

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Nepal is basically an agricultural, mountainous and landlocked kingdom surrounded by two large, fast developing nations, China and India. More than 80% of the population is involve in the agricultural sector. The economic development of Nepal has been limited by the variety of geo-political and structural constraints. As such, country's land locked location; limited exportable resources, low economic growth, low savings, low income, higher rate of population growth, limited transportation facilities and infrastructure etc are the major factors that have proved obstacle in the economic development of the country.

As being developing country, Nepal is striving to develop and modernize her economy rapidly on rational and socially desired footings. But the structure of the economy has still remained primarily agricultural with very small manufacturing base. So it is essential to divert and modify agro based economy. Nepal has adopted mixed and liberal economic policy with the implicit objective to help the state and the private sector, on the ground of open and liberal eco-system. Especially after restoration of the democracy, the concept of the liberalization policies has been incorporated as directive principal and state policies. The continuing thrust to the development of nation has helped in establishing many company banks, financial institution and manufacturing industries. Thus these establishments helps the country

for its development in some level but for actual economic development, capital formation and utilization are the two major things that should be essential for the investment in a country. The formation and utilization of capital are shaped by many factors like prosperity of country, GDP of country, export-import of country, lending-deposit pattern, and interest rate and so on. In modern economy banks, insurance companies and other financial institutions play the major role for capital generation and utilization. In other words they take part actively in funds mobilization. Especially the role of insurance company is crucial in development of the nation.

Growing number of companies in the Nepalese insurance market is the indication of expanding scope. Liberalized economic policies have tempted profit oriented joint venture companies. Insurance business is likely to accelerate with the speeded economic activities. With the rise in purchase power of the people and increased in educational level, the insurance business is expected to take upward course. There has been a growth of premium by 15% in average in non-life insurance. The volume of premium has been increasing. Similarly, the agent for life insurance has increased very significantly as compared to last fiscal year. This gives a clue that there is a growth in life insurance as well.

Most of the industries and business houses have been closed down and those who have been operating in the present condition taking full fledged risk are not been able to perform their daily activities and earn as they have expected to earn. So in the present context profitability return is one of the most important and challenging goal.

Importance of profit is hardly required to be explained. Company should earn profits to survive and grow over a long period of time. Profits are essential as it would be wrong to assume that every action initiated by management of a company should be at maximizing profits, irrespective of social consequences. It is unfortunate that the word profit is looked upon as a term of abuse since some firms always want to maximize profits at the interest of employees, customers and society. Except such infrequent cases it is a fact that sufficient profits must be earned to sustain the operations of the business to be able to obtain funds from investors for expansion and its growth and to contribute toward the social overhead for the welfare of the society.

Profit is the difference between revenues and expenses over a period of time. Profit is the ultimate 'output' of a company and it will have no future if it fails to make sufficient profits. Therefore, the financial manager should continuously evaluate the efficiency of the company in terms of profit. Therefore, the financial manager should continuously evaluate the efficiency of the company in terms of profit. The profitability ratios are calculated to measure the operating efficiency of the company. Besides management of the company, creditors and owners are also interested in the profitability of the firm. Creditors want to get interest and repayment of principle regularly. Owners want to get a required rate of return on their investment. This is only possible when the company earns enough profits; profitability is an indicator of efficiency of the business organization. Profitability ratio measures the management's overall efficiency. This shows that higher the profitability higher the management efficiency and vice versa.

1.2 Introduction of Insurance

Insurance is a contract made by a company, society, or by the state, to provide a guarantee of compensation for loss, damage, sickness, death etc in return for regular payment. In other words, it can be said that any measure taken as a safeguard against loss, failure etc.

It is a universal fact that the outcomes of most activities are uncertain. Uncertainty remains in every nature of businesses. So risk is associated with it. There are no such devices or methods which confirm that there is no risk and no chances of loss occurrence in any types of business. It should not necessarily be only businesses, even in the houses where we live; we are unsure what is going to happen tomorrow because we don't know when earthquake occurs. In fact, it is similar to our lives as we absolutely have no idea about our exact longevity. This is a tricky situation. Until now, we are able to transfer the risk primarily created due to natural disaster or an accident in the form of insurance but unable to eliminate in first hand. It is beyond our capacity to control natural calamities or an accident.

Insurance is a precautionary measure that has been taken by any party's to compensate for the loss incurred due to any undesirable events. It is an intangible service which helps to get rid from the painful sufferings caused by the uncertainties. Thus the insurance provides a relief in the form of compensation packages in a period of desperate need.

In a period of deepest sorrow and need, when funds appear to drain into abyss of creditor's demand and estate duties, the hefty cheque brought in the form of insurance claims provide great relief. So, insurance offers excellent financial protection.

Industrial and commercial risks are more complex. Apart from the normal trading risks, they are exposed to various natural and man created hazards, the result of which can kick them completely out of the business. Moreover, not all the risks are insurable which means the careful risk management should be administered. Risk management deals with the technique of identification, evaluation and handling of risks. After properly identifying the risk one is exposed to, one has to evaluate the monetary consequences of such risks before thinking of handling of the risks which may be consciously assuming certain risks oneself and transferring others by various devices including insurance. Insurance is one of the risk transfer mechanism.

Insurance is not a luxury; it is a necessity especially when one's paid up assets is few. Many people think insurance is for the rich people as they can afford but it is precisely for those who are not financially secure.

Insurance business is broadly classified into two groups

1. General Insurance (non-life)
2. Life Insurance

There are various types of services offered by General insurance and the most important services are

1. Vehicle Insurance
2. Marine Insurance
3. Fire Insurance

Similarly, Life insurance is mainly focused on the life of individual. It is related to the health of individual or policy covering the unnatural death of an individual.

1.3 Brief Introduction of Insurance Industry of Nepal

In Nepal, there are 25 insurance companies. One of them is fully government owned corporation. Most of the insurance companies are invested by private sector of the nation whereas some of them are joint venture with foreign companies and some are totally foreign investment company. Out of these these insurance companies, 2 companies are operating both life and non-life insurance business whereas other 8 are holding life insurance and other is non life insurance companies. (Insurance News & Views, Vol.9, 2008)

Following are insurance companies which are operating only the life insurance business.

1. Nepal Life Insurance Co. Ltd.
2. Life Insurance Corporation (Nepal) ltd.
3. American Life Insurance Company (ALICO)
4. Asian Life Insurance Company Ltd.

5. National Life Insurance Company Ltd.
6. Surya Life Insurance Company Ltd.
7. Gurans Life Insurance Company Ltd.
8. Prime Life Insurance Company Ltd.

Similarly, following two companies operate both life and non-life insurance business.

1. Rastriya Beema Sastan
2. National Life and General Insurance Co. Ltd

Following are non-life insurance companies.

1. Nepal Insurance Co. Ltd
2. The Oriental Insurance Co. Ltd.
3. National Insurance Co. Ltd.
4. Himalayan General Insurance Co. Ltd.
5. United Insurance Co. (Nepal) Ltd.
6. Premier Insurance Co. Ltd.
7. Everest Insurance Co. Ltd.
8. Neco Insurance Co. Ltd.
9. Sagarmatha Insurance Co. Ltd.
10. Alliance Insurance Co. Ltd.
11. N B Insurance Co. Ltd.
12. Prudential Insurance Co. Ltd.
13. Shree Shikhar Insurance Co. Ltd.
14. Lumbini General Insurance Co. Ltd.

15.Siddhartha Insurance Co. Ltd.

Growing number of companies in the Nepalese insurance market is the indication of expanding scope. Liberalized economic policies have tempted profit oriented joint venture companies. Insurance business is likely to accelerate with the speeded economic activities. With the rise in purchase power of the people and increased in educational level, the insurance business is expected to take upward course. There has been a growth of premium by 15% in average in non-life insurance. The volume of premium has been increasing. Similarly, the agent for life insurance has increased very significantly as compared to last fiscal year. This gives a clue that there is a growth in life insurance as well.

The fact that premium rate is decreased but the overall premium collection in insurance industry has increased suggest the increase of market size.

In this industry, there is a profitability of 10%-15%. Because of lucrative profitability, there have been 18 insurance companies.

The insurance Act 1993 has created an insurance regulatory Authority named "Insurance Committee" empowering to develop and regulate the insurance business, fix the priority area to invest the premium income, license and to facilitate administrative procedure to enable to function the insurance companies. The act has fixed the paid up capital requiring Rs. 300 million to run the insurance business. No restriction is imposed between national and alien companies as to entering into business.

The existence of economic and technological asymmetric between incumbent foreign investor has competitive advantage and the superiority of being foreign firms.

Due to low security, particularly in the context of Maoist insurgency most of the insurance companies have increased the premium particularly in terrorism insurance, which has discouraged the potential insured. Similarly, some insurance companies unnecessarily delay the claim or compensate very less has created panic among insured and compelled to think twice before purchasing policy. But in overall, the premium for other services such as fire insurance, vehicle insurance has decreased.

As there are several insurance companies in Nepal, competition is severe. As a result, this industry is going through innovation in its services offerings for example, services are ranged from theft insurance to mobile insurance.

The market for life insurance is tremendous and players are very few in this segment. There are hardly more than five major players in this segment. Concept of life insurance is still unknown to majority of Nepalese.

1.4 Profiles of the Insurance Companies under Study

1.4.1 Nepal Life Insurance Company Limited

Nepal Life Insurance Company Limited was established as a public limited company in 2058-1-1-21BS under Company Act, 2053BS and Insurance Act, 2049BS. It was established in the pure Nepalese investment of the

private sector. It has operating life insurance business by opening twelve branches offices in main urban area of Nepal. Its branch offices are located in Kathmandu, Banepa, Birgunj, Nepalgunj, Pokhara, Mahendranagar, Lahan, Janakpur, Biratnagar, Narayanghat, Butawal and Birtamodh. Life insurance policies are issued by every branches of the company. Total paid up capital of the company is Rs 250 million out of which 80% was paid by the founder member of the company and rest 20% by the general public.

1.4.2 Life Insurance Corporation Nepal Limited

Life Insurance Corporation Nepal Limited was established under the Company Act, 2053 and Insurance Act, 2049 in the joint capital investment with Indian Life Insurance Corporation by the private sector of Nepal. It was registered in 2058-4-23 and started its life insurance transactions from 2058-6-1 BS. It has operating life insurance business by opening the branches offices in main urban area of Nepal. Its branch offices are located in Kathmandu, Biratnagar, Birgunj, Dharan, Janakpur, Birtamodh, Butwal, Dhangadhi, Pokhara, Nepalgunj, Bhairahawa, Gaighat, and Gaur. Total paid up capital of the company is Rs 250 million out of which 80% was paid by the founder member of the company and rest 20% by the general public.

1.5 Statement of Problem

Nepal, like any other country has been laying emphasis on the upliftment of its economy. The process of economic development depends upon various factors. Financial institutions are viewed as catalyst in the process of economic growth. The mobilization of domestic resources, capital formation and its proper utilization plays an important role in the economic

development of a country. Every financial institution, big or small, either banks or insurance companies play an important role in the development of a country. In other hand, these financial sectors, banking and insurance, is regarded as a profitable sector. Insurance industry in the eyes of the layman appears as a very profitable sector. However, unlike the general perception, the industry is plagued with immense challenges to sustain it and outpace those within the industry, mainly due to rising competition and weak economic situation in the country. The following problems are currently prevailing in the insurance companies regarding the profitability of them.

-) Whether insurance companies are improving the profitability or not?
-) Whether curtailment of expenses of strategic importance is crucial in betterment of profitability or not?
-) Whether the trend of the profitability is increasing or not?
-) Whether investment on assets or other utilization of resources affects the profitability trend or not?
-) Whether or not the external or internal environmental factors affect the profitability?

1.6 Objectives of the Study

The study basically aims to evaluate the profitability of Nepal Life Insurance Company Ltd. and Life Insurance Corporation Nepal Ltd. and to suggest recommendation based upon it. The specific objectives of this study will be:

-) To evaluate and analyze the soundness of profitability of the companies.

-) To study the trend of profitability of the companies.
-) To evaluate and study the relation of various factors like assets, Interest income, Managerial Expenses and Life Insurance Fund on profitability.
-) To provide recommendation to the management in improving their activities to increase profitability on the basis of the findings and the study.

1.7 Rationale of the Study

Profitability is regarded as the lifeblood for any enterprise because it is needed for growth and expansion. If the business cannot maintain a satisfactory level of profitability, it is not regarded as a good enterprise and may even close. Insurance industry is vital sector for economic growth in a country. Insurance business is regarded as a profitable sector. So an independent study of profitability on insurance business is significant for the stakeholders and the persons who are interest on it. Researcher believes that following institution and individual will be benefited from the study.

-) Individual who will carryout further research work in profitability of insurance companies.
-) Insurance companies whose study been made.
-) Individuals who have keen interest in Nepalese economy and insurance industry.
-) Investors, policy holders and other stakeholders. Students, teachers, managers, policymakers, etc.

1.8 Limitations of the Study

The study and outcome of the study will be an individual effort. Therefore management and resource mobilization will limit the in-depth study of few insurance companies operating in the country.

-) The study will be based on secondary data; therefore, the accuracy of results and conclusions highly depends upon the reliability of these data.
-) The evaluation is made through the analysis of financial statement published and presented by the companies.
-) As the title specifies the study covers about profitability subject only others factor beside these are not studied.
-) Resource, time, money constraints and inaccessibility of sufficient information also limit the conclusion drawn from study.
-) This study may not be precise as it is prepare to fulfill the partial requirement of the MBS program.

1.9 Organization of the Study

Considering the objectives in mind, the study has been organized into the following five chapters.

Chapter 1: Introduction

This chapter includes a brief introduction of the study; it includes background of the study, focus of the study, statement of problem, objectives of the study, need of the study and limitation of the study.

Chapter 2: Review of Literature

This chapter includes conceptual framework, review of books, and review of previous study, reports, dissertation and journal articles related to the topic of the study.

Chapter 3: Research Methodology

This chapter contains the whole procedure of this research work i.e. research design, sources of data, populations and sample, data processing, method of analysis.

Chapter 4: Data Presentation and Analysis

This chapter consists of systematic presentation and analysis of financial statement employing financial and statistical tool. It also includes major findings.

Chapter 5: Summary, Conclusion and Recommendation

This chapter includes a brief summary of whole research report and its conclusion. It also includes some useful suggestions to the concerned parties and recommendation.

CHAPTER – II

REVIEW OF LITERATURE

2.1 Introduction

This chapter is divided into three sections. First section deals with conceptual review of profit. Second section deals about relevant journals and article review and the last section deals with the unpublished thesis review relating to the study.

2.2 Conceptual Review

In this section conceptual and theoretical review of profit, profit- a traditional approach and the modern approach, profit theories, factors affecting profit, functions of profit, profit and profitability and stability of profit.

2.2.1 General Concept of Profit

If we ask what the profit is, to the layman, the simplest answer would be the excess of income over expenses. Actually, in the simple sense it is totally true. If we deduct expenses by income then the difference amount is profit and if it comes negative then we term it as loss.

The simple definition of profit according to Oxford English Dictionary is, "Money gained in business especially the difference between amounts earned and amount spent." (Hornby; 1996:924) It further explains, "The financial gain in a transaction; the excess of returns over outlay; the surplus of a company or business after deducting wages, cost of raw materials, interest, and other expenses". But in order to describe from the technical view point, it is the surplus resulting after a defined trading period but must be regarded as the first essential charge upon business, being a reward a fort engaging resources in conditions of speculative risk for the satisfaction of consumer demand. It furnishes resources to invest in future operations and consequently its absences must result in a decline in effective capital resources and ultimately competitive extinction of the business.

According to Adam Smith, The Father of Economics, "Profit is the sum remaining after the payment of all wages in economics includes payments to officers of corporations, to proprietors, to partners and to farmers, as well as to what we today term labour, and rent on the unimproved value of land, as the return to capital." (Foulke; 1998: 56) This is one of the broadest definition that clearly defines what the profit is and how is it formed.

It is necessarily a residual sum. Land, labour and capital are frequently used under contracts whereby they receive a predetermined return. A net profit is a sum over and above the ordinary costs of business including such contractual outlay. Nobody contracts to pay the entrepreneur the residual sum, which constitutes net profit. Business profits are, therefore especially contingent upon successful management of risk. Business is faced with a number of uncertainties: (1) technical uncertainties- those relating to the

physical process of production (2) cost uncertainties either due to change in the prices of raw materials, wages, rent etc. or due to technology changes. (3) Demand uncertainties either due to changes in consumer preferences or due to demand uncertainties either due to changes in consumer preferences or due to innovation of new products and obsolesces of the existing products. (4) Market uncertainties- those relating to the future price of the product and the volume of sales. The entrepreneur receives a reward for combining the factors of productions to meet the economic needs of a world faced with uncertainties. He takes a risk, which others are unwilling to bear, and if he successfully manages the risk, he receives profits. The means that a business man, in order to earn profits, has to do two things: (1) select the risks which he wishes to bear, and (2) manage them successfully. The selection of risk is made at almost every step of businessman's career. His important problem is the selection of business in which he wishes to engage himself. But even thereafter many risks arise. Some of them he may give to bear even though he would rather not: others he may transfer to people more willing to bear them (or unable to escape them): still others he may shift by insurance. (Varshney & Maheshwari; 1979: 300)

Some experts explain profit as a measuring rod that measures the efficiency of business organization or corporation. According to them it is just a tool in measuring the efficiency of the activity of the firm. If it is positive then the activity of the organization is on the right track else in the wrong track.

Profit is simply, convenient and the most popular yardstick of Judging the efficiency to a business enterprise in private as well public sector. For private enterprise, it is taken to be the most satisfactory criterion of efficiency.

Profit helps in judging the overall efficiency and is easy to calculate,. Even through profit maximization, unlike private enterprise, is not objective of public enterprises, yet profit serves as a well-accepted criterion for judging the public enterprises, yet profit serves as a well accepted criterion for judging the overall efficiency of public enterprises too." (Narayan; 1980: 206) He states that the profit is not the main object of the public firm but the question arises how would the public firm survive? Would it be the government who would be responsible for its survival and successful operation?

R.R. Gilchrist and Argent expresses similar view that profit is equipment for measuring the organizations efficiency and effectiveness.

In the opinion of R.R. Gilchrist, "The profit is the ultimate measure of effectiveness. A profitable company is likely to offer not only security of employment but also promotion prospects job opportunities and the intense personnel motivation that comes from being associated with success." (Argent; 1968: 34)

"Profit is the Barometer of the success of business. It is indeed, a magic eye that mirrors all aspects of entire business organization including the quality output." (Argent; 1968:68)

Apart from successful operation, there may sometimes be less from external environment which cannot be controlled by the organizations. Let's for instance take war or any natural calamities or change in government and

international rules and regulations. So in this case this definition is yet to be updated.

These definitions summarize one profit i.e. profit is the main financial indicator of business firm which is indeed a need to survive and grow the business environment. Profit is essential to raise the market price of share and to attract additional capital investment. Profit is outcome of good management, cost control, credit risk management, efficiency of operation, etc. Simply stated, profit is money excess of sale over money spent but the term Profits vary controversial and there are several different definitions and its interpretations.

Usually profit does not just happen. Profits are managed before we can move an intelligent approach to the managerial accept of profit. There are after all, several different interpretations of term 'profit'. An economist will say that profit is the reward for entrepreneurship for risk taking. A labour leader might say that it is a measure of how efficiently labour has produced and that it provides a base for negotiating a wage increase. An investor will view it is a gauge of the return on his/her money. An internal revenue agent might regard it as a base for determining income taxes. The accountant will define it simply as the excess of firm's revenue over expenditure of producing revenue in given fiscal period." (Lynch & Williamson; 1989: 99-100) He has accumulated the wide view and perspective of what people in the different sector think about profit. These people may be an economist or labor or investor or accountant or manager.

Significance of profit to a business firm can hardly be neglected. It is equally important as for nutrition is required for human beings and animals to survive. To cover costs of staying in business such as replacement of machines, furniture, obsolescence of machines, market or technical risks, etc., profit is necessary. It is also essential in the sense to ensure supply of future capital. It provides capital through retained profits. According to the self-financing principle, it provides access to attract outsiders' capital. Naturally, investors would invest their money in a firm where there is adequate profit formation. Hence, profit is required to ensure and satisfy the entire expectation of management, shareholders or investors, employees and nation as a whole.

Ronald I. Robinson takes profit as the requirement for its existence and to survive in the long term. He explains, "Profit is essential for every enterprise to survive in the long run as well as to maintain capital adequacy through retain earning. It is also necessary to accept market for both debts and equity to provide funds for increased assistance to the productive sectors."(Robinson, 1951: 21)

R. Cauvery explains profit in accounting terminology and in economic since. According to him, "Profit in the accounting sense is 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."
(Cauvery, 1997: 122-123)

A. H. Taylor & H. Shering has given bit different view in profit. They have described as inspiring agents which pressurize the management to gain more efficiency by cost reduction, greater turnover. "The profit motive remains on the main springs of an enterprise and spur to efficiency. It is clearly the desire to make profit which inspires the search for more efficient methods, reduced unit cost, better organization and greater turnover." (Taylor & Shering; 1966: 170)

So from the above definition we can conclude that the profit is not only important for the survival of any business firm but is also an aspiring, motivating agent, a measuring rod for measuring the efficiency of each and every organization which should be taken as the major aim whose fulfillment cannot be diverted.

2.2.2 Profit- A Traditional Approach

From the past history, we see that the primary and final objective of every business enterprise is to maximize profit and all its activities are directly focused in earning profit. This traditional approach ignores the concept of external and internal environment that are directly and indirectly concerned with business and its positive and negative impact in. But this does not mean that the businessman in the past period does not spend for social welfare. Profit maximization approach is the most important assumption of economic theory also proves this fact. It always assumes that a firm sets target to maximize the profit and is discretionary behavior of the firm. Maximize profit is taken as the central belief. In the past the government provided their full support for the industrialist and the businessmen for smooth operation of

their activities in achieving and maximizing their profit. The consequent in the global environment was hardly taken into consideration. This does not mean that the consequent in the external environment like society, culture and other factors like legality etc. were ignored or neglected.

Profit is the measurement of the corporation's overall performance. A corporation can claim itself to be successful if it can maintain maximum profit to justify the worth of the return on investment. This helps corporation to save from shortage of funds and provides best opportunities to undertake the expansion of assets to enlarge business." (Sherstha; 1980: 23-24) He explains that the profit is only measures of success and those who able to maintain maximum profit is the most successful one. This would also help the organization to save form the shortage of funds, which can also lead to bankruptcy of that organization.

"It provides yardstick by which economic performance can be judged. It leads to efficient allocation of resources. It ensures maximum social welfare. (Khan & Jain; 1999: 1.9) This shows that the profit maximization is deeply rooted in the society and is taken as central belief because success measurement of any firm is done by how much profit has been able to acquire.

There was a strong belief or assumption in the society that in the process of maximizing profits, society's resources are efficiently utilized. These resources may be in the form of human resources, natural resources like land, water, mines, flora, and fauna or man made resources like machinery, vehicles and buildings, which have cyclic effect in the economic

development of the society. So firms adopt those ventures which increase profits and unprofitable activities are dropped.

This concept was taken to be advantageous while the business structure or firms were self-financing, single entrepreneurship and taken as private property. Obviously, profit maximization was entertained by the single owner to enhance his individual wealth and personal power in the past days. So it is now regarded or explained as a self-centered who has single dimensional aspect.

2.2.3 Profit – A Modern Approach

Modern business environment is completely different form that of the past, whether form the technological viewpoint or form the conceptual viewpoint. Today the activities that a firm performs have multi-dimensional aspect. So a firm must set several schedules with different objectives apart form profit maximization. Concept of social responsibility in the modern days was introduced with a view that only maximizing the profit is not the sole objective of a firm. The firm should use the acquired profit from its activities in the social welfare.

Businesses have multiple goals and the need of survival, goodwill, security or growth commonly calls for some sacrifice of short-term profits. Most businesses do, however, rate profitability consistently high among their long-term objectives and it could be argued that short-term goal such as security and growth are in fact, subordinate to long term profitability.

(Salvage and Smell; 1967:30)

The business firm today is financed by equity owners, creditors and professional management. Likewise customers, employees, government, society are connected with firm which we term in the modern language as the stakeholders. So in order to protect the interest of these stakeholders different concepts in the protection of their rights are developed and implemented.

Apart from it, government also imposed different acts for preservation of the environment or environmental protection, consumer protection trade and merchandise marks protection different ethics and values in business.

Besides several other objective of a firm, shareholder' wealth maximization is taken as a normative goal of the firm or otherwise a firm should set a standard for reasonable profit. The principle of maximization of share holders' wealth following timing of returns and risk provides a rational guide for running a business and for efficient allocation of resources in society. "In developing countries the corporation have to determine what the outcome would be before allocation the resource in the attempt to maximize the social benefit side by side in accompanying the maximizing the share holders wealth. (Shrestha; 1980:25, 26)

2.2.4 Profit Theories

With the passage of time in the history of economic thought, wide range of theories are developed and in the process to explain the exact meaning of profit. Each of the many theories that have been offered, however, tends to

focus upon just some small fraction of the various aspects of profit (e.g., its source, components or function). Nevertheless, most profit theories can be classified as one of three major types: (Seo; 1988: 424)

-) Compensatory or Functional Theories
-) Frictional and Monopoly Theories
-) Technology and Innovation Theories

This classification cannot be all inclusive. Furthermore it should be taken to mean that one type of theory may not contain elements of other types. It merely points out of the differences in orientation that have emerged historically in the course of thinking about profit. For this reason, this classification represents a fair arrangement of the major issues involved in profit analyzing and convenient starting point for approaching them in managerial decision making.

2.2.4.1 Compensatory or Functional Theories

This group of theorist holds that economic profits (surplus) are the necessary payments to the entrepreneur in return for coordinating and controlling production. It is the entrepreneur who organizes the factors of production into a logical sequence, plans their efficient combination, and establishes policies to see that production is carried out. Profits, therefore, are the compensation for fulfilling these functions successfully.

Functional theories were proposed in the early 19th century, before the advent of large corporations. At that time, the entrepreneur was regarded as a higher type of laborer, similar in certain ways to an individual proprietor.

When attempts were made later, however, to apply functional theories to modern publicly owned corporations with their separation of ownership and control, the results appeared confusing and contradictory.

In the corporate form of business organization, the coordinative function is usually delegated by the owners (stockholders) to professional salaried executives. If executive remuneration is taken to be profits, despite its contractual form, the theory still leaves unexplained the residual income of the enterprise that goes to stockholders who exercise no active control. The only alternative, if functional theories are to be consistent with their original definition, is to allocate a share of the entrepreneurial function to stockholders. But attempts to do this are not in accord with the reality that the corporation is an organization of active leadership by managers and passive ownership by stockholders. With the growing importance of the large corporation as a dominant type of business organization in the American economy, functional profit theories lost much of their usefulness. In their place, a group of friction and monopoly theories emerged around the turn of the century.

2.2.4.2 Friction and Monopoly Theories

By 1900, the theory of a stationary economy had very nearly become a complete and unified system of thought. Against this background, the noted American economist, J.B. Clark, constructed an economic model that was intended to be a reconciliation of static theoretical laws and the dynamic world of fact. In modern times, this model has been called the model of perfect competition.

Fundamental assumptions of the model of perfect competition are the complete mobility of resources and the freedom of firms to enter and exit the market. Thus the economy is characterized by a smooth and frictionless flow of resources, with the system automatically slipping into equilibrium through the free play of market forces. Changes may occur that cause a departure from equilibrium, but so long as resources are mobile and opportunities are equally accessible to all economic entities (i.e., knowledge is perfect), the adjustment to a new equilibrium is accomplished quickly and smoothly. In this type of economic equilibrium all factors of production receive their opportunity costs' and an enterprise's revenues exactly equal its costs (including the imputed wages and interest of the owner). Hence no economic surplus or profit residual can result.

2.2.4.3 Technology and Innovation Theories

This group of theories holds that new technology gives rise to inventions, and inventions adapted to business use become innovations. Many inventions, of course, do not become innovations. But those that do, being dynamic phenomena, upset the equilibrium of an otherwise static system. The original purpose of the innovation theory proposed by the late Professor Joseph Schumpeter was to show how business cycles result from these technological disturbances and from successive adaptations to them by business. His procedure was to assume a stationary system in equilibrium in which all economic life is repetitive and goes on smoothly, without disturbance. Into this system a shock-an innovation-is introduced by an enterprising and forward looking entrepreneur who foresees the possibility of

extra profit. The quietude and intricate balance of the system are thus disrupted. The successful innovation prompts a large number of businessmen (Followers rather than leaders) to plunge ahead and adopt the innovation. In turn such mass rushes create and stir up secondary waves of business activity. When the disturbance finally subsides, the system settles into equilibrium once again only to be disturbed later on by another innovation. Economic development thus takes place as a series of fits and starts (cycles) rather than as a smooth and continuous process.

Innovation refers broadly to any purposeful change in production methods or consumer tastes that output that increases national output more than it increases costs. The increase in net output is the profit that comes from innovation. It includes not only new products such as synthetic fibers but also new organizations, new markets, new promotion and new raw materials. It may also include a new way of doing old things or a different combination of existing methods to accomplish new things. To an important degree, innovation has been built into the competitive system complete with research and advertising staff.

The innovation theory focused on the dynamic, uncertain, ever changing nature of capitalism. It holds that the only limits to human progress are the inherent limits of human beings themselves.

From the stand point of managerial economics, a theory's values is not so much determined by how well it explains the past or even the present, but how well it predicts the future. For this purpose, the innovation theory is

somewhat inadequate because it cannot foresee whether or when an invention will become an innovation.

2.3 Factors Affecting Profit

Profits vary from industry to industry and from businessman to businessman. The greater the risk and uncertainty in business or industry, the greater are the opportunities for large profits. Similarly, those businessmen who are temperamentally cautious and are not willing to assume large risks get a smaller margin of profit as compared to those who are more confident and adventurous. Since risks, profit and losses appear because of changes and uncertainties in a dynamic society, profits vary from year to year as well.

Profits are likely to be high in industries in which methods of production are constantly changing so that there is continuous adoption of new techniques;

- a) In nascent industries the prospects of which are rather uncertain.
- b) In industries in which there is a large gestation period.
- c) In industries. in which resources are irrevocably committed to narrowly specialized tasks.

Profits are also affected by the level of business activity. If business is brisk and firms are operation at their maximum capacity, their average costs would be reduced to the minimum while their sales would maximum. This would lead to higher profits. Profits would be reduced if the business activity is at low ebb or flow.

2.3.1 Functions of Profit

The basic function of profit is to provide businessman with an incentive to produce what consumers want, and when and where they want it at the lowest feasible cost. This includes innovation of new products and new methods. In fact, the profit motive is the kingpin of Peter Drucker, profit serves three main purposes.

1. Measure of Performance

It measures the net effectiveness and soundness of a business effort. A higher profit is an indicator that the business is being run successfully and effectively. It is true that profit is far from being a perfect measure of business efficiency but it is probably the best indicator of the general efficiency of a firm. It is certainly the only one which allows quick and easy comparison of performance of various firms.

2. Premium to Cover Costs of Staying in Business

Profit is the premium that covers the costs of staying in business replacement, obsolescence, market and technical risk and uncertainty. Seen from this point of view, it may be argued that there is no such thing as profit; these are only the costs of being and staying in business. The management of a business has to provide adequately for this cost by generation sufficient profit.

2.3.2 Ensuring Supply of Future Capital

Profit ensures the supply of future capital for innovation and expansion, either directly by providing the means of self financing out of retained profits, or indirectly through providing sufficient inducement for new external capital which will optimize the company's capital structure and minimize its cost of capital.

The primary goal of a business firm is to ensure its own survival. From this point of view, the firm must make a profit because profits are indispensable to remaining viable, to remain alive. Again the firm must have growth because that is the only way it can perpetuate itself as an institution. And profits are a natural concomitant of the growth and development of business over time.

2.3.3 Profit and Profitability

When these two words, 'Profit and Profitability' are presented together most people confuse because they think these both have same meaning. The word profitability is derived from word profit and has a bit different meaning than that of profit. Profit can be taken as the excess of income over expenses or it is the residual balance of earnings expected to be available from total revenue of a time period. It is also taken as the reward of entrepreneurship for taking risk.

Whereas the word profitability, is the ability or capacity of a firm or any business enterprises or any entrepreneur to make profit. Profitability can be

broken down into ‘profit and ‘ability’ which means the capacity to make profit. According to Howard and Upton, “The word profitability may be defined as the ability of a give investment to earn return in its use.” (Howard & Upton; 1961: 186) So any instrument if earns return in its use can be termed as the profitability of that instrument. It is a deviation of the term profit. It can also be termed as the basic efficiency measuring rod of success of business enterprise. Profitability is basically an arc around which the every business revolves.

W. M. Harper has tried to give distinct explanations between profit and profitability. According to him, “The Profitability is a relative measure. It indicates the most profitable alternative. The profit, in the other hand is an absolute measure. It indicates the overall amount of profit earned by transactions” (Harper; 1999: 4)

Table: 2.1

Difference between Profit and Profitability

Profit	Profitability
It is an absolute measure	It is the relative measure
It indicates the overall amount of profit earned by transactions	It indicates the most profitable alternative

K.K. Seo has expressed his distinct view on profit and profitability. “Profit in an economic sense is the difference between the cash value of the enterprise at the beginning and end of the period.” (Seo; 1988:433) Like wise “True profitability of any investment or business operation cannot be

determined until the ownership of the investment or business has been fully terminated.” (Seo; 1988:430)

So these definitions clearly explain the relationship, similarity and difference between profit and profitability.

2.3.4 Stability of Profitability

Acquiring profit for the company or any business organization is not a great thing. Maintaining it or making stable in the long run is one of the most challenging thing that we all know because there are various internal and external factors that directly and indirectly affect the profitability of the organization. So to minimize the affect on profit by these elements and take advantage from them long term and short term study depending upon the nature of the institution and related field is required through which we can accurately analyze the situation and then forecast accordingly. For acquiring stability in the profitability of any organization pre study and research, good internal management and external management, good plan policy making with the help of experts and related workgroup, implementation of that policy and plans revision of the performance of the policy and develop according to the achieved result is required. Same phases of activities are also applied in the banking sector.

2.4 Review of Thesis

In the past years we can see many researches in the profitability analysis and financial performance analysis of the Nepalese commercial banks but no study has been made research in the profitability analysis of insurance companies. So these available research works regarding profitability of commercial banks have been reviewed.

Mahat (2006) in his work had tried to deal with the profitability of Joint Venture Banks in Nepal.

Major objectives on the basis of which study is done are as follows:

-) To evaluate and compared the soundness of profitability and operation efficiency along several joint venture banks.
-) To compare and analyze fund based interest income with fee based income of joint Ventured Banks in light of interest earning assets.
-) To compare the cost of deposits of the Joint Ventured Banks in regard with profitability.

The major conclusions of the study are as follows:

-) Net profit margin ratio of Standard Chartered Bank Ltd. is found best performer and following by Nabil Bank Ltd. and Himalayan Bank Ltd. with the next best performer.
-) The established banks have gold tract record of their financial position and the newly established are penetrating the market. All the banks

are operation in profit although some of them suffered from losses during initial stages.

-) The correlation coefficient which measures the relationship between the market value seems highly significant for the Bank of Kathmandu Ltd. Nepal SBI Bank Ltd., and Nepal Bangladesh Bank Ltd. However these are negative relationship between market value and book value for Nabil Bank Ltd. and Standard Chartered Bank Nepal Ltd.

Like wise the major recommendations that are made on the basis of the study are as follows.

-) The commercial bank has been investing more in government securities rather than in loans and advances. So the author recommends the commercial banks to invest in the most earning assets i.e. loan and advances than that in non earning assets.
-) The joint venture banks are found least participated in the aspects of boosting up foreign investment in the kingdom. Thus the joint ventured commercial banks should strongly establish the bank which can achieve by using its wide, modern and strong means of communications.

Shrestha (2006) in his research has tried to analyze the profitability position of Standard Chartered Bank Nepal Ltd. and Nabil Bank Ltd. During the research work he has set the following specific objectives which are as follows.

-) To evaluate the soundness of profitability and operation efficiency of Nabil in comparison with that of standard Chartered Bank Nepal Ltd.

-) To compare and analyze fund based interest income with fee based income of Nabil Bank in comparison with that of Standard Chartered Bank in light of interest earning assets.
-) To compare the cost of deposits of the two banks in regard with the profitability.

The major findings of the thesis concerned to profitability are as follows.

-) Both the banks interest income to total earning assets ratio are decreasing. Earning spread rate of both of the banks ratio are also decreasing. Both of them are negative sign to the banks performance.
-) Both the banks net profit margin is decreasing every year. However Nabil's net profit is more than that of Standard Chartered bank Nepal Ltd. and interest margin of Nabil is more than that of Standard Chartered.

Major recommendations that are given by the researcher on the basis of research are as follows:

-) The study reveals that Nabil Bank has not adapted any cost management strategy to have control over its cost of funding. Nabil has paid very higher interest to deposits and other working funds than Standard Chartered bank. The cost of management strategy would be ideal to reduce the various costs and increase the profitability.
-) The fees based on activities of banks like commission, discount and fees are found to be very profitable and important nowadays in the banking business. They yield high return to a bank. Both the banks are not in the better position regarding the proportion of fee based

activities to loan and advances. It is recommend to enhance the off balance operation as it is very profitable and immediately realizable.

-) Majority of joint venture banks have been found to be profit oriented ignoring their social responsibility. For a survival for a long run, banks should be able to render their services in the rural, deprived areas. For more social movements, the bank is suggested to introduce a scheme like loan for further study to the student, loan for promoting skills of women or unemployed housewives.

Joshi (2007) in his research paper on the financial analysis on the context of Nepalese commercial banks, following facts has been reveled.

Objectives set in the research are as follows:

-) To find comparative financial strength and weakness of various commercial banks.
-) To find return rate and expected return to the shareholders
-) To study systematic and unsystematic risk.

Conclusions made on the basis of his research work are:

-) Lending condition of banks is in decreasing trend. Strong banks are holding good customers and discouraging low rates and less amounted loans. Instead of that they are initiated towards remittance, bank guarantees and other commission generating activities. While other banks are showing aggressive and are spontaneously increasing loan loss provision.
-) Deposits in the banks are also decreasing while some banks are holding enough funds.

CHAPTER – III

RESEARCH METHODOLOGY

3.1 Introduction

In order to start any activity preplanning of way to perform that activity is not only necessary but is also very important. It is important in the sense that it not only makes us easy to act and perform but also helps us to obtain our desired results and objectives within the specified time period. For analyzing the profitability in the context of insurance companies in Nepal we do have to determine the systematic process that we are going to use. An introduction relating to this thesis work is made in the first chapter and relevant literatures are received in the second chapter. The research methodologies, which are used to analyze to collected data, are mentioned in this chapter.

Research methodology is the systematic way to solve the research problem. This chapter highlights about the methodology adopted in the process of present study. It also focuses about sources and limitations of the data, which are used I to present study. ‘Research Methodology is a way for systematic solving the research problem in the other words; research methodology indicates the methods and processes employed in the entire aspects of the study. “Research Methodology refers to the various sequential steps (along with a rationale, if each such step) to be adopted by a researcher in studying a problem with certain object/objects I view” (Kothari; 1990; 39). This chapter incorporates Research design, Nature and Sources of Data,

Population and Sample, Data collection procedure and lastly, Methods of Analysis. This chapter offers the methods of investigation followed by the objective of the case study; also states the sources and limitations of the data used in the study. So, it is the methods, steps, and guidelines, which are to be followed in analysis, and it is a way presenting the collected data with meaningful analysis.

3.2 Research Design

The word “Research” is derived from French word “Researcher” which means to seek again. Therefore to seek and compare the concerned bans for the case study, the research is designed as per objective of the study.

“Research design is the plan, structure, and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The plan is the overall scheme or program of the research. It includes an outline of what the investors will do from writing the hypothesis and their operational implications to the final analysis of data. The structure of the research is more specific. It is the outline, the scheme, the paradigm of the operation of the variables. Then we draw diagrams that outline the variables and their relation and juxtaposition, we build structural schemes for accomplishing operational research purposes. Strategy, as used here, is also more specific than plan. In other words, strategy implies how the research objectives will be reached and how the problem encountered in the research will be tackled.” (Kerlinger; 1986; 275) But if we are to describe in one sentence it is purely and simply the framework of plan for a study that guides the collection and analysis of the data.

The research design is of both descriptive and prescriptive nature. Descriptive research is used to compare and to assess the options, behaviors of the firms and to describe the situation and events occurring during the study period where analytical research is used to find out the result employing financial as well as statistical tools. For the analytical purpose, the annual reports published by the relative banks and other publications of the related banks published by the banks respectively and Nepal Rastra Bank, Nepal stock Exchange Ltd & other agencies, were collected for the year fiscal year 1999/00 to 2003/04. In this study both descriptive and analytical research design is used.

3.3 Nature and Sources of Data

The study is based secondary data as well as primary and. The secondary data is collected from annual reports, profit and loss accounts, balance sheets, brochures, journals and articles published in various magazines, newspapers and other internal reports and publications of the sample insurance companies and other institutions. Besides it other necessary information that is concerned to the topic are also gathered from different websites, related companies and related agencies like Rastriya Beema Sansthan, Nepal Stock Exchange limited, Ministry of Finance, National Planning Commission etc. Primary data is collected in the form of interview, questionnaire and in other forms.

3.4 Data Processing Procedures

For the purpose of this study, the different data are obtained from different sources, which are scanned and tabulated under different heads. After tabulation, they are analyzed by applying both financial and statistical tools.

3.5 Population and Sample Size

According to the statistics of Rastriya Beema Samiti, there are 25 insurance companies operating under its approval. Out of these only two companies- Nepal Life Insurance Company Ltd. and Life Insurance Corporation Nepal Ltd. are selected as sample for the study. NLIC is selected from the group of pure Nepalese investment insurance company and LIC is taken from the group of joint venture insurance companies. It covers 10.52% of the total population.

3.6 Period of the Study

The study is based on five years financial data of sample insurance Companies i.e. Nepal Life Insurance Company Ltd. and Life Insurance Corporation Nepal Ltd. starting from fiscal year 2059/60 BS (year ending mid July 2003) to fiscal year 2063/64 BS (year ending mid July 2007).

3.7 Method of Analysis

Financial tools and empirical models are to be used in the process of research and study. Main focus is given to ratio analysis as it is taken as the powerful tool of financial analysis to point out the economic and financial position of business unit through which it can be x-rayed.

3.7.1 Statistical Tools

Statistical tools are the measures or the instruments to analyze the collected data from different sources. In statistics, there are numerous statistical tools to analyze data of various natures. In this study, the researcher has used the following statistical tools to analyze the data.

3.7.1.1 Average (Mean)

An average is a single value related from a group of values to represent them in some way, a value, which is supposed to stand for whole group of which it is part, as typical of all the values in the group (Gupta: 1990; E7-2). There are various types of averages. Arithmetic mean (A.M. simple and weighted), median, mode, geometric mean, harmonic mean, are the major types of averages. The most popular and widely used measure representing the entire data by one value is the A.M. The value of the A.M. is obtained by adding together all the items and by dividing this total by the number of items or observations.

Mathematically, (Gupta; 1992: 238)

Arithmetic Mean (A.M.) is given by, $\bar{X} = \frac{X}{n}$

Where,

\bar{X} = Arithmetic Mean

X = Sum of all the values of the variable X .

n = Number of observations

3.7.1.2 Standard Deviation

The standard Deviation () measures the absolute dispersion. The greater the standard deviation, greater will be the magnitude of the deviation of the values from their mean. A small standard deviation means a high degree of uniformity of the observations as well as homogeneity of a series and vice versa.

Mathematically, (Gupta; 1992: 380)

$$\text{Standard Deviation ()} = \sqrt{\frac{1}{n} \sum (X - \bar{X})^2}$$

3.7.1.3 Coefficient of Variation

The standard deviation is absolute measures of dispersion: where as the coefficient of variation (CV) is a relative measure. To compare the variability between two or more series, CV is more appropriate statistical tool..

Mathematically, (Gupta; 1992: 380)

$$\text{Coefficient of Variation (CV)} = \frac{s}{\bar{X}} \times 100$$

3.7.1.4 Correlation Analysis

Correlation is a statistical tool, which studies the relationship between two variables. Correlation coefficient summarized in one figure, the degree and they extend to which the two variables are correlated but is does not tell about cause and effect. (Bajracharya, 2053)

For analyzing the relationship between two variables, Karl Person's correlation coefficient (r) has been used. Correlation analysis describes the positive and negative relationship between variables. It helps to determine whether there is:

- ❖ A positive or negative relationship exists
- ❖ The relationship is significant or insignificant and
- ❖ Establish cause and effect relation if any

The statistical tool, correlation analysis is preferred in this study to identify the relationship between variables, whether the relationship is significant or not. For the purpose of decision- making, interpretation is based on following term:

1. When $r = 1$, there is perfect positive correlation.
2. When $r = -1$, there is perfect negative correlation
3. When $r = 0$, there is no correlation
4. When 'r' lies between 0.7 to 0.999 (-0.7 to 0.999) there is a high degree of positive (or negative) correlation.
5. When 'r' lies between 0.5 to 0.699, there is moderate degree of correlation.
6. When 'r' is less than 0.5, there is low degree of correlation.

3.7.1.5 Trend Analysis

Trend analysis is a significant tool of horizontal financial analysis. It is a dynamic method to indicate the changes in terms of financial statement. Trend analysis helps to identify the controllable items of given period and future forecast can be made for ongoing concern. It is one of the useful tools in making a comparative study of the financial statement of the number of years. It makes easy to identify the changes in an item or in a group of items over a period of time and to draw the conclusion regarding the changes there on.

Under this topic, trend of different ratios are forecasted for next five years. The projections are based on the following assumptions.

-) The main assumption is that other things will remain unchanged.

-) The banks will remain in the present position.
-) The economy will remain in the present stage.
-) NRB will not change its guidelines to commercial banks.
-) The forecast will be true only when the limitation of least square method is carried out.

Least square method:

This is one of the most commonly used methods to describe the trend. This is the mathematical method.

The straight line trend between the dependent variable 'y' and independent variable 'x' (i.e. time) is representing by equation

$$Y_c = a + bx$$

Where,

Y_c = estimated value of 'y' for any given value of independent variable X.

a = y – intercept of value of 'y' when x = 0 [i.e. $a = \frac{Y}{n}$]

b= slope of the trend line or amount of change in 'y' per unit change in x

$$[\text{i.e. } b = \frac{XY}{X^2}]$$

3.7.2 Financial Tools

In the research different financial tools are used to find, examine not only the financial strength but also the weakness of the bank. In the study financial tools like ratio and analysis has been used. These tools are very helpful to find symptoms of the firm.

3.7.2.1 Ratio Analysis

Ratio analysis is one of the most powerful tools for analyzing the financial performance of any firm. Since many diverse groups of people are interested in analyzing the financial information to indicate the operating and financial efficiency and growth of the firm. These people use ratio to determine those financial characteristics of the firm in which they are interested. “In the financial analysis, ratio analysis is used for evaluating the financial position and performance of the firm.” (Pandey; 1993; 104)

In this analysis detail analysis on return, expenses, income related ratios have been made in order to find out the true picture of profitability of the sample banks. Profitability analysis would be incomplete if these above aspects are not taken into consideration.

1) Return Analysis

a) Return on Total Assets

Return on Assets ratio measures the percentage of net profit on total assets employed to the firm. This ratio is obtained by dividing the net profit by total assets.

Return on Assets

$$= \quad \quad \quad \times 100$$

b) Return on Equity Ratio

Return on Equity Ratio shows the percentage of Net profit on total Equity. This ratio is measured by dividing the Net profit by total equity amount.

Return on Equity Ratio

$$= \frac{\text{Net Profit}}{\text{Total Equity}} \times 100$$

c) Return on Earning Assets Ratio

Return on Earning Assets ratio measures the percentage of net profit on total earning assets employed to the firm. This ratio is obtained by dividing the net profit by total earning assets.

Return on Earning Assets

$$= \frac{\text{Net Profit}}{\text{Total Earning Assets}} \times 100$$

d) Net Profit to Life Insurance Fund Ratio

Net Profit to Life Insurance Fund Ratio measures the percentage of net profit on life insurance fund employed to the firm. This ratio is obtained by dividing the net profit by life insurance.

Net Profit on Life Insurance Fund Ratio

$$= \frac{\text{Net Profit}}{\text{Life Insurance Fund}} \times 100$$

2) Income Analysis

a) Interest Income to Total Income Ratio

Interest Income to Total Income Ratio measures the percentage of Interest income on total income earned to the firm. This ratio is obtained by dividing the interest income by total income.

Interest Income to Total Income Ratio

$$= \frac{\text{Interest Income}}{\text{Total Income}} \times 100$$

b) Interest Income to Total Assets Ratio

Interest Income to Total Assets Ratio measures the percentage of Interest income on total assets employed to the firm. This ratio is obtained by dividing the interest income by total assets.

Interest Income to Total Assets Ratio

$$= \quad \quad \quad \times 100$$

c) Interest Income to Total Earning Assets Ratio

Interest Income to Total Earning Assets Ratio measures the percentage of Interest income on total earning assets employed to the firm. This ratio is obtained by dividing the interest income by total earning assets.

Interest Income to Total Assets Ratio

$$= \quad \quad \quad \times 100$$

3) Expenses Analysis

a) Salary and Allowance Expenses to Total Managerial Expenses Ratio

Salary and allowance expenses to total managerial expenses ratio measures the percentage of salary and allowance expenses on total managerial expenses of the firm. This ratio is obtained by dividing the salary and allowance expenses by total managerial expenses.

Salary and allowance Expenses to Total Managerial Expenses Ratio

$$= \quad \quad \quad \times 100$$

b) Office Expenses to Total Managerial Expenses Ratio

Office expenses to total managerial expenses ratio measures the percentage of office expenses on total managerial expenses of the firm. This ratio is obtained by dividing the office expenses by total managerial expenses.

Office Expenses to Total Managerial Expenses Ratio

$$= \quad \quad \quad \times 100$$

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter deals with the presentation, analysis and interpretation of statistical data to carry out the research work. Here the study presents the collected data for various purpose of analysis. The data are analyzed by using various financial and statistical tools. The analyzed data and results are presented clearly by using tables and graphs. Each of the results is interpreted in each topics and subtopics.

4.2 Financial Ratio Analysis

Financial Ratio Analysis is a tool, through which economic and financial position of organization can be fully to X-rayed. It is the indicated quotient of two mathematical expressions, and as the relationship between two or more things. Therefore, to find out the position of investment in government securities of sample commercial banks, the following ratios are examined.

4.2.1 Return Analysis

Under this topic, an attempt has been made to analyze the ratio of return on total assets, total earning assets, total equity capital and life insurance fund. The insurance companies under study have not separated the profit from life insurance fund; however the analysis has been made according to the profit calculated for income tax purposes.

4.2.1.1 Return on Assets Ratio

Return on Assets ratio measures the percentage of net profit on total assets employed to the firm. This ratio is obtained by dividing the net profit by total assets.

Return on Assets

$$= \quad \times 100$$

Comparative analysis of Return on assets ratio of the companies under study is shown in the following table.

Table: 4.1

Return on Assets Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Net Profit	Total Assets	Ratio (%)	Net Profit	Total Assets	Ratio (%)
2003		2111	0.00	NA	NA	NA
2004	73	2985	2.45	NA	2356	0
2005	142	5948	2.39	8	3876	0.21
2006	286	9752	2.93	53	6115	0.87
2007	392	12491	3.14	97	9474	1.02
Mean			2.18			0.52
SD			1.13			0.43
CV			0.5182			0.8202

From the table: 4.1, it is depicted that the return on assets ratio of NLIC is 2.18 percent on average. NLIC has not earned profit in the year 2003. The maximum ratio is 3.14 percent in 2007 and minimum ratio is 2.39% in the year 2003. Similarly average return on assets ratio of LIC is 0.52 percent. LIC also has not earned profit in its first operating year 2004. The highest ratio is 1.02 percent in the year 2007, while the minimum ratio is 0.21% in 2003. Higher coefficient of variation (CV) of LIC shows that the ratios are more scattered than NLIC in the study period.

With the help of figure: 4.1, it is seen more clearly.

Figure 4.1

Return on Assets Ratio

4.2.1.2 Return on Equity Ratio

Return on Equity Ratio shows the percentage of Net profit on total Equity. This ratio is measured by dividing the Net profit by total equity amount.

Return on Equity Ratio

$$= \text{Net Profit} / \text{Total Equity} \times 100$$

Comparative analysis of Return on equity ratio of the NLIC and LIC is presented in the following table: 4.2.

Table: 4.2

Return on Equity Ratio

Rs. in Lakh

Year	NLIC			LIC		
	Net Profit	Total Equity	Ratio (%)	Net Profit	Total Equity	Ratio (%)
2003	NA	2000	0	NA	NA	NA
2004	73	2000	3.65	NA	2000	0
2005	142	2500	5.68	8	2500	0.32
2006	286	2500	11.44	53	2500	2.12
2007	392	2500	15.68	97	2500	3.88
Mean			7.29			1.58
SD			5.6			1.55
CV			0.7682			0.9810

From the table: 4.2, it is found that the return on equity ratio of NLIC is 7.29 percent on average. NLIC has not earned profit in the year 2003. The maximum ratio is 15.68 percent in 2007 and minimum ratio is 3.69% in the year 2004. Similarly average return on equity ratio of LIC is 1.58 percent. LIC also has not earned profit in its first operating year 2004. The highest ratio is 3.88 percent in the year 2007, while the minimum ratio is 0.32% in 2005. Comparatively the ratios of LIC is more scattered than NLIC, which is shown by higher CV of the LIC.

Following figure: 4.2 helps to show these facts more clearly.

Figure: 4.2

Return on Equity Ratio

4.2.1.3 Return on Earning Assets Ratio

Return on Earning Assets ratio measures the percentage of net profit on total earning assets employed to the firm. This ratio is obtained by dividing the net profit by total earning assets.

Return on Earning Assets

$$= \quad \quad \quad \times 100$$

Comparative analysis of Return on earning assets ratio of the companies under study is shown in the following table: 4.3.

Table: 4.3

Return on Earning Asset Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Net Profit	Earning Assets	Ratio (%)	Net Profit	Earning Assets	Ratio (%)
2003	NA	1800	0.00	NA	NA	NA
2004	73	2770	2.64	NA	1980	0
2005	142	4852	2.93	8	3619	0.22
2006	286	7754	3.69	53	5628	0.94
2007	392	9338	4.20	97	8719	1.11
Mean			2.69			0.57
SD			1.45			0.47
CV			0.5391			0.8263

From the table: 4.3, it is found that the average return on earning assets ratio of NLIC is 2.69 percent. NLIC has not earned profit in the year 2003. The maximum ratio is 4.20 percent in 2007 and minimum ratio is 2.64 % in the year 2004. Similarly average return on earning assets ratio of LIC is only 0.57 percent. LIC also has not earned profit in its first operating year 2004. The highest ratio is 1.11 percent in the year 2007, while the minimum ratio is 0.22% in 2005. Ratios of the both insurance companies are in increasing trend. Higher the standard deviation and CV shows the greater variability in the ratios of LIC.

Figure: 4.3 helps to show these facts more clearly.

Figure: 4.3

Return on Earning Asset Ratio

4.2.1.4 Net Profit to Life Insurance Fund Ratio

Net Profit to Life Insurance Fund Ratio measures the percentage of net profit on life insurance fund employed to the firm. Since the companies under study have not separated the profit from their life insurance fund, this ratio is very significant to understand the percentage of net profit. This ratio is obtained by dividing the net profit by life insurance.

Net Profit on Life Insurance Fund Ratio

$$= \quad \quad \quad \times 100$$

Comparative analysis of Net Profit on Life Insurance Fund ratio of the companies under study is shown in the following table: 4.4.

Table: 4.4

Net Profit to Life Insurance Fund Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Net Profit	Life Insurance Fund	Ratio (%)	Net Profit	Life Insurance Fund	Ratio (%)
2003		80	0.00	NA	NA	NA
2004	73	753	9.69	NA	323	0.00
2005	142	2232	6.36	8	1254	0.64
2006	286	4938	5.79	53	3384	1.57
2007	392	8784	4.46	97	6731	1.44
Mean			5.26			0.73
SD			3.14			0.66
CV			0.5967			0.9053

From the table: 4.4, it is found that Net Profit on Life Insurance Fund ratio of NLIC is 2.26 percent on average. The ratio is 0 in 2003 since it has not earned profit in the year. The maximum ratio is 9.69 percent in 2004 and the ratio is decreasing then after. Similarly average Net Profit on Life Insurance Fund ratio of LIC is 0.73 percent. LIC also has not earned profit in its first operating year 2004. The highest ratio is 1.57 percent in the year 2006, while the minimum ratio is 0.64 % in 2005. Comparatively the ratios of LIC are more scattered than NLIC, which is shown by higher CV of the LIC.

Following figure: 4.4 helps to show these facts more clearly.

Figure: 4.4

Net Profit to Life Insurance Fund Ratio

4.2.2 Income Analysis

Income is the main factor, which affect the profitability significantly. In this section, an attempt has been made to analyze the various ratios regarding the income of the insurance companies under study.

4.2.2.1 Interest Income to Total Income Ratio

Interest Income to Total Income Ratio measures the percentage of Interest income on total income earned to the firm. This ratio is obtained by dividing the interest income by total income.

Interest Income to Total Income Ratio

$$= \quad \quad \quad \times 100$$

Comparative analysis of Interest Income to Total Income Ratio of the companies under study is shown in the following table.

Table: 4.5

Interest Income to Total Income Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Interest Income	Total Income	Ratio (%)	Interest Income	Total Income	Ratio (%)
2003	27	138	19.57	NA	NA	NA
2004	165	1029	16.03	127	552	23.01
2005	277	2151	12.88	210	1806	11.63
2006	431	3729	11.56	307	4215	7.28
2007	623	5259	11.85	454	7834	5.80
Mean			14.38			9.54
SD			3.12			7.16
CV			0.2170			0.7503

From the table: 4.5, it is depicted that Interest Income to Total Income Ratio of NLIC is 14.38 percent on average. The maximum ratio is 19.57 percent in the year 2003 and the minimum ratio is 11.56 percent in the year 2006. The ratios are in decreasing trend. Similarly average Interest Income to Total Income Ratio of LIC is 9.54 percent. The highest ratio is 23.01 percent in the year 2004, while the minimum ratio is 5.80 % in the year 2007. The ratio of LIC is also in decreasing ratio. Comparatively the ratios of NLIC are more homogeneous than LIC, which is shown by lower CV and SD of the NLIC. Following figure: 4.5 helps to show these facts more clearly.

Figure: 4.5

Interest Income to Total Income Ratio

4.2.2.2 Interest Income to Total Assets Ratio

Interest Income to Total Assets Ratio measures the percentage of Interest income on total assets employed to the firm. This ratio is obtained by dividing the interest income by total assets.

Interest Income to Total Assets Ratio

$$= \quad \quad \quad \times 100$$

Comparative analysis of Interest Income to Total Assets Ratio of the companies under study is shown in the following table: 4.6.

Table: 4.6

Interest Income to Total Assets Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Interest Income	Total Assets	Ratio (%)	Interest Income	Total Assets	Ratio (%)
2003	27	2111	1.28	NA	NA	NA
2004	165	2985	5.53	127	2356	5.39
2005	277	5948	4.66	210	3876	5.42
2006	431	9752	4.42	307	6115	5.02
2007	623	12491	4.99	454	9474	4.79
Mean			4.17			4.12
SD			1.5			1.07
CV			0.3594			0.2594

From the table: 4.6, it is depicted that Interest Income to Total Assets Ratio of NLIC is 4.17 percent on average. The maximum ratio is 5.53 percent in the year 2004 and the minimum ratio is 1.28 percent in the year 2003. Similarly average Interest Income to Total Assets Ratio of LIC is 4.12 percent. The highest ratio is 5.42 percent in the year 2005, while the minimum ratio is 4.79 % in the year 2007. Comparatively the ratios of NLIC are more dispersed than LIC, which is shown by greater CV and SD of the NLIC.

With the help of figure: 4.6, these facts are seen more clearly.

Figure: 4.6

Interest Income to Total Assets Ratio

4.2.2.3 Interest Income to Total Earning Assets Ratio

Interest Income to Total Earning Assets Ratio measures the percentage of Interest income on total earning assets employed to the firm. This ratio is obtained by dividing the interest income by total earning assets.

Interest Income to Total Assets Ratio

$$= \quad \quad \quad \times 100$$

Comparative analysis of Interest Income to Total Earning Assets Ratio of the companies under study is shown in the following table: 4.7.

Table: 4.7

Interest Income to Total Earning Assets Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Interest Income	Earning Assets	Ratio (%)	Interest Income	Earning Assets	Ratio (%)
2003	27	1800	1.50	NA	NA	NA
2004	165	2770	5.96	127	1980	6.41
2005	277	4852	5.71	210	3619	5.80
2006	431	7754	5.56	307	5628	5.45
2007	623	9338	6.67	454	8719	5.21
Mean			5.08			4.58
SD			1.83			1.22
CV			0.3603			0.2666

From the table: 4.6, it is found that Interest Income to Total Earning Assets Ratio of NLIC is 5.08 percent on average. The maximum ratio is 6.67 percent in the year 2007 and the minimum ratio is 1.50 percent in the year 2003. Similarly average Interest Income to Total Earning Assets Ratio of LIC is 4.58 percent. The highest ratio is 6.41 percent in the year 2005, while the minimum ratio is 5.21 % in the year 2007. Comparatively the ratios of NLIC are more dispersed than LIC, which is shown by greater CV and SD of the NLIC.

With the help of the figure: 4.7, these facts can be seemed more clearly.

Figure: 4.7

Interest Income to Total Earning Assets Ratio

4.2.3 Expenses Analysis

An expense is also the main factor, which affect the profitability crucially. In this section, an attempt has been made to analyze the various ratios regarding the expenses of the insurance companies under study.

4.2.3.1 Salary and Allowance Expenses to Total Managerial Expenses Ratio

Salary and allowance expenses to total managerial expenses ratio measures the percentage of salary and allowance expenses on total managerial expenses of the firm. This ratio is obtained by dividing the salary and allowance expenses by total managerial expenses.

Salary and allowance Expenses to Total Managerial Expenses Ratio

$$= \frac{\text{Salary and allowance Expenses}}{\text{Total Managerial Expenses}} \times 100$$

Comparative analysis of salary and allowance expenses to total managerial expenses ratio of the companies under study is shown in the following table:

4.8.

Table: 4.8

Salary and Allowance Expenses to Total Managerial Expenses Ratio

(Rs. in Lakh)

Year	NLIC			LIC		
	Salary & Allowance	Total Managerial Exp	Ratio	Salary & Allowance	Total Managerial Exp	Ratio
2003	6	29	20.69	NA	NA	NA
2004	53	125	42.40	42	121	34.71
2005	67	194	34.54	52	203	25.62
2006	75	267	28.09	75	231	32.47
2007	84	328	25.61	83	314	26.43
Mean			30.27			23.85
SD			7.53			7.11
CV			0.2488			0.2982

From the table: 4.8, it is found that salary and allowance expenses to total managerial expenses ratio of NLIC is 30.27 percent on average. The maximum ratio is 42.40 percent in the year 2004 and the minimum ratio is 20.69 percent in the year 2003. Similarly average salary and allowance expenses to total managerial expenses ratio of LIC is 23.85 percent. The highest ratio is 34.71 percent in the year 2004, while the minimum ratio is 25.62 % in the year 2005. Comparatively the ratios of NLIC are more consistent than LIC, which is shown by lower CV and SD of the NLIC. These facts are presented in Figure: 4.8 to make easier.

Figure: 4.8

Salary and Allowance Expenses to Total Managerial Expenses Ratio

4.2.3.1 Office Expenses to Total Managerial Expenses Ratio

Office expenses to total managerial expenses ratio measures the percentage of office expenses on total managerial expenses of the firm. This ratio is obtained by dividing the office expenses by total managerial expenses.

Office Expenses to Total Managerial Expenses Ratio

=

x 100

Comparative analysis of office expenses to total managerial expenses ratio of the companies under study is shown in the following table: 4.9.

Table: 4.9

Office Expenses to Total Managerial Expenses Ratio

(Rs. In Lakh)

Year	NLIC			LIC		
	Office Expenses	Total Managerial Exp	Ratio	Office Expenses	Total Managerial Exp	Ratio
2003	3	29	10.34	NA	NA	NA
2004	19	125	15.20	22	121	18.18
2005	20	194	10.31	26	203	12.81
2006	23	267	8.61	28	231	12.12
2007	30	328	9.15	31	314	9.87
Mean			10.72			10.60
SD			2.34			4.04
CV			0.2182			0.3813

From the table: 4.9, it is found that office expenses to total managerial expenses ratio of NLIC is 10.72 percent on average. The maximum ratio is 15.20 percent in the year 2004 and the minimum ratio is 8.61 percent in the year 2006. Similarly average office expenses to total managerial expenses ratio of LIC is 10.60 percent. The highest ratio is 18.18 percent in the year 2004, while the minimum ratio is 9.87 % in the year 2005. Ratios of the both companies are in decreasing trend. Comparatively the ratios of NLIC are more consistent than LIC, which is shown by lower CV and SD of the NLIC.

These facts are presented in Figure: 4.9 to make easier.

Figure: 4.9

Office Expenses to Total Managerial Expenses Ratio

4.3 Least Square Linear Trend Analyses

Trend analysis has been a very useful and commonly applied statistical tool to forecast the future events in quantitative terms. On the basis of tendencies in the dependent variables in the past periods, the future trend is predicted. This analysis takes the historical data as the basis for forecasting. This method of forecasting the future trend is based on the assumptions that the past tendencies of the variable are repeated in the future, i.e. the past events affect the future events significantly.

The future trend is forecasted by using the following formula:

$$Y_c = a + bx$$

Where,

Y_c = the dependent variable

a = the origin i.e. arithmetic mean.

b = the slope coefficient i.e. rate of change

x = the independent variable i.e. year

4.3.1 Trend Analysis of Return on Assets Ratio

Under this topic, an effort has been made to calculate the trend value of return on total assets ratio of NLIC and LIC comparatively under five years study period and project the trend for next five years.

The table: 4.10 presents the trend values trend value of return on total assets ratio.

Table: 4.10

Trend Value of Return on Assets Ratio

Year	NLIC	LIC
2003	0.82	NA
2004	1.50	-0.02
2005	2.18	0.35
2006	2.86	0.72
2007	3.54	1.09
2008 (Projected)	4.22	1.46
2009 (Projected)	4.90	1.83
2010 (Projected)	5.58	2.2
2011 (Projected)	6.26	2.57
2012 (Projected)	6.94	2.94
Mean (a)	2.18	0.53
Rate of Change (b)	0.68	0.37
Trend Equation	2.18+0.68x	0.53+0.37x

From the table: 4.10, it is found that the return on total assets ratio NLIC and LIC are in increasing trend. The rate of change of NLIC is higher than LIC. The trend of NLIC is increasing by the ratio of 2.18%. Similarly, the trend of LIC is increasing by the ratio of 0.53%.

If other things remain same, return on total assets ratio NLIC and LIC will be 6.94% and 2.94% respectively in the year 2012.

Trend line of return on total assets ratio of NLIC and LIC is presented in the figure: 4.10.

Figure: 4.10

Trend of Return on Assets Ratio

4.3.2 Trend Analysis of Return on Earning Assets Ratio

Under this topic, an effort has been made to calculate the trend value of return on earning assets ratio of NLIC and LIC comparatively under five years study period and project the trend for next five years.

The table: 4.11 presents the trend values trend value of return on earning assets ratio.

Table: 4.11

Trend Value of Return on Earning Assets Ratio

Year	NLIC	LIC
2003	0.79	NA
2004	1.74	-0.05
2005	2.69	0.37
2006	3.64	0.78
2007	4.59	1.19
2008 (Projected)	5.54	1.6
2009 (Projected)	6.49	2.01
2010 (Projected)	7.44	2.42
2011 (Projected)	8.39	2.83
2012 (Projected)	9.34	3.24
Mean (a)	2.69	0.57
Rate of Change (b)	0.95	0.41
Trend Equation	2.69+0.95x	0.57+0.41x

From the table: 4.11, it is found that the return on earning assets ratio NLIC and LIC are in increasing trend. The rate of change of NLIC is higher than LIC. The trend of NLIC is increasing by the ratio of 2.69%. Similarly, the trend of LIC is increasing by the ratio of 0.57%.

If other things remain same, return on earning assets ratio NLIC and LIC will be 9.34% and 3.24% respectively in the year 2012.

Trend line of return on total assets ratio of NLIC and LIC is presented in the figure: 4.11.

Figure: 4.11

Trend of Return on Earning Assets Ratio

4.3.3 Trend Analysis of Return on Equity Ratio

Under this topic, an effort has been made to calculate the trend value of return on equity ratio of NLIC and LIC comparatively under five years study period and project the trend for next five years.

The table: 4.12 presents the trend values trend value of return on equity ratio.

Table: 4.12

Trend Value of Return on Equity Ratio

Years	NLIC	LIC
2003	-0.55	NA
2004	3.37	-0.43
2005	7.29	0.91
2006	11.21	2.25
2007	15.13	3.59
2008 (Projected)	19.05	4.93
2009 (Projected)	22.97	6.27
2010 (Projected)	26.89	7.61
2011 (Projected)	30.81	8.95
2012 (Projected)	34.73	10.29
Mean (a)	7.29	1.58
Rate of Change (b)	3.92	1.34
Trend Equation	7.29+3.92x	1.58+1.34x

From the table: 4.12, it is found that the return on equity ratio NLIC and LIC are in increasing trend. The rate of change of NLIC is higher than LIC. The trend of NLIC is increasing by the ratio of 3.92%. Similarly, the trend of LIC is increasing by the ratio of 1.58%.

If other things remain same, return on earning assets ratio NLIC and LIC will be 34.73% and 10.29% respectively in the year 2012.

Trend line of return on total assets ratio of NLIC and LIC is presented in the figure: 4.12.

Figure: 4.12

Trend of Return on Earning Assets Ratio

4.3.4 Trend Analysis of Net Profit to Life Insurance Fund Ratio

Under this topic, an effort has been made to calculate the trend value of net profit to life insurance fund ratio of NLIC and LIC comparatively under five years study period and project the trend for next five years.

The table: 4.13 presents the trend values trend value of Net Profit to Life Insurance Fund ratio of NLIC and LIC.

Table: 4.13

Trend Value of Net Profit to Life Insurance Fund Ratio

Year	NLIC	LIC
2003	3.62	NA
2004	4.16	0.12
2005	4.70	0.65
2006	5.24	1.18
2007	5.78	1.71
2008 (Projected)	6.32	2.24
2009 (Projected)	6.68	2.77
2010 (Projected)	7.40	3.3
2011 (Projected)	7.94	3.83
2012 (Projected)	8.48	4.36
Mean (a)	4.7	0.91
Rate of Change (b)	0.54	0.53
Trend Equation	4.70+0.54x	0.91+0.53x

From the table: 4.13, it is found that the net profit to life insurance fund ratio NLIC and LIC are in increasing trend. The rate of change of NLIC and LIC is homogeneous i.e. 0.54% and 0.53% respectively.

If other things remain same, net profit to life insurance fund ratio of NLIC and LIC will be 8.48% and 4.36% respectively in the year 2012.

Trend line of net profit to life insurance fund ratio of NLIC and LIC is presented in the figure: 4.13.

Figure: 4.13

Trend of Net Profit to Life Insurance Fund Ratio

4.4 Correlation Analysis

Correlation is a statistical tool, which studies the relationship between two variables. Correlation coefficient summarized in one figure, the degree and they extend to which the two variables are correlated but is does not tell about cause and effect.

For analyzing the relationship between two variables, Karl Person's correlation coefficient (r) has been used. Correlation analysis describes the positive or negative relationship between variables. It helps to determine whether there is:

- ❖ A positive or negative relationship exists
- ❖ The relationship is significant or insignificant and

- ❖ Establish cause and effect relation if any

The statistical tool, correlation analysis is preferred in this study to identify the relationship between variables, whether the relationship is significant or not. For the purpose of decision- making, interpretation is based on following term:

1. When $r = 1$, there is perfect positive correlation.
2. When $r = -1$, there is perfect negative correlation
3. When $r = 0$, there is no correlation
4. When 'r' lies between 0.7 to 0.999 (-0.7 to 0.999) there is a high degree of positive (or negative) correlation.
5. When 'r' lies between 0.5 to 0.699, there is moderate degree of correlation.
6. When 'r' is less than 0.5, there is low degree of correlation.

4.4.1 Correlation between Net Profits and Total Assets

The coefficient of correlation between net profit and total assets is to measure the degree of relationship between these two variables. In the analysis net profit is dependent variable and a total asset is independent variable. The purpose of the computing correlation coefficient is to justify whether there is any relationship between two variables or not.

From the computation of correlation between the two variables of both the companies, it is found that the coefficient of correlation between net profit

and total assets is 0.99 i.e. nearly 1. It shows that there is perfect positive correlation between these two variables.

4.4.2 Correlation Between Net Profits and Earning Assets

The coefficient of correlation between net profit and earning assets is to measure the degree of relationship between these two variables. In the analysis net profit is dependent variable and a earning asset is independent variable. The purpose of the computing correlation coefficient is to justify whether there is any relationship between two variables or not.

From the computation of correlation between the two variables of both the companies, it is found that the coefficient of correlation between net profit and earning assets is 1. It shows that there is perfect positive correlation between these two variables.

4.4.3 Correlation Between Net Profits and Interest income

The coefficient of correlation between net profit and interest income is to measure the degree of relationship between these two variables. In the analysis net profit is dependent variable and interest income is independent variable. The purpose of the computing correlation coefficient is to justify whether there is any relationship between two variables or not.

From the computation of correlation between the two variables of NLIC and LIC, it is found that the coefficient of correlations between net profit and interest income is 1 and 0.98 respectively. It shows that there is perfect

positive correlation and high degree of positive correlation between these two variables of the insurance companies respectively.

4.4.4 Correlation Between Net Profits and Managerial Expenses

The coefficient of correlation between net profit and managerial expenses is to measure the degree of relationship between these two variables. In the analysis net profit is dependent variable and a managerial expense is independent variable. The purpose of the computing correlation coefficient is to justify whether there is any relationship between two variables or not.

From the computation of correlation between the two variables of NLIC and LIC, it is found that the coefficient of correlations between net profit and managerial expenses of NLIC is 0.98, and the correlation is 0.76 in LIC, which shows that there is high degree of positive correlation between these two variables.

4.4.5 Correlation Between Net Profits and Life Insurance Fund

The coefficient of correlation between net profit and life insurance fund is to measure the degree of relationship between these two variables. In the analysis net profit is dependent variable and life insurance fund is independent variable. The purpose of the computing correlation coefficient is to justify whether there is any relationship between two variables or not.

From the computation of correlation between the two variables of NLIC and LIC, it is found that the coefficient of correlations between net profit and life

insurance fund is 0.98 and 0.99 respectively, which shows that there is high degree of positive correlation between these two variables in both the companies.

4.5 Major Findings of the Study

It is depicted that the return on assets ratio of NLIC is 2.18 and LIC is 0.52 percent on average. The ratios of LIC are more scattered than NLIC in the study period.

It is found that the return on equity ratio of NLIC is 7.29 percent on average. Similarly average return on equity ratio of LIC is 1.58 percent. Comparatively the ratios of LIC is more scattered than NLIC.

It is found that the average return on earning assets ratio of NLIC is 2.69 percent and that of LIC is only 0.57 percent. Ratios of the both insurance companies are in increasing trend. Higher the standard deviation and CV shows the greater variability in the ratios of LIC.

It is found that Net Profit on Life Insurance Fund ratio of NLIC is 2.26 percent on average. Similarly the ratio of LIC is 0.73 percent. Comparatively the ratios of LIC are more scattered than NLIC.

It is depicted that Interest Income to Total Income Ratio of NLIC is 14.38 percent on average. Similarly that ratio of LIC is 9.54 percent. The ratios are in decreasing trend. Comparatively the ratios of NLIC are more homogeneous than LIC.

It is depicted that Interest Income to Total Assets Ratio of NLIC and LIC are 4.17 and 4.12 percent on average respectively. Comparatively the ratios of NLIC are more dispersed than LIC.

It is found that Interest Income to Total Earning Assets Ratio of NLIC is 5.08 percent on average. Similarly that of the LIC is 4.58 percent. Comparatively the ratios of NLIC are more dispersed than LIC.

It is found that salary and allowance expenses to total managerial expenses ratio of NLIC is 30.27 percent and LIC is 23.85 percent on average. Comparatively the ratios of NLIC are more consistent than LIC.

It is found that office expenses to total managerial expenses ratio of NLIC is 10.72 percent on average and LIC is 10.60 percent. Ratios of the both companies are in decreasing trend. Comparatively the ratios of NLIC are more consistent than LIC.

It is found that the return on total assets ratio NLIC and LIC are in increasing trend. The rate of change of NLIC is higher than LIC.

It is found that the return on earning assets ratio NLIC and LIC are also in increasing trend. The rate of change of NLIC is higher than LIC.

It is found that the return on equity ratio NLIC and LIC are in increasing trend.

It is found that the net profit to life insurance fund ratio NLIC and LIC are in increasing trend. The rate of change of NLIC and LIC is homogeneous i.e. 0.54% and 0.53% respectively.

From the correlation analysis of the net profit with total assets, earning assets, interest income, taking net profit as dependent variable, it is found that there is perfect positive correlation between net profit and these variables. Similarly, the correlation coefficient between net profit to managerial expenses and life insurance fund shows there is high degree of positive correlation between these variable respectively.

CHAPTER – V

SUMMARY, COMCLUSION AND RECOMMENDATIONS

5.1 Introduction

In this chapter, summary and conclusions of the research as well as recommendations are presented separately. After summarizing and concluding the research, recommendations are suggested to Nepalese insurance companies regarding the various matters concerning profitability. The researcher has tried to give suggestions and recommendations to the concerned groups and further researcher based on this research.

5.2 Summary

Basically, the entire research work has focused on the comparative study on profitability of insurance company. For the study, two life insurance companies are taken as sample and analyzed their profitability and other related factors affecting the profitability.. Five years secondary data, i.e. from 2000 to 2005, are taken for the study. The general objective of this study is to evaluate the profitability of Nepal Life Insurance Company Ltd. and Life Insurance Corporation Nepal Ltd. To meet the general objective, the other specific objectives are formulated as

-) To evaluate and analyze the soundness of profitability of the companies.
-) To study the trend of profitability of the companies.
-) To evaluate and study the impact of environmental factors on profitability trend.
-) To provide suggestions to the management in improving their activities to increase profitability on the basis of the findings and the study.

To meet the research objectives this study is divided into five chapters. First is introduction chapter, which includes general background statement of the problem, objectives of the study, significant of the problem, objectives of the study, significance of the study, limitations of the study and organization of the study.

Second chapter is review of literature; it includes conceptual framework, review of books, and review of previous study, reports, dissertation and journal articles related to the topic of the study.

Third chapter is about research methodology; it includes the whole procedure of this research work i.e. research design, sources of data, populations and sample, data processing, method of analysis.

Fourth chapter is about presentation and analysis of data; it includes position of current assets, financial analysis, statistical analysis and financing current assets.

The last or fifth chapter presents a brief summary of whole research report and its conclusion. It also includes some useful suggestions to the concerned parties and recommendation.

This study suffers from different limitations; it considers two life insurance companies as samples out of total insurance companies in Nepal. Time and resources are the constraints of the study. Therefore the study may not be generalized in all case and accuracy depends upon the data collected and provided by the organization.

5.3 Conclusions

Based on the research findings, following conclusions are derived.

Both the insurance companies have not separated its net profit from the life insurance fund. Both the companies have not declared dividend for the shareholders.

Return on earning ratio as well as return on assets ratio is less than 3 percent in the both company, which is very minimum.

It is found that the return on equity ratio of NLIC is 7.29 and LIC is 1.58 percent only.

It is found that Net Profit on Life Insurance Fund ratio of NLIC is 2.26 percent on average. Similarly the ratio of LIC is 0.73 percent. Comparatively the ratios of LIC are more scattered than NLIC.

The proportion of Interest Income in Total Income of NLIC and LIC are 14.38 and 9.54 percent respectively.

Salary and allowance expenses to total managerial expenses ratio of NLIC is 30.27 percent and LIC is 23.85 percent on average.

Return on total assets ratios, return on earning assets ratio, return on equity ratio and net profit to life insurance fund ratio of both the companies are in increasing trend. The rate of change of NLIC is higher than LIC on each of the ratios.

There is perfect positive correlation between net profit and total assets, earning assets and interest income respectively. Similarly, there is high degree of positive correlation between net profit and managerial expenses and life insurance fund.

5.4 Recommendations

Suggestion is the output of the study. It helps to take corrective action in their activities in future. On the basis of analysis and the findings of the study, following suggestions and recommendations are made to overcome weaknesses and inefficiency of the concerned body.

The companies are suggested to separate the net profit from its life insurance fund in the financial statements so that shareholders could see the profitability clearly.

LIC has poor performance in profitability ratios in comparison with NLIC, so it is suggested to increase profitability by investing the fund in productive sector.

The companies have invested high portion of their fund in government securities and deposit accounts of the financial institutions. These sectors are less profitable than other productive sectors. So the companies are suggested to search more profitable sectors to invest their fund.

Managerial expenses have to be reduced by both the companies to increase profitability.

The companies are suggested to launch attractive schemes to attract general people for life insurance, so that life insurance fund could be increased.

Insurance Committee is suggested to make effective monitoring system in the various activities of the insurance companies, so that they could invest their fund in proper profitable sectors.

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Appendix-I

Sample Calculation of Correlation between Net Profit and Total Assets of NLIC.

Let Net profit be dependent variable x and total assets be independent variable y.

X	Y	x=X-\bar{X}	y=Y-\bar{Y}	x²	y²	xy
	2111	-179	-4546	32041	20666116	813734
73	2985	-106	-3672	11236	13483584	389232
142	5948	-37	-709	1369	502681	26233
286	9752	107	3095	11449	9579025	331165
392	12491	213	5834	45369	34035556	1242642
x= 893	y= 33287			x ² = 101464	y ² = 78266962	xy= 2803006

Calculation of means,

$$\bar{X} = \frac{\sum x}{N} = \frac{893}{5} = 179$$

$$\bar{Y} = \frac{\sum y}{N} = \frac{33287}{5} = 6657$$

Calculation of Correlation Coefficient

$$r = \frac{\sum xy}{\sqrt{\sum x^2} \sqrt{\sum y^2}} = \frac{2803006}{\sqrt{101464} \sqrt{78266962}} = 0.69$$

