CHAPTER I

INTRODUCTION

1.1Background of the Study

Situated in the lap of Himalayan, Nepal is located in between the latitude 26^0 $22^{'}$ N to 30^0 27' North and longitude 80^0 40' E to 88^0 12' East, having 147.181 Square Km area and elevation ranges from 90 to 8848 m. The country is bordering between the two most populous countries of World, India in the east, south, west and China in the North. Nepal is a land locked country and home place of natural beauty with traces of artifacts.

Geographically, the country is divided in three Regions: Mountain, Hill and Terai. There are 5 development regions and 75 administrative districts. Districts are further divided into smaller units, called Village Development Committee (VDC) and Municipality. Currently there are 3915 VDCs and 58 Municipalities in the country. Each VDC is composed of 9 wards, Municipality wards ranges from 9 to 35 & Kathmandu is the capital city.

There are number of peaks, rivers and lakes in the country. Major peaks are the Mount Everest (8848m) the highest peak in the world, Mt Kanchanjangha (8586m) the third highest peak of the world and the second highest in the country, Mt Lhotse (8516m.) Mt Makalu (8463m.),Mt Choyou (8201m.), Mt Dhawalagiri (8167m.), Mt Manaslu (8163m.),Mt. Annapurna (8091m.), Mt. Gaurishnaker (7134m.), Mt. Machhapurchhre (6996m.) and many other gracious peaks. Not only this but also Nepal has eight World Heritage Sites which are Lumbini, Chitwan National Park, Sagarmatha National Park, Pashupatinath, Swayambhunath, Bauddhanath, Changu Narauan, Kathmandu Durabar Square, Bhaktapur Durabar Square and Patan Durabar Square.

Nepal is one of the least developed countries in the World. More than 80 % of the total people are still in the rural areas and most of them are deprived from the minimum requirement of human livelihood. In Nepal still 31 % of people are under the line of poverty, having 2.25 growth rate of population and average life expectancy of Nepalese people is 62.2 years

The evolution of banking industry had started a long time back, during ancient times. There was reference to the activities of moneychangers in the temple of Jerusalem in the New Testament.

In ancient Greece the famous temples of Delphi and Olympia served as the great depositors for peoples' surplus fund and these were the center of money lending transactions. Indeed the traces of "rudimentary banking" were found in the Chaldean, Egyptian and Phoenician history. The development of banking in ancient Rome roughly followed the Greek pattern. Banking suffered oblivion after the fall of the Roman Empire after the death of Emperor Justinian in 565 A.D., and it was not until the revival of trade and commerce in the middle Ages that the lessons of finance were learnt a new form the beginning. Money lending in the middle Ages was, however, largely confined to the Jews since the Christians were forbidden by the Canon law to indulge in the sinful act of lending money to others on interest. However, as the hold of the Church lossened with the development of trade and commerce about the thirteenth century Christians also took to the lucrative business of money lending, thereby entering into keen competition with the Jews who had hitherto monopolized the business.

As a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy and the Bank of Venice, founded in 1157 was the first the public banking institution. Following it were established the Bank of Barcelona and the Bank of Genoa in 1401 & 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate until the eighteen century. With the expansion of commercial activities in Northern Europe there sprang up a number of private banking housed in Europe and slowly it spread throughout the world.

In context to Nepal, the development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. In Nepalese chronicle, it was recorded that the new era known as Nepal Sambat was introduced by Shakhandhar, a Sudra Merchant of Kantipur in 879 or 880 A.D. after having paid all the outstanding debts in the country. This shows the basic of money lending practices in ancient Nepal. However, in the absence of any regulatory measure, the unscrupulous Moneylenders were known to have charged exorbitant rates of interest and other dues on loans advanced. The establishment of "Tejarath Adda" during the year 1877 AD was fully subscribed by the government of Kathmandu valley, which played a vital role in the banking system. Later on in 1936 AD the "Udyog Parisad" and in 1937 AD the "Company Acts" & "Nepal Bank Act" formulated and the development of banking sector flourished.

In any economy, the importance of financial sector in general and banking sector in particular cannot be undermined. Banking sector definitely plays a pivotal role in the overall development of an economy. The economy reforms initiated by the Government more than decade ago have changed the landscape of several sector of the Nepalese economy. The Nepalese banking sector is no exception. This sector is going through major changes as a consequence of economic reforms. The changes affect the ownership pattern of banks, regulatory aspects, availability of funds, the cost of funds as well as opportunity to earn, range of services (fee-base & fund base), and management of priority sector lending.

Different organizations are established for different motives. Some are established by profit motives while others are Service Motive (Humanitarian Organization). So for the Profit Motive Organization it is very important to earn or generate profit from its daily operational activities, if not, then it will be vanished from the competitive market sooner or later. The new private sector banks, reached a remarkable position due to its high level of technology, core banking and aggressive marketing strategies. Talking about the Banks, economic development of any country is mainly influenced by the growth of banking industry in that country. In worldwide, finance industry is considered highly flexible and risky and so they are under the strict control of regulatory authorities. In Nepal, the monitoring authority, Nepal Rastra Bank, has formulated and implemented the guidelines to safe guard the interest of the both parties (Customers and Investors) under which banks has to operate. Also, Following the Basel I and II accords for which many countries are members calls for a healthy banking system in the world. To have global standards, Now CAMEL model is an internationally accepted tool for evaluating performance and predicting bank failures. CAMEL stands for Capital Adequacy, Asset Quality, Management Quality, Earnings Quality and Liquidity. It is considered as the best available method for evaluating bank performance and healthy position of the bank since it considers all areas of banking operations.

It is not always important to say that this bank is good than that bank on the basis of its one or two years profit. Rather, than we have to look overall aspect of the bank and have to analyze the past performance as well. Profit may serve as the main basis for any organization in the short run but in the long run, activities that are done to generate the profit for short run may be the reason for the failure of that organization. So it is really important to know "How efficiently the business is managed in the short run as well as for the long run?" While regarding the

commercial banks the latest and widely used tools to analyze the banks overall performance is known as "CAMEL Analysis".

1.2 Introduction of the Organization

EVEREST BANK LIMITED (EBL)

Everest Bank Limited (EBL) started its operation in 1994 with a view and objectives of extending professionalized and efficient banking services to various segments of the society. Its joint venture partner, Punjab National Bank (PNB), (holding 20% equity in the bank) is the largest nationalized bank in India having 112 years of banking history. The bank is providing customer friendly services through a network of 26 branches in Nepal.

Against the Paid-Up Capital by shareholders of Rs. 37.80 corer, the shareholders' funds now amount to Rs. 119.87 crore – with Core Capital base of Rs. 81.67 corer. The local Nepalese Promoters hold 50% stake in the Banks equity, while 20% of equity is contributed by joint venture partner PNB whereas remaining 30% is held by the public.

EBL was one of the first banks to introduce Any Branch Banking System (ABBS) in Nepal. It has introduced Mobile Vehicle Banking system to serve the segment deprived of proper banking facilities through its Birtamod Branch, which is also the first of its kind.

The bank was bestowed with the "NICCI Excellence award" by Nepal India chamber of commerce for its spectacular performance under finance sector. This bank has been conferred with *"Bank of the Year 2006, Nepal"* by the banker, a publication of financial times, London.

The main and best features of this bank are:

- One of the Largest Network among private sector banks spread across Nepal and all connected with ABBS.
- Strong Joint Venture Partner providing Technical Support.
- Representative office in India to facilitate remittance from India.
- Direct Drawing arrangement with PNB and HDFC bank India whereby instant payment is done on presentation of the instrument.

- Direct account credit in PNB branches connected with Central Banking System and RTGS member banks via speed remittance. More than 126 remittance payout location in Nepal.

EBL in association with Smart Choice Technology (SCT) is providing ATM service to its customers through more than 74 ATMs and over 850 Point of Sales across the country. ATM sharing arrangement with Punjab National Bank has facilitated usage of EBL Debit Card at more than 1000 PNB ATM outlets across the India at a nominal rate. Similarly, Indian tourists and businessmen having PNB cards will be able to use EBL ATM, while in Nepal

EBL is playing a pivotal role in facilitating remittance to and from across globe. Being the first Nepalese bank to open a representative office in Delhi, India, the Nepalese in India can open account in Nepal from the designated branches of Punjab National Bank and remit their saving economically through banking channel of Nepal. With India Remit, the Bank has same day remittance facility with India with association of PNB's 2200 networked branches at 550 locations, besides draft drawing arrangement with 280 PNB branches across India. The Bank is also offering Cash Management System through HDFC Bank., India for managing the funds of corporate exporting to India by collecting their fund from about 183 locations in India. The Bank's own Web based online remittance product "Everest Remit" facilitates remittance from Malaysia, Doha, UK, Bahrain, UAE and Qatar to more than 126 payout location in Nepal.

Services that the bank is providing currently are:

- Deposit

Current Account	Sunaulo Bhavishya Yojana
Saving Account	Saral Samriddhi Bachat
Saving Premium Account	Unfixed Fixed Deposit Scheme
Deposit Fixed Account	USD Account
Cumulative Deposit Scheme	EBL NRN Deposit

- Loan and Advance

Home Loan	EBL Property Plus
Home Equity Loan	Professional Loan Scheme
Vehicle Loan	Professional Loan Scheme
Education Loan	Loan Against Shares
Loan against Mortgage	

- FC Deposits/Lending
- Trade Finance Activities
- Remittance Facilities
- Foreign Exchange
- Facilities For NRN
- Other Facilities

KUMARI BANK LIMITED (KBL)

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. Kumari Bank Ltd has been providing wide - range of modern banking services through 16 points of representations located in various urban and semi urban part of the country, 11 outside and 5 inside the valley.

The bank has Authorized Capital of Rs. 1,600,000,000.00 and Issued & Paid-Up Capital of Rs. 900,000,000.00. Out of paid up capital of Rs. 900 million, 70 % is contributed from promoters and remaining 30%from public.

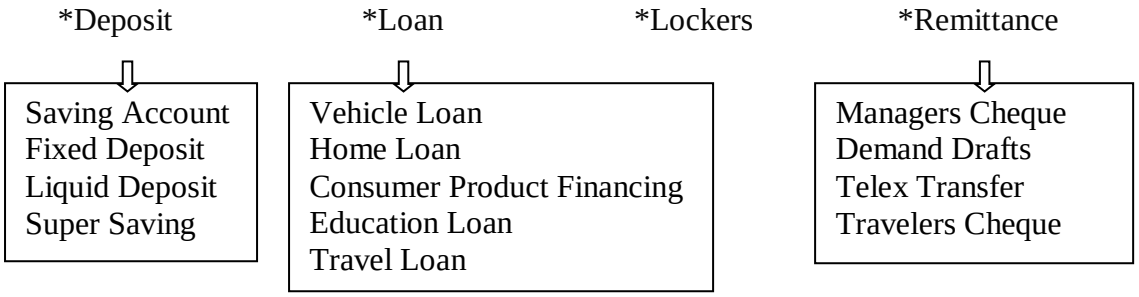
The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured

transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, utility bill payment services, inward and outward remittance services, and various other banking services.

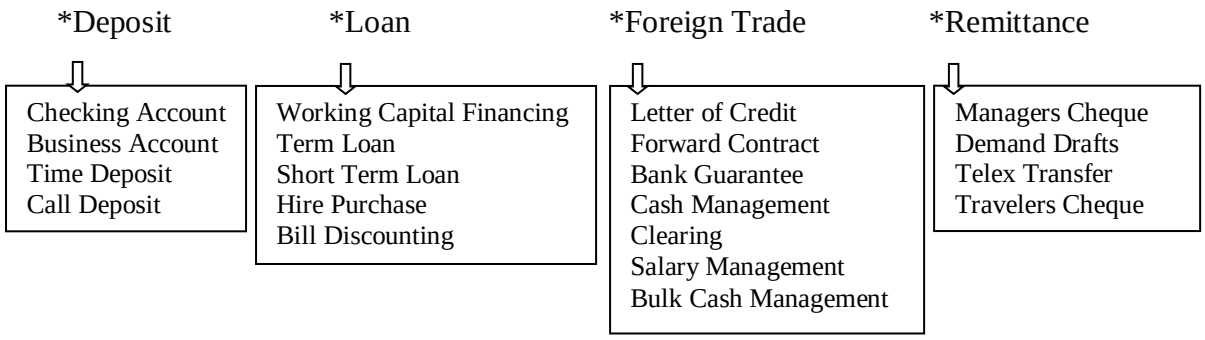
Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 14 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers.

Kumara Bank Limited has divided all its service under four banking activities and under each banking activities it provides different services to different customers which are presented below:

- Personal Banking



- Business Banking:



- Convenience Banking
  - *Evening Banking
  - *Week end Banking

- E- Banking
  - *Internet Banking
  - *Mobile Banking
  - *Utility Bill Payment

The missions of the bank are

To Provide world class service so that our customers at a higher satisfaction level.

To Practice total quality management and embrace good governance.

To Optimize our assets to achieve sound business growth.

The visions of the bank are

We are customer oriented. Client is always our first priority.

Employees have direct input and control over work processes.

Employees are treated equitably, with respect and good faith.

We are transparent in our dealings and conduct.

SIDDHARTHA BANK LIMITED (SBL)

Siddhartha Bank Limited (SBL) commenced operations in 2002. The Bank was promoted by a group of highly reputed Nepalese dignitaries having wide commercial experience. This bank provides a full range of commercial banking services through our seven branches established in Kathmandu, Birgunj, Biratnagar, Pokhara and Damak.

The bank has Authorized Capital of Rs. 1,000,000,000.00 and Issued & Paid-Up Capital of Rs. 600,000,000.00. Out of paid up capital of Rs. 600 million, 70 % is contributed from promoters and remaining 30% from public.

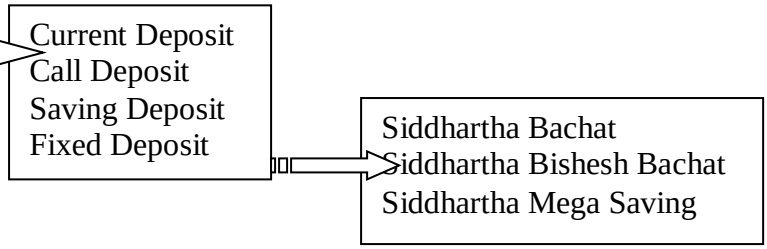
Siddhartha Bank Limited also has offered different ranges of products to its customers which are presented below:

Vision of Siddhartha Bank Limited:

SBL's vision is to be financially sound, operationally efficient and keep abreast with technological developments. The Bank firmly believes customer focus is a core value, shareholder prosperity is a prime priority, employee growth is a commitment and economic welfare is a sincere concern.

Siddhartha Bank Limited also has offered different ranges of products to its customers which are presented below:

- Corporate Banking
  - Deposits
  - Business Loan
  - Trade Finance
  - Bank Guarantee
  - Treasury Operations



- Personal & Retail Banking
  - Siddhartha Home Loan
  - Siddhartha Vehicle Loan
  - Siddhartha Education Loan
  - Siddhartha Personal Loan
  - Loan against Fixed Deposit Receipt

- Remittance
  - Demand Draft
  - Telegraphic Transfer (TT)
  - SWIFT
  - Western Union Money Transfer
  - Sale or Purchase of Foreign Currency
  - Travelers Cheque
  - Managers Cheque

- Siddhartha i Connection
  - Balance Inquiry
  - Fund Transfer
  - Transaction History
  - Cheque Inquiry
  - Access to Multiple Accounts
  - Request for Cheque Book
  - Stop Payment Request
  - Message / Email
- Cash Management

- Other Services
  - Debit / ATM Card
  - Safe Deposit Locker
  - Evening Banking
  - Holiday Banking
  - ABBS (Any Branch Banking Service)

The Vision statement of the Bank describes the core values and purposes that guide the Bank as well as an envisioned future. Fundamentally, in all dealings SBL earnestly believes in transparency, financial soundness, efficiency and better technology.

Vision of Siddhartha Bank Limited:

SBL's vision is to be financially sound, operationally efficient and keep abreast with technological developments. The Bank firmly believes customer focus is a core value, shareholder prosperity is a prime priority, employee growth is a commitment and economic welfare is a sincere concern.

Mission of Siddhartha Bank Limited

The Bank wants to be a leader among the banks of its age in Nepal by fulfilling the interest of the stakeholders and also aims to provide total customer satisfaction by way of offering innovative product and by developing and retaining highly motivated and committed staff. It directs all its efforts to move ahead with increased profits. The following mission statement is a guide to meet the Vision of the Bank:

- As a first step, SBL will strive to be in a leading position amongst the banks of its age in terms of profitability, productivity and innovation
- SBL aims at total customer satisfaction by rendering efficient and diversified financial services through improved technology.
- SBL will build a highly motivated and committed team of staff by nurturing a good work culture to achieve superior individual performance aiming to enhance organizational effectiveness.
- SBL will be the place of pride to all its stakeholders

1.2Focus of the Study

This research is mainly focus on the CAMEL analysis of Everest Bank Limited, Siddhartha Bank Limited and Kumari Bank Limited. A wide range of indicators is available for reporting by FIs before the CAMEL Analysis tools are generally not appropriate for assessing all FI performance. So, originally CAMEL method was devised as a supervision tool. The most important criteria for determining the appropriateness of an FI to act as a financial intermediary are its solvency, profitability, and liquidity. So this study is mainly focused on risk associated with the bank, mainly Liquidity Risk and Credit Risk.

1.3 Statement of Problem

The main objective of Financial Institution is to increase its returns for its owners. But to generate the increase return or profits, banks also have to take high risks. Such risks may be: Credit Risk, Liquidity Risk, Interest Rate Risk, Market Risk, Off- Balance Sheet Risk, Foreign Exchange Risk, Country Risk, Technology Risk, Operational Risk and Insolvency Risk. In context to Nepal, Government owned banks were almost running in loss due to not following proper guidance set by Nepal Rastra Bank and as there is Government to fulfill those losses but now these banks have posted profit. Although, the private sector banks are making profit while facing those above mentioned risks, it is very important that all the Financial Institutions manage these risks and follow appropriate policies, processes or practices to avoid unpleasant situation. Otherwise, it will be very costly to the depositors, creditors, owners and national economy as a whole.

The elementary problem of this research is to analyze the financial condition of Everest Bank Limited, Kumari Bank Limited and Siddhartha Bank Limited in the framework of CAMEL and is an attempt to come back with the following research question:

- How well the above banks are managing its Capital Adequacy? Is it in line with the regulated minimum capital requirement or is it sufficient to safeguard the depositors?
- What is the trend of Asset Composition? What is the position of Risk Weight Asset of above mentioned bank in the Balance Sheet?
- How the bank is managing its loan? What is the condition of Good loans and Bad loans? Is there enough loan loss provision to cover up Bad Loans?
- How well is the bank's management? What control and monitoring mechanism are maintained in the bank?
- What are the level, trend and stability of earning with respect to its assets and capital?
- What is the liquidity position? What are the sources and volume of liquid assets?
- How changes in interest rates can affect each bank's earning?

1.4 Objectives of the Study

Analysis of different data published to public by the above mentioned banks of Nepal in their financial pictures is the main objective of this study. After the analysis and matching those results and comparing it to the guidance set by Nepal Rastra Bank and also to each other and making recommendations on following aspects are also objective of this study on specific terms.

- To analyze and compare the Capital Adequacy with reference to Risk Weight Assets
- To analyze Quality of Assets and determined how efficiently the loans are disbursed and managed.
- To find out the efficiency of Management.
- To evaluate the level, trend and stability of the Earning in terms of Capital and Assets.
- To determine whether liquidity is managed as per the NRB Guidance or not.

1.5 Important of the Study

A part from aiming to gain knowledge, research itself adds new to the existing literature. The significant of this study lies mainly in identifying problem or deteriorating Financial Institution, as well as for categorizing institution with deficiencies in particular component areas. Further, it assists in following safety and soundness trends and assessing the aggregate strength and soundness of the financial industry. The study bears much usefulness to carious parties as mentioned below:

To the Management:

Management always wants to know the financial viability of the bank. This study will be helpful to go deeply in to the various matters as to why the performance of their bank is better or worse than other joint venture banks. The management will know about their loose areas and gaps, which can be corrected in future.

To the Share Holders:

Shareholders also want to know whether their funds are in safe hands or not. In other words, how their funds are utilizing and what extent they are gaining. The outcome of this study will help them to identify the productivity of their scarce sources.

To the Others:

Other refers to those all interested group except the management and shareholders such as depositors, investors, competitors, merchant bankers, creditors. This analysis will help them to know about the banks positions and can make their decisions regarding whether to deposit, finance, and invest or not. Moreover, policy makers such as governing authority, government and tax officials, security exchange board, Nepal stock exchange can also be benefited or informed which helps then in formulating policies regarding joint venture banks. This research can be useful materials to students & researchers also.

1.6 Limitation of the Study

This research proposal is conducted to fulfill the academic requirement of Master of Business Studies. The study is bounded in certain limitation, which are as follows:

- The evaluation made herein is taken of only three samples.
- The study covers the data of five years only.
- The study mostly and mainly based on the secondary sources of data and information and the accuracy of the study is based on the data available from the annual report published by the respective banks.
- The study focuses on the financial analysis if the study unit in the framework of six component of CAMELS Analysis.
- Being a student resource constraint such as time, finance and other resources have limited the scope of the study.

1.7 Scheme of Study

This study has been comprised into five chapters. The titles of each these chapters and the contents of each of these chapters of this study are summarized below:

Chapter 1: Introduction

This chapter deals with the subject matter consisting Background, Focus of the Study, Statement of Problem, Objectives of the Study, Significant of the Study, Limitation of the Study of Everest Bank Limited, Kumari Bank Limited and Siddhartha Bank Limited.

Chapter 2: Review of Literature

The second chapter, Review of literature deals with review some work analysis and discussion already made in CAMEL Analysis.

Chapter 3: Research Methodology

This chapter includes the research methodology adopted in carrying out the present research. It deals with Research Design, Sources of Data, Data Collection Procedure, Data Processing, Data Analysis Tools and Limitation of the Methodology.

Chapter 4: Presentation and Analysis of Data

The fourth chapter is concerned with analytical frameworks. It includes the analysis of Financial Statement of Everest Bank Limited, Kumari Bank Limited and Siddhartha Bank Limited under the framework of CAMEL and comparing it with the guidelines set by Nepal Rastra Bank and also to each other.

Chapter 5: Summary, Conclusion and Recommendation

This is the last chapter, which consists of the suggestive framework that consists with the overall findings, issues and gaps, conclusion and recommendations of the study.

CHAPTER II

REVIEW OF LITERATURE

Introduction

This chapter focuses on the concept of commercial bank, bank supervision, CAMELS rating system and review of research papers and dissertations. The basic concept of the functions of commercial bank, objective of bank supervision and detailed evaluation criteria of the components of CAMELS are reviewed in this chapter. Besides these, current stage of the related research work and dissertations on the research work have been reviewed and summed up.

2.1 Conceptual Framework

This section presents the theoretical aspect of the study, which includes the concept of commercial banks, functions of commercial bank, concept of CAMEL rating system.

2.1.1 Meaning and Definition of Bank

A bank is an institution, which deals in money, receiving it on deposit from customer; honoring customer's drawing against such deposit on de4mand, collecting cheques for customers and lending or investing surplus deposit until they are required for repayment. Generally, an institution established by law, which deals with money and credit is called bank. It is obvious that in a common sense, an institution involved in monetary transaction is called bank. A bank simply carries out the work of exchanging money, providing loan, accepting deposits and transferring the money. Section 2(a) defines bank, which is established under the existing law shall be called bank.

Different scholars have presented the definition or meaning upon the bank and they varies. Here are the some renowned scholar's that most of them have defined bank as follows:

"I believe in that fact the banks are not merely purveyors of money, but also in an important sense; manufactures of money". ***R.S Sayers***

"Bank is a manufacture of credit and machine so facilitating exchanges". ***Horace White***

"A bank is an institution which collects money from those who have it spare or who are saving it out of their income and lends this out who requires it". ***G. Crowther***

"A bank is established for the custody of money received from or on behalf of its customers, it's essential duty is to pay their draft on it, its profit arises from its use of the money left unemployed by them". ***Shorter Oxford English Dictionary***

"A banker is defined as an individual, partnership or corporation, whose sole or predominating business is banking, that is, the receipt of money on current or deposit account, and the payment of cheques pain in by a customer" ***Halsbury's Laws of England***

"A person or company carrying on the business of receiving money and collecting draft, for customer subject to the obligation of honoring cheques drawn upon them from time to time by the customer to the extent of the amounts available on their current account". ***Dr. Hart***

2.1.2 Concept of Commercial Bank

According to the Black's Law Dictionary "Commercial Bank" means a bank authorized to receive both demand and time deposits, to engage in trust services, to issue letter of credit, to rent time-deposit boxes, and to provide similar services.

Likewise ***Section 2(a) of the Commercial bank Act 2031 (1974)*** has defined that "Commercial Bank" means a bank which operates currency exchanges transactions, accepts deposits, provides loan; performs, dealing, relating of commerce except the banks which have been specified for the co-operatives, agricultural, industry of similar other specific objective.

Upadhaya and Tiwari (1998) stresses that the commercial bank is established with a view to provide short term debt necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surplus in the form of deposit, lending debts by discounting bills etc.

In the same way, ***Abrol and Gupta (2002)*** explain that principally a commercial bank accepts deposits and provides loans primarily to business firm. On the other hand, the broad concept of commercial bank holds that the commercial bank is a banking institution other the central bank. The commercial bank is the only institution other than central bank permitted to accept demand and time deposits (Cross, 1963).

So, Commercial banks are the important source of institutional credit in the money market. A commercial bank is a profit-seeking business firm, dealing in money or rather dealing in claims to money. It is a FI that creates deposits liabilities which circulates as money unlike the deposits of other FIs. In fact, the greater part of money supply is the direct consequence of the profit-seeking or money-creating activities of commercial banks.

A commercial bank is an institutional that operates for profits. Like other industrial or commercial enterprise, a bank too, seeks to earn maximum income through the suitable employment of its resources. It is a financial intermediary-a sort of a middleman between people with surplus funds and people in need of funds. It accepts deposits for the purpose of lending or investment and thereby hopes to make a profit-profits which are adequate enough to enable the bank to pay interest at the prescribed rates to its depositors, meet establishment expenses, build reserves, pay dividend to the shareholders, etc. in general, commercial banks are those FIs, which play the role of financial intermediary in collection and disbursement of funds surplus unit to deficit unit.

2.1.3 Functions of Commercial Banks

Commercial banks are directly related with the people and institution. Although these banks are truly inspired with the objective of gaining profit, these commercial banks are also established to, to accelerate common people's economic welfare and facility, to make available loans to agriculture, industry and commerce and to provide the banking services to the public and the state.

Kohn (2004) states that the basic business of banking is a combination of two functions-payments and financial intermediation and has however, changed and continues to change along three dimensions: entry of new institutions into banking, as new forms of lending and borrowing are developing the intermediation function is evolving; and other related functions to the basic ones are being added. The commercial banks in Nepal provide the following main banking functions

Accepting Deposits: This is the oldest function of a bank in which the banker charged commission for keeping the money in its custody. Now a day a bank accepts three kinds of deposits from its customers. The first is the 'savings' deposits on which the bank pays interest relatively at low rate to the depositors. Depositors are allowed to withdraw their money by cheque up to a limited amount during a week or a year. Businessmen keep their deposits in current accounts known as demand deposits. They and can withdraw any amount available in their current account by tuque without notice. The bank does not pay interest on such accounts. A bank accepts fixed or time deposits from savers who do not need money for a stipulated period form 6 months to longer periods ranging up to 10 years or more.

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

Cash Credit: The bank advances collateral based loans to businessmen. The amount of the loan is credited to the current account of the browser.

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

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

Overdraft: A bank allows the browser to over draw his current account upto a sum equal to the loan sanctioned.

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

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

Foreign Trade Operation: A commercial bank finances foreign trade of its customers by accepting foreign bills of exchange business-buying and selling of foreign currency.

Agency Services: A bank acts as an agent of its customers while collecting and paying cheques, bills of exchange, drafts, dividends etc. It also buys and sells shares, securities,

debentures etc. for its customers. Further, it pays subscriptions, insurance premium, utilities bills and other similar charges on behalf of its clients. It also acts as a trustee and executor of the property and will of its customers. Moreover, the bank acts as consultants to its clients. For these services, the bank charges a normal fee while it renders others free of charge.

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

2.1.4 Bank Supervision

Tuning with the present scenario of globalization and increased economical activities in the country, commercial banks are now introducing complex and innovative banking products. This has amplified as well as diversified the functions to be performed by the Bank supervision Department. This section deals with the concept of bank supervision, objective of bank supervision and the process of supervision.

2.1.4.1 Concept of Bank Supervision

The success of the banking system helpless without an effective and efficient risk management of it operation. As commercial banks are now involved in complex and innovative banking products they are exposed to many risks. The Board of Governors of the Federal Reserve System defined six safety and soundness risks in SR Letter 95-51, issued in November 1995. These risks are defined as follows:

- Credit Risk arises from a potential borrower failing to perform on an obligation.
- Market Risk is the risk of FI's condition resulting from adverse movements in market interest rates or prices.
- Liquidity Risk is the potential that an institution will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding.

- Operational Risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or unforeseen catastrophes will result in unexpected losses.
- Legal Risk arises from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations or condition of a banking organization.
- Reputational Risk is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation or revenue reductions.

There is no theoretically optimal system or standard textbook blueprint for the structure and process of regulating and supervising FI's including banks. In fact, arrangements for banking regulation and supervision differ considerably from country to country. Apart from differences in political structures, the most important factors that account for the differences in regulatory and supervisory approaches included the general complexity and state of development of the financial system, the number, size and complexity of banking institution, the relatives openness of the domestic financial system, the nature and extent of public disclosure of banks' financial positions and the availability of technological and human resources for regulation and supervision.

However, an implicit framework for the regulation and supervision of banks can be found in the *Core principles for Effective Banking Supervision* issued by the Basel Committee on Banking Supervision in 1997. The framework can be interpreted as comprising four distinct yet complementary sets of arrangements:

- Legal and Institutional Arrangements for the formulation and implementation of public policy with to the financial sector, and the banking system in particular,
- Regulatory arrangements regarding the formulation of laws, policies, prescription, guidelines or directives applicable to banking institution(e.g. entry requirements, capital requirements, accounting and disclosure provisions, risk management guidelines);
- Supervisory arrangements with respect to the implementation of the banking regulations and the monitoring and policing of their application;

- Safety arrangements providing a framework for the handling of liquidity and solvency difficulties that can affect individual banking institution of the banking system as a whole and for the sharing of financial losses that can occur (e.g. deposit insurance schemes or winding-up procedures).

2.1.4.2 Objectives of Banking Supervision:

With respect to the supervisory arrangements the core principle describe what could be termed a "cradle to grave" approach covering potential problem that may emerge in the future on account of the current risk profile of the banking institution, overall, supervisory risk assessment and early warning systems assist in

- Systematical assessment of banking institution within a formalized framework both at a time of on-site examination and in between examinations through off-site monitoring;
- Identification of institution and areas within institutions where problems exist or are likely to emerge;
- Prioritization of bank examinations for optimal allocation of supervisory resources and pre-examination planning; and
- Initiation of warranted and timely action by the supervisory.

2.1.4.3 Process of Bank Supervision

Ongoing banking supervision consists of a differentiated mix of Off-site monitoring procedures and On-site monitoring procedures. Off-site monitoring is the minimum tools for ongoing supervision. Supervisory authorities which so not have the mandate of resources to carry out periodic onsite examinations, rely extensively on this method to monitor the financial condition and performance of banks and to identify those institutions that may need closure scrutiny. The process involves analyzing and reviewing periodic financial and other information received by the supervisor relating to banks' activities. Supervisors typically subject regulated banks to reporting requirements covering, for instance balance sheet and profit and loss statements, business profile, loans, investments, liabilities, capital and liquidity levels, loan loss provisions, etc.

During on-site examinations, supervisors make an overall assessment of a banking institution on the premises of the organization. Examinations be specialized and trained bank examiners allow a more hands-on assessment of qualitative factors such as management capabilities and internal control procedures that may not be reflected adequately in regulatory reports. Supervisory authorities may also commission outside organization such as external auditors to undertake a full on-site examination or to review specific areas of operations within a banking institution.

Of course, external auditors also conduct independently, annual statutory audits of the accounts of a banking firm as well as the firm's compliance with accounting procedures and best practices. In principle, this should provide the supervisor with an additional assurance that the accounts of a bank provide a true and fair view of the bank's financial position. In many cases, bank examiners will pay particular attention to these audit reports and to the ways in which banks deal with recommendations formulated by their external auditors.

2.1.5 Concept of "CAMELS" Banking Rating System

Federal Reserve Bank of New York (1997) has defined the component of CAMEL as rating system which produces a composite rating of an institution's overall condition and performance by assessing five components: Capital adequacy, Assert quality, Management administration, Earnings, and Liquidity.

CAMEL was originally developed by the FDIC for the purpose of determining when to schedule an on-site examination of a bank (Thomson, 1991; Whalen and Thomson, 1998). The FFIEC is revised in January 1997, the DFURS, which is commonly referred to as the CAMEL rating system. This system was designed by regularly authorities to quantity the performance and the financial condition of the banks which it regulates. The CAMELS rating system is subjective. Benchmarks for each component are provided, but they are guidelines only, and present essential foundations upon which the composite rating is based. They do not eliminate consideration of other pertinent factors by the examiner. The uniform rating system provides the groundwork for necessary supervisory response and helps institutions supervised by all three US supervisors to be reasonably compared and evaluated. Ratings are assigned for each component in addition to the overall rating of a bank's financial condition. The ratings are assigned on a scale from 1 to 5. The CAMELS

ratings are commonly viewed as summary measures of the private supervisory information gathered by examiners regarding banks' overall financial conditions, although they also reflect available public information.

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

During an on-site bank exam, supervisors gather private information, such as details on problem loans, with which to evaluate a bank's financial condition and to monitor its compliance with laws and r regulatory policies. A key product of such an exam is a supervisory rating of the bank's overall condition, commonly referred to as CAMELS rating. CAMELS rating system is used by the three federal banking supervisors [the Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency (OCC)] another financial supervisory agencies to provide a convenient summary of bank conditions at the time of an exam. In Nepal, the NRB plays the supervisory role for evaluating bank's financial condition though rating the bank's in accordance to CAMELS is still in its initial phase.

Composite Ratings

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

profile; and the greatest supervisory concern. The composite ratings are defined in the FFIEC press release (1996) is as follows:

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

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

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

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

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

2.1.6 CAMEL Components

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

2.1.6.1 Capital Adequacy

Bank capital performs several important functions. Most importantly they are:

Absorbs Losses: Capital allows institutions to continue its operations when operating losses or other adverse financial results are experienced.

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

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

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

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

- The Tier 1 Risk-Based Capital Ratio
- The Total Risk-Based Capital Ratio
- The Tier 1 Leverage Ratio

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

- Size of the bank
- Volume of inferior quality assets
- Bank's growth experience, plans and prospects
- Quality of capital Retained earnings
- Access to capital markets
- Non-ledger assets and sound values not shown on books (real property at nominal values, charge-offs with firm recovery values, tax adjustments).

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

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

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

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

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

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

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

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

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

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

Ratings Capital Component

- A rating of 1 indicates a strong capital level relative to the institution's risk profile.
- A rating of 2 indicates a satisfactory capital level relative to the FIs risk profile.
- A rating of 3 indicates a less than satisfactory level of capital that does not fully support the institution's risk profile. The rating indicates a need for improvement, even if the institutions' capital level exceeds minimum regulatory and statutory requirements.
- A rating of 4 indicates a deficient level of capital. In light of the institution's risk profile, viability of the institution may be threatened. Assistance from shareholders or other external sources of financial support may be required.
- A rating of 5 indicates a critically deficient level of capital such that the institution's viability is threatened. Immediate assistance from shareholders or other external sources of financial support it required.

A FI is expected to maintain capital commensurate with the nature and extend of risks to the institution and the ability of management to identify, measure, monitor, and control these risks. The effect of credit, market, and other risks on the institution's financial condition

should be considered when evaluating the adequacy of capital. The types and quantity of risk inherent in an institution's activities will determine the extent to which it may be necessary to maintain capital at levels above required regulatory minimums to properly reflect the potentially adverse consequences that these risks may have on the institution's capital.

2.1.6.1.1 BASEL Capital Accord

The Basel Committee on Banking Supervision (BCBS) is a committee of banking supervisory authorities that was established by the central bank governors of the Group of Ten countries in 1975. It consist of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. It usually meets at the Bank for International Settlements (BIS) in Basel, where its permanent Secretariat is located. (BIS, November 2005) starting with it publication of "International Convergence of Capital Measurement and Capital Standards" in July 1988, popularly known as Basel I Capital Accord, BCBS set out a minimum capital requirement of 8% for banks. Prior to that, the committee introduced 25 core principles on effective banking supervision. In 1996, the committee incorporated market risk in the 1988 capital accord. With a major revision of the 1988 accord, there followed by the revised publication of the Committee's first round of proposals for revising the capital adequacy framework in June 1999 popularly known as Basel II Capital Accord. Since then, it is revised in January 2001, April 2003 and released its final revised its final revised framework updated in November 2005. In this accord, the concept and rationale of the three pillars (minimum capital requirements, supervisory review, and market discipline) approach was introduced, on which the revised framework is based. In the revised framework BCBS retains key elements of the 1988 capital adequacy framework, including the general requirement for banks to hold total capital equivalent to at least 8% of their risk-weighted assets; the basic structure of the 1996 Market Risk Amendment regarding the treatment of market risk; and the definition of eligible capital. (BIS, 2005)

The new Basel capital accord (Basel II), shall be applicable to internally active banks all over the world with effect from end of 2006. Implementing the new accord in Nepal has been a challenging task for the supervisors as well as FIs. Hence, certain preparatory

homework is needed to Nepalese financial system to implement BASEL II. NRB and FIs need to have coordinated effort efficiently in Nepalese banks and FIs to establish certain baseline for the effective implementation of BASEL II. In this regard, second interaction program was held in Nepal with the banks executives to make them aware of the new development. The commercial banks so far has shown positive attitude towards the implementation of Basel II. "New Capital Accord Implementation preparatory Core Committee" was drafted "NRB's Concept Paper on New Capital Accord". According to the program of New Capital Accord implementation, concept paper was forwarded to all the commercial banks for comments and recommendations. A form was also developed so that commercial banks classify their exposures as per the new approach, which was reviewed by the "Basel-II Implementation Working Group". NRB has adopted Basel Core Principles for effective Supervision as guideline for supervision of commercial banks. Core principle methodology adopted by BCBS provides a uniform template for both self-assessment and independent assessment. It involves four part qualitative assessment system: Complaint, Largely Complaint, Materially Non-Complaint, and Non-Complaint. For each principle essential and additional criteria are defined. To achieve a "complaint' assessment with a principle, all essential and additional criteria must be meet without any significant deficiencies. A "largely complaint" assessment is given if only minor shortcoming are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially non-complaint assessment is given when the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance, but substantial progress has been made. A "non-complaint" assessment is given when no substantial progress towards compliance has been achieved.

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

2.1.6.1.2 Capital Adequacy Norms by NRB

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

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

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

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

i. Rs. 250 million to operate all over Nepal except Kathmandu Valley.
ii. Rs. 1000 million to operate all over Nepal.
iii. All existing commercial banks are required to raise capital base to Rs. 1000 million by mid July, 2009 through minimum 10 percent paid-up capital increment every year.

Generally, the capital measurement tool is basically represented by a ratio of primary capital to assets (Estrella, et al., 2000; Tam and Kiang, 1992; Elliott, 1991; Looney et al., 1989; Lane e t al., 1986; Martin, 1977). Estrella et al. (2000) utilized three measures, including a more complex weighted measure, but found the simple measures of capital were relatively good explanatory power over short time horizons, while risk-weighted ratios provided relatively better explanatory power over longer horizons. Eccher et al. (1996), Thomson (1991), Whalen (1991) and Sinkey (1978) employed an analogous ratio definition, but with a refinement to adjust for loan losses, which theoretically would account for some portion of related risk in the asset portfolio (Cantor, 2001).

2.1.6.2 Assets Quality

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

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

2.1.6.2.1 Evaluation of Asset Quality

The evaluation of asset quality should consider the adequacy of the allowance for loan and lease losses (ALLL) and weight the exposure to counter-party, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including, but not limited to, operating, market, reputation, strategic, or compliance risks, should also be considered. Prior to assigning an asset quality rating, several factors should be considered. The factors should be reviewed within the context of any local and regional conditions that might impact bank performance. In addition, any systematic weaknesses, as opposed to isolated problems, should be given appropriate consideration. The following is not a complete list of all possible factors that may influence an examiner's assessment; however, all assessment should consider the following:

- The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices,
- The level, distribution, severity, and trend of problem, classified, on accrual, restructured, delinquent, and non-performing assets for both on- and off- balance sheet transactions,

- The adequacy of the allowance for loan and lease losses and other asset valuation reserves,
- The credit risk arising from or reduced by off-balance sheet transactions, such as un-funded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit,
- The diversification and quality of the loan and investment portfolios,
- The extent of securities underwriting activities and exposure to counter-parties in trading activities,
- The existence of assets concentrations,
- The adequacy of loan and investments policies, procedures, and practices,
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets,
- The adequacy of internal controls and management information systems,
- The volume and nature of credit documentation exceptions.

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

2.1.6.2.2 Rating the Asset Quality Factor

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

- A rating 1 indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality is such institution is of minimal supervisory concern.
- A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classification and other weakness warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.

- A rating of 3 is assigned when quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality. The level and severity of classified assets, other weakness, and risks require an elevated level of supervisory concern.
- A rating 4 is assigned to FIs with deficient assent quality or credit administration practices. The levels of risk and problem assets are significant; inadequacy controlled, and subjects the FI to potential losses that, if left unchecked, may threaten its viability.
- A rating of 5 represents critically deficient asset quality of credit administration practices that present and imminent threat to the institution's viability.

2.1.6.2.3 NRB Directive related to Assets quality

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

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

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

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

Loss: All loans and advances which are past due for more than 1 year and have least or thin possibility if recovery of considered unrecoverable shall include in this category. Besides this, any whether past due or not, in situations of inadequate security, borrower declared insolvent, no whereabouts of the borrower or misuse of borrowed fund, are to be classified as Loss category.

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

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

With the objectives of lowering risk of bank loans to a few big borrowers and to increase the access of small and middle size borrowers to the bank loans, NRB through directive number E.Pra.Ni.Na 03/061/62 Limits commercial banks to extend credit to a single borrower or group of related borrowers up to 25% of its core capital for fund based credit facilities and not more than 50% of its core capital for Non fund based credit facilities like letters of credit, guarantees, acceptances, commitments.

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

Name of the corporation	Merchandise
Nepal Oil Corporation	Petrol, Diesel, Kerosene, L.P.G.
Nepal Food Corporation	Cereals

2.1.6.3 Management Quality

The capabilities of the board of directors and management, in their respective roles, to identify, measure, monitor and control the risks of an institution's activities and to ensure a FI's safe, sound and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Depending on the nature and scope of an institution's activities, management practice may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance, legal liquidity and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls

taking into consideration the size and sophistication of the institution; maintenance of an appropriate audit program and internal control environment; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is involved. The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors

- The level and quantity of oversight and support of all institution activities by the board of directors and management.
- The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products.
- The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.
- The accuracy, timeliness, and effectiveness of management information and risk monitoring system appropriate for the institution's size, complexity, and risk profile.
- The adequacy of audits and internal controls to: promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations and internal policies.
- Compliance with laws, regulations.
- Responsiveness to recommendations from auditors and supervisory authorities.
- Management depth and succession.
- The extent that the board of directors and management is affected by, or susceptible to, dominant influence or concentration of authority.
- Reasonableness of compensation policies and avoidance of self-dealing.
- Demonstrated willingness to serve the legitimate banking needs of the community.
- The overall performance of the institution and its risk profile.

2.1.6.3.1 Rating the Management factor

- A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the institution's size, complexity, and risk profile. All significant risks are consistently and effectively

identified, measured, monitored and controlled and the board has demonstrated the ability to promptly and successfully address existing and potential problems and risks.

- A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weakness may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.
- A rating of 3 indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size or condition of the institution. Problems and significant risks may be inadequacy identified, measured, monitored, or, controlled.
- A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measure, monitored or controlled and require immediate action by the board of director and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary.
- A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution. Replacing or strengthening management or the board of directors is necessary.

Researches construct various financial ratios to capture management quality. Meyer and Pifer (1970) state that "Management ability is like Lord Action's elephant-difficult to define but easy to identify. Over a period of time differences between good and poor management will be systematically reflected by the balance sheet and income data, and analysis of such data should enable prediction of failures." Graham and Homer (1988) evaluate the factors

that contributed to the failure of 162 national banks in USA and conclude that more than 60 percent of failed banks experienced poor management, measured, by such variables as poorly followed loan policies, inadequate problem loan identification systems, and non-existent or poorly followed asset/liability management.

Barr and Siems (1993) provide the only direct measurement of management quality, using data envelopment analysis (DEA) to quantify the quality of management. They concluded that the predictive performance of their failure-prediction model improves markedly with the inclusion of the DEA efficiency variable.

Sinkey (1975) purported that a specific ratio representative of management is difficult to identify, but his view was that many ratios are proxies. Often, researches (Tam and Kiang, 1992; Espahbodi, 1991; West, 1985) have not attempted to include a variable to represent management quality. Thomson (1991) and Whalen (1991) employed the ratio of overhead expenses to total assets as representative of management operating efficiency. As none of the ratios from previous research exhibited significance.

2.1.6.4 Earning Quality

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

- The level of earnings, including trends and stability,
- The ability to provide for adequate capital through retained earnings,
- The quality and sources of earnings,
- The level of expenses in relation to operations,
- The adequacy of the budgeting systems, forecasting processes, and management information systems in general,
- The adequacy of provisions to maintain the ALLL and other valuation allowance accounts,
- The earnings exposure to market risk such as interest rate, foreign exchange, Price risks.

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

2.1.6.4.1 Evaluation of Earnings Performance

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

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

- Net Income to Average Assets Ratio [Return on Assets (ROA) ratio]
- Net Interest Income to Average Assets Ratio
- Net Interest Income to Average Earning Assets Ratio
- Non-interest Income to Average Assets Ratio
- Non-interest Expense to Average Assets Ratio
- Provision for Loan and Lease Losses (PLLL) to Average Assets Ratio
- Realized Gains/Losses on Securities to Average Assets Ratio(s)

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

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

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

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

2.1.6.4.2 Rating the Earnings Factor

- Earnings rated 1 are strong. Earnings more than sufficient to support operations and maintain adequate capital and allowance levels after are given to asset quality, growth, and other factors affecting the quality, quantity and trend of earnings.
- Earnings rated 2 would be satisfactory and sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity and trend of earnings. Earnings that are relatively static, or even experiencing a slight decline, may receive a 2 rating provided the institution's level of earnings is adequate in view of the assessment factors listed above.
- Earnings rate 3 may need to improve. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth, and other factors affecting the quality, quantity, and trend of earning.
- A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowance levels. Erratic fluctuations in net income margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous year may characterize institutions so rated.

- A rating of 5 indicates earnings that are critically deficient. A FI with earnings rated 5 is experiencing losses that represent a distinct threat to its viability through the erosion of capital.

2.1.6.5 Liquidity

In evaluating the adequacy of a FIs liquidity position, co0nsideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly is not maintained at a high cost, or through undue reliance in funding sources that may not be available in times of financial stress or adverse changes in market conditions. Liquidity is rated based upon, but not limited to, an assessment of the following evaluation factors

- The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
- The availability of assets readily convertible to cash without undue loss.
- Access to money markets and other sources of funding.
- The level of diversification of funding sources, both on-and off-balance sheet.
- The degree of reliance on short-term, volatile sources of funds, including borrowing and brokered deposits, to fund longer-term assets.
- The trend and stability of deposits.
- The ability to securitize and sell certain pool of assets.
- The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, management information systems, and contingency funding plans.

2.1.6.5.1 Rating the Liquidity factor

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

2.1.6.5.2 Liquidity Management Concepts

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

The Real Bills Doctrine: The Real Bills doctrine states that a commercial bank should extend only short-term self-liquidating productive loans to business firms. Self liquidating loans are those meant to finance the production, storage, transportation, and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. Secondly, there is no risk of running into bad debts since they mature in the short run and are for productive purpose. Lastly, such loans earn income for the banks as they are productive.

The Shift-ability Theory: H.G. Moulton propounded the shift-ability theory of bank liquidity. According to this view, an asset to be perfectly shift-ability must be immediately transferable without capital loss when the need for liquidity arises. But in a general crisis

requires that all banks should posses such assets which can be shifted on to the central bank which is the lender of the last resort. This theory has certain elements of truth.

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

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

2.1.6.5.3 Liquidity Management Techniques

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

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

Managing Cash Position: A cash position refers to the amount in the process of collection and currency and demand balances due from other banks and the central bank. Numerous

transactions that cause an inflow or outflow of cash during a day continually change the cash position of the banks and FIs. because cash yields no income. Cash holdings must be limited to a minimum. The treasury/fund manager may invest any excess cash or may acquire additional cash sources from interbank loans or from discount window at the central bank.

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

- The treasury manager must coordinate and keeps track of the activities and strategies of the funds-raising and funds-using departments within the banks and FIs.
- The treasury managers should know the timing of large withdrawals from big credit clients or depositors in order to plan.
- The priorities and objective of liquidity management should be clear and properly communicated.
- The needs and decision must be evaluated on a continuous basis to invest access liquidity and avoid liquidity shortages.

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

- Public confidence in terms of withdrawal of deposits from the banks and FIs.
- Share price behavior, falling share prices indicate perceived liquidity problems.
- Risk premiums on money market borrowings.
- Losses because of the hasty sale of assets for liquidity purpose.
- Inability to meet the demands of new credits customers.
- More frequent and larger borrowings from the central bank.

Considering the aforementioned technique, the treasury manager must also consider the purposes of the liquidity need, the length of time for which funds are needed, the access to liability markets, the cost and characteristics of various liquidity sources and interest rate

forecast. It is revealed that the large banks have better access to liability liquidity sources due to the better assets and a broader capital base. The small banks have to rely more on assets for liquidity. Thus, an effective liquidity management is essential to reduce costs.

A liquidity ratio measures an entity's ability to pay its short-term obligations out of liquid assets. Liquidity (L) was generally represented in previous studies with a ratio of cash (with some adjustment for short-term liquid securities) to total assets (Tam and Kiang, 1992; Espahbodi, 1991; Lane et al., 1977; Sinkey, 1975).

2.1.6.5.4 NRB Directives related to Liquidity

NRB had given the instruction to the commercials banks since 2023 B.S. to deposit the amount the amount ratio of 8 percent from their deposit liability. In the beginning of 2047 B.S. the increase in the quantity of internal credit was very high and began to show negative effect on economy. The deflation grew up to 21 percent. So, high liquidity appeared in economy, hence, control of the negative effect that may fall on economy to improve the growth of price rate and improvement of the position of loss of running account and control the capacity of flowing the loan of the commercial banks, was necessary and the NRB second time prescribed liquidity ratio. It made compulsory to invest 24 percent the amount of the total deposit of the commercial bank in Nepal Government Bond, treasury bills, or NRB Bonds. With some signs of improvement of economy, the investment ratio was revised accordingly, since Poush 2049 B.S. Since the beginning of 2050 B.S., the economy showed improvement and the rate of deflation fell down to 8.8% with this, the provision of investing in the government securities was removed.

With effective from, 2054, Chaitra 31st, commercial banks were required to maintain liquidity of 8% of the total Current & Saving deposits and 6% of the fixed deposits, in addition to 3% of total deposit in cash at vault. Since then the NRB reserve requirement has been changed. To ensure adequate liquidity, following arrangements have been put into force by NRB effective from 22 July 2002 (2059/04/06).

NRB directives on Reserve Requirement at NRB Account of Banks

a)	Cash Reserve Ratio	5 % (Before 1st Kartik 2065)
b)	Cash Reserve Ratio	5.5 % (effective from 1st Kartik, 2065)

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

a. The CRR maintained by the banks will be examined on the basis of average weekly balance of deposit liability immediately preceding 2nd week. A week shall comprise form each Sunday through Saturday.

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

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

d. Weekly average of Monday to Friday of Total Deposit, Cash in Vault and NRB balance is calculated by dividing by 5.

In the case of shortfall in maintenance of NRB balance, Penalty will be levied for failing to maintain the adequate liquidity and the applicable rate of penalty is as follows:

- First time short fall = Equivalent to bank rate/highest refinance rate
- Second time short fall = Equivalent to 2 times of bank rate
- Third time shortfall and all subsequent shortfalls = Equivalent to 3 times of bank rate

2.2 Review of Related Studies and Papers

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

2.2.1 Review of Research and Work Papers

Several academic studies have examined whether and to what extent private supervisory information is useful in the supervisory monitoring of banks and developing banks failure-

prediction models. It is very crucial for such analysis to identify variables that reliably predict future bank failure. The studies used variables that reflect asset quality, liquidity, capital adequacy and management quality. Most studies find that capital adequacy, earning ability, and asset quality, measured by the concentration of certain loan types, help to predict bank failure (Sinkey 1975, Pantalone and plam 1987, Barr and Siems 1993, and Barker Holdsworth 1993). Barker and Holdsworth(1993) reported that, on average, capital and income slowly deteriorate while past-due loans and charge offs increase as failure approaches. On the other hand, Heyliger and Holdren (1991) discover that asset quality, measured by the ratios of loan loss provisions and net charge offs to total loans, do not provide reliable indicators of banks failure. These studies adapted a no of methods including multiple discriminate analysis, factor analysis, proportional hazard models, and logic analysis.

Jackson (1975) conducted a study on commercial bank regulation structure and performance. The study was carried out to identify the determinants of commercial banks allocation efficiency. Both theoretical and empirical microeconomics analysis has applied to examine the competitive effects of banking influences. In this paper, the nature of banking was examined; showing that banks are essentially financial intermediaries that are engaged in greater completion than is commonly believed. Many theories of the firm as a bank are presented emphasizing efficiency-distorting forces such as liquidity provisions. Almarin Philip's Model of complex interaction between banking firms and other influences on observed performance was used to summarize banking theories. For the empirical purpose, data covering 1644 banks over the period 1969-1971 were collected. Regression analysis was used to measure the relationship among variables. As a conclusion, the study showed that, the relatively *desirable* banking performance is associated with several traits including bank assets size, non bank competition, low cash holdings, low labor cost, state non member basis status, multi bank company legislation, national bank status , low time deposit and low equity capitalization. Demand levels and temporal variations also significantly affect the banking performance. Furthermore, the study showed that the commercial banks regulation, structure and performance are interrelated with each other.

Sinkey (1975) notes that bank examiner identify a "substandard" loan component of the net capital ratio as a critical to identification of problem banks. In later research, Sinkey (1978) recognize the usefulness of loan default information in utilization of a ratio of provision for loan losses to operating expenses, although he did not find the "substandard" loan component to be significant.

Martins (1977) study said the standard for discrete-response models of bank failure prediction. Whereas most other research focused on a small sample of banks over 2 or 3 years, Martin used all Fed-supervised institutions during a 7 year period in 1970s, yielding over 33000 observations. In what would become a standard approach, he confronted the data agnostically with 25 financial ratios and ran several different specifications in search of the best fit. He found that capital ratios, liquidity measured, and profitability were the most significant determinants of failure over his sample period. Although Martin did not employee direct measured of asset quality. His indirect measured-provision expense and loan concentration-also turned out to be significant.

West (1985) develop a model to predict bank failure, with different from the majority of research utilizing FDIC generated information, rather than data from the financial statements. Some evidence resulted to support the contention that a loan quality factor (i.e. non-performing loan) had predictive value in this context for monitoring problems banks through its choice in a step wise logic analysis.

Hirschhom (1987) used a multi factor market model to predict a quarterly stock returns for the 15 largest US banks between 1979 and 1987. He included both contemporaneous CAMEL ratings and lagged quarter-to-quarter changes in CAMELS rating s as explanatory variables. Although the lagged CAMEL values were not useful for predicting stock returns, Hhirschhom found that contemporaneous CAMEL ratings were significantly related to stock returns. These result suggested that exam ratings contain useful information, but that must of this information is not private-market participants have either independently inferred this information at the time of the exam, or this information has been leaked shortly after the exam was completed.

Shrestha (1990) conducted a research work on portfolio behavior for commercial banks in Nepal. She has analyzed the debt to equity ratios of commercial bank in aggregate and Agricultural Development Bank from 1971 to 1990. She found that the debt to equity ratio of minimum 8.30% in 1971 and the maximum of 1583.3% in 1974. Similarly the range of debt to equity ratios of ADBN is minimum of 21.44% in 1972 and maximum of 652.74 in 1974 to1990. On the basis of this finding, she conducted that the Nepalese commercial banks are highly leveraged and highly risky. Further, she argued that the capital adequacy ratio explains the strengths of the capital base of commercial bank. Higher the capital adequacy ratio, higher is its internal sources. Lower the value of capital adequacy ratio with regard to the standard value shows that the bank's ability to attract deposit from the surplus units and inter-bank funds also be limited.

Tam and Kiang (1992) utilize stepwise logic analysis. The researchers examined a small sample of Texas banks, where results indicated two measures of loan default risk were significant in their prediction of bank failure. Provision for loan losses to average loans and net charge-offs to average loans exhibited no predictive value.

Barker and Holdswoth (1993), in respect to predicting bank failure, find evidence that CAMEL ratings are useful, even after controlling for a wide range of publicly available information about the condition and performance of banks.

Berger and Davies (1994) evaluate the impact of CAMEL rating changes on the parent holding company's stock price. They separate stock price changes into two components: a 'private information' effect (which identifies the public's awareness of new information discovered by examiners), and a 'regulatory discipline' effect (which values the regulator's presumed ability to force a bank to change its behavior). Berger and Davie's empirical results provide only weak evidence of a regulatory discipline effect, but they find a strong private information effect. However, the information effect applies only to CAMEL downgrades, which tend to precede stock price declines.Consistent with the findings of Hand, Holthausen and Leftwich (1992), Berger and Davies find no movement in stock prices following a CAMEL upgrade.

Cole and Gunther (1998) examine a similar question and find that although CAMEL ratings contain useful information, it decays quickly. For the period between 1988 and 1992, they find that a statistical model using publicly available financial data is a better indicator of bank failure than CAMEL ratings that are more than two quarters old.

Morgan (1998) finds that rating agencies disagree more about banks than about other types of firms. As a result, supervisors with direct access to private bank information could generate additional information useful to the financial markets, at least by certifying that a bank's financial condition is accurately reported.

The direct public beneficiaries of private supervisory information, such as that contained in CAMELS ratings, would be depositors and holders of bank's securities. Small depositors are protected from possible bank default by FDIC insurance. This probably explains the finding by ***Gilbert and Vaughn (1998)*** that the public announcement of supervisory enforcement actions, such as prohibitions on paying dividends, did not case deposit runoffs or dramatic increases in the rates paid on deposits at the affected banks. However, uninsured depositors could be expected to respond more strongly to such information. Jordan, et al., (1999) finds that uninsured deposits at banks that are subjects of publicly-announced enforcement actions, such as cease-and-desist orders, decline during the quarter after the announcement.

As of year-end 1998, bank holding companies (BHCs) had roughly $ 120 billion in outstanding subordinated debt. ***DeYoung, et al., (1998)*** examine whether private supervisory information component of the CAMEL ratings for the BHC's lead banks and regresses it onto subordinated bond prices. They conclude that this aspect of CAMEL ratings adds significant explanatory power to the regressing after controlling for publicly available financial information and that it appears to be incorporated into bond prices about six months after an exam. Furthermore, they find that supervisors are more likely to uncover unfavorable private information, which is consistent with manager's incentives to publicize positive information while de-emphasizing negative information. These results indicate that supervisors can generate useful information about banks, even if those banks already are monitored by private investors and rating agencies.

Focusing specially on CAMEL ratings, ***Berger and Davies (1998)*** use event study methodology to examine the behavior of BHC stock prices in the eight-week period following an exam of its lead bank. They conclude that CAMEL downgrades reveal unfavorable private information about bank conditions to the stock market. This information may reach the public in several ways, such as through bank financial statements made after a downgrade. These results suggest that bank management may reveal favorable private information in advance, while supervisors in effect force the release of unfavorable information.

Berger, Davies, and Flannery (1998) extend this analysis by examining whether the information about BHC conditions gathered by supervisors is different from that used by the financial markets. They find that assessments by supervisors and rating agencies are complementary but different from those by the stock market. The authors attribute this difference to the fact that supervisors and rating agencies, as representatives of debt holders, are more interested in default probabilities that the stock market, which focuses on future revenues and profitability. This rationale also could explain the authors' finding that supervisory assessments are much less accurate than market assessments of banks' future performances.

On-site bank exams seem to generate additional useful information beyond what is publicly available. However, according to ***Flannery (1998)***, the limited available evidence does not support the view that supervisory assessments of bank conditions are uniformly better and timelier than market assessments.

The market for bank equity, which is about eight times larger than for bank subordinated debt, was valued at more than $910 billion at year-end 1998. Thus, the academic literature on the extent to which private supervisory information affects stock prices is more extensive. For example, ***Jordan, et at., (1999)*** find that the stock market views the announcement of formal enforcement actions as informative. That is, such announcements are associated with large negative stock returns for the affected banks. This result holds especially for banks that had not previously manifested serious problems.

Hirtle and Lopez (1999) examine the usefulness of past CAMEL ratings in assessing bank's current conditions. They find that, conditional on current public information, the private supervisory information contained in past CAMEL ratings provides further insight into bank current conditions, as summarized by current CAMEL ratings. The authors find that, over the period from 1989 to 1995, the private supervisory information gathered during the last on-site exam remains useful with respect to the current condition of a bank for up to 6 to 12 quarters (or 1.5 to 3 years). The overall conclusion drawn from academic studies is that private supervisory information, as summarized by CAMELS ratings, is clearly useful in the supervisory monitoring of bank conditions.

Kolari et al. (2000) developed models and predicted bank failure, where the models initially included three measures of loan default disclosure along with 25 other financial measures. The loan default measures included allowance for loan losses to total assets, net loan charge-offs to total assets and provision for loan losses to total assets. In the final analysis, the allowance for loan losses to total assets was significant row of the six predictions. As with many other studies, there was a lack of theory for the choice of variables, as stepwise logic was utilized for the decision of inclusion or elimination.

Dziobek, Hobbs, and Marston (2000) analyze the determinants of bank liquidity-defined as the degree to which a FI is able to meet its obligations under normal business conditions. Volatility in the depositor (and creditor) base depends on the type of depositor, insurance coverage, and maturity. Banks that relay on a narrow or highly volatile funding base are more prone to liquidity squeezes. Household deposits are typically more stable than, for instance, the deposits of institutional investors or corporate entities. Deposit concentration (i.e., fewer, larger-size deposits) can also be indicative of volatility. Deposit insurance increase the stability of the deposits it covers, with the important caveat that insurance schemes that are not credible may not have this effect. On the external front, foreign financing, for instance through commercial credit lines, and deposits of nonresidents (either in foreign or domestic currency) can become highly volatile in situations of distress and make the financial system vulnerable to external shocks or adverse developments in the domestic economy. As regards instrument maturity, the more stable is the funding ; however, in countries where banks are required meet early withdrawal requests with only minor penalties, maturity may be less relevant to determining funding stability.

Sahajwala and Van den Bergh (2000) based their work paper of Basel committee on banking supervision on a study of a number of new bank monitoring systems currently in use or under development in various G10 countries. Such systems are collectively termed "supervisory risk assessment and early warning systems". The objective of the paper was to provide an overview of the different approaches taken by bank supervised and to make a preliminary general assessment of the methods that are being used or developed. The study reveals that supervisory authorities are now clearly moving towards putting in place more formal, structured and risk focused procedures for ongoing banking supervision. Individual approaches and systems have been developed and adopted, typically in the 1990s, with a greater focus on risk profiles and risk management capabilities of individual banking institutions and on the generation of timely warning of potential changes to a bank's financial position. These new and modified systems have contributed positively to the supervisory process, and supervisors are working towards refining the systems further in order to improve the system's accuracy and predictive power.

Gytan and Johnson (2001) have presented their work paper on a review of alternative methodologies for early detection of banking distress. The various methodologies proposed by different researchers, in the paper are aimed to the early identification of financial distress for countries without an important recent history of bank failure, but facing an unstable international environment. They evaluate several indicators and methodologies to measure financial distress such as qualitative indicators, the signal extraction approach, limited dependent estimation and finally duration models. In the Early Warning System (EWS) of Systemic Banking Crises section they reviewed the literature aimed to predict crises of the complete banking of a country. They also include some methodological approaches that have been used as early warning systems for currency crises, but have a potential application for the prediction of banking crises. The prediction of banking crises by statistical methods requires a sample in which the events have appeared repeatedly. Since there has not been so may repeated episodes in any given country, the estimation must rely on a sample of different countries that have suffered banking problems. According to them, the literature on indicators and EWS of systemic crises can be classified by their methodological approach: (1) Qualitative indicators, (2) Signal Extraction, (3) Limited Dependent Regression, (4) Other models.

Derviz and Podpiera (2004) based their assessment of commercial banking performance on bank ratings and studied with respect to detecting situations with the potential for adverse development towards failure, and owing to the costly nature of frequent supervisory examinations. In this paper they studied models of rating downgrades and consider a specific sets of indicators that are suitable as determinants of a bank's rating. The conclusions about the predicators obtained from the analysis of downgrades are applicable in relatively stable banking sector situations. Banks experiencing minor liquidity trouble might raise their interest rates on deposits, but a regulator would have a hard time distinguishing which bank has increased its deposit rate because of liquidity problems and which has done so owing to an increase in its cost of funds caused by some other factor. Therefore, in their approach the cost of funds-one of the plausible downgrade indicators-was used in the form of the banks' "credit spread". In addition to credit spread, they tested the inclusion of the Value at Risk (VaR) indicator in the form of Total Asset VaR, as they believed that this type of indicator might play an important role in determining the level of the rating due to its easy computability and data availability to the public. They focused on the Capital-Assets-Management-Earning-Liquidity-Market Risk based composite (CAMELS) rating and the Standard and Poor (S&P) ratings. The choice of their sample was determined by the fact that cross-section data its probably less appropriate given the specific character of the relatively small banking market in the Czech Republic. The three chosen banks, i.e., Ceska Sporitelna (CS), Komercni Banka (KB) and Ceskoslovenska Obchodni Banka (CSOB), cover a dominant portion of the market, the rest being occupied by small narrowly specialized banks and their financial indicators to analyze the change in the CAMELS and S&P ratings. They found that the reliable predictors of a bank's S&P rating are Credit Spread, Capital Adequacy, and the Total Loans to Total Assets ratio. In the case of the CAMELS rating they verified the total Asset VaR, the ratio of Total Loans to Total Assets, and Capital Adequacy as reliable predictors. In addition, they found that the CAMELS rating does not yield itself easily to predictions within any horizon with the studied technique. On the contrary, the S&P rating can be relatively precisely predicted one month in advance.

Baral (2005), during the annual report data set of joint ventures banks and NRB supervision reports, published his paper abstract in the Journal of Nepalese Business Studies (Volume II No. 1, December 2005). The paper examined the financial health of joint ventures banks in the CAMEL framework for a period ranging from FY 2001 to FY 2004. The health checkup which was conducted on the basis of publicly available financial data concludes that the financial health of joint ventures banks is better than that of the other commercial banks. The study further indicates that the CAMELS component indicators of the joint ventures banks are not much encouraging in managing the possible shocks.

2.2.2 Review of Dissertations

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

Pradhan (1980) conducted a study on investment policy of Nepal Bank Ltd. The objective to that study was to evaluate the lending policy and to find out the ways to encouraged the bank lending. This study has covered only five fiscal years BS 2028/29 through BS 2033/34. He used Karl Pearson's coefficient of correlation, ratio analysis and percentage analysis. He conducted with the positive relationship between deposits and loans and advances. But the same was not in a proportionate manner, greater increase in deposits led to little increase in the loans and advances. Increase in the interest rate was the main factor for the decrease in loan demand. The bank had investment only 3 percent of its total investment in the priority sector, which was lower than the percentage (7 percent) imposed by NRB.

Shrestha (1990) conducted a research work on portfolio behavior for commercial banks in Nepal. She has analyzed the debt to equity ratios of commercial banks in aggregate and Agriculture Development Bank from 1971 to 1990. The researcher has found that the debt to equity ratio in commercial banks minimum of 8.30% in 1971 and the maximum of 1583.3% in 1974. Similarly, the range of debt to equity ratios of ADB/N is minimum of 21.44% in 1972 and maximum of 652.74% in 1990. On the basis of the finding, the researcher conducted that the Nepalese commercial banks are highly leveraged and highly

risky. Further, the researcher argued that the capital adequacy ratio explains the strength of the capital base of commercial banks. Higher the capital adequacy ratio, higher is its internal sources. Lower value of capital adequacy ratio with regard to the standard value shows that the bank's ability to attract deposit from the surplus units and interbank funds also limited.

K.C. (1991) has done a study on dividend policy of joint ventures banks in Nepal. The objective of this study was to provide conceptual framework of dividend models and to analyzes the financial variables affecting the stock value and interpret the implication of paying dividend in dividend valuation models. The study has covered the time span of FYs 1984/85 through 1989/90. In this study, various financial ratios have been analyzed with the help of two types of analytical tools-investment and statistical tools. Investment tools consist of dividend payout ratio, earning per share, return on paid up capital, retention ratio and divided valuation model. In addition to the coefficient of correlation, the researcher has used financial tools in this study. The researcher concluded that earning per share of all three joint ventures banks (Nepal Arab Bank Ltd; Nepal Indosuez Bank Ltd. and Nepal Grind lays Bank Ltd.) were satisfactory and actual capitalization rate was higher than the normal capitalization rate.

Bohara (1992) has done a study on financial performance of Nepal Arab Bank Ltd. (NABIL) and Nepal Indosuez Bank Lid. (NIBL). The basic objectives of this study were to highlight on the functions and policies of joint ventures banks and to evaluate the comparative financial performance of NABIL. The study has covered the five fiscal years 1986/87 through 1990/91. In this study financial tools along with statistical tools have been used. Different ratios-liquidity, activity, coverage, leverage, profitability and other indicators like earning per share, dividend per share, market value to book value ratio, have been used to evaluate the performance of NABIL and BIBL. In statistical tool the least square method has been employed. The researcher has, on the basis of different financial indicators, concluded that performance of NABIL is better than that of NIBL. The researcher further concluded that bank performance cannot be judged solely in term of profit as it may have earned profit by maintaining adequate liquidity and safety position. The researchers has recommended to NIBL to extend their banking facilities even in the

rural areas by opening up branches besides the improvement in maintaining adequate capital structure by increasing equity base.

Adhikari (1993) conducted a study on evaluation of the financial performance of Nepal Bank Ltd. The objective of the study was to evaluate the financial performance of Nepal Bank Ltd. the study has been limited to FYs 2038/39 BS through 2046/47 BS. The main indicators of financial performance used were financial ratios-current, loan to deposit, return on capital, return on net worth, return on total assets, earning per share, divided per share, pay out and net worth per share vs. market price per share. The researcher concluded that the bank had not managed investment portfolio efficiently. Operational efficiency was not satisfactory. During the study period, except liquidity position all other financial indicators were not satisfactory.

Joshi (1993) conducted a study on commercial banks of Nepal with reference to financial analysis of Rastriya Banijya Bank. The objective of this study was to provide conceptual framework of commercial banks, and to analyze and interpret these financial variables of Rastriya Banijya Bank (RBB) on qualitative and quantitative performance basis. The study was based on the financial data of FYs 2042 B.S. through 2046 B.S. Researchers has used various financial ratios like-current. Liquidity, funded debt to total capitalization, and funded debt to equity in this study. The researcher had drawn the conclusion that performance of RBB was not satisfactory during the study period. Further, the researcher concluded that bank had not been managed in true professional environment rather than commercial environment.

Shakya (1995) performs a study on financial analysis of joint ventures banks in Nepal. The objective of this study was to carry out the comparative financial performance evaluation of Nepal Arab Bank Ltd. (Nabil) and Nepal Gridlays Bank Ltd. (NGBL). This study has covered the time span of FYs 1988/89 through 1993/94. In this study, he has financial ratios viz. liquidity, leverage, activity, profitability, growth and valuation, and statistical tools viz. Karl Pearson's correlation coefficient, student-test, simple average, and index. The researcher has found that in spite of the increase in loans and deposits of both banks, their performance measured in terms of deposit utilization rate is not satisfactory. Further, the study showed that financial performance of NABIL is better than that of NGBL.

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

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

Likewise, ***Deoja (2001)*** conducted study entitled "A comparative study of the financial performance between Nepal State Bank of India Limited and Nepal Bangladesh Bank Limited." The researcher's main objective of study was to evaluate the trend of deposits and loan and advances of NSBIL and NBBL and to evaluate the liquidity, profitability, capital structure, turnover and capital adequacy position of NSBL and NBBL. Through research found that the cash and bank balance to current assets, saving deposit to total deposit etc. of NABIL are while fixed deposit to total deposits, loans and advances to total deposits ratio and loan advances to fixed deposit ratio. Through the study of the different ratios has concluded that both banks are highly leveraged.

Sharma (2005) in his paper on Capital Structure of Selected Commercial Banks of Nepal concludes with following key points:

- Paid up Capital of Nepalese Commercial Banks is increasing indicating banks maintain the capital standards set by NRB
- Total equity capital is growing as compared to total debt.
- The fluctuating interest coverage ratio of the Nepalese Commercial Banks indicates the earnings stream and interest expenses are inconsistent over the period of past five years. The debt servicing capacity of the Nepalese Banks is not highly satisfactory but it is sufficient to meet the interest expenses in all years and is continuously improving.
- The capital adequacy ratios of the banks are adequate against set norms of NRB indicating sound financial health and sufficient to meet on banking operation.
- The total capital fund and capital adequacy ratios are fluctuating which indicate fluctuating risk adjusted assets of the banks.
- Core Capital and supplementary capital ratios are in line with the NRB norms.

Bhandari (2006) used descriptive analysis in his research work of evaluating financial performance of Himalayan Bank in the framework of CAMEL during 1999 to year 2004 A.D. The analysis revealed adequate Capital of the bank. The non performing loans thought in decreasing trend are still a matter of concern. The bank is still with better ROE however it is in decreasing trend. The decreasing trend of net interest margin shows management slack monitoring over the bank's earning assets. The liquid funds to total deposit ratio is above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ration during the study period. Various studies have been conducted in the past on financial analysis of commercial banks in the US and other regions were found done. The research paper done in the context of Nepal mainly emphasizes on liquidity, profitability and leverage of the commercial banks. These studies lack micro-level analysis and found applying traditional analysis of financial performance. In the context of Nepalese banking environment, there are few academic researchers found conducted in the framework of CAMEL (Bhandari, 2006).

Sanjal (2007), on his thesis "Comparative analysis of Financial Status & Performance evaluation of Himalayan Bank Limited, NABIL Bank Limited in the framework of CAMEL Rating System", pointed various findings based on the analysis of data and information as follows.

Objectives of Research

- To analyze Capital Adequacy & Liquidity Position of HBL & NABIL and compare with regulatory minimum capital requirement.
- To analyze quality of assets and evaluate Risk Weighted Assets of HBL & NABIL.
- To evaluate the level, trend and stability of HBL & NABIL's earning.

Findings of Research

- Capital adequacy ratio of HBL and NABIL bank are maintained adequately as per the guidance made by the NRB during the FY 2000/01 to 2004/05 except HBL fails to maintain in the year 2004/05.
- The NPL ratio of NABIL found below the industrial average in all years i.e. 5% where as NPL ratios of HBL were not good as it is above the international standard of 5%.
- Loan Loss Provision of NABIL bank is continuously decreasing trend which indicates bank's quality of loan asset is getting better where as Loan Loss Provision of HBL for the study period was in increasing trend.
- The observed TOE and TOI ratio of NABIL fluctuated only in 2001/02 which was the maximum of all the review period years ease the trend is in decreasing trend. Likewise, the observed TOE to TOI ratio of HBL increased up to 2003/04 and then decreasing in year 2004/05. Decreasing trend of ratio is favorable on measure management quality of HBL.
- The earning per employee of NABIL decreases in 2001/02, increases in 2002/03 and following 2 year decreases but the trend is positive and increasing which is good for the bank. Whereas the earning per employee on HBL were fluctuating over the period of study period and the trend of ratio is negative which reflects the inefficiency as a result of overstaffing, with similar repercussion in term of profitability.
- The mean ROE and ROA of NABIL is in increasing trend which implies that the earning quality of bank is getting better. Whereas the mean value of ROE and ROA of HBL is above the benchmark but it is in decreasing trend.

- The Net interest margin of NABIL, despite fluctuated only once, is in increasing trend and mean NIM ratio is slightly above the generally accepted benchmark. Whereas the mean ratio of NIM of HBL is above the generally accepted benchmark but is in decreasing tendency.
- EPS of NABIL bank fluctuate only in the first year of the review period thereafter it increased continuously till the final review period. On the other hand EPS of HBL is fluctuated over the study period and overall trend is decreasing.

Recommendation of Research

- The Capital Adequacy of NABIL is as pre NRB directives and the variance of CAR is also positive but in decreasing trend. This requires the bank to increase its capital fund either through internal sources or decrease investment in risky asset in the coming days. Similarly, the proportion of Tier II capital in total capital fund of HBL also in decreasing as compare to Tier I capital. This means the bank's capital adequacy ratio is not sufficient. So the recommendation is provided to maintain stable capital adequacy ratio in the bank and strictly follow the NRB directives is better.
- The Provision for Doubtful Loans has increased in last year's which is a matter of concern, so the bank need to give attention in recovering the Doubtful and Loan Loss and lower the provision accordingly. Likewise, the loan loss provision to total loans and advances is increasing regularly during the study period, which shows there is highly probability of loan default in future, so the bank is recommended to lower the proportion of loan loss provision by increasing the quality of assets by strengthening the credit appraisal and follow up measures.
- The total expenses to total revenue and the earning per employee on NABIL bank in the later years has both shown decreasing trend, so the bank need to increase its operating revenues and decrease its operating expenses to maintain and increase in the coming years. Likewise the earning per employee is decreasing trend during the study period, so the necessary corrective actions should be implemented by HBL to enhance the earning per employee.
- The earning quality ratios i.e. return on equity, return on assets, net interest margin and earnings per share are decreasing trend, so to increase these ratios bank should minimize its operating cost by increasing operating efficiencies of its employees.

Kutwal (2007), on his thesis "CAMEL Study on joint venture banks with special reference of Standard Chartered Bank Limited, NABIL Bank Limited & Himalayan Bank Limited", outlined some finding and recommendations as follows:

Objectives of Research

- To analyze financial strength and weakness if banks.
- To test the financial performance of banks.
- To making comparisons of the first generation banks of Nepal in terms of financial.
- To identify the quality of NPA & ratio of NPA.
- To identify the return, standard deviation and coefficient of variation of different banks.
- To provide suggestion and recommendation to improve banks performance as per findings on the study.

Findings of Research

- HBL has dispensed highest amount of loans from the accepted deposit amount but if we look into the profit figures are far lower than SCB and NABIL.
- HBL has highest loan amount but lowest percentage loan loss provision. Considering the statutory requirements, 1% provision on good loan also required.
- SCB and NABIL deposits of meeting CRR statutory requirement on weekly basis also should maintain minimum 5% CRR on balance sheet date.
- HBL cash and bank balance is highest despite of high volume of lending. It means still there is lot of find lying idle in HBL. HBL can reduce its deposits so that lending pressure can be minimized.
- NABIL investment chunk in government securities has gone down substantially. It is advisable to NABIL to manage balanced investment portfolio so that there could be balance on risk and return on investment.
- All bank's capital adequacy is in decreasing trend. If it further goes down, NRB may provide directions to maintain at the mark. It will be beneficial to keep open eye on this issue.
- SCB has higher stakes on earning but seems more conservative lending to avoid NPL hassles. However, looking into the competitions and flooding liquidity in financial market, it should try to expand its loan span, preferably expanding its products.

- The return is the income received on a stock investment, which is usually expressed in percentage. Expected return on the common stock of NABIL is maximum i.e. 52.30% and expected return of the HBL is found to be a minimum i.e. 11.40%. The minimum return is due to the decrease in share price and distribution of low amount of dividend per share.
- Employee's job satisfaction reflects efficiently in servicing which is found very well in average for each bank.
- Suggestion from customers concerned with their respective banks is found they would be happier if interest on deposit increased and then decreased in minimum balance requirement to open deposit account.
- Loan approval procedures of each bank not found easy it means these all bank are quite sensitive in loan disbursement which covers their credit management policy controls the possibility of non-performing loan in future.
- Awareness program conducted by the SCBL is found more effective than the NABIL and HBL. Eighty two percent customer found awareness about all the products and services provided by the SCBL which score highest where as NABIL score seventy two percentage and HBL score sixty eight percentage stands in second and third position respectively.

Recommendations of Research

- HBL has dispensed highest amount of loans from the accepted deposit amount but if we look into the profit figures are lower than SCB and NABIL. This means, despite of aggressive credit policy, HBL's Non Performing Loan volume increases. HBL must concentrate to make profitable its loans not only dispensing loans. Higher NPL figures must be taken care by developing robust credit policies by HBL. Otherwise, the situation will be more alarming.
- HBL has highest loan amount but lowest percentage loan loss provisions. Considering highest loan amount but lowest percentage loan loss provisions. Considering the statutory requirements, 1% provisions on good loan also required, there might be thinly sufficient LLP that may not prudent foe good health of bank. HBL should put either extra effort to decrease NPL or increases LLP further.
- SCB and NABIL despite of meeting CRR statutory requirement on weekly basis also should maintain minimum 5% CRR on balance sheet date. Otherwise, it will be misleading of financial statement reviewers that could be detrimental to bank's image.

- HBL cash and bank balance is highest despite of high volume of lending. It means still there is lit of find lying idle in HBL. HBL can reduce its deposits so that lending pressure can be minimized.
- NABIL investment chunk in government securities has gone down substantially. It is advisable to NABIL to manage balanced investment portfolio so that there could be balance in risk and return on investments. It seems highest figure of loan mobilization from deposits is of NABIL. This clearly indicates NABIL has more risky lending preferences. It will be better to balance in other investments and keep liquidity position in moderate level.
- All bank's capital adequacy is in decreasing trend. If it further goes down, NRB may provide direction to maintain at the mark. It will be beneficial to keep open eye on this issue.
- SCB has higher stakes on earning but seems more conservative lending to avoid NPL hassles. However, looking into the competitions and looking liquidity in financial market, it should try to expand its loan span, preferably expanding its product. This will help it to meet its brand promising as well.
- Nepalese stock market is in emerging state. Its development is acceleration science the political change in 1990 in effect of openness and liberalization national economy. But due to the lack of information and poor knowledge, Nepalese individual investors cannot analyze the security as well as market properly.
- The return is the incomes receive on a stock investment, which is usually expressed on percentage. Expected return on the common stock of NABIL is maximum i.e. 52.30% and expected return of the HBL is found to be minimum i.e. 11.40%, The minimum return is due to the decrease in share price and distribution of low amount of dividend per share
- Risk is the variability of return. Which is measured in term of standard deviation? On the basis of S.D. common stock of SCBL is most risky since it has S.D. i.e. 0.2180 and common stock of NABIL is least risky because it's lowest S.D. i.e. 0.05372. On the other hand, we know that the coefficient of variation is more rational basis of investment decisions. Which measure the risk per unit of return? On the basis of C.V. common stock of NIBL is the best among all banks. NABIL has 0.1027 unit of risk per 1 unit of return and in another hand common stock has the highest C.V. i.e. 0.8026 among the selected sample banks.

Bhusal (2008), on his thesis "Financial Performance Analysis of commercial banks in Nepal in the framework of CAMEL, A comparative study of Kumari Bank Limited & Machhapuchhre Bank Limited", outlined some findings and recommendations.

Objectives of the study

- To analyze the capital adequacy of KBL and MBL.
- To assess the quality of assets of KBL and MBL.
- To evaluate whether KBL and MBL is managing its expenses with respect to incomes.
- To study the trend of earning performance made by KBL and MBL.
- To measure the liquidity position of KBL and MBL.

Findings of the Research

- Over the five year study period the core capital adequacy ratios of both the banks are in decreasing trend except in the FY 062/063.
- The supplementary capital adequacy ratio of KBL is little fluctuating over the study period whereas the ratio of MBL are almost the same level throughout the study period. Both the banks have maintained the supplementary capital adequacy ratio as per NRB standard which should not be more than core capital ratio of the company.
- The non performing loan ratio of both KBL and MBL are in decreasing trend. The NPL of MBL is lower than the NPL of KBL in all the fiscal year except in 059/060. The lower NPL ratio of MBL shows the better proportion of performing loans and risk of default (credit) than that of KBL
- The loan loss ratio of KBL is fluctuating over the study period while the loan loss ratios of MBL are in decreasing trend.
- The earning per employee of KBL and MBL are in increasing trend in all the years except of KBL un the F.Y. 062/063. The increasing trend of earning per employee reflects the efficiency of staffs as well as good management.
- The return on equity ratios of both banks are below the benchmark set by World Bank except of KBL in F.Y. 063/064. But the return on equity ratios of KBL and MBL are in increasing trend which is a good sign of them.
- The return on asset ratios of both KBL and MBL are in increasing trend over the study period except in the FY 062/063of KBL and in the F.Y. 061-062 of MBL. Though the

ratios are in increasing trend, the return on asset ratios of both the banks have not met the benchmark of 1.5 or higher, set by the World Bank.

- The net interest margin ratios of both KBL and MBL are in fluctuating trend. The ratios of both banks have met the benchmark of 3 to 4 percentage as prescribed by the World Bank which means both the banks have well managed its assets and liabilities.
- Over the five studies year period, the earning per share of both KBL and MBL are in increasing trend except in the F.Y. 062/063 of KBL. The decreasing in earning per share of KBL in the F.Y.062/063 is because of the higher proportion of increment in the number of shares than the net profit after taxes.
- The liquid assets to total deposit ratios of KBL are in decreasing trend except in the F.Y. 060/061 but the ratios of MBL are fluctuating.
- NRB balance to total deposit ratios of both banks are in fluctuating trend. It is found that both the banks have maintained the balance as per the standard set by Nepal Rastra Bank in all the observed year.

Recommendations of Research

- The total capital adequacy ratios of both KBL and MBL are as per the NRB standard over the review period. But the ratios are in decreasing trend and if it further goes down, NRB may provide directions to maintain at the mark. So the recommendation is to provide to maintain and keep open eye for the stable and adequate capital ratio in future.
- The asset quality ratios of both the banks show the satisfactory level. So the recommendation is to maintain this lower and appropriate rate of non-performing loan ratio and loan loss ratio.
- The total expenses to total income ratios of the banks are in fluctuating trend over the review period. So, it is recommended to the management of the banks to try to reduce the operating expenses. Decreasing in total expenses to total incomes ratio will positively affect the company's profitability.
- The earning quality ratios of both banks like return on equity and return on assets are in increasing trend but are below the benchmark set by the World Bank. The most important performance measure for any firm's is profitability. Without profit, no firm can grow and survive in long run. So, the company is recommended to increase its yield as its net profit to gain the trust of the equity holders and other stakeholders.

- The liquidity position of the commercial banks should meet their current and contingent obligations. Liquid assets to total deposit ratios, NRB balance to total deposit ratios and cash at vault to total deposit ratios of KBL and MBL are very low and most of them have not met the benchmark set by NRB which need to be monitored and complied in accordance with the NRB requirement.

2.3 Research Gap

There are only few research and thesis done regarding the CAMEL Analysis of Nepalese banks. So, while doing research I found that only trend analyses of the ratios are shown in previous thesis. In this thesis, I have presented both the bar diagrams and trend analysis graphs to give clear picture of the ratios. Furthermore I have also presented the calculation tables at appendix so that for other researchers and students have clear ideas about how the amount figures are obtained while calculating ratios.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Introduction

Research is a process of searching specific problem to solution again and again. The researcher will search again and again to get the appropriate findings. Research methodology is a systematic way to solve the research problem. As the basic objective of the present research is to find out the ratios under the CAMEL framework and to determine whether they are in satisfactory level or not as well as under the guideline set by Nepal Rastra Bank or not .

This chapter includes research design, justification for the selection of study unit, nature and sources of data, methods of data collection, data analysis tools and limitation of methodology. The above research procedures are adopted comprehensively to accomplish the objectives set in the chapter. Following are the major contents of research methodology in course of this thesis.

3.2 Research Design

The research design is of both descriptive and analytical in nature. For the analytical purpose, the annual reports published by the relative banks and other publications of the related banks published by Nepal Rastra Bank, Nepal Stock Exchange Ltd. were collected.

3.3 Periods Covered

To do this research work Five Year's Annual Reports have been taken of respective banks which are published by the bank after audit to the general public. It covers the fiscal year of 2002/2003 to 2006/2007.

3.4 Nature and Sources of Data

Basically the research is based on secondary information data. The annual reports of the banks are the major sources of data. The regulatory data were collected from Nepal Rastra Bank's descriptive, reports and its official web site. Other basic conceptual information are collected from different journals, previously conducted research work, relative websites of banks and formal and informal discussion with the senior staff of the banks, colleague etc.

3.5 Data Processing

For the purpose of this study, the different data's are obtained from different sources, which are scanned and tabulated and also presented in graphs and charts under different heads. After tabulation they are analyzed by applying both financial and statistical tools.

3.6 Population Sampling

At present there are 25 commercial banks are operating in Nepal. Due to time lack and resource constrain it is not possible to study all of them regarding the study topic. Therefore sampling will be done selected from population. The populations are as follows.

Banks	Established in (B.S.)
1. Nepal Bank Limited	1994/07/30
2. Rastra Banijya Bank	2022/10/10
3. Nepal Arab Bank Limited	2041/03/29
4. Nepal Investment Bank Limited	2042/11/26
5. Standard Chartered Bank Nepal Limited	2043/10/16
6. Himalayan Bank Limited	2049/10/05
7. Nepal SBI Bank Limited	2050/03/23
8. Nepal Bangladesh Bank Limited	2050/02/23
9. Everest Bank Limited	2051/07/01
10. Bank of Kathmandu Limited	2051/11/28
11. Nepal Credit and Commerce Bank Limited	2053/06/28
12. Lumbini Bank Limited	2055/04/01
13. Nepal Industrial and Commercial Bank	2055/04/05
14. Machhapuchhre Bank Limited	2057/06/17
15. Kumari Bank Limited	2057/06/17
16. Laxmi Bank Limited	2058/12/21
17. Siddhartha Bank Limited	2059/09/09
18. Agricultural Development Bank Limited	2024/11/07
19. Global Bank Limited	2063/09/18
20. Citizen Bank International Limited	2064/01/07
21. Prime Commercial Bank Limited	2064/06/10
22. Bank of Asia Nepal Limited	2064/06/25

23. Sunrise Bank	2064/06/25
24. Development Credit Bank	2057/04/06
25. NMB Bank Limited	2062/01/20

Among above mentioned bank the selected samples are taken for the research work is

- Everest Bank Limited (EBL)
- Kumari Bank Limited (KBL)
- Siddhartha Bank Limited (SBL)

3.7 Data Analysis Tools and Techniques

Financial Ratios are the major tools used for the descriptive analysis of the study. They are used to determine the performance of the banks in the framework CAMEL component. The CAMEL stands for:

C = Capital Adequacy

- Capital Adequacy Ratio

$$Capital\ Adequacy\ Ratio = \frac{Total\ Capital\ Fund}{Total\ Risk\ Weight\ Asset}$$

Where,

Total Capital Fund = Core Capital + Supplementary Capital

- Tier I Capital Adequacy Ratio / Core Capital Ratio

$$Core\ Capital\ Adequacy\ Ratio = \frac{Core\ Capital}{Total\ Risk\ Weight\ Asset}$$

- Tier II Capital Adequacy Ratio / Supplementary Capital Ratio

$$Supplementary\ Capital\ Adequacy\ Ratio = \frac{Supplementary\ Capital}{Total\ Risk\ Weight\ Asset}$$

A = Asset Quality

- Performing Loan Ratio

$$Performing\ Loan\ Ratio = \frac{Total\ Performing\ Loan}{Total\ Loan\ \&\ Advances}$$

Where,

Total Performing Loan = those loans which have been paying or overdue up to 3 months either in the form of interest servicing or principal repayment,
= Pass Loan + Restructured Loan

Total Loan & Advances = Total Performing Loan + Total Non Performing Loan

Performing Loan = Pass Loan + Restructured Loan

- Non Performing Loan Ratio

$$Non\ Performing\ Loan\ Ratio = \frac{Total\ Non\ Performing\ Loan}{Total\ Loan\ \&\ Advances}$$

Where,

Total Non-performing Loan = those loans which have been past due either in the form of interest servicing or principal repayment and graded as possible default
= Sub Standard Loan + Doubtful Loan + Bad Loan

Total Loan & Advances = Total Performing Loan + Total Non Performing Loan

Performing Loan = Pass Loan + Restructured Loan

- Loan Loss Coverage Ratio

$$Loan\ Loss\ Coverage\ Ratio = \frac{Total\ Loan\ Loss\ Provision}{Total\ Non\ Performing\ Loan}$$

Where,

Total Loan Loss Provision = Provision on (Pass Loan+ Restructured Loan + Sub Standard Loan + Doubtful Loan + Bad Loan)

Total Non Performing Loan = Sub Standard Loan + Doubtful Loan + Bad Loan

- Loan Loss Provision Ratio

$$Loan\ Loss\ Provision\ Ratio = \frac{Total\ Loan\ Loss\ Provision}{Total\ Loan\ \&\ Advances}$$

Where,

Total Loan Loss Provision = Provision on (Pass Loan+ Restructured Loan + Sub Standard Loan + Doubtful Loan + Bad Loan)

Total Loan & Advances = Total Performing Loan + Total Non Performing Loan

Performing Loan = Pass Loan + Restructured Loan

Total Non Performing Loan = Sub Standard Loan + Doubtful Loan + Bad Loan

M = Management Efficiency

- Total Expenses to Income Ratio

$$Total\ Expenses\ to\ Income\ Ratio = \frac{Total\ Expenses}{Total\ Income}$$

Where,

Total Expenses = Interest Expenses + Employee Expenses +Other Operating Expenses + Exchange Loss + Non Operating Loss

Total Income = Interest Income + Commission & Discount Income + Other Operating Income + Exchange Gain +Non Operating Income

- Earning Per Employee

$$Earning\ Per\ Employee = \frac{Net\ Profit\ After\ Tax}{Total\ No.of\ Employees}$$

- Efficiency Ratio

$$Efficiency\ Ratio = \frac{Total\ Non\ Interest\ Expenses}{Total\ Net\ Interest\ Income^{*} + Total\ Non\ Interest\ Income}$$

Where,

Total Non Interest Expenses = Exchange Loss + Employee Expenses + Other Operating Expenses + Non Operating Loss

Total Net Interest Income* = Total Net Interest Income (before provisions)

Total Net Interest Income = Total Interest Income - Total Interest Expenses

Total Non Interest Income = Commission and Discount Income +Other Operating Income + Exchange Gain + Non Operating Income

E = Earning

- Return on Equity

$$Return\ on\ Equity\ (ROE) = \frac{Net\ Income\ after\ Tax}{Share\ holders'\ Fund}$$

- Return On Assets

$$Return\ on\ Assets\ (ROA) = \frac{Net\ Income\ after\ Tax}{Total\ Assets}$$

- Earnings Per Share

$$Earning\ per\ Share(EPS) = \frac{Net\ Income\ after\ Tax}{No.of\ Shares\ Outstanding}$$

- Price Earnings (P.E) Ratio

$$Price\ Earning\ (P\ /E)Ratio = \frac{Market\ Price\ Per\ Share}{Earning\ Price\ Pre\ Share}$$

- Net Interest Margin

$$Net\ Interest\ Margin = \frac{Net\ Interest\ Income}{Total\ Earning\ Assets}$$

L = Liquidity

- Cash Reserve Ratio
  - NRB Balance to Total Deposit Ratio

$$NRB\ Balance\ to\ Total\ Deposit\ Ratio = \frac{Local\ Currency\ Balance\ in\ NRB}{Total\ Local\ Currency\ Deposit - Margin\ Deposit}$$

  - Cash in Vault to Total Deposit Ratio

$$Cash\ in\ Vault\ to\ Total\ Deposit\ Ratio = \frac{Cash\ in\ Vault}{Total\ Deposits}$$

Where,

Cash in vault = Local Currency in Hand + Foreign Currency in Hand

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

- Cash & Bank Balance Ratio to Total Deposit Ratio

$$Cash\ and\ Bank\ Balance\ Ratio = \frac{Total\ Cash\ and\ Bank\ Balance}{Total\ Deposits}$$

Where,

Total Cash & Bank Balance = Cash Balance + Balance with NRB + Balance with Bank/Financial Institution (Local Currency +Foreign Currency)

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

- Investment in Government Security Ratio to Total Deposit Ratio

$$Investment\ in\ Gov.Security\ to\ Total\ Deposit = \frac{Investment\ in\ Government\ Security}{Total\ Deposits}$$

Where,

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

- Liquid Assets to Total Depositing Ratio

$$Total\ Liquid\ Asset\ to\ Total\ Deposit\ Ratio = \frac{Total\ Liquid\ Asset}{Total\ Deposits}$$

Where,

Total Liquid assets = Cash in hand + NRB Balance + Domestic bank balance + Foreign currency bank balance + Money at call & short notice+ Investments in Government securities.

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

Further more for the detail study and analysis of research work different kinds of Tabular, Graphical and diagram presentation are also done wherever necessary.

3.8 Research Variables

Capital, Core Capital, Supplementary Capital, Total Risk Weight Asset, Loans, Loan Provisions, Total Non Performing, Total Performing Loan, Total Loan & Advances, Total Expenses, Total Income, Share Holder's Fund, Total Assets, Earning Per Share, Market Price Per Share, Total Earning Asset, Total Deposits, Cash Balance, Bank Balance, Liquid Assets, Investment in Government Securities, Net Profit after Tax, No of Employees, No of Shares, Total Expenses, are research variables of present study.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter deals with the presentation and analysis of data collected from different sources with the focus on the camel component. As stated in the theoretical prescription, the financial performance analysis of Everest Bank Limited, Siddhartha Bank Limited and Kumari Bank Limited are concentrated in the five component of camel; i.e. Capital Adequacy, Assets Quality, Management Quality, Earning Quality and Liquidity. The data collected from annual reports of respective banks have been analyzed with the application of camel.

4.2 Data Presentation and Analysis

The data collected from different sources has been refined and documented in Excel tables, which are further processed to analyze and arrived at the findings on the financial conditions of above mentioned banks in terms of Camel Analysis. The major findings of the study on financial performance of Everest Bank Limited (EBL), Siddhartha Bank Limited (SBL) and Kumari Bank Limited (KBL) are also described on each section and part of CAMEL Analysis.

4.2.1 CAPITAL ADEQUACY

Capital Adequacy is a measure of an FI's financial strength, in particular its ability to cushion operational and abnormal losses. In other words, it is a ratio of solvency. Minimum capital adequacy ratios have been designed to ensure banks can absorb a reasonable level of losses before becoming insolvent. The higher the capital adequacy ratios a bank has, the greater the level of unexpected losses it can absorb before becoming insolvent. An FI should have adequate capital to support its risk assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to asset structure than to the volume of liabilities. Risk Weight Assets, Core Capital and Supplementary Capital are major figures used to calculate Capital Adequacy Ratio.

Risk-weighted assets are the total of all assets held by the bank which are weighted for credit risk according to a formula determined by the Regulator (usually the country's Central Bank).

Assets-at-risk are defined as the total of the impaired values of assets at the date of making the advance to the sub borrower. Assets are typically classified as: (i) risk-free; (ii) minimum risk; (iii) general risk; (iv) substandard; (v) "workout" (or minimal chance of recovery); and (vi) fixed assets, furniture and office equipment, computers, etc. To each of these classifications is awarded a percentage of their values for which an FI's capital is needed to cover risk of losses. Most central banks follow the Bank of International Settlements (BIS) guidelines in setting formulae for asset risk weights. Nepal Rastra Bank has categorized the assets of the bank, on the balance sheet items and off the balance sheet items, on their nature and risk associated with them. So The Total Risk Weighted Asset is computed by the multiplying the Total net value of asset by its risk weight. In the context of Nepal, NRB has assigned following weight for following Assets of Banks

0% risk weight Asset

Cash Balance, Gold (Tradable), Balance with Nepal Rastra Bank, Investment in Government Security, Investment in Nepal Rastra Bank's Bond, Fully Secured Loans against own Fixed Deposit Receipt, Fully Secured Loan against Government Security, AIR on Government Security, Bills Collection.

10% risk weight Asset

Forward Foreign Exchange Contract

20% risk weight Asset

Balances with Domestic Licensed Banks and Financial Institutions, Fully secured FDR Loan against Fixed Deposit Receipt of Other Banks, Receipt of other Licensed Banks & Financial Institutions, Balances with Foreign Banks, Money at Call, Loan Against Guarantees of Internationally Rated Banks, Other Investment in Internationally Rated Banks, Letter of Credit with maturity less than 6 month (Full Value), Guarantees issued against counter guarantee of Internationally rated Foreign Banks.

50% risk weight Asset

Letter of Credit with maturity more than 6 months (Full Value), Bid Bond, Performance Bond.

100% risk weight Asset

Investment in Shares, Debentures and Bonds, Other Investment, Loan Advances and Bills Purchased/ Discounted, Fixed Assets, All Other Assets, Other Accrued Interest Receivable (Accrued Interest Receivable- Interest on Government Security-interest

Suspense), Advanced Payment Guarantee, Financial Guarantee, Other Guarantee, Irrevocable Loan Commitment, Contingent Liabilities in respect of Income Tax, All Other Contingent Liabilities

The 1993 Basel Accord enforced the capital ratio to risk adjusted assets of commercial banks. According to this accord, core capital must equal to or exceed 4 percent of the risk weighted assets of the commercial banks. Similarly, the amount of the supplementary capital should not exceed the amount of the core capital and the total capital must equal or exceed 8 percent of risk weighted assets. NRB initially fixed the core capital at the level of 4.5 percent of the risk weighted assets and total capital at the level of 9 percent of risk weighted assets of the commercial banks (NRB 2058). The mandatory level of total capital, as set by Nepal Rastra Bank, for the FY 2002/03 is 10% and for FY 2003/04 to 2006/07 is 11% of risk weighted assets of commercial banks. But NRB has strictly directed all commercial banks that the amount of the supplementary capital should not be in excess to the amount of the core capital (NRB 2005). Capital Adequacy Ratio is calculated as:

$$Capital\ Adequacy\ Ratio = \frac{Total\ Capital\ Fund}{Total\ Risk\ Weight\ Asset}$$

$$= \frac{Tire\ I\ Capial + Tire\ II\ Capital}{Total\ Risk\ Weight\ Assets}$$

$$= \frac{Core\ \ Capial + Supplementary\ Capital}{Total\ Risk\ Weight\ Assets}$$

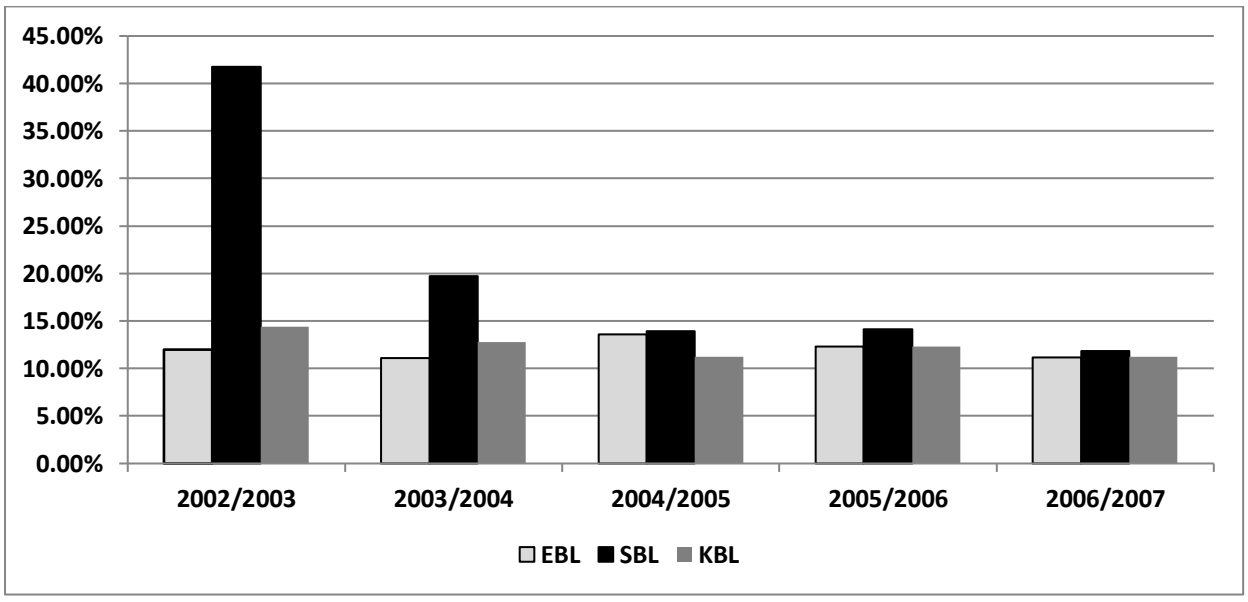
Table 4.2.1 is the observed Capital Adequacy Ratio during the study period in numerical terms which is presented below:

Table: 4.2.1 Capital Adequacy Ratio

Fiscal Year	Banks	Total Capital Fund "in Rs."	Total Risk Adjusted Asset "in Rs."	Capital Adequacy Ratio
2002/2003	EBL	684,163,000.00	5,707,030,000.00	11.99%
	SBL	355,005,994.87	850,647,012.29	41.73%
	KBL	363,469,934.00	2,528,767,733.00	14.37%
2003/2004	EBL	766,879,000.00	6,924,807,000.00	11.07%
	SBL	390,258,002.41	1979823911.75	19.71%
	KBL	570,147,056.00	4,449,407,210.00	12.81%
2004/2005	EBL	1,247,562,000.00	9,195,588,000.00	13.57%
	SBL	413,424,989.16	2,968,444,347.06	13.93%
	KBL	705,529,193.00	6,291,843,521.00	11.21%
2005/2006	EBL	1,391,339,000.00	11,291,137,000.00	12.32%
	SBL	632,279,000.00	4,465,021,233.00	14.16%
	KBL	940,979,000.00	7,625,050,127.00	12.34%
2006/2007	EBL	1,676,115,000.00	14976737000.00	11.19%
	SBL	863,832,000.00	7,297,686,632.00	11.84%
	KBL	1,115,207,000.00	9,959,911,399.00	11.20%

Chart 4.2.1.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Capital Adequacy Ratio among three banks.

Chart: 4.2.1.a Capital Adequacy Ratio



As shown in the above table 4.2.1 and chart 4.2.1.a, the Capital Adequacy Ratio of SBL of 41.73% is the highest and EBL of 11.99% is the lowest in FY 2002/2003; SBL of 19.71% is the highest and EBL of 11.07% is the lowest in FY 2003/04; SBL of 13.93% is the highest and KBL of 11.21% is the lowest in FY 2004/05; SBL of 14.16% is the highest and 12.32 of EBL is the lowest in FY 2005/06 and SBL of 11.84% is the highest and EBL of 11.19% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.1.b helps to find out the trend of three banks regarding Capital Adequacy Ratio over the last five year's period.

Chart: 4.2.1.b Trend Analysis of Capital Adequacy Ratio

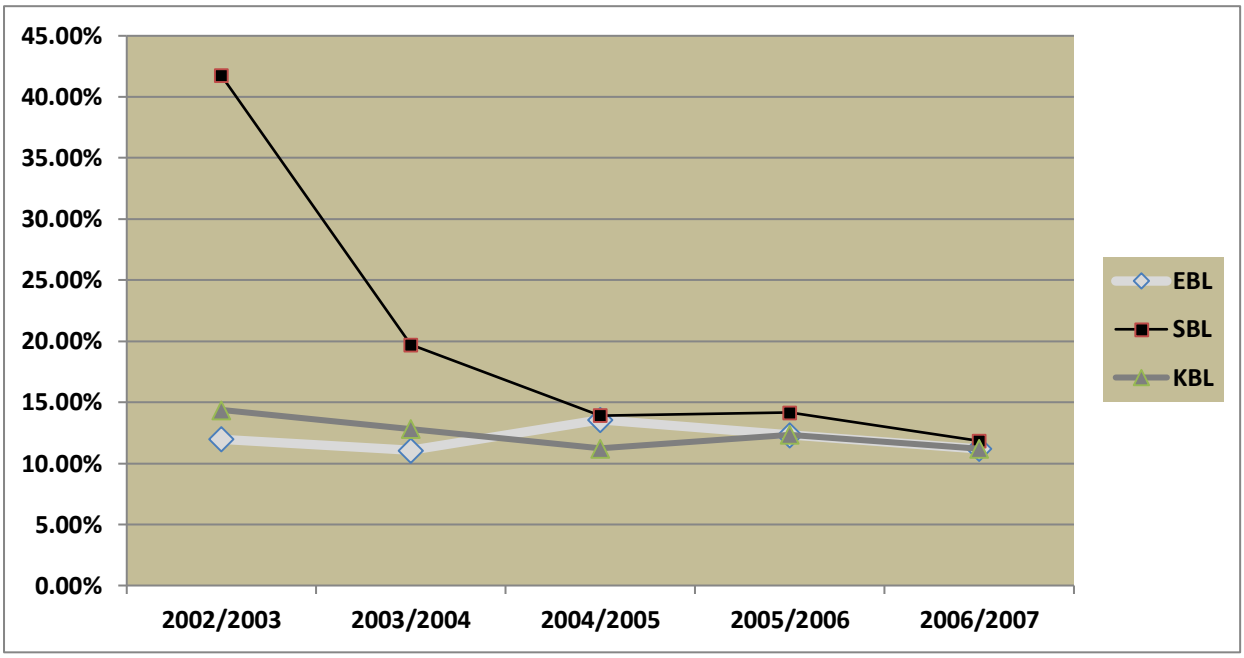


Chart 4.2.1.b is the trend analysis of three banks over the five year's study period. As shown in the figure Capital Adequacy Ratio of EBL started by 11.99% in FY 2002/03, decreased in FY 2003/04 thereafter increases in 2004/05, then again decreases in FY 2005/06, it continuous and reaches 11.19% in FY 2006/07. Overall Capital Adequacy Ratio of EBL decreases.

Similarly, SBL is always highest among three banks starting with 41.37% in FY 2002/03, then after decreases in FY 2003/04 & 2004/05, slightly increases in FY 2005/06 and again decreasing in 2006/07 and reaches to 11.84% at the end of study period 2006/07. Overall Capital Adequacy Ratio of SBL also is in decreasing trend.

Likewise, Capital Adequacy Ratio of KBL started with 14.37% in FY 2002/03 decreases in FY 2003/04 and 2004/05, there after increases in FY 2005/06 and again decreases and reached to 11.20% at the end of FY 2006/07. This also shows the decreasing trend in overall.

Capital Adequacy ratio has two parts, which are

4.2.1.1 Tier I (Core) Capital Adequacy Ratio

Tier I Capital is the core measure of a bank's financial strength from a regulator's point of view. It is also known as Core Capital. In the context of Nepal, Tier I (core/primary) Capital includes Paid-up Capital, Share Premium, Non redeemable Preference Share, General Reserve Fund, Cumulative Profit / Loss, Capital Redemption Reserve, Capital Adjustment Fund/ Proposed Bonus Share and Other Free Reserve. Amount of the Goodwill, Fictitious Assets, Investment in excess of prescribe limit specified by NRB, and investment in security of companies with financial interest is deducted from the sum of all elements of the primary capital to arrive at the core capital.

Tier I ratio shows the relationship between the total core capital or internal sources and total risk adjusted assets. The theoretical reason for holding capital is that it should provide protection against unexpected losses. It is also called Core Capital Ratio (CCR). The mandatory level of Core Capital, as set by Nepal Rastra Bank, for the FY 2002/03 is 5% and for FY 2003/04 to 2006/07 is 5.5% of risk weighted assets of commercial banks. It is calculated by using the following model.

$$Tire\ I\ Capital\ Adequacy\ Ratio = \frac{Tire\ I\ Capital}{Total\ Risk\ Weight\ Asset}$$

OR

$$Core\ Capital\ Adequacy\ Ratio = \frac{Core\ Capital}{Total\ Risk\ Weight\ Asset}$$

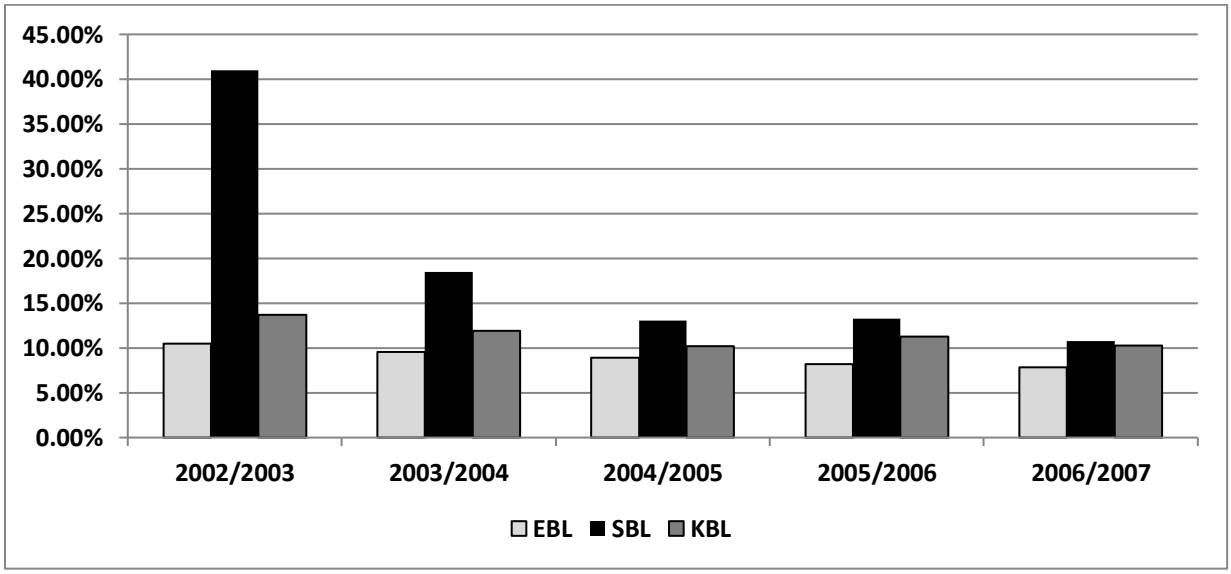
Table 4.2.1.1 is the observed Tire I (Core) Capital Adequacy Ratio during the study period in numerical terms which is presented below:

Table 4.2.1.1 Tier I (Core) Capital Adequacy Ratio

Fiscal Year	Banks	Core Capital "in Rs."	Total Risk Adjusted Asset "in Rs."	Core Capital Ratio
2002/2003	EBL	597,009,000.00	5,707,030,000.00	10.46%
	SBL	348,715,745.19	850,647,012.29	40.99%
	KBL	347,289,038.00	2,528,767,733.00	13.73%
2003/2004	EBL	663,269,000.00	6,924,807,000.00	9.58%
	SBL	366,198,329.81	1979823911.75	18.50%
	KBL	529,677,363.00	4,449,407,210.00	11.90%
2004/2005	EBL	816,793,000.00	9,195,588,000.00	8.88%
	SBL	387,615,864.54	2,968,444,347.06	13.06%
	KBL	641,715,719.00	6,291,843,521.00	10.20%
2005/2006	EBL	927,550,000.00	11,291,137,000.00	8.21%
	SBL	593,244,000.00	4,465,021,233.00	13.29%
	KBL	858,520,000.00	7,625,050,127.00	11.26%
2006/2007	EBL	1,171,133,000.00	14976737000.00	7.82%
	SBL	786,870,000.00	7,297,686,632.00	10.78%
	KBL	1,019,893,000.00	9,959,911,399.00	10.24%

Chart 4.2.1.1.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Core Capital Adequacy Ratio among three banks.

Chart: 4.2.1.1.a Tier I (Core) Capital Adequacy Ratio



As shown in the above table 4.2.1.1 and chart 4.2.1.1.a, the Core Capital Adequacy Ratio of SBL of 40.99% is the highest and EBL of 10.46% is the lowest in FY 2002/2003; SBL of 18.50% is the highest and EBL of 9.58% is the lowest in FY 2003/04; SBL of 13.06% is the highest and EBL of 8.88% is the lowest in FY 2004/05; SBL of 13.29% is the highest and

8.21% of EBL is the lowest in FY 2005/06 and SBL of 10.78% is the highest and EBL of 7.28% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.1.1.b helps to find out the trend of three banks regarding Tier I (Core) Capital Adequacy Ratio over the last five year's period.

Chart: 4.2.1.1.b Trend Analysis of Tier I (Core) Capital Adequacy Ratio

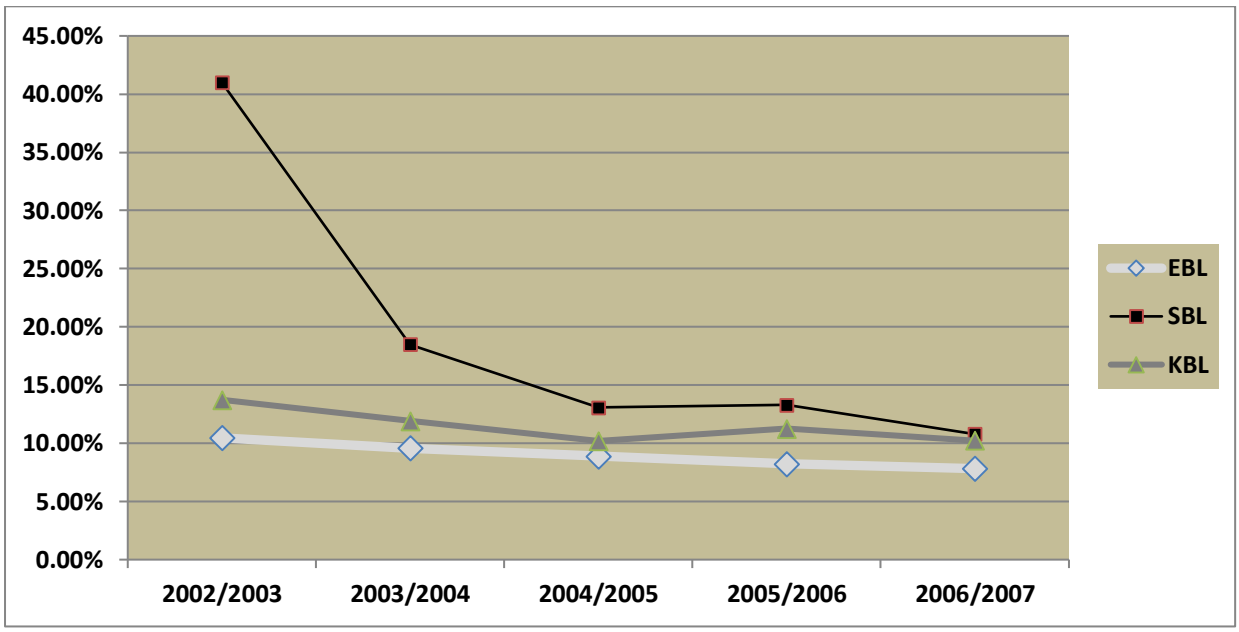


Chart 4.2.1.1.b is the trend analysis of three banks over the five year's study period. As shown in the figure Core Capital Adequacy Ratio of EBL started by 10.46% in FY 2002/03, decreases there after till FY 2006/07 and reaches to 7.82%. Overall Core Capital Adequacy Ratio of EBL decreases.

Similarly, Core Capital Adequacy Ratio of SBL is always highest among three banks starting with 40.99% in FY 2002/03, then after decreases in FY 2003/04 & 2004/05, slightly increases in FY 2005/06 and again decreasing in 2006/07 and reaches to 10.78% at the end of study period 2006/07. Overall Core Capital Adequacy Ratio of SBL also is in decreasing trend.

Likewise, Core Capital Adequacy Ratio of KBL started with 13.73% in FY 2002/03 decreases in FY 2003/04 and 2004/05, there after increases in FY 2005/06 and again decreases and reached to 10.24% at the end of FY 2006/07. This also shows the decreasing trend in overall.

4.2.1.2 Tier II (Supplementary) Capital Adequacy Ratio

Tier II Capital is a measure of a bank's financial strength with regard to the second most reliable form of financial capital, from a regulator's point of view. This ratio shows the absolute contribution of supplementary capital in capital adequacy. In Nepalese context, Tier II (supplementary) capital comprises of Loan Loss Provision on Pass Loan, Assets Revaluation Fund, Hybrid Capital Instruments, Unsecured Subordinated Term Debt, Exchange Equalization Fund, Excess Loan Loss Provision, and Provision for Loss on Investment. It is used to analyze the supplementary capital adequacy of the banks and determined by using the following model.

$$Tire\ II\ Capital\ Adequacy\ Ratio = \frac{Tire\ II\ Capital}{Total\ Risk\ Weight\ Asset}$$

OR

$$Supplementary\ Capital\ Adequacy\ Ratio = \frac{Supplementary\ Capital}{Total\ Risk\ Weight\ Asset}$$

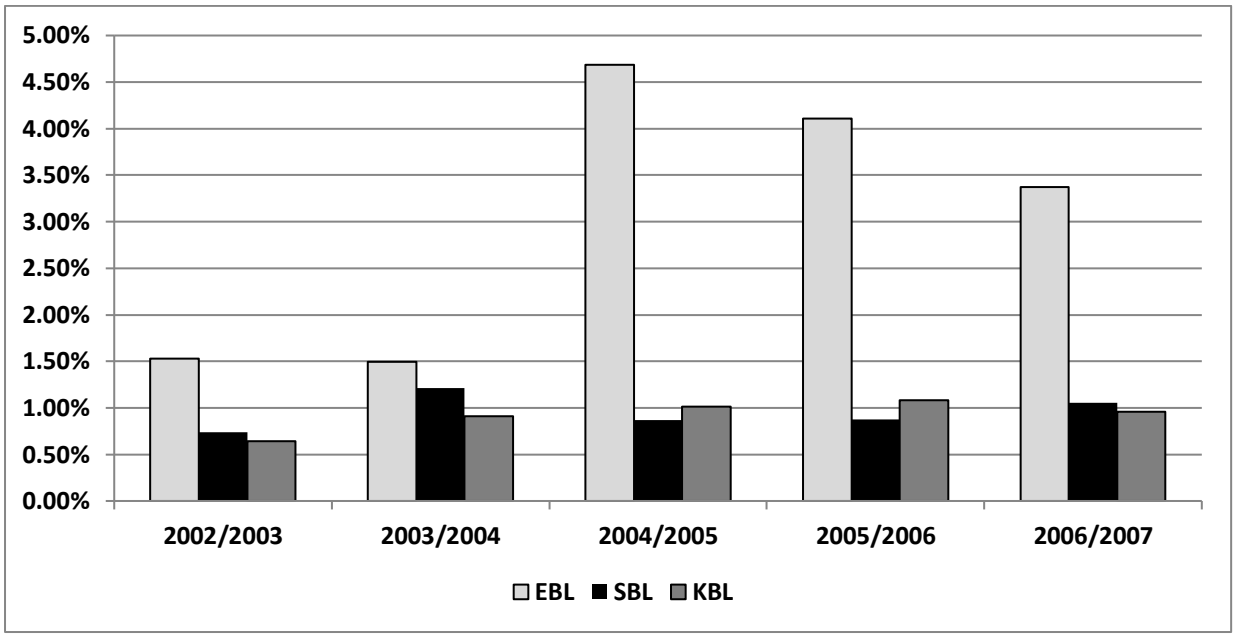
Table 4.2.1.2 is the observed Tire II (Supplementary) Capital Adequacy Ratio during the study period in numerical terms which is presented below:

Table 4.2.1.2 Tier II (Supplementary) Capital Adequacy Ratio

Fiscal Year	Banks	Supplementary Capital "in Rs."	Total Risk Adjusted Asset "in Rs.)	Supplementary Capital Ratio
2002/2003	EBL	87,154,000.00	5,707,030,000.00	1.53%
	SBL	6,290,249.68	850,647,012.29	0.74%
	KBL	16,180,896.00	2,528,767,733.00	0.64%
2003/2004	EBL	103,610,000.00	6,924,807,000.00	1.50%
	SBL	24,059,672.60	1979823911.75	1.22%
	KBL	40,469,693.00	4,449,407,210.00	0.91%
2004/2005	EBL	430,769,000.00	9,195,588,000.00	4.68%
	SBL	25,809,124.62	2,968,444,347.06	0.87%
	KBL	63,813,474.00	6,291,843,521.00	1.01%
2005/2006	EBL	463,789,000.00	11,291,137,000.00	4.11%
	SBL	39,035,000.00	4,465,021,233.00	0.87%
	KBL	82,459,000.00	7,625,050,127.00	1.08%
2006/2007	EBL	504,982,000.00	14976737000.00	3.37%
	SBL	76,962,000.00	7,297,686,632.00	1.05%
	KBL	95,314,000.00	9,959,911,399.00	0.96%

Chart 4.2.1.1.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Supplementary Capital Adequacy Ratio among three banks.

Chart: 4.2.1.2.a Tier II (Supplementary) Capital Adequacy Ratio



As shown in the above table 4.2.1.2 and chart 4.2.1.2.a, the Supplementary Capital Adequacy Ratio of EBL of 1.53% is the highest and KBL of 0.64% is the lowest in FY 2002/2003; EBL of 1.50% is the highest and KBL of 0.91% is the lowest in FY 2003/04; EBL of 4.68% is the highest and SBL of 0.87% is the lowest in FY 2004/05; EBL of 4.11% is the highest and 0.87% of SBL is the lowest in FY 2005/06 and EBL of 1.08% is the highest and EBL of 0.96% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.1.2.b helps to find out the trend of three banks regarding Tier II (Supplementary) Capital Adequacy Ratio over the last five year's period.

Chart: 4.2.1.2.b Trend Analysis of Tier II (Supplementary) Capital Adequacy Ratio

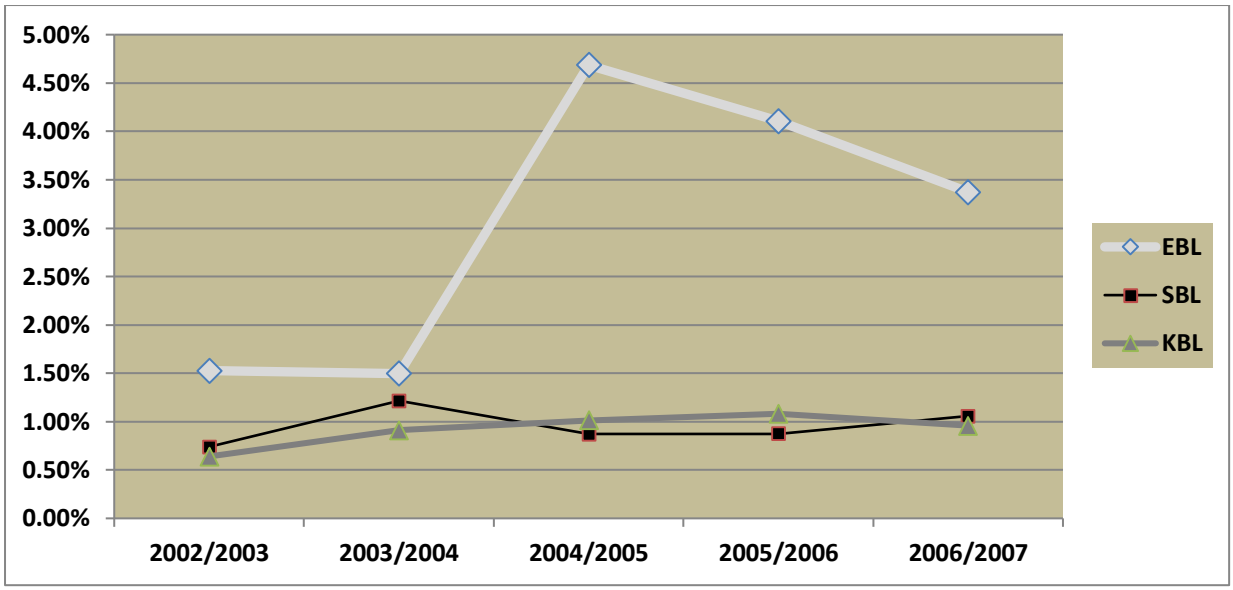


Chart 4.2.1.2.b is the trend analysis of three banks over the five year's study period. As shown in the figure Tier II (Supplementary) Capital Adequacy Ratio of EBL always highest among three bank started by 1.53% in FY 2002/03, decreased in FY 2003/04 and highly increased in FY 2004/05 and reached to 4.68% and again decreased till FY 2006/07 and finally reached to 3.37%. Overall Supplementary Capital Adequacy Ratio of EBL has increased.

Similarly, Supplementary Capital Adequacy Ratio of SBL started with 0.74% in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and again increased in 2005/06 and 2006/07 and reached to 1.05% at the end of study period. Overall Supplementary Capital Adequacy Ratio of SBL also is in increasing trend.

Likewise, Capital Adequacy Ratio of KBL started with 0.64% in FY 2002/03 and increased till FY 2005/06. In FY 2006/07 it decreased to 0.96% but in overall it is in increasing trend.

Findings:

Although Core Capital of all the three banks has increased over the study period, still the Core Capital Ratio of all the three banks are is in decreasing trend. It is mainly due to higher percentage of the increment in the Total Risk Weight Assets. On the other hand, there is increment in supplementary capital as well as Supplementary Capital Adequacy Ratio due to the higher percentage increment in Supplementary Capital than Total Risk Weight Assets. So, while looking overall Capital Adequacy Ratio, it is in decreasing trend as Supplementary capital ratio provides only small contribution to Total Capital Adequacy Ratio. But, Core Capital Adequacy Ratio, supplementary Capital Adequacy Ratio and as well as Total Capital Adequacy Ratio of all banks are higher than that standard set by the Nepal Rastra Bank. So, all

banks show the financial strength and soundness throughout the study period which indicates that the banks are applying adequate amount of internal sources of shareholder's funds with significant Core Capital Adequacy ratio throughout the study period.

4.2.2 ASSETS QUALITY

Asset quality has direct impact on the financial performance of an FI. The quality of assets particularly, loan assets and investments, would depend largely on the risk management system of the institution. Credit risk is one of the factors that affect the health of an individual FI. The extent of the credit risk depends on the quality of assets held by an individual FI. The quality of assets held by an FI depends on exposure to specific risks, trends in non-performing loans, and the health and profitability of bank borrowers: especially the corporate sector. We can use a number of measures to indicate the quality of assets held by FIs. ADB suggests these measures: loan concentration by industry, region, borrower and portfolio quality; related party policies and exposure on outstanding loan, approval process of loan, check and balance of loans; loan loss provision ratio; portfolio in arrear; loan loss ratio; and reserve ratio—of checking the quality of assets of an FI (ADB 2002).

NRB uses composition of assets, nonperforming loan to total loan ratio, net nonperforming loan to total loan ratio as the indicators of the quality of assets of commercial banks (NRB 2005). NRB has directed the commercial banks in regards to the concentration of the loan. Any licensed FI can grant the fund base loan to a single borrower or borrowers related to the same business group up to the 25 percent of its primary capital. In the same vein, it can provide the non-fund base loan up to 50 percent of its core capital (NRB 2005). Similarly, it has directed FIs to classify the loans into performing loan and nonperforming loans. The loans that are not due and 3 months past due fall in the class of performing loans/performing assets (which are overdue up to 3 months) and others do in the non-performing loans. Further, non-performing loans are classified into three groups: substandard (Which are overdue from 3 month up to 6 months), doubtful (which are overdue from 6 months up to 12 months), and bad debt/ loss (which are over due after 1 year). Here are the some regulations that NRB has made e regarding to the provision of performing and non performing loan which are given below:

- For any normal loan, Commercial banks have to make 1 percent provision for pass loan/performing loan, 25 percent for substandard loan, 50 percent for doubtful loan and 100 percent for bad loan (NRB 2005).
- If any bank has given loan on the basis of Personal Guarantee (i.e. without taking any movable or immovable property as security), bank has to make 20 percent more provision in general, i.e. 21 percent provision for pass loan/performing loan, 45 percent for substandard loan, 70 percent for doubtful loan and 100 percent for bad loan.
- Shareholder holding 1 percent or more shares of any bank cannot take a lone from that bank. If loan is already taken before this NRB regulation, that bank has to make 2 provision for pass loan/performing loan, 50 percent for substandard loan, 100percent for doubtful loan.
- In the case of reschedule of restructured loans (i.e. Old Principle + Due interest = New principle), any bank has to report to the NRB about the restructured and has to make a provision of 12.50, considering as pass loan/performing loan, on the first day of reschedule / reschedule, 50 percent for substandard loan, 100 percent for doubtful loan.

Under the Asset Quality following ratios are used to measure the performance of banks.

4.2.2.1 Performing Loan Ratio:

Performing loan refers to those good loans of bank which are paying its Principle + Interest on time or overdue up to 3 months. So, The Performing Loan Ratio is the proportion of Performing Loan to Total Loan and Advances. This ratio shows the proportion of good loans. Hence, higher Performing Loan Ratio reflects the competency or success of loan department of bank and vice versa or the better financial health of bank. The ratio is used to analyze the asset quality of the bank and determined by using the given model.

$$Performing\ Loan\ Ratio = \frac{Total\ Performing\ Loan}{Total\ Loan\ \&\ Advances}$$

Where,

Total Performing Loan = those loans which have been paying or overdue up to 3 months either in the form of interest servicing or principal repayment, or

= Pass Loan + Restructured Loan

Total Loan & Advances = Total Performing Loan + Total Non Performing Loan

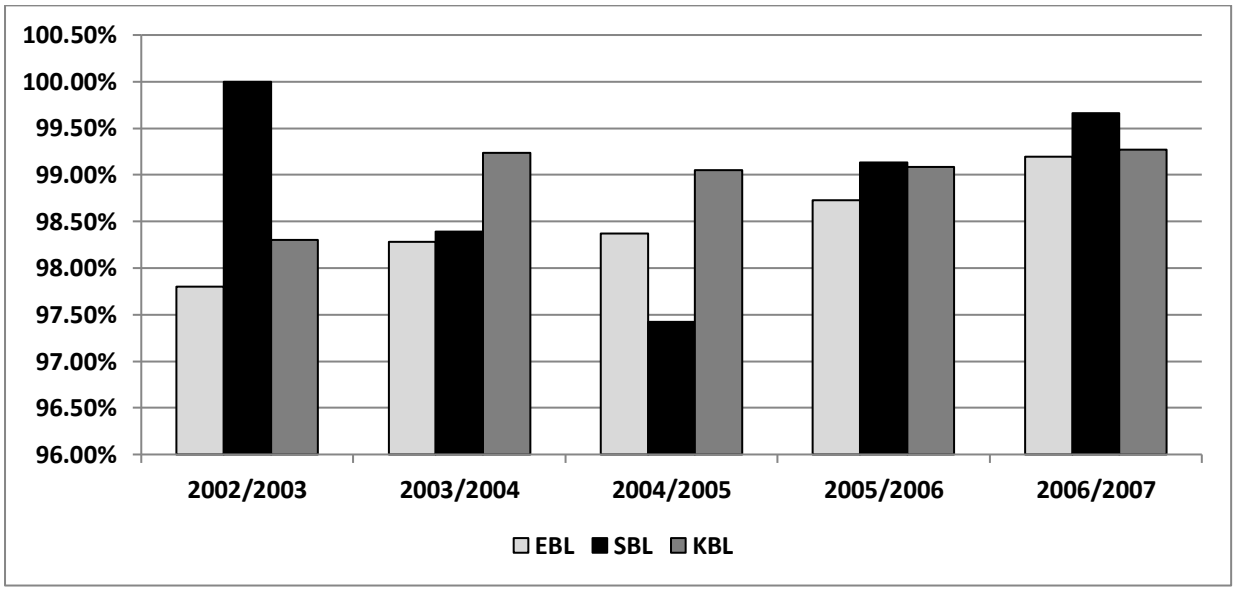
Table 4.2.2.1 is the observed Performing Loan Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.2.1 Performing Loan Ratio

Fiscal Year	Banks	Total Performing Loan "in Rs."	Total Loan & Advances "in Rs."	Performing Loan Ratio
2002/2003	EBL	4,938,390,206.00	5,049,581,309.00	97.80%
	SBL	629,024,968.48	629,024,968.48	100.00%
	KBL	2,101,263,243.00	2,137,587,047.00	98.30%
2003/2004	EBL	5,991,085,718.00	6,095,841,087.00	98.28%
	SBL	1,542,603,738.25	1,567,826,770.76	98.39%
	KBL	3,669,794,872.00	3,697,984,528.00	99.24%
2004/2005	EBL	7,771,282,526.00	7,900,090,271.00	98.37%
	SBL	2,567,003,700.00	2,634,930,609.08	97.42%
	KBL	5,627,024,183.00	5,681,012,721.00	99.05%
2005/2006	EBL	10,007,018,658.00	10,136,254,448.00	98.73%
	SBL	3,835,697,432.00	3,869,269,992.00	99.13%
	KBL	6,943,433,808.00	7,007,787,514.00	99.08%
2006/2007	EBL	13,969,507,151.00	14,082,686,087.00	99.20%
	SBL	6,298,185,615.00	6,319,727,198.00	99.66%
	KBL	8,996,314,613.00	9,062,433,481.00	99.27%

Chart 4.2.2.1.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Performing Loan Ratio among three banks.

Chart: 4.2.2.1.a Performing Loan Ratio



As shown in the above table 4.2.2.1 and chart 4.2.2.1.a, the Performing Loan Ratio of SBL of 100% is the highest and EBL of 97.80% is the lowest in FY 2002/2003; KBL of 99.24% is the

highest and EBL of 98.28% is the lowest in FY 2003/04; KBL of 99.05% is the highest and SBL of 97.42% is the lowest in FY 2004/05; SBL of 99.13% is the highest and 98.73% of SBL is the lowest in FY 2005/06 and SBL of 99.66% is the highest and EBL of 99.20% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.2.1.b helps to find out the trend of three banks regarding Performing Loan Ratio over the last five year's period.

Chart: 4.2.2.1.b Trend Analysis of Performing Loan Ratio

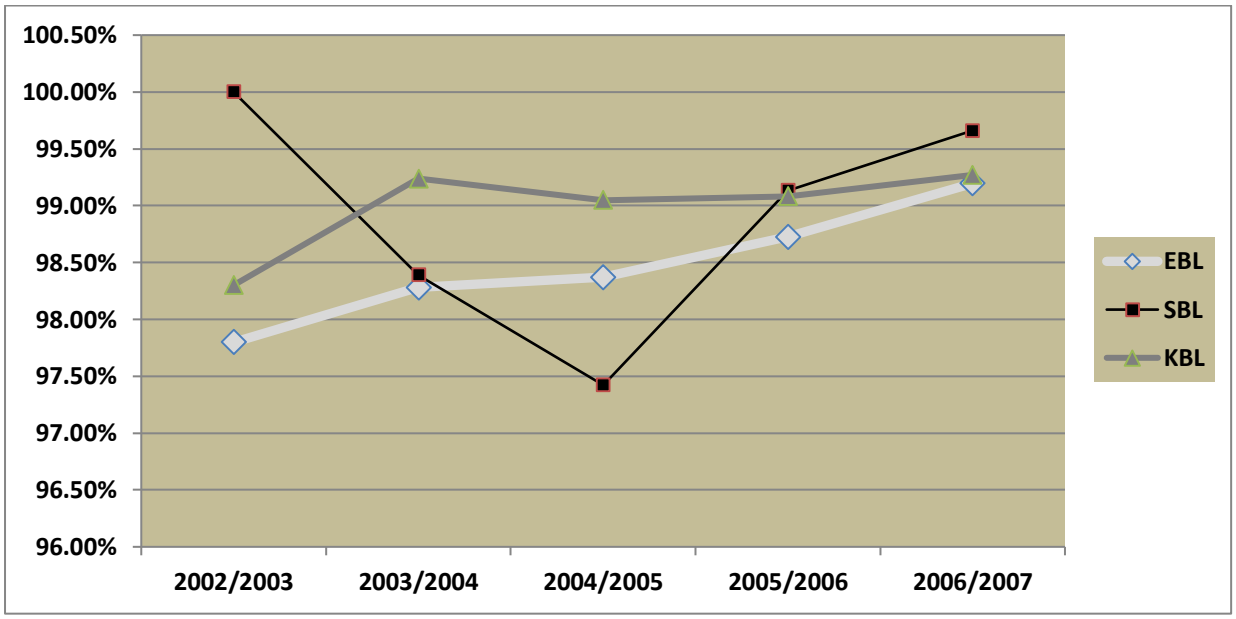


Chart 4.2.2.1.b is the trend analysis of three banks over the five year's study period. As shown in the figure Performing Loan Ratio of EBL started from 97.80% in FY 2002/03 and thereafter is continuously increased till FY 2006/07and reached to 99.20%. So, trend analysis shows that EBL is doing good regarding its performing loan ratio.

Similarly, Performing Loan Ratio of SBL started with 100% in FY 2002/03, decreased in FY 2003/04 and 2004/05 and again increased in 2005/06 and 2006/07 and reached to 99.66% at the end of study period. In General, Performing Loan Ratio of SBL is not too bad.

Likewise, Performing Loan Ratio of KBL started with 98.30% in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and increased in FY 2005/06 and 2006/07 and reached to 99.27%. In general Performing Loan Ratio of KBL is in increasing trend.

4.2.2.2 Non-Performing Loan Ratio:

Non-performing loan refers to those loans which are not paying its Principle + Interest in time or overdue more than three months. So, it consists of Sub-standard loan, Doubtful loan and Bad Loan. The non-performing loan ratio indicates the relationship between Non-performing Loan and Total Loan. It measures the proportion of Non-performing Loan in Total Loan and Advances. Higher non performing loan ratio indicates that the bank's assets are not doing well or the loan department is not so conscious while passing loan. So, lower ratio will be preferred regarding Non-performing Loan Ratio. The ratio is determined by using the given model.

$$Non\ Performing\ Loan\ Ratio = \frac{Total\ Non\ Performing\ Loan}{Total\ Loan\ \&\ Advances}$$

Where,

Total Non-performing Loan = those loans which have been past due either in the form of interest servicing or principal repayment and graded as possible default OR

= Sub Standard Loan + Doubtful Loan + Bad Loan

Total Loan & Advances = Total Performing Loan + Total Non Performing Loan

Performing Loan = Pass Loan + Restructured Loan

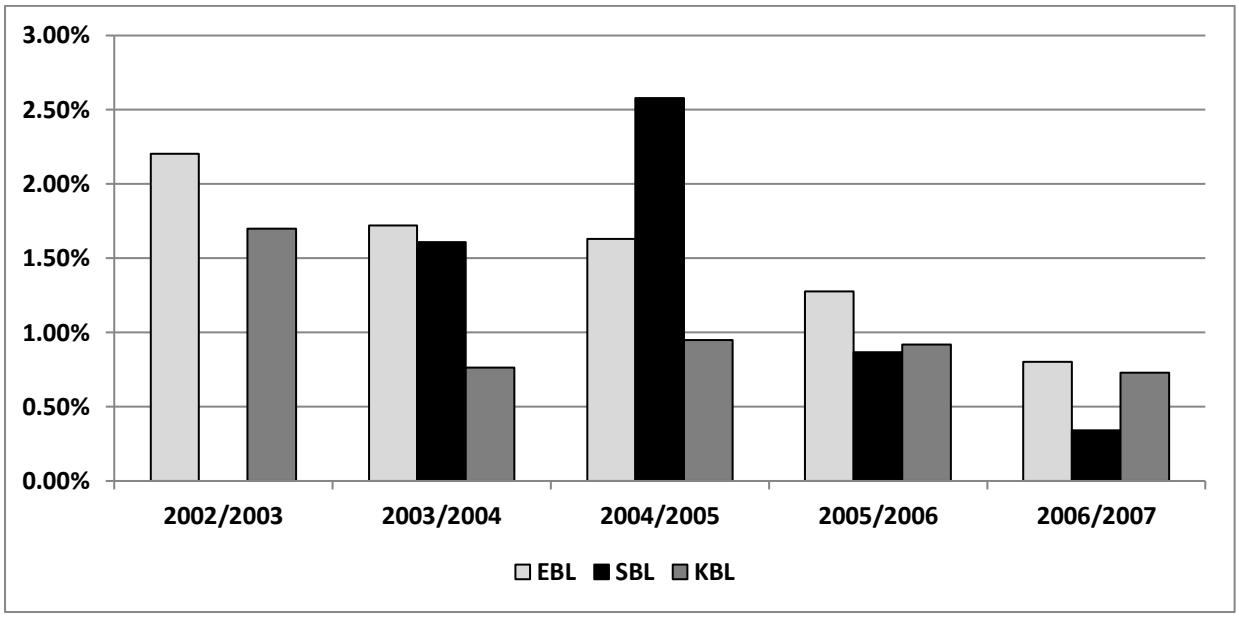
Table 4.2.2.2 is the observed Non Performing Loan Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.2.2 Non Performing Loan Ratio

Fiscal Year	Banks	Total Non Performing Loan "in Rs."	Total Loan & Advances "in Rs"	Non Performing Loan Ratio
2002/2003	EBL	111,191,103.00	5,049,581,309.00	2.20%
	SBL	-	629,024,968.48	0.00%
	KBL	36,323,804.00	2,137,587,047.00	1.70%
2003/2004	EBL	104,755,369.00	6,095,841,087.00	1.72%
	SBL	25,223,032.51	1,567,826,770.76	1.61%
	KBL	28,189,656.00	3,697,984,528.00	0.76%
2004/2005	EBL	128,807,745.00	7,900,090,271.00	1.63%
	SBL	67,926,909.08	2,634,930,609.08	2.58%
	KBL	53,988,538.00	5,681,012,721.00	0.95%
2005/2006	EBL	129,235,790.00	10,136,254,448.00	1.27%
	SBL	33,572,560.00	3,869,269,992.00	0.87%
	KBL	64,353,706.00	7,007,787,514.00	0.92%
2006/2007	EBL	113,178,936.00	14,082,686,087.00	0.80%
	SBL	21,541,583.00	6,319,727,198.00	0.34%
	KBL	66,118,868.00	9,062,433,481.00	0.73%

Chart 4.2.2.2.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Non Performing Loan Ratio among three banks.

Chart: 4.2.2.2.a Loan Loss Coverage Ratio



As shown in the above table 4.2.2.2 and chart 4.2.2.2.a, the Non Performing Loan Ratio of EBL of 2.20% is the highest and SBL of 0% is the lowest in FY 2002/2003; EBL of 1.72% is the highest and KBL of 0.76% is the lowest in FY 2003/04; SBL of 2.58% is the highest and KBL of 0.95% is the lowest in FY 2004/05; EBL of 1.27% is the highest and 0.87% of SBL is the lowest in FY 2005/06 and EBL of 0.80% is the highest and SBL of 0.34% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.2.2.b helps to find out the trend of three banks regarding Non Performing Loan Ratio over the last five year's period.

Chart: 4.2.2.2.b Trend Analysis of Non Performing Loan Ratio

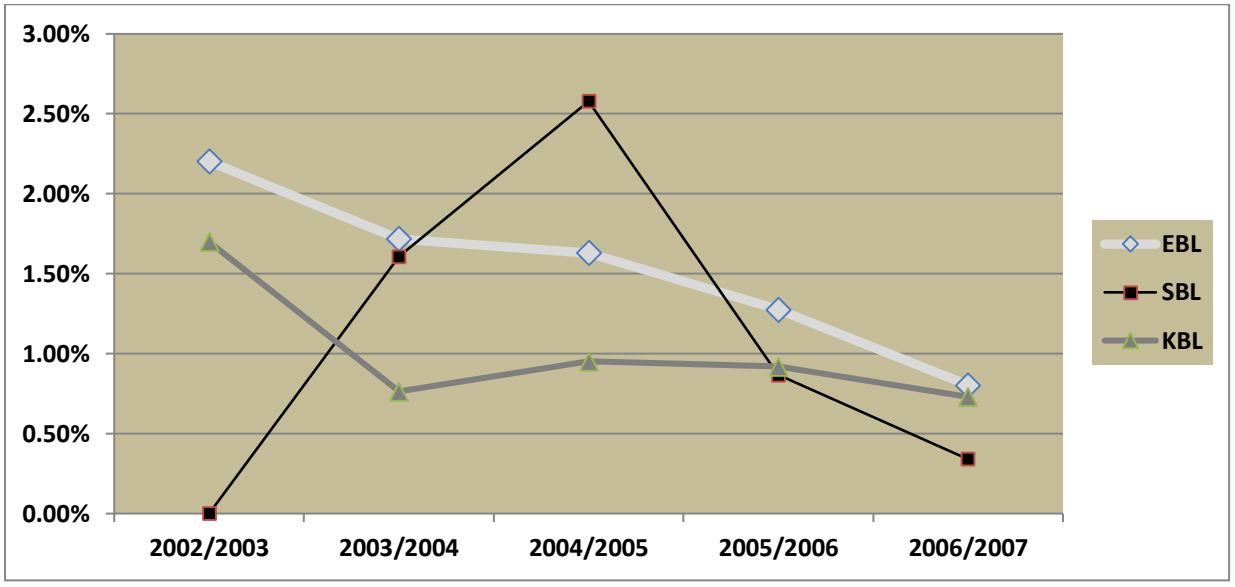


Chart 4.2.2.2.b is the trend analysis of three banks over the five year's study period. As shown in the figure Non Performing Loan Ratio of EBL started from 2.20 % in FY 2002/03 and thereafter is continuously decreased till FY 2006/07and reached to .080%. So, trend analysis shows that EBL is able to decrease its non performing loan continuously which is good sign of bank.

Similarly, Non Performing Loan Ratio of SBL started with 0%, due to the first year of operation where there is less volume transaction of loans and low probability of loan being default or bad, in FY 2002/03, increased in FY 2003/04 and 2004/05 and again decreased in 2005/06 and 2006/07 and reached to 0.34% at the end of study period.

Likewise, Non Performing Loan Ratio of KBL started with 1.70% in FY 2002/03, decreased in FY 2003/04, increased in FY 2004/05 and again decreased in FY 2005/06 and 2006/07 and reached to 0.73%. In general Non Performing Loan Ratio of KBL is in decreasing trend.

4.2.2.3 Loan Loss Coverage Ratio

Loan Loss Coverage Ratio is the relationship between Total Loan Loss Provision and Total Non Performing Loan. It measures the proportion of Total Loan Loss Provision in relation to Total Non Performing loan. Out of the Total Non-Performing if some loans become bad or default then that loss to the bank is covered from the Loan Loss Provision fund. So, from that point of view, higher the loan loss coverage ratio is better for the banks. . The ratio is determined by using the given model:

$$Loan\ Loss\ Coverage\ Ratio = \frac{Total\ Loan\ Loss\ Provision}{Total\ Non\ Performing\ Loan}$$

Where,

Total Loan Loss Provision = Provision on (Pass Loan+ Restructured Loan + Sub Standard Loan + Doubtful Loan + Bad Loan

Total Non Performing Loan = Sub Standard Loan + Doubtful Loan + Bad Loan

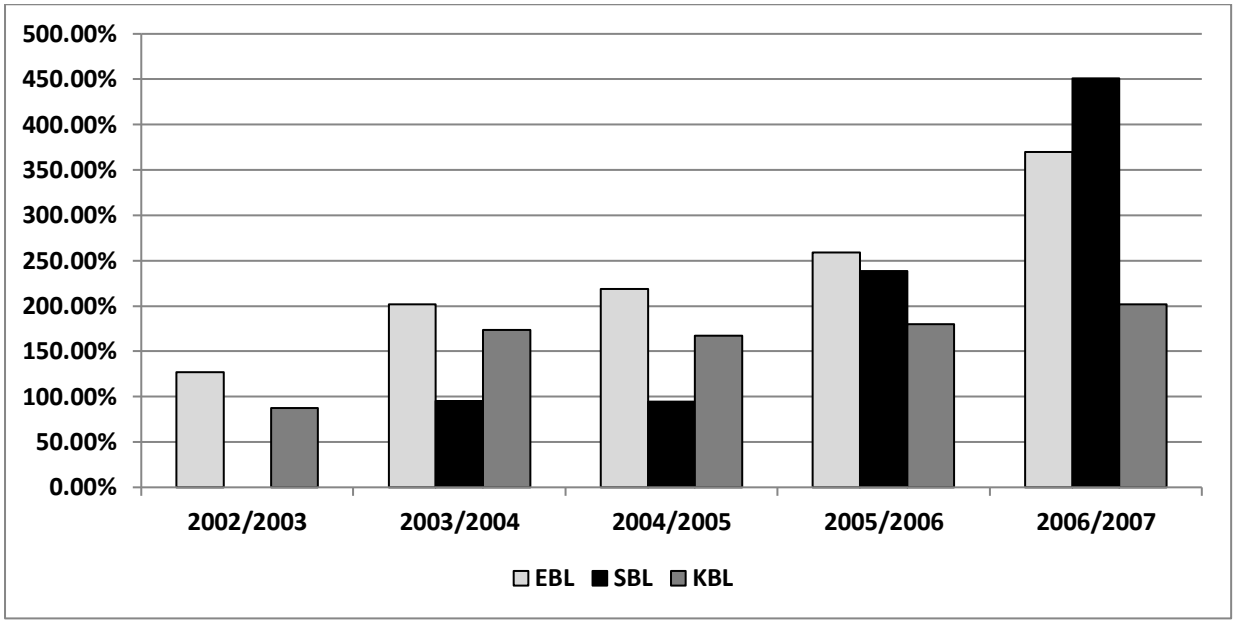
Table 4.2.2.3 is the observed Loan Loss Coverage Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.2.3 Loan Loss Coverage Ratio

Fiscal Year	Banks	Total Loan Loss Provision "in Rs."	Total Non Performing Loan "in Rs."	Loan Loss Coverage Ratio
2002/2003	EBL	141,120,662.00	111,191,103.00	126.92%
	SBL	6,290,249.69	0.00	-
	KBL	31,850,225.00	36,323,804.00	87.68%
2003/2004	EBL	211,718,478.00	104,755,369.00	202.11%
	SBL	24,059,672.60	25,223,032.51	95.39%
	KBL	48,975,805.00	28,189,656.00	173.74%
2004/2005	EBL	281,418,795.00	128,807,745.00	218.48%
	SBL	64,154,594.28	67,926,909.08	94.45%
	KBL	90,087,062.00	53,988,538.00	166.86%
2005/2006	EBL	334,946,772.00	129,235,790.00	259.17%
	SBL	80,147,301.00	33,572,560.00	238.73%
	KBL	115,932,088.00	64,353,706.00	180.15%
2006/2007	EBL	418,604,424.00	113,178,936.00	369.86%
	SBL	97,140,384.00	21,541,583.00	450.94%
	KBL	133,420,366.00	66,118,868.00	201.79%

Chart 4.2.2.3.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Loan Loss Coverage Ratio among three banks.

Chart: 4.2.2.3.a Loan Loss Coverage Ratio



As shown in the above table 4.2.2.3 and chart 4.2.2.3.a, the Loan Loss Coverage Ratio of EBL of 126.92% is the highest and SBL of 0% is the lowest in FY 2002/2003; EBL of 202.11% is the highest and SBL of 95.39% is the lowest in FY 2003/04; EBL of 218.48% is the highest and SBL of 94.45% is the lowest in FY 2004/05; EBL of 259.17% is the highest and 180.15% of KBL is the lowest in FY 2005/06 and SBL of 450.94% is the highest and KBL of 210.79% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.2.3.b helps to find out the trend of three banks regarding Loan Loss Coverage Ratio over the last five year's period.

Chart: 4.2.2.3.b Trend Analysis of Loan Loss Coverage Ratio

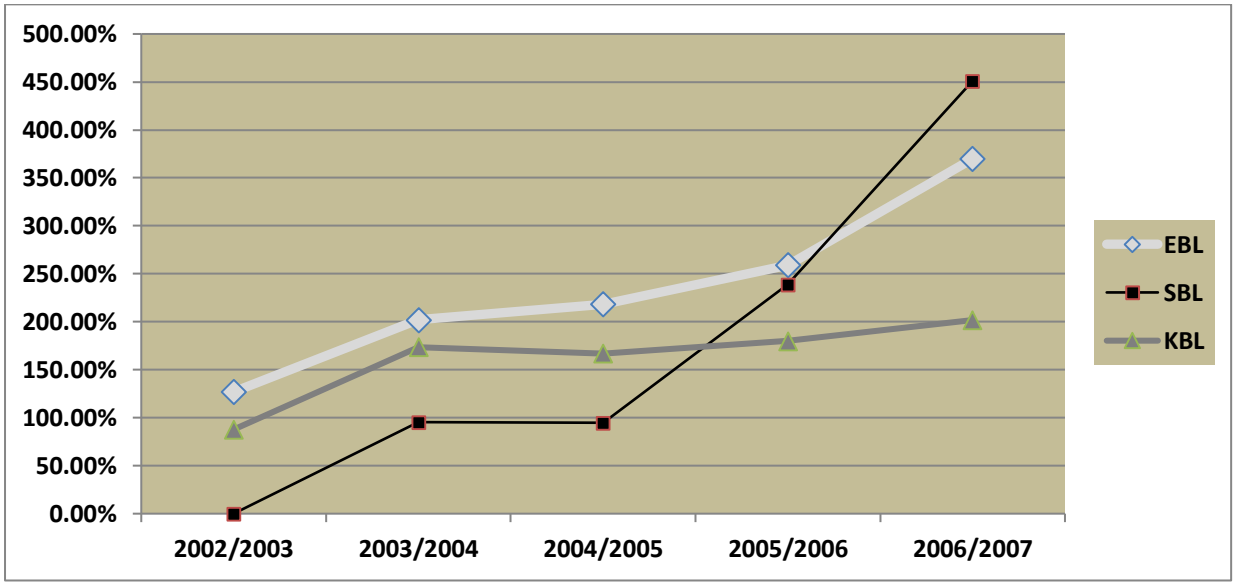


Chart 4.2.2.3.b is the trend analysis of three banks over the five year's study period. As shown in the figure Loan Loss Coverage Ratio of EBL started from 126.92 % in FY 2002/03 and thereafter is continuously increased till FY 2006/07and reached to 369.86%. So, trend analysis shows that EBL is able to increase its Loan Loss Coverage Ratio continuously which will be benefit to the bank if any loan goes to band or default.

Similarly, Loan Loss Coverage Ratio of SBL started with 0%, due to the first year of operation where no provisions are made in the loans, in FY 2002/03, increased in FY 2003/04 ; decreased in FY 2004/05 and again increased in 2005/06 and 2006/07 and reached to 450.94% at the end of study period.

Likewise, Loan Loss Coverage Ratio of KBL started with 87.68% in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and thereafter continuously increased till 2006/07 and reached to 201.79%. In general Loan Loss Coverage Ratio of KBL is in increasing trend.

4.2.2.4 Loan Loss Provision Ratio:

Out of the main functions of the bank one of them is to provide loans to customers. It is important to take note that non-performing loan signals risk of non recovery of the loan which is invested from the pool fund of deposits taken from general public. So, when bank provides loan to customer then there will be chance to convert those loans to Pass Loan, Sub Standard Loan, Doubtful Loan and Bad Loan. In all cases the banks have to keep the provision to protect the public interest as well as taking the preventive measure for the sound health of financial. It reflects adequacy to absorb estimated credit losses associated with the loan and lease portfolio of the bank or it shows the percentage of the provision made to make good the default loans. The provision for loan losses is a charge to current earnings to build the Allowance for Loan and Lease Losses (ALLL). This ratio indicates the proportion of the loan loss provision on Total Loan and Advances. A high ratio is always better safety net to the general public but supposed to mean a bad quality of assets. Central bank has to protect rights of public and thus will be happy with the higher ratio of loan loss provision. However despite of safety net benefits, higher loan loss provision also indicates the banks profit is crunching down by this higher provision as well as poor credit management.

In fact provision made on loans depends on whether information on 'bad loans' is correctly revealed. For the purpose of this study following model is used to determine the Loan Loss Provision Ratio:

$$Loan\ Loss\ Provision\ Ratio = \frac{Total\ Loan\ Loss\ Provision}{Total\ Loan\ \&\ Advances}$$

Where,

Total Loan Loss Provision = Provision on (Pass Loan+ Restructured Loan + Sub Standard Loan + Doubtful Loan + Bad Loan

Total Loan & Advances = Total Performing Loan + Total Non Performing Loan

Performing Loan = Pass Loan + Restructured Loan

Total Non Performing Loan = Sub Standard Loan + Doubtful Loan + Bad Loan

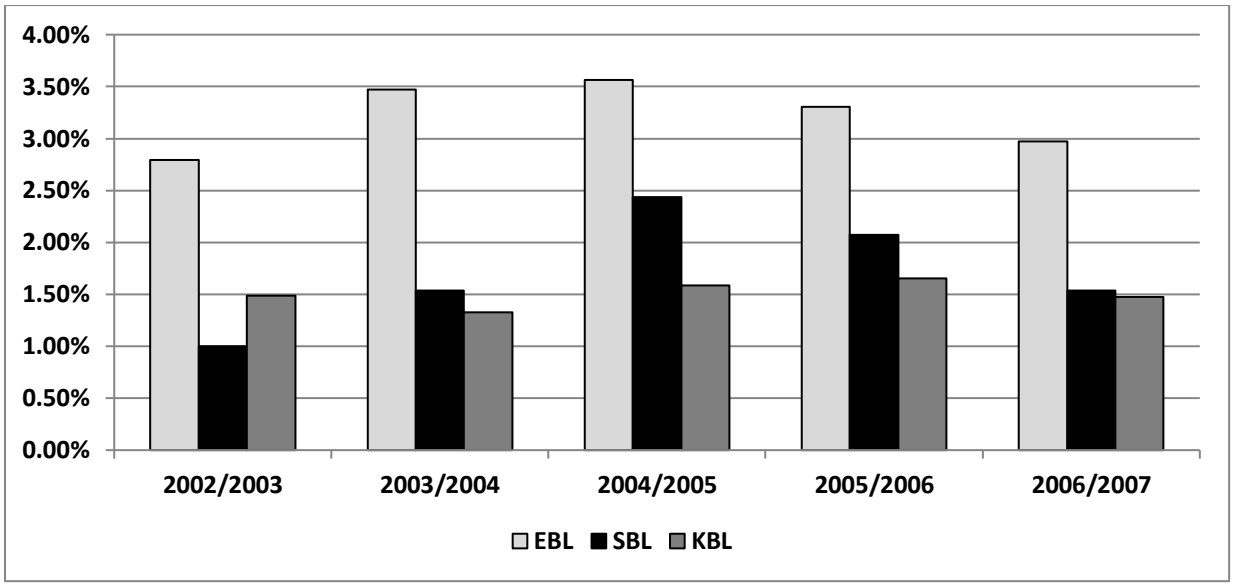
Table 4.2.2.4 is the observed Loan Loss Provision Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.2.4 Loan Loss Provision Ratio

Fiscal Year	Banks	Total Loan Loss Provision "in Rs."	Total Loan & Advances "in Rs."	Loan Loss Provision Ratio
2002/2003	EBL	141,120,662.00	5,049,581,309.00	2.79%
	SBL	6,290,249.69	629,024,968.48	1.00%
	KBL	31,850,225.00	2,137,587,047.00	1.49%
2003/2004	EBL	211,718,478.00	6,095,841,087.00	3.47%
	SBL	24,059,672.60	1,567,826,770.76	1.53%
	KBL	48,975,805.00	3,697,984,528.00	1.32%
2004/2005	EBL	281,418,795.00	7,900,090,271.00	3.56%
	SBL	64,154,594.28	2,634,930,609.08	2.43%
	KBL	90,087,062.00	5,681,012,721.00	1.59%
2005/2006	EBL	334,946,772.00	10,136,254,448.00	3.30%
	SBL	80,147,301.00	3,869,269,992.00	2.07%
	KBL	115,932,088.00	7,007,787,514.00	1.65%
2006/2007	EBL	418,604,424.00	14,082,686,087.00	2.97%
	SBL	97,140,384.00	6,319,727,198.00	1.54%
	KBL	133,420,366.00	9,062,433,481.00	1.47%

Chart 4.2.2.4.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Loan Loss Provision Ratio among three banks.

Chart: 4.2.2.4.a Loan Loss Provision Ratio



As shown in the above table 4.2.2.4 and chart 4.2.2.4.a, the Loan Loss Provision Ratio of EBL of 2.79% is the highest and SBL of 1% is the lowest in FY 2002/2003; EBL of 3.47% is the highest and KBL of 1.32% is the lowest in FY 2003/04; EBL of 3.56% is the highest and KBL of 1.59% is the lowest in FY 2004/05; EBL of 3.30% is the highest and 1.65% of KBL is the lowest in FY 2005/06 and EBL of 2.97% is the highest and KBL of 1.47% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.2.4.b helps to find out the trend of three banks regarding Loan Loss Provision Ratio over the last five year's period.

Chart: 4.2.2.4.b Trend Analysis of Loan Loss Provision Ratio

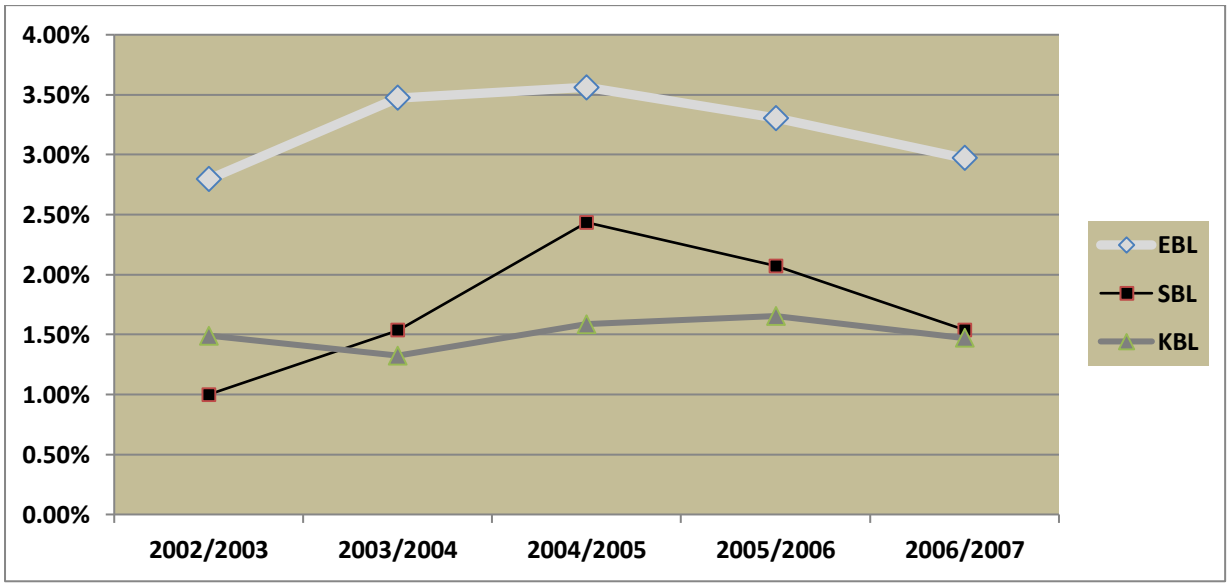


Chart 4.2.2.4.b is the trend analysis of three banks over the five year's study period. As shown in the figure Loan Loss Provision Ratio of EBL started from 2.79 % in FY 2002/03 and

thereafter is continuously increased I FY 2003/04 and 2004/05, thereafter it decreased in FY 2005/06 and 2006/07and reached to 2.97%.

Similarly, Loan Loss Provision Ratio of SBL started with 1%, in FY 2002/03, thereafter is continuously increased I FY 2003/04 and 2004/05, thereafter it decreased in FY 2005/06 and 2006/07and reached 1.54%.

Likewise, Loan Loss Provision Ratio of KBL started with 1.49% in FY 2002/03, decreased in FY 2003/04, increased in FY 2004/05 and2005/06 and again decreasing it reaches to 1.47% in FY 2006/07.

Findings:

In the above calculations and graphs, all the three banks' Total performing loan ratio is in increasing trend alone with the total loan and advances increases. It is due to the good loan and credit management. On the other hand, although the amount of Non- performing loan all EBL and KBL has increased the Non-performing loan ratio has decreased. The reason behind this is percentage increase of Non Performing loan is less than percentage increase in total loan and advances. In other hand we can say that banks are reducing their Sub Standard Loan, Doubtful Loan and Bad Loan by taking and implementing good credit policy. As on the one hand banks' total non-performing loan are increasing in decreasing rate on the other hand total loan and advances are increasing each year and provision on those loans are also increasing. This results in increment in loan loss provision ratio of all three banks which is good for banks health. Last couple of years, loan loss provision ratio is in decreasing trend. the reason behind this is that total loan and advances are increasing each year, but on the other hand due to the decrement in non-performing loans compare to total loan and advances banks has to keep less provision on large part of its loans (i.e. for performing loan) which results the decrement in Total loan loss provision ratio. So, there is no point for investors to worry for their safeguard.

4.2.3 MANAGEMENT EFFICIENCY

Management is a key functioning force of an institution that leads it towards its success. Policy determination, formulation of procurers, preparation of business plan, and implementation of

the planned projects are some of the core functions of management. In financial institutions like banks, policies related to deposits, loans and other services are rendered by management that is essential to achieve organizational objectives. Efficiency of the policies set by the board of directors, implementation by the management, and other human resources is evaluated under their mgmt analysis section. Sound management is a key to bank performance but is difficult to measure. The performance of the other four CAMEL components will depend on the vision, capability, agility, professionalism, integrity, and competence of the FI's management and can be quantified fairly easily from current financial statements. Management quality is a somewhat elusive and subjective measure. It will be evaluated through technical efficiency. As sound management is crucial for the success of any institution, management quality is generally accorded greater weighting in the assessment of the overall CAMEL composite rating. It is primarily a qualitative factor applicable to individual institutions. Management performance can be measured up by two ways. One, observing the physical facilities in place and another is measuring the organizational systems and efficiency factors. Though not compressive, following points generally points out the quality of management skills.

- Structure and authority distribution among employees
- Abilities to meet sufficient expenses
- Robust internal control / check, reporting systems include.
- Diversified human resources (combination of managers and experts)
- Formal work flow and effective communication system
- Service excellence, good customer relations
- Good working environment
- Well-functioning, set of functional sub systems.

Several indicators, however, can jointly serve as an indicator of management soundness. Operating Expenses Ratio, Earning per Employee, Cost per Loan, Average Loan size and Cost per unit of Money Lent can be used as a proxy of the management quality. ADB recommends cost per unit of money lent as a proxy of management quality and can be computed by:

$$Cost\ per\ unit\ of\ Money\ Lent = \frac{Operating\ Cost}{Total\ Amount\ Disbursed}$$

But this cannot be used as an indicator of management quality in Nepal. Since the data on amount of the total loan mobilized during a particular FY is not available in published financial statements and annual reports. As stated earlier, NRB has skipped up this component of CAMELS in the performance evaluation of commercial banks. So here are some basic formulas that are used to measure Management Quality:

4.2.3.1 Total Expense to Total Income Ratio

The ratio of total expenses to total revenue is used as a proxy measure of the management quality and the expression of numerical relationship between total expenses to total incomes of the bank. A high or increasing ratio of expenses to total revenues can indicate that FIs may not be operating efficiently. This can be due to management deficiencies. In any case, it is likely to negatively affect profitability. (IMF 2000)

Commercial banks earnings originate from interest earned loans and advances, investments, commissions and discounts; foreign exchange rate gains and other miscellaneous income. Conversely, it expends on depositors interest, staff salary, provident fund allowances and other operating expenses like rent, water and electricity, fuel expenses, audit fee expenses, management expenses, depreciation, miscellaneous expenses and all other expenses direct related to the operation of the bank. Expenses such as loss on sale of assets, write off exp, losses shortage, written off, provision for income tax are non-operating expenses.

$$Total\ Expenses\ to\ Income\ Ratio = \frac{Total\ Expenses}{Total\ Income}$$

Where,

Total Expenses = Interest Expenses + Employee Expenses +Other Operating Expenses + Exchange Loss + Non Operating Loss

Total Income = Interest Income + Commission & Discount Income + Other Operating Income + Exchange Gain +Non Operating Income

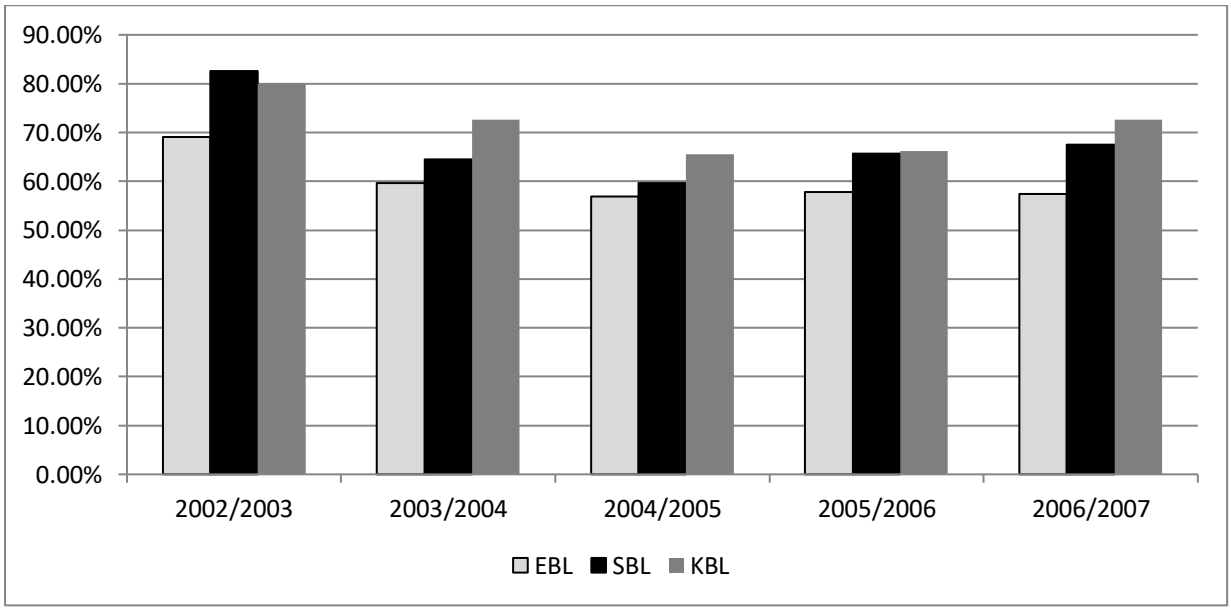
Table 4.2.3.1 is the observed Total Expenses to Total Income Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.3.1 Total Expenses to Total Income Ratio

Fiscal Year	Banks	Total Expenses "in Rs."	Total Income "in Rs."	Total Expenses to Total Income Ratio
2002/2003	EBL	438,592,032.00	635,332,348	69.03%
	SBL	23,821,531.67	28,827,527	82.63%
	KBL	161,702,999.00	202,233,513	79.96%
2003/2004	EBL	468,704,084.00	785,058,755	59.70%
	SBL	83,631,299.90	129,758,524	64.45%
	KBL	248,920,112.00	342,849,125	72.60%
2004/2005	EBL	489,229,861.00	858,958,981	56.96%
	SBL	143,189,168.26	240,259,437	59.60%
	KBL	354,337,190.00	540,604,139	65.54%
2005/2006	EBL	615,884,193.00	1,066,510,219	57.75%
	SBL	223,921,017.00	341,090,978	65.65%
	KBL	575,376,224.00	869,110,498	66.20%
2006/2007	EBL	780,830,116.00	1,360,608,994	57.39%
	SBL	361,052,612.00	534,641,892	67.53%
	KBL	485,597,702.00	668,184,603	72.67%

Chart 4.2.3.1.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Total Expenses to Total Income Ratio among three banks.

Chart: 4.2.3.1.a Total Expenses to Total Income Ratio



As shown in the above table 4.2.3.1 and chart 4.2.3.1.a, Total Expenses to Total Income Ratio of SBL of 82.63% is the highest and EBL of 69.03% is the lowest in FY 2002/2003; KBL of 72.60% is the highest and EBL of 59.70% is the lowest in FY 2003/04; KBL of 65.54% is the highest and EBL of 56.96% is the lowest in FY 2004/05; KBL of 66.20% is the highest and

57.75% of EBL is the lowest in FY 2005/06 and KBL of 72.67% is the highest and EBL of 57.39% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.3.1.b helps to find out the trend of three banks regarding Total Expenses to Total Income Ratio over the last five year's period.

Chart: 4.2.3.1.b Trend Analysis of Total Expenses to Total Income Ratio

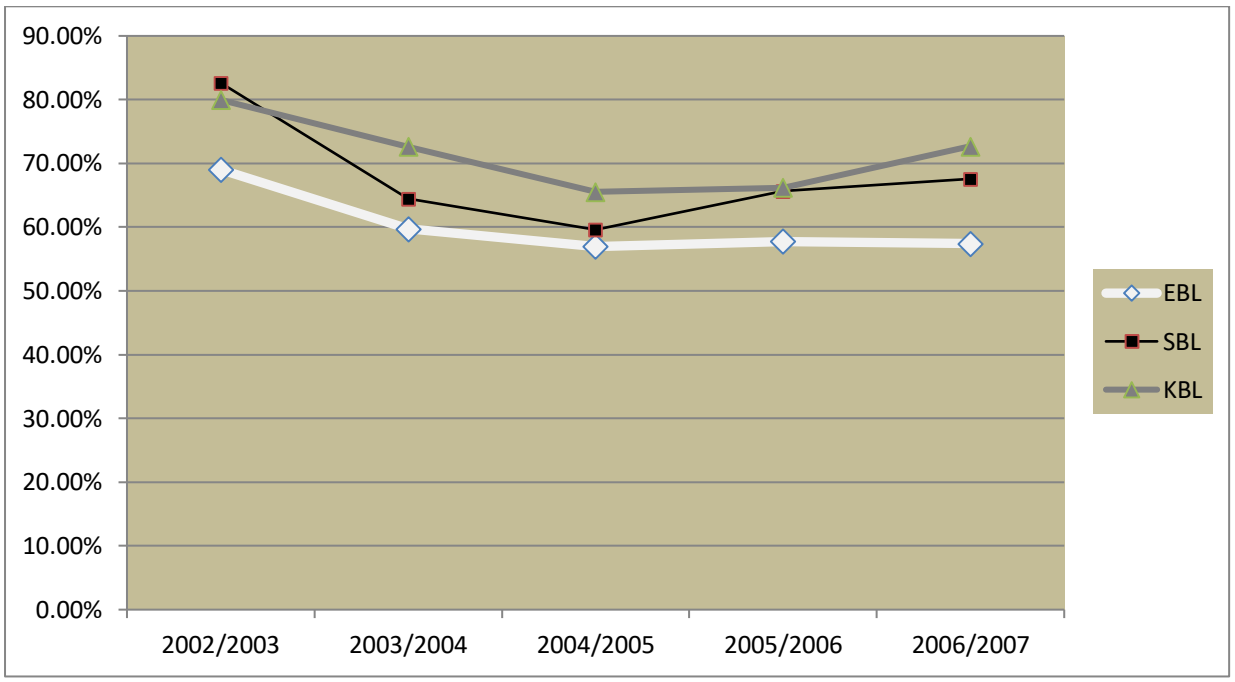


Chart 4.2.3.1.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Total Expenses to Total Income Ratio of EBL started from 69.03 % in FY 2002/03, decreased in FY 2003/04 and 2004/05, again it increased in FY 2005/06 and thereafter decreasing in FY 2006/07and reached to 57.39%.

Similarly, Total Expenses to Total Income Ratio of SBL started with 82.63%, in FY 2002/03, thereafter decreased in FY 2003/04 and 2004/05, and increasing in FY 2005/06 and 2006/07 reached to 67.53%.

Likewise, Total Expenses to Total Income Ratio of KBL started with 79.96% in FY 2002/03, decreased in FY 2003/04 and 2004/05, and again increasing in FY 2005/06 and 2006/07 reached to 72.67%.

4.2.3.2 Earning Per Employee

Earning per employee is the numerical relationship between Net Profit after Taxes to Total Numbers of Employee. Low or decreasing earnings per employee can reflect inefficiencies as a

result of overstaffing, with similar repercussions in terms of profitability (IMF, 2000). It is calculated by using the following model:

$$Earning\ Per\ Employee = \frac{Net\ Profit\ After\ Tax}{Total\ No.\ of\ Employees}$$

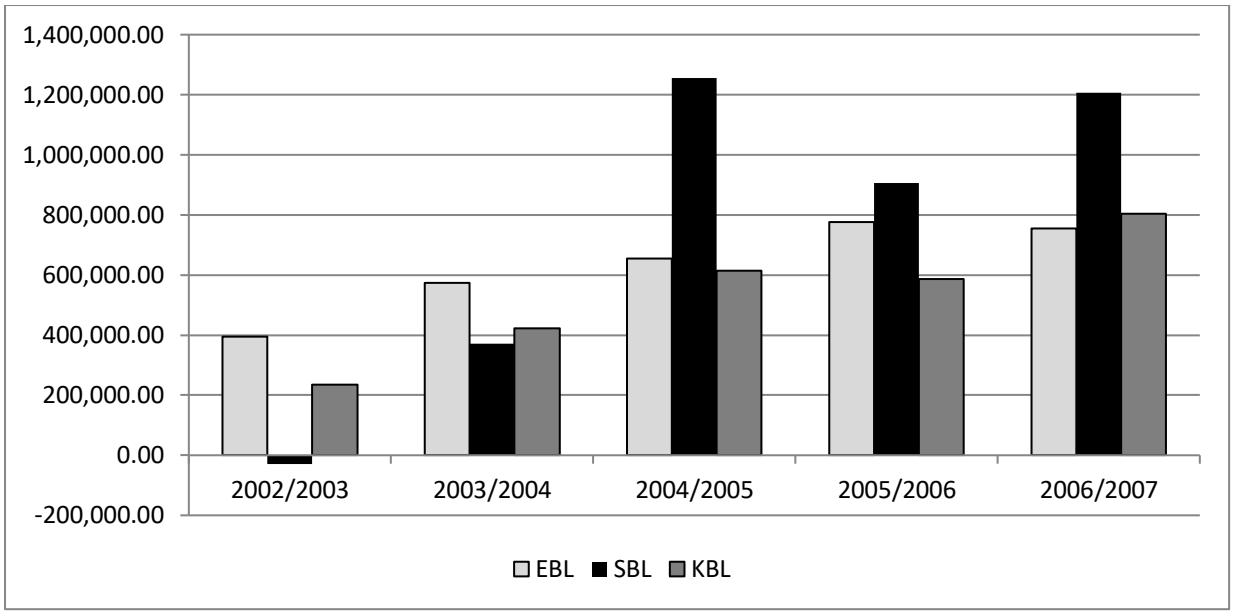
Table 4.2.3.2 is the observed Earning per Employee of three banks during the study period in numerical terms which is presented below:

Table 4.2.3.2 Earning per Employee

Fiscal Year	Banks	Net Profit after Tax "in Rs."	No of Employees	Earning Per Employee "in Rs"
2002/2003	EBL	94,180,428.00	239	394060.37
	SBL	(1,284,254.81)	43	-29866.39
	KBL	12,474,065.00	53	235359.72
2003/2004	EBL	143,566,683.00	250	574266.73
	SBL	17,482,584.62	47	371969.89
	KBL	48,685,822.00	115	423354.97
2004/2005	EBL	168,214,611.00	257	654531.56
	SBL	70,279,794.13	56	1254996.32
	KBL	87,880,557.00	143	614549.35
2005/2006	EBL	237,290,936.00	306	775460.58
	SBL	65,252,813.00	72	906289.07
	KBL	103,666,767.00	177	585687.95
2006/2007	EBL	296,409,281.00	393	754222.09
	SBL	95,305,326.00	79	1206396.53
	KBL	170,262,909.00	212	803126.93

Chart 4.2.3.2.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Earning per Employee among three banks.

Chart: 4.2.3.2.a Earning per Employee



As shown in the above table 4.2.3.2 and chart 4.2.3.2.a, Earning per Employee of EBL of Rs. 394060.37 is the highest and SBL of Rs. -29866.39 is the lowest in FY 2002/2003; EBL of Rs. 574266.73 is the highest and SBL of Rs. 371969.89 is the lowest in FY 2003/04; SBL of Rs. 1254996.32 is the highest and KBL of Rs. 614549.35 is the lowest in FY 2004/05; SBL of Rs. 906289.07 is the highest and Rs. 585687.95 of KBL is the lowest in FY 2005/06 and SBL of Rs. 1206396.53 is the highest and EBL of Rs. 754222.09 is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.3.2.b helps to find out the trend of three banks regarding Earning per Employee over the last five year's period.

Chart: 4.2.3.2.b Trend Analysis of Earning per Employee

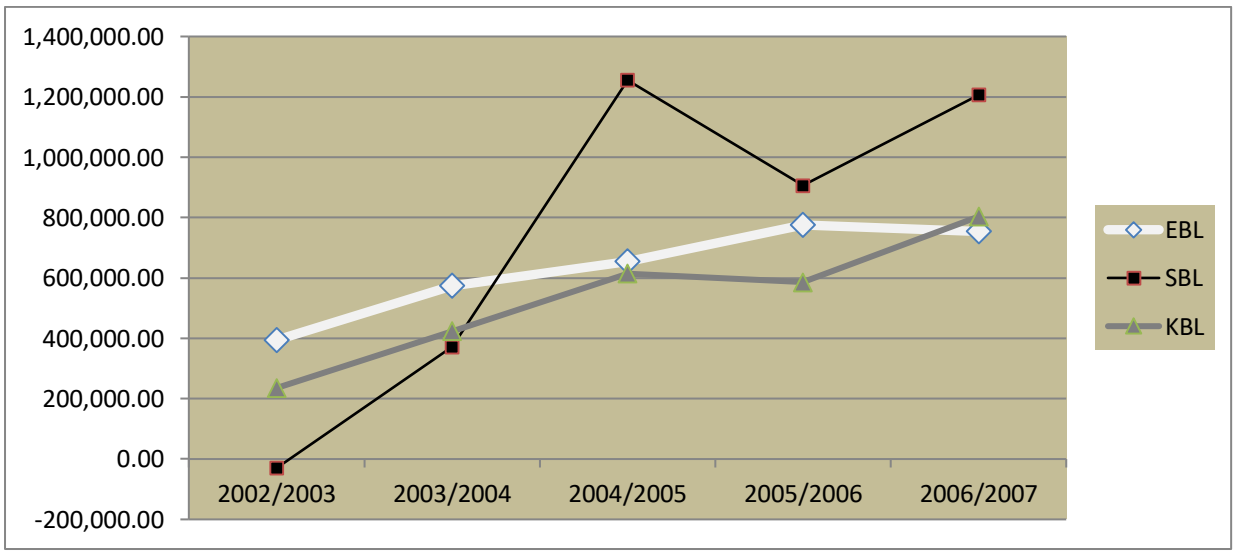


Chart 4.2.3.2.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Earning per Employee of EBL started from Rs. 394060.37 in FY 2002/03, increased in FY 2003/04, 2004/05 and 2005/06 and decreasing in FY 2006/07and reached to Rs 754222.09.

Similarly, Earning per Employee of SBL started with Rs. -29866.39 in FY 2002/03, thereafter increased in FY 2003/04 and 2004/05, decreased in FY 2005/06 and again increasing in FY 2006/07 reached to Rs. 1206396.53.

Likewise, Earning per Employee of KBL started with Rs. 235359.72 in FY 2002/03, increased in FY 2003/04 and 2004/05, decreased in FY 2005/06 and again increasing in FY 2006/07 reached to Rs. 803126.93.

4.2.3.3 Efficiency Ratio

Efficiency Ratio is a measure of productivity of the bank, and is targeted at the middle to low 50% range. This may seem like break-even but it is not; what this is saying is that for every dollar the bank is earning it gets to keep 50 cents and it has to spend 50 cents to earn that dollar. Efficiency improves as the ratio decreases, which is obtained by increasing net interest income, increasing non-interest revenues and/or reducing operating expenses. Non-interest expenses (expenses other than interest expense and loan loss provisions, such as salaries and employee benefits plus occupancy plus depreciation and amortization) tend to rise faster than income in a time of inflation. As it is a measure of productivity of the bank, and is targeted at the middle to low 50% range. This may seem like break-even but it is not; what this is saying is that for every dollar the bank is earning it gets to keep 50 cents and it has to spend 50 cents to earn that dollar. The ratio can be as low as the mid to low 40% range, which means that for every dollar the bank earns it gets to keep 60 cents and spends 40 cents, a very efficient bank. Ratios in excess of 75% mean the bank is very expensive to operate. Following model is used to calculate this ratio:

$$Efficiency\ Ratio = \frac{Total\ Non\ Interest\ Expenses}{Total\ Net\ Interest\ Income^{*} + Total\ Non\ Interest\ Income}$$

Total Non Interest Expenses = Exchange Loss + Employee Expenses + Other Operating Expenses + Non Operating Loss

Total Net Interest Income* = Total Net Interest Income (before provisions)

Total Net Interest Income (before provision) = Total Interest Income - Total Interest Expenses

Total Non Interest Income = Commission and Discount Income +Other Operating Income + Exchange Gain + Non Operating Income

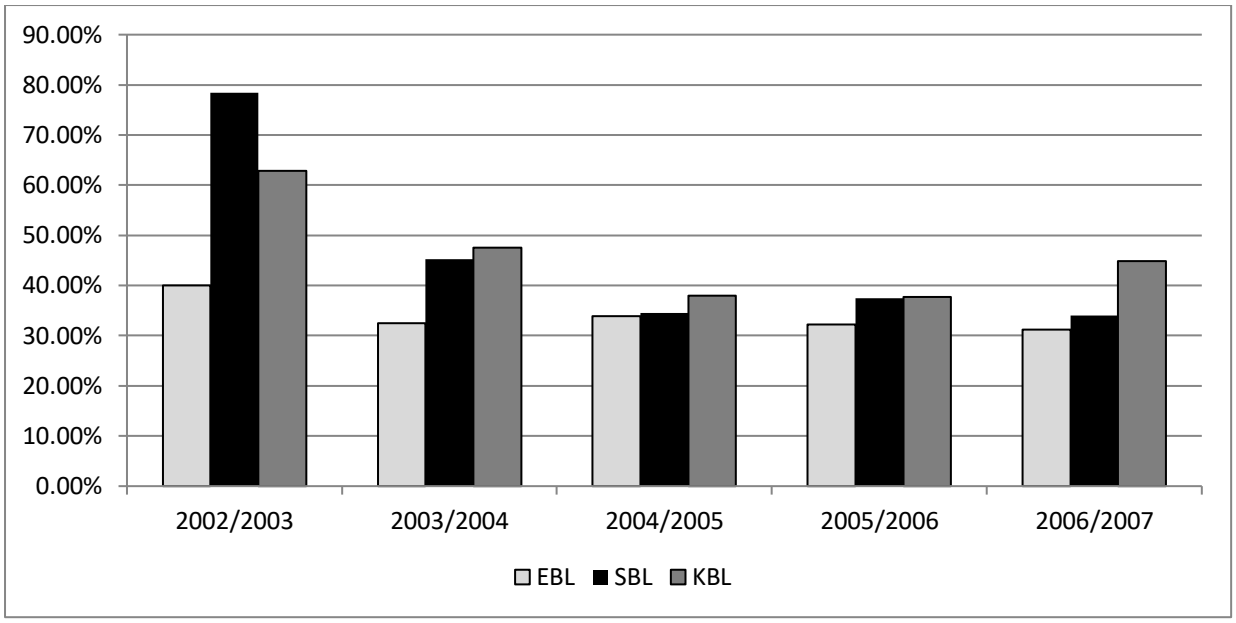
Table 4.2.3.3 is the observed Efficiency Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.3.3 Efficiency Ratio

Fiscal Year	Banks	Total Non Interest Expenses "in Rs."	Total Net Interest Income* + Total Non Interest income "in Rs."	Efficiency Ratio
2002/2003	EBL	130,953,130.00	327,693,446	39.96%
	SBL	18,202,758.36	23,208,753	78.43%
	KBL	68,757,692.00	109,288,203	62.91%
2003/2004	EBL	152,337,821.00	468,692,492	32.50%
	SBL	38,125,732.57	84,252,957	45.25%
	KBL	85,017,449.00	178,946,462	47.51%
2004/2005	EBL	189,664,592.00	559,393,712	33.91%
	SBL	51,208,214.59	148,278,483	34.54%
	KBL	114,207,011.00	300,470,960	38.01%
2005/2006	EBL	214,486,842.00	665,112,868	32.25%
	SBL	70,212,055.00	187,382,016	37.47%
	KBL	178,323,104.00	472,057,378	37.78%
2006/2007	EBL	263,663,875.00	843,442,733	31.26%
	SBL	89,341,662.00	262,930,942	33.98%
	KBL	148,541,557.00	331,128,458	44.86%

Chart 4.2.3.3.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Efficiency Ratio among three banks.

Chart: 4.2.3.3.a Efficiency Ratio



As shown in the above table 4.2.3.3 and chart 4.2.3.3.a, Efficiency Ratio of SBL of 82.63% is the highest and EBL of 69.03% is the lowest in FY 2002/2003; KBL of 72.60% is the highest and EBL of 59.70% is the lowest in FY 2003/04; KBL of 65.54% is the highest and EBL of 56.96% is the lowest in FY 2004/05; KBL of 66.20% is the highest and 57.75% of EBL is the lowest in FY 2005/06 and KBL of 72.67% is the highest and EBL of 57.39% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.3.3.b helps to find out the trend of three banks regarding the Efficiency Ratio over the last five year's period.

Chart: 4.2.3.3.b Trend Analysis of Efficiency Ratio

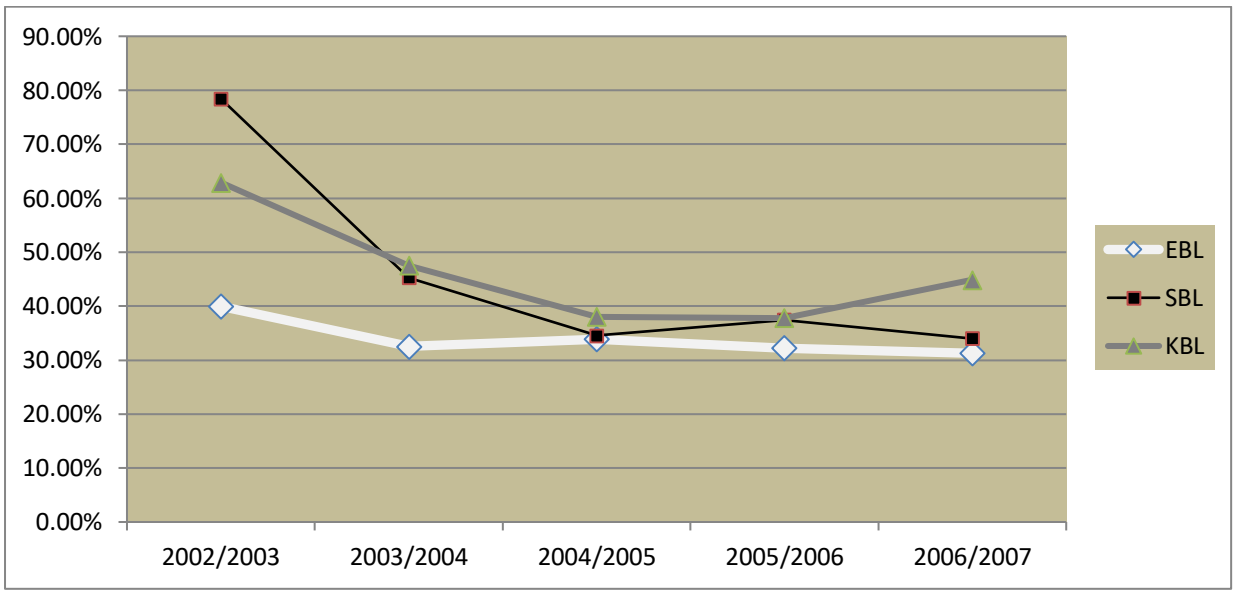


Chart 4.2.3.3.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Efficiency Ratio of EBL started from 39.96 % in FY 2002/03, decreased in FY 2003/04, increased in FY 2004/05, and thereafter continuously decreasing it reached to 31.26% at the end of FY 2006/07.

Similarly, Efficiency Ratio of SBL started with 78.43%, in FY 2002/03, decreased in FY 2003/04 and 2004/05, increased in FY 2005/06 and again decreasing in FY 2006/07 reached to 33.98%.

Likewise, Efficiency Ratio of KBL started with 62.91% in FY 2002/03, continuously decreased in FY 2003/04, 2004/05 and 2005/06, lastly increasing in FY 2006/07 reached to 44.86%.

Findings:

Although the net profit after taxes increases of all banks each year except SBL in FY 2005/06, the Total Expenses to total income ratio for the last couple of years of study period is in increasing trend, which is not the good sign of effective and efficient management. This is due to the high proportion of incensement in total expenses compare to total income. But the earning per employee of all banks is in increasing trend except for SBL and KBL in FY 2005/06. The reason for the decrement is the increment to total no of staffs of both banks and also decrement in Net profit after tax for SBL bank. Similarly, Efficiency ratio of all banks is in decreasing trend which is good sign for the bank due to the high percentage increment in Total Net interest income plus total non-interest income compare to Total non-interest Expenses, except for the KBL in FY 2006/07.

4.2.4 EARNING

Earnings determine the ability of a bank to retain capital, absorb loan losses, support the future growth of assets, and provide a return to investors. The largest source of income for a bank is net interest revenue (interest income from lending activity less interest paid on deposits and debt). The second most important source is from investing activity. A substantial source of income also comes from foreign exchange and precious metal trading, and commissions/transaction fees and trust operations.

Earning capacity largely counts on the efficiency of management. The quality and trend of earnings of an institution depend largely on how well the management manages the assets and liabilities of the institution. An FI must earn reasonable profit to support asset growth, build up adequate reserves and enhance shareholders' value. Good earnings performance would inspire

the confidence of depositors, investors, creditors, and the public at large. Chronically, loss making commercial banks reduces their capital base, risk the solvency and eventually bring down the wealth of their shareholders. Conversely, constantly profit making banks add equity to the total capital fund, reduce the risk of insolvency, and finally increase the wealth of their shareholders. Since, chronically unprofitable FI risks insolvency on one hand and on the others, unusually high profitability can reflect excessive risk taking of an FI, management and decision making body has to be conscious about it.

Earning capacity or profitability keeps up the sound health of an FI. So, earning capacity is one of the indicators of the sound health of a commercial bank. Though different indicators can be used to measure the profitability of banks, NRB uses return on total assets as an indicator of profitability of a commercial bank. In addition, it uses the absolute measures such as interest income, net interest income, noninterest income, net non-interest income, non-operating income, net non-operating income and net profit, to evaluate the profitability of a commercial bank (NRB 2005). Here we use the following tools to measures the earning

4.2.4.1 Return on Equity (ROE)

The return on equity indicates the relationship between net profits after taxes to total equity capital. Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. In other words, It measures a firm's efficiency at generating profits from every dollar of net assets (assets minus liabilities), and shows how well a company uses investment dollars to generate earnings growth. So, it measures the ability to augment capital internally (increase net worth), pay a dividend to the shareholders and also measures the return on the stockholder's investment. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. ROE encompasses the three pillars of corporate management -- profitability, asset management, and financial leverage. By seeing how well the executive team balances these components, investors can not only get an excellent sense of whether they will receive a decent return on equity but can also assesses management's ability to get the job done. For the most part, the higher a company’s return on equity compared to its industry, the better. For the purpose of the study following model is used to determine the return on equity ratio:

$$Return\ on\ Equity\ (ROE) = \frac{Net\ Income\ after\ Tax}{Share\ holders'\ Fund}$$

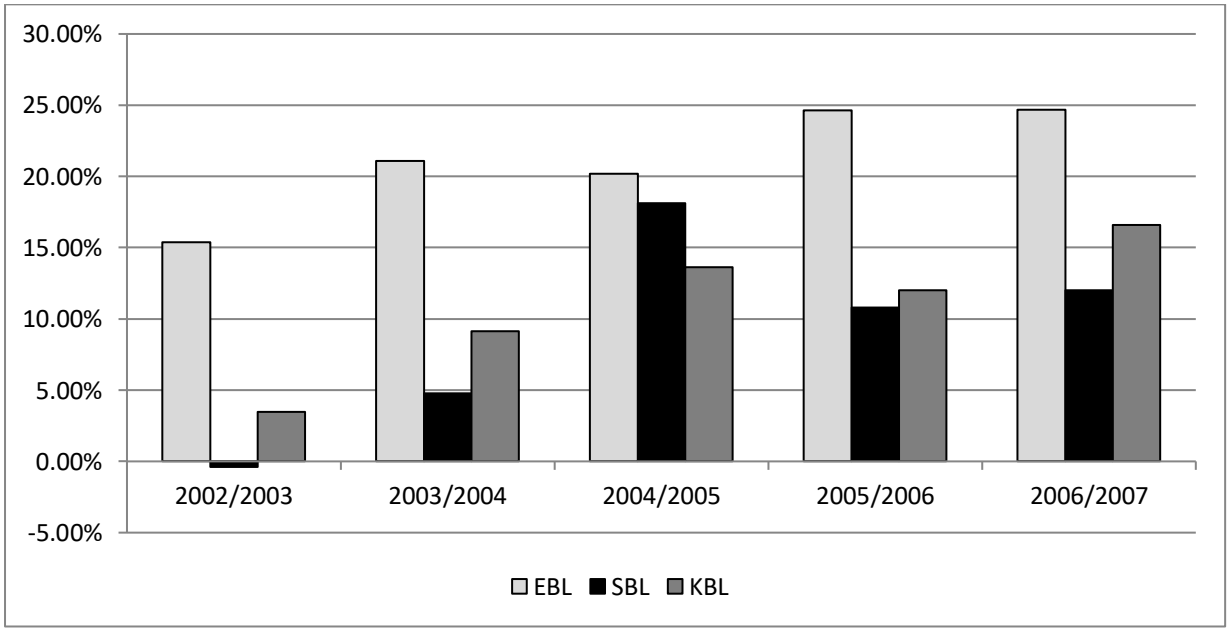
Table 4.2.4.1 is the observed Return on Equity of three banks during the study period in numerical terms which is presented below:

Table 4.2.4.1 Return on Equity (ROE)

Fiscal Year	Banks	Net Profit after Tax "in Rs."	Share Holder's Fund "in Rs."	Return on Equity (ROE)
2002/2003	EBL	94,180,428.00	612,824,701.00	15.37%
	SBL	(1,284,254.81)	348,715,745.19	-0.37%
	KBL	12,474,065.00	361,033,148.00	3.46%
2003/2004	EBL	143,566,683.00	680,318,543.00	21.10%
	SBL	17,482,584.62	366,198,329.81	4.77%
	KBL	48,685,822.00	533,403,180.00	9.13%
2004/2005	EBL	168,214,611.00	832,617,365.00	20.20%
	SBL	70,279,794.13	387,888,643.00	18.12%
	KBL	87,880,557.00	645,441,536.00	13.62%
2005/2006	EBL	237,290,936.00	962,808,301.00	24.65%
	SBL	65,252,813.00	603,141,455.00	10.82%
	KBL	103,666,767.00	863,850,557.00	12.00%
2006/2007	EBL	296,409,281.00	1,201,515,266.00	24.67%
	SBL	95,305,326.00	793,709,939.00	12.01%
	KBL	170,262,909.00	1,025,630,159.00	16.60%

Chart 4.2.4.1.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Return on Equity among three banks.

Chart: 4.2.4.1.a Return on Equity (ROE)



As shown in the above table 4.2.4.1 and chart 4.2.4.1.a, the Return on Equity of EBL of 15.37% is the highest and SBL of -0.37% is the lowest in FY 2002/2003; EBL of 21.10% is the highest and SBL of 4.77% is the lowest in FY 2003/04; EBL of 20.20% is the highest and KBL of 13.62% is the lowest in FY 2004/05; EBL of 24.65% is the highest and 10.82% of SBL is the lowest in FY 2005/06 and EBL of 24.67% is the highest and SBL of 12.01% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.4.1.b helps to find out the trend of three banks regarding Return on Equity over the last five year's period.

Chart: 4.2.4.1.b Trend Analysis of Return on Equity

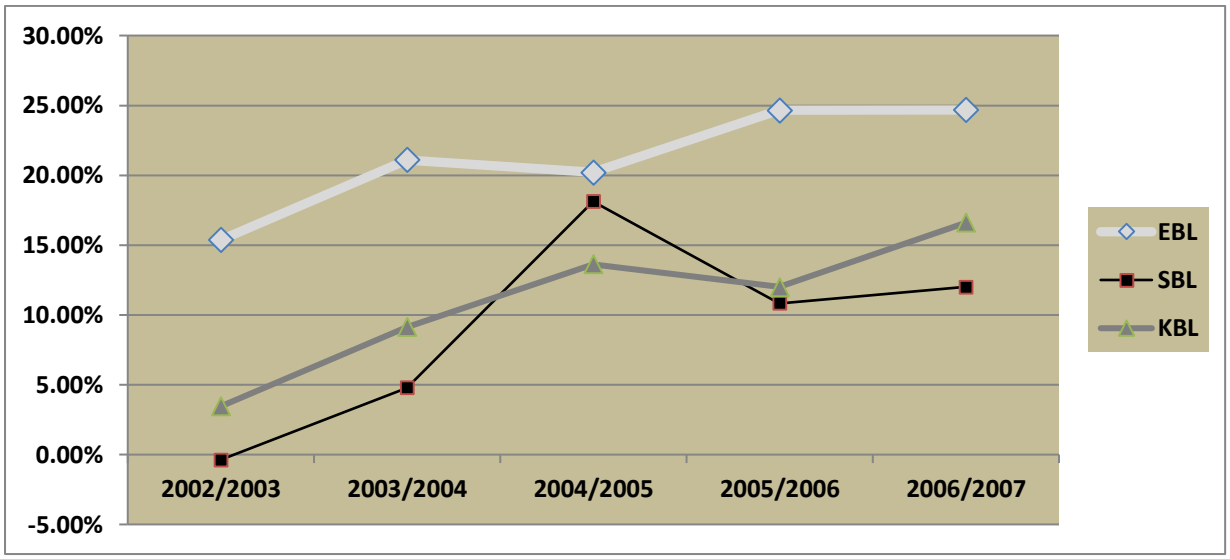


Chart 4.2.4.1.b is the trend analysis of three banks over the five year's study period. As shown in the figure Return on Equity of EBL started from 15.37 % in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and thereafter is continuously increased till 2006/07and reached to 24.67%.

Similarly, Return on Equity of SBL started with -0.37% as it was the beginning period of operation of the bank and there is losses in FY 2002/03, thereafter is it increased in FY 2003/04 and 2004/05, decreased in FY 2005/06 and increasing again in FY 2006/07 it reached to 12.01%.

Likewise, Return on Equity of KBL started with 3.46% in FY 2002/03, thereafter is it increased in FY 2003/04 and 2004/05, decreased in FY 2005/06 and increasing again in FY 2006/07 it reached to 16.60%.

Overall trend line shows that return on equity of all three banks is in increasing trend which is good for shareholders.

4.2.4.2 Return on Assets (ROA)

Return on assets is the numerical relationship between net income after taxes to total assets of a bank. It measures how the assets are utilized by indicating the profitability of the assets base or asset mix. ROA gives an idea as to how efficient management is at using its assets to generate earnings. The assets of the company are comprised of both debt and equity. Both of these types of financing are used to fund the operations of the company. The ROA figure gives investors and potential investors an idea of how effectively the company is converting the money it has to invest into net income. A comparison of net income and average total assets, the ROA ratio reveals how much income has been able to squeeze from each dollar's worth of a company's assets. Higher the ROA, the better is the quality of assets and efficient asset utilization; because the company is earning more money on less investment It is calculated by using the following model.

$$Return\ on\ Assets\ (ROA) = \frac{Net\ Income\ after\ Tax}{Total\ Assets}$$

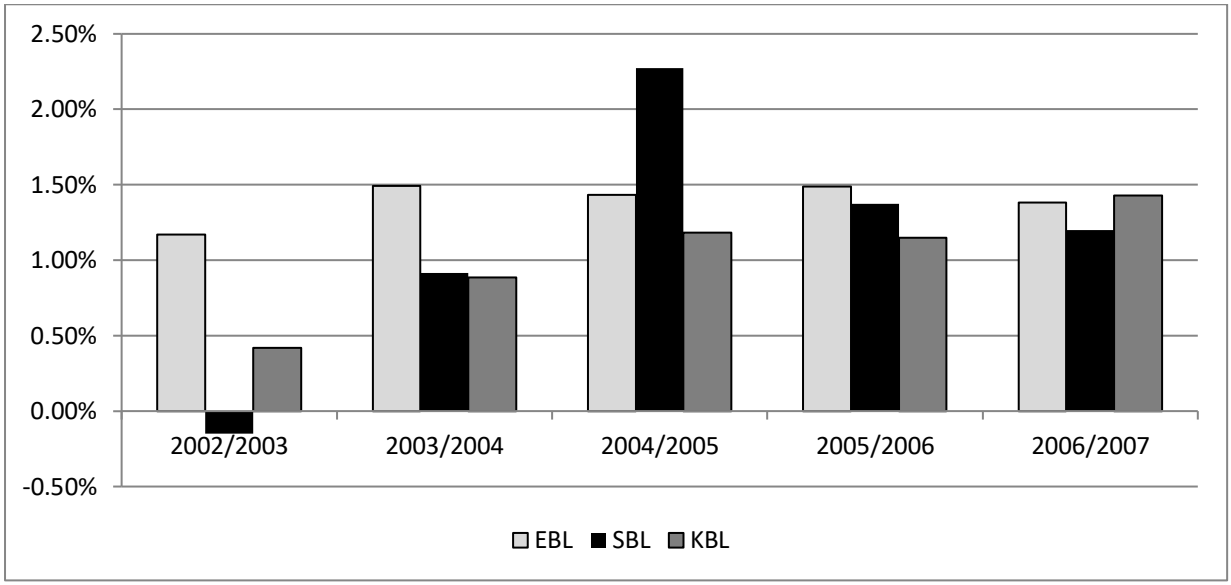
Table 4.2.4.2 is the observed Return on Assets of three banks during the study period in numerical terms which is presented below:

Table 4.2.4.2 Return on Assets (ROA)

Fiscal Year	Banks	Net Profit after Tax "in Rs."	Total Asset "in Rs."	Return on Asset (ROA)
2002/2003	EBL	94,180,428.00	8,052,209,125	1.17%
	SBL	(1,284,254.81)	863,735,348	-0.15%
	KBL	12,474,065.00	2,986,175,454	0.42%
2003/2004	EBL	143,566,683.00	9,608,570,861	1.49%
	SBL	17,482,584.62	1,912,039,287	0.91%
	KBL	48,685,822.00	5,494,176,578	0.89%
2004/2005	EBL	168,214,611.00	11,732,516,418	1.43%
	SBL	70,279,794.13	3,091,102,752	2.27%
	KBL	87,880,557.00	7,437,882,125	1.18%
2005/2006	EBL	237,290,936.00	15,959,284,687	1.49%
	SBL	65,252,813.00	4,756,935,449	1.37%
	KBL	103,666,767.00	9,010,276,184	1.15%
2006/2007	EBL	296,409,281.00	21,432,574,300	1.38%
	SBL	95,305,326.00	7,954,664,475	1.20%
	KBL	170,262,909.00	11,918,311,429	1.43%

Chart 4.2.4.2.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Return on Assets among three banks.

Chart: 4.2.4.2.a Return on Assets (ROA)



As shown in the above table 4.2.4.2 and chart 4.2.4.2.a, the Return on Assets of EBL of 1.17% is the highest and SBL of -0.15% is the lowest in FY 2002/2003; EBL of 1.49% is the highest and KBL of 0.89% is the lowest in FY 2003/04; SBL of 2.27% is the highest and KBL of 1.18% is the lowest in FY 2004/05; EBL of 1.49% is the highest and 1.15% of KBL is the lowest in FY 2005/06 and KBL of 1.43% is the highest and SBL of 1.20% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.4.2.b helps to find out the trend of three banks regarding Return on Assets over the last five year's period.

Chart: 4.2.4.2.b Trend Analysis of Return on Assets

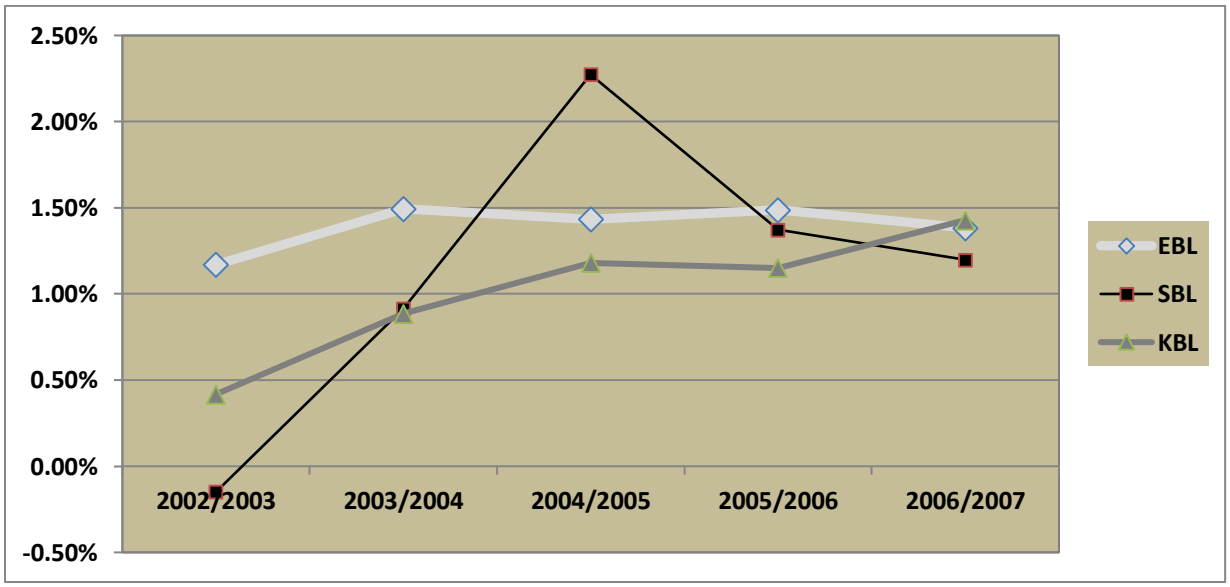


Chart 4.2.4.2.b is the trend analysis of three banks over the five year's study period. As shown in the figure Return on Assets of EBL started from 1.17 % in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05, again increased in FY 2005/06 and again decreased in 2006/07 and reached to 1.38%.

Similarly, Return on Assets of SBL started with -0.15% as it was the beginning period of operation of the bank and there is losses in FY 2002/03, thereafter it increased in FY 2003/04 and 2004/05, and decreased in FY 2005/06 and FY 2006/07 and finally reaches to 1.20%.

Likewise, Return on Asset of KBL started with 0.42% in FY 2002/03, thereafter is it increased in FY 2003/04 and 2004/05, decreased in FY 2005/06 and increasing again in FY 2006/07 it reached to 1.43%.

Overall comparing the initial period of study period at the end Return on Assets of all banks had increased

4.2.4.3 Earning Per Share (EPS)

Earnings per share are generally considered to be the single most important variable in determining a share's price. It is the portion of a company's profit allocated to each outstanding share of common stock. An important aspect of EPS that's often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment) - that company would be more efficient at using its capital to generate income and, all other things being equal would be a "better" company. Following is the expression of earning per share:

$$Earning\ per\ Share(EPS) = \frac{Net\ Income\ after\ Tax}{No.\ of\ Shares\ Outstanding}$$

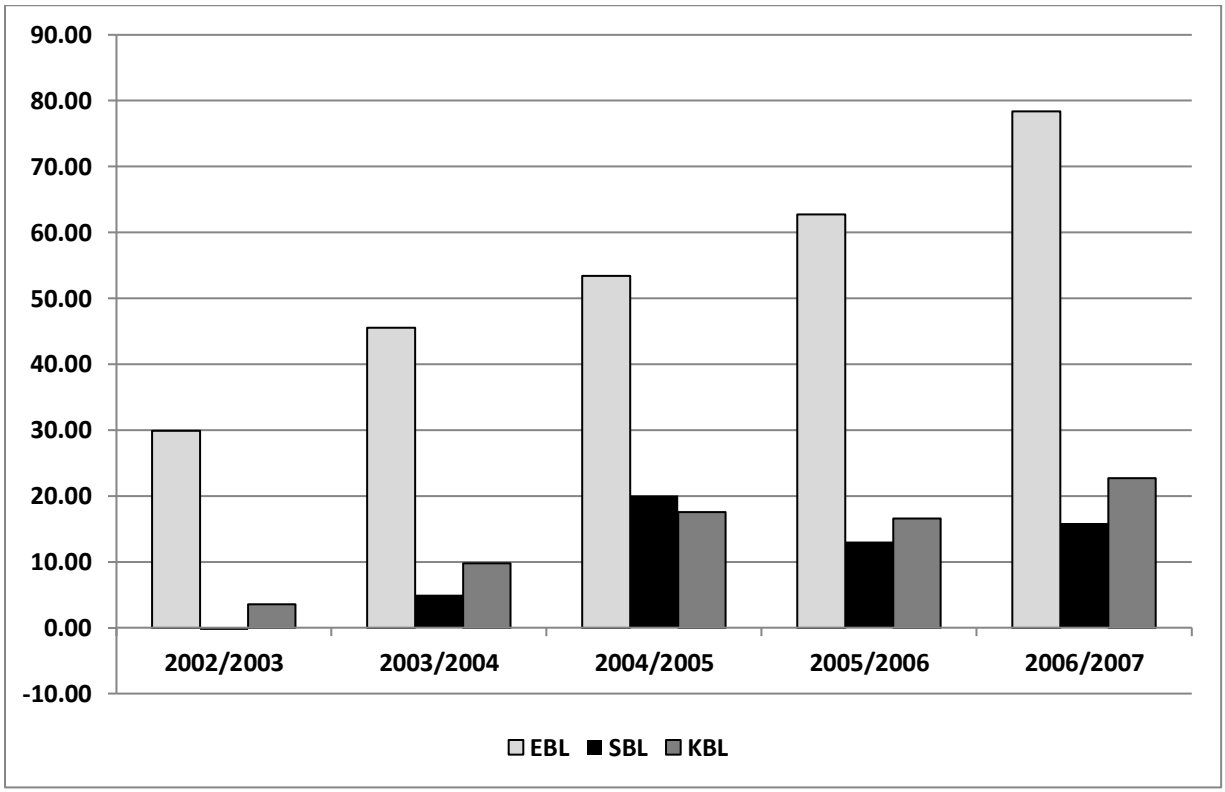
Table 4.2.4.3 is the observed Earning per Share of three banks during the study period in numerical terms which is presented below:

Table 4.2.4.3 Earning per Share (EPS)

Fiscal Year	Banks	Net Profit after Tax "in Rs."	No of shares outstanding	Earning Per Share "in Rs"
2002/2003	EBL	94,180,428.00	3,150,000	29.90
	SBL	(1,284,254.81)	3,500,000	-0.37
	KBL	12,474,065.00	3,500,000	3.56
2003/2004	EBL	143,566,683.00	3,150,000	45.58
	SBL	17,482,584.62	3,500,000	5.00
	KBL	48,685,822.00	5,000,000	9.74
2004/2005	EBL	168,214,611.00	3,150,000	53.40
	SBL	70,279,794.13	3,500,000	20.08
	KBL	87,880,557.00	5,000,000	17.58
2005/2006	EBL	237,290,936.00	3,780,000	62.78
	SBL	65,252,813.00	5,000,000	13.05
	KBL	103,666,767.00	6,250,000	16.59
2006/2007	EBL	296,409,281.00	3,780,000	78.42
	SBL	95,305,326.00	6,000,000	15.88
	KBL	170,262,909.00	7,500,000	22.70

Chart 4.2.4.3.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Earning per Share among three banks.

Chart: 4.2.4.3.a Earning per Share (EPS)



As shown in the above table 4.2.4.3 and chart 4.2.4.3.a, the Earning per Share of EBL of Rs.29.90 is the highest and SBL of Rs.-0.37 is the lowest in FY 2002/2003; EBL of Rs.45.58 is the highest and SBL of Rs. 5.00 is the lowest in FY 2003/04; EBL of Rs.53.40 is the highest and KBL of Rs. 17.58 is the lowest in FY 2004/05; EBL of Rs. 62.78 is the highest and Rs. 13.05 of SBL is the lowest in FY 2005/06 and EBL of Rs. 78.42 is the highest and SBL of Rs. 15.88 is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.4.3.b helps to find out the trend of three banks regarding Earning per Share over the last five year's period.

Chart: 4.2.4.3.b Trend Analysis of Earning per Share

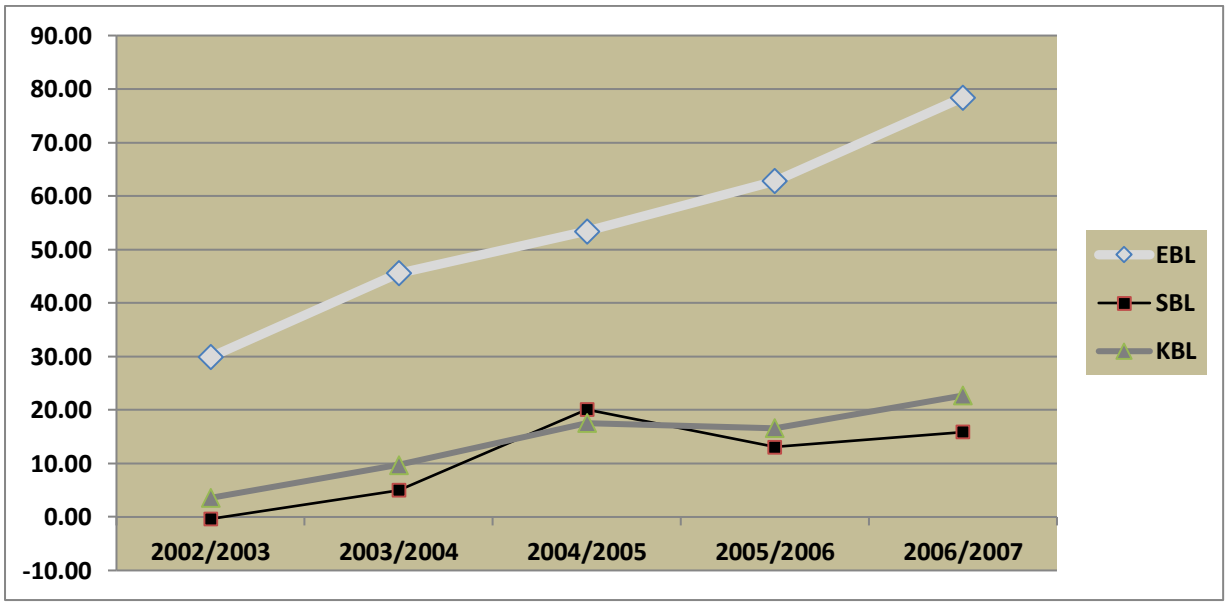


Chart 4.2.4.3.b is the trend analysis of three banks over the five year's study period. As shown in the figure Earning per Share of EBL started from Rs. 29.90 in FY 2002/03, and continuously increased till FY 2006/07. Although there was increasement in no of shares in FY 2005/06 it didn't caused to decrease in Earning per Share and reaches to Rs.78.42 at the end of FY 2006/07.

Similarly, Earning per Share of SBL started with Rs. -0.37 as it was the beginning period of operation of the bank and there is a loss in FY 2002/03, thereafter it increased in FY 2003/04 and 2004/05, and decreased in FY 2005/06 and increasing again in FY 2006/07 finally reaches to Rs. 15.88.

Likewise, Earning per Share of KBL started with Rs. 3.56 in FY 2002/03, thereafter is it increased in FY 2003/04 and 2004/05, decreased in FY 2005/06 and increasing again in FY 2006/07 it reached to Rs.22.70.

4.2.4.4 Price Earning (P/E) Ratio

The P/E gives an idea of what the market is willing to pay for the company's earnings or an indication of how many times you are paying for a company's stock verse a company's earnings. The higher the P/E the more the market is willing to pay for the company's earnings. Some investors read a high P/E as an overpriced stock and that may be the case, however it can also indicate the market has high hopes for this stock's future and has bid up the price. It is simply a company's stock price divided by a company's earnings per share. P/E ratios can be used to compare against other companies, or against a company's own historical P/E ratio. It is believed by some that a company with a high (large) P/E ratio is expensive verse a company with a low P/E ratio, since with a high P/E ratio you are paying a larger multiple verses a company's earnings.

$$Price\ Earning\ (P\ /E) Ratio = \frac{Market\ Price\ Per\ Share}{Earning\ Price\ Pre\ Share}$$

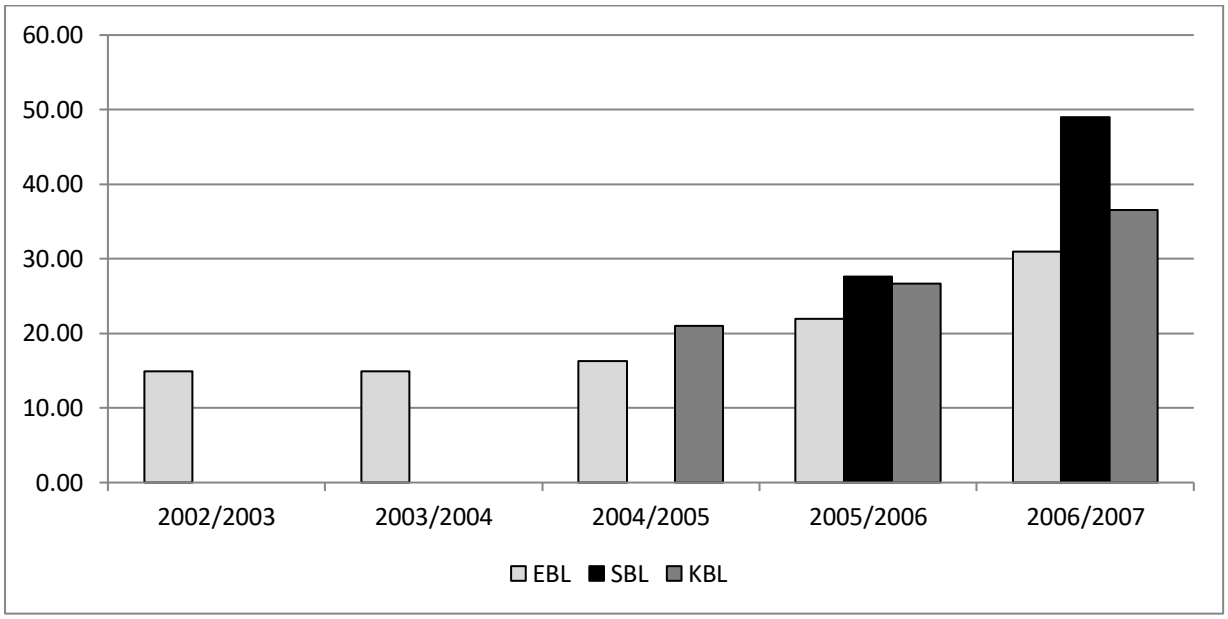
Table 4.2.4.4 is the observed Price Earning Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.4.4 Price Earning (P/E) Ratio

Fiscal Year	Banks	Market Price Per Share "in Rs"	Earning Price Per Share "in Rs"	P/E Ratio
2002/2003	EBL	445.00	29.90	14.88
	SBL	-	-0.37	-
	KBL	-	3.56	-
2003/2004	EBL	680.00	45.58	14.92
	SBL	-	5.00	-
	KBL	-	9.74	-
2004/2005	EBL	870.00	53.40	16.29
	SBL	-	20.08	-
	KBL	369.00	17.58	20.99
2005/2006	EBL	1,379.00	62.78	21.97
	SBL	360.00	13.05	27.59
	KBL	443.00	16.59	26.70
2006/2007	EBL	2,430.00	78.42	30.99
	SBL	778.00	15.88	48.99
	KBL	830.00	22.70	36.56

Chart 4.2.4.4.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Price Earning Ratio among three banks.

Chart: 4.2.4.4.a Price Earning Ratio



As shown in the above table 4.2.4.4 and chart 4.2.4.4.a, the Price Earning Ratio of EBL for FY 2002/03 and 2003/04 are 14.88 times and 14.92 times. As we don't know the Market price of per share of SBK and KBL we are not able to determine the Price Earning Ratio for the FY 2002/03 and 2003/04. In the FY 2004/05 Price Earning Ratio of KBL of 20.99 times is the highest and that of EBL is 16.29 times. Still for FY 2004/05 we could have the information on Market Price per Share of SBL, so not be able to calculate Price Earning Ratio. But, in the FY 2005/06 SBL had Highest Price Earning Ratio of 27.59 times and lowest of EBL of 21.97 times. Similarly in the FY 2006/07, SBL had highest Price Earning Ratio of 48.99 times and EBL had lowest of 36.56 times. Furthermore chart 4.2.4.4.b helps to find out the trend of three banks regarding Price Earning Ratio over the last five year's period.

Chart: 4.2.4.4.b Trend Analysis of Price Earning Ratio

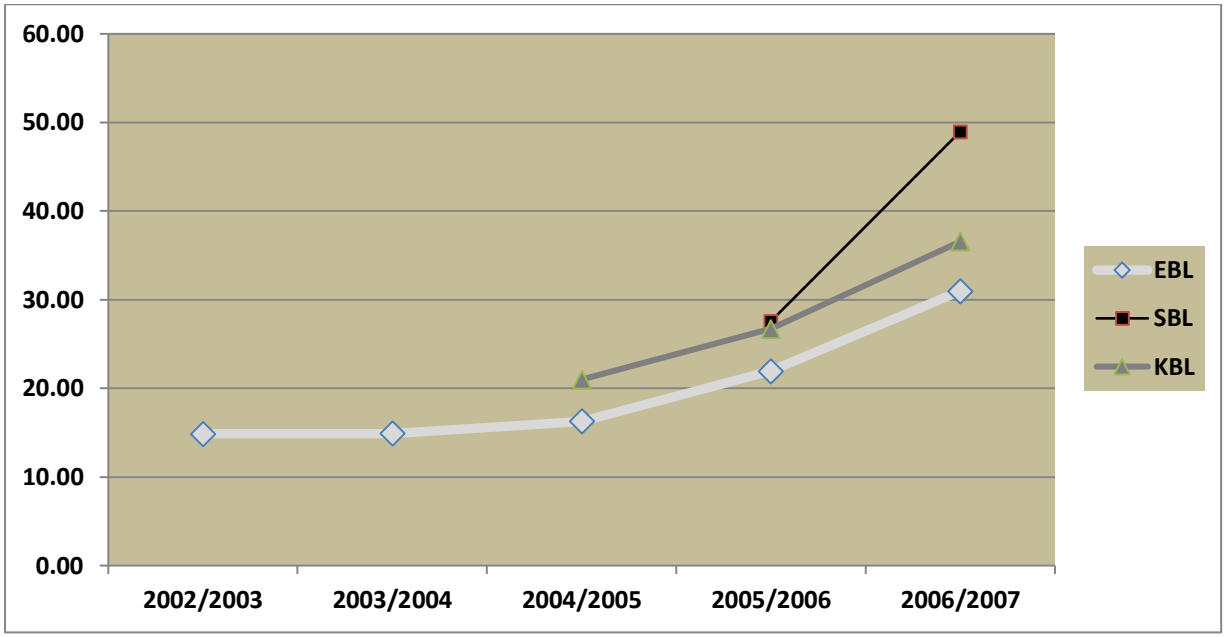


Chart 4.2.4.4.b is the trend analysis of three banks over the five year's study period. As shown in the figure Price Earning Ratio of EBL started from 14.88 times in FY 2002/03 and continuously increased till FY 2006/07.

Similarly, Price Earning Ratio of SBL started with Rs. 27.59 times in FY 2005/06 and increased i\to 48.99 times in FY 2006/07.

Likewise, Price Earning Ratio of KBL started with 20.99 times in FY 2002/03 and continuously increased till FY 2006/07 and reached to 36.56 times.

Overall the Price Earning Ratio of all three banks is increasing during the study period.

4.2.4.5 Net Interest Margin

Net interest margin is net interest income expressed as a percentage of average earning assets. So it is the expression of numerical relationship between net interest income and total earning assets of a bank. It measures how large a spread between interest revenues and interest costs management has been able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sources of funding (Rose, 1999). The lower the net interest margin, approximately 3.0% or lower, generally it is reflective of a bank with a large volume of non-earning or low-yielding assets. For the purpose of the study following model is used to determine net interest margin:

$$Net\ Interest\ Margin = \frac{Net\ Interest\ Income}{Total\ Earning\ Assets}$$

Where,

Net interest income = Interest Income – Interest Expenses

Total Earning assets = Total Interest bearing Assets

= Money at Call and Short Notice + Investment + Loans, Advances and Bills Purchase

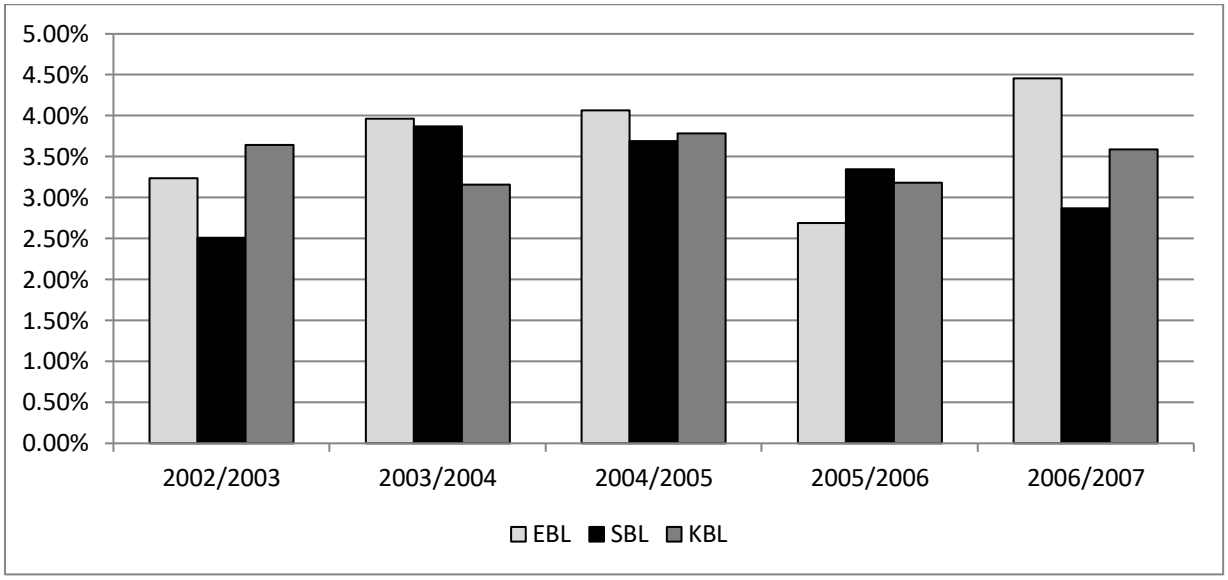
Table 4.2.4.5 is the observed Net Interest Margin of three banks during the study period in numerical terms which is presented below:

Table 4.2.4.5 Net interest Margin

Fiscal Year	Banks	Net Interest Income "in Rs."	Total Earning Assets "in Rs."	Net Interest Margin
2002/2003	EBL	212,534,566.00	6,562,437,707	3.24%
	SBL	18,270,383.64	728,582,657	2.51%
	KBL	92,145,100.00	2,528,891,702	3.64%
2003/2004	EBL	340,882,810.00	8,607,225,303	3.96%
	SBL	68,124,346.52	1,760,647,658	3.87%
	KBL	146,313,432.00	4,632,513,126	3.16%
2004/2005	EBL	419,732,586.00	10,317,603,328	4.07%
	SBL	106,203,584.01	2,879,870,450	3.69%
	KBL	259,788,286.00	6,871,196,670	3.78%
2005/2006	EBL	502,013,786.00	18,648,396,250	2.69%
	SBL	151,851,934.00	4,540,101,862	3.34%
	KBL	268,470,712.00	8,431,803,179	3.18%
2006/2007	EBL	627,242,067.00	14,068,782,896	4.46%
	SBL	209,812,857.00	7,317,221,679	2.87%
	KBL	394,231,089.00	10,979,646,530	3.59%

Chart 4.2.4.5.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Net Interest Margin among three banks.

Chart: 4.2.4.5.a Net Interest Margin



As shown in the above table 4.2.4.5 and chart 4.2.4.5.a, Net Interest Margin of KBL of 3.64% is the highest and SBL of 2.51% is the lowest in FY 2002/2003; EBL of 3.96% is the highest and KBL of 3.16% is the lowest in FY 2003/04; EBL of 4.07% is the highest and SBL of 3.69% is the lowest in FY 2004/05; SBL of 3.34% is the highest and 2.69% of EBL is the lowest in FY 2005/06 and EBL of 4.46% is the highest and SBL of 2.87% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.4.5.b helps to find out the trend of three banks regarding Net Interest Margin over the last five year's period.

Chart: 4.2.4.5.b Trend Analysis of Net Interest Margin

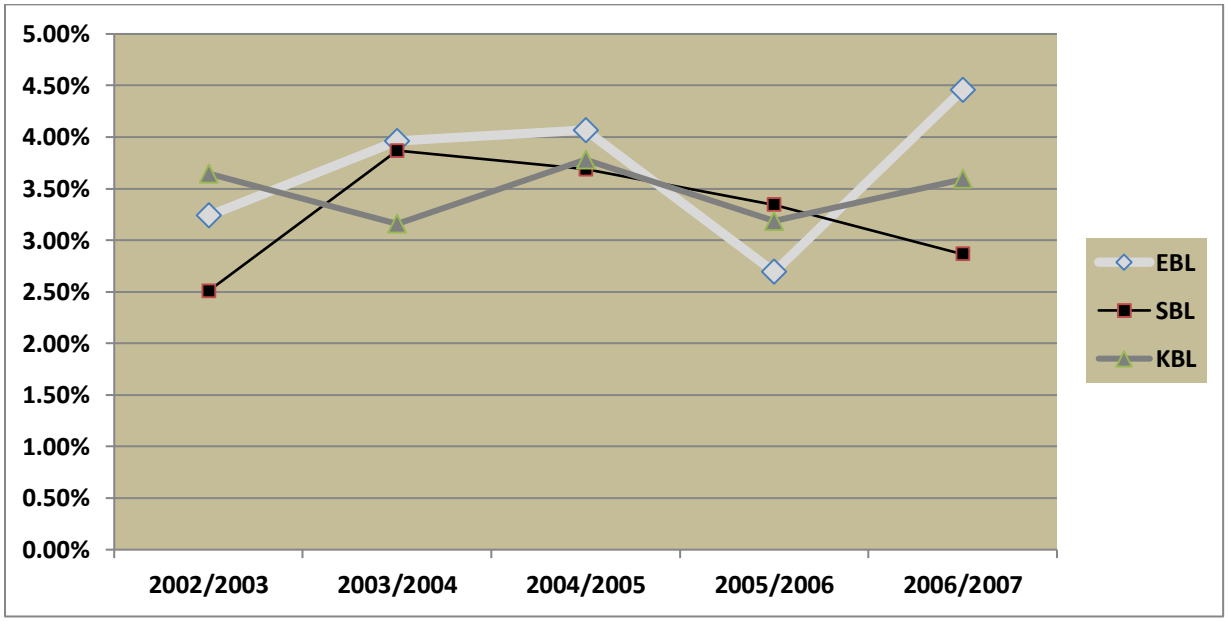


Chart 4.2.4.5.b is the trend analysis of three banks over the five year's study period. As shown in the figure Net Interest Margin of EBL started from 3.24%in FY 2002/03, increased in FY 2003/04 and 2004/05 thereafter decreased in FY 2005/06 and again increasing reached to 4.46% in FY 2006/07.

Similarly, Net Interest Margin of SBL started with 2.51%, increased in FY 2003/04 and thereafter continuously decreasing it reached to 2.87% in FY 2006/07.

Likewise, Net Interest Margin of KBL started with 3.64% in FY 2002/03, decreased in FY 2003/04, increased in FY 2004/05, again decreased in FY 2005/06 and increasing again in FY 2006/07 it reached to 3.59%.

Findings:

ROE of all three banks is in increment trend in general except EBL in FY 2004/05 and SBL KBL in FY 2005/06.is in-creasing trend except for the FY 2004/05. The reason for EBL and KBL for the decrement in ROE is the percentage change in NPAT is less than the percentage change in shareholders' fund compare to previous year, For SBL there is decrement in profit than previous year. Similarly ROA of all banks is in fluctuating but in general in increasing trend. ROA of EBL is decreased in FY 2004/05 and 2006/07, KBL in FY 2005/05 and SBL in FY 2005/06 and 2006/07. The reason behind is as similar as to the ROE. But the earning per share of all banks is in increasing trend except SBL and KBL in FY 2005/06. The reason for this is that there is increment in no of shares in FY 2005/06 for the both bank and also there is decrement in net profit after tax for SBL. Likewise, lack of availability of market price per share of SBL and KBL for some FYs we are not be able to calculate and analyze P/E ratio for all study period but for rest of FYs there is increment in P/E ratio of all banks. Lastly, the un-even increment trend in net profit after tax and total earning assets of all banks the net interest margin ratio is also in fluctuating trend.

4.2.5 LIQUIDITY

Liquidity refers to reserves of cash, securities, a bank's ability to convert an asset into cash, and unused bank lines of credit. Liquidity shows ability of institution to meet projected near term obligations. Liquidity must be sufficient to meet all maturing unsecured debt obligations due within a one-year time horizon without incremental access to the unsecured markets. An FI must always be liquid to meet depositors' and creditors' demand to maintain public confidence.

There needs to be an effective asset and liability management system to minimize maturity mismatches between assets and liabilities and to optimize returns.

Liquidity risk threats the solvency of FIs. Much more liquidity surplus hurts the profitability of the commercial bank by reducing the return on assets. Similarly, liquid deficit also costs much to the commercial banks in term of the higher purchasing price of liquidity and hurt in the reputation of the banks. In the case of commercial banks, first type of liquidity risk arises when depositors of commercial banks seek to withdraw their money and the second type does when commitment holders want to exercise the commitments recorded off the balance sheet. Commercial banks have to borrow the additional funds or sell the assets at fire sale price to pay off the deposit liabilities. They become insolvent if sale price of the assets are not enough to meet the liability withdrawals. The second type of liquidity risk arises when demand for unexpected loans cannot be met due to the lack of the funds. Commercial banks can raise the funds by running down their cash assets, borrowing additional funds in the money markets and selling off other assets at distressed price. Both liability side liquidity risk (first type risk) and asset side liquidity risk (second type risk) affect the health of commercial banks adversely. But maintaining the high liquidity position to minimize such risks also adversely affects the profitability of FIs. Return on highly liquid assets is almost zero. Therefore, FIs should strike the tradeoff between liquidity position and profitability so that they could maintain their health sound. Commercial bank's liquidity exposure can be measured by analyzing the sources and uses of liquidity. In this approach, total net liquidity is worked out by deducting the total of uses of liquidity from the total of sources of liquidity. Current and quick ratios are inappropriate for measuring FI liquidity.

NRB uses total loan to total deposit ratio (LDR), cash and equivalents to total assets ratio (CETAR), cash and equivalents to total deposit ratio (CETDR), and cash balance with NRB to total deposit ratio (CBNRBR) to measure the liquidity position of commercial banks.
As directed by NRB, commercial banks had to maintain 3 percent cash of the total deposits in their vault in the FY 2001 and 2002, and 2 percent in the FY 2003 (NRB 2003a). NRB withdrew the provision of maintaining 2.0 percent balance in commercial banks' vault as part of CRR (NRB 2004).

4.2.5.1 Cash Reserve Ratio (CRR)

It is the minimum amount of reserves a bank must hold in the form account balance with NRB. This ratio ensures minimum level of the bank's first line of defense in meeting depositor's obligations. It is the mandatory reserve that the commercial bank has to keep in the form of cash in their account in NRB for depositors' assurance and safety of bank which also reflects the bank's goodwill. As per the regulation made by NRB, Cash Reserve Ratio is to be maintained 5% on average of total deposits of bank on weekly basis. It is calculated as

$$NRB\ Balance\ to\ Total\ Deposit\ Ratio = \frac{Local\ Currency\ Balance\ in\ NRB}{Total\ Local\ Currency\ Deposit - Margin\ Deposit}$$

Since, we cannot find the daily deposit amount in annual report and also cannot access it, we cannot find cash reserve ratio and compare it as mandatory set by NRB of 5% on average of total deposit of bank on weekly basis. So, it will give false information or mislead to others if we calculate it on the figure that is given on year ending Balance Sheet.

4.2.5.2 Cash in Vault to Total Deposit Ratio

Cash in vault to total deposits ratio indicates the relationship between cash in vault to total deposits. It shows the percentage of total deposit maintained as vault. Cash at vault facilitates the commercial banks to meet their daily operational activities and solve the immediate liquidity crisis or we can say that this ratio measures the immediate obligation mainly cash withdraw by the depositors. Lower ratio indicates that the company might face a liquidity crunch while paying its obligation; where as a very high ratio indicates that the company has been keeping its idle fund and not deploying them properly. It is worked out by using the following model:

$$Cash\ in\ Vault\ to\ Total\ Deposit\ Ratio = \frac{Cash\ in\ Vault}{Total\ Deposits}$$

Where,

Cash in vault = Local Currency in Hand + Foreign Currency in Hand

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

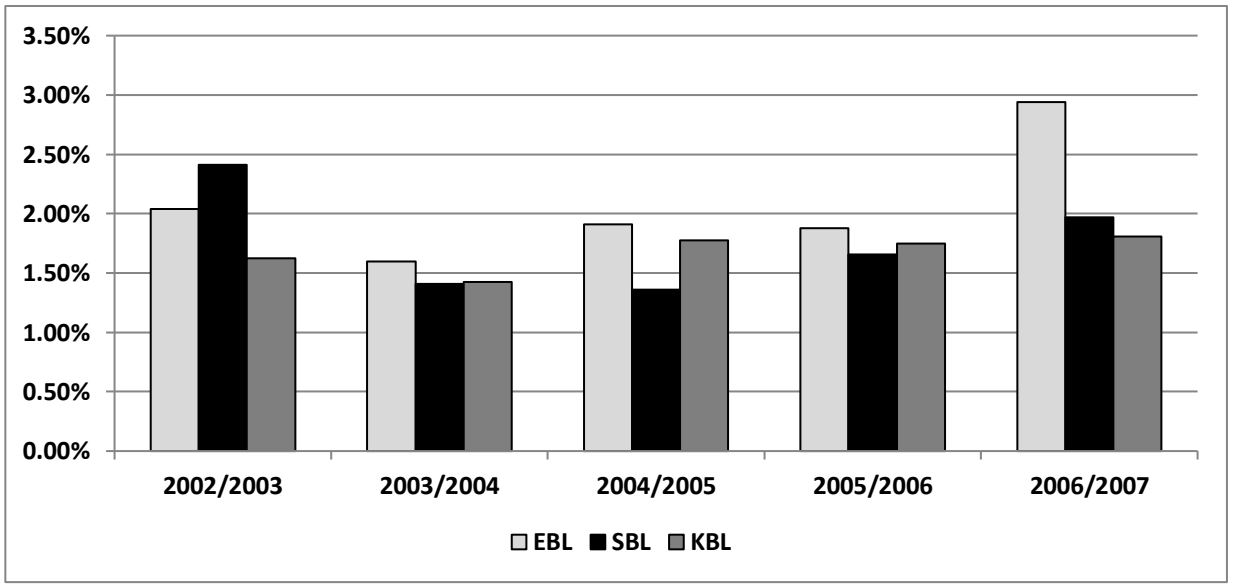
Table 4.2.5.2 is the observed Cash in Vault to Total Deposit Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.5.2 Cash in Vault to Total Deposit Ratio

Fiscal Year	Banks	Cash in Vault "in Rs."	Total Deposit "in Rs."	Cash in Vault to Total Deposit Ratio
2002/2003	EBL	136,658,509.00	6,694,963,060	2.04%
	SBL	9,438,897.00	391,677,605	2.41%
	KBL	40,800,041.00	2,513,144,223	1.62%
2003/2004	EBL	128,757,118.00	8,063,902,086	1.60%
	SBL	18,214,418.75	1,291,313,880	1.41%
	KBL	68,471,908.00	4,807,936,964	1.42%
2004/2005	EBL	192,590,297.00	10,097,690,989	1.91%
	SBL	33,459,440.75	2,461,922,522	1.36%
	KBL	111,249,095.00	6,268,954,481	1.77%
2005/2006	EBL	259,347,645.00	13,802,444,988	1.88%
	SBL	64,977,328.00	3,918,076,217	1.66%
	KBL	135,794,991.00	7,768,957,276	1.75%
2006/2007	EBL	534,996,791.00	18,186,253,541	2.94%
	SBL	130,442,580.00	6,625,078,506	1.97%
	KBL	190,748,210.00	10,557,416,461	1.81%

Chart 4.2.5.2.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Cash in Vault to Total Deposit Ratio among three banks.

Chart: 4.2.5.2.a Cash in Vault to Total Deposit Ratio



As shown in the above table 4.2.5.2 and chart 4.2.5.2.a, Cash in Vault to Total Deposit Ratio of SBL of 2.41% is the highest and KBL of 1.62% is the lowest in FY 2002/2003; EBL of 1.60%

is the highest and SBL of 1.41% is the lowest in FY 2003/04; EBL of 1.19% is the highest and SBL of 1.36% is the lowest in FY 2004/05; EBL of 1.88% is the highest and 1.66% of SBL is the lowest in FY 2005/06 and EBL of 2.94% is the highest and KBL of 1.81% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.5.2.b helps to find out the trend of three banks regarding Cash in Vault to Total Deposit Ratio over the last five year's period.

Chart: 4.2.5.2.b Trend Analysis of Cash in Vault to Total Deposit Ratio

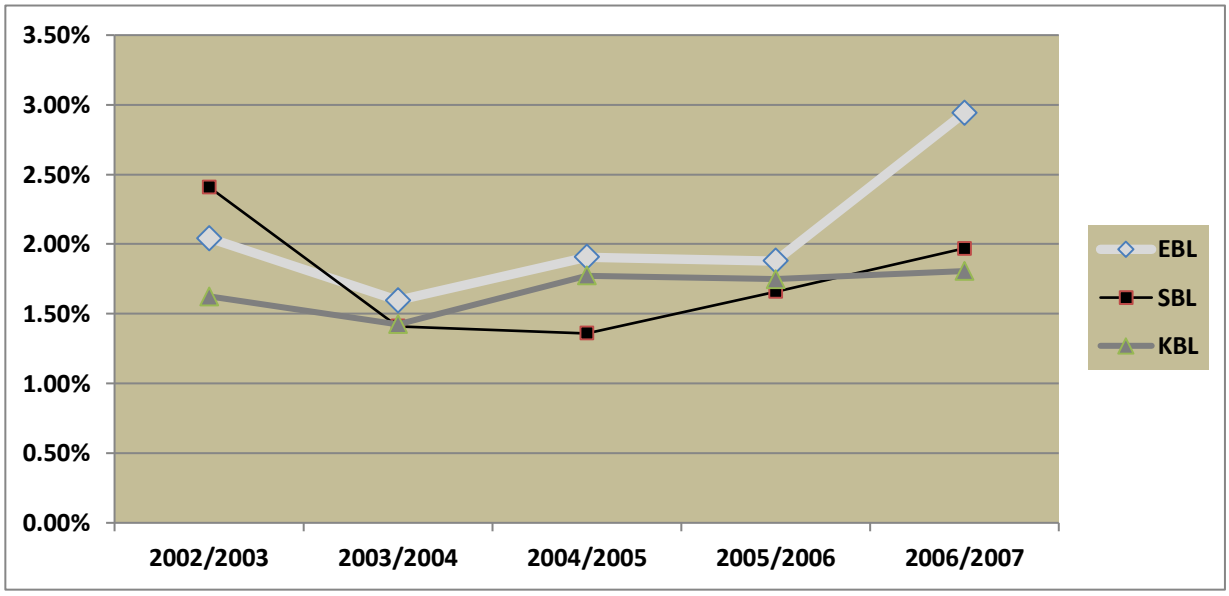


Chart 4.2.5.2.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Cash in Vault to Total Deposit Ratio of EBL started from 2.04%in FY 2002/03, decreased in FY 2003/04, increased in FY 2004/05, again decreased in FY 2005/06 and thereafter increasing reached to 2.94% in FY 2006/07.

Similarly, Cash in Vault to Total Deposit Ratio of SBL started with 2.41%, decreased in FY 2003/04 and FY 2004/05 and thereafter continuously increasing it reached to 1.97% in FY 2006/07.

Likewise, Cash in Vault to Total Deposit Ratio of KBL started with 1.62% in FY 2002/03, decreased in FY 2003/04, increased in FY 2004/05, again decreased in FY 2005/06 and increasing again in FY 2006/07 it reached to 1.81%.

4.2.5.3 Cash & Bank Balance to Total Deposit Ratio

This ratio tests cash balance kept in the bank required to meet depositors day to day withdraw. Banks earning is result of floating or investing depositors money but also necessary to maintain adequate cash balance to meet daily operation as well. This need to strike out a balance and not tying up of fund more than need that will adversely affect bank's profitability. It is calculated as:

$$Cash\ and\ Bank\ Balance\ Ratio = \frac{Total\ Cash\ and\ Bank\ Balance}{Total\ Deposits}$$

Where,

Total Cash & Bank Balance = Cash Balance + Balance with NRB + Balance with Bank/Financial Institution (Local Currency +Foreign Currency)

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

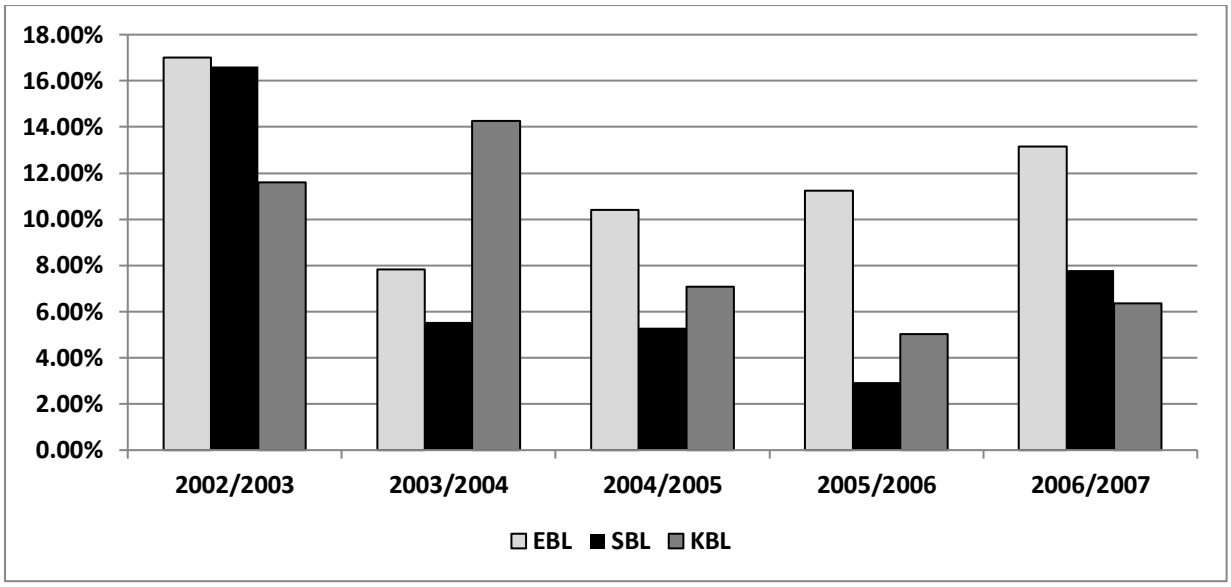
Table 4.2.5.3 is the observed Cash and Bank Balance to Total Deposit Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.5.3 Cash and Bank Balance to Total Deposit Ratio

Fiscal Year	Banks	Cash & Bank Balance "in Rs."	Total Deposit "in Rs."	Cash & Bank Balance to Total Deposit Ratio
2002/2003	EBL	1,139,568,776.00	6,694,963,060	17.02%
	SBL	65,086,751.45	391,677,605	16.62%
	KBL	291,705,250.00	2,513,144,223	11.61%
2003/2004	EBL	631,804,931.00	8,063,902,086	7.83%
	SBL	71,846,215.48	1,291,313,880	5.56%
	KBL	685,477,911.00	4,807,936,964	14.26%
2004/2005	EBL	1,049,989,208.00	10,097,690,989	10.40%
	SBL	130,729,164.82	2,461,922,522	5.31%
	KBL	443,371,369.00	6,268,954,481	7.07%
2005/2006	EBL	1,552,967,494.00	13,802,444,988	11.25%
	SBL	115,946,306.00	3,918,076,217	2.96%
	KBL	389,629,745.00	7,768,957,276	5.02%
2006/2007	EBL	2,391,420,594.00	18,186,253,541	13.15%
	SBL	517,226,354.00	6,625,078,506	7.81%
	KBL	672,112,951.00	10,557,416,461	6.37%

Chart 4.2.5.3.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Cash and Bank Balance to Total Deposit Ratio among three banks.

Chart: 4.2.5.3.a Cash and Bank Balance to Total Deposit Ratio



As shown in the above table 4.2.5.3 and chart 4.2.5.3.a Cash and Bank Balance to Total Deposit Ratio of EBL of 17.02% is the highest and KBL of 11.61% is the lowest in FY 2002/2003; KBL of 14.26% is the highest and SBL of 5.56% is the lowest in FY 2003/04; EBL of 10.40% is the highest and SBL of 5.31% is the lowest in FY 2004/05; EBL of 11.25% is the highest and 2.96% of SBL is the lowest in FY 2005/06 and EBL of 13.15% is the highest and KBL of 6.37% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.5.2.b helps to find out the trend of three banks regarding Cash and Bank Balance to Total Deposit Ratio over the last five year's period.

Chart: 4.2.5.3.b Trend Analysis of Cash and Bank Balance Ratio

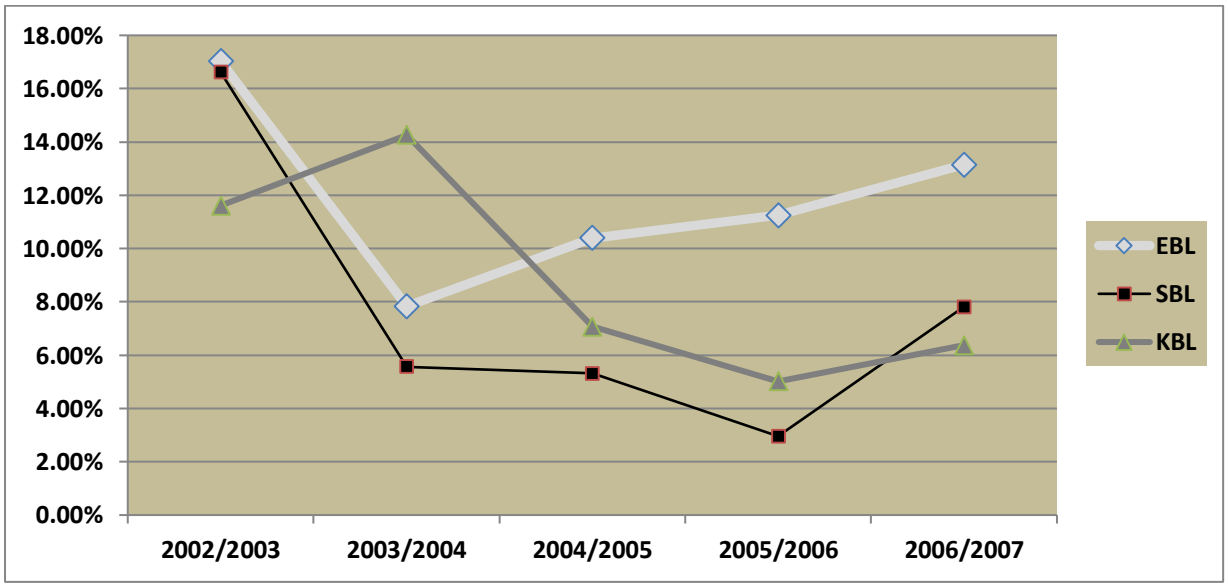


Chart 4.2.5.3.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Cash and Bank Balance to Total Deposit Ratio of EBL started from 17.02% in FY 2002/03, decreased in FY 2003/04, and continuously increasing it reached to 13.15% by the end of FY 2006/07.

Similarly, Cash and Bank Balance to Total Deposit Ratio of SBL started with 16.62% in FY 2002/03, decreased in FY 2003/04, in FY 2004/05 and in FY 2005/06, thereafter increasing it reached to 7.81% in FY 2006/07.

Likewise, Cash and Bank Balance to Total Deposit Ratio of KBL started with 11.61% in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and in FY 2005/06 and lastly increasing in FY 2006/07 it reached to 6.37%.

4.2.5.4 Investment in Government Security to Total Deposit Ratio

Government security refers to the securities issued by the government or through NRB. It can be in the form of treasury bills, government bond, NRB Bond etc. Government securities are least risky, highly liquid and moderately paying instruments and usually short term in nature. Although they generate a low return but in the need of liquidity they play a vital role to save the bank from solvency as they can be traded in the market easily at any time when the bank need fund immediately. It not only protect the banks from the solvency but also useful to absorb the excess liquidity of banks for the short periods. This ratio indicates how much portion of the fund is utilized in the least risky investment and calculated as:

$$Investment\ in\ Gov.Security\ to\ Total\ Deposit = \frac{Investment\ in\ Government\ Security}{Total\ Deposits}$$

Where,

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

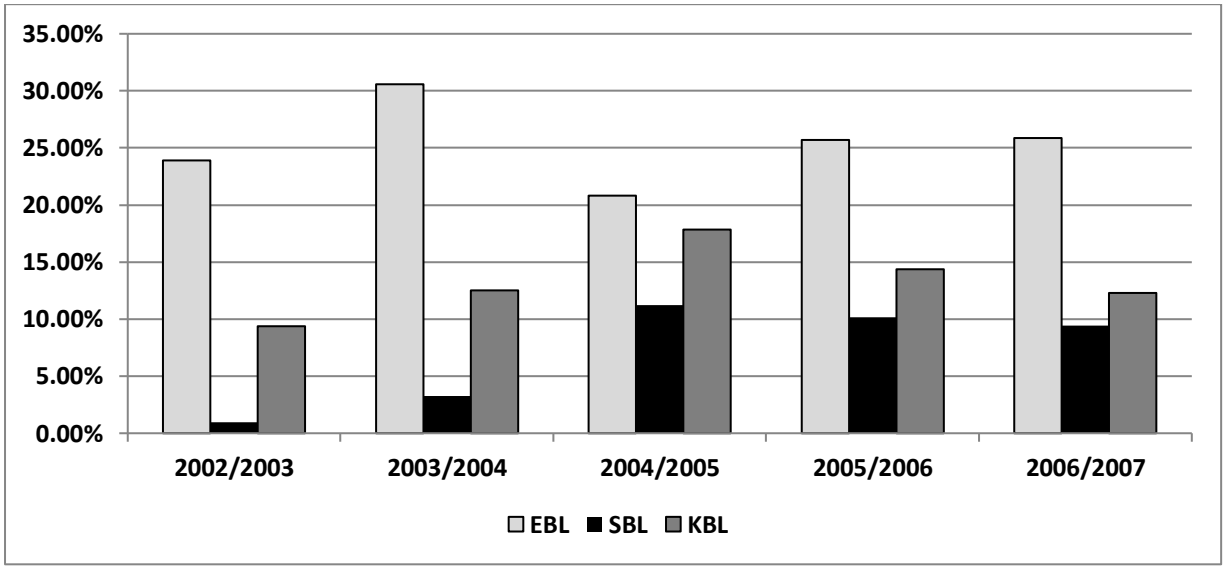
Table 4.2.5.4 is the observed Investment in Government Security to Total Deposit Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.5.4 Investment in Government Security to Total Deposit Ratio

Fiscal Year	Banks	Investment in Government Security "in Rs"	Total Deposit "in Rs"	Investment in Government Security to Total Deposit Ratio
2002/2003	EBL	1,599,350,560.00	6,694,963,060	23.89%
	SBL	3,775,000.00	391,677,605	0.96%
	KBL	235,629,880.00	2,513,144,223	9.38%
2003/2004	EBL	2,466,428,694.00	8,063,902,086	30.59%
	SBL	42,050,560.00	1,291,313,880	3.26%
	KBL	601,609,403.00	4,807,936,964	12.51%
2004/2005	EBL	2,100,289,702.00	10,097,690,989	20.80%
	SBL	276,270,433.40	2,461,922,522	11.22%
	KBL	1,119,994,196.00	6,268,954,481	17.87%
2005/2006	EBL	3,548,616,968.00	13,802,444,988	25.71%
	SBL	398,364,670.00	3,918,076,217	10.17%
	KBL	1,114,319,438.00	7,768,957,276	14.34%
2006/2007	EBL	4,704,632,426.00	18,186,253,541	25.87%
	SBL	625,748,040.00	6,625,078,506	9.45%
	KBL	1,297,867,040.00	10,557,416,461	12.29%

Chart 4.2.5.4.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Investment in Government Security to Total Deposit Ratio among three banks.

Chart: 4.2.5.4.a Investment in Government Security to Total Deposit Ratio



As shown in the above table 4.2.5.4 and chart 4.2.5.4.a Investment in Government Security to Total Deposit Ratio of EBL of 23.89% is the highest and SBL of 0.96% is the lowest in FY 2002/2003; EBL of 30.59% is the highest and SBL of 3.26% is the lowest in FY 2003/04; EBL of 20.80% is the highest and SBL of 11.22% is the lowest in FY 2004/05; EBL of 25.71% is the

highest and 10.17% of SBL is the lowest in FY 2005/06 and EBL of 25.87% is the highest and SBL of 9.45% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.5.4.b helps to find out the trend of three banks regarding Investment in Government Security to Total Deposit Ratio over the last five year's period.

Chart: 4.2.5.4.b Trend Analysis of Investment in Gov. Security to Total Deposit Ratio

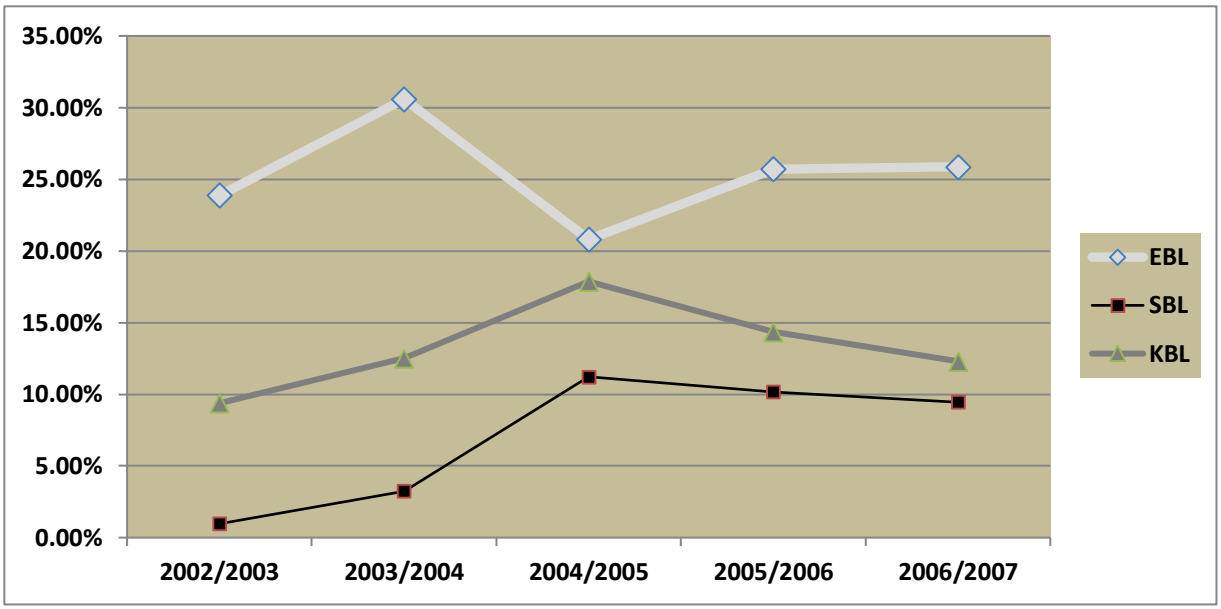


Chart 4.2.5.4.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Investment in Government Security to Total Deposit Ratio of EBL started from 23.89% in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and thereafter continuously increasing it reached to 25.87% by the end of FY 2006/07.

Similarly, Investment in Government Security to Total Deposit Ratio of SBL started with 0.96% in FY 2002/03, increased in FY 2003/04 and in FY 2004/05 and thereafter decreasing it reached to 9.45% in FY 2006/07.

Likewise, Investment in Government Security to Total Deposit Ratio of KBL started with 9.38% in FY 2002/03, increased in FY 2003/04 and in FY 2004/05 and thereafter decreasing it reached to 12.29% in FY 2006/07.

4.2.5.5 Liquid Assets to Total Deposit Ratio

Total liquid assets to total deposits ratio is a numerical relationship between total liquid assets and total deposits of a bank. The higher ratio implies better liquidity position. But when the bank keep much liquid asset to safe from liquidity risk, it impact in profitability because the return is low on liquid assets. Therefore bank has to maintain the balance between liquidity and profitability. It is calculated by using the following model:

$$Total\ Liquid\ Asset\ to\ Total\ Deposit\ Ratio = \frac{Total\ Liquid\ Asset}{Total\ Deposits}$$

Where,

Total Liquid assets = Cash in hand + NRB Balance + Domestic bank balance + Foreign currency bank balance + Money at call & short notice+ Investments in Government securities.

Total Deposit = Total Deposit of Non Interest Bearing Accounts + Total Deposits of interest Bearing Accounts (Local Currency +Foreign Currency)

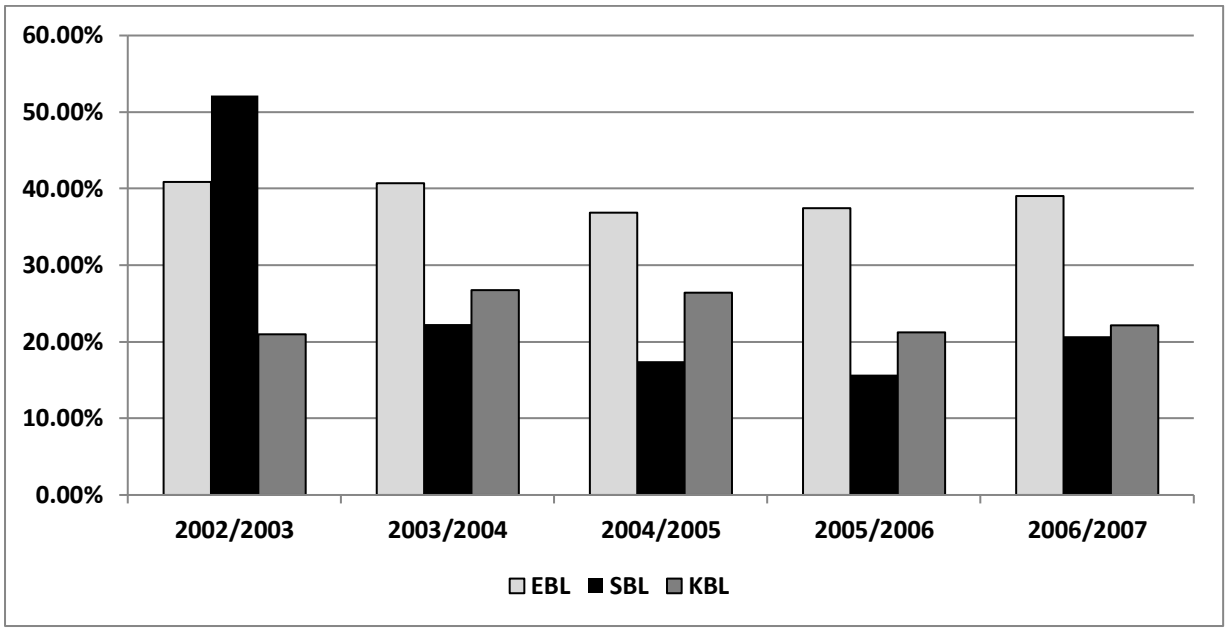
Table 4.2.5.5 is the observed Liquid Assets to Total Deposit Ratio of three banks during the study period in numerical terms which is presented below:

Table 4.2.5.5 Liquid Assets to Total Deposit Ratio

Fiscal Year	Banks	Liquid Asset "in Rs"	Total Deposit "in Rs"	Liquid Asset to Total Deposit Ratio
2002/2003	EBL	2,738,919,336.00	6,694,963,060	40.91%
	SBL	204,234,689.69	391,677,605	52.14%
	KBL	527,335,130.00	2,513,144,223	20.98%
2003/2004	EBL	3,285,678,625.00	8,063,902,086	40.75%
	SBL	288,726,775.48	1,291,313,880	22.36%
	KBL	1,287,087,314.00	4,807,936,964	26.77%
2004/2005	EBL	3,720,278,910.00	10,097,690,989	36.84%
	SBL	429,470,600.46	2,461,922,522	17.44%
	KBL	1,653,365,565.00	6,268,954,481	26.37%
2005/2006	EBL	5,168,544,462.00	13,802,444,988	37.45%
	SBL	614,310,976.00	3,918,076,217	15.68%
	KBL	1,648,949,183.00	7,768,957,276	21.22%
2006/2007	EBL	7,096,053,020.00	18,186,253,541	39.02%
	SBL	1,372,420,699.00	6,625,078,506	20.72%
	KBL	2,342,194,991.00	10,557,416,461	22.19%

Chart 4.2.5.5.a is a bar diagram which represents the above tabulated numerical data which helps to compare the Liquid Assets to Total Deposit Ratio among three banks.

Chart: 4.2.5.5.a Liquid Assets to Total Deposit Ratio



As shown in the above table 4.2.5.5 and chart 4.2.5.5.a Liquid Assets to Total Deposit Ratio of SBL of 52.14% is the highest and KBL of 20.98% is the lowest in FY 2002/2003; EBL of 40.75% is the highest and SBL of 22.36% is the lowest in FY 2003/04; EBL of 36.84% is the highest and SBL of 17.44% is the lowest in FY 2004/05; EBL of 37.45% is the highest and 15.68% of SBL is the lowest in FY 2005/06 and EBL of 39.02% is the highest and SBL of 20.72% is the lowest in the FY 2006/07 among three banks. Furthermore chart 4.2.5.5.b helps to find out the trend of three banks regarding Liquid Assets to Total Deposit Ratio over the last five year's period.

Chart: 4.2.5.5.b Liquid Assets to Total Deposit Ratio

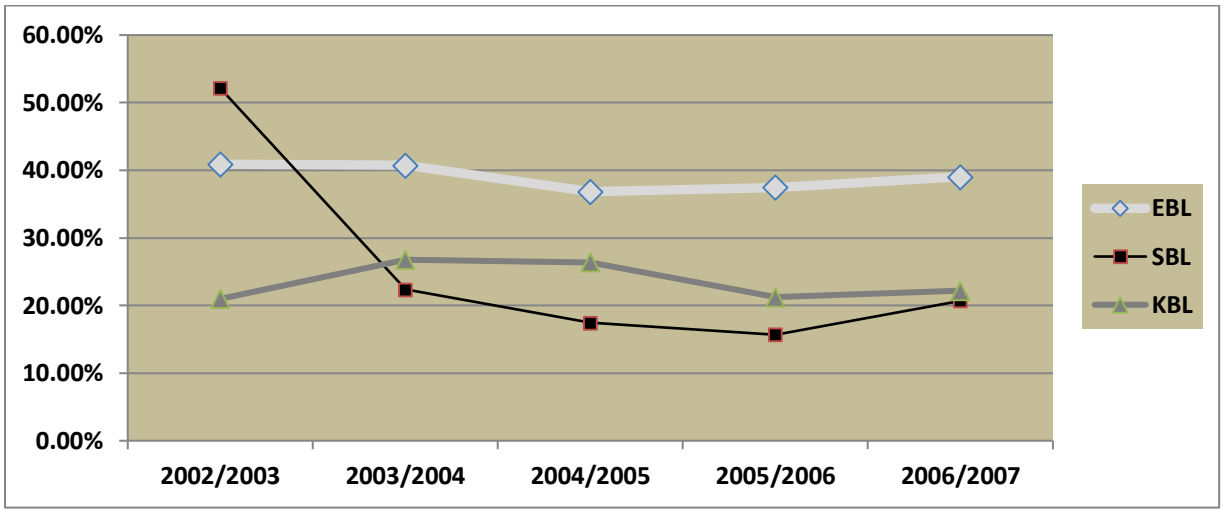


Chart 4.2.5.5.b is the trend analysis of three banks over the five year's study period. As shown in the figure, Liquid Assets to Total Deposit Ratio of EBL started from 40.91% in FY 2002/03, decreased in FY 2003/04 and in FY 2004/05 and thereafter increasing it reached to 39.02% by the end of FY 2006/07.

Similarly, Liquid Assets to Total Deposit Ratio of SBL started with 52.14% in FY 2002/03, decreased in FY 2003/04, in FY 2004/05 and in FY 2005/06, after that it increased and reached to 20.72%by the end of FY 2006/07.

Likewise, Liquid Assets to Total Deposit Ratio of KBL started with 20.98% in FY 2002/03, increased in FY 2003/04, decreased in FY 2004/05 and in FY 2005/06 and increasing at last it reached to 22.19% in FY 2006/07.

Findings:

All the liquidity ratio of banks is in very much fluctuating trend. This may be the reason of liquidity risk associated with it and NRB directions regarding the liquidity and deposits. There is increment in total deposit as well as in cash at vault, cash and bank balance, investment in government in security and also in liquid assets. Although, all those variables are increased over the study period, but in un-even pattern, it caused to fluctuate in trend line of all the ratios. Among all the banks EBL has the highest liquidity ratio which is the safe from the liquidity side.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Introduction

This chapter deals with three aspects of the study: summary, conclusion and recommendations. The first aspect summarizing the whole study, the second draw the conclusion based upon findings and the last one forwards the recommendation for the banks on their weak parts.

5.1 Summary

The study was conducted with the objective to analyze and compare the financial performances of Everest Bank Limited (EBL), Siddhartha Bank Limited (SBL) and Kumari Bank Limited (KBL) in the framework of CAMEL over the five year period from FY 2002/03 to 2006/07 following a descriptive and analytical research design prescribed by UFIRS and in accordance to BASEL accord. The study is based on secondary data. For the analysis of the study, annual reports and financial statement of EBL, SBL and KBL are used as the major sources of data out of 25 commercial banks. CAMEL is a common method for analyzing the health of individual institution, to quantify the performance and the financial condition of the firm. It was designed by regulatory authorities and this study scrutinizes the financial performance of EBL, SBL and KBL as regards to CAMEL i.e. Capital Adequacy, Asset Quality, Management Quality, Earning Quality and Liquidity. The analysis of financial statement are done to obtain a better insight into the bank's position and performance, Various financial and statistical tools have been used in this study to get the meaningful result and to meet the research objectives.

Various materials were reviewed in order to build up the conceptual foundation and reach to the clear destination of research. During the research the areas that formed part of the conceptual review were; historical development of financial system and evolution of commercial banks in Nepal, concept of commercial banks, function of commercial banks, approach to supervision, financial performance approaches, components of CAMEL, New Basel Capital Accord, NRB norms. Besides these, review of journals articles and review of dissertations were carried out under research review.

The analysis has been made to compare the company's ratios with NRB and international standards. The Core Capital Adequacy Ratio above the NRB standard of EBL, SBL and KBL show the protection and security to creditors and depositors and financial soundness of the company. The supplementary capital adequacy ratios of all three banks are as per NRB standard in all the years in the review period which leads to conclude that the banks are running with adequate capital. The higher observed capital adequacy ratios of SBL thorough the study period shows the higher internal sources and comparatively strong financial position and higher security to depositors that that of EBL and KBL.

The non performing loan ratio is below the international standards i.e. 5% of both banks. It reflects the good performance of the banks in mobilizing loan and advances. The lower NPL ratio of KBL shows the better proportion of performing loans and risk of default (credit) than that of EBL and SBL. The lower and average loan loss ratio of SBL fin FY 2002/03, 2003/04 and 2004/05 during the operation of initial period of SBL shows the lower risky asset of SBL in the volume of loan and advances than that of KBL and SBL but while looking the trend overall average loan loss ratio of KBL shows the lower risky asset of KBL in the volume of loan and advances than that during the study period is constant and tend to be low than that of SBL and EBL.

The management quality proxy ratio, the lower average total expenses to total income ratio and Efficiency Ratio of EBL shows the better operation of the bank and better profitability than SBL and KBL. Another management quality proxy ratio, earning per employee of all banks are in increasing trend. The higher average of the earning per employee of SBL over last three years means the better management system and efficiency of staffs of SBL than that of EBL and KBL.

The return on equity of EBL is highest among three banks and above the benchmark of 15% set by World Bank where as return on equity of KBL is only higher than 15 in FY 2006/07 and that of SBL is only higher than 15% in FY 2004/05. But in overall they are in increasing trend. On the other hand return on asset of all the three banks are in increasing trend with fluctuation but at the end of the study period assets of the KBL seem to be used in better way to generate profit than other banks. Similarly, EPS of all banks are in increasing trend but EBL has much more highest EPS than other two banks. Likewise P/E ratios of all banks are in increasing trend

but at the end of study period SBL has highest P/E Ratio.Net interest Margin of all banks are volatile but EBL has the highest NIM at the end of FY 2006/07.

The higher Cash at vault to Total deposit ratio, Cash and Bank balance to Total Deposit ratio, Investment in Gov. Security to Total Deposit ratio and Liquid Asset to total Deposit Ratio of EBL shows that the liquidity position of EBL is stronger than other two banks.

5.2 Conclusion

Based on the findings, following conclusion have been drawn from the study on Everest Bank Limited (EBL), Siddhartha Bank Limited (SBL) and Kumari Bank Limited (KBL) in the framework of CAMEL Analysis.

5.2.1 Although Core Capital Adequacy Ratio of all banks is in fluctuating but in decreasing trend through the study period, Core Capital Adequacy Ratio of all banks is above the NRB standard. It reveals that the bank have adequately maintained its internal sources or Core Capital in the past five year's period and have strictly followed the NRB rules and Regulations. The higher CCAR of SBL throughout the study period shows SBL's better protection and security to its creditors and depositors and higher financial strength than EBL and SBL. Similarly, Supplementary Capital Adequacy Ratio of all banks are also within the NRB norms during the review period which reveals that the banks are running with adequate capital through the study period and has strictly followed the NRB directives i.e. Supplementary Capital should not be more than Core Capital of the company. In case of Supplementary Capital Adequacy Ratio EBL has the highest ratio than SBL and KBL but overall Capital Adequacy Ratio of SBL is the highest than that of EBL and KBL which shows higher internal sources and comparatively strong financial position and higher security to depositors even in case of liquidation. In the point of view all EBL, SBL and KBL are financially sound and strong.

5.2.2 Although the Non Performing Loan Amount of all banks are increasing but in comparison to Total Loan and Advances it is getting lower and lower each year and below 5 percent of internal standard. So, this decreasing non performing loan ratio shows that banks are very much conscious and aware of non-performing loans and adopting appropriate policies to manage this problem and to increase good quality of assets. In this study KBL

has the lowest Non performing loan ratio among all three banks that indicates very conscious and better position regarding distribution of good loans. Similarly, loan loss provision is made on total loan and advances and total loan and advances of all three banks are increasing every year. But, loan loss provision ratio of all banks is decreasing in last couple of years although total loan and advances amount increases. So, it can therefore, concluded that banks has placed efficient credit management while distributing loans by which they are increasing volume of good loans and by taking appropriate recovery policy and efforts they are decreasing its non performing loan. Also increasing loan loss ratio (and above 100 percent) of all three banks shows that in case of any loan becoming default out of non-performing loans bank can easily handle it and will be safe from the liquidation.

5.2.3 The higher average total expenses to total income ratio shows the better operation of the bank. But from the middle of the study period the trend line of total expenses to total income ratio increases. It is due to the increase in operating expenses and also increment in net interest income in decreasing trend. So, last couple of year total expenses to total income ratio of all banks are increasing which is not good for banks. On the other hand earning per employee of all banks is increasing which shows the sign of good management system, regarding human resources, even though the numbers of employees in all banks are in increasing. Among three banks SBL has the highest earning per employee. Similarly, efficiency ratio of all three banks is in decreasing trend except KBL in year 2006/07. This indicates that productivity of all bank's are increasing in general as this decreasing efficiency ratio shows that for 1 dollar income it is spending less and less and saving more each year. From this efficiency ratio point of view EBL is in better position.

5.2.4 The increasing ROE of all banks shows the positive sign to their investors but only crossing above the bench mark of 15 percent EBL presents it as dominant. Similarly in case of ROA, the trend line is in increasing in general but it did not cross the bench mark of 1.5% set by the World Bank. But both increment in ROE and ROA are good signal for investors or shareholders. Similarly, Earning per Share and P/ E Ratio of all three banks are in increasing trend. Although the no of shares increased, due to the increment in Net profit after tax EPS of all banks has increased and EBL has highest among them. The Net

interest Margin ratio of all three banks are in fluctuation trend and have met the bench mark of 3 to 4 percent as prescribed by the world bank except EBL in 2005/06 and SBL in 2002/03 and 2006/07. But in general it seems that all banks have well managed its assets and liabilities.

5.2.5 The cash at vault to total deposit ratio of all banks are in fluctuating trend but EBL has the highest among three banks. Similarly cash and bank balance to total deposit ratio of all banks are in also is in fluctuating trend and in this case also EBL has highest cash and bank balance ratio to total deposit ratio. Also investing huge amount in Government security, EBL presents itself as most secured from the liquidation risk among all three banks.

5.3 Recommendation

The following recommendations are made based on the conclusions as suggestion to overcome the weakness as regard to financial performance of Everest Bank Limited (EBL), Siddhartha Bank Limited (SBL) and Kumari Bank Limited (KBL).

5.3.1 The Core Capital Adequacy Ratio of all banks are as per NRB standard over the review period but are in decreasing trend which also results decrease in Total Capital Adequacy Ratio and if it continuous goes down, NRB may provide directions to maintain at the mark. So recommendation is provide and maintain stable (if possible increase) core capital adequacy ratio and open eye for future circumstances.

5.3.2 The assets quality ratio of all banks seems to be satisfactory level and being better each year. So, the recommendation is to maintain non performing loan ratio as lower as possible and try to give additional attention in recovering the doubtful and loss loan in future and try to increase its performing loan ratio near to 100 percent.

5.3.3 The total expenses to total income ratio of all banks seems to be decreasing till the middle of the study period and there after increases except EBL in FY 2006/07. So it is recommendation to the management of the banks to try to reduce the operating as well as non-operating expenses and by exploring new schemes and packages to its regular and

non regular customers and try to increase its operating income which will cause to decrease in total expenses to total incomes ratio so that will increase bank's profitability.

5.3.4 The earning quality ratios of both banks like return on equity and return on assets are in increasing trend but are below the bench mark set by the World Bank except of EBL in return on equity. So, the all banks are recommended to increase its yield as its net profit to gain the trust of the equity holder and stakeholder as the most important measure for any firm is profitability and no firm grow and survive in ling run without profitability. To increase profit of the bank it is recommended that bank should minimized its operating cost by increasing the operating efficiency of its employeesm

5.3.5 Liquid assets of the commercial banks play an important role to meet the day to day and short term obligation. If liquid assets of the banks are not maintained properly then there is a high probability of banks going to liquidation. The liquidity ratio of EBL seems to be satisfactory among three banks but SBL and KBL should be careful and try to increase liquidity position by increasing total cash to total deposit, cash and bank balance to total deposit, investment in government security to total deposit and liquid assets to total deposit ratios.

BIBLIOGRAPHY

Books:

Bhandari, Dilli Raj. **Banking and insurance Principle and Practices**, January 2003, Aayush Publication

Chandra, Prasana (1986), **Fundamental of Financial Management**, 2nd edition, Bangalore: India Institute of Management.

Franke, Julial R. and Scholefied, Harsy H. (1974), **Corporate Financial Management** 1st edition, Great Britain: Grower Press Ltd.

Gitman, L.J. (1988). **Principles of Managerial Finance**, 5th edition, Mew York: Harper Collins Publishers

Hampton, John J. (1988), **Financial Decision Making Concept,** Problems and Cases, 3rd edition. New Delhi: Prentice Hall of India

Joshi, Shyam (2001), **Economic Policy Analysis**, 1st edition, Kathmandu: Taleju Prakashan

Khan, M.T. and P.K. Jain (1990) **Financial Management, Text and Problem**, 9th edition. New Delhi: Tata MC Grow-Hill

Kothari, CR. (1997) **Research Methodology, Method & Technique**: New Delhi, Willey Estern Limited

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

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

HMG Ministry of Finance. **Banking and Financial Institution Ordinance** (2004). Nepal Gazette, Kathmandu

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

Joshi. D. (1993). **A study on Commerical Banks of Nepal With Special Reference Financial Analysis of Rastriya Banijya Bank.** Master diss, Tribhuban University.

K.C. Ramesh (1991). **Dividend Policy of Joint Venture Banks in Nepal**. Master diss. Tribhuvan University

Mayer, P.A. and H.W. Piffer (1970, September). **Prediction of Banks Failures**. The Journal of Fianace, 25:835-868.

Shakya, D.R. (1995). **Financial Analysis of joint venture Banks in Nepal**. Master diss, Tribhuvan University.

Shayn Resham (2005)., **Capital Structure of Selected Commercial Banks of Nepal**. Master diss. Tribhuvan University

Thapa, Samiksha (2001). **A Comparative Study on the Finical Performance of Nepal Arab Bank Ltd. and Nepal Indosuez Bank Ltd. Master diss., Tribhuvan University**.

Related Studies and Journals:

Adhikari, Dev R. (1993) **Evaluating the Financial Performance of Nepal Bank Ltd**. MBA. diss., Tribhuvan University

Baral, Keshar J. (2005). Health Check up of Commercial Banks in the Framework of CAMEL**, A Case Study of Joint Venture Banks in Nepal.** Journal of Nepalese Business Studies, Vol 2, No 1.

Barker, D. and D. Holdsworth (1993). **The case study of banks failures in the 1990s.** Federal Reserve Bank of New York, Research Paper No 9325.

Barr, R.s., L.M. Seiford and T.F. Siems (1993). **An Envelopment- Analysis Approach to Pleasuring the Management Quality of Banks.** Analysis of Operations Research,38.
Berger Alien N., Sally M. Davies and Mark J. Flannery (1998) **Comparing Market and Regulatory Assessments of Banks Performance, who knows what when?** Federal Reserve Board of Governors FEDS Working Paper.
Berger, A.N. and S.M. Davies (1994). **The Information Content of Bank Examinations**, Journal of Financial Services Research 14, pp. 117-144
Bhandari, Krishna (2006), **The financial performance of Himalayan Bank Ltd. In the Framework of CAMEL**. Master diss., Tribhuvan University
Bhusal , Manisha, **"Financial Performance Analysis of commercial banks in Nepal in the framework of CAMEL, A comparative study of Kumari Bank Limited & Machhapuchhre Bank Limited"**

Bohara, Bhoj R. (1992). **A comparative Study of the Financial Performance of Nepal Arab Banl Ltd. and Indosuez Bank Ltd.**, Master diss., Tribhuvan University
Cantor R. (2001) **A new Capital Adequacy Framework**. Journal of Banking and Finance, 25 171-185
Crosse, H.D. **Management Policies for Commercial Banks**. USA: Prentice Hall Inc.
Deoja, S. (2001) **A Comparative Study of the Financial Performance between Nepal State of India Ltd. and Nepal Bangladesh Bank Ltd. Master diss. Tribhuvan University**
KFA, **KFA Professional Banking Course**, Baneshwor, Kathmandu

Kutwal, Khim Kumari; **"CAMEL Study on joint venture banks with special reference of Standard Chartered Bank Limited, NABIL Bank Limited & Himalayan Bank Limited"**

Sanjal, Rakesh; **"Comparative analysis of Financial Status & Performance evaluation of Himalayan Bank Limited, NABIL Bank Limited in the framework of CAMEL Rating System"**

Related Websites:

Asian Development Bank; http://www.adb.org

Bank for International Settlement; http://www.bis.org

Everest Bank Ltd.; http://www.everestbankltd.com

http://www.nepjol.info

http://www.thefreedictionary.com

http://www.investopedia.com

http ://www.dic.go.jp

Kumari Bank Ltd.; http://www.kumaribank.com

Nepal Rastra Bank; http://www.nrb.org.np

Siddhartha Bank Ltd.; http://www.siddharthabank.com

Wikipedia Encyclopedia; http://en.wikipedia.org