A COMPARATIVE FINANCIAL ANALYSIS OF NEPALESE COMMERCIAL BANKS

With references to Sanima Bank Limited, Agricultural Development Bank Limited and Nabil Bank Limited

A Thesis Proposal

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1. Background of the study

Banks are the monetary units of national economy. They work as facilitator for achieving sustained economic growth through providing effect monetary intermediation. They provide financial resources from surplus sector to deficit sector. A financial system promotes investment by financing productive business opportunities, mobilizing savings, efficiently allocating resources and makes trade of goods and services easy. Banking renders service to the people in financial matters, and it magnitude of action is extending day by day. It is a major financial institutional system in Nepal. The performance evaluation of bank is important for all parties including depositors, investors, managers and regulators (Jha and Hui, 2012).

Banks help to the growth of agriculture, trade, commerce and industry of the national economy. They are inevitable for the resources mobilization and economic development of the country. Banking industries are regarded as one component of economy. They transfer the scattered funds collected from saving of the public into various productive sectors. Economic activities remain halt in absence of banking industries. It helps to enhance economic activities of the country by providing capital funds for the smooth operation of business activities. People deposit their saving in trust of banks repay their deposits promptly when they demand for it. If one bank fails to repay the deposited amount to the public then the public do not believe the bank and it leads to insolvency of the banks. So as the regulator and supervisor NRB always dictate the activities of the banks in the country. It provides its directives from time to time in order to have fair competition between the banks and to safeguards the deposits of the public. As number of banks in the country increases NRB has to be more active towards its regulative and supervising role. For healthy competitions of the banks, NRB planned to merge two banks and they have to make their capital NPR 8,000,000,000.

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

Commercial banks collect deposits from the public and the largest portion of deposited money is utilized in disbursing loan and advances. Loans and advances constitute a major portion of the assets and deposits constitute a major portion of the liabilities of balance sheet of commercial banks. Similarly earning of the banks depends upon the spread that it enjoys between the interest it receives from the borrowers and that to be paid to the borrowers. An average, bank generates sixty to seventy percent of its revenue through its lending activities. The return that the bank enjoys of deposit mobilization through loan and advances is very attractive but they do not come free of cost and free of risk. There is risk inherent in lending portfolio. Banking sector is exposed to number of risk like, interest rate risk, liquidity risk, credit risk or default risk, borrowers risk, security risk, earning risk etc. Such risk are excessive had led many banks to go bankrupt in a number of countries. Performing loans have multiple benefits to the society while non-performing loan erodes even existing capital.

2. Statement of the problem

There are twenty seven commercial banks in Nepal in current situation. The number of established of new banks had been increased after 2040 B.S. But now, the private commercial banks are merging. They are trying to make their performance better. But most of the commercial banks have their branches are only in the urban areas other But its presence is also in urban area generally. It could not able to cover the village area satisfactory. Most of the business is concentrated in urban area and their offices are almost confined inside of Kathmandu valley. When even they are in to outside the valley, then they move towards urban sectors but not in rural sector. Therefore, the high mass of rural sector is not getting the advantages of such institutional development.

This state of affair cannot contribute much to the socio-economic development of the country where most of the population living in the rural areas and 80% of population depend upon agriculture. This problem remained to be saved so that even the small investors in the rural area will benefit from services of these banks. Sanima, Agriculture Development Bank and Nabil Bank have its high responsibilities to the villages as it has governments' share. In the changed scenario Sanima Bank, Agriculture Development Bank And Nabil Bank need to explore their strengths and weaknesses and improve their performance because their success depends upon their ability to boost their productivity and financial performance.

These following specific problems are being made to explore in details:

vi. What is the capital adequacy ratio of sample banks?

vii. What are the qualities of assets of sample banks?

viii. What are the management qualities of sample banks?

ix. How efficiently are the sample banks managing their liquidity?

At what extents the banks are able to raise and maintain their profitability?

3. Objectives of the study

The main objective of the study is to analyze the comparative financial performance of three commercial banks: Sanima Bank, ADBL Bank and Nabil Bank Those specific objectives of the study are as follows:

v. To analyze the capital and assets management of sample banks.

vi. To examine the management quality of sample banks.

vii. To evaluate their liquidity position.

viii. To examine the profitability of these banks.

4. Significance of the study

The banking sector is one of the major sectors of the country. It helps to emerge new business in industries by providing different facilities to businessmen so that they can run their business smoothly. This study will help to analyze the financial performance of sample banks.

The study will mainly compare the financial performance of Sanima Bank, Agricultural Development Bank, and Nabil Bank Limited which will compare the position of selected bank under the study, which will encourage improving the different position and performance of the selected banks. From data presentation and analysis researcher will find different and weakness of the selective banks which will be recommended to the banks for their further improvement.

The study will have multidimensional significance in particular area of concerned banks which will be undertaken that justifies for finding out important points and facts to researcher, shareholders, brokers, traders, financial institution, and public knowledge.

This study wil help and justify for finding out the financial performance of concerned selected commercial banks and Government of Nepal to make plans and policies.

The study will certainly input the policymakers of concerned selected banks for making plans and policies of the effective banking system.

5. Limitations of the study

The limitations of the study are as follows:

i. The study will cover only ten fiscal years 2010/11 to 2019/20.
ii. This study will mainly conducted on the basis of secondary data such as annual reports of three sample banks and other related journal, magazines, books etc.
iii. This study will be conducted only to analyze the financial performance on the basis of accounting data. It will not analyze market based performance banks.
iv. Results will be depend upon the availability of data

6. Review of literature

Review of literature is the study of previous research or article or book in related field or topics for finding the past studies conclusion and deficiencies that may be known for further research. This will help to check the chances of duplication in the present study. Thus the gap between the previous research and current research can be filled. The concept of financial performance of the banks based on financial ratio is applied by different researchers and the following is the summary of past studies and their results about the performance of the banks.

The trend of commercial banking is changing rapidly. Competition is getting stiffer and therefore, banks need to enhance their competitiveness and efficiency improving performance. Normally, the financial performance of commercial banks and other financial institutions has been measured using a combination of financial ratio analysis, benchmarking, measuring performance against budget or a mix of these methodologies (Jha and Hui 2012).

Shah and Jan (2013) in the article *Analysis of Financial Performance of Private Banks in Pakistan* states that their paper used multiple linear regression technique and simulated neutral network techniques for predicating bank performance. ROA was used as dependent variable of bank performance and seven variables including liquidity, credit risk, cost to income ratio, size and concentration ratio, were used as independent variables. The concept of the financial performance of the banks based on the financial ratio is applied by different researcher.

Shrestha (2010) in the thesis *Financial Performance Analysis of Leading Commercial Banks in Nepal* with reference to Standard Chartered Bank Nepal Limited , Nabil Bank Limited , Himalayan Bank Limited and Everest Bank Limited has used cash reserve ratio as the indicator of liquidity ratio. Similarly, profitabiliy measuring ratios are Net profit margin, Return on Assets (ROA), and Return on Equity (ROE). The other factors to be considered in analyzing the financial statement of bank are to assess the capital adequacy ratio and liquidity position. in the line of adequacy of bank is assessed on the basis of risk weighted assets. In indicates a bank's strength and solvency. Bank facing with capital adequacy problem may increase capital or reduce assets or reallocate the existing assets structure in order to maintain the desired level of capital base.

7. Methodology

Generally, most of the past studies made on financial performance of commercial banks based on different financial variables such like ROA and ROE. This is made for analyze the liquidity position, profitability position and assets management of Sanima Bank , ADBL and Nabil Bank Average of ten years ratios from 2007 to 2017 will be evaluated to assess the financial performance of these banks. So, in this study, we used different ratio analysis to find out the financial performance of Sanima Bank , ADBL and Nabil Bank.

7.1 Research design

To achieve the objective of this study, descriptive research design will be used. Ratio analysis Financial statements Arithmetic mean**,** Standard deviation and Coefficient of variation (C.V.) will be uses statistical tools will be also applied to examine facts and descriptive techniques will be adopted to evaluate financial performance of the banks.

7.2 Population and sample

There are altogether twenty eight commercial banks in Nepal. In this study, the focus will be on the analytical and comparative study of financial performance of Sanima Bank, ADBL and Nabil Bank. So, the study is based on sample not on the population. Here all twenty eight banks are population and three banks are sample for this study. Here random sampling method is used.

7.3 Sources and type of data

This study is mainly based on secondary data. The main sources of secondary data are annual reports, NRB website, published materials from these banks, financial statements of these banks, books, journals.

7.4 Data Analysis Tools and Techniques

To achieve the objectives of the study, various financial and statistical tools will be used in this study. The analysis of data will be done according to pattern of data available. With the available tools and resources, analytical statistical tools and financial tools will be used for financial analysis.

The various calculated results obtained through financial and statistical tools are tabulated under different headings. Then they are compared with each other to interpret the results.

7.4.1 Financial tools

There are various financial tools to measure the performance of an organization. Financial ratios will be based on CAMEL Framework are related to capital, assets, mangement, earnings and liquidity considerations.. The following financial tools will be used for the analysis:

i. Return on Assets (ROA)
ii. Return on Equity (ROE)
iii. Capital Adequacy Raio (CAR)
iv. Non-performing Loan Ratio (NPLR)
v. Credit to Deposite Ratio(CDR)
vi. Interest Expenses to Total Loan (IETTL)

Return on Assets (ROA)

Return on assets (ROA) is an indicator of how profitable a company is relative to its total assets. ROA gives a manager, investors, or analyst an idea as to how efficient a company's management is at using its assets to generate earnings. Return on assets is displayed as a percentage.

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Return on Equity (ROE)

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity because shareholders' equity is equal to a company's assets minus its debt, ROE could be thought of as the return on net assets.

$$\text{ROE}=\frac{\text{Net income}}{\text{Shareholder's Equity}}$$

Capital Adequacy Ratio (CAR)

The capital adequacy ratio (CAR) is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures. The capital adequacy ratio, also known as capital-to-risk weighted assets ratio (CRAR), is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital are measured: tier-1 capital which can absorb losses without a bank being required to cease trading, and tier-2 capital which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors.

$$\text{CAR}=\frac{Tier\ 1\ Capital+Tier\ 2\ Capital}{Risk\ Weighted\ Assets}$$

Non Performing Loan Ratio (NPLR)

Non-performing Loan (NPL) ratio compares non-performing loans to the total loan portfolio **(loans are assets for the bank),** and the higher ratio means higher risk of losses for some of the loans. Non-performing loans are those loans that are late on payments (common term is 90 days but it may depend on the financial regulations in the market).

$$\text{NPL Ratio} = \frac{Non\ Performing\ Loan}{Total\ Loan}$$

Credit Deposit Ratio (CDR)

Credit Deposit ratio is the ratio that shows how much a bank lends out of the deposits it has mobilized. It indicates how much a bank funds are being used for lending, the main banking activity. A higher ratio indicates more reliance on deposits for lending, and vice-versa.

$$\text{CDR} = \frac{Total\ Loan}{Total\ Deposits}$$

Interest Expenses to Total Loan (IETTL) Ratio

The Interest Expense to Total Debt ratio measures the estimated interest rate the company is paying on its total debt. This ratio assumes both Short Term Debt and Long Term Debt are summed together, as the Interest Expense figure is usually shown on the income statement as a summation of short and long-term interest expenses.

$$\text{IETTL} = \frac{Interest\ Expenese}{Total\ Loan}$$

7.4.2 Statistical tools

Arithmetic Mean (A.M.)

The sum of a collection of numbers divided by the number of the collection is arithmetic mean. It is known as mean or average. It is denoted by $\overline{X}$.

Arithmetic Mean $(\overline{X}) = \frac{\sum X}{n}$

Where,

$\overline{X}$ = Arithmetic mean

$\sum$x = Sum of all the values of the variable X

n = Number of observations

Standard Deviation (S.D.)

Standard deviation is a measure that is used to quantify the amount of variation or dispersion of a set of data values. It is denoted by the Greek letter sigma σ or SD.

Standard deviation $(\sigma) = \sqrt{\frac{1}{n}\sum\left(X - \overline{X}\right)^2}$

Coefficient of Variation (C.V.)

Coefficient of variation is the relative measure of dispersion which is defined as the ratio of standard deviation to the mean expressed in percentage. It is denoted by C.V.

$$CV = \frac{\sigma}{\overline{X}} \times 100\%$$

8. Chapter Plan

The study will be divided to five chapters as follows:

Chapter -1 Introduction

This chapter will include Background of the study, Statement of the problem, Objectives of the study, Significance of the study and Limitations of the study.

Chapter -2 Review of literature

The second chapter will review the existing literature on financial performance and reviews of earlier studies.

Chapter -3 Methodology

This chapter will introduce the research design sources and type of data population and samples, method of data analysis.

Chapter -4 Results and major findings

This chapter will deal with systematic analysis of data; various financial and statistical tools have been used to analysis and interpret the data.

Chapter -5 Discussion, Conclusion, and Implication

This chapter will summarize the main conclusion that flow from the study and offers necessary recommendations for future improvements of financial performance of Sanima Bank ltd, ADBL and Nabil Bank. At the end of the study, reference has also been incorporated.

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