

COMPARATIVE FINANCIAL PERFORMANCE ANALYSIS

OF

NABIL BANK AND NEPAL SBI

IN

THE FRAMEWORK OF

"CAMEL RATING SYSTEM"

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RECOMMENDATION

This is to certify that the thesis:

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Entitled:

**COMPARATIVE FINANCIAL PERFORMANCE
ANALYSIS**

OF

NABIL BANK AND NSBI BANK

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DECLARATION

I hereby declare that the data and work reported in this thesis entitled
**"COMPARATIVE FINANCIAL PERFORMANCE
ANALYSIS OF NABIL BANK AND NSBI BANK"**
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University is my authentic work done for the partial fulfillment of the
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Commercial Banks are the backbone of any economy; a bank cannot be imagined without the presence of investors. Thus, protection of Investors should be considered seriously. Legal provision and the practice regarding shareholders' interests also are immature in our country.

This study has been prepared for partial fulfillment of the requirement for the master degree in business studies. It is my privilege to complete this thesis entitled "**COMPARATIVE FINANCIAL PERFORMANCE ANALYSIS OF NABIL BANK AND NSBI BANK**" which analysis the performance evaluation of the sample banks.

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ABBREVEATIONS

ADBL : Agricultural Development Bank.

ALLL : Allowance for Loan and Lease Losses.

ALM : Assets Liabilities Management.

ATM : Automated Teller Machine.

CAPM : Capital Assets Pricing Model.

CAMELS : Capital adequacy, Asset quality, Management effectiveness, Earning and Liquidity

CEO : Chief Executive Officer.

CML : Capital Market Line. .

CRR : Cash Reserve Ratio.

C. V. : Coefficient of Variation.

EBIL : Emirates Bank International Ltd.

EBL : Everest Bank Limited.

EPF : Employee Provident Fund.

EPS : Earning per Share.

FY : Fiscal Year.

FI : Financial Institution

HBL : Himalayan Bank Limited.

HMG : His Majesty Government

IRC : Interest Rate Change.

IRR : Interest Rate Risk

LLP : Loan Loss Provision.

MBS : Masters of Business Studies.

MPS : Market Price per Share.

NBL : Nepal Bank Limited.

NEPSE : Nepal Stock Exchange Limited.

NIB : Nepal Investment Bank Limited.

NIC : National Insurance Corporation

NIDC : Nepal Industrial & Development Bank.

NIM : Net Interest Margin.

NP : Net Profit.

NRB : Nepal Rastra Bank.

PLLL : Provision for Loan and Lease Losses.

ROA : Return on Assets

ROE : Return on Equity.

RRR : Required Rate of Return.

RSA : Rate Sensitive Assets

RSL : Rate Sensitive Liabilities

RWA : Risk weighted Assets.

S.D. : Standard Deviation.

SCBNL : Standard Chartered Bank Nepal Limited.

SDC : Shanker Dev Campus.

TE : Total Expenses

TI : Total Income

TU : Tribhuvan University.

VAR: Vault at Risk

CHAPTER - I

INTRODUCTION

1.1 BACKGROUND OF THE STUDY:

As we are well known about Nepal second largest capacity in the world water resources which are enough for the better development of the country if these resources are well utilized. But the development sectors of Nepal which are handling by the politician are not putting extra effort to uplift the development of water resources, so that the economic growth of Nepal is not growing as expected which has somehow sliding the development steps down and down. That is why the current position of Nepal is very poor, most of the people are living below the poverty line, and many development works are under the shadow of the Nepali's Politicians.

The history of modern commercial banking industry dates back to 1937 A.D in which year Nepal Bank Ltd. was incorporated. Till 1984, financial sector was closed to private sector and foreign investors. Nepal started to liberalize the financial sector in the first half of the 1980s. But it speeded up this process only in early 1990s. The financial scenario has changed with introduction of joint venture banks in 1984. The domestic banks of Nepal, Nepal Bank Ltd. and RBB could no longer hold monopoly. The number of commercial banks has been increasing so is the investment volume and opportunity in various sectors that extends to agriculture, industry, commercial and social sectors. The new commercial banks at the recently time have added new opportunities and threats. New innovations deregulation and globalization in banking sector has contributed a lot in making banking business more complex and potentially riskier. NRB as an apex monetary authority of the country started to monitor and control the Finance industry especially at the end of the 1990s by issuing the directives to the financial institutions which has adopted the CAMEL system to check up the health of FIs. It has yet to use the CAMELS to evaluate the financial performance and check up the financial health. Independent outsiders also cannot use all components of CAMELS to check up the financial health of FIs in Nepal due to the full disclosures of required financial information to outsiders. (*Keshar J Baral, Dec 2005:3*)

As we know, Nepal is a least developed country which is not being able to develop its economic condition due to various factors like political, Socio-cultural, technological environment of the country. Banking industries is also regarded as one component of economy. It transfers the scattered funds collected from saving of the public into various productive sectors. Economic activities remains halt in absence of banking industries. It plays the role of catalyst for economic development of the country in the developing country where there prevails unorganized transaction. As financial intermediary, the commercial banks also play an important role as implementing body for central bank.

“Financial statement analysis applies analytical tools and techniques to general purpose financial statement and related data to derive to estimates and interferences useful in business decision. It is a screening tool in selecting investment or merger candidates and is a forecasting tools of future financial conditions and consequences. It is a diagnostic tools in assessing financing, investing and operating activities and is an evaluating tool for managerial and other business decision.” (*Bernsten, Leopard, Wild 1983:3*)

CAMEL’s framework is considered as one commonly used framework for analyzing the health of individual institutions, which looks at six major aspects of a financial institution: capital adequacy, asset quality, management soundness, earnings, liquidity, and sensitivity to market risk which have shown that certain macroeconomic crises. The purpose of this research is to focus on to identify and monitor current and potential areas of risk under the framework of CAMEL rating of the major selected commercial bank of Nepal, they are ***NSBI Bank and NABIL Bank***. This research study about the factors which are the part of CAMELS analysis. Also this research effort to find the major issue of the sample banks and to direct public beneficiaries of private supervisory information, such as that contained in CAMELS ratings, would be depositors and holders of banks' securities. Small depositors are protected from possible bank default. Rather than evaluating a bank’s solely on its performance to date or focusing on areas of minimal risk, it is imperative to evaluate both bank’s performance and management’s ability to identify, measure, monitor, and control risk. Brief profile of the sample banks is presented below:

NABIL BANK LIMITED.

NABIL Bank Limited, the first joint venture bank of Nepal, started operations in July 1984 as the name of Nepal Arab Bank Ltd under the company act. Dubai Bank Ltd was the initial foreign joint venture partner of this bank with 50% equity investment. The shares owned by DBL were transferred to Emirates Bank International Ltd (EBIL), Dubai. Later EBIL sold its entire holding to National Bank Ltd, Bangladesh (NBLB). Hence 50% of equity shares of NABIL Bank Ltd are held by NBLB and out of remaining, financial institutions have taken 20% and 30% were issued to general public of Nepal. NABIL Bank was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, NABIL Bank provides a full range of commercial banking services through its 47 points of representation across the nation and over 170 reputed correspondent banks across the globe. NABIL Bank as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business.

Highly qualified and experienced management team manages operations of the bank, including day-to-day operations and risk management. Bank is fully equipped with modern technology, which includes ATMs, credit cards, state-of-art world-renowned software from Infosys Technologies System, Bangalore, India, and Internet banking system and Tele-banking system. (*www.nabilbank.com*)

NSBI BANK LIMITED.

NSBI Bank Ltd. (NSBI) is the first Indo-Nepal joint venture in the financial sector sponsored by three institutional promoters, namely State Bank of India (SBI), Employees Provident Fund (EPF) and Agricultural Development Bank Ltd.(ADBL)through a Memorandum of Understanding signed on 17th July 1992. NSBL was incorporated as a public limited company at the Office of the Company Registrar on April 28, 1993 under Regn. No. 17-049/50 with an Authorized Capital of Rs.12 Crores and was licensed by Nepal Rastra Bank on July 6, 1993 under license No. NRB/I.Pa./7/2049/50. NSBL

commenced operation with effect from July 7, 1993 with one full-fledged office at Durbar Marg, Kathmandu with 18 staff members. The staff strength has since increased to 511. Under the Banks & Financial Institutions Act, 2063, Nepal Rastra Bank granted fresh license to NSBL classifying it as an "A" class licensed institution on April 26, 2006 under license No. NRB/I.Pra.Ka.7/062/63. The Authorized, Issued and Paid-Up Capitals have been increased to Rs. 200 Crores, Rs. 166.16 Crores and Rs. 165.36 Crores, respectively. In terms of the Technical Services Agreement concluded between SBI and the Bank, SBI provides management support to the bank through its 3 expatriate officers including Managing Director who is also the CEO of the Bank. ADBL divested its stake in the Bank by selling its entire 5% promoter shares to SBI on 14th June, 2009. Consequently, the Bank's corporate status has undergone change from its previous status as a Joint-venture Bank to a Foreign Subsidiary Bank of SBI. Presently fifty five percent of the total share capital of the Bank is held by the SBI, fifteen percent is held by the EPF and thirty percent is held by the general public. (*Pandey, 2010:32*)

NSBI Bank Limited (SBI) was established under the company act 1964, in 1993. This is the joint venture of state bank of India and Nepali promoters. The State Bank of India holds 50 percent shares of total investment. NSBI Bank Limited is managed by the State Bank of India under the Joint Venture and Technical Services Agreement signed between it and Nepali promoters.

The main objectives of the bank are to carryout modern banking business in the country under the commercial act 1974, and to provide loan on agriculture, commercial and industrial sectors.

The following facilities have been providing by the bank are:

International Trade and Bank Guarantee

Any Branch Banking

Conventional Banking Facilities

Remittances, etc.

www.nepalsbi.com.np

1.1.1 Concept of Banking:

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 FI that creates deposits liabilities which circulate as money unlike the deposits of other FIs. In fact, the greater part of money supply is the direct consequence of the profit-seeking or money-creating activities of commercial banks. Bank is a financial institution, which play a significant role, in the development of the country.

“Banking institutions are inevitable for the resources utilization and all round development of the country. It is resources for the economic development; it maintains economic confidence of various segments and extends credit to people” (*Ronald, 1993:87*)

1.1.2 Origin of Banking System in World.

“Banking concept existed even in the ancient period when the rich people used to issue the common people against the providers of safe keeping of their valuable items on the presentation of the receipt: the depositors would get back their gold and valuables of the paying a small amount of safe keeping and saving" (*Paul, 1973:27*)

The Word ‘bank’ is derived from the Italian word ‘banko’ signifying a bench, which was erected in the market place, where it was customary to exchange money. The Lombard Jews were the first to practice this exchange business, the first bench having been established in Italy A.D. 808. Some authorities assert that the Lombard merchants commenced the business of money-dealing, employing bills of exchange as remittances, about the beginning of the thirteenth century

About the middle of the twelfth century it became evident, as the advantage of coined money was gradually acknowledged, that there must be some controlling power, some corporation which would undertake to keep the coins that were to bear the royal stamp up to a certain standard of value; as, independently of the ‘sweating’ which invention may place to the credit of the ingenuity of the Lombard merchants- all coins will, by wear or

abrasion, become thinner, and consequently less valuable; and it is of the last importance, not only for the credit of a country, but for the easier regulation of commercial transactions, that the metallic currency be kept as nearly as possible up to the legal standard. The gradual merging of the business of a goldsmith into a bank appears to have been the way in which banking, as we now understand the term, was introduced into England; and it was not until long after the establishment of banks in other countries—for state purposes, the regulation of the coinage, etc. That any large or similar institution was introduced into England. It is only within the last twenty years that printed cheques have been in use in that establishment. First commercial bank was Bank of Venice which was established in 1157 in Italy.

1.1.3 Origin of Banking System in Nepal

Nepal's first commercial bank, the Nepal Bank Limited, was established in 1937. The government owned 51 percent of the shares in the bank and controlled its operations to a large extent. Nepal Bank Limited was headquartered in Kathmandu and had branches in other parts of the country.

There were other government banking institutions. Rastriya Banijya Bank (National Commercial Bank), a state-owned commercial bank, was established in 1966. The Land Reform Savings Corporation was established in 1966 to deal with finances related to land reforms. There were two other specialized financial institutions. Although the government invested in the corporation, representatives from the private business sector also sat on the board of directors. The Co-operative Bank, which became the Agricultural Development Bank in 1967, was the main source of financing for small agribusinesses and cooperatives. The Agricultural Development Bank also served as the government's implementing agency for small farmers' group development projects assisted by the Asian Development Bank and financed by the United Nations Development Programme. The Ministry of Finance reported in 1990 that the Agricultural Development Bank, which is vested with the leading role in agricultural loan investment, had granted loans to only 9 percent of the total number of farming families since 1965. (*Ale, Vaidhya, Chaudhary and friends, 2009:18-22*)

Since the 1960s, both commercial and specialized banks have expanded. More businesses and households had better access to the credit market although the credit market had not expanded. In the mid-1980s, three foreign commercial banks opened branches in Nepal. The Nepal Arab Bank was co-owned by the Emirates Bank International Limited (Dubai), the Nepalese government, and the Nepalese public. The Nepal Indosuez Bank was jointly owned by the French Banque Indosuez, Rastriya Banijya Bank, Rastriya Beema Sansthan (National Insurance Corporation), and the Nepalese public. Nepal Grindlays Bank was co-owned by a British firm called Grindlays Bank, local financial interests, and the Nepalese public.

Nepal Rastra Bank was created in 1956 as the central bank. Its function was to supervise commercial banks and to guide the basic monetary policy of the nation. Its major aims were to regulate the issue of paper money; secure countrywide circulation of Nepalese currency and achieve stability in its exchange rates; mobilize capital for economic development and for trade and industry growth; develop the banking system in the country, thereby ensuring the existence of banking facilities; and maintain the economic interests of the general public. Nepal Rastra Bank also was to oversee foreign exchange rates and foreign exchange reserves.

Prior to the establishment of Nepal Rastra Bank, Kathmandu had little control over its foreign currency holdings. Indian rupees were the prevalent medium of exchange in most parts of the country. Nepalese currency was used mostly in the Kathmandu Valley and the surrounding hill areas. The existence of a dual currency system made it hard for the government to know the status of Indian currency holdings in Nepal. The exchange rates between Indian and Nepalese rupees were determined in the marketplace. Between 1932 and 1955, the value of 100 Indian rupees varied between Rs71 and Rs177. The government entered the currency market with a form of fixed exchange rate between the two currencies in 1958. An act passed in 1960 sought to regulate foreign exchange transactions. Beginning in the 1960s, the government made special efforts to use Nepalese currency inside the country as a medium of exchange.

It was only after the signing of the 1960 Trade and Transit Treaty with India that Nepal had full access to foreign currencies other than the Indian rupee. Prior to the treaty, all foreign exchange earnings went to the Central Bank of India, and all foreign currency needs were provided by the Indian government. After 1960 Nepal had full access to all foreign currency transactions and directly controlled its exports and imports with countries other than India.

In the context of Nepal having adopted an open economy, an excessive level of liquidity will initially exert reassurance on the balance of payments and foreign exchange reserve and subsequently cause adverse effects on the domestic price situation. Thus, it will be necessary to maintain a balanced monetary position to attain the economic growth rate envisaged in the plan. The sustainable economic growth can only be achieved if the monetary balance is maintained. Another important objective of monetary management is to achieve maximum mobilization of internal resources. The monetary policy needs to be oriented towards encouraging the people to save through the creation of a competitive environment among banks and financial institutions and motivating the desirous entrepreneurs to mobilize the available resources through the collection of the scattered savings in production and employment. Generating programmed in the country. In this perspective, it is necessary along with a planned process of economic development to initiate programmed that can create new financial bases for the economy, consolidate the existing ones and encourage healthy competition. A review of the requirements and availability of resources. Reveals that there is a tremendous resource gap between resource requirements and its availability in the country This is indeed indicative of the fact that a large share of private savings is still lying outside the domain of institutional systems, In this context, an efficient mobilization of internal resources can further enhance the participation of the private sector in the economic development of the nation. As a result of the treaty, the government had to separate Indian currency (convertible currency because of free convertibility) from other currencies (nonconvertible currency because it was directly controlled by Nepal Rastra Bank). In 1991 government statistics still separated trade with India from trade with other countries. Tables showing international reserves listed convertible and nonconvertible foreign exchange reserves separately.

Due to the lack of transparency and adequate control mechanism, there may be the chance of vested interest and moral hazard problems. It is a universal fact that the higher degree of transparency contributes towards the maximizing shareholders value and ensuring the fairness to rest of the shareholders. . It is also the field of economics, which studies the many issues arising from the separation from ownership and control. (*Thapa, 2008:21*)

The following is to-date list of major commercial banks operating in Nepal.

List of Commercial Banks

1. Nepal Bank Limited
2. Rastriya Banijya Bank
3. Agriculture Development Bank
- 4. Nabil Bank Ltd. (#)**
5. Nepal Investment Bank
6. Standard Chartered Bank
7. Himalayan Bank Ltd.
- 8. Nepal SBI Bank Ltd. (#)**
9. Nepal Bangladesh Bank Ltd.
10. Everest Bank Ltd.
11. Bank of Kathmandu Ltd.
12. Nepal Credit and Commercial Bank Ltd.
13. Nepal Industrial and Commercial Bank Ltd.
14. Lumbini Bank Ltd.
15. Macchapuchhre Bank Ltd.
16. Kumari Bank Ltd.
17. Laxmi Bank Ltd.
18. Siddhartha Bank Ltd.
19. Global Bank Ltd.
20. Citizen Bank International Ltd.
21. DCBL Bank Ltd.
22. Prime Bank Ltd.
23. Bank of Asia Ltd.

24. Sun Rise Bank Ltd.
25. Kist Bank
26. NMB Bank Ltd.
27. Janata Bank Nepal Limited
28. Civil Bank
29. Mega Bank
30. Commerce and Trust Bank
31. Century Commercial Bank

(Source: [www.nrb.org.np-useful links](http://www.nrb.org.np-useful-links))

1.2 FOCUS OF THE STUDY:

In Nepal, NRB uses the CAELS (Capital, Assets, Earnings, Liquidity, and Sensitivity) system for assessing the financial soundness of commercial banks. The research study is focused on assessing the financial condition and performance of selected banks by using descriptive and analytical research design, prescribed by CAMELS rating. The study encompasses all the six components of CAMELS and carried out with annual Reports of Condition and Income. More specifically, the study focuses on the trend analysis of Capital Adequacy ratio, Non Performing, Loan composition, Total Expenses to Revenues ratio, earning per employee, return on equity, return on assets, net interest margin, earning per share, liquidity and Sensitivity to Market Risk with respect to NRB standard during the period of past five years starting from FY 2004/05 to 2008/2009. The commercial banks are competing mainly in service in order to put in competitive position, majority of the branches of commercial banks have been adapting differentiation strategy. The response shows that different branches of the similar bank have adapted different strategy and few of the banks have followed more than one strategy at the same time. The priority of the majority of Nepalese commercial banks is to retain customers whereas 28 percent of them are concentrating on customer acquisition. While these changes have positively affected the banking sector, at the same time, increased competition due to mushrooming of financial institutions has impacted the banks negatively. The study aims to find out the position of the bank and its viability by using descriptive and analytical research design.

1.3 STATEMENT OF PROBLEM:

The Nepalese commercial banking sector is very competitive. The main objective of commercial banks is to increase its returns for their owner which often comes, however, at the cost of various increased risk: Credit Risk, Liquidity Risk, Interest Rate Risk, Market Risk, Off-Balance Sheet Risk, Foreign Exchange Risk, Country Risk, Technology Risk, Operational Risk and Insolvency Risk. The governments owned banks in Nepal are almost running in loss. It is also very difficult to call the private sector banks sound though they are earning profit since they may be exposed to aforesaid risks. (*Keshar J Baral, 2005*)

The general problem towards which the study is directed is to investigate the financial performance of two major commercial bank of Nepal in the framework of CAMELS. Based on this fundamental problem the following specific problems are set in this study. The elementary problem of this research is to scrutinize the financial condition of both the banks in the framework of CAMELS and is an attempt to come back with the following research questions:

- How the selected banks are managing their Capital Adequacy?
- What is the trend of Asset Composition, what is the banks quality of Loans and Loan provision mix?
- How the selected banks are managing their expenses with respect to revenues?
What control and monitoring mechanism are maintained in the bank?
- What are the level, trend and stability of the selected bank's earnings?
- Is the selected bank's liquidity position adequate in consideration of the current level and prospective sources of liquidity compared to funding needs?
- How changes in interest rates can affect each bank's earnings?
- How the major commercial banks of Nepal are contributing to uplift the economy?

1.4 OBJECTIVES OF THE STUDY:

Commercial banks are established with intention of earning profit so that the wealth of their shareholder is maximized and earning depends upon efficient mobilization of resources. Financial analysis is the tools for measuring the successes of any business performance. All the detail financial information of bank is shown by the financial analysis. Therefore the main objectives of this study are to analyze, examine and interpret the financial position of the selected banks with the help of ratio analysis and other portfolios. In addition the study tries to evaluate the efficiency and progress of both banks comparatively. The world economy has undergone through drastic changes over a decade and abruptly since last 5 years along with the Nepalese economy. Although recent developments in Nepal's financial sector have moderately improved its performance, including the entry of many new actors, the sector remains fragile and access to financial services has been declining. The threats imposed by Nepalese economy, have made it imperative to search for opportunities in order to curb any hindrances to the economical development. Because of the importance and relevance of banks in shaping the economy, it has become important to review the banking industry and its business strategies.

In line with the statement of problem, the main objective of this study is to analyze the financial condition of the selected banks and following are the objectives on specific terms:

- To analyze Capital Adequacy & Liquidity Position of selected banks and compare with regulatory minimum capital requirement.
- To analyze and compare quality of assets of selected banks.
- To evaluate and compare the level, trend and stability of selected banks earning.
- To analyze and compare the efficiency of the selected banks management.

1.5 SIGNIFICANCE OF THE STUDY:

The significance of this study lies mainly in identifying the problems of the bank over the study period, as well as for categorizing institution with deficiencies in particular component areas. Further, it assists in following safety and soundness trends and in assessing the aggregate strength and soundness of the financial industry. After the economic reforms initiated by the government, this sector has been going through the major changes. Increased competition due to mushrooming of financial institutions across the country has impacted the banking sector negatively, so the financial performance of the banks has to be evaluated properly to know the strength and weaknesses of the banks.

Commercial banks suffered from various types of problem such non-performing loan. They do not mobilize their deposit properly in terms of development of the nation. It is no debate that high profitable institutions can easily get their goals and can serve the society. To improve the profitability situation of the bank, it is necessary to establish the higher creditability position of the bank. Commercial bank's investment has been found to be have lower productive due to the lack of supervision regarding whether there is a proper utilization of their investment or not.

Although the various studies have been carried out regarding financial performance of banks, very few studies have employed the CAMEL framework of analysis. This study aims to analyze the financial performance of two major commercial bank of Nepal in the framework of CAMEL. The researcher is quite confident that the research will be useful to the financial sector of Nepal. The study will also be a great value for investors, equity holders, bankers, capital markets, government, financial intuitions, researchers and students.

1.6 LIMITATION OF THE STUDY:

The evaluations made herein are taken of only two sample units. It is focused on the financial analysis of the study unit in the frame work of the six components of CAMELS system. The study remains largely in the realms of Offsite Monitoring System. So there are some limitations, which narrowed the generalization. This study will be limited by following factors:

- The study deals with the two major commercial banks but it may not-applicable to other banks.
- The whole study is based on secondary data collected from the respective banks & web sites on internet. As far as the output concerned, any research based on secondary data is not far from limitations due to inherent character.
- The study concerns only for period of 5 years i.e. from FY 2005/06 to FY 2009/010.

1.7 ORGANISATION OF STUDY:

The study shall be divided into six chapters. They are as follows:

- The first chapter shall concern with the introduction of the study which covers the general background, Focus of the study, Statement of the study, Limitation of study, Objectives of study, Significance of study and Organization of the study.
- The second chapter shall contain review of literature. This part deals with different article, books & relevant thesis related to financial performance are also study.
- The third chapter shall deals with the research methodology where process of research is mention. This part shall concern with research question, research design, sources of data, population and sample, sources of data, data collection process and method analysis
- The Fourth chapter shall be financial analysis and presentation of data where different part of ratio analysis are analyze like liquidity ratio, profitability ratio, assets management ratio and growth ratio. Likewise the Major findings of the study have been included in detail in this chapter.
- The last chapter shall deal with Summary & Conclusion and Recommendation. In this chapter summary of whole chapter and different results find in data analysis and recommendation to bank for nation development are included.

CHAPTER - II

REVIEW OF LITERATURE

Review of literature is the study of previous research or article or book in related field or topics for finding the past studies conclusion and deficiencies that may be known for further research. This chapter will help to check the chances of duplication in the present study. The chapter is categorized under three main heading. Conceptual framework is concern with fundamental of supportive text that will ensure the interpretation whether it is under the principles and doctrine of the theories related to the topic. Review of related studies is about the studies of previous thesis, related books and previous researcher in similar topics. The last is research gap which will describe the difference between the previous thesis and current thesis.

A review may be a self-contained unit - an end in itself - or a preface to and rationale for engaging in primary research. A review is a required part of grant and research proposals and often a chapter in theses and dissertations. Generally, the purpose of a review is to analyze critically a segment of a published body of knowledge through summary, classification, and comparison of prior research studies, reviews of literature, and theoretical articles. (*www.writing.wisc.edu*)

2.1 CONCEPTUAL FRAMEWORK

This section presents the theoretical aspect of the study, which includes the concept of commercial banks, functions of commercial banks, concept of CAMELS rating system.

“Financial analysis is to analyze the achieved statement to see if the result meet the objectives of the firm, to identify problems, if any, in the past or present and/or likely to be in future, and to provide recommendation to solve the problems”(Pradhan, 2000:120)

“Financial analysis is process of identifying the financial strength and weakness of the firm by properly establishing the relationship between the items of balance sheet which represent analysis snapshots of the firm’s financial position analysis at analysis moment in time and next, income statement, that deposits analysis summary of the firm’s profitability overtime” (*Vanhorne & Watchowicz,1997:120*)

2.1.1 Concept of Commercial Bank

A commercial bank is a profit-seeking business firm, dealing in money or rather dealing in claims to money. It is a FI that creates deposits liabilities which circulate as money unlike the deposits of other FIs. 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 one which exchange money, deposit money, accepts, grant loan and perform commercial banking functions and which is not a bank meant for co-operative agriculture industries or for such specific purpose” (*Nepal Commercial Bank Act, 2031:1*)

A commercial bank is an institution that operates for profits. Like other industrial or commercial enterprise, a bank too, seeks to earn maximum income through the suitable employment of its resources. It accepts deposits for the purpose of lending or investment and thereby hopes to make a profit which are adequate enough to enable the bank to pay interest at the prescribed rates to its depositors, meet establishment expenses, build reserves, pay dividend to the shareholders, etc. In general, commercial banks are those FIs, which play the role of financial intermediary in collection and disbursement of funds from surplus unit to deficit unit. A commercial bank is established with a view to provide short term debt necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surplus in the form of deposit, lending debts by discounting bills of exchange, accepting valuable goods in security, acting as an agent of the client etc. A commercial bank accepts deposits and provides loans 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 central bank permitted to accept demand and time deposits. A commercial bank is a profit-seeking business firm, dealing in money or rather dealing in claims to money. It is a FI that creates deposits liabilities which circulate as money unlike the deposits of other FIs. In fact, the greater part of money supply is the direct consequence of the profit-seeking or money-creating activities of commercial banks. The commercial banks should careful while performing the credit creation function.

2.1.2 Functions of Commercial Bank

The basic business of banking is a combination of two functions - payments and financial intermediation and has however, changed and continues to change along three dimensions: entry of new institutions into banking, as new forms of lending and borrowing are developing the intermediation function is evolving; and other related functions to the basic ones are being added. The commercial banks in Nepal provide the following main banking functions:

Deposits collection:

This is the oldest function of a bank in which the banker charges commission for keeping the money in its custody. Now-a-days 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. 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 known as demand deposits. They can withdraw any amount available in their current account by cheque without notice. The bank does not pay interest on such accounts. A bank accepts fixed or time deposits from savers who do not need money for a stipulated period from 6 months to longer periods ranging up to 10 years or more.

Advance and Loans:

One of the primary functions of a commercial bank is to advance loans to its customers. A bank lends a certain percentage of the cash lying in deposits at a higher interest rate than it pays on such deposits. This is how it earns profits. The bank advances loans in the ways of: Cash Credit, Term Loans, Hire purchase loan, Call Loans, Overdraft and discounting Bills of Exchanges.

Credit Creation:

Credit creation is one of the most important functions of the commercial banks. When a bank advances a loan, it opens an account in the name 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.

Trade Credit:

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 acts as an agent of its customers while collecting and paying cheque, bills of exchange, drafts, dividends etc. It also buys and sells shares, securities, debentures etc. for its customers. Further, it pays subscriptions, insurance premium, utilities 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 these services, the bank charges a normal fee while it renders others free of charge.

Other Services:

Banks also act as custodian of valuables of the customers by providing locker facility where they can keep their jewelry and valuable documents. It issues various forms of credit instruments, such as cheque, drafts and travelers' cheque etc., which facilitate transactions. It renders underwriting services to companies and helps in the collection of funds from the public. Lastly, it provides statistics on money market and business trends of the economy.

2.1.3 Concept of “CAMELS” Bank Rating System

Federal Reserve Bank of New York (1997) has defined the component of CAMEL as rating system which produces a composite rating of an institution's overall condition and performance by assessing five components: **C**apital adequacy, **A**sset quality, **M**anagement administration, **E**arnings, and **L**iquidity. The CAMEL was later updated with inclusion of sixth component, **S**ensitivity to Market Risk, now is referred to as the CAMELS rating system. The Basle Committee on Banking Supervision of the Bank of International Settlements (BIS) has recommended using capital adequacy, assets quality, management quality, earnings and liquidity (CAMEL) as criteria for assessing a FI in 1988 (ADB 2002). The sixth component, market risk (S) was added to CAMEL in 1997

(Gilbert, Meyer and Vaughan 2000). However, most of the developing countries are using CAMEL instead of CAMELS in the performance evaluation of the FIs. The central banks in some of the countries like Nepal, Kenya use CAEL instead of CAMELS. CAMELS framework is a common method for evaluating the soundness of FIs. This system was developed by regulatory authorities of the U.S banks. The Federal Reserve Bank, the Comptroller of the Currency and the Federal Deposit Insurance Corporation all use this system (McNally 1996). Monetary authorities in the most of the countries are using this system to check up the health of an individual FI. In addition, International Monetary Fund also is using the aggregated indicators of individual FIs to assess the financial system soundness of its member countries as part of its surveillance work. *(Hilbers, Krueger and Moretti, 2000)*

The CAMELS rating system is subjective. Benchmarks for each component are provided, but they are guidelines only, and present essential foundations upon which the composite rating is based. They do not eliminate consideration of other pertinent factors by the examiner. The uniform rating system provides the groundwork for necessary supervisory response and helps institutions supervised by all three US supervisors to be reasonably compared and evaluated. Ratings are assigned for each component in addition to the overall rating of a bank's financial condition. In Nepal, the NRB plays the supervisory role for evaluating bank's financial condition though rating the banks in accordance to CAMELS is still in its initial phase.

2.1.4 CAMELS Components

The analysis of this study is entirely based on the CAMELS framework. As stated in theoretical prescription, health check up of any FIs in this framework is concentrated in the six components: capital adequacy, asset quality, management quality, earning, liquidity and sensitivity to market. But in this study, the last component has been dropped due to the presence of much more complication. So, analysis of financial health of joint venture banks is carried out in the framework of CAMEL. Indicators of each component also have been used according to the financial data disclosed in annual reports of sampled joint venture banks. So, complicated indicators of each component of CAMEL

framework of checking up the health of the banks have been skipped up in this study. The listing of evaluation factors for each component rating is in no particular order of importance. The description of the CAMELS components are made as under based on *(FFIEC Press release 1996)*

2.1.4.1 Capital Adequacy

CAMELS framework system looks at six major aspects of an FI: capital adequacy, asset quality, management soundness, earnings, liquidity, and sensitivity to market risk. The first component, capital adequacy ultimately determines how well FIs can manage with shocks to their balance sheets. Thus, it tracks capital adequacy ratios that take into account the most important financial risks—foreign exchange, credit, and interest rate risks—by assigning risk weightings to the institution's assets. *(Hilbers, Krueger & Moretti, 2000)*

For the purpose of capital adequacy measurement, bank capital is divided into Tier I and Tier II. Tier I capital is primary capital and Tier II capital is supplementary capital. In Nepalese context, Tier I (core/primary) capital includes paid-up capital, share premium, non-redeemable preference share, general reserve fund, accumulated profit, capital redemption reserve, capital adjustment fund, and other free reserve. Amount of the goodwill, fictitious assets, investment in the financial instruments issued by an organized organization in excess to the limit specified by NRB, and investment in the financial instruments issued by the organizations having the own financial interest is deducted from the sum of all elements of the primary capital to arrive at the core capital. Similarly, Tier II (supplementary) capital comprises of general loan loss provision, assets revaluation reserve, hybrid capital instruments, subordinated term loan, exchange equalization reserve, excess loan loss provision, and investment adjustment reserve. Thus, the total capital of commercial banks is the sum of core capital and supplementary capital. Leverage ratio can be used to measure the capital adequacy of a bank. This is the ratio of bank's book value of core capital to the book value of its assets. The higher ratio shows the higher level of capital adequacy. The leverage falling in the last three zones indicates that bank is inadequately capitalized and regulators should take prompt

corrective action to bring the capital to the desirable level. The leverage ratio stated in the foregoing discussion is simple capital to assets ratio. In other words, assets are not risk adjusted. The 1993 Basel Accord enforced the capital ratio to risk adjusted assets of commercial banks. According to this accord, core capital must equal to or exceed 4 percent of the risk weighted assets of the commercial banks. Similarly, the amount of the supplementary capital should not exceed the amount of the core capital and the total capital must equal or exceed 8 percent of risk weighted assets. (*Saunders and Cornett, 2004:26-29*)

NRB initially fixed the core capital at the level of 4.5 percent of the risk weighted assets and total capital at the level of 9 percent of risk weighted assets of the commercial banks (NRB 2058). For the current FY2005/06, the mandatory levels of core capital and total capital are 6 percent and 12 percent of risk weighted assets of commercial banks. But NRB has strictly directed all commercial banks that the amount of the supplementary capital should not be in excess to the amount of the core capital. (*NRB Report, 2005*)

Capital is necessary for the bank to operate. While many areas of a bank are important and subject to scrutiny, capital adequacy is the area that triggers the most regulatory action. This action is largely based on the three major ratios used in the assessment of capital adequacy, which are:

The Tier 1 Risk-Based Capital Ratio.

The Total Risk-Based Capital Ratio.

The Tier 1 Leverage Ratio.

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

- Size of the bank
- Volume of inferior quality assets
- Bank's growth experience, plans and prospects
- Quality of capital Retained earnings
- Access to capital markets

Non-ledger assets and sound values not shown on books (real property at nominal values, charge-offs with firm recovery values, tax adjustments). The FDIC Improvement Act of 1991, which created a link between enforcement actions and the level of capital held by a bank. This supervisory link is commonly known as Prompt Corrective Action (PCA) and aims to resolve banking problems early and at the least cost to the bank insurance fund. PCA has classified the banks as:

Well-Capitalized:

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

Total risk-based capital ratio is 10 percent or more,

Tier 1 risk-based capital ratio is 6 percent or more, and

Tier 1 leverage ratio is 5 percent or more.

In addition to these ratio guidelines, to be well capitalized a bank cannot be subject to an order, a written agreement, a capital directive or a PCA directive.

Adequately Capitalized:

To be adequately capitalized, a bank will meet the following conditions:

Total risk-based capital ratio is at least NRB minimum capital adequacy ratio requirement.

Tier 1 risk-based capital ratio is at least NRB minimum Tier I capital ratio requirement.

Tier 1 leverage ratio is at least 4 percent.

Undercapitalized:

To be considered undercapitalized, a bank will meet the following conditions:

Total risk-based capital ratio is less than 8 percent,

Tier 1 risk-based capital ratio is less than 4 percent, or Tier 1 leverage ratio is less than 4 percent.

Significantly Undercapitalized:

To be considered significantly undercapitalized, a bank will meet the following conditions:

Total risk-based capital ratio is less than 6 percent,
Tier 1 risk-based capital ratio is less than 3 percent, or
Tier 1 leverage ratio is less than 3 percent.

Ratings Capital Component

A rating of 1 indicates a strong capital level relative to the institution's risk profile.

A rating of 2 indicates a satisfactory capital level relative to the FI's risk profile.

A rating of 3 indicates a less than satisfactory level of capital that does not fully support the institution's risk profile. The rating indicates a need for improvement, even if the institution's capital level exceeds minimum regulatory and statutory requirements.

A rating of 4 indicates a deficient level of capital. In light of the institution's risk profile, viability of the institution may be threatened. Assistance from shareholders or other external sources of financial support may be required.

A rating of 5 indicates a critically deficient level of capital such that the institution's viability is threatened. Immediate assistance from shareholders or other external sources of financial support is required.

A FI is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor, and control these risks.

The effect of credit, market, and other risks on the institution's financial condition should be considered when evaluating the adequacy of capital. The types and quantity of risk inherent in an institution's activities will determine the extent to which it may be necessary to maintain capital at levels above required regulatory minimums to properly reflect the potentially adverse consequences that these risks may have on the institution's capital.

BASEL Capital Accord

The Basel Committee on Banking Supervision (BCBS) is a committee of banking supervisory authorities that was established by the central bank governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. It usually meets at the Bank for International Settlements (BIS) in Basel, where its permanent Secretariat is located. *(BIS, November, 2005)*

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

The new Basel capital accord (Basel II), shall be applicable to internally active banks all over the world with effect from end of 2006. Implementing the new accord in Nepal has been a challenging task for the supervisors as well as FIs. Hence, certain preparatory homework is needed to Nepalese financial system to implement BASEL II. NRB and FIs need to have coordinated effort efficiently in Nepalese banks and FIs to establish certain baseline for the effective implementation of BASEL II. In this regard, second interaction program was held in Nepal with the banks executives to make them aware of the new

development. The commercial banks so far has shown positive attitude towards the implementation of Basel II. "New Capital Accord Implementation Preparatory Core Committee" was drafted "NRB's Concept Paper on New Capital Accord". According to the program of New Capital Accord implementation, concept paper was forwarded to all the commercial banks for comments and recommendations. A form was also developed so that commercial banks classify their exposures as per the new approach, which was reviewed by the "Basel-II Implementation Working Group". NRB has adopted Basel Core Principles for Effective Supervision as guideline for supervision of commercial banks. Core principle methodology adopted by BCBS 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 shortcoming is 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 "non-compliant" assessment is given when no substantial progress towards compliance has been achieved. There is no doubt that the new accord though complex carries a lot of virtues and will be milestone in improving banks internal mechanism and supervisory process and beneficial to the commercial banks.

Capital Adequacy Norms by NRB

NRB has from time to time stipulated minimum capital fund to be maintained by the banks on the basis of risk weighted assets. The total capital fund is the sum of core capital and supplementary capital. According to the NRB unified directives for Banks and Non-Bank FIs issue number E. Pra.Ni.No 01/061/62 (Ashar 2062 BS), the capital funds of a bank comprise the following:

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

Supplementary Capital: Supplementary capital includes general loan loss provision, exchange fluctuation reserve, assets revaluation reserve, hybrid capital instruments, unsecured subordinated term debt and other free reserves not allocated for a specific purpose. Banking and Financial Institution Ordinance (BAFIO) (2061) also assimilates the same things, which were included and explained in NRB Act 2058, in regard of bank capital. NRB Act is effective from 1st Shrawan 2058 (July 16th 2001). According to the NRB 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. 1000 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 capital measurement tool is basically represented by a ratio of primary capital to assets (*Estrella, 2000; Tam and Kiang, 1992; Elliott, 1991; Looney et al., 1989; Lane et al., 1986; Martin, 1977*). *Estrella (2000)* utilized three measures, including a more complex weighted measure, but found the simple measures of capital were relatively good explanatory power over short time horizons, while risk-weighted ratios provided relatively better explanatory power over longer horizons. *Eccher (1996), Thomson (1991), Whalen (1991) and Sinkey (1978)* employed an analogous ratio definition, but with a refinement to adjust for loan losses, which theoretically would account for some portion of related risk in the asset portfolio. (*Cantor, 2001*)

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

Evaluation of Asset Quality

The evaluation of asset quality should consider the adequacy of the Allowance for Loan and Lease Losses (ALLL) and weigh the exposure to counter-party, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including, but not limited to, operating, market, reputation, strategic, or compliance risks, should also be considered. Prior to assigning an asset quality rating, several factors should be considered. The factors should be reviewed within the context of any local and regional conditions that might impact bank performance. In addition, any systemic weaknesses, as opposed to isolated problems, should be given appropriate consideration. The following is not a complete list of all possible factors that may influence an examiner's assessment; however, all assessments should consider the following: The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices, The level, distribution, severity, and trend of problem, classified, on accrual, restructured, delinquent, and non-performing assets for both on- and off-balance sheet transactions, The adequacy of the allowance for loan and lease losses and other asset

valuation reserves, The credit risk arising from or reduced by off-balance sheet transactions, such as un-funded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit, The diversification and quality of the loan and investment portfolios, The existence of asset concentrations, The adequacy of loan and investment policies, procedures, and practices, The ability of management to properly administer its assets, including the timely identification and collection of problem assets, The adequacy of internal controls and management information systems, The volume and nature of credit documentation exceptions. As with the evaluation of other component ratings, the above factors, among others, should be evaluated not only according to the current level but also considering any ongoing trends. The same level might be looked on more or less favorably depending on any improving or deteriorating trends in one or more factors.

Rating the Asset Quality Factor

The Asset Quality Rating definitions are applied following a thorough evaluation of existing and potential risks and the mitigation of those risks. The definitions of each rating are as follows:

- A rating of 1 indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality in such institutions is of minimal supervisory concern.
- A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.
- A rating of 3 is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern.

- A rating of 4 is assigned to FIs with deficient asset quality or credit administration practices. The levels of risk and problem assets are significant, inadequately controlled, and subject the FI to potential losses that, if left unchecked, may threaten its viability.
- A rating of 5 represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability. (*Shrestha, 2009:34-36*)

Non-Performing Assets (NPAs)

Loans and advances of FIs need to be serviced by either the principal or the interest of the amount borrowed in stipulated time as agreed by the parties at the time of loan settlement. NRB unified directives E. Pra.Ni.No 02/061/62 (Ashar 2062 BS) for Banks and Non-Bank FIs, defines Non Performing Loans as loans classified as Substandard, Doubtful and Loss or Loans which are past due by principal for more than 3 months.

The details and classification of standards of Non Performing Loans may vary from country to country depending upon the own banking system requirement norms. He further states that unlike Nepal, countries like Korea, Indonesia, Philippines, India have classified the loan into five categories on which normal and special categories are classified as Performing loans whereas sub standard, doubtful and estimated loss categories are considered as Non Performing Loans. (*Dhungana, 2006*)

The study conducted by World Bank highlights that all commercial banks of South Asian countries except Nepal and Sri Lanka classify loans as non-performing only after it has been in arrear for at least six months (*Pernia, 2004*). According to international practice, into three categories depending on the temporal position of loan default. Substandard, Doubtful and Loss Assets are the categories on the basis of the time barred to repay either interest or the principal. The degree of NPA assets depend solely on the length of time the asset has been in the form of non-obliged by the loan. The more time it has elapsed the worse condition of assets is being perceived and such assets are treated accordingly. However, the treatment of NPAs depends according to countries. No uniform rule seems to apply.

Factors causing NPAs

Subedi (2006) in his column broadly categorized into internal and external factors for high level of NPA in Nepalese banking system. The following factors can also be the reason for causing NPA: NPAs may arise due to failure of business for which loan was used. Whatever may be the reasons for failure of business, it obstructs the carrying out of timely payments of financial obligations. On the other part of appraising institutions, the defect in appraising projects breed mismatch not only in investment planning but also in receivables due to defective projection of returns. Large portion of NPAs in developing countries arise due to defective and standard credit appraisal system. Monitoring of projects in time provide insurance against failure of enterprises through rectification of minor flaws that ape ear during the course of operation. Inability of sound monitoring system can also lead to failure of the project. The resources of FIs collected through deposits from people may be misutilized. Recklessness or negligence on the part of the officials while approving the loan will turn into default. Attitude of the officials that does not amount to sincere corporate culture also leads to breed drawbacks in the payment of dues to FIs.

The credit programs sponsored by the government are regarded as the source of NPAs. For political benefits government, without assessing the financial feasibility of the credit program, announces and compels the credits agencies to go along with the declared policies. Moreover, dishonest politicians often want free ride of on the amounts of loan delivered by credit agencies under government designed programs. Such loans are hardly recoverable. The fact is evidenced from the experience in Nepal and India by the manifestation of higher percentage of NPAs found in priority sector loans.

Effects of NPAs

Financial crisis emerged from Thailand in South East Asian countries largely is considered to be due to higher level of NPAs existed with the FIs. The situation was grave when the assets stopped to repay loans to credit agencies which were borrowed from overseas capital market. 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 honor the repayment on due time was

the principal reason to result in financial crisis that terminated into economic crisis in South East Asian countries. Financial crisis occurred in Asia had the higher proportion of NPAs emanate from loans which constituted highest share in the total assets of FIs. 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% in the fiscal year 1997/98 (NRB, 1999). Similarly India had the proportion of loan in the total assets as 42.0% while those figures for Thailand, Indonesia and Malaysia were 78%, 70%, and 69 percent respectively. (*Mukherjee, 1999*)

Empirically, it has been 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 Asian with relatively higher proportion of loans in the total assets of the FIs fell victim of the shock of regional crisis. The credit institutions are repelled from further investment after the interest accrual or due principal repayment has stopped. Interest incomes from such assets are reduced to the extent of declared amount as NPAs. As the assets declared NPA emanate from the deposits, it puts the depositors fund at risk. The credit agencies are put to an extra amount of liability by regulatory authorities in the form of provision. The amount required for provision depends on the level of NPAs and their quality. Rising level of NPAs create a psyche of worse environment especially in the financial sector. Depositors are not interested to save. Rather the hard earned savings are diverted to consumptions. Consequently the savings pattern hence investment is affected thereby creating an unhealthy atmosphere in the financial sector.

NRB Directives related to Assets quality

NRB unified directive for Banks & Non-Bank FIs (Ashar 2062 BS) through directive number E. Pra.Ni.No 02/061/62, requires the banks to classify outstanding loans and advances on the basis of aging of Principal amount. As per the directive the Loans and Advances should be classified into the following four categories:

Pass: Loans and Advances whose principle amount are not past due over for 3 months included in this category. These are classified and defined as performing loans.

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

Doubtful: All loans and advances, which are past due for a period of 6 months to 1 year, included in this category.

Loss: All loans and advances which are past due for more than 1 year and have least or thin possibility of recovery or considered unrecoverable shall included in this category. Besides this, any loan whether past due or not, in situations of inadequate security, borrower declared insolvent, no whereabouts of the borrower or misuse of borrowed fund, are to be classified as Loss category. The directive further requires banks to provision for loan loss, on the basis of the outstanding loans and advances and bills purchased classified as above. Loan loss provision set aside for performing loans is defined as General Loan Loss Provision and that set aside for nonperforming loan as Specific Loan Loss Provision. With the objectives of lowering the concentration risk of bank loans to a few big borrowers and to increase the access of small and middle size borrowers to the bank loans, NRB through directive number E. Pra.Ni.No 03/061/62 limits commercial banks to extend credit to a single borrower or group of related borrowers up to 25% of its core capital for fund based credit facilities and not more than 50% of its core capital for Non fund based credit facilities like letters of credit, guarantees, acceptances, commitments. The facilities extended against bank's own fixed time deposit, HMG securities, NRB Bonds, counter guarantees of World Bank/Agricultural Development Bank/International A+ rated banks (as per list of top 1000 world international banks published by the London based magazine, The Banke), are excluded from the restriction. (*NRB unified directive, 2067 BS*)

2.1.4.3 Management Quality

The capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a FI's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Depending on the nature and scope of an institution's activities, management practices may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance,

legal, liquidity, and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls taking into consideration the size and sophistication of the institution; maintenance of an appropriate audit program and internal control environment; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is involved. The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors: The level and quality of oversight and support of all institution activities by the board of directors and management. The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products. The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities. The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and risk profile. The adequacy of audits and internal controls to: promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations, and internal policies. Compliance with laws and regulations. Responsiveness to recommendations from auditors and supervisory authorities. Management depth and succession.

Rating the Management factor

A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the institution's size, complexity, and risk profile. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

A rating of 3 indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary. (*Shrestha, 2009:24-26*)

A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution. Replacing or strengthening management or the board of directors is necessary. Researchers construct various financial ratios to capture management quality.

"Managerial ability is like Lord Acton's elephant - difficult to define but easy to identify. Over a period of time differences 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." (*Meyer and Pifer, 1970*)

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 poorly followed loan policies, inadequate problem loan identification systems, and non-existent or poorly followed asset/liability management. *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.

2.1.4.4 Earning Quality

Under the UFIRS, in evaluating the adequacy of a FI's earnings performance, consideration should be given to:

The level of earnings, including trends and stability,

The ability to provide for adequate capital through retained earnings,

The quality and sources of earnings,

The level of expenses in relation to operations,

The adequacy of the budgeting systems, forecasting processes, and management information systems in general, From a bank regulator's standpoint, the essential purpose of bank earnings, both current and accumulated, is to absorb losses and augment capital. Earnings are the initial safeguard against the risks of engaging in the banking business, and represent the first line of defense against capital depletion resulting from shrinkage in asset value. Earnings performance should also allow the bank to remain competitive by providing the resources required to implement management's strategic initiatives.

Analysis of Earnings Performance

An analysis of earnings comprise of examiner reviewing each component of the Earnings Analysis Trail and Ratio Analysis. Generally, the analysis of earnings begins with the examiner reviewing each component of the earnings analysis trail. The earnings analysis

trail provides a means of isolating each major component of the income statement for individual analysis. The earnings analysis trail consists of the following income statement components: net interest income, non-interest income, non-interest expense, provision for loan and lease losses, and income taxes. Each component of the earnings analysis trail is initially reviewed in isolation. Typically, ratios are examined to determine a broad level view of the component's performance. The level of progression along the analysis trail will depend on a variety of factors including the level and trend of the ratio(s), changes since the previous examination, and the institution's risk profile.

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

- Net Income to Average Assets Ratio [Return on Assets (ROA) ratio]
- Net Interest Income to Average Assets Ratio
- Net Interest Income to Average Earnings Assets Ratio
- Non-interest Income to Average Assets Ratio
- Non-interest Expense to Average Assets Ratio
- Provision for Loan and Lease Losses (PLLL) to Average Assets Ratio
- Realized Gains/Losses on Securities to Average Assets Ratio(s)

Earnings quality is the ability of a bank to continue to realize strong earnings performance. It is quite possible for a bank to register impressive profitability ratios and high volumes of income by assuming an unacceptable degree of risk. An inordinately high ROA is often an indicator that the bank is engaged in higher risk activities. For example, bank management may have taken on loans or other investments that provide the highest return possible, but are not of a quality to assure either continued debt servicing or principal repayment. Seeking higher rates for earning assets with higher credit risk will boost short-term earnings. Poor asset quality may necessitate increasing the PLLL to bring the ALLL to an appropriate level and must be reviewed for impact on earnings quality.

Rating the Earnings Factor

- Earnings rated 1 are strong. Earnings are more than sufficient to support operations and maintain adequate capital and allowance levels after are given to asset quality, growth, and other factors affecting the quality, quantity and trend of earnings.
- Earnings rated 2 would be satisfactory and sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity and trend of earnings. Earnings that are relatively static, or even experiencing a slight decline, may receive a 2 rating provided the institution's level of earnings is adequate in view of the assessment factors listed above.
- Earnings rated 3 may need to improve. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth, and other factors affecting the quality, quantity, and trend of earnings.
- A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowance levels. Erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous years may characterize institutions so rated.
- A rating of 5 indicates earnings that are critically deficient. A FI with earnings rated 5 is experiencing losses that represent a distinct threat to its viability through the erosion of capital.

2.1.4.5 Liquidity

In evaluating the adequacy of a FI's liquidity position, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. Eventually, however, earnings may suffer if losses in these higher-risk assets are recognized. In addition, certain of the bank's adversely classified and non-performing assets, especially those upon which future interest payments are not anticipated, may need to be reflected on non-accrual basis for income statement purposes. Similarly, material amounts of troubled debt restructured assets may have an adverse impact on earnings. An institution's asset quality has a close relationship to the analysis of earnings quality. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. Liquidity is rated based upon, but not limited to, an assessment of the following evaluation factors:

The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.

The availability of assets readily convertible to cash without undue loss.

Access to money markets and other sources of funding.

The level of diversification of funding sources, both on- and off-balance sheet.

The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer-term assets.

The trend and stability of deposits.

The ability to securitize and sell certain pools of assets.

The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, management information systems, and contingency funding plans.

Rating the Liquidity factor

- A rating of 1 indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.
- A rating of 2 indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices.
- A rating of 3 indicates liquidity levels or funds management practices in need of improvement. Institutions rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.
- A rating of 4 indicates deficient liquidity levels or inadequate funds management practices. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs.
- A rating of 5 indicates liquidity levels or funds management practices so critically deficient that the continued viability of the institution is threatened. Institutions rated 5 require immediate external financial assistance to meet maturing obligations or other liquidity needs. (*Maharjan, 2006:19*)

Liquidity Management Concepts

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

The Real Bills Doctrine: The Real Bills doctrine states that a commercial bank should extend only short-term self-liquidating productive loans to business firms. Self liquidating loans are those meant to finance the production, storage, transportation, and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. Firstly, they possess liquidity due to which, they liquidate themselves automatically. Secondly, there is no risk of running into bad debts since they mature in the short run and are for productive purpose. Lastly, such loans earn income for the banks as they are productive.

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

The Anticipated Income Theory: The Anticipated Income Theory was developed by *H.V. Proch* in 1944 based on term loan practices by USA commercial banks. According to this theory, the bank plans for liquidation of long term loans from the anticipated income of the borrower regardless of the nature and character of a borrower's business. Consequently, the bank takes into consideration not only the security but with major consideration, the anticipated earnings of the borrower. This theory is superior to the bills doctrine and the shift ability 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 case of need. A bank can acquire reserves by creating additional liabilities against it, 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 plowing back of profits.

Liquidity Management Techniques

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

Liquidity Planning: The liquidity planning entails the accurate estimation of liquidity needs and the structuring of the portfolio to meet the expected liquidity needs. To ensure that funds are available to meet the liquidity needs at the lower cost, the treasury manager of the banks and FIs must manage its money position to comply with 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 FIs. Because cash yields no income, cash holdings must be limited to a minimum. The treasury/ fund manager may invest any excess cash or may acquire additional cash sources from interbank loans or from discount window at the central bank.

Managing the Liquidity Position: Once the liquidity needs of the banks and FIs have been estimated, the treasury manager must decide how these needs are to be funded. The banks and FIs must choose between two general liquidity management strategies, namely, asset management and liability management. In the asset management, 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. The following guidelines must be kept in mind by the treasury manager when managing the liquidity position of the banks and FIs: The treasury manager must coordinate and keeps track of the activities and strategies of the funds-raising and funds-using departments within the

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

The priorities and objectives of liquidity management should be clear and properly communicated. The needs and decisions must be evaluated on a continuous basis to invest access. Liquidity and avoid liquidity shortages.

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

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

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

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.

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*)

NRB regulations regarding Liquidity

NRB had given the instruction to the commercial banks since 2023 B.S. to deposit the amount the amount ratio of 8 percent from their deposit liability. In the beginning of 2047 B.S. the increase in the quantity of internal credit was 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 NRB second time prescribed liquidity ratio. It made compulsory to invest 24 percent the amount of the total deposit of the commercial bank in H.M.G. Bond, treasury bills, or NRB Bonds. With some signs of improvement of economy, the investment ratio was revised accordingly, since Poush 2049 B.S. Since the beginning of 2050 B.S., the economy showed improvement and the rate of deflation fell down to 8.8%. With this, the provision of investing in the government securities was removed. With effective from, 2054, Chaitra 31st, commercial banks were required to maintain liquidity of 8% of the total Current & Saving deposits and 6% of the fixed deposits, in addition to 3% of total deposit in cash at vault. Since then the NRB reserve requirement has been changed to ensure adequate liquidity of 5% of the total deposit and following arrangements have been put into force by NRB effective from F/Y 2061/062. The compliance of liquidity maintenance, the NRB applies following procedures:

- NRB balance (CRR) will be calculated as a weekly basis. (Every Sunday to Saturday)
- NRB balance will be calculated weekly average deposit of 15 days ago. In case of fully off week, balance will be calculated weekly average deposit of previous week.
- For the purpose of NRB balance calculation, the total deposit liability and balance of NRB will be calculated as total daily balance divided by 7 on weekly average basis by counting from Sunday to Saturday. Previous balance will be taken in the case of off day.
- Weekly statement of deposit balance to be submitted to NRB Inspection and Supervision Department within 7 days from the end of the week end by filling the specific direction form no. 131.

2.1.4.6 Sensitivity to Market Risk

Sensitivity to market risk refers to the risk that causes due to the changes in market conditions which would adversely affect the earnings and/or capital. One of the market risks is the interest rate risk also called price risk. It is the risk that is caused by changes in market interest rate. A bank may have different types of assets and liabilities. Some assets and liabilities are sensitive to changes in interest rate. Such assets and liabilities are called rate sensitive assets (RSA) and rate sensitive liabilities (RSL). The assets and liabilities having maturity less than a year need to be re-priced periodically. Therefore, when a bank has more liabilities re-pricing in a rising rate environment than assets re-pricing, the net interest margin decreases. Conversely, if the bank is asset sensitive in a rising interest rate environment, net interest margin will increase because the bank has more assets re-pricing at higher rates.

There are various methods of measuring interest rate risk. Such as gap analysis, simulation, duration analysis etc. This study focuses on the gap analysis which simply measures the net quantity of assets or liabilities re-pricing within a given period to estimate the likely impact that changes in interest rates will have on earnings. With a view to minimize the IRR NRB requires the banks to use gap analysis for minimization of liquidity risk.

Rating the Sensitivity to Market Risk factor

A rating of 1 indicates that market risk sensitivity is well controlled and that there is minimal potential that the earnings performance or capital position will be adversely affected. Risk management practices are strong for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide substantial support for the degree of market risk taken by the institution.

A rating of 2 indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide adequate support for the degree of market risk taken by the institution.

A rating of 3 indicates that control of market risk sensitivity needs improvement or that there is significant potential that the earnings performance or capital position will be adversely affected. Risk management practices need to be improved given the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital may not adequately support the degree of market risk taken by the institution.

A rating of 4 indicates that control of market risk sensitivity is unacceptable or that there is high potential that the earnings performance or capital position will be adversely affected. Risk management practices are deficient for the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital provide inadequate support for the degree of market risk taken by the institution.

A rating of 5 indicates that control of market risk sensitivity is unacceptable or that the level of market risk taken by the institution is an imminent threat to its viability. Risk management practices are wholly inadequate for the size, sophistication, and level of market risk accepted by the institution. (*Shrestha, 2007*)

Gap Analysis

Gap analysis is the most well known ALM (Asset-Liabilities Management) technique, normally used to manage interest rate risk, though it can also be used in liquidity risk management. The gap is the difference between interest sensitive assets and liabilities for a given time interval, e.g., six months. In gap analysis, each of the bank's asset and liability categories is classified according to the date the asset or liability is re-priced, and time buckets'', groupings of assets or liabilities, are placed in the time buckets, normally overnight-3 months, >3-6 months, >6-12 months, and so on. An incremental gap is defined as earning assets less funding sources in each time bucket; cumulative gaps are the cumulative subtotals of the incremental gaps. If total earning assets must equal total funding sources, then by definition, the incremental gaps must always total zero and therefore, the last cumulative gap must be zero. For every time buckets over the study period i.e. FY 2005/06 to FY 2009/10, the assets exceeds the liabilities figure which meet the short and loan term liabilities very easily which will obviously win the confidence of the shareholders, customers and stakeholders indeed. Analysts focus on the cumulative gaps for the different time frames

Types of gap

Gap, difference between risk sensitive assets and risk sensitive liability, can be classified as:

- a. Liabilities-sensitive gap
- b. Asset-sensitive gap

Liabilities-Sensitive Gap

A liabilities-sensitive gap is called negative gap. It occurs when interest-bearing liabilities exceed interest-earning assets for a specific or cumulative maturity period, that is, more liabilities re-price than assets. In this situation, a decrease in interest rates should improve the net interest rate spread in the short term, as deposits are rolled over at lower rates before the corresponding assets. On the other hand, an increase in interest rates lowers earnings by narrowing or eliminating the interest spread.

Asset-Sensitive Gap

A positive or asset-sensitive gap occurs when interest-earning assets exceed interest-bearing liabilities for a specific or cumulative maturity period, that is, more assets re-price than liabilities. In this situation, a decline in interest rates should lower or eliminate the net interest rate spread in the short term, as assets are rolled over at lower rates before the corresponding liabilities. An increase in interest rates should increase the net interest spread. Most banks have a positive gap because most banks borrow long and lend short, so their assets will mature later than their liabilities. For example, a bank will have rate sensitive deposits, which can be withdrawn any time, but the majority of its rate sensitive loans are not due to be paid back anywhere from a year up to 25 years in the case of a mortgage. When a bank has a positive gap ($RSA > RSL$), a rise in interest rates will cause a bank to have asset returns rising faster than the cost of liabilities. But if interest rates fall, liability costs will rise faster than asset returns.

Limitation of Gap Analysis

Gap analysis is subject to limitations. Gap analysis does not capture basis risk or investment risk, is generally based on parallel shifts in the yield curve, does not incorporate future growth or changes in the mix of business, and does not account for the time value of money. Moreover, simple gap analysis (based on contractual term to maturity) assumes that the timing and amount of assets and liabilities maturing within a specific gap period are fixed and determined, therefore ignoring the effects of principal and interest cash flows arising from honoring customer drawdown on credit commitments, deposit redemptions, and prepayments, either on mortgages or term loans, as well as the timing of maturities within the gap period. Depending on the interest rate environment, the mix of assets and liabilities (both on- and off-balance sheet), and the exercise of credit and deposit options by customers, these deficiencies may represent a significant interest rate risk to an institution. Accordingly, the use of gap reports should be complemented with present-value sensitivity systems, such as duration analysis or simulation models.

2.2 REVIEW OF RELATED STUDIES AND PAPERS

The research studies and work papers carried out by different scholars within various geographical region including dissertations conducted by Nepalese scholars are reviewed in this section, which are related with financial performance analysis of commercial bank and/or the area of the study.

2.2.1 Review of Research and Work Papers

Several academic studies have examined whether and to what extent private supervisory information is useful in the supervisory monitoring of banks and developing bank failure prediction models. It is very crucial for such analysis to identify variables that reliably predict future bank failure. 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.

“The ratio analysis is defined as the systematic use of ratio to interpret the financial performance so that the strength and weakness of firm as well as its historical performance and current financial condition can be determined” (*Khan and Jain, 1990*) *Heyliger and Holdren (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. These studies adopted a number of methods, including multiple discriminate analysis, factor analysis, proportional hazard models, and logic analysis.

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.

Barker and Holdsworth (1993) reported that, on average, capital and income slowly deteriorate while past-due loans and charge offs increase as failure approaches.

“Financial Performance analysis is a process of evaluating the relationship between components parts of a financial statement to obtain a better understanding of a firm’s position and performance” (*Metcalfe and Tatar, 1996*)

I.M. Pandey (1997) in his book “Financial Management” defines financial management as that managerial activity which is concerned with the planning and controlling of the firm’s financial resources. *I.M. Pandey* believes that among the most crucial decision of the firm are those which relate to finance and an understanding of the theory of financial management provides the conceptual and analytical insights to make the decisions skill fully.

I.M. Pandey further identifies two kinds of finance functions:

(a) Routine and (b) Managerial finance functions.

The routine finance function do not require a great managerial ability to carry them out and they are chiefly clerical in nature. Managerial finance functions on the other hand are so called because they require skillful planning. There are according to *I.M. Pandey* four important managerial finance functions:

- Investment or long term assets mix decision.
- Financing or capital mix decision.
- Dividend of profit allocation decision.
- Liquidity of short term asset mix decision.

A summary of what the study have reviewed in various books of finance have been highlighted below:

Finance is defined as the acquisition and investment of fund for the purpose of enhancing the value and wealth of an organization. The various finance areas include investments, public finance corporate finance and financial institutions. The basic functions of finance are to manage the firms balance sheet in most efficient way. The balance sheet reflects how a firm acquired financing through. The objectives of the company must be to create value for its shareholders.

“Financial Performance analysis is a study or relationship among the various financing factor in business a disclosed by a single set of statement and a study of the trend of these fact as shown in a series of statements. By establishing a strategic relationship between the item of a balance sheet and income statements and other operative data, the financial analysis unveils the meaning and signification of such items” (*Ahuja, 1998*)

Focusing specifically on CAMEL ratings, *Berger and Davies (1998)* use event study methodology to examine the behavior of BHC stock prices in the eight-week period following an exam of its lead bank. They conclude that CAMEL downgrades reveal unfavorable private information about bank conditions to the stock market. This information may reach the public in several ways, such as through bank financial statements made after a downgrade. These results suggest that bank management may reveal favorable private information in advance, while supervisors in effect force the release of unfavorable information.

Berger, Davies, and Flannery (1998) extend this analysis by examining whether the information about BHC conditions gathered by supervisors is different from that used by the financial markets. They find that assessments by supervisors and rating agencies are complementary but different from those by the stock market. This rationale also could explain the authors' finding that supervisory assessments are much less accurate than market assessments of banks' future performances. On-site bank exams seem to generate additional useful information beyond what is publicly available.

Kolari (2000) 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 row of the six predictions. As with many other studies, there was a lack of theory for the choice of variables, as stepwise logic was utilized for the decision of inclusion or elimination.

Dziobek, Hobbs, and Marston (2000) analyze the determinants of bank liquidity-defined as the degree to which a FI 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. Deposit concentration (i.e., fewer, larger-size deposits) can also be indicative of volatility. On the external front, foreign financing, for instance through commercial credit lines, and deposits of nonresidents (either in foreign or domestic currency) can become highly volatile in situations of distress and make the financial system vulnerable to external shocks or adverse developments in the domestic economy. As regards instrument maturity, the longer the time before the liability matures (in terms of remaining maturity), the more stable is the funding; however, in countries where banks are required to meet early withdrawal requests with only minor penalties, maturity may be less relevant to determining funding stability.

Based on the assessment of commercial banking performance on bank ratings and studied with respect to detecting situations with the potential for adverse development towards failure, and owing to the costly nature of frequent supervisory examinations. In this paper they studied models of rating downgrades and consider a specific set of indicators that are suitable as determinants of a bank's rating. The conclusions about the predictors obtained from the analysis of downgrades are applicable in relatively stable banking sector situations. Banks experiencing minor liquidity trouble might raise their interest rates on deposits, but a regulator would have a hard time distinguishing which bank has increased its deposit rate because of liquidity problems and which has done so owing to an increase in its cost of funds caused by some other factor. Therefore, in their approach the cost of funds – one of the plausible downgrade indicators – was used in the form of the bank's credit spread. In addition to credit spread, they tested the inclusion of the Value at Risk (VaR) indicator in the form of Total Asset VaR, as they believed that this type of indicator might play an important role in determining the level of the rating due to its easy computability and data availability to the public. They focused on the Capital-Assets-Management-Earnings-Liquidity-Market Risk based composite (CAMELS) rating and the Standard and Poors (S&P) ratings. *(Derviz & Podpiera, 2004)*

A comparative study of financial performance is a basic process, which provides information on profitability, liquidity position, earning capacity, efficiency in operation, sources and uses of capital, financial achievement and status of the companies. This information will help to determine the extent of efficiency and effectiveness of the company in respect of deploying financial resources in the profitable manner.

The other factors to be considered in analyzing the financial statement of bank is to assess the capital adequacy ratio and liquidity position. In the line of adequacy of bank is assessed on the basis of risk weighted assets. it indicates a bank's strength and solvency. Bank facing with capital adequacy problem may increase capital or reduce assets or reallocate the existing assets structure in order to maintain the desired level of capital base. *(Maharjan, 2006)*

2.2.2 Review of Related Thesis

Karki (2005), in his thesis entitled “A comparative analysis of financial performance of NABIL Bank and SCBNL” has pointed out following objectives.

- I. To evaluate liquidity position of both banks.
- II. To analyze comparative financial performance of both banks.
- III. To study the comparative position of both banks.
- IV. To offer a package of suggestion to improve the financial performance.
- V. To identify the relationship between interest earned and operating profit.

Major Findings of this study are as follows:

- I. SCBNL has efficiently operated its long term fund, deposit and assets to generate more profits.
- II. Liquidity position of NABIL Bank is favorable in many cases it seems excessive. The proposed recommendation for these banks are to reduce its excessive non-performing assets (cash and bank balance) and invest on the income generating current assets (Treasury bills), while SCBNL must strength the liquidity position.
- III. Comparatively SCBNL’s profit ability position is better than that of NABIL Bank.

Saud (2006), conducted his master thesis on “ A study of Financial Performance of Selected Commercial Bank in Nepal (Himalayan Bank, NB Bank and Everest Bank)” has pointed out following objectives.

- I. To evaluate the trends and growth of loan.
- II. To evaluate the investment and total deposit patterns.

Major Findings of this study are as follows:

- I. Due to lower liquidity position (below than normal standard) and highly leveraged structure and lower liquidity position as profitability as long as more risky.

- II. In case of earning capital and utilization of profit researcher come into the following conclusion.
- III. Himalayan Bank has performed better in terms of net profit during the study period. All of these three sample banks are able to earn above 1% on total assets and to mobilize deposit properly.
- IV. In case of dividend all sample banks are not able to pay regular dividend to its stakeholder. However they maintaining its EPS above its value.
- V. Regarding earning per share all of the sample banks are not able to retain its EPS on its previous level. The researcher concluded that during the study period trend line shows the decreasing pattern of net income after tax.

Upreti (2007), in his thesis entitled “A comparative study of financial performance of NIBL, HBL, SCBNL and EBL” has pointed out following objectives.

- I. To study the present of the four joint venture banks.
- II. To do the comparative study about the financial performance of these banks with regard to the profitable liquidity, efficiency and capital structure.
- III. To provide recommendation and suggestion on the findings to improve financial performance of these banks.

Major Findings of this study are as follows:

- I. Among all the sample banks, HBL has the lowest ratio and EBL has not mobilized its assets into profit generating projects.
- II. SCBNL has been successful in earning more net profit by the proper use of its available assets.
- III. EBL with the highest ratio has been successful in generating more interest by the proper use of its available assets.
- IV. EBL and HBL seem to have held more cash and bank balance rather than other commercial banks.

Joshi, Archana (2008) conducted a study on “A comparative study on financial performance of NSBI bank ltd & Nepal Bangladesh bank Ltd” with the following objectives.

- I. To highlight various aspects of relating to financial performance of Nepal Bangladesh bank and NSBI bank.
- II. To analyze various aspects of relating to financial performance through the use of appropriate financial tools.
- III. To show the cause of change in cash position of the two banks. Through her research she has presented the following findings of the study.

Major Findings of this study are as follows:

- I. The average current ratio of NSBI is greater than that of NBBL. The liquidity position of NSBI is in normal position.
- II. NBBL has better turnover than NSBI in terms of loans and advances to total deposit ratio. Thus NBBL has better utilization of resources income generating activities than NSBI bank which definitely led to increase in income and this making an increment profit.
- III. From the ratio calculation NBBL seems to tackle their investor more efficiently going through net profit to total deposit ratio it can be said that NBBL seems to be more successful in mobilizing its customers saving in much more productive sectors.

Subi (2009), in her thesis entitled “Financial performance of Nepal Investment Bank Limited” has tried to summarize the financial performance of NIBL. And she has pointed out the following objectives.

- I. To evaluate liquidity position of NIBL.
- II. To analyze the financial performance of this bank.
- III. To offer a package of suggestion to improve the financial performance.
- IV. To identify the relationship between interests earned and operating profit.

Major Findings of this study are as follows:

- I. The result of the analysis indicates that the bank has the high debt equity ratio which again exhibits that the creditors have invested more in the bank than the owners.
- II. The result of the analysis indicates that the bank has better mobilization of saving deposits in loan and advances for income generating purpose.

Pandey, Narayan (2010) in his entitled thesis “A study on a comparative analysis on financial performance of banks” (with reference to EBL, HBL and NSBIL). And he has pointed out the following objectives.

- I. To analyze mobilization of its assets into profit generation projects.
- II. To evaluate the liquidity position of the selected banks.
- III. To offer a package of suggestion to improve a financial performance.
- IV. To examine the mobilization of the collected funds.

Major Findings of this study are as follows:

- I. Among the entire sample bank, NSBI has the lowest ratio of net profit to total assets. It means NSBI has not utilized its assets into profit generating projects as much as other sample bank does.
- II. EPS of EBL is the highest than other sample bank in the study period. Similarly with the highest dividend payout ratio of HBL refers that the bank provides maximum amount of dividend to its shareholders.
- III. NSBI bank has highest price earnings ratio than other sample banks likewise HBL has highest net interest income compare to other bank which is the strong strength of bank.

The annual reports data set of joint venture banks and NRB supervision reports published his paper abstract in the Journal of Nepalese Business Studies (Volume II No.1, December 2009). The paper examined the financial health of joint venture banks in the CAMEL framework for a period ranging from FY 2005/06 to FY 2009/10. The health

checkup which was conducted on the basis of publicly available financial data concludes that the financial health of joint venture banks is better than that of the other commercial banks. The study further indicates that the CAMEL component indicators of the joint venture banks are not much encouraging to manage the possible shocks. *(Baral, 2005)*

2.3 Research Gap:

Various studies have been conducted in the past on financial analysis of commercial banks in the US and other regions were found done. The research paper done in the context of Nepal mainly emphasized on liquidity, profitability and leverage of the commercial banks. These studies lack micro-level analysis and found applying traditional analysis of financial performance. In the context of Nepalese banking environment, there are a few academic researchers found conducted in the frame work of CAMEL. *(Bhandari, 2006)*

However these researches lack analysis of the 6th component i.e. Sensitivity of Market Risk. This research attempts to evaluate financial performance of NABIL Bank and NSBI Bank Ltd. On all the six components of CAMELS framework. This research will be helpful to understand the overall condition and performance of these two banks.

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)*

CHAPTER III

RESEARCH METHODOLOGY

This chapter includes research design, justification for the selection of study unit, nature and sources of data, methods of data collection, data analysis tools and limitations of methodology. This chapter provides the overall framework or plan for the collection, analysis and presentation of data required to fulfill the objectives of the study. Different tools and techniques used for the analysis and presentation as to answer the research questions are explained under this section. It includes the type of information to be collected and sources of the information for the study purpose. “Research methodology refers to the various sequential steps (along with a rationale on each such step) to be adopted by a researcher in studying a problem with certain object in view.” (*Kothari, 1989:32*)

“Research is the process of systematic and in-depth study or search for any particular topic, subject or area of investigation, backed by collection, presentation and interpretation or relevant details or data.” (*Michael, 1985:57*)

To meet the objectives, the methodologies applied in the study are described below:

3.1 RESEARCH DESIGN

Research design is the task of defining the research problem. A research design is the arrangement of conditions, for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. (*Kothari, 1989*)

Research design is the plan structure and strategy of investigation conceived so as to obtain answer to research question and to control variance. In other words research design is the framework for a study that helps the analysis of data related to study topic.

“A research design is the arrangement of condition, for collecting and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure.” (*Chaire, Selliz and others. 1967;261*)

In fact the research design is the conceptual structure within which the research is conducted. The evaluation of the performance is designed to reflect an assessment of the financial condition of NABIL Bank and NSBI Bank Ltd. based on the CAMELS perspective prescribed by UFIRS/UBPRS in line with the BASEL II accord. Hence, the research is conducted on a historical and analytical case study basis. Therefore descriptive analytical research methodology has been followed, to achieve the desired objectives. In order to evaluate the financial performance of selected two banks, some financial and statistical tools and descriptive techniques are applied. It is the plan, structure and strategy on investigations conceived for obtaining answers to research questions and to control variances To achieve the objective of this study, descriptive and analytical research designs have been used. Some statistical and accounting tools have also been applied to examine facts and descriptive techniques have been adopted to evaluate financial performance of the bank.

3.2 NATURE AND SOURCES OF DATA

Basically the research is based on secondary information data. The annual reports of the banks form the major sources of data. The regulatory data were collected from NRB directives and reports. The basic conceptual information was collected through BASEL, FDIC and NRB publications and work papers. The information related to the past and current work conducted in the research field was collected from the following sources:

- NRB reports & bulletins and its official website
- Basel Committee publications through its official website
- Various research papers and Dissertations,
- Various articles published in journals and financial magazines
- Nepal Stock Exchange reports
- Official Website of banks

Formal and informal discussions with the senior staff of the banks were held which was helpful in understanding and obtaining the additional information.

3.3 DATA COLLECTION PROCEDURE

The required information was collected by conducting visit to the Head office of each bank at, consulting library at Shanker Dev College of Management, Internet Surfing and related text books. The annual reports of each Bank for the study period were obtained from their Head offices through personal approach and internet surfing to the banks' official website. NRB regulatory directives, Statistics of the Commercial Banks of Nepal and other related publication were obtained through internet surfing to NRB's official website and periodicals. Existing literature on the subject matter was collected from various research papers placed in Library of Nepal Commerce Campus and Central Library (T.U.). Likewise, the review of working papers conducted by various international scholars on the related matter was done through internet surfing to various websites.

3.4 DATA PROCESSING

The financial data from the published documents and audited financial statements were manually extracted into the computer files of Microsoft Excel program which acted as master database file. The data was refined further into spreadsheets to carry out financial ratio calculation and graphical illustrations through mathematical functions and Chart program of the Excel program.

3.5 DATA ANALYSIS TOOLS

Financial ratios are the major tools used for the descriptive analysis of the study. In addition to the financial tools, simple statistical tools are also used.

3.5.1 Financial Ratio Analysis Tools

Financial Ratio Analysis tools are used to determine the performance of the banks in the framework CAMELS components. These ratios are categorized in accordance of the CAMELS components. Following category of key ratios are used to analyze the relevant components in terms of CAMELS: *(McNally & Edward, 1996)*

“Financial analysis is the process of identifying the financial strength and weakness of firm establishing relationship between times of balance sheet and profit and loss account.” (*Van Horne, 1979:67*)

“Ratio analysis is one of the most frequently used tools to evaluate the financial health, operating result and growth.” (*Poudel, 2053:67*)

Ratio analysis is an important way to state meaningful relationship between components of financial statement. Ratios are guided or shortcuts that one useful in evaluation the financial position and operations of a company and in comparing then to previous year or two other business concerns. The term ratio refers to the numerical or quantitative relationship between two variables. The rational of ratio analysis lies in the fact that it makes related information comparable. (*Khan and Jain,80*)

Ratio analysis involves basic understands of comparison to a useful interpretation of the financial statements. A single ratio by itself does not indicate favorable or unfavorable condition of a firm unless it is compared to some appropriate standard. Selection of a proper standard of comparison is a most important element of the ratio analysis. Ratio analysis provides guides specially in spotting trends toward better or poor performance and in finding out significant deviation from any average or relatively applicable standard. (*Dangol R.M., 2052:370*)

Capital Adequacy Ratio: Capital Adequacy Ratios take into account the most important financial risks-foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution’s assets. Risk-weighted assets (RWA), Tier 1 capital, Tier 2 capital are used to calculate the capital adequacy ratios.

$$\text{Capital Adequacy Ratio} = \frac{\text{Tier I} + \text{Tier II Capital}}{\text{RWA}}$$

Tier I Capital Adequacy Ratio: Tier I ratio shows the relationship between the total core capital or internal sources and total risk adjusted assets. It is calculated by using the following model.

$$\text{Tier I Adequacy Ratio} = \frac{\text{Tier I Capital}}{\text{RWA}}$$

Tier II Capital Adequacy Ratio: This ratio shows the absolute contribution of supplementary capital in capital adequacy. It is used to analyze the supplementary capital adequacy of the banks and determined by using the following model.

$$\textit{Tier II Adequacy Ratio} = \frac{\textit{Tier II Capital}}{\textit{RWA}}$$

Non- Performing Loan Ratio: The non-performing loan ratio indicates the relationship between non-performing loan and total loan. It measures the proportion of nonperforming 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.

$$\textit{Non Performing Loan Ratio} = \frac{\textit{Non Performing Loan}}{\textit{Total Loans and Advances}}$$

Where, Non-performing Loan = Theses loans which have been past due either in the form of interest servicing or principal repayment and graded as possible default.

Loan Loss Provision to Total Loans Ratio: The provision for loan losses is a charge to current earnings to build the Allowance for Loan and Lease Losses (ALLL). The ALLL is a general reserve kept by banks to absorb loan losses. While it measures the possibility of loan default, it reflects adequacy of to absorb estimated credit losses associated with the loan and lease portfolio, of the bank. For the purpose of this study following model is used to determine the loan loss ratio:

$$\textit{Loan Loss Provision Ratio} = \frac{\textit{Loan Loss Provision}}{\textit{Total Loans and Advances}}$$

Total Expense to Total Income Ratio: 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 revenues. A high or increasing ratio of expenses to total revenues can indicate that FIs 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 Report, 2000*)

Following is the expression of total expenses to total revenues ratio.

$$\textit{Total Expenses to Income Ratio} = \frac{\textit{Total Expenses}}{\textit{Total Income}}$$

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, 2000*). It is calculated by using the following model:

$$Earning\ Per\ Employee = \frac{Net\ Income\ After\ Tax}{Total\ Number\ of\ Employees}$$

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 used to determine the return on equity ratio:

$$Return\ on\ Equity = \frac{Net\ Income\ After\ Tax}{Shareholders\ Equity}$$

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 indicator of the quality of assets, managerial efficiency to utilize the institution's assets into net earnings. (*Rose, 1999*)

Higher the ROA, higher is the quality of assets and efficient asset utilization. It is calculated by using the following model.

$$Return\ on\ Assets = \frac{Net\ income\ After\ Tax}{Total\ Assets}$$

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 offending (*Rose, 1999*). For the purpose of the study following model is used to determine net interest margin:

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

Where, Net interest income = Interest Income- Interest Expense

Total Earning assets = Total Interest bearing Assets

Earning Per Share (EPS): Earning 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, 1999). It gives the strength of the share in the market Following is the expression of earning per share:

$$\text{Earning Per Share} = \frac{\text{Net Income After Tax}}{\text{Number of Shares}}$$

Cash Reserve Ratio (CRR): It is the minimum amount of reserves a bank must hold in the form account balance with NRB and cash held in vault. This ratio ensures minimum level of the bank's first line of defense in meeting depositor's obligations. Commercial banks are required to maintain cash reserve ratio in two forms; NRB Balance and Cash at Vault specified as the Percentage of total deposits as follows:

NRB Balance to Total Deposits Ratio: NRB balance to total deposits ratio shows the numerical relationship between NRB balance and total deposits of a bank. It measures the proportion of NRB balance in total deposits. Following model is used to determine the NRB balance to total deposits ratio:

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

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

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

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

Liquid Assets to Total Deposits Ratio: Total liquid assets to total deposits ratio is a numerical relationship between total liquid assets and total deposits of a bank. The higher ratio implies better liquidity position. It is calculated by using the following model:

$$\text{Total Liquid Assets to Deposit Ratio} = \frac{\text{Total Liquid Assets}}{\text{Total Deposits}}$$

Where,

Total liquid assets = Cash in hand + NRB Balance + Domestic bank balance + Foreign Currency bank balance + Placements + Investment in Government securities.

GAP Ratio

GAP ratio is used to examine whether bank's rate sensitive assets (RSA) are sufficient enough to cover its rate sensitive liabilities (RSL). It is calculated as the ratio between RSA and RSL. It is computed by expressing RSA divided by RSL.

$$\text{GAP Ratio} = \frac{\text{RSA}}{\text{RSL}} \times 100$$

Interest Rate Sensitivity Ratio :

The interest rate sensitivity (IRS) is used to determine whether changes in interest rate positive or negatively affect the bank's net interest margin or profitability. It can be computed by expressing cumulative GAP as a percentage of total risk sensitive assets.

$$\text{IRS Ratio} = \frac{\text{Cumulative GAP}}{\text{RSA}} \times 100$$

3.5.2 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 as:

$$\text{Mean} = \frac{\sum x}{n}$$

Where, Mean = 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*). Here, the standard deviation is used to find out the deviation in absolute term. Standard deviation is determined as:

$$\sigma = \sqrt{((\sum(x - \bar{x}))^2/n)}$$

Here, n= Number of observations

x=Individual value, \bar{x} = Simple Arithmetic mean

Coefficient of Variation: Coefficient of variation is the relative measure of dispersion based on the standard deviation. 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:

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

Here, σ = standard deviation , \bar{X} =Mean , CV = Coefficient of variation

3.6 LIMITATIONS OF THE METHODOLOGY

The research is conducted to fulfill the academic requirement of Master of Business degree. It is focused on the financial analysis of NABIL Bank and NSBI Bank in the frame work of all the six components of CAMELS system and is based on the audited financial annual reports of condition of each bank during the period FY 2005/06 to FY 2009/10. The study by large is based on secondary data obtained from annual reports and financial results published by the bank. The reliability of analysis depends on the reliable disclosure of the data.

Audited data published by the bank are treated as authentic. The study is carried out within the framework of case study research design. So, it is difficult to eliminate the limitation of the case study, in which the study as well as the methodology is bounded. Only a single unit is taken for the study, therefore, the study may not be able to represent the whole scenario. As this study is in the framework of case study research design, limitations of case study-type research are inevitable and the methodology is bounded as well. Different tools used to analyze the collected data are based on certain assumptions which may not also be considered as absolute. Hence, the reliability of the analysis depends upon the circumstances on which the models are based.

The basic limiting conditions, within which the research work is conducted, are:

- The evaluation made herein of one sample unit of two banks only, hence cannot be representative of the whole industry. However, it gives a particular direction to the industry if not actual.
- The study remains largely in the realms of Offsite Monitoring System hence qualitative assessment may not be reflected by the study. However, the proxy financial tools are helpful to give a close picture of such factors.
- The quarterly financial reports of the bank are not publicly available or if available not adequate whereas the effectiveness of CAMELS assessment requires quarterly financial reports.

Likewise Statistical model using publicly available financial data is a better indicator of bank failure than CAMEL ratings that are more than two quarters old. (*Cole and Gunther, 1998:112*)

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the presentation of data collected and its analysis with focus on the CAMELS six components has been made. The major findings from the analysis are made following the presentation.

4.1 DATA PRESENTATION AND ANALYSIS

The data collected from different sources has been refined and documented in Excel tables, which are further processed to analyze and arrive at the findings on the financial conditions of NABIL Bank and NSBI Bank in terms of CAMELS framework.

4.1.1 Capital Adequacy

Capital adequacy component analysis NABIL Bank of and NSBI Bank is made based on the regulations and standard ascertain by NRB as to maintaining minimum risk-based Core & Total Capital Standard, and maximum risk based Supplementary capital standard. The minimum risk-based capital standard which includes a definition for Risk Based Capital, a system for calculating Risk Weighted Assets (RWA) by assigning on and off balance sheet items to broad risk categories. Capital Adequacy Ratios take into account the most important financial risks-foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution's assets.

4.1.1.1 Core Capital Adequacy Ratio

Core (Tier I) Capital, which is a capital of permanent nature, comprise of Paid Up, Share premium, Non Redeemable Preference Share, General Reserve, Dividend Equalization Fund, Capital Adjustment Reserve, Retained Earning and Profit & Loss accounts. Table 4.1 presents the observed Core Capital Ratio during the study period i.e. from FY 2005/06 to FY 2009/10 for NABIL Bank and NSBI Bank and minimum core capital standard set by NRB in the corresponding period along with variance from NRB Standard.

Table 4.1: Core Capital Adequacy Ratio Vs NRB Standard**NABIL BANK**

Fiscal Year	Core capital (Million)	RWA (Million)	Core capital to RWA (%)	Min NRB standard (%)	Variance
2005/2006	1,744	16,012	10.78	5.5	5.39
2006/2007	1,992	19,154	10.40	5.5	4.90
2007/2008	2,363	27,005	8.75	5.5	3.25
2008/2009	3,044	34,816	8.74	5.5	3.24
2009/2010	3,667	41,822	8.77	5.5	3.27

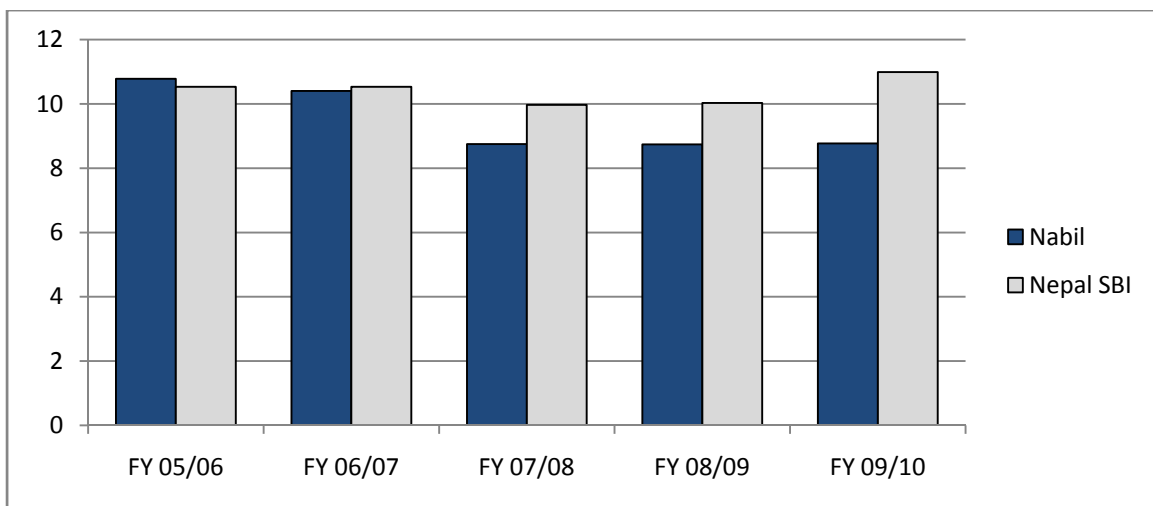
*(Source: Annex-1)***NSBI BANK**

Fiscal Year	Core capital (Million)	RWA (Million)	Core capital to RWA (%)	Min NRB standard (%)	Variance
2005/2006	964	9,159	10.53	5.5	5.03
2006/2007	1,145	10,873	10.53	5.5	5.03
2007/2008	1,394	16,086	9.97	5.5	4.47
2008/2009	1,673	16,873	10.03	5.5	4.53
2009/2010	2,430	22,099	10.99	5.5	5.49

(Source: Annex-1)

As shown in the table 4.1, the Tier I ratio of NABIL Bank of 10.78% was maximum in FY 2005/06 and minimum ratio of 8.74% in FY 2008/2009. The Tier I ratio has been continuously declining from FY 2004/2005 to till FY 2008/2009 and then increase in FY 2009/2010. The reason of this decrease was due to comparatively high increase of RWA. Whereas Tier I ratio of NSBI Bank of 10.99% was maximum in FY 2009/10 with minimum ratio of 9.97% in FY 2007/08. The tier I ratio for NSBI Bank fluctuate for the sample period. The Core ratio decrease in FY 2007/2008 and continuously increase till FY 2009/2010 with 10.99%.

Diagram 4.1 Core Capital Adequacy Ratio Vs. NRB Standard



The graphical representation in Diagram 4.1 shows, Core capital ratio of NABIL Bank varied fluctuates in all the 5 years of the review period, with maximum positive variance of 5.39 % in FY 2005/06 and minimum positive variance of 3.24% in FY 2008/09. The bank was able to maintain positive variance greater than 3% during the period 2005/06 to 2009/10. Likewise NSBI Bank also fluctuates in all the five years, with maximum positive variance of 5.49% in FY 2009/2010 and minimum positive variance of 4.47% in FY 2007/2008. Comparatively NSBI Bank shown the higher Core Capital Adequacy ratio than NABIL Bank, In general, both banks have maintained Tier I capital adequately above the NRB standard. It means the banks are applying adequate amount of internal sources of shareholders' fund with significant core capital adequacy ratio in all the years over the study period, which supports the banks to operate the business transaction smoothly without any obstacles.

4.1.1.2 Supplementary Capital Adequacy Ratio

Supplementary capital are collected by way of hybrid capital instruments, General Loan Loss Provision, Exchange Fluctuation reserve, Asset Revaluation reserve, Interest Spread Reserve, Subordinate Term Debt, and other free reserve. The ratio reflects proportion of supplementary capital components in total risk adjusted assets and relative contribution in the CAR for NABIL Bank and NSBI Bank. Supplementary Capital is also known as the tier II capital of bank in the study. Supplementary capital of the sample banks helps to formulate the Total Capital of the bank which is calculated on the next section. As we know that Core and Supplementary capital sum generate the Total Capital of the bank. This study is made and presented as from the below table 4.2 Supplementary Capital Adequacy also the calculated ratio has been further analysis in diagram 4.2 which embody the period i.e. from FY 2005/06 to FY 2009/10 for NABIL Bank and NSBI Bank. NRB regulates Supplementary Capital ratio by allowing Supplementary capital not exceeding 100% of the core capital for CA calculation.

Table 4.2: Supplementary Capital Adequacy

NABIL BANK					
Fiscal Year	Supp. capital (Million)	RWA (Million)	Supp. capital to RWA (%)	Min NRB standard (%)	Variance
2005/2006	150	16,012	0.94	5.5	(4.56)
2006/2007	315	19,154	1.64	5.5	(3.86)
2007/2008	635	27,005	2.35	5.5	(3.15)
2008/2009	683	34,816	1.96	5.5	(3.54)
2009/2010	722	41,822	1.73	5.5	(3.77)

(Source: Annex-2)

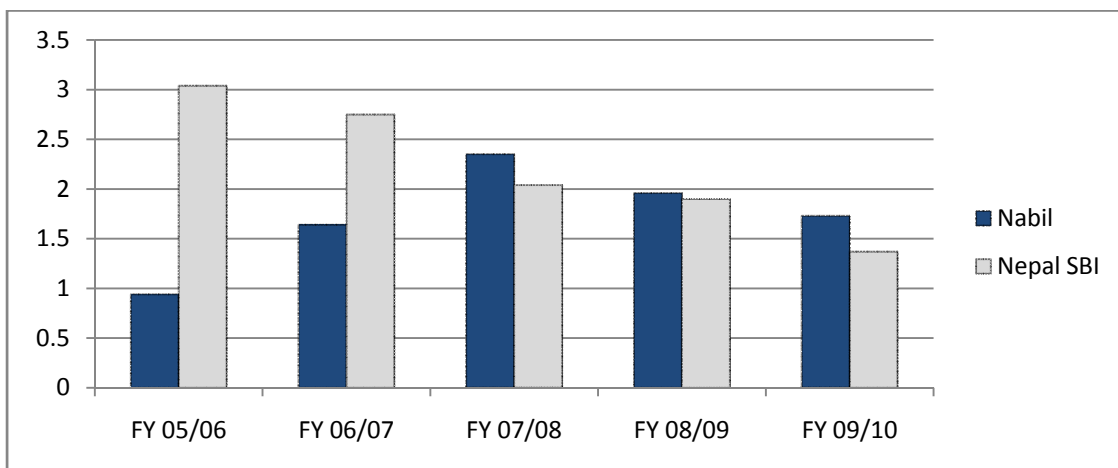
NSBI BANK

Fiscal Year	Supp. capital (Million)	RWA (Million)	Supp. capital to RWA (%)	Min NRB standard (%)	Variance
2005/2006	278	9,159	3.04	5.5	(2.46)
2006/2007	299	10,873	2.75	5.5	(2.75)
2007/2008	328	16,086	2.04	5.5	(3.46)
2008/2009	320	16,873	1.90	5.5	(3.60)
2009/2010	304	22,099	1.37	5.5	(4.13)

(Source: Annex-2)

As shown in Table 4.2, the Supplementary capital ratio of NABIL Bank was maximum in FY 2007/08 with 2.35% and minimum in FY 2005/06 with 0.94%. The ratio is in fluctuating trend during the study period. Recently the ratio has declined in this FY i.e. 2009/010. Whereas the Supplementary ratio of NSBI Bank was maximum with 3.04% in FY 2005/06 and minimum with 1.37% in FY 2009/010. This ratio is declining trend due to decrease in Supplementary Capital Fund and increased in RWA. From the FY 2005/2006 in which the ratio was maximum and started to decline continuously till the recent year i.e. 2009/010.

Diagram 4.2 Supplementary Capital Adequacy Ratio Vs NRB Standard



A diagram 4.2 show, Supplementary capital ratio of NABIL Bank is very fluctuating from the starting to the end of the review period. The maximum level is on FY 2007/08 and minimum level is on FY2005/06. None of the ratio over the period for NABIL Bank has reached the standard set by NRB i.e. 5.5%. Same as, Supplementary capital ratio of Nepal SBI also were well below the maximum level allowed by NRB norms in all the years with maximum ratio of 3.04% in FY 2005/06 and minimum ratio of 1.37% FY 2009/010. The bar chart for the NSBI Bank continuously decline over the study period.

4.1.1.3 Total Capital Adequacy Ratio

Capital adequacy ratio above the NRB standard indicates adequacy of capital and signifies higher security to depositors, higher internal sources and higher ability to cushion operational and unanticipated losses. The lower value, on the contrary, indicates lower internal sources, comparatively weak financial position and lower security to depositors. Total Capital of sample banks i.e. NABIL Bank and NSBI Bank is the sum of the Core Capital and Supplementary Capital which formulate the Total Capital which have been further presented in the below table and also further analysis in the diagram table 4.3.

Table 4.3: Total Capital Adequacy Vs NRB Standard

NABIL BANK

Fiscal Year	Total capital (Million)	RWA (Million)	Total capital to RWA (%)	Min NRB standard (%)	Variance
2005/2006	2,307	16,012	12.31	11.0	1.31
2006/2007	2,999	19,154	12.04	11.0	1.04
2007/2008	2,969	27,005	11.10	11.0	0.10
2008/2009	3,727	34,816	10.70	11.0	(0.30)
2009/2010	4,390	41,822	10.50	11.0	(0.50)

(Source: Annex-3)

NSBI BANK

Fiscal year	Total capital (Million)	RWA (Million)	Total capital to RWA (%)	Min NRB standard (%)	Variance
2005/2006	964	9,159	13.57	11.0	2.57
2006/2007	1444	10,873	13.29	11.0	2.29
2007/2008	1722	16,086	12.32	11.0	1.32
2008/2009	1993	16,873	11.92	11.0	0.92
2009/2010	2,734	22,099	12.37	11.0	1.37

(Source: Annex-3)

Table 4.3 tabulates the bank’s Total Capital Adequacy Ratio and its comparison with minimum NRB standard during the review period. As tabulated, the total capital to RWA of NABIL Bank with 12.31% is maximum in FY 2005/06 and minimum with 10.50% in FY 2009/10, The ratio was found above the minimum NRB standard in all the study period except on FY 2008/2009 and FY 2009/010 with maximum positive variance of 1.31% and negative variance of 0.3 % in FY 2005/06 and 2009/10 respectively. Similarly in the case of NSBI Bank the total capital to RWA is maximum with 13.57% in FY 2005/06 and minimum with 11.92% in FY 2008/09, The ratio was found above the minimum NRB standard in all the study period with maximum positive variance of 2.57% in FY 2005/06 and minimum variance of 0.92% in FY 2008/09.

Diagram 4.3 Total Capital Adequacy Vs NRB Standard

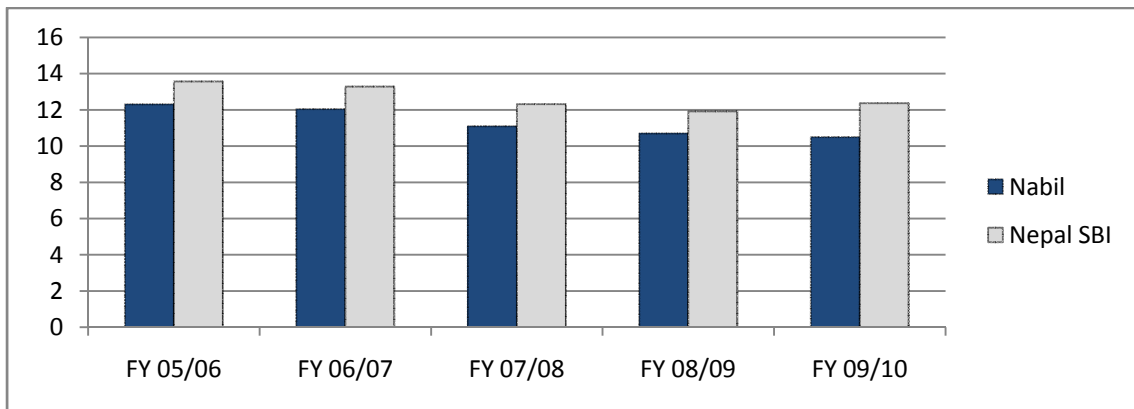


Diagram 4.3 exhibits the data tabulated in Table 4.3. As shown in the Diagram, the capital adequacy ratio of NABIL Bank was above the minimum NRB standard for the review period except the current FY 2008/09 and FY 2009/010 by only 0.30% and 0.50% respectively. The variances were in decreasing trend represented by the variance with NRB standard. Similarly Capital Adequacy ratio of NSBI Bank was also found above the minimum NRB Standard. Also the positive variances were in decreasing trend in the study period expected in FY 2009/010 which has been presented in the above bar chart. In general, NABIL Bank is not able to maintain CAR above the minimum NRB standard efficiently during the study period. Comparatively Nepal SBI was able to maintain Total Capital Adequacy ratio greater than NABIL Bank.

4.1.2 Asset Quality Analysis

Out of the several indicators of asset quality, Asset composition, Non-Performing asset ratio and Loan Loss provisioning ratio are taken to examine the asset quality of NABIL Bank & NSBI Bank. The total asset composition of NABIL Bank & NSBI Bank is analyzed using time series technique over the review period with major highlight on Investment component due to its sensitive exposure. The quality of assets is examined from the recovery of loan and advances with the good return on investment sectors of any bank. Also every bank Non-performing asset and Loan loss provision indicates the quality of the assets. Higher the ratio of Nonperforming loan and Loan loss provision indicates the higher risk and low quality of the bank assets indeed and *vice versa*. The Loans & Advances having major exposure and sensitive to bank's performance, was carried out using time series and comparative analysis technique. The analysis of Loans & Advances contains examination of loan classification and Non- Performing Loans to Total Loans ratio which is used as a proxy for asset quality. The coverage ratio—the ratio of provisions to loans was examined since it provides a measure of the share of bad loans for which provisions have already been made. The loan portfolio diversification analysis to assess inherent credit risks could not be conducted as the bank's financial data format in the annual reports lacked detailed sectorial loan portfolio unlike financial reports required in US region.

4.1.2.1 Asset Composition

The assets portfolio of the bank represents the varied nature and consequence of the bank's function and investment policies. Usually every banker seems to arrange their assets appearing in balance sheet in descending order of liquidity. The capital and liabilities of banks are invested in various assets in the form of Cash & Bank Balance, Investments, Bills purchase, Loans and advances and Fixed Assets. Of these, Loans usually make the largest portion of all the assets. As they are the least liquid form of assets, Loans and Advances contain the high proportion of potential risk to the bank's capital. Loans and advances dominate the asset side of the balance sheet of the banks. Similarly earning from such loans and advances occupy a major space in income statement of the bank. Hence Asset is the critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. The quality of assets are measured in terms of ratio of past due loans to total loans and loan classified as substandard/doubtful/loss to total loans. Provisions made for NPAs and loan provided to single Borrower are also the measuring rods used to analyze the assets' quality of the bank.

Table 4.4: Bank Asset Composition (in %)

NABIL BANK

Fiscal Year	05/06	06/07	07/08	08/09	09/10	Mean
Cash & Bank Bal	3.25	5.14	7.19	7.69	2.68	5.19
Money at call	5.05	2.07	5.26	1.26	5.98	3.92
Investment	24.83	32.82	26.77	24.68	26.21	27.06
Loan & Advance	61.59	57.04	57.54	62.89	61.88	60.19
Fixed assets	2.10	1.05	1.61	1.51	1.50	1.56
Other assets	3.16	1.88	1.63	1.97	1.75	2.08

(Source: Annex-4A)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10	Mean
Cash & Bank Bal	8.58	8.08	7.81	6.27	9.04	7.96
Money at call	1.65	2.52	1.77	0.00	0.00	1.19
Investment	28.84	19.13	18.97	43.97	42.85	30.75
Loan & Advance	58.51	68.05	70.48	48.94	45.94	58.38
Fixed assets	1.51	2.19	0.97	0.82	1.12	1.32
Other assets	0.90	0.03	0.00	0.00	1.05	0.40

(Source: Annex-4B)

Asset composition of NABIL Bank is same like in every banks remained largely in loans and investment during the last five financial years i.e. FY 2005-06 to FY 2009-10. As shown in the Table, percentage of cash and bank balance fluctuate during the study period with maximum balance of 7.69% in FY 2008/09 and minimum balance of 2.68% in FY 2009/10. The average Cash & Bank Balance of 5 years were 5.19%. Money at Call was maximum in FY 2009/10 at 5.98% which has been increase over the review period for NABIL Bank. The Investments composition of the total assets has shown fluctuation during the review period with maximum of 32.82% in 2006/07 and minimum of 24.68% in 2008/09. The Investment proportion in the 5 year period averaged 27.06%. The Loan & Advances was 62.89% as the maximum and 57.04% in FY 2008/2009 and 2006/07 respectively with 60.19% in an average. The mean loan and advance for NABIL Bank is over 60% and in aggregate with the investment make the portion of above 87%, which is very good and acceptable. As we know loan and advance with investment is the earning assets for every financial institution and each financial institution should effort to flow its assets in earning assets. Also financial institution should pay attention to keep adequate cash and bank balance to meet the liabilities. Similarly, fixed assets and other assets proportions is fluctuated and in the review period which slightly decrease and increase over the period of the last 5 years.

In the case of NSBI Bank, percentage of Bank and Cash Balance cumulatively ups and down in all the years with 8.58%, 8.08%, 7.81%, 6.27% and 9.04% respectively with average balance of 7.96%. Money at call is maximum with 2.52% in FY 2006/07 after then decreases till FY 2007/08 to Nil in FY 2008/09 and FY 2009/010. Over the study period the portion has the fluctuating trend. However the trend is in fluctuating with mean value of 1.19%. The Investment Composition is in Ups and downs with maximum of 43.97% in 2008/09 and with minimum 18.97% in 2007/08. Loan, Advances and Bills Purchase is fluctuating over the review period. It has increase in FY 2005/06 to FY 2007/08 continuously and then decline in FY 2008/09 and FY 2009/010 with the mean value of 58.38% which is over 50% of the total assets. As we know loan and advance with investment is the earning assets for every financial institution and each financial institution should effort to flow its assets in earning assets. In comparison NSBI Bank is investing more of its assets in loan and advances with investment than NABIL Bank. Similarly, Fixed assets and other assets proportion is in customary changing trend in the review period and occupied very ostensible portion of the bank assets. NSBI Bank should also effort to keep adequate cash and current assets to meet the current liabilities.

4.1.2.2 Loans and Advances

The fact that the Loans usually form the largest of the asset items and can carry the greatest amount of potential risk to the bank's capital account, the primary factor effecting overall asset quality is the quality of the loan portfolio and the credit administration program. For the evaluation of asset quality of NABIL Bank and Nepal SBI the adequacy of Allowance for Loan and Lease Losses has been considered and the exposure to counter-party, issuer, or borrower default under actual or implied contractual agreements is weighed. Assets with inherent credit weaknesses, categorized into non-performing assets components: Substandard, Doubtful and Loss grades are examined, as per minimum criteria laid down by NRB based on the overdue period of the advances. These graded loans are required require provisioning of 25%, 50% and 100% respectively, in order to safe guard the interest of the stakeholders. Quality of loans and advances of NABIL Bank and Nepal SBI is assessed based on its Loan Classification and Loan Loss Provision mix as below.

4.1.2.2.1 Loan Classification Mix Analysis

The default in repayment of interest or principal within the stipulated time frame, the performing loan turns into NPL. As per NRB directives, all Loans and Advances must be classified in order of Principal default aging into Pass (due up to 3 months), Sub-standard (due between 3-6 months), Doubtful (due between 6-12 months) and Loss (due over 1 year). NPL forms an aggregate of Substandard, Doubtful and Loss loans. The lower the ratio the better is the proportion of performing loans and risk of default.

Table 4.5: Non Performing Loan Ratio.

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Non Performing Loan	182.62	178.29	161.08	224.80	486.28
Total Loan	13,278.78	15,903.02	21,759.40	27,999.00	33,030.96
NPL ratio%	1.38	1.12	0.74	0.80	1.47

(Source: Annex-6)

NSBI BANK

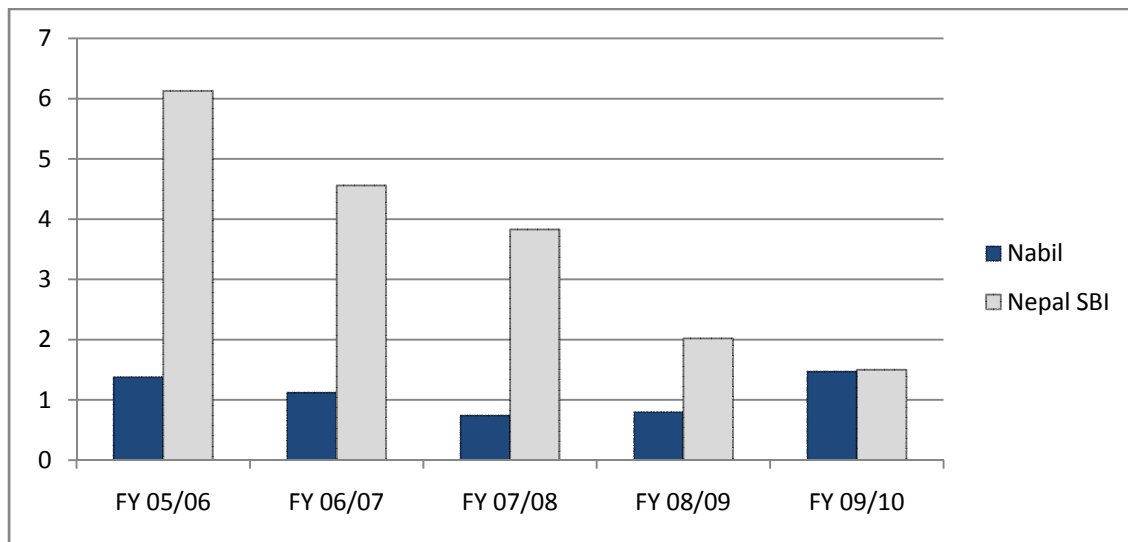
Fiscal year	05/06	06/07	07/08	08/09	09/10
Non Performing Loan	505.33	458.76	488.41	315.95	265.13
Total Loan	8,241.45	10065.05	12746.21	15612.05	17,693.64
NPL ratio%	6.13	4.56	3.83	2.02	1.50

(Source: Annex-6)

The mid figures of NPL of both of the banks were adequate to tell the trend analysis. The NPL ratio of NABIL Bank is in continuously decreasing from FY 2005/06 to FY 2007/08 and then increase from FY 2008/09 to FY 2009/10 with maximum 1.47% in FY 2009/10 and minimum with 0.74% in FY 2007/08. Whereas, NPL of Nepal SBI is in continuously decreasing trend was found maximum with 6.13% in FY 200/06 and

minimum with 1.50% in FY 2009/010. Comparatively the NSBI has greater NPL than NABIL Bank which show the weakness of the bank management committee of NSBI. NABIL Bank has able to maintain NPL ratio less than 1.5% over the period of the study and Nepal SBI is able to maintain 1.50% at the recent FY 2009/010 which is improving in recent year.

Diagram 4.4 Non Performing Loan Ratio



In figure 4.4, the non-performing loan ratio curve of the NABIL Banks is very low. Likewise the non-performing loan ratio of Nepal SBI is very high compared to NABIL Bank. The ratios of both banks are positively standing. The NPL ratio of NABIL Bank remains fluctuating over the review period which has been presented by the bar chart. Likewise the declining level of bar from the initial to end shows that the NSBI Bank is improving. The NPL ratio of Nepal SBI is continuously decreasing from FY 2005/06 to FY 2009/010. Generally, an internationally recognized nonperforming loan benchmark is less than 5 percent. With regards to the Nepalese banking scenarios. Having non-performing loan ratio in a single digit is said to be acceptable.

4.1.2.2.2 Loan Loss Provisioning Ratio

The Loan Loss Provisioning ratio indicates adequacy of allowance for loans and trend in the collection of loan and the performance in loan portfolio. It is obtained by the ratio of loan loss provision to the total loan. Greater loan loss provision is required to allow in income statement if high loss is expected. 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 holding. The provision for loan loss reflects the increasing probability on non-performing loans in the volume of total loans and advances. The high ratio signifies the relatively more risky assets in the volume of loans and advances. More delay the bank gets to collect the loan, the provision will be higher and the ratio will be higher. 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.

Table 4.6: Loan Loss Provisioning

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Loan loss provision	356.23	357.24	394.40	409.00	762.09
Total Loan	13,278.78	15,903.02	21,759.40	27,999.00	33,030.96
LLP Ratio	2.68	2.25	1.81	1.46	2.31

(Source: Annex-7)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Loan loss provision	614.72	604.6	632.51	480.3	483.09
Total Loan	8,241.45	10065.05	12746.21	15612.05	17,693.64
LLP Ratio	7.46	6.01	4.96	3.08	2.73

(Source: Annex-7)

Table 4.7 exhibits that the loan loss provisioning ratio of NABIL Bank for the study period is in decreasing trend except in FY 2009/010. The ratio in FY 2005/06 is 2.68% which is maximum and decline to 1.46% till FY 2008/09 which is minimum over the study period. The decreasing ratio trend implies improvement in the loan management for NABIL Bank, which indicates that the ratios are variable and not consistent with the decreasing trend. Where in the case of NSBI Bank the loan loss provisioning ratio for FY 2005/06 is 7.46% which is maximum and continuously declining to FY 2009/010 to 2.73% which is the minimum over the study period and also indicates that the ratios are variable and not consistent with the decreasing trend. Also for NSBI Bank the continuously decreasing of the loan loss provisioning ratio trend implies improvement in the loan management.

Diagram 4.5 : Trend of Loan Loss Provision Ratio

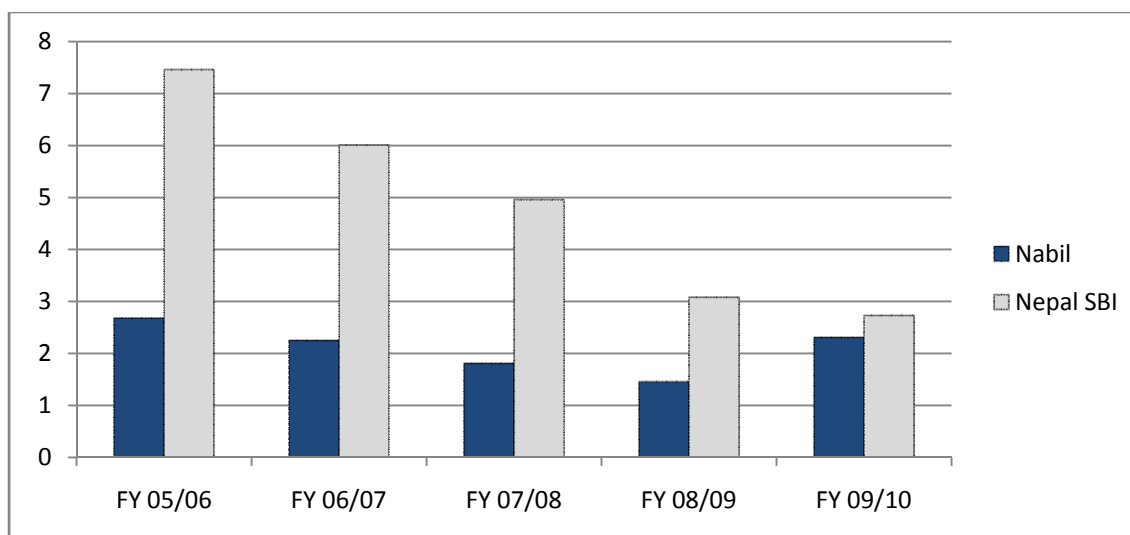


Diagram 4.5 shows the observed value of loan loss provisioning ratio of NABIL Bank and Nepal SBI both has decreasing trend, The declining bar chart above from FY 2005/06 to FY 2009/010 for the both bank indicates the trend of the loan loss ratio is improving over the study period. On the other hand loan loss provisioning of Nepal SBI is comparatively very higher than that of NABIL Bank observing over the study period. It indicates the trend of the loan loss ratio is in decreasing over the study period. The range of the LLP ratio of NABIL Bank is 2.68% to 1.46% and for Nepal SBI the LLP ration is 7.46% to 2.73%.

4.1.2.3 Ratio of Loans Classified as Substandard, Doubtful and Loss to Total Loans.

The total assets of the bank comprise with high portion of Loan and advances, the loan of the bank are very sensitive which one of the highest earning assets of bank. The loan and advances provided to the borrowers are categories as pass, substandard, doubtful and loan loss which are not providing regular income as targeted. NRB has also directed the financial institution to make provision of such loan to reduce uncertain loss. The provision for commercial bank is 1% for pass, 25% for substandard, 50% for doubtful and 100% for loan loss categories. The high ratio of such categories implies high risk and vice versa. So the management of the bank always tried to reduce such ratio to make the management effective.

Table 4.7 Loans Classified as Substandard, Doubtful and Loss to Total Loans.

NABIL BANK

Year	Total loan	Total Sub.loan	% of Sub. Loan to T L	Total Doub Loan	% of Doub Loan to TL	Total Loss Loan	% of Loss Loan to TL
FY 05-06	13,278.78	62.67	0.47	29.57	0.22	90.39	0.68
FY 06-07	15,903.02	119.7	0.75	14.47	0.09	44.12	0.28
FY 07-08	21,759.40	66.22	0.30	42.58	0.20	52.28	0.24
FY 08-09	27,999.01	113.31	0.40	45.76	0.16	65.76	0.23
FY 09-10	33,030.96	14.76	0.04	11.36	0.03	400.40	1.21

(Source: Annex-5A)

NSBI BANK

Year	Total loan	Total Sub.loan	% of Sub Loan to TL	Total Doub Loan	% of Doubtful Loan to TL	Total Loss Loan	% of Loss Loan to TL
FY 05-06	8,241.45	1.8	0.02	3.84	0.05	499.7	6.06
FY 06-07	10,065.05	3.28	0.03	11.17	0.11	444.3	4.41
FY 07-08	12,746.21	3.87	0.03	21.63	0.17	462.9 1	3.63
FY 08-09	15,612.05	13.24	0.08	11.34	0.07	291.3 8	1.87
FY 09-10	17,963.64	3.19	0.02	0.20	0.00	245.7 5	1.37

(Source: Annex-5B)

The ratio of substandard loan to total loan, doubtful loan to total loan and loss loan to total loan. The percentage of NABIL Bank substandard loan to total loan ranges from 0.04 percent to 0.75 percent in the study period. It is in fluctuating order from FY 2005/06 to FY 2009/010. The ratio increased for the first year FY 2006/07 with maximum 0.75% and then decrease in FY 2007/08 and then slightly increase in FY 2008/09 and again decrease in FY 2009/010 with minimum 0.04%. While the total loan is in increasing trend, percentage of substandard loan to total loan is in fluctuating trend over the study period. The percentage of substandard loan to total loan is below 1 percent throughout the study period implies that the quality of loan is strong. The ratio of doubtful loan to total loan is also in fluctuating trend. The ratio ranges from 0.03% to 0.22% for the study period. The ratio was maximum in FY 2005/06 with 0.22% and minimum in FY 2009/010 with 0.03% which implies the progressing nature for NABIL Bank. The ratio of Loan loss to total loan reveals the decreasing trend over the study period except in FY 2009/010. The ratio was maximum of 1.21% in FY 2009/010 and minimum of 0.23% in FY 2008/09. Likewise the ratio of substandard loan to total loan, doubtful loan to total loan and loss loan to total loan of NABIL Bank has fluctuating trend. For NSBI

Bank the ratio of substandard loan to total loan ranges from 0.02 percent to 0.08 percent in the study period. It is in fluctuating order from FY 2005/06 to FY 2009/010. The ratio increased for the first four years with maximum 0.08% in FY 2008/09 and then decrease with minimum 0.02% for FY 2009/010. While the total loan is in increasing trend. The percentage of substandard loan to total loan is below 1 percent throughout the study period implies that the quality of loan is strong. The ratio of doubtful loan to total loan is also in fluctuating trend. The ratio was maximum in FY 2007/08 with 0.17 % in FY 2007/08 and minimum with 0.00% in FY 2009/010. The ratio of Loan loss to total loan reveals the decreasing trend over the study period. The ratio was maximum of 6.06% in FY 2005/06 and minimum of 1.37% in FY 2009/010. The decreasing trend shows that the management has effective control over the loan over the study period. Since the ratio of substandard loan, doubtful, loan loss to total loan indicates the quality of assets maintain by the sample banks. The high ratio of such categories implies high risk and vice versa. In comparison NABIL Bank is successful than NSBI Bank to have control over the loan and advances. Both samples bank should generate the strategy to minimize the above categories ratio to minimal which demonstrates the high management effectiveness.

4.1.3 Management Component Analysis

Management role is very important in the performance of FIs. The key distinct areas that reflect the overall quality of management are governance, general management, human resource policy, management information system, internal control and audit strategic planning and budgeting. The qualitative assessment of aspects like Depth and succession of top management, Technical Aspects, Internal Control decisions, Operating and Lending decisions, Involvement of Board of Directors, Willingness to serve community needs etc, illustrate the level of management quality as these decisions are reflected in the final balance sheet. There is one measure that is relevant to management is the ratio of Total expenses to Total revenue. Since the profitability of an institution is determined by the gap of Total Revenues and Total Expenses which are well in direct control and monitoring of the management, it is used to represent the management quality. Greater the gap between the Total Revenue and Total Expenses, the greater is the income of the banks and *vice versa*. Every financial institution should put high effort to maximize the revenue or to minimize the expenses to generate the greater gap. This ratio also indicates

the quality of management in term of other ratio. Another measure that is also relevant to management is the ratio of earnings per employee is used as a proxy of management quality which is calculated by 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.

4.1.3.1 Total Expense to Total Revenue Ratio

The ratio of total expenses to total revenue is used as a proxy measure of the management quality. This ratio is calculated by dividing the total expenses by total revenues. Commercial bank's earnings originate from interest on Loans & Advances, Investments, Commissions & Discounts, Foreign Exchange Rate Gains and other miscellaneous income. Conversely, it expends on, Depositors' Interest, Staff Salary, Provident Fund allowances and other operating expenses like rent, water & electricity, fuel expenses, audit fee expenses, management expenses, depreciation, miscellaneous expenses, and all other expenses directly related to the operation of bank.

Table 4.8: Total Expenses to Total Revenues Ratio

NABIL BANK					
Fiscal year	05/06	06/07	07/08	08/09	09/10
Total Expenses	763.41	998.26	1,306.15	1,804.06	3,017.00
Total Revenue	1,716.67	2,035.87	2,428.86	3,374.26	6,812.00
TE to TR Ratio (%)	44.47	49.03	53.78	53.47	44.29

(Source: Annex-8)

NSBI BANK					
Fiscal year	05/06	06/07	07/08	08/09	09/10
Total Expenses	484.52	6,449.83	739.64	1,211.00	1,978.00
Total Revenue	799.67	945.77	1,092.98	1655.88	3,377.00
TE to TR Ratio (%)	60.59	68.19	67.67	73.13	58.57

(Source: Annex-8)

As shown in Table 4.8, the total expenses (TE) to total revenue (TR) ratio of NABIL Bank has fluctuating trend over the study period from FY 2005/06 to FY 2009/10. The ratio range from 53.78% to 44.29%. The maximum ratio was in FY 2007/08 with 53.78% and minimum was in FY 2009/10 with 44.29%. Whereas, TE to TR ratio of Nepal SBI is also has fluctuating trend over the study period which range from 68.19% to 58.57% on FY 2006/07 and FY 2009/10 respectively. The ratio of both banks indicates the ratio are variables and not consistent. Although in comparison the ratio of NABIL Bank is better indeed than that of NSBI Bank which indicates NABIL Bank is better than NSBI Bank. NSBI Bank should formulate new policy and strategy to reduce the ratio as far as possible in coming days.

Diagram 4.6 Trend Analyses of Total Expenses/ Total Revenue Ratio

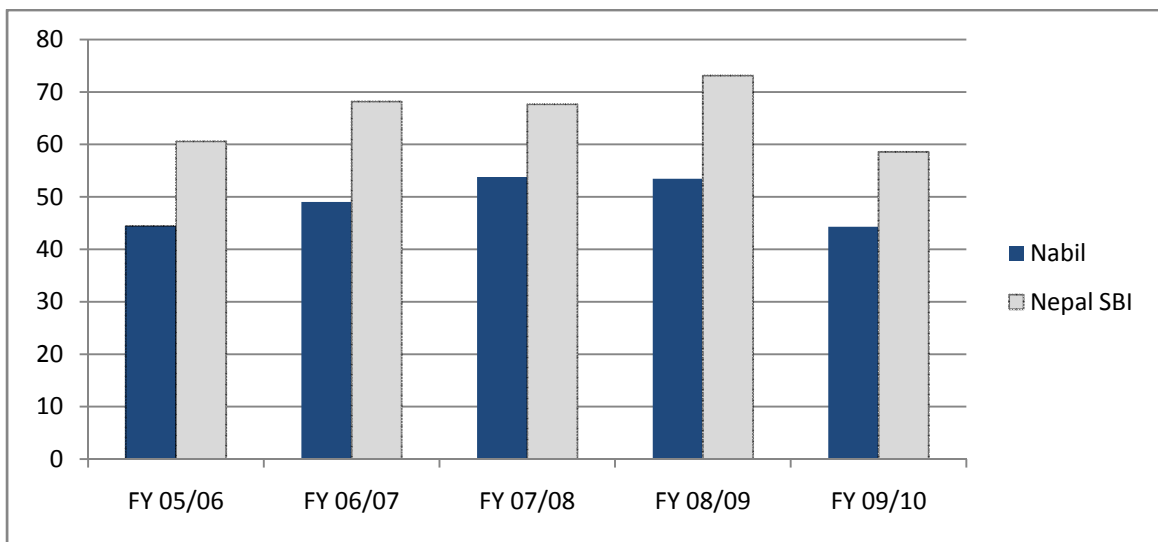


Diagram 4.6 exhibits the observed TE to TR ratio of NABIL Bank and Nepal SBI within the study period of last five years. As shown in the Diagram, the observed ratio of NABIL Bank fluctuates over study period. The bar is the highest in FY 2007/08 and has the lowest in FY 2005/06. In case of Nepal SBI the height of the chart fluctuates over the study period. The bar is highest in FY 2008/09 and lowest in FY 2009/10. Hence the downwards movements of the bar chart of both banks at the current FY 2009/10 indicates decreasing expenses with respect to income which is accredited to good management quality.

4.1.3.2 Earnings per Employee

Earning per Employee is calculated by 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.

Table 4.9: Earnings per Employee

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Profit	635.62	673.95	746.00	1,031.00	1,139.00
No. of employee	441	427	416	505	575
Earning Per employee	1,441,315	1,578,337	1,793,269	2,041,584	1,981,043

(Source: Annex-9)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Profit	117.00	254.9	247.77	316.37	391.74
No. of employee	174	189	249	323	465
Earning Per employee	672,413	1,348,677	995,060	979,473	842,451

(Source: Annex-9)

Table 4.9 shows the Earnings per Employee in rupees during the study period. The net profit of NABIL Bank has increasing trend from the start to end of study period. Also the EPE for NABIL Bank continuously increased up to from 2005/06 to 2008/09 and then slightly decline in FY 2009/010. In the case of Nepal SBI, the net profit has also the increasing trend but with low growth rate compared to NABIL Bank. The EPE at first increased from 2005/06 to 2007/08 and then started declining from 2007/08 to 2009/010. The main reason the declining of the EPE of Nepal SBI was the high increase in number of employee compared to the volume of Net profit. So, the Earning Per Employee of both the Banks NABIL Bank & Nepal SBI were satisfactory

Diagram 4.7: Earning per Employee Trend

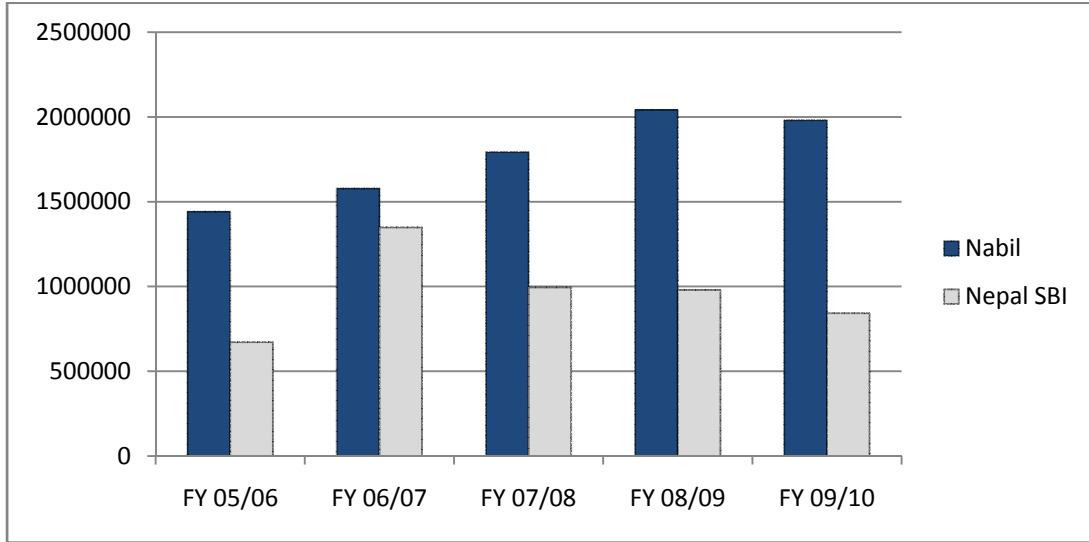


Diagram 4.7 shows the observed Earning per Employee for both banks. The bar chart of NABIL Bank is positive and continuously climbing ups the bar chart except in FY 2009/010, which indicates the Earning per Employee is increasing over the study period from FY 2005/06 to FY 2008/09. This indicates that, in the review period the increased number of staff with increased amount in net profit have increase the ratio of earnings per employee with similar repercussion in terms of profitability. Whereas, the chart bar of Nepal SBI shows ups and downs which has fluctuating trend over the study period. The bar increase from FY 2005/06 to FY 2006/07 and then the bar decline the height till the FY 2009/010 which indicates the earning per employee is declining during the study period. The main reason was the net profit growth was low as compared to the increment in number of staff. Thus the table shows the Earning Per Employee trend of NABIL Bank is better than NSBI Bank. Since Earning per employee ratio is also the quality measurement of the management of the bank. It indicates the quality that management of banks maintained.

4.1.4 Earning Quality:

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

4.1.4.1 Return on Equity (ROE)]

ROE is measure of the rate of return flowing to the bank's shareholders. ROE is the profit as a percentage return on the owner's stake in a firm. The level of profit depends on the ROE i.e. the profit per dollar invested. Computed as the ratio of net income to the equity, it reflects the income earned from its internal sources. The ROE measures the book return to the owners of the firm. It is a "bottom line ratio" in that sense. Return on equity reveals how well the bank uses the resources of owners. The higher ratio represents sound management and efficient mobilization of the owner's equity and vice-versa. ROE of 15% is treated as standard and banking industry are desired to have higher than this

Table 4.10: Return on Equity

NABIL BANK					
Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Profit	635.62	673.95	746.00	1,031.00	1,139.00
Equity	1,874.99	2,057.05	2,437.20	3,130.24	3,835.00
ROE	33.90	32.76	30.61	32.94	29.70

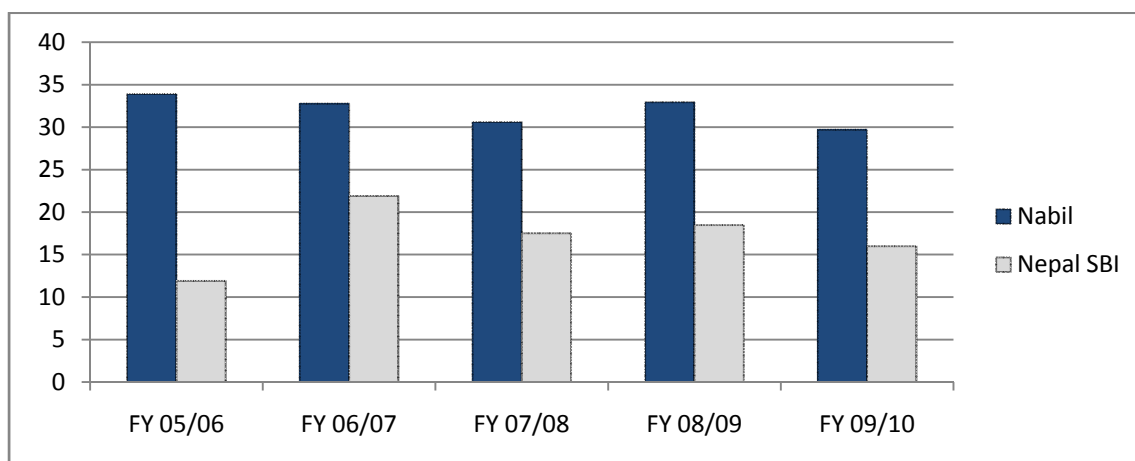
(Source: Annex-10)

NSBI BANK					
Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Profit	117.00	254.9	247.77	316.37	391.74
Equity	982.37	1163.29	1414.64	1712.61	2,450.00
ROE	11.91	21.91	17.51	18.47	15.99

(Source: Annex-10)

As shown in Table 4.10, the Return on Equity of NABIL Bank of 33.90% is the maximum in FY 2005/06 and minimum of 29.70% in 2009/010. The ratio fluctuated from 29.70% to 33.90% over the study period. At the recent FY 2009/010 the ratio has decrease as compared to previous year. Hence the bank's Return on Equity ratio is very sound. In the other hand, Return on Equity of Nepal SBI is maximum with 21.91% in the FY2006/07 and minimum of 11.91% in FY 2005/06. The ratio fluctuated from 11.91% to 21.91% over the study period. At recent FY 2009/010 the ratio decreases. Both bank ROE's is at declining at the current stage.

Diagram 4.8: Return on Equity Trend



As shown in Diagram 4.8, the bar chart of NABIL Bank continuously fluctuates over the study period. The bar level moves up and down from FY 2005/06 to FY 2009/010. The observed values of the ratio are fluctuating over study period. The low bar chart at the FY 2009/010 indicates the downward trend in ratio of bank during the period of FY 2005/06 and FY 2009/010. The average ratio is also above the benchmark. Likewise the bar chart of NSBI Bank also fluctuates over the study period from FY 2005/06 to FY 2009/010. The low bar chart at the FY 2009/010 indicates the downward trend in ratio of bank. Comparatively, The increasing trend of ratios implies that earning quality of bank is getting comparatively better of NABIL Bank than NSBI Bank, the ratio of NABIL Bank is in increasing trend. But the observed ratio is not stuffiest in the Nepalese Commercial Banks. The Performance of bank shows that earning quality of Bank was not satisfactory for the last three year but now the ratio has steep to satisfactory level.

4.1.4.2 Return on Assets (ROA)

ROA determines the net income produced per rupee of assets. It is a measure of profitability linked to the asset size of the bank. It 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. ROA is a popular tool to measure how well their assets are utilized in generating profit. It measures the profit earning capacity by utilizing available resources i.e. total assets. Return will be higher if the banks resources are well managed and efficiently utilized. Generally, the return on assets ratio should be 1% and higher is desired to the banking industry. In table 4.11 the Net profit, Total assets and ROA of NABIL Bank and NSBI Bank has been presented and the detail analysis is done in the diagram no.4.9.

Table 4.11: Return on Asset

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Profit	635.62	673.95	746.00	1,031.00	1,139.00
Total Assets	22,329.97	27,235.39	37,313.00	43,867.00	52,150.00
ROA	2.85	2.47	2.00	2.35	2.18

(Source: Annex-11)

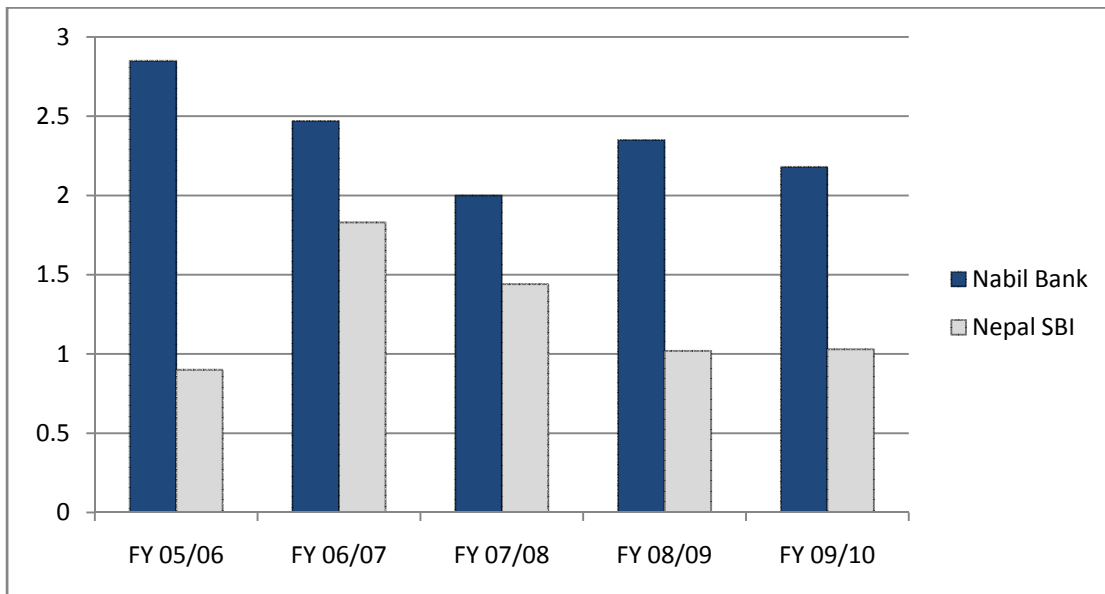
NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Profit	117.00	254.9	247.77	316.37	391.74
Total Assets	13,035.84	13,901.2	17,187.44	30,916.68	38,047.67
ROA	0.90	1.83	1.44	1.02	1.03

(Source: Annex-11)

As shown in Table 4.11, the Return on Assets of NABIL Bank of 2.85% is the maximum in FY 2005/06 and minimum of 2.00% in 2007/08. The ratio fluctuated among 2.00% to 2.85% over the study period. At the recent FY 2009/010 the ratio has decrease as compared to previous year. From FY 2005/06 the ROA of NABIL Bank continuously decline till FY 2007/08 to 2.00% and then slightly increase by 0.35% in FY 2008/09 to 2.35% and again slightly decline to 2.18% in FY 2009/010. Hence the bank's Return on Assets ratio is sound which is above 2.00%. In the other hand, Return on Assets of Nepal SBI is maximum with 1.83% in the FY2006/07 and minimum of 0.90% in FY 2005/06. The ratio fluctuated from 0.90% to 1.83% over the study period. From the FY 2005/06 the ROA ratio increases in FY 2006/07 and then decline for the next two year to 1.02% in FY 2008/09 and again slightly increase by 0.01% to 1.03% in FY 2009/010. The ROA ratio of NSBI Bank is below 2.00% which is very low compared to NABIL Bank ratio.

Diagram 4.9 Return on Assets



As shown in Table 4.9, the return on asset ratio of Nabil was minimum in 2007/08 with 2.0% and maximum in 2005/06 with 2.85%. The bar chart continuously fluctuates over the study period which seems ups and down from FY 2005/06 to FY 2009/010. The mean ratio of the bank is 2.37% which is above 2.00%. The bank's mean ratio is above the 1% benchmark. The bank's ROA is in decreasing trend which shows the quality of assets and their efficiency to generate return is decreasing. Whereas, the ROA of Nepal SBI is minimum of 0.90% in FY 2005/06 and maximum of 1.83% in FY 2006/07. The bank's

mean ratio is 1.24% which is consistent but less than the benchmark of 1%. The ratio has fluctuating trend over the study period. Comparatively the bar level of NABIL Bank is higher than NSBI Bank which shown the quality of assets and their efficiency to generate return is increasing. On the basis of mean ratio of the bank is under the benchmark 1% so this indicates that the bank's ratio is not good enough.

4.1.4.3 Net Interest Margin (NIM)

The net interest margin measures the net return on the bank's earning assets (investment securities and loans and leases). It is calculated by dividing the Net Interest Income (NII) with the earning assets. Generally, the net interest margin ratio should be 3% to 4% and higher is better in banking industry. Generally the higher this ratio, the better. However it highlights the fact that looking at returns without looking at risk can be misleading and potentially dangerous in terms of bank solvency and long run profitability.

Table 4.12: Interest Margin

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Interest Income	952.83	1,032.04	1,220.00	1,645.00	2,087.00
Earning Assets	20,835.98	25,054.62	33,257.19	38,969.20	49,058.00
Net Interest Margin	4.57	4.12	3.67	4.22	4.25

(Source: Annex-12)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Interest Income	373.94	418.86	515.59	635.74	826.01
Earning Assets	11,600.71	12154.9	15506.6	28417.93	33,785.00
Net Interest Margin	3.22	3.45	3.32	2.24	2.44

(Source: Annex-12)

In the past five years, the NIM ratio of NABIL Bank was distributed over from 4.57% to 3.67%. The minimum ratio was observed in 2007/08 with 3.67% and the maximum ratio was found in the FY year 2005/06 with 4.57%. The ratios decrease from the FY 2005/06 to FY 2007/08 and then increase by 0.55% to 4.22% in FY 2008/09 and then slightly increase in FY 2009/010. Likewise the NIM ratio of NSBI Bank was distributed over from 3.45% to 2.24% over the study period. The ratio fluctuates which moves ups and downs over the review period. Throughout the review period the NIM ratio of NABIL Bank was found slightly above the generally accepted benchmark. On the basis of the mean ratios it can be concluded that the ratios are stable and it was below the benchmark of 3% to 4%.

Diagram 4.10: Net Interest Margin

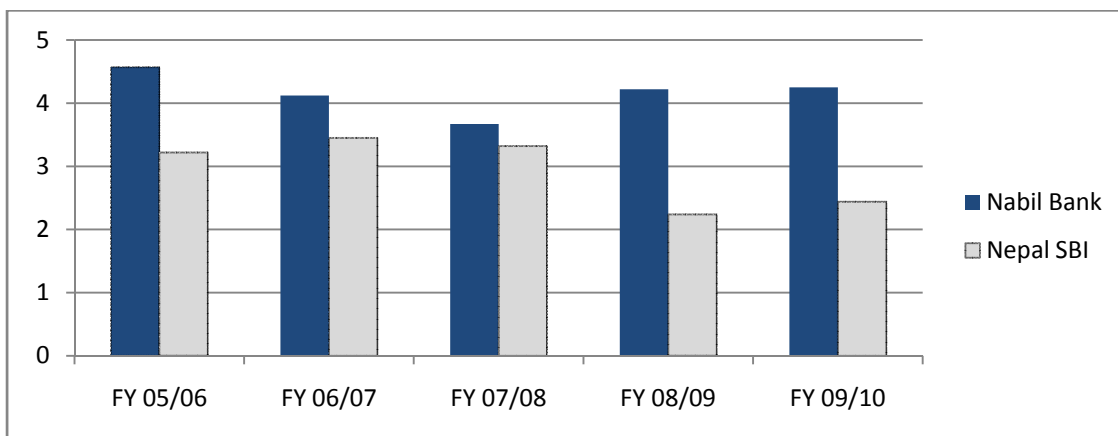


Diagram 4.10 shows the trend of NIM of the NABIL Bank from 2005/06 to 2009/010 has fluctuating bar level over the study period with the highest ratio of 4.57% and the lowest bar level of 3.67%. The overall chart shows that the height of NIM for NABIL Bank fluctuates for the study period. It indicates bank's capacity to maintain higher interest margin than the benchmark during the study period. Likewise, the trend of Nepal SBI is negative expect on FY 2006/07 and FY 2009/010 which has reveals slow rise in NIM. The chart shows the highest on FY 2006/07 with 3.45% and lowest on FY 2008/09 with 2.24% which shows decreasing trend of NIM ratio during the study period also the bank was not able to maintain higher interest margin than the benchmark. Comparatively the NIM of Nepal SBI is very low to NIM of NABIL Bank which indicates that NABIL Bank is able to maintain satisfactory NIM than Nepal SBI

4.1.4.4 Earning Per Share (EPS)

The profitability of a firm from the point of view of the ordinary shareholders is the Earning per Share. It measures the profit available to the equity shareholders on per share basis (*Shiva Prasad Munankarmi, 2002*). The earnings per share of an organization give the strength of the share in the market. The higher the EPS is supposed to be a best comparing between two banks.

Table 4.13: Earning Per Share

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Income	635.62	673.95	746.00	1,031.00	1,139.00
No. of Shares (million)	4.92	4.92	6.89	9.66	14.50
Earning Per Share	129.21	137.08	108.31	106.76	78.55

(Source: Annex-13)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Net Income	117.00	254.9	247.77	316.37	391.74
No. of Shares (million)	6.40	6.47	8.74	8.74	16.53
Earning Per Share	18.27	39.35	28.33	36.18	23.69

(Source: Annex-13)

Table 4.13 reveals that EPS of NABIL Bank fluctuated over the study period. The EPS increase in FY 2006/07 and continuously decreases from FY 2007/2008 to FY 2009/010. The EPS was maximum on FY 2006/2007 with NPR 137.08 and minimum on FY 2009/010 with NPR 78.55. For the final year the EPS has decline to NPR 78.55 which is lower to all the previous year. Whereas, in the case of NSBI Bank EPS of the bank has fluctuation trend over the study period. The EPS of the bank has ranged between Rs. 39.35 in FY 2006/07 which is the maximum to Rs. 18.27 in FY 2005/06 which is the

minimum over the study period. The EPS for Nepal SBI show decreasing trend for the final year but not to the acceptable level for the comparison with NABIL Bank which shows that the earning per share of NABIL Bank is higher and attractive than NSBI Bank.

Diagram 4.11: Earning Per Share

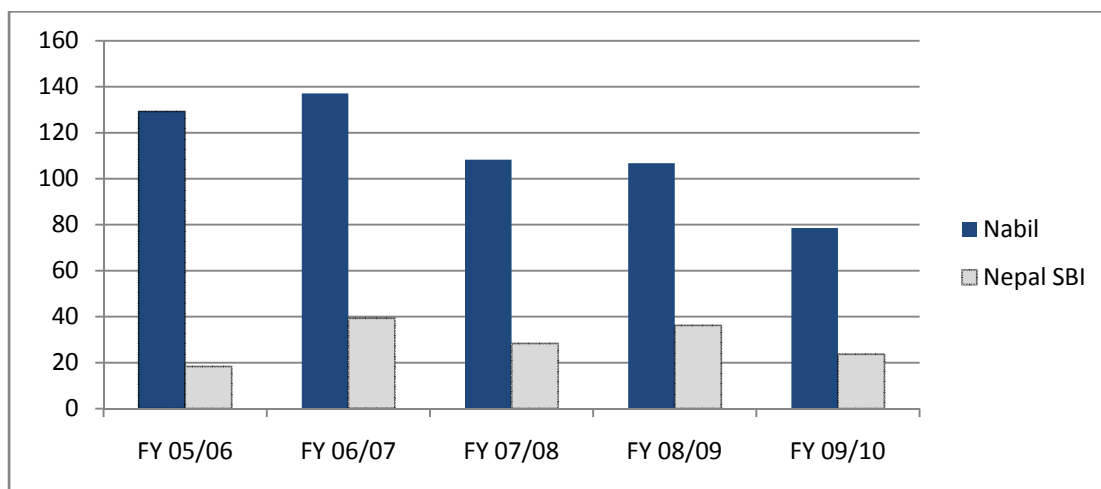


Diagram 4.11 shows the EPS chart of NABIL Bank fluctuated up and down from FY 2005/06 to FY 2009/010. The EPS range from Rs. 78.55 to Rs 137.08. The maximum EPS was reached on 2006/07 with Rs.137.08 per share and minimum was reached on FY 2009/010 with Rs. 78.55 per share. The decreasing trend of EPS is also supported by declining chart bar and increasing trend is reveals from moving upward bar chart. However, the bar chart of NSBI Bank is also fluctuating over the study period indicates that the trend of earning per share is inclining over the study period but the EPS is very low in comparison to NABIL Bank.

4.1.5 Liquidity component Analysis

The level of liquidity influences the ability of a banking system to withstand shocks. Liquidity risk arises when an FI's liability holders like depositors demand immediate cash for the financial claims they hold with an FI. The most liquid asset is cash, which FIs can use directly to meet liability holders' demands to withdraw funds. Day to day withdrawals by liability holders are generally predictable and large FIs can expect to

borrow additional funds on the money and financial markets to meet any sudden shortfalls of cash. At times FIs face a liquidity crisis due to either a lack of confidence on the FIs problem or some unexpected need for cash, the liability holders may demand larger withdrawals than usual.

4.1.5.1 Liquid Assets to Total Deposit Ratio

The ratio of Liquid assets to Deposit measures the levels of liquid assets available with the bank to meet short term obligations. This ratio is computed by dividing liquid assets by total deposits. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the bank. As per NRB direction, only investments in government securities are considered as liquid.

Table 4.14: Liquid Assets to Total Deposit Ratio

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Liquid Assets	2,301.30	4,808.35	4,646.88	3,706.10	4,517.00
Total Deposit (million)	19,347.39	23,342.28	31,915.00	37,348.00	46,411.00
Liquid assets to Total Deposit ratio	11.89	20.60	14.56	9.92	9.73

(Source: Annex-14)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Liquid Assets	3,591.77	2345.58	3035.55	3306.57	3,440.00
Total Deposit (million)	11,002.04	11,445.28	13,715.39	27957.00	34,896.42
Liquid assets to Total Deposit ratio	32.65	20.49	22.13	11.83	9.86

(Source: Annex-14)

Table 4.14 shows that the liquid assets to total deposit ratio of NABIL Bank during the period FY 2005/06 to FY 2009/010 is fluctuating trend. The liquid assets to deposit ratio was minimum in 2009/010 with 9.73% when the deposit were the highest with Rs.46,411

million. The ratio was maximum in 2006/07 with 20.60% when the deposit volume was Rs.23,342.28 millions. Whereas, liquid funds to total deposit ratio of NSBI Bank during the period of FY 2005/06 to FY 2009/010 was in fluctuating trend. The highest ratio was 32.65% in FY 2005/06 when the deposit was Rs. 11,002.04 millions and the lowest ratio was 9.86% in FY 2009/010 when the deposits were Rs.34,896.42 million.

Diagram 4.12: Trend of Liquid Asset to Total Deposits

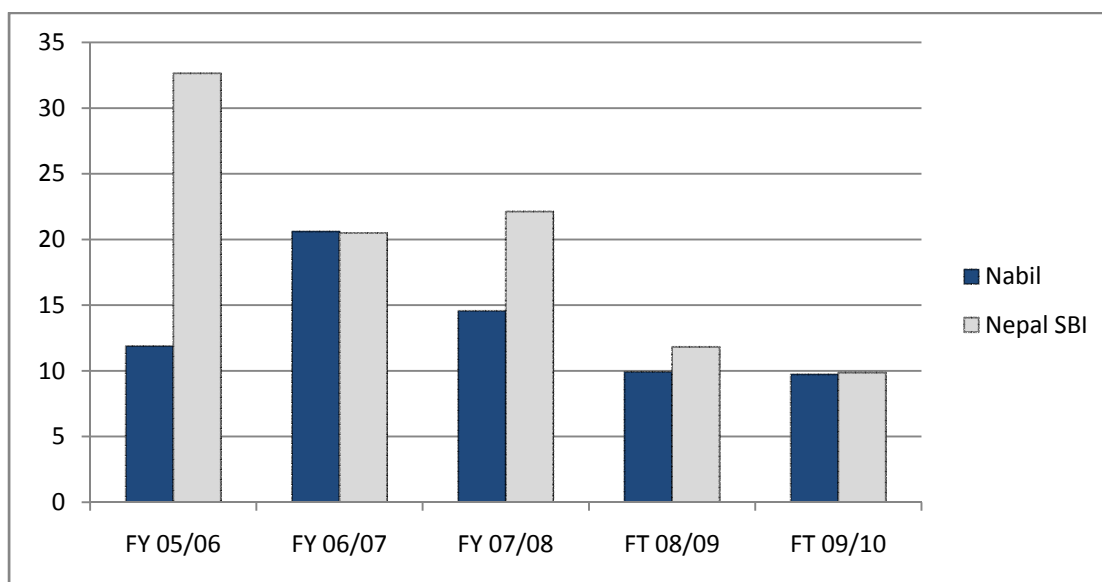


Diagram 4.12 exhibits the liquid fund to total deposits ratio of NABIL Bank in comparison to the NSBI Bank ratio within the study period of last five years. In the Diagram, the total liquid fund to total deposit of bar chart of NSBI Bank is higher than NABIL Bank in all observed fiscal years except in FY 2006/07. This fact implies that the overall liquidity position of the NSBI Bank is better than NABIL Bank. Hence the Liquid Assets to Total Deposits of both NABIL Bank and NSBI Bank is in fluctuating trend. Both bank bar charts continuously move up and down over the study period. As the both of banks has switched to investing on more profitable assets.

4.1.5.2 NRB Balance to Total Deposit Ratio

This ratio shows whether bank is holding the balance as required to 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 deposited

funds NRB has put the directives to maintain certain percent of total deposit in NRB by the commercial Banks. Total Deposit means Current, Savings and Fixed Deposit Account as well as Call Account deposit and certificates of deposits. For the purpose, deposits held in convertible foreign currency, employees guarantee amount and margin account will not be included. The following table shows the NRB Balance to Total Deposit Ratio.

Table 4.15: Balance to Total Deposit Ratio

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
NRB Balance	318.35	1,113.41	182.90	264.80	549.00
Total deposit less margin and FYC	14,292.00	18,072.48	24,529.80	29,729.43	40,409.00
NRB Bal to TD Ratio	2.2	6.2	0.7	0.9	1.40

(Source: Annex-15)

NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
NRB Balance	626.12	556.67	403.81	444.14	1,842.80
Total deposit less margin and FYC	10,659.82	11035.47	13459.77	17501.23	22,575.23
NRB Bal to TD Ratio	5.9	5.0	3.0	2.5	8.16

(Source: Annex-15)

Table 4.15 shows that NABIL Bank has maintained fluctuating reserve with NRB during the observed period. NRB balance was range from 182.90 to 1,113.41 over the study period. It has increase for FY 2006/07 and then decline on FY 2007/08 and rises on FY 2008/09 and FY 2009/010. The NRB bal was maximum on FY 2006/07 with 1113.41 and minimum on FY 2007/08 with 182.9. As regard to the deposit volume, it is in increasing trend up to the concluding year. The deposit for the study period has been increasing continuously. Despite of the increment on the deposit the NRB bal has been fluctuating over the study period. The ratio was maximum in 2006/07 with 6.2% when deposit

volume was Rs. 18,072.48 millions and minimum ratio was in 2007/08 with 0.7% when deposit volume was Rs. 24,529.80 millions. Whereas Nepal SBI maintained reserved with NRB balance were fluctuating over the study period. NRB balance was range from 1824.80 to 403.81 over the study period. The NRB bal decline from FY 2005/06 to FY 2007/08 and then increases in FY 2008/09 and FY 2009/010. The ratio was maximum in 2009/010 with 8.16% when deposit volume was Rs. 22,575.23 millions and minimum ratio was in 2008/09 with 2.5% when deposit volume was Rs. 17,501.23. Instead of fluctuation and decreasing trend NABIL Bank was not able to maintain NRB balance to Total Deposit ratio in an adequate ratio. Whereas NSBI Bank seems adequate ratio in over the study period. This indicates that the Bank has more expose towards the balance with NRB. However it does not necessarily mean that the cash reserve ratio at NRB is not maintained. The above calculation is based on year end volumes and NRB Balance where as NRB calculates CRR on weekly average balances. Hence this is a limitation of the study.

Diagram 4.13: NRB Balance/Total Deposit ratio

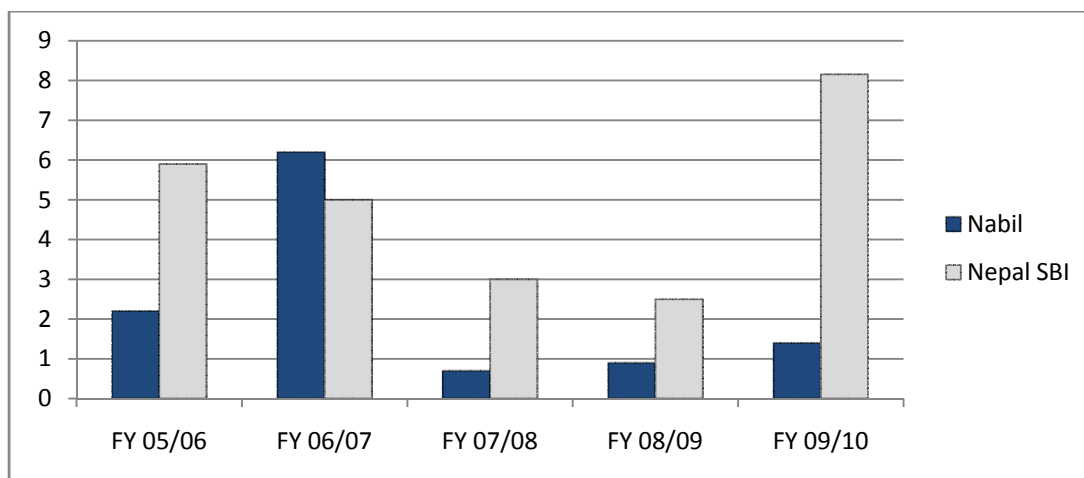


Diagram 4.13 shows the NRB balance to total deposit ratio of Nabil and Nepal SBI with in the study period of last five years. As shown in the Diagram, the NRB balance to total deposit chart of NABIL Bank is the maximum on FY 2006/07 and minimum on FY 2007/08. The NRB to deposit ratio shows fluctuates trend over the study period. The chart ups on FY 2006/07 and move downs in FY 2007/08 and slightly moves up in FY 2008/09 and FY 2009/010. This fact implies that the balance with NRB of the bank is

more than the minimum balance. Same as, NRB balance to total deposit chart of Nepal SBI is maximum on FY 2009/010 and minimum on FY 2008/09. The NRB bal to deposit ratio chart down from FY 2005/06 to FY 2008/09 and highly moves up in FY 2009/010. Comparatively NSBI Bank has able to maintain the sufficient NRB bal to deposit ratio than NABIL Bank. This shows that the NABIL Bank has not maintained the balance with NRB as per directives over two year i.e. FY 07/08 and FY 08/09.

4.1.5.3 Cash at Vault to Total Deposit Ratio

This ratio shows the percentage of total deposits held at vault at a particular time. It is computed by dividing cash at vault by total deposits. Cash and foreign currencies in hand are included as cash in vault. Total Deposit means Current, Savings and Fixed Deposit. Deposits held in convertible foreign currency will not be included as Total deposit.

Table 4.16: Cash at vault to Total Deposit Ratio

NABIL BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Cash at Vault	237.00	270.00	511.00	674.00	635.00
Total deposit less margin and FYC	14,292.00	18,072.48	24,529.80	29,729.43	40,409.00
Cash at Vault to TD Ratio	1.66	1.49	2.08	2.27	1.57

(Source: Annex-16)

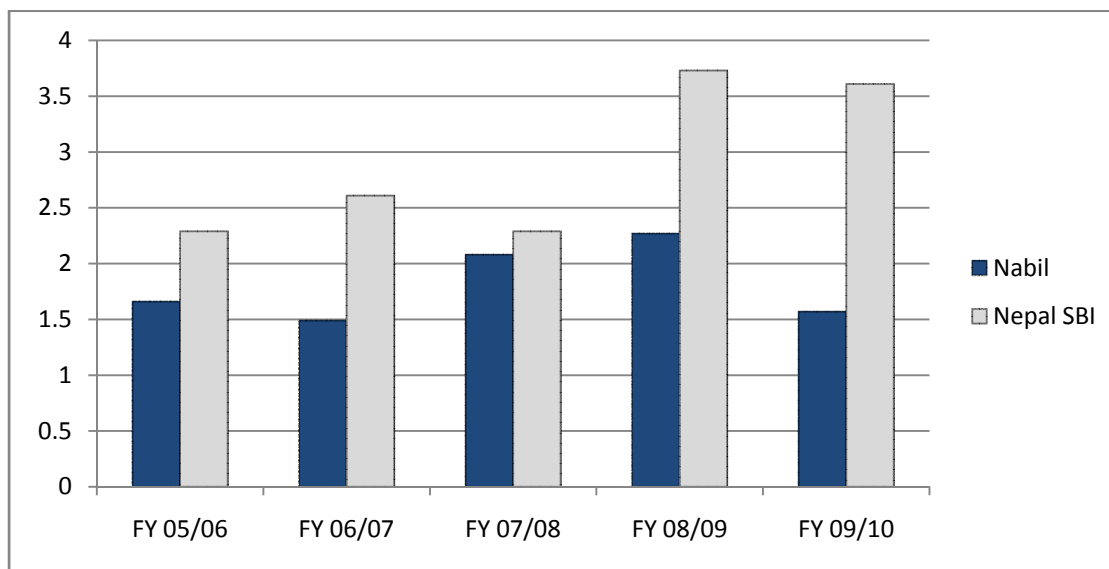
NSBI BANK

Fiscal year	05/06	06/07	07/08	08/09	09/10
Cash at Vault	244.19	287.53	308.1	652.03	815.68
Total deposit less margin and FYC	10,659.82	11035.47	13459.77	17501.23	22,575.23
Cash at Vault to TD Ratio	2.29	2.61	2.29	3.73	3.61

(Source: Annex-16)

The volume of cash at vault to total deposits ratio of NABIL Bank is in increasing trend over the study period except in FY 2009/010. The ratio has fluctuating trend during the study period. The range of the ratio starts from 1.66% on FY 2005/06 to 1.57% on 2009/010. The ratio was maximum in FY 2008/09 with 2.27% in line with the highest deposit volume during the year. The ratio was minimum in FY 2006/07 with 1.49%. Whereas the ratio of Nepal SBI has also continuously increased over the study period. The highest ratio is 3.73% in FY 2008/09 and the lowest ratio is 2.29% in FY 2005/06 and FY 2007/08. The ratio has increase in FY 2006/07 and then decrease in FY 2007/08 and then again increases in FY 2008/09 and finally decreases in the FY 2009/010 which shows the ups and downs movement of the ratio for NSBI Bank. Cash Vault has increased at lower rate than deposit has. So, increase in vault relatively lower rate has decreasing trend in the ratio for these years.

Diagram 4.14 Cash at vault/ Total Deposit Ratio



As shown in the Diagram 4.14, NABIL Bank has maintained the cash at vault in increasing trend except in FY 2009/010. NABIL Bank has maintained cash at vault ratio from 1.49% to 2.27% during the observed period. The chart has goes ups at the normal growth not fluctuating over the study period and move down in FY 2009/010 as shown by the bar chart. In case of NSBI Bank has maintained the cash at vault in increasing trend except on FY 2007/08 and 2009/010. It has the fluctuating trend over the study

period which moves ups and downs in the review period. NSBI Bank has maintained cash at vault ratio from 2.29% to 3.73% during the observed period. The cash at vault to total deposit ratio of NSBI Bank is higher than NABIL Bank in all the study period except in FY 2007/08 and FY 2008/09 which has indicates that comparatively NSBI Bank has the ability not to face liquidity problem than NABIL Bank at all. NABIL Bank should effort to form new strategy to maintain adequate cash at vault to meet the liabilities of the savers and also to meet the current liabilities. As we know banking transaction is very sensitive so every bank should not give any rooms to create any liquidity crisis at the bank.

4.1.6 Sensitivity to Market Risk

Sensitivity to market risk refers to the risk that causes due to the changes in market conditions which would adversely affect the earnings and/or capital. One of the market risks is the interest rate risk also called price risk. It is the risk that is caused by changes in market interest rate. A bank may have different types of assets and liabilities. Some assets and liabilities are sensitive to changes in interest rate. Such assets and liabilities are called rate sensitive assets (RSA) and rate sensitive liabilities (RSL). The assets and liabilities having maturity less than a year need to be re-priced periodically. Therefore, when a bank has more liabilities re-pricing in a rising rate environment than assets re-pricing, the net interest margin decreases. Conversely, if the bank is asset sensitive in a rising interest rate environment, net interest margin will increase because the bank has more assets re-pricing at higher rates. There are various methods of measuring interest rate risk. Such as gap analysis, simulation, duration analysis etc. This study focuses on the gap analysis which simply measures the net quantity of assets or liabilities re-pricing within a given period to estimate the likely impact that changes in interest rates will have on earnings. With a view to minimize the IRR. NRB requires the banks to use gap analysis for minimization of liquidity risk. Since we know that liquidity crisis is the only one challenge for the bank, so all the banks should effort not to create liquidity crisis for which banks should keep and maintain short term assets to meet the liabilities.

4.1.6.1 Measuring Interest Rate Sensitivity

The interest rate sensitivity (IRS) is used to determine whether changes in interest rate positive or negatively affect the bank's net interest margin or profitability. It can be computed by expressing cumulative GAP as a percentage of total risk sensitive assets (RSA). One of the market risks is the interest rate risk also called price risk. It is the risk that is caused by changes in market interest rate. A bank may have different types of assets and liabilities. Some assets and liabilities are sensitive to changes in interest rate. Also the assets and liabilities of banks are for different time buckets from 1-90 days to above 1 year. At the table no. 4.17 below represents the interest rate sensitivity of NABIL Bank and NSBI Bank for all the time buckets from FY 2005/06 to FY 2009/10.

Table No. 4.17 Interest Rate Sensitivity

NABIL BANK

Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	54.26	197.36	473.53	196.42	0.00
FY 06-07	7.29	32.01	111.96	140.40	0.02
FY 07-08	32.12	164.40	130.58	122.88	0.00
FY 08-09	1.38	62.39	85.55	71.87	0.00
FY 09-10	33.26	144.52	267.00	100.70	0.00
Mean	25.66	120.14	213.72	126.45	0.01

(Source: Annex-17A)

NSBI BANK

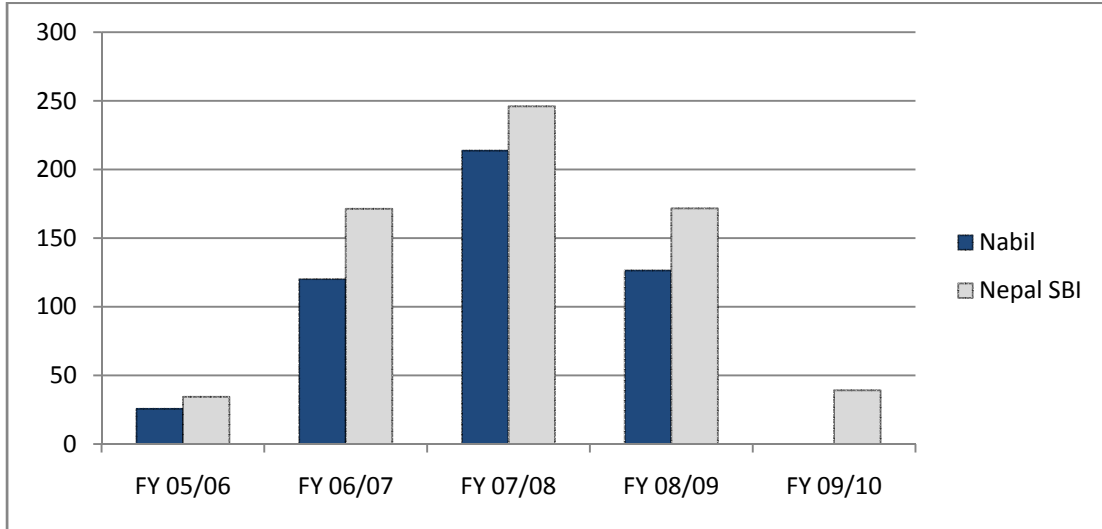
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	55.65	266.88	281.77	234.74	46.36
FY 06-07	35.14	144.97	153.33	370.77	51.48
FY 07-08	37.94	270.68	760.18	159.19	37.58
FY 08-09	38.19	154.09	39.50	55.56	33.39
FY 09-10	5.08	20.28	(4.89)	37.90	26.90
Mean	34.40	171.38	245.98	171.63	39.14

(Source: Annex-17B)

Interest Rate Sensitivity of NABIL Bank and NSBI Bank

The above table shows the interest rate sensitivity as measured by cumulative gap divided by total rate sensitive asset for NABIL Bank and NSBI Bank. For NABIL Bank, during all time buckets, the mean gap is positive. A positive mean gap indicates an increase in interest rate will lead to a positive increase in bank's net interest margin. In the sample period 2005-2010, the gap for this bank is always positive. Therefore, if the banking company had been analyzed on a quarterly or yearly basis, no liquidity problem would be evident. Similarly, for NSBI Bank, the mean gap indicated a positive difference between RSA and RSL except in FY 2009/010 for the time bucket (181-270). It indicated a positive increase in bank's net interest margin with an increase in interest rate. However, taking the data of each sample year, there is some variation. It indicates that during these time bucket, asset coming due are insufficient to cover liabilities coming due. However, average figure showed a positive gap indicating that asset are sufficient enough to satisfy liabilities. The mean value for both banks is positive and for NABIL Bank the highest figure is 213.72 for the time bucket for (181-270) and lowest figure is 0.01 for the time bucket for more than one year. Likewise, For NSBI Bank the highest figure is 245.98 for the time bucket for (181-270) and lowest figure is 34.40 for the time bucket (1-90) days.

Diagram 4.15 Interest Rate Sensitivity of NABIL and NSBI Bank



The diagram no. 4.15 shows that the gap of NSBI Bank is always greater than that of NABIL Bank. It indicates that the net interest margin or the profitability of Nepal SBI is more sensitive to interest rate changes than NABIL Bank.

4.1.6.2 GAP Ratio

Banks shall classify the time interval of the assets and liabilities on the basis of maturity period of 0-90 days, 91-180 days, 181-270 days, 271-365 days, over 1 year. The effect on the profitability is measured by multiplying the change in interest rate, ΔR_i in the i^{th} maturity bucket annualized with cumulative Gap (NRB Directive Manual 2004). If the interest rate rise on RSAs and RSLs the positive CGAP ($RSA > RSL$) would project the increase in the expected annual NII. However, if the interest rate falls when CGAP is positive, NII will fall. As rates, fall interest revenue falls by more than interest expenses. Thus, NII falls by approximately by $(CGAP) \times (-\Delta R)$. In general when CGAP is positive the change in NII is positively related to the change in interest rates. Hence banks would want to keep CGAP positive when interest rates expected to rise.

Conversely, When the CGAP or the Gap ratio is negative (RSA>RSL) if the interest rates rise by equal amounts for RSAs and RSLs, NII will fall. Similarly if the interest rates fall equally for RSAs and RSLs, NII will increase when CGAP is negative. As rates fall interest expenses decrease by more than the revenues. In general when CGAP is negative the change in NII is negatively related to the change in interest rates. Thus the banks are expected to keep CGAP negative when interest rates are expected to fall. Gap analysis of RSAs and RSLs of NABIL and NSBI Bank for the period of FY 2005/06 to FY 2009/010 is made as shown in Table 4.18 which is based on the different maturity time bucket.

Here in case of NABIL BANK.

The period from FY 2005/06 to FY 2009/010 is taken for the review of the sensitivity of market risk. From FY 2005/06 to FY 2009/010 net financial assets (RSA-RSL) reprising in the short term maturity bucket ranging from 0-90 days to 271-365 days was found positive except in FY 2005/06 and FY 2007/08 when it was shortfall by 1478.00 and 88.00 millions reprised in 181-270 days time bucket. In the long term maturity bucket (>365 days) the gap was negative in all the years by NPR 71,966.00, NPR 76,955.00, NPR 51,985.00, NPR 2,868.00 and NPR 4,049.00 (all figures in millions) for FY 2005/06 to FY 2009/010 respectively. The CGAP or the interest rate sensitivity ratio to the total earning assets over the short term horizon i.e. up to one year was highest with 31.72% in FY 2005/06 and the lowest with 0.26% in FY 2008/09. The CGAP ratio to the earning assets over the long term horizon was highest with 0.01% in FY 2006/07 and lowest with 0% in all the other study period. It indicates the RSAs and RSLs re-pricing in the short term maturity bucket are highly sensitive to interest rate even though it is in decreasing trend. Comparatively the RSAs and RSLs of the bank re-pricing in the long term horizon is low sensitive to interest rate. As shown in the table above with the simulated interest change by 1%, it would make the NII of the bank sensitive by the quantity of CGAP held in the short term horizon. CGAP increase in FY 2005/06, FY 2006/07 and fluctuates over the other FY of the study period. This would make the bank less asset sensitive in future. Since the CGAP in the concluding 4 years in the long term horizon is ZERO except in FY 2006/07, the RSAs and RSLs remain unaffected by the fall or rise of the interest rates. Hence the bank is low sensitive to interest rate in the long horizon.

Here In case of NSBI Bank.

The period from FY 2005/06 to FY 2009/010 is taken for the review of the sensitivity of market risk. From FY 2005/06 to FY 2009/010 net financial assets (RSA-RSL) reprising in the short term maturity bucket ranging for 0-90 days was found positive, for 91-180 days it found positive too except in FY 2007/08 and FY 2008/09, for 181-270 days it found positive except in FY 2005/06, FY 2007/08 and FY 2008/09, for 271-365 days it found positive except in FY 2006/07. But in the long term maturity bucket (>365 days) the gap was positive only in FY 2009/010 over the study period. The CGAP ratio or the interest rate sensitivity ratio to the total earning assets over the short term horizon i.e. up to one year was highest with 30.84% in FY 2005/06 and the lowest with (1.13%) in FY 2009/010. The ratio is in fluctuating trend over the study period. It indicates the RSAs and RSLs re-pricing in the short term maturity bucket are highly sensitive to interest rate even though it is in decreasing trend. Comparatively the RSAs and RSLs of the bank re-pricing in the long term horizon is low sensitive to interest rate. As shown in the table above with the simulated interest change by 1%, it would make the NII of the bank sensitive by the quantity of CGAP held in the short term horizon. Hence it can be concluded the bank in the later years with the mismatched (RSA-RSL). This would make the bank less asset sensitive in future. Since the CGAP in the long term horizon is above 6% over the study period, the RSAs and RSLs remain affected by the fall or rise of the interest rates. Hence the bank is high sensitive to interest rate in the long horizon.

Aggregate GAP ratio Analysis over the study period for NABIL Bank and NSBI Bank.

GAP ratio analysis is an assessment tool to help identify differences between information systems or applications. A gap is sometimes called "the space between where we are and where we want to be." A gap analysis helps bridge that space by highlighting which requirements are being met and which are not. The tool provides a foundation for measuring the investment of time, money and human resources that's required to achieve a particular outcome. It is used to examine whether bank's rate sensitive assets (RSA) are sufficient enough to cover its rate sensitive liabilities (RSL). It is calculated as the ratio between RSA and RSL. It is computed by expressing RSA divided by RSL. Also below table no. 4.18 present the GAP ratio with the mean GAP ratio for the every time buckets.

$$GAP\ Ratio = \frac{RSA}{RSL} \times 100$$

Table No. 4.18 GAP ANALYSIS

NABIL BANK

Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	2.19	1.12	0.85	7.69	0.55
FY 06-07	1.08	1.23	3.88	7.15	0.58
FY 07-08	1.47	0.56	1.22	2.06	0.77
FY 08-09	1.01	2.40	0.96	1.40	0.90
FY 09-10	1.50	1.39	0.38	0.85	0.88
Mean	1.45	1.34	1.46	3.83	0.74

(Source: Annex-18A)

NSBI BANK

Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	2.25	1.96	0.62	2.21	0.57
FY 06-07	1.54	1.31	2.10	0.57	0.70
FY 07-08	1.61	0.69	0.31	1.31	0.86
FY 08-09	1.62	0.99	0.72	1.39	0.73
FY 09-10	1.05	1.03	0.88	1.92	1.10
Mean	1.62	1.20	0.93	1.48	0.79

(Source: Annex-18B)

The table 4.18 shows the gap ratio as measured by rate sensitive assets divided by rate sensitive liabilities for different time period or bucket. The ratio of greater than 1 indicates a positive gap i.e. RSA is greater than RSL. Similarly, ratio of less than 1 indicates a negative gap i.e. RSA is lesser than RSL. Both of these situations are considered as the gap mismatch. However, the ratio of 1 indicates a perfect match. The mean gap ratio of NABIL Bank for all four quarters is greater than 1 indicating a positive gap except for the time bucket more than one year which is less than 1 percent i.e. 0.74% only. For all liabilities maturing within a year, bank has sufficient amount of assets. However, for liabilities maturing above a year, bank's assets are insufficient indicating a negative gap. Generally this result indicates that bank's liquidity position for satisfying liabilities maturing in a year or above seems satisfactory as all the gap ratio for all year shows positive gap. Similarly, the mean gap ratio of NSBI Bank for four quarter is positive except for the time bucket for (181-270) and above 1 year is negative. This indicates that the bank liabilities maturing for the time bucket for (181-270) and above one year bank's assets are insufficient indicating below 1% which may arise liquidity problems. In average the liquidity position is sound. Bank's assets are sufficient to meet liabilities. Further the bar chart below will demonstrate the result of the table indication.

Diagram 4.16 Gap Ratio

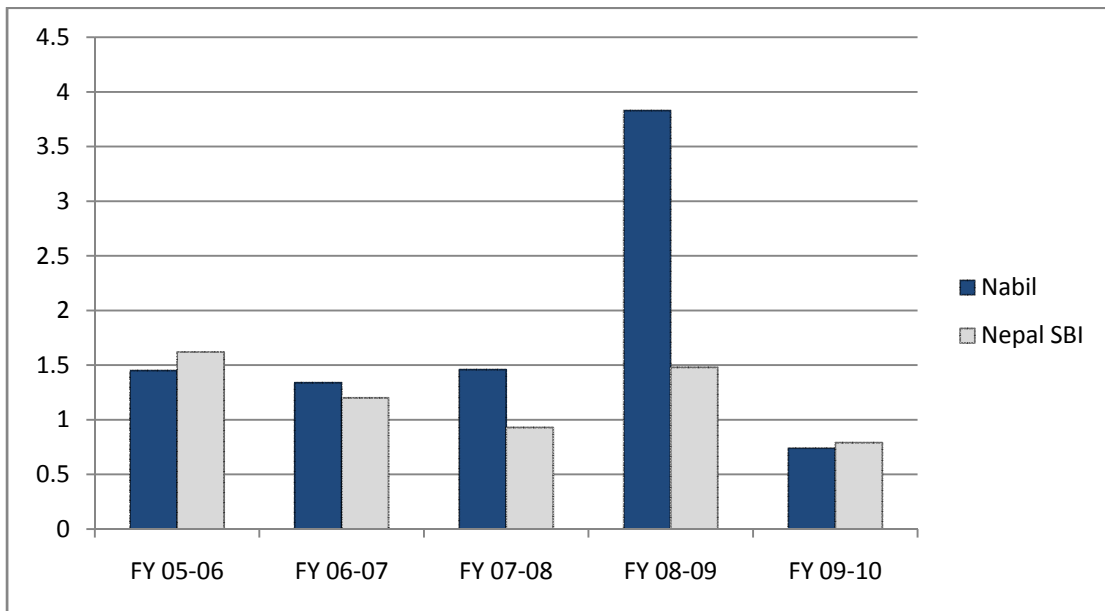


Diagram 4.16 presents the bar chart of the GAP ratio for NABIL Bank and NSBI Bank for all the time buckets over the study period. The GAP of NABIL is higher than of NSBI Bank, which indicate that NABIL Bank is capable to meet the liabilities very comfortable indeed. The bar chart shows that the GAP ratio of NABIL Bank is higher than NSBI Bank in FY 2006/07, FY 2007/08 & FY 2008/09.

4.1.6.3 Measurement of Interest Rate Risk

A maturity mismatch approach is a commonly used tool to measure a banking company's exposure to interest rate risk. Interest rate risk occurs when a bank is exposed to operating gains and losses arising because the maturities of fixed-rate assets and liabilities do not match. That is, the bank has a mismatch in amount of assets and liabilities that are subject to reprising with a given time span. The full valuation approach to measuring the interest rate risk involves using a pricing model to value individual bonds and can be used to find the price impact of any scenario of interest rate/yield curve changes. A positive mismatch would mean that more assets than liabilities are reprised in a given period. Interest rate risk measurement systems use an earnings approach, an economic value approach, or a blend of those two approaches. NRB unified directive (2062 BS) number E.Pr . Ni. No.05/061/62 requires the banks to classify the assets and liabilities on the basis of repayment maturity and conduct Gap Analysis of the maturity mismatch. With a positive mismatch, a rise in market interest rates will have a positive effect on the bank's earnings. On the other hand, a negative mismatch, where more liabilities are reprised than assets in a given period, would mean a drop in earnings if interest rates had increased. Interest rate risk can arise from two distinct types of rate movement, a sustained shift in the yield curve or sharp swings in rates over a short period of time. Since the situation in Nepal is far more likely to the former case, the analysis will focus on a sustained upward (+1%) shift in the interest rates inherent to the yield curve.

Table 4.19 Bank's Exposure to Interest Rate Risk**NABIL BANK**

Fiscal Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
Total Assets	18,501.00	5,274.00	1,779.00	4,022.00	29,832.00
Total Liabilities	12,348.00	3,805.00	4,651.00	4,722.00	33,881.00
GAP	6,153.00	1,469.00	(2,872.00)	(700.00)	(4,049.00)
Cumulative GAP	6,153.00	7,622.00	4,750.00	4,050.00	1.00
Adjusted interest rate change (IRC)	0.0025	0.0025	0.0025	0.0025	0.0010
Quarterly Earning Impact (Cum GAP* IRC)	15.38	19.06	11.88	10.13	0.00
Accu. Earning Impact to date	15.38	34.44	46.31	56.44	56.44

(Source: Annex-19A)

Bank's Exposure to Interest Rate Risk

NSBI BANK

Fiscal Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
Total Assets	134,253.04	40,317.15	97,886.75	47,206.47	102,388.83
Total Liabilities	127,429.35	38,963.57	110,849.47	24,528.87	92,736.96
GAP	6,823.69	1,353.58	(12,962.72)	22,677.60	9,651.87
Cumulative GAP	6,823.69	8,177.27	(4,785.45)	17,892.15	27,544.02
Adjusted interest rate change (IRC)	0.0025	0.0025	0.0025	0.0025	0.001
Quarterly Earning Impact (Cum GAP* IRC)	17.06	20.44	(11.96)	44.73	27.54
Accu. Earning Impact to date	17.06	37.50	25.54	70.27	97.81

(Source: Annex-19B)

In the above table, the adjusted interest rate change (IRC) is calculated assuming a sustained 1% increase in interest rate. For a 90 days asset, it is calculated as $0.01 \times 90/365 = 0.0025$. Similarly, the IRC for one year asset, it is calculated as $0.01 \times 365/365 = 0.01$. The table shows that for both banks, over the all periods, the banks had a positive earnings impact (gains). NABIL Bank has a positive earnings impact indicating the accumulated earnings impact for the year owing to a 1% increase in interest rate. Although the quarterly earnings impact of NSBI Bank has a negative earnings impact for the time bucket for (181-270) but the accumulated earning impact to recent date is positive in all time bucket indicating the accumulated earnings impact for the year owing to 1% increase in interest rate. However, the calculated accumulated earning impact to date of Nepal SBI is greater than NABIL Bank. Both banks have a positive earnings impact with each percent increase in interest rate.

Diagram 4.17 Interest Rate Risk

Interest Rate Risk of NABIL Bank and NSBI Bank

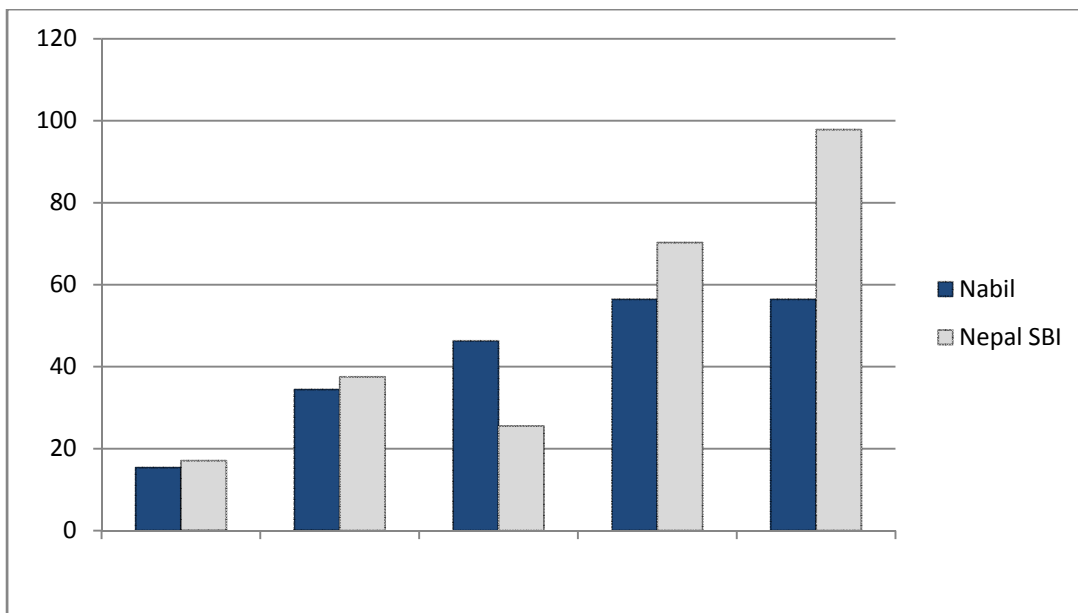


Diagram 4.17, exhibits that the bar chart level indicating the interest rate risk of NABIL Bank and NSBI Bank above state that the interest rate risk of NSBI Bank is higher than NABIL Bank in comparison.

4.1.6.4 Statistical Tools:

Co-relation of Earning Per Share between NABIL Bank and NSBI Bank.

Table No. 4.20 EARNING PER SHARE (EPS)

EPS of NABIL BANK.

Fiscal Year	EPS (X)	(X-x)	(X-x) ²
2005/06	129.21	17.23	296.80
2006/07	137.08	25.10	629.91
2007/08	108.31	-3.67	13.48
2008/09	106.76	-5.22	27.27
2009/10	78.55	-33.43	1,117.70
			2,085.17

(Source: Annex-20A)

We have,

Expected Return (x) = **111.98**

Standard Deviation (σ) = **22.83**

Coefficient of Variation (CV) = **20.39**

EPS of NSBI BANK

Fiscal Year	EPS (Y)	(Y-y)	(Y-y) ²
2005/06	18.27	-10.89	118.68
2006/07	39.35	10.18	103.75
2007/08	28.23	-0.834	0.70
2008/09	36.18	7.01	49.22
2009/10	23.69	-5.47	29.96
			302.32

(Source: Annex-20B)

We have,

Expected Return (y) = **29.16**

Standard Deviation (σ) = **8.69**

Coefficient of Variation (CV) = **29.80**

Above calculation shows that the earning per share of NABIL Bank is higher than NSBI Bank. The mean EPS of NABIL and NSBI Bank are Rs. 111.98 and Rs. 29.16 respectively. Likewise from the view point of risk as calculated above in the form of standard deviation, it indicates that the standard deviation of NABIL Bank (22.83) is more risky than that of NSBI Bank (8.69). Since the mean and standard deviation is different for both sample banks. So C.V is more appropriate tool to measure risk with different Mean and S.D value. CV is a relative measure of variability which measure risk per unit. C.V of NSBI Bank is greater than NABIL Bank which indicates that earning per share of NSBI Bank is more variability due to higher rate of increment of earning per share over the study period.

4.2 MAJOR FINDINGS

The major findings of the study on financial performance analysis of NABIL Bank Limited and NSBI Bank Limited in the framework CAMEL are as follows:

- ❖ The NABIL Bank maintained maximum Tier I ratio capital adequacy ratio i.e. 10.78% in FY 2005/06 and the minimum ratio of 8.74% was found in FY 2008/09. The Tier I ratio decreased continuously till from FY 2005/06 to till FY 2008/09 with decreasing trend and slightly increase in FY 2009/010. In all the 5 years of the review period, the Tier I capital ratio was above the NRB standard with maximum positive variance of 5.39% in FY 2005/06 and minimum positive variance of 3.24% in FY 2008/09. The bank was able to maintain more than 5% above the NRB requirement in Tier I ratio during the period from FY 2005/06 to FY 2009/010 however it has slightly decreased in preceding year of study period. In general, the bank has maintained Tier I capital adequately above the NRB standard during the study period. Similarly, Tier I ratio of NSBI Bank is distributed from the minimum of 9.97% in FY 2007/08 to maximum of 10.99% in FY 2009/010 with maximum positive variance of 5.49% in FY 2009/010 and minimum positive variance of 4.47% in FY 2007/08. The Core Capital (Tier I) of the bank is fluctuating trend over the study period. It has remained constant for the first year and then decline and continuously increases till FY 2009/010. Even if the bank was able to maintain above NRB standard. Hence the core capital adequacy ratio of NSBI Bank and NABIL Bank is adequate and sufficient.

- ❖ The Tier II ratio of NABIL Bank was maximum in FY 2007/08 with 2.35% and minimum in FY 2005/06 with 0.94%. The ratio is in fluctuating trend since 2005/06 till 2009/010. The fluctuating occurred due to increase in supplementary capital and increasing in RWA during the period. Tier II capital of the bank in all years is (0.94%, 1.64%, 2.25%, 1.96% and 1.73%). Likewise, Tier II ratio of NSBI Bank is distributed from minimum of 1.37% in FY 2009/010 to maximum of 3.04% in FY 2005/06. The ratios of Nepal SBI were (3.04%, 2.75%, 2.04%,

1.90% and 1.37%). The ratio trend is decreasing. Hence the Supplementary capital ratio of both bank aren't within the boundary of NRB.

- ❖ Total Capital adequacy ratios of NABIL Bank in the review period were 12.31%, 12.04%, 11.1%, 10.7% and 10.50%. The ratio of 12.31% was maximum in FY 2005/06 and ratio of 10.50% was minimum in FY 2009/010. The total capital adequacy ratio is decreasing continuously all the year of the observed period. The Capital adequacy ratio of NABIL Bank is below NRB standard for FY 2008/09 and FY 2009/010. In the same way, Total capital adequacy ratios of NSBI Bank in the review period were 13.57%, 13.29%, 12.32% 11.92% and 12.37%. The ratio of maximum of 13.57% in FY 2005/06 and minimum of 11.92% in FY 2008/09. The Capital adequacy ratio of NSBI Bank is above NRB standard.
- ❖ Assets composition of NABIL Bank like in every banks remained largely in the loans and investment in the last five financial years above 50%. In the study period of 5 years, the average composition of Cash & Bank Balance, Money at Call, Investment, Loan & Advances, Fixed and Other Assets were 5.19%, 3.92%, 27.06% 60.19%, 1.56% and 2.08% respectively. In the same way, the average composition of Cash & Bank Balance Money at Call, Investment, Loan & Advances, Fixed and Other Assets of NSBI Bank were 7.96%, 1.19%, 30.75%, 58.38%, 1.32% and 0.40% respectively during the study period. The loan and advances for FY 2008/09 and FY 2009/010 portion to total assets is below 50% only over the study period.
- ❖ The NPL ratios of NABIL Bank were distributed 1.38%, 1.12%, 0.74%, 0.8% and 1.47% during the FY 2005/06 to 2009/010. Likewise, the NPL ratios of NSBI Bank were 6.13%, 4.56%, 3.83%, 2.02% and 1.50% for the FY 2005/06 to FY2009/010. The trend speaks of NPL ratio of NABIL Bank and NSBI Bank well in control and below international standard of 5% in general. But NPL of NSBI Bank can't maintain the standard in FY 2005/06. It also shows efficient credit management and recovery efforts for both banks.

- ❖ The loan loss provisioning ratio of NABIL Bank for the study period is in decreasing trend except in FY 2009/010. The ratio ranges from 2.68% in FY 2005/06 to 1.46% in FY 2008/09. It also indicates bank's quality of loan assets is getting better. Likewise, the loan loss provisioning ratio of NSBI Bank for the study period is also in decreasing trend ranges from 7.46% in FY 2005/06 to 2.73% in FY 2009/010. Thereafter it is in continuously decreasing trend.
- ❖ The observed TE to TI ratio of NABIL Bank has fluctuating trend over the study period from 53.78% to 44.29%. The ratio has reached 44.29% in FY 2009/010 which is the minimum of all the years of the review period, which implies decreasing trend of ratio is favorable on measure management quality of NSBI Bank. Likewise, the absorbed TE to TI ratio of NSBI Bank has fluctuating trend which moves up and down over the study period from FY 2005/06 to FY 2009/010. The ratios distributed from a minimum of 58.57% in FY 2009/010 to maximum of 73.13% in FY 2008/09. Currently the ratio is decreasing which reveals that the trend of ratio is favorable on measure management quality of NSBI Bank.
- ❖ The Earnings per Employee in rupees during the study period, the ratio of NABIL Bank at increasing trend expect in FY 2009/010. The mean earning per employee of the study period is Rs.1,767,109.86. The trend is positive, which indicates the Earning per Employee is increasing over the study period. This indicates that high or inclining earning per employee can reflect efficiencies of well staffing. Whereas, the earning per employee of NSBI Bank increased in FY 2006/07 and then decreased from FY 2007/08FY to FY 2009/010. The mean earning of the employee is Rs. 9,676,153.14 the trend of ratio is declining, which indicates the earning of the employee is declining over the study period. The earning per employee is decreasing although the net profit is increasing due to high number of recruitment in employee.

- ❖ The mean ROE of NABIL Bank was 31.98%. The ratio has fluctuating trend. This trend of ratios implies that earning quality of bank is getting better. The ROE is maximum on FY 2005/06 with 33.90% and minimum on FY 2009/010 with 29.70%. Hence the bank's ROE ratio is sound. In the same way, the mean value of ROE of NSBI Bank is 17.16%. The ratio has fluctuating trend with maximum on FY 2006/07 with 21.91% and minimum with 11.91% on FY 2005/06. Both bank ROE is above the benchmark, it indicates the bank's ratio of ROE is better & it shows the disability of used the resources.

- ❖ The mean ROA ratio of NABIL Bank is 2.37%. The movement of ROA of NABIL Bank is in fluctuating trend over the study period. Whereas the mean ROA ratio of NSBI Bank is 1.24% which is also in fluctuating trend over the study period. The ratio of the both bank is above the benchmark which shows the quality of assets and their efficiency to generate return is better.

- ❖ The net interest margin of NABIL Bank fluctuated over the study period. The mean ratio for the study period was found 4.17%. Throughout the review period the NIM ratio was found slightly above the generally accepted benchmark. This indicates bank's capacity to maintain higher interest margin than the benchmark in the latter half of the review period, despite increase in earning assets. On the other hand, the mean ratio of NIM of NSBI Bank is 2.93% which is less than that of generally accepted benchmark. Hence, the bank's ratio is lower and it is in decreasing tendency.

- ❖ EPS of NABIL Bank fluctuated over the review period firstly it increased in FY 2006/07 and then continuously decreased till FY 2009/010. The decreasing trend of EPS is also supported by downward bar chart in the diagram till FY 2009/010. Whereas, the EPS of NSBI Bank also fluctuated over the study period. The chart bar fluctuating indicates good sign but in comparison with NABIL Bank EPS is very low.

- ❖ The liquid assets to total deposit ratio of NABIL Bank is in fluctuating trend during the FY 2005/06 to FY 2009/010. The Liquid Assets to Total Deposit ratio was minimum in FY 2009/010 with 9.73%. The ratio was maximum in FY 2006/07 with 20.60%. Hence maintain of Liquid Assets were in decreasing trend but the ratio of Liquid Assets to Total Deposit ratio were good. Whereas Liquid Assets to Total Deposits of NSBI Bank during the period of FY 2005/06 to FY 2009/010 were in fluctuating trend. The highest ratio was 32.65% in FY 2005/06 and lowest was 9.86% in FY 2009/010. The Liquid Assets to Total Deposits of NABIL Bank and NSBI Bank were in fluctuating trend. This fact implies that the overall position of liquidity of the NABIL Bank is slightly better than NSBI Bank because more liquidity impacts profitability negatively.

- ❖ NABIL Bank has maintained cash reserve with NRB in fluctuating trend from FY 2005/06 to FY 2009/010 with maximum of 6.2% in FY 2006/07 and minimum of 0.70% in FY 2007/08. This implies the bank is not following strictly the directives of NRB in respect to balance must held in NRB. Whereas NSBI Bank has maintained adequate cash reserve with NRB balance in FY 2005/06 to FY 2009/010 with maximum 8.16% in FY 2009/010 and with minimum 2.5% in FY 2008/09 which indicates the bank has strictly following the NRB directions in respect to balance must maintained with NRB. Thus the lack of balance of NSBI Bank in NRB does not conclude inadequate Cash Reserve Ratio at NRB. Since the calculation is based on year end volumes of deposit and NRB balance and NRB calculates CRR on weekly average balances, ratio is observed low which is a limitation of the study.

- ❖ The volume of cash at vault to total deposits ratio of NABIL Bank is in fluctuating trend over the study period. The ratio moves up and down over the review period with maximum in FY 2008/09 with 2.27% in line with the highest deposit volume during the year and minimum in FY 2006/07 with 1.49%. Whereas the ratio of NSBI Bank also has the fluctuating trend over the study period. The highest ratio is 3.73% in FY 2008/09 and the lowest ratio is 2.29% in

FY 2005/06. Vaults have increased at lower rate than deposit has. So, increase in vault relatively lower rate has decreasing trend in the ratio for these years. The cash at vault to total deposit ratio of NSBI Bank is higher than NABIL Bank in all the study period except in FY 2007/08 and FY 2008/09 which has indicates that comparatively NSBI Bank has the ability to minimize liquidity problem than NABIL Bank comparatively. It is necessary for all the financial institution to maintain adequate cash at vault to meet the liabilities.

- ❖ The mean Gap ratio of NABIL Bank for all four quarters is greater than one indicating a positive gap. For all Liabilities maturing within a year Bank has sufficient amount of assets. However, for Liabilities maturing above a year is less than one but Banks assets are sufficient indicating a positive gap. Similarly the mean gap of NSBI Bank for first four quarters is greater than one except in the time bucket for (181-270) days and more than one year which indicate positive impact over the study period.
- ❖ Interest rate sensitivity of NABIL Bank for the particular review period for all time buckets is positive with the mean value too. Likewise the interest rate sensitivity of Nepal SBI also has positive value for the entire time bucket for the review period expect for the time bucket (181-270) in FY 2009/010 with the mean value over the different time structure. Interest rate risk of both Banks NABIL Bank and NSBI Bank found positive earning impacts during the study period
- ❖ Bank exposure to interest rate risk of NABIL Bank for 1-90 and 91-180 time bucket the gap is positive and for 181-270, 271-365 and above 365 days is negative. But cumulative gap is positive in the entire time bucket over the study period. Similarly for NSBI Bank during all the time buckets for 1-90, 271-365 the gap is positive and for 91-180, 181-270 and above 365 days the gap is negative. But the cumulative gap is positive in all time buckets over the study period.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMENDATIONS

5.1 SUMMARY

The research study is focused on CAMELS rating of NABIL Bank and NSBI Bank Ltd comparatively in the framework CAMELS, by using descriptive and analytical research design in accordance to BASEL accord. The bank's financial soundness is judged on the basis of some factors-capital adequacy, asset quality, and management soundness, earning quality, liquidity position and sensitivity to market risk. The study scrutinizes the financial performance of NABIL Bank and NSBI Bank as regards to their capital adequacy, level and trend of risk weighted assets, asset composition and quality of loan assets, management of revenues and expenses, level and trend of earnings, liquidity position, and sensitivity to interest rate risk. The study is conducted with the general objective to analyze the financial performance of NABIL Bank and NSBI Bank Ltd. Moreover, the specific objectives of the study were-to examine the capital adequacy of the bank, to assess the quality of the bank's assets, to analyze the efficiency of the bank's management, to evaluate the earning performance of the bank, to find out the liquidity position of the bank in the period of FY 2005/06 to FY 2009/010. Different materials were reviewed to build up the conceptual foundation and to find out the clear destination of the research work.

Review of concept of banking, origin and historical growth of banking, evolution of banking in Nepal, concept of bank, concept of commercial bank functions of commercial bank, concept of financial performance analysis, financial statements, balance sheet, assets, liabilities, income statements, financial performance analysis, types of financial analysis, trend analysis, ratio analysis, funds flow statement, concept of financial performance analysis in the framework of CAMELS, concept of capital adequacy, assets quality, non performing assets, management soundness, earnings, liquidity, sensitivity to market risk were reviewed as conceptual review. In addition, reviews of dissertations were included in dissertations review section. As commercial banks are now introducing complex and innovative banking products, they are exposed to many risks and therefore

have amplified as well as diversified the functions performed by the Bank Supervision Department. A key product of such supervision is a rating of the bank's overall condition, commonly referred to as a CAMELS rating. CAMELS rating system is used by the three federal banking supervisors the Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency (OCC)] and other financial supervisory agencies to provide a convenient summary of bank conditions at the time of an exam. Various studies have been conducted in the past on financial analysis of commercial banks in the US and other regions were found done. In context of Nepalese banking environment, there are only few researches found conducted in the frame work of CAMEL.

The study analyzes the level, trend and comparative analysis of Capital Adequacy, Non Performing Loans, Loan Loss Provision, Asset composition, Management Quality ratios, Earning capacity, Liquidity position and Sensitivity to Market risk components of the bank during a 5 year period from FY 2004/05 to 2008/09. Various materials were reviewed in order to build up the conceptual foundation of this study and reach to the clear destination of research. During the research the areas that formed part of the research review were; Functions of Commercial Bank, Concept of CAMELS rating system and component evaluation system, Basel Capital Accord, NRB guidelines of different time. Besides these, review of research papers, work papers, dissertations and related reports were conducted. The research was conducted within the framework of descriptive and analytical research design. The required data and information were collected from secondary sources. The capital adequacy ratio has decreasing trend for NABIL Bank and also same for NSBI Bank which has decreasing trend for over the study period except in FY 2009/10. The ratio is above the NRB standard for NSBI Bank but has the ratio is above the NRB standard for NABIL Bank only from FY 2005/06 to FY 2007/08 and after that in FY 2008/09 and FY 2009/10 the ratio is below the NRB standard. The ratio for NSBI Bank shows additional protection and security to the stakeholders and financial soundness of the bank. The assets are mainly composed of Loans and advances, Investments, fixed assets etc. The loan and advances has the highest portion in the total assets for both banks which is also the earning assets of the bank. The non-performing loans to loan ratios are well below the international standard. The loan loss provision of NSBI Bank is decreasing over the study period, which indicates that the

loan quality of NSBI Bank is getting better than earlier. Whereas, the loan loss provision of NABIL Bank is decreasing over the study period except in FY 2009/10 which indicates better loan quality. Where the total expenses to revenue ratio is in fluctuating trend for both NABIL Bank and NSBI Bank. The Earning per Employee is in increasing trend for NABIL Bank except in FY 2009/10 which indicates effective management with well staffing on NABIL Bank. Similarly in case of NSBI Bank, earning per employee is in fluctuating trend and recently declining at the current context which implies ineffectiveness in the bank. The earning quality ratios like return on equity, return on assets, net interest margin, earning per share of NABIL Bank is generally above the benchmark prescribed by concern authority and in increasing trend this shows that the quality of earning is increasing. Likewise in case of NSBI Bank earning quality ratios like return on assets return on equity, net interest margin are also above the benchmark except in FY 2005/06. The Cash in Vault to Total Deposits ratio of NABIL Bank is in fluctuating trend. Also Cash at vault to total deposit of NSBI Bank is also in fluctuating trend. NRB balance to Total Deposits ratio of NABIL Bank is fluctuating and not following strictly the directives of NRB. For NSBI Bank the ratio is adequate and maintain at NRB which shows strictly following the NRB direction. Whereas the Liquid Assets to Total Deposits ratios is in decreasing trend for NABIL Bank during the study period except in FY 2006/07 and also for NSBI Bank. Overall the liquidity position of the bank is good if we look at the composition investment in government securities. There is limitation in CRR ratio calculation as it is based on year end volume only rather than weekly average and hence cannot be justifiable when compared with NRB norms. NRB directives where the liquid funds to total deposit ratios are in good standing position during the study periods. This shows that the liquidity position of both banks is overall good. Comparatively the ratio of NSBI Bank is better than NABIL Bank. Bank exposure to interest rate risk of NABIL Bank for 1-90 and 91-180 time bucket the gap is positive and for 181-270, 271-365 and above 365 days is negative. But cumulative gap is positive in the entire time bucket over the study period. Similarly for NSBI Bank during all the time buckets for 1-90, 91-180, 271-365 and above 365 days the gap is positive and 181-270 the gap is negative. The cumulative gap is positive in all time buckets over the study period expect for 181-270 period. The mean Gap ratio of NABIL

Bank for all four quarters is greater than one indicating a positive gap. For all Liabilities maturing within a year Bank has sufficient amount of assets. However, for Liabilities maturing above a year is less than one but Banks assets are sufficient indicating a positive gap. Similarly the mean gap of NSBI Bank for first four quarters is greater than one except in the time bucket for (181-270) days and more than one year which indicate positive impact over the study period. In average the liquidity position is sound.

5.2 CONCLUSIONS

Based on the findings, the performance of NABIL Bank and NSBI Bank in the framework of CAMELS is concluded as under:

The Core capital adequacy ratio of NABIL Bank varied negatively over the study period but above NRB standard during the review period. Supplementary capital ratio of the banks is within the boundary of NRB regulation over the study period though the proportion of Supplementary capital in the total capital fund is in decreasing trend. The Capital adequacy ratio of NABIL Bank is below NRB standard for FY 2008/09 and FY 2009/010 which result the decreasing trend. Likewise the core capital adequacy ratio of NSBI Bank has fluctuating trend over the study period. The supplementary capital ratio has the decreasing trend. The total capital adequacy ratio is above NRB norms but at decreasing trend. This means both banks have adequately maintained its internal sources during the past five years. The bank is running with adequate capital and the capital fund of the bank is sound and sufficient to meet the banking operation as per NRB standard

Assets composition of both banks like in every banks remained largely in the loans and investment. There is a switch over of asset composition observed since 2005/06 from Net investments on to Loan and advances which falls under high risk category of assets. The decreasing trend of non-performing loans and advances ratio of NSBI Bank helps to conclude that the bank is aware of nonperforming loans and adopting the appropriate policies to manage this problem and to increase the quality of asset. Likewise the decreasing trend of non-performing loans and advances ratio of NABIL Bank except in FY 2008/09 and FY 2009/10 which conclude that the bank is not putting much awareness

of the non performing loan. The performing loans are increasing steadily and conversely the NPL are decreasing during the review period. The both banks TE to TI ratio is managed and operating efficiently since the total expenses to total revenues ratios are at fluctuating trend and decrease at the current FY 2009/10. This could be, but not limited to management efficiencies. In any case, the decreasing trend will positively affect the bank's profitability in future. The increasing trend of earning per employee of NABIL Bank depicts management capacity to control overhead expenses due to overstaffing with similar repercussions in terms of profitability. Overall it can be concluded that the management decisions related to operation and investment have assisted in controlling over the recovery of bad debt. Likewise earning per employee of NSBI Bank is fluctuating due to the net profit is increasing and there is high number of recruitment in employee. The ROE ratio of both banks is above the universal benchmark and fluctuating trend. The fluctuating trend of ROE shows that the return per unit of equity invested by the shareholders is also fluctuating year by year i.e. ups and downs in the study period. The both banks ROA is also in fluctuating trend. The NABIL Bank has net interest margin above the benchmark in all years but the NSBI Bank has net interest margin above the benchmark from FY 2005/06 to FY 2007/08. Based on these findings it can thus be concluded that NSBI Bank is able to establish investor's and public faith.

The liquid assets to total deposit ratio of NABIL Bank is in decreasing trend in the study period except in FY 2006/07. The investment in liquid assets is in fluctuating trend and switched into more profitable but high risk assets. The NRB balance is ups and down continuously over the study period. This implies the bank is not following strictly the directives of NRB in respect to balance must held in NRB. The volume of cash at vault to total deposits ratio of NABIL Bank is in fluctuating trend over the study period. In case of NSBI Bank, it has maintained adequate cash reserve with NRB balance in FY 2005/06 to FY 2009/10 with maximum 8.16% in FY 2009/10 and with minimum 2.5% in FY 2008/09 which indicates the bank has strictly following the NRB directions in respect to balance must maintained with NRB. Cash in vaults have increased at lower rate than deposit has. So, increase in vault relatively lower rate has decreasing trend in the ratio for these years. However the calculations are based on year end balances whereas NRB takes

average weekly balances for NRB balance calculation which is a limitation of the study and the cash in vault to total deposit ratio of the bank is also above NABIL Bank that depicts the bank is comparatively maintaining the adequate balance at vault to satisfy the short-term obligation, that might create the financial crunch at the bank sometimes. Interest rate sensitivity of NABIL Bank for the particular review period for all time buckets is positive with the mean value too. Likewise the interest rate sensitivity of NSBI Bank also has positive value for the entire time bucket for the review period expect for the time bucket (181-270) in FY 2009/010 with the mean value over the different time structure. Interest rate risk of both Banks NABIL Bank and NSBI Bank found positive earning impacts during the study period

5.3 RECOMMENDATIONS

The following recommendations are made based on the conclusions as regard to financial performance of NABIL Bank and NSBI Bank.

- ❖ The proportion of Tier I Capital in the Total Capital fund of NABIL Bank is decreasing over the observed period except in FY 2009/10 and Tier II capital is fluctuating trend. This means the bank is slightly decreasing the capital of permanent nature which is shown from the Total Capital Adequacy Ratio. The bank needs to keep additional cushion reserve in the form of general reserve, capital adjustment reserve, dividend equalization fund etc. In case of NSBI Bank the proportion of Tier I capital in the total fund of NSBI Bank is fluctuating over the study period and Tier II capital proportion is decreasing over the study period. The Total Capital Adequacy Ratio is in decreasing trend except in FY 2009/10. Hence the bank is recommended to maintain additional reserve and also to maintain the stable capital adequacy ratio.

- ❖ For assets composition like every bank loans and advances occupied largely in assets components. NABIL Bank has mean value of 60.19% and NSBI Bank has mean value of 58.38% as the proportion on loan and advances of total assets over the study period. It is recommended to use the fund for loan and advances to raise

its portion on loan as it is the only greatest earning assets of any financial institution. Moreover NSBI Bank is recommended to use more fund in Loan and Advance compared to NABIL Bank.

- ❖ For NABIL Bank the substandard loan to total loan, doubtful loan to total loan is fluctuating trend where as loan loss to total loan is in decreasing trend except in FY 2009/10. Decreasing trend value reveals the effectiveness of management over the control over the loan flow. For NSBI Bank the substandard loan to total loan, doubtful loan to total loan is fluctuating where as loan loss to total loan is in decreasing trend. Comparatively NSBI Bank has control over the quality of loan than NABIL Bank so it is recommended for NABIL Bank to control over the quality of loan in the process of loan sanctioning.
- ❖ The proportion of NPL to total loan for NABIL Bank is decreasing except in FY 2008/09 and FY 2009/10 likewise NPL portion for NSBI Bank is decreasing trend over the study period which sign good of the management also it is recommended to check on trend before they are ultimately written off from the books. LLP ratios for NABIL Banks is decreasing over the study period except in FY 2009/10 which sign good management quality likewise LLP ratios for NSBI Bank is decreasing over the study period and hence recommended to pay more concern in recovering the doubtful and loan loss and make as much as possible to reduce the provision accordingly. LLP ratio of NSBI Bank is higher than of NABIL Bank which seems that NSBI Bank loan is more risky than NABIL Bank so hence it is further recommended that NSBI Bank should formulated new strategy and policy to minimize the LLP ratio.
- ❖ The TE to TR of both banks is in fluctuating trend and decreasing the ratio currently which is not good sign for the organization. Although it is recommended for both banks which need to generate additional operating revenue in the coming years and to maintain the ratio as lower as possible. Of course, profit is essential and a crucial part of any business, without it no firm can survive and grow. To

increase profit the bank should minimized its operating cost by increasing the operating efficiencies of its employees. Thus, the both bank is recommended to increase its yield as its net profit. The decreasing trend of profit of the bank may lose the confidence of the shareholders and other stakeholders.

- ❖ Earning per employee of NABIL Bank is increasing except in FY 2009/10 which signs favorable for the organization. Increasing earning per employee ratio of NABIL Bank is satisfactory. The number of employee in FY 2009/10 has rapidly increased although the net profit has average growth which has decrease the EPE ratio. But for NSBI Bank it has ups and downs over the study period but recently the trend is decreasing. Decreasing trend of Earning per employee of NSBI Bank is not satisfactory so it is recommended to adopt the further more corrective action in order to enhance the earning per employee.

- ❖ During the study period the earning assets ratio i.e. ROE, ROA, NIM & EPS of NABIL Bank and NSBI Bank is fluctuating trend. But the ratio is sound and recommended to maintain even better than at current level. Although the ratio of NSBI Bank is lower than NABIL Bank which is not satisfactory condition so it is recommended to the management of NSBI Bank to increase the revenue and further control the operating expenses to the acceptable level which would be cushion in competition environment. However it is also recommended that NABIL Bank should build good strategy to maintain the same or above the current level.

- ❖ For liquidity composition Liquid assets to deposit ratio, Cash at vault to total deposit ratio, NRB bal to total deposit ratio of both bank is fluctuating over the study period which turn ups and downs. NSBI Bank has better liquidity position than NABIL Bank due to the increasing volume of Cash at Vault, NRB bal and Liquid Assets. More reserve of liquidity adversely affects in profitability of organization and less reserve of liquidity invites the financial crisis of the organization. Hence it is recommended that to maintain the current position held and explore new investments opportunities for proper utilization of the idle liquid

assets i.e. to invest in secured field without having troublesome for management while there is immediate need of cash. If there is possibility of high liquid assets then find the opportunities of secured investment and if there is possibility of low liquid assets than find the right option for the financial security.

- ❖ Interest rate sensitivity of NABIL Bank for the particular review period for all time buckets is positive with the mean value too. Likewise the interest rate sensitivity of NSBI Bank also has positive value for the entire time bucket for the review period except in FY 2009/10 with time bucket (181-270) with the mean value over the different time structure. Under the sensitivity to market risk Mean Gap Ratio of NABIL Bank and NSBI Bank is positive and the Bank's Exposure to Interest Rate also have a positive earnings impact, whatever the sources of interest rate exposes, the discovery of significant imbalances in a banking asset/liability structure , leading to a potentially large impact on earnings. Hence it is recommended investing more funds of its assets in short time bucket to have the sufficient amount of assets to meet the liabilities in the entire time buckets.

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ANNEX – 1

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Core capital	RWA	Core capital to RWA (%)	Core capital	RWA	Core capital to RWA (%)
2005/06	1,744	16,012	10.78	964	9,159	10.53
2006/07	1,992	19,154	10.40	1,145	10,873	10.53
2007/08	2,363	27,005	8.75	1,394	16,086	9.97
2008/09	3,044	34,816	8.74	1,673	16,873	10.03
2009/10	3,667	41,822	8.77	2,430	22,099	10.99

Note : Core capital to RWA = (Core capital / RWA) × 100
Same formula has been used to calculate the Core capital to RWA for both banks.

(Source; Annual Reports of NABIL and NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 2

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Supp. capital	RWA	Supp. capital to RWA (%)	Supp. capital	RWA	Supp. capital to RWA (%)
2005/06	150	16,012	0.94	278	9,159	3.04
2006/07	315	19,154	1.64	299	10,873	2.75
2007/08	635	27,005	2.35	328	16,086	2.04
2008/09	683	34,816	1.96	320	16,873	1.90
2009/10	722	41,822	1.73	304	22,099	1.37

Note : Supplementary capital to RWA = (Supplementary Capital / RWA) × 100
Same formula has been used to calculate the Supp. capital to RWA for both banks.

(Source; Annual Reports of NABIL and NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 3

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Total capital	RWA	Total capital to RWA (%)	Total capital	RWA	Total capital to RWA (%)
2005/06	2,307	16,012	12.31	964	9,159	13.57
2006/07	2,999	19,154	12.04	1,444	10,873	13.29
2007/08	2,969	27,005	11.10	1,722	16,086	12.32
2008/09	3,727	34,816	10.70	1,993	16,873	11.92
2009/10	4,390	41,822	10.50	2,734	22,099	12.37

Note : Total capital to RWA = (Total Capital / RWA) × 100
Same formula has been used to calculate the Core capital to RWA for both banks.

(Source; Annual Reports of NABIL and NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 4A

NABIL BANK						
Fiscal year	05/06	06/07	07/08	08/09	09/10	Mean
Cash & Bank Balance	3.25	5.14	7.19	7.69	2.68	5.19
Money at call	5.05	2.07	5.26	1.26	5.98	3.92
Investment	24.83	32.82	26.77	24.68	26.21	27.06
Loan & Advance	61.59	57.04	57.54	62.89	61.88	60.19
Fixed assets	2.10	1.05	1.61	1.51	1.50	1.56
Other assets	3.16	1.88	1.63	1.97	1.75	2.08

Note : C&B Bal(%) = (Cash & Bank Bal / Total Assets) × 100
Mean C&B Bal =
(C&B %05/06+C&B%06/07+C&B%07/08+C&B%08/09+C&B%09/10) ÷ 5
Each assets topic has been calculated as Cash & Bank bal (%) and Mean for NABIL Bank.

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 4B

NSBI BANK						
Fiscal year	05/06	06/07	07/08	08/09	09/10	Mean
Cash & Bank Balance	8.58	8.08	7.81	6.27	9.04	7.96
Money at call	1.65	2.52	1.77	0.00	0.00	1.19
Investment	28.84	19.13	18.97	43.97	42.85	30.75
Loan & Advance	58.51	68.05	70.48	48.94	45.94	58.38
Fixed assets	1.51	2.19	0.97	0.82	1.12	1.32
Other assets	0.90	0.03	0.00	0.00	1.05	0.40

Note : C&B Bal(%) = (Cash & Bank Bal / Total Assets) × 100
Mean C&B Bal =
(C&B %05/06+C&B%06/07+C&B%07/08+C&B%08/09+C&B%09/10) ÷ 5
Each assets topic has been calculated as Cash & Bank bal (%) and Mean for NSBI Bank.

(Source; Annual Reports of NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 5A

NABIL BANK

(Amount In Millions)

FY	Total loan	Total Sub. loan	% of Sub.Loan to TL	Total Doubtful Loan	% of Doubtful Loan to Total Loan	Total Loss Loan	% of Loss Loan to TL
05-06	13,278.78	62.67	0.47	29.57	0.22	90.39	0.68
06-07	15,903.02	119.7	0.75	14.47	0.09	44.12	0.28
07-08	21,759.40	66.22	0.30	42.58	0.20	52.28	0.24
08-09	27,999.01	113.31	0.40	45.76	0.16	65.76	0.23
09-10	33,030.96	14.76	0.04	11.36	0.03	400.40	1.21

Note: % of Sub Loan to Total Loan = (Total Substandard loan ÷ Total loan) × 100
% of Doub Loan to Total Loan = (Total Doubtful Loan ÷ Total loan) × 100
% of Loss Loan to Total Loan = (Total Loss Loan ÷ Total loan) × 100

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 5B

NSBI BANK

(Amount In Millions)

FY	Total loan	Total Sub. loan	% of Sub. Loan to TL	Total Doubt Loan	% of Doubtful Loan to TL	Total Loss Loan	% of Loss Loan to TL
05-06	8,241.45	1.8	0.02	3.84	0.05	499.7	6.06
06-07	10,065.05	3.28	0.03	11.17	0.11	444.3	4.41
07-08	12,746.21	3.87	0.03	21.63	0.17	462.91	3.63
08-09	15,612.05	13.24	0.08	11.34	0.07	291.38	1.87
09-10	17,963.64	3.19	0.02	0.20	0.00	245.75	1.37

*Note: % of Sub Loan to Total Loan = (Total Substandard loan ÷ Total loan) × 100
 % of Dout Loan to Total Loan = (Total Doubtful Loan ÷ Total loan) × 100
 % of Loss Loan to Total Loan = (Total Loss Loan ÷ Total loan) × 100*

(Source; Annual Reports of NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 6

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	NPL	Total Loan	NPL Ratio (%)	NPL	Total Loan	NPL Ratio (%)
2005/06	182.62	13,278.78	1.38	505.33	8,241.45	6.13
2006/07	178.29	15,903.02	1.12	458.76	10065.05	4.56
2007/08	161.08	21,759.40	0.74	488.41	12746.21	3.83
2008/09	224.80	27,999.00	0.80	315.95	15612.05	2.02
2009/10	486.28	33,030.96	1.47	265.13	17,693.64	1.50

*Note : NPL ratio (%) = (Non Performing Loan ÷ Total Loan) × 100
 Same formula has been used to calculate NPL ratio for both banks.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 7

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Loan Loss Provision	Total Loan	LLP Ratio (%)	Loan Loss Provision	Total Loan	LLP Ratio (%)
2005/06	356.23	13,278.78	2.68	614.72	8,241.45	7.46
2006/07	357.24	15,903.02	2.25	604.6	10065.05	6.01
2007/08	394.40	21,759.40	1.81	632.51	12746.21	4.96
2008/09	409.00	27,999.00	1.46	480.3	15612.05	3.08
2009/10	762.09	33,030.96	2.31	483.09	17,693.64	2.73

*Note : LLP ratio (%) = (Loan Loss Provision ÷ Total Loan) × 100
Same formula has been used to calculate LLP ratio for both banks.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 8

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Total Expenses	Total Revenue	TE to TR Ratio (%)	Total Expenses	Total Revenue	TE to TR Ratio (%)
2005/06	763.41	1,716.67	44.47	484.52	799.67	60.59
2006/07	998.26	2,035.87	49.03	644.83	945.77	68.19
2007/08	1,306.15	2,428.86	53.78	739.64	1,092.98	67.67
2008/09	1,804.06	3,374.26	53.47	1,211.00	1655.88	73.13
2009/10	3,017.00	6,812.00	44.29	1,978.00	3,377.00	58.57

*Note: TE to TR Ratio (%) = (Total Expenses ÷ Total Revenue) × 100
Same formula has been used to calculate TE to TR ratio for both banks.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 9

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Net Profit	No. of Employee	EPE	Net Profit	No. of Employee	EPE
2005/06	635.62	441	1,441,315.19	117.00	174	672,413.79
2006/07	673.95	427	1,578,337.23	254.9	189	1,348,677.25
2007/08	746.00	416	1,793,269.23	247.77	249	995,060.24
2008/09	1,031.00	505	2,041,584.15	316.37	323	979,473.68
2009/10	1,139.00	575	1,981,043.48	391.74	465	842,451.61

Note : EPE = Net Profit 'In million' ÷ No. of Employee

Same formula has been used to calculate EPE for NABIL Bank and NSBI Bank.

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 10

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Net Profit	Equity	ROE	Net Profit	Equity	ROE
2005/06	635.62	1,874.99	33.90	117.00	982.37	11.91
2006/07	673.95	2,057.05	32.76	254.9	1163.29	21.91
2007/08	746.00	2,437.20	30.61	247.77	1414.64	17.51
2008/09	1,031.00	3,130.24	32.94	316.37	1712.61	18.47
2009/10	1,139.00	3,835.00	29.70	391.74	2,450.00	15.99

Note : ROE = (Net Profit ÷ Equity) × 100

Same formula has been used to calculate ROE for NABIL Bank and NSBI Bank.

(Source; Annual Reports of NABIL and NSBI Bank from FY 2005/06 to FY 2009/10.

ANNEX – 11*(Amount In Millions)*

NABIL BANK				NSBI BANK		
FY	Net Profit	Total Asset	ROA	Net Profit	Total Asset	ROA
2005/06	635.62	22,329.97	2.85	117.00	13,035.84	0.90
2006/07	673.95	27,235.39	2.47	254.9	13,901.2	1.83
2007/08	746.00	37,313.00	2.00	247.77	17,187.44	1.44
2008/09	1,031.00	43,867.00	2.35	316.37	30,916.68	1.02
2009/10	1,139.00	52,150.00	2.18	391.74	38,047.67	1.03

Note : ROA = (Net Profit ÷ Total Asset) × 100
Same formula has been used to calculate ROA for NABIL Bank and NSBI Bank.

*(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)***ANNEX – 12***(Amount In Millions)*

NABIL BANK				NSBI BANK		
FY	Net Interest Income	Earning Asset	NIM	Net Interest Income	Earning Asset	NIM
2005/06	952.83	20,835.98	4.57	373.94	11,600.71	3.22
2006/07	1,032.04	25,054.62	4.12	418.86	12154.9	3.45
2007/08	1,220.00	33,257.19	3.67	515.59	15506.6	3.32
2008/09	1,645.00	38,969.20	4.22	635.74	28417.93	2.24
2009/10	2,087.00	49,058.00	4.25	826.01	33,785.00	2.44

Note : NIM = (Net Interest Income ÷ Earning Asset) × 100
Same formula has been used to calculate NIM for NABIL Bank and NSBI Bank.

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 13

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Net Profit	No. Of Share	EPS	Net Profit	No. Of Share	EPS
2005/06	635.62	4.92	129.21	117.00	6.40	18.27
2006/07	673.95	4.92	137.08	254.9	6.47	39.35
2007/08	746.00	6.89	108.31	247.77	8.74	28.33
2008/09	1,031.00	9.66	106.76	316.37	8.74	36.18
2009/10	1,139.00	14.50	78.55	391.74	16.53	23.69

*Note : EPS = Net Profit ÷ No. Of Share
Same formula has been used to calculate EPS for NABIL Bank and NSBI Bank.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 14

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Liquid Assets	Total Deposit	Liquid Assets to TD Ratio	Liquid Assets	Total Deposit	Liquid Assets to TD Ratio
2005/06	2,301.30	19,347.39	11.89	3,591.77	11,002.04	32.65
2006/07	4,808.35	23,342.28	20.60	2345.58	11,445.28	20.49
2007/08	4,646.88	31,915.00	14.56	3035.55	13,715.39	22.13
2008/09	3,706.10	37,348.00	9.92	3306.57	27957.00	11.83
2009/10	4,517.00	46,411.00	9.73	3,440.00	34,896.42	9.86

*Note: Liquid assets to Total Deposit ratio = (Liquid Assets ÷ Total Deposit) × 100
Same formula has been used to calculate LA to TD ratio for NABIL Bank and NSBI Bank.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 15

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	NRB Balance	TD less Margin & FYC	NRB bal to TD	NRB Balance	TD less Margin & FYC	NRB bal TD ratio
2005/06	318.35	14,292.00	2.2	626.12	10,659.82	5.90
2006/07	1,113.41	18,072.48	6.2	556.67	11035.47	5.0
2007/08	182.90	24,529.80	0.7	403.81	13459.77	3.0
2008/09	264.80	29,729.43	0.9	444.14	17501.23	2.50
2009/10	549.00	40,409.00	1.4	1,842.80	22,575.23	8.16

*Note: NRB bal to TD ratio = (NRB bal ÷ Total Deposit less margin & FYC) × 100
Same formula has been used to calculate NRB bal to TD ratio for NABIL Bank and NSBI.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 16

(Amount In Millions)

NABIL BANK				NSBI BANK		
FY	Cash at Vault	Total Deposit less Margin & FYC	CV to TD ratio	Cash at Vault	Total Deposit less Margin &	CV to TD ratio
2005/06	237.00	14,292.00	1.66	244.19	10,659.82	2.29
2006/07	270.00	18,072.48	1.49	287.53	11035.47	2.61
2007/08	511.00	24,529.80	2.08	308.1	13459.77	2.29
2008/09	674.00	29,729.43	2.27	652.03	17501.23	3.73
2009/10	635.00	40,409.00	1.57	815.68	22,575.23	3.61

*Note: Cash at Vault to TD ratio=(Cash at vault ÷ Total deposit less margin & FYC) ×100
Same formula has been used to calculate CV to TD ratio for NABIL Bank and NSBI Bank.*

(Source; Annual Reports of NABIL Bank and NSBI Bank from FY 2005/06 to FY2009/10)

ANNEX – 17A

(Amount In Millions)

NABIL BANK-Interest Rate Sensitivity (IRS)					
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	54.26	197.36	473.53	196.42	0.00
FY 06-07	7.29	32.01	111.96	140.40	0.02
FY 07-08	32.12	164.40	130.58	122.88	0.00
FY 08-09	1.38	62.39	85.55	71.87	0.00
FY 09-10	33.26	144.52	267.00	100.70	0.00
Mean	25.66	120.14	213.72	126.45	0.01

*Note: Every time bucket IRS for each year = (CGAP ÷ RSA) × 100
Mean IRS = IRS of each year from 05/06 to 09/10 ÷ 5
Same formula has been used to calculate IRS for NABIL Bank for all the time buckets for all the FY i.e. from FY 2005/06 to FY 2009/10.*

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 17B

(Amount In Millions)

NSBI BANK- Interest Rate Sensitivity (IRS)					
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	55.65	266.88	281.77	234.74	46.36
FY 06-07	35.14	144.97	153.33	370.77	51.48
FY 07-08	37.94	270.68	760.18	159.19	37.58
FY 08-09	38.19	154.09	39.50	55.56	33.39
FY 09-10	5.08	20.28	(4.89)	37.90	26.90
Mean	34.40	171.38	245.98	171.63	39.14

*Note: Every time bucket IRS for each year = (CGAP ÷ RSA) × 100
Mean IRS = IRS of each year from 05/06 to 09/10 ÷ 5
Same formula has been used to calculate IRS for NSBI Bank for all the time buckets for all the FY i.e. from FY 2005/06 to FY 2009/10*

(Source; Annual Reports of NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 18A

(Amount In Millions)

NABIL BANK - GAP					
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	2.19	1.12	0.85	7.69	0.55
FY 06-07	1.08	1.23	3.88	7.15	0.58
FY 07-08	1.47	0.56	1.22	2.06	0.77
FY 08-09	1.01	2.40	0.96	1.40	0.90
FY 09-10	1.50	1.39	0.38	0.85	0.88
Mean	1.45	1.34	1.46	3.83	0.74

*Note: GAP for different time bucket for each year = RSA ÷ RSL
Same formula has been used to calculate GAP for NABIL Bank for all the FY.*

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 18A

(Amount In Millions)

NSBI BANK - GAP					
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
FY 05-06	2.25	1.96	0.62	2.21	0.57
FY 06-07	1.54	1.31	2.10	0.57	0.70
FY 07-08	1.61	0.69	0.31	1.31	0.86
FY 08-09	1.62	0.99	0.72	1.39	0.73
FY 09-10	1.05	1.03	0.88	1.92	1.10
Mean	1.62	1.20	0.93	1.48	0.79

*Note: GAP for different time bucket for each year = RSA ÷ RSL
Same formula has been used to calculate GAP for NABIL Bank for all the FY.*

(Source; Annual Reports of NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 19A

(Amount In Millions)

NABIL BANK – BANK’S EXPOSURE TO INTEREST RATE RISK FY 2009/010					
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
Total Assets	18,501.00	5,274.00	1,779.00	4,022.00	29,832.00
Total Liabilities	12,348.00	3,805.00	4,651.00	4,722.00	33,881.00
GAP	6,153.00	1,469.00	(2,872.00)	(700.00)	(4,049.00)
Cumulative GAP	6,153.00	7,622.00	4,750.00	4,050.00	1.00
Adjusted interest rate change (IRC)	0.0025	0.0025	0.0025	0.0025	0.0010
Quarterly Earning Impact (QEI)	15.38	19.06	11.88	10.13	0.00
Accu. Earning Impact to date	15.38	34.44	46.31	56.44	56.44
<p><i>Note: GAP = Total Assets – Total Liabilities</i></p> <p><i>Cumulative GAP (CGAP) = Last time bucket GAP + Current time bucket GAP</i></p> <p><i>IRC = assumed as mentioned above for each time bucket.</i></p> <p><i>Quarterly Earning Impact (QEI) = CGAP × IRC</i></p> <p><i>Accu. Earning Impact = Last time bucket QEI + Current time bucket QEI</i></p>					

(Source; Annual Reports of NABIL Bank – FY 2009/2010)

ANNEX – 19B

(Amount In Millions)

NSBI BANK – BANK’S EXPOSURE TO INTEREST RATE RISK FY 2009/010					
Year	(1-90)	(91-180)	(181-270)	(271-365)	>365
Total Assets	134,253.04	40,317.15	97,886.75	47,206.47	102,388.83
Total Liabilities	127,429.35	38,963.57	110,849.47	24,528.87	92,736.96
GAP	6,823.69	1,353.58	(12,962.72)	22,677.60	9,651.87
Cumulative GAP	6,823.69	8,177.27	(4,785.45)	17,892.15	27,544.02
Adjusted interest rate change (IRC)	0.0025	0.0025	0.0025	0.0025	0.001
Quarterly Earning Impact (Cum GAP* IRC)	17.06	20.44	(11.96)	44.73	27.54
Accu. Earning Impact to date	17.06	37.50	25.54	70.27	97.81
<p><i>Note: GAP = Total Assets – Total Liabilities</i></p> <p><i>Cumulative GAP (CGAP) = Last time bucket GAP + Current time bucket GAP</i></p> <p><i>IRC = assumed as mentioned above for each time bucket.</i></p> <p><i>Quarterly Earning Impact (QEI) = CGAP × IRC</i></p> <p><i>Accu. Earning Impact = Last time bucket QEI + Current time bucket QEI</i></p>					

(Source; Annual Reports of NSBI Bank – 2009/2010)

ANNEX – 20A

NABIL BANK			
FY	EPS (X)	(X-x)	(X-x)²
2005/06	129.21	17.23	296.80
2006/07	137.08	25.10	629.91
2007/08	108.31	-3.67	13.48
2008/09	106.76	-5.22	27.27
2009/10	78.55	-33.43	1,117.70
			2,085.17

Note : Expected Return (x) = $\frac{\sum X}{n}$

$$= \frac{559.91}{5}$$

$$= 111.98$$

Standard Deviation (σ)

$$= \sqrt{((\sum(X - x))^2 / (n - 1))}$$

$$= \sqrt{2085.17 / (5 - 1)}$$

$$= 22.83$$

Coefficient of Variation (CV)

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

$$= \frac{22.83}{111.98}$$

$$= 20.39$$

ANNEX – 20B

NSBI BANK			
FY	EPS (Y)	(Y-y)	(Y-y)²
2005/06	18.27	-10.89	118.68
2006/07	39.35	10.18	103.75
2007/08	28.23	-0.834	0.70
2008/09	36.18	7.01	49.22
2009/10	23.69	-5.47	29.96
			302.32

Note : Expected Return (y) = $\frac{\sum Y}{n}$

$$= \frac{145.82}{5}$$

$$= 29.16$$

Standard Deviation (σ)

$$= \sqrt{((\sum(Y - y))^2 / (n - 1))}$$

$$= \sqrt{302.32 / (5 - 1)}$$

$$= 8.69$$

Coefficient of Variation (CV)

$$= \frac{\sigma}{y}$$

$$= \frac{8.69}{29.16}$$

$$= 29.80$$

ANNEX – 21

GAP Ratio Analysis, Interest Rate Sensitivity & Bank's Exposure to Interest rate risk related Calculation part as mentioned below:

NABIL BANK

FY 2005/2006	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	72,410.00	21,061.00	8,466.00	36,638.00	88,308.00
RSL	33,118.00	18,786.00	9,944.00	4,762.00	160,274.00
GAP	39,292.00	2,275.00	(1,478.00)	31,876.00	(71,966.00)
CGAP	39,292.00	41,567.00	40,089.00	71,965.00	(1.00)
RSA/RSL	2.19	1.12	0.85	7.69	0.55
CGAP ratio (CGAP/Total RSAs](%)	17.32	18.32	17.67	31.72	(0.00)
ΔR (%)				1.00	1.00
Δ NII = CGAP × ΔR				719.65	(0.01)
% Change in NII				32.00	-

FY 2006/2007	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	56,685.00	31,412.00	26,641.00	54,828.00	106,676.00
RSL	52,551.00	25,492.00	6,869.00	7,673.00	183,631.00
GAP	4,134.00	5,920.00	19,772.00	47,155.00	(76,955.00)
CGAP	4,134.00	10,054.00	29,826.00	76,981.00	26.00
RSA/RSL	1.08	1.23	3.88	7.15	0.58
CGAP ratio (CGAP/Total RSAs](%)	1.50	3.64	10.80	27.87	0.01
ΔR (%)				1.00	1.00
Δ NII = CGAP × ΔR				769.81	0.26
% Change in NII				28.00	-

FY 2007/2008	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	119,961.00	15,817.00	23,137.00	42,306.00	174,319.00
RSL	81,434.00	28,341.00	18,928.00	20,533.00	226,304.00
GAP	38,527.00	(12,524.00)	4,209.00	21,773.00	(51,985.00)
CGAP	38,527.00	26,003.00	30,212.00	51,985.00	-
RSA/RSL	1.47	0.56	1.22	2.06	0.77
CGAP ratio(%)	10.26	6.92	8.04	13.84	-
ΔR (%)				1.00	1.00
Δ NII = CGAP × ΔR				519.85	-
% Change in NII				14.00	-

FY 2008/2009	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	8,396.00	2,922.00	2,028.00	3,992.00	26,988.00
RSL	8,280.00	1,215.00	2,116.00	2,858.00	29,856.00
GAP	116.00	1,707.00	(88.00)	1,134.00	(2,868.00)
CGAP	116.00	1,823.00	1,735.00	2,869.00	1.00
RSA/RSL	1.01	2.40	0.96	1.40	0.90
CGAP ratio (%)	0.26	4.11	3.91	6.47	0.00
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				28.69	0.01
% Change in NII				6.00	-

FY 2009/2010	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	18,501.00	5,274.00	1,779.00	4,022.00	29,832.00
RSL	12,348.00	3805.00	4,651.00	4,722.00	33,881.00
GAP	6,153.00	1,469.00	(2,872.00)	(700.00)	(4,049.00)
CGAP	6,153.00	7,622.00	4,750.00	4,050.00	1.00
RSA/RSL	1.50	1.39	0.38	0.85	0.88
CGAP ratio (%)	10.36	12.83	8.00	6.82	0.00
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				40.50	0.01
% Change in NII				6.00	-

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 22

GAP Ratio Analysis, Interest Rate Sensitivity & Bank's Exposure to Interest rate risk related Calculation part as mentioned below:

NSBI BANK

FY 2005/2006	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	56,476.98	14,423.19	11,253.89	17,608.78	34,269.30
RSL	25,046.31	7,361.05	18,036.97	7,983.05	59,717.30
GAP	31,430.67	7,062.14	(6,783.08)	9,625.73	(25,448.00)
CGAP	31,430.67	38,492.81	31,709.73	41,335.46	15,887.46
RSA/RSL	2.25	1.96	0.62	2.21	0.57
CGAP ratio (%)	23.45	28.72	23.66	30.84	11.85
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				413.35	158.87

FY 2006/2007	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	58,772.00	16,996.00	24,385.00	8,391.00	33,108.00
RSL	38,118.00	13,011.00	11,635.00	14,669.00	47,175.00
GAP	20,654.00	3,985.00	12,750.00	(6,278.00)	(14,067.00)
CGAP	20,654.00	24,639.00	37,389.00	31,111.00	17,044.00
RSA/RSL	1.54	1.31	2.10	0.57	0.70
CGAP ratio (%)	14.58	17.39	26.39	21.96	12.03
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				311.11	170.44
% Change in NII				22.00	12.00

FY 2007/2008	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	92,453.00	11,136.00	3,056.00	17,122.00	50,723.00
RSL	57,374.00	16,072.00	9,968.00	13,097.00	58,918.00
GAP	35,079.00	(4,936.00)	(6,912.00)	4,025.00	(8,195.00)
CGAP	35,079.00	30,143.00	23,231.00	27,256.00	19,061.00
RSA/RSL	1.61	0.69	0.31	1.31	0.86
CGAP ratio (%)	20.10	17.27	13.31	15.62	10.92
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				272.56	190.61
% Change in NII				16.00	11.00

FY 2008/2009	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	103,464.00	25,399.00	49,950.00	72,304.00	56,645.00
RSL	63,951.00	25,774.00	69,358.00	51,862.00	77,902.00
GAP	39,513.00	(375.00)	(19,408.00)	20,442.00	(21,257.00)
CGAP	39,513.00	39,138.00	19,730.00	40,172.00	18,915.00
RSA/RSL	1.62	0.99	0.72	1.39	0.73
CGAP ratio (%)	12.84	12.72	6.41	13.05	6.15
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				401.72	189.15
% Change in NII				13.00	6.00

FY 2009/2010	(1-90)	(91-180)	(181-270)	(271-365)	>365
RSA	134,253.04	40,317.15	97,886.75	47,206.47	102,388.83
RSL	127,429.35	38,963.57	110,849.47	24,528.87	92,736.96
GAP	6,823.39	1,353.58	(12,962.72)	22,677.60	9,651.87
CGAP	6,823.69	8,177.27	(4,785.45)	17,892.15	27,544.02
RSA/RSL	1.05	1.03	0.88	1.92	1.10
CGAP ratio (%)	1.62	1.94	(1.13)	4.24	6.53
ΔR (%)				1.00	1.00
$\Delta NII = CGAP \times \Delta R$				178.92	275.44
% Change in NII				13.00	6.00

(Source: Annual Report of NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 23
NABIL BANK LIMITED
BALANCE SHEET
FROM FY 2005/06 TO FY 2009/10

Capital & Liabilities	FY 2005/2006	FY 2006/2007	FY 2007/2008	FY 2008/2009	FY 2009/2010
Share Capital	491,654,400	491,654,400	689,216,000	1,448,620,500	2,028,773,600
Reserves and Surplus	1,383,340,017	1,565,395,315	1,747,982,989	1,681,620,137	1,805,980,925
Debentures & Bonds	-	-	240,000,000	300,000,000	300,000,000
Borrowings	173,201,710	882,572,500	1,360,000,000	1,681,305,000	74,900,000
Deposit	19,347,399,440	23,342,285,327	31,915,047,467	37,348,255,840	46,410,700,628
Bills Payable	112,606,736	83,514,820	238,421,890	463,138,615	425,443,908
Proposed Dividend	435,084,062	509,417,925	437,373,004	338,011,450	434,737,200
Income Tax Liabilities	34,604,855		38,776,869	80,232,454	24,904,405
Other Liabilities	352,079,858	378,552,721	465,940,930	526,213,508	2,028,773,600
Total	22,329,971,078	27,253,393,008	37,132,759,149	43,867,397,504	52,150,237,343
Cash Balance	237,818,512	270,406,987	511,426,584	674,395,434	635,986,600
Balance with Nepal Rastra Bank	318,358,771	1,113,415,436	1,829,470,769	2,648,596,348	549,454,618
Balance with Banks/Financial Institutions	74,061,305	16,003,428	330,243,702	49,520,68	214,656,586
Money at Call and Short Notice	1,734,901,943	563,532,632	1,952,360,700	552,888,297	3,118,144,000
Investment	6,178,533,108	8,945,310,567	9,939,771,428	10,826,379,001	13,670,916,613
Loans, Advances and Bills Purchased	12,922,543,153	15,545,778,730	21,365,053,318	27,589,933,041	32,268,873,283
Fixed Assets	319,086,147	286,895,224	598,038,998	660,988,986	779,539,760
Non Banking Assets	-	-	-	-	-
Other Assets	544,668,139	512,050,004	606,393,650	864,695,708	912,665,884
Total	22,329,971,078	27,253,393,008	37,132,759,149	43,867,397,504	52,150,237,343

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 24
NABIL BANK LIMITED
PROFIT & LOSS STATEMENT
FROM FY 2005/06 TO FY 2009/10

Particulars	FY 2005/2006	FY 2006/2007	FY 2007/2008	FY 2008/2009	FY 2009/2010
Interest Income	1,309,998,500	1,587,758,714	1,978,696,727	2,798,486,196	4,047,725,656
Interest Expense	357,161,304	555,710,109	758,436,212	1,153,280,052	1,960,107,90
Net Interest Income	952,837,196	1,032,048,605	1,220,260,515	1,645,206,144	2,087,617,754
Commission and Discount	138,293,913	150,608,550	159,319,857	179,693,027	215,481,543
Other Operating Income	82,897,862	87,574,553	94,359,475	144,164,143	169,548,006
Exchange Income	185,483,662	209,926,167	196,487,415	251,919,712	291,440,756
Total Operating Income	1,359,512,633	1,480,157,875	1,670,427,262	2,220,983,026	2,764,088,060
Staff Expense	219,780,853	240,161,275	262,907,576	339,897,913	366,940,054
Other Operating Expense	182,696,413	188,183,330	220,750,570	265,158,033	334,186,212
Exchange Loss	-	-	-	-	-
Operating Profit before Provision for Possible Losses	957,035,367	1,051,813,270	1,186,769,116	1,615,927,080	2,062,961,794
Provision for Possible Losses	3,769,541	14,206,365	64,055,186	45,722,434	355,829,115
Operating Profit	953,265,826	1,037,606,905	1,122,713,930	1,570,204,646	1,707,132,679
Non Operating Income /(Expense)	735,324	5,280,641	24,083,737	2,190,102	6,454,724
Provision for Possible Losses Write Back	7,729,444	10,926,317	11,100,529	10,617,867	39,791,809
Profit from Regular Activities	961,730,594	1,053,813,863	1,157,898,196	1,583,012,615	1,753,379,212
Income/(Expense) from Extra-ordinary	26,073,578	40,736,694	39,990,808	43,521,866	34,321,843
Profit from All Activities	987,804,172	1,094,550,557	1,197,889,004	1,626,534,481	1,787,701,056
Provision for Staff Bonus	89,800,379	99,504,596	108,899,000	147,866,771	162,518,278
Provision for Income Tax	262,741,444	321,086,263	342,521,610	447,614,612	486,083,379
Current Tax	262,562,561	314,526,570	340,625,244	470,701,921	472,823,385
Prior Period Tax	178,883	6,559,693	52,872	918,745	831,939
Deferred Tax			1,843,494	(24,006,054)	12,428,055
Net profit/loss	635,262,349	673,959,698	746,468,394	1,031,053,098	1,139,099,399

(Source; Annual Reports of NABIL Bank from FY 2005/06 to FY 2009/10)

ANNEX – 25

NEPAL SBI BANK LIMITED**BALANCE SHEET****FROM FY 2005/06 TO FY 2009/10**

Capital & Liabilities	FY 2005/2006	FY 2006/2007	FY 2007/2008	FY 2008/2009	FY 2009/2010
Share Capital	640,236,100	647,798,400	874,527,840	1,224,338,976	1,861,324,239
Reserves and Surplus	342,137,628	515,492,451	540,116,972	488,268,219	589,229,831
Debentures & Bonds	-	200,000,000	200,000,000	200,000,000	200,000,000
Borrowings	612,428,650	815,365,219	1,627,480,190	-	-
Deposit	11,002,040,633	11,445,286,030	13,715,394,960	27,957,220,794	34,896,424,201
Bills Payable	46,238,743	48,855,749	75,115,471	62,947,325	72,368,229
Proposed Dividend	35,469,706	91,024,235	12,228,852	18,411,112	83,080,145
Income Tax Liabilities	-	-	-	-	-
Other Liabilities	157,287,664	137,378,475	142,581,889	215,253,123	345,252,820
Total	13,035,839,124	13,901,200,559	17,187,446,174	30,166,439,549	38,047,679,465
Cash Balance	244,187,671	287,530,644	308,101,599	652,027,266	815,679,624
Balance with Nepal Rastra Bank	626,123,385	556,678,464	403,810,203	444,138,596	1,842,802,239
Balance with Banks/Financial Inst.	247,847,352	278,481,119	631,048,524	80,273,976	782,779,614
Money at Call and Short Notice	215,000,000	350,000,000	304,012,877	-	-
Investment	3,758,975,484	2,659,452,919	3,088,886,918	13,286,181,660	16,305,632,815
Loans, Advances and Bills Purchased	7,626,736,137	9,460,450,701	12,113,698,428	15,131,747,944	17,480,548,194
Fixed Assets	66,711,798	97,218,804	120,222,259	253,580,695	418,244,760
Non Banking Assets	24,555,992	3,847,024	-	-	-
Other Assets	225,701,305	207,540,884	217,665,366	318,489,412	401,992,219
Total	13,035,839,124	13,901,200,559	17,187,446,174	30,166,439,549	38,047,679,465

(Source; Annual Reports of NSBI Bank from FY 2005/06 to FY 2009/10)

ANNEX – 26
NEPAL SBI BANK LIMITED
PROFIT & LOSS STATEMENT
FROM FY 2005/06 TO FY 2009/10

Particulars	FY 2005/2006	FY 2006/2007	FY 2007/2008	FY 2008/2009	FY 2009/2010
Interest Income	708,718,614	831,116,781	970,512,681	2,798,486,196	4,047,725,656
Interest Expense	334,770,096	412,261,744	454,917,713	1,153,280,052	1,960,107,902
Net Interest Income	373,948,518	418,855,037	515,594,96	1,645,206,144	2,087,617,754
Commission and Discount	40,753,985	52,591,560	50,917,830	179,693,027	215,481,543
Other Operating Income	7,136,575	12,601,352	19,557,259	144,164,143	169,548,006
Exchange Income	43,060,315	49,463,539	51,989,275	251,919,712	291,440,756
Total Operating Income	464,899,393	533,511,488	638,059,332	2,220,983,026	2,764,088,060
Staff Expense	50,539,528	53,232,464	74,890,269	339,897,913	366,940,054
Other Operating Expense	99,214,082	120,111,581	152,379,842	265,158,033	334,186,212
Exchange Loss	-	-	-	-	-
Operating Profit before Provision for Possible Losses	315,145,783	360,167,443	410,789,221	1,615,927,080	2,062,961,794
Provision for Possible Losses	146,656,796	59,376,948	57,463,909	45,722,434	355,829,115
Operating Profit	168,488,987	300,790,495	353,325,312	1,570,204,646	1,707,132,679
Non Operating Income /(Expense)	(2,926,272)	(256,759)	(271,006)	2,190,102	6,454,724
Provision for Possible Losses Write Back	54,177,763	78,515,105	29,782,580	10,617,867	39,791,809
Profit from Regular Activities	219,740,478	379,048,841	382,836,886	1,583,012,615	1,753,379,212
Income/(Expense) from Extra-ordinary	-	-	-	43,521,866	34,321,843
Profit from All Activities	219,740,478	379,048,841	382,836,886	1,626,534,481	1,787,701,056
Provision for Staff Bonus	19,976,407	34,458,986	34,803,353	147,866,771	162,518,278
Provision for Income Tax	82,762,098	89,681,011	100,262,775	447,614,612	486,083,379
Current Tax	66,120,456	86,704,011	105,745,947	470,701,921	472,823,385
Prior Period Tax	16,641,642	2,977,000	870,463	918,745	831,939
Deferred Tax			(6,353,635)	(24,006,054)	12,428,055
Net profit/loss	117,001,973	254,908,844	247,770,758	1,031,053,098	1,139,099,399

(Source; Annual Reports of NSBI Bank from FY 2005/06 to FY 2009/10)