

CHAPTER - I

INTRODUCTION

1.1 General Background

Nepal is developing country with agro-based economy. Agriculture, fisheries and forestry altogether account for some 39% of the country's GDP. During the last decade the average growth in the GDP was around 5%. However, the last year (FY 2005/06) GDP growth was 2.3 percent. The overall growth rate depends primarily on the growth rate of agriculture sector. The growth in other sectors of the economy is constrained by the small domestic market, poor physical infrastructure, inadequate human and financial resources, and land-locked ness of the country, the political instability and the topography of the country. In later years the insecurity caused by moist insurgency though currently resolved has also become a major factor to limit the overall economic development of the country.

Nepal is one of the least developed countries in the world. The country has one of the lowest levels of per capita income in the world. During the first eight months of fiscal year FY 2062/63, the country's economy depicted the following:

- The level of inflation in 2063 Falgun stood at 6.2%.
- The exports have decreased by 3.5% in the first seven months of FY 2063/064.
- The imports have increased by 0.3% in the same period.
- The Balance of Payment stood at Rs.6.3 billion at the end of Magh 2063.
- The foreign exchange reserve as on Magh end 2063 is Rs.163 billion.
- The GDP growth was 2.3% in FY 2062/063.

(Source: Nepal Rastra Bank Annual Report 2064):

1.2 Background of the study:

A bank is a financial institution, which accepts deposit from the public and mobilizes deposit to the public as loans and thereby makes a profit. A banking system is indispensable in the modern society and plays a pivotal role in the economic development of the country. In the current scenario, there are a large number of institutions dealing with the finances, operating in the country. In Nepal, by mid April 2006, there are twenty Commercial Banks of class A, twenty-eight Development Banks of class B, five Rural Development Banks, sixty seven Finance companies of class C, eleven development banks of class D including five Grameen banks, nineteen cooperative societies and forty-seven NGOs' operating as financial institutions.

The banks can be further classified into various categories on the basis of their functions:

- Central Bank
- Commercial Bank
- Development Bank

The central bank controls the entire currency and credit of the country. It also undertakes the major functional operation of the government and through this influences the behavior of other financial institutions so as to support and develop the country's economy as a whole.

Commercial banks, on the other hand, perform different functions like accepting deposits, capital formation, granting credits, remittances, foreign exchanges etc. The functions of these banks are concentrated on fulfilling the needs of the customers. Thus, various new and modern facilities have emerged like Credit cards, debit cards, ATM, tele-banking, e banking, lockers etc.

The activities of the development banks are focused on the development of the certain sectors of the economy. But, their overall operations are similar to the commercial banks. They are also entitled to accept deposits and lend money to the public. Thus, they are also an important part of the banking system.

1.3 Statement of Problem:

Commercial Banks play vital role in economic growth of a country. As being a commercial institution, a commercial bank must make profit out of its operations for its survival and fulfillment of its responsibilities. The major activities of the commercial banks include mobilization of resources, which involves cost, and profitable deployment of the resources, generating income. The excess return, income over expenses, is the main source of profit to the bank. In case the bank fails to generate sufficient returns on the resources deployed, it is a drain on the company's resources and the country's resources as well.

In Nepalese economy, government owned and privately incorporated banks co-exist. However, the performance of the privately incorporated banks is much better than those with the government control. As such, a large number of banks and finance companies beside the cooperative societies have mushroomed in the last decade. Because of the tailor-made product and services provided by the private institutions, they have been able to perform significantly well in the market.

A Joint venture is an association of two or more persons or parties undertaken to make the operation highly effective with their collective efforts. This sort of financial institutions under the combined capital of persons or between organizations, are meant to work for the development of trade, commerce & industry.

Joint venture means” a business contract of management effort between two persons, companies or organizations involving risk and benefit sharing”

Joint venture banks are generally considered as benchmark of quality services in Nepalese banking sector. However, in the current unstable environment and declining economy, the productivity of all sectors of the economy has been affected. Likewise, it is affecting the banking performance in various aspects like financial, operational, productivity and profitability sectors, which is a

cause for the decline in the profit of all types of financial institutions. In this context, an analysis of Joint Venture Banks' performance with regard to their profitability is essential as it provides an insight to the joint venture bank's industry situation with respect to profitability.

Profit is essential for an entity to survive in the short run and to grow in the long run. Evaluation of profitability of Nabil Bank makes sense to know its ability to survive and grow in comparison to other joint venture banks operating in the same business environment. To explore the issue, it would be appropriate to carry out a benchmarking study of Nabil Bank profitability against the Joint Venture (JV) Bank industry of the country.

1.4 Objectives of the Study:

The general objective is to dissect the performance of Nabil Bank in respect of its ability to produce profits in comparison to the sample banks. Thus the major objectives are:

1. To examine the profitability situation of the JV bank industry as a whole and sample banks.
2. To analyze the profitability trend of Nabil Bank and the JV bank industry the over the last five years
3. To ascertain the comparative position of profitability of Nabil Bank with respect to other JV banks

1.5 Significance of the Study:

The mushrooming of commercial banks, development banks, finance companies and co-operatives in a short span of time has brewed new competitive scenario and has posed a new challenge to sustain and perform well in the market. Private Banks is covering a significant banking market, and among the private banks joint venture banks are the prime players. Though the overall banking market is expanding day by day, the market place is gradually becoming like a battle field for banks due to increase in competition. Moreover, the prevailing economic and social condition has further made it difficult to do

so. In this context, the analysis of the financial performance of JV Banks, the industry as a whole, and the Nabil Bank in particular would be more appropriate to contrast Nabil bank out from all other joint venture banks. This study is therefore necessary to provide information to a wide range of stakeholders on the profitability position of Nabil Bank compared to the JV bank industry and JV banks individually.

1.6 Limitations of the Study:

Social science research is a complex process. From conceptualization of the research area to research design, collecting data, analyzing the data as well as drawing the conclusion, all stage have some kinds of limitations. So, this study is also not an exception. Although, the effort has been made to minimize the limitations to the best possible extent, yet it suffers from the following limitations:

1. The research is mostly based on the secondary data published and processed by the respective banks. Information other than provided in the secondary data has been collected from the banks through personal contact and from the Banking Regulation Department, Nepal Rastra Bank.
2. The scope of research is only JV banks. The Banks included in this research are Nabil, Standard Chartered, Himalayan, NB, Everest and NSBI bank. The profitability condition of the banking industry computed here therefore may not represent the whole commercial banking industry of the country composed of 20 commercial banks.
3. Findings will be based only on the five fiscal years' data (2002 to 2006) of Sample banks.

1.7 Profile of Nabil Bank Ltd.

1.7.1 Establishment:

Nabil Bank Limited, formerly known as Nepal Arab Bank Limited, Was

incorporated on 29 Baisakh 2041(11May 1984)as the first foreign joint venture bank in Nepal with the Authorized capital of Rs.100 million and called-up share capital of Rs 30 million.It commenced its operation from 12 July, 1984 with the Technical Service Assistance and 50% shares of Dubai Bank Limited (Acquired in April 1985 by Emirates Bank International Limited, Dubai) and remaining 50% shared among Nepal Industrial Deveioption Corporation 10%, Rastriya Beema sansthan 9.67%,Nepal Stock Exchange Limited 0.33% and Nepalese General Public 30%.Today, the total paid-up capital of the establishment is Rs.491,654,400 and the foreign investor is NB(international) Limited ,ireiand.

The total number of staffs of Nabil Bank Ltd is 426 as at 15 July 2005.

1.7.2 Branches:

Nabil provides a full range of commercial banking services through its 17 points of representation across the kingdom and over 250 reputed correspondent banks across the globe. The head office of the bank is located at Kantipath, Kathmandu. Besides the head office, the bank has 28 numbers of branches within the country.

1.7.3 Banking Product & Services:

Nabil Bank has been providing full-fledged Commercial banking services to the clients. The facilities provided by the bank are as follows:

- Deposits.
- Loans and advances.
- Export finance.
- Import finance.
- Bank Guarantees.
- Remittances.
- Bill Purchase.
- SWIFT facility for remittances and Letter of Credit.

- Lockers.
- Tele banking.

1.7.4 Technology:

From its inception, the bank has been providing the services with latest technologies and computerized equipments. The bank is providing Tele banking facilities, which enables the clients to get the information as well as statements through fax whenever required simply by dialing a phone. The bank is using world-renowned software from Infosys Technologies System, Bangalore, India. The bank has also obtained a membership of SWIFT which has enables it to transmit messages of remittances, Letter of credit etc. to other member banks in no time.

1.8 Organization of the Study:

Chapter I - General Background:

This chapter includes Current picture of the Nepalese economy, background of the study, statement of problem, objective of study, significance of study, limitation of the study and profile of Nabil Bank Ltd.

Chapter II - Conceptual Review:

This chapter includes the concept of commercial banks, conceptual framework of relevant terminologies, the summary of the financial statements of the commercial banks and review of previous works and publications.

Chapter III - Research Methodology:

This chapter includes the research design, data collection procedures and the tools and techniques to be employed for the analysis of the data.

Chapter IV - Data Presentation, Analysis and Major Findings:

This part of the study includes presentation and analysis of financial figures of various banks. This presentation and analysis helps to come to the ultimate conclusion of the study. The financial figures of the individual institutions as

well as of the industry as a whole are dissected and analyzed in detail to arrive at the conclusion. The analysis is made on the basis of various tools and techniques like ratio analysis, comparisons and trend analysis. This part also contains the list of major findings derived from the analysis.

Chapter V - Summary, Conclusion and Recommendations:

Summary of the findings of the study are outlined in this chapter. Conclusion on the comparative position of the Nabil bank against the JV bank industry is presented in this section. Recommendations on the solutions to the foreseen problems foreseen problems are also recommended which could be helpful in better performance in the forthcoming years.

CHAPTER - II

REVIEW OF LITERATURE

A literature review is an account of what has been published on a topic by accredited scholars and researchers. A review may be a self-contained unit an end in itself –or a preface to and rationale for engaging in primary research. A review is a required part of grant and research proposal and often a chapter in thesis and dissertations. The purpose of writing the literature review is to convey the reader what knowledge and ideas have been established on a topic and what their strength and weaknesses are.

This chapter sheds light on the conceptual framework of the commercial banks and joint venture banks. This chapter is also concerned with the review of literature relevant to the financial statements of commercial banks, specially the contents of the Balance sheet and the Profit & Loss Account. The chapter also provides insight into the findings of earlier studies through the review of books, publications and previous studies.

2.1 Concept of Banks:

Bank in simple terms means a place where we keep our money for safekeeping and from where we can borrow money in case of need. So, in other words a bank is an organization, which collects funds from the public in form of deposit and mobilizes these deposits to the public as loan and thereby makes a profit.

However, many individuals and institutions have defines bank in their own ways:

G.Crowther in “An outline of money” defines bank as “an institution, which collects money from those who have it spare or who are saving it out of their income and lends this out to those who require it.”

According to R.S. Sayers in "Modern Banking": I believe in the fact that banks are not merely purveyors of money, but also, in an important sense manufacturers of money.

According to Horace White in "Money & Banking": "Bank is a manufacturer of credit and machine for facilitating exchanges."

The shorter Oxford English Dictionary defines it as "an establishment for the custody of money received from or on behalf of its customers its essential duty is to pay their draft on it, its profit arise from its use of the money left unemployed by them."

As per Oxford Dictionary, "Bank" is "an establishment for keeping money and valuable safely, the money being paid out on the customer's order (by means of cheque)"

The Random House Dictionary of the English Language defines the bank as "an institution for receiving money and in some cases, issuing notes and transacting other financial business."

According to Hallsbury's Laws of England "A banker as an individual, partnership or corporation, whose sole or dominating business is banking, that is, the receipt of money on current or deposit account, and the payment of cheques drawn by and the collection of cheques paid in by a customer."

The conclusion that we can draw from these definitions is that the core function of a bank is to accept deposits and provide loans and advances and thereby make a profit.

2.2 Needs of Banks:

In order to develop the country as a whole, economic development is the key. Among many factors that have significant impact in the economic development, Banking is one. The major needs of the bank can be highlighted

as follows:

- To relieve people from financial exploitation
- To develop industry and commerce
- For economic development
- To provide security of valuable goods and property
- To transfer funds
- To create employment and skilled entrepreneurship
- To develop the saving habit
- To monetize the economy
- To develop agricultural and backward areas
- To balance economic development as a whole
- To exchange and control foreign currencies
- To control and regulate money management, credit and price stability

2.3 Origin of Banking in Nepal:

The history of banking in Nepal may be described as a component of the gradual and orderly evolution in the financial and economic sphere of the Nepalese life. Even now the financial system is still in evolutionary stage. The extension of the unorganized money markets, consist of Landlords, Sahukars, Shopkeepers and other indigenous individual moneylenders have acted as barriers to institutionalized credit. Although their influence have been decreasing in the urban areas the absence of banking institutions in the remote areas mean that the people living there still have to depend on the traditional lenders to meet their needs.

The history of banking in Nepal is not long. During the Prime Minister-ship of Ranodwip Singh in 1877 A.D. “Tejarath Adda” was established. The main purpose of it was to provide credit facilities to the general public at a very low rate of interest at 5%. The credit facilities were extended against security of gold, silver and other valuables. This was the first institution to provide such services. Tejarath Adda extended its services outside the Kathmandu valley by opening branches.

The banking in Nepal took a significant step forward with establishment of Nepal Bank Ltd in the late 20th Century of B.S Calender. In cooperation with the Imperial bank of India, Nepal Bank Ltd. came into existence in 1994 B.S. with an authorized capital of Rs.10.00 Million and paid up capital of Rs.0.842 Million. After the establishment of Nepal Bank Limited, it took over the responsibilities of the Tejarath Adda too.

Although the commercial bank was established, the Nepalese economy continued to face various difficulties caused by the dual currency system and unstable exchange rates. Therefore an urgent need was felt for the establishment of Central Bank dedicated to the development of banking and finance to promote trade and industry, to manage the circulation of national currency and to stabilize the exchange rates. Thus, Nepal Rastra Bank Act was formed in 1955 and through which Nepal Rastra Bank came into existence.

Nepal Rastra Bank came in existence on 14 Baisakh 2013. The NRB has played a significant role in the monetisation of the economy. Within a decade of its establishment the dual currency system was completely abolished, the exchange rate of the Indian Rupee was stabilized and the foreign exchange reserves came under the jurisdiction of the NRB.

As the monetary transactions became larger and more complicated Nepal Rastra Bank requested suggested the Government to establish another commercial bank. Thus, the government formulated a Commercial Bank Act in 2031 and which paved the way for establishment of Rastriya Banijya Bank. Rastriya Banijya Bank along with Nepal Bank Limited entered the far-flung remote areas of the country and provided banking services there. These two banks still have the largest network of branches in the country and in many remote areas.

As the economic condition changed and the economic development gathered speed it was felt that Nepal Bank Ltd. and Rastriya Banijya Bank were not sufficient to cope in the changing environment. Thus, in FY 2039/040 the policy for allowing establishment of foreign joint venture banks was taken with

an aim of having fair competition and skill development in the banking sector.

The reforms that were carried out in the 1980s were:

- allowing foreign banks to operate as a joint venture
- lifting of control on the interest rates
- introduction of the auctioning of the government security

This created a favorable environment for the establishment of various banks.

Thus the following Commercial Banks came into existence in chronological order:

1. Nepal Arab Bank Ltd. (Currently known as Nabil Bank Ltd.)
2. Nepal Indosuez Bank Ltd. (Currently known as Nepal Investment Bank Ltd.)
3. Nepal Grindlays Bank Ltd.(Currently known as Standard Chartered Bank Nepal Ltd.)
4. Himalayan Bank Ltd.
5. Nepal SBI Bank Ltd.
6. Nepal Bangladesh Bank Ltd.
7. Everest Bank Ltd.
8. Bank of Kathmandu Ltd.
9. Nepal Bank of Ceylon Ltd. (Currently known as Nepal Credit & Commerce Bank)
10. Lumbini Bank Ltd.
11. Nepal Industrial & Commercial Bank Ltd.
12. Machhapuchhre Bank Ltd.
13. Kumari Bank Ltd.
14. Laxmi Bank Ltd.
15. Siddhartha Bank Ltd.
16. Global Bank Ltd.
17. Citizens Bank International Ltd.
18. Prime Bank Ltd.
19. Sunrise Bank Ltd.
20. Bank of Asia Nepal ltd.

21. Development Credit Bank Ltd.

22. NMB Bank Ltd.

2.4 Joint venture banks:

2.4.1 Meaning:

Various authors and experts have defined joint venture in their various ways:

According to D.P.Gupta in "The Banking System: Its role in Export development" "A joint venture is the joining of forces between two or more enterprises for the purpose of carrying out specific operation (industrial or commercial investment, production or trade)"

As per Jauch & Glueck In Business Policy and Strategic Management, 5th edition, (New York: McGraw Hill Book Company, 1988), P.232 "When two or more independent firms mutually decide to participate in a business venture, contribute to the total equity or more or less capital and establish a new organization, it is known as a joint venture."

B.N.Ahuja in Dictationery of Management, 2nd edition ,academic (India)publishers describes joint venture "as a business contract of management effort between two persons, companies or organizations involving risk and benefit sharing"

In summary, a joint venture bank is one, which is established as an agreement between two or more than two parties with a purpose of providing banking facilities to the public. They also agree to participate in the equity and on the returns/losses made by the entity in predetermined proportions.

2.4.2 Joint venture banks in Nepal:

The joint venture banks in Nepal have a short history. These types of banks came in existence after the reforms in the 1980's.

According to Pramesh K.C. The Financial System : The evolution of Nepalese

Financial Institution; Banijya Sansar, (ABS, Vol.13, Issue 8, T.U., Kathmandu, 2048, pp. 69-74), the basic reforms that were carried out in the 80's were as follows:

- Allowing foreign banks to operate as a joint venture
- Lifting of control on the interest rates
- Introduction of the auctioning of the government security

Before these reforms were introduced, the Commercial banks that were in operation were only Nepal Bank Ltd. and Rastriya Banijya Bank Ltd., both of which were government controlled. Being the government controlled, they lacked the efficiency of a private organization and the prompt decision-making. Besides that the absence of other financial institutions in the market gave them a monopoly over the market. The public had nowhere else to turn and had to surrender to the hassles of these organizations. So, as the economic development gathered speed and volume of transaction started to grow, the government carried out those reforms.

As per M.K.Shrestha in “ Commercial Banks comparative Performance Evaluation (Kathmandu: Karmachari Sanchaya Kosh 2047),says HMG's deliberate policy of allowing joint venture banks to operate in Nepal is basically targeted to encourage local traditionally run commercial banks to enhance their bankable capacity through competition, efficiency, modernization, mechanization via.computerization and prompt customer services.

2.4.3 Role of Joint Venture Banks in Nepal:

The establishment of joint venture banks in Nepal have brought about the following changes in the market:

1. Modern management and banking techniques:

The banks today are more professionally run and with modern management techniques thereby minimizing the hassles faced by the clients. The banks

today employ more and more professional to carry out the jobs, which has increased their efficiency and effectiveness. The banks are also employing latest banking soft wares to provide more efficient services.

2. Customer oriented:

The focus today is in the requirements of the customers. The market today is the buyers' rather than the sellers. The banks are continuously innovating and coming out with new products to fulfill the demands of the customers.

3. Creation of the competitive environment:

The entry of more players in the market, have increased the competition manifolds. The bargaining power of the customer has increased and the banks are always on their toes to perform better than their contemporaries by providing better and tailor made products and services to its clients.

4. Contribution to the national economy:

The banks have contributed significantly to the national economy. The banks by providing more and more customized services have developed the banking habits of the public. These banks have invested in various productive sectors, which ultimately contribute to the development of the national economy. Through their efficient and effective operations they have managed to make efficient use of the rare resources. Besides that another important role played by these banks is in the human resources development. These banks have provided a large volume of employment to the public both directly and indirectly.

5. Information to the foreign investors:

The joint ventures banks in our country have been performing significantly well. So, they have been instrumental in providing good returns to the foreign investors. Besides that they also provide information regarding economic environment in the country. They can also provide information about the

potential profitable sectors of the economy and help in bringing the foreign investment in the country.

2.4.4 List of the joint venture banks of Nepal:

After the economic reforms in the 80s, several banks came into existence. The joint venture banks that came into existence are as follows:

1. Nepal Arab Bank Limited (Currently known as Nabil Bank Ltd.)
2. Nepal Indosuez Bank Limited (Currently known as Nepal Investment Bank Ltd.)
3. Nepal Grindlays Bank Limited (Currently known as Standard Chartered Bank Nepal Ltd.)
4. Himalayan Bank Limited
5. Nepal SBI Bank Limited
6. Nepal Bangladesh Bank Limited
7. Everest Bank Limited
8. Bank of Kathmandu
9. Nepal Bank of Ceylon (Currently known as Nepal Credit & Commerce Bank)

2.5. Conceptual Review of Relevant Terminologies:

2.5.1 Revenue:

The amount of money received or receivable from selling a given quantity of product or services is called revenue. Every entity earns revenue and it is the lifeblood of any business entity. If any business cannot generate sufficient level of revenue, it cannot continue to exist for a long period of time.

The International Accounting Standard (IAS 18) states “Revenue is the gross inflow of economic benefits during the period arising in the ordinary activities of an enterprise when those inflows result in increase in equity, other than increases relating to contributions from equity participants.” The standard classifies the sources of revenue into three categories namely sale of goods,

rendering of services and use of enterprise's resources. The standard further goes on to provide the measurement devices for the revenue under various transaction-cycles of goods, rendering services use of enterprise's resources.

In order to be recognized as revenue under the different categories, the following needs to take place:

2.5.2 Sale of goods:

- The enterprise has transferred the significant risks and rewards of ownership of the goods to the buyer.
- The enterprise has no continuing managerial involvement to the degree usually associated with ownership, and no longer has effective control over the goods sold
- The amount of revenue can be measured reliably
- It is probable that the economic benefits associated with the transaction will flow to the enterprise.
- The costs incurred in respect of the transaction can be measured reliably.

2.5.3 Rendering of services:

- The amount of the revenue can be measured reliably.
- It is probable that the economic benefits associated with the transaction will flow to the enterprise.
- The stage of completion of the transaction at the balance sheet date can be measured reliably.
- The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

2.5.4 Interest, royalties and dividends:

- It is probable that the economic benefits associated with the transaction will flow to the enterprise.
- The amount of the revenue can be measured reliably.
- Interest is recognized on a time proportion basis that takes into account

the effective yield on interest.

- Royalties are recognized on an accruals basis in accordance with the substance of the relevant agreement.
- Dividends are recognized when the shareholder's right to receive payment is established.

2.5.5 Accounting Policy:

International Accounting Standard (IAS 1) defines it as “the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.” Thus, accounting policy is the heart of any financial statements. One example of an accounting policy is the revenue recognition policy.

2.5.6 Accrual basis of Accounting:

Under this principle, the effects of transactions are recognized when they occur regardless of actual receipt of cash. Under this method, in computing profit, revenue earned must be matched against the expenditure incurred in earning it.

2.5.7 Principle of Prudence:

Prudence is the procedure of accounting in a most cautious manner. The International Accounting Standards Committee Glossary defines it as “the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets and income are not overstated and liabilities or expenses are not understated.” It further states that prudence must be exercised when preparing financial statements because of the uncertainty surrounding many transactions. According to this principle the following issues are to be kept in mind:

- Where alternative procedure or valuations are possible, the one selected should be the one, which gives the most cautious presentation of the business's financial position or results.
- Where a loss is foreseen, it should be anticipated and taken into account immediately. Even when the exact amount of the loss is not known, an

estimate of the loss should be made, based on the best information available.

- Profits should only be recognized when the realization of cash is reasonably certain.

2.5.8 Profit & Profitability:

In business, profits are the excess of revenue over cost. In other words, business profits are the residual income, which is equal to sale proceeds minus costs. In a simple term, profits mean the residual balance of earning expected to be available with the firm that is obtained after deducting entire expenses, costs, charges and provision from total revenue of a period of time. Profit is the resources left to the firm for future growth and expansion or reward to be distributed to the entrepreneurship in the form of dividends.

2.5.9 Theories of Profit:

Economists have propounded several theories of profits to explain profits of entrepreneurs. Most of the theories are centered on the controversy about the role of the entrepreneur. In the following section we shall consider some of the fundamental theories of profit.

Theory of risk and uncertainty bearing:

It was F.B. Hawley who first developed the theory of risk bearing and concluded that profit is a reward of the entrepreneurs for bearing risks. But, the theory was picked up by Professor F.H. Knight who divided risks into insurable and non-insurable risks and concluded that profit is a reward for bearing non-insurable risks and uncertainties. Thus according to Knight, profit is a reward to the entrepreneur for his non-transferable function of bearing non-insurable risk and uncertainties.

Dynamic theory of Profit:

This theory was propounded by J.B. Clark. According to this theory, 'dynamic changes' in the economy are the basic causes of emergence of profits. There is

no profit in a static economy as no changes take place. In a dynamic economy there are constant changes in population, capital, methods of production and industrial set up. These changes multiply wants of consumers, which earn profits to the entrepreneur.

Innovation theory of profits:

Joseph Schumpeter singled out 'innovation' from the dynamic theory of profits and developed the innovation theory of profits. According to Schumpeter changes take place in a dynamic economy and innovation in the changing world gives rise to profits. In his view, the entrepreneur plays an important role of introducing innovation in an economy and profits are the rewards for his role as an innovator. The innovation could be changes or techniques that reduce cost of production or increase demand for the product.

2.5.10 Accounting Policy:

Meaning of Profit:

The term profit has three meanings:

1. In economics, the concept of reward of the entrepreneur for risk taking and management.
2. In business operations, the gain from manufacturing, merchandising and selling operations after all expenses are met. Since profit normally is added to net worth, it may be measured by the increase in net worth over that of the previous accounting period.

The amount of the concern's profit thus may be determined not only through the profit and loss statement but also by the comparison of the earned surplus or net worth in the balance sheet which, however, is the residue of profits after dividends and any other appropriations and does not reveal details of sources of income and expenses, such as are found in the profit and loss account.

3. In speculative transactions, the excess of the net selling price over the costs (including all charges) of the security or commodities traded in. (Charles J

Woelfel, Encyclopedia of Banking and Finance, 1999)

Profit is a motivating factor behind many managerial activities. Much has been written about the role (as opposed to the method of calculation) of profit. Profit plays three roles in the capitalistic society. Profit is the financial reward of risk taking; profit is the financial reward for having monopoly power; profit is the financial reward for the efficient management.

The promise of profit provides a strong incentive to owners and managers to act efficiently. Therefore it is common in economic theory to hypothesize that the criteria for evaluating the action of the firm is profit maximization. The basic incentive for businesses is to produce goods and services. The profit motive is the engine for the free enterprise system. Under conditions of pure competition, economic profits residual, dynamic and temporary. Profit in this sense is revenue that remains after deducting both explicit and implicit costs, including the nominal profit considered as a cost of the entrepreneur's service. "Profit is essential for every enterprise to survive in the long run as well as to maintain capital adequacy through retained earning. It is also necessary to accept market for both debts and equity to provide funds for increased assistance to the productive sectors (Ronald I. Robinson, *The Management of Bank Funds*, (New York:McGraw-Hill, 2nd edition 1951).

Profits are constantly changing in amount and among firms. Long run forces in the economy tend to reduce or eliminate economic profit. When losses prevail, market forces tend to make adjustments that can result in profits. The other terms used for profit are surplus, reserves, income, revenue etc.

There is a wide difference between profit in the accounting and economic terms:

“Profit in the accounting sense are the excess of revenue receipts over the costs incurred in producing this revenue. This concept of profit is also known as residual concept. But, in economics, both implicit and explicit costs are deducted from total sales revenue in determining profits” (R.Cavery, Managerial Economics, Irwin Publication, 1st edition 1997)

Profit in the accounting sense is the net figure of difference between all types of measurable revenues and all measurable costs. In accounting, profit is expressed only on explicit and measurable accounting terms and on the book value basis. However, in economics, profit is measured in the realizable terms.

Multiple meaning of the word “profits” has always been troublesome. Accountants have made an energetic effort in recent years to discard the word for that purpose and to refer to the conventional concept as business income a natural term that avoids any overlap with economic theory. The most important points of difference between the economists and accountants are as follows:

1. The inclusiveness of costs i.e. what should be subtracted from revenue to get profit
2. Meaning of depreciation
3. The treatment of capital gains and losses
4. The price level basis of valuation of assets and liabilities
5. Although there may be arguments in favor and against profit generating almost all firms require earning it. Their rate of earning differs from firm to firm and time to time.

2.5.11 Need for profit:

Profit is a must for the following reasons:

1. Measurement of performance:

Profit is only one factor to measure the management efficiency, productivity and performance. Profit is the most widely used yardstick to see what really is to be achieved and where the firm is to go in the future.

2. Premium to cover costs of staying in business:

Business environment is full of risks and uncertainties. To grasp the globally changing technologies, to stay in the market uncertainties, to replace and acquire assets and enhancing business scope etc. require a profit margin.

3. Ensuring supply of future capital:

Profit is necessary to plough back in the investments like innovations, business expansion and self-financing. It also attracts investors for further investment.

4. Return to the Investors

Shareholders provide equity capital to the business because they expect the entity will provide return to their funds at least equal or above market rate of return. To maintain the shareholders expectation, it is most important that a firm should earn sufficient profit so that it can distribute dividends.

2.6 Profitability of Commercial Banks:

Unlike in any other organizations, there are various forms of stakeholders in the Bank. So, the bank also has to make the best efforts to meet the interests of the stakeholders. The majority of the needs of the stakeholders are related with the profitability of the banks. For example, in case the bank earns profits, the investors get dividends, employees get bonus, government gets benefits in forms of taxes etc. Thus, the foremost objective of the banks is the profit maximization.

The major source of funds of the bank is the public deposit. The bank in most of the cases has to pay certain rate of interest to the public in their deposit. Thus, the banks have to mobilize these funds in the profitable sectors, which derive the maximum return on the assets. Hence, the investment or granting of loan and advances by them are highly influenced by profit margin. The profit of the bank is dependent on the interest rate, volume of loan and time period of

loan. However, the bank at the same time has to ensure that their investment is safe from default.

Although the banks have to invest in order to earn profits. But, at the same time have to set aside some of its fund in order to maintain their liquidity. As we all know the major source of bank's fund is public deposits, the bank has to be able to allow the depositors to withdraw their deposit in terms of need. Thus, the bank cannot invest all its funds in the profitable sectors. Thus, a successful bank is one who invests most of its funds in different earning asset standing safely from the problem of liquidity i.e. keeping cash reserves to meet the daily requirements of the depositors. Lower the liquidity, higher the profitability and higher the liquidity, lower the profitability. So, profitability and liquidity maintain a highly negative co-relation. Since both are equally important, banks cannot afford to ignore any of them. So, the management has to make a crucial decision regarding a mixture of liquidity and profitability.

2.6.1 Financial Statements of a Commercial Bank:

The financial statement of a commercial bank includes Balance Sheet, Profit and Loss Account, Cash Flow statement and other relevant disclosures.

2.6.1.1 Balance Sheet:

The balance sheet includes two sides Capital and Liabilities and Assets side. The brief explanation on accounting heads of the balance sheet is provided below:

Capital and Liabilities:

Share Capital:

The amount of paid up capital of the bank should be mentioned under this head. The amount received against calls made should be credited in this Share Capital Account.

Reserves and Funds:

This accounting head shall contain the amount of reserves appropriated from profit, as well as created through any other process and the accumulated profit. Generally, this account shall be credited by debit to Profit & Loss Appropriation Account and utilization of such reserves shall be debited to the concerned reserve and fund accounts. The following account heads fall under this heading:

General Reserve Fund: This is a statutory reserve. Under this head, only the amount appropriated from profit as per Commercial Banking act shall be credited. Currently, 20% of the net profit should be transferred to this account. Distribution of dividend by utilizing this fund is restricted and approval of Nepal Rastra Bank shall be obtained for the use of this fund for any other purposes.

Capital Reserve Fund: Profit on revaluation of assets and capital assets received in grant from others shall be accounted under this head.

Share Premium: This represents the amount of money collected on issue of shares in excess of its face value. The outstanding amount in this account shall not be considered eligible for distribution of dividends. However, it may be used for issue of bonus shares under approval of Nepal Rastra Bank.

Other Reserves: Funds and reserves, other than those mentioned above shall be included under this head.

Accumulated Profit/Loss: Under this head, the balance of the accumulated profit or loss as per shown in the Profit and Loss Appropriation account shall be shown.

Borrowings:The borrowed funds of the bank shall be disclosed under this head.

Deposits:

Deposit received from the depositors as well as the interest payable on the deposits shall be credited to the account of the depositors. The deposit liabilities accepted by the bank shall be exhibited under this head.

Bills Payable:

Under this head, the outstanding amounts pertaining to draft, telex transfer, Payment orders issued by one branch to another branch of the bank, as well as bills drawn on the bank by other local and foreign banks shall be accounted.

Other Liabilities:

Other than the capital and liabilities mentioned above, all other liabilities of whatsoever nature shall be included under this heading. Any other accounting heads that could not be exhibited elsewhere may be included under this head, as required.

Assets Side:

Cash Balance:

This heading shall be used for showing the total amount of cash-in-vault, consisting of local and foreign currency.

Balance with Banks:

The balances of amounts in non-interest bearing accounts maintained by the bank with Nepal Rastra Bank as well as with other local and foreign banks shall be exhibited under this head.

Money at Call or Short Notice:

The amount of all interest bearing placements with other banks with maturity of less than 7 days with stipulated condition for payment at call or at short notice (48 hours) shall be exhibited under this head.

Investments:

As a line of defense to meet demands for cash and serve as a quick source of funds, banks invest certain proportion of funds in the liquid assets. These

typically include holding of shorter-term government bonds like treasury bills, development bonds etc. and other securities purchased in the open market and readily convertible into cash in the financial market Other forms of investment include investment in the shares and debentures of other companies. These investments are mainly made for their ability to generate income. The investments are to be valued at market price or cost price whichever is lower.

Loan, Advances and Bills Purchased:

The sum outstanding of all loans and advances extended to the customers as well as bills purchased and discounted bills less the amount of provisions made shall be exhibited. However, the loans extended to the staffs shall not be disclosed under this head and should be shown under other assets.

Fixed Assets:

All assets of long-term nature owned by the bank shall be accounted under this head and be exhibited in the Balance Sheet at written down value after deducting the depreciation from the total cost.

Other Assets:

The heading shall be used for accounting of any other tangible or intangible assets, not mentioned above. Stationary stock, Accrued interest on investment, accrued interest on loan, Sundry debtors, Assets in transit, Non-banking assets, Expenses not written off etc.

Contingent Liabilities:

➤ Claims on bank but not accepted by bank:

It means any compensation claimed or other claims for payments in writing by a third party for whatsoever reason against the bank to which the bank holds a different view and has not accepted the liability.

➤ Full value of unmatured guarantees shall be disclosed under this head.

➤ If the bank has entered into a forward foreign exchange contract with its customers, the full value of unmatured contract shall be disclosed under

this head.

- The full value of the letters of credit shall be disclosed under this head.

2.6.2.2 Profit & Loss Account:

The summary of the heads of account in the profit and loss account of a commercial bank is given below:

Expenses Side:

Interest Expenses:

Payment of interest on deposits accepted by the bank and on the borrowings is shown under this head.

Employee Expenses:

All expenses related to the employees of the bank for the specific period shall be included under this head. Expenses included are salary, allowances, pension, gratuity, training expenses, uniform expenses etc.

Office Overhead Expenses:

All expenses related to the office overhead of the bank during the specific period shall be included under this head. Some of the expenses under this head are house rent, insurance, audit expenses, newspapers and magazines, advertisement etc.

Exchange Loss:

The negative balance in exchange fluctuation gain/loss account shall be exhibited under this head.

Non-Operating Expenses:

These are the expenses that have no direct relationship with the operation of banking transaction. Some of the examples are loss on sale of investment and loss on sale of assets.

Bad Debts Written off:

Where the bank has written off loans on account of being unrecoverable, such written off amount to the extent not covered by loan loss provision shall be

charged to profit and loss account under this head

Provision for Loan Loss:

This is one of the most important heads of account related to the profitability of the bank. As per the directive of the Nepal Rastra Bank, the banks are required to make provisions for loan losses. The provisions are to be made on the basis of the expiry dates on the principal amount of the loans and advances. As per the directive the provisions to be made is as follows:

Category	Provision required	Criteria
Pass	1%	due upto 3 months
Substandard	25%	due for 3 - 9 months
Doubtful	50%	due for 9 months – 2 year
Loss	100%	due for more than 2 years

However, in case of bills purchased items, provision is to be provided at 1% if it stands due for 90 days and in case it remains due for more than 90 days 100% provision is required.

Staff Bonus:

The amount of bonus set aside for payment to staffs is disclosed under this head. As per the Nepal Rastra Bank directives the bank is entitled to make provision for staff bonus @ 10% on the net profit after adjustment for loan loss provision.

Provision for Income Tax:

The amount of income tax on net taxable profit for the period shall be determined through this head. Taxable profit has to be determined considering the allowable and disallowable expenses as per the prevailing Income Tax Act and Finance bill.

Net Profit:

This figure represents the excess of total income over total expenses of the bank during the period.

Income Side:

Interest Income:

This is the most significant source of income of any commercial bank. Under this head the interest received from the customers on behalf of the loans and advances and on the investments of the bank is exhibited. However, Nepal Rastra Bank has established several criteria for the recognition as interest income.

- The interest income should be recognized on cash basis.
- The amount of interest accrued but not received, have to be credited to the interest suspense account.
- In case if the interest accrued is realized within one month from the date of closure of fiscal year, such amount may be recognized in the income of the earlier fiscal year.
- The interest on loans and advances should not be recovered by overdrawing the borrower's current account or where overdraft limit has been extended, by overdrawing such limit.

Commission and Discount:

The total amount of commission, service charges and discount earned by the bank from the transactions during the period shall be exhibited under this head. Some examples are commission on issue of guarantees, commission on issuance of L/C etc.

Exchange Gain:

The foreign exchange transaction gains of the banks are to be classified separately into Trading Gain and Revaluation Gain.

Non-Operating Income:

Income or profit that has no direct relationship with the operation of banking transaction has to be recognized into Profit and Loss Account under this head. For example, loss on sale of assets, loss on sale of investment etc.

Other Income:

Receipts of all other income not specifically provided under the income heads as above shall be booked under this head. E.g. rental income of safe deposit boxes, renewal income of ATM cards etc.

Net Loss:

This figure represents the excess of total expenses over total income of the bank during the period.

2.7 Review of related Studies:

2.7.1 Review of Journals:

M.R.Sharma in article “Joint Venture Banks in Nepal: Co-existing or crowding out Prasasan”, (HMG , Year 19, No.3, 52nd issue (1988), PP.34-42) expressed view regarding commercial bank in Nepal that “It would be definitely unwise for Nepal not to let the JVBs to operate in the country and not taking advantage of them as an additional means of resource mobilization as well as hubinger of new area in banking. But, it will certainly be unfortunate to the country to develop the JVBs at the cost of the domestic banks. So far, one should admit freely, no partial treatment has been extended to the domestic banks and JVBs, at least from the government’s side. If HMG keeps on the stance of treating the domestic and JVBs equally despite the later’s bargaining strength. If JVBs show their alercity to come forward to share the trails and tribulations of the poor country both types of banks will co-alliance and co-exist, complementing each other and contributing to accelerate the nations economic development. On the contrary, if the cumbersome path of development along with the domestic banks and government, they will eventually crowd-out the domestic banks from the more profitable urban areas and lucrative urban area unless revived in by the determination of the government.”

Sunil Chopra in “The Role of foreign banks in Nepal”, (Nepal Rastra Bank Samachar, 2056 PP 10-11) writes as: “JVBs are already playing on increasing dynamic and vital role in the economic development of the country. This will

undoubtedly increase with time.”

R.R.Bajracharya in the article “Rastriya Banijya Bank: A Comparative Performance Study”, (Rajat Jayanti Smarika 2047 PP 125-133), states that “Despite the growth of commercial banks is not consistent, low growth of local banks and JVBs. The mobilization of rural savings is better in case of local banks. Credit expansion is decreased in local banks than JVBs. Credit deposit ratio is better in JVBs. Non performing loan is greater in local banks and profitability is greater in JVBs. Local banks are forced to open and continue their branches at rural areas therefore the competition among the local banks and JVBs is not healthy.”

Manohar K. Shrestha, in “Commercial Banks: Comparative Performance Evaluation” (Karmachari Sanchaya Kosh (2047) PP 44-55), states that JVBs are new, operationally more efficient, having superior performance while comparing with local banks. Better performance of JVBs is due to their sophisticated technology, modern banking system, method and skill. Their better performance is also due to the burden that local banks are facing due to the government branching policy in rural areas and financing public enterprises. Local banks are efficient and expert in rural sector dealing but having number of deficiencies, they are lacking to generate required revenue. So, the local banks have to face growing constraints and challenges of JV banks commanding significant banking business on other spectrum.

Article “Problem Encountered by Nepalese Financial System”, (NRB Samachar 2053 PP 36-37), written by Bhisma Raj Dhungana, highlighted the major weaknesses of the banking sector, mainly of RBB and NBL. According to the writer, the financial sector is dominated by banking sector and which in turn, is dominated by two old government owned banks. These two banks constitute the largest component of total deposit of banking system. These two banks suffer from various problems, which results the unsound health of the banking industry of Nepal. The major weaknesses of these banks are:

- Concentration of loan to limited borrowers
- Large number of branches with limited transaction
- Inefficient staff and absence of manpower development and planning
- Poor supervision and follow up after credit disbursement
- Insufficient records and bookkeeping
- No application of modern banking equipments in bank branches

To improve the productivity and quality of banking sector the authorities have created a new environment-giving rise to JV Banks.

Dr. Shrestha's article "Commercial Banks Comparative Performance Evaluation", (Karmachari Sanchaya Kosh, 2047 PP 44-45), highlights on a proper risk management. He believes in the appropriate classification of loans under performing and non-performing category. Regarding the risk management of the bank Dr. Shrestha suggests that:

- Any customer having overdue loans if two years or more in his account should not be given other loan facilities.
- Financial creditworthiness of the borrower must be evaluated properly before granting the loans.

Writer concludes that JV banks are now operationally more efficient having superior performance while comparing with local banks. Better performance of JV banks is due to their sophisticated technology, modern banking method and skill. Their better performance is also due to the burden that the local banks are efficient and expertise on rural sector. But, having number of deficiencies local banks have to face growing constraints of socio-economic political system on one hand spectrum and that issue and challenges of JV banks commanding sign on other spectrum.

Narayan Prasad Poudel in the article "Financial Statement Analysis" (NRB Samachar Patra 2053, PP 53), pointed on the importance of Balance Sheet and Profit & Loss account. The banks balance sheet is composed of financial claims as liabilities in the form of deposits and as assets in the form of loans. Interest received on loans and investments are the major components of

income. Fees, commissions, discounts and service charges are other source of income. According to him the principle objective of analyzing financial statements are to identify liquidity, profitability and solvency of the bank. The other factors to be considered in analyzing the financial statements of banks are to assess to the capital adequacy ratio and liquidity position.

2.7.2 Review of Books:

Peter Rose in her book Commercial Bank Management, (MC-Grew Hill, 4th Edition 1999, Page 325), says, “Achieving superior profitability for a bank depends upon several crucial factors:

- Careful use of financial leverage (or the proportion of bank assets financed by debts as opposed by the shareholders equity capital.
- Careful use of operating leverage from fixed assets (or the proportions of fixed-cost input the bank uses to boost its operating earnings before taxes as bank output grows.
- Careful control of operating expenses so that more dollars of sales revenue become net income
- Careful management of assets portfolio to meet liquidity needs while seeking the highest returns from any assets acquired.
- Careful control of the bank’s exposure to risks so that the losses don’t overwhelm its income and equity capital.

Michael R. Baye and Dennis W. Jansen through their book Money, Banking and Financial Markets, (Greenwich: JAI. Press, 1996 PP 215), have tried to analyze a bank’s profitability under an economic approach. They state “to maximize profits bank should attract the interest rate paid on deposits.”

“Banks earn interest on loans and investments, they pay interest to the depositors. When interest rate sensitive assets and liabilities. If, for example, a bank holds more rate sensitive assets than liabilities when interest rate rise, profits will be improved because the bank will receive more in increased interest revenue than it will pay out in rising costs. The reverse would be true

during a period of falling interest rates.

The interest gap is the difference between rate sensitive assets and liabilities; holding more rate sensitive assets than liabilities is called a Positive Gap and an excess of rate sensitive liabilities over assets result in a Negative Gap”

“Analyzing the behavior and future prospects for profitability of a financial institution is a complex task. Many factors affect each institution’s profitability. Among the most important factors are the riskiness of loans and investments made: liquidity needs and the institution’s provision for those needs; the effectiveness of tax management practices; the level of efficiency in utilizing human and non-human resources; and the ability of management to control expenses (particularly interest expenses and employee costs” (Lyn M.Fraser & Allien Ormiston, *Understanding Financial Statements* (New Delhi:Prentice Hall of India, 6th edition, 2002)

2.7.3 Review of Thesis:

A thesis presented by Bhandari, Pashupati (2004), entitled “*Profit Planning in Royal Drugs Limited*” has made conclusion analyzing the practices of profit planning in RDL. He has concluded that,

-) The management of RDL is incapable of controlling its overflowing expenses as a result the expenses are increasing year to year.
-) RDL has been suffering from operating loss. The main cause of loss is low contribution margin ratio, burden of high fixed costs, under capacity utilization.
-) RDL has improper cash position. The cash flow statement shows the negative cash flow operation due to increase in operating expenses and improper cash management.
-) The balance sheet of RDL shows that the financial structure of RDL is not satisfactory. The total assets of RDL are financed by the equity capital. No long-term debts are taken. So RDL has no financial leverage

and insolvency risk. Only some current assets are financed by current liabilities.

-) Liquidity position of RDL is poor. One major cause of poor operation and under utilization of capacity is its inadequate liquidity.

The following are the major weakness i.e. major conclusion, he had recommended the RDL,

-) Sales budget should be prepared.
-) Cash flow should be improved lowering its inventory level to some extent.
-) Unnecessary government intervention should be controlled in planning system, price fixation and personnel system.
-) RDL should improve its liquidity position raising long term capital.
-) A systematic approach should be mad towards comprehensive profit planning. This can be considerably contributed to increase profitability of the RDL.

Another sorts of dissertation was presented by Sharma, Suman Prakash (2005), entitled “*A Study on Financial Performance of Commercial Banks (Nepal SBI Bank, NBL, EBL)*” presented as partial fulfillment for the requirements of the master degree.

Major findings of his research work were;

-) Current ratio of three banks showed slightly fluctuating trend. The average of the ratios appeared higher in NBB, which signifies that NBB is more capable of meeting immediate liabilities in contrast to NSBL and EBL.
-) Average cash and bank balance to current deposit ratio of EBL appeared greater than NSBL and NBB. Average liquidity position of NBB and EBL is almost same during the study period. It indicates that the solvency position of NBB and EBL is better than NSBL.
-) The average cash and bank balance to current assets ratio remained higher in NSBL. The higher average ratio of NSBL showed that the

bank has held the greater portion of most liquid assets than NBB and EBL.

-) Loans and advances to total deposits ratio appeared considerably higher in NBB. It indicates that NBB is more successful in utilizing the depositors' fund to earn profit. The ratio of NSBL and EBL is almost the same.
-) The earning per share ratios of three banks seemed fluctuating. The average ratio of NBB remained greater and NSBL remained lower among the banks.
-) Higher ratio of investment to total deposits in EBL showed that it has more successfully allocated its deposits in investment portfolio. The ratio seemed to vary less in EBL.

Mr. Sharma has provided some recommendations to improve negative position of the banks;

-) The sampled banks should diagnose the root cause of unsatisfactory liquidity.
-) Debt assets ratios of the sampled banks show the aggressive use of debt capital by the banks. The banks are recommended to invest such debts in profitable assets.
-) NSBL should utilize its total deposits for the investment purposes more efficiently as total investments to total deposit ratio of the bank shows lower position among the sampled banks.
-) NSBL and NBB are recommended to decrease their non performing loans position. On one hand, they should strictly study the viability of the projects before disbursing the loans. On the other hand, they should strengthen the loan recovery process. Likewise, EBL should keep non performing loans in the constant position. It will create problem if the non performing loans position of the EBL increases.
-) The sampled banks should go on to install state of the art technologies in order to give quick services to their customers on one hand and to gain competitive advantage on the other hand.

Another thesis presented by Adhikari, Bhoj Raj (2006), entitled “*Comparative Study of the Profitability of Nepal SBI Bank & Nepal Bangladesh Bank*” has the following major findings which are summarized as below;

-) The mean ratio of return on equity of NB Bank is nearly too five times of SBI Bank. The variability of return on overall equity of NB Bank is very higher than that of SBI Bank. It shows the inconsistency in return on equity.
-) The mean ratio of return on total assets NB Bank is less than SBI Bank. It shows the inconsistency in return on assets.
-) The ratio of net profit margin of NB Bank is remarkably low compared to SBI Bank. The bank is not able to control operating expenses and other leakage. The mean ratios of the both banks show that SBI Bank has higher mean ratio of net profit margin 7.40 than that of NB Bank 6.09.
-) The C.V of SBI Bank is higher than that of Nepal Bangladesh Bank.
-) It can be concluded that the profitability position of NB Bank is comparatively worse than that of SBI. The bank must maintain its high profit margin for the well being in future.
-) Average cash and bank balance to total deposit ratio of SBI Bank remained greater than that of NB Bank. It indicates the better liquidity position of SBI Bank.

Further Mr.Adhikari has recommended that,

-) Both the banks should be established after proper diagnosis of the root causes of unsatisfactory liquidity. In this regard, NB Bank should be more serious than SBI Bank.
-) Both banks should attract more non interest bearing amount deposit for increase profit margin. The share of fixed deposit on its total deposit is very high. So it is recommended to reduce its fixed deposit.
-) Both banks must formulate the strategy to control unnecessary expenses using modern technology, computer networks and experts, and well

trained personnel which also increase the operating efficiency of the bank.

-) The earning per share and dividend per share attract the investors. So higher cash dividend strategy should be adapted for the better growth of shareholders worth.
-) Need to invest on small entrepreneurs development programs.
-) NB Bank and SBI Bank are suggested to make modern banking technologies accessible to there all kinds of depositors as far as possible.
-) An emphasis should be given on planning, research and development for the proper planning and controlling purpose. Proper and regular internal audit system can help the management in regards the cost control strategy and avoid unnecessary leakage in the expenses.

In the like manner, somehow related thesis to profitability was presented by Tandukar, Shambhu (2007), entitled “*Dividend Policy: A Comparative Study of Joint Ventures Banks (Listed) of Nepal*”. From the analysis, the major findings help to conclude that among the sample banks, except one or two banks have satisfactory earning per share and has paid satisfactory dividend per share according to the earnings. Although the banks have made earning every year, some banks have not paid dividend every year. It can be said that there is no consistency in dividend payment of the sample banks except NABIL and SCBL, which pays average dividend of 48 and 104 each year. It can be found that dividend payout ratio is most stable than the dividend per share paid, as there is significant difference in dividend payout and earning per share, while there is no significance difference in the dividend payout ratio of sample banks. The financial indicators don’t seem to reflect the capital market properly, due to which the stock market is imperfect and inefficient. Investors invest their capital by studying the financial position and performance of the institutions but not by properly understanding the stock market.

On the basis of the study considering the target objective, following recommendations are given,

-) It is recommended that the banks should develop proper dividend payout ratio policy and strategy and should follow the optimal, long-term dividend policy to satisfy stockholders and to create good image in market.
-) Among seven banks more than half banks coefficient of variation (C.V) shows high fluctuations in DPS, DPR DY and PER. So it should be necessary to decrease the fluctuation rate to become more consistent.
-) The stock or capital market should be efficient and perfect enough in order to attract the shareholders.
-) The banks should forward their step to decrease the high fluctuation in their EPS and DPS. EPS has always been a major factor in determining the dividend and increase in EPS increases DPS has always been an accepted fact. It seems that DPS does not affected by EPS or the dividend amount is not declared on the basis of earnings. It is important for the banks to consider their earning rather than neglecting it while making dividend decisions.

Miss Sangita Shakya (2003) in her thesis paper “Comparative analysis of Financial Performance of Selected Joint Venture Banks: A case study of NGBL and HBL “uses both primary and secondary data, the methods of analysis included financial ratios and statistical tools like charts, correlation, regression and central tendency, to fulfill her objectives to find out the comparative financial position of NGBL and HBL banks. On the basis of her research she concluded that:

-) Liquidity ratios have been higher for HBL than NGBL
-) Profitability ratio of NGBL is better than that of HBL.
-) Activity ratio is higher for HBL than NGBL.
-) Income generating assets to total assets ratio is higher for NGBL than HBL.

) Investment to total deposit ratio of NGBL is higher than HBL.

Mr. Prem Bahadur Shahi (2001) in his thesis paper “ Investment Policies of Commercial Banks in Nepal (A Comparative Study of Nepal bank Ltd. and Joint Venture Banks)” had basic objectives of the study to review the investment policies adopted by NBL and compare the same with the JV banks of Nepal. Only Nabil, Grindlays and Indosuez played the role of JV banks. He used both descriptive and analytical research design. Data was the secondary and analytical, tools were financial and statistical. He concluded the research in the following way:

NBL has not followed innovative approach toward lending. Its lending procedure follows traditional approaches. The mean ratio of return on loan and advances of NBL has been found significantly lower than that of JV Banks. Similarly, NBL’s return on loan and advances has been found less uniform than that of JV banks. Off balance sheet yield high return and NBL fail to utilize the modern fee base of Balance sheet.

2.8 Research Gap

Commercial Banks invest their deposit in different profitable projects according to the investment regulatory framework and guidance issued by Nepal Rastra Bank as well as the bank’s own risk and return appetite. Financial analysis of such investment and profitability of a bank is always fruitful to a wide range of stakeholders. So, the updated information on banks’ profitability would be of great advantage to the researcher, the bank concerned, as well as to the public at large who has any kind of stake in that organization. This study covers latest financial data and analysis based there on of joint venture banks particularly the NABIL bank itself.

The previous researches can’t represent the overall practices of management account in Nepalese companies, especially to service sector. These studies can’t identify financial and statistical tools are practicing and which financial

tools are not practicing till now. What might the reason behind the non practicing of financial tools as well as statistical in Nepalese joint ventures companies. To fulfill these gaps, the research has been done. The research has suggested and recommended, where statistical tools can apply to overcome the difficulties for the proper application of financial tools and techniques in Nepalese companies.

In this context, a detail analysis of financial performance and position of NABIL bank keeping in mind the JV bank industry was extremely important to examine the real situation of NABIL bank. This study fulfils the prevailing research gap on profitability of NABIL bank's financial position and performance against other joint venture banks in Nepal.

CHAPTER - III

RESEARCH METHODOLOGY

This section describes the methods and process applied in entire study. It sequentially refers to the various steps to be adopted by a researcher. This study basically helps to conclude the real profitability position of Nabil Bank Ltd. in comparison to other joint venture banks operating in Nepal. It thereby helps to highlight and recommend the useful and meaningful points so that all concerned can achieve something from this study. To accomplish the goal, the study follows the research methodology described in this chapter.

3.1 Research Design:

Research design is the plan, structure and strategy of investigations conceived so as to obtain answers to research questions and to control variances. It is the arrangement of conditions for collection and analysis of data. To achieve the objective of this study, descriptive cum analytical research design has been used. Some recent financial tools along with statistical tools have been applied to examine facts and techniques have been adopted to evaluate the profitability of Nabil Bank and compare with other joint venture banks.

3.2 Sources of Data:

The study is conducted on the basis of secondary data. The data required for the analysis are directly obtained from the balance sheet and the profit and loss account of the concerned bank's annual reports and the other publications. Supplementary information are collected from the number of institutions and authorities like NRB, Security Exchange Board, Nepal Stock Exchange, Ministry of Finance and economic surveys. Likewise, various data and information are collected from the economic journals, periodicals, bulletins, magazines and other published and unpublished reports and documents from various sources.

3.3 Population and Sample:

The total number of commercial banks operating in Nepal is 20 including Nepal Bank Limited and Rastriya Banijya Bank Limited. Out of these, the number of joint venture banks with foreign investment is six. In this study an attempt is made to analyze the profitability of Nabil Bank Ltd. and compare it with other individual JV Banks. The comparison with the other JV Banks is likely to provide a clear picture about the performance of Nabil Bank.

3.4 Tools and Techniques Employed:

3.4.1 Net Profit ratios:

1. Return on Equity:

The shareholder's are the true owners of the Bank and thus the profit belongs to them. This ratio displays the returns earned on the shareholder's equity. The shareholders' equity involves share capital and all other reserves including the loan loss provision.

$$\text{Return on Equity} = \frac{\text{Net Profit}}{\text{Shareholder's Equity}} \times 100\%$$

Where, Shareholder's equity = Share capital + Reserves + Loan loss provision

2. Earning Per Share:

The performance and achievement of the bank can be identified with the earning power of the bank. The higher ratio displays the strength of the bank. This ratio displays the portion of each share on the profit made by the bank. It is one of the major tool used by the investor to access the performance of their investment.

$$\text{Earning per Share} = \frac{\text{Net Profit}}{\text{No.of Shares}}$$

3. Net Profit Margin:

The income generated by the bank, are put to various uses. There are various expenses of the bank to be dealt with. So, in case the income of the bank exceeds the expenses, there is a surplus, which is called a profit. The net profit margin displays the proportion of net profit from the income of the bank.

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Total Income}} \times 100 \%$$

Where, Total Income is the sum total of the Credit side of Profit & Loss Account

3.4.2 Income Expense ratios:

1. Components of Income:

The income of the bank is comprised of various sources. This mix provides an insight of the contribution made by them towards the total income. The source of income is classified into three parts-interest incomes, commission income and other income.

Interest income = Income from loans and advances, investment, agency balance, money at call and inter bank lending.

Commission income = Income from Bills (Document) purchase, L/C, G'tee commission, remittance income, collection charges etc.

Other Income = Exchange income + Income from sale of assets + Other Miscellaneous income like safe locker rentals, credit cards etc, service charges etc.

2. Components of Expenses:

Like income, the expenses of the bank can be broadly categorized into three parts-interest expenses, staff expenses, operating expense and other expenses. So, this mix will provide a clear picture of the portion of each head in the total expense of the bank.

Where,

Interest Expense = Interest expense on deposits and borrowings

Staff Expense = Salary + Allowances + Bonus + Pension and gratuity + provident fund etc.

Operating Expense = Rent + Water, Electricity, Power, Telephone charges + Repair and maintenance + Depreciation on fixed assets + legal charges + advertisement expenses + newspapers and periodicals etc.

Other Expenses = Loss on sale of assets + write off of bad debts + additional loan loss provision

3. Interest Payout Ratio:

We are well aware that the main function of a bank is to collect deposit and advance loans. The bank pays interest on the deposits and charges interest on the loans and advances. It also realizes income from the investments and call deposits. Similarly the bank has to pay interest on its borrowings. Thus, this ratio provides the proportion of interest payment of the bank as compared to the interest income generated by the bank.

$$\text{Interest Payout Ratio} = \frac{\text{Interest Expense}}{\text{Interest Income}} \times 100 \%$$

Where,

Interest Expense = Expense on deposit and borrowings

Interest Income = Income on loans and advances + investment + money at call + inter bank lending etc.

4. Loan Loss Provision to Total Income:

The risk associated with the lending cannot be completely eradicated. However, it can be minimized through creating a buffer in case of losses. Thus, NRB directive requires the banks to create a certain level of provision for loan loss. The requirement depends on the quality of the assets of the bank with provision rate ranging from 1 % to 100 %. Thus this comparison provides an impact of the loan loss provision on the income of the bank.

$$\text{Loan Loss Provision to Income} = \frac{\text{Additional Loan Loss Provision}}{\text{Total Income}} \times 100 \%$$

Where,

Additional Loan Loss Provision = Additional Provision created in the period
Sum total of the Credit side of Profit & Loss Account

5. Operating Expense to Total Income:

The bank during its operation has to undergo various expenses. Some of the expenses are rent, insurance, depreciation, postage, telephone, electricity, advertisement etc. This ratio shows the proportion of operating expense on the total revenue of the year.

$$\text{Operating Expense to Total Income} = \frac{\text{Operating Expenses}}{\text{Total Income}} \times 100 \%$$

Where,

Operating Expense = Expenses Rent + Water, Electricity, Power, Telephone charges + Repair and maintenance + Depreciation on fixed assets + legal charges + advertisement expenses + newspapers and periodicals + board meeting expenses etc.

6. Staff Expenses per Employee:

In a service industry, the importance of the human element cannot be ignored. The service organizations have to keep their employees satisfied. Although cost minimization is one way to maximize the profits, the minimum level of staff expense can work other way round. Unmotivated and unsatisfied workforce can be highly inefficient and unproductive in their work thereby affecting the profitability of the organization. Thus, the perks and benefits should be designed at an appropriate level keeping both the organization and staff satisfied. This ratio provides the average spending of the bank on its employee during the year including the bonus payments.

$$\text{Staff Expenses per Employee} = \frac{\text{Total Staff Expenses}}{\text{No. of Staff}}$$

Where,

Staff Expense = Expense on Salary + Allowances + Bonus + Medical Expenses + Provident Fund + Pension and Gratuity + Training expense etc.

No.of staff = Total number of staff on a payroll at the end of the fiscal year.

3.4.3 Other Ratios:

1. Credit to Deposit Ratio:

The bank cannot invest all the resources on the profitable sectors. It has to apportion a certain amount of resources for the liquidity purposes. So, the banks normally do not invest all their deposits in loans and advances. This ratio analyses the proportion of deployment of total deposit in loans and advances including the bills purchased.

$$\text{Credit Deposit Ratio} = \frac{\text{Total Credit}}{\text{Total Deposit}} \times 100 \%$$

Where,

Total Credit = Loans and advances (except Staff Loan) + bills (documents) purchased

Total Deposit = Sum of all forms of deposits in the bank.

2. NPA to Credit:

All the loans and advances of the bank are not good. So, in order to identify such lending, the NRB has erected certain criteria for the classification of loans with respect to the risks involves. There are four classifications pass, substandard, doubtful and loss. The loans and advances falling under categories expect pass is called NPA. The NPA can be a result of many factors like poor credit appraisals, poor credit management or the economic slowdown. The probability of default is higher as the credit move into the next category. This ratio provides the proportion of such loans and advances in the total portfolio. In the industry average, average is taken of banks of which the data is available i.e. if the data of HBL for 1 year is not available; the industry average is taken

of only four banks.

$$\text{NPA to Total Credit} = \frac{\text{NPA}}{\text{Total Credit}} \times 100 \%$$

Where,

NPA = Loans and advances with due for more than 3 months and 90 days in case of bills purchased.

Total Credit = Loans and advances (except Staff Loan) + bills (documents) purchased

3. Loan loss provision to NPA:

In order to protect the banks from financial difficulty in case of default, the banks are required to create loan loss provisions according to the quality of their lending. The NPA refer to that part of the credit, which has likelihood of default. The NPA of the banks are identified as per the criteria laid down by the NRB directive. The NPA are also of three types substandard, doubtful and bad. The rate of provision required is higher as the loans degrade from one classification to another. This ratio helps to ascertain the amount of cover available to the bank to absorb the financial impact in case all the NPA are immediately defaulted. It also in an indirect manner shows the quality of lending portfolios.

$$\text{Loan Loss Provision to NPA} = \frac{\text{Loan Loss Provision}}{\text{NPA}} \times 100 \%$$

Where,

Loan Loss Provision = Sum of loan loss provision after the current year adjustments

Loans and advances with due for more than 3 months and 90 days in case of bills purchased.

4. Interest Spread:

The banks pay interest to its depositors and collect interest on the loans and advances. The banks collect at a higher rate than at what they provide. This

margin is the profit of the banks. The interest spread is the difference in rates between the loans/advances and deposits. So, higher the margin, greater is the likelihood of larger profit. The comparisons of spread of different banks provide an analysis of the different contribution margins. Spread is calculated as follows:

$$\text{Interest Spread} = \% \text{ of Interest income} - \% \text{ of Interest Expense}$$

Where,

$$\% \text{ of Interest Income} = \frac{\text{Interest Income from Loans \& Advances}}{\text{Total Loans \& Advances}} \times 100\%$$

$$\% \text{ of Interest Expense} = \frac{\text{Interest Expense}}{\text{Deposits + Borrowings}} \times 100\%$$

5. Net Profit of Commercial Banks:

Under this head, a comparison of the net profit of joint venture banks over the years has been conducted. The comparison between various banks and of same bank over the years is useful to understand the ups and downs of the bank and the industry itself.

CHAPTER - IV

DATA PRESENTATION & ANALYSIS

Under this chapter we evaluate the performance of Nabil Bank Ltd with relation to other banks. To accomplish the objective of measuring the profitability the relevant data are extracted and presented in tabular and graphical form. In order to analyze we use various performance measuring tools like ratio analysis, comparisons and trend analysis.

4.1 Net Profit Ratios:

4.1.1. Return on Equity:

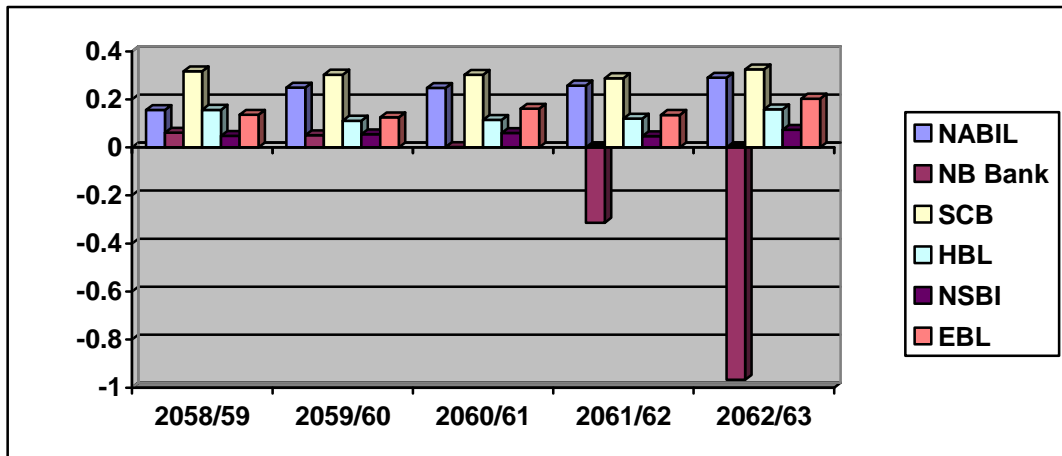
The equity is the wealth of the shareholders. The bank is liable to provide a good return on the wealth of the shareholders. The return on equity of the banks over a period of 5 years is given below:

Table No. 1 Return on equity

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	15.63%	24.90%	24.74%	25.77%	28.99%
<i>NB Bank</i>	6.10%	5.12%	0.16%	-31.32%	-96.80%
<i>SCB</i>	31.74%	30.30%	30.22%	28.83%	32.53%
<i>HBL</i>	15.65%	11.13%	11.48%	12.00%	15.85%
<i>NSBI</i>	4.83%	5.43%	6.00%	4.73%	7.33%
<i>EBL</i>	13.62%	12.49%	16.09%	13.52%	20.32%

It can be better understood with the help of the following figure:

Figure No. 1 Return on Equity



The above table demonstrates that Nabil Bank's performance is high leading to huge return in FY 2062/63.. If the individual performance of each of the banks is looked, most of the banks performance has increased in this year whereas only NB Bank has decreased sharply. From the above, the market leader in terms of ROE is SCB with an average ROE 30.72% in last five years.

The main reason for the increment in performance of Nabil Bank is increment in the profitability of the bank caused by increment in Income and decrease in Non Performing Loans.

4.1.2 Earning per share:

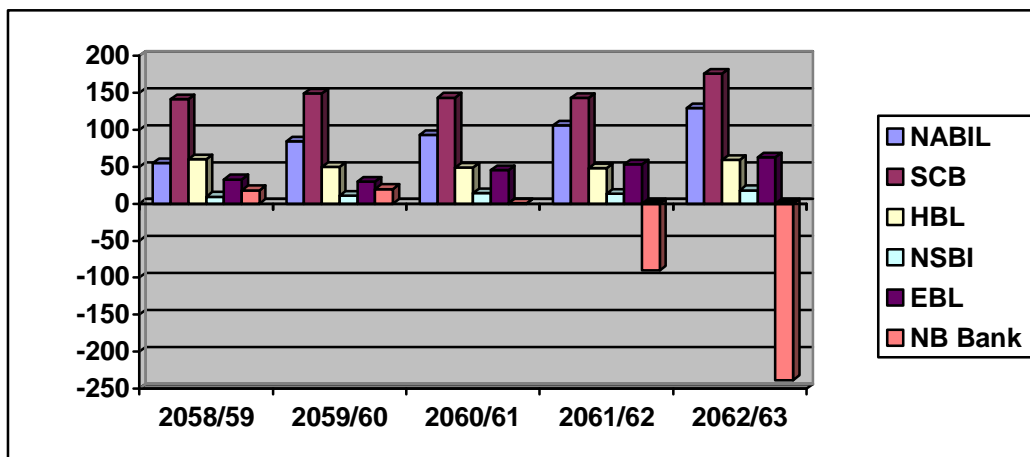
The investors are concerned about the performance of their investment. This is one of the important tools frequently used by the investors to gauge the value of their investment. The earning per share for the last five years is provided in the table below:

Table No. 2 Earning per share (In Rs.)

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	55.24	84.65	92.60	105.78	129.20
SCB	141.15	149.32	143.57	143.15	175.86
HBL	60.26	49.45	49.05	47.91	59.24
NSBI	9.61	10.71	14.25	13.29	18.28
EBL	32.91	29.90	45.58	53.40	62.78
NB Bank	18.27	19.86	0.73	-90.21	-238.45

This is further presented in the following figure:

Figure no.2 Earning Per Share



The earning per share of Nabil Bank rose to a maximum of Rs.129.20 during the year 2062/063 SCB has consistently been able to provide the best earning per share of Rs.175.86. The reason for the massive increment of Nabil Bank Ltd. is increase in the number of shares on one hand and also the net profit has significantly increased to the position of huge net profit.

4.1.3 Net Profit Margin:

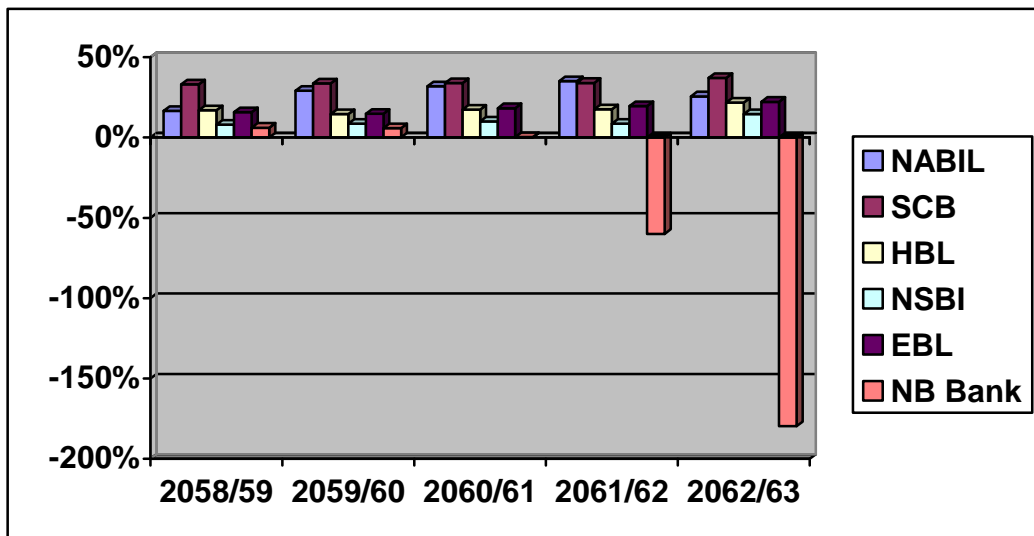
This ratio measures the efficiency of the bank in conversion of the revenue to the net profit. The margin for the last five years is tabulated below:

Table No. 3 Net Profit Margin

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	16.57%	29.16%	31.92%	35.15%	25.64%
<i>SCB</i>	33.12%	33.69%	33.95%	34.02%	37.09%
<i>HBL</i>	16.91%	14.59%	17.31%	17.51%	21.79%
<i>NSBI</i>	8.03%	8.61%	9.95%	8.62%	14.63%
<i>EBL</i>	15.78%	14.80%	18.29%	19.58%	22.25%
<i>NB Bank</i>	6.11%	5.75%	0.20%	-59.97%	-179.73%

This is further presented in the following figure:

Figure No.3 net Profit margin



The net profit margin of Nabil Bank, at its highest, was 35.15% in the year 2061/062 which has fallen to 25.64% in the year 2062/063. In simple terms it means that out of revenue of Rs.100, Nabil Bank is converting it to a net profit of Rs.25.64. Thus, Nabil Bank has used of resources generated from the operation

4.2 Income Expense Ratios:

4.2.1 Component of Income

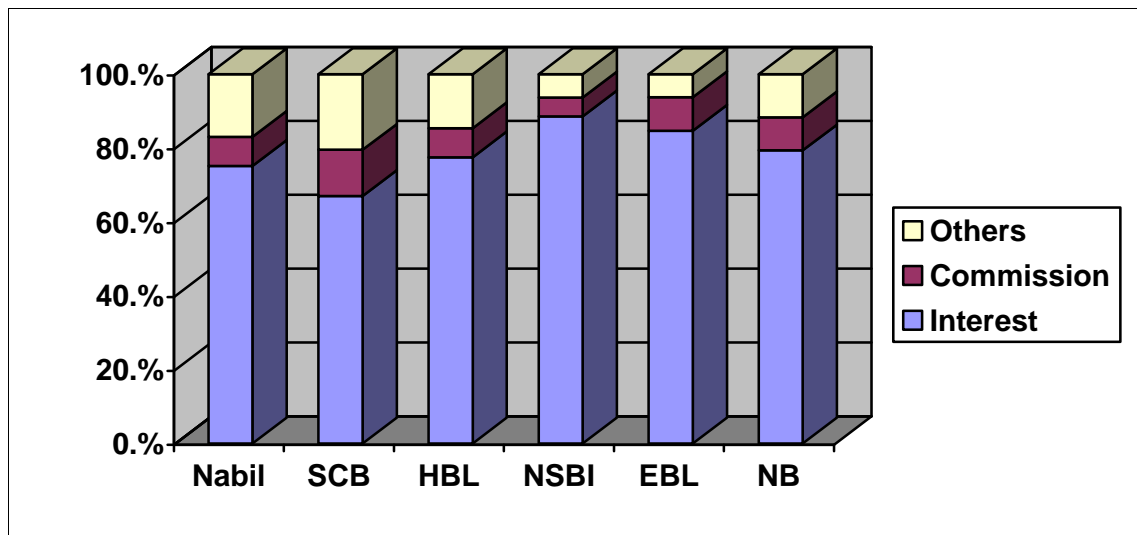
The revenue of the bank results from various sources like interest, commissions etc. Here we look at the mix of various sources of income namely interest, commission and other. The table below provides the components of income for the last fiscal year i.e. 2062/063.

Table No. 4 Component of Income

	<i>NABIL</i>	<i>SCB</i>	<i>HBL</i>	<i>NSBI</i>	<i>EBL</i>	<i>NB Bank</i>
<i>Interest</i>	75.14%	66.98%	77.49%	88.63%	84.71%	79.37%
<i>Commission</i>	7.93%	12.55%	7.88%	5.10%	9.08%	8.93%
<i>Others</i>	16.93%	20.46%	14.63%	6.28%	6.21%	11.70%
<i>Total</i>	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

The contribution from various sources can be better understood from the following figure:

Figure No.4 Component of Income



The major source of income of banks is interest, Commission and rest is from other sources. Out of the Nabil Bank's total income, interest accounts for 75.14

indicating that its income sources is less dependent on interest income. SCB appears to have a more balanced income structure as it has earned 20.5% of its income as coming from other sources, followed by HBL with 14.63%.

4.2.2 Component of Expense:

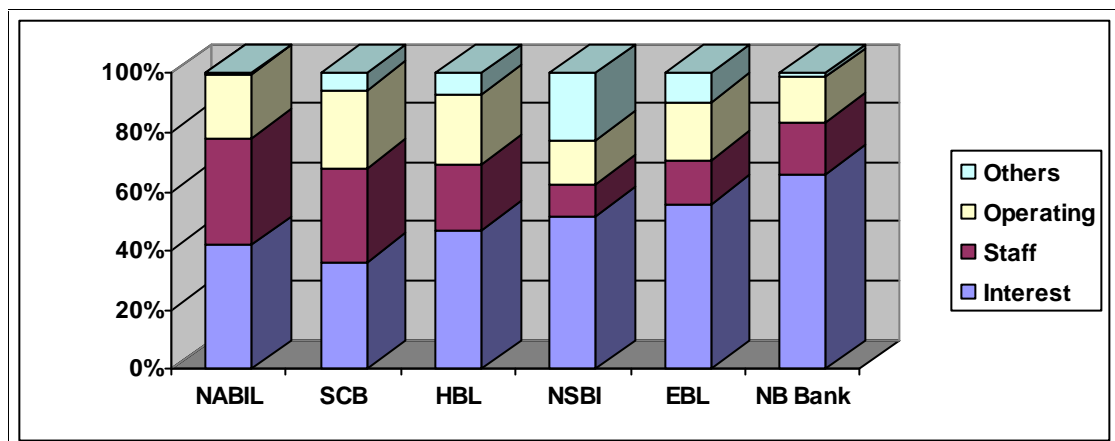
Like the sources of income, the expense of the bank can be broadly categorized into interest expense, staff expense, operating expense and other expenses. The components of expense of Year 2062/063 of the banks are tabulated below:

Table No. 5 Component of Expenses

	<i>NABIL</i>	<i>SCB</i>	<i>HBL</i>	<i>NSBI</i>	<i>EBL</i>	<i>NB Bank</i>
<i>Interest</i>	41.86%	36.35%	47.15%	51.41%	55.68%	65.60%
<i>Staff</i>	36.28%	31.43%	21.93%	10.83%	14.63%	17.81%
<i>Operating</i>	21.41%	26.50%	23.96%	15.24%	19.91%	15.18%
<i>Others</i>	0.44%	5.72%	6.95%	22.52%	9.77%	1.41%

This is further presented in the following figure:

Figure No.5 Component of Expenses



The comparison of Nabil Bank with the other bank reveals that the bank has balanced composition of operating and other expense while the interest expense

is significant high with 42% of total expenses.

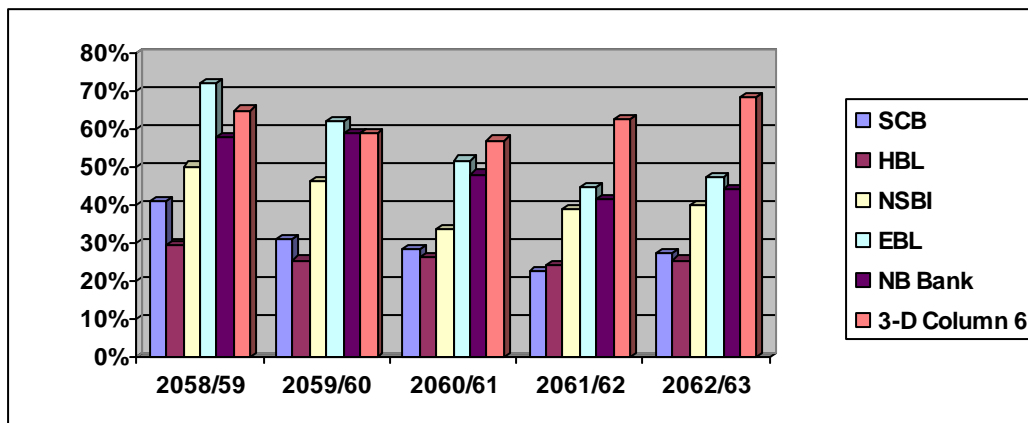
4.2.3 Interest Payout ratio:

The primary function of the bank is to collect deposit and lend money. The banks pay interest on the deposits collected and receive interest on the loans and advances. The major source of income of the bank is from the interest income and the major part of expense is the interest expense. The profitability of the bank is dependent on the spread between these two.

Table No. 6 Interest Payout Ratio

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	41.25%	31.18%	28.25%	22.79%	27.26%
SCB	29.58%	25.48%	26.46%	24.00%	25.49%
HBL	50.32%	46.13%	33.67%	38.85%	39.89%
NSBI	72.21%	62.12%	51.85%	44.68%	47.24%
EBL	57.92%	59.14%	48.13%	41.65%	44.43%
NB Bank	64.99%	58.98%	57.08%	62.51%	68.34%

Figure No. 6 Interest Payout Ratio



The interest payout ratio of Nabil Bank has remained within the range of 22.79% to 41.25%. It means that in last year, for an interest income of Rs.100, at best, the bank pays Rs.27.26 to its depositors. Thus the contribution is at most Rs.72.74. The ratio is lower than all other banks except SCB. The lowest payout ratio or the most profitable of the lot is of SCB. The main reasons for

the low ratio are high volume of NPAs and high cost deposits.

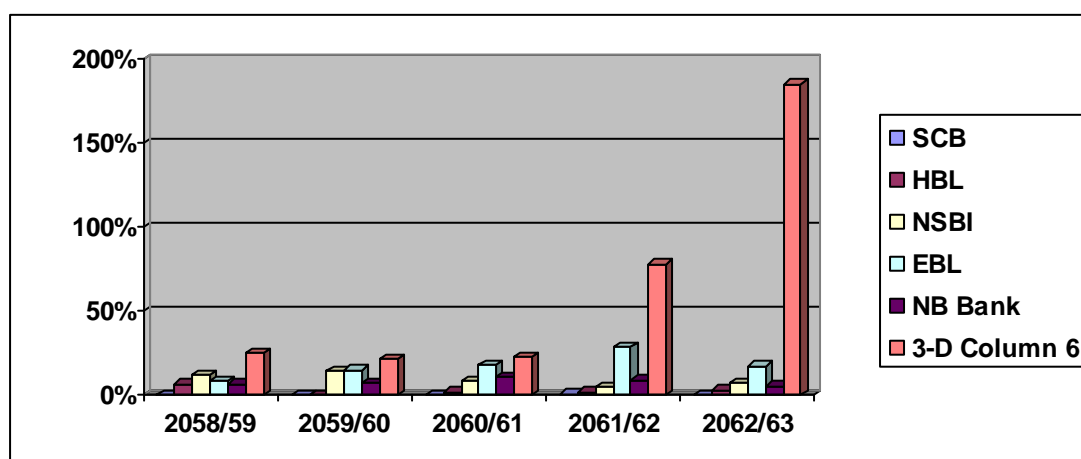
4.2.4 Loan Loss Provision to Total Income:

The ratio provides an insight of the proportion of revenue that has to be siphoned-off as the provision of loan loss as per the directive of NRB. The ratio of the banks is tabulated below:

Table No. 7 Loan Loss Provision to Total Income

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	0.00%	0.00%	0.07%	0.59%	0.22%
<i>SCB</i>	6.49%	0.16%	1.48%	1.76%	2.69%
<i>HBL</i>	11.98%	13.94%	8.23%	4.20%	6.92%
<i>NSBI</i>	8.32%	14.87%	17.91%	28.57%	17.10%
<i>EBL</i>	6.42%	7.19%	10.42%	8.73%	5.02%
<i>NB Bank</i>	25.01%	21.05%	22.55%	77.85%	185.14%

Figure No.7 Loan Loss Provision To Total Income



The above table shows that Nabil Bank had to divert 0.22% of its revenue of 2062/063 as a provision for loan loss. The ratio is continually decreased in last years and finally reached at 0.59 times of the total revenue of FY 2061/62. This is because of high volume of NPA with the bank.

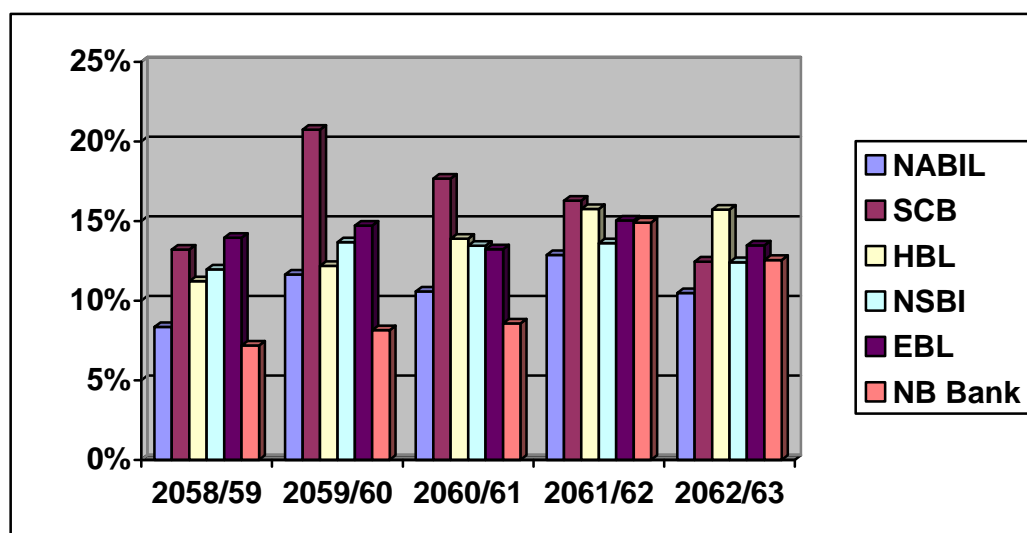
4.2.5 Operating Expense to Total Income:

The bank while carrying out its normal activity has to incur various costs. These are called operating costs. Some of the examples are electricity, rent, stationery, insurance etc. These expenses consume a significant amount of the revenue. The proportion of such expenses in total income is tabulated below:

Table No. 8 Operating Expense to Total Income

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	8.35%	11.64%	10.57%	12.86%	10.48%
SCB	13.20%	20.74%	17.66%	16.28%	12.45%
HBL	11.21%	12.18%	13.89%	15.75%	15.71%
NSBI	11.95%	13.67%	13.44%	13.61%	12.41%
EBL	13.94%	14.71%	13.22%	15.03%	13.46%
NB Bank	7.17%	8.15%	8.57%	14.90%	12.55%

Figure no.8 Operating Expenses to Total income



The operating expense of Nabil Bank has been remained comparatively low consistently over the years. The management of the operating expenses in Nabil Bank should be said to be highly efficient.

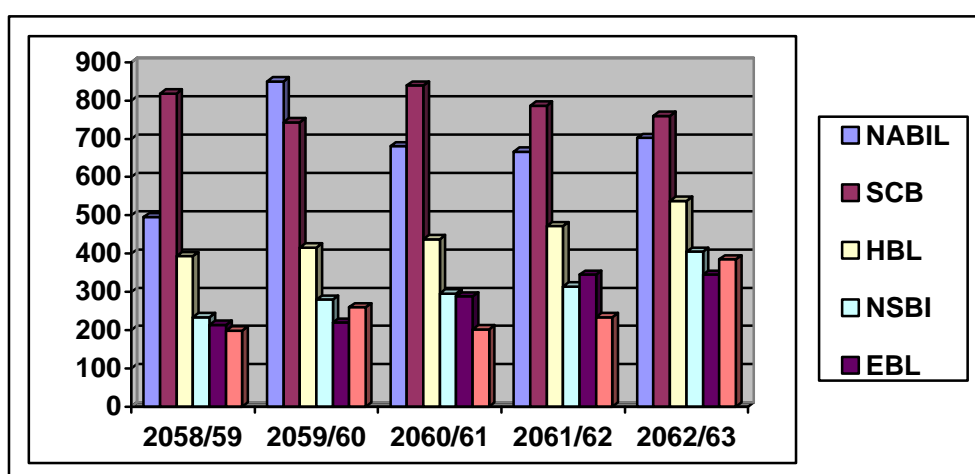
4.2.6 Staff Expense per Employee:

The human resource of any organization is a very important facet. The organization needs to keep its human element satisfied and motivated. The spending of the banks on its human resources is as follows:

Table No. 9 Staff Expense per Employee (Rs.In '000)

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	495	850	680	666	702
SCB	818	743	839	786	760
HBL	393	416	438	472	538
NSBI	234	280	296	314	405
EBL	214	220	288	345	345
NB Bank	199	260	202	234	385

Figure No.9 Staff Expenses Per Employee



The above table demonstrates that Nabil Bank is second from top in this aspect. Although this is not good from the cost aspect but other influences like staff motivation cannot be ignored. The market leader in this respect is SCB followed by HBL respectively. The ratio generally shows an increasing trend.

4.3 Other Ratios:

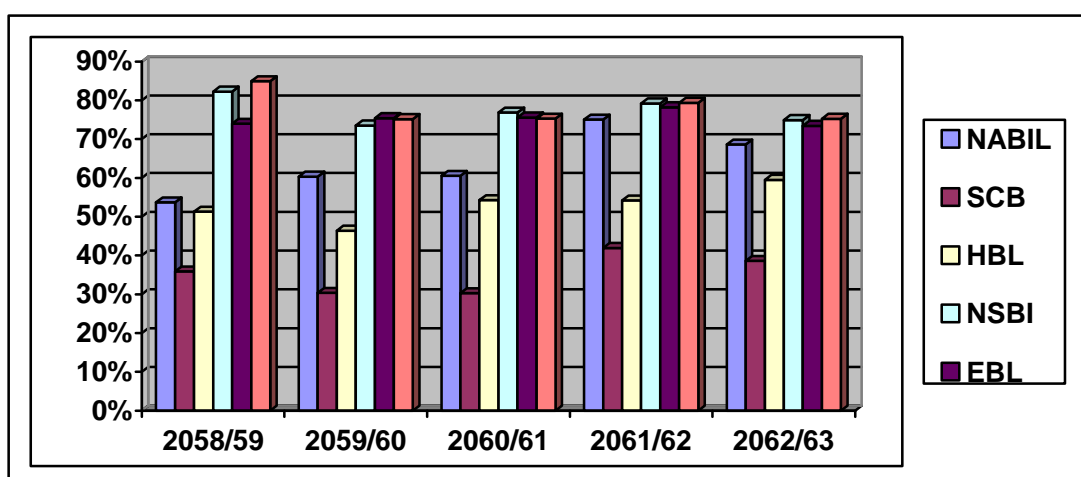
4.3.1 Credit to Deposit Ratio:

The major source of resource of a bank is deposit and the major outlet of resource is the credit. So, this ratio provides the ratio of efficiency with which the resources are mobilized. Following table displays the deposit collected by the banks and their subsequent mobilization as at the end of corresponding fiscal year.

Table No. 10 Credit Deposit Ratio

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	53.68%	60.34%	60.55%	75.05%	68.63%
<i>SCB</i>	35.88%	30.37%	30.29%	41.96%	38.62%
<i>HBL</i>	51.33%	46.41%	54.30%	54.21%	59.50%
<i>NSBI</i>	82.27%	73.52%	76.85%	79.21%	74.92%
<i>EBL</i>	73.98%	75.42%	75.59%	78.24%	73.44%
<i>NB Bank</i>	84.97%	75.17%	75.31%	79.39%	75.27%

Figure No. 10 Credit Deposit Ratio



The ratio of Nabil Bank has been increased over the years, 53.68% in 2058/059 to 68.63% in the last year. Though this is good for the profitability of

the bank, it could be sign of potential liquidity risk of the bank. Thus, the bank should look to lower the ratio be either decreasing the credit volume or increasing the deposit base of the bank.

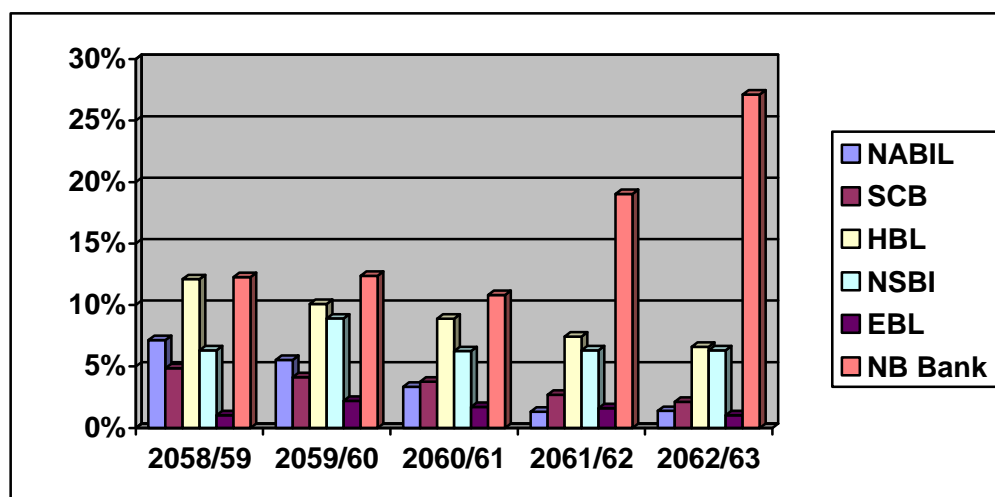
4.3.2 NPA to Credit:

The loans and advances classified as NPAs have high potential for default. This ratio thus provides the proportion of such lending in the credit portfolio of the bank.

Table No. 11 Proportion of NPA in Credit Portfolio

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	7.14%	5.54%	3.35%	1.32%	1.38%
SCB	4.85%	4.13%	3.77%	2.69%	2.13%
HBL	12.10%	10.08%	8.88%	7.44%	6.60%
NSBI	6.32%	8.90%	6.25%	6.32%	6.32%
EBL	1.04%	2.20%	1.70%	1.60%	1.04%
NB Bank	12.26%	12.37%	10.81%	19.04%	27.12%

Figure No. 11 Proportion of NPA in Credit Portfolio



The NPA proportion in Nabil Bank is alarmingly low. The bank had managed to reduce such lending from 7.14% in 2058/059 to 1.32% in FY 2061/62.

However, it has increased slightly amounted to 1.38% in the year 2062/063. All this clearly indicates that Nabil Bank is performing better performance in sense of proper credit appraisal and management. Looking at the micro picture, EBL seems to be most capable in the management of NPA. Although the position of HBL is also not satisfactory, it has made significant progress after FY 2060/061.

The growth in the NPA of Nabil Bank can be better understood with the following chart:

4.3.3 Loan Loss Provision to NPA:

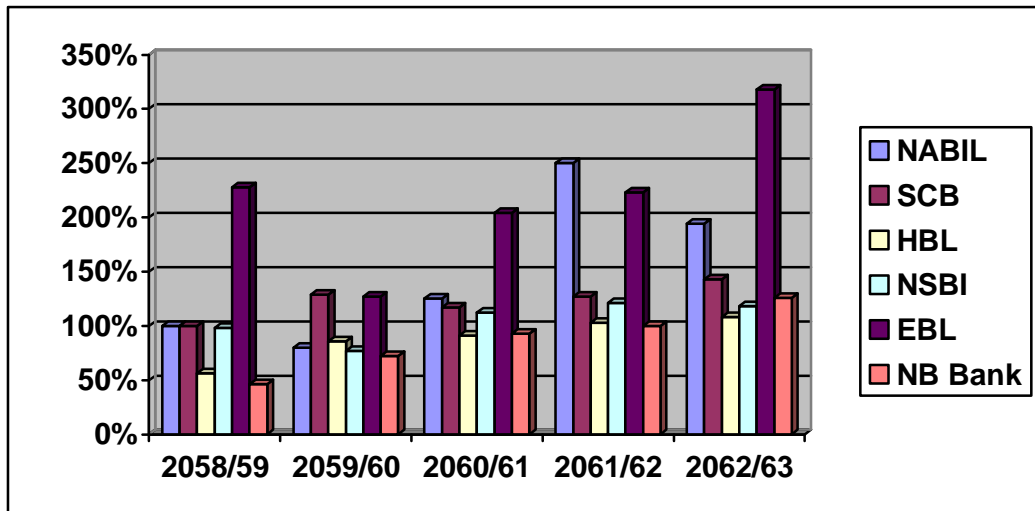
In order to protect banks from financial difficulty, they are required to create a buffer to absorb the financial impact of credit default. The provision varies according to the quality of lending. This ratio shows the proportion of cover available to the banks.

Table No. 12 Loan Loss Provision to NPA

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	100%	80%	125%	250%	194%
SCB	100%	129%	117%	127%	143%
HBL	56%	86%	91%	103%	108%
NSBI	98%	77%	112%	121%	118%
EBL	228%	127%	204%	223%	318%
NB Bank	46%	72%	93%	100%	126%

The performance of the banks can be better understood with the aid of the following figure:

Figure No.12 Loan Loss Provision To NPA



The table illustrates all Banks have braced themselves for the potential rainy days ahead. They have built up reserve capable of absorbing the full force of financial impact. Moreover, EBL has created a buffer which is more than what is necessary. Nabil Bank, has been able to create a sufficient buffer. The practice of EBL of providing thrice, of what is required at a worst scenario, can be considered too much pessimistic and over prudent.

4.3.4 Interest Spread:

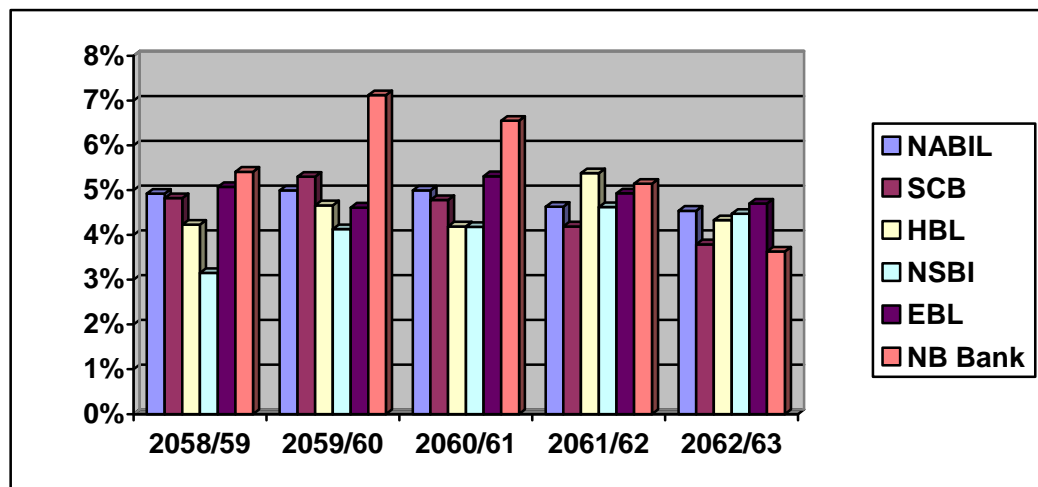
The spread is the difference between the buying and selling rates of the fund. The major source of income in a bank is from the interest on loans and advances. Thus, the rate of interest spread is of significant importance in the aspects of profitability. The spread can be increased either by acquiring funds of lower casts or lending at higher rates of interest. Both these choices have drawbacks as acquiring funds at low cost is difficult to achieve while lending at high rates means taking higher risk of default. The interest spread of banks for the last five years is tabulated below:

Table No. 13 Interest Spread

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	4.92%	4.99%	4.99%	4.63%	4.54%
SCB	4.82%	5.30%	4.78%	4.19%	3.79%
HBL	4.23%	4.66%	4.19%	5.38%	4.33%
NSBI	3.15%	4.13%	4.18%	4.62%	4.47%
EBL	5.07%	4.61%	5.31%	4.93%	4.70%
NB Bank	5.41%	7.12%	6.55%	5.14%	3.63%

The performance of the banks can be better understood with the aid of the following figure:

Figure No.13 Interest Spread



The spread of Nabil Bank has always been in similar ratios in FY 2059/060 and FY 2060/061 i.e 4.99% and slightly lower in FY 2061/062 i.e 4.63% and FY 2062/063 i.e 4.54%. This is because of the largest proportion of NPA that is arisen in last year. The higher ratio does not necessarily mean higher profit. So, although NB Bank has higher spread than others, it could not perform well because it had to suffer on account of accepting higher risk of default associated with higher rate of lending.

4.3.5 Net Profit:

The profit is the universal measurement tool of the performance of any institution. Likewise, it also serves as an important yardstick to measure the performance of the banks. Profit is important to various parties like management, employees and the government for their own reasons. Management may use it to measure their performance; employees may use it to validate their claim for better remunerations and the government to receive taxes.

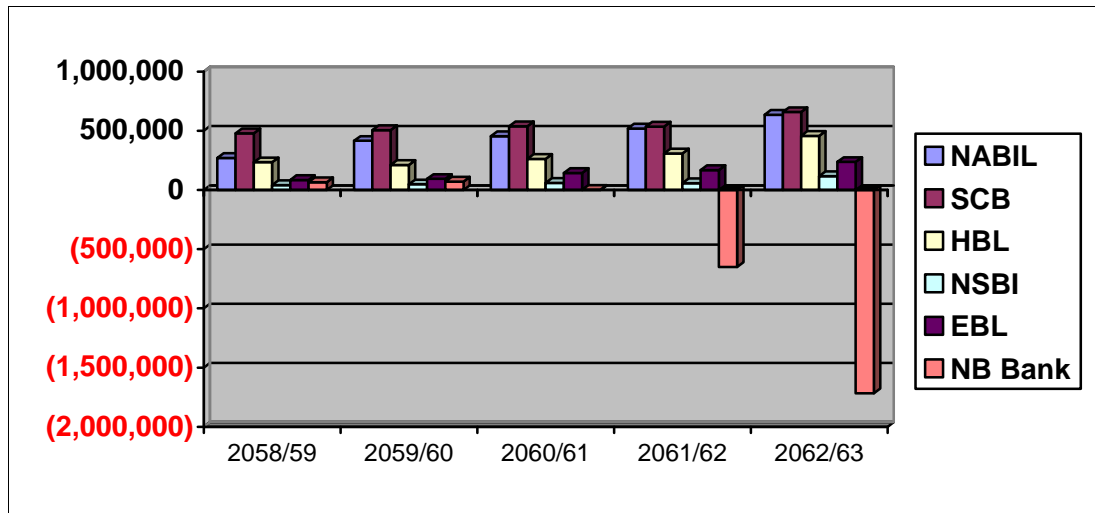
Table No. 14 Net Profit of JV Banks (Rs'000)

	2058/59	2059/60	2060/61	2061/62	2062/63
NABIL	271,639	416,236	455,311	520,114	635,262
<i>SCB</i>	479,207	506,932	537,800	536,245	658,756
<i>HBL</i>	235,023	212,128	263,053	308,275	457,458
<i>NSBI</i>	40,844	48,748	60,852	57,386	117,002
<i>EBL</i>	85,347	94,180	143,567	168,215	237,291
<i>NB Bank</i>	65,784	71,495	2,643	-649,543	-1,716,811

The above table illustrates that Nabil Bank has always well performed. The profit in FY 2058/59 started to increased and reached at a huge profit of Rs.635,262 thousands in FY 2062/063. SCB posted the best results in a consistent manner followed by HBL and EBL respectively. The last three years' performance of NB Bank is worst in its history.

The performance of the banks can be better understood with the aid of the following figure:

Figure No.14 Net Profit of JV Banks



4.3.6 Profitability of Nabil Bank Ltd.

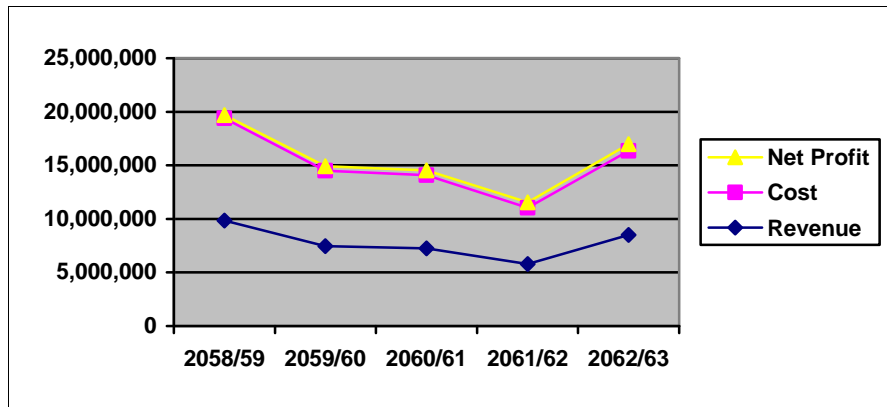
The overall profitability of the bank is dependent on two factors- revenue and cost. Cost comprises both regular operating expenses like interest, staffing, operating, and net movement in loan loss provision. Thus, in order to be profitable the management of these factors has to be good. The breakup of the overall profitability of the Nabil Bank is provided in the following table:

Table No. 16 Revenue, Cost & Profit of Nabil Bank Ltd. (Rs'000)

	2058/59	2059/60	2060/61	2061/62	2062/63
Revenue	9,838,630	7,458,625	7,262,383	5,777,917	8,490,882
Cost	9,566,991	7,042,389	6,807,072	5,257,803	7,855,620
Net Profit	271,639	416,236	455,311	520,114	635,262

The trend in these factors is more visible from the following diagram

Figure No. 15 Revenue, Cost and Profit of Nabil Bank Ltd.



The above figure illustrates that the revenue, cost & net profit of Nabil Bank is slightly lower in F/Y 2059/60 to 2061/62 respectively & again increased in F/Y 2062/63.

4.4 Major Findings

The major findings of the ratio are as follows.

Net Profit Ratios:

Profitability reveals the degree of success in achieving desired profit. From ROE (Return on Equity) of Nabil Bank, it is found that the operating efficiency of the bank is in increasing trend. It is due to increase in income and decrease in non performing loans.

The Earning per share of Nabil Bank is very good during the period which shows the better position of bank in the market. It increases the value of the firm.

The Net Profit Margin ratio has been increasing till F/Y 2061/62 and then slightly decreased. Though there is low fluctuation, Nabil Bank has been able to mobilize the resources generated from the operation.

Income Expenses Ratios:

The Interest Payout Ratio of Nabil Bank is lower. The main reason of low ratio is high volume of NPAs and high cost deposit.

Nabil Bank has lowest loan loss provision to total income. It means it has high volume of NPAs and is successful in mobilizing the loans.

The Operating Expenses of Nabil Bank has been remained comparatively low consistently over the years. The management of the operating expenses in Nabil Bank should be said to be highly efficient

The Staff Expenses of Nabil Bank is in increasing trend. Although this is not goods from the cost aspect but other influences like staff motivation cannot be ignored.

Other Ratios:

The Credit to Deposit ratio of Nabil Bank has been increased over the years, 53.68% in 2058/059 to 68.63% in the last year. Though this is good for the profitability of the bank, it could be sign of potential liquidity risk of the bank. Thus, the bank should look to lower the ratio be either decreasing the credit volume or increasing the deposit base of the bank.

The NPA to Credit proportion of Nabil Bank is alarmingly low. The bank had managed to reduce such lending from 7.14% in 2058/059 to 1.32% in FY 2061/62. However, it has increased slightly amounted to 1.38% in the year 2062/063. All this clearly indicates that Nabil Bank is performing better performance in sense of proper credit appraisal and management.

The comparison between various banks and of same bank over the years is useful to understand the ups and downs of the bank and the industry itself. In profitability aspect the Nabil Bank has always been well performed.

CHAPTER - V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary:

The study was carried out with the objective of comparing the profitability of the Nabil Bank with other Joint venture banks. At Present there are 23 commercial banks operating in Nepal. However, for this study, 6 joint venture banks were taken as the sample. The study was conducted within a period of recent 9 months.

The term profitability comprises of the profit and ability to earn profit. Profit in general sense refers to the excess of revenue over expenses incurred. There are various ways of defining profit viz: accounting sense, economic sense, traditional approach, modern approach etc. These all are concerned with the objective of the firm (bank) adopted. Profit maximization was considered as the primitive and the most common form of objective of the firm. And Shareholder's wealth maximization is considered the best and modern objective of the firm. The former objective is concerned only to the term profit regardless of other things. Whereas the latter objective considers all other aspects such as shareholders, stakeholders and corporate social responsibility along with maximization of profits.

The study in this context is mainly focused on the performance of the bank in terms of profitability. The performance of the bank is monitored with the performance of the contemporaries and the industry to study its performance in comparative terms. The financial data used for the study is obtained from secondary sources. The data are then analyzed with the help of various tools like ratio analysis, comparisons and statistics like trend analysis. The data are then presented in tabular as wells as in graphical form that can be easily understood and interpreted by the user.

5.2 Conclusion

On the basis analysis and interpretation of various ratios indicating the performance of Nabil banks, the whole study can be deduced as follows:

Nabil had the second highest net profit and EPS followed by HBL.EBL & NSBI.The profitability ratio of SCBNL were the best among all. Nabil had utilized its assets more efficiently in generating income.

Nabil was found the efficient in mobilizing its total deposit and the quality of extended credit was the moderate for Nabil.

Based on overall performance .assets mobilization, profitability ratios, quality of the lending, and market prices, Nabil occupied the second position and the SCBNL occupied the leading and the highest position among the other joint venture banks.

Therefore, it was concluded i that Nabil Bank is performing well above of the industry standard but also has highest performance among all players in the JV Bank Industry in Nepal. In conclusion, Nabil Bank's past and present earning generating potential is assessed as high in every parameters of profitability in comparison to the industry as well as other joint venture banks in the country.

5.3 Recommendations:

In respect of the various observations made during the study, the following recommendations are made:

- a. A serious effort has to be made towards the NPA management. The asset quality is the most serious issue in the organization and the sincere effort of the management is to be concentrated in that matter if the bank is to sustain and perform well in the forthcoming days.
- b. The bank seems to be lacking in the conduct of detailed and proper credit appraisal and monitoring process. The bank before extending the facilities needs to make detailed analysis about various aspects like feasibility

of the party, creditworthiness of the client, collateral offered and previous performances.

c. The human resource is the most important component in a service industry. Thus, utmost care should be taken to increase and maintain high levels of motivation. The bank in this regard needs to review the benefit packages and provide ample training and development opportunities to its staff.

d. Banks should try to correct their market prices according to the net worth, earning per share and other profitability indicators. The banks are recommended to decrease their price – earning ratios to a reasonable level.

e. The credit deposit ratio of the bank stands at 69% in the Year 2062/063. This is good from the profitability aspect; there could be potential problems of liquidity. So, the bank should look to lower this ratio either by increasing deposits or lowering credits.

f. Nabil Bank seems to have complied to the directive in literary terms rather than its meaning. So, although it has a negative impact on profit of the bank, it has to assess the real threat of NPAs in a prudential manner and make additional provisions wherever necessary. For a bank that is in dire straits, it would be a good option for the long-term sustainability of the bank rather than looking to maximize the short-term profit.

g. This study carries a lot of limitation. So a more comprehensive study needs to be carried from the concerned authorities and the further researchers to reach a more authentic conclusion depicting the picture of the banks.

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Appendix I

Company Profile Nabil Bank Limited

Nabil Bank Ltd. (NABIL) was the first bank to be registered in Nepal in the Year 1984. It is a joint venture between Nepalese Promoters and the Emirates Bank International Limited, Dubai. Later on, Emirates bank sold its entire equity holding to National Bank Ltd, Bangladesh. The management of the bank has been entrusted to National Bank Ltd. under the Technical Services Agreement. The management of the bank is now led by Mr. Anil Shah under a management contract. The bank is currently providing its services from 28 branches across the country. The bank has gained considerable popularity in the market in less than a decade of operation.

Nabil is doing a good performance in Nepalese market. That's why Federation of Nepalese Chamber of Commerce & Industry (FNCCI) has awarded the National Excellence Award for the achievement and services as Commendations for Significance Achievement in Institutional Policy Planning & Commitment during the past year.

The Bank has always felt responsible towards the betterment of the society and the community of which we are a part. In this regard, Nabil continue three pillar approaches to great corporate citizenship through the partnership in: Health, Education and Sports. In health their partnership with the Glaucoma Eye Center at Tiganga Eye Hospital continues, in Education, the bank has been associates with the Mary Ward School and is sponsoring the education of less privileged girl children of grade 8,9and 10. And in sports, their alliance with the Nabil Three Star football club is growing from strength to strength.

Nabil has around 250 correspondent banking relationship and drawing /accounting arrangement

with more than 75 banks in 40 countries in the world. Major corrosodent banks are Nostro Bank,INR Draft Arrangement,FCY Draft Arrangement,Import LC Advising Bank,Bilateral Key Exchange.