FINANCIAL PERFORMANCE EVALUATION OF API FINANCE LIMITED IN THE FRAMEWORK OF CAMELS

By:

Yashodha Koirala
Prithivi Narayan Campus
Roll No: 12/2066
T. U. Registration No: 7-2-295-184-2006

A Thesis Submitted to:

Office of the Dean
Faculty of Management
Tribhuvan University

In partial fulfillment of the requirements for the degree of

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

Pokhara
March, 2014

RECOMMENDATION

This is to certify that the thesis

Submitted by:

Yashodha Koirala

Entitled

FINANCIAL PERFORMANCE EVALUATION OF API FINANCE LIMITED IN THE FRAMEWORK OF CAMELS

has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

Supervisor	Head of Department
Name: **Prof. Keshar J. Baral, PhD**	Name: **Prof. Dr. Puspa Raj Sharma**
Signature:	Signature:

Campus Chief

Name:

Signature:

Date:

VIVA VOCE SHEET

We have conducted the viva-voce examination of the thesis

Submitted by:

Yashodha Koirala

Entitled

FINANCIAL PERFORMANCE EVALUATION OF API FINANCE LIMITED IN THE FRAMEWORK OF CAMELS

and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirements for degree of

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

Viva-Voce Committee

Chairperson, Research Committee: ……

Member (Thesis Supervisor): ……

Member (External Expert): ……..

Date:

ACKNOWLEDGEMENTS

I would like to express my gratitude to all the people who have been a part of the process in developing this Master Dissertation. It is a matter of great pride for me to express my sincere gratitude to the Research and Viva Voce Committee, Department of Management, Tribhuwan University, Prithivi Narayan Campus, Pokhara, Nepal and Office of the Dean, Faculty of Management, Tribhuvan University for providing me an opportunity to present a thesis on the topic of ***Financial Performance Evaluation of Api Finance Limited in the Framework of CAMELS.***

First of all, I would like to thank to my GURU and supervisor, Professor Keshar J. Baral, PhD, for giving his valuable time and knowledge, for the comments and feedback throughout the study. This research work would not come out in the present shape without his guidance and counseling.

I owe a great-debt of thanks to Professor Dr. Puspa Raj Sharma, and Head of Department of Management Research, Tribhuwan University, Prithivi Narayan Campus, Pokhara who continuously encouraged me with cordial environment while attending the lectures and gave suggestions whenever I was in need of help. I am also thankful to all the respected teachers of Faculty of Management, Tribhuwan University, Prithivi Narayan Campus, Pokhara, for their invaluable suggestions and encouragement for the completion of this study.

I extend my deepest thanks to the Api Finance Limited, Pokhara, Kaski for providing me the valuable information and annual reports, without which the present research work, would not have been materialized. Likewise, I am also indebted to Mr. Bijendra Sharma, Branch Manager of Tudhikel Branch, Pokhara-1 and Mr. Madhav Adhikari, Branch Manager of Abukhairani Branch, Tanahun of Api Finance Limited for thier kind cooperation and help in data collection of the study.

Finally, I am very indebted to my family members for their regular inspiration and encouragement in preparing this thesis. I would like to thanks my husband, Mr. Rajendra Adhikari for word processing, typing and setting.

Yashodha Koirala

Date:

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ACRONYMES

ANOVA	Analysis of Variance
BOK	Bank of Kathmandu
CAMELS	Capital, Assets, Management, Earnings, Liquidity, Sensitivity
CBOs	Community Based Organizations
CEDA	Centre for Economic Development and Administration
CGAP	Cumulative Gap
FIs	Financial Institutions
FY	Fiscal Year
GDP	Gross Domestic Product
HBL	Himalayan Bank Limited
ISR	Interest Sensitivity Ratio
MBL	Machhapuchhare Bank Ltd.
NGOs	Non-governmental Organizations
NIC	Nepal Industrial and Commercial Bank Ltd.
NII	Net Interest Income
NIM	Net Interest Margin
NRB	Nepal Rastra Bank
OCL	Oriental Co-operative Limited
PACRA	Pakistan Credit Rating Agency
ROA	Return on Assets
ROE	Return on Equity
RSA	Rate Sensitive Assets
RSL	Rate Sensitive Liabilities
RWA	Risk Weighted Assets
SFCL	Small Farmers Cooperative Limited

CHAPTER I

INTRODUCTION

1.1 General Background of the Study

A modern financial system is important in the economy in order to pool and utilize financial resources, reduce costs and risks, expand and diversify opportunities, increase the allocative efficiency of resources and promote the productivity and facilitate the economic growth. As a country's financial sector develops and becomes more efficient, it enables individuals and institutions to channel savings to more productive enterprises. This offers the prospect of significant growth in GDP. Hence, while a sound and healthy financial system contributes to the growth of the real sector on a sustainable basis, uncertainty and fragility in the financial system adversely affect the objectives of economic development in general and poverty reduction in particular, as witnessed by the experiences of the financial crises of the 1990s (Pant, 2009).

Financial sector of an economy plays an important role in its economic development and prosperity of the country. Banking and financial industry serves as the backbone of the financial sector that accumulates saving from surplus economic units in the form of deposits and provides it to deficit economic units in the form of advances. Banking industry provides support to economy and industries in specific in the time of recessions and economic crisis.

The financial sector in Nepal is just developing and mushrooming day by day. Recently, there has been a proliferation of formal financial institutions in Nepal. Also, the informal financial institutions, such as Guthis, moneylenders, and Dhikuri are in operation in the rural, and, to a limited extent, in the urban areas since long. Furthermore, the financing institutions have been expanding in the country since the 1990s. The developing and mushrooming of financial institutions in central as well as

local level has meeting financial needs of the local people in their respective locations.

Today's world is the world of business; it is moving very fast, coping with various ups and downs. There is competition in every field. The business generates money to further invest in various securities. The savings of the people are also invested to generate money. Thus, it is one of the most common and crucial place for business persons, individuals, households and stakeholders in financial institutions (Devkota, 2008).

There has been a sizable increase in financial institutions after the introduction of financial sector reform or economic liberalization since the mid-eighties. Before 1980 there were only two commercial banks and two development banks providing banking services to the firms and individuals. However, the growth of financial sector in terms of the emergence of financial entities during the last two decades witnessed remarkable progress. The role of private sector in the financial intermediation and financial market development has become quite significant over the years. Such achievement has increased the number of financial institutions and also the beneficiaries of the financial services so that firms and individuals have better access to the credit market (CEDA, 2007).

Financial development contributes to the economic development of the country. It also plays a fundamental role in promoting industrialization by mobilizing finances of severs. Financial development is also contributes to reducing poverty, by access to finances so that the poorer segment of the society will also benefit. The development of the formal financial institutions with a good system not only benefits the rich but also the poor. Besides, a sound public finance system, a stabilized currency is the means to the development of the private financial institutions within the country. In Nepal, the financial sector represents both banking sector and nonbanking sector. The banking sector consists of the Nepal Rastra Bank (NRB) the Central Bank and all the commercial banks operating within the country and is classified under 'A' category of financial institutions. The nonbanking sector consists of development banks, finance companies, micro-credit development banks, saving and credit cooperatives; and non-governmental organizations (NGOs) performing limited banking activities. Besides, other financial institutions such as insurance companies, employee's provident fund,

citizen investment trust, and other financial institutions not licensed by the NRB such as postal savings bank, microfinance institutions, cooperative societies, community based organizations (CBOs) and the Nepal Stock Exchange are also included under the category of the nonbank financial institutions in Nepal. The World Bank has classified the nonbank financial institutions as Investment Institutions, Merchant Banks, Contractual Savings Institutions (life insurance companies, mutual funds and pension funds), Securities Market, Specialized Financial Institutions (Leasing Financiers and Real Estate Financiers) and Financial Cooperatives. However, the Nepal Rastra Bank (NRB) has classified it as Development Banks, Financial Companies, Microfinance Institutions, NRB licensed cooperatives and the NGOs (CEDA, 2007).

Performance evaluation is the important approach for enterprises to give incentive and restraint to their operators and it is an important channel for enterprise stakeholders to get the performance information (Sun, 2011; Jha and Hui, 2012). The performance evaluation of a financial institution is usually related to how well the institution can use its assets, shareholders' equities and liabilities, revenues and expenses. The performance evaluation of finance is important for all parties including depositors, investors, bank managers and regulators. This study deals with the performance of financial Institutions (FIs), especially API Finance Ltd. The FIs are also an important subsector for the efficient functioning of the economy of Nepal.

Currently, financial ratios are often used to measure the overall financial soundness of a bank and the quality of its management. Bank regulators, NRB, for example, use financial ratios to help evaluate a bank's performance as part of the CAMEL system. Evaluating the economic performance of banks, however, is a complicated process. A number of variables such as profits, liquidity, asset quality, attitude toward risk, and management strategies must be accounted for. The changing nature of the banking industry has made such evaluations even more difficult, increasing the need for more flexible alternative forms of financial analysis (Yue, 1992; Thagunna & Poudel, 2013). Therefore, the performance of the financial institution is evaluated on the basis of CAMELS framework.

1.2 Focus of the Study

Economic prosperity is a symbol of success of a country. Soundness of an economy is achieved through positive macroeconomic indicators that become possible via bringing together and proper utilization of country resources such as financial, informational, physical and human resources, etc. Banking and financial sectors of an economy is an important constituent of financial sector of a country that facilitates proper utilization of financial resources.

Analysis of the financial performances of financial institution is very crucial and important factor for the successful management of such financial institution. Thus, the research will focuses how well the API Finance can use assets. The research will also focus on the financial performance of API Finance in the framework of internationally recognized bank's rating system known as CAMELS such as capital adequacy, asset quality, management, earnings, liquidity and sensitivity of market risk. Randomly API Finance was taken as a sample for this study among the eleven financial institutions in Pokhara Sub-metropolis. In any economy, the importance of financial sector in general, and banking sector in particular cannot be undermined. The banking and financial sector plays vital role in the overall development of an economy of Nepal. The economic reform has more impact in Nepalese financial and banking sector. These sector has been going through major changes in regularity framework, alteration in ownership pattern and liberalization of inters and exchange rates while these changes have positively affected the financial sector as well as increases the competition due to mushrooming of various financial institutions. Thus, the study focused on strengths and weakness of the financial performance of API Finance. This study also focused on the position of the API Finance and its viability and capability. Finally, the research focused to measures of the API Finance's overall financial health over a given period of time.

1.3 Statement of the Problem

The mushrooming of financial firms–commercial banks, development banks, and finance companies – is cosmetic rather than of any substance; and their population raises the concern for efficiency and innovation (CEDA, 2007) as well as performance. The main challenge in financial institution is how to pragmatically

utilize the available deposits and use the assets. Thus, the study is trying to evaluate the performance of Api Finance Ltd. in the framework of CAMELS.

Highlights of banking sector in Nepal that are presented above show growth of the banking industry over the last few years. Performance of several other financial sectors of the region and world shows contrary results. In the present political and economic chaos in the country it is of great significance to analyze and evaluate fragile banking and financial sector of Nepal. As a result of globalization of financial markets financial and banking institutions face today a fast paced, dynamic and a competitive environment at the global scale. Within such a competitive environment, financial institutions are forced to examine their performance because their survival in the dynamic economics of twenty-first century will be dependent upon their productive efficiencies and sound performance. It is very important to analyze the performance of financial institutions of Nepal.

The performance of the banks and financial institutions can be gauged by considering the sources and use of funds. The components under the sources or the liabilities are capital fund, deposits, borrowings and other liabilities. In the same manner, the uses of funds (or the assets side) comprises of liquid funds, investment, and loan and advance and other assets. Therefore, the performance of the financial institutions is evaluated on the basis of CAMELS framework. Organizations that build a financial sector are run mostly by the public money, so it is very important to measure their performance.

The CAMELS method is commonly used for the evaluation of performance and ranking. The CAMELS assesses the performance based on capital adequacy, asset quality, management competency, earnings, liquidity and sensitivity of market risk. In general, the study analysis and evaluate the financial performance of API Finance using the result of CAMELS method. The general problem towards which the study is directed is to investigate and analyze the financial performance of Api Finance Ltd. Base on this fundamental problem the following specific problems are set in this study:

i. What is the capital adequacy ratio of the Api Finance Ltd.?
ii. What is the quality of assets of the Api Finance Ltd.?

iii. How efficient is the management of the Api Finance Ltd.?
iv. Do the earning indicators show the performance of the Api Finance Ltd.?
v. What is the liquidity position of the Api Finance Ltd.?
vi. What are the sensitivity risks of market of the API Finance?

1.4 Objectives of the Study

The general objective of this study is to analyze and evaluate the financial performance of API Finance in the CAMELS framework such as capital adequacy, asset quality, management, earnings, liquidity and sensitivity of market risk. The specific objectives of the study are as follows:

i. To analyze the capital adequacy of the API Finance.
ii. To evaluate the quality of the API Finance's assets.
iii. To examine the efficiency of the API Finance's management.
iv. To assess the earning performance of the API Finance.
v. To analyze the liquidity position of the API Finance, and
vi. To analyze the sensitivity risks of market of the API Finance.

1.5 Significance of the Study

Banking sector is an important and unquestionable determinant of the economic development of the country. Banking and financial industry being an important pillar of financial sector of an economy, its performance measurement is very essential and useful. The financial performance evaluation issues are becoming an interest and hot cake to the business person, administrators, investors, owners, managers, scholars, professionals, planners, policy makers, development agents, and even everyone in recent years throughout the world as well as in Nepal. The researcher hope this study will be useful not only for those mentioned above but to all those who wish to develop their business. And such a study in performance evaluation and analysis may also be equally important for all those interested in similar studies in the context of other business areas also.

It is expected that this study has some academic as well as practical significance. The findings of this study may also be useful for future research and researcher to carry

out the financial studies on the issues concerned with CAMELS framework. The study will be useful to administrators, managers, planners and policy maker. Similarly, the finding will be helpful in providing some information needed for financial institutions concerned with similar problems. The study will contribute to the improvement of financial institutions' performance as a whole. At last, my research has not only empowered me with new understandings but it can also empower that financial institution which is participating with me.

1.6 Delimitation of the Study

This study has the following some specific delimitation:

i. The study was only take one financial institution i.e. Api Finance Ltd. as the sample of study among the numerous financial institutions available in Nepal. Therefore, it will not represent the overall scenario of all finance institutions.
ii. The study has only covered the five years of period i.e. from fiscal year 2064/65 to 2068/69 BS before merger only.
iii. This study has only confined to the financial performance analysis of the Api Finance Ltd. in the CAMELS framework.
iv. The study was only base on secondary data. That is why the reliability and validity of conclusion of the study was depending upon accuracy of the secondary data.
v. The qualitative and external variables that affect the performance of the Api Finance Ltd. was not considered in the research. Therefore, the results should be interpreted cautiously and not to be generalized widely.

1.7 Organization of the Study

This dissertation report is divided into five chapters. The first chapter discusses the introduction of the study including background of the study, focus of the study, statement of the problem, objectives, significance and delimitations of the study. Pertinent literature has been reviewed in chapter two. This chapter deals with conceptual review including CAMELS Framework and also deals with review of related and previous studies. The research methodology used including the research design, population and sample, nature and sources of data, data collection procedures, data analysis and presentation, data analysis tools, limitation of the methodology, and research gap have

been discussed in the third chapter. The fourth chapter deals with data presentation and analysis. The fourth chapter presents, examines and analyzed the gathered data from different sources using facts and figures. This chapter also deals with the major findings of the study. In the last chapter, the summary, conclusion and recommendation are presented.

CHAPTER II

REVIEW OF LITERATURE

This chapter is mainly concerned with the literature review pertinent to the financial performance analysis of financial institutions. This chapter deals with conceptual overview. On the other hand, it also reviews empirical studies on financial performance analysis using CAMELS framework. It mainly deals with previous studies, research articles, dissertation and other related materials.

2.1 Conceptual Review

This section presents the conceptual aspects of the study. It includes the concept of banking and financial institutions, historical development of banking and financial institutions in Nepal, functions of financial institutions, bank and financial institutions acts and role of NRB towards financial institutions, methods of bank supervision and monitoring system, approaches to financial performance analysis, CAMELS framework, and composite rating.

2.1.1 Concept of banking and financial institutions

Financial sector is the backbone of economy of a country. It works as a facilitator for achieving sustained economic growth through providing efficient monetary intermediation. A strong financial system promotes investment by financing productive business opportunities, mobilizing savings, efficiently allocating resources and makes easy the trade of goods and services. Several studies (McKinnon, 1973; Levine, 1997; Jha & Hui, 2012) have reported that the efficacy of a financial system to reduce information and transaction costs plays an important role in determining the rate of savings, investment decisions, technological innovations and hence the rate of economic growth (Jha & Hui, 2012).

In Nepal, financial sector is composed of banking and non banking sectors. Banking sector comprises Nepal Rastra Bank and commercial banks. The non banking sector includes development banks, finance, companies, microcredit development banks, cooperative financial institutions, nongovernmental organizations performing limited banking activities and other investment trust, postal saving offices and Nepal Stock Exchange (NRB, 2007; Shrestha, 2010`

Financial institutions perform their activities as intermediaries in the financial market. They cater the need of depositors and borrowers by efficiently channelising the fund from surplus to deficit units. While satisfying various financial needs of customers, they offer proliferated financial services and thereby create economic value. Nepalese financial sector comprises of both banks and other non-bank financial institutions. Due to the liberal licensing policy adopted by Nepal Rastra bank, there are growing numbers of development banks and finance companies. Besides, there are micro-credit development banks, co-operatives, NGOs and postal saving offices that undertake limited banking and near banking financial services. Non-bank financial sector comprises saving funds and trusts like Employee Provident Fund, Citizen Investment Trusts and insurance companies. Nepalese financial system is largely dominated by commercial banks. Financial sector in Nepal has shown better performance relative to other sectors in the economy. Despite the long socio-political imbalances in the country, financial sector has left with some landmarks in the overall development of the country. Furthermore, the economic reforms initiated by the Government in 1990s have changed the landscape of several sectors of the Nepalese economy. As a result, several banks and financial institutions have been providing financial services across the country (NRB, 2009).

2.1.2 Historical Development of Banking and Financial Institutions in Nepal

The history of financial system of Nepal was begun in 1937 with the establishment of the Nepal Bank Ltd. as the first commercial bank of Nepal with the joint ownership of government and general public. Nepal Rastra Bank was established after 19 years since the establishment of the first commercial bank. A decade after the establishment of NRB, Rastriya Banijya Bank, a commercial bank under the ownership of Government Nepal was established (NRB, 2013).

Nepal Rastra Bank (NRB) was established in 1956. The Central Office and Banking Office of the Bank are located in Kathmandu. It has seven other offices outside Kathmandu Valley. The NRB Act, 2002, which has granted more autonomy to the NRB, came into effect since 31 January 2002, replacing the NRB Act, 1955. In the new Act, the maximum limit for government overdraft borrowing from NRB has been fixed at 5% of the preceding year's net government revenue. The new Act has also given autonomy to NRB to choose the appropriate exchange rate regime. Additionally, the new Act includes a definite procedure for the appointment and dismissal of the Governor. It has also upgraded the positions of the two Deputy Governors to be voting members of the Board. All these provisions in the new Act have enhanced the degree of independence of NRB (NRB, 2010).

The central bank, the Nepal Rastra Bank (NRB), has been in operation since the early 1956 (established on 26th April 1956). It manages the money supply and the monetary policy of Nepal, subject to the financing requirements of the government, and is responsible to maintain price stability, and to promote sustainable economic growth. It is also entrusted with the responsibility of managing the foreign exchanges. However, it has a fixed exchange rate system with India rupee, which is aligned with the US$ but operates with the market mechanism for other currencies. It pursues banking policies and regulates credit creation through the conventional monetary instruments-the reserve ratio, benchmark interest rate, and open market operations through sells or purchases of securities, i.e. government bills and bonds. In addition, the NRB provides banking services to the government and commercial banks (inclusive of interbank transactions), undertakes supervision of the financial system, and renders, last but not least, advisory services to the government on monetary and financial policies (CEDA, 2007).

The modern commercial banking was introduced in 1938 with the establishment of the Nepal Bank Limited (NBL). The establishment of the Rastriya (national) Banijya (commerce) Bank (RBB) in 1966 was to promote banking further to semi-urban and rural areas of Nepal. The participation of foreign banks through joint –ventures begun since 1984 when the Nabil Bank was created. Then there came Nepal indo-Suez Bank

in 1985 and Nepal Standard Chartered Bank in 1987. The mushrooming of banks did happen since the early 21st century (CEDA, 2007).

The history of the finance companies began with the establishment of the Nepal Housing Development Finance Company Limited in 1992. In addition to the private banks, there are 73 private finance companies operating in Nepal. These institutions have all commenced operations over the past six years since the Finance Company Act was promulgated. The Act permits these companies to offer installment credit for the purchase of vehicles, equipment, or durable household goods, for purchase or construction of residential buildings, for leasing financing, and for operating industrial, commercial or other enterprises. Majority of the finance companies have their corporate offices in the Kathmandu Valley, and a very few are operating outside the Valley (CEDA, 2007).

Finance companies are those intermediaries, which link the savers and users of capital. They collect small and scattered saving of the individuals and mobilize it in the productive sectors in the form of investment or loan. Previously Finance Company Act, 2042 used to govern finance companies in Nepal. After that, the Bank and Financial Institutions Ordinance, 2004 governs all types of banks and financial institutions (Upadhyay, 2004). In this way, the process of establishing finance companies began after the first amendment of the Finance Companies Act, 1986 in 1993. Now, the companies are operating as “C” class financial institutions under the Bank and Financial Institutions Act, 2006 (NRB, 2012).

Present Status of Banking and Financial Institutions of Nepal

A strong financial system promotes economic growth, mobilizes and allocates resources efficiently, establishes efficient payment system and effective transmission mechanism, makes capital more productive and creates employment opportunities. It reduces vulnerability to financial crisis and lowers the economic and social costs of financial disruption (NRB, 2012).

The financial system in Nepal comprises bank and financial Institutions (commercial banks, development banks, finance companies and micro finance institutions), co-operatives, contractual saving institutions, (Employee Provident Fund and Citizen

Investment Trust), insurance companies and postal saving banks. At the end of 2011/12 the number of financial institutions stood at 293 comprising 265 banks and financial institutions licensed by NRB, 25 insurance companies, one Employees Provident Fund, one Citizen Investment Trust and one Postal Saving Bank (NRB, 2012).

The number of finance companies decreased to 69 in mid-July 2012 from 79 in previous year. The merger of 7 pairs of finance companies and up-gradation of one finance company to development bank is the primary reason behind the reduction in the number of finance companies. As of mid July 2012, there were altogether 292 branches of finance companies operating in the country (NRB, 2012).

Table: 2.1

Number of Banks, Financial Institutions and Other Institutions

Banks and Financial Institutions	**Mid-July 2012**
Commercial Banks	31
Development Banks	86
Finance Companies	59
Micro-Finance Development Banks	31
Saving & Credit Cooperatives Limited Banking Activities	15
NGOs (Financial Intermediaries)	31
Total	**253**

Source: Banking and Financial Statistics, NRB, No 59, Mid-July, 2013, p 2

By the end of mid-July 2013, altogether 253 banks and non- bank financial institutions licensed by NRB are in operation. Out of them, 31 are "A" class commercial banks, 86 "B" class development banks, 59 "C" class finance companies, 31 "D" class micro-credit development banks, 15 saving and credit co-operatives and 31 NGOs. In mid- July 2013, the total banks branches reached to 3,138 with the population of eight thousand four hundred and forty three per branch (NRB, 2013). Nepalese banking system has now a wide geographic reach and institutional diversification. The total number of finance companies decreased to 59 in Mid - July

2013 from 69 in Mid - July 2012. The decrease in significant number of finance company is observed due to the merger and up gradation.

Merger

The total of 27 Banks and Finance companies merged and formed 11 BFIs in the FY 2012/13. During the period, two commercial banks namely Nepal Industrial and Commercial Bank Ltd and Bank of Asia Ltd. merged and started operation as NIC Asia Bank Ltd. Similarly, two finance companies namely Prabhu Finance Co. Ltd. and Royal Merchant Banking and Finance Ltd. upgraded to development bank after merger and started operation as Prabhu Bikash Bank Ltd. and Apex Development Bank Ltd. respectively (NRB, 2013).

Api Finance Ltd., Rara Bikas Bank Ltd. and Royal Merchant Banking and Finance Ltd. were merged and upgraded as a national level Apex Development Bank Ltd. The date of operation after merger was 15 July, 2013.

2.1.3 Functions of Financial Institutions

The functions performed by financial institutions such as mobilizing savings of the surplus units of an economy, risk measuring and management activities, complicated transactions being performed by these institutions and evaluation of the business projects all together increase the pace of economic growth.

Financial institutions perform different functions and services. In the contemporary world, banking is assuming wider functions and greater responsibilities in the economic areas; hence, it is not possible to make an exhaustive catalogue of its functions and services. The primary functions of finance companies are to make loan to both individual and business, accept deposits, saving deposit, providing various types of loan, other miscellaneous services, etc. Most importantly, financial institutions are more popular among the low and medium income people of Nepal. Financial institutions should have to perform their activities as prescribed by the NRB directives and according to Banks and Financial Institutions Act, 2006. In the present section, the fundamental functions usually performed by financial institutions are discussed.

2.1.3.1 Acceptance of Deposit's from Public

The primary function of financial institutions is to accept deposits from the public. Banks maintain demand deposits accounts for their customer and convert deposit money into cash and vice-versa at the discretion of the latter. Demand deposits are technically accepted in current accounts which are withdrawn able any time by means of cheques.

Deposits are made in fixed deposit accounts which are withdrawn able only after a specific period. Thus, fixed deposits are time liabilities of the financial institutions. Deposits are also received in saving bank accounts subject to certain restrictions on the amount receivable and withdraw able. This is how banks pool the scattered saving of the community and serve, so to speak as the reservoir of it's saving.

2.1.3.2 Making Loans and Advances

Another major function of financial institutions is to extend loans and advances out of the money which comes to them by way of deposits to businessman and entrepreneurs against approved securities such as gold or silver bullion; government securities, easily saleable stocks and shares and marketable goods. Bank advances to customers may be made in the following ways; i) overdraft ii) discounting bills iii) money-at-call and short notice, loans and iv) Various forms of direct loans to traders and producers. Specifically financial institutions provided the following types of loan.

Hire purchase loan is the main function of financial institutions. In this loan, companies provide loan for the purchase of equipment, machines, vehicles, durable household goods and other property. The loan is provided in installment basis and the interest rate is depends on the situation and act.

Housing loan is another type of loan provided by financial institutions. Finance companies provide loan for the purchase of house, construction of house, purchase of land, etc.

Financial institutions also provided loan against fixed deposit. Such types of loan facility are only provided to the organization or person who has the certain amount on fixed deposit. In such case, the company charges plus two percent interest.

2.1.3.3 General Utility Services

Apart from agency services, the financial institutions also provide general utility services. These are:

Provide locker facility: During the middle ages banks began the practice of holding gold, securities and other valuables owned by their customers in secure vaults. A modern banks are also receives from its customers, valuables such a securities, jewelries, documents of title to goods etc. for safe custody. The bank acts as the custodian of the valuables belonging to the customers. The bank receives them and returns back when demanded. The financial companies charges some rate to the customers while for the massive deposit customers institutions also provided free service.

Assist in foreign trade and business: The bank assists traders engaged in foreign trade of the country. It discounts the bills of exchanges drawn by Nepalese exporters on the foreign importers and enables the exporters to receive money in the currency. Similarly it also accepts the bills drawn by the foreign exporters.

Making venture capital loans: Increasing banks have become actives in financing the start-up costs of new companies, particularly in high-tech industries. Because of the added risk involved in such loans, this is generally through a venture capital firm that is a subsidiary of a bank holding company, and other investors are often brought into share the risk.

Financial advising and statement facility: Bankers have long been asked for financial advice by their customers, particularly when it comes to the use of credit and the saving or investing of funds. Many banks offer a wide range of financial advisory services, from helping financial planning to consulting to business mangers and checking on the credit standing of firms. Financial institutions also provided financial statement to their customers.

Automated teller machines (ATM): Most of the banks and financial institutions have provided the facility to the customer to withdraw money from their accounts through a machine kept in the prime locations of the cities called as ATM in 24 hours basis. This has provided the customers with a facility to withdraw the money when they require it.

Any branch banking service (ABBS): Banks and financial institutions offer account holder of a branch to available some banking services from other branches located at

various parts of the country which is called anywhere branch banking service. This is one of the distinguished features of the modern banking services.

E-banking: Customers may acquire information like, account balance, exchange rate and requisition and may instruct banks to do various jobs over the phone, fax and mobile phone etc.

Credit/ debit card: Banks issue credit cards to highly creditworthy customers. Banks also issue debit card as well. This relieves the customers form carrying cash. Besides these, financial institutions also finance internal and foreign trade, collects statistics about money, banking, trade and commerce and underwrite shares and debentures issued by private companies, offer some of the banking services at the door of highly valued customers. It also guarantees to other parties on behalf of its customers to make payment up to a specified sum of money to the beneficiary on demand in case of default by its customers. In modern context, financial institutions and bank also provided the remittance services too.

2.1.4 Bank and Financial Institutions Acts and Role of NRB towards Financial Institutions

The bank and financial policy was developed by policy making body of NRB. The Board of Directors, which consists of the Governor as Chairman, Finance Secretary, two Deputy Governors, and three independent Directors, appointed by the Government of Nepal from amongst the persons renowned in the field of economics, monetary, banking, finance and commercial Law as Board members, is the policy-making body of NRB.

The NRB Act, 2002, which has granted more autonomy to the NRB, came into effect since 31 January 2002, replacing the NRB Act, 1955. In the new Act, the maximum limit for government overdraft borrowing from NRB has been fixed at 5% of the preceding year's net government revenue. The new Act has also given autonomy to NRB to choose the appropriate exchange rate regime. Additionally, the new Act includes a definite procedure for the appointment and dismissal of the Governor. It has also upgraded the positions of the two Deputy Governors to be voting members of the Board. All these provisions in the new Act have enhanced the degree of independence of NRB (NRB, 2010).

As mandated in the NRB Act, 2002, NRB prepares and publishes the annual monetary policy statement at the beginning of the fiscal year i.e. mid-July. The Bank also prepares and releases the mid-term review of monetary policy. NRB announces its policy and information through its own publications and other public media. It also releases information on other activities through circulars to concerned agencies/institutions. The Bank publishes monthly statements of its accounts (NRB, 2010).

The NRB Act, 2058 has empowered Nepal Rastra Bank to perform regulatory and supervisory activities for the development and sustainability of financial system. NRB issues license to banks and financial institutions to perform banking activities, supervises and monitors their performances, and enforces the actions based on the supervision and inspection reports. Supervisory actions include from capital charges to management takeover and cancellation of licenses as specified in NRB Act (NRB, 2009).

It was the Finance Companies Act, 2042 that governed the operation and limitations of finance companies in 1985. It allowed finance companies to take deposits from the people and institutions and make investment on hire purchase, housing industry, commerce etc. In effect they were allowed to operate as mini banks. Some eight years later the Merchant Banking Act, 2050 allowed certain finance companies that met the regulatory requirements to acquire merchant banking license. As of 2007 data there are 8 non banking financial institutions (NBFI) with merchant banking license. This has been from the beginning till date the only major difference between a commercial bank and finance company in terms of the activities allowed to them. The only areas reserved for the commercial banks are: over drafts, personal loans, foreign exchange except Indian currency, and opening letters of credit. Recently, the finance companies are allowed to transact also in Indian currencies though they are still restricted to transact in other foreign currencies. In order to govern this sector more prudently the Banks and Financial Institutions Act, 2061 (also known as the Umbrella Act) replaced all other earlier acts thus making this the single Act that governs all financial sector players from commercial banks and finance companies. The banks and finance companies are divided into various categories fixing the extent of services based on capital. The players with the highest capital base are commercial banks and they were

given a class “A” category; development banks a class “B” category, finance companies a class “C” category and micro-financing institutions and cooperatives were given a class “D” category. Products and services were allowed according to the class the institution belonged to. Although this has been in line with the principle of prudential regulation factor and it has enabled the Nepal Rastra Bank to incorporate all the formal players in the financial sector under its regulatory jurisdiction, the purpose of making financial services endemic has not materialized. All it has done is that it has divided up the number of players into capital structured groups. The Umbrella Act along with the prudential regulations of the Nepal Rastra Bank has made this sector the most transparent and highly regulated industrial group despite the frequent changes in directives (Pandey, 2009).

NRB's directives and circulars encompass regulations relating to capital, asset quality, liquidity, corporate governance, risk management etc. The objectives of these regulations are to strengthen the health and soundness of the banks and financial institutions, enhance public confidence and ultimately contribute in maintaining stability in the financial system (NRB, 2012).

2.1.5 Methods of Bank and Financial Institutions Supervision and Monitoring System

NRB is the apex authority responsible for financial stability of the nation. NRB is authorized and also responsible for the regulation and supervision of commercial banks and all other financial institutions licensed by it. The Insurance board and Securities Board of Nepal (SEBON) are the regulatory and supervisory authorities for insurance companies and Nepal Stock Exchange limited (only one stock exchange in Nepal, which is owned by the government) respectively.

NRB is the regulator of banks and financial institutions. Its liability and obligation is to promote and maintain the safety, soundness and integrity of the financial system. An important function of a central bank is supervision and monitoring of banks and financial company to find out the solvency position and take corrective action in time when needed. Monitoring system is a check and follow-up system. It conform that suggestion and direction given while supervision are properly conducted or not. Central bank monitors commercial banks and financial institutions after supervision

and inspection. There is a separate monitoring department in Nepal Rastra Bank. Based on the findings of supervision, the supervisory and inspection department gives advice and instructions to the banks and financial institutions to regulate their performances. In order to see whether these advices and instructors have been properly followed or not, bank monitors them. This is conducted through monitoring departments.

All the financial institutions undertaking banking activities are licensed and supervised by NRB. Among the financial intermediaries; commercial banks, development banks, finance companies, micro-finance development banks and other micro-finance institutions that are licensed to perform limited banking activities are under the supervision of NRB. Normally, the supervision and monitoring can be done using on-site and of-site supervision and examination.

As required by Nepal Rastra Bank Act, 2002, NRB has implemented comprehensive inspection manual for conducting examination of banks and financial institutions. The manual covers areas of capital adequacy, loan portfolio management, treasury operation, management information system, and internal control system and information technology. The manual has comprehensively discussed techniques of preliminary review, analytical review, system appraisal, and detailed verification procedures for conducting on site inspection. Manual guides bank examiners on in site inspection procedure and risk concerns in detail on each area of inspection. Well-developed supervision questionnaire helps examiners to focus on relevant area of inspection and widens their vision with regard to specific area (NRB, 2002).

While performing on site examination examiners is required inter-alia to review risks of all kinds inherent in financial business namely credit risk, market risk, liquidity risk, operation risks and management strat3egy to mitigate such risks. Inspectors are also required to perform CAMELS rating of the banks so as to enable effective supervisory planning and policy decisions. As comprehensive review of commercial banks is not possible by examination of transactions at branch level only; corporate level inspection is felt to be more necessary.

Nepal Rastra Bank is focusing its effort towards strengthening off-site supervision with following objectives. The first objective is identifying potential problems of the commercial banks so as to enable supervisory authorities to take appropriate decision within appropriate time. Monitoring compliance of various prudential regulations issued by NRB to ensure long term stability of commercial banks and support and strengthen quality of onsite examination.

To achieve aforesaid objectives, standard formats for periodical reporting of required data by commercial banks have been developed. Data so received from commercial banks are to be analyzed and consolidated off site report is to be prepared. Nepal Rastra Bank, Inspection and Supervision by law 2003 have laid down minimum requirements of such reports. Time limit for preparation of reports is also prescribed so as to avoid unnecessary delays (NRB, 2002).

Preparation of Basel II Implementation

The Basel Committee has come out with new capital accord, which has been set to replace the existing capital accord published on 1988. The new accord obviously is very complex to implement. In a country like ours where banks are operating in low volume of transactions always striving to lower the cost for earning even small profits, it is hard to pursue the banks to follow the new accord exactly in the manner envisaged by the Basel Committee. A high level Basel II preparatory core committee and a working group have been formed by the Nepal Rastra Bank to comprehensively study the provisions of new accord and its possible impact. In this regard an interaction program was also held with the banks chiefs to make them aware of the new development.

There is no doubt that the new accord though complex carries a lot of virtues and will be a milestone in improving banks internal mechanism and supervisory process. It will be beneficial to the supervisory authority of Nepal as it has recently started focusing on risk-based supervision and the internal risk measurement concept an envisaged in new accord is very helpful in this regard. The banks so far has shown positive attitude towards the implementation of Basel II (NRB, 2002).

The Bank of International Settlement established in 1930 is world oldest financial institution. To bring stability in International financial system, BIS created a committee in year 1988 which came forward with Basel Capital Accord that is usually known as Basel I. According to the accord banks were obliged to maintain certain amount of capital to soak up unanticipated losses. In year 2005 amendments were made in Minimum Capital Risk Requirement of Basel I Accord and the revised edition is known as Basel II. Currently more than 100 countries are using Basel II Accord to apply it on banks and other financial securities firms (Sjolander, 2009; Babar & Zeb, 2011). Basel II is an authoritarian framework that identifies preeminent practice for transactions and dealings particularly with risk. Simply Basel II provides recommendation regarding a variety of subjects such as market risk, management risk and credit risk. Haber, 2003 discusses in his article that Basel II stands upon three pillars these are: Minimum capital requirement, Supervisory review process & and Market discipline (Babar & Zeb, 2011).

Basel II, Concept and Its Implication in Nepal

With a view of adopting the international best practices, NRB has already implemented Basel II framework in commercial banks. The complexity and sophistication of the Nepalese financial market doesn't warrant advanced approaches like the IRB Approach or the Standardized Approach. In light of the complexity, Nepal Rastra Bank adopted the simplified standardized approach for credit risk, Basic Indicator Approach for Operational Risk and Net Open Exchange Model for the Market Risk (NRB, 2009).

In line with the international development and thorough discussion with the stakeholders, evaluation and assessment of impact studies at various phases, this framework 2007 is implemented. This framework provides the guidelines for the implementation of Basel II framework in Nepal. Reminiscent of the International convergence of capital measurements and capital standards, this framework also builds around three mutually reinforcing pillars, viz. minimum capital requirements, and supervisory review process and market discipline. The new capital adequacy framework attempts to achieve supervisory objectives with three mutually reinforcing pillars (NRB, 2009).

The first pillar aligns minimum capital requirements more closely with banks' actual underlying risks. In concept, the first pillar is similar to the existing capital framework, in that, it provides a measure of capital relative to risk (NRB, 2009).

The second pillar – supervisory review process – allows supervisors to evaluate a bank's assessment of its own risks and determine whether that assessment seems reasonable. It is not enough for a bank or its supervisors to rely on the calculation of minimum capital under the first pillar. Supervisors should provide an extra set of eyes to verify that the bank understands its risk profile and is sufficiently capitalized against its risks (NRB, 2009).

The third pillar – market discipline – ensures that the market provides yet another set of eyes. The third pillar is intended to strengthen incentives for prudent risk management. Greater transparency in banks' financial reporting should allow marketplace participants to better reward well-managed banks and penalize poorly managed ones (NRB, 2009).

Accord Implementation Group (AIG is responsible for overseeing the implementation of Basel II in Nepal. The Accord Implementation Group consists of officers from Bank and Financial Institution Regulation Department, Bank Supervision Department and Financial Institution Supervision Department. Realizing the importance of the involvement of the stakeholders from the preliminary stage itself, members of the commercial and development banks have also been included in the Accord Implementation Group (NRB, 2009).

In order to ensure a smooth transition to new approach prescribed by this framework, a parallel run for the whole year from Mid July 2007 (Fiscal Year 2064/065) to Mid-July 2008. All banks within the scope of this framework required to adopt the prescribed approaches by Mid July 2008. Banks are required to compute their capital adequacy requirements, based on this framework, on a quarterly basis. The so arrived result should be reported to their respective board of directors as well as to the Nepal Rastra Bank in the prescribed formats (NRB, 2009).

Furthermore, as a part of NRB's continuous effort to enhance regulatory framework, homework is being done to adopt some of the provisions of BASEL III (NRB, 2012).

Two Methods used for Supervision and Examination

Bank supervisors use on-site examination and off-site surveillance to identify the banks most likely to fail. The most useful tool for identifying problem institutions is onsite examination, in which examiners travel to a bank and review all aspects of its safety and soundness. On-site examination is, however, both costly and burdensome: costly to supervisors because of its labor-intensive nature and burdensome to bankers because of the intrusion into their day-to-day operations. As a result, supervisors also monitor bank condition off-site. Off-site surveillance yields an ongoing picture of bank condition, enabling supervisors to schedule and plan exams efficiently. Off-site surveillance also provides banks with incentives to maintain safety and soundness between on-site visits (Gilbert, Meyer, & Vaughan, 2000). On-site and of site supervision and examination are the widely used methods of supervision. They are explaining briefly in below.

On-Site Supervision and Examination

An important element of overall banking supervision is the evaluation, on an on-going basis, of the various risks to which a credit institution is exposed, the management of these risks and actions taken to mitigate them. This task is assigned to the On-Site Section which carries out periodical reviews of the activities and management of licence holders. The identification of risks is a continuous process. As such, the outcome of off-site analysis of statutory and regulatory returns and risk rating reports are normally the main sources through which risks can be identified.

Off-Site Supervision and Examination

Off-site supervision or inspection techniques mandate intermittent reports of the bank such as consolidated annual financial reports, disclosure reports regarding financial and operational risk and other important reports gathered by the concerned departmental examiner. Off-site supervisory systems have several advantages such as it is very cheap as compare to the cost incurred on on-site supervisory examinations, it can be easy and regularly updated with the inflow of new information such as quarterly reports and these supervisory systems are good enough to segregate those

financial risks that may lead the bank to future problems. Some of the most important and familiar off-site supervisory bank rating systems are ORAP, PATROL and CAMELS rating systems (Sarker 2005; Babar & Zeb, 2011).

Strategy for Supervision and Monitoring of Financial Stability

To ensure that the overall financial system in the nation is safe and sound and threats to financial stability are identified and reduced, NRB is currently using CAMELS based approach for supervision. Similarly, CAELS based offsite surveillance with early warning measures are also adopted to meet the supervisory objectives. NRB is conducting risk assessment and risk reduction approaches to ensure financial stability. NRB is gradually moving towards risk-based approach for supervision.

NRB has implemented the Prompt Corrective Action (PCA) Rule to safeguard the financial system effective from mid – October 2008. Under the PCA Rule, banks and financial institutions licensed by NRB should maintain the prescribed level (NRB, 2010).

NRB has initiated the implementation of Basel II. In this process, a high level Basel II core preparatory committee and a working group called the Accord Implementation Group (AIG) were formed, comprising of central bank and commercial banks' officials. A quantitative impact study was also conducted. A draft for the new capital adequacy framework was published and several interactions among stakeholders were held. Subsequently, NRB introduced a new framework on a parallel basis since July 2007 (NRB, 2010).

With respect to the approaches, the simplest and most practical approach suitable for the Nepalese banking industry called Simplified Standardized Approach (SSA) has been selected to implement Basel II known as "Basel II Minus". The advanced approaches in Nepal's circumstances may still be a long way off although it has been planned that more advanced approaches be adopted gradually as the market attains maturity and becomes more sophisticated (NRB, 2010).

2.1.6 Approaches to Financial Performance Analysis

Performance of the banks is measured at two levels, one is at the management and regulatory level of the banks and another is at external rating agencies. Purpose of regulatory and supervisory rating systems is to measure the bank performance at internal level and its compliance with regulatory requirements to keep the bank on right track. These ratings are highly confidential and are only available to the bank management. External credit rating agencies examine and evaluate the banks and issue ratings for the general public and investors in particulars. It is of great importance that both these ratings present the same results about the condition of the banks to provide clear information to investors and management. In past several banks suffer from bankruptcy that was the failure of both internal rating systems and credit rating agencies.

The evaluation of bank performance is a complex process involving interactions between the environment, internal operations and external activities. The ultimate objective of management is to maximize the value of the bank's equity shares by attaining the optimal mix of returns and risks. In this respect bank management needs to develop a comprehensive plan in order to identify objectives, goals, budgets and strategies that will be consistent with the maximization of share values (Gup & Kolari, 2005).

The primary method of evaluating internal performance is by analyzing accounting statements. Financial ratios of accounting items permit an historical sketch of bank returns and risk. External performance is best measure by evaluating the bank's market share, regulatory compliance and public confidence (Gup & Kolari, 2005). The various approaches to financial performance analysis are discussed below.

2.1.6.1 Risk Adjusted Return on Capital (RAROC)

One of the widely used methods of bank supervision and monitoring system is risk adjusted return on capital (RAROC). RAROC allocates equity capital depending on risk of loss, calculates a required rate of return and then uses this information in pricing loans to make sure that they are profitability to the bank.

In the 1990s banker's trust popularized a method of evaluating loans known as RAROC that has been expanded to include other areas of internal performance, including product lines and customers. Applied to pricing loans, RAROC allocates equity capital depending on risk of loss, calculates a required rate of return on equity, and then uses this information in pricing loans to make sure that they are profitable to the bank (Gup & Kolari, 2005). RAROC system allocates capital for two basic reasons: risk management and performance evaluation. RAROC also evaluate banks profitability and risk too. It represents a maximum potential loss based on the profitability of future returns necessary to cover loss associated with the volatility of earnings.

A critical step in applying RAROC is determining the capital assigned to the loan. RAROC can be extended to product lines that divide the bank into business units. For example, a large bank will typically have consumer banking, wholesale banking, and securities components. Now days, many banks employ RAROC to measure managerial performance and tie compensation to earned rates of return relative to benchmark required rates of return. One potential drawback of applying RAROC to product lines is that it may not be possible to separate the economic costs and revenues of the different products (Gup & Kolari, 2005).

2.1.6.2 Economic Value Added (EVA)

Economic value added (EVA) is also one of the widely used methods of bank supervision and monitoring system. The consulting firm Stern, Stewart and Co. developed EVA to help managers incorporate two basic principles of finance into their decision making. EVA can be defined as adjusted earnings minus opportunity cost of capital, where adjusted earnings are net income after taxes, and the opportunity cost of capital equals the cost of equity time's equity capital.

Economic value added (EVA) is an internal bank performance metric computed as adjusted earnings (or net income after taxes) minus the opportunity cost of capital (or the cost of equity times equity capital). EVA is useful in evaluating loans and other investment to determine if shareholders wealth would increase. It can be apply to loans, projects, product lines and so on in order to evaluate whether the investment will be justifiable in terms of rewarding shareholders. In this context new investments

should undertaken until the marginal contribution of the last investment is zero. A high EVA can be achieved by boosting adjusted earnings, lowering the cost of equity or by lowering the equity allocated to the investment (Gup & Kolari, 2005). EVA is the financial performance measure that comes closer than any other to capturing the true economic profit of an enterprise and also measure most directly linked to the creation of shareholders wealth over time.

EVA is beneficial in assessing managerial performance and developing incentive compensation schemes compatible with shareholders wealth goals. EVA presents some difficult challenges in allocation costs, revenues, and equity when applied to lines of business, divisions, products, etc. that are not separate of one another due to joint production of multiple products with shared inputs (Gup & Kolari, 2005).

2.1.6.3 Return on Equity (ROE)

Same as like RAROC and EVA, return on equity (ROE) is also another widely used method of bank supervision and monitoring system. Bank and financial institution's performance can be analyzed by using return on equity (ROE) which measures how much earning a company can generate from on their equity investment.

ROE measures the amount of net income after taxes earned for each dollar of equity capital contributed by the bank's stockholders (Saunders & Cornett, 2012). ROE is a measure of how productively an entity's equity has been employed. It is calculated by dividing annual net income by total equity. ROE offers a useful signal of financial success since it might indicate whether the company is growing profits without pouring new equity into the business. Equity capital as the sum of common and preferred stock paid in surplus, retained earnings and reserve for future contingencies (Gup & Kolari, 2005).

In recent years, the commercial banking industry has experienced a period of record profits, quite a change from the late 1980s and early 1990s, when banks were failing in record numbers. Despite record profits, many banks have weak and inefficient areas that still need to be addressed. One way to identify weakness and problem areas is by analyzing financial statements. The ROE framework starts with the most frequently used measure of profitability, ROE, and then breaks it down to identify

strength and weaknesses in a bank's performance. The resulting breakdown provides a convenient and systematic method to identify strength and weaknesses of a bank's profitability. Identification of strengths and weaknesses, and the reasons for them provides an excellent tool for bank managers as they look for ways to improve profitability (Saunders & Cornett, 2012). In this way, the aggregate bank profitability is measured and compared in terms of return on equity. The rate of return on equity is a good starting point in the analysis of financial institutions' financial conditions.

2.1.6.4 CAMELS plus Corporate Governance

It is understood that financial company and bank's corporate governance have an impact on its creditworthiness. NRB assess the quality of bank's corporate governance data on several qualitative and quantitative measures. Nepal Rastra Bank has introduced higher corporate governance standards for financial companies and banks as part of a wider program of financial reform sector. Effective control system and strong corporate governance are the basic foundation of a sound and stable financial institutions and banks. For this reason, NRB is issuing a directive for yearly basis on corporate of director and employees Good corporate governance can be enhanced the company's image. It helps to introduced good practice in corporate behavior with a view to rebuilding and maintaining public trust in company. The poor governance practices including inadequate disclosures, lack of independent over right directors and weak minority shareholders tend to discourage investment and weaken incentives for efficient management.

After following economic liberalization policy since mid 1980's the establishment of joint stock company in Nepal has been speed up competition in the banking sector is being more intense. Banks are required to compare in the domestic market as also in the international market in the context of liberalization and globalization. Adoption of corporate governance practices assumes greater importance in this context. A corporate governance system is expected to provide protection to shareholders and creditors and to assure them of getting return on their investment. Corporate governance is defined as a set of rules and the relationships between a company's management and its board of director's shareholders and other stakeholders (Khamcha, 2009).

Now days, globalization and liberalization and marketing policies play a decisive role increasing the demand for good governance. Effective corporate governance may be described as reconciliation between the power and obligations of the board of directors to ensure good performance awareness of the rights and duties of stakeholders and the expectation of the society. Good corporate governance features are transparency, accountability, information disclosures and stringent ethics. It helps ensure the business corporations undertake their operations to maximize shareholders value which should eventually bring benefits to other stakeholders from a long term perspective.

Basel II framework has governance in banking institution would be the great help for the financial institutions and banking operation in world as well as Nepal. Effective corporate governance practices are essential to achieving and maintaining public truth and confidence in the ability of a bank to properly manage its assets and liability including deposits with could in turn liquidity crises.

To understand corporate governance and financial performance variables in relation to financial institutions, the major corporate governance pillars that is financial transparency, discloser and trust are dissected. Financial performance especially relating to financial institutions is also reviewed based in the performance dimensions comprising capital adequacy, assets quality, earnings and liquidity.

From above discussion, we know that there is various method of financial performance analysis of financial companies. Among them, CAMELS rating method is more effective for performance analyzing of financial institutions as well as other banks. CAMELS rating method is also conducted and using by the NRB's Bank supervision department to evaluate financial and banking performance. Thus, the study is also prefers to analyze financial institution using CAMELS rating method.

2.1.6.5 CAMELS Framework

The CAMEL methodology was originally adopted by North American bank regulators to evaluate the financial and managerial soundness of U.S. commercial lending institutions. The CAMEL reviews and rates five areas of financial and managerial performance: capital adequacy, asset quality, management, earnings, and

liquidity management (Saltzman & Salinger, 1998) and in modern context, sensitivity of the market risk as a six areas of financial managerial performance.

The Basel Committee on Banking and Supervision of the bank of international settlements has recommended using capital adequacy, assets quality, management quality, earnings and liquidity (CAMEL) as criteria for assessing financial institutions in 1988. The sixth component, sensitivity of market risk was added to CAMEL in 1997 (Gilbert, Meyer, & Vaughan, 2000)

CAMEL stands for capital adequacy, asset quality, management efficiency, earnings performance and liquidity. The capital adequacy ratio is a key measure to determine the health of banks and financial institutions. Capital adequacy refers to the sufficiency of the amount of equity to absorb any shocks that the bank may experience (Kosmidou 2008; Jha & Hui, 2012). CAMELS are an acronym that comes from the key areas of financial institution's safety and soundness examination. It is a collection of the first letter of the six components evaluated. It stands for: C for capital adequacy which is the quality of banking capital and their availability to offset unexpected losses.

A for asset quality, it means level, trend and comparison of non-accrual and renegotiated loans. M for management factors that is technical competence, leadership, skill, talent, experience of middle and senior management and their compliance with banking laws and regulations. E for earnings that is returns on assets, income and expenses as compared to other firm's averages. L for liquidity that is adequacy of liquid sources that is availability of assets readily convertible into cash without undue loss, to cater for present and future needs. **S** for sensitivity of market risks that is foreign exchange risk, interest rate risk, equity price risk, and commodity price risk, etc.

CAMELS framework for analyzing the health of individual institutions looks at six major aspects of a Financial institutions: capital adequacy, asset quality, management soundness, earnings, liquidity, and sensitivity to market risk, has shown that certain macroeconomic trends have often preceded banking crisis. Assessments of financial soundness, therefore, need to incorporate the broad picture, particularly an economy's

vulnerability to capital flow reversals and currency crises (Hibers, Krueger & Moretti 2000; Devekota, 2008). To examine a bank or financial institution on the CAMELS system, information is required from different sources such as financial statements, funding sources, macroeconomic information, budget and cash flow projection, staffing and business operations. This model assesses the overall condition of the bank, its strengths and weaknesses (Babar & Zeb, 2011).

Bank's performance or rather solvency or insolvency has been given much attention both at the local and international level. Financial ratios are often used to measure the overall financial soundness of a bank and the quality of its management. Banks' regulators, for example, use financial ratios to help evaluate a bank's performance as part of the CAMEL system.

Despite continuous use of ratios analysis in banks performance appraisal by regulators, opponents to it still thrive. Financial ratios are somewhat limited in scope, that is, simple gap analysis are one dimensional views of a service, product, or process that ignore any interactions, substitutions or trade-offs between key variables (Siems & Barr 1998; Wirnkar & Tanko, 2006).

CAMEL Information and Adjustment

The CAMEL framework required to gather the following information for a CAMEL examination: financial statements, budgets and cash flow projections, portfolio aging schedules, funding sources, information about the board of directors, operations/staffing and macroeconomic information.

Financial statements form the basis of the CAMEL's quantitative analysis. FIs are required to present audited financial statements from the last three years and interim statements for the most recent 12-month period. The other required materials provide programmatic information and show the evolution of the institution. These documents demonstrate to CAMEL analysts the level and structure of loan operations and the quality of the FI's infrastructure and staffing (Saltzman & Salinger, 1998).

Once the financial statements have been compiled, adjustments need to be made. These adjustments serve two purposes: first, they place the FI's current financial

performance in the context of a financial intermediary; second, they enable comparisons among the different institutions in the industry. The CAMEL performs six adjustments, for the scope of microfinance activity, loan loss provision, loan write-offs, explicit and implicit subsidies, effects of inflation, and accrued interest income (Saltzman & Salinger, 1998).

The Six Components of CAMELS

In recent days, an international bank rating system with bank supervisory authorities rate institutions according to six factors. The six factors are represented by the acronym 'CAMELS'. The six key components used to assess an institution's financial condition and operations are discussed in below.

2.1.6.5.1 Capital Adequacy

The objective of the capital adequacy analysis is to measure the financial solvency of an FI by determining whether the risks it has incurred are adequately offset with capital and reserves to absorb potential losses. One indicator is leverage, which illustrates the relationship between the risk-weighted assets of the FI and its equity. Another indicator, ability to raise equity, is a qualitative assessment of an FI's ability to respond to a need to replenish or increase equity at any given time. A third indicator, adequacy of reserves, is a quantitative measure of the FI's loan loss reserve and the degree to which the institution can absorb potential loan losses (Saltzman & Salinger, 1998).

Capital forms the most important part of any bank operation for the simple reason that it acts as a shock absorber during the times of crisis. Banking business by definition includes calculated risk taking. However the amount of risk in its business is important from the view point of capital to be kept aside for mitigating future shock events. Capital adequacy ratio precisely aims at finding the amount of capital bank has in its portfolio to counter such shocks. However the higher amount of capital adequacy ratio does not always imply that the bank is sound enough, the most important factor is the amount of risk the bank is exposed to. Thus capital adequacy ratio does not convey any idea on absolute terms but is a measure to be considered after factoring in the risk profile of the bank. So, Capital adequacy ratio in relative terms makes sense (Chowdhury, 2011).

2.1.6.5.2 Asset Quality

The analysis of asset quality is divided into three components: portfolio quality, portfolio classification system, and fixed assets. Portfolio quality includes two quantitative indicators: portfolio at risk, which measures the portfolio past due over thirty days; and write-offs/write-off policy, which measures the FI's adjusted write-offs based on CAMEL criteria. Portfolio classification system entails reviewing the portfolio's aging schedules and assessing the institution's policies associated with assessing portfolio risk. Under fixed assets, one indicator is the productivity of long-term assets, which evaluates the FI's policies for investing in fixed assets. The other indicator concerns the institution's infrastructure, which is evaluated to determine whether it meets the needs of both staff and clients (Saltzman & Salinger, 1998).

The banking business can be simply described as the act of channeling the savings of the economy to the economic activity of the economy. Thus this simple act requires very prudent acumen to identify which activity is worth financing. Loans and advances constitute the greatest part of asset portfolio of the banks in general. However the amount of Non Performing Asset class in the portfolio eats away the portion of the profit earned by the bank in terms of provisions depending on the Income Recognition and Prudential Norms set by RBI. However the amount of profit a particular bank may be earning, it is not going to add value to the share holders‟ wealth if it is not available. The quantum of Non Performing Asset in the portfolio plays a major role in deciding the financial performance of the banks. Thus to account for the extent of Non Performing Asset in the portfolios of the banks and the extent of damage this particular asset class can have on the financial performance the following ratio is considered for the purpose of analysis (Chowdhury, 2011).

2.1.6.5.3 Management

Five qualitative indicators make up this area of analysis: governance; human resources; processes, controls, and audit; information technology system; and strategic planning and budgeting. Governance focuses on how well the institutions' board of directors functions, including the diversity of its technical expertise, its independence from management, and its ability to make decisions flexibly and effectively. The second indicator, human resources, evaluates whether the department of human resources provides clear guidance and support to operations staff, including

recruitment and training of new personnel, incentive systems for personnel, and performance evaluation system. The third indicator, processes, controls, and audit, focuses on the degree to which the FI has formalized key processes and the effectiveness with which it controls risk throughout the organization, as measured by its control environment and the quality of its internal and external audit. The fourth indicator, information technology system, assesses whether computerized information systems are operating effectively and efficiently, and are generating reports for management purposes in a timely and accurate manner. This analysis reviews the information technology environment and the extent and quality of the specific information technology controls. The fifth indicator, strategic planning and budgeting, looks at whether the institution undertakes a comprehensive and participatory process for generating short- and long-term financial projections and whether the plan is updated as needed and used in the decision-making process (Saltzman & Salinger, 1998).

A bank act as custodian of public money and also ensures faith in the financial system as whole. Banks have been successfully playing the dual role very efficiently for ages. However with the changing scenario of banking and the extent of globalization, banks are now required to play an additional role of professional financial manager. The banks now need to act as agencies which act on behalf of the shareholders with the sole objective of adding value to the shareholders wealth. Banking competition has brought about a sea change in the characteristic role played by the conventional bankers. Everything is now viewed from the management perspective and the extent of value creation. Thus the management dimension in CAMEL analysis has assumed much important position like never before. To capture the possible dynamics of management efficiency affecting the financial performance of the banks the following ratios are considered (Chowdhury, 2011).

2.1.6.5.4 Earnings

This area of analysis includes the three quantitative and one qualitative indicator to measure the profitability of FIs: adjusted return on equity, operational efficiency, adjusted return on assets, and interest rate policy. Adjusted return on equity (ROE) measures the ability of the institution to maintain and increase its net worth through earnings from operations. Operational efficiency measures the efficiency of the

institution and monitors its progress toward achieving a cost structure that is closer to the level achieved by formal financial institutions. Adjusted return on assets (ROA) measures how well the FI's assets are utilized, or the institution's ability to generate earnings with a given asset base. CAMEL analysts also study the MFI's interest rate policy to assess the degree to which management analyzes and adjusts the institution's interest rates on microenterprise loans (and deposits if applicable), based on the cost of funds, profitability targets, and macroeconomic environment (Saltzman & Salinger, 1998).

Banks depend on its strong capability of earnings for performing the activities like funding dividends, maintaining adequate capital levels, providing for opportunities of investment for bank to grow, strategies for engaging in new activities and maintaining the competitive outlook. Traditionally banks depends on its spread or interest income as a major source of earning, while in the contemporary scenario the fee based income or the non-interest income also contributes significantly to earnings. With the spread gradually coming down for the banking industry due to competitive pressure banks have started to rely heavily on fee based income sources (Chowdhury, 2011).

2.1.6.5.5 Liquidity Management

The fifth area of the CAMEL evaluates the FI's ability to accommodate decreases in funding sources and increases in assets and to pay expenses at a reasonable cost. Indicators in this area are liability structure, availability of funds to meet credit demand, cash flow projections, and productivity of other current assets. Under liability structure, CAMEL analysts review the composition of the institution's liabilities, including their tenor, interest rate, payment terms, and sensitivity to changes in the macroeconomic environment. The types of guarantees required on credit facilities, sources of credit available to the FI, and the extent of resource diversification are analyzed as well. This indicator also focuses on the FI's relationship with banks in terms of leverage achieved based on guarantees, the level of credibility the institution has with regard to the banking sector, and the ease with which the institution can obtain funds when required. Availability of funds to meet credit demands measures the degree to which the institution has delivered credit in a timely and agile manner. Cash flow projections evaluate the degree to which the institution is successful in projecting its cash flow requirements. The analysis looks at

current and past cash flow projections prepared by the FI to determine whether they have been prepared with sufficient detail and analytical rigor and whether past projections have accurately predicted cash inflows and outflows. Productivity of other current assets focuses on the management of current assets other than the loan portfolio, primarily cash and short-term investments. The FI is rated on the extent to which it maximizes the use of its cash, bank accounts, and short-term investments by investing in a timely fashion and at the highest returns, commensurate with its liquidity needs (Saltzman & Salinger, 1998).

Liquidity management in banks has assumed prime importance due to competitive pressure and the easy flow of foreign capital in the domestic markets. The impact of liquidity crisis in the banks can adversely impact the financial performance of the banks. Inability of the banks to manage its short term liquidity liabilities and loan commitments can adversely impact the performance of the banks by substantially increasing its cost of fund and over exposure to unrated asset category. Also the cash flow from principal and interest payments could vary due to the types of loans on the balance sheet impacting the liquidity position. The dynamics of competitors practice for the same source of deposit, management team's anticipation of loan growth, movement of interest rates and changes in macro economic variables also decides the liquidity management dimension of the banks (Chowdhury, 2011).

Liquidity is also considered as one for the indicators of judging the performance of a stock market. It makes the financial assets less risky. Liquidity is judge by considering the total value of shares traded in the stock market as a percentage of GDP. Even though this indicator does not measure the cost of trading of shares whereas, it does indicate the extent of easiness in trading in a stock market. There are abundant evidences which support of growing stock markets in the countries. The countries with relatively liquid stock markets can grow faster than the countries with illiquid stock market. There is, however, low ratios of the value of shares traded to GDP in Nepal. This ratio has a fluctuating tendency, and has declined in the fiscal year 2005/06 over the fiscal year 2004/05 (CEDA, 2007).

2.1.6.5.6 Sensitivity of Market Risk

Sensitivity of market risk assess the risk of the market primarily based on adverse changes in commodity price, interest rate, foreign exchange rate, fixed assets and the ability of management to identify and control these risks.

Earning and capital of financial institutions can be adversely affected by changes in exchange rate, interest rate, equity price or commodity price. Many financial institutions consider changes in interest rates as market risk. This S component of the CAMELS rating system mainly focuses on the ability of the bank to recognize, monitor, manage and control the market risk and give indication to management for the supervision in the problematic area. Sensitivity to the market risk is an extension of the liquidity or we can say to focus on stock ratios whether bank has sufficient liquidity. To know that bank position is secure or not the management and credit analyst should thoroughly approach and make analysis of liquidity (Grier 2007; Babar & Zeb, 2011).

Sensitivity of the market risk are examined by the banks to assess the changes in foreign currency, interest rate, product purchase and selling prices which totally effects the bank´s assets values and profits. The ratio used to measure the sensitivity of the market risk is total securities to total assets = total securities/total assets. Banks now a day's have to changes their self because of market demands. Portfolio may boost the bank's profit if the price movement is in favor of banks, and if it is not then it may create big problems for the bank. The ratio tells the correlation of banks securities with total assets and provides us the percentage change of its portfolio with respect to alteration in interest rates or other issues associated with the issuer of the securities. The higher the value of this ratio is more risky, that the bank´s portfolio is subjected to market risk. The lower the ratio is good for the bank since it shows the response towards market risk is appropriate (Christopoulos, et al, 2011; Babar & Zeb, 2011).

2.1.6.6 Composite Rating

After understanding of all CAMELS components there is need for understanding of composite rating which is to be assigned to all banks. Composite rating takes place on the basis of evaluation and rating of six components. This rating is like qualitative

analysis rather than quantitative analysis; it is not to be assigned on arithmetic average of all components rating (Trautmann, 2006; Babar & Zeb, 2011). Composite rating assigns on 1 to 5 numerical scales, where "1" is the highest rating for the bank, which shows bank strongest performance whereas rating "5" shows the lowest rating and worse performance of the bank. When composite rating is assigned to each component the result will be disclosed to senior management and to the board of directors (Comptroller's Handbook, 2007; Babar & Zeb, 2011). CAMELS are the supervisory and regulatory rating system implemented by NRB. It takes into account six important components of a bank when it evaluates performance of the bank. These components are Capital, Assets, Management, Earning, Liquidity and Sensitivity to market risk. Ratings is assigned to theses components on the scale of 1 to 5 and that is a base for composite rating that also ranged from 1 to 5.

Composite Rating 1:

Composite rating "1" denotes strong position of the bank. Assigning of this rate shows the soundness and strongest performance of the bank in all aspects, and usually given to the banks who are rated 1 or 2 in almost all components. Management and board of directors are strong enough to handle weaknesses easily and can control risk associated with the business activities and to deal with complex situations. Fundamental risk management practices of the bank are strong enough and minimum level of supervisory is needed for the bank (Trautmann, 2006; Babar & Zeb, 2011).

Composite Rating 2:

Composite rating "2" is usually given to fundamentally and financially strong banks and usually have component rating not more than 3. At this position banks are stable and have the capability to hold out the economic depression. Management and board of directors have good enough hold to rectify the moderate weakness of the bank at this stage. Risk management practices of the bank are not strong enough but are at satisfactory level and supervision is required to guide the bank towards strong position (Trautmann, 2006; Babar & Zeb, 2011).

Composite Rating 3:

Composite rating "3" shows that the bank has weaknesses in different component areas. Proper concentration is required at this stage and if it is not provided it may lead the bank towards liquidity or bankruptcy. More than 2 rating components of the

banks are above 3 rating. Management of the bank does not have the ability to control the situation and to find out the way to guide the banks out of the weaknesses. There is evidence of significant noncompliance of the bank with regulatory requirements. Risk management performance is less satisfactory, such bank require more than normal supervision from regulatory authorities. Proper guidance from the regulatory authorities will help the management to identify the weaknesses and guide towards improved performance. Bankruptcy is unlikely but overall financial position of the bank need proper supervision (Trautmann, 2006; Babar & Zeb, 2011).

Composite Rating 4:

Composite rating "4" of a bank under examination shows risky and unstable performance of the bank. Unsatisfactory performance of banks is mostly because of managerial or financial insufficiencies. At this stage management of the bank and its board of directors are unable to take hold on flaws and weaknesses to resolve the problem. Most of it components ratings are above three and 1 or 2 of them are in 5 as well. The violation of Law and regulations is on rise and risk management practices are not acceptable at this stage. There is a need of corrective action and proper supervision and if an immediate supervision action is not taken the result may be solvency of the bank (Trautmann, 2006; Babar & Zeb, 2011).

Composite Rating 5:

Composite rating "5" indicate extremely unsound, risky and unstable performance of the bank. Usually risk management practices of the bank are insufficient. Management and board of directors are totally failed to take control on weaknesses. Most of its components are rated 4 and 5 and usually have negative earnings. At this stage continues supervision is required from the regulators and financial assistance from outside is much needed to avoid the highly probable bank failure (Trautmann, 2006; Babar & Zeb, 2011).

Performance evaluation of banks and financial institutions takes place at several levels. At first level bank's management do critical evaluation of their banks at internal level to keep the bank on track and in second level banks performance is measured at regulatory level to counter check its compliance with the regulatory requirement. For that purpose both management of the bank and bank regulators

perform on-site examination and off-site examination of the bank. But the results of these examinations are kept confidential and general public have no access to them (Babar & Zeb, 2011).

There are several on-site and off-site examination rating systems that have been developed on by regulator banks of the countries. CAMELS rating system was implemented in early 1980 by Federal Reserve System of USA. Compared to other onsite and off-site examination system there has been much debate on the efficiency of CAMELS rating system. Before implementation of their national rating system, most of these countries were using CAMELS to evaluate their financial institutions. Much of the research work has been done on this system for its improvement. Compared to CAMELS system, the prior systems were newly developed and went through the phase of improvement and have improved a lot in the previous years. State Bank of Pakistan implemented CAMELS in 1997, the year when other countries such as France and Germany developed their own rating systems and few years before England's Risk Assessment Tool of Supervision and Evaluation (RATE) Netherlands RAST. SBP decided for CAMELS rating system as the best to align the supervisory mechanism with international standards and requirements (Babar & Zeb, 2011).

Beside internal management of the bank and regulatory supervision there are outsiders who are also interested to know who these banks or institutions performed. These are the stakeholders of the banks that may include there shareholders, investors and expected investors. For this purpose banks avail the services of external credit rating agencies (CRAs) for which theses banks or institutions are charged extensively. These agencies are independent of any control or interventions of any organization or governments. They do critical examination of bank's business activities and associated risk and rate them on the scale of their predefined performance scale. After getting these ratings from credit rating agencies, they are announced and published publically in their annual reports or magazines. This may help the bank to attract new investors that may be utilized in expansion of the bank. It is important that both of these examinations performed at the different levels have the same results so that both managements and investors get full advantage of them (Babar & Zeb, 2011).

2.2 Review of Related Studies

This section presents the review of related studies. It contains the review of different research works carried out by different scholars within the different countries and mainly focusing on Nepalese researchers' studies on financial performance analysis using CAMELS framework. It includes the review of previous studies, research articles, dissertation and other related materials. This section also presents research gap.

Gilbert, Meyer, & Vaughan (2000) have conducted a study on the role of a CAMEL downgrade model in bank surveillance. They examined the potential contribution to bank supervision of a model designed to predict which banks will have their supervisory ratings downgraded in future periods. Bank supervisors rely on various tools of off-site surveillance to track the condition of banks under their jurisdiction between on-site examinations, including econometric models. One of the models that the Federal Reserve System uses for surveillance was estimated to predict bank failures. Because bank failures have been so rare during the last decade, the coefficients on this model have been "frozen" since 1991. Each quarter the surveillance staff at the Board of Governors provides the supervision staff in the Reserve Banks the probabilities of failure by the banks subject to Fed supervision, based on the coefficients of this bank failure model and the latest call report data for each bank. The number of banks downgraded to problem status in recent years has been substantially larger than the number of bank failures. During a period of few bank failures, the relevance of this bank failure model for surveillance depends to some extent on the accuracy of the model in predicting which banks will have their supervisory ratings downgraded to problem status in future periods. They compared the ability of two models to predict downgrades of supervisory ratings to problem status: the Board staff model, which was estimated to predict bank failures, and a model estimated to predict downgrades of supervisory ratings. They find that both models do about as well in predicting downgrades of supervisory ratings for the early 1990s. Over time, however, the ability of the downgrade model to predict downgrades improves relative to that of the model estimated to predict failures. This pattern reflects the value of using a model for surveillance that can be re-estimated frequently. They conclude that the downgrade model may prove to be a useful

supplement to the Board's model for estimating failures during periods when most banks are healthy, but that the downgrade model should not be considered a replacement for the current surveillance framework.

Baral (2005) has conducted a study on Health check-up of commercial banks in the framework of CAMEL: A case study of joint venture banks in Nepal. The aim of the study was to check up the financial health of joint venture banks in the framework of CAMEL and the study has covered four years of period. The research revealed that joint venture commercial banks are well capitalized but their capital base relative to the risk weighted assets is not strong. According to the international convention of rating, their capital base is fair. This implies that their financial health is not so strong to manage the strong balance sheet shocks. Quality of assets of joint venture banks on the average is satisfactory. Both indicators—operating expenses ratio and earning per employee—of management quality of joint venture banks are above the industry average during the study period. So, relative to the industry average, performance of management of joint venture banks is satisfactory. Earning/profitability indicators—ROE, ROA and PM—shows that financial health of joint venture banks is not so weak. Liquidity indicators of joint venture banks show that they have stored high level of liquidity and are not facing the liquidity deficit problem, instead, they are facing the high liquidity problem. With a view point of liquidity position, the health of joint venture banks is looked like a little bit unhealthy.

Khamcha (2009) has conducted a study on financial performance analysis of joint venture commercial banks in Nepal in the framework of CAMEL. The aim of the study was to analyze the financial performance analysis of all joint venture banks in the framework of CAMELS. The study has covered 6 years of period and used descriptive and analytical research design. The study has revealed that the capital funds of joint ventures banks are sound and sufficient to meet the banking operation as per NRB standard (except HBL). Core capital adequacy ratios of joint venture were above the NRB standards. The study further revealed that the decreasing trend of total operating expenses to total operating revenue ratio shows that the bank operate efficiency. The increasing trend of return on equity ratio concludes that the quality of assets and their efficiency to generate return is increasing. She further concluded that

the banks were low sensitive to interest rate in the long horizon but highly sensitive to interest rate in short term horizon due to CGAP ration to earning assets is high.

Pant (2009) has conducted a study on Nepalese financial system: Policy development and challenges. He examined the policy developments pertaining to Nepal's financial system and to delineate some challenges of the country's financial system. He found that financial markets build in many ways the backbone of an economy. A well-regulated financial sector leads to an efficient transformation of savings to investment, ensuring that resources are deployed where they earn the highest returns. A strong and resilient financial system and the orderly evolution of financial markets are the major prerequisites for financial stability and economic progress. A healthy financial system is the one that effectively fosters resource mobilization for capital accumulation and determines efficient allocation of resources. It is important to remember that success of any financial system, in its resource mobilization and allocation functions, depends on its ability to offer the public a variety of assets (money as a medium of exchange, earning assets, pension funds, etc.) corresponding to the various needs and preferences of economic agents. A clear understanding and recognition of this fact is very important to formulate appropriate policies to enable the financial system to function properly and efficiently.

Gurung (2009) has conducted a study on financial performance analysis of domestic private commercial banks in Nepal in the framework of CAMEL. The study has evaluated the performance of selected domestic banks in Nepal in the framework of CAMEL during the period 2001/002 to 2006/007 using descriptive and analytical research design. The Sample banks were Machhapuchhare Bank Ltd., Bank of Kathmandu and Nepal Industrial and commercial banks Ltd. The researcher concluded that the banks under study are well capitalized and they are complying with NRB directives on capital adequacy ratio. The loan loss reserve ratio shows fluctuating trend though the ratio is at satisfactory level. The fluctuating trend of this ratio indicates that there is possibility of default in future. The return on equity figure and its increasing trends put BOK in first position as compared to MBL and NIC. The increasing trends of ROE show that the rate of return flowing to the banks' shareholders in adequate. The fluctuating ROA shows that the capacity of management to convert the bank's assets into earning is not at satisfactory level. The

loan to deposit ratio of banks though fluctuating over the years are well above the industrial average in all the years under study.

Chowdhury & Ahmed (2009) have conducted a study on performance evaluation of selected commercial banks in Bangladesh. The selected banks are Dutch Bangla Bank (DBBL), Dhaka Bank Ltd. (DBL), National Bank Ltd. (NBL), Prime Bank and Islami Bank Bangladesh Limited (IBBL). This study was based mainly on data from secondary sources. They overviewed on private commercial banks of Bangladesh and appraised the performance of selected private commercial banks of Bangladesh. They revealed that, in a developing country like Bangladesh the banking system as a whole play a vital role in the progress of economic development. In this paper we have tried to analyze the development and growth of Selected Private Commercial Banks of Bangladesh. It is observed that all the selected private commercial banks are able to achieve a stable growth of branches, employees, deposits, loans and advances, net income, earnings per share during the period of 2002-2006. Seven trend equations have been tested for different activities of the private commercial banks. Among them the trend value of branches, employees, deposits and net income are positive incase of all the selected banks. Square of correlation coefficient (r2) has also been tested for all trend equations. The r2 of branches, deposits and net income are more than 0.5. It indicates the prospect of private commercial banks in Bangladesh is very bright.

Shrestha (2010) has conducted a study on financial performance of Small Farmers Cooperative Limited in Nepal. The study has examined the relationship between the social mobilization components and the financial performance indicators of the SFCLs. The researcher concluded that based on the correlation and regression analysis of financial performance of SFCLs, it is necessary to consider independent variable such as skill development trainees, internal resources, savings, women client, and social and community development activities for the better performance of financial performance such as investment, repayment rate and profit. At the same time, social mobilization including various other supports such as financial management, transparency in accounts, inspection, monitoring and supervision of SFCLs, social and community development activities, etc. are equally required in order to improve and maintain the better financial performance of SFCLs.

Tiwari (2010) has conducted a study on financial performance analysis of Pokhara Finance Company Limited in the framework of CAMELS. The study has evaluated the performance of Pokhara Finance in the framework of CAMELS during the period of five year i.e. 2061/062 to 2065/066 using descriptive and analytical research design. The researcher concluded that the Pokhara finance's CAR varied NRB standard during the review period. The total CAR is above NRB norms and industry average as well. Assets composition remained largely in the loans and investment. The company is aware of non-performing loans and adopting the appropriate policies to manage this problem and to increase the quality of asset. The company has managed its operation efficiently since the total expenses to total revenues ratios are in decreasing trend. The ROE ratio of company is above the universal benchmark. The liquid assets to total deposit ration of company is also above the industrial average ratio except in the initial period. The sensitivity of net financial assets in a short term maturity bucket of company is high and is therefore highly sensitive to interest change risk.

Shar, Shah & Jamali (2010) have conducted a study on performance evaluation of banking sector in Pakistan: An application of bankometer. The main objective of this study is to develop a scale ‘bankometer’ which could measure the vulnerability of a financial institution better than conventional models, i.e. CAMEL, Credit Leona’s Securities Asia stress test (CLSA-stress test) etc. The study would concentrate on developing ‘bankometer’ and evaluating the soundness of banking institutions during 1999-2002 in Pakistan. The study was based on secondary data. Ability to predict which bank is vulnerable to financial distress is of critical importance to investors, creditors, accountholders and many other stakeholders. An effort has been made to develop and evaluate a new model called ‘bankometer’. To confirm the accuracy of bankometer, it has been applied on individual banks covering the period 1999-2002 for gauging the solvency of each bank in Pakistan and the results has been compared with CAMEL and CLSA-stress test. This is an initial attempt to develop a scale which could be applied at global level and prescribes a procedure to gauge the vulnerability of an individual bank.

Paudel (2011) has conducted a study on a case study on financial performance analysis of Oriental Co-operative Limited in the framework of CAMEL. The study

analyzed the level, trend and comparative analysis of capital adequacy, non performing loan, loan loss provision, assets composition, management quality ratios, earning capacity, liquidity position and sensitivity to market risk components of the OCL during 5 years period i.e. FY 2061/62 to FY 2065/66 using CAMEL Framework. The research revealed that OCL is using adequate amount of internal sources. OCL is financially sound and strong as internal financially. The supplementary capital of the OCL is sufficient. Capital adequacy ratios reveal that the OCL is not sufficient. The increasing trend of loan loss provision ratio indicates that the quality of loans decreasing year by year. The study further revealed that the OCL management is not aware about stockholder's profit. The capacity of management has not increased earning. The liquid funds to total deposit ratio is below the industrial average ratio. It shows that OCL has not sufficient liquid fund. The cash in vault to total deposit ratio is below the industrial average. The sensitivity of net financial assets in a long term maturity bucket is high.

Lohia (2011) has conducted a study on a performance of the Indian banking industry over the last ten years. The researcher analyzed the performance of Indian banks over the period of the last ten years. It uses the CAMEL Framework to determine the performance of public and private banks in India. The researcher also conducts an empirical analysis to determine the share price performance of Indian banks relative to the share price performance of banks in Hong Kong, Europe and the US. The researcher concluded that private banks perform better than public banks overall based on the CAMEL Framework. In addition it also found that the Indian banks share price performance is dependent on the share price performance of Hong Kong and European banks, and it has a significant positive relationship with the overall Hong Kong stock market, and this relationship strengthens after 2007. On the whole, the researcher searched to offer as comprehensive a perspective as possible upon the conduct, structure and performance of the banking industry of India.

Chowdhury (2011) has conducted a study on 'An inquiry into the financial soundness of commercial banks in India using 'CAMEL' approach'. Chowdhury reveals that banking in India has been through a long journey. Banking scenario in India has also assumed a total new dimension with the changing times. It has become a different ball game in terms of its service and the array of products. The use of technology has

brought about a revolution in the way the bank conducts its business. But, the fundamental dimension of Trust and the confidence of the people on the institution remain. The majority of the banks are till now successful in keeping with the confidence of the stakeholders. However, with the changing dynamics of banking business, banking as an activity has become more than diversified bringing in all sorts of services under its fold. The transition of banks to these new areas of business eventually brings in new kind of risk exposure in the portfolio. Therefore, in order to continue with the faith and the confidence of the general public the regulator have included risk based assessment of banks. The risk based rating of the banks is kept confidential by the Reserve Bank of India due to the sensitive nature of the information. But people must know and understand their banks so that they are in a position to differentiate between the good and not so good. Thus an attempt is made in this study to use the publicly available information and feed the information to the criteria (based on the internationally accepted CAMELS rating system) to arrive at conclusion.

Babar & Zeb (2011) have conducted a study on a CAMELS rating system for banking industry in Pakista. The core intention of their research study was to answer their research question that is “Does CAMELS system provides similar rating as PACRA system in assessing the performance of banks in Pakistan”. The research findings show that ratings published by PACRA rating agency show almost all banks are financially strong and stable where as results of CAMELS rating system are completely different from these ratings. They concluded that there are no similarities in the results of these rating systems. Based on the component rating displayed by 17 sample banks selected for our research from banking industry of Pakistan MCB Bank is ranked 1st, Bank Al-Habib 2nd and ABL 3rd where as Summit Bank is at the bottom of Table.

Kabir & Dey (2012) have conducted a study on a performance analysis through CAMEL: A comparative study of selected private commercial banks in Bangladesh. The overall objective of the study is to investigate into the comparative financial soundness of two leading private sector commercial banking companies through using CAMEL ratings. They concluded that due to radical changes in the banking sector in the recent years, the central banks of all around the world have improved their

supervision quality and techniques. In evaluating the function of the banks, many of the developed countries are now following uniform financial rating system (CAMEL RATING) along with other existing procedures and techniques; Bangladesh Bank is also following the above techniques in respect of evaluating scheduled Commercial banks. Keeping these developments in view, this paper has applied CAMEL Ratings techniques for assessing financial strength of IFIC bank and EXIM bank IFIC Bank's, capital adequacy ratio and leverage ratio show better performance than EXIM Bank, but, in respect of return on equity and net worth protection, IFIC shows poorer performance than the other. With regard to 'asset quality', percentage of classified loan of IFIC Bank shows a much stronger performance than EXIM Bank and in relation to 'management capacity', income per share of EXIM bank is higher than IFIC. Further, expenses per employee of EXIM bank is less than the IFIC bank which confirms EXIM bank's better management capacity to deal with administrative and office overheads. With respect to 'earning ability', net investment margin of IFIC Bank shows a laudable performance but for other criteria, such as, net profit margin, diversification ratio and earnings per share, EXIM Bank has been exhibiting better performance. Finally, with regard to 'Liquidity', loan to deposit ratio and earning assets to deposit ratio of IFIC Bank have been showing excellent performance but liquid asset to total deposit ratio shows poor performance than the EXIM Bank.

Jha & Hui (2012) have conducted a study on a comparison of financial performance of commercial banks: A case study of Nepal. The research tried to compare the financial performance of different ownership structured commercial banks in Nepal based on their financial characteristics and identify the determinants of performance exposed by the financial ratios, which were based on CAMEL model. Eighteen commercial banks for the period 2005 to 2010 were financially analyzed. In addition, econometric model (multivariate regression analysis) by formulating two regression models was used to estimate the impact of capital adequacy ratio, non-performing loan ratio, interest expenses to total loan, net interest margin ratio and credit to deposit ratio on the financial profitability namely return on assets and return on equity of these banks. The results show that public sector banks are significantly less efficient than their counterpart are; however domestic private banks are equally efficient to foreign-owned (joint venture) banks. Furthermore, the estimation results reveal that return on assets was significantly influenced by capital adequacy ratio, interest

expenses to total loan and net interest margin, while capital adequacy ratio had considerable effect on return on equity.

Kouser & Saba (2012) have conducted a study on gauging the financial performance of banking sector using CAMEL model: Comparison of Conventional, Mixed and Pure Islamic Banks in Pakistan. The study is a comparison based on performance of Pure Islamic banks, mixed banks and conventional banks using CAMEL model. It is an appropriate and simple model to evaluate the financial and managerial assessment of institutions. The ratios defined by CAMEL method are analyzed by using ANOVA to investigate any significant difference. The data analysis is done using SPSS. Based on their analysis, they found that Islamic banks have adequate capital and have good asset quality when compared to Islamic branches of conventional banks and conventional banks. Moreover, Islamic banks in general have good management competency in comparison to conventional banks. The earnings of Islamic branches of conventional banks are greater than full-fledge Islamic banks and conventional banks. Finally, it can be concluded that Islamic banks have a developing setup.

Vijayakumar (2012) has conducted a study on evaluating performance of banks through CAMEL model: A case study of state bank of India and its associates. He attempted to analyze the overall efficiency and its components in banking sector in India. The CAMEL rating system provides a means to categorized bank based on the overall health, financial status and measurement of banks financial, managerial, operational and complying performance. In this study CAMEL rating system has been adopted for measuring overall health and financial status SBI and its associate's bank. From the analysis, it can be concluded that State Bank of India and its associate banks have succeeded in maintaining capital adequacy ratio at higher level than the prescribed level (more than 9 per cent) during the study period The study indicates for improvement in the asset quality position of State Bank of India and its associate banks during the study period. The State Bank of India and its associate banks have succeeded in maintaining higher level of management efficiency. The earning quality shows that associate banks has outperformed State Bank of India during the study period. The study also shows the efficiency of State Bank of India and its associate banks in generating income from their operations during the study period. The Liquidity ratio indicated better liquidity position of State Bank of India and its

associate banks during the study period. However, State Bank of India has edge over associate banks, if compared with each other according to these ratios.

Prasad & Ravinder (2012) have conducted a study on a CAMEL model analysis of nationalized banks in India. The study examined the performance of nationalized banks during the period 2006-10. The study is based on twenty ratios of the variables relating to capital adequacy, as sets quality, management efficiency, earnings quality and liquidity. To evaluate the performance of banking sector researchers have chosen the CAMEL model which measures the performance of banks from each of the important parameter like Capital Adequacy, Assets Quality, Management Efficiency, Earning Quality and Liquidity. After deciding the model researchers have chosen twenty nationalized banks. According to the importance of study, researcher gave equal weights to each parameter. Results shown that on an average Andhra bank was at the top most position followed by bank of Baroda and Punjab and Sindh Bank. The researcher also concluded that the Central Bank of India was at the bottom most position.

Soltani, Esmaili, Poor & Karami (2013) have conducted a study on evaluating the performance of public and private banks and providing suggestions for improving the performance of them (Case study: Melli, Agriculture, Pasargad and Parsian Bank of Qom). They seek to answer this question: Is there a significant difference between public and private bank in terms of performance? In this study, the research team use the CAMEL model which includes dimensions such as capital adequacy, asset quality, management quality, earning performance and liquidity to evaluate and compare the financial performance of public and private banks. Statistical sample includes Melli and Agriculture bank which are public and Pasargad and Parsian bank which are private. The results show that there is a significant difference between private and public banks in terms of liquidity and earning performance and management quality. It was also found that private banks have poorer performance in one case which is management quality. In terms of liquidity and earning performance the private banks have better performance but the public banks have better performance in terms of management performance. Also the result of testing the main hypothesis show there is no significant difference in the performance of public and private banks. Although the overall mean suggests the better performance of private

banks, but this difference is not significant. So the private banks should try to improve their performance.

Thagunna & Poudel (2013) have conducted a study on measuring bank performance of Nepali banks: A data envelopment analysis (DEA) perspective. The aim of this study was to develop a performance model for measuring relative efficiency and potential improvement capabilities of Nepali banks by scrutinizing intermediation aspects. For measuring the efficiency and performance, this paper uses a relatively new frontier approach known as data envelopment analysis (DEA). The paper uses two basic DEA models to fulfill its objectives. This paper seeks to measure and analyze the efficiency levels of banks in Nepal during 2007-08 to 2010-11. The study reveals that efficiency level is relatively stable and has increased on overall. Additionally, it also breaks down the overall efficiency of banks into technical and scale efficiency. This study found no significant relationship with efficiency level and ownership structure of banks and there were no notable differences in the efficiency levels of banks according to their asset size.

The above literature review shows that previous researchers have been carried out regarding financial performance analysis of commercial banks as well as financial institutions in the CAMEL framework and only few researchers have tried to attempt to conduct on financial performance on CAMELS framework. Previously, various studies have been conducted on financial performance analysis of various banking and financial institutions in the Nepalese contexts as well as international contexts. It shows that CAMELS framework is suitable, popular, and internationally and widely used framework of financial performance analyzing and evaluation. Focusing the light of such fact, this study attempts to evaluate and analyze the financial performance of Api Finance of Pokhara city on all the six component of CAMELS framework. The selection of CAMELS system is not only because these systems are theoretically sound that attracts as but also it's because their presence in the banking and financial industry of Nepal.

2.3 Research Gap

In the context of Nepalese, especially in Pokhareli banking and financial environment, only a few academic researchers have conducted in the framework of CAMELS. The

previous researchers conducted their researches mainly on commercial banks but there are few research reports on financial institutions. The study was definitely differing from the previous studies because in this study, researcher has made an attempt to evaluate the financial performance of API Finance in the CAMELS framework including sixth component i.e. sensitivity of market risk. This study differs from other research as it looks at the performance evaluation of API Finance which is different from finances in previous researchers. The financial performance analysis and evaluation of Api Finance has not been conducted previously. It means no one has conducted research on the financial performance of API Finance using CAMELS framework. Therefore, this research is conducted to know the actual financial performance of Api Finance Limited in the framework of CAMELS. Focusing the fact of such things, the study of financial performance of such financial company will definitely add a new dimension and lookup towards financial functions of finance companies in general and Api Finance Limited in particular.

CHAPTER III

RESEARCH METHODOLOGY

This study mainly focuses on analyzing and evaluating the financial performance of API Finance in the CAMELS framework. The study has been designed to obtain information on financial performance using CAMELS framework. Therefore, this study has employed a broad framework and tried to apply a more realistic approach to fulfill its objectives. This section discusses research methods employed to accomplish the study objectives. This chapter deals with research design, population and sample, justification of the selection of the unit, nature and sources of data, data collection procedures, data analysis and presentation, methods of data analysis, and limitation of the methodology.

3.1 Research Design

The study designed as case of Api Finance Limited within the descriptive and analytical research design framework. The major emphasis in this study was to analyze and evaluate the performance of Api Finance Ltd. in the CAMELS framework. In the compliance with the objective of the research, both analytical as well as descriptive research designs were chosen in this work in order to analyze and interpret the available data and information. Api Finance Ltd. was chosen as a case of this study. Thus, a case study research design was also used to analyze and describe the data. The research focused the different sources and techniques of historical study and employed several techniques and sources of data for examining the current aspects of the Api Finance Limited.

3.2 Population and Sample

In the study time, all together 32 commercial banks, 90 development banks and 69 financial institutions are in operation in all over Nepal (NRB, 2012). Out of this, Rastriya Banijya Bank is fully owned by Nepal Government while in case of Nepal Bank Ltd, Nepal Government is the major shareholder. There are few joint venture banks in collaboration with the foreign investment partners and remaining are fully owned by Nepalese investors. For the purpose of this study, the population was defined in term of financial institutions. So the population of this study was 69 financial institutions (See Appendix I). Out of these 69 financial institutions, five financial institutions have their central offices in Pokhara Metropolis. But being a case study of a single unit, Api Finance Limited was selected purposively as a sample for this study. That is why for the purpose of this study, one financial institution i.e. Api Finance Ltd. was selected purposively due to the time and budget constraints and previously no any study was conducted in such a financial institution.

3.3 Justification for the Selection of the Study Unit

The researcher selects the Api Finance Limited because it is one of the leading finance company in Nepal. Due to the special role play by the company, questions arises that what is the actual financial performance of Api Finance Limited. The financial performance analysis of Api Finance has not been conducted previously. It means no one has conducted research on the topic of financial performance of API Finance using CAMELS framework. Therefore, this research is conducted to know the actual financial performance of Api Finance Limited in the framework of CAMELS. To fulfill the gap, the study has attempted to solve the problem by taking Api Finance Limited as study unit through purposive and convenience sampling technique. It is also easier to collect the data due to its proximity and recognitions of few branch managers of the Api Finance Limited.

3.4 Nature and Sources of Data

Secondary data and information had been be extensively utilized as the main source of this research work. These data were both quantitative as well as qualitative. But the focus was given to quantitative data. The annual reports of the finance were from the major sources of data. Thus, the study was based on the historical data disclosed by

annual report of Api Finance Ltd. Some other secondary data and information had also been extracted from the different published and unpublished sources such as Nepal Rastra Bank's reports and bulletins, journals, books, articles, various research papers and dissertations, official website of Api Finance Ltd, website of Nepal Rastra Bank, etc. as per the need. The study had covered the last five consecutive fiscal years—from the FY 2064/65 through FY 2068/69.

3.5 Data Collection Procedures

The study was mainly based on secondary data. The study was also based on the historical data disclosed by annual report of Api Finance Ltd. Therefore, the annual reports and other pertinent and related information of Api Finance Ltd. were collected from the Api Finance Ltd's Central Office and official website of the Api Finance and website of Nepal Rastra Bank. Some other related secondary data and information was also extracted from the different published and unpublished sources such as Nepal Rastra Bank's reports and bulletins, journals, books, articles, various research papers and dissertations, etc. as per the need.

3.6 Data Analysis and Presentation

The analysis of this study was exclusively based on the CAMELS framework. Financial performance evaluation is concentrated in the six components such as capital adequacy, asset quality, management quality, earning, liquidity and sensitivity of the market risk. Indicators of each component also were used according to the financial data disclosed in annual reports of Api Finance Limited.

All the collected data from the finance and website have been analyzed both qualitatively as well as quantitatively as per their nature. The information collected from the finance was coded, edited and entered to the computer using the Microsoft Office Excel. Simple descriptive statistics such as percentage, mean/average, etc. have been used to analyze the data and necessary tables, graphs, lines and figures were prepared and inserted under suitable headings. Bibliography was prepared using APA sixth edition available in computer software Microsoft office word 2007. Much more qualitative data were manually managed and descriptively analyzed.

3.7 Method of Data Analysis

Different financial and statistical tools have been used in this study to get the meaningful and reliable result and meet its objectives. Financial ratios are the major data analysis tools for the performance analysis of this study. Besides these, percentage, average, etc. have been used for further analysis. The computer software program such as Microsoft Office Excel 2007 was also used as a tool of data analysis. The computer software, Microsoft Office Excel 2007 and Microsoft Office Word 2007 was used to calculate, analyze and prepare the data, to make figures, tables, graphs, and bibliography. APA sixth references and citation was also used and prepared using the computer software, Microsoft Office Word 2007.

3.8 Data Analysis Tools

Financial ratios in the frame work of CAMELS have been used to analyze the financial performance of Api Finance Limited. The financial ratios are used in this study given in ensuring part of this section.

3.8.1 Capital Adequacy

Capital adequacy ratio is the numerical relationship between total fund and risk adjusted assets. It measures the adequacy of capital and financial soundness of finance company. The following ratios can be used to determine the capital adequacy of Api Finance Limited.

Total Capital Adequacy Ratio

Total capital adequacy ratio can be defined as the numerical expression of total capital fund to total risk weighted assets. It is used to measure the adequacy of capital in the finance. It is determine by the following model.

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

Where,

Total Capital Fund = Core Capital+ Supplementary Capital.

Total Risk Weighted Assets = On-Balance Sheet Risk Assets + Off- Balance Sheet Adjusted Assets.

Core Capital Adequacy Ratio

Core capital adequacy ratio is the expression of numerical relationship between the total core capital and total risk weighted assets. It measures the adequacy of core capital. The ratio is expressed as:

$$\text{Core Capital Adequacy Ratio} = \frac{\text{Total Core Capital}}{\text{Total Risk Weighted Assets}} \times 100$$

Where,

Total Core Capital = Paid-up capital + share premium + non-redeemable preference share + general reserve + cumulative profit.

Supplementary Capital Adequacy Ratio

Supplementary capital adequacy ratio is the expression of numerical relationship between supplementary capital and total risk weighted assets. It measures the proportion of supplementary capital in total risk adjusted assets. The ratio is used to analyze the supplementary capital adequacy of the sample finance institution and determined in the given way:

$$\text{Supplementary Capital Adequacy Ratio} = \frac{\text{Supplementry Capital}}{\text{Total Risk Weighted Assets}} \text{ x } 100$$

Where,

Supplementary Capital = Loan loss provision + exchange equalization reserve + assets revaluation reserve+ hybrid capital instrument + unsecured sub-ordinate term debt + interest rate fluctuation fund + other free reserves.

3.8.2 Asset Quality

Asset Quality can be assessed only indirectly using financial ratios. On-side inspection of the finance outstanding individual loans is certainly the best way to evaluate asset quality. In the absence of this opportunity some financial ratios can provide at least a historical account of the credit worthiness of a particular bank's loan portfolio.

Non-performing Loan Ratio

Non-performing Loan Ratio is the expression of numerical relationship between the Non-performing assets and total loan and advance of the sampled banks and which is determine by using the given model.

$$\text{Non-Performing Loan Ratio} = \frac{\text{Non-Performing Loan}}{\text{Total Loan and Advance}} \text{ x } 100$$

Loan Loss Reserve Ratio

Loan Loss Reserve Ratio is the expression of numerical relationship between the loan loss reserve and total loan and advances. It is used to measure the assets quality of the finance company. For the purpose of this study following model is used to determine the loan loss reserve ratio.

$$\text{Loan Loss Reserve Ratio} = \frac{\text{Loan Loss Reserve}}{\text{Total Loan and Advances}} \times 100$$

3.8.3 Management Efficiency

The following ratios can be used to determine the efficiency of finance company's management.

Earning Per Employee (EPE)

EPE is numerical relationship between operating income and number of employees. Low or decrease earning per employees can reflect in efficiencies as a result of overstaffing with similar repercussions in terms of profitability. It is calculated by using the following model;

$$\text{Earning Per Employee} = \frac{\text{Operating Income}}{\text{Number of Employees}} \times 100$$

Operating Expenses Ratio

Operating expenses ratio is the expression of numerical relationship between total expenses and total income of the finance company. The objective of financial institution is reducing total expenses ratio indicates that financial institutions may not be operating efficiency. The following model can be used calculation of total expenses to total income ratio.

$$\text{Operating Expenses Ratio} = \frac{\text{Total Expenses}}{\text{Total Income}} \times 100$$

3.8.4 Earning Performance

The following ratios can be used to assess the quality of the finance company's earning;

Return on Equity (ROE)

Return on Equity is a measure of the return on money provided by the firm's owners on equity, higher the investment which the shareholders will undertake. It also measure a firm's efficiency at generating profits from every rupee of net assets and shows who well a company uses investment rupees to generate earning model is used to determine the return on equity ratio.

$$\text{Return on Equity} = \frac{\text{Net Income After Tax}}{\text{Total Shareholder's Equity}} \times 100$$

Where,

Total Shareholder's Equity Capital = Paid up Capital + Reserve Funds and Surplus.

Return on Assets (ROA)

Return on Assets is a measure of the return on money provided by both owners and creditors and is a measure of how efficiently all resources are managed. It indicates how capably the management of the finance company has been converting the institutions assets into net earnings. It is calculated by using the following model;

$$\text{Return on Assets} = \frac{\text{Net Income After Tax}}{\text{Total Assets}} \times 100$$

Earnings per Share (EPS)

EPS are the earnings returned on the initial investment amount. It provides a direct measure of the returns flowing to the company's owners and its stockholder measured relative to the numbers of share to the public. It gives the strength of the share in the market. It is calculated by using the following model;

$$\text{Earning per Share} = \frac{\text{Net Income After Tax}}{\text{Number of Share of Common Stock}} \times 100$$

Where,

$$\text{Number of Share of Common Stock} = \frac{\text{Paid up Capital}}{\text{Rs. 100}}$$

Net Interest Margin (NIM)

Net interest margin indicates the relationship between the differences of interest income and interest expenses to earning assets. At least 4% of this ratio can be considered as fair, it can be calculate by using following ratio.

$$\text{Net Interest Margin} = \frac{\text{Interest Income - Interest Expenses}}{\text{Earning Assests}} \times 100$$

3.8.5 Liquidity Position

The following ratios can be used to assess the liquidity of the banks.

Total Liquid Fund to Total Deposit Ratio

A total liquid fund to total deposit is the expression of numerical relationship between total liquid funds and total deposits of the company. It measures the proportion of total liquid funds in total deposits. Furthermore, it shows the overall short-term liquidity position. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the company. It is calculated by using the following model.

$$\text{Total Liquid Fund to Total Deposit Ratio} = \frac{\text{Total Liquid Fund}}{\text{Total Deposit}} \times 100$$

Cash Balance with NRB to Total Deposit Ratio

Cash balance with NRB to Total deposit ratio is the expression of numerical relationship between NRB balance and total deposits of sampled banks. It measures the adequacy of NRB balance held by the bank. It can be calculated by using following model;

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

Cash in Vault to total Deposit Ratio

Cash in vault to Total Deposit Ratio is derived dividing total cash in vault by deposit of sampled company. It shows the percentage of total deposit maintains in vault of the company. It can be calculated by using following model;

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

3.8.6 Sensitivity to Market Risk

The interest rate sensitivity position of a financial institution is estimated by gap analysis. A gap exists between these interest sensitivity assets and interest sensitive liabilities. If interest sensitive assets in an each planning period. i.e. day, week, month etc. which is exceed the volume of interest sensitive liabilities subject to reprising the bank is said to have positive gap and to be assets sensitive. If ΔR_i is the average interest rate change affecting assets and liabilities that can be reprised within i^{th} maturity bucket, the effect on the company's Net Interest Income (ΔNII) in the i^{th} maturity bucket is calculated by;

$$\Delta \text{Nlli} = \left(\sum_{i=1day}^{i=1th\,MaturityBucket} RSAi - \sum_{i=1day}^{1th\,MaturityBucket} RSLi \right) \times \Delta Ri$$

$$= GAP_i \times \Delta R_i$$

Where,

ΔNII_i = Change in interest income in the i^{th} maturity bucket.

GAP_i = Rupee size of gap between book value of rate sensitive assets (RSA) and rate sensitive liabilities (RSL) in the i^{th} maturity bucket.

3.9 Limitation of the Methodology

The study has been carried out in the CAMEL framework only and only one finance i.e. Api Finance Ltd. was the unit of study. It was difficult to use complicated statistical tools in the study due to the nature and sources of data. It was only based on historical secondary data provided by finance or annual reports extracted from website. The analysis of this study has been exclusively based on the CAMELS framework. Indicators of each component also have been used according to the financial data disclosed in annual reports of Api Finance Limited. Therefore, complicated indicators of each component of CAMELS framework of analyzing financial performance of the finance have been skipped up in the study. The qualitative and external variables which affect the performance of the finance were not considered in the study.

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

This chapter is mainly concerned with the data presentation and analysis. As mentioned in earlier chapter, the financial performance analysis of financial institutions is concentrated in the CAMELS framework. The latter portion of the chapter presents the major findings of the study.

4.1 Presentation and Analysis of Data

The pertinent data of this study are collected from annual financial reports of Api Finance Ltd., NRB, etc. Time series data have been used to analysis the financial performance of financial institution in the framework of CAMELS. The major findings from the analysis are made in the following discussion.

4.1.1 Capital Adequacy

Capital adequacy is the fundamental determinant to ensure and rate the banks' soundness and overall health. Capital Adequacy should maintain on the basis of total risk weighted assets. The logic behind the capital adequacy is to protect the interest of public deposit as well as safeguard the banks in their critical financial position. Capital adequacy represents the C in CAMELS and hence is the first component of the CAMELS analysis. Capital adequacy is a measure used to investigate the financial strength of the financial institutions. For a bank to be stable it needs to have sufficient funds in order to cover for the risk assets that are connected to the risk-weighted capital ratios. In this study, to analyze the capital adequacy of Api Finance Ltd., the core capital adequacy ratio, supplementary capital adequacy ratio and capital adequacy ratio have been used.

Capital Adequacy reflects the overall financial condition of the banks and also the ability of management to meet the need for additional capital. It also indicates whether the bank has enough capital to absorb unexpected losses. Qualifying capital consists of Tier 1 (core) capital and Tier 2 (supplementary) capital elements, net of required deductions from capital. Thus, for the purpose of calculation of regulatory capital, banks and financial institutions are required to classify their capital into two parts- core capital and supplementary capital.

4.1.1.1 Core Capital Adequacy Ratio

The key element of capital on which the main emphasis should be placed is the Tier 1 (core) capital. It comprises of equity capital and disclosed reserves. This key element of capital is the basis on which most market judgments of capital adequacy are made. It has a crucial bearing on profit margins and a bank's ability to compete. Capital, for supervisory purposes, was defined in two tiers in a way, which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings. In order to rank as Tier 1, capital must be fully paid up. It has no fixed servicing or dividend costs attached to it and are freely available to absorb losses ahead of general creditors. Capital also needs to have a very high degree of permanence if it is to be treated as Tier 1 (NRB, 2010).

The core capital adequacy reflects the financial strength and soundness of a company. In this study, the core capital adequacy ratio was calculated by core capital divided by total risk weight assets. Core capital is a primary and a permanent nature of capital which comprises of paid-up, share premium, non-redeemable preference share, general reserve, dividend equalization fund, capital adjustment reserve, retained earnings and goodwill detectible if any. The core capital consists principally of stockholder's equity. NRB had provided the minimum standard of core capital adequacy ratio in order to stabilize the capital and assets of financial companies. They are required to maintain the core capital adequacy ratio of 5.5 percent in each year of study period. Table 4.1 shows the core capital adequacy ratio during the study period and minimum core capital standard set by Nepal Rastra Bank in the corresponding period along with variance from NRB standard.

Table 4.1 shows that the core capital adequacy ratio, minimum NRB standard and differences between Api Finance and NRB standard. Table further shows that NRB standard in each year was 5.5 percent.

Table: 4.1
Core Capital Adequacy Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Core Capital	46623.96	68141.95	105662.16	131528.17	145249.97
Total Risk Weight Assets	111358.09	329732.47	407485.09	669089.68	709242.17
Core capital adequacy ratio (%)	41.87	20.66	25.93	19.66	20.48
NRB standard (%)	5.5	5.5	5.5	5.5	5.5
Difference (%)	36.37	15.16	20.43	14.16	14.98

Source: Calculated data from Appendix IV and NRB

The data shows that the core capital ratio of Api Finance Ltd. was found maximum in FY 2064/65. In this year, it is 41.87 percent. It indicates that the very sound core capital adequacy ratio in the beginning year of Api Finance Limited. The minimum core capital ratio of Api Finance Ltd. was found 19.66 percent in FY 2067/68. In the study years, the average core capital adequacy ratio was 25.72 percent. The study revealed that the core capital is in slightly increasing trend while total risk weighted assets are in highly increasing trend during the study period. That is why the core capital ratio is in fluctuating trend during the study period.

The study further reveled that the Api Finance Limited always has met the core capital adequacy ratio set by the minimum standard of NRB. A higher value of the ratio above the NRB standard shows that the adequacy of internal sources and higher security to creditors and depositors in sample company. This can also be shown in figure 4.1.

Figure: 4.1

Core Capital Adequacy Ratio with NRB Standard

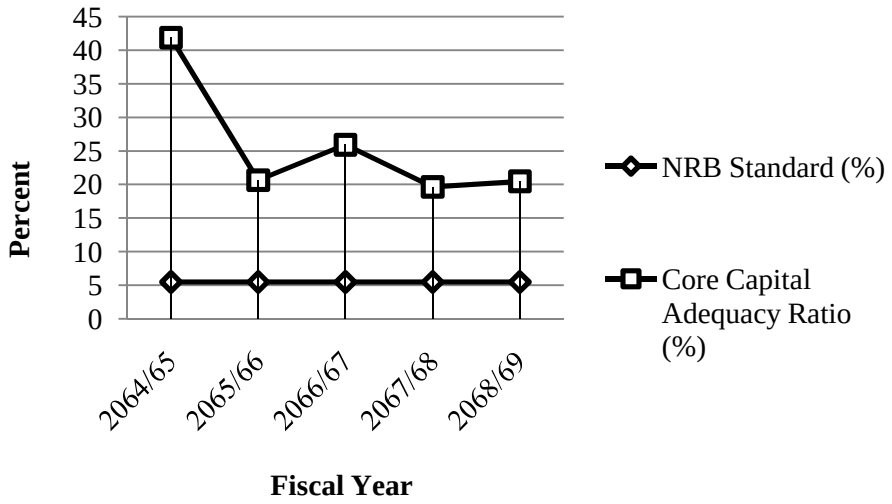


Figure 4.1 shows that the observed value of core capital adequacy ratios of the Api Finance Limited compared with NRB standard. It shows that the core capital adequacy ratios of Api Finance Ltd. are above the NRB standard. This figure ropes the best ratio of the Api Finance Ltd. with the NRB standard during the study years. It indicates that the company was applying adequate amount of internal sources of shareholder's funds with significant core capital adequacy ratio thorough the study years.

4.1.1.2 Supplementary Capital Adequacy Ratio

The supplementary (Tier 2) capital includes reserves which, though unpublished, have been passed through the profit and loss account and all other capital instruments eligible and acceptable for capital purposes. Elements of the Tier 2 capital is reckoned as capital funds up to a maximum of 100 percent of Tier 1 capital arrived at, after making adjustments. In case, where the Tier 1 capital of a bank is negative, the Tier 2 capital for regulatory purposes shall be considered as zero and hence the capital fund, in such cases, should be equal to the core capital (NRB, 2010).

The supplementary capital adequacy also reflects the financial strength and soundness of a company. In this study, the supplementary capital adequacy ratio was calculated by supplementary capital divided by total risk weight assets. Supplementary capital is a secondary capital resource. It includes loan loss provision for pass loan, asset

revaluation reserves, unsecured subordinate term debt, hybrid capital instrument, exchange equalization reserve, additional loan loss provision, investment adjustment reserve and provision for loss in investment. According to NRB unified directives for banks and non-bank financial institutions, the maximum limit of supplementary capital ratio that can be included in capital adequacy ratio was not more than core capital adequacy ratio of the company in each year.

Table: 4.2

Supplementary Capital Adequacy Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Supplementary Capital	965.15	3110.54	4282.43	5535.96	6464.09
Total Risk Weight Assets	111358.09	329732.47	407485.09	669089.68	709242.17
Supplementary Capital Adequacy Ratio (%)	0.87	0.94	1.05	0.83	0.91
NRB standard (Not more than core Capital) (%)	41.87	20.66	25.93	19.66	20.48
Difference (%)	-41	-19.72	-24.88	-18.83	-19.57

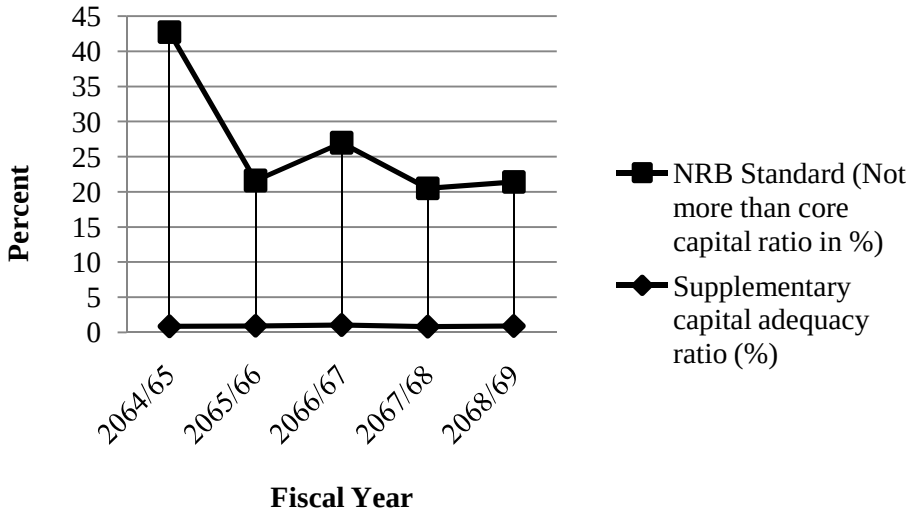
Source: Calculated data from Appendix IV

Table 4.2 presents the supplementary capital adequacy ratio along with NRB standard (not more that core capital) and differences between Api Financial Ltd. and NRB over the study period. Table further shows that the supplementary capital and risk weighted assets both were found in increasing trend. The supplementary capital adequacy ratio was found maximum in FY 2066/67. In this year, it is 1.05 percent while minimum ratio of 0.83 percent was found in FY 2067/68. The average supplementary capital adequacy ratio was found 0.92 percent during the study period. The data shows that supplementary capital adequacy ratio was found in increasing in every study year beside the fiscal year 2067/68. A low value of the supplementary capital then the NRB present the total risk adjusted assets was lower in the capital adequacy ratio. That is why the company was running with adequate supplementary capital. The

observed value of supplementary capital adequacy ratio of Api Finance Ltd. is also shown with NRB standard in Figure 4.2.

Figure: 4.2

Supplementary Capital Adequacy Ratio with NRB Standard



The figure 4.2 indicates that the supplementary capital ratio was not more than that core capital ratio which was set by NRB standard. Therefore the ratio of Api Finance Limited was found within the boundary of NRB standard in the study period. In this way, the study revealed that Api Finance Ltd. was running with adequate capital during the study period.

4.1.1.3 Capital Adequacy Ratio

The capital adequacy ratio (CAR) is calculated by dividing eligible regulatory capital by total risk weighted exposure. The total risk weighted exposure shall comprise of risk weights calculated in respect of bank's credit, operational and market risks.

Same as like core capital adequacy and supplementary capital adequacy, capital adequacy also reflects the financial strength and soundness of a company. In this study, the capital adequacy ratio was calculated by total capital funds divided by total risk weight assets. Total capital fund is the summation of core capital and supplementary capital. Capital adequacy ratio is a measure of a financial institutions' financial strength and capital as a percentage of its risk weighted assets such as the loans it has provided and the securities it holds. Banks and financial institutions

should have adequate capital to support its risk assets in accordance with the risk weighted capital ratio framework. Capital adequacy ratio is used to protect depositors and promote the stability and efficiency of financial system around the world. In Nepalese context, bank and financial institutions also should maintain the adequate capital ratio as directed by NRB. Capital adequacy ratio above the NRB standard indicates the sound and strong financial position of institutions and privileged security to depositors while lower the NRB standard shows weak financial status and lower security to depositors.

Table: 4.3

Capital Adequacy Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Total Capital Funds	47589.12	71252.50	109944.58	137064.14	151711.05
Total Risk Weighted Assets	111358.09	329732.47	407485.09	669089.68	709242.17
Capital Adequacy Ratio (%)	42.74	21.61	26.98	20.49	21.39
NRB standard (%)	11.0	11.0	11.0	11.0	11.0
Difference (%)	31.74	10.61	15.98	9.49	10.39

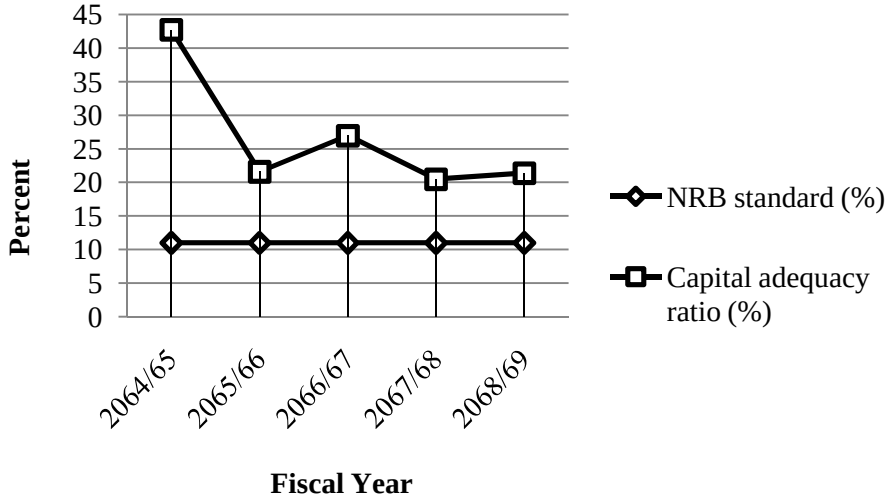
Source: Calculated data from Appendix IV and NRB

Table 4.3 presents that the capital adequacy ratio along with minimum capital adequacy ratio set by NRB standard and differences between NRB standard and Api Finance Limited's capital adequacy ratio during the study period. Table shows that the minimum NRB standard was found 11 percent in each year of the study period. Capital adequacy ratio was found maximum in FY 2064/65. In this year, it is 42.74 percent while minimum ratio was found in FY 2067/68. In this year, it is 20.49 percent. In FY 2065/66 and 2068/69, capital adequacy ratio was almost same (21 percent). During the study period, the average capital adequacy ratio was found 26.64 percent. The study revealed that the total capital funds were in slightly increasing trend while total risk weighted assets were in highly increasing trend during the study period. That is why the capital adequacy ratio was in fluctuating trend during the study period. The study revealed that capital adequacy ratio of Api Finance Ltd. was

above the NRB standard in each study years that indicates the sound and strong financial position and performance of such institution and privileged security to its depositors and creditors.

Figure: 4.3

Capital Adequacy Ratio with NRB Standard



The figure 4.3 indicates that the capital adequacy ratio was more than the NRB standard during the each study years. Therefore the ratio of Api Finance Limited is sound within the boundary of NRB standard in the study years. In this way, the study revealed that Api Finance Ltd. has maintained good and sound adequate capital ratio during the study period. In this way, the company had met NRB standards in each year during the study period.

4.1.2 Assets Quality

The A in CAMELS stands for evaluating the financial performance for a bank and financial institution's asset quality. Ratings for asset quality present current conditions and prospects of future events which can cause changes within the asset quality ratios. The quality can be assessed by looking upon economic condition, practices and trends. Asset quality can be assessed by analyzing loans and investments for the specific institutions. Loans are often the largest item on the balance sheet. The loan portfolio requires management to make it solid and long lasting during all phases in the economic cycle. When there is high loan concentration it requires risk management and reliable practices within the financial institution.

Management of financial institution is generally evaluated in terms of capital adequacy, asset quality, earnings and profitability, liquidity and risk sensitivity ratings. That is why asset quality has a direct impact on the financial performance. In addition, performance evaluation includes compliance with set norms, ability to plan and react to changing circumstances, technical competence, leadership and administrative ability. Sound management is one of the most important factors behind financial institutions' performance. Indicators of quality of management, however, are primarily applicable to individual institutions, and cannot be easily aggregated across the sector. Furthermore, given the qualitative nature of management, it is difficult to judge its soundness just by looking at financial accounts of the banks. Nevertheless, total advance to total deposit, business per employee and profit per employee helps in gauging the management quality of the banking institutions.

The quality of assets is an important parameter to gauge the degree of financial strength. The prime motto behind measuring the assets quality is to ascertain the component of non-performing assets (NPAs) as a percentage of the total assets. This indicates what types of advances the bank has made to generate interest income. Thus, assets quality indicates the type of the debtors the bank is having.

Asset quality had direct impact on the financial performance of any financial institution and there are different indicators of measuring the quality of assets held by a financial institution. But in this study only non-performing loan to total loan and advance ratio and loan loss ratio were used to measure the quality of assets. These two factors are explained in details in below.

4.1.2.1 Non-performing Loan Ratio

Asset quality had direct impact on the financial performance of any financial institution. Loan and advances are the primary sources of income and the most advantageous assets of all the assets of bank and financial institutions. But company need to be careful about the safety of such loan and advances because company may be influenced by bad debts. When the borrowers fail to pay back the interest of principal within the given timeframe, the performing loan begins to start in non-performing loan. The loans which are in pass class and which have been restructured

are called as the performing loan, and the sub-standard, doubtful and loss categories are called non-performing loans.

The average proportion of non-performing loan to total outstanding loan of Finance Companies reached to 16.8 percent in Mid - July 2013 and reached to Rs. 10,512 million. The ratio was 10.7 percent and amount of Rs. 7,145 million in the Mid - July 2012 (NRB 2013).

Non- performing loan includes sub standard, doubtful and loss loan. Sub standard loan is loans/advances which are overdue by a period from three months to a maximum period of six months. Loans/advances which are overdue by a period from six-months to a maximum period of one year is called doubtful loan. Loans/advances which are overdue by a period of more than one year are known as loss loan. Normally international standard of the percentage of non-performing assets is 5-8 percent of the total assets. Non-performing loan to total loan ration of Api Finance Limited is shown in Table 4.4.

Table: 4.4

Non-performing Loan Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Non-performing Loan	126.09	321.06	3025.83	4774.78	1179.25
Total Loan and Advance	96709.97	311375.48	391268.37	558371.19	624287.74
Non-performing Loan Ratio (%)	0.13	0.10	0.77	0.86	0.19

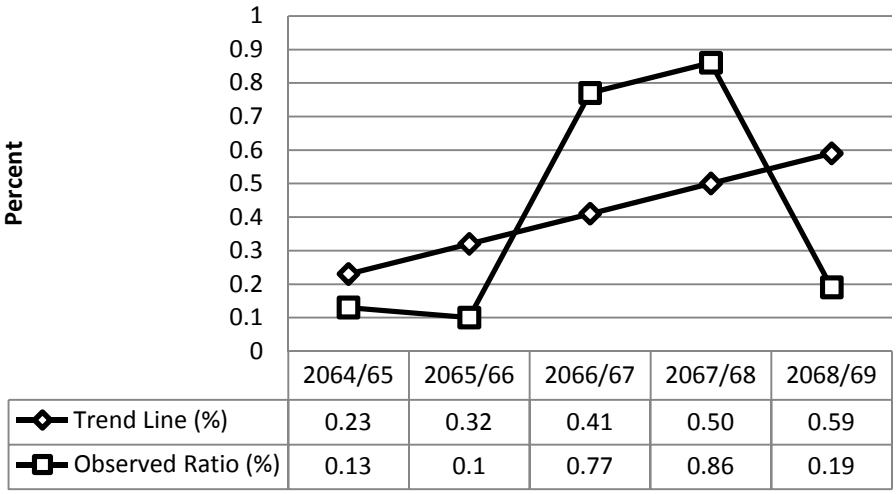
Source: Calculated data from Appendix IV

Table 4.4 presents the non-performing loan to total loan ratio during the study period. Nor performing loan is in increasing trend from FY 2064/65 to 2067/68 while in FY 2068/69 it is decreased. Total loan and advance was in increasing trend in each year of the study period. The study revealed that non performing loan ratio was in

fluctuating trend. The nor performing loan ratio of API Finance Ltd. was 0.13 percent, 0.10 percent, 0.77 percent, 0.86 percent and 0.19 percent in FY 2064/65 to 2068/69 respectively. Non- performing loan ratio was found maximum in FY 2067/68. In this year, it is 0.86 percent while minimum ratio was found in FY 2065/66. In this year, it is 0.10 percent. The average non-performing loan to total loan ratio was found 0.41 percent. The data indicates that the Api Finance Limited was sound in the non-performing loans because in spite of its large amounts of lending, it has very small amounts of loan loss. The study revealed that the non performing loan to total loan ration of Api Finance Limited is in satisfactory level. In general, 5 to 10 percent of non-performing assets is considered as satisfactory level of quality of financial assets.

Figure: 4.4

Trend of Non-performing Loan Ratio



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (%)	0.23	0.32	0.41	0.50	0.59
Observed Ratio (%)	0.13	0.1	0.77	0.86	0.19

Figure 4.4 shows the trend of non-performing loan to total loan ratio during the study period. Trend line (non-performing loan ratio) was found in increasing trend while the non-performing loan ratio was found in fluctuating trend. The non-performing loan ratio was decreased in second year while it was increased in third and fourth year and again it was decreased in last year during the study years.

4.1.2.2 Loan Loss Reserve Ratio

In case there seem any of the following discrepancies in any of the following loans, whether or not the deadline for repayment of which is expired, such loans and advances has to be categorized as the loss loan. These includes: the market price of the collateral cannot secure the loans. The debtor is bankrupt or has been declared to be bankrupt. The debtor disappears or is not identified. In case non-fund based facilities such as purchased or discounted bills and L/C and guarantee which have been converted into fund-based loan, are not recovered within ninety days from the date of their conversion into loan. Loan is misused and expiry of six months of the date of auction process after the loan could not be recovered or a case is pending at a count under the recovery process. Providing loan to a debtor, who has been enlisted in the black-list of Credit Information Bureau Ltd. The Project or business is not in a condition to be operated or project or business is not in operation. The credit card loan is not written off within 90 days from the date of expiry of the deadline. While converting the L/C, guarantee and other possible liabilities into a fund based loan under the regular process, if the said loan is not recovered within 90 days and in case of expiry of the deadline of a trust-receipt loan (NRB 2010).

Loan loss is loans/advances which are overdue by a period of more than one year. It is also known as the loan extended to blacklisted persons, firms, company or corporate body. Loan loss ratio is calculated by amount of loan loss provision divided by amount of total loan and advance. It shows how efficiently the finance manages its loan and advances and makes effort for the loan recovery. If the finance collects the loan lately, more provision has to make and the ratio will be higher which leads to low earning and high losses in the finance.

Table: 4.5

Loan Loss Reserve Ratio

Rupees in '000'

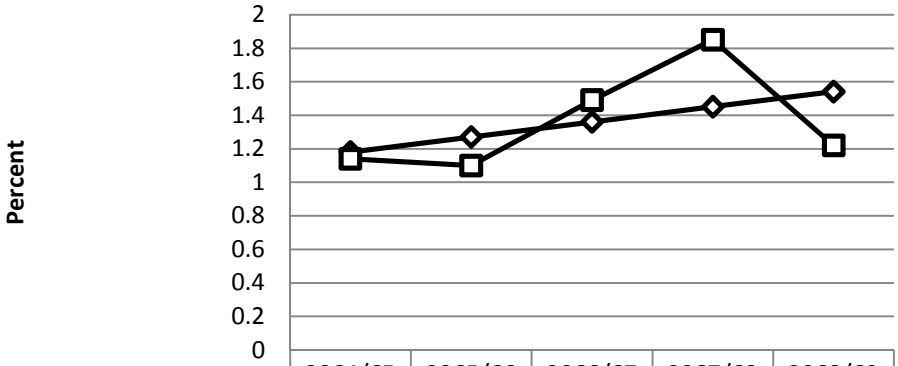
Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Loan Loss Provision	1099.80	3431.60	5823.25	10310.75	7640.33
Total Loan and Advance	96709.97	311375.48	391268.37	558371.19	624287.74
Loan Loss Reserve Ratio (%)	1.14	1.10	1.49	1.85	1.22

Source: Calculated data from Appendix IV

Table 4.5 shows the observed loan loss reserve ratio of Api Finance during the study years. The amount of loan loss provision was found in increasing trend from FY 2064/65 to 2067/68 while in FY 2068/69, it was found decreased. Total loan and advance was in increasing trend in each year of the study period. The study revealed that loan loss ratio was found in fluctuating trend. The loan loss reserve ratio of API Finance Ltd. was found 1.14 percent, 1.10 percent, 1.49 percent, 1.85 percent and 1.22 percent in FY 2064/65 to 2068/69 respectively. Loan loss reserve ratio was found maximum in FY 2067/68. In this year, it is 1.85 percent while minimum ratio was found in FY 2065/66. In this year, it is 1.10 percent. Thus the study revealed that the loan loss ratio were variable and not consistent with the increasing trend. In FY 2064/65, 2066/67 and 2067/68, the loan loss reserve ratio was found in increasing trend than the FY 2064/65 and 2068/69. The lower ratio or decreasing trend indicates the good quality of assets in total volume of loan and advance. It further indicates that the better performance of an institution. The higher ratio or increasing trend indicates that the relatively more risky assets in the volume of loans and advances and also indicates poor credit management and performance. The study revealed that the ratio of Api Finance Limited was found up and down trend but in aggregate all the ratios were found lowest. Therefore, it shows the performance of Api Finance Limited was sound and resonance even in the case of credit management.

Figure: 4.5

Trend of Loan Loss Reserve Ratio



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (%)	1.18	1.27	1.36	1.45	1.54
Observed Ratio (%)	1.14	1.1	1.49	1.85	1.22

The figure 4.5 shows the trend of loan loss reserve ratio during the study period comparing to trend line. Trend line (loan loss reserve ratio) was found in increasing trend while the loan loss ratio was found in fluctuated trend. It was decreased in second year while increased in third and fourth year and in last year it was also decreased during the study period.

4.1.3 Management Quality

The M in CAMELS stands for assessing Management quality. A sound and proper management is innermost for the overall success of institutions. It is generally accorded greater weighting in the analysis of the overall CAMELS components. Management can be seen as the component that has the largest focus on the future and is an important determinant of the ability to create properly computed analysis of how the bank and financial institution responds to financial stress. Management factors should consider among others the risks of interest rate, liquidity, reputation and credit.

Management quality is another vital component of the CAMELS framework that ensures the survival and growth of a bank and financial institution. The ratios in this segment involve subjective analysis and efficiency of management. The management of the bank and financial institution takes crucial decisions depending on the risk perception. It sets vision and goals for the organization and sees that it achieves them. This parameter is used to evaluate management efficiency as to assign premium to better quality banks and discount poorly managed ones. In this study, management quality is gauge by only using total expenses to total income ration and earning per employee which is explain details in below.

4.1.3.1 Operating Expenses Ratio

In any organization and institutions, total income and total expenses are the vital and crucial components to maximize or minimize its profit. To meet the company's objectives, it is necessary to get more income with minimum expenses that can clearly indicate the company's management quality. Interest on loans, advances, remittances, fees and discounts, commissions, foreign exchange rate gains, and other miscellaneous income, etc. are the main income sources of earnings of banks and institutions. On the other hand, main expenses of bank and finance institutions are interest on deposits, staff salary, staff bonus, provident funds, allowances, and other

operating expenses as like rent, electricity, fuel expenses, water, tax and audit fee expenses, management and operations expenses, depreciation, various kinds of losses as like bad debt write-off on loan, loss of sale of assets, loss on investment, etc. and other miscellaneous expenses, etc. In this study, operating expenses ratio is used to assess the management. Operating expenses ratio is arrived by dividing the total amount of expenses by the total amount of income.

Table 4.6 presents the total amount of expenses to total amount of income ratio of Api Finance Limited during the study period. The data indicates that the amounts of total expenses were found in increasing trend except in FY 2068/69.

Table: 4.6

Operating Expenses Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Total Expenses	769.49	1037.24	2147.78	21214.66	14220.33
Total Income	875.55	4178.79	11732.66	22443.51	14834.42
Operating Expenses Ratio (%)	87.89	24.82	18.31	94.52	95.86

Source: Calculated data from Appendix IV

The amounts of total income were also found in increasing trend except in FY 2068/69. Operating expenses ratio was found in fluctuating trends during the study period. In the FY 2065/66 and 2066/67, total expenses to total income ratio has decreased while in the FY 2067/68 and 2068/69, the ratio has been increased. Total expenses to total income ratio was found maximum in FY 2068/69 with 95.86 percent while minimum in FY 2066/67 with 18.31 percent. The average operating expenses ratio was found 64.28 percent during the study period.

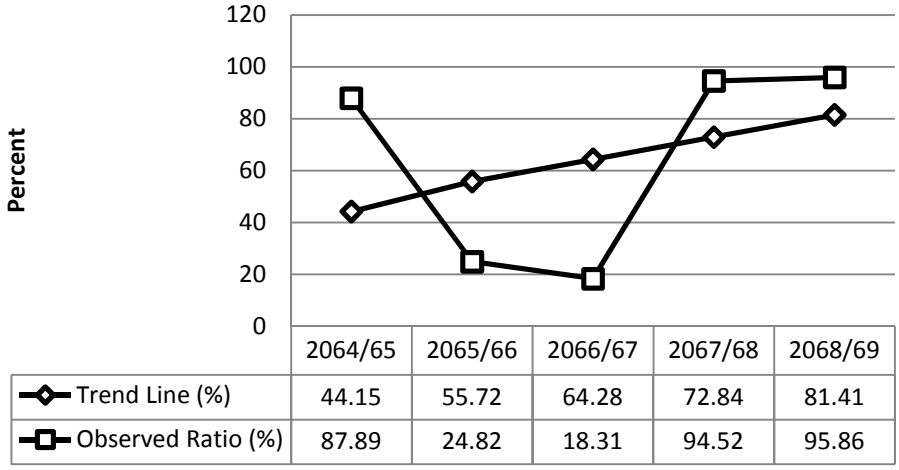
In conclusion, operating expenses ratio is found in satisfactory level because expenses was less than in income level. Although, the expenses ratio has been increased, the income ratio has also been in increasing trend. It indicates that the efficient operation and good management of Api Finance Limited but the company's management should focus to decrease its expenses for the better management in future. That is why it is

concluded that the management quality of Api Finance Limited is in satisfactory level.

Figure 4.6 present the trend of operating expenses ratio. Trend line (operating expenses ratio) was found in increasing trend. Operating expenses ratio was found in fluctuating trend. The ratio was decreased in second and third year while the ratio was increased in last two year of the study period.

Figure: 4.6

Trend of Operating Expenses Ratio



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (%)	44.15	55.72	64.28	72.84	81.41
Observed Ratio (%)	87.89	24.82	18.31	94.52	95.86

4.1.3.2 Earning Per Employee

This tool measures the efficiency of all the employees of a financial institution in generating earning for the financial institution. It is arrived at by dividing the total amount of operating income by number of employees. Generating earning is the sum of total deposits and total advances in a particular year. The higher the ratio, higher is the efficiency of the management. The lower the earning per employee, lower the efficiency of the management or staffs. Due to overstaffing, earning per employee will be decreased which directly and badly affect on the profitability, productivity and good management quality of the institutions.

Table: 4.7

Earning Per Employee

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Operating Income in Thousand (Rs)	963.11	6514.07	13349.55	20250.10	18843.42
Number of Employee	12	20	37	39	61
Earning Per Employee in Thousand (Rs)	80.26	325.70	360.80	519.23	308.91

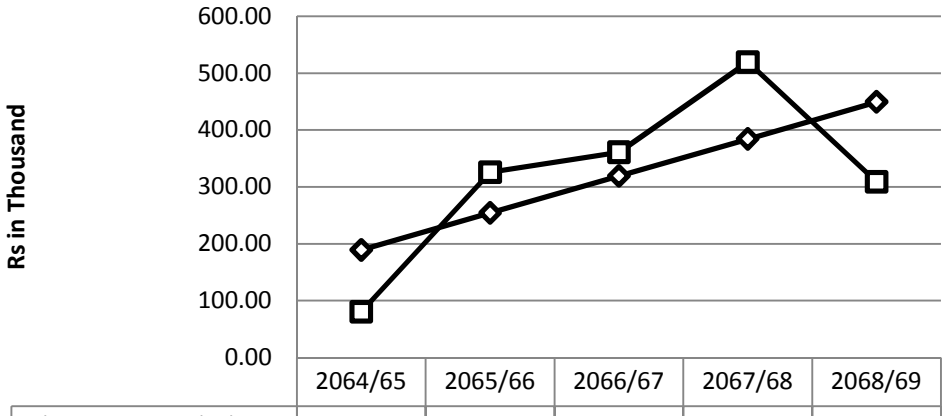
Source: Calculated data from Appendix IV

Table 4.7 shows the earning per employee of Api Finance Limited during the study period. Table further shows that the amount of operating income was increasing in each year except in FY 2068/69. Similarly, total number of employee was also increased. The total employee of Api Finance Limited in FY 2068/69 is 61. The earning per employee was found in increasing trend except in FY 2068/69. The maximum amount of earning per employee was found Rs 519.23 in FY 2067/68 while the minimum amount of earning per employee was found Rs 80.26 in FY 2064/65. The average amount of earning per employee was found Rs 318.98. In this way, earning per employee was found in increasing trend which indicates the good management quality of Api Finance Limited but in final year it was decreased so the company's management should pay the attention of such things. In conclusion, earning per employee of Api Finance Limited was found in comparatively at satisfactory level.

Figure 4.6 present the trend of earning per employee. Trend line (earning per employee in Rs) was found in increasing trend. The amount of earning per employee was found in increasing trend while the amount was decreased in last year of the study.

Figure: 4.7

Trend of Earning Per Employee



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (Rs)	188.81	253.90	318.98	384.06	449.15
Observed Ratio (Rs)	80.26	325.7	360.8	519.23	308.91

4.1.4 Earning Quality

Earning quality reflects quality of a financial institution's profitability and its ability to earn consistently. The quality of earning is a very important criterion that determines the ability of a financial institution to earn consistently, going into the future. The performance of the financial institution's ability to make and maintain earnings is of vital importance; hence the E in CAMELS symbolizes earnings performance.

Long term growth is connected to reasonable profit levels and reserves along with enhancing shareholder value. A positive earnings performance opens opportunities for further expansion, creates competitive advantage and increases capital. The earnings performance can be analyzed by historical earnings, current as well as under different economic conditions. The key factor to investigate is past and current growth level and the stability. The quality and composition of earnings and the assets are reported in the balance sheet.

It basically determines the profitability of a financial institution. It also explains the sustainability and growth in earnings in the future. This parameter gains importance in the light of the argument that much of financial institution's income is earned through non-core activities like investments, treasury operation, and advisory service and so on. In this study, the following ratios (ROE, ROA, NIM and EPS) try to assess the

quality of income in terms of income generated by core activity-income from lending operation.

4.1.4.1 Return on Equity (ROE) Ratio

Return on equity is an earning measure from the equity investor's point of view on the profitability. The return on equity measures how much was earned on the equity invested in the institution. The return is relevant for both investors and management in how to create value for shareholders. Therefore it is one of the important ratios to measure whether the company has earned a satisfactory return for its equity shareholders or not. The historical trends will be analyzed and an indicator on positive return on equity is most often an increasing return during the years. Higher ratio of return on equity ensures to shareholders that their investment is secure and they can get regular return. The higher return on equity ratio represents sound management and efficient mobilization of the shareholders' equity while the lower ratio represents worse management and inefficient mobilization of the shareholders' equity. Generally fifteen percent or more than fifteen percent of return on equity ratio is considered as a sound management and efficient mobilization of the shareholders' equity. Return on equity is arrived at by dividing the total amount of net profit after tax by total shareholder's equity.

Table: 4.8

Return on Equity Ratio

Rupees in '000'

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net Profit after tax	875.55	4148.94	8591.10	12858.63	13605.57
Total shareholder's Equity	42000	60000	60000	126000	137340
Return on Equity Ratio (%)	2.08	6.91	14.32	10.21	9.91

Source: Calculated data from Appendix IV

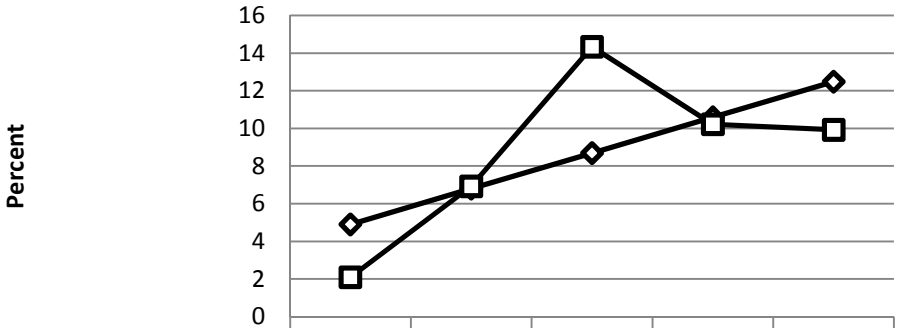
Table 4.8 presents return on equity ratio of Api Finance Limited from FY 2064/65 to FY 2068/69. The data shows that the amount of net profit after tax was found in increasing trend during the study period. It means total shareholder's equity was in

increasing trend except in FY 2066/67. The return on equity ratio was found increasing in first three years of study while remaining two years, it was found decreased. The highest return on equity ratio was found in FY 2066/67. In this year, it is 14.32 percent while lowest return on equity ratio was found in FY 2064/65. In this year, it is 2.08 percent. The study found out that the average return on equity ratio was 8.69 percent during the study period. The study found out that the lower return on equity ratio of Api Finance Limited which represents the worse management and inefficient mobilization of the shareholders' equity. In conclusion, return on equity ratio of Api Finance Limited was not in satisfactory level.

Figure 4.8 presents the trend of return on equity ratio. Trend line (return on equity ratio in percent) was found in increasing trend. The return on equity ratio was found in increasing trend in first three year and while the ratio was found decreased in last two years of study.

Figure: 4.8

Trend of Return on Equity Ratio



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (%)	4.89	6.79	8.68	10.58	12.47
Observed Ratio (%)	2.08	6.91	14.32	10.21	9.91

4.1.4.2 Return on Assets (ROA)

The return on assets is a percentage indicator on the financial institutions efficiency in generating returns on its assets. By taking the total assets one get a measure on the total financial performance for the institution. The total return measures both the profit margin and the efficiency in the organization. An increasing return on asset is considered positive. The higher ratio of return on assets indicates the higher efficiency

of utilizing financial institution's resources and generating more profit. Generally 1.5 or more than 1.5 percent of return on assets ratio is considered as a strong earning capacity of the company. By analyzing the historical changes and trends of return on asset creates an ability to determine impact on changes from policies and managements action. Return on assets is arrived at by dividing the amount of net profit after tax by total assets.

Table 4.9

Return on Assets

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Net Profit after tax	875.55	4148.94	8591.10	12858.63	13605.57
Total Assets	172984.65	400591.66	513579.70	861216.55	990638.80
Return on Assets (%)	0.51	1.04	1.67	1.49	1.37

Source: Calculated data from Appendix IV

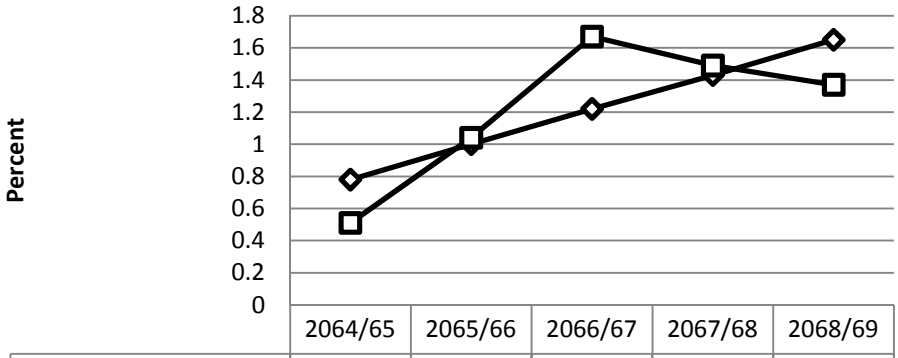
Table 4.9 presents return on assets ratio of Api Finance Limited from FY 2064/65 to FY 2068/69. The data shows that the amount of net profit after tax was found in increasing trend during the study period. Similarly, the amount of total assets was also found in increasing trend but its ratio was higher than the amount of net profit after tax.

In FY 2065/66 to FY 2068/69, return on assets ratio was found higher than expected ratio of 1.5 percent which indicates the higher efficiency of utilizing the Api Finance Limited's resources and generating more profit. It also indicates a strong earning capacity of the company. But in FY 2064/65 and 2065/66, return on assets ratio was found lower which indicates the lower efficiency of utilizing resources and generating less profit. The maximum return on assets ratio was found 1.67 percent in FY 2066/67 while the minimum return on assets ratio was found 0.15 percent in FY 2064/65. The study revealed that the return on assets ratio of Api Finance Limited was increased in second and third year while the ratio was decreased in last two years of study. The average return on assets ratio was found 1.22 percent during the study period which is less than expected ratio of 1.5 percent. That is why the return on assets ratio of Api

Finance Limited was not in satisfactory level. But in the later period, the finance is doing good regarding the return on assets.

Figure: 4.9

Trend of Return on Assets Ratio



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (%)	0.78	1.00	1.22	1.43	1.65
Observed Ratio (%)	0.51	1.04	1.67	1.49	1.37

Figure 4.9 presents the trend of return on assets ratio. Trend line (return on assets ratio in percent) was found in increasing trend. The return on assets ratio was found in increasing trend in first three year and while the ratio was found decreased in last two years of study.

4.1.4.3 Net Interest Margin (NIM)

Net interest margin (NIM), being the difference between the interest income and the interest expenses as a percentage of earning assets. It is an important measure of a financial institution's core income. A higher spread indicates the better earnings given the total assets. High interest revenues and low interest expenses increases the net interest margin of an institutions. This ratio measure of how effectively an institution utilizes its earning assets in relation to the interest cost of funding. In this study, net interest margin was calculated by the amount of the net interest income divided by the amount of earning assets. Earning assets is the sum of loan and advance and investment on securities.

Table: 4.10

Net Interest Margin

Rupees in '000'

Fiscal Year	2064/65	2065/66	2066/67	2067/68	2068/69
Net Interest Income	3234.72	10178.34	21975.78	36277.45	34517.43
Earning Assets	96709.97	311375.48	396190.35	623371.19	624287.74
Net Interest Margin Ratio (%)	3.34	3.27	5.55	5.82	5.53

Source: Calculated data from Appendix IV

Table 4.10 presents the net interest margin ratio of Api Finance Limited during the study period of FY 2064/65 to FY 2068/69. The study found out that the maximum net interest margin was 5.82 percent in FY 2067/68 while the minimum net interest margin was 3.27 percent in FY 2065/66. The study revealed that the net interest margin ratio of Api Finance Limited was found in fluctuating trend. The average net interest margin ratio was found 4.7 percent during the study period which meet the expected ratio of company- between 3 to 4 percent or more than that. The ratio between 3 to 4 percent and higher is better in banking and financial industry. Api Finance Limited has managed well about the interest return on the total landing. That is why the net interest margin ratio of Api Finance Limited was found in satisfactory level. It also indicates that the net interest margin ratio of Api Finance Limited was better.

Figure: 4.10

Trend of Net Interest Margin

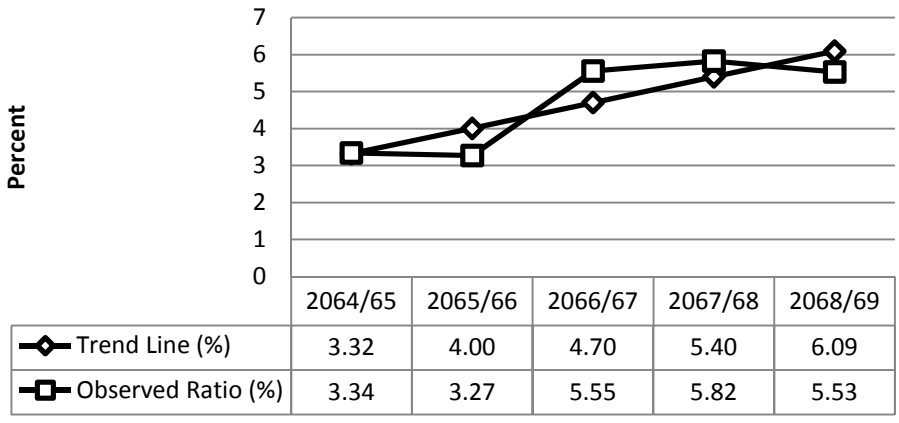


Figure 4.10 presents the trend of net interest margin. Trend line (net interest margin in percent) was found in increasing trend. The net interest margin ratio was found in fluctuating trend. The ratio was decreased in second and last year while the third and fourth year of study it was increased.

4.1.4.4 Earning Per Share (EPS)

Earnings per share are also one of the measurer of earning quality of any financial institution. It measures the profit available to the equity shareholders as per share which is the amount they get from every share. The higher earnings per share indicates greater net profits while lower earnings per share indicates less net profits of institutions. In this study, earning per share was calculated by the amount of the net income after tax divided by the number of share of common stock.

Table: 4.11

Earning Per Share

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Net Income after Tax (Rs)	875.55	4148.94	8591.10	12858.63	13605.57
Number of Share of Common Stock	420	600	600	1200	1260
Earnings Per Share (Rs)	2.08	6.91	14.32	10.72	10.80

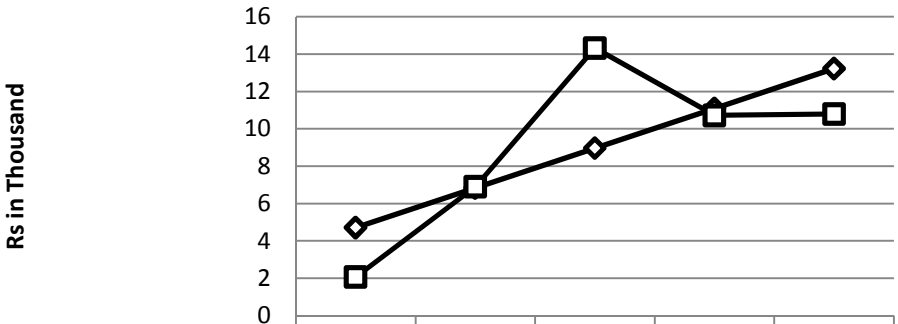
Source: Calculated data from Appendix IV

Table 4.11 shows the amount of earning per share of Api Finance Limited during FY 2064/65 to 2068/69. Table further shows that the number of share was in increasing trend in each study year whereas in the FY 2065/66 and 2066/67, the number of share was same. Earnings per share of Api Finance Limited has been ranged between Rs 2.08 to Rs 14.32 thousand during the study period. The amount of earning per share was in increasing trend except in FY 2067/68 with Rs 10.72. The maximum amount of earnings per share was found in FY 2066/67. In this year, it is Rs 14.32 while the minimum amount of earnings per share was found in FY 2064/65. In this year, it is Rs 2.08. The average amount of earning per share was found Rs 8.97 during the study period. In conclusion, the trend of amount of earning per share was fluctuating during

the study period. Therefore, the management of the institution should focus on their return based on per share basis otherwise shareholder of the institution will not be satisfied with the institution's management. The earnings per share of Api Finance Limited indicates the low strength of the share in the market. That is why the amount of earning per share of Api Finance Limited was not in satisfactory level.

Figure: 4.11

Trend of Earning Per Share



	2064/65	2065/66	2066/67	2067/68	2068/69
Trend Line (Rs)	4.72	6.84	8.97	11.09	13.22
Observed Ratio (Rs)	2.08	6.91	14.32	10.72	10.80

Figure 4.11 presents the trend of earning per share. Trend line (earning per share in percent) was found in increasing trend. The earning per share ratio was found in increasing trend except in second last year of study period.

4.1.5 Liquidity

Liquidity is L in CAMELS and the second last component of this framework. Liquidity is important because a bank or a financial institution must be able to respond to the depositors and creditors demands. The risk that is associated with liquidity is the risk of not being able to respond to the cash flow today and in the future at the same time as the daily operations continue as regular.

An adequate liquidity position refers to a situation, where institution can obtain sufficient funds, either by increasing liabilities or by converting its assets quickly at a reasonable cost. It is, therefore, generally assessed in terms of overall assets and liability management, as mismatching gives rise to liquidity risk. Efficient fund

management refers to a situation where a spread between rate sensitive assets and rate sensitive liabilities is maintained.

For a financial institution, liquidity is a crucial aspect which represents its ability to meet its financial obligations. It is of utmost importance for an institution to maintain correct level of liquidity, which will otherwise lead to declined earnings. Banks and financial institutions have to take proper care in hedging liquidity risk, while at the same time ensuring that a good percentage of funds are invested in higher return generating investments, so that banks and financial institutions can generate profit while at the same time provide liquidity to the depositors. Among a financial institution and a bank's assets, cash investments are the most liquid. A high liquidity ratio indicates that the bank is more affluent. In this study, the liquidity of Api Finance Limited was measured by liquid assets to total deposit ratio, NRB balance to total deposit ratio and cash in vault to total deposit ratio only.

4.1.5.1 Liquid Assets to Total Deposit Ratio

Liquid Assets include cash in hand, balance with the NRB, balance with other banks, and money at call and short notice. Total deposits include demand deposits, savings deposits, term deposits and deposits of other financial institutions. Liquid assets to total deposit ratio is arrived by dividing liquid funds by total deposit. The proportion of liquid funds to total deposits indicates the overall liquidity position of the bank and financial institution. The higher liquid assets to total deposit ratio indicates the better liquidity position of an institution while the lower ratio indicates the inefficient liquidity position of an institution.

Table: 4.12

Liquid Assets to Total Deposit Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Liquid Funds	73708.78	85056.61	106525.02	216507.37	333803.32
Total Deposit	111978.36	326110.07	401740.57	702533.16	833394.66
Liquid Assets to Total Deposit Ratio (%)	65.82	26.08	26.52	30.82	40.05
Industrial Average (%)*	33.93	28.75	28.06	24.00	35.32
Difference (%)	31.89	-2.67	-1.54	6.82	4.73

*Source: Calculated data from Appendix IV and *Appendix II*

Table 4.12 presents the liquid assets to total deposit ratio of Api Finance Limited comparing with industrial average during the study period. The liquid assets to total deposit ratio of FY 2064/65 was found 65.82 percent. It was decreased from 65.82 percent to 26.08 percent in next year- FY 2065/66. After that, the liquid assets to total deposit ratio was increased in each remaining year. In this way, the liquid assets to total deposit ratio was found in increasing trend except in FY 2065/66. The liquid assets to total deposit ratio was found maximum in FY 2064/65. In this year, it is 65.82 percent while the minimum ratio was found in FY 2065/66. In this year, it is 26.08 percent.

The liquid assets to total deposit ratio was positively varied with the industrial average in the three study year- FY 2064/65, FY 2067/68 and FY 2068/69 while the ratio was negatively varied in the other two year- FY 2065/66 and FY 2066/67. But the variation is found in minimum level of percentage. The average liquid assets to total deposit ratio was 37.86 percent during the study period while the average of industrial average was found 30.01 percent in the same study period. That is why Api Finance Limited was able to maintain industrial average to its liquid assets to total deposits ratio during the study period in aggregate. In conclusion, the higher liquid assets to total deposit ratio of Api Finance Limited indicates that the better liquidity position of an institution. The study also revealed that the Api Finance Limited always did not maintain industrial average ratio. Therefore, the finance should try to increase its liquidity position in future for maintain better liquidity position and better performance.

Figure: 4.12

Liquid Assets to Total Deposit Ratio

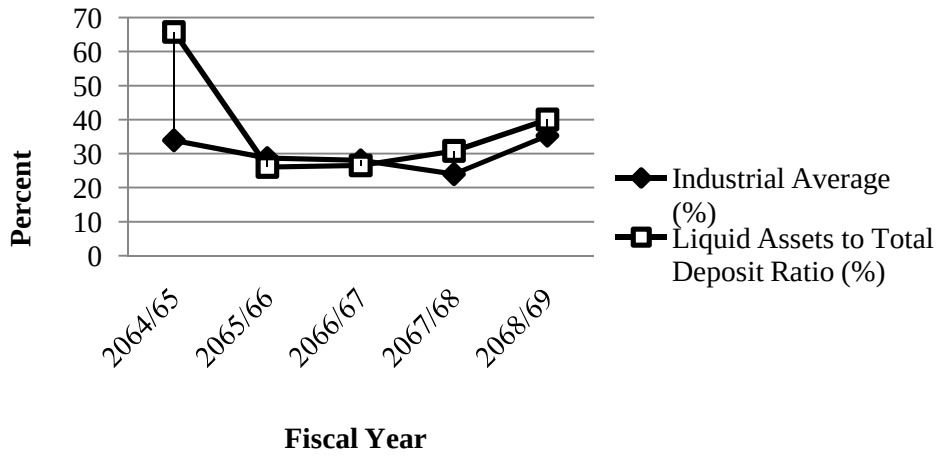


Figure 4.12 shows compared liquid assets to total deposit ratio with industrial average during the study period. It shows the Finance Limited maintained more than industrial average in three years i.e. first and last two years while did not maintain industrial average ratio in remaining two years. But the figure shows that the finance did not maintain industrial average ratio in minimum level of percentage. The figure also indicates that the overall liquidity position of the finance and majority of the years was better than industrial average ratio. The study found the overall liquidity position of the Finance Limited was in satisfactory level comparing with industrial average ratio.

4.1.5.2 NRB Balance to Total Deposit Ratio

NRB balances are the most liquid and safe investment of any financial institution and bank. This ratio measures the proportion of risk-free liquid assets balanced in NRB as a percentage of the deposits held by the bank and financial institution and is arrived by dividing NRB balance by the amount of total deposits. This ratio measures the risk involved in the assets held by a bank or financial institution. NRB balance to total deposit ratio indicates whether the financial institution is holding the balance as required by NRB or not. NRB balance to total deposit ratio is shown in table below.

Table: 4.13

NRB Balance to Total Deposit Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
NRB Balance	3987.14	6564.49	10913.25	15340.43	22683.61
Total Deposit	111978.36	326110.07	401740.57	702533.16	833394.66
NRB Balance to Total Deposit Ratio (%)	3.56	2.01	2.72	2.18	2.72
Industrial Average (%)*	7.37	3.97	3.28	2.82	5.14
Difference (%)	-3.81	-1.96	-0.56	-0.64	-2.42

*Source: Calculated data from Appendix IV and *Appendix II*

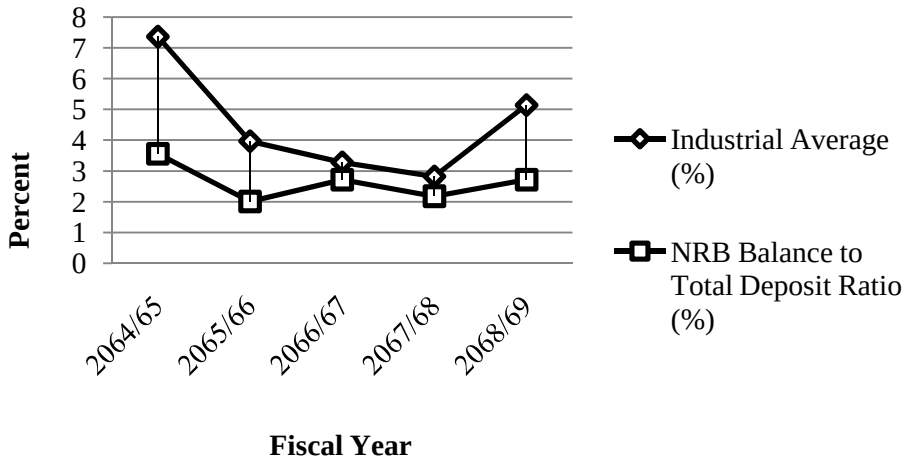
Table 4.13 presents the NRB balance to total deposit ratio with industrial average during the study period of FY 2064/65 to FY 2068/69. Table further shows that the amount of NRB balance and total amount of deposit both were in increasing trends in each year of the study. But the increasing ratio of the amount of NRB balance was

lower than the ratio of the amount of total deposit. Therefore, NRB balance to total deposit ratio was in fluctuating trend. The data indicates that the NRB balance to total deposit ratio was decreased in FY 2065/66 while increased in FY 2066/67. The ratio was decreased in FY 2067/68 while increased in FY 2068/69. In this way, the ratio was found up and down. The NRB balance to total deposit ratio was found maximum in FY 2064/65. In this year, it is 3.56 percent while the minimum ratio was found in FY 2065/65. In this year, it is 2.01 percent. The average NRB balance to total deposit ratio was 2.64 percent during the study year. The study also revealed that Api Finance Limited has not maintained reserve with NRB above the industrial average during the each study year. It indicates that the management of Api Finance Limited was less experience towards the NRB balance. In conclusion, the NRB balance to total deposit ratio of Api Finance Limited was not in satisfactory level because the ratio was below the industrial average which cannot satisfied its depositors.

Figure 1.13 exhibits the compared NRB balance to total deposit ratio with industrial average ratio in percentage during the study period. Compared to the industrial average, the NRB balance to total deposit ratio was found below the industrial average in each study year. The figure further revealed that Api Finance Limited has not maintained reserve with NRB above the industrial average during the study period.

Figure: 1.13

NRB Balance to Total Deposit Ratio



4.1.5.3 Cash in Vault to Total Deposit Ratio

Cash in vault to total deposit ratio is one of the major measuring components of liquidity management of the financial institution. The higher the cash in vault to total deposit ratio is better to liquidity position whereas the lower the cash in vault to total deposit ratio is worse to liquidity position which badly affected the management and performance of an institution. Cash in vault means cash in hand. It represents the ratio measures the percentage of most liquid fund with the bank to make immediate payment to the depositors. Therefore, the financial institution should properly maintain sufficient and appropriate cash reserve in the vault. Cash in vault to total deposit ratio is arrived by dividing the amount of cash in vault by the amount of total deposits. The ratio indicates the percent of total deposit maintained in vault.

Table: 4.14

Cash in Vault to Total Deposit Ratio

Rupees in '000'

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Cash in Vault	1534.53	3756.25	5370.49	11340.66	20534.60
Total Deposit	111978.36	326110.07	401740.57	702533.16	833394.66
Cash in Vault to Total Deposit Ratio (%)	1.37	1.15	1.34	1.61	2.46
Industrial Average (%)	1.13	1.06	1.23	1.43	1.77
Difference (%)	0.24	0.09	0.11	0.18	0.69

*Source: Calculated data from Appendix IV and *Appendix II*

Table 4.14 shows the cash in vault to total deposit ratio of Api Finance Limited along with industrial average during the study period of FY 2064/65 to FY 2068/69. Table further indicates that the amount of cash in vault and amount of total deposit both were increasing year by year during the study period. The cash in vault to total deposit ratio was increased every year except in FY 2065/66. The maximum cash in vault to total deposit ratio was found in FY 2068/69. In this year, it is 2.46 percent whereas the minimum ratio was found in FY 2065/66. In this year, it is 1.15 percent. The average ratio was found 1.59 percent during the study period whereas the average of industrial average was found only 1.32 percent during the same study period. The study revealed that Api Finance Limited has maintained cash in vault to total deposit ratio above the industrial average during the each study year. In conclusion, the cash

in vault to total deposit ratio of Api Finance Limited was found in satisfactory level because the ratio was above the industrial average. It further indicates that Api Finance Limited have adequate cash in vault as liquidity during the study period. In this way, the Api Finance Limited has a good ability to meet the immediate obligation and cash withdrawal by its depositors.

Figure: 4.14

Cash in Vault to Total Deposit Ratio

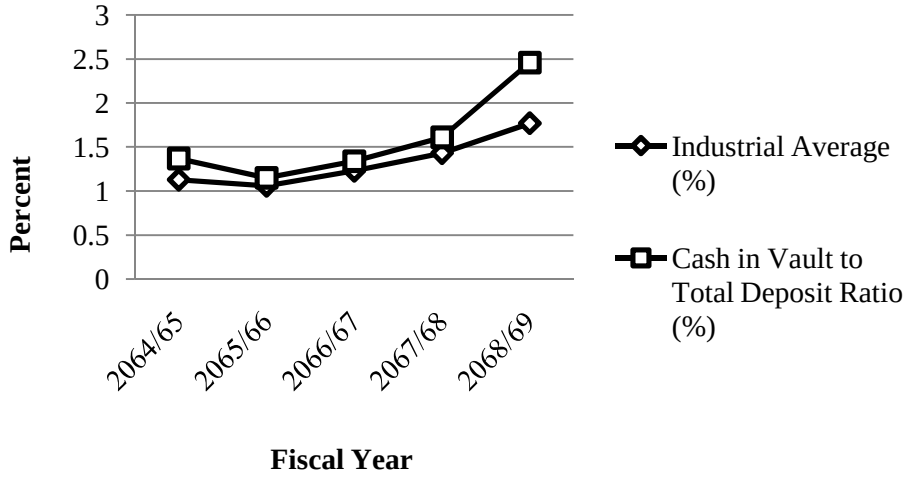


Figure 1.14 exhibits the compared cash in vault to total deposit ratio with industrial average ratio in percentage during the study period. Compared to the industrial average, the NRB balance to total deposit ratio was found above the industrial average in each study year. The figure further revealed that Api Finance Limited has maintained cash in vault to total deposit ratio with the industrial average during the study period. It means that Api Finance Limited have adequate cash in vault as liquidity during the study period.

4.1.6 Sensitivity of Market Risk

Sensitivity of market risk is S in CAMELS and the last component of this framework. It is the one of the most important components to measure and analyze the financial performance and management of any institution. Managing market risk is important because it affects earnings and capital of the financial institutions. Risks are associating in all the banking and financial activities. In banking and financial business risk minimization is to be taken very challenging work. There is a challenge

to maintain competitors' prices and competitors cost of fund. In general, risk has been classified in four categories and directed to manage and minimize the inherent risk according to the nature of the product based on time interval. They are liquidity risk, interest rate risk, foreign exchange risk and credit and investment risk. In the context of Nepalese bank and financial institutions, interest rate risk and exchange rate risk are considered as more challenging risks. Sensitivity of market risk attempts to measure the financial institution’s exposure to changes in interest rates and foreign exchange rates.

According to NRB's unified directives (2010), for the purpose of monitoring the risks relating to banking and financial activities by licensed institutes, the risks have been classified into the liquidity risks, interest rate risks, foreign exchange risks and credit and investment risks.

Furthermore, under this category, rating is applied on the financial institution’s exposure and vulnerability to the interest rate patterns, exchange-rate volatility and fluctuations in the stock prices. For this purpose, rating and measurement are implemented on the sensitivity of the financial institution’s shareholders’ equity and the capital base to any and all changes in the earnings or variables such as the market interest rates, depending on the occurrence of such changes. The study mainly focused interest rate risk which is considered as a primary risk. This study is worked with duration gap model, which are simple method then 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 change in interest rates will have in earnings or capital of the financial institution.

NRB's unified directive published in 2010 has provided the calculation procedure of gap or how to measure a gap. The gap between assets and liabilities was measured by subtracting the total liabilities from the total assets pertaining to each time intervals. Such gap may be positive or negative. For the purpose of minimizing the interest rate risk, the cumulative gap of each time interval was also measured. The cumulative gap is measured by summing the individual gaps up to and including the gap under consideration. Possible changes in interest rate were estimated. For this purpose, the effect that may arise from changes of interest rates by one percent was also

considered. The expected change in interest rate estimated according to changes of interest rates by one percent was adjusted to each of the time interval. With a view to examine the effect on profitability of the bank on account of change in interest rate, the cumulative gap of various time intervals was multiplied by the estimated interest rate determined by each of time interval.

According to NRB, duration gap analysis model adopted for minimization of liquidity risks was also adopted in respect of minimization of interest rate risk. Financial institutions are classify the time interval of the assets and liabilities on the basis of maturity period of 0-90 days, 91-180 days, and 181-270 days, 271-365 days and 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 net interest income (NII) was arrived by multiplying the change in interest rate (Δ R) i in the i^{th} maturity bucket annualized with cumulative gap (CGAP). If the interest rates rise on rate sensitive assets' (RSA) and rate sensitive liabilities' (RSL), the positive CGAP (RSA>RSL) would project increase in the expected annual NII. However, if interest rate falls 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 positively related to the change in interest rates. Thus, banking and financial institutions would want to keep CGAP positively when interest rates expected to rise. On the contrary, when CGAP is negative, the change in NII is negatively related to the change in interest rates. Therefore, financial institutions are expected to keep CGAP negative when interest rates are expected to fall. In this study, the sensitivity of market risk of interest rate were analyzed using rate sensitive assets (RSA), rate sensitive liabilities (RSL), GAP i, cumulative gap, CGAP i ratio, interest rate percent (R %) and change in net interest income (Δ NII), etc. categories. GAP i is arrived by subtracting RSL by RSA. CGAP i ratio is arrived by dividing CGAP by Total RSA. The period from FY 2065/66 to FY 2068/69 were taken for review of the sensitivity of market risk. The FY 2064/65 was not included in this study for reviewing the sensitivity of market risk due to the lack of the availability of the data.

Table 4.15 presents the sensitivity of market risk of Api Finance Limited from FY 2065/66 to 2068/69 on the basis of gap analysis of RSAs and RSLs and on the different maturity time bucket.

Table 4.15 shows that the Rupees gap (RSA-RSL) re-pricing in the short term maturity bucket ranging from 1-90 days to 271-365 days was found negative except in 1-90 days bucket in FY 2065/66. In the long term maturity bucket (> 365 days), the gap was found positive. In the FY 2065/66, the CGAP ratio in the short term horizon was found highest in 1-90 days bucket. In this bucket, it is 11.08 percent while the lowest in 271-365 days bucket. It is minus 25.71 percent. In the long term horizon, CGAP ratio was found 17.73 percent.

Table 4.15 further shows that the Rupees gap (RSA-RSL) re-pricing in the short term maturity bucket ranging from 1-90 days to 271-365 days was found positive except in 271-365 days bucket in FY 2066/67. In the long term maturity bucket (> 365 days), the gap was found positive same as like in previous year. In the FY 2066/67, the CGAP ratio in the short term horizon was found maximum in 181-270 days bucket. In this bucket, it is 19.82 percent while the minimum in 271-365 days bucket. In this bucket, it is 2.55 percent. In the long term horizon, CGAP ratio was found 20.09 percent in the same year.

Table 4.15 presents the Rupees gap (RSA-RSL) re-pricing in the short term maturity bucket ranging from 1-90 days to 271-365 days was found negative except in 1-90 days bucket in FY 2067/68. In the long term maturity bucket (> 365 days), the gap was found positive same as like in previous years. In the FY 2067/68, the CGAP ratio in the short term horizon was found highest in 1-90 days bucket. In this bucket, it is 23.15 percent while the lowest in 271-365 days bucket. It is 2.34 percent. In the long term horizon, CGAP ratio was found 15.17 percent. Table 4.15 further exhibits that the Rupees gap (RSA-RSL) re-pricing in the short term maturity bucket ranging from 1-90 days to 271-365 days was found negative except in1-90 days bucket in FY 2068/69. In the long term maturity bucket (> 365 days), the gap was found positive same as like in previous years.

Table: 4.15

Sensitivity of Market Risk of Api Finance Limited (FY 2065/66 to 2068/69)

Rupees in '000'

FY 2065/66						
	Days					**Total**
Category	**1-90**	**91-180**	**181-270**	**271-365**	**> 365**	
RSA	97970	19510	19510	19510	239899	396399
RSL	54053	55231	54053	95063	67710	326110
GAPi = (RSA-RSL)	43917	-35721	-34543	-75553	172189	70289
CGAP	43917	8196	-26347	-101900	70289	
RSA/RSL (Interest Sensitivity Ratio- ISR)	1.81	0.35	0.36	0.21	3.54	1.22
CGAPi ratio = (CGAP /Total RSA) in %	11.08	2.07	-6.65	-25.71	17.73	
R %				1	1	
Δ NII = (CGAP x R)				-1019	702.89	
FY 2066/67						
RSA	158823	75512	70590	70590	130480	505995
RSL	71406	66417	66797	157977	41764	404360
GAPi = (RSA-RSL)	87417	9095	3793	-87387	88716	101635
CGAP	87417	96512	100305	12918	101634	
RSA/RSL (ISR)	2.22	1.14	1.06	0.45	3.12	1.25
CGAPi ratio = (CGAP /Total RSA) in %	17.28	19.07	19.82	2.55	20.09	
R %				1	1	
Δ NII = (CGAP x R)				129.18	1016.34	
FY 2067/68						
RSA	310962	79937	75093	80997	311290	858278
RSL	112228	103315	85253	226078	201227	728102
GAPi = (RSA-RSL)	198734	-23378	-10160	-145081	110063	130176
CGAP	198734	175356	165196	20115	130178	
RSA/RSL (ISR)	2.77	0.77	0.88	0.36	1.55	1.18
CGAPi ratio = (CGAP /Total RSA) in %	23.15	20.43	19.25	2.34	15.17	
R %				1	1	
Δ NII = (CGAP x R)				201.15	1301.78	
FY 2068/69						
RSA	435955	96311	96311	96311	263101	987991
RSL	117812	123136	117379	328940	162889	850156
GAPi = (RSA-RSL)	318143	-26825	-21068	-232629	100212	137835
CGAP	318143	291318	270250	37621	137833	
RSA/RSL (ISR)	3.70	0.78	0.82	0.29	1.62	1.16
CGAPi ratio = (CGAP /Total RSA) in %	32.20	29.49	27.35	3.81	13.95	
R %				1	1	
Δ NII = (CGAP x R)				376.21	1378.33	

Source: Annual reports of Api Finance Ltd. and worked out from Table 4.15

In the FY 2068/69, the CGAP ratio in the short term horizon was found maximum in 1-90 days bucket. In this bucket, it is 32.20 percent while the minimum in 271-365 days bucket. It is 3.81 percent. In the long term horizon, CGAP ratio was found 13.95 percent in the same year.

The CGAP in the short term maturity bucket was found both positive and negative during the study period. The CGAP in the long term maturity bucket was found positive in all the study period. In short term horizon, the CGAP trend of Api Finance Limited was found decreasing except in FY 2066/67. In long term horizon, comparing to all the year, the CGAP was found in increasing trend during the study period. Comparing to all the study period, the CGAP ratio in short term horizon was found maximum in FY 2068/69. In this year, it is 32.20 percent while the minimum ratio was found in FY 2065/66. In this year, it is minus 25.71 percent during the study period. The CGAP ratio in short term horizon bucket was found positive except in 181-270 and 271-365 days bucket in same FY 2065/66. It indicates RSA and RSL in re-pricing in short-term maturity bucket are sensitive to interest rate. The CGAP ratio in long term maturity bucket was found maximum ratio in FY 2066/67. In this year, it is 20.09 percent while the minimum ratio was found in FY 2068/69. In this year, it is 13.95 percent during the study period. The study revealed that the CGAP ratio of Api Finance Limited was found in fluctuating trend in every study year. The CGAP ratio in long term maturity bucket was found positive during the study period. That is why the long-term horizon of the company is also sensitive to interest rate risks.

4.2 Major Findings of the Study

The major findings of the study of financial performance analysis of Api Finance Limited company ltd. in the framework of CAMELS are as follows:

4.2.1 The core capital ratio of Api Finance Ltd. was found maximum in FY 2064/65 In this year, it is 41.87 percent while the minimum core capital ratio of Api Finance Ltd. was found 19.66 percent in FY 2067/68. In the study years, the average core capital adequacy ratio was 25.72 percent.

4.2.2 The supplementary capital and risk weighted assets both were found in increasing trend. The supplementary capital adequacy ratio was found maximum in FY 2066/67. In this year, it is 1.05 percent while minimum ratio of 0.83

percent in FY 2067/68. The average supplementary capital adequacy ratio was found 0.92 percent during the study period.

4.2.3 Capital adequacy ratio was found maximum in FY 2064/65 with 42.74 percent while minimum in FY 2067/68. In this year, it is 20.49 percent. In FY 2065/66 and 2068/69, capital adequacy ratio was almost same (21 percent). During the study period, the average capital adequacy ratio was found 26.64 percent.

4.2.4 The nor performing loan ratio of API Finance Ltd. was 0.13 percent, 0.10 percent, 0.77 percent, 0.86 percent and 0.19 percent was found in FY 2064/65 to 2068/69 respectively. Non- performing loan ratio was found maximum in FY 2067/68. In this year, it is 0.86 percent while minimum in FY 2065/66. In this year, it is 0.10 percent. The average non-performing loan ratio was found 0.41 percent.

4.2.5 The study revealed that loan loss reserve ratio was found in fluctuating trend. The loan loss reserve ratio of Api Finance Limited was found 1.14 percent, 1.10 percent, 1.49 percent, 1.85 percent and 1.22 percent in FY 2064/65 to 2068/69 respectively. Loan loss reserve ratio was found maximum in FY 2067/68. In this year, it is 1.85 percent while minimum in FY 2065/66. In this year, it is 1.10 percent. Thus the study revealed that the loan loss reserve ratio were variable and not consistent with the increasing trend. In FY 2064/65, 2066/67 and 2067/68, the loan loss reserve ratio was found in increasing trend than the FY 2064/65 and 2068/69.

4.2.6 Operating expenses ratio was found in fluctuating trend during the study period. In the FY 2065/66 and 2066/67, operating expenses ratio has decreased while in the FY 2067/68 and 2068/69, the ratio has been increased. Operating expenses ratio was found maximum in FY 2068/69. In this year, it is 95.86 percent while minimum in FY 2066/67. In this year, it is 18.31 percent. The average operating expenses ratio was found 64.28 percent during the study period.

4.2.7 The earning per employee was found in increasing trend except in FY 2068/69. The maximum amount of earning per employee was found Rs 519.29 in FY 2067/68 while the minimum amount of earning per employee was found Rs 80.26 in FY 2064/65. The average amount of earning per employee was found Rs 318.98. In this way, earning per employee was found in increasing trend but in final year it was found decreased.

4.2.8 The highest return on equity ratio was found in FY 2066/67. In this year, it is 14.32 percent while lowest return on equity ratio was found in FY 2064/65 with 2.08 percent. The study found out that the average return on equity ratio was 8.69 percent during the study period. Api Finance Limited's ROE ratio is lower than the generally accepted ratio. It is 15 percent or more than 15 percent.

4.2.9 In FY 2065/66 to FY 2068/69, return on assets ratio was found higher than expected ratio of 1.5 percent which indicates the higher efficiency of utilizing Api Finance Limited's resources and generating more profit. It also indicates a strong earning capacity of the company. But in FY 2064/65 and 2065/66, return on assets ratio was found lower which indicates the lower efficiency of utilizing resources and generating less profit. The maximum return on assets ratio was found 1.67 percent in FY 2066/67 while the minimum return on assets ratio was found 0.15 percent in FY 2064/65. The study revealed that the return on assets ratio of Api Finance Limited was increased in second and third year while the ratio was decreased in last two years of the study. The average return on assets ratio was found 1.22 percent during the study period which is less than expected ratio i.e. 1.5 percent.

4.2.10 The study found out that the maximum net interest margin ratio was 5.82 percent in FY 2067/68 while the minimum net interest margin was 3.27 percent in FY 2065/66. The study revealed that the net interest margin ratio of Api Finance Limited was in fluctuating trend. The average net interest margin ratio was found 4.7 percent during the study period which meet the expected ratio of company i.e. between 3 to 4 percent or more than that.

4.2.11 Earnings per share of Api Finance Limited has been ranged between Rs 2.08 to Rs 14.32 thousand during the study period. The amount of earning per share was in increasing trend except in FY 2067/68. The maximum amount of earnings per share was found in FY 2066/67. In this year, it is Rs 14.32 while the minimum amount of earnings per share was found in FY 2064/65. In this year, it is Rs 2.08. The average amount of earning per share was found Rs 8.97 during the study period.

4.2.12 Liquid assets to total deposit ratio was found in increasing trend except in FY 2065/66. The liquid assets to total deposit ratio was found maximum in FY 2064/65. In this year, it is 65.82 percent while the minimum ratio was found in FY 2065/66. In this year, it is 26.08 percent. The liquid assets to total deposit

ratio was positively varied with the industrial average in the three study year i.e. FY 2064/65, FY2067/68 and FY 2068/69 while the ratio was negatively varied in the two year i.e. FY 2065/66 and FY 2066/67. But the variation is found in minimum level of percentage. The average liquid assets to total deposit ratio was 37.86 percent during the study period while the average of industrial average was found 30.01 percent in the same study period.

4.2.13 NRB balance to total deposit ratio was found in fluctuating trend during the study period. The data indicates that the NRB balance to total deposit ratio was decreased in FY 2065/66 while increased in FY 2066/67. The ratio was decreased in FY 2067/68 while increased in FY 2068/69. In this way, the ratio was found up and down. The NRB balance to total deposit ratio was found maximum in FY 2064/65. In this year, it is 3.56 percent while the minimum ratio was found in FY 2065/66. In this year, it is 2.01 percent. The average NRB balance to total deposit ratio was 2.64 percent during the study year.

4.2.14 Cash in vault to total deposit ratio was increased every year except in FY 2065/66. The maximum cash in vault to total deposit ratio was found in FY 2068/69. In this year, it is 2.46 percent whereas the minimum ratio was found in FY 2065/66. In this year, it is 1.15 percent. The average ratio was found 1.59 percent during the study period whereas the average of industrial average was found only 1.32 percent during the same study period.

4.2.15 During the study period, the CGAP ratio in short term horizon was found maximum in FY 2068/69. In this year, it is 32.20 percent while the minimum ratio was found in FY 2065/66. In this year, it is minus 25.71 percent during the study period. The CGAP ratio in short term horizon bucket was found positive except in 181-270 and 271-365 days bucket in the same FY 2065/66. The CGAP ratio in long term maturity bucket was found maximum in FY 2066/67. In this year, it is 20.09 percent while the minimum ratio was found in FY 2068/69. In this year, it is 13.95 percent.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

From the analysis and discussions of above information, the summary, conclusions and recommendations /suggestions were deduced and are presented as follows:

5.1 Summary

The general objective of this study is to analyze and evaluate the financial performance of Api Finance Limited in the framework of CAMELS. For this, the study covered five fiscal years' of data (2064/65 to 2068/69 BS) of Api Finance Ltd. were used for analyzing and evaluating the financial performance. For analyzing the data, descriptive and analytical research design were used. The sample of the study, API Finance Ltd was chosen purposively and conveniently. The study was mainly based on secondary data available in pertinent financial institution and difference websites. Annual report and financial statements of the finance were major sources of data for this study. Various financial and statistical tools were used in the study go get the meaningful result and to meet the objectives of the study. The computer software, Microsoft Office Excel 2007 and Microsoft Office Word 2007 was used to calculate, analyze, and prepare data, to make figures, tables, and bibliography too. CAMELS framework was used as a common technique for evaluating and describing the financial performance of such financial institution.

The CAMELS rating system provides a means to categorized bank based on the overall health, financial status and measurement of financial institutions and banks financial, managerial, operational and complying performance. The CAMELS assessed the performance based on capital adequacy, asset quality, management competency, earnings, liquidity and sensitivity of market risk. Therefore, in this study CAMELS rating system has been adopted for measuring overall health and financial status of Api Finance Limited. In this study, these six individual factors were typically

evaluated on a ratio scale. The CAMELS rating ranges from 1 to 5, lower rating representing a better and well managed firm. In the modern context, CAMELS Framework is widely used framework for analyzing and evaluating the financial and banking performance. In the Nepalese context, Nepal Rastra Bank's Supervision Department is also used CAMELS rating scale to find out the financial performance of banking and financial institutions of Nepal. A variety of literatures were reviewed to develop the conceptual and theoretical foundation of the study. Different types of research works as like research articles and dissertations were also reviewed to compare and draw conclusion. For the analysis, NRB standard, trend of ratios and industrial average were used to compare the sampled institution's ratios.

The core capital ratio of Api Finance Limited is in fluctuating trend during the study period. The institution always met the core capital adequacy ratio set by the minimum standard of NRB. The company was applying adequate amount of internal sources of shareholder's funds with significant core capital adequacy ratio. The supplementary capital ratio was not more than that core capital ratio which was set by NRB standard. Therefore the ratio of Api Finance Limited was found within the boundary of NRB standard in the study period. The capital adequacy ratio is above the NRB standard in each study years that indicates the sound and strong financial position and performance of institution and privileged security to its depositors and creditors. Core capital, supplementary capital and total capital adequacy ratios indicates that the Api Finance Limited is running with adequate capital. The capital adequacy ratios above the NRB standard show the financial soundness of company. Api Finance Limited is sound in the non-performing loans because in spite of its large amounts of lending, it has very small amounts of loan loss. The loan loss reserve ratio of Api Finance Limited is found in up and down trend but in aggregate all the ratios are found lowest. Non-performing loan ratio and loan loss reserve ratio are found in low level. That indicates the credit management of finance is sound and resonance.

Operating expenses ratio is satisfactory because expenses was less than in income level. Operating expenses ratio was found in fluctuating trend during the study period. Although, the expenses ratio has increased, the income ratio has also been in increasing trend. Earning per employee is found in increasing trend which indicates the good management quality of finance but in final year it is decreased. It indicates

that the efficient operation and good management of finance. The return on equity ratio is found increasing in first three years of study while remaining two years, it is found decreased. The study found out that the lower return on equity ratio. The return on assets ratio of Api Finance Limited is increased in second and third year while the ratio is decreased in last two years of study. It means the institution is doing better in present context. The net interest margin ratio of Api Finance Limited is found in fluctuating trend. Api Finance Limited has managed well about the interest return on the total landing because it maintained the expected ratio of company i.e. between 3-4 percent or more than that. The trend of amount of earning per share is found fluctuating. The earnings per share of Api Finance Limited indicates the low strength of the share in the market. The amount of earning per share is not satisfactory.

The liquid assets to total deposit ratio is found in increasing trend except in one study year. The ratio is positively varied with the industrial average in the three study years while the ratio was negatively varied in the two years. But the variation is found in minimum level of percentage. Api Finance Limited was able to maintain industrial average to its liquid assets to total deposits ratio during the study period in aggregate. NRB balance to total deposit ratio is found in fluctuating trend. The ratio is below the NRB standard in each study years. It indicates that the management of Api Finance Limited was less experience towards the NRB balance. The cash in vault to total deposit ratio is increased every year except in one study year. Api Finance Limited has maintained cash in vault to total deposit ratio above the industrial average during the each study year. The CGAP ratio in short term horizon bucket was found positive except in two bucket in the same one year. It indicates RSA and RSL in re-pricing in short-term maturity bucket are sensitive to interest rate. The CGAP ratio in long term maturity bucket was found positive during the study period. The study revealed that the CGAP ratio of Api Finance Limited was found in fluctuating trend in every study year.

5.2 Conclusions

Based on the major findings, the performance of API Finance Ltd. in CAMELS framework, following conclusions have been drawn:

5.2.1 The core capital adequacy and total capital adequacy ratios are above the NRB standard and supplementary capital adequacy ratio is within the boundary of

NRB standard. The ratios indicate that the Api Finance Limited is running with adequate capital with good ratios. The company has maintained the adequacy of internal sources and higher security to creditors and depositors.

From the analysis, it can be concluded that the Api Finance Limited is well capitalized and have succeeded in maintaining capital adequacy ratio at higher level than the prescribed level during the study period which indicates that the financial soundness of company.

5.2.2 Api Finance Limited is sound in the non-performing loans because it has very small amounts of loan loss. The non-performing loan ratio of Api Finance Limited is satisfactory. The loan loss reserve ratio of Api Finance Limited is found in up and down trend but in aggregate all the ratios are found lowest. Non-performing loan ratio and loan loss reserve ratio are found in low level.

It is concluded that the credit risk of the Api Finance Limited is minimum level and company is performing well in the loan and advance mobilization. It is also concluded that the performance of Api Finance Limited is sound and resonance even in the case of credit management and recovery efforts. The company is maintaining and improving loan quality day by day and aware of bad loan too. The assets quality of finance is good and satisfactory.

5.2.3 Operating expenses ratio is satisfactory because expenses was less than in income level. Although, the expenses ratio has been increased, the income ratio has also been in increasing trend. It indicates that the efficient operation and good management of Api Finance Limited.

That is why it is concluded that the management quality of finance is satisfactory. Earning per employee is increasing which indicates the good management quality of Api finance but in final year it is decreased. In conclusion, earning per employee of Api Finance Limited is in comparatively at satisfactory level. The income of company is more than its expenses and the earning per employee is increasing. Thus, in conclusion, the company is

succeeded in maintaining management efficiency and quality during the study period.

5.2.4 The return on equity ratio is lower than the prescribed level which indicates the worse management and inefficient mobilization of the shareholders' equity. The return on assets ratio is fluctuated and lower than the prescribed level. The return on equity ratio and return on assets ratio both are not satisfactory. But in contrary, the finance is managing well about the interest return on the total landing. In conclusion, the net interest margin ratio is better and satisfactory. The amount of earning per share is fluctuating during the study period. Therefore, the management of the institution should focus on their return based on per share basis. The earnings per share indicate the low strength of the share in the market.

That is why the amount of earning per share of Api Finance Limited is not satisfactory. From the analysis, it can be concluded that the finance company is not succeeded in maintaining earning quality at higher level than the prescribed level during the study period which indicates the earning quality of company is not so strong. In conclusion, the company has a low capacity to earn more profit that cannot be satisfying shareholders. Further, the return on equity ratio, return on assets and earnings per share is not so strong and satisfactory while net interest margin ratio is strong and satisfactory.

5.2.5 The Liquidity ratio indicated better liquidity position of finance during the study period. The company is not facing the liquidity deficit problem. Liquid assets to total deposit ratio is above the industrial average in aggregate. The overall liquidity position of the finance is satisfactory. The finance has maintained cash in vault to total deposit ratio above the industrial average during the each study year. The cash in vault to total deposit ratio of finance is satisfactory. It further indicates that finance have adequate cash in vault as liquidity during the study period.

In conclusion, the finance has a good ability to meet the immediate obligation and cash withdrawal by its depositors. But, the finance is not maintaining

reserve with NRB above the industrial average during the each study year. It indicates that the management of Api Finance Limited is less experience towards the NRB balance. In conclusion, the NRB balance to total deposit ratio of finance is not in satisfactory level because the ratio is below the industrial average which cannot satisfied its depositors.

5.2.6 The CGAP ratio in short term horizon bucket is positive except in two bucket in the same one year. It indicates RSA and RSL in re-pricing in short-term maturity bucket are sensitive to interest rate. The CGAP ratio in long term maturity bucket is also positive during the study period. The study revealed that the CGAP ratio of Api Finance Limited is fluctuating. In conclusion, the company is sensitive to both the short term horizon and the long-term horizon to its interest rate risk. Thus, the company is highly sensitive to its market risk.

From the above emerging point it is obvious that the Api Finance Limited perform excellently in respect of most important parameters of performance. The sufficient levels of capital adequacy, good quality assets, improve efficiency of management quality, improved profitability and sufficient liquidity and highly sensitive to market risk indicates the good performance of finance. However, there are some areas of deficiencies in the financial sector, especially the earning quality, ROE, ROA, EPS and NRB balance to total deposit ratio.

5.3 Recommendations

Based on the findings of the study, following recommendations/suggestions are made:

5.3.1 The core capital ratio and capital adequacy ratio both are fluctuated while the supplementary capital ratio is not always in increasing trend. Thus the company should always maintain the total capital adequacy ratio in increasing trend. Although, the total capital adequacy ratio is above the NRB standard over the study period, the financial institution should strictly follow the NRB standard and directives in future too.

5.3.2 The finance is sound in the non-performing loans because in spite of its large amounts of lending, it has very small amounts of loan loss but the ratio is fluctuated. The loan loss reserve ratio is variable and not consistent with the

increasing trend. Thus, the company should be sincere while disburse loan and to do effective follow up for recovery of non-performing loan in future too and should maintain its fluctuated trend.

5.3.3 Operating expenses ratio was found in fluctuating trends during the study period. The ratio is increased in last two years of the study. Thus the company's management should focus to decrease its expenses for the better management in future. Amount of earning per employee is found in increasing trend but in final year it is decreased so the company's management should pay the attention of such things. Thus the finance should try to increase the amount of earning per employee.

5.3.4 The return on equity ratio and return on assets ratios are increased in first three years of study while remaining two years, it is decreased. The finance has a lower return on equity ratio which represents the worse management and inefficient mobilization of the shareholders' equity. The net interest margin ratio of finance is fluctuating. Thus, the finance should try to increase and maintain the ratios. The amount of earning per share is fluctuated during the study period. Therefore, the management of the institution should focus on their return based on per share basis otherwise shareholder of the institution will not be satisfied with the institution's management. The finance should try to increase ROE, ROA and EPS. The finance should properly used shareholders’ equity, financial assets and employees to increase its own earning and profit.

5.3.5 The finance is able to maintain industrial average to its liquid assets to total deposits ratio during the study period in aggregate. But, the liquid assets to total deposit ratio is positively varied with the industrial average in the three study years while the ratio is negatively varied in the two study years. Thus, the company should try to maintain the liquid assets to total deposit ratio.

5.3.6 The NRB balance to total deposit ratio is below the industrial average in each study year which cannot satisfied its depositors. It indicates that the management of Api Finance Limited is less experience towards the NRB balance. Therefore, it is strongly recommended that the company should strictly

maintain the NRB balance to total deposit ratio. The company should try to maintained sufficient amount and try to increase the NRB balance.

5.3.7 The CGAP in short term horizon is decreasing trend except in one year of two buckets. In this way, the CGAP in the short term maturity bucket is both positive and negative during the study period. The CGAP in the long term maturity bucket is positive in each study year. The decreasing trend of CGAP in short term horizon and the increasing trend of long term maturity bucket both indicates the company's sensitivity to interest rate risk. But the CGAP in the short term maturity is not always decreased. The CGAP ratio of finance was found in fluctuating trend in every study year. Therefore, the company should try to maintain the CGAP in short term horizon and also try to maintain the CGAP ratio.

BIBLIOGRAPHY

American Psychological Association. (2010). *Publication manual of the American Psyhological Association* (Sixth ed.). Washington, DC: Author. Retrieved from http://www.apaguide.org

Babar, H. Z., & Zeb, G. (2011). *CAMELS rating system for banking industry in Pakistan.* Unpublished master's Dissertation: Umea University.

Babin, B. J., Carr, J. C., Griffin, M., & Zikmund, W. G. (2009). *Business research methods* (Eighth ed.). Canada: Cengage South-Western. Retrieved from http://www.ebay.com/ctg/Business-Research-Methods

Baker, T. L. (1999). *Doing social research* (Third ed.). Singapore: McGraw-Hill.

Banks and Financial Institutions Act, 2063. (2006). *Banks and Financial Institutions Act, 2063.* Kathmandu: Government of Nepal, Ministry of Law, Justice and Parliamentary Affairs.

Baral, K. J. (2005). Health check-up of commercial banks in the framework of CAMEL: A case study of joint venture banks in Nepal. *The Journal of Nepalese Business Studies, Vol.II, No 1,* 41-55.

CEDA. (2007). *Development of financial institutions in Nepal.* Kathmandu: CEDA, Tribhuvan University.

Chowdhury, S. (2011). An inquiry into the financial soundness of commercial banks in India using 'CAMEL' approach. *Journal on Banking, Financial Services and Insurance Research, Volume 1, Issue 7.* Retrieved from http://www.skirec.com

Chowdhury, T. A., & Ahmed, K. (2009). Performance evaluation of selected private commercial banks in Bangladesh. *International Journal of Business and Management, Vol. 4, No. 4,* 86-97. Retrieved from http://www.ccsenet.org/journal.html

Cooper, D. R., & Schindler, P. S. (2003). *Business research methods* (Sixth reprint ed.). New Delhi: Tata McGraw-Hill.

Devkota, L. (2008). *Financial performance analysis of Fewa Finance Company Limited in the framework of CAMEL.* Unpublished master's Dissertation, PN Campus, Tribhuvan University.

Gilbert, R. A., Meyer, A. P., & Vaughan, M. D. (2000). *The role of a CAMEL downgrade model in bank surveillance.* Research division. St.Louis: Federal

Reserve Bank. Retrieved from http://research.stlouisfed.org/wp/2000/2000-021.pdf

Gup, B. E., & Kolari, J. W. (2005). *Commercial banking: The management of risk* (Third ed.). Singapore (Asia) Pte. Ltd.: John Wiley & Sons.

Gurung, A. (2009). *Financial performance analysis of Fewa Finance Company Limited in the framewwork of CAMEL.* Unpublished master's Dissertation, PN Campus, Tribhuvan University.

Horne, J. C., & Wachowicz, J. M. (2005). *Fundamentals of financial management* (Eleventh ed.). Delhi: Pearson Education.

Jha, S., & Hui, X. (2012). A comparasion of financial performance of commercial banks: A case study of Nepal. *African Journal of Business Management Vol.6 (25),* 7601-7611. Retrieved from http://www.academicjournals.org/AJBM

Kabir, A., & Dey, S. (2012). Performance analysis through CAMEL rating: A comparative study of selected private commercial banks in Bangladesh. *Journal of Politics & Governance Vol. 1, No. 2/3,* 16-25.

Khamcha, S. (2009). *Financial performance analysis of joint venture commercial banks in Nepal in the framework of CAMELS.* Unpublished master's Dissertation, PN Campus, Tribhuvan University.

Kouser, Rehana, & Saba, I. (2012). Gauging the financial performance of banking sector using CAMEL model: Comparison of conventional, mixed and pure Islamic Banks in Pakistan. *International Research Journal of Finance and Economics*. Retrieved from http://www. international researchjournal offinanceandeconomics.com

Kumar, R. (2011). *Research methodology: A Step-by-step guide for beginners.* New Delhi: Sage Publication.

Lohia, S. (2011). *Performance of the Indian banking industry over the last ten years.* A master diss: Claremont McKenna College. Retrieved from http://scholarship.claremont.edu/cmc_theses/282

Nepal Rastra Bank Act, 2058. (2002). *Nepal Rastra Bank Act, 2058.* Kathnmandu: Government of Nepal, Misistry of Law, Justice and Parliamentary Affairs.

NRB. (2002). *Annual report 2001-2002.* Bank supervision department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2009). *Bank supervision report 2008.* Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2009). *Report of fiscal year 2008/09.* Research department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2010). *Report of fiscal year 2009/10.* Research department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2010). *Unified directives: Issued by Nepal Rastra bank to the licensed banks and financial institutions, 2010.* Bank and financial institutions regulation department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2011). *Annual report fiscal year 2010/11.* Research department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2011). *Bank supervision report.* Bank supervision department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2012). *Annual report fiscal year 2011/12.* Research department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2012). *Banking and financial statistics, No 58.* Bank and Finanical Institution Regulation Department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2012). *Financial stability report.* Banks and financial institutions regulation department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

NRB. (2013). *Banking and financial statistics, No 59.* Bank and Financial Institutions Regulation Department. Kathmandu: NRB. Retrieved from http://www.nrb.org.com

Pandey, S. R. (2009). Development and challenges of the Nepalese finance companies. *Nepalese financial system: Growth and challenges, Speical publication* (NRB), 78-84. Retrieved from http://www.nrb.org.com

Pant, B. (2009). Nepalese financial system: Policy developments and chalenges. *Nepalese finanical system: Growth and challenges, Special publication* (NRB), 24-35. Retrieved from http://www.nrb.org.com

Pant, P. R. (2009). *Social science research and thesis writing* (Fifth ed.). Kathmandu: Buddha Publication.

Paudel, A. (2011). *A case study on financial performance analysis of Oriental Co-operative Limited in the framework of CAMEL.* Unpublished master's Dissertation, PN Campus, Tribhuvan University.

Paudel, R. B., Baral, K. J., Gautam, R. R., & Rana, S. B. (2007). *Corporate financial management.* Kathmandu: Asmita Publication.

Pradhan, R. S. (2003). *Research in Nepalese finance.* Kathmandu: Buddha Publication.

Prasad, K. V., & Ravinder, G. (2012). A Camel model analysis of nationalized banks in India. *International Journal of Trade and Commerce- IIARTC, Vol. 1, No. 1,* 23-33. Retrieved from http://www.sgsrjournals.com

Saltzman, S. B., & Salinger, D. (1998). *The ACCION CAMEL: Technical note.* Massachusetts, USA: ACCION International.

Saunders, A., & Cornett, M. M. (2012). *Financial markets and institutions: An introduction to the risk management approach* (Third ed.). New Delhi: McGraw-Hill.

Shar, A. H., Shah, M. A., & Jamali, H. (2010). Performance evaluation of banking sector in Pakistan: An application of bankometer. *International Journal of Business and Management, Vol. 5, No. 8,* 113-118. Retrieved from http://www.ccsenet.org/ijbm

Shrestha, P. (2010). *Financial performance of Small Farmers Cooperative Limited in Nepal.* Kathmandu: Oriental Publication.

Soltani, M., Esmaili, M., Poor, M. H., & Karami, H. (2013). Evaluating the performance of public and private banks and providing suggestions for improving the performance of them (Case study: Melli, Agriculture, Pasargad and Parsian Bank of Qom). *Journal of Basic and Applied Scientific Research, Vol. 3 (2),* 480-487. Retrieved from http://www.textroad.com

Tanko, M., & Wirnkar, A. (2006). CAMEL(S) and banks performance evaluation: The way forward. Retrieved from Electronic Copy: http://ssrn.com/abstract

Thagunna, K. S., & Poudel, S. (2013). Measuring bank performance of Nepali Banks: A data envelopment analysis (DEA) perspective. *Internationa Journal of Economics and Financial Issues, Vol.3, No.1,* 54-65. Retrieved from http://www.econjournals.com

Tiwari, S. (2010). *Financial performance analysis of Pokhara finance company limited in the framework of CAMELS.* Unpublished master's Dissertation, PN Campus, Tribhuvan University.

Upadhyay, K. P. (2004). Financial analysis of finance companies in Pokhara: A comparative study of Pokhara Finance Ltd. and Annapurna Finance Company Ltd. *The Journal of Nepalese Business Studies, Vol.I, No 1,* 101-106.

Vijayakumar, A. (2012). Evaluating performance of banks through CAMEL model: A case study of state bank of India and its associates. *Online International Interdisciplinary Research Journal, Vol. II, Issue VI,* 104-124. Retrieved from http:/www.oiirj.org

Appendix I

List of Class C Licensed Financial Institutions (Finance Companies), Mid - July, 2012

SN	Name of the Financial Institutions	Operation Date (A.D.)	Head Office
1	Nepal Aawas Finance Co.Ltd.	3/8/1992	Bijulibazar, Kathmandu
2	Nepal Finance Co.Ltd.	1/6/1993	Kamaladi Mode, Kathmandu
3	Nepal Aawas Finance Co.Ltd.	3/8/1992	Bijulibazar, Kathmandu
0	Narayani National Finance Ltd.	11/1/2009	Kalikasthan, Kathmandu
5	Nepal Share Markets and Finance Ltd.	10/19/1993	Ramshahapath, Kathmandu
6	Peoples Finance Ltd.	4/15/1993	Tripureshwor, Kathmadu
7	Mercentile Finance Co. Ltd.	11/10/1994	Birgunj, Parsa
8	Kathmandu Finance Ltd.	11/10/1994	Dillibazar, Kathmandu
9	Himalaya Finance Ltd.	11/11/1993	Sundhara, Kathmandu
10	Union Finance Ltd.	12/12/1995	Kamaladi, Kathmandu
11	Gorkha Finance Ltd.	3/12/1995	Hattisar, Kathmandu
12	Paschhimanchal Finance Co.Ltd.	4/9/1995	Butawal, Rupandehi
13	Nepal Housing & Merchant Finance Ltd.	4/11/1995	Dillibazar, Kathmandu
14	Goodwill Finance Ltd.	5/16/1995	Hattisar, Kathmandu
15	Siddhartha Finance Ltd.	5/25/1995	Siddarthanagar, Rupandehi
16	Shree Investment & Finance Co.	6/1/1995	Dillibazar, Kathmandu
17	Lumbini Finance & Leasing Co. Ltd.	6/26/1995	Thamel, Kathmandu
18	Yeti Finance Ltd.	7/23/1995	Hetauda, Makawanpur
19	International Leasing & Finance Co. Ltd.	10/31/1995	Naya Baneshwor, Kathmandu
20	Mahalaxmi Finance Ltd.	11/26/1995	Putalisadak, Kathmandu
21	Lalitpur Finance Ltd.	12/12/1995	Lagankhel, Lalitpur
22	Bhajuratna Finance Ltd.	-	Kantipath, Kathmandu
23	United Finance Ltd.	1/25/1996	Durbarmarg, Kathmandu
24	General Finance Ltd.	2/2/1996	Chabahil, Kathmandu
25	ProgressiveFinance Co. Ltd.	1/2/1996	Newroad, Kathmandu
26	Alpic Everest Finance Ltd.	7/16/1996	Kathmandu Mall, Kathmandu
27	Nava Durga Finance Co.Ltd.	2/9/1997	Itachhe, Bhaktapur
28	Janaki Finance Company Ltd.	3/7/1997	Janakpurdham, Dhanusha
29	Pokhara Finance Ltd.	3/16/1997	Gairapatan, Pokhara
30	Central Finance Ltd.	4/14/1997	Kupondole, Lalitpur
31	Premier Finance Co. Ltd.	5/8/1997	Kumaripati, Lalitpur
32	Arun Finance Ltd.	8/17/1997	Dharan, Sunsari
33	Multipurpose Finance Co. Ltd.	3/25/1998	Rajbiraj, Saptari
34	Butwal Finance Ltd.	6/21/1998	Butawal, Rupandehi
35	Shrijana Finance Ltd.	12/14/1999	Biratnagar, Morang

36	Om Finance Ltd.	9/17/2000	New Road, Pokhara
37	CMB Finance Ltd.	11/20/2000	Jamal, Kathmandu
38	World Merchant Banking & Finance Ltd.	8/10/2001	Hetauda, Makawanpur
39	Capital Merchant Banking & Finance Ltd.	2/1/2002	Battisputali, Kathmandu
40	Crystal Finance Ltd.	2/13/2002	Bag Durbar, Kathmandu
41	Royal Merchant Banking & Finance Ltd.	2/14/2002	Durbarmarg, Kathmandu
42	Guheshwori Merchant Banking & Finance Ltd.	6/13/2002	Pulchowk, Lalitpur
43	Patan Finance Ltd.	2002/06/23	Pulchowk, Lalitpur
44	Fewa Finance Ltd.	4/30/2003	Chipledhunga, Pokhara
45	Everest Finance Co. Ltd.	7/2/2003	Siddarthanagar, Rupandehi
46	Prudential Finance Company Ltd.	6/6/2003	Dillibazar, Kathmandu
47	ICFC Finance Ltd.	6/15/2003	Bhatbhateni, Kathmandu
48	Sagarmatha Merchant Banking and Finance Ltd	8/29/2005	Manvawan, Lalitpur
49	Civil Merchant Bittiya sanstha Ltd.	9/18/2005	Kuleshwor, Kathmandu
50	Prabhu Finance Co. Ltd.	2/16/2006	Lainchaur, Kathmandu.
51	Imperial Finance Ltd.	3/8/2006	Thapathali, Kathmandu
52	Kuber Merchant Finance Ltd.	3/24/2006	Kamalpokhari, Kathmandu
53	Nepal Express Finance Ltd.	5/4/2006	Sundhara, Kathmandu
54	Valley Finance Ltd.	5/11/2006	Maharajganj, Kathmandu
55	Seti Bittiya Sanstha Ltd.	6/7/2006	Tikapur, Kailali
56	Hama Merchant & Finance Ltd.	6/16/2006	Tripureshwor, Kathmandu
57	Reliable Finance Ltd.	9/6/2006	Sundhara, Kathmandu
58	**Api Finance Ltd.**	**4/25/2007**	**B.P. Chowk, Pokhara**
59	Nameste Bitiya Sanstha Limited.	7/7/2007	Ghorahi, Dang
60	Kaski Finance Limited.	7/30/2007	Pokhara, Kaski
61	Zenith Finance Ltd.	10/8/2007	Newroad, Kathmandu
62	Unique Financial Institution Ltd.	10/12/2007	Putalisadak, Kathmandu
63	Manjushree Financial Institution Ltd.	10/15/2007	New Baneshor, Kathmandu
64	Subhalaxmi Finance Ltd.	11/11/2007	Naxal, Kathmandu
65	Jebils Finance Ltd.	10/28/2009	New Road, Kathmandu
66	Reliance Finance Ltd.	12/3/2009	Pradarsani Marg, Kathmandu
67	Lotus Investment Finance Ltd.	4/11/2010	Newroad, Kathmandu
68	Baibhab Finance Ltd.	1/24/2011	Naya Baneshwor , Kathmandu
69	Bhaktapur Finance Ltd.	2/8/2011	Chyamsing ,Bhaktapur

Source: NRB 2012, Banking and Financial Statistics, Mid July, 2012, No. 58

Appendix II

Calculation of Liquidity Ratio of Aggregate Financial Institution (Industry Average Ratio)

Fiscal Year	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Liquid Fund	177417.40	164065.50	217179.30	205109.80	268839.60
Total Deposit	522821.70	570734.40	774063.50	854768.80	761157.50
Liquid Assets/ Total Deposit Ratio	33.93	28.75	28.06	24.00	35.32
NRB Balance	38526.00	22669.80	25382.60	24100.20	39160.60
Total Deposit	522821.70	570734.40	774063.50	854768.80	761157.50
NRB Balance/ Total Deposit Ratio	7.37	3.97	3.28	2.82	5.14
Cash in Vault	5883.70	6054.50	9495.50	12199.20	13469.80
Total Deposit	522821.70	570734.40	774063.50	854768.80	761157.50
Cash in Vault/ Total Deposit Ratio	1.13	1.06	1.23	1.43	1.77

Source: Banking and Financial Statistics, NRB, No 58, Mid-July, 2012, p 70

Appendix III

Comparative Balance Sheet of Api Finance Company Ltd. (in Rs.)

Categories	**Fiscal Years**				
Capital and Liabilities	**2064/65**	**2065/66**	**2066/67**	**2067/68**	**2068/69**
Share Capital	42000000	60000000	60000000	126000000	137340000
Reserve and Fund	5165126.06	11381805.70	47952279.63	6974411.00	8643136.00
Debenture and Bond	0	0	0	0	0
Borrowing	0	0	0	0	0
Deposit Liability	111978358.40	326110071	401740564.80	702533161.00	833394656
Bills payable	0	0	0	0	0
Proposed Dividend	0	0	0	18000000.00	596842.00
Income tax Liability	0	521781.83	625211.38	1968098.00	765707.00
Other Liability	13841161.41	2577998.32	3261645.40	5740886.00	9898463.00
Total	172984645.90	400591656.00	513579701.20	861216547.00	990638804.00
Assets					
Cash Balance	1534529.25	3756250.90	5370493.73	11340658.00	20534602.00
Balance With NRB	3987138.84	6564490.72	10913249.56	15340426.00	22683607.00
Balance with Bank /FI	782997.31	100000.00	659193.43	600069.00	1375794.00
Money at Call and Short Notice	67404115.90	74635869.90	89582078.77	189226220.00	289209320.00
Investment	0	0	4921980.00	65000000.00	0
Loan and Short Notice	95610174.50	307943879.00	385445118.10	548060446.00	616647411.00
Fixed Assets	1605496.21	3331830.35	9159825.02	11231729.00	12023343.00
Non-Banking Assets	0	0	0	0	0
other Assets	2060193.86	4259335.12	7527762.63	20416999.00	28164727.00
Total	172984645.90	400591656.00	513579701.20	861216547.00	990638804.00

Sources: Annual reports of Api Finance

Appendix IV

Data Master Sheets (Calculation of CAMEL)

Category	Fiscal Year				
	2064\065	2065\066	2066\067	2067\068	2068\069
Capital Adequacy (C)					
A. Core Capital					
Paid up Capital	42000000	60000000	60000000	120000000	126000000
Proposed Bones Share	4883950			6000000	11340000
Share Premium		4883950	4883950	450708	
Irredeemable Preference Share	175110.9				
Generable Reserve	106065.16	1004899.65	2723120.47	5294846.00	8015959.00
Accumulated Profit/Loss		3141556.07	9584884.17	1228857.00	614092.00
Capital Redemption Reserve					
Capital Adjustment Fund					
Call in Advance		2351400	30760325		
Other Free Reserve					
Less					
Good Will					
Fictitious Assets	-541163.38	-3239853.81	-2290122.25	-1446239.00	-733170.00
Total Core Capital	46623962.68	6814151.92	1056620157.40	1315281172.00	1452499966.00
Core Capital Adequacy Ratio (Total core capital/total risk weighted assets)	0.418685017	0.206658302	0.259303126	0.19657779	0.20479601
B. Supplementary Capital					
Loan Loss Provision For Pass Loan	965154.20	3110544.24	3882425.44	5535964.00	6231085.00
Additional Loan Loss Provisions			400000		230000
Hybrid Capital Instrument					
Unsecured Subordinate Term Debt					
Exchange Equalization Fund					
Assets Revolution Reserve					
Investment Adjustment Reserve					
Total Supplementary Capital	965154.20	3110544.24	4282425.44	5535964.00	6461085.00
Supplementary capital adequacy ratio (Supplementary capital/total risk weighted assets)	0.008667123	0.009433539	0.010509404	0.00827387	0.009109843
Total Capital Fund (A+B)	47589116.88	7125296.15	1099440582.80	1370641136.00	1517110051.00
Total Capital Adequacy Ratio (Total	0.42735	0.21609	0.2698	0.2048	0.2139

Capital Fund/total risk weighted assets)	2140	1842	12530	51667	05853
C. On-Balance -Sheet Assets					
Cash Deposit					
Gold Deposit					
Deposit with Nepal Rastra Bank					
Investment in Government of Nepal Bond					
Investment in Nepal Restra Bank Bond					
Fixed Receipt Pledged Loan Extended Against One's Own Fixed Receipt to be must Secured					
Loan Extended against Security of Government Bond to be must Secured					
Accrued interest for Government Bond					
Amount Deposited by Classes "B" and "C" Licensed Institutions in the Youth and Small Employment Fund Under the Deprived Sectors Lending					
Claims of Deposits /Fixed receipts at the Domestic Bank and Financial institutions	156599.46	20000.00	131838.69	275159.00	120014.00
Fixed Receipt Pledged Loan Extended Against Fixed Receipts of other Bank					
Deposit with Foreign Banks					
Money at Call	13480823.18	14927173.98	17916415.75	57841864.00	37845244.00
Loan Extended against Guarantee of Internationally Rated Licensed Institution					
Other Investment made in Internationally Rated Banks					
Inter-Bank Lending					
Investment in Share, Debentures and Bond					
Other Investments					65000000
Total Amount (including loan, credit and bills purchase/discount)	94029974.56	31043981.50	37503369.40	61167244.00	53437692.00
Fixed Assets	1605496.21	3331830.35	9159825.02	1202343.00	1123172.00
Other Net Interest Amount to be Received					
All Other Assets (except advance income tax payment)	2060193.86	1019481.31	5237640.38	2743157.00	2041699.00
Real Estate /Residential Housing Loan Exceeding the Limits					
Total	11133308 7.30	32973246 7.20	40748508 9.30	70924216 7.00	66898967 8.00
D:Off -Balance Sheets Transaction					
Bill Collection					
Forward Foreign Exchange Contract					
Letter of Credit of Less than Six month Duration (Full amount)					
Guarantee issued against the Guarantee of Internationally Rated					

Letter of Credit of more than six-month Duration					
Commitments Relating to bid Bond, Performance Bond and Under Writing	25000				
Credit Purchase /Repurchase and Take Over					
Advance Payment Guarantee					
Financial and Other Guarantee					100000
Irrevocable Loan Commitment					
Possible Liabilities for income tax					
All type of Possible Liabilities including Acceptance					
Unpaid Guarantee Claims					
Total	25000				100000
Total Risk Weight Assets (C+D)	111358087.27	32973467.20	40748089.30	66908678.00	70924167.00
Assets Quality (A)					
Non-performing loan	126087.40	321057.85	3025825.94	4774782.00	1179248.00
Total Loan and Advance	96709974.56	31137481.50	39126869.00	55837192.00	62428744.00
Non- performing loan ration (Non performing loan/Total loan and advance)	0.001303768	0.001031095	0.007733377	0.00855127	0.001888949
Loan Loss Provision	1099800.06	3431602.09	5823251.38	1031046.00	7640333.00
Loan loss reserve ratio (Loan loss provision/Total loan and advance)	0.011372147	0.011020785	0.014883011	0.01846576	0.01223848
Management Efficiency (M)					
Total Expenses	769489.36	1037235.94	2147776.00	212146657.00	1422032.00
Total Income	875554.52	4178792.01	1173260.00	224435514.00	1483442.00
Operating Expenses Ratio (Total expenses /Total income)	0.878859446	0.248214302	0.183059596	0.94524668	0.958603583
Operating Income	963109.97	6514065.46	1334948.55	202509096.00	1884341.00
Total Number of Employee	12	20	37	39	61
Earning per Employee ratio (Operating income /Number of employee)	80259.16	325703.27	360798.61	5192323.23	30890 8.48
Earning Performance (E)					
Net Profit After Tax	875554.52	4148943.76	8591104.00	12858630.00	1360567.00
Total Equity Capital	42000000	60000000	60000000	126000000	137340000
Return on equity capital ratio (Net profit after taxes/Total equity)	0.020846536	0.069149063	0.143185067	0.10205262	0.099064854
Total Assets	172984645.90	40059656.40	51357701.00	86121547.00	99063804.00
Return on Assets (Net Income After Taxes/Total Assets)	0.005061458	0.01035704	0.016727889	0.01493077	0.013734135
Net Interest Income	3234716.88	10178343.96	21975776.91	36277445.00	34517430.00
Earning Asset	9670997	311375	396190	623371	624287

	4.56	481.50	349.00	192.00	744.00
Net Interest Margin Ratio (Net Interest Income/Earning Assets)	0.03344 7603	0.03268 8328	0.05546 7724	0.0581 9558	0.0552 90898
Number of Share of Common Stock	420000	600000	600000	120000 0	126000 0
Earnings per Share (Net Profit After Taxes/ Number of Share of common stock)	2.08465 3619	6.91490 6267	14.3185 0667	10.715 525	10.798 06905
Liquidity Position (L)					
Total Liquid Assets	7370878 1.30	850566 11.50	106525 016.00	216507 373.00	333803 323.00
Total Deposit	1119783 58.40	326110 070.50	401740 565.00	702533 161.00	833394 656.00
Total liquid assets to total deposit ratio (Total liquid assets /Total deposit)	0.65824 131	0.26082 1787	0.2651 58725	0.3081 81	0.4005 34513
Cash in Vault	1534529 .25	375625 0.90	537049 3.73	113406 58.00	205346 02.00
Cash in vault to total deposit ratio (Cash in vault /Total deposit)	0.01370 3802	0.01151 8353	0.0133 68064	0.0161 4252	0.0246 39709
NRB Balance	3987138 .84	656449 0.72	109132 50.00	153404 26.00	226836 07.00
NRB balance to total deposit ratio (NRB Balance/Total deposit ratio)	0.03560 6334	0.02012 9678	0.0271 64919	0.0218 3587	0.0272 18325

Source: Annual Reports of Api Finance Limited