

**FINANCIAL PERFORMANCE ANALYSIS OF JOINT VENTURE
COMMERCIAL BANKS IN NEPAL IN THE FRAMEWORK OF
CAMELS**

A Thesis Proposal

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1. Background of the Study

Banking sector plays vital role in the economic development of any country. An effective banking system leads to the effective mobilization of sources like saving and investment which in turn leads to the sound economy health of the country. Banks offers the various types of services to their customers to facilitate the economic transactions. Banks are those financial institutions that offers the wider ranges of financial services-especially credit, saving and payments services-and perform the widest range of financial functions of any firm in economy. This multiplicity of bank services and functions has led to banks being labeled “financial department stores.” Bank failures have stronger adverse effects on economic activities than other business failure. So banking is one of the most closely supervised industries.

Commercial banks are major financial institutions which occupy an important place in the economy. It performs various functions such as payments, financial intermediation between depositors and borrowers and other financial services. In the same way commercial banks operation records the economic pulse reflecting economic situation of the country. Commercial Banks, by playing active rules, have changed the economic structure of the world. Thus, they have become the heart of financial system.

The most common supervisory methods used by the regulatory agencies in promoting safety and soundness are on-site supervision and off-site supervision. On-site examination ratings like CAMELS are useful in the analysis of the bank at the time of the examination. The CAMELS rating ranges from 1 to5, lower rating representing better and well managed bank. CAMELS’ framework is a common method for evaluating financial performance. This method is development to assess not only of the financial performance of banks but also risk management. This CAMELS rating of banks is not disclosed to concerned banks and other external parties.

NRB central office prepared a working paper in 2006 about supervisory provision for foreign bank branches in Nepal. NRB supervises joint venture banks of financial information and compliance of applicable rules regulations and legal provisions including NRB directives. Performance of joint venture banks has been better than domestic banks reflected in profitability position, non-performing assets levels and capital adequacy position.

The commercial banks in Nepal can be broadly classified into two categories: public banks and private banks. The banks which are owned by government are called as public banks while the banks owned by the private sector are categorized as private banks. The private banks can be further regrouped into the domestic banks and joint venture banks. Nepal has adopted most liberal economic policies since 1990. The country is open to foreign investment and a numbers of joint venture banks came into existence. Out of 28 commercial banks six are joint venture.

Joint venture is a contractual business under taking between two or more parties and Joint venture bank is bank own by the joint investment of domestic investors and foreign banks. Joint venture banks have been increasing with an aim to provide modern banking services and facilities more effectives

2. Statement of the Problem

Profitability position of all commercial banks is generally known through annual reports. But information given in the annual report is not enough to look into the performance of the commercial banks. Investors should analyze the performance on hand and on the other hand regulatory body should carry out off-site and onsite supervision of commercial banks and keep their sound financial health. The major problem of this study is to check up to the financial health of all joint venture banks of Nepal in the framework of CAMELS. Therefore, this study will attempt to solve the following specific research questions:

1. How the JVBs are managing their Capital Adequacy?
2. What is the trend of non-performing assets and loan loss provision in JVBs?
3. How JVBs are managing their expenses with respect to revenues?
4. What is the trend of earning of JVBs?
5. What is the trend of liquidity position of the JVBs?
6. How changes in interest rates affect JVBs earnings?

3. Objectives of the Study

The fundamental objective of this study is to analyze the financial performance analysis of all joint venture banks in the framework of CAMELS. The specific objectives of the study are given below:

- 1 To analyze the capital adequacy of JVBs.
- 2 To analyze the trend of nonperforming assets and loan loss provision in JVBs.
- 3 To analyze operating efficiency of management of JVBs.
- 4 To analyze the trend in earning of JVBs.
- 5 To analyze liquidity position of JVBs.
- 6 To analyze the sensitivity of earnings to interest rates risk of JVBs.

4. Significance of the Study

This study is the financial performance of joint venture banks in Nepal in the framework of the CAMELS. It will help to know the existing problem of banks and give recommendation their sound financial health. This research would help to managers to evaluate performance of their banks. CAMELS rating system will crucial and convenient technique to assess the financial performance of any financial institutions and it will provide a framework for the supervisory authority. Other hand, the study is an important for the commercial banks, researchers, scholars, students and many other partners. At last it will add little worth to those who want to conduct a research work in the related topic.

-) This study will help to the management of the concerned banks to know their key competitiveness of their banks.
-) Policy maker of these banks will also be benefited by knowing the key strength and weakness of their banks. That helps them to formulate the appropriate policy.
-) Lenders and borrowers of these banks will also be benefited by knowing the actual liquidity position and leverage rating of the banks.

-) From this study shareholders will come to know the actual profitability and actual worth of the bank in terms of their investment.
-) Nepal Rastra Bank will also be able to know whether these banks were followed the rules and regulation.
-) Likewise, other similar commercial banks will also be benefited from this study etc.

5. Limitation of the Study

Although various methods are use in financial performance of commercial banks, CAMELS Rating System is focused of the study. It will cover only 6 years of period begins from the fiscal year 2001/002 to 2006/007. The analysis of the study is based on its annual reports, NRB publication and work papers. In this study, I tried my best for carry out the factual result. Despite sample efforts on the part of the researcher, this study is also not free from limitations. This is mainly due to the time and resources constraints on the part of the researcher which can be presented as follows:

-) This study will be based on the secondary data provided by Nepal Investment Bank Ltd. and Himalayan Bank Ltd. As far as the output concerned, any research based on secondary data is not far from limitations due to inherent character.
-) The study will be based upon only the five years financial data of concerned bank.
-) This study is limited only to the financial performance of the concerned bank. It will not cover the overall performance of the bank.
-) In this study, just two commercial banks will be selected as sample bank.
-) This study may not able to show the real financial performance of all the commercial bank due to small number of samples.

6. Organization of the Study

The whole study will be organized into five chapters. The first chapter will deal with the *Introduction* including backgrounds, focus of the study,

statement of the problem, objectives, significance, delimitations of the study and organization of the study. The second chapter will contain *Literature Review*. It reviews the relevant theories and past empirical studies. It includes conceptual review and research review. Chapter three describes the *Research Methodology* followed in this study. This includes the research design, population and sampled, nature and sources of data, data collection procedures, data processing. The fourth chapter deals with *Data Presentation and Analysis*. Finally, the fifth chapter covers the *Summary, Conclusion and Recommendation*.

7. Review of Literature

The most common supervisory methods used by the regulatory agencies in promoting safety and soundness are on-site supervision and off-site supervision. On-site examination ratings like CAMELS are useful in the analysis of the bank at the time of the examination. The CAMELS rating ranges from 1 to 5, lower rating representing better and well managed bank. CAMELS framework is a common method for evaluating financial performance. This method is developed to assess not only financial performance of banks but also risk management. The CAMELS rating of banks is not disclosed to concerned banks and other external parties.

NRB as a regulator and supervisor of the banking sector has been effortful to ensure a healthy and efficient financial sector by improving regulation on par with international standard. Bank supervision department NRB bases its evaluation of financial performance of commercial banks on a CAMELS rating system. An effective performance measurement system presents both financial results and operating data of a responsibility basis. Many countries are applying CAMELS monitoring tools, which is designed by UFIRS to supervisory controls in the commercial banks operation and help to find the critical deficiencies faced by such banks.

Cole and W. Gunther prepared studied on bank failure through comparison of one and off-site monitoring system in 2004. They found on site examination re regulators primary tools for monitoring the financial condition of federally

insured depository institutions. The study assessed the speed with which the information content of the supervisory rating assigned during bank exams the CAMEL Rating-decays. This is an important issue because cost and regulatory burden considerations often cause CAMEL rating to be assigned relatively infrequently.

Derviz and Podpiera studied on CAMEL and S&P Ratings at Czech Republic in 2005. They investigated the determinants of the movements in the long term standards and poor and CAMELS bank ratings in the Czech Republic during the period when the three biggest banks representing approximately 60% of the Czech banking sectors total asserts. The predictors for which they found significant explanatory power are capital adequacy, credit spread, the ratio of total loans to total assets and the total value at risk. Models based on these predictors exhibited a predictive accuracy of 70%.

Although, previous researchers have been carried out regarding financial performance analysis of commercial banks in the CAMEL and CAMELS framework, researchers havenot triedto conduct on financial performance of joint venture commercial banks in Nepal framework of CAMELS ratings on comparative analysis. This study will reflect the financial performance of joint venture banks in the framework of CAMELS ratings.

8. Research Methodology

Research methodology is the way to solve the research problem systematically. It facilitates the research work by providing reliability and validity. It refers to the various sequential steps to be adopted by a researcher in the study problem with certain objectives in view. This chapter is concerned with the procedures and techniques used in the objectives of the study. It includes research design, population and sample, nature and sources of data, methods of data collection, data analysis, tools and limitations of methodology.

8.1 Research Design

This study will be based on descriptive research approach to achieve the desired objectives. This study examines and evaluates of performance of joint venture banks in the framework of CAMELS. Financial ratios are applied to examine facts and descriptive techniques are adopted to evaluate financial performance of joint venture banks.

8.2 Population and Sample

There are 28 commercial banks in operation by the end of 2018. Among these bank, 6 are joint venture banks. For the purpose of this study, those joint venture banks are taken as the population. From the population 2 commercial banks will be taken as samples on the basis of convenience sampling method.

8.3 Sources of Data

This study will be fully based on the secondary data. Therefore, the main sources of data will be historical data disclosed by published reports of commercial bank especially annual report of sample banks. The regulatory data were collected form NRB directives and reports. The basic conceptual information was collected through BASEL, FDIC and NRB publications and working papers which are available in website. The major sources of data used in this study are:

- NRB Reports and Bulletins, and its' website.
- Various articles published in journals and financial magazine;
- Basel committee publications through its official website;
- Nepal Stock Exchange Reports;
- Research paper and dissertations of website of the sample bank in addition supportive qualitative information was collected by formal and informal discussions with the senior staff of the banks.

8.4 Method of Data Analysis

For the purpose of data analysis, various financial and statistical tools will be used to achieve the objective of the study.

Financial Tools:

Ratio Analysis, Liquidity Ratio, Assets Management Ratio (Activity Ratio), Leverage/Capital Structure Ratio and Profitability Ratios will be calculated.

Statistical Tools:

Arithmetic Mean or Average, Standard Deviation, Coefficient of Variation, Correlation Analysis, Probable Error and Trend Analysis will be done.

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