FINANCIAL PERFORMANCE ANALYSIS OF OM FINANCE LIMITED IN THE FRAMEWORK OF CAMELS

By:

Sher Bahadur Gurung

Prithivi Narayan Campus

Roll No: 319/066

T.U. Regd. No.: 7-2-48-3076-2006

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RECOMMENDATION

This is to certify that the thesis

Submitted by:

Sher Bahadur Gurung

Entitled

FINANCIAL PERFORMANCE ANALYSIS OF OM FINANCE LIMITED IN THE FRAMEWORK OF CAMELS

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

Supervisor

Name: **Prof. Keshar J. Baral, PhD**

Signature

Head of Department

Name: **Prof. Dr. Puspa Raj Sharma**

Signature:

Campus Chief

Name: **Prof. Dr. Debendra Bahadur Lamichhane**

Signature:

Date:

VIVA VOCE SHEET

We have conducted the viva-voce examination of the thesis

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Sher Bahadur Gurung

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

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

Viva-Voce Committee

Chairperson, Research Committee: ……

Member (Thesis Supervisor): ……

Member (External Expert): ……

Date:

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LIST OF ABBREVIATIONS/ACRONYMS

ALLL	:	Allowance for Loan and Lease Losses
BAFIA	:	Bank and Financial Institution Act
BCBS	:	Basel Committee of Banking Supervision
BIS	:	Bank for International Settlements
CAMELS	:	Capital, Assets, Management, Earning, Liquidity, Sensitivity
CAR	:	Capital Adequacy Ratio
CCAR	:	Core Capital Adequacy Ratio
CGAP	:	Cumulative GAP
EAGLES	:	Earning, Assets, Growth, Liquidity, Equity, Strategy
EPE	:	Earning Per Employee
EPS	:	Earning Per Share
FFIEC	:	Federal Financial Institution Examination Council
FIs	:	Financial Institutions
Ind.	:	Industrial
MACRO	:	Management, Assets, Capital, Risk, Operating
NIM	:	Net Interest Margin
NPL	:	Non Performing Loan
OFL	:	Om Finance Limited
PCA	:	Prompt Corrective Action
PLLL	:	Provision for Loan and Lease Losses
ROA	:	Return on Assets
ROE	:	Return on Equity
SCAR	:	Supplementary Capital Adequacy Ratio
TER	:	Total Expenses Ratio
UFIRS	:	Uniform Financial Institutions Rating System

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

Nepal is agriculture dominated economy where most of the population is engaged in farming. Urban areas are dominated by rural areas in Nepal and which are mainly focused on agriculture. Therefore, it is obvious that contribution of the sector in national economy is huge. Never less, in recent year non-agriculture sector is significantly contributing in national economy. Due to political insurgency manufacturing sector is not growing as expected but service sector is growing rapidly. Banking industry is growing highly than it was anticipated. Banking sector is the most dynamic part of economy which collects unused funds and mobilizes it in needed areas. Today's world is "the word of business"; it is moving very fast, coping with various ups and downs. There is competition in every field. The business generates money to further invest in various securities. The saving of the people is also invested to generate money. Thus, it is one of the most common and crucial place for businesspersons, individuals and households in financial institutions (Devkota, 2008).

Generally financial institution collects and mobilizes funds into the productive sectors. They have a major responsibility to utilize unused scattered money into development of the nation. In this sense, financial institutions occupy a vital role for the development of the country like Nepal. Banking is regarded as the backbone of economy. Banking helps to achieve fast economic development by mobilizing the available resources and channeling capital to the productive sector of the economy.

Financial performance analysis is a process of identifying the financial strength and weakness of the firm by properly establishing the relationship between item of balance sheet and the profit and loss account. It is undertaken to assess the financial strength and weakness of the firm. The analysis is usually based on financial statement prepared by the firm. Financial analysis serves as the basis for decision making. Moreover this analysis is also made to find out whether to use debt or equity funds to finance planned plant expansion. Financial analysis uses data contented in

the firm's financial statement supplemented by the statement of cash flows. Furthermore, it summarized the large quantity of financial data and makes qualitative judgment about the firm's financial performance. The primary tools of financial analysis are financial ratios. Financial ratios provide a good technique for assessing financial performance.

Finance companies are the financial institutions that engage in satisfying individual credit need and perform merchant banking function. In other words, finance companies are the non-bank-financial institutions that tend to meet the various kinds of consumer credit need. They involve in leasing, project financing, housing and other kind of real estate financing (Paudel, 2006).

The primary function of finance companies is to make loan to both individuals and businesses. These companies are popular among low income and medium class people for financing hire purchase, vehicles, machinery tools, equipments, durable household goods etc. they can also perform merchant banking activities with prior approval of NRB. There is no restriction for finance companies to invest in government securities and NRB bonds. But, they have to perform their activities as prescribed by NRB directives (Gurung, 2007).

There are 59 finance companies are operating in Nepal and 16 in Pokhara by Mid July 2013. Om Finance Limited (OFL) is one of the leading finance company of Pokhara. It was registered in 2054 B.S., by group of highly reputed and skilled promoters and came into operation on 29th Bhadra, 2057 B.S. The main objective of OFL is to collect dispersed saving of people and convert them in to capital and lend to individuals or institutional borrowers. As a whole, its main objective is to support the national economy by considering financial and technical facility to general public. Its head office is located at Newroad, Pokhara (OFL, 2070).

Om Finance Limited is providing the financial services in Pokhara valley as per market demands. The service provided by the finance is trustworthy, protective and easy financial services. It has branches at Bagdarbar; Kathmandu, Safasadak; Damouli, Beshisahar; Lamjung, Rambazar; Pokhara, Bhairab Tole; Pokhara, Maharajgunj; Kathmandu, Golmadi; Bhaktapur and Kumaripati; Patan (http://omfinance.com/content/?page_id=726).

At the starting period, OFL had authorized capital of Rs 40 million, issued capital of Rs 20 million and paid up capital of Rs 10 million and present it has increased its authorized capital to Rs 840 million, issued capital to Rs 320 million and

paid up capital to Rs 320 million. Initially its operation was started with 6 employees and now the total numbers of employees is 87. There are six members in board of directors of whom two members are elected by general shareholders and four members are from the promoters of OFL. All the decisions of OFL are taken by BOD under rules and regulations formulated by NRB as well as BAFIA 2063 B.S (OFL, 2070)

1.2 Focus of the Study

Financial performance analysis is a process of identifying the financial strength and weakness of the firm by properly establishing relationship between the item of balance sheet and the profit and loss account. Ratio analysis is a powerful tool of financial analysis. The study aims to analyze the financial performance of OFL in the framework of CAMELS by using descriptive and analytical research design. Thus, whole energy and effort concentrate on analysis of financial performance of the company. More specifically, the study focuses on the trend of capital adequacy ratio with comparing to NRB standard, non-performing loan ratio with comparing to industrial average, trend of loan loss ratio, and trend of total expenses to total revenues ratio, trend of earning per employee, trend of return on equity, return on assets, net interest margin and earning per share and trend of NRB balance to total deposit ratio, vault to total deposits ratio with comparing to industrial average during the period of pass five years starting from FY 2065/66.

1.3 Statement of the Problem

A financial institution's soundness is judged on the basis of capital adequacy, asset quality, management, earning, liquidity and sensitivity to market risk (CAMELS). Some financial institution have very low capital adequacy ratio while some have piles of non-performing assets. Similarly, it appears that financial institutions do not have proper system managing the correctness of credit classification and provision of some finance company. The profitability position of a firm is generally known through financial statements but a major question emerges whether there are adequate to reflect the overall performance of company. The fundamentals problem of this study is to check up the financial health of Om finance

company in the framework of CAMELS. Based on this general problem the following specific problems are set in this study.

1. What is the capital adequacy ratio of OFL?
2. What is the quality of assets of OFL?
3. How far the company is managing their expenses with respect to revenues?
4. What is the trend of profitability made by the OFL?
5. What is the trend of liquidity position in the OFL?
6. How changes in interest rates can affect OFL's earning?

1.4 Objectives of the Study

The finance company should know its financial health. To know the financial condition of OFL, it can use many financial tools and techniques. So, the objective of this study is to check up the financial health of OFL in the framework of CAMELS. By using these tools, we will be able to know the capital adequacy, quality of assets, management quality, earning performance liquidity position and sensitivity to interest rate risk of OFL. On the basis of these general objectives the following specific objectives have been set.

1. To analyze the capital adequacy ratio of OFL.
2. To analyze the quality of assets of OFL.
3. To assess the efficiency of the OFL's management.
4. To analyze the trend of profitability of OFL.
5. To analyze the trend of liquidity position in the OFL.
6. To assess sensitivity of OFL's earning to interest rate risk.

1.5 Significance of the Study

Research itself has own importance because it aims to gain knowledge and to add the new literature to the existing field. The significance of this study lies mainly in filling a research gap on the study of financial performance analysis of finance company with respect to Om Finance Company. This study will contribute significantly to solve the problem existing in the financial institution and to formulate the policy and strategies to maintain activities effectively. The study is important for finance companies, researchers, scholars, investors, students, government and many other parties. So, this study will be helpful to those who want to study in further detail

and widely in this field. Apart from this, the study will benefit the stakeholders to know the financial health of OFL. Besides, the study will also be helpful to the investors, board of directors, managers, shareholders, debtors, creditors and consumers of Om Finance Limited. At last, it is expected that the study will add a drop of literature to the field of finance company and their financial performance analysis.

1.6 Limitation of the Study

Every study is conducted within certain limitation. The present study is not an exception. The study is a case study of OFL, which may not represent the overall scenario of all finance companies. Basically, the study is limited within the following factors.

1. The study is only confined to financial performance analysis of OFL, so all the activities and intended to analyze the financial performance.
2. Last five years' data is taken in consideration for the study purpose. (from FY 2065/66 to FY 2069/70)
3. The study is simply a partial fulfillment of MBS degree and prepared with in time constraint.
4. Only one finance company is taken as the sample of the study.
5. This study is more importantly rely on secondary data which will be collected from the annual reports of NRB, books, journals, articles and other available records.
6. It will be based on historical data.

1.7 Organization of the Study

This study is organized into five chapters. The first chapter includes background of the study, statement of the problem, objective of the study, significance of the study, limitation of the study and organization of the study.

The second chapter is review of literature. This chapter includes conceptual review and review of related studies. Past studies conducted by foreign and Nepalese scholars in the performance of financial institution have also been presented.

The third chapter is research methodology. This chapter includes the research design, population and sample, the sampling procedure, the sample characteristics, the data gathering procedure and the statistical procedure.

The fourth chapter is data analysis and presentation. This chapter is included data presentation, data analysis and major finding of the study.

The fifth and last chapter is summary, conclusions and recommendations. Last part of the study is bibliography and appendices.

CHAPTER 2

LITERATURE REVIEW

This chapter is divided into two parts: conceptual review and review of related studies.

2.1 Conceptual Review

This sub-chapter presents the theoretical aspect of the study. It includes the concept of finance company, function of finance company, historical development of financial institutions in Nepal, concept of financial performance analysis and concept of CAMELS rating.

2.1.1 Concept of Finance Companies

Finance companies are the non-bank financial institutions which borrow funds so as to profit on the difference between the rates paid on borrowed funds and those charged on loans. However, they act as the borrowing and lending financial institution with additional financial risk taking management. They came into existence under the finance company act, 2042 and now operating under Bank and Financial Institution Act, 2063. They are registered as Limited Companies at the office of the company Registar. A finance company can accept time deposits of the maturity of three months to maximum six years. They can also collect fund by issuing debentures. These companies provide basically three types of loan. Such as hire purchase loan, housing loan and term loan. Some of the finance companies deal with leasing finance also. Finance companies make installments loans. They offer attractive rates on the deposits than commercial Banks (Devkota, 2008).

In Nepal, the finance companies are established with the slow growth and traditional attitude of commercial Banks in mobilizing financial resources lack of financial innovation and growing interest of the public on Uphar and Dhukuti programmed (Neupane, 1995).

In the same way, the finance company is established with a view to provide easy access to fulfill individual credit needs, provide attractive return , incentives and favorable terms on deposits encourage consumers to strengthen their purchasing power (Sherstha, 1995). Finance companies are those intermediaries which link the savers and users of capital. They collect small and scattered saving of the individuals and mobilize it in the productive sectors in the form of investment or loan (Upadhaya, 2004). On the other hand, finance company being a financial intermediaries accept time deposits and advance loans to the individuals , firms, companies or institution for agriculture as well as non-agriculture purpose in order to increase economic activities. Finance companies are the market maker, investigator and use of money market and capital market (Sharma, 2005). In the same way, finance companies are the non-banking financial institutions which borrowed funds so as to profit on different rates paid on borrowed funds and those charged on loans (Devkota, 2008).

2.1.2 Historical Development of Financial Institutions in Nepal

The history of modern financial system of Nepal was begun in 1937 A.D. with the establishment of the Nepal Bank Limited (NRB) as the first commercial bank of Nepal with the joint ownership of government and general public. As mentioned above, Nepal Rastra Bank (NRB) was established after 19 years since the establishment of the first commercial bank i.e., Nepal Bank Limited. After the establishment of NRB, Nepal witnessed a systematic development of the financial system. After the restoration of the democracy in 1991, Nepal has clearly been following a liberalized economic policy and witnessing diversification in financial system (Dhakal and Panthi, 2002). As a result, various banking and non-banking financial institutions have come into existence. As of Mid-July 2013, there are 31 Commercial Banks, 86 Development Banks, 59 Finance Companies, 31 Micro Finance Development Banks, 15 Savings and Credit Co-operatives and 31 Non-Government Organizations (NGOs) operation in the country. These financial institutions are under the regulation and supervision of the NRB (NRB, 2013).

In the developing stage of financial institution in Nepal, the establishment of Agriculture Development Bank was another significant achievement. It was established in 1968 A.D. under the ADBN Act 1967 A.D. to address the need of agriculture sector (Gurung, 2007).

Globalization of the banking sector presents a unique set of challenges. Nepal's history of financial sector development has been around for a little over twenty years. The development in this sector actually started in mid-1980s with the entry of foreign banks in joint venture with Nepali promoters breaking the monopoly of the state-owned banks. Non Banking Financial Institutions (NBFIs) started being licensed in 1984 with lower capital requirement than the banks and it marked the need for more players in the market to expand the access of services to the general public. However, the actual proliferation of finance companies did not commence until the mid nineties.

The finance companies Act-2042 was the first law that governed the operation and limitations of finance companies. It allowed finance companies to take deposits from the people and make investment on hire purchase, housing industry, commerce etc. In effect they were allowed to operate as mini banks. Some eight years later, the Merchant Banking Act 2050 allowed certain finance companies that met the regulatory requirement to acquire merchant banking license as well. The only major difference between a commercial bank and a finance company in terms of the activities allowed to them. The only areas reserved for the commercial banks are: overdrafts, personal loans, foreign exchange transaction and opening letters of credit. Recently, the finance companies are allowed to transact also in Indian currencies though they are still restricted from other foreign currencies.

In order to govern this sector more prudently, the Banks and Financial Institution Act 2063 (also known as the Umbrella Act) was introduced by replacing all the other earlier Acts thus making this the single Act that governs all financial sector players from commercial banks to finance companies. The banks and financial institutions are divided into various categories fixing the extent of permitted services based on the capital.

The players with the highest capital base are the Commercial banks and they are given "A" class category, Development banks "B" class category, Finance companies "C" class category and Micro-Financing Institutions and Cooperatives are given "D" class category. Product and services are allowed according to the category an institution belonged to. Although this has been in line with the principal of prudential regulation and it has enabled the Nepal Rastra Bank to incorporate all the formal players in the financial sector under its regulatory jurisdiction, the purpose of making financial services endemic has not materialized. All it has done is dividing the

number of players into capital structured groups. However, the Umbrella Act along with the prudential regulations of the Nepal Rastra Bank has made this sector the most transparent and highly regulated industrial group, which is positive development despite the frequent changes in directives (Devkota, 2008).

2.1.3 Financial Product and Services

Finance companies can accept time deposit of the maturity of minimum three months to maximum six years. Generally, the following types of financial products are provided by finance companies.

Saving deposit: finance companies accept saving deposit from individuals and organizations. The main purpose of saving deposit is to encourage the habit of saving among the common people and institutions. Depositors can deposit any amount in their accounts in any time. But they can withdraw their money up to limited amount in certain period. Prior information is required in case of withdrawal beyond the restricted limit. Finance companies are allowed to accept saving deposits not exceeding 2.5 times of their core capital. They provide interest on daily balance basis in saving deposit.

Fixed deposit: fixed deposits are also known as time deposits or term deposits. They carry a fixed maturity, a penalty is charged for early withdrawal. Savers that do not need money for a stipulated period from 3 months to longer periods ranging up to 6 years are encouraged to keep it in fixed deposits. This type of deposit offers higher interest rate than saving account. Longer the maturity period, higher will be the rate of interest. However, the depositors can take 90 percent loan from the finance companies against the security of fixed deposit receipt.

Recurring Deposit: various type of recurring deposit schemes are introduced by finance companies. This scheme was developed to encourage the economical among the people of fixed regular earnings. In this scheme, the depositor is required to deposit the fixed amount in each installment and repaid the total amount with interest at maturity.

Finance companies advance loans to individual firms, companies and institutions. They provide different types of loan which are as follows.

Hire Purchase Loan: under this type of loan, finance companies provide loan for the purchase of vehicle, machines, equipments and tools, durable household goods and

other movable property. The loan will be provided in installment basis and the interest rate will be depending on the situation. The repayment of this loan will be in installment with interest.

Housing Loan: under this type of loan, finance companies provide loan for the purchase of land, construction of house for individuals and warehouse. The interest rate will be up and down according to economic situation. It is issued in installment basis and repayment will also be in installment with interest.

Term Loan: under this type of loan, finance companies provide loan for the expansion of trade industry, further education, health, tourism, agriculture, water resources, irrigation etc.

Loan against fixed deposit: under this type of loan, only the person or organizations that have certain amount on fixed deposit in the company will get loan. Only the fixed depositors can get the loan up to 90 percent of fixed deposit amount. The company charges plus 2 percent interest in this type of loan.

Finance companies are free to fix interest rates on both the deposits they take and the loan they provide (NRB, 2062). So, the rate of interest on both the deposits and loans will vary from one finance company to another. Other financial services provide by finance companies are issue of shares and underwriting, act as financial guarantee, collect share applications, purchase and sale of government bonds.

2.1.4 Bank and Financial Institution Act, 2063

Bank and Financial Activities are governed by rules and regulations which are reviewed from time to time to reflect the changing economic environment. Previously, Finance Company Act, 2042 used to govern finance companies in Nepal. Due to the absence of Parliament, Bank and Financial Institutions ordinance (BAFIO) came into existence in February 4, 2004. The ordinance is renewed in every six months. BAFIO governs all types of financial institutions. It aims to ensure reliable and quality banking and financial intermediation services through healthy completion among banks and financial institutions safeguard and promote the interest of the depositors and people at large in the overall banking and financial system of the country. The ordinance repeals and replaces all existing Acts relating to commercial banks. Nepal Industrial Development Bank, other Development Banks and Finance companies and brings all such institutions under one single Act which is known as

Umbrella Act. As per the Umbrella Act, banks and financial institutions are to be classified as A, B, C and D class on the basis of minimum paid up capital. Accordingly, Commercial banks are in the 'A' class and they are labeled as Banks. Similarly, development banks, finance companies and micro credit developments are categorized into 'B', 'C' and 'D' class respectively and they are called Financial Institutions (BAFIO, 2004). By Mid-July 2013, there are 31 commercial banks of 'A' class, 86 Development banks of 'B' class, 59 Finance companies of 'C' class and 31 micro credit development banks of 'D' class. Besides this, there are 15 saving and credit co-operative and 31 NGOs undertaking limited banking functions after obtaining permission from the NRB.

For the proper and smooth operation of bank and financial institutions, an Umbrella Act named Bank and financial Institution Act, 2063 has recently been enacted, which is effective since 16th of Shrawan, 2063. As per the Act, well performing bank or financial institution may be upgraded if it has met capital requirement, has been in profit for the last 5 years in a row, total non-performing assets has remained within the NRB prescribed limit and all the prescribed condition have been met. Similarly, NRB can downgrade any bank or financial institutions from 'A' to 'B' or 'B' to 'C' class if its status of performance is found to have turned totally other way around against as prescribed. Subject to this Act, class 'C' licensed institution may conduct the following types of financial transactions:

1. Accept deposits with or without interest and refund such deposits, subject to the limit prescribed by the NRB.
2. Supply credits other than hypothecation credit as prescribed.
3. Supply credits for businesses relating to hire-purchase, leasing and housing, as well as for service enterprise.
4. Engage in merchant banking business.
5. Write off credit subject to the bye-rules framed by the Board.
6. Supply credit on the basis of co-financing by joining hands with other licensed institutions according to the agreement concluded for the purpose so as to divide the collateral.
7. Supply credit against the guarantee provided by any bank or financial institution.
8. Obtain credits by pledging its movable or immovable asset as collateral.

9. Supply a fresh credit in a lump sum or in installment against the security of the same movable or immovable assets which have already been pledged with it or with any other licensed institution, to the extent covered by the total value of such security.
10. Properly manage, sell or lease out its assets.
11. Issue, accept, pay, discount or deal in bills of exchange, promissory notes, cheques, travellers' cheques, drafts or other financial instruments.
12. Deal in Indian currency.
13. Supply credits not exceeding the amount prescribed by the Rastra Bank to ensure the economic upliftment of the destitute class, low income families, victims of natural calamities and inhabitants of any area of the country with the provision of individual or collective guarantee.
14. Exchange with the Rastra Bank or any other licensed institution particulars, information or notices regarding debtors or customers who have obtained credits or any other facility from it or any other licensed institution.
15. Supply installment or hire-purchase credit to any individual, firm, company or institution for vehicles, machinery, tools, equipment, durable household goods or similar other movable property.
16. Supply credit to any individual, firm, company or institution for the purchase or construction of residential houses or go downs, or for the purchase of lands for the construction of such residential house or go downs.
17. Supply credit (leasing-finance) to any individual, firm, company or institution for taking up vehicles, machinery, tools, equipment, durable household goods or similar other movable property on lease, or provide such movable property on lease.
18. Prescribe conditions according to need in order to protect its interests while supplying credit to any individual or institution or carrying out any Hans action with him/her/it.
19. Operate projects such as those relating to purchase of lands and construction of buildings for lands and buildings, or make arrangement for doing so.
20. Perform such other functions as are prescribed by the Rastra Bank.

2.1.5 Approaches to Supervision

Effective supervision is prerequisite for growth and stability of financial system. The supervision facilities the detection of frauds, malpractices, abuses of power by management and undesirable trends and imprudent practices such as deterioration in the quality of loan portfolio and insider lending. Due to the fast growth of financial institutions, a separate department for supervision of financial institution was established in 1998, which was named as Financial Institution Supervision Department (FISD). So at present all the commercial banks are supervised by FISD (NRB, 2002). The FISD carry out on-site examination of financial institution by sending examination team to the institutions. The most common supervisory tools used by the regulatory agencies in promoting safety and soundness are on-site supervision and off-site supervision. Both on-site and off-site supervision (inspection reports) helps to discourage the unnecessary delays.

On-Site Supervision: The on-site supervision is a regular full scope corporate level examination to assess the condition of financial institutions. On-site examination is the most effective tools for constraining financial institution's risk. On-site supervision is performed on the basis of on-site inspection manuals. The manual covers the areas of capital adequacy, loan portfolio management, treasury operation, management information system, and internal control system and information technology. This manual provides guidelines to examiners for preparation of inspection report. Generally 15 days before, the concerned financial institutions are informed to prepare the necessary documents by the FISD, and then only on-site examination is done. After the completion of on-site inspection, CAMELS rating of financial institutions are done by Supervisors.

Off-Site Supervision: An off-site supervisory undertakes an assessment of the soundness of financial institution based exclusively on an analysis of information obtained from statutory returns submitted by the institutions than actual on-site field examination. Then monitors the financial health of supervised institution and analyzed the reports and conditions. The off-site review and analysis deal with capital, liquidity which can be quantified, but is less well suited to qualitative issues such as management strength and operational risks. Besides, off-site supervision is taken as early warning system to identify potential problems in financial institution as well as

for the compliance of applicable provisions. This support and strengthen quality of on-site examination.

2.1.6 Financial Performance Analysis

Financial performance analysis is a process of identifying the financial strength and weakness of the firm by properly establishing the relationship between item of balance sheet and the profit and loss account. It is undertaken to assess the financial strength and weakness of the firm. The analysis is usually based on financial statement prepared by the firm. Financial analysis serves as the basis for decision making. Moreover this analysis is also made to find out whether to use debt or equity funds to finance planned plant expansion. Financial analysis uses data contented in the firm's financial statement supplemented by the statement of cash flows. Furthermore, it summarized the large quantity of financial data and makes qualitative judgment about the firm's financial performance. The primary tools of financial analysis are financial ratios. Financial ratios provide a good technique for assessing financial performance (Devkota, 2008).

Financial statements contain a wealth of information, which if properly analyzed and interpreted, can provide valuable insights into firm's performance and position (Chandra, 1992). Analysis of financial statements is of interest to lenders, investors, security analysis, managers and others. It generally begins with the calculations of set of financial ratios designed to reveal the relative strength and weaknesses of a company as compares to other companies in the same industry, and to show whether the firm's position has been improving or deteriorating over time (Weston and Copeland, 1991). Financial analysis is a process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the item of balance sheet and the profit and loss account (Pandey, 1999).

2.1.7 Financial Performance Analysis Approach

There are many approaches for measuring the performance of financial institution focuses on balance sheet. They are ROA, ROE, RAROC, CAMELS, EAGLES and MACRO. Among them, CAMELS has been considered in this study. Within this framework, the financial condition and performance of OFL has been assessed.

Return on Assets (ROA) **Approach:** The rate of return on assets is one of the most common performance measurement approaches of financial institutions. It measures the ability of management to utilize the real and financial resources of the firm to generate returns. Further it examines the profitability of a concern in the firm. It shows the effectiveness of the utilization of assets. It is primarily an indicator of managerial efficiency; it indicates how capably the management of the firm has been converting the institutions assets into net earnings (Rose, 2002). The return on assets provides information on how efficiently a firm is being run. The higher the firms return on assets the better it is doing in operation and vice versa.

Return on Equity (ROE) Approach: The return on equity is also one of the popular performance measurement approaches of financial institutions. Equity holders of company are concerned about how much the company is earning on their equity investment. This information is provided by the return on equity. It measures the rate of return on share holders' investment. It is the aggregate returns to stockholders before dividends. The higher the returns the better, as company can add more to retained earnings and pay more I cash dividends when profits are higher (Koch and Macdonald, 2004). It measures the rate of return flowing to the firm's shareholders. It indicates how well the firm has utilized the resources of the owners.

Risk Adjusted Return on Capital (RAROC) Approach: Risk adjusted return on capital is an effective tool for measuring risk-adjusted financial performance. In the 1990s Banker's just popularized a method of evaluating loans known as RAROC. Today, many banks and financial institutions employ RAROC to measure managerial performance (Gup and Kolari, 2005). It is a risk adjusted framework for profitability measurement and profitably management. It is defined as the ratio of risk-adjusted return to economic capital-Economic capital is attributed on the basis of three risk factors: market risk, credit risk and operational risk. The use of risk-based capital strengthens the risk management discipline within business lines, as the methodologies employed quantify the level of risk within each business line and attribute capital accordingly. Using this method, income is adjusted for risk. Typically, income is adjusted for expected losses. It provides a uniform view of profitability across businesses.

EAGLES Approach: The rating system, EAGLES refers to six parameters namely Earning Ability, Assets Quality, Growth, Liquidity, Equity and Strategy. EAGLES, one of the performance evaluation rating technique which was introduced in 1980s.

This approach has been pioneered and has gained credibility among the banking community and fund management industry in Asia, for competition analysis and investment planning, respectively. Each of the six parameters is divided into sub-parameters for effective evaluation. The EAGLES rating is based purely o arithmetic ratios and banks are judged purely on the ratio outputs and ranked higher to lower on these parameters. Under this framework the bank with higher ranks on more sub-parameters will be ranked the highest in that particular parameter and vice versa. So accumulating all the parameters, the bank that gets the highest rank on more parameters stands on the top of the list (Vaidya, 2012).

MACRO Approach: MACRO is a rating system formerly used by examiners to evaluate the safety and soundness of savings institutions. MACRO is an acronym for the five elements that were evaluated: Management, Assets quality, Capital adequacy, Risk management and Operating results. Based on the examiner's evaluation, each element would be rated on a scale of 1 to 5, and the institution would be assigned an overall MACRO rating of 1 to 5. So rating 1 indicates the strong performance, significantly higher than average. The MACRO rating system was used by the Federal Thrift Examiners from (exact date) 1984 to August 15, 1994, before it was replaced by the CAMELS rating system (Vaidya, 2012).

CAMELS Approach: CAMELS is an ideal rating system, practiced worldwide by central banks and rating agencies, to evaluate and analyze safety and soundness of a financial institution. The acronym CAMELS refers to six components namely Capital Adequacy, Assets Quality, Management Quality, Earning Quality, Liquidity and Sensitivity to Market Risks. It has proved an effective internal supervisory attention or concern. Since January 1, 1997 the rating became CAMELS with the addition of a market sensitivity rating (Koch and Macdonald, 2004). Under such framework, individual rating is then aggregated to arrive at a composite ranking of the institutions, which usually reflects differential emphasis on individual components, and not a simple average.

Due to CAMELS rating system is practiced worldwide by central banks and other rating agencies to evaluate and analyze safety and soundness of their financial institutions, the researcher has chosen CAMELS rating system among other evaluating techniques, to evaluate and analyze OFL's performance.

2.1.8 Concept of CAMELS Rating System

Federal Reserve Bank of New York has defined the component of CAMEL as rating system which produces a composite rating of an institution's overall condition and performance by assessing five components: Capital Adequacy, Asset Quality, Management Administration, Earning and Liquidity. The CAMEL was later updated with inclusion of sixth components Sensitivity to Market Risk now is referred to as the CAMELS rating system (New York, 1997).

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

The CAMELS rating system is subjective. Benchmarks for each component are provided, but they are guidelines only, and present essential foundations upon which the composite rating is based. They do not eliminate consideration of other pertinent factors by the examiner. The uniform rating system provides the groundwork for necessary supervisors to be reasonably compared and helps institutions supervised by all three US supervisors to be reasonably compared and evaluated. Ratings are assigned for each component in addition to the overall rating of a financial institution's financial condition. The ratings are assigned on a scale from 1 to 5. The CAMELS rating are commonly viewed as summary measures of the private supervisory information gathered by examiners regarding financial institutions' overall financial conditions, although they also reflect available public information.

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

During an on-site bank exam, supervisors gather private information, such as details on problem loans with which to evaluate a bank's financial condition and to monitor its compliance with laws and regulatory policies. A key product of such an exam is a supervisory rating of the bank's overall condition, commonly referred to as

a CAMELS rating. CAMELS rating system is used by the three federal banking supervisors [the Federal Reserve, the FDIC, and the office of the comptroller of the currency (OCC)] and other financial supervisory agencies to provide a convenient summary of bank conditions at the time of an exam. In Nepal, the NRB plays the supervisory role for evaluating financial institution's financial condition through rating the financial institution's in accordance to CAMELS is still in its initial phase.

Composite Rating

The FFIEC press describes the composite rating and defines the six components rating. According to the press release, composite ratings are based on a careful evaluation of an institution's managerial, operational, financial and compliance performance. The six key components used to assess an institution's financial condition and operations are: capital adequacy, asset quality, management capability, earnings quality, the adequacy of liquidity and sensitivity to market risk. The rating scale range from 1 to 5, with a rating of 1 indicating: the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile and the level of performance inadequate risk management practices relative to the institution's size, complexity, risk profile and the greatest supervisory concern (USA, 1996). The composite ratings are defined in the FFIEC press releases (1996) are as follows.

Composite 1: FIs in this group are in every respect and generally have components rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. These FIs are the most capable of withstanding the vagaries of business condition and are resistant to outside influences such as economic instability in their trade area. These FIs are in substantial compliance and risk management practices relative to the institution's size, complexity and profile and give no cause for supervisory concern.

Composite 2: FIs in this group are fundamentally sound. For a FI to receive this rating, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These FIs are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity and risk profile.

Composite 3: FIs in this group exhibit some degree of supervisory concern in one or more of the component areas. These FIs exhibit a combination of weaknesses that may range from moderate to severe: however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. FIs in this group generally are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these FIs may be in significant noncompliance with laws and regulations.

Composite 4: FIs in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. FIs in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institution in this group poses a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved.

Composite 5: FIs in this group exhibit extremely unsafe and unsound practices or conditions exhibit a critically deficient performance, often contain inadequate risk management practices relative to the institution's size, complexity and risk profile are of the greatest supervisory concern. The volume and severity of problems are beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in order for the FIs to be viable. Ongoing supervisory attention is necessary. Institutions in this group pose a significant risk to the deposit insurance fund and failure is highly probable.

2.1.9 CAMELS Components

Each of the components rating description in the FFIEC press release is divided into three sections: an introductory paragraph a list of the principal evaluation factors that relate to that component and a brief description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of

the other components to reinforce the interrelation between components. The listing of evaluation factors for each component rating is in no particular order of importance (USA, 1996). The description of the CAMELS components are made as under based on the FFIEC press release (1996).

2.1.9.1 Capital Adequacy

Bank capital performs several important functions. Most importantly they are:
Absorbs Losses: Capital allows institution to continue operating as going concern during periods when operating losses or other adverse financial results are experienced.

Promotes Public Confidence: Capital provides a measure of assurance to the public that an institution will continue to provide financial services even when losses have been incurred, thereby helping to maintain confidence in the banking system and minimize liquidity concerns.

Restricts Excessive Asset Growth: Capital along with minimum capital ratio standard, restrains unjustified asset expansion by requiring that asset growth be funded by a commensurate amount of additional capital.

Provides Protection to Depositors: Placing owners at significant risk of loss, should the institution fail, helps to minimize the potential "moral hazard" and promotes safe and sound banking practices.

Capital is necessary for the bank to operate. While many areas of a bank are important and subject to scrutiny, capital adequacy is the area that triggers the most regulatory of capital adequacy, which are:

- The Tier 1 Risk-Based capital ratio.
- The total risk-based capital ratio.
- The tier 1 leverage ratio.

The capital adequacy of an institution is rated based upon, but not limited to, an assessment of the following evaluation factors:

- Size of the bank.
- Volume of inferior quality assets.
- Bank's growth experience, plans and prospects.
- Access to capital markets.

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

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

Well-Capitalized: To be considered well-capitalized, a bank will meet the following conditions:

- Total risk-based capital is 10 percent or more.
- Tier 1 risk-based capital ratio is 6 percent or more.
- Tier 1 leverage ratio is 5 percent or more.

In addition to these ratio guidelines, to be well capitalized bank cannot be subject to an order, a written agreement, a capital directive or a PCA directive.

Adequately Capitalized: to be considered well capitalized, bank will meet the following conditions:

- Total risk-based capital ratio is at least NRB minimum capital adequacy ratio requirement.
- Tier 1 risk-based capital ratio is at least NRB minimum tier 1 capital ratio requirement.
- Tier 1 leverage ratio is at least 4 percent.

Undercapitalized: to be considered undercapitalized, a bank will meet the following conditions:

- Total risk based capital ratio is less than 8 percent.
- Tier 1 risk based capital ratio is less than 4 percent or tier 1 leverage ratio is less than 4 percent.

Significantly Undercapitalized: To be considered significantly undercapitalized a bank will meet the following conditions:

- Total risk based capital ratio is less than 6 percent.
- Tier 1 risk based capital ratio is less than 3 percent
- Tier 1 leverage ratio is less than 3 percent.

2.1.9.1.1 BASEL Capital Accord

The BASEL committee on banking supervision (BCBS) is a committee of banking supervisory authorities that was established by central bank governors of the group of ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the bank for international Settlements (BIS) in BASEL, where it is permanently located (BIS, 2005).

Starting with its publication of "International Convergence of Capital Measurement and Capital Standards" in July 1988, popularly known as BASEL I Capital Accord, BCBS set out a minimum capital requirement of 8 percent for banks. Prior to that, the committee introduced 25 core principles on effective banking supervision. In 1996, the committee incorporated market risk in the 1988 capital accord. With a major revision of the 1988 accord, there followed by the revised publication of the committee's first round of proposals for revising the capital adequacy framework in June 1999 popularly known as BASEL II capital Accord. Since then, it is revised in January 2001, April 2003 and released its final revised framework updated in November 2005. In this accord, the concept and rationale of the three pillars (minimum capital requirements, supervisory review and market discipline) approach was introduced, on which the revised framework is based. In the revised framework, BCBS retains key elements of the 1988 capital adequacy framework, including the general requirement for banks to hold total capital equivalent to at least 8 percent of their risk-weighted assets; the basic structure of the 1996 market risk amendment regarding the treatment of market risk; and definition of eligible capital (BIS, 2005).

The new BASEL capital accord (BASEL II), shall be applicable to internally active banks all over the world with effect from end of 2006. Implementing the new accord in Nepal has been a challenging task for the supervisors as well as FIs. Hence, certain preparatory homework is needed to Nepalese financial system to implement BASEL II. NRB and FIs need to have coordinated effort efficiency in Nepalese banks and FIs to establish certain baseline for the effective implementation of BASEL II. In this regard, second interaction program was held in Nepal with the banks executive to make them aware of the new development.

The commercial banks so far has shown positive attitude towards the implementation of BASEL II. "New capital accord implementation preparatory core committee" was drafted "NRB's concept paper on new capital accord". According to the program of new capital accord implementation, concept paper was forwarded to all the commercial banks for comments and recommendations. A form was also developed so that commercial banks classify their exposures as per the new approach, which was reviewed by the "BASEL- II implementation working group".

NRB has adopted Basel core principles for effective supervision as guideline for supervision of commercial banks. Core principle methodology adopted by BCBS provides a uniform template for both self-assessment and independent assessment. It involves four part qualitative assessment system: compliant, largely compliant, materially non-compliant and non-compliant. For each principle essential and additional criteria are defined. To achieve a "compliant" assessment with a principle, all essential and additional criteria must be met without any significant deficiencies. A "largely compliant" assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A materially non-compliant assessment is given when the shortcoming is sufficient to raise doubts about the authority's ability to achieve compliance, but substantial progress towards compliance has been achieved.

There is no doubt that the new accord though complex carries a lot of virtues and will be a milestone in improving banks internal mechanism and supervisory process and beneficial to the commercials banks.

2.1.9.1.2 Capital Adequacy Norms by NRB

NRB has form time to time stipulated minimum capital fund to be maintained by the banks on the basis of risk weighted assets. The total capital fund is sum of core capital and supplementary capital. According to the NRB unified directives for Banks and non-banks FIs issue number E.pra.Ni.no 01/061/062 (NRB, 2062), the capital funds of a bank comprise the following:

Core Capital: Core capital of a bank includes paid up equity, share premium, non-redeemable preference shares, general reserve and accumulated profit and loss. However, where the amount of goodwill exists, the same shall be deducted for the purpose of calculation of the core capital.

Supplementary Capital: Supplementary capital includes general loan loss provision, exchange fluctuation reserve, assets revaluation reserve, hybrid capital instruments, unsecured subordinated term debt and other free reserves not allocated for specific purpose.

Banking and Financial institution Ordinance (BAFIO) (2061) also assimilates the same things, which were included and explained in NRB Act 2058, in regard of bank capital. NRB Act is effective from 1st Shrawan 2058(July 16th 2001). According to the NRB directive, minimum paid-up capital requirement for establishment of finance company is as under:

- Rs 10 crore to operate all over except Kathmandu valley.
- Rs 20 crore to operate all over Nepal.
- Rs 30 crore to operate all over Nepal including leasing finance.

2.1.9.2 Assets Quality

Asset quality is one of the most critical areas in determining the overall condition of the finance company. The primary factor effecting overall asset quality is the quality of the loan portfolio and the credit administration program. Loans are usually the largest of the asset items and can also carry the greatest amount of potential risk to the company's capital account. Security can often be a large portion of the assets and also have identifiable risks. Other items which impact a comprehensive review of asset quality are other real estate, other assets, off-balance sheet items and, to a lesser extent, cash and due from accounts and premises and fixed assets (Koch and Macdonald, 2004).

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

2.1.9.2.1 Evaluation of Asset Quality

The evaluation of asset should consider the adequacy of the allowance for loan and lease losses (ALLL) and weigh the exposure-party, issuer or borrower default

under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including but not limited to, operating, market, reputation, strategic, or compliance risks, should also be considered. Prior to assigning an asset quality rating, several factors should be considered. The factors should be reviewed within the context of any systematic weaknesses, as opposed to isolated problems, should be given appropriate consideration. The following is not a complete list of all possible factors that may influence an examiner's assessment; however, all assessment should consider the following:

- The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices.
- The level, distribution, severity, trend of problems, classified, on accrual, restructured, l delinquent and non-performing assets for both on-and off – balance sheet transactions.
- The adequacy of the allowance for loan and lease losses and other asset valuation reserves.
- The credit risk arising from or reduced by off-balance sheet transactions, such as un-funded commitments, credit derivatives, commercial and standby letters of credit and lines of credit.
- The diversification and quality of loan and investment portfolios.
- The extent of securities underwriting activities and exposure to counter-parties in trading activities.
- The existence of asset concentrations.
- The adequacy of loan and investment policies, procedures and practices
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal controls and management information systems.
- The volume and nature of credit documentation exceptions.

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

2.1.9.2.2 Rating the Asset Quality Factor

The asset quality rating definitions are applied following a thorough evaluation of existing and potential risks and the mitigation of those risks. The definitions of each rating are as follows:

1. Rating of 1 indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality in such institutions is of minimal supervisory concern.
2. A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.
3. A rating of 3 is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern.
4. A rating 4 is assigned to FIs with deficient asset quality or credit administration practices. The levels of risk and problem assets are significant, inadequately controlled, and subject the FI to potential losses that, if left unchecked, may threaten its viability.
5. A rating of 5 represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability.

2.1.9.2.3 Non-performing Assets (NPAs)

Loans and advances of FIs need to be serviced by either the principal or the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. NRB unified directives for banks and non-bank FIs, defines non performing loans as loan classified as substandard, doubtful and loss or loans which are past due by principal for more than 3 month (NRB, 2062). Dhungana, in his column states that the details and classification of standards of Non-performing loans may from country to country depends upon their own banking system requirement norms. He further states that unlike Nepal, countries like Korea, Indonesia, Phillipines, India have classified the loan into five categories on which normal and

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

2.1.9.2.4 Factors Causing NPAs

Dhungana, in his column broadly categorized reasons of NPAs into internal and external factors for high level of NPA in Nepalese banking system (Dhungana, 2062). The following factors can also be the reason for causing NPA:

1. NPAs may arise due to failure of business for which loan was used. Whatever may be the reasons for failure of business, it obstructs the carrying out timely payments of financial obligations.
2. On the other part of appraising institutions, the defect in appraising projects breed mismatch not only in investment planning but also in receivables due to defective projection of returns. Large positions of NPAs in developing countries arise due to defective and standard credit appraisal system.
3. Monitoring of projects in time provide insurance against of enterprises through rectification of minor flaws that ape ear during the course of operation. Inability of sound monitoring system can also lead to failure of the project.
4. The resources of FIs collected through deposits from people may be misutilized. Recklessness or negligence on the part of the officials while approving the loan will turn in to default.
5. Attitude of the officials that does not amount to sincere corporate culture also leads to breed drawbacks in the payment of dues to FIs.

6. The credit programmers sponsored by the government are regarded as the source of NPAs. For political benefits government, without assessing the financial feasibility of the credit programmer, announces and compels the credits agencies to go along with the declared policies.
7. Moreover, dishonest politicians often want free ride of on the amounts of loan delivered by credit agencies under government designed programmers. Such loans are hardly recoverable. The fact is evidence from the experience in Nepal and India by the manifestation of higher percentage of NPAs found in priority sector loans.
8. Quite often the definition of the NPAs and accounting norms adopted by concerned agencies also amount to higher or lower magnitude of such assets. Each institution may have different norms to declare the assets whether it is not-performing. The income cycle of the project and amount of loan involved, set the installments of loan repayment. The nature of project also determines the level of NAPs.
9. Slow down in economy, global as well as domestic particularly in industrial sector. Contribution to adversely affect the bottom-line of borrower units and their capacity to service the debt (Taore-1999). Recession debars the economic activities to run smoothly which affect the performance of FIs.

2.1.9.2.5 NRB Directives Related to Assets Quality

NRB unified directive for Banks & Non-Bank FIs through directive number E.pra.Ni.No 02/061/62, requires the banks to classify outstanding loans and advances on the basis of aging of principal amount (Ashar, 2062). As per the directive the loans and advances should be classified into the following four categories:

Pass: Loans and advances whose principal amount is not past due over for 3 months included in this category. These are classified and defined as performing loans.

Substandard: All loan and advances that are past due for a period of 3 months to 6 months included in this category.

Doubtful: All loans and advances, which are past due for a period of 6 months to 1 year, included in this category**.**

Loss: All loans and advances which are past due for more than 1 year and have least or thin possibility of recovery or considered unrecoverable shall included in this category. Besides this, any loan whether past due or not, in situations of inadequate

security, borrower declared insolvent, no whereabouts of the borrower or misuse of borrowed fund, are to be classified as loss category.

The directive further requires banks to provision for loan loss, on the basis of the outstanding loans and advances and bills purchased classified as above. Loan loss provision set aside for performing loans is defined as General Loan provision and that set aside for non-performing loan as specific loan loss provision.

Table: 2.1

Loan Loss Provision

Loan Class	**Loan Loss Provision**
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Source: NRB Directives.

With the objectives of lowering the concentration risk of bank loans to a few big borrowers and to increase the access of small and middle size borrowers to the bank loans, NRB through directive number E.pra.Ni.No 30/061/62 limits finance companies to extend credit to a single borrower or group related borrowers up to 25% of core capital for fund based credit facilities and not more than 50% of its core capital for non fund based credit facilities like letters of credit, guarantees, acceptances, commitments.

2.1.9.3 Management Quality

The management component (M) reflects the amount of existing credit risk of directors and senior management systems and procedures to identify, measure, monitor and control risk (Koch and Macdonal, 2004) .

Good management can make and poor management can break an organization. The performance of the other five CAMELS components will depend on the vision, capability, agility, professionalism, integrity and competence of the financial institution management. As a sound management is crucial for the success of any institution management of the overall CAMELS framework, generally, directors do not actively involved in day to day operations; however, they provide clear guidance

regarding acceptable risk exposures levels and ensure that appropriate policies procedures and practices have been established. Senior management is responsible for developing and implementing policies, procedures and practices, objectives and risk limit prudent operating standards.

The quality of management is the most important element in CAMELS framework of financial performance analysis. The competence of the management is the key in evaluating the performance of the financial institution. The management is responsible to mobilize the resources of the firm and to create a sound control environment and risk management practices. Thus, it focuses on appraising the competence, involvement and integrity of the management in the day to day administration of the firm, involvement in formulating policies and procedures and the implementation of systems and controls and ensuring the firm's compliance with applicable laws and regulations. It shows how management is able to utilize their strength to grab opportunities. The board of director plays a key role in formulation of policies, supervision and control. On the other hand managing director is liable to the successful operation of the bank. The success of any bank is largely determined by the efficiency of its management. Poor loan policies and the poor assets/liabilities management lead any firm to failure.

2.1.9.3.1 Rating the Management Factors

1. A rating of 1 indicates strong performance by management and board of directors and strong risk management practices relative to the institution’s size, complexity and risk profile. All significant risks are consistently and effectively identified, measured, monitored and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.
2. A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the institution’s size, complexity and risk profile. Minor weakness may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured and controlled.
3. A rating of 3 indicates management and board performance that need improvement or risk management practices that are less than satisfactory

given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored or controlled.

4. A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary.
5. A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored or controlled and now threaten the continued viability of the institution. Replacing or strengthening management or the board of directors is necessary.

2.1.9.4 Earning Quality

The earning quality reflects not only the quantity and trend in earnings, but also the factors that affect the sustainability or quantity or earnings (Koch and Macdonald, 2004). Under the UFIRS, in evaluating the adequacy of FIs earning performance, consideration should be given to:

- The level of earning, including trends and stability.
- The ability and provide for adequate capital through retained earnings.
- The quality and sources of earnings
- The level of expenses in relation to operations.
- The adequacy of the budgeting systems, forecasting processes and management information systems in general.
- The adequacy of provisions to maintain the ALLL and other valuation allowance accounts.

- The earnings exposure to market risk as interest rate, foreign exchange, price risks.

From a bank regulator's standpoint, the essential purpose of bank earnings, both current and accumulated, is to absorb losses and augment capital. Earnings are the initial safeguard against the risks of engaging in the banking business and represent the first line of defense against capital depletion resulting from shrinkage in asset value (Saunders and Cornett, 2004). Earnings performance should also allow the bank to remain competitive by providing the resources required to implement management's strategic initiatives.

2.1.9.4.1 Evaluation of Earnings Performance

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

2.1.9.4.2 Earning Ratio Analysis

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

- Net income to average assets ratio [return on assets (ROA) ratio]
- Net interest income to average assets ratio.
- Net interest income to average earnings assets ratio.
- Non-interest income to average assets ratio.
- Non-interest expenses to average assets ratio.
- Provision for loan and lease losses (PLLL) to average assets ratio.
- Realized gains/losses on securities to average assets ratios.

Earning quality is the ability of a bank to continue to realize strong earnings performance. It is quite for a bank to register impressive profitability ratios and high volumes of income by assuming an unacceptable degree of risk. An inordinately high ROA is often an indicator that the bank is engaged in higher risk activities. For example, bank management may have taken on loans or other investments that provide the highest return possible, but are not of a quality to assure either continued debt servicing or principal repayment. Seeking higher rates for earning assets with higher credit risk will boost short-term earnings. Eventually, however, earnings may suffer if losses in these higher-risk assets are recognized.

In addition, certain of the bank's adversely classified and non-performing assets, especially those upon which future interest payments are not anticipated, may need to be reflected on a non-accrual basis for income statement purposes. If such assets are not places on a non-accrual status, earnings will be overstated. Similarly, material amounts of troubled debt restructured assets may have an adverse impact on earnings.

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

2.1.9.4.3 Rating the Earnings Factor

1. Earning rated 1 is strong. Earnings are more than sufficient to support operations and maintain adequate capital and allowance levels after are given to asset quality, growth and other factors affecting the quality, quantity and trend of earnings.
2. Earnings rated 2 would be satisfactory and sufficient support operations and maintain adequate capital and allowances levels after consideration is given to asset quality, growth and other factors affecting the quality, quantity and trend of earnings. Earnings that are relatively static or even experiencing a slight decline, may receive a 2 rating provide the institution's level of e3arnings is adequate in view of the assessment factors listed above.
3. Earnings rated 3 may need to improve. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth and other factors affecting the quality, quantity and trend of earnings.

4. A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowances levels. Erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous years may characterize institutions so rated.
5. A rating of 5 indicates earnings that are critically deficient. A FI with earnings rated 5 is experiencing losses that represent a distinct threat to its viability through the erosion of capital.

2.1.9.5 Liquidity

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

1. The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
2. The availability of assets readily convertible to cash without undue loss.
3. Access to money markets and other sources of funding.
4. The level of diversification of funding sources, both on and off balance sheet.
5. The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits to fund longer-term assets.
6. The trend and stability of deposits.

7. The ability to securities and sell certain pools of assets.
8. The capability of management to properly identify, measure, monitor and control the institution's liquidity position, management information systems, and contingency funding plans.

2.1.9.5.1 Rating the Liquidity Factors

1. A rating of 1 indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.
2. A rating of 2 indicates satisfactory liquidity levels and finds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practice.
3. A rating of 3 indicates liquidity levels or funds management practices in need of improvement. Institutions rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices
4. A rating of 4 indicates deficient liquidity levels or inadequate funds management practices. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet needs.
5. A rating of 5 indicates liquidity levels or funds management practices so critically deficient that the continued viability of the institution is threatened. Institutions rated 5 require immediate external financial assistance to meet maturing obligations or other liquidity needs.

2.1.9.5.2 Liquidity Management Concepts

There are several principles which the economists have propounded to resolve the conflicts between objectives of liquidity, safety and profitability. These concepts are discussed as under:

The Real Bills Doctrine: the real bills doctrine states that FIs should extend only short-term self-liquidating productive loans to business firms. Self liquidating loans are those meant to finance the production, storage, transportation and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. The short-term self liquidating productive loan has three advantages.

Firstly, they possess liquidity due to which, they liquidate themselves automatically. Secondly, there is no risk of running into bad debts since earn income for the banks as they are productive.

The Shift Ability Theory: H.G. Moulton propounded the shift ability theory of bank liquidity. According to view, an asset to be perfectly shift ability must be immediately transferable without capital loss when the need for liquidity arises. But in a general crisis requires that all banks should possess such assets which can be shifted on to the central bank which is the lender of the last resort. This theory has certain elements of truth.

The Anticipated Income Theory: The Anticipated Income Theory was developed by H.V. proch in 1944 based on term loan practices by USA commercial banks. According to this theory; the bank plans for liquidation of long term loans from the anticipated income of the borrower regardless of the nature and character of a borrower's business. The bank puts restrictions on the financial activities of the borrower while granting this loan. Consequently, the bank takes into consideration not only the security but with major consideration the anticipated earnings of the borrower. This is superior to the bills doctrine and the shift ability theory because it fulfills the three objectives of liquidity, safety and profitability.

The Liabilities Management Theory: This theory was developed in the 1960s. According to this theory, there is no need for banks grant self-liquidating loans and keep liquid assets because they can borrow reserve money in the money market in case of need. A bank can acquire reserves by creating additional liabilities against it, from different sources. These sources includes the issuing of time certificates of deposit, borrowing from the other commercial banks, borrowing from the central bank, raising of capital funds by issuing shares, and by plowing back of profits.

2.1.9.5.3 Liquidity Management Techniques

Techniques for liquidity assessment have evolved over the years with the significant changes in the monetary policy operating procedures. Despite the uncertainty in predicting liquidity conditions, econometric models could be used to provide first indicative forecasts, given the estimated structure of inter-relationships based on past information. The treasury or fund manager of any banks and FIs should adopt following techniques for effective liquidity management.

Liquidity Planning: The liquidity planning entails the accurate estimation of liquidity needs and the structuring of the portfolio to meet the expected liquidity needs. To ensure that funds are available to meet the liquidity needs at the lower cost, the treasury manager of the banks and FIs must manage its money position to comply with reserve requirements as well as managing its liquid sources.

Managing the Cash Position: A cash position refers to the amount in the process of collection and currency and demand balances due from other banks and the central bank. Numerous transactions that cause an inflow or outflow of cash during a day continually change the cash position of the banks and FIs. Because cash yields no income, cash holdings must be limited to a minimum. The treasury/ fund manager may invest any excess cash or may acquire additional cash sources from interbank loans or from discount window at the central bank.

Managing the Liquidity Position: Once the liquidity needs of the banks and FIs have been estimated, the treasury manager must decide how these needs are to be funded. The banks and FIs must choose between two general liquidity management strategies, namely, asset management and liquidity needs. In the liability management, money is borrowed to meet liquidity needs. A combination of these strategies is normally employed. The following guidelines must be kept in mind by the treasury manager when managing the liquidity position of the banks and FIs:

- The treasury managers should know the timing of large withdrawals from big credit clients or depositors in order to plan.
- The priorities and objectives of liquidity management should be clear and properly communicated.
- The needs and decisions must be evaluated on a continuous basis to invest access liquidity and avoid liquidity shortages.

Controlling Liquidity Risk: To assess how well the banks and FIs are managing its liquidity position, the management should be cautious on the following signals from the marketplace that indicate pending liquidity problems:

- Public confidence in terms of withdrawal of deposits from the banks and FIs.
- Share price behavior, falling share prices indicates perceived liquidity problems.
- Risk premiums on money market borrowings.
- Losses because of the hasty sale of assets for liquidity purposes.

- Inability to meet the demands of new credits customers.
- More frequent and larger borrowings from the central bank.

Considering the aforementioned technique, the treasury manager must also consider the purpose of the liquidity need, the length of time for which funds are needed, the access to liability markets, the costs and characteristics of various liquidity sources and interest rate forecast. It is received that the large banks have better access to liability liquidity sources due to the better quality assets and a broader capital base. The small banks are to rely more on assets for liquidity. Thus, an effective liquidity management is essential to reduce costs.

2.1.9.5.4 NRB Directives Related to Liquidity

NRB has set certain liquidity requirement to all banks and non-bank financial institutions sufficient liquidity is important not only for deposits withdrawals or the provision of loans but also for regulatory purposes.

The NRB, 2023 B.S. had given the institution to the commercials banks since 2023 B.S. to deposit the amount the amount ratio of 8 percent from their deposit liability. In the beginning of 2047 B.S. the increase in the quantity of internal credit was high and began to show negative effect on economy. The deflation grew up to 21 percent. So, high liquidity appeared in economy, hence, control of negative effect that may fall on economy to improve the growth of price rate and improvement of the position of loss of running account and control the capacity of flow the loan of the commercial banks, was necessary and the NRB bonds. With some signs of improvement of economy, the investment ratio was revised accordingly, since Poush 2049 B.S. since the beginning of 2050 B.S., the economy showed improvement and the rate of deflation fell down to 8.8 percent. With this, the provision of investing in the government securities was removed.

With effective from, 2054, Chaitra 31st, commercial banks were required to maintain liquidity of 8 percent of the total current and saving deposits and 6 percent of the fixed deposits, in addition to 3 percent of total deposit in cash at vault. Since then the NRB reserve requirements have been put into force by NRB effective from 22 July 002 (2059/04/06).

Table: 2.2

Prevailing Directives as to Cash Reserve Ratio Requirement

a)	Balance to NRB	1. 7 % of current & savings deposit liabilities. 2. 4.5% of fixed deposit liabilities
b)	Cash to vault	2% Total deposit liabilities.

Source: NRB Directives.

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

a. The CRR maintained by the banks will be examined on the basis of average weekly balance of deposit liabilities immediately preceding 4th week. A week shall comprise from each Sunday through Saturday.
b. CRR will not be calculated for the week which is fully off.
c. Weekly statement of deposit balances to be submitted to NRB inspection and supervision department within 15 days from the date of end of the week.
d. Weekly average of Monday to Friday of total deposit, cash in vault and NRB balance is calculated by dividing by 5.

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

a. In the case of shortfall in maintenance of NRB balance but cash at vault is exactly 2%.
b. In case of shortfall in NRB balance but cash at vault is more than 2% then up to 1% excess cash of total deposit is added in the balance with NRB then on such shortfall account (after adding up to 1% excess)
c. In case of shortfall in cash in vault as well as shortfall in NRB balance then on total shortfall amount.

The applicable rate of penalty is as follows:

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

Second time shortfall = Equivalent to 2 times of bank rate

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

2.1.9.6 Sensitivity to Market Risk

The sensitivity to market risk component reflects the degree to which changes in interest rates, foreign exchanges rates, commodity prices or equity prices, can

adversely affect a FI's earnings or economic capital (Baral, 2005). When evaluating this component, consideration should be given to: management's ability to identify measure, monitor and control market risk; the institution's size; the nature and complexity of its activities; and the adequacy of its capital and earning in relation its level of market risk exposure. For many institutions, the primary source of market risk arises from non-trading positions and their sensitivity to changes in interest rates. In some larger institutions, foreign operations can be a significant source of market risk. For some institution, trading activities are a major source of market risk. Market risk is rated based upon, but not limited to, an assessment of the following evaluation factors :(Koch and Macdonald, 2004)

1. The sensitivity of the FI's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchanges rates, commodity prices or equity prices.
2. the ability of management to identify, measure, monitor and control exposure to market risk given the institution's size
3. Complexity and risk profile.
4. The nature and complexity of interest rate risk exposure arising from non-trading positions.
5. Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

2.1.9.6.1 Rating the Sensitivity to Market Risk Factor

1. A rating of 1 indicates that market risk sensitivity is well controlled and that there is minimal potential that the earning performance or capital position will be adversely affected. Risk management practices are strong for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide substantial support for the degree of market risk taken by the institution.
2. A rating 2 indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide adequate support for the degree of market risk taken by the institution.

3. A rating 3 indicates that control of market risk sensitivity needs improvement or the there is significant potential that the earnings performance or capital position will be adversely affected. Risk management practices need to be improved given the size, sophistication, and level of market risk accepted by the institution. The level of market risk taken by the institution.
4. A rating 4 indicates that control of market risk sensitivity is unacceptable or that there are high potentials that the earnings performance or capital position will be adversely affected. Risk management practices are deficient for the size, sophistication and level of market risk accepted by the institution. The level of earnings and capital provide inadequate support for the degree of market risk taken by the institution.
5. A rating of 5 indicates that control of market risk sensitivity is unacceptable or that the level of market risk by the institution in imminent threat to its viability. Risk management practices are wholly inadequate for the size, sophistication and level of market risk accepted by the institution.

2.1.9.6.2 Gap Analysis

Gap systems use an accrual approach to identify risk to net interest income. Typically, gap systems identify maturity and reprising mismatches between assets, liabilities and off-balance sheet instruments. Gap schedules segregate rate-sensitivity assets, rate-sensitive liabilities and off-balance sheet instruments according to their reprising characteristics. Then, the analysis summarizes the reprising mismatches for each defined time horizon. Additional calculations convert that mismatch into risk to net interest income. Gap analysis may identify periodic, cumulative or average mismatches. The most common gap ratio formula is:

$$\frac{Risk\ Sensitivity\ Assets - Risk\ Sensitivy\ Liabilities}{Average\ Earning\ Assets}$$

Occasionally, average assets or total assets may be used in place of average earnings assets. However; those denominators can underestimate interest rate risk. The gap ratio can and should be used to calculate the potential impact on interest income for a given rate change. This is done by multiplying the gap ratio by the assumed rate change. The result estimates the changes to the net interest margin. For example, a bank has a 15% one-year average gap. If rates decline 2%, then the net

interest margin will decline by 30 basis points (15% x 02). This estimate assumes static balance sheet and an immediate, sustained interest are shift. Gap analysis has several advantages, specifically, it (Chanda, 2006).

- Does not require sophisticated technology.
- May be relatively simple to develop and use.
- Can provide clear, easily interpreted results.

However, gap's weaknesses often overshadow its strength, particularly for larger, more complex banks. For example, gap analysis:

- Generally captures only reprising risk.
- May not identity intra-period reprising risk.
- Does not measure EVE.
- Generally cannot analyze complex instruments.

Gap analysis may provide sufficient interest rate risk measurement for some banks. However, gap analysis may be ineffective for banks with complex structure, sophisticated activities, or significant exposures to embedded options.

2.2 Review of Related Studies

The research studies and work papers carried out by different scholars within various geographical region including dissertations conducted by Nepalese scholars are reviewed in this section, which are related with financial performance analysis of commercial bank, Finance company and the other area of the study.

Gurung, conducted a research on "A financial study of joint venture banks in Nepal". The objective of this study was to examine the financial strengths and weaknesses of Nepal Grindlays bank Limited (NGBL) and Nepal Indosuez Bank Ltd. (NIBL). The study has covered the period of seven fiscal years i.e. 1986/87 through 1992/93. In this study, he has used financial ratios viz. current, activity, profitability, capital structure and statistical tool viz. Karl Person's coefficient of correlation. The researcher has, based on different financial indicators; found that performance of NGBL is better than that of NIBL (Gurung, 1995).

Hirtle and Lopez, examine the usefulness of past CAMEL ratings in assessing banks' current conditions. They find that, conditional on current public information, the private supervisory information contained in past CAMEL ratings provides further insight in to bank current conditions, as summarized by current CAMEL ratings. The

authors find that, over the period from 1989 to 1995, the private supervisory information gathered during the last on-site exam remains useful with respect to the current condition of a bank for up to 6 to 12 quarters (or 1.5 to 3 years). The overall conclusion drawn from academic is that private supervisory information, as summarized by CAMELS ratings, is clearly useful in the supervisory monitoring of bank conditions (Hirtle and Lopez, 1999).

Thapa, has conducted her study "A comparative study on investment policy of Nepal Bangladesh bank ltd. And other joint ventures banks". The researcher's main objective of study was to evaluate the liquidity, assets management efficiency, profitability and risk position on NBBL in comparison NABIL and NGBL and to examine the fund mobilization and investment policy NBBL through off-balance sheet and on-balance sheet activities in comparison to other two banks. Through research, the researcher found that the liquidity position of NBBL is comparatively not better than of NABIL and NGBL. The liquidity ratios are moderately fluctuating which means the bank has not properly formulated stable policy. As per the study, NBBL is not better position regarding its on-balance sheet as well as off-balance sheet activities in compare to NABIL and NGBL and it does not seem to follow and definite policy regarding the management of its assets. The researcher at the last suggested following a specific policy in investment and she further recommended to maintain the optimum level of relationship among deposit and loan and advances, outside assets and net profit and to maintain the adequate recovery rate (Thapa, 2001).

Derviz and Podpiera, based their assessment of commercial banking performance on bank ratings and studied with respect to detecting situations with the potential for adverse development towards failure and owing to the costly nature of frequent supervisory examinations. In this paper they studied models of rating downgrades and consider a specific set of indicators that are suitable as determinants of a bank's rating. The conclusions about the predictors obtained from the analysis of downgrades are applicable in relatively stable banking sector situations. Banks experiencing minor liquidity trouble might raise their interest rates on deposits, but a regulator would have a hard time distinguishing which bank has increased its deposit rate because of liquidity problems and which has done so owing to an increase in its cost of funds caused by some other factor. Therefore, in their approach the cost of funds one of the plausible downgrade indicators was used in the form of the banks "credit spread". In addition to credit spread, they tested the inclusion of the value at

risk (VaR) indicator in the form of total asset VaR, as they believed that this type of indicator might play an important role in determining the level of the rating due to its easy computability and data availability to the public. They focused on the capital, assets, management, earning, liquidity, market risk based composite (CAMELS) rating and the Standard and Poors (S&P) ratings.

The choice of their sample was determined by the fact that cross section data is probably less appropriate given the specific character of the relatively small banking market in the Czech Republic. The three chosen banks, i.e., Ceska Sporirelna (CS), Komercni Banka (KB) and Ceskoslovenska Obchodni Banka (CSOB), cover a dominant portion of the market, the rest being occupied by small narrowly specialized banks or foreign bank branches. Therefore, they used panel data with three banks and their financial indicators to analyze the change in the CAMES and S&P ratings. They found that the reliable predictors of a bank's S&P rating are credit spread, capital adequacy, and the total loans to total assets ratio. In the case of the CAMELS rating does not yield itself easily to predictions within any horizon with the studies technique. On the contrary, the S&P rating can be relatively precisely predicted one month in advance (Derviz and Podpiera, 2004).

Baral, has conducted a research and published his paper in the journal of Nepalese business studies (Vol. II No.1, December 2005) on health check-up of Commercial Bank in the framework off CAMEL, a case study of joint venture Banks in Nepal. The paper examined the financial health of joint venture Banks in the CAMEL framework for a period ranging from fiscal year 2001 to 2004. Three joint venture Commercial Banks of Nepal were randomly selected for the study. The study was based on historical data disclosed by annual reports of Commercial Banks. It has covered four fiscal years' data for the purpose of study. The study was based totally on the CAMEL framework. Through the analysis of data, the researcher has diagnosed the health of sample joint venture banks. Banks under study were well capitalized and they were complying with the directives of NRB on capital. But, their capital base relative to the risk-weighted assets is not so strong. It uncovered further, non-performing assets of joint venture banks on the average is at satisfactory level, but they are far below the aggregate percentage of non-performing assets of commercial banks. The researcher has also found that the management of NSBI is least efficient among sampled banks and SCBN has most efficient management. The profitability of joint venture bank is not so weak during the study period. Profitability

of Nabil and SCB was better than the NSBI. Furthermore, the liquidity of joint venture banks was higher the industry average ratio. Thus, with a viewpoint of liquidity position, the health of joint venture banks is looked like a bit unhealthy (Baral, 2005).

Bhandari, has conducted a study on the financial performance of Himalayan Bank Limited in the framework of CAMEL. The basic objective of this study was to analyze the financial performance of Himalayan Bank Limited through CAMEL. The study has covered the time period of 6 years from fiscal year 1999 to 2004. The researcher has used different financial tools and other statistical tools in the study. The analysis revealed adequate capital of the bank. The non-performing loans through in decreasing trend are still a matter of concern. The bank is still with better ROE however, it is in decreasing trend of net interest margin shows management stock monitoring over the bank's earning assets. The liquid funds to total deposit ratio to above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period (Bhandari, 2006).

Chanda, has conducted a study on financial performance analysis of Nabil Bank Limited in the framework of CAMELS with the objective to analyze the financial condition of Nabil Bank Limited. It has covered five years data starting from fiscal year 2000/01 to 2004/05. The analysis discovered that the Bank is running with adequate capital and the capital fund of Bank is sound and sufficient to meet the banking operation as per NRB standard. The bank has placed efficient credit management and recovery efforts of good quality loans will increase in future. The management decision related to operation and investments have assisted in future. The management decisions related to operation and investments have assisted in controlling control and recovery the interest spared and cost effective sources of fund. The liquid funds to total deposit ratio is above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period (Chanda, 2006).

Sharma, has conducted a research study on "Financial Performance Analysis of Nepal SBI Bank Limited In the framework of CAMEL". The main objective of the study was to analyze the financial performance of Nepal SBI bank Ltd. Through CAMEL framework, the study was based on secondary data covering the six years from 2001 to 2006. The researcher conducts the financial tools to analyze the six years data. He concluded that SBI bank Ltd. was well capitalized and complying with

directives of NRB. The bank has maintained satisfactory level of past due loan on total loan except 2001. Earning per employees of the bank was found quite high. Net interest margin of the bank was found satisfactory. Further the liquidity position of the bank was found sound (Sharma, 2007).

Cole and Gunther, in their article "A CAMEL Rating's shelf Life" have stated that under more stable financial conditions, CAMEL rating typically remains accurate for relatively long periods. Also, off-site monitoring systems depend on the integrity of data, which can be enhanced through regular periodic exams. Moreover, the examination process and CAMEL ratings it generates have numerous important uses, many of which are quite distinct from the relatively narrow application of off-site monitoring systems for the identification of bank failure. The CAMEL ratings can change only when financial conditions change appreciably, as was the case during the particularly volatile time period (Cole and Gunther, 2008).

Devkota, carried out the research entitled "Financial Performance Analysis of Fewa Finance Company Limited (FFCL) in the framework of CAMEL" with the objective to analyze the financial performance in the framework of CAMEL. Researcher had taken secondary data from fiscal year (F.Y.) 2060/061 to 2063/064 and used financial and statistical tools for the descriptive analysis. Devekota concluded that the core capital adequacy ratios were above the Nepal Rastra Bank (NRB) standard of the company and showed that the protection and security to creditors and depositors, which further illustrated the financial soundness of the company. The supplementary capital adequacy ratios of FFCL were as per the NRB standards in all the review period which leads to conclude that the company was running with adequate capital. The non performing loan (NPL) ratios were in increasing trend whereas the loan loss ratio of the company was in fluctuating trend over the review period. It implied that the company was inefficient in recovering the default loan. Earning Per Share (EPS) of FFCL was highly fluctuating trend in the study period but return per share was well for the shareholder. The earning quality ratios like return on equity and return on assets were in fluctuating trend. Besides, net interest margin was in increasing trend, it can be concluded that company management had done a good job of Assets and Liabilities management during the study period. The liquid assets to total deposit ratios and cash in vault to total deposit ratios were below the industrial average. In total FFCL is financially sound and healthy (Devkota, 2008).

Marasini, concluded a research study entitled, "Financial Performance Analysis of Rastriya Banijya Bank Limted (RBBL) in the Framework of CAMELS", using mainly secondary data sourced by bank's central bank, surfing internet, consulting library from F.Y. 2058/059 to 2063/064 and used financial & statistical tools for analysis. Marasini concluded that the core capital ratio and total capital adequacy ratio bank were highly negative. It showed that bank had not been so concerned to maintain capital adequacy. The non performing loan ratio was rapidly decreasing during the last two years which showed that efficient credit management of bank better than the past. ROE, ROA and EPS of the bank was in increment trend showed that the bank can be able to provide a satisfactory and sound return in future. Liquid fund to total deposit ratio is below than the industrial average indicated that the bank had not maintained efficient liquidity management. Bank had not been able to match risk sensitive assets to risk sensitive liabilities like in long term maturity bucket and changes of interest rate positive effects in the bank income which had been proved by higher positive interest rate sensitivity ratio. So the bank was weak in risk management efforts. In total RBBL is financially sound and healthy in average (Marasini, 2008).

Sangmi and Nazir, published an article on "Analyzing Financial Performance of Commercial Banks in India: Application of CAMEL Model" the study focused an effort has been made to evaluate the financial performance of the two major banks operating in northern India. This evaluation has been done by using CAMEL parameters, the latest model of financial analysis. Through this model it is highlighted that the position of the banks under study is sound and satisfactory so far as their capital adequacy, assets quality, management capability and liquidity is concerned (Sangmi and Nazir, 2010).

Gurung, conducted a research with objectives to evaluate the financial performance of Nepal Credit and Commerce Bank Limited (NCCBL) in the framework of CAMELS. The study has covered the five fiscal years (FY 2003/04-2007/08). The researcher found that core capital maintained is poor which in turn affect the capital adequacy of the bank over the four consecutive fiscal years. Performing assets turned out into non performing asset due to lack of effective recovery policies as bank goes on. Management control on expenses and employees earning power is poor. Though earning is fine in concluding fiscal year, but overall

earning performance of the bank is weak. The liquidity of bank is shown satisfactory. Though CRR is fluctuating and show negative effect on profitability (Gurung, 2010).

Tiwari, concluded a research study entitled, "Financial Performance Analysis of Pokhara Finance Company Limited (PFCL) in the Framework of CAMELS" using only secondary data from F.Y. 2061/062 to 2065/066 and used financial as well as statistical tools to analyze the data. Here Tiwari concluded that total capital adequacy ratio was above the NRB norms and industry as well. This means the company had adequately maintained its internal sources during the study periods. The non performing loan ratios were decreasing during the review period, so the company had placed efficient credit management and recovery efforts. The ROE, ROA and net interest margin (NIM) ratios of the company were in increasing trend, showed good quality of Assets. The liquid asset to total deposit was above the industrial average ratio except in the initial period, where NRB balance to total deposit ratio was below the industrial average ratio during the study period. The sensitivity of net financial assets in a short maturity bucket was high so high so it showed highly sensitive to interest change risk. In total the study had showed that the Pokhara finance is not so sound & healty in terms of CAMELS analysis (Tiwari, 2010).

Jaffar and Manarvi, published an article on "Performance Comparison of Islamic and conventional Banks in Pakistan". The study examined and compared the performance of Islamic and Conventional banks operating inside Pakistan during 2005 to 2009 analyzing CAMEL test standard factors such as capital adequacy, assets quality, management quality, earning ability and liquidity provision. The financial data for the study was mined form the banks financial statements existing on state bank of Pakistan website. A sample of 5 Islamic Banks and 5 Conventional Banks were selected to measure and compare their performance. Each year the average ratios were considered, because some of the young Islamic banks in the sample do not have 5 years of financial data. CAMEL test which is a standard test to check the health of financial institutions was used to determine the performance of Islamic and conventional banks. The study found that Islamic banks performed better in possessing adequate capital and better liquidity position while conventional banks pioneered in management quality and earning ability. Assets quality for both modes of banking was almost the same, conventional banks recorded slightly smaller loan loss ratio showing improved loan recovery policy whereas, UNCOL ratio analysis showed a nominal better performance for Islamic banks (Jaffar and Manarvi, 2011).

Shrestha, concluded a research study entitled, "Financial Performance Analysis of Machhapuchhre Bank Limited (MBL) in the Framework of CAMEL" using mainly secondary data from F.Y. 2062/063 to 2066/067 and used financial & statistical tools for the descriptive analysis. In this study, Shrestha concluded that core capital adequacy ratio of MBL was above the NRB standards in the fiscal years. It proved that MBL was financially sound, strong and properly maintained its internal sources. The NPL ratios were below the international standard; therefore it had placed efficient credit management and recovery efforts. The ROE was in decreasing trend, that had showed return flowing to the shareholder was not adequate. ROA & NIM trend were decreasing with some fluctuations during the study period, that had shown capacity of management to convert the bank's assets into earning was not satisfactory level. EPS of MBL was in decreasing trend with some fluctuation, which had indicated return flowing to the banks owner is not adequate. The liquid assets to total deposit ratios were above the industrial average ratio, i.e. high proportion of liquid funds & lack of specific policy of investment. NRB balance to deposit and cash vault to total deposit of MBL was above the industrial average throughout the study. In overall the study showed that the MBL is running with the adequate liquidity to meet its short term obligation and need to adopt effective investment policy to generate profit for the bank (Shrestha, 2011).

Wagle, carried out the research entitled "Financial Performance Analysis of Business Development Bank Limited (BDBL) in the Framework of BASEL II". Researcher had taken secondary data from F.Y. 2063/064 to 2067/068 and used various financial and statistical tools for descriptive analysis. Wagle concluded that Bank was not completely risk free as per BASEL II. The capital adequacy ratio of the bank was above the standard set by NRB, it revealed that the bank performed well & improved the overall capital position with adequate capital fund. The NPL to total loans and advance ratios of the bank was below the industrial average and loan loss provision is below 2%. It showed favorable proportion of NPL ratio. The Non-performing assets of BDBL was found to be decreasing each year which showed the optimum utilization of the assets by BDBL in income generating activities and increase in the ratio of performance assets. The stable trend of loan and advances to total deposit had showed the company adopting the appropriate policies to manage and utilize the fund in income generating activities as well as to increase the quality of assets. ROE ratios of bank were near about industrial average showed satisfactory

awareness of management about stockholder's wealth maximization. The profit margin ratio was in increasing order & NRB balance to total deposit ratio of the bank was above the NRB norms. Cash in vault to total deposit ratios and liquid assets to total deposit ratios of bank is more than industrial average over the study period. In overall the Bank's capital adequacy position is satisfactory (Wagle, 2011).

Giri, has done a research study on Financial Performance Analysis of Machhapuchhre Bank Limited (MBL) in the framework of CAMEL during the F.Y. 2062/63 to 2066/67. With the help of both secondary data as well as primary data, she conducted her study by applying some financial and statistical tools and techniques. The study showed that the Capital adequacy ratio of MBL was above the NRB standard during the study period. Furthermore, ROA, ROE & EPS of MBL was in decreasing trend with some fluctuation during the study period, which shows that bank's assets into earning and return flowing to the banks shareholders is not satisfactory and acceptable. The cash and bank balance ratio of MBL were in fluctuating trend which shows that there is greater element of risk effect on lending and profit. Similarly, MBL has good liquidity position which shows the investment of MBL is secured. Thus, in this study different indicators of each component of CAMEL are calculated in the form of financial ratio. The ratios obtained are compared with NRB standard to know where the bank's position has been improving or not during the study period (Giri, 2012).

Rana, has conducted a research to evaluate the financial performance of SBI bank limited in the framework of CAMEL. The study has covered the period of five fiscal year i.e. 2062/63 -2066/67. The objective of the study was to examine the capital adequacy of banks, to assess the quality of bank's assets, to analyze the efficiency of the bank's management, to evaluate the earning performance of the bank and to find out the liquidity position of the bank. The financial data extracted from annual report and other relevant documents are analyzed and interpreted to get valuable insight into a firm's performance and position. In this study, different indicators of each component of CAMEL are calculated in the form of financial ratios. The financial ratios obtained are compared with Nepal Rastra Bank standard, industrial average and trend of the ratio are analyzed to know where the bank's position has been improving or deteriorating overtime (Rana, 2012).

Thagunna & Poudel, have conducted a study on measuring bank performance of Nepali banks: A data envelopment analysis (DEA) perspective. The aim of this

study was to develop a performance model for measuring relative efficiency and potential improvement capabilities of Nepali banks by scrutinizing intermediation aspects. For measuring the efficiency and performance, this paper uses a relatively new frontier approach known as data envelopment analysis (DEA). The paper uses two basic DEA models to fulfill its objectives. This paper seeks to measure and analyze the efficiency levels of banks in Nepal during 2007-08 to 2010-11. The study reveals that efficiency level is relatively stable and has increased on overall. Additionally, it also breaks down the overall efficiency of banks into technical and scale efficiency. This study found no significant relationship with efficiency level and ownership structure of banks and there were no notable difference in the efficiency levels of banks according to their assets size (Thagunna & Poudel, 2013).

Koirala, has conducted a research to evaluate the financial performance of Api Finance Limited in the framework of CAMELS. The study has covered the period of five fiscal years i.e. 2064/65 – 2068/69. The objectives of the study was to analyze capital adequacy, to evaluate the quality of assets, to examine the efficiency of management, to assess the earning performance, to analyze the liquidity position and analyze the sensitivity risks of market of the Api Finance Limited. The financial data extracted from annual reports and other relevant documents were analyzed and interpreted to get valuable insight into a firm's performance and position. In this study, different indicators of each component of CAMELS were calculated in the form of ratios. The financial ratios obtained were compared with Nepal Rastra Bank Standard, Industrial Average and trend of the ratio were analyzed to know where the firm's position has been improving or deteriorating over the study period. The researcher found that the company has sufficient levels of capital adequacy, good quality assets, improved efficiency of management quality, improved profitability, sufficient liquidity and highly sensitive to market risk (Koirala, 2014).

2.3 Research Gap

Various studies have been conducted in the past on financial performance analysis of Commercial banks in the US and other regions. The researches done in the context of Nepal have mainly emphasized on liquidity, profitability and leverage of commercial banks. These studies lack micro-level analysis and have found applying traditional analysis of financial performance. In the context of Nepalese Banking

environment, only a few academic researchers have been conducted in the framework of CAMELS. There are a few research reports of Finance Companies. However, the financial performance analysis of Om Finance Limited has not done yet by using modern technique of evaluation i.e., CAMELS. A few researchers have conducted their research on other topics, but no one has conducted research on financial performance analysis of this Finance Company. So this research is conducted to know actual financial performance of Om Finance Limited in the framework of CAMELS using most recent five fiscal years data. Therefore the study of financial performance of financing companies will add a new dimension towards financial function of finance companies.

CHAPTER 3

RESEARCH METHODOLOGY

Research methodology is the procedure by which researchers go about their work of describing, explaining and predicting phenomena. In other words, research methodology describes methods and process applied in the entire aspect of the study. To meet the objectives, the methodology applied in the study is described as below.

3.1 Research Design

Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variance (Kerlinger, 1996). The research design is an integrated frame that guides the researcher in planning and executing the research works (Wolff and Pant, 2005). This study designed as case of OFL, within this descriptive and analytical research design has adopted. Descriptive and analytical approach has been followed mainly to show the effect of trend and OFL healthiness and effectiveness around the crux, to fulfill the research objectives.

3.2 Population and Sample

For the purpose of this study, finance companies were taken as its population. By Mid July 2013 there were altogether 59 finance companies established in Nepal. But being a case study of a single unit, Om Finance Limited was taken as sample based on the data availability and convincing of getting information.

3.3 Justification for the Selection of the Study Unit

The researcher selects the Om Finance Limited because it is one of the leading finance company in Nepal. Due to the specific role play by the company, questions arises that what is the actual financial performance of Om Finance Limited. The financial performance of Om Finance has not been conducted previously. It means no one has conducted research on the topic of financial performance of Om Finance Limited using CAMELS framework. Therefore, this research is conducted to know the actual performance of Om Finance Limited in the framework of CAMELS. To

fulfill the gap, the study has attempted to solve the problem by taking Om Finance Limited as study unit through purposive and convenience sampling technique. It is also easier to collect the data due to its proximity and recognitions of few branch managers of the Om Finance Limited.

3.4 Nature and Source of Data

As per nature of the study, it was mainly based on secondary data. For the study purpose, annual reports of OFL were used as the major sources of data. In addition to this, necessary information were collected from the NRB reports, bulletins and its website, various articles published in journals, and books written by various authors. Formal and informal talks with the senior staff of the company were also helpful to obtain the supportive information of the related problem.

3.5 Data Collection Procedures

In order to estimate the models used in the study, the required data had been taken from my working finance institution, OFL. Similarly, NRB directives, banking and financial statistics and other publications were collected from the website of NRB. Other supplementary information, literature reviews were collected from the Central Library of Tribhuvan University (T.U.), Western Regional Library Pokhara, Public Library Pokhara.

3.6 Data Processing

At first, necessary data were extracted from above mentioned sources and recorded in the master sheet. The data were then entered into the spreadsheet to work of the CAMELS financial ratios and prepare the necessary figures. Finally, different financial tools under CAMELS were worked out with the help of Microsoft Word and Excel. Simple descriptive statistics such as percentage, mean/average etc. have been used to analyze the data and necessary tables, graphs, lines and figures were prepared and inserted under suitable headings. Bibliography was prepared using APA sixth edition available in computer software Microsoft office word 2007.

3.7 Method of Data Analysis

Various financial and statistical tools have been used in this study to get the meaningful result and to meet the research objective. The computer software program such as Microsoft Office Word 2007 and Microsoft Office Excel 2007 were also used as a tool to calculate, analyze and prepare the data, to make figure, tables, graphs and bibliography. Financial ratios are major tools for the analysis. In addition to the financial tools other simple statistical (descriptive) tools were also used. The major tools applied in this study are described in the following sections.

3.7.1 Financial Tools

To make rational interpretations, keeping with the objectives of the study, various analytical financial tools have been used in this study. Financial ratio analysis tools were used to determine the performance of the company in the framework of CAMELS. These ratios were categorized in accordance of CAMELS components. Following category of key ratios were used to analyze the relevant components in terms of CAMELS.

Capital Adequacy Ratio: Capital adequacy ratio is the numerical relationship between total fund and risk adjusted assets. It measures the adequacy of capital and financial soundness of finance company. Capital adequacy ratio is used to measure of capital in the finance company. It is worked by using the following model.

$$\text{CAR} = \frac{Total\ Capital\ Fund}{Total\ Risk\ Adjusted\ Assets} \times 100$$

Where,

CAR= Capital Adequacy Ratio

Total capital fund= Core capital + Supplementary capital

Total Risk Adjusted Assets= On-balance sheet risk adjusted assets + off balance sheet risk adjusted assets

Core Capital Adequacy Ratio: Core capital adequacy ratio shows the relationship between the total core capital or internal sources and total risk adjusted assets. It is used to measure the adequacy of core capital and financial soundness from very close angle. It is calculated by using following model.

$$\text{CCAR}=\frac{Core\ Capital}{Total\ Risk\ Adjusted\ Assets}\times 100$$

Where,

CCAR=Core Capital Adequacy Ratio

Core Capital = paid-up capital + share premium + non-redeemable preference share + general reserve + cumulative profit –goodwill if any

Supplementary Capital Adequacy Ratio: Supplementary capital adequacy ratio is the expression of numerical relationship between supplementary capital and total risk adjusted assets. It measures the proportion of supplementary capital in total risk adjusted assets. Furthermore, it shows the absolute contribution of supplementary capital in capital adequacy. The ratio is used to analyze the supplementary capital adequacy and determined by using the following model

$$\text{SCAR}=\frac{Supplementary\ Capital}{Risk\ Weighted\ Assets}\times 100$$

Where,

SCAR= Supplementary Capital Adequacy Ratio

Supplementary Capital=Loan loss provision + exchange equalization reserve + assets revaluation reserve + hybrid capital instrument + Unsecured subordinate term debt + interest rate fluctuation fund + Other free reserves

Non-performing Loan Ratio: The non-performing loan ratio indicates the relationship between non-performing loan and total loan. It measures the proportion of non-performing loan in total loan and advances. The ratio is used to analyze the asset quality and determined by using the given model.

$$\text{Non-performing Loan Ratio} = \frac{Non-perfor\min gAssets}{Total\ Loan\ and\ Advance}\times 100$$

Where,

Non-performing loan= loan not recovered within the given time frame either in the form of interest servicing or principal repayment.

Loan Loss Ratio: The loan loss ratio is the expression of numerical relationship between loan loss provision and loan and advances. It is used to appraise quality of asset. It measures the proportion of loan loss provision in total and advances. This ratio shows the possibility of loan default. Higher ratio implies higher portion of non-performing loan portfolio. For the purpose of study following is used to determine the loan loss ratio.

$$\text{Loan Loss Ratio} = \frac{Loan\ Loss\ \text{Pr}ovision}{Total\ Loan\ and\ Advances} \times 100$$

Total Expenses to Total Incomes Ratio: The total expenses to total income ratio is the expression of numerical relationship between total expenses and total incomes of the company. It measures the proportion of total expenses in total revenues. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability (IMF, 2000). Following is the expression of total expenses to total revenues ratio.

$$\text{Total Expenses to Total Income Ratio} = \frac{Total\ \text{exp}enses}{Total\ Income} \times 100$$

Earning Per Employee: Earning per employee is the numerical relationship between net profits after tax to total number of employee. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with similar repercussions in terms of profitability (IMF, 2000). It is calculated by using the following model.

$$\text{Earning Per Employee} = \frac{Net\ \text{Pr}ofit\ After\ Tax}{Number\ of\ Employee} \times 100$$

Return on Equity (ROE): The return on equity indicates the relationship between net profit after tax to total equity capital. It measures of the rate of return following to the company's shareholders. Higher is the return on equity, higher the investment which the shareholders will undertake. For the purpose of the study following model is used to determine the return on equity ratio.

$$\text{Return on Equity} = \frac{Net\ \text{Pr}\ ofit\ after\ Tax}{Total\ Equity\ Capital} \times 100$$

Return on Assets (ROA): Return on assets is the numerical relationship between net incomes after taxes to total assets of a company. It is primarily an indicator of managerial efficiency; it indicates how capably the management of the company has been converting the institution's assets into net earnings (Rose, 1999). It is calculated by using the following model.

$$\text{Return on Assets} = \frac{Net\ Income\ After\ Tax}{Total\ Assets} \times 100$$

Net Interest Margin: Net interest margin is the expression of numerical relationship between net interest income and total earning assets of a company. It measures how large a spread between interest revenues and interest costs management has been able to achieve by close control over the company's earning assets and the pursuit of the cheapest sources of funding (Rose, 1999). For the purpose of the study following model is used to determine net interest margin.

$$\text{Net Interest Margin} = \frac{Net\ Interest\ Income}{Earning\ Assets} \times 100$$

Where,

Net interest income = interest income –interest expenses

Earning assets = loan & advances + investment on securities

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

$$\text{Earning Per Share} = \frac{Net\ Income\ to\ Shareholder}{Number\ of\ Share}$$

Total Liquid Fund to Total Deposits Ratio: A total liquid fund to total deposits is the expression of numerical relationship between total liquid funds and total deposits of the company. It measures the proportion of total liquid funds in total

deposits. Furthermore, it shows the overall short-term liquidity position. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the company. It is calculated by using the following model.

$$\text{Total Liquid Fund to Total Deposits Ratio} = \frac{Total\ Liquid\ Fund}{Total\ Deposit} \times 100$$

Where,

Total Liquid Fund= cash in hand + foreign currency in hand + Balance with NRB + balance with domestic bank + balance Held abroad + calls deposits

NRB Balance to Total Deposit Ratio: NRB balance to total deposits ratio is the expression of numerical relationship between NRB balance and total deposits of a bank. It measures the proportion of NRB balance in total deposits. It shows whether bank is holding the balance as required by NRB. For the purpose of this study following model is used to determine the NRB balance to total deposits.

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

Cash in Vault to Total Deposit Ratio: Cash in vault to total deposits ratio indicates the relationship between cash in vault to total deposits. It shows the percentage of total deposit maintained as vault. It is worked out by using the following model.

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

Where,

Cash in vault = cash in hand + foreign currency in hand

Interest Rate Sensitivity

Interest rate sensitivity is estimated by GAP analysis. If ΔR_{id} is the average interest rate change affecting assets and liabilities that can be reprised within i_{th} maturity bucket, the effect on the net interest income (NII) in the i_{th} maturity bucket is calculated by (Saunders and Cornett, 2004).

$$\Delta NIIi = \left[\sum_{i=1day}^{i=IthMarutyBucket} RSAi - \sum_{i=1Day}^{i=IthMaturityBucket} RSLi \right] X \Delta Ri$$

$$= GAP_i \; X \; \Delta Ri$$

Where,

ΔNIIi = Change in interest income in the i_{th} maturity bucket.

GAPi = Rupee size of gap between book value of rate sensitivity assets (RSA) and rate sensitivity liabilities (RSL) in maturity bucket i.

Similarly cumulative GAP (CGAP) of interest is the one year reprising gap estimated as:

ΔNIIi =CGAP x ΔRi

CGAP =

$$\left[\sum_{i=1Day}^{i=90Days} RSAi - \sum_{i=1Day}^{i=90Days} RSLi \right] + \left[\sum_{i=91Days}^{i=180Days} RSAi - \sum_{i=91Days}^{i=180Days} RSLi \right] + \left[\sum_{i=181Days}^{i=270Days} RSAi - \sum_{i=181Days}^{i=270Days} RSLi \right] + \left[\sum_{i=271Days}^{i=360Days} RSAi - \sum_{i=271Days}^{i=360Days} RSLi \right]$$

Interest Rate Sensitivity: Interest Rate Sensitivity can be computed by expressing cumulative GAP as a percentage of total risk sensitivity assets (A) as:

Interest Rate Sensitivity = $\frac{CGAP}{A} x100$

3.7.2 Statistical Tools

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

$$(\overline{X}) = \frac{\sum X}{N}$$

Where,

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

N= Number of pairs of observation

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

Standard Deviation: Standard deviation is the absolute measure of dispersion of the values and shows the deviation or dispersion in absolute term (Kothari, 1989). It is said that higher the value of standard deviation the higher the variability and vice versa. Karl person introduced the concept of standard deviation in 1983. Here, the standard deviation is used to find out the deviation in absolute term. Standard deviation is determined in following way.

$$\text{S.D. } \sigma = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2}$$

Here,

n= no. of observation

x=individual value

During the analysis of data, standard deviation is calculated by using the statistical formula on SPSS program on computer.

Coefficient of Variation: Coefficient of variation is the relative measure of dispersion based on the standard deviation (Kothari, 1989). It is most commonly used to measure the variation of data and more useful for the comparative study of variability in two or more series or graph or distribution. Symbolically, the coefficient of variation is calculated as:

$$\text{CV} = \frac{\sigma}{\overline{X}}$$

Here,

σ =standard deviation

$\overline{X}$ = mean

CV= Coefficient of variation

Least Square Trend Analysis: Least square trend has been used to find out the trend of ratio (Kothari, 1989). The general equation used for trend is given below:

$$Y = a + bx$$

Where,

Y=Dependent variable

x= Coded time in year (independent variable)

a= Y-intercept

b= Slope of the trend line

In the above model,

$$b = \frac{N.\sum XY - \sum X.\sum Y}{N.\sum X^2 - (\sum X)^2}$$

$$a = \frac{\sum Y - b.\sum X}{N}$$

CHAPTER 4

DATA ANALYSIS AND PRESENTATION

The purpose of this chapter was to examine data empirically from the different sources. The financial performance analysis of OFL was concentrated in the six components, CAMELS: Capital Adequacy, Assets Quality, Management Quality, Earning Quality, Liquidity and Sensitivity to Market Risk. The data collected from annual reports of OFL had been analyzed with the application of CAMELS. The major findings found in the study had been presented based on the data analysis.

4.1 Data Analysis and Presentation

In this section, components of CAMELS and its sub-components were presented in the tables and graphs for analyzing the competitive strength and weaknesses of the company.

4.1.1 Capital Adequacy

Capital adequacy is a measurement of a financial institution to determine if solvency can be maintained due to risks that have been incurred as a course of business. Capital adequacy component analysis of OFL is made based on the regulations and standard ascertain by NRB as to maintaining minimum risk based core and total capital standard and maximum risk based supplementary capital standard. The minimum risk based capital standard which includes a definition for risk based capital, a system for calculating Risk Weighted Assets (RWA) by assigning on and off balance sheet items to broad risk categories. Capital Adequacy Ratio (CAR) takes into account the most important financial risks-foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution's assets. A finance company must be able to generate capital internally, through earnings retention, as a test of capital strength. To measure the capital adequacy, core capital adequacy ratios, supplementary capital adequacy ratios and total capital adequacy ratios are calculated.

4.1.1.1 Core Capital Adequacy Ratio

Core (Tier 1) capital means the primary capital of a finance company. Core capital includes the paid up equity capital, share premium, dividend equalization fund, capital adjustment reserve, non-redeemable preference share, general reserve, accumulated profit and loss amount and goodwill deductible if any (Baral, 2005). In this way it is the amount of shareholders fund. It gives an assurance to the outsiders for smooth operation of a finance company even in the time of economic crisis. Core capital adequacy ratio is also known as core capital to total risk adjusted assets ratio, which measures the adequacy of internal sources or shareholder's funds to support the financing activities (Baral, 2005).

It reflects the financial strength and soundness of finance company. Higher values of the ratio above the NRB standard show the adequacy of internal sources and higher security to creditors and depositors. The lower value of core capital adequacy ratio with regard to the NRB standard indicates the lower is its internal sources. Table 4.1 presents the observed value of core capital adequacy ratio of OFL, during the period of past five FYs.

Table 4.1

Core Capital Adequacy Ratio

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Core Capital (Rs)	151,210	190,746	289,789	321,160	390,128
Total risk weighted assets (Rs)	1,305,720	1,440,969	2,002,611	2,600,715	3,478,254
Core capital adequacy ratio (%)	11.58	13.24	14.47	12.35	11.22
NRB standard (%)	5.5	5.5	5.5	5.5	5.5
Difference (%)	6.08	7.74	8.97	6.85	5.72

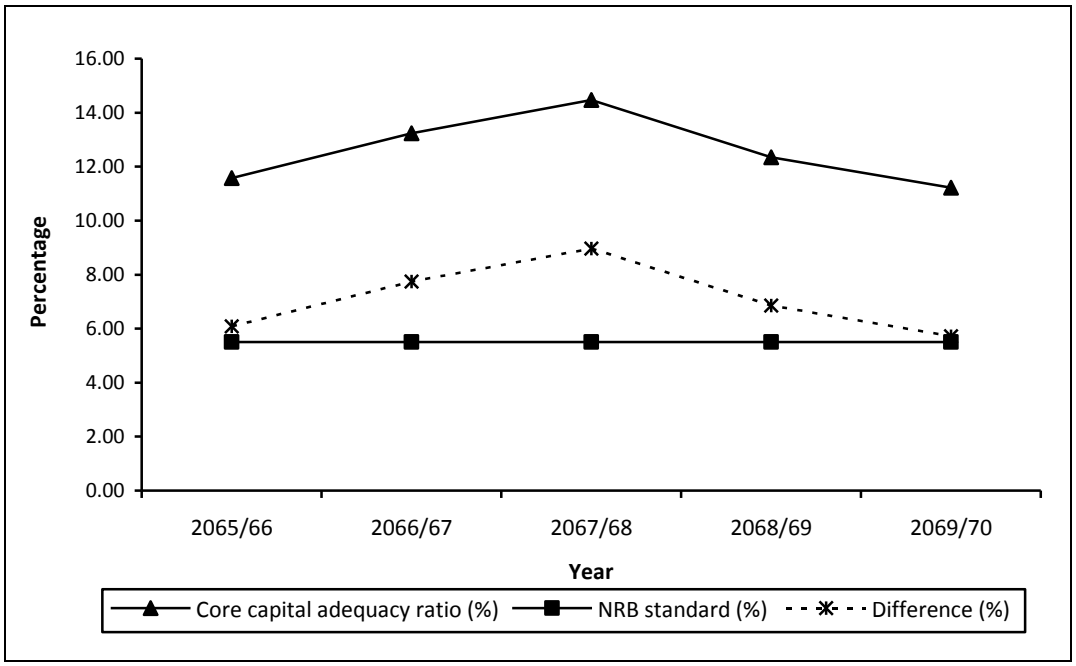
Source: Appendix 2.

As shown in Table 4.1, the core (Tier 1) capital ratio of OFL is maximum of 14.47 in FY 2067/68 and minimum of 11.22 in FY 2069/70. Thus, it is clear that the core capital adequacy ratio of the OFL has increased up to FY 2067/68 and thereafter, it has decreased in FY 2068/69 and 2069/70. The ratio is in fluctuating trend. The changing pattern of the core capital adequacy ratio and regularly increasing and decreasing trend of core capital provide the clear way for conclusion that the total risk

adjusted assets of the OFL is instable during the study period. However, the core capital adequacy ratio of the OFL is greater than the NRB standard over the study period. The observed value of core capital adequacy ratio of the OFL is shown with NRB in figure 4.1.

Figure 4.1

Comparing Core Capital Adequacy Ratio with NRB Standard



As shown in Figure 4.1, it is clear that the core capital adequacy ratio of OFL is above the NRB standard during the study period. It means the OFL is applying adequate amount of internal sources of shareholder's funds with significance core capital adequacy ratio throughout the study period.

4.1.1.2 Supplementary Capital Adequacy Ratio

Supplementary (Tier 2) capital is another component of Capital. Supplementary capital means the amount of capital that are transferred in free reserve and collected by using the hybrid capital instruments, General Loan Loss provision, Exchange Equalization Reserve, Assets Revaluation Reserve, Interest Spread Reserve, Subordinate Term Debt and other Free Reserve (Baral, 2005). The ratio reflects proportion of supplementary capital component in total risk adjusted assets and relative contribution in the CAR. NRB regulates supplementary capital ratio by allowing supplementary capital not exceeding 100% of the core capital for CAR calculation.

Table 4.2

Supplementary Capital Adequacy Ratio

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Supplementary capital (Rs)	12,773	14,633	19,523	25,163	32,135
Total Risk Weighted assets (Rs)	1,305,720	1,440,969	2,002,611	2,600,715	3,478,254
Supplementary capital Adequacy Ratio (%)	0.98	1.02	0.98	0.97	0.92
NRB standard (not more than Core capital) (%)	11.58	13.24	14.47	12.35	11.22
Excess/ Short (%)	10.6	12.22	13.49	11.38	10.3

Source: Appendix 2.

As shown in Table 4.2, the supplementary capital ratio of OFL is range from a minimum of 0.92% in FY in 2069/70 to maximum of 1.02% in FY 2066/67. The ratio of OFL is increasing up to FY 2066/67 and thereafter decreased. There is maximum supplementary capital in FY 2066/67 of 1.02% and minimum in FY 2069/70 of 0.92% over the study period. However, the supplementary capital ratio of OFL is within boundary of NRB standard over the study period. The observed value of supplementary capital ratio of the OFL is shown with NRB standard in figure 4.2.

Figure 4.2

Comparing Supplementary Capital Adequacy Ratio with NRB standard

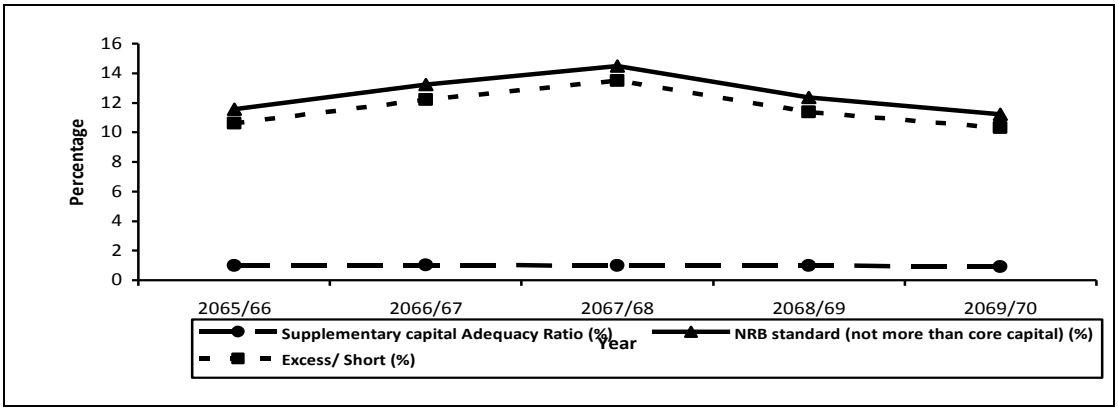


Figure 4.2 shows the observed supplementary capital adequacy ratios are within the standard of NRB, over the study period. It means the supplementary capital

of the OFL is significant as per the NRB standards. The OFL is able to maintain positive difference greater than 10% throughout the study period. It indicates that OFL has maintained adequate supplementary capital in the study period.

4.1.1.3 Total Capital Adequacy Ratio

Total capital fund means the amount invested by shareholders, creditors and the amount collects from the various free reserve maintained in a company. Capital fund includes the amount of core capital and supplementary capital. Strong capital base is the pre-requisite for the safety and soundness of any company (Baral, 2005). Capital adequacy ratio above the NRB standard indicates adequacy of capital and signifies higher security to depositors, higher internal sources and higher ability to cushion operational and unanticipated losses. The lower value, on the contrary indicted lower internal sources, comparatively weak financial position and lower security to depositors.

Table 4.3

Capital Adequacy Ratio

Rupees in '000'

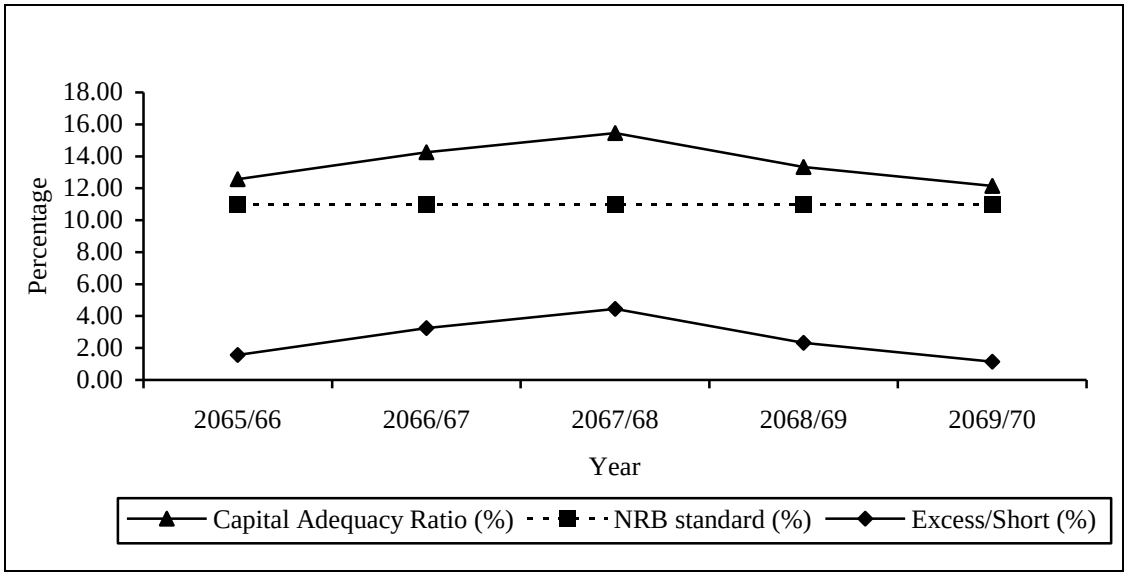
Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Capital Funds (Rs)	163,983	205,379	309,312	346,323	422,263
Total Risk Weighted assets (Rs)	1,305,720	1,440,969	2,002,611	2,600,715	3,478,254
Capital Adequacy Ratio (%)	12.56	14.25	15.45	13.32	12.14
NRB standard (%)	11	11	11	11	11
Excess/Short (%)	1.56	3.25	4.45	2.32	1.14

Source: Appendix 2.

As shown in Table 4.3 the capital adequacy ratio of OFL is distributed as minimum ratio of 12.14% in FY 2069/70 and a maximum ratio of 15.45% in FY 2067/68. The ratio of the OFL is increasing in the beginning year up to FY 067/68 and thereafter decreased. Capital funds and risk weighted assets are in increasing trend. The OFL capital adequacy ratios are within NRB standard over the study period. The observed value of capital adequacy ratio of the OFL is shown with NRB standard in figure 4.3.

Figure 4.3

Comparing Capital Adequacy Ratio with NRB Standard



As shown in Figure 4.3, the observed capital adequacy ratios of OFL are above the NRB standard during the study period. The graph further shows that the company has met NRB standard in all years. It implies that the company has maintained adequate capital adequate ratio in each year of the study period. Hence, OFL has strictly followed the NRB directives and its capital adequacy requirements

4.1.2 Asset Quality Analysis

Asset quality is one of the most critical areas in determining the overall condition of a financial institution. The primary factor affecting overall asset quality is the quality of the loan portfolio and the credit administration program. The extent of the credit risk depends on quality of assets held by an individual FI. The quality of assets held a FI depend an exposure to specific risk, trends in non-performing loans and the health and profitability of bank borrowers especially the corporate sector (Baral, 2005). NRB uses compositing of assets, non-performing loan to total loan and loan loss provisioning ratio are taken as the indicator to examine the asset quality of financial institutions. NRB has directed the financial institution in regards to the concentration of the loan. Any licensed FI can grant the fund base loan to a single borrower or borrowers related to the same business group up to 25% of its primary capital. In the same vein, it can provide the non fund base loan up to 50 % of its core capital (NRB, 2010). Similarly it was directed FIs to classify the loans into

performing loan and non-performing loans. The loans that are not due and 3 months past due fall in the class of performing loans/performing assets and others do in the non-performing loans. Further non-performing loans are classified into three groups; substandard, doubtful and bad/loss assets requiring provisioning of 25%, 50% and 100% respectively (NRB, 2010).

To measure assets quality of the company, assets composition, non-performing loan and loan loss provision are calculated.

4.1.2.1 Assets Composition

The assets portfolio of the financial institution is both complex and interesting. It represents more faithfully the varied nature and ramification of the FI function and policies. In fact the assets side of the balance sheet indicates the manner in which the funds entrusted to the FI are deployed. Usually every banker seems to arrange its assets in an ascending order of profitability and descending order of liquidity (Chand, 2006). Thus, the structure of a balance sheet indicates assets appearing in the descending order of liquidity. The capital and liabilities of FIs are invested in various assets in the form of cash and bank balance, placements, investments, bills purchase, loan and advances and fixed assets. Loans and advances contain the high proportion of potential risk to the FI's capital. Assets not only determine the soundness of a FI but also its capacity to earn profits.

Table 4.4

Assets Composition (in %)

Fiscal Year	2065/66	2066/67	2067/68	2068/69	2069/70	Mean
Cash & Bank balance	2.23	2.96	2.66	2.82	2.67	2.67
Money at call	5.85	9.25	13.42	23.42	17.24	14.64
Investment	1.07	1.44	4.49	2.88	2.86	2.55
Loan & advances	87.05	82.34	75.88	68.72	75.47	77.9
Fixed Assets	3.09	3.36	2.43	1.7	1.37	2.39
Other Assets	0.71	0.66	1.12	0.46	0.38	0.67
Total	100	100	100	100	100	100

Source: Appendix 2.

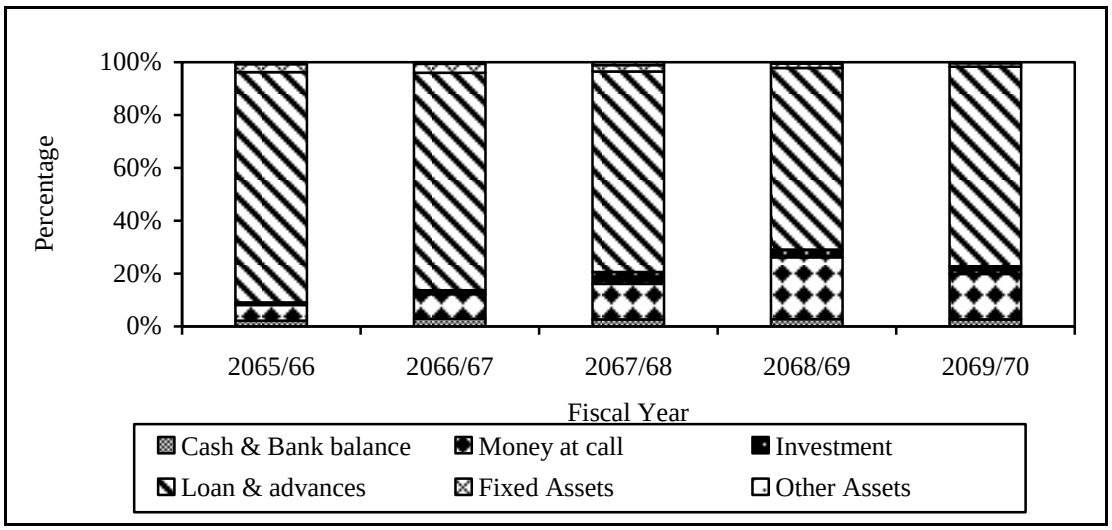
As shown in Table 4.4, percentage of cash and bank balance is fluctuating trend. In the beginning the balance is increased, then decreased, again increased and

in last two years the balance is decreased. The money at call is in increasing trend up to FY 2068/69, and then decreased. The percentage of investment has increased in first two fiscal years. Then it is decreasing trend from FY 2068/69 till FY 2069/70. Similarly, the percentage of loan and advances is decreasing trend up to FY 2068/69 and then increased. Likewise, the percentage of fixed assets and other assets is fluctuating trend over the study period. The mean percentage of cash and bank balance, money at call, investment, loan and advances, fixed assets and other assets are 2.67, 14.64, 2.55, 77.9, 2.39 and 0.67 percent respectively during the study period.

As shown in Table, the company's large part of assets is loan and advances and lowest part is other assets. The figure 4.4 shows the assets composition of the finance company during the study period.

Figure 4.4

Assets Composition



4.1.2.2 Non-performing Loan to Total Loan and Advances.

Loan and advances usually represent the single largest assets of most financial institutions. When the borrowers fail to pay the interest or even principles within the time frame the performance loan begins to start in non-performing loan. As per NRB directives all loans and advance must be classified in order of principles default aging into pass (past due up to 3 months), sub-standard (past due between 3-6 months), doubtful (past due 6-12 months) and loss/bad (past due over 1 FYs) (NRB, 2010). NPL forms an aggregate of substandard, doubtful and loss loans. The ratio of NPL to total loan and advances shows the percentage of NPL in total loan. Lower ratio shows the better proportion of performing loans and risk of default and vice versa.

Table 4.5

Non-performing Loan Ratio

Rupees in '000'

Fiscal Year	2065/66	2066/67	2067/68	2068/69	2069/70
Non-performing loan (Rs)	2,911.4	3,401.6	4,095.9	6,182.6	24,859
Total Loan (Rs)	1,280,284.6	1,466,745.6	1,954,408.2	2,521,096.5	3,236,330.1
NPL Ratio (%)	0.23	0.23	0.21	0.25	0.77

Source: Appendix 2.

The data given in the Table 4.5 exhibit that the non-performing loan to total loan and advance ratio of OFL is maximum in FY 2069/70 with 0.77 percent and minimum in FY 2067/68 with 0.21 percent and an average of 0.34 percent. The lower ratio is considered favorable for the company and vice versa. The ratios of the company are same in first two fiscal years and decreased next year and increased thereafter. The CV between them is 0.64. On the basis of CV, it can be concluded that the ratios are variable and less consistent. The observed value of NPL ratio of OFL is shown with trend line in Figure 4.5

Figure 4.5

Trend of Non-performing Loan Ratio

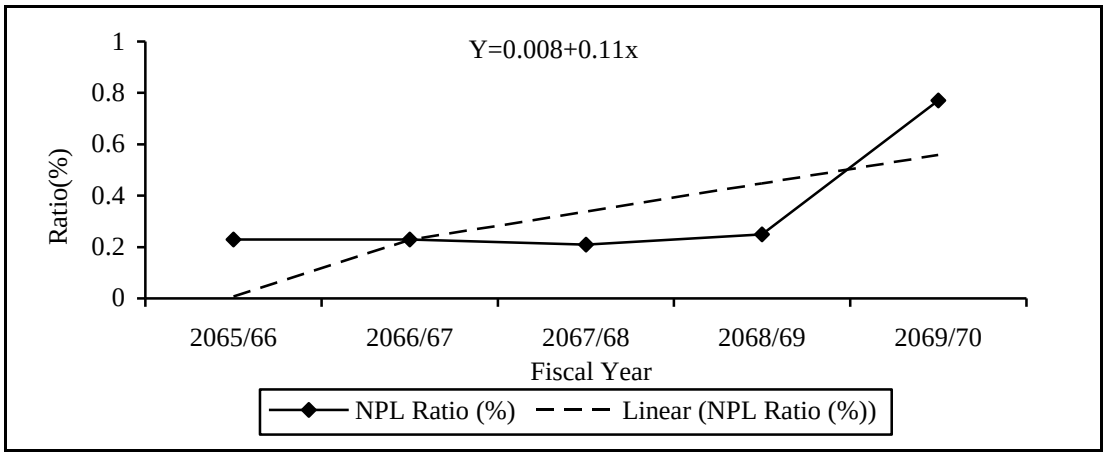


Figure 4.5 shows the NPL ratio of OFL compared with trend line. The graph shows that NPL ratio of the company is in decreasing trend in beginning year and then increasing trend thereafter. However, the NPL ratios are below the international standard i.e. 5 percent. It shows the efficient credit management. It indicates that the company has low credit risk. It reflects the good performance of the company in mobilizing loan and advance.

4.1.2.3 Loan Loss Ratio

The loan loss provisioning ratio indicates adequacy of allowance for loans and trend in the collection of loan and the performance in loan portfolio. It is obtained by the ratio of loan loss provision to the total loan (Garden and Miller, 1988). Loan loss ratio is useful insight into the quality of a financial institution loan portfolio and bad debts coverage and the adequacy of loan loss provisions. Greater loan loss provision is required to allow if high loss is expected. This ratio shows the possibility of loan default of a financial institution. It indicates how efficiently FI manages its loan and advances and makes effort for the loan recovery. Higher ratio implies higher portion of non-performing loan portfolio. The ratio of loan loss provision to total loans and advances describes the quality of assets that FI is holding. The provision for loans loss reflects the increasing probability on non-performing loans in the volume of total loans and advances. Loan loss provision on the other hand signifies the cushion against future contingency created by the default of the borrowers. The high ratio signifies the relatively more risky assets in the volume of loans and advances. The high provision for loan loss shows the recovery of loan to be difficult and irregular and the age of the loan in increasing. More delay the FI gets to collect the loan, the provision will be higher and the ratio will be higher. Altman and Sametz, have identified few early warning variables based on the balance sheet. The loan loss ratio is defined as the measure of prospective losses that are envisioned by the FI management in relation to the FIs overall loan and investment (Altman and Sametz, 1977).

Table 4.6

Loan Loss Ratio

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Loan Loss Provision (Rs)	15,685. 2	18,035.2	23,599	32,083.5	56,973.7
Loan and Advances(Rs)	1,264,599.30	1,466,746	1,954,408	2,521,096	3,236,331
Loan Loss Ratio (%)	1.24	1.23	1.21	1.27	1.76

Source: Appendix 2.

Table 4.6 exhibits that the loan loss ratio for the study period has decreasing trend up to FY 2067/68 then increased. The ratio range is from 1.21% to 1.76%. The

mean of loan loss ratio is 1.34% and standard deviation is 0.21% over the study period. Figure 4.6 shows trend of loan loss ratio.

Figure 4.6

Trend of Loan Loss Ratio

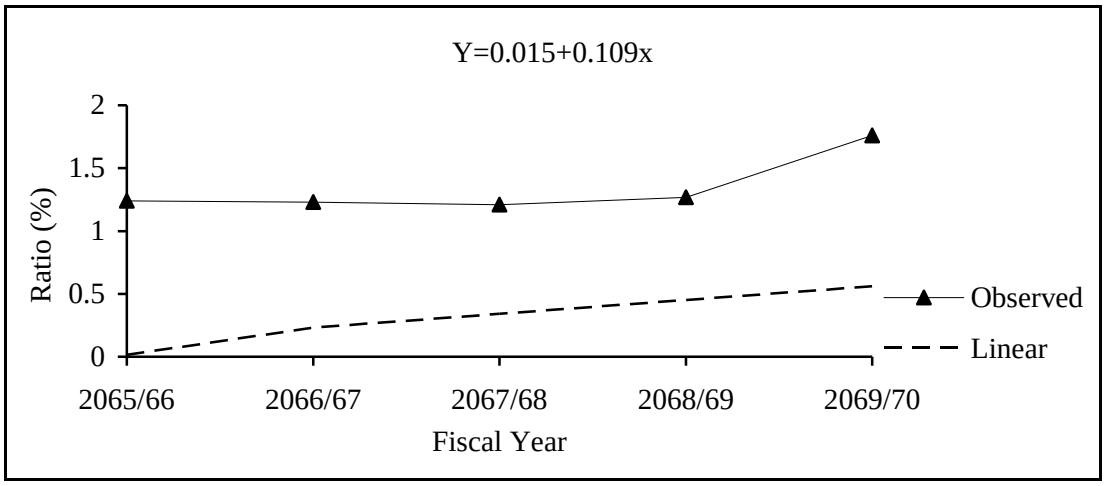


Figure 4.6 shows the observed value of loan loss ratio along with least square trend line. The ratio is moving down at first then up during the study period. The slope of the trend line is determined by the least square method is positive which indicates the trend of loan loss ratio is increasing over the study period.

4.1.3 Management

Sound management is the key of financial institution performance. The general management of the institution, human resources policy, governance, management information system, internal control, auditing, strategic planning and budgeting are distinct areas that reflect the overall quality of management (Rose, 1999).

While the others factors can be quantified fairly easily from current financial statements, management quality is somewhat being subjective and difficult to measures. There is one measure that is relevant to management is the ratio of total expenses total revenue. Assuming that how good the management is correlated with this ratio is use to represent the management. Another measure that is also relevant to management is the ratio of earnings per employee is used as a proxy of management quality.

4.1.3.1 Total Expenses to Total Revenue Ratio

The ratio of total expenses to total revenue is used as a proxy measure of the management quality. This ratio is calculated by dividing the total expenses by total revenues. A high level of expenditure in un-productive activities may reflect an inefficient management. A high or increasing ratio of expenses to total revenue may give indication of inefficient operation. This can be, but necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability (IMF, 2000).

Financial institution earning originates from interest on loan and advances, investments, commission and discounts, foreign exchange rate, gains and miscellaneous income. Conversely, it expends on depositor's interest, staff salary, provident fund, allowances and other operating expenses like rent, water, electricity, fuel expenses, audit fee expenses, management expenses, losses shortage written off, provision for income tax are non operation expenses.

Table 4.7

Total Expenses to Total Revenue Ratio

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Total Expenses (Rs)	107,823	167,696	284,547	374,716	444,822
Total Revenue (Rs)	145,238	216,879	345,666	458,521	545,087
Total Expenses /Total Revenue Ratio (%)	74.24	77.32	82.32	81.72	81.61

Source: Appendix 2.

As shown in Table 4.7, the total expenses to total revenue ratio has increased up to FY 2067/68 then after it is decreased. From the above table, OFL expenses are high. In FY 2067/68, there is greater expenses 82.32% and in FY 2065/66 lower expenses 74.24% over the study period. In this way, OFL expenses are high with the comprising its revenue.

Figure 4.7

Total Expenses to Total Revenue Ratio

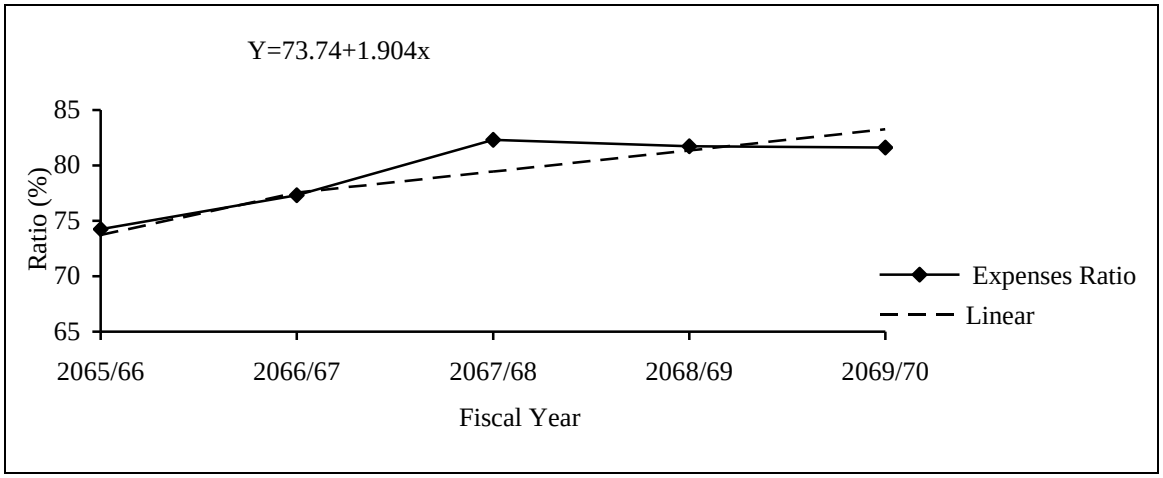


Figure 4.7: shows the total expenses to total revenue ratio with least square trend line. The slope of least square trend line is positive i.e.1.904. So the linear line is going down to up. It shows the ratio is increasing trend over the study period. It is not favorable for OFL. The loan loss provision is very high in FY 2067/68. So, the total Expenses also is increased highly but revenue is increased in low less than expenses ratio. So, the total expenses to total revenue ratio in FY 2067/68 is very high i.e. 82.32%.

4.1.3.2 Earning Per Employee

An earning per employee is also taken as measure of management quality in this study. It is calculated dividing net profit after taxes by number of employees. Low or decreasing earning per employee can reflect inefficiencies as a result of overstaffing with similar repercussion in terms of profitability (IMF, 2001).

Table 4.8

Earning Per Employee

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Net Profit (Rs)	26,141.30	33,961.10	40,400.20	60,153.40	70,341.20
No. of employees	32	67	74	80	87
Earning per employee (Rs)	816.92	506.88	545.95	751.92	808.52

Source: Appendix 2.

Table 4.8 shows the earning per employee in rupees during the study period. The ratio is decreasing trend at the beginning but then increasing trend remaining the study period. Over the study period, maximum earning per employee is Rs 816.92 thousands and minimum is Rs 506.88 thousands in FY 2065/66 and 2066/67 respectively. The mean ratio of earning per employee is Rs 686.04 thousands over the study period.

Figure 4.8

Trend of Earning Per Employee

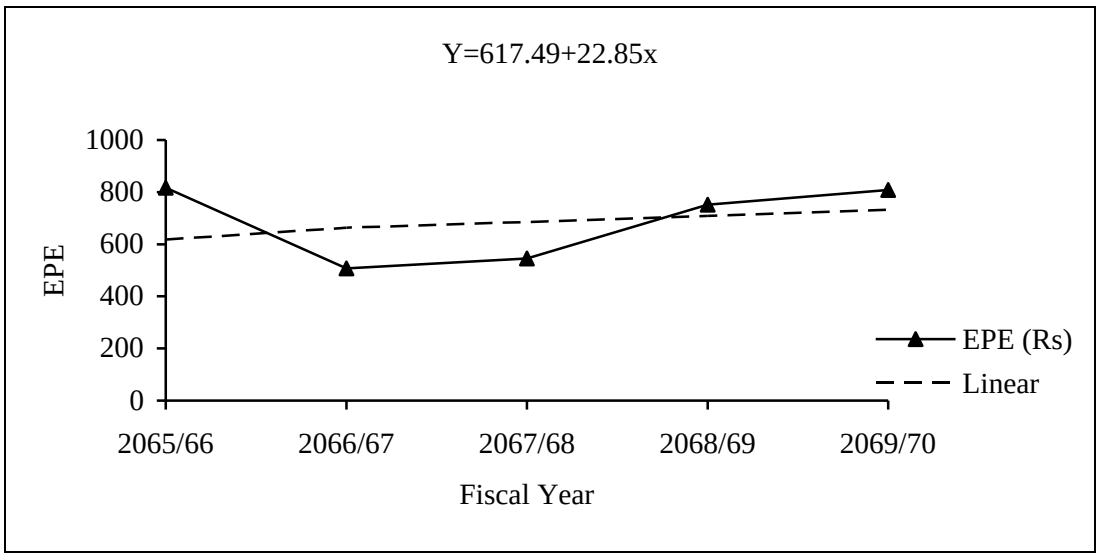


Figure 4.8 shows the observed value of earning per employee with least square linear line. The slope of the trend line is positive i.e. 22.85. Which indicates the earning per employee is increasing trend over the study period.

4.1.4 Earning Quality

The main objective of FI is to earn profit and their level of profitability is measured by profitability ratios. Earnings represent the first line of defense against capital depletion resulting from shrinkage in asset value. Earning performance should also allow the FI to remain competitive by providing the resources. Profitability ratio are calculated to measure to the efficiency of FI, higher profit ratios indicates higher efficiency and vice versa.

4.1.4.1 Return on Equity (ROE)

ROE is measure of the rate of return flowing to the company's shareholders. It approximates the net received from investing their capital in the company (Peter,

1999). Return on equity reveals how well the FI uses the resources of owners. The higher ratio represents sound management and sufficient mobilization of the owner's equity and vice versa. ROE of 15% is treated as standard and banking industry are desired to have higher than this (Baral, 2005).

Table 4.9

Return on Equity (ROE)

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Net Profit (Rs)	26,141.30	33,961.10	40,400.20	60,153.40	70,341.20
Shareholder Equity (Rs)	151,210	175,972	288,925	325,404	392,888
Return on Equity (%)	17.29	19.3	13.98	18.49	17.9

Source: Appendix 2.

As shown in Table 4.9, the return on equity ratio of the OFL is minimum of 13.98% and maximum of 19.3% in FY 2067/68 and 2066/67 respectively. The mean ratio of the OFL is 17.39%, standard deviation is 1.83% and the coefficient of variation of them is 0.105. The observed values of ratio are fluctuating over the study period. The profit is very low in FY 2067/68 due to very high loan loss provision and the shareholder equity is increased in this year by 112,953 thousands. So, ROE of OFL is inconsistency.

Figure 4.9

Trend of Return on Equity Ratio

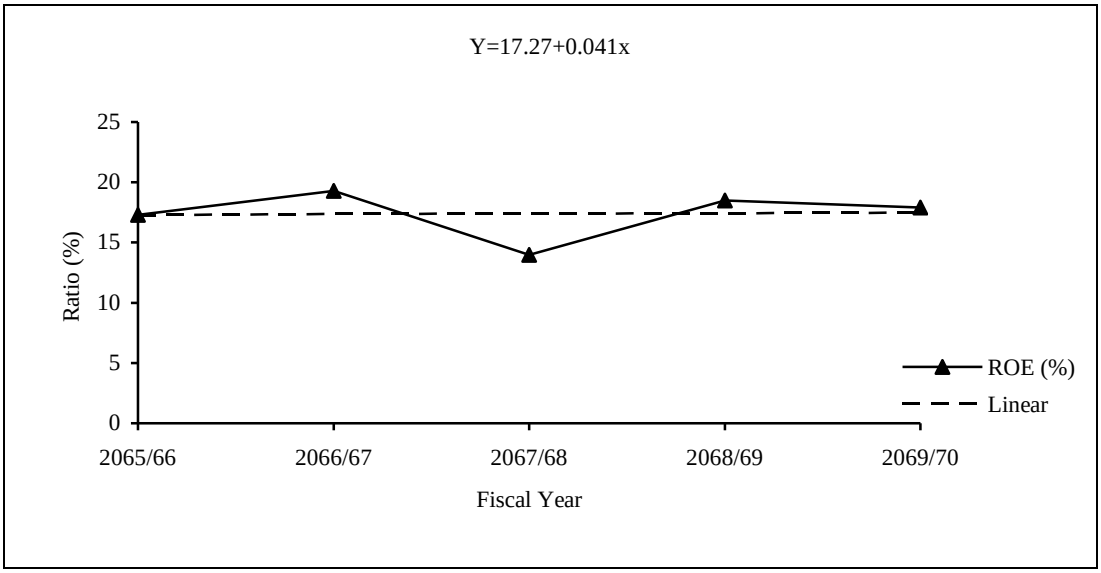


Figure 4.9, shows the trend of return on equity with least square linear line. The least square slope is positive i.e., 0.041. This indicates the trend of ROE is increasing trend over the study period.

4.1.4.2 Return on Assets (ROA)

ROA is measure of the rate of return flowing to the company's total assets. It is a measure of profitability linked to the asset size of the FI (Dongal and Parjapati, 2000). It is primarily an indicator of managerial efficiency; it indicates how capably the management of the FI has been converting the institutions assets into net earnings (Krishna, 2006). ROA is a popular tool to measure how well its assets are utilized in generating profit. It measures the profit earning capacity by utilizing available resources i.e. total assets, return will be higher if the FI resources are well managed and efficiently utilized. Generally, the return on assets ratio should be 1% and higher is desired to the banking industry (Krishna, 2006).

Table 4.10

Return on Assets

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Net Profit (Rs)	26,141.30	33,961.10	40,400.20	60,153.40	70,341.20
Total Assets (Rs)	1,452,809.4	1,763,070.6	2,543,428.8	3,636,587.3	4,321,045.8
Return on Assets (%)	1.8	1.93	1.59	1.65	1.63

Source: Appendix 2.

As shown in Table 4.10, the return on asset ratio of the OFL is minimum of 1.59% in FY 2067/68 and maximum of 1.93% in FY 2066/67. The ratio is fluctuating trend over the study period. The mean ratio of ROA is 1.72%, standard deviation is 0.126%. The mean ratio is above 1% benchmark. So, the OFL, ROA is also within benchmark.

Figure 4.10

Trend of Return on Assets Ratio

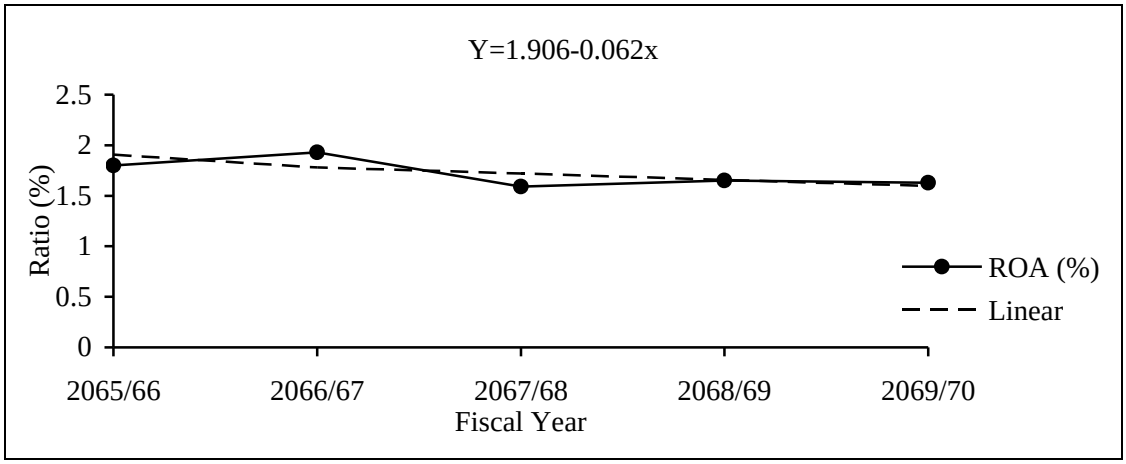


Figure 4.10 shows the observed value of ROA with least square linear line. The slope of linear line is negative i.e., -0.062. The negative slope of linear indicates decreasing trend. So, the trend of ROA is decreasing over the study period. The total assets of OFL have increased in last three years very high but net profit is increased in very low ratio. So, the ROA of OFL also is in decreasing trend over the study period.

4.1.4.3 Net Interest Margin (NIM)

The net interest margin measure how large a spread between interest revenues and interest costs management has been able to achieve by close control the FI earning assets and the pursuit if the cheapest sources of finding (Peter, 1999). It is calculated the net interest income dividing by earning assets. Under earning assets loans and advances, bills purchase and discounted and investment made in securities (T-Bill, Bonds) are included.

Generally, the net interest margin ratio should be 3% to 4% and higher is better in FI industry (World Bank, 1996). However, it highlights the fact that looking at returns without looking at risk can be misleading and potentially dangerous in terms of FI solvency and long run profitability (Saunders and Cornett, 2004).

Table 4.11

Net Interest Margin

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Net Interest Income (Rs)	86,584.2	73,555.4	102,772.6	121,684.2	164,875.1
Earning Assets (Rs)	1,280,176	1,492,323	2,069,985	2,626,673	3,359,032
Net Interest Margin (%)	6.76	4.93	4.97	4.63	4.02

Source: Appendix 2.

As shown in Table 4.11, the NIM of OFL ratio is minimum of 4.02% in FY 2069/70 and maximum of 6.76% in FY 2065/66. The NIM ratio of OFL is decreased in FY 2066/67 and then it is slightly increased in FY 2067/68, thereafter decreased in last two FY. The mean ratio for the period is 5.06%, and standard deviation is 0.92% .it can be concluded that, the NIM ratio of OFL is accepted. Because it is with in standard, the standard of NIM ratio is 3% to 4%.

Figure 4.11

Trend of Net Interest Margin Ratio

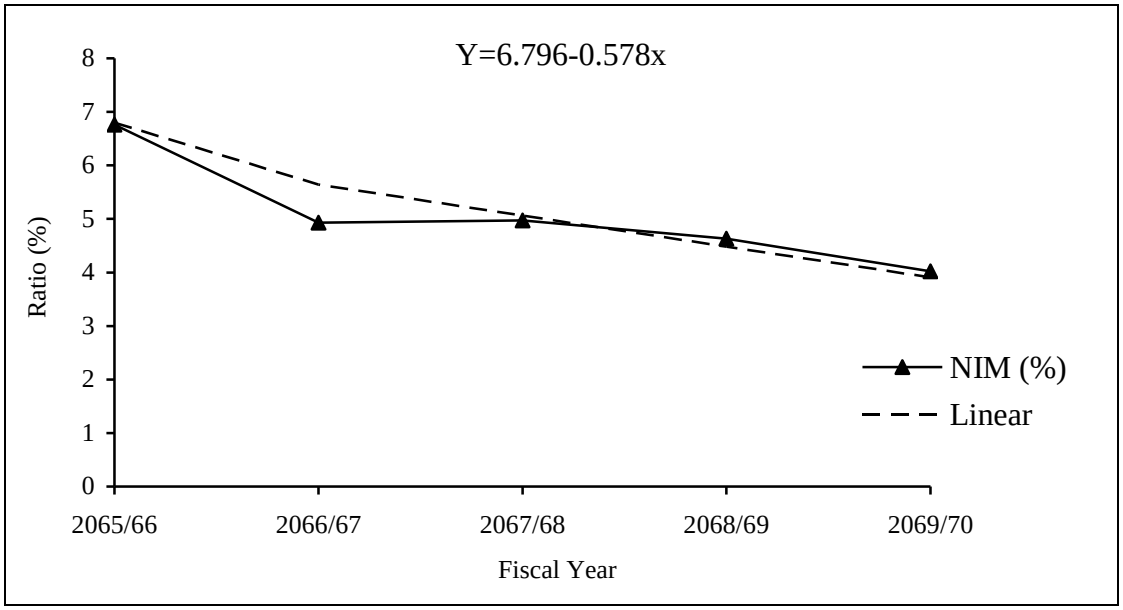


Figure 4.11 shows the observed value of net interest margin ratio with least square linear line. The slope of linear line is negative i.e., -0.578. It indicates that, the trend of NIM is decreasing over the study period.

4.1.4.4 Earning Per Share (EPS)

Earning per share provides a direct measure of the returns flowing to the company owners, its stock holder's measure relative to the number of shares to the public (Peter, 1999). The earnings per share of an organization give the strength of the share in the market. The earnings per share of OFL are tabulated below:

Table 4.12

Earning Per Share

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Net Profit (Rs)	26,141.30	33,961.10	40,400.20	60,153.40	70,341.20
No. of Share (In thousands)	1,050	1,480.50	2,476.50	2,467.50	3,257.10
Earning Per Share (Rs)	24.9	22.94	16.31	24.38	21.6

Source: Appendix 2.

Table 4.12 shows that the EPS of the OFL has ranged between Rs 16.31 to Rs 24.9. The OFL EPS is in fluctuating trend. The maximum EPS is Rs 24.9 in FY 2065/66 and minimum of Rs 16.31 in FY 2067/68. The mean EPS of OFL is Rs 22.03 and standard deviation is 3.08%.

Figure 4.12

Trend of Earning Per Share

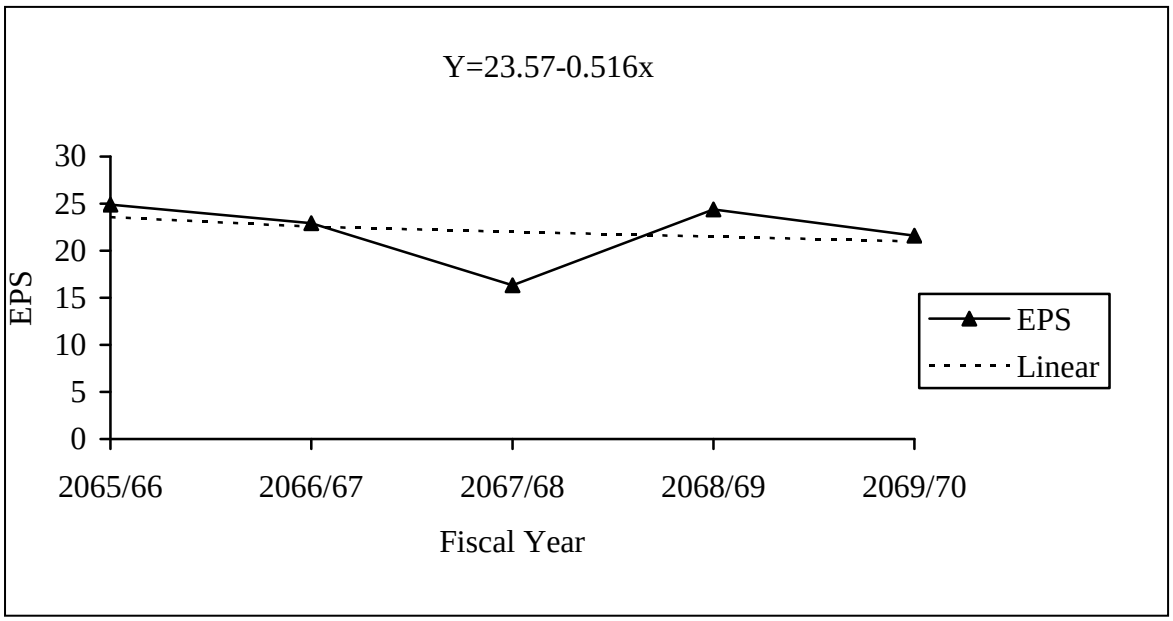


Figure 4.12 shows the observed value of EPS with least square linear line over the study period. The slope of EPS is negative i.e., -0.516. It indicates that, the trend

of EPS is decreasing. The number of share has increased in FY 2066/67 and then decreased up to FY 2068/69 then again increased in FY 2069/70, but net profit has increased in very low ratio. So, the EPS has decreased decreasing trend over the study period.

4.1.5 Liquidity

The level of liquidity influences the ability of FI system to withstand shocks. Liquidity risk arises when an FI's liability holders like depositors demand immediate cash for the financial claims they hold with an FI. The most liquid asset is cash for which FIs can use directly to meet liability holder's demands to withdraw funds. Day to day withdrawals by liability holders is generally predictable and large. FIs can except to additional funds on the money and financial markets to meet any sudden shortfalls of cash. At times face a liquidity crisis due to either lack of confidences on the FIs problem or some unexpected need for cash, the liability holders may demand larger withdrawals than usual. This turns the FI's liquidity problem into a solvency problem and causes it to fail (Saunders and Cornett, 2004).

4.1.5.1 Liquid Assets to Total Deposit Ratio

This ratio measures the percentage of liquid fund with the company to meet short term obligation. It measures overall liquidity position. Cash in hand foreign currency in hand, balance with NRB, balance held abroad and money at call are including in total liquid fund. This ratio is computed by dividing liquid assets by total deposits. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the company (NRB, 2061).

Table 4.13

Liquid Funds to Total Deposit Ratio

Rupees in '000'

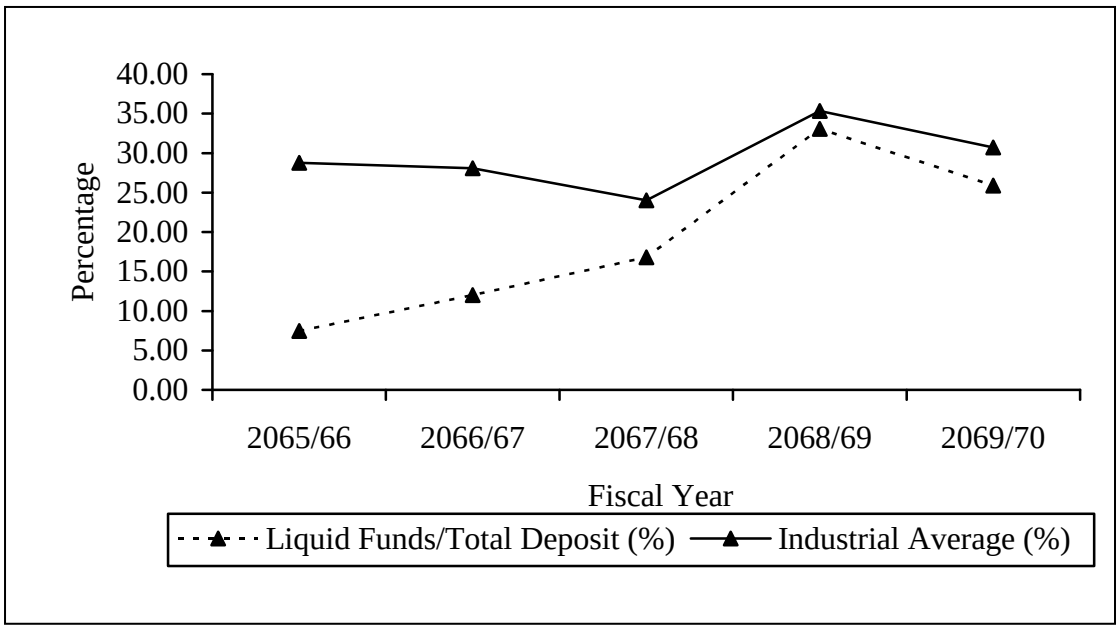
Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Liquid Funds (Rs)	86,984	183,087	363,244	1,067,291	974,220
Total Deposit (Rs)	1,168,341	1,527,281	2,162,235.80	3,227,517	3,765,595
Liquid Funds/Total Deposit (%)	7.45	12	16.8	33.07	25.87
Industrial Average (%) *	28.75	28.06	24	35.32	30.7
Diff. from Industrial Avg. (%)	-21.3	-16.06	-7.2	-2.25	-4.83

Source: Appendix 2. Banking and financial statistics NRB, No. 59 July, 2013*

Table 4.13 shows that the liquid funds to total deposit ratio of OFL during the period of FY 2065/66 to FY 2069/70. The ratio is increased up to FY 2068/69; thereafter it is decreased in FY 2069/70. The ratio is minimum in FY 2065/66 i.e., 7.45% and maximum in FY 2068/69 i.e., 33.07%. The liquid fund to total deposit ratio of OFL are lower than industrial average during the study period. So, the difference with industrial average is negative for all fiscal year during the study period.

Figure 4.13

Comparing Liquid Funds to Total Deposit Ratio with Industrial Average



In the above Figure 4.13, the total liquid fund to total deposit curve of OFL is under the industry average curve in all the observed fiscal year. It shows that, the liquidity position of OFL is not better than industrial average ratio.

4.1.5.2 NRB Balance to Total Deposit Ratio

This ratio shows whether the FI is holding the balance as required to NRB. To ensure adequate liquidity in the FI to meet the depositors demand for cash at any time, to inject the confidence in depositors regarding the safety of their deposit funds NRB has put the directives to maintain certain percent of total deposit in NRB by the FIs. Total deposits means current, savings and fixed deposit account as sell as call account deposit and certificates of deposits. For the purpose, deposits held in convertible foreign currency, employee guaranteed amount and margin account will not be

included (NRB, 2061). The following table shows the NRB balance to total deposit ratio with compare to industrial average by OFL.

Table 4.14

NRB Balance to Total Deposit Ratio

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
NRB Balance (Rs)	30,389.4	34,632.3	50,870.8	70,912.6	67,974.7
Total Deposit (Rs)	1,168,341	1,527,281	2,162,235.8	3,227,517	3,765,595
NRB Balance/ Total deposit (%)	2.6	2.27	2.35	2.2	1.87
Industrial Average (%) *	3.97	3.28	2.82	5.14	3.92

*Source: Appendix 2,*Banking and financial statistics NRB, No. 59 July, 2013*

Table 4.14 shows NRB balance to total deposit ratio of OFL. The table shows that, OFL has not maintaining balance with NRB. The balance is under the industrial average in each fiscal year over the study period. The balance ratio is fluctuating trend.

Figure 4.14

Comparing NRB Balance to Total Deposits Ratio with Industrial Average

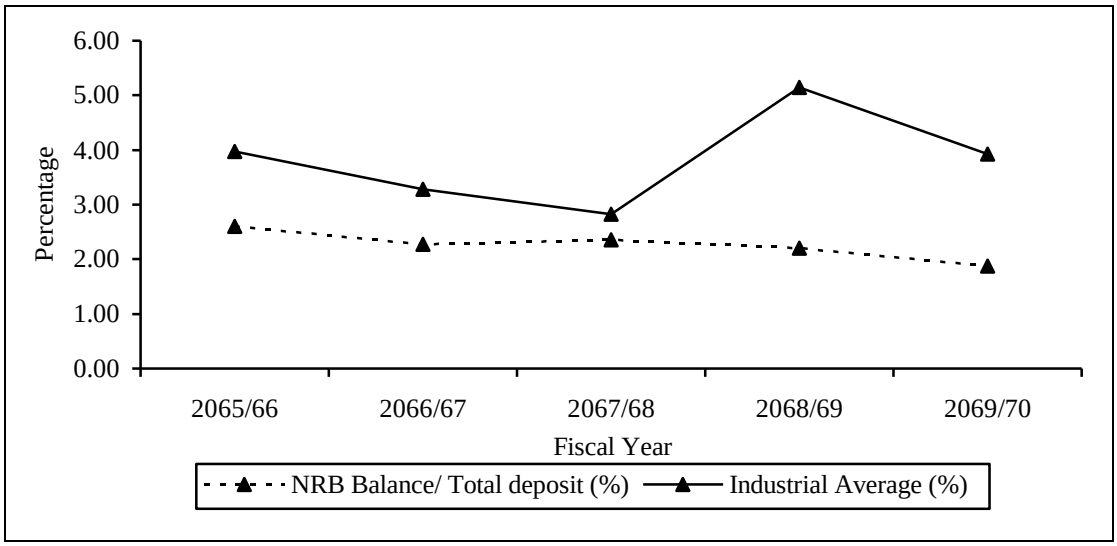


Figure 4.14 shows the NRB balance to total deposit ratio with compare to industrial average over the study period. As shown in figure 4.14 the NRB balance to total deposit ratio curve of OFL is below the industrial average curve in each year over the study period. It shows that the NRB balance is less than industrial average

and OFL has not maintained the balance with NRB as the directives over the study period.

4.1.5.3 Cash in Vault to Total Deposit Ratio

This ratio shows the percentage of total deposits held as cash in vault. This ratio is computed by dividing cash at vault by total deposits. Cash and foreign currencies in hand are included as cash in vault. Total deposit means current savings and fixed deposits account as well as call account deposit and certificates of deposits. For the purpose deposits held in convertible foreign currency, employees guarantee amount and margin account will not be included (NRB, 2061).

Table 4.15

Cash in Vault to Total Deposit ratio

Rupees in '000'

Fiscal Year	**2065/66**	**2066/67**	**2067/68**	**2068/69**	**2069/70**
Cash in Vault (Rs)	1,799.20	18,038.70	17,614.60	32,518.80	46,507.90
Total Deposit (Rs)	1,168,341	1,527,281	2,162,235.80	3,227,517	3,765,595
Cash in Vault/Total Deposit (%)	0.15	1.18	0.82	1	1.24
Industrial Average (%) *	1.06	1.23	1.43	1.77	1.43
Diff. from Industrial Average (%)	-0.91	-0.05	-0.61	-0.77	-0.19

*Source: Appendix 2, *Banking and financial statistics NRB, No. 59 July, 2013*

Table 4.15 shows that the cash in vault to total deposit of OFL has fluctuating trend. The highest ratio is 1.24% in FY 2069/70 and lowest ratio is 0.15% in FY 2065/66. The ratio has increased in FY 2066/67 and then decreased in FY 2067/68 then slightly increased in remaining study period. The ratio is less than industrial average in each year over the study period.

Figure 4.15

Comparing Cash in Vault Total deposit Ratio with Industrial Average

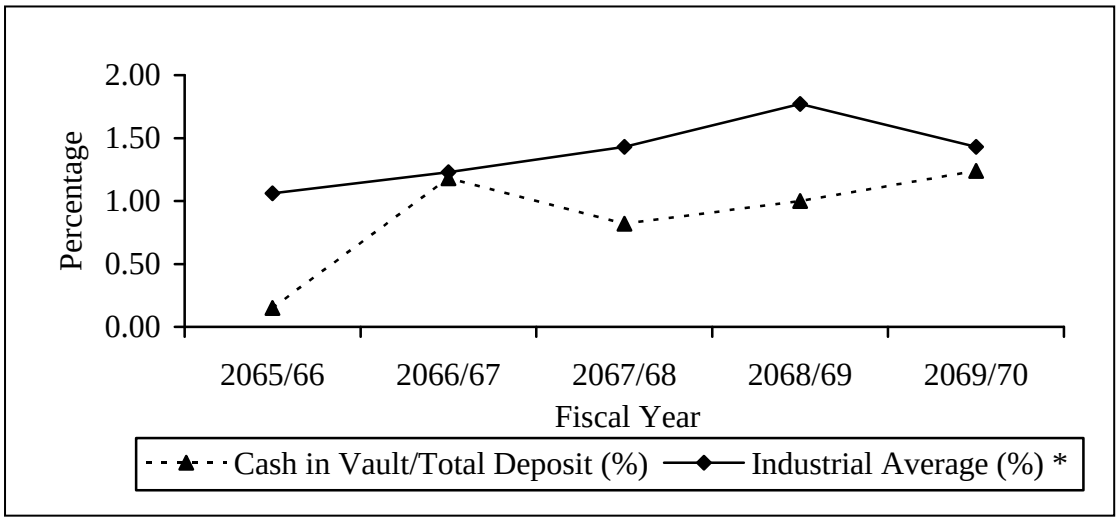


Figure 4.15 shows the observed cash in vault ratio of OFL with compare to industrial average ratio within the study period. In the figure, the ratio curve is under the industrial average curve in each year. It shows that, the ratio of OFL is less than industrial average in each year.

4.1.6 Sensitivity to Market Risk

Sensitivity to market risk refers to the risk that changes in market conditions could adversely affect earnings and or capital. Commercial banks are increasingly involved in diversified operations such as lending and borrowing, transaction in foreign exchange, selling off assets pledged for securities and so on. All these are subject to market risk like interest rate risk, foreign exchange rate risk and financial asset and commodity price risk. The health of an FI more sensitive to market risk is more hazardous than of less sensitive. Foreign exchange risk, interest rate risk, equity price risk commodity price are the indicators of sensitivity to market risk (Baral, 2005).

When a FI has more liabilities re-pricing in arising rate environment than assets re-pricing, the net interest margin (NIM) shrinks. Conversely, if the FI is asset sensitivity in arising interest rate environment, NIM will improve because the FI has more assets re-pricing at rates. There are many ways to monitor or exposure to IRR, measurement systems vary in complexity from very simple methods such as a gap model, to very sophisticated models such as a simulation or duration analysis (Peter, 1999). This study is worked with gap model, which simply measures the net quantity

that changes in interest rates will have on earnings. With a view to minimize the IRR, NRB requires the banks to adopt gap analysis adopted for minimizations of IRR. Banks shall classify the time interval of the assets and liabilities on the basis of maturity period of 0-90 days, 91-180 days, 181-270 days, and 271-365 days over 1 FY. The effect on the profitability is measured by multiplying the change in interest rate, ΔRi in the i^{th} maturity bucket annualized with cumulative gap (NRB, 2061).

If the interest rates rise on RSAs and RSLs, the positive CGAP (RSA>RSL) would project the increase in the expected annual net interest income (NII). However, if interest rates fall when CGAP is positive, NII will fall. As rates, fall interest revenue falls by more than interest expenses. Thus NII falls by approximately by (CGAP) x (ΔR). In general when CGAP is positive the change in NII is positively related to the change in interest rates. Thus, FI would want to keep CGAP positive when interest rates expected to rise (Bhandari, 2006).

Conversely, when the CGAP or the gap ratio is negative (RSA<RSL) and if interest rates by equal amounts for RSAs and RSLs, NII will fall. Similarly, if interest rates fall equally for RSAs and RSLs, NII will increase when CGAP is negative. As rates, fall interest expenses decrease by more than the revenues. In general, when CGAP is negative, the change in NII is negatively related to the change in interest rates. Thus, FIs are expected to keep CGAP negative when interest rates are expected fall (Bhandari, 2061).

Expressing the re-pricing gap as a percentage of assets, gives: (1) the direction of the interest rate exposure (+ or CGAP) (2) the scale of the CGAP against the assets size of the FI.

Gap analysis of RSAs and RSLs of OFL for the period of FY 2068/69 and 2069/70 is made as shown in Table 4.16 (a and b) based on the different maturity time bucket.

a. 2068/69

2068/69	1 to 90	91 to 180	181 to 270	271 to 365	>365	Total
RSA (Thousands)	1232.2	163.1	163.1	166	1891	3615.4
RSL (Thousands)	637.4	637.7	617.4	600.1	778.2	3263.8
GAPi (RSA-RSL) thousands	594.8	-467.6	-454.3	-434.1	1112.8	351.6
CGAP (RSA-RSL) thousands	595.8	128.2	-326.1	-760.2	352.6	
RSA/RSL	1.93	0.26	0.26	0.27	2.43	1.11
CGAPi Ratio [CGAP/Total RSA] (%)	16.48	3.55	NA	NA	9.75	
$\boxed{\Delta R\%}$				1%	1%	
$\boxed{\Delta\, NII\,(thousands)\, CGAP \times \Delta R}$				-7.60	3.53	

Source: OFL annual reports.

b. 2069/70

2069/70	1 to 90	91 to 180	181 to 270	271 to 365	>365	Total
RSA (Thousands)	1181.6	200.4	199.1	195.4	2459.6	4236.1
RSL (Thousands)	613.4	566.8	471.7	471.7	1688.6	3812.2
GAPi (RSA-RSL) thousands	568.2	-366.4	-272.6	-276.3	771	423.9
CGAP (RSA-RSL) thousands	568.2	201.8	-70.8	-347.1	423.9	
RSA/RSL	1.93	0.35	0.42	0.41	1.46	1.11
CGAPi Ratio [CGAP/Total RSA] (%)	13.41	4.76	4.7	4.61	58.06	
$\boxed{\Delta R\%}$				1%	1%	
$\boxed{\Delta\, NII\,(thousands)\, CGAP \times \Delta R}$				-3.46	4.24	

Source: OFL annual reports

The research period is 2065/66 to 2069/70 but lack of the data for review of sensitivity of market risk only two fiscal years (2068/69 and 2069/70) data are taken. Net financial assets (RSA-RSL) reprising in the short term maturity bucket ranging from 0-90 day to 271-365 days was positive and negative both. In the long term maturity bucket (> 365 Days) the gap was positive in both two years by Rs 1112.8 and Rs 771.

Figure 4.16

Level of Risk Sensitivity Assets and Liabilities over Term

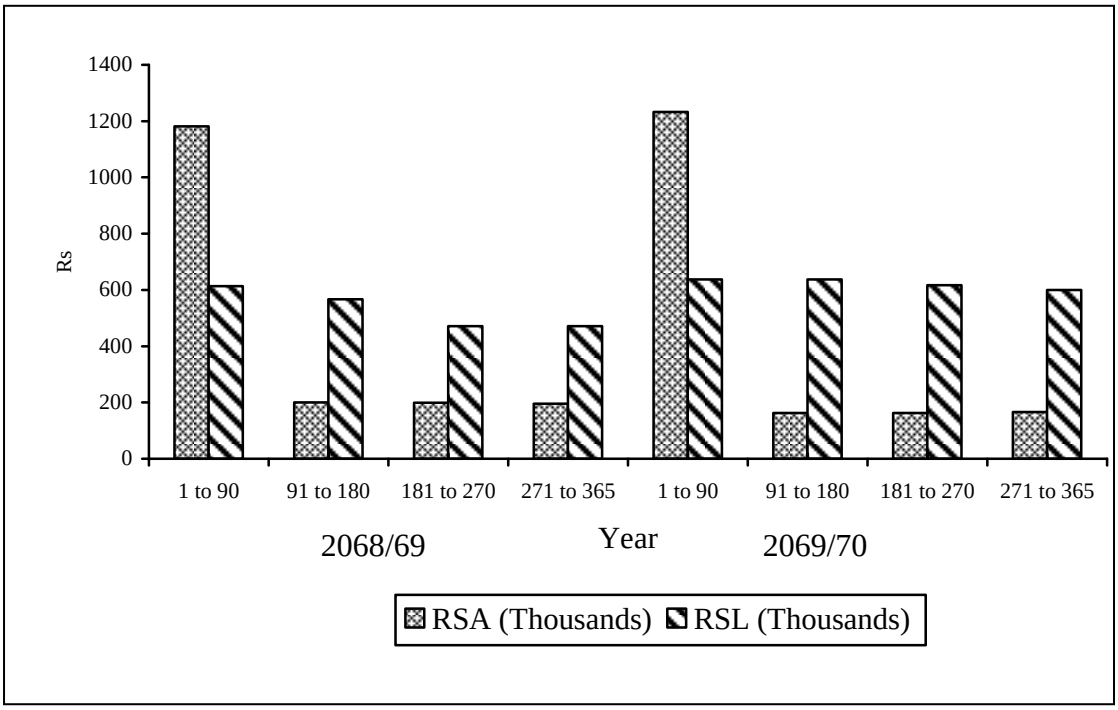


Figure 4.16 shows a comparison of RSAs and RSLs of the OFL in a time bucket ranging from 0-90 days to 365 days time horizon. The cumulative gap, CGAP of the RSAs and RSLs reprising in the short term maturity bucket (0-90) days is positive, (91-181) positive, (181-270) negative, (271-365) negative in FY 2068/69. In FY 2069/70 short term maturity bucket (0-90) and (91-181) are positive and other two periods are negative. The CGAP or the interest rate sensitivity ratio to the total earning assets over the short term horizon i.e. up to one FY was highest with 16.48% in FY 2068/69 and lowest with 13.41% in FY 2069/70. The CGAP ratio to the earning assets over the long term horizon was highest with 58.06% in FY 2069/70 and lowest with 9.75% in 2068/69.

4.2 Major Findings

The major findings of the study on financial performance analysis of OFL in the framework of CAMELS are as follows:

4.2.1 Core capital ratio is above the NRB standard with maximum positive difference 8.97% in FY 2067/68 and minimum positive difference of 5.72% in FY 2069/70. OFL is able to maintain more than 5% above the

NRB requirement in core capital ratio during the study period. In general it is found that the core capital adequacy ratio of OFL is adequate and sufficient.

4.2.2 The proportion of supplementary capital in the total capital fund is decreasing as compared to core capital except FY 2066/67. This means the OFL is increasing capital of permanent nature. The ratio of supplementary capital is within NRB standard over the study period. The difference of supplementary capital ratio with NRB standard is maximum is 13.49% in FY 2067/68 and minimum is 10.3% in FY 2069/70. Thus, it is clear that the company is running with adequate capital.

4.2.3 Total capital adequacy ratio of OFL is maximum with 15.45% in FY 2067/68 and minimum of 12.14% in FY 2069/70. The total capital adequacy ratio is increasing trend up to FY 2067/68 then decreased. The CAR difference is positive over the study period. So, OFL CAR is within NRB standard throughout the study period. It indicates that the financial position of the company is sound and strong.

4.2.4 Assets composition of OFL like in every FIs largely proportion in the loans and advances and lowest proportion in other assets over the study period. In the study period of five FYs, the average composition of cash & Bank balance , money at call, investment, loan and advances, fixed assets and other assets were 2.67%, 14.64%, 2.55%, 77.9%, 2.39% and 0.67% respectively.

4.2.5 The non-performing loans to total loans & advances ratio range from 0.21% in FY 2067/68 to 0.77% in FY 2069/70. The NPL ratios are below the international standard i.e., 5 percent. It shows the efficient credit management. It indicates that the company has low credit risk. It reflects the good performance of the company in mobilizing loan and advance.

4.2.6 The loan loss ratio for the study period is in increasing trend. The ratio ranges from 1.21% in FY 2067/68 to 1.76% in FY 2069/70 within average of 1.34%. The increasing trend of loan loss ratio indicates OFL's quality of loan assets is not getting better.

4.2.7 The total expenses to total revenue ratio is increasing trend. The range of ratio is 74. 24% in FY 2065/66 to 82.32% in FY 2067/68. The slope of

linear line is positive which indicates, that the ratio of OFL is increasing trend during the study period.

4.2.8 The average earning per employee of the study period is Rs 686.04 thousands. The slope of the observe earning per employee trend along with least square trend line is positive, which indicate the earning per employee is increasing trend over the study period.

4.2.9 The return of equity ratio of the OFL is minimum of 13.98% in FY 2067/68 and maximum of 19.3% in FY 2066/67. The mean ratio of OFL is 17.39%. The ratio is fluctuating in upward trend. The slope of trend line determined by the least square method is positive. This indicates, the OFL ROE ratio is increasing trend over the study period.

4.2.10 The return on assets mean ratio of OFL is 1.72%. The ratio is maximum of 1.93% in FY 2066/67 and minimum of 1.59% in FY 2067/68. The slope of least square trend line of ROA is negative. This indicates, OFL ROA ratio is decreasing trend.

4.2.11 Over the study period, the mean ratio of NIM of OFL is 5.06%. The slope of the trend line determined by least square trend line is negative which shows decreasing trend of NIM ratio during the study period.

4.2.12 The EPS of the OFL are fluctuating over the FYs of the study period. The EPS of OFL is ranged between RS 16.31 in FY 2067/68 to Rs 24.9 in FY 2065/66. The mean of EPs is Rs 22.03. The slope of linear line is negative, which indicates the EPS is decreasing trend.

4.2.13 The liquid assets to total deposit ratio of OFL during the period FY 2065/66 to FY 2068/69 are increasing trend except FY 2069/70. But the ratios are lower than industrial average. The difference is negative in all over the period.

4.2.14 NRB balance to total deposit ratio of OFL are fluctuating trend. The range of ratio is 1.87% in FY 2069/70 to 2.6 in FY 2065/66. The ratio of OFL is lower than industrial average in all over the study period.

4.2.15 The volume of cash at vault ratio is less than the industry average in all over the study period. The observed cash in vault ratio was increasing trend except FY 2067/68. The difference of cash in vault with industrial average is negative in all over the study period. It shows, the OFL is not

strictly following the directives issued by NRB in respect to balance must held as a vault.

4.2.16 FYS 2068/69 and 2069/70, net financial assets (RSA-RSL) re-pricing in the short term maturity bucket ranging from 0-90 days to 271-365 days is found negative and positive both in different periods. In the long term maturity bucket (>365 days) the gap is positive in both two years. The cumulative gap CGAP of RSA and RSL re-pricing in the short term maturing bucket (0-365) in both FYs is found negative and positive both in different periods. The interest rate sensitivity is higher for long term maturity than short term maturity bucket.

CHAPTER 5

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter includes three aspects of the study summary, conclusion and recommendations. The first aspect summarizing the whole study, the second draws the conclusion and last one forwards the recommendations.

5.1 Summary

This study was carried out as academic requirements for MBS degree on the topic of "Financial Performance Analysis in the Framework of CAMELS (A Study of Om Finance Limited)." The study was started with the objective to find out the fact about financial performance of OFL. The analysis of financial statement is done to obtain a better insight in to firm's position and performance. CAMELS is a technique of health checking of financial institutions. Financial institution's financial soundness is judged on the basis of capital adequacy, asset quality, management quality, earning quality, liquidity position, and sensitivity to market risk. Almost, all the government Banks in Nepal are running at loss. Though almost private sector's Banks are earning profit. It is difficult to call them sound if appraised from CAMELS approach. Thus, the interest was expressed to analyze the financial performance of current balance with carrying a case study of OFL in the framework of CAMELS.

FIs are introducing complex and innovative products, they are exposed to many risks and therefore more amplified as well as diversified the functions performed by the FI supervision department. A key product of supervision is a rating of the FI's overall condition, commonly related to as a CAMELS rating. CAMELS rating system is used by the three federal banking supervisors [The Federal Reserve, FDIC and Office of the controller of the Currency (OCC)] and other financial supervisory agencies to provide a convenient summary of FI conditions at the time of exam. Various studies have been conducted in the past on the financial analysis of commercial banks in the US and other regions were found done. In context of Nepalese banking environment, there are only few researchers conducted in the framework of CAMELS. The study analyze the level, trend and comparative analysis

of capital adequacy, non-performing loans, loan loss provision, assets composition, management quality ratios, earning capacity, liquidity position and sensitivity to market risk components of the OFL during of 5 years period FY 2065/66 to FY 2069/70. During the research the areas that formed part of the research review were functions of finance companies, concept of CAMELS rating system and component evaluation system, Basel capital accord, NRB guidelines. Besides these, review of research paper, work paper dissertations and related reports were reviewed.

The research was conducted within the framework of descriptive and analytical research design. For the study purpose, Om Finance Limited was chosen as a study unit applying convenience sampling as technique out of 59 finance companies. The required data and information were collected from secondary sources. In addition with this primary data also are used in this research work, which was collected, by using unstructured interview with senior staff in the OFL. Financial ratios, simple mathematical and statistical tools have applied to get the meaningful result of the collected data in this research work.

The analysis has been made to compare OFL's ratio with NRB standard, industrial average and analyze the trend of ratios. The capital adequacy ratios of the OFL are above than NRB standard during the study period, which lead to conclude that the OFL is running with adequate capital. The assets are mainly composed of loans and advances investment. The non-performing loans to loan ratios are in increasing trend but below the international standard. The loan loss provision of the OFL is increasing trend. The total expenses to revenue ratio are in increasing trend over the study period, which is not favorable for OFL. The earning per employee is in increasing trend, which indicates the good management. The earning quality ratio like ROA, NIM and EPS are decreasing trend except ROE is increasing trend. The cash in vault to total deposit ratio and NRB balance to total deposit ratio and liquid assets to total deposit ratios are below than the standard during the study period. This shows that, the OFL is not following NRB directives strictly. FYs 2068/69 and 2069/70, net financial assets (RSA-RSL) re-pricing in the short term maturity bucket ranging from 0-90 days to 271-365 days is found negative and positive both in different periods. In the long term maturity bucket (>365 days) the gap is positive in both two years. The cumulative gap CGAP of RSA and RSL re-pricing in the short term maturing bucket (0-365) in both FYs is found negative and positive both in different periods. The

interest rate sensitivity is higher for long term maturity than short term maturity bucket.

5.2 Conclusions

Based on the findings the performance of OFL in the framework of CAMELS is concluded as under.

5.2.1 Core capital adequacy ratio measure in terms of core capital to total risk adjusted assets is as per NRB standard. It means the OFL is using adequate amount of internal sources or core capital in past five years looking to the fact, the OFL is financially sound and strong as internal financing.

5.2.2 Supplementary capital ratio of the OFL is within the standard of NRB over the study period. Which supports to draw the conclusion of the supplementary capital of the OFL is sufficient.

5.2.3 Capital adequacy ratios reveals that the OFL is running with the adequate capital and the capital fund of OFL is sound and sufficient. The total capital adequate ratios of OFL are within boundary of NRB standard over the study period.

5.2.4 The assets composition of the OFL during the study period reveals that the major part of total assets was held in from of loans and advances. As it can be seen, the lower part of total assets was held in from of other assets.

5.2.5 The increasing trend of non-performing loans and advances ratio indicates the decline in loan quality. The ratios are not more fluctuating trend, it shows that the OFL is advance of non-performing loans and adopting the appropriate polices to manage this problem to increase the quality of assets. The NPL ratios are below the international standard i.e. 5 percent. It can therefore, concluded that OFL has placed efficient credit management and recovery efforts.

5.2.6 The increasing trend of loan loss provision ratio indicates that the quality of loans becoming down grading year by year. It seems that amount of non-performing loans and possibility of default is increasing in future.

5.2.7 The increasing trend of total expenses to total revenues ratios shows that the OFL is gradually moving towards cost maximization.

5.2.8 The increasing trend of earning per employee indicates the efficient management in staffing and the profitability of the company is increasing.

5.2.9 The return on equity ratios are in fluctuating trend. The return on equity percent is slowly increasing but the company has not earned satisfactory return for its equity shareholders.

5.2.10 The total assets of OFL is highly increasing trend, but net profit has not increased like total assets. So ROA is in decreasing trend. This shows that the ability of the management to utilize company's assets to generate profits is declining trend but average ratio is above the World Bank benchmark i.e., 1.5 percent.

5.2.11 The decreasing trend of net interest margin shows the spread between interest costs management has been not able to achieve by close control over the OFL's earning assets and the pursuit of the cheapest sources of funding. Stoll, the OFL has satisfactory net interest margin comparing with benchmark i.e., 3 to 4 percent.

5.2.12 The decreasing trend of EPS shows that the return flowing to the OFL's owner is decreasing. The tendency affect the strength of the share in the market is also decreasing.

5.2.13 The liquid funds to total deposit ratio is below the industrial average ratio. This shows that the OFL has not sufficient liquid fund. Lower liquid fund ratio implies the inefficient liquidity position of the company.

5.2.14 The NRB balance to total deposit ratio is below the industrial average during the study period. This shows that the OFL is not maintain sufficient amount of balance in NRB.

5.2.15 The cash in vault to total deposit ratio is below the industrial average. This shows that ignoring the percentage of liquid fund with the OFL to make immediate payment to the depositors.

5.2.16 The sensitivity of net financial assets in a long term maturity bucket is high and is therefore sensitivity to interest rate change risk than short term maturity bucket. Conversely, the OFL has not able to match the risk sensitivity liabilities in long then maturity bucket and therefore interest rate change has affect on them.

5.3 Recommendations

Based on analysis and findings of the study, the following recommendations can be made as suggestions to overcome the weakness in the existing financial performance of OFL.

1. Capital adequacy ratio of the OFL is within the NRB standard but fluctuating trend during the study period. So it is suggested to maintain stable capital adequacy ratios within the boundary of NRB standard.
2. The non-performing loan ratio of OFL is in increasing trend, which is not favorable for OFL. So the OFL is suggested to control its non-performing loan ratio or to reduce the non-performing loan ratio and to formulate an effective powerful loan recovery committee. So, the company should control NPA to reduce non-performing loan ratio.
3. The loan loss provision to total loan and advances is increasing trend in ending year of the study period. So, the OFL needs to give attention to lower the proportion of loan loss provision by increasing the quality of assets by strengthening the credit appraisal and follow-up measures. So, the company should reduce the NPA so that, the loan loss ratio will decrease.
4. The total expenses to total revenue ratio is in increasing trend during the study period. So, it is recommended that to reduce its total expenses and to increase its total revenue in the coming year.
5. The earning quality of OFL i.e., ROA is in decreasing trend. Which indicates the earning performance of OFL is not good. So, the OFL is suggested to increase its ROA. ROA directly affected by net profit. Although it's ROE is in slightly increasing trend that is not satisfactory for OFL. So, net profit has positive relation to ROA and ROE. So, the company should increase its net profit to increase its ROA and ROE by properly using its shareholders equity, financial assets and employees.
6. The NIM of OFL is within the benchmark. It is good for the company, but NIM is in decreasing trend. So, it is needed to increase its NIM ratio in the coming year.
7. The EPS is in decreasing trend, which is not good for its shareholders. Earning per share provides a direct measure of the returns flowing to the company

owners. So it is suggested to its management to increase its net profit by reducing its NPA.

8. The liquidity ratios of OFL are not within the boundary of industrial average i.e., liquid fund to total deposit ratio, NRB balance to total deposit ratio and cash in vault to total deposit ratio. It indicates the neglect of OFL to NRB directives. So, it is recommended to maintain its all liquidity ratios with in the industrial average and NRB standard. Otherwise NRB may interfere to its management.
9. The data for sensitivity analysis is not sufficient. However, the researcher has concluded that the OFL's long term net financial assets are highly sensitive to interest rate risk than short. As the short term earning assets is high. Since positive CGAP is beneficial when interest rates expected to rise and conversely negative CGAP is beneficial when interest rates are expected to fall, The OFL should minimize the mismatch of long term risk sensitive assets in order to minimize sensitivity to prevailing falling interest rates scenario.

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APPENDIX 1

List of Finance Company in Nepal (Mid July 2013)

S.N.	Names	Operation Date	Head Office
1	Nepal Aawas Finance Ltd.	1992/08/03	Bijulibazar, Kathmandu
2	Nepal Finance Ltd.	1993/01/06	Kamaladi, Kathmandu
3	NIDC Capital Markets Ltd.	1993/03/11	Kamalpokhari, Kathmandu
4	Narayani National Finance Ltd.	1993/05/07	Kalikasthan, Kathmandu
5	Nepal Share Markets and Finance Ltd.	1993/10/19	Ramshahapath, Kathmandu
6	Peoples Finance Ltd.	1994/04/15	Mahabauddha, Kathmandu
7	Kathmandu Finance Ltd.	1994/11/10	Dillibazar, Kathmandu
8	Himalaya Finance Ltd.	1994/11/11	Sundhara, Kathmandu
9	Union Finance Ltd.	1994/12/12	Kamaladi, Kathmandu
10	Paschhimanchal Finance Co.Ltd.	1995/04/09	Butawal, Rupandehi
11	Nepal Housing & Merchant Finance Ltd.	1995/04/11	Dillibazar, Kathmandu
12	Samjhana Finance Co. Ltd.*8	1995/05/03	Banepa, Kavre
13	Goodwill Finance Ltd.	1995/05/15	Dillibazaar, Kathmandu
14	Siddhartha Finance Ltd.	1995/05/25	Siddarthanagar, Rupandehi
15	Shree Investment & Finance Co. Ltd.	1995/06/01	Dillibazar, Kathmandu
16	Lumbini Finance & Leasing Co. Ltd.	1995/06/26	Thamel, Kathmandu
17	International Leasing & Finance Co. Ltd.	1995/10/31	Naya Baneshwor, Kathmandu
18	Mahalaxmi Finance Ltd.	1995/12/01	Putalisadak, Kathmandu
19	Lalitpur Finance Co. Ltd.	1995/12/14	Lagankhel, Lalitpur
20	United Finance Co. Ltd.	1996/01/26	Durbarmarg, Kathmandu
21	General Finance Ltd.	1996/02/01	Chabahil, Kathmandu
22	Progressive Finance Co. Ltd.	1996/02/26	Newroad, Kathmandu
23	Nava Durga Finance Co.Ltd.	1997/02/09	Itachhe, Bhaktapur
24	Janaki Finance Co. Ltd.	1997/03/07	Janakpurdham, Dhanusha
25	Pokhara Finance Ltd.	1997/03/16	Pokhara, Kaski
26	Central Finance Ltd.	1997/04/14	Kupondole, Lalitpur
27	Premier Finance Co. Ltd.	1997/06/08	Kumaripati, Lalitpur
28	Arun Finance Ltd.	1997/08/17	Dharan, Sunsari
29	Multipurpose Finance Co. Ltd	1998/04/15	Rajbiraj, Saptari
30	Synergy Finance Ltd.	1998/06/21	Butawal, Rupandehi
31	Shrijana Finance Ltd.	1999/12/14	Biratnagar, Morang

32	Om Finance Ltd.	2000/09/17	Pokhara, Kaski
33	World Merchant Banking & Finance Ltd.	2001/08/10	Hetauda, Makawanpur
34	Capital Merchant Banking & Finance Co. Ltd.	2002/02/01	Battisputali, Kathmandu
35	Crystal Finance Ltd.	2002/03/13	Thapathali, Kathmandu
36	Guheshwori Merchant Banking & Finance Ltd.	2002/06/13	Pulchowk, Lalitpur
37	Patan Finance Co. Ltd.	2002/06/23	Pulchowk, Lalitpur
38	Fewa Finance Ltd.	2003/04/30	Pokhara, Kaski
39	Everest Finance Ltd.	2003/07/02	Siddharthanagar, Rupandehi
40	Prudential Finance Company Ltd.	2004/06/06	Nagpokhari, Kathmandu
41	ICFC Finance Ltd.	2004/07/15	Bhatbhateni, Kathmandu
42	Sagarmatha Merchant Banking and Finance Ltd.	2005/08/29	Maanvawan, Lalitpur
43	Civil Merchant Bittiya Sanstha Ltd.	2005/09/18	Kuleshwor, Kathmandu
44	Imperial Finance Ltd.	2006/03/08	Thapathali, Kathmandu
45	Kuber Merchant Finance Ltd.	2006/03/24	Kamalpokhari, Kathmandu
46	Nepal Express Finance Ltd.	2006/05/04	Sundhara, Kathmandu
47	Seti Finance Ltd.	2006/05/18	Tikapur, Kailali
48	Hama Merchant & Finance Ltd.	2006/06/16	Tripureshwor, Kathmandu
49	Reliable Finance Ltd.	2006/09/24	Sundhara, Kathmandu
50	Namaste Bitiya Sanstha Ltd..	2007/07/09	Ghorahi, Dang
51	Kaski Finance Ltd.	2007/07/30	Pokhara, Kaski
52	Zenith Finance Ltd.	2007/10/08	Newroad, Kathmandu
53	Unique Financial Institution Ltd.	2007/10/12	Putalisadak, Kathmandu
54	Manjushree Financial Institution Ltd.	2007/10/17	Nayabaneshwor, Kathmandu
55	Subhalaxmi Finance Ltd.	2007/11/01	Naxal, Kathmandu
56	Jebil's Finance Ltd.	2009/10/28	Newroad, Kathmandu
57	Reliance Finance Ltd.	2009/12/03	Pradarsani Marg, Kathmandu
58	Lotus Investment Finance Ltd.	2010/04/15	Newroad, Kathmandu
59	Bhaktapur Finance Ltd.	2011/02/08	Chyamsing, Bhaktapur

Source: www.nrb.org.np

APPENDIX 2

Master Sheets of Data

(Mid July 2013)

S.N.	Fiscal Year	2065/66	2066/67	2067/68	2068/69	2069/70
1	Core Capital	151,210,000	190,746,000	289,789,000	321,160,000	390,128,000
2	Total Risk Weighted Assets	1,305,720,000	1,440,969,000	2,002,611,000	2,600,715,000	3,478,254,000
3	Supplementary Capital	12,773,000	14,633,000	19,523,000	25,163,000	32,135,000
4	Capital Fund	163,983,000	205,379,000	309,312,000	346,323,000	422,263,000
5	Cash & Bank Balance	32,438,581	52,671,000	68,485,000	103,431,000	114,483,000
6	Money at Call	84,935,000	164,820,000	345,630,000	859,310,000	739,187,000
7	Investment	15,577,000	25,577,000	115,577,000	105,577,000	122,701,000
8	Loan & Advance	1,264,599,282	1,466,746,000	1,954,408,000	2,521,096,000	3,236,331,000
9	Fixed Assets	44,942,871	59,784,000	62,666,000	62,316,000	58,860,000
10	Other Assets	10,316,671	11,672,000	28,838,000	16,941,000	16,458,000
11	Non-performing Loan	2,911,443	3,401,756	4,095,877	6,182,634	24,858,951
12	Total Loan	1,280,284,455	1,466,745,602	1,954,408,201	2,521,096,476	3,236,330,074
13	Loan Loss Provision	15,685,173	18,035,195	23,598,999	32,083,477	56,973,671
14	Total Expenses	107,823,000	167,696,000	284,547,000	374,716,000	444,822,000
15	Total Revenues	145,238,000	216,879,000	345,666,000	458,521,000	545,087,000
16	Net Profit	26,141,283	33,961,088	40,400,177	60,153,436	70,341,167
17	No. of Employees	32	67	74	80	87
18	Shareholders Equity	151,210,000	175,972,000	288,925,000	325,404,000	392,888,000
19	Total Assets	1,452,809,411	1,763,070,614	2,543,428,795	3,636,587,313	4,321,045,773
20	Net Interest Income	86,584,243	73,555,432	102,772,549	121,684,200	164,875,096
21	Earning Assets	1,280,176,000	1,492,323,000	2,069,985,000	2,626,673,000	3,359,032,000
22	No. of Shares	1,050,000	1,480,500	2,476,500	2,467,500	3,257,100
23	Liquid Funds	86,984,000	183,087,000	363,244,000	1,067,291,000	974,220,000
24	Total Deposits	1,168,341,000	1,527,281,000	2,162,235,800	3,227,517,000	3,765,595,000
25	NRB Balance	30,389,349	34,632,292	50,870,760	70,912,622	67,974,657
26	Cash in Vault	1,799,193	18,038,698	17,614,574	32,518,773	46,507,876

Source: OFL Annual Reports.

APPENDIX 3

Calculation of Liquidity Ratios of Aggregate Finance Companies

(Industry Average Ratio)

(Rs. in millions)

End of Ashad(FY)	2065/66	2066/67	2067/68	2068/69	2069/70
Mid-July	2008/09(77)	2009/10(79)	2010/11(79)	2011/12(69)	2012/13(58)
Liquidity Assets to Total Deposit Ratio					
Liquidity Assets	16406.6	21717.9	20511	26884	21177
Total Deposit	57073.4	77406.3	85476.9	76115.8	68981.6
Liquidity Assets/Total Deposit(%)	28.75	28.06	24	35.32	30.7
NRB Balance to Total Deposit Ratio					
NRB Balance	2267	2538.3	2410	3916.1	2702.5
Total Deposit	57073.4	77406.3	85476.9	76115.8	68981.6
NRB Balance/Total Deposit(%)	3.97	3.28	2.82	5.14	3.92
Cash in Vault to Total Deposit Ratio					
Cash in Vault	605.4	949.5	1219.9	1347	986.8
Total Deposit	57073.4	77406.3	85476.9	76115.8	68981.6
Cash in Vault to Total Deposit Ratio(%)	1.06	1.23	1.43	1.77	1.43

Source: Banking and Financial Statistics, No. 59, Mid July 2013: 87,88

APPENDIX 4

List of On-Balance Sheet and Off-Balance Sheet Asset and Weights

S.N.	Particulars	Percentage
A	**On Balance Sheet Assets**	
1	Cash Balance	0
2	Gold (Treasure)	0
3	Balance with NRB	0
4	Investment in Govt. Securities	0
5	Investment in NRB Bond	0
6	Fully Secured Loan Against Govt. Securities	0
7	Balance with Domestic Banks and FIs	20
8	Fully Secured FDR Loan Against FDR of Other Bank	20
9	Balance with Foreign Banks	20
10	Money at Call	20
11	Loan against Guarantee of Internationally Rated Bank	20
12	Other Investments in Internationally Bonus	20
13	Investments in shares Debentures and Bonus	100
14	Other Investments	100
15	Loan Advanced and Bills Purchase/Discounts	100
16	Fixed Assets	100
17	All Other Assets	100
18	Housing Home loan	150
B	**Off Balance Sheet Assets**	
1	Bills Collections	0
2	Forward Foreign Exchange Contract	10
3	Letters of Credit with Maturity of Less than 6 months	20
4	Guarantee Provided against CG of at International Banks	20
5	Letters of Credit with Maturity of more than 6 Months	50
6	Bid Bond	50
7	Performance Bond	50
8	Advance Payment Guarantee	100
9	Other Guarantee	100
10	Irrevocable Loan Commitment	100
11	Contingent Liability in respect of income Tax	100
12	Financial Guarantee	100
13	All other Contingent Liabilities	100
A+B	**Total Risk Weight Assets**	

Source: OFL Annual Report, 2069/70

APPENDIX 5

Calculation of Linear Line of Non- Performing Loan Ratio by Least Square Method

Year (X)	LLR (Y)	X^2	XY
1	0.23	1	0.23
2	0.23	4	0.46
3	0.21	9	0.63
4	0.25	16	1
5	0.77	25	3.85
$\Sigma X = \mathbf{15}$	$\Sigma Y = \mathbf{1.69}$	$\Sigma X^2 = \mathbf{55}$	$\Sigma XY = \mathbf{6.17}$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x6.17 - 15x1.69}{5x55 - (15)^2} \qquad = \frac{1.69 - 0.11x15}{5}$$

$$= 0.11 \qquad = 0.008$$

$$Y = 0.008 + 0.11x$$

APPENDIX 6

Calculation of Linear Line of Loan Loss Ratio by Least Square Method

Year (X)	LLR (Y)	X^2	XY
1	1.24	1	1.24
2	1.23	4	2.46
3	1.21	9	3.63
4	1.27	16	5.08
5	1.76	25	8.8
$\Sigma X = \mathbf{15}$	$\Sigma Y = \mathbf{6.71}$	$\Sigma X^2 = \mathbf{55}$	$\Sigma XY = \mathbf{21.21}$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x21.21 - 15x6.71}{5x55 - (15)^2} \qquad = \frac{6.71 - 0.109x15}{5}$$

$$= 0.109 \qquad = 0.015$$

$$Y = 0.015 + 0.109x$$

APPENDIX 7

Calculation of Linear Line of Total Expenses to Total Revenue Ratio

Year (X)	TER (Y)	X^2	XY
1	74.29	1	74.29
2	77.32	4	154.64
3	82.32	9	246.96
4	81.72	16	326.88
5	81.61	25	408.05
$\Sigma X = \mathbf{15}$	$\Sigma Y = \mathbf{397.26}$	$\Sigma X^2 = \mathbf{55}$	$\Sigma XY = \mathbf{1210.82}$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x1210.82 - 15x397.26}{5x55 - (15)^2} \qquad = \frac{397.26 - 1.904x15}{5}$$

$$= 1.904 \qquad = 73.74$$

$$Y = 73.74 + 1.904x$$

APPENDIX 8

Calculation Linear Line of Earning per Employee by Using Least Square Method

Year (X)	EPE (Y)	X^2	XY
1	816.92	1	816.92
2	506.88	4	1013.76
3	545.95	9	1637.85
4	751.92	16	3007.68
5	808.52	25	4042.6
$\Sigma X = 15$	$\Sigma Y = 3430.19$	$\Sigma X^2 = 55$	$\Sigma XY = 10518.81$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x10518.81 - 15x3430.19}{5x55 - (15)^2} \qquad = \frac{3430.19 - 22.85x15}{5}$$

$$= 22.85 \qquad = 617.49$$

$$Y = 617.49 + 22.85x$$

APPENDIX 9

Calculation Linear Line of ROE by Using Least Square Method

Year (X)	ROE (Y)	X^2	XY
1	17.29	1	17.29
2	19.30	4	38.6
3	13.98	9	41.94
4	18.49	16	73.96
5	17.90	25	89.5
$\Sigma X = \mathbf{15}$	$\Sigma Y = \mathbf{86.96}$	$\Sigma X^2 = \mathbf{55}$	$\Sigma XY = \mathbf{261.29}$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x261.29 - 15x86.96}{5x55 - (15)^2} \qquad = \frac{86.96 - 0.041x15}{5}$$

$$= 0.041 \qquad = 17.27$$

$$Y = 17.27 + 0.041x$$

APPENDIX 10

Calculation Linear Line of ROA by Using Least Square Method

Year (X)	ROA (Y)	X^2	XY
1	1.8	1	1.8
2	1.93	4	3.86
3	1.59	9	4.77
4	1.65	16	6.6
5	1.63	25	8.15
$\Sigma X = 15$	$\Sigma Y = 8.6$	$\Sigma X^2 = 55$	$\Sigma XY = 25.18$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x25.18 - 15x8.6}{5x55 - (15)^2} \qquad = \frac{8.6 + 0.062x15}{5}$$

$$= -0.062 \qquad = 1.906$$

$$Y = 1.906 - 0.062x$$

APPENDIX 11

Calculation Linear Line of NIM by Using Least Square Method

Year (X)	NIM (Y)	X^2	XY
1	6.76	1	6.76
2	4.93	4	9.86
3	4.97	9	14.91
4	4.63	16	18.52
5	4.02	25	20.1
$\Sigma X = 15$	$\Sigma Y = 25.31$	$\Sigma X^2 = 55$	$\Sigma XY = 70.15$

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x70.15 - 15x25.31}{5x55 - (15)^2} \qquad = \frac{25.31 + 0.578x15}{5}$$

$$= -0.578 \qquad = 6.796$$

$$Y = 6.796 - 0.578x$$

APPENDIX 12

Calculation Linear Line of EPS by Using Least Square Method

Year (X)	EPS (Y)	X2	XY
1	24.90	1	24.90
2	22.94	4	45.88
3	16.31	9	48.93
4	24.38	16	97.52
5	21.60	25	108.00
ΣX **=15**	ΣY **=110.13**	ΣX^2 **=55**	ΣXY **=325.23**

$$b = \frac{N\Sigma XY - \Sigma X\Sigma Y}{N\Sigma X^2 - (\Sigma X)^2} \qquad a = \frac{\Sigma Y - b\Sigma X}{N}$$

$$= \frac{5x325.23 - 15x110.13}{5x55 - (15)^2} \qquad = \frac{110.13 + 0.516x15}{5}$$

$$= -0.516 \qquad = 23.57$$

$$Y = 23.57 - 0.516x$$