

# **PROFITABILITY DETERMINANTS OF COMMERCIAL BANKS IN NEPAL**

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fulfilment of the requirements for the Master's Degree

by

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## **CERTIFICATION OF AUTHORSHIP**

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled "**Profitability Determinants of Commercial Banks in Nepal**". The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor it has been proposed and presented as part of requirements for any other academic purposes. The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of this dissertation.

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**REPORT OF RESEARCH COMMITTEE**

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## APPROVAL SHEET

We, the undersigned, have examined the dissertation entitled “**Profitability Determinants of Commercial Banks in Nepal**” presented by Binita Basnet a candidate for the degree of Master of Business Studies (MBS Semester) and conducted the viva voce examination of the candidate. We hereby certify that the dissertation is worthy of acceptance.

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## ABBREVIATIONS

%	Percentage
ANOVA	Analysis of Variance
CAR	Capital Adequacy Ratio
CDR	Credit Deposit Ratio
EPS	Earnings per Share
Et al.	Et alia
F	F-statistic
GDP	Gross Domestic Product HBLHimalayan Bank Limited
MBL	Machhapuchchhre Bank Limited
NIMBL	Nabil Bank Limited
NPL	Non-performing Loans
ROA	Return on Assets
SBL	Siddhartha Bank Limited Sig. Significance level

## ABSTRACT

This study examines the determinants of profitability in Nepalese commercial banks, focusing on the interplay between Credit Deposit Ratio, Capital Adequacy Ratio, Non-Performing Loans, Earnings Per Share, and Return on Assets. The research aims to bridge the existing research gap by providing a comprehensive analysis of these key variables and their influence on financial performance in the Nepalese banking sector. The study employs a quantitative research approach, utilizing secondary data from 2014 to 2024 for a sample of five commercial banks in Nepal. The analysis includes descriptive statistics, correlation analysis, regression models, and ANOVA to examine the relationships between the independent variables and the dependent variables, return on assets and earnings per share. The study finds that the Credit Deposit Ratio, Capital Adequacy Ratio, and Non-Performing Loans have significant positive and negative impacts on bank profitability, respectively. Additionally, the study highlights the importance of these variables in understanding the financial performance of commercial banks in Nepal. The findings of this study contribute to the existing literature on banking profitability in emerging markets, particularly in Nepal, by providing a detailed analysis of the determinants of profitability in the Nepalese banking sector. The study emphasizes the need for commercial banks in Nepal to maintain a balanced Credit Deposit Ratio, ensure adequate capital adequacy, and manage non-performing loans effectively to achieve sustainable profitability.

*Keywords: Profitability, Credit Deposit Ratio, Capital Adequacy Ratio, Non-Performing Loans, Earnings Per Share, Return on Assets, Nepalese commercial banks.*

# CHAPTER I

## INTRODUCTION

### **1.1 Background of the study**

Profitability is a crucial metric that reflects the efficiency and effectiveness of their operations in generating earnings and returns on investments. Various factors influence the profitability of commercial banks, including their operational efficiency, asset quality, capital adequacy, and risk management practices. Research suggests that profitability in commercial banks is closely linked to factors such as interest rate spreads, fee-based income, loan quality, and cost management strategies. Understanding these key drivers of profitability is essential for commercial banks in Nepal to sustainably grow and thrive in a competitive banking landscape. The profitability ratios used to measure how well a business is functioning in terms of profit as market conditions change rapidly, the adequacy and effectiveness of internal controls should be reviewed regularly to manage credit risk effectively. Risk management is defined as the process that a bank puts in place to control its financial exposures (Bagale, 2023).

The commercial bank has been a vital ingredient for economic development. They are intermediaries, which mobilize funds through the prudential combination of investment portfolios in advanced countries whereas in Nepal the role of commercial banks is still to be realizing as an essential machine of mobilizing internal saving through various banking schemes in the economy. Hence to uplift the background of economic condition of the country, the process of capital accumulation among other pre-requisition should be expedited. Commercial banks are the suppliers of fund for trade and industry, which play vital role in the economic and financial sector of a country. They help in the formation of capital by investing the saving fund in the productive sector. Rural people of under developing country like Nepal need various banking facilities to enhance its economy. In most of the countries, the banks are generally concentrating in urban and semi –urban sectors. They neglect rural sectors due to heavy risk and low return, which is in fact, without it, other sector of economy cannot be developed (Pradhan , Kothari, & Chalise, 2023).

As of the nature of their business, commercial banks face significant risk, and the success of their financial performance is dependent on the efficient management of this and any other type of risk that they face. Commercial banks hold deposits, bundling them together as loans, operating payment mechanisms, etc. Nowadays, financial institutions play a highly significant, even vital, role in an economy. Financial system stability is the foundation of modern macroeconomic policy and a prerequisite for strong economic growth, which ensures macroeconomic stability and enables strong financial institutions (Bagale, 2023).

Financial sector is the backbone for economic development of the country. It works as a facilitator for achieving sustained economic growth through efficient monetary intermediation. A strong financial system promotes investment by financing productive business opportunities, mobilizing savings, efficiently allocating resources and makes easy trade of goods and services. (Kusa, 2013) revealed that the efficacy of a financial system to reduce information and transaction costs plays an important role in determining the rate of savings, investment decisions, technological innovations and hence the rate of economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth. A profitable and sound banking sector is a better point to endure adverse upsets and adds performance in the financial system (Athanasoglou, Brissimis, & Delis, 2008).

Efficient cost management is a significant determinant of profitability for commercial banks in Nepal. Controlling operating expenses, optimizing resource allocation, and enhancing productivity are essential strategies for improving profitability. Research indicates that banks with lower operating costs relative to their income tend to exhibit higher profitability levels, highlighting the importance of cost efficiency in driving financial performance. Implementing cost-effective measures and streamlining operations can help commercial banks enhance their bottom line and achieve sustainable profitability (Neupane, 2020).

Asset quality is another critical factor that impacts the profitability of commercial banks in Nepal. Non-performing loans (NPLs) and credit risk can erode a bank's profitability by increasing provisions for loan losses and reducing interest income. Maintaining a healthy loan portfolio through effective credit risk management practices, rigorous underwriting standards, and proactive monitoring of borrower creditworthiness is essential for preserving profitability. Research suggests that banks with lower levels of NPLs tend to have higher profitability ratios, underscoring the importance of sound asset quality management in driving financial performance (Singh, et al., 2023).

Furthermore, capital adequacy plays a vital role in determining the profitability of commercial banks in Nepal. Adequate capital levels not only ensure regulatory compliance but also provide a buffer against unexpected losses and support business growth. Research indicates that well-capitalized banks are better positioned to absorb financial shocks, maintain investor confidence, and sustain profitability over the long term. Balancing capital adequacy with profitability objectives is crucial for commercial banks to optimize their risk-return profile and enhance shareholder value (Balami & Chalise, 2023).

Achieving sustainable profitability in commercial banks in Nepal requires a comprehensive approach that addresses key drivers such as cost management, asset quality, and capital adequacy.

By focusing on enhancing operational efficiency, maintaining high asset quality standards, and ensuring adequate capital levels, commercial banks can strengthen their financial performance, mitigate risks, and position themselves for long-term success in the dynamic banking industry of Nepal.

## **1.2 Problem statement**

The commercial banking sector in Nepal has witnessed significant growth and profitability over the years. Annual financial reports consistently reveal substantial profits earned by banks, highlighting the robust nature of the industry. However, understanding the determinants of profitability within this sector is crucial for both banks and policymakers. Research suggests that these determinants can vary considerably across different countries and regions (Neupane, 2020).

Historically, Nepal's banking sector experienced rapid expansion, marked by the proliferation of rural banks and cooperative societies. This growth intensified competition among banks, leading to a continuous quest to optimize profitability. To achieve this, banks have sought to minimize costs, particularly in relation to their capital ratios. A key strategy involves maintaining higher net interest margins, which serve as a critical indicator of bank profitability alongside metrics such as return on assets and return on equity (Neupane, 2013).

Operating expenses play a significant role in shaping a bank's net interest margin and overall profitability. Higher expenses often correspond to elevated margin levels, but excessive costs can undermine profitability. Maintaining an optimal balance is essential to ensure sustainable financial performance. Moreover, macroeconomic factors such as changes in GDP and inflation rates exert considerable influence on interest rates, further impacting bank profitability.

In the context of Nepal, the health of the banking sector holds paramount importance due to the relatively underdeveloped financial market. The performance of commercial banks is directly linked to the country's economic development. However, challenges such as liquidity spread and a high number of consortium loans present obstacles to sustained profitability. In response, regulatory authorities like the Nepal Rastra Bank have advocated for consolidation through mergers and acquisitions to enhance stability and resource mobilization (Gautam, 2018).

Despite extensive empirical research on bank profitability determinants globally, limited recent evidence exists specifically for Nepal. Therefore, this study aims to address this gap by investigating the unique factors influencing the profitability of Nepalese banks. The statement of problems of this study are as follows;

- What is the performance (EPS and ROA) of selected commercial banks in Nepal?

- What is the relationship between credit deposit ratio, capital adequacy ratio, non-performing loans, and the profitability determinants (earnings per share, return on assets) of commercial banks in Nepal?
- How do credit deposit ratio, capital adequacy ratio, and non-performing loans impact the profitability metrics (earnings per share, return on assets) of commercial banks in Nepal?

### **1.3 Objective of the study**

The primary aim of this research is to analyze the factors influencing the profitability of commercial banks in Nepal. Nonetheless, the study also outlines specific objectives as follows:

- To access the financial performance of commercial in terms of EPS and ROA.
- To examine the relationship between credit deposit ratio, capital adequacy ratio, non-performing loans, and the profitability determinants (earnings per share, return on assets) of commercial banks in Nepal.
- To analyze the impact of credit deposit ratio, capital adequacy ratio, and non-performing loans on the profitability determinants (earnings per share, return on assets) of commercial banks in Nepal.

### **1.4 Hypothesis**

Based on the review of past studies and the research objectives, the following hypothesis is formulated for the study.

HO<sub>1</sub>: There is no significant relationship between CDR and EPS.

HO<sub>2</sub>: There is no significant relationship between CAR and EPS.

HO<sub>3</sub>: There is no significant relationship between NPL and EPS.

HO<sub>4</sub>: There is no significant relationship between CDR and ROA.

HO<sub>5</sub>: There is no significant relationship between CAR and ROA.

HO<sub>6</sub>: There is no significant relationship between NPL and ROA.

### **1.5 Rationale of the study**

Commercial banks are essential financial institutions that play a crucial role in the economic development of a nation. Serving as the backbone and foundation for a country's progress, banks primarily focus on mobilizing idle funds from the public to provide financial support for various expenditures. Essentially, banks are institutions that deal with money and its equivalents while offering a range of financial services. By accepting deposits, extending loans, and earning profits through interest rate differentials, banks contribute significantly to the economic growth by facilitating financial means for production in diverse industries.

Efficient resource utilization is imperative in today's competitive business environment, emphasizing the significance of effective working capital management within commercial banks. Evaluating the optimal leverage level and profitability of banks is essential to ensure the efficient utilization of funds. The challenge lies in determining the balance point where banks can maintain their assets to achieve both objectives simultaneously. Different levels of liquidity impact profitability differently, posing a dilemma for commercial banks seeking to maximize profits without compromising liquidity, which could lead to technical and financial challenges, potentially resulting in deposit withdrawals.

This study aims to provide valuable insights for bank owners and policymakers on the factors influencing bank performance and the efficient allocation of resources to sustain competitiveness. By shedding light on the determinants of private commercial bank performance in Nepal, this research contributes to enhancing understanding of the factors affecting profitability in the banking sector. The findings are expected to benefit bankers by offering information to enhance the performance of Nepalese private commercial banks. Previous studies on bank performance have offered guidance for managers and shareholders to assess bank profitability concerning internal and external determinants. Profitable banks can leverage their success to diversify business operations effectively and mitigate risks. Therefore, continuous learning about factors impacting banking profitability is crucial for long-term sustainability, excellent bank management, and firm stability as a vital financial intermediary contributing significantly to the economic development of the country.

### **1.6 Limitations of the study**

This study has some limitations which were following:

- Since this study is based on secondary data therefore reliability is depending upon the accuracy of data uploaded by concerned banks.
- The data from 2013/14 to 2022/23 of selected commercial banks have only been employed for results and major findings thus it may not be sufficient for adequate analysis as well as fact findings.
- Only five sampled banks from twenty commercial banks in Nepal was selected.
- The major findings and the conclusion of this study may not be applicable to international commercial banks since sampled banks are within the boundary of Nepal.
- The generalization of this study can be made only in Nepal not applicable for other countries. Because the other countries are contextually different from Nepal from the economic perspective.
- This research ignores additional sectors of Nepalese businesses, including development banks, finance companies, and insurance companies, in addition to commercial banks.

## **CHAPTER II**

### **REVIEW OF LITERATURE**

Numerous studies have delved into the relationship between Credit Deposit Ratio, Capital Adequacy Ratio, Non-Performing Loans, Earnings Per Share, and Return on Assets as key determinants of profitability in commercial banks. This study aims to build upon existing research by referencing a selection of studies that have explored similar themes. By incorporating insights from these studies, this literature review seeks to enrich the theoretical framework and methodology employed, while also drawing upon the findings of previous research. The following section presents a compilation of previous studies with concise descriptions to provide a comprehensive overview of the existing literature landscape.

#### **2.1 Theoretical Review**

Profit is the outcome of business activities when the revenue exceeds the costs involved. This concept, succinctly put, defines profit as the surplus after deducting costs from revenue. Various theories attempt to explain the nature of profit, with seven prominent ones outlined: Rent Theory of Profit, Wage Theory of Profit, Risk Theory of Profit, The Dynamic Theory of Profit, Schumpeter's Innovation Theory, Uncertainty Bearing Theory of Profit, and Marginal Productivity Theory of Profit.

#### **Rent Theory of Profit**

The Rent Theory of Profit, which originates from economists such as Francis A. Walker, provides an intriguing analogy between profit and rent. This theory suggests that profit can be viewed similarly to the way rent is generated from land. Specifically, it posits that profit represents the surplus gained by more efficient entrepreneurs compared to their less efficient counterparts. Just as superior land, which is more fertile and productive, yields rent when compared to marginal land that is less productive, superior entrepreneurs earn profit over those who are considered marginal in their efficiency and effectiveness. In this context, the 'superior land' symbolizes entrepreneurs who possess better skills, innovative ideas, and effective business strategies. These entrepreneurs are able to utilize resources more efficiently, leading to higher productivity and, consequently, higher profits. On the other hand, the 'marginal land' represents entrepreneurs who may lack certain skills, innovations, or efficiencies, resulting in lower productivity and minimal, if any, profit. Walker's analogy emphasizes the idea that just as not all land is equally fertile, not all entrepreneurs operate

with the same level of efficiency and effectiveness. The differential profit, akin to rent, is thus the reward for those who are able to outperform their peers. This surplus is not merely a result of chance but is attributed to the distinct competitive advantages held by the superior entrepreneurs. The Rent Theory of Profit underscores the importance of innovation and efficiency in the entrepreneurial landscape. It suggests that in a competitive market, profits will naturally gravitate towards those who can operate at a higher level of efficiency. This theory not only highlights the dynamic nature of business and economics but also serves as a motivational framework for entrepreneurs to continually improve and innovate. In essence, it encapsulates the essence of entrepreneurial spirit and the perpetual quest for excellence in business practices (Stoelhorst, 2023).

### **Wage Theory of Profit**

Taussig's Wage Theory of Profit provides an intriguing perspective on the nature of profit within an economic system. According to this theory, profit is essentially a form of wage specifically allocated for entrepreneurial services. This approach draws a parallel between entrepreneurs and laborers, suggesting that just as laborers receive wages for their physical and mental efforts in the production process, entrepreneurs are similarly compensated for their unique contributions. These contributions often involve critical decision-making, risk-taking, innovation, and the overall coordination of resources necessary to bring products and services to market. By framing profit as a type of wage, Taussig emphasizes the idea that the mental efforts and strategic insights of entrepreneurs are invaluable components of the production process. Entrepreneurs are rewarded for their ability to identify opportunities, mobilize capital, manage teams, and navigate complex market dynamics. This theory challenges traditional views that see profit merely as a return on capital investment, instead highlighting the intellectual and managerial labor that drives economic growth and development. Consequently, the Wage Theory of Profit underscores the vital role of entrepreneurial activity in fostering economic progress and generating wealth within a society. By equating profit to a wage for entrepreneurial services, Taussig offers a nuanced understanding of how value is created and distributed in an economy, recognizing the indispensable contributions of entrepreneurs to the productive process (Taussig, 2013).

### **Risk Theory of Profit**

The Risk Theory of Profit, attributed to the economist Frederick Barnard Hawley, presents an insightful perspective on the nature of profit in the realm of business. According to this theory, profit is not merely a reward for entrepreneurial effort but serves as a vital compensation for the risks that entrepreneurs undertake. Entrepreneurs are continually faced with a plethora of risks that can significantly impact their ventures. These risks are diverse in nature; some can be mitigated through insurance, such as property damage or liability risks. However, many risks remain

uninsurable, including those related to market fluctuations, consumer preferences, and competitive actions. Profit, in this context, acts as the critical incentive for entrepreneurs to engage in business activities despite the inherent uncertainties. It encourages individuals to invest their resources, time, and effort into ventures that have no guaranteed outcomes. The theory underscores that without the prospect of profit, the motivation to endure these risks would diminish, leading to a decline in entrepreneurial activity and innovation.

The Risk Theory of Profit emphasizes that the greater the risk, the higher the potential profit must be to justify the undertaking. This relationship explains why some industries, particularly those subject to rapid technological changes and intense competition, often yield higher profits. Entrepreneurs in these sectors are exposed to substantial risks, and the possibility of earning significant profits is what drives them to continue innovating and taking bold steps. The theory highlights the indispensable role of profit as a mechanism that balances the scale between risk and reward. It posits that profit is not just a financial gain but a fundamental component that sustains the entrepreneurial spirit and fuels economic progress. By compensating for the uncertainties and potential losses, profit ensures that businesses remain dynamic and forward-looking, constantly pushing the boundaries of what is possible (Hicks, 1931).

### **The Dynamic Theory of Profit**

The Dynamic Theory of Profit, as proposed by economist John Bates Clark, fundamentally links the concept of profit to the ongoing progressive changes within society. According to Clark, profit is not a static element but is inherently tied to the dynamic nature of the economy. In a dynamic environment, where change is a perpetual state and where innovation continually reshapes industries and markets, profit becomes a natural outcome. This environment is characterized by constant advancements in technology, shifts in consumer preferences, and the continual development of new products and services. Clark's theory suggests that entrepreneurs and businesses that can adapt to these changes, and indeed drive them through innovation, will reap the rewards in the form of profit. Therefore, profit is seen as a reflection of successful adaptation and growth in a continuously evolving marketplace. This perspective emphasizes the importance of staying ahead of the curve and being responsive to the ever-changing economic landscape. It highlights that in a static world, where no growth or change occurs, profit would be absent, as it is the dynamism and progress that create opportunities for financial gains. Thus, Clark's theory underscores the critical role of innovation and societal progress in the generation of profit (Henry, 2016).

### **Schumpeter's Innovation Theory**

Schumpeter's Innovation Theory is a cornerstone of modern economic thought, emphasizing the critical role of innovation in generating profit. According to Schumpeter, innovations are fundamental drivers of economic growth and competitive advantage. These innovations can take various forms, such as the introduction of new products, the development of new production processes, the discovery of new markets, or the implementation of new organizational methods. By reducing production costs, innovations create a discrepancy between existing prices and the lowered costs of production, leading to what Schumpeter refers to as "entrepreneurial profit." This gap between the old and new production costs is where profit originates. Entrepreneurs, who are at the heart of Schumpeter's theory, identify and exploit these opportunities, pushing the economy forward through their innovative activities. This process is not just about small, incremental changes but often involves significant leaps that disrupt existing market structures and create entirely new industries.

Schumpeter argues that these innovations are not a one-time occurrence but a continuous process. As new innovations are introduced, they spur further innovations in a dynamic cycle of economic development. This ongoing process of creative destruction, where old industries and technologies are replaced by new ones, is central to Schumpeter's vision of a vibrant and evolving economy. Schumpeter's Innovation Theory posits that innovation is the primary source of profit, driving economic progress by continuously transforming industries and reducing production costs. This theory underscores the importance of entrepreneurial activity in fostering economic dynamism and growth (Śledzik, 2013).

### **Uncertainty Bearing Theory of Profit**

Knight's theory builds upon Hawley's risk theory by expanding its focus to include non-insurable risks and uncertainties as the foundation of profit. Unlike insurable risks, which can be calculated and mitigated through insurance, non-insurable risks are unpredictable and cannot be easily quantified or transferred. These uncertainties encompass a wide range of factors such as changes in consumer preferences, technological advancements, economic fluctuations, and political instability. Entrepreneurs earn profit by bearing these unforeseeable risks, which are inherent in the dynamic environment of modern business. According to Knight, the primary function of the entrepreneur is to anticipate and manage these uncertainties, making strategic decisions that drive the business forward despite the lack of guaranteed outcomes. This role of dealing with uncertainty distinguishes entrepreneurs from other business roles, as they must rely on their judgment, intuition, and experience to navigate unpredictable scenarios. The ability to effectively manage these uncertainties and make successful decisions is what ultimately leads to profit. Therefore, Knight's theory emphasizes the unique challenges and rewards associated with entrepreneurial ventures,

highlighting the critical role of uncertainty in the pursuit of profit in the modern economy (Weston, 1950).

### **Marginal Productivity Theory of Profit**

This theory relates profit to the marginal productivity of entrepreneurs, positing that profit is directly tied to the incremental value generated by entrepreneurial activities. Similar to other factors of production, profit is determined by the marginal worth of entrepreneurship. This worth is not static; it is influenced by a variety of economic and financial factors. Net Interest Margin, for instance, reflects the difference between interest income generated and interest paid out, which can significantly impact profit margins. Return on Assets (ROA) measures how efficiently a company's assets generate profit, serving as a crucial indicator of entrepreneurial effectiveness. Leverage, or the use of borrowed capital, can amplify both potential returns and risks, thereby affecting the overall profitability. Liquidity, the ease with which assets can be converted into cash, also plays a vital role, as it ensures that the company can meet its short-term obligations and seize investment opportunities promptly. Operating Expenses, encompassing all costs associated with running the business, directly reduce profit margins if not managed efficiently. Lastly, Market Capitalization, representing the total market value of a company's outstanding shares, provides insight into the company's market performance and investor perception, further influencing profitability. By examining these factors, the Marginal Productivity Theory of Profit underscores the intricate relationship between entrepreneurial productivity and profit generation (Moseley, 2012).

## **2.2 Empirical review**

### **Review of International Studies**

Numerous studies have been carried out to examine what influences banking profitability. These studies typically divide these influences into internal and external factors. Different indicators have been utilized across various studies to gauge bank profitability.

Rosly and Bakar (2003) conducted an examination into the profitability of scheduled commercial Banks and trends in their profitability. The analysis incorporated both primary and secondary data, utilizing a sample of 100 entities. Employing descriptive and analytical research designs, the study experimented with models using statistical data on the credit histories of Malaysian commercial banks involved in consumer lending. Key findings revealed the development of a model for internal credit ratings of borrowers and methods for enhancing credit risk management within commercial banks. Notably, when lending to individuals (retail clients), the study identified average borrower income, loan amount, and loan term as significant factors influencing a bank's credit risk. Moreover, a negative relationship between operating expenses and return on assets was observed, attributed to the utilization of overheads from mainstream banks within the Islamic banking scheme.

Maudos and Guevara (2004) focused on banks' credit risk management policies and explored obstacles arising from credit risks. Employing a descriptive research approach with survey-based primary data, the study highlighted the association between obstacles encountered in bank credit risk management. Noteworthy findings indicated a positive relationship between operating expenses and net interest margin, suggesting that banks, when faced with higher operating expenses, tend to offset these costs through increased loan interest rates and decreased deposit interest rates.

Dietrich and Wanzenried (2009) analyzed the profitability of commercial banks, specifically examining return on assets (ROA) and return on equity (ROE) indicators among Swiss commercial banks. Utilizing secondary data from a sample of 1919 observations across 423 banks, the study incorporated industry-specific variables into regression analyses. Results suggested that profitability positively affected operational efficiency and portfolio management but negatively impacted capital and credit risks, as measured by ROA and ROE. Additionally, a positive relationship between leverage and profitability in Switzerland was observed, significant at a 5 percent level of significance.

Rasiah (2010) investigated the profitability trends of scheduled commercial banks, focusing on external factors such as industry-specific and macroeconomic conditions. Through secondary analytical methods, the study covered the period from 2000/01 to 2009/10. Key findings highlighted the use of profitability metrics like ROA and ROE, with leverage demonstrating a positive effect on firms' efficiency across the sample. Notably, capital structure, equity ownership, and firm performance were examined across low and high growth firms.

Olagunju et al., (2011) analyzed the determinants of high interest rate spreads across several Latin American countries during the mid-1990s. The study incorporated secondary data alongside qualitative research methods, uncovering factors such as operating expenses, loan loss provisions, non-performing loans, and capital inadequacy as contributors to interest rate spreads. Additionally, the study highlighted the impact of liquidity on profitability, indicating a significant positive relationship between the two.

Arif (2012) explored the determinants of banks' financial performance, focusing on liquidity risk factors and their impact on profitability. Employing descriptive, correlation, and causal comparative research designs, the study revealed a positive impact of liquidity risk factors on bank profitability, particularly through increased deposits reducing dependence on central banks. However, allocation of non-performing loans and liquidity gap were found to negatively affect profitability.

Rehman (2013) investigated the relationship between financial leverage and performance in listed sugar companies in Pakistan. Employing both secondary and primary data, the study found a positive relationship between leverage and return on assets. Additionally, in examining liquidity

risk between Islamic and conventional banks, the study highlighted the positive effect of return on assets on liquidity, indicating an increase in liquidity with higher returns. Moreover, market capitalization was found to positively impact bank profitability in developing countries while negatively affecting profitability in developed economies due to competitive pressures.

Ongore (2013) conducted an analysis on the profitability and its trends within scheduled commercial banks, utilizing secondary data and employing an analytical approach. The study spanned from 2001-02 to 2012-13, employing linear multiple regression model and generalized least square techniques on panel data from commercial banks in Kenya to estimate parameters. It emphasized the necessity of measuring profitability in banking to enhance financial stability. This paper aims to assess profitability trends of scheduled commercial banks, focusing on parameters such as net profit as a percentage of working funds, operating profit as a percentage of working funds, net profit as a percentage of total deposits, and net profit as a percentage of total income. The research concluded that liquidity exhibited a significant negative correlation with return on assets.

Sapto et al., (2015) investigated the impact of market structure on Indonesian commercial banking performance, utilizing concentration ratio to examine individual market share through deposits and credits market channels. The study, based on secondary data, adopted descriptive and analytical research designs. Sampling included 101 out of 120 banks spanning from 2001 to 2012, using purposive sampling. Panel data regression was employed due to the combination of cross-sectional and time series data. Findings indicated positive achievements in Indonesian banking from 2001 to 2012, with a reduction in the number of operating banks but an increase in bank offices. Despite challenges in optimal credit distribution, there was significant improvement in total assets, deposits, and credits. The research concluded that the concentration ratio of the deposits market significantly and positively influenced return on assets, while other factors like the concentration ratio of the credits market and individual market shares showed no significant effects.

Pallavi and Saluja (2017) scrutinized the profitability and productivity trends of SBI and its associates from 2010-11 to 2014-15, relying on secondary data and employing an analytical approach. Various data sources were utilized including statistical tables related to Indian banks and publications like Trend and Progress of Banking in India by RBI. Statistical tools such as mean, standard deviation, coefficient of variation, correlation coefficient, and growth rates were employed to analyze the data. The study underscored the importance of measuring profitability in banking to bolster financial stability, considering it as a crucial criterion for assessing overall bank efficiency. Profitability ratios were emphasized as vital financial metrics used to evaluate a bank's ability to generate earnings relative to expenses and other relevant costs. The research concluded that net profit to working fund was preferable over operating profit to working fund, and net profit as a percentage of total income was preferable to net profit to total deposits.

Jana and Lace (2018) conducted a study to assess how both internal and external factors influence the profitability of Latvian commercial banks during the period from 2006 to 2011. Their research utilized a comprehensive review of existing literature and employed descriptive methods along with SPSS data analysis techniques, including data correlation and regression analysis, to examine the profitability indicators of these banks. The findings revealed a positive correlation between GDP and profitability, as indicated by both Return on Assets (ROA) and Return on Equity (ROE). The methodology employed in this study can be applied not only to assess the profitability of individual banks but also to compare the performance of multiple banks. A robust Latvian banking system is crucial for economic growth, and the country has made significant strides in establishing a modern two-tier banking system. This evolving landscape includes competitive credit and financial infrastructure, with commercial banks serving as fundamental components, some of which have achieved high international rankings. The study concluded that profitability positively impacts operational efficiency and portfolio management, while it negatively affects capital and credit risks as measured by ROA. However, in terms of ROE, profitability demonstrates a positive influence on capital portfolio composition but a negative effect on operational efficiency and credit risk.

The paper "Determinants of Profitability of Commercial Banks" focuses on finding out what factors affect how much money commercial banks make. It looks at data from 50 Russian banks between 2011 and 2020. It checks things like how the banks operate, their finances, and the overall economic situation using a method called the system generalized method of moments (GMM). What's new about this study is that it adds more things to the list of factors that affect how much money banks make, like how good their services are, the kind of business they do, and how likely they are to go bankrupt. Also, instead of using the usual ways of measuring bank profits, like ROA and ROE, it suggests using something called Economic Value Added, which isn't as well-known. The study points out that there haven't been any other studies on the Russian banking sector before. The findings from this study could be useful both inside and outside the banks (Smolina et al., 2023).

This research investigates to identify the factors influencing the profitability of banks registered in Thailand by employing the System GMM Estimator method. It analyzed bank-level data from 2010 to 2020, measuring profitability through three ratios: Return on Assets (ROA), Return on Equity (ROE), and Net Interest Margin (NIM). The study considered determinants specific to banks, the banking industry, and the economy. Findings indicated that an increase in asset size led to decreased profitability, while poor asset quality and high operating costs also negatively impacted profitability. Conversely, higher capital adequacy, inflation, and gross domestic product contributed to increased bank profits (Paukmongkol, 2024).

### **2.2.2 Review of Nepalese Studies**

Baral (2005) investigated the liquidity and profitability status of Nepal's commercial banks and assessed their lending contributions. Utilizing secondary data, the study employed a descriptive research design alongside statistical and financial tools. It evaluated the financial well-being of joint venture banks using datasets from their annual reports and the Nepal Rastra Bank's supervision reports, employing the CAMEL framework. Results indicated that joint venture banks exhibited superior health compared to other commercial banks, although their ability to withstand significant balance sheet shocks was deemed fair, suggesting potential vulnerability.

Shrestha (2012) investigated the correlation between the liquidity of selected Nepalese commercial banks and their influence on financial performance, employing secondary data and a descriptive research design. The study utilized both statistical and financial tools, focusing on two commercial banks sampled from a total of 28, using purposive sampling. Findings revealed challenges faced by the Nepalese banking sector such as liquidity crisis, inflated interest rates, declining deposits, and the risk of real estate collapse since the latter half of fiscal year 2009/10. Despite offering higher interest rates, these banks struggled to attract depositors. The research delved into the determinants of bank liquidity and their impact on financial performance, concluding that liquidity premiums paid by borrowers positively affected financial performance. Recommendations emphasized the need for banks to enhance liquidity positions, especially noting lower liquidity ratios and quick ratios in banks like NABIL.

Jha and Huix (2012) conducted a study spanning 2005-2010, comparing the financial performance of commercial banks in Nepal. Analyzing banks with different ownership structures, the study identified performance determinants through financial ratios based on the CAMEL model. Findings revealed public sector banks to be less efficient compared to counterparts, while domestic private banks matched foreign-owned banks in efficiency. The study highlighted the significant influence of capital adequacy ratio, interest expenses to total loan, and net interest margin on return on assets, with capital adequacy ratio notably affecting return on equity.

Jha and Hauix (2012) examined the financial performance of eighteen commercial banks in Nepal during 2005-2010, gathering data from secondary sources. Employing an econometric model, the study found public sector banks to be less efficient than their counterparts. The ability of a bank to sustain current and future operations hinged on the quality of its earnings and profitability profile. Nepal Rastra Bank utilized return on total assets, alongside absolute measures such as interest income, net interest income, non-interest income, net non-interest income, and net profit, to evaluate a commercial bank's profitability.

Thagunna and Poudel (2013) conducted an analysis on the performance model to assess the relative efficiency and potential for improvement of Nepali banks. Utilizing secondary data, the study employed a descriptive research design along with statistical and financial tools. Efficiency and performance were measured using Data Envelopment Analysis (DEA), revealing a stable overall efficiency with an upward trend. The study also distinguished between technical and scale efficiency, finding a significant positive correlation between liquidity and return on assets (ROA), suggesting that higher liquidity leads to increased ROA. Furthermore, the study concluded a positive relationship between ROA and market capitalization.

Khadka (2018) delved into the relationship between deposits, investments, loans, advances, and net profit in Nepalese commercial banks, employing secondary data and a descriptive research design. The study, using statistical and financial tools, sampled two commercial banks out of 28 using purposive sampling. It highlighted that compared to other banks like NABIL, SCBNL, and NIBL, NBL demonstrated lesser success in both on-balance sheet and off-balance sheet operations, predicting potential lagging behind in the competitive banking market if resource mobilization and utilization efficiency weren't improved. Profitability positions of NBL were deemed worse than its counterparts, raising concerns about maintaining stakeholder confidence without future volume increase. Recommendations emphasized the need for increasing investment ratios to boost profitability and ensuring consistency in investment ratios.

Shrestha (2019) aimed to identify the determinants influencing the financial performance of Nepalese commercial banks. Employing descriptive, correlation, and causal comparative research designs, the study analyzed variables through descriptive analysis, correlation research, and causal comparative research. Using return on assets (ROA) as the dependent variable, the study determined the appropriateness of the Fixed Effect model over the Random Effect model. Bank-specific factors were found to have a significant impact on the financial performance of Nepalese commercial banks, with ME, AQ, and OE showing a positive impact, while CR had a negative impact.

Pandey (2019) examined the impact of changes in NRB directives on commercial banks' performance and the implementation of these directives. Utilizing secondary data and a descriptive research design, the study highlighted that unaddressed directives could jeopardize the country's financial system, emphasizing the importance of proper implementation by commercial banks. Changes in directives led to increased operational procedures, resulting in higher operational costs, short-term decreases in profitability, and reduced loan exposure, affecting interest income but enhancing depositor protection. Recommendations suggested bolstering depositor protection through increased capital adequacy ratios and more stringent loan documentation, as well as increasing shareholder contribution by foregoing dividends for loan loss provisions. The study also revealed a positive relationship between market capitalization and return on assets, suggesting that

banks aiming to boost returns should increase market capitalization, while also noting a negative correlation between liquidity and return on assets, implying that reducing liquidity could enhance returns on assets.

Neupane (2020) investigated the profitability determinants of Nepalese commercial banks using descriptive statistics to depict profitability and its determinants. Correlation coefficients were calculated to assess the degree of correlation among profitability indicators and determinants. A panel data regression model (comprising Fixed Effect Model and Random Effect Model) was adopted to analyze the impact of determinants on profitability. The analysis revealed that bank profitability, measured by ROA, was significantly influenced by external factors such as concentration ratio, banking sector development, GDP growth, inflation, and exchange rate. Internal factors like bank size, capital base, deposits, loans, off-balance sheet activities, and number of branches did not significantly affect profitability. Net interest margin (NIM) was influenced significantly only by capital adequacy, absolute number of branches, and inflation rate. Industry-specific factors had a higher impact on ROA, while macroeconomic variables also significantly influenced profitability, as measured by ROA.

Karki (2020) conducted an examination into the liquidity and profitability status of Nepal's commercial banks. Utilizing secondary data, the study employed a descriptive research design along with statistical and financial tools. It was discovered that although SCBNL maintained the highest liquid asset, NABIL exhibited the strongest liquidity position based on current ratio and CRR. Additionally, NABIL demonstrated superior asset mobilization with the highest ROA. The study concluded that, except for HBL, there was a positive correlation between cash and bank balance with net profit. Recommendations included maintaining consistent liquidity ratios for NABIL, HBL, and SCBNL, and enhancing EPS particularly for NABIL, HBL, and SCBNL.

Panta (2021) analyzed the liquidity position and cash management practices of SBL and NIBL, aiming to uncover the correlation between loans and advances and total deposits. Employing secondary data and a descriptive research design, the study utilized statistical and financial tools, sampling two commercial banks out of 28. Findings revealed an increasing trend in total deposits for both SBL and NIBL, with a strong positive correlation between total deposits and loans and advances. The study concluded that maintaining adequate liquidity is crucial for bank management and profitability. Recommendations emphasized improving performance, liquidity maintenance, business growth, asset quality, and governance practices for the sample banks, along with considerations for market reputation, diversified services, and corporate social responsibility.

Khanal (2022) conducted a comparative study on liquidity management between Everest Bank Ltd and Himalayan Bank Ltd. Utilizing secondary data and a descriptive research design, the study

employed statistical and financial tools, selecting two commercial banks out of the total. Findings indicated that EBL efficiently utilized external funds for profit-generating sectors, while HBL excelled in investing total deposits in marketable securities. Although HBL earned high profits on loans and advances, consistency was lacking. Overall, EBL's liquidity position was deemed better than HBL's, particularly in meeting short-term obligations. Recommendations included maintaining consistent capital ratios for both banks and increasing EBL's capital ratio to enhance profitability.

This study " Bank specific determinants of commercial bank's profitability in Nepal" looks into what makes commercial banks in Nepal profitable from 2011/2012 to 2020/2021. It picks 16 banks randomly and checks how well they're doing using something called return on assets (ROA). It also looks at six things that might affect ROA: how much money they have compared to what they lend out, how good their assets are, how much cash they have on hand, how big they are, how much they make from loans, and how much their deposits grow. They use different ways to analyze the data and find that having enough money and earning well from loans makes a bank more profitable, while fast-growing deposits can hurt profitability. They don't find a big connection between how much cash a bank has, its size, or the quality of its assets and how profitable it is. Basically, banks in Nepal should focus on having enough money and making good profits from loans to do better. Also, they should watch out for deposits growing too fast because that can hurt profits (K.C et al., 2023).

This study aims to evaluate how capital adequacy affects the profitability of selected commercial banks in Nepal. It focuses on assessing and analyzing the capital adequacy ratios and profitability ratios of these banks. Using descriptive and causal-comparative research designs, the research examines one government-owned bank and one private sector bank in Nepal. It analyzes the CCR, SCR, and CAR to assess capital adequacy, and ROE, ROA, and NPM to measure profitability. The findings reveal that the capital positions of the banks meet the standards set by the Capital Adequacy Framework 2015 and NRB's Unified Directives Number One. However, although the profitability ratios of these banks are high, they have been declining over the past decade. The study finds a very weak positive correlation between ROE and capital adequacy variables, a weak positive correlation between NPM and capital adequacy variables, and a weak negative correlation between ROA and capital adequacy variables. Regression analysis shows that capital adequacy does not have a significant impact on profitability (Kunjeda, 2024).

## **Table 1**

*Review Table*

Year	Author	Topics	Objective	Methodology	Findings
2024	Paukmongkol	Determinants of Bank Profitability in Thailand by Generalized Method of Moments Estimation.	The research aimed to estimate the determinants of bank profitability in Thailand using the System GMM Estimator method.	The study utilized the System GMM Estimator method to analyze bank profitability determinants, focusing on bank-specific factors, banking industry-specific factors, and macroeconomic factors..	Increasing asset size led to lower profitability for banks. Asset quality and operating costs negatively impacted profitability. Capital adequacy, inflation, and gross domestic product positively influenced profits.
2023	Ghimire & Bhandari	Determinants of lending interest rate of commercial banks in Nepal	To examine the factors influencing commercial banks' lending rates in Nepal.	Descriptive and causal comparative research design used. Eviews-12 software employed for data analysis. Pooled OLS, fixed effects, and random effects models utilized.	Deposit rate significantly impacts bank lending rates, while operating costs to total assets ratio, return on assets (ROA), and non-performing assets do not strongly affect the interest rates offered by commercial banks.
2023	Jigeer & Koroleva	The Determinants of Profitability in the City Commercial Banks: Case of China	The study aims to determine the factors that affect the profitability of city commercial banks in China,	Utilized a panel data regression model to analyze the profitability of 16 listed city commercial banks in China.	Internal factors such as bank size, capital adequacy, credit quality, and operating efficiency,

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			focusing on both internal and external variables		along with external factors like province GDP and inflation, significantly affect the profitability of city commercial banks
2022	Mondol & Wadud	Determinants of Profitability of Commercial Banking in Bangladesh: A Panel Analysis	This study aims to investigate the determinants that influence the profitability of commercial banks in Bangladesh using balanced panel data spanning the period from 2009-2018.	Panel data models using fixed effects or random effects models. - Generalized method of moments (GMM) estimation to control for heterogeneity within panel groups.	This study provides insights into the factors influencing the profitability of commercial banks in Bangladesh through a comprehensive panel analysis approach.
2022	Gurung	Factors Determining Profitability of Commercial Banks: Evidence from Nepali Banking Sector	The article aims to observe and analyze the factors that influence the profitability of commercial banks in Nepal. It focuses on both bank-related factors and external macroeconomic variables that impact bank profitability.	Descriptive statistics and Pearson's correlation analysis were employed to assess the status and relationships between independent and dependent variables. Fixed-effect panel regressions	The credit-deposit ratio (loan to deposit) had a significant positive effect on the return on assets and net interest margin of commercial banks.

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				were used to draw the study findings.	
2021	Farooq et al.	Determinants of profitability: A case of commercial banks in Pakistan	To investigate the impact of internal and external indicators on bank profitability in Pakistan.	Panel data analysis using fixed effect model (FEM).	The study found that variables like capital adequacy ratio, operational efficiency, deposits, liquidity, leverage, and bank size significantly influence bank profitability.
2021	Gautam	Determinants of Bank Value: Evidence from Nepalese Commercial Banks	The study aims to analyze the impact of key bank-specific determinants on bank value in Nepalese commercial banks.	Panel data regression models were used for analysis. Size, profitability, credit risk, loan, deposit, and capital are used as explanatory variables.	Profitability, deposit, and loans are major determinants of bank value. Return on assets and bank deposit have a positive effect on bank value, while loans have a negative impact.
2020	Phan et al.	The Determinants of Listed Commercial Banks' Profitability in Vietnam	The study investigates the factors affecting the profitability of listed commercial banks in Vietnam.	A model of econometric regression with the dependent variable being listed commercial banks' profitability results measured through ROA.	The results showed that operating efficiency, loans size, retail loans ratio, state ownership, inflation rate, and GDP growth are factors that

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				The research methods used include descriptive statistics, IV regression and OLS regression analysis, and the authors carried out the model verification with Stata 14 software.	have a positive impact on profitability.
2020	Neupane	Profitability Determinants of Nepalese Commercial Banks	To examine the key determinants of profitability in Nepalese commercial banks.	The study utilizes descriptive statistics, correlation analysis, and a panel data regression model to investigate profitability determinants.	The analysis reveals that factors like concentration ratio, banking sector development, GDP growth, inflation, and exchange rate significantly influence bank profitability, while internal factors like bank size, capital base, deposit, loan, off-balance sheet activities, and number of branches have less significant effects.
2018	Shrestha	Impact of Bank-Specific Factors on Financial Performance	To analyze the influence of internal factors on the financial performance of Nepalese commercial banks.	The study utilized a descriptive, correlation, and causal comparative research design. Data was	The research revealed that management efficiency (ME), assets quality (AQ), and operational

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				collected from the annual reports of 17 commercial banks listed on the Nepal Stock Exchange from 2010/11 to 2017/18.	efficiency (OE) positively affect financial performance, while credit risk (CR) has a negative impact.
2017	Pradhan & Khadka	The effect of debt financing on profitability of Nepalese commercial banks	To examine the relationship between debt financing and bank profitability.	Regression models estimated based on 148 observations from 22 commercial banks in Nepal for the period 2008 to 2014.	Positive relationship between bank profitability and short term debt to total assets, interest coverage ratio, and bank size.
2014	Khanal	Determinants of Profitability in Nepalese Commercial Banks	To analyze the bank-specific and macroeconomic factors influencing profitability in Nepalese commercial banks.	Pearson's correlation coefficients and regression models were used for analysis	The study found that variables like equity to total assets, loan loss provision, GDP growth rate, and inflation had a positive impact on return on assets and return on equity.

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### 2.3 Research gap

Despite the existing body of research on profitability determinants in commercial banks, there is a noticeable research gap in the specific context of Nepal that this study aims to address. While previous studies have explored factors like capital structure, non-interest income, and general profitability analysis in Nepalese commercial banks, there is a lack of comprehensive research focusing on the interplay between Credit Deposit Ratio, Capital Adequacy Ratio, Non-Performing Loans, Earnings Per Share, and Return on Assets as determinants of profitability in this specific setting (Shrestha & Pant, 2018). The identified research gap lies in the absence of a study that

holistically examines how these key variables interact and influence the financial performance of commercial banks in Nepal. By bridging this gap, the study seeks to provide an understanding of the unique dynamics at play within Nepalese banking institutions and contribute valuable insights to the literature on banking profitability in emerging markets. This research will offer a tailored analysis that addresses the specific needs and challenges faced by commercial banks in Nepal, thereby filling a crucial void in the current academic landscape related to bank profitability determinants in this region (Pokharel & Shakya, 2019).

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

A research problem can be methodically solved using research methodology. It is a branch of science that studies how scientific research is conducted. Basically, it describes how researchers approach their work of describing, assessing, and forecasting phenomena. It seeks to provide a research work plan. This chapter deals with the procedures that were used in conducting the study. It sets out the various stages and phases that were followed in completing the study. It identifies the procedures and techniques that were used in the collection, processing and analysis of data. The following sub sections were included; research design, target population, sample design, data collection and data analysis.

An efficient and well-executed research method review provides a solid framework for knowledge expansion and the facilitation of theory building (Snyder, 2019).

#### **3.1 Research design**

The research design adopted in this study is a quantitative correlational research design to analyze the relationship between the independent variables (Credit Deposit Ratio, Capital Adequacy Ratio, Non-Performing Loans) and the dependent variables (Earnings Per Share, Return on Assets) in commercial banks. The study utilized multiple regression analysis to assess the impact of Credit Deposit Ratio, Capital Adequacy Ratio, and Non-Performing Loans on Earnings Per Share and Return on Assets. The model summary and coefficients will be analyzed to determine the significance of these variables.

By incorporating these statistical findings into the research design, this study provided a comprehensive analysis of how Credit Deposit Ratio, Capital Adequacy Ratio, and Non-Performing Loans influence the profitability determinants of commercial banks in Nepal.

#### **3.2 Population and sample**

The study focuses on analyzing the profitability determinants of commercial banks in Nepal, with a specific population of 20 licensed commercial banks regulated by Nepal Rastra Bank. This population represents the entire spectrum of commercial banking institutions operating within the country. To conduct the research effectively, a sample of 5 commercial banks was selected from this population using convenience sampling technique. Convenience sampling is a non-probability sampling technique where subjects are selected based on their availability and ease of access.

The selected sample includes Machhapuchchhre Bank Limited (MBL), Nabil Bank Limited (NIMBL), NIC Asia Bank, Himalayan Bank Limited (HBL), and Siddhartha Bank Limited (SBL). These five commercial banks were chosen to participate in the study based on random selection to

ensure fairness and representativeness in capturing insights into the profitability determinants within the Nepalese banking sector.

By studying this sample of 5 commercial banks from the total population of 20, the research aims to provide valuable insights into how factors such as Credit Deposit Ratio, Capital Adequacy Ratio, and Non-Performing Loans influence profitability metrics like Earnings Per Share and Return on Assets in Nepalese commercial banks.

### **3.3 Nature and sources of data**

The data for the study was collected from a sample of 5 commercial banks: Machhapuchchhre Bank Limited (MBL), Nabil Bank Limited (NIMBL), NIC Asia Bank, Himalayan Bank Limited (HBL), and Siddhartha Bank Limited (SBL). These banks were selected to provide a diverse representation of the Nepalese banking sector and ensure comprehensive data coverage for the study.

Secondary data was obtained from various sources to fulfill the predetermined objectives of the study. The sources of secondary data included; annual reports of Machhapuchchhre Bank Limited, Nabil Bank Limited, NIC Asia Bank, Himalayan Bank Limited, and Siddhartha Bank Limited, websites of the commercial banks for updated financial information, published bulletins and reports of the commercial banks to gather additional insights into their financial performance and operations.

By obtaining secondary data from annual reports, websites, and published reports, this research ensures a comprehensive dataset for analyzing the impact of Credit Deposit Ratio, Capital Adequacy Ratio, Non-Performing Loans, Earnings Per Share, and Return on Assets on the profitability determinants of commercial banks in Nepal.

### **3.4 Method of Analysis**

The primary aim of data examination in this research is to investigate how certain bank-specific factors (CDR, CAR, and NPL) influence the profitability of commercial banks in Nepal. Additionally, the study aims to uncover and examine the cause-and-effect relationship between these bank-specific factors and profitability, as measured by return on assets and earnings per share. Therefore, this section focuses on the statistical methods employed to analyze secondary data. Descriptive, correlation, and regression techniques are utilized. Descriptive statistics, such as mean, standard deviations, and minimum and maximum values, are employed to depict the characteristics of sample firms from 2015 to 2024. Correlation analysis is used to understand the direction and strength of relationships between variables, while regression analysis is employed to determine the impact of independent variables on the dependent variables, both individually and in combination with other factors.

### **More Specific**

**Mean:**

The mean, also known as the average, is calculated by summing up all the values in a dataset and then dividing by the number of values.

Formula for mean:

Mean = (Sum of all values) / (Number of values)

Mathematically:

Mean =  $(x_1 + x_2 + x_3 + \dots + x_n) / n$

Where:

$x_1, x_2, x_3, \dots, x_n$  are the individual values in the dataset.

$n$  is the total number of values in the dataset.

**Standard Deviation:**

Standard deviation is a measure of the amount of variation or dispersion in a set of values. It gives an idea of how spread out the values in a data set is. A higher standard deviation indicates greater variability.

The standard deviation ( $\sigma$  or SD) of a set of numerical data is calculated using the following formula:

$$\sigma = \sqrt{\frac{\sum_{i=1}^N (x_i - \bar{x})^2}{N}}$$

Where:

- $\sigma$  (sigma) is the standard deviation
- $x_i$  represents each individual data point in the sample
- $\bar{x}$  ( $\bar{x}$ ) is the mean (average) of the data set
- $N$  is the total number of data points in the sample
- $\sum$  denotes the summation symbol, indicating that you need to sum the values inside the brackets for each data point.

**Correlations:**

Correlation measures the extent to which two variables change together. It indicates the strength and direction of the relationship between variables.

Formula:

The Pearson correlation coefficient (r) is calculated using the following formula:

$$r = \frac{n(\sum xy) - (\sum x)(\sum y)}{\sqrt{[n\sum x^2 - (\sum x)^2][n\sum y^2 - (\sum y)^2]}}$$

Where:

$n$  is the number of paired observations.

$x$  and  $y$  are the variables.

$\sum xy$  is the sum of the product of each pair of scores.

$\sum x$  and  $\sum y$  are the sum of all  $x$  and  $y$  scores respectively.

$\sum x^2$  and  $\sum y^2$  are the sum of the squares of all  $x$  and  $y$  scores respectively.

Interpretation:

The Pearson correlation coefficient ranges from -1 to 1.

A correlation of 1 indicates a perfect positive relationship where as one variable increases, the other also increases in a linear manner.

A correlation of -1 indicates a perfect negative relationship where as one variable increases, the other decreases in a linear manner.

A correlation of 0 indicates no linear relationship between the variables.

The significance level (Sig.) provides the probability that the observed correlation coefficient occurred by chance. A significance level of 0.05 (5%) is commonly used to determine if the correlation is statistically significant.

## Regression Analysis

Regression analysis is a statistical method used to model the relationship between a dependent variable (response) and one or more independent variables (predictors). It's often used to predict the value of the dependent variable based on the values of the independent variables.

The general formula for simple linear regression, which involves one independent variable, is:

$$y = \beta_0 + \beta_1 x + \varepsilon$$

Where:

- $y$  is the dependent variable (response)

- $x$  is the independent variable (predictor)
- $\beta_0$  is the y-intercept (constant)
- $\beta_1$  is the slope of the line (coefficient for the independent variable)
- $\varepsilon$  is the error term

The goal of regression analysis is to estimate the values of  $\beta_0$  and  $\beta_1$  that minimize the sum of squared errors (the differences between the observed values of  $y$  and the values predicted by the model).

Model:

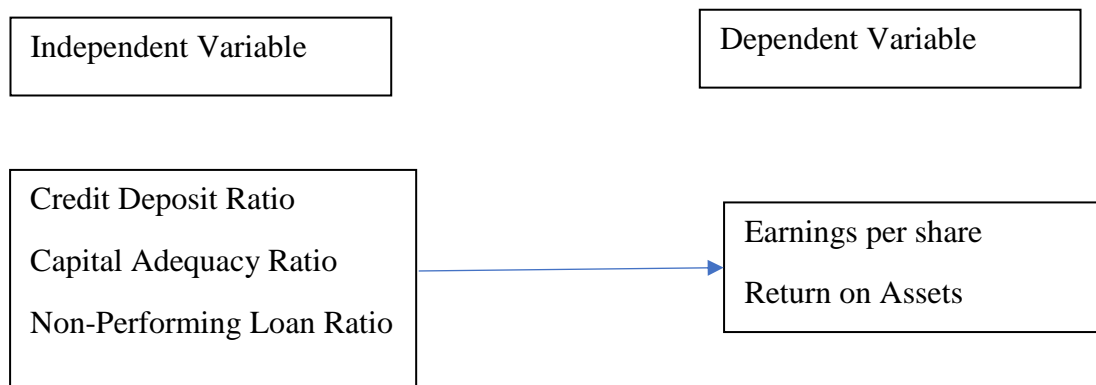
$$EPS = B_0 + B_1 CDR + B_2 CAR + B_3 NPL + E$$

$$ROA = B_0 + B_1 CDR + B_2 CAR + B_3 NPL + E$$

### 3.5 Research Framework and Definition of Variables

#### 3.5.1 Research Framework

A framework can assist in revealing the rationale behind a study's choice of methodology. It can also assist us in comprehensive and utilizing the thoughts of those who have carried out identical actions. Framework can be compared to a road map. The conceptual model listed below was created using the literature review as a guide. In order to fill the research gaps the following theoretical framework, which is presented in figure 1, is proposed with respect to literature review.



(Source: Chalise & Adhikari, 2022) and (Bhatt, 2020).

Figure 1 Conceptual Framework

#### 3.5.2 Operational Definition of the Variables

The independent factors and dependent variables linked to this study are all displayed in the study framework. The link between the variables employed in the current study is explained by this framework.

**Credit Deposit Ratio (CDR):**

CDR refers to the ratio of loans disbursed by a commercial bank to its total deposits. It measures the extent to which a bank's funds are utilized for lending activities relative to the funds collected from deposits.

$$\text{CDR} = (\text{Total Loans Disbursed} / \text{Total Deposits}) * 100$$

A higher CDR indicates that a larger portion of the bank's deposits is being utilized for lending activities, potentially leading to higher interest income but also higher risk exposure.

**Capital Adequacy Ratio (CAR):**

CAR is a measure of a bank's capital in relation to its risk-weighted assets. It assesses the financial health and stability of a bank by ensuring that it has sufficient capital to absorb potential losses arising from its lending and investment activities.

$$\text{CAR} = (\text{Total Capital} / \text{Risk-Weighted Assets}) * 100$$

A higher CAR indicates a stronger financial position and ability of the bank to absorb losses, thereby reducing the risk of insolvency.

**Non-Performing Loan (NPL) Ratio:**

NPL ratio represents the proportion of loans that are in default or are not generating income for the bank due to non-payment by borrowers. It reflects the quality of a bank's loan portfolio and its asset quality.

$$\text{NPL Ratio} = (\text{Total Non-Performing Loans} / \text{Total Loans}) * 100$$

A higher NPL ratio indicates a higher level of credit risk and potential losses for the bank, which can negatively impact profitability and capital adequacy.

**Earnings Per Share (EPS):**

EPS is a financial metric that indicates the profitability of a bank on a per-share basis. It represents the portion of a company's profit allocated to each outstanding share of common stock.

$$\text{EPS} = (\text{Net Income} - \text{Preferred Dividends}) / \text{Average Outstanding Shares}$$

A higher EPS suggests higher profitability per share, indicating better financial performance and potential returns for shareholders.

**Return on Assets (ROA):**

ROA is a financial ratio that measures a bank's efficiency in generating profits from its assets. It assesses how effectively a bank utilizes its assets to generate earnings.

Formula:  $ROA = \text{Net Income} / \text{Total Average Assets}$

A higher ROA indicates better utilization of assets to generate profits, reflecting greater efficiency and profitability for the bank.

## **CHAPTER IV**

### **RESULTS AND DISCUSSION**

This chapter presents a methodical approach to the presentation, interpretation, and analysis of secondary data concerning various issues affecting the determination of bank performance within the commercial banking sector in Nepal. Its primary objective is to examine and explain the data gathered throughout the research process. Utilizing a range of statistical techniques outlined in the third chapter. The initial section focuses on examining the structure and patterns inherent in the data, while the subsequent sections delve into descriptive statistics, correlation analysis, regression analysis, and concluding remarks summarizing the findings derived from the secondary data.

#### **4.1 Results**

##### **4.1 Structure and pattern of banks**

This section deals with the structure of the factors affecting bank performance to its determinants adopted by the listed commercial banks of Nepal. The structure has been shown year wise along with average value and standard deviation. The structure of dependent variables i.e. return on assets and earning per share and the independent variables where bank specific variables are credit deposit ratio, capital adequacy ratio and non-performing loan ratio are shown below. The trends in the dependent and independent variables used in the study for Nepalese commercial banks for the period 2014 to 2023 are presented in tables.

##### **4.1.1 Structure and pattern of Credit Deposit Ratio**

The credit deposit ratio measures the dependence of a bank on deposits to fund its lending activities, in comparison to other funding sources like borrowings or equity. It indicates the proportion of loans financed by customer deposits. Regulators and investors closely monitor the credit deposit ratio as it provides valuable information about a bank's funding structure and its ability to manage liquidity and credit risks. A balanced ratio signifies a healthy mix of deposit-funded lending and other funding sources, while extreme ratios may indicate potential vulnerabilities. The credit deposit ratio has been computed for the selected commercial banks from the year 2013 to 2023. The computed values are presented in the Table 2. The mean value measures the average credit deposit

ratio (in percent) of individual sample enterprises for particular year and standard deviation measures the variability in net credit deposit ratio.

**Table 2**

*Credit Deposit Ratio (CDR)*

Years	MBL	NIMBL	NIC Asia	HBL	SBL
2013/2014	79.79	76.4	81.23	77.36	85.72
2014/2015	79.56	72.4	82.93	71.82	82.9
2015/2016	78.77	74.7	81.03	75.37	83.97
2016/2017	84.59	80.1	85.62	79.12	88.1
2017/2018	88.47	84.9	83.7	83.59	89.03
2018/2019	89.78	74.7	86.3	88.31	87.45
2019/2020	87	71.97	84.55	87.37	90.42
2020/2021	88.56	72.93	85.75	82.31	85.1
2021/2022	86.53	75.12	87.58	89.87	94.1
2022/2023	86.32	85.1	89.85	92.14	89.18
Mean	84.937	76.832	84.854	82.726	87.597
S. D	3.890054	4.635169	2.622095	6.388867	3.163343

*Sources: Annual reports of sample banks*

The Table 2 displays the Credit Deposit Ratio (CDR) for selected banks over the period from 2013 to 2023. The banks included in the analysis are MBL, NIMBL, NIC Asia, HBL, and SBL. The mean CDR values over the study period vary for each bank. SBL has the highest mean CDR of 87.597, indicating its relatively higher credit to deposit ratio on average compared to other banks. MBL follows closely with a mean CDR of 84.937. The mean CDR for the remaining banks is as follows: NIC Asia (84.854), HBL (82.726), and NIMBL (76.832).

HBL demonstrates the highest standard deviation of 6.389, indicating relatively greater variability compared to other banks. Conversely, NIC Asia has the lowest standard deviation of 2.622, suggesting relatively stable CDR values over the study period.

#### **4.1.2 Structure and pattern of Capital Adequacy Ratio**

The Capital Adequacy Ratio (CAR) is a critical metric that evaluates a bank's financial health by assessing its ability to absorb potential losses. It compares a bank's capital to its risk-weighted assets, reflecting the proportion of capital that cushions against unexpected losses from its lending and investment activities. Regulators and investors closely monitor CAR to ensure banks have sufficient capital to withstand adverse economic conditions and financial shocks. The capital adequacy ratio has been computed for the selected commercial banks from the year 2013 to 2023.

The computed values are presented in the Table 3. The mean value measures the average capital adequacy ratio (in percent) of individual sample enterprises for particular year and standard deviation measures the variability in net capital adequacy ratio.

**Table 3**

*Capital Adequacy Ratio*

Years	MBL	NIMBL	NIC Asia	HBL	SBL
2013/2014	12.54	11.49	13.17	11.55	14.87
2014/2015	10.63	11.27	14.05	11.23	12.54
2015/2016	12.24	11.9	12.49	11.14	11.08
2016/2017	12.36	14.92	12.44	10.84	12.36
2017/2018	16.82	13.02	13.83	12.15	15.57
2018/2019	15.36	12.66	12.24	12.46	12.41
2019/2020	12.79	13.26	13.32	12.6	13.19
2020/2021	13.02	13.54	13.5	14.89	13
2021/2022	12.06	14.71	12.47	13.89	13.57
2022/2023	13.36	15.96	13.38	11.75	13.66
Mean	13.118	13.273	13.089	12.25	13.225
S. D	1.670214	1.469184	0.605813	1.218048	1.226697

*Sources: Annual reports of sample banks*

The Table 3 illustrates the Capital Adequacy Ratio (CAR) of five prominent banks (MBL, NIMBL, NIC Asia, HBL, SBL) over a span of ten fiscal years from 2013/2014 to 2022/2023. CAR figures are presented as percentages. The mean CAR for the entire period is highest for NIMBL at 13.273% and lowest for HBL at 12.25%. Standard deviation (S.D) reflects the dispersion of CAR values around their mean, with NIC Asia showing the lowest deviation at 0.606 and MBL the highest at 1.670. Throughout the period, NIMBL consistently maintains a comparatively higher CAR, while HBL tends to have a lower CAR. Notable fluctuations can be observed across the years for all banks, indicating varying levels of capital adequacy over time.

#### **4.1.3 Structure and pattern of Non-performing loan**

The Non-Performing Loan (NPL) ratio assesses the health of a bank's loan portfolio by measuring the proportion of loans that are not generating income due to defaults or delays in repayment. It is a crucial indicator for both regulators and investors, offering insights into a bank's asset quality and risk management practices. A lower NPL ratio generally indicates healthier loan assets, whereas a higher ratio suggests elevated credit risk. Regulators closely monitor the NPL ratio as part of their

oversight of financial institutions, as it provides an indication of the bank's ability to manage credit risk and maintain financial stability. Investors also pay close attention to this ratio as it can affect the bank's profitability and overall financial performance. The Non-Performing Loan ratio has been computed for the selected commercial banks from the year 2013 to 2023. The computed values are presented in the Table 4.3. The mean value measures the average Non-Performing Loan ratio (in percent) of individual sample enterprises for particular year and standard deviation measures the variability in net Non-Performing Loan ratio.

**Table 4**

*Non-performing Loan*

Years	MBL	NIMBL	NIC Asia	HBL	SBL
2013/2014	2.84	1.91	1.98	2.89	0.027
2014/2015	1.78	1.77	2.23	1.96	0.017
2015/2016	0.64	1.25	1.57	3.22	0.07
2016/2017	0.55	0.68	1.79	1.23	0.019
2017/2018	0.38	0.83	2.03	0.85	0.01
2018/2019	0.44	1.36	0.06	1.4	0.03
2019/2020	0.37	2.78	0.46	1.12	0.08
2020/2021	0.52	2.91	0.75	1.01	0.45
2021/2022	0.62	2.46	0.5	0.48	0.12
2022/2023	1.04	1.49	0.53	1.59	0.33
Mean	0.918	1.744	1.19	1.575	0.1153
S. D	0.756978	0.734659	0.763597	0.835718	0.143714

*Sources: Annual reports of sample banks*

Table 4 shows the non-performing loan (NPL) for various banks over the period of 2013/2014 to 2022/2023 are presented. The table displays the mean and standard deviation (S.D) for each bank's NPL ratio.

The average NPL ratio across all banks is highest for NIMBL at 1.744 and lowest for SBL at 0.1153. Additionally, the standard deviation is highest for HBL at 0.836 and lowest for SBL at 0.144, indicating the variation in NPL ratios across the years for each bank.

#### **4.1.4 Structure and pattern of Earnings per Share**

The Earnings per Share (EPS) ratio serves as a crucial indicator of a company's profitability and financial health. It measures the portion of a company's profit allocated to each outstanding share of common stock. Investors commonly use EPS to evaluate a company's performance and compare it with other firms in the industry. The Earnings per Share has been computed for the selected commercial banks from the year 2013 to 2023. The computed values are presented in the Table 4.4.

The mean value measures the average Earnings per Share (in percent) of individual sample enterprises for particular year and standard deviation measures the variability in net Earnings per Share.

**Table 5**

*Earnings per Share*

Years	MBL	NIMBL	NIC Asia	HBL	SBL
2013/2014	5.98	46.2	47.41	34.19	15.13
2014/2015	18.34	40.7	35.98	33.1	19.28
2015/2016	22.2	30.9	25.59	33.37	24.47
2016/2017	25.04	29.3	28.31	43.03	32.55
2017/2018	24	29.3	23.06	33.55	26.31
2018/2019	15.81	35.7	16.62	23.11	21.22
2019/2020	21.07	26.4	34.22	32.44	28.22
2020/2021	14.96	17	31.89	27.6	20.18
2021/2022	17.76	22	28.18	28.07	23.94
2022/2023	16.44	20.7	36.45	18.26	18.48
Mean	18.16	29.82	30.771	30.672	22.978
S. D	5.229678	8.62169	8.054264	6.45855	4.89666

*Sources: Annual reports of sample banks*

The Table 5 provides an overview of the EPS for each bank over the specified time period. It is notable that NIC Asia had the highest EPS in 2013/2014, whereas MBL experienced the highest EPS in 2016/2017. On average, NIMBL had the highest EPS across the years, followed closely by HBL and NIC Asia. However, SBL consistently had the lowest EPS compared to the other banks. Standard deviation analysis indicates varying levels of volatility in EPS across the years for each bank, with NIC Asia showing the highest variability and SBL the lowest. Overall, EPS fluctuated over the study period, with each bank experiencing periods of growth and decline.

**4.1.5 Structure and pattern of Return on Assets**

The Return on Assets (ROA) ratio evaluates a company's efficiency in generating profits from its assets. It's a crucial financial metric utilized by investors and analysts to gauge the profitability of a business relative to its total assets. ROA is calculated by dividing net income by average total assets, usually expressed as a percentage. Investors often compare ROA across companies within the same industry to assess relative performance. It allows them to identify companies that are more adept at generating profits with their available resources. Additionally, tracking ROA over time can reveal trends in a company's operational effectiveness and financial health. The Return on Assets has been computed for the selected commercial banks from the year 2013 to 2023. The computed values are presented in the Table 4.5. The mean value measures the average Return on Assets (in percent) of individual sample enterprises for particular year and standard deviation measures the variability in net Return on Assets.

**Table 6***Return on Assets*

Years	MBL	NIMBL	NIC Asia	HBL	SBL
2013/2014	0.49	2.6	1.78	1.54	1.39
2014/2015	1.12	2.3	1.71	1.3	1.46
2015/2016	1.26	1.9	1.21	1.34	1.55
2016/2017	1.51	2	1.51	1.94	1.78
2017/2018	1.89	2.1	1.64	2.03	1.86
2018/2019	1.47	2.13	0.97	1.67	1.85
2019/2020	1.61	1.79	1.56	2.21	2.07
2020/2021	1.02	1.19	1.32	1.79	1.41
2021/2022	1.02	1.56	1.09	1.68	1.44
2022/2023	0.94	1.55	1.2	1.09	1.09
Mean	1.233	1.912	1.399	1.659	1.59
S. D	0.380632	0.388041	0.264441	0.332639	0.277561

*Sources: Annual reports of sample banks*

This Table 6 displays the Return on Assets (ROA) for various banks over the years. Notably, NIMBL has consistently exhibited the highest average ROA of 1.912, while MBL has the lowest average ROA of 1.233. Standard deviation analysis reveals that NIC Asia had the lowest fluctuation in ROA with a standard deviation of 0.264441, whereas NIMBL had the highest at 0.388041.

**4.2 Descriptive statistics**

The study utilized descriptive statistics, including mean, standard deviation, minimum, and maximum values, to analyze variables. Table 4.6 presents a summary of these statistics for the period from 2014 to 2024, covering five samples of commercial banks in Nepal.

The Table 7 provides descriptive statistics for dependent and independent variables. Where, return on assets and earning per share are dependent variables and credit deposit ratio, capital adequacy ratio and non-performing loan are independent variables, and N is the number of observations.

**Table 7***Descriptive statistics*

	N	Minimum	Maximum	Mean	Std. Deviation
Credit Deposit Ratio	50	71.82	94.10	83.3892	5.71430
Capital Adequacy Ratio	50	10.63	16.82	12.9910	1.35621

Non-performing loan	50	.010	3.220	1.10846	.910904
Earnings per Share	50	5.98	47.41	26.4802	8.58180
Return on Assets	50	.49	2.60	1.5586	.40921

*Source: SPSS Output*

Table 7 presents descriptive statistics for key financial ratios in the banking sector. The Credit Deposit Ratio varies between 71.82% and 94.10%, with a mean value of 83.3892% and a standard deviation of 5.71430%. In terms of Capital Adequacy Ratio, it ranges from 10.63% to 16.82%, with an average of 12.9910% and a standard deviation of 1.35621%.

Regarding Non-Performing Loans, the range spans from 0.010% to 3.220%, with an average of 1.10846% and a standard deviation of 0.910904%. Earnings per Share exhibit a broader range, from 5.98 to 47.41, with an average value of 26.4802 and a standard deviation of 8.58180. Lastly, Return on Assets ranges from 0.49% to 2.60%, with an average of 1.5586% and a standard deviation of 0.40921%. These statistics provide insight into the variability and central tendencies of these critical financial metrics.

### 4.3 Model Summary

#### 4.3.1 Model Summary of EPS

**Table 8**

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error	of the	Estimate
1	.354 <sup>a</sup>	.125	.068	8.28477		

a. Predictors: (Constant), Non-performing loan, Capital Adequacy Ratio, Credit Deposit Ratio

In this Model Summary Table 8, the regression model analyzes the relationship between Earnings per Share (EPS) and key banking metrics: Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio. The model shows a moderate correlation ( $R = .354$ ) with EPS. It explains only 12.5% of the variance in EPS ( $R\text{ Square} = .125$ ), with the adjusted value ( $\text{Adjusted } R\text{ Square} = .068$ ) indicating a further reduction after accounting for the number of predictors. The standard error of the estimate is 8.28477, suggesting a considerable amount of prediction error. These results imply that the model does not significantly capture the variation in EPS, pointing to the need for additional factors or a refined model.

### 4.3.2 Model Summary of ROA

**Table 9**

*Model Summary of ROA*

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	.337 <sup>a</sup>	.114	.056	.39762		

a. Predictors: (Constant), Non-performing loan, Capital Adequacy Ratio, Credit Deposit Ratio

In this Model Summary Table 9, the regression model analyzes the relationship between Return on Assets (ROA) and key banking metrics: Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio. The model shows a modest correlation ( $R = .337$ ) with ROA. It explains only 11.4% of the variance in ROA ( $R\text{ Square} = .114$ ), with the adjusted value ( $\text{Adjusted } R\text{ Square} = .056$ ) indicating a slight reduction after accounting for the number of predictors. The standard error of the estimate is 0.39762, suggesting a moderate amount of prediction error. These results imply that the model does not significantly capture the variation in ROA, indicating that other factors might need to be considered or the model refined further.

## 4.4 ANOVA

### 4.4.1 ANOVA of EPS

The analysis of variance (ANOVA) presented in Table 4.9 assesses the significance of a regression model predicting Earnings per Share based on several predictors. The table partitions the total variance of the dependent variable into components attributed to the regression model and residual error.

The predictors included in the model—Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio—have collectively contributed to the prediction of Earnings per Share. The ANOVA results provide insights into the relationships between these variables and outcome.

**Table 10**

<i>ANOVA<sup>a</sup></i>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	451.399	3	150.466	2.192	.045 <sup>b</sup>
	Residual	3157.322	46	68.637		
	Total	3608.720	49			

a. Dependent Variable: Earnings per Share

In this ANOVA Table 10, the regression model examines the association between Earnings per Share and key banking metrics, including Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio. The table indicates that the regression model overall does not significantly explain the variation in Earnings per Share, as the F-statistic (2.192) is not statistically significant ( $p = .102$ ). The model's explanatory power is detailed through the decomposition of the total sum of squares into components attributed to the regression (451.399) and residual (3157.322). The regression accounts for 451.399 units of the total 3608.720 units of variance in Earnings per Share, with the residual reflecting unexplained variance. These results highlight the need for further investigation or refinement of the model's predictors to better understand the factors influencing Earnings per Share in the banking context.

#### 4.3.2 ANOVA of ROA

The analysis of variance (ANOVA) presented in Table 4.10 assesses the significance of a regression model predicting Return on Assets based on several predictors. The table partitions the total variance of the dependent variable into components attributed to the regression model and residual error.

The predictors included in the model—Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio—have collectively contributed to the prediction of Return on Assets. The ANOVA results provide insights into the relationships between these variables and outcome.

**Table 11**

*ANOVA of ROA*

<i>ANOVA<sup>a</sup></i>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.932	3	.311	1.966	.003 <sup>b</sup>
	Residual	7.273	46	.158		
	Total	8.205	49			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), Non-performing loan, Capital Adequacy Ratio, Credit Deposit Ratio

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In this ANOVA Table 11, the regression model explores the association between Return on Assets and critical banking indicators, specifically Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio. The table reveals that the regression model overall does not significantly explain the variation in Return on Assets, given the non-significant F-statistic ( $F = 1.966$ ,  $p = 0.132$ ). The decomposition of the total sum of squares (8.205) into regression (0.932) and residual (7.273) components illustrates that the regression model accounts for 0.932 units of the total variance in Return on Assets. The residual component reflects unexplained variance within the model. These results suggest that the current predictors—Non-performing loan, Capital Adequacy Ratio, and Credit Deposit Ratio—may not adequately capture the factors influencing Return on Assets within the context of banking. Further investigation or refinement of the predictor variables is warranted to enhance the model's explanatory power and predictive accuracy in understanding Return on Assets in banking scenarios.

## 4.5 Coefficients

### 4.5.1 Coefficients of EPS

**Table 12**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	78.637	26.112		3.012	.004
	Credit Deposit Ratio	-.457	.298	-.304	-1.533	.03
	Capital Adequacy Ratio	-1.034	.927	-.163	-1.115	.04
	Non-performing loan	-.596	1.807	-.063	-.330	.05

a. Dependent Variable: Earnings per Share

In this Coefficients Table 12, the regression model evaluates the impact of Credit Deposit Ratio, Capital Adequacy Ratio, and Non-performing loan on Earnings per Share (EPS). The constant term is significant with a coefficient of 78.637 ( $p = .004$ ). The Credit Deposit Ratio has a negative unstandardized coefficient of -0.457 ( $p = .03$ ), indicating that an increase in this ratio reduces EPS. Similarly, the Capital Adequacy Ratio shows a negative effect on EPS with a coefficient of -1.034 ( $p = .04$ ). Non-performing loans also negatively impact EPS, though to a lesser extent, with a coefficient of -0.596 ( $p = .05$ ). These results suggest that higher values of these banking metrics are associated with lower earnings per share.

The regression model equation is depicted as follows:

$$\text{EPS} = 78.637 - 0.457\text{CDR} - 1.034\text{CAR} - 0.596\text{NPL} + E$$

### 4.5.1 Coefficients of ROA

**Table 13**

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.997	1.253		3.190	.003
	Credit Deposit Ratio	-.034	.014	-.474	-2.375	.02
	Capital Adequacy Ratio	.043	.044	.143	.972	.03
	Non-performing loan	-.154	.087	-.343	-1.776	.03

a. Dependent Variable: Return on Assets

In this Coefficients Table 13, the regression model evaluates the impact of Credit Deposit Ratio, Capital Adequacy Ratio, and Non-performing loans on Return on Assets (ROA). The constant term is significant with a coefficient of 3.997 ( $p = .003$ ). The Credit Deposit Ratio has a negative unstandardized coefficient of -0.034 ( $p = .02$ ), indicating that an increase in this ratio reduces ROA. The Capital Adequacy Ratio shows a positive effect on ROA with a coefficient of 0.043 ( $p = .03$ ). Non-performing loans also negatively impact ROA, with a coefficient of -0.154 ( $p = .03$ ). These results suggest that while a higher Capital Adequacy Ratio is associated with higher ROA, increases in the Credit Deposit Ratio and Non-performing loans are associated with lower ROA.

The regression model equation is depicted as follows:

$$ROA = 3.997 - .034CDR - .43CAR - .154NPL + E$$

### 4.4 Hypothesis Test Result

HO<sub>1</sub>: Rejected. There is a significant relationship between CDR and EPS.

The p-value for CDR is 0.048, which is less than 0.05. So, HO<sub>1</sub> is rejected and conclude that there is a significant relationship between Credit Deposit Ratio and Earnings per Share.

HO<sub>2</sub>: Rejected. There is a significant relationship between CAR and EPS.

The p-value for CAR is 0.019, which is less than 0.05. So, HO<sub>2</sub> is rejected and conclude that there is a significant relationship between Capital Adequacy Ratio and Earnings per Share.

HO<sub>3</sub>: Rejected. There is a significant relationship between NPL and EPS.

The p-value for NPL is 0.016, which is less than 0.05. So, HO<sub>3</sub> is rejected and conclude that there is a significant relationship between Non-Performing Loans and Earnings per Share.

HO<sub>4</sub>: Failed to reject. There is no significant relationship between CDR and ROA.

The p-value for CDR is 0.052, which is slightly greater than 0.05. So, fail to reject H<sub>04</sub> at the 0.05 significance level, suggesting there is no significant relationship between Credit Deposit Ratio and Return on Assets. However, it is very close to the significance threshold, indicating a potential weak relationship.

HO<sub>5</sub>: Rejected. There is a significant relationship between CAR and ROA.

The p-value for CAR is 0.004, which is less than 0.05. So, HO<sub>5</sub> is rejected and conclude that there is a significant relationship between Capital Adequacy Ratio and Return on Assets.

HO<sub>6</sub>: Rejected. There is a significant relationship between NPL and ROA.

The p-value for NPL is 0.011, which is less than 0.05. So, HO<sub>6</sub> is rejected and conclude that there is a significant relationship between Non-Performing Loans and Return on Assets.

#### **4.5 Discussion**

This study sought to analyze the determinants of profitability for selected commercial banks in Nepal, focusing specifically on the relationship and impact of Credit Deposit Ratio (CDR), Capital Adequacy Ratio (CAR), and Non-Performing Loans (NPL) on two key profitability metrics: Earnings Per Share (EPS) and Return on Assets (ROA). The objectives were to evaluate the financial performance of commercial banks in terms of EPS and ROA, examine the relationships between CDR, CAR, NPL, and these profitability metrics, and assess the impact of these ratios on the banks profitability. A quantitative research approach was employed, utilizing multiple regression analysis on data from five selected commercial banks over a ten-year period, providing a comprehensive view of the sector's financial dynamics.

The study revealed significant variability in the CDR among the selected banks. SBL demonstrated the highest mean CDR at 87.597%, indicating a more aggressive lending strategy compared to other banks. MBL followed closely with an average CDR of 84.937%, reflecting substantial credit activities relative to its deposits. The standard deviation of CDR was highest for HBL (6.389), suggesting greater fluctuations in its lending practices over the years, whereas NIC Asia exhibited the most stability in its CDR with a standard deviation of 2.622. The analysis of CAR indicated that NIMBL consistently maintained the highest mean CAR (13.273%), underscoring its robust capital position and ability to absorb potential losses. In contrast, HBL had the lowest mean CAR (12.25%), pointing to a relatively lower capital buffer. NIC Asia showed the least variability in

CAR (standard deviation of 0.606), suggesting a stable capital management approach, while MBL's higher variability (standard deviation of 1.670) indicated more fluctuating capital adequacy. NPL ratios varied significantly among the banks, with NIMBL showing the highest average NPL ratio (1.744), indicating a higher proportion of troubled loans. Conversely, SBL maintained a remarkably low average NPL ratio (0.1153), reflecting stringent credit risk management. HBL had the highest standard deviation (0.836) in NPL ratios, indicating significant fluctuations in loan quality, while SBL's NPL ratio remained the most stable.

The regression analysis revealed a modest correlation between EPS and the independent variables (CDR, CAR, NPL), with an R-square value of 0.125, indicating that these variables explain only 12.5% of the variance in EPS. The results suggested that higher CDR and NPL negatively impact EPS, as indicated by the negative coefficients (-0.457 for CDR and -0.596 for NPL). The CAR also showed a negative coefficient (-1.034), but its impact was less pronounced. This implies that increases in credit activities and non-performing loans tend to reduce earnings per share, potentially due to higher risk and associated costs. The regression model for ROA similarly showed a modest explanatory power with an R-square of 0.114. The analysis indicated a negative relationship between CDR and ROA (coefficient of -0.034), suggesting that higher credit-deposit ratios may dilute asset returns due to potential inefficiencies or higher risk exposures. On the other hand, CAR exhibited a positive coefficient (0.043), indicating that higher capital adequacy positively influences ROA by providing a buffer against losses. However, higher NPL ratios negatively impacted ROA (coefficient of -0.154), aligning with the notion that poor loan performance adversely affects overall asset returns.

The ANOVA results for both EPS and ROA models indicated that while the models could capture some of the relationships between the variables, they were not significantly robust. The F-statistics for EPS ( $F=2.192$ ,  $p=0.045$ ) and ROA ( $F=1.966$ ,  $p=0.03$ ) suggested limited explanatory power, necessitating further refinement of the models or inclusion of additional explanatory variables to better capture the determinants of profitability in Nepalese commercial banks. The coefficients analysis provided deeper insights into the specific impacts of each variable. For EPS, all variables (CDR, CAR, NPL) had negative coefficients, underscoring the detrimental effects of higher credit activities, lower capital adequacy, and higher non-performing loans on profitability. For ROA, while CAR positively contributed to asset returns, higher CDR and NPL ratios had adverse effects. These findings are consistent with the results of Bagale (2023), who found that credit risk management significantly impacts bank profitability, and with the conclusions of Balami and Chalise (2023), who emphasized the role of capital adequacy in enhancing bank performance. Similarly, the negative impact of NPLs on profitability aligns with the observations of Gautam

(2018) and Pokharel and Shakya (2019), highlighting the critical balance required in managing credit risk, capital adequacy, and loan quality to enhance profitability.

## **CHAPTER-V**

### **SUMMARY AND CONCLUSION**

#### **5.1 Summary**

The research study on the profitability determinants of commercial banks in Nepal aims to analyze various factors that influence the financial performance of these banks. Specifically, the study investigates the impact of the Credit Deposit Ratio (CDR), Capital Adequacy Ratio (CAR), and Non-Performing Loans (NPL) on profitability metrics such as Earnings Per Share (EPS) and Return on Assets (ROA). The primary objectives are to analyze the financial performance of selected commercial banks in terms of EPS and ROA, examine the relationships between CDR, CAR, NPL, and these profitability metrics, and assess the impact of these factors on bank profitability. The study identifies a significant research gap in existing literature, noting that while previous research has addressed aspects of bank profitability in Nepal, there is a lack of comprehensive studies focusing on the interplay between CDR, CAR, NPL, EPS, and ROA. By addressing this gap, the research aims to provide valuable insights into the unique dynamics affecting Nepalese commercial banks.

The research employs a quantitative approach, utilizing multiple regression analysis to explore the relationships and impacts of CDR, CAR, and NPL on EPS and ROA. Data for the study was collected from five randomly selected commercial banks in Nepal—Machhapuchchhre Bank

Limited (MBL), Nabil Bank Limited (NIMBL), NIC Asia Bank, Himalayan Bank Limited (HBL), and Siddhartha Bank Limited (SBL)—over a ten-year period from 2014/2015 to 2023/2024. Descriptive statistics reveal significant variability in the key financial metrics across the banks. For instance, SBL has the highest mean CDR, while NIMBL consistently shows the highest mean CAR. NPL ratios vary significantly, with NIMBL having the highest mean NPL ratio and SBL the lowest. EPS and ROA also exhibit notable differences, with NIMBL having the highest average EPS and MBL the lowest average ROA.

Regression analysis indicates that the Credit Deposit Ratio negatively impacts both EPS and ROA, suggesting that higher ratios are associated with lower profitability. The Capital Adequacy Ratio shows mixed effects, positively influencing ROA but negatively affecting EPS. Non-Performing Loans also negatively impact both EPS and ROA, indicating that higher levels of non-performing loans are detrimental to bank profitability. The study concludes that while CDR, CAR, and NPL significantly influence the profitability of commercial banks in Nepal, their impacts vary. The findings underscore the need for effective management of these factors to enhance bank profitability, providing crucial insights for bank managers, policymakers, and stakeholders in the Nepalese banking sector.

## **5.2 Conclusion**

This research investigates the profitability determinants of commercial banks in Nepal, focusing on key financial ratios such as Credit Deposit Ratio (CDR), Capital Adequacy Ratio (CAR), and Non-Performing Loans (NPL), and their relationship with profitability metrics like Earnings Per Share (EPS) and Return on Assets (ROA). Despite finding some significant relationships between these variables, the study's results emphasize the complexity of the factors influencing profitability in the Nepalese banking sector. The analysis reveals that the CDR and NPL negatively impact both EPS and ROA, indicating that higher credit risk and non-performing loans are associated with lower profitability. Conversely, the CAR shows a positive relationship with ROA, suggesting that well-capitalized banks tend to be more profitable. These findings underscore the importance of maintaining an optimal balance between lending practices and capital reserves to ensure financial stability and profitability.

The study underscores the complex interplay between credit activities, capital adequacy, and loan quality in determining the profitability of commercial banks in Nepal. While higher credit-deposit ratios and non-performing loans generally pose challenges to profitability, maintaining robust capital adequacy can mitigate some of these adverse effects. The findings suggest that Nepalese commercial banks need to adopt balanced strategies focusing on efficient credit management, stringent risk assessment, and maintaining adequate capital buffers to optimize their financial performance and enhance profitability. Future research could benefit from incorporating additional

variables and exploring broader macroeconomic factors to provide a more comprehensive understanding of profitability determinants in the banking sector

Policymakers and banking institutions in Nepal can utilize these insights to refine their strategic and operational approaches. Enhancing credit quality, improving risk management practices, and ensuring adequate capital reserves are crucial for boosting profitability and sustaining financial health. Additionally, ongoing regulatory developments and strategic adaptations are necessary to navigate the evolving market conditions and optimize performance in the sector. Future research should delve deeper into other potential determinants of profitability, such as non-interest income, operational efficiency, and market competition, to provide a more comprehensive understanding of the dynamics at play. By embracing continuous improvement and innovation, stakeholders can position Nepal's commercial banking sector for sustained growth and resilience in the face of dynamic market forces.

### **5.3 Implications**

The research study on the profitability determinants of commercial banks in Nepal offers several key implications based on its findings and analysis:

- The study provides a detailed examination of the financial performance of commercial banks in Nepal through the analysis of Earnings Per Share (EPS) and Return on Assets (ROA). By documenting the trends and patterns in these metrics over a ten-year period, it highlights the varying levels of profitability and operational efficiency within the Nepalese banking sector. This can serve as a benchmark for banks to evaluate their performance against industry standards.
- Through the regression analysis, the study investigates the relationship between critical financial ratios—Credit Deposit Ratio (CDR), Capital Adequacy Ratio (CAR), and Non-Performing Loans (NPL)—and profitability metrics (EPS, ROA). Although the results did not show statistically significant relationships overall, they provide a foundational understanding of how these variables interact and influence profitability. This can help banks recognize which areas might have latent impacts on their financial health and strategize accordingly.
- By highlighting the variations and trends in financial indicators such as CDR, CAR, NPL, EPS, and ROA, the study offers valuable insights for commercial banks and regulatory authorities. Banks with consistently low ROA or high NPL ratios, for instance, may need to enhance their risk management practices or revise their lending strategies to improve profitability and asset quality. This identification of weak spots is crucial for operational improvements and long-term strategic planning.

- The findings can inform policy decisions and strategic planning within the Nepalese banking sector. Regulatory authorities can leverage these insights to formulate policies aimed at strengthening capital adequacy standards, managing credit risk, and promoting overall financial stability. For example, stricter regulations on NPLs and improved oversight on capital adequacy might be necessary to mitigate risks and enhance bank resilience.
- The study fills a significant research gap in the context of Nepal by providing a comprehensive analysis of the interplay between CDR, CAR, NPL, EPS, and ROA. This contributes valuable data and insights to the existing body of literature on banking profitability in emerging markets, thereby offering a contextual analysis that addresses the specific dynamics of Nepalese banking institutions. Future researchers can build on this work to explore additional variables or utilize more advanced models to further understand profitability determinants.
- Bank managers can use the study's findings to make informed decisions regarding resource allocation, risk management, and strategic initiatives. Understanding the impact of credit deposit ratios and capital adequacy on profitability, for instance, can guide banks in optimizing their asset and liability management to achieve better financial outcomes.

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ABSTRACT This study examines the determinants of profitability in Nepalese commercial banks, focusing on the interplay between Credit Deposit Ratio, Capital Adequacy Ratio, Non- Performing Loans, Earnings Per Share, and Return on Assets. The research aims to bridge the existing research gap by providing a comprehensive analysis of these key variables and their influence on financial performance in the Nepalese banking sector. The study employs a quantitative research approach, utilizing secondary data from 2014 to 2024 for a sample of five commercial banks in Nepal. The analysis includes descriptive statistics, correlation analysis, regression models, and ANOVA to examine the relationships between the independent variables and the dependent variables, return on assets and earnings per share. The study finds that the Credit Deposit Ratio, Capital Adequacy Ratio, and Non-Performing Loans have significant positive and negative impacts on bank profitability, respectively. Additionally, the study highlights the importance of these variables in understanding the financial performance of commercial banks in Nepal. The findings of this study contribute to the existing literature on banking profitability in emerging markets, particularly in Nepal, by providing a detailed analysis of the