

CHAPTER-1

Introduction

1.1 Background of the Study:

The basis for the financial planning, analysis and decision-making is the financial information. Financial information is needed to predict, compare and evaluate the firm's earning ability. It is required to aid in economic decision-making. The financial information of an enterprise is contained in the financial statement or accounting reports.

"Financial statement analysis applies analytical tools and techniques to general purpose financial statements and related data to derive, to estimates and interferences useful in business decisions. It is a screening tool in selecting investment or merger candidates and is a forecasting tool of future financial conditions and consequences. It is a diagnostic tool in assessing financing, investing and operating activities and is an evaluation tool for managerial and other business decision."(Bernsten and Wild, 1998: 3) Financial Statement analysis reduces over reliance on hunches, guesses, and intuition and in turn it diminishes its uncertainty in decision-making. It doesn't lessen the need for expert judgment but rather establishes an effective and systematic basis for making business decisions.

Financial statements of a firm mainly include income statement and the balance sheet. They are important sources of financial information regarding the firm's operations and its financial position. To analyze the financial performance and strength & weakness of the firm, many types of tools and techniques are used.

Commercial banks play an important role in affair of the economy in various ways. The operations of commercial banks record the economic pulse of the economy. The size and composition of their transaction mirror the economic happening in the country. They are essential instruments of accelerated growth in a developing economy, by mobilizing community savings and diverting them into productive channels commercial banks expand the tempo and appreciate the value of aggregate economic activity in the economy.

The financial system in Nepal has developed from a narrow, repressed regime till the eighties to a dynamic expanding sector in the nineties. An indicator of the last decade shows that the sector has growth both quantitatively and qualitatively. It could be observed that, at the same time, the financial market has become more competitive, dynamic and also very complex. This constitutional network and the volume of operations of financial system have expanded and diversified with the number of increased commercial banks.

The adoption of the market economy has given birth to many private commercial banks in the country as said earlier. So far all these banks are doing very well. With the slowdown in the economy, interest rates are falling down. All the banks are flushed with funds and looking for safe and profitable avenues to invest into.

CAMELS Rating analysis, which refers to capital adequacy ratio, assets quality ratio, management, earning, liquidity positions and sensitivity to market risk, are required to predict, evaluate and make decision. It represents a systematic summary of banking transaction, stating actual cash inflow and outflow, and earning. They reflect the financial position of a bank

CAMELS Rating analysis is a screening tool in selecting investment alternatives, a forecasting tool of future financial conditions and consequences and a diagnostic tool

in assessing financial, investing and other business decision. It avoids intuition, guesses and hunches which is made for making any business decision and helps in reducing uncertainty in decision making.

CAMELS Rating analysis is one of the very popular and most appropriate tools of the financial analysis. These tools play the role of yardstick for evaluating financial condition and performance of the firm and show the relationship between financial statement account and between firms.

And on the basis of CAMELS Rating System, the study will be attempting to analyze the financial performance of Nabil Bank Limited.

Concept of Banking:

Bank is a financial institution, which plays a significant role, in the development of a country. "Banking institutions are inevitable for the resources mobilization and all round development of the country. It is resources for economic development and maintains economic confidence of various segments and extends credit to people." (Grywinshki, 1993: 87)

"The banking sector is largely responsible for collecting household saving in terms of different types of deposits and regulating them in the society by lending in different sectors of economy. The banking sector has now reached to 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 industries under intensive banking program has enabled the banks to share in the economic growth of the economy."(Shrestha, 1993: 32) Banks are institutions whose debts-usually referred to as "bank deposits" are commonly accepted in final settlement of other people's debt. Bank is also defined as an institution, which accepts deposits from the public and in turn advances loan by creating credit. It is different from other financial institutions in the sense that they cannot create credit though they may be accepting deposits and making advances. Banking system occupies an important place in nation's economy. A banking institution is in dispensable in a modern society. It plays an essential role in the economic development of a country and forms the core of the money market in an advanced country.

Various types of banking institutions are performing different functions. There is for instance the central bank, which controls the entire currency and credit of the country. It is the organ of government that under takes the major financial operations of the government and by its conduct of these operations and by other means influences the behavior of financial institutions so as to support the economic policy of the government. Similarly, commercial banks also perform different functions by accepting the deposits and advancing loans etc. But in modern times commercial banks are concentrated in their activities of fulfilling the financial needs of their customers. The commercial banks have become the heart of financial system as they hold the deposit of the people, government and business units and investing activities to individuals, business firm and government.

Evolution of Banking Industry Globally:

The evolution of banking industry had started a long time back, during the ancient time. There was reference to the activities of money changers in the Temple of Delphi and Olympia served as the great depositories for people's surplus funds and these were the centers of money lending transaction. Indeed the traces of "rudimentary banking" were found in the Chaldean, Egyptian and Phoenician history. The development of banking in ancient Rome roughly followed the Greek pattern. Banking suffered oblivion after the fall of the Roman Empire after the death of Justinian in 565AD, and it was not until the recovery of trade and commerce in the middle age that the lessons of finance were learnt a new from the beginning. Money lending in the middle ages was, however, largely confined to the Jews since the Christians were forbidden by the Canon law to indulge in the sinful act of lending money to others on interest. However, as the hold of the Church loosened with the development of trade and commerce about the thirteenth century Christians also took to the lucrative business of money lending, thereby entering into keen competition with the Jews who had hitherto monopolized the business.

As a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy and the Bank of Venice, founded in 1157 was the first public banking institution. Following it were established the Bank of Barcelona and the Bank of Genoa in 1401 and 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate until end of eighteenth century. With the expansion of commercial activities in Northern Europe there sprang up a number of private banking houses in Europe and slowly it spread throughout the world.

Historical Development of Banking System in Nepal:

In the country, the development of banking is relatively recent. The record of banking system in Nepal gives detail account of mixture of slow and steady evolution in the financial and global economy of Nepalese life. Involvement of landlords, rich merchants, shopkeepers and other individual moneylender has acted as fence to institutional credit in presence of unorganized money market.

Banking concept existed even in the ancient period when the goldsmiths and the rich people used to issue the common people against the promised of safe keeping of their valuable items on the presentation of the receipt; the depositors would get back their gold and valuables of the paying a small amount of safe-keeping and saving.

The history of banking in Nepal can be described as a component of gradual and economic sphere of the Nepalese life. Even the financial system is still in evolutionary phase. Though establishment of banking industry was very recent, some crude bank operation was in practice even in ancient times. In Nepalese chronicle, it was recorded that the new era known as "Nepal Sambat" was introduced by "Shankhadhar" a merchant from Kantipur in 880 A.D. after having paid all the outstanding debt of the country. This shows basic of money lending practice in ancient Nepal. In 11th century during Malla regime there was an evidence of professional moneylenders and bankers. It is further believed that money-lending business; particularly for financing the foreign trade with Tibet became quite popular during regime of Mallas. However, in the absence of any regulatory measures, the unscrupulous moneylenders were known to have charged exorbitant rate of interest and other extra dues on loans advanced.

The establishment of the "Tejarath Adda" by Prime Minister "Ranoddip Singh" during the year 1877 A.D. was fully subscribed by government of Kathmandu Valley which played vital role in the banking system, was regarded as the father of the modern banking institution. The prime task of "Tejarath Adda" was granting of loans and safeguarding of total national deposits. At that time, Indian currency was commonly used in most part of Terai. The primary task of the "Tejarath Adda" was to attract the deposits in government exchequer at the beginning but later on general public was also allowed to take the loan at the same rate of interest with gold and silver ornaments as securities and collateral. Although the institution did not accept any deposits, it had played an important role in development process of banking system in Nepal.

The main defects of this institution showed that there was no further financial institution set-up & there was no effort to expand the services. Above all of the defects, this institution did not accept any deposit from the public. In the absence of saving mobilization the "Adda" faced financial problems making it impossible to charter to the credit and service need of general population throughout the country. Udyog Parishad (Industrial Development Board) was constituted in 1936 A.D. One year after its establishment, it formulated the "Company Act" and "Nepal Bank Act" in 1937A.D.

In the year 1994 B.S. the establishment of Nepal Bank Limited, with the Imperial Bank of India came into existence under "Nepal Bank Act 1993 B.S." as the first commercial bank of Nepal. At that time Nepalese economy was characterized by the existence of dual currency system (Indian and Nepalese), which was affecting economic stability and development of nation. Thus, the need of establishment of the central bank required great urgency. As a result Nepal Rastra Bank was established as a central bank of country on 13th Kartik 2013 under NRB Act 2012 with the authorized capital of Rs. 10 million fully subscribed by government.

Integrated and speedy development of the country is possible only when the competitive banking services reaches nooks and corners of the country. To cope this situation, government set up Rastriya Banijya Bank in 2022 B.S. as a fully government owned commercial bank. With the come up of RBB, banking services spread to both urban as well as rural area. Agriculture Development Bank was established for the promotion of agriculture sector in country. When the government adopted liberal and market oriented economic policy in the mid 80's Nepal allowed the entry of foreign banks on joint venture basis with foreign capital, technology and experience. Nepal Arab Bank Ltd. was the first joint venture bank established on 2041B.S. under the commercial bank act 2031. With the opening of Nabil the door of opening joint venture banks was opened to the private sector.

1.2 A Brief Profile of the Bank:

Nabil Bank Limited (NBL), the first foreign joint venture bank of Nepal, started operations in July 1984. Nabil was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 19 points of representation across the kingdom and over 170 reputed correspondent banks across the globe.

As at 16 July, 2008, the bank had Rs. 1,600,000,000 of Authorized Capital, Rs. 689,216,000 of Issued Capital and Rs. 689,216,000 of Paid Up Capital.

The bank has the following ownership structure as at mid July 2008:

Rastriya Beema Sansthan	-	9.67%
Nepal Stock Exchange	-	0.33%
NB (International) Limited	-	50%
NIDC	-	6.15%
General Public	-	30%
Promoters Other	-	3.85%

Similarly, the present composition of Board of Directors (BOD) of the bank comprises as given below;

Board of Directors

1.	Mr. Satyendra Pyara Shrestha	Chairman
2.	Mr. A.P. Bazgain (Professional)	Director
3.	Mr. Dayaram Gopal Agrawal	Director
4.	Mr. Milan Bikram Shah	Director
5.	Mr. Mohiuddin Ahmed	Director
6.	Mr. Shambhu Prasad Poudyal	Director
7.	Mr. Supriya Gupta	Director
8.	Mr. Tabith Awaal	Director

Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business.

Operations of the bank including day-to-day operations and risk management are managed by highly qualified and experienced management team. Bank is fully equipped with modern technology which includes ATMs, credit cards, state-of-art, world-renowned software from Infosys Technologies System, Bangalore, India, Internet banking system and Telebanking system.

1.3 Statement of the Problem:

It has been said that Joint Venture Banks (JVBs) are now operationally more efficient having superior performance while comparing with other commercial banks in Nepal. JVBs have contributed significantly to overall economic development of the country. Yet they are not free from the problems that needed to be resolved for improving their performance of JVBs. Their profitability position and stock prices are generally considered to be yardstick of their better performance but one can raise the question whether these are enough to reflect the overall performance of JVB's.

A study of financial performance is a basic process which provides information about the profitability, liquidity position, earning capacity, efficiency in operation, credit worthiness, sources and uses of capital, financial achievement and status of the company. The information obtained can be used to measure the efficiency and effectiveness of the company in respect of deploys financial resources in profitable manner.

Among the commercial banks, the performance of those bank are satisfactory with in the short period of time, they have succeed to capture and remarkable share of Nepalese financial sectors.

Economic liberation policy of government has provided a better opportunity for foreign investors. Consequently joint venture banks and financial institutions have been incorporated rapidly. Because of rapid establishment of commercial banks at present they are facing competition.

In Nepal the profitability, operating expenses and dividend distribution to shareholders have found inconsistent. So the statement of the problem of the study will ultimately be finding out the reason of difference in financial performance in different period of time of NBL.

Also the study will be focused on evaluating financial performance and capital employment of NBL to check out which factors are responsible for variation of the profits, liquidity and investment. Also, the researcher tries to examine the level that the bank is complying with the regulation directed by NRB.

1.4 Objectives of the study:

The primary objective of the study is to analyze the financial performance of the bank through the tools of CAMELS Approach. The main objectives of the study are;

- ✓ To assess whether the bank is operating with adequate capital funds in relation to its size of operations and the risk assumed, as well as the bank's compliance with regulatory requirements.
- ✓ To evaluate the market or realizable values of bank's assets, particularly the loan portfolio.
- ✓ To evaluate the efficiency of overall management of bank.
- ✓ To assess the current and future earning capability and the efficiency of the bank based on the existing assets and liability structure as well as pricing and costs.

- ✓ To evaluate the bank's liquidity in the light of its existing assets and liability mix, and in relation to the legal liquidity requirements.
- ✓ To determine the bank's ability to monitor and manage its exposure to market risk.

1.5 Significance of the Study:

The banking sector is gearing up to operate in a more competitive and market obtained system. It is modernizing its operations and moving towards providing a range of financial products and services in an innovative and competitive way. In this context no bank can be regarded as competent and well managed unless they manage their resources well, generate adequate profits and provide a decent return to the shareholders.

Thus at the care of pegging, the performance of a bank lays the twin parameters of profitability and productivity. Both productivity and profitability of banks have suffered because of directed lending, satisfactory preemption, existence of unviable bank branches, pattern of investment, human resource management policies, ever rising-operational costs, bank debts, inadequate automations, frauds etc. Since there is no room for soft options to survive in the changed environment with status, goodwill, command and respectability, banks have to enhance their competitive capabilities and develop independent strategies and plans for increasing profitability after carefully considering their strength and weakness and have to take advantage of opportunities available in order to facilitate the socio-economic progress of the country. For this regard the banks should deliberately think as to how best they can top the available potential, garner resources, deploy them judiciously and monitor them prudently to maximize income and reduce expenses to achieve an optimum level of profit for the benefit of the stake holder of the bank viz. customers, shareholders, staffs and government.

Hence, the present study will be destined to provide financial information to different sectors of business that is directly influenced by financial performance of NBL. Especially, this study will serve the management shareholders, long terms and short-term moneylenders, creditors and employees/staff members of the bank in implementing future projects or initiating corrective action. In addition to this, the study will also help these potential investors, financial institutions and other people in raising interest in financial institution and similar business. The study will also open many doors to future research in the area of investment and assets management for business.

1.6 Limitations of the study:

The study consists of certain assumption limitation due to some reasons which are as follows:

- ✓ This study is simply to fulfill a partial requirement of MBS program under Tribhuvan University.
- ✓ This study only covers the last five years data i.e. from 2003/04 to 2007/08.
- ✓ The researcher independently has to conduct this study that's why there has been a time constraint. Further this study is not the final study on this area.

- ✓ There are plenty of banks and financial institutions in Nepal but due to the time constraints the study will be undertaken only in one bank ‘Nabil Bank Limited (NBL)’.
- ✓ The study has to depend on the secondary data taken from the annual reports, internet website of the bank. Similarly, on the other bank related magazines and journals. So, the reliability of the conclusions depends on the accuracy of the pooled secondary data.

1.7 Organization of the Study:

This study, on the financial analysis with the help of CAMELS Rating System of NBL, will be organized into five chapters as follows;

Chapter 1: Introduction

Chapter 2: Review of literature

Chapter 3: Research Methodology

Chapter 4: Data Presentation, Analysis & Interpretation

Chapter 5: Summary, Conclusions & Recommendations

The introduction chapter will briefly explain about the meaning and historical background of commercial bank in Nepal and also the joint venture banks. It will contain the background of the study, a brief profile of the bank, statement of problem, objective of the study, significance of the study and limitation of the study.

In the second chapter, the brief explanation of CAMELS Rating analysis will be presented. The relevant and pertinent literature and various studies will also be reviewed.

The third chapter will briefly explain about the research methodology that will be used to evaluate the financial performance of the bank under consideration. This chapter will consist of research design, sample and population, source of data and financial tools and techniques to measure the financial performance of NBL on the basis of CAMELS analysis.

In the fourth chapter, the data required for the study will be presented, analyzed and interpreted by using various tools and techniques of financial management, accounts and statistics to present the result relating to the study in a very logical manner.

The fifth chapter will be the final chapter of the study, which will consist of the summary of the four earlier chapters. This chapter will try to fetch out a conclusion of the study and attempt to offer various suggestion and recommendations for the improvement of the future performance of the Nabil Bank Limited.

Finally ***Bibliography and Appendix*** are presented at the end of the study.

CHAPTER-2

Review of Literature

Review of literature means reviewing research studies or other relevant preposition in the related areas of the study so that all past studies, their conclusion and deficiencies may be known and further research can be conducted. This chapter highlights upon the literature that have already been conducted by some thesis researches in this particular topic of Joint Venture Banks. Some of them, as are supposed to be relevant for this study purpose.

2.1 Conceptual Review

2.1.1 Concept of Commercial Banks

Financial intermediaries play significant role for the development of national economy. They influence savings and surpluses considerably, which results investments. Financial intermediaries collect financial resources and supply them to the productive sectors that boosts the trade and industry and at last development of the country's economy.

Commercial banks are also financial intermediaries they mediate people who save money and who want to secure the use of money by accepting the deposits, burrowing funds and advancing loans. In addition to these primary functions, commercial banks, collect checks and bills, open letter of the credit, guarantee on behalf of customers, undertake capital and other many activities, exchange foreign currencies etc.

"A commercial bank is one which exchanges money, deposits money, accept deposits, grants loan and performs commercial banking functions and which is not a bank meant for co-operative, agriculture industries or for such specific purpose."(*Nepal Commercial Bank Act, 2031: 1*)

"Commercial Banks are heart of financial system they hold the deposits of many person, government establishment business unit. They make fund available through their lending and investing activities to borrowers, individuals, business firms and services for the producers to customers and the financial activities of the government. They provide the large portion of the medium of exchange and they are media through which monetary policy is affected. These facts show that the commercial banking system of nation is important to the functioning of the economy." (Reed /Cotler /Will /Smith, 1976: 39)

In the context of Nepal, commercial banks are operated under "Commercial Bank Act 2031 B.S.", In addition to Commercial Bank Act, Nepal Rastra Bank also lays down other many directives.

2.1.1.1 Functions of Commercial Bank

Regarding the function of commercial banks, a Commercial Bank Act state that a commercial bank is one that exchanges money, accept deposits, grants loans, and performs commercial banking functions. The functions and services of modern commercial banks are classified under the following headings;

(i) Accepting Deposits

A commercial bank accepts deposits from customers in the forms of current, saving and fixed deposits. These deposits are repayable on demand. The depositors other than current A/c are paid interest.

(ii) Granting Loans and Deposits

The second main function of the commercial bank is to grant loans and advances to businessman, the industrialist, the individuals, the different organizations etc. in the forms of term loans, cash credit, overdraft, trust receipts, hire purchase loans etc. Banks charge interest on such loan and advances, which is the largest source of total income.

(iii) Agency Service

A modern commercial banks act as an agent of individual customers, business institutions and different organization. The agency services of banks may involve collection of interest and dividends on debt and share capital. A bank buys and sells securities on behalf of the customers. Bank also collects cheques, drafts promissory notes etc and receives their payments. Sometimes, it makes payments of insurance premium, bills of electricity, telephone etc. It takes commission for the services rendered.

(iv) Guarantee on Behalf of Customers

The need of bank guarantee arises in business. Generally, business customers enjoy this service. Sometimes, personal customers may also need a bank guarantee. A guarantee is a definite and irrevocable undertaking by a bank on behalf of its customers to make payments up to a specified sum of money to the beneficiary on demand in case of default by its customers.

(v) Issuance of Traveler's Cheque

The people traveling outside the country want to reduce the fear of getting money stolen during the travel. Bank sells the traveler's cheque. The unique feature of the traveler's cheque is that unless the purchaser of traveler's cheque signs for encashment it cannot be encashed.

(vi) Letter of Credit Facility

A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount is called a letter of credit. Today letter of credit has become very popular in foreign business. The letter of credit is established /opened by the bank on the request of the customers.

(vii) Remittance Function

Sending and receiving fund to /from various places is the necessity of today. The remittance service of bank has benefited both business and personal customers. Funds transfers are made through various modes like demand drafts, telegraphic payment order, swift, fax and mail payment orders.

(viii) Other Services

Modern commercial banks are equally important in undertaking safe custody of important valuable and documents. Banks also offer some of the bank services at the door of highly valued customers. Few large banks conduct research and survey in the economic conditions and they supply trade statistics and information. In addition to these, banks also inform their customers about the credit standing of other particles.

2.1.2 Concept of Joint Venture Bank

"A Joint Venture Bank is joining of forces between two or more enterprises for the purchase of carrying out a specific operation i.e. industrial and commercial investment production or trade."(Gupta, 1984: 15)

The joint venture is common variant for expansion. "A joint venture business involves in equity arrangement between two or more independent enterprises which results in the creation of new organization entity."(Jauch and Glueck, 1988: 232). This thought identified the joint venture as a mutual understanding among two or more firms then bringing a new enterprise in existence. Basically they are constant about the ownership of new firms. In what proportion they are going to contribute ownership is also decided mutually.

Firms within a country as well as operating in different countries may participate in a venture that happens to be more common firm's indifferent countries. The foreign joint venture banks with full-fledged banking functions in Nepal are formed under the 2031 B.S. Joint Venture Bank have been established for trading to achieve mutual exchanges of goods and services, for sharing comparative advantages by performing joint investment schemes between Nepalese investors, financial and non-financial institutions as well as private investors and their parent banks. The parent banks that have experience in highly mechanized and efficient modern banking services in the many part of the world have come to Nepal with superior technology, advanced management skills and international network of banking.

The existence of foreign joint venture banks has presented an environment of healthy competition among the existing commercial banks. The increased competition has led to improve their quality and has caused an extension of services by simplifying procedures and training.

The concept of joint venture banks is a new innovation in finance and it is at a growing stage, mostly in developing countries.

"HMG's deliberate policy of allowing foreign JVB's to operate in Nepal is basically targeted to encourage local traditionally run commercial banks to enhance their

balanceable capacity through competition efficiency, modernization via computerization and prompt customer service."(Shrestha, 2041: 44).

Joint venture banks in Nepal are expected to be the medium of economic development and uplift the community under the guidance, operate under the supervision, controlling and direction of Nepal Rastra Bank. Nepal Arab Bank Limited was the first joint venture bank of Nepal, established in 29th Ashar 2041 B.S.

2.1.2.1 Role and Functions of Joint Venture Banks

With the entry of foreign joint venture banks with foreign collaboration advanced managerial skills, international network, personalized manpower, and modern computerized technology have created serious challenges to the existence of the traditionally running inefficient domestic state owned banks. JVB's are able to provide quality-banking service at the cheaper costs. At same time, JVB's create the opportunity and environment to the domestic banks to improve their style of doing business by modernizing themselves and sharpening the internal strength.

The JVBs have already been providing a dynamic and vital role for the development of the efficient financial market as well as for successful mobilizing and utilizing financial resources in the country, which can be illustrated in the following headings.

Providing Advanced Banking Services

The joint venture banks are expert and efficient for practicing new methods of doing banking business like computerization, providing tele-banking facility, automatic teller machine (ATM), 24 hours banking services, any branch banking facility, premium saving account (PSA), free life insurance of account holders, and other many attractive facilities.

International Management Network

The top level-management of the JVB is either from foreign country or supported by foreign parent institutions for expertise and professional services. And the management is able to formulate policy and strategy according to Nepalese economic climate with the participation of native promoters. Such management system can be a model example to the domestic banks that are operating traditionally.

Creation of Healthy Competition in the Banking Industry

In the post liberalization period the introduction of the JVB's has ended the monopoly of the two domestic banks namely NBL and RBB and brought satisfactory fair competition in the banking business, which results the competitive advantages to customers. Efficiency of the financial market is the backbone of the economy. The advent of the JVB's has contributed much to the direction of domestic saving as well as to the efficiency of funds flow into the economy which surely would not have been possible through the government's conservative and restricting free competition policy.

Advantage of Foreign Investment

The JVBs play a remarkable role in making available foreign financial resources for the investment. They act as mediators between foreign investors and native investors and promoters. That will help for the promotion of the trade and commerce in the country.

Recently, the JVB's are being criticized, as they only want to operate in urban and suburban areas rather than to rural ones driven by profit motive. However the JVB's have been contributing much in the direction of the development and modernization of the efficient banking system, financial system, domestic saving and creation of the employment opportunities.

2.1.3 CAMELS System

Background:

The CAMELS approach was developed from the *Uniform Financial Institutions Rating System (UFIRS)* by bank regulators in the United States as a means of measurement of the financial condition of a financial institution.

First of all, CAMEL rating system was adopted on November 13th, 1979 by the Federal Financial Institution (FFICE). The objective is to evaluate five different components of an institution's operations including: capital adequacy, asset quality, management, earnings, and liquidity. A sixth component was added in 1997 -Sensitivity to market risk. Each of the factors is scored from "one" to "five", with "one" being the strongest rating (Barr, Killgo, Siems, & Zimmel, 2002).

A researcher may adopt many independent variables; however, fewer than ten variables are selected to construct a model, and these variables are grouped into CAMEL, CAMEL-S, or CAMELO models. As Swindle (1995) pointed out the purpose of the CAMEL model is to improve the inadequately capitalized banks in the U.S. in the 1980s. In addition, an application of CAMEL-S like Rieker's (2003) writes, "Deposit insurance premium levels generally correlate with the CAMEL-S ratings regulators assign to banks". If banks are rated as a one or two, then pay nothing for coverage. But if banks rated as three, four, and five, then they pay increasingly large premiums. These related studies of deposit insurance are: Federal Deposit Insurance Corporation (FDIC), Hoffman (1989), and Guerrero (2000).

Many prior studies by bank examiners and regulators have used the CAMEL-S rating system to detect financial efficiency and performance. But few researchers study the insurers' financial rating systems, let alone use the CAMEL-S model and RBC model simultaneously to evaluate the financial rating systems of life insurers in this study. For example, some researchers, such as Guerrero (2000), Rosenstein (1987), Milligan (2002), Scott, Spudeck, and Jens (1991), Phillips (1996), Paden (2002), and Rieker (2003) have studied the application of the CAMEL or CAMEL-S model but only Burton, Adams, and Hardwick (2003) have applied the CAMEL model to the insurance industry.

CAMEL-S ratings, or CAMEL-S scores, provide a letter grade or numerical ranking to indicate the safety or soundness of the institution as assigned by supervisors. Table 1 shows implications of CAMEL-S rating, based on study of Barr, Killgo, Siems,

and Zimmel (2002). Hence, this study assumes the financial insolvency of life insurers when their CAMEL-S rating is “four” or “five.”

CAMELS Rating according to NRB

The major responsibility of the Nepal Rastra Bank (NRB) is to perform the inspection and supervision of the commercial bank, under the several policy documents such as Nepal Rastra Bank Act 2058, Bank and Financial Institution Ordinance 2061 etc. Due to this responsibility NRB makes the inspection and supervision by law 2059. Under this by law, NRB also develops the several norms and tools to measure the financial performance of the commercial banks. NRB inspects and supervises the commercial banks because they have to perform for the safety of the depositors' interest.

To protect the depositor's interest, NRB perform the two types of the inspection and supervision. One is *on-site* and other is *off-site*. The main approach of supervising banking institution is to concentrate on corporate governance, marked discipline and management oversight. But concerning only with the off-site supervision, it is simply analyzing and reviewing the several financial and statistical reports of financial institutions and their compliance with the provisions made for them.

On-site financial analysis is based on collecting, reviewing and analyzing prudential reports and statistical returns from financial institutions on a regular basis. This report should include basic financial statements as well as supporting schedules that provide great details on exposure to different risk and various other financial aspects of the institution, including provisions and off-sheet balance sheet activities.

The main objective of the on-site supervision of the commercial banks is to determine their financial performance and soundness and to check adherence to some prudential requirements. It also provides some ideas to identify problems and their corrective actions.

Supervision Department of NRB establishes some mechanisms to perform the on-site financial analysis (Supervision) which are as follows:

- A system of information by reporting institutions.
- Ratio analysis for each reporting institutions
- An analysis of the key ratios and determinations of CAMELS rating for each institution.
- An executive summary of each institution.

For the purpose, the financial analysis is made under the CAMELS system that is designed in the off-site supervision manual. CAMELS system is simply the financial tool that is used to rank the commercial bank's performance. CAMELS is the composition of the six financial elements; *Capital Adequacy, Assets Quality, Management, Earning Position, Liquidity Position and Sensitivity to Market Risk.*

2.2 Utility and Importance of CAMELS Analysis

CAMELS analysis is an important and new technique of financial analysis. The data given in financial statement in absolute form are dumb and unable to communicate anything. Ratios are relative form of financial data and very useful technique to check out the efficiency with which working capital is being used in the enterprises. The following are some main importance of the CAMELS analysis.

- ✓ CAMELS analysis simplifies the financial statement. It tells the whole story of change in financial condition of the business.
- ✓ CAMELS analysis provides data for inter-firm comparison.
- ✓ CAMELS analysis helps in planning and forecasting.
- ✓ CAMELS may be used as a measure for inter-firm and intra-firm comparisons.
- ✓ CAMELS analysis is also very useful for decision-making.
- ✓ For simple assessment of liquidity, profitability, leverage and activity position of the firm, the ratios are very useful. It helps to evaluate the financial condition and performance of the company.
- ✓ It also helps NRB to check its directives.

2.3 Users of Financial Statement and CAMELS Analysis

Financial statement users are broadly classified into two groups. *Internal users*, primarily the managers of a company who are involved in making operating and strategic decisions for the business and the employees who have complete access to a company's information system. Internally generated financial reports are, therefore, specially tailored to the unique information needs of an internal decision maker, such as CEO or internal auditor.

External users are individuals not directly involved in the company's operations and NRB. These users must rely on information provided by management as a part of the financial reporting process. There are many classes of external users of financial statements. Creditors are bankers, bondholders and other individuals who lend money to business enterprises. Creditors look towards financial statements for evidence concerning the ability of the borrower to pay periodic interest payments and repay the principle amount when the loan matures. Equity investors include existing and potential shareholders of a company. Existing shareholders need financial information in deciding whether to continue holding the stock or sell it. Potential shareholders need financial information to help in choosing among competing alternative investment.

Merger and acquisition analysts are interested in determining the economic value and assessing the financial and operating compatibility of potential merger candidates.

Auditors use financial analysis techniques in determining areas warranting special attention during their examination of a client's financial statements.

A company's board of directors, in their role as appointees of shareholders, monitors management's actions.

Regulatory agencies utilize financial statements in the exercise of their supervisory functions, including the Securities and Exchange Commission, which vigilantly oversees published financial statements for compliance with federal securities laws.

Other above mentioned users including *employees, intermediaries, suppliers and customers* rely on the analysis of financial statements.

2.4 Reviews from Relevant Studies

Some studies have been made on the financial performance of the commercial banks. No, sufficient studies review of the financial performance related studies can be made in this subsection. But again no meaningful studies on the CAMELS system and evaluation of the financial soundness of commercial banks could be found. However, some relevant studies on financial performance of the commercial banks have been reviewed so that the possibilities of limitation can be avoided from the current study and some originality can be aimed at serving the objective set.

2.4.1 Reviews from Research Studies

Timothy J. Curry, Peter J. Elmer, and Gary S. Fissel on their working paper, "Regulator Use of Market Data to Improve the Identification of Bank Financial Distress" has conclude that the notion that the stock price, return, and other market-related variables can be used to improve the predictive content of Call Report (*Report of Condition and Income*) financial ratios for the purpose of anticipating CAMEL rating changes. A sample of 122 banks and thrifts that were downgraded to the CAMEL 3 level and 148 banks and thrifts downgraded to the 4 or 5 level were analyzed over the period 1988-1996. Extensive univariate analysis confirms that relatively simple measures of stock prices and returns exhibit downward trend as much as two years before banks and thrifts experience CAMEL rating downgrades to 3, 4, or 5. The longer-term nature of these trends suggests that the unvaried trends are not commonly found in stock returns of healthy institutions. However, no relation appears in unvaried comparisons of several other market variables, including average trading volume and average quarterly turnover of shares.

Further they add stock return variables to regression equations that include financial ratios commonly used to predict CAMEL rating changes in off-site monitoring models. The result provides several additional points of interest. Most important, adding relatively simple measures of excess returns, stock prices, and an institution's dividend record improve the CAMEL ratings predictive content of Call Report data and otherwise appear to have a limited independent role in anticipating financial distress. The predictive content of the model is most robust for institutions experiencing the greatest financial distress those being downgraded to the 4 or 5 levels. Other market-related variables, such as return volatility, trading volume, and the book-to-market equity ratio, appear to have limited predictive value.

Richard S. Barr, Lawrence M. Seiford, and Thomas F. Siems on their working paper, “Forecasting Bank Failure: A Non-Parametric Frontier Estimation Approach” have presented the multiple-input, multiple-output DEA model (data envelopment analysis) has proven to be effective in qualifying management quality. Banks that survive can be statistically differentiated from banks that fail using the managerial efficiency scores generated by the DEA model. Long before failure occurs, significant differences in the efficiency metric appear which can be statistically detected.

Two new bank-failure prediction models were presented in which the incorporation of the management quality metric results in a significant improvement in classification accuracy. Both the one-year-ahead and two-year-ahead models use proxy variables for each factor in the CAMEL rating plus a variable to capture local economic conditions. The results confirm that management is, indeed, important to the successful operation of a bank. When the management variable was removed from the full model, the results were worse in terms of the model’s classification accuracy. The newly developed DEA-based models show superior results to leading published approaches.

2.4.2 Reviews from Articles

The KFA (2006, p: 75-81) article on “Banking at Boiling Point” has tried to find out the financial position of Nepalese 17 commercial Banks on the basis of CAMEL approach. The study has concluded that the total capital fund and CAR of most of the commercial banks is satisfactory except few commercial banks who have failed to maintain it as per the NRB directives. NBL and RBB are exempted from maintaining minimum capital adequacy as these banks are under reform process of World Bank. The main reason for the banks not being able to maintain minimum capital fund is due to the increased non performing loan. This study also finds that a number of banks have lower NPL and LLP ratio; however, there are banks whose NPL ratios are higher than industry average. These banks will have to focus on risk management control and should focus on recovery of bad loans. In the study period of 2002/03 to 2005/06 total loans and advances of commercial banks has increased by 46% even though there is political uncertainty, conflict and unrest in the country. Most of the commercial banks have been able to grow their net profits while some of the banks resulting from high non performing loans, lack of avenues for earning fee based income and operating in inefficiencies are struggling with either very low net profit or negative profits. EPS reflects the earning power of the bank. Higher ratio shows sound profitability position of the bank. It is found that most banks have been able to earn good EPS, while few are unable to do so.

The study further concludes that the good management can make and poor management can break an organization. Net Profits of some of the banks are extremely low or even negative, which can be attributed to higher provision of loan loss resulting from poor quality of loans. This has caused in negative per employee productivity of such bank, which is quite a paradoxical situation. In management analysis, another important analysis on sustainability of earning has been conducted. The study conclude that management of those banks who have been able to increase net profits in a constant and sustainable manner over a period of time, are considered as efficient and successful whereas management of banks who have not been able to grow their earning in a sustainable manner can be considered as inefficient. It has been observed that some of the banks could not perform well because there are significant interference o f shareholders

in day to day affairs of management. Unfortunately Nepali banking needs to do a lot more in terms of implementing fair corporate governance practices.

The study further concludes that all commercial banks have maintain CRR as per NRB's direction and all these banks are successful to set aside reasonable cash and bank balance to meet their payment obligations. There are few banks who might be maintaining a very low percentage of their deposits as investment in government securities. This can cause liquidity crisis or the banks inability to honor deposit withdrawal, if it so happens it can send a very wrong signal about the entire economy.

Murari R. Sharma (1988, p: 31-42) on his article "Joint Venture Banks in Nepal: Co-existing or crowding out", has highlighted that "It would be operated in the country and not to take advantage to them as additional means of new era in banking. However, it will certainly be unfortunate for the country to develop the JVB's at the cost of the domestic banks. So for one should admit frankly no different treatment has been extended to the domestic and JVB's at least from the government side, which is commendable. If His Majesty's Government keeps on the stance of treating the domestic banks and JVBs, equally deposit the latter's bargaining strength and if the JVB's also show their alacrity to come forward to share the trials and tribulations of this poor country, both types of banks will coalesce and co-exist, complementing each other and contributing to accelerated development. On the contrary, if the JVB's use their strength against trading into the cumbersome path of development along with the domestic banks and the government, they will eventually crowd out the domestic banks from the more profitable urban areas and lucrative urban sectors unless remedying by the determination of the government".

Manohar Krishna Shrestha (2047,p:44-54) in his article, "Commercial banks comparative performance evolution", concludes that JVB's are new, operationally more efficient, having superior performance of JVB's is due to their sophisticated technology, banking methods and skill. Their better performance is also due to the government's branching policy in rural areas and financing local banking area efficient in rural sector. Despite having number of deficiency, local banks have to face growing constraints of socio-economic political system on one spectrum and that of issue and challenges of JVB's commanding significant banking business on other spectrum".

Mr. Jagat Timilsina (2004,p:96-102) in his article, "Consumer satisfaction in Joint Venture Commercial Bank," has tried to find out the satisfaction or dissatisfaction from the performance of joint venture commercial bank to people. He concludes that if perceived performance matches expected performance customers are felt neutral. But if perceived performance exceeds desired performance, customers are highly satisfied and vice-versa. Here, perceived performance refers to product or service characteristic. The researcher had taken eight banks as the sample for the study whether these banks are capable for consumer satisfaction or not. Interest rate, fast and efficiency service, reliability, timely information, targeted for poor people, pleasant office environment, good behavior of employees, distance from customers residence has been taken responsible factors for customer satisfaction and another five factors have been identified as contributing to dissatisfaction i.e., low interest rate, employee behavior, complicated to get other services, hesitation to be familiar with modern banking and high minimum balance. Form these factors he concludes that these joint venture banks are performing high satisfaction to their customer. He further concludes that customer's satisfaction is a critical element in attaining success in any business venture as it helps to gain the market

share and retain it. It is imperative that service organizations like banks should be particularly aware of customer satisfaction and dissatisfaction factors.

2.4.3 Reviews from Thesis

Imesh Poudel (2005), on his thesis paper, “CALES SYSTEM: An Evaluation of Everest Bank Limited”, has tried to conduct the evaluation of EBL under the CALES Ratio. The primary objectives of this research work are to determine the financial position and quality of operation of EBL and also to examine the need of evaluation of sample bank’s performance with reference to prudential requirements i.e. CALES System. Mr. Poudel has tried to conduct his research work with the help of CALES ratios, the tools of off-site evaluation of NRB. These ratios are basically determined by NRB for the supervision of financial institution of Nepal.

In this research work he has concluded that the financial position of EBL was very satisfactory. The bank had maintained most of the provision required by NRB for the safety of depositors’ deposit. Bank had maintained adequate capital position, adequate provision for loan and advances, proper management on utilizing the resources, identification of profitable investment sectors, adequate liquidity position and management.

Further he concludes that the NPA of EBL is decreasing at the end of the study period which shows that the bank has the high degree of performing assets. The performance of overnight borrowing and loan to deposit performance is strong in each period. In the case of interest rate sensitivity position of RSL and RSA the bank held the higher sensitive assets. Concerning the foreign exchange position, only the final year performance is strong, which indicates the higher degree of protection of depositors’ deposit and public confidence over the bank’s performance. He further concludes that ROA of the bank improve only at the final year of the study period. Similarly, the operating income and operating expenses were higher in FY 2057/58, 2058/59 and 2060/61. It was found that the bank performance was improving, when reached at the end of study period.

This research work has not been completed with the view of NRB directives. First of all the ratios of CALES Analysis are not used. Second the NRB off-site supervision is basically designed for rating which has not been used in this research.

Prabhu Narayan Pradhan (2005), on his thesis paper, “Financial Analysis: A Comparative Study of Himalayan Bank Limited and Standard Chartered Bank Nepal Limited” has tried to evaluate the comparative financial position of these two sample banks. The primary objectives of this research work is to analyze the financial strength and weakness of these two joint venture banks and also the comparative financial positions between these two banks in various aspects.

This research work is conducted basically on the basis of secondary data. Financial tools as well as statistical tool have been used to analyze this research work. The key ratios i.e., liquidity ratios, activity ratio, capital structure ratio, profitability ratios and invisibility ratio has been used as financial ratios. The researcher has use arithmetic mean, standard deviation, coefficient of variation and t-test as statistical tool. To make

this research more accurate the researcher has segregated the sample years as 3 years, 4 years and 10 years.

He had concluded that both the banks are unable to maintain its liquidity position. It is found that both banks are not adopting constant policy regarding liquidity position. But the analysis signifies that both banks are successful in utilizing its funds. SCBNL is more in utilizing its deposit in investment opportunities where as HBL is more successful in utilizing its deposit in loan and advances. He further concludes that profitability position SCBNL is comparatively better than HBL. It may be due to earlier establishment of SCBNL. The invisibility ratio reverb that both the banks have bright future. The earning per share and dividend per share of SCBNL is higher than that of HBL, but price earning ration of HBL is to some extent greater than that of SCBNL. So this analysis signifies that both banks investment performance is better and the trend of net income to its shareholders' is stability and growing.

Sangita Shakya (2000), in her thesis paper, "Comparative Analysis of Financial Performance of Selected Joint Venture Banks', a case study of NGBL & HBL", has tried to find out the comparative financial performance of NGBL and HBL. The primary objective of this research work is to evaluate the financial position of these two joint venture banks and to make comparison between these two joint venture banks.

The researcher has used the financial ratio analysis to evaluate the financial performance. No other tools have been used to evaluate the financial performance. Only five years data has been used in this research.

The researcher has concluded that liquidity ratio of HBL have been higher than NGBL. Profitability ratios of both the banks revealed that among various profitability ratios like return on total assets, return on total deposits, the performance of NGBL is better than HBL. HBL has higher return on net worth or shareholder's fund than that of NGBL. She further includes that the activity ratios such as loans and advances to total deposit ratio, total income generating assets of total assets ratio of HBL is higher than NGBL. Total debt to total assets ratios of both the banks exceeded 90%, which indicates that both banks are successful in exploiting debt to total assets, however HBL's ratio is higher as compared to NGBL. The capital adequacy position is better in NGBL than HBL.

Further she recommends that NGBL should increase its cash & bank balance as directed by Nepal Rastra Bank. HBL is also suggested to increase its capital adequacy ratio above 8%. She strongly recommends to both banks to minimize their operating expenses as far as possible since it contributes to enhance the volume of profits. NGBL is suggested to utilize more of the deposits in extending loans and advances and HBL should attempt to stabilize the fluctuating loans and advances to total deposit. She further recommends to both banks to extend their banking facilities even in the rural areas providing special loans to the deprived and priority sectors.

Another thesis submitted by *Resham Raj Pathak (2001)* on "A Comparative Study on Financial Performance Between NGBL & HBL ", has tried to compare the financial position of these two banks. The primary objectives of this study is to compare these joint venture banks financial position and able to find out their strength and weakness and to recommend in their weak sectors.

Ratio analysis has been used as financial tools to evaluate the data of these sample banks. The researcher has only used the secondary data for the evaluation. The statistical and other tools rather than financial ratios have been used in this research study. Only five years data has been used from FY 1995/96 to FY2000/01.

In this research work the researcher has concluded that the liquidity position of both banks is unsatisfactory. He has also concluded that short-term solvency positions of both the banks are found below the normal standard. Both the banks have been efficiently in utilizing most part of their total assets in profit generating purpose but comparing both banks NGBL has better performance than HBL for utilizing assets. He also concludes that net profit to total assets of NGBL is higher than that of HBL. Also the return an investment and rate of return of NGBL has always been higher in all fiscal year as compared to HBL. In conclusion, ROI comparatively decided that HBL has idle deposits due to lower return as compared with NGBL. The researcher has found that both the banks are highly leveraged. Comparatively HBL seems relatively more. Thus both banks have lower ratio of shareholder's equity over total claims of creditors. Total debt to total assets ratio of both the banks is found 90% of the total assets are financed by the outsider's funds. The average ratio of HBL is found slightly higher than that of NGBL. The EPS of NGBL is always higher than HBL in all fiscal years but both banks EPS is found in decreasing trend after 1996/97. NGBL has declared dividends in all fiscal years and it can be concluded that NGBL seems much better in terms of offering dividends to its shareholders as compared to HBL.

Further he recommends that both the banks should improve their current ratio. Profitability ratios in both banks are not satisfactory and both these banks should utilize its resources to more profitable sector. Both banks are highly leveraged and it is unfavorable to both the banks. So, banks are suggested to use low debt capital. NGBL has been investing more in government securities rather than investing on loans and advances. He strongly recommended NGBL to invest more in the most earning assets like loans and advances. Lastly the researcher suggests both banks to involve in social responsibility by investing a part of profit.

Mr. Uddhab Prasad Sapkota (2002), in his thesis paper "A Study on Fund Mobilization Policy of SCBNL in Comparison to NBBL & HBL" has tried to compare fund mobilization policy of SCBNL with NBBL and HBL. The primary objectives of this research are to find out the mobilization of funds in different sectors by these sampled banks whether they are properly utilizing there funds or not. Also this study tries to compare SCBNL with HBL and NBBL in profitability and return on investment in different sectors. This study is based on the secondary data basically annual reports published by these sampled banks. Only financial tools have been used in this research study. Ratio has been used as the key financial tools.

The researcher has compared the fund mobilization policy of SCBNL with HBL & NBBL. He had concluded that liquidity position of SCBNL was not found satisfactory. Loan and advances, cash and bank balances ratio seems too weak than NBBL & HBL. Investment on share and debenture and interest earning power on total working fund seems also in weak condition than NBBL and HBL. Growth ratio of deposits, loan and advances, investments, net profits seems too weak in comparison to NBBL and HBL. The relation of investment and loan and advances with deposits seems positive and the relation of net profit with outside assets seems also be positive. He further concludes that

in overall condition SCBNL seems in satisfactory position in comparison to NBBL & HBL.

Further he recommends that investment opportunity is less in present condition, so that SCBNL can select education as its potential investment sector SCBNL has maintained the ratio to cash and bank balance to total deposits considerably lower than NBBL & HBL. SCBNL is recommended to increase cash and bank balance to meet the need of investment and demanded of loan and advances. Since SCBNL use to provide less loan and advances in comparison to its total deposits, SCBNL is strongly recommended to follow a liberal lending policy so that more percentage of deposits can be invested to different profitable sectors. He also recommends that besides giving priority of investing to government securities, SCBNL is recommended to invest its funds in the purchase of share and debenture of other financial and non-financial companies.

Ganesh Prasad Awasthi (2003) in his thesis "A Comparative Study on Financial Performance between HBL & BOKL" has tried to attempt the financial position and comparison between HBL and BOKL. The primary objectives of this study is to evaluate the financial strength and weakness of these sample banks and make comparison between these banks with respect to their financial position.

The researcher is reliable only on secondary data basically five years' annual reports of respective banks. The researcher has only attempt to use the financial ratio analysis to evaluate the financial performance of these banks. No other tools and techniques had been used in this study.

The researcher had concluded that liquidity position of HBL is better than that of BOKL but they are not satisfactory, also the assets utilization in profit generating purpose of HBL is better than BOKL. He also concluded that return on total assets of HBL is found in better performance by utilizing overall resources but the generated profit is found lower for the overall resource in both commercial banks. The ROI has been in fluctuating trend in both banks but in yearly average BOKL has higher rate of return than HBL.

The debt to total assets ratio of both banks is found high. The earning profit on shareholder's equity of both banks is same but not satisfactory. Further he concludes that EPS of HBL is always higher than BOKL and the DPS is also high than that of BOKL.

Further he recommends that profitability ratio in both banks such as ROI, ROTA are not satisfactory. He has also suggested using low debt capital to both banks.

Another thesis submitted by **Chandra Prasad Regmi (2003)** on "A Comparative Analysis of Financial Performance Of Himalayan Bank Limited & Standard Chartered Bank Nepal Limited", has found that both the banks have unsatisfactory liquidity position. Even though, HBL is found slightly in better position than SCBNL on an average. He has further concluded that HBL has been successfully utilized their total deposit in the form of extending loan and advance for profit generating purpose as compared to SCBNL. It is also concluded that rate on total assets ratio in use of SCBNL is found better performance by utilizing overall resources but the generated profit is found lower for the overall resources in both banks. Net profit to total deposit ratio of both banks have been found higher and are able to generate profit from deposits. ROI comparatively decided that SCBNL has idle deposit due to the lower return as compared with HBL. He has also concluded that both the banks are highly leveraged, comparatively

HBL seems relatively more. In case of DPS, SCBNL is higher than HBL, which shows better signal from investors.

Further he recommends that profitability ratios in both the banks such as ROI, ROTA are not satisfactory. These banks have also idle resources that have to be invested. He also suggests using low debt capital because higher debt capital is unfavorable to the bank and both banks are highly leveraged on shareholder's equity. Both banks are suggested to reduce the operating expenses to maximize the profit. He has also suggested extending the banking facilities in rural areas providing special loans to the derived and priority sector.

2.4.4 Conclusion from Review of Thesis

There had been no complete previous studies regarding CAMELS analysis. Mr. Imesh Poudel had tried to attempt CALES System of EBL but the research work has not been completed with the view of NRB directives. First, all the ratios regarding CALES System had not been calculated. Second, according to NRB directives, the research should be focused on CAMELS but management portion is totally neglected which is one of the most essential part of the supervision and finally, the method of evaluating sensitivity to market risk is totally incorrect.

Besides CALES System, all other studies have been done in comparative financial performance of different banks namely SCBNL, HBL, NBBL, and BOKL. In these research studies all the ratios had not been used which might show the financial strength and weakness of the respective banks. Most of the researchers had neglected the capital adequacy ratio which is one of the important indicators of financial institutions. These entire theses are based in only financial ratio analysis so that these research works are not fully reliable. There has been made comparison between different banks in all theses, which are totally immeasurable because there was vast time period gap between the operations of these banks. Most of the researcher had recommended in those sectors which had not been analyzed or evaluated nowhere in the study.

Basically, this research work is different from all other previous research studies because the researcher had tried to attempt all the factors CAMELS Approach. The researcher had tried to fulfill all the basic requirements of CAMELS Approach that has been directed by NRB. Though all NRB directives had been used in this study the rating is not used because it is done by NRB only and there is only one sample bank in this study.

CHAPTER-3

Research Methodology

The prime objective of this study is to evaluate and assess the financial performance of Nabil Bank Limited on the basis of CAMELS analysis that is directed by NRB. This chapter contains the methods that make the comparison of the financial performance made by the sample bank with due respect to the directives of NRB more convenient.

A research methodology helps us to find out accuracy, validity, and suitability of any particular study. The research methodology used in the present study is briefly mentioned below.

3.1 Research Design

The research design followed is basically an evaluation of financial performance of NBL on the basis of CAMELS Approach. Analytical as well as descriptive approaches are used to evaluate the financial performance of the sample bank.

3.2 Sources of Data

This study is mainly based on secondary data. Secondary data are collected from their respective annual report especially from profit and loss account, balance sheet and other publications made by the Banks. Also some data have been gathered from Nepal Stock Exchange's Website. Similarly, articles, journals related to the financial performance of the study, previous research reports etc., have also been taken into account while collecting information.

3.3 Population and Samples

All commercial banks currently operating in Nepal is the population and the samples are those few which are undertaken for the study. And here, as a sample bank, Nabil Bank Limited (NBL) has been taken for the study.

3.4 Methods of Data Analysis

Analytical methods have been applied as simply as possible. To make research simple and easily understandable, tables and figures have also been used. Every result is tabulated and clear interpretation is made simultaneously.

3.4.1 Financial Tools

In this research study various financial tools are employed for the analysis. There are more than 200 ratios available today, but in this study some selected ratios related to CAMELS Analysis have been used.

A ratio is defined as "the indicated quotient of two mathematical expression" and as "the relationship between two or more things." (*Merriam, 1975: 58*)

In financial analysis, "a ratio is used as an index or yardsticks for evaluating the financial position and performance of a firm."(Pandey, 1999: 109)

So ratio analysis is the part of whole process of analysis of financial statements of any business or industry. Ratio indicates a quantitative relationship, which can be in turn used to make a qualitative judgment. The ratio related to CAMELS analysis is presented below:

3.4.1.1 Capital

The inspection of every business starts with the requirement of fund commonly known as capital. The capital of any kind of business enterprise is the permanent fund supplied by the owners of the business. Using an accounting definition, capital is shareholders equity reflected in excess of total liabilities. Normally the capital structure consists of both equity and debt. Equity refers to the fund contributed by the promoters or shareholders whereas debt is temporary way of raising fund without further dilution of ownership. This is mainly done by issuing bonds and debenture of various maturities.

Every bank should maintain sufficient level of capital to support the basic infrastructure of the business. Then, aside from capital used to meet the funding requirement for fixed assets and infrastructure investment, it is used to absorb unusual losses and to continue to conduct business when recourses are not available or have been withdrawn. The strength of the capital position is an important signal to the public as to the safety of their deposit. Therefore, capital strength is important not only for the individual bank but also for the banking system as a whole.

a) Capital Adequacy

This is the section where the adequacy of the capital requirements is measured. Ratios under this section measures whether the firm has maintained the adequate capital fund or not. It helps to decide whether the existing capital is adequate or there is the need of capital reform.

To ensure capital adequacy among the banks, the NRB issued in April 2001 a revised capital adequacy directive. The revised regulation on capital adequacy requires the banks to observe a capital ratio consistent with international standards. Every bank should maintain minimum capital of fund on the basis of risk weighted assets as per the NRB Directives.

Risk-Based Capital Ratio

Risk-based capital ratio is calculated by dividing the capital by risk weighted assets. Nepal Rastra Bank divides risk-based capital system into two tiers, - core or equity capital and supplemental capital. For the study purpose the ratio is divided into two ratios:

$$(1) \text{ Core Capital to Total Risk Weighted Assets} = \frac{\text{Core Capital}}{\text{Total Risk Weighted Assets}}$$

$$(2) \text{ Total Capital to Total Risk Weighted Assets} = \frac{\text{Total Capital Fund}}{\text{Total Risk Weighted Assets}}$$

Both of these ratios evaluate the level of the capital funds i.e. core capital fund level and total capital fund level and the results are compared with the minimum capital adequacy requirements according to the directive of NRB. The total capital fund is total of core capital and supplementary capital and the risk weighted assets is the total of the risk weighted assets of *on balance sheet* items and *off balance sheet* item.

b) Proposed Dividend to after Tax Income

The ratio is calculated by dividing the proposed dividend to after tax income. The rate of retention is directly related to increasing capital though high retention is not necessary. The retention rate must be analyzed relative to the growth rate. The dividend payout ratio is directly relative to the retention rate and firm's growth rate. So, it is very necessary to analyze the dividend rate. The ratio indicates the dividend percentage on total after tax income. The comparison of the dividend payout is made with the standard norms to check whether the dividend payout ratio is within the norms or not.

$$\text{Proposed Dividend to after Tax Income} = \frac{\text{Proposed Dividend}}{\text{After Tax Income}}$$

c) Growth Rate of Capital

The ratio is determined by subtracting the balance as of the previous year from the current year balance and dividing the result by the prior year's balance.

$$\text{Growth Rate of Capital} = \frac{\text{Current Year's Balance} - \text{Prior Year's Balance}}{\text{Prior Year's Balance}}$$

This ratio determines the growth rate of capital with comparative growth rate of assets. There should be capital adjustment with respect to the asset growth rate. So there should be equal pace of growth rate of capital and assets. This ratio measures the degree of safety of depositors.

d) Growth Rate of Assets

The ratio is determined by subtracting the balance as of the prior year from the current year's balance and dividing the result by the prior year's balance.

$$\text{Growth Rate of Assets} = \frac{\text{Current Year's Balance} - \text{Prior Year's Balance}}{\text{Prior Year's Balance}}$$

The asset side of the balance sheet represents the primary risk faced by the bank and the loans are the highest risk carrying factors. The ratio measures the growth rate of assets. The growth rate should be within the acceptable range. There are no any standard norms of the assets growth rate. But there should be identification of the change in the percentage change in the risk rated assets and less risk rated assets. This ratio is further used to compare the growth rate of capital.

3.4.1.2 Assets Quality

This is the most critical factor in determining the strength of any bank. The extension of credit is one of the major functions of banking institution. Credit usually represents bulk of the institution's assets while interest on credit represents the major sources of income. Loan involves a high degree of risk. Usually, they represent the major assets of the bank capable of generating interest earnings and therefore with a potential of having a profound impact on the bank's profitability, liquidity and solvency. The quality of a bank's credit points to soundness and stability of the bank and the risk borne by the depositors and creditors. Poor management of loan portfolio is the major cause of liquidity crisis and bank failure around the world.

The ratios under this section are as follows:

a) Performing Loan to Total Loan Ratio

The ratio is calculated by dividing the Performing Loan by Total Loan.

$$\text{Performing Loan to Total Loan} = \frac{\text{Performing Loan}}{\text{Total Loan}}$$

This ratio measures the proportion of the performing loan on total loan. Higher ratio reflects higher efficiency in good loan.

b) Non-Performing Loan to Total Loan

The ratio is calculated by dividing the non-performing loan by total loan.

$$\text{Non - Performing Loan to Total Loan} = \frac{\text{Non - Performing Loan}}{\text{Total Loan}}$$

This ratio measures the proportion of the non-performing loan on total loan. This ratio evaluates the degree of management to control the loan loss as well as degree of management to identify the risk less investment sectors. The low value of ratio less than 5% indicates the strong position and greater than 30% indicates the very unsatisfactory position.

c) Loan Loss Provision to Total Loan Ratio

This ratio helps to show the provision for the loss out of total loan. The lower rate shows the better financial position of the bank and vice versa. This ratio can be computed by dividing total loan loss provision by total loan. Mathematically it can be computed as:

$$\text{Loan Loss Provision to Total Loan Ratio} = \frac{\text{Total Loan Loss Provision}}{\text{Total Loan}}$$

d) Provision for Loan Classified

Provision for Loan Classification is done as follows:

i) Provision for Pass Loan to Total Pass Loan

The ratio is calculated by dividing the pass loan provisioning to total pass loan.

$$\text{Provision for Pass Loan To Pass Loan} = \frac{\text{Provision for Pass Loan}}{\text{Total Pass Loan}}$$

The ratio indicates the percentage of the provisioning regarding to the pass loan. As the prudential requirement of NRB, commercial banks should maintain the certain percentage of provision. The pass loan requires at least 1% of provision, , for the strong performance.

ii) Provisioning for Substandard Loan to Total Substandard Loan

The ratio is calculated by dividing provisioning of substandard loan to substandard loan.

$$\text{Provision for Substandard Loan to Total Substandard Loan} = \frac{\text{Provision for Substandard Loan}}{\text{Total Substandard Loan}}$$

This ratio indicates the percentage of the substandard provisioning to total substandard loan. The management willingness to obey the requirements issued by the NRB can be evaluated through this ratio analysis. The range of ratio at 25% indicates the

strong performance and ratio at most 10% is the very unsatisfactory performance. If the ratio is below of the 25% the management is not performing to protect the deposition interest.

iii) Provision for Doubtful Loan to Total Doubtful Loan

The ratio is calculated by dividing provisioning for doubtful loan by the total doubtful loan.

$$\text{Provision for Doubtful Loan to Total Doubtful Loan} = \frac{\text{Provision of Doubtful Loan}}{\text{Toal Doubtful Loan}}$$

The ratio measures the level of the doubtful loan provisioning on total loan. Each of the commercial banks is required to maintain the minimum level of provision on the doubtful loan. The banks should maintain at least 50% provision of the total doubtful loan for the strong or sound performance.

iv) Provision for Loan Loss to Total Loan Loss

The ratio is calculated by dividing the loss provision by total loan loss.

$$\text{Provision for Loan Loss to Total Loan Loss} = \frac{\text{Provision for Loan Loss}}{\text{Total Loan Loss}}$$

As other ratio, this ratio also measures the percentage of the provision amount on the loss amount. As the prudential requirements, the bank should maintained 100% provisioning to protect the depositors' deposits. The value greater than or equal to 100% indicates the strong or sound performance of the bank on loss provision.

3.4.1.3 Management

Good Management can make and poor management can break an organization. Banks are no exception to this universal phenomenon. The success of any institution depends on the competency of its management. In fact the management not only makes suitable policy and the business plans but also implements them for the short time and the long time interests which helps to achieve aimed objectives of banks. Management capabilities can be measured by staff efficiency (productivity per staff) and net profit trends.

i) Staff Efficiency (Productivity per Staff)

This ratio is calculated by dividing total net profit by total number of staff.

$$\text{Staff Efficiency} = \frac{\text{Net Profit}}{\text{Total No. of Staff}}$$

This ratio indicates the total efficiency of management. The degree of management counts over the productivity of staffs. Higher ratio indicates the higher degree of efficiency and lower degree indicates that the management is not so efficient in that particular bank.

3.4.1.4 Earnings Capability

Earning is income generated by any organization during its operation. Earning capability measures the bank's profit level. Every business organization needs profit for the survival and growth of a business. Besides that, profit is needed to meet variety of objectives like achieving a desirable liquidity position, meet fixed interest obligation, overcome the future contingencies, exploit hidden investment opportunities, encourage branch expansion, finance government in need development funds etc. Profit can also be defined as ultimate outputs that a company has. Besides management, both creditors and owners are interested in profitability of the firm; as creditors want to get interest and repayment of principals regularly while owner's want to get a reasonable return on their investment

The ratio under the section, reflect not only the quantity and trend of earning but also factors that may affects the sustainability or quality of earning. The inadequacy management on credit supply affects the quantity and quality of earnings because the interest on loan and advance is the major source of income of the commercial banks. Further the earnings may be adversely affected by the inability to forecast and operating expenses, poorly executed strategies or badly managed or uncontrolled exposure to other risks.

The section includes the following ratios:

a) Earning Assets to Total Assets

The ratio is calculated by dividing the earning assets by the total assets.

$$\text{Earning Assets to Total Assets} = \frac{\text{Earning Assets}}{\text{Total Assets}}$$

This ratio determines the portion of assets that earn. Interest is the major earning of the Commercial Banks. Management should be efficient to control the non-earning assets such as cash, fixed assets etc. Therefore this ratio cannot be 100%. The

management should try to maintain the maximum level of the earning assets to earning more. No standard norm is developed. During the analysis, the trend should be in increasing trend. But also there should be 75% earning assets in an average.

b) Interest Income to Total Assets

The ratio is calculated by dividing the interest income by total assets.

$$\text{Interest Income to Total Assets} = \frac{\text{Interest Income}}{\text{Total Assets}}$$

This ratio determines the average rate of interest return on the assets. Interest income, as the major source of income, is the income of each of the assets. This ratio evaluates the average performance the total or gross interest income should be in between the 70% to 80% of total income. So the ratio should be 70% to 80% of return on assets. Higher value is desirable.

c) Interest Expense to Total Assets

The ratio is calculated by dividing the interest income by total assets.

$$\text{Interest Expense to Total Assets} = \frac{\text{Interest Expense}}{\text{Total Assets}}$$

Interest expenses are the major expenses. All assets are not earning assets and no all assets are paid. So this ratio evaluates the average level of expenses as the interest that the bank has to pay. Higher ratio indicates the management in efficiency, unable to control interest expenses. So, the lower value is desirable.

d) Net Interest Margin

Net interest margin is calculated as the difference between interest Income and interest expenses and the ratio can be shown as:

$$\text{Net Interest Margin} = \frac{\text{Interest Income} - \text{Interest Expenses}}{\text{Total Assets}}$$

This ratio evaluates the net earnings of interest by the total assets. Most of the portion of interest earnings is paid as the interest expenses. So the remaining portion of the interest earning is available for the bank. The higher value indicates the management efficiency. The limit of the ratio should be 5% maximum.

e) Non- Interest Income to Total Assets

The ratio is calculated by dividing non interest by total assets.

$$\text{Non - Interest Income to Total Assets} = \frac{\text{Non - Interest Income}}{\text{Total Assets}}$$

This ratio evaluates the capacity of earning of assets other than interest income. Moderated value of the ratio is acceptable because there is the small non-interest income; there is the low potential of earning and low impact of profit or loss.

f) Non-Interest Expenses to Total Assets

The ratio is calculated by dividing the non interest of expenses by total assets.

$$\text{Non - Interest Expenses to Total Assets} = \frac{\text{Non - Interest Expenses}}{\text{Total Assets}}$$

Interest expenses are the major cost of operation of the bank. No the higher value of the non-interest expenses is acceptable. This expense includes the office expenses and staff expenses in major. So there should be the less value of the ratio.

g) Return on Assets

The ratio is calculated by dividing the net income after tax by total assets.

$$\text{Return on Assets} = \frac{\text{Net Income after Tax}}{\text{Total Assets}}$$

Net profit represents the profit after the deduction of the tax and before deducting the preference dividend. Total assets are the total value of assets side of balance sheet. It measures the bank efficiency in the utilization of the overall assets. Higher value indicates the management success in overall operation and lower value indicates inefficient operation of the bank.

h) Earning per Share (EPS)

EPS measures the amount value of shareholders gains from each share held. Higher EPS indicates the higher return to shareholders and vice versa. This is computed by dividing by net profit after tax by no. of shares outstanding.

Mathematically it can be stated as,

$$\text{EPS} = \frac{\text{Net Profit After Tax}}{\text{No. of Shares Outstanding}}$$

i) Price earning ratio (P/E Ratio)

P/E ratio assesses the market appraisal of the performance of a firm. If there is higher P/E ratio, the investors will be very optimistic about the future of the bank. So, higher ratio indicates better for the investors and vice versa. This ratio is computed by dividing market price per share (MPS) by earning per share (EPS). Mathematically it can be stated as:

$$\text{P/E Ratio} = \frac{\text{Market Price Per Share (MPS)}}{\text{Earning Per Share (EPS)}}$$

j) Net Profit to Shareholder's Equity

The ratio denotes how much of the shareholders fund is mobilized towards earning profit. The higher the ratio the better it is for the bank. Mathematically it can be calculated as:

$$\text{Net Profit to Shareholder's Equity} = \frac{\text{Net Profit}}{\text{Total Shareholder's Equity}}$$

3.4.1.5 Liquidity Position

Banks are in business where liquidity (ability to pay cash to its depositors) is of prime importance. Liquidity ratio is used to judge a bank's ability to meet short term obligation. It is the comparison between short term obligation and short term resources available to meet such obligation. An institution is in better liquidity position when it has the ability to obtain sufficient level of funds in timely manner at a reasonable cost. But an institution is in liquidity problem when it has to sell assets in order to unforeseen cash needs.

In evaluating the adequacy of a bank liquidity position, consideration should be given to its capacity to promptly meet the demand for payment on its obligation and to readily fulfill the credit needs of the community it serves. Similarly consideration should be given to the overall effectiveness of the bank's asset/liability strategies and compliance with and adequacy of established liquidity policies. Beside these, the capability of management to properly identify, measure, monitor, and control the bank's liquidity position including effectiveness of funds management strategies, management information system etc should be considered. This section includes the following ratios:

a) Cash Reserve Ratio (CRR)

Every commercial bank has to maintain a reserve fund with Nepal Rastra Bank equal to 5% of their total local currency deposit which is known as cash reserve ratio. For maintaining the balance, total local currency deposit of the first week is calculated and then 5% balance has to be maintained in the third week and this turn goes out respectively. Generally it should be done to avoid any problem relating to deficiency of liquid cash. This ratio can be calculated by dividing cash balance at NRB by total local currency deposit in bank. Mathematically it can be stated as:

$$\text{Cash Reserve Ratio} = \frac{\text{Cash Balance At NRB}}{\text{Total Local Currency Deposit}}$$

b) Cash and Bank Balance to Total Deposit Ratio

This ratio is used to measure how much amount bank has set aside as cash and bank balance out of total deposit. Cash and bank balances are the most liquid current assets of bank. Mathematically it can be stated as:

$$\text{Cash and Bank Balance to Total Deposit Ratio} = \frac{\text{Cash and Bank Balance}}{\text{Total Deposit}}$$

c) Overnight Borrowing to Total Liabilities

The ratio is calculated by dividing the call money by the total liabilities.

$$\text{Overnight Borrowing to Total Liabilities} = \frac{\text{Call Money}}{\text{Total Liabilities}}$$

Call money is the money borrowed in the inter-bank market. The ratio indicates the percentage of the call money on the total liabilities. The higher value of ratio indicates the liquidity problem on the bank because this form of money is borrowed usually for the daily liquidity purpose. So, the higher frequency is the best to minimize the cost with the fulfillment of short term obligations.

d) Loan to Deposit

The ratio is calculated by dividing the loan by deposit

$$\text{Loans to Deposit} = \frac{\text{Loans}}{\text{Deposit}}$$

The ratio indicates the degree to which a bank is using its fund to its loan. The higher value of the ratio is desirable. The ratio should not exceed 100%. But due to the non- interest bearing type deposit in the total deposit that should be paid on demand. The ratio should be 40-60% for the strong performance.

e) Growth Rate of Deposit

Subtracting the prior year's amount form current year's amount and dividing the result by the prior year's amount calculate the ratio.

$$\text{Growth Rate of Deposit} = \frac{\text{Current Year Amount} - \text{Prior Year Amount}}{\text{Prior Year Amount}}$$

This ratio evaluates he trend of the deposit growth. So, there should be the increasing trend of deposit and should match or exceed the growth rate of loan. For the liquidity purpose, the increasing the amount deposit than that of loan can meet the obligations regarding to the liabilities.

3.4.1.6 Sensitivity to Market

Sensitivity position defines the bank's ability to monitor and manage the exposure to risk. The ratios under this section reflect the degree to which the changes in interest rate, foreign exchange rates etc. can adversely affect the bank's earning and capital. During the evaluation, several factors should be considered such as management's ability to identify, measure and control market risk, as well as its capital and earnings in relation to its level of market risk exposure, amount of market risk arising from trading and foreign exchange position etc. The following are the concepts under this section:

a) Interest Rate Risk

This risk measures the degree of the risk due to the interest rate. This risk is analyzed under the *Rate Sensitive Liabilities (RSL)* and *Rate Sensitive Assets (RSA)* on their respective maturing period. Interest rate risk can arise from two distinct types of rate movement- a sustained shift in the yield curve or shape swing in rates over a short period of time. The analysis will focus on a sustained upward (+1%) shift in the interest rates inherent to yield curve. The adjusted *Interest Rate Change (IRC)* for a one percent point increase in interest will be:

$$.01 \times 90/365 = 0.0025 \text{ for 90-days intervals}$$

- a) RSL Maturing 1-90 days to RSA Maturing 1-90 days
- b) RSL Maturing 91-180 days to RSA Maturing 91-180 days

- c) RSL Maturing 181-270 days to RSA Maturing 181-270 days
 d) RSL Maturing 271-365 days to RSA Maturing 271-365 days

3.4.2 Statistical Tools

Several numbers of statistical tools can be employed to examine the economic data of NBL. But for this study, the trend analysis has been taken into consideration.

Trend Analysis

An effective use of financial ratios can be made by observing the behavior of ratios over a period of time. This can be done with the help of trend analysis depicts the trends in the operation of banks. The trend analysis of ratios indicates the direction of change. It helps in studying the banks position and change there of overtime and determine whether there has been on improvement or deterioration is the financial condition and performance overtime. It is important to analyze trends in ratios as well as their absolute levels, for trends give clues as to whether the financial situation is improving or deteriorating.

The straight-line trend is computed as:

$$Y_c = a + bx$$

Where,

Y = Value of dependent variable.

X = Independent variable (Time in Trend Analysis)

$$a = \frac{\sum y}{n} \text{ \{Y- intercept (the value of Y when X=0)\}}$$

b = Slope of Trend Line [Level of Change or Growth]

$$\text{i.e., } b = \frac{\sum xy}{\sum x^2}$$

Y - Y_c = Fluctuation

CHAPTER-4
**Data Presentation,
Analysis &
Interpretation**

This chapter deals with the analysis and interpretation of the data for the purpose of developing the unprocessed form of data to an understandable presentation. Analyzing the data indicates organizing, tabulating and calculating relevant financial analysis of the data gathered from the various sources. The financial analysis is made after collecting the raw data from the various sources. The result of the analysis has been interpreted under the rationality of the ratio analysis, prudential requirements issued by the NRB for the commercial banks, offsite supervision manual, on-site inspection manual and other factors regarding to the tools used.

4.1 Interpretation and Analysis of Data:

4.1.1 Capital Adequacy Ratio

Capital adequacy refers to the condition of having sufficient permanent resources to continue operation of the organization despite financial losses or non availability of external funding. Normally the capital structure consists of the mixture of equity and debt. Equity refers to the fund contributed by the promoters/ shareholders whereas debt is temporary way of raising funds without further dilution of ownership, which is mainly done by issuing bonds and debentures of various maturities.

To ensure adequate capital in the banking system, NRB has prescribed the Capital Adequacy Ratio parameters on which the capital of the banks need to be maintained as the percentage of its risk weighted assets such as loans it has provided and the securities it holds. Thus this parameter indicates whether a particular bank has enough capital to absorb unexpected losses or not. Under the capital adequacy section, the financial position of the NABIL is analyzed and interpreted using risk based capital ratio, proposed dividend to after tax income, growth rate of capital and growth rate of assets.

4.1.1.1 Risk-Based Capital Ratio

This is the ratio of capital that should be maintained at the level of NRB provision that described in Directive No.1, basing on the risk –weighted assets. Risk –Based Capital System is divided into two tiers and analysis is also made basing on these system and NRB directive. So, the analysis is made using the following ratios;

4.1.1.2 Core Capital to Risk Weighted Assets

Core Capital represents the highest form of capital because it represents permanent equity. Permanent equity includes paid up capital, share premium, non-redeemable preference share, general reserve fund etc. This ratio evaluates the proportion of the core capital to the total risk-weighted assets.

This proportion should be within the provision that is made on NRB directive no.1. According to the NRB directives no.1 every Commercial Bank should maintain 5% in FY 2003/04, 5.5% in FY 2004/05, 6% in FY 2005/06, 5.5% in FY 2006/07 and 6% in FY 2007/08.

Table 1
Capital Fund to Risk-Weighted Assets Ratio

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Core Capital (A)	1,276,849,132	1,439,454,303	1,610,510,308	1,830,794,417	1,992,849,715	1,630,091,575
Supplementary Capital (B)	178,246,483	169,961,989	155,562,222	258,529,605	314,782,680	215,416,596
Total Capital (A+B)	1,455,095,615	1,609,416,292	1,766,072,530	2,089,324,022	2,307,632,395	1,845,508,171
Total Risk-Weighted Assets (RWA)	11,153,130,802	11,872,009,411	14,193,071,630	16,976,368,425	19,166,766,033	14,672,269,260
Core Capital to RWA	11.45%	12.12%	11.35%	10.78%	10.40%	11.22%
Total Capital to RWA	13.05%	13.56%	12.44%	12.31%	12.04%	12.68%

Source: Annual Reports of NABIL.

From table no 1, the core capital ratio of NABIL in the FY 2003/04, is 11.45%, and in the subsequent FY 2004/05, 2005/06, 2006/07 and 2007/08 are 12.12%, 11.35%, 10.78% and 10.40% respectively. This indicates the ratios are always within the provision made on NRB directives.

4.1.1.3 Total Capital to Risk Weighted Asset

Total capital is the sum of core capital and supplementary capital. This ratio shows the proportion of the total capital in the total risk-weighted assets which is already calculated above in the table no. 1.

This proportion should be within the proportion that is made on the directive no.1 by NRB. According to the NRB directives no.1 every Commercial Bank should maintain 10% for F.Y 2003/04, 11% for F.Y 2004/05, 12 % for F.Y 2005/06, 11% for FY 2006/07 and 12% for FY 2007/08.

From the above table no.1, it is known that the total capital to risk weighted assets ratios of NABIL were 13.05% in FY 2003/04, 13.56% for FY 2004/05, 12.44% for FY 2005/06, 12.31% for FY 2006/07 and 12.04% for 2007/08. So the NABIL has always maintained its capital adequacy as mentioned by the NRB directives.

4.1.1.4 Proposed Dividend to After Tax Income

This ratio is calculated by dividing the proposed dividend by after tax income.

Table 2
Proposed Dividend to After Tax Income

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Proposed Dividend	245,827,200	319,575,360	344,158,080	417,906,240	491,654,400	363,824,256
After Tax Income	416,235,811	455,311,222	518,635,749	635,262,349	673,959,698	539,880,966
Proposed Dividend to After Tax Income	59.06%	70.19%	66.36%	65.78%	72.95%	66.87%

Source: Annual Reports of NABIL.

The table shows that the NABIL has been paying handsome dividend to its shareholders because the ratios are very high, more than 50%, in every year of the study period. Paying higher dividend might attract the shareholders but ultimately it may create capital shortage in the future. So the bank should retain its net income to increase its capital. The dividend payout ratio is directly related to the retention rate and the retention rate is to growth rate of the firm because the retained amount contributes to the capital amount. But NABIL has been paying the dividend of more than 50% to its shareholders which means its target is to satisfy and attract more shareholders.

4.1.1.5 Growth Rate of Capital

The growth rate of capital is calculated by subtracting prior year capital balance from current year balance and dividing by prior year balance.

Capital supports prudent growth and controls unjustified expansion of assets by requiring that asset growth be funded by proportionate amount of additional capital. Ideally, this ratio should keep pace with the growth in assets.

Table 3
Growth Rate of Capital
(Figures in NPR)

F.Y.	Total Capital	Growth Rate
2002/03	1,464,453,039	
2003/04	1,455,095,615	-0.64%
2004/05	1,609,416,292	10.61%
2005/06	1,766,072,530	9.73%
2006/07	2,089,324,022	18.30%
2007/08	2,307,632,395	10.45%

Source: Annual Reports of NABIL

The above table shows that the bank had experienced the negative growth rate of -0.64% in FY 2003/04 comparing to the previous year. But the growth rate of 10.61% in 2004/05 shows that the bank had raised the huge amount of capital during one year period to strengthen its financial position. In 2005/06 it shows slight decrement from 10.61% to 9.73% and again huge increment from 9.73% to 18.30% in 2006/07. In 2007/08, the rate has decreased to 10.45%. So the capital growth rate of NABIL is highly fluctuated in the five year period.

There are no any norms to measure the quality of direction of the capital independently. So, it should be measured with the comparison of the growth rate of the assets. With the comprising between the growths rate of assets and capital denotes the position of the financial coverage of the bank.

4.1.1.6 Growth Rate of Assets

This ratio is determined by subtracting prior year assets balance from current year assets balance and dividing the result by prior year assets balance.

This ratio simply calculates the growth rate of an asset's item within the balance sheet. This represents primary risk faced by a bank.

Table 4
Growth Rate of Assets
(Figures in NPR)

F.Y.	Total Assets	Growth Rate
2002/03	17,629,252,392	
2003/04	16,562,624,992	-6.05%
2004/05	16,745,486,638	1.10%
2005/06	17,186,330,816	2.63%
2006/07	22,329,971,078	29.93%
2007/08	27,253,393,008	22.05%

Source: Annual Reports of NABIL

Above table shows that the total assets level had decreased by 6.05% in FY 2003/04 comparing to the previous year. FY 2004/05 and 2005/06 it has experienced the slight increment to 1.10% and 2.63% respectively. In 2006/07, the growth rate has rocket to 29.93% from 2.63%. Then in 2007/08, it is 22.05%.

Under the CAMELS norms, the growth rate of capital should be equal or exceed the growth rate of assets. Ideally both ratios should keep the same pace.

4.1.1.7 Comparison of Capital Growth Rate and Assets Growth Rate

Table 5
Comparison of Assets Growth Rate and Capital Growth Rate
(Figures in NPR)

F.Y	Capital Growth Rate	Assets Growth Rate
2003/04	-0.64%	-6.05%
2004/05	10.61%	1.10%
2005/06	9.73%	2.63%
2006/07	18.30%	29.93%
2007/08	10.45%	22.05%
Average	9.69%	9.93%

From the table no. 5, in 2003/04, there is negative growth rate of capital and assets, which mean, in that year, capital and assets level were decreased comparing to its previous year's level. But the decrement in capital level is lower than the decrement in assets level because negative growth rate of capital is only 0.64% whereas negative growth rate of assets is 6.05%. In 2004/05 and 2005/06, capital level is increased by 10.61% and 9.37% respectively and assets level is increased by 1.10% and 2.63% respectively. In both the year, the growth rate of capital has exceeded the growth rate of assets. In 2006/07 and 2007/08, the growth rate of capital is 18.30% and 10.45% respectively, whereas the growth rate of assets is 29.93% and 22.05%. In these years, assets growth rate has exceeded the capital growth rate. In average, the growth rates of capital and assets are 9.69% and 9.93% which means the assets level has slight high growth rate than the capital level.

4.1.2 Assets Quality

This is the most critical factor in determining the strength of any bank. The assets quality section measures the quality of the existing and the potential credit or loan risk, investment portfolios and other assets. The ratios under this section measures the ability of the bank's management to identify, measure, monitor and control the risks associated with the asset quality and the different provision associated with the asset quality section. For the purpose, performing loan to total assets, non-performing loans to total assets, provisioning to classified loan, are analyzed and interpreted.

4.1.2.1 Performing Loan to Total Loan Ratio

This ratio shows much the banks are successful in utilizing their assets for generation purpose. Generally performing loan will have been due date up to 90 days. Higher ratio reflects higher efficiency in the good loans. This ratio can be calculated by dividing performing loan by total loan.

Table 6
Performing Loan to Total Loan

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Performing Loan	7,664,053,458	8,261,978,118	10,802,229,684	13,096,157,779	15,724,729,781	11,109,829,764
Total Loan	8,113,684,221	8,548,657,038	10,946,736,577	13,278,782,259	15,903,023,765	11,358,176,772
Performing Loan to Total Loan	94.46%	96.65%	98.68%	98.62%	98.88%	97.46%

Source: Annual Reports of NABIL

The above table no. 6 highlights that the performing loan to total loan ratio of NABIL in FY 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 are 94.46%, 96.65%, 98.68%, 98.62% and 98.88% respectively. In fiscal year 2003/04 NABIL has the lowest performing loan compared to other years. From FY 2003/04 it has the increasing trend up to final year of the study period which has the highest performing loan ratio of 98.88%. The average performing loan of NABIL is 97.46% which is satisfactory. This ratio indicates that the bank is performing well in their asset management. Because, more than 95% of performing loan is considered good to generate more profit and NABIL has crossed it every year except in 2003/04.

4.1.2.2 Non-Performing Loan to Total Loan Ratio

This ratio reflects the threat to capital from the low quality loans and includes loans classified as sub-standard, doubtful and loss. This ratio evaluates the soundness of credit management practices, degree of risk identification, diversification of loan, adequacy of the credit policy, degree of internal control system etc. However, if non performing loans exceed 5 percent to total loans, it would be considered as a weak management.

Table 7
Non-Performing Loan to Total Loan

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Non-Performing Loan	449,630,763	286,678,920	144,506,893	182,624,480	178,293,983	248,347,008
Total Loan	8,113,684,221	8,548,657,038	10,946,736,577	13,278,782,259	15,903,023,765	11,358,176,772
Non-Performing Loan to Total Loan	5.54%	3.35%	1.32%	1.38%	1.12%	2.54%

Source: Annual Reports of NABIL

Table 7 highlights the low quality loans including the substandard, doubtful and bad loans and its proportion to the total loan. During the review period the non-performing loans to total loan ratio in FY 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 are 5.54%, 3.35%, 1.32%, 1.38% and 1.12% respectively. The non performing loan is highest in FY 2003/04 and lowest in 2007/08 over the study period which shows the decreasing trend. The average non performing loan is 2.54% which shows that there is low degree of credit risk. And NABIL has been successful in maintaining the ratio below than 5% except in 2003/04 which means the credit management policy of NABIL is satisfactory.

4.1.2.3 Loan Loss Provision to Total Loan

This ratio helps to show the provision for the loss loan out of total loan. The lower rate shows the better financial position of the bank and vice versa. This ratio can be computed by dividing total loan loss provision by total loan.

Table 8
Loan Loss Provision to Total Loan

(Figures in NPR)

Particulars	F.Y.					Average
	2003/04	2004/05	2005/06	2006/07	2007/08	
Loan Loss Provision	357,732,236	358,664,187	360,566,575	356,239,106	357,245,035	358,089,428
Total Loan	8,113,684,221	8,548,657,038	10,946,736,577	13,278,782,259	15,903,023,765	11,358,176,772
Loan Loss Provision to Total Loan	4.41%	4.20%	3.29%	2.68%	2.25%	3.37%

Source: Annual Reports of NABIL

Above table highlights that the Loan loss Provision to Total Loan of NABIL in FY 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 are 4.41%, 4.20%, 3.29%, 2.68% and 2.25% respectively. The average of five years is 3.37%. This indicates that NABIL has only 3.37% of bad loans which might not be covered by the Bank. So, the bank is performing well in loan management area and should be focused even more to reduce the ratio to Zero.

4.1.2.4 Provision for Pass Loan to Total Pass Loan

This ratio measures the proportion of the provision of pass loan on total pass loan. This ratio is related to the general loss reserve because the provision made against the loan is never made to avoid the risk.

Table 9
Provision for Pass Loan to Total Pass Loan

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Provision for Pass Loan	122,587,932	127,733,990	235,345,571	130,343,145	175,502,575	158,302,643
Total Pass Loan	7,664,053,458	8,261,978,118	10,802,229,684	13,010,864,147	15,638,481,983	11,075,521,478
Provision for Pass Loan to Total Pass Loan	1.60%	1.55%	2.18%	1.00%	1.12%	1.49%

Source: Annual Reports of NABIL

The ratio is 1.60% in FY 2003/04, 1.55% in 2004/05, 2.18% in 2005/06, 1.00 in 2006/07 and 1.12% in 2007/08. According to NRB directives every commercial bank should maintained 1% of pass loan provision to cover the future unknown losses and NABIL, within the study period, has always met the provision for pass loan according to NRB directives which is satisfactory.

4.1.2.5 Provision for Substandard Loan to Total Substandard Loan

This ratio measures the proportion of the provision of substandard loan on total substandard loan.

Table 10
Provision for Substandard Loan to Total Substandard Loan

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Provision for Substandard Loan	18,320,228	5,140,970	6,865,463	42,573,904	56,636,400	25,907,393
Total Substandard Loan	76,311,974	22,139,923	22,072,562	62,665,914	119,704,599	60,578,994
Provision for Substandard Loan to Total Substandard Loan	24.01%	23.22%	31.10%	67.94%	47.31%	38.72%

Source: Annual Reports of NABIL

The above table highlights that the provision for substandard loan to total substandard loan of NABIL in FY 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 are 24.01%, 23.22%, 31.10%, 67.94% and 47.31% respectively. And the average ratio is 38.72%. According to NRB directives, every bank should maintain the substandard loan of 25%. And NABIL has not met the criteria of NRB in 2003/04 and 2004/05.

4.1.2.6 Provision for Doubtful Loan to Total Doubtful Loan

This ratio measures the proportion of the provision of doubtful provision on total doubtful loan.

Table 11
Provision for Doubtful Loan to Total Doubtful Loan

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Provision for Doubtful Loan	136,619,817	32,384,357	1,415,926	13,896,064	7,119,443	38,287,121
Total Doubtful Loan	279,117,410	65,552,224	1,934,092	29,565,952	14,471,646	78,128,265
Provision for Doubtful Loan to Total Doubtful Loan	48.95%	49.40%	73.21%	47.00%	49.20%	53.55%

Source: Annual Reports of NABIL

The above table highlights that the provision for doubtful loan to total doubtful loan of NABIL in FY 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08 are 48.95%, 49.40%, 73.21%, 47.00% and 49.20% respectively. And the average ratio is 53.55%. NABIL has tried to maintain its provision below 50% in all years but in FY 2005/06 the provision is more than 50%, which indicates chances of more doubtful debts in that year.

4.1.2.7 Provision for Bad Loan to Total Bad Loan

This ratio measures the proportion of the provision of bad loan provision on total bad loan.

Table 12
Provision for Bad Loan to Total Bad Loan

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Provision for Bad Loan	80,204,259	193,404,870	116,939,615	85,467,837	38,145,522	102,832,421
Total Bad Loan	94,201,379	198,986,773	120,500,239	90,392,614	85,467,837	117,909,768
Provision for Bad Loan to Total Bad Loan	85.14%	97.19%	97.05%	94.55%	44.63%	83.71%

Source: Annual Reports of NABIL

This ratio also measures the proportion of loss provision to total loss loan. The ratios are 85.14%, 97.19%, 97.05%, 94.55%, 44.63% and average of 83.71% respectively in the reviewed period. Throughout the study period, the provision for bad loan of NABIL is below 100%. According to NRB directives every commercial bank has to maintain at least 100% loss loan provision. The loan loss provision of NABIL is not satisfactory; it is below NRB directives and in 2007/08 it is 44.63% which is more than 50% below the NRB directives.

4.1.3 Management

The management should reflect the capabilities of the Board of Directors and management in their respective roles to identify, measure, monitor, and control the risks of an institution's activities and to ensure a bank's safe, sound and efficient operation in compliance with applicable laws and regulations.

Directors need not be actively involved in day to day operations. However, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Senior management

is responsible for developing and implementing policies, procedures, and practices that translate the Board's goals, objectives, and risk limits into prudent operation standards.

Sound management practices are demonstrated by active oversight by the Board of Directors and management: competent personnel; adequate policies, processes and controls taking into consideration the size and sophistication of the bank; maintenance of an appropriate audit program and internal control environment; and effective risk monitoring and management information systems. This reflects the Board's and management's ability as it applies to all aspects of banking operation as well as other financial service activities in which the bank is involved.

The ratio relating to management is staff efficiency ratio, which is analyzed and interpreted in this section.

4.1.3.1 Net Profit Trend

Net profit is the basic features to analyze whether the management is efficient or not in fulfilling its target with its entire resources. Net Profit Trend shows the bank's position and change over the time period and the degree of earnings sustainability for bank in the country.

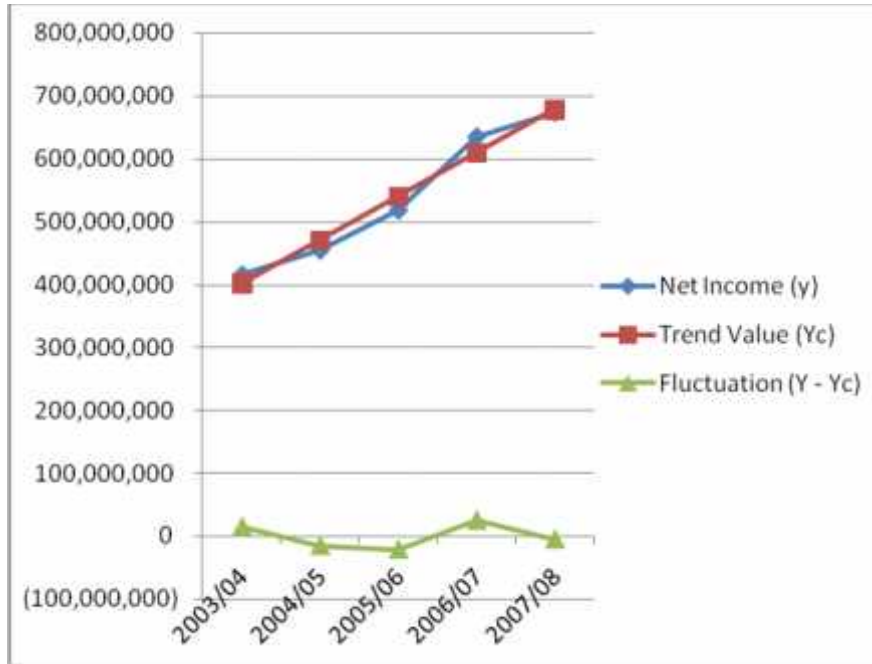
Table 14
Net Profit Trend

(Figures in NPR)

*b = 69539890.1
**a = 539880965.8

Year	Net Income (y)	x	x ²	xy	Trend Value (Yc)	Fluctuation (Y - Yc)
2003/04	416,235,811	-2	4	-832471622	400801185.6	15434625.4
2004/05	455,311,222	-1	1	-455311222	470341075.7	-15029853.7
2005/06	518,635,749	0	0	0	539880965.8	-21245216.8
2006/07	635,262,349	1	1	635262349	609420855.9	25841493.1
2007/08	673,959,698	2	4	1347919396	678960746	-5001048
Total	2,699,404,829	0	10	695398901		

Figure 1
Time Variations of Net Profit



The table no. 13 shows that the NABIL’s profit trend is in increasing position but there is high fluctuation in the net profit which can be seen also from the figure no. 1 presented above. So, It can safely conclude that management of NABIL is efficient and successful because net profit is continuously increasing in a sustainable manner over the study period.

4.1.4 Earning Capability

Earning capability or the profitability ratios have been employed to measure the operating efficiency of the bank. The earning capability does not only reflect the quantity and trend of earnings but also the quality of the earnings. The ratios relating to earning capability under CAMELS system are earning assets to total assets, interest income to total assets, interest expenses to total assets, net interest margin, non-interest income to total assets, non-interest expenses to total assets, return on assets, total operating income to total assets, staff expenses to total expenses, total operating expenses to total assets, earning per share, price earning ratio, net profit to shareholder’s equity which have been analyzed and interpreted here below.

4.1.4.1 Earning Assets to Total Assets

None of the bank or any business firm contains the 100% earning assets because some of the assets will be none earning e.g. cash and fixed assets. This ratio examines the proportion of the earning assets on total assets.

Table 14
Earning Assets to Total Assets

(Figures in NPR)

Particulars	F.Y.					Average
	2003/04	2004/05	2005/06	2006/07	2007/08	
Bank Balance (Other Than Current Account) (a)	Nil	Nil	Nil	Nil	Nil	Nil
Call Money (b)	670,204,297	918,733,400	868,428,307	1,734,901,943	563,532,632	951,160,116
Investments (c)	6,031,175,547	5,835,948,498	4,267,233,178	6,178,533,108	8,945,310,567	6,251,640,180
Loans (Net) and Bills Purchased/Discounted (d)	7,755,951,985	8,189,992,851	10,586,170,002	12,922,543,153	15,545,778,730	11,000,087,344
Earning Assets (a+b+c+d)	14,457,331,829	14,944,674,749	15,721,831,487	20,835,978,204	25,054,621,929	18,202,887,640
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Earning Assets to Total Assets	87.29%	89.25%	91.48%	93.31%	91.93%	90.94%

Source: Annual Reports of NABIL

Table no. 14 shows that the ratios of earning asset to total assets of NABIL are 87.29%, 89.25%, 91.48%, 93.31% and 91.93% respectively during the reviewed period. Since 2003/04, the NABIL has been successful in increasing its earning assets until 2006/07 from 87.29% to 93.31% and in 2007/08, the ratio is slightly decreased comparing to previous year and reached 91.93%. The average earning assets of NABIL is 90.94%.

The ratio analyzed above shows that the Bank has most of the assets as the earning assets due to its low amount of cash reserve, fixed assets plus current account of bank reserve. Bank is performing strongly for the earning assets. The NRB norms for the CAMELS system are established for 75% of the earning assets on total assets. In each of the study period bank has maintained maximum level of the earning assets which indicates the strong financial management or performance for the earning assets.

4.1.4.2 Interest Income to Total Assets

Interest is the major sources of banks' operating income necessary to cover its expenses. This ratio is calculated by dividing the income interest by total assets.

Table 15
Interest Income to Total Assets

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Interest Income	1,017,872,280	1,001,616,901	1,068,746,769	1,309,998,500	1,587,758,714	1,197,198,633
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Interest Income to Total Assets	6.15%	5.98%	6.22%	5.87%	5.83%	5.98%

Source: Annual Reports of NABIL

Table 15 exhibits that the ratio is 6.15%, 5.98%, 6.22%, 5.87% and 5.83% respectively during the reviewed period. The average interest income is 5.98%. The table shows the fluctuating trend of NABIL's interest income. 6.22% in 2005/06 is the highest and 5.83% in 2007/08 is the lowest among all. From 005/06 to 2007/08, the ratio has been decreasing.

4.1.4.3 Interest Expenses to Total Assets.

This ratio is computed by dividing the interest expenses by total assets.

Table 16
Interest Expense to Total Assets

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Interest Expense	317,348,258	282,947,633	243,544,611	357,161,304	555,710,109	351,342,383
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Interest Expense to Total Assets	1.92%	1.69%	1.42%	1.60%	2.04%	1.76%

Source: Annual Reports of NABIL

The table 16 demonstrates that the ratio are 1.92%, 1.69%, 1.42%, 1.60% and 2.04% respectively during the reviewed period. The average interest expense to total assets is 1.76%. This low level of ratios shows that the bank has been successful in

maintaining its assets in the lower cost, which indicates that the bank's management is well in bringing the low interest assets.

4.1.4.4 Net Interest Margin

This is the ratio that evaluates the management efficiency to earn more interest income with control on the interest expenses. It is not simply to control the expenses as interest on loan. So, there should be better management, policies, practices, identification for maximizing the net interest margin.

Table 17
Net Interest Margin

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Interest Income (A)	1,017,872,280	1,001,616,901	1,068,746,769	1,309,998,500	1,587,758,714	1,197,198,633
Interest Expense (B)	317,348,258	282,947,633	243,544,611	357,161,304	555,710,109	351,342,383
Net Interest Income (A-B)	700,524,022	718,669,268	825,202,158	952,837,196	1,032,048,605	845,856,250
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Net Interest Margin	4.23%	4.29%	4.80%	4.27%	3.79%	4.23%

Source: Annual Reports of NABIL

The table 17 discloses that the ratios are 4.23%, 4.29%, 4.80%, 4.27% and 3.79% respectively during the reviewed period. The average net interest margin is 4.23%. This indicates that NABIL does not have any negative or loss in the interest side and in sum, the net interest margin of NABIL can be considered quite satisfactory.

4.1.4.5 Non-Interest Income to Total Assets

The ratio measures the proportion of the non-interest income, the second major source of income on total assets. Non-interest income includes commission, non-operational profits, income from foreign exchange and other income.

Table 18
Non-Interest Income to Total Assets

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Commission and Discount Income (a)	144,405,701	135,958,435	128,883,480	138,293,913	150,608,550	139,630,016
Foreign Exchange Income (b)	144,075,171	157,324,299	184,878,868	185,483,662	209,926,167	176,337,633
Other Income (c)	34,150,842	38,754,927	55,933,830	82,897,862	87,574,553	59,862,403
Non Operating Income (d)	86,946,330	92,780,639	72,241,283	735,324	5,280,641	51,596,843
Total Non-Interest Income (a+b+c+d)	409,578,044	424,818,300	441,937,461	407,410,761	453,389,911	427,426,895
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Non-Interest Income to Total Assets	2.47%	2.54%	2.57%	1.82%	1.66%	2.14%

Source: Annual Reports of NABIL

Table 18 shows that the ratios are 2.47%, 2.54%, 2.57%, 1.82%, and 1.66% respectively during the reviewed period. The average non-interest income to total asset is 2.14%. The ratios are increasing from 2003/04 to 2005/06 and then decreasing until 2007/08. The ratios are very small and stable on only few points' change. This indicates the small impact on making the significant change of potential income, Bank's total income could not be changed significantly because of the main earning source is interest income and income other than interest does not carry the higher weight on earnings.

4.1.4.6 Non-Interest Expense to Total Assets

The ratio relates with the expenses relating generally with staff and office activities. Every institution always tries to maintain the minimum level of the non-interest expenses.

Table 19
Non-Interest Expense to Total Assets

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Employee Expense (a)	210,582,937	180,840,420	199,516,217	219,780,853	240,161,275	210,176,340
Office Expense (b)	166,200,160	150,759,027	190,299,470	182,696,413	188,183,330	175,627,680
Provision for Doubtful Debts (c)	Nil	1,051,951	4,207,388	3,769,541	14,206,365	4,647,049
Provision for Staff Bonus (d)	66,364,097	71,940,693	84,198,357	89,800,379	99,504,596	82,361,624
Total Tax Provision (e)	199,145,165	201,762,769	239,149,464	262,741,444	321,086,263	244,777,021
Non-Operating Expense (f)	Nil	Nil	Nil	Nil	Nil	Nil
Total Non-Interest Expense (a+b+c+d+e+f)	642,292,359	606,354,860	717,370,896	758,788,630	863,141,829	717,589,715
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Non-Interest Expense to Total Assets	3.88%	3.62%	4.17%	3.40%	3.17%	3.59%

Source: Annual Reports of NABIL

The non-interest expense to total assets ratios are 3.88%, 3.62%, 4.17%, 3.40% and 3.17% respectively in the reviewed period. The average non-interest expense is 3.59%. The table shows that the ratio of Non-interest Expense to Total Assets of NABIL has been decreasing year by year except in 2005/06. Although the non-interest expenses have been in increasing trend, the ratio is decreasing and this is all because the NABIL has been able to increase the volume of total assets in greater quantity than the non-interest expenses.

4.1.4.7 Earning Per Share (EPS)

Shareholders are concerned about the earnings that will eventually be available to pay them as dividends and the part of this earning is used to expand their interest in the firm because the firm retains the earning. Earning per share indicates after tax earnings for equity shareholders on per share basis. It reflects the earning power of the bank. The ratio is calculated by dividing net income available by number of share outstanding.

Table 20
Earning Per Share (EPS)

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Net Profit After Tax	416,235,811	455,311,222	518,635,749	635,262,349	673,959,698	539,880,966
No. of Shares Outstanding	4,916,544	4,916,544	4,916,544	4,916,544	4,916,544	4,916,544
EPS	84.66	92.61	105.49	129.21	137.08	109.81

Source: Annual Reports of NABIL

The above table presents that the EPS is Rs.84.66, Rs.92.61, Rs.105.49, Rs.129.21 and Rs.137.08 for the reviewed period. The EPS of the NABIL is in increasing trend which indicates that the bank has been performing well to increase its level of earnings year by year.

4.1.4.8 Return on Assets (ROA)

It is the most important ratio to measure the assets performance under profitability concern.

Table 21
Return on Assets (ROA)

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Net Profit After Tax	416,235,811	455,311,222	518,635,749	635,262,349	673,959,698	539,880,966
Total Assets	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
ROA	2.51%	2.72%	3.02%	2.84%	2.47%	2.70%

Source: Annual Reports of NABIL

Table No. 21 declares that the ratios are 2.51%, 2.72%, 3.02%, 2.84% and 2.47% respectively during the reviewed period. The ratio is fluctuating throughout the period by small points. The ratio has been increasing till 2005/06 and then decreasing till the end of the reviewed period. If the analysis shows ROA is very high, it might indicate the institution taking excessive risk or be capitalizing interest by restructuring bad loans and including uncollected interest in the restructured advance. The low level of ROA of NABIL indicates that the bank is doing well in all above aspects.

4.1.4.9 Price Earning Ratio (PE Ratio)

This price earning ratio is used as a going concern method of valuing stock. This ratio is widely used by the security analysts to value the firm's performance as expected by investors. It indicates investors' judgment or expectations about the firm's performance. In other words, it measures, how the market is responding towards the earning performance of the concerned banks.

Price Earning Ratio expresses the relationship between market price of a share of the stock and the stock's current earning per share. Thus it is calculated by dividing market price of share by earning per share.

Table 22
Price Earning Ratio (PE Ratio)

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Market Price per Share	740	1,000	1,505	2,240	5,050	2,107
EPS	84.66	92.61	105.49	129.21	137.08	109.81
PE Ratio	8.74 times	10.80 times	14.27 times	17.34 times	36.84 times	19.19 times

Source: Annual Reports of NABIL

The above table describes that the P/E ratios of NABIL are 8.74 times, 10.80 times, 14.27 times, 17.34 times and 36.84 times respectively over the reviewed period. The ratio is increasing. The table shows the significant increment in the PE Ratio over the study period. It is 8.74 times in the first year of the study period whereas 36.84 times in the last year which is very high comparing to the first year.

The higher the P/E ratio the greater will be the investors' confidence in the bank's future and vice versa. In average NABIL's P/E ratio is 19.19 times which shows that NABIL has been able to satisfy its investors to take their position in the market.

4.1.4.10 Return on Equity (ROE)

The ratio denotes how much of the shareholders fund is mobilized towards earning profit. The higher the ratio the better it is for the bank.

Table 23
Return On Equity (ROE)

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Net Profit After Tax	416,235,811	455,311,222	518,635,749	635,262,349	673,959,698	539,880,966
Total Shareholders' Equity	1,312,717,248	1,479,879,744	1,657,661,975	1,874,973,220	2,057,032,844	1,676,453,006
ROE	31.71%	30.77%	31.29%	33.88%	32.76%	32.20%

Source: Annual Reports of NABIL

The Net Profit to Shareholders' equity (ROE) of NABIL for the reviewed period are 31.71%, 30.77%, 31.29%, 33.88% and 32.76% respectively. In average NABIL's ROE is 32.20%. During the study period, in average, NABIL has been able to pay 32.20% return to its shareholders equity which can be considered very well in respect to satisfying shareholders and attracting even more shareholders.

4.1.5 Liquidity Analysis

Liquidity ratio refers to the ability of a business firm to pay its short term obligation as and when they fall due for payment. A satisfactory liquidity position is one of the distinguishing characteristics of a bank to satisfy the credit needs of the community, to meet demand for substitutes, withdraws, pay maturing obligations on time and convert non cash assets into "cash" to satisfy immediate needs without loss to bank and consequent impact in longer range projection on profitability. An institution has liquidity, when it has the ability to obtain sufficient funds in a timely manner at a reasonable cost. An institution is considered to have a liquidity problem if it needs to rely upon prohibitively high cost of funds or sale of assets in order to meet unforeseen cash needs such as deposit run off.

Liquidity position is the key element of effective and efficient management of the assets and liabilities. Some ratios under the liquidity position are used in this study to analyze and interpret the liquidity position of the sampled bank. These ratios are mostly used under the supervisory and inspection tools of the commercial banks to evaluate the liquidity performance. This section includes current ratio cash reserve ratio, cash and bank balance to total deposit, investment in government securities to total deposit, overnight borrowing to total liabilities, loan to deposit, and growth rate of deposits.

4.1.5.1 Cash Reserve Ratio

Every commercial bank have to maintain a reserve fund with Nepal Rastra Bank equal to 5% of their total local currency deposit which is known as cash reserve ratio. For maintaining the balance, total local currency deposit of the first week is calculated and then 5% balance has to be maintained in the third week and this turn goes out respectively. Generally it should be done to avoid any problem relating to deficiency of liquid cash. This ratio can be calculated by dividing total local currency deposit by cash balance at NRB.

Table 24
Cash Reserve Ratio (CRR)

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Total Local Currency Deposit	7,597,273,217	4,167,991,861	1,492,570,330	1,037,849,593	6,680,492,616	4,195,235,523
Cash Balance at NRB	892,746,559	606,694,594	389,705,047	318,358,771	1,113,415,436	664,184,081
CRR	8.51 times	6.87 times	3.83 times	3.26 times	6.00 times	6.32 times

Source: Annual Reports of NABIL

The above table indicates that the cash reserve ratio has been maintained by NABIL in all years. This indicates that the NABIL has not been able to meet required level of CRR every year as directed by the NRB directives. Only in 2003/04, 2004/05 and 2007/08, it has met the requirement but not in 2004/05 and 2005/06. Which means, in 2005/06 and 2006/07, NABIL has taken an aggressive investment policy not maintaining enough level of liquid cash.

4.1.5.2 Cash and Bank Balance to Total Deposit

This ratio indicates the ability of banks immediate funds to cover their current margin call, saving, fixed call deposit and other deposits. A high ratio represents the greater ability to cover their deposits and vice versa. This ratio is calculated by dividing cash and bank balance by total deposit.

Table 25
Cash & Bank Balance to Total Deposit

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Cash & Bank Balance	1,144,767,483	970,486,543	559,380,614	630,238,588	1,399,825,851	940,939,816
Total Deposit	13,447,661,064	14,119,032,115	14,586,608,707	19,347,399,440	23,342,285,327	16,968,597,331
Cash & Bank Balance to Total Deposit	8.51%	6.87%	3.83%	3.26%	6.00%	5.55%

Source: Annual Reports of NABIL

The above table shows that the cash and bank balance to total deposit of NABIL for the reviewed period are 8.51%, 6.87%, 3.83%, 3.26% and 6.00%. The ratio has fallen from 8.51% in 2003/04 to 3.26% in 2006/07 and then it has risen to 6.00% in 2007/08. The average ratio is 5.55%.

Lower ratio indicates that the bank might face liquidity crunch while paying its obligations; whereas a high ratio points out that the bank has been keeping idle funds and not deploying them properly. In average NABIL has 5.55% of cash and bank balance to total deposit which shows that NABIL has just reasonable funds to meet their payment obligation.

4.1.5.3 Money at Call (Overnight Borrowing) to Total Liabilities

This ratio represents the percentage of money borrowed in inter-bank market. This form of borrowing is usually for daily liquidity purposes or for one day.

Table 26
Money at Call to Total Liabilities

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Money at Call	670,204,297	918,733,400	868,428,307	1,734,901,943	563,532,632	951,160,116
Total Liabilities	16,562,624,992	16,745,486,638	17,186,330,816	22,329,971,078	27,253,393,008	20,015,561,306
Money at Call to Total Liabilities	4.05%	5.49%	5.05%	7.77%	2.07%	4.75%

Source: Annual Reports of NABIL

The above table shows that the money at call to total liabilities of NABIL over the reviewed period are 4.05%, 5.49%, 5.05%, 7.77% and 2.07% respectively. The average money at call to total liabilities is 4.75%. The ratio has been increasing from 4.05% in 2003/04 to 7.77% in 2006/07 but significantly decreased to 2.07% in 2007/08.

From this increasing trend it can be said that Bank has high ability of the borrowing in the final year to maintain the strong liquidity position. The high percentage of the ratio indicates the high amount of less costly borrowing among other borrowings because call money is less costly. The borrowing is made to meet the daily liquidity purpose. So, one should identify the frequency of borrowing rather than amount of borrowing.

4.1.5.4 Loans to Deposit

This ratio shows the degree to which a bank is using its deposit fund to its loans.

Table 27**Total Loans to Total Deposits**

(Figures in NPR)

Particulars	F.Y.					
	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Total Loans	8,113,684,221	8,548,657,038	10,946,736,577	13,278,782,259	15,903,023,765	11,358,176,772
Total Deposits	13,447,661,064	14,119,032,115	14,586,608,707	19,347,399,440	23,342,285,327	16,968,597,331
Total Loans to Total Deposits	60.34%	60.55%	75.05%	68.63%	68.13%	66.94%

Source: Annual Reports of NABIL

The above table describes that the ratio of total loans to total deposits ratios of NABIL are 60.34%, 60.55%, 75.05%, 68.63% and 68.13% respectively over the reviewed period. The average total loan to total deposit ratio is 66.94%. The above table indicates that NABIL's investment in loan sector is just an average out of their total deposit. This ratio shows the degree of using the deposit amount. The bank has been able to use just more than half of total deposit as the loan requirement.

Under the NRB norms, there should be 40% to 60% for the usual range the deposit and never to exceed 100%. Thus, NABIL has always met the NRB norms for loan to deposit.

4.1.5.5 Growth Rate of Deposit

This ratio is calculated by subtracting last year deposit from current year deposit and dividing the remaining part by last year deposit.

Table 28

Growth Rate of Deposits

(Figures in NPR)

F.Y.	Total Deposits	Growth Rate
2002/03	15,506,428,215	
2003/04	13,447,661,064	-13.28%
2004/05	14,119,032,115	4.99%
2005/06	14,586,608,707	3.31%
2006/07	19,347,399,440	32.64%
2007/08	23,342,285,327	20.65%
Average	16,968,597,331	9.66%

Source: Annual Reports of NABIL

The above table highlights that the growth rates of deposits of NABIL are - 13.28%, 4.99%, 3.31%, 32.64% and 20.65% respectively in the study period. The average growth rate of deposit is 9.66%. The table shows that the deposit level of NABIL had decreased by 13.28% in 2003/04 comparing to the previous year. Then in 2004/05, the growth rate increased and reached 4.99%. Again in 2005/06, it slightly decreased to 3.31%. In 2006/07, the growth rate reached to 32.64% which means the NABIL had made the great improvement in its deposition in this year. In 2007/08, it again slightly decreased and reached 20.65%.

4.1.6 Sensitivity to Market Risk

The sensitivity to market risk reflects the degree of changes in interest rates that affect a bank's earnings and capital. So, the sensitivity is the combination of market risk associated with interest rate.

4.1.6.1 Interest Rate Risk

This section includes Rate Sensitive Liabilities (RSL) to Rate Sensitive Assets (RSA) regarding to respective maturity period. This ratio measures the sensitivity of assets and liabilities under each quarter.

Table 29

Rate Sensitive Liabilities (RSL) & Rate Sensitive Assets (RSA)

(Figures in NPR 100,000s)

Particulars	Days			
	Jan-90	91-180	181-270	271-365
F.Y. 2003/04				
Total Assets	63,290	11,807	16,947	14,120
Total Liabilities	22,254	11,267	529	3,573
Net Financial Assets maturing in Each Time Interval	41,036	540	16,418	10,547
Cumulative Net Financial Assets	41,036	41,576	57,994	68,541
Adjusted Interest Rate(IRC)	0.0025	0.0025	0.0025	0.0025
Cumulative Net Financial Assets × IRC	101.18	102.52	143.00	169.01
Accumulated Earnings Impact to Date	101.18	203.70	346.70	515.70
F.Y. 2004/05				
Total Assets	53,358	17,008	15,514	27,410
Total Liabilities	32,054	15,296	3,452	3,073
Net Financial Assets maturing in Each Time Interval	21,304	1,712	12,062	24,337
Cumulative Net Financial Assets	21,304	23,016	35,078	59,415
Adjusted Interest Rate(IRC)	0.0025	0.0025	0.0025	0.0025
Cumulative Net Financial Assets × IRC	52.53	56.75	86.49	146.50
Accumulated Earnings Impact to Date	52.53	109.28	195.78	342.28
F.Y. 2005/06				
Total Assets	4,690.40	1,441.50	661.10	2,026.20
Total Liabilities	2,794.30	780.00	325.20	346.90
Net Financial Assets maturing in Each Time Interval	1,896.10	661.50	335.90	1,679.20

Cumulative Net Financial Assets	1,896.10	2,557.60	2,893.50	4,572.70
Adjusted Interest Rate(IRC)	0.0025	0.0025	0.0025	0.0025
Cumulative Net Financial Assets × IRC	4.68	6.31	7.13	11.28
Accumulated Earnings Impact to Date	4.68	10.99	18.12	29.40
F.Y. 2006/07				
Total Assets	72,410	21,061	8,466	36,638
Total Liabilities	33,118	18,786	9,944	4,762
Net Financial Assets maturing in Each Time Interval	39,292	2,275	-1,478	31,877
Cumulative Net Financial Assets	39,292	41,567	40,089	71,966
Adjusted Interest Rate(IRC)	0.0025	0.0025	0.0025	0.0025
Cumulative Net Financial Assets × IRC	96.88	102.49	98.85	177.45
Accumulated Earnings Impact to Date	96.88	199.37	298.22	475.67
F.Y. 2007/08				
Total Assets	56,685	31,412	26,641	54,828
Total Liabilities	52,551	25,492	6,869	7,673
Net Financial Assets maturing in Each Time Interval	4,107	5,920	19,773	47,155
Cumulative Net Financial Assets	4,107	10,027	29,800	76,955
Adjusted Interest Rate(IRC)	0.0025	0.0025	0.0025	0.0025
Cumulative Net Financial Assets × IRC	10.13	24.72	73.48	189.75
Accumulated Earnings Impact to Date	10.13	34.85	108.33	298.09

Source: Annual Reports of NABIL

From the above table it can be summarized that in 2003/04, the NABIL's accumulated earnings were NPR 10,118,000 (101.18 x 100,000) in first quarter, NPR 20,370,000 in second quarter, NPR 34,670,000 in third quarter and NPR 51,570,000 in fourth quarter. So the accumulated earnings impact for the year owing to 1% increase in interest rate was a gain of NPR 51,570,000.

Similarly, in 2004/05, the NABIL's accumulated earnings were NPR 5,253,000 in first quarter, NPR 10,928,000 in second quarter, NPR 19,578,000 in third quarter and NPR 34,228,000 in fourth quarter. So the accumulated earnings impact for the year owing to 1% increase in interest rate was a gain of NPR 34,228,000.

Again, in 2005/06, the accumulated earnings were NPR 468,000 in first quarter, NPR 1,099,000 in second quarter, NPR 1,812,000 in third quarter and NPR 2,940,000 in

fourth quarter. So the accumulated earnings impact for 2004/05 owing to 1% increase in interest rate was a gain of NPR 2,940,000.

In 2006/07, the accumulated earnings were NPR 9,688,000 in first quarter, NPR 19,937,000 in second quarter, NPR 29,822,000 in third quarter and NPR 47,567,000 in fourth quarter. So the accumulated earnings impact for 2005/06 owing to 1% increase in interest rate was a gain of NPR 47,567,000.

And in 2007/08, the accumulated earnings were NPR 1,013,000 in first quarter, NPR 3,485,000 in second quarter, NPR 10,833,000 in third quarter and NPR 29,809,000 in fourth quarter. So the accumulated earnings impact for 2006/07 owing to 1% increase in interest rate was a gain of NPR 29,809,000.

4.2 Major Findings

S.No.	Particulars	F.Y.					Average
		2003/04	2004/05	2005/06	2006/07	2007/08	
1	Core Capital to RWA	11.45%	12.12%	11.35%	10.78%	10.40%	11.22%
2	Total Capital to RWA	13.05%	13.56%	12.44%	12.31%	12.04%	12.68%
3	Proposed Dividend to After Tax Income	59.06%	70.19%	66.36%	65.78%	72.95%	66.87%
4	Growth Rate of Capital	-0.64%	10.61%	9.73%	18.30%	10.45%	9.69%
5	Growth Rate of Assets	-6.05%	1.10%	2.63%	29.93%	22.05%	9.93%
6	Performing Loan to Total Loan	94.46%	96.65%	98.68%	98.62%	98.88%	97.46%
7	Non-performing Loan to Total Loan	5.54%	3.35%	1.32%	1.38%	1.12%	2.54%
8	Loan Loss Provision to Total Loan	4.41%	4.20%	3.29%	2.68%	2.25%	3.37%
9	Provision for Pas Loan to Total Pass Loan	1.60%	1.55%	2.18%	1.00%	1.12%	1.49%
10	Provision for Substandard Loan to Total Substandard Loan	24.01%	23.22%	31.10%	67.94%	47.31%	38.72%
11	Provision for Doubtful Debt to Total Doubtful Debt	48.95%	49.40%	73.21%	47.00%	49.20%	53.55%
12	Provision for Bad Loan to Total Bad Loan	85.14%	97.19%	97.05%	94.55%	44.63%	83.71%
13	Staff Efficiency						
14	Earning Assets to Total Assets	87.29%	89.25%	91.48%	93.31%	91.93%	90.94%
15	Interest Income to Total Assets	6.15%	5.98%	6.22%	5.87%	5.83%	5.98%
16	Interest Expense to Total Assets	1.92%	1.69%	1.42%	1.60%	2.04%	1.76%
17	Net Interest Margin	4.23%	4.29%	4.80%	4.27%	3.79%	4.23%
18	Non-interest Income to Total Assets	2.47%	2.54%	2.57%	1.82%	1.66%	2.14%
19	Non-interest Expense to Total Assets	3.88%	3.62%	4.17%	3.40%	3.17%	3.59%
20	EPS	NPR 84.66	NPR 92.61	NPR 105.49	NPR 129.21	NPR 137.08	NPR 109.81
21	ROA	2.51%	2.71%	3.02%	2.84%	2.47%	2.70%
22	PE Ratio	8.74 times	10.80 times	14.27 times	17.34 times	36.84 times	19.19 times
23	ROE	31.71%	30.77%	31.29%	33.88%	32.76%	32.20%
24	CRR	8.51 times	6.87 times	3.83 times	3.26 times	6.00 times	6.32 times
25	Cash & Bank Balance to Total Deposit	8.51%	6.87%	3.83%	3.26%	6.00%	5.55%
26	Money at Call to Total Liabilities	4.05%	5.49%	5.05%	7.77%	2.07%	4.75%
27	Total Loans to Total Deposit	60.34%	60.55%	75.05%	68.63%	68.13%	66.94%
28	Growth Rate of Deposit	-13.28%	4.99%	3.31%	32.64%	20.65%	9.66%

CHAPTER-5
Summary,
Conclusion &
Recommendation

5.1 Summary

In the present world, finance has occupied the center-stage in the process of economic advancement of the societies. The pace and quality of financial development not only affects the efficiency of financial services delivery but also determines the rate of economic growth and development in the country. In the present global environment of increasing economic integration along with the rising competitiveness among the economies, the financial system of a country needs to be made more capable and stronger even on a comparative basis. Strengthening related institutions, maintaining sound macroeconomic policies are necessary for strengthening the financial sectors.

Commercial banks are the major player in the financial system and they cover the most of the financial activities of the financial system. To make the financial system sound, capable, dynamic, and healthy, there should be a strong performance of commercial banks. And this performance should be either promoted or controlled. That is why there is the high needs of inspection and supervision of these banks with an evaluation of their performance and the degree of compliance of regulatory.

On other hand, these banks, as the JVBs, are working with the average quality of banking service. There is the high need of the quality performance of the commercial banks to meet the international standard. This study was conducted with a view to examine the operating position of NABIL, as JVBs, under the CAMELS system concept. CAMELS system is the off-site evaluation of the financial performance of the commercial banks and non-bank financial institution. The study provides the complete idea about the strength and weakness of the sampled bank regarding to ensure deposit and degree of compliance of prudential requirements. The main objective of the CAMELS system is to ensure that the bank is operating in a manner to the interest of depositors or not within the NRB regulation.

In the present context banking business become highly complex and sophisticated. Number of changes creates the threats and opportunities which directly affect the performance of the commercial banks. The financial analysis made on this study, using the financial analysis tools of CAMELS system, helps to make the accurate financial decisions, plan and programs to tackled the threats and grasp the opportunities arouse in the competitive environment. That is why the analysis is made to evaluate the performance and potentiality of the Capital Adequacy, Assets Quality, Management, Earning Capability, Liquidity Position and Sensitivity Position of NABIL. Analysis of these five components, under the CAMELS system is made because most of the performance of the banks is covered by these components. Similarly, NRB as the authorized supervisory institution requires the compliance of the regulatory requirements. CAMELS tools evaluate the degree of the performance with compliance of regulatory requirements. Thus, CAMELS tools evaluate the sampled bank completely.

5.2 Conclusion

From the above analysis it can be concluded that the NABIL has properly maintained its total capital to risk weighted assets as directed by NRB. The proposed dividend after tax also seems satisfactory. The growth rate of capital and assets in the study period is fluctuating. In average, the assets level has slight high growth rate than the capital level.

The overall assets management of the banks seems satisfactory. The performing loan to total loan ratio is always more than 95% except in 2003/04 and the average is 97.46%. The non-performing loan to total loan ratio is always less than 5% except in 2003/04 and the average is 2.54%. Loan loss provision to total loan ratio is always below 5%. According to NRB directives every commercial bank should maintained 1% of pass loan provision to cover the future unknown losses and NABIL, within the study period, has always met the provision for pass loan according to NRB directives which is satisfactory. According to NRB directives, every bank should maintain the substandard loan of 25% and NABIL has not met the criteria of NRB in 2003/04 and 2004/05. Provision for doubtful loan to total doubtful loan ratio is higher than 50% in 2005/06 i.e. 73.21%. The loan loss provision of NABIL is also not satisfactory; it is below NRB directives and in 2007/08 it is 44.63% which is more than 50% below the NRB directives.

The management should reflect the capabilities of management and their roles towards achieving their goals. The management of NABIL is efficient and successful because net profit is continuously increasing in a sustainable manner over the study period. From this it can be concluded that the management of NABIL is quite satisfactory.

The earning capability of NABIL is highly satisfactory because its average earning assets to its total assets is above 90.94%. The average interest income to total assets ratio is 5.98% whereas the average interest expense to total assets ratio is 1.76%. Similarly, the average net interest margin during the study period is 4.23% and the average return on assets is 2.70%.

NABIL has not been able to meet required level of CRR every year as directed by the NRB directives. Only in 2003/04, 2004/05 and 2007/08, it has met the requirement but not in 2005/06 and 2006/07. Its cash and bank balance to total deposit ratio is 5.55% in average which shows that NABIL has just reasonable funds to meet their payment obligation. The money at call to total liabilities ratio of NABIL is increasing and the average money at call to total liabilities ratio is 4.75%. NABIL has always met the NRB norms in relation to loan to deposit ratio. The deposition rate is also growing. From this we can conclude that NABIL has maintained quite sufficient level of liquidity position to meet the market needs.

The sensitivity to market risk reflects the degree of changes in interest rates that affect a bank's earnings and capital. From the above analysis we have found that even when there is 1% change in interest rate there is profit. So it can be concluded that the 1% change in interest rate would not affect the Bank's profitability. So bank may change its interest rate by 1% if required.

5.3 Recommendation

- The analysis shows that the NABIL has been paying handsome dividend to its shareholders because the ratios are very high, more than 50%, in every year of the study period. Paying higher dividend might attract the shareholders but ultimately it may create capital shortage in the future. So the bank should retain its net income to increase its capital.
- The growth rate of capital and assets in the study period is fluctuating. In average, the growth rates of capital and assets are 9.69% and 9.93% which means the assets level has slight high growth rate than the capital level. This may bring problem of fund management. So it is suggested that NABIL should increase the growth rate of capital to satisfy the growth rate of assets.
- The total portion of non interest income to total assets is very low. This indicates that the income generated other than from interest income is very low. So the NABIL should try to bring new services to attract customer and provide their service to generate more income.
- Investors of any organization are interested on profit, earning per share and dividend per share. The earnings per share of NABIL seem to be highly satisfactory. So it seems that the investors may not shift their investment from NABIL but NABIL should try to increase their net profit as to increase the EPS.
- The net profit to share holder's equity seems to be just in average. Investors basically seek for the higher return. So, NABIL is suggested to increase its net profit by deducting other operating costs to satisfy the shareholders and investors.
- NABIL has not been successful in maintaining its cash reserve ratio as directed by NRB every year of the study period. This means, NABIL has been taken an aggressive investment policy not maintaining enough level of liquid cash. So it is suggested that the bank should invest its fund only after maintaining the cash reserve ratio according to the NRB directives.
- The growth rate of deposit is in highly fluctuating trend. Although the growth rate of deposit is high, the bank should maintain its deposit level with taking liquidity position and investment policy into consideration.
- The sensitivity is the combination of market risk associated with the interest rate. In above analysis we have found that the bank will earn even though there is 1% increment in the interest rate. So if there is a problem of deposit shortage in the market, NABIL is suggested to increase its rate of interest to capture the deposit market.

Besides all the above recommendations and suggestions, the bank should keep working on its strong parts to stay long and strong in this competitive world.