

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

**A Dissertation submitted to the Office of the Dean, Faculty of Management in  
partial fulfilment of the requirements for the Master's Degree**

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**January, 2022**

**CERTIFICATE OF AUTHORSHIP**

I certified that the work in this thesis has not previously been submitted for a degree nor has it been submitted as part of requirement for a degree except as fully acknowledged within the text.

I also certified that thesis has been written by me. Any help that I have received in my research work and the preparation of the thesis itself has been acknowledged. In addition, I certify that, all information sources and literature used are indicated in the reference section of the thesis.

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# TRIBHUVAN UNIVERSITY

## CENTRAL DEPARTMENT OF MANAGEMENT

Thesis

Office of Head of the Department  
Kirtipur, Kathmandu, Nepal

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## CENTRAL DEPARTMENT OF MANAGEMENT

Thesis

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### REPORT OF RESEARCH COMMITTEE

We, the undersigned, have examined the thesis entitled **Financial Performance Analysis of Joint Venture Commercial Banks in Nepal in the Framework of Camel** presented by Sona Pokhrel, a candidate for the degree of **Masters of Business Studies (MBS)** and conducted the Viva-Voce examination of the candidate. We hereby certify the thesis is worthy of acceptance.

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## ABSTRACT

*The study is to examine the Financial Performance of Commercial Bank on the Basis of CAMEL framework. Financial Performance measured by ROA and ROE is the dependent variable while the capital adequacy ratio (CAR), non-performing loan (NPL), management efficiency ratio (MER), return on assets (ROA) & cash reserve ratio (CRR) were chosen as independent variables. The data were collected from the annual reports of selected banks, annual report of SEBON, report of Nepal Rastra Bank and other official and unofficial publications. Data were analyzed by using appropriate financial and statistical tools and the descriptive research design were used. The Study shows that the capital adequacy ratio, NPL to total capital ratio, staff expenses ratio, Earnings per share, total loan to total deposit ratio which indicates the CAMEL framework has been satisfactory for joint venture banks of Nepal. There is significant impact of CAMEL on financial performance. The R value of .927 indicates strong positive relationship between CAMEL and ROA. Similarly, R-square value of 0.860 shows that the independent variables explain 86% of the variance in the dependent variable. The R value of .927 indicates strong positive relationship between CAMEL and ROE. Similarly, R-square value of 0.850 shows that the independent variables explain 85% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent.*

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## LIST OF ABBREVIATIONS

ACR	:	Capital Adequacy Ratio
ADBL	:	Agriculture Development Bank Limited
BCBS	:	Basel Committee on banking supervision
BIS	:	Bank for International Settlements
CCR	:	Cash Reserve Ratio
EPS	:	Earning Per Share
EVA	:	Economic Value Added
F/Y	:	Fiscal Year
GA	:	Growth of Assets
MBNL	:	Mega Bank Nepal Limited
MER	:	Management Efficiency Ratio
MPS	:	Market Price per Share
NABIL	:	Nabil Bank Limited
NEPSE	:	Nepal Stock Exchange
NIBL	:	Nepal Investment Bank Limited
NRB	:	Nepal Rastra Bank
NSBI	:	Nepal State Bank of India
OER	:	Operating Expenses Ratio
NPA	:	Non Performing Assets
NPL	:	Non Performing Loan
RBBL	:	Rastriya Banijya Bank Limited
RAROC	:	Risk Adjustment Return on Capital
ROROC	:	Return on Risk Adjusted Capital
ROA	:	Return on Assets
ROE	:	Return on Equity
S.D.	:	Standard Deviation
SEBON	:	Security Board of Nepal
TCR	:	Total Capital Ratio
UFIRS	:	Uniform Financial Institutions Rating System

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

Financial sectors play crucial role in economic growth and industrialization via channeling funds from surplus units- the depositors, to the deficit units, the borrowers, in the process gaining from the spread of the different interest charged. Their intermediation role can be said to be a catalyst for economic growth (Funso, Kolade and Ojo, 2012). The role and importance of banks of modern economy is enormous and its products/services which it provides growing in terms of depth, the number of institutions and the amount of money that managed by such institutions. The roles of such Banks are paramount in developing countries like Ethiopia where the financial market is underdeveloped and none existed.

In general the word bank means financial institution dealing with money. The financial performance of the financial institutions is playing the important role for the economy.. The whole scenarios of the economy activities and the development of a country can be ascertained by the condition of banking sector. In Nepal, the economic is directly influenced by the bank's performance, and on top of that "A" class banks are main banks category that is withstanding the its economy. There are different types of banks like central bank, commercial banks, Development banks, Investment Banks and co-operative banks. These financial institutions' main function is to play a role of financial intermediaries; providing public borrowing and lending.

Funso, Kolade and Ojo (2017) stated that the intermediation role of financial institutions can be said as catalyst of economic growth. According to Zeinab (2006) despite of some limitations such as macroeconomic instability, the fragility of stock markets, the limitation of capital markets, and the inefficiency of development banking systems in underdeveloped countries, banking system in underdeveloped countries remain integral components of the general economic systems and they can be considered as a key element in any development effort. The growth of financial sector in Nepal is much better compare to other sectors despite of timely different conflicts and political insurgency. Number of banks emerged in Nepal with the increasing demand of customers and different services with changing lifestyles of people.

Commercial banks are major financial institutions which occupy the quite an important place in the framework of every economy because they provide capital for the development of industry trade and other resource deficit sectors to the public. The function of the commercial banks has been enhanced in Nepal to sustain the increasing need of the service sector and the economy in general (Economic Survey, 2008).

Anteneh, Arega and Yonas, (2011), the pioneer researches made the evaluation of the performance of the selected commercial banks of the Ethiopia using the CAMEL framework for the period of 2000-2010 and they found that independent variables in CAMEL framework have highly explained the performance variables i.e., return on assets and return on equity. Hirtle and Lopez examine and stressed about the usefulness of the previous CAMEL rating for assessing the bank's present situation. The focused was on the confidentiality of the CAMEL rating to senior management only for protecting the business strategies and appropriate supervisory of staff. Over the period of 1989 to 1995, it indicate that the private supervisory information during the last on-site exam remains useful with the respect to the current condition of the bank up to 6 to 12 quarters.

In conclusion, it summarizes those CAMEL rating is clearly useful in supervisory monitoring of current condition. Misra and Aspal(2017) explains that the stage of development of banking industry is a good reflection of the development of the economy. The overall performance of financial institution may not reflect by financial statement, so that major question emerges whether these are adequate to reflect the overall performance of company. Hence, there is need to identify the overall conditions strengths, weakness, opportunity and threats of banks. For these purpose, several financial and statistical tools and techniques were developed by different experts and financial institutions all over the world, one of them is CAMEL. This study aims to assets the financial conditions and overall performance of sampled commercial bank in the framework of CAMEL.

### **1.1.1 Commercial Banks In Nepal**

Financial development in many developing economies like Nepal is still faced by a number of obstacles such as macroeconomic instability, the fragility of stock markets, the limitation of capital markets, and the inefficiency of development and specialized

banks. Despite some of these limitations, banking systems in underdeveloped countries remain integral components of the general economic systems and they can be considered as a key element in any development effort (Zeinab, 2006).

The commercial banks are currently regarded as key driver of financial institutions of Nepal. Financial services sector had commenced with the establishment of Nepal Bank Limited in 1937 (Baral, 2005). After the liberalization in the mid 1980s, the government permitted the opening of commercial banks in joint venture with foreign banks. Since then, the Nepalese financial system has undergone rapid structural changes, with a large number of financial institutions expose and display of financial products and services. There are presently 263 financial institutions among them 27 are commercial banks (NRB, 2010). The market size of both the joint venture and domestic private banks has been increasing at the expense of the public sector banks, which are shrinking over time. The commercial banks are divided into three separate groups based on ownership namely, (i) public sector banks, (ii) joint venture banks, and (iii) domestic private banks.

Public sector banks have substantial shares in the total assets of the industry and have huge branch networks around the country. Rastriya Banijya Bank (RBBL), Nepal Bank Limited (NBL) and Agriculture Development Bank (ADBL) are government owned banks. These banks have significant contribution on improving banking habit among the people at large and encourage entrepreneurship in both the urban as well as rural area. The public sector banks are still the largest banks in all aspects from deposit and credit mobilization to the number of branches in operation.

The joint venture banks have very few branch network and are concentrated in urban centers. JVBs started to establish since mid-1980s (Poudel, 2005) and there are seven in Nepal (NRB, 2010) including; Nabil Bank Ltd (NABIL), Standard Chartered Bank Ltd (SCBL), Himalayan Bank Ltd (HBL), Nepal SBI Bank Ltd (NSBI), Nepal Bangladesh Bank Ltd (NBBL) and Everest Bank Ltd (EBL). They have foreign equity participation (along with domestic) and management with good name with international reputation, conducting banking business professionally. They are well mechanized and supervised by their respective home country supervisory authorities. The share of total assets of the joint venture banks has been increased to about 50% of total commercial bank assets. The introduction of joint venture banks infused modern banking and financial

technology and new financial instrument in the financial system. However, the spillover effect of their efficient management and modern banking skills was less in the domestic banks, as per expectation.

Domestic private banks came in operation by late 1990s and early 2000s. There are seventeen domestic private banks including; Nepal Investment Bank Ltd (NIBL), Bank of Kathmandu Ltd (BOK), Nepal Credit and Commerce Bank Ltd (NCCBL), Lumbini Bank Ltd (LBL), Nepal Industrial and Commercial Bank Ltd (NIC), Machhapuchhre Bank Ltd (MPBL), Kumari Bank Ltd (KBL), Laxmi Bank Ltd (LXBL) and Siddhartha Bank Ltd (SBL). They are managed and owned by private sector without foreign equity participation. Since they are relatively new banks, they have the opportunity to start as 'fresh banks' without bad loans in their portfolios and with the possibility of adopting recent banking technologies during their inception. Most of them are relatively small in asset size as well as their networks.

## **1.2 Statement of the Problem**

The academic studies have been done regarding the performance evaluation whether extent private supervisory information is useful in the supervisory monitoring of banks or not. Barker and Holdsworth (1993) found the evidence that CAMELS ratings are useful with regard to estimating bank failure, even after controlling for a wide range of publicly available information about the condition and performance of banks. According to some studies, viability of information of CAMELS ratings is short lived.

Cole and Gunther (1996) analyzed a similar question and found that even if CAMELS ratings contain useful information, they depreciate quickly. Moreover CAMELS can be used for past ratings. Hirtle and Lopez (1999) examined the utility of past CAMELS ratings for evaluating banks' current conditions. Decamps et al. (2004) have supervisors choosing intervention thresholds to maintain adequate incentives for bank risk taking and study the effects of ex-post liquidity assistance and forbearance. Dahiyat (2012) examined each parameter of CAMELS system (Capital adequacy, asset quality, management quality, earning, liquidity and sensitivity to market risks) by conducting literatures and empirical studies, and relying on interviews with responsible persons in Jordan securities commission and brokerage firms. Barr et al. (2018) described the CAMELS rating system used by bank examiners and regulators; and finds that banks



with high efficiency scores also have strong CAMELS ratings. Berger and Davies evaluated the impact of CAMEL rating changes on the parent holding company's stock price. They separated stock price changes into two components: a 'private information' effect (which identified the public's awareness of new information discovered by examiners), and a 'regulatory discipline' effect which valued a regulators' presumed ability to force a bank to change its behavior). Berger and Davies' empirical results provided only weak evidence of a regulatory discipline effect, but they found a strong private information effect. However, the information effect applied only to CAMEL downgrades, which tend to precede stock price declines. Berger and Davies found no movement in the stock price following a CAMEL upgrade.

Kattel (2018) conducted research on evaluating the Financial Solvency of Selected Commercial banks of Nepal to evaluate the financial soundness of joint venture banks and private sector banks in Nepal by using bank meter model. The bankometer model was used developed according to International Monetary Fund guidelines. The study found that all the private and joint venture banks are in sound financial position. The finding of the study reveals that private sector banks are financially sounder in comparison to joint venture banks. The study concludes that bankometer model will help the bank's internal management to mitigate the insolvency risk within proper control and supervision at the operational level. Moreover, this model helps to manage internal control system.

Dhungana argues CAMEL rating system plays key role for bank supervision. According to him, The NRB as a central bank has the important task of regulating & supervising the banking system of Nepal. NRB assess the overall strength of the banking system as well as the safety and soundness of each individual bank and financial institution, In order to discharge this role. To help in this endeavor, a uniform rating system for all banks and financial institution has been used. Under this modality, supervisors assign individual numerical rating to the key areas of Capital, Assets, Management, Earnings, liquidity and sensitivity to the market risk (CAMELS) as well as assigning an overall composite rating to each banking institution. In this way, the NRB has been able to categorized banks and financial institutions into group based on their overall strength, quality and operating soundness. The rating system known as CAMEL has served as a supervisory tool to help identify those banks that are having problems and require increased supervision. To date,

early warning signals are drawn are drawn & monitored from the CAMEL rating through on-site inspection and CAMEL rating through offsite supervision.

The study explores the following research questions.

- i) What is the performance of sample commercial banks as per the CAMEL Parameters?
- ii) What is the relationship between CAMEL parameters and ROA?
- iii) What is the relationship between CAMEL parameters and ROE?

### **1.3 Significance of the Study**

Dahiyat (2018) examined each parameter of CAMELS system (Capital adequacy, asset quality, management quality, earning, liquidity and sensitivity to market risks) by conducting literatures and empirical studies, and relying on interviews with responsible persons in Jordan securities commission and brokerage firms. Barr et al. (2002) described the CAMELS rating system used by bank examiners and regulators; and finds that banks with high efficiency scores also have strong CAMEL ratings.

This study assist bank management give due emphasis on the management of identified variables and work thoroughly to enhance their respective bank's profitability and competence It assist investors in understanding the current situation (strength & weaknesses) of Private commercial banks in Nepal which in turn will help investors to make knowledge and information based decisions. It pin points the knowledge gap about CAMEL model rating observed in bank staffs and advises bank staffs in general and bank management in particular to acquire comprehensive knowledge about CAMEL rating.

### **1.4 Research Objectives**

The general objective of this study is to examine the financial performance of the selected commercial banks through CAMEL framework and compare with each other. To accomplish the main objective, specific objective of this study are;

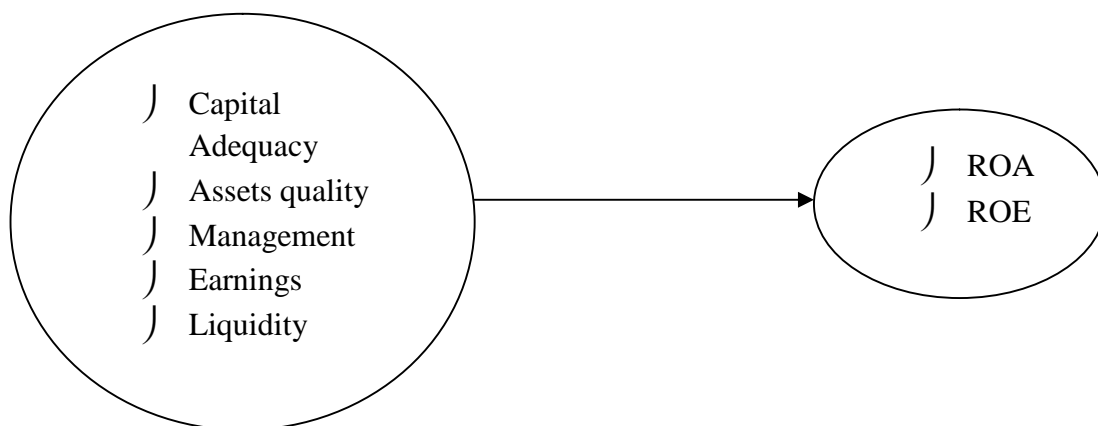
- i) To analyze the capital adequacy, assets quality, management quality, earning capability, liquidity positionof commercial banks.

- ii) To examine the relationship between indicators of CAMEL and bank's financial performance.

### 1.5 Conceptual Framework and Statement of Hypothesis

Rai, P., Ojha, P. et al (2018), in their article, - "Determinants of financial performance in Nepalese financial institutions" measured the impact of bank capital adequacy, assets quality, liquidity management, gross domestic product and inflation on return on assets, return on equity and net interest margin to make a comparative performance analysis of banks. The study concludes that capital adequacy ratio, assets quality and management efficiency are among the most dominant variables that affect the return on assets, return on equity and net interest margin as the determinants of financial performance in the context of Nepalese financial institutions

#### Indicators of CAMEL Financial performance



**Figure 1.1:** *Conceptual Framework*

#### Hypothesis

H<sub>1</sub>: There is Positive relationship between CAMEL indicators and ROA

H<sub>2</sub>: There is Positive relationship between CAMEL indicators and ROE

### 1.6 Limitation of the Study

This thesis is based on secondary data (published annual reports of commercial banks), journals, newspapers, magazines etc and unpublished thesis.. Further, the study has

been initiated by the student rather than by some economic or financial analyst so the study has some of its own limitations as stated below:

- i) The study covers only 5 years data, beginning from 2014/15 to 2018/19.
- ii) To some extent, the data published on the websites may vary sometimes, with that of the annual reports of commercial banks. So, the data from the websites are considered as authentic one.
- iii) The Sample size is very small and hence the results may not truly represent the characteristics of entire population.
- iv) Only ROA and ROE were taken as the variables to measure financial performance.

## **1.7 Organization of the Study**

### **Chapter I: Introduction**

The first chapter contains the introduction part of the study. It gives some earlier history of concern title and some related term as will. It present systematically of objective of the research, problem of the study, significant of the study and limitation of the study.

### **Chapter II: Review of Literature**

The second chapter is review of literature which presents some principles, theoretical aspects, some pilot studies had been made under some report, journals and some relevant studies on the topics of this thesis.

### **Chapter III: Research Methodology**

The third chapter explains the research methodology including research design, nature and resource of data, sample size, data collection procedure, tabulation, analysis and interpretation of data, period covered of research and review of literature.

### **Chapter IV: Results**

The fourth chapter presents analysis and interpretation data. It particularly concentrated to trace out the fact by the given data.

### **Chapter V: Summary, Conclusion and Recommendations**

This chapter summarizes the overall picture of the study, draws conclusions, offer suggestions and recommendations for improvement in the future.

## **CHAPTER II**

### **LITERATURE REVIEW**

This chapter is basically concerned with review of literature relevant to the financial performance analysis of commercial banks. Conceptual review and research review is most important part of this chapter. Conceptual review deals with various component of financial performance of commercial bank. Research review presents the dissertation, articles and other related published and unpublished materials.

#### **2.1 Conceptual Review**

##### **2.1.1 Concept of Commercial Bank**

The concept of commercial bank evolved from the concept of commerce. The name commercial implies that banks devote most of their resources to meeting the financial needs of business firms. The commercial sectors development of a country is largely development upon services of commercial banks. The commercial bank is that financial institution which deals in accepting deposits of persons and institution, and giving loans against securities. These bank are also provides technical and administrative assistance to industries, trades and business as well as a growing list of newer and more innovative services, such as investment advice security underwriting and financial planning. The commercial banks accept the deposit from unproductive sectors and channelize them in the productive sectors. They provide the working capital required by trade and industry in their day to day transactions. Apart from financing they also render services like collection of bills and cheque, safe keeping of valuables, finance advising etc. to their customers. In recent years, however, commercial banks have significantly expanded their offerings of financial services to consumers and units of government. Commercial banks “borrow money” with one hand at a low rate of interest and lend it with the other at a higher rate of interest. The difference between the borrowings and lending rate is the margin of profit of the bank. Although these banks are truly inspired with the objective of gaining profit, these commercial banks are established to accelerate common people’s economic welfare and facility to provide the banking services to the public and the state. The success of such a bank depends of the confidence that it creates in the minds of the public.

In this context, commercial bank is established with a view to provide short-term debt necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surplus in the forms of deposit lending debts by discounting valuable goods in security acting an agent of the client etc. In the same way, principally commercial banks deposits and provide loans primarily to business firm. According to the Bank and Financial Institutional Act 2063, under section 47 relating to section 31, Bank and financial institutions is classified under four categories according to paid up capital. The “A” classes financial institutions are called bank which should have to hundred cores paid up capital for national level and other “B”, “C” and “D” classes of financial institutions are called non-bank financial institutions such as development banks respectively. They also should maintain the paid up capital by doubling for existing capital provision.

### **2.1.2 Historical Development of Banking Industry in Nepal**

The growth of banking in Nepal is not so long. In comparison with other developing or developed country, the institutional development in banking system of Nepal is far behind. Nepal had to wait far a long time to come to this present banking position. Now, the banking system is still in the evolutionary phase. Even though, the specific date of the beginning of money and banking deal in Nepal is not obvious, it is speculated that during the reign of different king, the evidence of minted gold and silver coins. Landlord, merchants and other individual moneylender have acted as lender in the un-organized money market.

At the beginning of 8<sup>th</sup> century Gunakamadev had borrowed money to rebuild the kathmandu valley and at the end of the same century, a merchant named, Shankhaghar, has started the “New year” Nepal Sambat after freeing all the people of kathmandu from the debt. This record proves the existence of money lender function at that time. In 11<sup>th</sup> century, during Mallaregine, there were an evidence of professional money lenders and bankers. In 12<sup>th</sup> century, SadashivaDev introduced silver coins. However, due to the absences of regulatory bodies, the moneylender to change high rate of interest and other extra dues on loans extended.

During the course of development of borrowing , we further come across the term “Tanka Dhari “at the ends of the 14<sup>th</sup> century, meaning moneylenders, which is one of

the sixty four castes classified in the basis of occupation. In 1877 A.D. “TejarathAdda” was established by then government. The main purpose of this institution was to provide credit facilities to the general public at minimum interest rate of five percent. The establishment of this institution marked the beginning of organized financial institution in Nepal.

After establishment of NRB, a number of financial institutions were established. In 1957 A.D, Industrial Development Bank was establish to promote the industrialization in Nepal, which was latter converted into Nepal Industrial Development Corporation (NIDC) in 1959 A.D. Rastriya Banijya Bank was established in 1966 A. D. as ‘the second commercial bank of Nepal’ which fully owned by government. As the agriculture is the basic occupation of major Nepalese, the development of this sector plays the prime role in the economy. So, separate Agriculture Development Bank was established in 1968 A.D. This is the first institution in agriculture as financing; it was established with the objectives of providing facilities and financial support to the public by bringing about dynamism in agricultural development of the nation and to provide the capital and loan to the agricultural field. It also gives the technological advice to the formers.

The process of the development of banking system in Nepal was not satisfactory up to 1980s. The country cannot change its status by using only its own capital in the country without importing the new technology from foreign country. So, in mid 1980s, the financial liberalization policy introduce by the government. After declaring free economy and privatization policy, HMG encouraged the establishment of private banks including the foreign joint ventures. From this the real form to the development of the banking system started in Nepal. The banks began to offer their valuable services to the people through new technologies. This was the great significant event. Thus, Nepal Arab Bank Limited (NABIL) established in 1984 A.D. This is the first modern bank with latest banking technology, and then one after another several joint venture banks were established in the country. Nepal Indoswez Bank Limited (Later has been called Nepal Investment Bank Ltd.), Nepal Grindlays Bank Limited (now became Nepal Standard Chartered Bank Limited) were established under joint venture in 1985, 1986 AD respectively. NRB adopted a more liberal economy policy in establishing the commercial banks, as a result number of commercial banks come into existence like as

Himalayan Bank Limited, Nepal SBI Bank Limited, Nepal Bangladesh Bank Limited, Everest Bank Limited, Bank of Kathmandu, and Nepal Bank of Ceylon. Thereafter, local national and regional level banks also came into the country. As a result, twenty six commercial banks are in operation (including the commercial banking wing of the Agriculture Development Bank) out of twenty six commercial banks. Nine banks were established in joint venture, however, at present there are six joint venture banks after with drawls of foreign investment in three banks. Nepal Investment bank, Bank of Kathmandu, and bank of Ceylon (Later has been called Nepal Credit and Commerce Bank Ltd) have not foreign investment now. It has fully ownership of Nepalese shareholders.

### **2.1.3 Functions of Commercial Banks**

Commercial banks are directly related with the people and institutions. Its functions are very attractive for people. In the past, banks used to collect deposit from savers and provide loans to the businessmen and others. Now the services provided by bank have been expanded to money areas as human wants and the development of technology. In Nepal, the commercial banks perform the following functions;

**Accept Deposits:** The primary function of bank is to accept the deposits from savers. Banks accept deposits from those who can save money but cannot utilize them in profitable sectors. The bank allows for opening the three types of accounts to accept deposit for their customers. The first is the “current deposits” on which the bank does not pay interest. Especially, businessmen open the current account whose have to make a number of payment everyday. Money from these accounts can be withdrawn as many times as desired by the depositors. There is no limit on the amounts of cheque. This account is a save custody of deposit and unlimited drawing facility to the account holders. Banks have provided saving account facility especially for general public who have some saving out of their income and expenditure. The main objective of this account is to encourage and mobilize small savings of the public. Rate of interest paid on this account is low as compared to that on fixed account. Similarly, with drawl facility is also restricted in some limit as compared to that of current account. When account holders want to deposit their fund for certain time period, they have to open fixed account in banks. The fund deposit in Nepal is three months, six months one year and two years above. The money deposited into fixed account cannot be drawn before



the expiring of that period. So the rate of interest on this account is higher than other types of accounts.

**Advancing of Loans:** Commercial bank is a profit oriented business organization. So banks have to advance loans to public and generate interest from them as profit. After keeping certain cash reserves, banks provide short medium and long term loans to needy borrowers. For security, banks generally provide loan on mortgage. Now-a-days, banking business is also facing sharp competitions. So, bankers, sometimes, provide loans without mortgage, too. Such loans are advanced on the basis of goodwill and relationship with the party. The loan proposal is very good. The probability of success of proposed business is very high. Then bank may sometimes advance loans for such business without any security, According to the needs of the borrowers, banks provide different types of loan for different time periods as given below:

**Cash Credit:** Banks advance loan as cash credit to businessman against certain specified securities. The amount of the loan is credited to the current account of the borrower in case of a new customer a loan account for the sum is opened. The borrowers can withdraw money through cheques according to his requirement. Interest is charged only on the amount actually withdrawn from the account.

**Overdraft:** Generally, business and organizations open current account in bank. They deposit all receipts in the account and pay all dues through cheque. Bank provides overdraft facilities to such account holders; overdraft facility allows the customer to withdraw more than their deposit. The account holders have to go in a special contract with bank to get such facility.

**Money at Call:** It is a very short term loan provided by bank at a very short notice. Generally, loan under money at call has time duration of only one day to fourteen days. After that period, the money should be refunded. Such loan is useful especially for other financial institutions and traders.

**Discounting Bills of Exchange:** If a creditor holding a bill of exchange wants money immediately the bank provides him money by discounting bills of exchange. It deposits the amount of the bill in the current account of the bill holder after deducting its rate of interest for the periods of loan. The length is generally 90 days. When the bills of

exchange mature the bank gets its payment from the banker of the debtor who accepted the bill.

**Credit Creation:** Credit creation is one of the most important functions of the commercial banks. By the credit creation commercial banks become able to grant more loan than it has own capacity. Banks accept deposit in the different forms and advance loans on credit to customers. When a bank advances loan, it does not pay the amount in cash. However, it opens a current account in his name and allows him to withdraw by cheques. Thus the granted loan again deposited in the bank. For another customer also it is repeated the similar process in which advance loan on credit to customers however open current account I their name maintaining small cash in reserve and allows him to withdraw the required sum by cheques. This process is continued to other customer also because there are numerous transitions from taken place. Bank is also create credits or deposits by keeping small cash in reserve and lending the remaining amount of deposits. Therefore, the loans make of increase in the total amount of deposits.

**Financing Foreign Trade:** Commercial bank is finances foreign trade of its customer by accepting foreign bills of exchange and collecting them from foreign banks. It also transacts other foreign exchange business buying and selling of foreign currency.

**Agency Services:** Bank is an agent of its customers while collecting and paying cheque, bills of exchange, drafts dividends etc, it also buys and sells shares, securities debentures etc. for its customers. Further, it pays subscription, insurance premium customer bills and other similar charges on behalf of its clients. It also acts as a trustee and executer of the property and will of its customers. More ever, the bank acts all consultants to its clients. For these services, the bank charges a normal fee while its renders others free of charges.

**Miscellaneous Services:** Besides the above noted services, the commercial bank performs a number of other services. It acts as the custodian of the valuables of its customers by providing these lockers where they can keep their jewelry and valuable documents. It issues various forms of credit instruments such as cheque, drafts and travelers cheque etc which facilitate their transactions. It renders underwriting services to companies and helps in the collection of funds from the public.

#### **2.1.4 Financial Performance Analysis Framework**

Financial performance as part of the financial management is the main indicator of the success or failure of the company. Various groups of individuals are particularly interested in evaluation bank performance. Such as managers, stockholders, depositors, regulators and other partners etc use different performance evaluation method to evaluate bank.

Banking business is competitive due to banks and FI's are grown dramatically. Now sharp competition in banking sector has forced them to turn to the money and capital markets to raise funds by selling stock, bonds etc. At the same time competition for banks traditional loan and deposit customers has increased dramatically credit union, money market, mutual funds, insurance companies, brokerage firms are even chain stores are fighting for a slice of nearly every credit and deposit market traditionally served by banks. In this way banks financial statements are increasingly being examined by investors and by the public. All the trends have placed management under great pressure to set and meet bank performance.

Financial analysis is the process of identifying the financial strength and weakness of the firm. Banking institution to evaluate carefully the risks and returns involved in serving the needs of the public. Banks performance must be directed toward specific objectives. A fair evaluation of any bank's performance should start by evaluating whether it has been able to achieve the objectives its management and stockholders have chosen.

There are different methods to assess the bank performance financial .The most popular methods are Risk-Adjustment Return on Capital (RAROC), Economic Value Added (EVA), Return on Assets (ROE), CAMELS (Capital Adequacy, Assets Quality, Management Quality, Earning, Liquidity, and Sensitivity to market risk) methods and CAMEL plus Corporate Governance can be also evaluation of banks performance.

##### **2.1.4.1 Financial Performance Analysis in the Framework of ROE**

Bank's performance can be also evaluated using return on equity (ROE). It measures how much earning a company can generate from on their equity investment. ROE offers

a useful signal of financial success since it might indicate whether the company is growing profits without pouring new equity capital into the business. Equity capital as the sum of common and preferred stock paid in surplus, retained earnings, and reserve for future contingencies.

This framework reveals how much profit a company generates with the money shareholders have invested in the company to other firms in the same industry. ROE helps investors determine if a company is profitability or inefficiency. It is useful for comparing the profitability of a company to other firms in same industry. The relationship between the company's profit and investors return makes ROE a particularly valuable metric to examine. In 1972, David Cole introduces a procedure for evaluation bank performance through ratio analysis. Aggregate bank profitability is measured and compared in terms of return on equity. The company's ROE ratio is calculated by dividing the company's net income by its shareholders equity or book value. The profitability of two banks was analyzed using a return on equity framework. If the ROE is relatively low compared with other banks it will tend to decrease the bank's access to new capital that may be necessary to expand and maintained a competitive position in the market ROE, might not necessary tell the whole story about a company and therefore, must be used carefully, it is a negative part of ROE.

#### **2.1.4.2 Financial Performance Analysis in the Framework of CAMELS**

The CAMEL rating system is an internal supervisory tool for evaluating the safety and soundness of financial institutions using by capital adequacy, assets quality, management quality earnings and liquidity. Infect the rating system initially emerges as CAMEL covering the first five parameters only. The six component sensitivity to market risk(s) has only been used since January 1, 1997. The most notable change to the system is the proposed addition on an "S" to make "CAMELS".

Federal and state regulations regularly assess the financial condition of each bank and specific risks faced on site examination and periodic report. Based on these methodologies the bank's operations are assessed in respect of the components of CAMELS and the individual ratings of the component and a consolidated. The Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial

Institutions Examination Council (FFIEC) on November 13, 1979. UFIRS is revised in 1997. This rating is the UFIRS designed to evaluate banks condition on a uniform basis.

CAMELS rating system is used three federal banking supervisors (Federal Reserve, the FDIC, the office of the comptroller of the currency) and other financial supervisory agencies to supervision and examination time to time of bank. The CAMELS rating range from 1 to 5 CAMELS framework is common method for analyzing the health of financial institutions. All exam materials are highly confidential including the CAMELS. These ratings are not release to the public but only to the top management and the appropriate supervisory staff.

This rating system is common method for analyzing the health of financial institution. This system was originally developed by the FDIC. CAMELS are an ideal rating system practiced worldwide by central banks and rating agencies to evaluate and analysis safety and soundness of a bank. Reserve Bank of India has been used CAMELS ratings in its supervisory regulations of the banking system. In Nepal CAMELS rating system is still in its initial phase NRB has introduced the system for rating all the banks every year.

### **Composite Ratings**

An international bank rating system with which bank supervisory authorities rate institutions according to six factors. The six factors are represented by the acronym 'CAMELS'. The six key components used to assess an institution's financial condition and operations are: capital adequacy, asset quality, management capability earnings liquidity and sensitivity to market risk. This rating is based on financial statements of the bank and on-site examination by three federal banking supervisors (the Federal Reserve, the FDIC, and the OCC) and other financial supervisory agencies to provide a convenient summary of bank conditions at the times of exam. The banks for this rating is the uniform financial institutions rating system (UFIRS) designed to evaluated banks condition on a uniform basis and to identify banks requiring special attention or concern. Bank supervisory authorities assign each bank a score on a scale from one to five with 1 being strongest and 5 being weakest. If a bank have an average score less than two it is considered to be a high quality institutions while banks with scores greater than 3 are considered to be less than satisfactory establishments. The system helps the

supervisory authority identify banks that are in need of attention. Bank with ratings of 1 or 2 are considered to present few if any supervisory concerns while banks with rating of 3,4,5 present moderate to extreme degrees of supervisory concern.

The composite ratings from 1 to 5 are as follows.

**Composite 1:** The composite rating one is thought to indicate strong FIs that could weather adverse economic condition. These FIs are highest rating performance and risk management practices and the least degree of supervisory concern. These FIs are in substantial compliance with laws and regulations.

**Composite 2:** The composite rating of two means that the FIs could be severely weakened by adverse economic conditions. FIs in the group are fundamentally sound but many reflect modest weakness correctable in the normal courses of business. Over all risk management practices are satisfactory relative to the institutions size, complexity, and risk profit.

**Composite 3:** The three rated FIs are through to be at risk in unfavorable economic environment. There FIs in this category exhibit financial operational or compliance weaknesses rating from moderately severe to unsatisfactory.

**Composite 4:** Four rated FIs are considered to be banks that are danger of failing unless corrective actions are taken. These FIs generally exhibit unsafe and unsound practices or condition. These are serious financial or managerial deficiencies that result in unsatisfactory performance. There may be significant non compliances with laws and regulations.

**Composite 5:** FIs in this category indicates that the bank is likely to fail in the near future. These FIs are lowest rating performance, inadequate risk management precipices and therefore the highest degree of supervisory concern.

#### **2.1.4.2.1 Capital Adequacy (C)**

The first component of the CAMELS rating is capital adequacy. A key principle in bank supervision which is regards capital as the cornerstone of a banks' strength. Bank capital is a source of financial support to protect an institution losses arising out of the unexpected risks. Strong capital base is the prerequisite for the safety and soundness of any bank. Commercial bank should have adequate capital to support the stability and

sustainability of its operation. A financial institution, which has adequate capital can flow more loan and has the capital to bear the possible risk in future. Adequate capital helps to gain faith of the depositors, investors and the loan donors to increase the loan investment capacity to make defective property bearable and to make defective property bearable and to raise the credit of the bank. Bank capital serves three basic roles. The first, and most obvious, is that it is a source of funds. A new bank requires funds to internal investment. Established banks require capital to finance their growth, as well as to maintain and modernize operations. The second function of capital is to serve as a cushion to absorb unexpected operating losses. The third function of bank capital bears on the question of adequate capital bank regulators establishes minimum requirements to promote safety and soundness in banking system. The capital component is based on evaluation of and provide for future growth. An evaluation of capital relies on many factors such as regulatory capital requirements trends portfolio and institutional risk growth, adequacy of risk funds, management capability and other factors as appropriate.

Nepal Rastra Bank has ultimate power of right to decided how much capital is needed for a bank or non bank financed institutions. Adequacy and inadequacy of bank capital directly affects the banking transactions. 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. The bank should remove the inadequacy of bank capital through the medium of collecting of ownership and borrowed capital. If the bank cannot maintain the adequate capital, it may give many defects. The defects caused by the bank capital do not lead the bank forwards. So, special attention should be given to capital adequacy system of the bank capital. The adequacy of the bank capital is necessary for the following functions:

**For the Payments of all Types of Deposits:** Adequacy of bank capital is necessary for a bank, to give the payment of the amount of all types of deposits to its customers. Hence, the adequacy of bank capital is needed to gain trust from its customers.

**To Meet the Demand of All Types of Cash Reserve Funds:** A bank should deposit the amount in different types of funds, in the Nepal Rastra Bank and in its own bank. The commercial bank should deposit cash in such funds. This is a legal obligation, which is created in two ways. One obligation occurs by the provision of law and another obligation takes place due to circulars, policy and directives issued by the Nepal

Rastra Bank. A bank cannot reject both of these obligations. Therefore, there is a need of an adequate bank capital for the deposit of cash in all funds created.

**Investment for Banking Transaction and Business:** With the lack of an adequate bank capital, the bank can not meet daily administrative expenditure and the investment in different sectors to earn profit. So, to perform the above given functions the bank needs an adequate bank capital. Directly, the above mentioned functions affect to be adequacy of bank capital.

### **Directing Relating to Capital Adequacy Norms by NRB**

A bank capital is divided into Tier I and Tier II for the purpose of capital adequacy measurement. Tier I capital is primary or core capital and Tier II capital is supplementary capital. The total capital that the bank holds is defined as the sum of Tier I and Tier II capital. In Nepalese context, Tier I capital includes paid up capital, share premium, non-redeemable performance share, general reserve, capital adjustment fund, and other free reserve. Tier II capital includes general loan loss provision, exchange fluctuation reserve, assets revaluation reserve, hybrid capital instruments, unsecured subordinated term debt exchange equalization reserve, excess loan loss provision, and investment adjusted reserve. On the basis of risk-weighted assets the banks should maintain the prescribed proportion of minimum capital funds.

### **Capital Adequacy and Minimum Paid-Up Capital requirements for BFIs**

Licensed Institutions	Core Capital (%)	Total Capital Fund (%)	Minimum Paid Up Capital (Rs.)
Class 'A'	6	11	8 billion
Class 'B'	6	10	2.5 billion
Class 'C'	6	10	1.2 billion
Class 'D'	4	8	0.8 billion

In order to ensure smooth migration to Basel III without aggravating any near term stress, appropriate transitional arrangements have been made. The transitional arrangements for capital ratios will begin from Mid July, 2016 (Shrawan 2073). Capital ratios and deductions from Common Equity will be fully phased-in and implemented as



on Mid July, 2019. The phase-in arrangements for banks are indicated in the following Table:

### **BASEL III in Nepal**

#### **Transition Period**

#### **( Mid July)**

	2015	2016	2017	2018	2019
Minimum Common Equity Capital Ratio	4.00%	4.50%	4.50%	4.50%	4.50%
Capital Conservation Buffer	1.00%	1.25%	1.50%	2.00%	2.50%
Minimum common equity plus capital conservation buffer	5.00%	5.75%	6.00%	6.50%	7.00%
Minimum Tier 1 Capital (Excluding conservation buffer)	6.00%	6.00%	6.00%	6.00%	6.00%
Minimum Total Capital Excluding conservation buffer)	10.00%	9.75%	9.50%	9.00%	8.50%
Minimum Total Capital (including conservation buffer )	11.00%	11.00%	11.00%	11.00%	11.00%
Counter Cyclical Buffers	Introduce minimum standard	0-2.5%	0-2.5%	0-2.5%	0-2.5%

#### **2.1.4.2.2 Assets Quality (A)**

This is one of the most critical factors in determining overall condition of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. The assets quality means the capacity of assets to generate income as well as the recover ability of the principal amount.

This component is based on an assessment of both the quality of the current portfolio and the quality of the associated management process that substantially impact the quality of assets. An assessment of assets relies on many factors such as loan portfolio management, investment portfolio trends, risk identification process, and other factors that affect the quality performance, income producing capacity and stability of assets. Examiner judgment is to the quality of each borrowers and his ability to repay the loan. It is necessary to study the quality of assets to maintain the sound economic

condition of the financial institutions. For this purpose, it should be checked up whatever the risk found, which is fixed by the NRB is maintained or not by the commercial banks and FIs. For this provision it helps the FIs to save for losing the various types of financial risk with the provision of keeping the risk fund according to the quality of the assets as per the rules regulation and policy of the central bank. Loans are usually the largest of the assets items and can also carry the greatest amount of potential risk to the bank's capital account.

### **Non-Performing Assets / Loan (NPA)**

Non-performing loan means an outstanding loan not repaid, i.e. neither payment on interest or principle are made. In case of the banks the loans and advances are the assets as the banks flow loans for the funds generated through shareholders equity ,money deposited by the people and fund having through the borrows . Hence the term NPA means the loans and advances that are not performing well. Thus all the irregular loans can be terms as NPA. Generally, non-performing loans/assets include all loans in the portfolio more than 90 days overdue on interest or principle payments. The definition of NPA differs with countries of the Asia pacific economic cooperation (APEC) forum: loan is classified as non-performing only after it has been in arrear for at least six months. In India, after three months from the date of deemed commercial production to release interest income, any default or reschedule was considered as an NPA on the book of accounts.

### **Directives Relating to Assets Quality by NRB**

<b>classification of loan</b>	<b>fiscal year 2074/075</b>	<b>loan loss provisions</b>
pass	Loans and advances whose principal amounts are not past due or past due for maximum 3 months only.	1%
sub standard	Loans and advances that are past due for a period of months to 6 months.	25%
doubtful	Loans and advances which are past due for a period of 6 months to 1 year.	50%
loss	All loan and advances which are past due more than 1 year.	100%

Loans are classified as performing and non performing loans. According to NRB directives, performing loan means pass loan, remaining sub standard, doubtful and loss loan is non performing loan. The provision of allowance issued by NRB is 1%, 25%, 50% and 100% for pass sub-standard, doubtful and loss respectively.

#### **2.1.4.2.3 Management Quality (M)**

The quality of management is probably the single most important element in the successful operation of a bank. For purpose of this section, management includes both the board of directors and executive officers. Board of director is elected by the shareholders and executive officers who are appointed to their position by the board. It is evaluated by checking the effectiveness of the board of directors, the quality of the qualification, the manpower and official management operating expenditure customer relationship between the official and institution, management information system, organization and working method, control system, power decision process, policy, rules etc. Sound management is the key to bank performance but is difficult to measure. It is primarily a qualitative factor applicable to individual institutions. As management quality is subjective measure, it is very difficult to prescribe any specific ratings method for this parameter, leaving this parameter open to subjective judgments. The management rating is based on the examiner's perception of the quality of the bank's officers and the efficiency of the management structure. Management is responsible to mobilize the securities of the bank and to create a sound control environment of and risk management practice. Thus this review is focused on appraising the competence. Involvement and integrating of the management in day to day administration of the bank's involvement in formulating, implementation control policies, and insuring the banks compliance with applicable laws and regulations.

#### **2.1.4.2.4 Earnings Quality (E)**

This parameter lays importance on how a bank earns its profit. This also explains the sustainability and growth in earnings in the future. Earnings are rated on both recent performance and the historical stability of the earnings stream. The earnings of the banks should able to absent normal and expected losses in given period. It also provides a source of financial support by contributing to the intuition's internal generation of capital.

Earning quality is the ability of a bank to continue to realize strong earnings performance. It is based on an evaluation of the quantity, quality and sustainability of the banks earning performance. An evaluation of earning considers factors, composition and quality of net income, stability of earnings performance, relationship to portfolio risk and quality of earning management etc.

Earning quality is quite possible for a bank to register impressive profitability ratio and assuming unacceptable degree of risk. Return on assets return on equity, interest spread ratio, gross margin operating profit margin and net profit margin are commonly used profitability indicators.

#### **2.1.4.2.5 Liquidity (L)**

Liquidity management is a critical factor influencing the financial health of the banks. It is the extent to which the bank has funds available to meet cash demands for loans and deposit withdraws. This is an important area of risk facing banks because a liquidity crisis many result in the failure of a solvent bank. Examiners look at the banks funding sources as well as the liquidity of assets in determining the rating.

Banks must be able to manage demand and supply of funds. Cash balance bank, bank balance and investment in government bonds are the most liquid form assets. Optimum liquidity is achieved by balancing risks and returns. In banks liquidity needs to be high enough to meet even unexpected changes in liquidity needs and sources. On other hands, liquidity should not be too high because there is on opportunity cost in the sense of excessive near cash assets that could be earning higher rates of return if funds were invested in other assets. Thus, the bank must trade off the cost of maintaining excessive liquidity and the cost of insufficient liquidity

Banks are also concerned about the danger of not having sufficient cash and borrowing capacity to meet deposit withdraws loan demand and other cash need. Liquidity risk is danger of having insufficient cash to meet a bank's obligation when due. It affect the health of commercial bank adversely affects the profitability of financial institutions. NRB directive (2062B.S) number E.Pra.Ni. 05/061/062 requires the banks to classify the assets and liquidity on the basis of maturity period classification different time interval for liquidity risk minimize.

### **NRB Directives Related to Liquidity**

According to NRB, every commercial bank has maintained minimum balance of cash reserve ratio 5% of their total deposit liabilities compulsory. Under sub-section (1) they should be bears the following penalty for not sufficient of minimum requirement balance.

- a. First time insufficient balance is exiting interest rate
- b. For second times of under balance is double interest rate
- c. For third times of under balance is triple interest rate

#### **2.1.4.2.6 Sensitivity to Market Risk (S)**

Market risk is the current and potential risk to earnings and stockholders equity resulting form adverse movements in market rates or prices. The three areas of market risk are interest rate risk, foreign exchange risk and commodity or equity price risk. For most FIs, market risk primarily reflects exposing to changes in interest rates. The sensitivity to market risk components focuses on an institution's ability to identify, monitor, manage and control its market risk and provides FIs management with a clear and focused indication of supervisory concerns in this area.

Market risk is the current and potential risk to earnings and stockholders' equity resulting from adverse movements in market rates or price. The sensitivity to market risk is assessed to determine the bank's ability to monitor and manage its exposure to market risk; it reflects the degree to which changes in the interest rates, foreign exchange rates and equity prices can adversely affect a bank's earnings and capital. For most FIs market risk primarily reflects exposing to changes in interest rates. The sensitivity to market risk components focuses on an institution's ability to identify, monitor, manage and controls market risk and provides FIs management with a clear and focused indication of supervisory concern in this area.

Equity prices risk examines how changes in market prices, interest rates and foreign exchange rates affect the market values of any equities, fixed income securities, foreign exchange currency holdings, and associated derivative and other off-balance sheet contracts. Foreign exchange risk arises from changes in foreign exchange rates that

affect the values of assets liabilities and off-balance sheet activities denominated in currencies different from the banks domestic currency. Interest rate risk analysis compares the sensitivity of interest income to change in assets yields with the sensitivity of interest expense to changes in the interest lost of liabilities.

Dollar gap, duration gap and simulation are three techniques of measuring interest rate risk. The dollar gap is the oldest technique. The most commonly used measure of the interest sensitivity position of a financial institution is duration gap analysis. Duration is defined as the elasticity measure that indicates the relative price sensitivity of different securities. The duration gap is the difference between the duration of a bank's assets and liabilities. It helps to explain how changed in interest rates affect the market value of a bank assets and liabilities. Thus, the focus of gap analysis is on net interest income or net worth the number of years of the duration of assets and liabilities.

Net worth = assets-liabilities.

If duration gap is positive lie, the duration of assets exceeds the duration of liabilities then increases in interest rates will reduce the value of net worth and decrease in interest rates will increase the value of net worth. Conversely the duration gap is negative with the duration of asset less than the duration of liabilities, raising interest rate will increase the value of net worth, whereas falling interest rates will lead to a reduction in it.

An aggressive interest rate risk management strategy would alter the duration gap in anticipation of changes in interest rates. If interest rates were expected to increase management would want to shift from positive to a negative gap position. It could do this by reducing the duration of asses or increasing the duration of liabilities.

Simulation analysis determines the effect of interest rate changes on short-term net interest income net income. It also measure risk presented by non-parallel yield curve shift. Simulation models are often not “user friendly” and may require more data and expertise than other interest rate risk measurement system.

According to NRB directive every commercial bank should classified of risk and provision for minimizes the risk. There are liquidity, interest rate, foreign exchange,

loan and investment risk to monitoring on related of banking and financial institutional risk.

### **2.1.5 CAMEL plus Corporate Governance**

After following economic liberalization policy since mid 1980s, the establishment of joint stock Company in Nepal has been speed up. Competition in the banking sector is being more intense. Banks are required to compare in the domestic market as also in the international market in the context of liberalization and globalization. Adoption of corporate governance practices assumes greater importance in this context. A corporate governance system is expected to provide protection to shareholders and creditors and to assure them of getting return on their investment.

Corporate governance is defined as a set of rules and the relationships between a company's management and its board of director's shareholders and other stakeholders. These rules help setup mechanisms of attaining good governance. Globalization and liberalization policies also play a decisive role increasing the demand for good governance. Effective corporate governance may be described as reconciliation between the power and obligations of the board of directors to ensure good performance awareness of the rights and duties of stakeholders and the expectation of the society. Good corporate governance feature such as transparency, accountability, information disclosures, and stringent ethics. It helps ensure the business corporations undertake their operations to maximize shareholders value, which will eventually bring benefits to other stakeholders from a long term perspective. The poor governance practices including inadequate disclosures, lack of independent over right directors and weak minority shareholders tend to discourage investment and weaken incentives for efficient management. Good corporate governance will enhance the companies image .It helps to introduced good practice in corporate behavior with a view to rebuilding and maintaining public trust in company.

In Nepalese banking industry, lack of proper corporate governance, we had also faced lots of problem and loss of public faith on banking system in past days. But we can see a ray of hope with the stringent supervision system adoption by NRB on banking supervision with the implementation of Basel II framework recommended by Basel Committee of Banking Supervision (BCBS). Basel II framework has recommended

various suggestions policies to address corporate governance in banking institution would be the great help for the commercial banks operation in Nepal. Effective corporate governance practices are essential to achieving and maintaining public truth and confidence in the banking system. Poor corporate governance can lead market to loose confidence in the ability of a bank to properly manage its assets and liability, including deposits with could in turn liquidity crises.

To understand corporate governance and financial Performance variables in relation to commercial banks, the major corporate governance pillars i.e. financial transparency, discloser and trust are dissected. Financial performance especially relating to commercial banks is also reviewed based in the performance dimensions comprising capital adequacy, assets quality, earnings and liquidity. The significance of stakeholders in commercial banks is also highlighter.

Numerous stakeholders (internal and external) exist in any business enterprises some of these include; customers, stakeholders, government among others. Internal stakeholders such as the employees and external stakeholders like stakeholders, customers, tax authorities and bank supervisors. Transparency, disclosure and trust, which constitute the integral part of corporate governance, can provide pressure for improved financial performance. Macro economic variables through factors such as inflation and changes in interest rates may either enhance or distress commercial banks financial performance. Awareness of the importance of corporate governance is growing. The NRB has introduced higher corporate governance standards for banks and other financial companies as part of a wider program of financial sector reform. Effective control system and strong corporate governance are the basic foundation of a sound and stable bank. Realizing the importance of this facet NRB has issued a directive on corporate of director and employees.

### **Basic Principle of Corporate Governance in Banking Organization**

There are major 8 principles formulated and evolved by BCBS for enhancing corporate governance of banking institutions. These principles if practiced honestly, banking institution could be run very efficiently and effectively with controlled management resulting good financial health of the organization practicing of these principles is very



much essential for the banking industry of the developing countries like Nepal. These principles have briefly discussed below in the Nepalese perspectives.

**Principle1:** Board members should be qualified of their positions, have a clear understanding of their positions.

In most of the banking and financial institutions of Nepal it has been observed that the board of directors have been nominated according to their share investment in the banks where their qualification and understanding capabilities about the core functions of the bank have been almost neglected. The minimum qualification for being member of the board of directors has been raise as one of the important principles requirement for a bank and financial institution.

**Principle 2:** The board of directors should approve and oversee the banks strategic objectives and corporate values that are communicated throughout the banking organization.

Generally, board of directors without mark accepts the policies and strategic objectives of the bank recommended by the employees or the consultant. But formulation of the strategic objectives and the corporate values of a bank is the main task of the board of directors. Where ensuring full implementation of such formulated policies is another must important to oversee by the board of directors.

**Principle 3:** The board of directors should set and enforce clear lines of responsibility and accountability through the organization.

It is third principle the board of directors must set and enforce the lines of responsibility and accountability of the each part of the banking organization including individual element of the functioning team and departments. Performance of the task according to the set responsibility has to be measured and accountably rewarded and punished for the good and bad doings respectively. So, that a clear understanding of the responsibility and their accountability is communicated throughout the banking organization.

**Principle 4:** The board should ensure that there is appropriate oversight by senior management consistent with board police.

It is another principle of corporate governance that the board of directors must have proper and effective review process and controlling mechanism that the senior management is working according to the policy set by the board all the time.

**Principle 5:** The board and senior management should effectively utilize the work conducted by the internal audit function, external auditors and internal control functions.

The board of directors and the senior management of bank should study deeply the report submitted by the internal auditors, external auditor's regulators instructions and utilize their recommendations and should be committed to follow.

**Principle 6:** The bank should be governed in a transparent manner.

Transparency is the most important principle of the corporate governance that all the discloser of a bank is published transparently and operation of the bank is conducted in transparent manner. It is different for shareholders, other stakeholders and the market participates to effectively monitor and properly hold accountable the board of directors and the senior management when there is lack of transparency.

**Principle 7:** The board should ensure that compensation policies and practices are consistent with the bank's corporate culture, Long term objectives and strategy and control environment.

Compensation and remuneration to the board of directors and the senior management of the bank should be controlled and regulated by the appropriate policy and accordingly practiced throughout the banking organization. Executive or non executive board of directors should not take any compensation of remuneration deviating to the norms of the policy set out and they should very much conscious for such compensation to be taken by other senior managers. This commitment and compliance is must important for the enhancement of the better corporate governance of a banking organization.

**Principle 8:** The board and senior management should understand the bank's operational structure including where the bank operates in jurisdictions.

Banks may choose to operate in a particular jurisdiction or may establish complex structures often for legitimate and appropriate business purpose. However, operating in such jurisdiction may pose financial, legal and reputation risks to the banking organization. Clear understanding of such possible risk by the board of directors and the senior management is very much important for the effective corporate governance in a banking institution.

Hence, for enhancement of the corporate governance in banking organization above 8 basic principles formulated and recommended by the Basel committee for banking supervision could be a great help especially in the context of Nepalese culture of managing banking organization.

## **2.2 Review of Related Studies**

Jha&Hui (2018), conducted a study on "A Comparison of Financial performance of commercial banks: A Case study of Nepal". The objective of this study was to compare the financial performance of different ownership structured commercial banks in Nepal based on their financial characteristics and identify the determinants of performance exposed by the financial ratios, which were based on CAMEL Model. Eighteen commercial banks were financially analyzed. In addition, econometric model (multivariate regression analysis) by formulating two regression models was used to estimate the impact of capital adequacy ratio, non-performing loan ratio, interest expenses to total loan, net interest margin ratio and credit to deposit ratio on the financial profitability namely return on assets and return on equity of these banks. The results found that public sector banks are significantly less efficient than their counterpart are; however domestic private banks are equally efficient to foreign-owned (joint-venture) banks. Furthermore, the estimation results revealed that return on assets was significantly influenced by capital adequacy ratio, interest expenses to total loan and net interest margin, while capital adequacy ratio had considerable effect on return on equity.

Kavitha (2017) conducted study on "Determinants of capital structure: Empirical evidence from India". The study found that operating leverage, four-size, earning rate, tangibility and debt service capacity -are statistically significant determinants of financial leverage. Similarly, companies do not care of their liquidity and non-debt tax

shield but do care of the expansion of their business and risk. Finally, the study also suggested that policy makers should focus on these determinants when making any decisions regarding capital structure.

Rostami (2017) conducted research on determination of Camels model on bank's performance to find out the strengths and weaknesses through CAMEL model. Capital adequacy, Asset quality, Management soundness, Earnings and profitability and Liquidity are the focus points of this rating. There are significant relation between each category and Q-Tobin's ratio as bank's performance ratio. The important factor to analyze this model is to find and concentrate on effective indicators and elements in each category. The result found that it can be challengeable and interpreting since this indicators can be different in each industry. The study also suggested that banks can focus on risk and some important ratios and try to manage and control some possible crisis.

Kattel (2018) conducted research on evaluating the Financial Solvency of Selected Commercial banks of Nepal to evaluate the financial soundness of joint venture banks and private sector banks in Nepal by using bank meter model. The bankometer model was used developed according to International Monetary Fund guidelines. The study found that all the private and joint venture banks are in sound financial position. The finding of the study reveals that private sector banks are financially sounder in comparison to joint venture banks. The study concludes that bankometer model will help the bank's internal management to mitigate the insolvency risk within proper control and supervision at the operational level. Moreover, this model helps to manage internal control system.

Ahsan (2018) conducted research on Financial Performance based on CAMEL: A Study on Selected Islamic Banks in Bangladesh to analyze the financial performance of selected Islamic Banks in Bangladesh based on CAMEL Rating Analysis. This study was based on measuring performance of banks with respect to CAMEL model and shows that all selected Islamic banks (IBBL, EXIM bank, and SJIBL) financial performance under CAMEL rating was strong in every respect. The findings revealed that the performance of the bank was a continuous process, and it required the continuous innovation and improvement in order to adjust the increasing demand. Hence, the trend of the performance of Islamic banking sector in Bangladesh can be

improved more if all concerns pay due attention and work according to the requirement of time.

Rahman & Islam (2018) had conducted a research entitled "Use of CAMEL Rating Framework: Comparative Performance Evaluation of Selected Bangladeshi Private Commercial Banks" with the objective to evaluate the comparative performance of the selected private commercial banks in Bangladesh using the CAMEL Rating framework and suggest some measures on the basis of the results of this study to further improve the financial performance of the sample banks under the study. This study has been conducted to examine the performance of 17 selected private commercial banks in Bangladesh during the period (2010-16) with respect to CAMEL ratios. It is found that on an average the Capital Adequacy ratio of all banks is much higher than the benchmark of 10% as mandated by Bangladesh Bank. The average CAR of City Bank is the highest (12.90%) among all the banks. As the NPLs of City Bank (6.94%) is much higher than other banks, Bangladesh Bank should look after the bank and suggest corrective measures to overcome potential losses due to increase in NPLs. The profit per employee (PPE) of Eastern Bank is the highest and it can be inferred that the efficiency of EBL is much higher as compared to other banks. Estimating the profitability ratios it can be observed that for long-term period, One Bank's profitability is outstanding on an average as compared to other banks.

Rai, P., Ojha, P. et al (2018) studied Determinants of financial performance in Nepalese financial institutions based on descriptive and causal comparative design to examine the relation between financial performances of Nepalese financial institutions. The study has been conducted to measure the impact for sound financial efficiency at the operational level. of bank capital adequacy, assets quality, liquidity management, gross domestic product and inflation on return on assets, return on equity and net interest margin to make a comparative performance analysis of banks. The study concludes that capital adequacy ratio, assets quality and management efficiency are among the most dominant variables that affect the return on assets, return on equity and net interest margin as the determinants of financial performance in the context of Nepalese financial institutions.

Gawde, S.U., Panda, A.C., et al (2018) studied camel rating system in banking supervision – A case study of Nepal Bangladesh Bank Ltd.". Capital adequacy ratio

indicated that the financial position of the bank was strong. The assets quality of NBBL seems to be performing well. Management efficiency of Nepal Bangladesh Bank has excellent banking services and very good management as a whole. NBBL has more productive employees and customers are found to be more satisfied with the services provided by the NBBL. Return on Assets (ROA) Nepal Bangladesh Bank Ltd. was satisfactory in terms of profitability as measured by return on assets. NBBL have maintained the liquidity i.e., cash reserve ratio. NBBL has increased its investment in government securities. In short, CAMELS rules are the true measurement of financial performance of any bank. If a bank fails to obey CAMELS norms in true spirit and letter, it can be construed as a failed bank. Prior to this, several thesis works have been conducted by various researchers regarding different aspects of commercial banks like financial performance, capital structure, investment policy, interest rate structure and resources mobilization. Some of research works are relevant for these studies are reviewed over here.

Adhikari (2015) conducted a study evaluating the "Financial performance of Nepal Bank Ltd". The study has concluded that investment portfolio of the bank has not managed so efficient to maximize the return. Operational efficiency of the bank is indicated by the operational loss has been found unsatisfactory. So the bank has been suggested to manage its investment portfolio efficiently. It is recommended that the bank should try to mobilize its resources efficiently by creating new business and service ideas which will certainly help for the better utilization of ideal resources and for the economic development of the country. It has focused on utilization and mobilization of funds and resources of Nepal Bank Ltd. This study especially concentrated on the deposit collection of the bank and disbursement of fund as loan and advances. Therefore, its main study areas are uses and sources of funds and income and expenses trends of the bank.

Poudel (2017) in the thesis entitled "Financial Performance Analysis of EBL" has focused on the objectives as to examine the financial statement of the bank and analyze them to see the financial soundness of the bank to observe the return over the equity to highlight the relationship between different variables. The research provides suggestions and recommendation for the improvement of the future performance of EBL based on the findings of the analysis. The study is found that the liquidity position

of the bank to meet the daily cash requirement is sound. There is strong position regarding the mobilization of total deposit on loan and advances, normal position and decreasing trend of regarding the mobilization of total deposit as investment and bank has average position towards the utilization of working fund. Analysis of EPS reveals that the bank has very good increasing trend regarding EPS even though first two years shows the negative figure. The trend analysis of deposit, net profit, loan and advances and EPS shows the increasing trend even though the value shows in the beginning of studying period.

Luintel (2018 ) conducted a study entitled “A Study on Financial Performance of Nepal Bank Limited”, an unpublished master level thesis submitted to ShankerDev Campus, Faculty of Management, T.U. The main objectives of the study are: a) To measure the comparative financial strengths and weakness and to analyze the banks performance under priority sectors of government, (b) To evaluate whether the bank is efficient to face the challenges and assist the government in the points outlined in the statement of the problems of this study. The study pointed out the following findings in this study: The bank seemed to be unable to utilize its high cost resources in high yielding investment portfolio. Due to the bank’s failed in collecting earned interest and matured loan, it has suffered continues loss. Liquidity position of the bank is also not satisfactory during this study period. This study also found that bank has not followed any policy regarding long-term debts, total debts and total deposit ratios. This study concluded that the financial position of the NBL is worse during the study period due to its failure to utilize its inefficiency in risk management. The overall financial position of the bank is unsatisfactory during the studyperiods.

Gautam (2018) conducted thesis on entitled on "A Study on Financial Performance of Nepal Bank Limited". The objectives of this study was: a)To evaluate the bank’s efficiency to face the challenges and measure the comparative financial strengths and weakness, b) To analyze the bank’s performance under priority sectors of government, C) To analyze income and expenditure of sample bank. The studyfound that: a) The bank is seemed to be unable to utilize its high cost resources in high yielding investment portfolio b) The only positive aspect is, if risk can be managed, percentage of loans and advances on total deposits has increased, c) Long –term debts, total debts and total deposit ratios have gradually decreased. It indicates that bank has not followed any

policy regarding these items, d) the bank has experienced negative EPS and P/E ratios which have also heavily fluctuated during the study periods. Thus, it can be said that the financial position of the NBL is worse due to its failure to utilize its resources efficiently and due to its inefficiency in risk management.

Shrestha (2016) conducted study on "Financial performance analysis of Nepal SBI bank Limited in the CAMEL framework". The main objectives of this study has: a) To examine the capital adequacy of the bank, b) To assess the quality of the bank's assets, c) To analyze the efficiency of the bank's management, d) To evaluate the earning performance of the bank. The study found that: The risk based core capital ratio of NSBL is distributed from the minimum of 8.67 percent in the year 2007/08 to the maximum of 10.89 percent in the year 2009/10. The core capital adequacy ratio is above the NRB standard in the entire study period. The ratio of past due loan to total loan has decreasing trend during the study period. The total loan of the bank has gone up throughout the study period. Hence, the assets quality of the bank is strong as indicated by this ratio. It is found that the percentage of substandard loan to total loan is below 5 percent throughout the study period which indicates the quality of loan is strong from the perspectives of total substandard loan to total loan ratio. Bank's inefficiency to recover its NPAs. Thus, the quality of assets is strong during the study period. The bank has not made adequate provision for substandard loan prescribed by NRB. The provision for loss loan is observed below the NRB standard in the study period. Therefore, the bank has made no adequate provisioning for loss loan. The net interest margin of the bank is satisfactory. Similarly, loan to deposit ratio of the bank shows that the bank has maintained reasonable liquid position of its fund.

Gautam (2017) conducted thesis on "Financial performance analysis of Nepal SBI bank Ltd. in the CAMEL framework". The objectives of this study has: a) To examine the capital adequacy of the bank, b) To assess the quality of the bank's assets, b) To evaluate the earning performance of the bank, c) To analyze the liquidity position of the bank. The study found that: the capital fund of the bank is in increasing trend. The total risk based assets has also in increasing trend during the study period. Compared to the NRB standard, the risk based capital ratio of the bank is excess all over the study period. The bank has to say capital adequacy had been maintained as per the NRB guideline/directives for the study period. The core capital of the bank has been



fluctuating. The risk based core capital ratio is maximum i.e. 11.18% in the year 2014/15 and the lowest is 9.16% in the fiscal year 2011/12. The supplementary capital ratio of the bank is slightly fluctuating trend. SBI has maintained adequate supplementary capital during the study period. The total loan of the bank has gone up throughout the study period whereas the portion of the total non-performing loan in total loan is decreasing trend. Hence, SBI is good performer in regards to credit risk as maintain the NRB directives. Thus, the bank has maintained strong position regarding the net earning to core capitalratio.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

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.

#### **3.1 Research Design**

This study was based on descriptive cum analytical research approach to achieve the desired objectives. This study examined performance of joint venture banks in the framework of CAMEL. Financial ratios are applied to examine facts and descriptive techniques are adopted to evaluate financial performance of joint venture banks.

#### **3.2 Population and Sample**

There were 27 commercial banks in operation by the end of mangsir 2077. Out of this 3 are public and 24 are private banks. Among these private bank, 7 were joint venture banks. 2 were selected on the basis of convenience.

#### **3.3 Sources of Data**

This study is fully based on the secondary data. Therefore, the main sources of data are 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.

### 3.4 Data Collection Procedure

The required data of this study is entirely based on the historical data disclosed in annual reports. NRB publications were downloaded from the website of NRB. Relevant information and annual report of respective commercial banks have been obtained from the Kathmandu branch and website of the bank. Conceptual review and research review has been through related text books. Reviews of working paper written by various international scholars were downloaded from the related websites respectively. Related text books are available in Central Library T.U., Public Library Kathmandu and NRB publication, different Journals, Magazines and other published and unpublished reports help to research more convenient.

### 3.5 Data Processing Procedure

At first relevant data were extracted from above mentioned sources and recorded in the master sheet. The data were then entered into the spread sheet to work out. The financial ratios were worked out with the help of applicable software such as Microsoft Word, Microsoft Excel. In addition tables were generated with the help of Microsoft Excel.

### 3.6 Data Analysis Tools

Financial ratios in the framework of CAMEL was used to analyze the financial performance of joint venture banks. The relevant ratios used in this study are given in ensuing part of this section.

#### 3.6.1 Capital Adequacy

**Total Capital Ratio (TCR):** Total capital is the sum of Tier I core capital and Tier II supplementary capital. Capital ratio used to measure of capital in the banks. It is determined by the following model.

$$\text{Total Capital Ratio} \times \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}} | 100 \%$$

Where,

$$\text{Total Capital Fund} = \text{Core Capital} + \text{Supplementary Capital}$$

Total Risk weighted Assets = On-Balance Sheet Risk Assets + Off-Balance Sheet Risk Adjusted Assets

**Core Capital Adequacy Ratio:** Core ratio shows the relationship between the total core capital or internal sources and total risk adjusted assets. It is calculated by using the following model;

$$\text{Core Adequacy Capital Ratio} \times \frac{\text{Core Capital}}{\text{Total Risk Adjustment Assets}} | 100$$

**Supplementary Capital Adequacy Ratio:** Tier I capital ratio is the expression of numerical relationship between Tier I capital and total risk adjusted assets. It shows the absolute contribution of supplementary capital in capital adequacy. It is calculated by using the following model;

$$\text{Supplementary Capital Adequacy Ratio} \times \frac{\text{Supplementary Capital}}{\text{Total Risk Adequacy Ratio}} | 100$$

### 3.6.2 Assets Quality

**Non-Performing Loan to Total Loan (NPL):** It measures the proportion of Non Performing loan in total loan and advance. The ratio is used to analyze the assets quality of the bank and determine by using the given model.

$$\text{Non Performing Loan to Total Loan Ratio} \times \frac{\text{Non Performing Loan}}{\text{Total Loans and Advance}} | 100 \%$$

Where, **Non-performing loan:** These loans which is not recovered with in the given the time frame either in the form of interest or principle repayment.

**Loan Loss Ratio (LLR):** A loan loss ratio indicates the valuable allowance offset against total loans which represents the amount considered by management to be adequate to absorb unexpected losses inherent in the loan portfolio. For the purpose of this study following model is used to determine the loan loss ratio.

$$\text{Loan Loss Ratio} \times \frac{\text{Loan Loss Provision}}{\text{Total Loan and Advances}} | 100 \%$$

### 3.6.3 Management Efficiency

**Operating Expenses Ratio (OER):** Operating Expenses Ratio is the expression of numerical relationship between total operating expenses and total operating revenue of the bank. The objective of bank is reducing operating of expenses and increased in the total operating revenue. Higher operating expenses ratio indicates that financial institutions may not be operating efficiency, following model can be used calculation of operating expenses ratio.

$$\text{Operating Expenses Ratio} \times \frac{\text{Total Operating expenses}}{\text{Total Operating Revenue}} | 100 \%$$

Where,

Total Operating Expenses = Interest expenses+ employees expenses+ office operating expenses+ exchange fluctuation loss+ provision for possible loss.

Total Operating Revenues= Interest Income +Commission and Discount + other operating income +Exchange Income.

**Earning Per Employees(EPE):** EPE is numerical relationship between net operating incomes and total numbers of employees. Low or decrease earning per employees can reflect in efficiencies as a result of overstaffing, with similar repercussions in terms of profitability. It is calculated by uses of the following models;

$$\text{Earning Per Employees} \times \frac{\text{Net Operating Income}}{\text{Number of Employees}} | 100 \%$$

### 3.6.4 Earning Performance

**Return on Equity (ROE):** Return on Equity is a measure of the return on money provided by the firm's owners on equity, higher the investment which the shareholders will undertake. It also measures a firm's efficiency at generating profits from every dollar of net assets. And shows who well a company uses investment dollars to generate earnings growth. For the purpose of the study following models is used to determine the return on equity ratio.

$$\text{Return on Equity} \times \frac{\text{Net Income After Tax}}{\text{Total Equity Capital}} \mid 100\%$$

Total Equity Capital = Paid up Capital + Reserve Funds and Surplus

**Return on Assets (ROA):** Return on Assets is a measure of the return on money provided by both owners and creditors and is a measure of how efficiently all resources are managed. It indicates how capably the management of the bank has been converting the institutions assets into net earnings

$$\text{Return on Assets} \times \frac{\text{Net Income After Tax}}{\text{Total Assets}} \mid 100\%$$

**Net Interest Margin (NIM):** It refers to the income generated by banks via their operations. It is the difference between the average interests generate by the bank on loans advances, and toe average interest paid by the bank deposits.

Net interest margins of banks may vary depending upon market conditions. For the purpose of the study following model issued to determine net interest margin

$$\text{Net Interest Margin} \times \frac{\text{Net Interest Income}}{\text{Earning Assets}} \%$$

Where,

Net Interest Income = Interest Income - Interest Expenses

Earning Assets = Loan and Advances + Investment on securities

**Earning Per Share (EPS):** EPS are the earnings returned on the initial investment amount. It provides a direct measure of the returns flowing to the bank's owners-it's stockholder-measured relative to the numbers of share to the public. It gives the strength of the share in the market; following is the expression of earning per share.

$$\text{Earning Per Share} \times \frac{\text{Net Income After Tax}}{\text{No of Share of Commonstock}} \mid 100\%$$

No of Share of Common Stock= Paid up Capital/Rs. 100

### 3.6.5 Liquidity Position

**Liquid Assets to Total Deposits Ratio:** It measures the proportion of total liquid assets in total deposits. For more it shows the overall short term liquidity position. The higher liquidity position and lower ratio shows the en efficient liquidity position of the bank. It is calculated by the using following model;

$$\text{Total Liquid Assets to Total Deposits Ratio} \times \frac{\text{Total Liquid Assets}}{\text{Total Deposits}} | 100\%$$

Total liquid Assets = Cash in hand + NRB Balance+ Domestic Bank Balance + Foreign Currency Bank Balance + Placement+ Investment in Government Securities

**NRB Balance to Total Deposits Ratio:** It measures the proportion of NRB balance in total deposits. For the purpose of this study following model is used to determine the NRB balance to total deposits ratio

$$\text{NRB Balanceto Total Deposits Ratio} \times \frac{\text{NRBbalance}}{\text{TotalDeposits}} | 100\%$$

NRB Balance = Balance with Nepal Rastra Bank

**Cash in Vault to Total Deposit Ratio:** It shows the percentage of total deposit maintained as vault. It is worked out by using the following model;

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

Where,

Cash in Vault = Cash in hand+ Foreign currency in hand

### 3.7 Model Specification

$$ROA = 0 + 1CA + 2AQ + 3ME + 4E + 5LQ +$$

$$ROE = 0 + 1CA + 2AQ + 3ME + 4E + 5LQ +$$

Where,

CA= Capital Adequacy represented by Capital adequacy ratio

AQ= Assets Quality represented by Non-performing Loan to Total loan

ME= Management Efficiency represented by Employee expenses to total operating expenses,

E= Earnings represented by Net interest margin

LQ= Liquidity represented by total loans to total deposit ratio



## **CHAPTER IV**

### **RESULTS**

This chapter includes presentation and analysis of data collected from different sources. As stated in the theoretical prescription, the financial performance analysis of joint venture commercial banks in Nepal is concentrated in the FIVE components: capital Adequacy, Assets Quality, Management Quality, Earnings, and Liquidity. The final portion of this chapter presents the major findings of the study.

#### **4.1 Analysis of Capital Adequacy**

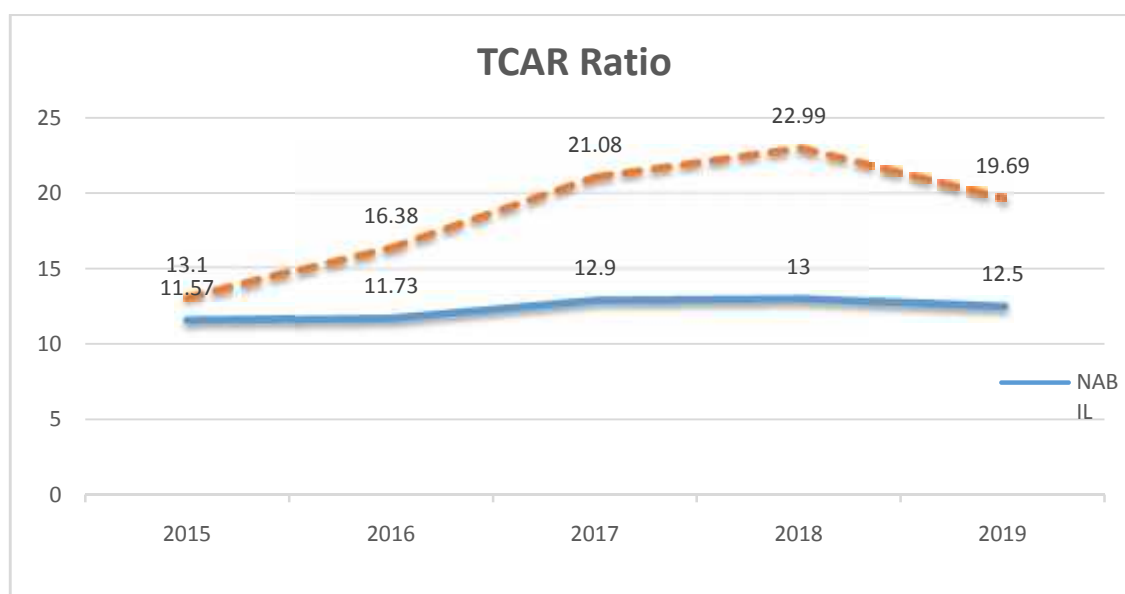
Capital Adequacy is a measure of a commercial bank's capital as a percentage of its risk weighted assets, such as the loans it has provided and the securities it holds. The capital requirement is a bank regulation, which sets a framework on how commercial banks must handle their capital. The categorization of assets and capital is highly standardized so that it can be risk weighted. Total risk weighted assets comprise the sum of on-balance sheet assets and off-balance sheet items. Capital adequacy component analysis of sampled joint venture banks is used to find out whether banks are maintaining capital adequacy ratio as directed by NRB. Capital adequacy ratio, core capital ratio and supplementary ratio are used to analyze the of capital adequacy of banks.

##### **4.1.1 Capital Adequacy Ratio**

Capital adequacy ratio measures the adequacy of capital for smooth operation of a bank. This ratio is used to protect depositors and promote the stability and efficiency of financial system around the world. A bank should maintain the adequate capital ratio as directed by NRB. Capital adequacy ratio below the NRB standard indicates lower internal sources, lower security to depositors and comparatively weak financial position. So it is required to maintain depositors' confidence and preventing the bank from going bankrupt. Capital adequacy ratio of sampled banks for the observed fiscal years is given in Table 4.1.

**Table 4.1***Total Capital Adequacy Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	11.57	13.1
<b>2015/16</b>	11.73	16.38
<b>2016/17</b>	12.9	21.08
<b>2017/18</b>	13	22.99
<b>2018/19</b>	12.5	19.69
<b>MEAN</b>	<b>12.34</b>	<b>18.648</b>
<b>SD</b>	<b>0.589881</b>	<b>3.515039</b>

**Figure 4.1***Capital adequacy ratio*

*Source:* - Annual Reports of Sampled Joint Venture Banks.

In the case of NABIL, the mean capital adequacy ratio over the 5 years is 12.34% with maximum of 13% in FY2017/18 and minimum of 11.57% in FY2014/15. The capital fund is in fluctuating trend but risk weighted asset is in increasing trend. In the case of SCBL, the capital adequacy ratio is maximum of 22.99% in FY2017/18 and minimum

of 13.1% in FY2014/15 with average of 18.648% over the five years time. Capital adequacy of SCBL is more effective than that of NABIL.

#### 4.1.2 Core Capital Adequacy Ratio

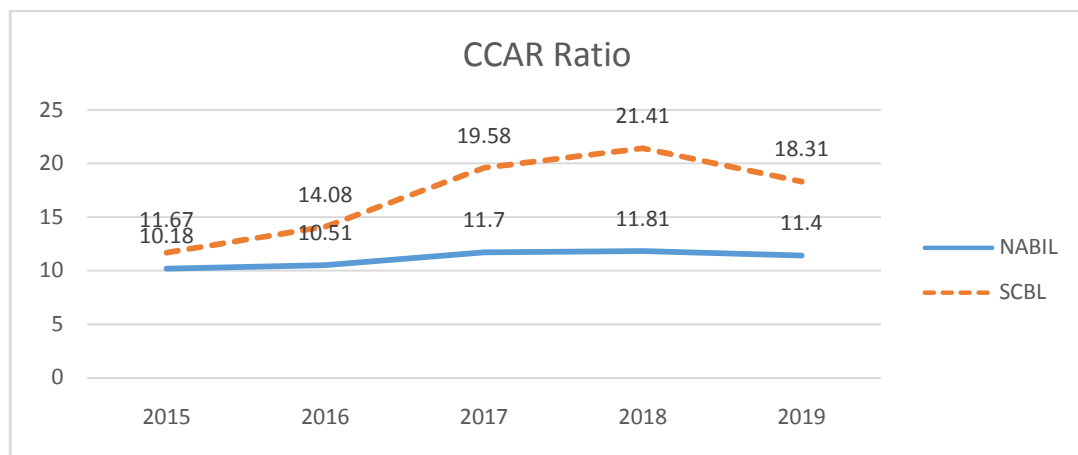
Core capital is primary capital, which can absorb losses without a bank being required to cease trading. It includes paid-up capital, share premium, non-redeemable preference share, general reserve, accumulated profit and loss amount and goodwill detectible if any. In this way, the core capital consists primarily of stockholder's equity. Table 4.2 presents the observed core capital

**Table 4.2**

*Core Capital Adequacy Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	10.18	11.67
<b>2015/16</b>	10.51	14.08
<b>2016/17</b>	11.7	19.58
<b>2017/18</b>	11.81	21.41
<b>2018/19</b>	11.4	18.31
<b>MEAN</b>	<b>11.12</b>	<b>17.01</b>
<b>SD</b>	<b>0.655225</b>	<b>3.598761</b>

In the case of NABIL, the mean core capital adequacy ratio over the 5 years is 11.2% with maximum of 11.81% in FY2017/18 and minimum of 10.18% in FY2014/15. In the case of SCBL, the capital adequacy ratio is maximum of 21.41% in FY2017/18 and minimum of 11.67% in FY2014/15 with average of 17.01% over the five years time. Core Capital adequacy of SCBL is more effective than that of NABIL.

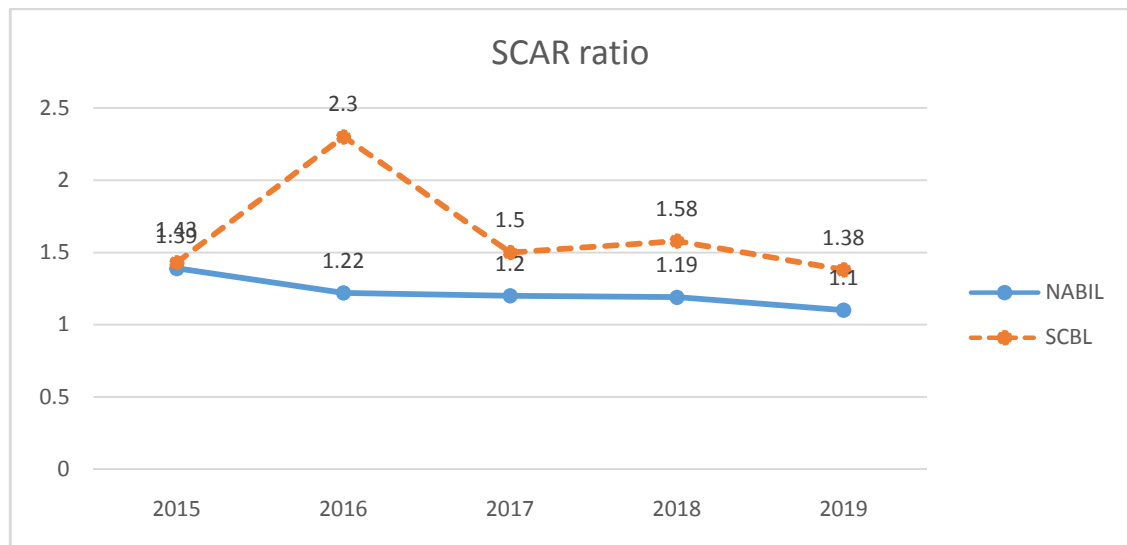
**Figure 4.2***Core capital adequacy ratio***4.1.3 Supplementary Capital Adequacy Ratio**

Supplementary capital is a broad array of secondary capital resource. It is collected using the hybrid capital instruments, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. It includes loan loss provision, exchange equalization resources, assets revaluation reserve, hybrid capital instruments, unsecured sub-ordinate term debt, interest rate fluctuation fund and other free reserves. NRB has set a standard of supplementary capital is not more than the core capital ratio of the bank.

**Table 4.3***Supplementary Capital Adequacy Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	1.39	1.43
<b>2015/16</b>	1.22	2.3
<b>2016/17</b>	1.2	1.5
<b>2017/18</b>	1.19	1.58
<b>2018/19</b>	1.1	1.38
<b>MEAN</b>	<b>1.22</b>	<b>1.638</b>
<b>SD</b>	<b>0.094446</b>	<b>0.337781</b>

*Source: Annual Reports of Sampled Joint Venture Banks.*

**Figure4.3***Supplementary capital adequacy ratio*

In the case of NABIL, the mean supplementary capital adequacy ratio over the 5 years is 1.22% with maximum of 1.39% in FY2014/15 and minimum of 1.1% in FY2018/19. In the case of SCBL, the supplementary capital adequacy ratio is maximum of 2.3% in FY2016/17 and minimum of 1.38% in FY2018/19 with average of 1.638% over the five years' time.

#### **4.2 Analysis of Assets Quality**

Assets a quality ratio is one of the most critical factors in determine overall condition of any commercial banks. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. Assets of the banks comprises of cash and bank balance, call money and short notice , investment, loans and advances and fixed assets. However investments and loans and advances play a major role in determine the quality of assets. These ratios look at the amount of different types of assets and attempt to determine if there are too high or too low with regard to current operating levels. The prime reason behind meaning the assets quality is to ascertain the component of non-performing assets as a percentage of total assets/loan and ascertain the components of non-performing assets as a percentage of total assets/loan and advances. In addition, we have analyzed the ratio of loan loss reserve ratio and nonperforming loan. It reflects the safety margin for the bank

against NPL. These ratios used to evaluate managerial efficiency proper utilization of assets and it also measures the degree of effectiveness in use of resources of funds by commercial banks.

#### 4.2.1 Non-Performing Loan

Loan and advances are the most profitable of all the assets of a commercial bank. This is the primary source of income and the most profitable of all the assets of the bank. But bank need to be careful about the safety of such loan and advances because bank may be influences by bad debts. When the borrower fail to pay the interest or even principal within the timeframe the performing loan begins to start in non-performing loan.

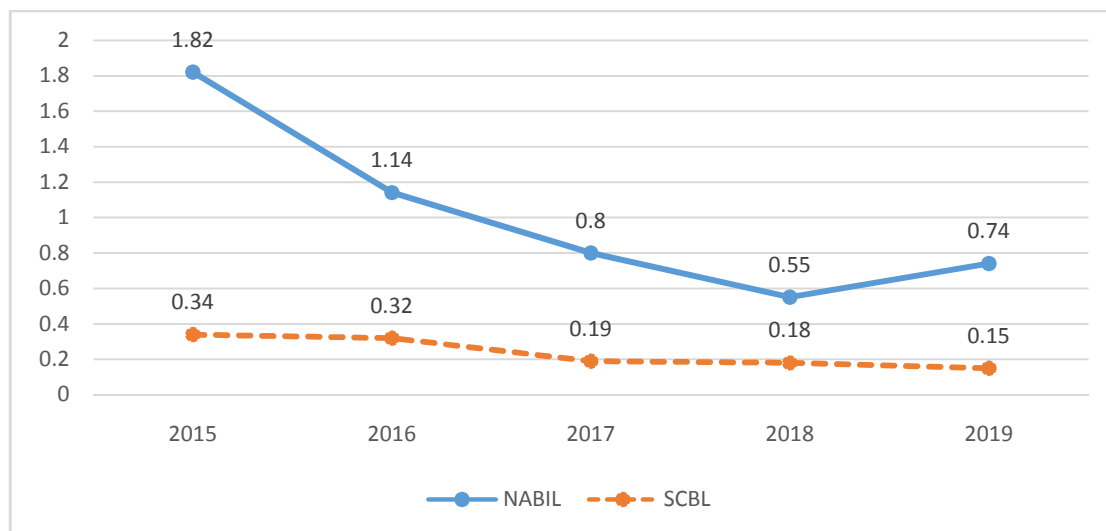
As per the NRB unified directives 2062 all loans and advances must classify into four-pass, sub-standard, doubtful and loss. As a result, it has classified the pass loan as performing loans and other three types of loans are non- performing loans or past due loan. The ratio of non-performing loan total loan and advances measures the proportion of non-performing loan on the total volume of loans and advances. Lower ratio shows the better performance of the bank in mobilization of loans and advance and vice versa. The ratio is less than 5% shows that the bank has strong level of non-performing loan to total loan. The ratio having 10% to 20% can be fair level of non-performing loan on total loan

**Table 4.4**

*Ratio of Non-Performing Loan to Total Loan*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	1.82	0.34
<b>2015/16</b>	1.14	0.32
<b>2016/17</b>	0.8	0.19
<b>2017/18</b>	0.55	0.18
<b>2018/19</b>	0.74	0.15
<b>MEAN</b>	<b>1.01</b>	<b>0.236</b>
<b>SD</b>	<b>0.447571</b>	<b>0.078128</b>

*Source:* Annual Reports of Sampled Joint Venture Banks.

**Figure 4.4***Non Performing Loan to total loan ratio*

In the case of NABIL, the mean non-performing loan to total loan over the 5 years is 1.01% with maximum of 1.82% in FY2014/15 and minimum of 0.55% in FY2017/18. In the case of SCBL, non-performing loan to total loan is maximum of 0.34% in FY2014/58 and minimum of 0.15% in FY2018/19 with average of 0.236% over the five years' time. The non-performing loan to total loan of SCBL is more effective than that of NABIL.

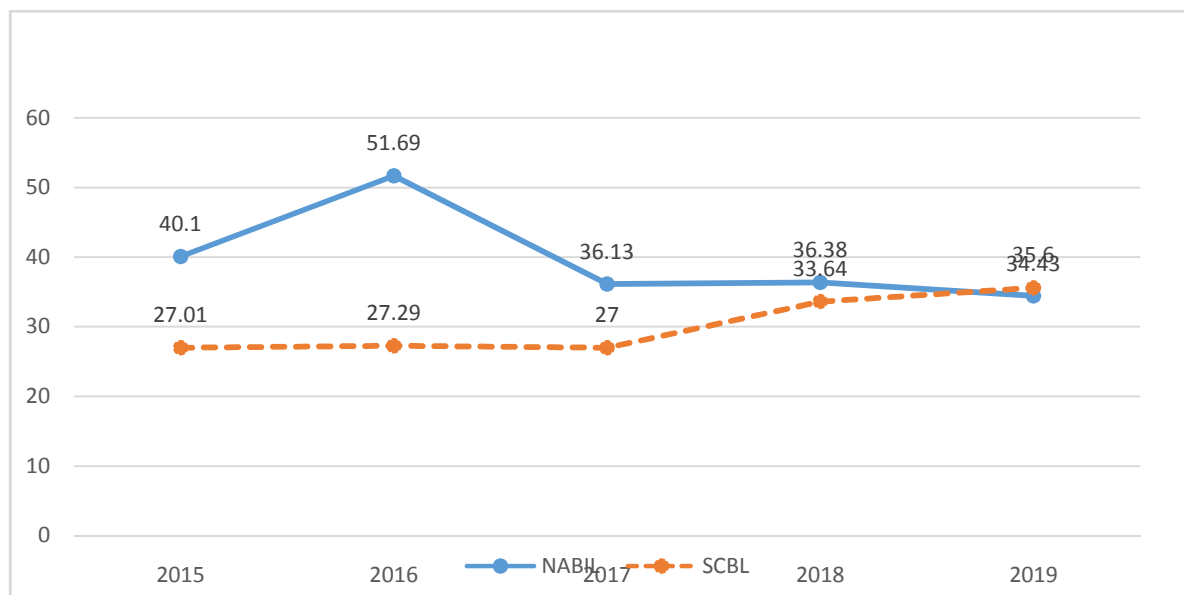
### 4.3 Analysis of Management Quality

Sound management is important key to bank performance. Every bank has find out actual management performance involves two analysis, which is subjective analysis and objective analysis. Mainly subjective analysis for measuring the efficiency of the management, but it is difficult to measure. There is no particular facture can be used measure for assessing management quality. Involvement of board of directors, success of top management, quality of manpower, customer relationship, management information system, internal control decision process, operating and lending decisions and technical factor etc are qualitative aspects of assessment of management.

**Table 4.5***Staff Expense Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	40.1	27.01
<b>2015/16</b>	51.69	27.29
<b>2016/17</b>	36.13	27
<b>2017/18</b>	36.38	33.64
<b>2018/19</b>	34.43	35.6
<b>MEAN</b>	<b>39.746</b>	<b>28.56</b>
<b>SD</b>	<b>6.252195</b>	<b>3.790314</b>

In the case of NABIL, the mean staff expense ratio over the 5 years is 39.746% with maximum of 51.69% in FY2015/16 and minimum of 34.43% in FY2018/19. In the case of SCBL, staff expense ratio is maximum of 35.6% in FY2018/19 and minimum of 27% in FY2016/17 with average of 28.56% over the five years time.

**Figure 4.5***Staff expense ratio*



### 4.3.1 Total Operating Income (TOI) to Total Operating Expenses (TOE)

In this study, total operating expenses to total operating revenues ratio is used as a proxy of management quality. It indicates profitability of a company. It is determined by the gap of total operating revenue and total operating expenses which is direct control and monitoring of the management. A high or increasing ratio of expenses to total incomes indicates inefficient operation of the company which may negative affect productivity of the company.

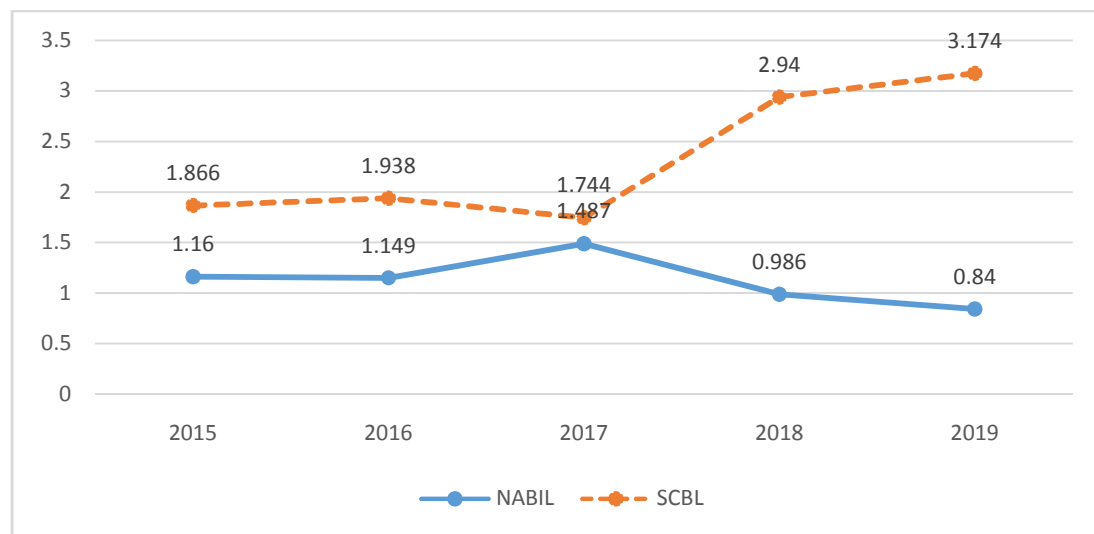
Commercial banks mainly earns income from interest on loans and advances, commissions, fees, and discounts, foreign exchange rate gains, and other miscellaneous income. And, the main components of expenses of commercial banks are interest on deposits, staff salary, provident fund write-off of bad debt loan and other operating expenses like rent, water supply and electricity, fuel expenses, audit fee expenses, management expenses, depreciation, miscellaneous expenses, direct related to the operating of company.

**Table 4.6**

*Total Operating Income to Total Operating Expenses*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	1.16	1.866
<b>2015/16</b>	1.149	1.938
<b>2016/17</b>	1.487	1.744
<b>2017/18</b>	0.986	2.94
<b>2018/19</b>	0.84	3.174
<b>MEAN</b>	<b>1.1244</b>	<b>2.56</b>
<b>SD</b>	<b>0.216051</b>	<b>10.72414</b>

*Source:* Annual Reports of Sampled Joint Venture Banks.

**Figure4.6***Total Operating Income to Total Operating Expenses*

In the case of NABIL, the mean total operating income to total operating expenses ratio over the 5 years is 1.1244% with maximum of 1.487% in FY2016/17 and minimum of 0.84% in FY2018/19. In the case of SCBL, total operating income to total operating expenses ratio is maximum of 3.174% in FY2018/19 and minimum of 1.744% in FY2016/17 with average of 2.56% over the five years' time. The overall ratio implies that all JVBs in decreasing expenses with respect to income which is symbol of good management quality

#### 4.4 Analysis of Earning

The main objective of bank is to earn profit by providing different types of banking services to its customer. A required level of profit is necessary for the firm's growth and survival in the competitive environment. The success of the bank heavily relies upon the efficiency of management to drive the bank to earn good profits. Most of the commercial banks have been able to grow their net profits while some of the banks, resulting from high non-performing loan and operating inefficiencies are struggling with either very low net profit or negative profits. Analysis of the earnings helps the management, shareholders and depositors to know about the performance of the bank, sustainability of earnings and to forecast growth of the bank.

#### 4.4.1 Earning Per Share (EPS)

EPS measures the profit available to the equity shareholders as per share i.e. the amount they get from every share. It does not reflect how much is paid as dividend and how much is retained in the business. A bank can decide whether to increase or reduce of shares on issue. This decision will automatically affect the earning per share. It reflects the earning power of the bank. Higher EPS ratio shows the sound profitability position of the bank and vice versa. Table 4.9 exhibits the EPS of sampled JVBs during the study period.

**Table 4.7**

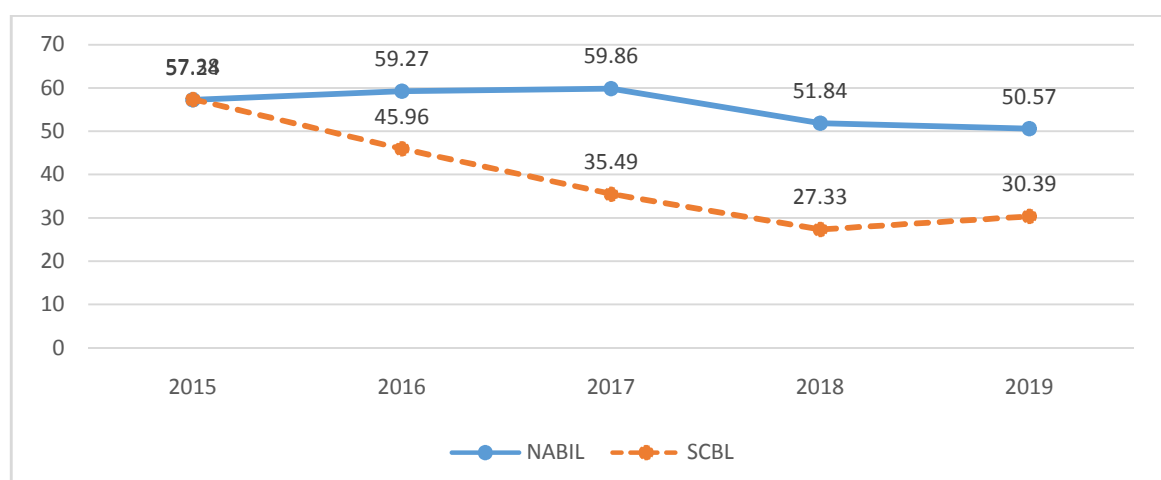
*Earning Per Share*

YEAR	NABIL	SCBL
2014/15	57.24	57.38
2015/16	59.27	45.96
2016/17	59.86	35.49
2017/18	51.84	27.33
2018/19	50.57	30.39
MEAN	<b>55.756</b>	<b>39.31</b>
SD	<b>3.837263</b>	<b>11.03111</b>

*Source:* Annual Reports of Sampled Joint Venture Banks.

**Figure 4.7**

*Earning per share*



In the case of NABIL, the mean earning per share over the 5 years is 55.756 with maximum of 59.86 in FY2016/17 and minimum of 50.57 in FY2018/19. In the case of SCBL, earning per share is maximum of 57.38 in FY2014/15 and minimum of 27.33 in FY2017/18 with average of 39.31 over the five years time. The overall ratio of NABIL is better than that of SCBL. Both NABIL bank and SCBL have maintained strong position regarding the EPS.

#### 4.4.2 Net Interest Margin

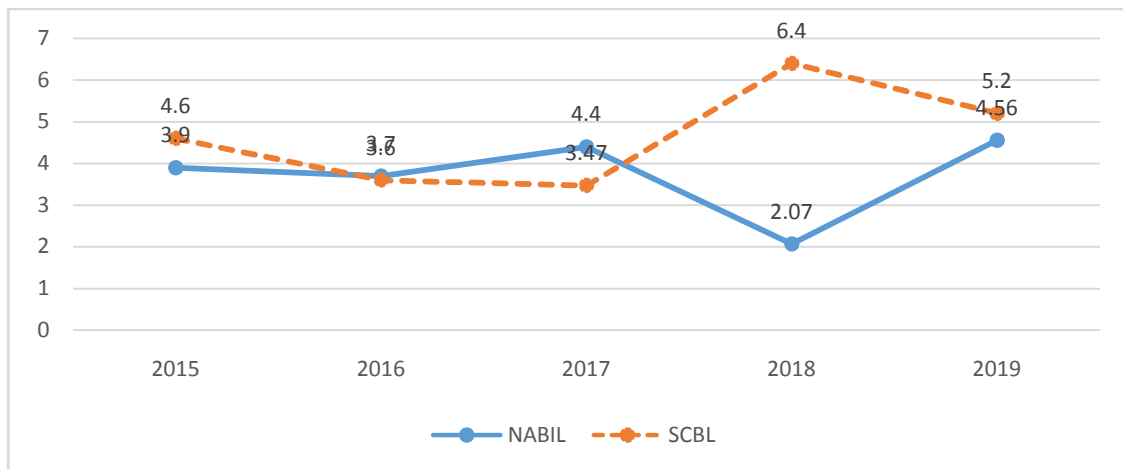
The net interest margin measures the banks ability in mobilizing lower cost funds and investing them at reasonably higher interest by borrowing short and lending long. Net interest income is different between interest income and interest expenses. Earning assets includes investment, loan and advances and bills purchased and money at call and short notice. The net interest margin means net interest income as percentage of net earning assets. The positive or increasing ratio indicates better efficiency of interest generating by utilizing the earning assets and vice versa. The net interest margin ratio between 3 to 4 percent and higher is better in banking industry. Net interest margin of sampled JVBs are presented in Table 4.10.

**Table 4.8**

*Net Interest Margin*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	3.9	4.6
<b>2015/16</b>	3.7	3.6
<b>2016/17</b>	4.4	3.47
<b>2017/18</b>	2.07	6.4
<b>2018/19</b>	4.56	5.2
<b>MEAN</b>	<b>3.726</b>	<b>4.654</b>
<b>SD</b>	<b>0.88579</b>	<b>1.082804</b>

*Source:* Annual Reports of Sampled Joint Venture Banks.

**Figure 4.8***Net Interest margin*

In the case of NABIL, the mean net interest margin over the 5 years is 3.726% with maximum of 4.4% in FY2016/17 and minimum of 2.07% in FY2017/18. In the case of SCBL, net interest margin is maximum of 6.4% in FY2017/18 and minimum of 3.6% in FY2015/16 with average of 4.654% over the five years time. The overall ratio of SCBL is better than that of NABIL. Both NABIL bank and SCBL have maintained strong position regarding the NIM.

#### **4.5 Analysis of Liquidity**

The main objective behind this parameter is to assess the ability of a bank to meet the demand from the deposit holders in a particular time. Liquidity risk arises when liquidity deficit and much more liquidity surplus which indicates the problem in the financial health of a commercial bank. Day to day withdraws by liability holders are generally predictable but large FIs can borrow additional funds or demand large amount then usual that makes sudden shortfalls of cash in bank. So every commercial bank should manage the liquidity risk using various methods. Liquidity has been compared based on the following parameters.

##### **4.5.1 Total Loan to Total Deposit Ratio (LDR)**

The LDR reveals the efficiency with which the commercial banks and collects so many from the available sources and channeling these to a various productive

activities in the economy. Commercial banks collect deposits from the individual and institutional deposits in from of different accounts offered. These funds are further extended in the form of loan and advances to different borrowers consider various aspects like risk analysis, diversification bank's policy, NRB rules and regulations, customer behavior etc.

The ratio tries to find out which banks is successful to utilize the depositor's funds to earn profit by computed by dividing the total amount of loans and advances by total deposit. Higher ratio indicates proper utilization of funds that the bank has more funds than it needs for investment.

**Table 4.9**

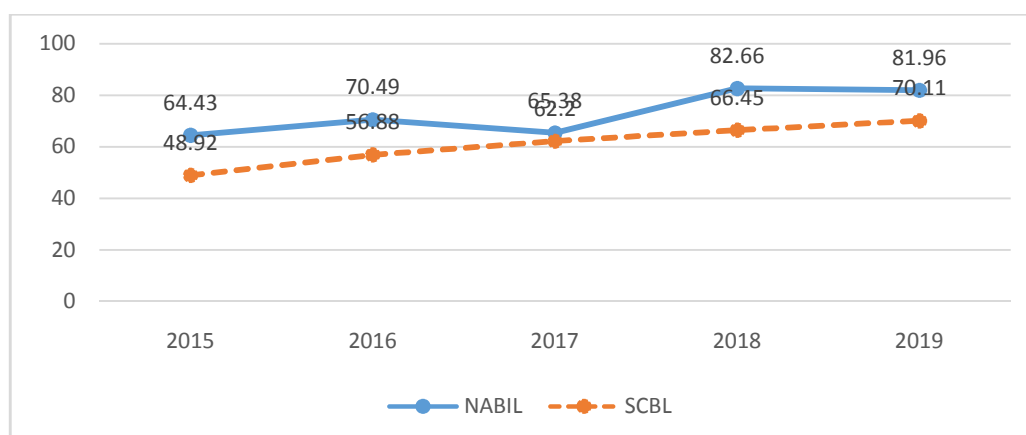
*Total Loan to Total Deposit Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	64.43	48.92
<b>2015/16</b>	70.49	56.88
<b>2016/17</b>	65.38	62.2
<b>2017/18</b>	82.66	66.45
<b>2018/19</b>	81.96	70.11
<b>MEAN</b>	<b>72.984</b>	<b>60.912</b>
<b>SD</b>	<b>7.891835</b>	<b>7.443073</b>

*Source: Annual Reports of Sampled Joint Venture Banks.*

**Figure 4.9**

*Total loan to total deposit ratio*



In the case of NABIL, the mean total loan to total deposit ratio over the 5 years is 72.98% with maximum of 82.66% in FY2017/18 and minimum of 64.43% in FY2014/15. In the case of SCBL, total loan to total deposit ratio is maximum of 70.11% in FY2018/19 and minimum of 48.92% in FY2014/15 with average of 60.912% over the five years time. The overall ratio of NABIL is better than that of SCBL.

#### 4.5.2 NRB Balance to Total Deposit Ratio

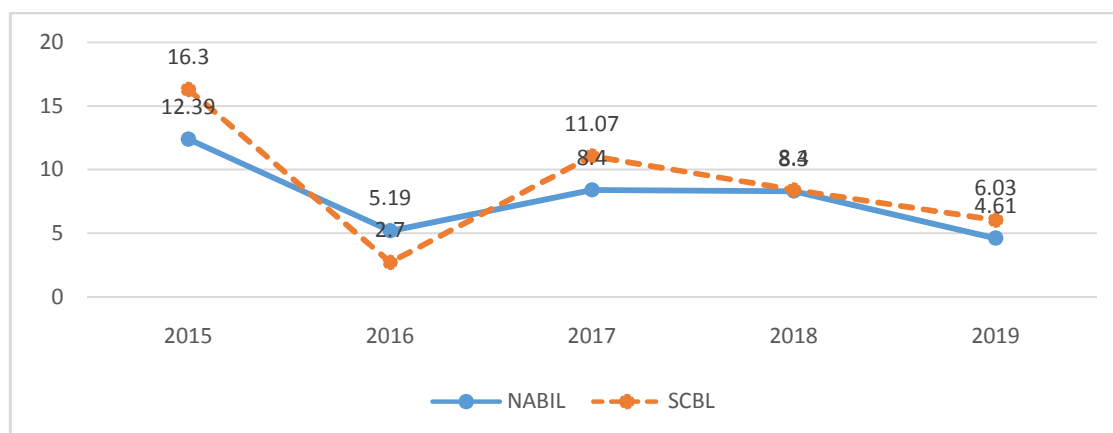
This ratio measures the proportion of NRB balance in total deposits. It shows whether the commercial bank is holding the balance as required by NRB or not. According to NRB directives, every commercial bank should maintain certain percent of total deposit in NRB, to ensure adequate liquidity in the commercial banks, to meet the depositor's demand for cash at any time, to inject the confidence in depositors regarding the safety of their deposited funds. The bank should strictly comply with the directives. Total deposit means current saving and fixed deposit an account as well as call account deposit and certificates of deposits.

**Table 4.10**

*NRB Balance to Total Deposit Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	12.39	16.3
<b>2015/16</b>	5.19	2.7
<b>2016/17</b>	8.4	11.07
<b>2017/18</b>	8.3	8.4
<b>2018/19</b>	4.61	6.03
<b>MEAN</b>	<b>7.778</b>	<b>8.9</b>
<b>SD</b>	<b>2.780787</b>	<b>4.612934</b>

*Source:* Annual Reports of Sampled Joint Venture Banks.

**Figure 4.10***NRB balance to total deposit ratio*

In the case of NABIL, the mean nrb balance to total deposit ratio over the 5 years is 7.778% with maximum of 12.39% in FY2014/15 and minimum of 4.61% in FY2018/19. In the case of SCBL, nrb balance to total deposit ratio is maximum of 16.3% in FY2014/15 and minimum of 2.7% in FY2015/16 with average of 8.9% over the five years time.

#### **4.5.3 Cash in Vault to Total Deposits Ratio**

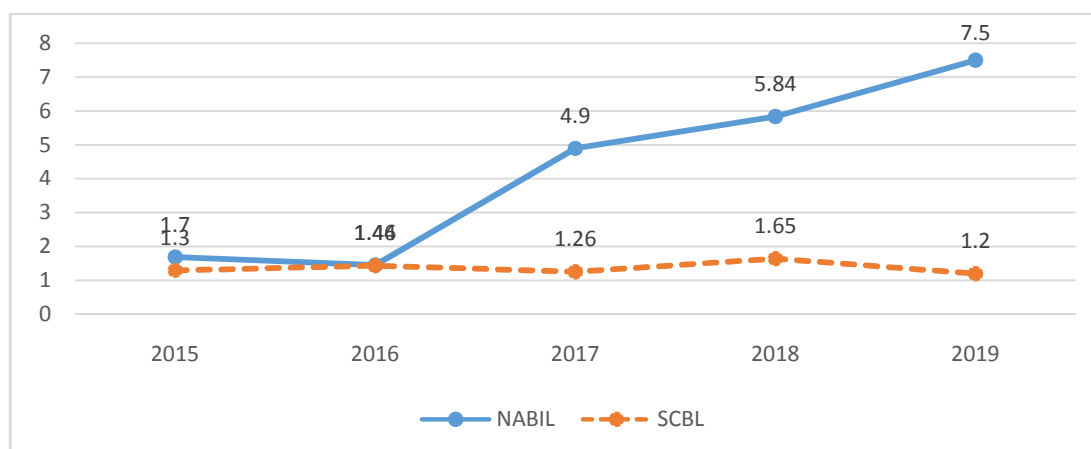
This ratio shows the percentage of total deposit maintained in vault. The term cash in vault represent the ratio measures the percentage of most liquid fund with the bank to make immediate payment or the depositors. Cash in hand and foreign currencies in hand are included as cash in vault. So, sufficient and appropriate cash reserve in the vault should be maintained.



**Table 4.11***Cash in Vault to Total Deposits Ratio*

<b>YEAR</b>	<b>NABIL</b>	<b>SCBL</b>
<b>2014/15</b>	1.7	1.3
<b>2015/16</b>	1.46	1.44
<b>2016/17</b>	4.9	1.26
<b>2017/18</b>	5.84	1.65
<b>2018/19</b>	7.5	1.2
<b>MEAN</b>	<b>4.28</b>	<b>1.37</b>
<b>SD</b>	<b>2.357762</b>	<b>0.160748</b>

Source: Annual Reports of Sampled Joint Venture Banks.

**Figure 4.11***Cash in Vault to total deposit*

In the case of NABIL, the mean cash in vault to total deposit ratio over the 5 years is 4.28% with maximum of 7.5% in FY2018/19 and minimum of 1.46% in FY2015/16. In the case of SCBL, cash in vault to total deposit ratio is maximum of 1.65% in FY2017/18 and minimum of 1.2% in FY2018/19 with average of 1.37% over the five years time.

#### 4.6 CAMEL Framework and ROA

**Table 4.12**

*Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.927a	.860	.685	2.11425

The results in Table 4.14 indicate that there is significant impact of CAMEL on financial performance. The R value of .927 indicates strong positive relationship between CAMEL and Financial performance. Similarly, R-square value of 0.860 shows that the independent variables explain 86% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent. Likewise, Standard error of the estimate of 2.11425 indicates the variability of the observed value of financial performance from regression line is 2.11425 units. Thus, it has shown that there is significant relationship between CAMEL ANALYSIS and ROA. Table 4.14 explains the model fit through the F statistic and the probability of F-statistic.

**Table 4.13**

*Goodness of Fit Test*

	Sum of Squares	d.f	Mean Square	F	Sig.
Regression	109.698	5	21.940	5.212	.033 <sup>b</sup>
Residual	17.88	4	4.470		
Total	127.579	9			

Dependent variable: ROA<sub>a</sub>

Predictors: (constant), Capital Adequacy, Assets Quality, Management , Earnings and Liquidity<sub>b</sub>

The results in Table 4.15 show that the F statistic was 5.212. At 5% level of confidence, the F statistic was significant. This explains the variation in financial performance and that the overall model is significant.

**Table 4.14***Coefficients*

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	27.365	7.008		3.905	0.17
	Capital Adequacy	-1.041	0.303	-1.152	-3.432	0.26
	Assets Quality	2.778	1.954	0.393	1.423	0.228
	Management Efficiency	0.325	0.086	1.031	2.726	0.053
	Earnings	0.230	0.941	0.070	0.245	0.819
	Liquidity	.001	0.071	0.002	0.012	0.991
a. Dependent Variable: ROA						

Source: SPSS output

The study found that increase in Capital Adequacy and Earnings will decrease the profitability whereas an increase in assets quality, management efficiency and liquidity will increase the financial performance.

From the above results, the estimated equation can be written by taking the values from the model-1:  $ROA = 27.635 - 1.041CA + 2.778AQ + 0.325ME + 0.230E + 0.001LQ$

where CA represents Capital Adequacy, AQ= Assets Quality, ME= Management Efficiency, E= Earnings, LQ= Liquidity

#### 4.7 Relationship between CAMEL indicators and ROE

**Table 4.15***Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.922a	.850	.663	2.18605

The results in Table 4.17 indicate that there is significant impact of CAMEL on financial performance. The R value of .922 indicates strong positive relationship between CAMEL and Financial performance. Similarly, R-square value of 0.850 shows that the independent variables explain 85% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent. Likewise, Standard error of the estimate of 2.18605 indicates the variability of the observed value of financial performance from regression line is 2.18605units. Thus, it has shown that there is significant relationship between CAMEL ANALYSIS and ROE. Table 4.18 explains the model fit through the F statistic and the probability of F-statistic.

**Table 4.16**

*Goodness of Fit Test*

	Sum of Squares	d.f	Mean Square	F	Sig.
Regression	107.698	5	20.940	4.412	.023 <sup>b</sup>
Residual	15.88	4	3.870		
Total	123.579	9			

Dependent variable: ROE <sub>a</sub>

Predictors: (constant), Capital Adequacy, Assets Quality, Management , Earnings and Liquidity <sub>b</sub>

The results in Table 4.18 show that the F statistic was 4.412. At 5% level of confidence, the F statistic was significant. This explains the variation in financial performance and that the overall model is significant.

**Table 4.17***Coefficients*

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	
	B	Std. Error	Beta			
1	(Constant)	21.083	7.298		2.889	0.45
	Capital Adequacy	-0.634	0.277	-0.717	-2.288	0.084
	Assets Quality	-2.107	2.382	-0.298	-0.884	0.426
	Management Efficiency	0.395	0.151	0.779	2.621	0.59
	Earnings	0.834	0.768	0.255	1.087	0.338
	Liquidity	-0.110	0.085	-0.301	-1.294	0.265
a. Dependent Variable: ROE						

Source: SPSS output

The study found that increase in Capital Adequacy, assets quality and liquidity will decrease the profitability whereas an increase in management efficiency and earnings will increase the financial performance. From the above results, the estimated equation can be written by taking the values from the model-1:  $ROE = 21.083 - 0.634CA - 2.107AQ + 0.395ME + 0.834E - 0.110LQ$

where CA represents Capital Adequacy, AQ= Assets Quality, ME= Management Efficiency, E= Earnings, LQ= Liquidity

#### 4.8 Findings

The major findings of the study of financial performance analysis of sampled joint venture banks in the framework of CAMEL are as follows.

- ) Capital adequacy ratio of joint venture banks is satisfactory. SCBL has effective CAR with average of 22.9% as compared to 12.34% of NABIL.

- ) Supplementary capital adequacy ratio of joint venture banks is satisfactory too. SCBL has effective SCAR with average of 1.638% as compared to 1.22% of NABIL.
- ) The NPL to Total Loan ratio of joint venture banks has been decreasing over the years. SCBL has effective NPL to total loan ratio with average of 0.236% as compared to 1.01% of NABIL.
- ) The staff expense ratio of joint venture banks has been satisfactory over the years.
- ) The total operating income to total operating expenses ratio implies that all JVBs in decreasing expenses with respect to income which is symbol of good management quality.
- ) The ROE of joint venture banks has been excellent with Nabil having mean return of 21.89% and SCBL having 17.8% over the period. Both NABIL bank and SCBL have maintained strong position regarding the ROE.
- ) The overall ROA of NABIL is better than that of SCBL.
- ) Both NABIL bank and SCBL have maintained strong position regarding the EPS as well as NIM.
- ) The total loan to total deposit ratio of joint venture banks has been increasing over the years. NABIL has effective total loan to total deposit ratio with average of 72.98% as compared to 60.912% of SCBL.
- ) The mean nrb balance to total deposit ratio and cash in vault to total deposit ratio over the 5 years has been satisfactory of both the banks
- ) There is significant impact of CAMEL on financial performance. The R value of .927 indicates strong positive relationship between CAMEL and ROA. Similarly, R-square value of 0.860 shows that the independent variables explain 86% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent
- ) There is significant impact of CAMEL on financial performance. The R value of .922 indicates strong positive relationship between CAMEL and ROE. Similarly, R-square value of 0.850 shows that the independent variables explain 85% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent

## **CHAPTER V**

### **CONCLUSION**

#### **5.1 Discussion**

The objective of the study was to analyze the financial performance of joint venture banks in Nepal in CAMEL framework. This study covered five years data following a descriptive and analytical research design. NABIL and SCBL were sampled as a study unit with using convenience sampling method. This study was based on the secondary data. Annual report and financial statements of the respective banks are major sources of data of study. CAMEL are a common technique of evaluating the financial performance of commercial banks. In this technique consists of six factors- Capitals Adequacy, Assets Quality, Management Quality, Earning Quality and Liquidity Position.

The specific objectives of the study were to analyze the capital adequacy, non-performing assets, loan loss reserve ratio, and management quality, earning quality, liquidity position sampled JVBs during five years period form FY 2014/15 to FY 2018/19. Various theories relating to the performance evaluation of commercial banks were reviewed in order to build up the conceptual foundation and reach to the clear destination of research. Besides these review of journals, articles and review of dissertations were carried out under research review.

The capital adequacy ratio of all sampled JVBs were generally above the NRB standard during the study period whereas supplementary capital adequacy ratio was as per NRB standard which led to conclude that the sampled JVBs were running with adequate capital. The non-performing to total loan ratios showed strong position of asset quality. The management quality ratio: the earning per employee was fluctuating trend. Overall EPE ratio of JVBs shows relatively satisfactory level. Whereas the total operating expenses to total operating revenue of JVBs ratios were decreasing expenses with respect to income which indicate good symbol of good management quality. The earning ratios like ROE, ROA and EPS show the profitability of EPS ratio is in increasing trend. The NIM ratio was above the bench mark. It indicates that banks manager done a good job of assets and liabilities. The high liquidity however is affecting financial health adversely by deteriorating their profitability.

## 5.2 Conclusions

The main objective of the study was to make CAMEL analysis on performance of banks. The influence of the variables of CAMEL for rating the impact on the return on assets. The outcome of research clearly showed the factors that mainly affect the performance of banks entirely. From result we can conclude that earning quality of the banks mainly affect their performance. Other factors too have the influence for the bank's performance; capital adequacy, assets quality, management and liquidity.

Capital adequacy ratio of joint venture banks is satisfactory. Supplementary capital adequacy ratio of joint venture banks is satisfactory too. The NPL to Total Loan ratio of joint venture banks has been decreasing over the years. The staff expense ratio of joint venture banks has been satisfactory over the years. The total operating income to total operating expenses ratio implies that all JVBs in decreasing expenses with respect to income which is symbol of good management quality. Joint venture banks in Nepal have maintained strong position regarding the ROE. The total loan to total deposit ratio of joint venture banks has been increasing over the years.

The objective of measure bank's performance through the financial indicators of banks were conducted which stated the result of indication to those variables that actually influenced the bank's performance. There is significant impact of CAMEL on financial performance. The R value of .927 indicates strong positive relationship between CAMEL and Financial performance. Similarly, R-square value of 0.860 shows that the independent variables explain 86% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent. Proper calculation and measurement of these indicator are important for maintaining bank's performance and growth. There is significant impact of CAMEL on financial performance. The R value of .927 indicates strong positive relationship between CAMEL and ROE. Similarly, R-square value of 0.850 shows that the independent variables explain 85% of the variance in the dependent variable. This means that CAMEL influence the financial performance to a large extent



### 5.3 Implications and Recommendations

The study revealed that assets quality ratio, earning ability and liquidity were key factors for driving the bank's performance of commercial banks of Nepal. For the commercial banks of Nepal through this research, it is suggested that managers must pay their due attention to these factors of CAMEL model.

- ) The ratio used may not suitable for the commercial banking situation in Nepal for the period of study. So, further study should use another ratio under the factor of CAMEL to test the best ratio in order to evaluate bank performance.
- ) Additionally, another factor should be considered for the next study, such as including corporate governance in the evaluation to get the various results for bank performance in Nepal. The sixth dimension of the CAMEL, sensitivity to risk is not included in this study so future researchers can also consider for their research.
- ) All the data used for analysis were based on secondary financial data so the future researchers can use the primary data such as interview to give more relevant perspectives to the actors of management efficiency and other financial indicators of CAMELS analysis.

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