

A STUDY ON DETERMINANTS OF PROFITABILITY OF COMMERCIAL BANKS IN NEPAL

A Thesis

Submitted By:

Tulsi Karki

Saraswati Multiple Campus

Roll No.: - 70/065

T.U. Regd. No.: - 7-1-31-59-2001

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RECOMMENDATION

This is to certify that the thesis

Submitted by:

TULSI KARKI

Entitled:

**DETERMINANTS OF PROFITABILITY OF COMMERCIAL BANKS IN
NEPAL**

*has been prepared as approved by this Department in the prescribed format of
the Faculty of Management. This thesis is forwarded for examination.*

.....

Keshav Raj Pantha
(Thesis Supervisor)

.....

Dr. Dhurba K. Guatam
(Head of Research Comm.)

.....

Ram H. Lamsal
(Campus Chief)

VIVA-VOCE SHEET

We have conducted the viva –voce of the thesis presented

by:

TULSI KARKI

Entitled:

**DETERMINANTS OF PROFITABILITY OF COMMERCIAL BANKS IN
NEPAL**

The thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for the degree of

Master of Business Studies (MBS)

Viva-Voce Committee

Head, Research Department

Member (Thesis Supervisor)

Member (External Expert)

Member

Member

Certificate of Authorship

I hereby declare that this- submission of **Determinants of Profitability of Commercial Banks in Nepal** is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person nor material which to a substantial extent has been accepted for the award of any other degree of a university or other institution of higher learning, except where due acknowledgement is made in the acknowledgements

.....

Tulsi Karki

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Tulsi Karki

Executive Summary

Profitability is simply the difference between total revenue and total cost. Thus, the factors which affect commercial bank profitability would be those which affect banks' revenue and costs. Hence, the impact of the internal and external determinants of commercial bank profitability is analyzed with a view to show their impact on bank revenue and costs. This theoretical study focuses on the dependent variable namely bank profitability. This is followed by the internal determinants of commercial bank profitability.

This study investigates the determinants of profitability of commercial banks in Nepal with respect to firm specific variables. The specific objectives of this study were to analyze the relationship and impact of capital adequacy ratio, bank size, liquidity, quality of asset and operating cost efficiency on return on asset and return on equity.

The research was based on primary and secondary data. The methods used for secondary data analysis included financial analysis, and analysis by forming portfolio, correlation analysis and regression analysis. The methods used for primary data analysis included percentage frequency distribution, mean scores of responses to 5 point Likert scale items.

The results of from the financial analysis concluded that profitability of SCBL, Nabil Bank and EBL is higher than other sampled banks. Additionally, HBL, NIBL, NSBI, BOK, NIC Bank, NCC Bank's profitability is average and lastly, Laxmi, SBL, KBL, and LBL does not have satisfactory level of profitability of commercial bank in Nepal. Furthermore, from correlation analysis, portfolio analysis and regression analysis of secondary data shows that credit to deposit ratio, non performing loan and cost efficiency ratio has shown consistently significant explanatory power in negative manner in a ROA model indicating that return on asset decreases with increase in credit to deposit ratio, nonperforming loan ratio and cost efficiency ratio. In contrast, the study documents that capital adequacy ratio and firm size as insignificant in explaining the variations in return on asset of commercial banks in Nepal. Furthermore, cost efficiency ratio has shown consistently significant explanatory power in ROE model indicating that return on equity decreases with increase in cost

efficiency ratio. Whereas, the study documents that capital adequacy ratio, firm size, credit to deposit ratio and non performing loan ratio as insignificant in explaining the variations in return on equity of commercial banks in Nepal. Furthermore, the study also concluded that the effect of a growing size on profitability has been proved to be positive to a certain extent. However, for banks that become extremely large, the effect of size could be negative due to bureaucratic and other reasons. Similarly the study also concluded that current profitability of commercial banks of Nepal is not sufficient in order to survive for the long run.

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List of Abbreviation

ADF	:	Augmented Dickey Fuller
BOK	:	Bank of Kathmandu Limited
CAR	:	Capital Adequacy Ratio
CBK	:	Central Bank of Kenya
CBS	:	Central Bureau of Statistics
CDR	:	Credit to Deposit Ratio
CE	:	Cost Efficiency
DSE	:	Dhaka Stock Exchange
EBL	:	Everest Bank Limited
ER	:	Efficiency Ratio
EU	:	European Union
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
HBL	:	Himalayan Bank Limited
IFS	:	IMF Financial Statistics
IMF	:	International Monetary Fund
IRR	:	Internal Rate of Return
KBL	:	Kumari Bank Limited
KSE	:	Karachi Stock Exchange
LAXMI	:	Laxmi Bank Limited
LBL	:	Lumbini Bank Limited
NABIL	:	Nabil Bank Limited
NBC	:	National Bank of Commerce

NCC	:	Nepal Credit and Commerce Bank Limited
NEPSE	:	Nepal Stock Exchange Limited
NIBL	:	Nepal Investment Bank Limited
NIC	:	Nepal Industrial and Commercial Bank
NMB	:	National Microfinance Bank
NPA	:	Non-performing Assets
NPL	:	Non performing Loan
NPV	:	Net Present Value
NRB	:	Nepal Rastra Bank
NSBI	:	Nepal SBI Bank
OLS	:	Ordinary Least Square
PI	:	Profitability Index
ROA	:	Return on Asset
ROCE	:	Returns on Capital Employed
ROE	:	Return on Equity
ROI	:	Return on Investment
SBI	:	State Bank of India
SBL	:	Siddhartha Bank Limited
SCBL	:	Standard Chartered Bank Limited
SCP	:	Structure-Conduct Performance
SEBON	:	Security Board of Nepal
SEE	:	South Eastern European
SPSS	:	Statistical Package of Social Science
Std.Dev	:	Standard Deviation
SSA	:	Sub- Saharan Africa
T.U	:	Tribhuvan University