CHAPTER – I
INTRODUCTION

1.1 General Background

In any country, the financial sector plays a crucial role in the overall development of the economy. Nepal is one of the least developed countries, which lies between two great countries of Asia – China & India. China and India has already recognized as second and third largest economies respectively in the global economy. Both these Asian powers have achieved significant rates of economic growth despite their domestic complexities. Nevertheless, Nepal is lagging behind in the field of socio-economic development and the tragedy of the Himalaya kingdom is that it is recognized as seventh poorest countries of the world and poorest country in Asia. The poverty is a common event of Nepalese economy, which is also reflected in low GNP per capita, and insignificant growth rates. Despite the huge potentiality of development, Nepal has been able to reap the sluggish rate of economic growth and insignificant infrastructure to promote the healthy development of the economy.

Banking sector plays an important role in the economic development of the country. Commercial banks are one of the vital aspects of this sector, which deals in the process of channelizing the available resources in the needed sectors. It is the intermediary between the deficit and surplus of financial resources. Financial system contains two components viz., depository financial institutions, and non-depository financial institutions. Commercial banks and Finance companies (in Nepalese context) are the example of depository financial institution whereas Employee Provident Fund, Development Banks, Insurance Companies etc. are the examples of non-depository financial institutions. All the economic activities are directly or indirectly channeled through these banks. People keep their surplus money as deposits in the banks and hence banks can provide such funds to finance the industrial activities in the form of loan & advances.

Financial institutions play a major role in the proper functioning of an economy. These institutions act as an intermediary between the individuals who lend and who borrow. These institutions accept deposits and in turn lend it to people who are in need of financial resources. These institutions make the flow of investment easier. Therefore, we cannot deny the role of a bank as crucial in developing

an economy. It pools the fund scattered in the economy and mobilizes them to the productive sector. However these institutions inherent a huge amount of risk, which cannot be denied either. If a bank behaves irresponsibly, the costs borne by the economy are enormous. A large amount of depositors' money is at stake. Bank came into existence mainly with the objective of collecting the idle funds, mobilizing them into productive sector, and causing an overall economic development. The bankers have the responsibility of safeguarding the interest of the depositors, the shareholders, and the society they are serving.

The evolution of the banking industry had started a long time back, during ancient times. There was reference to the activities of moneychangers in the temple of Jerusalem in the New Testament. In ancient Greece the famous temples of Delphi and Olympia served as the great depositors for people's surplus fund and these were the centres of money lending transactions. Indeed the trace of "rudimentary banking" was found in the Chaldean, Egyptian and Phoenician history. The development of banking in ancient Rome roughly followed the Greek pattern. As a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy and the Bank of Venice, founded in 1157 AD was the first public banking institution. Following it were established the bank of Barcelona and the bank of Genoa in 1401 and 1407 respectively.

In our country, the development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. Involvement of landlords, rich merchants, shopkeepers and other individual moneylender has acted as fence to institutional credit in presence of unorganized money market. The establishment of "Tejarath Adda" during the year 1877 AD was fully subscribed by the government of Kathmandu valley, which played a vital role in the banking system. At the same time, the government started trade with India and Tibet. And the various indigenous bankers handled even the trade, because transfer of the money could be safely made only through these bankers in the absence of modern banking institutions. Hence, the need of banking institution was realized.

In the year 1934 AD, the establishment of Nepal Bank Limited with the Imperial Bank of India came into existence under "Nepal Bank Act, 1937" as the first commercial bank of Nepal. Rastriya Banijya Bank, the second commercial bank was established in the year 1956. RBB being the largest

commercial bank plays a major role in the economy. That is the reason why these banks still exist in spite of their bad position. With the opening of NABIL (Nepal Arab Bank Limited) in 1985, the door of opening commercial banks was opened to the private sector. Then whole lot of commercial banks was opened in Nepal. Today almost all the banks are making profit. Altogether, there are 30 commercial banks in Nepal and also couple of commercial bank opening shortly.

Commercial banks are the major component in the financial system. They work as the intermediary between depositors and lenders and facilitate in overall development of the economy, with major thrust in industrial development. There is the great role of financial institutions in the economic development. Mainly they mobilize the relationship between incomes, consumption, saving investments, increase the financial volume by credit creation as expand the economy. The pace of the economic development of the state depends upon the soundness of the financial position. Thus it is necessary to inspect and supervise the activities of the financial institutions for the sound, capable, healthy and dynamic financial system. Inspection and supervision of the financial institutions is to control and promote their performances.

Finance is the lifeblood of the economic development of any country. In general it is regarded as one of the most important and common areas in today's economic world for the economic and financial development. For the development of the state economy, it is very essential to develop the financial system. The sound financial system makes the sound development of trade, commerce, industry. So, finance and financial institutions are very important for economic development. Economic development of the state mostly depends upon the financial activities and these financial activities more often dominate the other functions or activities. Economic system develops depending upon the capability, reliability, competitiveness, soundness and dynamism of the financial system. "Finance, in a real sense, is the core stone of the enterprise system-good financial management is vitally important to the economic health of business firm and hence to the nation and world". **(Weston and Brigham, 2000)** So it is very important to study about the universal concepts of finance for the global economic development. But the practices of the financial system in each country differ from each other. "There is always lack of finance in underdeveloped economy because natural resources are either utilized or unutilized in productive sectors or even other purpose i.e., social welfare and so on.

Likewise, under developed countries are not deficient in land, water, minerals, forest or power resources, though they may be untapped; constituting only potential resources". **(Dowett, 1998)** So, for the economic development in those under developed countries, there should be proper resource mobilization, managing resources, increasing investments.

"Financial institutions are distinguished from all kinds of business enterprises in that their principle operations are directed to accumulating the temporarily idle money of the public and passing it on for spending to borrowers and to sellers of securities. The term financial institution is a broad phrase referring to organizations which act as agents, brokers and intermediates in financial transactions"**(Edimester,1980)**. So, the financial institutions are only the accumulation of the financial activities for the sound financial system. They are only the financial intermediates rather than others. They monetize the economy through the process of demand and supply of money assets through the saving and loans. Financial institutions facilitate the saving and borrowing process, and in so doing, maximize the wealth of the institution. Or they only act as agents for transferring funds from ultimate lenders to ultimate borrower. That is why they play the vital role to encourage thrift and discourage hoarding by the mobilizing the resources and removing the habit of hoarding. They pursue rapid economic growth, developing the banking habit among people, collecting the small-scattered resources in one bulk and utilizing them in further productive purposes and rendering other valuable services to the country. Thus, this gives the individuals an opportunity to borrow funds against future income, which may improve the economic well being of the borrower. In monetary economy, a person simply accumulates saving in cash. Through financial markets, this surplus cash can be lend to a business firm, borrower for making investment in different sectors. These all activities are possible only through the financial intermediates i.e. financial institutions. But in the process of transmission of money, both saver and lender bear high risk rather than the borrower. So there should be proper and sound financial management system.

The below figure shows the role of the financial institution in the financial system.

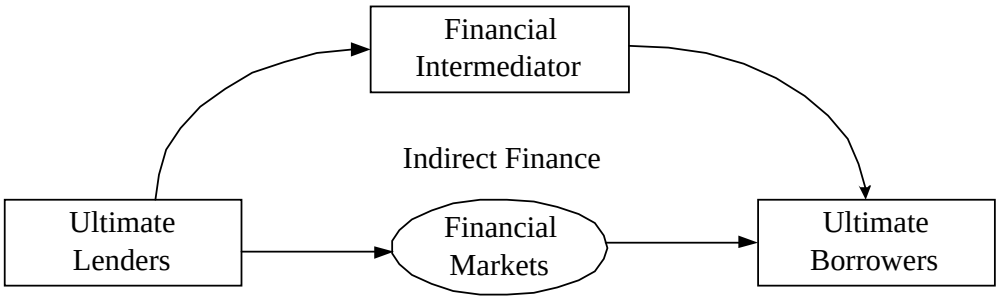

Fig. 1

Flows of funds from lenders to borrowers.

(Source: L.A.,Rictteg,William L,Silber,8th edition)

These financial intermediates are nothing other than financial institutions-commercial bank, finance companies, credit unions, insurance companies, co-operative, development banks, civil investment trust etc. those act as the agent of transferring the surplus money to deficit unit.

Financial intermediates are generally classified into the following three sections.

1. Banking sectors
2. Non-banking financial sectors
3. Other institution involved in financial activities.

While talking about the bank, it is means of indirect financing. Bank is an absolute dealer in money, which intermediates the related parties. "Banks are financial institutions that accept funds in the form of deposits repayable on demand or at short notice"**(World Bank Report, 1989)**. So, it can be said that bank is the integration of activities related to money. Earlier the banks were different from modern commercial banks in many respects. The banks which operated in the past combined central banking functions such as issue of currency with commercial banking functions like accepting deposits and financing business. But the time passes, the meaning of the banks with function change due to the practical commitments of banks and specialization on their functions. So, the central bank can be clearly distinguished from others in the respect to objectives and functions.

1.2 Evolution of Banking Sector Globally

The history of the banks explains that the commercial banks were the first bank as the bank. Thus the bank, in general, means the commercial bank. Banking has crossed various phases to come to the modern form. Traditional forms of banking were traced during the civilization of Greek, Rome and Mesopotamia. According to Alfred Marsal, "In Greece, the temples of Delphi and other safer places acted as store houses for the precious metals before the days of coinage and in later times, they lend out money for public and private purposes at interest though they paid none themselves. Private money changers begin with the task of reducing many metallic currencies more or less exactly to a common unit of value and went into accept money on deposit at interest and to lend it out at higher interest permitting meanwhile drafts to be drawn on them".

The term bank was developed from Latin word "bancus", Italian word "banco", French word "banque" which all means the bench, which is used for accepting and paying the valuables and coins in the major cities of Europe. Though, there is no absolute history about the word "bank", the German word "bank" means the Join Stock Company. As a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy. The Bank of Venice, founded in 1157 AD, was the first public banking institution. Then the Bank of Barcelone and the bank of Genao, were established in year 1401 AD and 1407 AD respectively. Both banks were in operation till the end if eighteen century. Similarly the Bank of Hindustan was the first bank established in India by 1770 A D. Though there were the long history commercial of banks, the pace of the establishment and development of the banks increased after the introduction of the Banking Act 1833 in England. But the bank of England was the first bank in England, which was established in 1694 AD.

According to Ronald Grywinsnki, the 19th century witnessed the phenomenal development of modern problems enabling to turn their attention way from old ‘money changing’ business to many new important jobs that comes in the wake of new industrial progress. The 20th century observed development of various banking institutions highly specialized, sophisticated particularly in advanced countries, like the USA, UK, France, Japan and others.

Today the commercial banks are identified in different name such as merchant banks, investment banks, retail banks, clearing banks, joint venture banks, business banks etc. Though they are called differently, they aim similarly i.e. provide a link between the lenders and borrowers. They do the banking business through the service providing. They are related to lenders and borrowers, thus called financial intermediates and their main aim is to earn. The commercial banks are operated by accepting deposits in the form of current, saving and fixed deposit and providing loans as long term and short term.

Commercial banks are the major players in the economic and financial system. They provide finance for financial sector like trade and industry. Capital is one of the most important components in the financial system. Commercial banks help in the formation of the capital. By investing the saving in productive areas, they help in the formation of the capital. So, it is very essential that the commercial banks should play the vital role in the economic and financial development of the state rather than concentrating themselves in earning maximum. In the most of the countries, banks are established in the urban areas. But rural people need various financial facilities than urban people. There is the maximum possibility of development of country, if the rural sectors are made involving in the financial system. A sound banking system is important because of the key roles it plays in the economy intermediation, maturity, transformation, facilitating payments flows, credit allocation and maintaining financial discipline among borrowers. Banks provide important positive externalities as gathering of saving, allocation resources and providers of liquidity and payments services.

1.3 History of Banking Sector in Nepal

Nepal is landlocked country located in the south of Asia. India and China are the only neighboring countries of Nepal. So, the most of the economic and financial structure as well as development of Nepal is directly affected by financial and economic structure and development of these two countries. Mostly the Indian financial and economical structure and development diverts the path of Nepalese financial and economic structure and development. Nepalese economy is survived by agricultural sectors. Agriculture sectors contribute the most in the GDP. Over 80% of the population is primarily engaged in agricultural sectors. 41% of the GDP is contributed by agriculture sectors. Nepal is one of the least developed country of the world by all major indicators of socio-economic

development indicators of various report. So, the Nepalese financial sector is not still properly developed.

The history of modern financial system was begin with the establishment of Nepal Bank limited (NBL) in 1937 A.D. Prior to the establishment of NBL, banking service, in Nepal, carried the long history but the record of banking system gives the detail about the slow and steady evolution in the financial and global economy of Nepalese life. The banking system has gone-through the various stages of the development of financial system. Individuals like, landlords, merchant, rich people, shopkeeper, moneylenders etc. were involved in the financial system in ancient times. Before NBL there were no any institutional practices in the financial system of Nepal. But the morden Nepalese financial system collects some experiences. At that period Shankhdhar, Gunakamadev, Tankadhar, Tejrath Adda etc played the vital role in the Nepalese financial system. After the establishment of Nepal Bank Limited, the modern financial system was introduced in Nepal. The bank was established to render the services such as accepting deposits, to extend credit facilities and to render customer related services i.e. issue bill of exchange, to invest in government bonds and securities, to perform agency function and act as bankers to the government. Nepal Bank Limited was the sole institution undertaking wide rage of banking and financial activities.

Prior to the establishment of Nepal Rastra Bank, the Central Bank of Nepal, the branch network of Nepal Bank Limited was limited to 12. In the absence of the central bank, Nepal Bank Limited had to manage apart from commercial banking function, portion of government accounts, entire business of currency note, exchange and other concerned activities were entrusted by the government to this bank, excepting the note issuing function which was undertaken by Muluki Khana, the treasury of the government.

The pace of economic and financial development increased after the adoptation of the first five-year plan in 1956 A D. During the period of five year plan, Nepal Rastra Bank was established in 1956 A D as the Central Bank of Nepal. Prior to the establishment of the Nepal Rastra Bank, Nepal Bank Limited played the role of Central Bank with the share of Reserve Bank of India. Nepal Rastra Bank was established under the Nepal Rastra Bank Act 1956. With the establishment of the Nepal Rastra

Bank, the development pace of financial sector increased, which resulted the establishment of Rastriya Banijaya Bank in year 1966 A D in public sector. With the equity participation of HMG/N and NRB, the Agricultural Development Bank (ADB/N) was established in year 1983 A D under the Agricultural Development Act 1967.

Before globalization and financial liberalization of mid 1980s in Nepal, only two commercial banks NBL and RBB were in operation. The financial liberalization paves the way for the establishment of the commercial banks including the foreign joint venture. To create better environment for the development of the commercial banks, RBB, ADB and NBL expanded the banking services to both rural and urban areas. They expanded their branches in urban area also, which helped common public to reduce the burden of paying higher rate of interest to local moneylender. After a decade of releasing the Commercial Bank Act 1974, Nepal Arab Bank Limited (renamed as Nabil Bank Limited) was established in year 1984 A D as the first joint venture commercial bank. The bank was the outcome of joint venture with Dubai Bank Ltd. of United Arab Emirates. With the opening of NABIL Bank, the door of opening commercial banks was opened to the private sectors. The aim of the joint ventures was to help transmit banking managerial and technical knowledge in the economy. As the result Nepal Indosuez Bank, a joint venture bank with Bank of Paris in 1986 A D, Nepal Grindlays Bank Limited (now Standard Chartered Bank Limited Nepal) a joint venture bank with a bank of United Kingdom in 1987 A D was established. Similar to the commercial banks, there was the quantitative and qualitative financial reforms made in non-banks financial sectors also, which aim was to provide the financial services in those area where the commercial banks were unable to provide such services. As the result, till today, thirty commercial banks, fifty-eight non-banks finance companies, seventy eight development banks, eleven rural micro finance development banks, and other like civil investment trust, insurance companies etc. are in operation.

1.4 Commercial Banks

Commercial Banks are the major plays in the economic and financial development. They work as the financial intermediary between lenders; depositors and borrowers in the financial system. Their nature and the role in the financial system of the state in superior because their activities are usually superintended than of any other business. They are important because the state's economic and

financial system depends on how well banks are functioning. Commercial banks means a Bank which operates currency exchange transactions, accepts deposits, provides loan and performs dealing relating to commerce, and other than those Banks which have been specified for the cooperative, agriculture, industry of likely any other specific objectives. In general, the commercial banks are the deposits and loans relating financial institutions. But in broad they perform most of the activities relating to the financial system. Their fundamental function is to accept deposits from and provide loan to households, business, government and others. They accept deposits under the condition to pay back as and when demanded along with a certain amount of interest also the loans are granted under the certain rate of interest on the basis of collateral kept by the borrowers. 'The financial system or the banking industry in precise is a complex network embracing payments mechanism and the borrowing and lending of funds. Though they have other important functions, the key role played by these banks in the system is to act as financial intermediation channeling funds from those with excess income to those wishing to borrower.'(Don Write and Eally Valentine 1984)

1.4.1 Growth of Commercial Banks

It is very important that the financial system should be operated in sound, competitive, dynamic and healthy manner at the high level of operating efficiency for the economic development. There is the mark able development in the financial system in Nepal. The history of the financial development in Nepal may be divided into three phases; 1937-1956, 1956-1985 and post 1985. Nepal Bank Limited, the first commercial bank in the country, was established as joint venture between the government and private sector is 1937. That was only bank and financial institution in country till 1956. Before the establishment of NBL, Nepalese people had to keep their saving in the Indian Banks even the function of the central Bank was performed through the share of Reserve Bank of India and; Revenue and Uniting Department in the Ministry of Finance in Nepal.

Nepal Rastra Bank, as a Central Bank of Nepal, was established in 1956. After the establishment of the Nepal Rastra Bank (NRB), the pace of financial development in Nepal increased. Within the decade, a number of institutions were established in the public sector. The public sector includes Nepal Industrial Development Corporation (NIDC), Agricultural Development Bank (ADB/N), the Employee Provident Fund Corporation, Nepal Insurance Corporation, Rastriya Banijaya Bank, Credit

Guarantee Corporation and the Security Marketing Centre. Beside these, the branches of the commercial banks were expanded highly in between 1970 to 1989, which were partially subsidized by NRB provide the banking service in rural areas. The expansion made because commercial banks tended to concentrate in urban area and to avoid higher cost of rural operations.

As Nepalese were involved in the banking habit, NRB was also concentrated to develop the financial system. Financial system remained small and inefficient with high cost of financial intermediates, weak management, poor service delivery etc. As a consequence of the financial liberalization and other measures, the number and variety of financial institutions have grown in between 1980 to 2004. The number increased from 6 to more than 150, with more than 1100 branches but mostly concentrated in urban areas. During the period the Nepal Arab Bank Limited (NABIL), as a joint venture with foreign and local capital was established in year 1984. Civil Bank Limited is the latest commercial Bank. As our concern there are seventeen commercial banks most of them are established in urban area. Now, the recent policy of NRB to open one branch in remote area all most all banks have started to open it's branches at remote area and as well as I othe center of outside Kathmandu Valley.

The pace of the economic development depends upon the soundness, dynamism, and healthy financial position. So there should be qualitative development of financial system with quantitative development.

1.4.2 Introduction of Everest Bank Limited

Everest Bank Limited (EBL) was established a decade back in 1994 and started its operation with its first branch at New Baneshowar, Kathmandu with a small capital. EBL initially started its operation with the share of United Bank of India Limited but in 1997 it joined hands with Punjab National Bank (PNB), India as its joint venture partner with a view and objective of extending professionalized and efficient banking services to the various segment of the society. PNB is the largest public sector bank of India having 115 years of banking history with more than 5000 offices all over the India and is known for strong system and procedures. 3000 branches of PNB are interconnected and it has over 4000 ATMs spread across India.

The vision of EBL is to evolve and position the bank as a world class, progressive, cost effective and customer friendly institution providing comprehensive financial and related services, integrating frontiers of technology and serving various segments of society especially the weaker and middle class sections, committed to excellence in serving the public and also excelling in corporate values.

Mission of EBL is to provide excellent professional services and improve its position as a leader in the field of financial and related services, build and maintain team of motivated and committed workforce with high work ethos, use latest technology aimed at customer satisfaction and act as an effective catalyst for socio economic development.

The local Nepalese promoters hold 50% stake in the bank's equity, while 20% of equity is contributed by the joint venture partner PNB whereas remaining 30% is held by the general public.

Besides, showing growth in its operations, the bank has also been growing horizontally on a satisfactory pace. It has now network of 38 branches spread over the entire length and breath of the country right from Far-East to Far-West. Fifteen of its branches are located in Kathmandu valley. All the branches branches are interconnected through centralized banking systm which enables its customers to do banking transactions from any of it's 38 branches irrespective of their having accounts in the other branch. Furthermore, the bank has taken another historical step by opening its representative office in New Delhi, India, the first ever bank in Nepal to an office opened outside Nepal.

Not to be left behind in technology advancement, a continuous review and upgrading of the technology is taken for the convenience of its customers. It has also introduced "EBL Debit Card" in association with Smart Choice Technology (SCT) to provide ATM services for its customer. EBL Debit Card can be accessed at more than 600 ATMs and over 1000 Point of Sales (POS) across the nation and also acess at the ATM of PNB in all over the India. It has installed two ATM'S (Automated Teller Machine) at its main branches New Baneshowar and New Road. It is also managing the SCT ATM at at it's all most all branches.

Although the economy of the country has been facing ups and downs during last decade, EBL has been maintaining a steady growth rate over this period. It has been able to increase its customer base manifold and has also shown outstanding growth in all parameters of Banking. Despite fragile law and order situation especially during last 3-4 years, the bank has recorded spectacular growth in size and operation.

This sustained growth of the bank is attributable to its strong systems and procedures, professional approach, quality lending and highly motivated staff members. The staff strength of EBL has reached around 600 as per annual report of 2066/067. Drawing its strength from its joint venture partner, EBL has been steadily growing in its size and operations and established itself as a leading private sector bank in Nepal.

1.4.3 Objectives and Functions

Commercial Banks are the major player in the financial system of Nepal for the financial stability, competitiveness, etc. The history of the commercial banks shows the need of the commercial banks in Nepalese financial system. Due to this need joint venture as well as non-joint venture commercial banks are increasing in number. The overall economic objective of in Nepal is to reduce poverty, based on sustainable economic growth achieved through the all round liberalization including in the financial sector. So, the commercial banks should be established with business motives in financial system for poverty alleviation of the state. Government policies are always to support the commercial banks. Thus they should help the government to achieve the overall economic objectives.

To achieve their objectives, they should perform the several functions under the regulation of the authorized institutions. In general, their function is to reconcile the needs of lenders and borrower i.e. mobilized surplus unit to deficit units. The functions of the commercial banks define their role in the modern mixed economy and need of the organized banking system. Thus, they have to perform their activities in a significant way so as to gain their position in the financial system. At a short, they perform several activities such as:

- To provide for short term trading, for meeting working capital needs of industries and business and for consumption a social functions against sufficient collateral
- To mobilize the deposit
- To advance the loans
- To accept the amounts with or without interest
- To operate transactions in foreign exchange

But at any cost they have been able to perform satisfactory through service excellence and customer satisfaction, thereby earning a stable and consistent return to their shareholders though they have to pay high in terms of commitment and financial resources. But still they have no any other choice if want to remain competitive and set an example towards economic prosperity.

1.4.4 Overall Financial Performance of commercial Banks

It is very necessary to know about the financial performance of the commercial banks to appraise the degree of compliance of the prudential requirements to achieve their objectives. Analyzing financial performance is a process of evaluating the components of financial indicators to obtain the operational position and performance. Financial performance of any bank is measured with its ability of resource mobilization and utilization.

1.5 Focus of the Study

Nepal Rastra Bank (NRB), the central Bank of Nepal, was established in 1956 AD to discharge the central banking responsibilities including guiding the development of embryonic domestic financial sectors. To reflect this dynamic environment, the functions and objectives of NRB are as, to formulate necessary monetary and foreign exchange policies, to maintain the stability in price and consolidated the balance of payments for sustainable development of economy of the kingdom of Nepal, to develop a secure, healthy and efficient systems of payments, to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development and to further enhance the public confidence in Nepal's entire banking and financial system. Since the establishment of the NRB, there has been a remarkable growth in quantitative and qualitative financial institutions and their activities.

Due to the increment in the financial institutions, their activities, services are also increased. But it is very necessary to control and promote their performance for the healthy, stable, sound, capable and dynamic financial system and for public confidence over them. Commercial Banks are the major players in the economic and financial development in Nepal. So, their performance should be controlled and promoted through the inspection and supervision. NRB is the authorized institution for the supervision of commercial Banks. Effective supervision of the commercial banks is an essential component of economic and financial environment of the state. That is why; it is necessary to perform the supervision and inspection task over performance of commercial banks'. The task of supervision is to ensure commercial banks operation and performance in a safe and sound manner and holding capital and reserve to support the risks of the banking business. The basic objective of NRB supervision and inspection is to conduct a direct assessment of the overall financial performance of the banking institutions, the evaluation of Capital adequacy, Assets quality, Management, Earnings, Liquidity, Sensitively to market and review of their records.

The objective of the principles in banks supervision and inspection are to safeguard the interests of depositors, investors, to stabilize the monetary system, to promote an efficient financial system and maintain financial stability etc. In context of Nepal, NRB uses two basic inspection and supervision methods. One is on-site inspection, performed examination of files and projects and overall condition of banks in presence at on site and other is off-site supervision, act of evaluation of banks overall economic and financial condition by gathering relevant information at NRB's desk. This study concerned with the financial performance of the sampled bank, analyzing under the CAELS ratios; the tools of off-site evaluation. Generally the off-site evaluation is made on regular basis but as the study nature, the analysis is made on the basis of financial statements published at the end of the year. An international bank rating system, with which bank authority rate banking institutions according to five factors. The five areas examined are represented by the acronym “CAELS”. The five factor examined are as follows.

C- Capital Adequacy: To assess whether the bank is operating with adequate capital funds in relation to its size of operations and the risk assumed, as well as the bank's compliance with regulatory requirements.

A- Assets Quality: To evaluate the market or realizable values of bank's assets, particularly the loan portfolio.
E- EARNINGS: To assess the current and future earning capability and the efficiency of the bank based on the existing assets and liability structure as well as pricing and costs.
L- Liquidity: To evaluate the bank's liquidity in the light of its existing assets and liability mix, and in relation to the legal liquidity requirements.
S- Sensitivity to market risks: To determine the banks ability to monitor and manage its exposure to market risk.

For each of the financial institutions, every financial indicator carries the high value. Nepal Rastra Bank, central bank of Nepal has been using CAELS as one of the important indicators, which judges the soundness and performance level of commercial banks. On measuring the performance level of commercial banks each of the components is measured under the certain standard.

Economic system of the state depends upon the financial system of the same economic system because it is the reflection of the financial system at most. So, the financial system of the country should be dynamic, capable, sound, healthy etc. The pace of the economic development depends upon the soundness, capable, healthy financial system. Financial system is the outline philosophy of the financial intermediates and their activities and the commercial banks are the major players in the financial system. As the financial intermediates, activities of the commercial banks are the major components in the financial system. These activities should be promoted as well as controlled for the dynamic, healthy, capable, sound financial system. Thus, it is necessary to perform the task of inspection and supervision of the commercial banks and others.

Supervision of the financial institution is an essential component of a strong economic environment to ensure that the commercial banks operate in a safe and sound manner which contributes in enhancing the financial stability of the country. Inspection and supervision task is done in order to achieve both long-term financial stability and sector efficiency.

After the economic liberalization in Nepal, there is the quantitative and qualitative development of financial institutions and their activities in the financial system. With the variety of the financial institutions and their activities gradually become complex and risk arises in their performance, which indicates the need of control and promotion on their activities by inspection and supervision day to day. With the supervisory concern NRB performs the function of making appropriate supervision of the banking and financial system, to enhance the public confidence in Nepalese entire banking and financial system and to promote the banking and financial sector's stability and required liquidity as major.

NRB is only one authorized institution for inspection and supervision in order to maintain banking stability and foster their healthy development. Central Bank needs to supervise and inspect the financial performance of financial institutions because they play the critical and vital role in the economic system. The involvement of the central bank in the inspection and supervision is to create the public confidence over the financial performance of the banking system and to determine whether the institution has complied with relevant mandatory and regulatory requirements or not. NRB is given authority of inspection and supervision of the commercial banks by Nepal Rastra Bank Act 2058, section 9 and section 7 of banks and financial institutions ordinance.
Similarly, NRB issues the inspection and supervision by law 2059 for the inspection and supervision of commercial banks. NRB uses two types of the inspection and supervision system. One is on-Site Inspection and other is off-site Supervision.

On-site inspection is performed examination of files and projects and overall condition of the financial institutions (commercial banks) in presence at on-site and off-site supervision is act of evaluation of financial institutions' (commercial banks') overall financial condition or performance by gathering relevant information's at NRB's desk. This study is concerned with the evaluation of EBL under the CAELS ratios, the tools of off-site evaluation. The assessment of the financial performance of the sampled bank as the evaluation of the financial soundness is made under the CAELS tools and prudential requirements.

This evaluation system will provide meaningful and concise information about the financial position of the sampled bank. CAELS stands for Capital adequacy, Assets quality, Earning capability, Liquidity position and Sensitivity to market.

1.6 Statement of the Problem

Nepal is economically back pushed country. Most of the resources are remained unused due to the lack of financing. But there is the great chance of financing due to the increasing number of financial institutions. Since the economic liberalization, the number of the commercial bank with the number of joint ventures bank is increasing. The inadequacy of the financing can be removed by the participation of the foreign investments though the joint venture commercial banks to some extent.

As per the several economic indicators, Nepalese economy is not performing satisfactorily. Concerning with the commercial banks, the credit and the investment growth is not in the satisfactory and at the acceptable level. The resource mobilization by the commercial banks has affected adversely. Banks have been facing the several problems relating to the interest rate, investing sectors, which directly affects the profitability concern of the bank. Though financial institutions are performing better, most of the financial sectors are just surviving. None of the banking sectors can identify the less risky project with high return for investment. Most of the banks are concentrating on the similar types of investment sectors. In this context, financial institutions have not been performing enough to meet the increasing financing needs of economy.

With the prevailing economic background of the country, banks are unable to investment in most of the sectors. Hence, the commercial banks are also not performing perfectly to shift the deposit in the profitable sectors. The problem of the study is based on the issues related with the financial performance or soundness of one of the joint venture commercial banks i.e. Everest Bank Limited. In fact the financial performance is a mirror that shows the weakness and strength of the bank. On the other hand, NRB is the authorized institution that performs the task of supervision of the commercial banks. The main purpose of the NRB supervision is to ensure the performance of the commercial banks according to the interest of depositors. NRB supervision also ensures to make the sound, capable, dynamic, healthy and competitive financial institution through the assessment of their

performance. In this context, NRB issues the several prudential requirements, rules, regulations, act to control and promote the performance of the commercial banks to make them financially sound. Also those banks should maintain each of the provision, made by the NRB to protect the depositors' interest or to perform them in the manner of depositor's will. In the light of the above explained background this study tries to answer the following questions related to the Everest Bank Limited.

- How the bank is operating to protect depositors' interest?
- What is the degree or level that the banks is complying the legal provisions required by the NRB?
- What is the comparative position of financial performance under capital adequacy, Assets Quality, Earning Capability, Liquidity Position, and Sensitivity to market risks position, during the last five year?

1.7 Objective of the Study

As the CAELS system examines the commercial financial performance of the sampled banks (EBL). On analyzing the performance through the tools of CAELS system the following objectives of the study can be derived.

- To determine the financial position and quality of portfolios and operations of the sampled banks so as to ensure that the bank is operating in manner of depositors' interest, banking legislation and banking system norms.
- To examine the comparative financial position of the sampled banks.
- To examine the relationship between the components of CAELS so as to determine the financial soundness of sampled banks.
- To examine the need of evaluation of commercial banks performance with reference to prudential requirements.

1.8 Significance of the Study

- The study will be of multidimensional significance for the each of people who are interested about banking sectors, engaged in banking business and to general public.

- The study will be helpful to depositors regarding the deposit and made them aware about the performance of commercial banks and made them confidence for their deposits.
- The study will be helpful for every one who is interested to know about the financial soundness of commercial banks.

1.9 Research Methodology

The main basis of the study is the secondary data gathered from EBL, NRB, and other various publication and institutions. Some of descriptive analysis will be made with help of information collected by direct interview with the concerned people. Due to the nature of the study, most of the information will be collected from banking legislation, different research studies and financial statements of the sampled bank. Various types of the financial tools will be used to analyze the performance of the sampled bank. But most of the tools used are of under the CAELS system.

- Research Design:

  Research design is the art of designing the procedure of study that the researcher is going to conduct. It is simply the track of research procedure that includes the framework or plan for the collection and analysis of data research design guides the process of the whole study. This study mainly focuses on financial soundness of the joint venture Bank especially that of Everest Bank Limited. For the purpose, the analytical and descriptive types of research design are adopted. This study focuses on the examination of relationship between those variable that play the vital role on making the financial decisions, under the CAELS system, of the sampled bank.

- Population and Sampling:

  This study is related with the financial performance and its soundness of the joint venture Bank. So, the population for this study comprises six joint venture banks, which are currently operating in Nepal. Each of the commercial banks is operating under the same rules; regulations and directives issued by the Nepal Rastra Bank and each bank perform the activities of commercial banks. As the number base, the study sample consists of the Everest Bank Limited.

- Sources of Data:

  Primary Data: This study is primarily based on the secondary source of data. However, the necessary suggestions, ideas, materials related with the study are collected from the primary sources whenever needed. These primary sources are various experts both inside and outside the bank.

Secondary Data: Accordingly the nature of the study, the necessary data are obtained from the head office and downloaded from web site of the sampled bank and some are from the Nepal Rastra Bank. Published balance sheet, profit and loss account and other supplementary statements and account as well as the annual reports of each sampled years are collected from the head office of the sampled bank.

- Data analysis procedures and tools

The study will be conducted to evaluate the soundness of the financial performance of the sampled bank. For this purpose, several visits of the sampled bank and the central bank will be made with the view of obtaining and collecting the required data. The raw data obtained from various sources cannot be used in their original state. They needed to be verified and simplified for the purpose of analysis and presentation. Information and figures obtained should be tabulated and edited for the computation. For the simplification, data will be plotted in meaningful tables for analysis and interpretation section according to the nature of the data. But their corresponding tables with the detail information will be presented in the annexes. The tables presented in the study will not be presented in their original format but for the simplicity they will be presented in the required form.

The study includes the analysis of the financial statements and other supportive statements using different financial tools. But these financial tools should strongly under the CAELS system, the off-site supervision tools. There will be a brief discussion of the tools under the CAELS system, which will be used to analyze and interpret the financial soundness of the sampled bank. CAELS is the composite of the five components which play the vital role on the performance of the banks. These five components are Capital Adequacy, Assets Quality, Earning Capability Liquidity Position and Sensitivity to Market. Each component contains different ratio with the respective standard. Thus, the ratios under each component and other various financial and banking tools will be used for data analysis to get desired outcomes.

1.10 Limitation of the Study

- The study emphasizes only the banking sectors as the financial institutions.
- Primary data is collected from the financial experts, depositors, and students of banking and finance available in the Kathmandu Valley only, as direct interview.

- Time is the main constraint for the empirical study.
- The study is mainly based on secondary data.
- Data regarding to the some requirements cannot be found for some period because before releasing the current directives commercial banks were not forced to record those data as mandatory.
- The study is based on evaluating the financial soundness of the sampled bank under the tools used in CAELS system rather than its rank under the system.

1.11 Organization of the Study

The study is divided into five different sections, VIZ Introduction, Review of Literature, Research Methodology, Analysis and Interpretation; and Findings, Conclusions and Recommendations.

1.11.1 Introduction

This is the first section, which introduce the subject matter of the study. This Chapter consists of General Background, Evolution of Banking Sector Globally, History of Banking Sector in Nepal, Commercial Banks, Overall Financial Performance of Commercial Banks, Focus of the Study, Statement of the Problem, Objective of the Study, Significance of the Study, Limitation of the Study and Organization of the Study.

1.11.2 Review of Literature

This chapter briefly reviews the related studies and findings and various literature and quoted in this chapter which includes concept of banking policies regarding to commercial bank, review of the super visionary & inspections provisions, journals, articles and thesis works.

1.11.3 Research Methodology

This is the section, which explains about the research design, sources of data, data collection process, and data processing procedures tools used for the study and limitations of the methodology. This is the section, which explains about the research design, sources of data, data collection process, and data processing procedures tools used for the study, and limitations of the methodology.

1.11.4 Presentation and Analysis of Data

In this chapter, data collected are presented, analyzed and interpreted using the different tools. This is the main body of the study and makes analysis of the several data. In this chapter, data collected are presented, analyzed and interpreted using the different tools. This is the main body of the study and makes analysis of the several data collected.

1.11.5 Summary, Findings, Conclusion and Recommendation

The summary of whole study is included in this chapter. This chapter further describes the major findings of the study with the conclusion of the study. As well as possible and viable, recommendations have also been made in this chapter.

CHAPTER II
REVIEW OF LITERATURE

This chapter tries to review the literature related to this study i.e. the inspection and supervision of the commercial banks and their CAELS System. Till the date of this study, there is no any thesis report regarding to the CAELS System of Commercial banks under the inspection and supervision manual. However, there are numerous research documents regarding to the financial performance, impact of Nepal Rastra Bank directives towards the commercial Banks and finance companies. CAELS Rating System is supervision task that should be performed by NRB. In some limit, financial performance, NRB Directives, inspection and supervision are interrelated and similar. This study is made on reviewing some earlier thesis report, research report, books, reports, and various articles published in some national newspaper, other publications. Most of the review is made to provide the valuable inputs for the study. But, in fact, there is no absolute and sufficient literature to the topic.

2.1 Conceptual Review

2.1.1 Concept of Banking

Society is the platform where the each of the social activities is performed. Economic activities are the important social activities, which are in practice after the development of human civilization. The continuous practice in the economic system induced the concept of banking in the human society. Banks are the heart of the financial and economic system. The banking practice was originated in Europe. "Bank of Venice" was the first bank; established in Venice City is 1157 AD. Since 1157, thousands of banks and other financial institutions are in practice. Banks make the easy on the transaction of money and credit as well as made payment, keep financial assets safe and others because they are financial intermediators.

As per Banking Regulation Act of India, "*Banking means the accepting for the purpose of lending or investment of deposit money from the public repayable on demand or otherwise, and withdraw able by cheque, draft or otherwise*." In this sense, the bank is responsible to repay the public deposits and should make the investment or lending of the public deposit.

According to The word book encyclopedia (1984)," *A Bank is a business establishment that safeguards people's money and uses it to provide loans and investment*". This explains that the banks made the public deposits, in the form of money and other asset safe and also have authority to use those deposit in the several productive projects.

On other hand bank is just like a individual dealing with the several banking activities such as collecting drafts, cheques, writing drafts, etc. In this sense, M. Radhaswamy (1979) explains "*A banker or bank is a person or company carrying on business of receiving and collecting drafts for customers subject to the obligation of honoring cheque drown upon them from time to time by the customers to the extent of the amount available in the current accounts*."

Banks are simply working for accepting deposits and lending those deposits. Beside this, they perform other several activities in the depositors and their own interests for the economic and financial development. In broad, The Encyclopedia America (1999) explains, *"the banking is a dynamic economic activities that links together savers and borrower in a way that maximizes the activities of both groups, as well as generates benefits for the bank. When this process is carried out poorly or blocked by regulations, banking acts as a constraint on a nation's economy, effectively preventing it from achieving its full potential in terms of output, income growth and international competitiveness"*. Concerning the Nepalese banking history, it started several years ago. Modern banking system is not so experienced in Nepal. Nepal Bank Limited is the first bank established, as the commercial bank (in 1994 B.S). Today three types of banks in are operation; Nepal Rastra Bank, as central bank; Deposit money banks or Commercial Bank and Development Banks. More than five hundred banking branches are operated in the Nepalese financial sectors with and without foreign joint venture.

2.1.2 Concept and Development of Central Bank

The concept of central banking was started about 300 years ago in England in 1694. During the beginning of 20th century several central banks were established in most of the country. The important of central bank was justified by the Geneva (1920) and Brasels (1922). Central Bank is the national banking institution that monitors all financial and monetary procedures and policies.

Before the establishment of the Central Bank, Commercial Banks acted as the Central Bank. Due to profit making motive of the commercial banks, each of the country realized the need of the central or national banks.

Vaidya (1997) has explained that *the Central Banks is the apex bank in a country that controls all monetary and banking structure.*

De Kock has stated that *a Central Bank may be defined as the bank in any country to which these has been entrusted the duty of regulating the volume of currency and credit in that country.*

R.S Sayers (1997), explains, *'The Central Bank is the organ of the government that undertakes the major financial operations of the government and by its conduct of these operations and by other means, influences the behavior of the government'.*

"Central Bank as on institution that is charged with regulating the size of a nation's money supply the availability and cost of credit and the foreign exchange value of its currency. Regulation of the availability and cost of credit may be none selective or may be designed to influence the distribution of credit among competing uses. The principles objectives of modern Central Bank in carrying out these functions are to maintain monetary and credit conditions conducive to a high level of employment and production, a reasonably stable level of domestic prices, and an adequate level of international reserves"(Encyclopedia Britannica, 2002).

In fact Central Bank is the national bank which is related with government interest and public interest for which it discharges several regulations regarding to the monetary policies and others. It is the regulating authority for commercial banks, and other financial institutions.

In context of Nepal, Nepal Rastra Bank is a central bank established in 1956 AD. The existence of central bank in Nepal crosses five decades. Nepal Rastra Bank is established to issue and manage the currency, for monetary management, to promote and stabilize the financial system, as government's bank, financial agent and adviser, work for foreign exchange policies and others.

Shekhar & Shekhar (1988) explains that *it is difficult to lay down any hard and fast rules regarding the functions of a central bank. The powers and the range of functions of central banks vary from*

country to country. In fact it is a difficult task to put aside the importance and functions of a central bank.

The most important task of the central bank is to regulate the commercial banks in any manner. Beside this, in the context to co-ordinate with different international institutions, the bank has to play the vital role.

2.1.3 Concept of Commercial Banks

Commercial banks are the major financial intermediators in the state financial system. They work with the though of profit making but not as the sole objective. They accept deposits from the public and provide the short-term or long-term debt, necessary for the development of trade and commerce of the state. John Holland explains, commercial banks are financial intermediators that borrow money from savers in the form of deposit and re-lend them to ultimate borrowers by making loans on buying securities.

Clark (1999) has stated that *the commercial bank as bank that concentrates on cas*h *deposit and transfer services to the general public often to be found on the high street.*

Johnson & Johnson states "A commercial banks is a financial intermediary that provides a financial service product in an evolving industry. The industry is characterized by changing competition, regulation and technology. The central activity of banking remains the securing of deposit funds and making of consumer and commercial banks".

"Banking, the business of providing financial services to consumers and business. Commercial banks specialize in loan to commercial and industrial business. Commercial banks are owned by private investors, called stockholders, or by companies called bank holding companies" (Microsoft Encarta Reference Library, 2003).

Explaining the functions, *"Commercial Banks are the most numerous banks. They offer a full rage of services including current and saving accounts, loans and trust services. They primarily serve the need of business but also offer their services to individuals"*(The World Book Encyclopedia,1984).

Defining the functions, Acharya, M. (2003) explained, "commercial banks lend for short term trading, for meeting working capital needs of industries and business, and for consumption and social function against sufficient collateral".

2.1.4. Concept of Joint Venture Bank

Joint venture is the corporate alliance in which two or more independent companies combine their resources to achieve specific limited objective. It is a made of trading through partnership among nations and also a form of negotiations between various groups of industries and traders to active mutual exchange and are controlled by two or more parent companies. D.P. Gupta on Banking System, its role in export development explains, *"A joint venture is defined as the joining of forces between two or more enterprise for the purpose of carrying out a specific operation (industrial or commercial investment, production or trade)".*

Joint venture banks are established to achieve the competitive advantages through the performance of joint investment between two or more firms of the two or more countries. The parent bank, which have more experiences in highly mechanized and efficient morden banking system in many parts of the word, have come to a country with higher technology, advanced management skills and international banking system.

The joint venture banks are established in the developing countries like Nepal is to create competitive banking environment, to create quality services. It also helps to need the shortage of funds, needed for investments. JVBs are the financial intermediators to finance in deficit units and collect the money from the surplus unit. In Nepal, HMG of Nepal has allowed to operate joint venture banks in the private sectors. JVBs are already playing on increasing dynamic and vital role in the economic development of the country. JVBs of Nepal are in the better position than local commercial banks in profit making. On average most of the banks are making profits. Also the JVBs, in Nepal are contributing more in the GDP than other commercial bank.

2.1.5 Role of JVBs in Nepal

Joint venture banks expose a serious challenge to the existence of the inefficient any very traditional bank. But the same challenge can be taken on the domestic banks as an opportunity to modernize themselves and sharpen their competitive zeal. The following are the major roles of the commercial banks in the economic development of the country:

a) Providing effective banking services

JVBs are strong in the most of the aspects of the banking because they obtain the several experiences in the banking business. So they can provide the effective banking services than domestic bank. They can provide that services which are not provided by the domestic bank yet. Because of their high global access then domestic bank, they can adopt the newly introduced technology to make their service effective.

b) Creating the competitive environment

Due to their activities and services in the banking sectors they are benefited rapidly. Due to this zeal other domestic banks are interested to step up for the other activities and services which the JVBs are not adopted yet. This is the competitive environment. Due to competitive environment, banks engage to provide something new in the banking business.

c) Linking the international market

The JVB is one of the major means of linkage between domestic banking sector to global banking sector because they are established with the alliances of people of two or more countries. So they play the vital role in the banking business for linking the domestic banking in international banking.

List of JVBs in Nepal: With Brief Profile Equity Composition

Bank	**Date of Establishment**	**Equity Composition**	**Head Office**
NABIL	2041-03-29	Dubai Bank Ltd. 50%, General Nepalese Public 30%, NIDC 10%, Rastriya Beema Sansthan 9.6%, Nepal Stock Exchange Ltd. 0.33%	Kathmandu

SCBLN	2043-10-16	Standard Chartered Group (UK) 75%, General Nepalese Public 15%	Kathmandu
HBL	2049-10-05	Nepalese Promoters 51%, Habib Bank of Pakistan 20%, General Nepalese Public 15%, EPF 14%	Kathmandu
NBBL	2050-03-23	International Finance Investment & Commercial Bank of Dhaka 50%, General Nepalese Public 30%, Nepalese Promoter 20%	Kathmandu
EBL	2051-07-01	Nepalese Promoter 50%, Public 30%, Punjab National Bank 20%	Kathmandu
NSBIBL	2056-03-23	State Bank of India-50%, General Nepalese Public 30%, EPF-15%, ADB/N-5%	

2.1.6 CAELS system

A bank-rating system with which bank supervisory authorities rate institutions according to five factors. The five areas examined are represented by the acronym "CAELS". The five factors examined are as follows:

C - Capital adequacy

A - Asset quality

E - Earnings

L - Liquidity

S - Sensitivity to Market Risk

Bank supervisory authorities assign each bank a score on a scale of 1 (best) to 5 (worst) for each factor. If a bank has an average score less than 2 it is considered to be a high-quality institution while

banks with scores greater than 3 are considered to be less-than-satisfactory establishments. The system helps the supervisory authority identify banks that are in need of attention.

In our country the bank supervisory authority is the central bank of Nepal i.e. Nepal Rastra Bank. The major responsibility of the Nepal Rastra Bank is to perform the inspection and supervision of the commercial bank, under the several policy documents such as Nepal Rastra Bank Act 2058, Bank and Financial Institution Ordinance 2061 etc. Due to this responsibility NRB issues the inspection and supervision by law 2059. Under this by law, NRB also develops the several norms and tool to measure the financial performance position of the commercial banks. NRB inspects and supervise the commercial banks because they have to perform for the safety of the depositors' interest.

To protect the depositor's interest, NRB perform the two types of the inspection and supervision. One is on-site inspection and other is off-site supervision. According to Surendra Man Pradhan (2003), *"the main approach to supervising banking institution is to concentrate on corporate governance, marked discipline and management oversight"*. But concerning only with the off-site supervision, it is simply analyzing reviewing the several financial and statistical reports of financial institutions and their compliance with provisions made for financial institutions.

Off-site financial analysis is based on collecting reviewing and analyzing prudential reports and statistical returns from financial institutions on a regular basis. These report should include basic financial statements as well as supporting schedules that provide great details on exposure to different risk and various other financial aspects of the institution, including provisions and off-sheet balance sheet activities. (Off-site Supervision Manual, 2003)

The main objective of the off-site supervision of the commercial banks is to determine their financial performance and soundness and to check adherence to some prudential requirements. It also provides some ideas to identify problems and their corrective actions.

The Bank Supervision Department and Financial Institution Supervision Department of NRB establish the some objective to perform the off-site financial analysis (Supervision) as follows:

- A system of information by reporting institutions.

- Ratio analysis for each reporting institutions
- An analysis of the key ratios and determinations of CAELS rating for each institution.
- An executive summary of each institution.

For the purpose, the financial analysis is made under the CAELS system that is designed in the off-site supervision manual. CAELS system is simple the financial tools that is used to rank the commercial banks performance. CAELS is the composition of the five financial elements. They are Capital Adequacy, Assets Quality, Earnings Position, Liquidity Position and Sensitivity to Market Risk.

2.1.7. Financial Analysis and its Soundness

It is just the analysis of the financial performance of the financial institutions. According to the J.C. Vanhorne & J.M. Wachowier, (1998) *"Financial analysis involves the use of various financial statements – the first is balance sheet which represents a snapshot of the firm's financial position at a moment in time and next is the income statement, that depicts a summary of the firm's profitability over time. Because of the various tools used, under the financial analysis, it measures the financial performance of the firm."*

In Myers (1961) thinking, *"Financial statement analysis is largely a study of relationship among the various financial factors in a business a disclosed by a single set of statement and a study of trends of these factors as shown in a series of statements."*

In the words of Weston and Brigham (2002), *"Financial statement analysis involves the a comparison of a firm's performance with that of other firms' in the same line of business, which is often identified by the firm's industry classification."*

Financial analysis can be defined an the evaluation of progress towards meeting the goals and objectives by management and comparison with the industry norms.

Through the financial analysis, it evaluates the firm's past performance and assesses its present financial strength. Management of the firm would be particularly interested in knowing the financial strengths to make their best use and to spot out the financial weakness to take corrective actions. The main purpose of the financial analysis is to evaluate the financial position of the financial institution. It is an art of interpreting financial statements and other numerical data. The primary tools of financial analysis are ratios and comparison.

Each of the banks should operate in the interest of depositors because depositors are the major stakeholders of the bank. If the bank can not gain public trust or confidence, it cannot get success. So it is necessary to evaluate the performance of the banks to identify whether it is operating in safe and sound manner or not. Because for the stable economic development of the state, there should be the sound, stable, capable, healthy and dynamic banking system. It is only possible to measure the degree of the financially sound banking system through the evaluation of the financial performance of the corresponding banks. The financially sound banks are superior in the performance evaluation and adherence with the most of the prudential requirements.

The financial performance analysis is targeted to highlight the strengths and weakness so, that the management can take appropriate action to strengthen the weak and maintain performance in the strong areas is to make institutional soundness.

Pandy, I M (1997) has explained that *the financial analysis is the process of identifying the financial strengths and weakness of firm by properly establishing relationships between the items of the balance sheet and the profit and loss accounts.*

Heifer (1992) has defined that *the financial analysis is also the analytical and judgmental process that helps answer questions that have been posed. Therefore, it is means to end. A part from the specific analytical answer, the solutions to financial problems are issues depend significantly on the views of the parties involved in the related issues and on the nature and reliability of the information available*.

Shrivastav (1993) defines *financial analysis makes an attempt to dissect the financial statements into their components on the basis of the purpose on one hand and between individual's components and total of these items of the other. In course of studying and evaluating the financial position of the organization, a study trends of various important factors over the past several years is also undertaken to have clear understanding of changing profitability and financial condition of the business organization.*

So, the financial performance analysis is the measuring the financial soundness of the bank and it degree of compliance with the prudential requirements. And the best tools used to evaluate the financial performance analysis are the tools under the CAELS system because the system provides the provisions requirements with the ratios correspondingly. The provisions requirements are the obligations that the bank should obey during the operating period for their sound performance.

2.2 Review of Policy Documents

Policies, regarding to the commercial banks, aim to develop the economic and financial position or condition of the country and to protect the public interest. Policy ensures the economic interests, facilities the credit supply, makes reliable and feasible banking and financial services to the public. This sub-section tries to review the several regulatory policy documents regarding the activities of the commercial banks (related to the CAELS system under the inspection and supervision of the commercial banks)

Inspection and supervision of the financial institutions is one of the prime responsibility of the NRB as the supervisory and inspection authority. NRB inspection and supervision task ensures that the banks' operation is in safe and sound manner and that they hold capital and reserves sufficient to support the risks that arise in their banking business.

Prior to the inception of Nepal Rastra Bank Act 2058, the inspection and supervision function of Nepal Rastra Bank has been governed by section 23 A of Nepal Rastra Bank Act 2012 which has vested NRB with all the authority to inspect and supervise all the bank and financial institutions operated in the Kingdom of Nepal.

Section 2, subsection 4 D explains as the objectives of the NRB to regulate, inspect, supervise and follow up the banking and financial system.

These all above statements are related to the inspection and supervision of the commercial banks to develop the efficient and sound banking system. For this NRB issues several policies a regulations regarding to promote and control of the commercial banks through the inspection and supervision.

The section 9 of the act explains the inspection and supervision of the banks.

"Banks are supervised in order to achieve both long term financial stability and sector efficiency. A weak regulatory framework and poor supervision provide backgrounds for inefficient and unsafe banking practices, which increase the risk of bank failure. Preventing systematic risk, protecting small depositors, and containing financial crimes are concrete steps in attaining these objectives", (Pradhan, 2002). Thus, there is the requirement of inspection and supervision of the financial institutions. NRB is the inspection and super visionary authority in Nepal.

For the operation of the bank and financial institutions in proper, smooth and sound manner within the legal framework, some exercises have been worked out. The preparation to ward the Umbrella Act is the most important task to operate the bank and financial institutions, which defines that it is the duty and responsibility of Nepal Rastra Bank to inspect and supervise the banks and financial institutions (Section 7) subsection 52 of the section 7 of the Act, defines the authority of NRB off-site inspection and supervision of any financial institution.

On other hand NRB issues directive from time to time to enhance the strength of the commercial banks. The final objectives of these directives are interlinked with the objectives of the CAELS system. In some extend both contain the similar provisions such as the capital fund, asset quality etc. As the study related directive 1 is provision of minimum capital fund to be maintained by the commercial banks. This directive indicates the provision of capital adequacy ratio such as core capital ratio, capital fund ratio, general loan loss provision etc. Similarly directive 2 is provision of loan classification and loan provisioning on the credit. This directive indicates the provision that should be made in the different types of loan loss. Directive 5 is the provision of reducing the risk on the activities of the commercial banks. The risk includes Liquidity risk, Interest, rate risk, foreign exchange risk, risk related to loan and investment. But the study of sensitivity to market under the

CAELS System is only related to interest rate risk and foreign exchange risk. Thus the CAELS study is also related to this directive. Some provisions under these directives that are related with the CAELS System are reviewed as follows:

The norms under the capital adequacy (directive1) prescribe the minimum fund requirement, on the basis of the risk-weighted assets. The banks are required to maintain the prescribed proportion of minimum capital fund on the basis of weighted risk assets. These norms are directly related to the some tools under capital Adequacy norms of the CAELS System Core Capital is the sum of Share Capital, Share premium, non-redeemable preference Share, general reserve fund and accumulated profit/loss. Total capital is the total of core capital and supplementary capital. Supplementary capital is the sum of loan loss provision, exchange equalization reserve, assets revaluation reserve, hybrid capital instruments, unsecured Subordinated term debt, interest rate fluctuation fund, and other free

reserves. The risk weighted assets is the sum of risk weighted assets of on and off site balance sheet items as prescribed on the same directive. In case of non fulfillment of the capital funds, the bank will fulfill the shortfall amount within next six months. During the fulfillment period bank is not allow to distribute the dividend.

Under the directive 2, loans and advances are classified, on the basis of ageing of principle, into four categories; pass loan, sub-standard loan, doubtful loan and loss. For F.Y. 2060/61 and onward, pass loan is not pass due loan, substandard is past due loan up to 6 months from 3 months, doubtful loan is past due loan for a period over 6 months to 1 year and loss is past due loan over 1 year period. And provision should be made 1% of pass loan to general loan loss and 25%, 50% and 100% for substandard, doubtful and loss respectively, for possible loss.
Reference to directive 5, interest rate risk and foreign exchange risk provision (as our study related) should be made.

2.3 Review of Relevant Studies

Some studies have been made about the financial performance of the commercial banks. Some studies have been made on the CAMELS rating system but not about the CAELS system. No, sufficient studies review of the financial performance related studies can be made in this subsection. But again no specific studies about the CAELS system and evaluation of the financial soundness of commercial banks could be found. However, some relevant studies about financial performance of the commercial banks have been reviewed so that the possibilities of limitation will be avoided from the current study and some originality can be created for serving the objective set.

Mr. Bindeshwor Mahato in his thesis entitled "A comparative study of the financial performance of NABIL Bank Ltd and Nepal Indosuez Bank Limited" finds that over all liquidity ratios of Nepal Indosuez Bank is much higher than that of NABIL Bank. Again he remarks that NABIL is investing its more funds in the form of loan and advances then that of NABIL. However, the profitability ratio of the NABIL is higher that of Nepal Indosuez Bank Limited

In another dissertation conducted by Mr. Pramod Dhungana entitled "A study of JVBs profitability, he summarizes that the JVBs operating in Nepal are under the satisfactory, profit condition during the reviewed period". He finds better utilization of the funds of the JVBs during the reviewed period. On the same context, the NGBL, NABIL are improving the profitability trend than that of NABIL. But NABIL is employing greater number of employees and operating through more branches. His study concludes the better performance of JVBs.

In the thesis entitled. "An appraisal of financial position of Standard Chartered Bank Nepal Limited, Mr. Rajendra Siwakoti states that the liquidity position of the bank is below the standard norms, due to the inefficient management on managing the liquid assets. The high liquid assets are due to the high flow of the deposits and unable to identify the investment sectors. Among the deposit, the bank is unable to provide loan and advance amount highly. The bank is adopting very tight credit policy and also considers about debt financing generating more returns as the analysis suggests".

The study perused by D.R. Shakya entitled "A comparative study of the financial performance of NABIL and NIBL, has specified the objectives as to analysis and interpreter the liquidity, profitability, capital structure, activity and capital adequacy trend with NABIL and NGBL. He finds the NABIL performance comparatively more successful regarding deposit utilization activity ratio. The capital structure position is better and capital structure ratio is in increasing trend of the NABIL whereas, the liquidity and profitability of NGBL are a comparatively better than that of NABIL".

Mr. Depak Joshi in his study. "A study on commercial bank of Nepal with special reference to financial analysis of Rastra Banijaya Bank" finds that the bank was efficient in managing the proper amount of liquidity. He again indicates that there is gradual increment in the amount of funded debt capital structure to be highly graded but return on assets was not satisfactory. He lastly suggests that the bank should identify and invest in productive sectors".

In another thesis study entitled "A study on financial performance of commercial banks". Mr. Kesab Raj Joshi remarks that the liquidity positions of the commercial banks are satisfactory. Local

commercial banks have been founded relatively leveraged compared to other JVBs. The profitability condition of the NABIL is more than that of other JVBs.

Highlighting the growth, objectives, functions and role of commercial banks, Jha, R in the thesis study entitled "A comparative study of the financial performance of NIBL and NGBL, has examined the strength and weakness of the JVBs of Nepal. According to his study NIBL has better results in case of the profitability except on net worth and also has the better performance in liquidity, deposit and capital adequacy position as compared to HBL, NABIL and NGBL. NGBL holds highest rank regarding to the performing assets ratio and other indicators like dividend payout ratio, earning per shares and book value per share. Each of the sampled banks is extremely livered though NABIL & NIBL had relatively low. Loan and advances and total deposits have been increasing rapidly in NABIL than other sampled banks.

Under the thesis study entitled, "A comparative study of financial performance of NABIL and NGBL, Kishi, B.P. focuses on the performance of the sampled bank and tries to evaluate the role of JVBs in Nepal. He concludes that the NABIL is more successful in a identifying the investment sectors and utilization of the balance sheet assets than NGBL. NABIL bank is performing better than NGBL in the case liquidation position, profitability position, and capital adequacy position than other sampled bank. But NGBL is more coverage".

Lamsal, Rajendra, in the thesis study entitled "A comparative financial statement analysis of HBL and NGBL considers the examination of the performance of HBL and HGBL with regard of their liquidity and profitability position as the objectives of the study. He finds the NGBL is better in terms of profitability, capital adequacy, DPS and EPS but HBL is more successful in liquidity position with higher rate of deposit utilization and higher capital structure regarding long term financing.

In the next study entitled. "A comparative analysis of financial performance of JVBs in Nepal: NABIL and Grindlays, the researcher named Paudel, Nagendra, tested various financial ratios and compared the same type of ratios between the sampled bank. From his study, he has concluded that

the capital structure is highly levered efficiency in utilizing the resource is regarded satisfactory on the basis of activity ratios and profitability ratios show that the both of these banks been unable to earn satisfactory profits. Comparatively, NABIL has maintained higher liquidity position and higher leverage So, NABIL is slightly better in terms of these measures.

Concentrating on the comparative strength and weakness and their ability through the analysis of liquidity position, Sangita Shakya in her study comparative analysis of financial performance of selected JVBs: A case study of NGBL and HBL, finds that the HBL is more efficient in case of liquidity position and leverage position than NGBL. Whereas, GBL is in better condition from the aspect of capital adequacy, activity and profitability ratios in the loan and advance to total debt of the both banks, there is the positive correlation. HBL has no effective earnings than that of NGBL.

Lekhanath Ghimire performed his research study on "A comparative study of financial performance of HGL and Nepal SBI Bank Ltd", analyses and interprets the financial performance of the sampled bank. The study summarizes that the overall liquidity, earnings and growth position of HBL is better than that of Nepal SBI Bank Ltd. But in case of capital adequacy, assets quality, turnover position is not so satisfactory than that of NSBIBL. Both banks have increasing trend in income and operating expenses.

The next study entitled, "A comparative study of financial performance of NSBIBL and EBL" conducted by Adhikari, S., is focused on the financial performance of two JVBs. In the study researcher sets up the null hypothesis as: There is no significant difference between the financial performance of EBL and NSBI Bank Ltd. Under the finding Mr. Adhikari states that EBL is found superior regarding the liquidity, quality assets they possessed and capital adequacy. Overall capital structure of NSBIBL appears more levered than that of EBL. NSBIBL is found superior in terms of profitability and turnover. Comparatively, interest remained more dominant in total income and expenses of NSBIBL than EBL. Under the 5% significant level, the test of hypothesis in the performance of the sampled banks is resulted the significant difference with respect to the ratios like loan and advance to saving deposits, loan loss provision to total deposits, interest earned to total assets and tax per share.

CHAPTER – III
RESEARCH MATHODOLOGY

A Research Methodology refers to the various sequential steps that are adopted by a researcher during the study period of the specific problem with certain view. It is systematic and scientific way of solving the research problem. Research study made is not meaningful and never gives the solution of the particular problem, if the study is made without any order. Research methodology is the need of the research study to understand the analysis and search done. So, the research methodology is the systematic analytical steps to conduct the research study. For the purpose, at analyzing and interpreting the financial soundness of EBL, the study focuses and deals with the following aspects of methodology.

* Research Design
* Population and Sampling
* Sources of Data
* Data Collection Procedure
* Data Processing
* Methods of Data Analysis

3.1 Research Design

Research design is the art of designing the procedure of study that the researcher is going to conduct. In the words of Chaire Selliz and others (1962), "A research design is the arrangement of conditions, for collecting and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. But in general, it is the conceptual structure within in which the research is conducted. It is simply the track of research procedure that includes the framework or plan for the collection and analysis of data research design guides the process of the whole study.

In the context of the study, this study is to evaluate the financial soundness of the joint venture Bank especially that of Everest Bank Limited. For the purpose, the analytical and descriptive types of research design are adopted. This study focuses on the examination of relationship between those

variable that play the vital role on making the financial decisions, under the CAELS system, of the sampled bank.

3.2 Population and Sampling

This study is related with the financial performance and its soundness of the joint venture Bank. So, the population for this study comprises six joint venture banks, which are currently operating in Nepal. Each of the commercial banks is operating under the same rules; regulations and directives issued by the Nepal Rastra Bank and each bank perform the activities of commercial banks. As the number base, the study sample consists of the Everest Bank Limited. This limit represents the 16.67% of total population. But basing on the study period, the study sample represents the 50% of the total population because the duration of the operation of the sampled bank is ten years and study is made of five years' operational performance.

3.3 Sources of Data

Primary Data: This study is primarily based on the secondary source of data. However, the necessary suggestions, ideas, materials related with the study are collected from the primary sources whenever needed. These primary sources are various experts both inside and outside the bank.

Secondary Data: Accordingly the nature of the study, the necessary data are obtained from the head office of the sampled bank and some are from the Nepal Rastra Bank, head office. Published balance sheet, profit and loss account and other supplementary statements and account as well as the annual reports of each sampled years are collected from the head office of the sampled bank. Similarly, the prudential requirements for the commercial banks issued by NRB, are collected from the NRB. The prudential requirements include the rules and regulations that the commercial banks should comply. These requirements include Directives, Bank and Financial Institution Ordinance 2061, Nepal Rastra Bank Act 2058, Inspection and Supervision By-Law 2059, On-site Inspection Manuals (for commercial banks and finance companies), Off-site Supervision Manual. These two sources are the major source of data collection. Likewise, other related and necessary information are also obtained from the Publication of Nepal Stock Exchange, Nepal Rastra Bank and other publications used for the purpose are books & booklets, journals magazine, newspaper, reports, dissertations, websites. Beside these some relevant data are collected from the primary sources through the direct interview

with the experts relating to the commercial banks. Some of these experts are from the Nepal Rastra Bank, some are of sampled bank and some are independent banking experts. Some informations from the students of banking and some account holders are also collected. But all of the primary data are collected from the direct interview due to time limitation.

3.4 Data Collection Procedure

The study has been conducted to evaluate the soundness of the financial performance of the sampled bank. For this purpose, with the view of obtaining and collecting the required data several visits of the sampled bank and the central bank are made In the initial visit with the concerned authority of the sampled bank, objective of the study was explained. In the same visit, it was cleared that why the study was going to conduct and interest of the researcher in the bank and his aim to analyze. Each of the subject matters of the study of the bank that are explained with the concerned authorities made the authorities convince. They suggested the researcher to contact different department and assured that they would help as for as possible.

In the following visits each of the required materials were provided, from the share department of the bank. For the some materials that were unavailable in the department the authority of the department advised the researcher to visit and request in the concern departments. The authority of these departments provided the data as possible as they could. During the visit period, the researcher assured that the materials collected would not use for other than the study and would not affect the privacy and secrecy of the bank. At the same period several visits were made on the NRB. In the first visit the concerned officials suggested the researcher to use the proper tools and standards norms for analyzing and evaluating the financial soundness of the commercial banks. On the following frequent visits, they provided me the evaluation tools, standards norm of performance, directives, inspection and supervision manual, several publications etc.

Some visits were made on the sampled bank and a visit in the central bank was made. With the increasing number of the visitors, the concerned authority could not afford more time to the researcher. But they managed time for the researcher and hence, the researcher got the information through the direct interview with them during the period, some visits were made in the branch of the

sampled bank to collect the primary data from the depositors and other stakeholders. But these visits were made whenever there was the necessity.

A last visit was made in Nepal Rastra Bank for the direct interview of the concerned authority of the inspection and supervision visit. During the interview, the official provided several information and suggested to maintain the quality of the study.

Several references visits were made in college's library and Nepal Rastra Bank and several materials were collected from those libraries which helped the researcher to track the study.

3.5 Data Processing

None of the data can be directly used in their original state. The data obtained from the various sources are in the raw form. They need to be verified and simplified for purpose of analysis. Data, information, figures and facts so obtained need to edited and tabulated for the computation. For the simplification, according to the nature of the data, they are carried for the meaningful tables within the analysis and interpretation section. But their corresponding tables with the detail information are presented in the annexes. The tables presented in the study are not presented in their original format. For the simplicity they are presented in the required form.

3.6 Method of data Analysis

Data analysis is the uses of the various tools to show the relationship between the data. The suitable tools and proper analysis, interpretation makes the data effective. The study includes the analysis of the financial statements and other supportive statements. Thus, the analysis of the study is made under the financial tools. But these financial tools are strongly under the CAELS system, the off-site supervision tools. There is the brief discussion of the tools under the CAELS system, which are used to analyze and interpret the financial soundness of the sampled bank i.e. Everest Bank Limited.

CAELS is the composite of the five components which play the vital role on the performance of the banks. These five components are Capital Adequacy, Assets Quality, Earning Capability Liquidity

Position and Sensitivity to Market. Each components contains different ratio with the respective standard. Thus, the ratios under each components are as follows.

3.6.1 Capital Adequacy

This is the section where the adequacy of the capital requirements is measured. Ratios under this section measures whether the firm has maintained the adequate capital fund or not. If helps to decide whether the existing capital is adequate or there is the need of capital reform.

Capital adequacy section evaluates whether the bank is operating with adequate capital funds in relation to its size of operation the risks assumed as well as the bank's compliance with regulatory requirements or not. In brief, this section evaluation the degree of firm's capital adequacy limits and compares with the prudential requirements. The section includes:

3.6.1.1 Risk-Based Capital Ratio

Risk-based capital ratio is calculated by dividing the capital by risk weighted assets. The Nepal Rastra Bank divides risk-based capital system divides capital into two tiers,-core or equity capital and supplemental capital. For the study purpose the ratio is divided into two ratios:

(a) Core Capital to Total Risk Weighted Asstes $X \frac{\text{Core Capital}}{\text{Total Risk Weighted Assets}}$

(b) Total Capital to Risk Total Weighted Assets $X \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}}$

These both ratios evaluates the level of the capital funds i.e. core capital level and total capital fund level and compared with the minimum capital adequacy requirements according to the direction of Nepal Rastra Bank .The total capital funds is total of core capital and supplemental capital and the risk weighted assets is the total of the risk weighted assets of on balance sheet items and off balance sheet item.

3.6.1.2 Proposed Dividend to after Tax Income

The ratio is calculated by dividing the proposed dividend to after tax income.

$$\text{Proposed Dividend to after Tax Income } X \frac{\text{Proposed Dividend}}{\text{After Tax Income}}$$

The rate of retention is directly related to increasing capital though high retention is not necessary. The retention rate must be analyzed relative to the growth rate. The dividend payout ratio is directly relative to the retention rate and firm's growth rate. So, it is very necessary to analyze the dividend rate. The ratio indicates the dividend percentage on total after tax income. The comparison of the dividend payout is made with the standard norms to check whether the dividend payout ratio is within the norms or not.

3.6.1.3 Growth Rate of Capital

The ratio is determined by subtracting the balance as of the prior year from the current year balance and dividing the result by the prior year's balance.

$$\text{Growth Rate of Capital } X \frac{\text{Current Year's Balance - Prior Year's Balance}}{\text{Prior Year's Balance}}$$

This ratio determines the growth rate of capital with the comparative growth rate of assets. There should be capital adjustment with respect to the asset growth rate. So there should be the equal pace of growth rate of capital and assets. This ratios measures the degree of safety of depositors.

3.6.1.4 Growth Rate of Assets

The ratio is determined by subtracting the balance as of the prior year from the current year's balance and dividing the result by the prior year's balance.

$$\text{Growth Rate of Assets } X \frac{\text{Current Year's Balance - Prior Year's Balance}}{\text{Prior Year's Balance}}$$

The asset side of the balance sheet represents the primary risk faced by the bank and the loans are the highest risk carrying factors. The ratio measures the growth rate of assets. The growth rate should be within the acceptable range. No the higher rate and no growth is accepted. There are no any standard norms of the assets growth rate. But there should be identification of the change in the percentage change in the risk rated assets and less risk rated assets. Because equal and opposite change in the

100% risk rated assets and 0% risk rated assets result zero percent growth on assets but change on risky assets. This ratio is further used to compare the growth rate of capital.

3.6.2 Asset Quality

Asset Quality reflects the quality of existing and potential Credit risk associated with the loan and investment portfolios other assets as well as the off-balance sheet transactions. The ratios under this section evaluate the market value of assets, particularly the loan portfolio with the ability of management to identify measure, monitor and control the credit risk. The evaluation of assets quality mostly considers the adequacy of general and specific provisioning for loan losses. During the evaluation of the assets quality, there should be the consideration of several factors such as adequacy of general loan loss provisioning, specific provisioning and other assets valuation reserves, diversification and quality of loan and investment portfolio, degree of concentration of loans and investments, the ability of management to properly administer its assets, including the timely identification and collection of problem assets, the adequacy of internal controls and management information system, level of non performing assets etc.

The ratio value above the average indicates the strong quality assets and Credit administration practices, good capital protection and management ability. But the ratio value below the average indicates the poor credit practices, higher level of sensible assets risk and assets problem, inadequacy and need of improvement.

The most important factors that are used on analyzing the asset quality is classified loan. According to the directive issued by NRB with the required provisioning, the loan is divided into four sections as:

Pass loan, performing loans, which is at most 90 days past due and requires 1% provisioning of total balance outstanding; Sub-standard loan, non-performing assets, which is at least 90 days to at most 180 days past due loans and requires provisioning of 25% of total balance outstanding; doubtful loan, non-performing assets, which is at least 180 days to at most 1 year past due loans and requires the provisioning of 50% of total balance outstanding: non-performing assets, which is due from 1 year and requires 100% provisioning of total balance outstanding.

The ratios under this section are

3.6.2.1 Non-Performing Assets to Total Capital

The ratio is calculated by dividing the Non-performing Assets by total capital.

$$\text{Non - Performing Assets to Total Capital X} \frac{\text{Non - performing Assets}}{\text{Total Capital}}$$

This ratio reflects the threat to capital from the low quality asset and includes assets classified sub-standard, doubtful and loss. This ratio evaluates the soundness of credit administration practices, degree of risk identification, diversification of loan, adequacy of the credit policy, degree of internal control system etc. The most limit of the ratio is 5% the weakness of the management. Note that non-performing asset is sum of substandard, doubtful and loss assets.

3.6.2.2 Non-Performing Assets to Total Assets

The ratio is calculated by dividing the non-performing assets by total assets.

$$\text{Non - Performing Assets to total Assets X} \frac{\text{Non - Permorning Assets}}{\text{Total Assets}}$$

This ratio measures the proportion of the non-performing assets on total asset. This ratios evaluates the degree of management to control the loan loss as well as degree of management to identify the risk less investment sectors. The low value of ratio less than 5% indicates the strong position and greater than 30% indicates the very unsatisfactory position.

3.6.2.3 Classified Investment to Total Capital

The ratio is calculated by dividing the classified investment by total capital.

$$\text{Classified Investments to Total Capital X} \frac{\text{Total Investments}}{\text{Total Capital}}$$

This ratio evaluates the investment proportion on total capital. This ratio indicates the degree of the management to identify, the risk less investment sector, control system portfolio management etc. The same comments as in the non-performing assets to the capital can be made for this ratio.

3.6.2.4 Recoveries to Total Capital

The ratio is calculated by dividing the recoveries amount by total capital

$$\text{Recoveries to Total Capital X} \frac{\text{Recoveries}}{\text{Total Capital}}$$

This ratio indicates the proportion of the loss provision amount written back on total capital. The higher amount of recoveries results high value of ratio that indicates the effective management ability and effort in collecting the loans previously classified as bad and vice versa. The recoveries also include the restructuring and rescheduling of with interest amount.

3.6.2.5 Loan Classified Loss to Earning Assets.

The ratio is calculated by dividing the loss loan by earning assets.

$$\text{Loans Classified Loss to Earning Assets X} \frac{\text{Loss Loan}}{\text{Earning Assets}}$$

This ratio examines the proportion of the poor assets among the earning assets or the proportion of unacceptable poor assets among the earning assets. The higher value of the ratio indicates the inefficient management, an unacceptable level of poor assets or could indicate aggressively classifying assets as bad. The acceptable range of the ratio is 2% to 4%. Here the earning is total assets except non-earning assets like cash, fixed assets etc.

3.6.2.6 Provisioning for Loan Classified

3.6.2.6.1 Provisioning for Pass Loan to Pass Loan

The ratio is calculated by dividing the pass loan provisioning to pass loan.

$$\text{Provisioning for Pass Loan To Pass Loan X} \frac{\text{Provisioning for Pass Loan}}{\text{Total Pass Loan}}$$

The ratio indicates the percentage of the provisioning regarding to the pass loan. As the prudential requirement of NRB, commercial banks should maintain the certain percentage of provision. The pass loan required 1% of provision, at least, for the strong performance.

3.6.2.6.2 Provisioning for Substandard to Substandard Loan

The ratio is calculated by dividing provisioning of substandard loan to substandard loan.

$$\text{Provisioning for Substandard to Substandard Loan X} \frac{\text{Provisioning for Substandard}}{\text{Substandard Loan}}$$

This ratio indicates the percentage of the substandard provisioning to total substandard loan. The management willingness to obey the requirements issued by the NRB can be evaluated through this ratio analysis. The range of ratio at 25% indicates the strong performance and ratio at most 10% is the very unsatisfactory performance. If the ratio is below of the 25% the management is not performing to protect the deposition interest.

3.6.2.6.3 Provisioning for Doubtful Loan Doubtful Loan

The ratio is calculated by dividing provisioning for doubtful loan by the total doubtful loan

$$\text{Provisioning for Doubtful Loan to Doubtful Loan X} \frac{\text{Provision of Doubtful Loan}}{\text{Doubtful Loan}}$$

The ratio measures the level of the doubtful loan provisioning on total loan. Each of the commercial banks is required to maintain the minimum level of provision on the doubtful loan. The banks should maintain at least 50% provision of the total doubtful loan for the strong or sound performance.

3.6.2.6.3 Provisioning for Loss to Loan Loss

The ratio is calculated by dividing the loss provision by total loan loss.

$$\text{Provisioning for Loss to Loan Loss X} \frac{\text{Provisioning for Loss}}{\text{Loan Loss}}$$

As other ratio, this ratio also measures the percentage of the provision amount on the loss amount. As the prudential requirements, the bank should maintained 100% provisioning to protect the depositors'

deposits. The value greater than or equal to 100% indicates the strong or sound performance of the bank on loss provision.

3.6.2.7 Growth Rate of Loans

The ratio is calculated by subtracting the prior year's loan balance from the current year's balance and dividing the results by the prior year's balance

$$\text{Growth Rate of Loans } X \frac{\text{Current Year's Balance - Prior Year's Balance}}{\text{Prior Year's Balance}}$$

This ratio indicates the increment rate of loan. The higher value of the ratio indicates the management efficiency to identify the investing sector but during the analysis period the quality of the loans should be considered. There are no standard norms for the loan growth rate but should be compared with trend or previous year's performance.

3.6.3 Earnings Capability

Earning Capability measures the bank's profit level. As the basic requirement, each of the financial institution should earn to survive and grow. This section assesses the current and future earnings capability and efficiency of the bank basing in the existing assets and liability structure. The profitability ratios are calculated to measure the operating efficiency of the bank. Each of the stockholders of the bank, management, creditor, owner etc is interested on the profitability ratios of the firm, trends of the earning, level of earning etc.

The ratio under the section, reflect not only the quantity and trend of earning but also factors that may affects the sustainability or quality of earning. The inadequacy management on credit supply affects the quantity and quality of earnings because the interest on loan and advance is the major source of income of the commercial banks. Further the earnings may be adversely affected by an inability to forecast and operating expenses, poorly executed strategies or badly managed or uncontrolled exposure to other risks.

During the period of evaluating profitability ratios, some factors such as level of earning including trends and stability, ability to contribute to adequate capital through retained earnings quality and

sources of earnings, forecasting processes and management information system relating to the earnings, adequacy of general loan loss provisioning, earnings through the market risk etc. should be considered. The sting performance of the ratio indicates the excellent management of practices to forecast evaluates and invest in the project with quality and quantity growth in the return. Similarly the poor performance may lead to chronic losses

The section includes the following ratios

3.6.3.1 Earning Assets to Total Assets

The ratio is calculated by dividing the earning assets by the total assets

$$\text{Earning Assets to Total Assets X} \frac{\text{Earning Assets}}{\text{Total Assets}}$$

This ratio determines the portion of assets that earn. Interest is the major earning of the Commercial Banks. Some earns other than interest. Non-all assets earn. Some are non-earning assets. Management should be efficient to control the non-earning assets such as cash, fixed assets etc. Therefore this ratio cannot be 100%. The management should try to maintain the maximum level of the earning assets to earning more. No standard norm is developed. During the analysis, the trend should be in increasing trend. But also there should be 75% earning assets in an average.

3.6.3.2 Interest Income to Total Assets

The ratio is calculated by dividing the interest income by total assets.

$$\text{Interest Income to Total Assets X} \frac{\text{Interest Income}}{\text{Total Assets}}$$

This ratio determines the average rate of interest return on the assets. Interest income, as the major source of income, is the income of each of the assets. This ratio evaluates the average performance the total or gross interest income should be in between the 70% to 80% of total income. So the ratio should be 70% to 80% of return on assets. Higher value is desirable.

3.6.3.3 Interest Expenses to Total Assets

The ratio is calculated by dividing the interest income by total assets.

$$\text{Interest Expenses to Total Assets X} \frac{\text{Interest Expenses}}{\text{Total Assets}}$$

Interest expenses are the major expenses. All assets are not earning assets and no all assets are paid. So this ratio evaluates the average level of expenses as the interest that the bank has to pay. Higher ratio indicates the management in efficiency, unable to control interest expenses. So, the lower value is desirable.

3.6.3.4 Net Interest Margin

Net interest margin is calculated as the difference between interest Income and interest expenses and the ratio can be shown as:

$$\text{Net Interest Margin X} \frac{\text{Interest Income - Interest Expenses}}{\text{Total Assets}}$$

This ratio evaluates the net earnings of interest by the total assets. Most of the portion of interest earnings is paid as the interest expenses. So the remaining portion of the interest earning is available for the bank. The higher value indicates the management efficiency. The limit of the ratio should be 5% maximum.

3.6.3.5 Non- Interest Income to Total Assets

The ratio is calculated by dividing non interest by total assets.

$$\text{Non - Interest Income to Total Assets X} \frac{\text{Non - Interest Income}}{\text{Total Assets}}$$

This ratio evaluates the capacity of earning of assets other than interest income. Moderated value of the ratio is acceptable because there is the small non-interest income; there is the low potential of earning and low impact of profit or loss.

3.6.3.6 Non-Interest Expenses to Total Assets

The ratio is calculated by dividing the non interest of expenses by total assets.

$$\text{Non - Interest Expenses to Total Assets X} \frac{\text{Non - Interest Expenses}}{\text{Total Assets}}$$

Interest expenses are the major cost of operation of the bank. No the higher value of the non-interest expenses is acceptable. This expense includes the office expenses and staff expenses in major. So there should be the less value of the ratio.

3.6.7 Return on Assets

The ratio is calculated by dividing the net income after tax by total assets.

$$\text{Return on Assets X} \frac{\text{Net Income after Tax}}{\text{Total Assets}}$$

Net profit represents the profit after the deduction of the tax and before deducting the preference dividend. Total assets are the total value of assets side of balance sheet. It measures the bank efficiency in the utilization of the overall assets. Higher value indicates the management success in overall operation and lower value indicates inefficient operation of the bank.

3.6.3.8 Total Operating Expenses to Total Operating Income

The ratio is calculated by dividing the total operating expenses by total operating income.

$$\text{Total Operating Expenses to Total Operating Income X} \frac{\text{Total Operating Expenses}}{\text{Total Operating Income}}$$

The major portion of the operating income is paid as the operating expenses. The higher value indicates the management inefficiency to control the expenses of operation. Operating income and expenses includes all of the earnings and expenses respectively of the bank operation. There should not be more than 100% ratio value and less than 85% indicates the strong performance.

3.6.3.9 Total Operating Income to Total assets

The ratio is calculated by dividing total operating income to total assets.

$$\text{Total Operating Income to Total Assets } X \frac{\text{Total Operating Income}}{\text{Total Assets}}$$

The ratio determines the efficiency of total assets utilization during the bank operation or the asset utilization except in non-operational activities.

The minimum level of the ratio is 6% but considered as very unsatisfactory performance. So there should be greater than 13% performance.

3.6.3.10 Total Operating Expenses to Total Assets

The ratio is calculated by dividing the total operating expenses to total assets.

$$\text{Total Operating Expenses to Total Assets } X \frac{\text{Total Operating Expenses}}{\text{Total Assets}}$$

It is not accepted the higher value of the ratio because if the total operation expenses is high it creates greater impact in the income position. So there should be 13% of total operational expenses at most. But 9% indicated the strong and usual performance.

3.6.3.11 Net Operating Income to Total Assets

The ratio is calculated by dividing the difference between total operating income and total-operating expenses by total assets

$$\text{Net Operating Income to Total Assets } X \frac{\text{Total - Operating Income - Total - Operating Expenses}}{\text{Total Assets}}$$ This ratio measures the net performance of non-operational activities of the assets. The higher value is more desirable because it shows the efficient management practices.

3.6.3.12 Staff Expenses to Total Expenses

The ratio is calculated by dividing the Staff Expenses by total Expenses.

$$\text{Staff Expenses to Total Expenses } X \frac{\text{Staff Expenses}}{\text{Total Expenses}}$$

A staff expense is one of the major parts of non-interest expenses. Staffs are the major players of any institution. But the higher value of ratio indicates management inefficiency because most of the total expenses are covered by the interest and other operating expenses other than staff expenses. There should be 8% of total expenses for strong performance.

3.6.3.13 Total Assets to Full Time Employee

The ratio is calculated by dividing the total assets by the full time employee.

$$\text{Total Assets to Full Time Employee} \, X \frac{\text{Total Assets}}{\text{Full Time Employee}}$$

This ratio evaluates the personnel performance. Higher value indicates the efficiency of the operation or the higher the amount of assets per employee, the more efficient the operations.

3.6.4 Liquidity Position

Liquidity position evaluates the liquidity in the light of its existing assets and liability mix and in relation to the legal requirement. An institution is in better liquidity position when it has the ability to obtain sufficient funds in timely manner at a reasonable cost. But in liquidity problem when it needs to rely upon prohibitively high cost of funds or sales of assets, in order to unforeseen cash needs.

Liquidity ratios are used to judge the firm's ability to meet short-term obligation. The ratios under this section give insights into the present cash solvency of the bank and its ability to remain solvent in the event adversities. Traditionally, liquidity is the comparison between the liquid assets and liquid liabilities or the short term obligation and resources to meet those obligations. The result will be adverse if there are the poor management practices on the liquidity management. Thus, in evaluating the adequacy of the bank's liquidity position, there should be consideration of its capacity to promptly meet the demands for payments on its obligations and to readily fulfill the credit needs of the community it serves. Similarly, the consideration should be given to the overall effectiveness of bank's assets/liabilities strategies and compliance with adequacy of established liquidity policies. Beside these, the capability of management to properly identify, measure, monitor, and control the

bank's liquidity position including effectiveness of funds management strategies, management information system etc should be considered. This section includes the following ratios.

3.6.4.1 Current Ratio

This ratio indicates the current short term solvency position of the bank. It is the relationship between the current assets and current liability. It is calculated by dividing the current assets by current liabilities. It is calculated the dividing the current assets by current liabilities.

$$\text{Current Ratio X} \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

This ratio determines or evaluates the degree of meeting the short term obligation of the bank. Higher value of ratio is desirable but extremely high value of the ratio indicates the management inefficiency to maintain the proper current assets. High amount currents do not earns. So, there should be the ratio of 2:1 as the satisfactory measure.

3.6.4.2 Overnight Borrowing to Total Liabilities

The ratio is calculated by dividing the call money by the total liabilities.

$$\text{Overnight Borrowing to Total Liabilities X} \frac{\text{Call Money}}{\text{Total Liabilities}}$$

Call money is the money borrowed in the inter-bank market. The ratio indicates the percentage of the call money on the total liabilities. The higher value of ratio indicates the liquidity problem on the bank because this form of money is borrowed usually for the daily liquidity purpose. So, the higher frequency is the best to minimize the cost with the fulfillment of short term obligations.

3.6.4.3 Loan to Deposit

The ratio is calculated by dividing the loan by deposit

$$\text{Loans to Deposit X} \frac{\text{Loans}}{\text{Deposit}}$$

The ratio indicates the degree to which a bank is using its to fund its loan. The higher value of the ratio is desirable. The ratio should not exceed 100%. But due to the non- interest bearing type deposit

in the total deposit that should be paid on demand. The ratio should be 40-60% for the strong performance.

3.6.4.4 Growth Rate of Deposit

Subtracting the prior year's amount form current year's amount and dividing the result by the prior year's amount calculate the ratio.

$$\text{Growth Rate opf Deposit X} \frac{\text{Current Year Amount - Prior Year Amount}}{\text{Prior Year Amount}}$$

This ratio evaluates he trend of the deposit growth. So, there should be the increasing trend of deposit and should match or exceed the growth rate of loan. For the liquidity purpose, the increasing the amount deposit than that of loan can meet the obligations regarding to the liabilities.

3.6.4.5 Liabilities Maturing 1-90 days to Assets Maturing 1-90 days

This ratio is determined by dividing the liabilities maturing 1-90 days by assets maturing 1-90 days.

$$\text{Ratio X} \frac{\text{Liabilities Maturing 1-90 days}}{\text{Assets Maturing 1-90 days}}$$

This ratio evaluates the firm performance on the assets/liabilities mismatches, maturing 1-90 days. The significant mismatches exist could adversely affects the liquidity position. The standard ratio should be 1. The ratio higher than 1 indicates high liabilities amount than that of assets amount, which doesn't show the efficient management.

3.6.4.6 Liabilities Maturing 91-180 days to Assets Maturing 91-180 days

This ratio is calculated by dividing the liabilities maturing 91-180 days to Assets Maturing 91-180 days.

$$\text{Ratio X} \frac{\text{Liabilities Maturing 91-180 days}}{\text{Assets Maturing 91-180 days}}$$

This ratio evaluates the bank efficiency on the bank efficiency on managing the assets/liabilities mismatches maturing 91-180 days. The ratio of 1 would be ideal. The significant mismatches will

affect the liquidity position. The mismatches greater than 1 indicates higher amount of liabilities and less than 1 indicates higher amount of assets maturing 91-180 days which shows the management inefficiency.

3.6.4.7 Liabilities Maturing 181-270 days to Assets Maturing 191-270 days

The ratio is calculated by dividing the liabilities maturing 181-270 days by the assets maturing 181-270 days.

$$\text{Ratio X} \frac{\text{Liabilities Maturing 181 - 270 days}}{\text{Assets Maturing 181 - 270 days}}$$

Similar to the above last two ratios this ratio also measures the degree of the assets/liabilities maturing 181-270 days. Same as those ratio 1 would be ideal.

3.6.4.8 Liabilities Maturing 271-365 days to Assets Maturing 271-365 days

The ratio is calculated by dividing the liabilities maturing 271-365 days by assets maturing 271-365 days.

$$\text{Ratio X} \frac{\text{Liabilities Maturing 271 - 365 days}}{\text{Assets Maturing 271 - 365 days}}$$

Similar to the above last three ratios, this ratios also measures the degree of assets/liabilities mismatches maturing 371-365 days. Ratio 1 would be ideal. Ratios other than 1 would indicate assets/liabilities mismatches and affects the liquidity position adversely.

3.6.5. Sensitivity to Market

Sensitivity position defines the bank's ability to monitor and manage the exposure to risk. The ratios under this section reflect the degree to which the changes in interest rate, foreign exchange rates etc. can adversely affect the bank's earning and capital. During the evaluation several factors should be considered such as management ability to identify, measure and control market risk, as well as it capital and earnings in relation to its level market risk exposure, amount of market risk arising from trading and foreign exchange position etc. The following are the concepts under this section.

3.6.5.1 Interest Rate Risk

This risk measures the degree of the risk due to the interest rate. This risk is analyzed under the rate sensitive liabilities (RSL) and rate sensitive assets (RSA) on their respective maturing period. The ratios under this section are:

3.6.5.1.1 RSL Maturing 1-90 days to RSA Maturing 1-90 days

The ratio is calculated by dividing the RSL maturing 1-90 days by RSA maturing 1-90 days.

$$\text{Ratio X} \frac{\text{RSL Maturing 1-90 days}}{\text{RSA Maturing 1-90 days}}$$

The ratio measures the degree of the rate sensitivity of assets and liabilities. Ratio of 1 indicates the balance position of sensitivity 1 indicates the assets sensitive maturing 1-90 days.

3.6.5.1.2 RSL Maturing 91-180 days to RSA Maturing 91-180 days

The ratio is calculated by dividing RSL maturing 91-180 days by RSA maturing 91-180 days.

$$\text{Ratio X} \frac{\text{RSLMaturing 91-180 days}}{\text{RSA Maturing 91-180 days}}$$

This ratio measures the degree of rate sensitive assets and liabilities maturing 91-180 days. Ratio of 1 is balance position. Ratio more than 1 indicates sensitive liabilities and less than 1 indicates sensitive assets maturing 91-180 days.

3.6.5.1.3 RSL Maturing 181-270 days to RSA Maturing 181-270 days

The ratio is calculated by dividing the RSL maturing 181-270 days by RSA maturing 181-270 days.

$$\text{Ratio X} \frac{\text{RSLMaturing 181-270 days}}{\text{RSA Maturing 181-270 days}}$$

The ratio measures the degree of rate sensitive of assets and liabilities maturing 181-27- days. Ratio of 1 indicates the balance position. Ratio more than 1 indicates liabilities sensitive and less than 1 is assets sensitive maturing 1810-270 days.

3.6.5.1.4 RSL Maturing 271-365 days to RSA Maturing 271-365 days

The ratio is calculated by dividing the RSL maturing 271-365 days by RSA maturing 271-365 days.

$$\text{Ratio X} \frac{\text{RSLMaturing } 271-365 \text{ days}}{\text{RSA Maturing } 271-365 \text{ days}}$$

The ratio evaluates the degree of rate sensitive of assets and liabilities maturing 271-365 days. Ratio 1 is balance position ratios more than 1 indicates the sensitive liabilities and less than 1 indicates the sensitive assets maturing 271-365 days.

3.6.5.2 Foreign Exchange Risk

This is the risk that arises from transaction of foreign exchanges. To measure this risk, the following ratio is used.

3.6.5.2.1 Net Foreign Exchange Position to Total Capital

The ratio is determined by dividing the net foreign exchange position by total capital.

$$\text{Ratio X} \frac{\text{Net Foreign Exchange Position}}{\text{Total Capital}}$$

Net foreign exchange position is non equivalent position of assets and liabilities sides relating to the foreign exchange. The risk will arise in the foreign currency transaction because there are the high chances of being change in exchange rate. The net position may be either negative or positive. These both condition may results the risk on foreign exchange. The maximum limit of the net foreign exchange position on total capital is 30%. But less than 15% of the value is the strong or sound performance.

3.6 Limitation of Financial Analysis

Though the financial analysis is the best way of evaluating the financial performance, it has some limitations some of them are:

a) Analysis of the Historical Financial Statements

Basic impact of the financial analysis is the past financial statements. Past can not correctly predict the future and future planning.

b) Inflexibility in Substitution of Judgment

Basically, the tools under the CAELS system are specially designed to evaluate the rank of the commercial bank's performance under the off-site supervision. So, no more flexibility can be created for the purpose.

c) Reliability of the Figures

The reliability of analysis depends upon the reliability of the figures of the financial statements. Some times the entire working of analysis will be less valuable due to the manipulation in the financial statement.

d) Different Interpretation

Some time the tools under the system can not be interpreted easily due to the standard fixed by the authorized institutions.

CHAPTER – IV
PRESENTATION AND ANALYSIS OF DATA

4.1 Introduction

This chapter deals with the analysis and interpretation of the data for the purpose to change the unprocessed form of data to an understandable presentation. Analyzing the data indicates the organization, tabulation, performing relevant financial analysis of the data gathered from the various sources. A number of tables, charts are prepared and most of them are presented during the analysis of relevant data and some other relevant tables are presented in the annexes. The financial analysis is made after collecting the raw data from the various sources. The result of the analysis has been interpreted under the rationality of the ratio analysis, prudential requirements issued by the NRB for the commercial banks, offsite supervision manual, on-site inspection manual and other factors regarding to the tools used. Financial performance analysis enables the various facts relating to the past performance of the financial institution and predict about the future potentials for achieving expected results. The financial status of the sampled bank is analyzed in the cross-sectional manner, especially under the CAELS norms of off-site supervision of the commercial banks. The CAELS is the tools of measuring the off-site rating of the commercials banks and off-site financial analysis is based on collecting, reviewing and analyzing prudential reports and statistical returns from financial institution. These include the basic financial statements as well as supporting schedules. So this study is also based on the some basic financial statements analysis and some supportive schedules analysis of the Everest Bank Ltd.

Financial status analysis is the art of interpreting financial statements and other numerical data. The primary and mostly used tools are financial ratios regarding to the CAELS system and other comparison. Especially the chapter includes the analysis and interpretation of the ratios under the CAELS system. Early known that the CAELS includes the five components and each component contains several financial, ratios to measure the financial position of the commercial banks. The components under the analysis are Capital Adequacy, Assets Quantity, Earning position, Liquidity position and Sensitivity to market risks.

4.2 Capital Adequacy

Capital adequacy is the position of the bank's capital, as the provision made by the NRB. The components measure the level of the capital funds with respects to the several concepts or ratios. These ratios measure the depositor's trust level on the bank's performance over the capital fund. Bank should make the strong capital position for the better performance. Under the capital adequacy section, the financial position of the EBL is analyzed and interpreted using risk based capital ratio, proposed divided to after tax income, growth rate of capital and growth rate of assets

4.2.1 Risk-Based Capital Ratio

This is the ratio of capital that should be maintained, at the level of NRB provision that described in Directive No.1, basing on the risk –weighted assets. Risk –Based capital system is divided into two tiers and analysis is also mode, basing on these system and NRB directive. So, the analysis is made using the following ratios;

4.2.1.1 Core capital to Risk weighted Assets

$$\text{Ratio X} \frac{\text{Core Capital}}{\text{Total Risk Weighted Assets}}$$

This ratio predicates the proportion of the core capital to the total risk-weighted assets. This proportion should be within the proportion that is made on the directive no.1 by NRB. From table no 4.1, in the F.Y. 2066/67, this ratio was 8.55%, and in the subsequent F.Y. 2062/63, 2063/64, 2064/65, 2065/66, this was 7.73%, 8.61%, 7.72% & 8.55% respectively. This indicate the ratio is within the provision made on directive no.1

Table No. 4.1

Capital Fund & Risk-based Ratio Assets

(in Rs. '000')

Particulars	**Fiscal Year**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Core capital	926324	1157908	1812188	1862630	2351348

Supplementary capital	465015	518208	593868	841240	905793
Total capital	1391339	1676116	2406056	2703870	3257141
Total Risk-weighted assets (RWA)	11291137	14976736	21039879	24131922	27499899
Core capital ⎤RWA %	8.2%	7.73%	8.61%	7.72%	8.55%
Total capital ⎤RWA %	12.32%	11.18%	11.44%	11.20%	11.840%

Source: Annual Reports of EBL

It can be said that the core capital ratios of the Bank were made within the standards in increasing trend up to 2062/63 but decreased in the subsequent years. It was due to the directive provision because the provision is limited up to the minimum level of 5.5% for 2060/61 which is itself increasing and limited for 6% for 2060/61 and onwards. So, it can be said that the bank may be going to maintain the minimum core capital ratios, rather than maintaining the high level, for the better performance.

Under the financial performance analysis the core capital ratio was in strong performance position in mentioned fiscal years. None of the year had unsatisfactory and very unsatisfactory financial performance position as per the supervision norms defines that the risk-based capital ratio as per the NRB directives.

4.2.1.2 Total capital - Risk weighted Asset.

$$\text{Ratio X} \frac{\text{Total Capital}}{\text{Total Risk Weighted Assets}}$$

It is another strong measure of capital performance for the better capital adequacy this ratio should be within the different norms as explained above. it was 12.32%, 11.18%, 11.44%, 11.20% & 11.84% respectively in the reviewed years. Comparing to the NRB directives provision, the ratio was within the satisfactory position. but the ratio was in slightly increasing trend and it is 11.84% in Fy 2066/67, which shows the satisfactory, mostly strong, capital performance position. Under the Bank for International settlement total capital ratio is also under the satisfactory position in the latest years because there should be 8% of total capital fund as minimum requirement.

Similar, to the core capital ratio, bank should maintain the minimum proportion of the capital fund for requirement to support the financial activities. In total capital ratio, Everest Bank Limited is in adequate position and has the satisfactory performance of total capital fund. In the study years the risk based capital ratios are in the satisfactory condition which indicates the satisfactory, some how better, capital performance to protect the depositor's interest and interest of other creditor from unexpected losses arising from its operation.

4.2.2 Proposed Dividend to after Tax Income

$$\text{Ratio X} \frac{\text{Proposed Dividend}}{\text{After tax Income}}$$

Table No. 4.2

Proposed Dividend and After Tax Income

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Proposed Dividend	107100	57702	131496	218080	276253
After Tax Income	238847	297999	451218	832113	831765
Proposed Dividend to after Tax Income	44.84%	19.36%	29.14%	26.21%	33.21%

Source: Annual Reports of EBL

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From the above table 4.2, dividend payout ratio on the after tax income is 44.84% in Fy 2062/63 and it it in average position in rest of the review period, it indicates that the earning is not sufficient to distribute the dividend or it was retained for the growth of the organization. In the year 2062/63, the ratio was at highest level and in the subsequent years the dividend was proposed only to the preference shareholders due to which the ratio is very low compared to other period. The retention was low in F.Y.2062/63 and average other years. The high retention was due to the necessity to increase capital amount. The dividend payout ratio is directly related to the retention rate and retention rate is to growth rate of the firm because the retained amount of income is contributed to the

capital amount. In both years the dividend proportion is high of the normal assumption of 10%. From this it can be said that there may be the requirement of the capital increment and the bank was playing to attract and satisfy the shareholders. But if there was no any capital concern than it would not be unusual to say that dividend payout ratio may be less than 10%. On increasing the profit after tax, the bank is not paying higher dividend comparing to the previous year.

4.2.3 Growth Rate of Capital

$$\text{Growth rate of Capital } X = \frac{\text{Current year balance } Z - \text{Prior year balance}}{\text{Prior year balance}}$$

Table No. 4.3

Growth Rate of Capital

(in Rs. '000')

F.Y.	Capital	Growth Rate
2061/62	998030	--
2062/63	1043731	4.58%
2063/64	1087048	3.55%
2064/65	1940591	78.52%
2065/66	2232419	15.03%
2066/67	2768260	24.00%

Source: Annual Reports of EBL.

From table no 4.3 the growth rate of the capital was 3.55%, 78.52%, 15.03% and 24% respectively in the reviewed period. In year 2064/65, the capital growth rate was extremely higher than the rate of other years. There are no any norms to measure the quality of direction of the capital independently. So, it should be measured with the comparison of the growth rate of the assets. With the comprising between the growths rate of assets and capital denotes the position of the financial coverage of the bank.

4.2.4 Growth Rate of Assets

$$\text{Growth rate of Assets } X = \frac{\text{Current year balance } Z - \text{Prior year balance}}{\text{Prior year balance}}$$

Table No. 4.4

Growth Rate of Assets

(in Rs. '000')

F.Y.	Assets	Growth Rate
2061/62	11792126	--
2062/63	15959284	35.34%
2063/64	21432573	34.29%
2064/65	27149340	26.67%
2065/66	36916848	35.97%
2066/67	41382761	12.09%

Source: Annual Reports of EBL

This ratio simply calculates the growth rate of an asset's item within the balance sheet. But while evaluating the ratio during the offsite supervision, it should be strongly consider the each items growth trend because growth rate of each component of the assets carry more value than the overall value to evaluate the financial position of the bank. From table no. 4.4 in F.Y. 2062/63, ratio was 35.34% and decline to the lower rate 26.67% in F.Y. 2063/64 and even decreased to 12.09% in F.Y. 2066/67. The high increment in assets amount results the increment in capital section. This decrement trend in the growth rate of both assets indicates the fair position of the assets growth rate rather than the strong and satisfactory financial position. Under the CAELS norms, the growth rate of capital should be equal or should exceed the growth rate of the assets. Ideally both ratio should keep the same pace.

From the table no.4.5, in each year the asset growth rate exceeded the capital growth rate except in F.Y. 2064/65 and in 2066/67. In this year, the capital growth rate is higher than assets.

Table No. 4.5

Comparison of Asset Growth Rate and Capital Growth Rate

(in Rs. '000')

F.Y.	Capital Growth Rate	Asset Growth Rate
2062/63	4.58%	35.34%
2063/64	3.55%	34.29%
2064/65	78.52%	26.67%
2065/66	15.03%	35.97%
2066/67	24.00%	12.09%

On other hand, it is essential to measure the growth rate of assets item individually because due to the positive changed in the risk assets and equal negative change in the zero risk assets results the zero growth in the balance sheet. So the individual items should be evaluated. Capital adequacy is the financial position of the bank where the public can see the safety on their deposits so that the bank should maintain the better performance. Everest Bank Limited had maintained the satisfactory capital adequacy position as the capital performance. Everest Bank Limited has made the core capital ratio of 8.55% and total capital ratio 11.84% in year2066/67 which was within the norms of capital adequacy but the total capital ratio should be increased for the more public confidence and to meet the legal framework. The overall capital adequacy provision is significantly in the satisfactory condition.

4.3 Assets Quality

The assets quality section measures the quality of the existing and the potential credit or loan risk, investments portfolios, other assets. The ratios under this section measures the ability of the bank's management to identify, measure, monitor and control the risks associated with the asset quality and the different provision associated with the asset quality section. For the purpose, non-performing loan to the capital, non-performing loans to total assets, classified investments to total capital, recoveries to total capital, loan classified to earning assets, provisioning to classified loan, growth rate of loans are analyzed and interpreted.

4.3.1 Non-Performing Loans to Total Capital Ratio

$$\text{Non - Performaning Loans to Total Capital X} \frac{\text{Non - Performing Loans}}{\text{Total Capital}} \text{ | 100\%}$$

Table No. 4.6

Non-Performing Assets and Total Capital

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Non-Performing Assets (A)	129236	113178	127311	117984	43706
Total Capital (B)	1391339	1676116	2406056	2703870	3257141
Ratio (A⌉B) ⌈ 100%	9.29%	6.75%	5.29%	4.36%	1.34%

Source: Annual Reports of EBL.

Table 4.6 highlights the low quantity assets including the substandard doubtful and bad assets and its proportion to the total capital. During the review period the non-performing loans to total capital ratio was 9.29%, 6.75%, 5.29%, 4.36% and 1.34% respectively. The ratio in the review years was in the fluctuating condition.

There was the high amount of the non-performing assets in 2062/63 compared to the other year. Also there was the low amount of capital which had result the high percentage of the ratio. But non-performing assets itself higher than that of other year. This indicates inefficiency in loan management. But in year 2066/67, it decreased to the lowest limit among the review period with the highly efficient management or sound credit administration practices and appropriate risk identification. Similarly in year 2062/63 it was quite higher, it can be said that there was the adequate credit policies, practices procedure internal control and management information system, relating to credit management, due to the strong performance in the NPA in last few years.

4.3.2 Non-performing Assets to Total Assets.

$$\text{Non - Performaning Assets to Total Assets X} \frac{\text{Non - Performing Assets}}{\text{Total Assets}}$$

Table No. 4.7

Non-performing Assets to Total Assets

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Non-Performing Assets (A)	129236	113178	127311	117984	43706
Total Assets (B)	15959584	21432573	27149340	36916848	41382761
Ratio (A⎤B) ⎢ 100%	0.80%	0.52%	0.46%	0.31%	0.10%

Source: Annual Reports of EBL.

The table 4.7 exhibits the quality of the assets. During the review period there is highly satisfactory assets performance. The ratio was 1.27%, 0.80%%, 0.68%, 0.48% and 0.16% in reviewed year respectively.

There was no significant fluctuation of the ratios in each year. in overall, there was the strong range of the ratio. It seems to because of the growth of total assets though there was no higher change in non-performing assets.

With the performance concern NRB established some norms relating to the past due loans (loans and investments) as follows.

Acceptable range (of total assets)	**performance**
Less than 5%	Strong
5% to less than 10%	Satisfactory
10% to less than 20%	Fair
20% to less than 30%	Unsatisfactory
30% or greater	Very unsatisfactory

During the review period the bank has the strong performance of the past due loans to total assets. From this norms point of view we can say the bank has been making the strong assets performance due to the low value of the ratio with the adequate and appropriate credit risk identification management control.

4.3.3 Classified Investments to Total Capital

$$\text{Classified Investments to Total Capital X} \frac{\text{Investments}}{\text{Total Capital}}$$

This ratio evaluates the proportion of the investments on the total capital. Table no 4.8 demonstrates that the investment proportion of the bank remained at 3.02, 2.97, 2.10, 2.20 and 1.54 in the respective study period.

Table No. 4.8

Investments and Total Capital

(in Rs. '000')

	F.Y.				
Particulars	**2062/63**	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Investments (A)	4200515	4984314	5059557	5948480	50082307
Total Capital (B)	1391339	1676116	2406056	2703870	3257141
Ratio A⎪B	3.02	2.97	2.10	2.20	1.54

Source: Annual Reports of EBL.

The ratio of the bank is almost in constant position in the four year of the review period and it is gradually decreased in FY 2066/67. So, the decrease in the ratio indicated the providing loan rather than Investment. However, the investments amount of the bank generally includes the investments in government securities Share, debenture, bonds and others. Provision for the said investments was not necessary due to no risk in such risk free investments.

4.3.4 Recoveries to Total Capital

$$\text{Recoveries to Total Capital } X \frac{\text{Recoveries}}{\text{Total Capital}}$$

Table No. 4.9

Recoveries and Total Capital

(in Rs. '000')

Particulars	F.Y.				
	2057/58	**2058/59**	**2059/60**	**2060/61**	**2061/62**
Recoveries (A)	-	-	-	--	-
Total Capital (B)	1391339	1676116	2406056	2703870	3257141
Ratio A⎤B	-	-	-	--	-

Source: Annual Reports of EBL.

4.3.5 Loans Classified Loss to Earning Assets

$$\text{Loans Classified Loss to Earning Assets } X \frac{\text{Total Loan Losses}}{\text{Total Earning Assets}}$$

Table No. 4.10

Loan Losses and Earning Assets

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Loans Loss	118783	106607	120258	88110	25603
Earning Assets	14406720	19068000	24241988	30418035	33164706
Bank Balance (other than current A/C)	2991	--	--	--	--
Call Money	66960	--	346000	--	--
Investments	4200515	4985314	5059557	5948480	5008307
Loans (Net)	10136254	14082686	18836431	24469555	28156399
Ratio	0.82%	0.56%	0.50%	0.29%	0.08%

Source: Annual Reports of EBL.

Table no. 4.10 declares the position of the bad loans on the earning assets. Earning assets are the total of those assets which earn. The ratio in the study year was 0.82%, 0.56%, 0.50%, 0.29% and 0.08%.

The ratio was not steady but in much fluctuation trending. Some changed were occurred during the period. It was higher in the first year of the reviewed period and declined in next year and again decreased in subsequent year and became lower in the last period.

The position of the bad loans was in the strong position because the NRB norms relating to this ratio is between 2% to 4% as usual. But the higher percentage is unaccepted level of poor quality. Due to the high management quality, bank can maintain the strong asset performing position relative to the bad loans to total earnings assets.

4.3.6 Provisioning to Loans Classified Loss

$$\text{Provisioning to Loans Classified Loss } X \frac{\text{Actual Provision}}{\text{Loan Loss}} \mid 100$$

This ratio evaluates the compliance of the legal format that should be followed by the bank for the safe deposit. For the study purpose the ratio should be divided into the following ratios.

Table No. 4.11

Loan Provision and Loans

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
A. Pass Loan	9807018	13969507	18709121	24351569	28112693
Provision	128800	164866	204783	255357	290540

Ratio	1.31%	1.18%	1.09%	1.05%	1.03%
B. Substandard Loan	10669	4218	6307	1361	5469
Provision	2667	1054	1576	340	1367
Ratio	24.99%	24.98%	24.98%	25%	25%
C. Doubtful	684	2353	746	28514	12633
Provision	342	1176	373	14257	6316
Ratio	50%	50%	50%	50%	50%
D. Loss Loan	117883	106607	120257	88110	25603
Provision	117883	106607	120257	88110	25603
Ratio	100%	100%	100%	100%	100%

Source: Annual Reports of EBL.

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4.3.6.1 Provision for Pass Loan to Pass Loan

$$\text{Provision for Pass to Pass Loan } X \frac{\text{Pass Provision}}{\text{Pass Loan}}$$

This ratio is related to the general loss reserve because the provision made against the loan is never made to avoid the risk. The ratio was 1.31%, 1.18%, 1.09%, 1.05% and 1.03% respectively during the study period. There was a fluctuation in the ratios. The ratio has increased in FY 2062/63 and then slightly decreased in third year and again increased in next year and in the final year it has again decreased. (Table 4.11)

4.3.6.2 Provision for substandard loan to substandard loan

$$\text{Ratio } X \frac{\text{Provision for Substandard}}{\text{Substandard Loan}}$$

This ratio measures the proportion of the provision of substandard provision on the substandard loan. From the table 4.11, it can be said that the ratio was consistent during the period. It was 24.99% in first year and 25% in last two years of review period.

4.3.6.3 Provision for Doubtful loan to Doubtful loan

$$\text{Provision for Doubtful to Doubtful Loans X} \frac{\text{Provision}}{\text{Doubtful Loan}}$$

This ratio measures the proportion of the provision of doubtful loans on doubtful assets. The ratio was 50% in each period (From table 4.11)

4.3.6.4 Provision for Bad loan to Bad loan

$$\text{Provision for Bad to Bad Loan X} \frac{\text{Provision}}{\text{Loan Loss}}$$

This ratio also measures the proportion of loss provision to loss. The ratio was 100% in the reviewed period. (table 4.11).

Prudential requirements relating to the loan provisioning, the provisioning should be maintained by each of the commercial banks as follows:

Loans	**Provisions**
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Concerning to this provision the bank had strong provisioning in most of the period for most of the ratio.

Growth Rate of Loans

$$\text{Growth Rate of Loans } X = \frac{\text{Current year Loans - Previous Year Loans}}{\text{Previous Year Loans}}$$

Table No. 4.12
Growth Rate of loans

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Loans	10136254	14082686	18836432	24469555	28156399
Growth	28.30%	38.93%	33.75%	29.90%	15.06%

Source: Annual Reports of EBL.

Table 4.12 states that the growth rate of the loans about 28.30% 38.93%, 33.75%, 29.90% and 15.06% respectively during the study period. The ratio indicated that the growth rate of the loans was in decreasing trend. Slightly increment is seen in second year of the study period and it has increased in the last year. According to the CAELS norms only the final year was near the standard. So, there was not so satisfactory condition of the loan growth rate.

In totality, the assets quality of the bank seems better in the last year of the study period. There may be the assumption of the betterment in the soundness of credit administration practices, and appropriateness of the risk identification due to the decrement in the bad loans at the end of the study period. Beside this the provisions made for the loans were strongly performing. But relating to investment the bank was unable to make the better diversification but also performed well. Bank was unable to perform better over the recoveries of bad loans. Thus the banks could be rated for satisfactory assets quality.

4.4 Earning Capability

Earning capability or the profitability ratios have been employed to measure the operating efficiency of the bank. The earning ratings not only reflect the quantity and tend of earning but also

reflects the quality of the earnings. For the purpose of the study earning performance under the CAELS system, the ratios relating to earning assets to total assets, interest income to total assets interest expenses to total assets, net interest margin, non-interest income to total assets, non-interest expenses to total assets net spread, total operating income to total assets, total operating expenses to total assets net operating income to total assets, total operating expenses to total operating income. Staff expenses to total expenses, staff expenses to total operating income, ROA, and total assets to full time employee have been analyzed and interpreted.

4.4.1 Earning Assets to Total Assets.

$$\text{Earning Assets to Total Assets X} \frac{\text{Total Earning Assets}}{\text{Total Assets}}$$

None of the bank or any business firm contains the 100% earning assets. This ratio examines the proportion of the earning assets on total assets.

Table No. 4.13

Earning Assets to Total Assets

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Bank Balance (other than current A/C)	2291	--	--	--	--
Call money	66960	--	346000	--	--
Investments	4200515	4985314	5059557	5948480	5008307
Loans (net) and bill purchased/ discounted	10136254	14082686	18836431	24469555	28156399
Total Earning Assets (A)	14406720	19068000	24241988	30418035	33164706
Total assets (B)	15959284	21432573	27149340	36916848	41382761
Ratio (A⌉B)	90.27%	88.96%	89.29%	82.39%	80.14%

Source: Annual Reports of EBL

Table no. 4.13 shows the ratios of the bank remained 90.27%, 88.96%, 89.29%, 82.39% and 80.14% respectively during the reviewed period.

The ratio was highest in the first year and decreased to second year and again increased in third year and there after it is again decreased. The ratio analyzed that the bank contained most of the assets as the earning assets, due to the low amount of the cash reserve, fixed assets plus current account of bank reserve. Bank was performing strongly for the earning assets.

The NRB norms for the CAELS system are established for 75% of the earning assets on total assets. In each of the study period bank had maintained to maximum level of the earning assets; which indicates the strong financial management or performance for the earning assets.

4.4.2 Interest Income to Total Assets.

$$\text{Interest Income to Total Assets X} \frac{\text{Interest Income}}{\text{Total Assets}}$$

Table No. 4.14

Interest Income to total Assets

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Interest Income (A)	903411	1144408	1548657	2186815	3102451
Total Assets (B)	15959284	21432573	27149340	36916848	41382761
Ratio (A⌉B)	5.66%	5.33%	5.70%	5.92%	7.49%

Source: Annual Reports of EBL

Table no. 4.14 exhibits that the ratio was 5.66%, 5.33%, 5.70%, 5.92% & 7.49% respectively in the reviewed year. The interest earning proportion had been declining over the five years period. The ratio was highest in the first year and gradually decreased up to the third year and again decreased in the final year. This trend shows that the bank was not growing the interest earning on the loans while the total assets was increasing highly. With the NRB norm, bank was performing fairly rather than satisfactory and strong performance.

4.4.3 Interest Expenses to Total Assets.

$$\text{Interest Expenses to Total Assets } X \frac{\text{Interest Expenses}}{\text{Total Assets}}$$

The table 4.15 demonstrates that the ratio was 2.51%, 2.41%, 2.33%, 2.74% and 3.80% respectively during the reviewed period.

Table No. 4.15

Interest Expenses to Total Assets

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Interest Expenses (A)	401379	517166	632609	1012874	1572790
Total Assets (B)	15959284	21432573	27149340	36916848	41382761
Ratio (A⌉B)	2.51%	2.41%	2.33%	2.74%	3.80%

Source: Annual Reports of EBL.

There is the decreasing trend in the ratio in first three years and thereafter it starts to increase and it is 3.80% in last year of the review period. The ratio continuously decreased shows the management efficiency on controlling the interest expenses paid on the deposits and due to the prevailing market crises the interest rate in deposit have gone up and ratio has increased in FY 2065/66 and FY 2066/67. Though the interest expenses were increasing, there was better improvement concerning to the total assets with the supervision norms of the NRB, the ratio performed strongly during the reviewed period.

4.4.4 Net Interest Margin

$$\text{Net Interest Margin } X \frac{\text{Net Interest Income}}{\text{Total Assets}}$$

$$X \frac{\text{Interest Income - Interest Expenses}}{\text{Total Assets}}$$

This is the ratio that evaluates the management efficiency to earn more interest income with control on the interest expenses. It is not simply to control the expenses as interest on loan. So, there should be better management, policies, practices, identification for the maximizing the net interest margin.

The table 4.16 discloses that the ratio was 3.14%, 2.92%, 3.37%, 3.17% and 3.69% respectively in the study period. In the last year the net interest margin was so high. According to the NRB norms for the inspection and supervision concern the ratio performance is allocated as:

Table No. 4.16

Net Interest Margin

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Interest Income	903411	1144408	1548657	2186815	3102451
Interest Expenses	401379	517166	632609	1012874	1572790
Net Interest Margin	502032	627242	916048	1173941	1529661
Total Assets	15959284	21432573	27149340	36916848	41382761
Ratio	3.14%	2.92%	3.37%	3.17%	3.69%

Source: Annual Reports of EBL.

Ratio Value	**Performance**
5% (not exceeding)	Strong
4.5% to less than 5%	Satisfactory
4 % to less than 4.5%	Fair
3% to less than 4%	Unsatisfactory
Below 3%	Very unsatisfactory

With the performance concern, the bank was not performing better but it is not fully unsatisfactory during the reviewed period. In the first three years of the reviewed period, the bank's earning

performance relating to the net interest margin was very unsatisfactory according to the prudential requirements. But at the end of the period, some improvement was made and the performance rose to above of very unsatisfactory condition. The main cause of this unsatisfactory performance is due to the increment in the banking business because during the period other commercial banks were established in Nepal and the earning was also affected by the critical political environment.

4.4.5 Non-Interest Income to total Assets

$$\text{Non - Interest Income to Total Assets X} \frac{\text{Non - Interest Income}}{\text{Total Assets}}$$

The ratio measures the proportion of the non-interest income, the second major source of income on total assets. Concerning with the non-interest income of the sampled bank included commission non-operational profits, income from foreign exchange, and others income.

Table No. 4.17

Non-Interest Income

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Commission & Discount	96689	117718	150264	202094	208123
Foreign Exchange Income	14398	28404	64452	62527	47879
Non-Operational Income	2959	1315	4519	5005	12338
Other Income	48902	67967	79133	106403	142311
Total Non-Interest Income	**162939**	**215404**	**298368**	**376029**	**410651**
Total Assets	15959284	21432573	27149340	36916848	41382761
Ratio	1.02%	1%	1.09%	1.01%	0.99%

Source: Annual Reports of EBL.

Table 4.17 indicates that the ratio was 1.02%, 1%, 1.09%, 1.01% and 0.99% respectively. There was no any fluctuation in the ratio. The ratio was very small and stable on only few points' change. This

indicates the small impact on making the significant change of potential income, bank total income could not be change significantly changed because of the main earning source was interest income and income other than interest did not carry the higher weight on earnings.

4.4.6 Non-Interest Expenses to Total Assets

$$\text{Non - Interest Expenses to Total Assets X} \frac{\text{Non - Interest Expenses}}{\text{Total Assets}}$$

The ratio relates with the expenses relating, generally with staff and office activities. Any institution always tries to maintain the minimum level of the non-interest expenses. Table No. 4.18 demonstrates the brief details of the topic relating with the non-interest expenses and the defined ratio relating with it.

Table No. 4.18

Non-Interest Expenses

(inRs. '000')

	F.Y.				
Particulars	**2062/63**	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Employee Expenses	70925	86118	157959	186919	226364
Operating Expenses	143562	177545	233766	292010	352511
Loan Loss Provision	70465	89696	99340	93085	77011
Employee Bonus Provision	34560	45471	65869	89132	118799
Income Tax Provision	106753	216913	158299	376864	357020
Non-Operating Expenses	--	-	-	-	-
Technical Service	--	-	-	-	-
Total Non-Interest Expenses	**426265**	**615743**	**715233**	**1038010**	**1151705**
Total Assets	15959284	21432573	27149340	36916848	41382761
Ratio	2.67%	2.87%	2.63%	2.81%	2.78%

Source: Annual Reports of EBL.

The ratio was 2.67%, 2.87%, 2.63%, 2.81% and 2.78% respectively in the reviewed period. Analyzing the ratio trend it can be said that it was in fluctuation in the review period. It is increased in the fsecond year of the review period and agin secreased in the third year and remains almost same in last two years of the review period. We can say the management was efficient to control the non-interest expenses during the first three period but greater in last year, with respect to the assets

increment. In each of the year the office expenses was seemed higher than other topics, which was also increasing gradually over the period. The staff expenses were also increasing due to increment in number of employee and employee facilities. Technical and non-operational expenses were also incurred only during the first two years of the period. In overall the ratio shows the satisfactory performance of the non-interest expenses but slightly descending the performance at the end of the period.

4.4.7 Return on Assets

$$\text{Return on Assets X} \frac{\text{Net Income after Taxes}}{\text{Total Assets}}$$

It is the most important ratio to measure the assets performance under profitability concern. The ratio of the sampled bank was mostly concerned with the interest income interest expenses, provisions, non-interest income and expenses.

Table No. 4.19

ROA

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Net Income after Tax	238847	297999	451218	638732	831765
Total Assets	15959284	21432573	27149340	36916848	41382761
ROA	1.50%	1.39%	1.66%	1.73%	2.01%

Source: Annual Reports of EBL.

Table No. 4.19 declare that the ratio was 1.50%, 1.39%, 1.66%, 1.73% and 2.01% respectively in the reviewed period. The ratio was consistent during the period. The ratio decreased by few points in FY 2063/64 and increased thereafter. Any way the bank made the better performance in the end of final period of the study period.

With the supervision concern of the NRB there are some provision made relating to the return on assets performance of the commercial banks as follows:

Ratio of ROA	**Performance**
1.5% or more	Strong
1.0% to less than 1.5%	Satisfactory
0.5% to less than 1%	Fair
0% to less than 0.5%	Unsatisfactory
Below 0%	Very unsatisfactory

Comparing the return performance of the bank with the performance provision, the sampled bank had the much better return performance. During the reviewed period the bank was performing better or satisfactory performance. In each year the ratio came in between the 1% to 2% which was satisfactory return performance. At the end of the period the performance was quite better than of previous period. At the final year it was more over better than satisfactory but not strong if the bank makes the best investment or the loan policies or practices the bank can make the strong performance under the return on assets.

4.4.8 Total Operating Expenses to Total Operating Income

$$\text{Ratio X} \frac{\text{Total Operating Expenses}}{\text{Total Operating Income}}$$

This ratio evaluates the proportion of the operating expenses on the total operating income and efficiency of the management to control the operating expenses.

Table No. 4.20

Operating Expenses and Operating Income

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Operating Income	1063550	1358497	1842507	2557840	3500765

Operating Expenses	827662	1074295	1406453	1950884	2704495
Ratio	77.82%	79.08%	76.33%	76.27%	77.25%

Source: Annual Reports of EBL.

The table no. 4.20 explains that the ratio was 77.82%, 79.08%, 76.33%, 76.27% and 77.25% respectively in the study period. There was the strong performance on controlling the operating expenses from the operating income, but also there was some fluctuation on the ratio. With the volume of the transaction, the income and expenses both were increased but at the end of the period the expenses were controlled more in the final year. The ratio was slightly decreased from first period to the end of second period..

With the supervisory concern, the bank performed very well. The supervisory norms on this ratio are as follows:

Ratio Value	**Performance**
85% and below	Strong
More than 85% to 90%	Satisfactory
More than 90% to 95%	Fair
More than 95%, to 100%	Unsatisfactory
Over 100%	Very unsatisfactory

4.4.9 Total Operating Income to total Assets

$$\text{Total Operating Income to Total Assets X} \frac{\text{Total Operating Income}}{\text{Total Assets}}$$

This ratio evaluates the capacity of the assets to earn on the operating phase.

Table No. 4.21

Total Operating Income, Operating Expenses and total Assets

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Operating Income (A)	1063550	1358497	1842507	2557840	3500765
Operating Expenses (B)	827662	1074295	1406453	1950884	2704495
Total Assets (C)	15959284	21432573	27149340	36916848	41382761
Ratios: A÷C	6.66%	6.34%	6.79%	6.93%	8.46%
B÷C	5.19%	5.01%	5.18%	5.28%	6.54%
Net Position	1.48%	1.33%	1.61%	1.64%	1.92%

Source: Annual Reports of EBL.

From the table No. 4.21 the ratio of total operating income to total assets on the reviewed year was 6.66%, 6.34%,6.79%, 6.93% and 8.46% respectively.

With the supervisory concern the following norms are established for the ratio performance.

Ratio Value	**Performance**
13% or more	Strong
11% to less than 13%	Satisfactory
8% to less than 11%	Fair
6% to less than 8%	Unsatisfactory
Below 5%	Very unsatisfactory

Comparing the performance norms the sampled bank was not performing well. In the first two year there was the fair performance and in the third year the performance declined to unsatisfactory. Again the performance rose towards the fair in the forth year and it has again decreased to unsatisfactory level in final year. In overall the performance was not so good.

4.4.10 Total Operating Expenses to Total Assets

$$\text{Total Operating Expenses to Total Assets } X \frac{\text{Total Operating Expenses}}{\text{Total Assets}}$$

This ratio evaluates the management efficiency to control the operating expenses.

The ratio during the period is consistently decreasing. With the supervisory concern, the ratio performance norms are

Ratio Value	**Performance**
9% or less	Strong
11% to more than 9%	Satisfactory
12% to more than 11%	Fair
13% to more than 12%	Unsatisfactory
Above 13%	Very unsatisfactory

Comparing to the norms the bank was performing strongly to control the operating expenses. All the value of the ratio was less than 9%. So, the expenses performance was strong.

4.4.11 Net Operating Income to Total Assets

$$\text{Ratio } X \frac{\text{Total Operating Income}}{\text{Total Assets}} Z \frac{\text{Total Operating Expenses}}{\text{Total Assets}}$$

From the table 4.21 the ratio was 1.48%, 1.33%, 1.61%, 1.64% and 1.92% respectively during the study period. The ratio has declined over next two periods and again rose by few points in the fourth year and fifth year. This ratio relates with total operating income to total assets and total operating income to total assets. Though the ratio relating to the total operating expenses to total assets performed strongly over the study period net operating income ratio was not good. It happened so, because the operating income performance was not good, which was below the average performance.

In overall it can be said that though the bank management was able to control the operating expenses, it was inefficient to earn more operating income.

4.4.12. Staff Expenses to Total Expenses

$$\text{Staff Expenses to Total Expenses } X \frac{\text{Staff Expenses}}{\text{Total Expenses}}$$

Table No. 4.22

Staff Expenses and Total Expenses

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Staff Expenses	70924	86118	157957	186919	226364
Total Expenses	827662	1074295	1406453	1950884	2704495
Ratio	8.57%	8.02%	11.23%	9.58%	8.37%

Source: Annual Reports of EBL.

The table no. 4.22 analyzed that the ratio was 8.57%, 8.02%, 11.23%, 9.58% and 8.37% respectively during the study period. The ratio during the study period was more fluctuating. The ratio in the first year was 8.57% and 8.02% in second year and rose in third year and again decline by few point in fourth and fifth years. During the period total expenses increased with increased in the staff expenses. With the supervisory concern, the following standard is established for this ratio.

Ratio Value	**Performance**
9% and below	Strong
More than 9% to 11%	Satisfactory
More than 11% to 13%	Fair
More than 13% to 15%	Unsatisfactory

Over 15% Very unsatisfactory

Comparing with the standard the bank staff expenses on the total expenses was performing strongly during the study period. Overall the bank performance under the ratio during the study period was much better.

4.4.13 Total Assets to Full Time Employee

$$\text{Total Assets to Full time Employee} X \frac{\text{Total Assets}}{\text{No. of Employee}}$$

Table No. 4.23

Total Assets and No. of Employee

(in Rs. '000')

Particulars	**F.Y.**				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Total Assets (A)	15959284	21432573	27149340	36916848	41382761
No. of Employee (B)	267	319	391	478	535
Ratio in Rs.	59772	67186	69435	77231	77350

Source: Annual Reports of EBL

The table 4.23 demonstrates the employee assets performance which was Rs. 59772.00, Rs. 67186.00, Rs. 69435.00, Rs. 77231.00 and Rs. 77350 (in thousands) respectively during the study period.

It can be said that the employee performance on total assets of the sampled bank was in increasing trend. As the number of employee increased, the performance was also increase due to the increment in the total assets, the increment was continuing during the period. Due to this increment we can say that the employees of the bank were performing efficiently because higher amount of the assets per employee indicates the better performance.

In overall, the bank profitability performance was better in the final year of the study period. In some case like total operating income to total assets income to total assets, net interest margin were not performing well. Some were performing fairly and some were weak in the performance. But the performance each ratio in the last review period was better than previous year's performance. So, it can be said that the profitability concern of the bank was above of average performance.

4.5 Liquidity Position

Liquidity ratios are used to justify the firm's performance to meet the short term obligations in general it is the solvency ratio that is used to evaluate the assets liquid position. It can be viewed in terms of liquidity stored in balance sheet and in terms of liquidity available through purchase funds. The degree of liquidity depends upon the relationship between cash assets plus those assets which can be quickly turned into cash and the liabilities awaiting payment. Each of the commercial banks needs the liquidity to meet loan demand and deposit withdrawals. Liquidity position is the key element of effective and efficient management of the assets and liabilities. Some ratios under the liquidity position are used in this study to analyze and interpret the liquidity position of the sampled bank. These ratios are mostly used under the supervisory and inspection tools of the commercial banks to evaluate the liquidity performance. This section includes current ratio, call money to total liabilities, loans to deposits, growth rate of deposits, liabilities maturing 1 to 90 days to assets maturing 1-99 days, liabilities maturing 91-180 days to assets maturing 91-180 days, liabilities maturing 191-270 days to assets maturing 191-270 days, liabilities maturing 271-365 days to assets maturing 271-265 days.

4.5.2 Overnight Borrowings (Call Money) to Total Liabilities

This ratio evaluates the percentage of the bank's inter bank borrowing.

$$\text{Overnight Borrowing to Total Liabilities X} \frac{\text{Call Money}}{\text{Total Liabilities}}$$

Table No. 4.25

(Call Money) to Total Liabilities

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Call Money	66960	--	346000	--	--
Total Liabilities	15959284	21432573	27149340	36916848	41382761
Ratio	0.41%	--	1.27%	--	--

Source: Annual Reports of EBL.

The table 4.25 details that the ratio was 0.41%, Nil, 1.27%, Nil and Nil respectively in the study period.

From this it can be said that bank had the high ability of the borrowing in the first year to maintain the strong liquidity position then the ability decreased slightly. The high percentage of the ratio indicated the high amount of less costly borrowing among other borrowings because the call money is less costly. The borrowing is made to meet the daily liquidity purpose. So; it should to identify the frequency of the borrowing rather than the amount of the borrowing. But also the calculation is made for the reporting period. It can be said that due to the high frequency of the borrowing, the call money at the time of calculation was resulted low.

4.5.3 Loans to Deposits

$$\text{Loan to Deposits } X \frac{\text{Loans}}{\text{Deposits}}$$

Table No. 4.26

Loans to Deposit

(in Rs. '000')

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Loans	9801308	13664082	18339085	23884673	27556356
Deposits	13802444	18186253	23976298	33322946	36932310
Ratio	71.01%	75.13%	76.49%	71.68%	74.61%

Source: Annual Reports of EBL.

The table 4.26 exhibits the ratio was 71.01%, 75.13%, 76.49%, 71.68% and 74.61% respectively in the study period.

Under the NRB norms, there should be 40% to 60% for the usual range the deposit and never to exceed 100%. Thus, the loan to deposit performance was strong in each year.

4.5.4 Growth Rate of Deposits

$$\text{Growth Rate } X \frac{\text{Current Year Deposit - Previous Year Deposits}}{\text{Previous Year Deposits}}$$

Table No. 4.27

Growth Rate of Deposit

(in Rs. '000')

F.Y.	Deposit	Growth Rate
2061/62	10097691	--
2062/63	13802444	36.69%
2063/64	18186253	31.76%
2064/65	23976298	31.83%
2065/66	33322946	28.04%
2066/67	36932310	10.83%

Source: Annual Reports of EBL.

The table 4.27 describes that the ratio was 36.69%, 31.76%, 31.83%, 28.04% and 10.83% respectively in the study period.

The amount of the deposit was increasing during first three years of review period and it starts to decline in last two years of the review period and it is due the present liquidity crisis in the market as well as not being properly expenditure in development budget of government.

With the NRB supervision norms relating to the liquidity position the growth rate of deposit should match or exceed the growth rate of the loans.

Referring to table no. 4.26, and 4.27, it can be concluded that the loan amount did not exceed the deposits amount. So the performance was satisfactory in last three year because the ratio extremely exceeds to 20% should be investigated. On another hand, the growth rate of the deposit creates the higher liquidity position. With increase in the deposit amount, the liquidity position also increases but the loans executed should be taken in the consideration. Hence there is the adequate and efficient liquidity position of the sampled bank.

4.6 Sensitivity position

This section reflects the degree to which the changes in the interest rate and foreign exchange rate can affects the sample bank's earnings or capital. So, the sensitivity is the combination of market risk associated with interest rate and foreign exchange rate. A possible source of market risk arises from the non-trading position and their sensitivity to changes in interest rate and foreign operation. Under this interest rate risk ratios; First Quarter gap to Average Quarterly Earnings, Second Quarter gap to Average Quarter Earnings, Foreign exchange risk:; Net foreign exchange position to core Capital and rate sensitivity liabilities to rate sensitively assets are analyzed and interpreted.

CHAPTER – V
SUMMARY, FINDINGS AND RECOMMENDATION

5.1 Summary

For the development of the financial system it is essential to consider it as a component of the economic system. Without the development of the financial system, none of the economic system can be completely developed because the economic development of the state, at most, depends upon the financial system of the same state. More often the financial system dominates the other systems within the economic system. Commercial banks are the major player in the financial system and they cover the most of the financial activities of the financial system. To make the sound, capable, dynamic, and healthy financial system there should be the strong performance of the commercial banks. This each of the performance should be either promoted or controlled. That is why there is the high needs of inspection and supervision of this bank with the evaluation of their performance, with the degree of compliance of regulatory.

On other hand, these banks, as the JVBs, are working with the average quality of banking service. There is the high need of the quality performance of the commercial banks to meet the international standard. This study was conducted with a view to examine the operating position of EBL, as JVBs, under the CAELS system concept. CAELS system is the off-site evaluation of the financial performance of the commercial banks and non-bank financial institution. The study provides the complete idea about the strength and weakness of the sampled bank regarding to ensure deposit and degree of compliance of prudential requirements. The main objective of the CAELS system is to ensure that the bank is operating in a manner to the interest of depositors or not.

In the present context banking business become highly complex and sophisticated. Number of changes creates the threats and opportunities which directly affect the performance of the commercial banks. The financial analysis made on this study, using the financial analysis tools of CAELS system, helps to make the accurate financial decisions, plan and programs to treacle the threats and grasp the opportunities arouse in the competitive environment. That is why the analysis is made to evaluate the performance and potentiality of the Capital Adequacy, Assets Quality, Earning

Capability, Liquidity Position and Sensitivity Position of EBL. Analysis of these five components, under the CAELS system is made because most of the performance of the banks is covered by these components. Similarly, NRB as the authorized supervisory institution requires the compliance of the regulatory requirements. CAELS tools evaluate the degree of the performance with compliance of regulatory requirements. Thus, CAELS tools evaluate the sampled bank completely.

5.2 Major Findings

Based on the analysis and interpretation of the data the following are the major findings, under each components of the CAELS system.

- Everest Bank Limited has maintained the satisfactory capital adequacy position as the capital performance. Everest Bank Limited has made the core capital ratio of 8.55% and total capital ratio 11.84% in year 2066/67 which is within the norms of capital adequacy and depositors can find the high degree of confidence on their deposits in each case. In each year dividend payout ratio is reasonable concerning the capital growth rate and the assets growth rate.
- The assets quality of the bank seems better in the final year of the study period. There was decrement in the bad loans on NPA at the end of the study period. Concerning the NPA to total capital, the bank was performing strongly due to the decreasing trend of NPA. During the first period of study, there was high amount of NPA which declined in the following few years. Similarly NPA to total assets performance during the study period was strong with the best compliance of the regulatory requirements. Beside this the provisions made for the NPA by the sampled bank was highly satisfactory. But relating to investment, the bank was unable to make the better diversification but also performed well because no provisions were made for the investment risk which indicates there were no any risks associated with investments. Bank was unable to perform better over the recoveries of bad loans in each period. So the recoveries' performance was not satisfactory. Bank performance on loan classified loss to earning assets was strong during the study period. That indicates the high degree of public confidence to protect their deposits. Relating to the loan provisioning to classified loan, bank had the strong performance on all types of loan and their provisioning. The performance met the regulatory requirement.
- Concerning the earning capability, the ratio relating to the earning assts to total assets the bank was performing strongly over the study period. Similarly the non-interest income and non-interest

expenses on total assets performed strongly and return on assets for the bank was strong in the last of the study period, but only satisfactory in remaining years. Beside these staff expenses to total expenses, total employee to total assets, performed strongly during the study period. The portion staff expense on total expenses was below the 9%, the standard norms for strong performance and the employee performed strongly on total assets also. Due to the strong performance on all above ratios, depositors can see the higher degree of protection of their deposits. But at the same time interest income on total assets was not performing better. It declined during the period while the earning assets increased during the same period. With the regulatory requirement, bank was fairly performing. But during the same period, the interest expenses on the total assets performed strongly. It was in decreasing trend relating to the assets value. Due to fair performance on interest income, the net interest margin was not in satisfactory condition though the interest expenses were strong. Most of the operating income of the bank was paid as the operating expenses. But the performance of the operating expenses on operating income was strong in each of the year; however, the performance of operating income on total assets was not satisfactory. Similarly, the operating expenses on the total assets again performed strongly with unsatisfactory net operating income.

- With the liquidity concern, the performance of overnight borrowing and loan to deposit performed strongly in each period because the loan less than 100% of the deposit provide the better liquidity position and public confidence on the repayment of deposit at least. Similarly, the liabilities to assets performance under the respective maturity period performed above the satisfactory.
- The comparative study of banks performance shows that the banks performed strongly in most of the cases. Concerning the capital adequacy, core capital and total capital proportion on the risk weighted assets increased when reached the third period of the study period and then decreased, but also within the banking norms. Low dividend was paid in the final year than that of final year with high capital growth. No dividend was paid in the remaining period. Both the asset growth rate and capital growth rate were comparatively similar in each period except in the first year.
- Under the asset quality section, NPA to total capital, NPA to total assets, Investment to total capital performed strongly in the third and the final year than other years. In the case of recoveries to total capital the bank performed better in the first and final year than other year. In the case of loan loss to earning assets, the performance was higher in the third year of the study period. Each of the ratios of the loan loss provision to loan performed strongly.

- CAELS system is the best tools to measure the financial performance of the commercial banks because the tools under the CAELS system cover the most of the financial aspects that are related to the banks. Ratios are classified into capital adequacy, assets quality, earning capability, liquidity position and sensitivity position; and measure the performance position of each of the components. Those ratios finally measure performance position of the banks. As the findings of the study, each of the components performed strongly except the earning capability during the study period. Though there was better performance of the earning capability independently, the bank was only unable to maintain the standards of the prudential requirements for earning concern. That is why the overall performance position of the bank was above of satisfactory performance. It is very important to establish the several provisions relating to the financial performance. If the bank was not required to maintain such provisions, bank could not protect the depositors' interest. EBL maintained most of the provisions, so its performance was above the satisfactory performance. To gain the satisfactory performance there should be the rule of obeying the requirements. The bank performed satisfactory because of obeying most of the prudential requirements. From this study, it is found that the CAELS system is one of the better tools to measure the bank's off-site financial status because it helps facilitating the detection of imprudent banking practices on its performance.

5.3 Conclusion

On analyzing and interpretation the available data, we can conclude that the financial position or performance of the EBL was very satisfactory. The bank had maintained most of the provision required by NRB for the safetymen of depositors' deposit. Bank had maintained adequate capital position, adequate provisioning for the loan and advance, proper management on utilizing the resources, identification of profitable investment sectors, adequate liquidity position and management. Thus, it is the higher than satisfactory performance and bank was able to protect the depositors' interest, under the banking legislation and norms. It was found that the bank's performance was improving, when reached the last of the study period.

5.4 Recommendation

On the basis of the above findings, some important suggestion and recommendations have been made to overcome the weakness, inefficiency and to improve current financial position of the bank as well as to follow the prudential requirements.

a) The regulatory requirements need the higher proportion of total capital fund requirements from the coming year. So it is suggested to maintain higher capital fund as required relating to the risk weighted assets.
b) Similarly the bank has maintained core capital requirement on total risk weighted assets remarkable higher than that of regulatory requirements prescribed. So it should be carefully maintained only the required amount of core capital. If the higher amount of core capital comparing with the total risk weighted assets is held then it adversely affects the yield of the bank.
c) Though the amount of NPA of EBL was not so high, but it is very essential to work hard to recover such NPA. It is suggested to create the ability on management for properly administration of the assets, such as timely identification and collection of problematic assets.
d) The bank is recommended to make or revise the loan and investment policies to identify the new quality sectors to earn more through the increment of quality assets and investment which also helps to increase the ROA because the bank had low ROA in most of the cases.
e) Bank is recommended to perform within the standard norms for the earning concern because most of the income ratios of earning capability of the bank, during the study period, were found out of the standard.
f) The bank is suggested to lower the current ratio as requirement because the funds field up in the current assets can not yield more and invest the surplus fund in other assets.
g) Regarding the rate sensitivity assets and liabilities, the bank has maintained higher sensitive assets. For the strong or ideal performance, it is suggested to increase the sensitive liabilities in the proportion of sensitive assets.

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Annex 1

Capital Fund Requirements

Period	On the basis of RWA*	
	Core Capital	Capital Fund
F.Y. 2063/64	6.00%	12.00%
F.Y. 2064/65	6.00%	11.00%
F.Y. 2066/67	6.00%	10.00%

* RWA = Risk Weighted Assets.

Annex 2

Risk Weighted assets

(in Rs. 000)

Particulars	Risk Weighted Assets				
	2062/63	2063/64	2064/65	2065/66	2066/67
Total Risk Weighted Assets (A+B)	**11291137**	**14976736**	**21039879**	**24131922**	**27499899**

Annex 3

Capital Fund

(in Rs. 000)

Particulars	F.Y.				
	2062/63	2063/64	2064/65	2065/66	2066/67
A) Core Capital	**926324**	**1157908**	**1812188**	**1862630**	**2351348**
i) Paid-up Capital	378000	378000	491400	638821	830467
ii) Share Premium	6427	6427	206427	14780	14780
iii) Non-Redeemable Preference Share	140000	140000	340000	200000	200000
iv) General Reserves	173566	232848	323091	450839	617193
v) Capital Adjustment Reserve	132300	170100	220100	284100	367147
vi) Accumulated Profit and Loss A/C	108640	130547	83750	82444	72621
vii) Bonus share yet to be capitalized		113400	147420	191646	249140
vii) Investment	-12609	-13414			
B) Supplementary Capital	**465015**	**518208**	**593868**	**841240**	**905793**
i) Loan Loss Provision	141139	187209	243219	320247	378005
ii) Exchange Fluctuation Reserve	16650	16968	20378	22044	22044
iii) Assets Revaluation Reserve					
iv) Hybrid Capital Instrument					
v) Unsecured Subordinate Term Loan	300000	300000	240000	180000	120000
vi) Other Free Reserves	7226	14031	90271	318949	385744
Total Capital Fund (A+B)	**1391339**	**1676116**	**2406056**	**2703870**	**3257141**

Annex 4

Total Capital

(in Rs. 000)

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Paid-up Capital	378000	378000	491400	638821	830467
General Reserve	173566	232848	323091	450839	617193
Share Premium	6427	6427	206427	14780	14780
Capital Adjustment Reserve	132300	170100	220100	284100	367147
Other Reserves	7226	14031	90271	318949	385744
Profit Loss Account	108640	132136	83749	82444	72621
General Loan Loss Provision	97572	13506	185553	242486	280308
Total Shareholders Fund	**903731**	**947048**	**1600591**	**2032419**	**2568260**
Non-Redeemable Preference Share	**140000**	140000	340000	200000	200000
Total Capital	**1043731**	**1087048**	**1940591**	**2232419**	**2768260**

Balance Sheet

Annex 5

(in Rs. 000)

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Liabilities and Capital					
Share Capital	518000	518000	831400	1030467	1279607
Reserve and Surplus	444808	683515	1089837	1173158	1479530
Loans Advance Payable	300000	300000	300000	612000	704600
Deposits	13802444	18186253	23976298	33322946	36932310
Bills Payable	15805	26776	49429	148655	145515
Other Liabilities	878227	1718029	902376	629622	841199
Total Liabilities	**15959284**	**21432573**	**27149340**	**36916848**	**41382761**
Assets					
Cash	259348	534996	822989	944696	1091500
Bank	1293620	1856424	1844982	5219675	6727314
Call Money	66960	-	346000	-	0
Investment	4200515	4984314	5059557	5948480	5008307
Loan, Advance and Bill Purchased	9801308	13664082	18339085	23884673	27556356
Fixed Assets	152090	170097	360512	427157	463094
Other Assets	185443	222660	376215	492167	536190
Total Assets	**15959284**	**21432573**	**27149340**	**36916848**	**41382761**

Annex 6

Profit and Loss Account

(in Rs. 000)

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Income	**1066509**	**1371499**	**1867227**	**2570888**	**3596657**
Interest Income	903411	1144408	1548657	2186814	3102451
Commission and Discount	96839	117718	150264	202094	208123
Exchange Fluctuation Income	14398	28404	64452	62527	47880
Non-Operating Income	2959	13002	24720	13049	95892
Other Income	48902	67967	79134	106404	142311
Expenditure	**829219**	**1073500**	**1416009**	**1932155**	**2764891**
Interest Expenses	401397	517166	632609	1012874	1572790
Staff Expenses	70925	86118	157957	186920	226364
Office Operation Expenses	143562	177546	233766	292010	322511
Loan-Written Off					
Exchange Fluctuation Expenses					
Non-Operating Expenses		796	18999	5549	61192
Staff Bonus Provision	34560	45471	65869	89132	118799
Loan Loss Provision	70466	89696	99340	93085	77011
Income Tax Provision	108309	158299	207469	252585	386224
Net Income	237290	297999	451218	638733	831766

Annex 7

Classified Loans and Provisions

(in Rs. 000)

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Loans					
Pass	10007018	13969507	18709121	24351569	28112693
Substandard	10669	4218	6306	1360	43705
Doubtful	684	2353	746	28514	12633
Loss	117883	106607	120257	88110	12633
Total	**10136254**	**14082685**	**18836430**	**24469553**	**28181664**
Provisions					
Pass	128800	164866	204783	255358	290540
Substandard	2667	1054	1577	304	1367
Doubtful	342	1176	373	14257	6317
Loss	117883	106607	120257	8811	25603
Additional Provision	85255	144899	170354	226816	276216
Total	**334947**	**418602**	**497344**	**505546**	**600043**

Annex 8

Investment

(in Rs. 000)

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
HMG's Securities	3548616	4704632	4821604	5146045	4354353
Foreign Government's Securities					
NRB's Securities					
Share Debenture, Bonds	19887	19887	101152	102034	102034
Others Investment	632011	259795	136800	700400	551920
Total	**4200514**	**4984314**	**5059556**	**5948479**	**5008307**

Annex 9

Earning Assets

(in Rs. 000)

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Bank	2991	--	--	--	--
Money at Call	66960	--	346000	--	--
Investments	4200515	4985314	5059557	5948480	5008307
Loan, Advance, Bills Discounted (Net)	10136254	14082686	18836431	24469555	28156399
Total	**14406720**	**19068000**	**24241988**	**30418035**	**33164706**

Annex 10

Deposits **(in Rs. 000)**

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Non-Interest Bearing (A)	**1337579**	**1956840**	**2865612**	**5196631**	**4719191**
Current Account	1145795	1673983	2492346	4859947	4173320
Margin	126516	222068	221439	291984	375934
Others	65268	60789	151827	44700	169937
Interest Bearing (B)	**12464866**	**16229413**	**21110686**	**28126315**	**32213119**
Saving Account	6929217	9029255	11883857	14782331	13360038
Fixed/Time Deposit	4242352	5626662	6446181	7049978	10440278
Call Deposit	1293297	1573496	2780648	6294006	8412803
Certificates of Deposit					
Total Deposit (A+B)	**13802445**	**18186253**	**23976298**	**33322946**	**36932310**

Profit & Loss Appropriation Account

Annex 11 **(In Rs. 000)**

Particulars	F.Y.				
	2062/63	**2063/64**	**2064/65**	**2065/66**	**2066/67**
Profit and Loss Allocation Account	**309380**	**406639**	**581764**	**915862**	**914210**
Balance of the last year	70533	108640	130546	83749	82445
Profit for this year	238847	297999	451218	832113	831765
Expenditures	**309380**	**406639**	**581764**	**915862**	**914210**
Loss up to last year					
Loss of this year					
Transfer to Statutory Reserve	47458	59282	90244	127747	166354
Contingency Reserve	6000	6000	9445	24278	795
Other reserves					
Dividend Equalization Fund					
Reserve Related to Staff					
Interim/Proposed Dividend					
a) Interim Dividend					
b) Proposed Dividend for Common Equity	94500	45102	107773	201733	262253
c) Proposed Dividend for Preference Share	12600	12600	23723	16347	14000
Bonus Share	0	113400	147420	191646	249140
Captal equalization fund	37800	37800	110000	264000	143047
Special Reserve			6000	6000	6000
Exchange Fluctuation Fund	826	319	3410	1666	
Previous Tax Adjustment	1556				
Balance Transferred to Balance Sheet	**108640**	**132136**	**83749**	**82445**	**72621**