

A Thesis Proposal on

**FINANCIAL PERFORMANCE ANALYSIS: A COMPARATIVE
ANALYSIS**

Submitted by:

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1. INTRODUCTION

1.1 Background of Study

In developing countries like Nepal, banks play a major role in financial development. This is especially true since stock and corporate bond markets are usually underdeveloped (Saunders and Cornett, 2004). Moreover, the development of banking system and improving of its financial performance is related to higher economic growth of a country. In Nepal, commercial banks contribute to economic growth through their financial intermediation role. Better performance of commercial banks is pro foundation for product innovation, diversification and efficiency of the commercial banks (Hempell, 2002). The stability of commercial banks as whole in the economy depends on better financial performance. Better financial performance level has tendency to absorb risks and shocks that commercial banks can face.

Financial sector is the backbone of economy of a country. It works as a facilitator for achieving sustainable economic growth through providing efficient monetary intermediation. A strong financial system promotes investment by financing productive business opportunities, mobilizing savings, efficiently allocating resources and makes easy the trade of goods and services. Banking system is considered as the heart of an economy because of its contribution toward the mobilization of savings and thus to the utilization of this country's resources. Commercial banks play important role for the development of the countries through the resource mobilization (Naceur, 2013). They channel funds from savers to borrowers continuously. They should generate sufficient income to cover their operational cost they incur in the due course. The financial performance of banks has critical implications for economic growth of countries. How well a financial institution is performing is of great importance for the resource providers for making correct investment decisions. Good financial performance rewards the shareholders for their investment. This, in turn, Wheelock and Wilson (2000) encouraged additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth. Profitability of financial institution is one of the important parameters from which funds providers can understand performance of the institutions. Financial performance depends on various factors. Some of them are Capital Adequacy, Asset Quality, Management Efficiency, Liquidity, Gross Domestic Product etc. Therefore, in order to ensure sound financial performance

banks should focus on the factors likely to affect profitability and the extent of their influence.

Financial performance analysis of commercial banks has been of great interest to academic research since the Great Depression Intern the 1940's (Gopinathan, 2009). In the last two decades studies have shown that commercial banks in Sub-Saharan Africa (SSA) are more profitable than the rest of the world with an average Return on Assets (ROA) of 2 percent. The performance of commercial banks can be affected by internal and external factors. These factors can be classified into bank specific (internal) and macroeconomic variables. The internal factors are individual bank characteristics which affect the bank's performance. These factors are basically influenced by the internal decisions of management and board. The external factors are sector wide or country wide factors which are beyond the control of the company and affect the profitability of banks (Dahiyat, 2012). Furthermore, the evaluation of a company's performance has been focusing the operational effectiveness and efficiency, which might influence the company's survival directly.

The empirical results of the researches explained that a company, which has better efficiency, it does not mean that always it will show the better effectiveness. Alam (2011) concluded that ranking of banks differ as the financial ratio changes. They noted that interest expenses divided to total loans can be measured as the bank management quality. Ability to support the present and future operations of a bank depends on the quality of its earnings and profitability profile. Tarawneh (2006) found that the banks having high total capital, deposits, credits, or total assets does not always mean that has healthier profitability and performance. The operational efficiency and asset management, in adding to the bank size, positively influenced the financial performance of these banks. Gopinathan (2009) has presented that the financial ratios analysis can spot better investment options for investors as the ratio analysis measures various aspects of the performance and analyzes fundamentals of a company or an institution. Banking has become an important feature, which renders service to the people in financial matters, and its magnitude of action is extending day by day. It is a major financial institutional system in Nepal, which accounted for more than 70% of the total assets of all the financial institutions. NRB uses return on total assets as an indicator of profitability of a commercial bank.

Financial analysis is the process of evaluating financial statement of a firm through the application of various techniques to detect financial strengths and weaknesses of a firm (Kuchhal, Financial management: An analytical and conceptual approach, 2008). Hence, financial performance analysis is also termed as financial health check- up of any business concern. Regular financial health check-up any financial institution is necessary to maintain and protect the interest of depositors, lenders, shareholders and other stakeholders (Chowdhury, 2002). International monetary authorities such as International Monetary Fund and World Bank directed their member countries to conduct regular financial health check -up of FIs to reform financial sector. In order to reform financial sector, the World Bank is constantly providing technical and financial support to reengineer Nepal Rastra Bank (NRB) and restructure Nepal Bank Ltd. and Rastriya Banijya Bank.

Health of individual FIs affects the health of financial sector. Micro and macro factors affect the financial health of individual FIs. Political stability and the real sector growth are major macro factors whereas capital base, quality of assets, liquidity position, management quality, market sensitivity and earnings are micro factors (Saunders and Marcia, 2004). There are so many techniques available today to evaluate financial performance of banks and financial institutions. Among them, CAMEL model of financial analysis is considered more efficient. Under CAMEL model, five (now six) critical dimensions are used to evaluate financial performance regarding bank's operations and performance. CAMEL is an effective tool to analyze financial performance for examiners and regulators. Different aspects of a bank based on various information are used under CAMEL model to detect financial soundness. The CAMEL model is highly confidential to project business strategy for the bank's senior management and supervisory staff. Cole and Gunther (1995) carried out a study as a pioneer by using CAMEL model in rating bank's performance. They proved the effectiveness of this model to analyze financial performance of commercial banks and financial institutions. This study, therefore, attempts to examine the financial performance analysis based on CAMEL components and their influence on the profitability of the Nepalese BFIs.

1.2 Problem statement

Establishment of banks concentrate only in urban area, like Kathmandu, Pokhara, Birgung, Hetauda, Biratnagar, etc. has raised certain questions. This application is not