

Chapter-I

Introduction

1.1 Background of the study

Nepal is one of the least developed countries of the world as well as landlocked .Nepal is surrounded by too big and rapidly developing countries. Nepal is surrounded three sides by India and one side by China. Because of the landlockedness of the country, Nepal has to depend with neighbor countries, mainly with India. Nepal has an agro-based economy, where most of people are engaged with agriculture. The main reason for agro-based economy of Nepal is the geographical construction of the country. The other reason is due to its low literacy rate, which has restricted the people to primitive and traditional forms of occupation.

The source of finance is the most essential element for the establishment and operation of any profit and non-profit oriented institutions. Profit oriented institutions usually obtain these sources through ownership capital, public capital and financial institutions such a banks; in the form of credit and overdraft. Banking sector plays a vital role of the country's economic development. Bank is a resource mobilizing institution, which accepts deposits from various sources and invests such accumulated resources in the field of agriculture, trade commerce, industry, tourism etc.

Shrestha(1993), the banking sector is largely responsible for collecting household savings in terms of different types of deposits and regulating them into the society by lending them in different sectors of the economy. The banking sector has now reached to the most remote areas of the country and has experienced a good deal in the growth of the economy by lending their resources in small scale. An industry under intensive banking program has enabled the banks to share in the economic growth of the economy.

Grywinshki(1993),banking institutions are inevitable for the resources mobilization and all the round development and banking institutions maintain economic confidence of

various for economic development and banking institution maintain economic confidence of various segments and extend credit to people.

Bank refers to any firms that are basically concerned with the transaction of money however; today's banks are established for specific purpose. Different types of banks focus different types of services to their customers although the basic principle is same.

The history of the development of financial institution in Nepal is not very long. The history of Nepalese banking begins from the establishment of the commercial bank; Nepal Bank Limited in 1994 B. S. for the first time to provide modern and organized banking services in Nepal. Up to 2012, only NBL provided services to the public as an organized bank. Later, Nepal Rastra Bank was established in 14th Baisakh 2013 B.S. as a central bank of Nepal under NRB Act 2012. Similarly, Rastriya Banijya Bank was established in 2012 B. S. the birth of this bank brought a new landmark in the history of banking facilities in Nepal. Thereafter banks were established gradually.

The commercial act,2031 B.S,according to commercial Bank Act 2013 B. S. "A Commercial Bank is the one which exchanges money, deposits money, accepts deposits, grants loan and performs commercial banking functions and which is not a bank meant for co-operative agriculture, agriculture, industries as for such specific purpose. Commercial banks are the central part of financial institutions and commercial banks are the most visible series of financial intermediaries, Banks hold the deposits of many persons, government, establishments and business units. Commercial banks make funds available through their lending and investing activities to borrow business firms, industries and individuals etc. Bank is a resource for the economic development which maintains the self confidence of various segments of society and extends credit to people.

When the government adopted liberal and market oriented economic policy since mid 1980's, Nepal allowed foreign banks on joint venture basis to operate in the country after getting the approval from NRB. These foreign JVBs namely Nabil Bank Ltd., Nepal

Indo-Suez Bank Ltd., Standard Chartered Nepal Bank LTD., were established in 2041, 2042 and 2043 B.S. respectively. Now we have 25 commercial banks in Nepal, among of them two are under government control and other 23 are non govt. and joint ventures, Joint ventures banks gave a new horizon to the financial sectors of the country. They were expected to bring the foreign capital, technology experience, healthy competition, expertise and skills in Nepal.

Shrestha(2047),Nepal Government liberate policy of allowing JVBs operation in Nepal in basically to encourage local traditionally run commercial banks to enhance their bankable capacity through competition, efficiency modernization mechanism via computerization and prompt customer's service.

1.2 Commercial Banks and Economy

Commercial banks are those banks, which perform all kinds of banking functions as accepting deposits, advancing credits, credit creation, and agency functions e.t.c. commercial banks provide short term credit, medium credits and long term credits to trade and industries. Commercial banks also operate off-balance sheet functions such as issuing guarantee bonds, letter of credit, etc. In every country outset of economic development is quite different but there is no debate about the significant role of banking sector for the economic development of the country, as commercial banks are considered as the main source of finance.

Without the development of sound commercial banking, underdeveloped countries cannot hope to join the ranks of advanced countries. Industrial development requires use of capital, use of capital equipment is not being possible without the existence of banks to provide the necessary capital. Besides, industrial development is impossible without the existence of markets to dispose of the goods produced. On the other hand the existence of the commercial banks helps to extend the market. Commercial banks play an important role to and for:

- a. Help in Business Expansion
- b. Encouragement of the right type of Industries
- c. Necessary for Trade and Industry
- d. Transfer of Surplus Funds to Needy Regions
- e. Promotion of Capital Formation

1.3 Information about Banks under study

In Nepal, we have six JVBs, which are Nabil Bank Ltd., Nepal Bangladesh Bank Ltd., Everest Bank Limited, Himalayan Bank Ltd., Nepal SBI Bank Ltd. And Standard Chartered Bank Nepal Ltd. But only Everest Bank Limited is taken as sample for the study.

Table 1.1

List of Licensed Joint Venture Banks of Nepal, Mid July, 2007.

Joint venture Banks	Operation Date (A.D.)	Head Office	Telephone No.	Fax.No.
Nabil Bank Limited	16-07-1984	Kantipath, Kathmandu	44295469	4429548
Standard chartered Bank Nepal Ltd.	30-01-1987	NewBaneshwor, Kathmandu	4781469	4780762
Himalayan Bank Ltd.	18-01-1993	Thamel, kathmandu	4227749	4222800
Nepal Bangladesh Bank Ltd.	07-07-1993	Bijuli Bazar, kathmandu	4783972/75	4780106
Nepal SBI Bank Ltd.	07-07-1993	Hattisar, Kathmandu	4435516	4435612
Everest Bank Ltd.	18-10-1994	Lazimpat, Kthmandu.	4443377	4443160

Sources: www.nrb.org.np

Everest Bank Limited [EBL]

Everest bank limited is a joint venture bank with Punjab National Bank of India was established in 18th Oct. 1994. Everest bank limited is established with 20% equity capital hold by Punjab National Bank and other 80% equity capital sharing by general public of Nepal. Everest bank limited has Rs.600 million authorized capital, Rs.466.8 million of issued capital and Rs. 831.40 million of paid up capital. Everest bank limited has 29 branches spread over the country at the end of 2007.

1.4 Focus of the Study

Present situation of Nepalese market is not so good for any kind of business, banking business is totally on lending business, which is naturally a risky business, as per present situation banks are playing the vital role on the growth of the Nepalese economy. So what kinds of precautions is taken by bank for it survival is very serious matte

As loan is the core area of commercial banking, it plays the significance impact on the commercial bank's liquidity and profitability. But the most worry factor in banking industry is the total management of loan. Due to the excessive amount of non-performing assets in commercial banks, there is the wide spread suspicion on the performance on the commercial banks.

So the main focus point of this study is as follows:

1. What types of risk are exists in the banking business?
2. What is the technique of credit risk management?
3. What is the framework of risk management?
4. What central bank plans to control the commercials banks?
5. What is the current condition of commercial banks regarding the credit risk position?

1.5 Importance of the study

The needs of the study are:

1. The study gives a clear picture of financial position of the company under study.
2. This study provides information to those who are planning to invest in Everest Bank Limited.
3. With the help of the report of this study, management may apply corrective measures for the improvement of the banks performance.
4. The policy formulates of the bank may gain something with the help of the result of the study.
5. The study helps general public to know about the overall financial position of the Everest Bank Limited.
6. After the completion, this report keeps in the library, which plays the role of reference to the students making the similar study in future.

1.6 Statement of the problem

Nepal is a small country with small Market. Economic condition of the country is regarding due to conflict since 2052 B.S. Overall economic sectors either manufacturing or commercial have undergone heavy losses. However the financial institutions are increasing regularly. Liquidity is at maximum level with the financial institutions. Hence the banks and financial institutions are competing among themselves to advance credit to limited opportunity sectors. Due to unhealthy competition among the banks, the recovery of the banks credit is going negative trends. Non-performing credits of the banks are increasing year by year. To control such type of state, the regulatory body of the banks and financial institutions NRB has renewed its directives of the credits loss provision. Since the objective of the commercial banks is wealth maximization and achievement of organizational objective contributes to the national economy and the success and failure of the commercial bank largely depends on the total credit risk management of the commercial banks. It is important to determine the factors affecting the default risk and its management. This study will try to find out how the joint venture banks of Nepal

manage the 'credit risk'. Especially the study is expected to answer the following research questions:-

- How the commercial banks are managing credit risk?
- What are the main causes of highly increasing credit risk in commercial banking sector?
- Do the credit risk management is affected by the political, social and economic factor?
- Do credit risk increased in the lack of proper investment policies and practices?
- Is there any necessity to reform in regulations?
- How to make optimal management of credit risk in commercial banks?

1.7 Objective of the study

Undoubtedly, the role of commercial bank in mobilizing and utilizing scattered resources of nation is praiseworthy one. The basis objectives of the study are to have true insight into the credit management aspects [practice of disbursing loans and recovery of the Everest Bank Ltd.]. This aims to examine its efficient ineffectiveness, systematization and sincerity in disbursing and recovery loan as well within the directives of NRB, financial institution act and its own policy.

The main objective of this study is to evaluate the credit management of Everest Bank Limited. Besides, there may be other objectives as well.

1. To examine the impact of deposit in liquidity.
2. To examine and evaluate the various stages occurred in loan management procedure.
3. To analyze the lending efficiency of the bank.
4. To examine the assets management efficiency and portfolio ratios.

1.8 Limitation of the study

The studies being the partial fulfillment of master degree in business studies has the following being a student, lack of the sufficient time resources are the major limitations. Therefore the study has been conducted as partial fulfillment of the requirement for the "Master of Business Study" of management faculty of T. U.

1.9 Organization of the study

This study has been organized into the following five chapters:

The first chapter includes background of the study, introductions of commercial banking industry of Nepal, focus of study, statement of problem, objectives, significance and the limitations of the study. The second chapter deals with the review of available literature. Second chapter includes reviews of books, reports, journals etc. The third chapter explains the research methodology used in the study, which includes research design, source of data, population & sample, method of data analysis etc. The fourth chapter concerned with the data presentation and analysis of the study. The fifth chapter is concerned with the major findings of the study, conclusion drawn from the findings and recommendation.

Chapter –II

Review of Literature

2.1 Conceptual review

The review of textbooks and other reference materials such as: newspaper, magazines, research articles and past thesis have been included in this topic. Credit administration involves the creation and management of risk assets. The process of lending takes into consideration about the people and system required for evaluation and approval of loan requests, negotiation of terms, documentation, disbursement, administration of outstanding loans and workouts, knowledge of the process and awareness of its strength and weaknesses are important in setting objectives and goals for lending activities and for allocating available funds to various lending functions such as commercial, Installment and mortgage portfolios.

Mobilization of the domestic saving is one of the prime objectives of the monetary policy in Nepal. And commercial banks are the most active financial intermediary for generating resources in the form of deposit of private sector and providing credit to the investors in different sectors of the economy. In banking sector or transaction, an unavoidable ness of loan management, many subject matters are considered and thought. For example, there are subject matters like the policy of loan, the condition of loan flow, the provision of security, the provision o f the payment of capital and interest and other such procedures. This management plays a great role in healthy competitive activities. It is very important to remind that most of the bank failures in the world are due to shrinkage in the value of loan and advances. Hence, risk of non-payment of loan is known as credit risk or default risk.

2.2 Concept of commercial banking

Commerce is the financial transactions related to selling and buying activities of goods and services. Therefore commercial banks are those banks, which work from commercial viewpoint. Commercial banks perform all kinds of banking functions as accepting deposits, advancing credits, credit creations, and agency functions. Commercial banks are

those financial institutions that deal in accepting deposits of persons and institutions and give loans against securities. Commercial banks meet working capital needs of trade and industry and even of agricultural sectors. Moreover commercial banks provide technical and administrative assistance to industries, trades and business.

Reed, 1976, Commercial banks are the heart of the financial system. Commercial banks hold the deposits of many persons, government establishment and business units. Commercial banks make fund available through their lending and investing activities to borrowers. Individuals, business firms and services, from the producers to customers and for the government too. These facts show that the commercial banking system of the nation is important to the functioning of the economy.

Grvwinshki (1994), Commercial bank has its own role and contribution in the economic development. Commercial bank is a source for economic development; it maintains economic confidence to various segments and extends credit to people.

Shekher&shekher (1999) Commercial banks are organized as a joint stock company system, primarily for the purpose of earning profit, they can be either of the branch banking types as we in most of countries, with a large network branches like in Nepal or of the unit banking type, as we see in the United States where a bank operations are confined to a single office or to a few branches within a strictly limited area.

Nepal commercial bank act 2013 BS,defines, “A commercial bank is one of which exchanges money, deposits money, accepts deposits, grants loans and performs commercial banking functions and which is not a bank meant for co-operations, agriculture, industries or for such specific purposes. Commercial bank obtains deposits from customers under different accounts such as saving, fixed and current. Commercial banks also provide short-term drawing as necessary for trade and commerce e. g. hypothecation, against stock guarantee against any deviation in performing tasks, purchasing and selling of securities, discounting bills exchanging promissory notes, overdrafts facilities, treasury bill, foreign currencies, performing such tasks on the

behalf of required as persons. Central bank's main task is to monitor, direct and control the lending activities in the country. In Nepal, commercial banks perform their function under the rules and regulations of the Nepal Rasta Bank as the central bank of Nepal.

To sum up, a bank is defined as a financial institution, which performs widest range of economic and financial functions of any business firms in the economy. Commercial bank is that financial institution which collects scattered saving of the people and provides loans against proper securities for their productive purpose. Moreover commercial bank also provides technical help and suggestions, administrative suggestions, safekeeping of valuables, collection of bills cheque and overdraft facilities and provides modern banking facilities to industries and commerce.

2.3 Concept of Joint Venture Banking

A joint venture is joining forces between two or more enterprises for the purpose of carrying out specific operations like industrial or commercial investment, production or trade. When two commercial banks from different countries join hands to form independent enterprises it is said as joint venture commercial banks (JVB). The deliberate policy of allowing JVB in Nepal is basically to enhance local commercial banks performance via competition, efficiency, modernization, and computerization and prompt customer services, etc.

Thus, conclusively, it can be said that JVB mobilizes the passive fund towards trade and commerce, provides economic assistant to enterprises, creates saving habits in general public, invests in priority sectors etc.

Our report is based on CAMELS ratings and BASAL II guidelines as issued by the NRB.

2.4 Camels Ratings: An Introduction

The NRB, as central bank, has the important task of regulating and supervising the banking system of Nepal. To play this vital role, it is imperative that the NRB be able to assess to overall strength of the banking system as a whole, as well as the safety and soundness of each individual bank/non bank.

To help in the endeavor, a uniform rating system for all bank/non banks may be used. This rating system provides meaningful and concise information about the conditions of the Nepal banking system as well as identifies that banks/nonblank that requires closer supervision by the NRB. By assigning individual numerical ratings to the key areas of Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to market risk, as well as assigning an overall composite rating to each banking institution, the NRB will be able to categorize banks/nonblank into groups based on their overall strength, quality and operating soundness. The rating system, known as the CAMELS, serves as a supervisory tool to help identify that banks/nonblank that are having problems and require increased supervision.

Under the CAMELS rating system, banks /nonblank should be assigned two sets of ratings:

- A. Performance ratings, which comprise six (6) individual ratings that address each of the CAMELS components, and
- B. An overall composite rating, which is a single rating that is based on a comprehensive assessment of the overall condition of the bank/nonblank.

Both the ratings are expressed by using a numerical scale of “1” to “5” in ascending order of supervisory concern. That is “1” represents the best rating, while “5” indicates the worst rating.

A. Performance ratings

The six aspects of CAMELS performance encompass: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to market risk. Each of these component areas is to be evaluated on a numerical scale “1” to “5”. A “1” indicates the highest rating, the strongest performance, best risk management practices and least supervisory concern. A “5” is the lowest rating, indicating the weakest performance, inadequate risk management practices, and the highest degree of supervisory concern.

A side from the component ratings, an overall composite rating, one number, ranging from 1 to 5, is calculated reflecting a weighted sum of the 6 component ratings. When determining a composite rating, some components are given more weight than others. The composite rating determined as a result of an inspection is to be disclosed to the bank/non bank's senior management and Board of Directors.

The ability of management of identify, measure, monitor and control the risks of its operators is also taken into account when assigning each component rating. Appropriate management practices vary considerably among bank/non bank, depending on their size, complexity and risk profile. For less complex institutions engaged solely in traditional banking actively involved in the oversight and management of day-to-day operations, relatively basic management systems and controls may be adequate. At more core complex banks/non bank, on the other hand, detailed and formal management systems and controls are needed to address their broader range of financial activities and to provide senior managers and directors, in their respective roles, with the information managers and directors need to monitor and direct day-to-day activities. All bank/non bank are expected to properly manage their risks. For less complex institutions engaging in less sophisticated risk taking activities, detailed or higher formalized management systems and controls are not required to receive strong or satisfactory component or composite ratings.

The following is a description of the gradations to be utilized in assigning performance ratings for the six components:

Ratings "1"- Indicates very strong performance;

Ratings "2"-Indicates above average performance that adequately provides for the safe and sound operations of the bank/non banks;

Ratings "3"- Indicates performance that is flawed to some degree;

Ratings “4”- Indicates unsatisfactory performance. If left unchecked, such performance could threaten the solvency of the bank/non bank;

Ratings “5”-Indicates very unsatisfactory performance in need immediate remedial attention for the sake of the bank/non bank’s survival.

Capital Adequacy: A bank/non bank is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor and control these risks. The effect of credit, market and other risks on the bank/non bank’s financial condition should be considered when evaluating the adequacy of capital. The types and quantity of risk inherent in an institution’s activities will determine the extent to which it may be necessary to maintain capital at levels above required regulatory minimums in order to properly reflect the possible adverse consequences that these risks may have on the bank/non bank’s capital.

The capital adequacy of a bank/non bank is rated from “1” to “5” based upon, but not limited to, the following evaluation factors:

-) The volume of poor quality assets;
-) The bank/non bank capital growth experience, as well as prospects for the future;
-) The ability of management to address emerging needs for additional capital;
-) The bank/non bank’s risk-based capital ratio relative to industry norms and regulatory requirements;
-) The quality and strength of earnings, earnings retention and reasonableness of dividends;
-) Risk exposure in terms of off-balance sheet activities;
-) Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk and risks associated with nontraditional activities: and
-) Access to capital markets or other sources of financial assistance

Asset Quality: The assets quality ratings reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other assets, as well as off-balance sheet transactions. The ability of management to identify, measure, monitor, and control credit risk is also reflected here. The evaluation of asset quality should consider the adequacy of general and specific provisioning for loan losses and weight exposure to counterparty, issuer or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability of a bank/non bank's assets, such as operating, market, reputation, or compliance risks should be considered.

The asset quality of bank/non bank is rated from "1" to "5" based upon, but not limited to an assessment of the following factors:

-) The level, severity, trend of problem, restructured and nonperforming loans;
-) The adequacy of underwriting standards, soundness of credit administration practices and appropriateness of risk identification practices;
-) The adequacy of general loan loss provisioning, specific provisioning and other asset valuation reserves;
-) The credit risk arising from off-balance sheet transactions, such as irrevocable loan commitments or foreign currency swaps;
-) The diversification and quality of the loan and investment portfolios;
-) The extent of securities underwriting a activities and exposure to counterparties in trading activities;
-) The degree of concentrations of credit and/or investments;
-) The adequacy of loan and investment policies, procedures and practices;
-) The ability of management to properly administer its assets, including the timely identification and collection of problem assets;
-) The adequacy of internal controls and management information systems (MIS)

-) The volume and nature of credit documentation expectations.

Earnings: The ratings reflect not only the quantity and trend of earnings, but also factors that may affect the sustainability or quality of earnings. The quantity, as well as quality of earnings can be affected by inadequately managed credit risk that may result in loan losses and require additions to provisions for the absorption of current and potential losses, or by high levels of market risks that may unduly expose a bank/non bank's earnings to volatility. The quality of earnings may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or unusually favorable tax effects. Future earnings may be adversely affected by an inability to forecast or control funding and operating expenses, poorly executed or ill-advised business strategies, or badly managed or uncontrolled exposure to other risks.

Earnings should be rated from "1" to "5" based upon but not limited to, an assessment of the following factors:

-) The level of earnings including trends and stability
-) The bank/non bank's ability to contribute to adequate capital through retained earnings
-) The quality and sources of earnings (recurring? non-recurring?)
-) The adequacy of the budgeting systems, forecasting processes, and management information systems in general
-) The adequacy of general loan loss provisioning and provisioning for loans classified as substandard doubtful and loss
-) The earnings exposure to market risk, such as interest rate, foreign and price risks.

Liquidity: In evaluating the adequacy of a bank/non bank's liquidity position, consideration should be given to its capacity to promptly meet the demand for payment on its obligations and to readily fulfill the credit needs of community it serves. Consideration should be given to the overall effectiveness of the bank/non bank's

asset/liability strategies and compliance with and adequacy of liquidity policies. The nature, volume and anticipated utilization of bank/non bank's credit commitments (e.g. irrevocable loan commitments) are also factors to be weighted in arriving at a rating for the liquidity component of the CAMELS.

Liquidity is rated from "1" to "5", based upon, but limited to an assessment of the following factors:

-) Volatility, type, concentration and trend of deposits in the interest of meaning the bank/non banks liquidity needs;
-) Availability of assets readily convertible into cash;
-) Access to money markets or other ready sources of funds;
-) Reliance on interest sensitive funds(those assets and liabilities that can be re-priced at prevailing market rates within one year);
-) Trend and stability of deposits;
-) Compliance with statutory requirements prescribed by the NRB, and
-) The capability of management to property identify, measure, monitor, and control the bank/non bank's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems and contingency funding plans.

Sensitivity to market risk: The sensitivity to market risk reflects the degree to which changes in interest rates, foreign exchange rates, commodity prices, or equity prices can adversely affect a bank/non bank's earnings and capital. When evaluating this sensitivity component, consideration should be given to management's ability to identify, measure and control market risk, as well as the adequacy of its capital and earnings in relation to its level of market risk exposure.

For many bank/non banks the primary source of market risk arises from non-trading positions and their sensitivity to changes in interest rates. In some institutions, foreign

operations can be a significant source of market risk. For other institutions, trading activities are a major source of market risk.

Sensitivity to market risk is rated upon, but not limited to, an assessment of the following factors:

-) The sensitivity of the bank/non bank's earnings or the economic value of its capital (net equity value) to adverse changes in interest rates, foreign exchange rates commodity prices, or equity prices.
-) The ability of management to identify, measure, monitor and control exposure to market risk given the bank/non bank's size, complexity and risk profile
-) The amount of interest rate risk exposure arising from non trading positions
-) The amount of market risk arising from trading and foreign exchange operations

B. Composite ratings:

In assigning a composite rating for a bank/non bank, consideration must be given to the individual component ratings of the CAMELS. These components can be weighted and summed, in order to quantify a composite rating. However a composite estimate probably needs modification as a result of considering qualitative factors that may strongly influence the inspector's judgment.

CAMELS RATING FORM

The camel rating is a United States supervisory rating of the bank's overall condition used to classify the nation's fewer than 8000 banks. This rating is based on financial statements of the bank and on – site examination by regulators like the Federal reserve, the office of the comptroller of the currency and Federal deposit insurance corporation.

Circle appropriate rating:

Table 2.1: CAMELS rating form

	1	2	3	4	5	<u>Weights</u>	<u>Ratings</u>
Capital						0.25	
Assets						0.25	
Management						0.25	
Earnings						0.10	
Liquidity						0.10	
Sensitivity to Market Risk						0.05	
COMPOSITE							
Weighted Sum							

The scale is from 1 to 5 with 1 being strongest and 5 being weakest. These rating are not released to the public but only to the top management of the banking company to prevent a bank run on a bank which has a bad CAMEL rating.

2.4.1 Basel II

The Capital Accord or Basel I was released in 1988 by the Basel Committee on Banking Supervision (BCBS). It aimed at

- . Strengthening stability and soundness of international banking system
- . Creating greater consistency in the assessment of internationally active banks

Member countries are mandatory to keep minimum 8% capital i.e. Capital Adequacy Ratio (CAR). It is adopted in over 100 countries worldwide. In 1996, it was refined to incorporate market risk.

Due to many shortcomings in Basel I, revised international Capital Standard or Basel II was finalized by the Basel Committee on Banking Supervision (BCBS) in 2006.

Key objectives of Basel II

To ensure banks set aside sufficient capital for risk it assumes

Not intended to be neutral amongst different banks/exposures/countries

To provide incentive to banks for greater risk management (RM) and corporate governance in recognition of significant enhancements in RM practices since Basel I

Even for simpler approaches, more risk sensitive RM capabilities required

More is expected from banks adopting more advanced approaches

Nevertheless, the reduction in overall level of capital within the industry was not a desired outcome

Basel II Framework is based on 3 pillars:

Pillar 1: Capital Adequacy: It specifies how banks should determine the capital requirements for the major risks that they face. It ensures banks set aside a sufficient level of capital which is commensurate with the level of risk undertaken.

Pillar 2: Supervisory Review Process: It recognizes that although banks are ultimately responsible for managing their risks, supervisors can play a more active role in assessing banks' risk management practices.

Pillar 3: Market Discipline: It emphasizes the role played by disclosure in 'regulating' bank's behavior and promoting market discipline.

2.5 Review of journals related to Joint Venture Banks

Madlin C. and Snock H(1998),when government decided to establish banks with joint ventures, two benefits were expected. First, that competition would force domestic banks. Nepal Bank Limited and Rastriya Banijya Bank have to improve their service and efficiency. Second, the introduction of new banking procedures, methods, and technology would occur.

Shrestha, M.K(1990) ,there has been substantial growth in the number of joint venture banks in Nepal since 1990s. The basic reason behind this is the government's deliberate policy of allowing foreign joint venture banks to operate in Nepal. Government's liberalization policy also encourages the traditionally run domestic commercial banks to enhance their efficiency and computerization and prompt customers service by setting them to the exposure of the joint venture banks.

Sharma,M.R;1988),explains in his article, "Joint venture banks in Nepal coexisting or crowding out" that is would be definitely un wishful for Nepal not to let JVBS to operate in the country and not to take advantage of additional means of resources mobilization as well as harbinger of new in banking. But it will certainly be unfortunate for the country to let the development on the JVBS at the cost of domestic banks. So far, one should admit frankly, no differential treatment has been made to the domestic and joint venture banks, at least form the latter's bargaining.

It is JVBS shows strength and briskness to come forward to share the trails and tribulation of this poor country, both types of bank will collapse and co-exist complementing each other, contributing to the nation' accelerated development. On the contrary if the joint venture bank use their strength against treading to the cumbersome path of development along with the domestic banks and government, they will eventually throw out the domestic bans from the more profitable and lucrative urban sectors unless reincarnated by the determination of the government.

Mr. Sharma has made a comparative study of two different natures of banks, especially on-nature of transaction and expertise in banking network. JVBS basically were orientated in urban areas whereas the local banks are set up and conducted their transactions both in urban and rural areas. Moreover a number of commercial banks are situated in rural rather than in urban areas.

Thapa, G. B(1994) has expressed the view that commercial banks including foreign joint venture banks seen to be doing pretty well in mobilizing deposits. Likewise, loans and

advances of these banks are also increasing but compared to the high credit needs particularly by the newly emerging industries, the banks still seem to lack adequate funds. The banks are increasing their lending to non-traditional along with traditional sectors. Thapa has also commented that out of the commercial banks operating, Nepal Bank Limited and Rastriya Banijaya Bank are operating with nominal profit, the later turning towards negative from time to time. Because of non-recovery of accrued interest, the margin between interest income and interest expense is declining. They have heavy burden of personal and administrative overhead. On the other hand foreign joint venture banks are functioning in an extremely efficient way. They are making huge profit year after year. Because of their effective persuasion on loan, recovery, overdue, and defaulting loans has been limited resulting in high margins between interest income and interest expenses.

2.6 Conceptual review on credit risk

Credit is the amount of money lent by the creditor to borrower either on the basis of security or without security. Credit and advances is an important item on the asset side of the balance sheet of a commercial bank.

Varshney, N. P. and Swaroop(1994), bank earns interest on credits and advances which is one of the major sources of income for banks. Bank prepares credit portfolio, otherwise it will not only add debts but also affect profitability adversely

Chhabra, T.N. and Taneja(1991), credit is financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for an obligation to repay on specified date on demand. Bank generally grants credit on four ways:

1. Overdraft
2. Cash Credit
3. Direct Credit
4. Discounting of Bills

Joseph (1998), for bank's overall corporate strategy and strategic plan at least three critical components are needed, they are:

- a. Business plan
- b. Framework for risk management
- c. Strategies for corporate control

These are the basic components to provide a solid foundation for managing value and risk. As with the traditional approach to strategic planning, it focuses in just on operating and competing in the financial services industry. The modern strategic approach also includes a framework for risk management and strategic for completing in the component fits for the modern idea of the basic business of banking as measuring, managing and accepting risk. The bank's objective is to manage value and risk by maximizing those items that create value and minimizing or eliminating those that destroy value.

As far as it is concerned to the commercial bank, the main task of the commercial bank is to collect funds as deposit through several sources and lends them to different sectors like; manufacturing, transportation, trade, construction, communication and other public utilities etc. Doing all these activities every bank has to a face so many risks. There are several types of risk prevailed in the banking industry, but the major area of risk are widely recognized i.e. Credit Risk, Market Risk, and Operating Risk etc.

Shrestha (2000),the credit risk is the potential financial loss resulting from the failure of customers to honor fully the terms of a loan or contract. On the other hand, the Market Risk includes balance sheet risk and trading risk such as potential risk to earning and capital resulting from changes in interest rate, liquidity conditions, and impact of foreign exchange rate fluctuations etc. Meanwhile Operating Risk arises from the natural disasters, errors in processing and settlement of transactions safeguarding of assets, system failure, fraud and forgery.

2.6.1 Credit risk management

Credit risk is the risk of loss as a result of failure by a client or counterparty to meet its contractual obligations. It is an integral part of many of our business activities and is inherent in traditional banking products like loans, commitments to lend and contingent liabilities, such as letters of credit, trade products, derivative contracts such as forward,

swaps, options, repurchase agreements (Repos and Reverse Repos) and securities borrowings and lending transactions.

Financial environment is dynamic. In this dynamic financial environment fluctuation in interest rates, exchange rates and commodity and real estate price are not something new. These fluctuating in economic and financial variables destabilize the corporate strategies and performance of bank. Thus it is necessary that bank has a framework of risk management. Effective credit risk management allows a bank to reduce risk and potential non performing assets. Once bank understand their risks and their cost, they will be able to determine their most profitable business. Therefore the bank must have an explicit credit risk strategy by organizational changes, risk measurement techniques and fresh credit processes and systems.

Table 2.6.1
(Guidelines of Assessing Risk)

Applicant Characteristics	Credit Risk
Character + Capacity	Very Low
Character + Capacity without Capital	Low to Moderate
Character + Capacity but Insufficient Capital	Low to Moderate
Capacity + Capital but Impaired Character	Moderate
Capacity + Capital without Character	High
Character + Capital without Capacity	High
Character + No Capital + No capacity	Very high
Capital + No Character + No Capacity	Very high
Capacity + No Character + No Capital	Fraudulent

Source: www.ehow.co.uk

While talking about the credit risk management, five C's of creditworthiness should be considered and they are;

1. Character:

The good character and intention of the borrower is very important and thus should be seriously considered. Information about the character of the client can be gathered from his working place, reference, neighbors and other places he is associated with. This job is tedious but should be carried out for secure investment.

2. Capacity:

It can be describe as a customer's ability to pay. It is measured by applicants past performance records. For this on interview with applicant's customers, suppliers will further clarify the situation. The gross income, expenses and net income of the borrower should be analyzed whether the borrower lives on salary/wages or any other forms of income source. Whether the borrower has some extra income source other than usual based which should be used to repay the scheduled installments should be considered.

3. Capital:

Capital provides a caution to absorb operating and asset losses that might otherwise impair debt repayment. This, is fact, is the insurance against the loans granted to the borrowers.

4. Collateral :

Sufficiency of collateral is necessary to ensure the recovery of loan. In case of default, by any cause, the collateral kept should have enough to recover the loan granted and interest borne by it, it is recommended that only 50% of the value of collateral is granted as loan, but considering other factors like character of borrower and his credit worthiness, this percentage can be made flexible.

5. Conditions:

Borrowers may be subject to unfavorable economic conditions beyond their control. Repayment depends not only upon character, capacity and collateral but those factors over which the borrower exercise little or on control. As for example: natural calamities or drastic economic crisis.

Risk is dependent upon the quality found on each 'c' and the combination of these five Cs. Assuming the same conditions prevail, the guideline of table 2.6.1 is suggested.

2.6.2 Credit risk framework

Joseph, (1998), fluctuations in interest rate, exchange rates, and commodity and real estate prices are not something new. However, fluctuation in economic and financial variables destabilized the corporate strategies and performance of the banks and their client customers. Thus, it is crucial to those banks have a framework for risk management and for selling risk management services to clients. Risk management can be conducted on a bank's balance sheet through adjustments in portfolio composition, or off the balance sheet by using host of risk- management weapons derived from the technology of financial engineering, these off-balance sheet tools of risk management are known as derivatives contracts or activities or simply as 'derivatives'.

Froot (1994), the risk management framework rests on three pillars are summarized as follows:

Making good investment decisions creates corporate value

For tradition banks this means making good loans and investments and tradition banks, it means this plus making good investment decision regarding their non traditional activities e. g. investment banking, mutual funds, insurance derivatives.

Generating enough cash flow internally is the key to making good investments

Companies that don't generate cash flow internally tend to cut investment more substantially than their competitors do. Those banking, generating enough cash flow internally plays a critical role in maintaining a firm's capital adequacy. Adequate capital in turn is a prerequisite for expansion and making good investments. With respect to cost and control, banks with inadequate capital are subject to higher deposit insurance premiums greater regulatory scrutiny and possible takeover by outsiders.

Proper and prudent look at major market indicators

Bank should look properly at major market indicator because adverse movements in external factors such as interest rates, and commodity prices can disrupt cash flow, a company ability to invest be jeopardized.

2.6.3 Credit Risk Management Techniques

As the majority of bank's assets are in the form of loan, even the lending function is simple and creates the value of the bank; the main danger is the chance of the borrower not to pay the loan amount. So the proper and prudent management of the credit risk is very important.

Miller and Merton (1995) have suggested three techniques for managing the credit risk in their article published in the Journal of Banking and Finance.

Risk based pricing

It has been established that risk based pricing requires lenders to change the rate that compensates for the risk nee of the loan. The pricing procedure needs to be straightforward and not based solely on historical loan loss experience. In practice, loan pricing tends to follow the prime rate plus basis. Because the prime rate is not the lowest rate a bank charges, the credit worthiest customers can negotiate from the prime rate. The discount prime rate is what banks use to a

attempt to complete with open market instruments such as commercial paper and corporate bonds.

Assets restriction

Bank lenders and other creditors have a claim on the borrower's assets. As long as the market value of assets exceeds the value of liabilities, creditors are protected because proceeds from sale of assets cover the entire claim alternatively, as long as positive net worth exists, business firms are not going to turn over to creditor's assets that exceed the value of claim against them. Thus one way for lenders to protect themselves is to try to ensure that the value of assets always exceed than value of claims. Restriction amount of debt a borrower takes on and restricting the variability of the value of assets are the basic ways of meeting this objectives. Restricting covenants in loan agreement and the strength of bank customer relationship are practical ways that lenders impose asset restrictions or establish borrower's incentives for compliance.

Monitoring

If lenders have a contractual right to monitor assets value continuously and to seize assets, then loan losses can be minimized either by auditing asset values and seizing assets before shortfalls exist or by requiring the posted value of collateral assets to equal or exceed the promised payments. For private loans, for which banks have considerable expertise in organization, monitoring with continuous surveillance is costly.

Before providing credit to the customer, bank makes analysis of project from various aspects and angles. It will help the bank to see whether project is really suitable to invest or not. For that, bank needed to do a project appraisal. The purpose of project appraisal is to achieve the guarantee of reasonable return from the project. Project appraisal answers the following questions:

Is the project technically sound?

Will the project provide a reasonable return?

Is the project in line with the overall economic objectives of the country?

Gautam, (2004) the project appraisal involves the investigation from the following aspects

- Financial aspect
- Economic aspect
- Management/Organizational aspect
- Legal aspect

2.6.4 Directives issued by NRB for the Commercial Bank: (related to credit aspect only)

Commercial banks are heavily regulated than its non-bank competitors in the financial service industry. They are subject to follow the updated regulating authority for Nepal. As per directives issued by NRB, loans and advances shall be classified into the following four categories:

Pass Credit

Pass loan and advance whose principle amounts are not past due and past due for a period up to 3 months shall be included in this category. Those are classified and defined as performing loans.

Sub Standard Credit

All loans and advances that are past due for a period 3 to 6 month shall be included in this category. Those are classified as non-performing loans.

Doubtful Credit

All loans and advances, which are past due for period of 6 month to 1 year, shall be included in this category. Those loans are classified as non-performing loans.

Loss

All loans and advances which are past due for a period of more than 1 year as well as advance which have at least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category. These loans and advances are also classified as non-performing loans.

The credit loss provision for performing credit is termed as general credit loss provision whereas the credit loss provision for non-performing credit is termed as specific credit loss provision. Auditor has to correctly rate the credit and ensure that accurate credit loss provision has been made. The auditor should examine whether the bank has obtained complete documentation so that banks interest is secured. In addition audit is made to inspect compliance of terms and conditions laid down. Credit audit is required to check whether credit given is within authority, drawing power etc. credit audit helps the bank to know the quality of its credit, its weaknesses and the strengths. This in turn, helps the bank to adopt corrective measures where weaknesses have been pointed out and to focus further on strengths.

On the basis of outstanding loans and advances classification and provisioning for credit as per directives shall be provided as follows:

Table 2.6.4
Classification of Loan and Loss Provision

Classification of loan	Loss Provision
Pass	1%
Substandard	25%
Doubtful	50%
Loss	100%

Source: NRB Directives

2.7 Review of Major Studies in Nepal

In Nepalese context Mr regmi(2004),in his studies addressed credit management of commercial bank with reference to Nepal Bangladesh Bank and Bank of Katmandu.

Regmi stated liquidity matters, unfair competition between banks and service institutions, lack of enough profitable investment sectors, poor credit recovery process and lengthy and ineffective legal process in the recovery of credit as a statement of statement of research problem.

Mr. Regmi has concluded in his thesis that, both of the banks (NB Bank and BOK) have sufficient liquidity. It shows that banks have not got investment sectors to utilized their liquid money; both of the bank have provided modern facilities to its customers and have used modern technology; non-performing credits are increasing, it concludes that credit is not satisfactory; because of increasing in non-performing credit bank should increase its provision for credit loss; lack in efficiency in the management of credit resulting the process of

recover in slow motion; due to increase in the non-performing credit, banks' profit is decreasing year by year.

In his thesis he recommended some suggestions which are as follows:

-) Cash and bank balance of both banks are high. Unused cash and bank balance do not provide return to the bank, therefore some percentage of cash and bank balance should be invest somewhere in profitable sectors.
-) Non-performing assets of both banks are high. It doesn't provide return to banks therefore bank should increase its effort to recover its credit on time.
-) Weighted average capital funds of both banks are lesser than the required as per directives issued by the NRB. Therefore he suggested to increase the amount of the capital fund for overcome out from panelize by NRB.
-) Few customers are unsatisfied with the service charges and interest of credit; therefore he suggested that banks should decrease service charges and interest charges.

Mr. Ganesh Bahadur Chand (1988) has submitted his thesis on Credit Disbursement and Repayment of Agricultural Development Bank Nepal. In his thesis, he stated problem of balance development; slowly ness in credit collection hinder the flow of capital required to develop the economic growth as a statement of research problem. And the main objectives of his study were: to analyze the repayment situation, finding out the rate of growth of investment and to explain the possible causes of none and delayed repayment.

MR. Chand has found some finding and recommendation which are as follows:

-) There is systematic relationship between credit disbursement and repayment.
-) Repayment situation is satisfactory on production inputs and agro-based industry, warehouse and marketing percentage of repayment to due to the

farm mechanization and irrigation and tea horticulture and livestock, poultry and fisheries is much less satisfactory.

-) ADB should have to play a significant role in such direction as to fulfill the credit demands of the rural areas. For effective credit recovery from the borrower or clients' credit should be channeled through the borrower groups.

Mr. Kimananda Aryal(2004) has submitted a thesis names “An Evaluation of Credit Investment and Recovery of Financial Public Enterprise in Nepal” a case study of ADB/N.

In his thesis, he stated high interest rate of non-institutional sources; people are unable to pay their credit at fixed time. These institutions compel them to transfer their property to the moneylender resulting himself or herself as a landless person as a research statement of problem.

ADB/N is one of the major financial institutions supporting for the people for the different purpose like agro, industries, tea, coffee, livestock farming etc.ADB/N provides the credit for individual and co-operative sector to all region of the country. Credit outstanding amount is increasing day by day but the collection amount is not good. However ADB/N has increased its effort to collect its credit. It is said that people who really need to do receive sufficient amount of credit from ADB/N, So, Mr, Aryal chose this bank to analyze the credit disbursement and recovery pattern of ADB/N.

From his research, he made some major findings which are shown below:

-) Actual credit disbursement, collection and outstanding are increasing in decreasing rate.
-) Yearly increase in credit disbursement is higher than that of collection
-) Positive relation between credit disbursement and collection is 0.996.
-) Targeted credit collection and disbursement fixed by planning and project department is not significantly different than the actual.

-) Most of the customers are unaware of the policy of the bank.
- Mr. Aryal has concluded in his thesis that, the borrower should be informed about the credit, its use and its payment procedures and schedule.
-) Greater attention should be given to increase the credit collection and to collect old outstanding amount of credit and renewal of it.
 -) To accelerate the collection, credit should be followed continuously in a regular interval of time.
 -) The behavior of the personal should be strictly supervised in granting credit in proper investment proposal because of most the bad credit disbursement is due to weak decision of the personal.

2.8 Research Gap

Research gap is the difference between previous work done and the present work. Earlier works conducted by the previous researchers are very useful and appreciated by personnel in various related field. The suggestions and recommendations given by the previous researchers help to improve and increase the necessary data for the related topic. Although, there is a long gap between previous studies and this study, the gap between earlier studies and this study is that, this study analyses the credit risk management system of Joint Venture Commercial Bank i.e. Everest Bank Limited, in this study requirement of loan loss provisions are studied and its effect on activity and profitability of those JVBs, which are very crucial for the going concern strategy of those banks. For the analysis purpose this study mostly used “Risk Index and Probability of Book Value Insolvency” as suggested by Joseph F. Sinkey, Jr, in his book “Commercial Bank Financial Management”.

Chapter-III

RESEARCH METHODOLOGY

In this chapter research methodology is presented for achieving the predetermined objective which is already stated. One various statically and financial instrument will be used for the required purpose. It counts on the resources and techniques available and to the extent of their reliability and validity in this chapter. This research methodology has primary sought the evaluation of the credit practices of the targeted joint venture bank i.e. Everest Bank Ltd. The research methodology adopted in this chapter follows some limited but crucial steps aimed to achieve the objective of the research. Research methodology refer to the various sequential steps (along with a rationale of each such steps) to be adopted by researcher in studying a problem with certain objective in view.

3.1 Research Design

This research is to analyze the soundness of Everest Bank Limited in relation to credit disbursement and recovery as well. Decision regarding what, when, how, when by what means concerning an enquiry of a research study constitute a research design. “A research design is the arrangement of conditions for collection and analysis of data in manner that aims to combine relevance to the research purpose with economy in procedure.” In fact the research constitutes the blueprint of the collection, measurement and analysis of data. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implication to the final analysis of data.

3.2 Population and Sample

Commercial banks are the principle agents of the money market which is turn is the major instrument of the financial system. Thus commercial banks and their l ending transaction obviously affect the national economy. Moreover lending and borrowing transaction that takes place through t he commercial banks influence the daily livings of

each national. And at the same time from the government side a great concern should be taken as the misleading by the commercial banks can violate the total economic system. Commercial banks, financial management system can contribute the economic growth too because this bank is the major variable of financial market. The total 32 Commercial banks shall constitute the population of the data and single bank under the study constitute the sample under the study. So among the various commercial banks in the banking industry. Everest Bank limited is taken sample for the study.

3.3 Data collection procedure:

Secondary Sources: The entire study was based on the secondary data collected from the respective institutions and documents collected from the internet. Performance of the bank can be only measured by critically analyzing the financial statements. So we have analyzed the annual report of the Everest Bank limited (EBL) which has been downloaded from the internet. Other information on Basel II and various reports and guidelines have been downloaded from the NRB sites.

3.4 Data Analysis and Presentation

Data Analysis Tools: MS excel software has been used to calculate various financial ratios mentioned in the CAMELS rating guideline. To get the CAMELS rating figure, Composite Rating tools have been used.

Method of data analysis: Necessary tables, graphs and charts have been constructed to fit the data obtained from analysis.

CHAPTER -5

SUMMARY, CONSLUSION AND RECOMMENDATIONS

This chapter focuses on major findings of the research and factors that affecting the facts. This will give the way to find the weakness and strengths of the bank. So the re commendations on the basis of the findings are determined and suggestions are presented on the areas of improvement to improve the performance of the bank.

5.1 Summary

Banking industry plays the vital role on the processes of development. Banking industries not only influence the structure of the economy but also its development process. Bank refers to any firm that is basically concerned with the transaction of money. However, today's banks are established for specific purpose. Different types of banks focus different types of services to their customers although the basic principle is same. Commercial bank, National bank, Agriculture development bank, Finance companies, Co-operative societies are examples of the banking industry.

Commercial banks are those banks, which works from commercial view point. They perfume all kinds of banking functions such as accepting deposits, advancing credits, credit creation, agency functions etc. This activity build industrial environment in the country, create employment and investment opportunity for the people and consequently economy of the country secures people growth. On 30th kartik, 1994, Nepal Bank Ltd. Was established for the first time to provide modern and organized banking facilities. The birth of this bank brought a new landmark in the history of banking facility in the Nepal. Today, 32 commercial banks, which of them 6 are JVBs are operating to provide modern banking services and facilities to boost the economic condition of the country. This is happened within 2 decades when the government of Nepal adopted liberal and market oriented economic policy since from 1980.

When two commercial banks from different countries join hands to form independent enterprise it is said as joint venture bank. Nepal started to allow this policy of JVB in mid 1980, for to enhance local commercial banks performance via competition, efficiency, modernization, and computerization and prompt customer services. Along with that it also brings foreign capital, skills, experience and latest technology and techniques too. This first joint venture bank established in Nepal is 'Nabil Bank Limited' in 1984.

Present situation of Nepalese market is not so good for any kind of business, banking business is almost focus on lending business, which is naturally a risky business. As per present situation banks are playing the vital role in the growth of the Nepalese economy. As loan is the core area of commercial banking, it plays the significance impact on the commercial bank's liquidity and profitability. But the most worry factor in banking industry is the total management of loan. Due to the excessive amount of non-performing assets in commercial banks, there is the wide spread suspicion on the performance on the commercial banks. Moreover, the world economic crisis has been arising from the loans on real state evaluated artificially; this type of risk can damage the whole economy of the country as well. If valuation of property is not done properly by Nepalese bank then it can create a critical condition in the Nepal too.

The main focus point of the study is the current condition of commercial banks regarding the credit risk position. So, the objective of the study is to evaluate the credit risk management of the Everest Bank Limited (EBL) by using CAMEL tools.

There are different types of risk existing in banking business but the major area of risk is credit risk. The credit risk is the potential financial loss resulting from the failure of customers to honor fully the terms of a loan. To face these types of situation, banks should have to use credit risk management, framework and techniques. In practices banks are using five areas for the credit risk management. These are:

- Credit sanctioning and monitoring process
- Approach to collateral
- Credit risks arise from new business opportunities

- Credit exposures relative to capital total advances
- Concentration on correlated risk factor

As suggested by Froot, Scharfstein, there are three pillars where the risk management framework rest on. They are:

- Making good investment decisions create corporate value.
- Proper and prudent look at major market indicators
- Generating enough cash flow internally is the key to making good investments.

Quality of assets of EBL is satisfactory. In general, 5 percent to 10 percent of non-performing assets is considered as satisfactory level of quality of bank assets, Nonperforming assets under study are far below the assets quality ration directed by RNB. Both NPAR and LLRR show that EBL is improving the quality of their assets year by year. Overall, both NPAR and LLRR imply the sound financial health of the joint venture banks.

Both indicators, operating expenses ration and earning per employee of management quality of EBL is satisfactory. On the whole, indicators of management efficiency show relatively healthy.

Liquidity indicators of EBL show that they have stored high level of liquidity and are not facing the liquidity deficit problem, instead, they are facing the high liquidity problem. Their high liquidity is affecting their financial health adversely by declining their profitability.

5.2 Conclusion

Commercial bank has to manage their assets and liabilities prudently because it is the only way by balancing assets and liabilities commercial bank can achieve better financial result for long term survival and the profitability. At present out of 32 commercial bank 5 commercial bank (NBL,RBB,NBB,NCC and Lumbini Bank) are operating with accumulate loss, non performing loan and creation of non banking assets but they unique in character and performance to the extent that their success depend upon proper management of assets in determining the interest rate, maturity structure quality of assets

composition, reserve requirements and matching of risk return characteristic of assets as well as proper management of liabilities in determining the interest rate, maturity structure, composition of types of liabilities and deposit insurance coverage.

On this scenario, joint venture EBL, on overall observation, EBL has evaluate the performance of assets and their liabilities using the generally accepted CAMELS evaluation components in strong position and as well protect interest of depositors, creditors, investor and the financial system as a whole.

After analyzing the credit portfolio of joint venture banks of Nepal from both financial and statistical aspects, we can draw some conclusion from the study are described below. All the joint venture banks have sufficient liquidity. It shows that banks have not got proper investment sectors to utilize their liquid money. Now, in Nepal, many banks and other financial institutions are functioning to collect deposits and invest money somewhere. Therefore monetary have been increased since liberalization policy taken by the government. Heavy remittance has also help to increase the amount of deposits of the banks. On the other hand, due to political crisis, economic sectors have been fully damaged. Most of the projects have been withdrawn due to security problems. Therefore, banks have maximum liquidity due to lack of safety investment sectors.

All the joint venture banks have utilized most of funds in the form of credit and advances. Almost 64% of total deposits of the bank have been forwarded to customers as a credit and advances. Therefore, it is the major part of utilizing deposits and income generating sector. If the banks have deposits, bank can provide money to its customers as credit and advances. For that banks are attracting deposits from customers and have issued the deposits to the needy area to make profit for the bank.

Provision for credit and loss has been increasing year by year for all joint venture banks. Due to economic crisis in the country. Credit takers are not getting good return from their investment. Because of that situation, credit customers do not return money of the bank in

the stipulated time period, therefore the risk of default in credit is increases. That's why the bank should increase its provision for credit loss which has been guided by NRB.

Following conclusions can be derived relating to the objectives of the study:

-) To conduct a comparative analysis of financial statement of Everest Bank Limited (EBL) with financial statement of other banks.
-) The CAMELS rating is below 2 for EBL which implies that their performance is very god in the industry and it is risk free. The analysis of annual report of Fiscal Year 2007/08 shows that Everest Bank Limited (EBL) Nepal stood first position among all leading commercial banks in Nepal. The good position is held by Everest Bank Limited (EBL)
-) The CAMELS Rating shows that to become successful and sound bank, bank should have adequate capital adjusted to its risk weighted assets, strong internal credit administration practices, diversified portfolio of loans and advances, other revenue generating activities like Letter of Credit, Project Management, Guarantee, Customer's Acceptance, Bills Payable and Remittance Services where there is no involvement of banks' fund but they earn significant amount of fee income and commissions. Moreover, bank should be able to manage its asset and liability to minimize to excess liquidity and they should be able to manage their operating expenses.
-) Everest Bank Limited (EBL) has strong image because of its sound banking system which has been reflected in Price Earning Ratio and Market Price of Share. It has been able to maintain standard CAR. It has lowest Non Performing Loan, good net spread margin, and is profitable too. Banking with Everest Bank Limited (EBL) can be considered risk free from perspective of customers. Increasing staff expenses, excess liquidity, huge investment in other companies' shares and debentures are some of weaknesses of Everest Bank Limited (BL) bank. Everest Bank Limited (EBL) bank has opportunities to invest in various sectors as discussed above. Tough competition, unstable political situation, WTO policies are some of the threats to Everest Bank Limited EBL).

-) Opportunities discussed above can be materialized by Everest Bank Limited (EBL). Investment in hydro-sector, ITC, retailing and consumer financing, e-banking, branch expansion, customer care unit, separate unit to collect deposits from NRNs are highly recommended to Everest Bank Limited (EBL).

5.3 Recommendations

Using the data set published by joint venture bank (EBL) in their annual reports, and NRB in its supervision annual reports, this paper examines the financial health in the CAMEL framework. The health check up conducted on the basis of publicly available financial data concludes that the health of EBL is better and satisfactory. In addition, the warning of indicators of different components of CAMEL indicates that the financial health of EBL banks is strong to manage the possible large scale shocks to their balance sheet and their health is fair.

-) Cash and bank balance of the joint venture banks are high. Unused cash and bank balance do not provide return to the bank. Therefore some percentage of cash and bank balance should be invested somewhere in profitable sectors. There must be a good investment decision which increases the corporate value of the firm. It carries out by effectively identify, organize and manage discrete and diverse segmenting order to serve particular status of customers more effectively.
-) Good liquidity position is very necessary for commercial banks as it is enough to meet the depositors' obligations as well as for good investment and for expansion.
-) Banks should avoid extending credit merely based on oral information presented at the credit interview. Historical financial and trade records as well as realistic cash flow projections should be obtained for proper assessment of the proposal. Banks also should regularly follow the credit customers to confirm that whether the customers have utilized their credit for the same purpose committed at the time of taking credit from the bank.
-) Bank should be sensitive to adverse movements in external factors such as interest rates, exchange rate and commodity prices as it has direct disruption on cash trends of the bank.

-) Banks should strictly band the policy of nepotism and favoritism. On the basis of capability and efficiency, employees' recruitment, placement and promotion should be executed as well as creditors relationship with the employee should also be judge before providing loan. That means strictly follow the NRB directives about relationship factor.
-) Economic liberalization policy adopted by the government of Nepal has created an environment of strict competition even in the banking sectors. In this context, all the commercial banks are suggested to formulate and implement some sound and effective financial and non-financial strategies to minimize their operational expenses to meet required level of profitability.
-) Nepal Rastra Bank has formulated various kinds of rules and regulation. Every bank must follow these rules and regulation and central bank must examine timely whether the banks follow the rules and regulation or not. If any bank not follows the rules then central bank must take proper action to that bank.
-) In this research, joint venture banks were taken for the study. Joint venture banks definitely have international relation. Therefore, these banks should make negotiations with the international banks to increase its transactions in the internal areas.
-) Banks are one of the most reputed organizations of our country. So, banks should fulfill some social obligations by extending their resources to rural areas and promoting the development of poor, ethnic and disadvantaged group. In order to do so, they should open their branches in the remote areas with the objective of providing cheaper charge banking services.
-) Liquidity indicators show that they have stored high level of liquidity and are not facing the liquidity deficit problem, instead, they are facing the high liquidity problem. Their high liquidity is affecting their financial health adversely by declining their profitability. So it requires a proper liquidity position to be maintained near in the future for their prosperous future and eternal services with your motto.

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APPENDICES

Annexure 1

CAMELS Rating:

Capital:

Range of ratio	comment	Ratings
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1) Risk based capital ratio of

12% or more	strong	1
9% to less than 12%	satisfactory	2
6% to less than 9%	Fair	3
4% to less than 6%	unsatisfactory	4
Bellow 4%	very unsatisfactory	5

2) Past Due Loans/Total Loans

Less than 5%	Strong	1
5% to less than 10%	Satisfactory	2
10% to less than 20%	Fair	3
20% to less than 30%	Unsatisfactory	4
30% or greater	Very Unsatisfactory	5

3) Total Loans to a Single Sector/Total Loans

10% and below	Strong	1
More than 10% to 20%	Satisfactory	2
More than 20% to 30%	Fair	3
More than 30% to 40%	Unsatisfactory	4
Over 40%	Very Unsatisfactory	5

4) Total Loans to a single Sector/ Core Capital

25% and below	Strong	1
More than 25% to 50%	Satisfactory	2
More than 50% to 75%	Fair	3
More than 75% to 100%	Unsatisfactory	4
Over 100%	Very Unsatisfactory	5

5) Net Earnings before tax/ Core Capital

15% or more	Strong	1
12% to less than 15%	Satisfactory	2
8% to less than 12%	Fair	3
1% to less than 8%	Unsatisfactory	4
Below 1%	Very Unsatisfactory	5

6) Net Earnings after tax/Core Capital

12% or more	Strong	1
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10% to less than 12%	Satisfactory	2
8% to less than 10%	Fair	3
1% to less than 8%	Unsatisfactory	4
Below 1% Very	Unsatisfactory	5

Asset Quality:

1) Past Due Loans to Total Loans/Industry Av of Past Due Loans to Total Loans

50% and below	Strong	1
More than 50% to 100%	Satisfactory	2
More than 100% to 125%	Fair	3
More than 125% to 150%	Unsatisfactory	4
Over 150%	Very Unsatisfactory	5

2) Provisioning for Substandard Loans/Total Substandard Loans

More than 25%	Strong	1
25%	Satisfactory	2
20% to less than 25%	Fair	3
10% to less than 20%	Unsatisfactory	4
Less than 10%	Very Unsatisfactory	5

3) Provisioning for Doubtful Loans/Total Doubtful Loans

More than 50%	Strong	1
50%	Satisfactory	2
40% to less than 50%	Fair	3
20% to less than 40%	Unsatisfactory	4
Less than 20%	Very Unsatisfactory	5

4) Provisioning for Loss Loans/Total Loss Loans

More than 100%	Strong	1
100%	Satisfactory	2
80% to less than 100%	Fair	3
50% to less than 80%	Unsatisfactory	4
Less than 50%	Very Unsatisfactory	5

5) Total Loans to a Single Sector/Core Capital

25% or below	Strong	1
More than 25% to 50%	Satisfactory	2
More than 50% to 75%	Fair	3
More than 75% to 100%	Unsatisfactory	4
Over 100%	Very Unsatisfactory	5

6) Bank/non bank's investment in shares and securities of a company/paid up capital of the bank/nonblank

Less than 20%	Strong	1
20%	Satisfactory	2
21% to greater than 20%	Fair	3
22% to greater than 21%	Unsatisfactory	4
Over 22%	Very Unsatisfactory	5

Earnings:

Range of Ratios	Comments	Assets
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1) Net Income (after tax/ Annual Average of end-of-month Assets

1.5% or more	Strong	1
1.0% to less than 1.5%	Satisfactory	2
0.5% to less than 1.0%	Fair	3
0% to less than 0.5%	Unsatisfactory	4
Below 0%	Very Unsatisfactory	5

2) Net Spread:**Interest earned/Interest-earning assets – Interest paid/Interest-bearing liabilities**

2% or more	Strong	1
1.25% to less than 2%	Satisfactory	2
0.5% to less than 1.25%	Fair	3
0% to less than 0.5%	Unsatisfactory	4
Below 0%	Very Unsatisfactory	5

3) Net Interest Margin:**Interest Income – Interest Expenses/Annual Average of end-of-month****Total Assets**

5% (weighted average spread may Not exceed 5%)	Strong	1
4.5% to less than 5%	Satisfactory	2
4% to less than 4.5%	Fair	3
3% to less than 4%	Unsatisfactory	4
Below 0%	Very Unsatisfactory	5

4) Net Operating margin:**Interest on earning assets + fee income/ All financial assets- Interest Expenses/
All funding liabilities**

6.5% or more	Strong	1
6.0% to less than 6.5%	Satisfactory	2
4.5% to less than 6.0%	Fair	3
2% to less than 4.5%	Unsatisfactory	4
Below 2%	Very Unsatisfactory	5

5) Total Operating Income/Annual Av. Of end-of-month total assets

13% or more	Strong	1
11% to less than 13%	Satisfactory	2
8% to less than 11%	Fair	3
6% to less than 8%	Unsatisfactory	4

Below 6%	Very Unsatisfactory	5
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6) Total Operating Expenses/Annual Average of end-of-month total assets

9% or less	Strong	1
11% to more than 9%	Satisfactory	2
12% to more than 11%	Fair	3
13% to more than 12%	Unsatisfactory	4
Above 13%	Very Unsatisfactory	5

7) Net Operating Income/ Annual Average of end-of-month total assets

4% or more	Strong	1
3% to less than 4%	Satisfactory	2
2% to less than 3%	Fair	3
1% to less than 2%	Unsatisfactory	4
Below 1%	Very Unsatisfactory	5

8) Total Operating Expenses/ Total Operating Income

85% and below	Strong	1
More than 85% to 90%	Satisfactory	2
More than 90% to 95%	Fair	3
More than 95% to 100%	Unsatisfactory	4
Over 100%	Very Unsatisfactory	5

9) Interest on Deposits/ Total Expenses

35% and below	Strong	1
More than 35% to 40%	Satisfactory	2
More than 40% to 45%	Fair	3
More than 45% to 50%	Unsatisfactory	4
Over 50%	Very Unsatisfactory	5

10) Interest on Borrowings /Total Expenses

15% or less	Strong	1
More than 15% to 20%	Satisfactory	2

More than 20% to 30%	Fair	3
More than 30% to 40%	Unsatisfactory	4
Over 40%	Very Unsatisfactory	5

11) Total Interest Expenses/Total Operating Income

50% and below	Strong	1
More than 50% to 60%	Satisfactory	2
More than 60% to 70%	Fair	3
More than 70% to 80%	Unsatisfactory	4
Above 80%	Very Unsatisfactory	5

12) Interest Income on Loans/ Total Operating Income

60% or more	Strong	1
50% to less than 60%	Satisfactory	2
40% to less than 50%	Fair	3
30% to less than 40%	Unsatisfactory	4
Below 30%	Very Unsatisfactory	5

13) Staff expenses/ Total expenses

9% and below	Strong	1
More than 9% to 11%	Satisfactory	2
More than 11% to 13%	Fair	3
More than 13 to 15%	Unsatisfactory	4
Over 15%	Very Unsatisfactory	5

14) Staff Expenses/Total Operating Income

8% and below	Strong	1
More than 8% to 10%	Satisfactory	2
More than 10% to 12%	Fair	3
More than 12% to 14%	Unsatisfactory	4
Over 14%	Very Unsatisfactory	5

Liquidity

Range of Ratios	Comments	Rating
------------------------	-----------------	---------------

1) Liquidity Ratio: Current Assets* /Short Term Liabilities*

More than 25%	Strong	1
20% to 25%	Satisfactory	2

17% to less than 20%	Fair	3
15% to less than 17%	Unsatisfactory	4
Less than 15%	Very Unsatisfactory	5

*Maturing/ re pricing in 90 days or less

2) First Quarter Gap (Maturity A/L mismatch)/CRR;

40% or less	Strong	1
40% to less than 60%	Satisfactory	2
60% to less than 80%	Fair	3
80% to 100%	Unsatisfactory	4
Above 100%	Very Unsatisfactory	5

Note: A gap represents an asset/liability mismatch for a given period. NRB Directive No.5 requires the banks to complete a form showing quarterly gaps going out one year in order to measure the bank's exposure to liquidity risk. A negative mismatch pertaining to the first quarter may be large enough to cause concern, as it may indicate that the bank is going to have problems funding its obligations coming due in the short-run. The quarterly gap amount in the above ratio has been related to the size of the bank's required CRR (liquidity reserve). The bank's compliance with the required CRR is naturally important for the Inspectors to confirm.

3) Second Quarter cumulative Gap (A/L maturity mismatch)/CRR:

40% or less	Strong	1
40% to less than 60%	Satisfactory	2
60% to less than 80%	Fair	3
80% to 100%	Unsatisfactory	4
Above 100%	Very Unsatisfactory	5

Note: Same comment as above except that the negative mismatch pertains to the cumulative gap pertaining to the second quarter.

4) First Quarter Cumulative Gap (A/L Maturity Mismatch)/ Core Capital

Less than 15%	Strong	1
15% to less than 20%	Satisfactory	2
20% to less than 25%	Fair	3
25% to 30%	Unsatisfactory	4
More than 30%	Very Unsatisfactory	5

5) Second Quarter Cumulative Gap (A/L Maturity Mismatch)/ Core Capital

Less than 15%	Strong	1
15% to less than 20%	Satisfactory	2
20% to less than 25%	Fair	3
25% to 30%	Unsatisfactory	4
More than 30%	Very Unsatisfactory	5

Sensitivity to market risk

1) Exchange Rate Risk: Net Foreign Exchange Position/ Core Capital

Less than 15%	Strong	1
15% to less than 20%	Satisfactory	2
20% to less than 25%	Fair	3
25% to 30%	Unsatisfactory	4
More than 30%	Very Unsatisfactory	5

Annexure-2
Five-year comparative balance sheet
Everest Bank limited

Particular	(Rs. In million)				
	2007	2008	2009	2010	2011
Total assets (TWF)	9567.57	15540.00	15959.28	21432.57	27698.87
Current Assets	8399.97	15377.31	15780.67	21243.39	26990.75
1. Cash and Bank Balance	631.81	1049.98	1552.96	2391.43	2852.43
2. Money at call and short notice	187.45	570.00	66.96	-	346.00
3. Loan and Advance	5834.12	7618.76	9801.31	13664.08	18339.08
4. Investment on Government Securities	2466.43	2100.28	3548.61	4704.63	5059.55
5. Interest Receivable	145.26	159.78	51.33	26.07	17.48
6. Miscellaneous Current Assets	84.90	3878.60	126.68	196.59	376.21
Fix Assets	118.37	134.06	152.09	170.09	360.51
* Investment on share	17.11	19.39	19.08	19.08	99.55
* Other Investment	52.12	9.25	632.82	260.60	248.06
Liabilities					
* Current liabilities	8984.55	14770.39	14696.48	19931.05	25777.64
7. Deposit and Other A/C	8063.90	10097.69	13802.45	18186.25	23976.29
8. Short Tem Loan	0.00	30.00	0.00	-	-
9. Bills Payable	22.03	17.78	15.81	26.77	49.42
10. Tax provision	67.55	81.91	0.00	15.28	41.14
11. Staff Bonus	13.46	88.92	34.56	45.47	65.86
12. Dividend payable	7.36	10.92	114.67	68.14	140.76
13. Misc. Current liabilities	800.25	4443.17	126.68	198.59	1504.14
* Net worth	540.32	769.61	962.81	1201.52	2025.04
*share capital	315.00	455.00	518.00	518.00	831.40
*share holders reserve	222.32	314.61	444.81	551.20	1089.83
* Total liabilities	9587.57	15540.00	15959.28	21432.57	27698.87

Annexure-3

**Profit and loss account
Everest bank limited**

Particular	(Rs. In million)				
	2007	2008	2009	2010	2011
Interest income	657.25	719.30	903.41	1144.41	1547.91
Other operating income	125.94	136.69	160.14	214.09	299.13
Total operating income	783.19	855.99	1063.55	1358.5	1847.04
Non operating income	1.87	2.97	2.96	12.21	0.00
Total income (A)	785.06	858.96	1066.51	1370.71	1847.04
Expenditure:					
Interest expenditure	316.37	299.57	401.40	517.17	632.63
Overhead expenditure	48.53	60.60	70.92	86.12	157.10
Operating expenditure	127.27	129.07	143.56	177.55	236.74
Loan loss provision	58.31	88.93	70.47	89.70	97.74
Provision for bonus	23.46	28.08	31.56	45.47	65.71
Total expenditure (B)	573.94	606.24	720.91	916.00	1189.93
Profit before tax (A-B)	211.12	252.72	345.60	454.71	657.11
Tax provision	67.545	84.51	108.31	158.30	206.99
Net profit after tax	143.57	168.21	237.29	296.41	450.12

**Annexure-4
Everest Bank Limited
Five-Year Comparative Balance Sheet**

Particulars	Average ratio
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Cash reserve ratio	0.114 times
Cash and bank balance to interest sensitive deposit ratio	0.274 times
Cash and bank balance to current assets ratio	0.1002 times
Loan and advances to total deposit ratio	0.728 times
Interest spread rate ratio	3.658%
Non-performing assets to total assets ratio	0.244%
Net profit to Gross income ratio	18.2%
Interest income to total income ratio	0.834 times
Operating profit to loan and advances ratio	0.047 times
Total income to total expenses ratio	1.62 times
Return on loan and advances ratio	0.434 times
Earning per share	Rs.45.078
Price earning ratio	16.026 times
Loan loss provision to total loan and advances ratio	1.017 times
Interest deposit to total deposit ratio	3.739 times
Non-performing loan to total loan and advances ratio	1.562 times

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11. Staff Bonus	13.46	88.92	34.56	45.47	65.86
12. Dividend payable	7.36	10.92	114.67	68.14	140.76
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* Net worth	540.32	769.61	962.81	1201.52	2025.04
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Tax provision	67.545	84.51	108.31	158.30	206.99
Net profit after tax	143.57	168.21	237.29	296.41	450.12