CHAPTER I
INTRODUCTION

1.1 General Background

Nepal, the birth place of Loard Budha, the home for exotic biodiversity, highest mountain in the world-Everest, a landlocked agro-based economy with low industrial base, the most preferred tourist destination in South Asia is an underdeveloped country.

It is a small country with unique physical setting surrounded by India in south, east end west and by china in the north. It is landlocked country with 800KM, lengths and open boarder with India. The country is one of me least developed countries of the world. World development report 2009 shows that, the per capita income is $ 210 which is very low as per the international standard. The economic development of the country, which is reflected by the annual GDP growth rate, is also not very significant. The population growth rate is 2.3 percent World Development Report 2009 shows that economic growth rate on per capita GNP is -0.1 percent. The report shows that the public expenditure on education and health are 2.8 percent and 1.2 percent of GNP respectively. The country is facing the problem of nutritional deficiencies and higher infant mortality. Average fertility rate per women is higher in the country.

Development of financial sector is another strategic variable to uplift the economy. Financial institutions transfer the resources form surplus units to deficits units. In this way, financial institutions are catalyst in the process of economic growth of a country. A key factor in the development of an economy is the mobilization of domestic resources. As intermediaries, the financial institutions help the process of resource mobilization. The importance of financial institutions in the economy has of late grown to an enormous extent. The government in turn is required to regulate their activities to that the financial policies are implemented as per the requirements of the country. Polices such as lending to the priorities sectors, lending to the educated unemployed people, creation of entrepreneurship in the society are certain examples which the government in developing economies try to implement with the helps of financial institution. Furthermore, the selective credit controls imposed in most, developing economies. And the proposed

regulation of back credit distribution in some industrial countries (the United Kingdom and United States), are examples of the importance attached to the intermediary function of commercial banks as financial institutions (1977, Abdi). History shows that though the event may very from country to country, requirement of economic development of any country heavily relies upon the banking system of the country. During its industrial period, United Kingdom used bank credit to fulfill its working capital need. During the Industrialization proves of France and Germany, banks Played an important role in industrial finance and the growth of the nation.

Financial institutions transfer the resources by mobilizing them from surplus units and in turn lend these funds to deficit units. In this way, the financial institution provide savers highly liquid, divisible assets at a lower risk while the investors receive a larger pool of resources satisfaction of both lender's and borrowers determines the success of intermediary function of economy. Economies and historians agree that the process of modern economic growth has been closely associated in the expansion and increasing diversification of finical intermediation (Brayant, 1987)

Banking sector play an important role in the economic development of the country. Commercial banks are one of the vital aspects of this sector, which deals in the process of channel sing the available sources to the needy sector. It is the intermediary between the deficit and surplus of financial resources. People keep their surplus money and deposits in the banks and hence banks can provide such funds to finance the industrial activities in the form of loans and advances. The funds scattered in the economy and mobilize them to the productive sector. If a bank behaves irresponsibility, the costs borne by the economy are enormous. A large amount of depositor's money is at stake. The bankers have the responsibility of safeguarding the interest of the depositors, the shareholders and the society they are serving. Therefore, a sound, financially healthy, competitive and reliable banking system is essential for every country to develop. In Nepal, among the available financial institutions, banking industry dominates all. Thus, banking is a vital part of national economy and a vehicle for the mobilization of economy's financial resources and extension of credit to the business and service enterprise.

The development of financial system in Nepal dates bank to a rudiment economy dealing in the commodity money, as it would have elsewhere in the world, such as fold and silver coins. The silver coin age which came into existence in Nepal in the 12th century is said to have marked a new epoch in the economic history. Since then, the financial system underwent through various stages till the evolution of modern banking in 1937. Nepal Bank Ltd., the first bank of the country, was established with an objective to render services to the people and contribute the nation's development. Though the bank was established to render banking services to the people, Nepalese economy was characterized by the prevalence of dual currency system because of the border and excess concentration of trade with India. Indian currency was more common in use than the Nepalese currency. Given such a situation, a need for the central bank for the development of banking, and finance, promoting trade and industry, managing circulation of national currency, maintaining exchange rate stability was realized. In this background, Nepal Rastra Bank (NRB) was established on April 26, 1956. Establishment of NRB, undoubtedly, was an important event in the economic history of Nepal. Following the establishment of NRB, a number of financial institutions were established. Among these, establishment of Nepal Industrial Development Corporation in 2959, Rastriya Banijya Bank in 1966, Agriculture development bank in 1968 and securities Exchange Center in 1977 were the prominent ones for the development of financial market.

The decades of 1980s ahs its historical significance in the development of financial system in Nepal. The financial liberalization policy introduced by the government in mid eighties paved the way for the fast, healthier and competitive development of Nepal Arab Bank Ltd.

Himalayan Bank limited (HBL) was incorporated in 1992 by the distinguished business personalities of Nepal in partnership with the Employees Provident Fund and Habit Bank Ltd. One of the largest commercial bank in Pakistan Bank operation was commenced from January 1993. It is the first commercial bank of Nepal with maximum share holding by the Nepalese private sectors. It was established with and authorized capital of Rs. 120 million and issued capital Rs. 60 million. Besides commercial activities, the Bank also offers industrial and merchant banking services. The bank at present has five branched in

Kathmandu Valley. Besides, it has nine branches outside the Kathmandu Valley. The Bank has a very aggressive plan of establishing more branches in different parts of the kingdom in near future. The banking services and products offered by the bank includes conventional deposit scheme like fixed, saving and current, credit by term loans as well as working capital, letter of credit, bank guarantee, retail finance, remittances, SWIFT transfer facility, sale and purchase of rupees and dollar traveler cheque, tale banking, any branch banking, automatic toiler machine cards. Himalayan SMS, Fund Transfer, Locker Facility, 24-hour Banking etc.

1.2 Introduction of CAMEL Framework

A common method for evaluating the soundness of banks is to understand the CAMEL rating system. This system was designed by regulatory authorities to quantify the performance and the financial condition of the banks which it regulates. CAMEL stands for capital adequacy, asset quality, management, earnings, and liquidity. In 1997, the ratings became CAMELS with the addition of a market sensitivity rating.

The most important criteria for determining the appropriateness of financial institution (F1) to act as a financial intermediary are its solvency, profitability, and liquidity. In this respect, since 1988, the Basel Committee on Banking Supervision (BCBS) of the Bank of International Settlements (BIS) has recommended using capital adequacy, assets quality, management quality, earnings and liquidity (CAMEL) as criteria for assessing financial institution.

The majority of prior research for prediction of bank failure focused on capturing information representative of capital adequacy (C), asset quality (A), management quality (M), earnings (E) and liquidity (L), which are designated as a CAMEL model. The choice of these factors occurs based on the theory that each is representative of a major element in a bank's financial statements.

CAMEL was originally developed by the Federal Deposit Insurance Corporation (FDIC) for the purpose of determining when to schedule an on-site examination of a bank (Thomson, 1991; Whalen and Thomson, 1988). This relates to the likelihood that bank

failures my result when any of the five factors embodied in CAMEL prove inadequate. Although researchers have a common adherence to the broad guidelines available in CAMEL criteria, previous studies for predictions of bank failure contained inconsistent set of CAMEL measures.

The usefulness of the CAMEL criteria for prediction of bank future exists in establishment of foundation for understanding a bank's health. As the FDIC does not divulge the details of the representative measures for CAMEL, the ensuing complication for researchers arises in determination of which measures best correspond to the five CAMEL factors. Typically, in the past researchers collected a variety of measures relating to each of the five CAMEL, factors with variable selection often occurring as a function of a statistical method, such as step-wise regression of factor analysis.

Lane (1986) included 21 ratios representative of all five factors in CAMEL. Martin's (1977) model consisted of 25 variables representative of CAMEL, while West (1985), Espahbodi (1991) and Tam and Kiang (1992) employed 19 variables covering four CAMEL categories. Looney et al. (989) and Lane et al. (1986) used a stepwise approach to narrow their set of variables from 21 to 4. A majority of the studies examined only four of the CAMEL factors and excluded a representative measure for management, as it proves to be the most difficult measure to capture.

1.3 Focus of the Study

Topic itself is very clear about focus of the study. Financial performance analysis is a process of identifying the financial strengths and weakness of the firm by property establishing relationship between the item of balance sheet and the profit and loss account. Ratio analysis is a power full tool of financial analysis. The study aims to analyze the financial performance of Himalayan Bank Ltd. (HBL) in the framework of capital adequacy, assiduity, management, earning, liquidity and. CAMEL by using descriptive and analytical research design. Thus, whole energy and effort concentrate on analysis of financial performance of the bank. More specifically, the study focuses on the trend of capital adequacy ratio with comparing to NRB standard, non-performing loan

ratio with comparing to industrial average, trend of loan loss ratio, and trend of total expensed of total revenues ratio, trend of earnings per employee trends of return on equity, return on asset, net interest margin, and earning per share and trends of NAD balance of total deposits ratio, vault to total deposits ratio and liquid funds total deposits ratio with comparing to industrial average during the period of past six years starting from FY 2003/2004 to 2008/2009.

1.4 Statement of the Problem

A bank financial soundness is judged on the basis of capital adequacy, assets quality, management, earning, liquidity and sensitivity to market risk (CAMELS). Almost, all the government banks in Nepal are running in loss. Though almost all the private sector banks are earning profit, it is very difficult to call them sound if appraised from CAMELS approach. Some banks have very low capital adequacy ratio while some banks have piled of non-performing assets. Similarly, it appears that bank do not have proper system in managing the market risks. The people have been raising question over the correctness of credit classification and provision of some banks. Should the suspicion come true? It will prove very costly to the depositors, creditors and national economy over the correctness of credit classification and provision of some banks. Should the suspicion come true? It wills provide very costly to the depositors, creditors and national economy as a whole. It would be prudent to advise Nepal Rastra Bank to strictly implement: its directives so that banks avert the fate of public sector banks.

It has been reported that joint ventures banks are new operationally more efficient, having superior performance while comparing with local banks (Sherestha, 1990) However, despite claims the real evaluations and comparative evaluations do not seem to have been made to judge the performance of joint ventures banks (JVBs). Their profitability position and stock prices are generally known but a major question emerges whether these are adequate to reflect the overall performance of JVBs.

The fundamental problem of this study is to investigate into the financial health of HBL in the framework of CAMEL. So the study attempts to solve the following research question:

i) How the bank is managing the capital adequacy?

ii) What is the trend of non-performing loan and loan loss provision in the banks?

iii) How far the bank is managing their expenses with respect to revenues?

iv) What is the trend of earning performance made by the bank?

1.5 Objectives of the Study

The objective of the study is to analyze the financial performance of Himalayan Bank Ltd. (HBL) in terms of capital adequacy, asset quality, management, earning and liquidity (CAMEL). The specific objectives of the study are as following:

i) To analyze the bank's capital adequately.

ii) To analyze the trend of non-performing loan and loan loss provision in the bank.

iii) To compare the revenue with expense.

iv) To analyze the earning power and overall profitability of the bank.

v) To analyze the bank's liquidity position.

1.6 Significance of the Study

Research itself has its own importance because it aims to gain knowledge and to add the new literature to the existing field. The significance of this study lies mainly in filling a research gap on the study of financial performance analysis of commercial bank with respect to Himalayan Bank Ltd (HBL). This study will contribute significantly to solve the problem existing in the bank and to formulate the policy and strategies to maintain activities effectively. Mainly, the study is important for the researcher to fulfill the academic requirement of master degree. On the other the study is important for commercial banks, researchers, scholars, investors, students, government and many other parties. So, this study will be helpful to those who want to study in further detail and widely in this field. At last, it is expected that the study will add a drop of literature to the field of commercial banks and their financial performance analysis.

1.7 Limitation of the Study

As every study is conducted within certain limitations, the present study is not an exceptional. This study is carried out as an academic requirement for degree of Master of Business Study (MBS). So, the study may not be able to reveal the reliability and validity in every field. Basically, the study is limited within the following factors.

i) The study is only confined to financial performance analysis of Himalayan Bank Limited. Therefore, all the activities are intended to analyze the financial performance

ii) Last six years' data from 2004 to 2009 are taken into consideration for the study purpose, which are collected from the secondary sources.

iii) Data published by different authorities differ. Figure published by Nepal Rastra Bank and the bank's annual report do not tally each other. However, in this research work data collected and published by bank is taken as authentic sources of the data.

1.8 Organization of the Study

This study is organized into five chapter; Introduction. Review of Literature, Research Methodology, Data Presentation and Analysis and Summary, conclusion and recommendation.

Introduction chapters includes the general background, focus of the study, statement of the problem, objectives of the study, importance of the study, limitations of the study and organization of the study. Similarly, the second chapter deals with the review of available literature. It includes conceptual review and review of related studies. Research methodology chapter is concerned with the methodology adopted in the research work. It consists of research design, sample and population, sources of data, methods of analysis and financial tools to measure financial performance. In the same way, presentation and analysis of data is included in chapter four, finally, the summary of the research report, conclusions and recommendations are given in chapter five

CHAPTER II
REVIEW OF LITERATURE

This chapter is basically concerned with review of literature on to the financial performance analysis of commercial banks. So, this chapter highlights upon the literatures that are available in the area of financial performance and commercial banking sector. This chapter is divided into two parts: conceptual framework and review of related studies.

2.1 Review of Conceptual Framework

This sub-chapter presents the theoretical aspect of the study. it includes the concept of commercial bank, functions of commercial banks, historical development of commercial bank in Nepal, concept of financial performances analysis.

2.1.1 Review of Concept of Commercial Bank

Commercial banks are the most important source of institutional credit in the money market: A commercial bank is a profit-seeking business firm, dealing in money or rather dealing in claims to money. It is a financial institution that creates demand deposits, that is, deposit account which is subject to withdrawal by the owner to deposits, that is, deposit account which is subject to withdrawal by the over on demand as subject to transfer t a third party by means of a cheque. In that respect it differs from all other financial institutions Moreover. Deposits in a commercial bank, circulates as money, while deposits in other financial institution do not. In fact the greater part of money supply is the direct consequence of the profit-seeking or money creating activities of commercial banks.

A commercial bank is not a philanthropic institution. On the other hand, it is an institution that operates for profits. Like other industrial or commercial enterprise, a bank too, seeks to earn maximum income though the suitable employment of its resources. It is a financial intermediary - a sort of a middleman between people with surplus fund and people in need of funds. it accepts deposits for the purpose of lending or investment and

thereby hopes to make a profit-profit which are adequate enough to the bank to pay interest at the prescribed rates to its depositors, meet establishment expenses, bild reserves', pay dividend to the shareholders. etc. In general, commercial banks are those financial institutions which play the role of financial intermediary in collection and disbursement of funds from supplies unit to deficit unit.

Upadhya and tiwari (1998) stresses that the commercial bank is established with a view to provide short term to necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surpluses in the form of deposit, acting as an agent of the lint etc. In the save way. Abroal and Gupta (2002) primarily to business firm. On the other hand, the broad concept of commercial bank holds that the commercial bank is a banking institution other than central bank. The commercial bank is the only institution other than bank permitted to accept demand and time deposits

2.1.2 Historical Development of Commercial Bank

The evolution of commercial banking industry has started a load time bank, during in ancient time. There was reference to the activities of money changers in the temple of Jerusalem in the New Testament. In ancient Greece the famous temple of Delphi and Olympia served as great depositors of people surplus fund and these were the centers of money lending transaction. Indeed the tracks of "rudimentary banking" were found in the Children, Egyptian and Poinciana history. The development of banking in ancient Roma roughly followed the Greek pattern. Banking suffered void after the fall of the Roman Empire after the death of Emperor Just inland in 565 A.D. and it was not until the revival of trade and commerce in the Middle Ages that the lesions of finance were learnt a new from the beginning. Money leading in the middle Ages was, however, largely confined to the jews since the Christians were forbidden by the Canon law indulge in the sinful act lending money to theirs on interest. However, as the hold of the Church loosened with the development of trade and commerce about the thirteen century Christian also took the lucrative business of money leading, thereby entering into keep competition with the jews who had hitherto monopolized the business.

The origin of the banking system is traceable to the ancient Assyrians, Babylonians and Arthurian, but the forerunners of modern banks are considered or be the bank of Venice (1171A.D.), The BankofGenoa(1320A.D.) . Bank of Barcelona (1401A.D.) and The Bank of Amsterdam (1609A.D.), The Bank of Venice and Bank of Genoa continued to operate unit the end of eighteenth century. With the expansion of commercial activities in Northern Europe there sparing ups a number of private banking houses in Europe and slowly it spread throughout the world.

In almost all countries the logical historical order of the development o financial structure has gone through different stages. In Nepal, the first stage starts from rudimentary economy in which the commodity money such as gold and silver coins generally accepted as a means of payment. Involvements of landlords, risk merchants, shopkeepers and other individual moneylender have acted as feline to institutional credit in presence of unorganized money lender. Though establishment of banking industry was very recent, some crude bank operations were in practice even in the ancient times In Nepalese chronicle, it was recorded that the new era known as Nepali Samba was introduced by Shakdhar, a Sudra merchant to Kantipur in 879-880 A.D. , after having paid all the outstanding debts in the country, this shows the basis of money lending parties in ancient Nepal. Toward the end of eight century, Gunakam Dev Borrowed money to rebuild the kathmandu vally. In 11th century, during regime there was an evidence of professional money lenders and bankers further beleived that money-lending business, particularly for financing foreign trades with Tibet become popular during regime of mall's.

At the end of 14th century we further came across the term 'Tanka Dhari', meaning money dealer, which is one of the sixty four caste four caste classified basis of occupation. In historical order of development of the marmet is seem only in the stage, the establishment of the "tejrath adda" during the year 1877A.D. was fully subscribed by the government of kathmande valley. which played a vital role in banking system. The tejrath adda distributed credit facilities to the public especially on the collateral of gold and silver. Hence the establishment of Tejratha Adda could be regarded as pioneer foundation of banking in Nepal.

The history of the modern banking began only after the establishment of Nepal bank limited in 1973 A.D. as a semi-government organization, without existence of a central bank. It was established under special banking act 1936 having elementary functions of a commercial bank. It laid the foundation of modern banking system in Nepal. Because of the non-existence of a central bank in the country, the commercial bank had to act as its own central bank, and keep enough sources in had for meeting emergencies.

A that time, Nepalese economy was characterized by the prevalence of dual currency system. There were great fluctuations in the open market rate of exchange of the Nepalese rupees against the India currency which provided a great hindrance to the economic stability as well as development of the country. Thus, there was an immediate need of central bank. on April 26th 1967, under the Nepal Rasta Bank act 1955 with objectives of supervising, protecting and directing the functions of commercial banking activities. It had authorized capital of Rs. 10 million fully subscribed by the government. It was empowered by act to have direct control over financial institutions within the country. It started issuing currency in 19959A.D. Another commercial bank fully owned by the government, named as the 'Rastriya Banijya Bank' got established in 1996 A.D. (NRB, 2001). With a view of providing financial assistance for agriculture, Agriculture Development Bank of Nepal (ADB/N) was established in the government section in 1967 A.D.

In 1980A.D. government introduced "Financial Sector Reforms" which facilitated the establishment of different private sector financial institution in Nepal Besides Nepal Bank Limited and Rastriya Banijya Bank, other commercial banks did not come to existence unit 1984A.D. The commercial banking act 1974 was amended in 1984A.D. to increase the competition between commercial banks. As per the provision made in this act, private sector (including foreign investment) was given were eliminated. However, foreign participation in the financial sector is only allowed with the joint collaboration with domestic partners. The establishment of Joint venture banks gave a new horizon to the financial sectors of the country.

Consequently, Nabil Bank Limited (as decided by the annual general meeting held on 12 August 2001 the bank has been renamed as banil Bank limited, before this it was called Nepal Arab Bank Limited) was estiblished in 1984A.D. as a first joint called Nepal Investment Bank Ltd.) and Nepal Grindlays Bank limited (later it has been called Steandard Charterd Bankk Limited), Napal bangladesh Bank Limited were established under joint venture in 1986, 1987 and 1994 A.D. respectively.

After the restoration of democracy in 1990 A.D., NRB adopted a more liberal policy in establishing the commercial banks. As a result a number of commercial bank increased dramatically viz. Himalayan Bank Ltd., Nepal SBI Bank Ltd., Everest Bank Ltd., Bank of Kathmandu Ltd. etc. A present, 17 commercial banks, 63 finance companies, 34 development banks and 5 rural development] bank, 63 finance societies and 47 non-government organizations are working under the Banking and financial Institution Ordinance 2061. Out of these 17 commercial banks, two banks are public sector and fifteen are private sector banks.

2.1.3 Functions of Commercial Banks

Commercial banks performs folloeing essential function

1. Accepting Deposits: - This is the oldest functions of a bank and the banker used to charge commission for keeping the money in its custody when banking was developing as an institution. Now a day a bank accepts three kinds of deposits from its customers. The first is the 'savings' deposits on which the bank pays interest relatively at low rate to the depositors who are usually small savers. Depositors are allowed to withdraw their money by cheque up to a limited amount during a week or a year. Businessmen keep their deposits in current accounts. They can withdraw any amount standing to their credit in current deposits. A bank charges accepts fixed or time deposits. Savers who do not need money for a stipulated period from 6 months to longer periods. ranging up to 10 years or more are encouraged to keep it in fixed deposits. But there is always the maximum limit of the interest rate on fixed deposit.

Advance and Loans: One of the primary funcitons of a commercial bank is to advance loans to its customers. A bank lends a certain percentage of the cash lying in profits and carries on its business. the bank advances loans in the following ways:

2. Cash Credit: The bank advances loans to businessmen against certain specified securities. The amount of the loan is credited to the current account of the borrower. In case of a new customer, a loan account for the sum is opened. The borrower can withdraw money through cheques according to his requirements but pays interest on the full amount.

3. Call Loans: There are very short-term loans advanced to the bill brokers for not more than fifteen day. They are advanced against first class bill or securities. Such loans can be recalled at a very short notice. In normal times, they can also be renewed.

4. Overdraft: A bank often permits a businessman to draw cheques for a sum greater than the balance lying in his current account. Bank provides the overdraft facility up to a specific amount to the businessman. But bank charges interest only 'on the overdrawn amount.

5. Discounting Bills of Exchange: If a creditor holding a bill of exchange wants money immediately, the bank provides the money by discounting the bill of exchange. It deposits the amount of the bill in the current account of the bill holder after deducting its rate of interest for the period of the loan, which is not more than 90 days. When the bill of exchange matures, the bank gets its payment for the banker of the debtor who accepted the bill.

6. Credit Creation: Credit creation is one of the most important functions of the commercial banks. Like other financial institutions, its aim at earning profits. For this purpose, its accept deposits advance loans by keeping small cash in reserve for day-to-day transactions. When a bank advances a loan, it opens an account in the name by of the customer and does not pay him in cash but allows him to draw the money by cheque according to his needs. By granting a loan, the bank creates deposit.

7. Financing Foreign Trade: A commercial bank finances foreign trade of its customers by accepting foreign bills of exchange and collecting them from foreign banks. It also transacts other foreign exchange business-buying and selling of foreign currency.

Agency Services: A bank act as an agent of its customers in collecting and paying cheque, bills of exchange, drafts, dividends etc. It also buys and sell shares, securities, debentures etc. for its customers. Further it pays subscriptions, insurance premium, rent, electricity

and water bills and other similar charges on behalf of its clients. It also acts as a trustee and executor of the property and will of its customers. Moreover, the bank acts as consultants to its clients. For some of these services, the bank charges a normal fee while it renders other free of charge.

Miscellaneous Services: Besides the above noted services, the commercial bank performs a number of other services. It acts as the custodian of the valuables of its customers by providing those lockers where they can keep their jewelry and valuable documents. It issues various forms of credit instruments, such as cheque, drafts and travels' cheque etc., which facilities transactions. The bank also issues letters of credit and acts as a referee to clients. It underwrites shares and debentures of companies and helps in the collection of funds from the public. Moreover, it provides statistics on money market and business trends of the economy.

2.1.4 Supervisory and Monitoring System of the Nepal Rastra Bank

Principally, the central bank has the liability and obligation to maintain fair and healthy environment of the economic activities of the nation. For it, the necessary act, rules and regulations are enacted and developed. Thus, the act of checking whether the related officials and banks have honestly complied with the policy, regulation and provisions enacted by the controlled financial system, itself is called inspection. As a central bank, the Nepal Rastra Bank has been discharging such serious and sensitive task.

Before the establishment of the Nepal Rastra Bank, the function of the inspection and supervision used to be carried out by the officials by His Majesty of Government or Auditor General. this practiced was continued until the enactment of the Commercial Bank Act 2020 B.S.; After the introduction of this Act, the function of inspection and supervision for the commercial Bank was given to the Nepal Rastra Bank and this right was more strengthened by the Nepal Rastra Bank Act and the introduction of the Commercial Bank Act 1974. The Nepal Ratstra Bank has been year 2042/43 B.S., a separate department of inspection and supervision, was established to regulate and carry out an on site inspection of the banks and the financial institutions.

The system of inspection and supervise of the banking and the non-banking financial institutions is to be followed on a certain standard norm. In this regard, the Bank for International settlement (BIS) has formulated an important standard, which is called CAMELS system. The evaluation of financial institutions is done on the basis of it. In the case of Nepal, the Nepal Rastra Bank, adopting this system, has made it the main basis of the on site and off site supervision.

2.1.5 Financial Performance Analysis

Banks today are under great pressure to perform - to meet the objectives of their stockholders, employees, depositors, and borrowing customers, while somehow keeping government regulators satisfied that the bank's policies, loans, and investments are sound. As banking organizations have grow in recent years, more and more of them have been forced to turn to the money and capital markets to raise funds by selling stocks, bonds and short-term instruments. This development has placed management under great pressure to set and meet bank performance goals. Bankers have been called upon to continually reevaluate their loan and deposit policies, review their plans for expansion and growth, and asses their returns and risk in light of this new competitive environment. In addition, there is the added problem of bank failures. Many of these failures have beer associated with management mistakes, outright fraud and a more volatile and uncertain economy that demand new standards for bank management.

The most important performance dimensions for any bank is profitability and maximizing the value of the shareholders wealth invested in the firm at an acceptable level of risk. The objective of maximize profit with a level of risk acceptable to the bank's stockholders is not easy to achieve, as the recent upsurge in bank failures around the globe clearly suggests. Aggressive pursuit of such an objective requires an institution to be continually on the lookout for new opportunities for further revenue growth, greater efficiency, and mere effective planning and control. Bank performance must be directed toward specifies objectives. A fair evaluation of any bank's performance should start by evaluating whether it has been able to achieve the objectives its management and stockholders have chosen. Certainly many banks have their own unique

objectives. Some wish to grow faster and achieve some long-range growth objectives others seem to prefer the minimizing risk, conveying the image growth objectives others seem to prefer the minimizing risk, conveying the image of a sound bank but with modest rewards for their shareholders.

Financial statements including the incomes statements, statement of retained earning, balance sheet and the cash flow statement reflect the overall financial position of an enterprise which is the health of the entity. These statements provide information to both insiders and outsiders. Ratio analysis is a tool of scanning the financial statement of the firm. Through this, one comes to know that in which areas of the operation the organization is strong and in which areas it is weak. Analyses of financial statements for the purpose of management performance evaluation cover entire operation areas of the firm. Management performance should be evaluated from the perspective of productivity, profitability, activity, stability and possibility. Management itself can use these parameters to improve the organization's performance in future. Because, truly know-how of the strengths and weaknesses for exploiting maximum benefits and to repair the weaknesses to meet the challenges. Thus, the analysis of financial statements is done to obtain a better insight into a firm's position and performance.

Ratio is the expression of one figure in terms of another. It is an expression of the relationship between mutually independent figures. It is a simple mathematical expression of the relationship one item with another. Absolute figures alone convey no meaning unless they are comparing each other. Accounting ratios show the interrelationship among various accounting data. Wixon, Kell and Bedford are stresses tat a ratio is an expression of the quantitative relationship between two numbers. Thus, ratio refers to the numerical or quantitative relationship between two items or variables.

Ratio analysis is the process of determining and interpreting numerical relationships based on financial statements. A ratio is a yardstick that provides a measure of the relationship between two variables. This relationship can be expressed as percent or as a quotient (Kuchhal, 1980). The relationship of one item to another expressed in a simple mathematical form is known as the ratio. A company keeps fit by ensuring that

among other things, its various financial proportions are kept healthy. Its business performance can be measured by the use of ratios. Ratios must be interpreted against some standard (Kulkarni, 1981).

Financial statements contain a wealth of information which if properly analyzed and Interpreted can provide valuable insights into a firm's performance and position (Chandra, 1992). Analysis of financial statements is of interest to lenders, investors, security analyst, managers and other. It generally begins with the calculation of a set of financial ratios designed to reveal the relative strengths and weaknesses of a company as compared to other companies in the same industry, and to show whether the firm's position has been improving or deteriorating over time (Western & Copeland, 1991). Financial analysis is a process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the item of balance sheet and the profit and the loss account (Pandey, 1992).

2.1.6 Financial Performance Analysis in the Framework of CAMEL

A common method for evaluating the soundness of bank is to understand the CAMEL Rating System. This system was designed by regulatory authorities to quantify the performance and the financial condition of the banks which it regulates. CAMEL stands for capital adequacy, asset quality, management, earnings, and liquidity. In 1997, the ratings became CAMELS with the addition of a market sensitivity rating

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management quality (M), earnings (E) and liquidity (L), which are designated as a CAMEL model. The choice of these factors occurs based n the theory the each is representative of a major element in a bank's financial statements.

CAMEL was originally developed by the Federal Deposit Insurance Corporation (FDIC) for the purpose of deterring when lo schedule an on-site examination of a bank (Thomson, 1991; Whalen and Thomson, 1988). This relates to the likelihood the bank failures may result when any of the five factors embodied in CAMEL prove inadequate. Although researchers have a common adherence to the broad guidelines available in the CAMEL criteria previous studies for predictions of bank failures contained no consistent set of CAMEL measures.

The usefulness of the CAMEL criteria for prediction of bank failure exists in establishment of a foundation for understanding a bank's health. As the FDIC does not divulge the details of the representative measures for CAMEL, the ensuing complication for researchers arises in determination of which measures best correspond to the five CAMEL factors. Typically, in the past, researcher collected a variety of measures relating to each of the five CAMEL factors with variable selection often occurring as a function statistical method, such as step-wise regression or factor analysis.

Lane (1986) included 21 ratios representative of all five factors in CAMEL. Martin's (1977) model consisted of 25 variables representative of CAMEL, while West (1985), Espahbodi (1991) and Tam and Kiang (1992) employed 19 variables covering four CAMEL categories. Looney et al. (1989) and Lane et al. (1986) used a stepwise approach to narrow their set of variables from 21 to 4. A majority of the studies examined only four of the CAMEL factors and excluded a representative measure for management, as it proves to be the most difficult measure to capture.

2.1.7 Capital Adequacy (C)

Capital Adequacy is a measure of a financial institution's financial strength, in particular its ability to cushion operation and abnormal losses. Commercial bank should

have adequate capital to support its risks assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities

One of the most critical of all banking problems in recent years centers upon raising and maintaining sufficient capital. The word has special meaning to a banker-capital refers principally to funds contributed by the bank's owners, consisting mainly of stock, reserves, and those earnings that are retained in the bank (Rose, 1999). The capital accounts of a commercial bank play several vital roles in supporting its daily operations and ensuring its long-run viability. In the first place, capital provides a cushion against the risk of failure. Second, capital provides the funds need to get the bank charter, organized, and operating before deposits comes flowing in. Third, capital promotes public confidence in a bank and reassures its creditors (including the depositors) of the bank's financial strength. Fourth, capital provides funds for the organization's growth and the development of new services, programs, and facilities, and finally, capital serves as a regulator of bank growth, helping to ensure that the individual bank's growth is held to a pace that is sustainable in the long run.

In simple term, the capital is defined as wealth employed in production process to generate more wealth and profit. Capital includes any funds thus employed. In financial and accounting term capital can be defined as the excess amount of assets over liabilities. Financial institutions or/ and commercial banks produce loans and financial innovations (or financial products) to facilitate trade transactions. Because of special role they play in the economy, they are heavily regulated by concerned authorities. Thus the capital and composition of the capital components is different in these institutions. The Bank and Financial Institution Ordinance 2061 B.S. has defined Capital funds of a bank as, paid-up equity statutory reserve, retained profit and other reserve prescribed by Nepal rastra Bank from time to time.

Oxford Dictionary of Business Second Edition defines that the money contributed by he proprietors to an organization to enable it to functions' thus share capital is the amount provided by way of loans. However, the capital of the proprietors of the companies not

only consists of the share and loan capital, it also includes retained profit, which accrues to the holders of the ordinary shares. Similarly, Timothy W. Kiach and S. Scott MacDonald defines that funds subscribed and paid by stockholders representing ownership in a bank. Regulatory capital also includes debt components and loss reserves.

How much capital a bank should have has been one of the most controversial issues in the history of the banking industry. Much of the controversy has evolved around two questions: who should set capital standards for bank capital? Major function of the capital to absorb loss and to assure the society that the bank can run even tat the time of adversity. If the bank has risk free assets may not keep the alive. View of the regulator and management always contradict in the issue of how much is adequate capital.

Adequacy and bank capital directly affects the banking transaction. The adequacy of bank capital is the most important aspect of bank. If there is inadequacy of capital, the bank should step for the adequacy of capital as per legal requirement. The bank should remove the inadequacy of bank capital though the medium of collecting of ownership and borrowed capital. The bank should pay question to may things for the adequacy of the capital. To have the ownership over capital is most for the bank. It crates many opportunities. The bank should reduce the amount of the borrowed capital as far as possible. It is not good for a bank ot collect borrowed capital in the bank. Also, it is not good for it to have crises of capital. If the bank can not maintain the adequate capital, it may give birth to many defects. The defect caused by the bank capital, does not lead the bank forwards.

Therefore, special attention should be given to the capital adequacy system of the bank capital, if there is scarcity of capital in a bank, bank's financial health can't be regarded capable and healthy.

The advantages of the bank capital adequacy are as follows:

i. If the bank has an adequate bank capital, people trust upon such banks. Such bank becomes successful to; gain the trust of all sectors.

ii. If the bank has adequate capital, it can invest into any sectors at any time from which the bank gets success to gain a lot of profit.

iii. The bank does not need to take loan, and does not have to pay interest

iv. The bank doesn't face problem to collect the capital.

v. There will be not possibility of liquidation of bank.

The adequacy is necessary for the bank with the above given reasons. The bank should be alert about the adequacy of bank capital: - The bank solve it well, though, the establishment of a bank with the objectives of gaining profit is not good. So, the bank should' keep the balance of the adequacy of bank capital

New BASEL Capital Accord

In today's modern world, credit institutions are not playing merely as financial mediators but also widely involved in off balance sheet and other innovative financial transaction, having variety of risk. Hence, it calls for professional handling of business followed by close monitoring and supervision. In this regard the BASEL committee has been coordinating internationally in the field of banking regulation and supervision since many years. The Committee was established in 1975 by the central bank governors of the group of the group of ten (G-10) countries. The committee has established minimum capital standard in banks with its member countries in July 1988, further this standard have been implemented in the most of the countries of the world. It was indeed the first international standard in the area of capital requirement for the better solvency of a banking institution. Further BASEL. Committee developed New BASEL Accord and published it for the world wide discussion in 1999. As a result the New Capital Accord was introduced (BASEL, 2000).

BASEL committee set out a minimum capital requirement of 8 percent for banks in 1988. Prior to that, the committee introduced 25 core principles on effecitve banking supervision. In 1996, the committee incorporated market risk in the 1988 capital accord. It was followed by the publication of a consultative paper of BASEL New capital accord (BASEL-2) in 1999. It was the major revision of the 1988 accord. In this accord, capital

adequacy, supervisory review process and market discipline are set out as a pillar 1, pillar 2, and pillar 3.

Implementing the new accord in Nepal has been a challenging task for the supervisors as well as financial institutions. Hence, certain preparatory homework is needed to Nepalese financial system to implement BASEL-2. Nepal Rostra Bank and financial institutions need to have coordinated effort efficiently in Nepalese banks and financial institutions to establish certain baseline for the effective implementation of BASEL II, NAB has adopted Basel Core Principles for Effective Supervision as guideline for supervision of commercial, Banks. Core principle methodology adopted by Basel Committee provides a uniform template for both self-assessment and independent assessment. It involves four part qualitative assessment system: compliant, largely compliant, materially non-compliant, and non-compliant. For each principle essential and additional criteria are defined. To achieve a "compliant" assessment with a principle, all essential and additional criteria must be met without any significant deficiencies. A "largely compliant" assessment is given if only minor short comings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially non-compliant assessment is given when the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance, but substantial progress has been made. A "non-compliant" assessment is given when no substantial progress towards compliance has been achieved.

The Basel Committee on Banking Supervision has issued new capital accord (Basel II), which shall be applicable to internally active banks all over the world with eject form end of 2006. In this regard, second interaction program was held in Nepal with the banks executives to make aware of the new development. The commercial banks so far has shown positive attitude towards the implementation of Basel II. "New Capital Accord Implementation Preparatory Core Committee" was drafted "Nepal Rastra Bank's Concept Paper on New Capital Accord implementation, concept paper was forwarded to all the commercial banks for comments and recommendations. A form was also developed 'so that commercial bank classify their exposures as per the new approach, which was reviewed by the "Basle-II Implementation Working Group"

There is no doubt that the new accord though complex carries a lost of virtues and will be a milestone in improving banks internal mechanism and supervisory process. It will beneficial to the commercial banks, as it requires review and measurement of risk, which ultimately have effect of risk management approach to comply with the accord standards.

Directive Relating to Capital Adequacy Norms by NRB

The total capital fund is the sum of core capital and supplementary capital. On the basis of risk-weighted assets, the bank should maintain the prescribed proportion of minimum capital fund as per following:

FY	Require Capital fund on the basis of Risk-Weighted Assets (%)	
	Core Capital	
2058/59	4.5%	9.0%
2059/60	5.0%	10.0%
2060/61	5.5%	11.0%

According to the Nepal Rastra Bank Act 2058 and NRD Directives, the capital funds of a bank comprise the following:

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

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

Banking and Financial Institution Ordinance 2061 also assimilated the same things, which were included and explain in Nepal Rastra Bank Act 2058, in regard of bank capital. Nepal Rastra. Bank Act is effective from 1st shrawan 2058, in regard of bank capital. Nepal Rastra. Bank Act is effective from 1st shrawan 2058 (July 16th 2006): According to the NRD directive, minimum paid-up capital requirement for establishment of commercial banks is as under.

i. Rs 250 million to operate all over Nepal except Kathmandu Valley
ii. Rs 100 million to operate all over Nepal.
iii. All existing commercial banks are required to raise capital base to RS. 1000 million by mid July, 2009 through minimum 10 percent paid-up capital increment every year.

Generally, the representative measure chosen for basic capital (C) has been a ratio of primary capital to assets (Estella, et al., 2005a; Tam and Kiang, 1992; Elliott, 1991; Looney et al., 1989; Lane et all 1986,. MV in, 1977): Estella et al. (2005a) utilized three measures, including a more complex weighted measure, but found the simple measures of capital demonstrated relatively good explanatory power over short time horizons, while risk-weighted ratios provided relatively better explanatory power over longer horizons, while risk-weight ratios provided relavely better explanatory power over longer horizons. Eccher et al (1996), Thomos (20091), Whalen (1991) and Sinkey (1978) employed an analogous ratio definition, but with a refinement of adjust for loan losses, which theoretically would account for some portion of related risk in the asset portfolio (Cantor, 2006).

2.1.8 Asset Quality (A)

Loan and advances dominate the asset side of the balance sheet of any bank. Similarly, earnings from such loans and advances occupy a major space in income statement of the bank. However, it is very important to be reminded that the most of the bank failures in the world are due to shrinkage in the value of loan and advances. Hence, loan is known as risky assets. Risk of non-rep0ayment of loan is known as credit risk or default risk.

Asset quality has direct impact on the financial performance of a financial institution. The quality of assets particularly, loan assets and investments, would depend largely on the risky management system of the institution. The value of loan assets would

depend on the realizable value of the collateral while investment assets would depend on the market value. Asset quality measures how effective an institution is at lending money to people who are willing and able to pay bank. These measures the institution is at lending money to people who are willing and able to pay it bank. This measures the institutions asset quality, and consequently, the risk to its capital, given delinquent or nonperforming loan default.

What is asset quality? In theory, it is the extent to which a bank's assets namely its earning assets comprised of loans and securities, are likely to be repaid in accordance with their terms., In practice, it is more often than not refers to the degree to which a bank's loans are-performing or non-performing, the proportion of non-performing loans (NPLs) to total loans being a key measure of asset quality. While a look at a bank's NPL ratio reveals much when viewed in relation to its historical performance and to other comparable banks, depending upon nominal NPL figures alone rarely goes far enough in discerning a bark's true asset quality. Much of the problem is one of definition: how, precisely, is a NPL defined being the most salient example.

Lending is the essence of commercial banking; consequently, the formulation and implementation of sound lending policies are among the most important responsibilities of the bank directors and management (Crosse, 1963). A sound investment policy of a bank is such that is funds are distributed on different types of asset with good profitability on the on hand and provides maximum safety and security to the depositors and bank on the other hand. Moreover, risk in banking sector trends to be concentrated in the loan portfolio. When a bank gets into serious financial trouble its problem usually spring from significant amounts of loans that have become uncollectible due to mismanagement, illegal, manipulation of loan misguided lending policy or unexpected economic downturn. Therefore the banks investment policy must be such that it is sound and prudent in order to protect public funds (Baidhya, 1967). While forming the lending policy each commercial bank has to consider various factors. Commercial bank should consider the national interests followed by borrower's interests and interest of the bank itself, before lending to the customers (Clemens, 1983).

The purpose of a variable representative of assets in CAMEL is to reflect the major assets this could include variables related to loan concentrations, risk and/or to total assets, (Thomson, 1991; spahbodi, 1991; Whalen, 1991; Sinkey; 1975; Martin, 1977), Looney et al. (1989) measured loan quality as the ratio of commercial loans to total assets, while Thomson (1991) includes the index for different types of loans, including commercial and industrial loans. Tam and Kiang (1992) utilize several variables representative of various types of loans; including' measure of commercial and industrial loans to total loans and the log fo commercial loans to total loans to be significant.

Non-Performing Assets (NPAs): Loans and advances of financial institutions are meant be serviced either the part of the principal or the interest of the amount borrowed in stipulated time as agreed b the parties at the time of loan settlement. Since the date the loan becomes past dues, the loan becomes non –performing asset of the institution. With the lending institution should effectively operative by means of real transaction effected on the part of the debtor in order to remain the loan performing. The definition of NPA differs with counters. In some developing countries of the Asia Pacific Economic Cooperation (APEC) forum, loan is classified as nonperforming only after it has been in arrear for at least six months. In India after three months from the date of deemed commercial production to realize In India after three months from the date of demand commercial production to realize interest income, any default or reschedule meant was considered as an NPA on the book of accounts. Loans thus defaulted are classifies into various categories having their differing implications on the asset management of financial institutions.

NPAs are classified, according to international practice, into three categories depending on the temporal position of loan default. Substandard, doubtful and loss assets are the categories one the basis of the time barred to repay either interest or the principal. Substandard assets are those assets which are classified as NPA for a period not exceeding two years. Loans the repayments of principal or interest not honored Up to two years from the scheduled date fall under this category. The doubtful assets form those loans which are declared NPA for a period exceeding two years. In this category no transaction in terms of repayment by the loaner takes place for more than two years. Loss

Assets are those assets for which the creditor institution or is auditors, exothermal or term pr the sponsor authority's instructions term as non-recoverable but so far nt written off. This is the degree of NPA assets depend solely on the length of time the asset has been in the form of non-obliged by the loance. The more time it has elapsed he worse condition of assets is being perceived and such assets are treated accordingly. However, the treatment of NPAs depends according to countries. No uniform rule seems to apply.

Factors Generating NPAs: Financial resources are scarce resources having competing uses. The ands therefore have costs in the form of interest payment to creditor institution and business risk. Modern age characterizes the competitiveness of any undertaking that demands judicious decision in business enterprises. NPAs my arise due to failure of business for which loan was used. Changes in the perceived norms of the-market may subject to fail the undertaking. Management of the enterprise is no less significant than financial management to ensure the cash flow as per projection. Whatever may be the reasons for failure of business, it obstructs the carrying out of timely payments of financial obligations.

On the other part of appraising institutions, if the credit appraisal is not made properly, the stream of income projected at the time of preparing the project does not comply with the perceived manner. Defect in appraising projects breed mismatch not only in investment planning but also in receivables due to defective projection of returns. Large portion of NPAs in developing countries arise due to defective and standard credit appraisal system.

Operation of an enterprise alone does not quality the firm successful ensuring prompt repayment of financial obligations. Constant monitoring of financed projects by the creditors is one of vital aspects of the activities of credit institutions. Projects normally accepted looking into the sound functioning propositions that include the managerial ability of the entrepreneurs. Monitoring of projects in time provide insurance against failure of enterprises through rectification of minor flaws that appear during the course of operation.

Approval of loans, if are not based on proper scrutiny of facts and sound financial principles, may culminate the project into failure. In jack of proper attention into the nitty gritty of projects the resources of financial substitutions collected through deposits from people may be mis-utilised. Recklessness or negligence on the part of the officials while approving the loan will turn into default.

Risk seeking attitude of the official that does not amount to sincere corporate culture also leads to breed drawbacks in the payment of dues to financial institutions. NPAs tend to increase when undeserved behaviors of the officials take place. Individuals holding office when resort to take undue benefits, the institution employing such people is bound to suffer incurring defaulters to recover loans promptly.

The credit programmers sponsored by the government are regarded as the source of NPAs. For political benefits government, without assessing the financial feasibility of the credit programmer, announces and compels the credits agencies to go along with the declared policies. Backing for the policy by the governments is mistakenly signaled to the debtors that the amount involved is no other than a dole. More over, unscrupulous politician from the experience in Nepal and India by the manifestation of higher percentage of NPAs found in priority sector loans.

Quite often the definition of the NPAs and accounting norms adopted by concerned agencies also amount to higher or lower magnitude of such assets. Each institution may have different norms to declare the assets whether it is nonperforming. The income cycle of the project and amount of loan involved, set the installments of loan repayment. The nature of project also determines the level of NPAs.

Slow down in economy, global as well as domestic particularly in industrial sector, contributed to adversely affect the bottom line of borrower units and their capacity to service the debt (Taori-2009). Recession debars the economic activities to run smoothly which affect the performance of financial institutions.

Implications of NPAs: Upon the stoppage of repayment of interest of matured principal the credit institutions are debated from further investment of funds out of own income.

Interest incomes from such assets are reduced to the extent of declared amount as NPAs. Size of the learnable fund is limited due to constrained flow of income to the institution. The assets that have been declared non-performing emanate from the deposits made by savers who have entered into a contract of paying interest. The interest expenses of the credit agency do not reduce though the investment funds turn into income non-yielding.

The liability of credit agencies does limit to the amount declared non-performing asset but extend to extra amount that requires by regulation of supervisory authorities in the form of provision. The amount required for provision depends oh the level of NPAs and their quality. Increased proportion NPAs generates additional liability of resources to the financial institutions.

Financial crisis emered from Thailand in South East Asia countries largely is considered to be due to higher level of non-performing assets exised with the financial institutions. The situation was grave when the assets did cease to repay loans to credit agencies on the amount which was borrowed from overseas capital marked. Investment in domestic market did not provide returns, hence the amount involved turned into non-performing while repayment schedule to lending agency overseas was matured. Failure to honour the repayment o due time was the principal reason to result in financial crisis that terminated into economic crisis in South East Asia countries (Mukherjee, 2008).

Rising level of NPAs create a psyche of worse environment especially in the financial sector. Depositors are not interested to save. Rather the hard earned savings are diverted to consumptions. Consequently the saving pattern hence investment is affected thereby creating an unhealthy atmosphere in the financial sector.

Facts about NPAs- Financial crisis occurred in Asia had the higher proportion of NPAs emanate from loans, which constituted highest share in the total assets of financial institutions. Countries with higher proportion of loan in the total assets of banks and finance companies became vulnerable while institutions with lower share of loans in the total assets were affected less. Of the total assets of commercial banks in Nepal, total credit accounted 47.2 percent in the fiscal year 1997.87 (NRB, 2009). Similarly India had

the proportion of loan in the total assets as 42.0 percent while those figures for Thailand, Indonesia and Malaysia were 78 percent, 70 percent, and 69 percent respectively (Mukherjee, 2009). Empirically, it has bee seen that Nepal and India having lower proportion of loan in respect of total assets provided cushion to make ample provision and therefore were least affected by the financial crisis. On the other hand the South East Asia tigers with relatively higher proportion of loans in the total assets of the financial institutions fell victim of the shock of regional crisis.

The level of NPAs of financial institutions tends to shoot up with the lack of alertness of the measures to shoot up with the lack of alertness of the concerned institutions for follow up the recovery measures. In some cases diversion of funds and overstaffing have also contributed to accumulation of big NPAs. Since bad loans are the source of financial crisis in most cases of the modern day, policy markers need to show concerns to contain the level of NPAs.

Measures Redressing the Problem of NPA: NPAs, no doubt, are the issues of concern o financial institutions but should be accepted as 'necessary' evil viewing the occurrence of it in almost all sports of countries. It is, however, should be taken as the problems that have solutions. The solutions may have be of two types; the first with a view of reviving the activities of the agency with redressing measures, and second y eliminating the institution itself.

In the first category, the credit agency may be encouraged to reduce the level of NPAs by waiving the interest to be paid notionally. By doing so the debtor may feel less burden of interest obligation and be enable to pay the due regularly. Rescheduling of loans known as 'ever greening' also may help to address the problem f lapse in repayment caused due to circumstances hindering income flow temporarily. In the circumstances of short of capital, may be operating one, refunding the enterprises would also provide positive contributions to lessen NPAs. The institution may choose to write the due if any possibility of recovering loan exists. Carrying forward the amount that has no possibility to recovery only add up liability and therefore, write off becomes logical option.

The debtor may be invited to enter into compromise settlement. The debtor and creditor as per the objective conditions existing between the two may help to arrive at common consensus. One time settlements may be another option that encourages to settle the issue of payment on the basis of the conditions of funded project. Debts labeled as NPAs could be recovered by appointing priate recovery agents whose cost of collection might be lesser than the creditor agency. The willful defaulters and the NPAs resulted due to fraud or malfeasance may be treated harshly with the help of tribunals constituted with the help of law of the land.

High proportion of NPAs of any credit agency may not be justified to operate on the grounds of lack of viability, and should be treated accordingly. Closure of such agencies limits further liabilities. Similarly merger of such agency with other institution may also be suggested if possibility to continue with the experienced staffer and better clientele still exists. These are the measure eliminating the very existence of the agency.

Directives relating to assets quality by NRB: With the objectives of lowering the risk of over concentration of bank loans to a few big borrowers and also to increase the access of small and middle size borrowers to the bank loans, NRB has directed commercial banks to set an upper limit for single borrower limit. According to the directive, Commercial banks may extend credit to a single borrower or group of related borrowers the amount of fund based loans and advances up to 25% of the core capital and non fud based off balance sheet facilities like letters of credit, guarantees, acceptances, commitment is up to 50% of its core capital fund. The banks are required to adjust as per new regulation in phase wise manner as follows:

Time	Fund based credit limit	Non-fund based credit limit
By end of Ashad 2059	40% of core capital	75% of core capital
By end of Ahad 2060	25% of core capital	50% of core capital

The exposure limits above shall not be applicable in respect of the following:

Credits and facilities extended against fixed-deposit, receipts, deposits placed with the bank, government securities, NRB bonds as well as against unconditional guarantees issued by the World Bank, ADB etc.

Advances and facilities to be used for the purpose of importing specified merchandise by the following public corporation:

Name of the corporation	Merchandise
Nepal Oil Corporation	Petrol, Diesel, Kerosene, and L.P.G. gas
Agriculture Input Corporation	Fertilizer, seeds
Nepal Food Corporation	Cereals

Effective fro FY 058/59 (2006/02), Banks should classify outstanding loans and advances on the basis of aging of Principal amount, Loans and Advances should be classified into the following four categories:

Pass: Loans and Advances whose principal amount are not past due and past due for a period up to 3 months included in this category. These are classified and defined as performing loans.

Substandard: All loan and advance that are past due for a period of 3 months to 6 months included in this category.

Doubtful: All loans and advances, which are past due for a period of 6 months tolyear, included in this category.

Loss: All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall included in this category.

Loans and advances falling in the above category of sub-standard, doubtful and loss class are defined as non-performing loan. Her, if it is appropriate in the views of the bank management, there is no restriction in classifying the loan and advances from low risk category to high risk category. For instance, loans falling under sub-standard may be

classified into loss category. In addition, the term loans and advances include bills purchased and discounted.

The loan loss provisioning, o the basis of the outstanding loans and advances and bill purchased classified as above should be provided as follows:

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

Loan loss provision set aside for performing loans is defined as general loan loss provision and loan provision set aside for non-performing loan is defined as specific loan loss provision.

2.1.9 Management Quality (M)

The performance of the other four CAMEL components will depend on the vision, capability, agility, professionalism, integrity and competence of the fin ancial institution's management. As a sound management is crucial for the success of any institution, management quality is generally accorded greater weighting in the assessment of the overall CAMEL framework.

The quality of management is probably the single moist important element in the successful operation of a bank. For the purposes of this section, management includes both the board, of directors, which is elected by the shareholders, and executive officers, who are appointed to their positions by the board. In the complex, competitive, and rapidly changing environment of financial institutions, it is extremely important for all members of bank management to be aware of their responsibilities and to discharge those responsibilities in a manner which will ensure stability and soundness of the institution, so that it my continue to provide to the community the financial services for which it was created. The extreme importance of a bank director's position is clearly emphasized by the

fact that bank directors car, in certain instances, be held personally liable. Also, Government must placed greater emphasis on the role of bank management by passing legislation which allows regulatory authorities to utilize cease actions against individuals (instead of solely against the institution) to assess civil money penalties (CMPs), and even remove an officer, director, or other person participating in the affairs of the bank when their gross negligence or disregard for safety and soundness considerations threatens the financial safety of the bank. The board of directors is the source of all author its and responsibility. In the broadest sense, the board is responsible for formulation of sound policies and objectives of the bank, effective supervision of its affairs, and promotion of its welfare. On the other hand, the primary responsibility of executive management is implementation of the board's policies and objectives in the bank's day-to-day operations. While selection of competent executive management is critical to the successful operation of any bank, the continuing health, viability, and vigor of the bank are dependent upon an interested, informed and vigilant board of directors. Therefore, the main thrust of this section is devoted to the powers, responsibilities, and duties vested in bank directors.

Researchers construct various financial ratios to capture management quality. Meyer and Pifer (1970) sate that "Managerial ability is like Lord Action's elephant difficult to define but easy to identify. Over a period of time difference between good and poor management will be systematically reflected by the balance sheet and income data, and analysis of such data should enable prediction of failures. "Graham and Homer (1988) evaluate the factors that contributed to the failure of 162 national banks in USA and conclude that more than 60 percent of failed banks experienced poor management, measured by such variables as pcoriy followed loan policies, inadequate problem loan identification systems, and non-existent or poorly followed asset/liability management. Barr and Siems (1993) provide the only direct measurement of management quality, using Data Evelopment Analysis (DEA) to quantify the quality of management. They concluded that the predictive performance of their failure-prediction model improves markedly with the inclusion of the DEA efficiency variable.

The problematic variable for researchers in the development of CAMEL models has largely been the choice of a representative measure for management quality (M). Sinkey (1975) purported that a specific ratio representative of management is difficult to

identify, but his view was that many ratios are proxies. Often, researchers (Tam and Kiang, 1992; Espahbodi, 1991;- West, 1985) have not attempted to include a variable to represent management quality. Thomson (1991) and Whalen (1991) employed the ratio of overhead expense to total assets as representative of management operating efficiency. As none of the ratios from previous research exhibited significance.

2.1.1 Earnings quality (E)

The quality and trend of earnings of an institution depend largely on how well the management manages the assets and liabilities of the institution. A financial institution must earn reasonable profit to support asset growth, build up adequate reserves and enhance shareholders' value. Good earnings performance would inspire the confidence of depositors, investors, creditors, and the public at large.

Profit is an important factor that determines the firm's expansion and diversification. A required level of profit is necessary for the firm's growth and surviveness in the competitive environment. Profitability is the measurement of the worth of the selected investment in various categories of assets depending largely on sases performance and operative efficiency. Profitability is vitally more important than assuring that a bank stays in business or activity (Walker, 1974). It is true that a bank's survival is determined by the generation of profit, and profit itself is the measure of its overall success. In doing so, it is important that earning power of the bank should compare with the interest obligations incurred on funded deposits. Since shareholders' satisfaction with a bank relates to the stability of earnings as well as t the rate of earnings, bank manager try to avoid variability by "smoothing out" the peaks in the ongoing record of reported earnings (Shank and Burnell, 1974).

Profitability and liquidity are opposing considerations. The secret of successful banking is to distribute resources between the various forms of assets in such a way as to get a sound balance between profitability and liquidity (Crowther). A banker is loans in order to make more profits, and on the other, he is anxious to hold sufficient cash so that

he can at all time fulfill his obligations to pay cash on demand (Hansen). Thus A prudent banker always tries to balance between liquidity and profitability.

The purpose of the earnings (E) measure in CAMEL is providing a ratio representative of management's level of effectiveness in utilization of assets to earn profits. Past research provides a general supportive consensus for utilization of return on assets (Tam and Kiang, 1992; Thomson, 1991; Espahbodi, 1991; Whalen, 199; Martin, 1977).

2.1.2 Liquidity (L)

Sound bank management always involves prudent actions to assure liquidity. Adequate liquidity to deal with commitments and unanticipated need for funds at a reasonable price is a hallmark of a well-managed banking company. A financial institution must always be liquid to meet depositors' and creditors' demand in order to maintain public confidence. There needs to be an effective asset and liability management system to minimize maturity mismatches between assets and inabilities and to optimize returns. As liquidity has inverse relationship with profitability, a and to primize returns. A s liquid if it has ready access to immediately spend able funds at reasonable cost at precisely the time those funds are needed (Pater, 2009). Lack of adequate liquidity is often one of the first signs that a bank is in serious financial trouble. The troubled bank usually begins to lose deposits, which erodes its supply of its more liquid asset. Other banks become increasingly reluctant to lend the troubled bank any funds without additional security or a higher rate of interest, which further reduces the earnings of the problem institutions and threatens it with failure.

Oxford Dictionary of Business Second edition defines liquidity as the extent to which an organization's assets are liquid, enabling it to pay its debts when they fall due and also to move into new investment opportunities. The bank liquidity is the ability of bank to meet its current obligations for cash outflow and to respond to changes in customer demand for loans and cash outflow and to respond to changes in customer demand for loans and cash withdrawals without selling assets at a substantial loss. Bank assets are liquid to the extnt that they may be easily converted into cash without loss (Johson, 1993). Similarly, Koch emphasis that liquidity refers to more that just having

cash avilable, it also rifers to the banks and financial institutions' capacity to have immediate access to available, reasonably priced funds. However, the relationship between banks and financial institutions' cash liquidity requirements is institutions must convert assets to cash. Liquidity entails the eash with which banks and financial institutions convert these assets into a cash with the minimum loss. Gardner and Mills stresses that having sufficient liquidity is important not only for deposit withdrawals or the provision of loans but also for regulatory purposes. Because of the volatility of deposit withdrawals or the provision of loans but also for regulatory purposes. Because of the volatility of deposits, the regulatory authorities set certain liquidity requirements to which banks and financial institutions must adhere. Likewise, Prof. R.S. Sayers said that to earn profit at all the banker must maintain confidence. To monition confidence he must maintain adequate degree of liquidity in his assets. He further said that liquidly is the word that the banker uses to describe his ability to satisfy demands for cash in exchange of deposit.

Finally, liquidity needs of commercial banks are unique because in no other types of business there will be such a large proportions of deposits payable on demand. Inadequate liquidity in does damage credit-standing of those organization but if banks fail to repay the deposits on demand, the bank loses the trust of the public. This leads to "runs" in the bank and probably bankruptcy thereof.

Adequate liquidity performs following functions:

Reassurance to creditors, especially retail depositors of certificates of deposit, time deposits, repurchase agreements, other financial institution (such as correspondent banks), and holders of debt securities. Lack of liquidity and public knowledge of it can lead to a "run" on the bank.

Ensures ability to meet prior commitments such as commitments to make loans. These commitments can be legal and formal, such as revolving credit loans or informal, such as a typical seasonal line of credit.

A voids force sale of assets. For example, if a bank becomes illiquid in a high interest rate environment, it can be forced to sill securities at a likely substantial discount. In addition, it can be forced to sell loans-also at a discount.

Precludes having to "pay up" in the market. A bank with liquidity problems will surely have to pay substantially higher rates for deposits, CDs, debt securities, and the like.

A voids use of the Central Bank Discount Window. The Central Bank is the "lender of last resort" for banks, and any institutions utilizing it can be assured of increased scrutiny or more likey punitive actions.

Theories of Liquidity Management

There are apparent conflicts between objectives of liquidity, safety and profitability relating to a commercial bank. Economists have tried to resolve these conflicts by laying down certain theories from time to time. These principles or theories, in fact, govern the distribution of assets keeping in view these objectives. They have also come to known as the theories of liquidity management which area discussed under:

The Real Bills Doctrine: The real bills doctrine states that a commercial bank should advance only short-term self liquidating productive loans to business firms. Self liquidating loans are those which are meant to finance the production, storage, transportation, and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. Shuch short-term self liquidating productive loans pass three advantages. First, they process liquidity that is why, they liquidate themselves automatically. Sound, since they mature in the short run and are for productive purpose, there is no risk of their running into bad debts. Third, being productive such loans earn income for the banks.

The Suitability Theory: H.G. Moulton who asserted that if the commercial banks maintain a substantial amount of assets that can be shifted on to the other banks far cash without material loss in case of necessity, then there is no need to rely on maturities

propounded the suitability theory of bank liquidity. According to this view, an asset to be perfectly shiftabilty must be immediately transferable without capital loss when the need for liquidity arises, However, in a general crisis requires that all banks should possess such assets, which can be shifted on to the central bank which is the lender of the last resort. This theory has cetain elements of truth.

The Anticipated Income Theory: The anticipated income theory was developed by H.V. Proch in 12944 on the basis of the practice of extending term loans by the USA commercial banks. According to this theory, regardless of the nature and character of a borrower's business, the bank plans the liquidation of the long term loan from the anticipated income of the borrower. A term loan is for a period exceeding one year and extending to less than five years. It is granted against the hypothecation of machinery, stock and even immovable property. The bank puts restrictions on the financial activities-of the borrower while granting this loan. At the time of granting a loan, the bank takes into consideration not only the security but the anticipated canings of the borrower. In fact, the anticipated income is the main consideration. This theory is superior to the bills doctrine and the suitability theory because it fulfills the three objectives of liquidity, safety, and profitability

The Liabilities Management Theory: This theory was developed in the 1960s. According to this theory, there is no need for banks to grant self-liquidating loans and keep liquid assets because they can borrow reserve money in the money market in cash of need. A bank can acquire reserves by creating additional labilities against it self, from different sources. These sources includes the issuing of time certificates of deposit, borrowing from the other commercial banks, borrowing from the central bank, raising of capital funds by issuing shares, and by plaguing back or profits.

Techniques of Liquidity Management: Techniques for liquidity assessment have evolved over the years with the significant changes in the monetary policy operating procedures. Despite the uncertainty in predicting liquidity conditions, econometric models could be used to provide first indicative forecasts, given the estimated structure of inter=relationships based on past information, Various methods were identified to

determine the long term liquidity need including seasonal and cyclical trend, contingency forecasts, gaps analysis, and liquidity at risk. To provide for the short-term and long-term liquidity needs, the liquidity position must be managed actively. This will ensure that the right sources of funds are used for the liquidity need, thereby reducing the cost of funding. The treasury or fund manager of any banks and financial institutions should adopt following techniques for effective liquidity management

Liquidity Planning: The liquidity planning entails the accurate estimation of liquidity need and the structuring of the portfolio to meet the expected liquidity needs. It is essential to minimize unanticipated large deposit outflows. The liquidity planning takes place on two levels, namely planning to manage the required reserve position and estimating liquidity needs that arise from sensorial and cyclical changes and growth prospect. To ensure that funds are available to meet the liquidity needs at the lower cost, the treasury manager of the banks and financial institutions must manage its money position to comply with the reserve requirements as well as managing its liquid sources.

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

Managing the Liquidity Position: Once the liquidity needs of the banks and financial institutions have been estimated, the treasury manager must decide how these needs are to be funded. The banks and financial institutions must choose between two general liquidity management strategies, namely, asset management and liquidly management. In the assets are sold to meet liquidity needs. In the liability management, money is borrowed to meet liquidity needs. A combination of these strategies is normally employed and the factors dealing with matching liquidity sources and needs are applicable when choosing the liquidity management strategy. The following guidelines must be kept in

mind by the treasury manager when managing the liquidity position of the banks and financial institutions:

The treasury manager must coordinate and keeps track of the activities and strategies of the fund=raising and funds-using department within the bank and financial institutions.

The treasury managers should know the timing of large withdrawals from big credit clients or depositors in order to plan.

The priorities and objectives of liquidity management should be clear and properly communicated.

The needs and decisions must be evaluated on a continuous basis to invest access liquidity and avoid liquidity shortages.

Controlling Liquidity Risk: To asses how well the banks and financial institutions are managing its liquidity position, it only has to look at the market place. The managemet should be cautious on the following signals from the marketplace that indicate a pending liquidity problem:

Public cfonfidence in terms of withdrawal of deposits from the banks and financial institutions.

Share price behavior, falling share prices indicate perceived liquidity problem.

Risk premiums on money market borrowings.

Losses because of the hasty sale of assets for liquidity purposes.

Inability to meet the demands of new credits customers.

More frequent and larger borrowings from the central bank.

Considering the aforementioned technique, the treasury manager must also consider the purposes of the liquidity need the length of time for which funds are needed, the access to liability markets, the costs and characteristics of various liquidity sources and interest rate forecast. It is revealed that the large banks have better access to liability liquidity sources

due to the better quality assets and a broader capital base. The small banks have to rely more on assets for liquidity: Thus, an effective liquidity management is essential to reduce costs.

A liquidity ratio measures an entity's ability to pay its short-term obligations out of liquid assets. Liquidity (L) was generally represented in previous studies with a ratio of cash (with some adjustment for short-term liquid securities) to total assets (Tam and Kiang, 1992; Espahbodi, 1991; Lane et al., 1986; Martin, 1977; Sin key, 1975)

Directives relating to Maintenance of Liquidity by Nepal Rastra Bank

The Nepal Rastra Bank had given the instruction to the commercials banks in 2023 B.S. to deposit the amount the amount ratio of 8 percent from their liability of deposit. A provision of fine also has made for failure to deposit, less money than the fixed money stock (balance). In the beginning of 2047 B.S. the increase in the quantity of internal credit was very high and began to show negative effect on economy. The deflation grew up to 21 percent. So, high liquidity appeared in economy, hence, control of the negative effect that may fall on economy to improve the growth of price rate and improvement of the position of loss of running account and control the capacity of flowing the loan of the commercial banks, was necessary and the Nepal Rastra Bank second time prescribed liquidity ratio. It has made compulsory to invest 24 percent the amount of the total deposit of the commercial bank in the bond of government, in treasury bills, or the bond of the Nepal Rastra Bank. With some signs of improvement of economy appeared and the investment ratio has been revised accordingly, since Poush 2049 B.S. In this way, provision has been mad for the commercial banks to deposit 4 percent in their own treasury 8 percent in the Nepal Rastra Bank's account. Since the binning of 2050 B.S., the sign of improvement began to appear in economy and the rate of deflation fall down to 8.8 percent. An, Government removed the provision of investing in the bond of government in Treasury bill or in the bond of Nepal Rastra Bank.

With EFFECTIVE FROM, 2054, Chaitra 31th, it has been provided, for commercial banks are to keep the balance with in NRB was 8 percent for the liquidity of

current and saving deposit and 6 percent from deposit. They have to maintain cash stock, which is to keep in their own treasury, 3 percent from the total deposit. But this type f provision also has been changed by NRB. To ensure adequate liquidity in the commercial banks, to meet the depositors" demand for cash at any time to inject the confidence in depositors regarding the safety of their deposit funds, following arrangements have been put into force by Nepal Rostra bank effective from 22 July 2007 (2059/04/06).

Prevailing directives with respect to maintenance of Cash Reserve Requirement (CRR)

a)	Balance held with Nepal Rastra Bank	1. 7% of current and saving deposit liabilities. 2. 4.5% of fixed deposit liabilities.
b)	Cash in Vault	2% of total deposit liabilities

For the purpose of examination of compliance of liquidity requirement, the procedures will be as follows:

a. The cash reserve requirement will be examined based on the average weekly balance of deposit liabilities of immediately preceding 4th week. If the whole week is holiday, the average weekly deposit balance of the previous week is taken it calculation.

b. A weekly shall comprise from each Sunday trough Saturday.

c. Cash Reserve Ratio is not calculated for the week, which is fully holiday of previous day to be supplied for the holiday) shall compulsorily be submitted to NRB's Inspection and Supervision Department within 15 days from the date of end of the week.

d. For the purpose of calculating the weekly average (Monday to Friday) of total deposit, cash in vault and balance held with NRB, the weekly total aggregate amount is to be divided by 5. Balance of previous day to be supplied if any day happens to be holiday.

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

a. In the case of shortfall in maintenance of balance with NRB and maintenance of cash at vault more than 2 percent, then such shortfall amount.

b. In the case of shortfall in maintenance of balance with NRB and maintenance of cash at vault more than 2 percent, up to 1 percent excess cash of total deposit more than 2 percent, up to 1 percent excess cash of total deposit is added in the balance with NRB, than on such is –added in the balance with NRB, then on such shortfall amount (after adding up to 1 percent excess).

c. In the cash of shortfall in maintenance of cash in vault as well as shortfall in balance held with NRB, then on total shortfall amount.

However, no penalty will be imposed where the liquidity requirement is satisfied, despite shortfall in vault balance, owing to excess balance held with NRB.

The applicable rate of penalty is as follows:

First time shortfall = Equivalent to bank rat/highest refinance rate (currently 5.5% p.a)

For second time shortfall = Equivalent to 2 times of bank rate

For third time shortfall and all subsequent shortfalls = Equivalent to 3 times of bank rate;

The penalty is imposed on the shortfall amount at the rate mentioned above a weekly basis. This means shortfall amount is multiplied by above rate and divided by 52.

2.2 Review of Literalure Related to the Study

2.2.1 Review of Articles

Although, different research works are carried out by different scholars within the various geographical region. Those studies and issues are reviewed in this section, which are related with financial performance analysis of commercial bank and/or the area of the study.

Substantial literature exists that develops bank failure-prediction dowels. Crucial to any such analysis is the identification of those variables that reliably predict future bank failure. Studies adopt a number of different models, including multiple discriminate analysis, factor analysis, proportional hazard models, and logit analysis. The studies use variables that reflect asset quality, liquidity, capital adequacy, and management quality.

Most studies find that capital adequacy, earning ability, and asset quality, measured by the concentration of certain loan types, help to predict bank failure (Sinkey 1975, Pantalone and Platt 1987, Barr and Siems 1993, and Barker and Holds worth (1993) reported that, on average, capital and income slowly deteriorate while past-due loans and charge offs increase as failure approaches. on the other hand, Heyliger and Holder (1991) discover that asset quality, measured by the ratios of loan loss provisions and net charge offs to total loans, do not provide reliable indicators of bank failure.

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

Jackson (1975) conducted a study on commercial bank regulation structure and performance. The study was carried out to identify the determinants of commercial banks allocation efficiency. Both theoretical and empirical microeconomic analysis has applied to examine the competitive effects of banking influences. In this paper, the nature of banking was examined, showing that banks are essentially financial intermediaries that are engaged in greater competition than is commonly believed. Many theories of the firm as a bank are presented emphasizing efficiency-distorting forces such as liquidity provisions. Almarin Phillip's model of complex interaction between banking firms and other influences on observed performance was used to summarize banking theories.

For the empirical analysis purpose, data were collected by covering 1644 banks over the periods 1969-1971. Regression analysis was used to measure the relationship among variables. As a conclusion, the study showed that, the relatively "desirable" banking performance is associated with several traits including an asset size, non-bank competition, low cash holdings, low labor cost, state non member basic status, multi-bank company legislation, national bank status, low time deposits and low equity capitalization. Demand levels and temporal variations also significantly affect the

banking performance. Furthermore, the study showed that the commercial bank regulation, structure and performance are interrelated with each other.

Martin's (1977) study set the standard for discrete-response models of bank failure prediction. Whereas most other research focused on a small sample of banks over two or three years, Martin used all Fed=supervised institutions during a seven year period in the 1970s, yielding over 33,000 observations. In what would become a standard approach, he confronted the data agnostically with 25 financial ratios and ran several different specifications in search o the best fit. He found that capital ratios, liquidity measures, and profitability were the most significant determinants of failure over his sample period. Although Martin did not employ direct measures of asset quality, his indirect measures-provision expense and loan concentration-also turned out to be significant.

West (1985) developed a model to predict bank failure, which differed from the majority of research by utilizing FDIC generated information, rather than data from the financial statements. Some evidence resulted to supported the contention that a loan quality factor (i.e., no-performing loans) had predictive value in this context for monitoring problem banks through its choice in a stepwise logic analysis.

Hirsch horn (1987) used a multi-factor market model to predict quarterly stock returns for the 15 largest U.S. banks between 1979 and 1987. The included both contemporaneous CAMEL rating and lagged quarter-to-quarter changes in CAMEL ratings as explanatory variables. Although the lagged CAMEL values were not useful for predicting stock returns, Hirschhom found that contemporaneous CAMEL ratings were significantly related to stock returns. These results suggest that exam ratings contain useful information, but that most of this information is not private—market participants have either independently inferred this

Information at the time of the exam or this information has been leaked shortly after the exam was completed.

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

Berger and Davies (1994) evaluate the impact of CAMEL rating changes on the parent holding company's stock prince. They separate stock price changes into two components: a 'private information' effect (which identifies the public's awareness of new information discovered by examiners), and a regulatory discipline' effect (which values the regulators' presumed ability to force a bank to change its behavior). Berger and Davies' empirical results provide only weak evidence of a regulatory discipline effect, but they find a strong private information effect. However, the information effect applies only to CAMEL downgrades, which tend to precede stock price declines Consistent with the findings of Hand, Holthausen and Leftwich (1992). Beraer and Davies find no movement in stock prices following a CAMEL upgrade.

Cole and Gunther (1995) provide and examination of several measures to predict bank failure and survival time. Included in their independent variables was one measure of trouble assets. this was defined as a ratio of loans past due by 90days or more plus non-accrual loans plus other real estate owned assets to gross assets, which is similar to an overall measure of the category of non-performing loans as used in some capital markets research. Cole and Gunther provide evidence that this measure was significant in explaining bank failure and survival time; however, they do not note the classification accuracy of the model developed, nor use the model for prediction. Cole and Gunther (2008) found that new (less than 6 months old) CAMEL ratings more accurately predict bank financial distress than financial ratios can, but that financial ratios are better predictors than older (more than 6 months old) CAMEL ratings.

Berger, Davies, and Flannery (2008) apply Granger causality analysis to the leading and lagging relationships between exam ratings and the actions of banked stakeholder in financial markets for 184 bank holding companies between 1989 and 1992. They find that lagged movements in BOPEC ratings (the safety and soundness ratings for

bank holding companies explain 1.6 percent of the additional ' variation in shareholder market variables (i.e., stock returns, changes in insider and institutional shareholdings), but explain 4.1 percent of the 'additional' variation in bond ratings. This is not surprising, since the objectives of bank supervisors are more closely aligned with those of bank creditors.

Kolari et al. (2005a) developed models and predicted bank failure, where the models initially included three measures of loan default disclosure along with 25 other financial measures. The loan default measures included allowance for loan losses to total assets, net loan charge-offs to total assets and provision for loan losses to total assets. In the final analysis, the allowance for loan losses to total assets was significant in two of the six predictions. As with many other studies, there was a lack of theory for the choice of variables, as stepwise logit was utilized for the decision of inclusion or elimination.

Dziobek, Hobbs, and Marston (2005a) analyze the determinants of bank liquidity defined as the degree to which a financial institution is able to meet its obligations under normal business conditions. Volatility in the depositor (and creditor) base depends on the type of depositor, insurance coverage, and maturity. Banks that rely on a narrow or highly volatile funding base are more prone to liquidity squeezes. Household deposits are typically more stable than, for instance, the deposits of institutional investors or corporate entities. Deposit concentration (i.o., fewer, larger-size deposits) can also be indicative of volatility. Deposit insurance increases the stability of the deposits it covers, with the important caveat that insurance schemes that are not credible may not have this effect. On the external front, foreign financing, , for instance through commercial credit lines, and deposits of nonresidents (either in foreign or domestic currency) can be become highly volatile in situations of distress and make the financial system vulnerable to external shocks or adverse developments in the domestic economy. As regards instrument maturity, the longer the time before the liability matures (in terms of remaining maturity), the more stable is the fundingi; however, in countries where banks are required to meet early withdrawal requests with only minor penalties, maturity may be less relevant to determining funding stability.

2.2.2 Review, of Thesis

Before this, various researchers regarding the various aspects of commercial banks such as financial performance, investment poliey, interest rate structure, resources mobilization and capital structure have conducted ser overall thesis works. Some of them, as supported to relevant for the study presented as below:

Pradhan (1980) conducted a study on investment policy of Nepal Bank Ltd. The objective to that study was to evaluate the lending policy and to find out the ways to encourage the bank lending. This study has covered only five fiscal years BS 2028/29 through BS 2033/34. He used Karl Pearson's coefficient of correlation, ratio analysis and percentage analysis: He concluded with the positive relationship between deposits and loans and advances. But the same was not in a proportionate manner greater increase in deposits led to little increase in the loans and advances. Increase in the interest rate was the imain factor for the decrease in loan demand. The bank had investment only 3 percent of its total investment in the priority sector, which was lower than the percentage (7 percent) imposed by Nepal Rostra Bank.

Shretha (1990) conducted a research work on portfolio behavior for commercial banks in Nepal. She has analyzed the debt to equity ratios of commerial researcher has fount that the debt to equity ratio in commercial banks minimum of 8.30% in 1971 and the maximum of 1583.3% in i974. Similarly, the range of debt to 1990. On the basis of the finding, the researcher concluded that the Nepalese commercial bank are highly leveraged and highly risky. Further, the researcher argued that the capital adequacy ratio explain the strength of the capital base of commercial banks. Higher the capital adequacy ratio, higher is its internal sources. Lower value of capital adequacy ratio, higher is its internal sources. Lower value of capital adequacy ratio with regard to the standard value shows that the bank's ability to attract deposit from the surplus units and inter bank funds also be limited.

K.C. (1991) has done a study on dividend policy of joint venture banks in Nepal. The objective of this study was to provide conceptual framework of dividend models and

to analyze the financial variables, affecting the stock value and interpret the implication of paying dividend in dividend valuation models. The study has covered the time span of FYs 1984/84 through 1989/90. In this study, various financial ratios have been analyzed with the help of two types of analytical tools – investment and statistical tools consist of dividend payout ratio. Earning per share, return on paid-up capital, retention ratio ad dividend valuation model. In addition to the coefficient of correlation, the researcher has used financial tools in this study. The researcher concluded that earning per share of all three joint ventures banks (Nepal Arab Bank Ltd., Nepal Indosuez Bank Ltd. and Nepal Grind lays Bank Ltd.) were satisfactory and actual capitalization rate was higher than the normal capitalization rate.

Bohara (1992) has done a study on financial performance of Nepal Arab Bank Ltd. (NABIL) and Nepal Indosuez Bank Ltd. (BIBL). The basic objectives of this study were to highlight on the functions and polices of joint ventures banks and to evaluate the comparative financial performance of BABIL, and NBIL. The study has covered the five fiscal years 1985/87 through 1990/91. In this study financial tools along with statistical tools along with statistical tools have been used. Different ratios- liquidity, activity, coverage, leverage, profitability and other indicators like earning per share, dividend per share, market value to book value ratio, have been used to evaluate the performance of BABIL and NIBL. In statistical tool the least square method has been employed. The researcher has, on the basis of different financial indicators, concluded that performance of NABIL is better than the of NIBL. The researcher further concluded that bank performance can note be judged solely iin term fo profit as it may have earned by maintaining adequate liquidity and safely position. The researcher has recommended to BIBL to extend their banking facilities even in the rural areas by opening up branches besides the improvement in maintaining the adequate capital structure by increasing equity base.

Adhikari (1993) conducted a study on evaluation of he financial performance of Nepal Bank Ltd. The study has bee limited to FYs 2038/39 BS through 204+/47 BS, The main indicators of financial performance used were financial ratios-current, loan to deposit, return on capital, return in net worth, return on total assets, earning per share. The

researcher concluded that the bank had not managed investment portfolio efficiently. Operational efficiency was not satisfactory. During the study period, except liquidity position all other financial indicators were not satisfactory.

Joshi (1993) conducted a study on commercial banks of Nepal with reference to financial analysis of Rastriya Banijya. The objective of this study was to provide conceptual framework of commercial banks, and to analyze and interpret these financial variables of Rastriya Banijya Bank (RBB) on qualitative and qualitative performance basis. The study was base on the financial data of FYs 2040 B.S. through 2046 B.S. Researcher has used various financial ratio like-current, liquidity, funded dept to total capitalization, and funded debt to equity in this study. The researcher had drawn the conclusion that performance of RBB was not satisfactory during the study period. Further, the researcher concluded that bank had not been managed in true professional approach but had managed in bureaucratic approach to sustain with political environment rather than commercial environment.

Shakya (1995) performs a study on financial analysis of joint venture banks in Nepal. The objective of this study was to carry out the comparative financial performance evalution of Nepal Arab Bank Ltd. (Nabil0 and Nepal Grindlays Bank Ltd. (NGBL). This study has covered the time span of FYs 1988/89 through 1993/94. In this study, he has financial ratios viz, liqidity, leverage, activery, profitability, growth and valuation, and statistical tools viz, Kari Pearson's correlation coefficient, Student t-test, simple average, and index. The researcher has found that in spite of the increase in loans and deposits of both banks, their performance measured in terms of deposit utilization rate is not satisfactory. Further, the study showed that financial performance of BABIL is better than that of NGBL.

Gurung (1995) conducted a research on, "A financial study of joint venture banks in Nepal." The objective of this study was to examine the financial strengths and weaknesses of Nepal Grindlays Bank Ltd. (BGBL). The study has convered the period of seven fiscal years i.e. 1986/87 through 1992/93. In this study. He used financial ratios viz. current, activity, profitability, capital structure an d stantistical tool viz. kerl Pearson's

coefficient of correlation. The researcher has, on the basis of different financial indicators; found that performance of NGBL is better than that of NIBL.

Poudel (1997) carried out a study of comparative analysis of financial performance between Nepal Bnk Ltx. (NBL) and Bepal Grindlays Bank Ltd. (NGBL). The basic objective of that study was to provide comparative financial performance of NBL an BGBL. Only five fiscal years financial performance beginning from 2047/48 BS through 2051/52 BS were analyzedd. In that study, finacial and statistical tools were used to evaluate the performance of banks. In financial tools liquidity, activity, profitability, structural and income and expenditure ratios. Further, the researcher used the method of least square to find out the trend of different financial indicator like earning per share, dividend per share andantea profit per share. On the basis of different financial indicators he found the performance of NGBL is better than that of NBL.

Rana Bhat (1997) carried out a study on financial performance of finance companies in Nepalese context. The objective of the study was to analyze the financial performance of finance companies. The study covered five fiscal years of performance of tinance companies. the study covered five fiscal yearfas of period 1991 through 1996. He has used different analysical tools, for example, perecentages change, index and comparative study. Scholar found that the performance of finance companies in regard to hire purchase, housing loans was not satisfactory. Furthemore, the researcher concluced that the financial companies had not managed in true professional approach.

Thaepa (2006) has conducted her study "A comparative study on Investment Policy of Nepal Bangladesh Bank Ltd. and other joint ventures banks." The researcher's main objective of study was to evaluate the liquidity, assets management efficiency, profitability and risk position of NBBL in comparison BABIL and BGBL and ot examine the fund mobilization and investment policy of NBBL through off balance sheet and on balance sheet activities in comparison to other two banks.

Through research, the researcher found that liquidity position of NBBL is comparatively not better than of NABIL and BGBL. The liquidity ratios are moderately

fluctuating which means the bank has not properly formulated stable policy. As per the study, NBBL is not in better position regarding its on-balance sheet as well as off balance sheet activities in comparator BABIL and NGBL and it does not seem to follow any definite policy regarding the management of its assets. The researcher at the last suggested following a specific policy in investment and she further recommended to maintain the optimum level of relationship among deposit and loan and advances, outside assets and net profit and to maintain the adequate recovery rate.

Likewise, Deoja (1001) conducted study entitled "A Comparative Study of hte Financial Performance between Nepal State Bank of India Limited and Nepal Bangladesh Bank Limited," The researcher's main objective of study was to evaluate the trend of deposits and loan and advances of NSBIL and NBBL and to evaluate the liquidity, profitability, capital structure, turnover and capital adequacy position of NSBIL and NBBL. Through research found that the cash and bank balance to current assets, saving deposit to total deposit etc. of BSBIL are higher while fixed deposit to total deposits, loans and advances to current assets of NBBL are higher and NBBL has better turnover than BSBIL in terms of loan and advances to total deposits ratio 1 and loan and advances to fixed deposit ratio. Through the study of the different ratios has concluded that both banks are highly leveraged.

Although, various studies have been conducted in the past on financial analysis of commercial banks, they mainly emphasized an liquidity, profitability and leverage of the commercial banks. Those studies lack micro-level analyses and they are applying traditional analysis of financial performance and they are not applyinhg the CAMEL technique. And this study attempts to evaluate and analysis of financial performance of Himalayan Bank Ltd. in the framework of CAMEL.

CHAPTER III
RESEARCH METHODOLOGY

The basic objective of the study is to analyze and evaluate financial performance of commercial bank namely Himalayan Bank Lttd. comprehensively. To accomplish the objectives mentioned above in chapter one, the study has adopted the following research procedures. This chapter includes research design, justification for the selection of study unit, nature and sources of data, methods oif data collection, data analysis tools and limitations of study.

3.1 Research Design

The study aims at portraying accurately upon the financial iposition of Himalayan Bank Ltd. The research design followed for this study is basically a historical and analytical case study. There for, to achieve the desired end, descriptive cum-analytical research methodology is followed. Some financial and statistical tools are applied to examine facts and descriptive techniques are adopted to evaluate financial performance of Himalayan Bank Ltd.

3.2 Justification for the Selection of Study Unit

In Nepalese commercial banking industry. Himalayan Bank Ltd is leading joint venture bank today. Due to the special role play by the bank. Question arise that what is their actual financial performance. Thus to fulfill the gap this study is attempt to solve the problem by taking Himalayan Bank Ltd. as study unit through convenience sampling technique.

3.3 Nature and Sources of Data

The study is basically based on secondary data. For the purpose of the study, the annual reports of the bank are used as the major sources of data. Besides the annual

reports of the bank required data and information have been collected from the following sources:

NRB reports and bulletins and its website,

Various publications dealing in hte subject matters of the study,

Various articles published in hte jounals.

The NEPSE reports, and Teh website of HBh etc.

Fromal and informal talks with the senitor starff of the bank were also helpful to obtain the additional information of the related problem.

3.4 Data Collection Procedure

As stated earlier, the study is mainly based on secondary data. The annual reports and other information of Himalayan Bank Ltd. have been obtained from the Pokhara Branch and website of the bank. BR.B directives, Banking and Financial Statistics and other publications are collected fromj the Western Regional Library, Pokhara, Central Library T.U., NRB Publications, different journals, magazines and other published and unpublished reports documented by the concerned authorities.

3.5. Data Processing

First of all, necessary data have been extracted from the published documents audited financial statements and these data have been documentd with appropriate table. Then, data were entered into the spreadsheet to work out the financial ratios and prepare the necessary figures. Finally, different financial ratios were worked out with the help of computer programmers (Microsoft Excel)

3.6. Methods of Data Analysis

In this research work, only descriptive tools are used to et the meaningful result of the collected data and to meet the research objectives. Financial ratios are the major tools for analysis. In addition to the financial tools, other simple statistical (descriptive) tools

also have been used. The major tools applied in this study have been discussed in this section.

3.6.1 Financial Tools

Capital Adequacy Ratio: Capital adequacy ratio is the numerical relationship between total capital funk and total risk adjusted assets. It measures the adequacy of capital and financial soundness of a bank. Capital adequacy ratio is used to measure of capital in the banks. It is worked out by using the following model.

$$CCA = \frac{\text{Core Capital}}{\text{Total Risk Adjusted Assets}} \text{ x } 100 \text{ ... ... (3.6.1)}$$

Were,

CAR = Capital Adequacy Ratio

Total Capital Fund = Core capital + Supplementary capital

Total Risk Adjusted Assets = On- balance sheet risk adjusted asset + Off blance sheet risk adjusted assets (See appendix 5)

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

$$SCR = \frac{\text{Supplementary Capital}}{\text{Total Risk Adjusted Assets}} \text{ x } 100 \text{ ... ... (3.6.2)}$$

Where,

CCAR= core capital adequacy ratio.

Core Capital = paid-up capital + share premium + non-redeemable preference share + general reserve + cumulative profit – goodwill if any.

Supplementary Capital Adequacy Ratio: Supplementary capital ratio is the expression of numerical relationship between supplementary capital and total risk adjusted assets of a bank; It measures the proportion of supplementary capital in total risk

– adjusted assets. Further more, it shows the absolute contribution of supplementary capital in capital adequacy. The ratio is used to analyze the supplementary capital adequacy of the banks and determined by using the following model

$$SCR = \frac{\text{Supplementary Capital}}{\text{Total Risk Adjusted Assets}} \text{ x } 100 \text{ ... ... (3.6.3)}$$

Where,

SCR = Supplementary Capital Ratio

Supplementary Capital Ratio

Supplementary Capital = Loans loss provision + exchange equalization reserve + asset revaluation reserve + hybrid capital instrument + unsecured subordinate term debt + interest rate fluctuation fund + other free reserves

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

$$\text{Non-Performing Loan Ratio} = \frac{\text{Non-Performing Loan}}{\text{Total Loan and Advantaces}} \text{ x } 100 \text{ ... ... (3.6.4)}$$

Where,

Non-performing Loan = loan not recovered with in the given

The time frame either in the form of interest servicing of principal repayment.

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

$$\text{Loan Loss Ratio} = \frac{\text{Loan Loss Provision}}{\text{Loan and Advantaces}} \text{ x } 100 \text{ ... ... (3.6.5)}$$

Total Expenses to Total Income Ratios: The total expenses to total incomes ratio is the expression of numerical relationship between total expenses and total incomes of the bank. it measures the proportion of total expenses in total expenses and total incomes of the bank. It measures the proportion of total expenses in total revenues. A high or increasing ratio of expenses to total revenues can indi9cate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. in any case, it is likely to negatively affect profitability (IMF, 2005a). Following is the expression of total expenses to total revenues ratio.

$$\text{Total Expenses to Total Incomes Ratio} = \frac{\text{Total Expences}}{\text{Total incomes}} \text{ x } 100 \text{ ... ... } (3.6.6)$$

Earning per Employee: Earning per employee is the numerical relationship between net profit after taxes to total numbers of employee. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with similar repercussions in terms of profitability (IMF, 2005a). It is calculated by using the following model.

$$\text{Earnings Per Emsployee} = \frac{\text{Net Profit After Taxes}}{\text{Total Number of Employee}} \text{ x } 100 \text{ ... ... } (3.6.7)$$

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

$$\text{Return on Equity} = \frac{\text{Net Income After Tax}}{\text{Total Equity Capital}} \text{ x } 100 \text{ ... ... } (3.6.8)$$

Return on Assets (ROA): Return on assets is the numerical relationship between net incomes after taxes to total assets of a bank. It is primarily an in dictator of managerial efficiency; it indicates how capably the management of the bank has been converting the institution's assets into net earnings (Rose, 2009). It is calculated by using the following model.

$$\text{Return on Assets} = \frac{\text{Net Income After Tax}}{\text{Total Asset}} \text{ x } 100 \text{ ... ... } (3.6.9)$$

Net Interest Margin: Net interest margin is the expression of numerical relationship between net interest income and total earning assets of a bank. It measures how large a spread between interest revenues and interest costs management has been able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sources of funding. (Rose, 2009). For the purpose of the study following model is used to determine net interest margin:

$$\text{Net Interest Margin} = \frac{\text{Net interest income}}{\text{Earning assets}} \text{ x } 100 \text{ ... ... (3.6.10)}$$

Where,

Net interest income = interest income – interest expenses Earning assets = loan & advances + investment on securities

Earning Per Share (EPS): Earn in per share provides a direct measure of the returns flowing to the bank's owners- its stockholders- measured relative to the numbers of shares to the public (Rose, 2009). It gives the strength of the share in the market. Following is the expression of earning per share:

$$\text{EPS} = \frac{\text{Net Income After Tax}}{\text{No. of Shares of Common Stock}} \text{ x } 100 \text{ ... ... (3.6.11)}$$

Total Liquid Fund to Total Deposits Ratio: Total liquid funds to total deposits ratio is the expression of numerical relationship between total liquid funds and total deposits of a bank. It measures the proportion of total liquid funds in total deposits. Further more, it shows the overall short-term liquidity position. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the bank. It is calculated by using the following model.

$$\text{Total Liquid Funds to Total Deposits Ratio} = \frac{\text{Total Liquid Funds}}{\text{Total Deposits}} \text{ x } 100 \text{ ... ... (3.6.12)}$$

Where,

Total liquids funds = cash in hand + foreign currency in hand + balance with NRB + balance with domestic bank + balance held abroad + calls deposits

NRB Balance to Total Deposits Ratio: NRB balance to total deposits ratio is the expression of numerical relationship between NRB balance and total deposits of a bank. It measures the proportion of NRB balance in total deposits. It shows whether bank is holding the balance as required by Nepal Rastra Bank. For the purpose of this sturdy following model is used to determine the NRB balance to total deposits ratio.

$$\text{NRB Balance to Total Deposits Ratio} = \frac{\text{NRB Balance}}{\text{Total Deposits}} \text{ x } 100 \text{ ... ... } (3.6.13)$$

Where,

NRB balance = balance with NRB

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

$$\text{Vault to Total Deposits Ratio} = \frac{\text{Cash in Vault}}{\text{Total Deposits}} \text{ x } 100 \text{ ... ... } (3.6.14)$$

Where,

Cash in vault = cash in hand + foreign currency in hand

3.6.2 Statistical Tools

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

$$\overline{X} = \frac{\sum X}{\text{N}} \text{ x } 100 \text{ ...} \quad \text{...} \quad \text{...} \quad (3.6.15)$$

Where,

X = Mean of the values,

N = Number of pairs of observation.

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

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

$$\text{S.D.} = \sqrt{\sum (x - \bar{x})^2 . p} \Big/ \frac{\text{Cash} \sum X}{N} \text{ x } 100 = \sqrt{\frac{\sum x^2}{n} - \left(\frac{\sum x}{n} \right)^2} \quad \ldots \quad \ldots \quad \ldots \quad (3.6.16)$$

Here,

no = no. of observations

x = individual value

x = SIMPLE ARITHMETIC MEAN

During the analysis of data, standard deviation is calculated by using the statistical formula 'stdev' on excels data sheet on computer.

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

$$\text{CV} = \frac{¢}{\bar{x}} \quad \ldots \quad \ldots \quad \ldots (3.6.17)$$

Here, ¢ = standard deviation x = mean

CV = Coefficient of variation

Least Square Trend Analysis: Least square trend analysis has been used to find out the trend of ratios (Kothari, 19$9). The general equation used for trend is given

Below:

Y = a + bX... ... ... (3.6.18)

Where,

Y = Dependent Variables

X = Coded time in year (independent variable)

a = Y-intercept

b = slope of the trend line

In the above model,

$$b = \frac{\sum XU - n\overline{XY}}{\sum X^2 - n\overline{X^2}}$$

$$a = y - b\bar{x}$$

CHAPTER IV
PRESENTATION AND ANALYSIS OF DATA

This chapter deals with the presentation and analysis of data collected from the different sources. The purpose of this chapter is to study, evaluate and analyze the financial performance of Himalayan Bank Ltd. in the framework of CAMEL

4.1 Capital Adequacy

Capital Adequacy is a measurement of a bank to determine if solvency can be maintained due to risks that have been incurred as a course of business. Capital allows a financial institution to grow, establish and maintain public confidence, and provide a cushion (reserves to be able to absorb potential loan losses above and beyond identified problems. A bank must be able to generate capital internally, through earnings retention, as a test of capital strength.

4.1.1 Capital Adequacy Ratio Analysis

Strong capital base is the pre-requisite for the safety and soundness of any bank, since; any losses arising out of the unexpected risks have to be borne by the bank out of its own capital. It is for this reason, Basel Capital Accord, 1988 stresses on the creation and maintenance of the strong capital base in proportion to the Risk Weighted Assets of the banks (BASEL, 1988). Capital adequacy and availability ultimately determine the robustness of financial institutions to withstand shocks to their balance sheets. Aggregate risk-based capital ratios (the ratio of regulatory capital to risk-weighted assets) are the most common indicators of capital adequacy, based on the methodology agreed to by the BCBS in 1988. In line with the Basel Capital Accord, capital is defined in two tiers, collectively known as capital fund. Capital fund of the banks consists of permanent or core element called 'core capital' and less impermanent element called 'supplementary capital.

Capital Adequacy ratio is the measure of financial strength of a commercial bank. in the specific term, the capital adequacy ratio measures the adequacy of capital for smooth operation of a bank. Capital adequacy ratio above the Nepal Rastra Bank (NRB) standard indicates the adequacy of capital and the ration below the standard reveals the lack of adequate capital in a bank. higher capital adequacy ratio, above the standard signifies the higher is its internal sources and higher ability to cushion operational and abnormal losses. Furthermore, higher capital adequacy ratio indicated sound and strong financial position and higher security to depositors. On the contrary, the low value of capital adequacy ratio with regard to the minimum requirement of NRB show that the lower is its internal sources, comparatively weak financial position and lower security to depositors. Total capital fund means the amount invested by shareholders, creditors and the amount collected from the various free reserves maintained in a bank. Capital fund includes the amount of core capital and supplementary capital.

Nepal Rastra Bank has fixed out the standard or minimum requirement of capital adequacy \ratio (total capital fund to total risk adjusted assets or core capital plus supplementary capital to total risk adjusted asset) as 8 p0ercent, 8 percent, 8 percent. 9 percent, 10 percent and 11 percent in the year 2009, 2005a, 2006, 2007, 2008 and 2009 respectively. The Nepalese commercial banks have to adopt the directives of NRB and have to maintain the capital adequacy ratio as per the requirement of concerned authority. On the other hand, they have to maintain the industry norms and to utilize their resources in efficient way, which is really a complex jub for commercial banks.

Table 4.1 presents the observed values of capital adequacy ratio in Himalayan Bank Ltd. during the period of past six years.

Table 4.1: Capital Adequacy Ratio

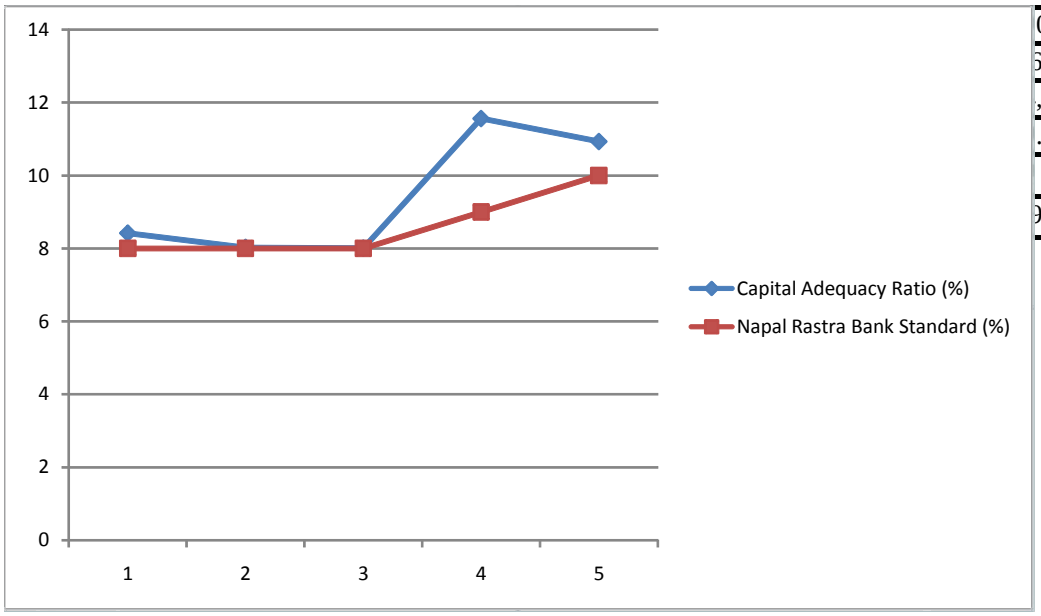
Fiscal year (as at mid July)	2009	2005	2006	2007	2008	2009
Capital Fund (in millions Rs.)	760.1	1,048.6	1,198.4	1,473.2	1,603.8	1,796.2
Total risk weighted assets (in million	9,026.13	13,058.53	14,956.9	12,76.2	14,661.4	16,860.6
Capital Adequacy Ratio (%)	8.42	8.03	8.01	11.56	10.93	10.65

Napal Rastra Bank Standard (%)	8.00	8.00	8.00	9.00	10.00	11.00
Capital Adequacy Ratio Excess/short (%)	0.4	0.003	0.01	2.56	0.93	0.35

Source: Annual reports.

As shown in Table 4.1 the capital adequacy ratio of HBL is distributed as a minimum ratio of 8.01 percent in FY 200 and a maximum ratio 11.56 percent in FY 2007. The3 ratio of the bank is decreasing continuously up to FY 2006 and it is moving upward in FY 2007 but again decreasing in later year. Its means the ratio of the bank is fluctuation in the period of FY 2008 to FY 2009. Capital Fund is increasing trend but total risk weighted assets are fluctuating, trend. The ratio is excess in years 2009, 2005a, 2006, 2007, 20083 and short in year 2009. Figure 4i.1 exhibits the observed capital adequacy ratio of the HBL with NRB standard within the study period of last six years

Figure 4.1 Trand of capital adequacy ratio



08
503.80
,661.40
.93
93

2004 2005 2006 2007 2008 2009

Year

As shown in Figure 4.1 the NRB standard is 8,8,8,9,10, and 11 percent in the FY 2009, 2005a,2006,2007,2008 and 2009 respectively. The observed capital adequacy ratio of I-IBL is above the NRB standard in each year from FY 2009 to FY 2008 except year 2009. Generally, the bank has maintained the ratio according with the NRB standard over the study period but it is observed that the capital adequacy ratio is not maintained for the year 2009. In the year 2009, the bank's capital adequacy ratio is below the NRB standard, this shows that the bank did not strictly follow the NRB directives and insufficient in that particular year.

4.1.2 Core Capital Adequacy Ratio Analysis

Core capital means the primary capital of a commercial bank. It is the amount invested by shareholders or owners. It gives an assurance to the outsiders for smooth operation of a bank even in the time of economic crisis. Core capital includes the paid-up equity capital, share premium, non-redeemable preference share, general reserves, and accumulated profit and loss amount and goodwill deductible if any. In this way, the core capital is the amount of shareholder fund.

Core capital adequacy ratio is also known as core capital to total risk adjusted assets ratio, which measures the adequacy of internal sources or shareholder's funds to support the bank activities. In real sense, it reflects the financial strength and soundness of a bank. A higher value of the ratio above the NARB standard shows the adequacy o f internal source and higher security to creditors and depositors. The lower value of core capital adequacy ratio with regard to the NRB standard indicates the lower is its internal sources.

Nepal Rastara Bank has provided the minimum standard of core capital adequacy ratio. In order to stabilize the capital and assets of a commercial bank. the Nepal commercial banks are required to maintain the core capital adequacy ratio of 4 percent, 4 percent, 4 percent, 4.5 percent, 5 percent and 5.5 percent in years 2009, 2005a, 2006, 2007, 2008 and 2009 respectively.

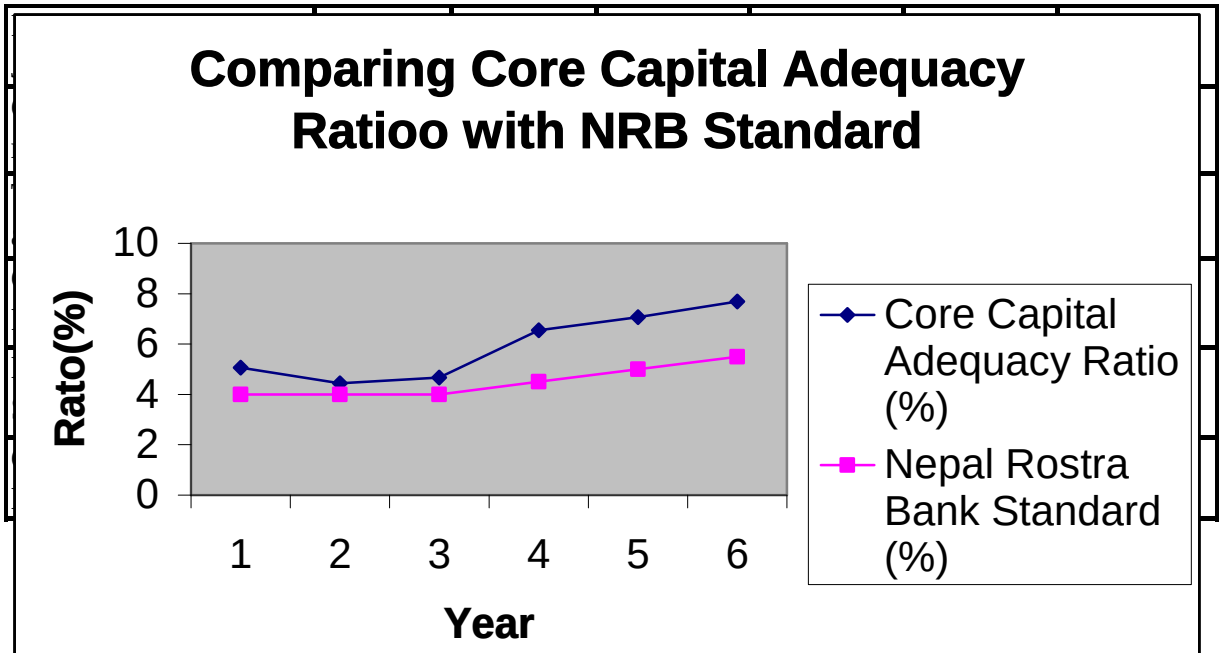
Table 4.2 presents the observed values of core capital adequacy ratio in Himalayan Bank Ltd. during the period of past six years.

Table 4.2: Core Capital Adequacy Ratio

Fiscal year (as at mid July)	2009	2005	2006	2007	2008	2009
Core Capital (in million Rs.)	1456.8	579.8	698.7	834.6	1,038.6	1,297.4
Total risk weighted assets (in million Rs.)	9026.13	13058.53	14,956.9	12,746.2	14,681.2	16,860.6
Core Capital Adequacy Ratio (%)	5.06	4.44	4.67	6.55	7.07	7.69
Nepal Rostra Bank Standard (%)	4.00	4.00	4.00	4.50	5.00	5.50
Core Capital Ratio Excess/Short (%)	1.06	0.44	0.67	2.05	2.07	2.19

Source: Annual reports,

As shown in Table 4.2, the core capital adequacy ratio of HBL is maximum of 7.69 percent in FY 2009 and minimum of 4.44 percent in FY 2005a with the average ratio of 5.91 percent. The ratio is decreasing year by year by year up to FY 2005a and thereafter it is increasing in the final four years of the study. Thus, it is clkear that the core capital adequacy ratio of the bank is in the declining tendency in beginning years and thereafter, it is in the increasing trend in final years. The ratio is in fluctuating trend. The changing pattern of the core capital adequacy ratio and the regularly increasing trend of core capital in absolute term provide the clear way for conclusion of the total risk adjusted assets of the bank is instable during the study period. However, the core capital adequacy ratio of the bank is greater than the NRB standard in each year over the study period. The observed value of core capital adequacy ratio of the HBL is shown with NRB standard in figure 4.2 below.



From the above Figure 4.2, it is clear that the core capital adequacy ratio of HBL is above the NRB standard in each year during the period of FY 2009 to FY 2009. It means the bank is applying adequate amount of internal sources of shareholder's funds with significant core capital adequacy ratio in all the years over the study period.

4.1.3 Supplementary Capital Adequacy Ratio Analysis

Supplementary capital is another component of bank capital. Supplementary capital means the amount of capital that are transferred in free reserve and collected by using the hybrid capital instruments. Supplementary capital ratio is a tool used to analyze the supplementary capital adequacy of a bank. The ratio reflects the relative contribution of supplementary capital components in total risk adjusted assets. Further, it indicates the contribution of supplementary capital in capital adequacy ratio of a bank. A high value supplementary capital ratio means the higher proportion of supplementary capital in total risk adjusted assets and large share of supplementary capital in capital adequacy ratio. Similarly, the low value of the ratio means lower is its contribution in total risk adjusted assets of a bank.

Nepal Rastar Bank has regulated to inside the supplementary capital in measuring the capital adequacy ratio of commercial banks. NRB has fixed out the maximum limit of

supplementary capital ratio that can be included in capital adequacy ratio a\s not more than core capital adequacy ratio of the bank in each year.

Table 4.3 presents the supplementary capital ratio of Himalayan Bank Ltd. during the study period last six years.

Table 4.3: Supplementary Capital Adequacy Ratio

Fiscal Year 9as at mid July)	2009	2005	2006	2007	2008	2009
Supplementary Capital	303.3	468.8	499.7	638.6	565.2	498
Total risk weighted assts (in million Rs.)	9026.13	468.8	499.7	638.6	565.2	498
Supplementary Capital (in million Rs.)	3.36	3.59	3.34	5.01	3.86	29
NRB Standard (not more than Core Capital)	5.06	4.44	4.67	6.55	7.07	7.6
Excess/Short	-1.70	-0.86	-1.33	-1.54	-321	-4.7

Source: Annual reports

As shown in Table 4.3, the supplementary capital ratio of the bank is ranges from a minimum of 3.34 percent in FY 2006 to maximum of 5.01 percent in FY 2007. The ratio of HBL is moving in the positive way till the FY 2007 and then declining in last two years. Here, the ratio of HBL is unduly high in FY 2007 because of the bank is using hybrid capital instrument as a supplementary capital in this year. The declining tendency in final years implies that the decreasing proportion of supplementary capital in total risk adjusted assets of the banks. However, the supplementary capital ratio in the bank is within the boundary of NRB standard in all times over the study period.

Figure 4.3

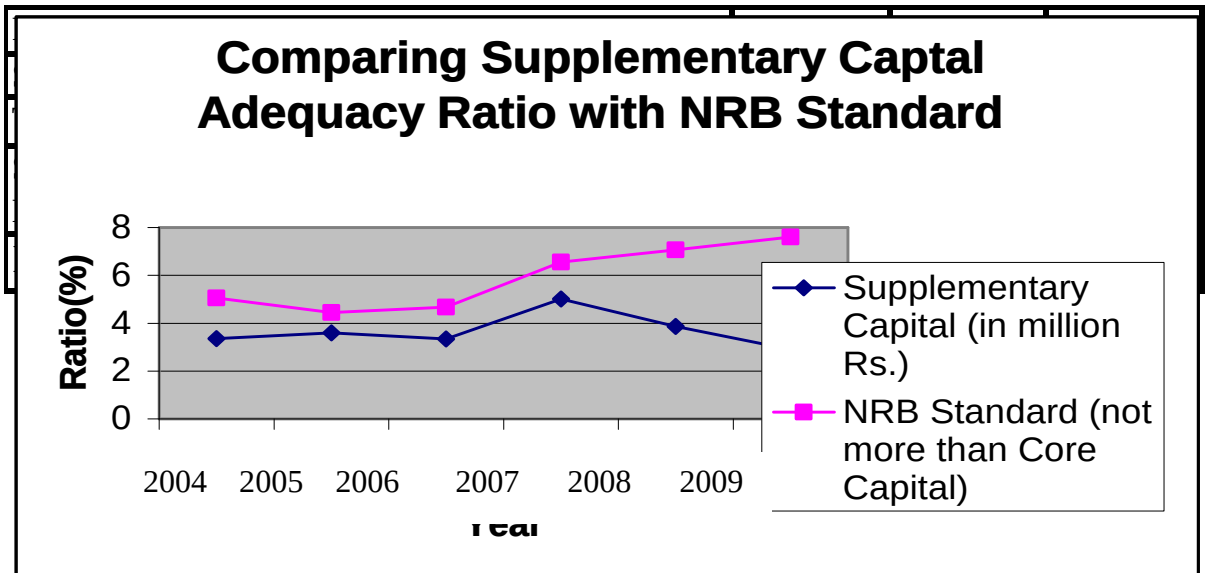


Figure 4.3 shows the observed supplementary capital adequacy ratio with NRB standard. It is clear that the supplementary capital ratio is within the standard of NRB in all the periods over the study duration. It means the supplementary capital of the bank is significant as per the NRB standard.

4.2 Asset quality

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

Management spends significant time, energy, and resources on their asset portfolio, particularly the loan portfolio. Problems within this portfolio can detract from their ability to successfully and profitably manage other areas of the institution. Risks to

the solvency of financial institutions most often derive from an impairment of assets, which in turn can arise from deterioration in the financial health and profitability of the institutions' borrowers, especially the non-financial corporation sector. The ratio of nonperforming loans (NPLs) to total loans is often used as a proxy for asset quality. The coverage ratio-the ratio of provisions to NPL-provides a measure of the share of bad loans for which provision have already been made.

Lack of diversification in the lcan portfolio signals the existence of and important vulnerability of the financial system. Loan concentration in a specific economic sector or activity (measured as a share of total loans) makes banks vulnerable to adverse developments in that sector or activity. This is particularly true for exposures to the real estate sector. Country or region-specific circumstances often determine the particular sectors of the economy that need to be monitored for macro prudential purposes.

Analysis of the trends of loans and advances could not be complete without considering the quality of these assets. The asset quality means the capacity of assets to generate income as well as the recoverability of the principal amount. NRB has laid down minimum criteria for the classification of assets based on the overdue period of the advances. Assets with inherent credit weaknesses are classified as non-performing assets (NPA), which are farther, classified into three categories, namely, substandard, doubtful and loss assets requiring provisioning of 25 percent, 50 percent and 100 percent respectively.

In this study, assets composition, non-performing loan and loan loss provision are taken as a proxy to measure asset quality of the bank.

4.2.1 Assets Composition

the assets portfolio of the bank is both complex and interesting. It represents more faithfully the varied nature and ramification of the banks' function and investment policiting. It represents more faithfully the varied nature and ramification of the bank’s function and investment policies. In fact the assets side of the balance sheet indicates the manner in which the funds entrusted to the bank are deployed. Usually every banker seems to arrange its assets in an ascending order of profitability and desending order of

liquidity. Thus the structure of a balance sheet indicates assets appearing in the descending order or liquidity. Assets not only determine the soundness of a bank but also its capacity to earn profits.

Table 4.4: Assets Composition (in percentage)

Fiscal years	2004	2005	2006	2007	2008	2009	Mean
Cash & Bank balance	7.13	5.69	7.36	5.93	8.18	7.78	7.01
Money at Call	36.70	29.51	20.80	1.65	0.62	1.43	15.12
Investment	4.17	13.97	20.90	42.96	42.10	36.12	26.70
Loan and Advances	46.66	45.54	46.23	44.84	44.82	50.21	46.38
Fixed assets,	1.52	1.22	1.08	1.5	0.90	1.16	1.23
Other Asset	3.82	4.07	3.63	3.12	3.38	3.30	3.55
Total	100	100	100	100	100	100	

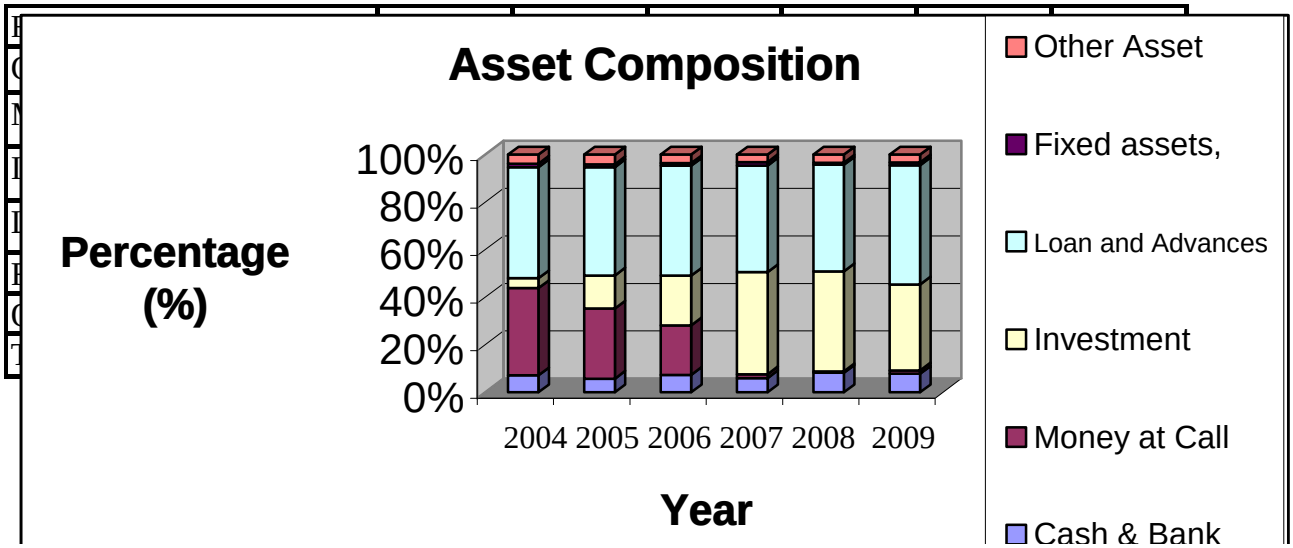
Source Annual report100s

The above table shows assets composition of E1BL for the fiscal years 2009 through 2009. As shown in Table 4.4, percentage of cash and bank balance is decreasing up to year 2005a and then it move up in year 2006 and then again decreasing in year 2007 and then increasing in year 2008 and still decreasing in 2009. Thus the trend is fluctuating. So on, Money at call in percentage is decreasing up to year 2008 and slightly increase in year 2009. The decreasing trend id very sharp in year 2007. Similarly, investment in percentage is increasing trend except year 2009 during study period. The increasing trend of investment is very sharp in year 2007, Likewise, loan and Advances in percentage is slightly up and down during study period and this shows that the variance is stable. Similarly, fixed assets and other assets are slightly up and down during the study period. the average mean percentage of cash and bank balance, money at call, investment, loan & advances, fixed assets and other assets were 7.01 percent, 15.12 percent, 25.70n percent, 46.38 percent, 1.23 percent and 3.55 percent respectively during study period.

Assets composition of the commercial banks remained largely same in last six financial years. Movement was observed in swith over of money at call in to investment during last three years. As it can be seen from the table given above major part of total

assets was held in the form of loans and advances, other assets and investment, which falls under high-risk category of assets.

Figure 4.4



The Figure 4.4 shows the assets composition of the bank during the study period. It reveals that movement of money at call was observed in swit5h over in to investment during last three years. But approximately including money at call, cash and bank balance and investment remain same during the study period.

4.2.2 Non-Performing loan to Total Loan and Advances Ratio

Loans and advances usually represent the single largest asset of most banks. Thus monitoring the quality of the banks loan portfolio is of the utmost importance. The greater the ratio the higher the credit the risk the bank is exposed it. When the borrowers fail to pay the interest to even principal within the time frame the performing loan begins to start in non-performing loan. As per the total loan classification viz, Pass loan, Substar loan, Doubtful loan and Loss loan the NPL consists all three except the pass loan. This pass loan refers as performing loan. Here the ratio of NPL to Total loan and advances shows the percentage of BPL in total loan. the lower the ratio the best management and utiliation of loan and advances is supposed.

NRB has directed the commercial banks to classify its loan and advances into the category of pass, substandard, doubtful and loss. Similarly, it has classified the pass loan as performing loan and other three types of loan as non-performing loans. Non-performing loans reflect the quality of assets that a bank is holding. This ratio measures Hither ratios refiect the bad performance of the bank in mobilizing loans and advances and bad recovery rate and vice versa. An increasing trend in the ratio of nonperforming consequently, in financial institutions' cash flows, net income, and solvency. This ratio is computed by dividing the non-performing loans by total loans and advances.

An NPL for a bank is like a developing cancer in a human body which will collapse the whole bank if not managed properly. Moreover, when the NPL begins in 2 digits then the problems begins to start. So, the management should always be aware to lower it in the single figures.

Table 4.5 presents the observed non-performing loan ratio of Himalayan Bank Ltd. during the study period.

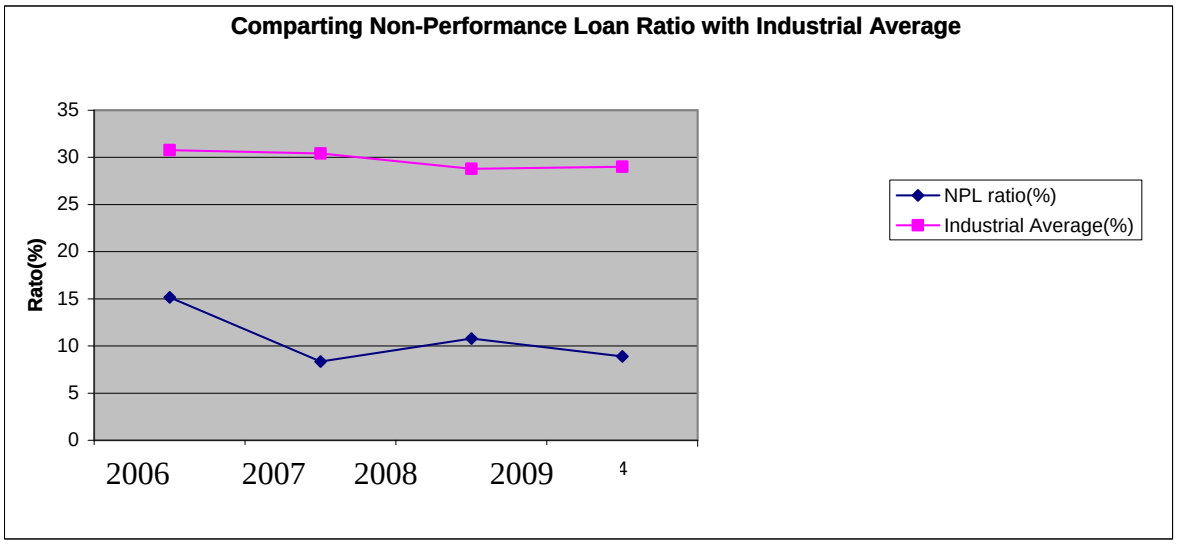
Table 4.5: Non-Performing Loan Ratio

Fiscal year as at mid July)	2004	2005	2006	2007	2008	2009
Non-Performing Loan in million Rs.	NA 5,246	NA	1,367.0	797,6	1,092.8	1,147.5
Total Loan in million Rs.		7,224.7	9,015.3	9,557.1	10,844.6	12,919.6
NPL ratio (%)	NA	NA	15.16	8.35	10.08	8.88
Industrial Average (%)	NA	NA	3078	30.41	28.8	29.00

Source: Annual reports and NRB Samachar 2060

Table 4.5 exhibits that the ratio of non-performing loan to total loan and advances ratios with comparing to industrial average for the study period. The ratio of the bank has decreasing trend with fluctuations over the years. The ratios range from 8.35 percent in year 2007 to 15.16 percent in year 2006 with an average of 10.52 percent. All the ratios are below the industrial average.

Figure 4.5



In figure 4.5, the non-performing loan ratio curve over the bank is below the industry average curve in all observed fiscal years. Due to the public sectors bank in Nepal have very high value of non-perfuming loan so the industrial average is also came very high. Thus, this industrial average ratio cannot taken as a benchmark for non-performing loan ratio. Generally, an internationally recognized non-performing loan benchmark is less than 8 percent. With regards to the Nepalese banking scenarios, having non –performing loan ratio in a single digit is said to be acceptable.

4.2.3 Loan Loss Ratio

Loan loss ratio provides useful insight into the quality of a banks loan portfolio and bad debts coverage, and the adequacy of loan loss provisions. The control of loan loss is an important facet of bank operations and the bank is greatly concerned to minimize it. A poorly administered loan portfolio usually has significant negative impact in the earnings and capital of the bank greater loan loss provision is required to allow in income statement if high loss is expected. This leads to low profit and possible losses that produce low increase or decrease in the capital.

The loan loss ratio indicates the adequacy of allowance for loan and trend in the collection of loan and the performance in loan portfolio. It is obtained by the ratio of loan

loss provision to the total loan (Garden and Miller, 1988). The high provision for loan loss shows the recovery of loan to be difficult and irregular and the age of the loan is increasing. More delay the bank gets to collect the loan, the provision will be higher and the ratio will be higher. Altman and Sametz (1977) have identified few early warning variables based on the balance sheet data. The loan loss ratio as defined by them is the ratio of provision for loss to the total loan and investments. This ratio is defined as the measure of prospective losses that are envisioned by the bank management in relation to the bank's overall loan and investment. The negative sign indicates that an increase in the value of the variables is indicative of weakness of the bank.

Loss of loan happens when the debtors are unable to pay their due loan on time. Loss of loan is not only the default of debtor's but it is because of the failure of recovery of loan by the bank. This ratio shows the possibility of loan default of a bank. It indicates how efficiently it manages its loan and advances and makes effort for the loan recovery. Higher ratio implies higher portion of non-performing loan portfolio. The ratio of loan loss provision to total loans and advances describes the quality of assets that a bank is provision to total loans and advances decries the quality of assets that a bank is holding. The provision for loan loss reflects the increasing probability on non-performing loan in the volume of total loans and advances. Loan loss provision or the other hand signifies the cushion against future contingency created by the default of the borrowers. The high ratio signifies the relatively more risky assets in the volume of loans and advances. The loan loss ratio shows how efficiently the bank manages it loans and advances and makes effoet for timely recovery of loans. This ratio is calculated by dividing the loan loss provision by total loans and advances.

Table 4.6: Loan Loss Ratio

Fiscal Year as at mid July	2004	2005	2006	2007	2008	2009
Loan Lose Provision in million Rs.	NA	NA	344.6	643.4	842.8	967.8
Loan and Advances in million Rs.	5346	7224.7	9,015.3	9,557.1	10,844.6	12,919.6
Loan Loss Ratio %	NA	NA	3.82	6.73	7.77	7.49

Source: Annual reports.

Table 4.6 exhibits that the loan loss ratio for the study period has increasing trend. The ratio ranges from 3.82 percent in FY 2006 to 7.77 percent in FY 2008 with and average of 6.45 percent. The coefficient of variation between them is 28.04 percent, which indicates that the ratios are variable and not consistent with the increasing trend.

Figure 4.6

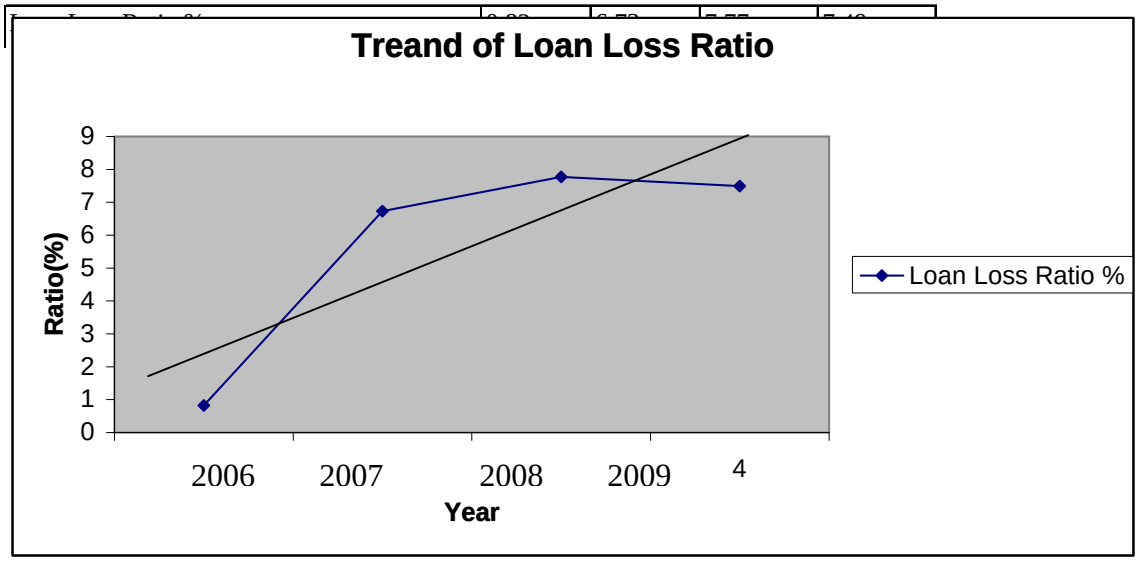


Figure 4.6 shows the observed value of loan loss ratio along with least square trend line. The ratio is increasing up to year 2008, thereafter, it is observed declining in year 2009. The slope of the trend line determined by the least square method is positive and sharp which indicates the trend of hte loan loss ratio is increasing over the study.

4.3 Management Quality

Sound management is the key to financial institutions' performance Governance, the general management of the institution; human resource policy, management information system, internal control and auditing and strategic planning and budgeting are distinct areas that reflect venality quality of management.

While the others factors can be quantified fairly easily from current financial statements, management quality is somewhat elusive and subjective measure. Among the

CAMWL variable, only management is hard to quantify. One measure is the relevant to management is the ratio of total expenses to total revenue. Assuming that how good the management is correlated with this ratio, this ratio is used to represent the management measure. Another measure that is also relevant to management is the ratio of earnings per employed is used as a proxy of management quality.

4.3.1 Total Expenses to Total Revenue Ratio

To account for management quality, this study includes the ratio of total expense to total revenue as a proxy. A high level of expenditures in non-directly productive activities may deflect an inefficient management. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability (IMF, 2005a). This ratio is calculated by dividing the total expenses by total revenues.

The main sources of income of commercial banks are interest received from loans and advances and investments on government securities, commission and discounts, exchange rate fluctuation income and other miscellaneous income. And, the main component of expenses of commercial banks are interest and commission expenses, and provision for staff bonus, salary, allowances and provident fund and other operating expenses such as house rent, water & electricity, fuel expenses, audit fee expenses, management expenses, depreciation, miscellaneous expenses, and all other expenses that are directly related to operation of the bank. Expenses such as loss on sale of assets, write off expenses, losses shortage, written off, provision for income tax are non-operating expenses.

Table 4.7: Total Expenses to Total Revenues Ratio

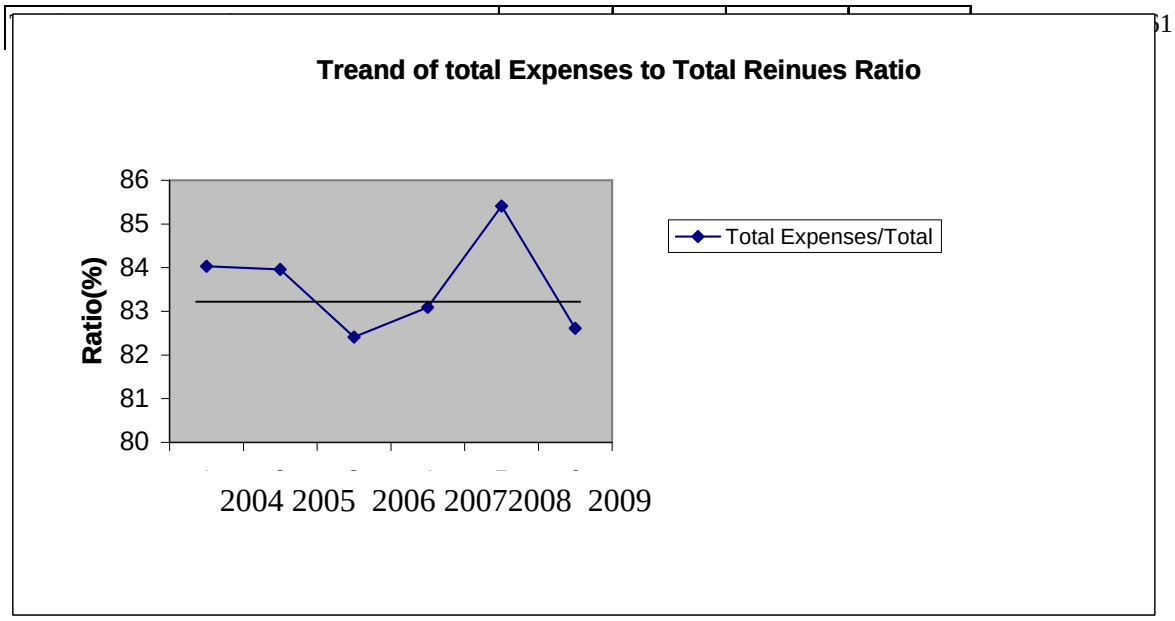
Year as at mid July) (in million Rs.)	2004	2005	2006	2007	2008	2009
Total Expenses (in million Rs.)	869.432	1043.31	1298.188	1154.769	1242.178	1256.565
Total Revenues (in	1034.68	1242.69	1575.227	1389.792	1454.308	1519.618

million Rs.)						
Total Expenses/Total Revenues Ratio (%)	84.03	83.96	82.41	83.09	85.41	82.69

Source: Annual reports.

As shown in table 4.7, the total expenses to total revenue ratio is decreasing up to year 2006, thereafter, it is observed increasing up to year 2008 and then decreasing in year 2009. The ratio is distributed from a minimum of 82.41 percent in year 2006 to maximum 85.41 percent in year 2008 with average ratio of 83.60 percent and coefficient of variation between them is 1.32 percent. On the basis of coeffiecient os variation, it can be concluded that the ratios are stable and consistent. Figure 4.7 exlibits the observed total expenses to total revenues ratio of HBI. With least square trean line within the study period of last six yeas.

Figure 4.7



As shown in Figure 4.7, the ratio has decreased in year 2005a and year 2006 but it has come up in year 2007 and year 2008 and finally it has decreased in year 2009. The observed values of the ratio are fluctuating over the study period. The slope of the trend

line is determined by the least square method is negative. Decreasing trend of ratio is favorable on measure management quality. Thus, negative slope of trend line of the ratios indicates the decreasing expenses with respect to income. This is good sign for the bank in measuring the quality of management.

4.3.2 Earnings per Employee

In this study, an earning per employee is also taken as measure of manage quality. It is calculate dividing net profit after taxes by number of employees. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with similar repercussions in terms of profitability (IMF, 2006).

Table 4.8: Earnings per Employee

Year (as at mid July)	2004	2005	2006	2007	2008	2009
Net profit (Rs in million)	165.2	199.4	277.0	235.0	212.10	263.10
No. of Employees	290	311	359	357	385	455
Earnings Per Employees(Rs)	569655.2	641158	771588	658263	550909	57824

Source: Annual reports.

Table 4.8 shows the earnings per employee in rupees during the study period. The ratio is increasing up to year 2006 and then decreasing till year 2008 and again increased in final year 2009. The observed values of the ratio are fluctuating over the study period. The mean of the ratios for the study period is Rs. 628,302.

Fig 4.8

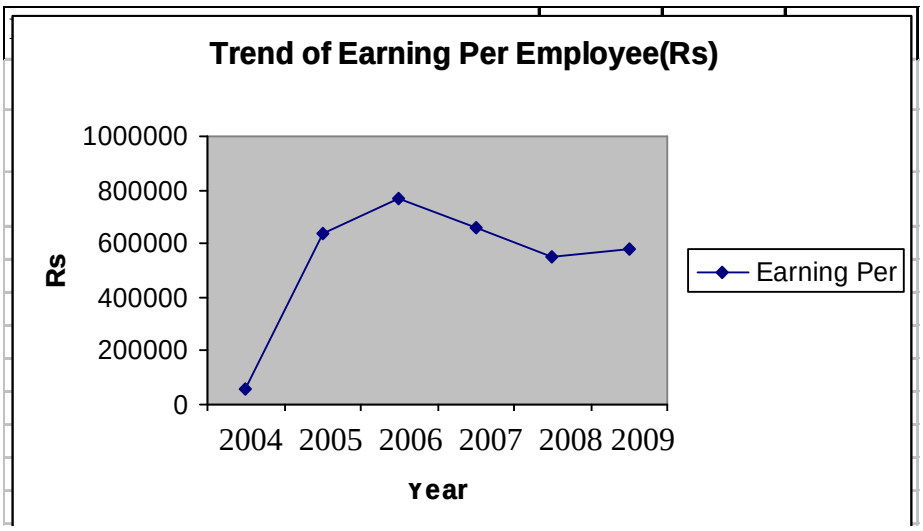


Figure 4.8 shows the observed value earning pr employee along with least square trend line. The slope of the trend line is negative, which indicates the earning per employee is declining over the study period. However the decline is not sharp. This indicates that, low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing, with similar repercussions in terms of profitability.

4.4 Earning Quality

Earning is the initial safeguard against the risks of engaging in the banking business, and represents the first line of defense against capital depletion resulting from shrinkage in assets value. Earnings performance should also allow the bank to remain competitive by providing to implement management's strategic initiatives.

Profitability ratios are calculating to measures the efficiency of operation of a firm in terms of profit. In the context of banks, no bank can survive without profit or the main objectives to establish the bank is to earn profit by providing different types of banking services o its customers. Profitability ratios measures the efficiency of banks, higher profit ratios they are supposed to be higher efficient and vice-versa.

4.4.1 Return on Equity (ROE)

ROE is measure of the rate of return flowing to the bank's shareholders. It approximates the net benefit that the stockholders have received from investing their capital in the bank (Pater, 2009). The Return on equity is the most important return measure of banks because it is influenced by how well the banks have performed on all other return categories and indicates whether a bank can compete for private sources of capital in the economy. Computed as the ratio of net income to the equity, it reflects the income earned from its internal sauces. The return on equity measures the book return to the owners to the firm. It is a 'bottom line ratio' in that sense (Weston & Copeland. 1991). It measures the company's return towards the invested by owner of the firm. Return on equity reveals how well the bank uses the resources of owners. It is one of the important ratios to judge whether the bank has earned a satisfactory return for its equity shareholders or not. The higher ratio represents the sound management and deficient

mobilization of the owner's equity and vice-versa. Generality, the return on equity ratio is 1.5 percent and higher is desired for the banking industry (World Bank, 1996).

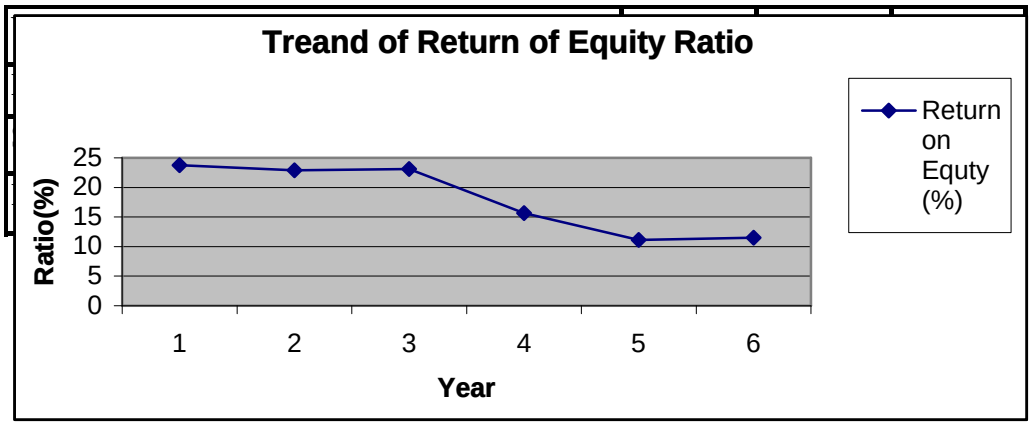
Table 4.9: Return on Equity

Year 9as at mid July)	2004	2005	2006	2007	2008	2009
Net Profit After Taxes (in million Rs.)	165.2	199.4	277.0	235.0	212.10	263.10
Shareholders equity (in million Rs.)	695.0	870.6	1198.4	1501.5	196.0	2292.1
Return on Equty (%)	23.77	22.90	23.11	15.65	11.13	11.48

Source:: Annual reports.

As shown in Table 4.9, the return on equity ratio of the bank is minimum of 11.13 percent in year 2008 and maximum of 23.77 percent in year 2009. The ratio decreasing in year 2005a and thereafter ratio is increasing in year 2006 and again ratio are decreasing up to year 2008 and finally in year 2009 it is increased. The mean ratio of the bank is 18.88 percent and the coefficient of variation of them is 31.41 percent which is variable and less consistent. The average mean ratio is above the 1.5 percent benchmark so this shows that the bank's ratio is better but it is in decreasing tendency.

Figure 4.9



As shown in Figure 4.9, the ratio has slightly decreasing in year 2005a and it has came up in year 2006 then it has vastly decreasing up to year 2008 and finally it has increased in year 2009. The observed values of the ratio are fluctuating over study period. The slope of the trend line determined by the least square method is negative. It indicates the steady downward movement or decreasing trend in ratio of bank during the period of five years. But the ratio is found minimum 11013 percent over the study period, which is not sufficient in the Nepalese commercial banks. The decreasing trend of ratios implies that earning quality of bank is also declaring.

4.4.2 Return on Assets (ROA)

The return on assets is a well known return measure of a bank that explains the net income for each unit of asset of the institution, the profitability. It is important for all the organizations, because maximum profitability is the first objective. ROA is primarily an indicator of managerial efficiency; it indicates how capably the management of the bank has been converting the institution's assets into net earnings (Rose, 2009).

It measures the profit earning capacity by utilizing available resources i.e. total assets. Return will be higher if the banks resources are well managed and are efficiently utilized. A firm has to earn satisfactory return on assets for its survival. Generally, the return on assets ratio should be 1 percent and higher is desired to the banking industry (World Bank, 1996).

Table 4.10; Return on Asset

Year (as at mid July)	2004	2005	2006	2007	2008	2009
Net profit (in million Rs.)	165.2	199.4	277.0	235.0	212.10	263.10
Total Assets (in million Rs.)	11,244.1	15,863.7	19,500.6	21315.8	24197.9	25729.8
Return on Assets (%)	1.47	1.26	1.42	1.11	0.88	1.02

Source: Annual reports.

As shown in Table 4.10, the return on asset ratio of the bank is minimum of 0.88 percent in year 2008 and maximum of 1.47 percent in year 2009. The ratio decreasing in year 2005a and thereafter ratio is increasing in year 2006 and again ratio are decreasing up to year 2009 it has increased. The mean ratio of hte bank is 1.23 percent and the coefficient of variation of them is 20.53 percent which is variable and less consistent. On the basis of mean ratio of the bank is above the benchmark 1 percent and higher so this shows that the bank's ratio is better but it is decreasing tendency.

Figure 4.10

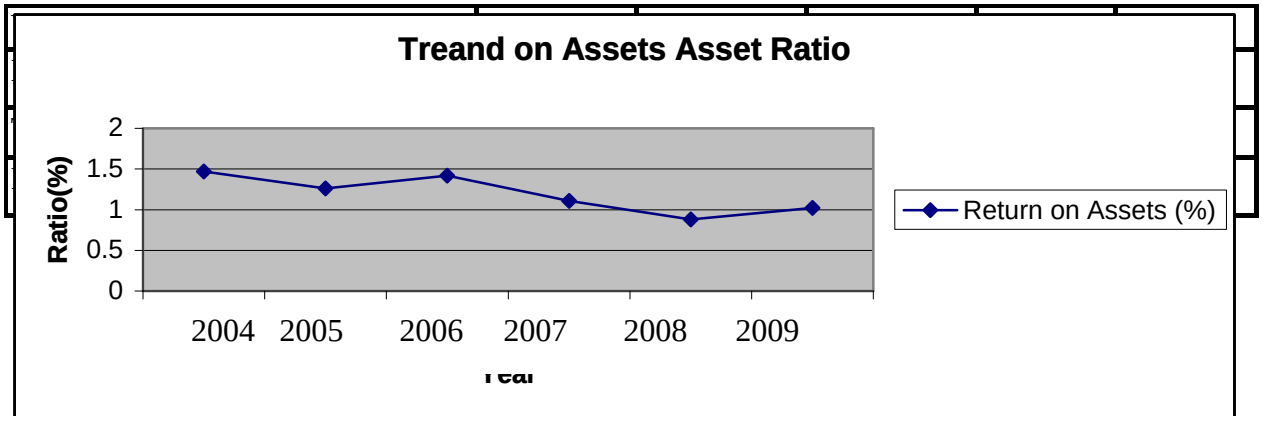


Figure 4.10 shows the observed return on asset ratio with least square trend line. It shows the downward movement of observel ratio in year 2005a and then it upward in year 2006 and then it downward movement of the ratio up to year 2008 and then it has rising in year 2009. The ratios were fluctuating trend. The negative slope of the trend line shows the falling trend in return on asset ratio during the study period.

4.4.3 Net Interest Margin

The net interest margin measures how large a spread between interest revenues and interest costs management has been able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sauces of funding (Peter, 2009). Net interest margin is calculated net interest income dividing by earning assets. Under earn in assets loans and advances, bills purchased and discounted and investment are included. In the

composition of earning assets, the loans and advances usually have higher yields which are more than the securities and its return. The net interest earned from loans and investment shows the percentage a bank earns as interest for each unit of investment made in loans and securities. It identifies and evaluates the core earning capacity of the bank. A negative or declining ratio is an important indicator of treasury management problems that require attention. Generally, the net interest margin ratio should be 3 to 4 percent and higher is better in banking industry (World Bank, 1996).

Table 4.11: Net Interest Margin

year (as at mid July)	2004	2005	2006	2007	2008	2009
Net Interest Income (in million Rs.)	328.5	488.9	591.9	570.9	647.1	754.4
Earning Assets (in million Rs.)	5714.9	9441	13098	18,714.2	21020.0	22,212
Net Interest Margin (%)	5.75	5.18	4.52	3.05	3.08	3.40

Source: Annual reports.

In the past six years, the net interest margin ratio of HBL was distributed as a maximum ratio of 5.75 percent in year 2009 and minimum ratio 3.05 percent in year 2007. The ratio of the bank decreased continually up to the year 2007 and then increased in year 2008 and year 2009. The mean ratio for the study period is found 4.34 percent and the coefficient of variation is found 25.40 percent. On the basis of the coefficient of variation, it can be concluded that the ratios are variable. On the basis of the mean ratio of the bank is above to benchmark 3 to 4 percent, so the bank's ratio is higher out it is in declining tendency.

Figure 4.11

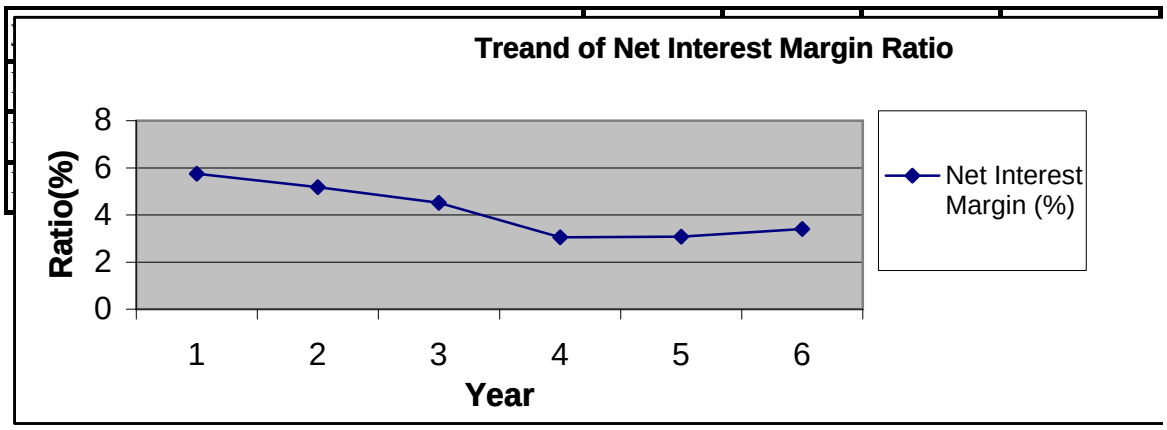


Figure 4.11 shows the observed net interest margin ratio with least square trend line. It shows the downward movement of observed net interest margin till year 2007 and then upward movement of the ratio up to final year of the study. The slope of the trend line is negative and it shows decreasing trend of net intrest margin ratio during the study period.

4.4.4 Earning per share (EPS)

Earning per share provides a direct measure of the returns flowing to the bank's owners-its stockholder- measured relative to the numbers of shares to the public (Pater, 2009). The earnings per share of an organization give the strength of the share in the market. The profitability of a firm from the point of view of the ordinary shareholders is the EPS. It measures the profit available to the equity holders on a per share basis, i.e. the amount that they can get on every share held. Higher the EPS is supposed to be a best comparing between two banks. The earning per share of HBL is tabulated below:

Table 4.12: Earning Per Share

Year (as at mid July)	2004	2005	2006	2007	2008	2009
Net Profit (in million Rs.)	165.2	199.4	277.0	235.0	212.10	263.10
No. of Shares (in million)	1.90	2.40	3.00	3.90	4.29	5.3625
Earning Per Share (Rs.)	86.95	83.08	92.33	60.26	49.44	49.06

Source: Annual reports.

Table 4.12 reveals that the EPS of the bank has fluctuated over the years of the study period. The EPS of the bank has ranged between RS. 49.06 In FY 2009 to Rs. 92.33 in FY 2006, this is decreasing trend during the study period. The mean average of EPS is Rs. 70.19 and coefficient of variation of the bank is 37.63 percent which shows less consistent and more volatile during the study period.

Figure 4.12

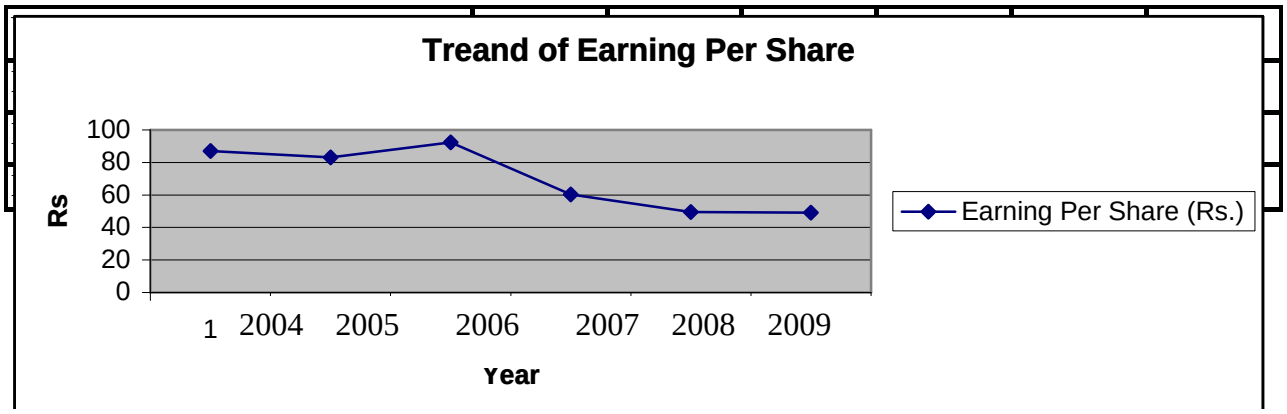


Figure 4.12 shows the observed values of earning per share along with the trend line. The EPS of the bank is fluctuating tread over the study period: The slope of the trend line is negative, which indicates that the trend of the earning per share is declining over the study period and the declining also sharp.

4.5 Liquidity

The level of liquidity influences the ability of a banking system to withstand shocks. For instance, a large shock, contributing to credit or market losses, could cause a loss of confidence ion the banking sector by market participants or depositors. In turn, this could result in a liquidity crisis that has the potential to push solvent banks into insolvency, because if they lose access to funding they could be forced to sill assets at depressed prices to obtain liquidity. Liquidity represents the ability to fund assets and meet obligations as they become due. Liquidity is essential in all banks to compensate for expected and unexpected balance sheet fluctuations and provide funds for growth. Liquidity risk is the risk of not being able to obtain funds at a reasonable price within a reasonable time period to meet obligations as they become due. Because liquidity is critical to the ongoing viability of any bank, liquidity management is among the most important activities that a bank conducts.

4.5.1 Liquid Funds to Total Deposit Ratio

This ratio measures the percentage of liquid fund with the bank to meet short term obligation. It measures overall liquidity position. Cash in hand, foreign currency in hand, balance with NRB, balance with domestic bank, balance held aboard and money at call are included in total liquid fund. This ratio is computed by dividing liquid funds by total deposits. The higher ratio implies the better liquid position and lower ratio shows the inefficient liquidity position of the bank. So, sufficient and appropriate liquid funds should be maintained properly.

Table 4.13: Liquid Funds to Total Deposit Ratio

Fiscal year (as at mid July)	2004	2005	2006	2007	2008	2009
Liquid Funds (in million Rs.)	4,787.5	5,446.5	7192.6	7,658.	8,281.7	8,613.5
Total Deposits (in million Rs.)	9780.4	14082.5	17513.6	18,595.2	21,002.8	22,760.9

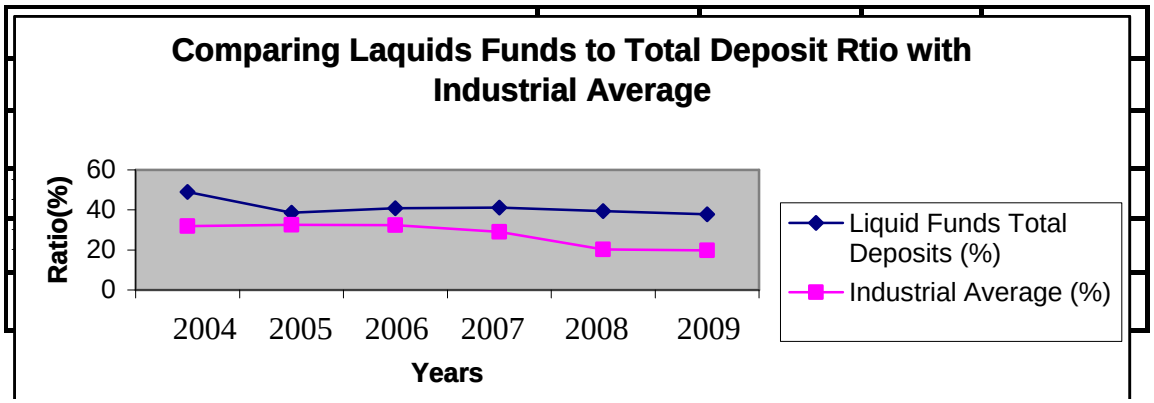
Liquid Funds Total Deposits (%)	48.95	38.68	40.84	41.19	39.43	37.84
Industrial Average (%)	31.90	32.50	32.40	29.00	20.20	19.80
Diff. from industrial average (%)	+17.05	+6.18	+8.44	+12.19	+19.23	+18.04

Source: Banking and Financial Statistics, NRB, No. 43, July, 2009.pp: 4-10.

Table 4.13 shows that the liquid funds to total deposit ratio of HBL during the total liquid fund and total deposit are increasing during the study period. The highest ratio was 48.99 percent in FY 2009 and the lowest ratio was 38.80 percent in FY 2005a. Difference is positive in all periods. This implies that liquidity position of HBL is up to industrial average.

Figure 4.13v below exhibits the observed liquid fund to total deposits ratio of the bank with compare to industrial average ratio within the study period of last six years.

Figure 4.13



In figure 4.13, the total liquid fund to total deposit curve of the bank is above the industry average curve in all observed fiscal years. This fact implies that the overall liquidity position of the bank is better than industrial average ratio but more liquidity impacts profitability negatively.

4.5.2 NRB Balance to Total Deposit

This ratio shows whether bank is holding the balance as required to Nepal Rostra Bank (NRB). T ensure adequate liquate liquidity in the commercial banks, to meet the depositors' demand for cash at any time, to inject the confidence in depositors regarding the safety of their deposited funds NRB has put the directives to maintain certain percent of deposit amount in NRB but the commercial Banks. The bank should strictly comply with the directives. The following table shows the NRB Balance to Total Deposit ratio with compare to industrial average ratio by HBL.

Table 4.14: NRB Balance to Total Deposit Ratio

Fiscal Year (as atmid July)	2004	2005	2006	2007	2008	2009
NRB Balance 9in million Rs.)	515.6	655.3	1,073.2	595.4	1,130.0	1,623.91
total Deposit 9in million Rs.)	9780.4	14082.5	17513.6	18,595.2	21,002.8	22,760.9
NRB Balanced Total Deposit	5.22	4.65	6.10	3.74	15.38	7.13
Industrial Average (%)	11.30	11.40	12.50	13.40	8.90	9.70
Diff.	-6.08	-6.75	-6.40	-9.66	-3.52	-2.57

Source: Banking and Financial Statistics, NRB, No.43, July, 2009, pp: 4-10

Table 4.14 shows that HBL has not maintained adequate liquidity by not maintaining balance with NR-B. NRB balance to total deposit ratio of the bank is fluctuating during the observed years. Balance with NRB has increased at lower rate than deposit, which resulted in the decreasing trend in the ratio in year 2005a and year 2008. The ratio has been increasing in year 2006, year 2008 and year 2009. The ratio was less than the industrial average ratio in all observed years i.e. difference is negative. This

implies that deposit of HBL with NRB is less than tat of average. This indicates that the bank has less exposure towards balance with NRB.

Figure4.14

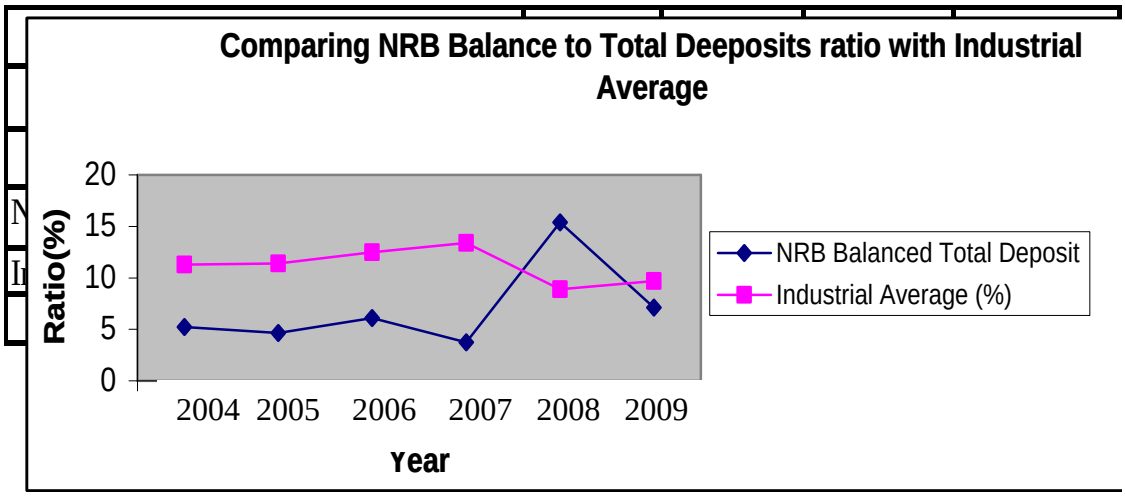


Figure 4.14 shows the NRB balance to total deposit ratio with compare to industrial average ratio within the study period of last six years. As shown in Figure 4.14, the NRB balance to total deposit curve of HBL is below the industrial average currve in must be maintained is less than the average balance. This shows that the bank has not maintained the balance with NRB as per the correctives over the study period.

4.5.2 Cash in Vault to Total Deposit Ratio

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

Table 4.15: Vault to Total Deposit Ratio

Fiscal year (as at mid July)	2009	2005	2006	2007	2008	2009
Cash in Vault (in million Rs.)	142.8	134.0	149.9	462.8	382.7	274
Total Deposits (in million Rs.)	9780.4	14082.5	17613.6	18,595.2	21,002.8	22,760.9
Vault 1 Total Deposits (%)	1.46	0.95	0.85	2.49	1.82	1.20

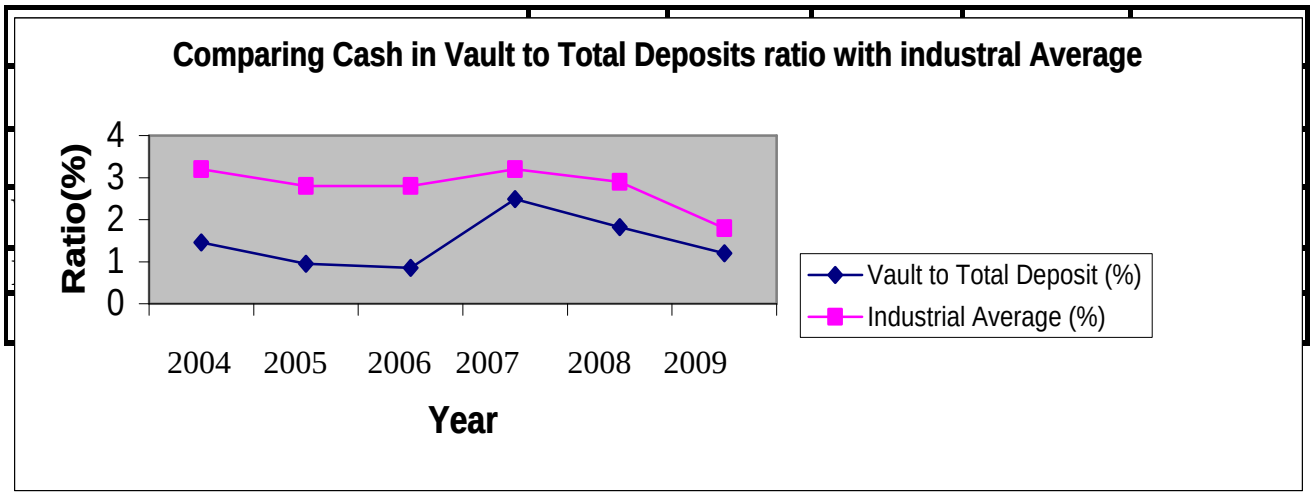
Industrial Average (%)	3.20	2.80	2.80	3.20	2.90	1.80
Diff. from industrial average (%)	-1.74	-1.85	-1.95	0.71	-1.08	-0.60

Source: Banking and Financial Statistics NRB, No.43, July, 2009. pp: 4-10.

Table 4.15 shows that the cash in vault that the cash in vault to total deposit ratio of bank has fluctuating trend. The highest ratio is 2.49 in FY 2007 and the lowest ratio is 0.85 in FY 2006. The ratio has decreased till year 2006 and then increased in year 2007 and then again decreased in final two years. Vaults have increased at lower rate then deposit has. So, increase in vault relatively lower rate has decreasing trend in the ratio for these years. But in year 2006, vault has decreased, so the ratio has came down in minimum. Ratio is less than the industry average ion all observed years.

Figure 4.15 exhibits the observed cash in vault ratio of the HBL with compare to industrial average ratio within the study period of last six years.

Figure 4.15



In figure 4.15, the vault to total deposit curve of HBL is below the ndustry average curve in all observed fiscal years and also below the NRB standard of 2 percent. It indicates that the bank is running with inadequate vault ads liquidity during the study period.

4.6 Major Findings

The major finding of the study on financial performance analysis of Himalayan Bank Ltd. in the framework CAME are as follows:

i) In the past six yeas, the capital adequacy ratio of HBL is distributed as a minimum ratio of 8.1 percent in year 2006 and maximum ratio 11.56 percent in year 2007. The ratios of this bank were fluctuating over study period. The ratos year 2007. The ratios of this banks weere fluctuating over study period. The ratios of HBL (in percent) were 8.42, 8.03, 8.01, 11.56, 10.93 and 1065 in year 2009, 2005a, 2006, 2007, 2008, and 2009 respectively and the NRB standard (in percent) in each year were 8, 8, 8, 9, 10, and 11 respectively. However, the capital adequacy ratio of the bank is above the NRB Standard in all the years except in year 2009 i.e. insufficient of capital in that year.

ii) The Core Capital adequacy ratio of HBL is distributed for the minimum of 4.4r percent in year 200 to maximum of 7.69 percent in year 2009. The core capital of the bank is in the increasing trend over the study period. But, the core capital adequacy ratio of the bank of the bank is unstable (the ratio is declining continuously in beginning yeas and rising in the final years). The ratios of HBL (in percent) were 5.06, 4.44, 4.67, 6.55, 7.07, and 7.69 in year 2009, 2005a, 2006, 2007, 2008, and 2009 respectively and the NRB standard (in percent) in each year were 4, 4, 4, 4.50, 5.00 and 5.50 r4espectively. With comparing to NRB standard, the core capital adequacy ratio is above then the NRB standard in each year over the study period. Thus, it is found that the core capital adequacy ratio of HBL adequate and sufficient.

iii) The supplementary capital adequacy ratio of HBL is distributed form the minimum of 3.34 percent in year 2006 to maximum of 5.01 percent in year 2007. The ratios of HBL (in percent) were 3.36, 3.59, 3.34, 5.01, 3.84 and 2096 in yerar 2009, 2005a, 2006, 2007, 2008, and 2009 respectively and the NRB standard (not more than core capital of bank) were 5.06, 4.44, 4.67, 6.55, 7.07 and 7.69 in each year respectively. Hence, the supplementary capital ratio is with in the boundary of NRB standard during the period of past six years.

iv) In the composition of assets, it reveals that movement of money at call was observed in switch over in to investment during last three years. But approximately including money at call, cash and bank balance and investment remain same during the study period. The average mean percentage of cash and bank balance, money at call, investment, loan & advances, fixed assets and other assets were 7.01 percent 15.12 percent, 26.70 percent, 46.38 percent, 1.23 percent and 3.55 percent respectively during study period.

v) The Non-Performing loans to total loans and advances ratios for the study period have decreasing trend with fluctuations over the years. The ratio ranges from minimum to 8.35 percent in year 2007 to maximum to 145.16 percent in year 2006 with an average of 10.62 percent. The ratios (in percent) were 15.16, 8.35, 10.08, 8.88 in year 2006, 2007, 2008 and 2009 and the industrial average (in percent)were 30.78, 3041, 28.8, 29.00 in each year respectively. The ratios were below the industrial average but it was not sufficient in banking industry.

vi) Loan loss provision to loans and advances ratios for the study period has increasing trend. The ratio ranges from 3.83 percent in FY 2006 to 7.77 percent in FY 2008 with an average of 6.45 percent. The coefficient of variation between them is 28.04 percent, which indicates that the ratios are variable and not consistent with the increasing trend. The slope of the trend line of loan loss ratio high this shows that the loan loss provision is increasing rapidly.

vii) The total expenses to total revenue decreasing up to year 2006, thereafter, it is observed increasing up to year 2008 and then decreasing in year 2009. The ratio is distributed from a minimum of 32.41 percent in year 2006 to maximum 85.41 percent in year 2008 with average ratio of 83.60 percent and coefficient of variation between them is 1.32 percent. On the basis of coefficient of variation, it can be concluded that the ratios are stable and consistent. Decreasing trend of ratio is favorable on measure management quality. Thus, negative slope of trend line of the ratios indicates the decreasing expenses with respect to income.

viii) The earning per employee ratio is increasing up to year 2006 and then decreasing till year 2008 and again increased in final year 2009. The observed values of the ratio are fluctuating over the study period. The mean of the ratios for the study period is Rs. 628,302 and the coefficient of variation between them is 1.33 percent. On the basis of the coefficient of variation, the ratios are less variable and consistent. The slope of the trend line is negative, which indicates the earning per employee is declining over the study period. However the decline is not sharp. This indicates that, low or decreasing earnings per employee can reflect inefficiencies as a result of over starring, with similar repercussions in terms of profitability.

ix) The return on equity ratio of the bank is minimum of 11.13 percent in year 2008 and maximum of 23.77 percent in year 2009. The ratio decreasing in year 2005a and thereafter ratio is increasing in year 2006 and again rare decreasing up to year 2008 and finally in year 2009 it is increased. The mean ratio of the bank is 18.88 percent and the coefficient of variation of them is 31.41 percent which is variable and less consistent. The average mean ratio is above the 15 percent benchmark so this shows that the bank's ratio is better but it is decreasing tendency.

x) The return on asset ratio of the bank is minimum of 0.88 percent in year 2008 and maximum of 1.47 percent in year 2009. The ratio decreasing in year 2005a and thereafter ratio is increasing in year 2006 and again ratio are decreasing up to year 2008 and finally in year 2009 it is increased. The mean ratio of the bank is 1.23 percent and the coefficient of variation of them is 20.53 percent which is variable and less consistent. On the basis of mean ratio of the bank is above the benchmark 1 percent above so this show that the bank's ratio is better but it decreasing tendency.

xi) The net interest margin ratio was distributed as a maximum ratio of 5.75 percent in year 2009 and minimum ratio 3.05 percent in year 2007. The ratio of the bank decreased continuously up to the year 2007 and then increased in year 2008 and year 2009. The mean ratio for the study period is found 4.34 percent and the coefficient of variation is found 26.50 percent. On the basis of the coefficient of variation is found 26.30 percent. On the basis of the coefficient

of variation, it can be concluded that the ratios are variable. On the basis of tee mean ratio of the bank is above the benchmark 3 to 4 percent and above, so the bank's ratio is higher but it is declining tendency.

xii) The EPS of the bank has fluctuated over the years of the study period. The EPS bank has ranged between Rs. 49.06 in FY 2009 to Rs. 92.33 in FY 2006, which is decreasing trend during the study period. The mean average of EPS is Rs. 70.19 and coefficient of variation of the bank is 37.63 percent which shows less consistent and more voltile during the study period.

xiii) Liquids to total deposit ratio of HBL (in percent) were 48.95, 38.68, 40.84, 41.19, 39.43 and 378.84 and industrial average ratios (in percent) were 31, 90, 32.50, 32.40, 29.00, 20.20 and 19.80 in year 2009, 2005a, 2006, 2007, 2008, and 2009. With comparing to industrial average, liquid fund to total deposit ratio of HBL is above the industry average ratio in each year, hence, the performance measured in terms of this ratio is better than that of industry average. This implies that the bank's liquidity position in overall is better but this impact in profitability negatively.

xiv) NRB balance to total deposit ratio of HBL (in percent) were found 5.22, 4.65, 6.10, 3.74, 5.38, and 7.13 and industrial average ratios (in percent) were 11.30, 11.40, 12.50, 13.40, 8.90 and 9.70 in year 2009, 2005a, 2006, 2007, 2008, an 2009 each year respectively. With comparing to industrial average, NRB balance to total deposit ratio of HBL is below the industry average ratio in each year. This implies that the bank is not strictly following the directives issued by NRB in respect to balance must held in NRB.

Cash in vault to total deposit ratio of HBL (in percent) were 1.46, 0.95, 0.85, 2.49, 1.82 and 1.20 and industrial average ratios (in percent) were 3.20, 2.80, 2.80, 3.20, 2.90 and 1.80 i8n year 2009, 2005a, 2006, 2007, 2008, and 2009 each year respectively. With comparing to industrial average, Vault to total deposit

CHAPTER V
SUMMARY, CONCLUSION AND RECOMMENDATIONS

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

5.1 Summary

The study was carried out as academic requirements for master's degree of business studies, on the topic of "Financial Performance Analysis of Himalayan Bank Limited in the Framework of CAMEL." The study was started with the objective to find out the fact about financial performance of Himalayan Bank Ltd. The analysis of financial statement is done to obtain a better insight into a firm's position and performance. Camel is a technique of health checking of financial institutions. Bank financial soundness is judged on the basis of capital adequacy, asset quality, and management quality, earning quality, liquidity position and sensitivity to market risk. Almost, all the government banks in Nepal are running at loss. Though almost all the private sectors banks are earning profit, it is very to difficult to call them sound if appraised from CAMELS approach. Thus, the interest was expressed to analyze the financial performance of commercial bank with carrying a case study of Himalayan Bank Ltd. in the framework of CAMEL.

The study was conducted with the general objective to analyze the financial soundness of the Himalayan Bank Ltd. in Nepal. In addition with this specific objectives of the study were to analyze the trend in capital adequacy, non-performing loan, loan loss provision, asset composition, management quality ratios, earning capacity and liquidity position of the bank in period of year 2009 to year 2009 A.D. Various material were reviewed in order build up the conceptual foundation and to find out the clear destination of the research work. Meaning and functions of commercial banks, historical developments or commercial bank in Nepal, regulation, supervision, monitoring system

of Nepal Rastra Bank, concept of financial performance analysis, concept of CAMEL, capital adequacy, Basel capital accord, concept of non-performing loan, its classification, and measures to readdress it, concept of management of quality, concept earning quality, concept of liquidity, its need, and liquidity management techniques etc. were reviewed as conceptual review. On the other hand, review of articles and review of dissertations were included in research review section of the report.

The research covers only six years period from year 2009 to year 2009 A.D. It is concerned with the financial performance analysis of the commercial bank. the study was designed within the framework of descriptive and analytical research design and the analysis has been made in the same way. For the study purpose, Himalayan Bank Ltd. is drawn as a study unit with applying convenience sampling technique out of 17 commercial banks. The required data and information were collected from secondary sources. In addition with this, primary data also are used in this research work which was collected by using unstructured interview with senjor staff in the bank. Financial ratios, simple mathematical and statistical tools have been implied to get the meaningful result of the collected data in this research work.

The analysis has been made the bank's ratios with compare to NRB standard, industrial average and trend of ratios. The capital adequacy ratios of the bank are generally above than NRB standard in all the years which leads to conclude that the bank is running with adequate capital. The capital adequacy ratios above the NRB standard of the banks show the protection and security to outsiders and financial soundess of the banks. In addition to these, observed capital adequacy ratios indicate that the capital of the banks is significant and sound as per the NRB standard over the study period except adequacy ratio below the NRB standard in year 2009. The non-performing loans to loan ratios are below the industrial average and in decreasing trend whereas the loan loss provision of the bank is increasing in cash year. The earning quality ratios like return on equity, return on assets, net interest margin, earning per share are generally above the benchmark prescribed by World Bank and in decreasing trend this shows that the quality of earning is depreciating. The management quality proxy ratios are: the total expenses to total revenues ratios are in decreasing trend this is favorable where as earning per

earnployee ratios are decreasing trend. The cash in vault to total deposits ratios and NRB balance to total deposits ratio are below the industrial average and NRB directives where as the liquid funds to total deposits ratios are above the industrial average during the study periods. This shows that the liquidity position of the bank in overall is good but the bank is do not strictly follow the NRB directives i.e. the amount must be maintained as a valued and NRB balance is little.

5.2 Conclusion

Based on the ridings, following conclusions have been drawn as a concluding framework of the study on financial performance analysis of Himalayan Bank Ltd:

1. Capital adequacy ratios reveals that the bank is running with the adequate capital and the capital find of the bank is sound and sufficient to meet the banking operation as per the NRB standard except year 2009 during the study period. This shows that the bank do not strictly follow the NRB standard in the year.

2. Core capital adequacy ratio measured in terms of core capital to total risk adjusted assets is as per NRB standard. It means the bank is using adequate amount of internal sources or core capital in past six years. In this point of view the banks is financially sound and strong.

3. Supplementary capital ratio of the bank is wit in the boundary of NRB standard over the study period which supports to draw the conclusion of the supplementary capital of the bank is sufficient or adequate. The declining tendency in final years implies that the decreasing proportion of supplementary capital in total risk adjusted assets of the bank.

4. The assets composition of the bank during the study period reveals that movement of money at call was observed in switch over in to investment during the last three years. As it can be seen the major part of total assets was held in form of loans and advances, other assets, and investment, which fails under high-risk category of assets.

5. The decreasing trend of non-performing loans and advances ratio helps to conclude that the bank is aware of non-performing loans and adopting the appropriate policies to manage this problem and to increase the quality of asset. But the ratio should be reduced to single digit.

6. The increasing trend of loan loss ratio indicates that the quality of loans becoming degrading year by year i.e., It seems that amount of non-performing loans and possibility of default in future is increasing.

7. The decreasing trend of total expenses to total revenues ratios shows that the bank may operate efficiently. This can be but is not necessarily due to management efficiencies. In any case, it is likely to positively affect profitability.

8. The decreasing trend of earning per employee depicts infancies as a result of overstaffing, with similar repercussions in terms of profitability. But the decreasing trend is not sharp.

9. The decreasing trend of return on equity shows that the rate of return flowing to the bank's shareholders is degrading year by year. Still, the bank has better return on equity.

10. The decreasing trend of return of assets concludes that the net income for each unit of asset of the bank is depreciating. This show that the capability of the management to obverting the bank's assets into net earning is declining. Still, the bank has better return on assets comparing with benchmark.

11. The decreasing trend of net interest margin shows that spread between interest revenues and interest costs management has been not able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sources of funding. Still, the bank has better net interest margin comparing with benchmarks.

12. The decreasing trend of earnings per share depicts that the returns flowing to tha bank's owner is declining. This tendency affect the strength of the share in the market is also declining.

13. The liquid funds to total deposit ratio is above the industrial average ratio. This shows that there is very high proportion of liquid funds than the proportion fo investment in income generating asset and shows lack of specific policy of invest of additional idle funds to high income generating assets in the form of investment.

14. The NRB balance to total deposits ratio is below the industrial average during the study period. This shows that the bank is not maintain sufficient amount of balance must held in NRB.

15. The cash in vault to total deposit ratio is below the industrial average ratio and NRB standard during the study period. This shows that ignoring the percentage of most liquid fund with the bank to make immediate payment to the depositors. It also indicates that the bank is running with the inadequate liquidity to meet its short term obligation.

5.3 Recommendations

On the basis of analysis and findings of the study, following recommendations can be made as suggestions to overcome the weakness in the existing financial performance of Himalayan Bank Ltd.

1. Capital adequacy ratio of the bank is not sufficient as per the NRB standard in year 2009 and the ratios are changing frequently over the study period. So, the recommendation is provided to maintain stable capital adequacy ratios in the bank and strictly follow the NRB directives is better.

2. Although the bank has been decreasing the proportion on non-performing loans to total loans and advances during the study period, the bank is advised to give more attention to decrease the level as it can to meet the international standers. For this bank management has to give serious attention towards the recovery and timely follow-up ot

the disbursed loan and bank management is recommend to formulate a effective powerful loan recovery committee.

3. The loan loss provision to total loans and advances is increasing regularly during the study period, which shows there is high probability of loan default in future. So the bank is recommended to lower the proportion of loan loss provision by increasing the quality of assets by strengthening the credit appraisal and follow-up measures.

4. The earning per employee is decreasing trend during the study period. So necessary corrective actions should be implemented.

5. During the study period, the earning quality ratios i.e. return on equity, return on assets, net interest margin and earning per share are decreasing trend. Of course, profit is essential and a crucial part of any business, without it no firm can survive and grow. To increase profit these banks should minimized their operating cost by increasing the operating efficiency of their employees. Thus, the bank is recommended to increase its yield as its net profit. The decreasing trend of profit of the bank may loose the confidence of the shareholders and other stakeholders.

xv) 6. As the liquidity position of the bank is found to be high, especially in liquid funds, the bank is recommended to look upon new area of lending and investment that helps in minimizing the idle funds. Otherwise, this may impact the profitability negatively. And the bank's vault to total deposits ratio and NRB balance to total deposits ratio are below the industrial average during the study period so strictly following the NRB directives is sit ratio of HBL is below the industry average ratio in each year. This implies that the bank not strictly following the directives issued by NRB in respect to balance must held as a vault.

better for regulatory mandatory.

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APPENDIX 1

List of Commercial Banks in Nepal

S.N	Name of the Banks	Estd. Year
1	Napal Bank Ltd.	1994
2	Tastri a Bani" a Bank	2022
3	NABIL Bank Ltd.	2041
4	Nepal Investment Bank	2042
5	Standard Chartered Bank Ltd.	2045
6	Himalayan Bank Ltd.	2049
7	Nepal SBI Bank Ltd.	2050
8	Nepal Bangladesh Bank Ltd.	2050
9	Everest Bank Ltd.	2051
10	Bank of Kathmandu Ltd.	2051
11	Nepal Credit and Commerce Bank Ltd.	2053
12	Lumbine Bank Ltd.	2055
13	NIC Bank Ltd.	2055
14	Machapuchre Bank Ltd.	22056
15	Kumari Bank Ltd.	2057
16	Laxmi Bank Ltd.	2058
17	Siddhartha Bank Ltd.	2058

Source: Nepal Rastra Bank Bulletin, 2005.

APPENDIX 2

Share Holding Pattern of Himalayan Bank Ltd.

Subcription	Percentage Holding
Promoter Share Holder	51%
Habib Bank Ltd., Pakistan	20%
Financial Institution (Employees Provident Fund)	14%
Nepalese Public Shareholder	15%
Total	100%

Source: Annual Report. 2009

APPENDIX 3

HIMALAYAN BANK LTD.

Comparative Profit and Loss Account

(In million Rs.)

Fiscal Year for the mid July	2004	2005	2006	2007	2008	2009
Expenses						
Interest Expenses	533.59	594.8	734.518	578.134	554.128	491.543
Staff Expenses	-	59.88	85.575	101.537	120.146	152.508
Office Operating Expenses	109.746	132.545	141.116	155.786	177.132	211.047
provision for Doubtful Debts	64.57	103.249	134.32	166.5506	202.873	186.226
Provision for Staff Bonus	27.941	34.855	48.336	38.783	40.003	46.731
Non-operating Expenses	-	3.672	-	-	-	10.988
Income Tax Provision	86.221	114.316	154.323	114.023	147.896	157.22
Net Profit	165.248	199.38	277.039	235.023	212.129	263.053
Total Expenses	1034.68	1242.7	1575.23	1389.79	1454.31	1519.62
Incomes						
Interest Income	862.054	1033.66	1326.38	1149	1201.23	1245.9
Commission & Discount	101.958	110.33	96.065	101.704	102.562	123.929
Foreign Exchange Gain	63.958	1.695	2.33	2.451	10.76	3.299
Non-Operating Income	1.061	1.695	2.303	2.451	10.75	3.299
other	5.624	9.685	31.22	32.038	30.154	34.076
Total Income	1034.68	1242.7	1575.23	1389.79	1454.31	1519.62

Source Annual Reports.

APPENDIX 4

HINIALAYAN BANK LTD. Comparative Balance Sheet

(in million Rs.)

Fical Year as at mid July	2004	2005	2006	2007	2008	2009
Capital and Liabilites						
Share Capital	192	240	300.0	390.0	429.0	536.3
Reserve Funds	503.1	630.6	898.4	1111.5	1476.9	1755.5
Borrowings	232.7	128.5	79.5	534.0	645.8	659.0
Deposit Accounts	9772.7	14043.1	17532.4	18619.4	210074	22010.3
Other Liabilities	543.6	821.5	590.4	660.4	638.9	768.5
Total Liabilities	11224.1	15863.8	1900.7	21315.8	24198.0	25729.6
Assets						
Cash & Bankl Balance	802.2	901.9	1435.2	1264.7	1979.2	2006.1
money at Call	4125.9	4682.8	4057.7	352.4	150.1	368.1
Investment	468.9	2216.4	4083.2	9157.1	110175.4	9292.1
Loan and Advances	5246.0	7224.7	9015.3	9557.1	10844.6	12919.6
Fixed Assets	171.3	193.1	201.7	318.8	229.9	299.6
Other Assets	429.8	644.9	707.6	665.7	818.8	848.3
Total Assets	11244.1	15863.8	19500.7	21315.8	24198.0	25729.6

Source: Annual Reports.

APPENDIX 5

List of On-Balance Sheet and Off-Balance Sheet Assets and Weights

S.N.	Particulars	Weights
A	On Balance Sheet Assets	
1	Cash Balance	0%
2	Gold Tradable	0%
3	Balance with Nepal Rastra bank	0%
4	Investment in Govt. Securities	0%
5	Investment in NRB Bond	0%
6	Full secured loan against own Fixed Deposit Rceipt	0%
7	Full secured loan against Govt. Securities	0%
8	Balance with Domestic Banks and Financial	20%
9	Full secured FDR loan against FDR of Other Bank	20%
10	Balance with Foreign Banks	20%
11	Money at Call	20%
12	Loan against Guarantee of internationally Rated	20%
13	Other Investments in internationally Rated Banks	20%
14	investment in Shares Debentures and Bonds	100%
15	Other Investments	100%
16	Loan Advances and Bills purchased I Discounted	100%
17	Fixed Assets	100%
18	All other assets	100%
B	Off balance Sheet Items	
1	Bills Collection	0%
2	Forward Foreign Exchange Contract	10%
3	Letters of Credit with mature of less than 6 m`	20%
4	Guarantees provided against CG of A+ international	20%
5	Letters of credit with maturity more than 6 months	50%
6	Big Bond	50%
7	Performance Bond	50%

8	Advance payment Guarantee	100%
9	Financial guarantee	100%
10	Other Guarantee	100%
11	Irrevocable Loan Commitment	100%
12	Contingent Liability in respect of income tax	100%
13	All other contingent liabilities	100%
A+B	Total Risk Weij hted Assets	

Source: Annual Report (Himalayan Bank Ltd.). 2009.

APPENDIX 6

Amount of Liquid Fund, Cash in Vault, NRB Balance and Total Deposits (in million Rs.)

	2009	2005	2006	2007	2008	2009
	4,787	5,446	7,192.d	7,658A	8.281	8,613.51
	121	116	131	450.1	350	274
	21.1	17	18.21	12.71	32	0.01
	515A	655	1,073	695	1,130	1,623
	22	12	11	36.3	40	33
	19	-38	52	36	600	-162
	4,125	4,682	5,905	6.427	6,129	6,844
	142	134	149	462	382	27
	121	116	131	450.1	350	274.2
	21.1	17	18	12	32.7	0
	515A	655	1,073.2	695	1,1130	1,623
	9780	14082	17613	18595	21002	22760
	1,292	1,772	2313.7	2,652	3,702	4,353.1
	5,084	6,844	9,164.1	9,102	10,840	11,719
	3,106	5,109	5,668.1	6,044	5,880	6,043
	0	0	0	343	201	219
	297.01	356.5	467	450	337	424

Source: Banking and Financial Statistics, NRB, NO-43, July, 2009.