

CHAPTER I

INTRODUCTION

1.1 BACKGROUND

The financial institution is that organization which plays a vital role in collecting unused funds from the households and general public and transferring those funds to the needy sector such as business sector, industrial sector, agricultural sector and government bodies. It plays an intermediary role between savers of funds and users of the funds. It collects the funds in terms of deposits & provides low interest to depositors and lends those funds in terms of loans & charge high interest from borrowers. This is how the financial institution makes profit, by serving the public. Nowadays the financial institution has extended loans to invest in housing, education, hire purchase and other consumption loans.

Bank, a financial institution, plays a vital role in the economic development of the country. The function of bank is not only to accept deposit and grant loans, but also to include wide range of services to the different strata of society, to facilitate the growth of trade, commerce, industry and agriculture of the national economy. Bank is a resource for the economic development, which maintains the self-confidence of various segments and advances credit to the people. In the absence or insufficiency of banking and financial facilities, the growth of economic development becomes stagnant. According to the Concise Oxford Dictionary, the term bank is defined as '*an establishment of the custody of money which it pays out on customer's order*'.

Thus, bank is the financial institution that deals with the financial situation of the society. It accepts deposits and invests those deposits as loan for individuals, corporate, government and private organizations to earn profit as interest. So, bank works as a lively body of the country which helps in economic and social development of a country. The function of bank is not only limited to collect deposit and lend money but also to provide different services such as remittance, letter of credit, bank guarantee, etc. Bank has also developed credit money such as Visa card, Debit Card, Credit card, etc. to facilitate the general public. So, bank can be considered as the backbone of overall economic development of the country.

1.2 NEPALESE ECONOMY

Nepal, a newest republic country of south Asia, is sandwiched between two Asian giants China on north and India on rest sides with open borders. It isn't a monolithic like all mountain states, but an agricultural country with 80% population depending on agriculture for livelihood and contributing around 60% of GDP. It has a population around 28 million with growing rate of 2.66% and average literacy ratio of 55% where men and women comprise 65% and 35% respectively. Due to geographical and topographical structure, about 60% people have no access to physical facilities and about 40% people still live below absolute poverty line.

Improvements in global and regional economic growth signal positive results for our two neighboring countries China & India. However, our country Nepal suffers from problems that inhibit economy at optimal level due to imbalance between resource mobilization & expenditure, saving & investment and export & import. Endemic problems such as low per capita income (US \$ 568), trade deficit, low growth rate, unemployment & migration, continue to plague our country. The economy registered 4% growth p.a. which is hardly enough to make perceptible impact.

The economic development is a way out to remove all ills for steeping up low income, living standards and market for developments. And Nepal, for many years depends upon banking and financial sectors in thrust of capital market development. Desire of development can be succeeded by increasing investment through exploiting available resources with private sectors participation. The contributions of financial intermediaries such as Nepal Stock Exchange and NIDC Capital Market are meaningful in capital formation. If the capital market performs duties and responsibilities successfully by creating investment opportunities judiciously, intelligently and appropriately, it may be saved from any impending economic disaster in future. *“Advice of the world Bank and IMF cannot be a remedy if strong legal action and effective enforcement of disciplinary measures against defaulters and loan granting employees are not implemented. If not, losses of billions of rupees in doubtful assets will continue to pose question in raising loans. The NRB's directives to enhance loan management for speedy recovery through minimizing risk of investments and track willful defaulters to address growing recovery problem on loans already issued have rarely been followed. The end of willful defaulters in recovering loan is possible only if the government is genuinely committed. And, social segregation is a must for such defaulters. Such default loans are known to be in the range of more than 50 percent of the total investment of many SOEs.”*

1.3 STATEMENT OF THE PROBLEM

The world is suffering from recession and because of that, financial and industrial sector is suffering heavily. And it's not possible for country like Nepal to remain unaffected from global recession. Slowly Nepal is also feeling the heat of global recession as the remittance and real estate prices has decreased dramatically and unemployment has increased. And it's a difficult phase for Financial Institutions (FI) as it has to provide loans for the needy and at the same time make profits. The main objective of a Financial Institution is to increase its returns for its owners which often come, however, at the cost of various increased risk: Credit Risk, Liquidity Risk, Interest Rate Risk, Interest, Market Risk, Off-Balance Sheet Risk, Foreign Exchange Risk, Country Risk, Technology Risk, Operational Risk and Insolvency Risk. It is very difficult to call the FIs sound though they are earning profit since they may be exposed to aforesaid risks. Questions are being raised over the validity of their balance sheet and profit & loss account. Should the suspicion come true, it will prove very costly to the depositors, creditors and national economy as a whole. In view of this it is important that FIs manage these risks and have appropriate policies, processes, or practices in place that management follows and uses.

Normally, general public are interested to invest their small saving amount in common stocks, mainly stocks of financial institutions such as commercial banks and finance companies rather than in stocks of industrial sector. But the main problem is general public cannot perfectly analyze which financial institution to invest and which to stay away. The recent trend shows that investors are investing their entire funds in single equity rather than applying the concept of portfolio and investing in different equities of different sectors. Without proper information and guidance, investors are suffering from huge losses and bearing high risk. Therefore, this thesis tries to evaluate and compare the soundness of selected five commercial banks through the CAMEL Analysis. The author hopes that this thesis will somehow help the investors to know the financial soundness of these institutions and help to make investment decisions.

The elementary problem of this research is to scrutinize the financial condition of Selected banks in the framework of CAMEL and is an attempt to come back with the following research questions:

-) How selected banks are managing its Capital Adequacy? Is it in line with the regulated minimum capital requirement?
-) What is the level, trend of Asset Composition and Risk Weighted Assets of selected banks and what is the quality of bank's Loans and Loan provision mix?
-) How are selected banks managing their expenses with respect to their

revenues?

-) What control and monitoring mechanism are maintained in the bank?
-) What are the level, trend and stability of selected bank's earnings?
-) Are the liquidity positions of selected banks adequate in consideration of the current level and prospective sources of liquidity compared to funding needs?

1.4 OVERVIEW OF THE SELECTED FIVE BANKS

1.4.1 KUMARI BANK

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 750 million, of which 70 % is contributed from promoters and remaining from public.

Kumari Bank Ltd has been providing wide-range of modern banking services through 28 points of representations located in various urban and semi urban part of the country, 19 outside and 9 inside the valley. The bank is pioneer in providing some of the latest and lucrative banking services like E-Banking and SMS banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, utility bill payment services, inward and outward remittance services, and various other banking services.

Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 11 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers. The bank has been able to get recognition as an innovative and fast growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission.

The key focus of the bank is always center on serving unfulfilled needs of all classes of customers located in various parts of the country by offering modern

and competitive banking products and services in their door step. The bank always prioritizes the priorities of the valued customers.

1.4.2 SIDDHARTHA BANK

Siddhartha Bank Limited commenced its operation from 2058/09/17(2002) and was initiated by highly reputed Nepalese business executives to provide quality financial services to the public. Its services are not only restricted to Nepalese but also to international customers. It has been seven years since Siddhartha Bank Limited enter the banking sector and yet it has been able to establish its branches throughout the various district of nation within this short period. It has 30 branches across the country.

SBL wants to be a leader among the banks of its age in terms of profitability, productivity and innovation in Nepal by fulfilling the interest of the stakeholders. It also aims to provide total customer satisfaction by rendering efficient and diversified financial services through improved technology. It aims to build highly motivated and committed team of staff by nurturing a good work culture to achieve superior individual performance aiming to enhance organizational effectiveness. It directs all its efforts to move ahead with increased profits. It firmly believes customer focus is a core value, shareholder prosperity is a prime priority, employee growth is a commitment and economic welfare is a sincere concern.

1.4.3 MACHHAPUCHHRE BANK

Machhapuchhre bank boasts as the first commercial bank to be established in the western part of Nepal in Pokhara and commenced its operations as a regional bank from 2057/06/17(2000). The bank is catering its valuable services to its customers with utmost dedication and devotion to most part of the country with 39 branches. The credit goes to the bank for identifying huge business potential outside the valley.

Furthermore the bank is performing well according to its set goals and objectives. It has also opened a full-fledged banking branch in a remote place like Jomsom. The bank has introduced centralized banking software named Globus Banking Software by Temenos NV, Switzerland. The guiding philosophy of the bank is “we value your time”. The philosophy conspicuously states its dedication and desire of the bank to be a service provider to its customers. Since its initiation eight years back, the bank has been consistently improving its financial status responsibilities towards its shareholders.

The bank is mainly focusing its policy for selective and consumer lending. It is interested to minimize its dependency on corporate deposits and encourage small and individual deposits to increase saving deposits and diversify its deposit structure. The Royale saving scheme has played a tremendous role in attracting individual account holders and it's giving fruitful results to its beneficiaries. Apart from this, the bank is providing various kinds of loan like educational loan, foreign employment loan, personal loans, housing loan. Since the increment in foreign employment the bank is playing a crucial role in focusing on international remittances and trying to strengthen its international relations.

1.4.4 NEPAL INDUSTRIAL & COMMERCIAL BANK (NIC BANK)

Nepal Industrial & Commercial Bank (NIC Bank) commenced its operation on 21 July 1998 from Biratnagar with a vision to become one of the most respectable banks in Nepal based on honorable conduct and long-term financial performance. The Bank was promoted by some of the prominent business houses of the country. Within 10 years of commencing business, the Bank has grown rapidly with 26 branches throughout the country. All branches are inter-connected through V-Sat and are capable of providing real time on-line transactions.

The Bank is the first commercial Bank in Nepal to have received ISO 9001:2000 certification for quality management system. Furthermore, NIC Bank became the 1st Bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its Global Trade Finance Program, enabling the Bank's Letter of Credit and Guarantee to be accepted/confirmed by more than 200 banks worldwide. The Bank has also been awarded the "Bank of the Year 2007-Nepal" by the world-renowned financial publication of The Financial Times, U.K.-The Banker.

The Bank has a mission to become a leading bank in Nepal by providing complete financial solutions to their customers, superior value to their shareholders and promising growth opportunities to their employees. The Bank is committed towards providing financial services to its patrons by the means of efficient and cost effective service delivery through its Transaction Banking, Consumer Banking, Business Banking and Treasury divisions.

1.4.5 LAXMI BANK

Laxmi Bank was incorporated in April 2002 as a commercial bank with a mission to deliver quality banking and stakeholder satisfaction in the true meaning of the word. The current shareholding constitutes of promoters holding 55.42 percent, Citizen Investment Trust holding 9.02 percent and the general public holding

35.56 percent. The bank has grown rapidly with 22 branches throughout the country in a short span of time.

With a view to providing safe, seamless, quick and advance banking services, the bank has been heavily investing in contemporary banking technologies. The Bank uses Flexcube as its main banking platform. Flexcube incidentally has been ranked the number one selling core banking solution globally, and has been embraced by over 500 financial institutions across over 90 countries. The Bank provides its services through a host of delivery channels including cell phone, Internet, ATM, Point of Sales (PoS) etc., in addition to a network of physical branches. Similarly, through the bank's alliance with Smart Choice Technologies (SCT), the ATM/Debit cardholder of Laxmi Bank has access to a network of ATMs, and PoS terminals located in all major urban centers of the country.

The bank is the first in South Asia to have implemented SWIFTNet, the advanced version of the SWIFT technology, which is used for speedy and secure payment and messaging services. The bank has written and implemented a comprehensive anti-money laundering policy for use within the Bank and is committed to high standards of anti-money laundering compliance and requires its employees to adhere to these standards.

Today the bank is recognized as an innovative and progressive bank geared to providing shareholders and customers with quality earnings and value-added services. Transparency, good governance, and sound business growth are its driving forces.

1.5 OBJECTIVES OF STUDY

The main objective of the study is to analyze the individual and comparative financial positions of the selected banks. However, there are some major objectives which are as follows:-

1. To evaluate and compare the financial performances of the sample banks in CAMEL Rating.
2. To ascertain the financial position of the sample banks by using the CAMEL Rating System.
3. To make suggestions to the banks with recommendations and conclusions.

1.6 SIGNIFICANCE OF STUDY

Apart from aiming to gain knowledge, research itself adds new to the existing literature. The significance of this study lays mainly in identifying problem or deteriorating FI, as well as for categorizing institution with deficiencies in

particular component areas. The research is prepared in order to supplement present examination procedures applicable to FIs of Nepal. As such, the study assists the stakeholders in fulfilling their collective mission of maintaining stability and public confidence. This study will try to analyze the strength and weakness of the selected banks and also help to trace similarities and differences in their performance from their immediate competitors, as the selected banks are similar in structure, size, capital, services etc. Shareholders of the banks can also gain from this study as they would like to make an analysis of the financial position to know how safe their investments are. It would be helpful for the senior management involved in day-to-day operations. Bankers, and Examiners, alike can use this report to further their understanding of banks financial condition. As CAMEL has little been researched in the context of Nepal, the scholars will find it a literature for their future research works.

1.7 LIMITATIONS OF STUDY

This study is basically based on secondary data. The study is prepared to portray the accurate report of financial analysis of the commercial banks; however there exist some drawbacks as it ignores other commercial banks. Although the study aims to achieve the objective mentioned earlier, few limitations are faced during the survey, which are as follows: -

1. The research is conducted to fulfill the academic requirement of Master of Business degree.
2. The study is based on annual reports published by the concern banks for the period 2061/62 to 2065/66 and are treated as authentic.
3. The study is focused on the financial analysis in the framework of the five components of CAMEL system.
4. The study remains largely in the realms of Offsite Monitoring System.

1.8 PLAN OF WORK

The study is divided into five chapters as follows:

Chapter 1 Introduction

This chapter includes the introductory framework of the study which contains general background, statement of the problem, objectives of study, significance of study and limitations of study.

Chapter 2 Review of Literature

This chapter includes the review of previous research in this field, books, journal and unpublished thesis and independent research on related field.

Chapter 3 Research Methodology

This chapter includes the research method, research design, data collection procedure, tools for analysis (statistical tools and financial tools), methods of analysis and presentation.

Chapter 4 Data Presentation and Analysis

This chapter is concern with the application of defined research method on the collected data and information. The generated results after the application of research method on data will be analyzed and interpreted in this chapter.

Chapter 5 Summary, Conclusion and Recommendation

This chapter summarizes the whole thesis report, presents finding of all the analysis and tries providing recommendation on the basis of study. And at the end bibliography and appendices are also included.

CHAPTER II

REVIEW OF LITERATURE

2.1 LITERATURE REVIEW

Review of literature is basically a stock taking of available literature in the field of a research. It supports a researcher to explore relevant and true facts for reporting purposes. In course of research review, existing literature can help to check chances of duplication. Thus, one can find what studies have been conducted and what remains to go with.

This chapter depicts upon existing literature and research related to the present study for the purpose of finding out what had already been explained and how this research adds to required dimension. This study is about the comparative financial performance analysis of commercial banks. So the theoretical aspect of the topic on financial performance analysis is reviewed in this chapter of review of literature.

2.2 HISTORY OF BANKS

The word 'bank' originated from Latin, Italian and French word 'bancus' , 'banca' and 'banque' respectively, all meaning 'bench'. At ancient times there used to be some moneylenders who sat in the bench for keeping, lending and exchanging of money in the market place. The origin of bank can be traced back to the early times of human history. It is believed that during 2000 BC, people had developed a system of banking in Babylonia. Furthermore, the activities of money changers in a temple of Jerusalem in New Testament proved that there was some form of banking in early periods. In ancient Greece, famous temples of Delphi and Olympia served as depositories for peoples' surplus funds and were center of money lending transactions. The traces of 'rudimentary banking' were found in Chaldean, Egyptian and Phoenician history. The Roman Empire had a highly developed banking system and its bankers accepted deposits of money, made loans and purchased mortgages. However, the development in ancient Rome roughly followed Greek pattern and suffered oblivion after fall of Roman Empire, Emperor Justinian in 565 AD. During those times, some rich people used to practice storing precious metals and coins at safe places and loaning out money for public and private purposes on interest.

According to Crowther, modern banking has three ancestors—merchants, goldsmiths and moneylenders.

The merchants or traders are entitled as the ancestors of the bank. As trading require remittance of money from one place to another, thieves were widespread and merchants were looted. So, traders those days began to issue documents which were taken as title of money. This gave rise to hundi which is the letter of transfer of money. It included the direction from one banker to another to pay the bearer of hundi, a specified amount of money and debit the amount against the drawer. Thus merchant bankers form the earliest stage in the evolution of modern banking.

The goldsmiths dealt with precious metals. In the period when money consisted of gold and silver, people largely started leaving their precious money in custody of goldsmiths because of danger of theft. As the practice of safeguarding others' money became widespread, goldsmiths became in charge for the safekeeping service. Performing the safekeeping duty, goldsmiths issued the receipt for deposits to the customer. Later such receipt for deposits with the goldsmiths began to be used as a means of payment. Then people started keeping gold, silver and coins with goldsmiths in exchange for receipts, which is called goldsmith note. It is the writer claims against the deposits. These receipts became a good medium of exchange and a means of payment.

The next step in the development of banking arose when the goldsmiths became the moneylender. This development was based on the goldsmiths' discovery that it was not necessary to hold hundred percent of the coins deposited with them. The goldsmiths soon realized that on average daily withdrawals were equal to daily deposits and only a contingency reserve was required for the period when withdrawals exceeded deposits. After keeping the contingency reserve, the goldsmiths loaned out the remaining deposits on interest. In this way, the system of fractional reserve banking was born. Thus, goldsmith became a banker. They started to perform the two major functions of a bank—receiving deposits and advancing loans.

During the above discussed period, private individuals did the banking business. As public enterprise, banking made its appearance in Italy in 1157 AD when the 'Bank of Venice' was established. It was not until revival of trade and commerce in middle age, lessons of finance were learnt anew from beginning. The money lending in middle ages was largely confined to Jews since Christians were forbidden by Canon Law to indulge in sinful act of lending money on interest. As hold of church loosened about 13th century, Christians took lucrative business of money lending, thereby entering into keen competition with Jews who hitherto monopolized the business. History shows the existence of the 'Monte', meaning as a standing bank according to Italian dictionary, in Florence in 1336 AD. As early

1349 AD, the banking business was carried on by the shopkeeper of Barcelona. Meanwhile, the local government restricted the shopkeepers to operate this business under insufficiency of security. During 1401 AD, a public bank 'Bank of Barcelona' was established in Barcelona, followed by 'Bank of Genoa' in 1407 AD in order to exchange money, receive deposits and discount bills of exchange. The 'Bank of Venice' and 'Bank of Genoa' continued to operate until the end of 18th century.

With expansion of commercial and financial activities in Northern Europe, number of private banking and corporate houses sprang up all over the Europe and slowly spread throughout the world. Lombards migrated to England and other parts of Europe from Italy and are regarded for their role in the expansion of modern banking. The bank of Amsterdam was established in 1609 AD to meet the needs of the merchants of the city. It accepted all kinds of precious metals, coins and currencies on deposits. These deposits could be withdrawn on demand and the facility of transferring the deposits from one account to another was available for the first time. The bank also provided the certificate of the deposits to withdraw within six months. Later this came to be used in the same manner as the modern check.

The beginning of the English banking may correctly be attributed to the London Goldsmiths of the 16th century. These men made loans and held valuables for safekeeping. By the 17th century English goldsmiths created the model for today's modern fractional reserve banking i.e. the practice of keeping a fraction of depositors' money in reserve while extending the remainder to borrowers in the form of loans. Customers deposited gold and silver with the goldsmiths for safekeeping and were given deposit receipts verifying their ownership of the gold. But the goldsmiths soon discovered that they could take a chance and issue additional receipts against the other people who needed to borrow money. This worked as long as the original depositors did not withdraw all their gold at one time. Hence, the amount of receipts or claims on the gold frequently exceeded the actual amount of the gold, and the idea the bankers could create money arose. They marked a turning point in the history of English banking. This led the growth of private banking and the establishment of the 'Bank of England' in 1694 AD as a real joint stock bank and later it became the first Central Bank of the World in 1844 AD. The growth of banks accelerated only after the introduction of Banking Act in England in 1833 AD which allowed opening joint stock company banks. These banks gradually replaced goldsmiths and moneylenders (The History of Banks by Richard Hildreth).

In early India, the religious book namely 'Manu' contains references regarding deposits, pledges, policy of loan and the rate of interest. The banking service in those days largely meant only money lending. The complicated mechanism of

modern banking was not known to them. However, 'Bank of Hindustan' was established as the first bank in India in 1770 AD.

2.3 EVOLUTION OF BANKING IN NEPAL

The existence of financial sectors in the form of money lending can be traced to beginning of the civilization in 723 AD. In Nepalese chronicles there is mentioned that towards the end of 8th century, King Gunakam Dev borrowed money from public to rebuild Kathmandu valley. And Shakhadhar, a Sudra merchant of Kantipur paid all outstanding debts of public in 879 AD and started a new era known as 'Nepal Sambat'. This indicates the basis of money lending practices in those days. During the Malla regime in 11th century, there were professional moneylenders and bankers. Towards the end of 14th century, King Jayasthiti Malla, ruler of Kantipur, classified people in 64 classes according to their occupations and among them 'Tankadhari', money dealers particularly for financing foreign trade with Tibet became quite popular.

In the absence of regulatory measures, unscrupulous moneylenders used to charge exorbitant interest rates and extra dues on loans advanced. They faced inconveniences when PM Ronoddip Singh (1877-1885 B.S.) established 'Tijarath' for simple banking transaction in 1876 B.S. within Kathmandu, which was government owned financial institution supplying credit to people at 5% interest rate against security of gold, silver and ornaments. The government employees were entitled to take loans from the 'Tijarath' by repaying from their salary at source. During the time of PM Chandra Shamsher JBR (1901-1929 B.S.), credit facilities of the 'Tijarath' were extended to other parts of the country by opening branches. But so-called well-to-do persons used to take loans from private moneylenders even at higher interest rates than those from the government institutions because they were not disclosing anything that likely to affect their prestige. Those professional moneylenders used to raise loans in their own names from the 'Tijarath' against securities which were in fact brought to them by their clients as security. Without any risks and resources, they exploited clients through middlemen.

To control such spurious interest rates and curb unfair practices, some legislative measures were taken. During the period of PM Juddha Shamsher JBR, the 'Tijarath' was replaced with Nepal Bank Limited (1994 B.S.), Nepal's first commercial bank under Nepal Bank Act. It had a great difficulty, and at the same times a huge responsibility of attracting people towards financial sectors from the net of pre-dominant moneylenders. It was a landmark in the modern banking for solving problems and difficulties that trade, commerce and finance had been facing. Though it was not in a position to cope all problems due to many limitations, the government had onus in stretching banking and financial services

to nook and corner. It performed some central banking activities as there was no central bank.

The country was changing fast with political changes of 2007 B.S. and more banking facilities were felt. The central bank, Nepal Rastra Bank was established in 2013 B.S., under NRB Act 2012 B.S. Its function were to overcome monetary and financial difficulties by circulating Nepalese currency all over the country, maintain economic interests of general public and oversee foreign exchange rates and reserves. 'Development Board' was formed for industrial growth and NIDC came into picture in 2016 B.S. which paved way to develop industrial investors. In 2022 B.S., second bank, Rastriya Banijya Bank was established with cent percent equity holding by the government. During 2024 B.S. Agriculture Development Bank was established. Almost 75% of bank was state-owned, 21% was owned by Nepal Rastra Bank and rest by private sector.

However, the decade of 2040s can be considered as the landmark in the modern banking history. It was only in this decade; government gave permission to foreign joint venture banks to be part of the Nepalese banking business. During this period, three foreign commercial banks opened branches in Nepal. The first was Nepal Arab Bank (currently NABIL Bank) established in 2041 B.S. It was co-owned by the Emirates Bank International Limited (Dubai), Nepalese government and general public. After that Nepal Indosuez Bank (currently Nepal Investment Bank) came in 2042 B.S. which was jointly owned by the credit Agricole Indosuez, Rastriya Banijya Bank, Rastriya Beema Sansthan and general public. Then Nepal Grindlays Bank (currently Standard Chartered Bank Nepal) was the third foreign joint venture to be established in Nepal which was co-owned by a British firm called Grindlays Bank at that time, local financial institutions and general public.

Although government had started the liberalization of financial sector during the decade of 40s but this process speeded up only in early 50s. In fact private sectors rushed into the banking and financial industry only after the restoration of democracy in 2047. Many commercial banks like Himalayan Bank, Everest Bank etc. were established during this decade. Since then there are twenty eight commercial banks in Nepal.

2.4 SERVICES OFFERED BY BANKS

The basic function of banks is to accept the deposits from unproductive sectors and channellize them in the productive sectors. By this, they earn profit as interest by advancing the fund as loan at the interest rate higher than its cost. In the mean time, banks generate capital for economic development of a country. Nowadays the services provided by bank have been expanded to many areas as of human

wants and development of technology. The commercial banks in Nepal provide the following banking services:

1. Accepting deposit

The primary function of bank is to accept deposits from savers. Deposits are the funds collected by bank from account holders for the security and transaction motives. It is the amount of money or a valuable item that is received into a bank as security against possible loss. Deposits are the foundation upon which bank thrive and grow. They are a unique item on a bank's balance sheet that distinguishes it from other types of business firms. The ability of a bank's management and staff to attract checking and saving accounts from business and customers is an important measure of the bank's acceptance by the public. Deposits provide most of the raw material for bank loans. It represents the ultimate source of bank profits and growth and generates cash reserves fund. Maintaining required cash reserve, the excess cash fund, a bank holds is lent to borrowers.

Utilization of the bank deposits indicates effectiveness of management. The management should be able to raise deposit fund in the lowest possible cost and use maximum portion of deposits safely into loan advancement to maximize profitability. It is really very hard for all banks to survive and make adequate profit. Bankers, who fail to stay on top of changes in their competitors' deposit pricing and marketing programs, stand to lose both customers and profits. Banks accept deposits from those who can save money, but cannot utilize them in profitable sectors. People consider it more rational to deposit their savings in a bank because they avoid the danger of theft and can earn interest. To attract savings from all sorts of customers, the banks provide following types of account facilities:

a. Current Account

Businessmen open the current accounts, who have to make a number of payment everyday. Money from these accounts can be withdrawn as many times as desired by the depositors without any limits. Generally, no interest is paid on this account and its purpose is the safe custody of deposits and unlimited drawing facility to the account holders. The depositors may have to pay certain incidental charges such as interest on bank overdraft, remittance charge, guarantee charge etc.

b. Fixed Account

Banks accept fixed or time deposits from savers who do not need money for a stipulated period from a month to longer periods ranging up to 5 years or more. The money deposited into fixed account cannot be withdrawn before the expiry of that period. So the rate of interest on this account is higher than that on other types of accounts. The longer the period, the higher will be the rate of interest.

c. Saving Account

Banks have provided saving account facility especially for general public, who have some saving out of their income and expenditure. The main

objective of this account is to encourage and mobilize small savings of the public. Certain restrictions are imposed on the account holders regarding the number of withdrawals and the amount to be withdrawn in a given period. Cheque facility is provided to the depositors but rate of interest paid on this account is low as compared to that on fixed account.

d. Home Saving Account

Account holders are provided the facility to deposit their saving in their own homes in this account. For this purpose, safe boxes locked by banker are supplied to all account holders to keep them at homes and to put their small savings in them. Periodically, the boxes are taken to the bank where the amount of safe box is taken out and credited to their accounts. This account is appropriate for those, who have very small savings and hesitate to come to bank to deposit them. Especially, children and housewives are targeted under this account. This account promotes saving habits among the people providing them home deposit facility. Banks provide some interest as well as safe custody on this deposit.

e. Recurring Deposit Account

Account holders have to pay in the installment deposit regularly in recurring deposit account. Generally, money in these accounts is deposited in monthly installments for a fixed period and is repaid to the depositor along with interest on maturity. The rate of interest on these deposits is nearly the same as on fixed deposits. The main purpose of this account is to encourage regular savings of general public. People, who have fixed income, are target to make saving habit by this account.

2. Advancing of Loans

One of the primary functions of a commercial bank is to advance loans to its customers. After keeping certain cash reserves, banks provide short, medium and long term loans to needy borrowers against securities. Loans for individuals are provided on the mortgage of gold, silver, fixed deposit, receipts, Treasury bills; Development bonds etc. whereas business loans are advanced on the mortgage of negotiable instruments such as land, building, godown etc. Nowadays, because of sharp competitions, banks sometime provide loans without mortgage on the basis of goodwill and relationship with the party. If the loan proposal is good and the probability of success of proposed business is very high, then the bank may sometimes advance loans for such business without any security. In this case, the bankers assume the loan proposal itself as the security of loan. According to the needs of the borrowers, banks provide different types of loan for different time periods as given below:

a. Term Loans

Banks advance loans of different terms or period as required to customers on the basis of loan proposal. The maturity period of such loans is more

than one year and the interest is charged on the entire amount of the loan and the loan is repaid either on maturity or on installments.

b. Cash Credit

Banks advance loan as cash credit to businessmen against certain specified securities. The amount of the loan is credited to the current account of the borrower or a loan account for the sum is opened in case of a new customer. The borrower can withdraw money through cheques according to his/her requirement. Interest is charged only on the amount actually withdrawn from the account.

c. Overdraft

Generally, businessmen and organizations open current account in bank and deposit all receipts in the account and pay all dues through cheques. Banks allow the borrower to overdraw his/her current account up to a sum equal to the loan sanctioned. The account holders have to go in a special contract with bank to get such facility.

d. Money at Call

These are very short term loans, not more than fifteen days, advanced to the bill brokers. They are advanced against first class bills or securities and can be recalled at a very short notice. Such loans are useful especially for other financial institutions and traders.

e. Hire Purchase Loan

These are the long term loans provided by the banks to its customers for the purchase and are repayable generally on monthly basis on equal installments.

3. Discounting of Bill of Exchange

Bill of exchange is a negotiable instrument, which is accepted by the debtor, drawn upon him/her by the creditor (drawer) and agrees to pay the amount mentioned on maturity. Discounting bill of exchange is another important function of modern banks. Banks purchase bill of exchange from holder in discount after making some marginal deduction in the form of commission. The banks pay the deducted value to the holders when traders discount it into bank. The percentage of discount is determined by mutual agreement between bank and trader, which is affected by duration of expiry and goodwill of drawer of bill of exchange.

4. Remittance

It is a system through which cash fund is transferred from one place to another. Banks provide the facilities of remittance to the customers and earn some service charge. Generally, a bank provides such facility through cheque, bank drafts, letter of credit (LC) etc. Remittance plays an important role in the modern national as well as international trade and has benefited both the business and personal customers.

5. Exchange Foreign Currencies

Banks deal with foreign currencies. As the requirement of customers, banks exchange foreign currencies with local currencies, which is essential to settle down the dues in the international trade.

6. Consultancy

Banks are large organizations which provide consultancy service to its customers. Banks hire financial, legal and market experts, who provide advices to customers in regarding investment, industry, trade, income, tax etc.

7. Bank Guarantee

Customers are provided the facility of bank guarantee by modern commercial banks. When customers have to deposit certain fund in government offices or courts for specific purpose such as legal case, bank can present itself as the guarantee for the customer, instead of depositing fund by customer. Bank provides such facility only, when the customers have sufficient fund in their account.

8. Agency Functions

Modern banks perform different type of functions on the behalf of customers such as:

a. Periodic Payment and Collection

Banks can execute the standing order or instruction of customers for making periodic payment on behalf of their customers. Under this function, banks pay subscription, income tax, rents, bills, insurance premium etc. for their respective customers and earn appropriate service charge. Similarly banks can collect incomes of customers such as dividends of share, interest on debenture and fixed deposit etc.

b. Purchase and Sales of Securities

On behalf of customers, banks undertake purchase and sales of various securities like share, stocks, bonds, debentures etc. Banks do not interfere in the decision and process of their customers regarding these investments. They simply perform the function of a broker only to purchase and sell the securities.

c. Representative

Banks can act as representatives of their customers. They can proceed for passports, traveler's tickets, book, vehicles, plots of lands etc. for their customers. In connection to getting such things for customers, they can exchange correspondence to concerned parties.

d. Trustee or Executor

When customers want to transfer their property to specific persons after demise, they can make a legal document about them and handover it to the bank as trustee or executor. Banks preserve such documents of customer's will and execute their will after their demise.

9. Others

Except above services, modern banks provide many general utility services such as locker system, traveler's cheque, credit card, underwriting securities, collection of data, and individual information of customers and so on.

(Banking and Insurance, 2007, Hriday Bir Singh)

2.5 BANK SUPERVISION

Tuning with the present scenario of globalization and increased economical activities in the country, commercial banks are now introducing complex and innovative banking products. In the mean time, the probability of loss becomes significant to banks, which are running behind in the competition. In case of insolvency, the public depositors as well as the shareholders of the bank may suffer significantly which adversely affect the overall banking sector. The supervision of banks is essential to find out the solvency position and take corrective action in time when needed. Besides, commercial banks are exposed to many risks such as:

-) **Credit Risk** arises from a potential borrower failing to perform on an obligation.
-) **Market Risk** is the risk to a bank's condition resulting from adverse movements in market interest rates or prices.
-) **Liquidity Risk** is the potential that an institution will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding.
-) **Operational Risk** arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or unforeseen catastrophes will result in unexpected losses.
-) **Legal Risk** arises from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations or condition of a banking organization.
-) **Reputational Risk** is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation or revenue reductions.

An implicit framework for the regulation and supervision of banks can be found in the *Core Principles for Effective Banking Supervision* issued by the Basel Committee on Banking Supervision in 1997. The framework can be interpreted as comprising four distinct yet complementary sets of arrangements:

-) **Legal and institutional arrangements** for the formulation and implementation of public policy with respect to the financial sector, and the banking system in particular;
-) **Regulatory arrangements** regarding the formulation of laws, policies, prescriptions, guidelines or directives applicable to banking institutions

- (e.g. entry requirements, capital requirements, accounting and disclosure provisions, risk management guidelines);
-) **Supervisory arrangements** with respect to the implementation of the banking regulations and the monitoring and policing of their application;
 -) **Safety net arrangements** providing a framework for the handling of liquidity and solvency difficulties that can affect individual banking institutions or the banking system as a whole and for the sharing of financial losses that can occur (e.g. deposit insurance schemes or winding-up procedures).

2.6 OBJECTIVE OF BANK SUPERVISION

The overall objective of supervision process is to guarantee that banks can be established, operated and restructured in a safe, transparent and efficient manner. Over the last few years supervisors have adopted new approaches and developed new systems for ongoing banking supervision in order to be better equipped to face the many challenges presented by financial innovation and globalization. These new systems seek to assess and track changes in a bank's financial condition and risk profile and to generate timely warning for the supervisor to help initiate warranted action. G10 countries have developed recently supervisory risk assessment and early warning systems and are currently in use or being developed. Many supervisors implemented one or more systems for risk assessment and early warning during the 1990s. While some of the systems are able to provide *ex post* indication of existing problems, other systems try to generate *ex ante* warnings of potential problems that may emerge or develop in the future on account of the current risk profile of the banking institution. Overall, supervisory risk assessment and early warning systems assist in:

-) Systematic assessment of banking institutions within a formalized framework both at the time of on-site examination and in between examinations through off-site monitoring;
-) Identification of institutions and areas within institutions where problems exist or are likely to emerge;
-) Prioritization of bank examinations for optimal allocation of supervisory resources and pre-examination planning; and
-) Initiation of warranted and timely action by the supervisor.

2.7 PROCESS OF BANK SUPERVISION

There are basically three types of supervisory system. They are:

1. Off-site Supervision

Off- site monitoring is the minimum tool for ongoing supervision. Supervisory authorities, which do not have the mandate or resources to carry out periodic

on-site examinations, rely extensively on this method to monitor the financial condition and performance of banks and to identify those institutions that may need closer scrutiny. The process involves analyzing and reviewing periodic financial and other information received by the supervisor relating to banks' activities. Supervisors typically subject regulated banks to reporting requirements covering, for instance, balance sheet and profit and loss statements, business profile, loans, investments, liabilities, capital and liquidity levels, loan loss provisions, etc. This helps the central bank to judge whether they have accomplished the legal requirements and the instruction regarding the following issues:

- a. Capital adequacy
- b. Cash reserve ratio
- c. Priority sector loan
- d. Deprived sector loan
- e. Classification of loan and provision
- f. Profitability

2. On-site Supervision

During On-Site examinations, supervisors make an overall assessment of a banking institution on the premises of the organization. Examinations by specialized and trained bank examiners allow a more hands-on assessment of qualitative factors such as management capabilities and internal control procedures that may not be reflected adequately in regulatory reports. Supervisors check various files and examine whether they are recorded and maintained as per rules and regulations. Especially, the documents about loan accounts, expenses, letter of credit, bank guarantee, and remittance are checked properly. Supervisory authorities may also commission outside organizations such as external auditors to undertake a full on-site examination or to review specific areas of operations within a banking institution. For conformity, supervisors can randomly verify the physical balance of cash and other assets with records.

3. Special Supervision

Special supervision is conducted only for special purpose. It is not conducted regularly. Depending upon the nature of crisis and objective, the process and method of special supervision may vary from one case to another. Mostly, special supervision is conducted only in the following circumstances:

- a. When a bank suffers a great loss or economic crisis,
- b. When government or central bank feels that a bank is indulged in major fraud,
- c. When majority of shareholders request the central bank for the special supervision,
- d. When a bank is decided to go into liquidation.

In the course of supervision, when supervisors find minor mistakes, they provide suggestion and guidelines for correction. They prepare report containing all the findings after conducting each supervision. If a bank is found violating or neglecting the rules and regulations, then they recommend central bank to take necessary actions from a simple warning to tuff penalty like snatching license, penalty charge etc. (Banking and Insurance, 2007, Hriday Bir Singh)

2.8 CAMEL 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. CAMEL was originally developed by the FDIC for the purpose of determining when to schedule an on-site examination of a bank (Thomson, 1991; Whalen and Thomson, 1988). This system was designed by regulatory authorities to quantify the performance and the financial condition of the banks which it regulates.

The CAMEL 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 to be reasonably compared and evaluated. Ratings are assigned for each component in addition to the overall rating of a bank's financial condition. The ratings are assigned on a scale from 1 to 5. The CAMEL ratings are commonly viewed as summary measures of the private supervisory information gathered by examiners regarding banks' overall financial conditions, although they also reflect available public information.

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

In Nepal, the NRB plays the supervisory role for evaluating bank's financial condition though; rating the bank's in accordance to CAMEL is still in its initial phase. There is no institution here that provides ratings on the safety and soundness of banks and thrift institutions to the public. However in the international level, there are private companies that provide their own ratings of these institutions. They have their own rating principles which are as follows:-

PRIMARY RATING PRINCIPLES:

1. Quantitative as well as qualitative assessments of banking operations incorporating management meetings and discussions with the rated institution.
2. Industry peer comparison.
3. Long-term focus through industry cycles.
4. Rating profile determined by both current and stressed conditions.
5. Consideration of impacts of affiliates and parent companies within the group.

KEY RATING CONSIDERATION

1. Long-term core earnings capability:
 -) Historical earnings from core operations.
 -) Development of additional viable business lines for future earnings generation.
2. Business profile:
 -) Franchise strength (brand recognition, defensible market leadership, niche stronghold, long-term client base).
 -) Competitive dynamics within pertinent markets.
 -) Profitability, stability and growth potential of primary lines of business.
 -) Diversified mix of assets and revenue sources (interest vs. fee income).
3. Balance sheet strength:
 -) Liquidity profile (adequacy of funding to support existing business, future growth as well as diversification of short-term & long-term sources of funding).
 -) Core capitalization (quality, adequacy in providing protection and capital requirements for existing business/future growth).
 -) Capital structure and financial flexibility (degree of leverage and short-term & long-term access to various sources of financing).
 -) Asset quality (reviewed against de facto measures of credit loss statistics, risk concentration, as well as on credit risk management and administration).
4. Risk management:
 -) Measurement and management of risk factors: interest rate, market, liquidity, currency, operational and other risks.
 -) Organization and control systems.
 -) Integrity of data and modeling techniques.
 -) Back-end validation testing.

5. Other factors:
-) Regulatory structure.
 -) Management and corporate governance.
 -) Parent company and affiliated operations.

2.9 COMPOSITE RATINGS

The FFIEC press release, USA (1996) describes the composite rating and defines the five components ratings. According to the press release, Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The five key components used to assess an institution's financial condition and operations are: capital adequacy, asset quality, management capability, earnings quantity and quality and the adequacy of liquidity. The rating scale ranges from 1 to 5, with a rating of 1 indicating: the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile; and the level of least supervisory concern. A 5 rating indicates: the most critically deficient level of performance; inadequate risk management practices relative to the institution's size, complexity, and risk profile; and the greatest supervisory concern. The composite ratings are defined in the FFIEC press releases (1996) are as follows:

Composite 1: FIs in this group are sound in every respect and generally have components rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. These FIs are the most capable of withstanding the vagaries of business conditions and are resistant to outside influences such as economic instability in their trade area. These FIs are in substantial compliance with laws and regulations. As a result, these FIs exhibit the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile, and give no cause for supervisory concern.

Composite 2: FIs in this group are fundamentally sound. For a FI to receive this rating, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These FIs are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile.

Composite 3: FIs in this group exhibit some degree of supervisory concern in one or more of the component areas. These FIs exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. FIs in this group generally are more vulnerable to outside influences than

those institutions rated a composite 1 or 2. Additionally, these FIs may be in significant noncompliance with laws and regulations.

Composite 4: FIs in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. FIs in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institutions in this group pose a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved.

Composite 5: FIs in this group exhibit extremely unsafe and unsound practices or conditions; exhibit a critically deficient performance; often contain inadequate risk management practices relative to the institution's size, complexity, and risk profile; and are of the greatest supervisory concern. The volume and severity of problems are beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in order for the FI to be viable. Ongoing supervisory attention is necessary. Institutions in this group pose a significant risk to the deposit insurance fund and failure is highly probable.

2.10 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 Standards" 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 are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially non-compliant assessment is given when the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance, but

substantial progress has been made. A non-compliant" assessment is given when no substantial progress towards compliance has been achieved. There is no doubt that the new accord though complex carries a lot of virtues and will be a milestone in improving banks internal mechanism and supervisory process and beneficial to the commercial banks.

2.11 COMPONENTS OF CAMEL

2.11.1 CAPITAL ADEQUACY

Capital is necessary for bank to operate. Bank capital performs several important functions such as:

Absorbs Losses: Capital allows banks to continue operation during periods of operating losses or other adverse financial results are experienced.

Promotes Public Confidence: Capital provides a measure of assurance to the public that banks will continue to provide financial services even when losses have been incurred, thereby helping to maintain confidence in the banking system and minimize liquidity concerns.

Restricts Excessive Asset Growth: Capital, along with minimum capital ratio standards, restrains unjustified asset expansion by requiring that asset growth be funded by a commensurate amount of additional capital.

Provides Protection to Depositors: Placing owners at significant risk of loss, should the institution fail, helps to minimize the potential moral hazard and promotes safe and sound banking practices.

While many areas of a bank are important and subject to scrutiny, capital adequacy is the area that triggers the most regulatory action. Capital Adequacy is a measure of bank's financial strength, in particular its ability to cushion operational and abnormal losses. A bank should have adequate capital to support its risk assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to asset structure than to the volume of liabilities. This is exemplified by central banks' efforts internationally to unify the capital requirements of commercial banks and to generate worldwide classification formulae such as the one proposed here. This indicator requires that assets be classified by reference to their demands on the equity (or capital) structure of the bank. 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 bank 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

The FDIC Improvement Act of 1991, which created a link known as Prompt Corrective Action (PCA) between enforcement actions and the level of capital held by a bank. This supervisory link resolves banking problems early and at least cost to the bank insurance fund. PCA has classified the banks as:

I. **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.

II. **Adequately Capitalized:** To be considered 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.

III. **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.

IV. **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.

2.11.1.1 Rating 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.

2.11.1.2 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. 2000 million by mid July, 2009 through minimum 10 percent paid-up capital increment every year.

According to NRB directives, commercial banks should maintain their CAR more than 11%, core capital 5.5% and supplementary capital 5.5%, which is created to protect the interest of the depositors. In the event of non-fulfillment of CAR in any quarter, the banks should fulfill the shortfall amount within next six months. If any bank does not fulfill the minimum CAR within the specified period, NRB may initiate any of the following actions:-

-) Restriction on acceptance of new deposits.
-) Suspension of opening new branch.
-) Suspension of access to refinancing facilities of Nepal Rastra Bank.
-) Restriction on lending activities of the licensed institution.
-) Any actions may also be initiated under section 100 of Nepal Rastra Bank Act-2058.

2.11.2 ASSET QUALITY

Asset quality is one of the most critical areas in determining the overall condition of a bank and has direct impact on the financial performance of a bank. The quality of assets particularly, loan assets and investments, would depend largely on the risk management system of the institution. The value of loan assets would depend on the realizable value of the collateral while investment assets would depend on the market value. Commercial banks hold their assets in the form of liquid assets like cash and bank balance, short term investments, loans and advances etc. Banks lending policies and other regulation determines the quality of assets. 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.

2.11.2.1 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 unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit,
-) The diversification and quality of the loan and investment portfolios,
-) The extent of securities underwriting activities and exposure to counter parties in trading activities,
-) 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.

2.11.2.2 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.

2.11.2.3 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 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). NRB unified directives for Banks and Non-Bank FIs through directive number E. Pra.Ni.No 02/061/62 (Ashar 2062 BS) classifies NPL, 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 loanee. 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.

2.11.2.4 Factors causing NPAs

Dhungana (2006) in his column broadly categorized NPAs into internal and external factors for high level of NPA in Nepalese banking system. The following factors can 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.

- J 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.
- J 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.
- J Quite often the definition of the NPAs and accounting norms adopted by concerned agencies also amount to higher or lower magnitude of such assets. Each institution may have different norms to declare the assets whether it is not performing. The income cycle of the project and amount of loan involved, set the installments of loan repayment. The nature of project also determines the level of NPAs.
- J Slow down in economy, global as well as domestic particularly in industrial sector, contributed to adversely affect the bottom line of borrower units and their capacity to service the debt (Taori 1999). Recession debars the economic activities to run smoothly which affect the performance of FIs.

2.11.2.5 Implications 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 honour 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 (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.

2.11.2.6 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 non performing loan as Specific Loan Loss Provision.

Table 2.1
Prevailing directives as to Classification of loans

Classification of loans	Category	Duration Overdue	Loan Loss Provision
Performing Loan	Standard Pass/Good	Upto 1 to 3 months	1%
Non-Performing Loan	Sub-Standard	3 to 6 months	25%
	Doubtful	6 months to 1 year	50%
	Bad Loans	more than 1 years	100%

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 upto 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, Government 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 Banker"), are excluded from the restriction.

2.11.3 MANAGEMENT QUALITY

The performance of the other four CAMEL components will depend on the vision, capability, agility, professionalism, integrity, and competence of the financial institution's management. A sound management is crucial for the success of any institution; management quality is generally accorded greater weighting in the assessment of the overall CAMEL composite rating. The success of any institution depends on the competency of its management. In fact, the management not only makes suitable policy and the business plans, but also implements them for the short term and the long term interests, which helps achieve aimed objectives of bank and financial institutions. It is evaluated by checking the effectiveness of the board of directors, the management, manpower and the officials, operating expenditure, customer's relation with the officials and institution, management information system, organization and working method, internal control system, power concentration, monitoring, decision making process, policies. Therefore for efficient and effective management, the bank should have following other qualities:

2.11.3.1 QUALITIES OF GOOD MANAGEMENT

- Proper structure of the management
- Qualitative Human resources management

- Customer care department
- Use of modern Information technology
- Adequate management of loan and advances
- Fair Decision Making
- Proper Communication system
- Working Atmosphere and management

There is a universal phenomenon that good management can make and poor management can break an organization. Thus any organization, be it a bank, must be serious towards its management and hence hire professionals to increase the management efficiency and effectiveness to produce wonderful results for the organization.

2.11.3.2 STAFF MOTIVATION

Besides, the human resources are considered the most valued assets for any organization, who's effective and efficient contributions help in organizational growth. Efficiency can be enhanced through-

- © Self directed work team.
- © Job rotation.
- © Total quality management, procedures and processes.
- © Encouragement of innovative and creative behavior.
- © Extensive employee involvement and high level of skilled training.
- © Contingent pay based in performance.
- © Coaching and monitoring.
- © Significant amounts of information sharing.
- © Cross functional integration.
- © Comprehensive employee recruitment and selection procedure

The capability of the board of directors and management to identify, measure, monitors, and controls 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 audits 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.
-) The extent that the board of directors and management is affected by, or susceptible to, dominant influence or concentration of authority.
-) Reasonableness of compensation policies and avoidance of self-dealing.
-) Demonstrated willingness to serve the legitimate banking needs of the community.
-) The overall performance of the institution and its risk profile.

2.11.3.3 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.
-) **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. Meyer and Pifer (1970) state that 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. 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.

Barr and Siems (1993) provide the only direct measurement of management quality, using Data Envelopment Analysis (DEA) to quantify the quality of management. They concluded that the predictive performance of their failure prediction model improves markedly with the inclusion of the DEA efficiency variable. 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.

2.11.4 EARNING QUALITY

The quality and trend of earnings of an institution depend largely on how well the management manages the assets and liabilities of the institution. The financial institution must earn reasonable profit to support asset growth, build up adequate reserves and enhance shareholders' value. Good earnings performance would inspire the confidence of depositors, investors, creditors, and the public at large. An analysis of the earnings helps the management, shareholders and depositors to evaluate the performance of the bank, sustainability of earnings and to forecast growth of the bank. Therefore the following ratios have been analyzed to test earning capacity of the bank. 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,
-) The adequacy of provisions to maintain the ALLL and other valuation allowance accounts,
-) The earnings exposure to market risk such as interest rate, foreign exchange, Price risks.

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.

2.11.4.1 Evaluation 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:

-) Earning Per Share (EPS) Ratio
-) Return on Assets (ROA) Ratio
-) Return on Equity (ROE) Ratio

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. 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 a non-accrual basis for income statement purposes. If such

assets are not placed on a non-accrual status, earnings will be overstated. 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. 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.

2.11.4.2 Rating the Earnings Factor

-) **A rating of 1** indicates strong earnings and 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.
-) **A rating of 2** indicates satisfactory earnings 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.
-) **A rating of 3** is assigned when earnings may need improvement. 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.

2.11.5 LIQUIDITY

Liquidity means the capability of the bank to meet the demand on the customer's deposits. Liquidity is a sensitive factor for the banking sector. All the banks all

over the world invest a significant amount of total deposit on the government securities in their respective central banks to ascertain to meet the liquidity shortages in the banks in case of huge unanticipated withdrawals. Banks are highly encouraged to invest in the government securities because it is as good as liquid assets and there is no risk in government securities. Banks maintain liquidity in various forms like ready cash at its disposal, certain percentage at central bank (NRB) as a statutory requirement, makes placements in other banks and some percentage is utilized in investment on government securities.

Liquidity ratios are used to judge a bank's ability to meet short-term obligations. It is the comparison between short-term obligations and short-term resources available to meet such obligations. 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. 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 the availability of cash at the time needed at a reasonable cost. The capacity of banks to exchange cash for deposits is the liquidity. It is the assets of a bank in form of cash and near about cash that can be converted into cash immediately without losing the value of them.

The bank's capacity to meet immediate maturing liabilities is the liquidity of banks. A commercial bank needs a high degree of liquidity in its assets which refers to ease and certainty with which it can be turned into cash. A bank is considered to be liquid if it has ready access to immediately spendable funds at reasonable cost at the time these funds are needed. The liquidity position of banks is very important to maintain the public faith upon banks. Lack of adequate liquidity is often one of the first signs that a bank is in serious financial trouble. The troubled bank usually begins to lose deposits which erodes its supply of cash and forces the bank to dispose more liquid assets. Liquidity management is much more important than we may realize, because a bank can be closed if it cannot raise enough liquidity even though technically it may still be solvent. The enormous cash shortages experienced in recent years by banks in trouble make clear that liquidity needs cannot be ignored. For example, in America, the Federal Reserve forced the closure of (the \$10 billion) Southeast Bank of Miami because it

could not come up with enough liquidity to repay the loans it had received. 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.

2.11.5.1 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.

2.11.5.2 NRB Directives related to 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 the then 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, following arrangements have been put into force by NRB effective from 22 July 2002 (2059/04/06).

Table 2.2
Prevailing directives as to Cash Reserve Ratio Requirement

a)	Balance at NRB	1.	7% of Current & Savings deposit liabilities.
		2.	4.5% of Fixed deposit liabilities
b)	Cash at Vault	2% of Total deposit liabilities	

The compliance of liquidity maintenance, the NRB applies following procedures:

- a. The CRR maintained by the banks will be examined on the basis of average weekly balance of deposit liability immediately preceding 4th week. A week shall comprise from each Sunday through Saturday.
- b. CRR will not be calculated for the week which is fully off.
- c. Weekly statement of deposit balances to be submitted to NRB inspection and Supervision department within 15 days from the date of end of the week.
- d. Weekly average of Monday to Friday of Total Deposit, Cash in Vault

and NRB balance is calculated by dividing by 5.

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

- a. In the case of shortfall in maintenance of NRB balance but Cash at vault is exactly 2%.
- b. In case of shortfall in NRB balance but Cash at Vault is more than 2% then upto 1% excess cash of total deposit is added in the balance with NRB then on such shortfall account (after adding upto 1% excess)
- c. In case of shortfall in Cash in Vault as well as shortfall in NRB balance then on total shortfall amount. The applicable rate of penalty is as follows:

First time shortfall = Equivalent to bank rate/highest refinance rate

Second time shortfall = Equivalent to 2 times of bank rate

Third time shortfall and all subsequent shortfalls = Equivalent to 3 times of bank rate.

2.12 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.

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 (Sinkey 1975), Pantalone and Plan 1987, Barr and Siems 1993, and Barker and Holdsworth 1993). Barker and Holdsworth (1993) reported that, on average, capital and income slowly deteriorate while past-due loans and charge offs increase as failure approaches. On the other hand, Heyliger and 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 discriminant analysis, factor analysis, proportional hazard models, and logit analysis.

Pradhan (1980) conducted a study on investment policy of Nepal Bank Ltd. The objective to that study was to evaluate the lending policy and to find out the ways to encourage the bank lending. This study has covered only five fiscal years BS 2028/29 through BS 2033/34. He used Karl Pearson's coefficient of correlation, ratio analysis and percentage analysis. He concluded with the positive relationship between deposits and loans and advances. But the

same was not in a proportionate manner, greater increase in deposits led to little increase in the loans and advances. Increase in the interest rate was the main factor for the decrease in loan demand. The bank had investment only 3 percent of its total investment in the priority sector, which was lower than the percentage (7 percent) imposed by NRB.

Shrestha (1990) conducted a research work on portfolio behavior for commercial banks in Nepal. She has analyzed the debt to equity ratios of commercial banks in aggregate and Agriculture Development Bank from 1971 to 1990. She has found that the debt to equity ratio of minimum 8.30% in 1971 and the maximum of 1583.3% in 1974. Similarly the range of debt to equity ratios of ADBN is minimum of 21.44% in 1972 and maximum of 652.74% in 1990. On the basis of this finding, she concluded that the Nepalese commercial banks are highly leveraged and highly risky. Further, she argued that the capital adequacy ratio explains the strength of the capital base of commercial banks. Higher the capital adequacy ratio, higher is its internal sources. Lower the value of capital adequacy ratio with regard to the standard value shows that the bank's ability to attract deposit from the surplus units and inter-bank funds also be limited.

Bohara (1992) has done a study on financial performance of Nepal Arab Bank Ltd. (now NABIL) and Nepal Indosuez Bank Ltd.(now NIBL). The basic objectives of this study were to highlight on the functions and policies of joint ventures banks and to evaluate the comparative financial performance of NABIL and NIBL. The study has covered the five fiscal years 1986/87 through 1990/91. In this study financial tools along with statistical tools have been used. Different ratios- liquidity, activity, coverage, leverage, profitability and other indicators like earning per share, dividend per share, market value to book value ratio, have been used to evaluate the performance of NABIL and NIBL. In statistical tool the least square method has been employed. The researcher has, on the basis of different financial indicators, concluded that performance of NABIL is better than that of NIBL. The researcher further concluded that bank performance cannot be judged solely in term of profit as it may have earned profit by maintaining adequate liquidity and safety position. The researcher has recommended to NIBL to extend their banking facilities even in the rural areas by opening up branches besides the improvement in maintaining the adequate capital structure by increasing equity base.

Joshi (1993) conducted a study on commercial banks of Nepal with reference to financial analysis of Rastriya Banijya Bank. The objective of this

study was to provide conceptual framework of commercial banks, and to analyze and interpret these financial variables of Rastriya Banijya Bank (RBB) on qualitative and quantitative performance basis. The study was based on the financial data of FYs 2042 B.S. through 2046 B.S. Researcher has used various financial ratios like current liquidity, funded debt to total capitalization, and funded debt to equity in this study. The researcher had drawn the conclusion that performance of RBB was not satisfactory during the study period. Further, the researcher concluded that bank had not been managed in true professional approach but had managed in bureaucratic approach to sustain with political environment rather than commercial environment.

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

Thapa (2001) has conducted her study "A comparative Study on Investment Policy of Nepal Bangladesh Bank Ltd. and other joint ventures banks." The researcher's main objective of study was to evaluate the liquidity, assets management efficiency, profitability and risk position of NBBL in comparison Nabil and NGBL and to examine the fund mobilization and investment policy of NBBL through off-balance sheet and on-balance sheet activities in comparison to other two banks. Through research the researcher found that the liquidity position of NBBL is comparatively not better than of Nabil and NGBL. The liquidity ratios are moderately fluctuating which means the bank has not properly formulated stable policy. As per the study, NBBL is not in better position regarding its on-balance sheet as well as off-balance sheet activities in compare to Nabil and NGBL and it does not seem to follow any definite policy regarding the management of its assets. The researcher at the last suggested following a specific policy in investment and she further recommended to maintain the optimum level of relationship among deposit and loan and advances, outside assets and net profit and to maintain the adequate recovery rate.

Likewise, Deoja (2001) conducted study entitled "A Comparative Study of

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

Sharma (2005) in his paper on Capital Structure of Selected Commercial Banks of Nepal concludes with following key points:

- Paid up Capital of Nepalese Commercial Banks is increasing indicating banks maintain the capital standards set by NRB
- Total equity capital is growing as compared to total debt.
- The fluctuating interest coverage ratio of the Nepalese Commercial Banks indicates the earnings stream and interest expenses are inconsistent over the period of past five years. The debt servicing capacity of the Nepalese Banks is not highly satisfactory but it is sufficient to meet the interest expenses in all years and is continuously improving.
- The capital adequacy ratios of the banks are adequate against set norms of NRB indicating sound financial health and sufficient to meet on banking operation.
- The total capital fund and capital adequacy ratios are fluctuating which indicate fluctuating risk adjusted assets of the banks.
- Core Capital and supplementary capital ratios are in line with the NRB norms.

Baral (2005), using 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 2005). The paper examined the financial health of joint venture banks in the CAMEL framework for a period ranging from FY 2001 to FY 2004. 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 CAMELS component indicators of the joint venture banks are not much encouraging for managing the possible shocks.

Bhandari (2006) used descriptive analysis in his research work of evaluating financial performance of Himalayan Bank in the framework of CAMEL during

1999 to year 2004 A.D. The analysis revealed adequate Capital of the bank. The non-performing loans though are in decreasing trend is still a matter of concern. The bank is still with better ROE however it is in decreasing trend. The decreasing trend of net interest margin shows management slack monitoring over the bank's earning assets. The liquid funds to total deposit ratio is above the industrial average ratio. NRB balance and cash in vault to total deposit ratios are below the industrial average ratio during the study period.

2.13 Research Gap

Prior to this, several thesis works have been conducted by various researchers regarding different aspects of commercial banks like financial performance, capital structure, investment policy, interest rate structure, and resources mobilization. The excerpts from the findings of some of these research works are presented above which are relevant for this study.

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 analyses and found applying traditional analysis of financial performance. In the context of Nepalese banking environment, there are few academic research found conducted in the frame work of CAMEL.

However, there are certain gap between the present research and the previous research conducted. There are researches which had done general comparison and the comparison is done between the two banks only. This study tries to evaluate the financial performance of five medium size commercial banks in the frame work of CAMEL using annual reports of five consecutive years.

CHAPTER III

RESEARCH METHODOLOGY

3.1 INTRODUCTION

Research Methodology is a science that refers sequential and systematical steps to be adopted by a researcher in studying and solving problems with certain objectives in view. It is the main body and critical part of the study that describes methods and process applied in the entire subject. It is necessary for a researcher to know not only research method or techniques but also methodology like how to develop certain indices or tests, how significantly a research is done, how to calculate mean or mode, which methods or techniques are relevant and which are not and, what would they indicate and why. The following steps provide a useful procedural guidance so far the research methodology is concerned.

-) Defining and tentative selection of a research problem and the topic of a research.
-) Initial and extensive survey of literature.
-) Specification of information required and/or construction of questionnaires.
-) Formulating and testing of hypothesis.
-) Design of a research project or sample design.
-) Collection and analysis of data.
-) Execution of a project and arriving at generalizations.
-) Preparation of a report and stating or writing down results.

The purposeful methodology is fulfilled for the stated objective that consist research design, sources of data, data collection technique, data processing procedure, population, sample, method of analysis, processing, tabulating procedures and methodology among other. The case study approach is used to add up existing literature on the subject with an attempt to assess findings so as to contribute whatsoever simple type of generalizations that exist in the field of financial performance analysis. This study covers comparative financial analysis of selected commercial banks. So, simple and lucid research methodology as demanded are followed. The prime objective is to evaluate and compare the financial strength and weaknesses of these selected commercial banks.

3.2 RESEARCH METHOD

It is a plan, structure and strategy of investigation conceived to obtain answers to research questions and control variances. *“It describes methods and process*

applied in the entire aspect of the study. It is the way to systematically about the research problem.” The basic objective is to evaluate and compare the financial strength and weaknesses of these selected commercial banks. Based on data to achieve such objective, various tools are being used.

3.3 RESEARCH DESIGN

A true research design is concerned with various steps to collect data for analysis and consequently draw a relevant conclusion. *“Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance.”* It is simply a framework or plan or structure or strategy, which guides and arranges collection and analysis of data that aims to combine relevance to research purpose. It assesses opinions, behaviors and characteristics of a given population to describe situation and events occurring at present. It shall be more quantitative, specific, analytical and exploratory rather than descriptive.

Since the study is about the comparative financial performance analysis of selected commercial banks, descriptive and analytical research design along with graphical presentations are followed. To achieve the objective, fact findings operation searching through various tools along with adequate information for exploring reasons responsible for performance by presenting existing position and systematically analyzing wide range of data collected are applied.

3.4 POPULATION AND SAMPLE

At present, there are 28 commercial banks listed in Nepal Stock Exchange. Due to time and resource constraints, it is not possible to study all of them regarding the study topic. Hence, sampling will be done, selecting from population. The samples are as follows:-

Commercial Banks	Established Date
1. Kumari Bank Limited(KBL)	2055/04/05 BS
2. Machhapuchhre Bank Limited(MBL)	2056/08/24 BS
3. Siddhartha Bank Limited(SBL)	2057/06/17 BS
4. Laxmi Bank Limited(LBL)	2058/06/11 BS
5. Nepal Industrial & Commercial Bank Limited(NIC)	2058/06/12 BS

3.5 SOURCES OF DATA

The study is mainly based on secondary data, which are collected from their respective annual reports. The main source of data is annual trading report published by respective banks. Likewise, some other related information's were

collected from the following sources:

- NRB reports & bulletins and its official website
- Basel Committee publications through its official website
- Various research papers and Dissertations,
- Security Exchange Board Of Nepal
- Official Website of banks

3.6 DATA COLLECTION TECHNIQUE

The study is mainly based upon the secondary data obtained from various sources. The materials are mainly collected from Central Library of T.U., Kirtipur, Library of Central Department of Management T.U., Kirtipur, Library of Public Youth Campus, Dhobichour and Library of Shankar Dev Campus, Putalisadak. The annual reports, brochures and bulletins are collected from the concerned banks. Searching through internet and URL of concerned banks has been helpful. Apart from this, information and data are collected from published/unpublished materials and other different sources.

3.7 DATA PROCESSING PROCEDURE

The data collected has been scanned, reorganized and compiled in form of tables and necessary items have been picked up for analysis and interpretation. After tabulation, they are analyzed by applying both financial and statistical tools. Such data, information, facts and figures have been processed by editing, calculating and tabulating prior to their analysis in order to obtain proper results. The necessary statement, ratios, percentages etc. have been established as required.

3.8 ANALYSIS OF DATA

The study comprises calculations and interpretations of various ratios to evaluate and compare the financial performance of concerned banks, which is more centered in ratios. These analyses result in presentation of information that aid in appropriate decision making process. The presentation and analysis of collected data is the core of the research work. The collected raw data are first presented in a systematic manner in tabular forms and are then analyzed by applying different financial and statistical tools to achieve research objectives through tables, graphs and charts to interpret the findings.

3.9 METHODS OF ANALYSIS

Appropriate descriptive means of analysis with the help of different tools are used in the study. The main objective is to evaluate and compare the financial performance of the concerned banks. The collected data are arranged, tabulated and analyzed after necessary adjustment. Without financial tools, it is quite difficult to give conclusion and interpret data under statistical tools. The necessary analytical tools that basically help to analyze obtained data, financial strength and weakness in investment are applied and tables bar diagrams and other necessary mathematical tools are used.

3.10 DATA ANALYSIS TOOLS

The ratio analysis system is an important financial tool to evaluate and compare the financial performance and position. A ratio is a mathematical relationship between two accounting figures i.e. simply one number expressed in term of another and quantitative relationship between any two numbers, which is expressed in term of percentage and proportion. The process of identifying financial strength and weakness lies in, properly established relationship between items of Balance Sheet and Profit & Loss Account. The focus of financial analysis is made on key figures contained in financial statements with significant relationship among them. Various ratios are applied in the study for financial analysis.

3.10.1 FINANCIAL RATIO ANALYSIS TOOLS

Financial Ratio Analysis tools are used to determine the performance of the banks in the framework CAMEL components. These ratios are categorized in accordance of the CAMEL components and are as follows:

CAPITAL ADEQUACY RATIO (CAR)

The CAR indicator is derived by comparing the ratio of an entity's equity to its assets-at-risk. It takes into account the most important financial risks-foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution's assets.

According to the directive issued by NRB, the bank capital has been categorized into two parts:

- i. Core capital
- ii. Supplementary capital

The total of these two capitals is considered for calculating capital adequacy ratio. Supplementary capital includes General Loan Loss Provision, Exchange Equalization Reserve, Asset Revaluation Reserve, Hybrid Capital Instrument,

Interest Spread Reserve and Unsecured Subordinated Term Debt. The capital adequacy ratio would measure the total capital fund on the basis of total risk-weighted assets. 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. The capital adequacy ratio would measure the total capital fund on the basis of total risk-weighted assets. The capital adequacy ratio shall be determined as follows:

Where,

Total capital fund = Core Capital + Supplementary Capital

Total risk weighted asset = Total Assets - Loan loss Provision - Risk-free Assets

CORE CAPITAL RATIO (CCR)

Core (Tier I) Capital is a capital of permanent nature comprising of Paid Up Capital, Share premium, Non Redeemable Preference Share, General Reserve Fund, Dividend Equalization Fund, Capital Redemption Reserve, Capital Equalization Reserve, Retained Earnings, Accumulative Profit & Loss accounts and Other Free Reserves. The CCR shows the relationship between the total core capital or internal sources and total risk adjusted assets. It is calculated by using the following model.

NON-PERFORMING LOAN RATIO (NPLR)

Loans usually form the largest of the asset items and carry the greatest amount of potential risk to the bank's capital account. The primary factor affecting overall asset quality is the quality of the loan portfolio and the credit administration program. Assets with inherent credit weaknesses are categorized into

Substandard, Doubtful and Loss grades, as per minimum criteria laid down by NRB based on the overdue period of the advances. These graded loans are required provisioning of 25%, 50% and 100% respectively, in order to safeguard the interest of the stakeholders. The non-performing loan ratio indicates the relationship between non-performing loan and total loan. It measures the proportion of non-performing loan in total loan and advances. The ratio is used to analyze the asset quality of the bank and determined by using the given model.

LOAN LOSS COVERAGE RATIO (LLCR)

The loan loss coverage ratio provides an indication of the adequacy of bank's loan reserve to cover or absorb possible future loan losses. It is sometimes called the 'Coverage Ratio' because it gives an indication of how well the reserve covers potential loan losses. Greater loan loss coverage is required to allow in income statement if high loss is expected. Higher ratio implies higher portion of non-performing loan portfolio. It is calculated by using the following model.

LOAN LOSS PROVISION RATIO (LLPR)

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 to absorb estimated credit losses associated with the loan and lease portfolio of the bank. Loan loss provision ratio provides useful insight into the quality of banks loan portfolio and bad debts coverage, and the adequacy of loan loss provisions. 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 banks 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. Loan loss provision on the other hand signifies the cushion against future contingency created by the default of the borrowers. The high ratio signifies the relatively more risky assets in the volume of loans and advances. The high provision for loan loss shows the recovery of loan to be difficult and irregular and the age of the loan is increasing. More delay the bank gets to collect the loan, the provision will be higher and the ratio will be higher. 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. It is calculated by using the following model.

TOTAL EXPENSES TO TOTAL INCOME RATIO (EIR)

While the others factors can be quantified fairly easily from current financial statements, management quality being subjective is difficult to quantify. As such no particular factor can be pointed out as a concrete measure for assessing Management quality. 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. It measures the total expenditure and total revenue generated by the banks. It is an important ratio to measure management quality since the profitability of an institution is determined by the gap of Total Revenues and Total Expenses. It is calculated by the following formula.

EARNING PER EMPLOYEE (EPE)

It measures the productivity degree of employees in the organization and also indicates per unit contribution of employee. It is calculated by the following formula.

COST PER UNIT OF MONEY LENT RATIO (CMLR)

It measure the expenses incurred while distributing loans which indicates efficiency in distributing loans in monetary terms. It is calculated by the following formula.

EARNING PER SHARE (EPS)

It measures the amount value of shareholders gain from each share held. It is an important ratio for an investor because of its relationship to dividends and market price. Higher EPS indicates higher return for the shareholders. It is calculated by following formula.

RETURN ON ASSETS (ROA)

It ensures a company's success in earning a return for all provider of capital. It is primarily an indicator of the quality of assets, managerial efficiency to utilize the institution's assets into net earnings. Generally, the return on assets ratio should be 1% and higher is desired to the banking industry (World Bank, 1996). Higher the ROA, higher is the quality of assets and efficient asset utilization. It is calculated by using the following model.

RETURN ON EQUITY (ROE)

It measures a company's success in earning a return for the common stockholders. Computed as the ratio of net profit after tax to total equity, it reflects the income earned from its internal sources. Return on equity reveals how well the bank uses the resources of owners. ROE of 15% is treated as standard and banking industry are desired to have higher than this (World Bank, 1996). Higher ROE indicates better utilization of the capital fund and higher investment by the shareholders. It is calculated by the following model.

CASH RESERVE RATIO (CRR)

It is the minimum amount of reserves a bank must hold in the form account balance with NRB. 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 the form of NRB Balance specified as the Percentage of total deposits. 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 (NRB Directive Manual, 2004). It is calculated by the following model.

CASH AT VAULT RATIO (CAVR)

It is the minimum amount of reserves a bank must hold in its vault. It is designed to measure the bank's ability to meet immediate obligation, mainly cash withdrawal by depositors. Cash and foreign currencies in hand are included as cash in vault. Lower ratio indicated the banks might face a liquidity crunch while paying its obligation whereas very high ratio indicates that the banks has been keeping idle funds and not deploying them properly. It is calculated by the following model.

LIQUID ASSET TO TOTAL DEPOSIT RATIO (LADR)

Banks all over the world contribute a significant amount of total deposits as government securities in their respective central banks to meet liquidity shortages in case of huge unanticipated withdrawals. As per NRB direction, only

investments made in government securities are considered liquid. Banks are highly encouraged to invest in the government securities as there is no risk involved. It is calculated by the following model.

LOAN TO DEPOSIT RATIO

A loan-to-deposit ratio is a relevant ratio in order to measure the liquidity position of a financial institution. It is calculated by the following model.

3.10.2 Statistical Tools

Mean

Mean is the sum of the observations divided by the number of observations. It describes the central location of the data. It is sometimes stated as average. Thus, the mean is expressed as

\bar{X}
Where,

\bar{X} = Mean
 X = Individual Observation
 N = Number of observation

Standard Deviation

Standard deviation is a simple measure of the variability or dispersion of a data set. Formulated by Francis Galton in the late 1860s, the standard deviation remains the most common measure of statistical dispersion. A useful property of standard deviation is that it is expressed in the same units as the data. In addition to expressing the variability of a population, standard deviation is commonly used to measure confidence in statistical conclusions. A low standard deviation indicates that all of the data points are very close to the same value (the mean), while high standard deviation indicates that the data are “spread out” over a large range of values. Standard deviation is calculated as

Where,

- = Standard deviation
- X = Mean
- X = Individual Observation
- N = Number of observation

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. The standard deviation can be sometimes be misleading in comparing the risk of uncertainty, surrounding alternatives as they differ in size or scale. To adjust the problem, the standard deviation can be divided by mean to compute coefficient of variation. The coefficient of variation is more useful when we consider investments, which have different level of risks. It is calculated as

Where,

- C.V. = Coefficient of Variation
- = Standard deviation

X = Mean

CHAPTER IV

DATA PRESENTATION & ANALYSIS

4.1 CAPITAL ADEQUACY

Capital adequacy analysis of sampled banks is made based on the regulations and standard ascertain by NRB as to maintain minimum risk based Core & Total 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 such as foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution's assets.

4.1.1 Core Capital Ratio

The Core Capital Ratio shows the relationship between the total core capital or internal sources and total risk adjusted assets. Table 4.1 presents the observed Core Capital Ratio during the study period and their mean, standard deviation and coefficient of variation.

Table 4.1
Comparative Review of Core Capital Ratio

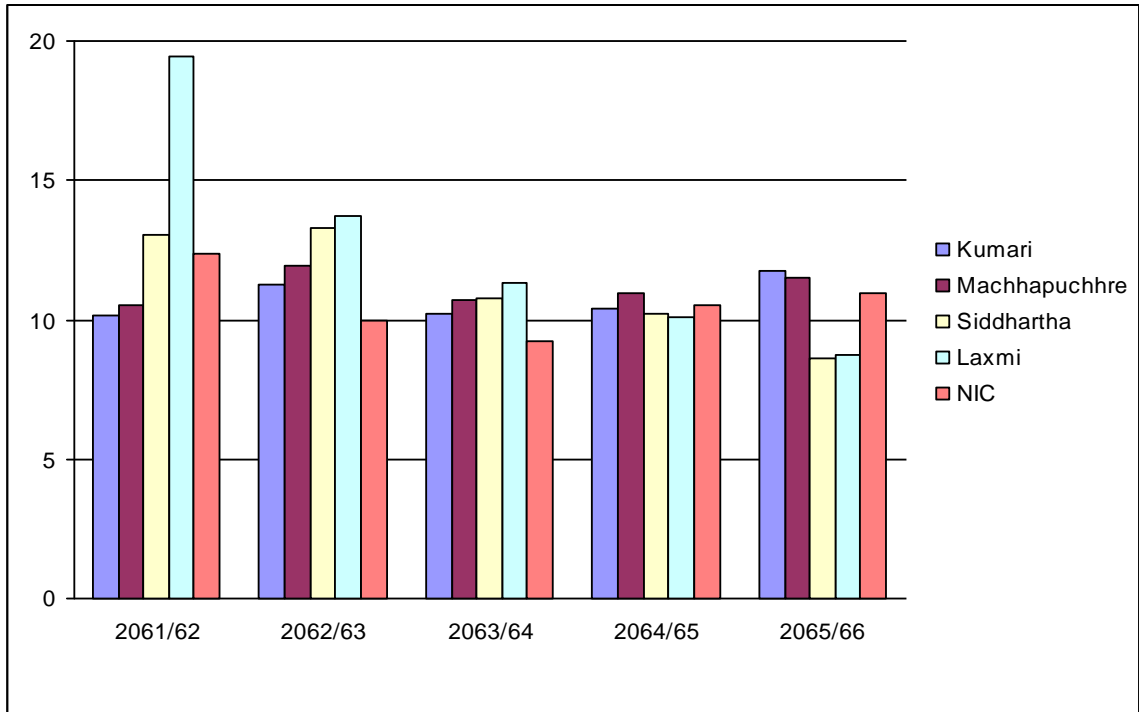
Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	10.14	11.26	10.24	10.4	11.78	10.76	0.64	0.06
Machhapuchhre	10.52	11.94	10.68	10.97	11.49	11.12	0.53	0.05
Siddhartha	13.06	13.29	10.78	10.19	8.62	11.19	1.77	0.16
Laxmi	19.45	13.71	11.33	10.1	8.72	12.67	3.77	0.30
NIC	12.37	9.94	9.21	10.5	10.98	10.60	1.06	0.10

(Details in Appendix 1)

The above figure represents that all banks have been more than able to fulfill the statutory requirement of NRB i.e. 5.5%. This shows that core capital shareholders are contributing more to the total risk weighted assets. NIC bank seems better than other bank as it has the least CCR ratio of 10.60% and exceeds the statutory requirement of NRB which means that it is able to utilize its capital in better ways than other banks. The average of CCR of Laxmi bank shows highest than other banks with 12.67%. The average CCR of Machhapuchhre, Siddhartha and Kumari banks are 11.12%, 11.19% and 10.76% respectively. The CV of banks is 0.06, 0.05, 0.16, 0.30 and 0.10 respectively. On the basis of CV, it can be said that CCR of Machhapuchchhre is more consistent as it has the least value among others and

is followed by Kumari, Siddhartha and NIC banks. Laxmi bank has the highest CV of 0.30 and is less consistent.

Figure 4.1
Core Capital Ratio



The above chart shows the fluctuation in CCR among the banks in the FY 2061/62 and 2062/63 whereas it has been steadied in the later years. For the first two fiscal years the ratio of Laxmi bank seemed very high and it has improved its ratio in later years. In the FY 2063/64 and 2064/65 the ratio has been similar.

4.1.2 Capital Adequacy Ratio

The CAR indicator is derived by comparing the ratio of an entity's equity to its assets-at-risk. It takes into account the most important financial risks-foreign exchange, credit and interest rate risks, by assigning risk weightings to the institution's assets. The capital adequacy ratio would measure the total capital fund on the basis of total risk-weighted assets. Table 4.2 presents the observed Capital Adequacy Ratio during the study period and their mean, standard deviation and coefficient of variation.

Table 4.2
Comparative Review of Capital Adequacy Ratio

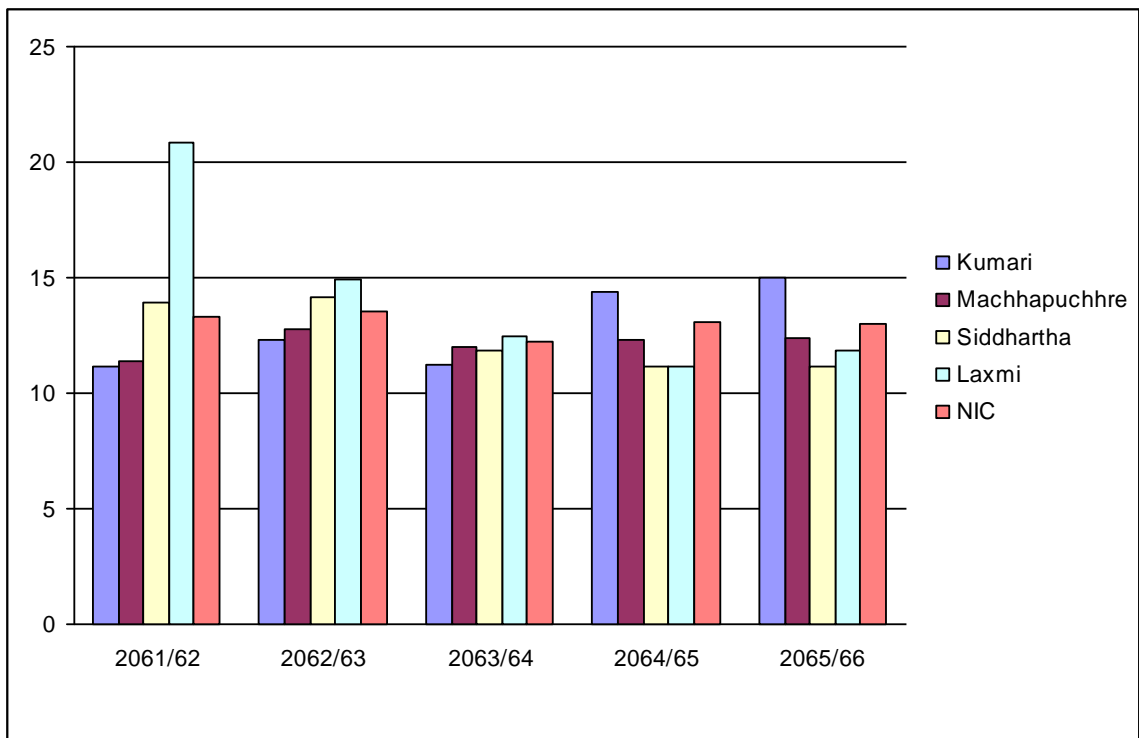
Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	11.15	12.34	11.2	14.41	14.98	12.82	1.60	0.12
Machhapuchhre	11.36	12.79	11.97	12.29	12.42	12.17	0.48	0.04
Siddhartha	13.93	14.16	11.84	11.14	11.15	12.44	1.34	0.11

Laxmi	20.88	14.96	12.43	11.17	11.82	14.25	3.55	0.25
NIC	13.29	13.54	12.21	13.11	13.01	13.03	0.45	0.04

(Details in Appendix 2)

The above figure represents that all banks have been more than able to fulfill the statutory requirements of NRB i.e. 11%. In terms of mean, Laxmi bank has the highest mean i.e. 14.25%. Higher the CAR, higher will be the level of protection available to the depositors. But here is a catch- a higher CAR could also mean a bank is sitting on the money rather than making productive use of it; interest isn't being earned. Thus CAR should be kept as minimum as possible but just above the NRB statutory requirement. Thus Machhapuchchhre bank seems to outperform other banks with average CAR of 12.17%. The average CAR of Kumari, Siddhartha and NIC banks are 12.82%, 12.44% and 13.03% respectively. On the basis of CV, it can be said that CAR of Machhapuchchhre and NIC bank both are more consistent as they have the least value among others i.e. 0.04. It is followed by Siddhartha and Kumari banks. Laxmi bank has the highest CV of 0.25 and is less consistent.

Figure 4.2
Capital Adequacy Ratio



The above chart shows the fluctuation in CAR among the banks in the FY 2061/62 and 2062/63 whereas it has been steadied in the later years. For the first two fiscal

years the ratio of Laxmi bank seemed very high and it has improved its ratio in later years. In the FY 2063/64 and 2064/65 the ratio has been similar.

4.2 ASSET QUALITY

Asset quality is one of the most critical areas in determining the overall condition of a bank and has direct impact on the financial performance of a bank. The quality of assets particularly, loan assets and investments, would depend largely on the risk management system of the institution. Commercial banks hold their assets in the form of liquid assets like cash and bank balance, short term investments, loans and advances etc. Banks lending policies and other regulation determines the quality of assets. 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.

Out of the several indicators of asset quality, Non- Performing Loan ratio, Loan Loss Provision ratio and Loan Loss Coverage ratio are taken to examine the asset quality of sampled banks. The analysis of Loans & Advances contains examination of loan classification and Non-Performing Loans (NPLs) 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.

4.2.1 Non-Performing Loan Ratio

The non-performing loan ratio indicates the relationship between non-performing loan and total loan. It measures the proportion of non-performing loan in total loan and advances. Table 4.3 presents the observed Non-Performing Loan Ratio during the study period and their mean, standard deviation and coefficient of variation.

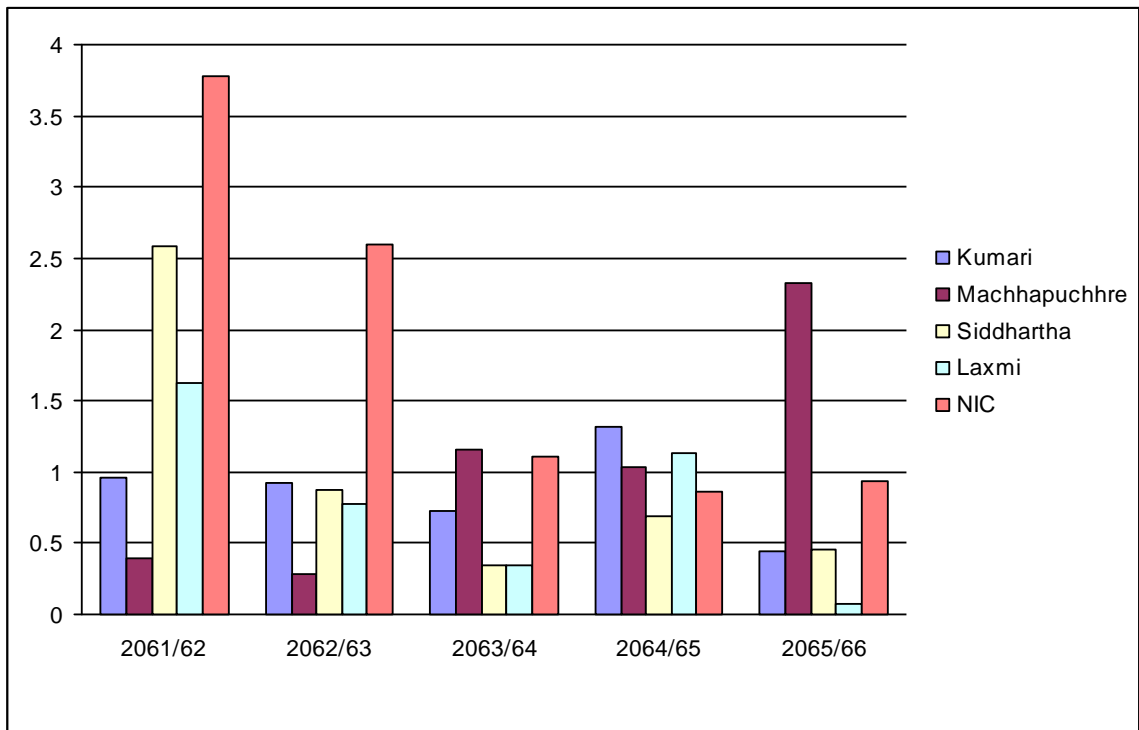
Table 4.3
Comparative Review of Non-Performing Loan Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	0.96	0.92	0.73	1.32	0.44	0.87	0.29	0.33
Machhapuchhre	0.39	0.28	1.16	1.04	2.33	1.04	0.73	0.70
Siddhartha	2.58	0.87	0.34	0.69	0.45	0.99	0.82	0.83
Laxmi	1.63	0.78	0.35	1.13	0.08	0.79	0.55	0.70
NIC	3.78	2.6	1.11	0.86	0.93	1.86	1.15	0.62

(Details in Appendix 3)

The above figure represents that all banks have some Non-Performing Loans. Higher ratio indicates risk to the bank's capital account so it should be kept as minimum as possible. In terms of mean, NIC bank has the highest mean i.e. 1.86 which indicates that its assets are risky. Then Machhapuchchhre bank follows NIC in terms of riskiness with average NPL ratio of 1.04. The average of Kumari, Siddhartha and Laxmi banks are 0.87, 0.99 and 0.79 respectively. On the basis of CV, it can be said that Kumari bank is more consistent as it has the least value among others i.e. 0.33. It is followed by NIC, Laxmi, and Machhapuchchhre banks. Siddhartha bank has the highest CV of 0.83 and is less consistent.

Figure 4.3
Non-Performing Loan Ratio



For the first fiscal year Siddhartha and NIC banks show higher NPL ratio. But the good thing is they have been in decreasing trend where as the ratio of other banks have been fluctuating over the years.

4.2.2 Loan Loss Provision Ratio

The Loan Loss Provision ratio indicates adequacy of allowance for loans and trend in the collection of loan and the performance in loan portfolio. Table 4.4 presents the observed Loan Loss Provision Ratio during the study period and their mean, standard deviation and coefficient of variation.

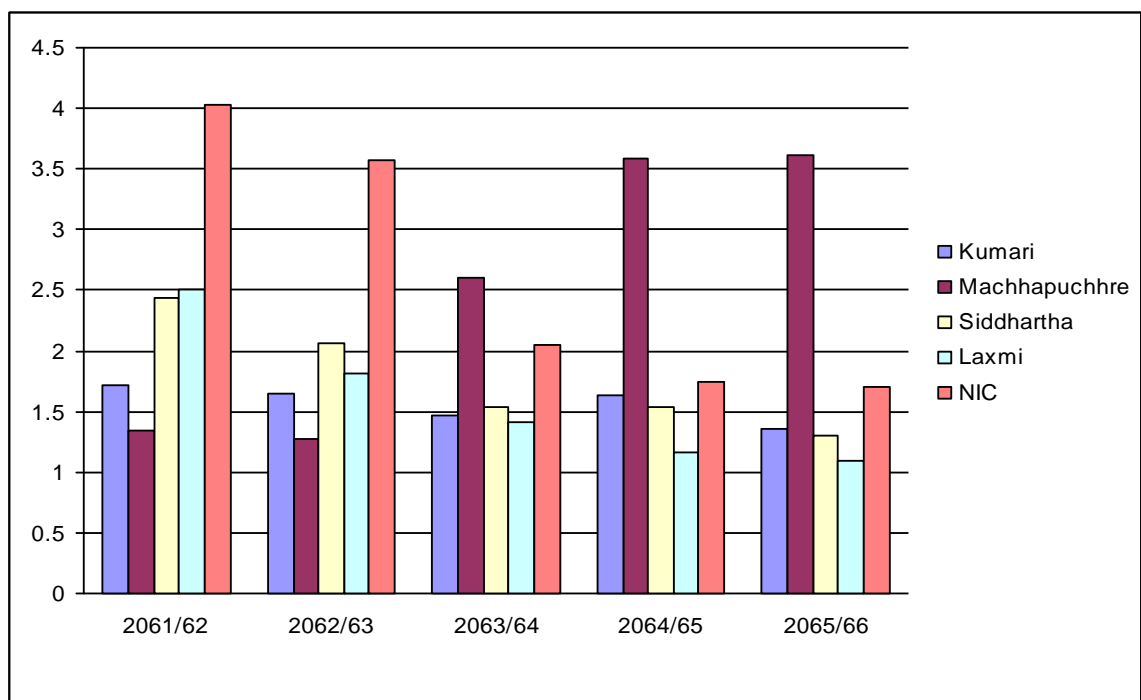
Table 4.4
Comparative Review of Loan Loss Provision Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	1.71	1.65	1.47	1.63	1.36	1.56	0.13	0.08
Machhapuchhre	1.34	1.27	2.6	3.59	3.61	2.48	1.03	0.41
Siddhartha	2.43	2.07	1.54	1.53	1.30	1.77	0.41	0.23
Laxmi	2.50	1.82	1.41	1.16	1.10	1.60	0.52	0.32
NIC	4.03	3.57	2.05	1.75	1.70	2.62	0.98	0.37

(Details in Appendix 4)

The above table represents the provision made by banks in order to cover for the loan loss. Higher ratio indicates that banks expected higher losses on loan. In terms of mean, NIC bank has the highest mean i.e. 2.62 which indicates that it expects higher portion of loans becoming default. The average of Kumari, Machhapuchhre, Siddhartha and Laxmi banks are 1.56, 2.48, 1.77 and 1.60 respectively. On the basis of CV, it can be said that Kumari bank is more consistent as it has the least value among others i.e. 0.08. It is followed by Siddhartha, Laxmi and NIC banks. Machhapuchhre bank has the highest CV of 0.41.

Figure 4.4
Loan Loss Provision Ratio



The loan loss provision ratio has been fluctuating within the banks over the period. In the first two fiscal years, NIC bank has highest ratio where as in third, fourth and fifth year Machhapuchchhre bank has highest ratio.

4.2.3 Loan Loss Coverage Ratio

The loan loss coverage ratio provides an indication of the adequacy of bank's loan reserve to cover or absorb possible future loan losses. It indicates how efficiently banks manages its loan and advances and makes effort for the loan recovery and shows how well a bank is prepared to cover for its non-performing loans.

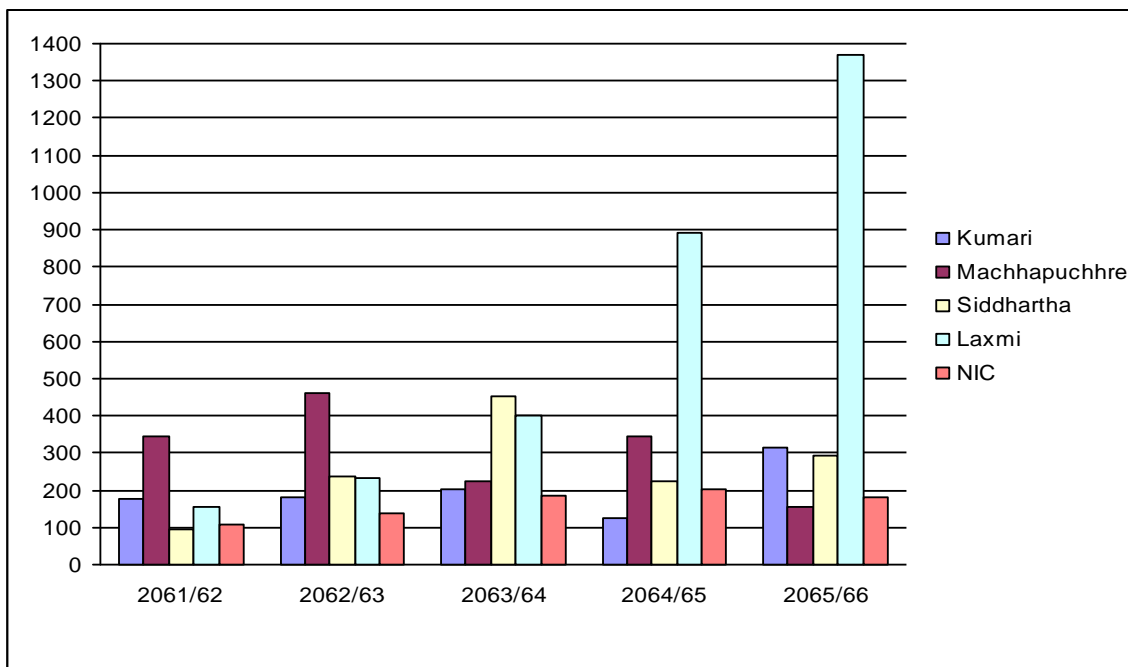
Table 4.5
Comparative Review of Loan Loss Coverage Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	178.51	180.15	201.79	122.83	312.84	199.22	62.52	0.31
Machhapuchhre	346.36	461.95	223.14	346.28	154.69	306.48	107.08	0.35
Siddhartha	94.45	238.73	450.94	222.76	292.15	259.81	115.53	0.45
Laxmi	153.25	232.05	398.72	891.52	1369.17	608.94	458.63	0.75
NIC	106.59	137.09	185.14	204.4	183.00	163.24	35.94	0.22

(Details in Appendix 5)

The above table represents how well the loan losses are covered by banks. Higher ratio indicates that banks expected higher losses on loan. In terms of mean, Laxmi bank has the highest mean i.e. 608.94 which indicates that it expected higher portion of loans becoming default. The average of Kumari, Machhapuchhre, Siddhartha and NIC banks are 199.22, 306.48, 259.81 and 163.24 respectively. On the basis of CV, it can be said that NIC bank is more consistent as it has the least value among others i.e. 0.22. It is followed by Kumari, Machhapuchhre and Siddhartha banks. Laxmi bank has the highest CV of 0.75.

Figure 4.5
Loan Loss Coverage Ratio



The loan loss coverage ratio has been fluctuating over the period. For the first two periods, Machhapuchhre bank seemed top the list where as in fourth and fifth period, Laxmi bank has been highest. The loan loss coverage ratio of Laxmi bank has been increasing during the period and in FY 2064/65 and 2065/66, it increased drastically.

4.3 MANAGEMENT QUALITY

The sound management is crucial for the success of any institution. There is a universal phenomenon that good management can make an organization and poor management can break it. The management quality is generally accorded greater weighting in the assessment of the overall CAMEL composite rating. The performance of the other four CAMEL components will depend on the vision, capability, agility, professionalism, integrity, and competence of the financial institution's management. In fact, the management not only makes suitable policy and the business plans, but also implements them for the short term and the long term interests, which helps achieve aimed objectives of bank and financial institutions. Thus any organization, be it bank, must be serious towards its management and hence hire professionals to increase the management efficiency and effectiveness to produce wonderful results for the organization.

4.3.1 Total Expenses To Total Income Ratio

This ratio measures the total expenditure and total revenue generated by the banks. It is an important ratio to measure management quality since the profitability of an institution is determined by the gap of Total Revenues and Total Expenses.

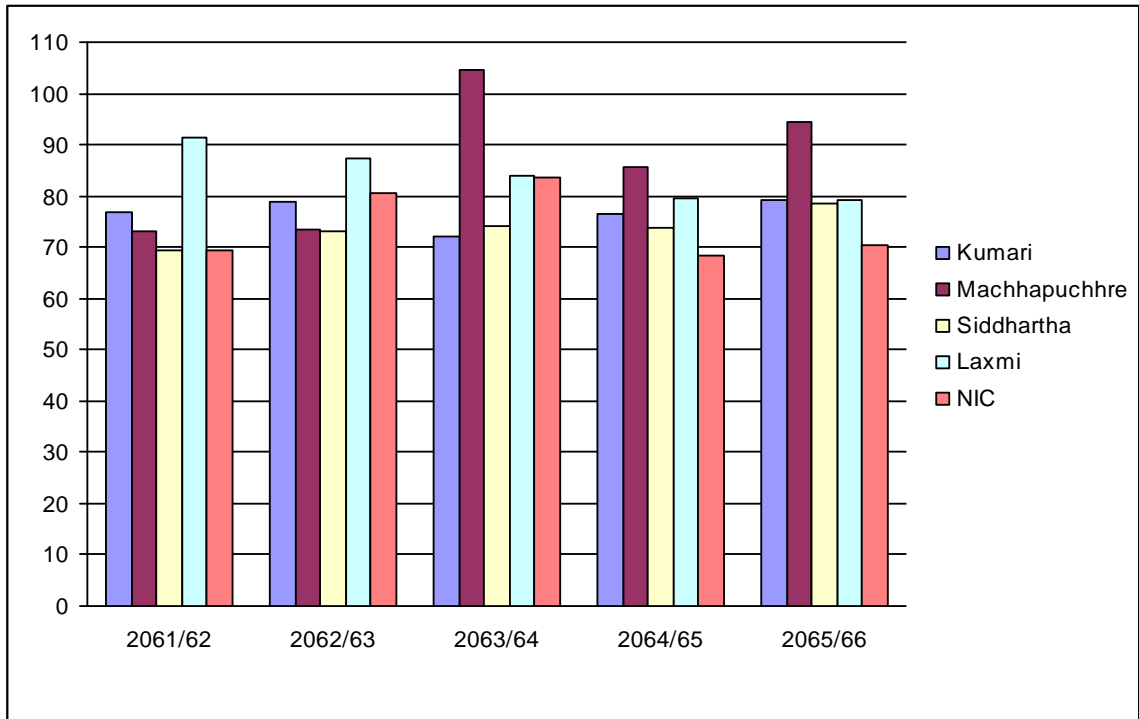
Table 4.6
Comparative Review of Total Expenses to Total Income Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	76.88	78.74	72.01	76.43	79.13	76.64	2.54	0.03
Machhapuchhre	73.03	73.34	104.75	85.61	94.52	86.25	12.27	0.14
Siddhartha	69.22	73.16	73.98	73.73	78.59	73.74	3.00	0.04
Laxmi	91.54	87.34	83.79	79.52	79.30	84.30	4.70	0.06
NIC	69.23	80.61	83.61	68.32	70.25	74.40	6.39	0.09

(Details in Appendix 6-8)

The above table shows the expenditure incurred by the banks to generate the revenue. Higher ratio indicates inefficient management of the banks and vice versa. The bank should try to keep this ratio as minimum as possible. In terms of mean, Siddhartha bank seems better than other banks as it has the least ratio of 73.74, closely followed by NIC bank with ratio of 74.40. Machhapuchchhre bank has the highest mean i.e. 86.25. In terms of CV, it can be said that Kumari bank is most consistent as it has the least value of 0.03 among other banks.

Figure 4.6
Total Expenses to Total Income Ratio



The total expenses to total income ratio of banks have been more or less similar during the period except in the FY 2063/64.

4.3.2 Earnings Per Employee

Earning Per Employee is an another ratio that is relevant to measure management quality and is used as a proxy of management quality. It helps to understand the productivity degree of employees in the organization and also indicates per unit contribution of employee.

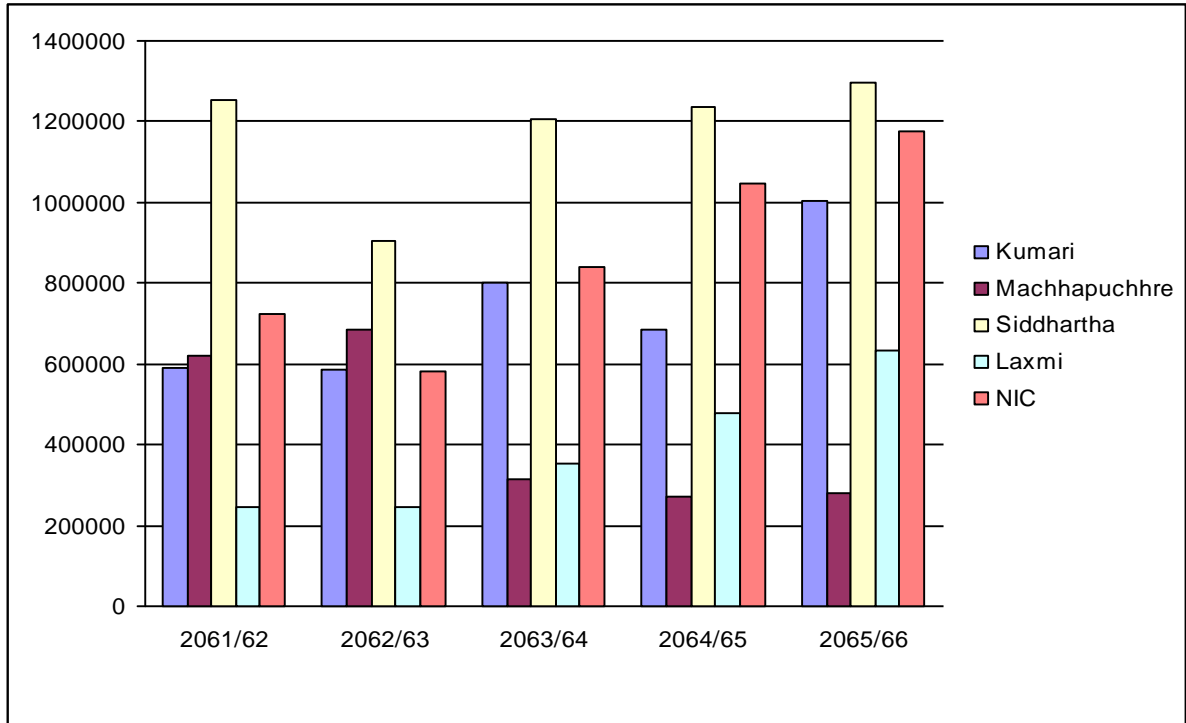
Table 4.7
Comparative Review of Earning Per Employee

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	588823	585688	803127	683321	1005548	733301	157579.00	0.21
Machhapuchhre	619489	683657	316605	271617	280754	434424	179091.06	0.41
Siddhartha	1254996	906289	1206397	1234250	1297118	1179810	139927.42	0.12
Laxmi	245044	244037	352578	476315	632102	390015	148176.59	0.38
NIC	724559	581853	838492	1047664	1175682	873650	214529.20	0.25

(Details in Appendix 9)

Table 4.7 shows the Earnings Per Employee in Rupees during the study period. In terms of mean, Siddhartha bank has the highest mean of 1179810, followed by NIC bank with 873650. This means that employees of these two banks are more productive than other banks. The average of Kumari, Machhapuchhre and Laxmi bank is 733301, 434424 and 390015 respectively. In terms of CV, Siddhartha bank has the highest consistency with 0.12, closely followed by Kumari bank with 0.21. The Machhapuchchhre bank has the least consistency with the highest CV of 0.41. The CV of Laxmi and NIC bank is 0.38 and 0.25 respectively.

Figure 4.7
Earning Per Employee



The earnings per employee show the fluctuating result over the period. From the first period Siddhartha bank has been leading other banks.

4.3.3 Cost per Unit Of Money Lent

This is another effective ratio to measure management quality which indicates efficiency in distributing loans in monetary terms. It measure the expenses incurred while distributing loans. Higher ratio indicates inefficiency of management in loan distribution.

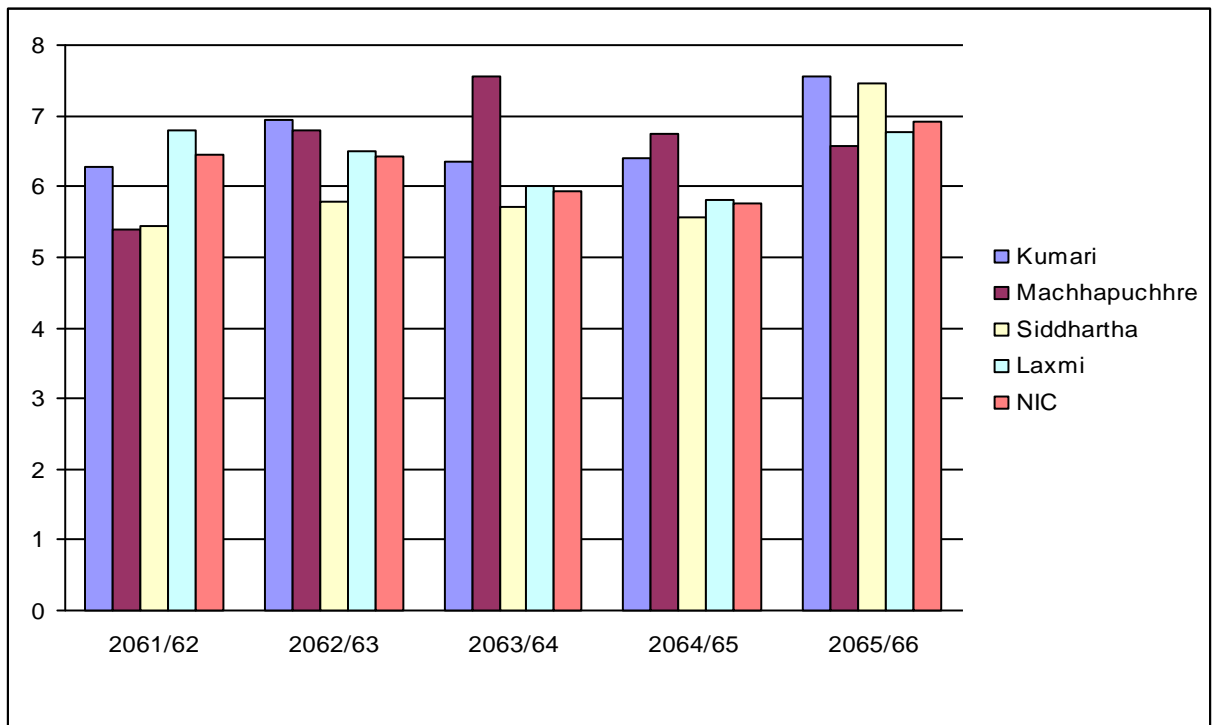
Table 4.8
Comparative Review of Cost per Unit Of Money Lent

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	6.28	6.93	6.35	6.39	7.56	6.70	0.49	0.07
Machhapuchhre	5.39	6.8	7.56	6.74	6.58	6.61	0.70	0.11
Siddhartha	5.43	5.79	5.71	5.57	7.46	5.99	0.74	0.12
Laxmi	6.8	6.5	6.01	5.82	6.77	6.38	0.40	0.06
NIC	6.45	6.42	5.93	5.75	6.91	6.29	0.41	0.06

(Details in Appendix 10)

The above table shows the expenditure incurred by the banks while providing loans. Higher ratio indicates inefficient management of the banks and vice versa. The bank should try to keep this ratio as minimum as possible. In terms of mean, all banks are in competitive position as their average ratios are within the range of 5.99 and 6.7. Kumari Bank has the highest mean i.e. 6.70 but it doesn't mean that Kumari bank's management is inefficient. In terms of CV, it can be said that Laxmi bank and NIC bank are most consistent as it has the least value of 0.06 among other banks closely followed by Kumari bank with CV of 0.07.

Figure 4.8
Cost Per Unit of Money Lent



The cost per unit of money lent of banks has been more or less similar over the period.

4.4 EARNING QUALITY

Earning represents the first line of defense against capital depletion resulting from shrinkage in asset value. Earnings performance also allows the bank to remain competitive by providing the resources. The main objectives of bank is to earn profit and their level of profitability is measured by Profitability ratios. Profitability ratios measures the efficiency of banks, higher profit ratios indicate higher efficiency and vice-versa.

4.4.1 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 higher ratio represents sound management and efficient mobilization of the owner's equity and vice-versa. Table 4.9 presents the observed Return on Equity during the study period and their mean, standard deviation and coefficient of variation.

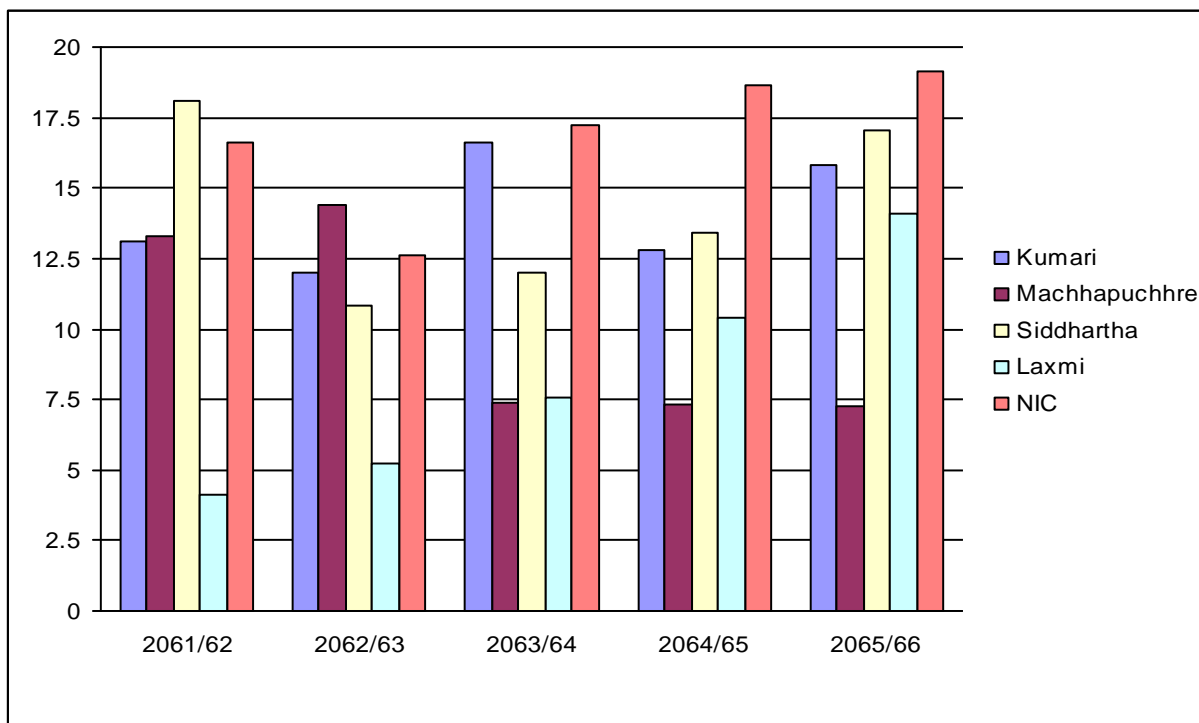
Table 4.9
Comparative Review of Return on Equity

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	13.12	12.00	16.60	12.82	15.80	14.07	1.80	0.13
Machhapuchhre	13.31	14.39	7.41	7.31	7.25	9.93	3.22	0.32
Siddhartha	18.12	10.82	12.01	13.40	17.04	14.28	2.84	0.20
Laxmi	4.11	5.21	7.59	10.38	14.07	8.27	3.61	0.44
NIC	16.63	12.60	17.26	18.65	19.12	16.85	2.31	0.14

(Details in Appendix 11)

Above table represents the Return on Equity of the sampled banks during the study period. The sampled banks has not been able to maintain ROE of 15% or above except in few fiscal year which shows that shareholder's equity has not been efficiently utilized, except that of NIC bank. In terms of mean, NIC bank has the highest mean of 16.85, followed by Siddhartha bank with 14.28 which lag behind from standard of 15%. The average of Kumari, Machhapuchhre and Laxmi bank is 14.07, 9.93 and 8.27 respectively. In terms of CV, Kumari bank seems consistent as it has the least CV of 0.13, closely followed by NIC bank with CV of 0.14. The Laxmi bank is less consistent and risky as it has the highest CV of 0.44. The CV of Machhapuchhre and Siddhartha bank is 0.32 and 0.20 respectively.

Figure 4.9
Return On Equity



The ROE ratios of banks seem to be fluctuating over the period except for Laxmi bank which has been increasing constantly.

4.4.2 Return on Assets (ROA)

ROA is a popular tool to measure how well its asset is utilized in generating profit. It measures the profit earning capacity by utilizing available resources i.e. total assets. 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. Return will be higher if the banks resources are well managed and efficiently utilized.

Table 4.10
Comparative Review of Return on Assets

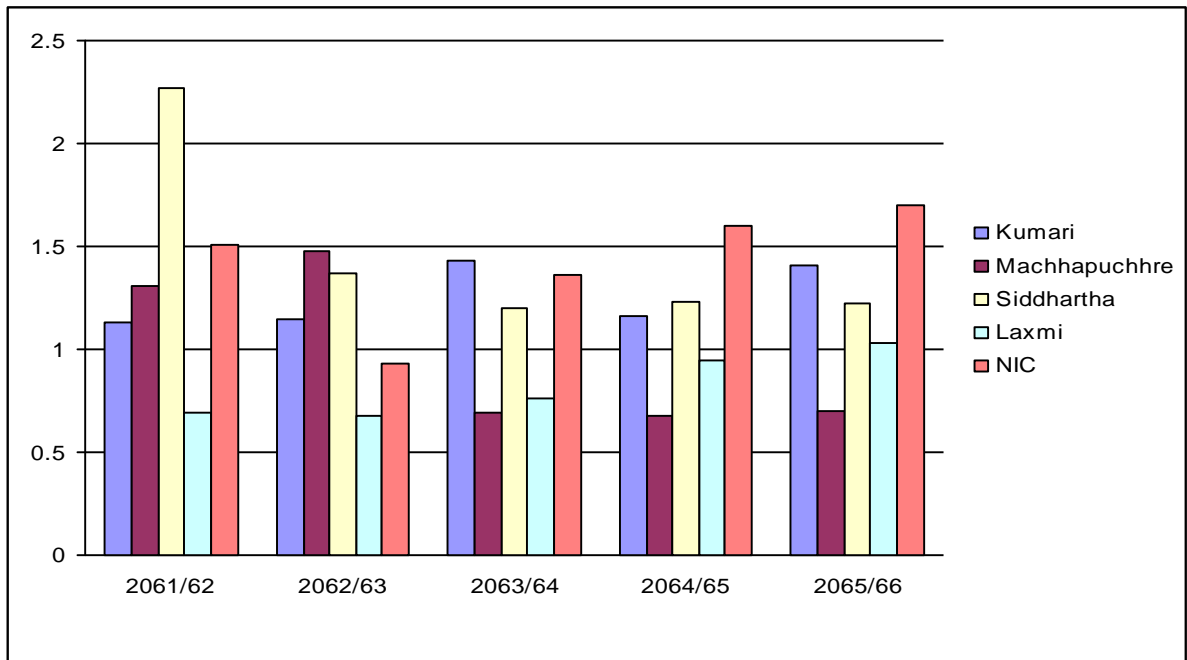
Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	1.13	1.15	1.43	1.16	1.41	1.26	0.13	0.11
Machhapuchhre	1.31	1.48	0.69	0.68	0.70	0.97	0.35	0.36
Siddhartha	2.27	1.37	1.20	1.23	1.22	1.46	0.41	0.28
Laxmi	0.69	0.68	0.76	0.95	1.03	0.82	0.14	0.17
NIC	1.51	0.93	1.36	1.60	1.70	1.42	0.27	0.19

(Details in Appendix 12)

Above table represents the Return On Asset of the sampled banks during the study period. The sampled banks have been able to maintain ROA of 1% or above except by Laxmi bank and Machhapuchchhre bank which shows that banks

resources has been well managed and efficiently utilized. In terms of mean, Siddhartha bank has the highest mean of 1.46, followed by NIC and Kumari bank with 1.42 and 1.26 respectively. The average of Machhapuchchhre and Laxmi bank is 0.97 and 0.82 respectively which lag behind the standard of 1% and shows that the assets of these banks have not been fully utilized. In terms of CV, Kumari bank seems consistent with least CV of 0.11, closely followed by Laxmi bank with CV of 0.17. The Machhapuchchhre bank has the highest CV of 0.36 and is therefore less consistent in comparison to Siddhartha and NIC bank with CV of 0.28 and 0.19 respectively.

Figure 4.10
Return on Asset



The ROA ratios of banks seem to be fluctuating over the period. Most of the bank's ratios have been above 1 during the period except Laxmi Bank and Machhapuchchhre Bank.

4.4.3 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. The earnings per share of an organization give the strength of the share in the market. The EPS is supposed to be a best comparison between two banks.

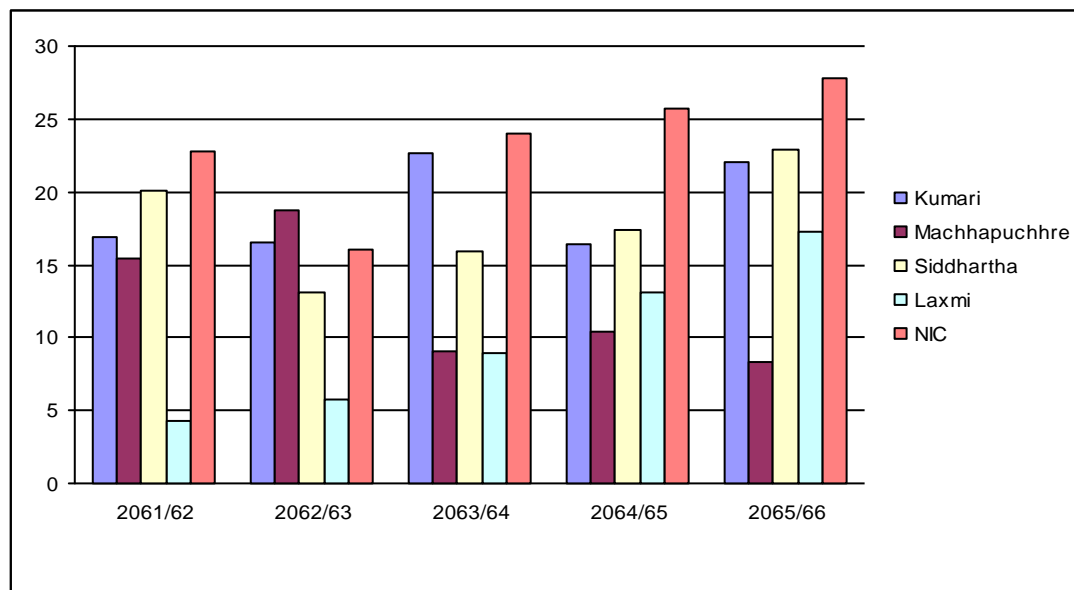
Table 4.11
Comparative Review of Earning Per Share

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	16.84	16.59	22.7	16.35	22.04	18.90	2.84	0.15
Machhapuchhre	15.43	18.74	9.02	10.35	8.33	12.37	4.04	0.33
Siddhartha	20.08	13.05	15.88	17.4	22.89	17.86	3.39	0.19
Laxmi	4.34	5.8	8.99	13.14	17.21	9.90	4.74	0.48
NIC	22.75	16.1	24.01	25.75	27.84	23.29	4.00	0.17

(Details in Appendix 13)

Table 4.11 represents the Earning Per Share of the sampled banks during the study period. From the above table, it shows that the EPS of NIC bank shows higher value than other banks i.e. 23.29. The average EPS of Kumari, Machhapuchhre, Siddhartha and Laxmi bank is 18.90, 12.37, 17.86 and 9.90 respectively. This shows that the EPS of NIC bank was far higher than other banks. This means NIC bank earned more profit on per share basis and greater profitability was available to each shareholder out of total earnings than average sampled banks. On the basis of CV, it seemed that Kumari bank ratio is more consistent than other banks due to lower CV of 0.15, closely followed by NIC bank with CV of 0.17. The Laxmi bank seemed the least consistent with the highest CV of 0.48.

Figure 4.11
Earning Per Share



The EPS of the banks seem to fluctuate over the period except for Laxmi bank which is constantly increasing.

4.5 LIQUIDITY

The level of liquidity influences the ability of a banking system to withstand shocks. Liquidity risk arises when large 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 or some unexpected need for cash, because of the liability holder's larger withdrawals demand than usual. This turns the FIs' liquidity problem into a solvency problem and cause it to fail.

4.5.1 Cash Reserve Ratio

This ratio shows whether bank is holding the balance as required to NRB. NRB has put the directives to maintain certain percent of total deposit in NRB by the commercial Banks in order to ensure adequate liquidity in the commercial banks, to meet the depositors' demand for cash at any time and to inject the confidence in depositors regarding the safety of their deposited funds.

Table 4.12
Comparative Review of Cash Reserve Ratio

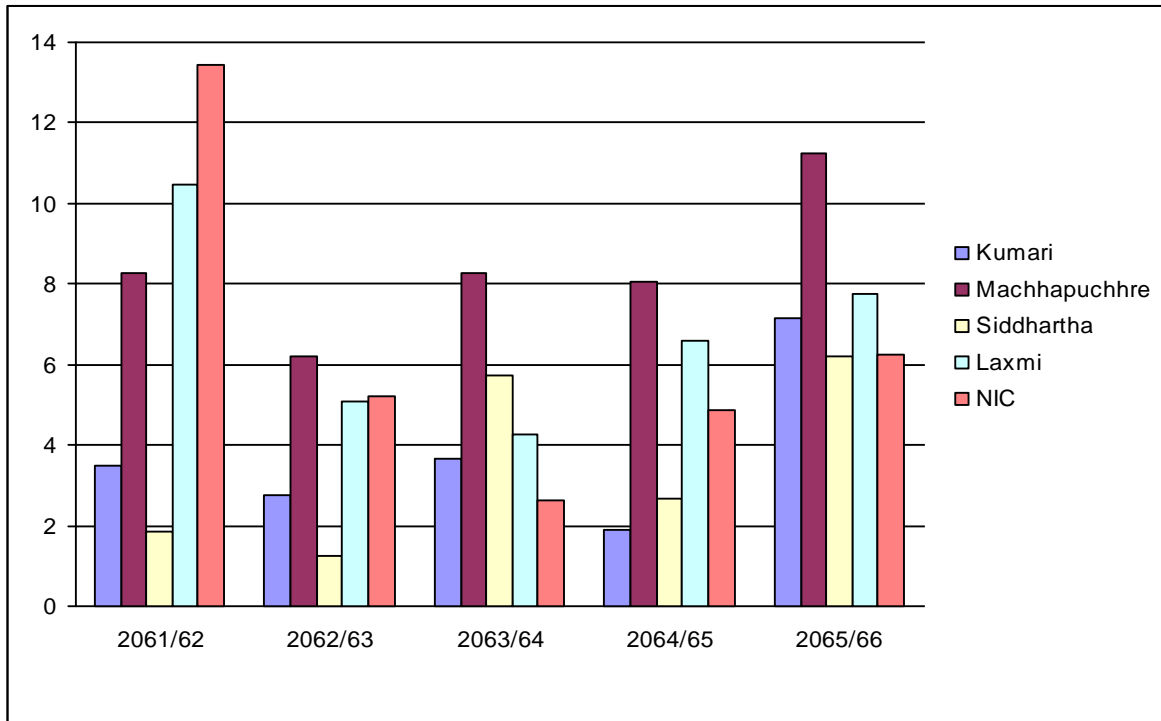
Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	3.51	2.76	3.65	1.91	7.13	3.79	1.78	0.47
Machhapuchhre	8.29	6.20	8.29	8.05	11.26	8.42	1.62	0.19
Siddhartha	1.85	1.25	5.74	2.65	6.21	3.54	2.04	0.58
Laxmi	10.47	5.07	4.25	6.60	7.75	6.83	2.19	0.32
NIC	13.42	5.2	2.61	4.85	6.23	6.46	3.67	0.57

(Details in Appendix 14)

Table 4.12 shows the Cash Reserve Ratio of the sampled banks during the study period. The ratios show that sampled banks are depositing certain amount of their deposits in NRB as per the rule in order to safeguard the interest of the depositors. The average CRR ratio of Kumari and Siddhartha bank are 3.79 and 3.54 which are less than the standard of 5 set by NRB directive. The average CRR ratio of Machhapuchhre, Laxmi and NIC banks are 8.42, 6.83 and 6.46 respectively and are above the standard of NRB.

Figure 4.12

Cash Reserve Ratio



It can be seen from the chart that the CRR has been fluctuating over the period. In FY 2061/62 Laxmi and NIC banks have CRR over 10%. During later periods, the CRR of banks have been under 8% except that of Machhapuchhre bank which has increased above 10 in the FY 2065/66.

4.5.2 Cash at Vault To Total Deposit Ratio

This ratio shows the percentage of total deposits held as cash in hand at vault. The banks are required by NRB to store certain portion of the total deposits in their own vault in order to meet unexpected withdrawal from certain depositors.

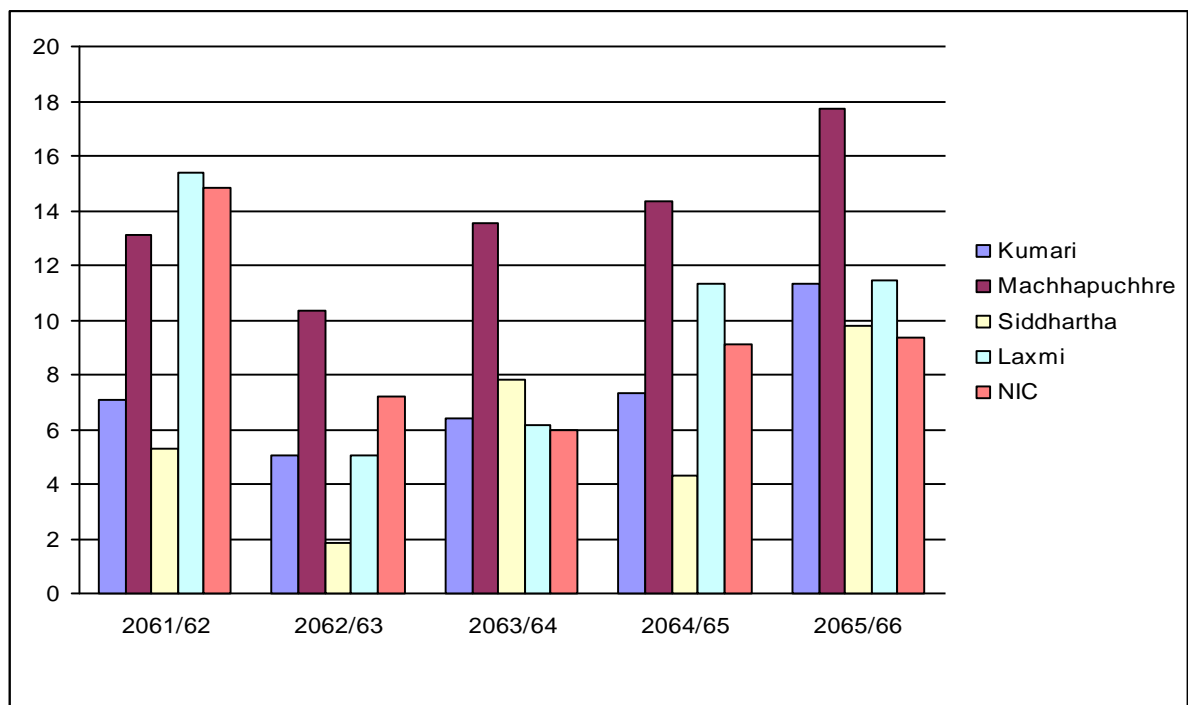
Table 4.13
Comparative Review of Cash at Vault to Total Deposit Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	7.07	5.02	6.37	7.31	11.31	7.42	2.10	0.28
Machhapuchhre	13.09	10.31	13.55	14.31	17.74	13.80	2.39	0.17
Siddhartha	5.31	1.84	7.81	4.29	9.76	5.80	2.75	0.47
Laxmi	15.39	5.07	6.17	11.34	11.42	9.88	3.79	0.38
NIC	14.84	7.18	5.96	9.11	9.38	9.29	3.05	0.33

(Details in Appendix 15)

Table 4.13 represents the cash and bank balance ratio of the sampled banks during the study period. This ratio shows that banks have been setting aside certain portion of the total deposits in their own vaults as per the direction of NRB. The ratio should be above the standard set by NRB and enough to meet the unexpected withdrawal of the money. Higher ratio indicates that money is just sitting in the vault instead of earning interest for the deposit holders. In terms of mean, Machhapuchhre bank has the highest ratio of 13.80, followed by Laxmi bank with 9.88 which indicate that these two banks aren't properly utilizing the deposit money. However, Machhapuchhre bank seemed more consistent than other sampled banks due to lower CV of 0.17. Siddhartha bank seemed less consistent with the highest CV of 0.47.

Figure 4.13
Cash at Vault to Total Deposit Ratio



For the first fiscal year most of the banks have higher CAVR averaging 15% which decreased during the later period. Kumari and Machhapuchhre banks' CAVR have been in increasing trend since FY 2062/63 where as other banks are fluctuating.

4.5.3 Liquid Asset to Total Deposit Ratio

This ratio shows the percentage of total deposits invested in liquid assets. This ratio measures the levels of liquid assets available with the bank to meet short term obligations. It measures overall liquidity position. The higher ratio implies the better liquidity position and lower ratio shows the inefficient liquidity position of the bank.

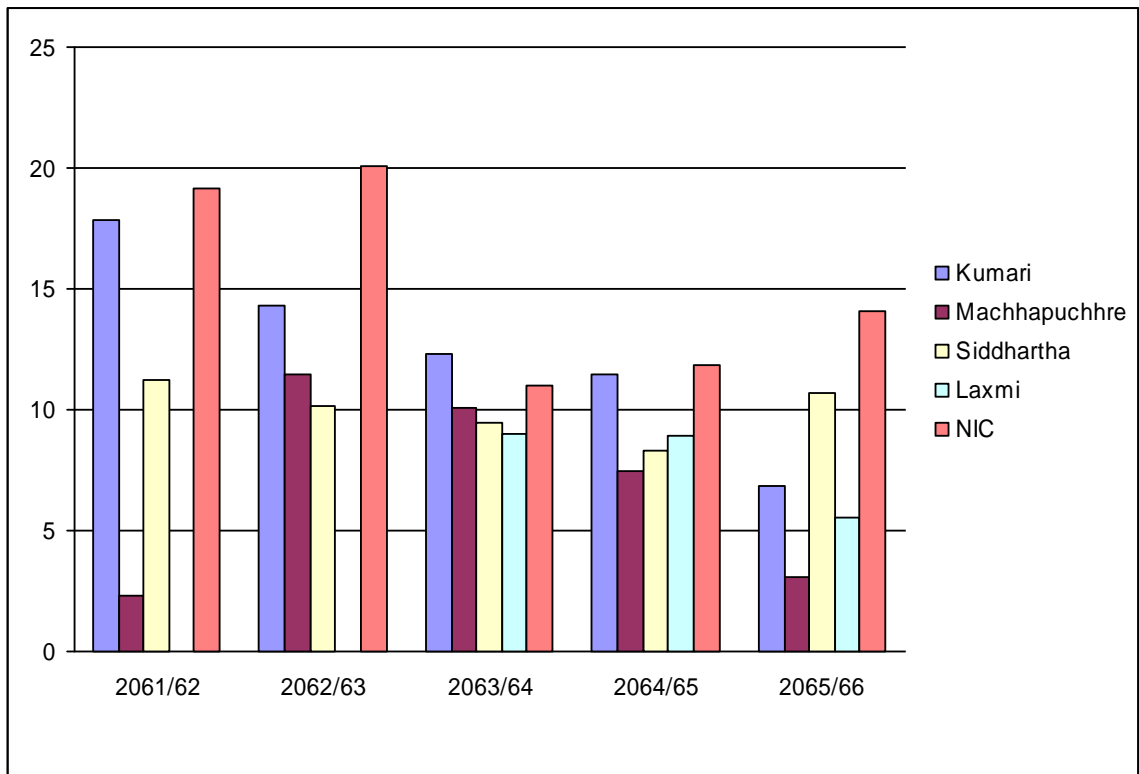
Table 4.14
Comparative Review of Liquid Asset to Total Deposit Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	17.87	14.34	12.29	11.5	6.87	12.57	3.60	0.29
Machhapuchhre	2.28	11.46	10.04	7.45	3.06	6.86	3.66	0.53
Siddhartha	11.22	10.17	9.45	8.34	10.68	9.97	1.00	0.10
Laxmi	0	0	9	8.96	5.51	4.69	4.04	0.86
NIC	19.14	20.04	10.97	11.81	14.09	15.21	3.73	0.25

(Details in Appendix 16)

Table 4.14 shows the percentage of deposits invested by the sampled banks in the liquid assets such as government securities. NIC bank has the highest average of 15.21 among other sampled banks which indicate that NIC bank has invested highly in government securities, followed by Kumari bank with average of 12.57. However, Siddhartha bank seemed more consistent than NIC bank as its CV is lower than the NIC bank.

Figure 4.14
Liquid Asset to Total Deposit Ratio



NIC bank has higher LADR in comparison to other banks during the period. In FY 2061/62 and FY 2062/63 there seem to be no investment made by Laxmi bank in government securities. During later periods, LADR of banks averages around 10%.

4.5.4 Loan to Deposit Ratio

The Financial Institution must always be liquid to meet depositors' and creditors' demand to maintain public confidence. There needs to be an effective asset and liability management system to minimize maturity mismatches between assets and liabilities and to optimize returns.

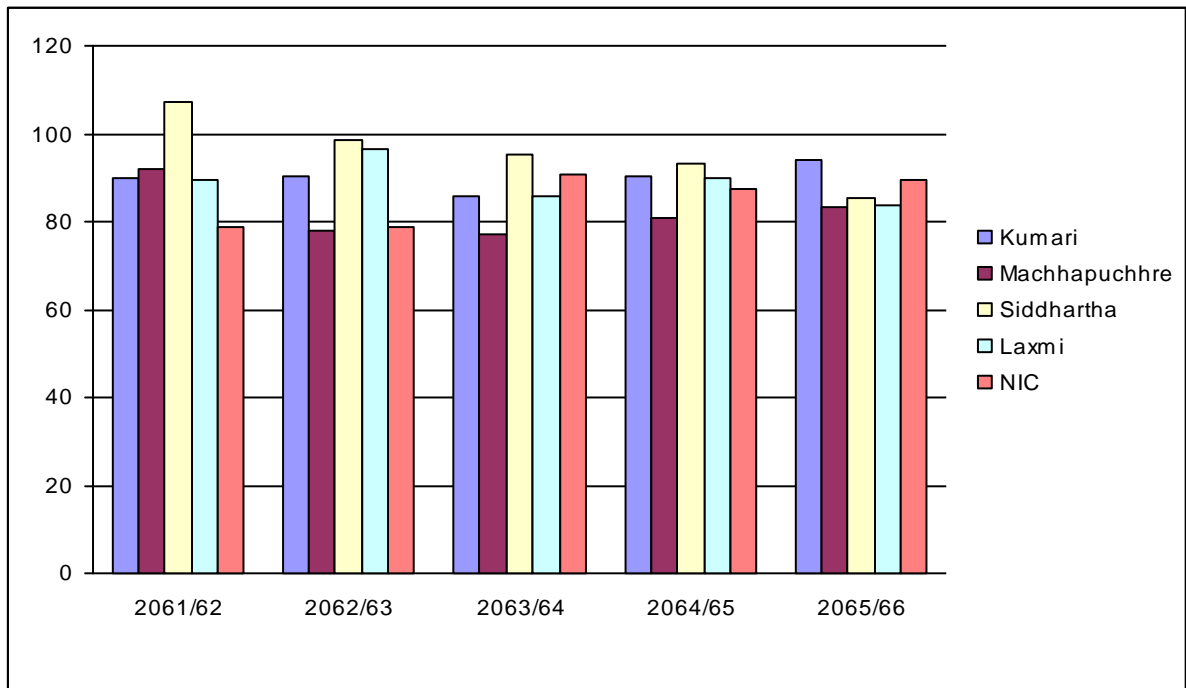
Table 4.15
Comparative Review of Loan to Deposit Ratio

Banks	Fiscal Year					Mean	Std. Deviation	CV
	2061/62	2062/63	2063/64	2064/65	2065/66			
Kumari	90.02	90.20	85.84	90.20	94.17	90.09	2.64	0.03
Machhapuchhre	91.83	77.87	77.25	80.74	83.25	82.19	5.28	0.06
Siddhartha	107.03	98.75	95.39	93.03	85.18	95.88	7.15	0.07
Laxmi	89.33	96.30	85.78	89.72	83.88	89.00	4.25	0.05
NIC	78.66	78.74	90.67	87.62	89.32	85.00	5.24	0.06

(Details in Appendix 17)

Table 4.15 shows the liquidity position of the sampled banks during the study period. Higher ratio indicates optimum utilization of deposits and vice versa. In terms of mean, Siddhartha bank has the highest mean of 95.88 which indicates that its deposit has been optimally utilized. On the basis of CV, it can be said that Kumari bank is most consistent as it has the least value of 0.03 among other sampled banks.

Figure 4.15
Loan to Deposit Ratio



During the period, Siddhartha bank's LDR has been in decreasing trend where as other banks' LDR seem to be hovering around 80%.

All the above ratios have been summarized in a single table below.

Table 4.16
Summarized Mean Ratios

S. No.	Ratios	Banks					Standard	Remarks
		Kumari	Machhapuchhre	Siddhartha	Laxmi	NIC		
1	CCR	10.76	11.12	11.19	12.67	10.60	5.5	NIC
2	CAR	12.82	12.17	12.44	14.25	13.03	11	Machhapuchhre
3	NPLR	0.87	1.04	0.99	0.79	1.86	>2, risky	Laxmi
4	LLPR	1.56	2.48	1.77	1.60	2.62	>NPL	Kumari
5	LLCR	199.22	306.48	259.81	608.94	163.24	>100	NIC
6	EIR	76.64	86.25	73.74	84.3	74.4	N/A	Siddhartha, NIC
7	EPE	733301	434424	1179810	390015	873650	N/A	Siddhartha, NIC
8	CMLR	6.70	6.61	5.99	6.38	6.29	N/A	Siddhartha, NIC
9	ROE	14.07	9.93	14.28	8.27	16.85	15	NIC
10	ROA	1.26	0.97	1.46	0.82	1.42	1	Siddhartha, NIC
11	EPS	18.9	12.37	17.86	9.9	23.29	N/A	NIC
12	CRR	3.79	8.42	3.54	6.83	6.46	5	NIC
13	CAVR	7.42	13.8	5.8	9.88	9.29	2	Siddhartha
14	LADR	12.57	6.86	9.97	4.69	15.21	N/A	NIC
15	LDR	90.09	82.19	95.88	89	85	N/A	Siddhartha

4.6 MAJOR FINDINGS

- ❖ Core Capital Ratio (CCR) indicator shows that NIC Bank is better than other banks. NIC bank's CCR is 10.60% which is least in comparison to other banks and is above the statutory requirements of the NRB standards which is 5.50% for CCR.
- ❖ Capital Adequacy indicators show that Machhapuchhre Bank is better than other banks. Machhapuchhre bank's CAR is 12.17% which is least in comparison to other banks and is above the statutory requirements of the NRB standards which is 11% for CAR.
- ❖ All the sampled banks have NPL ratio under 1. Among sampled banks, Laxmi bank seems well in handling loan as it has least NPL ratio of 0.79 in comparison with other banks.

- ❖ Sampled banks have made provision for loan loss which is greater than NPL ratio. This means banks are well prepared to cover for their NPLs. But since Kumari Bank has least provision which cover its NPL ratio, it can be considered good in comparison with its competitors.
- ❖ The banks undertaken for study have loan loss coverage ratio, greater than 100% which means all NPLs are well covered. The bank which has least loan loss coverage ratio but enough provision can be considered as good. NIC bank has loan loss coverage ratio of 163.24%, which is below than its competitors, hence can be considered as good.
- ❖ Most of the management quality indicator shows that Siddhartha and NIC are better than their rivals. Siddhartha bank's EIR and CMLR ratios are 73.74 and 5.99 respectively, and NIC bank's EIR and CMLR ratios are 74.40 and 6.29 respectively which are better than their competitors. Similarly, EPE of Siddhartha and NIC banks are NRS 1179810 and NRs. 873650 which is greater than other banks. Hence, under this indicator Siddhartha Bank and NIC Bank can be considered good in comparison with others.
- ❖ All of Earning Quality indicators show that NIC Bank is better than other banks. NIC has ROE, ROA and EPS ratios of 16.85, 1.42 and 23.29 respectively. These indicators are well ahead of other banks; hence NIC is leading in earning quality in comparison with other bank, except ROA of Siddhartha Bank is 1.46 a slight higher than that of NIC bank.
- ❖ Among the banks understudy Siddhartha Bank has CAVR ratio of 5.80%, which is lower than its competitors. Since cash at vault is idle assets, least amount above certain standard can be considered good.
- ❖ NIC bank has the LADR of 15.21%, which is better than its competitors. The banks having higher liquid assets can be considered good, since it can be easily converted in cash and grab investment opportunity.
- ❖ Higher LDR indicates that the bank is efficiently mobilizing its deposit. Siddhartha Bank has LDR of 95.88%, which is higher than its competitors, so Siddhartha is better in mobilizing deposit.
- ❖ NIC bank has CRR of 6.46%, which is above the standard of NRB but is least among its competitors. Hence, NIC is better in managing CRR than the other banks taken for study.

CHAPTER V

SUMMARY, CONCLUSION & RECOMMENDATION

5.1 SUMMARY

Structural adjustment program initiated during the period of 1980's and political change during the period of 1990's has opened door to the large numbers of commercial banks, numerous development banks, finance companies and co-operatives. Since the provision of WTO allows more foreign banks to operate in the country from 2010, banking sector are sure to face toughest competition in its history. As the numbers of banks are increasing, given the limited size of the market, the banks survival depend upon how well it can manage its resources and deliver the best desired quality services to its customer. As commercial banks are now introducing complex and innovative banking products, they are exposed to many risk, hence naturally the bank's activities require intensive supervision for their success. A key product of such supervision is a rating of the bank's overall condition, commonly referred to as a CAMEL rating. Well, there are many techniques to judge the financial performance and management efficiency of the banking sector, one of the latest and widely popular techniques has been CAMEL. The research study is focused on assessing the financial performance of the selected commercial banks comparatively in the framework of CAMEL, as prescribed by NRB directives and in accordance to BASEL accord. The study scrutinizes the financial performance of the sampled commercial banks 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. Various materials were reviewed in order to build up the conceptual foundation 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 Bank Supervision, Concept of CAMEL rating system and component evaluation system, Basel Capital Accord, NRB guidelines. 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. On the basis of judgmental sampling techniques researcher has selected five medium commercial banks which are Kumari Bank, Siddhartha

Bank, Machhapuchhre Bank, Nepal Industrial and Commercial Bank and Laxmi Bank. Data regarding the financial performances of these banks have been collected from the banks' audited annual reports from the period of FY 2061/62 to FY 2065/66 and are the primary source of information and are treated as authentic. Researcher has used different financial ratios, simple mathematical and statistical tools to get the meaningful result of the collected data and to judge the financial performance of these banks.

CAMEL analysis shows the mixed results. Some indicator shows that one bank is better while the another indicator indicates other is better. The statutory requirements of CCR and CAR as per the NRB standards have been 5.5% and 11% respectively. Every bank undertaken for study has maintained this standard, but the bank which has maintained this standard and has least CCR and CAR can be considered as good. Hence, NIC bank having least CCR of 10.60% and Machhapuchhre bank having least CAR of 12.82% can be considered as good. Laxmi bank has least non performing loan in comparison with other banks. Most of the management quality indicator shows that NIC and Siddhartha are better than their rivals. EIR and CMLR results show that there is a very slight difference in these ratios of NIC and Siddhartha bank and therefore their management is better in comparison with other banks understudy. The ratio of EPE shows that Siddhartha bank has higher earning per employees than other banks. NIC lead all the other banks in earnings quality indicator: ROE and EPS, whereas ROA of Siddhartha is again slightly higher than that of NIC bank. The indicators of the liquidity show the mixed results. Siddhartha bank is better than other banks in CAVR and LDR ratios respectively, where as NIC bank is leading other banks in LADR and CRR ratios. From overall comparison, NIC bank seems to be performing better among these five sampled banks.

5.2 CONCLUSION

Most of the commercial banks undertaken for the study has passed most CAMEL standard, hence from this aspect we can say that all of them are financially and commercially sound. From our study it shows that the bank having good management quality has good earnings and the banks which full comply with the CAMEL and NRB standard will sure to have good results than other banks. But since large numbers of financial institutions are already operating in the country and many are ready to enroll in the market the banks efficiency may not just be reflected by the CAMEL indicators. As large banking institution of developed nation following the CAMEL standard going bankrupt, we cannot just rely on CAMEL to measure the financial soundness and health of our banking institution. Proper socio-economic analysis, competitors analysis, changing perspective of the

people, customer oriented quality service, transparency and fulfillment of corporate social responsibility might be key issues for the success of the banking institution in coming days. As the banks of 21st century are facing lots of challenges, their strategy should be to develop customer loyal, dynamic and competent management team who can foresee and address the emerging problems and challenges before their competitors.

5.3 RECOMMENDATIONS

- ❖ All the sampled banks have higher CAR and CCR than the standards set by the NRB; hence banks can lower these ratios and make more capital available for investment.
- ❖ All the sampled banks have higher provision for loan loss than required. Higher provision means less capital for investments. Hence, banks are suggested to keep provision enough, only to cover for non performing loans.
- ❖ Earnings per employee of NIC, Siddhartha and Kumari bank is in the range of 7 to 12 lakhs, while Machhapuchhre and Laxmi banks have much below the above mentioned range , hence these banks are suggested to increase the productivity of the employees or downsize the number of employees.
- ❖ Generally return on assets of greater than 1 percent is considered good but since Laxmi and Machhapuchhre bank have ROA less than 1 percent, they are suggested to increase their assets utilization capacity or dispose off unnecessary assets.
- ❖ Return on Equity of 15 is the standard set by NRB but Machhapuchhre bank and Laxmi bank have ROE less than 15%, they are suggested to increase the better utilization of Capital fund.
- ❖ Financial institution's liquidity and solvency are directly affected by portfolio quality which should be carefully analyzed on the basis of collectability and loan-loss provisioning. As liquidity has inverse relationship with profitability, financial institution must strike a balance between liquidity and profitability. Hence, banks are suggested to keep LADR ratio minimum as possible and encouraged to take calculated risks and invest capital in other sectors where returns are higher.

- ❖ Most of the commercial banks have higher CAVR ratio than required by the NRB standard, excess liquidity means less fund for investment, hence all of the banks undertaken for study are suggested to maintain minimum level of liquidity and make funds available for investment and look for new areas of investment. But CRR ratio of Kumari bank and Siddhartha bank is below the standard set by NRB, so they are suggested to manage the CAVR and CRR just above the NRB standard so that they may not face the liquidity crisis. It is equally important for banks to make funds available for investment and maintain the minimum level of liquidity as well.

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Calculation Of Capital Adequacy Ratio of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	638037000	858250000	1019893000	1359032000	1612799000
Supplementary Capital	63813000	82459000	95314000	523894000	438108000
Total capital fund	701850000	940709000	1115207000	1882926000	2050907000
On balance sheet item	5816629520	7217426866	9401588477	12309295776	11627355000
Off balance sheet item	475241001	407623261	558322922	761083455	2061366000
Total risk weighted assets	6291870521	7625050127	9959911399	13070379231	13688721000
Capital Adequacy Ratio	11.15	12.34	11.2	14.41	14.98
Calculation Of Capital Adequacy Ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	637739000	911543000	982577000	1142970000	1676864624
Supplementary Capital	51104000	64524000	119149000	136826000	135004436
Total capital fund	688843000	976067000	1101726000	1279796000	1811869059
On balance sheet item	5451875000	6518992000	7776365000	9722885000	13232810421
Off balance sheet item	611255000	1113006000	1424294000	694179000	1355698398
Total risk weighted assets	6063130000	7631998000	9200659000	10417064000	14588508819
Capital Adequacy Ratio	11.36	12.79	11.97	12.29	12.42
Calculation Of Capital Adequacy Ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	387615865	593244000	786859000	1049679000	1257070000
Supplementary Capital	25809125	39035000	76962000	98055000	368385000
Total capital fund	413424990	632279000	863821000	1147734000	1625455000
On balance sheet item	2739762993	4151490300	6647608500	9719141384	13523361000
Off balance sheet item	228681350	313530903	650078132	580710913	1058424000
Total risk weighted assets	2968444343	4465021203	7297686632	10299852297	14581785000
Capital Adequacy Ratio	13.93	14.16	11.84	11.14	11.15
Calculation Of Capital Adequacy Ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	600271975	645963252	840530162	1086123415	1269743601
Supplementary Capital	44052300	58737522	81431555	114964235	451430601
Total capital fund	644324275	704700774	921961717	1201087650	1721174202
On balance sheet item	2998149983	4541656936	7056114022	10234074054	13877620944
Off balance sheet item	87347846	170053308	359992842	515966494	679949147
Total risk weighted assets	3085497829	4711710244	7416106864	10750040548	14557570091
Capital Adequacy Ratio	20.88	14.96	12.43	11.17	11.82

Appendix-1

Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	680142550	761128967	912312362	1293750759	1649007425
Supplementary Capital	50843235	275709696	296801251	321968707	305927368
Total capital fund	730985785	1036838663	1209113613	1615719466	1954934793
On balance sheet item	5184710975	7380372095	9566466551	11824278100	13687235508
Off balance sheet item	314724355	275758996	339075271	496853196	1334111990
Total risk weighted assets	5499435330	7656131091	9905541822	12321131296	15021347498
Capital Adequacy Ratio	13.29	13.54	12.21	13.11	13.01
Calculation Of Core Capital Ratio of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	638037000	858250000	1019893000	1359032000	1612799000
Total risk weighted assets	6291870521	7625050127	9959911399	13070379231	13688721000
Core Capital Ratio	10.14	11.26	10.24	10.4	11.78
Calculation Of Core Capital Ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	637739000	911543000	982577000	1142970000	1676864624
Total risk weighted assets	6063130000	7631998000	9200659000	10417064000	14588508819
Core Capital Ratio	10.52	11.94	10.68	10.97	11.49
Calculation Of Core Capital Ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	387615865	593244000	786859000	1049679000	1257070000
Total risk weighted assets	2968444343	4465021203	7297686632	10299852297	14581785000
Core Capital Ratio	13.06	13.29	10.78	10.19	8.62
Calculation Of Core Capital Ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	600271975	645963252	840530162	1086123415	1269743601
Total risk weighted assets	3085497829	4711710244	7416106864	10750040548	14557570091
Core Capital Ratio	19.45	13.71	11.33	10.1	8.72
Calculation Of Core Capital Ratio of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Core Capital	680142550	761128967	912312362	1293750759	1649007425
Total risk weighted assets	5499435330	7656131091	9905541822	12321131296	15021347498
Core Capital Ratio	12.37	9.94	9.21	10.5	10.98

Calculation Of Non-Performing Loan Ratio of Kumari					
Types of Loan \ Year	2061/62	2062/63	2063/64	2064/65	2065/66
Sub Standard	4614596	12236631	10378475	58320876	13082971
Doubtful	20894667	32745146	38636356	78966480	31735261
Bad	28479274	19371929	17104037	15188244	19724451
Total Non Performing Loan	53988538	64353706	66118868	152475600	64542683
Total Loan	5643337405	7007787514	9062433481	11522380653	14795261241
Non Performing Loan Ratio	0.96	0.92	0.73	1.32	0.44
Calculation Of Non-Performing Loan Ratio of Machhapuchhre					
Types of Loan \ Year	2061/62	2062/63	2063/64	2064/65	2065/66
Sub Standard	2113042	65003	19290865	82690767	1282203
Doubtful	1178855	1213723	26610217	6841182	2046187
Bad	16568994	15637870	39267157	3384131	299508910
Total Non Performing Loan	19860891	16916596	85168239	92916080	302837300
Total Loan	5130223362	6146572956	7319939264	8964070292	12984459357
Non Performing Loan Ratio	0.39	0.28	1.16	1.04	2.33
Calculation Of Non-Performing Loan Ratio of Siddhartha					
Types of Loan \ Year	2061/62	2062/63	2063/64	2064/65	2065/66
Sub Standard	29136238	4460923	14719	23783328	14030855
Doubtful	17954089	2695426	0	15777722	27688741
Bad	20836581	26416211	21526867	25617461	18582761
Total Non Performing Loan	67926908	33572560	21541586	65178511	60302357
Total Loan	2634930609	3869269993	6319727198	9480786943	13504795701
Non Performing Loan Ratio	2.58	0.87	0.34	0.69	0.45
Calculation Of Non-Performing Loan Ratio of Laxmi					
Types of Loan \ Year	2061/62	2062/63	2063/64	2064/65	2065/66
Sub Standard	13577960	2646985	1183093	1198699	0
Doubtful	1852291	4116952	2666987	590828	2495836
Bad	29061208	26738641	19171013	10940369	8294954
Total Non Performing Loan	44491459	33502578	23021093	12729896	10790790
Total Loan	2726143794	4280106038	6529239211	9794438354	13463349018
Non Performing Loan Ratio	1.63	0.78	0.35	0.13	0.08
Calculation Of Non-Performing Loan Ratio of NIC					
Types of Loan \ Year	2061/62	2062/63	2063/64	2064/65	2065/66
Sub Standard	45970000	654368	6133247	9632303	2422097
Doubtful	11389883	7864500	928740	11760428	61131299
Bad	128070928	171035567	94078214	76774413	65625036
Total Non Performing Loan	185430811	179554435	101140201	98167144	129178432
Total Loan	4909355200	6902123944	9128649206	11465334005	13915850035
Non Performing Loan Ratio	3.78	2.6	1.11	0.86	0.93

Appendix-3

Appendix-4

Appendix-5

Calculation of Loan Loss Coverage Ratio of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	96375609	115932088	133420366	187292714	201914411
Total Non Performing Loan	53988538	64353706	66118868	152475600	64542683
Loan Loss Coverage Ratio	178.51	180.15	201.79	122.83	312.84
Calculation of Loan Loss Coverage Ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	68790306	78145506	190047722	321746918	468447241
Total Non Performing Loan	19860891	16916596	85168239	92916080	302837300
Loan Loss Coverage Ratio	346.36	461.95	223.14	346.28	154.69
Calculation of Loan Loss Coverage Ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	64154594	80147301	97140385	145189205	176174183
Total Non Performing Loan	67926908	33572560	21541586	65178511	60302357
Loan Loss Coverage Ratio	94.45	238.73	450.94	222.76	292.15
Calculation of Loan Loss Coverage Ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	68185358	77744077	91789964	113489702	147744714
Total Non Performing Loan	44491459	33502578	23021093	12729896	10790790
Loan Loss Coverage Ratio	153.25	232.05	398.72	891.52	1369.17
Calculation of Loan Loss Coverage Ratio of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	197642899	246159924	187251555	200655909	236456256
Total Non Performing Loan	185430811	179554435	101140201	98167144	129178432
Loan Loss Coverage Ratio	106.59	137.09	185.14	204.4	183
Calculation of Loan Loss Provision Ratio of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	96375609	115932088	133420366	187292714	20194411
Total Loan	5643337405	7007787514	9062433481	11522380653	14795261241
Loan Loss Provision Ratio	1.71	1.65	1.47	1.63	1.36
Calculation of Loan Loss Provision Ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	68790306	78145506	190047722	321746918	468447241
Total Loan	5130223362	6146572956	7319939264	8964070292	12984459357
Loan Loss Provision Ratio	1.34	1.27	2.6	3.59	3.61
Calculation of Loan Loss Provision Ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	64154594	80147301	97140385	145189205	176174183
Total Loan	2634930609	3869269993	6319727198	9480786943	13504795701
Loan Loss Provision Ratio	2.43	2.07	1.54	1.53	1.30
Calculation of Loan Loss Provision Ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	68185358	77744077	91789964	113489702	147744714
Total Loan	2726143794	4280106038	6529239211	9794438354	13463349018
Loan Loss Provision Ratio	2.5	1.82	1.41	1.16	1.10
Calculation of Loan Loss Provision Ratio of NIC					

Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan Loss Provision	197642899	246159924	187251555	200655909	236456256
Total Loan	4909355200	6902123944	9128649206	11465334005	13915850035
Loan Loss Provision Ratio	4.03	3.57	2.05	1.75	1.70
Calculation Of Total Expenses To Total Income ratio Of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	240130179	337056145	397053120	498734222	816202890
Employees Expenses	42395007	59819533	74243628	89570438	115984919
Office Overhead Expenses	71812004	88683067	104079476	148143138	186502160
Foreign Exchange Loss	0	0	0	0	0
Expenses from Extraordinary Activities	0	0	816882	4531068	876031
Non-Operating Expenses	0	0	0	0	0
Provision for Losses	47399804	25870520	24950199	64023790	57403005
Provision for Staff Bonus	13886714	14712099	24855899	25743626	36703549
Total Expenses	415623708	526141364	625999204	830746282	1213672554
Interest Income	499918465	605526857	791284209	957245724	1374722437
Commission and Discount	23083001	26281002	40764126	48494633	79104277
Foreign Exchange Gain	14988827	26373738	20294440	41807623	59001781
Non-Operating Income	5442	0	669885	15588389	1111653
Other Income	2608404	10003006	15280956	17805210	19746723
Total Income	540604139	668184603	868293616	1080941579	1533686871
Expenses to Income ratio	76.88	78.74	72.1	76.85	79.13
Calculation Of Total Expenses To Total Income ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	187027981	288661548	397721715	407919238	580036192
Employees Expenses	29581861	43410161	54360311	71421059	90995685
Office Overhead Expenses	59973169	85924279	101467631	124408422	182841038
Foreign Exchange Loss	0	0	1893202	0	0
Expenses from Extraordinary Activities	345666	1529961	14319071	0	500188
Non-Operating Expenses	0	9271	0	48159	0
Provision for Losses	22907133	34702545	264487054	157606056	258938624
Provision for Staff Bonus	12868390	19229005	11402611	15922209	17626794
Total Expenses	312704200	473466770	845651595	777325143	1130938521
Interest Income	381930447	563362313	694482220	796597182	1041473434
Commission and Discount	21391062	33401892	34305033	35616247	38017284
Foreign Exchange Gain	11359386	35152376	29036308	45699321	59817534
Non-Operating Income	286968	0	462175	38000	24276
Other Income	13206186	13690768	49039122	30072127	57135632
Total Income	428174049	645607349	807324858	908022877	1196468160
Expenses to Income ratio	73.03	73.34	104.75	85.61	94.52

Appendix-6

Calculation Of Total Expenses To Total Income ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	91980954	153708962	271710950	408188955	813619042
Employees Expenses	20310190	26087462	33620506	48247208	79384785
Office Overhead Expenses	30898025	44124593	55721156	71480863	114816885
Foreign Exchange Loss	0	0	0	0	0
Non-Operating Expenses	0	0	0	0	0
Expenses from Extraordinary Activities	0	0	0	0	8857466
Provision for Losses	0	16472805	20544230	48048820	39842447
Provision for Staff Bonus	9707026	9154287	13913186	21698189	30500289
Total Expenses	152896195	249548109	395510028	597664035	1087020914
Interest Income	198184538	305560896	481523807	729872484	1265582131
Commission and Discount	7552790	13774645	20177802	21454424	32547830
Foreign Exchange Gain	7170573	12050770	14245653	27487389	38682163
Non-Operating Income	0	3195	35535	506222	0
Other Income	7981760	9701472	18659095	31294159	46354212
Total Income	220889661	341090978	534641892	810614678	1383166336
Expenses to Income ratio	69.22	73.16	73.98	73.73	78.59
Calculation Of Total Expenses To Total Income ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	118438529	190589535	280277851	421871791	712348311
Employees Expenses	29933955	37640491	47944202	63994813	86407247
Office Overhead Expenses	37122391	50122992	64388556	83848664	112972785
Foreign Exchange Loss	0	0	0	0	0
Non-Operating Expenses	9088866	8970912	8364867	7995173	7594833
Expenses from Extraordinary Activities	0	724256	4309340	7636567	4413129
Provision for Losses	18226032	15625545	22756445	36407480	41360065
Provision for Staff Bonus	3677938	5063566	9563142	17647563	26595510
Total Expenses	216487711	308737297	437604403	639402051	991691880
Interest Income	214132108	319253094	470494833	711006319	1098985452
Commission and Discount	11254272	15038886	15156901	20943463	29634632
Foreign Exchange Gain	5770043	9426234	20904775	46637081	51004554
Non-Operating Income	911756	0	0	0	0
Other Income	4427063	9788554	15710023	25482082	70919293
Total Income	236495242	353506768	522266532	804068945	1250543931
Expenses to Income ratio	91.54	87.34	83.79	79.52	79.30

Appendix-7

Calculation Of Total Expenses To Total Income ratio of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	225992488	340221921	421374951	505995879	767196816
Employees Expenses	39003504	45494167	54920384	72073510	84544834
Office Overhead Expenses	51629103	57356334	64631218	81203334	109784146
Foreign Exchange Loss	0	0	0	0	0
Non-Operating Expenses	0	0	0	0	0
Expenses from Extraordinary Activity	4261599	10359202	94457231	6037521	0
Provision for Losses	19952248	60913102	37770737	25414298	39509378
Provision for Staff Bonus	18302979	13739169	23090854	35519269	45463799
Total Expenses	359141921	528083895	696245375	726243811	1046498973
Interest Income	457609969	579979428	725819040	931400562	1283520711
Commission and Discount	27101792	29447261	36017034	43373395	61895316
Foreign Exchange Gain	24605930	25387941	44276889	39657785	97673440
Non-Operating Income	284887	59335	409114	10649150	2489084
Other Income	9180305	20242413	26174612	37905045	44028178
Total Income	518782883	655116378	832696689	1062985937	1489606729
Expenses to Income ratio	69.23	80.61	83.61	68.32	70.25

Appendix-8

Appendix-9

Calculation Of Earning Per Employee of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84201758	103666767	170262909	174930227	261442589
No. of Staff	143	177	212	256	260
Earning Per Employee	588823	585688	803127	683321	1005548
Calculation Of Earning Per Employee of Machhapuchhre					

Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84870027	133996709	74085647	85016002	123251098
No. of Staff	137	196	234	313	439
Earning Per Employee	619489	683657	316605	271617	280754
Calculation Of Earning Per Employee of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	70279794	65252813	95305326	143172989	217915808
No. of Staff	56	72	79	116	168
Earning Per Employee	1254996	906289	1206397	1234250	1297118
Calculation Of Earning Per Employee of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	26464785	35385333	65579489	120031347	188998637
No. of Staff	108	145	186	252	299
Earning Per Employee	245044	244037	352578	476315	632102
Calculation Of Earning Per Employee of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	113755734	96587674	158475051	243058040	317434138
No. of Staff	157	166	189	232	270
Earning Per Employee	724559	581853	838492	1047664	1175682

Calculation Of Cost per unit of money lent of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	240130179	337056145	397053120	498734222	816202890
Employees Expenses	42395007	59819533	74243628	89570438	115984919
Office Overhead Expenses	71812004	88683067	104079476	148143138	186502160
Total Operating Cost	354337190	485558745	575376224	736447798	1118689969
Total Amount Disbursed	5643337405	7007787514	9062433481	11522380653	14795261241
Cost per unit of money lent	6.28	6.93	6.35	6.39	7.56
Calculation Of Cost per unit of money lent of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	187027981	288661548	397721715	407919238	580036192
Employees Expenses	29581861	43410161	54360311	71421059	90995685
Office Overhead Expenses	59973169	85924279	101467631	124408422	182841038
Total Operating Cost	276583011	417995988	553549657	603748719	853872915
Total Amount Disbursed	5130223362	6146572956	7319939264	8964070292	12984459357
Cost per unit of money lent	5.39	6.8	7.56	6.74	6.58
Calculation Of Cost per unit of money lent of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	91980954	153708962	271710950	408188955	813619042
Employees Expenses	20310190	26087462	33620506	48247208	79384785
Office Overhead Expenses	30898025	44124593	55721156	71480863	114816885
Total Operating Cost	143189169	223921017	361052612	527917026	1007820712
Total Amount Disbursed	2634930609	3869269993	6319727198	9480786943	13504795701
Cost per unit of money lent	5.43	5.79	5.71	5.57	7.46
Calculation Of Cost per unit of money lent of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	118438529	190589535	280277851	421871791	712348311
Employees Expenses	29933955	37640491	47944202	63994813	86407247
Office Overhead Expenses	37122391	50122992	64388556	83848664	112972785
Total Operating Cost	185494875	278353018	392610609	569715268	911728343
Total Amount Disbursed	2726143794	4280106038	6529239211	9794438354	13463349018
Cost per unit of money lent	6.8	6.5	6.01	5.82	6.77
Calculation Of Cost per unit of money lent of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Interest Expenses	225992488	340221921	421374951	505995879	767196816
Employees Expenses	39003504	45494167	54920384	72073510	84544834
Office Overhead Expenses	51629103	57356334	64631218	81203334	109784146
Total Operating Cost	316625095	443072422	540926553	659272723	961525796
Total Amount Disbursed	4909355200	6902123944	9128649206	11465334005	13915850035
Cost per unit of money lent	6.45	6.42	5.93	5.75	6.91

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Appendix-11

Calculation Of Return on Equity of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84201757	103666767	170262909	174930227	2614425
Shareholder's Fund	641762737	863850557	1025630159	1364885269	16549527
Return on Equity	13.12	12.00	16.60	12.82	15.
Calculation Of Return on Equity of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84870027	133996709	74085647	85016002	1232510
Shareholder's Fund	637739384	931091357	1000264635	1163346958	17001980
Return on Equity	13.31	14.39	7.41	7.31	7.
Calculation Of Return on Equity of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	70279794	65252813	95305326	143172989	2179158
Shareholder's Fund	387888643	603141455	793709939	1068346086	12787445
Return on Equity	18.12	10.82	12.01	13.40	17.
Calculation Of Return on Equity of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	26464785	35385333	65579489	120031347	1889986
Shareholder's Fund	643569741	679033374	864392563	1156375808	13432190
Return on Equity	4.11	5.21	7.59	10.38	14.
Calculation Of Return on Equity of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	113755734	96587674	158475051	243058040	3174341
Shareholder's Fund	684193958	766462479	917990162	1303426900	16602537
Return on Equity	16.63	12.60	17.26	18.65	19.

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Appendix-13

Calculation Of Earnings Per Share of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84201758	103666767	170262909	174930227	2614425
No. of Shares	5000000	6250000	7500000	10700000	118609
Earnings Per Share	16.84	16.59	22.7	16.35	22.
Calculation Of Earnings Per Share of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84870027	133996709	74085647	85016002	1232510
No. of Shares	5500000	7150000	8216513	8216513	147926
Earnings Per Share	15.43	18.74	9.02	10.35	8.
Calculation Of Earnings Per Share of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	70279794	65252813	95305326	143172989	2179158
No. of Shares	3500000	5000000	6000000	8228000	95220
Earnings Per Share	20.08	13.05	15.88	17.4	22.
Calculation Of Earnings Per Share of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	26464785	35385333	65579489	120031347	1889986
No. of Shares	6098390	6099173	7296970	9131963	109808
Earnings Per Share	4.34	5.8	8.99	13.14	17.
Calculation Of Earnings Per Share of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66

Net Profit After Tax	113755734	96587674	158475051	243058040	3174341
No. of Shares	5000000	6000000	6600000	9438771	114048
Earnings Per Share	22.75	16.1	24.01	25.75	27.

Appendix-14

Calculation Of Cash Reserve Ratio of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
NRB Balance	219830413	210552637	384844510	244576115	1120760
Total Deposit	6268954431	7768957276	10557416461	12774281014	15710925
NRB Balance To Total Deposit	3.51	2.71	3.65	1.91	
Calculation Of Cash Reserve Ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
NRB Balance	463232971	489090528	785688815	893295419	1755982
Total Deposit	5586802644	7893297672	9475451509	11102242263	15596790
NRB Balance To Total Deposit	8.29	6.2	8.29	8.05	1
Calculation Of Cash Reserve Ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
NRB Balance	45636582	48831305	380563747	269812304	984981
Total Deposit	2461922522	3918076217	6625078506	10191440970	15854798
NRB Balance To Total Deposit	1.85	1.25	5.74	2.65	
Calculation Of Cash Reserve Ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
NRB Balance	319544000	225123000	323697613	720394571	1243649
Total Deposit	3051758905	4444351452	7611653306	10917232367	16051303
NRB Balance To Total Deposit	10.47	5.07	4.25	6.6	
Calculation Of Cash Reserve Ratio of NIC					

Year	2061/62	2062/63	2063/64	2064/65	2065/66
NRB Balance	837300718	455769231	262735366	634114316	970981
Total Deposit	6241378160	8765950638	10068230869	13084688672	15579930
NRB Balance To Total Deposit	13.42	5.2	2.61	4.85	

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Appendix-16

Calculation Of Return on Assets of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84201758	103666767	170262909	174930227	261442589
Total Assets	7428303218	9010276184	11918311429	15026599175	18538565109
Return on Assets	1.13	1.15	1.43	1.16	1.41
Calculation Of Return on Assets of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	84870027	133996709	74085647	85016002	123251098
Total Assets	6456460820	9069830401	10807616906	12498548226	17490782101
Return on Assets	1.31	1.48	0.69	0.68	0.70
Calculation Of Return on Assets of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	70279794	65252813	95305326	143172989	217915808
Total Assets	3091102752	4756935449	7954664475	11668355950	17881750138
Return on Assets	2.27	1.37	1.2	1.23	1.22
Calculation Of Return on Assets of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	26464785	35385333	65579489	120031347	188998637
Total Assets	3809775993	5205190267	8582688552	12695021516	18386412982
Return on Assets	0.69	0.68	0.76	0.95	1.03
Calculation Of Return on Assets of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Net Profit After Tax	113755734	96587674	158475051	243058040	317434138
Total Assets	7510396565	10383601708	11679339865	15238736314	18750633197
Return on Assets	1.51	0.93	1.36	1.6	1.70
Calculation Of Cash At Vault Ratio of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Cash and Bank Balance	443371369	389629798	672112951	933841677	1776298800
Total Deposit	6268954431	7768957276	10557416461	12774281014	15710925263
Cash At Vault Ratio	7.07	5.02	6.37	7.31	11.31
Calculation Of Cash At Vault Ratio of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Cash and Bank Balance	731133276	813923936	1284080185	1588563632	2766649116
Total Deposit	5586802644	7893297672	9475451509	11102242263	15596790845
Cash At Vault Ratio	13.09	10.31	13.55	14.31	17.74
Calculation Of Cash At Vault Ratio of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Cash and Bank Balance	130729165	71996306	517226354	437425269	1547684101
Total Deposit	2461922522	3918076217	6625078506	10191440970	15854798403
Cash At Vault Ratio	5.31	1.84	7.81	4.29	9.76
Calculation Of Cash At Vault Ratio of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Cash and Bank Balance	469543585	225123980	469722133	1238160854	1832777723

Total Deposit	3051758905	4444351452	7611653306	10917232367	16051303096
Cash At Vault Ratio	15.39	5.07	6.17	11.34	11.42
Calculation Of Cash At Vault Ratio of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Cash and Bank Balance	926452242	629336041	599758632	1192348786	1461150549
Total Deposit	6241378160	8765950638	10068230869	13084688672	15579930904
Cash At Vault Ratio	14.84	7.18	5.96	9.11	9.38
Calculation Of Investment in Government securities of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Investment in Govt. securities	1119994197	1114319438	1297867040	1469095002	1080094990
Total Deposit	6268954431	7768957276	10557416461	12774281014	15710925263
Investment in Govt. securities ratio	17.87	14.34	12.29	11.5	6.87
Calculation Of Investment in Government securities of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Investment in Govt. securities	127336220	904471864	951272430	827351580	477814030
Total Deposit	5586802644	7893297672	9475451509	11102242263	15596790845
Investment in Govt. securities ratio	2.28	11.46	10.04	7.45	3.06
Calculation Of Investment in Government securities of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Investment in Govt. securities	276270433	398334670	625748040	850084470	1693573056
Total Deposit	2461922522	3918076217	6625078506	10191440970	15854798403
Investment in Govt. securities ratio	11.22	10.17	9.45	8.34	10.68
Calculation Of Investment in Government securities of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Investment in Govt. securities	0	0	684705823	977826200	883644580
Total Deposit	3051758905	4444351452	7611653306	10917232367	16051303096
Investment in Govt. securities ratio	0	0	9	8.96	5.51
Calculation Of Investment in Government securities of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Investment in Govt. securities	1194313877	1756585150	1104060515	1545375347	2195003685
Total Deposit	6241378160	8765950638	10068230869	13084688672	15579930904
Investment in Govt. securities ratio	19.14	20.04	10.97	11.81	14.09

Calculation Of Loan To Deposit Ratio Of Kumari					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan	5643337405	7007787514	9062433481	11522380653	14795261241
Total Deposit	6268954431	7768957276	10557416461	12774281014	15710925263
Loan To Deposit Ratio	90.02	90.2	85.84	90.2	94.17

Calculation Of Loan To Deposit Ratio Of Machhapuchhre					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan	5130223362	6146572956	7319939264	8964070292	12984459357
Total Deposit	5586802644	7893297672	9475451509	11102242263	15596790845
Loan To Deposit Ratio	91.83	77.87	77.25	80.74	83.25
Calculation Of Loan To Deposit Ratio Of Siddhartha					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan	2634930609	3869269993	6319727198	9480786943	13504795701
Total Deposit	2461922522	3918076217	6625078506	10191440970	15854798403
Loan To Deposit Ratio	107.03	98.75	95.39	93.03	85.18
Calculation Of Loan To Deposit Ratio Of Laxmi					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan	2726143794	4280106038	6529239211	9794438354	13463349018
Total Deposit	3051758905	4444351452	7611653306	10917232367	16051303096
Loan To Deposit Ratio	89.33	96.3	85.78	89.72	83.88
Calculation Of Loan To Deposit Ratio Of NIC					
Year	2061/62	2062/63	2063/64	2064/65	2065/66
Total Loan	4909355200	6902123944	9128649206	11465334005	13915850035
Total Deposit	6241378160	8765950638	10068230869	13084688672	15579930904
Loan To Deposit Ratio	78.66	78.74	90.67	87.62	89.32

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