

CHAPTER - I

INTRODUCTION

1.1 Background

Financial institutions play very important role in the process of economic growth of the developing country. A developing country must maintain high and sustained rate of economic development. The commercial Banks has a significant place in financial system and plays an increasingly dynamic and vital role in the economy of our country, which provides economic and financial intermediation in the economy.

The threats imposed by Nepalese economy, have made it imperative to search for opportunities in order to curb any hindrances to the economical development. Because of the importance and relevance of banks in shaping the economy, it has become important to review the banking industry and its business strategies.

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

The performance of commercial banks is governed by the policies and regulations set by the government. Central bank represents the government and plays the role of monitor and controller in every country. In our context, Nepal Rastra Bank (NRB) deserves the authority to monitor and control the financial system of Nepal. Commercial banks and other financial institutions (FIs) have to be operated according to the directives issued by NRB. NRB as an apex of monetary authority of the country started to monitor and control the financial institutions especially at the end of the 1990s by issuing the directives to the financial institutions. As the banks play the

pivotal role in the economy, their performance should be supervised by the central bank and take necessary corrective actions if their health is poor. NRB by means of regular auditing and timely supervision of FIs has been inspecting their activities to maintain their sound financial health and to build up the confidence of private sector in the liberalized economy and protect the interest of the investors. It has adopted the international banks rating system (CAMEL) to assess the financial performance of Nepalese commercial banks.

1.2 Focus of the Study

Financial performance analysis is a process of identifying the financial strengths and weakness of the firm by properly establishing relationship between the item of balance sheet and the profit and loss account. In any economy, the importance of financial sector in general and banking sector in particular cannot be undermined. The banking sector plays vital role in the overall development of an economy. The economic reforms has many more impact in Nepalese banking sector and this sector has been going through major changes as a consequence of shift in banking needs among the customers, change in regulatory framework, alternation in ownership pattern and liberalization of interest and exchange rates. While these changes have positively affected the banking sector, at the same time, increased competition due to mushrooming of financial institutions has impacted the banks negatively.

The research study is focused on assessing the financial condition and performance of two leading commercial banks, Nepal SBI Bank Limited (NSBIL) & Machhapuchhre Bank Ltd. (MBL) by using descriptive and analytical research design, prescribed by UFIRS and in accordance to BASEL accord. The study encompasses all the six components of CAMELS and carried out with annual Reports of Condition and Income. More specifically, the study focuses on the trend analysis of Capital Adequacy ratio, Non Performing Loan composition, Total Expenses to Revenues ratio, earning per employee, return on equity, return on assets, net interest margin, earning per share and liquidity with respect to NRB standard and industrial average's during the period of past five years.

1.3 Statement of the Problem

It is said that the banking sector is the mirror of the larger economy, its linkage to all sectors makes it a proxy for what is happening in the economy as a whole, indeed, the Nepalese banking sector today is at boiling point. Questions frequently raised are in a situation where most business is struggling, how can banks show such large profits? Or if the banking sector mirrors the larger economy, why is this inverse relationship in their performance? Banks and FIs can be evaluated comparing with Nepal Rastra Bank's regulatory framework, in which banks and FIs are required to maintain a standard set by NRB; CAMEL is a widely used tool to analyze financial performance of banks.

The general problem towards which the study is directed is to investigate the financial performance of Nepal SBI Bank Ltd. and Machhapuchhre Bank Ltd. in the framework of CAMEL. Based on this fundamental problem the following specific problems are set in this study.

- (a) What is the capital adequacy ratio of the banks?
- (b) What is the scenario of assets quality of sample banks?
- (c) How efficient are the managements of the banks?
- (d) What are the level, trend and stability of earnings of Nepal SBI Bank Limited & Machhapuchhre Bank Limited?
- (e) What is the liquidity position of Commercial Banks?

1.4 Objectives of the Study

It is understandable and clear that banking industry play a vital role in the progress of a nation's economy; however the performance of the banks depends to the highest degree, upon the overall political, legal economic, social and technological scenarios prevailing in the country.

The national and international economy has undergone through drastic changes over a decade and abruptly since last 5 years. The threats imposed by Nepalese economy, have made it imperative to search for opportunities in order to curb any hindrances to the economical development. Because of the importance and

relevance of banks in shaping the economy, it has become important to review the banking industry and its business strategies.

The fundamental objective of the study is to analyze the financial performance of **Nepal SBI Bank Ltd.** and **Machhapuchhre Bank Limited** by the CAMEL framework. In line with the statement of problem, the main objectives of this study are:

- (a) To examine the capital adequacy of the bank.
- (b) To analyse the quality of assets of commercial Banks
- (c) To analyze the efficiency of the bank's management.
- (d) To evaluate the level, trend and stability of Commercial Banks earnings
- (e) To find out the liquidity position of the bank

1.5 Significance of the Study

The financial sector has evolved as the biggest sector in the economy. In the entire sector banks play the pivotal role in the overall development of an economy? After the economic reforms initiated by the government, this sector has been going through the major changes. Increased competition due to mushrooming of financial institutions across the country has impacted the banking sector negatively, so the financial performance of the banks has to be evaluated properly to know the strength and weaknesses of the banks.

The UFIRS takes into consideration certain and compliance factors that are common to all institutions. The UFIRS also serves as a useful vehicle for identifying problem or deteriorating financial institutions, as well as for categorizing institutions with deficiencies in particular component areas. Further, the rating system assists in following safety and soundness trends and in assessing the aggregate strength and soundness of the financial industry. As such, the UFIRS assists the agencies in fulfilling their collective mission of maintaining stability and public confidence in the nation's financial system.

The ability of management to identify, measure, monitor, and control the risks of its operations is taken into account when assigning each component rating. It is recognized, however, that appropriate management practices vary considerably

among financial institutions, depending on their size, complexity, and risk profile. All institutions are expected to properly manage their risks.

In a concise format, the research will show the impact of management decisions and economic conditions on a banks performance and balance sheet composition. The performance and composition data that will be contained in the report can be used as an aid in evaluating the adequacy of earnings, liquidity, capital, asset and liability management, and growth management. Bankers and examiners alike can use this report to further their understanding of a banks financial condition and through such understanding perform their duties more effectively. The report is based on findings derived from public and non-public sources. It contains several years worth of data, which are updated yearly. These data are presented in the form of ratios, percentages, and rupee amounts computed mainly from Reports of Condition and Income published by the bank. The research will provide a comparative standard for future peer-group researches.

Although the various studies have been carried out regarding financial performance of banks, very few studies have employed the CAMEL framework of analysis. This study aims to analyze the financial performance of two commercial banks of Nepal in the framework of CAMEL.

The researcher is quite confident that the research will be useful to the financial sector of Nepal. The study will also be a great value for investors, equity holders, bankers, capital markets, government, financial intuitions, researchers and students.

1.6 Limitation of the Study

The present study is subject to following limitations:

- (a) This study is carried out to fulfil the partial requirement course of Masters Degree in Business Administration of Tribhuvan University.
- (b) Time Constraints. This study is conducted and completed within a short period. As a result all the concerned areas might not be covered.
- (c) Reliability of the data. This study is mainly based on the secondary data. Therefore the accuracy of results and conclusions on the reliability of published secondary data.

- (d) The study is focussed on only getting financial standing of two samples. Hence, its financial standing cannot be compared and standardised with industry average figures.
- (e) Only 5 year's data are covered by the study.

1.7 Organization of Study

The study is organized into 5 chapters. Chapter 1 provides a brief background of the study, focus of the study, objective, significance and limitations of the study.

Chapter 2 is about the review of theories and previous research in the study area. It includes conceptual framework regarding banks and performance analysis of financial institutions, and review of related studies. Chapter 3 describes the research methodologies applied to the study. This includes the population, sample, sampling procedures and sources of data. It also comprises the research design employed along with the various financial and statistical tools used in the study.

Chapter 4 comprise of presentation and analysis of data and major findings. The data collected after processing have been presented using figures and tables and results of statistical analysis are interpreted in this chapter. Chapter 5 consists of summary and conclusion of the study. It also contains the major recommendations.

CHAPTER – 2

LITERATURE REVIEW

This chapter deals with the conceptual review regarding financial performance analysis and CAMEL framework of financial performance analysis. Past studies carried out on financial performance analysis are also incorporated here. This chapter is divided into two sections. Section I deals with theoretical review where as the Section II presents the review of relevant past studies.

2.1 Conceptual Review

This sub-chapter presents the theoretical aspect of the study. It includes historical background of banking industry, evolution of banking in Nepal, concept of bank, concept of commercial bank, functions of commercial banks, financial statements of commercial banks and concept of financial performance analysis, types of financial analysis, objectives of financial performance analysis and concept of financial performance analysis in the framework of CAMEL.

Historical Background of Banking Industry

Banking is of ancient origin though little is known about it before the middle ages. The origin of commercial banking can be traced in the ancient era of Greeks and Mesopotamians as well as Romans, then the practice of storing precious metals and coins at safe places and loaning out money to the people on interest was prevalent. The traces of rudimentary banking are found in the Chaldean Egyptian and Phoenician history. According to Alfred Marshall, "In Greece, the temples of Delphi and other safer places acted as store houses for the precious metals before the days of coinage, and private purposes at interest, though they paid none themselves. Private money changers began with the task of reducing many metallic currencies, more or less exactly, to a common unit of value, and went on to accept money on deposit at interest and to lend it out at higher interest permitting meanwhile drafts to be drawn on them (*Radhaswami, & Vasudevan, 1979*)

Modern banking made its first appearance in medieval Italy, despite strong Christian prohibitions against Usury (the charging of interest) according to the Canon Law.

Florence, Genoa, and Lucca became the centers of finance and trade in Twelfth and Thirteen Centuries. The first bank called the 'Bank of Venice' was established in Venice, Italy in 1157 AD to finance the monarch in his wards. Following its establishment, the banks established were the Bank of Barcelona; even the clergy was engaged in banking, the Germans and Swiss rose to pre-eminence in the 1480. The Bank of Amsterdam was the great bank of the 17th century and it enjoyed a prestigious position, no less important than is held currently by the Bank of England, for a long time in sphere of international commerce (*Dahal & Dahal, 2002*).

The concept of modern commercial bank came into existence by the emergence of Bank of England in 1694 with a capital of £ 1.2 million by a group of wealthy London merchants and financiers. Since, at that time there was no concept of joint stock Company it was necessary to obtain, a special charter from the crown to pool their money in common venture. King William III was too pleased to grant a royal charter to Bank of England, because in return a capital subscribed of £ 1.2 million was lent to him to finance his war against France. The charter also gave the new bank the right to issue notes, payable on demand, up to the amount of the loan to the King.

In spite of the establishment of Bank of England in 1694, the development of modern commercial banking institutions had to wait for another century and four decades until the passage of banking Act of 1833 which provided freedom for the establishment of Joint Stock banks, Chile banking arose far early and rapidly in some countries that in other, it was only in the 19th century that the modern joint stock commercial banking system developed in the leading countries of the world. When colonies were established in north and South America old banking services were transferred to the new world.

Evolution of Banking in Nepal

The development of modern banks in Nepal does not have as old history as the developed countries have got. Although there are mentions of lending and other banking activities in the ancient books 'Manusmriti' and 'Kautilya's Economics'. Found evidences have proved that in the seventh century King Guna Kamadev had collected loans from the people to rehabilitate the Kathmandu Valley. According to

ancient 'Vanshawali', during the last decade of Eighth century, Sahnakhadhar, a local merchant from Kathmandu started the Nepal Era after freeing the people by paying off their loans and liabilities. By this instance, it can be understood that there might have the transaction of money depositing and lending during the Rana Regime. The Rana prime minister Ranodip Singh Rana established a state-pawned lending institution called 'Tejarath Adda' which had provide financial assistance in the form of loans to the government employees against their personal guarantee (Dhan Jamani) and deduction of a certain amount of their salary as installment charging 5% interest. Later this institute started providing loans to the general people against pledge of precious and valuable materials like gold, silver etc. Tejaratha Adda can be regarded as the father of modern banking system in Nepal.

Though Nepal had rudimentary forms of banking as early as seventh century, the history of modern banking began in Nepal only after when the first organized and modern bank Nepal Bank Ltd, established in 1973 as a semi-government organization with an authorized capital, issued capital and paid up capital of Rs. 1 corer, Rs. 25 Lacs and Rs. 8.45 Lacs respectively. Before that unorganized money market was the only source of financing for investors in Nepal. Lack of economic development programmes in those days confirmed the services of Nepal bank ltd., in accepting deposits from the public and financing them trade transactions. Later the Nepal Rastra Bank was established in 1955 which has helped to make banking system more systematic and dynamic during that time. As the time passed, the Rastriya Banjiya bank was established in 1966 in order to play a major role not only in domestic banking but also in the foreign trade.

To encourage healthy competition in the Nepalese financial sector government introduced financial sector reforms policy in 1980, which allowed the entry of foreign banks in the form of Joint Venture Bank in Nepal. There are 26 commercial banks operating in Nepal including 5 joint venture banks. Today Nepal can take legitimate pride in the remarkable growth and progress in the banking industry (*Vaidhya, 2001*)

Concept of Bank

Banking is financial institution which plays a significant role in the development of the country. It facilitates the growth of trade and industry of the national economy. However, Bank is a resource for economic development which maintains the self confidence of various segments of society and extends credit to people.

Banks are among the most important financial institutions in the economy. Banks are those institutions, which perform the indispensable task of intermediating between two individuals and institutions in order to raise funds and then loaning to the funds to deficit spending individuals and institutions. There is no unanimity among the economists about the origin of word 'banking'. Some of them insist that the term 'bank' derives from the Latin 'bancus', which refers to the bench on which the banker would keep his money and his records. Some people trace the origin to the French word 'banque' and the Italian word 'banca' which means a bench for keeping, lending and exchanging of money or coins in the market place by money-lenders and money-changers (*Upadhaya & Tiwari, 1980*).

The bank operates in the modern and competitive business environment. So it is very difficult to illustrate any absolute definition of bank. Different economists have offered different definitions such as:

According to Kolb & Rodriguez (1996), "A bank is an organization whose principal operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for expenditure".

"A Bank may be defined as Institutions which performs economic and monetary activities." The 'Bank' was originated from Italian word, 'Banco'. The business in banking is one of collecting funds from the community and extending credit (making loans) of people for useful purpose. Bankers have played a pivot role in making money from lenders to borrow. Banking is a profit seeking business not a community charity. As a profit seeker, it is expected to pay dividends and other wise add to the wealth of its shareholders. (*Rebert O, edminister, Financial Institutions*)

A bank is business organizations that receives and holds deposits of funds from others to make loans or extends credits and transfer funds by written orders of depositors. (*America: Grolier Incorporated Encyclopedia, The Word Book (Vol. 3, 1984)*)

The more developed financial system of the world characteristically falls into three parts: The central bank, the commercial banks and other financial institutions. They are also known as financial intermediaries. (*R.S. Sayers, Modern banking*)

Banks play an important role in the economic growth of a country. Banking, when properly organized, aids and facilities the growth of trade and industry and hence of national economy. In the modern economy, banks are to be considered not as dealers in money but as the leaders of development. “Banks are not just the storehouses of the country’s wealth but are the reservoirs of resources necessary for economic development.”

According to Dr. Herbert L. Hart, “A banker is one who in the ordinary course of business honors cheque drawn upon him by persons from and for whom it receives money on current account.”

“A Bank is a government regulated, profit making business that operates in competition with other banks and financial institutions to serve the saving and credit needs of its customers. The primary business of banks is accepting deposit and lending money. Banks accepts deposits from customer who wants the safety and convenience of deposit service and the opportunity to earn interest on their excess funds. Banks put their depositor’s funds to other individuals to business and to federal, state and local government.” (*Gerald Halter, Banks Investments and Funds Management*)

2.1.4 Concept of Commercial Bank

More often banks and commercial banks are interpreted as being synonym of each other but in reality they are two different areas of study. Commercial bank is one of the various types of bank and would need a separate identity before one should go any further on study of commercial banks.

Banks are business firm; Like Frisbee Manufacturer, fast food chains and text book publishers, Bankers buy input, message them a bit, burn a little incense, say the magic works and out pop some output from the oven. If there luck holds, they can sell the finished product for more than its costs to buy the raw materials in the first place.

For banker, the raw material is money. They buy it at long counter they set up in the store, then rush around to the other side of the counter, sit down behind a huge desk (a little out of breath), and sell it as soon as they can to someone else. If they are really good at their business, sometimes they can even sell it back to the same person they bought it form.

About the only way we can tell whether banker are buying money or selling it is to observe whether they are standing up or sitting down. For some unknown reasons, probably an inherited trait, bankers always stand up when they buy money (take your deposit) but invariably sit down when they sell it (make loan or buy security). (*S. Ritter, Lawrence and Sliper William*)

Commercial banks are those financial institutions, which deals in accepting deposits form persons and institutions and giving loans against securities. They provide working capital needs or trade, industry and even to agriculture sectors. Moreover commercial banks also provide technical and administrative assistance to industries, trades and business enterprises.

"Commercial banks deal with other people's money. They have to find ways of keeping their assets liquid so that they could meet the demands of their customers. In this anxiety to make profit, the bank cannot afford to lock up their funds in assets, which are not easily releasable. The depositors must be made to understand that the bank is fully solvent. The depositor's confidence could be secured only if the bank is able to meet the demand for cash promptly and fully. The banker has to keep adequate cash for this purpose. Cash is an idle asset and the bankers cannot afford to keep a large possession of his assets in the form of cash. Cash brings in no income to the bank. Therefore, the bankers have to distribute his assets in such a way that he can have adequate profits without sacrificing liquidity. (M. *Radhaswamy, S.V. Vasudevan,*)

Commercial Bank Act 2031 B.S. of Nepal has defined that "A commercial bank is one which exchanges money, deposits money, accepts deposits, grant loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose. (*Ministry of Law and Justice - HMG/N, Commercial Bank Act, 2031 B.S.*)

Under the commercial bank Act 2031 B.S., the commercial banks are those banks which provide short term and long-term debts whenever necessary for trade and commerce. They accept deposits from the public, and grant loans in different forms. They purchase and discount the bill for exchange, promissory notes, and exchange foreign currency.

"The business of commercial bank is primarily is to hold deposits and make loan and investments with the objects of security profits for its primary motive is profit, other considerations are secondary. (*Shankespeare Vaidya, Banking Management*)

Commercial banks are the heart of the financial system. They hold the deposits of many persons, government establishment, and business units. They make fund available through their lending and investing activities to borrowers, individuals, and business firms. Services from the producers to customers and the financial activities of the government. They provide a large portion of the medium of exchange and they are medial through which monetary policy is affected. These facts show that the commercial banking system of the nations is important for the functioning of the economy. (*Reed Cotter, and Gil Smith, Commercial Banking*)

Commercial banks must mobilize its deposits and other funds to profitable, secured and marketable sector so that it can earn hand-some profit as well as it should be secured and can be converted into cash whenever needed. Obviously, a firm that is being considered for commercial loans must be analyzed to find out why the firm needs money, how much money the firm needs and when and it will be able to repay the loan. Credit policy provides the bank several inputs through which they can handle their credit operation efficiently ensuring the maximum return with minimum exposure to risk, which ultimately leads the bank to the path of success.

The American institute of banking has laid down the four major function of the commercial bank such as receiving and handling deposits, handling payments for its clients making loan and investments and creating money by extension of credit. (*Principle of Bank Operation, American Institute of Banking, USA*)

Meanwhile, under the free enterprises system like USA, the interest of the nation as well as that of the individual stockholders are supposed to be best served by vigorously profit seeking. But, profit cannot be a sole objective of an enterprise and it should not be evaluated just on the ground of the profit earned. Neither the bank nor the community will be best served if the banker unreasonably sacrifices the safety of his fund or liquidity of his bank in an effort to increase income. (*Principle of Bank Operation, American Institute of Banking, USA*)

2.1.5 Functions of Commercial Banks

A modern commercial bank performs a variety of functions and services. The functions of commercial banks are grouped under five sub-headings as under:

2.1.5.1 Acceptance of Deposits

The bank accepts different types of deposits from the public:

(a) Fixed Deposit:

Fixed deposit is also known as Time Deposit. Bank offers fixed interest rate on this deposit and repays principal together with interest at fixed maturity or pays interest on regular interval but principal only at the maturity, borrowers cannot write cheque on time deposit, but the interest rates are generally higher than those of saving deposits. Time deposits have fixed maturity length, ranging from several months to over five year and have substantial penalties for early withdrawal. Time deposits are more costly source of funds for the banks.

(b) Current Deposit:

In this type of deposit, the depositor can withdraw money whenever he requires and there is not limitation in issuing cheque by the customer. This type of deposit is generally maintained by business firms, other business motive institutions and individuals that have higher volume of transactions in their account. Banks charge certain amount to the customer for not maintaining the minimum balances in the current account.

(c) Saving Deposit:

Some restrictions are imposed on the depositor under this account. For example, s/he can withdraw only a specified sum of money in a day. Generally, in this type of deposit banks accept deposits from individuals and non-profit making organization. NRB however does not bar banks from accepting saving deposits form profit making organization. Saving deposits attract interest which is normally less than that of long term deposit but more than that of short term deposit. Saving deposit is an important source of Bank funds. Saving deposit are payable on demand, that is, if a depositor shows up at the bank and requests payment by making withdrawal, the bank must pay the depositor immediately.

(d) Recurring Deposit:

The purpose of this account is to encourage regular savings by the public, particularly by the fixed income group. Generally, money in these accounts is deposited in monthly installments for a fixed period and is repaid to the depositors along with interest on maturity.

(e) Call Deposit:

Call deposit incorporates the characteristics of currents and saving deposit. Current in the sense, deposits is withdrawn at call and savings in a sense the deposits earns interest. Interest rate on call deposit is negotiable between the bank and the depositors and hence it is normally not announced in public.

2.1.5.2 Advancing of Loan

The various types of loans and advances are as follows:

(a) **Cash Credit:**

It is revolving type of loan account, normally granted against stock and receivables. This account is regulated by stock statements and drawing power wherein credit/debit transactions are permitted within the sanctioned limit. The level to which debit balance can be permitted is decided by drawing power or limit whichever is lower. Cash credit is normally granted against security of certain commodities, products or book debts/receivables.

(b) **Overdraft:**

The bank allows its credit worthy and reliable customer to overdraw their accounts through cheques. The customers, however, pays interest to the bank on the amount overdrawn by them. An overdraft is granted against security of certain investments like Bonds/ Fixed Deposits or some time it is given against personal guarantee.

(c) **Demand/Term Loan:**

Demand loan is a loan provided on repayment basis and is not a running account. Demand/Term loan once granted will have a debit for the quantum sanctioned and thereafter only credits of repayment, normally personnel in nature, are permitted. It is given against security and the security will be in the form of fixed assets or fixed deposits and it will never be given against stocks. These loans are granted to acquire fixed assets like machinery and construction works.

(d) **Trust Receipt Loan:**

Trust receipt loans are sanctioned as a limit to be utilized against hypothecation of stocks imported under own letters of credit, normally for a period of 90 days. It is in the nature of demand loan, which is liquidated by 2-3 installments and the limit is not cancelled with liquidation but is reinstated. Hence this loan is more in the form of working capital loan.

(e) **Bill/Cheque Purchase/Discounting:**

This is the best form of advance in terms of credit discipline as it is self-liquidating in nature. Any trader/industrialist receives payments by cheques or draws documents on the buyer. These cheques/bills of exchange are discounted by the banks and in turn receive commission.

(f) Money at Call and Short Notice:

These loans are generally made to other banks and financial institutions. Such loans are very short period loans and can be called back by the bank at a very short notice of one day to 14 days.

2.1.5.3 Agency Functions of Banks

The various agency services rendered by the banks are as follows:

(a) Transfer of funds:

Fund transfer from one place to another is the necessity of the today's world but the physical transfer of cash from one place to another involves many risks. The banks help their customers in transferring funds from one place to another place through different mechanism such as bank draft, fax, TT and SWIFT and so on. People transfer money to or from one country to another such as Nepalese who are in abroad for foreign employment send their earnings through foreign bank to Nepalese bank called as inward remittance. Or one can transfers money to another country from Nepal called as outward remittance. In export and import business, a firm needs to send/bring money from/to a country. A firm that need to import raw material for producing its goods opens LC in a bank or it may directly import without opening LC in case it pays to the party in advance - called as outward remittance. Or a Nepalese firms export goods to a firm in abroad need to pay the bills to Nepalese party called as inward remittance.

(b) Collection of Funds:

The bank collects the funds of its customers from other banks and credits to their accounts. The customers do have bills/cheques that need to be collected from the other banks in own country or foreign. A bank plays a role of intermediary in collecting funds from other banks. Banks collect bills or cheques through local clearing or outward bills collection (OBC) through their correspondent banks.

(c) Purchase and Sale of Share and Securities:

The bank buys and sells stocks and shares of private companies as well as government securities on behalf of customers. Customers who wish to buy/sale securities and shares can get access through a bank which acts as an intermediary institution.

(d) Trustee and Executor:

A bank is registered under the existing laws of the nation and operates subject to the rules and regulations laid down in the act. So, the bank preserves the will of the customers and executes them after their deaths. This function of a bank is bound by specific laws and facilities to customers in trust worthy way.

(e) Acts as correspondent:

The bank may also act as a correspondent, agent or a representative of its customers. Global trade is widely practiced now a day. A bank in a part of world does have a correspondent bank in other corner of the world. The channel of correspondence bank helps clients do their business operating in any corner of the globe. Imports and exports business heavily rely on banks as they act as a correspondent to their clients in another country. Personal remittances too flow in and out through the banks having correspondence with other banks.

(f) Purchase and sale of Foreign Exchange:

The bank also carries on the business of buying and selling foreign currencies. Generally exchange of foreign currencies in developed countries is done by exchange company/banks but due to lack of exchange banks in our country this function is done by commercial bank. Tourists carrying foreign currency (FCY) such as US dollars, Great Britain Pounds (GBP), EURO and so on can exchange their currency in banks. This function has facilitated many people across the world. People in need of FCYs also get easily in their home country provided the purpose of their need is as per central bank regulations regarding FCYs exchange.

(g) Creation of Credit:

Creation of credit is one of the most important functions of commercial banks. In order to earn profits, they accept deposits and advance loans by keeping small cash in reserve for day-to-day transactions. When a bank advances a loan, customers need to open an account to draw money by cheque according to his needs. By granting a loan,

the bank creates credit or deposit. Bank lending in productive sector has multiplier effect in the economy. It not only helps the particular borrower / entrepreneur, it helps generate employment, contributes positively to international trade, and enhances national income and savings.

2.1.5.4 General Utility Services

Apart from agency services, the bank also renders some useful services known as general utility services. They can be explained as follows:

(a) Safekeeping of valuables:

During the middle ages banks began the practice of holding gold, securities and other valuables owned by their customers in secure vaults. A modern bank also receives from its customers, valuables such as securities, jewelries, documents of title of goods etc. for safe custody. The bank acts as the custodian of the valuables belonging to the customers. The bank receives them and returns back when demanded.

(b) Assist in Foreign Trade:

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

(c) Making Venture Capital Loans:

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

(d) Financial Advising:

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

(e) **Automated Teller Machine (ATM):**

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

(f) **Anywhere Branch Banking System (ABBS):**

Banks offer account holder of a branch to avail some banking services from other branches located at various parts of the country which is called anywhere branch banking service. This is one of the distinguished features of the modern banking services.

(g) **Tele-banking:**

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

(h) **Credit/Debit Card:**

Banks issue credit cards to highly credit worthy customers. Banks also issue debit card as well. This relieves the customers from carrying cash.

Besides these functions, a commercial bank also finance internal and foreign trade, collects statistics about money, banking, trade and commerce and underwrite shares and debentures issued by private companies, offer some of the banking services at the door of highly valued customers. It also guarantees to other parties on behalf of its customers to make payment up to a specified sum of money to the beneficiary on demand in case of default by its customers. Further, a commercial bank also facilitates the trading between two parties who live in different countries through letters of credit and guarantees the seller of payment in case the buyer defaults to pay.

2.1.6 Financial Statements of Commercial Banks

Financial information of commercial banks is reported in two basic documents. The report of condition (or Balance Sheet) presents financial information on a Bank's assets, liabilities and equity capital. The balance sheet reports a Bank's condition at a

single point of time. The report of Income (or the Income statement) presents the major categories of revenues and expenses (or cost) and the net profit or loss for a Bank over a period of time. Financial statements of commercial banks must be submitted to regulators and stockholders. Financial institutions are also engaging in an increase level of off-balance sheet (OBS) activities. These activities produce income (and sometimes losses) for the FIs that are reported on the income statement. Retail banks focus on individual consumer banking relationship, such as residential mortgages and consumer loans on the asset side of the portfolio, and individual demand, savings and time deposits on banking relationship, such as residential mortgages and consumer loans on the liability side. In contrast, wholesale banks focus their business activities in business banking relationship, they hold more business loans and fewer mortgages and consumer loans and use fewer consumer deposits and more purchased funds than retail banks do.

Financial statements report both on the firm's financial position at a point in time and on its operations over some past couples of years regarding what they have performed financially, this is reporting about what the company has done in terms of assets, liabilities, income and expense, Alternatively, they highlight in important financial aspects such as liquidity, profitability, activity capital structure and market capitalization value. Annual report made available to the shareholders in annual general meeting is the basic raw material of financial analysis, comments and interpretation. Shareholders raise various issues regarding irregularities, operational inefficiencies and internal management deficiencies causing poor performance of a company. Financial statements collected, consolidated and analyzed by Nepal Stock Exchange Limited provide better insights about the company's performance. In other words, financial statements comprise:

2.1.6.1 Balance Sheet

As the name implies, the balance sheet list balances that is, it has the characteristics that $\text{Total Asset} = \text{Total Liabilities} + \text{Capital}$. Hence, the balance sheet is a statement of the firm's financial position at a specific point in time regarding assets, liabilities and stockholder's equity to balance debt and ownership position. The Balance Sheet is a statement of resources at the disposal of the firm and how they are put to use. In

other words the acquired assets at the disposal of the firm and liabilities that the firm has incurred and remains indebted to others.

Furthermore, a Bank's balance sheet lists sources of Bank funds (liabilities) and uses to which they are put (assets) Bank obtain funds by borrowing and by issuing other liabilities such as deposits. They then use these funds to acquire assets such as securities and loans. Banks make profits by charging an interest rate on their holdings of securities and loans that is higher than the expenses on their liabilities.

Assets

A bank's assets are grouped into four major sub categories: (1) Cash and balance due from other depository institutions (2) Investment Securities (3) Loans and Leases and (4) Other Assets. Investment Securities and loans and leases are the bank's earning assets. Cash and balances due from depository institutions consists of vault cash, deposits at the Central Bank, deposits at other financial institutions, and cash items in the process of collection. None of these items generate much income for the bank, but each is held because they perform specific functions. Vault cash is composed of the currency and coin needed to meet customer withdrawals. Deposits at the central bank are used primarily to meet legal reserve requirements to assist in cheque, clearing, wire transfers, and the purchase or sale of Treasury securities. Deposits at other financial institutions are primarily used to purchase services from those institutions. These banks generally purchase services such as cheque collection cheque processing, and investment advice from correspondent banks. Cash items in the process of collection are cheque written against accounts at other institutions that have been deposited at bank.

Credit is given to the depositor of this cheque only after they clear. Investment securities consist of items such as interest bearing deposit at other financial institutions, repurchase agreements, Treasury and agency securities, securities issued by central bank and other debt and equity securities. These securities generate income for the bank and are used for liquidity risk management purpose. Investment securities are highly liquid, have low default risk and can usually be traded in secondary markets. Banks generally maintain significant amount of these securities to ensure that they can easily meet liquidity needs that arise unexpectedly. However,

because the revenue generated from investment securities is low compared to that from loans and leases, many banks attempt to minimize the amount of investment securities they hold.

Although banks with excess cash reserves invest some of this in interest earning liquid assets such as T-bills and short term securities, they have the option to lend excess reserves for short intervals to other banks seeking increased short-term funding. The market for excess reserves is inter-bank dealing. In an inter-bank transaction, the bank with excess reserves sells funds for one day to the purchasing bank. The next day the purchasing bank returns the funds plus one day's interest reflecting the market rate. Since credit risk exposure exists for the selling bank, because the purchasing bank may be unable to repay the funds the next day the seller may seek collateral backing for the one-day funds loan. In the context of Nepalese banking sector banks generally do not seek collateral but set the limit of exposure to the other banks. In this transactions, the funds selling bank receives government securities as collateral from the funds purchasing bank that is, the funds purchasing bank temporarily exchanges securities for cash. The next day, this transaction is reversed - the funds - purchasing bank sends back the funds it borrowed plus interest rate; it receives in return its securities used as collateral in the transaction.

Long-maturity investments such as NRB bonds usually offer somewhat higher expected returns than short-maturity investment since they are subject to greater interest rate risk exposure. Treasury securities and NRB Bonds are fully backed by the government and thus carry no default risk.

Loans are the major items in a bank's balance sheet and generate the largest flow of revenue income. However, loans are also the least liquid asset item and the major source of credit and liquidity risk for most banks. Leases are used as alternatives to loans when the bank, as owner of a physical asset, allows a customer too use an asset in return for periodic lease payments. Loans are categorized as commercial and industrial loans, loans secured by real estate, individual or consumer loans, and other loans. Commercial and industrial loans are used to finance a firm's capital needs, equipment purchases, and plant expansion. Commercial loans can be made at either fixed rates or floating rates of interest. This rate remains in force over the loan

contract period no matter what happens to market rates. The interest rate on revolving loans such as cash credit loan and overdraft loan can be adjusted periodically so that the interest rate risk is transferred in large part from the bank to the borrower. Commercial loans can be made for periods as short as few weeks to as long as eight years or more. Traditionally, short-term commercial loans are used to finance credit needs that extend beyond one year, such as the purchase of real assets (machinery), new venture start-up costs, and payment increases in working capital. Commercial loans can be secured or unsecured. A secured loan is backed by specific assets of the borrower; while an unsecured loan gives the lender only a general claim on the assets of the borrower should default occur.

However, in Nepalese banking sector all most all the loans are secured by collateral or fixed property such as real state, house building, equipments and machineries. Housing loans are primarily mortgage loans which are generally long term loans with an average maturity of approximately 10 years. Housing loans are made to purchase, construct and repair a house. Another major category of loans is the individual or consumer loan for example personal and auto loans. Commercial banks, finance companies and co-operatives also provide consumer loan financing. It can be in the form of auto loan, personal loan, educational loan etc. Each loan category entails a wide variety of characteristics that must be evaluated to determine the risk involved, whether the bank should grant the loan, and if so, at what price.

Unearned income and the allowance (reserve) for loan and lease losses are contra-asset accounts that are deducted from gross loans and leases on the balance sheet to create net loans and leases. Unearned income is the amount of income that the bank has received on a loan from a customer but has not yet recorded as income on the income statement. Over the life of the loan, the bank earns (or accrues) interest income and accordingly transfers it out of unearned income into interest income. The allowance for loan and lease losses is an estimate by the bank's management of the percentage of the gross loans (an leases) that will not be repaid to the bank, Although the maximum amount of the reserve is influenced by tax laws, the bank's management actually sets the level based on loan growth and recent loan loss experience. The allowance for loan losses is an accumulated reserve that is adjusted each period as management recognizes the possibility of additional bad loans and makes appropriate

provisions for such losses. Actual losses are then deducted from, and recoveries are added to (referred to as net write-offs), their accumulated loan and lease loss reserve balance. Investment securities plus net loans and leases are the earning assets of a depository institution. It is these items in the balance sheet that generate the most interest income.

Other assets in the bank's balance sheet consist of items such as premises and fixed assets, other real estate owned (collateral seized on defaulted loans), investments in unconsolidated subsidiaries, intangible assets (i.e. goodwill and mortgage servicing rights) and other (i.e. deferred taxes, prepaid expenses, and mortgage servicing fees receivables). These accounts are generally a small part of the bank's overall assets.

Liabilities

A bank's liabilities consists of various types of deposit accounts and other borrowing used to fund the investments and loans on the asset side of the balance sheet. Liabilities vary in terms of their maturity, interest payments, check-writing privileges, and deposit insurance coverage. A bank acquires funds by issuing (selling) liabilities, which are consequently also referred to as sources of funds. The funds obtained from issuing liabilities are used to purchase income earning assets.

Current accounts are transaction accounts held by individuals, business firms, corporations, and other institutions that pay no explicit interest. Saving deposits are all saving accounts other than current accounts. In saving accounts and current accounts some minimum balance should be kept.

The major categories of time deposits are fixed deposit. Fixed deposits are fixed maturity instruments. Although the size, maturity, and rates on these FDs are negotiable, most banks issue standardized FDs.

Deposits can be separated as foreign from domestic deposits on the balance sheet but it is not generally practiced in Nepal. Foreign deposits are generally large and held by corporations with a high level of international transactions activities. The liabilities described above are all deposit liabilities, reflecting deposit contracts issued by banks

in return for cash. However, banks not only fund their assets by issuing deposits but borrow in various markets for purchased funds, since the funds generated from these purchases are not deposits; they are subject to neither reserve requirements nor deposit insurance premium payments. The banks can also borrow funds from other bank for certain period; generally short term of 2/4 days and these transactions can be rolled over each day if the contemporary is willing. Some banks in search of stable sources of funds with low withdrawal risk have begun to issue subordinated notes and debentures, often in the five to seven years range. These notes are especially attractive because they are subject to neither reserve requirements nor deposit insurance premiums, and some can serve capital for the bank to satisfy NRB regulations regarding minimum capital requirements. Banks facing temporary liquidity crunches can borrow from the central Bank's discount windows at the discount rate. Since this rate is not market determined and usually lay below government security rates, it offers a very attractive borrowing opportunity of a bank with deficient reserves as the reserve maintenance period comes to an end.

Some bank separate core deposits from purchased funds on their balance sheets. The stable deposits of the bank are referred to as core deposits. These deposits are not expected to be withdrawn over short periods of time and are therefore a permanent source of funding or the bank. Core deposits generally are defined as demand deposits, current accounts, and saving accounts. Purchased funds are more expensive and/or volatile sources of funds because they are highly rate sensitive these funds are more likely to be immediately withdrawn or replaced as rates on competitive instruments change. Banks also list other liabilities that do not require interest to be paid. These items consist of accrued interest, deferred taxes, dividends payable, and minority interest in consolidated subsidies, and other miscellaneous claims.

2.1.6.2 Income Statements

Income statement shows the net result of the business operations. Banks have to be efficient to prove their viability depending upon their income generating power and cost minimizing strategy. The income statement reflects the earning capacity of the bank. The success or failure of bank largely depends on the differences between income and expenditures. The major determining factor of bank's soundness is supposed to be a net income though there are other factors too are equally important. The success is the measure of the excess of income over expenditure while failure is the cause of the excess of income over expenditures over income. Interest income by nature should be sufficient to cover interest expenses plus other overhead costs of the bank's revenues and expenses. Revenues are the interest received from loan values supplied to the customers. Expenses are the paying interest to depositors. Generally, commercial banks earn profit by mobilizing deposits of the customers.

The major sources of bank income are interest earnings assets held by the bank such as loans which generate interest income. Besides, commission and discount, exchange fluctuations gain, investment in securities, shares and debentures and other operating incomes and are sources of bank's income. Expenditures on the other hand are produced by interest bearing liabilities such as deposit liability. Moreover, staff expenses, exchange fluctuation loss, other operative expenses, interest on debentures and borrowings from other banks are sources of expenditures. The net interest income is defined as:

$$\text{Net interest income (NI)} = \text{interest income} - \text{interest expenses}$$

2.1.7 Financial Performance Analysis

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

A commercial bank is simply a business corporation organized for the purpose of maximizing the value of shareholders wealth invested in the firm at an acceptable

level of risk. Profit is one of the basic indicators of sound financial performance. It is usually the result of sound business management, cost control, credit risk management and general efficiency of operation (Robinson & Wrightman, 1957). Profit is essential for a firm for its survival, growth and to maintain capital adequacy through profit retention. The objective of maximizing profit with a level of risk acceptable to the bank's stockholders is not easy to achieve, as the recent upsurge in bank failures around the globe clearly suggests. Under the free economic system like USA or liberal economic system of Nepal, the interest of the nation as well as those of the individual stockholder's are supposed to be best served by vigorously seeking profit.

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

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

A fair evaluation of bank's performance should start by evaluating whether it has been able to achieve the objectives its management and stockholders have set. The fundamental analysis in terms of financial analysis is different from market message reflected in technical analysis guided by the investors 'psychology based in speculators' manipulation of information. These are very different from industry and overall economic analysis (Shrestha, 2004). Financial decisions cannot be made in vacuum. They are to be based on proper financial analysis by using financial tools

such as financial ratios so as to maximize the financial performance of a company. Annual report contains financial statements as well as management opinion of the past year's performance and firm's future prospects. In financial analysis, certain guiding criteria include.

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

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

Obtain information that can be used for decision making.

Judge performance and management effectiveness.

Identify the deficiencies and weaknesses.

Take corrective actions timely to improve the performance.

Gain adequate insights into the possibilities of making changes worthwhile.

Evaluate the possible implications of alternative courses of actions.

The roots of major management decisions revolve around financial information. A careful scrutiny of alternative choices on the basis of projected information depicting the comparative results of each is needed to arrive at the selection of most favorable decision for eventual implementation. This brings us to the question what constitute financial information? The basic source covering financial information about a firm's affairs is its annual final accounts i.e. Profit & Loss Statement for the last operating period (quarter / half year / year etc) and balance Sheet as at the need of that period. Profit and Loss accounts reveal the operating results of the business activities of the firm. These sources, however, reveal only part of the necessary and required information and leave a considerable gap. It is therefore necessary to further examine and break-down the information in these statements with a much greater elaboration and detail to decipher the comparative strengths and weaknesses of the firm. For this

purpose, we can employ certain analytical tools and perceptive statements based on the source data from the balance sheet and profit & loss account statements.

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

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

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

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

Identify the source information relevant to the decision to be made from the total pool of data provided by the annual financial statements.

Re-arrange the particular data selected to highlight significant relationship

Study the analyzed information critically and draw pertinent conclusions there from

2.1.7.1 Types of Financial Analysis

It may be categorized as external or internal analysis based to whom it is intended. Internal analysis for management information and decision thereon are generally more

detailed than external analysis intended for trade creditors, investors, term lending institutions and bankers supplying working capital.

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

(a) Trend Analysis:

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

(b) Ratio Analysis:

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

(c) Funds Flow Statement:

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

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

2.1.7.2 Concept of Financial performance analysis in the framework of CAMEL

CAMEL rating system is an international bank rating system with which bank supervisory authority rates institutions according to six factors. The five areas examined are represented by the acronym "CAMEL". In this acronym, each letter stands:

C - Capital Adequacy

A - Asset Quality

M - Management Quality

E - Earnings

L - Liquidity

(a) Capital Adequacy:

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

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

The advantages of the bank capital adequacy are as follows:

If the bank has an adequate bank capital, people trust upon such banks, such bank becomes successful to gain the trust of all sectors.

If the bank has adequate capital, it can invest into any sectors at any time from which the bank gets success to gain a lot of profit.

The bank doesn't face problem to collect the capital.

The bank doesn't need to take loan, and don't have to pay interest.

There will be not possibility of liquidation of bank.

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

(b) **Asset Quality:**

A bank's assets are grouped into four major sub categories: (a) cash and balance due from other depository institutions (b) investment securities (c) loans and leases and (d) other assets. Among them loans and advances dominate the asset side of the balance sheet of the banks. Similarly, earning from such loans and advances occupy a major space in income statement of the bank. Hence, asset is the critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. Many financial crises in the past (including the Asian crises) have been caused or amplified by downturns in particular sectors of the economy spilling over into the financial system via concentrated loan books of financial institutions. However, loans are also the least liquid asset item and the major source of credit and liquidity risk for most banks. Thus, quality of assets has direct impact in the financial performance of a financial institution. The quality of assets has direct impact in the financial performance of a financial institution. The quality of assets particularly, loans assets and investments, would depend largely in the risk management system of the institution. We can use number of measures to indicate the quality of assets held by the banks. An increasing trend in the ratio of non-performing loans to total loans signals deterioration in the quality of credit portfolios and consequently in financial institutions cash flows, net income and solvency. It is often helpful to supplement this information with information on nonperforming loans net of provisions, and on the ratio of provisions plus interest suspension on impaired loans to total loans - particularly if impaired loans have not yet been classified as nonperforming. Although these indicators are primarily backward looking, reflecting past problems that have already been recognized, they can be useful indicators of the current health of the financial system, and are often used in connection with stress tests of financial institutions. Trends in nonperforming loans should be looked at in conjunction with information on recovery rates - for example, using the ratio of cash recoveries to total nonperforming loans. Such information points to the level of effort or the ability of financial institutions to cope with high nonperforming loan portfolios. Loans outstanding to loss-making public sector entities are often the result of past directed lending, may also signal significant credit risk. Depending on the country, loans to loss-making public enterprises or to regional governments may not be classified as nonperforming, even though they may not be repaid on a timely basis and/or in full. (ADB 2002)

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

- (a) Interest and / or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan.
- (b) The account remains out of order for a period of more than 180 days, in respect of an overdraft/cash credit (OD/CC).
- (c) The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted.
- (d) Interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
- (e) Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

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

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

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

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

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

(i) Pass Loan:

Loans in this category are performing and have a sound fundamental which includes borrowers overall financial conditions, resources and cash flow, credit history and character. They also include the purpose of loan, and types of secondary sources of repayment. Loans and advances whose principal amount are not past due and past due

of for a period up to 3 months shall be included in this category. These are classified and defined as performing Loans or Performing Assets.

(ii) Substandard Loan:

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

(iii) Doubtful Loan:

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

(iv) Loss/Bad Loan:

These loans are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer full provision or writing of this basically worthless loan. Partial recovery of this may be possible in future. All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

(v) Loan Loss Provisioning:

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

<u>Types of Loans</u>	<u>Loan Loss Provisioning</u>
Pass	1 percent
Substandard	25 percent

Doubtful	50 percent
Loss/Bad	100 percent

Apart from the above mentioned arrangement following additional arrangement are provided for the loan loss provisioning.

Where the loan is extended only against the personal guarantee statement of the assets, equivalent to the personal guarantee amount not claimed by another shall be obtained. Such loans shall be classified as per above and where the loans fall under the category of pass, substandard and doubtful, in addition to the normal loans loss provision applicable for the category, an additional provision by 20 percentage shall also be provided.

The loan loss provisioning in respect of rescheduled, restructured and swap loans shall be provided at a minimum of 12.50 percent.

In case of priority sector loans the provisioning are made 1%, 25%, 50% and 100% to the loan categorized as pass, substandard, doubtful and loss respectively. However, in respect of insured loans, the provisioning should be made on the following way.

<u>Types of Loan</u>	<u>Loan Loss Provisioning</u>
Pass	0.25 percent
Substandard	6.25 percent
Doubtful	12.50 percent
Loss/Bad	25.00 percent

(c) **Management:**

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

performed poorly. Human resource management is a key management issue. Good or bad human resource management translates into staff efficiency of a particular bank.

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

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

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

(d) Earnings:

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

Net income (after tax) to total assets, net earnings (after tax) to core capital, net spread, net interest margin and net operating margin can be used to assess the earning performance of the bank.

(e) Liquidity:

Banks are in business where liquidity (ability to pay cash to its depositors) is of prime importance. Liquidity ratios are used to judge a bank ability to meet short-term obligation. It is the comparison between short-term obligations and short-term resources available to meet such obligations. Liquidity risk threatens the solvency of financial institutions. In case of commercial banks first type of liquidity risk arises when depositors of commercial banks seek to withdraw their money and the second type does when commitment holders want to exercise the commitments recorded off the balance sheet. Commercial banks have to borrow the additional funds or sell the assets at fire sale price to pay off the deposit liabilities. They become insolvent if sale proceeds of the assets are not enough to meet the liability withdrawals. The second type of liquidity risk arises when demand for unexpected loans cannot be met due to the lack of the funds. The banks can raise the funds by running down their cash assets, borrowing additional funds in the money markets and seeking off other assets at distressed price.

Commercial banks are directed by NRB to maintain 5.5% of their deposits as CRR in NRB's account to ensure adequate liquidity. As per NRB regulations banks has to maintain CRR on a weekly basis. Therefore, if a bank has maintained higher NRB balance on other days of the week, it can afford to maintain lower than five percent balance on next days. Therefore, rather than disclosing the CRR of year-end, banks should report the exact CRR ratio maintained during the week, in which year-end falls. Deposit organization like banks, showing lower than regulatory CRR in their annual accounts, might lead to depositors mistrust towards the bank. NRB should ensure that the banks report correct CRR ratio in their annual accounts.

Cash and bank balance to total deposit ratio is designed to measure the bank's ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower ratio indicates that banks might face a liquidity crunch while paying its obligations, where as a very high ratio points out that the banks have been keeping idle funds and not deploying them properly. From the above table we can see that all the banks have set aside reasonable funds to meet their payment obligations.

Banks around the world invest a significant portion of their deposits in government securities because maintain adequate CRR and C & B balance only cannot be considered sufficient for liquidity maintenance. There are occasions when a bank may need to face unexpected withdrawals. In such cases, as banks are run from depositor's money they need to maintain adequate investment in government securities as such investments can be liquidated at any point in time.

Review of Related Studies

Review of Thesis

For the purpose of this study the relevant thesis works which are completed by thesis workers regarding the various aspects of banking sector that are discussed as follows.

Singh (1988): Singh conducted a research on a comparative evaluation of financial performance of Nepal Arab Bank Ltd. and Nepal Grindlays Bank Ltd. in 1988. The researcher found that the major sources of funds collected by the banks were total deposits shareholder's equity and borrowed funds. During the period NGBL had higher total deposits than NABIL except in the year 95/96. NGBL had been able to collect more deposit on saving account where as NABIL in current account. Similarly, the researcher concluded, regarding the use of funds that the total assets of both of the banks were increasing each year. The researcher recommended that both banks should increase their liquidity as far as it does not remain idle which assign the poor performance. The loan and advances to total deposits ratio of both banks were fluctuating which meant the investment has not been done in stable manner. The researcher also suggested decreasing its debt to equity ratio since the ratio of both banks was excessively high".

Bohara (1992): Another study was conducted by Bohara on a comparative study of financial performance of the JVBs in Nepal. The objectives of this study were to analyze policies and basic functions of JVBs and to evaluate the comparative financial performance of joint venture banks in Nepal. The researcher has found that current ratios-loans and advances to current assets ratio and fixed deposit to total deposits ratio of NIBL was higher than NABIL; activity ratio of NIBL was also higher than NABIL. In profitability ratio, interest earning to total assets ratio and return on net worth ratio of NIBL was better than that of NABIL but net profit to total assets ratio and net profit to total deposit ratio of NABIL was better than NIBL. Thus NABIL has been adopting aggressive lending policy, investment and borrowing policy to earn more than NABIL. the study concluded that "Bank performance cannot be judged solely in terms of profit, bank earn profit by maintaining adequate liquidity and safety position but it should also be evaluated on the ground of the contribution it has made to assist on community, government and national economy or the social and national priority discharged by banks. This meant the banks should come forward to perform national priority task i.e. more deposit mobilization and resource mobilization. Those

tasks are possible when they expand branches, create more employment, and provide services to more customers developing skills and expertise in local staff, satisfaction on profit earning and exchange of autonomy provided by them. The accountability can be discharged by following their rules regulation, instructions, directions and priorities.

Joshi (1993): A research study had been conducted by Joshi on financial performance of commercial banks of Nepal with reference to financial analysis of Rastriya Banijya Bank. The basic objective of this study was to provide conceptual framework of commercial bank, and to analyze and interpret these financial variables of Rastriya Banijya Bank (RBB) in qualitative and quantitative performance basis. The study has covered the time span of 2042 B.S. to 2046 B.S. The researcher has applied various financial ratios like current, liquidity, funded debt to total capitalization, and funded debt to equity. The researcher has concluded that the performance of RBB was not satisfactory during the study period. Further, the researcher concluded that bank had not been managed in true professional approach but had managed in bureaucratic approach to sustain with political environment rather than commercial environment.

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

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

Another study under taken by Singh on a brief study in resource utilization by Nepalese commercial banks has concluded that banks were found inefficient in deposit utilization during seven years under study. Bank's branch expansion in rural sector was unsatisfactory. There was higher degree of positive correlation between expansion and collection of scattered savings and extension and extension of credit by banks as well. Likewise, there was higher degree of positive co-relation between deposit collection and extension of credit by bank and there was a positive co-relation between interest rate and deposit collection.

Dhakal (2001): Another study conducted by Dhakal on a Financial Performance of Nepal SBI Bank Ltd. and Nepal Indosuez Bank Ltd. concluded that liquidity position of Nepal Indosuez bank Ltd. is comparatively better than that of Nepal SBI Bank Ltd. It has adopted aggressive lending investment and borrowing policy which has generated more profit than NSBL. The researcher has recommended acting according to the government plans and policies on mobilizing their deposits in the productive sectors. The researcher has suggested stabilizing the cash and bank balance to total deposit ratio of both the banks after proper diagnosis of the root to the cause. The researcher based his study on overall financial performance of the banks. It was not particular on investment policy of the banks though the study has covered the deposit mobilization of these banks. For the purpose of the research study the researcher had set the objectives i.e. to study on the limited five year position of two JVBs. The

researcher had used descriptive research design based upon the secondary data. The researcher had used qualitative rather than quantitative analysis. Throughout the study the research was focused on investment practices and its impact on the practice among the bankers. But the researcher was not clear on investment policy. The researcher is only looked on the ground of the bank's side but his study was much more silent on the customer's point. It was truly accepted that by investing on the priority sector, taking on consideration of the remote sector business, although it was less profitable but was sustainable for the overall country's development.

Oli (2001): Oli had conducted a study on a comparative study of the financial performance of Himalayan Bank Ltd., Nepal SBI Bank Ltd. and Nepal Bangladesh Bank Ltd. The researcher found that the current ratio of HBL was below that normal standard 2:1 so HBL suggested increasing its current assets. The researcher suggested that the liquidity position of HBL, NSBIL and NBBL were fluctuating and was not in satisfactory level. Therefore, the banks were suggested to keep the reasonable amount of liquidity so the bank should maintain their short-term solvency position. The capital structure of three JVBs was highly leveraged. The total debt to shareholders equity ratio has indicated that the use of debt by the three banks helped to enhance the rate of return on shareholder's fund. However, excessive use of debt in non-profitable business may cause solvency of these banks so these JVBs were suggested to maintain improved improper balance of total debt to shareholders equity and basically capital structure as required by increasing equity base. It has been recommended that to HBL it was required by increasing equity base. It has been recommended that to HBL it was required to sustain and enhance its provision for possible issues due to excessive loans and advances in order to prevent from the threat of insolvency. Profitability position of three JVBs was not found satisfactory but profitability position of HBL was comparatively better than the same of NSBL and NBBL. So NSBL and NBBL have been recommended to utilize their resources more efficiently for generating more profit margins. The major sources of income of three JVBs were from the interest income. NBBL has been investing more in government securities rather than investing loan and advances. The researcher further suggested that the banks needed to minimize their operation expenses as far as possible since it contributes to enhance the volume of profit. The researcher finally recommended that banks should fulfill some social obligations by extending their resources to rural areas

and promoting the development of extending their resources to rural areas and promoting the development of poor and disadvantaged groups. In order to do so the banks should open their branches in remote areas with the objective of providing cheaper banking services.

Hence this study was descriptive rather than analytical. The qualitative analysis might not be enough to present exact picture of the status of the banks. Further the research was revolved around policy issued rather than practical issues. The analysis of financial performance aspect among the banks was a part of his research. Of course his suggestions seem to be very worthy from the customer's point of views but his study is silent on the sustainability of the bank's ground.

Deoja (2001): Deoja conducted study entitled "A Comparative Study of the Financial Performance between Nepal State Bank of India Limited and Nepal Bangladesh Bank Limited." The researcher's main objective of study was to evaluate the trend of deposits and loan and advances of NSBIL and NBBL and to evaluate the liquidity, profitability, capital structure, turnover and capital adequacy position of NSBIL and NBBL. Through research found that the cash and bank balance to current assets, saving deposit to total deposit etc. of NABIL are higher while fixed deposit to total deposits, loans and advances to current assets of NBBL are higher and NBBL has better turnover than NSBIL in terms of loan and advances to total deposits ratio and loan and advances to fixed deposit ratio. Through the study of the different ratios has concluded that both banks are highly leveraged.

Bhandari (2005): Bhandari used descriptive analysis in his research work of evaluating financial performance of Himalayan Bank in the framework of CAMEL during 1999 to year 2004 A.D. The analysis revealed adequate Capital of the bank. The non-performing loans though in decreasing trend is still a matter of concern. The bank is still with better ROE however it is in decreasing trend. The decreasing trend of net interest margin shows management slack monitoring over the bank's earning assets. The liquid funds to total deposit ratio is above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period.

The major findings of this study are; the capital adequacy ratio of the bank was above the NRB standard in all the years except in year 2004 i.e. insufficient of capital in that year however, it was found that the core capital adequacy ratio of HBL adequate and sufficient. The supplementary capital ratio was within the boundary of NRB standard during the period of past six years. The non-performing loan to total loans and advances ratios for the study period was in decreasing trend but it was not sufficient in banking industry. The slope of the trend line of loan ratio was high this showed that the loan loss provision was increasing rapidly. The return on equity ratio of the bank during study period was above the 15 percent benchmark so this showed that the bank's ratio was better but was in decreasing tendency. The net interest margin ratio of the bank was above the benchmark of 3 to 4 percent and above, so the bank's ratio was higher but in declining tendency. The EPS of the bank has been fluctuated over the years of the study period. The bank's liquidity position was better than that of the industry average. NRB balance to total deposit ratio of HBL was below the industry average ratio in each year during the study period. This has indicated that the bank has not strictly following the directives issued by NRB in respect to balance must be hold in NRB Vault to deposit ratio of HBL during the study period was below the industry average. This has implied that the bank was not strictly following the directives issued by NRB in respect to balance must hold as vault.

The researcher has concluded that capital adequacy ratios revealed that the bank was running with the adequate capital and the capital fund of the banks was sound and sufficient to meet the banking operation as per the NRB standard except in the year 2004 during the study period. The core capital adequacy ratio and supplementary capital ratio were in the boundary of NRB standard. The researcher further concluded that the assets composition of the bank during the study period revealed that movement of money at call was observed in switch over in to investment during the last three years. The decreasing trend of non-performing loans and advances ratio showed that the bank was aware of non-performing loans and adopting the appropriate policies to manage this problem and to increase the quality of asset. Whereas the increasing trend of loan loss ratio indicated that the quality of loans was degrading year by year. The decreasing trend of total revenues ratios has positively affected in profitability. The decreasing trend of return on equity showed that the rate of return flowing to the bank's shareholders was degrading year by year. Capability of

management to converting the bank's assets into net earnings was declining. The researcher further concluded that the decreasing trend of earnings per share was the implication of low return flowing to the bank's owner. The liquid funds to total deposit ratio was above the industrial average which showed that there was very high proportion of liquid funds than the proportion of investment in income generating assets and shows lack of specific policy of increasing additional idle funds to high income generating assets in the form of investment. The researcher also concluded that the bank was not maintaining the sufficient balance at NRB during the study period and the bank was running with the inadequate liquidity to meet its short-term obligations.

The researcher has recommended maintaining stable capital adequacy ratio in the bank and strictly following the NRB directives. It was also recommended that the bank has to give more attention to decrease the level of NPA to meet the international standards. Further it has recommended to lower the proportion of loan loss provision by increasing the quality assets by strengthening the credit appraisal and follow up measures. The researcher has also recommended that the bank should increase the profit by minimizing the operation cost and enhancing the operating efficiencies of the employees. The researcher has also recommended that the bank should look upon new areas of lending and investment that helps in minimizing the idle funds otherwise this may impact the profitability negatively.

Yug Basnet (2005): Yug Basnet, in his thesis "A comparative study on Financial Performance of commercial banks between Nepal Bangladesh Bank & Nepal SBI Bank Ltd." (2005 March) has analyzed different ratios of Nepal SBI Bank and Nepal Bangladesh Bank for the period of five years from 1999/1999 to 2002/2003. The main objective of his study was to highlight and analyze the various aspects relating to financial performance of Nepal SBI Bank Ltd. and Nepal Bangladesh Bank Ltd. It concludes that liquidity position of SBI Bank is normal standard and NBB is also trying to gain that position. Both banks are highly leveraged as well as risky. NBB has better utilization of resources but NSBL is more efficient in cash management. NBB's profitability is better than that of NSBL. The analysis of the bankruptcy score of the bank indicates that both the banks have crossed the limit of bankruptcy scores of 0.0299. There is very remote chance of failure of both banks.

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

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

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

Chand (2006): Chand has conducted a study on financial performance analysis of NABIL Bank Ltd in the framework of CAMELS with the objective to analyze the financial condition of NABIL Bank Ltd. It has covered 5 years data starting from fiscal year 2000/2001 to 2004/2005. The analysis revealed that the bank is running with adequate capital fund of the bank is sound and sufficient to meet the banking operation as per NRB standard. The bank has placed efficient credit management and recovery effort of good quality loans are increasing. Further, it seems that amount default associated in loan will decrease in future. The management decisions related to operation and investment will assist in controlling control and recovery of bad debt. The management has been able to control the interest spread and cost effective

sources of funds. This has helped the bank in increasing the market strength. The liquid assets to total deposit ratio is above the industrial average ratio. The bank has able to match the risk sensitive assets to risk sensitive liabilities in long term maturity bucket and therefore interest rate changes has no affect on them.

2.2.2 Research Gap

Various studies have been conducted in the past on financial analysis of commercial banks in the US and other regions were found done. The research paper done in the context of Nepal mainly emphasized on liquidity, profitability and leverage of the commercial banks. These studies lack micro-level analyses and found applying traditional analysis of financial performance. In the context of Nepalese banking environment, there are few academic researches found conducted in the frame work of CAMEL (Bhandari, 2006). However these researches lack clear cut analysis. This study attempts to evaluate financial performance of Nepal SBI Bank Ltd and Machhpuchhre Bank Ltd. on all the five components of CAMEL framework.

CHAPTER - III

RESEARCH METHODOLOGY

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

Research Design

Research design is the task of defining the research problem. A research design is the arrangement of conditions, for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Kothari, 1989). In fact the research design is the conceptual structure within which the research is conducted. This research study aims at portraying accurately on the financial performance of Nepal SBI Bank Ltd & Machhapuchhre Bank Ltd. Therefore, a case study analytical research design is used for the study purpose to achieve the desired end. The study period covers five fiscal years starting from 2004 to 2008 A.D.

Sources and Nature of Data

This study is mainly based on secondary data. The data used in the study are taken from the annual reports of the bank and publications of Nepal Rastra Bank.

Selection of Study Unit

The population of the study consists of all the commercial banks of Nepal. Hence, 26 commercial banks which are operated now in Nepal comprise the population and two banks Nepal SBI Bank Ltd. (NSBIL) and Machhapuchhre Bank Ltd are (MBL) taken for the study as sample banks. NSBL and MBL are selected as study unit since they are reputed commercial banks operated in Nepal since a decade long. NSBL is a joint

venture of State Bank of India, India's largest bank, and MBL is a commercial bank of Nepal.

Data Collection Procedure

As the study is based mainly on the secondary data, required facts and figures have been obtained from the annual reports collected from the corporate office of the banks. Data have also been obtained browsing the official websites of NRB and Security Board of Nepal.

Data Processing Procedures

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

Method of Data Analysis

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

3.6.1 Financial Tools

3.6.1.1 Capital Adequacy

(a) Risk Based Capital Adequacy Ratio:

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

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

where,

Total Capital Fund = (Core Capital + Supplementary Capital)

Total Risk Adjusted Assets = (On balance sheet risk adjusted assets
+ Off balance sheet risk adjusted assets)

(b) Risk Based Core Capital Adequacy Ratio:

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

$$\text{CCAR} = \frac{\text{Core Capital}}{\text{Total Risk Adjusted Assets}} \times 100$$

where,

CCAR = Core Capital Adequacy Ratio

Core Capital = (paid up capital + share premium
+ Non-redeemable preference share + general reserve
+ cumulative profit)

(c) Risk Based Supplementary Capital Ratio:

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

$$\text{SCR} = \frac{\text{Supplementary Capital}}{\text{Total Risk Adjusted Assets}} \times 100$$

where,

SCR = Supplementary Capital Ratio

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

3.6.1.2 Assets Quality

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

(a) **Past Due Loans to Total Loans:**

This is the ratio which expresses the relationship between past due loans and total loans and advances of the bank. Lesser the portion of past due loans in total loans can be regarded as the better assets quality. This relationship can be measured by using the following relation:

$$\text{Past Due Loans / Total Loans} = \frac{\text{Past Due Loans}}{\text{Total Loans}} \times 100$$

(b) **Loans Classified as sub-standard, Doubtful or Loss to Total Loans:**

The ratio of sub-standard, doubtful and loss loan to total loans indicates the relationship between the sub-standard loans to total loans, doubtful loans to total loans and loss loans to total loans. It shows the percentage of sub-standard, doubtful and loss loans to total loans. The lesser the percentage the better would be the quality of assets. It is worked out using the following relation:

Loans Classified as sub-standard, Doubtful or Loss / Total Loans =

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

(c) **Provisioning for sub-standard loans to Total sub-standard loans:**

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

Provision for sub-standard loans to total sub-standard loans

$$= \frac{\text{Provision for substandard loan}}{\text{Total substandard loans}} \times 100$$

(d) **Provision for Doubtful Loans to Total Doubtful loans:**

Provision for doubtful loans to total doubtful loans is the expression of numerical relationship between loan loss provision for doubtful loans to total doubtful loans.

The proportion of provision for doubtful for doubtful loans to total doubtful loans, according to NRB, should be at least 50%. This ratio can be calculated using following relation.

$$\begin{aligned} & \text{Provision for Doubtful Loans to Total Doubtful Loans} \\ &= \frac{\text{Provision for Doubtful Loans}}{\text{Total Doubtful Loans}} \times 100 \end{aligned}$$

(e) Provisioning for Loss Loans to Total Loss Loans:

Provisioning for loss loans to total loss loans is the expression of numerical relationship between loan loss provisions for loss loans to total loss loans. The proportion of provision for loss loans to total loss loans, according to NRB, should be at least 100%. This ratio can be calculate by using following method.

Provisioning for Loss Loans to Total Loss Loans =

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

(f) Total Loans to a Single Borrower to Core Capital:

The total loan to a single borrower to core capital is the expression of numerical relationship between total loans to a single borrower and core capital. It measures the proportion of total loans to a single borrower in core capital of bank. The lesser the percentage of this ratio can be considered as good assets quality. The following expression is used to calculate this ratio:

Total loans to a single borrower to core capital =

$$\frac{\text{Total loans to a single borrower}}{\text{Core capital}} \times 100$$

3.6.1.3 Management Soundness

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

(a) Total Expenses to Total Incomes Ratio:

The total expenses to total incomes ratio is the expression of numerical relationship between total expenses and total incomes of the bank. It measures the proportion of total expenses to total incomes. It can be calculated using the following model:

$$\text{Total expenses to total incomes ratio} = \frac{\text{Total Expenses}}{\text{Total Incomes}} \times 100$$

(b) Earnings Per Employee:

Earnings per employees is the numerical relationship between net profit after taxes to total numbers of employees. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing in terms of profitability (IMF, 2000). It is calculated using the following model:

$$\text{Earnings per employee} = \frac{\text{Net Income (after tax)}}{\text{Total Assets}} \times 100$$

3.6.1.4 Earnings

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

(a) Net Income (after tax) to Total Assets:

The ratio of net income (after tax) to total assets is the expression of numerical relationship between net income and total assets. It is used to measure the quality of bank's earning in comparison to the assets employed. The following model can be used for the calculation of this ratio:

$$\text{Net Income (after tax) to Total Assets} = \frac{\text{Net Income (after tax)}}{\text{Total Assets}} \times 100$$

(b) Net Earnings (after tax) to Core Capital:

Net earnings after tax to core capital shows the relationship between net earnings after tax to core capital of the bank. It measures the proportion of earnings to the core capital. Minimum of 8% of this ratio can be considered as satisfactory. The following mode can be used to calculate this ratio:

$$\text{Net Earnings (after tax) / Core Capital} = \frac{\text{Net Income (after tax)}}{\text{Core Capital}} \times 100$$

(c) Net Spread:

Net spread is the expression of numerical relationship of difference between interest earned on interest earning assets and interest paid on interest bearing liabilities. Minimum of 2% and above of this ratio can be considered as strong. The following model is used to calculate this ratio:

$$\text{Net Spread} = \frac{\text{Interest Earned}}{\text{Interest Earned, Interest Earning Assets} - \text{Interest Paid, Interest Bearing Liability}} \times 100$$

(d) Net Interest Margin:

Net Interest margin indicates the relationship between the difference of interest income and interest expense to total assets. At least 4% of this ratio can be considered as fair. It can be calculated by using following ratio.

$$\text{Net Interest Margin} = \frac{\text{Interest Income} - \text{Interest Expense}}{\text{Total Assets}} \times 100$$

3.6.1.5 Liquidity

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

(a) Loan to Deposit Ratio:

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

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

(b) NRB Balance to Total Deposit Ratio:

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

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

Cash in Vault to Total Deposit Ratio:

Cash in vault to total deposits ratio is derived dividing total cash in vault by total deposit of the bank. It shows the percentage of total deposit maintained in vault of the bank. It can be calculated by using following model:

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

Limitations of the Methodology

The study by large is based on secondary data obtained from annual reports and financial results published by the bank. The reliability of analysis depends on the reliable disclosure of the data. As this study is in the framework of case study research design, limitations of case study-type research are inevitable and the methodology is bounded as well. Different tools used to analyze the collected data are based on certain assumptions which may not also be considered as absolute. Hence, the reliability of the analysis depends upon the circumstances on which the models are based.

CHAPTER – IV

PRESENTATION AND DATA ANALYSIS

Data Presentation and Analysis

This unit of the research deals with presentation and analysis of the data collected from concern sources. The raw data collected has been organized and processed using various tools discussed in the chapter III – Research Methodology. In this chapter data and information are presented and analyzed using different financial and statistical tools in order to achieve the objectives of the study. In data presentation and analysis, the study is focused on CAMEL components.

4.1.1 Capital Adequacy

Capital adequacy determines how well banks can manage with shocks to their balance sheet. For the purpose of capital adequacy measurement, bank capital is divided into Tier I (Core or Primary capital) and Tier II (Supplementary Capital). Risk based capital ratio, core capital adequacy ratio, supplementary capital ratio, past due loans/total loan and actual provisioning to require provisioning are the ratios used to analyze the capital adequacy ratio.

Commercial bank should have adequate capital to support its risks assets in accordance with the risk weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities. Adequacy and inadequacy of bank capital directly affects the banking transaction. The adequacy of bank capital is the most important aspect of the bank. If there is inadequacy of capital, the bank should take step for the adequacy of capital as per legal requirements because its financial health can't be regarded capable and healthy without having adequate capital.

Analysis of Capital Adequacy Ratio

Capital adequacy ratio is the measure of financial strength of a commercial bank. Specifically, the capital adequacy ratio measures the adequacy of capital for smooth operation of a bank. A bank should maintain adequate capital ratio as set by NRB.

NRB has fixed a minimum standard of capital adequacy ratio of 10% in 2004, 11% in 2005, 12% in 2006 and 10% thereafter till the date.

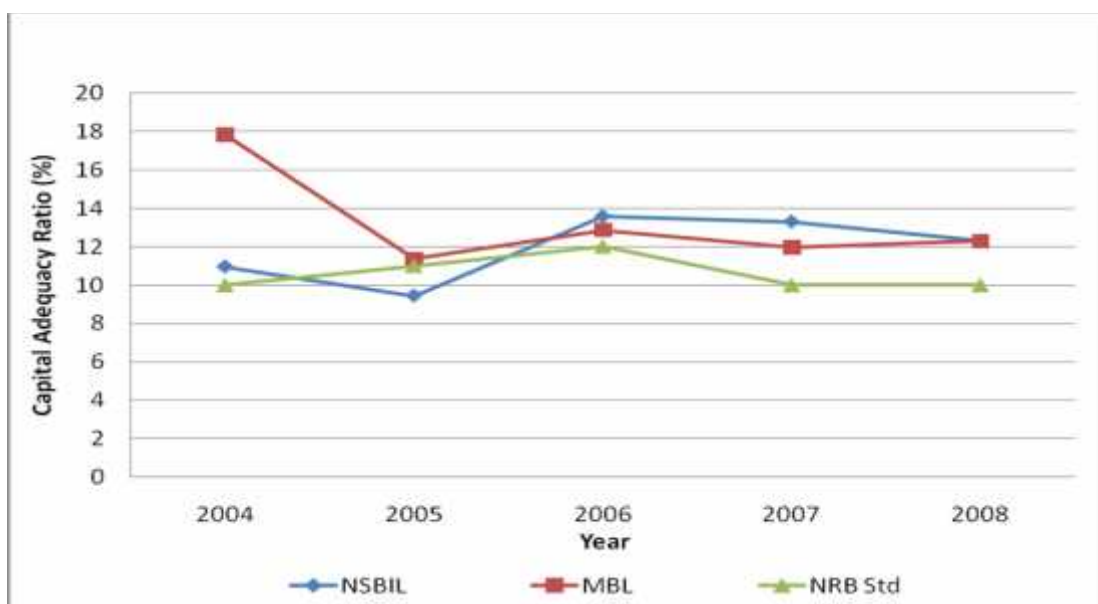
Table 4.1 shows the capital adequacy ratio of the sample banks. As per NRB guidelines, capital adequacy ratio of both the sample banks is sufficient in the sample year 2004 to 2008, except in the year 2005 NSBIL showed the short of 0.56%. The capital fund and the risk based assets of both the sample banks are in increasing but the ratio of capital fund to risk based assets of both the banks are fluctuating throughout the period. The average capital fund to risk based assets ratio of both the banks is above the standard set by NRB. So it can be considered that the capital fund of sample banks is strong one. NSBIL has not maintained adequate capital fund in the year 2005, which implies that NSBIL has not strictly followed the NRB directives in that year.

Table 4.1

Capital Adequacy Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Capital Fund	717.20	744.88	1242.57	1444.80	1722.19	-	-	-
R B Assets	6551.97	7887.66	9159.27	10873.28	13975.71	-	-	-
NSBIL	10.95	9.44	13.57	13.29	12.32	11.91	1.72	14.43
Capital Fund	579.38	688.84	976.07	1101.69	1279.8	-	-	-
R B Assets	3250.66	6063.13	7592.53	9200.66	10417.06	-	-	-
MBL	17.82	11.36	12.86	11.97	12.29	13.26	2.61	19.66
NRB Std	10	11	12	10	10	-	-	-

Figure 1
Trend lines of Capital Adequacy Ratio
of NSBIL, MBL and NRB Standard



As shown in fig. 1, the capital adequacy ratio of NSBIL AND MBL is above NRB standard in all the year except in the year 2005, where capital adequacy ratio of NSBIL is below the NRB standard. However, in the subsequent years it has maintained the standard. It implies that the bank has maintained an adequate risk based capital adequacy ratio in each year of the study period. Hence, we can say that NSBIL & MBL has followed the NRB directives and its capital adequacy requirements.

4.1.1.2 Analysis of Core Capital Adequacy Ratio

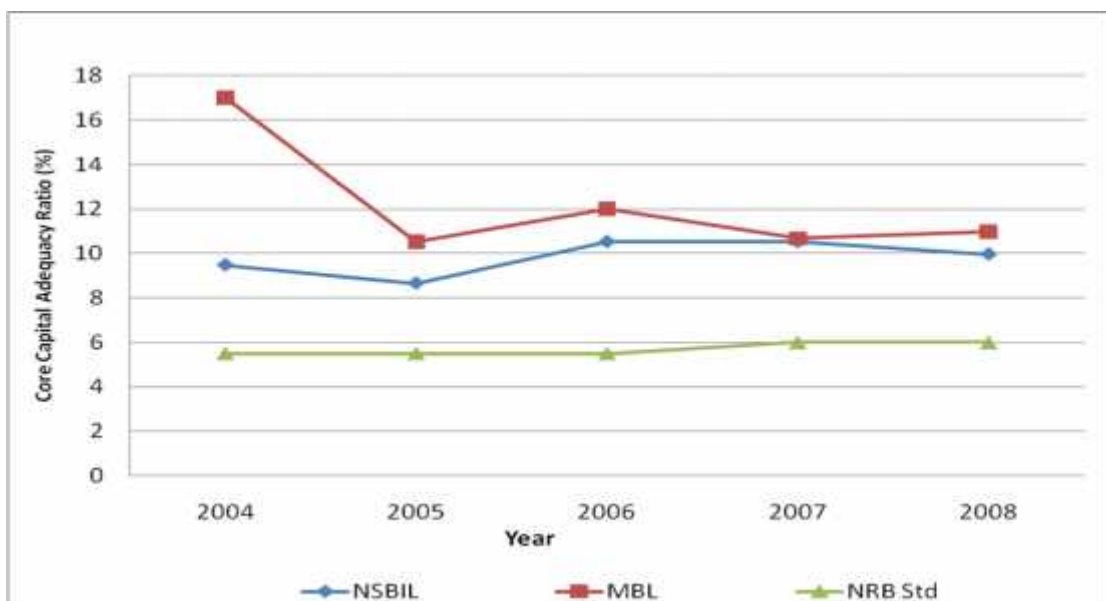
Core Capital is the primary capital of the bank. It includes the paid capital, share premium, non redeemable preference share capital, general reserves, accumulated profit and loss account and goodwill deductible in any. Thus, core capital is the amount of shareholders' fund. Core capital adequacy ratio is calculated as a percentage of total core capital to risk based assets of the bank. NRB has set the minimum standard of 5.5% in the year 2004, 2005 and 2006 and then 6% in the remaining sample period.

Table 4.2
Core Capital Adequacy Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Core Capital	620.80	682.85	964.42	1145.48	1394.06	-	-	-
R B Assets	6551.97	7887.66	9159.27	10873.28	13975.71	-	-	-
NSBIL	9.48	8.66	10.53	10.53	9.97	9.83	0.79	8.05
Core Capital	552.87	637.74	911.54	982.54	1142.97	-	-	-
R B Assets	3250.66	6063.13	7592.53	9200.66	10417.06	-	-	-
MBL	17.01	10.52	12.01	10.68	10.97	12.2	2.73	22.30
NRB Std	5.5	5.5	5.5	6.0	6.0	-	-	-

Table 4.2 shows the relationship between core capital and total risk based assets of the banks. The core capital of the banks has increasing gradually during the study period. NSBIL has the core capital of Rs. 620.80 million in the year 2004 and Rs.1394.06 million in the year 2008, whereas the MBL shows the core capital of Rs.552.87 million in the year 2004 and Rs.1142.97 million in the year 2008. The pattern of ratio of core capital to risk based assets is also same as the previous ratio. NRB has set the standard ratio and both the banks are able to manage this guideline. In this context, average ratio of NSBIL stands at 9.83% and MBL stands at 12.2% but there is greater variation in MBL's ratio distribution.

Figure 2
Trends of Core Capital Adequacy Ratio
of NSBIL, MBL and NRB Standard



As per Fig. 2, the above graph shows core capital ratios of the two banks are over of the NRB during the study period. The core capital ratio of MBL is very high in the year 2004, then the line goes down in FY 2004 then again it goes up gradually after all the years. The graph line of NSBIL seems to be in gradually increasing trend except in the year 2005 there is slight decrease. Thus, the risk adjusted core capital adequacy ratios of NSBIL & MBL are adequate as prescribed by NRB.

4.1.1.3 Analysis of Supplementary Capital Adequacy Ratio

Supplementary capital is the amount of capital that is transferred in reserve and collected using the hybrid capital instruments. It includes loan loss provisions, exchange equalization reserves, assets revaluation reserves, hybrid capital instruments, unsecured sub-ordinate term debt, interest rate fluctuation fund and other free reserves. NRB has set a standard of supplementary capital to be maintained by the commercial banks as not more than the core capital of the bank.

Table 4.3
Supplementary Capital Adequacy Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	SD	CV
Supplementary Capital	96.41	62.03	278.15	299.32	328.12	-	-	-
RB Assets	6551.97	7887.66	9159.27	10873.28	13975.71	-	-	-
NSBIL	1.47	0.79	3.04	2.75	2.35	2.08	0.93	44.89
Supplementary Capital	26.51	51.1	64.53	119.15	136.83	-	-	-
RB Assets	3250.66	6063.13	7592.53	9200.66	10417.06	-	-	-
MBL	0.82	0.84	0.85	1.30	1.31	1.02	0.26	25.10

Table 4.3 depicts the supplementary capital ratios of the banks during the study period. The supplementary capital ratio of NSBIL is 1.47, 0.79, 3.04, 2.75, and 2.35 and that of MBL is 0.82, 0.84, 0.85, 1.30, and 1.31 in the year 2004, 2005, 2006, 2007, and 2008 respectively.

The ratio of NSBIL spread from 0.79% in the year 2005 to 3.04% in the year 2006 respectively but MBL shows the minimum 0.82% in the year 2004 and 1.31% in the year 2008 respectively. These ratios indicate that NSBIL and MBL have maintained adequate supplementary capital during the study period.

Figure 3

Trends of Supplementary Capital Adequacy Ratio of NSBIL and MBL

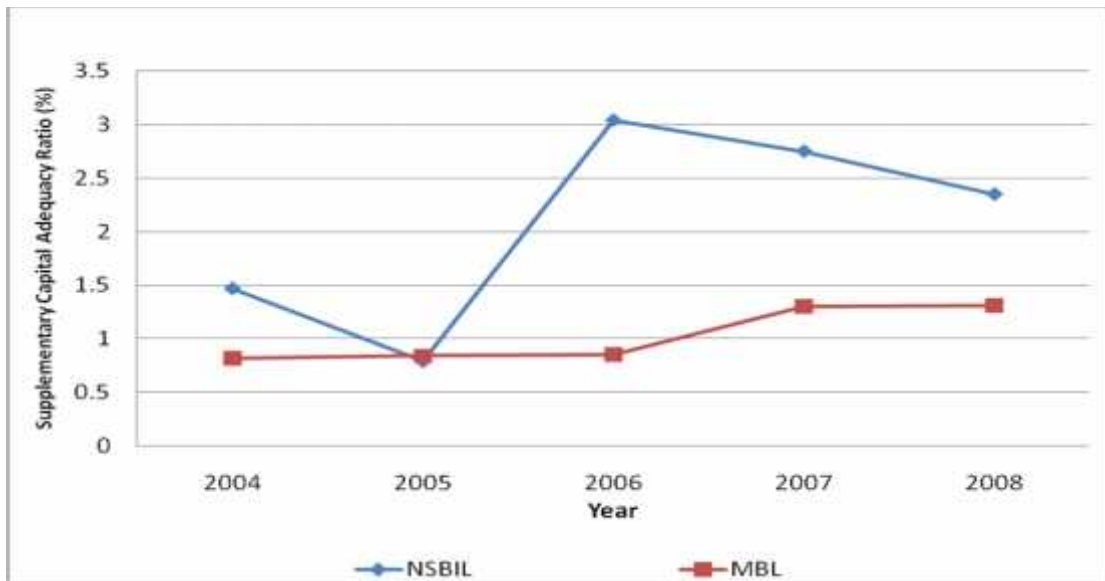


Fig. 3 shows the supplementary capital ratio of NSBIL & MBL. Supplementary capital ratio of the NSBIL bank is highly dispersed as compared to the MBL bank. This ratio implies that the portion of supplementary capital in the total risk based assets. However, the supplementary capital ratios of the banks are within the limit of NRB standard during the study period.

4.1.2 Assets Quality

Loan and advances dominate the asset side of the balance sheet of the banks. Similarly earning from such loans and advances occupy a major space in income statement of the bank. Hence asset is the critical factor in determining the strength of any bank. Prime factors that should be considered are quality of loan portfolio, mix of risk assets and credit administration system. The quality of assets are measured in terms of ratio of past due loans to total loans and loan classified as substandard/doubtful/ bad to total loans. Provisions made for NPAs and loan provided to single borrower are also the measuring rods used to analyze the assets quality of the bank.

4.1.2.1 Ratio of Past Due Loan to Total Loan

In table 4.4 the ratio of past due loan to total loan is presented. The total loans and the past due loan of both the banks have gone up throughout the study period.

Table 4.4
Past Due Loans to Total Loan Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Past due Loan	5186.01	6298.83	7736.12	9606.29	12257.81			
Total Loan	5531.83	6739.35	8241.46	10065.05	12746.16			
NSBIL	93.74	93.46	93.86	95.44	96.16	94.53	1.19	1.26
Past due Loan	2490.83	5090.5	6112.735	7149.6	8778.24			
Total Loan	2540.79	5130.22	6146.57	7319.94	8964.07			
MBL	98.03	99.22	99.44	97.67	97.92	98.46	0.81	0.82

The above table 4.4 shows the ratio of past due loan to total loan is fluctuating one in both the banks. The management of NSBIL made effort to increase this ratio from 93.75% in the year 2004 to 96.17% in the year 2008 whereas the ratio stood at 93.46% in the year 2004 reduce to 93.87% in the year 2005 and 95.44% in the following year. The averages values of ratio of NSBIL and MBL are 94.54% and 98.45% respectively which implies that the assets quality of MBL is superior to NSBIL one.

Figure 4
Bar Diagram Showing Ratios of Past Due Loans to Total Loan
of NSBIL and MBL

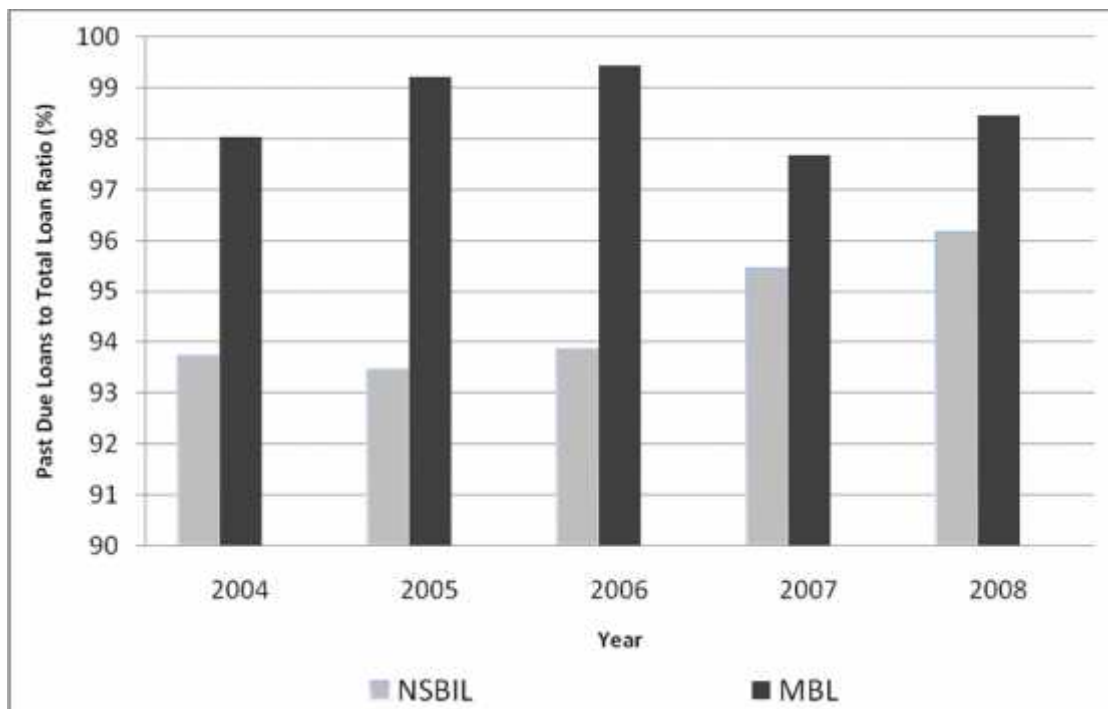


Fig. 4 shows the ratio of past due loan to total loan is fluctuating one in both the banks. Since the bar graph of MBL is seen higher we can say that assets quality of MBL is superior to NSBIL one.

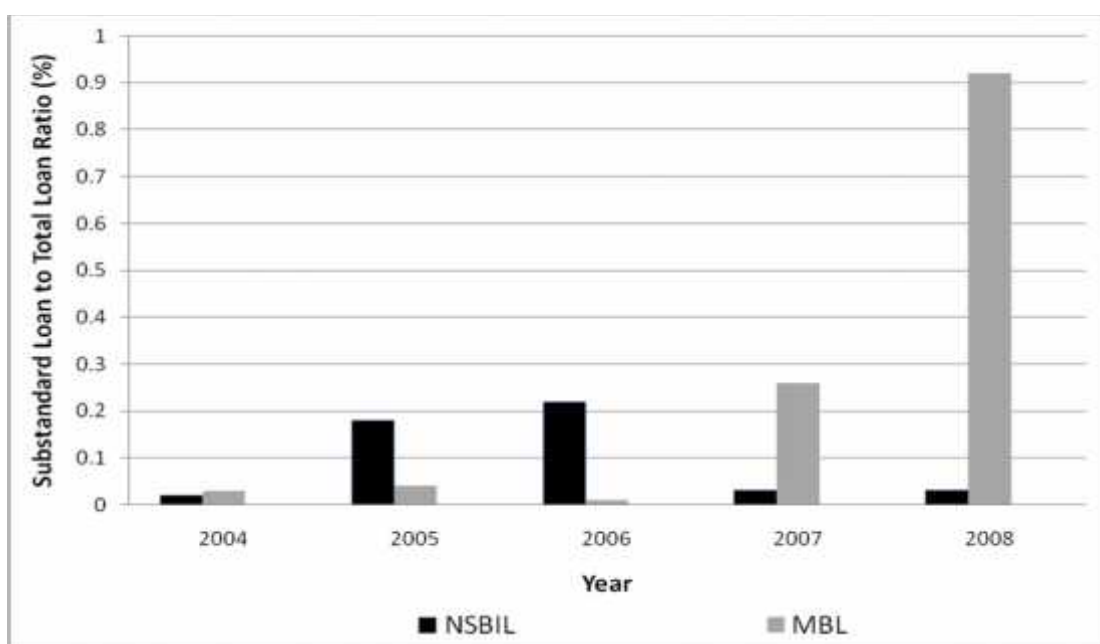
4.1.2.2 Ratio of Loans Classified as Substandard, Doubtful and Bad to Total Loan

Table 4.5 exhibits the ratio of substandard loan to total loan. The percentage of substandard loan to total loan of NSBIL ranges from 0.02% to 0.22%. The same ratio of MBL varies from the lowest value of 0.01% to 0.92%. The average value of this ratio is 0.10% of NSBIL and 0.25% of MBL. So it can be concluded that proportion of substandard loan to total loan of MBL is larger one.

Table 4.5
Substandard Loan to Total Loan Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Substd Loan	1.12	11.91	17.97	3.29	3.87			
Total Loan	5531.83	6739.35	8241.46	10065.05	12746.16			
NSBIL	0.02	0.18	0.22	0.03	0.03	0.10	0.09	98.48
Substd Loan	0.84	2.11	0.65	19.29	82.69			
Total Loan	2540.79	5130.22	6146.57	7319.94	8964.07			
MBL	0.03	0.04	0.01	0.26	0.92	0.25	0.39	154.18

Figure 5
Bar Diagram Showing Ratios of Sub Standard Loans to Total Loan of NSBIL and MBL



The volume of the total loan is continuously increasing from Rs. 5531.83 million to Rs. 12746.16 million but the ratio of substandard loan to total loan shows the mixed type movements it increase up to 0.22% (FY 2006) form 0.02% (F Y 2004) then decrease to 0.03% in the year 2007 and 2008 respectively. In contrast MBL shows the 0.03%, 0.04% and 0.01% in the year 2004, 2005 and 2007 respectively and then increased to 0.26% and 0.92% in the year 2007 and 2008 respectively. The percentage of substandard loan to total loan is below 5% throughout the study period implies that the quality of loan is strong.

Table 4.6 shows the percentage of doubtful loan to total loan of both the sample banks. The size of the total loan is gradually increasing, but the size of the doubtful loan is fluctuating giving the ratio of doubtful loan to total loan inconsistent trend. As the proportion increases, the management of the banks should take action in recovery steps effectively because larger the proportion larger the loan loss provision which adversely affect the profitability of the banks.

Table 4.6
Doubtful Loan to Total Loan Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Doubtful Loan	69.30	65.2	38.42	11.17	21.63	-	-	-
Total Loan	5531.83	6739.35	8241.46	10065.05	12746.16	-	-	-
NSBIL	1.25	0.97	0.47	0.11	0.17	0.59	0.49	83.51
Doubtful Loan	3.66	1.18	1.21	26.61	6.84	-	-	-
Total Loan	2540.79	5130.22	6146.57	7319.94	8964.07	-	-	-
MBL	0.14	0.02	0.02	0.36	0.08	0.13	0.14	113.64

Figure 6
Bar Diagram Showing Ratios of Doubtful Loans to Total Loan
of NSBIL and MBL

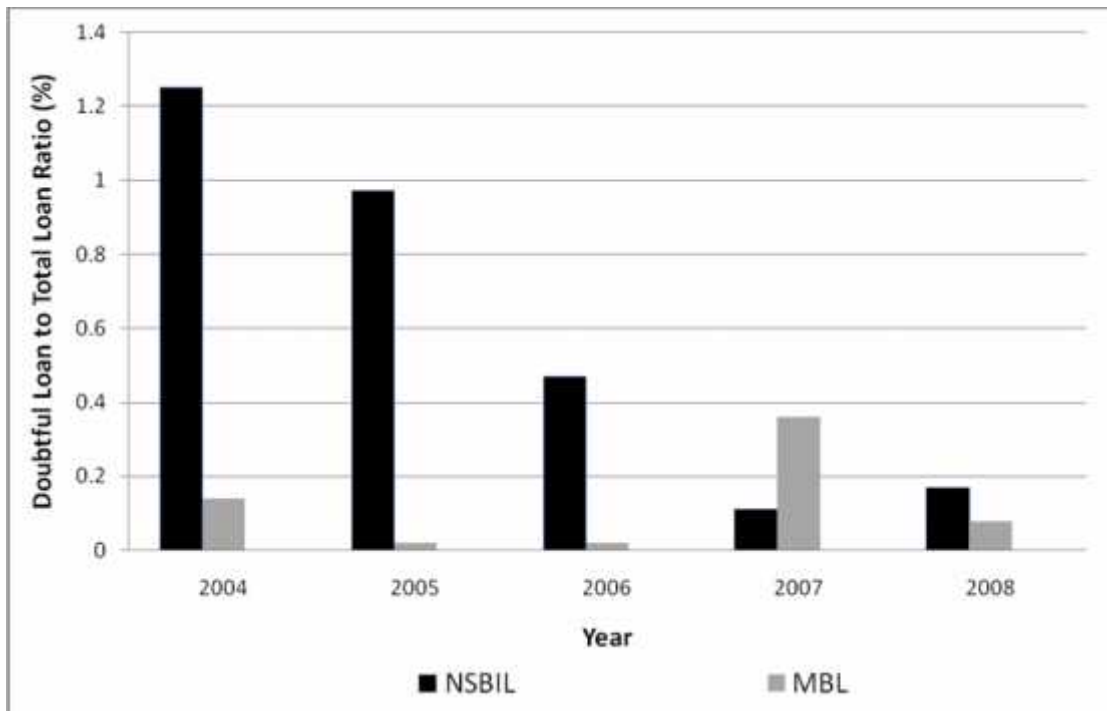


Fig. 6 shows the doubtful loan to total loan ratio of the sample banks. Both the banks have tried to decrease their doubtful loan and increase their total loan, which is clearly seen in the bar graph which is in the decreasing trend.

4.1.2.3 Ratio of Provision for Substandard Loan to Total Substandard Loan

Table 4.7 exhibits the ratio of provision for substandard loan to total substandard loan. The ratio of NSBIL is fluctuating in the study period. The highest provision is in the year 2008 27.50% and the least in the year 2004 of 13.39% only, giving the average value of 21.14%. But in the case of MBL, the least value is 25.00% in the years 2004 and 2008 and the highest value of 34.63% in the year 2007 giving the average value of 26.87% thus it can be assumed that the MBL has set larger proportion to provision, decreasing the volume of net income. According to NRB directive, it should be up to 25% if it exceeds there is threat.

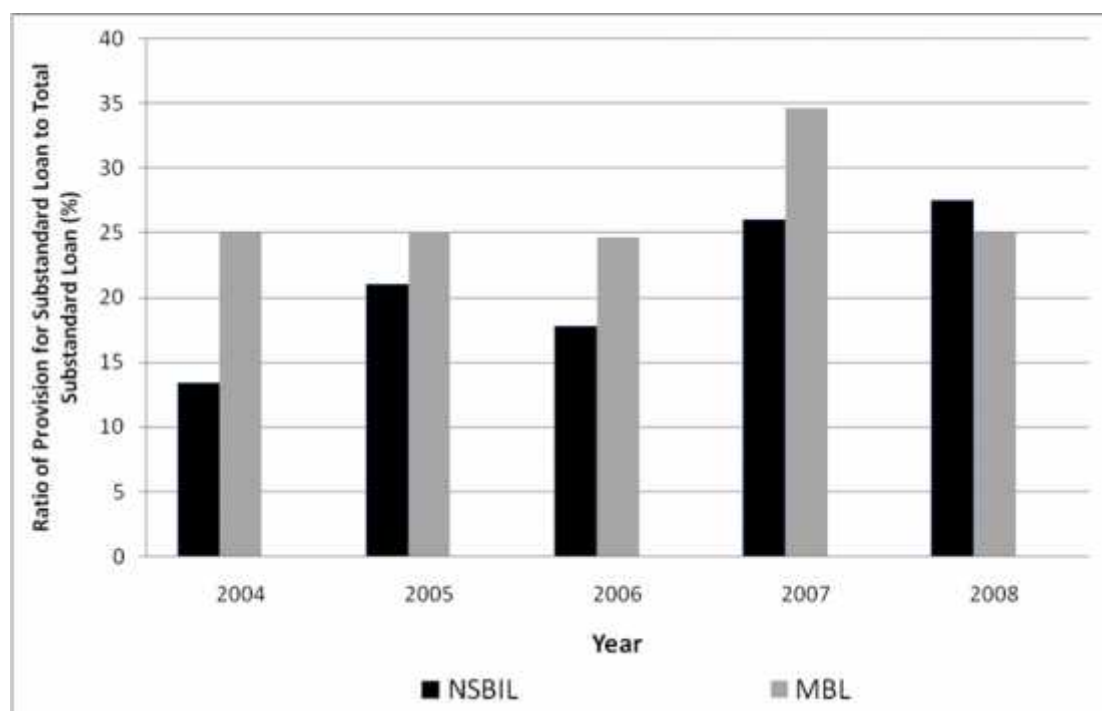
Table 4.7

Ratio of Provision for Substandard Loan to Total Substandard Loan (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Prov S L	0.15	2.50	0.32	0.86	1.06			
Total S L	1.12	11.91	17.97	3.29	3.87			
NSBIL	13.39	20.99	17.81	26.00	27.50	21.14	5.81	27.51
Prov S L	0.21	0.53	0.016	6.68	20.67			
Total S L	0.84	2.11	0.065	19.29	82.69			
MBL	25.00	25.12	24.62	34.63	25.00	26.87	4.34	16.15

Figure 7

Bar Diagram Showing Ratios of Provision for Substandard Loans to Total Substandard Loan of NSBIL and MBL



The ratio of provision for substandard loan to total substandard loan of both the sample banks can also be seen in the above bar graph fig. 7

4.1.2.4 Ratio of Provision for Doubtful Loan to Total Doubtful Loan

Table 4.8 shows that the ratio of provision for the doubtful loan to total loan. As per the table the ratio ranges from maximum 50.64% to minimum 48.40% of NSBIL and of MBL the least value is 50.00% and largest value is 61.63% , giving average value

of 49.90% (NSBIL) and 52.41% (MBL) respectively. According to NRB directives, there should be provision of 50.00% for doubtful loan hence NSBIL has not maintained the adequate provision in the 2004.

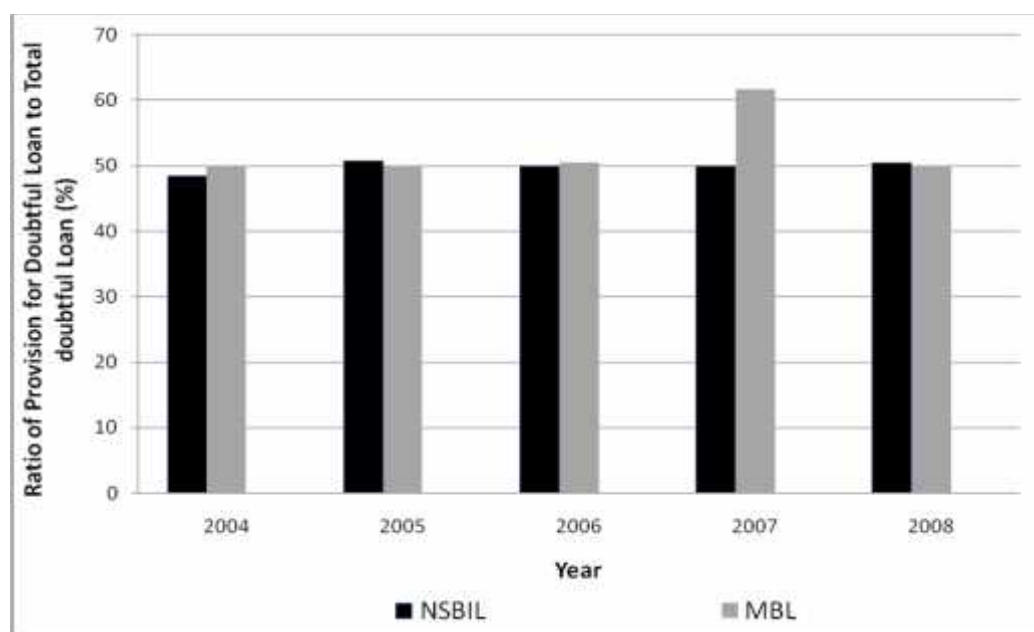
Table 4.8

Ratio of Provision for Doubtful Loan to Total doubtful Loan (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Prov D L	33.54	1.02	1.92	5.59	10.91	-	-	-
Total D L	69.30	6.52	38.42	11.17	21.63	-	-	-
NSBIL	48.40	50.64	49.97	50.02	50.44	49.90	20.36	40.81
Prov D L	1.83	0.59	0.61	16.4	3.42	-	-	-
Total D L	3.66	1.18	1.21	26.61	6.84	-	-	-
MBL	50.00	50.00	50.41	61.63	50.00	52.41	5.16	9.84

Figure 8

Bar Diagram Showing Ratios of Provision of Doubtful Loan to Total Doubtful Loan of NSBIL and MBL



The above bar graph fig. no. 8 shows the ratio both the banks have been maintaining during the year 2004, 2005, 2006, 2007, 2008. The figure shows that both the banks have been maintaining the provision of 50.00% as per NRB directives except on the year 2004 where this ratio was below 0% of NSBIL.

4.1.2.5 Ratio of Provision for Bad Loan to Total Bad Loan

Table 4.9 depicts the ratio of provision for bad loan to total loan. The amount of bad loan of NSBIL is continuously increasing from Rs. 275.40 million (FY 2004) to Rs. 499.70 million (FY 2006) then decreased to Rs. 444.30 million (FY 2007) and increased to Rs. 462.91 million (FY 2008). The amount of bad loan is Rs. 20.48 million in the year 2004 then decreased up to Rs. 15.64 million in the year 2006 but then dramatically increased to Rs. 39.28 million in the year 2007 then decreased to Rs. 3.38 million in the year 2008. According to NRB directives the bank must set provision of 100.00% in this class. Both the banks have set the provision as per the NRB guidelines. Larger the provision of bad loan, lesser the net income to the bank, hence the management should be very careful in loan recovery process.

Table 4.9

Ratio of Provision for Bad Loan to Total Bad Loan (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Prov for B L	275.40	422.59	499.70	444.30	462.91	-	-	-
Total B L	275.40	422.59	499.70	444.30	462.91	-	-	-
NSBIL	100.00	100.00	100.00	100.00	100.00	100.00	0.00	0.00
Prov for B L	20.48	16.57	15.64	39.28	3.38	-	-	-
Total B L	20.48	16.57	15.64	39.27	3.38	-	-	-
MBL	100.00	100.00	100.00	100.03	100.00	100.01	0.01	0.01

Figure 9

Bar Diagram Showing Ratios of Provision for Bad Loans to Total Bad Loan of NSBIL and MBL

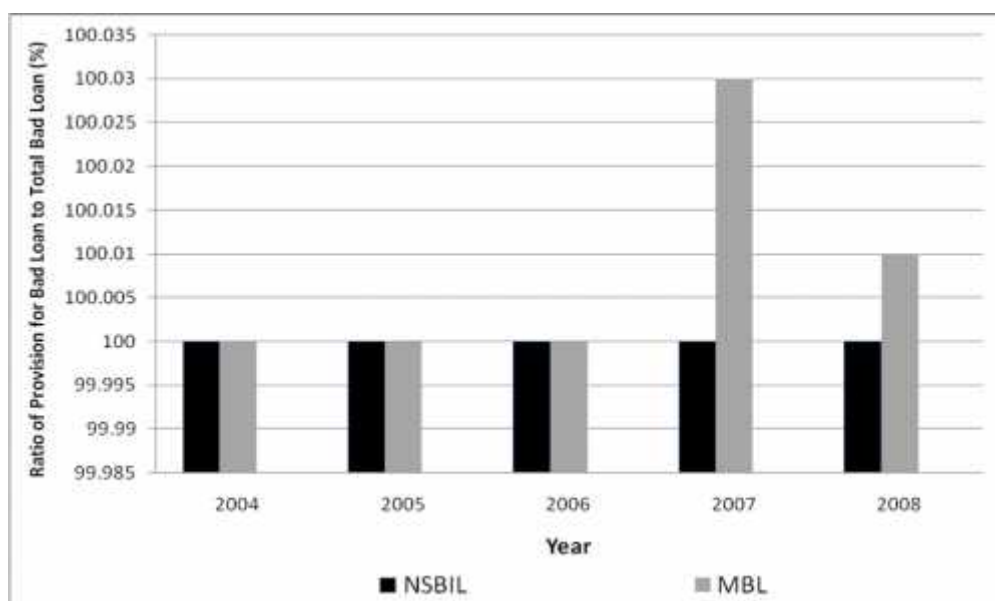


Fig. no. 9 shows that both the banks have maintained 100% provision for bad loan. However in year 2007 & 2008 MBL has maintained more than 100% ratio of provision for bad loan to total bad loan.

4.1.3 Management Soundness

Sound management is a key to financial institutions' performance. Although several indicators can be used as proxies for the soundness of management, such evaluation is still primarily a qualitative exercise, particularly when it comes to the evaluation of the management of operational risk, that is, the functioning of internal control systems. The productivity of employees is used as a measuring rod for evaluation. Likewise sustainability of earning shows the efficiency of management.

Expenses ratio and earning per employee are the ratios used as proxy of the management quality. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but it is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. Similarly, low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with similar repercussions in terms of profitability.

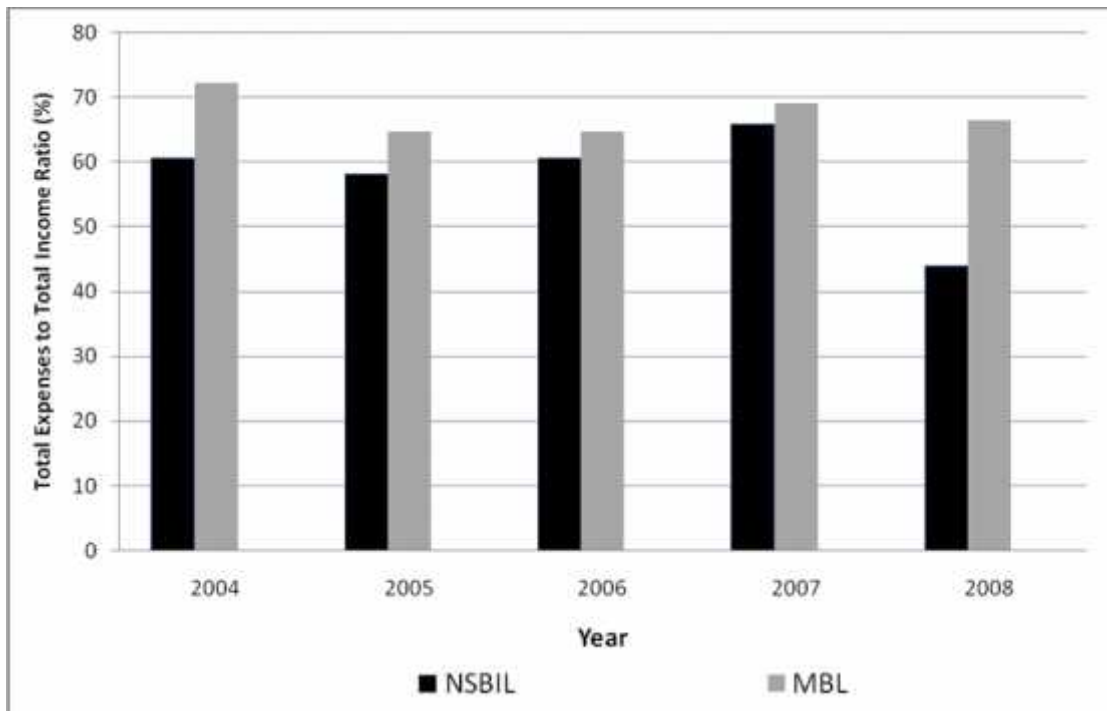
4.1.3.1 Total Expenses to Total Income Ratio

Table 4.10 exhibits the ratio of total expenses to total income ratio. The total expenses of both the bank has increasing trend, it may be due to branches expansion in recent period. The ratio of total expenses of both the banks somehow lies above 50% of the total income. The ratio of NSBIL is 60.59% in the year 2004, decreased to 58.18% in the year 2005 again increased to 60.59% in the 2006., in the next year it rose to 65.80% then dropped to 43.98% giving the average value of 57.83%. The same ratio of MBL is 72.15% in the year 2004, and then reduced to 64.64% and 64.74% in the year 2005 and 2006 respectively but in the year 2007 it rose to 69.10% in the year 2008 it once again dropped to 66.49% giving the average value of 67.43%. Thus, if the banks could decrease the total expenses up to the certain possible level, there would be positive affect in the profitability of the banks.

Table 4.10
Total Expenses to Total Income Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
T Expenses	370.61	386.64	484.52	585.60	682.19	-	-	-
T Income	611.62	664.58	799.67	889.91	1551.23	-	-	-
NSBIL	60.59	58.18	60.59	65.80	43.98	57.83	23.09	39.93
T Expenses	175.81	276.58	417.99	556.26	603.75	-	-	-
T Income	243.68	427.89	645.6	804.97	907.99	-	-	-
MBL	72.15	64.64	64.74	69.10	66.49	67.43	3.20	4.75

Figure 10
Bar Diagram Showing Ratios of Total Expenses to Total Income
of NSBIL and MBL



The above Fig.10 represent the ratio of total expenses to total income , as per the graph the ratio is slightly decreasing up to FY 2005 then after it is in slightly increasing trend till 2007 for both banks. But the ratio of NSBIL has dramatically for decreased and that of MBL has increased in the year 2008.

4.1.3.2 Earning Per Employee

Table 4.11 shows the earning per employee of both the banks. The net profit after tax of NSBIL is gradually increasing from Rs. 80.65 million to Rs. 382.84 million during

the sample period. But the net profit of MBL is different; the net profit was Rs. 46.69 million in the year 2004 and increased up to Rs. 134.00 million in the year 2006 then decreased to Rs. 76.80 million in the year 2007 and in the next year showed the net profit of Rs. 85.02 million. The number of staffs in both the banks shows the same increasing trend so that the earning per employee shows the fluctuating trend. The average earning per employee of NSBIL stood at Rs. 130.73 million and of MBL stood at Rs. 49.05 million only, so it can be considered that the volume of net profit of MBL is comparatively smaller than NSBIL.

Table 4.11
Earning Per Employee

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Net Income	80.65	139.10	219.74	379.00	382.84	-	-	-
# of staffs	151	164	174	189	203	-	-	-
NSBIL	53.41	84.82	126.29	200.53	188.59	130.73	63.31	48.43
Net Income	46.69	84.87	134	76.8	85.02	-	-	-
# of staffs	85	137	196	234	313	-	-	-
MBL	54.93	61.95	68.37	32.82	27.16	49.05	18.14	36.99

Figure 11
Trends of Earning per Employee of NSBIL and MBL

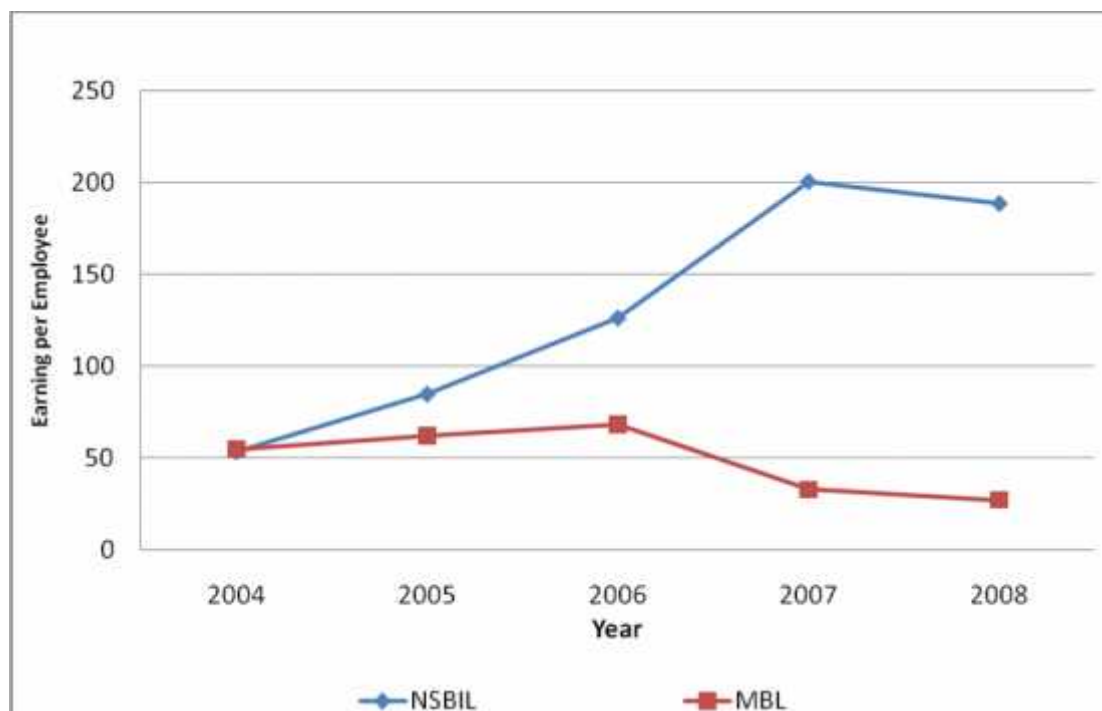


Fig. 11 shows that the earning per employ of NSBIL is in increasing trend which implies that net profit of NSBIL is also in increasing trend. Whereas, the earning per employ of MBL is fluctuating & seen to be in decreasing trend after year 2006.

4.1.4 Test of Earning

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

After tax net profit to total assets, after tax net profit to core capital, net spread, net interest margin and net operating margin are used to assess the earning performance of the bank.

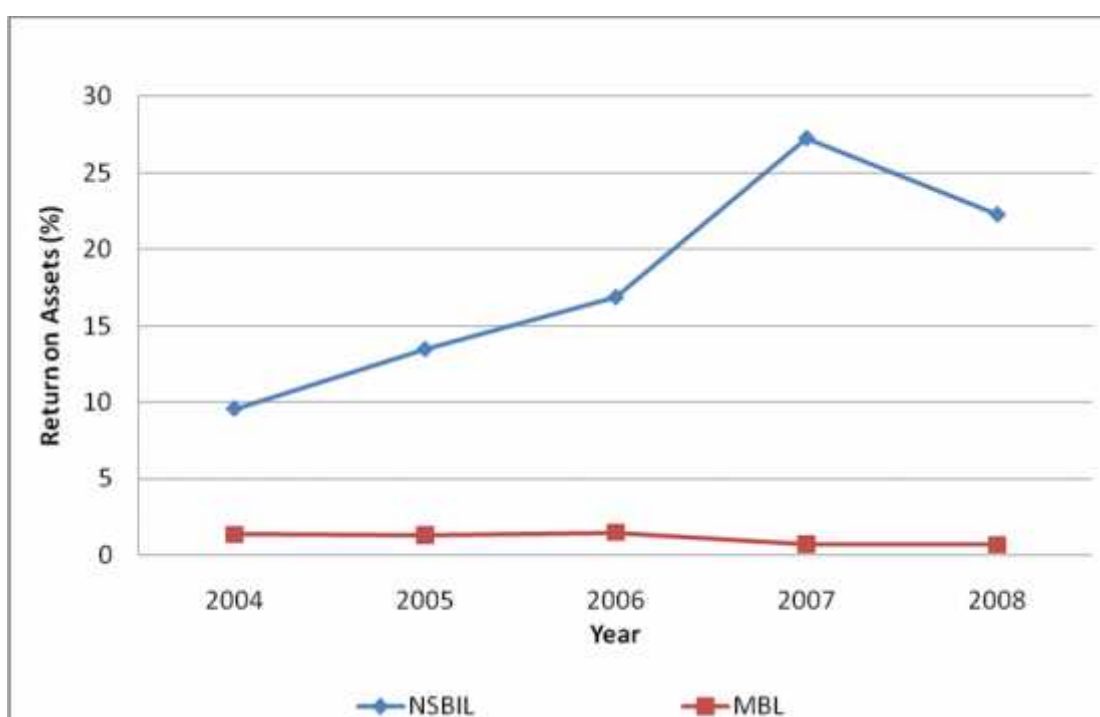
4.1.4.1 Net Income to Total Assets Ratio (Return on Assets)

Table 4.12 exhibits the ratio of net profit to total assets of both the banks during the study period. The net income of both the bank is in increasing trend as well as the volume of total assets also in the same trend. The returns on asset of both banks significantly differ due to vary in the volume of net income and total assets. NSBIL shows the average ROA of 17.88% with the least value 9.56% in the year 2004 and the largest value of 27.26% in the year 2007 but the average ROA of MBL is only 1.11% with the least value of 0.68% in the year 2008 and the largest value of 1.48% in the year 2006 respectively. The calculated ratios shows the satisfactory levels of income with relate to total assets utilization.

Table 4.12
Net Income to Total Assets (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Net Income	80.65	139.10	219.74	379.00	382.84	-	-	-
Total Assets	844.05	1034.54	1303.58	1390.12	1718.74	-	-	-
NSBIL	9.56	13.45	16.86	27.26	22.27	17.88	7.02	39.29
Net Income	46.69	84.87	134	76.8	85.02	-	-	-
Total Assets	3448.63	6456.46	9069.08	10810.53	12498.55	-	-	-
MBL	1.35	1.31	1.48	0.71	0.68	1.11	0.55	49.73

Figure 12
Trend lines showing ROA of NSBIL and MBL



The above graph represents the ratio of net income after tax to total asset of the sample banks during the study period from FY 2004 to FY 2008. It is in increasing trend till FY 2007 then it declines in 2008 for NSBIL. The trend line of MBL is consistent throughout the years with only slight fluctuations.

4.1.4.2 Net income to Core Capital

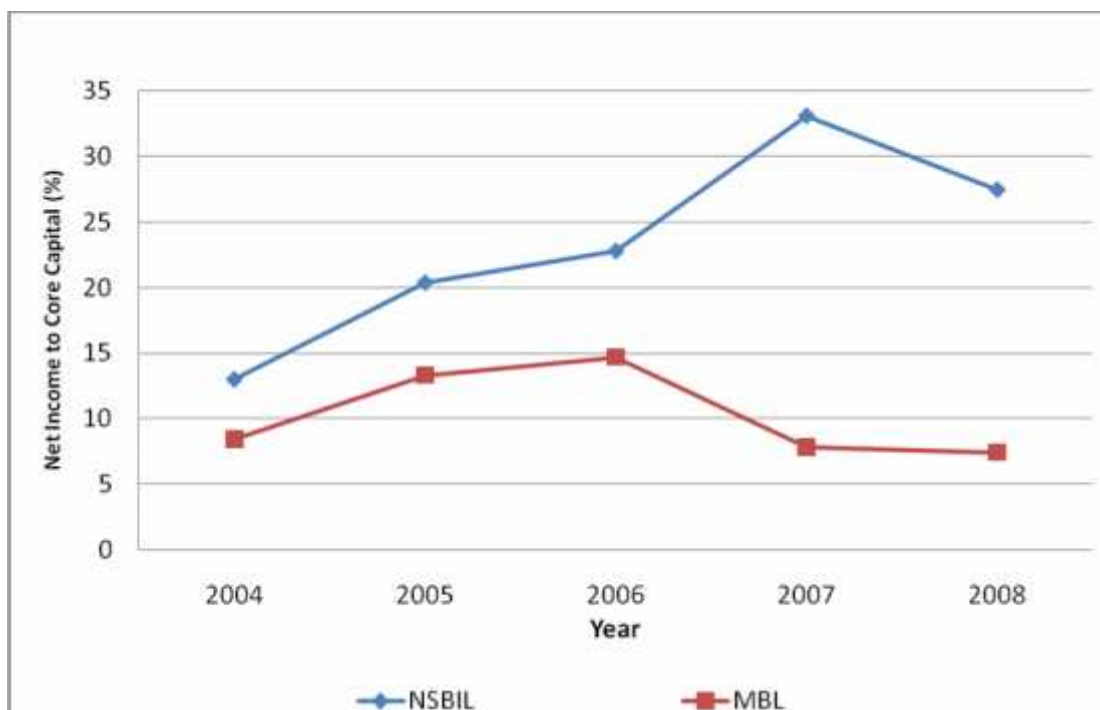
Table 4.13 shows the ratio of net income to core capital of the sample banks during the sample period. NSBIL shows the ratio continuously increasing but the same ratio

rose only for the first three years of study period in case of MBL. MBL can not generate earning as much as that of NSBIL hence the average ratio of net income to core capital stands very far that is it is 23.34% of NSBIL and 10.34% only of MBL. The size of the core capital is somehow closer to each other but the size of the net income is varied.

Table 4.13
Net Income to Core Capital (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Net Income	80.65	139.10	219.74	379.00	382.84	-	-	-
Core Capital	620.80	682.85	964.42	1145.48	1394.06	-	-	-
NSBIL	12.99	20.37	22.78	33.09	27.46	23.34	7.55	32.36
Net Income	46.69	84.87	134	76.8	85.02	-	-	-
Core Capital	552.87	637.74	911.54	982.54	1142.97	-	-	-
MBL	8.45	13.31	14.70	7.82	7.44	10.34	3.40	32.86

Figure 13
Net Income to Core Capital



The above graph shows the ratio of net earning to core capital of the NSBIL & MB during the sample period. The figure clearly shoes that net income to core capital

ratio of NSBIL is more than that of MBL, which implies that NSBIL has more income than MBL during the sample year.

4.1.4.3 Net Spread

Table 4.14 shows that the net spread of the sample banks during the study period. Regarding the net spread the bank has strong position. It varies from the minimum of 2.15% to 3.94% giving the average value of 2.76% in case of NSBIL and the same value varies from the minimum 4.27% to maximum 5.39% giving the average value of 4.83% in case of MBL.

Table 4.14
Net Spread (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
NSBIL	2.15	2.54	2.72	3.94	2.43	2.76	1.27	46.08
MBL	4.60	4.27	4.70	5.39	5.19	4.83	0.46	9.42

Net spread is the difference between the ratio of interest earned to total interest assets and interest paid to total interest bearing liability. It measures the earning capacity of the bank. Lower ratio shows the unsatisfactory earning quality as well as if it is negative there is threat of sustainability too. Having average net spread more than 2% shows that has strong earning capacity. Net spread less than 2% to more than 1.25% can be considered as satisfactory earning.

Figure 14
Net Spread

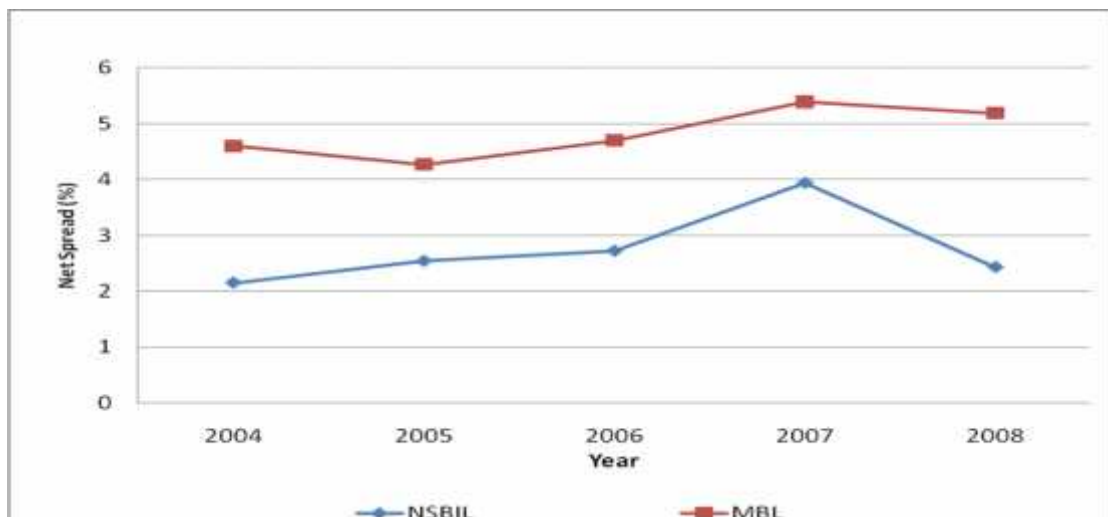


Fig. 14 clearly shows that MBL has higher net spread than that of NSBL. Thus, it can be considered the earning capacity of the MBL is superior to NSBIL during the sample period. In general, both of the banks have maintained strong position regarding the net spread; it proves the sustainability giving the profitability to the firm for long run.

4.1.4.4 Net Interest Margin

The net interest margin measures how large a spread between interest income and interest expenses management has able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sources of funding. Net interest margin is calculated dividing net interest income (interest income minus interest expenses) by total interest earning assets. Earning assets includes loan and advances, bills purchased and discounted and investment made in securities (T-bills) a negative or declining ratio is indicator of lack of treasury management skill and needs attention. The net interest margin ratio between 3% and 4% can be considered as better in banking industry.

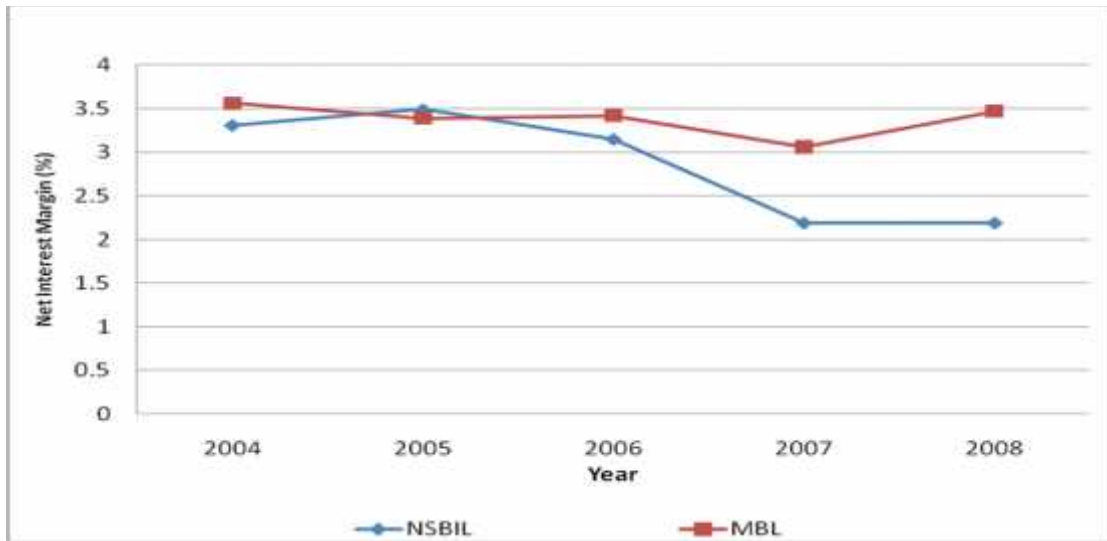
Table 4.15
Net Interest Margin (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
NSBIL	3.31	3.49	3.15	2.19	2.19	2.86	0.63	21.92
MBL	3.56	3.39	3.42	3.06	3.47	3.38	0.19	5.65

The table 4.15 shows the net interest margin of the sample banks during the study period. The average net interest margin of NSBIL is 2.86% whereas MBL has the same value of 3.38% so that it can be considered the management soundness of MBL is more efficient in fund raising from the cheapest sources. The net interest margin of the bank is fluctuated around the 3% during the study period. MBL recorded above 3% during the entire study period, but NSBIL starts with 3.31% in 2004 increase to 3.49% in 2005 and finally dropped to 2.19% in the year 2008. The net interest margin of NSBIL can only be considered as satisfactory but of MBL is better one. According to standard practice, the net interest margin of 3% to 4% is supported to be better.

Figure 15

Net Interest Margin



The above graph shows the trend line of net interest margin of NSBIL & MBL for FY 2004 to FY 2008. The trend line shows that the net interest margin of MBL is better than that of NSBIL.

Trend Analysis of Net Income by Least Square Method

Net income is one of the important factors to assess the financial position of the company. In this part of the study, the net income of the commercial banks are analyzed by using Least Square Method (LSM), to get the trend values and to find out the deviation from actually realized net income.

Nepal SBI Bank Limited

Table 4.16

Trend Analysis of Net Income by Least Square Method NSBI Bank Ltd

Year(X)	Net Income(Y)	t=X- 2006	t ²	t.Y	Trend Value (Yc)	Y-Yc
2004	80.65	-2.00	4.00	-161.30	71.41	9.24
2005	139.10	-1.00	1.00	-139.10	155.838	-16.738
2006	219.74	0.00	0.00	0.00	240.266	-20.526
2007	379.00	1.00	1.00	379.00	324.694	54.306
2008	382.84	2.00	4.00	765.68	409.122	-26.282
Total	1201.33	0.00	10.00	844.28		
a =	240.266		b =	84.428		

i.e. Net income = 240.266 + 84.428t

Figure 16

Trend Lines showing Actual and estimated Net Income of NSBIL

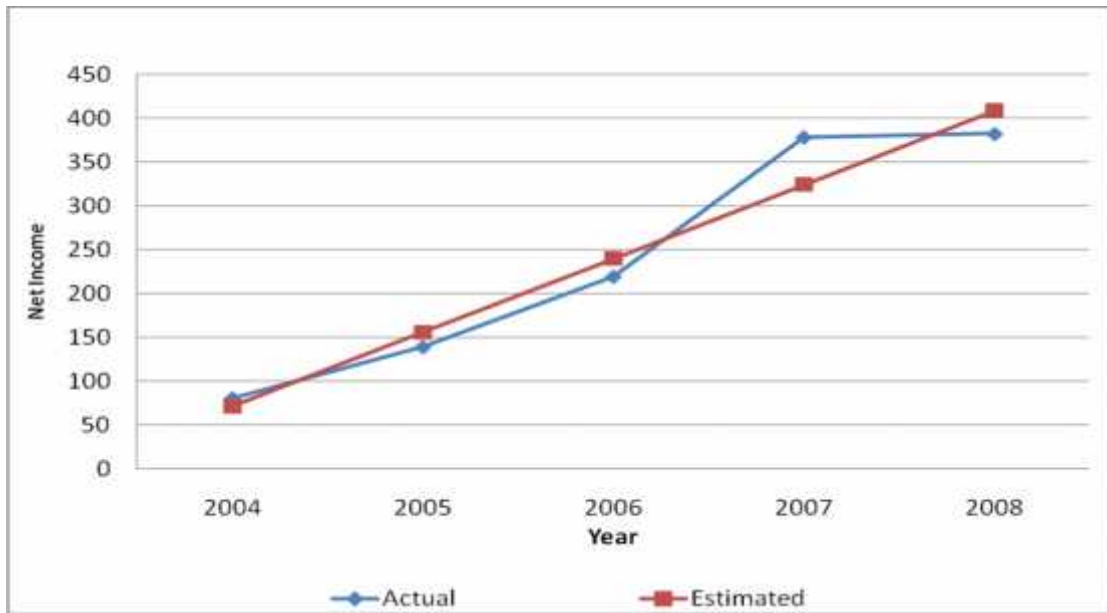


Table 4.16 and fig. 16 both shows the actual and estimated net income of NSBIL during the sample years. The actual income is 80.65, 139.1, 219.74, 379.00, 382.84 and the trend values are 71.41, 155.838, 240.266, 324.694, 409.122 in the years 2004, 2005, 2006, 2007, 2008 respectively. There is slight deviation in the actual income and trend value. However both are in the increasing trend throughout the sample years.

Machchhapuchhre Bank Ltd

Table 4.17

Trend Analysis of Net Income by Least Square Method MBL

Year(X)	Net Income(Y)	t=X- 2006	t ²	t.Y	Trend Value(Y _c)	Y-Y _c
2004	46.69	-2.00	4.00	-93.38	71.758	-25.068
2005	84.87	-1.00	1.00	-84.87	78.617	6.253
2006	134.00	0.00	0.00	0.00	85.476	48.524
2007	76.80	1.00	1.00	76.80	82.335	-5.535
2008	85.02	2.00	4.00	170.04	99.194	-14.174
Total	427.38	0.00	10.00	68.59		

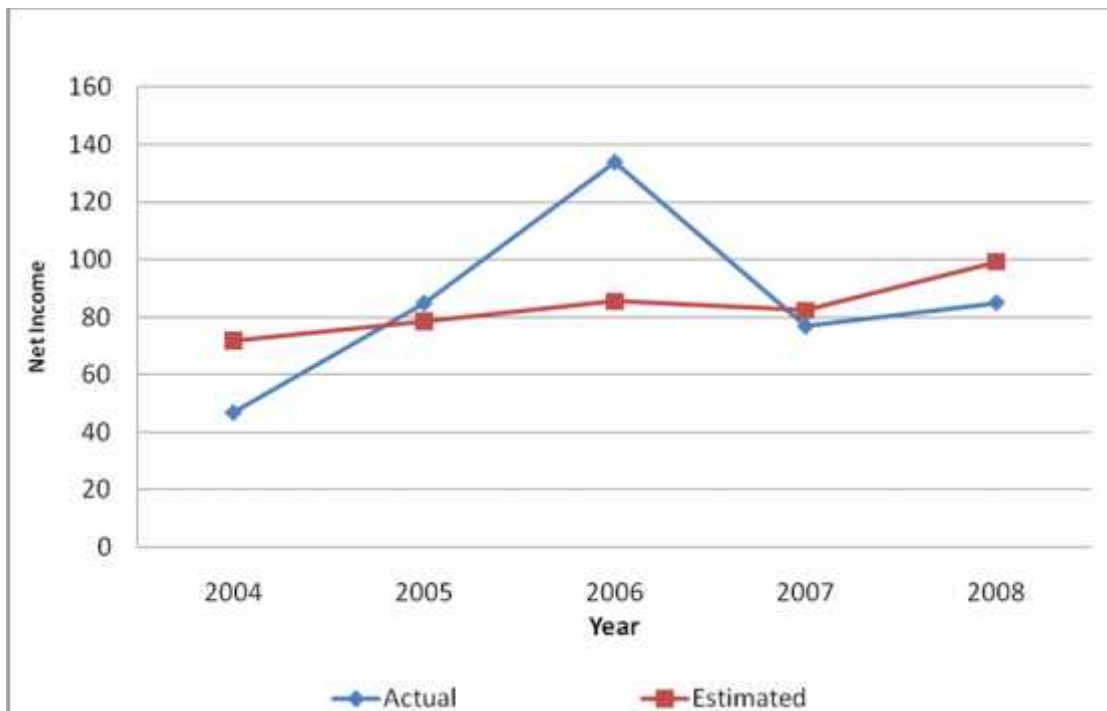
$$a = 85.476$$

$$b = 6.859$$

i.e. Net income = $85.476 + 6.859t$

Figure 17

Trend Lines showing Actual and estimated Net Income of MBL



The table 4.17 and figure 17 both shows that the actual and estimated net income of MBL during the sample years. The actual income is 46.69, 84.87, 134.00, 76.80, 85,02 and the trend values are 71.758, 78.617, 85.476, 82.335, 99.194 in the years 2004, 2005, 2006, 2007, 2008 respectively. There is very high deviation in the actual income and trend value. The trend line seen to be fluctuating throughout the years. In the year 2006 it has reached the maximum net income of 134.00 then it has tremendously declined to 76.80 in 2007. We can say the the actual income is not in consistency with the trend values calculated.

Test of Liquidity

Banks need to maintain reasonable level of liquidity to pay cash to its depositors so it is of prime importance. Liquidity ratios are used to judge banks' ability to meet short-term obligations. It is the comparison between short-term obligations and short-term resources available to meet such obligations. Commercial banks are directed by NRB to maintain 5% of their deposits as Cash Reserve Ratio (CRR) in NRB's account to ensure adequate liquidity. As per NRB regulation, bank has to maintain CRR on a weekly basis. Therefore, rather than disclosing the CRR of year-end, banks should report the exact CRR ratio maintained during the week, in which year-end falls.

Cash and bank balance to total deposits ratio is used to measure the banks' ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower ratio indicates that banks might face a liquidity crunch while paying its obligation, where as a very high ratio points out that bank has been keeping idle funds and not deploying them properly.

4.1.5.1 Total Loan to Total Deposit Ratio

Table 4.18

Credit Deposit Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Total Loan	5531.83	6739.35	8241.46	10065.05	12746.16	-	-	-
Total Deposit	7198.33	8654.77	11002.04	11452.90	13715.39	-	-	-
NSBIL	76.85	77.87	74.91	87.88	92.93	82.09	7.87	9.59
Total Loan	2540.79	5130.22	6146.57	7319.94	8964.07	-	-	-
Total Deposit	2754.63	5586.8	7893.3	9475.45	11102.24	-	-	-
MBL	92.24	91.83	77.87	77.25	80.74	83.99	7.46	8.89

The table 4.18 shows the loan to total deposit ratio of the NSBIL has increased during the study period. It varies from the minimum of 74.91% in the year 2006 to 92.93% in the year 2008 giving the average value of 82.09% whereas the MBL shows the declining trend. The C/D ratio is 92.24% in the year 2004 and continuously falling down and finally dropped to 80.74% in the year 2008 giving the average value of 83.99%.

Figure 18

Bar Diagrams showing Credit - Deposit Ratio of NSBIL and MBL

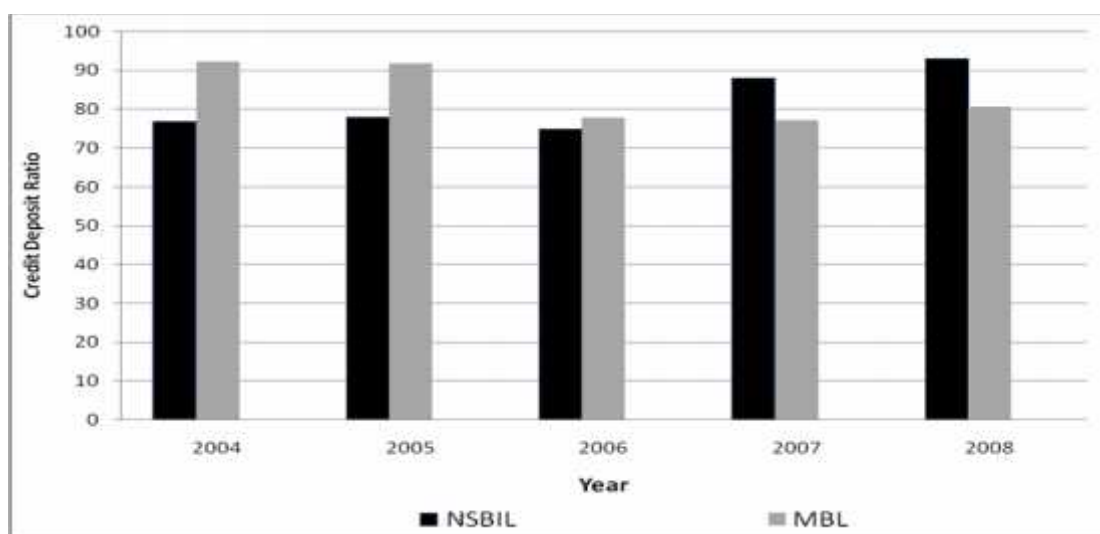


Fig. 18 shows the bar graph of total loan to total deposit ratio of NSBIL and MBL during the study five years period. It seems in the increasing trend for NSBIL. Whereas the graph shows the ratio of MBL is in declining trend. According to above data of C/D Ratio of both the sample banks during the study period it can be considered that both the banks have maintained reasonable amount of liquid funds for the period.

NRB Balance to Total Deposit Ratio

The table 4.19 depicts that the NRB balance to total deposit ratio of the sample banks during the study period. NSBIL shows the variation in the trend it drops from 8.06% in the year 2004 to 4.51% in the year 2005 and rises to 5.69% in the year 2006 then dropped and increase finally to 5.94% in the year 2008 giving average value of 5.81% the same nature also exists in case of MBL but the average value stands at 7.16% during the period.

Table 4.19

NRB Balance to Total Deposit Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
NRB Balance	580.45	390.03	626.12	556.68	403.81			
Total Deposit	7198.33	8654.77	11002.04	11452.90	13715.39			
NSBIL	8.06	4.51	5.69	4.86	5.94	5.81	1.88	32.36
NRB Balance	136.66	463.23	489.09	785.69	893.3			
Total Deposit	2754.63	5586.8	7893.3	9475.45	11102.24			
MBL	4.96	8.29	6.20	8.29	8.05	7.16	1.51	21.09

According to NRB directives, the commercial banks should maintained minimum 5.5% cash at NRB, of the total deposit collected. Thus both the banks have maintained this guideline of NRB.

Figure 19
Trend Lines showing ratio of cash in NRB to Total Deposit
of NSBIL and MBL

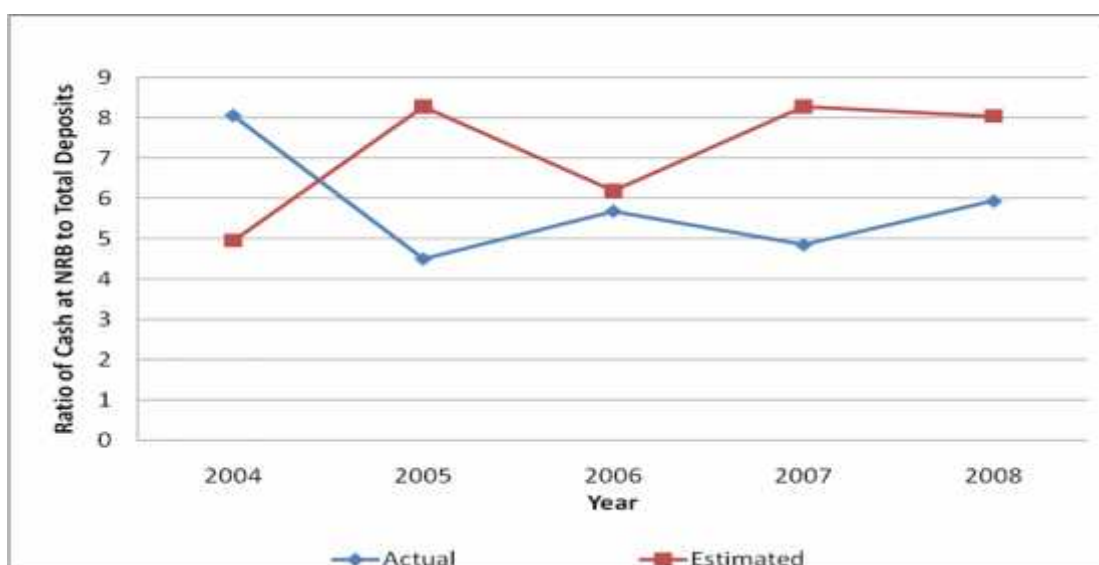


Fig. 19 shows the trend lines showing cash in NRB to total deposit ratio of NSBIL and MBL. The figure clearly shows that both the banks have maintained the cash reserve ratio as per NRB standards.

4.1.5.3 Cash in vault to Total Deposit Ratio

The table 4.20 shows the cash in vault to total deposit ratio. The total cash in vault of the banks varies from time to time. It varies from 2.24% in the year 2004 and finally reaches to 2.25% with fluctuation during the period giving the average value of 2.18% of NSBIL but MBL shows inclining trend throughout period, it increases from 2.18% in the year 2005 with continuous increments up to 5.05% in the year 2008 giving the average value of 3.44%.

Table 4.20
Cash in vault to Total Deposit Ratio (%)

Year	2004	2005	2006	2007	2008	Avg.	S D	C V
Cash in Vault	161.22	143.75	244.19	2875.30	3081.02	-	-	-
Total Deposit	7198.33	8654.77	11002.04	11452.90	13715.39	-	-	-
NSBIL	2.24	1.66	2.22	2.51	2.25	2.18	0.31	14.32
Cash in Vault	65.26	121.55	280.42	385.94	560.32	-	-	-
Total Deposit	2754.63	5586.8	7893.3	9475.45	11102.24	-	-	-
MBL	2.37	2.18	3.55	4.07	5.05	3.44	1.20	34.79

The cash in vault to total deposit ratio of both the sample banks can be considered as adequate as they have maintained above 2.00% level.

Figure 20
Bar Diagrams showing Cash in vault to Total Deposit
of NSBIL and MBL

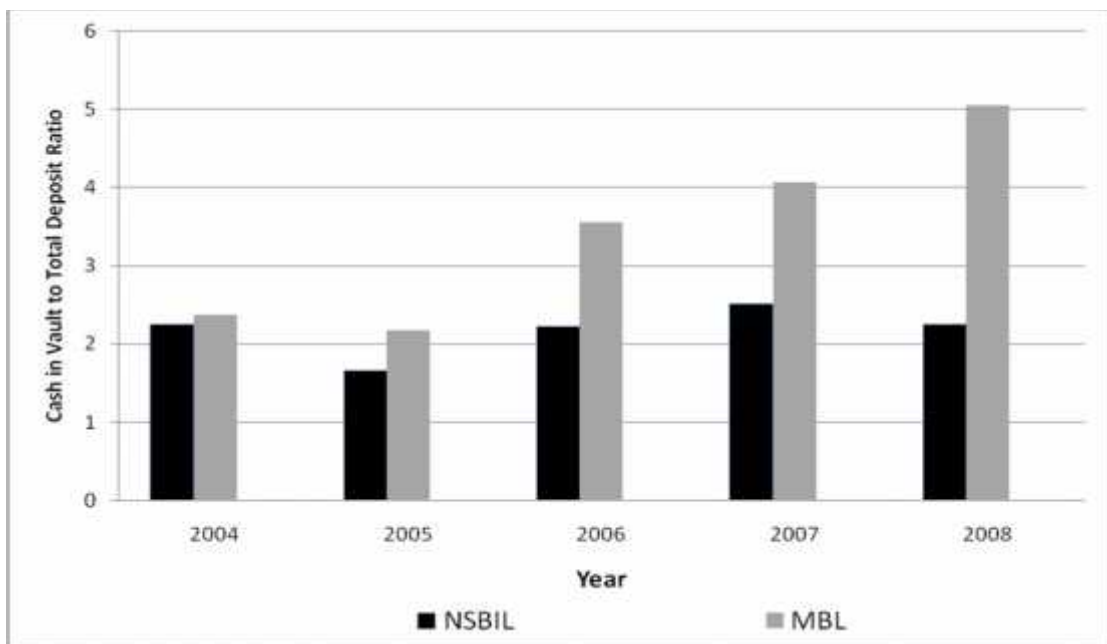


Fig. no. 20 shows the total cash in vault to total deposit ratio of NSBL and MBL during the FY 2004 to 2008. The ratio of NSBIL is seen to be fluctuating, increasing till the year 2007 and decreasing in year 2008. The ratio of MBL has decreased in 2005 then it starts to rise till 2008.

Major Findings of the Study

This unit of the study includes the key findings of the study obtained from the data analysis.

4.2.1 Capital Adequacy:

The risk based capital ratio of both the banks shows very fluctuating trends. NSBIL has average capital fund to total risk based assets (RBA) ratio of 11.91% with minimum 9.44% in the year 2005 and maximum 13.57% in the year 2006 and the rest of the value lies within this limit. MBL also shows the very inconsistent distribution, the least value is 11.36% in the year 2005 and the highest value is 17.82% in the year 2004 giving the average value of 13.26%. Both the banks maintain this ratio above the stated standard limits given by NRB. The average ratio of Core capital to RBA NSBIL is 9.83% and MBL reflects the same value of 12.10% during the study period. Both the sample banks are able to maintain the NRB guideline in this regard of 5.5%. Hence it can be concluded the capital fund to risk based assets or capital adequacy of the sample banks is strong.

4.2.2 Assets Quality:

The ratio of past due loan to total loan has fluctuating trend during the study period. The total past due loan of sample banks has gone above 90.00% throughout the study period. The average ratio of past due loan to total loan of NSBIL for the study period 94.54% while MBL shows 98.46%. The average ratio of substandard loan to total loan of NSBIL is about 0.10% but MBL shows about 0.25% of the total loan. The average ratio of doubtful loan to total loan of MBL is 0.13% and NSBIL has the same ratio of 0.59%. According to NRB Guideline, any bank has to maintain loan loss provision against the loan as their category of Pass, Substandard, Doubtful and Bad of 1.00%, 25.00%, 50.00% and 100.00%. The average provision of substandard loan to total loan of NSBIL is 21.14% and MBL maintains the same provision of 26.87%. The average provision of doubtful loan to total loan of MBL is 52.41% and NSBIL gives the same value of 49.90% during the study period. The average provision for bad loan to total loan of both the sample banks is 100.00%. Hence, both the banks maintained the average provision set by NRB.

4.2.3 Management Soundness:

The ratio of total expenses to total income of both the sample banks is very fluctuating one. NSBIL gives the average ratio of 57.83% with the least value in the 43.98% in the year 2008 and the highest value in the year 65.80% in the year 2007. MBL shows the average value of expenses out of their income of 67.43%. MBL spent maximum out of their income, 72.15% in the year 2004 and spent minimum out of their income, 64.64% in the year 2005 as well. There is vast difference in the earning per employee of sample banks. The average earning per employee of NSBIL is Rs. 130.73 million and average earning per employee of MBL is only Rs. 49.05 million during the study period.

4.2.4 Earning Quality:

Return on total assets or Net Income to total assets of both the sample banks also vastly vary. The ROA of NSBIL is 17.68% where ROA of MBL is only 1.11%. Return on Core Capital or Net Income to Core Capital of both the sample banks also differ with each other, NSBIL has average value of 23.34% and MBL has only 10.34% respectively during the study period. The average net spread of NSBIL is 2.76% only but MBL has average net spread of 4.83% as well as the average net interest margin of MBL is 3.38% and NSBIL has only 2.86%. Hence, net spread and net interest margin of MBL is superior to NSBIL or the sustainability of MBL is stronger than NSBIL in the long run.

4.2.5 Liquidity:

The credit deposit ratio of both the sample banks shows the reasonable amount of investment in the loan and advances. The average credit deposit ratio of NSBIL is 82.09% and MBL has average credit deposit ratio of 83.99%. The C/D ratio of NSBIL fluctuates minimum 74.91% in the year 2006 and maximum 92.93% in the year 2008 whereas MBL shows maximum value of 92.94% in the year 2004 and minimum value of 77.25% in the year 2007 respectively. Thus it can be considered that the loan to total deposit ratio of both the sample banks shows the banks have maintained reasonable liquidity position during the study period. The average CRR maintained by NSBIL is 5.84% and MBL has maintained 7.16% during the sample period, the minimum standard set by NRB is 5.5% hence it is seen that both the sample banks have maintained sound CRR level. The average cash in vault to total deposit ratio set

by NRB is 2.00% during the study period, NSBIL has average value of 2.18% with minimum value of 1.66% in the year 2005 and maximum of 2.51% in the year 2007 whereas MBL has average value of 3.44% with the least value of 2.18% in the year 2005 and the highest value of 5.05% in the year 2008. According to given facts, both the banks could maintain adequate liquidity position during the study period.

CHAPTER – V

SUMMARY, CONCLUSIONS AND RECOMMENDATION

This section of the study is divided into three sub sections. The first section provides the brief summary of the study. The second section demonstrates the conclusion of the study and finally the third section contains recommendations traced out in the background of analysis carried out.

5.1 Summary of the Study

The study was conducted with the objectives to analyze the financial performance of NSBIL and MBL with CAMEL framework. Five fiscal years data are collected for the study purpose. The study is based on secondary data and the data obtained were analyzed using various financial and statistical tools. CAMEL is a technique of evaluating the soundness of financial institutions. The bank's financial soundness is judged on the basis of some major factors – capital adequacy, assets quality, management soundness, earning quality and liquidity position.

The study is conducted with the general objective to analyze the financial performance of NSBIL and MBL. Moreover, the specific objectives of the study were to examine the capital adequacy, to assess the quality of bank's assets, to analyze the efficiency of the banks' management, to evaluate the earning performance of the bank and to find out the liquidity position of the bank during the study period of 2004 to 2008. Different materials were reviewed to build up the conceptual framework and to find out the clear guidelines to research work.

The study covered five fiscal years, as the sample period from 2004 to 2008. It is concerned with the financial performance analysis of commercial bank. The study was designed within the framework of case study analysis research design and the analysis has been made in the same way. For the purpose of the study, NSBIL and MBL are taken as sample banks by applying convenient sampling technique out of 26 commercial banks presently operating in Nepalese economy. The required data and information were collected from secondary sources.

The risk based capital adequacy ratio disclosed that NSBIL has maintained the adequate capital fund except in the year 2005 (9.44% and the NRB Standard is 11.00%). MBL has maintained the adequate capital fund during the study period. In

same way, the risk based core capital ratios of both the banks are above the NRB standard during the entire study period. It showed that the core capital adequacy ratio of both the banks is adequate and sufficient. The risk based supplementary capital ratio of both the banks showed both the sample banks NSBIL and MBL met the requirement as prescribed by the NRB.

The ratio of past due loan to total loan of NSBIL and MBL showed that the quality of assets of both the sample banks is satisfactory from the perspectives of NPS, though it is remarkably high than the contemporary successful banks of Nepal i.e. above 90.00% of the total loan. The percentage of substandard loan to total loan was below 1.00% level throughout the study period. This has implied that the quality of the loan of both the banks is strong during the study period. The percentage of doubtful loan to total loan was above 1.00% in context of NSBIL in the year 2004 and in the rest of the year it was below 1.00% level throughout the study period as well as MBL also showed the same value below 1.00% level for entire study period, which can be considered as the quality of loan was strong. Both the banks have maintained the loan loss provision around the NRB standard, so it can be considered that the recovery process of sample banks is sound. It is the indication of banks' efficiency to recover its NPAs.

The banks have given their best effort to minimize the expenses with respect to income. The ratio of total expenses to total income of both the banks have mixed ups and downs trends but seem trying to minimize that is decreasing year to year. The average of the earning per employee during the study period is Rs. 130.73 million of NSBIL and Rs. 49.05 million of MBL respectively. The earning per employee of NSBIL is sharply increasing but earning per employee of MBL is fluctuating one, which reflects efficiency of staffs as well as quality of management team. The return on assets and return on core capital of both the banks vary vastly. The earning capacity of NSBIL is superior to MBL because there is significant difference in earning quality. The larger ratio of net income to total assets and core capital reflects the bank is towards the progress. Net spread of NSBIL is 2.76% and MBL is 4.83% or above 2.00% level reflects the banks has maintained strong position regarding the net spread which is symbol of profitability and earning capacity of banks. The net interest margin of both the sample banks is fluctuated around 3.00%, giving average 2.86% by NSBIL and average 3.38% by MBL respectively. The net interest margin of NSBIL

can be considered only satisfactory and that of MBL is better, because it is generally assumed that the net interest margin 3% to 4% reflects healthy financial environment.

The liquidity ratio of both the banks showed they have strong liquidity position. The loan to deposit ratio of both the banks reflects both the banks have maintained reasonable liquid funds. The NRB balance to total deposit ratio of both the banks revealed that the banks have maintained adequate funds in NRB, both the banks have maintained above 5.5% level as CRR. Cash in vault to total deposit ratio of both the sample banks have maintained adequate balance because both the banks have maintained above 2.00% level.

5.2 Conclusions of the Study

Based on the findings the following conclusions have been drawn:

5.2.1 NSBIL and MBL both have maintained the adequate level of capital fund as prescribed by NRB. It is seen that there is capital short in the year 2005 of NSBIL because of regrouping of previous year's figure as per new NRB directives. The risk based core capital and supplementary capital adequacy ratio of both the banks showed that they have maintained the requirement of NRB standard during the study period.

5.2.2 NSBIL and MBL have maintained satisfactory level of past due loan to total loan. The percentage of substandard loan and doubtful loan to total loan has implied that the quality of the loan during the study period is strong from the perspective of their proportion to total loan outstanding. Both the banks have maintained strong assets quality. Both the sample banks maintained the average requirement of provision, provision to substandard loan around 25.00%, provision to doubtful loan around 50.00% and provision to bad loan around 100.00% according to NRB directives.

5.2.3 MBL has higher level of total expenses to total income comparing to NSBIL. Nevertheless, decreasing trend and controlled ratio indicates that the bank use their best effort to decrease expense with respect to income. The numbers of staffs are comparatively same in both the banks but earning per employee of MBL is lower than that of NSBIL. It reflects the efficiency of staffs as well as sound management quality.

5.2.4 The measuring rod of income of both the banks showed that the banks have satisfactory level of income during the study period. Return on assets and Return on core capital of NSBIL is higher than that of MBL, reflecting the bank is in the line of progress, sustainability giving profitability to the firm in the long run. Net spread above 2.00% level and net interest margin 3.00% to 4.00% of both the banks showed they have better financial scenario for coming days.

5.2.5 The credit deposit ratio of both the banks showed that the banks have maintained reasonable liquid funds. The NRB balance to total deposit and cash in vault to total deposit ratio of the banks revealed that both the banks have maintained an optimum level of balances as prescribed by NRB.

5.3 Recommendations

Based on above conclusions, the following recommendations can be carried out:

5.3.1 NSBIL and MBL have maintained adequate risk based capital ratio and risk based supplementary capital ratio as prescribed by NRB, it is strongly recommended that the bank should maintain total risk based capital adequacy as per NRB requirements.

5.3.2 If any loan turns to default, it directly affects the performance as well as profitability of the bank. The bank should aggressively recover its outstanding loan because larger the NPA lesser the profitability giving question to the sustainability in long run. Adequate loan loss provisions protect the bank from the dangers of consequences arising from the conversion of loan in bad loan. It is recommended to keep adequate provisions for NPAs as per NRB requirements.

5.3.3 The banks should increase their income and decrease expenses because it gives the life to the firm for the coming days. The banks should try to raise their present net spread level as well as net interest margin level.

5.3.4 The liquidity position of both the sample banks should meet its current and contingent obligations. It is observed that the bank has maintained the adequate cash balance in vault and NRB as well. It is strongly recommend that there should be an optimum level of cash balance in NRB and vault because the fund remains idle in both situations.

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APPENDIX 1

List of Commercial Banks in Nepal

S.N.	Name of the Banks	Estd. Year (B.S.)
1	Nepal Bank Limited	1937
2	Rastriya Banijya Bank	1966
3	NABIL Bank Limited	1984
4	Nepal Investment Bank Limited	1986
5	Standard Chartered Bank Nepal Limited	1987
6	Himalayan Bank Limited	1993

7	Nepal SBI Bank Limited	1993
8	Nepal Bangladesh Bank Limited	1994
9	Everest Bank Limited	1994
10	Bank of Kathmandu Limited	1995
11	Nepal Credit and Commerce Bank Limited	1996
12	Lumbini Bank Limited	1998
13	NIC Bank Limited	1998
14	Machapuchre Bank Limited	2000
15	Kumari Bank Limited	2001
16	Laxmi Bank Limited	2002
17	Siddhartha Bank Limited	2002
18	Agriculture Development Bank Limited	1968
19	Global Bank Limited	2007
20	Citizen Investment Bank Limited	2007
21	Prime Commercial Bank Limited	2007
22	Bank of Asia Nepal Limited	2007
23	Sunrise Bank Limited	2007
24	Development Credit Bank Limited	2001
25	NMB Bank Limited	1996
26	KIST Bank Limited	2003

Source: <http://www.nrb.org.np>

APPENDIX 2

Shareholding Pattern Nepal SBI Bank Limited

Share Ownership (End of Ashad 2065)				
Share Capital Previous Year	%	Particulars	%	Share Capital This Year
453,600,000	70.02%	(A) Promoters	70.02%	612,360,000
-	-	1.1 Nepal Government	-	-
324,000,000	50.02%	1.2 Foreign Institutions	50.02%	437,400,000
32,400,000	5.00%	1.3 "A" Class Liscensed Institutions	5.00%	43,740,000
-	-	1.4 Other Liscensed Institutions	-	-
97,200,000	15.00%	1.5 Other Entities	15.00%	131,220,000
-	-	1.6 General Public	-	-
-	-	1.7 Others	-	-
194,198,400	29.98%	(B) General Public	29.98%	262,167,840
647,798,400	100%	Total	100%	874,527,840

Source: Annual Reports 2061/62

APPENDIX 3

Nepal SBI Bank Limited Comparative BALANCE SHEET (Amount in Actual)

A. <u>ASSETS</u>	FY 2057-58	FY 2058-59	FY 2059-60	FY 2060-61	FY 2061-62
	2000-01	2001-02	2002-03	2003-04	2004-05
Cash	208,482,595	318,158,820	187,777,015	286,886,222	146,352,555
Local Currency	182,577,328	285,369,093	154,683,818	263,166,658	132,448,302
Foreign Currency	25,905,267	32,789,727	33,093,197	23,719,564	13,904,253
Cheques for Clearing					
Bank Balance	604,423,743	733,661,029	956,990,468	683,600,321	413,028,059
Nepal Rastra Bank	512,066,310	506,674,844	892,746,559	606,694,594	389,705,047
Other Local Banks	4,795,423	23,910,006	16,151,315	37,849,492	26,204,520
Foreign Banks	87,562,010	203,076,179	48,092,594	39,056,235	(2,881,508)
Money at Call or Short Notice (Placements)	522,550,000	31,368,000	670,204,297	918,733,400	868,428,307
Investment (At Cost)	7,704,308,930	8,199,514,813	6,031,175,547	5,835,948,498	4,267,233,178
HMG Securities	2,732,959,430	4,120,294,813	3,588,772,854	3,672,626,438	2,413,939,370
Treasury Bills	1,857,688,530	2,517,317,913	1,593,339,152	2,193,314,736	664,627,668
Development Bonds	840,270,900	1,567,976,900	1,960,433,702	1,479,311,702	1,749,311,702
National Savings Bond	35,000,000	35,000,000	35,000,000		
Company Shares	18,820,000	22,220,000	22,220,000	22,220,000	27,363,000
NHFDC Limited	2,125,000	2,125,000	2,125,000	2,125,000	2,125,000
Far Western Rural Development Bank	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
Mid-Western Rural Development Bank	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Eastern Rural Development Bank	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
NIDC Capital Markets Limited	100,000	300,000	300,000	300,000	300,000
Other Banks/Agencies	9,095,000	12,295,000	12,295,000	12,295,000	17,438,000
Debentures & Bonds					412,919,325
Shares in Subsidiary Companies					
Other Investments	4,952,529,500	4,057,000,000	2,420,182,693	2,141,102,060	1,413,011,483
Mutual Fund	1,000,000	1,000,000	1,257,000	1,257,000	1,257,000
Local Banks	-	-	12,500,000	12,500,000	22,500,000
Foreign Banks	4,951,529,500	4,056,000,000	2,406,425,693	2,127,465,060	1,391,679,483
Bills Purchases & Discounted	331,157,426	302,358,410	301,689,083	236,232,975	120,903,614
Local	64,190,326	55,612,910	46,752,478	24,990,336	72,907,382
Foreign	266,967,100	246,745,500	254,936,605	211,242,639	47,996,232
Loans, Advances & Overdrafts	7,993,282,006	7,135,536,266	7,454,262,902	7,953,759,876	10,465,266,388
Local	7,964,250,621	7,050,665,802	7,378,029,069	7,582,466,725	10,261,188,129
Foreign	29,031,385	84,870,464	76,233,833	371,293,151	204,078,259
Fixed Assets	248,665,708	237,638,807	251,915,161	338,126,262	361,235,392
Other Assets	749,583,805	671,016,247	708,610,519	492,199,084	543,883,323
Non-Banking Assets					
Interbranch Assets					
Loan Loss Provision adjusted*	(591,802,930)	-	-	-	-
Total Assets	17,770,651,283	17,629,252,392	16,562,624,992	16,745,486,638	17,186,330,816

B. LIABILITIES & CAPITAL	FY 2057-58	FY 2058-59	FY 2059-60	FY 2060-61	FY 2061-62
Share Capital	491,654,400	491,654,400	491,654,400	491,654,400	491,654,400
Authorised Capital	500,000,000	500,000,000	500,000,000	500,000,000	500,000,000
Issued Capital	500,000,000	500,000,000	500,000,000	500,000,000	500,000,000
Paid-Up Capital	491,654,400	491,654,400	491,654,400	491,654,400	491,654,400
Reserve Funds	571,192,254	654,773,894	822,533,056	990,027,903	1,165,983,908
General Reserve	514,504,393	568,832,115	652,079,277	743,200,000	847,000,000
Share Premium	74,000	74,000	74,000	74,000	74,000
Capital Adjustment Reserve	-	49,165,440	103,247,424	162,800,000	228,300,000
Retained Earning	26,173,532	2,110,372	29,794,031	29,794,031	29,981,908
Contigent Reserve	2,750,000	3,750,000	4,750,000	5,750,000	6,750,000
Dividend Equalization Fund				11,931,872	13,500,000
Exchange Fluctuation Reserve	25,112,329	28,263,967	30,010,324	33,900,000	37,800,000
Special Reserve Fund	2,578,000	2,578,000	2,578,000	2,578,000	2,578,000
Other Reserve					
Borrowing from other Banks/Agencies	-	417,298,060	961,461,153	229,660,000	17,062,680
Local	-	417,298,060	961,461,153	229,660,000	17,062,680
Nepal Rastra Bank-Repurchase	-	179,949,060	606,337,342		
Nepal Rastra Bank-Refinance	-	137,349,000	5,123,811		
Others Borrowings	-	100,000,000	350,000,000	229,660,000	17,062,680
Foreign					
Deposits	15,839,007,783	15,506,428,215	13,447,661,064	14,119,032,115	14,586,608,707
Current	2,850,971,642	2,703,818,737	3,034,002,537	2,688,966,557	2,799,184,977
Savings	4,917,138,344	4,972,056,618	5,229,723,260	5,994,121,406	7,026,334,402
Call	3,948,337,953	4,944,960,238	2,540,701,246	2,801,405,837	2,341,328,577
Fixed	3,719,202,825	2,446,845,914	2,252,544,590	2,310,571,784	2,078,535,135
Others	107,166,499	74,459,258	9,374,010	19,284,000	44,249,385
Margin	296,190,520	364,287,450	381,315,421	304,682,531	296,976,231
Bills Payable	69,696,788	67,752,859	108,943,551	173,499,287	119,753,038
Other Liabilities	799,100,058	491,344,964	730,371,768	741,612,933	805,268,083
Total Liabilities	17,770,651,283	17,629,252,392	16,562,624,992	16,745,486,638	17,186,330,816

C. OFF BALANCE SHEET ITEMS	2000-01	2001-02	2002-03	2003-04	2004-05
Contingent Liabilities			5,492,351,238		
Letters of Credit	4,911,497,142	4,992,552,999		5,297,735,422	4,691,540,706
< than 6 months	2,047,819,584	2,496,300,873	2,812,029,923	2,315,200,683	2,304,142,658
> than 6 months	2,047,819,584	2,211,219,769	1,956,465,223	1,383,833,174	1,386,588,460
Letter of Guarantee Outstanding			855,564,700		
Bid Bond Guarantee	-	285,081,104		931,367,509	917,554,198
Performance Guarantee	1,119,419,748	1,261,213,416	1,717,900,964	1,713,216,660	1,602,516,634
Advance Payment Guarantee	72,397,456	55,830,119	93,945,298	68,320,707	44,240,846
Financial Guarantee	978,750,154	1,150,599,388	1,487,776,832	1,504,252,743	1,454,530,552
Other Guarantee	68,272,138	54,783,909	136,178,834	140,643,210	103,745,236
G'tee against Counter G'tee of A+ Rated Banks	-	6,788,412	51,398,919	-	-
Forward Exchange Contract Outstanding	-	-	7,322,100	101,803,500	-
Bills under Collection	315,195,676	332,103,838	236,823,749	318,320,014	182,386,471
Contingent Tax Liability	856,516,294	192,350,833	177,856,311	249,433,936	32,253,269
Acceptance and Endorsements	52,337,181	177,637,234	7,012,822	155,151,778	137,638,991
Other Contingents	130,295,679	88,878,888	100,349,468	13,368,550	105,841,871
	389,912,980	437,279,505	381,580,742	431,240,301	400,701,385
	-	-	76,240	-	10,059,427

APPENDIX 4

Nepal SBI Bank Limited Risk Weighted Assets (Rs. in Millions)

Risk Weighted Assets of NSBIL						
		2004	2005	2006	2007	2008
On Balance Sheet	Total On Balance Assets	17,775	17,993	16,920	17,104	17,549
	RWA	9,869	8,702	8,801	9,568	12,132
Off Balance Sheet	Total Off Balance Assets	4,911	4,993	5,485	5,298	4,692
	RWA	1,672	1,861	2,345	2,304	2,062
Total	Assets	22,687	22,986	22,405	22,402	22,241
	RWA	11,541	10,564	11,146	11,872	14,193

Source: Annual Reports