

**A STUDY OF CAPITAL ADEQUACY AND LOAN LOSS PROVISION  
OF COMMERCIAL BANKS**

**(WITH REFERENCE TO GLOBAL IME BANK LTD AND EVEREST BANK LTD)**

**A THESIS**

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# VIVA-VOCE SHEET

We have conducted the viva –voce examination of the thesis presented

By

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Entitled:

**“A Capital Adequacy and Loan Loss Provision of Commercial Banks”  
(With Reference to Global IME Bank Ltd and Everest Bank Ltd)**

*And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for the Degree of Master of Business Studies (M.B.S)*

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## **DECLARATION**

I hereby declare that this thesis entitled **A Capital Adequacy and Loan Loss Provision of Commercial Banks (With Reference to Global IME Bank Ltd and Everest Bank Ltd)** submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Degree of Master of Business Studies (M.B.S) under the supervision of **Prof. Amuda Shrestha and Lecturer Dhurba Subedi** of Shanker Dev Campus.

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## **ABBREVIATION**

GIBL	=	Global IME Bank Limited
EBL	=	Everest Bank Limited
CAR	=	Capital Adequacy Ratio
CCAR	=	Core Capital Adequacy Ratio
SCAR	=	Supplementary Capital Adequacy Ratio
Rs.	=	Rupees
Co.	=	Company
FY	=	Fiscal Year
LLP	=	Loan Loss Provision
Ltd.	=	Limited
No.	=	Number
NPA	=	Non Performing Assets
NPL	=	Non Performing Loan
NRB	=	Nepal Rastra Bank
RWA	=	Risk Weighted Assets
S.N.	=	Serial Number
S.D.	=	Standard Deviation
r	=	Correlation Coefficient
P.E.	=	Probable Error
NPAT	=	Net Profit after Tax
NPL	=	Non Performing Loan
LLP	=	Loan Loss Provision
TLA	=	Total Loan & Advance
C.V.	=	Coefficient of Variation

# CHAPTER-I

## Introduction

### 1.1 Background of the study

The economy of nation depends on the uses of available resources in efficient way. The proper utilization of assets appreciates in wealth position of individual and country as well. To mobilize available resource, there should be proper planning, efficient management, far sighting strategy, good financial management and up-to-date information. Integrated and speedily development of the country is possible only when competitive banking and financial service reaches nook and corners of the country. To grow financial activities, it requires the banking habit of the community as well as potentially strong lending opportunities. Simply, Bank is an institution whose main function is to accept deposit and invest it. Bank collects money from public by providing attractive sound interest and can earn profit by lending it on mainly in business organization, industrial, agricultural sectors etc. So, we can say the main task of commercial bank is to mobilize idle resources in productive areas by collecting it from scattered sources and generating profit. Banking plays significant role in the economic development of country. Banks role as intermediaries channeling between saving and investment and fulfill the credit needs of customer as well as investment requirement of savers. It is clear that efficient and stable banking systems are crucial for an orderly economic growth. The pace development of country largely depends on the level of financial development.

Successfully formulation of investment policy and its proper utilization or implementation is the prime requisite for the development of performance of banks and other financial institution. Good Investment policy has positive impact on economic development of the country and vice-versa. A healthy development of any banks depends heavily upon its investment policy. ([www.studymode.com](http://www.studymode.com))

A strong financial system promotes economic growth, mobilizes and allocates resources efficiently, establishes efficient payment system and effective transmission mechanism, makes capital more productive and creates employment opportunities. It reduces vulnerability to financial crisis and lowers the economic and social cost of financial disruption.

The financial system in Nepal comprises bank and financial institutions (commercial banks, development banks, finance companies and microfinance institutions), cooperatives, contractual saving institutions.( Employment Provident Fund and Citizen Investment Trust), insurance companies and postal saving banks.

The bank helps in mobilization and allocation of scarce resources, which are essential for economic development. The banking system has facilitated the personal transactions such as deposit and remittance of money, and lending and borrowing of money. It has made easier to develop agriculture, industry and trade. At the same time, it has helped to accelerate the pace of economic development. Banks plays the intermediary role by receiving savings primarily from households and transforming them into loans to business firms and other in order to make investment in building factories, plants and equipments. The bank collects idle money from people. This money is channelized by banks to the individuals, businesses and government for productive investments. This increases capital formation by increasing productive investments. This, in turn, raises the level of employment, income and standard of living.

Financial institutions play an important role in financial intermediation to efficiently allocate scarce funds – this will spur economic growth and development. Banks are always faced with different types of risks that may have a potentially negative effect on their business. Risk taking is an inherent element of banking and indeed, profits are in part the reward for successful risk taking in business. On the other hand, excessive and poorly managed risk can led to losses and thus endanger the safety of a bank's depositors. Risks are considered warranted when they are understandable, measurable, controllable and within a bank's capacity to readily withstand adverse results. Sound risk management

systems enable managers of the banks to take risks knowingly, reduce risks where appropriate and strive to prepare for a future, which by its nature cannot be predicted.

Banking industry has stood as the most vulnerable yet the most profitable sector in Nepalese economy. The banking sector is prospering with much lesser difficulty in spite of increasing economic downturn and political instability in the nation. The clear picture is reflected in Nepal stock exchange; where 90% of stock traded is that of financial sector of which majority shares are held by commercial banks. With more number of commercial banks catering to the same market, it has given rise to the intense competition.

A sound banking system is important for smooth development of banking system. It can play a key role in the economy. It gathers savings from all over the country and provides liquidity for industry and trade.

### **1.1.1 Concept of Commercial Banks**

The commercial bank is a great institution that conducts the payment mechanism of a country. The individuals and institutions make payments to each other through the mechanism of commercial banks. The commercial bank plays a leading role in the smooth operation of an economy. It makes available all financial services to individuals and institutions. Section 2 (a) of the commercial Bank Act 2031 has defined that “Commercial Bank” means a bank which operates currency exchanges transactions, accepts deposits, provide loan, performs, dealings, relating to commerce except the banks which have been specified for the co-operative, agricultural, industry of similar other objective. Commercial banks are those banks, which pool together the savings of the community and arrange them for the productive use. They accept deposits from the public and provide same deposits to the public as loan and advances.

They supply the financial needs of modern business by various means. Commercial banks are restricted to invest their funds in corporate securities. Their business is

confined to financing the short-term needs of trade and industry such as working capital financing. They cannot finance in fixed assets. They grant loans in the form of cash credits and overdrafts. Apart from financing, they also render services like collection of bills and cheques, safekeeping of valuables, financial advising and act to their customers.

Modern commercial banks collect deposits in current, saving and fixed account from general public, and the institutions. It provides loans to individuals and institutions from the deposits. Modern commercial banks provide loans not only to traders but also to agriculture, industry and services. Although this bank concentrates itself in short-term loans, it has started to provide even medium and long-term loans to some extent. The difference between the rate of interest on deposits and loans is the main source of its income.

### **1.1.2 Functions of Commercial Banks**

Commercial banks are established as a joint stock company with a view to earn profit. These banks are regarded as the heart of modern economy. It is because they mobilize resources by collecting deposits and channelize those resources to productive sectors by granting loans. These banks collect different types of deposits. However, most of their deposits are of short-term nature payable on demand. Hence, from the view point of liquidity they are interested in meeting short-term credit needs. Beside accepting deposits and granting loans these banks render many other services to their customers. The services rendered by commercial banks are as follows:

#### **i) Accepting Deposits**

Commercial banks accept deposits in different accounts. This is the first most important and oldest function of the commercial bank. The main forms of deposit accepted by banks are as follows:

**a) Current or Demand Deposit**

The men and the institutions needing cash frequently deposit their money in current account. The amount deposited in this account can be withdrawn by drawing cheque without prior information. This is also known as demand deposit whereby the banker incurs the obligations of paying legal tender on demand. Since the bank should keep all money in reserve and cannot invest, no interest is offered in this account.

**b) Saving Deposit**

Generally, most accounts are opened saving deposit in a bank. Saving deposit is the deposit, which collected from general savers and middle-class people. The bank usually pays small interest to the depositors against their deposits. The money deposited in this account can be withdrawn only once or twice in a week or only in stipulated amount.

**c) Fixed Deposit**

The amount deposited for a fixed period is called fixed or time deposit. Thus bank pays higher rate of interest to the depositor. The amount deposited cannot be withdrawn before the fixed period. However, the depositor can take loan from the bank against the security of fixed deposit receipt. Since the bank can utilize the money for a fixed period high interest is offered in this account. The fixed deposit in Nepal is of 3 months, 6 months, 1 year, and 2 years and above.

**ii) Providing Loans**

The second important function of a bank is to provide different types of loans. The bank earns profit by giving the amounts deposited with it in the form of loans. Since the bank creates credit with its deposits, it is called manufacturer of credit. Likewise, since the bank earns profit by utilizing the deposits it is said, "It is banker's brain and other people's money".

Traditionally, commercial banks can grant only short-term credit. But in present time, it also provides loan of medium and long-term nature to some extent to even industry and

agriculture. The bank charges interest on loans, which are usually higher than those, offered on the deposit. The main forms of loan provided by the bank are as follows:

- a. Loans and Advances
- b. Overdraft
- c. Cash Credit
- d. Discounting of Bills

### **iii) Supporting Government Activities**

Banks invest on government securities and bonds for supporting government activities with credit. Banks earn interest by investing in government and non-government securities. Banks make government transactions with the permission of the central bank, such as Nepal Rastra Bank. It implies that banks collect government revenue and disburse government funds on behalf of the government.

### **iv) Agency Services**

The functions other than main functions performed by commercial bank are called secondary functions/services. These functions are also called agency functions. The bank charges minimum fees for undertaking agency functions for its customers. The objective behind undertaking agency function is to attract or retain customers rather than to earn income. The agency services rendered by banks are as follows:

- a. Collection of Credit Instruments (Bills)
- b. Income Receiving and Payment
- c. Purchase and Sale of Securities
- d. Trustee and Attorney
- e. Remittance of Money
- f. Correspondent Service
- g. Tax Consultant

**v) Credit Creation**

Credit creation is the very important function of the commercial banks. They accept deposits and advance loans. When the bank provides advance loans, customers should open an account to withdraw money. Then they can withdraw as per their needs.

**vi) General Utility Services**

**a) Safety Custody of Valuables**

Banks keep the valuable goods like diamond, jewelries and important documents like securities in its safe deposit vault. These goods can be taken to home in case of need by informing the bank.

**b) Issue Credit Instruments**

Banks issue the letter of credit, traveler's cheque, draft, and master card to customers. The traders can import goods on credit from foreign countries by the help of letter of credit. The credit instruments make it easier to transfer money from one place to other.

**c) Dealing of Foreign Exchange**

Banks exchange the foreign currency of customer. They make available the foreign exchange needed by individuals and traders and charges fee for this service. The commercial banks perform this function with the prior approval of the central bank.

**d) Economic Information and Statistics**

A separate department of research and statistics can be found in every bank. This department makes available the local and foreign information to the businessmen. The bank publishes monthly and annual bulletins given information's about the situation of trade, industry, rate of interest etc.

**e) Work as Referee**

Banks also work as the referee of the customers. The information on economic condition of other persons or institutions may be taken from the bank. But due to the need of maintaining secrecy, such information's can be obtained only on the consent of the concerned party. The bank knows well about the honesty and reliability of the customers. Hence, it is easier to make contract by taking secret information from the bank.

**f) Issue of Guarantee**

Banks issue letter of guarantee promising to pay in case of default of transactions. This facility is widely used in construction and other commercial transactions.

**g) Advisory Services**

Banks have knowledge about the existing economic situation of the country. So, they provide important advice on financial matters to their customers. This facilitates entrepreneurs and businessmen to make profitable investment.

**h) Underwriting Services:**

Banks underwrite the shares bonds issued by their customer firms. Since people have confidence over banks, it is not difficult to sell securities having underwriting of banks. Firms are thus able to operate their business by raising funds from the market.

Financial institutions are the backbone of the Nepalese economy at present. They play vital role in capital formulation, proper utilization of collected fund, providing various type of banking services. Mobilization of saving is most essential for the economic growth of the country. Commercial banks are organizations which normally perform financial transactions. The banks are mobilizing the savings of the people for the investment purposes. The investment portfolio should be carefully analyzed so that the investment should ensure minimum risk and maximum profit.

### **1.1.3 History of banking system**

Banking has come to the present advanced from various stages. Some sorts of banking activities have been carried out since the time immemorial. Traditional forms of banking were traced during the civilization of Greek, Rome and Mesopotamia. (Robest O Edmister Dr., 1980)

Despite strong criticism from the Church regarding charging interest, modern banking sowed its seed in the medieval Italy. Bank of Venice setup in 1157AD in Venice. Bank of Venice is regarded as the first modern bank. Subsequently Bank of Barce Long (1401AD) and Bank of Geneva (1407AD) were established. The Lombards migrated to England and other parts of Europe from Italy are regarded for the development and expansion of the modern banking. Bank of Amster dam setup in 1609AD was very popular. The bank of Hindustan established in 1770 AD and is regarded as the first bank in India. These modern banks gradually replaced goldsmiths and money lenders in Europe. Though, Bank of England was established in 1694. The growth of banks accelerated only after the introduction of banking act – 1883AD in UK as it allowed to open joint stock company banks.( D &D , 2056)

### **1.1.4 Origin and development of the Bank in Nepal**

It is very difficult to trace the correct chorological history of the Banking systems in Nepal because there are no sufficient historical records and data about Banking in Nepal.

As in other countries goldsmiths, landlords, merchants and money lenders were the ancient bankers of Nepal. Banking on modern lines developed in Nepal recently. But this does not mean that there was a complete absence of banking activities. From times immemorial, money lender existed before the establishment of modern bank. There is plenty of evidence to show that loans were borrowed in those days. In 723 AD, Gunakam Dev borrowed to rebuild Kathmandu. Towards the end of the fourteenth century, Jayasthiti Malla ruler of Kantipur (Now Kathmandu) classified the people in 64 classes according to their occupation one of them was “Tanka Dhari”. Their main occupation

was lending of money. Before Jayasthiti Malla, land could not be mortgaged when lending money. Several other king borrowed money to finance wars but there was no regulation of interest rate. ( D&D, 2056).

Tejarath Adda established in 1880 during the tenure of the then Prime Minister Ranoddip Singh was the first step towards the institutional development of banking in Nepal. Some historians say Kausi Tosha Khana established during the time of king Prithvi Narayan Shah(1723-1755) is the first banking institution but very little is known about it. Tejarath Adda did not collect deposits from the public but gave loans to public against the security of gold and silver and to the government employees against the security of their salary. Since the interest rate of Tejarath Adda was just 5%, beneficiaries were very much relieved of exorbitant interest rate being charged by the traditional bankers. Tejarath Adda however had a narrow reach because of just few branches and resources crunch it used to face due to not collecting deposits from the public. Thus, the larger section of deficit units of the society had no choice but to knock the doors of the traditional bankers to cover their deficit and the surplus units who were not traditional bankers had the Hobson's choice of keeping their surplus money in Ghyampos (a large clay jar)exposing themselves to the risk of theft and erosion in the value of money (NRB Bulletin, 2070).

Banking in true sense of term started with the inception of Nepal Bank Limited on 30th Kartik, 1994 BS with 51% of government ownership and 49% of ownership of general public. Due to the absence of the central bank, Nepal Bank has to play the role of central bank, operate the function of central bank and to help the government to formulate monetary policies, Nepal Rastra Bank was setup in 1956 AD (2013 BS). Since then, it has been functioning as the government's bank and has contributed to the growth of financial sector. In 1957 A.D. Industrial Development Bank was established to promote the industrialization in Nepal, which was later converted into Nepal Industrial Development Corporation (NIDC) in 1959 A.D. Rastriya Banijya Bank was established in 1965 A.D. as the second commercial bank of Nepal. The financial shapes for these two commercial banks have a tremendous impact on the economy. As the agriculture is the basic occupation of major Nepalese, the development of this sector plays in the prime

role in the economy. So, separate Agricultural Development Bank was established in 1968 A.D. This is the first institution in agricultural financing.

Despite all these efforts of the government, financial sector was found sluggish. Banking services to the satisfaction of customers was a far cry. Nepal Arab Bank Limited, in 1984 as a first Joint Venture Bank, proved to be a milestone in the history of banking. Nabil Bank gave a new ray of hope to the sluggish financial sector. Having observed the success of Nabil Bank based on marketing concept. NRB adopted liberal economic policy to promote the financial institution. After declaring free economy and privatization policy, the government of Nepal encouraged the foreign banks for joint venture in Nepal. Now, there are also some foreign ventures established in Nepal.

As envisaged by Nepal Rastra Bank Act,2002, monetary policy for each fiscal year has been formulated with the objectives of maintaining price stability, external and financial sector stability, promoting financial access to the general public and facilitating high and sustainable economic growth. A positive sign has been seen in sluggish share market and real estate transactions. Increased deposit mobilization of BFIs has put an end to liquidity crunch in banking system. The declining trend in the banking rates is creating a favorable environment for investment. Despite favorable economic scenario, as mentioned above, the expansion of credit toward productive sector has not been at the desired level.

The NRB has classified the institutions into “A” “B” “C” “D” groups on the basis of the minimum paid-up capital and provide the suitable license to the bank or financial institution. Group ‘A’ is for commercial bank, ‘B’ for the development bank, ‘C’ for the financial institution and ‘D’ for the Micro Finance Development Banks. Today, the banking sector is more liberalized and modernized and systematic managed. There are various types of bank working in modern banking system in Nepal. It includes central, development, commercial, financial, co-operative and Micro Credit (Grameen) banks. Technology is changing day by day and changed technology affects the traditional method of the service of bank.

At the end of 2069/070 there are 31 commercial banks, 86 development banks, 59 financial companies, 31 Micro-Finance institutions and 16 NRB licensed Cooperatives ( With limited banking activities, 36 NRB licensed NGOs ( With limited banking activities), 25 insurance companies, one Employees Provident Fund, one citizen Investment Trust and one Postal Saving Bank. are established so far in Nepal. (Nepal Rastra Bank, 2070). As of mid July 2012, there were altogether 26,501 cooperatives registered as per the prevailing acts, operating in Nepal out of which 11,851 were in the category of saving and credit cooperative. It is believed that significant volume of transaction is being done by the informal sector like various informal saving and credit groups, self help groups, Dhukuties and local money landers etc. (NRB Financial Stability Report, 2012).

Commercial banks in Nepal are playing vital roles to collect money in the state. Nepal has many nationalized and private banking ventures. At present, there are 31 commercial banks in Nepal whose name including date of operation, and head office are given below:

**Table no. 1.1****1 List of Commercial Banks, date of operation and their head offices.**

S.N.	Name of Commercial Bank	Date of Operation B.S.	Head office
1	Nepal Bank Limited	1994/07/30	Dharmapath, Kathmandu
2	Rastriya Banijya Bank Limited	2022/10/10	Singhdarbarplaja, Kathmandu
3	Nabil Bank Limited	2041/03/29	Kantipath, Kathmandu
4	Nepal Investment Bank Limited (previously Nepal Indosuez Bank)	2042/11/26	Darbarmarga, Kathmandu
5	Standard Chartered Bank Limited(previously Nepal Grindlays Bank Limited)	2043/10/16	New Baneshwor Kathmandu
6	Himalayan Bank Limited	2049/10/05	Thamel, Kathmandu
7	Nepal SBI Bank Limited	2050/03/23	Hattisar, Kathmandu
8	Nepal Bangladesh Bank Limited	2051/02/23	New Baneshwor, Kathmandu
9	Everest Bank Limited	2051/07/01	Lagimpat, Kathmandu
10	Bank of Kathmandu Limited	2051/11/28	Kamaladi, Kathmandu
11	Nepal Credit and Commerce Bank Limited (Previously Nepal Bank of Ceylon Limited)	2053/06/28	Bhairawa, Rupandehi
12	Lumbini Bank Limited	2055/04/01	Narayangad, Chitawan
13	NIC Asia Bank Limited	2055/04/05	Thapathali, Kathmandu
14	Machhapuchre Bank Limited	2057/06/17	Phokara, Kaski
15	Kumari Bank Limited	2057/12/21	Darbarmarga, Kathmandu
16	Laxmi Bank Limited	2058/12/21	Birjung, Parsa
17	Siddharth Bank Limited	2069/09/09	Kamaladi, Kathmandu

18	Agriculture Development Bank Ltd	2024/10/07	Ramshahapath, Kathmandu
19	Global Bank Limited	2063/09/18	Birjung, Parsa
20	Citizens Bank International Limited	2064/01/07	Kamaladi, Kathmandu
21	Prime Commercial Bank Limited	2064/06/07	Nayasadak, Kathmandu
22	Sunrise bank limited	2064/06/25	Gairidhara, Kathmandu
23	Grand Bank Nepal limited	2065/02/12	Kamaladi, Kathmandu
24	NMB Bank Limited	2065/02/20	Babarmahal, Kathmandu
25	Kist Bank Limited	2066/01/24	Anamnagar, Kathmandu
26	Janata Bank limited	2066/01/24	NewBaneshwor, Kathmandu
27	Mega Bank Limited	2067/04/07	Kantipath, Kathmandu
28	Commerz and Trust bank limited	2067/06/04	Kamaladi, Kathmandu
29	Civil Bank limited	2067/08/10	Kamaladi, Kathmandu
30	Century commercial bank limited	2067/11/26	Putalisadak, Kathmandu
31	Sanima Bank limited	2068/11/03	Nagapokahari, Kathmandu

Source : Nepal Rastra Bank , 2013

According to policy of NRB to promote merger and acquisition among BFIs, three finance companies have been merged into two commercial banks in FY 2011/12. With the merger of seven development banks and five finance companies with each other, six development banks were formed. As some other banks and financial institutions (BFIs) are also in the merger process, this activity is expected to accelerate in current fiscal year.

Banking software, ATM, E-banking, Mobile Banking, Debit Card, Credit Card, Prepaid Card etc. services are available in banking system in Nepal. It helps both customer and banks to operate and conduct activities more efficiently and effectively.

These commercial banks and financial institutions have played significant roles in creating banking habit among the people, widening area and business communities and the government in various ways.

Nepalese banking system has now a wide geographic reach and institutional diversification. Although, Nepalese financial sector is dynamic, a lot of scope for development of this sector exists. This is because the banking and non-banking sectors have not been able to capture all the potentialities of business till this time. It is evident from the Rural Credit Survey Report that the majority of rural credit is supplied by the unorganized sector at a very high cost – perhaps being at two or three time of the formal sector - suggesting that the financial sector is still in the path of gradual development. Overdue loans and inefficiency of the older and the larger of commercial banks have aggravated and have been made to compete with the new trim banks with no rural operations. Also, the commercial banks, domestic or joint venture have shown little innovation and positive attitude in identifying new areas of saving and investment opportunities.

Banking system of Nepal has undergone significant change since liberalization of the financial sector in mid eighties. It has improved in quantitative as well as qualitative terms. Though banking system in Nepal is not so multifaceted when compared to that of developed countries, it has definitely grown to become more complex in recent years. Supervisory strength at present is capable of meeting the existing challenges however, preparation for effective and efficient supervision even in the complex market situation, which is inevitable in future is necessary.

Commercial banks are the heart of our financial system. They hold the deposits of millions of persons, governments, and business units. They make funds available through their lending and investing activities to borrowers---- individuals, business firms, and governments.

The commercial bank is a great institution that conducts the payment mechanism of a country. The individuals and institutions make payments to each other through the mechanism of commercial bank. The commercial bank plays a leading role in the smooth operation of an economy. It makes available all financial services to individuals and institutions. It plays vital role in capital formulation and proper utilization of collected fund, providing services in domestic and international trade. Without these the operation of economy can't be succeeded. The commercial banks consequently have a specific role to play in the long process to profitable, secured, stable and marketable sector. Investment policy provides the bank several inputs through which they can handle their investment operation efficiently ensuring that maximum return with minimum risk which ultimately leads the bank to the path of success. Thus, investment is the most important function of commercial banks. The success of a commercial bank heavily depends upon the proper management of investment. So, a bank has to be very caution while investing their funds in various sectors.

A commercial bank must always mobilize its funds and other deposits to profitable secured and marketable sector so that it earns a handsome amount of profit as well as it should be secured and can be converted into cash as per the requirement. A commercial bank can maximize its volume of wealth through maximization of return on their investments and lending. So, they should invest their funds in those sectors from where they can gain maximum profit. The profit of CBs mainly depends on the interest rate, volume, period of loan and nature of investment in different securities. A bank should not lay all its eggs on the same basket i.e. to minimize risk; a bank must diversify its investment on different sectors. The loan provided by commercial bank is guided by several principles such as length of time, their purpose, profitability, safety etc. These fundamental principles of commercial banks investment are fully considered while making investment portfolio. The investment portfolio should be carefully analyzed so that the investment should ensure minimum risk and maximum profit. So, CBs should incorporate several elements such as regulatory environment, the availability of funds,

the selection of risk, investment portfolio balance term structure of the liabilities etc. while making investment decision.

One of the acceptable methods of reducing risk in the investment portfolio of a commercial bank is by diversification, a basic and important rule of any investment policy. Diversification means holding an assortment of securities rather than a very few. The diversification policy should consider industry, maturity, geography, type of security, and management. Risks may not be completely avoided by diversification, but they can be reduced.

### **1.1.5 Regulation of NRB**

It is always in need of regulating body so that the financial institutions are lead in the proper track. Without the regulating body, these financial institutions will track themselves according to their motives. These motives may lead themselves to the profit but without the welfare of the country and its economy. So, NRB issues directives from time to time. The directives issued by NRB to the commercial Banks in short are related with the points given below:

1. The provision of minimum capital fund to be maintained by the commercial bank.
2. The provision of loan classifications and loan loss provisioning on the credit.
3. The provision relating to limit on credit exposure and facilities to a single borrower, group of related borrowers and single sector of the economy.
4. The provision relating to accounting policy and the structure of financial statements to be followed by the commercial banks.
5. Regulation relating to minimization of risk inherent in the activities of commercial banks.
6. The provision of institutional good governance to be followed by commercial banks.
7. Time frame for implementation of regulatory directives issued in connection with inspection and supervision and supervision of commercial banks.

8. Regulation relating to investment in shares and securities by commercial banks.
9. The provision of submission of statistical data to the NRB. Banking management division and inspection and supervision division.
10. Regulation relating to sale and ownership transfer of promoters shares.
11. Regulation relating to, stringent blacklisting procedure for loan defaulters.
12. The provision relating to compulsory deposited amount of NRB.
13. Regulation relating to developing the branch office of commercial banks.
14. Provision relating to interest rates.
15. Provision relating to collection of financial sources.
16. Provision relating to consortium financing.

## **1.2 Focus of the Study**

The present study focuses on the capital structure of the selected commercial banks of Nepal. Special attention has been made to examine the capital availability in the respective banks in comparison with the benchmarks set out by the central bank (Nepal Rastra Bank). Further, an attempt has also been made to examine the loan loss provision practiced in these commercial banks vis-à-vis stability requirements as directed by NRB. To simplify the study, sampling method has been taken out of 31 commercial banks, only two commercial banks has been selected, namely, Global IME Bank Limited and Everest Bank Ltd.

## **1.3 Profile of Selected Banks**

### **a) Introduction of the Global IME Bank Limited**

Global IME Bank Ltd. emerged after successful merger of Global Bank Ltd (an “A” class commercial bank), IME Financial Institution (a “C” class finance company) and Lord Buddha Finance Ltd. (a “C” class finance company) in year 2012. Two more Development Banks (Social Development Bank and Gulmi Bikas Bank) merged with Global IME Bank Ltd in year 2013. Global bank was established in 2007 as an 'a' class commercial bank in Nepal which provides entire commercial banking services and

renamed as Global IME Bank Limited after the merger. The head office of the bank was established in Birgunj, the commercial hub of the nation.

For the day to day operations, the bank has been using the world renowned FINACLE software that provides real time access to customer database across all branches and corporate locations of the bank. This state of the art customer database has also been linked to a Management Information System that provides easy reach to all possible database information for balanced and informed decision making. A disaster recovery system (DRS) of the Bank has also been established in the Western Region of Nepal (200 kms west of Kathmandu).

The bank has been able to achieve excellent diversification of its assets. A well balanced distribution of exposure in areas of national interest has been possible through long term forecasting and timely strategic planning. The bank has diversified interests in hydro power, manufacturing, textiles, services industry, aviation, exports, trading and microfinance projects, just to mention a few.

The exemplary performance of the bank in these last five years has elevated it to a premier status in the industry. The bank has been handling government transactions and is officially among the only 5 banks in Nepal to do so. The bank has been able to earn the trust and confidence of the public, which is reflected in the large and ever expanding customer base of the bank. Through all this the bank has been able to truly achieve its vision of being “The Bank for All”. Even with all this success, the bank remains internally focused towards manpower development, product innovation and process innovation etc, to have a strong and solid foundation, which are ongoing and continuous improvement initiatives undertaken by the management and staff alike.

## Promoters

GBL has been promoted by a group of prominent indigenous entrepreneurs who have written a history of success in their field of ever growing business. The promoters of the bank include renowned, well established and respected businessmen/industrialists in Nepal from a variety of different sectors that include finance, remittance, trading, export, automotive services, manufacturing, media services and hydropower to name a few. The collective experience of the promoters have been realized to customize the bank's offerings and services to compete with best in the banking industry and instill a culture based on our core values of integrity, business ethics, teamwork, respect, humility, professionalism, loyalty and good governance.

## Shareholders Structure

Authorized Capital of Global IME Bank is NPR 3,000 million and Paid up Capital is NPR 2,253 million. The promoters hold 69% while 31% is floated for the public. Current shareholder structure of the bank remains as below:

	<u>Percentage of Ownership</u>	<u>Capital Invested</u>
➤ Institutional Shareholders	42	NPR 949 million
➤ Individual Promoters	27	NPR 607 million
➤ Public Shareholders	31	NPR 700 million
	Total	NPR 2,253 million

([www.globalimebank.com](http://www.globalimebank.com))

## **b) Introduction of the Everest Bank Limited**

Everest Bank Ltd is established in 1994 with a vision to position it as a progressive & customer friendly bank providing financial and other related services and to cater to various segments of society using advanced technology. Catering to more than 5.5 lacs customers,, the Bank has been one of the leading banks of the country and has been catering its services to various segments of the society. With clients from all walks of life, the Bank has helped develop the nation corporately, agriculturally & industrially.

Punjab National Bank (PNB), its joint venture partner (holding 20% equity) is the largest nationalized bank in India having presence virtually in all important centers. Owing to its performance during the year 2012-13, the Bank earned many laurels & accolades in recognition to its service & overall performance. Recently, PNB was awarded with "IDRBT Banking Technology Excellence Award" under Customer Management & Intelligence Initiatives. The Bank also bagged "Golden Peacock Business Excellence Award 2013" by Institute of Directors. Similarly, the Bank was recognized as 'Best Public Sector Bank' by CNBC TV 18. The bank has now more than 6,000 branches and 7000 ATMs spread all across the India. As a joint-venture partner, PNB has been providing top management support to EBL under Technical Service Agreement.

Everest Bank Limited (EBL) provides customer-friendly services through its wide Network connected through ABBS system, which enables customers for operational transactions from any branches. The bank has 50 Branches, 71 ATM Counters, 5 extension counter & 20 Revenue Collection across the country making it a very efficient and accessible bank for its customers, anytime, anywhere.

Everest Bank Limited (EBL) has mission to provide excellent professional services & improve its position as a leader in the field of financial related services, to build & maintain a team of motivated and committed workforce with high work ethos and to use the latest technology aimed at customer satisfaction & act as an effective catalyst for socio-economic developments

EBL is playing a pivotal role in facilitating remittances to & from India. It is the first Nepalese bank to open a Representative Office in Delhi, India. This office is helping Nepalese Citizens to open a bank account in their home place without having the botheration of visiting Nepal for the purpose. The Nepalese in India can also remit their money in most economical & safe manner through banking channel to Nepal. They can deposit their money in any of Punjab National Bank's branches all over India for remittance to Nepal. The Bank is also offering Cash Management System through HDFC Bank India for managing the funds of corporate exporting to India by collecting their fund from about 183 locations in India.

Everest Bank Limited (EBL) has been conferred with the "Best Managed Commercial Bank" by ASIAN PAINT NEWBIZ Award 2013. The bank adjudged as "Number 1 Bank" under CAMELS (along with Customer Base & Branch Network) rating conducted by KAROBAR national daily (a leading business media house of Nepal). The bank was conferred with "Bank of the Year 2006, Nepal" by the Banker, a publication of financial times, London. The bank was bestowed with the "NICCI Excellence Award" by Nepal India chamber of commerce for its spectacular performance under finance sector

EBL was one of the first banks to introduce Any Branch Banking System (ABBS) in Nepal. EBL introduced Mobile Vehicle Banking system to serve the segment deprived of proper banking facilities through its Birtamod Branch, which was the first of its kind. EBL introduced branchless banking system first time in Nepal to cover unbanked sector of Nepalese society through biometric machine. EBL is first bank that has launched e-ticketing system in Nepal where customers can buy yeti airlines ticket through internet. EBL introduced online payment of Mobile/PSTN/ADSL/NCELL bill or from the counter as well. EBL is the first bank to introduce agro-specialized branch "KRISHI UDHYAM BIKASH SAKHA" at Rajbiraj EBL introduced Cash Deposit Kiosk for the first time in Nepal through which the Customers can deposit Cash conveniently.

The Nepalese citizens can have the benefit of following banking facilities in India from Everest Bank Limited:

- Account Opening from India in EBL Branches
- Remitting Their Money to Nepal
- Role of liaison for any banking problems
- Provide necessary information and assistance
- Holding Seminars, participating in Nepalese Functions for Marketing of various facilities offered.

Any Nepalese Citizen can open a bank account at his / her native place without having botheration of visiting Nepal for the purpose. At present we have started the facility of account opening from the representative office and through designated Punjab National Bank branches.

EBL Representative Office provide necessary guidance and support to prospective businessman/industrialist willing to set up their establishment in Nepal on the following aspects:

- Rules/regulations for setting up business in Nepal
- Taxation benefits.
- Financial support subject to fulfillment of laid down criteria of lending institutions.
- Credit information.
- Fund Transfers

EBL Representative Office arranges marketing camping/ seminars at different places in India where there are concentration of Nepalese population. The camping is also arranged on the request of Nepalese organizations in India. The camp helps in opening accounts, solving people queries and problems in remitting funds, and educating Nepalese for using banking services. ([www.everestbankltd.com](http://www.everestbankltd.com))

#### **1.4 Statement of the problem**

Commercial banks and financial institutions are the backbone of the Nepalese economy at present. Capital Adequacy requirement is a must for effective running of bank capital adequacy play a catalytic role in protection of bank from getting failure and as well as it also helps generate sufficient confidence among depositors and creditors .Thus purpose of capital adequacy ratio is to protect the interest of depositors and creditors by making bank keep more risk- free assets and by increasing their capital base.

In 21st century, the increasing trend of banking sector in the country, there is a mushrooming growth of commercial banks in private sector as well as in joint venture. A large number of banking, serving in the small sector will obviously increase the top competition for survival which might leads to keen rivalry among them to occupy the bigger part. So there may offering of uneconomic rate of interest, including in risky enterprises, unhealthy competition etc. such situations may endanger the deposits of general public. In order to safeguard the public deposits and ensure the economic stability in the country, NRB issues directives from time to time to commercial banks. The directives are related to various performances of the banks and the banks are required to follow the directives. There are sixteen (16) directives related to the banking supervision and regulations.

In the beginning, due to lack of proper regulations Nepalese Commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problems of bad debts, over due loans, accrued interest, accumulations of non-banking assets and excess liquidity in the banking system. Viewing the need of structural reform amidst these adverse implications, NRB has issued suitable directives to run commercial banks in a healthy competitive manner to ensure the sustainable developments of the over all banking system. As the banking sector is highly affected by various negative factors of the economy, this sector is facing numerous problems as stated above. Among them the following problems are especially focused for this research purpose.

1. Do the Bank are maintaining the minimum core capital, supplementary capital and capital adequacy ratio set by the NRB?
2. What are the major problem faced by the bank in maintaining capital adequacy in selected commercial banks?
3. Do they keep the loan loss provision as directive by the NRB?
4. To what extend does the bank possess credit risk?

### **1.5 Objectives of the Study**

NRB has under taken various activities for the banking and financial development since its establishment. NRB has issued various directives for commercial banks and other financial institutions for regulation, supervision and monitoring. The overall objective of the study is to review directives of the NRB related to commercial banks. But special attention is given to capital adequacy and loan loss provision of commercial banks. The specific objectives of this study are given below.

1. To study the significance and impact of NRB capital adequacy norms on selected commercial banks.
2. To analyze and assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB.
3. To study the loan loss provision of selected commercial banks and compare their provision with the concerned directive of NRB.
4. To study and review the practices and effectiveness of capital adequacy in selected commercial banks.
5. To evaluate different financial indicators and suggest suitable model of capital adequacy for the strength of banks in Nepal.

## **1.6 Significance of the Study**

NRB is the main figure of this research study. NRB directives being only the tools of NRB to supervise monitor and control the financial institution, it obviously play important role in the development of commercial banks of Nepal. It issues directives to the commercial banks from time to time in order to maintain stability in the financial market. The directives are issued on the basis of monetary policies and the success of the country depends on the directives of the central bank and its central role.

1. This research will help commercial banks to reassess their strategies and policies to cope with the development created by the recent changes made in the directives by NRB.
2. It helps NRB to find out condition of the compliance of directives, their shortcoming and take necessary actions.
3. This study will beneficial to the person who is directly or indirectly related with these banks.
4. This study will be significant to the existing investor and the potential investor who keep interest with these banks.
5. This study will also be beneficial to the depositors of these banks to know the capital adequacy of these banks.

Finally, this study shows the position of capital adequacy and loan loss provision in selected banks in different time periods. It is expected that the finding of this study will exert a significance impetus to make decision of maintaining adequate capital and loan loss provision at minimize business risks.

## **1.7 Limitation of the Study**

This assignment is for the partial fulfillment of M.B.S. The effort has been made to present and analyze the fact clearly, truly and within the boundary. But reliability of tools, lack of research experiences and some other limitation can be enlisted as follows:-

1. The study concerns with the directives issued by NRB. There are 16 directives issued by the NRB. It is almost impossible to take in account all the directives issued and make the study on them. So, only two directives are taken into account for the study.
2. To find out the compliance of the directives issued, the study doesn't focus on all the financial institutions. The study is only made for the commercial banks and sampling technique is used to choose two banks out of Thirty one commercial banks and comparative study is made.
3. The study related only five years data, i.e, from the fiscal year 2007/8 to 2011/12.
4. The accuracy of the secondary data depends upon the reliability of annual reports & primary data depends upon the responses of respondents.
5. The Primary data are collected during the period of November 2013 to December 2013 so the, any changes in the general view, concepts and behavior of the people before and after the period are not included in the study.
6. The secondary data are used to analyze and interpretation made for result. So the accuracy of the finding depends on the reliability of available information.

## **1.8 Organization of the Study**

The study has been organized in to five chapters each devoted to some aspects of the study of the NRB directives. The chapters one to five consist of introduction, review of literature, research methodology, presentation and analysis of the data and summary, conclusions and recommendation. To follow the simple research methodology, it is rational behind this kind of organization of the study as:

### **CHAPTER -I: INTRODUCTION**

It deals with introduction of the main topic of the study like background, statement of the problems, objectives of the study and organization of the study and other introductory framework.

## CHAPTER -II: REVIEW OF LITERATURE

It includes with the review of available relevant studies. It will includes the conceptual review of the related books, journals, and the published and unpublished research works as well as thesis. It has also included review of NRB directives issued for commercial banks.

## CHAPTER -III: RESEARCH METHODOLOGY

It describes research methodology employed in this study i.e. research carried out in this size and shape. For the purpose various financial and statistical tools and techniques are defined which is used for the analysis of the presented data.

## CHAPTER -IV: DATA PRESENTATION AND ANALYSIS

This chapter is the major part of the whole study in which all collected relevant data are analyzed and interpreted by the help of different financial & statistical tools. In this chapter we will explain the major findings of the study.

## CHAPTER -V: SUMMARY, CONCLUSION AND RECOMMENDATIONS

In this chapter, the summary of the entire thesis has been comprised. This chapter further describes the major findings of the thesis. Conclusions of the study have also been included in this chapter. As well as, possible and viable recommendations has also been presented in this chapter.

Besides these, bibliography and annexure will be presented at end of the thesis. Similarly acknowledgements, table of contents, list of tables, list of figures, abbreviations are included in the front part of the thesis report.

## **CHAPTER-II**

### **Review of Literature**

Review of literature means reviewing research studies or other relevant propositions in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. For this study, different journals, articles, books, annual reports and some research paper related with this study has been reviewed. Review of literature consist two parts where first part deal with the advancement of knowledge regarding portfolio investment and portfolio management. In second part, researcher presents comment and resolution on the study initially made in concern component related to the study.

- i.** Conceptual Framework
- ii.** Review of Related Studies

Firstly, it has reviewed literature for conceptual framework which help to develop concept about NRB directives (focusing on capital adequacy and loan loss provision), and terms related with it. Then important finance journals, previous master's degree level thesis, articles and newspapers related to the research topics were reviewed on the second part. It helps the researcher not only to find out the research gap but also helps to precede this study in a systematic manner.

#### **2.1 Conceptual Framework**

##### **2.1.1 NRB Directives**

Guidelines issued by NRB to banks and financial institution for regulation, supervision and monitoring is termed as NRB directives. NRB is authorized bank to regulate, control and develop the banking system; it gives permission for the setting up of new commercial bank and financial institutions and lastly, serves as a lender of last resort to commercial banks and financial institutions. The NRB's mandate incorporates the supervision, regulation and monitoring of all commercial banks, development banks, and finance

companies as well as licensed NGOs and the co-operative engaged in micro finance. As NRB has the effective functioning of banks and financial institutions; it should issue guidelines for them, which are called directives. The main aim of issuing directives is to ensure the stability and healthy development of banking and financial system and towards enhancing the public creditability toward it.

### **2.1.2 Review of NRB Directives**

The world was witnessed many financial crises and devastating consequences due to huge financial and economic losses that resulted from each episode. Every crisis was sudden in onset and their, magnitude of losses was much larger than expected. If we go back to the history, then on 3<sup>rd</sup> march 1997; the Asian crisis began in the form of liquidity problem of two finance companies. Later this spread over to other financial intuition within the Thai financial system. Simultaneously, crisis began to cover Malaysian, Indonesian and South Korean financial statement and loomed in the form of Asian crisis. So this Asian crisis appealed the whole world for regular and timely supervision and assessment of financial system, its soundness and vulnerabilities. This event forced the regulatory authorities for the enforcement of prudential measures in order to avoid further crisis review and revision in prudential regulations such as capital adequacy ratio, asset classification. Provisioning for impaired assets, exposures limit and enforcement of international accounting standard etc have now become common issue all over the world since the late 1990s.

Similarly, in our country too commercial banks could not recognize the importance of the quality credit and banking sector failed to witness the expected developments. Subsequently, the banking sector faced the problem of bad debts, overdue loans, accrued interest, accumulation of non-banking assets and excess liquidity in the banking system. In addition to these expected happenings new challenger were added to the Nepalese banking sector due to the adverse development in the domestic economy resulting from deteriorating peace and security situation and continuous persistence of natural calamities inside the country on one hand and the global recession primarily caused by international terrorism on the other. Viewing the need of structural reform amidst these adverse

implications, NRB issued directives to run commercial banks in a healthy competitive manner to ensure the sustainable development of the overall banking system.

The financial sector reform of Nepal was initiated in mid 1980s. Since then NRB has been playing pioneer role in regulation, supervision and monitoring of commercial banks by issuing directives. At present the number of guidelines issued by NRB to commercial bank reaches sixteen, which are as follows:

### **2.1.3 Concept & Background of Basel Framework**

#### **Basel Capital Accord**

Basel Capital accord is a capital adequacy framework developed by the Base committee. In 1988, the Basel Committee decided to introduce a capital measurement system commonly referred to as the Basel Capital Accord. This system provided for the implementation of a credit risk measurement framework with a minimum capital requirement of 8% on banks Risk Weighted Assets (RWA). The 1988 framework is also known as "Basel – I". Since 1988, this framework has been progressively introduced not only in member countries but also virtually in all other countries.

#### **Basel - II**

The “international convergence on capital measurement and capital standard -2004” is popularly known as Basel-II. It is a capital adequacy related standard framed by Basel committee. After the successful implementation of 1988 accord in more than 100 countries, the Basel Committee on Banking Supervision reached an agreement on a number of important issues for promoting best and uniform banking practices as well as setting standards and guidelines for supervisory function. Following extensive interaction with banks, industry groups and supervisory authorities that are not members of the Committee, the revised framework was issued on 26 June 2004, which is being regularly revised and updated. The Basel-II aims to replace Basel I and to make the capital framework more risk sensitive. Basel II has recommended major revision on the

international standard on bank's capital adequacy, which requires banks to implement risk management policies that closely align banks capital with its economic capital. The Basel II has been introduced basically for the protection of depositor's interest by preserving the integrity of capital in Banks.

### **Basel Committee**

The Basel committee on Banking Supervision (BCBS) is popularly referred as Basel Committee. It was established by the central bank Governors of the Group of Ten countries (G-10) at the end of 1974 and meets regularly four times a year. It has about twenty-five technical working groups and task forces, which also meet regularly. Now the Committee's members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. Countries are represented by their central bank and also by the authority with formal responsibility for the supervision of banking business where this is not the central bank. The Basel Committee provides a forum for regular cooperation on banking supervisory matters. Over recent years, it has developed increasingly into a standard setting body on all aspects of banking supervision, including the Basel II regulatory capital framework.

The Committee encourages contacts and cooperation between its members and other banking supervisory authorities. It circulates to supervisors throughout the world both published and unpublished papers providing guidance on banking supervisory matters. The Committee does not possess any formal supranational supervisory authority, and its conclusions do not, and were never intended to, have legal force. Rather, it formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements - statutory or otherwise - which are best suited to their own national systems. In this way, the Committee encourages convergence towards common

approaches and common standards without attempting detailed harmonization of member countries' supervisory techniques.

### **Basel-II Mandatory**

Basel-II has been designed to provide options for banks and banking systems worldwide, the Basel Committee acknowledges that moving towards its adoption in the near future may not be the first priority for all central banks in all non-G10 countries in terms of what is needed to strengthen their supervision. Basel II aims to build on a solid foundation of prudent capital regulation, supervision, and market discipline, and to enhance further risk management and financial stability. As such, the Committee encourages each national supervisor to consider carefully the benefits of the new Framework in the context of its own domestic banking system and in developing a timetable and approach to implementation. Given resource and other constraints, these plans may extend beyond the Committee's implementation dates. That said, supervisors should consider implementing key elements of the supervisory review and market discipline components of the new Framework even if the Basel II minimum capital requirements are not fully implemented by the implementation date. It is said that the national supervisors should also ensure that banks that do not implement Basel II are subject to prudent capital regulation and sound accounting and provisioning policies.

### **Approaches of Basel II**

A major innovation of the Basel II is the introduction of distinct options for the calculation of key types of banking risk. For credit, operational and market risk, there are different approaches of increasing risk sensitivity to allow banks and supervisors to select the approach or approaches that they believe are most appropriate to the stage of development of banks' operations and of the financial market infrastructure. The following table identifies primary approaches available by risk type.

S.N	Credit Risk	Operational Risk	Market Risk
1	Standardized Approach	Basic Indicator Approach	Standardized Approach
2	Foundation IRB Approach	Standardized Approach	Internal Model Approach
3	Advanced IRB Approach	Advanced Measurement Approaches (AMA)	

### **Characteristics of Basel-II**

Basel-II captures the risk through its three pillar minimum capital requirement, Supervisory review process and market discipline. It addresses not only the credit & market risk but also the operational risk. The risk is computed based on the actual risk profile of the counterpart. It is not ad hoc or general. Hence the capital is truly risk based.

### **New Capital Adequacy Framework (NCAF)**

Nepal Rastra Bank has developed and enforced capital adequacy requirement based on international practices with appropriate level of customization based on domestic state of market developments. The existing regulatory capital is based on the Basel committee's 1988 recommendations. The NCAF outlines the Nepal Rastra Bank's guidelines for domestic commercial banks, which is based on the simplest approaches of Basel II framework. Only "A" Class financial institutions, licensed by Nepal Rastra Bank under the Bank and Financial Institution Act-2063 are subject to this new capital adequacy framework.

### 2.1.4 NRB Directives Related to Capital Adequacy

The sum of core capital and supplementary capital is called total capital fund. Capital adequacy ratio is calculated on the basis of core capital, supplementary capital and risk weighted assets.

Capital adequacy as a legal requirement that a financial institution should have enough capital to meet all its obligations and fund the services it offers. The provision of minimum capital fund to be maintained by the commercial banks as per directed by NRB since fiscal year 2064/065 is as follows:

**Table 2.1**  
**Capital fund to be maintained by Commercial Banks**

Time Period	Capital fund in % on the basis of Total risk weighted assets	
	Core capital	Total capital fund
2064/065	6	12
2066/067 to till date	6	10

*(Source: Unified directives 2064/065)*

### 2.1.5 Significance of Capital Adequacy

Capitals adequacy requirement is a must for effective running of bank capitals adequacy play a catalytic role in protection of bank from getting failure and as well as it also helps generate sufficient confidence among depositors and creditors. Thus purpose of capital adequacy ratio is to protect the interest of depositors and creditors by making bank keep more risk –free assets and by increasing their capital base. Adequate capital keeps the bank healthy and robust against all the contingencies and enhances the image of the bank in the financial market. Higher the capital adequacy ratio the more sound the bank is.

Regarding the capital adequacy ratio, there is always been conflict between management and regulatory authorities. Regulatory authorities always focus in increasing capital adequacy ratio in order to stabilize the financial system while management wishes to

reduce the ratio so as to increase shareholders rate of return on investment. Thus, capital management has been most important and most controversial issues in the financial institutions.

## **2.1.6 NRB Directives Related to Loan Classification and Loan Loss Provision**

### **1. Classifications of Loan and Advances**

Effective from FY 2058/59 (2001/02) banks shall classify outstanding principal amount of loan and advances on the basis of aging. As per the directives issued by NRB, all loans and advances shall be classified into the following four categories:

#### **a) Pass Loan**

Loans and advances whose principal amount are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing loans.

#### **b) Sub-Standard Loan**

All loans and advances that are past due for a period of 3 months to 6 months shall be included in this category.

#### **c) Doubtful Loan**

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

#### **d) Loss**

All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

### **2. Loan Loss Provisioning**

The loan loss provisioning, on the basis of the outstanding loans and advances and bills purchases classified as per this directives, shall be provided as follows:

<b><u>Classification of Loan</u></b>	<b><u>Loan Loss Provision</u></b>
Pass loan	1%
Sub-standard loan	25%
Doubtful loan	50%
Loss	100%

### **2.1.7 Definition of Capital**

The capital fund is divided in to two parts i.e. core capital and supplementary capital. Core capital and supplementary capital is also known as Tier-1 capital and Tier-2 capital respectively.

#### **I. Core Capital (Tier-1 Capital)**

The key element of capital on which the main emphasis should be placed is the Tier 1 (core) capital, which comprises of equity capital and disclosed reserves. This key element of capital is the basis on which most market judgments of capital adequacy are made; and it has a crucial bearing on profit margins and a bank's ability to compete. The BCBS has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way, which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings. In order to rank as Tier 1, capital must be fully paid up, have no fixed servicing or dividend costs attached to it and be freely available to absorb losses ahead of general creditors. Capital also needs to have a very high degree of permanence if it is to be treated as Tier 1. core capital includes the following components:

- Paid up Equity Capital.
- Irredeemable non-cumulative preference shares which are fully paid-up and with the capacity to absorb unexpected losses. These instruments should not contain any clauses whatsoever, which permit redemption by the holder or issuer upon

fulfillment of certain condition. Banks should obtain prior approval of NRB for this kind of instruments to qualify as a component of core capital.

- Share Premium
- Proposed Bonus Equity Share
- Statutory General Reserve.
- Retained Earnings available for distribution to shareholders.
- Un-audited current year cumulative profit, after all provisions including staff bonus and taxes. Where such provisions are not made, this amount shall not qualify as Tier 1 capital.
- Capital Redemption Reserves created in lieu of redeemable instruments.
- Capital Adjustment reserves created in respect of increasing the capital base of the bank.
- Dividend Equalization Reserves.
- Any other type of reserves notified by NRB from time to time for inclusion in Tier 1 capital.

### **DEDUCTIONS FROM CORE (TIER 1) CAPITAL**

Banks shall be required to deduct the following from the Tier 1 capital for capital adequacy purposes. The claims that have been deducted from core capital shall be exempt from risk weights for the measurement of credit risk.

a. Book value of goodwill.

b. Miscellaneous expenditure to the extent not written off. e.g.VRS expense, preliminary expense, share issue expense, deferred revenue expenditure, etc. However, software expenditure or software development expenditure, research and development expenditure, patents, copyrights, trademarks and lease hold developments booked as deferred revenue expenditure are subject to 100% risk weight and may not be deducted from Tier 1 capital.

- c. Investment in equity of financial institutions licensed by Nepal Rastra Bank.
- d. All Investments in equity of institutions with financial interest.
- e. Investments in equity of institutions in excess of the prescribed limits.
- f. Investments arising out of underwriting commitments that have not been disposed within a year from the date of commitment.
- g. Reciprocal crossholdings of bank capital artificially designed to inflate the capital position of the bank.
- h. Any other items as stipulated by Nepal Rastra Bank, from time to time.

## **II. Supplementary Capital (Tier-2 Capital)**

Tier-2- Capital/ supplementary is capital which is generally absorbs losses only in the event of a winding up of a bank, and so provides a lower level of protection for depositors and other creditors. It comes into play is absorbing losses after tier one capital has been lost by the bank. An example of tier-two capital is subordinated debt. This is debt which ranks is priority behind all creditors except shareholders. In the events of a winding-up, subordinated debt holders will only be repaid if all other creditors (including depositors) have already been repaid. According to NRB directives, Tier-2 Capital/ Supplementary capital includes the following components:

- Loan loss provision for pass loan, total excess amount of provision over the NRB requirements for substandard, doubtful and loss category of loans and loan loss provision made for restructured or rescheduled loans.
- Assets revaluation reserve
- Hybrid capital instruments
- Unsecured subordinated term debt
- Exchange equalization reserve
- Provision for possible loss in investment and investment adjustment fund.
- Investment adjustment reserves

- Revaluation reserve
- General loan loss provision limited to maximum of 12% of total risk weighted exposures
- Subordinate term debt fully paid up with a maturity of more than 5 years
- Cumulative preference shares with maturity of 5 years and above
- Any other type of reserve notified by NRB from time to time for inclusive in Tier II capital.

### 2.1.8 Total Risk Weighted Assets

The risk weighted assets has been classified in following two components:

#### I.On- Balance Sheet Risk-Weighted Assets

On-balance sheet assets of banks are group into three categories with assignment of separate risk-weighted. The assets categories and their corresponding risk-weights are given in the following table. To determine the risk weighted on-balance sheet assets, the national value of the various balance sheet assets are multiplied by their respective risk weights and then added together.

**Table No -2.2**  
**Risk-Weighted on-Balance Sheet Assets**

On Balance Sheet Assets	Risk Weighted %
<input type="checkbox"/> Cash balance	0%
<input type="checkbox"/> Gold (Tradable)	0%
<input type="checkbox"/> Balance at NRB	0%
<input type="checkbox"/> Investment on Government bonds/ securities	0%
<input type="checkbox"/> Investment on NRB bonds/ securities	0%
<input type="checkbox"/> Fully secured loan against own FDR	0%

<input type="checkbox"/> Fully Secured Loan against Government Securities	0%
<input type="checkbox"/> Accrued Interest for government bond	0%
<input type="checkbox"/> Amount deposited by classes “B” and “C” licensed institutions in the youth and small entrepreneurs self- employment fund under the deprived sector lending	0%
<input type="checkbox"/> Balance at domestic banks & financial institutions	20%
<input type="checkbox"/> Fully secured loan against other banks FDR	20%
<input type="checkbox"/> Inter – Bank lending	20%
<input type="checkbox"/> Balance with foreign banks	20%
<input type="checkbox"/> Money at Call	20%
<input type="checkbox"/> Loan against the Guarantee of Internationally Rated Banks	20%
<input type="checkbox"/> Other Investments with Internationally Rated Banks	20%
<input type="checkbox"/> Investment on share, debentures and bond	100%
<input type="checkbox"/> Other Investment	100%
<input type="checkbox"/> Loan, Advances and Bills Purchased/Discounted	100%
<input type="checkbox"/> Fixed assets	100%
<input type="checkbox"/> Other Net interest amount to be received	100%
<input type="checkbox"/> All Other Assets	100%
<input type="checkbox"/> Real estate / residential housing loans exceeding the limits	150%

*(Source: Unified Directives 2069)*

## **II. Off- Balance Sheet Risk-Weighted Assets**

Off balance sheets items of a bank the items are grouped in to four categories and accordingly risk weight of 10%, 20%, 50% and 100% have been assigned .The risk weight assigned for off –balance sheets items, the value of the off-balance sheets items shall be multiplied by their respective risk –weights and then added together.

**Table 2.3**  
**Risk –Weighted off –Balance Sheets Items**

Off –Balance Sheets Items	Risk Weighted %
<input type="checkbox"/> Bills collection	0%
<input type="checkbox"/> Forward foreign exchange contact.	10%
<input type="checkbox"/> L/C with maturity of more than 6 months (full value)	20%
<input type="checkbox"/> Guarantee provided against counter guarantee of international rated foreign bank	20%
<input type="checkbox"/> L/C with maturity of more than 6 months (full value)	50%
<input type="checkbox"/> Commitment relating to Bid bond Performance bond & Underwriting	50%
<input type="checkbox"/> Credit purchase / repurchase & takeover	50%
<input type="checkbox"/> Advance payment guarantee	100%
<input type="checkbox"/> Financial guarantee	100%
<input type="checkbox"/> Other guarantee	100%
<input type="checkbox"/> Contingent Tax Liability	100%
<input type="checkbox"/> Irrevocable loan commitment	100%
<input type="checkbox"/> Contingent Liability in Respect of Income Tax	100%
<input type="checkbox"/> Other contingent liabilities (including Acceptances & Endorsements)	100%
<input type="checkbox"/> Claims against the bank not acknowledge as liabilities	200%
<input type="checkbox"/> Unpaid guarantee claims	200%

*(Source: Unified Directives 2069)*

### 2.1.9 Capital Adequacy Ratio

Capital Adequacy Ratio is calculated by using following formula:

$$\text{Capital Adequacy Ratio (CAR)} = \frac{\text{Core Capital} + \text{Supplementary Capital}}{\text{Risk Weighted Assets}} \times 100$$

$$\text{OR, CAR} = \frac{\text{Tier - 1 Capital} + \text{Tier - 2 Capital}}{\text{Risk Weighted Assets}} \times 100$$

*Total Risk Weighted Assets = Risk-Weighted on-Balance Sheet Assets + Risk –Weighted off –Balance Sheets Assets*

Unless a higher minimum ratio has been set by Nepal Rastra Bank for an individual bank though a review process, every bank maintain at all time, the capital requirement set out bellow:-

- a) A Tier I (Core) capital of not less than 6% of its total risk weighted exposure
- b) A Total Capital Fund of not less than 10% of its total risk weighted exposure.

### 2.2 Review of Previous Studies

**Pandey (2002)** entitled “A Case Study of Himalayan Bank Ltd, NRB Directives their Implementation and Impact on the Commercial Bank” concluded the following finding and recommendation. This study concluded that change in NRB directives has lot of impact on commercial banks rules and regulations as well as activities. Because of new directives, commercial bank has to increase the operational cost. Dividends to shareholders and bonus to the employees are scaled down due to decrease in profits of the banks. He also said that the changes in directives would bring prosperity of the shareholders depositors, employees and the economy as a whole in a long run. The tough time through which the bank is undergoing at present will prevail only for a short period. His suggestion to NRB is that the NRB should issue directives after doing proper homework. NRB must strengthen the functioning of its credit information bureau. NRB should be practical and should issue directives applicable in the context of Nepal. Directives should not be issued only to meet the international standards. Otherwise

complaints may arise from commercial banks. However, in the present context, the commercial banks have to comply such directives and perform activities accordingly. (Pandey, 2002).

**Khatiwada (2003)** has enlightened that recent financial crisis have revealed a number of data deficiencies, notably in pledge assets, deposits held in financially weak domestic banks and their foreign affiliates, valuation practices leading to bank valuation of assets being significantly different from market values and complicating assessments of the realizable value of reserve assets. He emphasized various reform majors. One of the measures was increasing capital base and revising capital adequacy. It is stressed that experience has shown that undercapitalized financial institutions are the ones that are first attacked by the spectators and hedges at the time of crisis and create contagious effect on the other institution as well. Besides, undercapitalized financial institutions cannot gain credibility and corporate growth even in normal times. This requires that financial institutions are adequately capitalized and possess resilience against the attackers by dealers and customers. In this context, capital adequacy norms are being revised upward as per Basal Capital Accord. But increasing the capital base for loss making government owned financial institutions is not easy without involving private sector in the equity capital. ( Khatiwada, 2003).

**Bhattarai (2004)** there was a significant impact of the directives on the various aspects of the commercial banks. Also, it was found that banks would fall short in supplementary capital but can maintain its total capital according to the new directives relating to capital adequacy norms. All the changes in NRB directives made impact on the bank and results were the increase in the operational procedures of the bank increased the operational cost of the bank. Short term decreases in profitability, which results to lesser dividends to shareholders and lesser bonus to the employees. Reduction in loan exposure of the bank decreases in interest income but increases the protection to the depositors' money. Increased protection to the money of the depositors through increased capital adequacy ratios adds more stringent loan related directives and increase in demand for

shareholder's contribution in the banks by foregoing dividends for loan loss provisions and various other reserves to increase the core capital. (Bhattarai, 2004).

**Shrestha (2005)** entitled "NRB Guidelines on Investment Policy of Commercial Bank in Nepal; A Case Study of Nabil Bank Ltd." concluded the following finding and recommendation. In this study conclude that NRB has to play active or vital role to enhance the operation of commercial banks, development banks, finance companies and co-operatives. Strengthening and institutionalization of the commercial banks is very important to have a meaning relationship between commercial banks and national development through shift of credit to the productive industrial sectors. At the same time the series of reforms such as consolidation of commercial bank, directing attention to venture capital financing, appropriate risk return trade off by linking credit to timely repayment schedules avoiding imperfections, allowing flexibility in lending, one window service from NRB, strong supervision and monitoring form NRB, diversity scope of activities of commercial banks, professional culture within commercial banks etc. all these are necessary to ensure better future performance of commercial banks that have already been established and growing in Nepal. (Shrestha, 2005).

**Lamsal (2006)**, in his study," Capital adequacy and its significance to Commercial banks" ,has the main objective of the study are to review directives of NRB regarding Capital adequacy related to commercial banks.

The Major findings of the study are:-

- Among this eight banks SCBNL, HBL, NICBL, LBL and KBL have shortfull of supplementary capital in accordance with the NRB requirement.
- In case of capital adequacy ratio it is seen that NIBL, HBL, LBL and KBL has not meet the standard of 12% directed by NRB.
- All of these banks make its internal audit and inspection department stronger so that the directives are properly implemented keeping into mind that the violation of rules of directives have chances to pay penalties which may lead to unfavorable consequences.

-Among the analyzed bank 50% of the banks have not able to meet its capital adequacy ratio, so NRB needs to be practical while issuing these directives, NRB must not make the rules taking into mind only the international standard but to combat these problems the directives must be issued after being proper research and consultation with different banking experts.(Lamsal, 2006).

**Kutal (2007)** has conducted as study on, “ CAMEL study on Joint venture Banks with special reference to SCBL(Standard Chartered Bank), NABIL and HBL(Himalayan Bank Limited).” The main objective of this study was to find out the comparative details and evaluation of performance of Selected sample banks.

The Major findings of the study are:-

-All banks capital adequacy is in decreasing trend. SCB has higher stakes on earning but seems more conservative in lending to avoid NPL.

-The employee’s job satisfaction reflects efficiency in servicing, which was found very well in average for each banks. Despite of aggressive credit policy, on performing loan of HBL is increasing which is very risky sign. HBL has highest loan amount than SCBL and NABIL but lowest % loan loss provision. HBL should put either extra effort to decrease NPL or increase LLP.

-SCB and NABIL despite of meeting car statutory requirement on weekly basis also should maintain minimum 5% CRR on balance sheet date. HBL cash and bank balance is highest despite of high volume of lending which means there’s still lot of fund lying idle. NABIL’s investment fund in government securities has gone down substantially which clearly indicates more risky lending preferences. (Kutal, 2007).

**Luitel (2009)** has conducted a study on Analysis of Nonperforming Assets and Loan Loss Provision of SCBNL(Standard Chartered Bank Nepal Ltd), BOK( Bank Of Kathmandu) and EBL(Everest Bank Ltd) with the main objective of examining and

studying of nonperforming assets and loan loss provision of selected banks. And to find out the level of nonperforming assets of these banks, also find out the loan loss provision maintained by the bank and to measure the relationship between NPA with total deposit and net profit.

The Major findings of the study are:-

-The non –performing assets covered 0.79% the total assets of SCBNL, 2.40% of the total assets of BOK and 0.80% of total assets of EBL, thus implying more risky assets in BOK compared to SCBNL and EBL.

-Likewise, the non-performing assets to total deposit of SCBNL is 0.89% and that of BOK is 2.80% and EBL is 0.93% which has indicated better loan management in SCBNL than in BOK and EBL.

-IN average, SCBNL has kept 2.98 of the total loan loss provision and BOK has kept 3.71% of total loans as loan loss provision and EBL has kept 3.19% as loan loss provision. Similarly, the loan loss provision represented 141.99% and 106.40% and 288.06% of non- performing assets in SCBNL, BOK and EBL respectively. (Luitel, 2009).

**Poudel (2009)** has conducted the study entitled " Capital adequacy and loan loss provision of commercial banks ( with reference to NRB directives) with the objectives as to assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB, to study the loan loss provision of selected commercial banks and compares their provision with the concerned directive of NRB and lastly, to make necessary recommendations to the commercial banks and Nepal Rastra Bank for improvement in the findings of the early two objectives of this study. The researcher has revealed in the study that NRB directives related to capital adequacy are implemented by the selected commercial banks. Capital adequacy ratios of all selected banks are above the requirements of NRB in all year of the study period 2059/060 to 2063/064. All the sample banks have paid more attention to core capital rather than supplementary capital although 50% of the total capital fund requirement can

be fulfilled by the supplementary capital. All the banks have issued right share, bonus share to increase capital fund. Among the selected commercial banks SCBNL and EBL have fully implemented the NRB directives related to loan loss provision. They have managed extra loan loss provision than requirements of the NRB directives. Although aggregate loan loss provision of NABIL is excess over the requirement of NRB, provision for loss loan is short than NRB requirements in every year of the study period. But the provision for pass loan is excess for all year. Similarly the researcher has reached the conclusion that role of NRB is effective in regulating bank and financial institutions. Capital adequacy norms are set by the NRB in order to protect the depositors. The coefficient of correlation, coefficient of determination and probable error of all the sample banks shows that net profit is closely related with total loan and advances. (Poudel, 2009).

**Baral (2010)** conducted the study entitled " NRB directives on capital adequacy and loan loss provision of commercial banks" with the objectives as to assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB, to study the loan loss provision of selected commercial banks and compares their provision with the concerned directives of NRB and to make necessary recommendations to the commercial banks and Nepal Rastra Bank. The researcher has revealed in the study that NRB directives related to capital adequacy are implemented by selected commercial banks, capital adequacy ratios of all selected banks are above the requirements of NRB in all year of the study period 2061/62 to 2065/66. All the sample banks have paid more attention to core capital rather than supplementary capital although 50% of the total capital fund required can be fulfilled by the supplementary capital. All the banks have issued right share, bonus share to increase capital fund. Researcher further writes loan classification is made according to the NRB directives. Loan loss provision requirements as per the directives are not fully implemented by the commercial banks. Among the selected commercial banks SCBNL and EBL have fully implemented the NRB directives related to loan loss provision. They have managed extra loan loss provision than requirements of the NRB directives. Although, aggregate loan loss

provision of NABIL is excess over the requirement of NRB, provision for loss loan is short than NRB requirements in every year of the study period. Provision for the doubtful loan is also short than NRB requirement except in fiscal year 2063/064. But the provision for pass loan is excess for all year. Similarly the researcher has reached the conclusion that role of NRB is effective in regulating bank and financial institutions. Both off-site and on-site inspections are best for regulating banks and financial institutions. Capital adequacy norms are set by the NRB in order to protect the depositors. Depositors are the prime beneficiary of the capital adequacy norms. Little bit liberal capital adequacy norms should be set where banks may feel free to exercise. ( Baral, 2010).

**Kandel (2010)** conducted the study entitled " Capital adequacy of commercial banks in Nepal ( as per NRB directives and norms) with the objectives as to study how the new act has provided operational autonomy and independence to the banks, to study the capital adequacy directives and norms of NRB for the commercial banks, to study impact of NRB capital adequacy directives and norms on commercial banks, to examine the relationship of capital fund to deposit and credit etc. RBB, NBL,SCBNL, Nepal SBI Bank, EBL, Nabil Bank and NIBL were selected as sample for the study. The study is based on the capita funds of the banks which are supposed to be adequate as per the NRB directive no. 1 which is related to capital adequacy directives and norms for overall commercial banks. Capital adequacy is required to safeguard the money of depositors which are collected from them. It is found that all commercial banks have maintained the capital adequacy norms and directives of NRB. The core capital, supplementary capital and total capital ratio to be maintained by commercial banks have been increased every year during the study periods except the fiscal year 2003/04 to 2004/05 in which year the regulatory body has fixed the ratios. The major capital fund ratios analysis concludes that the total capital fund is contributed by in average of 81% of the core capital and remaining 19% from the supplementary capital. The growth of capital fund and risk weighted assets are in same direction but proportionate increment is not found matching with each other. The high positive correlation between net profit and core capital, and total capital fund and net profit indicates that there is positive relationship between these

variables. Majority of the respondents are found with the view that the present capital adequacy norms of NRB are suitable. This suggests that norms set by NRB as regulatory body are justifiable. Most of the commercial banks have welcomed the exclusion of loan loss provision of NPA as a component of capital fund. Though the majority of the commercial banks agreed that the enforcement of directive no 1 has affected the capital adequacy position of commercial banks but they denied that enforcement of the directive no 1 is the main reason for decrease in core capital and supplementary capital ratio. (Kandel,2010).

**Maharjan (2010)** has conducted a study on capital adequacy norms and loan loss provision for Nabil bank and investment bank ltd. The main objective of the study was to find out the capital Adequacy ratio of selected banks and should they are able to maintain their capital adequacy ratio directive by NRB.

The Major findings of the study are:-

- The average supplementary adequacy ratio maintain by NABIL is 9.88% & that of NIBL is 8.13 within the five fiscal years against the NRB's standard 6%.
- The average capital adequacy ratio of NABIL within five fiscal years is 11.72% and that of NIBL is 11.55% against the NRB's standard 12%.
- The average core capital adequacy ratio maintain by NABIL is 9.88% & NIBL is 8.13% within the five fiscal years against the NRB's standard.
- The average non performing loan to total loan of NABIL is 1.0% and than NIBL is 1.7%. The credit risk, i.e. non performing loan to total loan of both the banks is lower than the industry average, which is 14.42%.
- The loan loss provision to total loan and advance of NABIL is 2.30% while that of NIBL is 2.4 indications higher credit risk in NIBL than in NAB. (Maharjan, 2010).

**Thapa (2011)** conducted a thesis entitled " Capital adequacy norms and its impact (with reference to Nepal Industrial and commercial bank limited and Nepal credit and

commerce bank limited)" with the objectives as to analyze the significance and impact of NRB capital adequacy norms on selected commercial banks, to examine the capital adequacy of NIC bank and NCC bank, to examine the relation of capital fund to other stakes of the banks etc. The researcher concluded that the commercial banks of Nepal are bounded by the NRB directives and are currently bounded by unified directives issued for all the financial institutions. The directive no. 1 has set norms on capital adequacy for commercial banks. Every commercial banks has to meet the requirement of capital adequacy as stated by the directives. The study reveals that the bank under study NIC bank is found to be successful to comply with requirement of capital adequacy norms but the BCC bank is found to be unsuccessful before FY 2063/64 and then able to meet the capital adequacy norms of NRB in FY 2064/65 and 2065/066. The CD ratio of the NIC bank is adequate and satisfactory than that of NCC bank. The researcher further writes banks should maintain this ratio although the bank is successful to meet the capital requirement: it seems to be ineffective to fulfill other capital and deposit ratios which are also very much important in regard of safeguarding the money of the depositors. The bank should highly focus on optimum utilization of the deposits because under utilization of deposit means bearing additional cost as deposits do not come for free. The correlation coefficient between capital and deposit and between capital and credit of NCC bank are found to be positive and near to perfect correlation than of NCC bank. The test of hypothesis reveals that the capital and deposit are correlated. Also the test brought to light that credit and capital are also correlated. (Thapa, 2011)

**Karki (2011)** conducted the study entitled "Capital Adequacy Ratio Analysis" (Comparative study of Bank of Kathmandu Limited and Himalayan Bank Ltd) . The general objective of the study is to evaluate and compare the capital adequacy analysis and risks measurements of Nepalese commercial banks. The study was conducted with the objectives of : to analyze the capital adequacy ratio of selected banks, to examine the relation of capital fund of the other stakes of bank ( Deposit / Credit), to find out whether the selected commercial banks are achieving the NRB guidelines of minimum percent of

capital adequacy ratio or not and lastly, to make necessary suggestion and recommendations.

The study reveals that capital fund of BOK and HBL both have grown consistently over the study period comprising of FY 2061/62 to FY 2066/67. HBL is found to be successful to comply with the requirement of capital adequacy norms in all research period but BOK is not able to meet the capital adequacy ratio requirement as prescribed by NRB. The capital to deposit ratios of the both banks are adequate and satisfactory, however BOK has more satisfactory ratio than HBL cause of having higher ratio. The correlation coefficient of both the banks between capital and deposit and between capital and credit are found to be positive and near to perfect correlation. Deposit collection, credit lending, capital fund and risk weighted exposure of both banks are in increasing trend.

The study has made some recommendation like the capital fund and risk weighted exposure of both banks are increasing but the ratio of capital fund increment is not sufficient with risk weighted exposure increment, so they have to try to make suitable increment in capital fund with respect to risk exposure.

The study has further recommended that NRB is the regulating body of financial institution and which set the minimum capital fund requirement for the banks also. As per NRB requirement of capital adequacy ratio HBL is successful to maintain minimum requirement but BOK is unable to maintain CAR in FY 2064/65 and also the trend of CAR of BOK is very fluctuating in the research period, so BOK need to make strategy for maintaining capital adequacy ratio with respect to risk weighted exposure change.(Karki, 2011)

**Rai (2012)** has conducted the study entitled “A study of non-performing loan and loan loss provision of commercial banks” (With reference to Standard Chartered and NABIL Bank). Following objectives were put forth for the study: To see the proportion of non-performing loan and level of NPA in total deposit and total lending in selected commercial banks, to see the relationship between the loan amount provided by commercial banks and loan loss provision, to see the impact of non- performing assets in

the profit and trend line of non- performing assets loan and advances, loan loss provision etc.

The study has revealed that from the ratio analysis and trend analysis NABIL's performance is better than SCBL in terms of net profit, loan and advances and deposit collection but from risk management point of view, i.e with regard to NPL and LLP level, SCBL's performance is preferred to NABIL's NPL to total loan and advance and total deposit of SCBL bank is declining sharply and faster but same is increasing from 2010 onwards in case of NABIL, even though average total loan and advances of NABIL is higher than SCBL. The trend reveals higher performance of SCBL than NABIL. The trend of net profit is also increasing in higher ration of SCBL's than NABIL's. The trend to NPL of SCBL is negative or virtually, there will not be any NPL of SCBL in future years. Both the private banks under study SCBL and NABIL are trying hard to reduce the amount of NPL and LLP increase in NPL has two way adverse effect performance of the bank. First of all, Banks have to deposit LLP as compensation and guarantee. This reduce the fund of the banks for investment in some profitable sector, in second case it reduces credibility and accountability of the management which could have long term adverse consequences to the bank.

The researcher has recommended following points to both the banks:

- NPL of SCBL is declining so the bank has to make every effort to continue this trend but in case of NABIL the trend is increasing so it has to make effort to reverse the trend.
- In spite of the higher loan and advance of NABIL than SCBL, the average ration of net profit to loan and advances is lower than SCBL so NABIL has to increase the net profit by maintaining with the increment in loan and advances.
- Banks have to adhere to the guideline of central bank to reduce the amount of NPL and also the increase accountability and credibility of the bank.( Rai, 2012)

**Ghimire (2013)** conducted a study entitled “ A study on Capital Adequacy and Loan Loss Provision of Nepalese commercial banks” (With reference to NABIL, EBL,SCBNL).

The study was conducted with the objective of “to assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB, to study the loan loss provision of selected commercial banks and compare their provision with the concerned directives of NRB and to make necessary recommendations to commercial banks and NRB for improvement.

Study has showed that the core capital total capital fund and risk weighted assets of EBL are in increasing trend over the study period but supplementary capital is decreasing after the fiscal year 2065/66 and that of SCBNL and NABIL are in increasing trend over the study period. NPL of EBL is fluctuating trend where as NPL of NABIL is increasing trend except FY 2065/66 but the NPL of SCBNL is in fluctuating trend over the study period. Researcher in the study further reveals that the risk management system of the commercial banks as well as the operative environment of the commercial banks improved significantly. Accordingly, a revised capital adequacy framework and loan loss provision is justified in order to capture the various factors affecting banks risk exposure. The researchers further concludes previously about 25% of the total commercial banks were unable to maintain capital adequacy norms based on core capital to risk weighted assets. However, the rate of banks maintaining low or negative fund has been significantly decreased by the end of 2008. Sample banks seem satisfactory in terms of their capita conditions with respect to total risk weighted exposure and loan loss provision. One of the challenges of commercial bank to maintain capital standard is found to be non performing assets that are growing in volume and magnitude. The study shows the relationship of the capital fund with non performing loan which is found to be perfectly negative. The capital fund tends to be increasing all the years, where the NPL tends to decrease.

The researcher has recommended the following suggestions to commercial banks and NRB:

-Commercial banks are seems to be focus on minimization of credit risk so they are suggested to give appropriate weighted for the market and operational risk as well.

- To maintain the adequate capital the creditworthiness of the commercial banks should be assessed which is not currently available in Nepalese financial market.

-Adequate rules and capital adequacy should be issued for non bank thrift institution as well.

-Good management information system and risk management technique should be implemented Supervisory response should be done regularly and huge negative net worth problem should be solved by introducing reasonable tools by regulatory body. (Ghimire, 2013)

### **2.3 Research Gap**

Most of the research are concerned with the research related to impact of NRB directives on various aspects of commercial banks. Few of them have gone about capital adequacy ratio and loan loss requirement but none of them have written over the capital adequacy norms and loan loss provision taking Global IME bank and Everest Bank Ltd together in specific. So, this study is conducted to make a specific review of capital adequacy norms and loan loss provision with specific to Global IME and Everest Bank. It may be the case that Global IME bank is not very old though studies have been conducted taking the Everest Bank as one of the sample. No one previous study found doing the study taking Global IME bank as one of the sample. As such, this study might be a novelty one with reference to the study of the capital adequacy norms of Global IME and Everest bank together. However, the study has incorporated the views and opinions of the bank staffs with the help of questionnaires regarding capital adequacy requirements set by NRB. The study certainly gives the clear picture of the impact of NRB compliance on Global IME and Everest Bank with reference to the analytical study of capital adequacy ratio, non

performing loan and loan loss provision. The study has also reviewed few important items like ratio of Non performing Loan to Total Loan and Advances, Loan Loss Provision to Total Loan and Advances, correlation between net profit and CAR and also presented the trend value of capital adequacy ratio of Global IME and Everest Bank Ltd for the fiscal year 2007/08 to 2011/12 as well as forecasted the trend value of CAR of Global IME and Everest bank Ltd up to fiscal year 2016/17. Probably this study may be the first research of its kind in this area.

## **CHAPTER-III**

### **3. Research Methodology**

Research methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. In it we study the various steps that are generally adopted by a researcher studying his research problem along with the logic behind them.

Research methodology is the process of arriving at the solution of the problem through planned and systematic dealing with the collection, analysis and interpretation of facts and figures. It consists of research design, data collection procedure, tools and techniques for analysis, method of analysis and presentation and assumption of the study. The basic objective of the study is to review directives of the NRB related to commercial banks. But special attention is given to capital adequacy and loan loss provision of commercial banks.

#### **3.1 Research design**

By research design we mean an overall frame work or plan for the collection and analysis of data. The research design serves as a framework for the study, guiding the collection and analysis of the data. The research design then focuses on the data collection methods, the research instruments utilized, and the sampling plan to be followed. (Wolff and Pant, 2005).

A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework for the project that stipulates what information is to be collected, from which sources and by what procedures. Thus a research design is a plan for the collection an analysis of data. To achieve the objective of this study, descriptive and analytical research design has been

used. Some financial and statistical tools have been applied to examine facts and descriptive techniques have been adopted to examine and find out the problem and possibility for Global IME Bank Ltd and Everest Bank Ltd.

### **3.2 Population and Sample data**

The term population of data denotes for the data of each organization which is within the boundary of specific organization where as sample of data are data of those organization which has been selected from that whole population in a few numbers. From the population of 31 commercial banks, 2 banks have been taken as the samples of the study. Purposive Sampling method is used while selecting sample organizations for this study. The sample consists of two selected banks. The selected sample banks for the analysis are as follows:

- I. Global IME Bank Ltd.
- II. Everest Bank Ltd

### **3.3 Data Collection Procedures**

Data collection procedures consists of taking ordered information from reality and transferring it into some recording system so that it can later be examined and analyzed for patterns. Without the data, methodology cannot be utilized to bring us to the conclusion, which the hypotheses suggest. Data may be obtained from several sources; it is not easy to list them in detail. Each research project has its own data needs and data source. This study is mainly based on secondary data. Secondary sources refer to those for already gathered by others. These data are often in the form of raw data and published materials. However, the unpublished data such as the records, reports or statistics gathered or compiled by others prior to our study are also secondary data. The sources of secondary data in this study are published data like annual reports of banks, financial statement, review and reports, journals, articles from various magazine, statistical reports,

previous thesis, and dissertation, web pages and related text books and so on. According to the need and objectives, the secondary data's are compiled, processed, tabulated and graphed if necessary for better presentation. The data gathered from the banks are compared with the directives issued by the central bank and analysis is made on implementation and compliance aspects. Descriptive analysis method is used for analysis of primary data.

Following are the secondary & primary sources of data used in the study

- Annual reports, newsletters, broacher etc. of the selected banks.
- Textbooks, articles published in newspapers, journals magazines etc.
- Laws, NRB guidelines, NRB acts etc.
- Banks websites and other relative websites.
- Previous research studies and articles on the subject,
- Questionnaire to bank officials, depositors, investors, academicians and other stake holders of banking sector of Nepal.
- Personal interview with related persons of selected banks.

### **3.4 Method of Data Analysis**

According to the nature of statement of data, suitable or appropriate tools will make the analysis more effective and significant for achieving objective. So as, financial and statistical tools, are used in this study.

#### **3.4.1 Financial Tools**

Financial tools are used for the analysis and interpretation of financial data. For proper financial analysis of data ratio analysis is the best tool. It is very simple analysis tools under which ratios are taken to express the relation between two or more data. Through ratio analysis we can establish the relationship among the data and research into conclusion. Under ratio analysis following ratio related to bank are analyzed.

## 1. Capital Adequacy Ratio

The term used to describe or measure of a bank's capital fund. It is expressed as a percentage of a bank's risk weighted credit exposures. Capital adequacy ratio is calculated on the basis of core capital supplementary capital and total risk weighted assets of the bank. This ratio is used to protect depositors and promote the stability and efficiency of financial system around the world and to examine adequacy of the total capital fund and core capital, which is calculated by the following formulas:

To measure the adequacy of capital fund

$$\text{CAR} = \frac{\text{Total Capital Fund}}{\text{Risk Weigh ted Assets.}} \times 100\%$$

Where,

Total capital fund = Core capital + Supplementary capital

$$\text{CCAR} = \frac{\text{Core capital}}{\text{RWA}}$$

$$\text{SCAR} = \frac{\text{Supplementary capital}}{\text{RWA}}$$

## 2. Non Performing Loan to Total Loans and Advances Ratio

This ratio is used for find out the portion of non-performing loan is the portfolio of total loan and advances. Higher ratio shows that bank has bad quality of assets in the form of loan and advances. Hence, lower ratio is preferred. There is no fixed ratio to be maintained but as per international standard only 5% is allowed.

It is calculated as follows;

$$\text{NPL to total loan and advances} = \frac{\text{Non Performing Loan}}{\text{Total Loan and Advances}} \times 100\%$$

### 3. Provision for NPL to NPL

This ratio is used to find out the provision held for non-performing loan. This ratio measures up to what extent of risk interest in NPL is covered by loan loss provision held for NPL. Since higher ratio safe guard against future contingencies that may create due to non performing loan, higher ratio is preferred by bank or in other words banks have cushion of provision to cope the problem that may he cause due to NPL.

It is calculated as follows:

$$\text{Provision held for NPL to NPL} = \frac{\text{Provision Held for NPL}}{\text{Non Performing Loan}} \times 100\%$$

### 4. Loan Loss Provision to Total Loan and Advances:-

Loan loss provision signifies the cushion against future contingencies created by the default of the borrowers in the payment of loans and ensures the continued solvency of the banks. Since low ratio reflects the good quality of assets in the volume of total loan and advances, low ratio is preferred. It indicates how efficiently it manages loan and advances and makes efforts to cope with probable loan loss, since, high provision has to be made for non-performing loans, higher ratio implies, higher portion of NPL in the total loan portfolio.

It is calculated as follows;

$$\text{Loan loss provision to total loan and advances} = \frac{\text{Loan Loss Provision}}{\text{Total Loan \& Advances}} \times 100\%$$

#### 3.4.2 Statistical Tool

Various statistical tools have been adopted to analyze the data. For this following statistical tools are used.

## 1. Arithmetic mean

Arithmetic mean of a given set of observation is their sum divided by the number of observation. In general  $X_1, X_2, \dots, X_n$  are the given number of observation, their arithmetic mean can be derived in this way.

$$\bar{X} = \frac{\sum X}{N}$$

Where,

$\bar{X}$  = Arithmetic Average

$X$  = Value of variables

$N$  = number of items

$\sum x$  = summation for total values of the variable/observation

## 2. Standard Deviation

The standard deviation measures the absolute dispersion or variability of a distribution. A small standard deviation means a high degree of uniformity of the observation as well as homogeneity of a series. A large standard deviation means just the opposite. Hence, standard deviation is extremely useful in judging the representative of the mean. It is usually denoted by the letters ( $\sigma$ ).

$$\text{Standard Deviation (S.D.)} = \sqrt{\frac{\sum (X - \bar{X})^2}{n}}$$

Where,

$\sigma$  = Standard Deviation

$n$  = number of items in the sample

$\bar{x}$  = Mean of the sample

$x$  = Value of each of the observation

### 3. Karl Pearson's Coefficient of Correlation

A mathematical method for measuring the intensity or the magnitude of linear relationship between two variable series was suggested by Karl Pearson (1867-1936), a great British Bio-metrician and Statistician and is by far the most widely used method in practice. Karl Pearson's measure, known as Pearsonian correlation coefficient between two variables (series) x and y, usually denoted by  $r(X,Y)$  or  $r_{XY}$  or simply  $r$ , is a numerical measure of linear relationship between them and is defined by,

$$r_{XY} = \frac{n\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[n\Sigma X^2 - (\Sigma X)^2]} \sqrt{[n\Sigma Y^2 - (\Sigma Y)^2]}}$$

Where,

$r_{XY}$  = Correlation coefficient between variable X and Y

n = Number of observations

$\Sigma X$  = Sum of observations in series X

$\Sigma Y$  = Sum of observations in series Y

$\Sigma XY$  = Sum of the product of observations in series X and Y

$\Sigma X^2$  = Sum of squared observations in series X

$\Sigma Y^2$  = Sum of squared observations in series Y

#### Interpretation of Correlation Coefficient

- When  $r = +1$ , implies that two variables are positively perfectly correlated.
- When  $r = -1$ , implies that two variables are negatively perfectly correlated.
- When  $r = 0$ , there is no correlation.
- When  $r$  lies between 0.7 to 0.999 (-0.7 to -0.999), there is high degree of positive (negative) correlation.
- When  $r$  lies between 0.5 to 0.699, there is moderate degree of correlation.
- When  $r$  is less than 0.5, there is low degree of correlation.

Personian correlation coefficient lies always between -1 and +1. When  $r = +1$ , there is perfect positive correlation. Similarly, if  $r = -1$ , There is perfect negative correlation between the variables. And it has a zero value i.e.  $r = 0$ , there are no correlation between the variables.

#### **4. Probable Error:**

Probable error of correlation coefficient, usually denoted by P.E. (r) is an old measure testing the reliability of an observed value of correlation coefficient in so far as it depends upon the condition of random sampling. Probable error of correlation coefficient denoted by P.E. (r) is obtained as,

$$\text{P.E. (r)} = \frac{0.6745 \times (1-r^2)}{\sqrt{n}}$$

Where,

$r$  = Calculated correlation coefficient

$n$  = Number of observations

#### **Uses of Probable Error**

1. The probable error of correlation coefficient may be used to determine the limits within which the population correlation may be expected to lie.

Limits for population correlation coefficient are

$$r \pm \text{P.E.}(r)$$

2. P.E. (r) i.e., if the observed value of sample correlation coefficient is significant of any correlation in the population. The following guideline may be used:

- If  $r < \text{P.E. (r)}$  i.e., if the observed value of  $r$  is less than its P.E., then correlation is not at all significant.
- If  $r > \text{P.E. (r)}$  i.e., if observed value of  $r$  is greater than 6 times its P.E., then  $r$  is definitely significant.

- In other situations, nothing can be concluded with certainty.

## 5. Coefficient of Determination

The square of the correlation coefficient is called the coefficient of determination. It is used to interpret the value of the correlation coefficient. The main significance of the coefficient of determination is to represent the proportion of total variations in the dependent variable, which is explained, by the variations in the independent variables.

It is calculated as follows:

$$\text{Coefficient of Determination } (r_{xy})^2 = (\text{Correlation of coefficient})^2$$

## 6. Least Square Linear Trend Analysis

Trend analysis is an analysis of financial ratio over time used to determine the improvement of determination of its financial situation.

The general tendency of the time series data to increase or decrease or stagnate during a long period of time is called trend. This method is the most popular and widely used in practice. It provides basis for obtaining the line of best fit in the series. As per this method, the trend line between dependent variable Y and the independent variable X be represented by:  $Y = a + bX$

Where,

Y = Dependent Variable

X = Independent Variable i.e. time

a = Y-intercept

b = Slope of the trend line

The two parameters a and b in the equation are obtained by solving two normal equations as follows:  $\Sigma Y = na + b \Sigma X$

$$\Sigma XY = a \Sigma X + b \Sigma X^2$$

Where,

n = Number of years

To make calculation easier the mid-point in time is taken as origin from which the negative values (-1, -2, -3,.....) in the first half of the series balance out the positive values (1, 2, 3,.....) in the second half so that  $\Sigma X=0$ . In other words time variable is measured as a deviation from its mean so that  $\Sigma X=0$ .

Since  $\Sigma X = 0$ , then the value of a and b can be calculated by,

$$a = \frac{\Sigma Y}{n} \text{ and } b = \frac{\Sigma XY}{\Sigma X^2}$$

### **3.4.3 Method of Primary Data Analysis**

Data generate through questionnaire and personal interview of commercial bank's staffs are analyzed using descriptive method and are presented in table wherever necessary.

The study is confined in limited banks considering the time constraint. The findings should not be generalized. The study is only focused on commercial banks which have been guided by the NRB directives. Since data of the study is of non- experimental type; chance of observation errors may take place. Similarly, primary data are based on survey of personal interview and questionnaire; there can be selective bias because of non-response error. So this study is just to fulfill the partial requirement of the MBS of Tribhuvan University.

## **CHAPTER - IV**

### **4. Data Presentation and Analysis**

This chapter deals with the presentation, analysis and interpretation of relevant data and information of Global IME Bank Ltd and Everest Bank Ltd. The analysis and interpretation of the Information and data produced from questionnaire by various sources and related information which is also contained in this chapter. To obtain best result, the data and information have been analyzed according to the research methodology as mentioned in the Chapter 3. The purpose of analysis to review the bank, analysis of capital adequacy ratio on the basis of primary & secondary data.

#### **4.1 Presentation of Data**

The collected data and information are presented in this section. Various tables, Charts and graphs are used to best present the data. The data and information has been presented in most understandable format.

#### **4.2 Review of Bank performance**

##### **4.2.1 Global IME Bank Ltd**

The bank had total authorized capital of Rs. 2,000,000,000 in FY 2008/09 and it was become Rs. 3,000,000,000 in 2009/010 to till date ( i.e, upto FY 2012/13) but the issued capital was Rs. 1,000,000,000 in FY 2008/09 . It was increased to 1,500,000,000 in the fiscal year 2009/10. It remains same in the FY 2010/011. Again it was increased to 2,184,812,400 in the FY 2011/12. It is further increased to Rs. 2,418,137,800 in FY 2012/13. Global IME bank's balance sheet shows the total profit of Rs.23,597,584 in the FY 2008/09. The profit in the year 2009/010 was increased to Rs. 73,003,292. and it was further increased to Rs. 224,977,751 in the fiscal year 2010/011. The profit in the fiscal year 2011/012 was Rs. 265,316,025. In the FY 2012/13 the profit of the bank is Rs. 449,218,454. The position of banks performance of year 2065/66 to 2069/70 is mention in

table below which shows the bank's every year performance along with increasing or decreasing trend:-

**Table 4.1**

F/Y					
Details	2008-9	2009-10	2010-11	2011-12	2012-13
Authorized Capital	2,000,000,000	3,000,000,000	3,000,000,000	3,000,000,000	3,000,000,000
Issued Capital	1,000,000,000	1,500,000,000	1,500,000,000	2,184,812,400	2,418,137,800
Paid up Capital	1,000,000,000	1,473,350,200	1,500,000,000	2,184,812,400	2,418,137,800
Total Assets & Liabilities	12,626,472,559	17,201,415,486	17,522,708,435	30,664,113,427	39,018,489,785
Total Profit	26,304,628	73,003,292	224,977,751	265,316,025	449,218,454
Total borrowing on local sector	499,460,000	286,800,000	401,789,148	87,321,320	107,043,048
Total Borrowing on Foreign Sector	-	52,360,000	-	-	-
Total Interest Free Deposit	529,563,568	799,059,793	975,124,363	1,349,547,161	1,705,099,019

Total Interest Bearing Deposit	10,400,833,844	14,232,488,554	14,091,365,833	25,564,218,013	32,406,366,742
Bill Payable	76,458,752	66,631,883	60,460,181	17,728,014	19570748
Other Liability	71,229,828	168,795,196	205,678,387	490,117,689	1,146,951,247
Total Contingent Liability	2,537,847,307	4,882,863,703	4,881,896,399	9,353,847,657	10,878,785,217
Total Cash Balance	326,273,415	543,541,704	522,683,708	624,419,820	929,933,057
Total Investment	1,620,120,728	2,270,487,367	2,920,246,931	4,247,059,978	5,548,946,217
Total Fixed Assets	224,351,135	284,400,059	231,579,653	660,515,005	692,226,193
Net Worth(Other Assets)	300,123,915	251,737,595	244,012,496	490,693,519	1,004,955,435
Total Interest Income	683,933,210	1464977690	1,963,603,757	2,226,134,605	3,206,646,423
Total Interest Expenses	459,783,694	962009866	1,288,050,875	1,586,555,934	1,826,784,727
Employees	66,322,187	100,256,551	155,003,585	158,188,436	289,774,654

Expenses					
Office Operating Expenses	132,893,774	209,346,082	237,364,199	304,109,972	485,075,610
Total Capital Fund	860,318,438	1,641,326,775	1,823,045,000	3,146,504,000	3,894,582,000
Balance with NRB	914,398,993	945,041,257	808,764,905	2,249,529,502	3,190,125,447

(Sources:- Annual Report of Global IME 2008/09 to 2012/13)

#### **4.2.2 Everest Bank Ltd**

The bank has total authorized capital of Rs. 1,000,000,000 in FY 2008/09 and it had become Rs.1,250,000,000 in 2009/010 and remained at Rs. 2,000,000,000 from FY 2010/11 to FY 2012/13 but the issued capital was Rs. 840,620,000 in FY 2008/09 . It was increased to 1,050,000,000 in FY 2009/2010. It was further increased to Rs. 1,281,406,500 in the FY 2010/011. Again it is increased to Rs. 1,391,635,700 in the FY 2011/12. It was Rs. 1,761,126,410 in the FY 2012/13. Everest bank's balance sheet shows the total profit of Rs. 638,732,757in fiscal year 2008/09 which was raised to Rs. 831,765,632 in next fiscal year. The profit in the year 20010/11 was Rs. 931,303,628 and Rs. 1,090,564,222 in the fiscal year 2011/12. The profit in the fiscal year 2012/13 was Rs. 1,471,117,291. The position of banks performance of year 2065/66 to 2069/70 is mentioned in table below which shows the bank's every year performance along with increasing or decreasing trend:

**Table 4.2**

(Amount in Rs.)

F/Y	2008-9	2009-10	2010-11	2011-12	2012-13
Details					
Authorized Capital	1,000,000,000	1250000000	2,000,000,000	2,000,000,000	2,000,000,000
Issued Capital	840,620,000	1,050,000,000	1,281,406,500	1,391,635,700	1,761,126,410
Paid up Capital	838821000	1030467300	1279609490	1,391,635,700	1,761,126,410
Total Assets & Liabilities	36,916,848,654	41,382,760,711	46,236,212,262	55,813,129,057	65,741,150,457
Total Profit	638,732,757	831,765,632	931,303,628	1,090,564,222	1,471,117,291
Total borrowing on local sector	312,000,000	404,600,000	482,000,000	-	-
Total Borrowing on Foreign Sector	-	-	-	-	402,360,000
Total Interest Free Deposit	5,196,631,123	4,719,191,166	5,476,821,825	6,777,168,844	8,794,863,755
Total	28,126,315,123	32,213,118,842	35,651,092,514	43,228,931,427	48,925,600,877

Interest Bearing Deposit					
Bill Payable	148,655,592	145,514,679	49,716,572	692,398,816	393,056,902
Other Liability	378,574,715	566,081,795	559,237,454	897,383,129	1,084,456,540
Total Contingent Liability	7,203,640,814	7,517,695,899	8,682,550,410	13,049,884,771	13,995,209,700
Total Cash Balance	944,695,793	1,091,500,407	1,048,998,721	1,700,991,770	1,723,208,985
Total Investment	5,950,080,273	5,008,307,589	7,743,928,321	7,863,627,165	9,263,858,419
Total Fixed Assets	427,157,452	463,094,391	460,258,735	547,925,679	6,31,182,801
Net Worth(Other Assets)	492,166,151	536,187,696	851,470,792	1,127,295,233	1,237,128,209
Total Interest Income	2,186,814,992	3,102,451,484	4331,026,087	4,959,998,415	4,936,924,072
Total Interest Expenses	1,012,874,353	1,572,790,306	2,535,875,552	2,873,334,682	2,179,182,368
Employees Expenses	186,919,870	226,364,009	293,130,567	352,050,004	461,809,285

Office Operating Expenses	292,010,522	352,511,231	383,112,054	467,292,948	509,487,902
Total Capital Fund	2,703,870,000	3,257,141,000	3,605,841,000	4,574,753,000	5,777,682,000
Balance with NRB	4,787,163,541	5,625,113,849	4,706,320,590	8,159,753,523	8,205,090,428

(Sources:- Annual Report of EBL 2008/09 to 2012/13)

### **4.2.3 Capital Fund**

Capital fund of a bank consists of two types of components: Tier-1 capital and Tier- 2 capital. Tier-1 capital is known as core capital and Tier-2 capital is known as supplementary capital. Such as Total risk weighted Assets consists three type of risk i.e. Credit risk, Operational risk & Market risk.

#### **4.2.3.1 Capital Fund Analysis of Global IME Bank Ltd.**

The capital funds of Global IME Bank Ltd have been tabulated in table below which shows the capital fund of the bank over the period of last five fiscal years, i.e., from FY 2008/09 to FY 2012/13.

**Table 4.3**  
**Capital Fund of Global IME Ltd.**

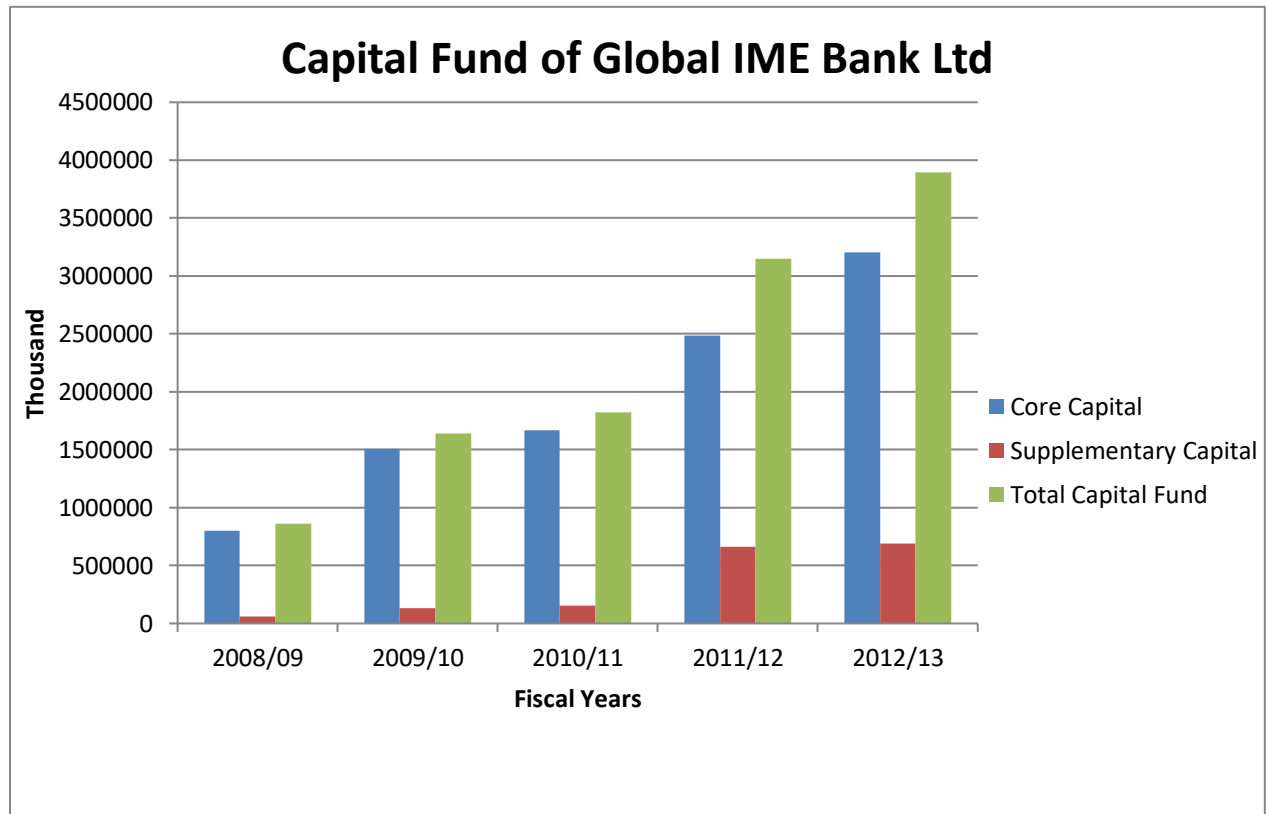
(Amount in Rs.)

F/Y	2008/09	2009/10	2010/11	2011/12	2012/13
Core capital	802177895	1506794790	1667815000	2486036000	3,206,102,000
Supplementary capital	58140543	134531985	155230000	660468000	688,480,000
Total Capital Fund	860318438	1641326775	1823045000	3146504000	3,894,582,000
Total RWA	10,978,082,276	15,058,346,000	16,443,808,000	26,978,407,000	34,969,452,000

(Source: Annual Reports of Global IME Bank 2008/09 to 2012/13)

**Figure 4.1**

**Capital Fund of Global IME Bank Ltd**



The above data and figure shows that the total capital fund and core capital and supplementary capital are in increasing trend from fiscal year 2008/09 to till date. If we see the figures, we can see that Global IME has subsequently increased its capital fund by increasing its core capital more than that of supplementary capital. The portion of core capital in total capital fund is 85.07% in five-year average while that of supplementary capital is 14.93% in five-year average. While portion of core capital fund in fiscal year 2012/13 is 82.32% and portion of supplementary capital is 17.68%. It means contribution of core capital is more in growth of total capital fund. Core capital plays vital role in stability and survival of the bank than that of supplementary capital. Total RWA of the bank is also increasing every year from fiscal year 2008/09 to 2012/13.

#### **4.2.3.2 Capital Fund Analysis of Everest Bank Ltd:-**

The capital funds of Everest Bank Ltd have been tabulated in Table below which shows the capital fund of the bank over the period of last five fiscal years, i.e., from FY 2008/09 to FY 2012/13.

**Table 4.4**

#### **Capital Fund of Everest Bank Ltd.**

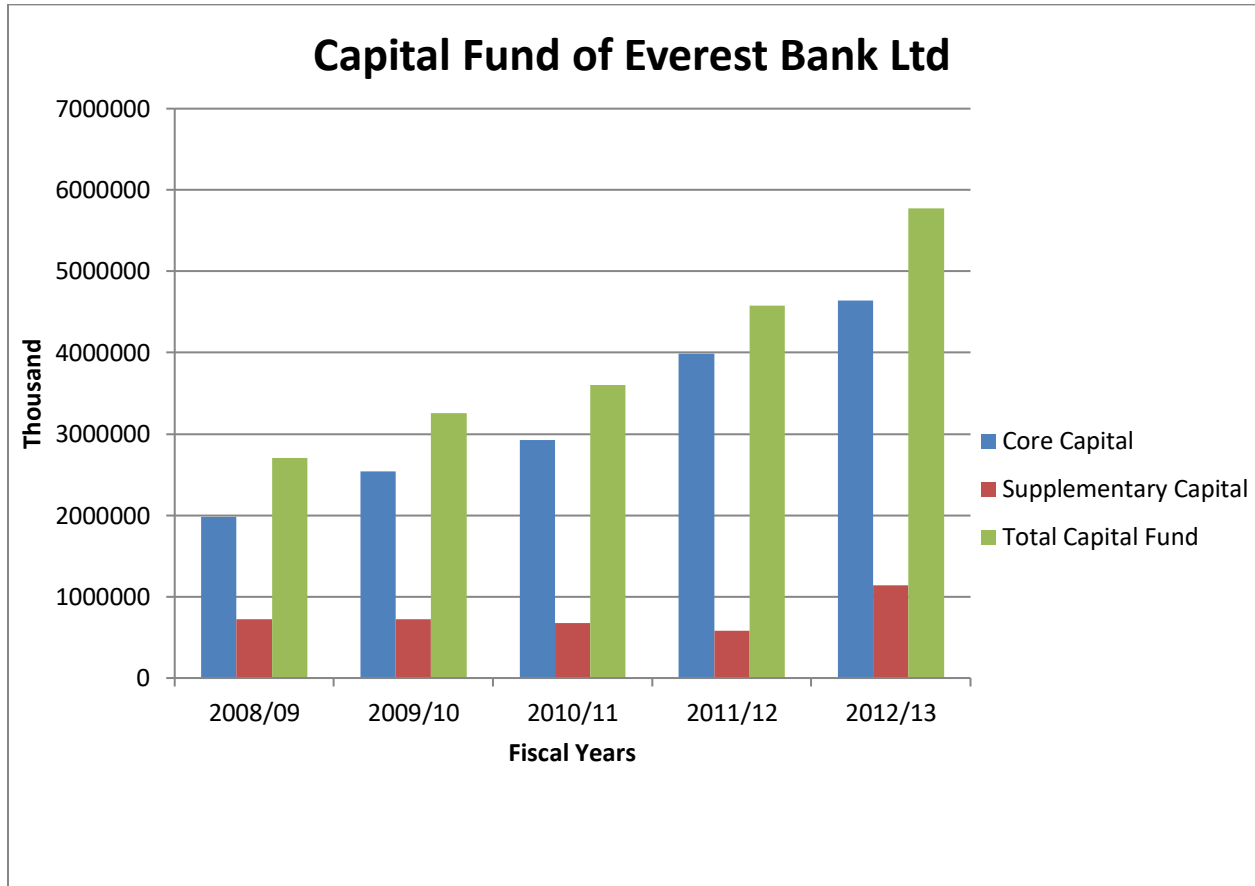
(Amount in Rs.)

F/Y	2008/09	2009/10	2010/11	2011/12	2012/13
Core capital	1981579000	2537092000	2927168000	3990924000	4639762000
Supplementary capital	722291000	720049000	678673000	583827000	1137920000
Total Capital Fund	2703870000	3257141000	3605840000	4574753000	5777682000
Total RWA	25619753000	30240428000	34583547000	41525347000	49834045000

Source: Annual Reports of EBL 2008/09 to 2012/13

**Figure 4.2**

**Capital Fund of Everest Bank Ltd.**



The above data shows the Core capital and total capital fund are in increasing trend but there is the fluctuation in supplementary capital fund. The supplementary capital is continuously decreasing from FY 2008/09 to FY 2011/012 but it is increased to highest in the FY 2012/13. The above figure shows that Everest bank Ltd has subsequently increased its capital fund by increasing its core capital than supplementary capital. The portion of core capital in total capital fund is 80.71 % in five-year average while that of supplementary capital is 19.29 % in five-year average. It means contribution of core capital is more in generating the total capital fund. Core capital plays important role in safeguarding both the survival of the bank and stability of the financial system so commercial banks give more priority to core capital than that of supplementary capital.

### 4.3 Financial Analysis on the basis of secondary Data

The use of secondary data is much extensive which are collected through records of annual report. The data have been collected from the published and unpublished official records of sample commercial bank & NRB. This part incorporates the analysis of secondary data that are related in measuring the capital adequacy ratio and in measuring the credit risk of the banks. Under this section financial analysis of the data is presented.

#### 4.3.1 Core Capital Adequacy Ratio

As per the unified directives of NRB, the bank has to keep minimum 6% of the total risk weighted assets as core capital. The core capital adequacy ratio maintained by Global IME Bank and Everest Bank Ltd within the five year periods are presented in the below table:-

**Table 4.5**  
**Core Capital adequacy ratio**

F/Y	NRB's Min Req %	Global IME Bank Ltd		Everest Bank Ltd	
		CCAR%	Variance%	CCAR%	Variance%
2008/09	6	7.31	1.31	7.73	1.73
2009/10	6	10.01	4.01	8.39	2.39
2010/11	6	10.14	4.14	8.46	2.46
2011/12	6	9.21	3.21	9.61	3.61
2012/13	6	9.17	3.17	9.31	3.31
Mean ( $\bar{X}$ )		9.17		8.70	
S.D ( $\sigma$ )		1.01		0.68	
C.V.%		11.01		7.82	

(Source: Appendix II -1)

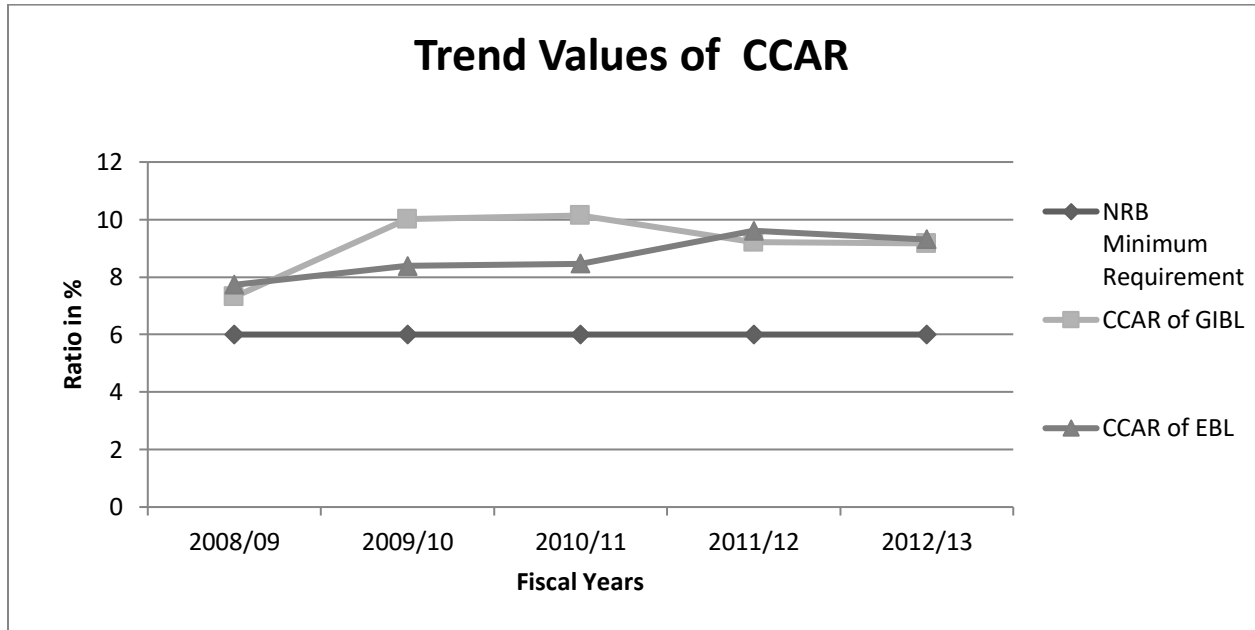
The above table indicates that in all the fiscal year taken for study, the core capital adequacy ratio of Global IME Bank has exceeded the NRB's minimum standard. The CCAR of Global IME was 7.31% in the FY 2008/09 and the ratio was 10.01%, 10.14%, 9.21% and 9.17% in the fiscal year 2009/10, 2010/11, 2011/12 and 2012/13 respectively, against the NRB standard 6%. There is the fluctuation in the variance of Global IME Bank Ltd. However, in average, the CCAR maintained by Global IME Bank is 9.17 and coefficient of variation is 11.01%.

Similarly, the CCAR maintained by Everest Bank Ltd has also crossed the benchmark set by NRB for core capital adequacy as the ratio of Everest is higher than the minimum requirement. The CCAR and variance maintained by Everest Bank Ltd are in increasing trend except in the fiscal year 2012/13. Everest Bank Ltd has maintained 7.73%, 8.39%, 8.46%, 9.61% and 9.31% CCAR against the 6% set by NRB in the fiscal year 2008/09, 2009/10, 2010/11, 2011/12 and 2012/13 respectively. In average Everest Bank Ltd has maintained 8.70% CCAR in the five years period and coefficient of variation is 7.82%.

Comparing the two banks on the basis of average CCAR, it can be concluded that the capital foundation of Global IME Bank is more adequate than that of Everest Bank Ltd in protecting its depositors and creditors and in commensuration of risk associating activities, since the average CCAR of Global IME Bank Ltd (9.17%) is higher than that of Everest Bank Ltd (8.70). In general, both the banks have maintained Tier I capital adequacy above the NRB standard, which has indicated the adequate application of internal sources, i.e. shareholders' equity.

**Figure 4.3**

**Core Capital adequacy ratio**



**4.3.2 Supplementary Capital Adequacy Ratio**

The ratio reflects proportion of supplementary capital component in total adjusted assets and relative contribution in CAR. NRB regulates supplementary capital ratio by following supplementary capital not exceeding 100% of the core capital for CAR calculation.

**Table 4.6****Supplementary Capital Adequacy Ratio**

FY	Global IME Bank Ltd			Everest Bank Ltd		
	Max.Req%	SCAR%	Variance	Max.Req%	SCAR%	Variance
2008/09	7.31	0.53	6.78	7.73	2.82	4.91
2009/10	10.01	0.89	9.12	8.39	2.38	6.01
2010/11	10.14	0.94	9.20	8.46	1.96	6.5
2011/12	9.21	2.45	6.76	9.61	1.41	8.2
2012/13	9.17	1.97	7.20	9.31	2.28	7.03
Mean( $\bar{X}$ )		1.36			2.17	
S.D( $\sigma$ )		0.73			0.47	
CV%		53.68			21.66	

(Source: Appendix II-2)

The table has showed that supplementary capital adequacy ratio maintained by Global IME Bank Ltd is maximum 2.45% in fiscal year 2011/12 and minimum, 0.53% in the fiscal year 2008/09. The ratios maintained by Global IME in fiscal year 2009/10, 2010/11 and 2012/13 are 0.89%, 0.94% and 1.97% respectively. This indicates that the supplementary capital is in increasing trend except in the FY 2012/13. In average, the supplementary capital adequacy ratio of Global IME Bank is 1.36%. However, in all the fiscal years taken for study, the supplementary capital ratio of Global IME is well below the maximum level directed by NRB, and thus the variance has ranged from 6.76 % in the fiscal year 2011/12 to 9.20% in the fiscal year 2010/11.

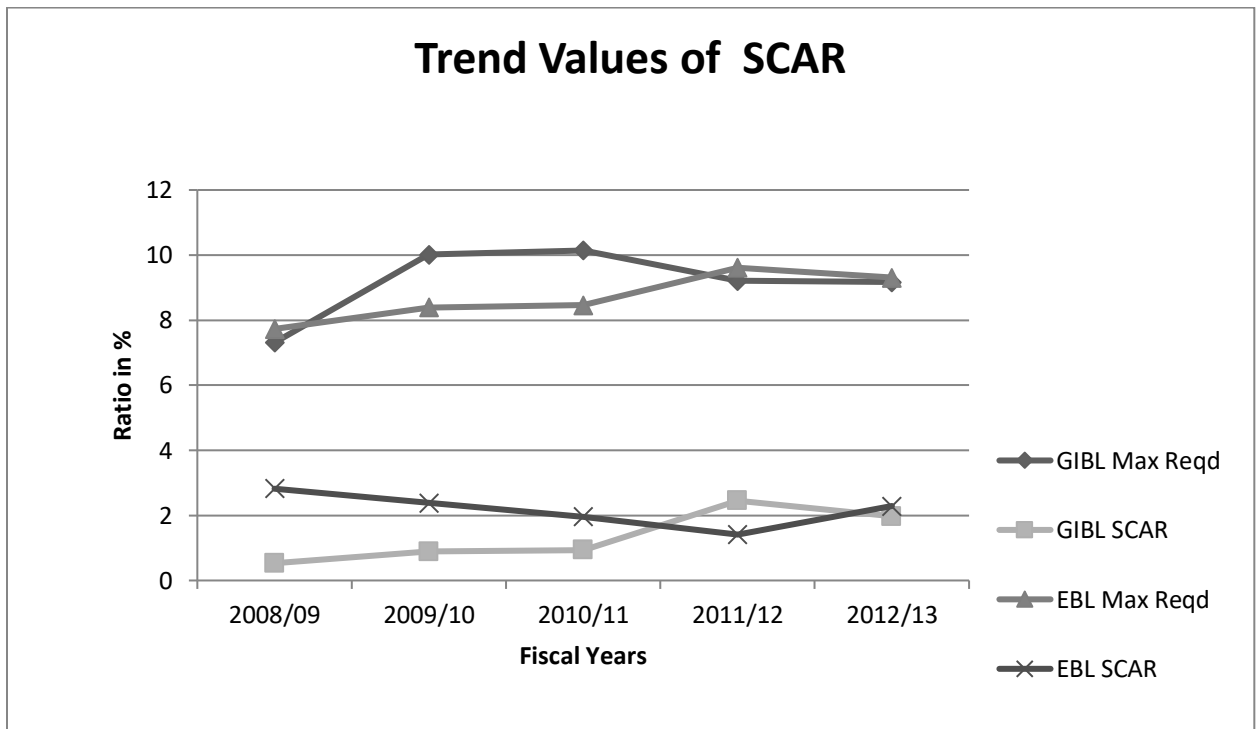
Likewise, the supplementary capital adequacy ratio of Everest Bank Ltd is in decreasing trend except in the FY 2012/13. In the fiscal year 2008/09 the ratio was 2.82 and it is

gradually decreased to 2.38, 1.96 and 1.41 in the fiscal year 2009/10, 2010/11 and 2011/12. But in the FY 2012/13, the ratio is increased to 2.28%. In average SCAR of the bank is 2.17% and coefficient of variation is 21.66%. The variance of the EBL has ranged from 4.91% in the fiscal year 2008/09 to 8.20% in the fiscal year 2011/12. During the study years Everest Bank is successful to maintain the supplementary capital adequacy ratio well below the NRB's norm.

Comparing two banks, it can be concluded that the capital base of Global IME is quite stronger than that of Everest Bank Ltd in meeting the risk as in average the supplementary capital adequacy ratio of Global IME is lower than that of Everest Bank Ltd.

**Figure 4.4**

**Supplementary Capital Adequacy Ratio**



**4.3.3 Capital Adequacy Ratio**

Capital Adequacy ratio above NRB standard, i.e. minimum 10%, indicates adequacy of capital and signifies higher security to depositors, higher internal source and higher

ability to cushion operational and unanticipated losses. The CAR maintained by GIBL and EBL with in the five years periods are presented in the table below.

**Table 4.7**  
**Capital Adequacy Ratio**

F/Y	NRB Min Req%	Global IME Bank Ltd		Everest Bank Ltd	
		CAR%	Variance%	CAR%	Variance%
2008/09	10	7.84	-2.16	10.55	0.55
2009/10	10	10.90	0.9	10.77	0.77
2010/11	10	11.09	1.09	10.43	0.43
2011/12	10	11.66	1.66	11.02	1.02
2012/13	10	11.14	1.14	11.59	1.59
Mean		10.53		10.87	
S.D.		1.37		0.41	
C.V.%		13.01		3.77	

(Source: - appendix II-3)

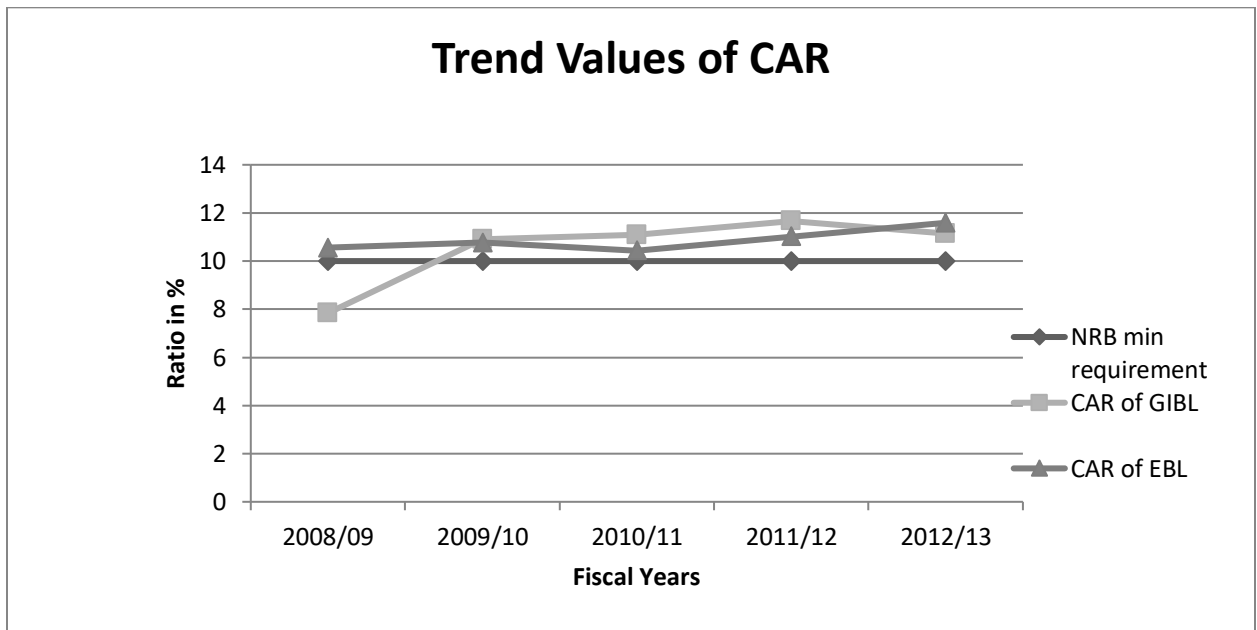
The above table measures the capital adequacy ratio of the selected banks. As per the BASEL II, the minimum capital adequacy ratio is 8%, however NRB has fixed 10% from fiscal year 2008/09 before it was 12%. The table shows that the CAR of Global IME Bank has deficit the minimum requirement of NRB in the fiscal year 2008/09 by 2.16%. Then after it was exceeded by 0.9%, 1.09%, 1.66% and 1.11% in the fiscal year 2009/010, 2010/11, 2011/12 and 2012/13 respectively. In average, Global IME has

maintained 10.53% CAR ratio, higher than the NRB's standard during the five years of study period and the coefficient of variation is 13.01%.

However, the CAR ratio maintained by Everest Bank Ltd is in fluctuating trend. The CAR ratio of Everest Bank was 10.55% in the fiscal year 2008/09 and it was increased to 10.77% in the fiscal year 2009/10. Again it was decreased to 10.43% in the fiscal year 2010/11 . Again it was increased to 11.02% in the fiscal year 2011/12 and in the fiscal year 2012/13 it is further increased to 11.59%. The CAR ratio of Everest bank indicates that it is successful to meet the NRB's minimum standard in the five years of study period. In average, Everest Bank Ltd has maintained 10.87% as CAR and coefficient of variation is 3.77 % indicating quite consistency in the ratio.

**Figure 4.5**

**Capital Adequacy Ratio**



#### 4.3.4 Non Performing Loan to Total Loan and Advance

The non performing loan to total loan measuring the risk on the total loan and thus represents the quality of the assets the bank is caring on. Higher the ratio indicates higher risk on the assets and vice-versa. The ratio of GIBL and EBL for five year periods is presented in the table below.

**Table 4.8**

#### **Non Performing Loan to Total Loan and Advance**

(Amount in Rs)

F/Y	Global IME Bank Ltd			Everest Bank Ltd		
	NPL	TLA	Ratio%	NPL	TLA	Ratio%
2008/09	8595000	9159798604	0.09	117985232	24469555526	0.48
2009/10	103195772	12163635545	0.85	43705982	28156399843	0.16
2010/11	321782395	12779175146	2.52	108512928	31661842757	0.34
2011/12	341321267	20,765181747	1.64	307492696	36616831527	0.84
2012/13	612360846	26991614623	2.27	276198772	44197762941	0.62
<b>Mean(<math>\bar{X}</math>)</b>			<b>1.47</b>			<b>0.49</b>
<b>S.D.(<math>\sigma</math>)</b>			<b>0.90</b>			<b>0.23</b>
<b>C.V%</b>			<b>61.22</b>			<b>46.94</b>

(Sources: Appendix II-4)

The above table shows the efficiency of bank in controlling non performing loan/assets. The table reveals that none performing loan of the Global IME Bank is increasing continuously. The non performing loan of the GIBL in the fiscal year 2008/09 was Rs. 8595000 and reached to Rs. 612,360,846 in the fiscal year 2012/13. The loan and

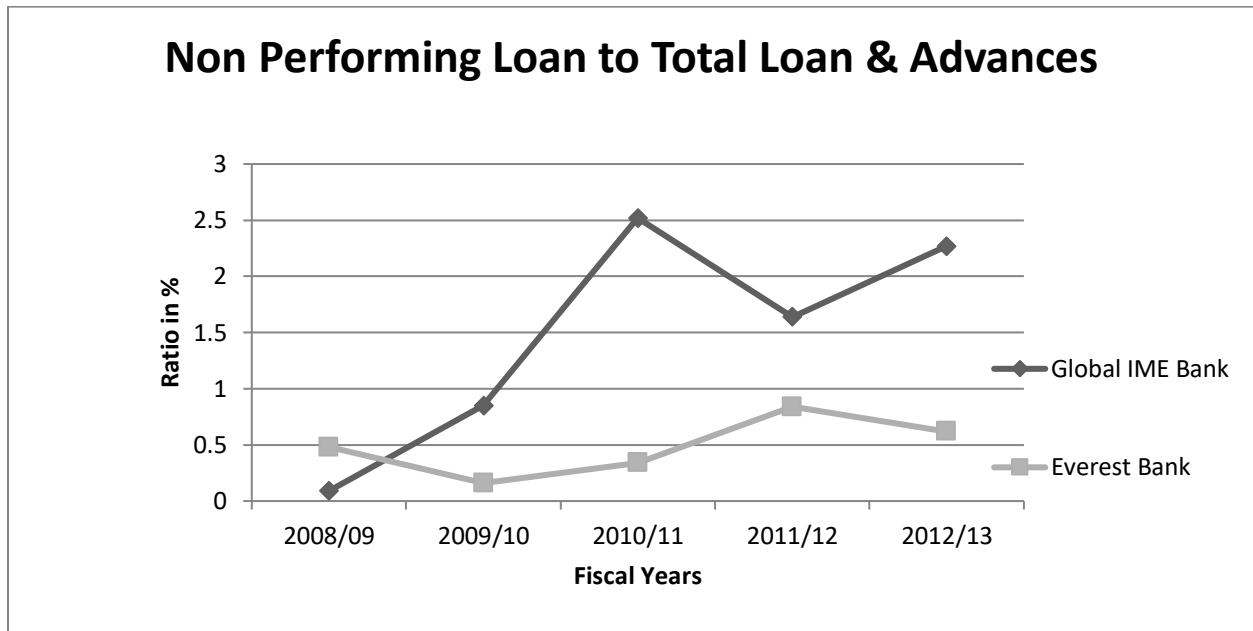
advance of Global IME Bank is in increasing trend ranging from Rs. 9159798604 in the fiscal year 2008/09 to Rs. 26991614623 in the fiscal year 2012/13. However the ratio of non-performing loan to total loan and advance of the bank is in fluctuating trend. The ratio was 0.09 % in the fiscal year 2008/09 and then increased to 0.85% in the fiscal year 2009/10. The ratio was further increased to 2.52% in the fiscal year 2010/11 and it was again decreased to 1.64% in the fiscal year 2011/12. Then after, the ratio is increased to 2.27% in the fiscal year 2012/13. The decreased rate of the ratio in some fiscal year indicates that the growth rate of loan and advance is far higher than the growth rate of non-performing loan. In average, the credit risk on total loan and advance is 0.90% and coefficient of variation on such risk is 61.22%, indicating higher inconsistency.

However, the non-performing loan of Everest Bank Ltd is found to be fluctuating. The non performing loan in the fiscal year 2008/09 was Rs. 117985232. It was decreased to Rs. 43705982 in fiscal year 2009/10. Then after the non performing loan was increased to Rs. 108512928 in the FY 2010/11 and it was further increased to Rs. 307492696 in the fiscal year 2011/12. But in the FY 2012/13, the ratio has decreased to Rs. 276,198,772. Although the total loan and advance is found to be in increasing trend, ranging from Rs. 24469.56 million in the fiscal year 2008/09 to Rs. 44197.76 million in the fiscal year 2012/13. The ratio of non-performing loan to total loan is in fluctuating trend. The ratio was 0.48%, 0.16%, 0.34%, 0.84% and 0.62% in the fiscal years 2008/09, 2009/10, 2010/11, 2011/12 and 2012/13 respectively. In average the credit risk ratio of Everest Bank Ltd for the five year period is 0.23% and coefficient of variation on such ratio is 46.94%, indicating extreme inconsistency.

Consequently, it can be concluded that both the banks have to decrease the non-performing assets ratio with sound loan management policy.

**Figure 4.6**

**Non Performing Loan to Total Loan and Advance**



**4.3.5 Loan Loss Provision to Total Loan and Advance**

The non- performing assets is considered much risky than the performing loan and finally effects the financial performance of the company. Thus, to remain secure each bank has to keep the options of the non- performing assets, 25% of substandard loan, 50% of doubtful loan and 100% of loss loan as provision. The loan loss provision to non- performing assets measures the aggregate representation of loan provision on non- performing assets.

**Table 4.9****Loan Loss Provision to Total Loan and Advance**

(Amount in Rs.)

F/Y	Global IME Bank Ltd			Everest Bank Ltd		
	LLP	TLA	Ratio	LLP	TLA	Ratio
2008/09	96707036	9159798604	1.06	584881910	24469555526	2.39
2009/10	203183027	12163635545	1.67	600043812	28156399843	2.13
2010/11	406751908	12779175146	3.18	604151295	31661842757	1.91
2011/12	468681247	20,765181747	2.26	705856854	36616831527	1.93
2012/13	779317450	26991614623	2.89	804575876	44197762941	1.82
<b>Mean(<math>\bar{X}</math>)</b>			<b>2.21</b>			<b>2.04</b>
<b>S.D.(<math>\sigma</math>)</b>			<b>0.78</b>			<b>0.20</b>
<b>C.V. %</b>			<b>35.29%</b>			<b>9.80%</b>

(Source: Appendix II)

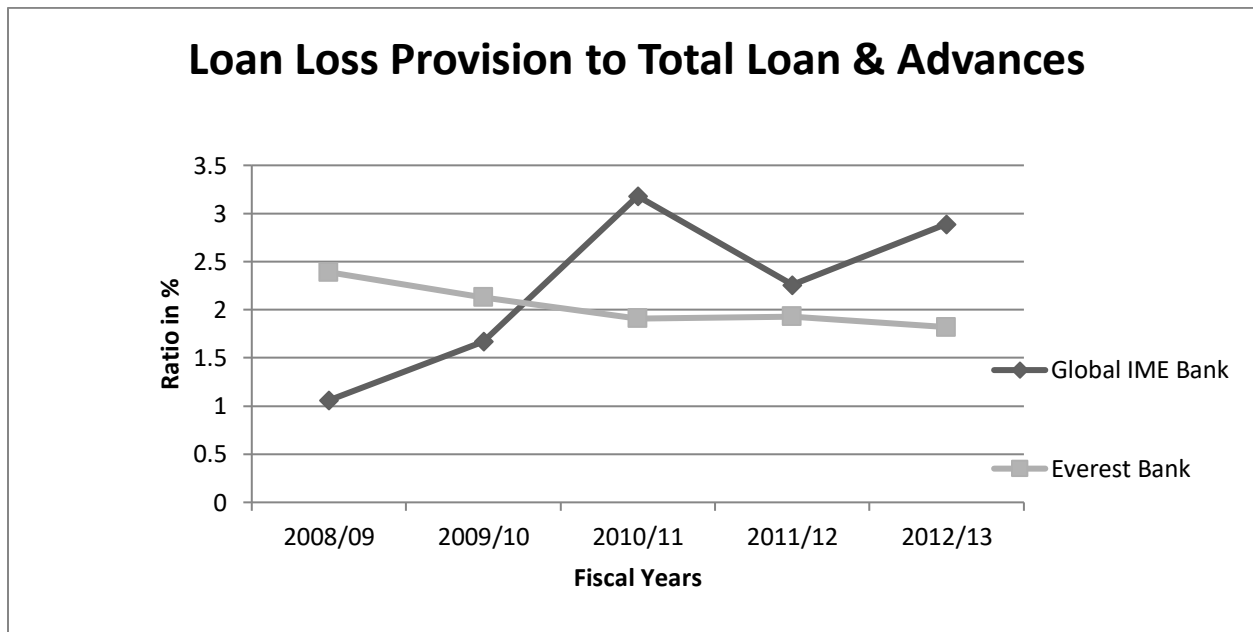
The above table shows the loan loss provision made by the banks against the loan and advance disbursed. The table shows that the loan loss provision kept by Global IME Bank has ranged from Rs. 96.71 million in the fiscal year 2008/09 to Rs. 779.32 million in the fiscal year 2012/13. Further, ratio of the loan loss provision to total loan and advance of Global IME Bank is found to be in fluctuating trend. The highest ratio is 3.18% in the fiscal year 2010/11 and lowest one is 1.06 % in the fiscal year 2008/09. In average, there is 2.21% of the Loan loss provision to total loan and advance ratio of the GIBL Bank.

Similarly, the loss provision amount of Everest Bank is in increasing trend and thus ranges from Rs. 584.88 million in the fiscal year 2008/09 to Rs. 804.58 million in the fiscal year 2012/13. However, Loan loss provision to total loan and advance ratio of the Everest Bank is in decreasing trend. The ratio of loan loss provision to total loan and advance of Everest Bank Ltd is 2.39%, 2.13%, 1.91%, 1.93% and 1.82% in the fiscal years 2008/09, 2009/10, 2010/11, 2011/12 and 2012/13 respectively. In average, Everest Bank has maintained the ratio at 2.04% .

Comparing two banks, it can be concluded that the Global IME requires to provision high loss against total loan than Everest Bank, since the credit risk of Global IME is higher than that of Everest Bank.

**Figure 4.7**

**Loan Loss Provision to Total Loan and Advance**



**4.3.6 Statistical Analysis**

Under this part of the study, the relationship between net profit and CAR has been measured using correlation coefficient and regression analysis. Generally, higher CAR

ratio indicates higher accumulation of unutilized capital amount for protection and thus deduces the net profit. Further the trend value of CAR also been estimated.

#### 4.3.6.1 Correlation between Net Profit and CAR

**Table no 4.10**

**Correlation Between NPAT & CAR**  
**Correlation Analysis of Global IME Bank Ltd.**

(Amount in Million)

FY	Net Profit(X)	CAR(Y)	XY	X <sup>2</sup>	Y <sup>2</sup>
2008/09	26.30	7.84	206.19	691.69	61.47
2009/10	73.00	10.90	795.70	5,329.00	118.81
2010/11	224.98	11.09	2,495.03	50,616.00	122.99
2011/12	265.32	11.66	3,093.63	70,394.70	135.96
2012/13	449.22	11.14	5,004.31	201,798.61	124.10
	$\Sigma X=1038.82$	$\Sigma Y=$ 52.63	$\Sigma XY=$ 11594.86	$\Sigma X^2=328830$	$\Sigma Y^2= 563.32$

Source: Annual Reports of Global IME Bank Ltd 2008/09 to 2012/13

$$\Sigma X = 1038.82$$

$$\Sigma Y = 52.63$$

$$\Sigma XY = 11594.86$$

$$\Sigma X^2 = 328830$$

$$\Sigma Y^2 = 563.32$$

By the formula,

Karl Person's Correlation Coefficient ( $r_{xy}$ )

$$= \frac{n\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[n\Sigma X^2 - (\Sigma X)^2]} \sqrt{[n\Sigma Y^2 - (\Sigma Y)^2]}}$$

$$= \frac{5 \times 11594.86 - 1038.82 \times 52.63}{\sqrt{[5 \times 328830 - (1038.82)^2]} \sqrt{[5 \times 563.32 - (52.63)^2]}}$$

$$= \frac{57974.30 - 54673.10}{551.67 \times 6.83}$$

$$= \frac{3301.20}{3494.71}$$

$$= 0.94$$

$$\text{P.E. (r)} = \frac{0.6745 \times (1-r^2)}{\sqrt{n}}$$

$$= \frac{0.6745 \times (1-(0.94)^2)}{\sqrt{5}}$$

$$= 0.04$$

Coefficient of Determination  $(r_{xy})^2 = (\text{Correlation Coefficient})^2 = 0.94^2 = 0.88$

**Table no 4.11**

**Correlation Between NPAT & CAR**  
**Correlation Analysis of Everest Bank Ltd.**

(Amount in Million)

FY	Net Profit(X)	CAR(Y)	XY	X <sup>2</sup>	Y <sup>2</sup>
2008/09	638.73	10.55	6,738.60	407,976.01	111.30
2009/10	831.77	10.77	8,958.16	691,841.33	115.99
2010/11	931.30	10.43	9,713.46	867,319.69	108.78
2011/12	1090.56	11.02	12,017.97	1,189,321.11	121.44
2012/13	1471.12	11.59	17,050.28	2,164,194.05	134.33
	$\sum X = 4,963.48$	$\sum Y = 54.36$	$\sum XY =$ 54,478.47	$\sum X^2 =$ 5,320,652.19	$\sum Y^2 =$ 591.84

Source: Annual Reports of EBL 2008/09 to 2012/13

$$\sum X = 4,963.48$$

$$\sum Y = 54.36$$

$$\sum XY = 54,478.47$$

$$\sum X^2 = 5,320,652.19$$

$$\sum Y^2 = 591.84$$

By the formula,

By the formula,

Karl Person's Correlation Coefficient ( $r_{xy}$ )

$$\begin{aligned}
&= \frac{n\Sigma XY - (\Sigma X)(\Sigma Y)}{\sqrt{[n\Sigma X^2 - (\Sigma X)^2]} \sqrt{[n\Sigma Y^2 - (\Sigma Y)^2]}} \\
&= \frac{5 \times 54,478.47 - 4,963.48 \times 54.36}{\sqrt{[5 \times 5,320,652.19 - (4,963.48)^2]} \sqrt{[5 \times 591.84 - (54.36)^2]}} \\
&= \frac{272392.35 - 269814.77}{1402.54 \times 2.05} \\
&= \frac{2577.58}{2875.20} \\
&= 0.90
\end{aligned}$$

$$P.E. (r) = \frac{0.6745 \times (1-r^2)}{\sqrt{n}}$$

$$= \frac{0.6745 \times (1-(0.90)^2)}{\sqrt{5}}$$

$$= 0.06$$

$$\text{Coefficient of Determination } (r_{xy})^2 = (\text{Correlation Coefficient}^2) = (0.90)^2 = 0.81$$

The correlation coefficient between net profit after tax (NPAT) and capital adequacy ratio (CAR) as calculated above is summarized below.

**Table 4.12****Correlation Analysis between Net Profit and CAR**

Banks	Correlation coefficient between	r	Type of correlation	$r^2$	P.E.	6 P.E.	Remarks
Global IME	NPAT and CAR	0.94	Moderate degree of positive correlation	0.88	0.04	0.24	Definitely Significant
Everest Bank	NPAT and CAR	0.90	Lower degree of negative correlation	0.81	0.06	0.36	Definitely Significant

The above calculation reveals that that the correlation coefficient between Net profit and CAR of Global IME is 0.94 which means that there is a high degree of positive correlation between the two variables. As the value of r is more than the value of 6P.E. (r) i.e.  $0.94 > 6 \times 0.04$ , the value of r is definitely significant. Likewise, in case of Everest bank, correlation coefficient between Net profit and CAR is 0.90 which indicates that there is a high degree positive correlation between the two variables. Here, correlation coefficient is more than 6 times its probable error i.e.  $r > 6P.E. (r)$  [ $0.90 > 6 \times 0.06$ ] which indicates that there is definitely significant relationship between Net profit and CAR.

However, it is cleared that there is high degree of positive relationship between Net profit and CAR in case of both Global IME and Everest Bank Ltd

The value of  $r^2$  of Global IME is 0.88, which indicates that 88% of variation is explained in the dependent variable NPAT due to the change in the value of independent variable CAR. Similarly, in case of EBL, coefficient of determination between NPAT and CAR is 0.81, which indicates that 81 % variation in the NPAT is explained due to the

CAR. Likewise, the probable error indicates that the relationship between NPAT and CAR of both Global IME and Everest bank is definitely significant.

#### 4.3.6.2 Trend Analysis of CAR

Under this section, the trend value of capital adequacy ratio for the forthcoming five fiscal year has been estimated.

**Table No. 4.13**  
**Least Square Trend Analysis of CAR**

End of Fiscal Years (t)	x = t - 2011	Global IME	Everest Bank Ltd
		Trend Value $y_c = 10.53 + 0.74x$	Trend Value $y_c = 10.87 + 0.23x$
2009	-2	7.84	10.55
2010	-1	10.90	10.77
2011	0	11.09	10.43
2012	1	11.66	11.02
2013	2	11.14	11.59
2014	3	12.75	11.56
2015	4	13.49	11.79
2016	5	14.23	12.02
2017	6	14.97	12.25
2018	7	15.71	12.48

Source: Appendix II -6 (A) and 6 (B)

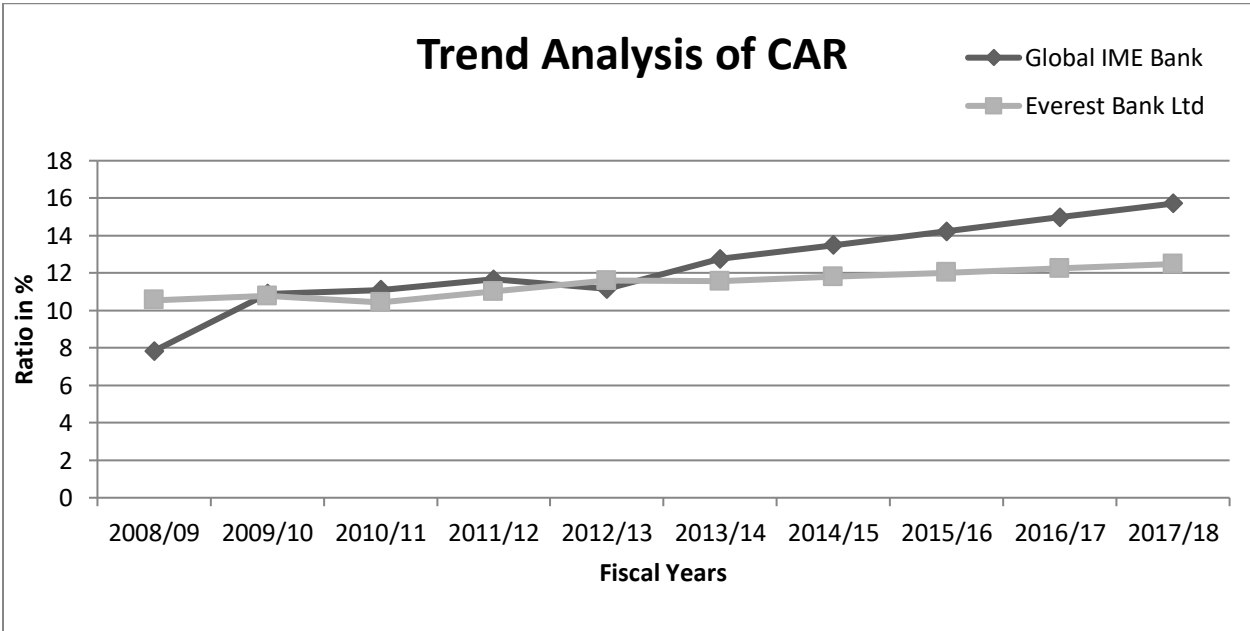
In the above table it is presented the trend value of capital adequacy ratio of Global IME and Everest Bank Ltd. The table shows the past CAR of Global IME for the fiscal year 2008/09 to 2012/13 as well as the forecasted CAR of Global IME for the fiscal year 2013/14, 2014/15, 2015/16, 2016/17 and 17/18 which will be 12.74%, 13.49%, 14.23%, 14.97% and 15.71% respectively. This clearly indicates that the CAR of Global IME will meet the NRB’s requirement as it is in increasing trend.

Likewise, the forecasted CAR of Everest Bank for the fiscal year 2013/14, 2014/15, 2015/16, 2016/17 and 2017/18 will be 11.56%, 11.79%, 12.02%, 12.25% and 12.48% respectively. The trend value of CAR indicates that because of positive trend Bank will be able to meet the standard set by NRB’s in every fiscal year for the next 5 year.

From the trend value, it can be concluded that Global IME will be more successful than Everest Bank Ltd to meet the standard set out by NRB in regard to the capital adequacy ratio.

**Figure 4.8**

**Trend Analysis of CAR**



#### 4.4 Primary Data Analysis

With the objective of finding out the view of banking personnel about the capital adequacy ratio and risk contorting to the bank, the primary data analysis has been done. For primary data collection, 10 employees of GIBL and 10 employees of EBL were requested to express their opinions.

##### 4.4.1 Reason for setting NRB directives for the commercial banks

To examine the NRB's directives issued for commercial banks, the respondents were asked on this matter. The responses obtained from them are presented in the table below.

**Table 4.14**

**Reason for setting NRB directives for the commercial banks**

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
To Protect the banks and financial institutions	6	60	4	40	10	50
To enhance the credibility of financial system	1	10	4	40	5	25
To protect the interest of the depositors	3	30	2	20	5	25
Total	10	100	10	100	20	100

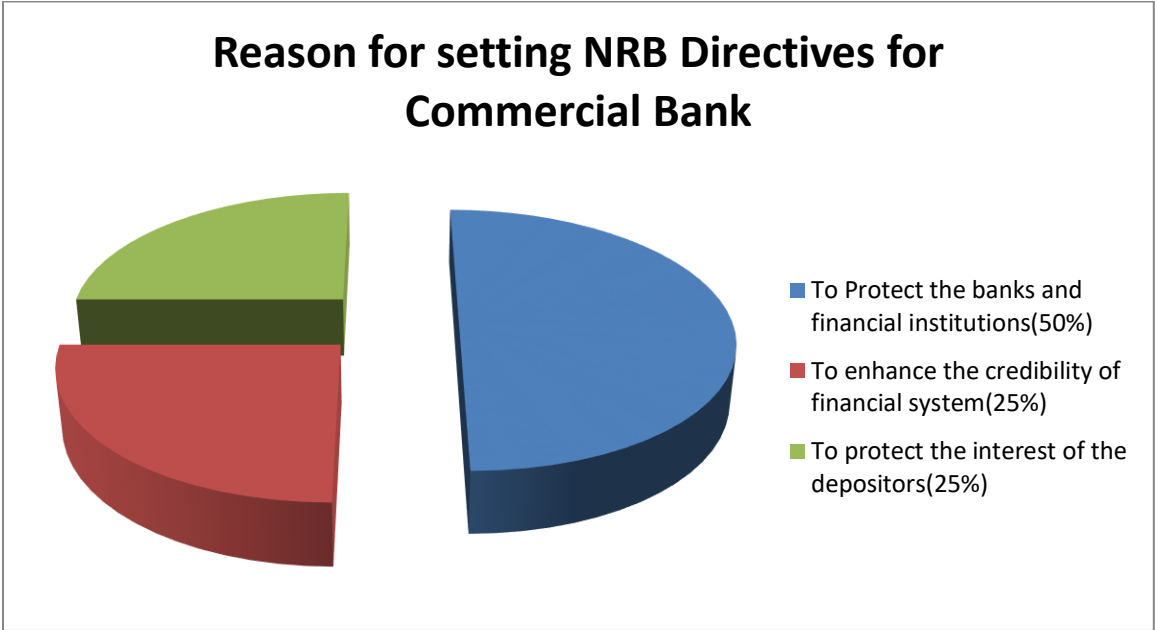
(Source:- Field Survey, 2013)

The above table present that 60% of the respondent from Global IME Bank, and 40% of the respondent from Everest Bank, and 50% of the total respondent (10 out of 20) have stated that NRB directives are necessary to protect the banks and financial institutions, similarly, 10% of the respondents from Global IME, 40% respondents from Everest Bank and 25% of the total respondents ( 5 out of 20) have affirmed that the NRB directives are necessary to enhance the credibility of financial system. Likewise, 30% respondents from

Global IME, 20% of the respondents from Everest Bank and 25% of the total respondents have said that the NRB directives are necessary to protect the interest of the depositors. However, majority of the respondents are in favor of the statement that NRB directives are necessary to protect the banks and financial institutions.

**Figure 4.9**

**Reason for setting NRB directives for the commercial banks**



**4.4.2 Effective role of NRB in Regulating and Supervising the Commercial Banks**

To ensure the smooth running of the banks and to ensure the security of deposit holders, the NRB annually makes both onsite and offsite supervision, the respondents are asked on this matter.

**Table 4.15**

**Effective Role of NRB in Regulating and Supervising Commercial Banks**

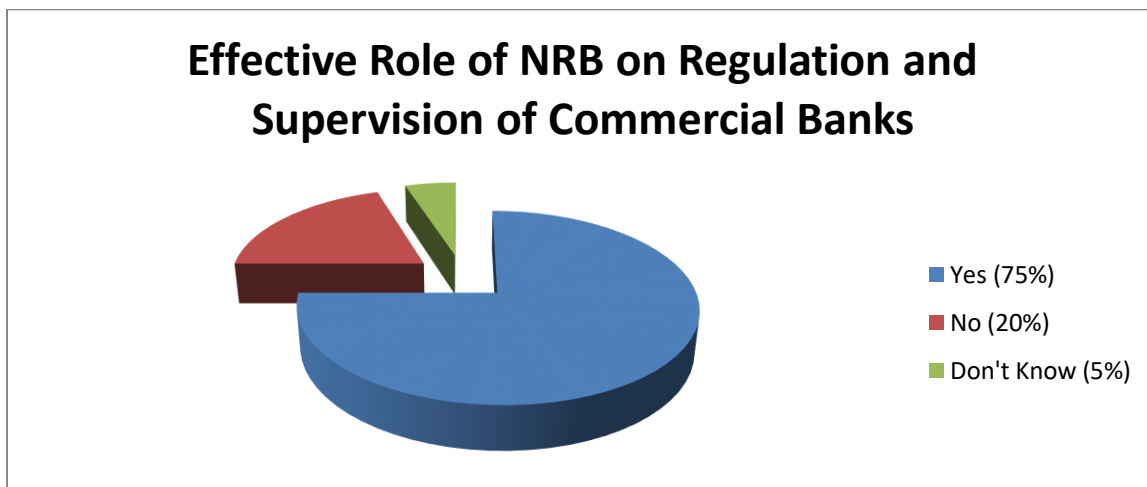
Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Yes	7	70	8	80	15	75
No	2	20	2	20	4	20
Don't Know	1	10	0	0	1	5
Total	10	100	10	100	20	100

(Source:- Field Survey, 2013)

The above table shows that 70% of the respondents from Global IME, 80% of Everest Bank Ltd and 75% (15 out of 20) as a whole are satisfied with the regulation and supervision of NRB, whereas 20% of the respondents from Global IME, 20% of the respondents from Everest Bank and 20% (4 out of 20) as a whole are unsatisfied with the regulation and supervision of NRB and 5 % of the respondents as a whole are indifferent by such supervision.

**Figure 4.10**

**Effective Role of NRB on Regulation and Supervision of Commercial Banks**



#### 4.4.3 Most benefited Beneficiaries by maintaining Capital Adequacy Requirement

To know who will be benefited most by maintaining capital adequacy requirement, the employees of the banks are asked to express their view. The responses obtained from them are presented in the table below.

**Table 4.16**

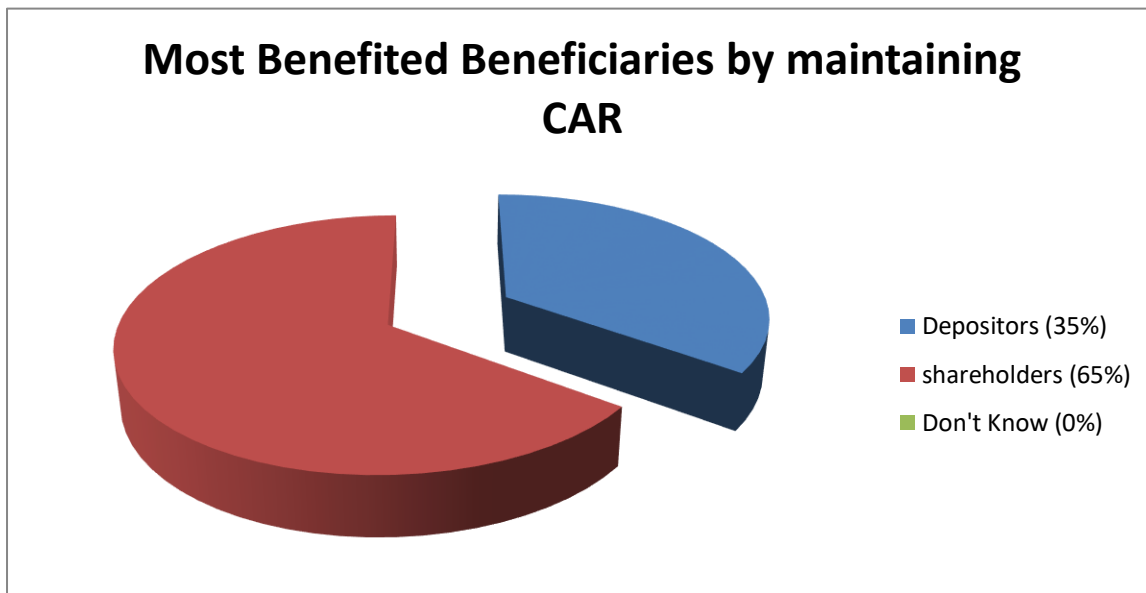
Most Benefited Beneficiaries by Maintaining Capital Adequacy Requirement

Responses	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Depositors	3	30	4	40	7	35
shareholders	7	70	6	60	13	65
Don't Know	0	0	0	0	0	0
Total	10	100	10	100	20	100

(Source:- Field Survey, 2013)

The above table shows that 30% of the respondents from Global IME, 40% respondents from Everest Bank and overall 35% of the respondents have said that the depositors are mostly benefited maintaining capital adequacy. Similarly 70% of the respondents from Global IME, 60% of the respondents from Everest Bank and overall 65% of the respondents have stated that shareholders are benefited most. Thus, looking the overall responses, it can be concluded that the shareholders would be mostly benefited by maintaining capital adequacy requirements.

**Figure 4.11 Most benefited Beneficiaries by maintaining Capital Adequacy Requirement**



#### 4.4.4 Appropriate Ratio for CCAR

As per the NRB directives, the core capital adequacy ratio of each bank be minimum 6%. To examine whether such rate is favorable, the respondents are asked to express their views.

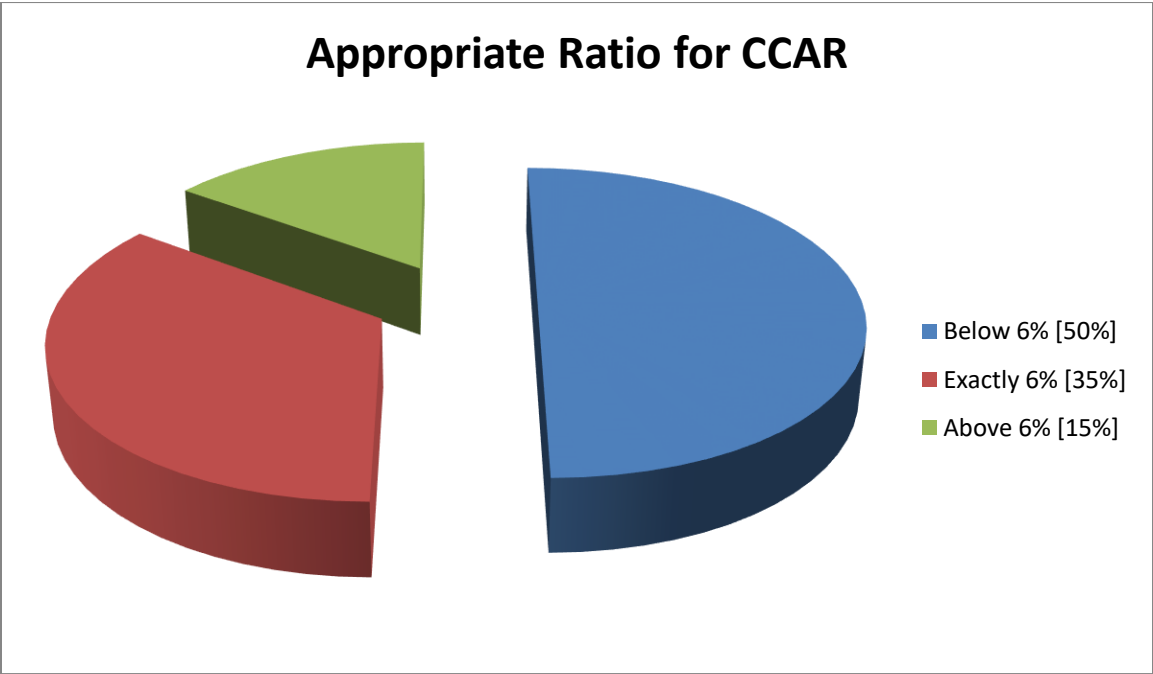
**Table 4.17  
Appropriate Ratio for CCAR**

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Below 6%	5	50	5	50	10	50
Exactly 6%	3	30	4	40	7	35
Above 6%	2	20	1	10	3	15
Total	10	100	10	100	20	100

(Source:- Field Survey, 2013)

The above table shows that 50% of the respondents from Global IME, 50% respondents from Everest Bank and overall 50% of the respondents (10 out of 20) have stated that the core capital adequacy ratio should be below 6%. Similarly, 30% of the respondents from Global IME, 40% respondents from Everest Bank and overall 35% of the respondents (7 out of 20) have affirmed that the ratio should be exactly 6%, which have been practiced. Likewise, 20% of the respondents from Global IME, 10% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) have said that the rate should be above 6%. However, accepting the opinion of majority, it can be concluded that the core capital adequacy ratio should be below 6% to have optimal capital base.

**Figure 4.12**  
**Appropriate Ratio for CCAR**



**4.4.5 CAR requirement set by NRB- Fit for Regulation & Supervision**

As per the NRB direction the minimum capital requirement should be 12% for the fiscal year 2007/08 and 10% for the fiscal year 2008/09 to till date. Thus, to determine the CAR ratio the respondents are asked on this matter.

**Table 4.18****CAR Requirement set by NRB-Fit for Regulation & Supervision**

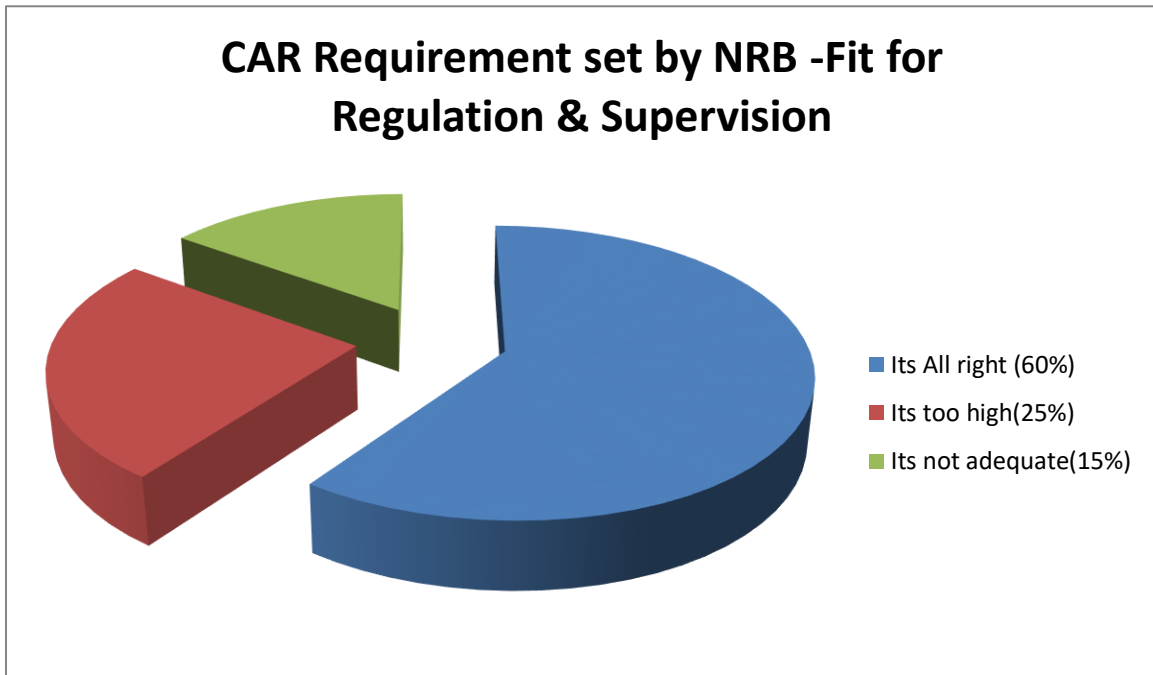
Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Its All right	7	70	5	50	12	60
Its too high	2	20	3	30	5	25
Its not adequate	1	10	2	20	3	15
Total	10	100	10	100	20	100

(Source:- Field Survey, 2013)

The above table shows that 70% of the respondents from Global IME, 50% respondents from Everest Bank and overall 60% of the respondents (12 out of 20) have said that the CAR set by NRB is fit for regulation & supervision of commercial banks. Likewise, 20% of the respondents from Global IME, 30% respondents from Everest Bank and overall 25% of the respondents (5 out of 20) have said that the ratio is too high. Similarly, 10% of the respondents from Global IME, 20% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) have opined that the NRB norms for CAR is not adequate for regulation & supervision for commercial banks.

Figure 4.13

**CAR requirement set by NRB- Fit for Regulation & Supervision**



**4.4.6 Main Factor to be ensured by Capital Adequacy Framework**

The adequacy framework should be adopted to have sound capital management and to strengthen the financial system of the bank. Hence, to investigate what should be the main factor that should be most ensured by capital adequacy framework, the respondents are asked on this issue.

**Table 4.19**

**Main Factor to be ensured by Capital Adequacy Framework**

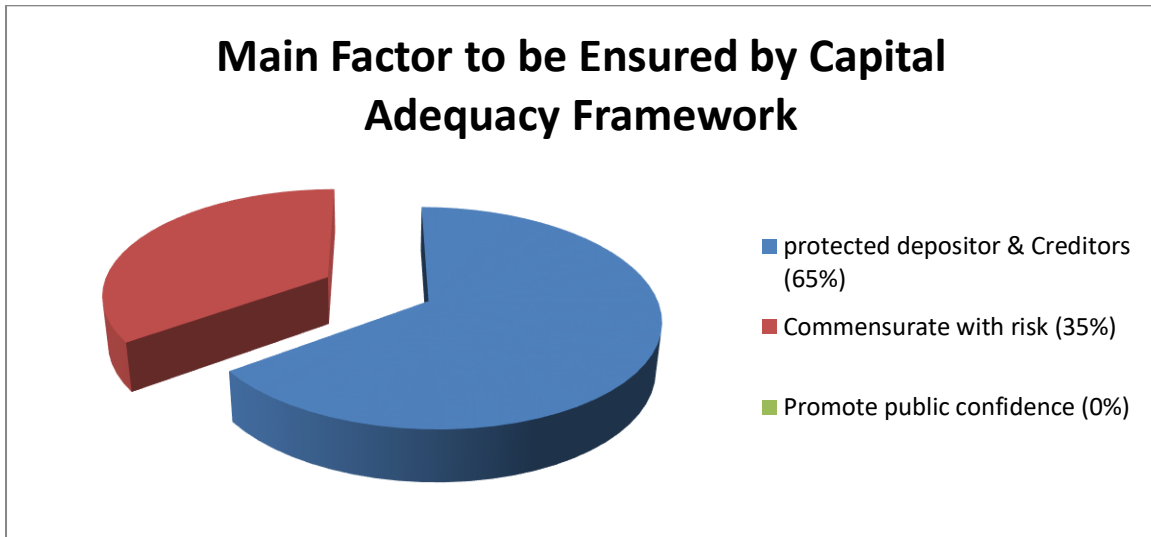
Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
protect the depositors & Creditors	7	70	6	60	13	65
Commensurate with risk	3	30	4	40	7	35
Promote public confidence	0	0	0	0	0	0
Total	10	100	10	100	20	100

(Source:- Field Survey, 2013)

The above table shows that 70% of the respondents from Global IME, 60% respondents from Everest Bank and overall 65% of the respondents (13 out of 20) have stated that the capital adequacy framework should ensure protection of depositors and creditor the most while 30% of the respondents from Global IME, 40% respondents from Everest Bank and overall 35% of the respondents (7 out of 20) have affirmed that the capital adequacy framework should ensure commensuration with risk.

Finally, none of the respondents from Global IME and Everest Bank have opined that the capital adequacy framework should ensure promotion of public confidence in the banking system most. Hence, on the basis of the majority, it can be concluded that the capital adequacy framework should be designed in protecting the depositors and creditors interest most.

**Figure 4.14**  
**Main Factor to be Ensured by Capital Adequacy Framework**



**4.4.7 Main Prerequisites for effective Implementation of CAR**

To examine the prerequisite that is crucial for the effective implementation of capital adequacy rate, the respondents were asked on this matter. The responses obtained from them is presented in the table below.

**Table 4.20**  
**Main Prerequisites for effective Implementation of CAR**

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Implementation of Basel core principle	1	10	0	0	1	5
Sound practice for managing operational risk	2	20	3	30	5	25
Comprehensive risk mgmt policy	3	30	4	40	7	35
High degree of Corporate Governance	4	40	3	30	7	35
Total	10	100	10	100	20	100

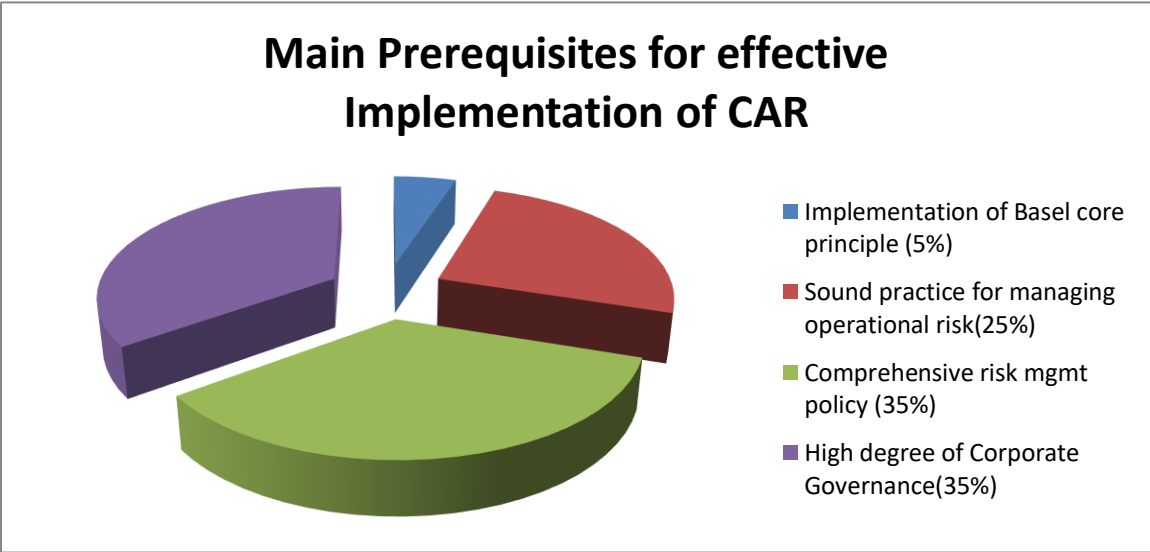
(Source:- Field Survey, 2013)

The above table shows that 10% of the respondents from Global IME, none of the respondents from Everest Bank and in overall 5% of the respondents (1 out of 20) have stated that the implementation of the Basel core principle is essential for the effective implementation of the capital adequacy framework. Similarly, 20% of the respondents from Global IME, 30% respondents from Everest Bank and overall 25% of the respondents (5 out of 20) have opined that the practice of sound operational risk management should be the main prerequisite for the effective implementation of capital adequacy framework.

Likewise, 30% of the respondents from Global IME, 40% respondents from Everest Bank and overall 35% of the respondents (7 out of 20) have affirmed the existence of comprehensive risk management policy should be the most prerequisite. Similarly, 40% of the respondents from Global IME, 30% respondents from Everest Bank and overall 35% of the respondents (7 out of 20) have suggested that high degree of corporate governance is the most prerequisite. However, considering the overall majority it can be concluded that existence of comprehensive risk management policy and high degree of corporate governance are the most prerequisites for effective implementation of the CAR.

**Figure 4.15**

**Main Prerequisites for effective Implementation of CAR**



#### 4.4.8 Coverage of Capital Adequacy Ratio

Addressing the risk that weaken the financial status of the bank is the other reason for having sound capital adequacy ratio. To examine what kind of risk and effect should the capital adequacy ratio address most, the respondents are asked to express their opinions the responses obtained them are presented in the table below.

**Table 4.21**  
**Coverage of Capital Adequacy Ratio**

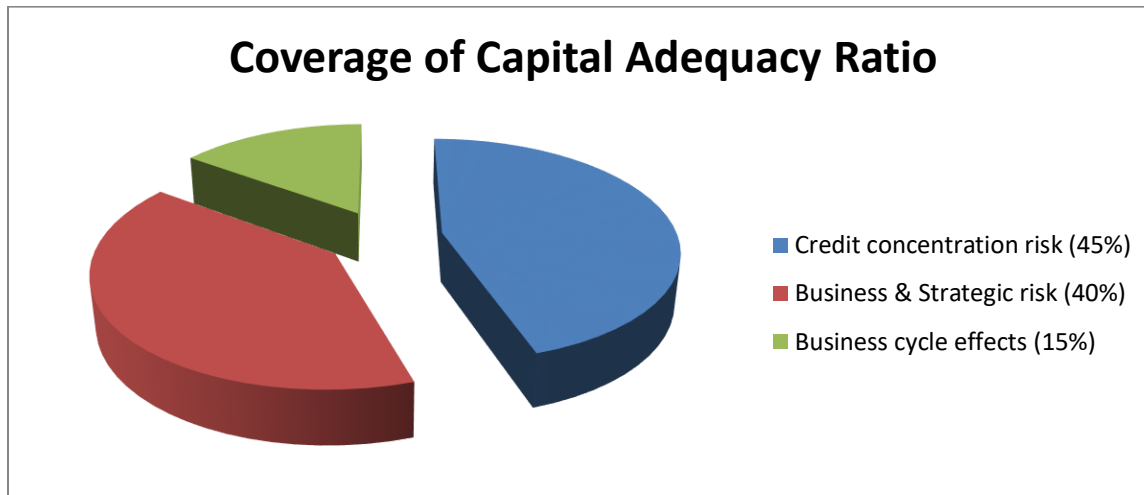
Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Credit concentration risk	5	50	4	40	9	45
Business & Strategic risk	4	40	4	40	8	40
Business cycle effects	1	10	2	20	3	15
Total	10	100	10	100	20	100

(Source:- Field Survey, 2013)

The above table shows that 50% of the respondents from Global IME, 40% respondents from Everest Bank and overall 45% of the respondents (9 out of 20) have stated that the capital adequacy ratio should cover the risk that is related to the credit management. Similarly, 40% of the respondents from Global IME, 40% respondents from Everest Bank and overall 40% of the respondents (8 out of 20) have opined that the business and strategic risk should be addressed by the CAR at first. Likewise, 10% of the respondents from Global IME, 20% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) have stated that the risk that effects the business cycle of the banks should be covered by CAR.

Considering the majority of respondents, it can be concluded that the capital adequacy ratio should cover mostly the risk associated with the credit management.

**Figure 4.16**  
**Coverage of Capital Adequacy Ratio**



#### 4.4.9 Significance of Capital Adequacy Ratio

To know the significance of the capital adequacy ratio, besides addressing the risk, the employees of the banks are asked to express their view. The responses obtained from them are presented in the table below.

**Table 4.22**  
**Significance of Capital Adequacy Ratio**

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Strengthening risk Mgmt	3	30	3	30	6	30
Applying Internal Limit	0	0	0	0	0	0
Strengthening Provision & Reserve	1	10	2	20	3	15
Improving Internal Controls	6	60	5	50	11	55
Total	10	100	10	100	20	100

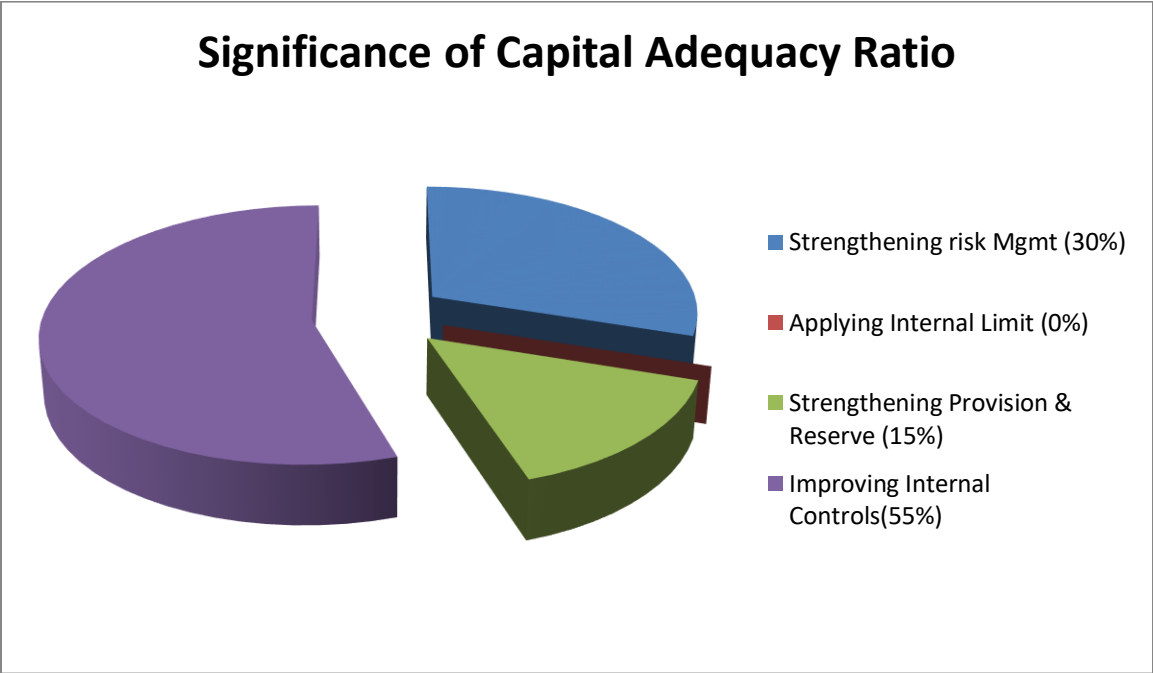
(Source:- Field Survey, 2013)

The table shows that 30% of the respondents from Global IME, 30% respondents from Everest Bank and overall 30% of the respondents (6 out of 20) have supported that the capital adequacy ratio is most significant in strengthening the risk management of the bank. Similarly, none of the respondents have stated that the capital adequacy ratio is useful for applying the internal limit of the bank. Likewise, 10% of the respondents from Global IME, 20% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) have stated that the ratio is most important for strengthening the provision and reserve for having sound capital management.

Likewise, 60% of the respondents from Global IME, 50% respondents from Everest Bank and overall 55% of the respondents (11 out of 20) have suggested that the ratio is most important for improving the internal financial control of the banks. However, considering the overall majority of the employees from each bank, it can be concluded that the ratio is most significant for improving the internal financial control of the banks.

**Figure 4.17**

**Significance of Capital Adequacy Ratio**



#### 4.4.10 Crucial component of Internal Capital Adequacy Assessment Process

To ensure long term safety and financial soundness of the bank, the internal capital adequacy assessment process, which consist of five major components, is crux. For further examination on which of the components is crucial, the employees are asked on this matter. The responses that are obtained from them are presented in the table below.

**Table 4.23**

#### Crucial component of Internal Capital Adequacy Assessment Process

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Board & Senior Mgmt Oversight	1	10	0	0	1	5
Sound capital Assessment	3	30	2	20	5	25
Comprehensive Assessment of Risk	4	40	5	50	9	45
Monitoring & Reporting	1	10	1	10	2	10
Internal Control Review	1	10	2	20	3	15
Total	10	100	10	100	20	100

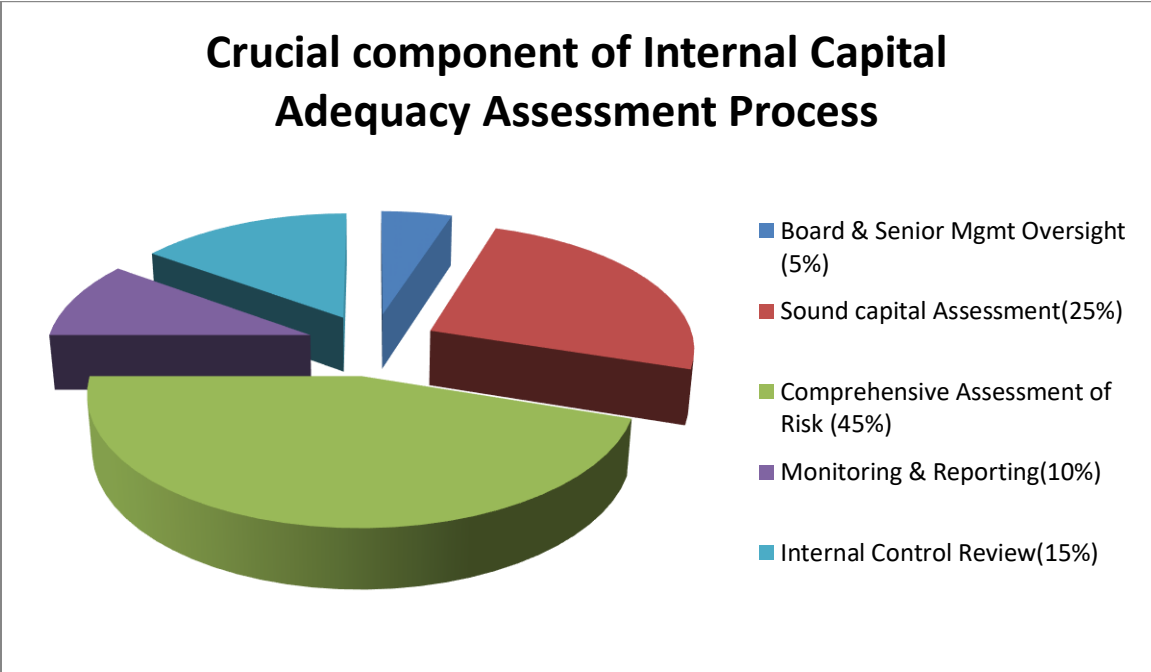
(Source:- Field Survey, 2013)

The above table shows that 10% of the respondents from Global IME, none respondents from Everest Bank and overall 5% of the respondents (1 out of 20) has stated that board and senior management oversight is the most key component of the internal capital adequacy assessment process. However, 30% of the respondents from Global IME, 20% respondents from Everest Bank and overall 25% of the respondents (5 out of 20) have said that sound capital assessment is the main component of internal capital adequacy assessment process. Likewise, 40% of the respondents from Global IME, 50% respondents from Everest Bank and overall 45% of the respondents (9 out of 20) have stated that comprehensive assessment process of risk weight most be high in the internal

capital adequacy assessment process. Likewise, The 10% of the respondents from Global IME, 10% respondents from Everest Bank and overall 10% of the respondents (2 out of 20) have said that the monitoring & reporting is the main component of internal capital adequacy assessment process. Finally, 10% of the respondents from Global IME, 20% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) stated that internal control review is the key component of the internal capital adequacy assessment process. However, considering the overall majority of the employees from each bank, it can be concluded that the comprehensive assessment of risk is the key component of the internal capital adequacy assessment process.

**Figure 4.18**

**Crucial component of Internal Capital Adequacy Assessment Process**



#### 4.4.11 Satisfaction with existing NRB provision for Loan Loss provision

As per the directives, each bank has to maintain 1% of the performing loan, 25% of the sub standard loan, 50% of the doubtful loan and 100% of the loss loan loss provision. To examine whether such loan loss provision is sufficient to meet the credit risk, the employees are asked to suggest their views. The responses that are obtained through questionnaire are presented in the table below.

**Table 4.24**

**Satisfaction with existing NRB provision for Loan Loss provision**

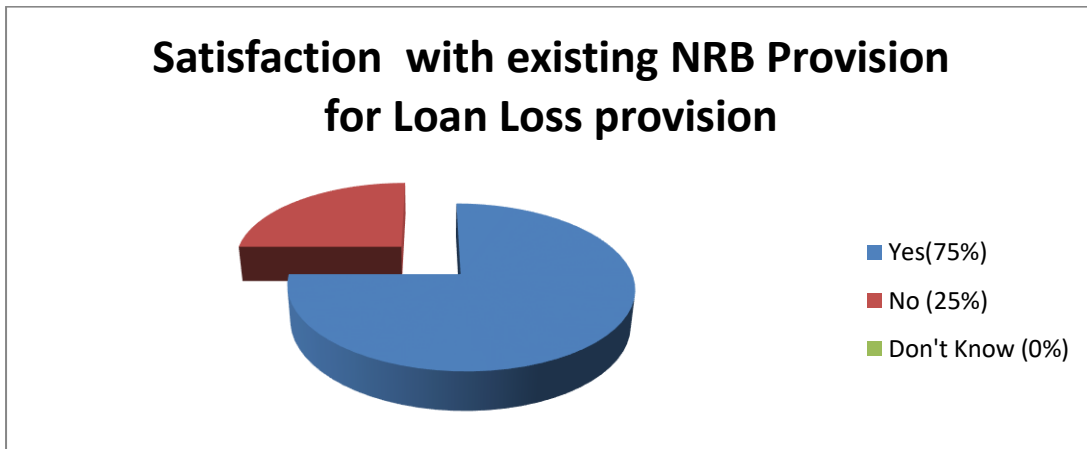
Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Yes	7	70	8	80	15	75
No	3	30	2	20	5	25
don't Know	0	0	0	0	0	0
Total	10	100	10	100	20	100

(Sources:- Filed survey 2013)

The above table shows that 70% of the respondents from Global IME, 80% respondents from Everest Bank and overall 75% of the respondents (15 out of 20) are satisfied with the existing requirement of loan loss provision whereas 30% of the respondents from Global IME, 20% respondents from Everest Bank and overall 25% of the respondents (5 out of 20) are unsatisfied and none of the respondents are indifferent by such requirement.

**Figure 4.19**

**Satisfaction with existing NRB Provision for Loan Loss provision**



**4.4.12 Impact of Non Performing Loan**

Increase in non-performing loan jeopardize the sustainability of the bank, thus it is essential to know the impact of non-performing loan on the financial health. Hence, the respondents are asked whether the NPA really inversely affect the financial soundness. The responses obtained from them are presented in the table below.

**Table 4.25**

**Impact of Non Performing Loan**

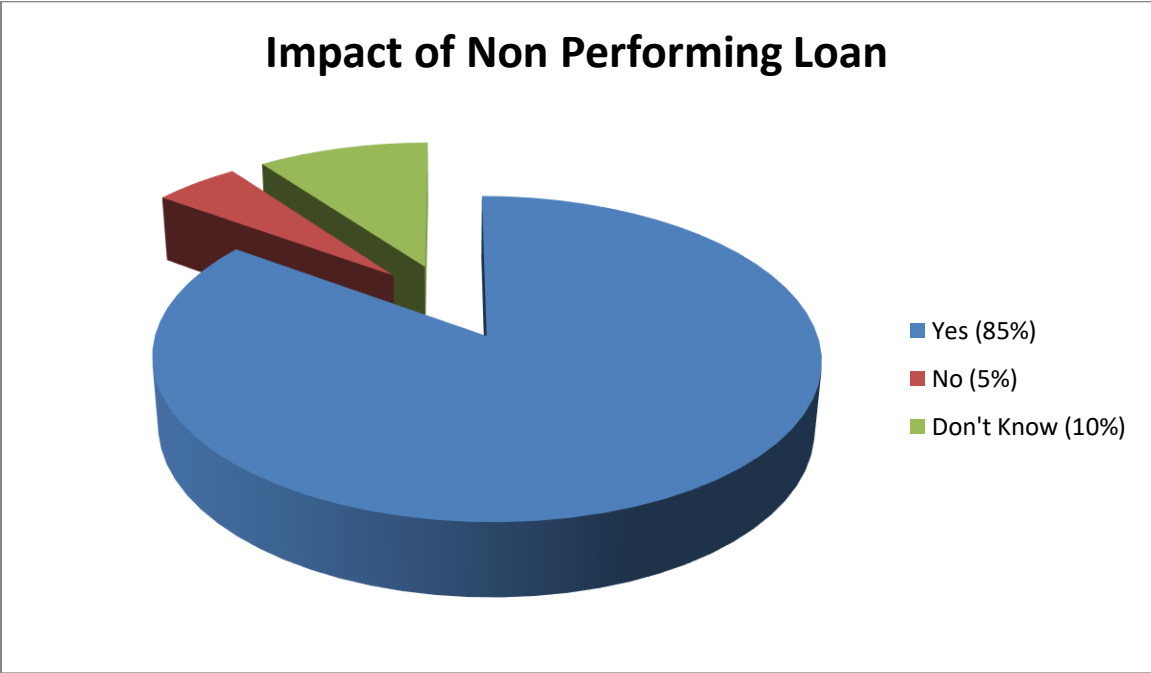
Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Yes	9	90	8	80	17	85
No	0	0	1	10	1	5
don't Know	1	10	1	10	2	10
Total	10	100	10	100	20	100

(Sources:- Filed Survey 2013)

The above table shows that 90% of the respondents from Global IME, 80% respondents from Everest Bank and overall 85% of the respondents (17 out of 20) have said that the NPA affects the financial health of the bank, while none of the respondents from Global IME, 10% respondents from Everest Bank and overall 5% of the respondents (1 out of 20) have denied. Likewise, 10% of the respondents from Global IME, 10% respondents from Everest Bank and overall 10% of the respondents (2 out of 20) have said that they have no idea. On the basis of above response, it can be considered that the inverse effect of NPA in the financial growth is widespread in Nepalese Commercial banks. Thus, both NRB and commercial bank should make appropriate policy to reduce the portion of NPA in order to have a good assets quality.

**Figure 4.20**

**Impact of Non Performing Loan**



**4.4.13 Best Method to Resolve NPA**

As NPA affects the financial growth of the bank, it is essential to reduce the problem of NPA by appropriate method. Thus, the respondents are asked the best method or way to

reduce the problem of NPA as its become the problems of almost all banks and financial institutions. The responses obtained from them are presented in the below table.

**Table 4.26**  
**Best Method to Resolve NPA**

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Strict Recovery Policy	2	20	4	40	6	30
Monitoring	4	40	4	40	8	40
New Rules & Regulations	2	20	1	10	3	15
Rebate for timely Payment	2	20	1	10	3	15
Total	10	100	10	100	20	100

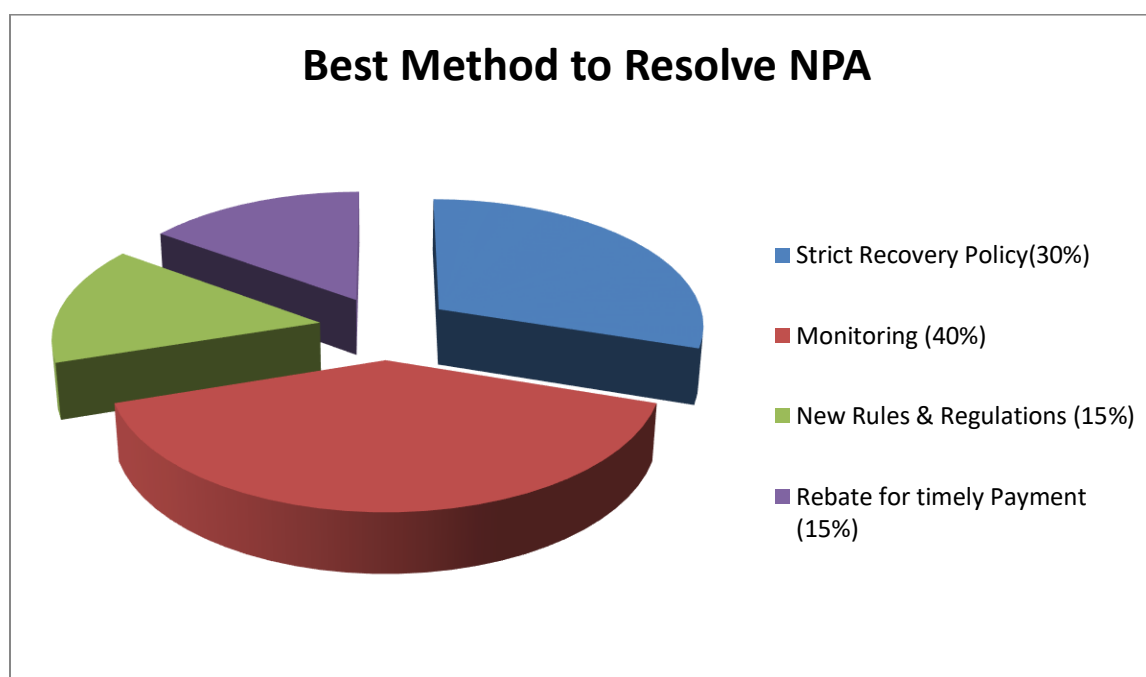
(Source:- Field Survey, 2013)

The above table shows that 20% of the respondents from Global IME, 40% respondents from Everest Bank and overall 30% of the respondents (6 out of 20) have said that strict recovery policy is the best method for resolving the problem of NPA. Likewise, 40% of the respondents from Global IME, 40% respondents from Everest Bank and overall 40% of the respondents (8 out of 20) have said that monitoring the activities of the borrower is the best method for resolving the problem of NPA. Similarly, 20% of the respondents from Global IME, 10% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) have affirmed formulation of new rule and regulation regarding NPA is the best method for resolving the NPA's problem.

Likewise, 20% of the respondents from Global IME, 10% respondents from Everest Bank and overall 15% of the respondents (3 out of 20) have said that rebate for timely payment is the best method for resolving NPA problem. Further, the majority of the respondents,

40% have also pointed out monitoring as the best method. Thus, looking the responses of each bank and the overall, it can be concluded that monitoring the activities of the borrower is the appropriate method for controlling the adverse effects of NPA. Besides this method, the adoption of strict recovery policy is also important.

**Figure 4.21**  
**Best Method to Resolve NPA**



#### **4.4.14 Black listing the loan defaulter**

To examine whether the provisions in NRB directives about the black listing of the loan defaulter are adequate or not, the respondents have been asked on this regard. The responses obtained from them have been presented in the table.

**Table 4.27**

**Black listing the loan defaulter**

Response	GIBL		EBL		Total	
	No.	%	No.	%	No.	%
Adequate	2	20	3	30	5	25
Not Adequate	8	80	7	70	15	75
Don't know	0	0	0	0	0	15
Total	10	100	10	100	20	100

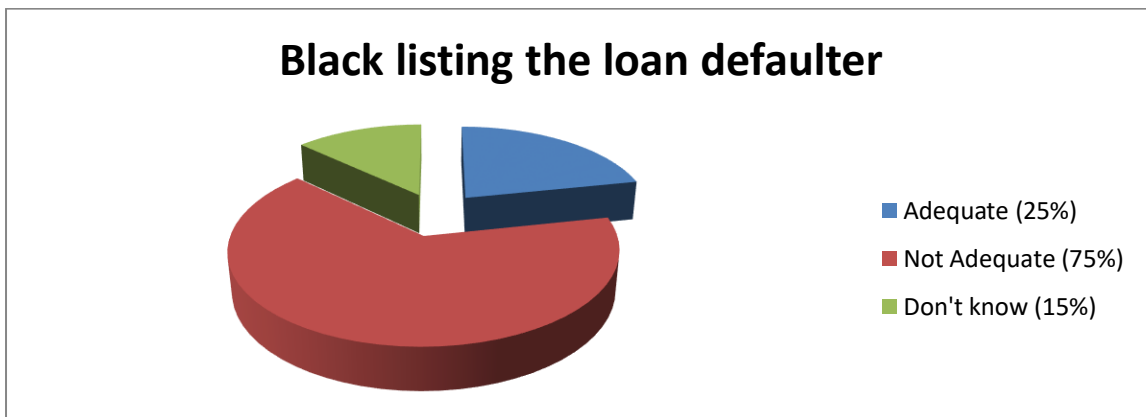
(Source:- Field Survey, 2013)

The above table shows that 20% of the respondents from GIBL and 30% from EBL and 25% as a whole (5 out of 20) opined that provisions in NRB directives about the black listing of the loan defaulter are adequate. Likewise, 80% of the respondents from GIBL and 70% from EBL and 75% as a whole (15 out of 20) opined that provisions in NRB directives about the black listing of the loan defaulter are not adequate.

Considering the view of majority of each bank, it can be concluded that provisions in NRB directives about the black listing of the loan defaulter are not adequate.

**Figure 4.22**

**Black listing the loan defaulter**



## **4.5 Major Findings of the Study**

On the basis of data analysis, primary data analysis and secondary data analysis, the following major findings have been drawn:-

### **Finding from Secondary Data Analysis**

- The total capital fund and core capital of the both Global IME and Everest bank are in increasing trend from fiscal year 2008/09 to till date. The supplementary capital of Global IME is in increasing trend whereas in case of Everest bank there is the fluctuation in supplementary capital fund. The contribution of core capital for both banks is more in generating the total capital fund.
- In all the fiscal years taken for study, the core capital adequacy ratio of both Global IME Bank and Everest bank has exceeded the NRB's minimum standard. The CCAR of Global IME was 7.31%, 10.01%, 10.14%, 9.21% and 9.17% whereas Everest Bank Ltd had maintained 7.73%, 8.39%, 8.46%, 9.61% and 9.31% CCAR against the 6% set by NRB in the fiscal year 2008/09, 2009/10, 2010/11, 2011/12 and 2012/13 respectively.
- The Supplementary capital adequacy ratio maintained by Global IME Bank Ltd is in increasing trend except in the FY 2012/13 whereas it is in decreasing trend except in the FY 2012/13 in case of Everest bank. During the study years both banks are successful to maintain the supplementary capital adequacy ratio well below the NRB's norm.
- The study shows that the CAR of Global IME Bank has deficit the minimum requirement of NRB in the fiscal year 2008/09 by 2.16% and thereafter it was exceeded the NRB's minimum standard. However, the CAR ratio maintained by Everest Bank Ltd is in fluctuating trend. The CAR ratio of Everest bank indicates that it is successful to meet the NRB's minimum standard in the five years of

study period. In average, Everest Bank Ltd has maintained 10.87% as CAR and coefficient of variation is 3.77 % indicating quite consistency in the ratio.

- The study reveals that non performing loan of the Global IME Bank is increasing trend whereas in case of Everest bank it is found to be fluctuating. However the ratio of non-performing loan to total loan and advance of both banks is in fluctuating trend. The decreased rate of the ratio in some fiscal year indicates that the growth rate of loan and advance is far higher than the growth rate of non-performing loan.
- In average, the credit risk of GIBL on total loan and advance is 0.90% and coefficient of variation on such risk is 61.22%, indicating higher inconsistency. In average the credit risk ratio of Everest Bank Ltd for the five year period is 0.23% and coefficient of variation on such ratio is 46.94%, indicating extreme inconsistency.
- The loan loss provision kept by Global IME Bank has ranged from Rs. 96.71 million in the fiscal year 2008/09 to Rs. 779.32 million in the fiscal year 2012/13. whereas the loss provision amount of Everest Bank is in increasing trend and thus ranges from Rs. 584.88 million in the fiscal year 2008/09 to Rs. 804.58 million in the fiscal year 2012/13.
- Ratio of the loan loss provision to total loan and advance of Global IME Bank is found to be in fluctuating trend. In average, there is 2.21% of the Loan loss provision to total loan and advance ratio of the GIBL Bank. However, Loan loss provision to total loan and advance ratio of the Everest Bank is in decreasing trend. In average, Everest Bank has maintained the ratio at 2.04%.
- The study reveals that that the correlation coefficient between Net profit and CAR of Global IME is 0.94 which means that there is a high degree of positive correlation between the two variables. As the value of r is more than the value of

6P.E. (r) i.e.  $0.94 > 6 \times 0.04$ , the value of r is definitely significant. Likewise, in case of Everest bank, correlation coefficient between Net profit and CAR is 0.90 which indicates that there is a high degree positive correlation between the two variables. Here, correlation coefficient is more than 6 times its probable error i.e.  $r > 6P.E.$  (r) [ $0.90 > 6 \times 0.06$ ] which indicates that there is definitely significant relationship between Net profit and CAR.

- The forecasted CAR of Global IME for the fiscal year 2013/14, 2014/15, 2015/16, 2016/17 and 17/18 which will be 12.74%, 13.49%, 14.23%, 14.97% and 15.71% respectively. This clearly indicates that the CAR of Global IME will meet the NRB's requirement as it is in increasing trend.
- Likewise, the forecasted CAR of Everest Bank for the fiscal year 2013/14, 2014/15, 2015/16, 2016/17 and 2017/18 will be 11.56%, 11.79%, 12.02%, 12.25% and 12.48% respectively. The trend value of CAR indicates that because of positive trend Bank will be able to meet the standard set by NRB's in every fiscal year for the next 5 year.

### **Findings from Primary Data Analysis**

- The study presents that majority of the respondents i.e, 50% of the total respondent from GIBL and EBL have stated that NRB directives are necessary to protect the banks and financial institutions whereas remaining respondents have equally divided favoring the option by 25% that the NRB directives are necessary to enhance the credibility of financial system and other 25% says they are necessary to protect the interest of the depositors.
- The study reveals that 75% of the respondents as a whole are satisfied with the regulation and supervision of NRB whereas remaining 20% are unsatisfied with the regulation and supervision of NRB and 5 % of the respondents as a whole are indifferent by such supervision.

- The study reveals that overall 35% of the respondents from both the banks have said that the depositors are mostly benefited maintaining capital adequacy whereas remaining 65% of the respondents have supported in the opinion that shareholders have got benefited mostly. Thus, looking the overall responses, it can be concluded that the shareholders would be mostly benefited by maintaining capital adequacy requirements.
- The study reveals that overall 50% of the respondents from GIBL and EBL have stated that the core capital adequacy ratio should be below 6%. and 35% of the respondents have affirmed that the ratio should be exactly 6% while merely, 15% of the respondents have said that the rate should be above 6%.
- The study reveals that overall 60% of the respondents from both the banks have said that the CAR set by NRB is fit for regulation & supervision of commercial banks whereas overall 25% of the respondents have said that the ratio is too high while remaining 15% of the respondents have opined that the NRB norms for CAR is not adequate for regulation & supervision for commercial banks.
- The study shows that overall 65% of the respondents have stated that the capital adequacy framework should ensure protection of depositors and creditor the most while remaining 35% of the respondents have affirmed that the capital adequacy framework should ensure commensuration with risk.
- The study shows that 35% of the respondents are in favor of comprehensive risk management policy and equally 35% are in favor of high degree of corporate governance while overall 25% of the respondents are in favor of the practice of sound operational risk management and merely 5% are in favor of the implementation of the Basel core principle essential for the effective implementation of the capital adequacy framework.

- The study reveals that overall 45% of the respondents have stated that the capital adequacy ratio should cover the risk that is related to the credit management whereas 40% of the respondents have opined that the business and strategic risk should be addressed by the CAR at first. However, 15% of the respondents have stated that the risk that affects the business cycle of the banks should be covered by CAR.
- The study shows that overall 55% of the respondents have suggested that the ratio is most important for improving the internal financial control of the banks whereas 30% of the respondents have supported that it is most significant in strengthening the risk management of the bank while 15% of the respondents have stated that the ratio is most important for strengthening the provision and reserve for having sound capital management.
- The study shows that overall 45% of the respondents have stated that comprehensive assessment process of risk weight must be high in the internal capital adequacy assessment process whereas 25% of the respondents have said that sound capital assessment is the main component while 15%, 10% and 5% of the respondents are in favor of internal control review, monitoring & reporting and board and senior management oversight respectively indicating them as the most key component of the internal capital adequacy assessment process.
- The above table shows that overall 75% of the respondents are satisfied with the existing requirement of loan loss provision whereas remaining 25% of the respondents are unsatisfied and none of the respondents are indifferent by such requirement.
- The study shows that overall 85% of the respondents have said that the NPA affects the financial health of the bank whereas 5% of the respondents have denied on it. However, overall 10% of the respondents have said that they have no idea regarding this matter.

- The study shows that overall 40% of the respondents have pointed out that monitoring is the best method for resolving the problem of NPA whereas 30% of the respondents have said that strict recovery policy is the best method while 15% of the respondents are in favor of formulation of new rule and regulation regarding NPA and rest says rebate for timely payment is the best method for resolving NPA problem.
- The study shows, 25% of the respondents as a whole from GIBL and EBL have opined that provisions in NRB directives about the black listing of the loan defaulter are adequate whereas 75% as a whole have opined that provisions in NRB directives about the black listing of the loan defaulter are not adequate.

## **CHAPTER – V**

### **5. Summary, Conclusion and Recommendations**

This chapter summarizes the whole study. Summary of the study has been mentioned in the first section. The second section reflects the conclusion drawn from the study. The recommendations are presented in terms of suggestions, which are prepared on the basis of findings and conclusion.

#### **5.1 Summary**

The economy of nation depends on the uses of available resources in efficient way. The proper utilization of assets appreciates in wealth position of individual and country as well. To mobilize available resource, there should be proper planning, efficient management, far sighting strategy, good financial management and up-to-date information. Integrated and speedily development of the country is possible only when competitive banking and financial service reaches nook and corners of the country.

To grow financial activities, it requires the banking habit of the community as well as potentially strong lending opportunities. Simply, Bank is an institution whose main function is to accept deposit and invest it. Bank collects money from public by providing attractive sound interest and can earn profit by lending it on mainly in business organization, industrial, agricultural sectors etc. So, we can say the main task of commercial bank is to mobilize idle resources in productive areas by collecting it from scattered sources and generating profit. Banking plays significant role in the economic development of country. Banks role as intermediaries channeling between saving and investment and fulfill the credit needs of customer as well as investment requirement of savers. It is clear that efficient and stable banking systems are crucial for an orderly economic growth. The pace development of country largely depends on the level of financial development.

A strong financial system promotes economic growth, mobilizes and allocates resources efficiently, establishes efficient payment system and effective transmission mechanism, makes capital more productive and creates employment opportunities. It reduces

vulnerability to financial crisis and lowers the economic and social cost of financial disruption.

The financial system in Nepal comprises bank and financial institutions (commercial banks, development banks, finance companies and microfinance institutions), cooperatives, contractual saving institutions.( Employment Provident Fund and Citizen Investment Trust), insurance companies and postal saving banks.

The commercial bank plays a leading role in the smooth operation of an economy. It makes available all financial services to individuals and institutions. Commercial Bank, means a bank which operates currency exchanges transactions, accepts deposits, provide loan, performs, dealings, relating to commerce except the banks which have been specified for the co-operative, agricultural, industry of similar other objective. Nepal Bank Ltd. remained the only financial institution of the country until the foundation of Nepal Rastra Bank is 1956 A.D. Due to the absence of the central bank, Nepal Bank has to play the role of central bank and operate the function of central bank. Hence, the Nepal Rastra Bank Act 1955 was formulated, which was approved by Nepal Government accordingly, the Nepal Rastra Bank was established in 1956 A.D. as the central bank of Nepal. Nepal Rastra Bank makes various guidelines for the banking sector of the country. In 1957 A.D. Industrial Development Bank was established to promote the industrialization in Nepal, which was later converted into Nepal Industrial Development Corporation (NIDC) in 1959 A.D. Rastriya Banijya Bank was established in 1965 A.D. as the second commercial bank of Nepal. The financial shapes for these two commercial banks have a tremendous impact on the economy. That is the reason why these banks still exist in spite of their bad position. As the agriculture is the basic occupation of major Nepalese, the development of this sector plays in the prime role in the economy. So, separate Agricultural Development Bank was established in 1968 A.D. This is the first institution in agricultural financing. After declaring free economy and privatization policy, the government of Nepal encouraged the foreign banks for joint venture in Nepal.

The NRB has classified the institutions into “A” “B” “C” “D” groups on the basis of the minimum paid-up capital and provide the suitable license to the bank or financial institution. Group ‘A’ is for commercial bank, ‘B’ for the development bank, ‘C’ for the financial institution and ‘D’ for the Micro Finance Development Banks.

At the end of 2069/070 there are 31 commercial banks, 86 development banks, 59 financial companies, 31 Micro-Finance institutions and 16 NRB licensed Cooperatives ( With limited banking activities, 36 NRB licensed NGOs ( With limited banking activities), 25 insurance companies, one Employees Provident Fund, one citizen Investment Trust and one Postal Saving Bank. are established so far in Nepal ( Source: Informatin provided by Nepal Rastra Bank). As of mid July 2012, there were altogether 26,501 cooperatives registered as per the prevailing acts, operating in Nepal out of which 11,851 were in the category of saving and credit cooperative. It is believed that significant volume of transaction is being done by the informal sector like various informal saving and credit groups, self help groups, Dhukuties and local money Landers etc. (Financial Stability Report, 2012)

This research aimed at studying capital adequacy norms for commercial banks set by NRB with case study of Global IME Bank and Everest Bank Ltd. Raise and utilization of funds are the Primary functions of commercial banks. As such, commercial banks collect a large amount of deposits from general public. Capital must be sufficient to protect a Bank’s depositors and counterparties from the risks like, credit and market risks. Otherwise the banks will use all the money of depositors in their own interest and depositors will have to suffer loss. Being the central bank of Nepal, NRB has the responsibility to give special attention to the interest of depositors. NRB has issued various directives to regulate commercial banks as such the directive related to capital adequacy has been issued which has to be followed by commercial banks. The legal minimum requirements stipulate that the capital base must correspond to at least 8% of the risk weighted assets. However, NRB has directed 12% capital adequacy rate till 2007/08 and effectives from 2008/09 the rate has been deduced to 10%.

This study “Capital Adequacy and Loan Loss Provision of Commercial Banks with Reference to Global IME Bank Ltd & Everest bank Ltd” is primarily prepared for the partial fulfillment of the requirements of master of business studies (MBS). This study is mainly based on secondary and primary data provided by concerned banks and respondents. The research study mainly focus on the two areas of the directives issued by NRB for the commercial banks namely, capital adequacy norms and the various types of loan and its provisioning in different sectors. The main objectives of the research study are to assess capital adequacy position of selected commercial banks and compare their performance with the concerned directives of NRB; to study the loan loss provision of selected commercial banks and compares their provision with the concerned directive of NRB and to provide necessary recommendations to the commercial banks and Nepal Rastra Bank for improvement in the findings of the early two objectives of this study. Although the study is limited to the two commercial banks out of the thirty one commercial banks acting in the country, it however reveals that there was a significant impact of the directives on the various aspects of the commercial banks. Information is collected during the period 2008/09 to 2012/13. The collected information is presented, analyzed and conclusion is drawn from the study. The study incorporates both the primary data and secondary data analysis to drive the true picture of capital adequacy framework. The total capital fund and core capital and supplementary capital of the Global IME are in increasing trend from fiscal year 2008/09 to till date. The supplementary capital is continuously decreasing from FY 2008/09 to FY 2011/012 but it is increased to highest in the FY 2012/13. In case of both banks Core capital plays important role in safeguarding both the survival of the bank and stability of the financial system so commercial banks give more priority to core capital than that of supplementary capital. In all the fiscal years taken for study, the core capital adequacy ratio of both Global IME Bank and Everest Bank Ltd has exceeded the NRB’s minimum standard against the NRB standard 6%. Comparing two banks, it can be concluded that the capital base of Global IME is quite stronger than that of Everest Bank Ltd in meeting the risk as in average the supplementary capital adequacy ratio of Global IME is lower than that of

Everest Bank Ltd. Both the sample banks have paid more attention to core capital rather than supplementary capital.

In average, Global IME has maintained 10.53% CAR ratio, higher than the NRB's standard during the five years of study period and the coefficient of variation is 13.01%.

Everest Bank Ltd has maintained 10.87% as CAR and coefficient of variation is 3.77 % indicating quite consistency in the ratio.

The table reveals that none performing loan of the Global IME Bank is increasing continuously. However the ratio of non-performing loan to total loan and advance of the bank is in fluctuating trend. The non-performing loan of Everest Bank Ltd is found to be fluctuating. The ratio of non-performing loan to total loan of EBL is in fluctuating trend. Further, ratio of the loan loss provision to total loan and advance of Global IME Bank is found to be in fluctuating trend whereas Loan loss provision to total loan and advance ratio of the Everest Bank is in decreasing trend.. The study reveals that that there is a high degree positive relationship between Net profit and CAR in both Global IME and Everest Bank Ltd.

Majority of the respondents are in favor of the statement that NRB directives are necessary to protect the banks and financial institutions. The study reveals that 75% as a whole are satisfied with the regulation and supervision of NRB. Looking the overall responses, it can be concluded that the shareholders would be mostly benefited by maintaining capital adequacy requirements. Accepting the opinion of majority, it can be concluded that the core capital adequacy ratio should be below 6% to have optimal capital base and in overall 60% of the respondents have said that the CAR set by NRB is fit for regulation & supervision of commercial banks.

The study is also mentioned that overall 75% of the respondents are satisfied with the existing requirement of loan loss provision and looking at the overall responses, it can be concluded that monitoring the activities of the borrower is the appropriate method for controlling the adverse effects of NPA. Besides this method, the adoption of strict

recovery policy is also important. Based on the responses of majority the study has come to the conclusion that provisions in NRB directives about the black listing of the loan defaulter are not adequate.

## **5.2 Conclusion**

On the basis of analysis and interpretation of data, the following conclusions have been derived.

- The total capital fund and core capital and supplementary capital of the Global IME are in increasing trend from fiscal year 2008/09 to till date. The portion of core capital in total capital fund of Global IME is 85.07% in five-year average while that of supplementary capital is 14.93% in five-years average. It means contribution of core capital is more in growth of total capital fund. Total RWA of the Global IME bank is also increasing every year from fiscal year 2008/09 to 2012/013.
- Core capital and total capital fund of Everest Bank are in increasing trend but there is the fluctuation in supplementary capital fund. The supplementary capital is continuously decreasing from FY 2008/09 to FY 2011/012 but it is increased to highest in the FY 2012/13. The portion of core capital in total capital fund of Everest Bank is 80.71 % in five-year average while that of supplementary capital is 19.29 % in five-years average. It means contribution of core capital is more in generating the total capital fund.

In case of both banks Core capital plays important role in safeguarding both the survival of the bank and stability of the financial system so commercial banks give more priority to core capital than that of supplementary capital.

- In all the fiscal years taken for study, the core capital adequacy ratio of both Global IME Bank and Everest Bank Ltd has exceeded the NRB's minimum standard against the NRB standard 6%. Comparing the two banks on the basis of average CCAR, it can be concluded that the capital foundation of Global IME Bank is more adequate than that of Everest Bank Ltd in protecting its depositors

and creditors and in commensuration of risk associating activities, since the average CCAR of Global IME Bank Ltd (9.17%) is higher than that of Everest. In general, both the banks have maintained Tier I capital adequacy above the NRB standard, which has indicated the adequate application of internal sources, i.e. shareholders' equity.

- In average, the supplementary capital adequacy ratio of Global IME Bank is 1.36% and coefficient of variation is 53.68% whereas in average SCAR of the Everest bank is 2.17% and coefficient of variation is 21.66%. Whatever, in all the fiscal years taken for study, the supplementary capital ratio of Global IME as well as Everest Bank Ltd is well below the maximum level directed by NRB. Comparing two banks, it can be concluded that the capital base of Global IME is quite stronger than that of Everest Bank Ltd in meeting the risk as the supplementary capital adequacy ratio of Global IME is lower than that of Everest Bank Ltd ( $1.36\% < 2.17$ ).

Both the sample banks have paid more attention to core capital rather than supplementary capital although 50% of the total capital fund requirement can be fulfilled by the supplementary capital. Both the banks have issued right share, bonus share to increase capital fund.

- As per the BASEL II, the minimum capital adequacy ratio is 8%, however NRB has fixed minimum 10% CAR need to be maintained by the banks effective from fiscal year 2008/09. The study shows that the CAR of Global IME Bank has deficit the minimum requirement of NRB only in the fiscal year 2008/09 by 2.16%. In average, Global IME has maintained 10.53% CAR ratio, higher than the NRB's standard during the five years of study period and the coefficient of variation in the ratio is 13.01%.

However, the CAR ratio maintained by Everest Bank Ltd is in fluctuating trend. The CAR ratio of Everest bank indicates that it is successful to meet the NRB's minimum standard in the five years of study period. In average, Everest Bank Ltd

has maintained 10.87% as CAR and coefficient of variation is 3.77 % indicating quite consistency in the ratio.

- The study reveals that non performing loan of the Global IME Bank is increasing trend whereas in case of Everest bank it is found to be fluctuating. However the ratio of non-performing loan to total loan and advance of both banks is in fluctuating trend. The decreased rate of the ratio in some fiscal year indicates that the growth rate of loan and advance is far higher than the growth rate of non-performing loan.
- In average, the credit risk of GIBL on total loan and advance is 0.90% and coefficient of variation on such risk is 61.22%, indicating higher inconsistency. In average the credit risk ratio of Everest Bank Ltd for the five year period is 0.23% and coefficient of variation on such ratio is 46.94%, indicating extreme inconsistency.
- The loan loss provision kept by Global IME Bank has ranged from Rs. 96.71 million in the fiscal year 2008/09 to Rs. 779.32 million in the fiscal year 2012/13. whereas the loss provision amount of Everest Bank is in increasing trend and thus ranges from Rs. 584.88 million in the fiscal year 2008/09 to Rs. 804.58 million in the fiscal year 2012/13.
- Ratio of the loan loss provision to total loan and advance of Global IME Bank is found to be in fluctuating trend. In average, there is 2.21% of the Loan loss provision to total loan and advance ratio of the GIBL Bank. However, Loan loss provision to total loan and advance ratio of the Everest Bank is in decreasing trend. In average, Everest Bank has maintained the ratio at 2.04% .
- The study reveals that that the correlation coefficient between Net profit and CAR of Global IME is 0.94 which means that there is a high degree of positive

correlation between the two variables. As the value of  $r$  is more than the value of  $6P.E. (r)$  i.e.  $0.94 > 6 \times 0.04$ , the value of  $r$  is definitely significant. Likewise, in case of Everest bank, correlation coefficient between Net profit and CAR is 0.90 which indicates that there is a high degree positive correlation between the two variables. Here, correlation coefficient is more than 6 times its probable error i.e.  $r > 6P.E. (r)$  [ $0.90 > 6 \times 0.06$ ] which indicates that there is a definitely significant relationship between Net profit and CAR.

The value of  $r^2$  of Global IME is 0.88, which indicates that 88% of variation is explained in the dependent variable NPAT due to the change in the value of independent variable CAR. Similarly, in case of EBL, coefficient of determination between NPAT and CAR is 0.81, which indicates that 81 % variation in the NPAT is explained due to the CAR.

Likewise, the forecasted CAR of Everest Bank for the fiscal year 2013/14, 2014/15, 2015/16, 2016/17 and 2017/18 will be 11.56%, 11.79%, 12.02%, 12.25% and 12.48% respectively. The trend value of CAR indicates that because of positive trend Bank will be able to meet the standard set by NRB's in every fiscal year for the next 5 year.

- Majority of the respondents are in favor of the statement that NRB directives are necessary to protect the banks and financial institutions.
- The study reveals that 75% as a whole are satisfied with the regulation and supervision of NRB.
- Looking the overall responses, it can be concluded that the shareholders would be mostly benefited by maintaining capital adequacy requirements.
- Accepting the opinion of majority, it can be concluded that the core capital adequacy ratio should be below 6% to have optimal capital base.

- In overall 60% of the respondents have said that the CAR set by NRB is fit for regulation & supervision of commercial banks.
- On the basis of the majority of respondents, it can be concluded that the capital adequacy framework should be designed in protecting the depositors and creditors interest most.
- Considering view of majority of respondents, it can be concluded that existence of comprehensive risk management policy and high degree of corporate governance are the most prerequisites for effective implementation of the CAR.
- From the views of majority, it can be concluded that the capital adequacy ratio should cover mostly the risk associated with the credit management.
- Considering the overall majority of the employees from each bank, it can be concluded that the capital adequacy ratio is most significant for improving the internal financial control of the banks.
- The study shows that considering the overall majority of the employees from each bank, it can be concluded that the comprehensive assessment of risk is the key component of the internal capital adequacy assessment process.
- The study shows that overall 75% of the respondents are satisfied with the existing requirement of loan loss provision.
- On the basis of overall responses, it can be considered that the inverse effect of NPA in the financial growth is widespread in Nepalese Commercial banks. Thus, both NRB and commercial bank should make appropriate policy to reduce the portion of NPA in order to have a good assets quality.

- Looking at the overall responses, it can be concluded that monitoring the activities of the borrower is the appropriate method for controlling the adverse effects of NPA. Besides this method, the adoption of strict recovery policy is also important.
- The study reveals that considering the view of majority of each bank, it can be concluded that provisions in NRB directives about the black listing of the loan defaulter are not adequate.

### **5.3 Recommendations**

On the basis of the major finding drawn and the conclusion arrived, the following recommendation has been made for having sound capital adequacy framework.

- Commercial banks are only focusing on core capital although they can fulfill the capital adequacy requirements by using supplementary capital up to the 50% of total capital fund. Commercial banks should also pay the attention toward raising the supplementary capital so that the excess of core capital can be cushioned for the hard period.
- It has been observed that the capital adequacy ratio of Global IME Bank Ltd has been maintained every year except in FY 2008/09. However, Everest Bank Ltd has been fulfilled this ratio in all study years as per the standard rate directed by NRB. So it is very essential for these banks to maintain the minimum requirement of the NRB in future too.
- Although the capital adequacy ratio as directed by NRB is 12% in past years and 10% from the fiscal year 2008/09, each bank should have its effective's internal capital adequacy assessment department and should maintain the ratio in such a way that it addresses the risk comforting to the bank.

- The forecasted trend value of CAR year for the next 5 year of both Global IME and Everest bank has shown positive trend of it though management should be careful to maintain the standard set by NRB in future too.
- Both the banks need to have sound credit management policy to decrease the credit risk, although the credit risk of both banks is comparatively lower.
- For effective implementation of capital adequacy framework, both bank need to have mainly the comprehensive risk management policy along with implementation of BASEL core principle and management of corporate risk as perquisites.
- Non performing loan of both banks have highly increased from fiscal year 2008/09 to fiscal year 2012/13. Similarly, its provisioning is also increased to secure itself from burden of NPL. So, it is the immediate need for both the banks to decrease the non-performing assets ratio with sound loan management policy. The banking sector needs to be very careful and aware in disbursement of loan and advances.
- Loan loss provision kept by Global IME Bank fiscal year 2008/09 is Rs. 96.71 million and it is increased to Rs. 779.32 million in the fiscal year 2012/13. Likewise, the loss provision amount of Everest Bank is in increasing trend and thus ranges from Rs. 584.88 million in the fiscal year 2008/09 to Rs. 804.58 million in the fiscal year 2012/13. So, management must be very careful and necessary steps should be immediately taken so that they can recover bad loan.
- While lending loans and advance, banks should keep in account that the fund they are going to lend is collected from public and hence it should be carefully treat on behalf of the depositors in order to protect their interest.

- Good management information system and risk management technique should be implemented. Supervisory response should be done regularly and for the risk management, banks should always focus on efficient portfolio of assets and maturity matching of liabilities with assets.

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## APPENDIX – I

### Questionnaire

Dear Sir/Madam,

In order to meet the partial requirement for the fulfillment of Master's Degree of Tribhuwan University. The purpose of this study is to access the performance of NRB directives on commercial banks. The information supplied will be used only for research purpose and high level of secrecy will be maintained. Please read the following statement and tick ( ) at the appropriate number that comes closest to your opinion.

Regards

Bishnu Prasad Pokhrel

Details of Respondent:

Name:

Sex:

Age:

Associated Bank:

Position:

1. Why NRB directives are necessary for the commercial banks?

- a) To protect the banks and financial institutions
- b) To enhance the credibility of financial system
- c) To protect the interest of the depositors

2. Do you agree with the view that the NRB is playing effective role in regulating and supervising your bank?

a) Yes

b) No

c) Don't Know

3. Who will be benefited most by maintaining capital adequacy requirements?

a) Depositors

b) Shareholders

c) Don't Know

4. The minimum core capital adequacy ratio (CCAR) directed by NRB is 6%. what should be such rate?

a) Below 6%

b) Exactly 6%

c) Above 6%

5. Is the capital adequacy requirement set by NRB, fit for regulation and supervision of commercial bank?

a) It's all right

b) No, its too high

c) No, its not adequate

6. The capital adequacy framework should ensure mainly which of the following?

a) Adequate to protect depositors and creditors

b) Commensurate with the risk associated activities

c) Promote public confidence in the banking system

7. What should be the main prerequisite for effective implementation of CAR framework?

a) Implementation of Basel care principle for effective Banking supervision

b) Adoption of the sound practice for the mgmt of optional risk

- c) Formulation and adaptation of comprehensive risk management policy
- d) Adherence to high degree of corporate government

8. The Capital Adequacy Ratio framework should cover mainly which of the following risk?

- a) Credit Concentration risk
- b) Business and Strategic risk
- c) Business cycle effects

9. Besides addressing the increased risks confronting the bank, the CAR framework should significant mainly for which of the following?

- a) Strengthening risk management
- b) Applying Internal Limit
- c) Strengthening the level of provision and reserves
- d) Improving Internal Controls

10. Which of the following components of Internal Capital Adequacy Assessment Process is most important to have sound capital management?

- a) Board and Senior Management Oversight
- b) Sound Capital Assessment
- c) Comprehensive Assessment of risk
- d) Monitoring and Reporting
- e) Internal Control Review

11. Are you satisfied with the existing requirement for the loan and loan loss provision directed by NRB for different category to meet the credit risk?

- a) Yes                      b) No                      c) Don't know

12. Does non performing loan affect the financial health of the commercial bank?

- a) Yes                      b) No                      c) Don't Know

13. Which measure is the best option to resolve the problem of NPA?

- a) Strict Recovery Policy
- b) Monitoring Payment
- c) New Rule and Regulation
- d) Rebate for Timely Payment

14. Are the provisions in NRB directives about the black listing the loan defaulter adequate ?

- a) Adequate                      d) Not Adequate                      c) Don't Know

## APPNIDIX II

### Appendix II-1

Global IME Bank Ltd			Everest Bank Ltd		
CCAR (X)	$x = X - \bar{X}$	$x^2$	CCAR (Y)	$Y = Y - \bar{Y}$	$y^2$
7.31	-1.86	3.46	7.73	-0.97	0.94
10.01	0.84	0.71	8.39	-0.31	0.10
10.14	0.97	0.94	8.46	-0.24	0.06
9.21	0.04	0.0016	9.61	0.91	0.83
9.17	0	0	9.31	0.61	0.37
$\Sigma X = 45.84$		$\Sigma x^2 = 5.11$	$\Sigma Y = 43.50$		$\Sigma y^2 = 2.29$

#### For Global IME Bank Ltd

$$\text{Mean}(\bar{X}) = \frac{\Sigma X}{n} = \frac{45.84}{5} = 9.17$$

$$\text{S.D}(\sigma) = \sqrt{\frac{\Sigma x^2}{n}} = \sqrt{\frac{5.11}{5}} = 1.01$$

$$\text{C.V} = \frac{\sigma}{\bar{X}} \times 100 = \frac{1.01}{9.17} \times 100 = 11.01\%$$

#### For Everest Bank Ltd

$$\text{Mean}(\bar{Y}) = \frac{\Sigma Y}{n} = \frac{43.50}{5} = 8.70$$

$$\text{S.D}(\sigma) = \sqrt{\frac{\Sigma y^2}{n}} = \sqrt{\frac{2.29}{5}} = 0.68$$

$$\text{C.V} = \frac{\sigma}{\bar{Y}} \times 100 = \frac{0.68}{8.70} \times 100 = 7.82\%$$

### Appendix II-2

Global IME Bank Ltd			Everest Bank Ltd		
SCAR (X)	$x = X - \bar{X}$	$x^2$	SCAR (Y)	$y = Y - \bar{Y}$	$y^2$
0.53	-0.83	0.69	2.82	0.65	0.42
0.89	-0.47	0.22	2.38	0.21	0.04
0.94	-0.42	0.18	1.96	-0.21	0.04
2.45	1.09	1.19	1.41	-0.76	0.58
1.97	0.61	0.37	2.28	0.11	0.01
$\Sigma X = 6.78$		$\Sigma x^2 = 2.65$	$\Sigma Y = 10.85$		$\Sigma y^2 = 1.10$

#### For Global IME Bank Ltd

#### For Everest Bank Ltd

$$\text{Mean } (\bar{X}) = \frac{\sum X}{n} = \frac{6.78}{5} = 1.36$$

$$\text{Mean } (\bar{X}) = \frac{\sum Y}{n} = \frac{10.85}{5} = 2.17$$

$$\text{S.D } (\sigma) = \sqrt{\frac{\sum x^2}{n}} = \sqrt{\frac{2.65}{5}} = 0.73$$

$$\text{S.D } (\sigma) = \sqrt{\frac{\sum y^2}{n}} = \sqrt{\frac{1.10}{5}} = 0.47$$

$$\text{C.V.} = \frac{\sigma}{\bar{X}} \times 100 = \frac{0.73}{1.36} \times 100 = 53.68\%$$

$$\text{C.V.} = \frac{\sigma}{\bar{X}} \times 100 = \frac{0.47}{2.17} \times 100 = 21.66\%$$

### Appendix II- 3

Global IME Bank Ltd			Everest Bank Ltd		
CAR(X)	$x = X - \bar{X}$	$x^2$	CAR(Y)	$Y = Y - \bar{Y}$	$y^2$
7.84	-2.69	7.24	10.55	-0.32	0.10
10.90	0.37	0.14	10.77	-0.1	0.01
11.09	0.56	0.31	10.43	-0.44	0.19
11.66	1.13	1.28	11.02	0.15	0.02
11.14	0.61	0.37	11.59	0.72	0.52
$\sum X = 52.63$		$\sum x^2 = 9.34$	$\sum Y = 54.36$		$\sum y^2 = 0.85$

$$\text{Mean } (\bar{X}) = \frac{\sum X}{n} = \frac{52.63}{5} = 10.53$$

$$\text{Mean } (\bar{X}) = \frac{\sum Y}{n} = \frac{54.36}{5} = 10.87$$

$$\text{S.D } (\sigma) = \sqrt{\frac{\sum x^2}{n}} = \sqrt{\frac{9.34}{5}} = 1.37$$

$$\text{S.D } (\sigma) = \sqrt{\frac{\sum y^2}{n}} = \sqrt{\frac{0.85}{5}} = 0.41$$

$$\text{C.V.} = \frac{\sigma}{\bar{X}} \times 100\% = \frac{1.37}{10.53} \times 100 = 13.01\%$$

$$\text{C.V.} = \frac{\sigma}{\bar{Y}} \times 100\% = \frac{0.41}{10.87} \times 100 = 3.77\%$$

## Appendix II- 4

### Non Performing Loan to Total Loan and Advance

Global IME Bank Ltd			Everest Bank Ltd		
Ratio(X)	$x = X - \bar{X}$	$x^2$	Ratio(Y)	$y = Y - \bar{Y}$	$y^2$
0.09	-1.38	1.89	0.48	-0.01	0.0001
0.85	-0.62	0.39	0.16	-0.33	0.11
2.52	1.05	1.10	0.34	-0.15	0.02
1.64	0.17	0.03	0.84	0.35	0.12
2.27	0.80	0.64	0.62	0.13	0.02
$\Sigma X = 7.37$		$\Sigma x^2 = 4.05$	$\Sigma Y = 2.44$		$\Sigma y^2 = 0.27$

**For Global IME Bank Ltd**

$$\text{Mean}(\bar{X}) = \frac{\Sigma X}{n} = \frac{7.37}{5} = 1.47$$

$$\text{S.D}(\sigma) = \sqrt{\frac{\Sigma x^2}{n}} = \sqrt{\frac{4.05}{5}} = 0.90$$

$$\text{C.V} = \frac{\sigma}{\bar{X}} \times 100 = \frac{0.90}{1.47} \times 100 = 61.22\%$$

**For Everest Bank Ltd**

$$\text{Mean}(\bar{Y}) = \frac{\Sigma Y}{n} = \frac{2.44}{5} = 0.49$$

$$\text{S.D}(\sigma) = \sqrt{\frac{\Sigma y^2}{n}} = \sqrt{\frac{0.27}{5}} = 0.23$$

$$\text{C.V} = \frac{\sigma}{\bar{Y}} \times 100 = \frac{0.23}{0.49} \times 100 = 46.94 \%$$

## Appendix II- 5

### Loan Loss Provision to Total Loan and Advance

Global IME Bank Ltd			Everest Bank Ltd		
Ratio(X)	$x = X - \bar{X}$	$x^2$	Ratio(Y)	$y = Y - \bar{Y}$	$y^2$
1.06	-1.15	1.33	2.39	0.35	0.12
1.67	-0.54	0.29	2.13	0.09	0.01
3.18	0.97	0.95	1.91	-0.13	0.02
2.26	0.05	0.0022	1.93	-0.11	0.01
2.89	0.68	0.46	1.82	-0.22	0.05
$\Sigma X = 11.05$		$\Sigma x^2 = 3.03$	$\Sigma Y = 10.18$		$\Sigma y^2 = 0.21$

#### For Global IME Bank Ltd

$$\text{Mean}(\bar{X}) = \frac{\Sigma X}{n} = \frac{11.05}{5} = 2.21$$

$$\text{S.D}(\sigma) = \sqrt{\frac{\Sigma x^2}{n}} = \sqrt{\frac{3.03}{5}} = 0.78$$

$$\text{C.V} = \frac{\sigma}{\bar{X}} \times 100 = \frac{0.78}{2.21} \times 100 = 35.29\%$$

#### For Everest Bank Ltd

$$\text{Mean}(\bar{Y}) = \frac{\Sigma Y}{n} = \frac{10.18}{5} = 2.04$$

$$\text{S.D}(\sigma) = \sqrt{\frac{\Sigma y^2}{n}} = \sqrt{\frac{0.21}{5}} = 0.20$$

$$\text{C.V} = \frac{\sigma}{\bar{Y}} \times 100 = \frac{0.20}{2.04} \times 100 = 9.80\%$$

### Appendix II-6(A)

#### Calculation of Trend Analysis

##### Calculation of Least Square Trend Analysis of CAR of Global IME

Year (t)	CAR (y)	x = t - 2011	xy	x <sup>2</sup>
2009	7.84	-2	-15.68	4
2010	10.90	-1	-10.9	1
2011	11.09	0	0	0
2012	11.66	1	11.66	1
2013	11.14	2	22.28	4
	Σy = 52.63	Σx = 0	Σxy = 7.36	Σx <sup>2</sup> = 10

$$a = \frac{\sum y}{n} = \frac{52.63}{5} = 10.53 \qquad b = \frac{\sum xy}{\sum x^2} = \frac{7.36}{10} = 0.74$$

The straight line trend for CAR of Global IME be  $y_c = 10.53 + 0.74x$

### Appendix II-6 (B)

#### Calculation of Least Square Trend Analysis of CAR of Everest Bank Ltd

(Rs. in million)

Year (t)	CAR(y)	x = t - 2011	xy	x <sup>2</sup>
2009	10.55	-2	-21.1	4
2010	10.77	-1	-10.77	1
2011	10.43	0	0	0
2012	11.02	1	11.02	1
2013	11.59	2	23.18	4
	Σy = 54.36	Σx = 0	Σxy = 2.33	Σx <sup>2</sup> = 10

$$a = \frac{\sum y}{n} = \frac{54.36}{5} = 10.87 \qquad b = \frac{\sum xy}{\sum x^2} = \frac{2.33}{10} = 0.23$$

The straight line trend for CAR of Everest Bank Ltd be  $y_c = 10.87 + 0.23x$