CHAPTER - I

INTRODUCTION

1.1 Background

The role of money in an economy is very important. Proper and well-planned management of money directs, determines and enhances the health and productivity of total financial sector and the performance of financial sector affect the growth of economy. Hence, money is a subject to manage, and banks are the managers of them. Banks as manager collects disburse and control the flow of money. Banks collect the fund from public who have saving and disburse the fund to the person and organizations who are in need of it. In this way, entire infrastructure of national development, direction of economy, rate of progress and even the habit of people falls under the periphery of banking systems.

The performance of commercial banks is governed by the policies and regulations set by the government. Central bank represents the government and plays the role of monitor and controller in every country. In our context, Nepal Rastra Bank (NRB) deserves the authority to monitor and control the financial system of Nepal.

Commercial banks and other financial institutions (FIs) have to be operated according to the directives issued by NRB. NRB as an apex of monetary authority of the country and it is monitoring and controlling the financial institutions by issuing various directives & policies to the financial institutions. As the banks play the pivotal role in the economy, their performance should be supervised by the central bank and take necessary corrective actions if their health is poor. NRB does the regular auditing and timely supervision of FIs have been inspecting their activities to maintain their sound financial health and to build up the confidence of private sector in the liberalized economy and protect the interest of the investors. It has adopted the international banks rating system (CAMELS) to assess the financial performance of Nepalese commercial banks.

1.2 Finance & Financial performance:

1.2. 1 Finance

Finance is the art and science of managing money, affects the lives of every person and every organization. Finance is concerned with the process, institutions, markets and instructions involved

in the transfer of money among and between individuals, businesses and governments. Financial Institutions are set up in accordance with prevailing law with the objectives of disbursing credit for agriculture, co-operative, industry or any particular economic purpose, or accepting deposits from public.

1.2.2 Financial Performance:

Financial Performance is the picture of the organisation that shows how the organization is doing. Profit is one of the basic indicators of sound financial performance.

Financial performance shows the financial strength and weakness of the firm. Balance sheet, profit and loss statement shows the financial performance of an organization. The analysis of these financial statements helps in measuring the overall financial performance of the organization. The analysis of financial performance helps to establish a strategic relationship between the items of balance sheet and income statement and other operative data to unveil the meaning and significance of such items. Thus, financial performance analysis is required to take managerial & financial decision..

1.3 Focus of the Study

The study has focused on the financial performance of a Nepalese bank in the framework of internationally recognized bank's rating system known as CAMEL. Although there are various commercial banks operating in Nepal, NIC Bank Ltd is taken as a sample for the study due to the following distinct attached with the bank.

Nepal Industrial & Commercial Bank Limited (NIC Bank) commenced its operation on 21 July 1998 from Biratnagar. The Bank was promoted by some of the prominent business houses of the country. The current shareholding pattern of the Bank constitutes of promoters holding 65% of the shares while 35% is held by general public. NIC Bank is one of the most widely-held Banking companies in Nepal, with over 32,000 shareholders. The staff strength has since increased to 189. The Authorized, Issued Capital and Paid up capital of the bank have been increased to Rs. 160 Crore and Rs. 94 Crore & Rs 94 Crore respectively.

The Bank is the first commercial Bank in Nepal to have received ISO 9001:2000 certification for quality management system. Furthermore, NIC Bank became the 1st Bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its

Global Trade Finance Program, enabling the Bank's Letter of Credit and Guarantee to be accepted/ confirmed by more than 200 banks worldwide.

To add to these achievements, the Bank has also been awarded the "Bank of the Year 2007-Nepal" by the world-renowned financial publication of The Financial Times, U.K.-The Banker. This is the fruit of the Bank's outstanding performance backed by belief and support of its customers towards the Bank.

The Compounded Annual Growth Rate (CAGR) of the Bank for the last 6 years is one of the highest in the industry. This shows that the Bank's performance has been consistent over the duration of five years. 6 year CAGR of key performance, indicators of the Bank are as under

Table 1.1 Growth rate for six years

	Growth %						CAGR
	2003	2004	2005	2006	2007	2008	
Operating Profit	51	50	34	5	37	35	31
Net Profit	271	162	68	(15)	64	53	56
Total Deposit	(3)	65	22	42	15	30	33
Risk Assets	8	42	32	41	32	26	35

The Bank believes in continuously offering new and value added services to its customers, with commitment to quality and value to its clients at the same time. Accordingly, the Bank has been in the forefront in launching innovative and superior products having unique customer friendly features with immense success

Hence, for a researcher it is quite fruitful opportunity to research about the financial performance of bank like NICBL. Besides, as per the rating conducted by Nepal Rastra Bank, NICBL is rated highest among all private sector commercial banks in the country, based on the international recognized "CAELS" rating during an assessment done in April 2005. Similarly, bank has adopted a policy of "Zero Tolerance" on matters of compliance. Therefore, I have selected NICBL as a sample for this study. In any economy, the importance of financial sector in general and banking sector in particular cannot be undermined. The banking sector plays pivotal role in the overall development of an economy. The economic reforms has many more impact in Nepalese banking sector and this sector has been going through major changes as a consequence of shift in banking needs among the customers, change in regulatory framework, alteration in ownership pattern and liberalization of

interest and exchange rates. While these changes have positively affected the banking sector, at the same time, increased competition due to mushrooming of financial institutions has impacted the banks negatively. The study aims to find out the position of the bank and its viability by using descriptive and analytical research design.

1.4 Statement of the Problem

It is said that the banking sector is the mirror of the larger economy, its linkage to all sectors makes it a proxy for what is happening in the economy as a whole, indeed, the Nepalese banking sector today is at boiling point. Questions frequently raised are in a situation where most business is struggling, how can banks show such large profits? Or if the banking sector mirrors the larger economy, why is this inverse relationship in their performance? Banks and FIs can be evaluated comparing with Nepal Rastra Bank's regulatory framework, in which banks and FIs are required to maintain a standard set by NRB. CAMEL is a widely used tool to analyze financial performance of banks.

The general problem towards which the study is directed is to investigate the financial performance of NIC Bank Ltd in the framework of CAMEL. As per the annual report published by the bank in the year 2007, NICBL has achieved the 64 percent growth in net profit in the year 2007, which is remarkable. Seeing its past record, it has achieved the continuous growth in profit. It is quite fruitful opportunity for the researchers to research the organization like NICBL. For this analysis, I have taken the required data of past Six Years (From 2003 to 2007). Based on this fundamental problem the following specific problems are set in this study:

i) What is the capital adequacy ratio of the bank?
ii) How is the quality of assets of the bank?
iii) How efficient is the management of the bank?
iv) Do the earning indicators show the performance of the bank satisfactory?
v) What is the liquidity position of the bank?

1.4 Objectives of the Study

The fundamental objective of the study is to analyze the financial performance of NIC Bank Ltd by in the CAMEL framework. The study has been undertaken with the following specific objectives:

i. To examine the capital adequacy of the bank.
ii. To assess the quality of the bank's assets.

iii. To analyze the efficiency of the bank's management.
iv. To evaluate the earning performance of the bank.
v. To find out the liquidity position of the bank.

1.5 Significance of the Study

The financial sector has evolved as the biggest sector in the economy. In the entire sector banks play the pivotal role in the overall development of an economy. After the economic reforms initiated by the government, this sector has been going through the major changes. Increased competition due to mushrooming of financial institutions across the country has impacted the banking sector negatively, so the financial performance of the banks has to be evaluated properly to know the strength and weaknesses of the banks.

Although the various studies have been carried out regarding financial performance of banks, very few studies have been employed in term of CAMEL framework analysis. This study aims to analyze the financial performance of one of the commercial bank of Nepal in the framework of CAMEL.

The researcher is quite confident that the research will be useful to the financial sector of Nepal. The study will also be a great value for investors, equity holders, bankers, capital markets, government, financial intuitions, researchers, and students.

1.6 Limitation of the Study

The present study is subject to following limitations:

- Only one commercial bank is taken as the sample of the study among 25 commercial banks of Nepal.
- Only six years' data are covered by the study.
- The qualitative and external variables that affect the performance of the bank have not been considered in the study.

1.7 Organization of Study

The study is organized into five chapters.

Chapter One :

It contains a brief background of the study, focus of the study, objective, significance, delimitations of the study.

Chapter Two:

This chapter is about the review of theories and pervious research in the study area. It includes conceptual framework regarding banks and performance analysis of financial institutions, and review of related studies.

Chapter Three:

This chapter describes the research methodologies applied to the study. This includes the population, sample, sampling procedures and sources of data. It also comprises the research design employed along with the various financial and statistical tools used in the study.

Chapter Four:

This chapter comprise of presentation and analysis of data and major findings. The data collected after processing have been presented using figures and tables and results of statistical analysis are interpreted in this chapter.

Chapter Five:

This Chapter consists of summary and conclusion of the study.

CHAPTER - II

LITERATURE REVIEW

This chapter deals with the conceptual review regarding financial performance analysis and CAMEL framework of financial performance analysis. Past studies carried out on financial performance analysis are also incorporated here. This chapter is divided into two sections. Section I deals with theoretical review where as the section II presents the review of relevant past studies.

2.1 Conceptual Review :

This sub-chapter presents the theoretical aspect of the study. It includes historical background of banking industry, evolution of banking in Nepal, concept of bank, concept of commercial bank, functions of commercial banks, financial statements of commercial banks, and concept of financial performance analysis, types of financial analysis, objectives of financial performance analysis and concept of financial performance analysis in the framework of CAMELS.

2.1.1 Financial Performance Analysis

Approach of financial performance analysis is presented in this sub-chapter. Financial performance analysis helps us to identify strength and weakness of financial institutions. Under this sub heading type of financial analysis, concept of financial performance analysis in the framework of CAMELS and objectives of financial analysis is discussed.

A commercial bank is simply a business corporation organized for maximizing the value of shareholders wealth invested in the firm at an acceptable level of risk. Profit is one of the basic indicators of sound financial performance. It is usually the result of sound business management, cost control, credit risk management and general efficiency of operation (Robinson & Wrightman, 1957). Profit is essential for a firm for its survival, growth and to maintain capital adequacy through profit retention. The objective of maximizing profit with a level of risk acceptable to the bank's stockholders is not easy to achieve, as the recent upsurge in bank failures around the globe clearly suggests. Under the free economic system like USA or liberal economic system of Nepal, the interest of the nation as well as those of the individual stockholder's are supposed to be best served by vigorously seeking profit.

Although the profit is important for any business motive firm, it cannot be the sole objective of an enterprise or financial institution and a financial enterprise should not be evaluated just on the ground of the profit it has earned. Neither the bank nor the community will be best served if the banker unreasonably sacrifices the safety of his funds or the liquidity of his bank in an effort to increase income.

Financial performance analysis is a process of identifying the financial strength and weakness of the firm by properly establishing relationship between the item of balance sheet and the profit and loss statements. It is also a study of relationship among various financial factors in a business as disclosed by a single set of statements and a study of the trend of these factors as shown in a series of statements. By establishing a strategic relationship between the items of a balance sheet and income statement and other operative data, the financial analysis unveils the meaning and significance of such items. Thus, financial performance analysis is required to take managerial and financial decisions.

A fair evaluation of bank's performance should start by evaluating whether it has been able to achieve the objectives its management and stockholders have set. The fundamental analysis in terms of financial analysis is different from market message reflected in technical analysis guided by the investors 'psychology based in speculators' manipulation of information. These are very different from industry and overall economic analysis (Shrestha M.K., and Bhandari D.B. 2004). Financial decisions cannot be made in vacuum. They are to be based on proper financial analysis by using financial tools such as financial ratios to maximize the financial performance of a company. The assessment of the company's past, present and anticipated future financial conditions is important to identify the overall financial health of such company. Annual report contains financial statements as well as management opinion of the past years' performance and firm's future prospects. In financial analysis, certain guiding criteria include:

Historical evidence as a base of evaluating company's financial performance- an understanding of change and factors of change that appropriately influence financial decisions. Economic consideration- gaining additional perspective and improved insight of both trend and averages such as price level, business profits, interest rates, dividends, security-price movements, etc.

Analysis of these financial statements helps in measuring the overall financial performance of companies. What can be done through financial performance analysis is to:

- Obtain information that can be used for decision-making.

- Judge performance and management effectiveness.
- Identify the deficiencies and weaknesses.
- Take corrective actions timely to improve the performance.
- Gain adequate insights into the possibilities of making changes worthwhile.
- Evaluate the possible implications of alternative courses of actions.

The roots of major management decisions revolve around financial information. A careful scrutiny of alternatives based on projected information depicting the comparative results of each is needed to arrive at the selection of most favorable decision for eventual implementation. This brings us to the question what constitute financial information. The basic source covering financial information about a firm's affairs is its annual final accounts i.e. Profit & Loss Statement for the last operating period (quarter/half year/year etc,) and Balance Sheet as at the end of that period. Profit and Loss accounts reveal the operating results of the business activities of the firm. These sources, however, reveal only part of the necessary and required information and leave a considerable gap. It is therefore necessary to further examine and breakdown the information in these statements with a much greater elaboration and detail to decipher the comparative strengths and weaknesses of the firm. For this purpose, we can employ certain analytical tools and perceptive statements based on the source data from the balance sheet and profit & loss account statements.

Financial analysis serves the following purposes to the concerned authorities/bodies:

The government for compiling national statistics relating to the status and growth of each industry; The shareholders, as well as perspective investors desirous to know the present and anticipated trends of the business; Banks and financial institutions who are interested with project appraisal and conducting feasibility and viability studies to ascertain the credit worthiness of the applicant-firm's project; Suppliers who want to know how viable the business is in order to enter into long-term contracts; the same need arises for customers who need to procure products from the business regularly; Credit Rating Agencies, Stock exchange authorities who study the risk-factor affecting the innumerable small investors who have parked their life-savings in the firm by way of equity, debt (bonds) or deposits.

Financial data is to be analyzed with reference to the particular objectives of the person concerned either external or internal as regards the firm. Before commencing analysis the type of analysis and the type of information needed are to be ascertained, as well as identification of the source-data, and the analytical tools to be employed. Analysis may be done with reference to a particular financial

year in respect of different firms of a particular group or industry to assess their comparative status and performance or it may be restricted to a particular firm for a stretched period of 5 to 10 years to decipher its strengths and weakness and to analyze how it is progressing indifferent directions over this period.

Basically, a financial analysis consists of a three-step process as under:

- Identify the source information relevant to the decision to be made from the total pool of data provided by the annual financial statements
- Re-arrange the particular data selected to highlight significant relationship
- Study the analyzed information critically and draw pertinent conclusions there form

2.1.1.1 Types of Financial Analysis

It may be categorized as external or internal analysis based to whom it is intended. Internal analysis for management information and decision thereon are generally more detailed than external analysis intended for trade creditors, investors, term lending institutions and bankers supplying working capital.

The analysis may be classified as Horizontal or vertical analysis. Horizontal analysis is conducted to compare the annual financial statements of the current year with that of the previous year to ascertain the comparative trends of the progress of the business, while vertical analysis is restricted to an in-depth study of the current year's financial statements. It converts each element of the information into a percentage of the total amount of the statement (like profit to sales turnover) so as to establish relationship with other components of the same statement

Trend Analysis:

This is arrived by preparing relevant ratios of the firm for a series of years (three or more) to study the comparative performance. The different performance ratios related to the previous year is compared with that of the current year (base year) to draw such conclusion

Ratio analysis:

An arithmetic ratio explains the relationship between two numbers. The ratio to be meaningful, the numbers selected must be co-related i.e. must bear a connected relationship. The one must have an influencing effect on the other. Ratio Analysis establishes meaningful quantitative relations between

two linked/connected items/variables of financial statements so that the strength or weakness of the business is brought out. For examples, current assets are the source to meet current liabilities. Availability of sufficient current assets capable of quickly being converted to cash will assure that creditors for liabilities in the short run will be promptly discharged. The quantitative relationship of the set of items is indicated by the 'Current Ratio'. Banks are happy if the borrowing firm to whom working capital accommodation is extended has a current ratio of 1.4 or more. Similarly, net profit is related to both capital employed and the sales turnover. Therefore, net profit can be compared either to net-worth or sales turnover. The net profit to net-worth ratio indicates the return on the investment, while the net profit to sales turnover indicates the operational efficiency.

Funds Flow Statement:

This is a statement, which explains the various sources from which funds were raised and the uses to which the funds are put. The statement indicates the changes which have taken place between two accounting periods. While the Balance sheet as at a particular date presents a static picture of the sources and uses of funds, the fund flow statement captures the movement of funds over a specified period. A fund flow statement, therefore, explains the transformation or changes underwent by individual assets and liabilities of a firm from one balance sheet date to another. A projected fund flow for a future span of periods can also be prepared. This will facilitate budgetary control and capital expenditure control to be exercised in the organization.

Break-even analysis helps to ascertain the point in terms of sales turnover at which the firm is able to cover all its expenses out of its earnings and reaches the position of neither profit nor loss. In other words before the BEP the firm incurs loss and after BEP the firm will show profit. BEP is the demarcating line. This is more meaningful for a newly established manufacturing business, as it takes time to develop the market for its products and build up sales. The period from the date of commencing construction/erection of the project to the date of reaching BEP sales is called the gestation period for the industry.

2.1.2 Concept of Financial Performance Analysis in the Framework of CAMELS

CAMELS rating system is an international bank-rating system with which bank supervisory authority rates institutions according to six factors. The six areas examined are represented by the acronym "CAMELS." In this acronym, each letter stands:

C- Capital adequacy

A- Asset quality

M- Management quality

E- Earnings

L- Liquidity

S-Sensitivity to Market Risk

1. Capital Adequacy:

The Capital is defined as wealth employed in production process to generate more wealth and profit. Capital includes any funds thus employed. Capital can also be defined as the money contributed by the proprietors to an organization to enable it to functions, thus share capital is the amount provided by way of loans. However, the capital of the proprietors of the companies not only consists of the share and loan, capital, but also includes retained profit, which accrues to the holders of the ordinary shares. Commercial bank should have adequate capital to support its risks assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities. Adequacy and inadequacy of bank capital directly affects the banking transaction. The adequacy of bank capital is the most important aspect of a bank. If there is inadequacy of capital, the bank should take step for the adequacy of capital as per legal requirement. They should remove inadequacy of bank capital through the medium of collecting of ownership and borrowed capital. If there is scarcity of capital in a bank, its financial health cannot be regarded capable and healthy. The advantages of the bank capital adequacy are as follows:

- If the bank has an adequate bank capital, people trust upon such banks, such bank becomes successful to gain the trust of all sectors.
- If the bank has adequate capital, it can invest into any sectors at any time from which the bank gets success to gain a lot of profit.
- The bank does not face problem to collect the capital.
- The bank does not need to take loan, and do not have to pay interest.
- There will be not possibility of liquidation of bank.

The capital accounts of a commercial bank play several vital roles in supporting its daily operations and ensuring its long-run viability. Firstly, capital provides a cushion against the risk of failure. Second, capital provides the funds needed to get the bank chartered, organized and operating before

deposits come flowing in. Thirdly, capital promotes public confidence in a bank and reassures its creditors (including the depositors) of the bank's financial strengths. Fourthly, capital provides funds for the organization's growth and the development of new services programs, and facilities. Finally, capital serves as a regulator of bank growth, helping to ensure that the individual bank's growth is held to pace that is sustainable in the end.

Nepal Rastra Bank has set the different capital adequacy ratio to be maintained by the bank in different time. The capital adequacy ratio set by NRB during the study period is as follows.

Capital Adequacy Ratio:

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Capital Adequacy Ratio (%)	10.00	10.00	11.00	11.00	11.00	11.00
Core Capital Adequacy Ratio (%)	5.00	5.00	5.50	5.50	5.50	5.50
Supplementary Capital (%) (not more than core capital i.e.)	5.00	5.00	5.50	5.50	5.50	5.50

Source: NRB report

2. Asset Quality:

A bank's assets are grouped into four major subcategories: 1) cash and balances due from other depository institutions 2) investment securities, 3) loans and leases and 4) other assets. Among them loans and advances, dominate the asset side of the balance sheet of the banks. Similarly earning from such loans and advances occupy a major space in income statement of he bank. Hence, asset is the critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. Many financial crises in the past (including the Asian crises) and current financial crisis which has been the headache of the world been caused or amplified by downturns in particular sectors of the economy spilling over into the financial system via concentrated loan books of financial institutions.

However, loans are also the least liquid asset item and the major source of credit and liquidity risk for most banks. Thus, quality of assets has direct impact in the financial performance of a financial institution. The quality of assets particularly, loans assets and investments, would depend largely in the risk management system of the institution. We can use number of measures to indicate the quality of assets held by the banks. An increasing trend in the ratio of nonperforming loans to total loans signals a deterioration in the quality of credit portfolios and, consequently, in financial institutions' cash flows, net income, and solvency. It is often helpful to supplement this information

with information on nonperforming loans net of provisions, and on the ratio of provisions plus interest suspension on impaired loans to total loans—particularly if impaired loans have not yet been classified as nonperforming.

Although these indicators are primarily backward looking, reflecting past problems that have already been recognized, they can be useful indicators of the current health of the financial system, and are often used in connection with stress tests of financial institutions. Trends in nonperforming loans should be looked at in conjunction with information on recovery rates-for example, using the ratio of cash recoveries to total nonperforming loans. Such information points to the level of effort or the ability of financial institutions to cope with high nonperforming loan portfolios. Loans outstanding to loss-making public sector entities are often the result of past directed lending, may also signal significant credit risk. Depending on the country, loans to loss-making public enterprises or to regional governments may not be classified as nonperforming, even though they may not be repaid on a timely basis and/or in full (NRB 2004).

Non-Performing Assets:

Non performing Assets means an assets or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI (Athmanathan and Venkatakrishnan, 2001). An amount due under any credit facility is treated as “past due” when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, up gradation of technology in the banking system, it was decided to dispense with past due concept, with effect from March31, 2001. Accordingly, as from that date, a non performing assets (NPA) shell be an advance where

1) Interest and/ or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan.
2) The account remains out of order for a period of more than 180 days, in respect of an overdraft/cash credit (OD/CC),
3) The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted.
4) Interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and

5) Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

In case of the banks the loans and advances are the assets of the banks. As the banks flow loans from the fund generated through shareholders equity, money deposited by the people and fund having through the borrowings, it expect the repayment of funds with some additional amount that is interest so that it could meet its all kinds of expenses. When any loans cannot be repaid in time, it directly effects to the performance of the banks. Hence, non-performing assets means that loans and advances, which are not performing well or those, loans and advance which, are irregular. In this regard, it would be very useful to present cross-country definition concerning non-performing assets, which is presented below:

Country	Definitions of Non-Performing Assets
India	Loans and advances, which are due for six months.
Indonesia	Loans and advances classified as substandard, doubtful and bad(over three months overdue)
Korea	Loans overdue over three months plus non accrual loans
Malaysia	Loans classified as substandard, doubtful and bad as per banks discretion (principal or interest overdue by three or six months at bank's discretion)
Philippines	Substandard, doubtful and loss loan. Loans payable in monthly installments more than three months overdue and loans repayable on other term if one month overdue.
Singapore	Loans classified as substandard and all loans and advances which are overdue more than three months
Thailand	Substandard, doubtful and bad loans (overdue more than three months)

Source: (Cotvaria L, Dziobek C., Kanaya A. and Song I., 2000)

As per the Nepal Rastra Bank Directives " Non-performing assets are the classified loans and advances and this includes sub-standard, doubtful, and bad loans categorized as defined by NRB directives (NRB Directives 2006, compiled by R. Bajracharya and Company)."

With an objective of minimize the possible loss of credits extended by commercial banks, Nepal Rastra Bank amended the policies relating to loan classification and provision. As per the new circular of NRB, the commercial banks should classify the principal amount of loans and advances on the basis of aging. Under the new rules the loans and advances are classified into the following categories:

a. Pass Loan:

Loans in this category are performing and have sound fundamentals, which includes borrowers overall financial conditions, resources and cash flow, credit history and character. They also include the purpose of loan, and types of secondary sources of repayment. Loans and advances whose principal amount are not past due and past due for a period up to 3 months shall be included in this category. These are classified and defined as performing Loans or Performing Assets.

b. Substandard Loan:

Loans in this category have well defined weakness, where the current sound worth and repayment capacity of borrower is not assured. Orderly repayment of debt is in jeopardy. All loans and advances that are past due for a period of 3 months to 6 months shall be included under this category.

c. Doubtful Loans:

Doubtful loans exhibit all the characteristics of substandard loans, with the added characteristics that collection is highly questionable and improbable. Classification of loss is deferred because of specific pending factors that may strengthen the quality of assets. Such factors include merger, acquisition, liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plan. All loans and advances, which are past due for a period of 6 months to 1 year, shall be included in this category.

d. Loss/Bad Loan:

These loans are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer full provision or writing of this worthless loan. Partial recovery of this may be possible in future. All loans and advances which are past due for a period of more than 1 year as well as advances which have least possibility of recovery or considered unrecoverable and those having thin possibility of even partial recovery in future shall be included in this category.

Loan Loss Provisioning:

Nepal Rastra Bank has made it mandatory to commercial banks to make the loan loss provisioning based on outstanding loans and advances and bill purchases on the following basis:

Types of Loans	Loan Loss Provisioning
Pass	1 percent
Substandard	25 percent
Doubtful	50 percent
Loss/ Bad	100 percent

Apart from the above-mentioned arrangement following additional arrangement are provided for the loan loss provisioning.

- Where the loan is extended only against the personal guarantee statement of the assets, equivalent to the personal guarantee amount not claimed by another shall be obtained. Such loans shall be classified as per above and where the loans fall under the category of pass, substandard and doubtful, in addition to the normal loans loss provision applicable for the category, an additional provision by 20 percentage shall also be provided.
- The loan loss provisioning in respect of rescheduled, restructured and swap loans shall be provided at a minimum of 12.50 percent.
- In case of priority sector loans the provisioning are made 1%, 25%, 50% and 100% to the loan categorized as pass, substandard, doubtful and loss respectively.

However, in respect of insured loans, the provisioning should be made on the following way:

Types of Loan Loss Provisioning	
Pass	0.25 percent
Substandard	6.25 percent
Doubtful	12.50 percent
Loss/Bad	25.00 percent

3. Management:

Good management can make, and poor management can break an organization. Banks are no exception to this universal phenomenon. Sound management is a key to financial institutions' performance. Although several indicators can be used as proxies for the soundness of management, such evaluation is still primarily a qualitative exercise, particularly when it comes to the evaluation of the management of operational risk, that is, the functioning of internal control systems. The quality of management is the most important element in CAMELS framework of financial performance analysis. The Nepali banking sector has matured over the last 20 years and there is sufficient evidence of professional management being able to translate their management efficiency towards producing wonderful results for the bank. At the same time we also have enough cases where due to poor management banks have performed poorly. Human resource management is a key management issue. Good or bad human resource management translates into staff efficiency of a particular bank.

The productivity of employees can be used as a measuring rod for evaluation. Like wise sustainability of earning shows the efficiency of management. Expenses ratio, earning per employee, cost per loan, average loan size and cost per unit of money lent can be used as proxy of the management quality. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. Similarly, low or decreasing earnings per employee can reflect inefficiencies a result of overstaffing, with similar repercussions in terms of profitability. Another possible ratio of management soundness is the rate of expansion in the number of branches whereas some expansion may reflect a healthy degree of competition, too rapid a rate of expansion may indicate lax licensing requirements, unsound management, and a gap in the supervisory capacity.

Although, there is a risk of being slightly subjective, the issue of evaluating management quality cannot be completed if we do not consider corporate governance factor. While management must work to maximize shareholder's value in any organization, there must be a clear line between management and shareholders or board of directors in terms of authority, responsibility and accountability levels. Good corporate governance requires policies, procedures and operating manuals to be supreme in any bank, whereby only professional considerations should play a role in strategic decision- making.

The board of director plays a key role in formulation of policies, supervisions and control. On the other hand, managing director is liable to the successful operation of the bank. The success of any bank is largely determined by the efficiency of its management. Poor Loan policies and the poor asset/liability management lead any bank to failure. The problematic variable for researcher in the development of CAMELS models has largely been the choice of a representative measure for management quality. NRB also has evaded this component of CAMELS in the performance evaluation of commercial banks in Nepal.

4. Earnings:

An analysis of the earnings helps the management, shareholders and depositors to evaluate the performance of the banks, sustainability of earnings and to forecast growth of the bank. The success of the bank heavily relies upon the efficiency of its management to drive the bank to earn good profits. Net profit is the major yardstick to measure such profits. A required level of profit is necessary for the firm's growth and survival in the competitive environment. Profitability is the measurement of the worth of the selected investment in various categories of assets depending largely on sales performance and operative efficiency. Profitability is vitally more important for assuring that a bank stays in business or activity. Net profit of any bank decreases resulting from high non-performing loans, lack of avenues for earning fee based income and operating in-efficiencies.

Net income (after tax) to total assets, net earnings (after tax) to core capital, net spread, net interest margin and net operating margin can be used to assess the earning performance of the bank.

5. Liquidity:

Banks are in business where liquidity (ability to pay cash to its depositors) is of prime importance. Liquidity ratios are used to judge a banks ability to meet short-term obligation. It is the comparison between short-term obligations and short-term resources available to meet such obligations. Liquidity risk threats the solvency of financial institutions. In case of commercial banks first type of liquidity risk arises when depositors of commercial banks seek to withdraw their money and the second type does when commitment holders want to exercise the commitments recorded off the balance sheet. Commercial banks have to borrow the additional funds or sell the assets at fire sale price to pay off the deposit liabilities. They become insolvent if sale proceeds of the assets are not enough to meet the liability withdrawals. The second type of liquidity risk arises when demand for unexpected loans cannot be met due to the lack of the funds. The banks can raise the funds by

running down their cash assets, borrowing additional funds in the money markets and seeking off other assets at distressed price.

Commercial banks are directed by NRB to maintain 5.5% percent of their deposits as CRR in NRB's account to ensure adequate liquidity. As per NRB regulations banks has to maintain CRR on a weekly basis. Therefore, if a bank has maintained higher NRB balance on other days of the week, it can afford to maintain lower than 5.5% percent balance on next days. Therefore, rather than disclosing the CRR of year-end, banks should report the exact CRR ratio maintained during the week, in which year-end falls. Deposit organization like banks, showing lower than regulatory CRR in their annual accounts, might lead to depositors mistrust towards the bank. NRB should ensure that the banks report correct CRR ratio in their annual accounts.

Cash and Bank(C & B) balance to total deposit ratio is designed to measure the bank's ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower ratio indicates that banks might face a liquidity crunch while paying its obligations, where as a very high ratio points out that the banks have been keeping idle funds and not deploying them properly.

Banks around the world invest a significant portion of their deposits in government securities because maintaining adequate CRR and C & B balance only cannot be considered sufficient for liquidity maintenance. There are occasions when a bank may need to face unexpected withdrawals. In such cases, as banks are run from depositor's money they need to maintain adequate investment in government securities as such investments can be liquidated at any point in time.

6. Sensitivity to Market Risk:

Banks are increasingly involved in diversified operations, all of which involve one or more aspects of market risk. A high share of investments in volatile assets may signal a high vulnerability to fluctuations in the price of those assets. In general, the most relevant components of market risk are interest rate and foreign exchange risk, which tend to have significant impacts on financial institutions' assets and liabilities. Large open foreign exchange positions (including foreign exchange maturity mismatches) and a high reliance on foreign borrowing (particularly of short-term maturity) may signal a high vulnerability of financial institutions to exchange rate swings and capital flow reversals.

Interest rate risk is one of the most common financial risks, and virtually all financial institutions are subject to it. Even though it is commonly considered as a market risk indicator, interest rate risk

arises from both an institution's banking book as well as from its trading book. Financial institutions can, in many countries, incur substantial equity price risk, by either trading or investing in the stock market, or via derivatives, which exposes the institutions to the risk of stock market crashes. Indicators of equity price risk would include the absolute size of certain classes of financial institutions' investment in equities, their size in terms of various balance sheet indicators, or the capital charges allocated against equity price risk.

2.1.3 Historical Background of Banking Industry

Banking is of ancient origin though little is known about it before the middle ages. The origin of commercial banking can be traced in the ancient era of Greeks and Mesopotamians as well as Romans, then the practice of storing precious metals and coins at safe places and loaning out money to the people on interest was prevalent. The traces of rudimentary banking are funds in the Chaldean Egyptian and Phoenician history. According to Alfred Marshall, "In Greece, the temples of Delphi and other safer places acted as store houses for the precious metals before the days of coinage, and private purposes at interest, though they paid none themselves. Private money changers began with the task of reducing many metallic currencies, more or less exactly, to a common unit of value, and went on to accept money on deposit at interest and to lend it out at higher interest permitting meanwhile drafts to be drawn on them (Radhaswami, & Vasudevan, 1979).

Modern banking made its first appearance in medieval Italy, despite strong Christian prohibitions against Usury (the charging of interest) according to the Canon Law. Florence, Genoa, and Lucca became the centers of finance and trade in Twelfth and Thirteen Centuries. The first bank called the 'Bank of Venice' was established in Venice, Italy in 1157 AD to finance the monarch in his wars. Following its establishment, the banks established were the Bank of Barcelona; even the clergy was engaged in banking, the Germans and Swiss rose to pre-eminence in the 1480s. the Bank of Amsterdam was the great bank of the 17th century and it enjoyed a prestigious position, no less important than is held currently by the Bank of England, for a ling time in sphere of international commerce (Dahal & Dahal, 2002).

The concept of modern commercial bank came into existence by the emergence of Bank of England in 1694 with a capital of £ 1.2 million by a group of wealthy London merchants and financiers. Since, at that time there was no concept of joint stock company, it was necessary to obtain, a special charter from the crown to pool their money in common venture. King William III was too pleased to grant a royal charter to Bank of England, because in return a capital subscribed of £ 1.2 million was

lent to him to finance his war against France. The charter also gave the new bank the right to issue notes, payable on demand, up to the amount of the loan to the King.

In spite of the establishment of Bank of England in 1694 AD, the development of modern commercial banking institutions had to wait for another century and four decades until the passage of Banking Act of 1833 AD, which provided freedom for the establishment of Joint stock banks. Chile banking arose far early and rapidly in some countries than in other, it was only in the 19th century that the modern joint stock commercial banking system developed in the leading countries of the world. When colonies were established in North and South America old banking services were transferred to the new world.

2.1.4 Evolution of Banking in Nepal

The development of modern banks in Nepal does not have as old history as the developed countries have got. Although there are mentions of lending and other banking activities in the ancient books' Manusmriti' and 'Kautilya's Economics". Found evidences have proved that in the seventh century King Guna Kamadev had collected loans from the people to rehabilitate the Kathmandu valley. According to ancient "Vanshavali", during the last decade of Eighth century, Sahnakhadhar, a local merchant from Kathmandu started the Nepal Era after freeing the people by paying off their loans and liabilities. By this instance, it can be understood that there might have the transaction of money depositing and lending. During the Rana Regime. The Rana primeminister Ranodip Singh Rana established a state-owned lending institution called 'Tejarath Adda'. Which had provide financial assistance in the form of loans to the government employees against their personal guarantee(Dhan jamani) and deduction of a certain amount of their salary as installment charging 5% interest. Later this institute started providing loans to the general people against pledge of precious and valuable materials like gold, silver, etc. Tejaratha Adda can be regarded as the father of modern banking system in Nepal.

Though Nepal had rudimentary forms of banking as early as seventh century, the history of modern banking began in Nepal only after when the first organized and modern bank Nepal Bank Ltd. Established in 1994 B.S as a semi-government organization with an authorized capital, issued capital and paid capital of Rs.1 core Rs.25 Lacs and Rs.8.45 Lacs respectively. Before that unorganized money market was the only source of financing for investors in Nepal. Lack of economic development programmes in those days confirmed the services of Nepal Bank Ltd., in accepting deposits from the public and financing them trade transactions. Later the Nepal Rastra Bank was established in 2013 B.S which has helped to make baking system more systematic and dynamic

during that time. As the time passed, the Rastriya Banijya Bank established in 2022 B.S in order to play a major role not only in domestic banking but also in the foreign trade.

To encourage healthy competition in the Nepalese financial sector government introduced financial sector reforms policy in 1980 A.D, which allowed the entry of foreign banks in the form of Joint Venture bank in Nepal. There are 26 commercial banks operating in Nepal including 5 joint venture banks. Today Nepal can take legitimate pride in the remarkable growth and progress in the banking industry (Deoja, S., 2001).

2.1.5 Concept of Bank

Banks are among the most important financial institutions in the economy. Banks are those institutions, which perform the indispensable task of intermediating between two individuals and institutions in order to raise funds and then loaning the funds to deficit spending individuals and institutions. There is no unanimity among the economists about the origin of word 'banking'. Some of them insist that the term 'bank' derives from the Latin 'bancus', which refers to the bench on which the banker would keep his money and his records. Some people trace the origin to the French word 'banque' and the Italian word 'banca' which means a bench for keeping, lending and exchanging of money or coins in the market place by money-lenders and money-changers (Upadhyay & Tiwari, 1980).

The bank operates in the modern and competitive business environment. So it is very difficult to illustrate any absolute definition of bank. Different economists have offered different definitions such as:

According to Kolb & Rodrigeuz (1996), A bank is an organization whose principal operations and concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for expenditure.

Banks provide short term debt necessary for trade and commerce of the country along with other ordinary banking business such as collecting the surplus in the form of deposit, lending debts by discounting bills of exchange, accepting valuable goods in security, acting as an agent of the client and so on. Therefore, a bank is an institution, which accepts deposits from the public and in turn advances loans by creating credit.

Ordinary banking business consists of changing cash for bank deposits and bank deposits for cash, transferring bank deposits from one person or corporation to another, giving bank deposits in

exchange for bills of exchange, government bonds, the secured or unsecured promises of businessmen to repay and so forth (Hayes & Meerchuan, 1991).

Therefore, it should be differentiated from other financial institutions as they can not create credit though they accept deposits. Any institution offering deposits subject to withdrawal on demand and making loans of a commercial or business nature is a bank.

2.1.6 Concept of Commercial Banks :

More often banks and commercial banks are interpreted as being synonym of each other but in reality, they are two different areas of study. Commercial bank is one of the various types of bank and would need a separate identity before one should go any further on study of commercial banks.

There are several types of banks like commercial bank, central bank, industrial bank, agricultural bank, rural development bank, saving bank, exchange bank, universal bank, co-operative bank, mutual fund, housing bank, equipment bank etc. commercial banks contribute significantly in the financial system of a country. They pool together the savings of the community and arrange for their productive use. They supply the financial needs of modern business by various means. They accept deposits from the public on the condition that they are repayable on demand or on short notice. Their business is confined to financing the short- term needs of trade and industry such as working capital financing. They grant loans in the form of cash credits and overdrafts. Apart form financing, the role of commercial banks, in modern age, is more vital in agency service and general utility service. Under agency service a commercial bank performs a number of activities on behalf of its customers. A commercial bank undertakes the payment of subscriptions, insurance premium, rent etc. and collection of cheques, bills salaries, pensions, dividends, interest etc. on behalf of the customers. It also arranges to remit money from one pace to another by means of cheques, demand drafts, money order, telex transfer (T.T), society for worldwide inter-bank financial telecommunication, (SWIFT) etc. Apart form agency services, the commercial bank also renders some useful services known as general utility services which include safekeeping of valuables, providing assistance in foreign trade, issuing credit instruments like letters of credit and traveler's cheques, acceptance of bill of exchange, financial advising, offering security brokerage services, etc (Singh, 2003).

Banking and Financial Institutions Act of Nepal has defined commercial bank as, organization which exchanges money, accepts deposits, grants loans and performs commercial banking functions and which is not a bank meant for co-operative, agriculture, industries or for such specific purpose (NRB, 2061)."

2.1.7 Functions of Commercial Banks

A modern commercial bank performs a variety of functions and services. The functions of commercial banks are grouped under five sub-headings as under:

2.1.7.1 Acceptance of Deposits

The bank accepts different types of deposits from the public:

Fixed Deposit:

Fixed deposit is also known as Time Deposit. Bank offers fixed interest rate on this deposit and repays principal together with interest at fixed maturity or pays interest on regular interval but principal only at the maturity, owners cannot write cheque on time deposit, but the interest rates are generally higher than those of saving deposits. Time deposits have fixed maturity length, ranging from several months to over five year and have substantial penalties for early withdrawal. Time deposits are more costly source of funds for the banks.

Current Deposit:

In this type of deposit, the depositor can withdraw money whenever he requires and there is no limitation in issuing cheque by the customer. This type of deposit is generally maintained by business firms, other business motive institutions and individuals that have higher volume of transactions in their account. Banks charge certain amount to the customer for not maintaining the minimum balances in the current account.

Saving Deposit:

Some restrictions are imposed on the depositor under this account. For example, he/she can withdraw only a specified sum of money in a day. Generally, in this type of deposit banks accept deposits from individuals and non-profit making organization. NRB however does not bar banks from accepting saving deposits form profit making organization. Saving deposits attract interest, which is normally less than that of long term deposit but more than that of short term deposit. Saving deposit is an important source of Bank funds. Saving deposit are payable on demand, that is, if a depositor shows up at the Bank and requests payment by making withdrawal, the Bank must pay the depositor immediately.

Recurring Deposit:

The purpose of this account is to encourage regular savings by the public, particularly by the fixed income group. Generally, money in these accounts is deposited in monthly installments for a fixed period and is repaid to the depositors along with interest on maturity.

Call Deposit:

Call Deposit incorporates the characteristics of currents and saving deposit. Current in the sense, deposits is withdrawn at call and savings in a sense the deposits earns interest. Interest rate on call deposit is negotiable between the bank and the depositors and hence it is normally not announced in public.

2.1.7.2 Advancing of Loan

The various types of loans and advances are as follows:

Cash Credit:

It is revolving type of loan account, normally granted against stock and receivables. This account is regulated by stock statements and drawing power wherein credit/debit transactions are permitted within the sanctioned limit. The level to which debit balance can be permitted is decided by drawing power or limit whichever is lower. Cash credit is normally granted against security of certain commodities, products or book debts/receivables.

Overdraft:

The bank allows its credit worthy and reliable customer to overdraw their accounts through cheques. The customers, however, pays interest to the bank on the amount overdrawn by them. An overdraft is granted against security of certain investments like Bonds/Fixed Deposits or some time it is given against personal guarantee.

Demand/Term Loan:

Demand loan is a loan provided on repayment basis and is not a running account. Demand/term loan once granted will have a debit for the quantum sanctioned and thereafter only credits of repayment, normally personal in nature, are permitted. It is given against security and the security will be in the

form of fixed assets or fixed deposits and it will never be given against stocks. These loans are granted to acquire fixed assets like machinery and construction works.

Trust Receipt Loan:

Trust receipt loans are sanctioned as a limit to be utilized against hypothecation of stocks imported under own letters of credit, normally for a period of 90 days. It is in the nature of demand loan, which is liquidated by 2-3 installments and the limit is not cancelled with liquidation but is reinstated. Hence this loan is more in the form of working capital loan.

Bill/Cheque Purchase/Discounting:

This is the best form of advance in terms of credit discipline as it is self-liquidating in nature. Any trader/industrialist receives payments by cheques or draws documents on the buyer. These cheques/bills of exchange are discounted by the banks and in turn receive commission.

Money at Call and Short Notice:

These loans are generally made to other banks and financial institutions. Such loans are very short period loans and can be called back by the bank at a very short notice of 1 day to 14 days.

2.1.7.3 Agency Functions of Banks

The various agency services rendered by the banks are as follows:

Transfer of Funds:

Fund transfer from one place to another is the necessity of the today's world but the physical transfer of cash from one place to another involves many risks. The banks help their customers in transferring funds form one place to another place through different mechanism such as bank draft, fax, TT, and SWIFT and so on. People transfer money to or from one country to another-such as Nepalese who are in abroad for foreign employment send their earnings through foreign bank to Nepalese bank called as inward remittance**.** Alternatively, one can transfers money to another country from Nepal called as outward remittance. In export and import business, a firm needs to send/ bring money from/to a country. A firm that need to import raw material for producing its goods opens LC in a bank or it may directly import without opening LC in case it pays to the party in advance –called as outward remittance. Alternatively, a Nepalese firms export goods to a firm in abroad need to pay the bills to Nepalese party called as inward remittance.

Collection of Funds:

The bank collects the funds of its customers from other banks and credits to their accounts. The customers do have bills/ cheques that need to be collected from the other banks in own country or foreign. A bank plays a role of intermediary in collecting funds from other banks. Banks collect bills or cheques through local clearing or outward bills collection (OBC) through their correspondent banks.

Purchase and Sale of Share and Securities:

The bank buys and sells stocks and shares of private companies as well as government securities on behalf of customers. Customers who wish to buy/sale securities and shares can get access through a bank, which acts as an intermediary institution.

Trustee and Executor:

A bank is registered under the existing laws of the nation and operates subject to the rules and regulations laid down in the act. So, the bank preserves the will of the customers and executes them after their deaths. This function of a bank is bound by specific laws and facilitates to customers in trust worthy way.

Acts as Correspondent:

The bank may also act as a correspondent, agent or a representative of its customers. Global trade is widely practiced now days. A bank in a part of world does have a correspondent bank in other corner of the world. The channel of correspondence bank helps clients do their business operating in any corner of the globe. Imports and exports business heavily rely on banks as they act as an correspondent to their clients in another country. Personal remittances too flow in and out through the banks having correspondence with other banks.

Purchase and sale of Foreign Exchange:

The bank also carries on the business of buying and selling foreign currencies. Generally exchange of foreign currencies in developed countries is done by Exchange Company/banks but due to lack of exchange banks in our country this function is done by commercial banks. Tourists carrying foreign currency (FCY) such as US dollars, Great Britain Pounds (GBP), EURO and so on, can exchange their currency in banks. This function has facilitated many people across the world. People in need

of FCYs also get easily in their home country provided the purpose of their need is as per central bank regulations regarding FCYs exchange.

2.1.7.4 General Utility Services

Apart from agency services, the bank also renders some useful services known as general utility services. They can be explained as follows:

Safekeeping of Valuables:

During the middle ages, banks began the practice of holding gold, securities and other valuables owned by their customers in secure vaults. A modern bank also receives form its customers, valuables such as securities, jewelries, documents of title to goods, etc. for safe custody. The bank acts as the custodian of the valuables belonging to the customers. The bank receives them and returns back when demanded.

Assist in Foreign Trade:

The bank assists traders engaged in foreign trade of the country. It discounts the bills of exchange drawn by Nepalese exporters on the foreign importers and enables the exporters to receive money in the home currency. Similarly, it also accepts the bills drawn by the foreign exporters.

Making Venture Capital Loans:

Increasingly, banks have become active in financing the start-up costs of new companies, particularly in high-tech industries, Because of the added risk involved in such loans, this is generally through a venture capital firm that is a subsidiary of a bank holding company, and other investors are often brought in to share the risk.

Financial Advising:

Their customers have long asked bankers for financial advice, particularly when it comes to the use of credit and the saving or investing of funds. Many banks offer a wide range of financial advisory services, from helping financial planning to consulting to business mangers and checking on the credit standing of firms.

Automated Teller Machines (ATM):

Most of the banks have provided the facility to the customer to withdraw money form their accounts through a machine kept in the prime locations of the cities called as ATM in 24 hours basis. This has provided the customers with a facility to withdraw the money when they require it.

Anywhere Branch Banking Service (ABBS):

Banks offer account holder of a branch to avail some banking services from other branches located at various parts of the country which is called anywhere branch banking service. This is one of the distinguished features of the modern banking services.

Telebanking:

Customers may acquire information like, account balance, exchange rate, and requisition for cheques and may instruct banks to do various jobs over the phone, fax, mobile phone etc.

Credit/Debit Card:

Banks issue credit cards to highly creditworthy customers. Banks also issue debit card as well. This relieves the customers form carrying cash.

Besides these functions, a commercial bank also finance internal and foreign trade, collects statistics about money, banking, trade and commerce, and underwrite shares and debentures issued by private companies, offer some of the banking services at the door of highly valued customers. It also guarantees to other parties on behalf of its customers to make payment up to a specified sum of money to the beneficiary on demand in case of default by its customers. Further, a commercial bank also facilitates the trading between two parties who live in different countries through letters of credit and guarantees the seller of payment in case the buyer defaults to pay.

2.1.7 Financial Statements of Commercial Banks

Financial Information of commercial Banks is reported in two basic documents. The report of condition (or Balance sheet) presents financial information on a Bank's assets, liabilities and equity capital. The balance sheet reports a Bank's condition at a single point of time. The report of Income (or the Income statement) presents the major categories of revenues and expenses (or cost) and the net profit or loss for a Bank over a period of time. Financial statements of commercial banks must be

submitted to regulators and stockholders. Financial institutions are also engaging in an increase level of off-balance sheet (OBS) activities. These activities produce income (and sometimes losses) for the FIs that are reported on the income statement. Retail banks focus on individual consumer banking relationship, such as residential mortgages ad consumer loans on the asset side of the portfolio, and individual demand, savings and time deposits on banking relationship, such as residential mortgages and consumer loans on the liability side. In contrast, wholesale banks focus their business activities in business banking relationship, they hold more business loans and fewer mortgages and consumer loans and use fewer consumer deposits and more purchased funds than retail banks do.

Financial statements report both on the firm's financial position at a point in time and on its operations over some past couples of years regarding what they have performed financially, this is reporting about what the company has done in terms of assets, liabilities, income and expense. Alternatively, they highlight in important financial aspects such as liquidity, profitability, activity capital structure and market capitalization value. Annual report made available to the shareholders in annual general meeting is the basic raw material of financial analysis, comments and interpretation. Shareholders raise various issues regarding irregularities, operational inefficiencies and internal management deficiencies causing poor performance of a company. Financial Statements collected, consolidated and analyzed by Nepal Stock Exchange Limited Provide better insights about the company's performance. In other words, financial statements comprise:

2.1.8.1 Balance Sheet

As the name implies, the balance sheet list balances that is, it has the characteristics that Total Asset = Total Liabilities + Capital. Hence, the balance sheet is a statement of the firm's financial position at a specific point in time regarding assets, liabilities and stockholder's equity to balance debt and ownership position. The Balance Sheet is a statement of resources at the disposal of the firm and how they are put to use. In other words the acquired assets at the disposal of the firm and liabilities that the firm has incurred and remains indebted to others.

Furthermore, a Bank's balance sheet lists sources of Bank funds (liabilities) and uses to which they are put (assets) Bank obtain funds by borrowing and by issuing other liabilities such as deposits. They then use these funds to acquire assets such as securities and loans. Banks make profits by charging an interest rate on their holdings of securities and loans that is higher than the expenses on their liabilities.

Assets

A bank's assets are grouped into four major subcategories:1) cash and balances due from other depository institutions 2) investment securities, 3) loans and leases and 4) other assets. Investment securities and loans and leases are the bank's earning assets. Cash and balances due from depository institutions consists of vault cash, deposits at the Central Bank, deposits at other financial institutions, and cash items in the process of collection. None of these items generate much income for the bank, but each is held because they perform specific functions. Vault cash is composed of the currency and coin needed to meet customer withdrawals. Deposits at the central bank are used primarily to meet legal reserve requirements to assist in cheque, clearing, wire transfers, and the purchase or sale of Treasury securities. Deposits at other financial institutions are primarily used to purchase services form those institutions. These banks generally purchase services such as cheque collection cheque processing, and investment advice from correspondent banks. Cash items in the process of collection are cheque written against accounts at other institutions that have been deposited at bank.

Credit is given to the depositor of these cheques only after they clear. Investment securities consist of items such as interest bearing deposit at other financial institutions, repurchase agreements, Treasury and agency securities, securities issued by central bank and other debt and equity securities. These securities generate income for the bank and are used for liquidity risk management purpose. Investment securities are highly liquid, have low default risk and can usually be traded in secondary markets. Banks generally maintain significant amount of these securities to ensure that they can easily meet liquidity needs that arise unexpectedly. However, because the revenue generated from investment securities is low compared to that from loans and leases, many banks attempt to minimize the amount of investment securities they hold.

Although banks with excess cash reserves invest some of this in interest-earning liquid assets such as T-bills and short term securities, they have the option to lend excess reserves for short intervals to other banks seeking increased short-term funding. The market for excess reserves is inter-bank dealing. In a inter bank transaction, the bank with excess reserves sells funds for one day to the purchasing bank. The next day, the purchasing bank returns the funds plus one day's interest reflecting the market rate. Since credit risk exposure exists for the selling bank, because the purchasing bank may be unable to repay the funds the next day, the seller may seek collateral backing for the one-day funds loan. In the context of Nepalese banking sector banks generally do not seek collateral but set the limit of exposure to the other banks. In this transactions, the funds selling

bank receives government securities as collateral from the funds- purchasing bank- that is, the funds-purchasing bank temporarily exchanges securities for cash. The next day, this transaction is reversed- the funds-purchasing bank sends back the funds it borrowed plus interest rate; it receives in return its securities used as collateral in the transaction.

Long-maturity investments such as NRB bonds usually offer somewhat higher expected returns than short-maturity investment since they are subject to greater interest rate risk exposure. Treasury securities and NRB Bonds are fully backed by the government and thus carry no default risk.

Loans are the major items in a bank's balance sheet and generate the largest flow of revenue income. However, loans are also the least liquid asset item and the major source of credit and liquidity risk for most banks. Leases are used as alternatives to loans when the bank, as owner of a physical asset, allows a customer too use an asset in return for periodic lease payments. Loans are categorized as commercial and industrial loans, loans secured by real estate, individual or consumer loans, and other loans. Commercial and industrial loans are used to finance a firm's capital needs, equipment purchases, and plant expansion.

Commercial loans can be made either at fixed rates or at floating rates of interest. This rate remains in force over the loan contract period no matter what happens to market rates. The interest rate on revolving loans such as cash credit loan and overdraft loan can be adjusted periodically so that the interest rate risk is transferred in large part from the bank to the borrower. Commercial loans can be made for periods as short as few weeks to as long as eight years or more. Traditionally, short-term commercial loans are used to finance credit needs that extend beyond one year, such as the purchase of real assets (machinery), new venture start-up costs, and payment increases in working capital. Commercial loans can be secured or unsecured. A secured loan is backed by specific assets of the borrower; while an unsecured loan gives the lender only a general claim on the assets of the borrower should default occur.

However, in Nepalese banking sector all most all the loans are secured by collateral or fixed property such as real state, house building, equipments and machineries. Housing loans are primarily mortgage loans which are generally long-term loans with an average maturity of approximately 10 years. Housing loans are made to purchase, construct and repair a house. Another major category of loans is the individual or consumer loan –for example personal and auto loans. Commercial banks, finance companies and co-operatives also provide consumer loan financing. It can be in the form of auto loan, personal loan, educational loan etc. Each loan category entails a wide variety of

characteristics that must be evaluated to determine the risk involved, whether the bank should grant the loan, and if so, at what price.

Unearned income and the allowance (reserve) for loan and lease losses are contra-asset accounts that are deducted from gross loans and leases on the balance sheet to create net loans and leases. Unearned income is the amount of income that the bank has received on a loan from a customer but has not yet recorded as income on the income statement. Over the life of the loan, the bank earns (or accrues) interest income and accordingly transfers it out of unearned income into interest income. The allowance for loan and lease losses is an estimate by the bank's management of the percentage of the gross loans (and leases) that will not be repaid to the bank. Although tax laws influence the maximum amount of the reserve, the bank's management actually sets the level based on loan growth and recent loan loss experience. The allowance for loan losses is an accumulated reserve that is adjusted each period as management recognizes the possibility of additional bad loans and makes appropriate provisions for such losses. Actual losses are then deducted from, and recoveries are added to (referred to as net write-offs), their accumulated loan and lease loss reserve balance. Investment securities plus net loans and leases are the earning assets of a depository institution. These items in the balance sheet generate the most interest income.

Other assets in the bank's balance sheet consist of items such as premises and fixed assets, other real estate owned (collateral seized on defaulted loans), investments in unconsolidated subsidiaries, intangible assets (i.e. goodwill and mortgage servicing rights) and other (i.e. deferred taxes, prepaid expenses, and mortgage servicing fees receivables). These accounts are generally a small part of the bank's overall assets.

Liabilities

A bank's liabilities consists of various types of deposit accounts and other borrowing used to fund the investments and loans on the asset side of the balance sheet. Liabilities vary in terms of their maturity, interest payments, check-writing privileges, and deposit insurance coverage. A bank acquires finds by issuing (selling) liabilities, which are consequently also referred to as sources of funds. The funds obtained from issuing liabilities are used to purchase income-earning assets.

Current accounts are transaction accounts held by individuals, business firms, corporations, and other institutions that pay no explicit interest. Saving deposits are all saving accounts other than current accounts. In saving accounts and current accounts some minimum balance should be kept.

The major categories of time deposits are fixed deposit. Fixed deposits are fixed-maturity instruments. Although the size, maturity, and rates on these FDs are negotiable, most banks issue standardized FDs.

Deposits can be separated as foreign from domestic deposits on the balance sheet but it is not generally practiced in Nepal. Foreign deposits are generally large and held by corporations with a high level of international transactions activities. The liabilities described above are all deposit liabilities, reflecting deposit contracts issued by banks in return for cash. However, banks not only fund their assets by issuing deposits but borrow in various markets for purchased funds, since the funds generated from these purchases are not deposits; they are subject to neither reserve requirements nor deposit insurance premium payments. The banks can also borrow funds from other bank for certain period; generally short term of 2/4 days and these transactions can be rolled over each day if the contemporary is willing. Some banks in search of stable sources of funds with low withdrawal risk have begun to issue subordinated notes and debentures, often in the five-to seven-years range. These notes are especially attractive because they are subject to neither reserve requirements nor deposit insurance premiums, and some can serve capital for the bank to satisfy NRB regulations regarding minimum capital requirements. Banks facing temporary liquidity crunches can borrow from the central Bank's discount window at the discount rate. Since this rate is not market determined and usually lay below government security rates, it offers a very attractive borrowing opportunity of a Bank with deficient reserves as the reserve maintenance period comes to an end.

Some Bank separate core deposits from purchased funds on their balance sheets. The stable deposits of the Bank are referred to as core deposits. These deposits are not expected to be withdrawn over short periods and are therefore a permanent source of funding or the Bank. Core deposits generally are defined as demand deposits, current accounts, and saving accounts. Purchased funds are more expensive and/or volatile sources of funds because they are highly rate sensitive –these funds are more likely to be immediately withdrawn or replaced as rates on competitive instruments change. Banks also list other liabilities that do not require interest to be paid. These items consist of accrued interest, deferred taxes, dividends payable, and minority interest in consolidated subsidies, and other miscellaneous claims.

2.1.8.2 Income Statements

Income statement shows the net result of the business operations. Banks have to be efficient to prove their viability depending upon their income generating power and cost minimizing strategy.

The income statement reflects the earning capacity of the bank. The success or failure of bank largely depends on the differences between income and expenditures. The major determining factor of bank's soundness is supposed to be a net income though there are other factors too are equally important. The success is the measure of the excess of income over expenditure while failure is the cause of the excess of income over expenditures over income. Interest income by nature should be sufficient to cover interest expenses plus other overhead costs of the bank's revenues and expenses. Revenues are the interest received from loan values supplied to the customers. Expenses are the paying interest to depositors. Generally, commercial banks earn profit by mobilizing deposits of the customers.

The major sources of bank income are interest-earning assets held by the bank such as loans, which generate interest income. Besides, commission and discount, exchange fluctuations gain, investment in securities, shares and debentures and other operating incomes and are sources of bank's income. Expenditures on the other hand are produced by interest bearing liabilities such as deposit liability. Moreover, staff expenses, exchange fluctuation loss, other operative expenses, interest on debentures and borrowings from other banks are sources of expenditures. The net interest income is defined as:

Net interest income (NI) = interest income-interest expenses.

2.2 Review of Related Thesis:

Dhakal, T.N. (2001) had conducted a study on a financial performance of Nepal SBI Bank Ltd and Nepal Indosuez Bank Ltd concluded that liquidity position of Nepal Indosuez Bank Ltd is comparatively better than that of Nepal SBI Bank Ltd. It has adopted aggressive lending investment and borrowing policy, which has generated more profit than NSBL. The researcher has recommended acting according to the government plans and policies on mobilizing their deposits in the productive sectors. The researcher has suggested stabilizing the cash and bank balance to total deposit ratio of both the banks after proper diagnosis of the root to the cause. The researcher based his study on overall financial performance of the banks. It was not particular on investment policy of the banks though the study has covered the deposit mobilization of these banks. For the purpose of the research study, the researcher had set the objectives i.e. to study on the limited five-year position of the two JVBs. The researcher had used descriptive research design based upon the secondary data. The researcher had used qualitative rather than quantitative analysis. Throughout the study the research was focused on investment practices and its impact on the practice among the bankers. However, the researcher was not clear on investment policy. The researcher only looked on the ground of the bank's side but his study was much more silent on the customer's point. It was truly

accepted that by investing on the priority sector, taking on consideration of the remote sector business, although it was less profitable but was sustainable for the overall country's development.

Oli, J.B. (2001) had conducted a study on a comparative study of the financial performance of Himalayan Bank Ltd, Nepal SBI Bank Ltd and Nepal Bangladesh Bank Ltd. The researcher found that the current ratio of HBL was below than normal standard 2:1 so HBL suggested increasing its current assets. The researcher suggested that the liquidity position of HBL, NSBL and NBBL were fluctuating and was not in satisfactory level. Therefore, the banks were suggested to keep the reasonable amount of liquidity so the bank should maintain their short-term solvency position. The capital structure of three JVBs was highly leveraged. The total debt to shareholders equity ratio has indicated that the use of debt by the three banks helped to enhance the rate of return on shareholder's fund. However, excessive use of debt in non-profitable business may cause solvency of these banks so these JVBs were suggested to maintain improved improper balance of total debt to shareholders equity and capital structure as required by increasing equity base. It has been recommended that to HBL it was required to sustain and enhance its provision for possible issues due to excessive loans and advances in order to prevent from the threat of insolvency. Profitability position of three JVBs was not found satisfactory but profitability position of HBL was comparatively better than the same of NSBL and NBBK. So NSBL and NBBL have been recommended to utilize their resources more efficiently for generating more profit margins. The major sources of income of three JVBs were from the interest income. NBBL has been investing more in government securities rather than investing loan and advances. So, NBBL is recommended to invest in the most earning assets like loan and advances. The researcher further suggested that the banks needed to minimize their operation expenses as far as possible since it contributes to enhance the volume of profit. The researcher finally recommended that banks should fulfill some social obligations by extending their resources to rural areas and promoting the development of poor and disadvantageous groups. In order to do so the banks should open their branches in remote areas with the objective of providing cheaper banking services.

Hence, this study was descriptive rather than analytical. The qualitative analysis might not be enough to present exact picture of the status of the banks. Further, the research was revolved around policy issued rather than practical issues. The analysis of financial performance aspect among the banks was a part of his research. Of course, his suggestions seem to be very worthy from the customer's point of views but his study is silent on the sustainability of the bank's ground.

Another study under taken by Sing, Ashok, K. (2003) on a brief study in resource utilization by Nepalese commercial Banks has concluded that banks were found inefficient in deposit utilization during seven years under study. Banks' branch expansion in rural sector was unsatisfactory. There was higher degree of positive correlation between expansion and collection of scattered savings and extension of credit by banks as well. Likewise, there was higher degree of positive co-relation between deposit collection and extension of credit by bank and there was a positive co-relation between interest rate and deposit collection. The researcher is silent about the lending diversification for the proper utilization of deposit as well as to minimize the risk.

Baral, K.J. (2005), has conducted a research and published his paper in the Journal of Nepalese Business Studies (Volume II No.1, December 2005) on health check-up of commercial banks in the framework of CAMEL, a case study of joint venture banks in Nepal. The paper examined the financial health of joint venture banks in the CAMEL framework for a period ranging from FY 2001 to FY 2004. Three joint venture commercial banks of Nepal were randomly selected for the study. The study was based on historical data disclosed by annual reports of commercial banks. It has covered four fiscal years' data for the purpose of study. The study was based entirely in the CAMEL framework.

Through the analysis of data, the researcher has diagnosed the health of sample joint venture banks.

Banks under study were well capitalized and they were complying with the directives of NRB on capital. Nevertheless, their capital base relative to the risk-weighted assets is not so strong. It uncovered further, non-performing assets of joint venture banks on the average is at satisfactory level, but they are far below the aggregate percentage of non-performing assets of commercial banks. The researcher has also concluded that management of NSBI is least efficient among sampled banks and SCBN has most efficient management. The profitability of NSBL is not so weak during the study period. Profitability of Nabil and SCB was better than the NSBI. Furthermore, the liquidity of joint venture banks was higher the industry average ratio. Thus, with a viewpoint of liquidity position, the health of joint venture banks is looked like a bit unhealthy.

Bhandari, S. (2006) has conducted a study on the financial performance of Himalayan Bank Ltd. (HBL) in the framework of CAMEL. The basic objective of this study was to analyze the financial performance of Himalayan Bank Ltd. (HBL) through CAMEL framework. The study has covered the period of 6 years from the F/Y 1999 to 2004. The researcher has used different financial tools in the study such as ratios like capital adequacy ratio, non- performing loan ratio, loan loss ratio, total

expenses to total income ratio, and return on equity, return on assets, net interest margin, earning per share total liquid fund to total deposit ratio, NRB Balance to total deposit ratio, cash in vault to total deposit ratio, and other financial tools like average, standard deviation, coefficient of variation, least square trend analysis.

The major findings of this study are; the capital adequacy ratio of the bank was above the NRB standard in all the years except in year 2004 i.e. insufficient of capital in that year however, it was found that the core capital adequacy ratio of HBL adequate and sufficient. The supplementary capital ratio was with in the boundary of NRB standard during the period of past six years. The non-performing loan to total loans and advances ratios for the study period was in decreasing trend but it was not sufficient in banking industry. The slope of the trend line of loan loss ratio was high this showed that the loan loss provision was increasing rapidly. The return on equity ratio of the bank during study period was above the 15 percent benchmark so this showed that the bank's ratio was better but was in decreasing tendency. The net interest margin ratio of the bank was above the benchmark of 3 to 4 percent and above, so the bank's ratio was higher but in declining tendency. The EPS of the bank has been fluctuated over the years of the study period. The bank's liquidity position was better than that of the industry average. NRB balance to total deposit ratio of HBL was below the industry average ratio in each year during the study period. This has indicated that the bank has not strictly following the directives issued by NRB in respect to balance must be hold in NRB. Vault to deposit ratio of HBL during the study period was below the industry average. This has implied that the bank was not strictly following the directives issued by NRB in respect to balance must hold as vault.

The researcher has concluded that capital adequacy ratios revealed that the bank was running with the adequate capital and the capital fund of the banks was sound and sufficient to meet the banking operation as per the NRB standard except in the year 2004 during the study period. The core capital adequacy ratio and supplementary capital ratio were in the boundary of NRB standard. The researcher further concluded that the assets composition of the bank during the study period revealed that movement of money at call was observed in switch over in to investment during the last three years. The decreasing trend of non-performing loans and advances ratio showed that the bank was aware of non-performing loans and adopting the appropriate policies to manage this problem and to increase the quality of asset. Whereas the increasing trend of loan loss ratio indicated that the quality of loans was degrading year by year. The decreasing trend of total revenues ratios has positively affected in profitability. The decreasing trend of return on equity showed that the rate of return flowing to the bank's shareholders was degrading year by year. Capability of management to

converting the bank's assets into net earning was declining. The researcher further concluded that the decreasing trend of earnings per share was the implication of low return flowing to the bank's owner. The liquid funds to total deposit ratio was above the industrial average which showed that there was very high proportion of liquid funds than the proportion of investment in income generating assets and shows lack of specific policy of increasing additional idle funds to high income generating assets in the form of investment. The researcher also concluded that the bank was not maintaining the sufficient balance at NRB during the study period and the bank was running with the inadequate liquidity to meet its short-term obligations.

The researcher has recommended maintaining stable capital adequacy ratios in the bank and strictly following the NRB directives. It was also recommended that the bank has to give more attention to decrease the level of NPA to meet the international standards. Further it was recommended to lower the proportion of loan loss provision by increasing the quality assets by strengthening the credit appraisal and follow-up measures. The researcher has also recommended that the bank should increase the profit by minimizing the operating cost and enhancing the operating efficiencies of the employees. The researcher has also recommended that the bank should look upon new area of lending and investment that helps in minimizing the idle funds otherwise this may impact the profitability negatively.

The research is quite descriptive than practical. Besides, the researcher has not mentioned all the ratios which are must for CAMEL analysis. I could not find the ratios like earning per employee, net spread etc. I have tried to overcome those lacking in my study.

Chand, D. (2006), has conducted a study on financial performance analysis of Nabil Bank Ltd in the framework of CAMELS with the objective to analyze the financial condition of NABIL Bank Ltd. It has covered 5 years data starting from Fiscal Year 2000/2001 to 2004/2005. The analysis revealed that the bank is running with adequate capital and the capital fund of the bank is sound and sufficient to meet the banking operation as per NRB standard. The bank has placed efficient credit management and recovery efforts of good quality loans are increasing. Further, it seems that amount default associated in loans will decrease in future. The management decisions related to operation and investment have assisted in controlling control and recovery of bad debt. The management has been able to control the interest spread and cost effective sources of funds. This has helped the bank in increasing the market strength. The liquid assets to total deposit ratio is above the industrial average ratio. The bank has able to match the risk sensitive assets to risk sensitive liabilities in long term maturity bucket and therefore interest rate changes has no affect on them.

Gautam. M (2007) has conducted a study on the financial performance of SBI Bank Ltd (SBL) in the framework of CAMEL. The basic objective of this study was to analyze the financial performance of SBI Bank Ltd (SBL) through CAMEL framework. The study has covered the period of 6 years from the F/Y 2001 to 2006. The researcher has used different financial tools in the study such as ratios like capital adequacy ratio, non- performing loan ratio, loan loss ratio, total expenses to total income ratio, and return on equity, return on assets, net interest margin, earning per share total liquid fund to total deposit ratio, NRB Balance to total deposit ratio, cash in vault to total deposit ratio.

The major findings of this study are; the capital adequacy ratio of the bank was below the NRB standard in the FY 2001 & 2005, and excess in rest of the FYs of the study period. The core capital adequacy ratio is above the NRB standard in the entire study period. The supplementary capital ratio was with in the boundary of NRB standard during the period of past six years. The ratio of past due loan to total loan of NSBL showed that the quality of assets is satisfactory except in 2001 from the perspectives of NPAs, though it is remarkably high than the contemporary successful banks of Nepal. The ratio of provision for substandard loan to total substandard loan has fluctuated in the study period and has not met the standard as prescribed by NRB. The ratio of total expenses to total income is in decreasing trend which indicates that the bank has decreasing expenses with respect to income. The earning per employee of the bank is in increasing trend except in 2005. The increased earning per employee reflects efficiency of staffs as well as good management quality. The ratio of net income after tax to total assets can be considered as satisfactory level of income comparing with the total assets of the bank. The increased ratio of net earning after tax to core capital shows that bank is towards the progress in satisfactory level of income compared to its core capital.
Net spread above 2 percent revealed the bank has maintained strong position regarding the net spread. The loan to deposit ratio of the bank shows that the bank has maintained reasonable liquid position of its fund.

The researcher has concluded that the bank should maintain total risk based capital adequacy ratio as per NRB requirements. The bank should aggressively recover its outstanding loan, as its NPA is a bit higher than the contemporary banks. Hence the bank should strengthen the quality of loan by giving serious attention in credit appraisal, follow up and disbursement of loan. The Bank should maintain adequate provision for substandard loan, doubtful loan and loss loan in all the time as prescribed by NRB. The bank should increase its income and reduce the expenses since its income compared to the total assets and total core capital is not strong .The bank should raise its net interest margin furthermore by raising its interest income and reducing the interest expenses. The high cost of fund brings the net interest margin down. The liquidity position maintained by the Bank at NRB

seems higher hence, it is recommended to maintain only optimum level of fund in NRB account and vault as they don't generate income.

Although various studies have been carried out, regarding financial performance analysis of banks and other financial institutions in Nepalese context, those studies mainly focused on liquidity, leverage and profitability of the banks. The financial performance analysis done in the past lack the analyses in the framework of CAMEL, a new technique of assessing financial performance of the banks. However very few studies have been done applying this technique, they also lack thorough study using appropriate models. This study attempts to analyze the financial performance of NIC Bank Ltd in the framework of CAMELS using appropriate models.

Chapter - III

RESEARCH METHODOLOGY

This chapter provides the overall framework or plan for the collection, analysis and presentation of data required to fulfill the objectives of the study. Objective of using different tools and techniques for the analysis and presentation as well as is to answer the research questions as explained under this section. It includes the type of information to be collected and sources of the information for the study purpose. Research methodology refers to the various sequential steps (along with a rational on each such steps) to be adopted by a researcher in studying a problem with certain object in view. To meet the objectives, the methodologies applied in the study are described below:

3.1 Research Design

Research design is the task of defining the research problem. A research design is the arrangement of conditions, for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Wolf, H.K., and P.R. Pant, 2002). In fact the research design is the conceptual structure within which the research is conducted. This research study aims at portraying accurately on the financial performance of NIC Bank Ltd. Therefore, a case study analytical research design is used for the study purpose to achieve the desired end. The study period covers six fiscal years starting from 2003 AD to 2008 AD.

3.2Sources and Nature of Data

This study is mainly based on secondary data. The data used in the study are taken from the annual reports of the bank and publications of Nepal Rastra Bank.

3.3 Selection of Study Unit

The population of the study consists of all the commercial banks of Nepal. Hence, commercial banks, which are operated, now in Nepal comprise the population where as a single bank NIC Bank Ltd (NICBL) is taken for the study unit, as it is a case study. NICBL is selected as study unit due to the following distinct attached with the bank.

1. It is the first commercial bank in the country to be capitalized at NPR 500 Million.
2. The Bank is the first commercial Bank in Nepal to have received ISO 9001:2000 certification

for quality management system.

3. NIC Bank became the 1st Bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its Global Trade Finance Program, enabling the Bank's Letter of Credit and Guarantee to be accepted/ confirmed by more than 200 banks worldwide.
4. The Bank had also been awarded the "Bank of the Year 2007-Nepal" by the world-renowned financial publication of The Financial Times, U.K.-The Banker.

Besides, I had worked in this bank for four years so my association with this bank inspired me to carry out its performance analysis.

3.4 Data Collection Procedure

As the study is based mainly on the secondary data, required facts and figures have been obtained from the annual reports collected from the corporate office of the bank. Data have also been obtained browsing the official web sites of NRB and Security Board of Nepal.

3.5 Data Processing Procedures

Firstly, data were extracted from the annual reports of the bank and put them in a sheet. Then data were entered into the spreadsheet to work out the financial ratios and prepare necessary figures, according to the need and requirement of this study. For this purpose, gathered data have been processed using computer programs like Microsoft Excel and Word.

3.6 Method of Data Analysis

Only descriptive tools are used to get the meaningful result of the collected data and to meet the research objectives. Collected data are tabulated under various heads. Then the tabulated data are analyzed using various financial tools which are briefly discussed below:

3.6.1Financial Tools

3.6.1.1 Capital Adequacy

1) Risk Based Capital Adequacy Ratio:

Risk based capital ratio can be defined as the numerical expression of total capital fund to total risk adjusted assets. It measures the adequacy of capital. Risk based capital ratio is used to measure the adequacy of capital in the banks, which is determined in the following way:

$$CAR = \frac{\text{Total Capital Fund}}{\text{Total Risk Adjusted Assets}} x100$$

Where,

CAR= Capital Adequacy Ratio

Total Capital Fund = (Core capital + supplementary capital)

Total Risk Adjusted Assets = (On-balance sheet risk adjusted assets + Off-balance sheet risk adjusted assets)

2) Risk Based Core Capital Adequacy Ratio:

Core capital adequacy ratio is the expression of numerical relationship between the total core capital and total risk adjusted assets. It measures the adequacy of core capital. The ratio is expressed as:

$$CCAR = \frac{\text{Core Capital}}{\text{Total Risk Adjusted Assets}} x100$$

Where,

CCAR = Core Capital Adequacy Ratio

Core Capital = (paid-up capital + share premium + non-redeemable preference share + general reserve + cumulative profit)

3) Risk Based Supplementary Capital Ratio:

Supplementary capital ratio is the expression of numerical relationship between supplementary capital and total risk adjusted assets of a bank. It measures the proportion of supplementary capital in total risk adjusted assets. The ratio is used to analyze the supplementary capital adequacy of the banks and determined in the given way:

$$SCR = \frac{\text{Supplementary Capital}}{\text{Total Risk Adjusted Assets}} x100$$

Where,

SCR = Supplementary Capital Ratio

Supplementary Capital =
(Loan loss provision + exchange equalization reserve + assets revaluation reserve

+ hybrid capital instrument +unsecured sub-ordinate term debt + interest rate fluctuation fund + other free reserves).

3.6.1.2 Assets Quality

The following ratios are used to assess the quality of assets of the bank:

1) Past Due Loans to Total Loans:

This is the ratio which expresses the relationship between past due loans and total loans and advances of the bank. Lesser the portion of past due loans in total loans can be regarded as the better assets quality. This relationship can be measured by using the following relation:

$$\text{Past Due Loans / Total loans} = \frac{\text{Past Due Loans}}{\text{Total Loans}} x100$$

2) Loans Classified as Substandard, Doubtful or Loss to Total Loans:

The ratio of substandard, doubtful and loss loans to total loans indicates the relationship between the substandard loans to total loans, doubtful loans to total loans and loss loans to total loans. It shows the percentage of substandard, doubtful and loss loans to total loans. The lesser

the percentage the better would be the quality of assets. It is worked out using the following relation:

Loans Classified as Substandard, Doubtful or Loss/ Total Loans

$$= \frac{\text{Total Sub - standard, Doubtful or Loss Loan}}{\text{Total Loans}} \text{ x100}$$

3) Provisioning for Substandard Loans to Total Substandard Loans:

Provisioning for substandard loans to total substandard loans ratio is the expression of numerical relationship between loan loss provisions for substandard loans to total substandard loans. It measures the proportion of substandard loans to total substandard loans. The percentage of provision for substandard loans to total substandard loans is 25% according to NRB directives. This ratio can be calculated by using following formula:

Provisioning for Substandard Loans to Total Substandard Loans

$$= \frac{\text{Provision for Sub - standard Loan}}{\text{Total Sub - standard Loans}} \text{ x100}$$

4) Provision for Doubtful Loans to Total Doubtful Loans:

Provision for doubtful loans to total doubtful loans is the expression of numerical relationship between loan loss provisions for doubtful loans to total doubtful loans. The proportion of provision for doubtful loans to total doubtful loans, according to NRB, should be at least 50%. This ratio can be calculated using following relation:

Provision for Doubtful Loans to Total Doubtful Loans =

$$\frac{\text{Provision for Doubtful Loans}}{\text{Total Doubtful Loans}} \text{ x100}$$

5) Provisioning for Loss Loans to Total Loss Loans:

Provisioning for loss loans to total loss loans is the expression of numerical relationship between loan loss provisions for loss loans to total loss loans. The proportion of provision for loss loans to total loss loans, according to NRB, should be at least 100%. This ratio can be calculated by using following model:

Provisioning for Loss Loans to Total Loss Loans =

$$\frac{\text{Provision for Loss Loans}}{\text{Total Loss Loans}} \text{ x100}$$

6) Total Loans to a Single Borrower to Core Capital:

The total loan to a single borrower to core capital is the expression of numerical relationship between total loans to a single Borrower and core capital. It measures the proportion of total loans to a single Borrower in core capital of the bank. The lesser the percentage of this ratio can be considered as good assets quality. The following expression is used to calculate this ratio:

Total Loans to a Single Borrower to Core Capital

$$= \frac{\text{Total Loans to a Single Borrower}}{\text{Core Capita}} \mid 100$$

3.6.1.3 Management Soundness

The following ratios can be used to determine the efficiency of bank's management:

1) Total Expenses to Total Incomes Ratio:

The total expenses to total incomes ratio is the expression of numerical relationship between total expenses and total incomes of the bank. It measures the proportion of total expenses to total incomes. It can be calculated using the following model:

$$\text{Total Expenses to Total Incomes Ratio} = \frac{\text{Total Expenses}}{\text{Total Incomes}} \text{ x100}$$

2) Earning Per Employee:

Earning per employee is the numerical relationship between net profit after taxes to total numbers of employees. Low or decreasing earnings per employee can reflect inefficiencies as a result of overstaffing in terms of profitability(IMF, 2000). It is calculated using the following model:

$$\text{Earning Per Employee} = \frac{\text{Net Profit After Taxes}}{\text{Total Number of Employees}}$$

3.6.1.4 Earnings

The following ratios can be used to assess the quality of the bank's earnings:

1) Net Income (after tax) to Total Assets:

The ratio of net income (after tax) to total assets is the expression of numerical relationship between net income and total assets. It is used to measure the quality of bank's earning in comparison to the assets employed. The following model can be used for the calculation of this ratio:

$$\text{Net Income (after tax) to Total Assets} = \frac{\text{Net Income (after tax)}}{\text{Total Assets}} \text{x}100$$

2) Net Earnings (after tax) to Core Capital:

Net earning after tax to core capital shows the relationship between net earnings after tax to core capital of the bank. It measures the proportion of earnings to the core capital. Minimum of 8% of this ratio can be considered as satisfactory. The following mode can be used to calculate this ratio:

$$\text{Net Earnings (after tax)/ Core Capital} = \frac{\text{Net Income (after tax)}}{\text{Core Cpital}} \text{x}100$$

3) Net Spread:

Net spread is the expression of numerical relationship of difference between interest earned on interest earning assets and interest paid on interest bearing liabilities. Minimum of 2 %and above of this ratio can be considered as strong. The following model is used to calculate this ratio:

$$\text{Net Spread} = \frac{\text{Interest Earned}}{\text{Interest Earned/Interest Earning Assests - Interest Paid/ Interest Bearing Liability}} \text{x}100$$

4) Net Interest Margin:

Net interest margin indicates the relationship between the difference of interest income and interest expenses to total assets. At least 4% of this ratio can be considered as fair. It can be calculated by using following ratio:

$$\text{Net Interest Margin} = \frac{\text{Interest Income - Interest Expense}}{\text{Total Assets}} \text{x100}$$

3.6.1.5 Liquidity

The following ratios can be used to assess the liquidity of the bank:

1) Loan to Deposit Ratio: Loan to deposit ratio is the proportion of total loans and advances (before deduction of loan loss reserve) to total deposit. It can be calculated using following model:

$$\text{Loan to Total Deposit Ratio} = \frac{\text{Total Loan and Advances}}{\text{Total Deposit}} \text{x100}$$

2) NRB Balance to Total Deposit Ratio: NRB balance to total deposit ratio is the expression of numerical relationship between NRB balance and total deposits of a bank. It measures the adequacy of NRB balance held by the bank. It can be calculated using following model:

$$\text{NRB Balance to Total Deposit Ratio} = \frac{\text{Total NRB Balance}}{\text{Total Deposit}} \text{x100}$$

3) Cash in Vault to Total Deposit Ratio: Cash in vault to total deposits ratio is derived dividing total cash in vault by total deposit of the bank. It shows the percentage of total deposit maintained in vault of the bank. It can be calculated by using following model:

$$\text{Cash in Vault to Total Deposit Ratio} = \frac{\text{Total Cash in Vault}}{\text{Total Deposit}} \text{x100}$$

Sources :

NRB, (2005,2006,2007)[2]

Vanhorne, J.C. (2003)[3]

Weston, J.F., and Copeland, T.E. (1992)[4]

World Bank. (1996)[5]

Kuchhal, S.C. (1980)[6]

Cantor, R. (2001)[7]

3.7 Limitations of the Methodology

The study is based on secondary data obtained from annual reports and financial results published by the bank. As this study is a case study, different tools used to analyze the collected data are based on certain assumptions, which may not also be considered as absolute. Hence, the reliability of the analysis depends upon the circumstances on which the models are based.

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

4.1.1 Data Presentation and Analysis

This chapter deals with presentation and analysis of data collected from annual reports of the bank. The raw data collected has been organized and processed using various tools discussed in the previous chapter-"Research Methodology". In this chapter, data and information are presented and analyzed using different financial and statistical tools in order to achieve the objectives of the study. In data presentation and analysis, the study is focused on CAMELS components.

4.1.1 Capital Adequacy

Capital adequacy determines how well banks can manage with shocks to their balance sheets. For the purpose of capital adequacy measurement, bank capital is divided into Tier I (core/primary) capital and Tier II (supplementary) capital. Risk based capital ratio, core capital adequacy ratio, supplementary capital ratio, past due loans/total loans, total loans to a single Borrower/ total loans, total loans to a single Borrower/ core capital & actual provisioning to required provisioning are the ratios used to analyze the capital adequacy ratio.

Commercial bank should have adequate capital to support its risks assets in accordance with the risk-weighted capital ratio framework. It has become recognized that capital adequacy more appropriately relates to assets structure than to the volume of liabilities. Adequacy and inadequacy of bank capital directly affects the banking transaction. The adequacy of bank capital is the most important aspect of a bank. If there is inadequacy of capital, the bank should take step for the adequacy of capital as per legal requirement because its financial health can't be regarded capable and healthy without having adequate capital.

4.1.1.1 Analysis of Capital Adequacy Ratio

Capital adequacy ratio is the measure of financial strength of a commercial bank. Specifically, the capital adequacy ratio measures the adequacy of capital for smooth operation of a bank. A bank should maintain adequate capital ratio as set by NRB. NRB has fixed a minimum standard of capital

adequacy ratio of 10 percent in 2003 & 2004 and 11 percent from 2005 to till 2008. It is measured as the ratio of total capital fund to total risk adjusted assets of the bank.

Table 4.1 shows the capital adequacy ratio of the bank. As per the NRB guidelines, capital adequacy ratio is sufficient during the entire study period.

Table 4.1

Capital Adequacy Ratio

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Capital Fund	594.51	656.36	730.99	1,036.84	1,208.61	1,615.72
Total Risk Based Assets	3,149.74	4,772.64	5,501.94	7,656.13	9,905.04	12,321.13
Risk Based Capital Ratio %	18.87%	13.75%	13.29%	13.54%	12.20%	13.11%
NRB Standard %	10%	10%	11%	11%	11%	11%
Excess/ Short	8.87%	3.75%	2.29%	2.54%	1.20%	2.11%

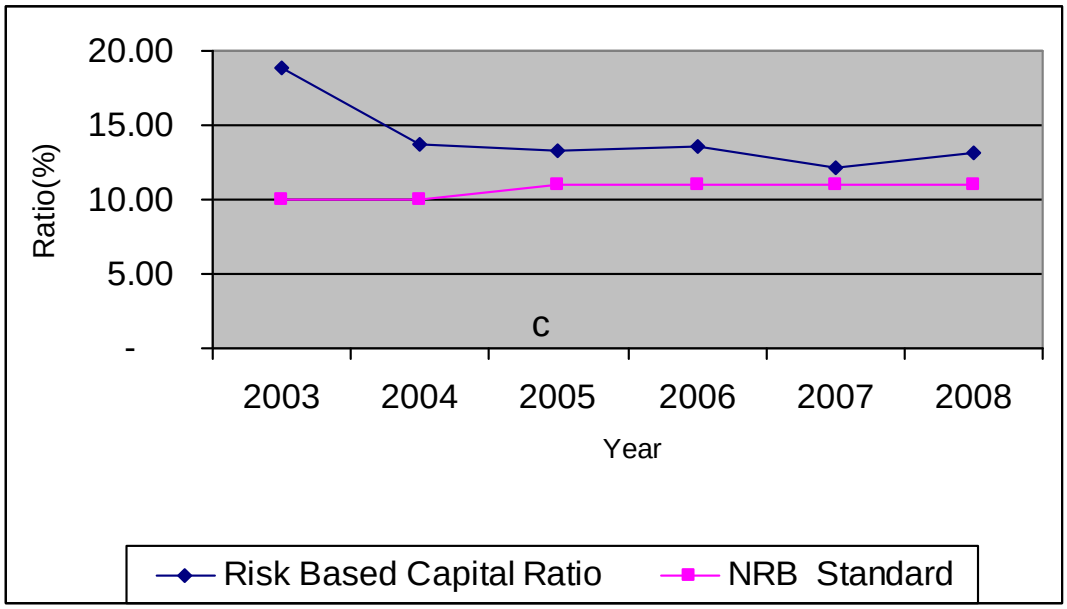
Source: NICBL, Annual Reports

Both the capital fund & risk based assets of the bank is in increasing trend. The risk based capital ratio of the bank is always excess than NRB standard.

Figure 4.1

Capital Adequacy Ratio

Fig.4.1: Comparing Risk Based Capital Adequacy Ratio with NRB Standard



As shown in fig. 4.1, the risk based capital adequacy ratio of NICBL is above NRB standard in the all the year covered by the study. Hence, NICBL has strictly followed the NRB directives and its capital adequacy requirements.

4.1.1.2 Core Capital Adequacy Ratio

Core capital is the primary capital of the bank. It is the most permanent source of capital and includes paid-up capital, share premium, non-redeemable preference share, general reserves, accumulated profit and loss amount and goodwill deductible if any. Thus, core capital is the amount of shareholders' fund. Core capital adequacy ratio is calculated as a percentage of total core capital to risk based assets of the bank. NRB has set the minimum standard of 5% in 2003 & 2004 and 5.5% from 2005 to till date.

Table 4.2

Core Capital Adequacy Ratio

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Core Capital	549.43	616.78	680.14	761.13	911.81	1,293.75
Total Risk Based Assets	3,149.74	4772.64	5,501.94	7,656.13	9,905.04	12,321.13
Risk Based Core Capital	17.44%	12.92%	12.36%	9.94%	9.21%	10.50%
NRB Standard %	5.00%	5.00%	5.50%	5.50%	5.50%	5.50%
Excess (Short)	12.44%	7.92%	6.86%	4.44%	3.71%	5.00%

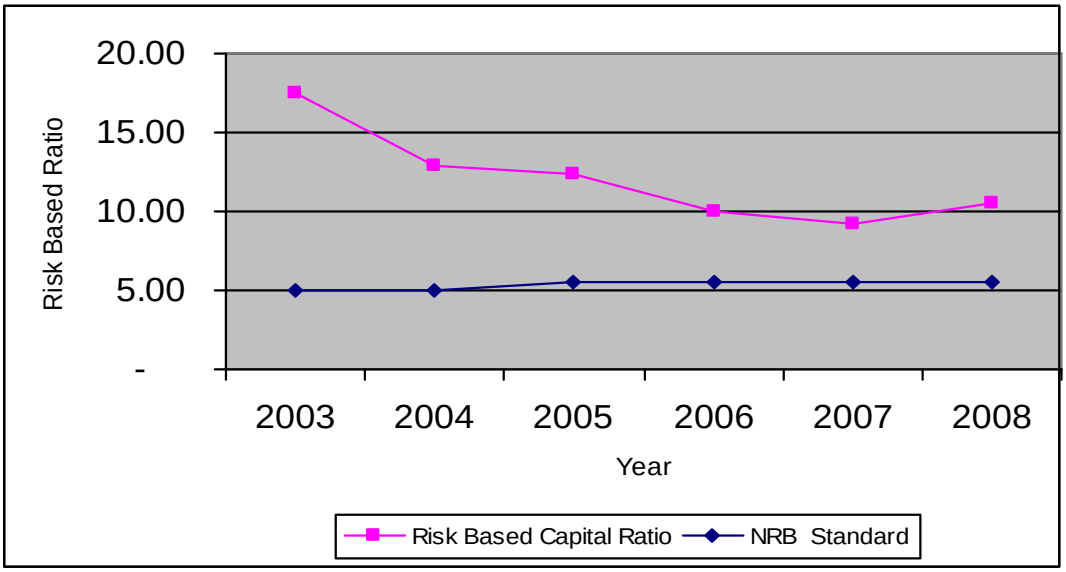
Source: NICBL, Annual Reports

Table 4.2 shows the relationship between core capitals to total risk adjusted assets of the bank. The core capital of the bank has increased from 549.43 million to 1293.75 million in the study period. Thus, the ratio of risk based core capital is in increasing trend meeting the NRB standard throughout the study period. The risk based core capital is maximum in the year 2003 i.e. 17.44%. Then it has decreased in the following year till 2007 and again increased to 10.50% in the year 2008. Nevertheless, there is an excess in the ratio of risk based core capital compared with the NRB standard in the study period.

Figure 4.2

Core Capital Adequacy Ratio

Comparing Risk Based Core Capital Adequacy Ratio with NRB Standard



As per Fig. 4.2, the difference between risk adjusted core capital adequacy ratio of NICBL & NRB is the highest in the year 2003 i.e. 12.44 % and declined gradually decreased up to 2007. However, it has again increased in the year 2008 making the difference of 5%. Thus, the risk adjusted core capital adequacy ratio of NICBL is adequate as prescribed by NRB.

4.1.1.3 Supplementary Capital Adequacy Ratio

Supplementary Capital is regarded as supplemental to core capital because it cannot provide the same degree of permanence as a core capital cushion. It is the amount of capital that is transferred in reserve and collected using the hybrid capital instruments. It includes loan loss provision, exchange equalization reserve, assets revaluation reserve, hybrid capital instruments, unsecured sub-ordinate term debt, interest rate fluctuation fund and other free reserves. NRB has set a standard of supplementary capital to be maintained by the commercial banks as not more than the core capital of the bank.

Table 4.3

Supplementary Capital Adequacy Ratio:

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Supplementary Capital	45.09	39.58	50.84	275.71	296.80	321.97
Total Risk Based Assets	3,149.74	4,772.64	5,501.94	7,656.13	9,905.04	12,321.13
Risk Based Supplementary Capital Ratio %	1.43%	0.83%	0.92%	3.60%	3.00%	2.61%
NRB Standard % (not more than core capital)	5%	5%	5.5%	5.5%	5.5%	5.5%
Excess/ Short	-3.57%	-4.17%	-4.58%	-1.90%	-2.50%	-2.89%

Source: NICBL, Annual Reports

Table 4.3 presents the supplementary capital ratio of the bank during the study period. As shown in table, the supplementary capital ratio of the bank ranges from a minimum of 0.83% in FY 2004 to 3.60 percent in the FY 2006. The ratio of the bank has decreased in the first year and has increased in second and third year. However, the ratio has decreased thereafter. The decreasing ratio of supplementary capital implies that the portion of supplementary capital in total risk based assets of the bank is decreasing. NRB has set the standard that supplementary capital to be maintained by commercial banks should not exceed the core capital of the bank. The above figure shows that NICBL has met the standard set by NRB through out the study period.

Figure 4.3

Comparing Supplementary Capital Adequacy Ratio with NRB standard

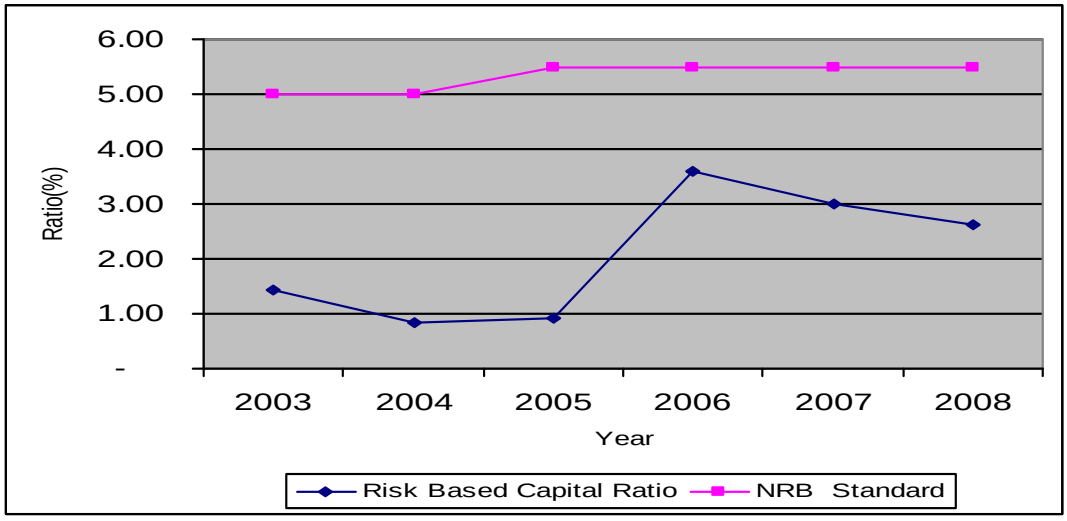


Fig. 4.3 shows the supplementary capital adequacy ratio of the bank is within the boundary of NRB through out the study period.

4.1.2 Assets Quality

Loans and advances dominate the asset side of the balance sheet of the banks. Similarly earning from such loans and advances occupy a major space in income statement of the bank. Hence, asset is the critical factor in determining the strength of any bank. Primary factors that can be considered are the quality of loan portfolio, mix of risk assets and credit administration system. The quality of assets are measured in terms of ratio of past due loans to total loans and loan classified as substandard/doubtful/loss to total loans. Provisions made for NPAs and loan provided to single Borrower are the measuring rods used to analyze the assets quality of the bank

4.1.2.1 Ratio of Past Due Loan to Total Loan

Table 4.4

Past Due Loans to Total Loans

(Rs. in million)

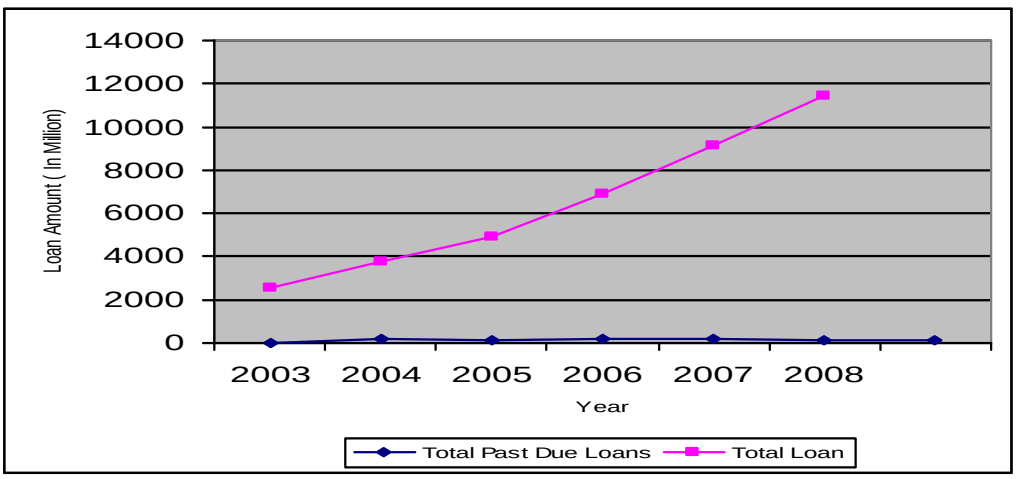
Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Past Due Loan	171	147	185	180	101	98
Total Loan	2563	3743	4909	6902	9129	11465
Ratio of Past Due Loan to Total Loan	7%	4%	4%	3%	1%	1%

Source: NICBL, Annual Reports

The above figures are shown in the graph as follows:

Figure 4.4

Past Due Loans to Total Loans:



In Table 4.4 the ratio of past due loan to total loan is presented. The total loan of the bank has gone up throughout the study period. Whereas the portion of the total past due loan in total loan is decreasing. The ratio of past due loan to total loan was 7 percent in the year 2003, and it has decreased to 1% in the year 2007 & 2008. This shows that the asset quality of the bank is good as indicated by this ratio.

4.1.2.2 Ratio of Loans Classified as Substandard, Doubtful or Loss to Total Loans

Table 4.5 exhibits the ratio of substandard loan to total loan, doubtful loan to total loan and loss loan to total loan. The percentage of substandard loan to total loan ranges from 1.55 percent to 0.02 percent in the study period. However, it has significantly decreased to 0.02 percent in the year 2004 as compared to 1.55 percent in 2003. However, it increased in the year 2005 and again decreased in the year 2006 and thereafter it is in increasing trend. However, the percentage of substandard loan to total loan is below 5 percent throughout the study period implies that the quality of loan is strong.

Table 4.5 Substandard/Doubtful/Loss Loan to Total Loan

(Rs. in million)

Year	Total Loan	Total Substandard loan	Percentage of Substandard Loan to Total Loan	Total Doubtful Loan	Percentage of Doubtful Loan to Total Loan	Total Loss Loan	% of Loss Loan to Total Loan
2003	2,562.86	39.77	1.55	60.00	2.34	70.93	2.77
2004	3,743.09	0.68	0.02	0.19	0.01	145.72	3.89
2005	4,909.36	45.97	0.94	11.39	0.23	128.07	2.61
2006	6,902.12	0.65	0.01	7.86	0.11	171.04	2.48
2007	9,128.65	6.13	0.07	0.93	0.01	94.08	1.03
2008	11,465.33	9.63	0.08	11.76	0.10	76.77	0.67

Source: *NICBL, Annual Reports*

The percentage of doubtful loan to total loan ranges from maximum of 2.34 percent in the year 2003 to a minimum of 0.01 percent in 2004 & 2007. Though percentage of doubtful loan to total loan is fluctuating, it is below the 5 percent in all the study period which can be considered as the quality of loan being strong.

Percentage of loss loan to total loan is fluctuated in the study period. It ranges from minimum of 0.67 percent in the year 2008 to maximum of 3.89 percent in 2004. Though the percentage of loss

loan to total loan had increased in the year 2004 as compared to 2003, it is continuously decreasing thereafter. This shows the quality of assets is being strong as it is below 5 percent in during the study period.

4.1.2.3 Ratio of Provision for Substandard Loan to Total Substandard Loan

Table 4.6 exhibits the ratio of provision for substandard loan to total substandard loan. This shows that bank has made adequate provision as per NRB guidelines. As per the NRB guidelines, provision for substandard loan should be at least 25 percent of the total substandard loan.

Table 4.6

Provision for Substandard Loan to Total Substandard Loan

(Rs. in million)

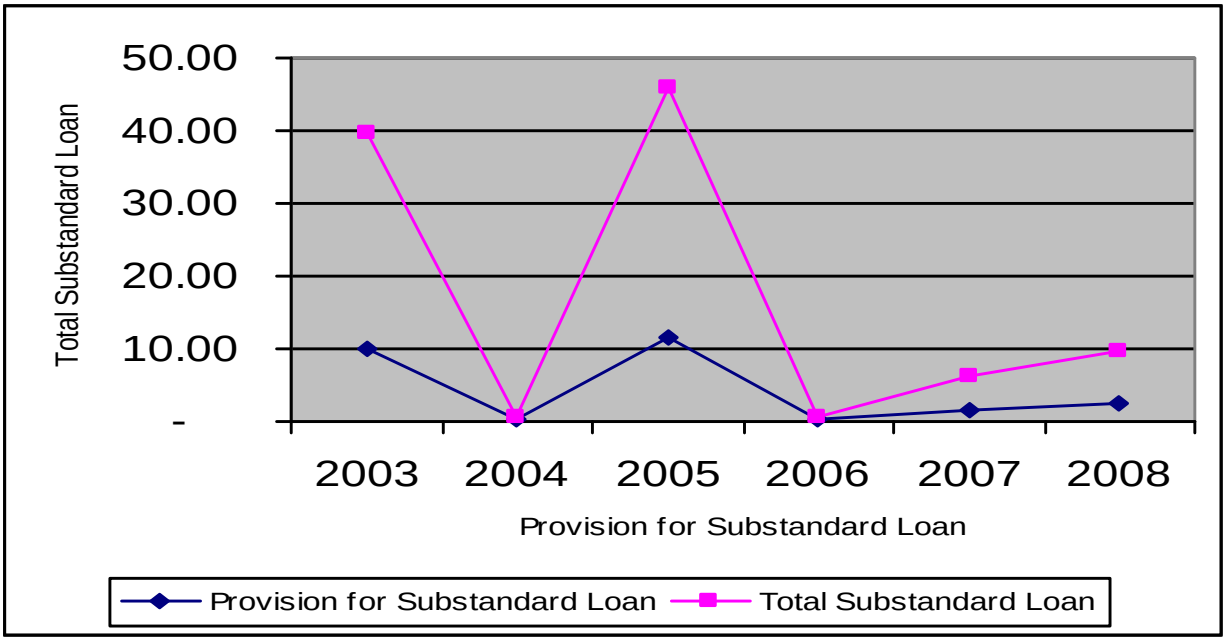
Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Provision for Substandard Loan	9.94	0.17	11.49	0.16	1.53	2.41
Total Substandard Loan	39.77	0.68	45.97	0.65	6.13	9.63
Ratio of Provision of Substandard Loan to Total Substandard Loan	25%	25%	25%	25%	25%	25%

Source: NICBL, Annual Reports

The above presentation is shown in the chart as follows:

Figure 4.5

Provision for Sub Standard Loan to total Sub Standard



4.1.2.4 Ratio of Provision for Doubtful Loan to Total Loan :

Table 4.7 shows that the ratio of provision for the doubtful loan to total doubtful loan. As per the table, the bank has made adequate provision as per NRB guidelines. As per NRB guidelines, provision for doubtful loan should be at least 50 percent of the total doubtful loan.

Table 4.7

Provision for Doubtful Loan to Total Doubtful Loan

(Rs. in million)

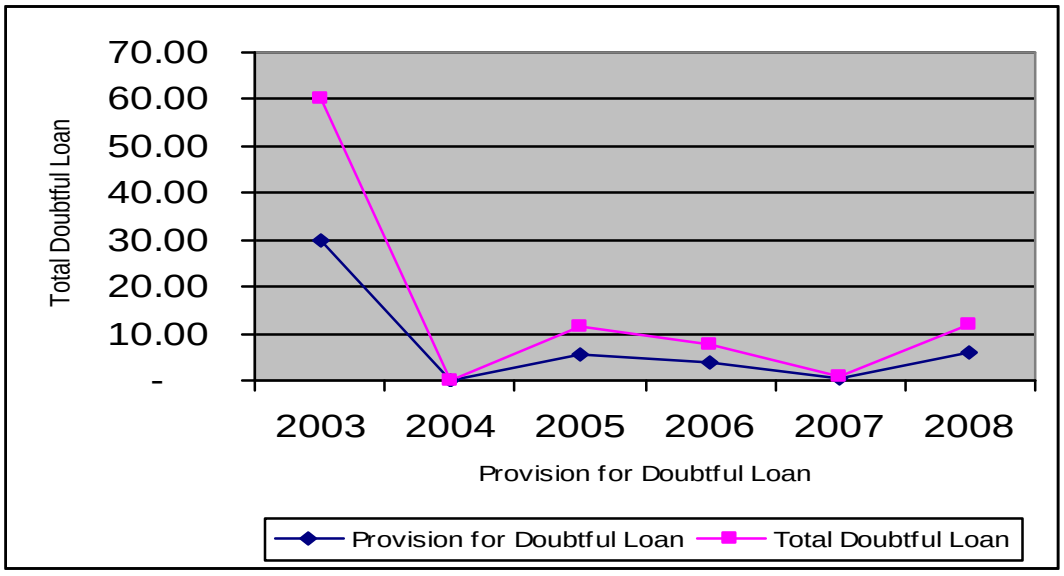
Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Provision for Doubtful Loan	30	0.10	5.69	3.93	0.46	5.88
Total Doubtful Loan	60	0.19	11.39	7.86	0.93	11.76
Ratio of Doubtful Loan to Total Doubtful Loan	50%	50%	50%	50%	50%	50%

Source: *NICBL, Annual Reports*

The above presentation is shown in the chart as follows:

Figure 4.6

Provision for Doubtful Loan to Total Doubtful Loan



4.1.2.5 Ratio of Provision of Loss Loan to Total Loss Loan:

Table 4.8 exhibits the ratio of provision for loss loan to total loss loan. As per the NRB directives, bank has t make provisioning of 100 percent for loss loan. The bank has made provisioning for loan loss of 100 percen during the entire study period.

Table 4.8

Provision for Loss Loan to Total Loss Loan

(Rs. in million)

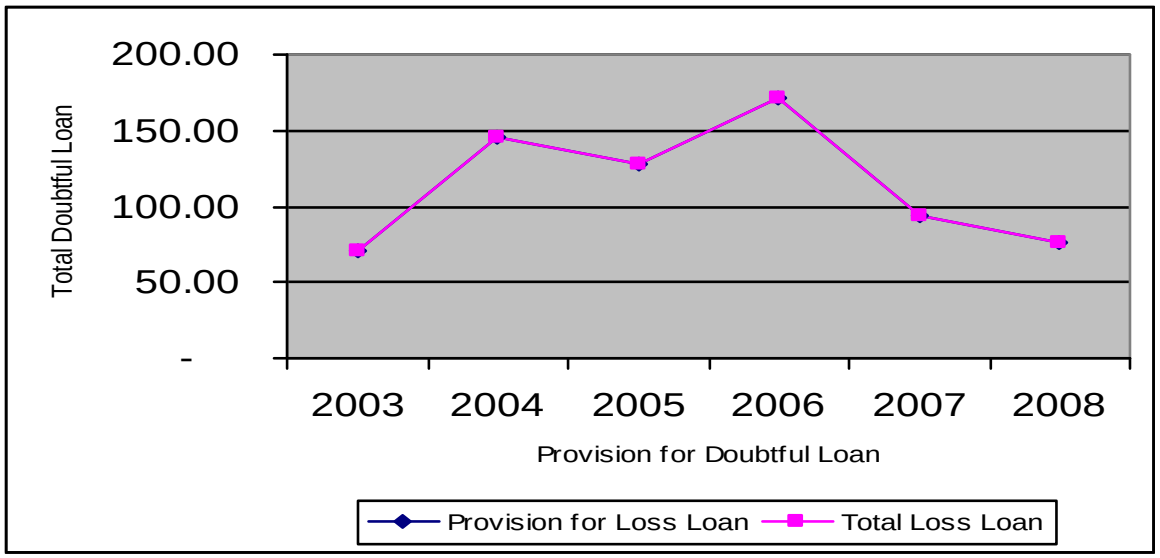
Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Provision for Loss Loan	70.93	145.72	128.07	171.04	94.08	76.77
Total Loss Loan	70.93	145.72	128.07	171.04	94.08	76.77
Ratio of Loss Loan to Total Loss Loan	100%	100%	100%	100%	100%	100%

Source: *NICBL, Annual Reports*

The above presentation is shown in the chart as follows:

Figure 4.7

Provision for Loss Loan to Total Loss Loan



4.1.3 Management Soundness:

Sound management is a key to financial institutions' performance. Although several indicators can be used as proxies for the soundness of management, such evaluation is still primarily a qualitative exercise, particularly when it comes to the evaluation of the management of operational risk, that is,

the functioning of internal control systems. The productivity of employees is used as a measuring rod for evaluation. Like wise sustainability of earning shows the efficiency of management.

Expenses ratio and earning per employee are the ratios used as proxy of the management quality. A high or increasing ratio of expenses to total revenues can indicate that financial institutions may not be operating efficiently. This can be, but is not necessarily due to management deficiencies. In any case, it is likely to negatively affect profitability. Similarly, low or decreasing earnings per employee can reflect inefficiencies because of overstaffing, with similar repercussions in terms of profitability.

4.1.3.1 Total Expenses to Total Income Ratio:

Table 4.9 exhibits the ratio of total expenses to total income ratio. The total expenses of the bank have been increasing continuously. It has increased from Rs 227 million in year 2003 to 659.27 in the year 2008. Similarly, the total income of the bank has gone up throughout the study period. The ratio of total expenses to total income is fluctuating in the study period. The ratio is distributed from the minimum of 61% in the year 2005 to the maximum of 69% in 2003. It has decreased by 5 percent reached at 64 % in 2004 from the 69 % of 2003 and further decreased to 61 percent in 2005. But it has increased by 7 percent and reached to 68 percent in 2006. After that the bank is success to decrease the ratio of total expenses to total income. It has decreased by 3 percent in the year 2007 and reached at 65 percent and further decreased by 2 percent and reached at 63 percent. The overall ratio implies that the bank has decreasing expenses with respect to income.

Table 4.9

Total Expenses to Total Income Ratio:

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Expenses	227.14	266.25	316.63	443.07	540.93	659.27
Total Incomes	327.77	416.71	518.50	655.06	832.29	1,052.34
Ratio of Total Expenses to Total Incomes	69	64	61	68	65	63

Source: NICBL, Annual Reports

4.1.3.2 Earning Per Employee

Table 4.10 shows the earning per employee of the bank. The net profit after tax of the bank is increased in the two year of the study period and decreased in the year 2006. In 2007 & 2008, it has

increased significantly. Whereas the total number of employees is in increasing trend in the study period. This ranges from minimum of 127 to maximum of 232. The earning per employee is increased in the first two year of the study period as the NPAT gone up gradually with the increase in number of staffs. It decreased in 2006 due to the decrease in net profit and increased number of staffs it has decreased to 0.58 million per employee. However, the earning per employee is in increasing trend and reached to 1.05 million per employee in 2008.

Table 4.10

Earning Per Employee

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
NPAT (in Million Rs.)	48	68	114	97	158	243
Total Number of Employees	127	140	157	166	189	232
Earning Per Employee (in Million Rs.)	0.38	0.49	0.72	0.58	0.84	1.05

Source: NICBL, Annual Reports

4.1.4 Earning

Earning is a yardstick indicating the management, shareholders and depositors to evaluate the performance of the banks, sustainability of earnings and to forecast growth of the bank. The success of the bank heavily relies upon the efficiency of its management to drive the bank to earn good profits. Net profit is the major yardstick to measure such profits. A required level of profit is necessary for the firm's growth and survival in the competitive environment. Profitability is vitally more important for assuring that a bank stays in business or activity. Net profit of any bank decreases resulting from high non-performing loans, lack of avenues for earning fee based income and operating in-efficiencies.

Net income (after tax) to total assets, net earnings (after tax) to core capital, net spread, net interest margin and net operating margin are used to assess the earning performance of the bank.

4.1.4.1 Net Income to Total Assets Ratio

Table 4.11 exhibits the ratio of net income to total assets of the bank in the study period. The net income of the bank is in increasing trend except in the year 2006 in which it is slightly decreased and reached to Rs. 97 million. On the other hand total asset of the bank is continuously increasing

through out the study period. However, the ratio of net income to total assets is fluctuating from minimum of 0.93 in 2006 to maximum of 1.60 in 2008. Since the ratio of net income to total assets is more than 1.5 percent in 2008, more than 1 percent but below 1.5 percent in 2003, 2004, 2005 & 2007 and more than 0.5 percent but less than 1 percent in 2006, the level of income comparing with the total assets of the bank is strong in 2008, satisfactory in 2003, 2004, 2005 & 2007 and fair in 2006.

Table 4.11

Net Income to Total Assets

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
NPAT (in Million Rs.)	48	68	114	97	158	243
Total Assets	3,769	5,939	7,508	10,834	11,679	15,239
Ratio of Net Income (after tax) to Total Assets	1.28	1.15	1.15	0.93	1.36	1.60

Source: NICBL, Annual Reports

4.1.4.2 Net Earnings to Core Capital Ratio

Table 4.12 exhibits the ratio of net earnings to core capital of the bank in the study period. Unlike with the net income, core capital of the bank rose up throughout the study period. The ratio of net profit after tax to core capital of the bank varies from the minimum of 8.79 percent in the year 2003 to maximum of 18.79 percent in the year 2008. Analyzing the data, the ratio of NPAT to core capital, it is more than 12 percent in 2005, 2006, 2007 & 2008, more than10 percent but less than 12% in 2004 and more than 8 percent but less than 10 percent in 2003, it is considered as strong position in 2005, 2006, 2007 & 2008, satisfactory position in 2004 & fair position in the year 2003.

Table 4.12

Ratio of Net Earnings to Core Capital

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
NPAT (in Million Rs.)	48	68	114	97	158	243
Core Capital	549	617	680	761	912	1294
Ratio of Net Earnings (after tax) to Core Capital	8.79	11.07	16.73	12.69	17.38	18.79

Source: *NICBL, Annual Reports*

4.1.4.3.1 Net Spread

Net spread is the difference between the ratio of interest earned to total interest earning assets and interest paid to total interest-bearing liability. It measures the earning capacity of a bank. Having net spread more tan 2% shows that the bank has strong earning capacity. Net spread less than 2 % to more than 1.25 % can be considered as satisfactory earning. Likewise, the lower ratios show that the bank's earning quality not being satisfactory. Negative net spread indicates the bank's earning quality is very unsatisfactory.

Table 4.13 exhibits the net spread of the bank in the study period. Regarding the net spread the bank has strong position. It varies from the minimum of 2.36 percent in 2006 to the maximum of 3.61 percent in the year 2003. The net spread of the bank is above 2 percent through out the study period. Net spread above 2 percent can be regarded as a strong position. Therefore, in general the bank has maintained strong position regarding the net spread. This is the good symbol of bank's profitability and earning.

Table 4.13
Net Spread

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Interest Earned	291	363	458	580	726	931
Interest Earning Assets	3,573	5,322	6,285	9,136	10,541	13,576
Interest Earned/ Interest Earning Assets **A**	8.15%	6.82%	7.28%	6.35%	6.89%	6.86%
Interest Paid	143	184	226	340	421	506
Interest Bearing Liability	3,144	5,146	5,945	8,521	9,676	12,558
Interest Paid/ Interest Bearing Liability **B**	4.54%	3.57%	3.80%	3.99%	4.35%	4.03%
(A – B)*100	3.61%	3.25%	3.48%	2.36%	2.53%	2.83%

Source: NICBL, Annual Reports

4.1.4.4 Net Interest Margin

The net interest margin measures how large a spread between interest income and interest expenses management has able to achieve by close control over the bank's earning assets and the pursuit of the cheapest sources of funding. Net interest margin is calculated dividing net interest income (interest income minus interest expenses) by total interest earning assets. Earning assets include loans and advances, bill purchased and discounted and investment made in securities (T-Bills,

Bonds). A negative or declining ratio is an indicator of lack of treasury management skill and needs attention. The net interest margin ratio between 3 to 4 percent can be considered as better in banking industry (World Bank, 1996).

The table 4.14 shows the net interest margin of the bank. Both the interest income & interest expense of the bank is increasing through out the study period. The total interest earning assets of the bank showed increasing trend in the entire study period. The net interest margin calculated in the table shows the minimum figure of 2.62% in 2006 and maximum of 4.16% in 2003. The net interest margin of the bank is fluctuated over the study. According to standard, the net interest margin between 3 to 4 percent is supposed to be better. The bank has net interest margin of above 3 percent except in the year 2006 & 2007. Thus, the data shows that the net interest margin of NICBL is satisfactory in the year 2006 & 2007 and it is better in rest of the period.

Table 4.14

Net Interest Margin

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Interest Income	291	363	458	580	726	931
Interest Expenses	143	184	226	340	421	506
Total Interest Earning Assets	3,573	5,322	6,285	9,136	10,541	13,576
Net Interest Margin	4.16	3.37	3.69	2.62	2.89	3.13

Source: *NICBL, Annual Reports*

4.1.5 Liquidity

Banks need to maintain reasonable level of liquidity to pay cash to its depositors so it is of prime importance. Liquidity ratios are used to judge a banks ability to meet short-term obligation. It is the comparison between short-term obligations and short-term resources available to meet such obligations. Commercial banks are directed by NRB to maintain 5.5% of their deposits as CRR in NRB's account to ensure adequate liquidity. As per NRB regulations banks has to maintain CRR on a weekly basis. Therefore, rather than disclosing the CRR of year-end, banks should report the exact CRR ratio maintained during the week, in which year-end falls.

Cash and bank balance to total deposit ratio is used to measure the bank's ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower ratio indicates that banks might face a

liquidity crunch while paying its obligations, where as a very high ratio points out that the banks have been keeping idle funds and not deploying them properly.

4.1.5.1 Total Loan to Total Deposit Ratio

Table 4.15 shows the loan to deposit ratio of the bank in the study period. The total loan and advances of the bank has increased in the study period from 2,562 million to 11,463 million. Similarly, the total deposit of the bank has increased from 3,144 million to 13,085 million. The loan to total deposit ratio of the bank has fluctuated from the minimum of 73 percent in the year 2004 to maximum of 91 percent in 2007. It has decreased to 73 percent in the year 2004 as compared to 82 percent in the year 2003.It has increased to 79 percent in the year 2005 & remain constant in the year 2006.However, it has significantly increased to 91 percent in the year 2007 and slightly decreased to 88 percent in the year 2008. The increased loan to total deposit ratio shows that the bank should be more serious to maintain reasonable liquid position of its fund.

Table 4.15

Loan to Deposit Ratio

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Loan and Advance	2,562	3,743	4,909	6,902	9,129	11,463
Total Deposit	3,144	5,146	6,241	8,766	10,068	13,085
Loan to Total Deposit Ratio	0.82	0.73s	0.79	0.79	0.91	0.88

Source: *NICBL, Annual Reports*

4.1.5.2 NRB Balance to Total Deposit Ratio

The table 4.16 exhibits the NRB balance to total deposit ratio of the bank. The bank has maintained the minimum balance of Rs. 175 million in 2003 and maximum of 832 million in 2005. The total deposit of the bank is maximum in the year 2008 and minimum in the year 2003. But the NRB balance to total deposit ratio of NICBL is maximum of 13 percent in 2007 and minimum of 3 percent in 2007. Total NRB balance to total deposit ratio of the bank is optimum except in the year 2001 and 2005.

Table 4.16

NRB Balance to Total Deposit

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total NRB Balance	175	205	832	456	263	634
Total Deposit	3,144	5,146	6,241	8,766	10,068	13,085
NRB Balance to Total Deposit Ratio	6	4	13	5	3	5

Source: *NICBL, Annual Reports*

4.1.5.2 **Cash in Vault to Total Deposit Ratio**

The table 4.17 depicts the cash in vault to total deposit ratio. The total cash in vault of the bank varies from minimum of Rs. 96 million in 2003 to maximum of Rs. 235 million in 2008 in the study period. The total deposit of the bank shows the increasing trend. Cash in vault to total deposit ratio has fluctuated in the study period. It varies from the minimum of 1percent in 2005 to maximum of 3 percent in 2003. The cash in vault to total deposit ratio of NICBL is adequate as it has maintained average of 2.58 %liquidity in vault which is supposed to be adequate liquidity.

Table 4.17

Cash in vault to Total Deposit Ratio

(Rs. in million)

Fiscal Year (Mid July)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Cash in Vault	96	79	70	139	182	235
Total Deposit	3,144	5,146	6,241	8,766	10,068	13,085
Cash in Vault to Total Deposit Ratio	3%	2%	1%	2%	2%	2%

Source: *N1CBL, Annual Reports*

4.2 Major Findings

This section includes the key findings of the study obtained from the analysis of the data. conclusions derived from the findings are presented in the next chapter

- The risk based capital ratio of the banks is distributed from the minimum of 12.20 percent in the year 2008 to the maximum of 18.87 percent in 2003. The risk based capital ratio is above the NRB standard in the entire study period. The risk based core capital ratio of NICBL is

distributed from the minimum of 9.21 percent in the year 2007 to the maximum of 17.44 percent in the year 2003.

The core capital adequacy ratio is above the NRB standard in the entire study period. Thus, it is found that the core capital adequacy ratio of NICBL is adequate and sufficient.

The risk based supplementary capital ratio of NICBL is distributed from the minimum of 0.83 in 2004 to maximum of 3.60 percent in 2006. This ratio as prescribed by NRB, which should not exceed the core capital, showed that NICBL has met the requirement of NRB during the study period.

- The ratio of past due loan to total loan has fluctuating trend during the study period. The total loan of the bank has gone up throughout the study period. The ratio of past due loan to total loan is 7% percent in the year 2003 which is less than 10 % and can be considered as fair, in rest of the study period it is below 5 percent which is the evidence of strong level of past due loan on total loan. Hence, the asset quality of the bank is strong as indicated by this ratio.

- The percentage of substandard loan to total loan ranges from 3.03 percent to 0.02 percent in the study period. While the total loan is in increasing trend, percentage of substandard loan to total loan is in decreasing trend except in the year 2005. This can be considered as enhancement in quality of assets of the bank. It is found that the percentage of substandard loan to total loan is below 5 percent throughout the study period, which indicates the quality of loan is strong from the perspectives of total substandard loan to total loan ratio.

- The percentage of doubtful loan to total loan ranges from maximum of 2.34 percent in the year 2003 to a minimum of 0.01 percent in 2004 & 2007. Though percentage of doubtful loan to total loan is fluctuating, it is below the 5 percent in all the study period, which can be considered as the quality of loan being strong.

- Percentage of loss loan to total loan is fluctuated in the study period. It ranges from minimum of 0.67 percent in the year 2008 to maximum of 3.89 percent in 2004. Though the percentage of loss loan to total loan had increased in the year 2004 as compared to 2003, it is continuously decreasing thereafter. This shows the quality of assets is being strong as it is below 5 percent in during the study period.

- The bank has maintained adequate provision in the entire loan category i.e. pass loan, substandard loan, doubtful loan and loss as prescribed by NRB i.e 1% in pass loan,25% in substandard loan,50% in doubtful loan and 100% in loss loan.

- The ratio of total expenses to total income is fluctuating in the study period. The ratio is distributed from the minimum of 61% in the year 2005 to the maximum of 69% in 2003. The ratio is in decreasing trend except in the year 2006 in which it has reached to 68%. The overall ratio implies that the bank has decreasing expenses with respect to income.

- The above figure shows that the earning per employee of the bank is increasing trend. Though it has decreased in the year 2006 and reached to Rs 0.58 million per employee due to decrease in NPAT and increase in number of staff. However, it has increased thereafter and reached to 1.05% in the year 2008. The increased earning per employee reflects efficiency of staffs as well as good management quality.

- The ratio of net income to total assets is fluctuating from minimum of 0.93 in 2006 to maximum of 1.60 in 2008. The ratio is less than 1% in 2006, which can be considered as fair. Similarly, the ratio in the year 2003, 2004, 2005 & 2007 lies between 1% to 1.5%, which can be considered as satisfactory. The ratio of more than 1.5% in the year 2008 indicates the strong in level of income comparing with the total assets of the bank.

- The ratio of net profit after tax to core capital of the bank varies from the minimum of 8.79 percent in the year 2003 to maximum of 18.79 percent in the year 2008. . Analyzing the data it seems that the ratio of NPAT to core capital is fair in the year 2003, satisfactory in the year 2004 and strong in rest of the study period.

- The net spread the bank has strong position. It varies from the minimum of 2.36 percent in 2006 to the maximum of 3.61 percent in the year 2003. The net spread of the bank is above 2 percent through out the study period. Net spread above 2 percent can be regarded as a strong position. Therefore, the bank has maintained strong position regarding the net spread. This is the good symbol of bank's profitability and earning.

- The net interest margin of the bank during the study period is minimum of 2.62% in 2006 and maximum of 4.16% in 2003. Though, the net interest margin of the bank is fluctuating over the study, it is above 3 percent except in the year 2006 & 2007 According to standard, the net interest margin between 3 to 4 percent is supposed to be better. Hence, the net

interest margin of NICBL is satisfactory in the year 2006 & 2007 and it is better in rest of the period.

- The loan to total deposit ratio of the bank has fluctuated from the minimum of 73 percent in the year 2004 to maximum of 91 percent in 2007. It has decreased to 73 percent in the year 2004 as compared to 82 percent in the year 2003.It has increased to 79 percent in the year 2005 & remain constant in the year 2006.However, it has significantly increased to 91 percent in the year 2007 and slightly decreased to 88 percent in the year 2008. The increased loan to total deposit ratio shows that the bank should be more serious to maintain reasonable liquid position of its fund.

- The NRB balance to total deposit ratio of the bank is maximum of 21.13 percent in 2002 and minimum of 4.51 percent in 2005. Total NRB balance to total deposit ratio of the bank is as per standard set by NRB except in the year 2001 and 2005. Overall, it is found that the bank has maintained an optimum level of NRB balance.

- The total cash in vault of the bank varies from minimum of Rs. 96 million in 2003 to maximum of Rs. 235 million in 2008 in the study period. The total deposit of the bank shows the increasing trend. Cash in vault to total deposit ratio has fluctuated in the study period. It varies from the minimum of 1 percent in 2005 to maximum of 3 percent in 2003. The bank should maintain the minimum balance of 1.5% of total deposit. Thus, the cash in vault to total deposit ratio of NICBL is adequate except in the year 2005.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This unit is divided into three sections. The first section provides the brief summary of the study. The second section demonstrates the conclusion of the study and third section contains recommendations.

5.1 Summary

The study was conducted with objective to analyze the financial performance of NIC Bank with CAMEL framework. Six years data are covered in the study. The study is based on secondary data and the data obtained were analyzed using various financial tools. CAMEL is a technique of evaluating the soundness of financial institutions. The bank's financial soundness is judged being based on some factors-capital adequacy, asset quality, management soundness, earning quality, liquidity position and sensitivity to market risk.

The study is conducted with the general objective to analyze the financial performance of NIC Bank. Moreover, the specific objectives of the study were-to examine the capital adequacy of the bank, to assess the quality of the bank's assets, to analyze the efficiency of the bank's management, to evaluate the earning performance of the bank, to find out the liquidity position of the bank in the period of 2003 to 2008 A.D. Different materials were reviewed to build up the conceptual foundation and to find out the clear destination of the research work. Review of concept of banking, origin and historical growth of banking, evolution of banking in Nepal, concept of bank, functions of commercial bank, concept of financial performance analysis, financial statements, balance sheet, assets, liabilities, income statements, financial performance analysis, types of financial analysis, trend analysis, ratio analysis, funds flow statement, concept of financial performance analysis in the framework of CAMELS, concept of capital adequacy, assets quality, non performing assets, management soundness, earnings, liquidity, sensitivity to market risk were reviewed as conceptual review. In addition, review of dissertations was included in dissertations review section.

The research covers only six years period from the year of 2003 to 2008 A.D. It is concerned with the financial performance analysis of the commercial bank. The study was designed within the framework of case study analysis research design and the analysis has been made in the same way. For the purpose of study, NIC Bank Ltd is taken as a study unit by applying convenient sampling

technique out of 26 commercial banks. The required data and information were collected from secondary sources. Financial ratios have been implied to get the meaningful result of the collected data in this research work.

The study is summarized as follows.

- The risk based capital adequacy ratio, the risk based core capital ratio & the risk based supplementary capital showed that NICBL has met the requirement as prescribed by the NRB during the entire study period.

- The ratio of past due loan to total loan, substandard loan to total loan, doubtful loan to total loan & loss loan to total loan showed that the quality of assets is strong, as it is below 5 percent in all the loan category.

- The bank has maintained adequate provision in the entire loan category i.e. pass loan, substandard loan, doubtful loan and loss as prescribed by NRB i.e. 1% in pass loan,25% in substandard loan,50% in doubtful loan and 100% in loss loan.

- The ratio of total expenses to total income is fluctuating in the study period. The ratio is distributed from the minimum of 61% in the year 2005 to the maximum of 69% in 2003. The ratio is in decreasing trend except in the year 2006 in which it has reached to 68%. The overall ratio implies that the bank has decreasing expenses with respect to income.

- The earning per employee is in increasing trend except in the year 2006. The earning per employee of the bank has increased to Rs 1.05 million in 2008 from Rs 0.38 million in the year 2003. The increased earning per employee reflects efficiency of staffs as well as good management quality.

- The ratio of net income to total assets is fluctuating from minimum of 0.93 in 2006 to maximum of 1.60 in 2008. The ratio is less than 1% in 2006, which can be considered as fair. Similarly, the ratio in the year 2003, 2004, 2005 & 2007 lies between 1% to 1.5%, which can be considered as satisfactory. The ratio of more than 1.5% in the year 2008 indicates the strong level of income comparing with the total assets of the bank.

- The data disclosed that the ratio of NPAT to core capital is fair in the year 2003, satisfactory in the year 2004 and strong in rest of the study period. . The increased ratio of net earning after tax to core capital shows that bank is towards the progress in strong level of income compared to its core capital.

- The net spread of the bank is above 2 percent through out the study period. Net spread above 2 percent can be regarded as a strong position. Therefore, the bank has maintained strong position regarding the net spread. This is the good symbol of bank's profitability and earning.

- The net interest margin of the bank during the study period is minimum of 2.62% in 2006 and maximum of 4.16% in 2003. Though, the net interest margin of the bank is fluctuating over the study, it is above 3 percent except in the year 2006 & 2007 According to standard, the net interest margin between 3 to 4 percent is supposed to be better. Hence, the net interest margin of NICBL is satisfactory in the year 2006 & 2007 and it is better in rest of the period

- The increased loan to total deposit ratio shows that the bank should be more serious to maintain reasonable liquid position of its fund.

- Total NRB balance to total deposit ratio of the bank is as per standard set by NRB except in the year 2001 and 2005. Overall, it is found that the bank has maintained an optimum level of NRB balance.

- The bank should maintain the minimum balance of 1.5% of total deposit. Thus, the cash in vault to total deposit ratio of NICBL is adequate except in the year 2005.

5.2 Conclusions

Based on the findings the following conclusions have been drawn:

a) Capital Adequacy Ratio :

i. The risk based capital adequacy ratio and risk based core capital adequacy ratio of the bank has met the requirements set by NRB during the entire study period.

ii. The supplementary capital ratio is within the boundary of NRB during the entire study period.

b) Assets Quality :

i. The ratio of past due loan to total loan, the ratio of substandard loan to total loan, the ratio of doubtful loan to total loan ,the ratio of loss loan to total loan shows that the quality of assets is strong.

ii. The bank has made adequate provision for substandard loan, doubtful loan and loss loan i.e. 25%, 50% & 100% as per the standard set by NRB, which shows the good practice of the bank to mitigate the possible risk in future.

c) Management Soundness :

i. The ratio of total expenses to total income is in decreasing trend, which indicates that the bank has decreasing expenses with respect to income.

ii. Earning per employee of NICBL is in increasing trend which reflects efficiency of staffs as well as good management quality

d) Earnings:

i. The net income to total assets ratio shows that the bank has strong level of income as compared to total assets in 2008 and satisfactory in the other study period.

ii. The NPAT to core capital is in increasing trend, which shows that the bank is towards the progress in strong level of income compared to its core capital. The bank has strong level of NPAT to core capital ratio except in the first two years i.e 2003 & 2004.

iii. Net spread above 2 percent revealed the bank has maintained strong position regarding the net spread. This is the good symbol of bank's profitability and earning.

iv. The net interest margin of NICBL is better except in the year 2006 & 2007. In 2006 & 2007, it was only satisfactory. This is also the good symbol of bank's profitability and earning.

e) Liquidity Ratio:

i. The increased loan to total deposit ratio shows that the bank should be more serious to maintain reasonable liquid position of its fund.

ii. Total NRB balance to total deposit ratio of the bank is as per standard set by NRB except in the year 2001 and 2005. Overall, it is found that the bank has maintained an optimum level of NRB balance.

iii. The cash in vault to total deposit ratio of NICBL is adequate except in the year 2005.

5.2.1 Recommendations

Based on above conclusions, the following recommendations have been provided:

- The bank should continue its "Zero Tolerance Policy" in matters of compliance and should continue to maintain adequate risk based core capital ratio and risk based supplementary capital ratio as prescribed by NRB.

- When any loan could not be repaid in time, it directly effects to the performance of the banks. The NPA is the factor of worsening income. The assets quality of NICBL is strong. The bank should continue it policy of booking qualitative assets.

- Adequate loan loss provisions protect the bank from the dangers of consequences arising from the conversion of loan into bad loan. NICBL has made adequate provisions for substandard loan, doubtful loan and loss loan in all the time as prescribed by NRB. The bank should continue its policy of keeping adequate provisions for NPAs as per NRB requirements.

- The bank should increase its income and reduce the expenses since its income compared to the total assets is not strong except in the year 2008.

- The bank should raise its net interest margin furthermore by raising its interest income and reducing the interest expenses. The high cost of fund brings the net interest margin down. Therefore, it should be given an attention to reduce it and enhance the net interest margin. The bank should more focus of low cost deposit rather then high cost institutional & fixed deposit.

- The liquidity position of the bank should meet its current and contingent obligations. It is observed that the bank has maintained the adequate cash balance in vault. But the loan to total deposit ratio of the bank is increasing, which shows that the bank should be more conservative in sanctioning loan and more focus on colleting deposit.

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