs.

Both the banks have very high staff expense related to total operating expense. This is mainly due to the over staffing of the bank. Under the FSRP, the bank have implemented VRS to cut down the number of staff and still both the banks have to rethink to maintain the appropriate level of staff to minimize the staff expenses.

For the better mobilization of deposit and credit, both the banks must take the help of media. It means special publicity campaign should be lunched to provide exposure of

its service, which will help to boost up the banking habits and confidence among the people upon the bank.

Both the bank have very large network in the country, as the bank has to fulfill some social obligations to the rural areas and promoting the development of poor and disadvantage group. In this large network, some branches were incurring very heavy loss whereas there were more branches than required in some urban areas. So, both the banks need to re-look in managing their network through out the country.

As the banks are fully or partially owned by the government, there seems some political influence in both the banks. The banks should be free from the political influence as it affects the overall activities of the bank. So government must be aware of this fact and policy must be developed to improve the current situation of NBL and RBB.

Both the banks still lack scientific MIS. The IT platform needs to be installed as soon as possible. Only after computerization of the activities, the public will feel improvements in the banking operation. But the computerized system is limited to certain branches of the banks. They have more than a million customers in rural and urban areas. So banks must be aware and accountable to these people for the implementation of integrated banking package.

Both the banks should introduce major programs as per the customers demand these days such as consumer banking, home loans, study loan, vehicle loans, credit car facilities, online banking, ATM card etc. These facilities are provided by the foreign and joint venture banks, which made RBB and NBL to lag behind.

BIBLIOGRAPHY

Books

Agrawal, G.R. (2002 A.D.), *Dynamics of business environment in Nepal*, M. K. Publishers and Distributors, Kathmandu

Argent, John (1968 A.D.), *Corporate Planning – A Practical Guide*, Jorge Allen and Unwin, London

Cauvery, R. (1997 A.D.), *Managerial Economics*, Irwin Publication, Singapore

Dahal, S. & Dahal, B. (1996 A.D.), *A Hand Book to Banking*, Asmita Books, Kathmandu

Dangol, R.M. (2000 A.D.), *Accounting for Financial Analysis and Planning*, Teleju
Prakasan, Kathmandu

Howard, B.B. and Upton, M. (1961 A.D.), *Introduction to Business Finance*,
McGraw Hill, New York

Narayan, L. (1980 A.D.), *Principal and Practice of Public Enterprises Management*,
S. Chand & Company, New Delhi

Robinson, Ronald I. (1951 A.D.), *The Management of Bank Funds*, McGraw Hill,
New York

Rose, Peter (1991 A.D.), *Commercial Bank Management*, Irwin Publication,
Singapore

Wagle, K. N. and Dahal, R.K. (2004 A.D.), *Management Accounting*, Khanal Books
and Stationery, Kathmandu

Woelfel, Charles J. (1999 A.D.), *Encyclopedia of Banking and Finance*, Irwin
Publication, Singapore

Sharma, P.K. and Choudhary, A.K. (2002), *Statistical Methods*, Kathmandu: Khanal
Books Prakashan.

Shrestha Manohar k. and Bhandari Dipak B. (2004), *Financial Markets and
Institutions*, Kathmandu: Amita Books Publishers and Distributers

Reports, Journals and Articles

Bajracharya, (2047 B.S.), *“Rastriya Banijya Bank: A comparative performance
study”* published in Rajat Jayanti Smarika, RBB, 2047

Dhungana, (2053 B.S.), *“Problem encountered by the Nepalese financial system”*,
NRB Samachar, Annual Publication, 2053 B.S

Poudel, (2058 B.S.), *“Financial statement Analysis: An Approach to Evaluate
Bank’s Performance”* NRB Samachar, Annual Publication, 2053 B.S

Demirgüç-Kunt and Harry Huizinga, (1999 A.D.), “*World Bank Policy*” Research Working Paper No. 1900

New Business Age, September 2009 A.D. entitled “*All Banks in Profit*”

Dhungan, (2005 A.D.), “*Financial sector reform program (FSRP) in Nepal*” RBB Newsletter Vol 6. September 2005

Panthi, (2005 A.D.), “*The importance of human resource management*”, RBB Newsletter Vol 6. September 2005

Kantipur Daily, July 06, 2007 A.D., “*Results of FSR are Encouraging*”, NRB Governor

New Business Age, August 2008 A.D., “*Banks & Profit*”

Unpublished Thesis

Khadgi, R. L. (2006 A.D.), A study on “*Investment Policy Analysis of NABIL Bank Ltd.*” submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies.

Sapkota, S. R. (2007 A.D.), A study on “*Profitability Benchmarking of NB Bank*” , submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies.

Dhungana, M. (2008), A Study on “*Investment & Liquidity Management of Insurance Companies*” submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies.

Maharjan, B. L. (2009 A.D.), A Study on “*Liquidity Management of Commercial Bank of Nepal (A comparative study with reference to NIBL, HBL and NABIL)*” ,submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies

Karki, L.B. (2010 A.D.) , A Study on “*Liquidity Management of Commercial Bank of Nepal (A comparative study with reference to NIBL, HBL and NABIL)*”,submitted to Shanker Dev Campus in partial fulfillment of the requirement of Degree of Master in Business Studies

Websites

www.nrb.org.np

www.nbl.com

www.rbb.com.np

Appendix - I

Summary of Financial Transaction of RRB (in Million)

| Particular | Ref. | 062/063 | 063/064 | 064/065 | 065/066 | 066/067 |
|------------------------|------|---------|---------|---------|---------|---------|
| Total Operating Income | a | 2348 | 3618 | 3466 | 2756 | 2980 |
| Net Profit | b | -4840 | 1040 | 1323 | 1592 | 1618 |
| Total Assets | c | 43172 | 45056 | 56822 | 39879 | 46140 |
| Shareholder Equity | d | -22396 | -21438 | -20200 | -18719 | -17220 |

| | | | | | | |
|-------------------------|---|------|------|------|------|------|
| Total Operating Exp. | e | 5601 | 2631 | 2050 | 1884 | 2102 |
| Interest Income | f | 2051 | 2236 | 2329 | 2283 | 2357 |
| Interest Expenses | g | 2108 | 1495 | 1005 | 850 | 943 |
| Total Income | h | 2355 | 3765 | 3510 | 4299 | 4236 |
| Fee & Commission Income | i | 210 | 310 | 288 | 289 | 344 |
| Staff Exp. | j | 3248 | 906 | 811 | 745 | 789 |

Appendix II

Calculation of Ratio Analysis of RRB

| Particular | Ref. | 062/063 | 063/064 | 064/065 | 065/066 | 066/067 |
|---|------|---------|---------|---------|---------|---------|
| Net profit Margin | b/a | 206.13 | 28.75 | 38.17 | 57.76 | 54.30 |
| Return on Total Assets | b/c | -11.21 | 2.31 | 2.33 | 3.99 | 3.51 |
| Return on Equity | b/d | -21.61 | -4.85 | -6.55 | -8.50 | -9.40 |
| Operating efficiency Ratio | e/a | 238.54 | 72.72 | 59.15 | 68.36 | 70.54 |
| Interest Payout ratio | g/f | 102.78 | 66.86 | 43.15 | 37.23 | 40.01 |
| Interest Income to Total Income | f/h | 87.09 | 59.39 | 66.35 | 53.11 | 55.64 |
| Fee & Commission Income to Total Income | i/h | 8.92 | 8.23 | 8.21 | 6.72 | 8.12 |
| Interest exp. to Total Operating Exp. | g/e | 37.64 | 56.82 | 49.02 | 45.12 | 44.86 |
| Staff Exp. to Total Operating Exp. | j/e | 57.99 | 34.44 | 39.56 | 39.54 | 37.54 |

Appendix III

Summary of Financial Transaction of NBL (in Million)

| Particular | Ref. | 062/063 | 063/064 | 064/065 | 065/066 | 066/067 |
|------------------------|------|---------|---------|---------|---------|---------|
| Total Operating Income | a | 2986 | 3336 | 2718 | 2488 | 2553 |
| Net Profit | b | -252 | 710 | 1730 | 1207 | 227 |
| Total Assets | c | 38816 | 44161 | 47045 | 35918 | 39258 |
| Shareholder Equity | d | -9831 | -9014 | -7426 | -6301 | -6248 |

| | | | | | | |
|-------------------------|---|------|------|------|------|------|
| Total Operating Exp. | e | 3354 | 3192 | 2435 | 2270 | 2273 |
| Interest Income | f | 2200 | 1825 | 1987 | 2049 | 1849 |
| Interest Expenses | g | 1586 | 1025 | 748 | 774 | 773 |
| Total Income | h | 3118 | 3981 | 4169 | 4324 | 2603 |
| Fee & Commission Income | i | 280 | 232 | 188 | 178 | 181 |
| Staff Exp. | j | 1542 | 1849 | 1305 | 1067 | 1125 |

Appendix IV
Calculation of Ratio Analysis of NBL

| Particular | Ref. | 062/063 | 063/064 | 064/065 | 065/066 | 066/067 |
|---|------|---------|---------|---------|---------|---------|
| Net profit Margin | b/a | -8.44 | 21.28 | 63.65 | 48.51 | 8.89 |
| Return on Total Assets | b/c | -0.63 | 1.61 | 3.68 | 3.36 | 0.58 |
| Return on Equity | b/d | -2.56 | -7.87 | -23.30 | -19.16 | -3.63 |
| Operating efficiency Ratio | e/a | 112.32 | 95.68 | 89.59 | 92.24 | 89.03 |
| Interest Payout ratio | g/f | 72.09 | 56.16 | 37.64 | 37.77 | 41.81 |
| Interest Income to Total Income | f/h | 70.56 | 45.84 | 47.66 | 47.39 | 71.03 |
| Fee & Commission Income to Total Income | i/h | 8.98 | 5.83 | 4.51 | 4.12 | 6.95 |
| Interest exp. to Total Operating Exp. | g/e | 47.29 | 32.11 | 30.72 | 34.10 | 35.65 |
| Staff Exp. to Total Operating Expenses | j/e | 45.97 | 57.93 | 53.59 | 47.00 | 49.49 |

Appendix V
Trend Analysis of Net Profit of RBB

| Year | Time Period | Net Profit | x ² | xy |
|----------|-------------|------------|----------------|-------|
| | (x) | (y) | | |
| 2062/063 | 1 | -4840 | 1 | -4840 |
| 2063/064 | 2 | 1040 | 4 | 2080 |
| 2064/065 | 3 | 1323 | 9 | 3969 |

| | | | | |
|----------|-----------------|------------------|-------------------|---------------------|
| 2065/066 | 4 | 1592 | 16 | 6368 |
| 2066/067 | 5 | 1618 | 25 | 8090 |
| | $\Sigma X = 15$ | $\Sigma y = 733$ | $\Sigma X^2 = 55$ | $\Sigma xy = 15667$ |

For this method we have a equation

$$y = a + bx \dots\dots\dots i$$

Where,

y = net profit

x = time period

n = 5 (number of years)

a and b = constant parameters which are to be estimated. The parameter b gives the measure of annual increase in sales. The unknown parameter a and b are estimated by solving the following two equation based on the principle of least square.

$$\Sigma y = na + b\Sigma x \dots\dots\dots ii$$

$$\Sigma xy = a\Sigma x + b\Sigma x^2 \dots\dots\dots iii$$

Substituting the value in eqn. ii and iii We have,

$$733 = 5a + 15b \dots\dots\dots iii$$

$$15667 = 15a + 55b \dots\dots\dots iv$$

Multiplying equation iii by 3 and solve them

$$\begin{array}{r} 15667 \quad 15a \quad 55b \\ \underline{2199 \quad 15a \quad 45b} \\ 13468 \quad \quad 10b \end{array}$$

$$\text{Or, } 10b = 13468$$

$$\text{Or, } b = 1346.8$$

Substituting the value of b in equation iii

$$733 = 5a + 15b$$

$$733 = 5a + 15 \times 1346.8$$

$$3622 = 5a + 20202$$

$$\text{Or, } a = -3893.8$$

Now substituting the value of constant a & b in equation (i) we get

$$y = -3893.8 + 1346.8x$$

From the equation, now we can obtain the forecast of the net profit for next five year.

Forecast for next 5 years profit

| Year | Time Period (X) | $Y = a + bx$ | Forecasted Net Profit |
|----------|--------------------|----------------------------------|-----------------------|
| 2062/063 | 6 | $y = -3893.8 + 1346.8 \times 6$ | 4187 |
| 2063/064 | 7 | $y = -3893.8 + 1346.8 \times 7$ | 5534 |
| 2064/065 | 8 | $y = -3893.8 + 1346.8 \times 8$ | 6881 |
| 2065/066 | 9 | $y = -3893.8 + 1346.8 \times 9$ | 8227 |
| 2066/067 | 10 | $y = -3893.8 + 1346.8 \times 10$ | 9574 |

Appendix VI Trend Analysis of Net Profit of NBL

| Year | Time Period (x) | Net Profit (y) | x^2 | xy |
|----------|--------------------|-------------------|-------|------|
| 2062/063 | 1 | -252 | 1 | -252 |

| | | | | |
|----------|-----------------|-------------------|-------------------|---------------------|
| 2063/064 | 2 | 710 | 4 | 1420 |
| 2064/065 | 3 | 1730 | 9 | 5190 |
| 2065/066 | 4 | 1207 | 16 | 4828 |
| 2066/067 | 5 | 227 | 25 | 1135 |
| | $\Sigma X = 15$ | $\Sigma y = 3622$ | $\Sigma X^2 = 55$ | $\Sigma xy = 12321$ |

For this method we have a equation

$$y = a + bx \dots\dots\dots i$$

Where,

y = net profit

x = time period

n = 5 (number of years)

a and b = constant parameters which are to be estimated. The parameter b gives the measure of annual increase in sales. The unknown parameter a and b are estimated by solving the following two equation based on the principle of least square.

$$\Sigma y = na + b\Sigma x \text{-----ii}$$

$$\Sigma xy = a\Sigma x + b\Sigma x^2 \text{----iii}$$

Substituting the value in eqn. ii and iii We have,

$$3622 = 5a + 15b \text{-----iii}$$

$$12321 = 15a + 55b \text{-----iv}$$

Multiplying equation iii by 3 and solve them

$$\begin{array}{r} 12321 \quad 15a \quad 55b \\ \underline{10866 \quad 15a \quad 45b} \\ 1455 \qquad \qquad 10b \end{array}$$

$$\text{Or, } 10b = 1455$$

$$\text{Or, } b = 145.5$$

Substituting the value of b in equation iii

$$3622 = 5a + 15b$$

$$3622 = 5a + 15 \times 145.5$$

$$3622 = 5a + 2182.5$$

$$\text{Or, } a = 287.9$$

Now substituting the value of constant a & b in equation (i) we get

$$y = 287.9 + 145.5x$$

From the equation, now we can obtain the forecast of the net profit for next five year.

Forecast for next 5 years profit

| Year | Time Period (X) | Y = a + bx | Forecasted Net Profit |
|-------------|----------------------------|-------------------------------|------------------------------|
| 2062/063 | 6 | $y = 287.9 + 145.5 \times 6$ | 1161 |
| 2063/064 | 7 | $y = 287.9 + 145.5 \times 7$ | 1306 |
| 2064/065 | 8 | $y = 287.9 + 145.5 \times 8$ | 1452 |
| 2065/066 | 9 | $y = 287.9 + 145.5 \times 9$ | 1597 |
| 2066/067 | 10 | $y = 287.9 + 145.5 \times 10$ | 1743 |