CHAPTER I

INTRODUCTION

1.1 Background of Study

The role of money in an economy is very important. Proper and well-planned management of money directs, determines and enhances the health and productivity of total financial sector and the performance of financial sector affect the growth of economy. Hence money is subject to manage and banks are the managers thereof. Banks, as manager collects, disburse and control flow of money. Banks collects the fund from public who have saving and disburse the fund to the person and organization who are in need of it. In this way, the entire infrastructure of national development, direction of economy, rate of progress and even the habit of people falls under the periphery of banking systems.

Banking system is volatile and sensitive sector of national economy which requires effective monitoring and efficient supervision. Smooth and effective regulation of banking activities is necessary for sustainable economic growth of a country. The regulatory agency should always be watchful of banking activities carried out by government and non-government financial institution (Pandit, 2002 : 31).

National development of any country depends upon the economic development of that country and economic development is supported by financial infrastructure of that country. Banks constitute an important segment of financial infrastructure of any country. Bank came into existence mainly with the objective of collecting idle funds and mobilizing them to productive sectors causing overall economic development which finally leads to national development of the country. “A bank can be defined as a ‘financial department store’ which renders a host of financial services besides taking deposits and loans”(Dahal & Dahal, 2002 : 7). Bank’s performance can be measured in terms of its ability to meet up with expectation of owners, employees, depositors and borrowers. Bank’s performance can be evaluated by analyzing some financial ratios from its financial reports, report

of condition and report of income. Analysis of bank's performance is usually based on the specific objectives of bank.

The performance of commercial banks is governed by the policies and regulations set by the government. Central Bank represents the government and plays the role of monitor and controller of every country. In our context, NRB deserves the authority to monitor and control the financial system of Nepal. Commercial banks and other financial institutions (FIs) have to be operated according to the directives issued by NRB. NRB as an apex of monitory authority of the country started to monitor and control the financial institutions especially at the end of 1990s by issuing the directives of financial institutions. As the bank play pivotal role in the economy, their performance should be supervised by the central bank and take necessary corrective action if their health is poor. NRB by means of regular auditing and timely supervision of FIs has been inspecting their activities to maintain their sound financial health and to build up the confidence of private sector in the liberalized economy and protect the interest of the investors. It has adopted the international bank rating system (CAMELS: Capital Adequacy, Asset Quality, Management Efficiency, Earning Performance, Liquidity Position, Sensitivity to Market Risk) to assess the financial performance of Nepalese commercial banks.

1.2 Focus of Study

Financial performance analysis is the process of identifying the financial weakness and strengths of the organization. Financial performance measure reflects strategic, operating and financing decision. The World Bank has underpinned the need of healthy financial sector to build up the confidence of banking organization in the liberalized financial system. Evaluation of financial performance is an important activity that helps to sustain the organization.

Both Joint Venture Bank and Domestic Private Commercial Bank are playing significant role in the development of national economy. Here main focus of the study is to evaluate the financial performance between Joint Venture Bank which have foreign investment, foreign rules and policy, foreign management and another Domestic Private Commercial Bank whose whole activities are done within the nation.

For the purpose of study, two banks- Nepal SBI Bank Limited (NSBI) and Machhapuchchhre Bank Limited (MBL) were selected randomly to compare which one is financially sound and which has better financial performance and position of the firm. The research study is focused on comparing financial performance and position of the firm. The research study is focused comparing financial performance of NSBI and MBL by using descriptive and analytical research design in the framework of CAMELS.

1.3 Statement of the Problem

Both MBL and NSBI have succeeded to capture satisfactory market share of Nepalese financial service industry because MBL have focused on heavy promotion and customer satisfaction whereas NSBI has an experience in international banking prompt and professional attitude. Almost all the private banks are earning profit; it is very difficult to call the private sector bank sound if appraised from CAMELS approach. The profitability position of a firm is generally known through financial statements but the major question emerges whether these are adequate to reflect the overall performance of bank. In general, the study seeks to compare financial health of NSBI and MBL in the framework of CAMELS.

i. To examine the Capital Adequacy of Banks
ii. To assess the quality of Bank's assets
iii. To analyze the efficiency of the Bank's Management
iv. To evaluate the earning performance of the Bank
v. To find out liquidity position of the bank
vi. To know how the change in interest rates can affect bank's earnings

1.4 Objectives of the Study

The fundamental objectives of the study are to evaluate the comparative financial performance of Nepal SBI Bank Limited and Machhapuchchhre Bank Limited in the CAMEL framework. However the specific objectives of the study are:

i. To examine the capital adequacy of banks
ii. To assess the quality of bank's assets
iii. To analyze the efficiency of the bank's management

iv. To evaluate the earning performance of the bank
v. To find out liquidity position of the bank
vi. To assess sensitivity of both banks earning to interest rate risk

1.5 Significance of the Study

Significance of banking business in national development is obvious. So the development of banking system is vital issue for the growth of an economy. This study is comparative financial performance of Joint Venture Bank and Domestic Private commercial Bank where sample is taken as NSBI and MBL which help to know the capacity difference of Joint ventures and domestic private banks. This study is also done on framework of CAMELS which help to know the existing problems of banks and give recommendation for their sound financial health. This research would help the managers to evaluate the performance of their banks. CAMELS rating system will be crucial and convenient technique to assess the financial performance of any financial institution and it will provide framework for the supervisory authority. In other hand, the study is equally important for commercial banks, researchers, concerned shareholders, students, scholars and policy makers.

1.6 Limitations of the Study

The limitation of the study are as follows:

i. Among various Joint Venture Banks and Domestic Private Commercial Banks, the study focuses only two banks NSBI and MBL. Hence it cannot be reasoned for similar condition of the whole industry. However it gives particular direction to industry
ii. The study is based on secondary data and remain largely in offsite monitoring system which is itself are limiting factors.
iii. Data published by different authorities differ. Figure published by NRB and bank's annual report do not tally each other. However in this research work data collected and published by the bank is taken as authentic source of the data.
iv. The study covers only the period of fiver years.

1.7 Organization of the Study

The whole study will be divided into five chapters:

i. The first chapter deals with introduction which includes general background focus of study, statement of problem**,** objectives of study and limitation of study.

ii. Second chapter deals with the review of available literature. It includes theoretical review and review of related studies.

iii. Third chapter explains the research methodology used in the study which includes research design, population and sample, sources of data, data collection techniques and limitation of study.

iv. Fourth chapter deals with data presentation and analysis which includes presentation and analysis of data and major finding of study.

v. Finally, fifth chapter discusses summary of main findings, conclusions and recommendations.

CHAPTER II

LITERATURE REVIEW

This chapter deals with the conceptual review regarding financial performance analysis and CAMELS framework of financial performance analysis. Past study carried out on financial performance analysis are also incorporated here. This chapter is divided into two parts: conceptual framework and review of related studies.

2.1 Conceptual Framework

This sub chapter presents the theoretical aspect of the study. It includes the concept of commercial bank, joint venture bank, function of commercial bank, historical development of commercial bank, outline of Nepal SBI Bank limited and Machhapuchchhre Bank Limited, concept and objectives of financial performance analysis, types of financial analysis and concept of financial performance analysis in the framework of CAMELS.

2.1.1 Concept of Commercial Bank

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

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

institutions which play the role of financial intermediary in collection and disbursement of funds from surplus unit to deficit unit.

Upadhaya and Tiwari (1998) stresses that the commercial bank is established with a view to provide short term debt necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surplus in the form of deposit, lending debts by discounting bill of exchange, accepting valuable goods in security, acting as an agent of the client etc. In the same way, Abrol and Gupta (2002) explain that principally a commercial bank accepts deposits and provide loans primarily to business firm. On the other hand, the board concept of commercial bank holds that the commercial bank is a banking institution other than central bank. The commercial bank is the only institution other than central bank permitted to accept demand and time deposits (Crosse 1963).

2.1.2 Concept of Joint Venture Bank

Joint ventures banks are mostly collaborations between a local and foreign company. Reasons to create joint venture bank are to put up corporation's strengths, reducing costs and risks, economies of scale, approach to new technologies, approach to new customers, expanding financial resources, developing new managerial practices. And the competitive objectives to create joint venture bank is to anticipate competition, manipulating structural development of the industry, improving quickness, formation of stronger competitive entity, improving speediness to capture market etc. The other objectives are expansion, transfer of technologies and skill and synergies.

In global perspective joint venture bank are mode of trading through partnership among nations and a form of negotiation between various groups of industries and traders to achieve mutual exchange of goods and service for sharing comparative advantage.

Janch and Glueck (1988) explain that when two or more independent firm mutually decides to participate in business venture contribute to the total equity or more or less capital and establish a new organization, it is known as joint venture. Similarly, Columbia journal of world business volume (Spring 1976) explain as a growth strategy joint venture may be regarded as a cross between internal growths, in this network Gullander S. has proved joint venture as a pool between spider webs and successive integral that leads to together split.

In the same way, Journal of international trade centre UNCTAD/ GATT (1984, Geneva) explain joint venture as the joining of forces between two or more enterprise for the purpose of care out a specific business operation (industrial or commercial, investment, production or trade).

2.1.3 Function of Commercial Bank

Commercial banks represent the largest group of depository institution measured by assets size. Nature of business and the structure of industry have change drastically in last decades; the role and importance of commercial banks have been rapidly are also commonly known in all industrialized countries. They perform functions similar to those of saving and credit unions. They accept deposit and make loans. According to American Institute of Banking (1972:345), the major four functions of commercial banks are receiving payments, handling payments, making loan and investment and creating money by extension of credit. Similarly, Upadhaya and Tiwari (1980:89) have argued that there are three major function of commercial bank, which are; primary function (accept deposits, provide loans and credit) agency functions (sales and purchase of securities, working as an agent and trustee of a customer, transfer of funds, provide financial information), general functions (safe custody of valuable assets, issue of credit instruments, dealing with foreign exchange, provide trade information and statistics.)

The spread between the prices received by banks on the funds lent and the price paid by them on the funds mobilized is one of the crucial factors which determine the viability of banking operations. Commercial banks in Nepal provide the following main banking functions;

Accepting Deposits: Commercial banks accept deposits from individuals, partnership firms and corporations as well as from central and local government (Shrestha and Bhandari, 2004). Accepting deposit is the major function of commercial bank and the banker used to charge commission for keeping the money in its custody when the banking industry was known as developing institutions. In these days, a bank accepts mainly three types of deposit from its customers, Savings deposits on which the bank interest relatively at low rate to the depositor customer. Depositors are allowed to withdraw their money by cheque up to limited amount during a prescribed time period by bank. Similarly, another form of deposit is

current account on which bank does not pay interest by charges certain amount instead of providing services to its customer. Businessperson and traders keep their deposits in current accounts known as demand deposits. They can withdraw any amount available in their current account by cheque without notice. Likewise, a bank accept fixed or time deposits from saver who do not need money for a stipulated period from six months to longer period ranging up to ten years or more which are encouraged to keep it in fixed deposits account because there is always the maximum limit of the interest rate on fixed deposit. Fixed depositors customers relatively receives higher interest rate due to carry a fixed maturity and a stipulated interest rate but may be of any denomination, maturity and yield agreed upon by the bank and its depositors. Large negotiable CDs that may be traded in the open market in million of rupees that bank use to raise money their most well to do customers (Rose, 2002:119). Nepalese banks provide 7.25 to 8.5 percent interest on 1- year deposit and 7.5 to 9% on 2-years and in above only fixed deposit receipt is given as evidence of deposit.

Providing Loans: Another primary function of commercial banks is providing advance loans to its customers. A bank lends a certain percentage of the cash lying in deposits at a higher interest rate then its pays on such deposits. This is how it earns profits and carries on long run sustaining the business smoothly. The banks advance loans can be mentioned in the following ways;

i. **Cash Credit:** Cash credit-advancing loans is the collateral based loans to businessperson or traders against certain specified securities. The amount of the loan is created to the current account of the borrower. In the case of new customer, a loan account is opened and borrower can withdrew money through cheque according to their requirements but pays interest on the full amount.

ii. **Call Loans:** These are very short-term loans advanced to the bill bankers for not more than fifteen days. They are advanced against first class bills or securities. Such loans can be recalled at a very short notice, they can also be renewed in normal time.

iii. **Overdraft**: A bank allows the borrower to overdraw his current account up to a sum equal to the loan sanctioned. Bank provides the overdraft facility up

to the specific amount to the businessperson. However, bank charges interest only on the overdrawn account.

iv. **Discounting Bills of Exchange:** Banks purchase bills of exchange offer discounting, i.e. charging rate of interest for the time to maturity, if the holders wants its proceeds before maturity. Bank is reimbursed by accepting on maturity. It deposits the amount of bill in the current account, if the bill holder after deducting its rate of interest for the period of loan not more than 90 days.

Bank charges interest on any loans, which are usually higher than those offered on other deposits. Since the banks in Nepal are now free to fix interest rates, the rate of interest on both deposits and loans various from bank to bank.

Credit Creation: Credit Creation is one of the most important functions of commercial banks. Commercial banks become able to grant more loan than it has own capacity. Thus, such credit creation activities fulfill the supply of money that eventually helps to promote trade and industry in the country (Shrestha, 2052). Bankers are dealers of money who deals other people's money, i.e. bank accept deposit in the different forms and advance loans on credit to customers. The bank usually synchronizes the withdrawals and deposits from their experiences. It opens a current account in his name and allows him to withdraw by cheques, thus the granted loan again deposit into the bank. Advances loan on credit to customers however open current account in their name maintaining small cash in reserve and allows him to withdraw the required sum by cheques. This process is continued to other customers also because there are numerous transitions have taken place. Therefore, it is true that the loans are children of deposits and create credits or deposits by keeping small cash in reserve and lending the remaining amount of deposits. Therefore, the loans make of increase in the total amount of deposits. In other words, loans by banks create deposit or credit is credited by banks.

Financing Foreign Trade: A commercial banks finance foreign trade of its customer by accepting foreign bills of exchange and collection them from foreign banks. It also transacts other foreign exchange business buying and selling of foreign currency.

Agency Services: A banks acts as an agent of its customers while collecting and paying cheque, bills of exchange, drafts, dividend etc. It also buys and sells shares, securities, debentures etc. for its customer. Further, it pays subscription, insurance premium, utilities bills and other similar charges on behalf of its clients. It also acts as a trustee and executor of the property will of its customer. Moreover, the bank acts as consultants to its client for these services, the bank charges a normal fee while it renders other fee of charge.

Other Miscellaneous Services: Besides these functions, Bank also acts as custodian of valuables of the customers by providing locker facility where they can keep their jewelry and valuable documents. It issues various form of credit instruments, such as cheque, drafts and traveler cheque etc. which facilitate transactions. It renders underwriting services to companies and helps in collection of funds from the public. Finally it provides statistics on money market and business trends of the economy.

2.1.4 Commercial Banking Industry in Nepal: Evolution and Present Scenario

A broad and brief picture of the progress of commercial banking in Nepal in terms of growth, in the numbers, number of branches, total deposits and total advances which has been increased continuously day by day. So the evolution of banking industry has started long time back, during in ancient time in the context of world. The origin of banking system is traceable to the ancient Assyrians, Babylonians and Athersian but the forerunners of modern banks are considered to be the Bank of Vanice (A.D.), The Bank of Genoa (1320 A.D.), Bank of Barcelona (1401A.D.) and The Bank of Amsterdam (1609 A.D.). The Bank of Vanice and Bank of Genoa Continued to operate until the end of eighteenth century with the expansion of commercial activities in Northern Europe there sprang up a number of private banking houses in Europe and slowly it spread throughout the world. Similarly, in almost all countries the logical historical order of the development of the commercial banks has gone through different steps age stages which start from rudimentary economy in which the commodity money such as gold and silver coins generally accepted as a means of payment. Involvement of property owners, rich merchants, shopkeepers and other individual moneylenders have acted as a fence to institutional credit in presence of unorganized moneylenders. Though establishment

of banking industry was very recent; some crude banking operations were in practice in the ancient time.

In the context of Nepalese chronicle, the development of banking industry is relatively recent. The record of banking system of Nepal gives detail account of mixture life. It was recorded that the new era known as Nepal Sambat was introduced by Shankhadar, a Sudra merchant of Kantipur, in 879-880 A.D. after having paid all the outstanding debts in the country which shows the basis of money lending practice in ancient time of Nepal. At the end of 8$^{th\ Century}$, Gunakam Dev had borrowed money to rebuild the Kathmandu valley. In the 11th Century, during Malla Regime, there were evidence of professional moneylenders and bankers. The Silver coin age, which came into existence in Nepal in 12th Century, is said to have marked a new epoch in the economic history.

However, due to the absence of regulatory bodies, the moneylenders used to charge high rate of interest and other extra dues on loan extended. At the end of 14th Century, we further came across the term *'Tanka Dhari'* meaning money dealer which is one of the 64 caste classified basis of occupation.

During the year 1877 A.D. establishment of '*Tejarath Adda'* by Government of Kathmandu Valley, the banking system was flourished which helped general public to provide credit facilities at very low interest rate, where Tejarath Adda extended the loan to the public against the collateral to gold and silver. Hence, the establishment of Tejarath Adda could be taken as pioneer foundation of banking in Nepal. At the time, the Tejarath Adda could not run and extend the advance requirement to the general public due to lack of financial support, as no other financial institutions were set up. Again, an unorganized moneylender became active. In the meantime, government started to establish trade relationship between Tibet and India. The need of banking institution was realized when there was need of finance for reconstruction of work in 1934 A.D. earthquake. Considering this Industrial Development Board was formed in 1936 A.D. which formulate the "Company Act" and "Nepal Bank Act" in 1937 A.D. Definitely, it has started on evolution of modern banking in Nepal. (Bista, 1989)

Nepal Bank Ltd. established in 1937 A.D., is the first bank of the country with an objective to render service to the people and contribute the nation's development. Similarly, establishment of Nepal Rastra Bank (NRB) in April 26, 1956 undoubtedly was an important event in the economic history of Nepal. The

Nepal Rastra Bank Act 1955 developed the objective of supervising protecting and directing the functions of commercial banking activities. Following the establishment of NRB, a number of financial institutions were established. Out of these, establishment of Nepal Industrial Development Corporation in 1959, Rastriya Banijya Bank in 1996 and Agricultural Development Bank in 1968 and Securities Exchange Center in 1977 were the prominent ones of the development of Nepalese Financial Market.

In 1980 A.D., government introduced "Financial Sector Reforms" which facilitate the establishment of different private sector financial institution in Nepal. The historical development of financial system in Nepal was significant in the decade of 1980's. The financial liberalization policy introduced by the government in the mid-eighties paved the way for faster, healthier and competitive development of financial system in Nepal. The financial liberalization initiated by the establishment of Nepal Arab Bank Ltd in 1984 opened and run a new vista for the establishment and promotion of financial institution Nabil Bank Ltd in 1984 which was established at a first joint venture bank in Nepal. Likewise, Nepal Indo-Suez Bank Ltd in 1986 (later it has been called Nepal Investment Bank Ltd.) and Nepal Grindlays Banks Ltd in 1987 (later it has been called Standard Chartered Bank Ltd), Nepal Bangladesh Bank Ltd in 1994 were establishment under joint venture. As a result, a number of commercial banks increased dramatically viz, Himalayan Bank Ltd, Nepal SBI Bank Ltd, Everest Bank Ltd, Bank of Kathmandu Ltd, Lumbini Bank Ltd, Machhapuchchhre Bank Ltd, Laxmi Bank Ltd, etc.

By mid December 2010, NRB licensed "A" class commercial banks are 31, "B" class development banks are 83 and "C" class financial institutions are 79. Among 31 commercial banks, 3 are public banks, 6 are foreign joint venture and the remaining are fully domestic private banks (Banking Supervision Annual Report, 2010: NRB)

2.1.5 Outline of Machhapuchchhre Bank Limited

Machhapuchchhre Bank was established in October 3, 2000 under the commercial bank act (1974 AD) in Pokhara as the first commercial bank with its head office in western region of our country. Its major objective is strives to facilitate its customer needs by delivering the best of services in combination with the latest technologies and the best international practices. MBL provides a full

range of commercial banking services through its outlets spread across the nation and reputed correspondent banks both at national and international level. To facilitate its international trade and foreign exchange business the bank has maintained relationship between ICICI Bank-Mumbai, Central bank of India, Mashreq-Bank-Dubai, SCB-New York, CCB- London, SCB- Calcutta, Australia and New Zealand Bank and western union Bank. The Authorized, Issued Capital and Paid-up capital has reached up to 200 crores, 147.9126 crores and 147.926 crores respectively. This bank has 39 branches.

MBL have the most sophisticated GLOBOS banking software enabling it to provide modern banking facilities like Tele banking, Internet banking, point of sale service, ATM facilities and many more.

2.1.6 Outline of Nepal SBI Bank Limited

Nepal SBI Bank Ltd. is the first Indo-Nepal joint venture in the financial sector sponsored by three institutional promoters, namely State Bank of India, Employee provident fund and agriculture Development Bank Ltd. through the memorandum of understanding signed on July 17, 1992. The Authorized, Issued and Paid-up capitals have been increased to Rs. 200 crores, Rs.166.16 crores and Rs. 165.36 crores respectively. Consequently the bank corporate status has undergone change from its previous status as a Joint Venture Bank to a Foreign Subsidiary Bank of SBI. Presently fifty five percent of the total share capital of the bank is held by the SBI, fifteen percent is held by EPF and thirty percent is held by the general public. To facilitate international trade NSBI has maintained its major currencies with various international banks. Later, it has opened an US Dollar nostro account with Mashreq Bank to easy settlement of funds. It also opened an INR account with SBI Jogbani branch for facilitating custom duty. Arrangement were finalized during the year with international money transfer companies in the Gulf and Malaysia, it have also maintain its relationship with Bank of Bhutan.

Today NSBI have 43 branches with 465 employees of different skill and competency dedicates to promote the various modern banking service and to ensure latest technologies. It has sophisticated FINACLE banking software enabling it to provide modern banking facilities.

2.1.7 Financial Performance Analysis

In this sub- chapter approach of financial performance analysis is presented. By the help of financial performance analysis we can identify strength and weakness of financial institutions. Under this sub heading type of financial analyses, concept of financial performance analysis in the framework of CAMELS and objectives of financial analysis is discussed.

A commercial bank is simply a business corporation organized for the purpose of maximizing the value of shareholders wealth invested in the firm at an acceptable level of risk. Profit is one of the basic indicators of sound financial performance. It is usually the result of sound business management, cost control, credit risk management and generally efficiency of operation (Robinson & Wrightman, 1990). Profit is essential for a firm for its survival, growth and to maintain capital adequacy through profit retention. The objective of maximizing profit with a level of risk acceptable to the bank's stockholder is not easy to achieve, as the recent upsurge in bank failures around the globe clearly suggests. Under the free economic system like USA or liberal economic system of Nepal, the interest of the nation as well as those of the individual stockholder's are supposed to be best served by vigorously seeking profit.

Although the profit is important for any business motive firm, it cannot be the sole objective of an enterprise or financial institution and a financial enterprise should not be evaluated just on ground of the profit it has earned. Neither the bank nor the community will be best served if the banker unreasonably sacrifices the safety of his funds or the liquidity of his bank in an effort to increase income.

Financial performance analysis is the process of identifying the financial strength and weakness of the firm by properly establishing relationship between the item of balance sheet and the profit and loss statements. It is also a study of relationship among various financial factors in a business as disclosed by a single set of statements and study of the trend of these factors as shown in a series of statements. By establishing a strategic relationship between the items of balance sheet and income statement and other operative data, the financial analysis unveils the meaning and significance of such items. Thus, financial performance analysis is required to take managerial and financial decisions.

A fair evaluation of bank's performance should start by evaluating whether it has been able to achieve the objectives its management and stockholders have set. The fundamental analysis in term of financial analysis is different from market

message reflected in technical analysis guided by the investor 'psychology based in speculators' manipulation of information. These are very different from industry and overall economic analysis (Shrestha, 2004).Financial decisions cannot made in vacuum. They are to be based on proper financial analysis by using financial tools such as financial ratios so as to maximize the financial performance of the company. The assessment of the company's past, present and anticipated future financial conditions is important to identify the overall financial health of such company. Annual report contains financial statement as well as management opinion of the past years performance and firm's future prospects. In financial analysis, certain guiding criteria include:

Historical evidence, as a base of evaluating company's financial performance, is an understanding of change and factors of change that appropriately influence financial decisions. Economic consideration- gaining additional perspective and improved insight of both trend and averages such as price level, business profits, interest rates, dividends, security-price movements etc.

Analysis of these financial statements helps in measuring the overall financial performance of companies. What can be done through financial performance analysis is to:

- Obtain information that can be used for decision-making.
- Judge performance and management effectiveness.
- Identify the deficiencies and weaknesses.
- Take corrective actions timely to improve the performance.
- Gain adequate insights into the possibilities of making changes worthwhile.
- Evaluate the possible implications of alternative courses of actions.

The roots of major management decisions revolve around financial information. A careful scrutiny of alternative choices based on projected information depicting the comparative results of each is needed to arrive at the selection of most favorable decision for eventual implementation. This brings us to the question what constitute financial information? The basic source covering financial information about the firm's affairs is its annual final accounts i.e. Profit & Loss Statement for the last operating period (quarter/half year/year etc,) and Balance Sheet as at the end of that period. Profit and Loss accounts reveal the operating results of the business activities of the firm. These sources, however, reveal only part of the necessary and

required information and leave a considerable gap. It is therefore necessary to further examine and breakdown the information in these statements with a much greater elaboration and detail to decipher the comparative strength and weaknesses of the firm. For this purpose, we can employ certain analytical tools and perceptive statements based on the source data from the balance sheet and profit & loss account statements.

Financial analysis serves the following purposes to the concerned authorities/bodies:

The government for compiling national statistics relating to the status and growth of each industry; The shareholders, as well as perspective investors desirous to know the present and anticipated trends of the business; Banks and financial institution who are interested with project appraisal and conducting feasibility and viability studies to ascertain the credit worthiness of the applicant- firm's project; Suppliers who want to know how viable the business is in order to enter into long-term contracts; the same need arises for customers who need to procure products from business regularly; Credit Rating Agencies, Stock exchange authorities who study the risk-factor affecting the innumerable small investors who have parked their life savings in the firm by way of equity, debt(bonds) or deposits.

Financial data is to be analyzed with reference to the particular objectives of the person concerned either external or internal as regards the firm. Before commencing analysis the type of analysis and the type of information needed are to be ascertained, as well as identification of the source-data, and the analytical tools to be employed. Analysis may be done with reference to a particular financial year in respect of different firms of a particular group or industry to assess their comparative status and performance or it may be restricted to a particular firm for a stretched period of 5 to 10 years to decipher its strengths and weakness and to analyze how it is progressing indifferent directions over this period.

Basically a financial analysis consists of a three-step process as under:

- Identify the source information relevant to the decision to be made from the total pool of data provided by the annual financial statements.
- Re-arrange the particular data selected to highlight significant relationship.
- Study the analyzed information critically and draw pertinent conclusions.

2.1.8 Types of Financial Analysis

It may be categorized as external or internal analysis based to whom it is intended. Internal analysis for management information and decision thereon are generally more detailed than external analysis intended for trade creditors, investors, term lending institutions and bankers supplying working capital.

The analysis may be classified as horizontal and vertical analysis. Horizontal analysis is conducted to compare the annual financial statements of the current year with that of the previous year to ascertain the comparative trends of the progress of the business, while vertical analysis is restricted to an in-depth study of the current year's financial statements. It converts each element of the information into a percentage of total amounts of the statement (like profit to sales turnover) so as to establish relationship with other components of same statement.

Trend Analysis: This is arrived by preparing relevant ratios of the firm for a series of years (three or more) to study the comparative performance. The different performance ratios related to the previous year is compared with that of the current year (base year) to draw such conclusion.

Ratio analysis: An arithmetic ratio explains the relationship between two numbers. The ratio to be meaningful, the numbers selected must be co-related i.e. must bear a connected relationship. The one must have an influencing effect on the other. Ratio Analysis establishes meaningful quantitative relations between two linked /connected item/variables of financial statements so that the strength or weakness of the business is brought out. For examples current assets are the source to meet current liabilities. Availability of sufficient current assets capable of quickly being converted to cash will assure that creditors for liabilities in the short run will be promptly discharged. The quantitative relationship of the set of items is indicated by the 'current ratio'. Banks are happy if the borrowing firm to whom working capital accommodation is extended has a current ratio of 1.4 or more. Similarly net profit is related to both capital employed and the sales turnover. Therefore net profit can be compared to either net worth or sales turnover. The net profit to net-worth ratio indicates the return on the investment, while the net profit to sales turnover indicates the operational efficiency.

Funds flow statement: This is the statement which explain the various sources from which funds were raised and the uses to which the funds are put. The statement

indicates the changes which have taken place between two accounting periods. While the balance sheet as at a particular date presents the static picture of the sources and use of the funds, the funds flow statement captures the movement of funds over a specified period. A fund flow statement, therefore, explains the transformation or changes underwent by individual assets and liabilities of the form from one balance sheet date to another. A projected fund flow for a future span of periods can also be prepared. This will facilitate budgetary control and capital expenditure control to be exercised in the organization.

Break- even analysis helps to ascertain the point in term of sales turnover at which the firm is able to cover all its expenses out of it s earning and reaches the position of neither profit nor loss. In other words before the BEP the firms incur loss and after the BEP the firm will show profit. BEP is the demarcating line. This is more meaningful for a newly established manufacturing business, as it takes time to develop the market for its products and build up sales. The period from the date of commencing construction/erection of the project to the date of reaching BEP sales is called the gestation period for the industry. (www. geocities.com)

2.1.9 Concept of Financial Performance Analysis in the framework of CAMELS

CAMELS rating system is international bank rating system with which bank supervisory authority rates institution according to six factors. The six areas examined are represented by the acronym “CAMELS”. In this acronym, each letter stands:

C - Capital Adequacy
A - Asset Quality
M - Management Quality
E - Earnings
L - Liquidity
S - Sensitivity to Market Risk

Capital Adequacy: The capital is defined as wealth employed in production process to generate more wealth and profit. Capital includes any funds thus employed. Capital can also be defined as the money contributed by the proprietors to an

organization to enable it to functions, thus share capital is the amount provided by the way of loans. However, the capital of the proprietors of the companies not only consists of the share and loan, capital, but also includes retained profit, which accrues to the holders of the ordinary shares. Commercial bank should have adequate capital to support its risks assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities. Adequacy and inadequacy of bank capital directly affects the banking transaction. The adequacy of bank capital is most important aspect of the bank. If there is inadequacy of the capital, the bank should take step for the adequacy of capital as per legal requirement. They should remove inadequacy of bank capital through the medium of collecting of ownership and borrowed capital. If there is scarcity of capital in the bank, its financial health cannot be regarded capable and healthy.

The advantages of bank capital adequacy are as follows:

- If the bank has an adequate bank capital, people trust upon such banks, such bank becomes successful to gain the trust of all sectors.
- If the bank has adequate capital, it can invest into any sectors at any time form which the bank gets success to gain a lot of profit.
- The bank does not face problem to collect the capital.
- The bank does not need to take loan, and do not have to pay interest.
- There will be not possibility of liquidation of bank.

The capital accounts of a commercial bank play several vital roles in supporting its daily operations and ensuring its long-run viability. Firstly, capital provides a cushion against the risk of failure. Second, capital provides the funds needed to get the bank chartered, organized and operating before deposits come flowing in. Thirdly, capital promotes public confidence in a bank and reassures its creditors (including the depositors) of the bank's financial strengths. Fourthly, capital provides funds for the organization's growth and the development of new services programs and facilities. And finally capital serves as a regulator of bank growth, helping to ensure that the individual bank's growth is held to pace that is sustainable in the long run.

Capital adequacy requirement has been existed for a long time, but the two most important are those specified by the Basel Committee of the Bank for international settlements. Basel 1 defined capital adequacy as a single number that was the ratio of a bank's capital to its assets. There are two types of capital, tier one and tier two. The first primarily share capital, the second other types such as preference share and subordinated debt. Each class of asset has a weight of between 0 to 100 percent. Very safe assets such as government debt have a zero weighting, high-risk assets (such as unsecured loans) have a rating of one. Other assets have weightings somewhere in between. The weighted value of an asset is it value multiplied by the weight for that type of asset. The Basel 1 accord is to be replaced, in stages by Basel 2. Basel 2 is based on three "pillars": minimum capital requirements, supervisory review process and market forces. The first pillar is similar to Basel 1 requirement; the second is the use of sophisticated risk models to ascertain whether additional capital (i.e. more than required by pillar 1 is necessary. The third pillar requires more disclosure by risks, capital and risk management policies. This encourages the markets to react to the taking of high risks.

Asset Quality: A bank's assets are grouped into four major subcategories: 1) cash and balances due from other depository institutions 2) investment securities, 3) loans and leases and 4) other assets. Among them loans and advances dominate the asset side of the balance sheet of the banks. Similarly earning from such loans and advances occupy a major space in income statement of the bank. Hence asset is the critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. Many financial crises in the past (including the Asian crises) have been caused or amplified by downturn in particular sectors of the economy spilling over into the financial system via concentrated loan books of financial institutions. However, loans are also the least liquid asset item and the major source of credit and liquidity risk for most banks. Thus quality of assets has direct impact in the financial performance of a financial institution. The quality of assets particularly, loans assets and investments, would depend largely in the risk management system of the institution. We can use number of measure to indicate the quality of assets held by the banks. An increasing trend in the ratio of nonperforming loans to total loans signals a deterioration in the quality of credit portfolios and consequently in

financial institution cash flows, net income and solvency. It is often helpful to supplement this information with information on non-performing loans net of provision and on the ratio of provisions plus interest suspension on impaired loans to total loans- particularly if impaired loans have not yet been classified as nonperforming. Although these indicators are primarily backward looking, reflecting past problem that have already been recognized, they can be useful indicators of current health of financial system and are often use in connection with stress tests of financial institutions. Trends on nonperforming loans should be looked at in conjunction with information or recovery rates- for example, using the ratio of cash recoveries to total non-performing loans. Such information points to the level of effort or the ability of financial institutions to cope with high nonperforming loan portfolios. Loans outstanding to loss-making public sector entities are often the result of past directed lending, may also signal significant credit risk. Depending on the country, loans to loss making public enterprises or to the regional governments may not be classified as nonperforming, even though they may not be repaid on a timely basis and/ or in full(ADB 2002)

Non Performing Assets: Nonperforming Assets means an assets or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI (Athmanathan and Venkatakrishnan, 2001). An amount due under any credit facility is treated as “past due” when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up gradation of technology in the banking system, it was decided to dispense with past due concept, with effect from March 31, 2001. Accordingly, as from that date, a non performing assets (NPA) shall be an advance where

1) Interest and/ or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan.
2) The account remains out of order for a period of more than 180 days, in respect of an overdraft/ cash credit (OD/CC).
3) The bill remains overdue for a period of more than 180 days in case of bills purchased and discounted.

4) Interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in case of an advance granted for agricultural purpose.
5) Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

In case of the banks, the loans and advances are the assets of the banks. As the banks flow loans from the fund generated through shareholders equity, money deposited by the people and fund having through the borrowings to, it accept the repayment of funds with some additional amount that is interest so that it could meet its all kinds of expenses. When any loans could not be repaid in time it directly effects to the performance of the banks. Hence non-performing assets means that loans and advances, which are not performing well or those, loans and advance which, are irregular. In this regard it would be very useful to present cross-country definition concerning non-performing assets, which is presented below:

Country	Definitions of Non- Performing Assets
India	Loans and advances which are due for six months.
Indonesia	Loans and advances classified as substandard, doubtful and bad(over three months overdue)
Korea	Loans overdue over three months plus nonaccrual loans
Malaysia	Loans classified as substandard, doubtful and bad as per banks discretion (principal or interest overdue by three or six months at bank's discretion)
Philippines	Substandard, doubtful and loss loan. Loans payable in monthly installments more than three months overdue and loans repayable on other term if one month overdue.
Singapore	Loans classified as substandard and all loans and advances which are overdue more than three months
Thailand	Substandard, doubtful and bad loans(overdue more than three months)

Source: (Cotvaria L, Dziobek C., Kanaya A.and Song I., 2000).

As per the Nepal Rastra Bank Directives " Non- performing assets are the classified loans and advances and this includes sub-standard, doubtful and bad loans categorized as defined by NRB directives (NRB Directives 2006, compiled by R. Bajracharya and company)."

With the objective of minimizing the possible loss of credits extended by commercial banks, Nepal Rastra Bank amended the policies relating to loan classification and provision. As per the new circular of NRB, the commercial banks should classify the principal amount of loans and advances based on aging. Under the new rules, loans and advances are classified into the following categories:

Pass Loan: Loans in this category are performing and have sound fundamentals which include borrowers overall financial conditions, resources and cash flow, credit history and character. They also include the purpose of loan and types of secondary sources of repayment. 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 or Performing Assets.

Substandard Loan: Loans in this category have well defined weakness, where the current sound worth and repayment capacity of the borrower is not assured. Orderly repayment of debt is in jeopardy. All loans and advances that are past due for a period of 3 months to 6 months shall be included under this category.

Doubtful Loan: Doubtful loans exhibit all the characteristics of substandard loans with the added characteristics that collection loan is highly questionable and improbable. Classification of loss is deferred because of specific pending factors that may strengthen the quality of assets. Such factors include merger, acquisition, liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plan. All loans and advances, which are past due or a period of 6 months to 1 year, shall be included in this category.

Loss/Bad Loan: These loans are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer full provision or writing of this basically worthless loan. Partial recovery of this may be possible in future. 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.

Loan Loss Provisioning: Nepal Rastra Bank has made it mandatory to commercial banks to make the loan loss provisioning based on outstanding loans and advances and bill purchases on the following basis.

Types of loans	**Loan Loss Provisioning**
Pass	1 percent

Substandard	25 percent
Doubtful	50 percent
Loss/Bad	100 percent

Apart from the aforementioned arrangement, the following additional arrangements are provided for the loan loss provisioning.

- Where the loan is extended only against the personal guarantee statement of the assets, equivalent to the personal guarantee amount not claimed by another shall be obtained. Such loans shall be classified as per above and where the loans fall under the category of pass, substandard and doubtful in addition to the normal loans loss provision applicable for the category, an additional provision by 20 percentage shall also be provided.
- The loan loss provisioning in respect of rescheduled, restructured and swap loans shall be provided at a minimum of 12.50 percent.
- In case of priority sector loans the provisioning are made 1%, 25%, 50% and 100% to the loan categorized as pass, substandard, doubtful and loss respectively. However, in respect of insured loans the provisioning should be made on the following way:

Types of Loan	**Loan Loss Provisioning**
Pass	0.25 percent
Substandard	6.25 percent
Doubtful	12.5 percent
Loss/ Bad	25 percent

Management: Good management can make and poor management can break an organization. Banks are no exception to this universal phenomenon. Sound management is a key to financial institutions performance. Although several indicators can be used as proxies for the soundness of management such evaluations still primarily a qualitative exercise, particularly when it comes to the evaluation of the management of operational risk, that is, the functioning of internal control systems. The quality of management is the most important element in CAMELS framework of financial performance analysis. The Nepali banking sector has matured over the last 20 years and there is sufficient evidence of professional management being able to translate their management efficiency towards producing

wonderful results for the bank. At the same time we also have enough cases where due to poor management banks have performed poorly. Human resource management is a key management issue. Good or bad human resource management translates into staff efficiency of a particular bank.

The productivity of employees can be used as a measuring rod for evaluation. Likewise sustainability of earning shows the efficiency of management. Expenses ratio, earning per employee, cost per loan average loan size and cost per unit of money lent can also be used as proxy of the management quality. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. Similarly, low or decreasing earnings per employee can reflect inefficiencies as result of overstaffing, with similar repercussions in term of profitability. Another possible ratio of management soundness is the rate of expansion in the number of braches whereas some expansion may reflect a healthy degree of competition, too rapid a rate of expansion may indicate tax licensing requirements, unsound management and a gap in the supervisory capacity.

Although, there is a risk of being slightly subjective, the issue of evaluating management quality cannot be completed if we do not consider corporate governance factor. While management must work to maximize shareholder's value in any organization, there must be clear line between management and shareholders or board of directors in term of authority, responsibility and accountability levels. Good corporate governance requires policies, procedures and operating manuals to be supreme in any bank, whereby only professional considerations should play a role in strategic decision-making.

The board of director plays a key role in formulation of policies, supervisions and control. On the other hand managing director is liable to the successful operation of the bank. The success of any bank is largely determined by the efficiency of its management. Poor Loan policies and poor asset/ liability management lead any bank to failure. The problematic variable for researcher in the development of CAMELS models has largely been the choice of a representative measure for management quality. NRB also has evaded this component of CAMELS in the performance evaluation of commercial banks in Nepal.

Earnings: Earnings quality is an important aspect of evaluating an entity's financial health, yet investor, creditors and other financial statement users often overlooked it. Earnings quality refers to the ability of reported earnings to reflect the company's true earnings, as well as usefulness of reported earnings to predict future earnings. Earnings quality also refers to the stability, persistence, and lack of variability in reported earnings. The evaluation of earnings is often difficult because companies highlight a variety of earnings figures; revenues, operating earnings, net income and pro forma earnings. In addition, companies often calculate these figures differently. The income statement alone is not useful in predicting future earnings.

Bellovary, Giacomino and Akers (2005) have cited in their article that Teets ["Quality of Earnings: An Introduction to the Issues in Accounting Education, 17(4), 2002] states that "some consider quality of earnings to encompass the underlying economic performance of a firm, as well as the accounting standards that report on that underlying phenomenon; others consider quality of earnings to refer only to how well accounting earnings convey information about the underlying phenomenon. Pratt defines earnings quality as "the extent to which net income reported on the income statement differs from true earnings" [in F. Hodge, Investors perceptions of Earnings Quality, Auditor Independence and the usefulness of Audited Financial Information," Accounting Horizons 17 (Supplement), 2003] indicates that quality of earnings is based on the quality of forward earnings as well as current reported earnings. Schipper and Vincent ["Earnings Quality," Accounting Horizons 17 (Supplement), 2003] define earnings quality as "the extent to which reported earnings faithfully represents Hicks Ian Income," which includes "the change in net economic assets other than from transactions with owners."

An analysis of earnings helps the management, shareholders and depositors to evaluate the performance of banks, sustainability of earnings and to forecast growth of bank. The success of the bank heavily relies upon the efficiency of its management to drive the bank to earn good profits. Net profit is the major yardstick to measure such profits. A required level of profit is necessary for the firm's growth and survival in the competitive environment. Profitability is the measurement of worth of the selected investment in various categories of assets depending largely on sales performance and operative efficiency. Profitability is vitally more important for assuring that a bank stays in business or activity. Net profit of any bank decreases resulting from high non- performing loans, lack of avenues for earning fee

based income and operating inefficiencies. The different indicators of profitability are return on equity, return on assets, earnings spread ratio, gross margin, operating profit margin and net profit margin. The financial indicator used by Nepal Rastra Bank for profitability is return on total assets. Besides it employs measures like interest income, net interest income, non-interest income, net non-interest income, and net profit to assess the profitability of commercial banks.

Liquidity: Liquid assets are those that can be converted quickly into cash. While high liquidity means that the company will not default on its short-term obligations, note that by retaining assets as cash, valuable investment opportunities might be lost.

Liquidity is defined as bank capacity to pay cash in exchange of deposits. Liquidity needs of commercial banks are unique because in no other types of business there will be such a large proportions of deposits payable on demand. In other organization too, liquidity is required for various purposes. Inadequate liquidity does damage credit standing of those organizations but if banks fail to repay the deposits on demand, the bank loses the trust of public. This leads to runs in the bank and probably bankruptcy thereof.

Liquidity is the lifeline of the bank. Banks maintain liquidity in the form of:

- Cash and Bank balance (primary reserve)
- Placement/ money at call or short notice (secondary reserve)
- Investment in government securities and other securities readily convertible into cash (secondary reserve)

Any assets which can be converted into cash immediately with/ without nominal loss of value are called liquid assets.

Banks should have ready to assess to immediately spendable funds at reasonable cost at precisely time those funds are needed. Lack one of the liquidity is often first signs that the bank is in serious financial trouble (Rose 1999). Banks should have adequate liquidity to minimize both asset side liquidity risk and liability side liquidity risk of a commercial bank. Both liquidity deficit and much more liquidity surplus indicate the problem in the financial health of a commercial bank. Much more liquidity surplus hurts the profitability of commercial bank by reducing the return on assets. Similarly, liquid deficit also cost much to the commercial banks

in term of higher purchasing price of liquidity and hurt in the reputation of the banks. Therefore, commercial banks should strike the trade-off between the profitability and liquidity risk (Baral, 2005)

A bank is considered to be a liquid if it has ready access to immediately spendable funds at reasonable cost at precisely the time those funds are needed(Peter,1999). The bank liquidity is the ability of bank to meet its current obligations for cash outflow and to respond to changes in customer demand for loans and cash withdrawals without selling assets at a substantial loss. Bank assets are liquid to the extent that they may be easily converted into cash without loss (Johnson, 1993).

Certainly there should be adequate liquid assets in bank at any time. Liquidity is necessary to make payment of depositor's cheque or to fulfill its (bank's) commitment. If liquidity fall short bank has to manage liquidity paying higher cost. Likewise if the banks fail to pay amount of cheque in time it is generally regarded as its' failure in fulfill commitments, which creates a senses of disbelief among general public toward the bank. Since the banks deal with other money, most of which repayable in demand, they need to maintain adequate liquidity. Inability of banks to repay deposits on demand damages the credit worthiness of the bank. This, in turn, may cause 'runs' to the bank and likely collapse the bank thereto. As the regulator, supervisor and monitor of the whole banking sector, central bank instructs banks to maintain a fixed percentage of liquidity of relation to deposit.

In evaluating the adequacy of a financial institution's liquidity position consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity and risk profile. In general, funds management practices should ensure than an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of institution to manage unplanned changes in funding sources as well as react to changes in market conditions the affect the ability to quickly liquidate assets with minimal loss. In addition, fund management practices should ensure that liquidity is not maintained at a higher cost or through undue reliance on funding sources that may be available in times of financial stress or adverse changes in market conditions.

Liquidity is rated based upon but not limited to an assessment of the following evaluation factors:

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

Sensitivity to market Risk: Market risk is the current and potential risk to earning and stockholder equity resulting from adverse movement in market ratios or prices. The three areas of market risk are interest rate risk, foreign exchange risk and commodity on equity price risk for most FIs market risk primarily reflects exposing to changes in interest rate. The components focuses on an institution's ability to identify, monitor, manage and control its market risk and provides FIs management with clear and focused indication of supervisory concerns in this area.

Market risk is the current and potential risk to earnings and stockholder equity resulting from adverse movements and market rates or price. The sensitivity to market risk is assessed to determine the bank's ability to monitor and manage its exposure to market risk, it reflect the degree to which change in the interest rates, foreign exchange rates and equity prices can adversely affect a bank's earning and capital. For most FIs market risk primarily reflects exposing to changes in interest rates. The sensitivity to market risk components focuses on an institution's ability to identify, monitor, manage and control market risk and provides FIs management with a clear and focused indication of supervisory concerned in this area.

Equity price risk examines how changes in market prices, interest rated and foreign exchange rates affect the market values of any equities, fixed income and securities, foreign exchange currency holdings and associated derivative and other off-balance sheet contracts. Foreign exchange risk arises from change in foreign exchange rates that affect the values of assets liabilities and off-balance sheet activities denominated in currencies different from the banks domestic currency.

Interest rate risk analysis compares the sensitivity of interest income to change in assets yields with the sensitivity of interest expenses to changes in the interest lost of liabilities.

Dollar gap, duration Gap and simulation are three techniques of measuring interest rate risk (Gup & Kolari). The dollar Gap is oldest technique. The most commonly used measure of the interest sensitivity position of a financial institution is duration gap analysis. Duration is defined as elasticity measure that indicates the relative price sensitivity of different securities (Koch & Macdonald). The duration gap is the difference between the duration of a bank assets and liabilities. It helps to explain how change in interest rates affects the market value of a bank assets and liabilities. Thus, the focus of gap analysis is on net interest income or net worth the number of years of the duration of assets and liabilities. Net worth = assets and liabilities.

If duration gap is positive i.e. the duration of assets exceeds the duration of liabilities then increase in interest rates will reduce the value of net worth and decrease in interest rates will increase the value of net worth. Conversely the duration gap is negative with the duration of assets less than duration of liabilities raising interest rate will increase the value of net worth whereas falling interest rate will lead to a reduction in it. An aggressive interest rate risk management strategy would alter the duration gap in anticipation of changes in interest rates. If interest rates were expected to increase management would want to shift from positive to a negative gap position. It could do this by reducing the duration of assets or increasing the duration of liabilities. Simulation analysis determines the effect of interest rate changes on short-term net interest income. It also measure risk presented by non- parallel yield curve shift. Simulation models are often not “user friendly” and may require more data and expertise than other interest rate risk measurement system.

According to NRB directives every commercial bank should classified the risk and provision for minimizes the risk. There are liquidity, interest rate, foreign exchange, loan and investment risk to monitoring on related of banking and financial institutional risk.

2.2 Review of Related Studies

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

Bohara (1992) has done a study on a comparative study of financial performance of the JVBs in Nepal. The objectives of this study were to analyze policies and basic functions of JVBs and to evaluate the comparative financial performance of joint venture banks in Nepal. The researcher has found that current ratios-loans and advances to current assets ratio and fixed deposit to total deposits ratio of NIBL was higher than NABIL; activity ratio of NIBL was also higher than NABIL. In profitability ratio, interest earning to total assets ratio and return on net worth ratio of NIBL was better than that of NABIL, but net profit to total assets ratio and net profit to total deposit ratio of NABIL was better than NIBL. Thus NABIL has been adopting aggressive lending policy, investment and borrowing policy to earn more than NABIL. The study concluded that “Bank performance cannot be judged solely in terms of profit, bank earn profit by maintaining adequate liquidity and safety position but it should also be evaluated on the ground of the contribution it has made to assist on community, government and national economy or the social and national priority task i.e. more deposit mobilization and resource mobilization. Those tasks are possible when they expand branches, create more employment and provide services to more customers developing skills and expertise in local staff, satisfaction in profit earning and exchange of autonomy provided by them. The accountability can be discharged by following their rules, regulation, instructions, direction and priorities.

Shakya (1995) performs a study on financial analysis of joint ventures banks in Nepal. The objective of this study was to carry out the comparative financial performance evaluation of NABIL and NGBL. This study has covered the time span

of fiscal year 1988/89 through 1993/94. in this study he has used financial ratios viz. liquidity, leverage activity, profitability, growth and valuation and statistical tools viz. Karl Pearson's correlation coefficient, student t-test, simple average and index. The researcher has found that in spite of the increase in loans and deposits of both banks, their performance measured in terms of deposit utilization rate is not satisfactory. Further, the study showed that financial performance of NABIL is better than that of NGBL.

Kaini (1996), in his study – a comparative study of financial performance of Nepal Arab Bank Ltd and Nepal Grindlays Bank Ltd states that although the current assets of these two banks were adequate to discharge current liabilities, the current ratio of both banks were below the standard which is 2:1, however NABIL seemed to have better average current ratio compared to NGBL. Similarly, he has added that, activity ratios of NABIL were always higher than that of NGBL, which has implied that NABIL was utilizing its assets more efficiently on income generating purpose than NGBL. Likewise, the profitability position of NABIL was much higher than that of NGBL. The researcher concluded that NABIL was relatively efficient in utilizing its overall resources in term of return on capital employed. However the researcher concluded that both the banks were able to maintain satisfactory level of profit. The researcher recommended that both bank should consider strengthening their respective liquidity position. The researcher has further suggested that there were more probabilities of utilizing the outsiders' funds for the income generating purpose. The researcher recommended NGBL needed to take a proper policy in utilizing the outsiders' funds in extending credit to further profit generation.

Mahato (1998) has performed a study on comparative study of financial performance of Nepal Arab Bank Ltd. And Nepal Indosuez Bank Ltd found that overall liquidity ratio of NIBL was much higher than that of NABIL. Further he has remarked that NIBL was investing its funds more in the form of loan and advances than the NABIL. However, the profitability position of NABIL was much more satisfactory than NIBL. The researcher has recommended that both the bank should increase the proportion of equity capital in their capital structure. The researcher further suggested that the banks should adopt a proposed policy regarding the expansion of branches in rural areas whenever it seems favorable. The researcher has also recommended that the banks should improve in the skill and expansion of the employees and keep high the clients satisfaction.

Dhakal (2001) on a financial performance of Nepal SBI Bank Ltd and Nepal Indosuez Bank Ltd concluded that liquidity position of Nepal Indosuez Bank Ltd is comparatively better than Nepal SBI Bank Ltd. It has adopted aggressive lending investment and borrowing policy which has generated more profit than NSBL. The researcher has recommended acting according to the government plans and policies on mobilizing their deposits in the productive sectors. The researcher has suggested stabilizing the cash and bank balance to total deposit ratio of both the banks after proper diagnosis of the root to the cause. The researcher based his study on overall financial performance of the banks. It was not particular on investment policy of the banks through the study has covered the deposit mobilization of these banks. For the purpose of the research study the researcher had set the objective i.e. to study on the limited five year position of the two Joint Venture Banks. The researcher had used qualitative rather than quantitative analysis. Throughout the study the research was focused on investment practices and its impact on practice among the bankers. But the researcher was not clear on investment policy. The researcher is only looked on the ground study was much silent on the customer's point. It was truly accepted that by investing on the priority sector taking on consideration of the remote sector business although it was less profitable but was sustainable for the overall country's development.

Bista (2004) has done a study on financial performance of Nepal Bangladesh Bank and Nepal SBI Bank as a comparative study. The objective of the study was to examine the financial performance of NBBL and NSBI Bank. The study covers the time period of five years from FY 1997 to FY 2001. He has used financial tools like liquidity, capital structure, activity, profitability etc and statistical tools like arithmetic mean, coefficient of variation, correlation analysis and probable error. The study concluded that the liquidity position of NSBI was better than NBBL. The capital structure ratio showed that the capital structures of both the banks were highly leveraged. Similarly the activity ratio has showed that both the banks had efficiently utilized their assets to income generation. Finally the researcher concluded that NBBL was better positive on activity, profitability and other ratios and NSBI had better position on liquidity and capital structure ratio.

Bhandari (2005) has conducted a study on the financial performance of Himalayan Bank Ltd. (HBL) in the framework of CAMEL. The objective of the study was to comprehend the financial performance of HBL through CAMEL

framework. The study has covered the time span of FYs 1 998/99 through 2003/04. He used financial tools like capital adequacy ratio, core capital adequacy ratio, supplementary capital adequacy ratio, non-performing loan ratio, loan loss ratio, total expenses to total incomes ratio, earning per employee, return on equity, net interest margin, earning per share, NRB balance to total deposits ratio etc. The statistical tools used are average, standard deviation, coefficient of variation and least square trend analysis. The researcher concluded that the bank is running with the adequate capital, non-performing loans to loan ratio is in declining trend where as loan loss provision is in increasing trend. The indicators of management and the earning quality showed the decreasing trend where as the overall liquidity position of bank is good.

Baral (2005) has conducted a research and published his paper in the journal of Nepalese Business Studies (Volume II No. 1, December 2005) on health check-up of commercial banks in the framework of CAMEL, a case study of joint venture banks in Nepal. The paper examined the financial health of joint venture banks in the camel framework for a period ranging from FY 2001 to FY 2004. Three joint venture commercial banks of Nepal were randomly selected for the study. The study was based on historical data disclosed by annual report of commercial banks. It has covered four fiscal year data for the purpose of study. The study was based entirely in the CAMEL framework.

Through the analysis of data, the researcher has diagnosed the health of sample joint venture banks as:

Banks under study were well capitalized and they were complying with the directives of NRB on capital. But, their capital base relative to the risk-weighted assets is not so strong. It uncovered further, non-performing assets of joint venture banks on the average is at satisfactory level, but they are far below the aggregate percentage of non-performing assets of commercial banks. The researcher has also found that management of NSBI is least efficient among sampled banks and SCBNL has most efficient management. The profitability of joint venture bank is not so weak during the study period. Profitability of Nabil and SCB was better than the NSBI. Furthermore, the liquidity of joint venture banks was higher the industry average ratio. Thus, with a viewpoint of liquidity position, the health of joint venture banks is looked like a bit unhealthy.

Chand (2006) has conducted a study on financial performance analysis of Nabil Bank Ltd. In the framework of CAMELS with the objective to analyze the financial condition of Nabil Bank Ltd. It has covered five-year data starting from fiscal year 2000/2001 to 2004/2005. the analysis revealed that the bank is running with adequate capital and capital fund of bank is sound and sufficient to meet the banking operation as per NRB standard. The bank has placed efficient credit management and recovery efforts of good quality loans are increasing. Further, it seems that amount default associated in loans will decrease in future. The management decision related to operation and investments have assisted in controlling control and recovery of bad debt. The management has been able to control the interest spread and cost effective sources of funds. This has helped the bank in increasing the market strength. The liquid asset to total deposit ratio is above the industrial average ratio. The bank has able to match the risk sensitive assets to risk sensitive liabilities in long term maturity bucket and therefore interest rate changes has no affect on them.

Sharma (2007) has conducted a study on financial performance analysis of NSBI in framework of camel. The study was based on secondary data covering the period of six years from 2001 to 2006 A.D. The researcher concluded that NSBI was well capitalized and complies with NRB directives. The bank has maintain satisfactory level of past due loan on total loan except in 2001. The quality of loan is strong from the perspectives of total substandard loan to total loan ratio. It is found in the analysis of data the bank has not made adequate provision for substandard loan prescribed by NRB. The ratio of total expenses to total income is fluctuated which indicate decreasing trend in ratio has decreasing expenses with respect to income, though it shows slight increase in 2006. Earning per employees ratio of the bank was found quite high which reflects efficiency of staffs as well as good management quality.Net interest margin of the bank was found satisfactory. The bank has maintained reasonable liquid position of its fund which shows liquidity position of bank is sound. The NRB balance to total deposit ratio of the bank revealed that the bank has maintained an optimum level of NRB balance.

Gurung (2009) has conducted a study on financial performance analysis of Domestic Private Commercial Banks in Nepal in the framework of CAMEL. Here three banks MBL, BOK and NIC are taken for study purpose from the year 2001/02 to 2006/07. Different indicators of each component of CAMEL are calculated in the

form of financial ratio. The major finding of the study are capital adequacy of banks are fair and banks are complying with the directive of NRB on the requirement of core capital and meet supplementary capital adequacy ratio. The non-performing loan is also at satisfactory level. The BOK is most efficient in case of earning per employee (EPE) and maintaining of operating expenses whereas MBL is least efficient. The return on equity (ROE) figure and its increasing trends put BOK in first position as compared to MBL and NIC. The earnings per share (EPS) ratio is in fluctuating trend as compared to MBL and NIC. BOK showed better result in case of EPS ratio. Researcher has concluded BOK is better than other two-sampled bank.

Thapa (2009) has conducted a study on financial performance of NBBL in framework of CAMEL. The main objective was to analyze financial soundness of NBBL. The study was based on secondary data covered a period of 2001 to 2006. The major findings are the leverage ratios are on decreasing trend and core capitals are also very low. Capital of NBBL is negative due to tremendous accumulated loss and it has not met the capital adequacy requirements required by NRB. The bank is not using the adequate amount of core capital in the last three years of study period. The nonperforming loans to total loans and advance ratios were observed unsatisfactory during the study period. The increasing trend of loan loss reserve indicates that the quality of assets is deteriorating year by year and increasing trend of operating expenses ratio indicates the decreasing operating revenue and increasing operating expenses of NBBL. The earning per employee was showing decreasing negative trend. The decreasing trend and negative ratio of return on equity and return on asset show bank has incur big loss in year 2005 and 2006. It shows that the bank capital base is very weak and management quality of bank is poor. The bank is not serious and not following the NRB standard. The researcher has recommended maintaining stable capital adequacy ratio and strictly following the NRB directives. The bank should provide loan after proper credit assessment to the appropriate party only. In conclusion during her study period NBB is on weaker position than other ‘A’ class commercial bank.

However, research on comparative analysis of financial performance of NSBI and MBL has not been carried out yet. So, this is the first attempt on this title in the framework of CAMELS.

CHAPTER III

RESEARCH METHODOLOGY

This chapter provides the overall framework or plan for collection, analysis and presentation of data required to fulfill the objectives of study. Different tools and techniques used for analysis and presentation as to answer the research question and explained under this section. It includes the type of information to be collected and sources of the information for the study purpose. “Research methodology refers to the various sequential steps (along with the rational on each such steps) to be adopted by a researcher in studying a problem with certain object in view.” (Kothari, 1989). To meet the objectives, the methodologies applied in the study are described below.

3.1 Research Design

Research design is the task of defining the research problem. A research design is the arrangement of the conditions, for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Kothari, 1989). In fact the research design is the conceptual structure within which the research is conducted. This research study aims at portraying accurately on the comparative analysis of financial performance of NSBI and MBL. The relevant data are collected, analyzed and correlated to evaluate the comparative performance of the sampled banks. So the study is based on descriptive research design. Different financial tools are used to interpret the collected data and information in relation to the sampled bank’s performance and recommendations for improvement are made to the organizations being studies. Hence, the analytical research design has also been adopted by the study.

3.2 Population and Sample

Currently 31 ‘A’ class commercial banks are operation in Nepal which are population of the study. Out of 28 banks, 3 are public, 6 are joint venture and the remaining are fully domestic private banks. From the population only two banks were drawn as sample of study. For sampling purpose, judgmental sample method

has been used where comparison is done one from Joint Venture (NSBI) and another from Domestic Private Commercial Bank (MBL) and banks are selected randomly.

3.3 Sources and Nature of Data

This study is mainly based on secondary data. The data used in the study are taken from the annual reports of the bank and publication of Nepal Rastra Bank. The directives by the NRB are also included in this study.

3.4 Data collection Procedure

As the study is based mainly on the secondary data required facts have been obtained from the annual reports collected from the corporate office of the banks. Data have also been obtained browsing the official web sites of the concerned bank and Nepal Rastra Bank. Literature review is collected from western regional library and some supplementary data and information have been collected from NRB publication and newspaper.

3.5 Data Processing Procedures

Firstly data were extracted from the annual reports of the bank and put them in a sheet. Then data were entered into the spreadsheet to work out the financial ratios and prepare necessary figures, according to the need and requirement of this study. For this purpose, gathered data have been processed using computer programs like Microsoft Excel and Word.

3.6 Method of Data Analysis

In this research work, descriptive and analytical tools are used to get the meaningful result of the collected data and to meet the research objectives. For this purpose of study, the collected data is tabulated on the various heads. Then the tabulated data are analyzed using various financial tools which are briefly discussed below:

3.6.1 Financial Tools

There are various CAMELS financial tools which are used to analyze the financial performance. The ratios used in this study are as follows:

1. Capital Adequacy

a. Ratio of Core Capital to Total Assets: This is the ratio which is used to calculate the financial leverage of a company to get an idea of the company's method of financing or to measure its ability to meet financial obligations. It shows the relationship between core capital and total assets. It measures the adequacy of the core capital. It is calculated by using the following model:

$$\textit{Core Capital to total Assets ratio} = \frac{\text{Core Capital}}{\text{Total Assets}} \times 100$$

b. Risk Based Capital Adequacy Ratio: Risk based capital ratio can be defined as the numerical expression of total capital fund to total risk adjusted assets. It measures the adequacy of capital in the banks which is determined in the following way:

$$\textit{Risk Based Capital Ratio} = \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}} \times 100$$

Where,

Total Capital Fund = (core capital + supplementary capital)

After the implementation of Basel II from 2065/2066 core capital is known as Tier I and supplementary capital is known as Tier II.

Total Risk Weighted Assets = (on-balance sheet risk adjusted assets + off- balance sheet risk adjusted assets)

After implementation of Basel II Total risk adjusted assets = Credit Risk + Operational Risk+ Market Risk

c. Risk Based Core Capital Adequacy Ratio: Core capital adequacy ratio is the expression of numerical relationship between the core capital and total risk adjusted assets. It measures the adequacy of core capital. The ratio is expressed as:

$$CCAR = \frac{\text{Core Capital } f\text{Tier I}\text{A}}{\text{Total Risk Weighted Assets}} \times 100$$

Where,

CCAR = Core Capital Adequacy Ratio

Core Capital (Tier I) = Paid up equity share capital+ Proposed bonus equity share+ Statutory General reserve + Retained Earnings + Unaudited current year Cumulative profit +capital adjustment + reserve + deferred tax reserve + Current year's P/L account +other free reserve – (Fictitious assets +Investment arising out of underwriting commitments)

d. Risk Based Supplementary Capital Ratio: supplementary capital ratio is the expression of numeric relationship between supplementary capital and total risk adjusted assets of a bank. It measures the proportion of supplementary capital in total risk adjusted assets. The ratio is used to analyze the supplementary capital adequacy of the banks and determined in the given way:

$$SCR = \frac{\text{Supplementary Capital (Tier II)}}{\text{Total Risk Weighted Assests}} \times 100$$

where,

SCR = Supplementary Capital Ratio

Supplementary Capital (Tier II) = Subordinated Term Debt + General Loan Loss Provision + Exchange Equalization Reserve + Investment Adjustment Fund

2. Assets Quality

The following ratios are used to assess the quality of assets of the bank:

a. Non Performing Loan Ratio: It shows the relationship between non-performing loan and advances. It measures the proportion of non-performing loan and advances in total loan and advances. Higher ratio implies higher portion of non-performing loan. The ratio is used to assess the asset quality of the bank. This relationship can be measured by using the following relation:

$$\textit{Non performing Loan Ratio} = \frac{\text{Non Performing Loan}}{\text{Total Loan and advance}} \times 100$$

b. Loans classified as Substandard, Doubtful and Loss to Total Loans: The ratio of substandard, doubtful and loss loans to total loans indicates the relationship between the substandard loans to total loans, doubtful loans to total loans and loss loans to total loans. It shows the percentage of substandard, doubtful and loss loans to total loans. The lesser the percentage the better would be the quality of assets. It is worked out using the following relation:

Loans classified as Substandard, Doubtful or Loss/Total Loans

$$= \frac{\text{Total Substandard, Doubtful or Loss Loan}}{\text{Total Loans}} \times 100$$

c. Provision for Substandard Loans to total Substandard Loans: Provision for substandard loans to total substandard loans ratio is the expression of numerical relationship between loan loss provisions for substandard loans to total substandard loans. It measures the proportion of substandard loans to total substandard loans. The percentage of provision for substandard loans to total substandard loan is 25% according to NRB directives. This ratio can be calculated by using following formula:

Provision for Substandard Loans to Total Substandard Loan

$$= \frac{\text{Provision for Substandard Loan}}{\text{Total Substandard Loan}} \times 100$$

d. Provision for Doubtful Loans to Total Doubtful Loans: Provision for doubtful loans to total doubtful loans is the expression of numerical relationship between loan loss provisions for doubtful loans to total doubtful loans. The proportion of provision for doubtful loans to total doubtful loans, according to NRB, should be at least 50%. This ratio can be calculated using following relation:

Provision for Doubtful Loans to Total Doubtful Loans

$$= \frac{\text{Provision for Doubtful Loans}}{\text{Total Doubtful Loans}} \times 100$$

e. Provision for Loss Loans to Total Loss Loans: Provision for loss loan to total loss loans is the expression of numerical relationship between loan loss

provisions for loss loans to total loss loans. The proportion of provision for loss loans to total loss loans, according to NRB, should be at least 100%. This ratio can be calculated by using following model:

$$\textit{Provisioning for Loss Loans to total Loss Loans} = \frac{\text{Provision for Loss Loans}}{\text{Total Loss Loans}} \times 100$$

3. Management Efficiency

The following ratios can be used to determine the efficiency of bank's management:

a. Operating Expenses Ratio: It is the ratio of total operating expenses to total operating incomes. A high or increasing ratio of expenses to revenue can indicate that financial institution may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. It can be calculated using following model:

$$\textit{Operating Expense Ratio (OER)} = \frac{\text{Operating Expenses}}{\text{Operating Incomes}} \times 100$$

Where,

Operating Expenses = It includes interest expenses, office operating expenses, currency exchange loss, employees expenses, bad loan advance written off and loan loss provision.

Operating Incomes = It includes interest income and non-interest income.

b. Earning Per Employees: It is ratio of net earnings after tax to total number of employees. Low or decreasing earning per employee can reflect inefficiencies as a result of overstaffing in terms of profitability (IMF 2000). It is calculated using following model:

$$\textit{Earning Per Employee (EPE)} = \frac{\text{Net Profit After Taxes}}{\text{Total no. of Employees}}$$

4. Earning Performance

The following Ratios can be used to assess the quality of bank's earnings:

a. **Return on Equity:** Return on equity is the relationship between net income and shareholder equity. It measures the rate of return on the shareholder's equity of common stock owners. It measures a firm's efficiency at generating profits for every rupee of net assets and shows how well a company uses investment rupees to generate earning growth. ROE is equal to a fiscal year net income (after preferred stock dividends but before common stock dividends) divided by total equity (excluding preferred shares).

$$\textit{Return on Equity (ROE)} = \frac{\text{Net Profit after Tax}}{\text{Shareholder's Equity}} \times 100$$

b. **Return on Assets:** Return on assets is calculated by dividing net income by total assets. It shows how profitable a company's assets are in generating revenue. Return on assets gives an idea as to how efficient management is at using its assets to generate earnings. It is calculated by dividing a company's annual earnings by its total assets. If a company has a ROA of 20%, it means that the company earned Rs. 0.2 for each Rs. 1 in assets.

$$\textit{Return on Assets (ROA)} = \frac{\text{Net Profit after Tax}}{\text{Total Assets}} \times 100$$

c. **Profit Margin:** A ratio of profitability calculated as net income divided by total operating revenues. A higher profit margin indicates a more profitable bank that has better control over its costs. It shows the proportion of net income in total operating revenues. A 20% profit margin, for example, means the bank has a net income of Rs. 0.2 for each rupee of revenue.

$$\textit{Profit Margin (PM)} = \frac{\text{Net Profit after Tax}}{\text{Operating Income}} \times 100$$

d. **Earning per Share:** The portion of a company's profit allocated to each outstanding share of common stock is earning per share. Earnings per share serve as indicator of a company's profitability. It provides a direct measure of the return flowing to the bank's stockholders. Earning per share is generally considered to be the single most important variable in determining a share's price.

$$\textit{Earnings per Share (EPS)} = \frac{\text{Net Profit after Tax}}{\text{No. of Shares}}$$

5. Liquidity Position

The following ratio can be used to assess the liquidity of the bank:

a. Loan to Deposit Ratio: Loan to deposit ratio is the proportion of total loans and advances (before deduction of loan loss reserve) to total deposit. It can be calculated using following model:

$$\textit{Loan to total deposit Ratio} = \frac{\text{Total Loan and Advances}}{\text{Total Deposit}} \times 100$$

b. NRB Balance to Total Deposit Ratio: NRB balance to total deposit ratio is the expression of numerical relationship between NRB balance and total deposits of a bank. It measures the adequacy of NRB balance held by the bank. It can be calculated using following model:

$$\textit{NRB balance to Total Deposit Ratio} = \frac{\text{Total NRB Balance}}{\text{Total Deposit}} \times 100$$

c. Liquid Assets Ratio: It shows the relationship between total liquid funds to total deposit. It shows the overall short-term liquidity position. The higher ratio implies the better liquidity position.

$$\textit{Liquid Asset} = \frac{\text{Liquid Asset}}{\text{Total Deposit}} \times 100$$

Total Liquid Assets = Cash in hand + NRB Balance + Domestic Bank Balance + Foreign Currency Bank Balance + Placement + Investment in Government Securities

d. Cash in Vault to Total Deposit Ratio: Cash in vault to total deposit is derived by dividing total cash in vault by total deposit of the bank. It shows

the percentage of total deposit maintained in vault of the bank. It is calculated by using the following model:

$$\textit{Cash in Vault to Total Deposit Ratio} = \frac{\text{Total Cash in Vault}}{\text{Total Deposit}} \times 100$$

where,

Cash in Vault = Cash in hand + Foreign Currency in hand

6. Interest rate sensitivity

The interest rate sensitivity position of financial institution is estimated by gap analysis. A gap exists between these interest sensitive assets and interest sensitive liabilities (Ross 1999). If a interest sensitive assets in a each planning period i.e. day, week, month etc exceed the volume of interest sensitive liabilities subject to reprising the bank is said to have positive gap and to be assets sensitive. If Δ Ri is the average interest change affecting assets and liabilities that can be repriced within ith maturity bucket, the effect on the bank's Net Interest Income (NII) in the ith maturity bucket is calculated by ;

$$\Delta NIIi = \sum_{i=1\text{day}}^{i=1\text{th Maturity Bucket}} RSAi - \sum_{i=1\text{day}}^{i=1\text{th Maturity Bucket}} RSLi \times \Delta Ri$$

$$= GAPi \times \Delta Ri$$

where,

RSA = Rate sensitive assets

RSL = Rate sensitive liabilities

ΔNIIi = change in interest income in the ith maturity bucket

GAPi = Rupee size of gap between book value of rate sensitive assets and rate liabilities in maturity bucket i.

ΔRi = change in level of interest rate influencing assets and liabilities in the ith maturity bucket.

3.7 Limitations of Methodology

To fulfill MBS level requirement this research has been prepared which includes MBL and NSBI financial status and its analysis and being concerned upon merely six components of CAMELS, which in general environment in Nepalese context can be adapted and similar tools are used. However, as samples within a definite time span, some limited data having included in analysis which does not represented absolute financial status. Moreover, within it only the quantitative tools are analysis is used which does not represent qualitative assessment. But it surely gives particular direction to an industry. Most data available from banks seem to be dissimilar which pose ambiguity in recognized real statement of data. However provisioned and audited data provided by banks are used as useful sources.

All necessary elements, values, norms, methodologies and systems cannot adopt in research process as on obsolete one. Though it includes those elements and follows the system which is similar and familiar with subjective and time. It is quite difficult to come across some limitation while giving absoluteness to any research regarding research methodology, which is in no sense in different from matter concept.

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

This chapter deals with presentation and analysis of data collected from annual reports of the bank. The raw data collected has been organized and processed using various tools discussed in the previous chapter-"Research Methodology". For meaningful conclusion five year's data (2063-2067) have been analyzed. Appropriate financial tool of CAMELS are applied to check the validity of trends. The analysis of different indicators used by study is presented in ensuing section.

4.1 Capital Adequacy

Capital adequacy determines how well banks can manage with shocks to their balance sheet. Banks and other financial institutions should have adequate capitals to support its risks assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities. Adequacy and inadequacy of bank capital directly affects the banking transaction. The adequacy of bank capital is the most important aspect of a bank. If there is inadequacy of capital, the bank should take step for the adequacy of capital as per legal requirement because its financial health cannot be regarded capable and healthy without having adequate capital.

4.1.1 Ratio of Core Capital to Total Assets

Core capital to total assets ratio shows how much amount of shareholders funds is used to finance a bank's assets. It measures the ratio of a bank's book value of primary capital to the book value of its assets. It calculates the relationship between primary capital and total assets of the bank. It shows the percentage of core capital in the total assets. Normally ratio of 5 percent or more than 5 percent shows that commercial banks are well capitalized.

Table 4.1: Ratio of Core Capital to Total Assets Ratio

Fiscal Year	Banks	Core Capital (in million Rs)	Total Assets (in million Rs)	Ratio (%)
2063	NSBI	964.42	13035.84	7.40

	MBL	911.54	9069.38	10.05
2064	NSBI	1145.48	13901.20	8.24
	MBL	982.57	10810.33	9.08
2065	NSBI	1394.06	17187.45	8.11
	MBL	1142.97	12498.54	9.14
2066	NSBI	1692.37	30916.68	5.47
	MBL	1676.86	17490.78	9.58
2067	NSBI	2430.02	38047.68	6.38
	MBL	1750.35	20678.80	8.46

Source: Annual Reports of NSBI and MBL.

As shown in the table 4.1 both the banks have ratio above as 5 percent which show banks are well capitalized and there is enough shareholders fund to manage the shock in balance sheet which shows creditors and depositors funds are in risk less condition.

4.1.2 Capital Adequacy Ratio Analysis

Capital Adequacy ratio is the measure of bank's capital. This ratio is used to protect depositors and promote the stability and efficiency of financial systems. Capital adequacy ratio above the central bank standard indicates the sufficiency of capital and ratio below the standard indicates lack of adequate capital in bank. Higher capital ratio above the standard indicates higher security to depositors, strong financial position and higher internal sources. On the opposite, the lower capital adequacy ratio below the standard indicates lower security to depositors, comparatively weak financial position and lower internal sources.

The central bank of Nepal, Nepal Rastra Bank has fixed the minimum requirement of capital adequacy ratio i.e. total capital fund (core capital plus supplementary capital) to total risk adjusted assets as 11% from the year 2063 to 2065 and 10% in the year 2066 and 2067. The commercial banks of Nepal have to follow the directives issued by NRB and have to maintain capital adequacy ratio as per directives.

Table 4.2 presents the observed values of capital adequacy ratio of NSBI and MBL of the last five years from 2063- 2067

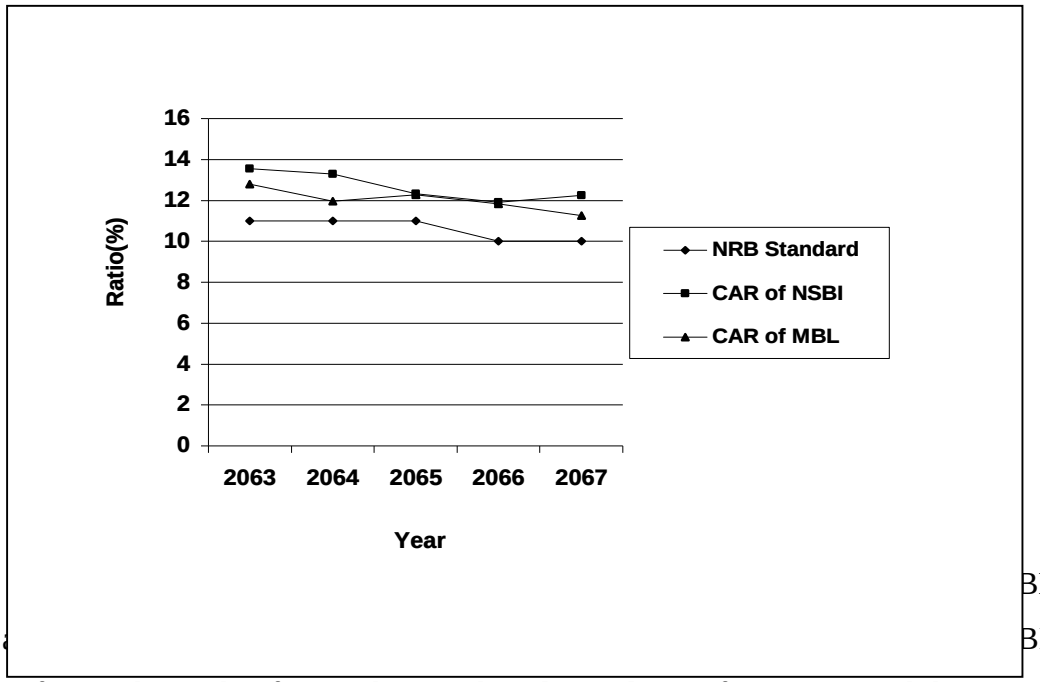
Table 4.2: Capital Adequacy Ratio

Fiscal Year	Banks	Total Capital Fund (in million Rs)	Total Risk Weighted Assets (in million Rs)	Capital Adequacy Ratio (%)	NRB Standard (%)	Variance (%)
2063	NSBI	1242.57	9159.30	13.56	11	2.56
	MBL	976.07	7592.53	12.85	11	1.85
2064	NSBI	1444.80	10873.28	13.28	11	2.28
	MBL	1101.73	9200.66	11.97	11	0.97
2065	NSBI	1722.18	13975.91	12.32	11	1.32
	MBL	1279.80	10417.06	12.28	11	1.28
2066	NSBI	2012.04	16872.72	11.92	10	1.92
	MBL	1811.87	15298.22	11.84	10	1.84
2067	NSBI	2734.46	22320.36	12.25	10	2.25
	MBL	1979.55	17600.71	11.25	10	1.25

Source: Annual report of NSBI and MBL.

As shown in the table both the banks under study have met the risk based capital adequacy ratio standard as directed by NRB. Both capital fund and Risk weighted assets are on increasing trend. The risk based capital ratio of NSBI is maximum with 13.56% in the year 2063 and minimum at 11.92% in the year 2066. Similarly, for MBL the ratio of 12.8% is maximum in the year 2063 and 11.25% is minimum in the year 2067.

Fig 4.1: Comparison of Risk Based Capital Adequacy Ratio with NRB Standard



BL is a BL therefore it shows that financial strength and soundness of NSBI is good than MBL but it seems both bank has maintained an adequate risk based capital adequacy ratio

in each year of study period and follow NRB directives and its capital adequacy requirements.

4.1.3 Core Capital Adequacy Ratio

Core Capital is the primary capital of commercial bank. Core capital is the minimum amount of capital that the financial institution must have on hand in order to be in compliance with the regulations put in place by Central Bank. The establishment of core capital as a basic requirement for functioning helps to keep the financial community stable as well. This help to maintain consumer confidence, keep financial institution viable and overall minimize shifts in the general economy. Core Capital includes paid up equity capital, irredeemable non- cumulative preference shares, shares premium, general reserve, accumulated profit, capital redemption reserve, capital adjustment reserve, dividend equalization reserves and other free reserves. Amount of fictitious assets, goodwill, investment in financial instruments issued by the organized organization in excess to the limit specified by NRB are deducted from the sum of all elements of the primary capital to come at the core capital.

Core Capital adequacy ratio is defined as core capital to total risk weighted assets ratio. It measures the adequacy of shareholders fund. If the ratio is high above NRB standard it shows the strong financial position of the bank and higher security to creditors and depositors fund if the ratio is below the NRB standard it shows weak financial position of bank and higher risk to the creditors and depositors funds. Nepal Rastra Bank has directed through its directives to all commercial bank to maintain minimum core capital ratio for the safety and soundness of the commercial banks. According to the NRB directives the commercial banks are directed to maintain 5.5% in the year 2063 to 2065 and 6% in the year 2066 and 2067.

Table 4.3: Core Capital Adequacy Ratio

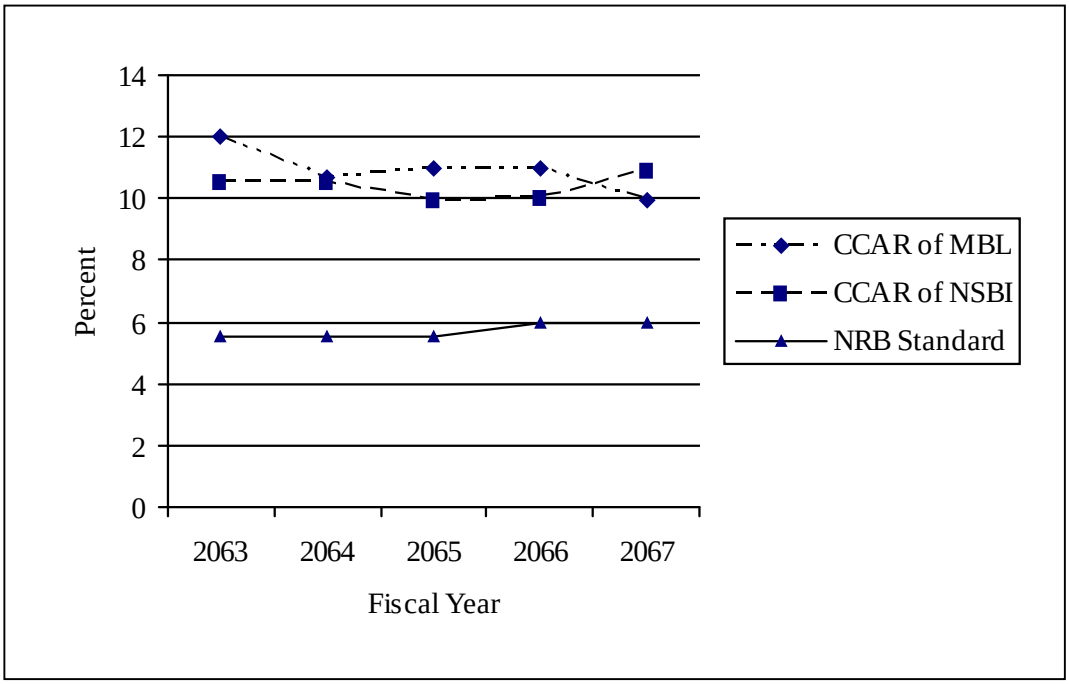
Fiscal Year	Banks	Core Capital (in million Rs)	Risk Weighted Assets (in million Rs)	Core Capital Adequacy Ratio (%)	NRB Standard (%)	Variance (%)
2063	NSBI	964.42	9159.27	10.53	5.5	5.03

	MBL	911.54	7592.530	12.00	5.5	6.50
2064	NSBI	1145.48	10873.28	10.53	5.5	5.03
	MBL	982.57	9200.66	10.68	5.5	5.18
2065	NSBI	1394.06	13975.71	9.97	5.5	4.47
	MBL	1142.97	10417.06	10.97	5.5	5.47
2066	NSBI	1692.37	16872.72	10.03	6	4.03
	MBL	1676.86	15298.22	10.96	6	4.96
2067	NSBI	2430.02	22320.36	10.88	6	4.88
	MBL	1750.35	17600.00	9.94	6	3.94

Source: Annual Report of NSBI and MBL

The Core Capital of NSBI has increased from 964.42 million to 2430.021 million and core capital of MBL increased from 911.543 million to 1750.353 million in the study period. Thus, the ratio of risk based core capital is in increasing trend meeting the NRB standard throughout the study period. The core capital adequacy ratio of NSBI is maximum with 10.88% in the year 2067 and minimum with 9.97% in the year 2065. Similarly, for MBL the ratio of 12% was maximum in year 2063 and ratio of 9.94% is minimum in the year 2067.

Fig.4.2: Comparison of Core Capital Adequacy Ratio with NRB Standard



As per figure 4.2 there is a big difference between core capital adequacy ratio of NSBI and MBL with NRB standard. The highest gap is of MBL in year 2063 which is excess by 6.5% and lowest gap is also of MBL in the year 2067 which

is excess by 3.94%. Thus, the risk adjusted core capital adequacy ratio of both banks is adequate as prescribed by NRB.

4.1.4 Supplementary Capital Adequacy Ratio

Supplementary Capital is the secondary capital of the commercial bank. Supplementary capital includes general loan loss provision, assets revaluation reserve, subordinated term loan, exchange equalization reserve, hybrid capital instruments, excess loan loss provision and investment adjustment reserve. Supplementary Capital Ratio is a tool used to analyze the supplementary capital adequacy of bank. The ratio shows the percentage of supplementary capital in total risk weighted assets. It also shows the contribution of supplementary capital to the total capital adequacy ratio. Nepal Rastra Bank has directed to the commercial banks to include the supplementary capital in the total capital structure while measuring the capital adequacy ratio. NRB has fixed the maximum limit of supplementary capital ratio as not more than core capital ratio of bank in each year.

Table 4.4: Supplementary Capital Adequacy Ratio

Fiscal Year	Bank	Supplementary Capital (in million Rs)	Total Risk Weighted Assets (in million Rs)	Supplementary Capital Adequacy Ratio (%)	NRB Standard (not more than core capital %)	Variance (%)
2063	NSBI	278.15	9159.27	3.04	10.53	-7.49
	MBL	64.62	7592.53	0.85	12	-11.15
2064	NSBI	299.32	10873.25	2.76	10.53	-7.77
	MBL	119.15	9200.66	1.3	10.68	-9.38
2065	NSBI	328.12	13975.71	2.35	9.97	-7.62
	MBL	136.83	10417.06	1.31	10.97	-9.66
2066	NSBI	319.66	16872.72	1.89	10	-8.11
	MBL	135.04	15298.22	0.88	10.96	-10.08
2067	NSBI	304.43	22320.36	1.36	10.88	-9.52
	MBL	229.20	17600.70	1.30	9.94	-8.64

Source: Annual Report of NSBI and MBL.

As shown in the table the risk based supplementary capital ratio of NSBI is distributed minimum of 1.36% in 2067 to maximum of 3.04% in 2063 during the study period. Similarly, for MBL the ratio 0.85% is minimum in year 2063 and 0.88% in year 2066 and other ratio are similar in the study period. As shown in the tables both bank have met the supplementary capital adequacy ratio standard as directed by NRB.

4.2 Assets Quality

. Assets quality ratio is one of the most critical factors in determine overall condition of any commercial banks. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. Assets of a banks comprises of cash and bank balance, call money and short notice, investment, loans and advances and fixed assets. However, investment and loan and advances play a major role in determine the quality of assets. These ratios look at the amount of different types of assets and attempt to determine if there are too high or too low with regard to current operating levels. The quality of assets is measured in term of ratio of non-performing loans to total loans and loan classified as substandard/doubtful/ loss to total loans. Provision for NPAs is also the measuring rod used to analyze the assets quality of the bank. These ratios used to evaluate managerial efficiency for proper utilization of assets and it also measures the degree of effectiveness in use of resources of funds by commercial banks.

4.2.1 Assets Composition

Asset composition is related to the left hand side of the bank balance sheet. The asset side of the balance sheet shows how the funds entrusted is utilized.

Table 4.5: Assets Composition of NSBI (in millions Rs)

Fiscal Year	2063	2064	2065	2066	2067
Cash Balance	244.187	287.530	308.101	652.027	815.679
Balance with NRB	626.123	556.678	403.810	444.138	1842.802
Balance with Banks/ FI	247.847	278.481	631.048	807.740	782.779
Money at Call	215.000	350.000	304.012	-	-
Investment	3758.975	2659.452	3088.886	13286.181	16305.632
Loan, Advances & Bills Purchase	7626.736	9460.450	12113.698	15131.747	17480.548
Fixed Assets	66.711	97.218	120.222	253.580	418.244
Non Banking Assets	24.556	3.847	-	-	-
Other Assets	225.701	207.504	217.665	341.256	401.992
Total	13035.839	13901.200	17187.446	30916.681	38047.679

Source: Annual Report of NSBI.

Table 4.6: Assets Composition of MBL (in million Rs)

Fiscal Year	2063	2064	2065	2066	2067

Cash Balance	280.421	385.940	560.317	743.198	1049.326
Balance with NRB	489.090	785.688	893.295	1755.982	1094.664
Balance with Banks/ FI	44.412	112.450	134.950	267.467	315.726
Money at Call	718.474	694.000	70.000	-	661.564
Investment	1190.829	1278.468	1443.550	1246.158	2096.792
Loan, Advance & Bill Purchase	6068.427	7129.891	8642.323	12516.012	14289.792
Fixed Assets	104.943	259.532	535.886	664.158	732.291
Non Banking Assets	12.532	3.392	-	4.500	-
Other Assets	160.698	158.251	218.224	293.303	438.632
Total	9069.830	10807.616	12498.548	17490.782	20678.790

Source: Annual Report of MBL

The above table shows assets composition for the fiscal year 2063 to2067. The cash balance of NSBI is on increasing trend and balance with NRB is decreased in the year 2065 and 2066. Similarly balance with other banks is also on increasing trend for four years but slightly decreased on the year 2067. The money at call is nil in last two years. The investment position is fluctuating but increased in last three years and loan, advance and bills purchase is in increasing trend.

Similarly for MBL, cash balance, balance with NRB and other banks are on increasing trend. Investment is showing increasing trend but slightly decreased in the year 2066. Loans, advance and bills purchase are also on increasing trend.

In conclusion while comparing between two banks Total Assets is more of NSBI than MBL in every year. Both banks fixed assets and total assets are increasing year by year and major part of asset composition is occupied by Loan, Advance, Bill purchase and Investment.

4.2.2 Non Performing Loan Ratio

Loans and advances are major part of assets composition. So, the sound financial condition of bank is largely depended on the quality of assets held by them. One of the indicators to measure the quality of assets being held by bank is non-performing assets ratio. The increasing trend of ratio shows the worsening quality of bank assets. Normally 5 to 10 percent of non-performing assets is considered satisfactory for quality of bank assets.

NRB has directed Banks to classify the loans into performing loan and non-performing loan. The loans that are not due and 3 months past due are called pass

loan or performing loans. Moreover, non-performing loans are classified into three groups: i) substandard ii) doubtful iii) loss. The loans that are past due for more than 6 months or one year past due are called doubtful loans and the loans that are past due for more than one year are called loss loan.

Table 4.7: Ratio of Non-Performing Loan to Total Loan

Fiscal Year	Bank	Non Performing Loan (in million Rs)	Total Loan (in million Rs)	Ratio of non-performing loan to total loan (in %)
2063	NSBI	505.34	8241.46	6.13
	MBL	16.92	6146.53	0.27
2064	NSBI	458.75	10065.05	4.55
	MBL	85.17	7319.94	1.16
2065	NSBI	488.41	12746.21	3.83
	MBL	92.92	8964.07	1.04
2066	NSBI	315.95	15612.05	2.02
	MBL	302.84	12984.45	2.33
2067	NSBI	265.13	17963.641	1.48
	MBL	347.58	14972.53	2.32

Source: Annual Report of NSBI and MBL.

As shown in the table 4.7 the total loan of the bank has gone up throughout the study period. The ratio of non-performing loan to total loan is on decreasing ratio of NSBI. For MBL, through the ratio are satisfactory it seem to be increasing in later year. The increasing trend of ratio is not good. By comparing we come to know that assets quality is strong of NSBI than MBL because it is in decreasing trend.

4.2.3 Ratio of Loans classified as Substandard, Doubtful or Loss Loan to Total Loan

Table 4.8: Substandard/Doubtful/Loss Loan to Total Loan

(Rs in million)

Fiscal Year	Bank	Total Loan	Total Substandard loan	%of Substandard Loan to Toal Loan	Total Doubtful Loan	% of Doubtful Loan to Total Loan	Total Loss Loan	% of Loss Loan to Total Loan
2063	NSBI	8241.46	1.80	0.02	3.84	0.05	499.70	6.06
	MBL	6146.53	0.06	.001	1.21	0.02	15.64	0.25
2064	NSBI	10065.05	3.28	0.033	11.17	0.11	444.30	4.41
	MBL	7319.94	19.30	0.26	26.61	0.36	39.26	0.54
2065	NSBI	12746.21	3.87	0.03	21.63	0.17	462.91	3.63
	MBL	8964.07	82.69	0.92	6.84	0.08	3.38	0.04
2066	NSBI	15612.05	13.23	0.08	11.38	0.07	291.38	1.87
	MBL	12984.45	1.28	0.01	2.05	0.02	299.51	2.31
2067	NSBI	17963.64	12.97	0.07	1.12	0.01	251.04	1.40
	MBL	14972.53	39.97	0.27	37.61	0.25	270.00	1.80

Source: Annual Report of NSBI and MBL.

Table 4.8 exhibits the ratio of substandard loan to total loan, doubtful loan to total loan and loss loan to total loan.

In case of MBL percentage of substandard loan to total loan, percentage of doubtful loan to total loan and percentage of loss loan to total loan is below 5% through out the study period which show satisfactory level. But the ratios of MBL are fluctuating.

For NSBI, percentage of loss loan to total loan s 6.06% in the year 2063 but after it is below 5%. Similarly, percentage of substandard loan to total loan and percentage of doubtful loan to total loan is below 5 percent. The ratios of substandard loan and doubtful loan fluctuating and loss loan is decreasing.

4.2.4 Ratio of provision for Substandard Loan to Total Substandard Loan

Table 4.9 exhibits the ratio of provision for substandard loan to total substandard loan. As per NRB guidelines, provision for substandard should be at least 25 percent of the total substandard loan. But the table shows that NSBI is below than 25 percent in all four years and nearest to 25 percent in last year which means that the bank has not made adequate provision for substandard loan.

Table 4.9 Provision for Substandard Loan to Total Substandard Loan

Fiscal Year	Bank	Provision for Substandard Loan	Total Substandard Loan	Ratio (%)

		(in million Rs)	(in million Rs)	
2063	NSBI	0.32	1.8	17.66
	MBL	0.016	0.06	25.00
2064	NSBI	0.54	3.28	16.58
	MBL	6.67	19.30	34.57
2065	NSBI	0.56	3.87	14.61
	MBL	20.67	82.69	25.00
2066	NSBI	2.74	13.23	20.71
	MBL	0.32	1.28	25.00
2067	NSBI	3.19	12.97	24.58
	MBL	17.61	39.97	44.05

Source: Annual Report of NSBI and MBL.

Similarly for MBL the highest provision is in the year 2067 that is 44.05 percent and rest of year also it is 25 percent and in year 2064 it has provision of 34.57 percent. It has shown that bank has adequate provision for substandard loan and bank is at per NRB guidelines

4.2.5 Ratio of provision for Doubtful Loan to Total Doubtful Loan

Table 4.10 shows the ratio of provision for doubtful loan to total doubtful loan. As per NRB guideline, provision for doubtful loan should be at least 50 percent but NSBI had made this provision adequate only in the year 2063 and for all rest of year it is below 50 percent and it have very smaller amount in the year 2067 so the provision is not adequate for NRB standard.

For MBL, it had made adequate provision in all of the year and it have highest provision of 61.63 percent in the year 2064 and second highest 59.53 percent in the year 2066 and rest of year it has 50 percent.

Table 4.10 Provision for Doubtful Loan to Total Loan

Fiscal Year	Bank	Provision for Doubtful Loan	Total Doubtful Loan	Ratio (%)

		(in million Rs)	(in million Rs)	
2063	NSBI	1.92	3.84	50
	MBL	0.61	1.21	50
2064	NSBI	3.90	11.16	34.87
	MBL	16.40	26.61	61.63
2065	NSBI	9.87	21.63	45.63
	MBL	3.42	6.84	50
2066	NSBI	3.68	11.38	32.38
	MBL	1.22	2.05	59.53
2067	NSBI	0.22	1.12	19.67
	MBL	18.81	37.61	50

Source: Annual Report of NSBI and MBL.

4.2.6 Ratio of Provision of Loss Loan to Total Loss Loan

Table 4.11 Provision for Loss Loan to total Loss Loan

Fiscal Year	Bank	Provision for Loss Loan (in million Rs)	Total Loss Loan (in million Rs)	Ratio (%)
2063	NSBI	495.36	499.70	99.13
	MBL	15.63	15.63	100
2064	NSBI	442.21	444.30	99.52
	MBL	39.28	39.28	100
2065	NSBI	456.40	462.91	98.59
	MBL	3.38	3.38	100
2066	NSBI	285.34	291.40	97.92
	MBL	299.51	299.51	100
2067	NSBI	245.75	251.04	97.89
	MBL	270.00	333.33	81

Source: Annual Report of NSBI and MBL.

Table 4.11 exhibits the ratio of provision for loss loan to total loss loan. The amount of loss loan of NSBI is in decrease position but it is slightly increase in the year 2065 than in the year 2064. As per NRB directives bank has to make provisioning of 100 percent for loss loan. Here NSBI has make provision nearest to the 100 percent.

Similarly for MBL the amount of loss loan is on fluctuating trend. It has made adequate provision for four year but in the year 2067 it has not made adequate provision and has shortfall loan loss provision by 63.34 million rupees.

4.3 Management Quality

Sound management is a key to financial institutions performance. Although several indicators can be used as proxies for the soundness of management, such evaluation is still primarily a qualitative exercise, particularly when it comes to the evaluation of the management of operational risk, that is, the functioning of internal control systems. The productivity of employees is used as measuring rod for evaluation. Likewise sustainability of earning shows the efficiency of management. NRB has been using a separate rating for the off-site supervision which uses the components of CAMELS except for the "M" representing management and the rating is thus labeled CAELS. However, only operating expenses ratio and earning per employees are used as indicators for management quality.

4.3.1 Operating Expenses Ratio

Operating expenses ratio shows the relationship between total operating expenses and total operating incomes. It measures the proportion of total operating expenses in total operating revenue. Low ratio indicates that the bank is operating efficiently and high or increasing ratio can indicate that financial institution may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. Operating expenses includes interest expenses, employees' expenses, office operating expenses, currency exchange loss, bad loan advance written off and loan loss provision and operating incomes includes interest incomes and non-interest incomes.

Table 4.12: Total Operating Expenses to Total Operating Revenue Ratio

Fiscal Year	Banks	Total operating expenses (in million Rs)	Total operating Revenue (in million Rs)	Operating Expenses Ratio (%)

2063	NSBI	631.18	799.67	78.93
	MBL	452.70	645.61	70.12
2064	NSBI	644.98	945.77	68.12
	MBL	713.05	806.86	88.37
2065	NSBI	739.65	1092.98	67.67
	MBL	868.23	907.98	95.62
2066	NSBI	1211.00	1653.37	73.24
	MBL	1112.81	1196.44	93.01
2067	NSBI	1980.23	2550.52	77.64
	MBL	1855.43	1841.85	100.73

Source: Annual Report of NSBI and MBL.

As shown in the table, the operating ratio of NSBI is maximum in the year 2063 by 78.93 percent then after it is decreasing in year 2064 and 2065 but again it is increased in 2066 and 2067. Decreasing trend is good for strong management quality but NSBI has fluctuating trend. However, operating revenue is above than operating expenses of NSBI. For MBL operating expenses is in increasing trend and it is increasing fast year by year. The ratio is maximum in the year 2067 by 100.73 and minimum in year 2063 by 70.12 percent.

Due to increase in office operating expenses and employee expenses both bank may have raised their operating expenses. Both NSBI and MBL have increased their branches in rapid way which may cause increment to other expenses also and directly affect operating expenses ratio. In 2063 NSBI have only 13 branches but it have reach up to 43 in 2067. Similarly, in 2063 MBL have 13 branches but it has reach up to 39 branches in 2067. Expanded number of branches has increasing trend of fixed expenses with ultimately increase operating expenses ratio.

4.3.2 Earning Per Employee

Earning per employee is another indicator of measuring management quality. It shows the relationship between net operating income and number of employees. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with repercussion in terms of profitability.

Table 4.13: Earning per Employee

Fiscal Year	Banks	NPAT (in million Rs)	Total number of Employees	Earning per employee (in Rs)
2063	NSBI	117.00	174	672419.54

	MBL	134.00	196	683653.06
2064	NSBI	254.91	189	1348719.57
	MBL	76.80	234	328200.85
2065	NSBI	247.77	249	995064.26
	MBL	85.02	313	271616.61
2066	NSBI	316.31	323	979256.96
	MBL	123.25	439	280754.00
2067	NSBI	391.74	465	842455.91
	MBL	73.31	492	149008.13

Source: Annual Report of NSBI and MBL.

The NPAT and number of employee of NSBI are on increasing trend. The earning per employee is peaked at Rs. 1348719.57 in 2064 due to the double increase in net profit and few numbers of increases in staff. Later also net profit increasing continuously but earning per employee decreased in 2067 because of increasing huge number of staff.

Similarly, MBL has highest NPAT of 134.00 million in the year 2063. In 2064 it is sharply declined and made improve in 2066 but again decline in the year 2007. In 2063 MBL has more earning per employee than NSBI. But later year it is decrease because increasing number of employee and decreasing trend of NPAT.

4.4 Earnings Quality

Earning is the yardstick indicating the management, shareholders and depositors to evaluate the performance of banks, sustainability of earnings and to forecast growth of the bank. The success of the bank heavily relies upon the efficiency of its management to drive the bank to earn good profits. Net profit is major yardstick to measure such profits. A required level of profit is necessary for the firm's growth and survival in the competitive environment. Profitability is vitally more important for assuring that a bank stays in business or activity. Net profit of any bank decreases resulting from high non- performing loans, lack of avenues for earning fee based income and operating inefficiencies. Higher profitability ratio indicates higher efficiency of banks and lower profitability ratio indicates lower efficiency of bank.

4.4.1 Return on Equity

Computed as the ratio of net income to the equity, it reflects the income earned from its internal sources. The ROE measures the book return to the owners of

the firm. It is a bottom line ratio in that sense (Weston & Copeland). Return o equity reveals how well the bank uses resources of the owners. The high ratio represents sound management and efficient mobilization of owner's equity and vice versa. ROE of 15 percent is treated as standard and banking industry are desired to have higher than this (World Bank, 1996). ROE is the measure of the rate of return flowing to the bank's shareholders. ROE is the profit as a percentage return on the owner's stake in a firm. The level of profit depends on the ROE i.e. profit per dollar invested. (Meir Kohn, 1999)

Table 4.14: Return on Equity

Fiscal Year	Banks	NPAT (in million Rs)	Shareholder Equity (in million Rs)	Return on equity (%)
2063	NSBI	117.00	982.37	11.9
	MBL	134.00	931.09	14.39
2064	NSBI	254.91	1163.30	21.91
	MBL	76.80	1007.30	7.62
2065	NSBI	247.77	1414.64	17.51
	MBL	85.02	1163.35	7.30
2066	NSBI	316.31	1712.01	18.46
	MBL	123.25	1700.20	7.24
2067	NSBL	391.74	2450.55	15.98
	MBL	73.31	1773.51	4.13

Source: Annual Report of NSBI and MBL.

Above table shown that return on equity of NSBI is on fluctuating trend. In the year 2063, its ROE remained below the benchmark of 15% and in the year 2064 it ROE is significantly increased up to 21.91% and again decreased in the year 2067. However, it is above 15% in four year except in the year 2063.

In the case of MBL, return on equity is on decreasing trend and its ROE remained below the benchmark of 15% throughout the study period. The ROE figure trends put NSBI in strong position as compared to MBL.

4.4.2 Return on Assets

Return on assets shows the relationship between net profit and total assets. It shows the percentage of net profit in total assets. Return on assets as an indicator of earnings quality indicates how well the management of the bank is converting the bank's assets into net earnings. If the company has a ROA of 10%, it means that the company earned Rs 0.10 for each Rs 1 in assets. Return will be higher if the banks

resources are well managed and utilized. According to World Bank the return of assets should be 1 percent and higher in banking industry.

Table 4.15: Return on Assets

Fiscal Year	Banks	NPAT (in million Rs)	Total Assets (in millions)	(%)
2063	NSBI	117.00	13035.84	0.89
	MBL	134.00	9069.40	1.48
2064	NSBI	254.91	13901.20	1.833
	MBL	76.80	10810.33	0.71
2065	NSBI	247.77	17187.45	1.44
	MBL	85.02	12498.54	0.68
2066	NSBI	316.31	30916.68	1.02
	MBL	123.25	17490.78	0.7
2067	NSBI	391.74	38047.68	1.03
	MBL	73.31	20678.80	0.35

Source: Annual Report of NSBI and MBL.

As shown in the table Return on Assets of NSBI is minimum in the year 2063 by 0.89 and maximum in the year 2064. Except in the year 2063 NSBI has meet the 1 percent benchmark in four years. In the case of MBL return on assets is in decreasing trend. The maximum ROA is 1.48 in the year 2063 than after it is below 1 percent in all four years. Ratio of NSBI is better than MBL in the study period.

4.4.3 Earning per Share

Earnings per share serve as an indicator of a company's profitability. It shows the relationship between net profit and number of shares. It provides the direct measure of return flowing to the bank's stockholders. Earnings per share are generally considered to be the single most important variable in determining a share's price. It is the amount the shareholders get on every share they held.

Table 4.16: Earning per Share

Fiscal Year	Banks	NPAT (in million Rs)	No. of Shares (in million)	Earning per Share (Rs)
2063	NSBI	117.00	6.40	18.27

	MBL	134.00	7.15	18.74
2064	NSBI	254.91	6.48	39.35
	MBL	76.80	8.21	9.35
2065	NSBI	247.77	8.74	28.33
	MBL	85.02	8.21	10.35
2066	NSBI	316.31	8.74	36.18
	MBL	123.25	14.80	8.33
2067	NSBI	391.74	16.54	23.69
	MBL	73.31	16.27	3.80

Source: Annual Report of NSBI and MBL.

The above table shows the earning per share of NSBI and MBL. In the year 2063 both NSBI and MBL have equal value where NSBI has Rs.18.27 and MBL have Rs.18.74. In 2064 NSBI has made more than double increase but MBL have made double decrease. In the third year 2065 NSBI has decreased by Rs.11.02 but again increase in 2066 and decrease in 2067. NSBI have fluctuating trend. In the case of MBL, earning per share is in decreasing trend. It has double decrease in the year 2064 and made little improve in the year 2065 but again decrease in 2066. In the year 2067, MBL have heavily fallen down.

4.4.4 Profit Margin

Profit margin shows the relationship between net income and total operating revenue. A ratio of profitability calculated as net income divided by total operating revenues. A higher profit margin indicates a more profitable bank that has better control over its costs. It shows the proportion of net income in total operating revenues. A 10% profit margin, for example, means the bank has a net income of Rs. 0.10 for each rupee of revenue.

Table 4.17: Profit Margin

Fiscal Year	Banks	NPAT (In million Rs.)	Total Operating Revenue (In million Rs)	Profit Margin (%)

2063	NSBI	117.00	799.67	14.63
	MBL	134.00	645.61	20.75
2064	NSBI	254.91	945.77	26.95
	MBL	76.80	806.86	9.51
2065	NSBI	247.77	1093.00	22.66
	MBL	85.02	907.98	9.36
2066	NSBI	316.31	1653.37	19.13
	MBL	123.25	1196.44	10.30
2067	NSBI	391.74	2550.52	15.35
	MBL	73.31	1841.85	3.98

Source: Annual Report of NSBI and MBL.

The profit margin of NSBI is 14.63 percent in the year 2063 and highly to 26.95 percent in the year 2064 then after it is in decreasing trend. Similarly, MBL have maximum profit margin in the year 2063 by 20.75 percent but heavily decrease in the year 2064 and 2065 and made improvement of 1 percent in the year 2066 but again heavy decline in the year 2067. So here, we can say MBL profit margin is in worse condition in comparison with NSBI.

4.5 Liquidity Position

Liquidity represents the ability to fund assets and meet obligations as they become due. Liquidity is essential in all banks to compensate for expected and unexpected balance sheet fluctuation and provide funds for growth. Liquidity risk is the risk of not being able to obtain funds at a reasonable price within a reasonable time period to meet obligations as they become due. Because liquidity is critical to the ongoing viability of any bank, liquidity management is among most important activities that a bank conducts.

4.5.1 Loan to Deposit Ratio

This shows the ratio of amount of loan to the amount of deposit. This is the measure of liquidity in the banking sector. It is the amount of a bank's loans divided by the amount of its deposits at any given time. The higher the ratio, the more the bank is relying on borrowed funds, which are generally more costly than most types of deposits.

Table 4.18: Loan to Deposit Ratio

Fiscal	Banks	Total Loan and	Total Deposits	Loan to deposit

year		Advances (in million Rs)	(in million Rs)	ratio (%)
2063	NSBI	8241.46	11002.04	74.90
	MBL	6146.57	7893.30	77.87
2064	NSBI	10065.05	11445.28	87.94
	MBL	7326.01	9475.45	77.31
2065	NSBI	12746.22	13715.40	92.94
	MBL	8964.07	11102.24	80.74
2066	NSBI	15612.05	27957.22	55.84
	MBL	12984.46	15596.80	93.25
2067	NSBI	17963.64	34896.42	51.47
	MBL	14927.53	18565.92	80.40

Source: Annual Report of NSBI and MBL.

The above table shows that NSBI have higher loan to deposit ratio in the year 2065 by 92.94 percent and less in the year 2067 by 51.47 percent. The total loan and advances has increased in the study period from 8241.46million to 17963.64 million and in the same way total deposit has also increased from 11002.04 million to 34896.42 million. Loan to deposit ratio is 74.9 percent in the year 2063 but it is rapidly increase in the year 2064 and 2065 and then it is decreasing in 2066 and 2067.

Similarly, MBL have higher loan to deposit ratio in the year 2066 by 93.25 percent and lower loan to deposit ratio in the year 2064 by 77.31 percent. It has a fluctuating trend. The loan and advances is on increasing trend from 6146.57 million to 14927.53 million. In the same way, deposits also increase from 7893.30 million to 18565.92 million. In average the ratio of loan to deposit ratio is higher of MBL than of NSBI.

4.5.2 Liquid asset to Deposit Ratio

Liquid assets to deposit ratio is computed by dividing total liquid assets to total deposits. It measures the percentage of liquid fund with the bank to meet short-term obligation. Cash in hand, balance with NRB, balance with bank/financial institution, money at call and short notice. Nepal government treasury bills and Nepal government's other securities are included in liquid assets. Higher ratio implies better liquidity position and vice versa.

Table 4.19: Liquid Assets to Deposit Ratio

Fiscal	Banks	Liquid Assets	Total Deposits	Liquid Assets to	Industrial

Year		(In millions)	(In millions)	Deposits (%)	Average (%)
2063	NSBI	4924.93	11002.04	44.76	13.34
	MBL	2436.87	7893.30	30.87	13.34
2064	NSBI	3818.27	11445.28	33.36	13.06
	MBL	2929.40	9475.45	30.91	13.06
2065	NSBI	4682.53	13715.40	34.14	15.70
	MBL	2485.91	11102.24	22.39	15.70
2066	NSBI	5210.48	27957.22	18.63	18.81
	MBL	3244.41	15596.80	20.80	18.81
2067	NSBI	7754.58	34896.42	22.22	14.41
	MBL	5017.76	18565.92	27.02	14.41

Source: Annual Report of NSBI and MBL, Banking and Financial Statistics.

The liquid assets to deposit ratio of both bank are high as compared to industrial average. The ratio is very high in the year 2063 by 44.76 percent then after it is decreased by 33.36 percent in year 2064. It has 34.14 percent, 18.63 percent and 22.22 percent respectively in the year 2065, 2066 and 2067 B.S. Similarly, MBL have also sufficient Liquid Fund as compared to industrial average. It have higher ratio in the year 2064 and 2063 by 30.91 percent and 30.87 percent respectively. In the year 2065 it have 22.39 percent then after it is decreased in the year 2066 by 18.63 percent then again it increase in the year 2067 by 27.02 percent. In comparison between two banks NSBI have highest ratio than MBL in the year 2063, 2064 and 2065. Only in 2066 and 2067 MBL is higher with few percent. So, we can say liquidity position of NSBI is better.

4.5.3 NRB Balance to Total Deposit Ratio

This is the ratio of NRB cash balance to total deposit. It measures the proportion of NRB cash balance to total deposit. It shows whether bank is holding the balance required by NRB. NRB through its directives has been directing banks to maintain certain percent of deposit amount in NRB. The limitation of the study is that the calculation is based on year-end volume of deposit and NRB balance whereas NRB requires banks to calculate CRR on weekly average balance.

Table 4.20: NRB Balance to Deposits Ratio

Fiscal Year	Banks	Balance at NRB (In millions)	Total Deposit (In millions)	NRB Balance to Deposits (%)	Industrial Average (%)
2063	NSBI	626.12	11002.04	5.70	6.48
	MBL	489.09	7893.30	6.20	6.48
2064	NSBI	556.68	11445.28	4.86	9.85
	MBL	785.68	9475.45	8.29	9.85
2065	NSBI	403.81	13715.40	2.94	7.23
	MBL	856.74	11102.24	7.72	7.23
2066	NSBI	444.14	27957.22	1.58	6.88
	MBL	1756.00	15596.80	11.25	6.88
2067	NSBI	1842.80	34896.42	5.28	7.23
	MBL	1094.66	18565.92	5.90	7.23

Source: Annual Report of NSBI and MBL, Banking and financial Statistics.

As shown in the table, NSBI has NRB balance to total deposit ratio below the industrial average in every year. It has highest ratio of 5.7 percent in the year 2063 later it is decreasing ratio and in the last year of the study period it has increased by 5.9 percent.

In the case of MBL, it has highest ratio in the year 2066 by 11.25 percent. Similarly, in the year 2065 it is above the industrial average by 7.72 percent and other years it is below the industrial average but in comparison MBL have greater NRB balance to deposit ratio than NSBI.

4.5.4 Cash in Vault to Total Deposit Ratio

This ratio shows the percentage of total deposits held as cash in vault. This ratio is computed by dividing cash in vault by total deposits. This is liquid fund with bank to meet the immediate payment. Cash and foreign currencies in hand are included as cash in vault. Total deposit means current savings and fixed deposits account as well as call account deposit and certificate of deposits. For the purpose deposits, held in convertible foreign currency, employees guarantee amount and margin account will not be included. (NRB Directives Manual, 2004).

Table 4.21: Cash in vault to Total Deposit Ratio

Fiscal Year	Banks	Cash in Vault (in million Rs)	Total Deposit (in million Rs)	Cash in vault to total deposit (%)	Industrial Average (%)
2063	NSBI	244.19	11002.04	2.22	2.17
	MBL	280.42	7893.30	3.55	2.17
2064	NSBI	287.53	11445.28	2.51	2.32
	MBL	385.94	9475.45	4.07	2.32
2065	NSBI	308.10	13715.40	2.24	2.97
	MBL	560.31	11102.24	5.046	2.97
2066	NSBI	652.03	27957.22	2.33	2.81
	MBL	743.20	15596.80	4.76	2.81
2067	NSBI	815.68	34896.42	2.33	2.92
	MBL	1049.33	18565.92	5.65	2.92

Source: Annual Report of NSBI and MBL, Banking and Financial Statistics.

As shown in the table, NSBI cash in vault to total deposit ratio is approximate with industrial average in every year. For MBL, the highest ratio is in the year 2067 by 5.65 percent and lowest in the year 2063 by 3.55 percent. It is above the industrial average in every year. So, by comparing between the ratios of these banks MBL have more cash in vault than NSBI.

4.6 Sensitivity to Market Risk

These parameters refer to risk conditions in the market such as exchange risk, interest rate risk etc which could adversely affect earnings or capital of the bank. Banking business is open to risks from movement in competitors prices, competitors cost of fund, foreign exchange rates and interest rates all of which need to be managed. Although Nepalese Banking sector is exposed to interest rate risk and the exchange rate risk, interest rate is the focus of this study. It is primary risk in most of the commercial banks in Nepal.

This study is worked with duration gap model which is simple method than other dollar gap and simulation analysis. Duration gap model simply measures the net quality of assets or liabilities re-pricing within a given period to estimate the likely impact changes in interest rates will have in earnings. According to NRB, duration gap analysis model adapted for minimization of liquidity risks shall also be adapted in respect of minimization of IRR. Banks shall classify the time interval of the assets and liabilities on the basis of maturity period of 0-90 days, 91-180 days, 181-270 days, and 271-365 days, over the 365 days. For changing probability of estimate interest rate is normally one percent can be determined. The effect on the

percent change in NII is calculated by multiplying the change in interest rate ΔRi in the ith maturity bucket annualized with cumulative GAP.

If the interest rates rise on RSAs and RSLs, the positive CGAP (RSA>RSL) would project increase in the expected annual NII. However if interest rate fall when CGAP is positive, NII will fall. In general, when the CGAP or the GAP ratio is positive (RSA>RSL), the change in NII is positive related to the change in interest rates. Thus banks would want to keep CGAP positively when interest rate expected to rise. Conversely, when CGAP is negative the change in NII is negatively related to the change in interest rates. Thus banks are expected to keep CGAP negative when interest rates are expected to fall. Gap analysis of RSAs and RSLs of NSBI and MBL for the period of fiscal year 2063 to 20667 is made as shown in table 4.22 (a, b, c, d, e, f, g, h, i, j) based on different maturity time.

Table 4.22

(a) GAP Analysis of 2063 of NSBI

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA(in millions)	56476.98	14423.19	11253.89	17608.78	34269.30	134032.14
RSL(in millions)	25046.31	7361.05	18036.97	7983.05	59717.30	118144.68
GAPi (RSA-RSL)(million)	31430.67	7062.14	(6783.08)	9625.73	(25448)	15887.46
CGAP(RSA-RSL)(million)	31430.67	38492.81	31709.73	41335.46	15887.46	-
RSA/RSL	2.25	1.95	0.62	2.20	0.57	1.13
CGAP Ratio [CGAP/Total RSA]%	55.65	266.88	281.76	234.74	46.36	
Δ R %				1%	1%	
NII(million)=CGAP× ΔR				413.35	158.87	
% change in NII				2.34%	0.46%	

(b) Gap Analysis of 2064 of NSBI

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	58772	16996	24385	8391	33108	141653
RSL (in millions)	38118	13011	11635	14669	47175	124607
GAPi(RSA-RSL)(millions)	20654	3985	12750	(6277)	(14067)	17046
CGAP(RSA-RSL)(millions)	20654	24639	37390	31113	17046	
RSA/RSL	1.54	1.30	2.095	0.57	0.70	1.136
CGAP Ratio [CGAP/Total RSA] %	35.14	144.96	153.33	370.79	51.48	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				311.13	170.46	
% change in NII				3.7%	0.51%	

(c) GAP Analysis of 2065 of NSBI

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	92453	11136	3056	17112	50723	174491
RSL (in millions)	57374	16072	9968	13097	58918	155429
GAPi(RSA-RSL)(millions)	35079	(4936)	6912	4025	(8195)	19062
CGAP(RSA-RSL)(millions)	35079	30143	23232	27257	19062	-
RSA/RSL	1.61	0.69	0.31	1.31	0.86	1.12
CGAP Ratio [CGAP/Total RSA] %	37.94	270.68	760.21	159.28	37.58	37.58
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				272.57	190.62	
% change in NII				0.016%	0.37%	

(d) GAP Analysis of 2066 of NSBI

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	103464	25399	49950	72304	56645	307762
RSL (in millions)	63951	25774	69358	51862	77902	288847
GAPi(RSA-RSL)(millions)	39513	(375)	(19408)	20442	(21257)	18915
CGAP(RSA-RSL)(millions)	39513	39138	19730	40172	18915	-
RSA/RSL	1.61	0.98	0.72	1.39	0.72	1.065
CGAP Ratio [CGAP/Total RSA] %	38.19	154.092	39.49	55.56	33.39	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				401.72	189.15	
% change in NII				0.55	0.33	

(e) GAP Analysis of 2067 of NSBI

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	134253.04	40317.15	97886.75	47206.47	102388.83	422052.24
RSL (in millions)	127429.35	38963.57	110849.47	24528.87	92736.96	394508.23
GAPi(RSA-RSL)(millions)	6823.69	1353.58	(12962.73)	22677.61	9651.86	27544.01
CGAP(RSA-RSL)(millions)	6823.69	8177.27	(4785.46)	17892.15	27544.01	-
RSA/RSL	1.05	1.0347	0.88	1.92	1.104	1.06
CGAP Ratio [CGAP/Total RSA] %	5.082	20.28	4.88	37.90	26.90	-
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				178.92	275.44	
% change in NII				0.38%	0.27%	

Source: NSBI, Annual Report, 2063-2067.

(f) GAP Analysis of 2063 of MBL

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	28284.76	7877.49	6386.77	2660.32	43485.03	88694.38
RSL (in millions)	26364.64	5877.36	3027.90	4257.13	39520.46	79047.49
GAPi(RSA-RSL)(millions)	1920.12	2000.13	3358.87	(1596.80)	3964.57	9646.89
CGAP(RSA-RSL)(millions)	1920.12	3920.25	7279.12	5682.32	9646.89	-
RSA/RSL	1.07	1.34	2.10	0.62	1.10	1.12
CGAP Ratio [CGAP/Total RSA] %	6.78	49.76	113.97	213.59	22.18	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				56.82	96.46	
% change in NII				2.13%	0.22%	

(g) GAP Analysis of 2064 of MBL

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	43198.25	8048.85	4577.00	25550.34	24390.43	105764.87
RSL (in millions)	40606.46	3278.81	1197.63	4997.50	43882.65	94945.05
GAPi(RSA-RSL)(millions)	2591.79	4770.04	3397.37	19552.84	(19492.22)	10819.82
CGAP(RSA-RSL)(millions)	2591.79	7361.83	10759.20	30312.04	10819.82	-
RSA/RSL	1.06	2.45	3.82	5.11	0.55	1.114
CGAP Ratio [CGAP/Total RSA] %	6	91.46	235.07	118.63	44.36	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				303.12	108.19	
% change in NII				1.18%	0.44%	

(h) GAP Analysis of 2065 of MBL

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	50606.43	17123.85	12309.05	12247.57	27489.87	119780.76
RSL (in millions)	13315.16	4760.30	5438.72	9385.24	51015.79	83919.20
GAPi(RSA-RSL)(millions)	37291.27	12363.55	6870.33	2862.33	(23525.92)	35861.56
CGAP(RSA-RSL)(millions)	37291.27	49654.82	56625.15	59387.48	35861.56	
RSA/RSL	3.80	3.6	2.26	1.30	0.53	1.42
CGAP Ratio [CGAP/Total RSA] %	73.68	289.97	460.02	484.89	130.45	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				593.87	358.61	
% change in NII				4.84%	1.30%	

(i) GAP Analysis of 2066 of MBL

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	65981.12	19371.30	22897.15	19271.31	42452.69	169973.57
RSL (in millions)	30389.55	5619.16	11976.30	9022.68	96849.76	153857.46
GAPi(RSA-RSL)(millions)	35591.57	13752.14	10920.84	10248.63	(54397.07)	16116.11
CGAP(RSA-RSL)(millions)	35591.57	49343.71	60264.55	70513.18	16116.11	
RSA/RSL	2.171	3.44	1.91	2.13	0.43	1.10
CGAP Ratio [CGAP/Total RSA] %	53.94	254.72	263.196	365.897	37.96	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				705.1318	161.16	
% change in NII				3.66%	0.38%	

(j) GAP Analysis of 2067 of MBL

Particulars	1-90	91-180	181-270	271-365	>365	Total
RSA (in millions)	110751.51	25289.36	24196.18	18694.18	56844.47	235775.71
RSL (in millions)	52301.57	20869.81	21216.33	11793.90	113146.89	219328.50
GAPi(RSA-RSL)(millions)	58449.94	4419.55	2979.85	6900.28	(56302.42)	16447.21
CGAP(RSA-RSL)(millions)	58449.94	62869.49	65849.34	72749.63	16447.21	-
RSA/RSL	2.117	1.211	1.140	1.585	0.5024	1.075
CGAP Ratio [CGAP/Total RSA] %	52.77	248.600	272.147	389.156	28.93	
Δ R %				1%	1%	
Δ NII (million)= CGAP ×ΔR				727.5	164.472	
% change in NII				3.9%	0.29%	

Source: Annual Report of MBL, 2063-2067.

The period from 2063 to 2067 is taken for review of the sensitivity of market risk of NSBI and MBL. The net financial assets (RSA-RSL) reprising in the short-term maturity bucket and long term maturity bucket ranging for five years are mentioned here.

NSBI

The short-term maturity bucket ranging from 1-90 days found positive in all five years by Rs 31430.67, Rs. 20654, Rs.35079, Rs.39513 and Rs. 6823.69 respectively. Similarly maturity bucket ranging from 91-180 days found positive by Rs. 7062.14, Rs.3985, Rs.1353.58 in the year 2063, 2064 and 2067 respectively and found negative in the year 2065 and 2066 by Rs4936 million and Rs 375 million respectively. The range from 181-270 found positive in year 2064, 2065 by Rs.12750 and Rs. 6912 and rest of the year banks gap were negative by Rs. 6783.08,

Rs.19408, and Rs.12962.73 respectively. The range from 271-365 days of the year 2063, 2065, 2066 and 2067 found positive by Rs.41335.46, Rs.4025, Rs.20442 and Rs.22677.61 found negative in year 2064 by Rs. 6277 respectively. In long term maturity bucket (>365 days) it has negative result in four years by Rs. 14067, Rs. 25448, Rs. 8195 and Rs. 21257 respectively and positive in the year 2067 by Rs.9651.86 (all figures are in million). The CGAP or interest rate sensitivity ratio of the total earning assets over the short term horizon i.e. up to one year was highest in the year 2064 by 370.79% and lowest ratio was in 2067 by 37.90%.The CGAP ratio to the earning assets over the long term horizon was 51.48% in the year 2064 and lowest with 26.90% in the year 2067.

MBL

The short-term maturity bucket ranging from 1-90 days to 271-365 days of MBL is positive in all five years. But the range of 271-365 is found negative in the year 2063 by Rs.1596.80 millions. In the long term maturity bucket(>365 days) the gap was positive in the year 2063 by Rs. 3964.57 million and then negative for four years by Rs.19492.22, Rs. 23525.92, Rs. 54397.07, Rs.56302.42 million respectively. The CGAP or the interest rate sensitivity ratio of the total earning assets over the short term horizon i.e. up to one year was highest in the year 2065 by 484.89% and lowest in the year 2064 by 118.63%.The CGAP ratio to the earning assets over the long term horizon was highest with 130.45% in 2065 and lowest with 22.18% in 2063.

It indicates RSA and RSL reprising in short term maturity bucket are highly sensitive to interest rate, even though it is in decreasing trend. In long term horizon is comparatively low sensitive to interest rate, when interest rate change by 1% its impact on annual NII. In the rising interest rate environment the bank would profit over the one-year time horizon as it has maintained CGAP > 0 (Positive) and vice versa.

4.7 Major Findings

This section includes the key findings of the study obtained from the analysis of data. Conclusion is derived from findings and presented in the next chapter.

4.7.1 The ratio of Core Capital to Total Assets is above 5 percent which show both bank are well capitalized. But while comparing, the ratio of MBL is more than NSBI by 2.66, 0.88, 1.03, 4.11, and 2.08 percent in five years respectively.

4.7.2 Both banks are able to maintain capital adequacy ratio as per NRB directives both in Basel I and in Basel II. In comparison, NSBI capital adequacy ratio is few more than MBL by 0.71, 1.31, 0.04, 0.08 and 1 percent in the study period respectively. In average it seems both banks ratio similar which show risk based capital ratio is fair during the study period.

4.7.3 MBL Core Capital Adequacy Ratio is higher than NSBI by 1.47 percent in year 2063. In other years both banks ratio seems approximately similar with each other. There is high gap between ratio of core capital and ratio of NRB standard. This clearly implies that both banks are complying with the directives of NRB on the requirement of the core capital base of commercial bank. For supplementary capital, the ratio as prescribed by NRB, which should not exceed core capital, showed that both bank has meet the requirement of NRB during the study period. It shows that both banks have managed their fund mostly by core capital.

4.7.4 As every commercial bank here also huge portion of assets composition is occupied by Loan, Advance and Bill Purchase. The cash balance of both banks is on increasing trend. Balance with NRB of NSBI is in fluctuating trend but highly increase in 2067. For MBL also it is in increasing trend but slightly decrease in 2067. Balance with Bank/ FI is in increasing trend of MBL but in case of NSBI it slightly decreases in last year. Money at call is nil in last two years of NSBI and 2066 of MBL. It reveals that movement of money at call observes in swift over into investment. Investment is on increasing trend of NSBI but for MBL it is slightly decrease in 2066. Loan and advances of both banks are in increasing trend. Fixed assets and total assets are in increasing trend. Non-banking assets are nil in last three years of NSBI and for MBL it is nil in 2065 and 2067 which is good for its management. The main findings here is both bank's assets composition are in increasing trend but while comparing between two banks Total Assets is

more of NSBI than MBL in every year so here we can conclude that assets quality of NSBI is strong.

4.7.5 The ratio of non-performing loan of NSBI is 6.13, 4.55, 3.83, 2.02, 1.48 percent and the ratio of MBL is 0.27, 1.16, 1.036, 2.33, and 2.32 in the year 2063, 2064, 2065, 2066 and 2067 respectively. While comparison, ratio of NSBI is higher than MBL but MBL is in increasing trend which is not good. NSBI is in decreasing trend which reflects it has improved it loan quality in later years.

4.7.6 The ratio of provision for substandard loan is below NRB guidelines of NSBI. It is below 25 percent in the five years period. It have highest ratio in the year 2067 by 24.58 percent. MBL have made adequate provision for substandard loan as prescribed by NRB in every year.

4.7.7 The ratio of provision for doubtful loan to total loan of NSBI was maximum in the year 2063 by 50 percent and rest of year it is below 50 percent. MBL has made adequate provision for doubtful loan as per NRB rules and regulation.

4.7.8 The provisioning of loss loan of NSBI is 99.13, 99.52, 98.59, 97.92 and 97.89 percent in the year 2063, 2064, 2065, 2066 and 2067 respectively. Similarly, MBL has 100 percent in first four years but it has maintained only 81 percent in the year 2067. Here we can conclude that NSBI has maintained nearest to 100 percent. MBL has maintained adequate provision in first four years but in the year 2067 it has shortfall by 19 percent.

4.7.9 The operating expenses ratio of NSBI is 78.93, 68.20, 67.67, 73.24 and 77.64 percent which is in fluctuating trend. Here, MBL operating expenses ratio is increasing rapidly by 70.12, 88.37, 95.62, 93.01 and 100.73 percent. The ratio of NSBI is less than MBL which show NSBI management quality is better than MBL management quality.

4.7.10 NSBI earning per employee is Rs 672419.54, Rs 1348719.57, Rs 995064.257, Rs 979256.96 and Rs 842455.914 and similarly MBL earning per employee is Rs 683653.06, Rs 328200.85, Rs 271616.61, Rs 280753.98 and Rs 149008.13 respectively in five-year study period. In the year 2063 both NSBI and MBL earning per employee are approximately same but after MBL start to decrease tremendously which show the NSBI efficiency of staff and management quality is good than MBL.

4.7.11 The ratio of return of equity of NSBI is 11.9, 21.91, 17.51, 18.46, 15.98 and ratio of MBL is 14.39, 7.62, 7.3, 7.24 and 4.13 respectively in five years. The ratio of MBL is decreasing rapidly and ratio of NSBI is also fluctuating. ROE of NSBI remain below the benchmark of 15 percent only in year 2063 but ROE of MBL remain below the benchmark in all study period. The ROE figure trends put NSBI in strong position as compared to MBL.

4.7.12 The ratio of return on Assets of NSBI is 0.89, 1.83, 1.44, 1.02, 1.03 percent and ratio of MBL is 1.48, 0.71, 0.68, 0.70 and 0.35 percent respectively in five years. As per the conventional rule of rate, the commercial bank having ROA less than 1 percent falls in the marginal earning performance zone. Here, NSBI is below 1 percent in 2063 but after it has improved. In case of MBL, ratio is decreased from 1.48 percent to 0.35 percent. So, here we can conclude NSBI has managed well in converting the bank's assets into net earnings.

4.7.13 Earnings per share of NSBI is Rs 18.27, Rs 39.35, 28.33, Rs 36.18, Rs 23.69 and of NBL is Rs 18.74, Rs 9.35, Rs 10.35, Rs 8.33 and Rs 3.80. NSBI have both increasing and decreasing trend. But EPS of MBL is heavily fallen down from Rs 18.74 to Rs 3.80. The instability and decreasing per share may be due to insecurity condition of country and political instability. Here while comparing, earning per share of NSBI is better than MBL.

4.7.14 The profit margin of NSBI is 14.63, 26.95, 22.66, 19.13, and 15.35 percent respectively which is increasing in two years and start to decrease in last two years. The profit margin of MBL is in decreasing trend by 20.75, 9.51, 9.36, 10.30 and 3.98 percent respectively. By looking ratio of profit margin we come to know that both bank cannot control over its cost. However, profit margin of NSBI is higher than MBL.

4.7.15 The loan to deposit ratio of NSBI is 74.9, 87.94, 92.94, 55.84, 51.47 percent and MBL has 77.87, 77.31, 80.74, 93.25 and 80.40 percent respectively. The maximum ratio of NSBI is 92.94 percent in year 2065 and MBL is 93.25 percent where it has proper utilization of fund. In average the ratio of loan to deposit ratio is higher of MBL than of NSBI. Here, MBL is more relying on borrowed funds.

4.7.16 Both banks have sufficient liquid fund as compared to industrial average. Liquid asset to deposit ratio of NSBI is 44.76, 33.36, 34.14, 18.63, 22.22

percent and ratio of MBL is 30.87, 30.91, 22.39, 20.80 and 27.02 percent respectively in five years. Only in last two year MBL exceeds NSBI with few percent. So, here we can say short-term liquidity position of NSBI is better than MBL.

4.7.17 Every year NRB balance to deposit ratio of NSBI is below industrial average. Similarly, MBL ratio is also below the industrial average in three years out of five years. So here we have find that both banks have not strictly follow the NRB directives on maintaining NRB balance. But when we compare between these two banks MBL have greater NRB balance to deposit ratio than NSBI.

4.7.18 Cash in vault to total deposit ratio of NSBI is approximate with industrial average in every year. MBL ratio is higher than industrial average every year. So here ratio of MBL is high than NSBI in this five year period. So here we can say cash in vault is greater with MBL than NSBI.

4.7.19 The highest CGAP ratio of total earning assets of NSBI in short-term horizon is 370.79% and lowest is 37.90%. Similarly for MBL highest CGAP in short term horizon is 484.89% and lowest with 118.63%. For long-term horizon CGAP ratio to earning assets of NSBI was highest by 51.48% and lowest with 26.90%. Similarly for MBL highest CGAP ratio in long term horizon is 130.45% and lowest 22.18%. Hence it can be concluded the bank are low sensitive in interest rate in long horizon.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMMENDATION

This unit is divided into three sections. The first section provides the brief summary of the study. The second section demonstrates the conclusion of the study and third section contains recommendations.

5.1 Summary

Banks are those financial institutions that offer widest range of financial services especially credit, savings and payments services and perform the widest range of financial functions of any firm in the economy. Bank faces many pressures today from changing regulation, intensifying competition from non-bank financial services firms, the spreading internationalization of banking markets and continuing innovation in technology and automation. This has forced banks to assess their performance overtime and relative to other banks. There are different approaches used worldwide to assess bank performance. CAMELS framework is one of the common methods for evaluating financial performance of the bank.

This study is focused to evaluate the financial performance between the joint venture bank and domestic private commercial bank in the framework of CAMELS by using descriptive and analytical research design. For the study purpose, two banks- Nepal SBI Bank Limited and Machhapuchhre Bank Limited were selected randomly. The study covered five-year period from B.S. 2063 to B.S. 2067. The historical data disclosed by annual reports of the sampled banks from major source of data. In addition to this require data and information have been collected from various other sources like NRB reports, directives, publication and other various articles, research papers, dissertations, books etc. The primary objectives of the study are to evaluate the comparative financial performance of Nepal SBI Bank Limited and Machhapuchhre Bank Limited in the framework of CAMEL during the period of B.S. 2063 to B.S. 2067. The specific objectives seek to achieve to examine the capital adequacy of banks, to assess the quality of bank’s assets, to analyze the

efficiency of bank's management, to evaluate the earning performance of the bank, to assess sensitivity of both banks earning to interest rate risk.

CAMELS system was developed by regulatory authorities of the US banks to quantify the performance and financial condition of the banks which they regulate. The acronym CAMELS stands for Capital Adequacy, Asset Quality, Management Efficiency, Liquidity Position and Sensitivity to Market Risk. Each of the components is assessed to evaluate the strength and weakness of the bank. In this study different indicators of each component of CAMELS are calculated in the form of financial ratios. A set of financial ratios are analyzed to reveal the financial condition of the bank and to compare with each other and to show whether the bank's position has been improved or deteriorating over time. The financial data extracted from annual reports and other relevant documents are analyzed and interpreted to get valuable insights into a firm performance and position. The financial ratios obtained are compared with NRB standard, industrial average and trend of ratio are analyzed to know whether the bank's position has been improving or deteriorating over time.

Regarding the capital adequacy ratios, banks under study are well capitalized and they are complying with the NRB directives. The total assets of both NSBI and MBL are in increasing trend but composition of assets is higher of NSBI than MBL in every year this may be due to difference in establishment date. The ratio of non-performing loan to total loan of NSBI is higher than MBL but is in decreasing trend and MBL is in increasing trend. So, here by comparing we can say NSBI has improve the quality of loan than MBL.

The ratio of provision for Substandard loan, Doubtful Loan and loss Loan is below the NRB guidelines of NSBI bank but MBL is able to maintain the adequate provision except in one year. The ROE figure put NSBI first than MBL where MBL ratio is below benchmark every year. For ratio of return on assets NSBI is above the benchmark of 1 percent in four years out of five years and MBL has met benchmark only in one year, so here also NSBI is first. The earnings per share also show NSBI in better position. The profit margin of NSBI is in fluctuating trend and profit margin of MBL is decrease from 20.75 percent to 3.98 percent which show MBL cannot control over its cost.

The ratio of operating expenses to operating revenue is in fluctuating trend of NSBI and for MBL it is increased rapidly and from 70.12 to 100.73 percent. Although beginning of the study period earning per employee of both bank are same, MBL is also increased highly in second year and started to decrease which may be due to increase in operating expenses. Here also we can evaluate that management quality of NSBI is strong. Loan to deposit ratio is higher of MBL than of NSBI which show MBL is more relying on borrowed funds. Liquid assets to deposit ratio is above the industrial average of both banks but ratio of NSBI is higher than MBL. Both banks are not strictly follow NRB directives in maintaining NRB balance however NRB balance to deposit ratio is MBL is higher than NSBI. The cash in vault is approximate with industrial average of NSBI and above than industrial average of MBL, so here also MBL has more cash in vault than NSBI. Both banks are low sensitive to interest rate in the long horizon but high sensitive to interest rate in short term horizon due to CGAP ratio to earning assets is high.

5.2 Conclusions

Based on findings the following conclusions have been drawn:

5.2.1 The Capital Adequacy Ratio of MBL and NSBI are able to meet both local and international regulatory requirement. The risk based core capital is adequate and sufficient. The supplementary capital adequacy ratio of the banks showed that it has met the requirement of NRB during the study period. The ratio of core capital to total assets is also above 5 percent which show both banks are well capitalized. So, here is no difference in maintaining capital adequacy by both Joint Venture and Domestic Private Bank.

5.2.2 The total assets composition of NSBI is higher than MBL which may be due to gap in establishment date but it is good that both banks total assets and fixed asset are in increasing trend. Normally 5 to 10 percent of non-performing assets are considered satisfactory for quality of bank assets. By looking non-performing loan ratio both banks are seems satisfactory because both banks are less than 5 percent except in one year of NSBI. But it also concludes that increasing trend of ratio show worsening quality of bank assets. Here, NSBI is in decreasing trend which show efficient credit

management and recovery efforts while MBL is in increasing trend which show it has decrease its quality of loan year by year.

5.2.3 The ratios of provision for Substandard Loan / Doubtful Loan / Loss Loan are seemed negligence by NSBI because here NSBI has not made adequate provision for it. MBL has made adequate provision except in the year 2067. So here we can conclude MBL follows NRB guidelines effectively.

5.2.4 The operating expenses ratio of MBL is in increasing trend which show it has not operate efficiently and NSBI has decrease in two years but started to increase then after. MBL has higher operating expenses ratio than NSBI. MBL has exceeded over the 100 percent in the year 2067. Here both banks show unsatisfactory ratio. Both banks has increased their branches rapidly in last two years which may increase to other expenses also and directly affect the operating expenses ratio. In 2063 NSBI have only 13 branches, in 2066 it have 32 branches and 43 branches in 2067. Similarly, MBL also have 13 branches in 2063 and 31 branches in 2066 and 39 branches in 2067. It is very good to have expansion strategy which may cause to increase expenses in operating years but will positively affect the profitability in future. So we can say that only management is not responsible for increase in operating expenses.

5.2.5 Earning per employee show better position of NSBI but it is not satisfactory because it is optimum at second year of study period then after decrease although there is increasing trend of NPAT which may be due to number of employee increasing rapidly from third year of the study period. MBL have earning per employee high in the first year than NSBI but after it is in decreasing trend which can reflect the inefficiencies of management as a result of overstaffing and decreasing trend of NPAT.

5.2.6 The ROE figure trends put NSBI in first position as compared to MBL but it does not mean NSBI in strong position because it is below benchmark of 15 percent in first year and have fluctuating trend instead of increasing trend. MBL has worse condition; it is below the benchmark of 15 percent every year and is in decreasing trend. MBL is not aware about shareholder maximization.

5.2.7 Although NSBI has ROA below 1 percent in first year but after it is above 1 percent in all year which show that the capability of management to

converting the bank's assets into net earnings is increasing. MBL has ROA 1.48 percent in first year but after it is in decreasing trend which show bank has not well managed and utilized its resources.

5.2.8 NSBI has earning per share high than MBL so here we can conclude that NSBI return flowing to bank owner is higher than MBL which mean market value of share is also high of NSBI than of MBL but it does not mean satisfactory because it has both increasing and decreasing trend. MBL earning per share is similar with NSBI in first year but it is decrease rapidly then after. It has Rs.18.74 per share in year 2063 which decrease to Rs 3.80 per share in year 2067. For this not only bank but also gloomy investment climate and political instability of Nepal may also be responsible which are the external factors, and banks cannot control over it.

5.2.9 Profit margin ratios also show NSBI is more profitable bank than MBL. The ratio of MBL shows it cannot control over its cost.

5.2.10 In average loan to deposit ratio is higher of MBL than NSBI. So here MBL has proper utilization of funds whereas NSBI have more funds it needs to investment. They will not face liquidity problem in future. Liquid assets to deposit ratio is above the industrial average of both banks. In average the ratio of NSBI is little more than MBL so here liquid assets of NSBI is more than MBL. The NRB balance to deposit ratio is below the industrial average of NSBI. MBL is also below the industrial average in three years out of five years. These ratios show they are not strictly follow the NRB Directives in maintaining balance. The cash in vault to total deposit ratio show MBL have more cash in vault than NSBI which is liquid fund to meet current short-term obligation.

5.2.11 The sensitivity of net financial assets in short term maturity bucket is high and are therefore highly sensitive to interest change risk. Conversely the bank hasn't able to match the risk sensitive assets to risk sensitive liabilities in long term maturity bucket and therefore interest rate changes has affect on them.

5.3 Recommendation

Based on the conclusion drawn earlier, the following recommendations have been forwarded to improve the financial performance of NSBI and MBL.

5.3.1 The capital adequacy of both banks is adequate so it is recommended keeping it up to met NRB benchmark.

5.3.2 Although NSBI has decreasing the proportion of nonperforming loans to total loans during the study period, the bank is advised to give more attention to decrease the level as it can meet the international standard. Here MBL has increasing trend so the management of MBL has to give serious attention towards the recovery and timely follow up of the disbursed loan. It is recommended to formulate powerful loan recovery committee.

5.3.3 Adequate loan loss provisions protect the bank from the danger of consequences arising from the conversion of loan into bad loan. NSBI has not made adequate provision for substandard loan, doubtful loan and loss loan as prescribed by NRB. Hence, it is recommended keeping adequate provision for NPAs as per NRB requirement in all the years of study period. MBL is recommending keeping up this provision.

5.3.4 Here operating expenses ratio of NSBI is in fluctuating trend and MBL is in increasing trend. So they should improve the ratio of total expenses to total revenue and to move towards cost minimization and cost efficiency. This is mainly recommended to MBL. Earning per employee may be decrease due to overstaffing so necessary corrective actions should be implemented.

5.3.5 The earnings ratio of bank like ROE, ROA, earning per share and profit margin of NSBI is on both increasing and decreasing but MBL has decreased this ratio rapidly so it is recommend to improve in this level. Every bank maintains their position in competitive environment to need increase profitability.

5.3.6 Loan maturity and sale of investments also provide liquidity so it is recommended that both banks should give attention to quality loan and investment on treasury bills and Government bonds as well as it should follow NRB directives in maintaining the NRB balance and cash in vault. It is also recommended to NSBI that it need to invest for proper utilization of ideal fund because its loan to deposit ratio is in decreasing trend.

5.3.7 The bank’s short-term net financial assets are highly sensitive to interest rate risk as the CGAP ratio to earning assets is high. Since, positive CGAP is beneficial when interest rates are expected to rise and conversely negative CGAP is beneficial when interest rates are expected to fall, the bank should minimize the mismatch of short-term risk sensitive assets in order to minimize sensitivity to prevailing falling interest rates scenario.

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APPENDIX 1

List of Commercial Banks in Nepal

S.N.	Names of Banks	Operation Date (in A.D.)
1	Nepal Bank Limited	1937/11/15
2	Rastriya Bankjya Bank	1966/01/23
3	Nabil Bank Limited	1984/07/16
4	Nepal Investment Bank Limited	1986/02/27
5	Standard Chartered Bank Nepal Limited	1987/01/30
6	Himilayan Bank Limited	1993/01/18
7	Nepali SBI Bank Limited	1993/07/07
8	Nepal Bangladesh Bank Limited	1993/06/05
9	Everest Bank Limited	1994/10/18
10	Bank of Kathmandu Limited	1995/03/12
11	Nepal Credit and Commerce Bank Limited	1996/10/14
12	Lumbini Bank Limited	1998/07/17
13	Nepal Industrial and Commercial Bank Limited	1998/07/21
14	Machhapuchchhre Bank Limited	2000/10/03
15	Kumari Bank Limited	2001/04/03
16	Laxmi Bank Limited	2002/04/03
17	Siddhartha Bank Limited	2002/12/24
18	Argiculture Development Bank Limited	2006/03/16
19	Global Bank Limited	2007/01/02
20	Citizens Bank International Limited	2007/06/21
21	Prime Commercial Bank Limited	2007/09/24
22	Sunrise Bank Limited	2007/10/12
23	Bank of Asia Nepal Limited	2007/10/12
24	DCBL Bank Limited	2008/05/25
25	NMB Bank Limited	2008/06/02
26	KIST Bank Limited	2009/05/07
27	Janata Bank Limited	2010/04/05
28	Megha Bank Limited	2010/07/23
29	Commerz and Trust Bank Limited	2010/09/20
30	Civil Bank Limited	2010/11/26
31	Century Bank Limited	-

Source: Banking and Financial Statistics (nrb.org.np).

APPENDIX 2

Comparative Balance Sheet of NSBI

S.N.	Capital & Liabilities	2063	2064	2065	2066	2067
1	Share Capital	640236100	647798400	874527840	847527840	1861324239
2	Reserve & Funds	342137628	515492451	838079355	838079355	589229831
3	Debentures & Bonds	200000000	200000000	200000000	200000000	200000000
4	Borrowings	612428650	815365219	1627480190	727466283	-
5	Deposits	11002040633	11445286030	13715394960	27957220794	34896424201
6	Bills Payable	46283743	48855749	75115471	62947325	72368229
7	Proposed & Dividend Payable	35469706	91024235	12228852	24904649	83080145
8	Income Tax & Liabilities	-	-	-	-	-
9	Other Liabilities	157287664	137378475	142581889	231535550	345252820
	Total	**13035839124**	**13901200559**	**17187446174**	**30916681796**	**38047679465**
	Assets					
1	Cash Balance	244187671	287530644	308101599	652027266	815679624
2	Balance with NRB	626123385	556678464	403810203	444138596	1842802239
3	Balance with Bank /FIs	247847352	278481119	631048524	807740259	782779614
4	Money at Call & Short Notice	215000000	350000000	304012877	-	-
5	Investment	3758975484	2659452919	3088886918	13286181660	16305632805
6	Loan, Advances and Bills Purchase	7626736137	9460450701	12113698428	15131747944	17480548194
7	Fixed Assets	66711798	97218804	120222259	253580695	418244760
8	Non Banking Assets	24555992	3847024	-	-	-
9	Other Assets	225701305	207540884	217665366	341265376	401992219
	Total	**13035893124**	**13901200559**	**17187446174**	**30916681796**	**38047679465**

APPENDIX 3

Comparative Balance Sheet of MBL

S.N.	Capital & Liabilities	2063	2064	2065	2066	2067
1	Share Capital	715000000	821651300	901339300	1479269600	1627196560
2	Reserves and Funds	216091357	178613335	262007658	220928496	146314335
3	Debentures & Bonds	-	-	-	-	-
4	Borrowings	131675197	228504143	88508134	-	150000000
5	Deposits	7893297672	9475451509	11102242263	15596790845	18535917002
6	Bills Payable	11365096	21482435	10311152	24444914	15402039
7	Proposed & Dividend Payable	5644736	4313669	8648961	112000	-
8	Income Tax & Liabilities	10462066	7372338	3037499	11764730	-
9	Other Liabilities	86294276	70228177	122453259	157471516	203960891
	Total	**9069830401**	**10807616906**	**12498548226**	**17490782101**	**20678790827**
	Assets					
1	Cash Balance	280421338	385940398	560317358	743198824	1049326707
2	Balance with NRB	489090529	785688815	893295419	1755982425	1094664194
3	Balance with Bank /FIs	44412070	112450972	134950855	267467867	315726516
4	Money at Call & Short Notice	718474521	694000000	70000000	-	661564400
5	Investment	1190829823	1278468559	1442550561	1246158653	2096792294
6	Loan, Advances and Bills Purchase	6068427449	7129891542	8642323375	12516012116	14289792667
7	Fixed Assets	104943331	259532932	535886142	664158227	732291377
8	Non Banking Assets	12532613	3392500	-	4500000	-
9	Other Assets	160698727	158251188	218224516	293303989	438632672
	Total	**9069830401**	**10807616906**	**12498548226**	**17490782101**	**20678790827**

APPENDIX 4

Profit and Loss A/C of MBL

S.N.	Particulars	2063	2064	2065	2066	2067
1	Interest Income	563362314	694482220	796597182	1041473434	168861799
2	Interest Expenses	288661549	397721715	407919238	580036192	1144808132
	Net Interest Income	**274700765**	**296760505**	**388677943**	**461437242**	**543809864**
3	Commission and Discount	33401892	34305033	35616247	38017284	49903864
4	Other Operating Incomes	13690769	49039122	30072127	57135632	60633751
5	Exchange Fluctuation Incomes	35152377	29036308	45699321	59817534	42695330
	Total Operating Income	**356945803**	**409140968**	**500065368**	**616407692**	**697042823**
6	Staff Expenses	43410162	54360310	71421059	90995685	152113212
7	Other Operating Expenses	85924280	104181243	124408422	182841039	223469557
8	Exchange Fluctuation Loss	-	1893202	-	-	-
	Operating Profit before provision for possible loss	**227611361**	**248706213**	**304236157**	**342570968**	**321460054**
9	Provision for possible losses	34702543	157606056	264487054	258938624	335040855
	Operating profit	192908815	91100157	39749102	83632344	(13580801)
10	Non operating Income/Loss	(9271)	462175	(48159)	24267	-
11	Provision for possible loss written back	20149478	48185458	135405358	110738300	117796398
	Profit from Regular Operation	**213049022**	**139747790**	**175106301**	**194394920**	**104215597**
12	Profit/Loss from extra-ordinary activities	(1529961)	(14319071)	38000	(500188)	9970320
	Net Profit after considering all activities	**211519061**	**125428719**	**175144301**	**193894732**	**114185917**
13	Provision for Staff Bonus	19229005	11402611	15922209	17626794	10380538
14	Provision for Income Tax	59293347	39940461	74206090	53016840	30492580
	*Current year's	57910630	39940461	49847336	49172404	32348414
	*Previous year's	382717	-	16498811	-	-
	Deferred Tax	-	-	7859943	3844436	(1855834)
	Total	**133966709**	**74085647**	**85061002**	**123251098**	**73312799**

APPENDIX 5

Profit and Loss A/C of NSBI

S.N.	Particulars	2063	2064	2065	2066	2067
1	Interest Income	708718614	831116781	970512681	1460445686	2269704291
2	Interest Expenses	334770096	412261744	454917713	824700275	1443693573
	Net Income Income	**373948518**	**514855037**	**515594968**	**635745411**	**826010718**
3	Commission and Discount	40753985	52591560	50917830	78836624	131692149
4	Other Operating Incomes	7136575	12601352	19557259	52790137	78796662
5	Exchange Fluctuation Incomes	43060315	49463539	51989275	61294299	70328247
	Total Operating Income	**464899393**	**533511488**	**638059332**	**828666471**	**1106827776**
6	Staff Expenses	50539528	53232464	74890269	121989160	130336536
7	Other Operating Expenses	99214082	120111581	152379842	223965592	343850266
8	Exchange Fluctuation Loss	-	-	-	-	-
	Operating Profit before provision for possible loss	**315145783**	**360167443**	**410789221**	**482711719**	**632640974**
9	Provision for possible losses	146656796	59376948	57463909	40345336	62350544
	Operating profit	168488987	300790495	353325312	442366382	570290430
10	Non operating Income/Loss	(2926272)	(256759)	(271006)	2516407	2552892
11	Provision for possible loss written back	54177763	78515105	29782580	198672788	56621276
	Profit from Regular Operation	**219740478**	**379048841**	**382836886**	**643555578**	**629464598**
12	Profit/Loss from extra-ordinary activities	-	-	-	(15622082)	(37266000)
	Net Profit after considering all activities	**219740478**	**379048841**	**382836886**	**487334750**	**592198598**
13	Provision for Staff Bonus	19976407	34458986	34803353	44303159	53836236
14	Provision for Income Tax	82762098	89681011	100262775	126658096	146620243
	*Current year's	66120456	86704011	105745947	133123502	183015350
	*Previous year's	16641642	2977000	870463	2582900	(28395565)
	Deferred Tax	-	-	(6353635)	(9048306)	(7999542)
	Total	**117001973**	**254908844**	**247770758**	**316373495**	**391742119**

APPENDIX 6

Operating Income of NSBI

Particulars	2063	2064	2065	2066	2067
Interest Income	708718614	831116781	970512681	1460445686	2269704291
Commission & Discount	40753985	52591560	50917830	78836624	131692149
Other Operating Income	7136575	12601352	19557259	52790137	78796662
Exchange Fluctuation Income	43060315	49463539	51989275	61294299	70328247
Total	**799669489**	**945773232**	**1092977045**	**1653366746**	**2550521349**

APPENDIX 7

Operating Expenses of NSBI

Particulars	2063	2064	2065	2066	2067
Interest Expenses	334770096	412261744	454917713	824700275	1443693573
Staff Expenses	50539528	53232464	74890268	121989160	130336536
Other Operating Expenses	99214082	120111581	152379842	223965592	343850266
Provision for possible loss	146656796	59376948	57463909	40345336	62350544
Total	**631180502**	**644982737**	**739651733**	**1211000363**	**1980230919**

APPENDIX 8

Operating Income of MBL

Particulars	2063	2064	2065	2066	2067
Interest Income	563362314	694482220	796597182	1041473434	1688617996
Commission & Discount	33401892	34305033	35616247	38017284	49903878
Other Operating Income	13690769	49039122	30072127	57135632	60633751
Exchange Fluctuation Income	35152377	29036308	45699321	59817534	42695330
Total	**645607352**	**806862683**	**907984877**	**1196443884**	**1841850955**

APPENDIX 9

Operating Expenses of MBL

Particulars	2063	2064	2065	2066	2067
Interest Expenses	288661549	397721715	407919238	580036192	1144808132
Staff Expenses	43410162	54360311	71421059	90995685	152113212
Other Operating Expenses	85924280	101467631	124408422	182841039	223469557
Exchange Fluctuation Loss	-	1893202	-	-	-
Provision for Possible Loss	34702546	157606056	264487054	258938124	335040855
Total	**452698537**	**71304895**	**868235773**	**1112811540**	**1855431756**

APPENDIX 10

Liquid Assets of MBL

Particulars	2063	2064	2065	2066	2067
Cash in hand	280421338	385940398	560317358	743198824	1049326707
Balance with NRB	489090529	785688815	893295419	1755982425	1094664194
Balance with Bank/FIs	44412070	112450972	134950855	267467867	315726516
Money at Call	718474521	694000000	70000000	-	661564400
Government of Nepal Treasury Bill	904471865	951272430	827351580	477814030	1896481708
Government of Nepal other Securities	-	-	-	-	-
Total	**2436870323**	**2929352615**	**2485915212**	**3244463146**	**5017763525**

APPENDIX 11

Liquid Assets of NSBI

Particulars	2063	2064	2065	2066	2067
Cash in hand	244187671	287530644	308101599	652027266	815679624
Balance with NRB	626123385	556678464	403810203	444138596	1842802239
Balance with Bank/FIs	247847352	278481119	631048524	807740259	782779614
Money at Call	215000000	350000000	304012877	-	-
Government of Nepal Treasury Bill	3473598064	2227404516	2762828586	2933848660	3720592315
Government of Nepal other Securities	118175000	118175000	272725000	372725000	592725000
Total	**4924931427**	**3818269743**	**4682526789**	**5210479781**	**7754578792**