

**A FINANCIAL ANALYSIS OF POKHARA DUGDHA UTPADAK  
COOPERATIVE LIMITED ON THE FRAMEWORK OF CAMEL**

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*A Thesis submitted to:*

**Office of the Dean**

**Faculty of management**

**Tribhuvan University**

In partial fulfillment of the requirements of the degree of

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

**Pokhara**

**March 2013**

## **Acknowledgement**

First and foremost, I am most grateful to my thesis supervisor, Mr. Dhaneshar Rakhai. The guidance and support that he gave really help me for the progression and fluency of the thesis.

I wish to express my sincere gratitude to Mr. Shova Kanta Dhakal, chairman of PDUCL who provided me a suitable environment to know about this cooperative and its main objective and vision. He also supported me to encourage for the research of the organization. My particular thanks also go to staff of department of management at thesis collection room for providing me with necessary material. Great appreciation goes to my friend Pradeep Thapa helped me in preparing the thesis; I also grateful to Managing Director, Mr. Chandra Bahadur Thapa and staff of PDUCL for providing me necessary data for the research work.

Last but not least I thank my beloved family for their support, strength, encouragement while I worked on this research.

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# TABLE OF CONTENTS

Recommendation

Acknowledgement

List of Tables

List of Figures

	<b>Page</b>
<b>CHAPTER – I INTRODUCTION</b>	<b>1-6</b>
1.1 Background of the Study	1
1.2 Focus of the study	5
1.3 Statement of the problem	5
1.4 Objective of the study	6
1.5 Significance of the study	6
1.6 Delimitation of the study	6
1.7 Organization of the study	6
<b>CHAPTER-II LITERATURE REVIEW</b>	<b>7-25</b>
2.1 Conceptual review of CAMEL	8
2.2 Concept of CAMEL system	9
2.3 Review of related study and papers	19
2.4 Research gap	25
<b>CHAPTER-III RESEARCH METHODOLOGY</b>	<b>26-31</b>
3.1 Research design	26
3.2 Population and sample	26
3.3 Nature and source of data	26
3.4 Data collection procedure	27
3.5 Data Processing	27
3.6 Method of data analysis	27

3.7	Limitation of methodology	31
<b>CHAPTER-IV DATA PRESENTAION AND ANALYSIS</b>		<b>32-51</b>
4.1	Data Presentation and Analysis	32
4.1.1	Capital Adequacy Ratio	32
4.1.2	Assets Quality Analysis	34
4.1.3	Management Component Analysis	40
4.1.4	Earning Quality Analysis	42
4.1.5	Liquidity Component Analysis	47
4.2	Major Findings	50
<b>CHAPTER-V SUMMARY, CONCLUSION AND RECOMMENDATION</b>		<b>52-55</b>
5.1	Summary	52
5.2	Conclusion	53
5.3	Recommendation	54

## BIBLIOGRAPHY

## APENDIXIES

## LIST OF TABLES

<b>Table</b>	<b>Title</b>	<b>Page</b>
4.1	Core capital ratio	33
4.2	Equity to total assets ratio	34
4.3	Assets composition	35
4.4	Assets growth rate	37
4.5	Deposit growth rate	38
4.6	Non performing loans	39
4.7	Total operating expenses to total operating revenue ratio	40
4.8	Earning per employee	41
4.9	Return on equity	42
4.10	Return on assets	44
4.11	Net interest margin	45
4.12	Earning per share	46
4.13	Cash and Bank Balance to total deposit ratio	47
4.14	Investment on government security ratio	49

## LIST OF FIGURES

<b>Figure</b>	<b>Title</b>	<b>Page</b>
4.1	Comparing Core Capital Adequacy Ratios with NRB Standard	34
4.2	Equity to total assets ratio	35
4.3	Assets composition	36
4.4	Assets growth rate	37
4.5	Deposit growth rate	38
4.6	Comparing non- performing loan with industrial average ratio	39
4.7	Total operating expenses to total operating revenue ratio	41
4.8	Earning per employee	42
4.9	Return on equity	43
4.10	Return on assets	45
4.11	Net interest margin	45
4.12	Earning per share	46
4.13	Comparing Cash and Bank Balance to Total Deposit Ratio with Industrial Average	48
4.14	Investment on government security ratio	49

## ABBREVIATION

B.S.	Bikram Sambat
CAMEL	Capital Adequacy, Assets quality, Management component, Earning quality, Liquidity position
CAR	Capital Adequacy Ratio
CBR	Cash and Bank Balance Ratio
CCR	Core Capital Ratio
EPS	Earning Per Share
FDIC	Federal Deposit Insurance Corporation
FIs	Financial Institutions
FY	Fiscal Year
IGSR	Investment in Government Security Ratio
NPL	Non-Performing Loan
NRB	Nepal Rastra Bank
OCC	The Office Controller of the Currency
PDUCL	Pokhara Dogdha Utpadak Cooperative Limited
ROA	Return on Assets
ROE	Return on Equity
UFIRS	Uniform Financial Institutions Rating System

# CHAPTER I

## INTRODUCTION

### 1.1 General Background

The cooperative movement began in Europe in the 19th century, primarily in Britain and France, although The Shore Porters Society claims to be one of the world's first cooperatives, being established in Aberdeen in 1498. The first documented consumer cooperative was founded in 1769, in a barely furnished cottage in Fenwick, East Ayrshire, when local weavers manhandled a sack of oatmeal into John Walker's whitewashed front room and began selling the contents at a discount, forming the Fenwick Weavers' Society. In the decades that followed, several cooperatives or cooperative societies formed including Lennoxton Friendly Victualling Society, founded in 1812. (Fredrick, 1997)

In Nepal, a **cooperative** is an autonomous association of persons who voluntarily cooperate for their mutual, social, economic, and cultural benefit. Cooperatives include non-profit community organizations and businesses that are owned and managed by the people who use its services (a consumer cooperative) or by the people who work there (a worker cooperative) or by the people who live there (a housing cooperative). Cooperation dates back as far as human beings have been organizing for mutual benefit. Tribes were organized as cooperative structures, allocating jobs and resources among each other, only trading with the external communities. (Uprety, 1996)

In agriculture, farmers' cooperative is important and present in Nepal. Basically there are following types of farmers' cooperatives in Nepal.

- a) Marketing Cooperatives
- b) Farm Supply Cooperatives
- c) Service Cooperatives
- d) Production Cooperatives, e) Processing Cooperatives

Past initiatives for the cooperative movement in Nepal have not shown much impact on the overall food self-sufficiency, agricultural commercialization, and socio-economic transformation of the nation. A scientific farmer cooperative movement that empowers farmers, commercializes agriculture, enhances food security, transforms socio-economic conditions, and contributes to rural development in Nepal is necessary. A renewed and revitalized cooperative movement should be all inclusive, fully managed at the grassroots level, and must have strong governmental support in terms of cooperative formation and safeguarding. Appropriate educational, research, and extension support programs are essential for a successful cooperative movement. Farmers' income and quality of life must be the yardstick of success of the cooperative movement in Nepal. (Hunt zinger, 2004).

At present context, there are 3500000 shareholders of cooperative. There are 24000 primary cooperative, 15 central cooperative organizations and national cooperative bank in the country. At national level, more than 200000 people are engaged, out of which 80% are working on voluntary basis. Today we have Agriculture cooperative central committee, Bee cooperative central committee, Vegetable and fruits cooperative central committee, Sugar cooperative committee, Coffee cooperative central committee, Dairy cooperative central committee, Seed cooperative central committee, Medicinal plants central committee at national level. Including all, a total of 10 agriculture related cooperative central committees are present. (NCFN, 2007)

#### Benefits obtained from cooperative movement in Nepal

Through farmer cooperatives, important agricultural developmental objectives such as enhancing agricultural production, adding value to agricultural produce, enhancing marketing of agricultural commodities, and developing technologies and practices related to agricultural production can be achieved. Farmers will derive income from multiple sources including production and marketing co-ops, value-added commodities, and trade. Trade profits will go directly to the farming communities rather than to a few intermediaries in the cities. The bargaining power of farmers will increase and they can get good market as well as good price for their products. Moreover, because of low market margin, consumers will get the products at lower price and hence efficient mobilization of product will be done. Due to the decentralized

grassroots level of production, marketing, and processing of agro-commodities in the cooperative mode of nation building, farmers and the rural population will feel that villages and rural areas are as good as cities for living. This will help to stop rural to urban migration. Governmental subsidies and support systems will directly help rural communities and the rural infrastructural development. People will generate income through various sources including farmer cooperatives, employment at farmer cooperatives, and other agricultural production activities. Through the formation of farmer cooperatives across the nation, farmers, ethnic groups, women, rural youth, and the suppressed classes will feel that they are part of nation building and are sharing in the fruits of economic growth. The ultimate benefit is food security for the farmers and good income through agriculture. (Shrestha, 2007)

Although the benefits that could be obtained from cooperatives are numerous, yet the development of cooperatives is not satisfactory in Nepal. Government has declared cooperative as one of the three pillars of Nepalese economy and interim constitution has focused on same, but practically, implementation as per the declaration is weak and the speed of development need to be accelerated but yet it is not done. The reasons behind the unsatisfactory development of cooperatives in Nepal could possibly be the following; **i)** Most profitable cooperatives are urban-based, and except for finance, credit, and dairy cooperatives, the rural sector has not felt the presence of the cooperative movement in the country, **ii)** Cooperative movements have to strive for the inclusion of women, dalits, poor people, and other oppressed classes of society. Lack of inclusion of every sector for the cooperative movement is a cause for its unsuccessful, **iii)** Lack of clarity about mission, national vision and adequate monitoring on the part of government with respect to cooperative movement, **iv)** Lack of managerial skills and professionalism, sound planning and implementation, **v)** Lack of working capital, appropriate research, extension and education about cooperative movement, **vii)** Lack of technological support and development, **viii)** Lack of creditability. (USAD, 2007)

Financial performance analysis is the process of identifying the financial weakness and strengths of the organization. It measure reflects strength, operating and financing decision. Success of a financial institutions is based on its performance and performance is appraised by means of certain rating system which is turn provide feedback to strengthen the performance. Uniform

rating system helps in assessment of overall strength of banking system as a whole as well as the safety and roundness of individual bank and financial institutions by reviewing the rating of all banks in a financial system. It can be assessed that in which direction the financial system is moving as well as problematic financial institutions (Pandey, 1999).

CAMEL is a common method for appraising the performance of the financial institutions used by the worldwide supervisory authorities. This system was developed by regulatory authorities of the US banks the Federal Reserve Bank. The Office Controller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), all use this system (MC Nally, 1996).

CAMEL is a technique for rating the FIs by analyzing their financial performance in term of five major components i.e. each component has its own meaning, procedure and stand for-

C- Capital adequacy

A-Assets quality

M- Management quality

E- Earning

L- Liquidity

CAMEL rating indentifies the problematic areas within the financial institutions which indicate requirement of additional supervisory attention. It helps the management in designing appropriate policies and strategies for raising the financial performance and thus maintaining safety and soundness of the financial institutions. Research is going to be conducted for the purpose of evaluating financial performance in the framework of CAMEL of Pokhara Dugdha Utpdak Cooperative Limited (PDUCL).

PDUCL was established on Mangsir in 2063 B.S. it was registered at district cooperative division office at Pokhara branch. It has been operated under Sahakari act 2048, it covers whole Kaski district for its operation. The authorized capital is 50 millions and paid up capital is 11117600/- . It has a head office at Buddha Chowk in Pokhara having 5 staff working there. There are more than 650 shareholders. It has been established for the purpose of focusing of agriculture and livelihood stock sectors. According to the annual report of fiscal Year 2068/69 B.S., on 13<sup>th</sup> Mangsir 2068 B.S., Milk production and making milk product machine was inaugurating by the former chairman of district development committee, Mr. Punya Prasad and

Head of Cooperative training and division office, Mr. Chandra Bahadur Thakuri. The main objective of this cooperative is to produce milk and supply to the targeted market along with focusing on agricultural sector too.

## **1.2 Focused on the study**

This research study has focused on the financial condition and performance of PDUCL by using all component of CAMEL. Descriptive and analytical research design is used for the purpose of finding financial soundness. More especially the study focuses on the trend of capital adequacy ratio, non performing loan, total expenses to revenue ratio, earning per employee ratio, return on equity, return assets, net interest margin, earning per share and liquidity ratios during the period of last five years from Fiscal Year (FY) 2064/65 to 2068/69.

## **1.2 Statement of the problem**

The statement of the problem reveals that the uncover area of the research. Most of the previous researchers were based on financial performance of the organization in the frame work of the CAMEL and analysis of different types of ratios but here new research question is emerged to find out the factors affecting the CAMEL, researchers may find out if the level of such tool is greater than he or she finds the position of the company is better but say to unsatisfactory. Here factors will be found i.e. customers satisfaction and planning and controlling of loan disbursement and collection along with recovering procedures.

- a) To make out the capital adequacy position of the PDUCL?
- b) To know the assets quality level of the PDUCL?
- c) To recognize the management performance of the PDUCL?
- d) To indentify the liquidity position of the organization?
- e) To find out earning quality of the PDUCL?

#### **1.4 Objectives of the study**

The major objective of this study is to analyze the performance of PDUCL through CAMEL framework. Its specific objectives are as follows

- a) To examine the capital adequacy position of the PDUCL?
- b) To analyze the assets quality level of the PDUCL?
- c) To evaluate the management performance of the PDUCL?
- d) To assess the liquidity position of the organization?
- e) To explore earning quality of the PDUCL?

#### **1.5 Significance of the study**

One of the important financial tools is commonly called “CAMEL”, this tool helps researchers to find out the financial condition, profitability condition of the company, status of the stakeholders and shareholders and lastly factors affecting of CAMEL.

#### **1.6 Delimitation of the study**

This project work is based on one of the financial tool i.e. CAMEL. This next limitation of this study is that only one cooperative limited and there is no comparative study at all. Basically the study is limited within the following factors:

- a) The study is only confined to financial performance analysis under CAMEL of PDUCL.
- b) Rating system of CAMEL has not been evaluated.
- c) Only one cooperative organization is taken as a sample of the study.

#### **1.7 Organization of the study**

According to the above topic includes many chapters. The first section includes introduction, statement of the problem, and objective of the study, significance of the study and delimitation of the study. Second chapter has review of literature. Likewise third and fourth sections have research methodology and presentation and analysis of data. The last section is summary, conclusion and recommendation. After that section, bibliography and appendix will be kept to show the source of thesis writing.

## **CHAPTER - II**

### **LITERATURE REVIEW**

Review of literature is the most important part of the study. Without clear concept on the subject matter, the study might not be conducted within its periphery. This section provides current stage of the research work and guidelines or further study and helps to avoid unnecessary duplication of research work. This chapter is focused on brief discussion about the abstract regarding the camel analysis. In order to accomplish the objectives of the study, the chapter includes review of relevant concepts, assumption, books and journals as well as major findings of previous studies of the relevant field are included in precise manner. (Panta, 2009)

The purpose of review of the literature is to develop some expertise in one's area, to see what new contribution can be made and to receive some ideas for developing a research design. Thus, the previous studies cannot be ignored, because they provide the foundation to the present study. In other words, these have to be continuity in research. This continuity in research is ensured by linking the present study with the past research studies. From this, it is clear that the purpose of literature review is to find out what researcher studies have been conducted in one's chosen field of study and what remains to be done. The review of literature is a crucial aspect because it denotes planning of the study. The main purpose of literature review is to find out what works have been done in the areas of the research problem understudy being undertaken. For review study, the researcher uses different books, reports, journals and research studies published by various institutions, unpublished dissertations submitted by master level students have been reviewed. (Johnson, 2006)

## 2.1 Conceptual Review of CAMEL

This section presents the theoretical aspect of the study, which includes the concept of commercial bank, function of commercial bank, concept of CAMEL rating system. Financial performance analysis is the process of identifying the financial weakness and strengths of the organization. It measure reflects strength, operating and financing decision. Success of a financial institutions is based on its performance and performance is appraised by means of certain rating system which is turn provide feedback to strengthen the performance. Uniform rating system helps in assessment of overall strength of banking system as a whole as well as the safety and roundness of individual bank and financial institutions by reviewing the rating of all banks in a financial system. It can be assessed that in which direction the financial system is moving as well as problematic financial institutions (Pandey, 1999).

The most important criteria for determining the appropriateness of a financial to act as a financial intermediary are its solvency, profitability and liquidity. In this respect, the Based Committee on Banking Supervision of Bank of International Settlement has recommended using capital adequacy, assets quality, management quality, earning and liquidity as criteria for assessing on financial institutions in 1988 (ADB, 2002).

CAMEL is a common method for appraising the performance of the financial institutions used by the worldwide suvervisionary authorities. This system was developed by regularity authorities of the US banks the Federal Reserve Bank. The office controller of the currency (OCC) and the federal deposit insurance corporation (FDIC), all use this system (MC Nally, 1996).

The Basle Committee on Banking Supervision of the Bank of International Settlements(BIS) has recommended using capital adequacy, assets quality, management quality, earnings and liquidity (CAMEL) as criteria for assessing a FI in 1988 (ADB 2002). The sixth component, market risk (S) was added to CAMEL in 1997 (Gilbert, Meyer and Vaughan, 2000). However, most of the developing countries are using CAMEL instead of CAMELS in the performance evaluation of the FIs. The central banks in some of the countries like Nepal, Kenya uses CAEL instead of CAMELS (Baral, 2005).

## **2.2 Concept of CAMEL System**

CAMEL looks at five major aspects of a financial institution: capital adequacy, asset quality, management soundness, earnings, liquidity, and sensitivity to market risk. It can be explain as follows:

### **Capital Adequacy**

According to the Uniform Financial Institutions Rating System (UFIRS), capital adequacy is the capital expected to maintain balance with the risks exposure of the financial institution such as credit risk, market risk and operational risk, in order to absorb the potential losses and protect the financial institution's debt holder. "Meeting statutory minimum capital requirement is the key factor in deciding the capital adequacy, and maintaining an adequate level of capital is a critical element".

The capital adequacy in term of capital-deposit ratio because the primary risk is depository risk derived from the sudden and considerably large scale of deposit withdrawals. In 1930, FDIC created a new capital model as capital-asset ratios since the default on loans came to expose the greatest risk instead of deposit withdrawals. To gauge the capital adequacy, bank supervisors currently use the capital-risk asset ratio. The adequacy of capital is examined based upon the two most important measures such as Capital Adequacy Ratio (CAR) or Capital to Risk-weighted Assets ratio, and the ratio of capital to assets. (Karlyn, 1984).

### **Asset quality**

Poor asset quality is the major cause of most bank failures". A most important asset category is the loan portfolio; the greatest risk facing the bank is the risk of loan losses derived from the delinquent loans. The credit analyst should carry out the asset quality assessment by performing the credit risk management and evaluating the quality of loan portfolio using trend analysis and peer comparison. Measuring the asset quality is difficult because it is mostly derived from the analyst's subjectivity (Grier, 2007).

The asset quality indicators highlight the use of non-performing loans ratios (NPLs) which are the proxy of asset quality, and the allowance or provision to loan losses reserve. As defined in

usual classification system, loans include five categories: standard, special mention, substandard, doubtful and loss. NPLs are regarded as the three lowest categories which are past due or for which interest has not been paid for international norm of 90 days. In some countries regulators allow a longer period, typically 180 days. The bank is regulated to back up the bad debts by providing adequate provisions to the loan loss reserve<sup>2</sup> account. The allowance for loan loss to total loans and the provision for loan loss to total loans should also be taken into account to estimate thoroughly the quality of loan portfolio (Frost, 2004).

### **Management quality**

Management quality is basically the capability of the board of directors and management, to identify, measure, and control the risks of an institution's activities and to ensure the safe, sound, and efficient operation in compliance with applicable laws and regulations. Grier (2007) suggests that management is considered to be the single most important element in the CAMEL rating system because it plays a substantial role in a bank's success; however, it is subject to measure as the asset quality examination (UFIRS, 1997).

### **Earning ability**

This rating reflects not only the quantity and trend in earning, but also the factors that may affect the sustainability of earnings. Inadequate management may result in loan losses and in return require higher loan allowance or pose high level of market risks. The future performance in earning should be given equal or greater value than past and present performance (UFIRS, 1997). A consistent profit not only builds the public confidence in the bank but absorbs loan losses and provides sufficient provisions. It is also necessary for a balanced financial structure and helps provide shareholder reward. Thus consistently healthy earnings are essential to the sustainability of banking institutions. Profitability ratios measure the ability of a company to generate profits from revenue and assets (Grier, 2007).

## **Liquidity**

There should be adequacy of liquidity sources compared to present and future needs, and availability of assets readily convertible to cash without undue loss. The fund management practices should ensure an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner; and capable of quickly liquidating assets with minimal loss (UFIRS, 1997). The liquidity expresses the degree to which a bank is capable of fulfilling its respective obligations”. Banks makes money by mobilizing short-term deposits at lower interest rate, and lending or investing these funds in long-term at higher rates, so it is hazardous for banks mismatching their lending interest rate (Rudolf, 2009).

## **CAMEL rating**

The Uniform Financial Institution Rating system, commonly referred to the acronym CAMEL rating, was adopted by the Federal Financial Institution Examination Council on November 13 1979, and then adopted by the National Credit Union Administration in October 1987. It has proven to be an effective internal supervisory tool for evaluating the soundness of a financial firm, on the basis of identifying those institutions requiring special attention or concern (UFIRS, 1997).

## **Composite Ratings**

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 as follows:

### Composite 1

Financial institutions 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 financial institutions 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 financial institutions are in substantial compliance with laws and regulations. As a result, these financial institutions 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 (UFIRS, 1997).

### Composite 2

Financial institutions in this group are fundamentally sound. For a financial institution to receive this rating, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These financial institutions are stable and are capable of withstanding business fluctuations. These financial institutions are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited (UFIRS, 1997).

### Composite 3

Financial institutions in this group exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2.

Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions (UFIRS, 1997).

#### Composite 4

Financial institutions in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. Financial institutions in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institutions in this group pose a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved (UFIRS, 1997).

#### Composite 5

Financial institutions 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 are of the greatest supervisory concern. The volume and severity of problems are beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in order for the financial institution 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. (UFIRS, 1997).

## **Component Ratings**

Each of the component rating descriptions is divided into three sections: an introductory paragraph; a list of the principal evaluation factors that relate to that component; and a brief description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship between components. The listing of evaluation factors for each management rating is in no particular order of importance (UFIRS, 1997).

## **Capital Adequacy**

A financial institution is expected to maintain capital commensurate with the nature and extent 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 (Alam, 2011).

## **Ratings**

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 financial institution's 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 institution's 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 is required (UFIRS, 1997)

## *Asset Quality*

The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned, and other assets, as well as off-balance sheet transactions. The ability of management to identify, measure, monitor, and control credit risk is also reflected here. The evaluation of asset quality should consider the adequacy of the allowance for loan and lease losses and weigh the exposure to counterparty, 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 (Geibert, 2000)

## **Ratings**

A rating of 1 indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality in such institutions is of minimal supervisory concern. A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities. A rating of 3 is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices. A rating of 4 is assigned to financial institutions with deficient asset quality or credit administration practices. The levels of risk and problem assets are significant, inadequately controlled, and subject the financial institution to potential losses that, if left unchecked, may threaten its viability. A rating of 5 represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability (UFIRS, 1997).

## **Management**

The capability 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 financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Generally, directors need not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Senior management is responsible for developing and implementing policies, procedures, and practices that translate the board's goals, objectives, and risk limits into prudent operating standards. Depending on the nature and scope of an institution's activities, management practices 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 boards 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 (Hilbers, 2000)

## **Ratings**

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. Management and the board have 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 weaknesses 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 inadequately 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, measured, monitored, or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary. 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 (UFIRS, 1997).

### ***Earnings***

This rating reflects not only the quantity and trend of earnings, but also factors that may affect the sustainability or quality of earnings. The quantity as well as the quality of earnings can be affected by excessive or inadequately managed credit risk that may result in loan losses and require additions to the allowance for loan and lease losses, or by high levels of market risk that may unduly expose an institution's earnings to volatility in interest rates. The quality of earnings may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or favorable tax effects. Future earnings may be adversely affected by an inability to forecast or control funding and operating expenses, improperly executed or ill-advised business strategies, or poorly managed or uncontrolled exposure to other risks (Singh, 2008)

### **Ratings**

A rating of 1 indicates earnings that are strong. Earnings are more than 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. A rating of 2 indicates earnings that are satisfactory. Earnings are 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. A rating of 3 indicates earnings that need to be improved. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth, and other factors affecting the quality, quantity, and trend of earnings. A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowance levels. Institutions so rated may be characterized by erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous years. A rating of 5 indicates earnings that are critically deficient. A financial institution with earnings rated 5 is experiencing losses that represent a distinct threat to its viability through the erosion of capital (UFIRS, 1997).

### *Liquidity*

In evaluating the adequacy of a financial institution's liquidity position, consideration 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 liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions (Jha, 2009)

## **Ratings**

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 indicates 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 weaknesses may be evident in funds management practices. A rating of 3 indicates liquidity levels or funds management practices in need of improvement. Institutions rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices. 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 (UFIRS, 1997).

### **2.3 Review of Related Studies and papers**

Bhandari, (2007) conducted the research study entitled “*Financial Performance analysis of Himalayan Bank ltd. In the framework of CAMEL*” with an objective to examine the financial performance of the Himalayan bank Ltd. The financial data of 1999 to 2004 extracted from the secondary source was analysis through descriptive approach. Financial tools like capital adequacy, NPL ratio, loan loss ratio, ROE, net interest margin, NRB balance to total deposit ratio etc. were used by the researcher. The major financial of the study are that bank has maintain adequate capital, NPL through in decreasing trend is still a matter of concern, satisfaction of ROE, however is decreasing trend. Decreasing trend of net interest margin shows management slack monitoring over the banks earning assets, liquid fund to total deposit ratio is above the IAR where as NRB balance cash in vault to total deposit ratios are below the IAR.

Sharma, (2007) conducted the research study entitled “*Financial performance analysis of the bank in the framework of the CAMEL.*” The study was based on secondary data during the study period starting from 2001 to 2006. The researcher found that the bank has maintain adequate capital prescribed by NRB and satisfactory level of past due loan on total loan expected in 2001. He has recommended increasing income and controlling high level of expenses. Earning per employees is quite high through the number of staffs is found relatively less. The liquidity position of the bank is found sound.

Gurung,(2007) carried out the research study entitled “*Financial performance analysis of Annapurna finance company limited in the frame work of CAMEL*” with the objective of to examine the financial condition of the bank. The study was based on secondary data covering the period of five years from the fiscal year of 2001/2002 to 2005/2006. The researcher had conducted that the bank had maintained adequate capital reflecting sound and strong financial position. The NPL ratio was found fluctuating and below the international standard. The total expenses to the total income ratio and ROE were also in fluctuating in trend. Further, the researchers found that the liquidity position of the bank is not satisfactory.

Dhungel, (2010) carried out the research study entitled “*A comparative analysis of financial performance of Nepal SBI bank and Machhapuchhre Bank Limited in the frame work of CAMEL*” with the objective of to compare the financial condition of the banks. The study was based on secondary data covering the period of five years from the fiscal year of 2062/2063 to 2066/2067 B.S. The researcher had concluded that both banks were well capitalized but the ratio of core capital to total assets of MBL was higher than NSBI bank. While comparing of none performing loan of both banks were analyzed, such loan was decreasing trend in NSBI and increasing in MBL showed that NSBI bank was better than MBL. The research had found that MBL had greater NRB balance than NSBI bank. It also showed that Nepal Rastra Bank had not control both of bank carefully.

Tiwari, (2008) carried out the research study entitled “*Financial performance analysis of Pokhara finance company limited in the frame work of CAMEL*” with the objective of to examine the financial position of the bank. The study was based on secondary data. The researcher had conducted that the bank had maintained capital adequacy ratio on the basis of

Nepal Rastra Bank's standard level. The researchers had found that EPS ratios were shown in fluctuating in trend.

**Bhandari**, (2006) conduct a study on "*Financial performance Analysis of Himalayan Bank Limited in the Framework of CAMEL*". The basic objective of the study was to analyze the financial performance of Himalayan Bank Limited through CAMEL framework. He had used secondary data for the period of six years from 1999 to 2004. The study revealed the adequate capital of the bank. The non-performing loan was in decreasing trend, which shows the improvement of the bank. The bank is still with better return which is proved by its better ROE; however it is in decreasing trend. The decreasing trend of net interest margin shows management slack monitoring over the banks earning assets. The liquid fund to total deposit ratio is above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period.

**Sharma**, (2007) performed a study on "*Financial Performance Analysis of Nepal SBI Bank Ltd., In the Frame work of CAMEL.*" The main objective of the study is to analyze the financial performance of Nepal SBI bank Ltd. Through CAMEL framework, the study was based on secondary data covering the six years from 2001 to 2006. The researcher conducts the financial tools to analyze the six years data. He concluded That Nepal SBI bank Ltd. Was well capitalized and complying with directives of NRB. The bank has maintained satisfactory level of past due loan on total loan except 2001. Earning per employees of the bank was found quite high. Net interest margin of the bank was found satisfactory. Further the liquidity position of the bank was found sound.

**Poudel**, (2007) carried out "A study on comparative analysis of financial performance between Himalayan Bank and Standard Chartered Bank" the basic objectives of that study was provided comparative financial performance of SBCNL and HBL. Only five fiscal years financial performance beginning from 1995/96 through 2000/2001 were analyzed. In this study financial and statistical tools were used to evaluate the performance of banks. In financial tools liquidity, activity, profitability, structural and income and expenditures ratios. Further, the research used the method of least square to find out tend of different financial indicators he found that the performance of SCBNL is better than that of HBL.

**Chand,** (2007) conducted "*Financial Performance Analysis (CAMEL - Test) of Selected CBs (Nabil, NIBL & SCBL)*" the main objective of the study is comparative analysis of commercial banks through the frame work of CAMEL. He did her study covering five FY (2001 to 2005) on the basis primary as well as secondary data. Some financial and statistical tools and techniques are applied to evaluate the performance of selected joint venture banks. On his study, except 2001, SCBL had highest CAR among these selected CBs where Nabil is moderate in all time. In the case of NIBL in 2001 it had highest CAR among them and then after it went behind and getting second and some year third position in CAR. Here Chand gave first rank to SCBL for maintain highest CAR. In case of Assets quality in average study show the Nabil performance is much better than other and SCBL and NIBL follows Nabil respectively. Chand study shows the factors affecting the management efficiency and effectiveness. Bank management quality model was also presented in his study. As per earning concern SCBL leads other two banks and tough fight between Nabil and NIBL. For comparative analysis of liquidity part which compare, it is found that NIBL secures first position for percentage of cash balance and percentage of balance with bank and SCBL scores first position for investment in government securities. Nabil is a little bit take risk and invest less in government securities as compare to other two banks. All banks are maintaining the benchmark of the NRB on case of CRR.

**Bhusal,** (2008) carried out a research study on "*Financial Performance Analysis of Commercial Banks in Nepal the Frame Work of CAMEL ( A Comparative Study of Kumari Bank and Machhapuchchhre Bank)*", with the fundamental objective to analyze and compare the financial performance of KBL and MBL in the frame work of CAMEL from FY 2058/59 to 2062/63. with the help of both secondary as well as primary data, she conducted her study by applying Some financial and statistical tools and techniques. Her study shows both banks are maintaining CAR as per rule of NRB and the trend of CAR is decreasing. Both banks are in much satisfactory level in the case of assets management. Increasing profit of both banks shows the good sign but it is not enough to compete with other established banks. According to her study, Profits are also not enough to meet benchmark set by the World Bank. In the case of liquidity both banks are not properly maintaining the rule of NRB. In her overall analysis there is tough competition between KBL and MBL and both are in the phase of improvement.

**Singh, R. B.** (2008) conducted "A Study of CAMEL Analysis of Commercial Banks" i.e. SCBNL, HBL & Nabil Bank. The objective of that study was to evaluate the capital adequacy ratio, to analyze assets quality and to absorb the liquidity position of these banks. He used ratio analysis and statistical tools to cover five years analysis. On the basis of Mr. Singh's analysis, SCBNL is on the top and NABIL followed by HBL.

**Shrestha,** (2003), in his study of "*Capital Adequacy Norms for Commercial Banks and its impact of Bank of Kathmandu and Himalayan Bank Ltd.*", has concluded that BOK and HBL are found to be successful to comply with requirement of capital adequacy norms. The CD ratio of HBL is very much low which needs to be improved immediately and CD ratio of BOK is satisfactory. Although, the banks are successful to meet the capital adequacy requirement as per NRB directive.

### **Review of Journals and Articles**

**Berger and Davies** evaluated the impact of CAMEL rating changes on the parent holding company's stock price. They separated stock price changes into two components a 'private information' effect (which identified the public's awareness of new information discovered by examiners), and a 'regulatory discipline' effect which valued a regulators' presumed ability to force a bank to change its behavior). Berger and Davies' empirical results provided only weak evidence of a regulatory discipline effect, but they found a strong private information effect. However, the information effect applied only to CAMEL downgrades, which tend to precede stock price declines. Berger and Davies found no movement in the stock price following a CAMEL upgrade.

**Hirtle and Lopez** examine the usefulness of the past CAMEL rating in assessing banks current conditions. They find that, condition on current public information, the private supervisory information contained in the past CAMEL rating 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 during the last onsite exam remains useful

with respect to the current condition of the bank for up to 6 to 12 quarters. 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.

**Dhungana Bhisma** argues CAMEL rating system plays key role for bank supervision. According to him, The NRB as a central bank has the important task of regulating & supervising the banking system of Nepal. NRB assess the overall strength of the banking system as well as the safety and soundness of each individual bank and financial institution, In order to discharge this role. To help in this endeavor, a uniform rating system for all banks and financial institution has been used. Under this modality, supervisors assign individual numerical rating to the key areas of Capital, Assets, Management, Earnings, liquidity and sensitivity to the market risk (CAMELS) as well as assigning an overall composite rating to each banking institution. In this way, the NRB has been able to categorized banks and financial institutions into group based on their overall strength, quality and operating soundness. The rating system known as CAMEL has served as a supervisory tool to help identify those banks that are having problems and require increased supervision. To date, early warning signals are drawn & monitored from the CAMEL rating through on-site inspection and CAMEL rating through offsite supervision.

**Pant Radish** argued that after 2010, there will be new international entrants in the market, we must remain very competitive, and we have to operate at international standards. However, he does not think we need to fear. He believed combined capital of all Nepalese commercial banks would not even equal to the capital of a small bank in developed countries. It somehow, Nepal is able to capitalize on the growth of China and India, there is no turning back for the banking sector. There will be opportunities for all types of banks. So, we need to work together to address the challenges of that WTO." 2008 was an extraordinarily tumultuous year, full of shocks & surprises. None of us have even quite seen the scale of dislocation & disruption in financial market that we have experienced this year. To put things in perspective, there has been more volatility in the US equity market in the three month since Lehman went bankrupt in the mid-September, than in the previous 45 years put together,. Moreover, with the disappearance or effective nationalization of several major players, and the demise of the US broke, dealer model, the global industry has changed fundamentally & irreversibly.

## **2.5 Research Gap**

The statement of the problem reveals that the uncover area of the research. Most of the researchers have done research for financial performance of the commercial, development and finance companies. A very few researchers have work out in case of cooperative organization in the framework of CAMEL. The important thing is that, the researchers like to focus on big organization. In case of PDUCL, the research is done for the first time to find out the financial soundness of the organization. As we all know that cooperative organizations are one of the pillars of the economy for the nation. That is why research is needed for such organization too.

## **CHAPTER – III**

### **RESEARCH METHODOLOGY**

Research methodology describes the methods and process applied in the entire study. In other words, research methodology is a systematic process to approach any research problem and explore it objectively. Hence this chapter includes research design, Source of Data, population and samples, Data collection tools and Data Analysis tools.

#### **3.1 Research Design**

To fulfill the objectives of the study certain research design is essential so the analysis of this study is based on the nature of data and tools for analysis. To fulfill the objectives of the study it emphasized on historical as well as descriptive and exploratory.

#### **3.2 Population and Sampling of Data**

For the purpose of the study, cooperative organizations are taken as population. Till celebrating 56<sup>th</sup> Cooperative day 2013, there are all together 497 cooperative organization in Kaski district. But being a case study of a single unit, Pokhara Dugdha Utpadak cooperative Limited, is selected as the sample for the study. For this sampling purpose, convenience sampling method is used

#### **3.3 Nature and Source of Data**

This research study is basically based on secondary data. The required data for the study will be collected in followings ways:

- ) Library research study
- ) Internet, home pages and related links visit.

- ) Directives of cooperative division
- ) Annual reports of the Pokhara Dugdha Utpadak Cooperative Limited
- ) The other sources will be articles, previous study on related topic, published articles of different authors and journals.

### **3.4 Data Collection procedure**

The study is mainly focused on secondary source of data. The annual reports of such cooperative and website of cooperative division department have been obtained for PDUCL. Some supplementary data and literature review are collected from the western regional library, Pokhara and other general magazine.

### **3.5 Data Processing**

First of all data are collected from published documents. The audited financial statements are taken and enter into the table to work out CAMEL financial ratio and prepare the necessary figures.

### **3.6 Method of Data Analysis**

#### **Financial ratio analysis tools**

The financial analysis tools are used to determine the performance of the financial institution in the frame work CAMEL components. These ratios are categorized in accordance of the CAMEL components. Following categories of key ratio are used to analyze the relevant components in terms of CAMEL.

#### **Capital Adequacy Ratio (CAR)**

Commercial bank holds adequate capital depending on their requirement. Capital adequacy ratio is a measure of the amount of a bank's capital as a percentage of its risk weighted credit exposure. Nepal Rastra Bank (NRB) which recommends minimum CAR of 11% and 5.5% of Core Capital Ratio (CCR).

$$\text{Capital Adequacy Ratio (CAR)} = \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}} \times 100\%$$

*(Minimum requirement as per NRB Directive is 11%)*

$$\text{Core Capital Ratio (CCR)} = \frac{\text{Total Core Capital Fund}}{\text{Total Risk Weighted Assets}} \times 100\%$$

*(Minimum requirement as per NRB Directive is 5.5%)*

Where,

Total Capital Fund = Core Capital + Supplementary Capital

Total Risk Weighted Assets = On Balance Sheet Risk Weighted Items + Off Balance Sheet Risk Weighted Items

### **Assets Quality**

FIs collect funds in the form of capital, deposit etc. It mobilizes these funds to generate certain returns by giving loans to the users of money to invest in various alternatives. A significant part of the FIs income is through its lending activities. There are basically two types of loans and advances.

### **Performing Loans**

Loan on which payments of interest and principal are less than 90 days past due called performing loan.

### **Non Performing Loans (NPL)**

A loan is non-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full.

### **Good Loan**

Such loan is disbursed by cooperative organization. Such loan is not crossed by 90 days and the organization has provision of one percent. That is why it is called good loan.

### **Doubtful Loan**

All loans and advances, which are past due for a period of 6 months to one year, shall be included in this category. Those are non performing loan. The organization has provision of 35 percent for such loan.

### **Bad/ Loss Loan**

All loans and advances, which are past due for a period of more than one year, shall be included in this category. Those are classified as nonperforming loan. The organization has provision of 100 percent for such loan.

### **Classification of loans Provision required**

Good 1%

Doubtful 35%

Bad loans 100%

$$\text{Non-performing Loan Ratio} = \frac{\text{Total Non-Performing loan}}{\text{Total Loan \& Advances}} \times 100\%$$

Where,

Total Non-Performing loan (NPL) = Doubtful Loan + Bad Loan

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

### **Management**

Management is the arrangement of various things in a systematic manner for the achievement of organizational goal. An institution can take a desired goal only when the management is capable, which is of strong and long-term vision. For the achievement of the goal of the bank within certain period of time proper and efficient management is required, for which the banks should have the following qualities:

- ) Qualitative Human resource management
- ) Adequate management expenses

- ) Perfect structure of management team.
- ) Fair decision making capability.
- ) Use of modern Information Technology and proper communication system
- ) Perfect working environment
- ) Internal management system and relationship between customer and organization.

Management analysis can be done by using following formula;

$$\text{Total expenses to total revenue ratio} = \frac{\text{Total operating expenses}}{\text{Total operating revenue}}$$

$$\text{Earning per employee Ratio (MER)} = \frac{\text{Net Profit after Tax}}{\text{Total No. of Staffs}}$$

### **Earning**

Earning means excess of revenue over cost, so excess revenue earned by any organization in the course of operation is known as profit. It is the ultimate result of any business. Generally, if the earnings are good then that business is running well. Similarly the aggregate performance of the bank reflects from its earnings. Earning is the ultimate result of any business. Generally, higher earnings reflect better financial position. Similarly the aggregate performance of the bank reflects from its earnings. Following ratios depicts the earning position of EBL, BOK & NIC.

$$\text{Earning per Shares (EPS)} = \frac{\text{Net Profit after Tax}}{\text{No. of outstanding Shares}}$$

$$\text{Return on Equity (ROE)} = \frac{\text{Net Income after Tax}}{\text{Total Shareholder's fund}} \times 100\%$$

$$\text{Return on Assets (ROA)} = \frac{\text{Net interest income}}{\text{Total Assets}} \times 100\%$$

$$\text{Net interest margin} = \frac{\text{Net interest income}}{\text{Earning assets}}$$

### **Liquidity**

Liquidity is the state of owning things of value that can easily be exchanged for cash. Liquidity is the term which denotes the ability of an organization to meet its financial obligation or debts in cash in time. Such an organization has assets which can be converted into cash and without any

loss at their conversion through the maintenance of certain reserves and provision. Liquidity reflects the short term financial strength of the banks. Bank does not provide all its deposit at loans and advances, but certain percentage is kept as liquidity in the bank itself or elsewhere.

Basically bank measures liquidity through three methods. They are as follows;

### **Cash and Bank Balance Ratio (CBR)**

The ratio measures the bank ability to meet immediate obligation. So, optimum balance should maintain in order to meet their paying obligation. Further, this ratio is employed to measure whether bank's cash balance is sufficient to cover unexpected demand made by the depositors.

It is calculated as follows

$$\text{Cash \& Bank Balance Ratio} = \frac{\text{Cash \& Bank Balance}}{\text{Total Deposit}}$$

### **Investment in Government Security Ratio (IGSR)**

Government securities are known as risk free assets, which are easily converted into cash to meet the short term obligation. That's why every commercial bank has to invest their certain amount in government securities. This ratio calculated as

$$\text{Investment in Govt. Security Ratio} = \frac{\text{Investment in Govt. Security}}{\text{Total Deposit}} \times 100\%$$

### **3.7 Limitation of the methodology**

The research methodology mostly based on the following areas.

- a. The study concerned only on PDUCL.
- b. The study id mainly concern with secondary data provided by the organization.
- c. Table and figure are used to presentation and analysis of data.
- d. The study result is especially based on available data and financial tool under CAMEL.
- e. The data are taken in the study of only 5 year through the fiscal year 2064/65 to 2068/69.
- f. The rating system of CAMEL is not mentioned.

## **CHAPTER IV**

### **DATA PRESENTATION AND ANALYSIS**

This chapter deals with the presentation and analysis of data collected from different sources with the focus on the camel components. As stated in the theoretical prescription, the financial performance analysis of Pokhara Dugdha Utpadak Cooperative is concentrated in the five components of camel i.e. Capital Adequacy, Assets Quality, Management Quality, Earning Quality and Liquidity. The data collected from annual reports of the organization.

#### **4.1 Data Presentation and Analysis**

The data collected from different sources has been defined and documented in Excel tables, which are further processed to analyze and arrived at the findings on the financial conditions of above mentioned cooperative in terms of CAMEL analysis. The major findings of the study on financial performance of PDUCL are also described on each section and part of CAMEL Analysis.

##### **4.1.1 Capital Adequacy**

Capital Adequacy is a measure of a FI' s financial strength, in particular its ability to cushion operational and abnormal losses. 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 coming 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 Weighted Assets, Core Capital and Supplementary Capital are major figures used to calculate Capital Adequacy Ratio.

$$\text{Core Capital Adequacy Ratio (CAR)} = \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}} \times 100\%$$

Table 4.1 is the observed Capital Adequacy Ratio during the study period in numerical terms which is presented below:

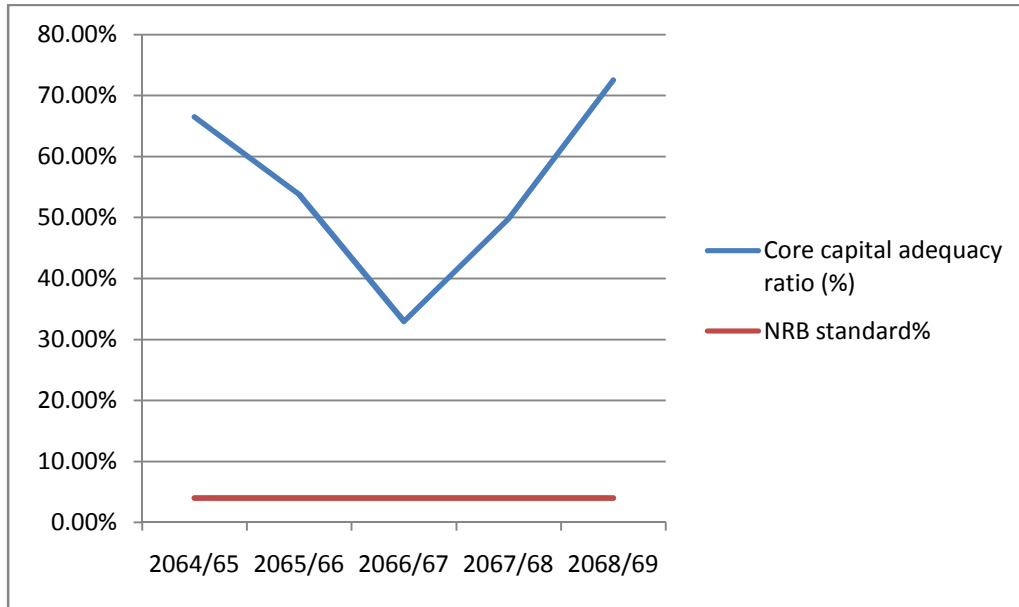
**Table 4.1 Core Capital Adequacy Ratio**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Core Capital(Rs)	80000	1471558	4063869	6340060	11620242
Total risk weighted assets(Rs)	120320	2736500	12329579	12730461	16027660
Core Capital Adequacy ratio (%)	66.48	53.77	32.96	49.80	72.50
NRB standard (%)	4	4	4	4	4
Difference (%)	62.48	49.77	28.96	45.80	68.50

Source: PDUCL Annual Reports

Table 4.1 shows that core capital and total risk weighted assets having different financial data are applied. Core capital adequacy ratio is fluctuation in trend. During the fiscal year 2068/69 has maximum percentage of 72.50 where as 32.96 percentage is located on fiscal year 2066/67. The PDUCL is applying adequate amount of internal source of shareholders fund with significant during the period. More differences shows that it has excess capital fund but not invested properly even though it maintain NRB standard.

**Figure 4.1 Comparing Core Capital Adequacy Ratios with NRB Standard**

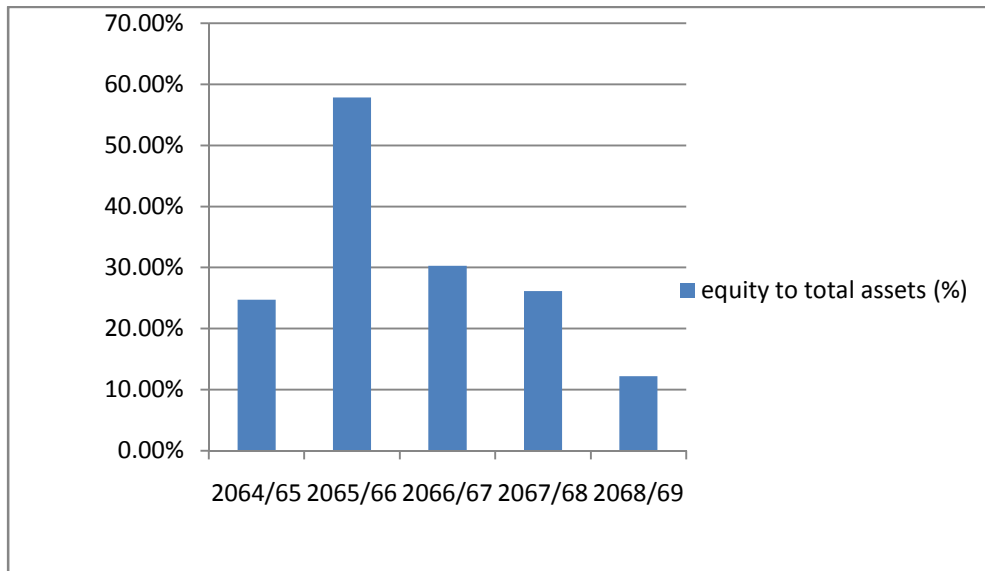


**4.1.2 Assets quality Analysis**

**Table 4.2 Equity to total assets ratio**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Shareholder equity (Rs)	80000	1453000	3861000	5966100	11175600
Total Assets (Rs)	19788	840152	1169736	1561123	1364971
Equity to total assets ratio (%)	24.74	57.82	30.30	26.17	12.21

**Figure 4.2 Equity to total assets ratio**



**Assets composition**

The assets quality analysis of PDUCL is analyzed using different technique over the review period with major highlight on investment components. It includes the assets composition, assets and deposit growth rate and lastly loan and advance.

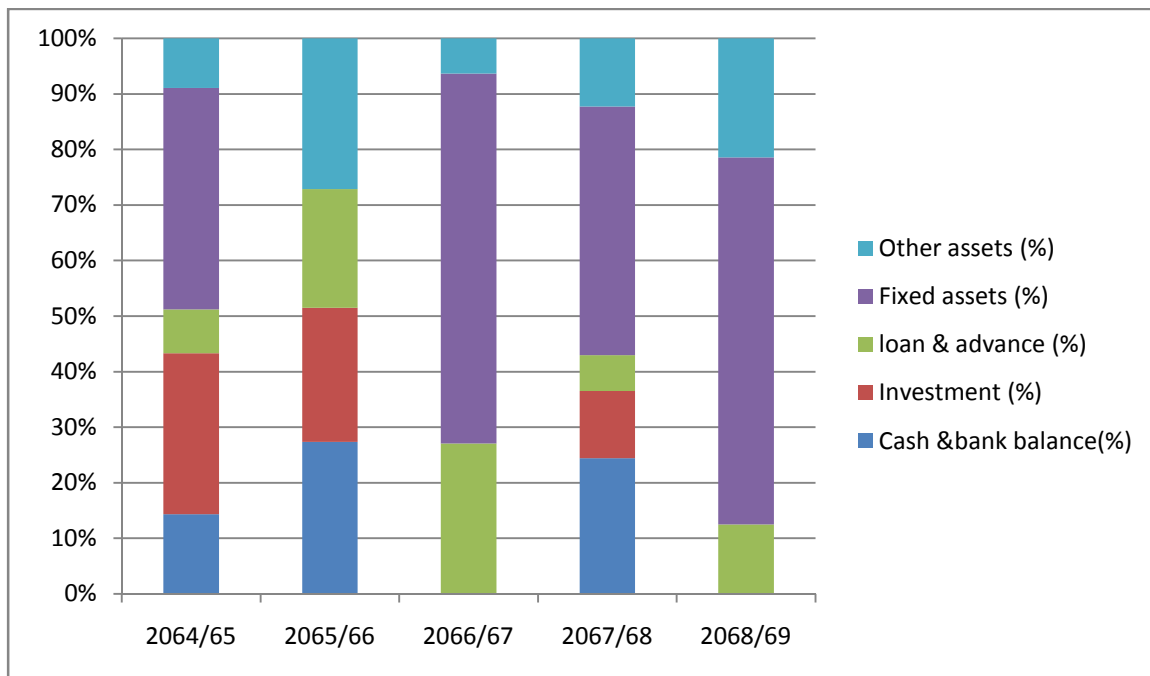
**Table 4.3 Assets composition**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Cash and bank balance	11.32	22.81	6.24	31.44	7.03
Investment	86.10	75.92	67.30	-	85.42
Loan and advance	-	-	25.63	63.11	6.02
Fixed assets	2.57	1.27	0.68	4.71	1.29
Other assets	-	-	0.14	0.74	0.24
Total	100.00	100.00	100.00	100.00	100.00

Source: PDUCL Annual Reports

According to the table no. 4.3, different data can be shown in fluctuation nature. On the basis of assets quality analysis, data shown in cash and bank balance reveal that it is increasing in trends from fiscal year 2064/65 to 2065/66. After this period, it declines largely and again increases of percentage of 31.44. While comparing investment, the most investment fiscal years are 2064/65 i.e. 86.10% and 2068/69 i.e. 85.42 % respectively. This cooperative limited has invested more amounts in fiscal year 2067/68. All other data are shown in fluctuation in nature.

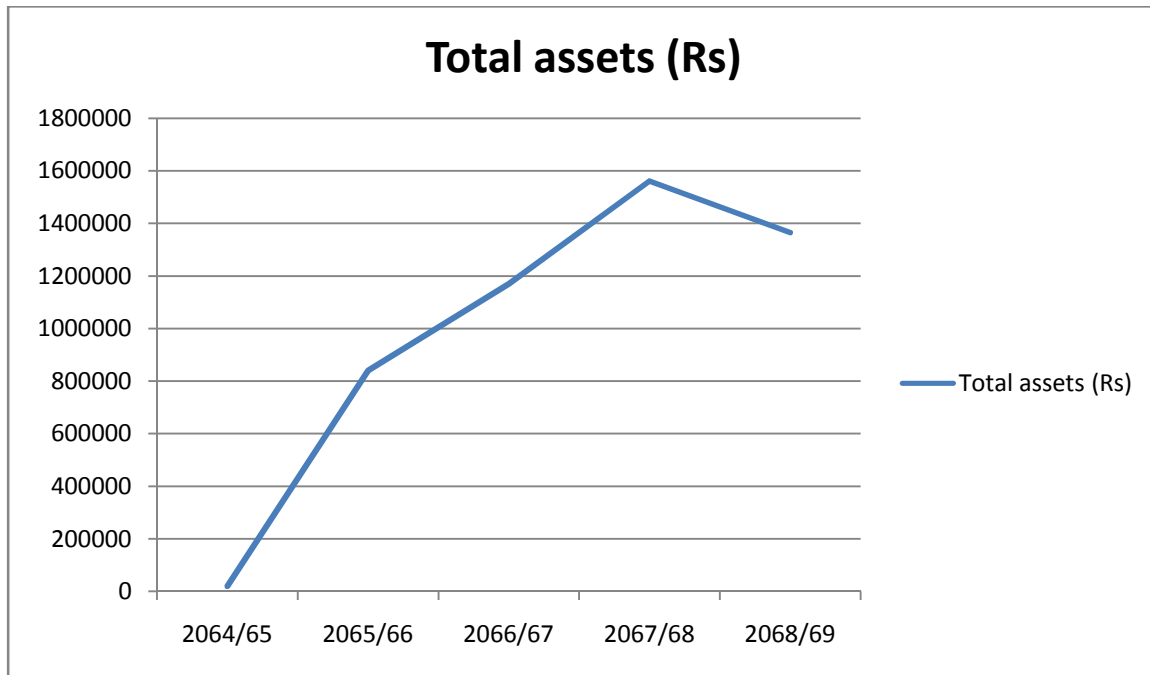
**Figure 4.3 Assets composition**



**Table 4.4 Assets growth rate**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Total Assets (Rs)	19788	840152	1169736	1561123	1364971

**Figure 4.4 Assets growth rate**

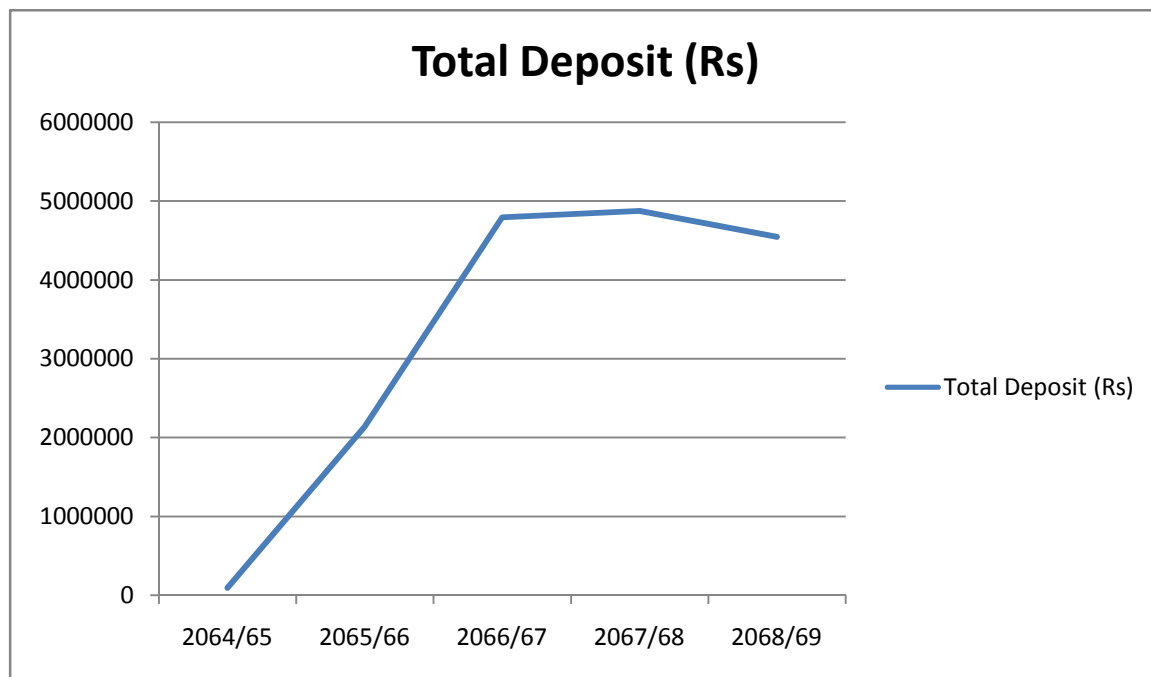


## Deposit growth rate

**Table 4.5 Deposit growth rate**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Total Deposit (Rs)	94208	2140566	4792215	4874248	4545817

**Figure 4.5 Deposit growth rate**



Non- performing loans

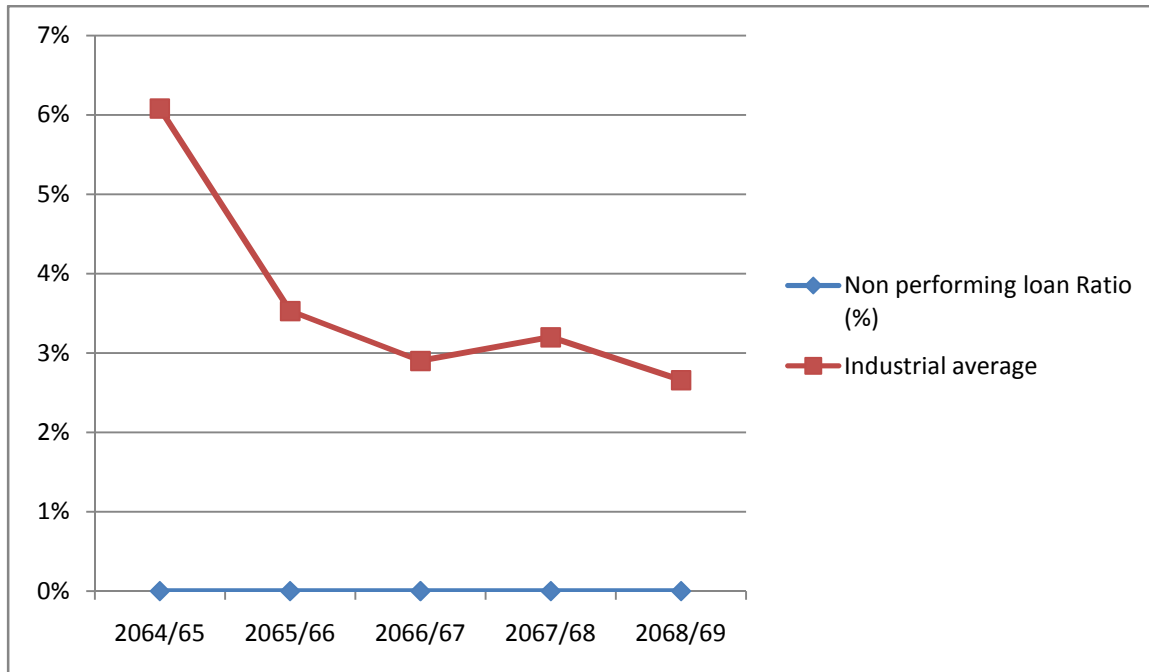
**Table 4.6 Non -performing loans**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Non-performing loan (Rs)	0	0	0	0	0
Total loan (Rs)	1020500	2720000	11588149	12713961	16011160
NPL ratio (%)	0	0	0	0	0
Industrial average%*	6.08	3.53	2.9	3.2	2.66

Source: PDUCL Annual Reports, \* Bank and financial statistics NRB, 2012

According to the above table no 4.6 the cooperative has different percentage of NPL ratio i.e. 4.15 and 14.18 percent in fiscal year 2067/68 and 2068/69 respectively. During the period of 2064/65 to 2066/67, the cooperative has no any non performing loan.

**Figure 4.6 Comparing non- performing loan with industrial average ratio**



In figure no. 4.6 shows that PDUCL has no any non performing loan because loan loss provision is applied and good loan is allocated of 1% loan loss provision. The organization is better in recovering loan and advance on time.

### 4.1.3 Management component analysis

Management role is very important in the performance of cooperative organization. The key distinct areas that reflect the overall quality of management are governance, general management, human resource policy, management information system, internal control, audit, strategic planning and budgeting.

Total operating expenses to total operating revenue ratio

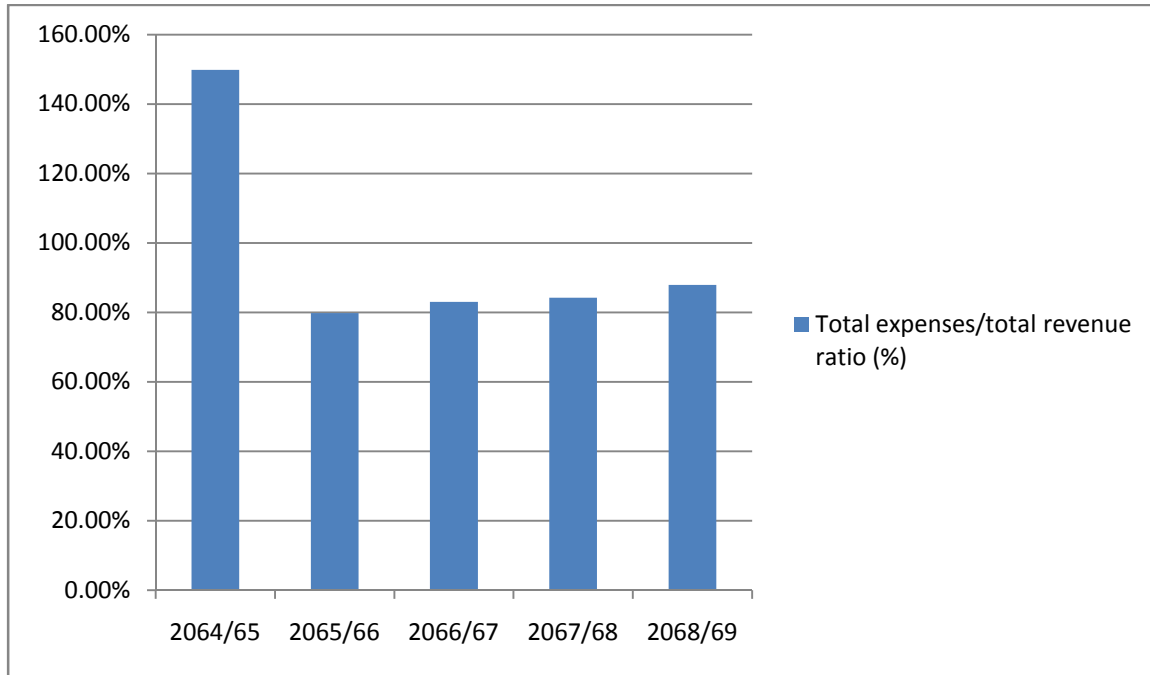
**Table 4.7 Total operating expenses to total operating revenue ratio**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Total expenses (Rs)	10970	126613	1185350	1628807	1784493
Total Revenue (Rs)	7321	158712	1426932	1933264	2029633
Total expenses/total revenue ratio (%)	149.84	79.77	83.06	84.25	87.92

Source: PDUCL Annual Reports

According to the table no. 4.7 different data of total expenses and revenue are shown. As comparing of its ratio, the least revenue is generated during the fiscal year 2064/65 whereas in fiscal year 2065/66 has the best revenue. All remaining data are not satisfactory in level.

**Figure 4.7 Total operating expenses to total operating revenue ratio**



Earning per employee

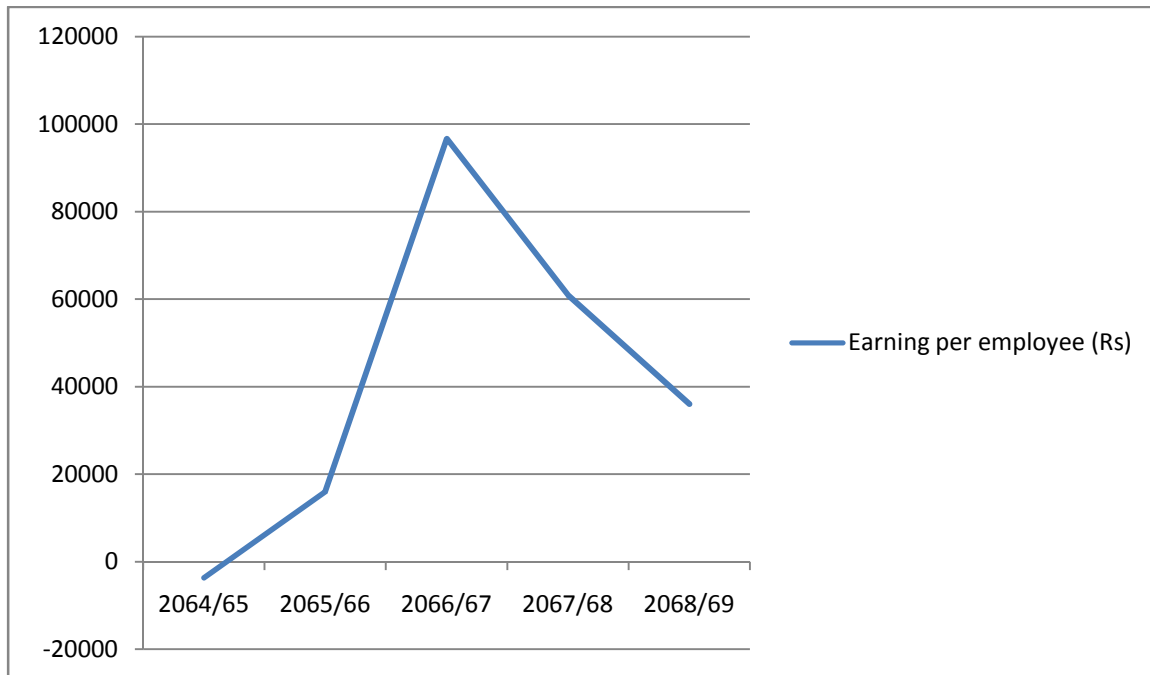
**Table 4.8 Earning per employee**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net profit after tax (Rs)	(3648)	32099	193265	243565	180286
No. of employees	1	2	2	4	5
Earning per employee (Rs)	(3648)	16049.5	96632.5	60891.25	36057.20

Source: PDUCL Annual Reports

As showing the table no.4.8 due to the starting period of the cooperative, a negative figure can be seen during the fiscal year 2064/65. The most satisfactory earning per employee is Rs. 96632.5 in fiscal year 2066/67. Other data are not fully satisfactory.

**Figure 4.8 Earning per employee**



#### 4.1.4 Earning quality analysis

The main objectives of the cooperative organizations are to earn profit and their level of profitability is major by different ratios.

Return on equity

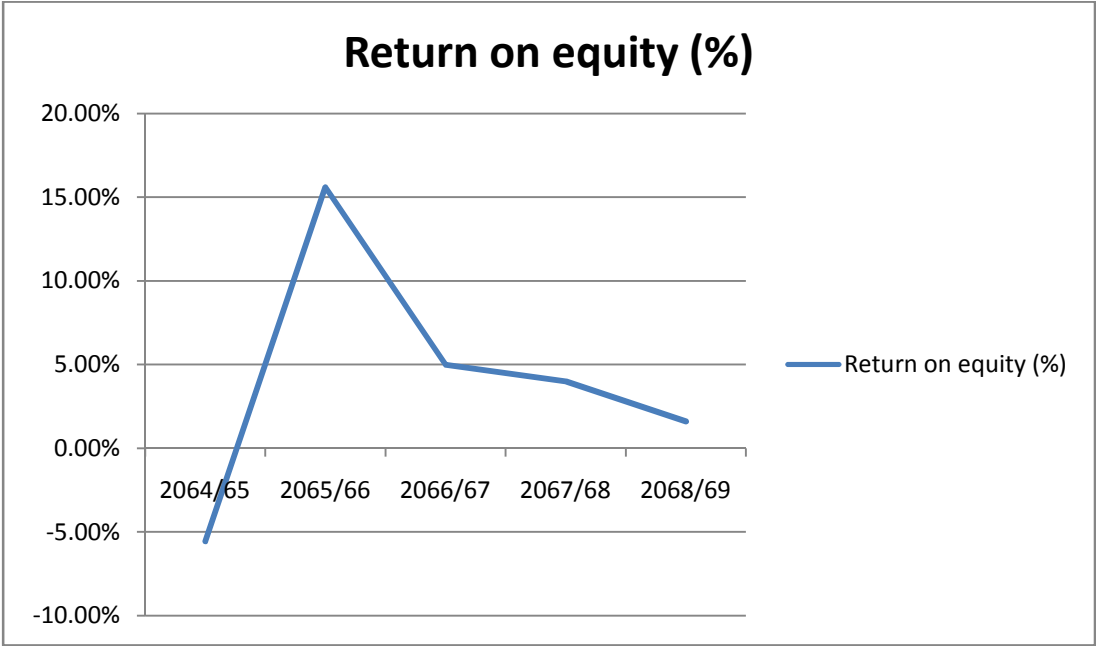
**Table 4.9 Return on equity**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net profit after tax(Rs)	(3648)	23879	193265	243565	180286
Shareholder equity (Rs)	80000	1453000	3861000	5966100	11175600
Return on equity (%)	(5.56)	15.60	5	4	1.6

Source: PDUCL Annual Reports

According to the table no 4.9 earning quality analysis under return on equity is observed. In fiscal year 2065/66 has the most satisfactory return on equity percentage. During the starting fiscal year, loss bearing on equity is revealed by this cooperative. All data are as shown in the figure.

**Figure 4.9 Return on equity**



Return on assets

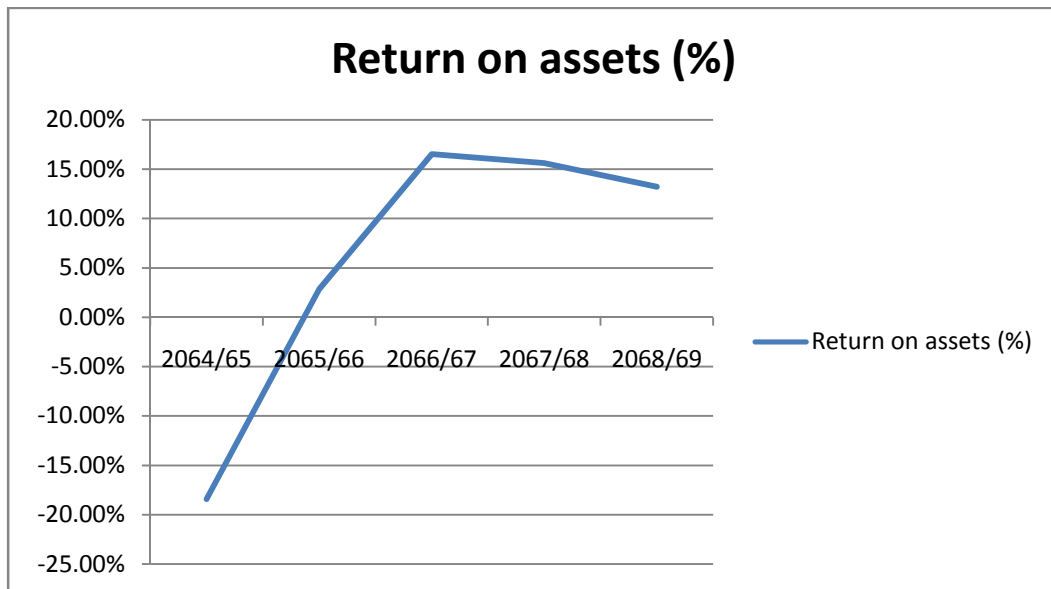
**Table 4.10 Return on assets**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net profit after tax(Rs)	(3648)	23879	193265	243565	180286
Total Assets (Rs)	19788	840152	1169736	1561123	1364971
Return on assets	(18.44)	2.84	16.52	15.60	13.20

Source: PDUCL Annual Reports

According to the above table no.4.10 the cooperative has fully satisfactory level gain on return on assets during the fiscal year 2066/67. The organization cannot produce return on assets in the fiscal year 2064/65. The gaining of return on assets is fluctuation way.

**Figure 4.10 Return on assets**



Net interest margin

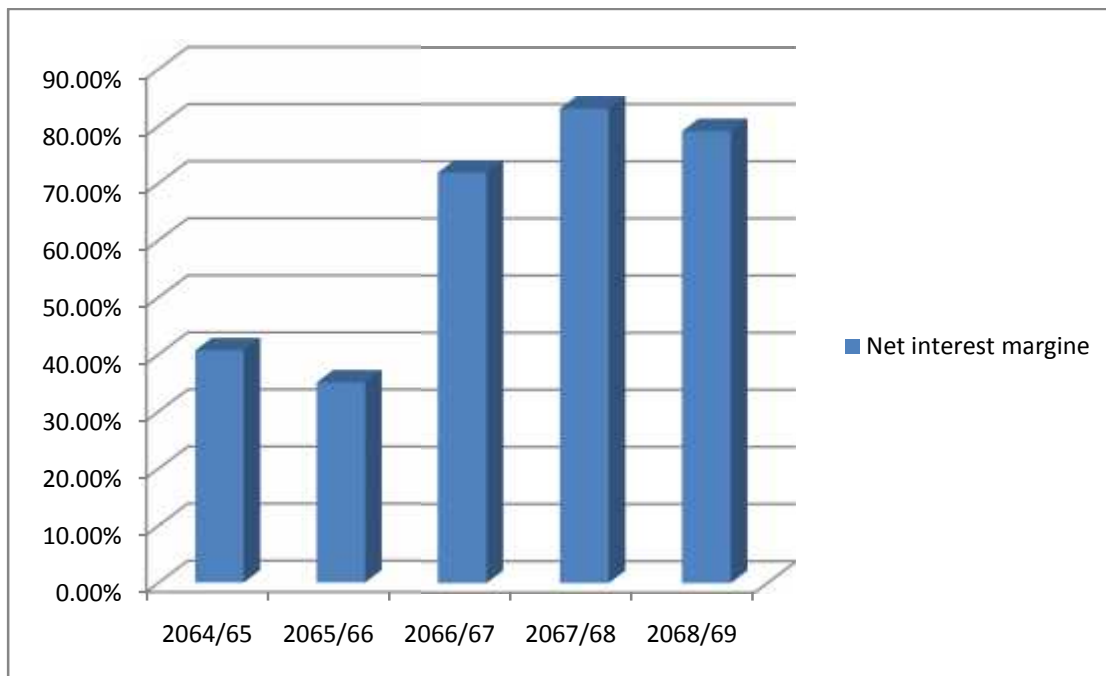
**Table 4.11 Net interest margin**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net interest Income (Rs)	3430	69736	1345178	2324689	2156792
Earning assets (Rs)	8430	198836	1872318	2798723	2726152
Net Interest margin (%)	40.69	35.07	71.84	83.06	79.11

Source: PDUCL Annual Reports

As showing the above table no.4.11 the cooperative has got maximum net interest margin i.e. 83.06 % during the period of 2067/68 whereas in fiscal year 2065/66, the least net interest margin can be obtained. As comparing data of net interest margin is increasing in trend from 2065/66 to 2067/68.

**Figure 4.11 Net interest margins**



## Earnings per share

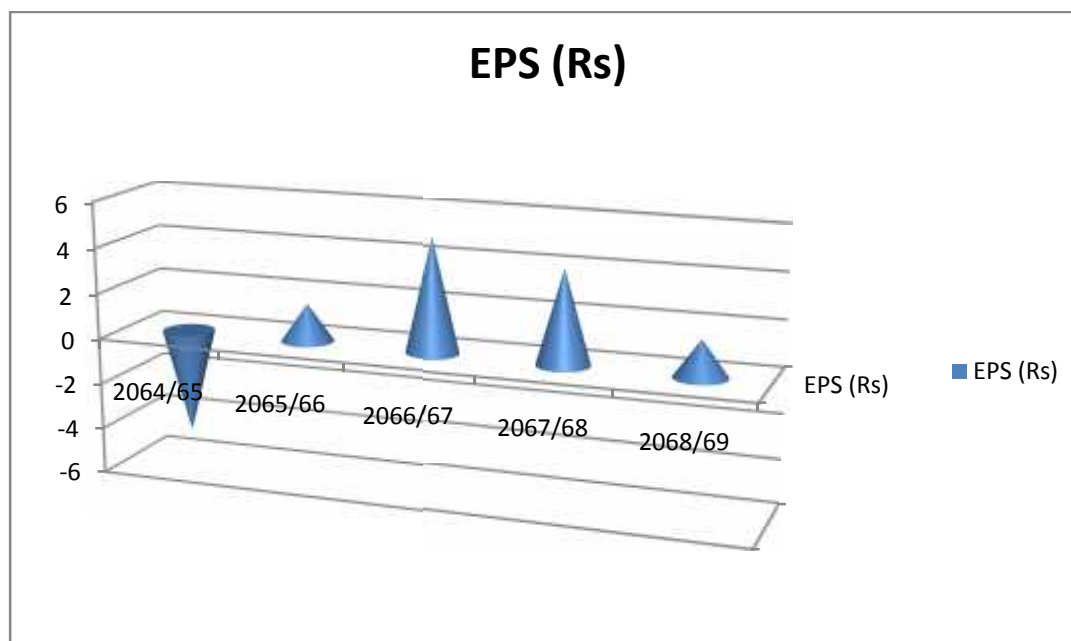
**Table 4.12 Earnings per share**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net profit after tax(Rs)	(3648)	23879	193265	243565	180286
No. of share	800	14530	38610	59661	111756
Earning per share (Rs)	(4.56)	1.64	5	4.08	1.61

Source: PDUCL Annual Reports

According to the table no 4.12 these data are not satisfactory for the shareholder of the cooperative. It shows that, the organization cannot able to provide better return to them. As comparing data, Rs 5 earnings per share are given to shareholders during the period of 2066/67. The fiscal years i.e. 2065/66 and 2068/69 are stayed in below standard and shareholders are not given any earnings during the starting year.

**Figure 4.12 Earnings per share**



#### 4.1.5 Liquidity Components Analysis

The most liquid assets are cash which can be used directly to meet liability holder's demands to withdraw funds.

##### Cash and Bank Balance Ratio (CBR)

The ratio measures the bank ability to meet immediate obligation. So, optimum balance should maintain in order to meet their paying obligation. Further, this ratio is employed to measure whether bank's cash balance is sufficient to cover unexpected demand made by the depositors. It is calculated as follows

$$\text{Cash \& Bank Balance Ratio} = \frac{\text{Cash \& Bank Balance}}{\text{Total Deposit}}$$

**Table 4.13 Cash and Bank Balance Ratio**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Cash and bank Balance (Rs)	19788	822152	1143856	1525346	1319470
Total Deposit (Rs)	94208	2140566	4792215	4874248	4545817
Cash and Bank balance Ratio (%)	21	38.40	23.86	31.29	29.02
Industrial average*	15.7	18.81	16.29	14.26	18.64
Diff. from industrial avg.	5.3	19.59	7.57	17.03	10.38

Source: PDUCL Annual Reports, Banking and financial statistics NRB, 2012

According to the table no.4.13 every financial institution such as cooperative organizations have to kept cash and bank balance for the purpose of fulfilling emergency period and fixed standard

set by governed body. The showing data during fiscal year 2065/66 has maximum percentage i.e. 38.40 whereas in the fiscal year 2064/65 has only 21 percent. The average in cash in bank balance ratio is almost 29 percentages.

**Figure 4.13 Comparing Cash and Bank Balance to Total Deposit Ratio with Industrial Average**

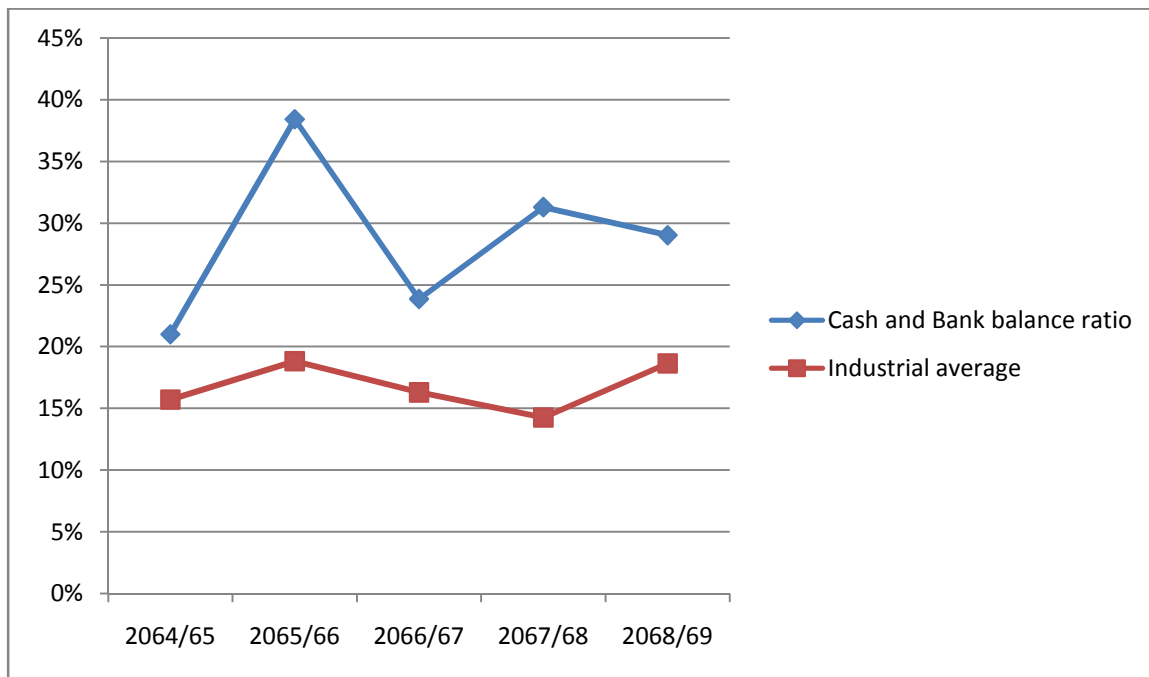


Figure no. 4.13 shows the cash and bank balance to total deposit ratio of the PDUCL in comparison to the industrial average ratio, within the study period of last five year. The figure shows the total cash and bank balance to total deposit curve of the PDUCL is revealed better in all fiscal year, this fact implies that the liquidity position of the organization is the best is compare to industrial average ratio.

#### Investment in Government Security Ratio (IGSR)

Government securities are known as risk free assets, which are easily converted into cash to meet the short term obligation. That's why every commercial bank has to invest their certain amount in government securities. This ratio calculated as

$$\text{Investment in Govt. Security Ratio} = \frac{\text{Investment in Govt. Security}}{\text{Total Deposit}} \times 100\%$$

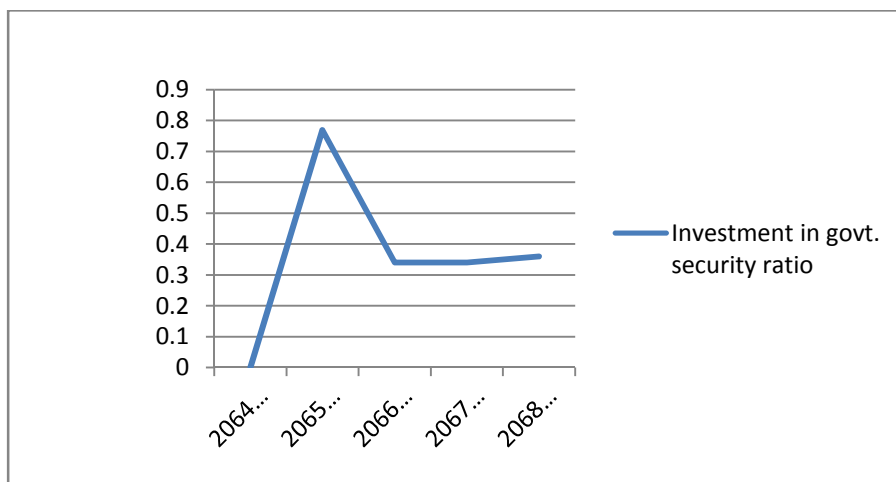
**Table 4.14 Investment in Govt. Security Ratio**

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Investment in govt. security (Rs)	–	16500	16500	16500	16500
Total Deposit (Rs)	94208	2140566	4792215	4874248	4545817
Investment in Govt. Security Ratio (%)	–	0.77	0.34	0.34	0.36

Source: PDUCL Annual Reports

According to the above table no.4.14 most of the organizations like to keep public relation among privet and government organizations by purchasing their share and bonds. This cooperative has invested in government securities in different fiscal year expect during the fiscal year 2064/65.

**Figure 4.14 Investments in Govt. Security Ratio**



## 4.2 Major findings:

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

- ) According to the core capital adequacy ratio of PDUCL, the organization is trying to maximum its ratio from fiscal year 2067/68 to 2068/69 i.e. 49.80% and 72.50% respectively during the fiscal year 2066/67, only 32.96% can be seen in the figure. The PDUCL is applying adequate amount of internal source of shareholders fund with significant during the period. More differences shows that it has excess capital fund but not invested properly even though it maintain NRB standard.
- ) Analysis of assets quality, the organization has maintain maximum of ratio quality to total assets ratio during the fiscal year 2065/66 i.e. 57.82%. The minimum ration cab be seen in fiscal year 2068/69.
- ) As showing the assets composition of this cooperative, it has maintained maximum percentage of cash and bank balance during the fiscal year 2067/68 i.e. 31.44% whereas in fiscal year 2068/69 it has only 7.03%. this organization also maintain other parts of assets composition in case of investment in 2064/65 while in fixed assets the maximum percentage can be seen during the fiscal year 2067/68.
- ) According to the assets composition, the maximum assets growth can be seen during the fiscal year 2067/68 where as minimum is in 2064/65
- ) As comparing of deposit growth rate the organization, the maximum deposit is collection during fiscal year 2067/68 whereas minimum is in 2064/65.
- ) The organization has followed provision of loan loss. The mainly cooperative have one percentage 35percentage, and 100 percentage loan loss provisions is applied for good loan, doubtful loan and bad loan respectively. PDUCL has no any non performing loan because loan loss provision is applied and good loan is allocated of 1% loan loss provision. The organization is better in recovering loan and advance on time.
- ) Out of different financial performance tool i.e. management component analysis, total operating expenses and revenue have been assessed. The maximum total operating

expenses to total operating revenue ratio is in fiscal year 2065/66 whereas the least ratio can be seen during the fiscal year 2064/65. The maximum ratio shows that, the revenue is overlapped by expenses and minimum is vice-versa.

- ) As comparing of earning per employee, during the fiscal year 2067/68 has maximum earning per employee whereas in fiscal year 2064/65 has no earning per employee.
- ) Analysis of return on equity of this organization, 15.60% return can be obtained on equity during fiscal year 2065/66 there is no any return on equity during the fiscal year 2064/65 i.e. negative 5.56%.
- ) According to the return on assets of the organization, the maximum return can be obtained during fiscal year 2066/67 i.e. 16.52% whereas the organization is not able to get gaining on assets during fiscal year of 2064/65 i.e. negative of 18.44%.
- ) One of the income sources of cooperative is in interest income from loan disbursement to customer and shareholders. The maximum net interest margin is obtained during the fiscal year 2067/68 i.e. 83.06%. The minimum one is 35.07% during fiscal year 2065/66.
- ) Analysis of earning per share of this organization, the maximum Rs. 4.08 earning per share is obtained during fiscal year 2067/68 whereas there is no any earning per share during fiscal year 2064/65.
- ) The ratio of cash and bank balance on the basis of total deposit of the organization, this cooperative has maintained 38.40% in 2065/66 whereas minimum ratio can be seen in 2064/65. The maintaining of cash and bank balance shows that the organization is ready to emergency period and awaiting of inspection by cooperative division office.
- ) Most of the organization or cooperatives intend to make public relation with other financial institution and government bodies. This cooperative also invest in government security in different fiscal year as same amount i.e. Rs. 16500 from 2065/66 to 2068/69.

## CHAPTER V

### SUMMARY, CONCLUSION AND RECOMMENDATION

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

#### 5.1 Summary

This study is focused on assessing the financial performance of PDUCL in the framework of CAMEL by using descriptive and analytical research design. The study indicated the financial performance of PDUCL as regard to its capital adequacy, trend of risk weighted assets, assets composition, quality of loan assets, liquidity position and management of revenue and expenses. The PDUCL's audited annual report of condition for the period 2064/65 to 2068/69 is the primary source of information. A very few researcher in Nepal have written about financial performance in the framework of CAMEL in the area of cooperative organization. This organization is better for maintenance core capital adequacy ratio in different year on the basis of standard level build by cooperative division office. In case of assets quality analysis, it is also good for the performance. According to the assets composition, cash and bank balance and investment are better in condition whereas the condition of loan and advance and fixed assets are only good in condition i.e. satisfactory level. The management of this cooperative has to recover non performing loan during fiscal year 2067/68 to 2068/069. It is unable to generate more operating revenue against operating expenses in different fiscal year. The cooperative has to decrease operating expenses. The main source of income of cooperatives is interest income from loan disbursement 83.06% net interest margin is gained by the cooperatives during fiscal year 2067/68. As comparing of earning per share in different fiscal year, the cooperative unable to provide more earning or dividend to the shareholders. Only Rs.4.08 earning per share is distributed during fiscal year 2067/68. The liquidity position of the cooperatives is better in different fiscal year. The cooperative also invest in government security for the least percentage. Overall the PDUCL is god in financial performance but it has to decrease operating expenses, increase in government securities and making better planning and implementation of loan loss

provision and effective recovery system along with providing maximum of 15% dividend to shareholder annually as per standard made by cooperative division office.

## **5.2 Conclusion**

The performance of PDUCL on the framework of CAMEL is concluded as under based on the finding:

1. The cooperative's CCAR is better in condition in different years. In the fiscal year 2068/69, 2064/65 and 2065/66 are better and other two fiscal years have less CCAR ratio. This means the cooperative has adequate internal source and capital fund is sound and good.
2. The cooperatives assets composition (AC) is also satisfactory in level. Cash in bank balance and investments are better but the organization needs to produce more effort for recovering non performing loan and assets. The growth rate of deposit and assets are also good in condition.
3. Cooperative's TOE and TOR is not satisfactory because more operating expenses can be seen during fiscal year 2064/65 and other fiscal year. Organization cannot control operating expenses effectively and efficiently. The difference between expenses and revenue is not so far i.e. less revenue has been generated in different fiscal year.
4. Cooperative's return on equity is better during fiscal year 2065/66 and other fiscal years have less return on equity. Return on assets of cooperatives has better return from 2066/67 to 2068/69 and other fiscal year cannot get satisfactory gain on assets.
5. The most satisfactory performance of cooperative is net interest margin the cooperative has produce 83.06% net interest margin during fiscal year 2067/68.
6. Cooperatives EPS is not satisfactory because only Rs. 4.08 EPS is shown during the fiscal year 2067/068. Shareholders cannot get more earning by investing this share in cooperative organization.

7. Cooperative's CBBR is better in condition for the purpose of emergency and standard maintain.
8. Cooperatives IGSR is not satisfactory in condition same and very low investment is done for government securities only Rs. 16500 has been invested.

### **5.3 Recommendation**

The following recommendation are made based on conclusion as regard of financial performance of PDUCL

1. PDUCL's core capital is adequate in some fiscal years. All its years have not maintained sufficient amount of capital for surviving and fighting against competitive market. That is why; this cooperative should maintain same level of capital in different years. It means that it has to collect adequate capital every year.
2. Every new established organization has to bear loss and more expenses during the earlier period but this cooperative has to decrease operating expenses and increasing operating revenue for the purpose of providing better dividend to shareholders and good salary to employees. This cooperative should provide dividend from 10 percentage to 15 percentage in range on the basis of capital and assets according to the rule made by Cooperative Division Office
3. According to the principle of cooperative organization, there are mainly seven principles i.e. a) independent and open membership b) democratic control by the members c) financial participation of the member d) autonomous and freedom e) education, training and information f) cooperation among cooperative organization g) accountability towards society and nation. Most of the cooperative organizations have focused on doing work related to banks job i.e. collection of deposit and disbursement of loan. But the main theme of such organization has own task or duty. This organization is also doing the same task as like bank. That is why cooperative organizations should focus on production and trade sector. The main concept of establishing cooperatives is to increase economy level of shareholders and showing responsibility and accountability towards society.

4. This cooperative is trying to involve in production sector i.e. milk production and sale but it is not only sufficient task for the cooperative organization. It has to focus on other production area and trade sector because it is due to increase financial condition of shareholders who like to anticipate getting more gaining from own locally established cooperative organization.
5. This organization has invested in government securities for public relation and contribution of development of cooperative organization and its concept. It has invested in government securities at different organization related to cooperatives but it should be invest more amounts there.

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