

CHAPTER-I

INTRODUCTION

1. Background of the Study

Generally speaking, co-operation means thinking and working together. In its technical sense, it denotes a special method of doing business. The terminology "Co-operative" has been derived from the Latin word "Co-operari" Co means together and operari means to work. Thus, in ordinary sense co-operation means working together for a common goal or objectives. In broader perspective, it means self-help, mutual help and assistance. The motto behind co-operation is "each for all and all for each". It is a system of people voluntarily associated working together on terms of equality to get rid of their economic exploitation by intermediaries.

According to the definition of International Co-operative Alliance (ICA), "A Co-operative is an autonomous association of people united voluntarily to meet their common economic, social and cultural needs aspiration throughout a jointly-owned and democratically-controlled enterprise".

Co-operative organization is developed to remove defects of capitalism, to lesser competence, to prevent exploitation over people and to help the weak class people. Its ideology is tried to use in different possible area. In the beginning a success achieved as a consumer store, whereas now it is found in the field of vegetable production, seed production, tea & coffee production, sales and distribution, transportation, health, education, wood carving, metal carving, furniture, cottage industry, carpet industry, housing and other. Besides these, co-operatives provide access to microfinance service, saving & credit co-operatives are the example of it. Due to its nature, co-operative with limited banking service, saving and credit co-operative is also called credit union (CU) and recognized as microfinance institutions (MFIs).

Co-operative refers to work together for common benefit. A co-operative organization is that business organization which is established by economically poor people with a view to working in an organized way for their common economic upliftment. In other words, co-operative organization is an organization established by the economically

poor people for freeing themselves from the exploitation of the rich. It is a voluntary association based on the principle of self-help through mutual help. It has to satisfy two objectives i.e. services as well as profit. According to National Co-operative Federation co-operative is a form of business enterprises or community organization, incorporated in service to its members and users, in order to meet their common economic, social and cultural needs and aspirations. Co-operative is jointly-owned and democratically controlled by its members and users on the basis of one member, one vote. Co-operatives follow democratic, participatory and transparent decision making processes and organizational structures so that their members and users (i.e. owners, workers and consumers) may be directly responsible for benefiting themselves and the society in general. Co-operative is based on the value of self-help, mutual help, self-responsibility, democracy, equality, equity and solidarity. Co-operative members believe in the ethical values of honesty, owners, social responsibility and caring for others.

Co-operative is probably as old as civilization. Early, people had to learn to work together to meet their common needs. In 1752, Benjamin Franklin organized the initial structured co-operative business, a mutual fire insurance company in the United States, a group of 28 workers of the cotton mills in the town of Rochdale in the first modern co-operative business. The Rochdale equitable pioneers society in 1844. Co-operative is usually incorporated under State Law filling articles of incorporation granting them right to do business.

In Nepal, the concept of co-operative in the form of Guthi, Parma, Dhikuti, Dharmabhakari etc. has been used from very beginning in Nepalese societies. Characteristics of these historical social institutions are almost resembled with primary form of co-operatives. For the institutional development of such societies, the then government aimed to adopt co-operative system as a means for economic social and cultural development of the people as well as an appropriate and effective tool for rural development. The then government established the Department of Co-operative under the ministry of Planning, Development and Agriculture in 1953 A.D. (2010 B.C.).

The modern cooperative movement initiated from Rapti Valley (Chitwan District) as a part of flood relief and resettlement program. At the first time 13 credit co-operative societies established in 2013 B.S. were provisionally registered under the executive order of the government which got legal recognition after the enactment of Cooperatives Societies Act 2016B.S.(1959A.D.). The first Co-operative Societies Act

was revised several times and it was replaced by the Sajha Societies Act in 2041 B.S. (1984 A.D). After the restoration of multiparty democracy the Sajha Societies Act was replaced again by the Co-operative Act 1992. The Department of Co-operative has provided the authority for registration and regulations of co-operative societies/unions/federations under the Acts.

In Nepal, the cooperation had been evaluated in various senses from remote past. We had the use of Dharmabhakari and Dhikuti especially in the Thakalis, Mang in Newar communities, Parmo among the farmers in the village's growth in the socio-cultural practices and so on. In Nepal's context, Co-operative societies are incorporated under Co-operative Act, 2048 Co-operative cover a wide range of development services. They are not only limited to financial services. They provide access to micro finance services. They are not only limited to financial services and agriculture inputs and marketing services. In Nepal, co-operative was first established in 1953 (2010 B.S.) but came into existence only after six years of commencement i.e.1959 (2016 B.S.) which they called "Co-operative Act 2016". Later on, it was concerned into co-operative Act, 2048 by abolishing Sajha Santha Act.

Nepalese economy has influences along with the expansion of liberation and globalization the world. Nepal has acquired the membership of international monetary authorities and financial institutions such as World Bank (WB) and Asian Development Bank (ADB). After the restoration of democracy, the government implemented open and liberal economic policies, which encourages the private sector on investment. Successful operation and supervision of FI's isn't so easier at its entrance in liberalized financial market, where the government of any countries highly monitors and controls the financial industries. Financial institute's regulatory authority of any country has been monitoring and controlling financial sector with some valid indicators of financial health. Those indicators are not only facilitated of financial system of country but also international standards at global level which are directed by international institutions like WB/ADB to their member countries to return the financial sector and conduct regular health check up of financial industries through onsite and offsite supervision.

The Basel Committee on Banking Supervision of the Bank of International Settlement (BIS) has recommended using Capital Adequacy (C), assets Quality (A), Management Quality (M), Earning (E) and Liquidity (L) - CAMEL as criteria for assessing a FI in 1988 (ADB, 2002). The sixth component market risk (S) was added to CAMEL in

1997 (Gilbert, Meyer and Vaughan, 2000). CAMEL frame developed by regulatory authority of US Bank, is a common method of evaluating the soundness of FIs. Most of the countries are using this system to check up the health of individual FI. In Nepal, Nepal Rasta Bank, an apex regulatory authority of FI's uses CAELS system for assessing the financial soundness of banks which is already mentioned. Accordingly it ranked the banks at first time, based on statistics of third quarter of the FY 2061/062. However the office of inspector generals (OIG) audit report USA (September, 2002), replaced CAEL with SCOR (Statistics CAMELS Offsite Rating) for review program of the FDIC supervised banks. SCOR uses quarterly reports of condition and income (call reports) to rate institutions.

Oriental Co-operative Limited (OCL) is an independent autonomous co-operative limited. It was established in 2053 B.S., Chaitra 4, under co-operative limited act, 2048 B.S. OCL is situated in Nayabazar, Pokhara. It has ten branches and one sub-branch within the boundary of country. The main objectives of OCL is to collect dispersed saving of the people or members, covert them into capital and lend them to the initiators, and institutional borrowers. Moreover, it provides facilities of underwriting shares, accepting guarantees collecting deposit, providing loans to the members their groups and so on. Being a co-operative in nature, its all shares are held by its members. The Board of Directors constitutes of seven members. All the decision regarding its operation is taken by the efficient and experienced Board of Directors members. Likewise, its daily activities are operated by capable staffs and computers to render quick and qualitative services its members. OCL has become successful to earn profit and render service to its member from its beginning. It has contributed a lot for development and betterment of people, society and national economy as a whole.

2. Statement of the Problem

The main objective of a financial Institution is to increase its returns for its owners which often come, however, at the cost of various increased risk: Credit Risk, liquidity Risk, Interest Rate Risk, Interest, Market Risk, Off-Balance Sheet Risk, Foreign Exchange Risk, Country Risk, Technology Risk, Operational Risk and Insolvency Risk. The government owned banks in Nepal are almost running in loss. It is also very difficult to call the private sector banks sound though they are earning profit since they may be exposed to aforesaid risks. Questions are being raised over the validity of their balance sheet and profit and loss account. Should the suspicion come true? It will prove very costly to the depositors, creditors and national economy as a whole In view of this it is important that financial institutions manage these risks and have appropriate policies, processes, or practices in place that management follows and uses. Under this fact, the proposed study will be a reasonable. The researcher undertakes a study on financial performance analysis of OCL in the framework of CAMELS. The elementary problem of this research is to scrutinize the financial condition of OCL in the framework of CAMELS. Thus, this study will attempt to address the following research questions.

-) How is OCL managing its capital adequacy? Is it in line with the regulated minimum capital requirement?
-) What is the level, trend of Asset Composition and Risk Weighted assets of OCL and what is the co-operatives quality of loans and Loan provision mix?
-) How OCL is managing their expenses with respect to revenues? What control and monitoring mechanism are maintained in the co-operative?
-) What are the level, trend and stability of OCL earning?
-) Is the OCL's liquidity position adequate in consideration of the current level and prospective sources of liquidity compared to funding needs?
-) How changes in interest rate can affect co-operative earnings?

3. Objectives of the Study

The national and international economy has undergone through drastic changes over a decade .The threats imposed by Nepalese economy, have made it imperative to search for opportunities in order to curb any hindrances to the economical development. Because of the importance and relevance of co-operative in shaping the economy, it has become important to review the co-operative industry and its business strategies. In line with the statement of problem, the main objective of this study is to analyze the financial condition of OCL and other specified objectives of the study are as follows:

-) To analyze Capital Adequacy of OCL.
-) To analyze the level, trend of asset composition, Risk Weighted Assets and quality of Loans and Loans provision Mix of OCL.
-) To evaluate the co-operative managing their expenses with respect to revenues.
-) To evaluate the level, trend and stability of OCL's earnings.
-) To assess OCL's liquidity position.
-) To assess sensitivity of co-operative earnings to interest rate risks?

4. Significance of the Study

Research itself has its own importance because it aims to gain knowledge and to add the new literature in existing field. The significance of this study lies mainly in filling a research gap on the study of financial analysis of co-operative in the framework of CAMELS with the respect to Oriental Co-operative Limited.

This study will help to reveal the financial position of the co-operative and it occupies an important role in the series of the studies of co-operatives. It will also help to shareholder and management committee of co-operative to know the actual clear vision of the policy adopted by the co-operative for better improve financial position and effective utilization of the fund.

This study may be important for researchers, scholars, investors, co-operative sector, students, government and other parties. So, it will be helpful to those who want to study in further detail and widely in the field. Similarly, the study encourages the general public where to invest further or not and depositors can take decision to deposit on their money.

5. Delimitation of the Study

The study will be based on a case study on financial performance analysis of OCL in the framework of CAMELS, which may not represent the overall financial position of the co-operative. Basically, the study is limited within the following factors. The study is not carrying out in micro level study on financial performance due to time and budget constraints. There are some limitations in this study. This study may not be able to expose every aspects of the topic. The study has following limitations:

-) This is basically will depend on secondary data collection from the co-operative, financial statements, publications and journals. Data of last five years only has taken into consideration to conduct the study.
-) The study mainly deals with financial performance analysis of Oriental co-operative in the framework of CAMELS. As the subject matter is concentrated on the given topic, other subject matter is not touched.
-) The study is simply a partial fulfillment of MBS degree.

6. Organization of the Study

The whole study will be divided into five chapters introduction, review of literature, research methodology, data analysis and presentation and summary, conclusion and recommendations.

Introduction will be presented in the first chapter. It will divide into eight sub topics. They are background of study, brief profile of OCL, focus of study, statement of problem, objectives of study, significance of the study, delimitation of the study and organization of the study.

Second chapter deals with the Review of Literature. It contains conceptual framework and review of related study, Journals, books, Articles and unpublished dissertations related to the study have been reviewed under this topic.

The third chapter will be related to the research methodology, which presents research design, population and sample, nature and source of data, data collection procedures and techniques, data analysis tools and limitations of the methodology.

Chapter fourth deals with presentation and analysis of data through a definite course of research methodology. This chapter is to analysis different financial ratios and statistical analysis related to study.

The final chapter will give summary, conclusion and recommendations that explain the major findings and some solid suggestions for improvement to the concerned institution.

CHAPTER–II

LITERATURE REVIEW

2. Literature Review

Many researchers have conducted their research in the field of cooperative especially on their financial performance analysis. Besides this, there are some books, articles, journals and other relevant studies concerned with the aspects of financial performance analysis which will be taken as the literature review for the study. Some of the relevant studies, their objectives, findings and conclusions and other literature relating to the topic will also be reviewed in the study.

2.1 Conceptual Review

Generally speaking, co-operation means living, thinking and working together. In its technical sense, it denotes a special method of doing business. The terminology "Co-operative" has been derived from the Latin Word "co-operari". Co means together and operari means to work (Dhal, 2007). Thus in ordinary sense co-operation means working together for a common goal or objectives. In broader perspective, it means self-help, mutual help and assistance. The motto behind co-operation is "each for all and all for each". It is a system of people voluntarily associated working together on terms of equality to get rid of their economic exploitation by intermediaries.

Thus co-operative is associated with human being in every step of life. It may be compared with birds, beasts and insects etc. It teaches us to maintain disciplined life and co-ordination among each other. From ant community we get the indication of instinctive co-operation. The story "Doves and Hunter" teaches us that life can be saved when we are united. The term co-operation has several meanings and it is difficult to convey the correct meaning of co-operation. Its meaning has varied from thinker to thinker and from one sphere of human activity to the other. To the sociologists, it is a socio-economic movement; for the socialists, it is a social order in which man is free from class struggle. According to economists, it is a form of business organization in which there is no scope of being exploited by middlemen and lawyers take it to be an organization in whose membership one enjoys "the special privileges and concession conferred by law" (Hajela, 2005). Bhide has defined "co-

operative represents itself as a happy means between the forces of extreme individualism on one hand and socialism and communism on the other. It stands for individual rights tampered by consideration of justice, equity and fair dealing between man and man ,and its one great aims is to prevent the exploitation the weakens by the stronger party (Bhide, 2005)".

‘H. Calvert’ defined co-operative as “A co-operative from organization wherein persons voluntarily associate together as human beings on basis of equality for the promotion of economic interest of themselves”. The definition given by international labor organizations covered most of the principles of co-operation so it can be considered to be the most comprehensive one. Co-operative society is “An association of the economically weak who voluntarily associates on the basis of equal rights functions, corresponding to one or other economics needs which are common to them all, but which each of them is unable to satisfy fully by his/her own individual efforts and manage and use such undertaking in mutual collaboration to their common material and moral advantage”. The progress of co-operative movement has been quite slow and in some countries it is even slow. In the constitution of Nepal, it has been resolved to secure to all the citizens of Nepal justice, social economic and political. As such, co-operative societies have been given an important place in the constitution. Economic development and social changes are equally vital elements in the reconstruction of Nepal’s socio-economic structure. Co-operation is one of the principal means for bringing about changes of a fundamental nature in the country. As such co-operative development has got priorities and various have been made by government through various economic plans to propagate the idea of co-operation in the country.

Thus, on the basis of foregoing explanation, the characteristics of co-operation can be listed as: a) It is an association of individuals for the achievement of a common objective b) It embodies in itself certain ideologies such as self help, mutual assistance and team spirit, c) It aims at common welfare, d) It clearly indicates that there are certain task which cannot be performed at individual level, e) It teaches us unity is Strength, f) It involves a spirit of dedication and honest service, and g) It is a business organization.

2.1.2 Principles of Co-operatives

Generally, principles refer to the code of conduct that governs the life and activity of human beings. Similarly, co-operative principles are the set of rules and regulations to

regulate and govern the activities of co-operative enterprise. All the co-operatives are guided by its principles. Co-operative principles are the set of rules and regulations to regulate and govern the activities of co-operative enterprise. Every economic system is based on certain fundamental principles. Co-operative as an economic system is not an exception to these principles.

Due to the rapid changes in the economy of the world, the need for review of this principle was increasingly felt. International co-operative alliance (ICA) has undertaken three reviews of the co-operative principles: 1937, 1966 and 1995. These reviews modernized the idea of co-operation, maintained its relevance and provide an up-to-date test of whether an organization qualified to call itself a co-operative. The definition of a co-operative as established in the 1995. Co-operative Principles has been included a number of policy documents including the United Nations Guidelines, the international labor organization recommendation 1937 On the promotion of co-operatives. In 1963, the ICA had reviewed the principles the existing principles and the committee enunciated the following principles which have commonly adopted all over the world.

Broadly speaking, there have been three types of co-operative systems, which are based, more or less, on the same principles, but differ from each other in the mode of the operation. The three systems are: 1) Rochdale system, 2) Raiffeisen System and 3) Schulze-Delitzsch System.

The first system was concerned with consumer, the second with the farmers and the third with traders. The Rochdale Pioneers laid emphasis on cash transactions, whereas Raiffisen and Schulze-Delitzsch organized co-operatives as credit organizations. Despite the operational difficulties of these systems, it is interesting to note that all types of co-operatives have the some philosophical basis. The principles that have been commonly adopted all over the world are those, which are laid down by Rochdale Pioneers. This includes:

-) Voluntary and open membership
-) Democratic Member Control
-) Member Economic Participation

- J Autonomy and Independency
- J Education, Trading and Information
- J Co-operation among co-operatives
- J Concern to society

The international Co-operative alliance prescribed the following seven principles of Co-operation.

1st Principle: Voluntary and Open Membership

The first of the Rochdale principles states that Co-operative societies must have an open and voluntary membership. According to ICA's Statement on the co-operative identity, "Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination".

2nd Principle: Democratic Member Control

The second of the Rochdale Principles states that Co-operative societies must have democratic member control, According to the ICA's statement on the Co-operative Identity, "Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organized in a democratic manner".

3rd Principle: Member Economic Participation

Member economic participation is one of the defining features of Co-operative societies, and constitutes the third Rochdale Principle in the ICA's Statement on the Co-operative Identity. According to the ICA, Co-operatives are enterprises in which "Members contribute equitably to, and democratically control, the capital of their co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible: benefiting members in proportion to their

transactions with the co-operative; and supporting other activities approved by the membership".

4th Principle: Autonomy and Independence

The fourth of the Rochdale Principles states that Co-operative societies must be autonomous and independent. According to the ICA's statement on the Co-operative Identity, "Co-operatives are autonomous, self-help organizations controlled by their members. If they enter to agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy".

5th Principle: Education, Training and Information

The fifth of the Rochdale Principles states that Co-operative societies must provide education and training to their members and the public. According to the ICA's Statement on the Co-operative Identity, "Co-operatives provide education and training for their members, elected representatives, managers and employee so they can contribute effectively to the development of their co-operatives. They inform the general public-particularly young people and opinion leaders-about the nature and benefits of co-operation".

6th Principle: Co-operation among Co-operatives

The sixth of the Rochdale Principles states that Co-operatives co-operate with each other. According to the ICA's Statement on the Co-operative Identity, "Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures".

7th Principle: Concern for Community

The seventh of the Rochdale Principles states that Co-operative societies must have concern for their communities. According to the ICA's Statement on the Co-operative Identity, "Co-operatives work for the sustainable development of their communities through policies approved by their members".

2.1.3 Global Perspective

In the early day in Great Britain, Co-operative movement contributed for the economic development. At the beginning of the 19th century, Robert Owen gave the idea of co-operative, but it was practically developed by a group of Rochdale pioneers called the “Customer Society”. This was a successful co-operative society, which was started all over Great Britain, this society sold goods only for its members in the beginning, but later it started to sell goods to non-members also.

Rochdale Principles of co-operative discussed in co-operative literature throughout the world are open membership, democratic control, distribution of surplus in proportion to purchase-limited interest on capital, religious and political neutrality cash trading, promotion and education. Although there have in extend hundreds of societies but the truth is that it was the Rochdale pioneers society that achieved tremendous success and put economic and social life to Britain on the read of continuous progress.

In 1919, the first co-operative collage in the world was established in Manchester. It is administered by the education committee of the co-operative union and open for the students from all parts of world. After the achievement of co-operative society, it was recognized in 1944. The government of the Great Britain decided that boys and girls must attend a country collage after learning school. The main motto was to produce good co-operative citizens with in the Great Britain.

Likewise, the idea of co-operative was suggested by two German at the time Rochadale Pioneers and they started their co-operative work in Germany after few years for improving the coordination of the poor peasants. Friedrich Raiffeisen successfully tried to help those poor peasants through agriculture credit co-operative societies by the other Germany co-operation was Freiz Schulze Delizsch who opened the co-operative bank to help the Germany people .there was little difference between these two Germany co-operative societies in 1849 and both ran successfully.

The successful co-operative movement in Germany and Britain followed it by other countries of the world. All of the developing countries as well as developed countries felt that co-operation might be one of the best instruments for uplifting the rural poor and liberating them the exploitation of landlords and moneylenders.

Denmark is the homeland of agriculture co-operation in the world. A local Pastor, Rev. Hans Christian, Started the co-operative movement in 1861 at thirsted in Juland. After the visit of England they established co-operative stores in 1868. In 1882, the first co-operative dairy was established and in 1887 the first balloon factory was established in Denmark. Today, the co-operative dairies occupy the front position in the Co-operative of Denmark.

In Switzerland, 'Daisies' started the co-operative movement. The various co-operative stores organize Swiss agriculture and numbers of food societies were also formed in 1851 other contributions of co-operatives to young people of Switzerland in 1934. By all this people of Switzerland realized that co-operatives provides many things to them.

In Canada, co-operative movement was started by 'Lancashire' Iron and steel workers. The government of Canada organized co-operative butter and cheese factories in 1891 and united Fruit Company also established. But there was no progress until 1937, due to build of warehouse by the co-operative who checked the fruits from the destroyed. One of the remarkable and successful contributions of Canadian co-operative society of 'Nova Scotia'.

In Japan, after the second half of the 19th century co-operative movement was started. This movement seems to have been influenced by the European Co-operative movement. The Credit (loan) co-operative in modeled on the British co-operative. The Japan Agriculture multi co-operative organization takes an important position in co-operative movement, through in low level; we find a vital role of the government. In the movement the government invests funds and grants, which directs the organizations.

As the co-operative movement took place in different countries, the International co-operative congress established International Co-operative Alliance (ICA) in London on August 1895, ICA is an independent Worldwide International association of co-operative organizations of all types. ICA has the affiliation in 102 countries with 256 national and 4 international level organizations as members serving well over 800 million individual members worldwide. ICA collaborates with several United Nations

agencies, including the International Labor Organization (ILO), Food and Agriculture organization (FAO) and the council for trade and Development (UNCTAD). ICA enjoys category-1 Consultative Status within the United Nations C\Economic and Social Council (UNECOSOC).

Similarly, in the early 1970s, World Council of Credit Unions, Inc. (WOCCU) was established. WOCCU has become the world's leading advocate, platform for knowledge exchange and development agency for credit unions on an international level, delivers the "Sound and Safe" credit unions on an international level, legislators, regulators, donors, credit union projects with proven, tangible results. The PEARLS system was originally designed and implemented with Guatemalan CUs in the late 1980s. WOCCU has been using it worldwide to monitor the performance of CUs. The target goal, or standard of excellence for each indicator is put forth by the WOCCU based on its field experience working to strengthen and modernize credit unions and promote savings-based growth.

2.1.4 Nepalese Perspective

In Nepal, co-operation is not a new concept. We are already familiar with the main theme of co-operative principles. Self help, mutual help, co-operation among people is very old theme. It is developed with the development or along with development of human civilization.

In Nepal, we have found our own type of co-operative principle in earlier period. The different types of traditional co-operative organization include "Dharma Bhakari", "Dhikuti" and "Parma". They still exist in the mountain villages. These forms of mutual co-operation and self help show that voluntary effort in respect of economic activities is not a foreign element to the Nepalese economic context. Similarly "Manka Jaya", or "Manka", "Guthi" are also ancient forms of co-operation. However, the co-operative in a modern concept in Nepal is a modified concept. Thus, various forms of informal co-operation (i.e. Dharma Bhakari, Parma and Hurt) were used in different parts of the country. Still it is not found the actual time of its origin in Nepal by date. The history of organized co-operative in Nepal is of recent origin. Its history can only be traced back to about 55 years old. Formally, the history of co-operative movement in Nepal was developed after the Ministry of Agriculture for the promotion, supervision and evaluation of co-operative societies.

In the beginning co-operative movement in the real sense was greed up with the establishment of “Bakhan Saving and Credit Co-operative Ltd”. In Rapti valley, Chitawan in 1956 as part of the resettlement program for the flood stricken people in Rapti dun basis under the active support of United States agency for International Development (USAID) on experimental basic. These co-operatives were previously registered under an executive order of Government of Nepal.

Considering the importance of necessary rules and regulations for managing and guiding co-operatives effectively and efficiently, the first Co-operative Act was promulgated in 1959, which provide legal entity among things, to all co-operatives registered under the executive order.

Consequently co-operative society rules, 1961 were promulgated which prompted the Co-operative Act numerical growth of the co-operatives boomed up. In the mean time, the co-operative activities were tied up with the so-called revolutionary many land reforms program. In later dates, the guided co-operative program was introduced which followed a rapid merging process. In 1969, the management of co-operative was entreated to the agricultural development bank of Nepal. The number of co-operative registered with the concerned department increased gradually and by the end with the concerned department increased gradually and by the end of F.Y. 1970/071 reached to be about 1500.

During the period, a Co-operative Development Fund (CDF) was established to finance co-operative for leading to their members. In order to provide broader spectrum of supervision, guidance and leading to co-operatives a co-operative bank was established in 1963. Within a short period of establishment, the co-operative bank suffered heavy financial losses because of misuse and fraud in the operation of its member co-operatives. This led to the establishment of Agriculture Development Bank and dissolution of Co-operative bank in 1970 with all the assets and liabilities under the formal control. In the early seventies they were redesigned as ‘Sajha’. The Co-operative Societies were also subjected to various agencies regarding management and control. This did not last long. They were handed over back to the co-operative development.

After the restoration of democracy in the country in 1990, it paved the way for new changes in the co-operative movement, consequently new co-operatives as people's organization with an autonomous body. On the basis of Act long a waited National Co-operative Federation came into existence in June 20, 1993.

Soon after the reinstatement of democracy in 1990, the interim government formed a National level Co-operative Confederation Advisory Committee. The committee made on an in depth analysis of the problems teaches by the co-operative movement and which emphasis on the need for promoting co-operatives in the line with co-operative principles and democratic values. The government and subsequently eleven members National Co-operative Development Board (NCDB) was formed by government of Nepal in august 1991 studied the committee's report. The board was formed with initial task of formulated co-operative policies and new legislation, to set up the structure of co-operatives in different sectors and for creating the necessary foundation for facilitating the process of co-operative development. There have been several commissions and Task Forces include Consultative Committee for national Co-operative Federation, 1990; Study on Improvement on organizational structure of co-operative development 2000; and high level co-operative sector improvement committee, 2004; legal framework and institutional development study of saving and credit co-operative society and National Co-operative Bank by Ministry of Finance 2004.

Co-operative Bank was established in 9th July, 2003 with the aim to provide financial services to all the co-operatives issuing share and making member to co-operatives. Within the four years period of establishment it is not capable to include most of the co-operatives of Nepal and facing problem in including all the co-operatives and extension of branch office in major parts of Nepal. For the supervision of co-operative, training office combining with division co-operative office in Kailali, Surkhet, Kaski and Chitwan in 2005 and 2006, being the 50 years of formal establishment of Co-operative in Nepal, co-operative golden jubilee was celebrated all over the country.

2.1.5 Rules Regarding to Co-operative in Nepal

Most of the countries in the world had already issued proper law for smooth operation of Co-operative organization. Britain had issued industrials and provident societies Act in 1952 A.D. this is the first co-operative act in the world. In 1904 A.D. Co-operative has given legal framework in India. The modern co-operative movement was begun from since 2010 B.S. in Nepal. The first co-operative society act came in effect in 2016 B.S. development process of co-operative law in Nepal is given as follows.

Co-operative organization Act, 2016

To develop mutual co-operative, economic development, self –reliance and elimination of poverty, Co-operative act 2016 was come in effect .It was published in gazette on 3rd Ashar of 2016 B.S. and began from 9th Kartik of 2016 B.S. This is the first Co-operative Act of co-operative movement in Nepal. People above 16 years, having more than 25 members could register co-operative organization. For saving and credit co-operative members had been same place or same aim and profession could register organization. After the issuance of Co-operative Rules 2018, operation and control of co-operative organization became very easy.

Co-operative Bank Act, 2019

Co-operative Bank Act 2019 has issued to provide easily loan to co-operative organization. After issuance of Co-operative Bank Act in 2024 B.S. Co-operative Bank was established in 18th Bhadra 2020 B.S. After in 2024 B.S., Co-operative bank was merged in Agriculture Development Bank.

Constitution of Nepal, 2019

Third amendment of constitution of Nepal had given acceptance to Co-operative. It has emphasized co-operative as a formation to Development of industry and commerce.

Sajha Sanstha Act 2041

Sajha Sastha Act had come in effect in 2041 B.S. This Act has managed the following provision.

-) Industrial Sajha having 15 or more than 15 members.
-) Others sasjha organization having 24 or more members.
-) District sajha union organization having 25 or more members.
-) National Sajha Union having 15 or more districts Sajha Union.

Co-operative Act, 2048

After the restoration of democracy in 2046 B.S. Co-operative act 2048 has come in effect. The new legislation recognized the democratic character of co-operative movement. Based on this Act Co-operative rules 2049 has come in effect. This Act has given the independence of co-operatives organization on their members. According to this Act, co-operative must have at least 25 members and should be follow co-operative rules and regulation. Apart from above mentioned these acts, National Co-operative development Board Act, 2049 and Privatization Act, 2049 also has been come in effect.

2.1.6 Saving and Credit Co-operative in Nepal

Nepal hasn't able to make separate saving and Co-operative Act till now. After the political change in Nepal in 1990 A.D. Co-operative Act 1992 came in effect. According to section 26 of Co-operative Act 1992, saving and Credit co-operative movement has been exercising in Nepal. There are four kinds of saving and credit organization in Nepal. They are as follows.

) Traditional Saving and Credit Co-operatives

These kinds of saving and credit Co-operatives encourage their members to save and collect saving from them. It provides debt to members for production and consumption functions. The main purpose of establishing these kinds of co-operative is to develop socio economic condition of members.

) Multipurpose saving and credit co-operative

These kinds of co-operative have different kind of functions. In addition to other Function, this kind of co-operatives provide saving and credit facility to their members.

) Banking Co-operative

These kinds of co-operative are established according to section 26 of co-operative act 1992. This type of co-operatives can conduct limited banking

activities after obtaining approval from NRB. Nepal Rastra Bank has given them only to saving and credits facilities. NRB has issued following provisions for these types of co-operatives.

- ✓ These type of co-operative can collect saving and provide debt to both members and other general people.
- ✓ These co-operatives can provide limited banking facilities.
- ✓ Co-operatives can't accept overdraft and foreign currency.
- ✓ Co-operatives can't give current account facilities.
- ✓ Co-operatives are able to accept saving land credit to ten times paid up Capital and one person can issue debt only 10% of total paid up capital.
- ✓ Co-operatives have to manage 10% liquidity fund of total collection.
- ✓ To conduct banking facilities, co-operatives have already provided saving and credit not more than 6%
- ✓ To conduct banking facilities, co-operatives have already provided saving and credit facilities in rural area.

) **Financial Co-operatives**

These co-operative have established according to sub section no.1 and section 26 of Co-operative Act 1992. The organization which can accept saving from general and provide loan to agriculture, industry or specific economic provision is call financial instruction. These types of co-operatives have limited right to provide financial activities.

2.1.7 Current Issues and Challenges of Co-operative

These have been several commissions and task forces formed for studies in the field of co-operatives. Such commissions and task forces include consultative committee for national co-operative Federation,1990; study on improvement of organizational structure of co-operative sectors,1999; Task force for suggestions for co-operative development,2000; and High level co-operative sector improvement committee,2004. All of the above committees have identified challenges of the co-operative sector and provide their recommendations to overcome them. The challenges identified are mostly too general and focus on what the government should do. The Challenges identified in these reports include but limited to:

- ✓ Confusion in national vision of co-operative sectors.
- ✓ Lack of identify of co-operatives.
- ✓ Lack of professionalism.
- ✓ Too small membership to gain economy of scale.
- ✓ Lack of creditability.
- ✓ Lack of capacity of government to monitor.

They are all true. But there are different challenges within the different types of co-operatives. To quote an example, saving and credit co-operative societies are not registered by the department of co-operative since last few years. Other types of co-operatives are not facing these challenges. There are number of Challenges that the co-operatives of Nepal are facing. Among them here are some of them.

) **Structural Reforms**

In order to make co-operatives competitive and free from government control, some of the cooperators have started for advocating conversion co-operatives into co-operative companies just on the lines of the joint stock companies. The question is whether change of co-operatives into a co-operative company would be in opposition to achieve the objectives and philosophy of co-operatives. As an experience in other countries shows, such steps had subsequently placed co-operatives in the hands of private sector who bought them. More incorporation of principles of co-operation in the articles of association and memorandum of association as prescribed under company law would not be a guarantee to maintain co-operative character. There is every possibility that over a period of time, these called Co-operative companies would be totally divested of co-operative character and would lose their identity in the vast multitude of private sector enterprises. Therefore it is strongly felt while discussing structural reforms, co-operative content should be focus on our attention.

) **Membership and Leadership**

The success of co-operative enterprise depends on loyalty of their membership based on commercial benefits and harmonious relationship between members and elected leaders. The changed scenario would call for complete restructuring of co-operative unions if they want to play a very effective role to safe guard the interests of co-operatives.

) **Lack of Adequate Monitoring**

There is very limited institutional capacity of co-operatives to self regulate. At the same time the capacity of department of co-operatives to monitor also is almost non-existent. NEFSCUN too has limited capacity to monitor and cannot monitor those co-operative that are not its member because of the above the qualities of financial services are negatively affected. For some instance there have been cases where some official's pf urban based credit co-operatives misused the funds of co-operatives and ran away.

) **Resources Mobilization**

The co-operative broadly raises their funds from the following sources as; a) members b) Capital Market operation, c) Money market operations) Borrowings from government ,e) Borrowing from banks and financial institutions, f) Share capital and reserves and g) deposit. However, major sources of their funds are equity contributed by the government and the members; borrowing from the members and resources raised from the money market. The shares of co-operative are not tradable and listed in stock exchange.

) **Diversifying Financial Services**

Most of the saving and credit co-operatives have not been able to diversify their financial services. They remain in providing saving and credit services within limited numbers of saving and loam products. Other competitors of saving and credit co-operatives have started providing micro insurance and even money transfer services. This may, in long run, stat membership dropouts in co-operatives.

) **Trade and Technology**

In the changed scenario benefit of trade and technology are generally going to private sector. Neither co-operatives are not enthusiastic and responsive towards mobilization of benefits of trade nor does technology flow or government pay any attention toward this aspect. Most of the foreign collaborations in different fields are in the private sector.

) **Government Support**

It should create an environment by providing level playing field to co-operative to operate in market economy .Therefore; the co-operative legislative framework should be immediately reshaped and readapted. Secondly, the benefits of the specific public and private sector's enterprises should also go to co-operative enterprises.

) Lack of Clear Vision of Promoters of Saving and Credit Programs

In Nepal almost all government and non-government organizations have included saving as a component of their various development programs such as literacy group, health group, forest user's group, mother's group, irrigation user's group, agriculture production group formation is completed the saving and later credit component continues and as the groups grow, the technical assistance need for these groups increases, which in most cases are not provided by the promoters.

2.1.8 Financial Performance Analysis

Financial performance analysis is a process of identifying the financial strength and weakness of the firm by properly establishing the relationship between item of balance sheet and the profit and loss account. It is undertaken to assess the financial strength and weakness of the firm. The analysis is usually based on financial statement prepared by the firm. Financial analysis serves as the basis of decision making. Moreover the analysis is also made to find out whether to use debt or equity funds to finance planned plant expansion. Financial analysis uses data contented in the firm's financial statement supplemented by the statement of cash flows. Furthermore, it summarized the large quantity of financial data and makes qualitative judgment about the firm' financial performance. The primary tools of financial performance.

2.1.9 Concept of "CAMEL" Rating System

Federal Reserve Bank of New York (1997) has defined the component of CAMEL as rating system which produces a composite rating of an institution's overall condition and performance by assessing five components: Capital Adequacy, Assets Quality, Management of Administration, Earning and Liquidity. The CAMEL was later updated with inclusion of sixth components Sensitivity to market Risk now is referred to as the CAMELS rating system.

The CAMELS rating system is subjective. Benchmarks for each component are providing, but they are guidelines only, and present essential foundations upon which the composite rating is based. They do not eliminate consideration of other pertinent

factors by the examiner. The uniform rating system provides the groundwork for necessary supervisors to be reasonably compared and helps institutions supervised by all there US supervisors to be reasonably compared and evaluated rating of a financial institution's financial condition. The ratings are assigned on a scale from 1 to 5. The CAMELS rating are commonly viewed as summary measures of the private supervisory informant gathered by examiners regarding financial institution's overall financial conditions, although they also reflect available public information.

The most important criteria for determining the appropriateness of FIs to act as financial intermediary are its solvency, profitability and liquidity. In the respect, the vagaries of business condition and are resistant to outside influences such as economic instability in their trade area. These FIs are in substantial complexity and profile and give no cause for supervisory concern.

Composite 1: FIs in this group are sound in every respect and generally have components rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. These FIs are the most capable of with standing the vagaries of business conditions and are resistant to outside influences such as economic instability in their trade area. These FIs are in substantial compliance with laws and regulations. As a result, these FIs exhibit the strongest performance and risk management practices relative to the institutions size, complexity and risk profile and give no cause for supervisory concern.

Composite 2: FIs in this group fundamentally sound. For a FI to receive this Rating, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within the board of directors and management's capabilities and willingness to correct. These FIs are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity and risk profile.

Composite 3: FIs in this group exhibit some degree of supervisory concern in one or more of the component areas. These FIs exhibit a combination of weaknesses than may range from moderate to severe: However, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. FIs in this group generally are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these FIs may be in significant noncompliance with laws and regulations.

Composite 4: FIs in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. FIs in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems.

Composite 5: In this group exhibit extremely unsafe and unsound practices or conditions exhibit a centrally deficient performance, often contain inadequate risk management practices relative to the institution's size, complexity and risk profile are of the greatest supervisory concern. The volume and severity of problems are beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in other for the FIs to be viable. Ongoing supervisory attention is necessary. Institutions in this group pose a significant risk to the deposit insurance fund and failure is highly probable.

2.1.10 CAMELS Components

Each of the components rating description in the FFIEC press release (1996) is divided into three sections: an introductory paragraph a list of the principal evaluation factors that relate to that component and a brief description of each numerical rating for that components to reinforce the evaluation factors are reiterated under one or more of the other components to reinforce the interrelation between components. The listing of evaluation factors for each components rating is in no particular order of importance. The description of the CAMELS components are made as under based on the FFIEC press release (1996).

2.1.10.1 Capital Adequacy

Bank capital performance several important functions. Most importantly they are: Absorbs Losses: Capital allows institution to continue operating as going concern during periods when operating losses or other adverse financial results are experienced.

Promotes Public Confidence: Capital provides a measure of assurance to the public that an institution will continue to provide financial services even when losses have been incurred, thereby helping to maintain confidence in the banking system and minimize liquidity concerns., Restricts Excessive Asset Growth: Capital along with minimum capital ratio standard restrains unjustified assets expansion by requiring that asset growth be funded by a commensurate amount of additional capital.

Capital is necessary for the cooperative to operate. While many areas of a bank are important and subject to scrutiny, capital adequacy is the area that triggers the most regulatory of capital adequacy, which are:

-) The Tier 1 Risk – Based capital ratio.
-) The total risk-based capital ratio
-) The tier 1 leverage ratio

The capital adequacy of an institution is rated based upon, but not limited to an assessment of the following evaluation factors:

-) Size of the bank.
-) Volume of inferior quality assets.
-) Bank's growth experience, plans and prospects.
-) Access to capital markets.
-) Non –ledger assets and sound values not shown on books (real property) at nominal values, charge – off with firm recovery values, tax adjustments.

The FDIC improvement Act. of 1991, which created a link between enforcement actions and the level of capital, held by a bank. This supervisory link is commonly known as prompt Corrective Action (PCA) and aims to resolve banking problems early and at the least cost to the bank insurance fund. PCA has classified the banks as:

Well – Capitalized: To be considered well- capitalized, a bank will meet the following conditions:

-) Total risk based capital is 10 percent or more.
-) Tier 1 risk based capital ratio is 6 percent or more.

Starting with its publication of International Convergence of Capital Measurement and Capital Standards in July 1998, popularity known as BASEL I Capital accord, BCBS set out a minimum capital requirement of 8% for banks. Prior to that, the committee introduced 25 core principles on effective banking and FIs supervision. In 1996, the committee incorporated market risk in the 1988 capital accord. With a major revision of the 1988 accord, there followed by the revised publication of the committee's first round of proposals for revising the capital adequacy framework in June 1999 popularly known as BASEL II capital accord. Since then, it is revised in January 2001, April 2003 and released its final revised framework updated in November 2005. In this accord, the concept and rationale of the three pillars (minimum capital requirements, supervisory review and market discipline) approach was introduced, on which the revised framework is based. In the revised framework, BCBS retains key elements of the 1998 capital adequacy framework, including the general requirement for banks to hold total capital equivalent to at least 8 percent of their risk-weighted assets; the basic structure of the 1996 market risk amendment regarding the treatment of market risk; and definition of eligible (BIS, 2005).

The new BASEL capital accord (BASEL II), shall be applicable to internally active banks all over the world with effect from end of 2006. Implementing the new accord in Nepal has been a challenging task for the supervisors as well as FIs. Hence, certain preparatory homework is needed to Nepalese financial system to implement BASEL II. NRB and FIs need to have coordinated effort efficiency in Nepalese banks and FIs to establish certain baseline for the effective implementation of BASEL II. In this regard, second interaction program was held in Nepal with the FIs executive to make them aware of the new development. The commercial banks so far has shown positive attitude towards the implementation of BASEL II. "New capital accord implementation preparatory core committee" was drafted NRB's concept paper on new capital accord". According to the program of new capital accord implementation, concept paper was forwarded to all the commercial banks for comments and recommendations. A form was also developed so that commercial banks classify their exposures as per the new approach, which was reviewed by the 'BASEL II implementation working group'. NRB has adopted BASEL core principles for effective supervision as guideline for supervision for commercial banks. Core principle methodology adopted by BCBS provides a uniform template for both self-

assessment and independent assessment. It involves four parts qualitative assessment system: compliant, largely compliant, materially non-compliant and non-compliant. For each principle essential and additional criteria must be met without any significant deficiencies. A “largely compliant” assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority’s ability to achieve the objective of that principle. A materially non-compliant assessment is given when the shortcoming is sufficient to raise doubts about the authority’s ability to achieve compliance, but substantial progress towards compliance has been achieved.

There is no doubt that the new accord though complex carries a lot of virtues and will be a milestone in improving banks internal mechanism and supervisory process and beneficial to the commercial banks.

Capital Adequacy Norms by NRB

NRB has from time to time stipulated minimum capital fund to be maintained by the FIs on the basis of risk weighted assets. The total capital fund is sum of core capital and supplementary capital. According to the NRB unified directives for Banks and non-banks FIs issue number E.pra.Ni.no.01/061/062 (Ashar 2062 BS); the capital funds of a bank comprise the following:

Core Capital: Core capital of a bank includes paid up equity, share premium, non-redeemable preference shares, general reserve and accumulated profit and loss. However, where the amount of goodwill exists, the same shall be deducted for the purpose of calculation of the core capital.

Supplementary Capital: Supplementary capital includes general loan loss provision, exchange fluctuation reserve, assets revaluation reserve, hybrid capital instruments, unsecured subordinated term debt and other free reserves not allocated for specific purpose.

Banking and Financial institution Ordinance (BAFIO) also assimilates the same things, which were included and explained in NRB Act 2058 (July 16th 2001).

According to the NRB directive, minimum paid-up capital requirement for establishment of finance company is as under:

-) Rs 10 corer to operate all over expect Kathmandu valley.
-) Rs 20 corer to operate all over Nepal.
-) Rs 30 corer to operate all over Nepal including leasing finance.

2.1.10.2 Assets Quality

Asset quality is one of the most critical areas in determining the overall condition of the finance company. The primary factor effecting overall asset quality is the quality of the loan portfolio and the credit administration program. Loans are usually the largest of the asset items and can also carry the greatest amount of potential risk to the company's capital account. Security can often be a large portion of the assets and also have identifiable risks. Other items which impact a comprehensive review of asset quality are other real estate, other assets, off balance sheet items and to a lesser extent, cash and due from accounts and premises and fixed assets (Koch and Macdonald, 2004).

Management often expends significant time, energy and resources on their asset portfolio, particularly the loan portfolio. Problems within this portfolio can detract from their ability to successfully and profitability manages other areas of the institution. Examiners need be diligent and focused in their review of the various asset quality areas, as they have an important impact on all other facets of finance company operations.

As with the evaluation of other component ratings, the above factors, among others, should be evaluated not only according to the current level but also considering any ongoing trends. The same level might be looked on more or less favorably depending on any improving or deteriorating trends is one or more factors.

Rating the Asset Quality Factor

The asset quality rating definitions are applied following a through evaluation of existing and potential risks and the mitigation of those risks. The definitions of each rating are as follows:

-) Rating of one indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality in such institutions is of minimal supervisory concern.
-) A rating of two indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.
-) A rating of three is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern.
-) A rating four is assigned to FIs with deficient asset quality or credit administration practices. The levels of risk and problem assets are significant, inadequately controlled, and subject the FIs to potential losses that, if left unchecked, may threaten its viability.
-) A rating of five represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability.

Non-performing Assets (NPAs)

Loans and advances of FIs need to be serviced by either the principle or the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement <NRB unified directives E.Pra.Ni. 20/061/62 (Ashar, 2062 BS) for banks and non bank FIs defines non performing loans as loan classified as substandard, doubtful and loss or loans which are past due by principal for more than 3 month. Dhungana (2006) in his column states that the details and classification of standards of non performing loans may from country to country depend upon their own banking system requirement norms. He further states that, unlike Nepal, countries like Korea, Indonesia, Philippines, and India have classified the loan into five categories on which normal and special categories are classified as performing loans whereas substandard, doubtful and estimated loss categories are considered as non-performing loans. The study conducted by World Bank highlights that all commercial banks of

south Asian countries expect Nepal and Srilanka classify loans as non-performing only after it has been in arrear for at least six months. NRB unified directives for banks and non bank FIs through directive number E. pra. Ni. No. 02/061/62 (Ashar 2062 BS) classifies NPL, according to international practice, into three categories depending on the temporal position of loan default, substandard, Doubtful and loss Assets are the categories on the basis of the time barred to repay either interest or the principal. The degree of NPA assets depend solely on the length of time the asset has been in the form of non-obliged by the loaner. The more time it has elapsed the worse condition of assets is being perceived and such assets are treated accordingly. However, the treatment of NPAs depends according to countries No uniform rule seems to apply.

Factors Causing NPAs

Dhungana (2006) in his column broadly categorized in to internal and external factors for high level of NPA in Nepalese banking system. The following factors can also be the reason for causing NPA:

-) NPAs may arise due to failure of business for which loan was used. Whatever may be the reasons for failure of business, it obstructs the carrying out timely payments of financial obligations.
-) On the other part of appraising institutions, the defect in appraising projects breed mismatch not only in investment planning but also in receivables due to defective projection of returns. Large positions of NPAs in developing countries arise due to defective and standard credit appraisal system.
-) Monitoring of projects in time provide insurance against of enterprises through rectification of minor flaws that ape ear during the course of operation. Inability of sound monitoring system can also lead to failure of the project.
-) The resources of FIs collected through deposits from people may be misutilized. Recklessness or negligence on the part of the officials while approving the loan will turn in to default.
-) Attitude of the officials that does not amount to sincere corporate culture also leads to breed drawbacks in the payment of dues to FIs. The credit programmers sponsored by the government are regarded as the source of NPAs. For political benefits government, without assessing the financial

feasibility of the credit programmer, announces and compels the credits agencies to go along with the declared policies.

-) Moreover, dishonest politicians often want free ride of on the amounts of loan delivered by credit agencies under government designed programmers. Such loans are hardly recoverable. The fact is evidence from the experience in Nepal and India by the manifestation of higher percentage of NPAs found in priority sector loans.
-) Quite often the definition of the NPAs and accounting norms adopted by concerned agencies also amount to higher or lower magnitude of such assets. Each institution may have different norms to declare the assets whether it is non-performing. The income cycle of the project and amount of loan involved, set the installments of loan repayment. The nature of project also determines the level of NPAs.
-) Slow down in economy, global as well as domestic particularly in industrial sector. Contribution to adversely affect the bottom-line of borrower units and their capacity to service the debt. Recession debar the economic activities to runs smoothly which affect the performance of FIs.

Implication of NPAs

Financial crisis emerged from Thailand in south east Asian countries largely is considered to be due to higher level of NPAs existed with the FIs. The situation was grave when the asset stopped to repay loans to credit agencies which was borrowed from overseas was matured. Investment in domestic market did not provide returns, hence the amount involved turned into non-performing while repayment on due time was the principal reason to result in financial crisis that terminated into economic crisis in south East Asian countries. Financial crisis occurred in Asian had the higher proportion of NPAs emanate from loans which consisted highest share in the total assets of FIs. Countries with higher proportion of loan in the total assets of the banks and finance companies became vulnerable while institutions with lower share of loans in the total assets were affected less.

Empirically, it has been seen that Nepal and having lower proportion of loan in respect of total assets provided cushion to make ample provision and therefore were least affected by the financial crisis. On the other hand the south East Asian with relatively higher proportion of loans in the total assets of the FIs felt victim of shock of regional crisis.

The credit institutions are repelled from further investment after the interest accrual or due principal repayment has stopped. Interest incomes from such assets are reduced to the extent of declared amount as NPAs. As the assets declared NPA emanate from the deposits, it puts the depositors fund at risk. The credit agencies are put to an extra amount of liability by regulatory authorities in the form of provision.

The amount required for provision depends on the level of NPAs and their quality. Rising level of NPAs create a psyche of worse environment especially in the financial sector. Depositors are not interested to save. Rather the hard earned saving are diverted to consumptions. Consequently the saving pattern hence investment is affected thereby creating unhealthy atmosphere in the financial sector.

NRB Directives Related to Assets Quality

NRB unified directive for banks & non bank FIs (Ashar 2062 BS) through directive number E.pra.Ni.No. 02/061/62, requires the banks to classify outstanding loans and advances on the basis of aging of principal amount. As per the directive the loans and advances should be classified into the following four categories:

Pass: Loans and advances whose principle amount is not past due over for three months included in this category. These are classified and defined as performing loans.

Substandard: All loan and advances that are past due for a period of three months to six months included in this category.

Doubtful: All loans and advances, which are past due for a period of six months to one year, included in this category.

Loss: All loans and advances which are past due for more than one year and have least or thin possibility of recovery or considered unrecoverable shall included in this category. Besides this, any loan whether past due or not, in situations of inadequate security, borrower declared insolvent, no whereabouts of the borrower or misuse of borrowed fund, are to be classified as loss category.

The directive further requires banks to provision for loan loss, on the basis of the outstanding loans and advances and bills purchased classified as above. Loan loss provision set aside for performing loans is defined as General Loan provision and that set aside for non-performing loan as specific loan provision.

Loan Class	Loan Loss provision
Pass	1%
Substandard	25%
Doubtful	50%
Less	100%

With the objectives of lowering the concentration risk of bank loan to a few big borrowers and to increase the access of small and middle size borrowers to the bank loans, NRB through directive number. E.pra.Ni.No.30/061/62 limits commercial banks to extend credit to a single borrower or group related borrowers up to 25% of core capital for fund based credit facilities and not more than 50% of its core capital for non fund based credit facilities like letters of credit, guarantees, acceptances, commitments.

2.1.10.3 Management Quality

The capability of the board of directors and management, in their respective roles, to identify, measure, monitors and controls the risks of an institution's activities and to ensure a FIs safe, sound and efficient operation in compliance with applicable laws and regulation is reflected in this rating. Depending on the nature scope of an institution's activities, management practices may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance, legal, liquidity and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel: adequate policies processes and controls taking into consideration the size and sophistication of the institution; maintenance of an appropriate audit program and internal control environment: and effective risk monitoring and management information systems. This rating should reflect the boards and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is involved (Mishkin and Eakins, 2006). The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors:

-) The level and quality of oversight and support of all institution activities by the board of directors and management.
-) The ability of the board of directors and management, in their respective roles to plan for and respond to, risks that may arise from changing business condition or the initiation of new activities or products.
-) The adequacy of and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.
-) The accuracy, timelines and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity and risk profile.
-) The adequacy of audits and internal controls to: promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations and internal policies.
-) Compliance with and regulations.
-) Responsiveness to recommendations from auditors and supervisory authorities.
-) Management depth and succession.
-) To extent that the board of directors and management is affected by, or susceptible to, dominant influence or concentration of authority.
-) Reasonableness of compensation policies and avoidance of self-dealing.
-) Demonstrated willingness to serve the legitimate banking needs of the community.
-) The overall performance of the institution and its risk profile.

Rating the Management Factors

-) A rating of one indicates strong performance by management and board of directors and strong risk management practices relative to the institution's size, complexity and risk profile. All significant risks are consistently and effectively identified, measured, monitored and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

-) A rating of two indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity and risk profile. Minor weakness may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured and controlled.
-) A rating of three indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size or condition of the institution. Problems and significant for the type, size or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored or controlled.
-) A rating of four indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary.
-) A rating of five indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored or controlled and now threaten the continued viability of the institution.

2.1.10.4 Earning Quality

Under the UFIRS, in evaluating the adequacy of FIs earning performance, consideration should be given to:

-) The level of earning, including trends and stability.
-) The ability and provide for adequate capital through retained earnings.
-) The quality and sources of earning.

-) The level of expenses in relation to operations.
-) The adequacy of the budgeting systems, forecasting processes and management information systems in general.
-) The adequacy of provisions to maintain the ALLL and other valuation allowance accounts.
-) The earning exposure to market risk as interest rate, foreign exchange, price risks.

From a FI regulator's standpoint, the essential purpose of FI earnings, both current and accumulated, is to absorb losses and augment capital. Earnings are the initial safeguard against the risks of engaging in the FI business and represent the first line of defense against capital depletion resulting from shrinkage in asset value (Squanders and Cornett, 2004). Earnings performance should also allow the FI to remain competitive by providing the resources required to implement management's strategic initiatives.

Evaluation of Earnings Performance

An analysis of earnings comprise of examiner reviewing each component of the Earnings Analysis trail and Ratio Analysis. Generally, the analysis of earnings begins with examiner reviewing each component of the earnings begins with examiner reviewing each component of the earnings analysis trail. The earnings analysis trail provides a means of isolating each major component of the income statement for individual analysis. The earnings analysis trail consists of the following income statement components: net interest income, net interest income, net interest expenses, provision for loan and lease losses and income taxes. Each component of the earnings analysis trail is initially reviewed in isolation. Typically, ratios are examined to determine a board level view of the component's performance. The level of progression along the analysis trail will depend on a variety of factors including the level and trend of the ratios, change since the previous examination and the institution's risk profile.

Earnings Ratio Analysis

Several key ratios used in the earnings analysis are used as shown below:

-) Net income to average assets ratio [return on assets (ROA) ratio].
-) Net interest income to average assets ratio.

-) Net interest income to average earning assets ratio.
-) Net interest income to average assets ratio.
-) Net interest expenses to average assets ratio.
-) Provision for loan and lease losses (PLLL) to average assets ratio.
-) Realized gains/ losses on security to average assets ratios.

Earning quality is the ability of a bank to continue to realize strong earnings performance. It is quite for a bank to register impressive profitability ratios and high volumes of income by assuming an unacceptable degree of risk. AN inordinately high ROA is often an indicator that the bank is engaged in higher risk activities. For example, bank management may have taken on loans or other investments that provide the highest return possible, but are not of a quality to assure either continued debt servicing or principal repayment. Seeking higher rates for earning assets with higher credit risk will boost short-term earnings. Eventually, however, earning may suffer if losses in these higher-risk assets are recognized.

In addition, certain of the bank's adversely classified and non performing assets, especially those upon which future interest payments are not anticipated, may need to be reflected on a non accrual basis for income statements purposes. If such assets are not places on a non-accrual status, earning will be overstated. Similarly, material amounts of troubled debt restructured assets may have an adverse impact on earnings. An institution's assets quality has a close relationship to the analysis of earning quality. Poor asset quality may necessitate increasing the PLLL to bring the ALL to an appropriate level and must be reviewed for impact on earning quality.

Rating the Earning Factor

-) Earning rated one is strong .Earning are more than sufficient to support operations and maintain adequate capital and allowance levels after are given to asset quality. Growth and other factors affecting the quality, quality and trend of earning.
-) Earning rated two would be satisfactory and sufficient support operations and maintain adequate capital and allowances levels after consideration is given to asset quality, growth and other factors affecting the quality, and

trend of earnings. Earnings that are relatively static or even experiencing a slight decline, a slight decline, may receive a two rating provide the institution's level of earnings is adequate in view of the assessment factors listed above.

-) Earnings rated three may need to improve. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth and other factors affecting the quality, quantity and trend of earnings.
-) A rating of four indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowances levels. Erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous years may characterize institutions so rated.
-) A rating of five indicates earnings that are critically deficient. A FI with earnings rated five is experiencing losses that represent a distinct threat to its viability through the erosion of capital.

2.1.10.5 Liquidity

In evaluating the adequacy of a FI's liquidity position, consideration should be given the level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligation in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned change in funding sources, as well as react to change in the market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in changes in market conditions. Liquidity is rated based upon, but not limited to, an assessment of the following evaluation factors:

-) The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
-) The availability of assets readily convertible to cash without undue loss.
-) Access to money markets and other sources of funding.
-) The level of diversification of funding sources, both on and off balance sheet.
-) The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits to fund longer-term assets.
-) The trend and stability of deposits.
-) The ability to securities and sell certain pools of assets.
-) The capability of management to properly identify, measure, monitor and control the institution's liquidity position, management information systems, and contingency funding plans.

Rating the Liquidity Factors

-) A rating of one indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.
-) A rating of two indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practice.
-) A rating of three indicates liquidity levels or funds management practices in need of improvement. Institutions rated three may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.
-) A rating of four indicates deficient liquidity levels or inadequate funds management practices. Institutions rated four may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet needs.
-) A rating of five indicates liquidity levels or funds management practices so critically deficient that the continued viability of the institution is threatened. Institutions rated five require immediate external financial assistance to meet maturing obligations or other liquidity needs.

Liquidity Management Concepts

There are several principles which the economists have propounded to resolve the conflicts between objectives of liquidity, safety and profitability. These concepts are discussed as under:

The Real Bills Doctrine: The real bills doctrine states that FI's should extend only short-term self-liquidating productive loans to business firms. Self liquidating loans are those meant to finance the production, storage, transportation and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. The short-term self liquidating productive loan has three advantages. Firstly they possess liquidity due to which, they liquidate themselves automatically. Secondly, there is no risk of running into bad debts since earn income for the banks as they are productive.

The shift ability theory: H.G. Moulton propounded the shift ability theory of bank liquidity. According to view, an asset to be perfectly shift ability must be immediately transferable without capital loss when the need for liquidity arises. But in a general crisis requires that all banks should possess such assets which can be shifted on to the central bank which is the lender of the last resort. This theory has certain elements of truth.

An Anticipated Income Theory: The anticipated Income Theory was developed by H.V. Proch in 1994 based on term loan practices by USA commercial banks. According to this theory; the bank plans for liquidation of long term loans from the anticipated income of the borrower regardless of the nature and character of a borrower's business. The bank puts restrictions on the financial activities of the borrower while granting this loan. Consequently, the bank takes into consideration not only the security but with major consideration the anticipated earnings of the borrower. This is superior to the bills doctrine and the shift ability theory because it fulfills the three objectives of liquidity, safety and profitability.

Liquidity Management Techniques

Techniques for liquidity assessment have evolved over the years with the significant changes in the monetary policy operating procedures. Despite the uncertainty in predicting liquidity conditions, econometric models could be used to provide first indicative forecasts, given the estimated structure of inter-relationships based on past information. The treasury or fund manager of any banks and FIs should adopt following techniques for effective liquidity management.

Liquidity Planning: The liquidity planning entails the accurate estimation of liquidity need and the structuring of the portfolio to meet the expected liquidity needs. To ensure that funds are available to meet the liquidity needs at the lower cost, the treasury manager of the banks and FIs must manage its money position to comply with reserve requirements as well as managing its liquid sources.

Managing the Cash Position: A cash position refers to the amount in the process of collection and currency and demand balances due from other banks and the central bank. Numerous transactions that cause an inflow or outflow of cash during a day continually change the cash position of the banks and FIs. Because cash yields no income, cash holdings must be limited to a minimum. The treasury/fund manager may invest any excess cash or may acquire additional cash sources from interbank loans or from discount window at the central bank.

Managing the Liquidity Position: Once the liquidity needs of the banks and FIs have been estimated, the treasury manager must decide how these needs are to be funded. The banks and FIs must choose between two general liquidity management strategies, namely, asset management and liquidity needs. In the liability management, money is borrowed to meet liquidity needs. A combination of these strategies is normally employed. The following guidelines must be kept in mind by the treasury manager when managing the liquidity position of the banks and FIs:

-) The treasury managers should know the timing of large withdrawals from big credit clients or depositors in order to plan.
-) The priorities and objectives of liquidity management should be clear and properly communicated.
-) The needs and decisions must be evaluated on a continuous basis to invest access liquidity and avoid liquidity shortages.

Controlling Liquidity Risk

To assess how well the banks and FIs are managing its liquidity position, the management should be cautious on the following signals from the marketplace that indicate pending liquidity problems:

-) Public confidence in terms of withdrawal of deposits from the banks and FIs.

-) Share price behavior, falling share prices indicates perceived liquidity problems.
-) Risk premiums on money borrowings.
-) Losses because of the hasty sale of assets for liquidity purposes.
-) Inability to meet the demands of new credits customers.
-) More frequent and larger borrowing from the central bank.

Considering the aforementioned technique, the treasury manager must also consider the purpose of the liquidity need, the length of time for which funds are needed, the access to liability markets, the costs and characteristics of various liquidity sources and interest rate forecast. It is received that the large banks have better access to liability liquidity sources due to the better quality assets and a broader capital base. The small banks are to rely more on assets for liquidity. Thus, an effective liquidity management is essential to reduce costs.

A liquidity ratio measures an entity's ability to pay its short-term obligations out of liquid assets. Liquidity was generally represented in previous studies with a ratio of cash (with some adjustment for short-term liquid securities) to total assets (Sinkey, 1975).

NRB Directives Related to Liquidity

NRB had given the institution to the commercial banks since 2023 B.S. to deposit the amount the amount ratio of 8 percent from their deposit liability. In the beginning of 2047 B.S. the increase in the quantity of internal credit was high and began to show negative effect on economy. The deflation grew up to 21 percent. So, high liquidity appeared in the economy, hence, control of negative effect that may fall on economy to improve the growth of price rate and improvement of the position of loss of running account and control the capacity of flowing the loan of the of the commercial banks, was necessary and the NRB bonds. With some signs of improvement of economy, the investment ratio was revised accordingly, since Poush 2049 B.S. since the beginning of 2050 B.S., the economy showed improvement and the rate of deflation fell down to 8.8 percent. With this, the provision of investing in the government securities was removed.

With effective from, 2054, Chaitra 31st, commercial banks & other financial institution were required to maintain liquidity of 8 percent of the total current and saving deposits and 6 percent of the fixed deposits, in addition to 3 percent of total deposit in cash at vault. Since then the NRB reserve requirements have been put into force by NRB effective from 2059/04/06.

Prevailing Directives as to Cash Reserve Ratio Requirement

Balance to NRB	1.7% of current & saving deposit liabilities. 2.45% of fixed deposit liabilities
Cash to vault	2% total deposit liabilities.

The compliance of liquidity maintenance, the NRB applies following procedures:

-) The CCR maintained by the banks will be examined on the basis of average weekly balance of deposit liabilities immediately preceding 4th week. A week shall comprise from each Sunday through Saturday.
-) CRR will not be calculated for the week which is fully off.
-) Weekly statement of deposit balances to be submitted to NRB inspection and supervision department within 15 days from the date of end of the week.
-) Weekly average of Monday to Friday of total deposit, cash in vault and NRB balance is calculated by dividing by 5.

Penalty will be levied for failing to maintain the adequate liquidity as above under any of the following conditions.

-) In the case of shortfall in maintenance of NRB balance but cash at vault is exactly 2 %.
-) In case of shortfall in NRB balance but cash at vault is more than 2% then up to 1% excess cash of total deposit is added in the balance with NRB then on such shortfall account (after adding up to 1 % excess).
-) In case of shortfall in cash in vault as well as shortfall in NRB then on such Shortfall amount.

The applicable rate of penalty is as follows:

First time shortfall= Equivalent to bank rate/ highest refinance rate.

Second time shortfall = Equivalent to 2 times of bank rate.

Third time shortfall and all subsequent shortfalls= Equivalent to 3 times of bank rate.

2.1.10.6 Sensitivity to Market Risk

The sensitive to market risk component reflects the degree to which changes in interest rates, foreign exchanges rates, commodity prices or equity prices, can adversely affect a FI's earning or economic capital (Baral, 2005). When evaluating this component, consideration should be given to: management's ability to identify measure, monitor and control market risk; the institution's size; the nature and complexity of its activities; and the adequacy of its capital and earning in relation its level of market risk exposure. For many institutions, the primary source of market risk arises from non-trading positions and their sensitivity to change in interest rates. In some larger institutions, foreign operations can be a significant source of market risk. For some institution, trading activities are a major source of market risk. Market risk is rated based upon, but not limited to, an assessment of the following evaluation factors.

-) The sensitivity of the FI's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchanges rates, commodity prices or equity prices.
-) The ability of management to identify measure, monitor and control exposure to market risk given the institution's size.
-) Complexity and risk profile.
-) The nature and complexity of interest rate risk exposure arising from non-trading positions.
-) Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

Rating the Sensitivity to Market Risk Factor

-) A rating of one indicates that market risk sensitivity is well controlled and that there is minimal potential that the earning performance or capital position will be adversely affected. Risk management practices are strong for the size, sophistication and market risk accepted by the institution. The level of earnings and capital provide substantial support for the degree of market risk taken by the institution.
-) A rating of two indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or

capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication and market risk accepted by the institution. The level of earnings and capital and capital provide adequate support for the degree of market risk taken by the institution.

-) A rating three indicates that control of market risk sensitivity needs improvement or there is significant potential that the earnings performance or capital position will be adversely affected. Risk management practices need to be improved given the size, sophistication and level of market risk accepted by the institution. The level of market risk taken by the institution.
-) A rating four indicates that control of market risk sensitivity is unacceptable or that there are high potentials that the earnings performance or capital position will be adversely affected. Risk management practices are deficient for the size, sophistication and level of market risk accepted by the institution. The level of earnings and capital provide inadequate support for the degree of market risk taken by the institution.
-) A rating of five indicates that control of market risk sensitivity is unacceptable or that the level of market risk by the institution is in imminent threat to its viability. Risk management practices are wholly inadequate for the size, sophistication and level of market risk accepted by the institution.

2.2 Review of Related Studies and Papers

The research studies and work papers carried out by different scholars within various geographical regions including dissertations by Nepalese scholars are reviewed in this section, which are related with financial performance analysis of commercial banks, finance companies and other areas of the study.

2.2.1 Review of Research and Work Papers

Several academic studies whether and to what private supervisory information is useful in the supervisory monitoring of banks and FIs failure-prediction models. It is very crucial for such analysis is identifying variables that reliably predict future bank & FI failure. The studies use variables that reflect asset quality, liquidity, capital adequacy and management quality. Barker and Holdsworth (1993) reported that, on average, capital and income slowly deteriorate while past due loans and charge offs

increase as failure approaches. On the other hand, Heyliger and Holdren (1991) discover that asset quality, measured by the ratios of loan provisions and net charge offs to total loans, do not provide reliable indicators of bank & FI failure. These studies adopted a number of methods, including multiple discriminate analysis, factor analysis, proportional hazard models and legit analysis.

Jackson, (1975) conducted a study on FI regulation structure and performance. The study was carried out to identify the determinants of FIs allocation efficiency. Both theoretical and empirical microeconomics analysis has applied to examine the competitive effects of banking influences. In this paper, the nature of banking was examined; showing that FIs are essentially financial intermediaries that are engaged in greater completion than is commonly believed. Many theories of the firm as FIs are presented emphasizing efficiency-distorting force such as liquidity provisions. Almarin Philip's model of complex interaction between banking firms and other influences on observed performance was used to summarize banking theories. For the empirical purpose, data conversing 1644 banks over the period 1969-1971 were collected. Regression analysis was used to measure the relationship among variables. As a conclusion, the study showed that, the relatively desirable banking performance is associated with several traits including bank asset size, on bank competition, low cash holdings, low labor cost, state non member basic status, multi bank company legislation, national bank status, low time deposits and low equity capitalization. Demand levels and temporal variations also significantly affect the banking performance. Furthermore, the study showed that the FIs regulation, structure and performance are interrelated with each other.

Sinkey, (1975) notes bank examiners identify a "substandard" loan component of the net capital ratio as critical to identification of problem FIs. In later research, Sinkey (1978) recognized the usefulness of loan default information in utilization of a ratio of provision for loan losses to operating expenses, although he did not find the "substandard" loan component to be significant.

Martins, (1977) study set the standard for discrete-response models of FI failure prediction. Whereas most other research focused on a small sample of FIs over two three years, Martin used all Fed-supervised institution during a seven year period in

the 1970 yielding over 33,000 observations. In what would become a standard approach, he confronted the data agnostically with 25 financial ratios and ran several different specifications in the search of the best fit. He found that capital ratios, liquidity measures and profitability were most significant determinates of failure over his sample period. Although Martin did not employ direct measures of asset quality, his indirect measures provision expenses and loan concentration also turned out to be significant.

West, (1985) developed a model to predict FI failure, which differed from the majority of research by research by utilizing FIDC generated information ,rather than data from the financial statements. Some evidence resulted to support the contention that a loan quality factor (i.e. non-performing loans) had predictive value in this context for monitoring problem FIs through its choice in a stepwise legit analysis.

Hirschhom, (1987) used a multi factor market model to predict quarterly stock returns for the 15 largest U.S. FIs between 1979 and 1987.He included both contemporaneous CAMEL rating and lagged CAMEL values were not useful for predicting stock returns, Hirschhom found that contemporaneous CAMEL ratings were predicting stock returns. These results suggest that exam ratings contain useful information, but that most of this information is not private market participants have either independently inferred this information at the time of the exam, or this information has been leaked shortly after the exam was completed.

Tam and Kiang, (1992) utilized stepwise legit analysis. The researchers examined a small sample of taxes banks, where result indicated two measures of loan default risk were significant in their prediction of FI failure, provision for loan losses to average loans and net charge-offs to average loans exhibited no predictive value.

Barker and Holdworth, (1993) in respect to predicting FI failure, find evidence that CAMEL ratings are 3 useful, even after controlling for a wide range of publicly available information about the condition and performance of FIs.

Cole and Gunther, (1998) examine a similar question and find although CAMEL ratings contain useful information, it decays quickly. For the period between 1988 and 1992, they found that a statistical model using publicly available financial data is better indicator of FI failure than CAMEL ratings that are more than two quarters old.

The direct public beneficiaries of private supervisory information, such as that contained in CAMELS rating, would be depositors and holders of FIs securities. Small depositors are protected from possible bank default by of FDIC insurance. This probably explains the finding by Gilvert and Vaughan (2004) that the public announcement of supervisory enforcement actions, such as prohibitions on paying dividends, did not cause deposit runoffs or dramatic increase in the rates paid on deposits at the affected FIs, however, uninsured depositors could be expected to respond more strongly to such information. Jordan, et al., (1999) find that uninsured deposits at banks that are subject of publicly-announced enforcement actions, such as case and desist orders, decline during the quarter the announcement.

As of yearend 1998, bank holding companies (BHCs) had roughly \$ 120 billion in outstanding subordinated debt. De young, et.al. (1998), examine whether private supervisory information would be useful in pricing the subordinated debt of large BHCs. The authors use an econometric technique that estimates the private information component of the CAMEL ratings for the BHCs lead banks and regress it on to subordinated bond prices. They conclude that this aspect of CAMEL rating adds significant explanatory power to the regression after controlling for publicly available financial information and that it appears to be incorporated into bond prices about six months after an exam. Furthermore, they find that supervisors are more likely to uncover unfavorable private information while de-emphasizing negative information. These results indicate that supervisors can generate useful information about FIs, even if those FIs already are monitored by private investors and rating agencies. Focusing specifically on CAMEL ratings, Berger and Davies (1998) use event study methodology to examine the behavior of BHC stock prices in the eight –week period following an exam of its lead bank, they conclude that CAMEL downgrades reveal unfavorable private information about bank conditions to the stock market. This information may reach the public in several ways, such as through bank financial statements made after a downgrade. These results suggest that bank financial statements made after a downgrade. These results suggest that bank management may reveal favourable private information in advance, while supervisors in effect force the release of unfavorable information.

Berger, Davies and Flannery, (1998) extend this analysis by examining whether the information about BHC conditions gathered by supervisors is different from that used by the financial markets. They find that assessments by supervisors and rating agencies are complementary but different from those by stock market. The authors attribute this differences to the fact that supervisors and rating agencies, as representatives of debt holders, are more interested in default probabilities than the stock market, which focuses on future revenues and profitability. This rationale also could explain the authors finding that supervisory assessments are much less accurate than market assessments of banks performances.

On site bank exams seem to generate additional useful information beyond what is publicly available. However, according to Flannery (1998), the limited available evidence does not support the view that supervisory assessments of FI conditions are uniformly better and timelier than market assessments.

The market for bank equity, which is about eight times larger than that for bank subordinated debt, was valued at more than \$ 910 billion at year-end 1998. Thus, the academic literature on the extent to which private supervisory information affects stock prices is more extensive. For example, Jordan, et al., (1999) find that the stock market views the announcement of formal enforcement actions as informative. That is, such announcements are associated with large negative stock returns for the affected banks. This result holds especially for banks that had not previously manifested serious problems.

Hirtle and Lopez, (1999) examine the usefulness of past CAMEL ratings in assessing FIs current conditions. They find that, conditional on current public information, the private supervisory information contained in past CAMEL ratings provides further insight in to FI current conditions, as summarized by current CAMEL ratings. The authors find that, over the period from 1989 to 1995, the private supervisory information gathered during the last on-site exam remains useful with respect to the current condition of a bank for up to 6 to 12 quarters (1.5 to 3 years). The overall conclusion drawn from academic is that private supervisory information, as summarized by CAMELS ratings, is clearly useful in the supervisory monitoring of FI conditions.

Kolari et. al., (2000) developed models and predicted FI failure, where the models initially included three measures of loan default disclosure along with 25 other financial measures. The loan default measures included allowances for loan losses to total assets, net loan charge-offs to total assets and provision for loan losses to total assets. In the final analysis, the allowances for loan losses to total assets were significant in row of the six predictions. As with many other studies, there was a lack of theory for the choice of variables, as stepwise legit was utilized for the decision of inclusion or elimination.

Dziobek, hobbs and Marston, (2000) analyze the determinants of FI liquidity defined as the degree to which a FI is able to meet its obligations under normal business conditions. Volatility in the depositors (and creditor) base depends on the type of depositors, insurance coverage and maturity; FIs that rely on a narrow or highly volatile funding base are more prone to liquidity squeezes. Household deposits are typically more stable than, for instance, the deposits of institutional investors or corporate entities. Deposit concentration (i.e. fewer, larger-size deposits) can also be indicative of volatility. Deposit insurance increase the stability of the deposits it covers, with the important caveat front, foreign financing for instance through commercial credit lines and deposits of nonresidents(either in foreign or domestic currency) can become highly volatile in situations of distress and make the financial system vulnerable to external shocks or adverse developments in the domestic economy. As regards instrument maturity, the longer the time before the liability matures (in terms of remaining maturity), the more stable is the funding; however, in countries where FIs are required to meet early withdrawal requests with only minor penalties, maturity may be less relevant determining funding stability.

Shajwala and Van den Bergh, (2000) based their work paper of Basel committee on banking supervision on a study of a number of new bank monitoring systems currently in use or under development in various G10 countries. Such systems are collectively termed 'supervisory risk assessment and early warning systems'. The objective of the paper was to provide an overview of the different approaches taken by bank supervisors and to make a preliminary general assessment of the methods that are being used or developed. The study reveals that supervisory authorities are now clearly moving towards putting in place more formal, Structured and risk focused

procedures for ongoing banking supervision. Individual approaches and system have been developed and adopted, typically in the 1990s, with a greater focus on risk profiles and risk management capabilities of individual banking institution and on the generation of timely warning of potential changes to a bank's financial position. These new and modified systems have contributed positively to the supervisory process, and supervisors are working towards refining the systems further in order to improve the systems accuracy and predictive power.

Gytan and Johnson, (2001) have presented their work paper on a review of alternative methodologies for early detection of banking distress. The various methodologies proposed by different researchers, in the paper are aimed to the early identification of financial distress for countries without an important recent history of FI failure, but facing unstable international environment. They evaluate several indicators, the signal extraction approach, limited dependent estimation and finally duration models. In the early Warning System (EWS) of systematic banking crises section they reviewed the literature aimed to predict crises of the complete banking system of a country. They also include some methodologies approaches that have been used as early warning systems for currency crises, but have a potential application methods requires a sample in which the events have appeared repeatedly. Since there has not been so many repeated episodes in any given country, the estimation must rely on a sample of different countries that have suffered banking problems. According to them, the literature on indicators and EWS of systems crises can be classified by their methodological approach: 1) Qualitative indicators, 2) Signal Extraction, 3) Limited Dependent Regression, 4) Other models.

Derviz and Podpiera, (2004) based their assessment of commercial banking performance on bank ratings and studied with respect to detecting situations with the potential for adverse development towards failure and owing to the costly nature of frequent supervisory examinations. In this paper they studied models of rating downgrades and consider a specific set of indicators that are suitable as determinants of a bank's rating. The conclusions about the predictors obtained from the analysis of downgrades are applicable in relatively stable banking sector situations. Banks experiencing minor liquidity trouble might raise their interest rates on deposits, but a regulator would have a hard time distinguishing which bank has increased its deposit

rate because of liquidity problems and which has done so owing to an increase in its cost of funds caused by some other factor. Therefore, in their approach the cost of the funds one of the plausible downgrade indicators was used in form of the banks' "Credit Spread". In addition to credit spread, they tested the inclusion of the value at risk (VAR) indicator in the form of total assets VAR, as they believed that this type of indicator might play an important role in determining the level of the rating due to its easy computability and data availability to the public. They focused on the capital, assets management.

Earning, liquidity, market risk based composite (CAMELS) rating and the standard and poor (S&P) rating. The choice of their sample was determined by the fact that cross section data is probably less appropriate given the specific character of the relatively small banking market in the Czech Republic. The three chosen banks, i.e. Ceska Sporitelna (CS), Komercni Banka (KB) and Ceskoslovenska Ochoodni Banka (CSOB), cover a dominant portion of the market, the rest being occupied by small narrowly specialized banks or foreign bank branches. Therefore, they used panel data with three banks and their financial indicators to analyze the change in the CAMELS and S&P ratings. They found that the reliable predictors of a bank's S&P rating are credit spread, capital adequacy, and the total loans to total assets ratio. In the case of the CAMELS rating does not yield itself easily to predictions within any horizon with the studies technique. On the contrary, the S&P rating can be relatively precisely predicted one month in advance.

Baral, (2005) has conducted a research on published his paper in the journal of Nepalese business studies. On health check-up of commercial bank in the framework of CAMEL, a case study of joint venture Banks in Nepal. The paper examined the financial health of joint venture Banks in the CAMEL framework for a period ranging from fiscal year 2001 to 2004. Three joint venture Commercial Banks of Nepal were randomly selected for the study. The Study was based on historical data disclosed by annual reports of Commercial Banks. It has covered four fiscal years data for the purpose of the study. The study was based totally on the CAMEL framework.

2.2.2 Review of Dissertations

Various studies have been carried out regarding the evaluation of co-operative societies and MFIs. Some of the leading and available studies have been reviewed in the study. The study concerns the financial performance analysis of Oriental co-operative Limited.

Shrestha, (1990) conducted a research work on portfolio behaviors for commercial banks in Nepal. The researcher has analyzed the debt to equity ratios of commercial banks in aggregated and agriculture development bank from 1971 to 1990. Researcher has found that the capital adequacy ratio explains the strength of the capital base of commercial banks. Higher the capital adequacy ratio higher is its internal sources. Lower the value of capital adequacy ratio with regard to the standard value shows that the bank's ability to attract deposit from the surplus units and interbank funds also be limited.

Bohara, (1992) has done a study on financial performance of Nepal Arab bank Limited (NABL) and Nepal Indozen Bank Limited (NIBL). The basic objectives of this study were to highlight on the functions and policies of joint ventures banks and to evaluate the comparative financial performance of NABIL and NIBL. The study has covered the five year FY 1986/87 through 1990/91. In this study, financial tools along with statistical tools has been used. Different ratios liquidity, activity leverage advantage profitability and other indicators like earning per share, dividend per share. Market value to book value ratio has been used to evaluate the performance of NABIL and NIBL. In statistical tools, the least square method has been employed. The researcher has based on different financial indicators concluded that performance of NABIL is better than that of NIBL. The researcher further concluded the bank performance couldn't be judged solely in term of profit as it may have earned profit by maintaining adequate liquidity and safety position. The researcher has recommended to NIBL to extend their banking facilities even in the rural areas by opening up branches besides the improvement in maintaining the adequate capital structure by increasing equity base.

Lamsal, (2007) has conducted a study on "Financial Performance Analysis of Nepalese Co-operative Societies with special reference to District Co-operative

Association Ltd. Kaski District in 2007". His findings were: Association had invested most of its funds in current assets unnecessarily, problem of over inventory, assets utilization position is not satisfactory having unnecessary fund accumulated in the current assets, which the association is not able to manage. He has also concluded that Capital structure of the association is not sound: there is heavy debt Capital as compared to ownership Capital. The main source of external Capital were bank loan and gratuity fund of the employees of the association. He further concluded that the association is unable to mobilize its fund in profitable sector. Therefore the association has been suffering from loss all over 5 years study period.

Bhandari, (2006) has conducted a study on the financial performance of Himalayan Bank Limited in the framework of CAMEL. The basic objective of this study was to analyze the financial performance of Himalayan Bank Limited through CAMEL. The study has covered the time period of six years from fiscal year 1999 to 2004. The researcher has used different financial tools and other statistical tools in the study. The study revealed adequate capital of the bank. The non performing loans through in decreasing trend are still a matter of concern. The bank is still with better ROE. However, it is in decreasing trend of net interest margin shows management stock monitoring over the bank's earning assets. The liquid funds to total deposit ratio to above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period.

Chanda, (2006) has conducted a study on financial performance analysis of Nabil Bank Limited in the framework of CAMELS with the objective to analyze the financial condition of Nabil Bank Limited. It has covered five years data starting from fiscal year 2000/01 to 2004/05. The analysis discovered that the bank is running with adequate capital and the capital fund of bank is sound and sufficient to meet the banking operation as per NRB standard. The bank has placed efficient credit management and recovery efforts of good quality loans will increase in future. The management decision related to operation and investment has assisted in future. The management decisions related to operation and investments have assisted in controlling control and recovery the interest spared and cost effective sources of fund. The liquid funds to total deposit ratio is above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period.

Similarly, Sharma (2007) carried out the research study entitled "Financial Performance Analysis of Nepal SBI Bank Ltd in the framework of CAMEL" with the basic objective of analyzing the financial performance of Nepal SBI Bank Ltd. (NSBL) in the CAMEL framework. It was based on secondary data covering the period of six years from 2001 to 2006 A.D. The researcher has used only the financial tools. The researcher concluded that NSBL was well capitalized and complying with the directives of NRB. The bank has maintained satisfactory level of post due loan on total loan expect in 2001. Earning per employees of the bank was found quite high NIM of the bank was found satisfactory. Furthermore, the liquidity position of the bank was found good.

Gurung, (2007) performed the research study entitled "Financial performance of Annapurna Finance Company Limited in the framework of CAMEL". The study was based on secondary data covering the period of five years from F.Y.2058/059 to F.Y.2062/063. The researcher has used various financial and statistical tools. The basic objective of the study was to analyze the financial performance of Annapurna Finance Company Limited through CAMEL framework. Researcher has following a descriptive and analytical research design. The study concluded that the company is financially sound and strong. The company is running with adequate capital and strictly followed the NRB directives. The capital fund of the company is sound and sufficient to meet the financial operation as per the NRB standard. The company has placed efficient credit management and recovery efforts. The amount of non-performing loans and possibility of default in future is increasing. The company is running with the inadequate liquidity to meet its short term obligation.

Koirala, (2007) carried out the research study on "Diagnosis of Financial Health of Nepal Investment Bank Limited in the framework of CAMELS" based on secondary data covering the period of six years from F.Y. 2201 to F.Y.2006. The researcher has used descriptive and analytical research design. The basic objective of the study was to analyze the financial health of Nepal Investment Bank Limited in the framework of CAMELS. The study concluded that the bank is financially sound and strong. The supplementary capital; of the bank is sufficient or adequate. The bank is running with the adequate capital and the capital fund of the bank is sound and sufficient. The bank is gradually moving towards cost minimizations and cost efficiency. The bank management is aware about stock holder's wealth maximization. The bank has adequate liquidity to meet its short term obligation in later years.

Shrestha, (2007) has conducted a study on “Financial Analysis of Suvechha Saving and Credit Co-operative Limited in the framework of PEARLS in 2007 .The basic objectives of the study was to analyze the Financial Health of Suvechha Saving and Credit Limited remaining confined within the framework of PEARLS. The analysis was made after the comparison of specific ratio obtained from SSCCI with the PEARLS standard. It found that the institution had adequately protected the loan loss with the provision of allowances. The allowance of loan losses to allowance required for loan losses ratio showed that the institution was able to maintain the PEARLS standard since last three years. There was high level of delinquency resulting from the provision of allowance for the loan losses and the institution invested its fund in more productive assets.

Ale, (2007) has conducted the study on “Diagnosis of Financial Health of Paschimanchal Grameen Bikas Bank Limited in the Framework of PEARLS” in 2007 with the objective of diagnoses the Financial Health of PAS GBB Ltd. in the Framework of PEARLS. He concluded in his study that the institution has adequate earning to defend any future losses by provisioning for loan loss. The solvency of the institution is not adequate due to speedily increase of delinquency and low institution is not adequate due to speedily increase delinquency and low increase of total saving. The ratio of net loans to the total assets falling below the PEARLS standard is the due poor quality of assets and provision of allowances for the loans losses. PAS. GBB Ltd. has maintained the ratio of financial investment of total assets high above the maximum 10 percent. It has the fluctuation trend of total loan portfolio ratio due to the poor asset quality. The decreasing trend of financial cost of saving deposits is that the institution is relying less accumulation the saving deposits. The institution has maintained a high amount of liquidity reserves with respect to total deposits. He further concluded that the growth in loans ratio is not true with increase in total assets due to poor quality assets resulted from delinquency. The growth in liquid investment and financial investments are high above PEARLS standard. The growth in shows, that PAS. GBB has unable to attract more deposits. The growth in total assets has decreasing trend over the years: it indicates that the institution has not relied on to increase the saving deposits so as to augment the total asset.

2.2.3 Research Gap

It would be wrong to claim that my research subject matter is totally undone; just a few researchers have done in this topic. However, the financial performance analysis of Oriental Co-operative limited by using modern technique of evaluation (i.e. CAMELS) has not been yet. A few researchers have conducted their research on other topic but, no one has conducted research on financial performance. Thus, there is necessary to conduct research on financial performance. So, this research is conducted to know actual financial performance of Oriental Co-operative Ltd in the framework of CAMELS. Therefore, the study of financial performance of co-operatives will add new dimension toward co-operative function of co-operatives companies.

CHAPTER–III

RESEARCH METHODOLOGY

Research methodology describes the theoretical foundation of data collection, data analysis for the study. This chapter provides overall framework of the study such as data collection, presentation & analysis, which help to fulfill the objective of the study.

3.1 Research Design

Research Design is a planned structure and strategy of investigation concerned to obtain answer to research objective through analysis of data. The first step of the study is to collect necessary information and data related with the study. Therefore, research design means the definite procedure and proposed ways of conducting a research. The study is based on descriptive research design followed by analytical approach to achieve the objective of the study. Some financial and statistical tools are applied to examine facts and descriptive techniques have been adopted to evaluate financial performance analysis of OCL in the framework of CAMELS.

3.2 Nature & Sources of Data

Primary & secondary data are used for the study. Primary data is collected by means of questionnaire & direct interview to individual of the concerned area. Similarly, secondary data is taken from annual reports of the OCL. Various visits are done in related area & stakeholders to collect the reliable data. Various bulletin, websites & magazines are also being the sources of data.

3.3 Population & Sample

For the purpose of the study, co-operatives limited are taken as population. Till FY 2065/66, there are all-together three hundred ninety four cooperatives societies established in Pokhara but among them two hundred thirty six cooperatives are financial cooperative societies in Pokhara. Oriental cooperative limited also comes under the financial cooperative society. But being a case study of a single unit, Oriental cooperative limited is selected as a sample for this study. For this purpose convenience sampling method is used.

3.4 Data Collection Methods

The study since is based on secondary data, the annual reports and other information of OCL will be obtained from its website.

3.5 Data Processing

Five year's data is used in this research work. It is presented in tabular form. All the collected data are ordered in master sheet manually. Different sheet for primary & secondary data can be used. Simple statistic methods such as percentage, average, pie charts, tables, graphs & other statistical tools are used for data analysis.

3.6 Form of Data Presentation

The data will receive from the various sources can be classified and tabulated according to the needs of the study. The study based on descriptive and analytical research design. Hence, tabular forms, graphical charts are used to present the data.

3.7 Method of Data Analysis

Various financial and statistical tools are used in this study to get the meaningful result and to meet the research objective. Financial ratios are major tools other simple statistical tools are used in research.

3.7.1 Financial Tools

This study is based on following financial tools and techniques. The tools are based in the framework of CAMELS.

Capital Adequacy Ratio

Capital adequacy ratio is the numerical relationship between total fund and risk adjusted assets. It measures the adequacy of capital and financial soundness of FI. Capital adequacy ratio is used to measure of capital in the FI. It is worked by using the following model.

$$CAR = \frac{\text{Total Capital Fund}}{\text{Total Ris Adjusted Assets}} \times 100$$

Where,

CAR = Capital Adequacy ratio

Total capital fund = Core capital + Supplementary capital

Total Risk adjusted Assets = On-balance sheet risk adjusted assets + off balance sheet risk adjusted assets.

Core Capital Adequacy Ratio

Core capital adequacy ratio shows the relationship between the total core capital or internal sources and total risk adjusted assets. It is used to measure the adequacy of core capital and financial soundness from very close angle. It is calculated by using following model.

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

Where,

CCAR = Core Capital Adequacy ratio

Core capital = paid-up capital + share premium + non redeemable

Preference share + general reserve + cumulative profit - goodwill if any

Supplementary Capital Adequacy Ratio

Supplementary capital adequacy ratio is the expression of numerical relationship between supplementary capital and total risk adjusted assets. It measures the proportion of supplementary capital in total risk adjusted assets. Further, more, it shows the absolute contribution of supplementary capital in capital adequacy. The ratio is used to analyze the supplementary capital adequacy and determined by using the following model.

$$SCAR = \frac{\text{Supplementary Capital}}{\text{Risk Weighted assets}} \times 100$$

Where,

SCAR = Supplementary capital adequacy ratio

Supplementary capital = Loan loss provision + exchange equalization

Reserve + assets revaluation reserve + hybrid capital instrument +

Unsecured subordinate term debt + interest rate fluctuation fund + other free reserves

Non-performing Loan Ratio

The non-performing loan ratio indicates the relationship between non-performing loan and total loan. It measures the proportion of non-performing loan in total loan and advances. The ratio is used to analyze the asset quality and determined by using the given model.

$$\text{Non-performing Loan Ratio} = \frac{\text{Non-performing Assets}}{\text{Total Loan and Advance}} \times 100$$

Where,

Non-performing loan=loan not recovered with in the given the time
Frame either in the form of interest servicing or principal repayment.

Loan Loss Ratio

The loan loss ratio is the expression of numerical relationship between loan loss provision and loan and advances. It is used to appraise quality of asset. It measures the proportion of loan loss provision in total and advances. This ratio shows the possibility of loan default. Higher ratio implies higher portion of non-performing loan portfolio. For the purpose of study following is used to determine the loan loss ratio.

$$\text{Loan Loss Ratio} = \frac{\text{Loan Loss Provision}}{\text{Total Loan and Advance}} \times 100$$

Total Expenses to Total Income Ratio

The total expenses to total income ratio is the expression of numerical relationship between total expenses and total incomes of the company. It measures the proportion of total expenses in total revenues. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability (IMF, 2000). Following is the expression of total expenses to total revenues ratio.

$$\text{Total Expenses to Total Income Ratio} = \frac{\text{Total expenses}}{\text{Total Income}} \times 100$$

Earning Per Employee

Earning per employee is the numerical relationship between net profits after tax to total number of employee. Low or decreasing earnings per employee can reflect

inefficiencies because of overstaffing, with similar repercussions in terms of profitability (IMF, 2000). It is calculated by using the following model.

$$\text{Earning Per Employee} = \frac{\text{Net Profit After Tax}}{\text{Number of Employee}} \times 100$$

Return of Equity (ROE): The return on equity indicates the relationship between net profit taxes to total equity capital. It measures of the rate of return following to the company's shareholders. Higher is the return on equity, higher the investment, which the shareholders will undertake. For the purpose of the study, following model is used to determine the return of equity ratio.

$$\text{Return on Equity} = \frac{\text{Net Profit After Tax}}{\text{Total Equity Capital}} \times 100$$

Return on Assets (ROA)

Return on assets is the numerical relationship between net incomes after taxes to total assets of a company. It is primarily an indicator of managerial efficiency; it indicates how capably the management of the company has been covering the institution's assets into net earnings (Rose, 1999). It is calculated by using the following model.

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

Net Interest Margin

Net interest margin is the expression of numerical relationship between net interest income and total earning assets of a company. It measures how large a spread between interest revenues and interest costs management has been able to achieve by close control over the company's earning assets and the pursuit of the cheapest sources of funding (Rose, 1999). For the purpose of the study, following model is used to determine net interest margin.

$$\text{Net Interest Margin} = \frac{\text{Net Interest Income}}{\text{Earning Assets}} \times 100$$

Where,

Net interest income = interest income – interest expenses

Earning assets = loan & advances + investment of securities

Earnings Per Share (EPS)

Earnings per share provides a direct measure of the returns flowing to the company's owners its stockholder- measured relative to the members of share to the public (Rose, 1999). It gives the strength of the share in the market. Following is the expression of earning per share.

$$\text{Earnings Per Share} = \frac{\text{Net Income Shareholder}}{\text{Number of Share}} \times 100$$

Total Liquid Fund to Total Deposits Ratio

A total liquid fund to total deposits is the expression of numerical relationship between total liquid funds and total deposits of the company. It measures the proportion of total liquid funds in total deposits. Further, more, it shows the overall short-term liquidity position. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the company. It is calculated by using the following model.

$$\text{Total Liquid Fund to Total Deposit Ratio} = \frac{\text{Total Liquid Fund}}{\text{Total Deposit}} \times 100$$

Where,

$$\text{Total liquid fund} = \text{cash in hand} + \text{foreign currency in hand} + \text{balance with NRB} + \text{balance with domestic bank} + \text{balance held aboard} + \text{calls deposits}$$

NRB Balance to Total Deposit Ratio

NRB balance to total deposits ratio is the expression of numerical relationship between NRB balance and total deposits of a FI. It measures the proportion of NRB balance in total deposits. It shows whether FI is holding the balance as required by NRB. For the purpose of this study, following model is used to determine the NRB balance to total deposits.

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

Cash in Vault to Total Deposit Ratio

Cash in vault to total deposits ratio indicates the relationship between cash in vault to total deposits. It shows the percentage of total deposit maintained as vault. It is worked out by using the following model.

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

Where,

$$\text{Cash in vault} = \text{cash in hand} + \text{foreign currency in hand}$$

Interest Rate Sensitivity

Interest rate sensitivity is estimated by GAP analysis. If ζR_{id} is the average interest rate change affecting assets and liabilities that can be reprised with i_{th} maturity bucket, the effect on the net interest income (NII) in the i_{th} maturity bucket is calculated by (Saunders and Cornett, 2004).

$$\begin{aligned} \zeta NII_i &= \sum_{i \text{ X1day}}^{1 \text{ XithMaturityBucket}} RSA_i - \sum_{i \text{ X1day}}^{1 \text{ XithMaturityBucket}} RSL_i \quad | \quad \zeta R_i \\ &= \text{GAP}_i \times \zeta R_i \end{aligned}$$

Where,

ζNII_i = change in interest income in the i_{th} maturity bucket.

GAP_i = Rupee size of gap between book value of rate sensitivity assets (RSA) and rate sensitivity liabilities (RSL) in maturity bucket i .

Similarly cumulative GAP (CGAP) of interest is the one year reprising gap estimated as:

$$\begin{aligned} \zeta NII_i &= \text{CGAP} \times \zeta R_i \\ \text{CGAP} &= \end{aligned}$$

$$\begin{aligned} & \sum_{i \text{ X1day}}^{1 \text{ X90Days}} RSA_i - \sum_{i \text{ X1day}}^{1 \text{ X90Day}} RSL_i + \sum_{i \text{ X91days}}^{i \text{ X180 Days}} RSA_i - \sum_{i \text{ X91days}}^{i \text{ X180Day}} RSL_i + \sum_{i \text{ X181days}}^{i \text{ X270 Days}} RSA_i - \sum_{i \text{ X181days}}^{i \text{ X270 Days}} RSL_i + \sum_{i \text{ X271days}}^{i \text{ X360 Days}} RSA_i - \sum_{i \text{ X271days}}^{i \text{ X360 Days}} RSL_i \end{aligned}$$

Interest Rate Sensitivity

Interest rate sensitivity can be computed by expressing cumulative GAP as a percentage of total risk sensitivity assets (A) as:

$$\text{Interest rate sensitivity} = \frac{\text{CGAP}}{A} \times 100$$

3.7.2 Statistical Tools

Average: A simple arithmetic average is used to summarize the data as a representation of mean data. A simple arithmetic average is a value obtained by dividing the sum of the values by their numbers (Kothari, 1989). Thus, the average is expressed as:

$$(\bar{X}) = \frac{\sum X}{N}$$

Where,

(\bar{X}) = Mean of the values

N = Number of observation

During the analysis of data, mean is calculated by using the statistical formulas average on excel data sheet on computer.

Standard Deviation

Standard deviation is the absolute measure of dispersion of the values and shows the deviation of dispersion or dispersion in absolute term (Kothari, 1989). It is said that higher the value of standard deviation the higher the variability and vice versa. Karl person introduced the concept of standard deviation in 1983. Here, the standard deviation is used to find out the deviation in absolute term. Standard deviation is determined in following way.

$$S.D. (\sigma) = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n}\right)^2}$$

Here,

n = No. of observation

x = Individual value

During the analysis of data, standard deviation is calculated by using the statistical formula on SPSS program of computer.

Coefficient of Variation

Coefficient of variation is the relative measure of dispersion based on the standard deviation (Kothari, 1989). It is most commonly used to measure the variation of data and more useful for the comparative study of variability in two or more series or graph or distribution. Symbolically, the coefficient of variation is calculated as:

$$CV = \frac{\sigma}{\bar{X}}$$

Here,

Σ = Standard deviation

\bar{X} = Mean

CV = Coefficient of variation

Least Square Trend Analysis

Least square trend has been used to find to the trend of trend of ratio (Kothari, 1989).

The general equation used for trend is given below:

$$Y = a + bx$$

Where,

Y = Dependent variable

x = Coded time in year (independent variable)

a = y – intercept

b= slop of the trend line

In the above model,

$$b = \frac{N \cdot \sum X \sum Y - \sum X \sum Y}{N \cdot \sum X^2 - (\sum X)^2}$$

$$a = \frac{\sum Y - b \sum X}{N}$$

CHAPTER–IV

DATA ANALYSIS AND PRESENTATION

This chapter deals with the presentation of data collected from the different sources. The purpose of this chapter is to study evaluate and analyze the financial performance of Oriental Co-operative Limited in the framework of CAMELS.

4.1 Data Presentation and Analysis

The data collected from different sources been refined and documented in Excel table, Which are further processed to analyze and arrive at the finding on the financial condition of Oriental Co-operative Limited in terms of CAMELS framework.

4.1.1 Capital Adequacy

Capital adequacy is a measurement of a financial institution to determine if solvency can be maintained due to risks that have been incurred as a course of business. Capital adequacy component analysis of OCL is made based on the regulations and standard ascertain by NRB as to maintaining minimum risk based core and total capital standard and maximum risk based supplementary capital standard. The minimum risk based capital standard which includes a definition for risk-based capital, a system for calculating Risk Weighted Assets (RWA) by assigning on and off balance sheet items to broad risk categories. Capital Adequacy Ratio (CAR) takes in to account the most important financial risks-foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution's assets. A finance company must be able to generate capital internally, through earnings retention, as a test of capital strength.

4.1.1.1 Core Capital Adequacy Ratios

Core (Tier 1) capital means the primary capital of a finance company. Core capital includes the paid up equity capital, share premium, dividend equalization fund, capital adjustment reserve, non-redeemable preference share, general reserve accumulated profit and loss amount and good will deductible if any (Baral, 2005) . In this way, it is

the amount of shareholders fund. It gives an assurance to the outsiders for smooth operation of a co-operative limited even in the time of economic crisis. Core capital adequacy ratio is also known as core capital to total risk adjusted assets ratio, which measures the adequacy of internal sources or shareholder's funds to support the financing activities (Baral, 2005).

It reflects the financial strength and soundness of co-operative limited. Higher values of the ratio above the NRB standard show the adequacy of internal sources and higher security to creditors and depositors. The lower value of core capital adequacy ratio with regard to the NRB standard indicates the lower is its internal sources. Table 4.1 present the observed value of core capital adequacy ratio of OCL, during the period of past five FYs.

Table 4.1: Core Capital Adequacy Ratio

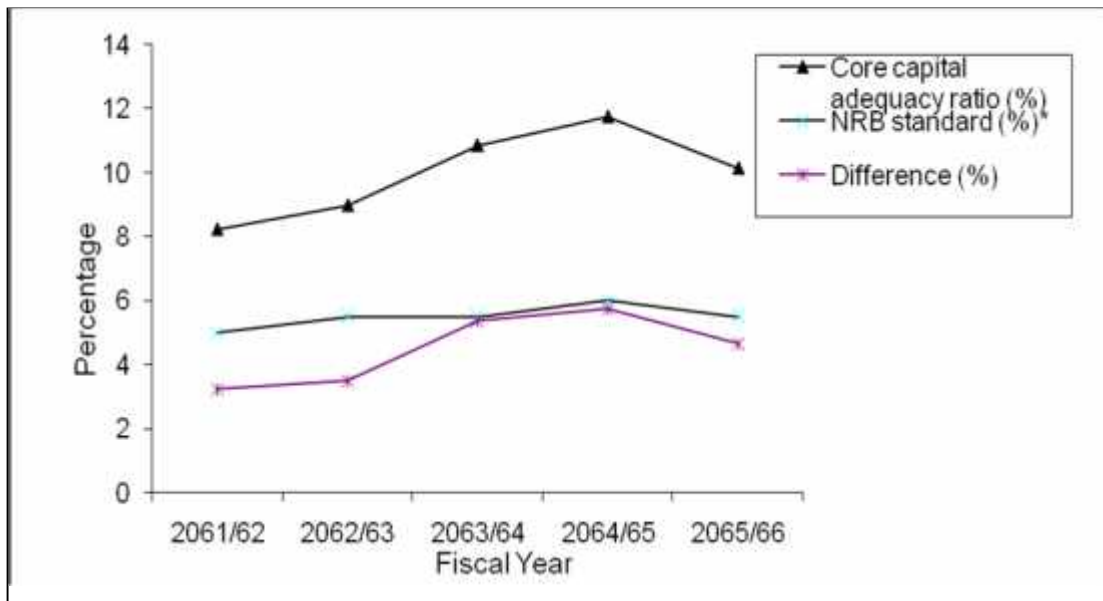
Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital (Rs)	46473.84	52931.43	73782.84	87714.26	109816
Total risk weighted assets (Rs)	564646.92	588592.1	679222.63	746602.5	1081858.42
Core capital adequacy ratio (%)	8.23	8.99	10.86	11.75	10.15
NRB standard (%)*	5	5.5	5.5	6	5.50
Difference (%)	3.23	3.49	5.36	5.75	4.65

Source: OCL Annual Reports.

As shown in table 4.1, the core (Tier 1) capital ratio of OCL is maximum of 11.75 in FY 2064/65 and minimum of 8.23 in FY 2061/62. Thus, it is clear that the core capital adequacy ratio of the OCL is increasing tendency up to FY 2064/65 and thereafter, it is decreased in FY 2065/66. The ratio is in fluctuating trend. The changing pattern of the core capital adequacy ratio and regularly increasing trend of core capital provide the clear way for conclusion that the total risk adjusted assets of the OCL is instable during the study period. However, the core capital adequacy ratio of the OCL is greater than the NRB standard over the study period. The observed value of core capital provides the clear ways for conclusion that the total risk adjusted assets of the OCL is instable during the study period. However, the core capital adequacy ratio of the OCL is greater than the NRB standard over the study period. The observed value of core capital adequacy ratio of the OCL is shown with NRB is figure 4.1 below.

Figure 4.1 : Comparing Core Capital Adequacy Ratio with NRB Standard



As shown in figure 4.1, it is clear that the core capital adequacy ratio of OCL is above the NRB standard during the study period. It means the OCL is applying adequate amount of internal sources of shareholder's funds with significance over the study period.

4.1.1.2 Supplementary Capital Adequacy Ratio

Supplementary (Tier 2) capital is another component of co-operative limited. Supplementary capital means the amount of capital that are transferred in free reserve and collected by using the hybrid capital instruments, General Loan Loss provision, Exchange Equalization Reserve, Assets Revaluation Reserve, Interest Spread Reserve, Subordinate Term Debt and other Free Reserve (Baral, 2005). The ratio reflects proportion of supplementary capital component in total risk adjusted assets and relative contribution in the CAR. NRB regulates supplementary capital ratio by allowing supplementary capital not exceeding 100% of the core capital for CAR calculation.

Table 4.2 Supplementary Capital Adequacy Ratio

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Supplementary Capital (Rs)	7893.25	7165	6113.2	6522.92	7016.7
Total risk weighted assets (Rs)	564646.9	588592.1	679222.6	746602.5	1081858.4
Supplementary capital adequacy ratio (%)	1.40	1.22	0.90	0.87	0.65
NRB standard (not more than core capital (%))*	8.23	8.99	10.86	11.75	10.15
Excess/ short (%)	6.83	7.77	9.96	10.88	9.50

Source: OCL Annual Reports.

As shown in table 4.2, the supplementary capital ratio of OCL is range from a minimum of 0.65% in FY in 2065/66 to maximum of 1.40% in FY 2061/62. The ratio of OCL is decreasing trend. There is maximum supplementary capital in FY 2061/62 of 1.40% and minimum in FY 2065/66 of 0.65% over the study period. However, the supplementary capital ratio of OCL is within boundary of NRB standard over the study period. The observed value of supplementary capital ratio of the OCL is shown with NRB standard in figure 4.2.

Figure 4.2 Comparing Supplementary Capital Adequacy Ratio with NRB Standard

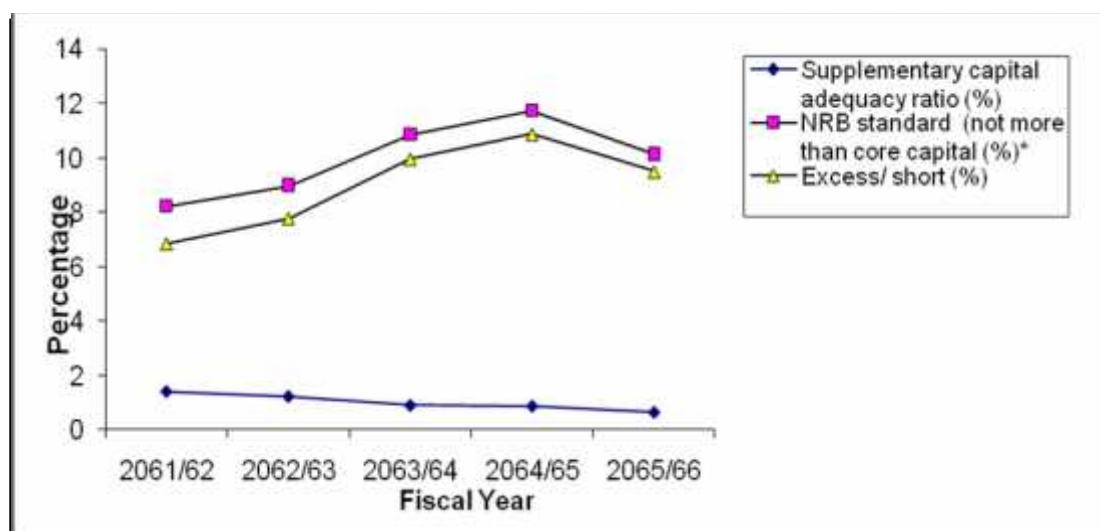


Figure 4.2 shows the observed supplementary capital adequacy ratios are within the standard of NRB, over the study period. It means the supplementary capital of the OCL is significant as per the NRB standards. The OCL is able to maintain positive difference greater than 6% through the study period.

4.1.1.3 Total Capital Adequacy Ratio

Total capital fund means the amount invested by shareholders, creditors and the amount collects from the various free reserve maintained in a co-operative. Capital fund includes the amount of core capital and supplementary capital. Strong capital base is the pre-requisite for the safety and soundness of any company (Baral, 2005). Capital adequacy ratio above the NRB standard indicates adequacy of capital and signifies higher security to depositors, higher internal sources and higher ability to cushion operational and unanticipated losses. The lower value, on the contrary indicted lower internal sources, comparatively weak financial position and lower security to depositors.

Table 4.3: Capital Adequacy Ratio

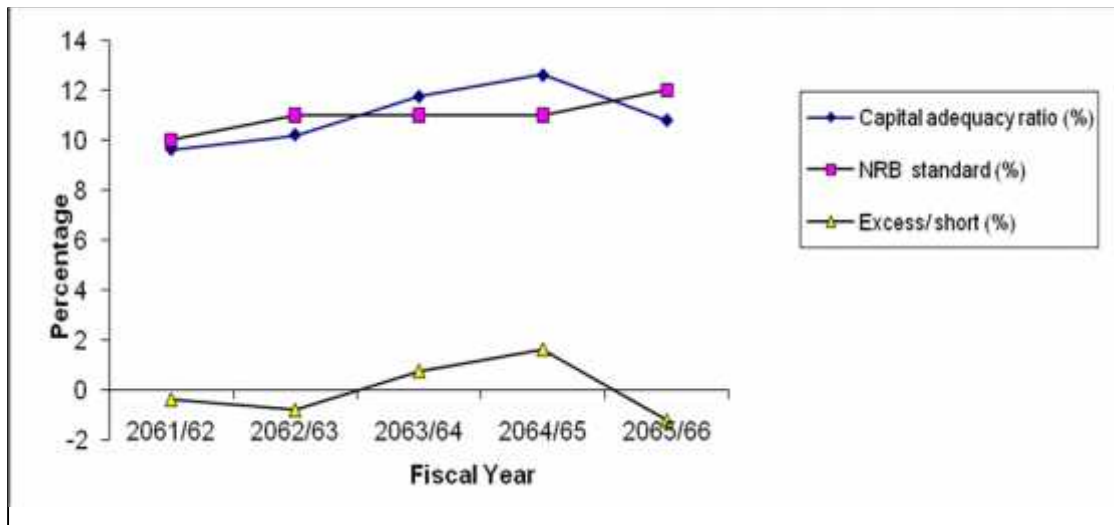
Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Capital Funds (Rs)	54367.09	60096.43	79896.04	94237.08	116832.7
Total risk weighted assets (Rs)	564646.9	588592.1	679222.6	746602.5	1081858
Capital adequacy ratio (%)	9.63	10.21	11.76	12.62	10.80
NRB standard (%)	10	11	11	11	12
Excess/ short (%)	-0.37	-0.79	0.76	1.62	-1.20

Source: OCL Annual Reports.

As shown in table 4.3 the capital adequacy ratio of OCL is distributed as minimum ratio of 9.63% in FY 2061/62 and a maximum ratio of 12.62% in FY 2064/65. The ratio of the OCL is increasing in the beginning year up to FY 062/63 and decreased in FY 2065/66. Capital funds and risk-weighted assets are in increasing trend. The OCL capital adequacy ratios are within NRB standard only in two years over the study period. (I.e. FY 2063/64 and 2064/65). The capital adequacy ratios aren't with in NRB standard in three FY over the study period (i.e.2061/62, 2062/63, 2065/66). The observed value of capital adequacy ratio of the OCL is shown with NRB standard in figure 4.3 below.

Figure 4.3: Comparing Capital Adequacy Ratio with NRB Standard



As shown in figure 4.3, the capital adequacy ratios of OCL are in fluctuating trend. The OCL is success to maintain its capital adequacy ratio only in two FY with NRB standard over the study period. The OCL was not able to maintain its capital adequacy ratio for three FY with NRB standard over the study period.

4.1.2 Asset Quality Analysis

Asset quality is one of the most critical areas in determining the overall condition of a financial institution. The primary factor effecting overall asset quality is the quality of the loan portfolio and the credit administration program. The extent of the credit risk depends on quality of assets held by an individual F1. The quality of assets held a F1 depend an exposure to specific risk, trends in non-performing loans and the health and profitability of bank borrowers especially the corporate sector (Baral, 2005). NRB used compositing of assets, non-performing loan to total loan and loan loss provisioning ratio are taken as the indicator to examine the asset quality of financial institutions. NRB has directed the financial institution in regards to the concentration of the loan. Any licensed F1 can grant the fund base loan to a single borrower or borrowers related to the same business group up to 25% of its primary capital. In the same vein, it can provide the non-fund base loan up to 50% of its core capital (NRB, 2005). Similarly it was directed F1s to classify the loan into performing loan non-performing loans. The loans that are not due and 3 months past due fall in the class of performing loans/performing assets and others do in the non-performing loans.

Further non-performing loans are classified into three group; substandard, doubtful and bad/loss assets requiring provisioning of 25%, 50% and 100% respectively (NRB, 2005). In the study assets composition, non-performing loan and loan loss provision are taken and prove to measure assets quality of the FIs.

4.1.2.1 Assets Composition

The asset portfolio of the financial institution is both complex and I interesting It represents more faithfully the varied nature and ramification of the F1 function and policies. In fact, the assets side of the balance sheet indicates the manner in which the funds entrusted to the F1 are deployed. Usually every banker seems to arrange its assets in an ascending order of profitability and descending order of liquidity (Chand, 2006). Thus, the structure of a balance sheet indicates assets appearing in the descending order of liquidity. The capital and liabilities of FIs are invested in various assets in the form of cash and bank balance, placements, investments, bills purchase, loan and advances and fixed assets. Loans and advances contain the high proportion of potential risk to the FI's capital. Assets not only determine the soundness of a FI but also its capacity to earn profits.

Table 4.4: Assets Composition (in %)

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66	Mean
Cash & Bank Balance	1.37	4.98	1.63	3.94	1.75	2.734
Money at call	0	0	2.02	6.83	5.57	2.884
Investment	10.42	7.6	9.57	15.72	22.7	13.202
Loan & advances	82.69	82.55	85.84	73.49	69.34	78.782
Fixed Assets	0.22	0.18	0.15	0.11	0.11	0.154
Other Assets	5.3	4.69	0.79	-0.09	0.53	2.244
Total	100	100	100	100	100	100

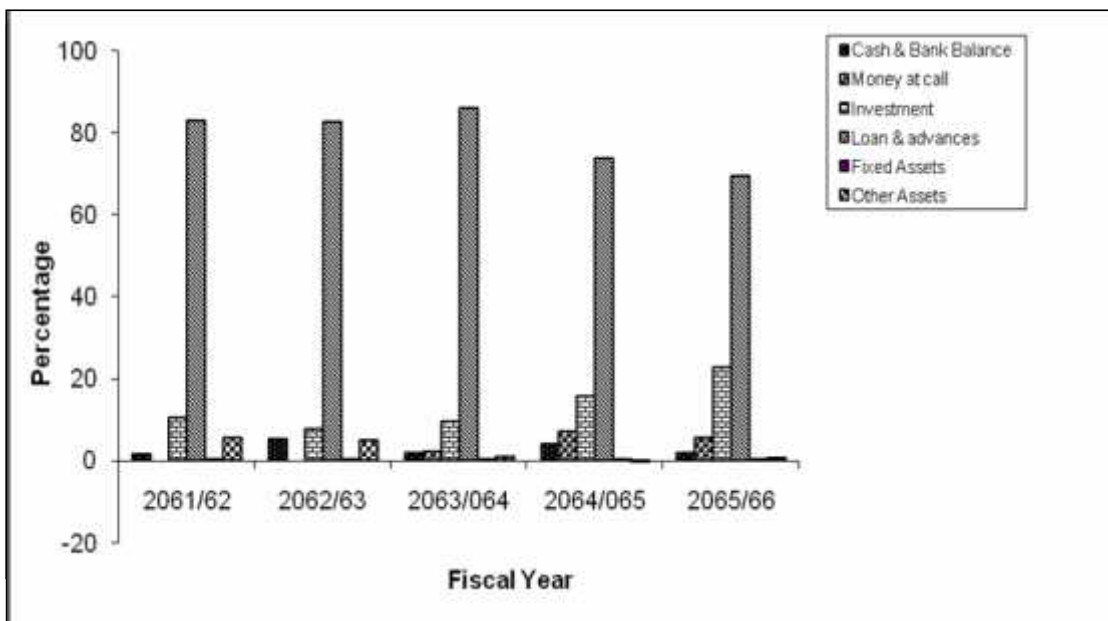
Source: OCL Annual Reports.

As shown in table 4.4, percentage of cash and bank balance is fluctuating trend. In the beginning the balance is increased, then decreased, again increased and in last year, the balance is decreased. The money at call is nil in the beginning two years. Then it is increasing trend for two years thereafter it is decreased in last fiscal year over the study period. The percentage of investment has decreased in first two fiscal years.

Then it is increasing trend from FY 2063/64 till FY 2065/66. Similarly, the percentage of loan and advances is decreasing trend except FY 2063/064. Likewise, the percentage of fixed assets and other assets is decreasing trend over the study period. The mean percentage of cash and bank balance, money at call, investment, loan and advances, fixed assets and other assets are 2.734, 2.884, 13.202, 78.782, 0.15 and 2.224 percent respectively during the study period.

As shown in table, the OCL's large part of assets is loan and advances and lowest part is fixed assets. The figure 4.4 shows the assets composition of the co-operative limited during the study period.

Figure 4.4 Assets Composition



4.1.2.2 Non-performing Loan to Total Loan and Advances

Loan and advances usually represent the single largest assets of most financial institutions. When the borrowers fail to pay the interest or even principles within the period the performance loan begins to start in non-performing loan. As per NRB directives all loans and advance must be classified in order of principles default aging into pass (past due up 3 months), sub-standard (pass due between 3-6 months), doubtful (past due 6-12 months) and loss/bad (Past due over FYs). (NRB directives, 2061). NPL forms an aggregate of substandard, doubtful and loss loans. The ratio of NPL to total loan and advances shows the percentage of NPL in total loan. The lower the ratio the better is the proportion of performing loans and risk of default.

Table 4.5: Non- Performing Loan Ratio

Amount in thousands

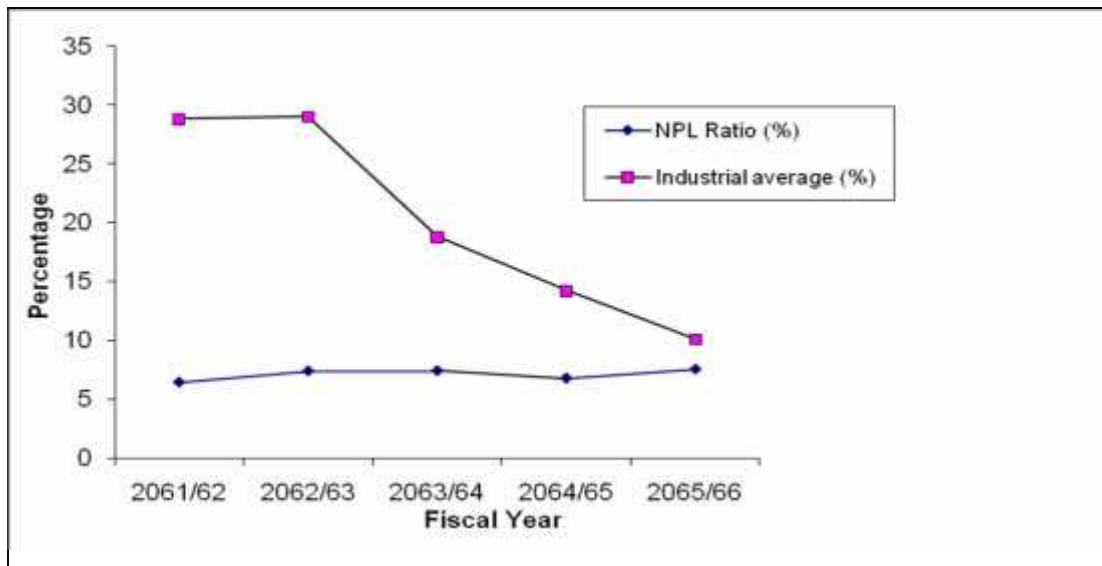
Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Non-performing loan (Rs)	24205	38753	49094	48107	62425.47
Total Loan (Rs)	375855	522983.9	660415.67	710660.9	825556.4
NPL Ratio (%)	6.44	7.41	7.43	6.77	7.56
Industrial average (%)	28.8	29	18.79	14.22	10.12

Source: OCL Annual Reports.

* Banking and financial statistics NRB, No, 49 July, 2007.

Table 4.5 shows that the ratio of NPL with comparing to industrial average for the study period. The NPL ratios of OCL are slightly increasing trend except FY 2064/65 over the study period. The ratios of OCL are not more fluctuating trend. The ratios of different FY are near one to another. The largest ratio is 7.56% in FY 2065/66 and smallest ratio is 6.44% in FY 2061/62. All ratios are below the industrial average. The observed value of NPL ratio of the OCL is shown with industrial average in figure 4.5 below.

Figure 4.5 Comparing Non-performing Loan Ratio with Industrial Average



In figure 4.5, NPL curve of OCL is below the industry average curve in all observed FYs. However, in last year the PEL ratio and industrial ratio are near. If the line is going in this trend, the OCL's NPL ratio may cross the industrial ratio because the industrial ratios are decreasing trend by very differently. However, the OCL's NPL ratios are single digit. Single digit NPL ratio is internationally recognized to be acceptable (Baral, 2005).

4.1.2.3 Loan Loss Ratio

The loan-provisioning ratio indicates adequacy of allowance for loans and trend in the collection of loan and the performance in loan portfolio. It is obtained by the ratio of loan loss provision to the total loan. Loan loss ratio previous useful insight into the quality of a financial institution loan portfolio and bad debts coverage and the adequacy of loan loss provisions. Greater loan loss provision is required to allow if high loss is expected. This ratio shows the possibility of loan default of a financial institution. It indicates how efficiently FI manages its loan, advances, and makes effort for the loan recovery. Higher ratio implies higher portion of non-performing loan portfolio. The ratio of loan loss provision to total loans and advances describes the quality of assets that F1 is holding. The provision for loan loss reflects the increasing probability on non-performing loan in the volume of total loans and advances. Loan loss provision on the other hand signifies the cushion against future contingency created by the default of the borrowers. The high ratio signifies the relatively more risky assets in the volume of loans and advances. The high provision for loan loss shows the recovery of loan to be difficult and irregular and the age of the loan in increasing. More delay the FI gets to collect the loan, the provision will be higher and the ratio will be higher (Jackson 1975) have identified few early warning variables based on the balance sheet. The loan loss ratio is defined as the measure of prospective losses that are envisioned by the FI management in relation to the FIs overall loan and investment.

Table 4.6: Loan Loss Ratio

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Loan Loss Provision (Rs)	18538	27445	31867	55913	77124
Loan and Advances (Rs)	375855	522983.9	660415.7	710660.9	825556.4
Loan Loss Ratio (%)	4.93	5.25	4.83	7.87	9.34

Source: OCL Annual Reports.

Table 4.6 exhibits that the loan loss ratio for the study period has increasing trend except FY 2063/64. The ratio range is from 4.83% to 9.34%. The mean of loan loss ratio is 6.44% and standard deviation is 2.046% over the study period. Figure 4.6 shows trend of loan loss ratio.

Figure 4.6 Trend of Loan Loss Ratio

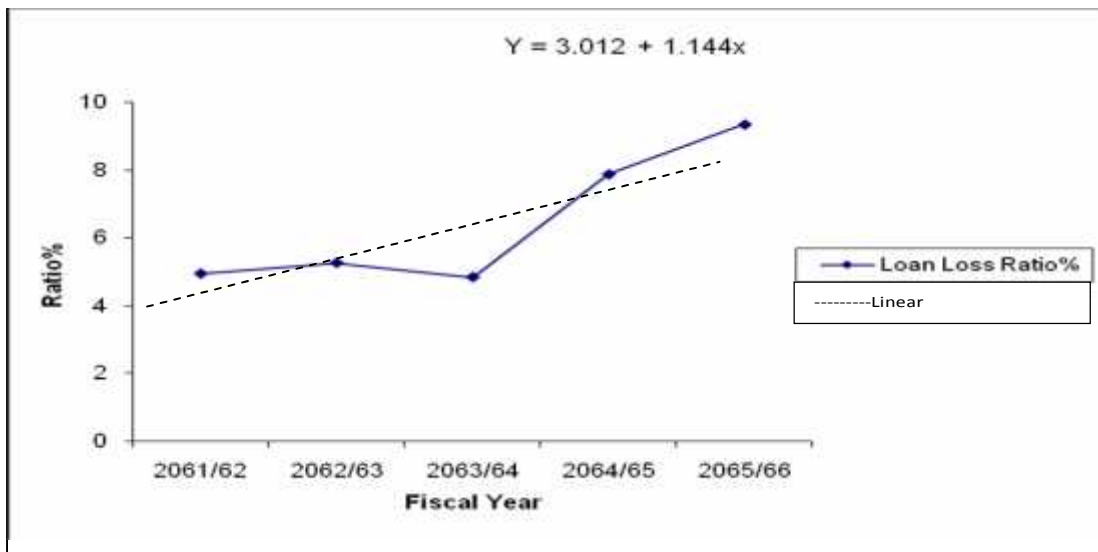


Figure 4.6 shows the observed value of loan loss ration along with least square trend line. The ratio is moving up and down during the study period. The slope of the trend line is determined by the least square method is positive which indicates the trend of loan loss ratio is increasing over the study period.

4.1.3 Management

Sound management is the key of financial institution performance. The general management of the institution, human resources policy, governance, management information system, internal control, auditing, strategic planning and budgeting are distinct areas that reflect the overall quality of management (Rose, 1999).

While the other factors can be quantified easily from current financial statements, management quality is somewhat being subjective and difficult to measures. There is one measure that is relevant to management is the ratio of total expenses total revenue. Assuming that how good the management is correlated with this ratio which used to represent the management. Another measure that is also relevant to management is the ratio of earnings per employee is used as a proxy of management quality.

4.1.3.1 Total Expenses of Total Revenue Ratio

The ratio of total expenses to total revenue is used as a proxy measure of the management quality. This ratio is calculated by dividing the total expenses by total revenues. A high level of expenditure in un-productive activities may reflect an inefficient management. A high of increasing ratio of expenses of total revenue may give indication of inefficient operation. This can be, but necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability (IMF, 2000).

Financial institution earnings originate from interest on loans and advances, investments, commissions and discounts, foreign exchange rates, gains and miscellaneous income. Conversely, it expends on depositor's interest, staff salaries, provident funds, allowances and other operating expenses like rent, water, electricity, fuel expenses, audit fees, management expenses, losses shorted off, and provisions for income tax are non-operation expenses.

Table 4.7: Total Expenses to Total Revenue Ratio

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Expenses (Rs)	35203	53515	55792	83593	88061
Total Revenue (Rs)	60679	78226	80937	92653	116185
Total Expenses /Total Revenue Ratio (%)	58.02	68.41	68.93	90.22	75.79

Source: OCL Annual Reports.

As shown in table 4.7, the total expenses to total revenue ratio is increasing up to FY 2064/65 then after it is decreased in FY 2065/66. From the above table, OCL expenses are high in FY 2064/65, there is greater expenses 90.22% and in FY 2061/62 lower expenses 58.02% over the study period. In this way, OCL expenses are high with the comprising its revenue.

Figure 4.7: Trend of Total Expenses to Total Revenue Ratio

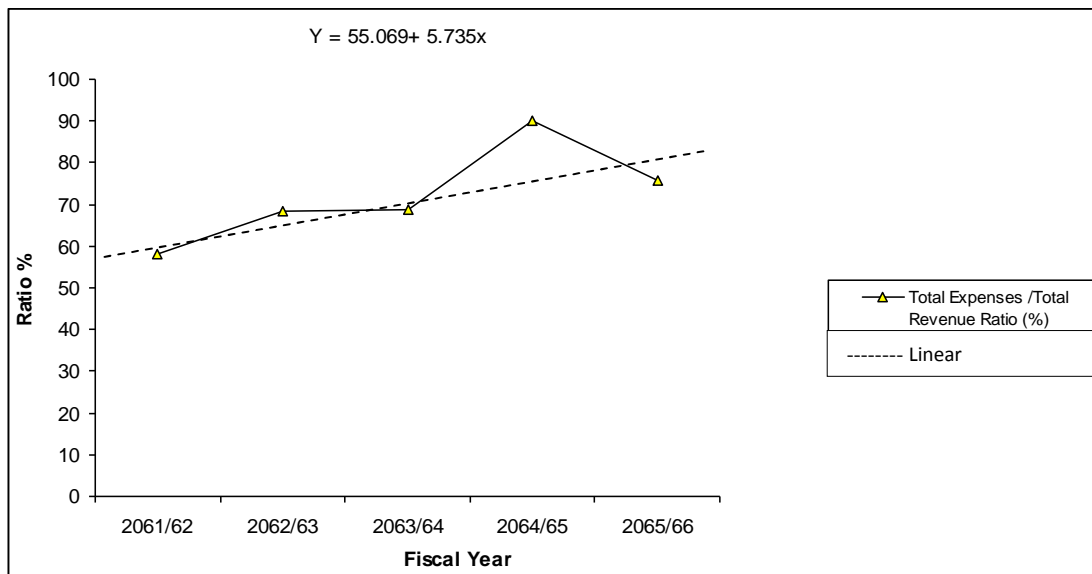


Figure 4.7: Shows the total expenses to total revenue ratio with least square trend line. The slope of least square trend line is positive i.e. 5.735. So the linear line is going down to up. It shows the ratio is increasing trend over the study period. It is not favorable for OCL. The loan loss provision is very high in FY 2064/65. So, the total expense also is increased highly but revenue is increased in low less than expenses ratio. Therefore, the total expenses to total revenue ratio in FY 2064/65 is very high i.e. 90.22%.

4.1.3.2 Earning Per Employee

As earning per employee is also taken as measure of management quality in this study. It is calculated dividing net profit after by number of employees. Low or decreasing earning per employee can reflect in efficiencies because of overstaffing with similar repercussion in terms of profitability (IMF, 2001).

Table 4.8 : Earning per Employee

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit (Rs)	13560	15493	15466	1827	14003
No. of employees	13	15	15	14	16
Earning per employee (Rs)	1043.08	1032.87	1031.07	130.50	875.19

Source: OCL Annual Reports.

Table 4.8 shows the earning per employee in rupees during the study period. The ratio is decreasing trend up to 2064/65 and then increasing but it is lower than its greatest value. Over the study period, maximum earning per employee is Rs. 1043. 08 thousands and minimum is Rs. 130.5 thousands in FY 2061/62 and 2064/65 respectively. The mean ratio of earning per employee is Rs. 822.54 thousands over the study period.

Figure 4.8: Trend of Earning Per Employee

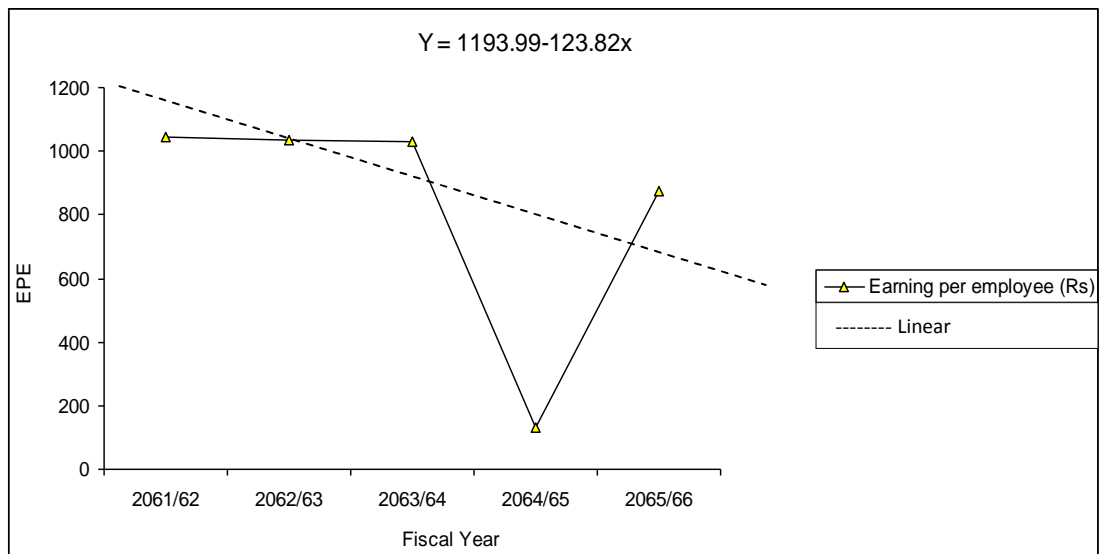


Figure 4.8 shows the observed value of earning per employee with least square linear line. The slope of the trend line is negative i.e. – 123.815. Which indicates the earning per employee is decreasing trend over the study period.

4.1.4 Earning Quality

The main objective of FI is to earn profit and their level of profitability is measured by profitability ratios. Earnings represent the first line of defense against capital depletion resulting from shrinkage in asset value. Earning performance should also allow the FI to remain competitive by providing the resources. Profitability ratio are calculated to measure to the efficiency of FI, higher profit ratios indicates higher efficiency and vice versa.

4.1.4.1 Return on Equity (ROE)

ROE is measure of the rate of return flowing to the company's shareholders. It approximates the net received from investing their capital in the company

(Rose, 1999). Return on equity reveals how well the FI uses the resources of owner. The higher ratio represents sound management and sufficient mobilization of the owner's equity and vice versa. ROE of 15% is treated, as standard and banking industry are desired to have higher than this (Baral, 2005).

Table 4.9: Return on Equity (ROE)

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit (Rs)	13560	15493	15466	1827	14003
Shareholder Equity (Rs)	20000	20000	20000	52000	60000
Return of Equity (%)	67.8	77.47	77.33	3.51	23.34

Source: OCL Annual Reports.

As shown in table 4.9, the return on equity ratio of the OCL is minimum of 3.51% and maximum of 77.47% in FY 2064/65 and 2062/63 respectively. The mean ratio of the OCL is 49.89%, standard deviation is 34.24% and the coefficient of variation of them is 0.69. The observed values of ratio are fluctuating over the study period. The mean ratio is near 50%, it is reasonable for the OCL. If we compare ROE with its mean, it is increasing trend in the beginning period and decreasing trend in ending period of over the study period. The profit is very low in FY 2064/65 due to very high loan loss provision and the shareholder equity is increased in this year by 32000 thousands. So, ROE of OCL in inconsistency.

Figure 4.9: Trend of Return of Equity Ratio

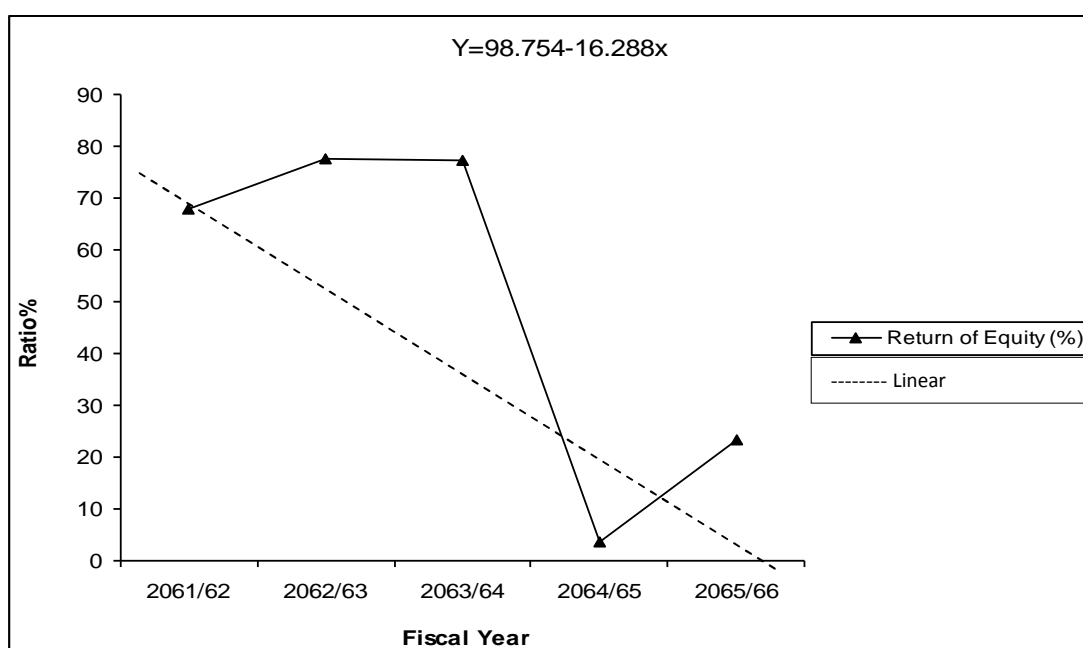


Figure 4.9, shows the trend of return of equity with least square linear line. The least square slope is negative i.e. 16288. This indicates, the trend of ROE is decreasing trend over the study period.

4.1.4.2 Return on Assets (ROA)

ROA is measure of the rate of return flowing to the company's total assets. It is a measure of profitability linked to the asset size of the FI. It is primarily an indicator of managerial efficiency; it indicates how capably the management of the FI has been converting the institutions assets into net earnings. ROA is a popular tool to measure how well its assets are utilized in generating profit. It measures the profit earning capacity by utilizing, available resources i.e. total assets, return will be higher if the FI resources are well managed and efficiently utilized. Generally, the return of assets ratio should be one percentage and higher is desired to the financial industry.

Table 4.10: Return on Assets

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit (Rs)	13560	15493	15466	1827	14003
Total Assets (Rs)	432097	600270	632191	890983	1079290
Return on Assets (%)	3.14	2.58	2.45	0.21	1.30

Source: OCL Annual Reports.

As shown in table 4.10, the return on asset ratio of the OCL is minimum of 0.21% in FY 2064/65 and maximum of 3.14% in FY 2061/62. The ratio is decreasing trend up to FY 2064/65 then increasing from 2065/66. But it is decreased than only last year. In overall, the trend is decreasing. The mean ratio of ROA is 1.93%, standard deviation is 1.17%. The mean ratio is above 1% benchmark. Therefore, the OCL ROA is also within benchmark.

Figure 4.10 Trend of Return of Assets Ratio

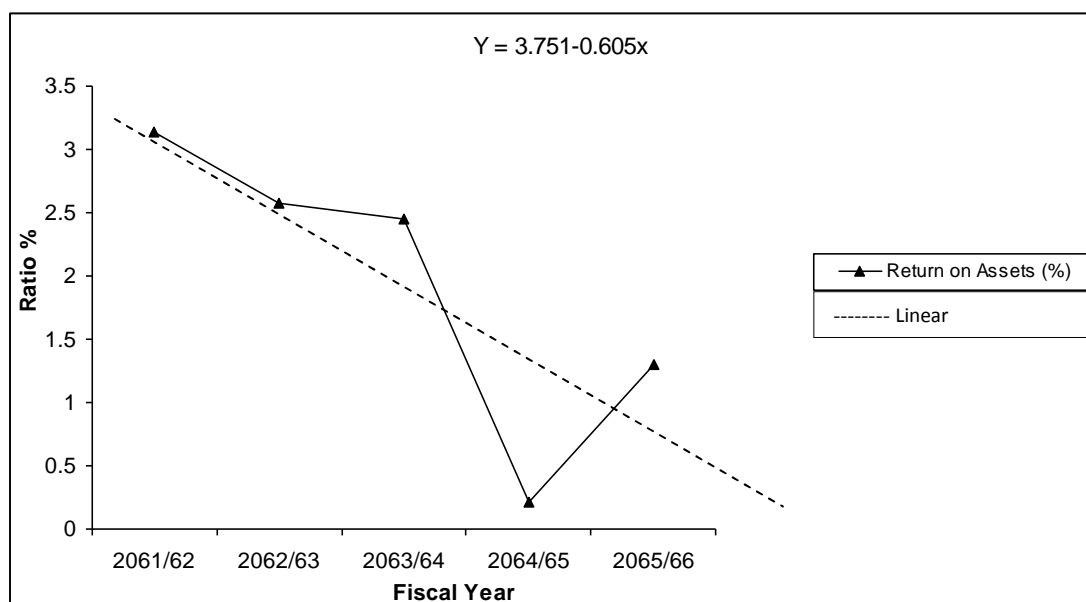


Figure 4.10 shows the observed value of ROA with least square linear line. The shape of linear line is negative i.e. 0.605. The negative slope of linear indicates decreasing trend. Therefore, the trend of ROA is decreasing over the study period. The total assets of OCL have increased in last two years very high but net profit is decreased due to high expenses. Therefore, the ROA of OCL also is in decreasing trend over the study period.

4.1.4.3 Net Interest Margin (NIM)

The net interest margin measure how large a spread between revenues and interest costs management has been able to achieve by close control the FI earning assets and the pursuit if the cheapest sources of finding (Rose, 1999). It is calculated the net interest income dividing by earning assets. Under earning assets loans and advances, bills purchase and discounted and investment made in securities (T-Bill, Bonds) are included.

Generally, the net interest margin ratio should be 3% to 4% and higher is better in FI industry (World Bank, 1996). However, it highlights the fact that looking are returns without looking at risk can be misleading and potentially dangerous in terms of FI solvency and long run profitability (Saunders and Cornet, 2004).

Table 4.11 Net Interest Margin

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Interest Income (Rs)	26647	30135	28299	33722	47811
Earning Assets (Rs)	377936	547056	680393	780621	886212
Net Interest Margin (%)	7.05	5.51	4.16	4.32	5.39

Source: OCL Annual Reports.

As shown in table 4.11, the NIM of OCL ratio is minimum of 4.16% in FY 2063/64 and maximum of 7.05% in FY 2061/62. The NIM ratio of OCL is decreasing trend up to FY in 2062/63 and then it is slightly increasing from FY 2064/65. The mean ratio for the period is 5.29%, and standard deviation is 1.16%. It can be concluded that, the NIM ratio of OCL is accepted. Because it is with in standard, the standard of NIM ratio is 3% to 4%.

Figure 4.11: Trend of Net Interest Margin Ratio

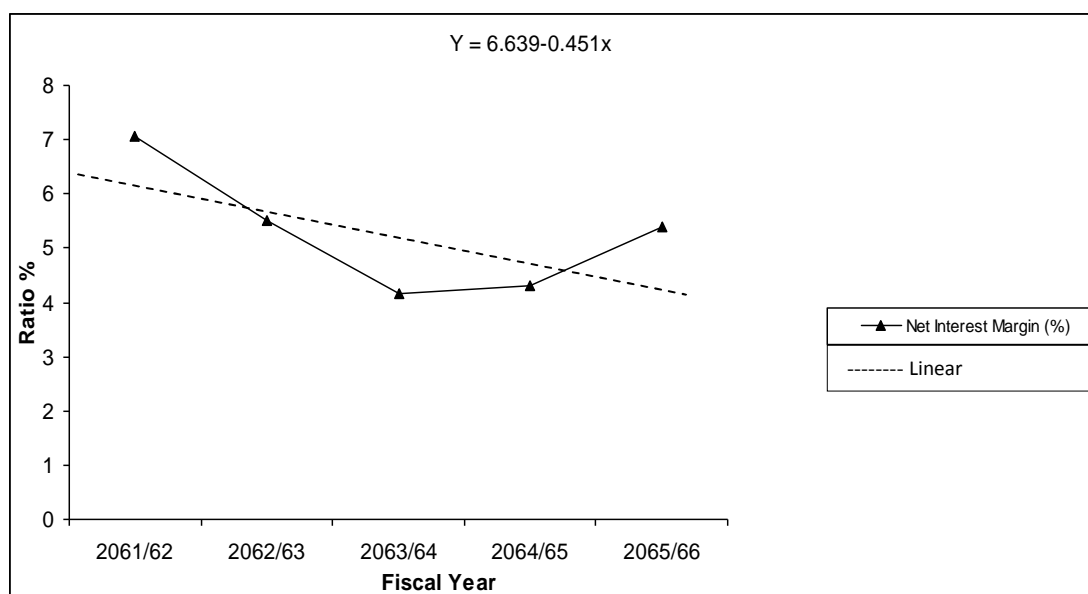


Figure 4.11 shows the observed value of net interest margin ratio with least square linear line. The slope of linear line is negative i.e. -0.451 . It indicates that, the trend of NIM is decreasing over the study period.

4.1.4.4 Earnings Per Share (EPS)

Earnings per share provides a direct measure of the returns flowing to the company owners, its stockholders' measure relative to the number of shares of shares to the public (Rose, 1999). The earnings per share of an organization give the strength of the share in the market. The earnings per share of OCL are tabulated below:

Table 4.12: Earning Per Share

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit	13560	15493	15466	1827	14003
No. of Share	200	200	200	400	600
Earnings Per Share (Rs)	67.8	77.47	77.33	4.57	23.34

Source: OCL Annual Reports.

Table 4.12 shows that the EPS of the OCL has ranged between Rs. 4.57 to Rs. 77.47. The OCL EPS is decreasing trend. The maximum EPS is Rs 77.47 in FY 2062/63 and minimum of Rs 4.57 in FY 2064/65. The mean EPS of OCL is Rs 50.10 and standard deviation is 33.89%.

Figure 4.12 Trend of Earning Per Share

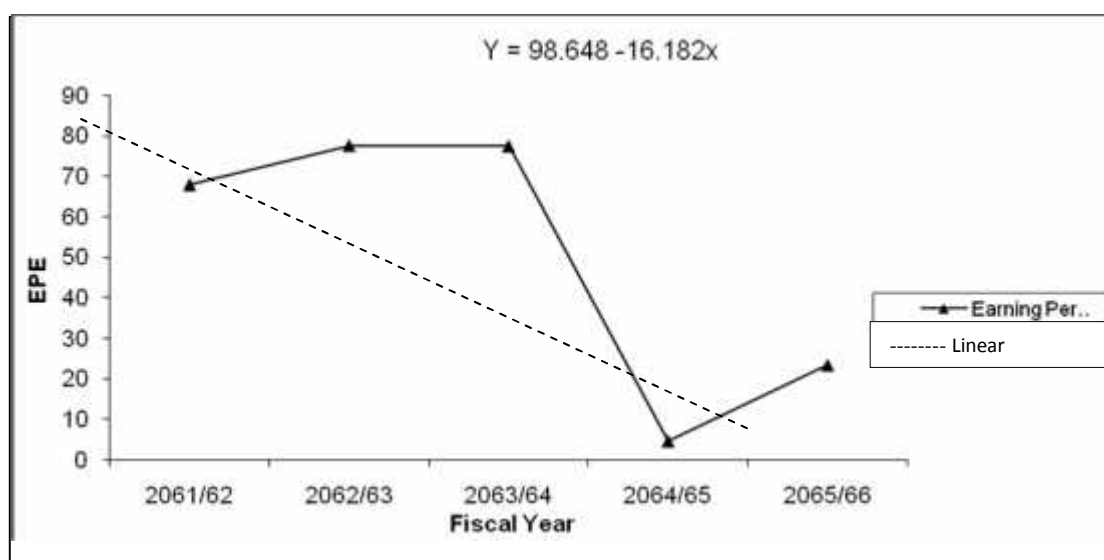


Figure 4.12 shows the observed value of EPS with least square linear line over the study period. The slope of EPS is negative i.e. 16.182. It indicates that, the trend of EPS is decreasing. The Number of Share has increase in last two years 064/65 and 2065/66 by 200 thousands respectively, but the net profit has decreased in these years. Therefore, the EPS has decreased by very high amount.

4.1.5 Liquidity

The level of liquidity influences the ability of FI system to withstand shocks. Liquidity risk arises when an FI'S liability holders like depositors demand immediate cash for the financial claims they hold with an FI. The most liquid asset is cash for which FIs can use directly to meet liability holder's demands to withdraw funds. Day to day withdrawals by liability holders is generally predictable and large. FIs can expect to additional funds on the money and financial markets to meet any sudden shortfalls of cash. At times face a liquidity crisis due to either lack of confidences on the FIs problem or some unexpected need for cash, the liability holders may demand larger withdrawals than usual. This turns the FI's liquidity problem into a solvency problem and causes it to fail (Saunders and Cornett, 2004).

4.1.5.1 Liquid Assets to Total Deposit Ratio

This ratio measures the percentage of liquid fund with the company to meet short-term obligation. It measures overall liquidity position. Cash in hand foreign currency in hand, balance with NRB, balance held abroad and money at call are including in total liquid fund. This ratio is computed by dividing liquid assets by total deposits. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the company (NRB directives, 2061).

Table 4.13: Liquid Funds to Total Deposit Ratio

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Liquid Funds (Rs)	5940	29865	26733	96031	78948
Total Deposit (Rs)	342862	493917	629069	763055	883222
Liquid Funds/Total Deposit (%)	1.73	6.05	4.25	12.59	8.94
Industrial Average (%)*	20.2	19.6	15.2	13.3	10.25
Diff. from Industrial Avg. (%)	-18.47	-13.55	-10.95	-0.71	-1.31

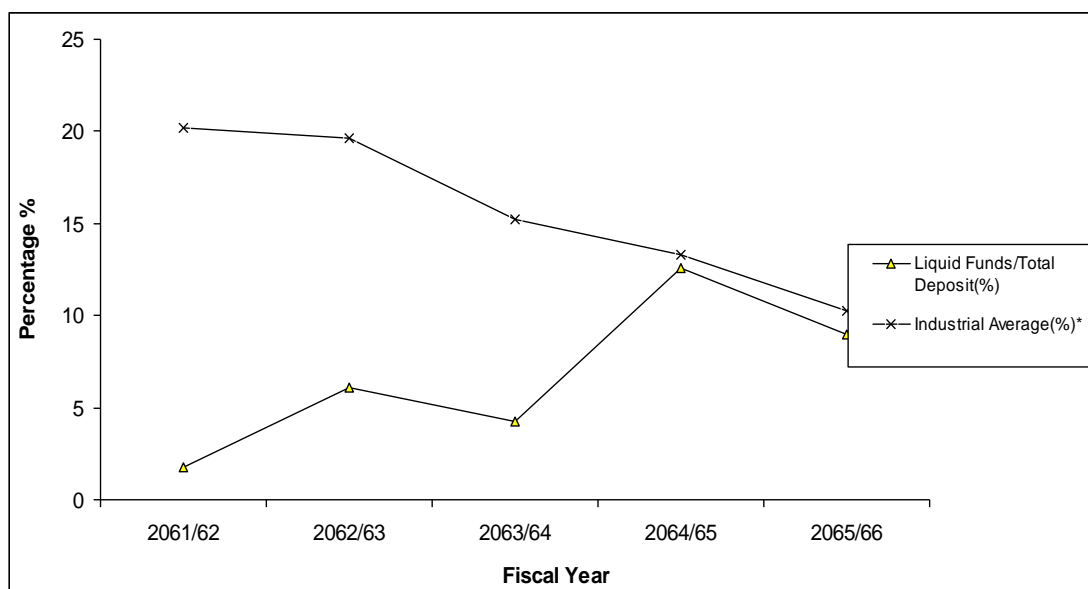
Source: OCL Annual Reports.

* Banking and financial statistics NRB, No. 49 July 2007.

Table 4.13 shows that the liquid funds to total deposit ratio of OCL during the period of FY 2061/62 to FY 2065/66. The ratios are fluctuating trend. The ratio is increased in FY 2061/62, thereafter it it increased in FY 2064/65 and again it is decreased in FY 2065/66. The ratio is minimum in FY 2061/62 i.e. 1.73% and maximum in FY

2064/65 i.e. 1.59%. The liquid fund to total deposit ratio of OCL are lower than industrial average during the study period. So, the difference with industrial average in negative for all fiscal year during the study period.

Figure 4.13: Comparing Liquid Funds to Total Deposits Ratio with Industrial Average



In the above figure 4.13, the total liquid fund to total deposit curve of OCL is under the industry average curve in all the observed fiscal year. It shows that, the liquidity position of OCL is not better than industrial average ratio.

4.1.5.2 NRB Balance to Total Deposit Ratio

This ratio shows whether the FI is holding the balance as required to NRB. To ensure adequate liquidity in the FI to meet the depositors demand for cash at any time. To inject the confidence in depositors regarding the safety of their deposit funds NRB has put the directives to maintain certain percent of total deposit in NRB by the FIs. Total deposits means current, saving and fixed deposit account as well as call account deposit and certificates of deposits. For the purpose, deposits held in convertible foreign currency, employee guaranteed amount and margin account will not be included (NRB Directive. Manual 2004, P.14). The following table shows the NRB balance to total deposit ratio with compare to NRB standard by OCL.

Table 4.14: NRB Balance to Total Deposit Ratio

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
NRB Balance (Rs)	3500	4950	6400	25902	18082
Total Deposit (Rs)	342862	493917	629069	763055	883222
NRB Balance/Total Deposit (%)	1.02	1.00	1.02	3.39	2.05
NRB Standard (%)	6	6	5	5	5

Source: OCL Annual Reports.

Table 4.14 shows NRB balance to total deposit ratio of OCL. The table shows that, OCL has not maintaining balance with NRB. The balance is under the NRB standard in each fiscal year over the study period. The balance ratio is fluctuating trend.

Figure 4.14: Comparing NRB Balance to Total Deposits Ratio with NRB Standard

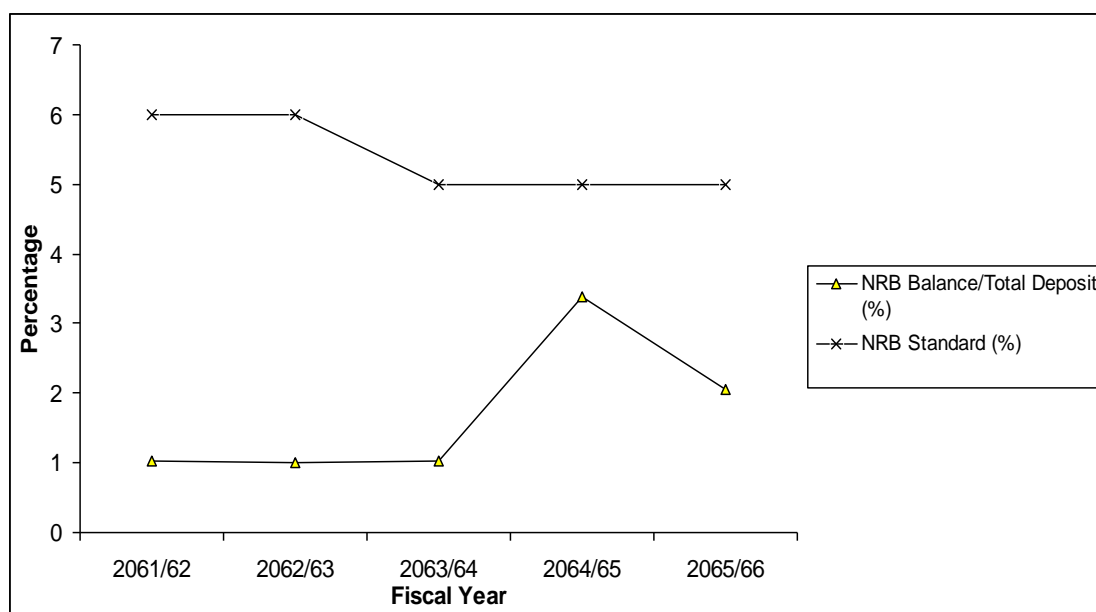


Figure 4.14 shows the NRB balance to total deposit ratio with compare to NRB standard over the study period. As shown in figure 4.14 the NRB balance to total deposit ratio curve of OCL is below the NRB standard curve in each year over the study period. It shows that the NRB balance is less than NRB standard not OCL has not maintained the balance with NRB as the directives over the study period.

4.1.5.3 Cash in Vault to Total Deposit Ratio

This ratio shows the percentage of total deposits held as cash in vault. This ratio is computed by dividing cash at vault by total deposits. Cash and foreign currencies in hand are included as cash in vault. Total deposit means current saving and fixed deposits account as well as account deposit and certificates of deposits. For the purpose deposits held in convertible foreign currency, employees guarantee amount and margin account will not be included (NRB directive manual, 2004).

Table 4.15: Cash in Vault to Total Deposit Ratio

Amount in thousands

Fiscal Year	2061/62	2062/63	2063/64	2064/65	2065/66
Cash in Vault (Rs)	359	392	355	168	260
Total Deposit (Rs)	342862	493917	629069	763055	883222
Cash in Vault/Total Deposit (%)	0.10	0.08	0.06	0.02	0.03
Industrial Average (%)*	2.9	1.8	1.9	2.2	1.6
Diff. from Industrial Average (%)	-2.80	-1.72	-1.84	-2.18	-1.57

Source: OCL Annual Reports.

**Banking and Financial Statistics, No. 49 July. 2007.*

Table 4.15 shows that the cash in vault to total deposit of OCL has fluctuating trend. The highest ratio is 0.10% in FY 2061/62 and lowest ratio is 0.02% in FY 2064/65. The ratio has decreased till FY 2064/65 and then slightly increased in FY 2065/66 over the study period. The ratio is less than industrial average in each year over the study period.

Figure 4.15: Comparing Cash in Vault Total Deposit Ratio with Industrial Average

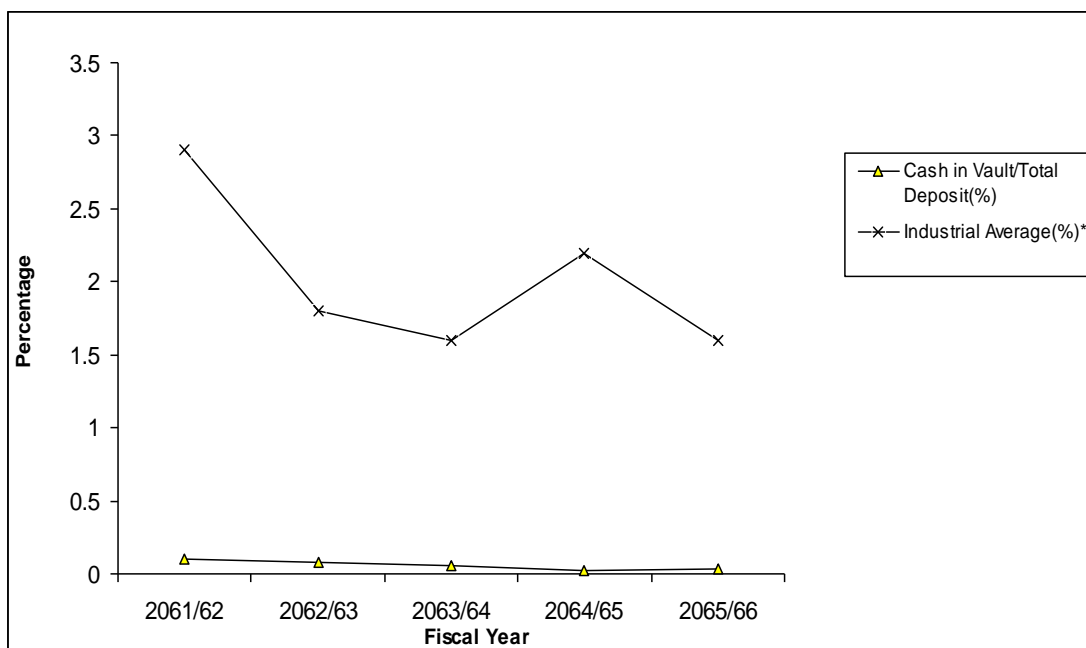


Figure 4.15 shows the observed cash in vault ratio of OCL with compare to industrial average ratio within the study period. In the figure, the ratio curve is under the industrial average curve in each year. It shows that, the ratio of OCL is less than industrial average in each year.

4.1.6 Sensitivity to Market Risk

Sensitivity to market risk refers to the risk that changes in market conditions could adversely affect earnings and or capital. FIs are increasingly involved in diversified operations such as lending and borrowing, transaction in foreign exchange, selling off assets pledged for securities and so on. All these are subject to market risk like interest rate risk, foreign exchange rate risk and financial asset and commodity price risk. The health of FI more sensitive to market risk is more hazardous than of less sensitive. Foreign exchange risk, interest rate risk, equity price risk commodity price are the indicators of sensitivity to market risk.

When a FI has more liabilities re-pricing in arising rate environment than assets re-pricing, the net interest margin NIM shrinks, conversely, if the FI is asset sensitivity in arising interest rate environment, NIM will improve because the FI has more assets

re-pricing at rates. There are many ways to monitor or exposure to IRR, measurement systems vary in complexity from very simple methods such as a gap model, to very sophisticated models such as a simulation or duration analysis (Rose, 1999). This study is worked with gap model, which simply measures the net quantity that changes in interest rates will have on earnings. With a view to minimize the IRR, NRB require the banks to adopt gap analysis adopted for minimizations of IRR. FIs shall classify the time interval of the assets and liabilities on the basis of maturity period of 0-90 days, 91-180 days, 181-270 days, and 271-365 days over I FY. The effect of the profitability is measured by multiplying the change in interest rate, R_i in the i^{th} maturity bucket annualized with cumulative gap (NRB Directives Manual, 2004).

If the interest rates rise on RSAs and RSLs, the positive CGAP ($RSA > RSL$) would project the increase in the expected annual net interest income (NII). However, if interest rates fall when CGAP is positive, NII will fall. As rates, fall interest revenue falls by more than interest expenses. Thus NII falls by approximately by $(CGAP) \times (\Delta R)$. In general when CGAP is positive the change in NII is positively related to the change in interest rates. Thus, FI would want to keep CGAP positive when interest rates expected to rise.

Conversely, when the CGAP or the gap ratio is negative ($RSA < RSL$). If interest rates by equal amounts for RSAs and RSLs, NII will fall. Similarly, if interest rates fall equally for RASs and RSLs, NII will increase when CGAP is negative. As rates, fall interest expenses decrease by more than the revenues. In general, when CGAP is negative, the change in NII is negatively related to relate to the change in interest rate. Thus, FIs are expected to keep CGAP negative when interest rates are expected fall.

Expressing the re-pricing gap as a percentage of assets, give: (1) the direction of the interest rate exposure (+ or CGAP) (2) the scale of the CGAP against the assets size of the FI.

Gap analysis of RSAs and RSLs of OCL for the period of FY 2064/65 and 2065/66 is made as shown in Table 4.16 (a and b) based on the different maturity time bucket.

Table 4.16: Gap Analysis**A. 2064/65**

Days	1 to 90	91 to 180	181 to 270	271 to 365	> 365	Total
RSA (Thousand)	9603.1		14000		71066.1	94669.2
RSL (Thousand)	990	2650	3220	46760	25475.5	79095.5
GAPi (RSA-RSL) thousands	8613.1	-2650	10780	-46760	45590.6	15573.7
CGAP (RSA-RSL) thousands	8613.1	5963.1	16743.1	-30016.9	15573.7	
RSA/RSL	9.70	0	4.347826	0	2.79	1.20
CGAPi Ratio (CGAP/Total RSA) %	9.10	6.30	17.69	NA	16.45	
(R %)				1%	1%	
NII (thousands) CGAP × R				-300.17	155.74	

Source : OCL Annual Reports.

B. 2065/66

Days	1 to 90	91 to 180	181 to 270	271 to 365	> 365	Total
RSA (Thousand)	7894.9				107055.6	114950.5
RSL (Thousand)	7495	4809	12001.8	4000.7	32565.7	60872.2
GAPi (RSA-RSL) thousands	399.9	-4809	-12001.8	-4000.7	74489.9	54078.3
CGAP (RSA-RSL) thousands	3999.9	-4409.1	-16410.9	-20411.6	54078.3	
RSA/RSL	1.05	NA	NA	NA	3.29	1.89
CGAPi Ratio (CGAP/Total RSA) %	0.35	NA	NA	NA	47.04	
(R %)				1%	1%	
NII (thousands) CGAP × R				-204.12	540.78	

Source : OCL Annual Reports.

The research period is 2061/62 to 2065/66 but lack of the data for review of sensitivity of market risk only two fiscal years (2064/65 and 2065/66) data are taken. A net financial asset (RSA-RSL) in the short-term maturity bucket ranging from 0-90 day to 271-365 days was positive and negatives both. In the long-term maturity bucket (>365 Days) the gap was positive in both two years by Rs. 45590.6 and Rs. 74489.9.

Figure 4.16: Level of Risk Sensitivity Assets and Liability Over Time

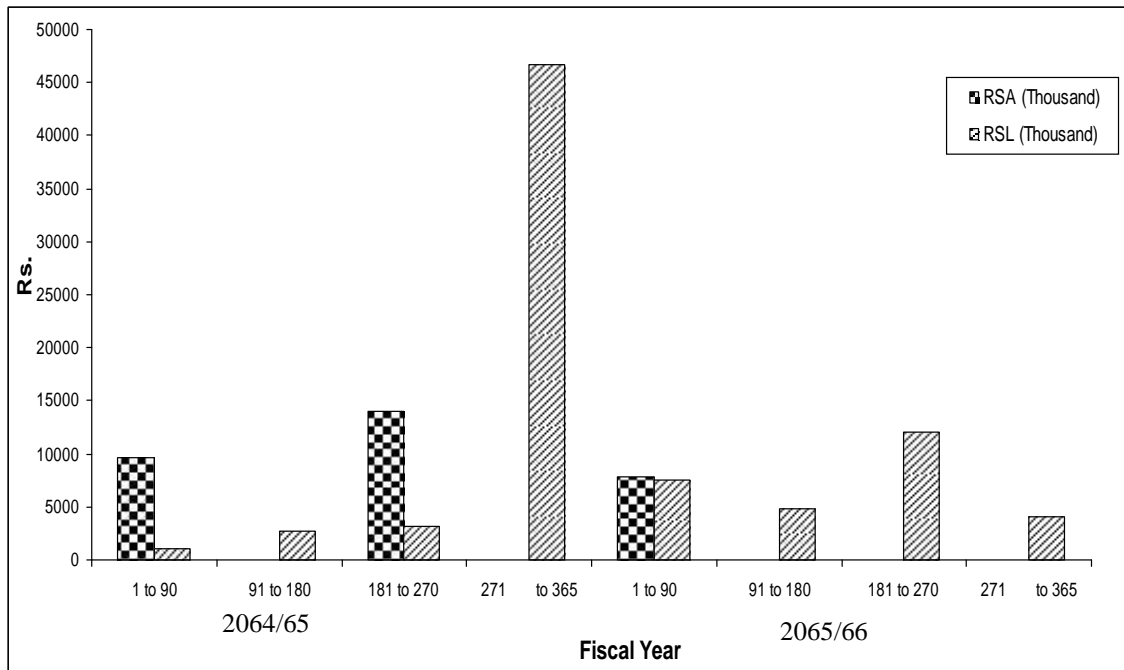


Figure 4.16, shows a compression of RSAs and RSLs of the OCL in a time bucket ranging from 0-90 days to 365 days time horizon. The cumulative gap, CGAP of the RSAs and RSLs representing in the short-term maturity bucket (0-90) days is positive, (91-181) negative (181-270) positive (271-365) negative in FY 2064/65. In FY 2065/66 short term maturity bucket (0-90) is positive and other all period's is negative. The CGAP or the interest rate sensitivity ratio to the total earning assets over the short-term horizon i.e. up to one FY was highest with 9.1% in FY 2064/65 and lowest with 0.35% in FY 2065/66. The CGAP ratio to the earning assets over the long-term horizon was highest with 47.04% in FY 2065/66 and lowest with 16.45% in 2064/65.

4.2 Major Findings

The major findings of the study on financial analysis of OCL in the frame of CAMELS are as follows.

-) Core capital ratio is above the NRB standard with maximum positive difference of 5.75% in FY 2064/65 and minimum positive difference of 3.23% in FY 2061/62. OCL is able to maintain more than 6% above the NRB requirement in core capital adequacy ratio or OCL is adequate and sufficient.

- J The proportion of supplementary capital in the total capital fund is decreasing as compared to core capital. This means the OCL is increasing capital of permanent nature. The ratio of supplementary capital is within NRB standard over the study period. The difference of supplementary capital ratio with NRB standard is maximum is 10.88% in FY 2064/65 and minimum is 6.83% in FY 2061/62.
- J Total capital adequacy ratio of OCL is maximum with 12.62% in FY 2064/65 and minimum of 9.63% in FY 2061/62. The total capital adequacy ratio is fluctuating from FY 2061/62 to 2065/66. The CAR difference is positive only in 2 FY 2063/64 and 2064/65. Except these two years the CAR difference is negative. Therefore, OCL CAR is within NRB standard only in two FY.
- J Assets composition of OCL like in every FIs largely proportion in the loans and investment over the study period. In the study period of five FYs, the average composition of cash & bank balance, money at call, investment, loan and advances, fixed assets and other assets were 2.734%, 2.884%, 13.20%, 78.782%, 0.154% and 2.244% respectively. It reveals that movement of money at call observe in switch over in to investment during in the beginning two FYs.
- J The non-performing loans to total loans & advances ratio range from 6.44% in FY 2061/62 to 7.56% in FY 2065/66. The ratios were below the industrial average in every FY during the study period.
- J The loan loss ratio for the study period is in increasing trend. The ratio ranges from 4.83% in FY 2063/64 to 9.34% in FY 2065/66 with in average of 6.44%. The increasing trend of loan ratio indicates OCL's quality of loan assets is not getting better.
- J The total expenses to total revenue ratio is increasing trend. The range of ratio is 58.02% in FY 2061/62 to 90.22% in FY 2064/65. The slope of linear line is positive which indicates, that the ratio of OCL is increasing trend during the study period.
- J The average earning per employee of the study period was Rs. 822.54 thousands. The Slope of the observe earning per employee trend along with least square trend line is negative, which indicate the earning per employee is decreasing trend over the study period.

-) The return of equity ratio of the OCL is minimum of 3.51% in FY 2064/65 and maximum of 77.47% in FY 2062/63. The mean ratio of OCL is 49.89%. The ratio is fluctuating in downward trend. The slope of trend line determined by the least square method is negative. This indicates, the OCL ROE ratio is decreasing trend over the study period.
-) The return on assets mean ratio of OCL is 1.93%. The ratio is maximum of 3.14% in FY 2061/62 and minimum of 0.21% in FY 2064/65. The slope of least square trend line of ROA is negative. This indicates, OCL ROA ratio is decreasing trend.
-) Over the study period, the mean ration of NIM of OCL is. 5.29%. The slope of the trend line determined by least square trend line is negative which shows decreasing trend of NIM ratio during the study period.
-) The EPS of the OCL was fluctuates over the FYs of the study period. The EPS of OCL was ranged between Rs. 4.57 in FY 2064/65 to Rs. 77.47 in FY 2062/63. The mean of EPs is decreasing trend.
-) The liquid assets to total deposit ration of OCL during the period FY 2061/62 to FY 2065/66 are increasing trend. However, the ratios are lower than industrial average. The difference is negative in all over the period.
-) NRB balance to total deposit ratio of OCL are fluctuating trend. The range of ratio is 1% in FY 2062/63 to 3.395 in FY 2064/65. The ratio of OCL is lower than NRB standard in all over the study period.
-) The volume of cash at vault ratio is less than the industry average in all over the study period. The observed cash in vault ratio was decreasing trend. The difference of cash in vault with industrial average is negative in all over the study period. It shows the OCL is not strictly following the directives issued by NRB in respect to balance must held as a vault.
-) FYs 2064/65 and 2065/66, net financial assets (RSA-RSL) re-pricing in the short term maturity bucket ranging from 0-90 days to 271-365 days is found negative and positive both in different periods. In the long-term maturity bucket (>365 days) the gap is positive in both two years. The cumulative gap CGAP of RSA and RSL re-pricing in the short term maturing bucket (0-365) in both FYs is found negative and positive both in different periods. The interest rate sensitivity is higher for long-term maturity that short term maturity bucket.

CHAPTER–V

SUMMARY, CONCLUSIONS AND RECOMMEDATIONS

This chapter includes three aspects of the study summary, conclusion and recommendations. The first aspect summarizing the whole study, the second draws the conclusion and last one forward the recommendations.

5.1 Summary

This study was carried out as academic requirements for MBS degree on the topic of "Financial performance Analysis of Oriental Co-operative Limited in the Framework of CAMELS". The study was started with the objective to find out the fact about financial performance of OCL. The analysis of financial statement is done to obtain a better insight in to firm's position and performance. CAMELS is a technique of health checking of financial institutions. Financial institution's financial soundness is judged on the basis of capital adequacy, asset quality, management quality, earning quality, liquidity position and sensitivity to market risk. Almost, all the government FIs in Nepal are running at loss. Though almost private sector FIs are earning profit. It is very to difficult to call them sound if appraised from CAMELS approach. Thus, the interest was expressed to analyze the financial performance of current balance with carrying a case study of OCL in the framework of CAMELS.

FIs are introducing complex and innovative products, they are exposed to many risky and therefore more amplified as well as diversified the functions performed by the FI supervision department. A key product of supervision is a rating of the FI's overall condition, commonly related to as a CAMELS rating. CAMELS rating system is used by the three federal banking supervisors (The Federal Reserve, FDIC and Office of the controller of the Currency (OCC) and other financial supervisory agencies to provide a convenient summary of FI conditions at the time of exam. Various studies have been conducted in the past on the financial analysis to the financial analysis of FIs in the US and other regions were found done. In context of Nepalese banking environment, there are only few researches conducted in the framework of CAMEL (Baral, 2005, Bhandari, 2006, Chanda. 2006, Koirala, 2007).

The study analyze the level, trend and comparative analysis of capital adequacy, non-performing loan, loan loss provisions, assets composition, management quality ratios, earning capacity, liquidity position and sensitivity to market risk components of the OCL during of 5 years period FY 2061/62 to FY 2065/66. During the research the areas that formed part of the research review were functions of FIs, concept of CAMELS rating system and component evaluation system, Basel capital accord, NRB guidelines besides these, review of research paper, work paper dissertations and related reports were reviewed.

The research was conducted within the framework of descriptive and analytical research design. For the study purpose, Oriental Co-operative Limited was chosen as a study unit applying convenience sampling as technique out of two hundred thirty six financial co-operatives. The required data and information were collected from secondary sources. In addition with this primary data also are used in this research work which was collected, by using unstructured interview with senior staff in the OCL. Financial ratios, simple mathematical and statistical tools have applied to get the meaningful result of the collected data in this research work.

The analysis is made to compare OCL's ratio with NRB standard, industrial average and analyze the trend of ratios. The capital adequacy ratios of the OCL are above than NRB standard only in two fiscal years during the study period. Which lead to conclude that the OCL in not running with adequate capital. The assets are mainly composed of loans and advances investment. The non-performing loans to loan ratios are below the industrial average and the international standard. The loan loss provision of the OCL is increasing trend. The earning per employee is in decreasing trend, which indicates management is not effective. The earning quality ratio like ROE, ROA NIM and EPS are decreasing trend. The cash in vault to total deposit ratio and NRB balance to total deposit ratio and liquid assets to total deposit ratios are below than the standard during the study period. This shows hat, the OCL is not following NRB directives strictly. FYs 2064/65 and 2065/66, net financial assets (RSA-RSL) re-pricing in the short term maturity bucket ranging from 0-90 days to 271-365 days is found negative and positive both in different periods. In the long term maturity bucket (>365 days) the gap is positive in both two years. The cumulative gap CGAP of RAS and RSL re-pricing in the short term maturing bucket (0-365) in both FYs is found negative and positive both in different periods. The interest rate sensitivity is higher for long term maturity than short term maturity bucket.

5.2 Conclusions

Based on the findings of this studies as stated at the following conclusions are drawn at the end of chapter four.

-) Core capital adequacy ratio measure in terms of core capital to total risk adjusted assets is as per NRB standard. It means the OCL is using adequate amount of internal sources or core capital in part five years looking to the fact, the OCL is financially sound and strong as internal financially.
-) Supplementary capital ratio of the OCL is within the standard of NRB over the study period which supports to draw the conclusion that the supplementary capital of the OCL is sufficient.
-) Capital adequacy ratios reveal that the OCL is not running with the adequate capital and the capital fund of OCL is not sufficient. The total capital adequate ratios of OCL are within boundary of OCL standard during the study period in FY 2063/64 and 2064/65.
-) The assets composition of the OCL during the study period reveals that movement of money at call has observed in switch over into investment during the beginning two years. As it can be seen, the major part of total assets was held in form of loans and advances.
-) The non-performing loans and advances ratios are near NRB Standard in every FY during the study period. The ratios are not more fluctuating trend; it shows that the OCL non-performing loans and adopting the appropriate polices to manage this problem to increase the quality of assets.
-) The increasing trend of loan loss provision ratio indicates that the quality of loans decreasing year by year. It seems that amount of non-performing loans and possibility of default is increasing.
-) The increasing trend of total expense to total revenues ratios show that the OCL is gradually moving towards cost maximization.
-) The decreasing trend of earning per employee shows that the profit has not increased when staff increased.
-) The decreasing trend of EPS shows that, OCL management is not aware about stockholder's profit.
-) The total assets of OCL is highly increasing trend, but net profit has not increased like total assets. Net profit is in decreasing trend. So ROA is also decreasing. It is concluded that, the capability of management has not increased earning.

-) The decreasing trend of net interest margin shows that interest costs management has not been able to achieve by close control over the OCL's earning assets and the pursuit of the cheapest sources of funding. Still, the OCL has better net interest margin comparing with benchmarks.
-) The decreasing trend of EPS shows that the return to the OCL's owner is going to be decreased. The tendency affect, the strength of the share in the market is also decreasing.
-) The liquid funds to total deposit ratio is below the industrial average ratio. This shows that OCL has not sufficient liquid fund. Lower liquid fund ratio implies the inefficient liquidity position of the company.
-) The NRB balance to total deposit ratio is below than the NRB standard during the study period. This shows that the OCL is not maintain sufficient amount of balance in NRB.
-) The cash in vault to total deposit ratio is below the industrial average. This shows that ignoring the percentage of liquid fund to make immediate payment to the depositors.
-) The sensitivity of net financial assets in a long term maturity bucket is high. Therefore sensitivity of interest rate risk changes into the short term maturity bucket. Conversely, the OCL has not able to match the risk sensitivity liabilities in long term maturity bucket so interest rate change has affect on them.

5.3 Recommendation

Based on analysis and findings of the study the following recommendations can be made as suggestions to overcome the weakness in the existing financial performance of OCL.

-) Capital adequacy ratio of the OCL is not sufficient as per the NRB standard in three FY 2061/62, 2062/63 and 2065/66 and the ratios are changing frequently during the study period. So it is suggested to maintain stable capital adequacy ratios within the boundary of NRB standard.
-) The non-performing loan ratio of OCL is in the boundary of industrial average, which is better for OCL. But the ratios are in increasing trend. So the OCL we suggested to control its non-performing loan ratio or to reduce the non-performing loan ratio and to formulate an effective powerful loan recovery committee.

-) The loan loss provision to total loan and advances is increasing trend in ending year of the study period. So, the OCL needs to give attention to lower the proportion of loan loss provision by increasing the quality of assets by strengthening the credit appraisal and follow-up measure. The loan loss provision affects directly to the net profit. If loan loss provision is less net profit will be high or vice versa. So, the company is suggested to reduce its loan loss provision ratios.
-) The total expenses to total revenue ratio is in increasing trend during the study period. So, it is recommended that to reduce its total expenses and to increase its total revenue in the coming year.
-) The earning per employee of the OCL is in decreasing trend. It is not good efficient of management. So, it is recommended that, to increase its earning per employee for this the OCL should increase its profit by reducing the expenses and it should reduce its number of staff for good earning per employee.
-) The earning quality of OCL i.e. ROA and ROE are in decreasing trend. Which indicates the earning performance of OCL is not good. So, the OCL is suggested to increase its ROA and ROE. ROE and ROA directly affected by net profit. So, net profit has positive relation to ROA and ROE. So, the company should increase its net profit to increase its ROE and ROA.
-) The NIM of OCL is within the benchmark. It is good for the company, but NIM is in decreasing trend. So, it is needed to increase its NIM ratio in the coming year.
-) The liquidity ratios of OCL are not within the boundary of industrial average and NRB standards. i.e. (liquid fund to total deposit ratio and cash in vault to total deposit ratio). It indicates the neglect of OCL to NRB directives. So. It is recommended to maintain its all liquidity ratios with in the industrial average and NRB standard. Otherwise NRB may interfere to its management.
-) The data for sensitivity analysis is not sufficient. However, I have concluded that the OCL's long term net financial assets are highly sensitive to interest rate risk than short. As the term earning assets is high. Since positive CGAP is beneficial when interest rates expected to rise and conversely negative CGAP is beneficial when interest rates are expected to fall, The OCL should minimize the mismatch of long term risk sensitive assets in order to minimize sensitivity to prevailing falling interest rates scenario.

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APPENDIX –I

Calculation linear line of loan loss ratio by least square method

Year (X)	LLR (Y)	X ²	XY
1	4.93	1	4.93
2	5.25	4	10.5
3	4.83	9	14.49
4	7.87	16	31.48
5	9.34	25	46.7
∑X = 15	∑Y = 32.22	∑X ² =55	∑XY = 108.1

$$b = \frac{N \sum XY - \sum X \sum Y}{N \sum X^2 - (\sum X)^2}$$

$$= \frac{5 \times 108.1 - 15 \times 32.22}{5 \times 55 - (15)^2}$$

$$= 1.44$$

$$a = \frac{\sum Y - b \sum X}{N}$$

$$= \frac{32.22 - 1.144 \times 15 \times 15}{5}$$

$$= 3.012$$

$$Y = 3.012 + 1.44x$$

APPENDIX –II

Calculation linear line of total expenses to total revenue ratio

Year (X)	TER (Y)	X ²	XY
1	58.02	1	68.02
2	68.41	4	136.82
3	68.93	9	206.79
4	90.22	16	360.88
5	75.79	25	378.95
∑X = 15	∑Y = 361.37	∑X ² =55	∑XY = 1141.46

$$b = \frac{N \sum XY - \sum X \sum Y}{N \sum X^2 - (\sum X)^2}$$

$$= \frac{5 \times 1141.46 - 15 \times 361.37}{5 \times 55 - (15)^2}$$

$$= 5.735$$

$$a = \frac{\sum Y - b \sum X}{N}$$

$$= \frac{361.37 - 5.735 \times 15}{5}$$

$$= 55.069$$

$$Y = 55.069 + 5.735x$$

APPENDIX –III

Calculation linear line of earning per employee by using least square method

Year (X)	EPE (Y)	X ²	XY
1	1043.08	1	1043.08
2	1032.87	4	2065.74
3	1031.07	9	3093.21
4	130.5	16	522
5	875.19	25	4375.95
∑X = 15	∑Y = 4112.71	∑X ² =55	∑XY = 11099.98

$$b = \frac{N \sum XY - \sum X \sum Y}{N \sum X^2 - (\sum X)^2} \qquad a = \frac{\sum Y - b \sum X}{N}$$

$$= \frac{5 \times 11099.98 - 15 \times 4112.71}{5 \times 55 - (15)^2} \qquad = \frac{4112.71 - 123.815 \times 15}{5}$$

$$= -123.815 \qquad = 1193.99$$

$$Y = 1193.99 - 123.815x$$

APPENDIX –IV

Calculation linear line of ROE by using least square method

Year (X)	ROE (Y)	X ²	XY
1	67.8	1	67.8
2	77.47	4	154.94
3	77.33	9	231.99
4	3.51	16	14.04
5	23.34	25	116.7
∑X = 15	∑Y = 249.45	∑X ² =55	∑XY = 585.47

$$b = \frac{N \sum XY - \sum X \sum Y}{N \sum X^2 - (\sum X)^2} \qquad a = \frac{\sum Y - b \sum X}{N}$$

$$= \frac{5 \times 585.47 - 15 \times 249.45}{5 \times 55 - (15)^2} \qquad = \frac{249.45 - 16.288 \times 15}{5}$$

$$= -16.288 \qquad = 98.754$$

$$Y = 98.754 - 16.288 x$$

APPENDIX –V

Calculation Linear line of ROA by using least square method

Year (X)	ROA (Y)	X ²	XY
1	3.14	1	3.14
2	2.58	4	5.18
3	2.45	9	7.35
4	0.21	16	0.84
5	1.3	25	6.5
∑X = 15	∑Y = 9.68	∑X ² =55	∑XY = 22.99

$$b = \frac{N \sum XY - \sum X \sum Y}{N \sum X^2 - (\sum X)^2} \qquad a = \frac{\sum Y - b \sum X}{N}$$

$$= \frac{5 \times 22.99 - 15 \times 9.68}{5 \times 55 - (15)^2} \qquad = \frac{9.68 + 0.605 \times 15}{5}$$

$$= -0.605 \qquad = 3.751$$

$$Y = 3.751 - 0.605x$$

APPENDIX –VI

Calculation linear line of EPS by using least square method

Year (X)	NIM (Y)	X ²	XY
1	7.05	1	7.05
2	5.51	4	11.02
3	4.10	9	12.48
4	4.32	16	17.28
5	6.39	25	25.95
∑X = 16	∑Y = 26.43	∑X ² =55	∑XY = 74.78

$$b = \frac{N \sum XY - \sum X \sum Y}{N \sum X^2 - (\sum X)^2} \qquad a = \frac{\sum Y - b \sum X}{N}$$

$$= \frac{5 \times 74.78 - 15 \times 26.43}{5 \times 55 - (15)^2} \qquad = \frac{26.43 + 16.182 \times 15}{5}$$

$$= 16.182 \qquad = 98.648$$

$$Y = 98.648 - 16.182x$$

Likewise, calculation linear line of NIM by using least square method is also calculated.