A STUDY ON PERFORMANCE OF COMMERCIAL BANKS THROUGH CAMEL ANALYSIS

A Thesis

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Banking sector plays a vital role for the country's economic development. Bank is a resource mobilizing institution, which accept deposit from various sources and invest such accumulated resources in productive areas like in the field of agriculture trade, commerce, entertainment, tourism, industry etc. The banking sector is mainly responsible to accepts deposits and channels the money into leading activities. A Bank is an institution that deals with money by accepting deposits from general public, corporate bodies and private organizations and deploys those deposits for profitable purpose in the form of loan and advances.

There are various types of banking institutions which are performing different function in the contest of Nepal. It can be divided into three parts. The central bank, the commercial bank and other financial institutions, which are known as financial intermediaries.

The main function of the central bank is to control the entire currency and credit of the country. It is the government organ that undertakes the major financial operation of the government. The main function of commercial bank is to accept deposits grants loan and operates commercial transaction. They make funds available through their lending and investing activities to borrowers, individuals, business firms and government. But today commercial banks are concentrated in their activities of fulfilling the financial needs of their customers. Other financial institutions are financial companies, insurance companies, employ's provident fund, which are taking of limited banking activities.

As talking about the capital formation commercial bank play a crucial role on it. Capital is one of the most important components for an organization. Capital, in the simple term, is defined as the wealth employed for the production of more wealth**.** Capital includes any fund thus employed. In accounting term, Capital is excess of assets of assets over liabilities**.** Without capital it is not possible to set up any type of business whether it is a general store or a big business house. Every organization is started with a zero position

and only come into existence when the promoters, owners or shareholders finance on it as capital. Each and every organization should have adequate capital to run business. Although the banks are the major source of capital, they also have to raise the capital to run business. Especially, the banks' capital have major role to play as the banks have obligation to mass people and its depositors. Capital is required by a bank as a cushion to absorb losses, which should be borne by shareholders rather than depositors and to finance the infrastructure of the business (NRB, 2007:20-22).

Capital adequacy has become one of the most important factors for assessing the soundness of the banking sector. Raise and utilization of fund are the primary function of the commercial banks. Commercial banks collect the large amount of deposit from general public. The depositors think that the depositing their money in a bank is safe. But what does happen if the bank does not have enough capital to provide a buffer against the future, unexpected losses? So, capital must be sufficient to protect a bank's depositors and counterparties from the risk like, market and credit risks. Otherwise the bank will use all the money of depositors in their own interest and depositors will have to bear loss (NRB, 2007:25).

Capital adequacy is one of the most important and emerging topics in the prudential regulations issued by Nepal Rastra Bank (central bank of Nepal) and implemented by Commercial Bank in Nepal. Capital adequacy is a measure of the financial strength of banks or securities firms, usually expressed as a ratio of its capital to its assets. For banks, there is now a worldwide capital adequacy standard, drawn up by the Basel committee, of the Bank for International Settlements (BIS). This BIS ration requires banks to have capital equal to 8 per cent of their assets.

Capital adequacy measures the financial strength of a financial institution. It tells how much capital it has relative to (as a percentage of) the money it has lent out, i.e. its assets. There are specific minimum levels of capital set by international banking rules. They are designed to make it possible for banks to absorb a reasonable amount of losses before getting into deep trouble.

With every investment decision, there is not only an anticipated return, but also a certain amount of risk associated with that return. The investment decision therefore, may be characterized as trade off between risk and return. It is generally assumed that the larger amount of risk, the larger the anticipated return must be to compensate for this risk. Just as the risk associated with various securities and assets varies widely, the ability and willingness to accept risk also varies substantially from investor to investor. This proposed study aims to look at the role of capital adequacy of the commercial banks in economic development, sustainable future for commercial banks with the maintenance of adequate capital.

The efficient functioning of markets requires participants to have confidence in each other's stability and ability to transact business. Capitals rules help foster this confidence because they require each member of the financial community to have adequate capital. This capital must be sufficient to protect depositors and counter-parties from the risks of the institution's on- and off-balance sheet risks. Banks are required to set aside capital to cover these two main risks. Capital standards should be designed to allow a firm to absorb its losses, and in the worst case, to allow a firm to wind down its business without loss to customers, counter-parties and without disrupting the orderly functioning of financial markets.

The commercial bank established under the commercial banks Act 2031 BS and Company Act 2053 BS. However, Nepal Rastra Bank as a regulatory body for banks and the financial institutions, has right to specify the capital requirements and other requirements. Being the Central Bank of Nepal, Nepal Rastra Bank has the responsibility to give special attention to the interest of the depositors. It is to be noted that as per the banking and financial statistics of Nepal Rastra Bank , the commercial banks of Nepal have collected more than Rs 310 billion money from the depositors by the end of 2006/2007. Such a big amount of money should have to be secured and Nepal Rastra Bank has the major responsibility to protect it (NRB, 2007:10).

Nepal Rastra Bank issues various directives to be complied by all commercial banks of the country in March 2001. The directives consist of nice volumes. The NRB directive no

1 includes the capital adequacy norms for the commercial banks representing the requirements of maintaining capital fund to the prescribed ratios. The directives are said to be based on the internationally accepted norms of Basel Committee. The Basle committee on banking supervision is a committee of banking supervisory authorities which was established by the central bank Governors of the Group of Ten countries in 1997. The Basle committee on banking supervision in 1988 has developed an internationally accepted standard for capital adequacy based on what is known as the "risk assets" approach. This show how important capital for supervisory purposes allocates weight to different board categories of assets (e.g. government securities, loans to banks, customers' advances) and expresses capital as a percentage of total risk – weighted assets. The committee consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden Switzerland, the United Kingdom and the United States. Widely accepted, though national authorities are free to impose higher standards on their banks and often do so. As originally designed, this approach was only concerned with credit risk, but at the beginning of 1996 the Basle Committee published proposal to bring market risks into the calculation of capital requirements (NRB, 2001:11-12).

1.1.1 Introduction of Sample Banks

a) Machhapuchchhre Bank Limited (MBL)

Machhapuchchhre Bank Limited, registered in 1998 is the first commercial bank in the western part of the Kingdom of Nepal having head office in Pokhara. The bank has its own land and well-built three storied office building with sufficient parking area and electronic surveillance system.

The bank with perception of tremendous business potentials outside Kathamandu, in a very short span of time, expanded branches in Kathmandu, Damauli, Bhairahawa, Birgunj, Mahendrapul (Pokhara), Rambazar (Pokhara) and in Bagar (Pokhara). A full-fledged banking branch is opened in Jomsom too. The bank aims to serve the people of urban and rural areas.

Machhapuchchhre Bank Limited is a pioneer in introducing the latest technology in banking in the country. It is the first bank to introduce centralized banking software named GLOBUS BANKING SOFTWARE developed by Temenos NV, Switzerland.

The bank provides modern banking facilities such as Anywhere Banking and Internet Banking to its valued customers.

Machhapuchchhre Bank Limited Strives to facilitate its customer needs by delivering the best services in combination with the state of the art technologies and best international practices.

b) Kumari Bank Limited (KBL)

Kumari Bank Limited, came into existence as the fifteenth commercial bank by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in Nepal.

Kumari Bank Ltd has been providing wide- range of modern banking services through 6 points of representation across the country. The bank has adopted Globus Banking Software, developed by Temenos NV, Switzerland, to provide centralized data base system to all branches. The bank has also been providing visa debit card, which has an access on ATMs (including 6 own ATMs) and POS (Point of Sale) terminals both in Nepal and India.

Within 5 years of its establishment, the bank has been able to recognize itself as an innovative and growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission.

c) Standard Chartered Bank Nepal Ltd (SCBL)

Standard Chartered Bank Nepal Limited has been in operation in Nepal since 1987 when it was initially registered as a joint-venture operation. Today the Bank is an integral part of Standard Chartered Group who has 75% ownership in the company with 25% shares

owned by the Nepalese public. The Bank enjoys the status the largest international bank currently operating in Nepal.

Standard Chartered Group employs 30,000 people in over 500 locations in more than 50 countries in the Asia Pacific Region, South Asia, the Middle East, Africa, the United Kingdom and the Americas. It is one of the world's most international banks, with a management team comprising 79 nationalities. Standard Chartered Bank Nepal Ltd. is in a position to service its customers through a large domestic network. In addition to which the global network of Standard Chartered Group gives the Bank the unique opportunity to provide truly international banking in Nepal. It is the first Bank in Nepal that has implemented the Anti-Money Laundering policy and applied the 'Know Your Customer' procedure on all the customer accounts.

Standard Chartered Bank Nepal Limited offers a full range of banking products and services in Wholesale and Consumer banking, catering to a wide range of customers from individuals, to mid-market local corporate to multinationals and large public sector companies, as well as embassies, aid agencies, airlines, hotels and government corporations.

Standard Chartered Bank Nepal concentrates on projects that assist children, particularly in the areas of health and education and it has taken up various initiatives to benefit the community. Major initiatives in the area of health 'Living with HIV' and 'Seeing is Believing' have been undertaken by the Bank since 2003.

d) Everest Bank Limited (EBL)

Everest Bank Limited (EBL) was established in 1994 and started its operations with a view and objective of extending professionalzed and efficient banking services to various segments of the society. EBL joined hands with Punjab National Bank (PNB), India as its joint venture partner in 1997. PNB is the largest Public Sector Bank of India having 109 years of banking history with more than 4400 offices all over India and is known for its strong systems and procedures and a distinct work culture

The Bank's Paid-up Capital has increased to 455 million against the Authorized Capital of 750 million whereas the Core Capital of the Bank is around 700 million. The local Nepalese promoters hold 50% stock in the Bank's equity, while joint venture partner PNB contributes 20 % of equity whereas the public holds remaining 30%.

Despite fragile law and order situation especially during last 2-3 years, the Bank has doubled its deposits, advances as well as profits during the period. Its operating profit have grown by 55% during the financial year 2060-61, the net profit has increased by 52%. The average credit growth has been over 26% reaching a figure of 6099 million, deposits having reached a figure of 8064 million, a notable feature of the bank's achievement is its containment of NPAs with gross NPAs restricted to 1.72% of the total credit whereas net NPA is being reduced to nil.

1.2 Focus of the Study

The study has been done with the help of the concept of “CAMEL” using various financial ratios and statistical tools. Financial analysis helps the judgment about the operating performance of financial position while through the use of statistical tools, the trends of position of the bank can be found. The study is based on the capital funds of the bank which is supposed to be adequate as per the Nepal Rastra Bank directive no. 1, which is related with the capital adequacy norms for commercial banks. Basically, the norms emphasize on the basic requirements of the capital fund that a commercial banks should possess. The basic objective of the norms is to safeguard the interest of the country. Generally, the thesis report is focused on CAMEL and on accordance of the capital adequacy norms of Nepal Rastra Bank by these commercial banks.

1.3 Statement of the Problem

A well functioning banking system is an essential element in economic growth. A good banking system is supposed to mobilize savings from households and business in low cost of financing activities and channel funds to the most productive investment opportunities. Bank is monetary institutional vehicle for domestic resources mobilization of the country. Modern day bank's business is not confined in borrowing deposits and

lending advances only, it performs a host of other financial activities which has immensely contributed to achieve industrial and commercial progress of every country.

With the prevailing economic recession in the country, there has been lower investment in the agriculture, manufacturing, industrial and financial sectors. Despite the better performance of commercial bank, there are still problem, which need to be resolved.

Every business form can take advantage through appropriate capital mix because long run profitability depends on its capital structure besides other factors. The depositors deposit their money in a bank for security of their money. Banking and financial statistics (2008) shows that the amount deposited in various banks of the country is Rs. 310,032.7 million by the end of FY 2007/08. But the question arises, if the bank go bankrupted, what will happen to the depositors of such money? Thus an adequate capital fund is required to safeguard the money of depositors.

NRB issued a new set of directives to commercial banks consisting of eleven parts. Out of eleven directives, the directives no.1 has been issued for norms on capital adequacy to be followed by commercial banks. The capital adequacy ratio is based on the total risk weighted assets. Capital adequacy is the core subject for long-term sustainability of any organization. It is an emerging topic in financial sector. It can play a vital role for the success of commercial banks. To bridge the gap of implementing and supervisory bodies for their effective results in performance, this research is conducted.

Due to differences in economic, political and financial situations, legal and other restrictions, government polices, risky business, management ownership and control and other environmental variables, provisions of capital adequacy may be different in different years.

The main problem area of study is to find out the performance, financial as well as the managerial, of the selected banks comparatively through CAMEL. Especially it deals with the following issues:-

- Whose financial performance is better?

- Which bank's management is efficient?
- Do they have sufficient capital?
- Do they manage and utilize its assets satisfactory?
- Are they maintaining sufficient liquidity position?
- Do they have sound operational result in relation to their profitability?
- Do the ratios vary widely from year after year in the bank?
- What is their future projected trend of the ratios?
- Are they utilizing their employees efficiently?
- Are their shareholders earning a profitable ratio?

1.4 Objectives of the Study

The general objective of this study is to analyze the performance of the banks under study, Everest Bank Limited (EBL), Standard Chartered Bank Limited (SCBL), and Machhapuchchhre Bank Limited (MBL) and Kumari Bank Limited (KBL) in a comparative analysis using different ratios, trend as well as graph through CAMEL analysis. The specific objectives are as follows:

- To evaluate the liquidity position of the selected banks.
- To compare the staffs' efficiency of the banks.
- To evaluate the trend in growth of total deposits, loan and advances and net profit of the banks.
- To acquire the knowledge about financial strength of the sampled banks.
- To know whether the banks are following the NRB regulations or not through CAR, CRR analysis.
- To learn the earning position of the respective banks.
- To get the idea about the assets position of the banks.
- Lastly, to draw the conclusions and to recommend some strategies for implementation to the concerned bankers based on the analysis.

1.5 Significance of the Study

The study will have a great importance in the present context of banking business in Nepal. It can be studied that there is a lack of investment opportunity of fund and performance of bank is competitive. In such a situation, these deposits have to be commercial bank. CAMEL analysis and raising capital is a tough task at present. The increasing non performing assets, being the main problem of commercial banks, meeting the capital adequacy is very tough, although it is not impossible.

1.6 Limitation of the Study

As each and every study has its limitation. We have limited resources and it may be difficult to explore researcher to find out new aspect. Reliability of statistical tools used and lack of research experience are the major limitation and some other limitations can be enlisted as follows:

- It covers the performance of the EBL, MBL, KBL and SCBL for the period of past five years
- The authenticity of the report depends on the authenticity of the data provided and collected.
- The study analyzes the five-year data from 2003/04 to 2007/08
- The study is limited of the capital fund and capital adequacy norms for commercial banks.
- The focus is given to the quantitative aspects of the sampled banks, qualitative factors are not studied.
- Due to availability of limited information this study will not cover every part of the performance aspects. So this study may not be sufficient.

1.7 Organization of the Study

The study has been organized into five chapters, each chapter deals with the specific aspects of the study, which is as follows:

First Chapter provides a general introduction to the study. It contains general background, statement of the problems, objective of the study, significance of the study and limitation of the study.

Second Chapter presents the theoretical analysis and review of the related and pertinent literature available. It will include a discussion on the conceptual framework and review of related studies highlighting on its relevant findings.

Third Chapter describes the methodology employed in preparing this study. It deals with research design, population and sample, source of data for the study. It briefly mentions the data collection and analysis technique and inherent limitation of such technique.

Four Chapter of study illustrates the collected data into a systematic format. The analysis of these data is also included in this section. As well as, interpretation of analysis has also been done in this section. The major findings of the study is presented in this chapter

Last Chapter presents summary, conclusion and recommendation of the study. This section incorporates an outlet for future research. Bibliography and appendix are included at the end of the study.

CHAPTER TWO
REVIEW OF LITERARURE

This second chapter consists of relevant review of literatures, which is very important as it provides valuable inputs to this study. Only by knowing what others have said, one can be realistic to make the study more useful and relevant.

The available literature is reviewed relating to the field of this study and conceptual thoughts are presented below:

2.1 Conceptual Review

2.1.1 Determination of CAMELS Rating for Bank / Non-banks

The NRB, as central bank, has the important task of regulating and supervising the banking system of Nepal. To play this vital role, it is important that the NRB be able to assess the overall strength of the banking system as a whole, as well as the safety and soundness of each individual bank/ nonbank.

To help in this endeavor a uniform rating system for all banks / non-banks may be used. This rating system will provide meaningful and concise information about the condition of the Nepali banking system as well as identify those banks / non banks that require closer supervision by the NRB. By assigning, the NRB will be able to categorize banks /non-banks into groups based on their overall strength, quality and operating soundness. The rating system, knows the CAMELS, will serve as a supervisory tool to help identity those banks/non-banks that are having problems and require increased supervision.

Under the CAMELS rating system, banks/non banks should be assigned two sets of ratings.

- performance rating , which comprise six (6) individual rating that address each of the CAMELS components ; and

- An overall composites rating, which, is a single rating that is based on a comprehensive assessment of the overall condition of the bank /non banks.

Both the rating are expressed by using a numerical scale of "1" to "5" in ascending order of supervisory concern. That is "1" represents the best rating, while "5" indicates the worst rating.

Performance Ratings

The six aspects of CAMELS performance encompass; capital Adequacy Asset Quality Management, Earning, Liquidity and Sensitive to market risk. Each of these component areas is to be evaluated on a numerical scale of "1" to "5". A "1" indicates the highest rating, the strongest performance, best risk management practices and least supervisory concern. A "5" is the lowest rating indicating the weakest performance, inadequate risk management practices and the highest degree of supervisory concern.

Asides from the component rating, an overall composite rating, one number, ranging from 1 to 5, is calculated reflecting a weighted sum of the 6 components are given more operation, relatively basic management system and controls may be adequate, At more complex banks /non banks, on the other hand detailed and formal management systems and controls are needed to address their broader range of financial activities and to provide senior managers and directors , in their respective roles ,with the information they need to monitor and direct day-to-day activities. All banks/non banks are expected to properly manage their risks (NRB, 2007). Some quantifiable parameters for the performance ratings are given as follows:

A. Capital Adequacy

A bank/non bank is expected to maintain capital commensurate with the nature and control these risks. The effect of credit, market and other risks on the bank/non bank's financial condition should be considered when evaluating the adequacy of capital. The type and quantity of risk in gerent in an institution's activities will determine the extent to

- the volume of poor quality assets ;
- the bank /non bank's capital growth experience , as well as prospects for the future ;
- the ability management to address emerging needs for additional capital;
- the bank/non bank's risk – based capital ratio relative to industry norms and regularly requirements.
- the quality and strength of earnings, earnings retention and reasonableness of
-
- dividends ;
- access to capital markets or other source of financial assistance

Ratings

1) Bank/non banks with capital rated a "1" are considered to have adequate capital relative to their risk profile.

2) Bank/non banks with capital rated "2" will have risk – based capital ratio somewhat less than those of bank /non-banks rated "1"but nonetheless satisfactory in relation to their risk profile.

3) A "3" rating for capital should be assigned when the bank/nonblank only complies marginally with the minimum risk –based capital ratio imposed by the NRB. That is the am

immediate injection of capital from shareholders or other external source of financial assistance would be required.

B. Assets Quality

The assets quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other assets, as well as off-balance sheet transaction. The assets quality of a bank /nonbank is related from "1" to "5" based upon, but not limited to, an assessment of the following factors:

- the level , severity , trend of problem , restructured and non-performing loans ;

- the adequacy of underwriting standard , soundness of credit administration practices ;
- the adequacy of general loan loss provisioning , specific provisioning and other asset valuation reserves.
- The credit risk arising from off- balance sheet transactions, such as irrevocable loan commitment of foreign currency swaps;
- the diversification and quality of the loan and investment portfolios ;
- the extent of securities underwriting activities and exposure to counterparties in identification and collection of problem assets.
- The adequacy of internal controls and management information systems (MIS);
- The volume and nature of credit documentation exceptions.

Rating

1) Banks/nonbanks with assets rating a "1" have indicate strong asset quality and credit administration practices .

2) Banks /nonbanks with assets rating a "2" have more classified loans than that of a "1" bank/ non/banks. However , these institution indicate good capital protection and management ability.

3) An assets rating of "3" assigned when asset quality or credit administration practices are less than satisfactory. The level and severity of classified assets, other weaknesses and risks require an increased level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

4) When asset quality is rated a "4" the level of risk and asset problems evident in the bank/nonbank are significant and inadequately controlled. The bank/ nonbank is subject to potential losses that, if unchecked, may threaten the viability of the institution.

5) ctices are less than satisfactory. The level and severity of classified assets, other weaknesses and risks require an increased level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

4) k/bank.

C. Management

The management rating should reflect the capability of the Board of Directors of the Board of Directors and management, in their respective roles, to identity, measure, monitor and control the risks of an institution's and to ensure a bank/nonbank's safe, sound, ctices are less than satisfactory. The level and severity of classified assets, other weaknesses and risks require an increased level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

4) e the Board's goals, objectives and risk limits into prudent operating standards.

Sound management practices are demonstrated by active oversight by the Board of Directors and management; competent personnel; adequate policies, processes and controls taking into consideration the size and sophistication of the bank/nonblank; maintenance of an appropriate information system (MIS). This rating should reflect the Board's and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the bank/nonbank is involved.

The Capability and performance of management and the Board of Directors is rated based upon, but limited to, an assessment of the following factors;

- The level and quality of oversight and support of all bank/nonblank activities by the Board of Directors and management.
- The ability of the Board of Directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products.
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems.
- The relative amount of skilled staff (senior staff/support staff), educational background of staff, experience in banking, rate of employee transfer between departments (e.g. harmony between management and staff.
- The adequacy of audits and internal controls to; promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations; ad internal policies.

- Compliance with laws and regulations.
- Responsiveness to recommendations and management is affected by, or susceptible t, "outside influence" or concentration of authority.
- Reasonableness of compensation policies and avoidance of self- dealing.

Rating

1) Management and the Board of Directors would be rated"1" if they demonstrating strong performance with respect to the above ten factors, particularly in the area of risk ma ctices are less than satisfactory. The level and severity of classified assets, other weaknesses and risks require an increased level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

4) nitored and controlled. Management and the Board have demonstrated the ability to act promptly and to successfully address existing and potential problems and risks.

2) A rating of "2" indicates satisfactory management and Board performance with respect to the above nine factors. Minor weaknesses may be apparent but they are not material to the safety and soundness of the bank/nonbank and are being addresses. In general, significant risks and problems have been identified, measured, monitored and controlled.

3) A management rating of "3" indicates that there is evidence of poor performance with respect to the above nine factors and that the risk management practices used within the bank/nonbank are not entirely satisfactory. The capabilities of management and/or the Board of Directors appear to be insufficient for the type, size or condition of the institution, problems and significant risks may be inadequately identified, measured, monitored and/or controlled.

4) A rating of "4" indicates deficient management and Board performance. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored or controlled and require immediate action by the Board and management or the Board may be necessary.

5) A rating of "5" points to critically deficient management and Board performance, management and the Board if Director have demonstrated an inability to correct problems and to implement appropriate risk management practices. Problems and significant risks have been inadequately identified, measured, monitored or controlled and currently

threaten the continued viability of the bank/nonbank. Replacing or strengthening management or the Board has become a necessity.

D. Earnings

The rating for earning reflects not only the quantity and trend of earnings, but also factors thatning can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risk that may unduly expose a bank/nonbank's earning to volatility. The quality of earning may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future ear rating expenses, poorly executed or ill-advised business strategies, or badly managed or uncontrolled exposure to other risks.

Earnings should be rated from "1" to "5" based upon, but not limited to, an assessment of the following factors.

- The level of earnings, including trends and stability.
- The bank/non bank's ability to adequate capital through retained earnings.
- The quality and source of earnings (recurring? non recurring?)
- The adequacy of the budgeting systems forecasting processes, and management information systems in general.
- The adequacy of general loan loss provisioning and provisioning for loans classified as substandard, doubtful and loss.
- The earning exposure to market risk, such as interest rate, foreign exchange and price risks.

Ratings

1. An earning rating of "1" indicates that earnings are strong. Earning are more than sufficient to support operations and maintain adequate capital and provisioning levels given the particular quality of the bank/non bank's assets and financial growth.
2. An earning rating of "2" suggests that earnings are satisfactory. Earning are sufficient to support operations and maintain adequate capital and provisioning

levels after consideration has been given to assets quality, growth and other factors affecting the quality, quantity and trend of earnings. Earnings that are relatively stable, or even experiencing a slight decline, may receive a "2" rating provided the bank/non bank's level of earnings is adequate in view of the six assessment factors listed above.

3. Earning that receive a rating of "3" indicates a need for improvement. The earning may not be sufficient to support the cost of operations, contribute to capital and adequately provision for classified loans.
4. A rating of "4" indicates earnings characterized by chronic losses. A bank/non bank with earnings rated "4" is experiencing losses that represent a distinct threat to its solvency through the erosion of capital.
5. A rating of "5" indicates that earning are deficient, institutions with such a rating may be characterized by erratic fluctuations in net income, intermittent losses or a substantial drop in earnings from the previous year. Furthermore, the earning if such a bank/non bank may not be sufficient to cover provisioning for classified debt and may demonstrate a downward trend related to poor assets quality.

E. Liquidity

In evaluating the adequacy of a bank/non bank's liquidity position, consideration should ning can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risk that may unduly expose a bank/nonbank's earning to volatility. The quality of earning may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future earlimited to, an assessment of the following factors.

- Volatility, type, concentration and trend of deposits in the interest of meeting the bank/non banks liquidity needs.
- Availability of assets ready convertible into cash;
- Access to money markets or other ready sources of funds.
- Reliance on interest sensitive funds (those assets and liabilities that can be reprised at prevailing market rates within one year);

- Trend and stability of deposits.
- Trend and stability of deposits;
- Compliance with statutory requirement prescribed by the NRB; and
- The capability of, management to properly identify, measure, monitor, and control the bank/non bank's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans

Rating

1. A liquidity rating of "1" indicates plenty of liquid assets to match obligations coming due and/or ready access on favorable terms to external source of funds.
2. A bank/non bank that shows a high level of liquidity, but a liquidity level that is decreasing somewhat and evidence of some minor weakness in funds management, would warrant "2".
3. A"3" liquidity rating indicates that the bank/non bank is managing to meet the minimum regulatory liquidity requirement (CRR), but the structure of the funding base appears unstable so that the bank/non bank is subject to cyclical liquidity pressures.
4. A rating of "4" reflects an insufficient volume of liquid assets. Bank/non banks with liquidity rated "4" may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.
5. Bank/non banks with liquidity positions so critical as to constitute threat to the continued viability of the institution, should be accorded a "5". Such bank/non banks require immediate remedial action or external financial assistance to allow them to meet their obligations.

F. Sensitively to Market Risk

The sensitively to market risk reflects the degree to which changes in interest rates, foreign exchange rates. In some institution affect a bank/non bank's earnings and capital. ning can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risk that may unduly expose a bank/nonbank's earning to

volatility. The quality of earning may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future earbut not limited to, an assessment of the following factors.

- The sensitivity of the bank/non bank's earning or the economic value of its capital (net equity value) to adverse changes in interest rates, foreign exchange rates, commodity prices
- The ability of management to identify, measure, monitor, and control exposure to market risk given the bank/non bank's size, complexity and risk profits.
- The amount of interest rate risk exposure arising positions.
- The amount of market risk arising from trading and foreign operations.

Ratings

1. A rating of "1" for the bank/non bank's sensitivity to market risk suggest that earnings performance and the capital position would be unlikely to be adversely affected by changes in interest rates, foreign exchange rates, commodity prices, or equity prices. Risk management practices are strong. The level of the bank/non bank's earning and capital provide substantial support for the amount of market risk taken.
2. A sensitivity of "2" indicates that market risk sensitivity is adequately controlled and that there is only a very small possibility that earning performance or the capital position will be adversely affected by changes in interest rates, foreign exchange rates, commodity prices or equity prices. Risk management practices are satisfactory. The level of the bank/non bank's earning and capital provide adequate support for the degree of market risk taken.
3. A rating of "3" suggest that the bank/non bank's control over market risk needs improvement and that there is a significant possibility that earnings performance and the capital position will be adversely affected by changes in interest rates, foreign exchange rates, commodity prices, or equity prices. Risk management practices need to be improves. The level of earning and capital

may not be enough to support the degree of market risk undertaken by the institution.

4. A sensitivity rating if "4" signals that control over market risk is inadequate and that there is a strong possibility that earning performance and the capital position of the bank/non bank will be adversely affected by changes in interest rates, foreign exchange level of earning and capital provide inadequate support for the amount of market risk taken by the bank/non bank.
5. A sensitivity rating of "5" indicates that the control over the bank/non bank's exposure to market risk is so poor as to create an imminent threat to the institution's solvency. Risk management practices are wholly inadequate

Composite Rating

In assigning a composite rating for a bank/nonbank, consideration must be given to the ning can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risk that may unduly expose a bank/nonbank's earning to volatility. The quality of earning may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future ear factors that may strongly influence the inspector’s judgement. Composite rating may be distinguished as follows;

Composite 1(strong) – Bank/non banks in this group are fundamentally sound in every respect. Any deficiencies are minor and can be handled in a routine in a routine manner by the bank/non bank. Such a bank/non bank is resistant to outside economic and financial disturbances and as a result, gives no cause for supervisory concern.

Composite 2 (satisfactory) – Bank/non banks in this group are fundamentally sound, but may demonstrate modest weaknesses that are easily correctable. To the extent that remedial and, as a result, gives no cause of the bank/nonbanks business, supervisory concern would be minor.

Composite 3(Fair) – Bank/non banks in this category exhibit a combination of financial, operational and compliance weaknesses ranging from moderately severe to unsatisfactory. Such bank/non banks may be vulnerable to the onset of adverse business

condition and could easily deteriorate if concerted action is not taken to correct the areas of weakness. Bank/non banks, which exhibit significant instance of non – compliance with legislation and regulations may also be accorded this rating. Consequently, these bank/non banks give cause for supervisory concern and require more than normal supervision to address deficiencies. The overall strength and financial capacity if these institution, however, are still such as to make failure only a remote possibility.

Composite 4(Unsatisfactory) – Bank/non banks in this group have a number of serious financial weaknesses. Unless effective action is taken to correct this condition, they could easily escalate into a situation that could impair future solvency. Bank/non banks in this category require close supervisory attention and a definitive plan for corrective action.

Composite 5(Critical)- This category is reserved for those bank/nonbanks in dire ning can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risk that may unduly expose a bank/nonbank's earning to volatility. The quality of earning may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future earfinancial support or takeover.

2.2 Theoretical Review

In 1975, an international committee was formed by the central banks and supervisory authorities of ten centralized countries to coordinate the surveillance exercised by national authorities over the international banks. This group of ten countries, known as thening can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risk that may unduly expose a bank/nonbank's earning to volatility. The quality of earning may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future earmmittee on Banking Supervision has met regularly at the Bank for International Settlement in Basle, Switzerland.

The Basle concordat 1975 provided a general statement on the responsibilities of national authorities for the supervision of international banks. This concordat was revised in 1983, paving the way for more standardized methods of bank supervision among central banks around the world.

In 1988, after consulting with bank supervisors around the world, the Basle Committee proposed a risk based capital adequacy framework. Underlying this framework, c

supervisory authorities of the Group of Ten countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, United States and Luxembourg (Basle Committee on Banking Supervision, 1988:1).

For the purpose of study, following major four sections are divided. The first two describe the framework: Section third constituents of capital and Section fourth the risk weighting system. Section III deals with the target standard ratio; and Section IV with implementing arrangements.

2.2.1 The Constituents of Capital under Capital Accord 1988

As per Capital Accord 1988, there are two types of capital. First one is core capital and the next is supplementary capital.

a) Core capital (basic equity)

The key element of capital on which the main emphasis is placed on equity capital and disclosed reserves is core capital. It includes fully paid ordinary shares/common stock and non-cumulative perpetual preferred stock (but excluding cumulative preferred stock).

of equity capital and published reserves. The other element of capital (supplementary capital) is admitted to an amount equal to that of the core capital.

b) Supplementary capital

While calculating supplementary capital, following points are included.

i. Undisclosed reserves: Unpublished or hidden reserves are constituted in various ways according to differing legal and accounting regimes in member countries. Under this heading are included only reserves which, though unpublished, have been passed through the profit and loss account and which are accepted by the bank's supervisory authorities.

ii. Revaluation reserves: Some countries, under their national regulatory or accounting arrangements, allow certain assets to be revalued to reflect their current value. Such reserve is included within supplementary capital provided that the assets are considered by the supervisory authority to be prudently valued, fully reflecting the possibility of price fluctuations. Such reevaluations can arise in two ways:

   (a) from a formal revaluation, carried through to the balance sheets of banks' own premises; or

   (b) from a notional addition to capital of hidden values which arise from the practice of holding securities in the balance sheet valued at historic costs.

iii. General provisions/general loan-loss reserves: General provisions or general ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset

class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and points, or exceptionally and temporarily up to 2.0 percentage points, of risk assets.

iv. Hybrid (debt/equity) capital instruments. This heading includes a range of instruments, which combine characteristics of equity capital and of debt. Their precise specifications differ from country to country, but they should meet the following requirements:

- they are unsecured, subordinated and fully paid-up;
- they are not redeemable at the initiative of the holder or without the prior consent of the supervisory authority;
- they are available to participate in losses without the bank being obliged to cease trading.
- Cumulative preference shares, having these characteristics, are eligible for inclusion in this category.

v. Subordinated term debt: Subordinated term debt instruments have significant deficiencies as constituents of capital in view of their fixed maturity and inability to absorb losses except in liquidation. These deficiencies justify an additional restriction on the amount of such debt capital, which is eligible for inclusion within the capital base. Subordinated term debt instruments with a minimum original term to maturity of over five years are included within the supplementary capital.

2.2.2 The Risk Weights under Capital Accord 1988

Weighted risk ratio in which capital is related to different categories of asset or off-balance-sheet exposure, weighted according to broad categories ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based

risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and mework of weights has been kept simple and only five weights are used - 0, 10, 20, 50 and 100%.

a) There are six aspects of the structure to which attention is particularly drawn while calculating risk weights in capital accord 1988

i. Categories of risk captured in the framework: There are many different kinds of risks against which banks' managements need to guard. For most banks the major risk is credit risk, that is to say the risk of counter-party. There are many other kinds of risk - for example, investment risk, interest rate risk, exchange rate risk and concentration risk. The central focus of this framework is credit risk and, as a further aspect of credit risk, country transfer risk.

ii. Country transfer risk: Firstly, a simple differentiation between claims on domestic institutions (central government, official sector and banks) and claims on all foreign countries; and secondly, differentiation on the basis of an approach involving the selection of a defined grouping of countries considered to be of high credit standing.

iii. Claims on non-central-government, public-sector entities (PEs): In order to preserve in the application of such discretion, the weights should be 0, 10, 20 or 50% for domestic PEs.

iv. Collateral and guarantees: In view of the varying practices among banks in different countries for taking collateral and different experiences of the stability of physical or financial collateral values, it has not been found possible to develop a basis for recognizing collateral generally in the weighting system. These attract the weight given to the collateral (i.e. a

zero or low weight). The contingent liability assumed by banks in respect of guarantees attracts a credit conversion factor of 100%.

v. Loans secured on residential property: Loans fully secured by mortgage on occupied residential property have a very low record of loss in most countries. 50% weight to loans fully secured by mortgage on residential property, which is rented or is (or is intended to be) occupied by the borrower. Other collateral has not been regarded as justifying the reduction of the weightings.

vi. Off-balance-sheet engagements: An importance that all off-balance-sheet activity should be caught within the capital adequacy framework. At the same time, it is recognized that there is only limited experience in assessing the risks in some of the activities. The credit conversion factors would be multiplied by the weights applicable to the category of the counter party for an on-balance-sheet transaction

b) Target Standard Ratio

The target standard ratio of capital to weighted risk assets should be set at 8% (of which the core capital element is at least 4%). This is expressed as a common minimum standard which international banks in member countries were expected to observe by the end of 1992.

Implementation

Each country should decide the way in which the supervisory authorities introduce and apply these recommendations in the light of their different legal structures and existing supervisory arrangements. Accordingly, Nepal Rastra Bank had developed it capital adequacy norms suitable to our country based on the framework prescribed in the 1988 capital accord.

This accord was revised in 1996 with the introduction of capital charge for market risk. This 1988 accord was adopted by more than 100 countries, including Nepal. The accord had contributed to strengthen bank capital at a time when a number of countries had

experienced problems in their banking systems. It has become one of the benchmark measures of bank's in financial health.

2.2.3 Provisions for Capital Adequacy in Commercial Banking Sector in Nepal

Present capital adequacy norms developed by central bank of Nepal had considered major international norms from The Basel I Capital Accord 1988. Nepal Rastra Bank had issued ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and l fund by commercial banks had been issued on 14 September, 2001 by Nepal Rastra Bank (NRB, 2001). Major areas covered in capital adequacy directives issued by Nepal Rastra Bank are given below.

1. Maintenance of Minimum Capital Fund

On the basis of the risk-weighted assets, the banks shall maintain the prescribed proportion of minimum capital fund as per the following time-table.

Table No: 2.1
Regulatory Requirement of Capital Adequacy

Time Table	Required Capital fund on the basis of weighted risk assets (In percentage)	
For FY 2000/1	4%	8%
For FY 2001/2	4.5%	9.0%
For FY 2002/3	5.0%	10.0%

For FY 2003/4	5.5%	11%
For FY 2004/5*	*5.5%	*11%

* Revised by circulars of NRB

2. Definition of Capital

For the purpose of calculation of Capital fund, the capital of the banks is divided into the following two components and defined:

a) **Core Capital**

The amounts under the following heads shall be included in the Core Capital

(a) Paid up capital
(b) Share premium
(c) Non-redeemable preference shares
(d) General Reserve Fund
(e) Accumulated Profit and loss account

However, where the amount of Goodwill exists, the amount of goodwill shall be deducted for the purpose of calculation of Core Capital.

b) **Supplementary capital**

For the purpose of the calculation of capital fund, the amount under the following heads, subject up to one hundred percent of the core capital, shall be included under the supplementary capital.

(a) General Loan Loss Provision

Under this head, provision made only against the Pass Loan shall be included. This amount shall be limited up to 1.25 percent of the total Risk Weighted Assets.

However, loan loss provisioning on sub-standard and doubtful loans shall be available for inclusion under the supplementary capital during the period as follows:

Table No: 2.2
Loan Loss provisioning for Inclusion in Supplementary Capital

Time period	loan loss provisioning available for inclusion under supplementary capital
For FY 2001/2	Pass, sub standard and doubtful
For FY 2002/3	Pass, sub standard
For FY 2003/4	Pass*

- Up to 1.25 percent of Total risk weighted assets

(b) Exchange Equalization Reserve

(c) Assets Revaluation Reserve

The amount of Assets Revaluation Reserve can be included for the purpose of calculation supplementary capital subject up to 2 percent of the total supplementary capital, inclusive of the amount of the reserve.

(d) Hybrid Capital Instruments

This includes the following instruments that have the characteristics of both debt and equity:

(i) Unsecured, fully paid up instruments issued by the bank which are subordinated to priority of payment after) depositors and creditors, and available to absorb losses as well as convertible into ordinary capital.

(ii) Instruments, which are non-redeemable at the option of the holder except with the approval of Nepal Rastra Bank.

(iii) Perpetual or long-term preference stock (Shares) convertible into common stock if the profit and loss account becomes negative.

However, banks and financial institutions can not hold (purchase) Hybrid Capital Instruments issued by any bank of financial institution.

(e) Unsecured Subordinated Term Debt.

Unsecured and subordinated debt instruments (priority of payment after the depositors) issued by bank with a minimum maturity term of over five years and limited life redeemable preference shares. To reflect the diminishing value of these instruments, a discount (amortization) factor of 20 percent during the last five years shall be applied.

The issue of these instruments by banks shall not exceed 50 percent of their core capital.

(f) Other Free Reserves not allocated for a specific purpose

3. Total Capital Fund

Total Capital Fund is defined as the sum of core capital and supplementary capital.

4. Total Weighted Risk Assets

For the purpose of calculation of capital fund, the risk weighted assets has been classified into following two components:

(a) On balance sheet risk weighted assets
(b) Off-balance sheet risk weighted assets

5. Risk weighted on Balance Sheet Assets and off-balance sheet items

(a) For the purpose of calculation capital fund, the on balance sheet assets are divided as follows with assignment of separate risk weight-age. Accordingly, for determining the Total Risk Weighted Assets the amount as exhibited in the balance sheet assets shall be multiplied by their respective risk weight-age and then added together. Risk weights for off balance sheet items are given in Appendix 2.
(b) Risk weighted off Balance Sheet items

(c) For the purpose of calculation Capital Fund, the Off-Balance Sheet Items are divided as follows with assignment of separate risk weight-age. Accordingly, for determining the total Risk Weighted Off Balance sheet assets, the amount of such transaction shall be multiplied by their respective risk-weights and then added together. Risk weights for off balance sheet items are given in Appendix 3.

6. Capital Fund Ratios

This ratio would measure the total capital fund on the basis of total risk-weighted assets. The capital fund ratio shall be determined as follows:

$$\text{Capital fund ratio} = \frac{\text{Core capital + Supplementary capital}}{\text{Sum of risk-weighted assets.}} \times 100$$

Sum of risk-weighted assets. = Total on balance sheet risk-weighted assets+ Total off balance sheet risk-weighted items.

7. Reporting Requirement of Capital Fund

Banks shall, at the end of Ashwin, Poush, Chaitra and Ashad of each fiscal year, prepare the statements of capital fund and other relevant statements on the basis of the financial ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights

according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and of calculation of the capital fund.

8. Time period for fulfilling the shortfall in capital fund

In the event of non-fulfillment of capital fund ratio as mentioned under section 1 above in any quarter, the shortfall amount shall be fulfilled within next 6 (six) months. Until the fulfillment of such capital fund, banks shall not declare or distribute dividend to its shareholders under section 18 of commercial bank act, 2031. The shortfall in the capital fund may be rectified:

(a) by issuing new shares.
(b) by reallocating assets.

9. Actions for not complying the directives relating to capital fund.

Where any bank does not fulfill the minimum capital fund within the period specified in clause (8) above, any of the following actions may be initiated:

(a) Suspension of declaration or distribution of dividend (including bonus shares)
(b) Suspension of opening new branch.
(c) Suspension of access to refinancing facilities of Nepal Rastra Bank.
(d) Restriction on lending activities of the bank
(e) Restriction on acceptance of new deposits.
(f) Initiation of any other actions by exercising the authority under Section 32 of Nepal Rastra Bank Act, 2012.

2.2.4 Playing Factors in the Provisions for Capital Adequacy in Commercial Banking Sector in Nepal as per On-Site Inspection Manual of Nepal Rastra Bank

Capital adequacy shows the condition of having sufficient permanent resources to continue operations despite financial losses or non-availability of external funding. Capital adequacy cannot be determined wholly on the basis of a numeric formula or

calculation of a ratio. The following factors come into play when considering the sufficiency of capital for the banks/non banks.

a. Competent and Effective Management

The competence and effectiveness of management including the board of directors, is a key determinant of capital adequacy. A competent and effective management team would chart the proper course of operations and establish efficient systems with effective ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and management team.

b. Growth Trends and Operating Targets

Capital needs depend upon a great deal on the volume and size of the bank's operations. In order to maintain adequate capital, asset growth should be supported by capital growth. Fixed assets and the long-term infrastructural investments of the bank/nonblank should be supported by capital or long term loans (preferably subordinated debt) rather than deposits. Growth that outpaces the bank/non-bank's ability to maintain a sufficient level of capital means that the bank/nonblank is highly geared and depends too much on less permanent funds as deposits are sometimes quite volatile. Such dependence is unsafe and imprudent. Therefore, banks/non-banks should not only target asset growth but should also plan adequately for their additional capital needs.

c. Earnings Performance and Expectation

Profitability is a fundamental component of capital adequacy. Profits contribute to the accumulation of revenue reserves that constitute the main ingredient of capital growth.

A trend of sustained profitability may be a sign of well-managed operations and may be a reflection of competent and efficient management. However, the components of profits should be analyzed to determine the quality of earnings. That is profits should be separated into operating profits and extraordinary profits. Obviously, profits from a stable source of operational earnings provided a better defense against losses than the occasional sale of assets or opportune gains from investments.

d. Balance Sheet Composition

The asset/liability mix as reflected in the balance sheet is a good indicator of the bank/non-bank's long term financial stability. The components of the balance sheet and ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and s in the asset/liability mix over time may indicate that the bank/non-bank lacks clear, long term objectives and is pursuing poor operational strategies that may put the bank/non-bank at greater risk of loss.

e. Assets Quality and Risk Estimations

Although the overall risk-mix inherent to assets appearing on the balance sheet is important in evaluating capital adequacy, possible weakness attached to individual assets are essential to consider. An indicator of asset quality problems is the amount of credit that has been classified and the relative severity of these classifications in relation to capital. Delinquency and foreclosure trends, the level of non-accrued interest or non performing loans, and the decline in the market value of securities are also signals with respect to asset quality. Consideration must be given to signs of deterioration in asset quality and its potential impact on the ban/non-bank's capital.

f. Off Balance Sheet Exposures

Off-balance sheet activities should be examined along with on balance sheet activities to ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and in relation to credit risk. It is important, therefore, for management to implement controls and procedures to identify, monitor, and manage all risks relating to the activities of the banks/non-banks.

2.2.5 Present Effort for the Development of Prudential Directives in Capital Adequacy

After the successful implementation of 1988 capital accord in more than 100 countries, the Basel Committee on Banking Supervision reached an agreement on a number of important issues for promoting prudential and uniform banking practices as well as setting standards and guidelines for supervisory functions. Realizing the fact, In January

2001, it has developed a new comprehensive framework for capital requirements based ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and expected that the Basel–II will be a milestone in the global banking history.

Key Elements of the New Accord

The New Accord consists of three re-enforceable pillars:

(1) Minimum capital requirements,

(2) Supervisory review process and

(3) Market discipline.

The proposals comprising of each of the three pillars are summarized below:-

1) Pillar 1: Minimum Capital Requirements

In new capital accord 2005 also, the definition of eligible regulatory capital, as outlined in the 1988 Accord11 is eligible for inclusion in Tier 1 (Core Capital) and in Tier II (Supplementary Capital) except in exceptional cases.

The current accord is based on the concept of a capital ratio where the numerator represents the amount of capital a bank has available and the denominator is a measure of the risks faced by the bank and is referred to as risk-weighted assets. The resulting capital ratio may be not less than 8%.

"Likewise, risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by 12.5 (i.e. the reciprocal of the minimum capital

ratio of 8%) and adding the resulting figures to the sum of risk-weighted assets for credit risk"(International Convergence of Capital Measurement and Capital Standards, 2005:5).

The current accord explicitly covers three types of risks in the definition of risk-weighted assets:

(1) credit risk
(2) market risk, and
(3) operational risk

A major innovation of the proposed Basel–II is the introduction of three distinct options for the calculation of three types of risk. It is not feasible or desirable to insist upon a ommonly known as the Basle Capital Accord, was the premise that a uniform approach to establishing minimum levels of capital will help to: a) Strengthen the soundness and stability of international banking system, b) Promote a fair and consistent basis for evaluating capital; and c) Diminish competitive inequalities among international banks. The weighted risk based risk based framework proposed by the Basle Committee focuses on credit risk and takes into account both off balance sheet and on balance sheet credit risk exposure. The approach also distinguishes the varying degrees of risk inherent to different assets by assigning weights according to asset class. The Basel I Capital Accord 1988 have been endorsed by the Group of Ten central-bank Governors. The Basle Committee on Banking Supervision comprises representatives of the central banks and allow banks and supervisors to select the approach or approaches that they believe are most appropriate to the stage of development of bank's operation and of the financial market infrastructure. The following table identifies the three primary approaches available by risk type.

1. Credit Risk

    a. Standardized Approach
    b. Foundation IRB Approach
    c. Advanced IRB Approach

2. Operational Risk

    a. Basic Indicator Approach
    b. Standardized Approach

c. Advanced Measurement Approaches (AMA)

3. Market Risk

a. Variance Co-variance Approach
b. Monte Carlo Simulation Approach
c. Historical Simulation Approach

Credit risk

A bank always faces the risk that some of its borrowers may renege on timely repayments of loan, interest on loan or meet the other terms of contract. This risk is called credit risk, which varies from borrower to borrower depending on their credit quality. Basel–II requires banks to accurately measure credit risk to hold sufficient capital to cover it.

Factors affecting credit risk can be summarized by the following formula:

Expected Loss (EL) on a loan = Exposure at default (EAD) X Loss

given default (LGD) X Probability of Default (PD).

The bank can also suffer losses in excess of expected losses, say, during economic downturns. These are called unexpected losses. Ideally, a bank should recover expected loss on a loan from its customer through loan pricing. The capital base is required to absorb the unexpected losses, as and when they arise.

Market risk

Investment is risky because of the change in their prices due to market forces. This volatility in the value of a bank's investment portfolio is known as the market risk, as it is driven by the market forces. The change in the value of the portfolio can be due to changes in interest rate, fluctuation in exchange rate or the changes in the values of equity or commodities.

Operational Risk

Several events that are neither due to default by third party nor because of the volatility of the market mechanism are called operational risks and can be attributed to internal systems, processes, people and external factors.

2) Pillar 2: Supervisory Review Process

Pillar II ensures that not only do the banks have adequate capital to cover their risks, but also that they employ better risk management practices so as to minimize the risks. Capital cannot be regarded as a substitute for inadequate risk management practices.

This pillar requires that if the banks use asset securitization and credit derivatives and wish to minimize their capital charge they need to comply with various standard and control. As a part of the supervisory process, the supervisors need to ensure that the regulations are adhered to and the internal measurement systems are standardized and validated.

The supervisory review process is based on four principles:

Principle 1:

Banks should have a process for assessing their overall capital adequacy vis-à-vis their risk profile and a strategy for maintaining their capital levels.

Principle 2:

Supervisors should review and evaluate bank's internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

Principle 3:

Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

Principle 4:

Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

Given the kind of responsibilities, the supervisor's role assumes high importance in the Basel–II . Pillar II does not seek to harmonize supervisory processes across countries as they have different supervisory objectives, legal processes and authority of supervisors. It allows for sufficient national discretion but still it wants supervisors to maintain some degree of consistency in their approaches.

3) Pillar 3: Market Discipline

Banking operation is becoming complex and difficult for supervisors to monitor and agencies, depositors and investors.

With frequent and material disclosures, outsiders can learn about the bank's risk. Armed with this information, the outsiders can always protect themselves by ending their relationships with the bank.

Market discipline has two important components:

a. Market signaling is the form of change in bank's share prices or change in bank's borrowing rates

Responsiveness of the bank or the supervisor to market signals Seeing the importance of the impact that the market can have on banks, Pillar III provides a comprehensive menu of public and regulatory disclosures like disclosures related to capital structure (core and supplementary capital), capital adequacy, risk assessment and risk management processes to enhance the transparency in banking operations.

2.3 Capital and Capital Adequacy

Capital is a part of wealth or money or property, which may be used for the production of more wealth and additional wealth. It consists of those kinds of wealth other than free gifts of nature, which yield income. Capital is a stock resource that may be employed in the production of goods and services and the price paid for the use of credit or money, respectively.

Patheja has defined banks capital as common stock plus surplus plus undivided profits

The Basel Committee sets a standard for all the baking norms, which will be accepted by central bank of all big industrialist countries. The first Basel Capital Accord was issued in 1988 and was implemented by 1992. The committee gas now issued New Basel Capital Accord which will be implemented by 2006 to overcome the drawbacks of the current capital accord. Central banks of developing underdeveloped countries follow these standards Nepal Rastra Bank also follows these standards and accordingly sets standard for commercial banks in Nepal.

According to the directive issued by Nepal Rastra Bank, the bank capital has been categorized in to two par parts: core capital and supplementary capital. This categorized is also known as core capital for Tier-1 capital and supplementary capital for Tier-2 capital.

The Tier-1 capital consists of the following components:

1. Share Capital,
2. Share Premium,
3. Non- Redeemable Preference Shares,
4. General reserve Found, and
5. Accumulated Profit and Loss Goodwill amount to be deducted, if any.

The Tier -2 capital consists of the following components:

1. General Loan Loss Provision,
2. Exchange Equalization Reserve,
3. Assets Revaluation Reserve,
4. Hybrid Capital Instruments,

   Unsecured Subordinated Term Debt,

5. Interest Rate Fluctuation Fund, and
6. Other free Reserves

The total of Tier-1 and Tier-2 capital is considered for calculating capital adequacy ratio. The capital adequacy ratio is based on total risk-weighted assets (NRB Directives No.1, 2004:1-2).

Clark has defined capital adequacy as legal requirement that a financial institution (such as a bank) should have enough capital to meet all its obligations and fund the services it offers (Clark, 1999:504).

The capital adequacy ratio is calculated using the following basic formula:

$$\text{Capital Adequacy Ratio} = \frac{\text{Total Capital Fund}}{\text{Total Risk - Weighted Asscets}} * 100\%$$

Total risk-Weighted assets (TRWA) = Assets held by a financial institution to which degree of risk have been assigned, so that adequate provision can be set aside.

2.3.1 Definition of Capital Fund for Commercial Banks

For the purpose of calculation of Capital Fund, the capital of the banks is divided into two components, Core Capital and Supplementary Capital.

Core Capital:

Core Capital of commercial banks includes:

- Paid up capital
- Share premium
- Non-redeemable preference shares
- General Reserve Fund
- Accumulated Profit and Loss Account

The amount of goodwill shall be deducted from; the; amount of core capital, if amount of goodwill exists at all.

Supplementary Capital:

Supplementary Capital of Commercial banks includes:

- General Loan loss provision:

Previously, total amount of loan loss provision made for all the six categories of loan used to be included in the supplementary capital but not with the new directives, the amount of general loan loss provision shall be included in the supplementary capital as per the following time table:

Time Period	**Provision available for inclusion in the Supplementary capital**
For FY 2001/02 (058/59)	Doubtful loans
For FY 2002/03 (059/60)	Sub-Standard and Doubtful loan
From FY 2003/04 (060/61)	Pass loan

The amount of general loan loss provision shall not exceed 1.25 percent of the total risk weighted asset

- Exchange Equalization Reserve
- Assets Revaluation Reserve

The asset revaluation reserve can be included in the supplementary capital but is limited only up to 2 percent of the total supplementary capital including this reserve amount

- Hybrid Capital Instruments

There are two types of instruments includes under this, they are:

- Unsecured, fully paid up instruments issued by the bank which are subordinated to (priority of payment after) depositors and creditors, not available to absorb losses as well as convertible into ordinary capital.
- Instruments which are non-redeemable at the option of the holder except with the approval of NRB

- Perpetual or long term preference stock (share) convertible into common shares if the profit and loss account becomes negative.
- Unsecured Subordinated Term debt

preference shares. In order to show the diminishing value of these instruments, banks are required to amortize the value of the instruments at the rate of 20 percent every year.

- Other free resources not allocated for a specific purpose.

(NRB Directives No.1, 2004:1-2)

2.3.2 Review of NRB Capital Adequacy Norms for Commercial Banks

With the objectives to build up a strong, capable and secured banking system for promoting economic growth of the country as well as to protect the interests of depositors, as provide under section 23 (1) of Nepal Rastra Bank Act 2012 relating to development and regulation of banking system. This directives is respects to maintenances of minimum capital fund by commercial banks has been issued in exercise of authority under section 14 (a) commercial banking Act, 2031.

Commercial banks need to maintain the prescribed proportion of minimum capital fund in the basis of the risk weighted assets. As per the directives issue by the Central Bank, the banks need to follow the following time table:

Time Table	Core Capital	Total Capital Fund
For FY 2058/59(2001/02)	4.5%	9.0%
For FY 2059/60(2002/03)	5.0%	10.0%
For FY 2060/61(2003/04)	5.5%	11.0%
From FY 2061/62(2004/05) Onward	6%	12.0%

Since, the capital of the bank is divided into two categories core and supplementary capital. Core capital is known as Tier-1 capital and Supplementary capital is known as Tier-2 capital. The core capital is the summation of share capital, share premium, non-redeemable preference shares, general reserve fund and accumulated profit/loss.

Similarly supplementary capital has been defined to include general loan loss provision, exchange equalization reserve, assets revaluation reserve, hybrid capital instruments, unsecured subordinated term debt, interest rate fluctuation fund and other fee reserves.

The sum of Core and Supplementary capital is measured to be total capital fund. For the purpose of calculation of capital fund, the risk-weighted assets have been classified in two parts on –Balance Sheet Risk-Weighted Assets and Off-Balance Sheet Risk Weighted Items. As stated by the norms, the capital fund ratio would measure the total capital fund on the basis of total risk-weighted assets. The capital fund ratio shall be determined as follows:

$$\text{Capital Fund Ratio} = \frac{\text{Core Capital } \Gamma \text{ Supplementary Capital}}{\text{Sum of risk - weighted assets}} * 100\%$$

The sum of risk weighted assets is the sum of total no-balance sheet risk-weighted assets and total off-balance sheet risk-weighted items. The bank shall, at the end of Ashoj (mid October), push (mid January), Chaitra (mid April) and Ashad (mid July) of each fiscal year, prepare the statements of Capital Fund and other relevant statements on the basis of Suspension of declaration/ distribution of dividend (including bonus share).

1. Suspension of opening new branch.
2. Suspension of access to refinancing facilities of Nepal Rastra Bank.
3. Restriction on lending activities of the bank.
4. Restriction on accepting new deposits.
5. Initiation of any other actions by exercising the authority under Section32 of Nepal Rastra Bank Act, 2012. (NRB Directives No. 1, 2004:1-5)

2.3.3 Loan Classification and Provision

All financial Institutions are required to classify their loan and advances as per the maturity date. Total loan and advances will be classified in to the following four categories.

Pass loan - Loan matured up to 3 months (including restructured and Rescheduled loan)

Sub standard loan- Loan matured up to 6 month

Doubtful loan- Loan matured up to 1 year

Loss loan- Loan matured more then a year

Loan against Gold and Silver, Fixed deposit, NSB and credit card loan shall be categorized as pass loan irrespective of maturity.

Credit card loan matured for more than 90 days should be classified as loss loan.

Pass loan is categorize as performing loan and all other three categories are categorize as Non performing loan.

Additional condition for loss loans

- Any loan and advances not matured but if any of the following condition is prevailed, it will be classified as loss loan.
- Insufficient collateral.
- Borrowers become bankrupt.
- Whereabouts of the borrower is not known.
- If the loan is mis-utilized
- Six months after the auction process initiated.
- Loan provided to blacklisted parties.
- If the funded projects are not in existence.
- B\P and non funded loan if converted to funded and not settled within 90 days.

Loan on installment basis

If the loan is provided on installment basis, whole principle should be classified as per the maturity of installment.

Any loan provided for more than one year period must be in installment basis.

Loan loss provision Loan loss provision will be set a side for all categories of loan and advances as per the following percentages.

Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Loan against personal guarantee

Loan and advances provided against personal guarantee needs details net worth of the guarantor and additional 20%provision. Personal guarantee taken on top of other collateral for additional security also have same treatment.

Current A\C overdrawn

Realization of interest and principle by overdrawing the current account and\or OD accounts not allowed, incase of such practiced is followed by the bank it should be classified one level down if it is not settled with in one month.

Restructuring and rescheduling

All restructured and rescheduled loans needs 12.5% loan loss provision.

There must be written proposal and sufficient collateral and projected cash flow for restructuring and rescheduling of loan.

At least 25% interest must be recovered for such restructuring. In case of loan classified as sick industry by the committee formed by Nepal government 12% interest recovery will be sufficient for restructuring but 25% provision is required. If such loan is regular for 2years, it can classify as good.

Provision for NBA

Non banking assets acquired on or before 2059\60 shall be make 100%provision within next three years providing equally during 2060\61, 2061\62and 2062\63. If the limit of maximum holding (i.e.7 years for banks and 5 years for Fls) is expiring during these periods, 100% provision shall be made irrespective of above mentioned 3 years grace period.

Non banking assets acquired after 2059\60 shall provide 100% provisions within 4 years in equal installment including the year of acquisition (i.e. 25% in each year)

If the NBA is sold provision set a side for such assets shall be adjusted in the year of sale.

Writing back of provision

Provision can be write back in the following circumstances only

If the loan is write off

If the loan is repaid

If the classification of loan is changed (surprisingly removed)

Change of classification due to restructuring and rescheduling of loan can not write back the provision already made at least for two years till the interest payment is regular.

Such written back provision cannot be utilized for distribution of dividend and bonus.

2.4 Review of Articles and Reports

Narayan Prasad. Poudel in his article called 'Financial Statement Analysis' published in Nepal Rastra Bank Samachar on 2053 is reviewed. According to Mr. Poudel, Balance Sheet, Profit/Loss account and the accompanying notes are the most useful aspects of the bank. We need to understand the major characteristics of bank's balance sheet and profit and loss account. The bank's balance sheet is composed of financial claims as liabilities in the form of deposits and as assets in the form of loans. Fixed assets account forms a small portion of total assets. Financial innovations, which are generally contingent in nature, are considered as off balance sheet items.

Mr. Poudel further writes that, "Saving collection is another factor which is essential for banks to balance their operations and generate sufficient surplus in their cash-flows. In recent years growth rate of banks deposits has decline to about 16% compared against 23% of the past. Mobilization of internal resources in the country demands that banks attract more financial resources from the public". Another useful contribution made by

The users of the financial statements of a bank need relevant, reliable and comparable information, which assists them in evaluating the financial position and performance of the bank and which is useful to them in making economic decision. According to Poudel, the principal objectives of analyzing financial statements are to identify:

-Financial adoptability (liquidity),

-Financial performance (profitability),

-Financial position of the bank (solvency)

According to Mr. Poudel, the other factors, to be considered in analyzing the financial The risks of the depositors were too high. Pandey further put forward that a good banking system is, therefore a sine qua non for maintaining financial balance in the country and NRB's efforts in this direction are really worthy"(Pandey, 2003:4).

An article by B.N. Rimal entitled "policy issued and development in Nepalese banking system" conclude that central bank should instead drive for an approach towards indirect monetary control rather than loan on quantities individual bank ceilings. Indirect monetary policy through open market operations e.g. recent Treasury bill auctions and opening up of inter bank market and targeting broad financial variables like net foreign assets of for that matter net domestic asset should ever out small irritants in the banking system (Rimal, 1989:10).

"The Basel Capital Accord of 1988 was an important first milestone in the regulatory treatment of collateralized transactions. Though, the role played by risk mitigating factors in this accord, such as the use of financial collateral, is still rather limited. The same holds for the European directives and national regulations derived from the Basel Accord. The regulatory treatment of collateral has recently entered a new phase, in the form of the proposed revision of the Basel Accord and banks will be able to choose either the comprehensive or the simple approach for the treatment of collateral. While the simple approach resembles the current Basel substitution, methodology in its treatment of collateral, the comprehensive approach is more innovative. It assigns a central role to

collateral haircuts, which may be based on bank's own internal estimates of collateral volatility. By making a wider range of collateral available for credit risk mitigation and making the calculation of risk-weighted assets more risk- sensitive, the revision of the Basel Accord is intended further to align regulatory capita which banks must hold and their actual economic risk structure"(Keijser and Hass, 2001:55)

A latest publication of NRB supporting the recessionary economic trends highlights the performance of the economy in the first month of the current fiscal year (mid july1997-mid March 1998). Revenue collection grew by mere 4.3% while the non-budgetary and industry and export related borrowers. The CRR reduction has released additional liquidity between NRP 1,000 million to NRP 1,500 million to the banks. As expected several banks have started to drop interest rates. The decision of NRB to cut CRR comes at a time when the Nepalese industry has been reeling under the recession. The cut in CRR and the resultant drop in the interest rates should contribute towards the recovery of the recession hit industry (NRB Press Communication, 1998).

Basel–II norms are expected to have far-reaching consequences on the health of financial sectors worldwide because of the increased emphasis on banks' risk-management systems, supervisory review process and market discipline. The new norms bring to front not only the issues of bank-wide risk measurement but also of active risk management.

The new capital adequacy framework (new capital accord) and its accompanying documentation constitute a very detailed set of proposals with something to say about every aspect of how banks originate measure and manage risk. This is quite fitting. Since the original Accord of 1988, every aspect of risk management in banking has changed and it is inevitable that regulators, as custodians of the financial system, should seek to leverage this transformation in banks' own methods. But instigating such wide-ranging, once and for all, change to the regulatory framework brings its own risks. In particular, a milestone in improving banks internal mechanism and supervisory process. It will be beneficial to the commercial banks, as it requires review and measurement of risk, which ultimately have effect of risk management approach to comply with the accord standards (NRB, 2006:15).

To reform of supervisory authorities' practices and measures to ensure that the national supervisory practices in different countries do not vary unnecessarily. Supervisory

authorities related to the current capital adequacy regime require a considerable input of work and expense from banks. The proposed changes would increase the amount of information needed by the authorities concerning risks related to commercial banking activities, in particular. In order to avoid unnecessary effort and costs, the changes should be implemented in a way that would allow the systems and data currently used for banks' business management and supervision to be utilized as far as possible (NRB, 2006:26).

This new accord has examined possible approaches in relation to these risks. that banks are expected to be disparate to meet the regret of capital adequacy norms since the consequences the banks have to face in case of non-compliance are very strict for this purpose they will have to issue additional shares, which is not possible for them in the short-run or they do not prefer to go for additional share issue simply because they will also have to pay the same dividend as the past to the holders of shares so issued. This becomes the more difficult as the business is not going to expand commensurately. The difficult is understandable now when every banker is complaining of the lack of new investment projects (Lamsal, 2001:31-35).

An article by R. Heakal entitled ‘what are central banks?’ has written that the central bank has been described as “the lender of the last resort.” This means that the central bank is responsible for providing its economy with funds when commercial banks cannot cover a supply shortage. In other words, the central bank prevents the country’s banking system from failing. Though, the primary goal of central banks is to provide their countries currencies with price stability by controlling inflation. A central bank also acts as the regulatory authority of a country’s monetary policy and is the sole provide and printer of notes and coins in circulation. Time has proven that the central bank can best function in these capacities by remaining independent from government fiscal policy and therefore uninfluenced by political concerns of any regime. The central bank should also be completely divested of any commercial banking interests (Heakal, 2003).

2.5 Review of Thesis

B.R Bohara, (1992), has conducted a research entitled 'comparative study of the financial performance of NABIL and NIBL. The basic objectives of his study were highlighted the luable suggestions to the commercial banks, which are outlined below:

- Banks need to make balance between distributing of cash dividend and issuing of bonus shares.
- They need to increase their equity base to maintain the Capital Adequacy.
- They need to increase operational profit by concentrating in consistence earnings rather than fluctuating earnings.
- They need to maintain liquidity in the form of Cash Reserve Ratio as per the regulation of Nepal Rastra Bank.

Besides these suggestions, he has emphasized small Entrepreneurs' Development Program, branch expansion and mobilization of deposits in the productive sectors, transfer of expertise and skills and enhancement of foreign investment in the country (Bohara:1992).

Sharad Wagle (2000), in his thesis entitled- "A Study on Trends of Saving, Investment and Capital Formation in Nepal" has indicated that capital fund has significant and positive relation with both deposit and loans. That means increase or decrease in capital fund increase or decrease deposits as well as loans. However the degrees of relationship were different. But relation of capital with profit was positive and insignificant. That indicated less of increase or decrease in profit is due to capital fund or capital fund is least responsible in changing profit. Bank should increase capital fund to increase the recommended that the proportion of debt and equity capital should be decided keeping in mind the effort of tax advantages and financial distress. The banks are required to maintain improved capital structure by increasing equity base i.e. issuing more equity capital, expanding general reserve and retaining more earnings. With this improvement, it will compromise among the conflicting factors of cost and risk. As mandated by NRB for the operation in all over Nepal, a commercial bank should have capital base of Rs.500million.Hence the banks should raise its paid-up capital to Rs.500 million as soon as possible (Karmacharya, 2002).

R. Sapkota, (2002) in his study entitled 'A study of capital and assets structure management of Nepal Bank of Ceylon Ltd.' has set up that the ratio of shareholders fund to total deposit ratio reveals that in the year 2053/54 it was highest. 101.40% and has been deceasing in the succeeding year. The average ratio is 35.69. Additionally, the ratio implementation and impact on the commercial banks- A case study of HBL' has set conclusion on the subject of the capital adequacy of HBL during his study periods, i.e., as of poush 2058 as the capital fund of HBL stands at Rs.1070 million comprising of Rs.756 million core capital and Rs.314 million of supplementary capital. For this, the bank has to try to increase its supplementary capital because the supplementary capital falls short by HBL should increase the capital base from Ts. 1070 million by least Rs.115 million to meet the capital adequacy ratio. For this, the bank should try to increase its supplementary capital as falls short by Rs.73 million. The bank should increase its core capital in order to expose itself to more credit risk. Supplementary capital can be fulfilled by the surplus in core capital (Pandey, 2002).

Samir Dhakal (2006), in his study entitled "A comparative study of Capital Adequacy of Joint Venture Banks in Nepal especially of Nepal Arab Bank Ltd. and Nepal Investment Bank Ltd." concludes that the liquidity position of both the banks is below the normal standard of 2:1. Comparatively this ratio of NIBL is better on an average. Both the banks are found to be efficient in utilizing most of their total assets. Capital structure is highly leveraged, capital adequacy ratio of NIBL is better than that of NABIL and the profitability position of both the banks is not recorded as satisfactory. Based on the

resources more efficiently and to extend their banking facilities even in the rural areas.

Uttam Kandel (2006), in his study entitled "Capital Adequacy of Commercial Banks in Nepal especially of Nepal Bank Limited, Himalayan Bank Limited and Nepal Investment Bank Limited." concludes that After detail analysis of capital adequacy directives issued by Nepal Rastra Bank based on Capital Accord 1988, International practices on capital

adequacy, the compliance status on capital adequacy by selected commercial banks and their management effort to built strong capital base, following conclusions are drawn:

During this time, the operating environment of the banks has changed radically, and their risk management systems have also improved. In the new conditions, the calculation of capital charges under the current regime has proved insufficient because it covers only credit risk.

themselves would be granted more discretionary power on the application of the provisions. When the changes are implemented, it is therefore of great importance that uniform application of the provisions should be ensured for all banks subject to the new Basel II issued on November, 2005 (latest revision). For this, Nepal Rastra Bank should be serious to develop new capital adequacy framework timely in order to implement it timely.

About 25% commercial banks (4 numbers) out of total numbers commercial banks (17 numbers) are unable to fulfill capital adequacy norms based on core capital to risk weighted assets. Out of which Nepal Bank Limited is also unable to maintain adequate core capital based on RWA based on average data of last three years. Himalayan Bank Limited and Nepal Investment Bank Limited are successful in this regard. 9 commercial banks had not complied regulatory requirement in the maintenance of capital fund out of 17 commercial banks.

Again, Nepal Bank Limited is not able to fulfill the regulatory requirement on capital capital fund ratio according to increase in deposit.

B. Karmacharya (2002), in his thesis entitled, ‘Study on capital structure of joint-venture commercial banks and NRB directives issued in regards to there’ has expressed that the

financial soundness as well as its strength of the company depends upon the large extend on the composition of the capital structure and asserts. Capital structure of the company presents its resource capacity and ability of its present worthiness. He has found that the all the banks in his study following the requirements of NRB directives regarding capital adequacy. The capital structure of studied banks is highly leveraged. So, he has

There is continuous growth in core capital, capital fund and risk weighted assets of NIBL. Average growth rate of capital fund, core capital, RWA, % of capital fund to RWA, % of core capital to RWA were 34.93%, 28.13%, 37.29%, 15.93%, 13.32% respectively in NIBL. There is continuous decrement in core capital, capital fund and risk-weighted assets of NIBL. But, risk weighted assets was begun to increase in FY 2004/5. Average growth rate of capital fund, core capital, RWA, % of capital fund, % of core capital to RWA were -72.25%, -16.64%, 3.39%, -27.94%, -35.63% respectively.

HBL has surplus core and supplementary capital by Rs 772.83 million and Rs 489.64 million in FY 2004/5 and in all the years the bank is successful to maintain capital adequacy requirement. In NIBL, there was surplus core and supplementary capital by Rs 421.66 million and Rs 78.14 million in FY 2004/5 and in all the years the bank is successful to maintain capital adequacy requirement except FY 2002/3. In NBL, there is deficit core capital and capital fund by Rs -24559.02 million and Rs -27614.92 million in FY 2004/5 and in all the years, the bank was failed to maintain capital adequacy requirement.

2.6 Research Gap

Previous researchers analyzed financial performance by using secondary source of information in terms of financial ratio. But actually speaking, financial performance can be analyzed by various tools like CAMEL and various factors. Among them, country's environment and fiscal policy in terms NRB directives and adequate fund may be the strong determinant for financial performance and management of the commercial banks. Present study tries to define different accord, directives and financial performance of commercial banks in Nepal by applying those various facts in the context of Nepalese commercial banks. It can be very useful or important for analyzing financial performance

using CAMEL and capital adequacy management. Thus, present study will be fruitful to those interested person, parties, scholars, professor, students, businessman and government for academically as well as policy perspective. Hope this study will help to others in future in the related field.

CHAPTER THREE
RESEARCH METHODOLOGY

Research is common parlance that refers to a search for knowledge. Research is a careful critical inquiry or examination on seeking facts and principles, diligent investigation in order to ascertain something. Research methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically (Kothari, 1990:35). A research methodology helps us to find out accuracy, validity and suitability. The justification on the present study can not be obtained without help of proper research methodology. For the purpose of achieving the objectives of study the applied methodology will be used. The following are the details of research Methodology used in the analysis.

3.1 Research Design

A research design is the arrangement of condition of collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. “Research design is a plan, structure and strategy of investigation concerted so as to obtain answer to research question and to control variance” (Kerlinger, 1993:300)

as statistical tools have been done for analyzing the research.

3.2 Population and Sample

A present 25 commercial banks have been working in Nepal. Since, it is difficult to study the entire population with this short period of time. Only four commercial banks have been selected. So, SCBL, EBL, KBL and MBL have been selected for the comparative study. It is assumed that these three samples can represent the basis financial characteristics of the remaining other commercial banks. So, Standard Chartered Band Ltd, Everest Bank Ltd, Kumari Bank Ltd. and Machhapuchchhre Bank Ltd. have been selected for the case study. Hence, the population of the study comprises of all these commercial banks and the samples are SCBL, EBL. KBL and MBL researcher will take

every precaution to avoid the sampling error and inaccuracies that may creep in during the process or collecting and analyzing the data.

3.3 Sources of Data

To conduct any research, data collection is a major task. This research is mainly based on the secondary sources of data and information. A. Major secondary sources are as follows:

i. Annual reports of sample commercial banks.
ii. Quarterly bank and financial institution statistics published by Nepal Rastra Bank.
iii. Annual reports of commercial banks published by Nepal Rastra Bank.
iv. Economic Survey published by Nepal Government, Ministry of Finance.
v. Statistical Year Book of Nepal published by Central Bureau of Statistics.
vi. Previous Research Studies and Articles on the subject.

3.4 Data Collection Technique

Study is based on secondary data. For the secondary data and information, directives of Nepal Rastra Bank, annual reports of Standard Chartered Bank Ltd., Everest Bank Ltd, Kumari Bank Ltd. and Machhapuchchhre Bank Ltd, various publications of Nepal Rastra Bank. A part from these various books, journals, seminar papers available in the library and relevant articles from the website has been used.

3.5 Data Analysis Tools

Generally different methodologies of data analysis have been adopted. However, in this study attempts have been made to apply some financial tools and statistical tools.

3.5.1 Financial Tools

The best tool for financial analysis is ratio analysis. Ratio can be taken as expression of relationships between two items or group of items and may be calculated in any number and ways so far meaningful co-relation is obtainable. “Ratios are relationship, expressed in mathematical terms between figures which have a cause effect relationship or which are connected with each other in some other manners” (Grewal, 1974:102). The study is basically focused on “CAMEL” analysis which has been done with the help of different financial ratios and statistical tools.

3.5.1.1 C= Capital

In economics, the term capital means the accumulated fund employed by the entrepreneur for the operation of the business. In the context of commercial bank, it is the fund employed by the shareholders and the funds retained in various reserves. According to the Commercial Bank Act 2031, bank capital includes paid-up equity, statutory reserve, retained profit and any other reserves prescribed by the Nepal Rastra Bank. Deposits and loans taken by the bank are working capital which make temporary fund for the banks.

"Adequate capital is required to the efficient operation and functioning of the firm in the modern competitive environment" is always the matter of controversial debate. In one hand, holding excess capital tides up the fund and yields low profit margin while on the other hand; inadequate capital limits the firm to meet the public demand of loan and grab other opportunities and also to protect against contingent liabilities. However, extremely high or low capital adequacy ratio is undesirable in terms of lower return and lower solvency respectively.

Therefore, how much capital is to hold, has always been a big questions to banks. In fact, all the business houses should hold an optimal level of capital with them. Capital Adequacy Ratio is the right solution to know the optimal level of capital to be held by any bank.. Capital Adequacy Ratio is nothing but a parameter provided by NRB according to which banks have to maintain their capital as a percentage of their risk weighted assets. The following ratios related to the banks are used to analyze the data:

a) Capital Adequacy Ratio

The capital adequacy ratio is one of the most significant ratios, used specially to assess the bank's strength of the capital structure of the adequacy of the capital. The adequacy ratio is the primary tool to analyze the capital fund of a bank. It is based on total risk-weighted assets of the bank. Capital adequacy ratios are a measure of the amount of a capital fund ratio according to increase in deposit.

, in his thesis entitled, 'Study on capital structure of joint-venture commercial banks and NRB directives issued in regards to there' has expressed that the financial soundness as well as its strength of the company depends upon the large extend on the composition of the capital structure and asserts. Capital structure of the company presents its resource capacity and ability of its present worthiness. He has found that the all the banks in his study following the requirements of NRB directives regarding capital adequacy. The capital structure of studied banks is highly leveraged. So, he has depositors and creditors, ensures to absorb unexpected losses and protects them against the contingent liabilities. Higher ratio is preferable.

To determine the adequacy of total capital fund:

$$\text{Capital Adequacy Ratio} = \frac{\text{Total Capital Fund}}{\text{Total Risk - Weighted Asscets}} * 100\%$$

Total risk-Weighted assets (TRWA) = Assets held by a financial institution to which degree of risk have been assigned, so that adequate provision can be set aside.

To determine the adequacy of core capital:

$$\text{Capital Adequacy Ratio} = \frac{\text{Core Capital}}{\text{Total Risk - Weighted Asscets}} * 100\%$$

b) Capital to Deposit ratio: The capital/deposit ratio is an important tool in measuring capital adequacy ratios of banks. Naturally, the function of a bank requires a lot of capita. It is known on the basis of deposit in the bank, whether a bank gas an adequate ownership

capital or not. But this ratio cannot reflect the capital adequacy of a bank. The capital to deposit ratio is derived by the following method:

$$\text{Capital to Deposit ratio: } \frac{\text{Total Capital Fund}}{\text{Total Deposit Collected}} * 100\%$$

c) Credit/Deposit Ratio: The major tool to examine the liquidity of a bank is credit/ deposit ratio. It measures the ratio to fund that a bank has utilized in credit out of the deposit total collected. In other words, credit and deposit are the major function of commercial banks. The relationship between these two factors shows the efficiency, ability and idle resources of commercial banks. The ratio of credit and deposit declares by the effective utilization of collected resources. The credit /deposit ratio is derived by the following method:

$$\text{Credit/Deposit ratio: } \frac{\text{Total Credit}}{\text{Total Deposit Collected}} * 100\%$$

3.5.1.2 A= Assets Quality

Assets quality refers to the degree of financial strength and risk in bank assets typically capital fund ratio according to increase in deposit.

B. Karmacharya (2002), in his thesis entitled, 'Study on capital structure of joint-venture commercial banks and NRB directives issued in regards to there' has expressed that the financial soundness as well as its strength of the company depends upon the large extend on the composition of the capital structure and asserts. Capital structure of the company presents its resource capacity and ability of its present worthiness. He has found that the all the banks in his study following the requirements of NRB directives regarding capital adequacy. The capital structure of studied banks is highly leveraged. So, he has relating to the loan and advances adopted by the banks.

1. Loan Classification and Provisions:

All the loans provided by bank are good at the time of disbursement, but they can not be remain always remain so. Based on the health of the loan they are classified into two types and the provision is made as cushion against possible losses and to reflect the true picture of bank. The classifications of loan are as below:

Performing Loan:

- ***Pass loan:*** Pass Loan is that loan in which Principal is overdue up to 3 months.

Non Performing Loan:

- ***Substandard Loan:*** Are those loans which principal is overdue by more then 3 months up to 6 months.
- ***Doubtful Loan:*** Are those loans which principal are overdue more than 6 months up to 1 year.
- ***Bad Loan:*** Are those loans which principal is overdue by more than 1 year.

The NRB regulation on provisioning of different loans is as follows:

Type	Provision
Pass	1%
Substandard	25%
Doubtful	50%
Bad	100%

To measure the Assets quality of the banks the Ratio, Non Performing Ratio and Loan Loss Provision to Total Loan Ratio are used. The ratios used for analyzing the assets qualities have been explained below:-

a) Non Performing Loan Ratio:

Non Performing loan are those loan which are less likely to produce any outcomes. Substandard, Doubtful and Bad loan are non performing loan. This ratio measures the

share of risky loan out of total loan. The ratio is derived by dividing the non performing loan by the total loan. Lower ratio indicates the management's better efficiency in credit management. So lower the ratio better the performance.

$$\text{NPL Ratio} = \frac{\text{Total Non Performing Loan (TNPL)}}{\text{Total Loan (TL)}} * 100\%$$

b) Loan Loss Provision Ratio:

The provision for the loan is made as per the rules and regulation of NRB and Banks own be presented as:

$$\text{LLP Ratio} = \frac{\text{Total Loan Loss Provision (TLLP)}}{\text{Total Non Performing Loan (TNPL)}} * 100\%$$

c) Loan Loss Provision to Total Loan:

The loan loss provision to total loan ratio indicates the ratio of the provision made by any bank against its non performing loan to its total loan volume. The higher ratio indicates that the management is not efficient enough to handle proper credit transaction. Therefore more funds have been tied up as loan loss provision. This ultimately reduces the profit volume. Therefore lower ratio is preferable. The ratio can be calculated by using following formula:-

$$\text{LLP /TL} = \frac{\text{Total Loan Loss Provision (TLLP)}}{\text{Total Loan (TL)}} * 100\%$$

3.5.1.3 M= Management

The literal meaning of management is managing ones life tactfully. For the proper functioning of the bank as well as to accomplish the goal, sound management is the most important for the banking institutions. The success of any institution depends on the competency of its management. In fact, the management not only makes suitable policy Management practices are demonstrated by active oversight by the Board of Directors and Management ; competent personnel; adequate policies , processes and controls taking into consideration the size and sophistication of the bank/nonblank ; maintenance of an appropriate audit program and internal control environment ; and effective risk

monitoring and management information system. Therefore what we can say is a bank." For efficient and effective management, the bank should have following other qualities:

- Proper structure of the management
- Qualitative Human recourse management
- Customer care department
- Use of modern Information Technology
- Adequate management of loan and advances
- Fair Decision making
- Proper Communication system
- Working Atmosphere and management

As we know no one in this world is full of perfection, but it can be maximized to some management, one of the very important financial ratios has been used to analyze the management efficiency.

a) Management Efficiency Ratio:

Management Efficiency Ratio is the ratio of net income of any bank to its number of existence of efficient management and vice versa. It can be calculated by using following formula:-

$$\text{ME Ratio} = \frac{\text{Net profit after tax}}{\text{No of employees}}$$

3.5.1.4. E= Earning

Earning is the necessary for survival of bank because it is a profit making organization. Profitability indicates how well management is using the resources at its disposal to earn a return on funds invested by various groups. Creditors are concern with a company's earning because a profitable company is more likely to be able to make principal and income and lower expenses. Higher earning is always a result of better performance. Therefore earning is one of the measuring rods of any banks financial performance.

a) Return on Equity:

It measures a company's success in earning a return for the common stockholders. Higher ROE indicates better utilization of capital fund. The Return on Equity ROE is derived by dividing net profit after tax by total equities. Mathematically,

$$\text{ROE} = \frac{\text{Net Profit after Tax (NPAT)}}{\text{Total Equities (TE)}} * 100\%$$

b) Return on Assets (ROA):

It measures a company's success in earning a return for all providers of capital. Higher ROA means optimum utilization and management of the total assets. This ratio is calculated by dividing the net profit after tax by total assets, it can be expressed as,

$$\text{ROA} = \frac{\text{Net Profit after Tax (NPAT)}}{\text{Total Assets (TA)}} * 100\%$$

c) Earning Per Share (EPS):

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

d) Price Earning Ratio (P/E ratio):

This ratio reflects the price currently being paid by the market for each rupee of currently reported EPS. This ratio helps security analysts to asses a bank's performance as expected by the investors. Higher ratio indicates better place for the investment and vice versa. It can be calculated by using following formula:-

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earning per share}}$$

3.5.1.5 L=Liquidity

Liquidity means the capability of the bank to meet the demand on the customer's deposits. Banks maintain liquidity in various forms like ready cash at its disposal, certain

percentage at central bank (NRB) as a statutory requirement, makes placements in other banks and some percentage is utilized in investment on government securities.

a) Calculation of Cash Reserve Ratio:

As we know that every bank has to maintain a reserve with Nepal Rastra Bank (NRB) equal to 5% of total local currency deposit. This is done so that there will be no problem relating to deficiency of liquid cash as it affects the goodwill of the banks. How much CRR a bank has maintained can be calculated by using following formula:-

$$\text{CRR} = \frac{\text{Cash balance in NRB}}{\text{Total deposit}}$$

b) Cash and bank balance to total deposit:

This Ratio is designed to measure the Banks ability to meet immediate obligation, mainly

$$\text{Cash \& Bank Balance Ratio} = \frac{\text{Cash and Bank Balance}}{\text{Total Deposit}} * 100\%$$

c) Investment in Government Securities:

Liquidity is a sensitive factor for the banking sector. All the banks all over the world rule regarding the percentage to be invested in the government securities like treasury bills, development bonds, and national saving bonds. The ratio is calculated by dividing the investment in government securities by total deposits. Mathematically,

$$\text{Investment in Government Securities} = \frac{\text{Investment in Government Securities}}{\text{Total Deposit}} * 100\%$$

CHAPTER FOUR
DATA PRESENTATION AND ANALYSIS

This chapter deals with the presentation, analysis and interpretation of relevant data of SCBL, EBL, KBL and MBL Which were collected from various sources, are changed into an understandable presentation using financial as well as statistical tools mentioned in the previous chapter i.e., research methodology. In general, Financial Performance Indicators is an authoritative reference source of key financial ratios of related organization. It is based on up-to-date, reliable and comprehensive data, derived from Statistics of financial statements. The indicators will be helpful to serve as financial performance of individual bank. Such indicators show the overall financial position at a glance. Financial performance indicators in the form of ratios cover a number of concepts and are grouped as: profitability; liquidity; utilization; financial structure; and investment – shareholder ratios. The analyses of data consist of organizing, tabulating and performing financial as well as statistical analysis.

4.1 Financial Analysis

In this section the collected data and information are presented, various tables, charts and graphs are used to best present the data. The data and information has been presented below:

4.1.1 Capital Fund

Capital fund of a bank consists of two types of components: tier-1 capital and tier-2 capital. Tier-1 capital is known as core capital and Tier-2 capital is known as supplementary capital. So, the total capital fund of a bank derived by adding these two components. The capital fund of SCBL, KBL, KBL and EBL has been presented below:

4.1.1.1 Capital Fund of MBL

MBL has increasing its capital fund and reached Rs. 976 Million in 2007\08, the core capital at Rs 911 million. The capital fund of MBL over the period of last five years has been presented below:

Table 4.1
Capital Fund of MBL

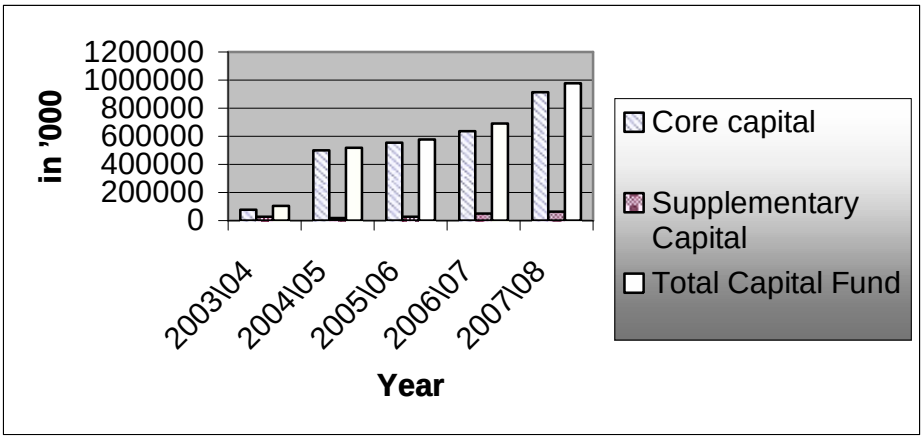
(Rs. in '000)

Fiscal Year	Core capital	Supplementary Capital	Total Capital Fund
2003\04	78425	26354	104779
2004\05	501706	16161	517867
2005\06	552869	26511	579380
2006\07	637739	51104	688843
2007\08	911543	64524	976067

Source: Annual Report of MBL.

The above table shows that the capital fund of MBL has been increasing throughout the review period. The core capital and supplementary capital has been significantly increased over the five years period. The total capital fund of MBL seems to be growing consistently. The capital funds of bank are largely depends upon share capital. The capital fund of MBL is presented in the figure 4.1.

Figure 4.1
Capital Fund of MBL



4.1.1.2 Capital Fund of KBL

Issued and paid up capital of the bank increased by Rs. 150 million and reached Rs. 500 million.

Table 4.2
Capital Fund of KBL

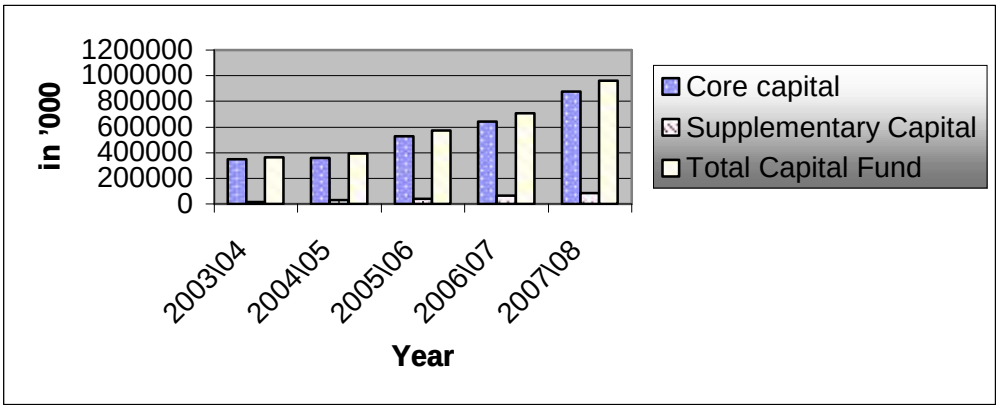
(Rs. in '000)

Fiscal Year	Core capital	Supplementary capital	Total Capital Fund
2003\04	78425	26354	104779
2004\05	501706	16161	517867
2005\06	552869	26511	579380
2006\07	637739	51104	688843
2007\08	911543	64524	976067

Source: Annual Report of KBL

The above table shows that the capital fund of KBL has been increasing. The core capital and the supplementary capital of KBL have been gradually increased over the five years period. Therefore, the total capital fund of KBL increased form 363 million to 961 million in the FY 2007\08.The capital fund of KBL has been presented in the figure below:

Figure 4.2
Capital Fund of KBL



4.1.1.3 Capital Fund of SCBNL

The total capital fund of the bank increased by Rs. 909.27 million and reached Rs. 2344.6 million from FY 2003/04 to 2007/08.

Table 4.3
Capital Fund of SCBL

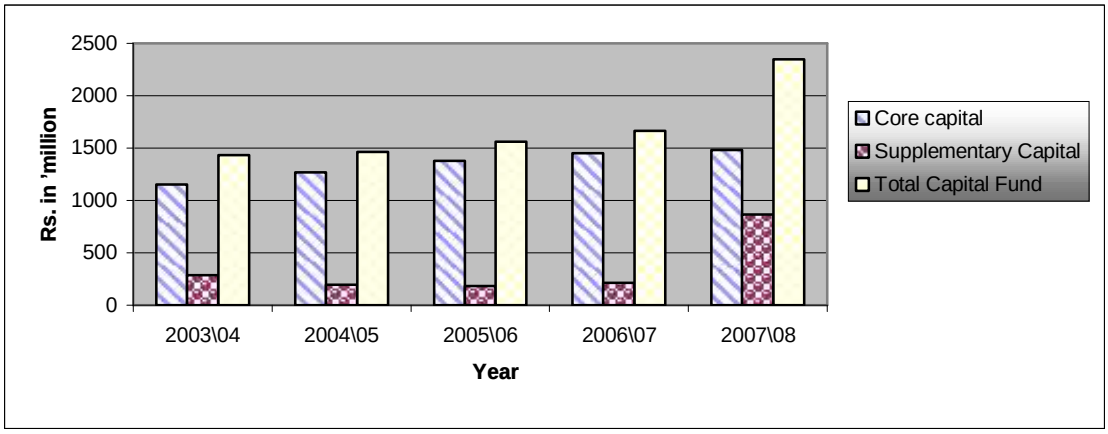
(Rs. in million)

Fiscal Year	Core capital	Supplementary capital	Total Capital Fund
2003\04	78425	26354	104779
2004\05	501706	16161	517867
2005\06	552869	26511	579380
2006\07	637739	51104	688843
2007\08	911543	64524	976067

Source: Annual Report of SCBL

The above table shows that the capital fund of SCBL has been increasing. The core capital and the supplementary capital of SCBL have been gradually increased over the five years period. Therefore, the total capital fund of SCBL increased form 1435.33 million to 2344.6 million in the FY 2007\08.The capital fund of SCBL has been presented in the figure 4.3.

Figure 4.3
Capital Fund of SCBL



4.1.1.4 Capital Fund of EBL

EBL has increased its capital fund. The bank issued an unsecured subordinate term debt in the FY 2004\05 amounting at Rs 300 million to increase its supplementary capital. The

bank has a plan to issue bonus share by 20% of its paid up capital. The capital fund of EBL over the period of last five fiscal years has been presented below:

Table 4.4
Capital Fund of EBL

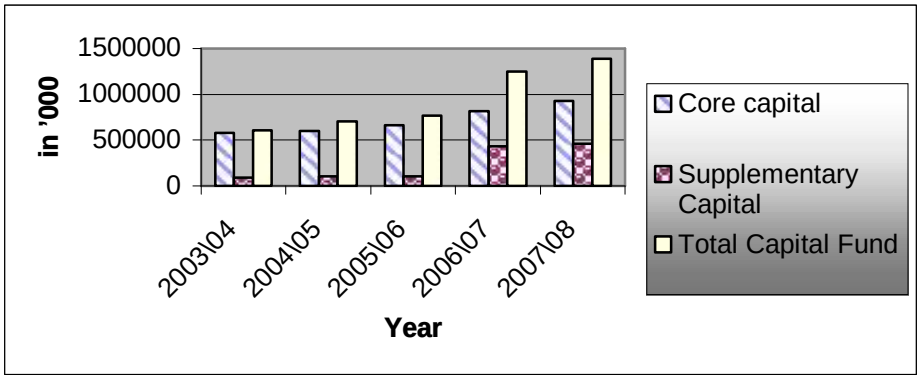
(Rs. in '000)

Fiscal Year	Core capital	Supplementary capital	Total capital Fund
2003\04	78425	26354	104779
2004\05	501706	16161	517867
2005\06	552869	26511	579380
2006\07	637739	51104	688843
2007\08	911543	64524	976067

Source: Annual Report of EBL

The above table shows that the capital fund of EBL has been increasing throughout the review period. The core capital and supplementary capital has been significantly increased over the five years period. The capital fund of EBL is presented in the figure below:

Figure 4.4
Capital Fund of EBL



4.1.2 Risk –Weighted Assets of MBL, KBL, SCBNL and EBL

Capital adequacy ratio deals with the asset side of the balance sheet of the banks. For this purpose, first the bank calculates the total weighted assets, both the on balance sheet assets and the off- balance sheets are considered for the purpose of calculation of total

risk weighted assets. The assets are categorized into four types while assigning weight-age then NRB has assigned weight-age of 0%, 20%, 50% and 100% according to their nature of risk bearing which is based on the standard of bases committee. On the basis of the data collected from MBL, KBL, SCBL and EBL the total risk-weighted assets have been presented below:

Table 4.5

Risk- weighted Assets of MBL, KBL, SCBNL and EBL

(Rs. in 'million)

Fiscal Years	MBL	KBL	SCBL	EBL
2003\04	78425	26354	104779	78425
2004\05	501706	16161	517867	501706
2005\06	552869	26511	579380	552869
2006\07	6063.130	6291.843	10497.53	9195.588
2007\08	7631.998	7606.400	11056.5	11291.137

Source: Annual Report of MBL, KBL, SCBNL and EBL

4.2 Financial Analysis through CAMEL

Financial Analysis is a process of evaluating relationship between component parts of financial statements, i.e. balance sheet and profit and loss account to obtain a better understanding of the banks position and performance. It is based on up-to-date, reliable and comprehensive data, derived from Statistics of financial statements. The indicators will be helpful to serve as financial performance of individual bank. Such indicators show the overall financial position at a glance. The best tool for financial analysis is ratio analysis.

4.2.1 Capital Adequacy Ratio Analysis

The ratio analysis is the most powerful tool of the financial analysis and it is used in analyzing the financial information to indicate the operating and financial efficiency and growth of the bank. The following ratios are used to evaluate the financial statement of MBL, KBL and EBL in regard of the capital adequacy and capital fund.

4.2.1.1 Capital Adequacy Ratio of MBL, KBL, SCBNL and EBL

Capital adequacy ratio is the ratio of the total capital fund of the bank to the total Risk-Weighted assets (are required to TRWA). NRB requires banks to maintain a certain capital adequacy ratio based on the total risk weighted assets in order to safe guard the money of the depositors against any possible loss. The first of the eleven different directives issued by NRB under the prudential norms to be followed by the banks contains detailed instructions with respect to the maintenance of capital adequacy ratio, its calculation and the possible penalties for its non compliance. Banksmaintain capital adequacy mainly in three different ways, the core capital adequacy ratio, the supplementary capital adequacy and the total capital adequacy ratio. The calculation of capital adequacy ratios of MBL, KBL, SCBL and EBL has been presented in Appendix-I. The below table 4.5 shows the capital adequacy ratio for the period of five FY starting from 2003\04 to FY 2007\08.

Table 4.6
Adequacy of Capital Fund on Risk –Weighted Assets

Fiscal Year	MBL Percentage of Total Capital	Percentage of Core Capital	KBL Percentage of Total Capital	Percentage of Core Capital	SCBNL Percentage of Total Capital	Percentage of Core Capital	EBL Percentage of Total Capital	Percentage of Core Capital
2003\04	10.68%	7.99%	26.79%	25.60%	17.35%	13.92%	12.90%	12.10%
2004\05	24.75%	23.98%	15.46%	14.22%	14.14%	12.24%	13.10%	11.60%
2005\06	17.82%	17.01%	13.41%	12.50%	15.56%	13.75%	11.07%	9.58%
2006\07	11.36%	10.52%	11.21%	10.20%	15.85%	13.81%	13.54%	8.86%
2007\08	12.79%	11.94%	12.64%	11.53%	21.20%	13.38%	12.72%	8.59%
Average	15.48%	14.29%	15.90%	14.81%	16.83%	13.43%	12.67%	9.36%

Details calculation shown in Appendix -I

The above table shows that the capital adequacy ratio of MBL, SCBL and EBL are able to comply with the requirement of NRB. Since the prescribed proportion of minimum capital fund by NRB for the FY 2003\04 to 2007\08 were total capital fund at 9%, 10%, 11% and 12%. Core capital at 4.5%, 5%, and 5.5% on total risk weighted assets.

total capital fund In FY 2003\04 to 2007\08 KBL has maintained the average total capital fund at 15.90% and average core capital 14.81% of total risk weighted assets. While

required of norms directed by NRB was 9% to 12%. So, KBL have higher capital adequacy ratio than prescribed ratio. SCBL has maintained the averageat 16.83% and average core capital 13.43% to of total risk weighted assets. So, SCBL have higher capital adequacy ratio than prescribed ratio by NRB.

EBL has also maintained the average total capital fund at 12.67% and average core capital 9.36% of total risk weighted assets. MBL has maintained the average total capital fund at 15.48% and average core capital 14.29% of total risk weighted assets. So, EBL and MBL have higher capital adequacy ratio than prescribed ratio by NRB. The percentage of total capital and percentage of core capital of KBL, MBL and SCBNL is higher than average, which are14.81%, 14.29% and 13.43% respectively.

4.2.1.2 Capital to Deposit Ratio of MBL, KBL, SCBNL and EBL

good. The The capital to deposit ratio is an important tool in measuring capital adequacy ratio of banks. It is assumed that the capital to deposit ratio should be 10%. If there is 8% capital of the total deposit of the bank it is considered calculation of capital to deposit ratios of MBL, KBL, SCBL and EBL are shown in Appendix- II. The table 4.6 shows that capital to deposit ratios for the period of five FY starting from FY 2003\04 to 2007\08.

Table 4.7
Capital to Deposit Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	10.50%	30%	7.65%	11.2%
2004\05	29.10%	15.6%	6.92%	10.5%
2005\06	21.02%	11.9%	8.06%	9.5%
2006\07	12.30%	11.3%	7.22%	12.4%
2007\08	12.40%	12.3%	9.51%	10.1%
Average	14.20%	16.22%	7.52%	9.7%

Calculations shown in Appendix-II

The above table shows that the capital to deposit ratios of MBL, KBL and EBL has been found satisfactory. It can be said that the capital to deposit ratios that the commercial banks presently maintaining are sufficient. Capital to deposit ratio of SCBL bank is seemed to be adequate than want actually required. The average capital to deposit ratio of, MBL, KBL, SCBL and EBL are 14.2%, 16.22%, 7.52% and 9.7%. KBL has higher

capital to deposit ratio among four banks. The average capital to deposit ratio of EBL and SCBNL is lower than overall average.

4.2.1.3 Credit\ Deposit Ratio of MBL, KBL, SCBNL and EBL

The credit\deposit ratio is one of collected from the most important ratios for commercial banks. The major tool to examine the liquidity of a bank is credit \deposit ratio. This ratio shows how effectively the banks have been using the fund they depositors. If 75% of amount deposited by the customers are invested in various sectors, it is considered satisfactory. It is a good sign.

The calculation of credit\deposit ratio of MBL, SCBL and EBL are shown in Appendix-III .The table 4.8 shows that credit\deposit ratios for the period of five FY starting from FY 2002\03 to FY 2006\07.

Table 4.8

Credit \Deposit Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	65.85%	95.48%	32.14%	74%
2004\05	84.09%	85.06%	31.48%	75.4%
2005\06	92.24%	76.91%	42.46%	75.6%
2006\07	91.83%	90.62%	38.63%	78.2%
2007\08	77.87%	89.8%	42.77%	80.4%
Average	67.66%	87.57%	35.63%	69.5%

Calculation shown in Appendix-III

The above table shows that credit to deposit ratio of MBL, KBL, SCBL and EBL has been found satisfactory. The credit deposit to deposit ratio of MBL was 65.85% at the end of FY 2003/04 which is increased to 92.24% at the end of FY 2005/06. The average C/D ratio of MBL is 67.66%, whereas SCBL was 32.14% at the end of FY 2003/04 which is decreased to 31.48% at the end of FY 2004/05. The average C/D ratio of SCBL is 35.63%. Similarly EBL was 74% at the end of FY 2003/04 which is decreased to 80.4% at the end of FY 2007/08. The average C/D ratio of EBL is 69.5%. The average C/D ratio of KBL is 87.57%. There is not any standard for credit\deposit ratio in Nepal, a ratio between 75% - 80% can be accepted to be adequate. As compare to three banks two banks are somehow nearer to this standard. The average credit to deposit ratio of KBL, EBL and MBL is higher than overall average.

4.2.2 Analysis of Assets Quality

4.2.2.1 Non Performing Loan Ratio

This ratio is used to identify the share of bad debts or useless credits in the total credit & advances of banks. In other words, this is the share of credits, which are failed to generate regular earnings. It is always expressed in percentage. Lower and lower ratio is desirable for banks.

Table 4.9

Non Performing Loan Ratio of MBL, KBL, SCBL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.08%	1.70%	4.13%	2.20%
2004\05	0.98%	0.76%	3.77%	1.72%
2005\06	0.39%	0.95%	2.69%	1.63%
2006\07	0.28%	0.92%	2.13%	1.27%
2007\08	1.16%	0.73%	1.83%	0.80%
Average	0.96%	1.01%	2.80%	1.38%

Calculation shown in Appendix-IV

The non-performing credits to total credit ratios of SCBNL in the fiscal years 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 4.13%, 3.77%, 2.69%, 2.13% and 1.83% respectively.

The non-performing credits to total credit ratios of MBL in the fiscal years2003/04, 2004/05, 2005/06, 2006/07 ing credits to total credit ratios of EBL in the fiscal years 2003/04, 2004/05, 2005/06, 2006/07 and 2007/0and 2007/08 were 2.08%, 0.98%, 0.39%, 0.28% and 1.16% respectively. Similarly non-performing credits to total credit ratios of KBL in the fiscal years 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 1.7%, 0.76%, 0.95%, 0.92% and 0.73% respectively. The non-perform8 were 2.20%, 1.72%, 1.63%, 1.27% and 0.80% respectively. The average non performing credits ratio to total credit and advance of MBL, KBL, SCBL and EBL are 0.99%, 1.02%, 2.80% and 1.38% respectively. SCBL has highest among four sampled banks.

The comparison of non performing credits ratio to total credit and advance showed that SCBL had the highest non-performing loans to total credit ratio among the three banks. MBL had the lowest average non-performing credit to total credit ratio over the period

among the three sampled commercial banks. The average non performing loan ratio of EBL, KBL and SCBNL is higher than overall average.

4.2.2.2 Loan Loss Provision Ratio

This ratio is also known as covering of the possible cause of loan loss as compared to non-performing assets. or commercial banIt help to find out how much amount (%) is set aside as loan loss provision to cover the possible cause of loan loss as compared to non-performing assets. Lower ratio is desirable for all firms and so on fks also. This ratio for banks is given by dividing the total loan loss provision by the non-performing assets of the bank as shown hereunder:

$$\text{LLP Ratio} = \frac{\text{Total Loan Loss Provision (TLLP)}}{\text{Total Non Performing Loan (TNPL)}} * 100\%$$

Table 4.10

Loan Loss Provision Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBL	EBL
2003\04	2.08%	1.70%	4.13%	2.20%
2004\05	0.98%	0.76%	3.77%	1.72%
2005\06	0.39%	0.95%	2.69%	1.63%
2006\07	0.28%	0.92%	2.13%	1.27%
2007\08	1.16%	0.73%	1.83%	0.80%
Average	2.08%	1.70%	4.13%	2.20%

Calculation shown in Appendix-V

The non-performing loan to loan loss provisioning ratios given by non-performing loan to loan loss provision of SCBL in the fiscal years 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 were 89.29%, 93.27%, 78.72%, 71.18% and 69.92% respectively.

The non-performing loan to loan loss provisioning ratios, given by non-performing loan to loan loss provision of MBL in the fiscal years 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 46.21%, 32.27%, 8.66%, 11.73% and 47.84% respectively. Likewise for KBL in the fiscal years 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 42.09%, 57.57%, 59.94%, 57.66% and 48.57% respectively. Similarly non-performing loan to loan loss provision of EBL in the fiscal years 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 were 35.0%, 29.42%, 30.77%, 32.49% and 24.35% respectively.

The above study suggests that SCBNL had the highest average non-performing loan to loan loss provisioning ratios, given by non-performing loan to loan loss provision ratio, while MBL had the SCBNL had been recovering its non-performing assets for possible cause of loan loss as compared to lowest average non-performing assets to loan loss provision ratio over the study period. The average non-performing loan to loan loss provision ratio of EBL lied in between these two. It indicates that NPA in an efficient way as compared to the other two banks. However, MBL seemed little backward in recovering its non-performing loan for possible cause of loan loss.

4.2.3 Analysis of Management

An Institution can achieve their objectives and goals only when the management has its strategic mission, vision and objectives. Sound Management practices are demonstrated by active ut not good moversight by the Board of Directors and Management, competent personnel, adequate policies , processes and controls taking into consideration the size and sophistication of the bank/nonblank ; maintenance of an appropriate audit program and internal control environment ; and effective risk monitoring and management information system. Therefore what it can be said is a bank having all other factors viz. adequate capital, large no. of staffs, good location, good market etc banagement can do nothing as it has been rightly said "good management can make, bad management can break." In addition to the physical observation of the management, one of the very important financial ratios has been used to analyze the management efficiency.

4.2.3.1 Management Efficiency Ratio

Management Efficiency Ratio is the ratio of net income of any bank to its number of working employees. This ratio shows the contribution of each employee in generating total net income. A good management always has sufficient number of efficient, motivated, responsible and dedicated manpower in the team. It is always confident at its system. The higher ratio indicates existence of efficient management and vice versa. It can be calculated by using following formula:-

$$\text{ME Ratio} = \frac{\text{Net profit after tax}}{\text{No of employees}}$$

Table 4.11

Management Efficiency Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.08%	1.70%	4.13%	2.20%
2004\05	0.98%	0.76%	3.77%	1.72%
2005\06	0.39%	0.95%	2.69%	1.63%
2006\07	0.28%	0.92%	2.13%	1.27%
2007\08	1.16%	0.73%	1.83%	0.80%
Average	2.08%	1.70%	4.13%	2.20%

Calculation shown in Appendix-VI

The above table shows that the average ratio of SCBL is highest where as the average ratio of EBL and KBL are lowest. The ratio of SCBL is the highest in the F/Y 2003/04 to 2007/08. The ratio of SCBL in the F/Y 2003/04 is lower than unity. The movement of the ratio is in increasing trend in case of MBL after 2004/05. Similarly the ratio is in increasing trend in case of EBL. of the This has happened because the number of staffs in each bank has been increased but at the same time the income banks has been increased in the more than proportion. As effectively the human resources are mobilized, the better earning the bank gain. So, the remedy would be either to reduce no of staffs or to increase efficiency or to increase profit volume.

4.2.4 Analysis of Earning

Earning is the difference between income and expenses. Higher earning indicates higher income and lower expenses. Higher earning is always a result of better performance. Therefore earning is one of the measuring rods of any banks' financial performance.

4.2.4.1 Return on Equity

It measures a company's success in earning a return for the common stockholders. Higher ROE indicates better utilization of capital fund. The Return on Equity ROE is derived by dividing net profit after tax by total equities. Mathematically,

$$\text{ROE} = \frac{\text{Net Profit after Tax (NPAT)}}{\text{Total Equities (TE)}} * 100\%$$

Table 4.12

Return on Equity of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	21.80%	8.16%	42.82%	21.83%
2004\05	19.90%	12.46%	33.18%	19.92%
2005\06	26.57%	13.52%	42.07%	26.57%
2006\07	43.97%	14.08%	38.41%	25.46%
2007\08	43.56%	15.91%	46.75%	23.02%
Average	31.2%	12.82%	40.60%	23.40%

Calculation shown in Appendix-VII

The above table shows that the average return on equity ratio of SCBL is highest, which is 40.60%. Whereas the ratio of EBL and KBL are the lowest which are just 23.40% and 12.82%. The ratio of SCBL in the F/Y 2007/08 is the highest among all the ratios which indicates the bank was most successful in mobilizing its equity to yield highest return. However the movement of ratio of all the banks is in increasing trend through out the study period.

4.2.4.2 Return on Assets (ROA)

It measures a company's success in earning a return for all providers of capital. Higher ROA means optimum utilization and management of the total assets. This ratio is calculated by dividing the net profit after tax by total assets, it can be expressed as,

$$\text{ROA} = \frac{\text{Net Profit after Tax (NPAT)}}{\text{Total Assets (TA)}} * 100\%$$

Table 4.13

Return on Assets of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	11.31%	0.89%	2.60%	1.32%
2004\05	9.32%	1.18%	2.42%	1.19%
2005\06	7.01%	1.15%	2.28%	1.51%
2006\07	7.57%	1.31%	2.36%	1.56%
2007\08	7.38%	1.52%	2.61%	1.61%
Average	8.5%	1.21%	2.5%	1.4%

Calculation shown in Appendix-VIII

The above table shows that the average return on assets ratio of MBL is highest, which is 8.5%. Whereas the ratio of EBL and KBL are the lowest which, are just 1.4% and 1.21% respectively. The ratio of MBL in the F/Y 2003/04 is the highest among all the ratios which indicates the bank was most successful in mobilizing its assets to yield highest return. However the movement of ratio of all the banks is in fluctuating trend through out the study period.

4.2.4.3 Earning Per Share (EPS)

It measures the amount value of shareholders gain from each share held. It is an important ratio for an investor because of its relationship to dividends and market price. Higher EPS indicates higher return for the shareholders.

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

Table 4.14

Earning Per Share of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	58.0	97	95.1	35.0
2004\05	64.0	176	100.6	39.0
2005\06	97.0	166	106.8	59.0
2006\07	165.0	194	120.2	64.0
2007\08	174.0	240	162.9	70.0
Average	110.0	175	117.0	50.0

Calculation shown in Appendix-IX

The above table shows that the average EPS of KBL is the highest which is Rs 175.0 where as the average ratio of EBL is the lowest which is Rs 50.0. SCBL has the highest EPS in the F/Y 2007/08 which is Rs 162.9. The movement of EPS of all sample banks seems to be in increasing trend. There is no standard value prescribed for EPS but higher value is preferable. Higher volume of profit is required to have higher level of EPS. So the banks need to increase profit volume

4.2.4.4 Price Earning Ratio (P/E ratio):

This ratio reflects the price currently being paid by the market for each rupee of currently reported EPS. This ratio helps security analysts to asses a bank's performance as

expected by the investors. Higher ratio indicates better place for the investment and vice versa. It can be calculated by using following formula:-

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earning per share}}$$

Table 4.15

Price Earning Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.16	14.72	20.87	16.41
2004\05	4.00	16.59	21.31	23.76
2005\06	3.30	17.08	23.88	24.31
2006\07	1.82	25.76	21.96	41.81
2007\08	2.01	26.96	16.85	28.52
Average	2.16	20.22	20.98	26.96

Calculation shown in Appendix-X

MBL has average ratio of 2.16. The above table shows that EBL has the highest value of average ratio which is 26.96. Where as MBL has the lowest average ratio of 2.16. EBL has the highest ratio in the F/Y 2006/07 which is 41.81% which signifies that the public have more trust on the bank's earning as well as its performance. They have seen future potentiality of the bank's even better performance. The movement of the ratio is in increasing trend.

4.2.5 Analysis of Liquidity

Banks pay the depositors their money when demanded and if this is not met, it damages bank's image. efore banks keep a certain percentag4e of their fund on such assets that can be utilized as need arises, wThe confidence of the public will be lost and this leads the bank towards its down fall. So, banks should not invest all the money it has on exposure based assets only, as it will not be repaid when required. Therhich is known as liquid assets. To maintain Liquidity we have to analyze few ratios, which are as follows:

4.2.5.1 Calculation of Cash Reserve Ratio

As we know that every bank has to maintain a reserve with Nepal Rastra Bank (NRB) equal to 5% of total local currency deposit. This is done so that there will be no problem

relating to deficiency of liquid cash as it affects the goodwill of the banks. How much CRR a bank has maintained can be calculated by using following formula:-

formula:-

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earning per share}}$$

Table 4.15

Price Earning Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.16	14.72	20.87	16.41
2004\05	4.00	16.59	21.31	23.76
2005\06	3.30	17.08	23.88	24.31
2006\07	1.82	25.76	21.96	41.81
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Average	2.16	20.22	20.98	26.96

Calculation shown in Appendix-X

MBL has average ratio of 2.16. The above table shows that EBL has the highest value of average ratio which is 26.96. Where as MBL has the lowest average ratio of 2.16. EBL has the highest ratio in the F/Y 2006/07 which is 41.81% which signifies that the public have more trust on the bank's earning as well as its performance. They have seen future potentiality of the bank's even better performance. The movement of the ratio is in increasing trend.

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As we know that every bank has to maintain a reserve with Nepal Rastra Bank (NRB) equal to 5% of total local currency deposit. This is done so that there will be no problem relating to deficiency of liquid cash as it af

$$\text{CRR} = \frac{\text{Cash balance in NRB}}{\text{Total deposit}}$$

Table 4.16

Cash Reserve Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	8.94%	8.91%	6.08%	10.83%
2004\05	7.68%	10.89%	7.25%	5.48%
2005\06	16.82%	3.51%	3.58%	7.67%
2006\07	8.75%	2.68%	3.25%	8.26%
2007\08	9.95%	3.64%	6.55%	9.67%
Average	10.43%	5.93%	5.34%	8.38%

Calculation shown in Appendix-XI

As prescribed by NRB the commercial banks have to maintain a reserve of 5% against their deposits. The above calculated data of the three observed banks show that MBL, KBL, SCBL and has more EBL are able to maintain the average reserve of 10.43%, 5.93%, 5.34% and 8.38% respectively. This annual end calculation shows that all sample banks may be able to pay its depositors when needed whereas the MBLcash idle in bank. As NRB wants bank to maintain CRR on weekly basis the above shown CRR may not reflect actual position of banks. The provision of showing weekly CRR at the Year end in the annual report is thus required.

formula:-

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earning per share}}$$

Table 4.15

Price Earning Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.16	14.72	20.87	16.41

2004\05	4.00	16.59	21.31	23.76
2005\06	3.30	17.08	23.88	24.31
2006\07	1.82	25.76	21.96	41.81
2007\08	2.01	26.96	16.85	28.52
Average	2.16	20.22	20.98	26.96

Calculation shown in Appendix-X

MBL has average ratio of 2.16. The above table shows that EBL has the highest value of average ratio which is 26.96. Where as MBL has the lowest average ratio of 2.16. EBL has the highest ratio in the F/Y 2006/07 which is 41.81% which signifies that the public have more trust on the bank's earning as well as its performance. They have seen future potentiality of the bank's even better performance. The movement of the ratio is in increasing trend.

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4.2.5.1 Calculation of Cash Reserve Ratio

As we know that every bank has to maintain a reserve with Nepal Rastra Bank (NRB) equal to 5% of total local currency deposit. This is done so that there will be no problem relating to deficiency of liquid cash as it af

4.2.5.2 Cash and Bank Balance to Total Deposit

This Ratio is designed to measure the Banks ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower Ratio indicates that banks might face a liquidity crunch while paying its obligations whereas very high ratio indicates that the bank has kept idle funds and not deploying them properly. Cash and Bank Balance Ratio is derived by dividing the cash and bank balance by total deposits. Symbolically,

$$\text{Cash \& Bank Balance Ratio} = \frac{\text{Cash and Bank Balance}}{\text{Total Deposit}} * 100\%$$

Table 4.17

Cash and Bank Balance to Total Deposit Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	20.28%	11.61%	8.06%	16.71%
2004\05	23.07%	22.16%	9.56%	7.91%
2005\06	26.54%	8.18%	5.74%	10.44%
2006\07	14.32%	10.43%	5.54%	11.73%
2007\08	16.27%	13.49%	9.07%	17.44%
Average	20.09%	13.17%	7.59%	12.84%

Calculation shown in Appendix-XII

This ratio reflects the banks ability to pay short term and immediate obligation to the average n that tcustomers. MBL has the highest average ratio of 20.09% among the three banks, whereas SCBL has the lowest of 7.59%. It can be seehe ratios are in fluctuating trend in all the three banks which shows that the banks are trying to manage their cash effectively so that their won't be extra idle cash and the obligation should also meet.

4.2.5.3 Investment in Government Securities

Liquidity is a sensitive factor for the banking sector. All the banks all over the world invest a significant amount of total deposit on the government securities in their Liability respective central banks to ascertain to meet the liquidity shortages in the banks incase of huge unanticipated withdrawals. Banks are highly encouraged to invest in the government securities because it is as good as liquid assets and there is no risk in government securities. In case of Nepal, since October 1974, NRB instructed banks to maintain Statutory Reserve Ratio (SRR) of 32% of total deposit in the form of government securities and CRR. Since July 1997, this provision of SLR was fully removed as this hindered the bank’s capacity to lend and created obstruction on the credit expansion of the banks. Thus NRB has not laid down any specific rule regarding the percentage to be invested in the government securities like treasury bills, development bonds, and national saving bonds. The ratio is calculated by dividing the investment in government securities by total deposits. Mathematically,

$$\text{Investment in Government Securities} = \frac{\text{Investment in Government Securities}}{\text{Total Deposit}} * 100\%$$

Table 4.18

Investment in Government Securities Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.08%	1.70%	4.13%	2.20%
2004\05	0.98%	0.76%	3.77%	1.72%
2005\06	0.39%	0.95%	2.69%	1.63%
2006\07	0.28%	0.92%	2.13%	1.27%
2007\08	1.16%	0.73%	1.83%	0.80%
Average	2.08%	1.70%	4.13%	2.20%

Calculation shown in Appendix-XIII

Government securities are easily liquid able assets and to meet shot term obligation. The banks invest some percentage of their deposit in these risk free assts. The above table shows that investing SCBL has invested the highest proportion of its deposit in the government securities i.e. 35.41%. In MBL the percentage shows raise from 7.97% to 16.19% from year 2003/04 to 2006/07 which is very vast. This scenario shows that the banks are adopting their own initiation andin government securities accordingly. Generally the investment depends on the combination of deposits the bank has. The more the percentage of fix deposits higher the investment in government securities. The higher percentage shows the better liquidity position of the bank.

formula:-

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earning per share}}$$

Table 4.15

Price Earning Ratio of MBL, KBL, SCBNL and EBL

Fiscal Year	MBL	KBL	SCBNL	EBL
2003\04	2.16	14.72	20.87	16.41
2004\05	4.00	16.59	21.31	23.76

2005\06	3.30	17.08	23.88	24.31
2006\07	1.82	25.76	21.96	41.81
2007\08	2.01	26.96	16.85	28.52
Average	2.16	20.22	20.98	26.96

Calculation shown in Appendix-X

MBL has average ratio of 2.16. The above table shows that EBL has the highest value of average ratio which is 26.96. Where as MBL has the lowest average ratio of 2.16. EBL has the highest ratio in the F/Y 2006/07 which is 41.81% which signifies that the public have more trust on the bank's earning as well as its performance. They have seen future potentiality of the bank's even better performance. The movement of the ratio is in increasing trend.

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4.2.5. Calculation of Cash Reserve Ratio

As we know that every bank has to maintain a reserve with Nepal Rastra Bank (NRB) equal to 5% of total local currency deposit. This is done so that there will be no problem relating to deficiency of liquid cash as it af

4.3 Percentage of Pass, Doubtful, Bad Loan to Total Loan of Total Commercial Banks

There should be 1%, 25%, 50% and 100% provisioning for pass loan, substandard loan, doubtful loan and. So, bad loan as per regulatory requirement. When pass loan increases and other loan decreases, the requirement of provisioning will be lower and it will increase the profitability due to low amount of provisioningfor increased amount of

profitability, position of pass loan, sub standard loan, doubtful loan and bad loan are studied here.

Table 4.19

Percentage of Pass, Doubtful, Bad Loan to Total Loan of MBL

(Rs. in million)

Particulars	2003/04		2004/05		2005/06		2006/07		2007/08	
	Rs	**%**	**Rs**	**%**	**Rs**	**%**	**Rs**	**%**	**Rs**	**%**
Performing Loan	**401.3**	**90.5**	**550.2**	**90.7**	**1342.2**	**95.7**	**2090.7**	**93.2**	**3014.6**	**93.7**
Pass Loan	401.3	90.5	550.2	90.7	1342.2	95.7	2090.7	93.2	3014.6	93.7
Non performing Loan	**42.1**	**9.5**	**55.9**	**9.3**	**59.8**	**4.3**	**151.2**	**6.8**	**201.3**	**6.3**
Substandard	9.3	2.1	13.3	2.2	17.1	1.2	40.0	1.7	10.4	0.4
Doubtful	14.3	3.2	14.3	2.3	23.0	1.6	90.0	4.1	104.5	3.2
Bad	18.5	4.2	28.3	4.8	19.7	1.5	21.2	1.0	86.4	2.7
Total Loan	**443.4**	**100.0**	**606.1**	**100.0**	**1402**	**100.0**	**2241.9**	**100.0**	**3215.9**	**100.0**

Source: Annual Reports of MBL

From above table, percentage of pass loan to total loan is increasing in each year of MBL where as percentage of bad loan is decreasing each year. It is good indicator of the bank to reduce credit risk and to increase profitability of the bank. Pass loan of the bank consist about more than 95% of total loan where as bad loan consists less than 2.5% of total loan.

Table 4.20

Percentage of Pass, Doubtful, Bad Loan to Total Loan of KBL

(Rs. in million)

	2003/04		2004/05		2005/06		2006/07		2007/08	
Particulars	Rs	%	Rs.	%	Rs	%	Rs	%	Rs.	%
Performing Loan	**591.8**	**95.2**	**748.4**	**96.9**	**1003.5**	**97.2**	**1635.2**	**98.4**	**2331.6**	**98.3**
Pass Loan	591.8	95.2	748.4	96.9	1003.5	97.2	1635.2	98.4	2331.6	98.3
Non performing Loan	**29.8**	**4.8**	**23.9**	**3.1**	**28.9**	**2.8**	**26.5**	**1.6**	**40.3**	**1.7**
Substandard	7.5	1.2	3.8	0.5	13.4	1.3	19.9	1.2	21.3	0.9
Doubtful	13.1	2.1	15.4	2.0	11.3	1.1	1.7	0.1	14.2	0.6
Bad	9.2	1.5	4.7	0.6	4.2	0.4	4.9	0.3	4.8	0.2
Total Loan	**621.6**	**100.0**	**772.3**	**100.0**	**1032.4**	**100**	**1661.7**	**100.**	**2371.9**	**100**

Source: Reports of KBL

In case of KBL, percentage of pass loan to total loan is also increasing each year where as percentage of bad loan is decreasing each year. Such management of loan in the bank will be helpful to profitability of reduce credit risk and to increase the bank. Pass loan of the bank consist about more than 97% of total loan where as bad loan consists about 0.5% of total loan.

Table 4.21
Percentage of Pass, Doubtful, Bad Loan to Total Loan of EBL

(Rs. in million)

Particulars	2003/04		2004/05		2005/06		2006/07		2007/08	
	Rest	%	Rs	%	Rs	%	Rs	%	Rs.	%
Performing Loan	**2270.6**	**91.7**	**3003.2**	**95.2**	**3905.3**	**98.0**	**4857.1**	**97.5**	**5877.4**	**97.3**
Pass Loan	2270.6	91.7	3003.2	95.2	3905.3	98.0	4857.1	97.5	5877.4	97.3
Non performing Loan	**205.5**	**8.3**	**151.4**	**4.8**	**79.7**	**2.0**	**124.5**	**2.5**	**163.1**	**2.7**
Substandard	47.4	1.9	18.9	0.6	15.9	0.4	5.0	0.1	6.1	0.1
Doubtful	134.1	5.4	3.3	0.1	3.9	0.1	44.9	0.9	36.2	0.6
Bad	24.0	1.0	129.2	4.1	59.9	1.5	74.7	1.5	120.8	2.0
Total Loan	**2476.1**	**100.0**	**3154.6**	**100.0**	**3985.0**	**100.0**	**4981.6**	**100.0**	**6040.5**	**100.0**

Source: Annual Reports of EBL

From to reduce credit risk and to increase profitability of the bank. Pass loan of the bank consist above table, percentage of pass loan to total loan is also increasing each year in EBL where as percentage of bad loan is decreasing each year except in FY 2005/06. Such management of loan in the bank will be helpfulabout more than 95% of total loan where as bad loan consists about 2% of total loan.

Table 4.22
Percentage of Pass, Doubtful, Bad Loan to Total Loan of SCBL

Particulars	2003/04		2004/05		2005/06		2006/07		2007/08	
	Rs	**%**	**Rs**	**%**	**Rs**	**%**	**Rs**	**%**	**Rs**	**%**
Performing Loan	**5384.3**	**94.8**	**5420.2**	**95.2**	**5752.2**	**95.9**	**6441.7**	**96.2**	**8194.6**	**97.3**
Pass Loan	5384.3	94.8	5420.2	95.2	5752.2	95.9	6441.7	96.2	8194.6	97.3
Non performing Loan	**297.1**	**5.2**	**275.9**	**4.8**	**247.9**	**4.1**	**251.2**	**3.8**	**226.3**	**2.7**
Substandard	9.3	0.2	3.3	0.1	7.1	0.1	0.0	0.0	10.4	0.1
Doubtful	148.3	2.6	140.3	2.5	130.0	2.2	130.0	1.9	104.5	1.2
Bad	139.5	2.5	132.3	2.3	110.9	1.8	121.2	1.8	111.3	1.3

Total Loan	**5681.4**	**100**	**5696.2**	**100**	**6000.2**	**100**	**6692.9**	**100**	**8420.9**	**100**

Source: Annual Report of SCBL

From Table 4.22, profitability of the bank. Pass loan of the bank consist about more than 95% of total loan where as bad loan percentage of pass loan to total loan is increasing in each year of SCBL where as percentage of bad loan is decreasing each year. It is good indicator of the bank to reduce credit risk and to increase consists less than 2.5% of total loan.

4.4 Analysis of Primary Data

Regarding the impact of capital adequacy norms a questionnaire was developed as shown in Appendix. A total number of 25 bank officials of Standard Chartered Bank Nepal Limited, distributing questionnaires to 25 financial executives and employees. For analysis and Machhapuchhre Bank, Kumari Bank Limited and Everest Bank Limited participated in the inquiries. For each question, the responses where converted to percentage based on the total number of respondents so that percentage analysis can be made. The questionnaire revealed opinions of the bank officials towards the capital and capital adequacy. The qualitative aspects are examined by classification of the primary data, a simple yes/no questions are used. For classification, total number of respondents was assumed as 100%. Further, such classification was supported with the tabular presentation where it is appropriate.

Table 4.23

Role of Capital Adequacy in the Bank

Responses	No. of respondents	Percentage
It enhances the financial strength of the bank	6	25
It safeguards the depositor's money	6	25
It enhances the borrowing capacity of the bank	5	20
It protects the bank from bankruptcy	8	30
Total	25	100

Source: Field Survey, 2008

It was found that 50% of the respondents of selected banks felt that the maintenance of the capital t protects the banadequacy enhances the financial strength of the bank and also

help safeguards the money of the depositors. 20%believed that capital adequacy enhances the borrowing capacity of the bank and 30% are of the view that ik from bankruptcy.

Table 4.24

Step Appropriate for Bank to Follow to Cope With the Change in Capital Adequacy Ratio

Responses	No. of respondents	Percentage
Increase Core Capital	10	40
Increase Supplementary Capital	10	40
Decrease The Risk-Weighted Assets	5	20
Total	25	100

Source: Field Survey, 2008

All the officials of three banks agreed that the Nepal Rastra Bank should issue capital adequacy norms for change in capital adequacy is to decrease the banks risk-weighted assets and some officials believe that commercial banks. 80% of the respondents of sample banks answered that they can increase both the tiers of capital core as well as supplementary. 20% were of the view that one way of coping with the at present it is not necessary to increase capital but in future they can increase both components of capital.

Table 4.25

Views of Banks on the Capital Adequacy Ratio Set by Nepal Rastra Bank

Responses	No. of respondents	Percentage
Perfect	10	40
High	10	40
Low	5	20
Total	25	100

Source: Field Survey, 2008

The respondents were asked about their views on the present capital adequacy ratio, 80% of the respondents of banks believed that the ratios set by NRB are perfect. As well as, 20% of the respondents answered that it is more than required i.e. high. 70% of the respondents of sampled banks answered that the capital adequacy ratio prescribed by NRB is perfect while remaining answered that it is high. It seems that the officials are not quite satisfied with the prescribed capital adequacy ratio.

While, 85% of the respondents of sampled banks believed that the ratios set by NRB is satisfied, 15% of the respondents are not quite satisfied with the prescribed capital adequacy ratio.

Table 4.26

Perfectness of Risk-weighted Assets Prescribed by NRB on the On and Off Balance Sheet Items

Responses	No. of respondents	Percentage
It is OK	10	40
It should be revised	10	40
Yes	5	20
Total	25	100

Source: Field Survey, 2008

The respondents were asked about their view on risk-weighted assets, 40% of the respondents of sample t it should be revised.

5% of the respondents of banks view that the weightage prescribed banks answered that the weight age on risk-weighted assets prescribed by NRB are just OK and 40% said thaby NRB on the On- and Off- balance sheets items are perfect.

Table 4.27

Most Effected From the Change of Capital Adequacy Rate

Responses	No. of respondents	Percentage
The depositors	-	-
The shareholders	25	100
The loan clients	-	-
Total	25	100

Source: Field Survey, 2008

In the question, the the respondents respondents were asked on who would be the most effected from the change made. It was found that 100% of of SCBL, MBL, KBL and EBL view that the shareholders would be the most effected.

Table 4.28

Overlap Concept of Loan Loss Provisioning and Capital Adequacy Ratio

Responses	No. of respondents	Percentage
Yes	15	60
No	10	40
Total	25	100

Source: Field Survey, 2008

In context to the overlap concept of loan loss provisioning and capital adequacy ratio, most of the respondents opined that there is overlap of loan loss provisioning and capital adequacy ratio. If there is adequacy of capital, there will be no problem of loss provision. In context of relation between inflation and capital adequacy most of the respondents opined that there is no relation between them.

Table 4.29

Significance of Capital Adequacy in Nepalese Banking Sector

Responses	No. of respondents	Percentage
No significance	5	20
Significance	20	80
Total	25	100

Source: Field Survey, 2008

In the question, the respondents were asked on what significance capital adequacy has in Nepalese the loan banking sector. It was found that 80% of the respondents of SCBL, MBL, KBL and EBL view that there is significance of capital adequacy in Nepalese banking sector. The main reason of significance is to support loss provision. Similarly NRB has made amendments in paid up capital requirement for banks to fall in class A. this is made to support capital adequacy ratio.

4.5 Major Findings of the Study

The thesis has been concentrated on the financial analysis based on CAMEL of MBL,KBL, SCBL and EBL, certain findings based on the analysis are given below:

It was found al capital fund of Rs.1435.33 million in FY 2003\04 which has been increased by 25% in FY 2that the capital fund of MBL,KBL, SCBL and EBL are largely depending upon share capital. Capital fund of MBL, KBL, SCBL and EBL seems to be growing consistently. Capital fund of MBL is higher than that of EBL and SCBL. MBL

has total capital fund of Rs 136 million in FY 2003\04 which has been increased by 300%in the next year. The capital fund has been increased by 30% in FY 2007\08 making a total capital fund of Rs. 715 million. Whereas SCBL has tot006\07.The capital fund of EBL has Rs. 610.2 in FY 2003\04 which has been increased by 1391.3 in FY 2007\08

The risk- weighted assets are derived by calculating the amount from the respective On- and Off- balance sheet items with the prescribed weightage. MBL had risk-weighted assets of Rs.980 million in FY 2003\04 which has been increased to Rs.209.2 million, 325.06 million, Rs.606.3 million and Rs.763.1 million in FY 2004\05 to 2007\08.

SCBL had risk- weighted assets of Rs.8256.12 million in FY 2003\04 which has been increased to Rs. 10359.47 million, 10497.53 million and 11056.5 million in FY 2004\05 , 2006/07 to 2007 prescribed ratio i.e., MBL has capital adequacy ratio of 10.68%, KBL has 26.79% and EBL has 12.90%\08. EBL had risk- weighted assets of Rs.426.7 million in FY 2003\04 which has been increased to Rs.570.7 million, Rs.692.8 million, Rs.919.5 million, Rs.1129.1 million in FY 2004\05 to 2007\08. EBL has large amount of risk-weighted assets than that of MBL and SCBL.

Capital Adequacy ratio is the primary tool to analyze the capital fund of a bank. It is based on total risk-weighted assets of the bank. MBL, KBL, SCBL and EBL are successful in maintaining capital adequacy as prescribed by NRB. In the FY 2003\04, all three banks have higher capital adequacy ratio than while the requirement of norms directed by NRB was only 9% .However, in the FY 2004\05 MBL has capital adequacy ratio of 17.82%, SCBL has 17.35% and EBL has 12.90% while minimum requirement as per directives is 11%.All three banks are successfully maintaining their capital adequacy in every year.

The capital to deposit ratio is an important tool in measuring capital adequacy ratios of banks. The % in FY capital to deposit ratios of MBL, SCBL and EBL seems to be adequate. It is assumed that the capital to deposit ratio should be 10%. However, the ratio of MBL has 10.5% 29.1%, 21.02%, 12.3%, and 12.42003\04 to 2007\08. KBL has 30%, 15.6%, 11.9%, 11.3% and 12.3% in FY 2003\04 to 2007\08. EBL has 11.2%, 10.5%,

9.5%, 12.4% and 10.1% in FY 2003\04 to 2007\08. It is accepted world wide than 8% to 10% capital to deposit ratio is safe. All three banks have been able to maintain the capital to deposit ratio.

The credit\deposit ratio is a major tool to examine the liquidity of a bank. The C/D ratio of MBL, KBL, SCBL and EBL shows that their liquidity position is satisfy. This ratio shows how effectively the banks have been using the fund they collected from depositors. The C/D ratios of MBL are in between 70% to 90%. In FY 2003\04 C/D ratio is 65%which is nking sector. lower than standard ratio. SCBL has been maintaining C/D ratios are in between 31.48% to 42.77%.Whereas EBL has been maintaining C/D ratios are in between 70% to 80%.It is found that the C/D ratio of KBL is higher than MBL and EBL.

Nepal Rastra Bank issues prudential directives to all bank and financial institution licensed by it on various issues. Capital adequacy is on of the most important directives to strengthen the soundness and stability in the ba For high degree of consistency in the application, uniform capital adequacy norms were developed for banks in a country with a view to diminish an existing source of competitive inequality among commercial banks. Capital adequacy directives implemented by Nepal Rastra Bank were based on the framework prescribed by Basle Committee in "International Convergence of Capital Measurement and Capital Standard 1998".

Basel Capital Accord 1988 is a capital adequacy framework developed by the Basel committee. In number of 1988, the Basel Committee decided to introduce a capital measurement system commonly referred to as the Basel Capital Accord which has provided for the implementation of credit risk measurement framework with minimum capital standard of 8% by end 1992 which is known as Basel I.

Basel II is also a capital adequacy related standard framed by Basel Committee. After the successful implementation of 1988 accord more than 100 countries, the Basel Committee on Banking Supervision reached an agreement on a important issues for promoting best and uniform banking practices as well as setting standards and guidelines for supervisory function. Following extensive interaction with banks, industry groups and supervisory

authorities that are not members of the Committee, the revised framework was issued on 26 June 2004. The latest version on the framework was issued on November 2005.

The Basel II aims to replace Basel I and to make the capital framework more risk sensitive. Basel II has recommended major revision on the international standard on bank's capital adequacy, which requires bank to implement risk management policies that align capital adequacy assessment with underlying credit risk, market risk, and operational risk. Basel II has been introduced basically for the protection of depositor's interest by preserving the integrity of capital in banks.

respondents It was found that 50% of the respondents of selected banks felt that the maintenance of the capital adequacy enhances the financial strength of the bank and also help safeguards the money of the depositors. 20%believed that capital adequacy enhances the borrowing capacity of the bank and 30% are of the view that it protects the bank from bankruptcy.

All the officials of three banks agreed that the Nepal Rastra Bank should issue capital adequacy norms for commercial banks. 80% of theof sample banks answered that they can increase both the tiers of capital core as well as supplementary. 20% were of the view that one way of coping with the change in capital adequacy is to decrease the banks risk-weighted assets and some officials believe that at present it is not necessary to increase capital but in future they can increase both components of capital.

. The respondents were asked about their views on the present capital adequacy ratio, 80% of the respondents of banks believed that the ratios set by NRB are perfect. As well as, 20% of the respondents answered that it is more than required i.e. high. 70% of the respondents of sampled banks answered that the capital adequacy ratio prescribed by NRB is perfect while remaining answered that it is high. It seems that the officials are not quite satisfied with the prescribed capital adequacy ratio. While, 85% of the respondents of RBB believed that the ratios set by NRB is satisfied, 15% of the respondents are not quite satisfied with the prescribed capital adequacy ratio

The respondents were asked about their view on risk-weighted assets, 40% of the respondents of sample banks answered that the weight age on risk-weighted assets prescribed by NRB are just OK and 40% said that it should be revised.

In context to the overlap concept of loan loss provisioning and capital adequacy ratio, most of the respondents opined that there is overlap of loan loss provisioning and capital adequacy ratio. If there is adequacy of capital, there will be no problem of loss provision. In context of relation between inflation and capital adequacy most of the respondents opined that there is no relation between them.

It was found that 80% of the respondents of SCBL, MBL, KBL and EBL view that there is significance of capital adequacy in Nepalese banking sector. The main reason of significance is to support the loan loss provision. Similarly NRB has made amendments in paid up capital requirement for banks to fall in class A. this is made to support capital adequacy ratio.

CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

The study has been done with the help of the concept of "CAMEL" using various financial ratios and statistical tools. Financial analysis helps the judgment about the operating performance of financial position while through the use of statistical tools, the trends of position of the bank can be found. The study is based on the capital funds of the bank which is supposed to be adequate as per the Nepal Rastra Bank directive no. 1, which is related with the capital adequacy norms for commercial banks. Basically, the norms emphasize on the basic requirements of the capital fund that a commercial banks should possess. The basic objective of the norms is to safeguard the interest of the depositors. The thesis report is generally focused on accordance of the capital adequacy norms of Nepal Rastra Bank by these commercial banks. As stated by these norms, bank's capital has been divided into two categories which are usually known as Tier-1 and tier-2. At present, 25 commercial banks have been established in the country and some more are in the process of being established. The report as comparative study, analyzes the matters, issues and problem related the performance of commercial banks through CAMEL of Machhapuchchhre Bank Limited (MBL) and Kumari Bank Limited (KBL) which is struggling to include and Everest Bank Ltd (EBL) and Standard Chartered Bank Ltd. (SCBL) which are believed to be of the strong joint venture banks of the country. Generally, the thesis report is focused on CAMEL and on accordance of the capital adequacy norms of Nepal Rastra Bank by these commercial banks.

Financial institutions like banks are the replica of modernization of the society and play a vital role in the development of economic growth of the country. Commercial banks furnish necessary capital needed for trade and commerce for mobilizing the dispersed saving of the individuals and institutions. The primary functions of commercial banks are raise and utilization of funds. Commercial banks collect a large amount of deposit from general public capital is one of the most important components for an organization. Actually, no organization can exist without capital. Although the banks are the major

banks have obligations to mass people, its depositors. Thus, the bank should hold an adequate source of capital, they also have to raise capital to run business. Especially, the bank capital has significant role to play as the capital secure the interest of depositors.

The study showed that the capital fund of MBL, KBL, SCBNL & EBL meet the requirement of the norms. Capital adequacy ratio shows the strength of a bank. Capital to deposit adequacy ratios have been calculated to check the adequacy as per the norms. The capital adequacy ratio of MBL, KBL, SCBNL and EBL shows that the all four banks are able to comply with the requirements of NRB. The capital ratio has a significant role in measuring capital adequacy ratios of banks. C/D ratios, which are key ratios of commercial banks, have also been checked. The relationship of capital fund with credit and deposit has been calculated.

The thesis report also studies the responses of ten bank officials has been done through research interview. The financial statement of five years from 2003\04 to 2007\08 had been examined to fulfill the objective of the study.

5.2 Conclusion

After the summarizing the objective of the study, we will now go to the conclusion section. With some twenty five commercial banks operating in Nepal, the market seems over crowded and the banks are now finding a tough competition among themselves. Since the entry barriers are not so high due to the government liberal policy, this competition is expected to be more intense in the near future, as there is always the possibility of a new player entering this sectors. The commercial banks in Nepal are doing well but they are not giving satisfactory results due to some internal and external factors.

Commercial banks of Nepal are bound by the directives of NRB. The directives No. 1 has set norms on capital adequacy for commercial banks. Every commercial bank has to meet the requirement of capital adequacy as stated by the directives. Capital adequacy is the portion of capital fund in regard of risk-weighted assets that commercial banks hold.

Capital adequacy is required to the money of the depositors as the banks are playing with the money they collected from the depositors.

The study showed that the capital fund of MBL, KBL, SCBNL & EBL meet the requirement of the norms. Capital adequacy ratio shows the strength of a bank. Capital to deposit adequacy ratios have been calculated to check the adequacy as per the norms. The capital adequacy ratio of MBL, KBL, SCBNLios of MBL, SCBL and EBL seem to be satisfied. The lack of policy in regard of these types of ratios caused to the relaxation of the banks not to meet the adequate rations.

5.3 Recommendations

The recommendation of this study may be the important information for those who are very much concerned directly with the performance of the concerned banks and capital adequacy norms. Thus, following recommendation and suggestion can be outlined.

a) The capital fund of sampled commercial bank i.e. MBL, KBL, SCBL and EBL are largely depend upon share capital. It is recommended to the commercial banks to follow optimal capital structure which maximizes the market value of the firm. The banks should use some sort of debt financing depending upon its viability. Still in Nepal, debt financing is an accustomed source of financing for commercial banks. But it is notable that MBL has already started the debt financing.
b) Capital to deposit ratio of MBL, KBL, SCBL and EBL seems to be inadequate. It is less than what actually required. There is lack of standard on such type of ratio. So, NRB should set appropriate standard for capital to deposit ratio to be maintained by commercial banks. It is assumed that capital to deposit ratio should be in between 8% to 10%. So, sampled banks are suggested to keep the balance as required by NRB.
c) The The study showed that the capital fund of MBL, KBL, SCBNL & EBL meet the requirement of the norms. Capital adequacy ratio shows the strength of a bank. Capital to deposit adequacy ratios have been calculated to check the

adequacy as per the norms. The capital adequacy ratio of MBL, KBL, SCBNLare comparatively less than that of SCBL and EBL. This ratio shows how effectively the banks have been using the fund they collected from depositors. It is recommended to MBL that it should concentrate more on credit and investment. The bank shall expand its branches in rural areas and search investment opportunity there. The C/D ratios of SCBL and EBL in nearer to this standard but overall point of view, SCBL and EBL cannot relax with such C/D ratios. More credit flows are required to verge on the optimum C/D ratio.

d) MBL, KBL, SCBL and EBL are quite successful in maintaining capital The study showed that the capital fund of MBL, KBL, SCBNL & EBL meet the requirement of the norms. Capital adequacy ratio shows the strength of a bank. Capital to deposit adequacy ratios have been calculated to check the adequacy as per the norms. The capital adequacy ratio of MBL, KBL, SCBNL. It should be noted here that shortfall in the supplementary capital can be compensated by the use of the excess amount of core capital. Therefore, it is recommended that sampled banks should improve their supplementary capital.

e) The bank should increase its core capital in order to expose itself to more credit risk. With the reduction in the single obligor limit, there are only two choices for the bank to limit its clients within standards or to increase the core capital. While staying with the existing core capital, MBL, KBL, SCBL and EBL are exposing to the risk of losing huge and good clients to other banks with huge amount of core capital that can withstand the loan exposure of such client. On doing this, MBL, KBL, SCBL and EBL will on one way not be able to mobilize its deposits and on the other will have to stick to small client. The increase in the number of small client will take the operating costs of the bank up, thus decreasing the profitability.

f) While lending loans and advances, banks should keep in account that the fund they are going to lend is collected from public and hence should be carefully treated on behalf of the depositors to protect their interest.

g) The existing capital adequacy directives issued by Central bank of Nepal (Nepal Rastra Bank) had been prepared considering only credit risk. So, it is recommended that Nepal Rastra Bank should issue new directives on capital adequacy which can cover other risk in banking sectors such as operational risk, market risk, liquidity risk, reputational risk, strategic risk etc. For this purpose, new Basle capital Accord 2005 (revised) should be implemented with customization as per Nepalese requirements in Nepal in the context of liberalized economy after WTO membership of Nepal, new international branches will be established in Nepal after 2010 A.D.

h) For the preparation and successful implementation of new capital adequacy framework, concerned authorities should initiate following activities. :

a. Capacity Building in financial sector:

- by developing supervisory and regulatory activities,
- Home/Host Supervisions,
- Cross Boarder Supervision

b. Developing financial infrastructure:

- By establishing Credit Rating Agency and Asset Management Company.
- By issuing prudential rules and regulations on securities firms

c. Developing Management Information System and risk management practices

- By improving portfolio management skills in banking sectors
- By improving traditional risk management/manual banking practices
- By solving the problem with huge negative net worth problem
- By strengthening corporate governance in banking sectors

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