

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Economic development of any nation depends on the equal growth of all the units of economic system. One of the major units of economic system is financial sector. Existence of financial sector in the development of the capital market as well as money market is remarkable. The dominant privately owned financial institutions in financial sector of most major countries are the commercial banks. On a macroeconomic level, commercial banks represent the primary conduit of government monetary policy. On a microeconomic level, commercial banks represent the primary source of consumer credit and source of credit to small businesses.

Commercial banks are financial intermediaries between the people with surplus of fund and people in need for funds. In other words they are the most important source of institutional credit in the money market. Basically commercial banks provide a lending role in payment system, offer deposit and loan products and provide a variety of financial services (Gup & Kolari, 2005:25-26). They offer a wider array of financial services than any other financial institution, meeting the credit payments and savings needs of individuals, businesses and governments (Rose, 1997:82). Banks are still the principal means of making payments, through the checking accounts i.e. demand deposits and electronic funds transfer services they offer. Banks today are the principal channel for government monetary policy (Rose, 1997:89). Commercial banks are the financial departmental stores of the financial system and they operate for profit. Banks devote most of their resource to meeting the financial needs of business firms.

Banks are major buyers of debt securities issued by federal, state and local governments also. In recent years, however, commercial banks have significantly expanded their offerings of financial services to customers and units of government. Consumers simply have more choices now than ever before when purchasing financial services. Banks have now entered into non traditional areas by offering

products and services in addition to deposit and loans. A partial list includes; credit enhancement products, agency services, and standby letter of credit, mortgage servicing, trust services, commercial papers, junk bonds, securities underwriting, brokerage credit life insurance, real-state appraisal, and investment banking activities, personal financial consulting and others (Koch & Macdonald, 2004:16). Their financial characteristics largely reflect government imposed operating restrictions and peculiar features of the specific markets served (Rose, 1997:95).

And banks are important because of their ability to create money from excess reserves made available from the public's deposits. The banking system can take a given volume of excess reserves and by making loans and investments, generate a multiple amount of credit. A number of structural changes have affected the banking industry in recent years. The number of branch offices has increased dramatically in recent years. The growth of branching has been aided by the liberalization of many state laws to permit greater use of branch offices as a means of bank growth. Many of the nation's largest banks have followed their customers to distant markets through branching to protect their sources of funds and their earnings (Rose, 1997:84). In many cases, their corporate customers expanding abroad demand access to multinational banking facilities, foreign markets frequently offer fewer regulatory barriers and less competition than may be found at home. Most common characteristic of all international banks today is their striving to offer a full line of services to all customers. Thus, commercial banks which specialize prominently in lending and deposit taking, are combining with investment banks which deals in securities issued by their customers. Many banks in Canada, Great Britain, and Western Europe long ago took an additional step to become universal or merchant banks.

Merchant and Universal banks tend to make longer term investments than traditional banks and are active in both the money market simultaneously (Rose, 1997:87). Many bankers today are willing to accept greater risk in their operations, in part because of intensified competition and government insurance of bank deposits. Moreover a worldwide movement toward banking deregulation has given banks greater opportunities to market new services and expand geographically without such strict controls, but it has also increased their opportunities for failure.

Banking today is passing through a technological revolution. Computer terminals and high-speed information processing are transforming the industry stressing convenience on speed in handling such routine transactions as making deposits and cashing checks. Most of the new technology is designed to reduce labor and paper costs, making the industry less labor intensive and more capital intensive (Rose, 1997:88). These recent technological changes have profound implications for bank costs, employment and profitability (Rose, 1997:89). For all these reasons commercial banks play a dominant role in the money and capital markets and are worthy of detailed study to understand more fully about how the financial system works.

1.1.1 Introduction to Everest Bank Limited

Everest Bank Limited is one of the six joint venture banks in Nepal, which came into operation in 1994 with the objectives to extending professionalized and efficient banking services to various segments of the society (EBL, 2009). Punjab National Bank India, one of the largest nationalized banks in India having 114 years of banking history joined hands with EBL as a joint venture in 1997, holding 20% of the shares and rest 50% of the shares are owned by the local promoters and 30 % shares are owned by general public (EBL, 2009). The bank has been conferred with Bank of the Year 2006, Nepal by the banker, a publication of financial times, London. Similarly, EBL was bestowed with "NICCI Excellence" award twice in 1999 and in 2003 by Nepal India Chamber of Commerce for its spectacular performance under finance sector. The total branch networks of the bank are 35 by the end of Dec 2009.

EBL is the pioneer bank to introduce Any Branch Banking System in Nepal, having representative office in abroad i.e., in Delhi, India. EBL remittance facility is available not only in India but also provides remittance service through many countries in middle east like UAE, Qatar, Bahrain, Malaysia Afghanistan, Israel and UK(EBL, 2009). Everest Bank limited is the pioneer and front-runner in retail lending introducing Direct Housing Finance, Vehicle Loan Scheme, Education Loan Scheme, and Loan against future lease rentals of the properties and scheme for professionals. It has introduced 365 days banking service and in association with Smart Choice Technology providing ATM services for its customers. EBL envisions evolving & positioning the bank as a progressive, cost effective & customer friendly institution

providing comprehensive financial and related services integrating frontiers of technology & servicing various segments of society.

1.2 Focus of the Study

Unlike in the past, banks can no longer earn legally mandated yield spreads between the average interest rates earned on sources and uses of funds. Nor can banks continue to reap monopoly rents from banks charters that naturally endowed with a considerable degree of market power. Market driven competitive forces, deregulation of financial services, financial innovations, securitization, globalization and advances in technology are quickly changing the nature of commercial banking (Rose, 1997:83). These are the reasons for the continued interest in evaluating banks' performance. This study is mainly focused with the financial performance analysis of Everest Bank Limited in the framework of Return on Equity. Using the Return on Equity model this study makes an attempt to evaluate financial performance of Everest Bank Limited in terms of return on equity which measures overall profitability, in terms of return on assets which measures profit generation relative to assets, in terms of equity multiplier which measures the extent to which assets are funded with equity relative to debt, in terms of profit margin which measures ability to control expenses and in terms of asset utilization which measures amount of interest and non-interest income generated per unit of total assets.

1.3 Statement of the Problem

Performance of financial sector depends on the performance of individual financial institution. Commercial banking industry has emerged as a fast growing industry since economic liberalization was initiated. In recent years this industry has experienced a period of record profits with best operating result. Despite record profits, banks have weak and inefficient areas that still need to be addressed. The most important performance dimension for any bank is profitability and risk. One way to assess strengths and weakness is by analyzing financial statements of commercial banks.

Realizing the fact, many research studies have been done in financial performance of commercial banks using different models. However, there is hardly one using the

DuPont based ROE framework to evaluate financial performance of commercial banks in the context of Nepal. It is felt important to carry out an empirical study on the financial performance of Everest Bank Limited to investigate overall profitability in the framework of ROE. This study will attempt to solve the following research questions.

-) What is the overall profitability of Everest Bank Limited?
-) What is the profit generation in relation to the banks' assets?
-) To which extent assets of bank are funded with equity relative to debt?
-) What is the ability of banks to control expenses and generate income from interest and non-interest income?
-) What is the level of assets utilization?

1.4 Objectives of the Study

The general objective of the study is to analyze the financial performance of Everest Bank Limited in the framework of ROE. This study focuses on the following specific objectives.

-) To assess the return on equity (ROE) of Everest Bank Limited.
-) To measure the return on assets (ROA) of Everest Bank Limited.
-) To analyze the equity multiplier (EM) of Everest Bank Limited.
-) To examine the profit margin (PM) of Everest Bank Limited.
-) To evaluate the level of assets utilization (AU) of Everest Bank Limited.

1.5 Significance of the Study

The study gives a clear picture of performance of Everest Bank Limited in terms of profitability, return on assets, profit margin, equity multiplier and asset utilization. This study is important to the business community and general public who are concerned about the performance of Everest Bank Limited to the extent that their access to credit and other financial services is linked, to the success or failure of the bank. This study is also significant to the investors with provided the information about bank to develop expectations concerning future performance that aids in making investment decisions and price shares of bank. This study is also significant to

the shareholders and management of Everest Bank Limited with provided where it stand in its peer group in the market. In addition to this, this study adds little worth to the body of knowledge in this research area from which research scholars and students are benefited.

1.6 Delimitations of the Study

-) This study is confined to financial performance analysis of Everest Bank Limited.
-) This study analyzes the secondary data by using the DuPont based ROE framework for Financial Institutions.
-) Data of five years from fiscal year 2004/05 to 2008/09 are taken into consideration to conduct the study.
-) The study principally has been based on secondary data like annual report and other publication of the bank and audited data published by the bank are treated as authentic. Thus the findings and conclusions are drawn from the same.
-) Conclusions are drawn comparing the results with average ratio calculated from the ratios of three similar type banks viz. Himalayan Bank Limited, Nepal SBI Bank Limited, and NABIL Bank Limited which may not represent the whole banking industry.

1.7 Organization of the Study

The study has been organized into five chapters. The first chapter is introduction which includes background of the study, focus of the study, statement of the problem, objectives of the study, significance of the study, delimitation of the study and organization of the study.

The second chapter of the study is literature review which is divided into conceptual review and review of related studies. Conceptual review deals with conceptual part of commercial bank and DuPont based Return on Equity Framework for financial institutions. While review of related studies examines the review of different studies in this research area.

The third chapter is research methodology which includes research design, justification of the selection of the study unit, data collection procedures and data

processing. The fourth chapter data presentation and analysis contains the presentation of data relating to financial performance of Everest Bank Limited and analysis of such data using the ROE framework. The final or fifth chapter summary, conclusions and recommendations covers the summary of whole study and conclusions ascertained from the major findings of the study.

CHAPTER II

REVIEW OF LITERATURE

This section provides current stage of the research work and guidelines for further study and helps to avoid unnecessary duplication of research work. It highlights upon the literatures that are available in the area of financial performance analysis of commercial banks. This chapter is divided into two parts; conceptual framework and review of related studies.

2.1 Conceptual Review

This sub-chapter presents the theoretical aspect of the study. It includes concept of commercial bank, historical development of commercial bank in Nepal, functions of commercial bank, financial statement of commercial bank, concept of DuPont system of financial analysis and conceptual framework of return on equity (ROE) model.

2.1.1 Concept of Commercial Bank

Commercial banks are institution which deals with money and credit. Commercial banks are those financial institutions, which play the role of financial intermediary in collection and disbursement of funds from surplus unit to deficit unit. Currently in most jurisdictions commercial banks are regulated and require permission to operate. Operational authority is granted by bank regulatory authorities, which provides rights to conduct the most fundamental banking services such as accepting deposits and making loans. Commercial banks, which dominate this industry, offer a full range of services for individuals, businesses, and governments. These banks come in a wide range of sizes, from large global banks to regional and community banks. The name commercial implies that banks devote most of their resource to meeting the financial needs of business firms. In recent years, however, commercial banks have significantly expanded their offerings of financial services to customers and units of government. The result is the emergence of a financial institution that has been called a financial departmental store because it satisfies the broadest range of financial service needs in the economy. Banks today are the principal for government monetary

policy (Rose, 1997:82). Commercial banks are the most important source of institutional credit.

In the context of Nepal, bank and financial institutions act 2063 has classified bank and financial institutions under four categories according to paid up capital. 'Ka' class financial institutions are bank which should have two hundred corers of paid up capital for national level and other Kha, Ga, and Gha classes financial institutions are non-bank financial institutions such as development banks, finance companies, micro credit development banks and others. This act clarifies the financial transactions for each category.

2.1.2 Historical Development of Commercial Bank in Nepal

The development of banking is relatively recent in Nepal. Prior to modern banking system in, all the monetary transaction were carried out by indigenous money lenders. Commodity money, silver coin, gold coin, leather coins were the means of exchange. Towards the end of 8th century, Gunkam Dev had borrowed money to rebuild the Katmandu valley. In the Nepalese chronicle, it was recorded that the new era known as Nepal Sambat was introduced by Shakhadhar, a Sudra merchant of Kantipur in 880 A.D (Dahal & Dahal, 2002:10) after having paid all the outstanding debts in the country. In 11th century, during Malla regime there was an evidence of professional moneylenders and bankers. It is further believed that money-lending business, particularly for financing the foreign trade with Tibet, became quite popular during reign of Mallas. In the absence of any regulatory measures, the unscrupulous moneylenders were known to have charged exorbitant rates of interest and other extra dues on loans advanced. Tejarath Adda, established in B.S. 1933 during the tenure of the then prime minister Ranoddip Singh was the first step towards the institutional development of banking in Nepal (Dahal & Dahal, 2002:10). In 14th century, during the Malla regime, there was a class named Tankadhari who engaged in money lending business. Hence indigenous bankers and Tejarath Adda were the pioneers' foundation of banking in Nepal.

The history of modern commercial banking in Nepal dates back to 1937 A. D. In which year Nepal bank limited was incorporated (Baral, 2005: 41-45). The establishment of Nepal Bank Limited is a great landmark in the history of modern

banking in Nepal. This bank performed commercial and some of the central banking functions, as there was no central bank until 1956. In the year 1956 A.D. Nepal Rastra bank was established as the central bank of Nepal under the Nepal Rastra bank act 1955. It was established with the purpose of developing banking system in the country to promote industry, trade and agriculture as well as to circulate Nepalese currency all over the country. In 2022 B.S., the second commercial bank of Nepal, Rastriya Banijya Bank, was established.

The two, government owned commercial banks: Nepal bank limited and Rastriya Banijya bank led the commercial banking industry until the economic reforms initiated by the government in early 1980s (Baral, 2005:41). The inception of Nepal Arab Bank Limited, renamed as NABIL Bank Limited since 2002, in 1984, as a first joint venture bank proved to be the milestone in banking history of Nepal (Dahal & Dahal, 2002: 12). And it paved the way for new commercial banks to operate in the country. The economic liberalization adopted by the government brought surge in the banking industry and changed the landscape of financial sector. As a result, number of private commercial banks and other financial institutions mushroomed across the country and the number continues to grow.

The government of Nepal has taken universal banking policy in banking sector. Bank and financial institutions act 2006 has discouraged the protective banking concept classifying the whole banks and financial institutions into four categories according to their efficiency, financial transactions and paid up capital. Therefore any banks and financial institutions can go up and down depending up on their performance. This act focuses on healthy competition in this sector.

2.1.3 Functions of Commercial Bank

Commercial bank performs different functions such as core function and support function to the business world as well as general people. Core functions included two types of functions- fund based and non fund based functions. Similarly, support functions are those functions carried out to fulfill core functions. American institute of banking has fixed out four major functions of commercial bank, receiving payments, handling payments, making loans and investment and creating money by extension of credit. Major functions of commercial banks are as follows.

2.1.3.1 Financial Intermediation

The primary function of commercial bank is to accept deposits from savers and then lending those funds to borrowers. Commercial banks perform the role of intermediary between those who are surplus of funds and in need of funds. Accepting deposit is the oldest function of a bank and the banker used to charge commission for keeping the money in its custody when banking was developing as an institution. Now, banks accept both the interest paying and non-interest paying deposits mainly in three kinds. The first is the saving deposits on which the bank pays interest relatively at low rate to the depositors who are usually small savers. Another form of deposit is current deposits which is now called demand deposit that is non-interest paying deposit. Commercial banks accept fixed or term deposits for which banks pay higher rate of interest.

One of the primary functions of commercial banks is to advance loan to its customers. Historically short-term deposits were used to advance short-term commercial lending. Today, however, banks make every type of loan that is legally permissible and for periods up to thirty years (Gup & Kolari, 2005:25-26). Commercial banks extend loan facilities by a way of fund-based facilities and non-fund based facilities. The fund-based facilities are usually allowed by way of term loans, cash credit/overdraft, demand loans, overdrafts, bills finance, trust receipt and others. Further, the bank also provides non fund-based facilities by way of issuance of inland and foreign letters of credit, issuance of bid bonds/guarantees, deferred payment guarantees and others.

2.1.3.2 Credit Creation

Credit creation is one of the most important functions of the commercial banks. By the credit creation, banks are able to grant more than its own capacity. Banks synchronizes the withdrawals and deposit from their experiences. For this purpose, its accept deposits and advance loans by keeping small cash in reserve for day-to-day transactions. In many cases, when a bank advances a loan, it opens an account in the name of the customer and allows the client to draw the money by cheque according to needs. This process in turn increases the total amount of deposits.

2.1.3.3 Financing Foreign Trade.

Commercial banks finance foreign trade for their customers by accepting foreign bills of exchange and collecting them from foreign banks. Commercial banks facilitate foreign trade by purchasing and selling foreign currencies.

2.1.3.4 Agency Services

Commercial bank performs number of agency functions. Commercial banks act as agents for their customers in collecting and paying cheques, bills of exchange, drafts and dividends. It also buys and sells shares, securities, debentures etc. for its customers. Further, it pays subscriptions, insurance premium, rent, electricity and water bills and other similar charges on behalf of its clients. It also acts as a trustee and executor of the property and will of its customers. For some of these services, the bank charges a normal fee while it renders others free of charge.

2.1.3.5 Miscellaneous Services

In addition to above mentioned primary functions, commercial banks perform number of functions. A partial list includes: securities underwriting, brokerage credit life insurance, real-state appraisal, investment banking activities, personal financial consulting, consumer & retirement planning, issuing cheques, drafts, traveling cheques, credit cards, ATM cards, and debit cards and others. Commercial banks transfer money through wire transfer in the form of remittance inland and abroad. It acts as custodian of the valuable things by providing locker facilities. Issuing letter of credit and acting as a referee to clients is another services of commercial banks. With the revolution in technology, commercial banks have wider array of innovative products and services to offer to customers and continue to grow. Online or e-banking, anywhere branch banking, SMS banking, wire transfer facilities and others are the latest services of commercial banks.

2.1.4 Bank Balance Sheet

Financial data on commercial banks are presented in two basic documents: the report of condition i.e., the balance sheet and the report of income i.e., the income statement. Banks balance sheet contains information about resources and obligations of bank

what a bank owns and what it owes and the ownership interest of shareholders. A bank's balance presents financial information comparing what a bank owns and what it owes. Assets and liabilities are two major components of balance sheet.

Bank assets fall in to one of four general categories: loans and due from banks, and other assets. Loans are the major assets in most banks portfolios and generate the greatest amount of income before expenses and taxes. Investment securities are held to earn interest, help meet liquidity needs, speculate on interest rate movements, meet pledging requirements, and serve as part of a bank's dealer functions. Non-interest cash and due from banks consists of vault cash, deposits held at central bank, deposit held at other financial institutions, and cash items in the process of collection. Other assets are residual assets of relatively small magnitudes such as bankers' acceptances, premises & equipments, other real estate owned and other smaller amount. Banks liabilities represent the obligations of banks and shareholders interest. In other words, liabilities refer to the total claims that the depositors, shareholders, and others make on the banks.

2.1.4.1 Loans

Loans occupies major portion in a bank asset structure. They exhibit the highest default risk and some are relatively illiquid. A bank negotiates loan terms with each borrower that vary with the use of proceeds, source of repayment and type of collateral. Maturities range from call loans payable on demand to residential mortgages amortized over 30 years. The interest rate is either fixed over the life of the loan or varies with the changes in market interest rates. Similarly the loan principal is either repaid periodically or as a lump sum.

Loans are regrouped into several categories according to the use of proceeds: commercial loan, individual loan, real state loan, agricultural loan, other loans in domestic offices and loans in foreign offices. Commercial loans consist of commercial and industrial loans, loans to financial institutions and obligations other than securities to states and political subdivisions, credit extended to security brokers. Loans made for the purchase of credit card items and durable goods comprise the greatest volume in consumer credit. Other loans in domestic offices include all other loans and all lease-financing receivables in domestic offices. International loans

labeled loans and leases in foreign offices are essentially business loans & leases receivables made to foreign enterprises or loans guaranteed by foreign governments. International loan carry significant risks beyond normal default risk.

2.1.4.2 Investment Securities

Investment securities are extremely liquid as they can be easily sold at a price close to that initially paid by the bank. The primary attraction to investment securities is that they earn interest, and administration & transaction costs are extremely low. Banks also concentrate their purchases on higher quality instruments so that defaults are rare. In terms of liquidity, banks own a large amount of short-term securities-those with a maturity of one year or less, that can be easily traded in secondary market. Because of their lower risk, they generally earn less interest than what can be earned on longer-term securities.

These short-term investments include interest bearing bank balances (deposits due from other banks), federal funds sold, securities purchases under agreement to resell (repurchase agreements), treasury bills, and municipal tax warrants. They have maturities ranging from overnight to one year and carry returns that vary quickly with changes in money market conditions. Long-term investment securities consist of notes and bonds that have a maturity of more than one year and generate taxable or tax-exempt interest. Bank also purchases mortgage-backed securities and small amounts of foreign & corporate bonds.

2.1.4.3 Non-interest Cash and Due from Banks

This asset category consists of vault cash, deposits held at central bank, deposits held at other financial institutions and cash items in the process of collection. Vault cash is currency and coin that the bank holds to meet customer withdrawals deposit held at central bank are demand balances used to meet legal reserve requirements, assist in clearing cheques and wire transfers, or affect the purchase and sale of treasury securities. The amount of required reserve deposits is set by regulation as a fraction of qualifying bank deposit liabilities. The largest component of cash, cash items in the process of collection, represent cheque written against other institutions and presented to the bank for payment for which credit has not been given.

2.1.4.4 Other Assets

Residual assets of relatively small magnitudes, including customers' liability to the bank under acceptances, the depreciated value of bank premises and equipments, other real estate owned, investment in unconsolidated subsidiaries, bills receivables, interest receivables and prepaid expenses make up the majority of assets in this category. Commercial banks own relatively few fixed assets. They operate with low fixed costs relative to non-financial firms and exhibit low operating leverage.

2.1.4.5 Capital

Bank funding sources are classified according to the type of debt instrument and equity component. The characteristics of various debt instruments differ in terms of check-writing capabilities, interest paid, maturity and whether they can be traded in the secondary market (Gup & Kolari, 2005:26). All common and preferred capital or stockholders' equity is the ownership interest in the bank. Larger banks also issue subordinated notes and debentures, which are basically long-term uninsured debt. Retained earnings, which are the cumulative income, appear as the largest item in capital.

2.1.4.6 Reserve Fund

Other equity is small and usually reflects capital reserves. Reserve fund is the presentation of accumulated of profit appropriated over a period.

2.1.4.7 Deposits

Deposits are the main sources of funds, which the uses to generate profits. Commercial banks collect deposits in various forms such as demand deposits, saving deposits, and term deposits. Demand deposits are transactions accounts held by individuals, partnerships, corporations and governments that normally pay no interest. Businesses now own the bulk of existing demand deposits. Saving and term deposits represent interest bearing transactions accounts. The capacity of bank to earn profit depends on the volume and the deposit mix the bank has.

2.1.4.8 Other Liabilities

Other liabilities include; bank borrowings, bills payable such as unpaid drafts and wire transfer issued by banks, bills received for collection, acceptances outstanding, taxes and dividends payable, trade credit and other miscellaneous claims.

2.1.5 Bank Income Statement

A bank's income statement reflects the financial nature of banking. A bank's income statement reflects the financial nature of banking, as interest on loans and investments comprises the bulk of revenue. There are six main components of the income statement of commercial banks: interest income, non-interest income, realized gains and losses, interest expense, non-interest expense and loan loss provisions.

2.1.5.1 Interest Income

Interest income is the result of all interest and fees earned on all of bank's interest-bearing assets including loans, deposits held at other institutions, municipal and taxable securities and trading account securities (Gup & Kolari, 2005:27). It also includes rental receipts from lease financing.

2.1.5.2 Non-interest Income

Non-interest income is composed largely of trust or fiduciary income, which reflects what a bank earns from operating a trust department, and fees and deposit service charge, charges on checking account activity, maintenance fees, activity charges, administrative charges, overdraft charges, and check certification charges, safe deposit boxes, locker fees, and charges on many other transactions. These latter items typically generate the bulk of non-interest income. Another source of non-interest income is trading revenue that reflects commissions and profits or gains from operating a trading account and thus, from making a market in securities. Other non-interest income includes: income from fiduciary activities; gains, losses, and fees relating to foreign currency or foreign exchange transactions; gains, losses, and fees from assets held in trading accounts; net gains from the sale or disposition of loans, premises, and fixed assets, and other real estate owned; all service charges, fees, and commissions,

fees charged on bank-issued debit cards and credit cards; net gains on futures and forward contracts; and other miscellaneous income (Ennis, 2004).

2.1.5.3 Realized Securities Gains (or losses)

Realized securities gains or losses arise when a bank sells securities from its investment portfolio at prices above (or below) the initial or amortized cost to the bank. All such profits are reported and taxed as ordinary income. Securities gains are generally viewed as a predictable and unstable source of income because it is difficult to forecast interest rates and whether the bank can sell securities for a profit or loss. Generally, securities change in value as interest rates change but the gains or losses are unrealized, meaning that the bank has not sold the securities to capture the change in value.

2.1.5.4 Interest Expenses

Interest expense is the sum of interest paid on all interest bearing liabilities, including transactions accounts; term and saving deposits, short-term non-core liabilities and long-term debt. Gross interest income minus gross interest expense is labeled net interest income. This figure is very important because its variation over time indicates how well management is controlling interest rate risk.

2.1.5.5 Non-Interest Expenses

Non-interest expense is composed of personal expenses which include salaries and fringe benefit paid to bank employees, occupancy expenses for rent and depreciation on equipments and premises and other operating expenses including technology expenditure, utilities and deposit insurance premium. Non-interest expenses far exceed non-interest income at most banks, hence the label burden. Reducing this burden will improve profitability. Most banks face great pressure to keep net interest income from shrinking, they aggressively try to raise fee income and cut overhead expenses to support profit growth.

2.1.5.6 Provision for Loan and Lease Losses

Provision for loan and lease losses is deduction from income representing a bank's period allocation to its loan and lease loss allowance (loan loss reserve) on the balance

sheet. Conceptually management is allocating a portion of income to a reserve to protect against potential losses. It is a non-cash expense, but indicates management's perception of the quality of the bank's loan. It is subtracted from net interest income in recognition that some of the loans go into default. Provisions for loan and lease losses differ from loan charge-offs, which indicates loans and leases that a bank formally recognizes as uncollectible and charge-off against the loss reserves.

2.1.6 Concept of DuPont System of Financial Analysis

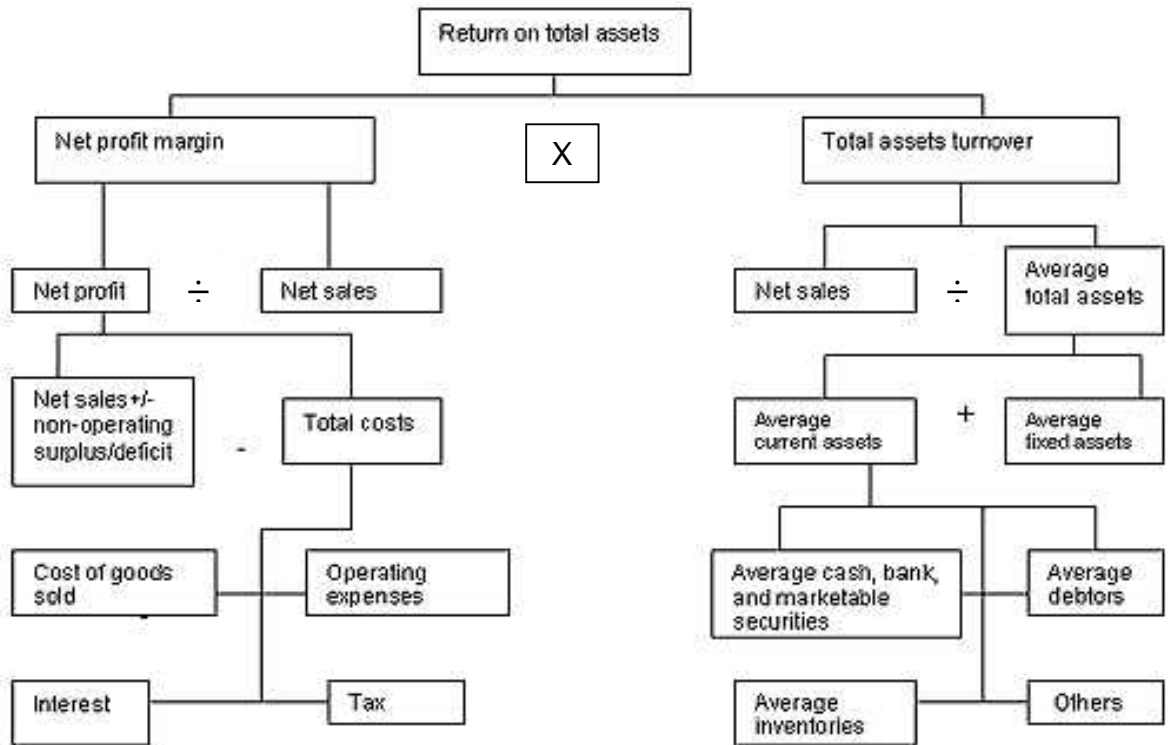
In the literature, the DuPont system is interchangeably referred to as the DuPont "formula" equation or "model." the DuPont system derives its name from the DuPont Corporation, which first used this technique of financial analysis (Lynn, Frank & Kirby, 1999). Developed in 1919 by a finance executive at e.i. DuPont de nemours and co., of Wilmington, Delaware, the DuPont system helps many companies visualize the critical building blocks in return on assets and return on investments (Blumenthal, 1998). This method received its name in recognition of DuPont Corp., which first developed it.

Dupont system is financial control oriented model that focused on a set of financial measures which were aggregated to the return-on-investment metric (Prieto and others, 2001). The DuPont method has the advantage of being much easier to use than other forms of analysis that depend on information buried in footnotes (Prieto and others, 2001). The DuPont system of analysis considers important interrelationships between different elements based on the information found in the financial statements. The approach establishes several financial ratios and demonstrates how these ratios interact to determine the profitability of an investment. It presents a fluid simulation model that shows how the return on investment will change in response to other variables (Fox, 2000). The DuPont formula, also known as the strategic profit model, is a common way to break down roe into three important components (Evans, 2007).

Using the DuPont equations, user is provided five different summary scores reporting net profit margin, asset turnover, return on assets, leverage multiplier, and return on equity. The summary scores then are used to facilitate evaluating the performance of a firm in three crucial management areas: profitability, asset management, and financial

leverage. Dupont system of analysis is an integrative approach used to dissect a firm's financial statements and assess its financial condition. It ties together the income statement and balance sheet to determine two summary measures of profitability, namely ROA and ROE (Fox, 2000). Following is the chart of DuPont.

Fig 2.1 DuPont Chart



2.1.7 Theoretical Framework of Return on Equity (ROE)

In 1972, David Cole introduced a procedure for evaluating bank performance via ratio analysis (Gup & Kolari, 2005:110). The ROE framework is based on the DuPont system of financial analysis and adaptation by Cole (Gup & Kolari, 2005:110). The ROE framework is similar to DuPont system of financial analysis, which is frequently used in non-financial institutions.

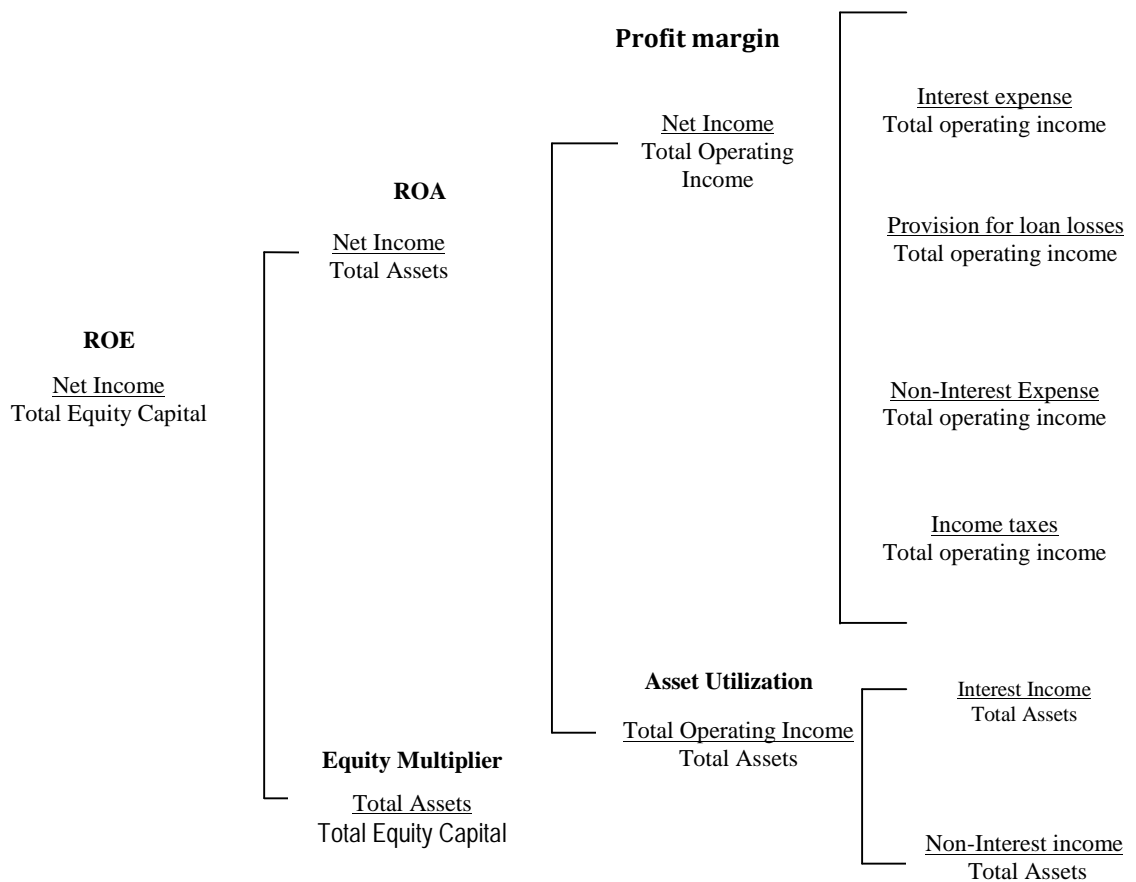
The return on equity framework is the modification of basic DuPont analysis to explore the determinants of the return on equity (ROE) breaking ROE into three parts that allows evaluation of how well one can manage the company's assets, expenses, and debt. Each of these primary drivers is impacted by the specific decisions on cost control, efficiency productivity, marketing choices and others. However it highlights the fact that looking at returns without looking at risk can be misleading and

potentially dangerous in terms of bank solvency and long run profitability (Saunders and Cornett, 2004:385). ROE framework is an analytical tool evaluating financial institutions' performance. The ROE framework starts with the most frequently used measure of profitability, return on equity and then breaks it down to identify strengths and weakness in a banks performance (Gup & Kolari, 2005:110). The resulting breakdown provides a convenient and systematic method to evaluate the source and magnitude of bank profits relative to selected risks taken. In turn identification of strengths and weaknesses and the reasons for them help to improve profitability.

Aggregate bank's profitability is measured and compared in terms of return on equity and return on assets (ROA). The ROE framework simply relates ROE to ROA and financial leverage then decomposes ROA in to its contributing elements. ROE is linked to ROA by the equity multiplier (EM). The return on equity (ROE) model disaggregates performance into three components: net profit margin (PM), total assets turnover and the equity multiplier (EM). The profit margin allows the financial analyst to evaluate the income statement. Total assets turnover allows evaluating the left-hand side of the balance sheet: assets. The equity multiplier allows evaluating the right-hand side of balance sheet: liabilities and owners equity.

Components of Return on Equity (ROE) model obtained from the breakdown of ROE (Saunders & Cornett, 2001:390) are as under.

Fig. 2.2 Components of Return on Equity Framework



2.1.7.1. Return on Equity

One of the most important profitability metrics is return on equity or ROE for short. Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. For the most part, the higher a company's return on equity compared to its industry, the better (Evans, 2007). Return On Equity measures a firm's efficiency at generating profits and a high ratio that is also sustainable, may mean that the managers are particularly good (Talacko, 2007).

Return on equity is a measure of how well management has used the capital invested by shareholders. It is the aggregate return to shareholders before dividends. Generally bank shareholders prefer high ROE to low as banks can add more to retained earnings and pay more in cash dividends when profit are higher. It is possible; however, that an increase in ROE indicates increased risk. ROE figures can also be flattered by

borrowing, so some firms with very high ROE figures also have very high debt. High levels of debt mean a greater chance of financial problems.

ROE increases if total equity capital decreases relative to net income. A large drop in equity capital may result in a violation of minimum regulatory capital standards and increased risk of insolvency for the bank. An increase in ROE may simply result from an increase in a bank's leverage –an increase in its debt-to-equity ratio. Finally, increasing financial leverage means that the firm uses more debt financing relative to equity financing. Interest payments to creditors are tax deductible, but dividend payments to shareholders are not. Thus, a higher proportion of debt in the firm's capital structure leads to higher ROE. Financial leverage benefits diminish as the risk of defaulting on interest payments increases. So if the firm takes on too much debt, the cost of debt rises as creditors demand a higher risk premium, and ROE decreases. Essentially, ROE will equal net margin multiplied by asset turnover multiplied by financial leverage. Splitting return on equity into three parts makes it easier to understand changes in ROE over time (Evans, 2007).

2.1.7.2. Equity Multiplier

The equity multiplier, a measure of financial leverage, allows the investor to see what portion of the return on equity is the result of debt (Kennon, 2007). Generally, management tends to prefer equity financing over debt since it carries less risk (Evans, 2007). Equity multiplier is a measure of leverage thus it measures the extent to which assets of the financial institutions' are funded with equity relative to debt. A bank's equity multiplier compares assets with equity such that large values indicate a large amount of debt financing relative to stockholders' equity. EM thus measures the financial leverage and represents both a profit measure and a risk measure. EM affects a bank's profit because it has a multiplier impact on return on assets to determine on bank's return on equity. Financial leverage works to the bank's advantage when earnings are positive. But, there are two sides of leverage, as it also accentuates the negative impact of losses. Higher ROE targets can be obtained either by increasing ROA or increasing financial leverage. EM represents a risk measure by reflecting how many assets can go into default before a bank becomes insolvent.

2.1.7.3. Return on Assets

The return on assets figure is also a common way to assess the asset intensity of a business. Return on assets measures a company's earnings in relation to all of the resources it had at its disposal i.e., the shareholders' capital plus short and long-term borrowed funds. Thus, it is the most stringent and excessive test of return to shareholders (Evans, 2007). Return on assets is a measure of profitability linked to the asset size of the bank. ROA equals net income divided by average total assets and thus determines net income per dollar of average assets owned during the period. This ratio measures overall profitability of investment in assets. Higher rates of return are desirable. The lower the profit per dollar of assets, the more asset-intensive a business is. The higher the profit per dollar of assets, the less asset-intensive a business is. All things being equal, the more asset-intensive a business, the more money must be reinvested into it to continue generating earnings. The basic of ROA is composed of two principal parts; income generation i.e. assets utilization (AU) and expense control i.e. profit margin (PM) including taxes.

2.1.7.4.. Profit Margin

Profit margin measures a banks ability to control expenses and thus its ability to generate net income from its operating income or revenue. The general rule-of-thumb is that a higher profit margin is preferable. Various expense ratios determine profit margin. These ratios measure the proportion of total operating income that goes to pay the particular expense item. Thus, the lower any of these expense ratios, the higher the banks profitability. A breakdown of profit margin therefore isolates the various expense items listed in the income statement.

I. Interest Expense Ratio

Interest expense ratio is the ratio of interest expenses on various kinds of deposits that the bank pays to its depositors and on various borrowings to the total operating income of the bank. A high level of interest expense ultimately results from maximum deposits volume collected by the bank. Besides interest rate offered on deposits also affect the volume of interest expense. This figure is very important because it's variation over time indicates how well management is controlling interest rate risk.

II. Provision for Loan Loss Ratio

Provision for loan losses is the amount charged as operating expenses to provide an adequate reserve to cover anticipated losses in the loan portfolio. Provision for loan loss ratio measures the proportion of total operating income that goes to keep provision for loan losses. These charges become part of the allowance for loan losses, a negative component on the asset side of the banks balance sheet, which is then used to charge off loans after they become nonperforming.

III. Non-Interest Expense Ratio

Non-interest expense ratio measures the proportion of total operating income that goes to pay non-interest expenses of the bank. Non-interest expense is composed of personal expenses which include salaries and fringe benefit paid to bank employees, occupancy expenses for rent and depreciation on equipments and premises and other operating expenses including technology expenditure, utilities and deposit insurance premium. Non-interest expense far exceeds non-interest income at most banks, hence the label burden.

IV. Tax Ratio

Tax ratio measures the proportion of total operating income of the bank that goes to pay income tax liabilities.

2.1.7.5. Assets Utilization

The assets utilization (AU) measures the extent to which the banks assets generate revenue. The breakdown of the AU ratio separates the total revenue generated into interest income and non-interest income. A sum of interest income ratio and non-interest income ratio equals au ratio that measures the banks ability to generate interest income and non-interest income.

I Interest Income Ratio

Interest income ratio measures the banks ability to generate interest income using its resources. Interest income is generated from loan, advances and overdraft, investments, balances in other banks, money at call and short notice and others like

inter-bank loan and foreign currencies placements. High value of this ratio signifies the efficient use of bank resources to generate income.

II. Non-Interest Income Ratio

Non-interest income ratio measures the bank's ability to generate non-interest income by using its resources. Banks prefer high value of this ratio as the same signifies the efficient use of banks resources.

2.2 Research Review

The research studies, work papers and articles related to financial performance analysis of commercial banks and DuPont based return on equity framework, carried out by different scholars within various geographical region including dissertations conducted by Nepalese scholars are reviewed in this section.

2.2.1 Review of Research Articles

This section presents the review of relevant studies and research articles.

Kunt &Huizing (1999) carried out a study on the topic "Determinants of Commercial Bank Interest Margins and Profitability: Some International Evidence." This article focuses on accounting measures of income and profitability as investors equalize (risk-adjusted) financial returns on bank stocks in the absence of prohibitive barriers. The researchers conceptualize bank interest spread as an indicator of the efficiency of the banking system and the study assess how bank interest spreads are affected by taxation, the structure of financial system, and financial regulations. The article uses bank-level data for 80 industrial and developing countries in 1988-1995. Regression analysis has been used to ascertain the results. Banks profitability has been measured by return on equity. The article shows that differences in interest margins and bank profitability reflect a variety of determinants: bank characteristics, macroeconomic conditions, explicit and implicit bank taxation, deposit insurance regulation, overall financial structure, and underlying legal and institutional indicators. A larger ratio of bank assets to gross domestic product and a lower market concentration ratio lead to lower margins and profits, controlling for differences in bank activity, leverage, and the macroeconomic environment. Foreign banks have higher margins and profits than

domestic banks in developing countries, while the opposite holds in industrial countries.

Barr, a. Hillgo, Siems & Zimmel (2002), carried out a study on the topic "Evaluating the Productive Efficiency and Performance of U. S. Commercial Banks." The study uses a constrained multiplier input-output oriented data envelopment analysis (DEA) to evaluate the productive efficiency of commercial banks. The DEA model allows analysis of multiple aspects of a financial institutions performance unlike more common benchmarking methodology that focus only one of many interrelated measures at a time. DEA model was applied to publicly available year-end data reported by u. S. Commercial banks rom 1984-1998. Overall hypothesis of the study is; more efficient institutions differ significantly from less efficient institutions in measurable ways. The study tends to see whether the changing conditions have different impacts on the performance measures of institutions of varying efficiencies. A similar rank-distinct relationship is discovered between efficiency and non-interest income, other non-interest expense and purchased funds as well as earning assets and return on average assets. Relationship between efficiency and interest income and expense is not as pervasive. Study found a noticeable tendency of efficiency to be positively correlated with interest income and negatively related to interest expense. The level of non-performing loans to total loans is significant and negatively related to efficiency.

Mukharjee, Nath, & Pal (2002), carried out a study on the topic "Performance Benchmarking and Strategic Homogeneity of Indian Banks." The study explores the linkage between performance benchmarking and strategic homogeneity of Indian commercial banks. The study attempts to obtain a performance benchmarking of the Indian banking sector from their financial parameters and to assess whether any groupings of the Indian banks can be obtained based on homogeneity in business strategies. The researchers conceptualize performance of the bank in terms of its efficiency in converting its resource inputs into transaction generating outputs. The bank performance model employed in this research is a relative evaluation of their overall efficiency using (DEA) and multiple Correlation clustering (MCC) model to identify homogeneity. The source of data for this study is the report on trend and progress of banking in India published by the reserve bank of India 1999. Data were

collected for 68 commercial banks over the period 1996-1999. Researchers have found the publicly owned banks to be more efficient to having less variation in the overall efficiency pattern, and foreign banks to be the most vulnerable lot. The study found almost all banks were overstaffed with high percentage of non-performing assets, capital adequacy ratio less than the standard norm and high cost funds.

Gunay & Rzutektas (2003) carried out a study on the topic "Efficiency Analysis of the Turkish Banking Sector in Pre-crisis Period: a DEA Approach." This study assesses the efficiency of non public commercial banks and to investigate the relationship between efficiency and bank failures for pre-crisis and crisis periods (1990– 2001) by using the data envelopment analysis (DEA) model. The study reports a declining trend in the number of efficient banks and the mean efficiency of bank sub-groups. It analyzes sensitivity to the output variables and depicts consistency between the model proposals and supervisory agent decisions. The study shows that banks had difficulty generating income during the crises period, but the impact of crises on the volume of deposits, loans, and securities portfolio are felt more deeply in the year following the crises.

Arby (2003), in the article "Structure and Performance of Commercial Banks in Pakistan", attempts to analyze the structure and performance of commercial banks in Pakistan under the framework of industrial organization. Performance of banks in Pakistan was analyzed in two respects; first a ratio analysis showing trend in profitability and showing affects of different parameters on the profit. There are number of indicators used to evaluate the performance of the banking industry; the best and widely used indicators are return on assets (ROA), return on equity (ROE) and net interest margin. On the basis of the study the researcher has made conclusion that distribution of banking business in Pakistan is highly skewed. Analysis of performance show that the profitability of state-owned banks deteriorated, especially after mid 1990s. The profitability of private banks was also not impressive during 1990s. Their profitability increased initially as, they started their business but they were unable to sustain it in subsequent years.

Ta Ho & Song Zhu (2004), in the study "Performance Measurement of Taiwan's Commercial Banks", presents a uses an Innovative two-stage data envelopment analysis model that separates efficiency and effectiveness to evaluate the performance

of 41 listed corporations of the banking in Taiwan. DEA is a linear programming approach used for measuring relative efficiency for a set of homogeneous decision-making units (DMUS) in converting multiple inputs (resources) to produce multiple outputs (performance). The result also indicates that the bank with better efficiency does not always mean that it has better effectiveness. There is no apparent correlation between these two indicators. The researcher has made conclusion that the inefficient banks can effectively promote resource utilization efficiency by better handling their labor and capital operating efficiency.

Baral (2005), Carried out a study on the topic "Health Check-up of Commercial Banks in the Framework of CAMEL: A Case Study of Joint Venture Banks in Nepal." Financial health check-up conducted on the basis of publicly available data set published by joint venture bank in their annual reports and NRB in its annual supervision reports. For the purpose of the study 3 bank: NABIL Bank Ltd. (NABIL) Nepal SBI Bank Ltd. (NSBI) and Standard Chartered Bank Ltd. (SCBN) are selected. The analysis of the study is entirely based on the camel framework. The researcher concludes that the joint venture banks are well capitalized but their capital base relative to the risk weighted assets is not strong. Quality of assets of joint venture banks on average is found satisfactory. Management quality of joint venture banks is above the industry average during the study period. The researcher found the earning performance of joint venture banks is fair. During the study researcher has found the joint venture banks facing high liquidity problem. Researcher concludes overall health of joint venture banks is fair.

Collier, McGowan & Muhammed (2006), carried out a research on the topic "Financial Analysis of Financial Institutions in an Evolving Environment." This paper employs return on equity model based on DuPont system of financial analysis presented by Saunders (2000). The banks return on equity is decomposed into net profit margin, total assets turnover and equity multiplier. This model is applied to Affin bank of Malaysia. The study covers the time span of 1999-2004. The DuPont system of financial analysis shows the impact of the Asian financial crisis on the financial performance of Affin bank that hit the region in 1997-98. Return on equity volatility results from significant variability in net profit margin and the equity multiplier.

Collier, Harjito & McGowan (2006), carried out a research on the topic "Using Accounting Information for Financial Institution Analysis in an Evolving Environment." This research adopted the ROE model for financial institutions based on the DuPont system provided by Saunders (2000). This model is applied to Maybank in Malaysia which is one of the ten anchor banks in Malaysia. The research attempts to provide additional insights into the improvement of a bank's financial situation, i.e. commercial banks, due to the recent series of bank mergers in Malaysia. Over the period of study from 1998 to 2003, during which substantial financial difficulties existed, Maybank's assets rose gradually. Both income and expenses dropped during the study period with unusually large decreases in expenses in 2000 because decreases in both interest expense and loan loss and provision. This combination leads to an increase in net profit margin and a subsequent increase in return on equity leading to an increase in the stock price. Maybank appears to have benefited from the financial crisis in Malaysia and the subsequent restructuring of the banking industry.

Tarawneh (2006), conducted a research on "A Comparison of Financial Performance in the Banking Sector: Some Evidences from Omani Commercial Banks." The objectives of study are: to analyze the financial data of Omani commercial banks for fiscal period 1999-2003, to examine the relationship among measures such as size, operational efficiency, asset management, ROA, interest income, to discuss their impact on the banks performance. The study based on secondary data. This research has used different financial and statistical measures such as ratios analysis; correlations, simple regression and analysis of variance are used in testing hypotheses. The research revealed the ranking of Omani commercial banks based on their deposits, total credits, total assets and total shareholders equity. The regression analysis results that the financial performance of bank is strongly and positively influenced by operational efficiency and asset management in addition to the bank size.

2.2.2 Review of Dissertations

There are several thesis works have been conducted by several researchers regarding financial performance of commercial banks. This section presents review of some relevant dissertations.

Adhikari (1993) carried out a research study on the topic "Evaluating Performance of Nepal Bank Limited (NBL)". The objectives of the study were; to examine the trend of deposit mobilization along with the cost of deposits; to assess the investment portfolio of the bank, to measure liquidity, profitability and operating efficiency of the bank, to evaluate earning power and dividend paying ability of the bank, to provide a package of suggestion and possible guidelines to improve the performance of Nepal Bank Ltd. Based on findings of the analysis. The study has covered the time span of 2038 to 2046/47. The study is a case study by nature. Different financial indicators such as CR, loan to deposit ratio, return on net worth, ROTA, EPS, DPS, DP ratio, net worth per share are used. Based on the study the researcher has concluded that NBL has not maintained a balanced ratio among its deposit liabilities. The bank does not seem to have been able to utilize its high cost resources in high yielding investment portfolio. The investment portfolio of the bank has not been managed so efficiently as to maximize the return there from. Lack of demarcation between operational and non-operational activities of the bank, performance and results show that the bank is more inclined towards non-operational activities. Operational activities of the bank found unsatisfactory because of the series of operational loss of bank. Profit shown in the financial statement has risen out of the non operational income. The researcher finds profitability of the bank unsatisfactory with the lower return on investment and lower market value of bank's share.

The researcher concludes NBL has not been able to utilize its resources efficiently. The researcher has suggested developing a separate investment promotion cell to explore opportunities for investment to diversify investment, to manage its investment portfolio efficiently, to strengthen loan recovery management, to launch productive credit programs, to reduce unproductive social loans, to simplify loan obtaining procedure.

Baral (1999) carried out a study on comparative study on "Financial Performance of Nepal Bank Ltd. and Nepal Grindlays Bank Ltd." The objectives of the study were to analyze the trend in deposits, credit and investment of NBL and NGBL, to evaluate the liquidity position of NBL and NGBL, to examine the credit and investment to total deposit ratio of NBL and ngbl and to evaluate the capital adequacy position of the NBL and NGBL. The study has covered the time span of 7 years ranging from fy

1991 to 1997. different financial ratios and statistical tools has been used for comparing financial performance of selected banks. The researcher has concluded that the performance of NBL measured in terms of collecting time deposit is better than that of NGBL. Performance of NBL measured in terms of mobilization of deposit to credit is better than NGBL. NBL was more successful in investing more amounts of loan and advances.

Shrestha (2004) carried out a research on the topic "Financial Performance of Nepalese Listed Commercial Banks and Return to Investor." The study has covered the time span of 5-year from 1997-2001. The objective of the study is: to examine the financial performance in terms of liquidity, activity, profitability and growth ratios, to find out the empirical relationship between various important variables; deposits, loan and advances, net profit, to analyze the deposit utilization trend. The study has adopted the exploratory cum analytical research design. The data were analyzed by using both the financial and statistical tools. Financial tools include: profitability ratio, activity ratio and growth ratio. Similarly, dividend yield, capital gain yield and total yield are used. Researcher has concluded that liquidity position of the selected banks is similar except NBBL SCBL, maintained good liquidity position. NBBL has poor liquidity position. Selected commercial banks have decreasing trend of loans and advances. SCBL shows more efficiency to collect deposit in fixed account and NSBI has success to collect deposit from saving. The average interest earning power with respect to working funds of selected banks is in decreasing trend. Banks have positive correlation between deposit and loan & advances. The researcher has found positive correlation between deposit and net profit. Average trend of dividend rate of all selected banks is in decreasing trend. Average trend of deposit is in slightly increasing trend. Overall financial performance of SCBL is very good.

Thapa (2004) conducted research study on the topic "Financial Performance of Commercial Banks in Nepal: A Comparative Study of NBL and NABIL Bank Limited." The objectives of the study are: to analyze the risk and return of NBL in comparison to NABIL, to analyze the liquidity position of the selected banks, to evaluate the financial ratios. The research is based on descriptive and analytical research design. The study covered the time span of 5 year from 1997/98 to 2001/2. Researcher has used different financial and statistical tools. Financial tools include:

ratio analysis, liquidity ratio, CR, cash and bank balance to total deposit ratio, cash and bank balance to non-interest bearing deposit ratio, cash and bank balance to interest bearing deposit, activity or turnover ratio, loan and advances to total deposit ratio, total investment to total deposit ratio, loan and advances to saving deposit ratio, leverage capital structure ratio, long-term debt to total assets ratio, capital adequacy ratio, profitability ratio, ROI, commission and discount income to personal expenses ratio, interest income to interest expenses ratio, return on common equity ratio, valuation ratios, statistical tools include: correlation analysis, trend analysis. The researcher concluded that NBL has not maintained a balanced ratio among its deposit liabilities. The bank does not seem to be able to utilize its high cost resources in high yielding investment portfolio. The investment portfolio of the bank has not been managed so efficiently as to maximize the return there from. The net worth of the bank for the last four periods is negative and decreased operating activities.

Kasaju (2006) carried out a study on a comparative study on "Performance Analysis of Top Five Commercial Banks in Nepal." The objectives of the study are: to analyze the comparative financial status of top five commercial banks in Nepal, to analyze and compare the liquidity, profitability, stability and market value position, to analyze and compare solvency ratios, such as core capital ratio, supplementary capital and total capital fund, to analyze and compare the position of non-performing assets. The study has used analytical and descriptive research design. The researcher has taken top five commercial banks; EBL, HBL, SCBNL, NIBL and NABIL as study unit. Data were analyzed by using both the statistical and financial tools. Financial tools include: liquidity ratios, solvency ratios, profitability ratios, activity ratios and market value analysis. Statistical tools include: mean, standard deviation, correlation of variance and ANOVA. The researcher has concluded that EBL and NIBL have been getting lower profit out of total income. HBL, EBL and NIBL have been suffering from inefficiency in using total fund. All top five commercial banks have been earning sufficient interest income on loan and advances. Except SCBNL, all remaining banks have maintaining lower capital adequacy ratio as per the directive of NRB. Performance of selected banks in maintaining NPA is satisfactory.

K. C. (2006) carried out a research on the topic "Role of Credit Management in Financial Institution of Nepal with reference to Everest Bank Limited." with the

objectives to evaluate and find out the credit management of the Everest Bank Limited, examine the information procedure in controlling the credit policies and practices of Everest Bank limited, identify norms laid by Nepal Rastra Bank in term of with regard to loan/credit management of the bank, identify the non-performing assets of Everest Bank Limited. The researcher has concluded that the growth of loan and advances of EBL is in increasing trend besides maintaining the low non performing loans; this shows the good result of credit management of the Everest Bank Limited. The bank applies strict rules and regulation considering the NRB directives while processing the loan appraisal of the borrower. The ratio of non performing loans on total loans of the bank among others highlights the sound credit management of the bank. The researcher has recommended introducing the credit card facility to its customers to increase the lending portfolio of the bank.

Sharma (2007) conducted a research study on "Financial Analysis of Nepal SBI Bank Ltd in the Framework of CAMEL." The study had been undertaken with the objectives to examine the capital adequacy of the bank, to assess the quality of the bank's assets, to analyze the efficiency of the banks management, to evaluate the earning performance of the bank and to find out liquidity position of the bank. The study has covered period of 6 year ranging from Fy 2001 to 2006.the study was based on entirely on camel framework. Study has found the NSBI maintaining adequate total capital fund as per NRB standard. The study revealed that the NSBI has maintained strong assets quality in beginning 4 years of study period. The study concludes the results based on the historical data disclosed by annual reports of commercial bank. The researcher concluded that NSBIL has maintained the adequate total capital fund prescribed by NRB standard.

Marasini (2008) carried out a research on the topic "Financial Performance Analysis of Rastriya Banijya Bank in the Framework of CAMEL." The objectives of the study were to examine capital adequacy of the bank, to analyze level and trend of assets composition, risk weighted assets and quality of loan, to examine liquidity position of the bank and to evaluate the level, trend and stability of bank's earnings. The study has covered the period from fiscal year 2001/2 to 2006/07. The study has been done within the framework of CAMEL. The researcher has found the core capital ratio and capital adequacy ratio of the bank are negative and incompatible with the NRB

standard. However operating efficiency of the bank was found to be good. With the negative ROE and liquid funds to total deposit ratio below the industry average, the researcher has concluded that the bank has not maintained effective liquidity management and weak in risk management efforts.

Gurung (2008) conducted a study on the topic "A Case Study on Financial Performance Analysis of Standard Chartered Bank Nepal Ltd. in CAMEL Framework." The objectives of the study were to analyze capital adequacy, liquidity position of SCBNL and compare with regulatory minimum requirement, to analyze management soundness, quality of assets and to evaluate weighted assets of SCBNL. The study adopts descriptive-cum analytical research methodology covering the data from fiscal year 2002 to 2006. The researcher drawn the conclusions that the core capital is maintained with the NRB standard, the bank is managed and operating efficiently.

Many researches have been done in financial performance of commercial banks using different models. However, there is hardly one using the DuPont based ROE framework to evaluate financial performance of commercial banks in the context of Nepal. It is felt important to carry out an empirical study on the financial performance of Everest Bank Limited in the framework of ROE.

CHAPTER III

RESEARCH METHODOLOGY

Research methodology is a way to systematically solve the research problem. This chapter is concerned with procedures that are adopted in this research work. It includes research design, justification of selection of the study unit, nature and sources of data, methods of data collection, data analysis tools and limitations of methodology. To accomplish the objectives mentioned above in chapter one, the study has adopted the following research procedures.

3.1 Research Design

The study is designed within the framework of descriptive and analytical research design to achieve the objective of the study. Descriptive research seeks to find out the fact with the help of sufficient data and information. Some financial and statistical tools have been applied to examine facts and descriptive techniques have been adopted to examine the financial performance analysis of the selected bank.

3.2 Justification for the Selection of Study Unit

Everest Bank Limited (EBL) is one of the leading commercial bank in the Nepalese banking industry. The reason for its selection as study unit is due to its past performance and record of accomplishment. In due course of its operation, as a joint venture bank, EBL has taken a leading and sensitive role in Nepalese financial intermediation. Hence, financial analysis of Everest Bank on the basis of financial performance, employing ROE model provides a glimpse regarding the financial performance of the commercial banks. Further similar nature joint venture commercial banks viz. NABIL Bank Limited, Himalayan Bank Limited and Nepal SBI Bank Limited were selected to develop standard to compare the overall result of the study unit.

3.3 Nature & Sources of Data

This research work is mostly based on secondary data. So, data were collected from using secondary sources as the major source for conducting research work. The annual reports of the bank form the major sources of data. And other sources are: NRB reports & bulletins and its official website, various articles published in journals and financial magazines and internet, official Website of Everest Bank Ltd., Himalayan Bank Limited, NABIL Bank Limited and Nepal SBI Bank Limited, various research papers and dissertations and others. Other supplementary information was collected from Western Regional Library, Pokhara, Central Library P.U, Public Library Pokhara, Central Libray T.U., different journals, magazine and websites.

3.4 Data Analysis Tools

Presentation and analysis of the collected data is the core of the research work. The collected raw data are first presented in systematic manner in tabular forms and then are analysed by applying different financial and statistical (descriptive) tools to achieve the research objectives. Besides, some graphs, charts and tables are presented to analyse and interpret the findings of the study. The data analysis tools used are discussed below.

3.4.1 Financial Tools

This study employs the ROE framework to assess the financial performance of Everest Bank Limited. ROE model provides a system for analyzing financial statements of commercial banks. ROE framework starts with the most frequently used measure of profitability, ROE and then breaks its down to provide a systematic method.

I. Return on Equity

Return on equity measures the amount of net income after taxes earned each dollar of equity capital contributed by the banks stockholders. Banks stockholders prefer ROE to be high.

$$\text{Return on Equity (ROE)} = \frac{\text{Net Income}}{\text{Total Equity Capital}} \times 100$$

Where,

$$\text{Net Income} = \text{Total Revenue (TR)} - \text{Total Operating Expenses (EXP)} - \text{Taxes}$$

$$\text{Total Equity Capital} = \text{Equity Share Capital} + \text{Reserve and Surplus}$$

II. Return on Assets

Return on Assets is a measure of profitability linked to the assets size of the bank.

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}} \times 100$$

III. Equity Multiplier

Equity Multiplier measures the dollar value of assets funded with each dollar of equity capital.

$$\text{Equity Multiplier} = \frac{\text{Total Assets}}{\text{Total Equity Capital}}$$

IV. Profit Margin

Profit Margin is the net income generated per dollar of total operating income.

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

Where,

Total Operating Income = Income before Operating Expenses, Taxes and Provisions.

$$\text{a) Interest Expense Ratio} = \frac{\text{Interest Expense}}{\text{Total Operating Income}} \times 100$$

$$\text{b) Provision for Loan Loss Ratio} = \frac{\text{Provision for Loan Losses}}{\text{Total Operating Income}} \times 100$$

$$c) \quad \text{Non-Interest Expense Ratio} = \frac{\text{Noninterest Expenses}}{\text{Total Operating Income}} \times 100$$

$$d) \quad \text{Tax Ratio} = \frac{\text{Income Taxes}}{\text{Total Operating Income}} \times 100$$

V. Assets Utilization

Assets Utilization is the amount of interest and non-interest income generated per dollar of total assets.

$$\text{Assets Utilization} = \frac{\text{Total Operating Income}}{\text{Total Assets}} \times 100$$

$$a) \quad \text{Interest Income Ratio} = \frac{\text{Interest Income}}{\text{Total Assets}} \times 100$$

$$b) \quad \text{Non-Interest Income Ratio} = \frac{\text{Noninterest Income}}{\text{Total Assets}} \times 100$$

3.4.2 Statistical Tools

Average/Mean

A simple arithmetic mean is used to summarize the data as a representative of mass data. A mean is the value or the sum of all observations divided by the numbers of observations. Mean is expressed as:

$$\text{Mean} = \frac{\text{Sum of Values}}{\text{No. of Values}}$$

$$X = \frac{x_1 + x_2 + x_3 + \dots + x_n}{n}$$

Where,

n = Number of values

X₁ = Individual values for the period N.

Trend Analysis

The term trend analysis refers to the concept of collecting information and attempting to spot a pattern or trend in the information. In general, trend analysis is used to predict future events. Here, trend analysis is used to predict the trend of various aspects of financial indicators for the study period. The general equation used for linear trend is given below.

$$Y = a + bx \text{ (the regression equation of Y on X)}$$

where,

Y= Dependent Variable

a= Y-intercept

x=Deviation for base year

b=Slope of line

Two general equations:

$$\sum Y = Na + b\sum x$$

$$\sum XY = a\sum X + b\sum X^2$$

Here, a and b are also called parameters of the line. The value of a and b is calculated by solving above general equation simultaneously.

Coefficient of Correlation

Correlation coefficient study measures the relation between the variables. The correlation between the different variables of a bank is compared to measure the relationship between the individual variables. Correlation refers to the degree of relationship between two variables. If between two variables increase or decrease in one causes increase or decrease in another, then such variables are correlated variables. The reliability of the value of coefficient of correlation is measured by probable error. The correlation coefficient between two variables describes the degree of relationship between those two variables. It interprets whether two or more

variables are correlated positively or negatively. The Karl Pearson coefficient of correlation (r) is given as below.

$$\text{Correlation Coefficient (r)} = \frac{N\sum XY - \sum X \sum Y}{\sqrt{N\sum X^2 - (\sum X)^2} \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

Where,

N = Number of observations

X = Independent variable

Y = Dependent variable

Probable Error (PE) of Correlation Coefficient.

Probable error of the correlation is denoted by P.E. It is applicable for the measurement of testing reliability of the computed value of the correlation coefficient 'r' (Bajracharya, 2050:160). It is used in interpreting whether calculated value of 'r' is significant or not. The P.E. is defined by:

$$\text{P.E.} = 0.6745 \sqrt{\frac{1-r^2}{N}}$$

Where,

r = Correlation Coefficient

N = No of Observations

If $r < 6 \text{ P.E.}$, It is insignificant

If $r > 6 \text{ P.E.}$, It is significant.

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Data Presentation and Analysis

This chapter is basically concerned with the presentation and analysis of collected data to meet the objectives of the study. Data collected from different sources are presented and analyzed using the DuPont based Return on Equity (ROE) model in this chapter.

4.1.1 Analysis of Return on Equity

Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity fund on the balance sheet. Return on equity is a measure of how well management has used the capital invested by shareholders. It is the aggregate return to shareholders before dividends. Computed as the ratio of net income to the equity, it reflects the income earned from its internal resources. In other words ROE measures the overall profitability of the financial institution per dollar of equity. ROE is interchangeably used as profit as a percentage of return on owners stake in a firm. Return on equity is the bottom line measure for the shareholders, measuring the profits earned for each dollar invested in the firm's stock. Generally bank shareholders prefer high ROE to low as banks can add more to retained earnings and pay more in cash dividend when profits are higher. For the most part, the higher a company's return on equity compared to its industry, the better.

If a firm with high return on equity reinvests the profits it makes, then it should also be able make a similar return on the reinvested profits and the profits become equity. If the company can continue to do this, profits should increase exponentially. Basically, ROE is the bottom line ratio and it measures the bank profitability. The higher ratio represents sound management and efficient mobilization of the owner's equity and vice-versa. ROE equals net income divided by total equity capital.

Analysis of Return on Equity of EBL

Fiscal Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	1682	2372	2964	4512	6387
Total Equity Capital (Rs In 00,000)	8326	9628	12015	19212	22036
ROE of EBL(%)	20.20	24.64	24.67	23.49	28.98
Average ROE (%)	19.98	24.08	25.56	24.23	26.13

Source: *Annual Reports*

(Note: Average ROE is obtained from calculation of average of ROE of EBL, NABIL, HBL and NSBI . See Appendix-VI)

Table 4.1 shows the Return on Equity of Everest Bank Limited from fiscal year 2004/05 to 2008/09. As shown in the table 4.1, ROE of EBL has increased by 2.44% in fiscal year 2005/06 and in the fiscal year 2006/07 it has increased only by 0.03%. This shows the ROE of EBL in increasing trend up to fiscal year 2006/07. But in the fiscal year 2007/08 ROE has decreased from 24.67 to 23.49. ie by 1.18%. However it has increased to 28.98% in the fiscal year 2008/09 which is maximum during the study period. In the fiscal year 2007/08 the bank has not maintained the increasing trend of ROE. During the fiscal year 2004/05 and 2005/06 ROE of EBL is greater than average ratio. But in the respective two fiscal years i.e., 2006/07 and 2007/08 it has obtained the ROE lower than the average. However in the fiscal year 2008/09 EBL has again achieved ROE greater than the average.

Fig. 4.1

Return on Equity of EBL

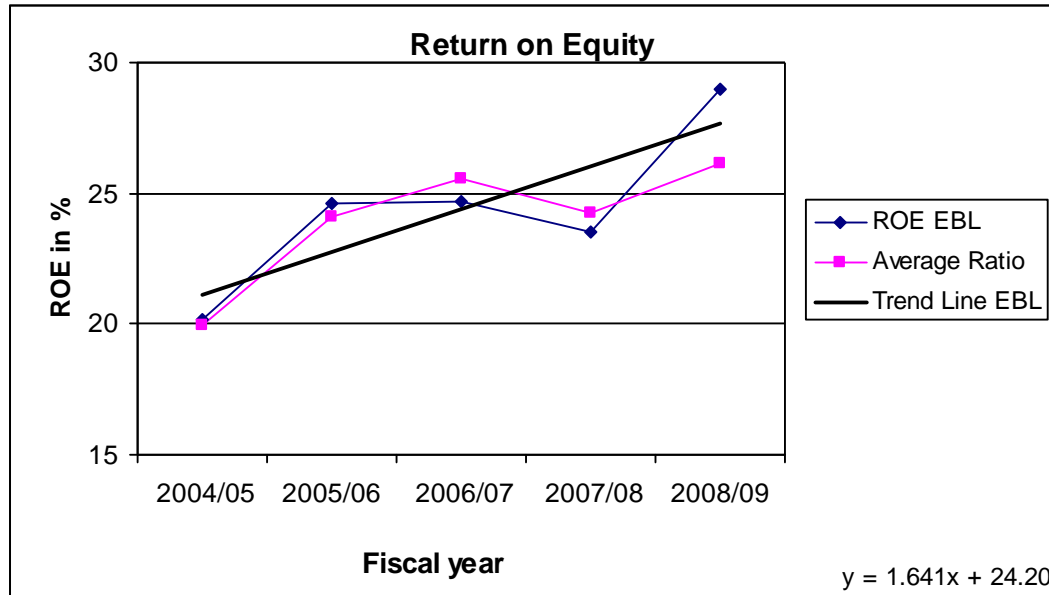


Fig. 4.1 shows the trend of return on equity ratio during the study period from fiscal year 2004/05 to fiscal year 2008/09. As shown in the fig. 4.1 ROE of EBL has raised in the Fiscal Year 2005/06 and it has remained almost straight in fiscal year 2006/7 with very tiny movement. The return on equity line has decreasing in fiscal year 2007/08. But again in the fiscal year 2008/09 it has gone up abruptly. As shown in the chart the return on equity line is fluctuating during the study period. It is above the average ratio line during the fiscal year 2004/05 and 2005/06 but below the average ratio line during fiscal year 2006/07 and 2007/08. But it has gone above the average in the fiscal year 2008/09. However the slope of the trend line determined by the least square method is positive and upward sloping in vertical way. This indicates the upward sloping trend of return on equity of EBL.

4.1.2 Analysis of Return on Assets

The return on assets figure is also a most used way to assess the asset intensity of a business. Return on assets is a measure of profitability linked to the asset size of the bank. Return on assets measures a company's earnings in relation to all of the resources it had at its disposal the shareholders' capital plus short and long-term

borrowed funds. Thus, it is the most stringent and excessive test of return to shareholders. Higher rates of return are desirable. The higher the profit per dollar of assets, the less asset-intensive a business is. The basic of ROA is composed of two principal parts; income generation i.e. assets utilization (AU) and expense control i.e. profit margin (PM) including taxes. ROA equals net income divided by average total assets and thus determines net income per dollar of average assets owned during the period. This ratio measures overall profitability of investment in assets. Higher ROA indicates better efficiency in utilizing banks overall resources and lower ROA indicates inefficiency in utilization of resources.

Table 4.2

Analysis of Return on Assets of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	1682	2372	2964	4512	6387
Total Assets (Rs In 00,000)	117325	159592	214325	271493	369168
ROA of EBL (%)	1.43	1.49	1.38	1.66	1.73
Average ROA (%)	1.55	1.70	1.79	1.72	1.75

Source: Annual Reports.

(Note: Average ROA is obtained from calculation of average of ROA of EBL, NABIL, HBL and NSBI for the study period. See Appendix-VI)

Table 4.2 represents the ratio of ROA of EBL during the study period from fiscal year 2004/5 to fiscal year 2008/09. In the fiscal year 2004/05 ROA is 1.43%. There is slight increase in ROA in fiscal year 2005/06 by 0.06%. As shown in the table 4.2, there is very slight fluctuation during fiscal year 2004/05 to 2005/6. In the fiscal year 2006/07 EBL has not maintained the previous level increase in ROA. It has been decreased to 1.38% from 1.49%. But in fiscal year 2007/08 ROA has gone to 1.66%, increasing by 0.28% and similarly in the fiscal year 2008/09 it has increased to 1.73. As shown in the table 4.2 ROA is less fluctuating in first two fiscal year but the same is more fluctuating in the respective three fiscal period of the study period. It is below

the average ratio during the study period. However it is near to average in the fiscal year 2008/09.

Fig 4.2

Return on Assets of EBL

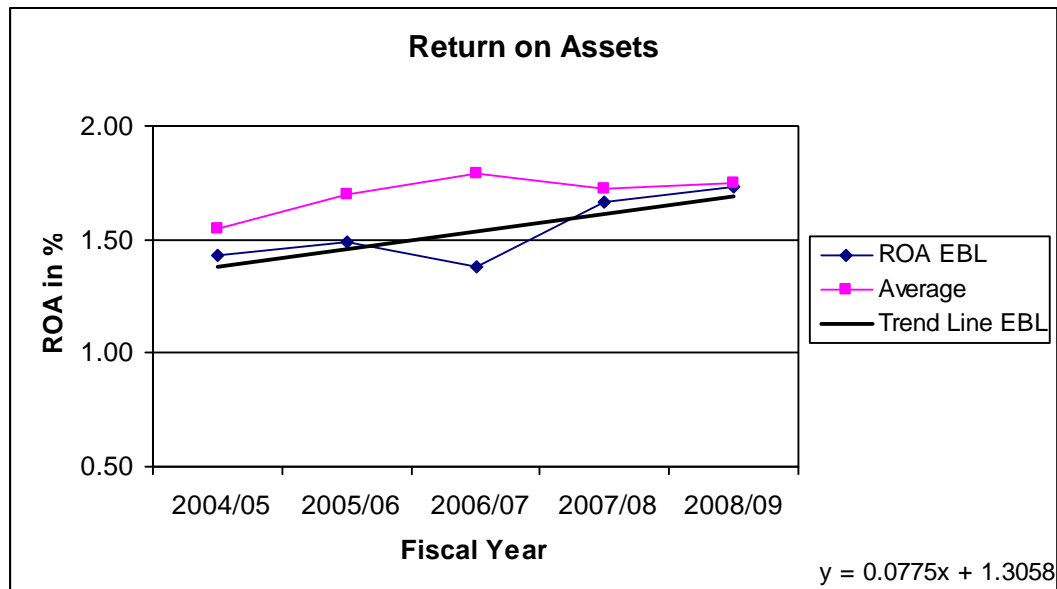


Fig 4.2 reveals the observed return on assets along with the trend line ascertained from the least square method and average ratio line obtained from the average ratio. Return on assets line is gradually increasing in fiscal year 2005/06. And it has gone down in the fiscal year 2006/07. But in the year 2007/08 and 2008/09 it has gone up. The trend line of ROA of EBL is positive and almost horizontal in shape. This indicates positive return on assets. However the ROA of EBL is far more below the average line during the first four fiscal periods of the study. EBL performed relatively poor in ROA in fiscal year 2006/07. However it tends to go near the average ratio line during the fiscal year 2008/09.

4.1.3 Analysis of Equity Multiplier

Equity multiplier is a measure of leverage thus it measures the extent to which assets of the financial institutions' are funded with equity relative to debt. EM affects a bank's profit because it has a multiplier impact on return on assets (ROA) to determine on bank's return on equity (ROE). The equity multiplier allows the investor to see what portion of the return on equity is the result of debt (Kennon, 2007).

Generally, management tends to prefer equity financing over debt since it carries less risk (Evans, 2007). A bank's equity multiplier compares assets with equity such that large values indicate a large amount of debt financing relative to stockholders' equity. EM thus measures the financial leverage and represents both a profit measure and a risk measure. EM represents a risk measure by reflecting how many assets can go into default before a bank becomes insolvent (Gup & Kolari, 2005:113). The higher this ratio the more leverage or debt the bank is using to fund its assets.

Table 4.3

Analysis of Equity Multiplier of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Total Assets (Rs In 00,000)	117325	159592	214325	271493	369168
Total Equity Capital (Rs In 00,000)	8326	9628	12015	19212	22036
EM of EBL (Times)	14.09	16.58	17.84	14.13	16.75
Average EM (Times)	14.16	14.61	14.67	13.98	15.35

Source: Annual Reports

(Note: Average EM is obtained from calculation of average of EM of EBL, NABIL, HBL and NSBI for the study period. See Appendix-VI)

Table 4.3 shows the Equity Multiplier during the study period i.e. from fiscal year 2004/05 to 2008/09. As shown in the table, there is increasing trend in EM during the first three fiscal year i.e. from 2004/5 to 2006/07. This indicates that EBL has used more debt to finance its assets during this period. But in the fiscal year 2007/08 EM has decreased to 14.13. This is due to the bank has increased equity capital in relation to debt to finance its assets. In this fiscal year EBL has increased the substantial amount of reserve and surplus in its total equity capital. Again in the fiscal year 2008/09 EM has increased to 16.75 EM of EBL is greater than the average during the study period except in fiscal year 2004/05.

Fig 4.3

Equity Multiplier of EBL

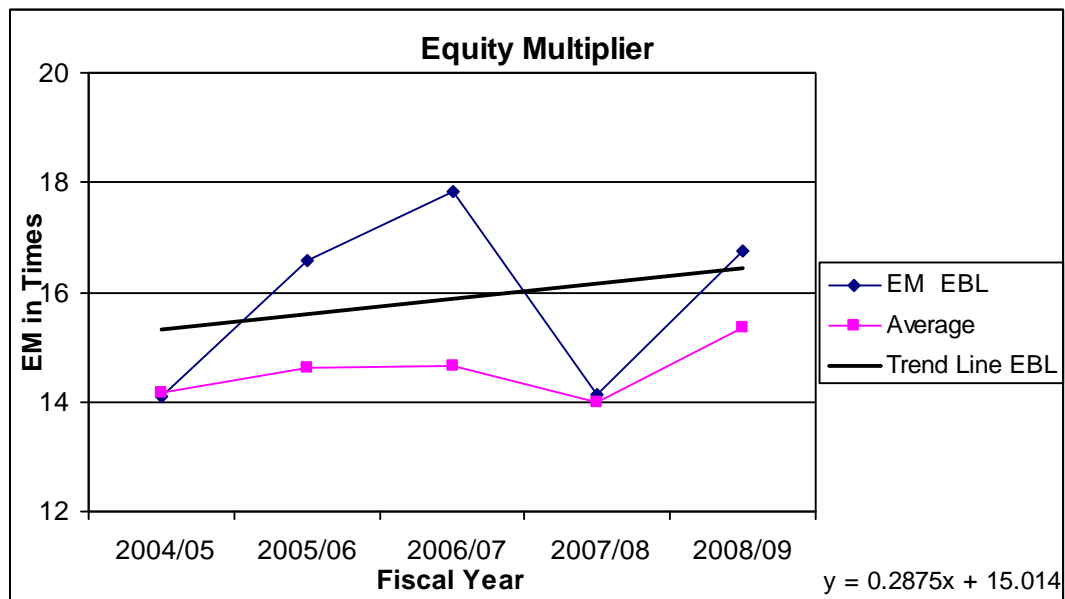


Fig 4.3 presents the trend of equity multiplier along with the observed ratios and average ratio line. As shown in the fig. 4.3 equity multiplier of EBL is more fluctuating during the study period. And it is gradually sloping upwards in the first three fiscal year of the study period. And it has gone downward in the fiscal year 2007/08. Again it tends to slope upwards in fiscal year 2008/09. However, the slope of trend line ascertained from the least square method is almost horizontal shaped. EM of EBL is far more above the average ratio line during the 2005/06, 2006/07 and 2008/09. However it is close to average line during the fiscal year 2007/08 and below the average in fiscal year 2004/05.

4.1.4 Analysis of Profit Margin

Profit Margin (PM) measures the banks ability to pay expenses and generate net income from interest and non interest income. The general rule-of-thumb is that a higher profit margin is preferable. Various expense ratios determine profit margin. As the profit margin measures the bank's ability to control expenses, the better the expense control the more profitable the bank.

Table 4.4**Analysis of Profit Margin of EBL**

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	Fy 2008/09
Net Income (Rs In 00,000)	1682	2372	2964	4512	6387
Total Operating Income (Rs In 00,000)	5564	6621	8413	12098	15449
PM of EBL(In %)	30.23	35.83	35.23	37.30	41.34
Average PM (In %)	28.42	35.14	40.96	40.16	40.95

Source: Annual reports

(Note: Average PM is obtained from calculation of average of PM of EBL, NABIL, HBL and NSBI for the study period. See Appendix-VI)

Table 4.4 shows the profit margin ratio during the study period i.e. 2004/05 to 2008/09. PM ratio of EBL has abruptly increased during the fiscal year 2005/06. However there is slight increment in PM in fiscal year 2006/07. Again in the Fiscal year 2007/08 it has increased to 37.29%. Again it has increased in fiscal year 2008/09 to 41.34%. EBL has faced high fluctuation in profit margin during the study period. During the first two fiscal periods of the study profit margin of EBL is greater than the average. However it is lower than the average during the respective two fiscal periods i.e., fiscal year 2006/07 and 2007/08. But again profit margin of EBL is greater than the average in 2008/09.

Fig 4.4

Profit Margin of EBL

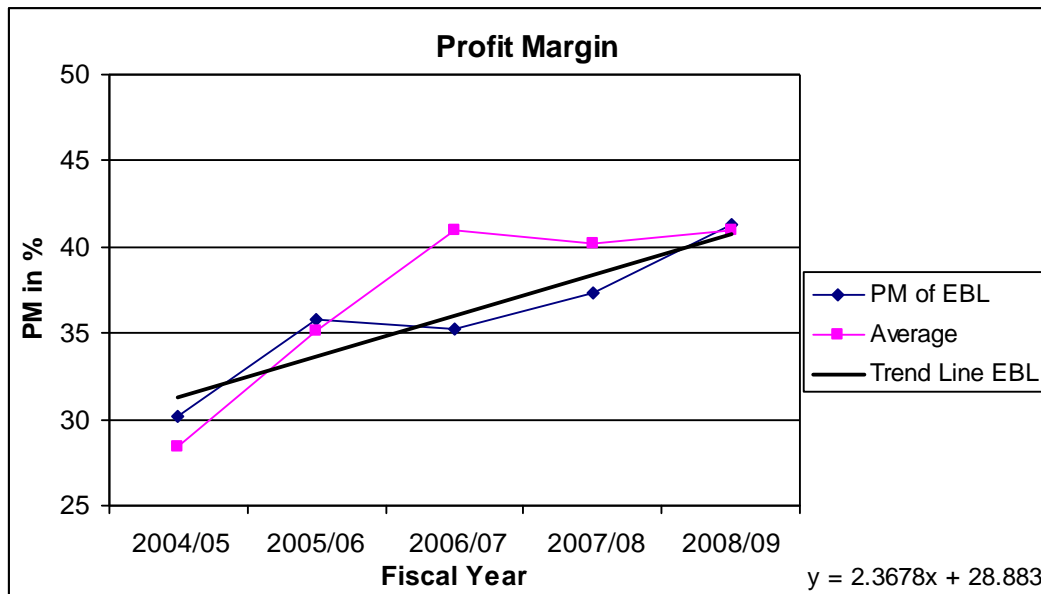


Fig 4.4 summarizes the trend of profit margin of EBL during the study period. As shown in the fig 4.4, profit margin of the bank is in increasing trend throughout the study period however the rate of increment is fluctuating. The positive and upward sloping trend line indicates the increasing trend in profit margin of the bank. As shown in the figure, PM line of EBL is above the average line in the first two fiscal periods of the study. But it is far more below the average line in the respective two fiscal periods. However it is above again in the fiscal year 2008/09. EBL performs poor in profit margin in fiscal year 2006/07 and 2007/08. In 2006/07 both the interest expenses ratio and provision for loan loss ratio of the bank are found to be high in 2007/08 non-interest expense ratio and tax ratio of the bank are found in increasing due to increase in staff expenses and other operating expenses of the bank contributing to decrease in profit margin.

A breakdown of Profit Margin isolates various expense ratios listed in the income statement which determine the profit margin.

4.1.4.1 Analysis of Interest Expense Ratio

Interest expense ratio is the ratio of interest expenses on various kinds of deposits that the bank pays to its depositors to the total operating income of the bank. This ratio

measures the proportion of the total operating income that goes to pay interest liabilities of the bank. As interest expense is the cost of deposit that has to bear against holding different types of deposits by the bank the, lower the ratio, the higher the banks profitability. The volume of interest expense ultimately results either from maximum deposits volume collected by the bank or high rate offered on deposits. Controlling cost of deposit should not result in decrease of volume of total deposits. Other interest expenses on borrowings (debentures, bond, loan from NRB, inter bank / financial institution borrowing etc) also has to be borne by the bank. A high or increasing ratio of expenses to total revenues may give indication of increase in cost and so is likely to affect profitability. Interest expense on total deposit comprise of interest liabilities on fixed, saving and call accounts, both local and foreign currencies. This figure is very important because it's variation over time indicates how well management is controlling interest rate risk.

Table 4.5

Analysis of Interest Expense Ratio of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Interest Expenses (Rs In 00,000)	2995	4013	5171	6326	10128
Total Operating Income (Rs In 00,000)	5564	6621	8413	12098	15449
Ratio (%)	53.83	60.61	61.46	52.29	65.56

Source: Annual Reports

Table 4.5 represents the interest expense ratios during the study period. EBL has obtained 53.83% of interest expense ratio in the fiscal year 2004/05. And it has increased substantially to 60.61% in fiscal year 2005/06 with 6.78% of increasing rate. It tends to increase by very tiny increment in the fiscal year 2006/07. It has decreased to 52.29% in the fiscal year 2007/08. Again it has increased to 65.56% in the final year of the study period. In this fiscal year there is substantial increase in the volume of total deposit and the bank has added loan and borrowing. This shows very high fluctuation in interest expense ratio of EBL. Although the total figure of deposit has been increased substantially in the fiscal year 2007/08 EBL has minimum of 52.29% interest expense ratio during the fiscal year 2007/08.

Fig 4.5

Interest Expense Ratio of EBL

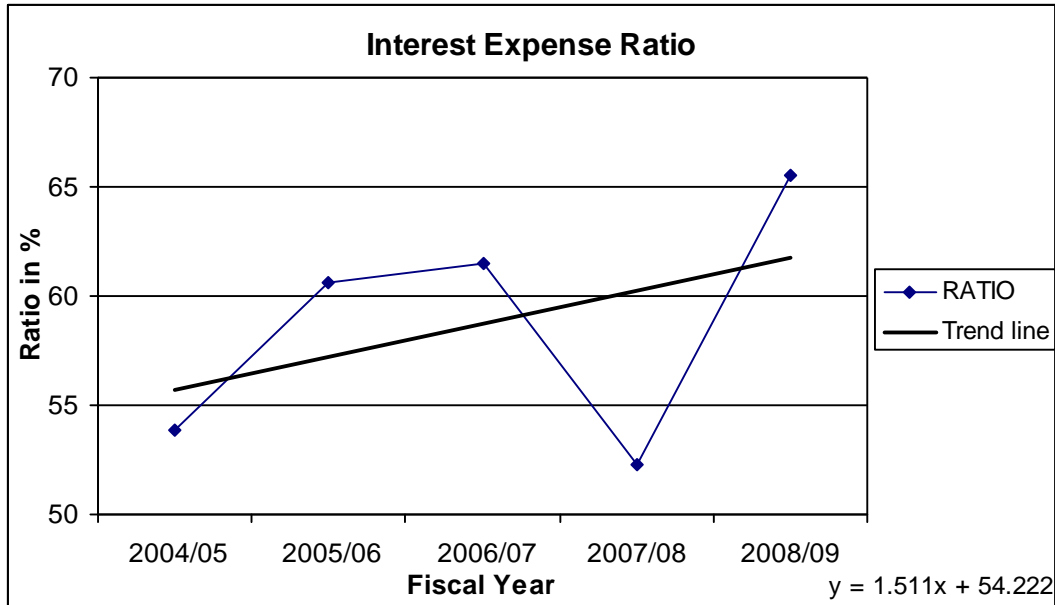


Fig. 4.5 presents the trend of interest expense ratio over the study period. The observed line is fluctuating during the study periods. It has been sloping upwards in the first three fiscal years. The trend line also tends to slope upwards in first three fiscal years. In the fiscal year 2007/08 it tends to slope downwards but again in the final year of the study period it goes upwards abruptly. As bank prefers lower of this ratio, the upward sloping line indicates banks inability to control cost of deposit.

4.1.4.2 Analysis of Provision for Loan Loss Ratio

Provision for loan losses is the amount charged as operating expenses to provide an adequate reserve to cover anticipated losses in the loan portfolio. These charges become part of the allowance for loan losses, a negative component on the asset side of the banks balance sheet, which is then used to charge off loans after they become nonperforming. Provision for loan loss ratio measures the proportion of total operating income that goes to keep provision for loan losses. The lower the provision for loan loss ratio, the higher the bank's profitability.

Table 4.6

Analysis of Provision for Loan Loss Ratio of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Povision for Loan Losses (Rs In 00,000)	889	696	896	977	930
Total Operating Income (Rs In 00,000)	5564	6621	8413	12098	15449
Ratio (%)	15.98	10.51	10.65	8.08	6.02

Source: Annual Reports

Table 4.6 presents the provision for loan loss ratios of EBL during the study period. The table shows the provision for loan loss ratio is decreasing. The ratio is decreased from 15.98% in fiscal year 2004/05 to 6.02% in fiscal year 2008/09. The ratio has decreased by more than half from 2004/05 to 2008/09. It has decreased by 5.46% in fiscal year 2005/06. There is slight decrease in fiscal year 2006/07 But again there is decrease in ratio from 10.65% in fiscal year to 8.08 % in fiscal year 2007/08. Similarly it has decreased form 8.08% to 6.02% in the final year of the study period. The ratio goes on decreasing trend over the study period.

Fig 4.6

Provision for Loan Loss Ratio of EBL

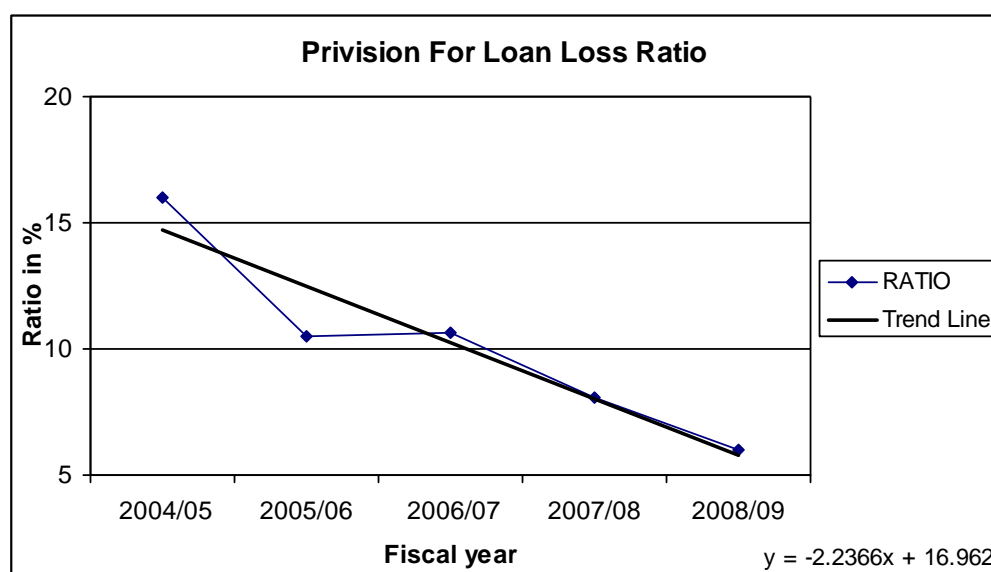


Fig. 4.6 presents the trend of provision for loan loss ratio during the study period. The trend line is downward sloping in vertical shape. The ratio has gone down abruptly in

the fiscal year 2005/06. And in the respective year it tends to remain almost same with very tiny movement. Again it goes downwards. The observed provision for loan loss ratio is in decreasing trend over the study period. This trend shows that EBL has been able to decrease its non-performing loan. Decreasing trend line of provision for loan loss indicates the sound management of bank to maintain low level of non performing loans.

4.1.4.3 Analysis of Non-Interest Expense Ratio

Non-interest expense ratio is the ratio of non-interest expenses to total operating income. In other words it measures the proportion of total operating income that goes to pay non-interest expenses of the bank. Non-interest expense is composed of personal expenses which include salaries and fringe benefit paid to bank employees, occupancy expenses for rent and depreciation on equipments and premises and other operating expenses including technology expenditure, utilities and deposit insurance premium. As an expense, banks prefer lower non-interest ratio. Thus, it measures the bank's ability to control the expenses to generate net income. Non-interest expense far exceeds non-interest income at most banks, hence the label burden. Reducing this burden will improve profitability. Most banks face great pressure to keep net interest income from shrinking, they aggressively try to raise fee income and cut overhead expenses to support profit growth.

Table 4.7

Analysis of Non-Interest Expense Ratio of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Non-interest Expenses (Rs In 00,000)	1896	2144	2636	3917	4789
Total Operating Income (Rs In 00,000)	5564	6621	8413	12098	15449
Ratio (%)	34.08	32.38	31.33	32.38	31.00

Source: Annual Reports

Table 4.7 presents non-interest ratio of EBL during the study period. In the fiscal year- 2004/05 non-interest expense ratio is 34.08%. Non-interest expenses ratio is fluctuating over the study period. It has decreased by 1.7% in fiscal year 2005/06 and

by 1.05% in fiscal year 2006/07. Again it has increased by 1.05% in fiscal year 2007/08 and decreased to 31.00% in fiscal year 2008/09. EBL has not been able to maintain stable non-interest expense ratio. Non-interest expenses have increased in 2007/08 due to increase in staff expenses and other operating expenses.

Fig 4.7

Non-interest Expense Ratio of EBL

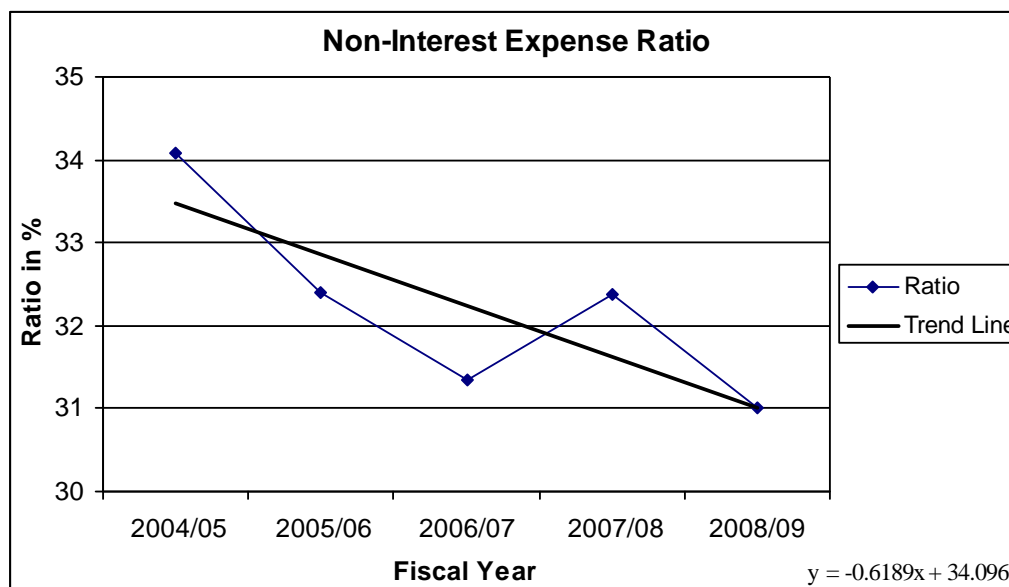


Fig. 4.7 shows the trend of non-interest expenses of EBL during the study period. There are high fluctuations in this ratio over the study period in spite of decreasing trend line of the ratio. These fluctuations indicate that the bank is not able to control non-interest expenses in first three fiscal years. Observed ratio line tends to slope downwards in the fiscal year 2005/06 and in 2006/07. But in the fiscal year 2007/08 it tends to slope upwards. And again in the final year of the study period it tends to decline. However the overall trend line is downward sloping.

4.1.4.4 Analysis of Tax Ratio

Tax ratio measures the proportion of total operating income of the bank that goes to pay income tax liabilities.

Table 4.8

Analysis of Tax Ratio of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Income Taxes (Rs In 00,000)	793	1051	1304	2525	2527
Total Operating Income (Rs In 00,000)	5564	6621	8413	12098	15449
Ratio (%)	14.25	15.57	15.50	17.14	16.34

Source: Annual Reports

Table 4.8 shows the income tax ratios of EBL during the study period. There are high fluctuations in tax ratios during the study period. This ratio is in increasing trend up to the fiscal year 2007/08. However it tends to decrease in fiscal year 2008/08.

Fig 4.8

Tax Ratio of EBL

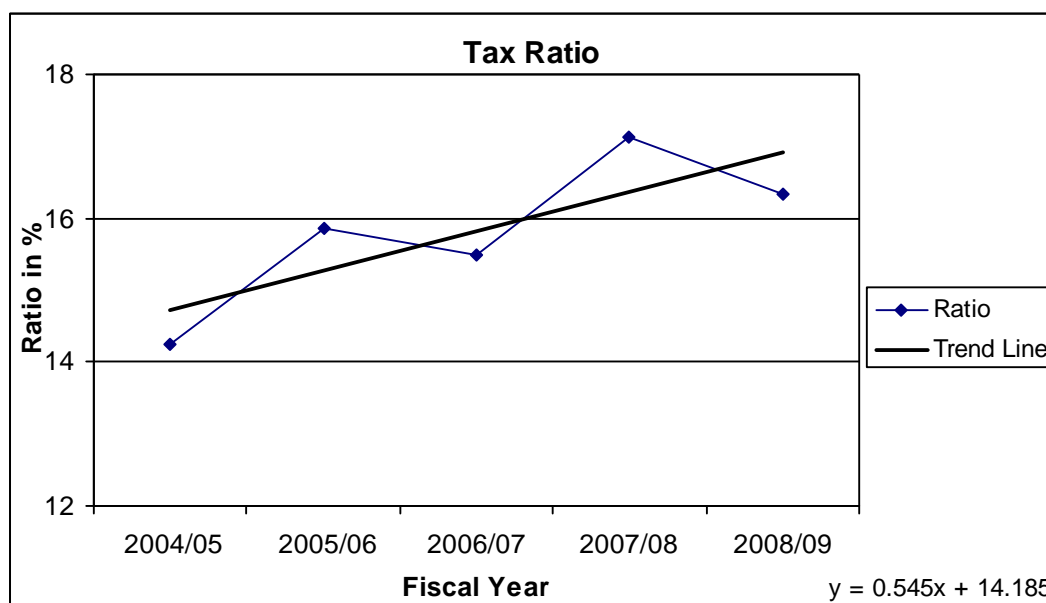


Fig 4.8 shows the trend of income tax ratios of EBL over the study period. In the fig 4.8 there is increasing movement in observed tax ratio line in the first two fiscal year of the study period. However the line goes downwards in the respective fiscal year of the study period. Again it tends to go up in fiscal year 2007/08. But in the final year of the study period it is declining. The trend line ascertained from the least square method is positively and slightly upward moving.

4.1.5 Analysis of Assets Utilization

The assets utilization (AU) measures the extent to which the banks assets generate revenue. In other words this ratio measures the bank's ability to generate interest income and non-interest income. High value of this ratio signifies the efficient use of bank's resources to generate interest income and non-interest income. The breakdown of the AU ratio separates the total revenue generated into interest income and non-interest income. A sum of interest income ratio and non-interest income ratio equals AU ratio.

Table 4.9

Analysis of Assets Utilization of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Total Operating Income (Rs In 00,000)	5564	6621	8413	12098	15449
Total Assets (Rs In 00,000)	117325	159592	214325	271493	369168
AU of EBL(%)	4.74	4.15	3.93	4.46	4.18
Average Ratio(%)	5.04	4.64	4.34	4.27	4.25

Source: Annual Reports

(Note: Average AU is obtained from calculation of average of AU of EBL, NABIL, HBL and NSBI for the study period. See Appendix-VI)

Table 4.9 presents the assets utilization ratios of Everest Bank Limited during the study period. Assets utilization ratio stands at 4.74% in fiscal year 2004/05. And it has decreased in respective two fiscal years. It has gone down to 3.93% in fiscal year 2006/07. However, it has increased to 4.46% in fiscal year 2007/08. But again in the respective fiscal year 2008 /09 it has decreased to 4.18%. Assets utilization ratio of EBL is lower than the average ratio in the first three fiscal periods of the study. However it is greater than the average in the fiscal year 2007/08. But again it is lower than the average in final year of the study period.

Fig 4.9
Assets Utilization of EBL

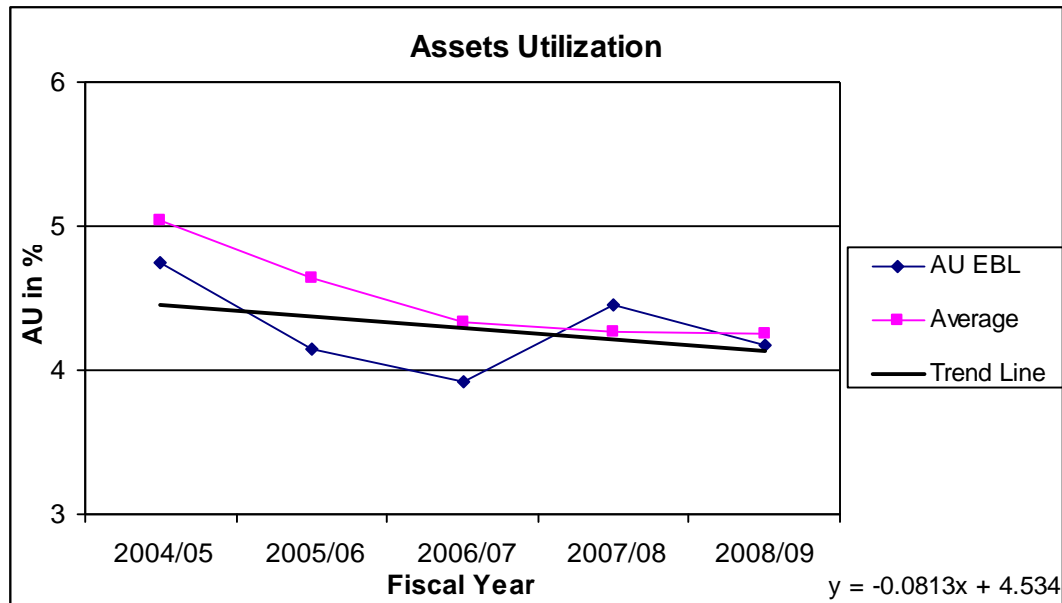


Fig 4.9 reveals the assets utilization trend of EBL over the study period. Observed assets utilization line is in decreasing trend during the first three fiscal periods of the study. However it tends to increase in fiscal year 2007/08. As shown in the fig. 4.9 the trend line of assets utilization of EBL is downward sloping with the slope of -0.159 through out the study period. Assets utilization of EBL is below the average during the first three fiscal periods of the study. However it goes above the average ratio line during the fiscal year 2007/08. As shown in the figure, EBL performs poor in assets utilization in fiscal year 2005/06 and 2006/07. It is observed that both the interest income and non-interest income ratios are relatively lower in these fiscal periods.

4.1.5.1 Analysis of Interest Income Ratio

Interest income ratio measures the banks ability to generate interest income using its resources. High value of this ratio signifies the efficient use of bank resources to generate income. Interest income is generated from loan, advances and overdraft, investments, balances in other banks, money at call and short notice and others like inter-bank loan and foreign currencies placements.

Table 4.10

Analysis of Interest Income Ratio of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Interest Income (Rs In 00,000)	7192	9034	11444	15486	21868
Total Assets (Rs In 00,000)	117325	159592	214325	271493	369168
Ratio (%)	6.13	5.66	5.34	5.70	5.92

Source: Annual Reports

Table 4.10 depicts the interest income ratio of EBL during the study period. As shown in the table 4.10, interest income ratio of 5.34% is minimum in fiscal year 2006/07. However interest income volume is increasing in each year, the ratio is fluctuating over the study period. The ratio has been decreasing during the first four fiscal years. But, in the fiscal year 2007/08 it has increased by 0.36% from previous year ratio and it has increased to 5.92% in fiscal year 2008/09.

Fig. 4.10

Interest Income Ratio of EBL

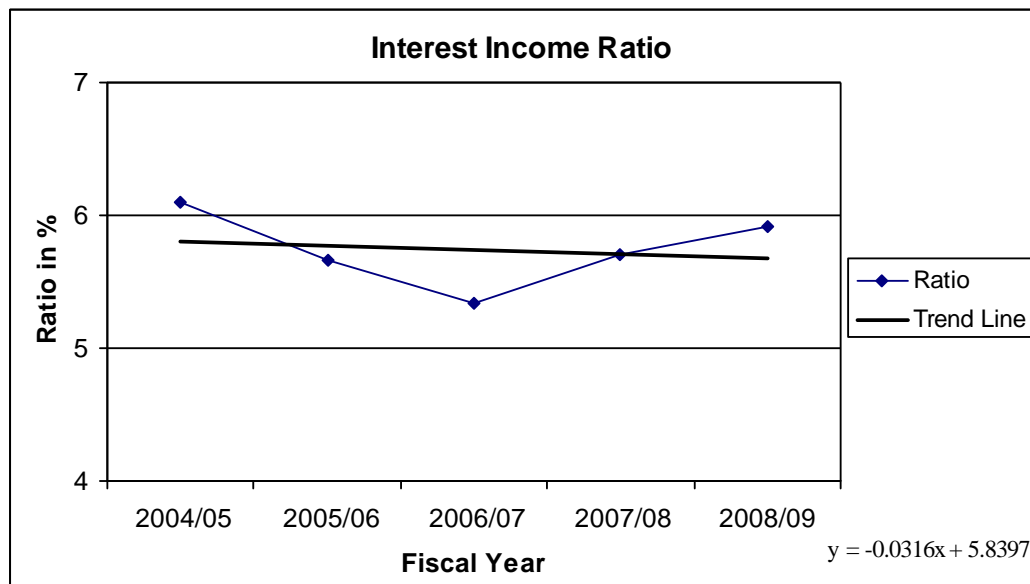


Fig. 4.10 presents the trend of interest income ratio over the study period. As shown in the fig. 4.10 the observed interest income ratio of EBL is in decreasing trend. However it tends to increase from fiscal year 2007/08. The slope of trend line

determined by least square method is -0.3032 and in decreasing trend. This indicates the bank is not highly efficient in mobilizing its resources to generate interest income.

4.1.5.2 Analysis of Non-Interest Income Ratio

The interest income and non-interest income are not necessarily independent. The bank's ability to generate loans affects both interest income and through fees and service charges, non-interest income. Non-interest income ratio measures the bank's ability to generate non-interest income by using its resources. Banks prefer high value of this ratio as the same signifies the efficient use of banks resources.

Table 4.11

Analysis of Non-Interest Income Ratio of EBL

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Non-interest Income (Rs In 00,000)	1366	1601	2140	2938	3710
Total Assets (Rs In 00,000)	117325	159592	214325	271493	369168
Ratio (%)	1.16	1.00	1.00	1.08	1.00

Source: Annual Reports

Table 4.11 shows the non-interest income ratios over the study period. Non-interest income ratio of EBL is decreasing during the fiscal year 2005/06 and 2006/07 of the study period. It has decreased from 1.16% in 2004/05 to 1.00% in 2005/06. In the respective year it remained the same at 1.00 %. But it has increased by 0.08% in fiscal year 2007/08. Again it has decreased to previous level of 1% in fiscal year 2008/09.

Fig 4.11

Non-Interest Income Ratio of EBL

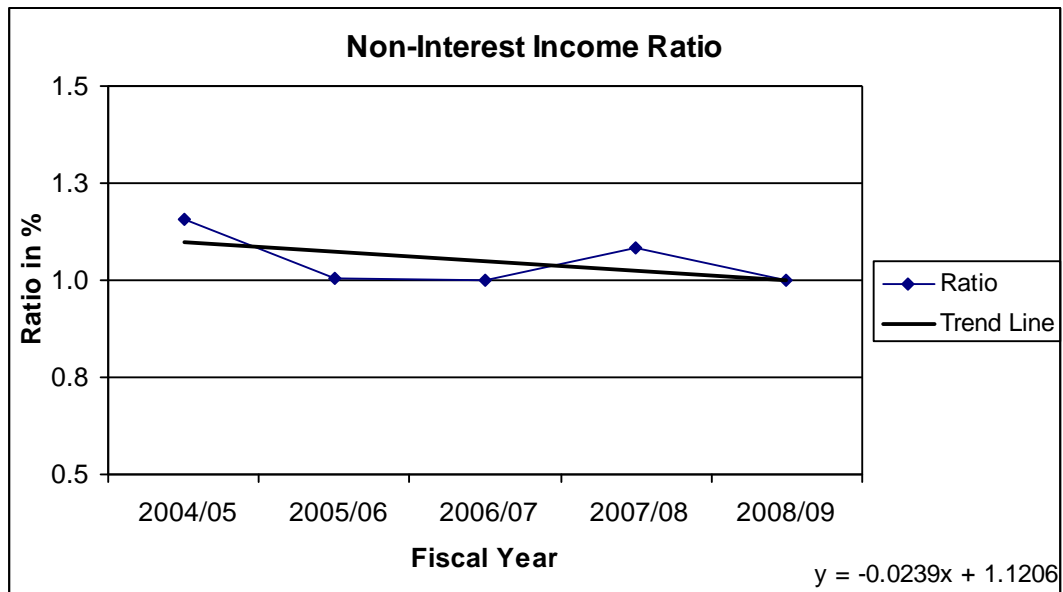


Fig. 4.11 depicts the trend of non-interest income ratio during the study period. The non-interest income ratio line of the bank is downwards loping from fiscal year 2004/05 to fiscal year 2005/06 and it remains straight in the respective fiscal year 2006/07. However it tends to go upward by very tiny movement in fiscal year 2007/08. The trend line ascertained from the trend values of non-interest income ratios is in decreasing trend. This indicates the EBL is not optimizing its utilization of its resources.

4.1.6 Correlation Between Net Income and Total Equity Capital

As return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity fund on the balance sheet, the correlation between net income and total equity capital measures the degree of relationship between these two. Similarly this measures how a change in total equity capital portfolio effects in the net income of the bank. Here net income is considered as dependent variable (Y) and total equity capital is considered as independent variable (X).

Table 4.12

Correlation between Net Income and Total Equity Capital of EBL

Correlation Coefficient (r)	P.E.	6* P.E.	Remarks
0.99	0.006	0.036	r>6* P.E.

Source: Annual Reports

Table 4.12 shows that coefficient of correlation between net income and total equity capital which is denoted by the symbol 'r' is 0.99. This indicates positive relation between net income and total equity capital. As shown in the table 4.12, value of 'r' is greater than 6P.E. and near to 1; it shows the significant relationship between dependent variable net income and independent variable total equity capital during the study period.

4.1.7 Correlation between Net Income and Total Assets

Banks mobilize their resources to generate net income by optimum utilization of their resources. The correlation between net income and total assets measures the degree of relationship between net income and total assets. Thus for the analysis net income is considered as dependent variable (Y) and a total asset is considered as independent variable (X).

Table 4.13

Correlation between Net Income and Total Assets of EBL

Correlation Coefficient (r)	P.E.	6* P.E.r	Remarks
0.98	0.012	0.072	r>6* P.E.

Source: Annual Reports

Table 4.13 presents the coefficient of correlation between net income and total assets. Observed value of coefficient of correlation between nit income and total assets is 0.98 for the study period is near to 1. Similarly, the value of 'r' is greater than 6P.E. which proves that there exists significant relationship between the dependent variable net income and independent variable total assets.

4.1.8 Correlation between Net Income and Total Operating Income.

Profit margin of the bank is proportion of net income to total operating income. Hence correlation between net income and total operating income measures the degree of relationship between these variable. In other words it shows their relationship in terms of how a change in total operating income affects the value of net income. Hence, for the convenience of analysis net income has been considered as dependent variable (Y) and total operating income has been considered as independent variable (X).

Table 4.14

Correlation between Net Income and Total Operating Income of EBL

Correlation Coefficient (r)	P.E.	6* P.E.	Remarks
0.99	0.006	0.036	r>6* P.E.

Source: Annual Reports

Table 4.14 shows the coefficient of correlation between net income and total operating income for the study period. The value of 'r' is as shown in the table 4.14 is 0.99 which is near to 1, this signifies the existence of positive and strong relationship between net income and total operating income. Likewise, the value of 'r' remains greater than 6PE, which indicates the significant relationship between the variables.

4.1.9 Correlation between Total Operating Income and Total Assets.

Correlation between net income and total operating income measures the degree of relationship between total operating income and total assets. In other words it reflects in what relation total operating income is affected by the changes in total assets. For the correlation analysis total operating income is considered as dependent variable (Y) and total assets of the bank is considered as independent variable (x).

Table 4.15

Correlation between Total Operating Income and Total Assets of EBL

Correlation Coefficient (r)	P.E.	6* P.E.	Remarks
0.98	0.012	0.072	r>6* P.E.

Source: Annual Reports

Table 4.15 reveals the coefficient of correlation between total operating income and total assets during the study period. Value of 'r' is 0.98 with probable error of 0.012. Since the value of 'r' is positive and near to 1 and greater than 6PE, this shows the significant relationship between total operating income and total assets.

4.2 Major Findings

The major findings from the financial performance analysis of Everest Bank Limited in the framework of ROE are as follows.

4.2.1 The return on equity (ROE) of EBL is fluctuating during the study period. And the slope of the trend line determined by the least square method is positive and upward sloping. This shows the return on equity of the bank is in increasing trend. However EBL has failed to maintain the increasing trend of ROE during the fiscal year 2007/08. During the first two fiscal periods, ROE of EBL is above the average ratio. But it is lower the average in the respective two fiscal years. Again ROE of EBL is higher than the average in fiscal year 2008/09.

4.2.2 Return on assets of EBL is fluctuating during the study period. During the last two fiscal periods of the study period ROA tends to increase. Overall trend of ROA of EBL is increasing during the study period. However, ROA of EBL is below the average ROA during the study period, it tends to closer to average ROA during the fiscal year 2007/08 and 2008/09. As compared to average ROA, the lower ROA of EBL indicates the inefficiency of the bank in utilization of its resources.

- 4.2.3 Equity multiplier of the bank is increasing and more fluctuating during the study period. Overall trend in equity multiplier is slightly increasing with very tiny movement almost in horizontal shape. EBL has EM above the average EM during the study period except in fiscal year 2004/05. This justifies that EBL is gradually increasing its leverage or debt financing in relation to equity capital to finance its resources.
- 4.2.4 EBL has obtained increasing profit margin trend during the study period. Some fluctuations are there in profit margin of EBL. During the first two fiscal periods, it has achieved PM above the average but it is below the average during the respective two fiscal periods. In 2006/07 both the interest expenses ratio and provision for loan loss ratios of the bank are found to be high and in 2007/08 non-interest expense ratio and tax ratios of the bank are found to be very high contributing to decrease in profit margin of the bank. However it tends to go above the average with increasing trend in the fiscal year 2008/09.
- 4.2.5 Interest expense ratio of EBL is highly fluctuating during the study period. EBL seems to be unable to maintain stability over cost of deposits to maximize the profitability. Although the trend is sloping upwards by very tiny movements, the bank has achieved increasing trend in interest expense ratio during the period. However, it is observed that increasing interest expenses is the result of increased volume of total deposit of the bank.
- 4.2.6 Provision for loan loss ratio of the bank is at lower level during the study period. Provision for loan loss ratio is sloping downwards abruptly during the study period. EBL has obtained lower level of provision for loan loss ratio. The trend line is also in declining trend during the study period.
- 4.2.7 There are high fluctuations in non-interest expense ratio over the study period in spite of decreasing trend line of the ratio. These fluctuations indicate the bank is not able to maintain stable control over non-interest expenses during the study period as the ratio stands at high level. In spite of fluctuations, EBL has achieved decreasing trend in non-interest expense ratio.

- 5.2.8 The income tax ratio of the bank is fluctuating during the study period. The trend line ascertained from the least square method is slightly upward moving.
- 4.2.9 During the study period, some fluctuations are observed. Assets utilization ratio line is in decreasing trend during the first three fiscal periods of the study. AU of EBL is below the average during the first three fiscal periods of the study. However, it tends to increase and has gone above the average in the fiscal year 2007/08. Except in the fiscal year 2007/08, EBL performs poor in assets utilization as compared to average level. Trend line of assets utilization of EBL is also downward sloping with the slope of -0.1597 , through out the study period. This decreasing trend indicates the banks inefficiency in mobilizing resources of the bank.
- 4.2.10 Interest income ratio of the bank is in decreasing trend. The ratio however is less fluctuating during the study period. The slope of trend line determined by least square method is downward sloping with the slope of -0.3032 and it is in decreasing trend. This indicates the bank is not highly efficient in mobilizing its resources to generate interest income.
- 4.2.11 Non-interest income ratio of the bank is decreasing during the two financial periods of the study. However it remains constant for a couple of period and tends to increase. The trend line for non-interest income ratio over the study period is downward sloping. This indicates that the EBL is not efficient in utilizing its resources to optimum level.
- 4.2.12 Correlation coefficient between the net income and return on equity stands at 0.99 which is near to 1 . This is also greater than $6P.E.$ From the study it is found that there exists significant relationship between net income and return on equity.
- 4.2.13 Correlation coefficient between net income and total assets is found to be 0.98 which is near to 1 and of course higher than $6P.E.$ i.e., 0.072 , this signifies the positive relationship between net income and total assets during the study period.

- 4.2.14 From the correlation coefficient analysis between net income and total operating income it is found the value of 'r' to be 0.99. The correlation coefficient is near to 1 and greater than 6P.E. This signifies the existence of positive and strong relationship between net income and total operating income.
- 4.2.15 From the correlation coefficient analysis between total operating income and total assets, it is found the value of 'r' to be 0.98. The correlation coefficient is near to 1 and greater than 6P.E. This signifies the existence of positive and strong relationship between total operating income and total assets.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter includes three aspects of the study - summary, conclusions and recommendations. The first aspect summarizes the whole study, the second draws the conclusion, and the last one forwards the recommendations.

5.1 Summary

The study was carried out as academic requirements for the degree of Master of Business Studies, on the topic Financial Performance Analysis of Everest Bank Limited in the Framework of Return on Equity. The General objective of the study was to evaluate the financial performance of Everest Bank Limited within the framework of DuPont based ROE model presented by Sounders and Cornett.

On a macroeconomic level, commercial banks represent the primary conduit of government monetary policy. On a microeconomic level, commercial banks represent the primary source of consumer credit and source of credit to small businesses. Commercial banks are financial intermediaries between the people with surplus fund and people in need for funds. In other words they are the most important source of institutional credit in the money market. Commercial banks play a dominant role in the money and capital markets and are worthy of detailed study to understand more fully about how the financial system works. In recent years, commercial banking industry has experienced a period of record profits as a very fast growing industry in the market scenario of Nepal. Despite record profits banks have weak and inefficient areas that still need to be addressed. Hence the study was carried out to evaluate the overall profitability of Everest Bank Limited in the framework of ROE. The specific objectives of the study were; to assess the return on equity, to measure the return on assets, to analyze the equity multiplier, to examine the profit margin and to evaluate the level of assets utilization of Everest Bank Limited.

Various materials were reviewed in order to build up the conceptual foundation and to find out the clear destination of the research work. Concept of commercial bank, historical development of commercial bank in Nepal, functions of commercial bank, financial statements of commercial bank, balance sheet and income statement, concept of DuPont system of financial ratios and conceptual framework of Return on Equity model reviewed in conceptual review section. Similarly, various research papers and research articles relevant with the study, and dissertations were also reviewed in the research review section of the report.

The study has covered the five fiscal periods from fiscal year 2004/05 to 2008/09. The study was done employing descriptive and analytical research design. In the research most of the data are of secondary in nature. These data are collected from secondary sources. However to some extent primary data were also used and the same were collected from unstructured interview with the authorities of Everest Bank Limited. Data were analyzed employing the DuPont based ROE framework along with some statistical tools to obtain the results. The analysis has been made evaluating the trend of return on equity, trend of return on assets, trend of profit margin and its contributing factors, level of equity multiplier and level of assets utilization of EBL. Conclusions are drawn comparing the results with average ratios calculated as standards from the ratios of Himalayan Bank Limited, NABIL Bank Limited and Nepal SBI Bank Limited. Return on Equity of EBL is in increasing trend. However, it is below the average during two fiscal periods. Although the overall trend of ROA of EBL is increasing during the study period, it is below the average ROA through out the study period. EBL is gradually increasing its leverage or debt financing in relation to equity capital to finance its assets. Some fluctuations are there in profit margin of EBL. It is found that the bank has been unable to mobilize its resources in optimum level to generate interest income and non-interest income.

5.2 Conclusions

Based on findings, following conclusions have been drawn as a concluding framework of the study on financial performance analysis of Everest Bank Limited in the framework of Return on Equity.

- 5.2.1 The return on equity of EBL is in increasing trend with some fluctuations. EBL has crossed average ROE during three fiscal periods. However it is below the average during the two fiscal periods. There is not consistency in the trend of ROE. It is concluded that management of owner's equity is better in 2004/05, 2005/06 and in 2008/09 as ROE is above the average. And management of owner's equity is relatively poor in fiscal year 2006/07 and 2007/8 since it has not met the average figure.
- 5.2.2 Although the overall trend of ROA of EBL is increasing during the study period, it is below the average ROA through out the study period. As compared to average, return on assets of the bank is very poor in the fiscal year 2006/07. Hence it is concluded that EBL is not inefficiently utilizing its assets to generate profit.
- 5.2.3 Equity multiplier of the bank is increasing and more fluctuating during the study period. Moreover, it is above the average during the four fiscal periods of the study. Hence it is concluded that EBL is gradually increasing its leverage or debt financing in relation to equity capital to finance its assets. As EM represents a risk measure, the increasing trend in EM indicates the increasing level of capital risks of the bank.
- 5.2.4 Some fluctuations are there in profit margin of EBL. The positively increasing overall profit margin trend shows EBL has been trying to getting control over expenses of the bank. However EBL has lower profit margin ratio than the average during the fiscal year 2006/07 and 2007/08. Hence, it is concluded that EBL is not consistent and able enough in controlling expenses to maintain average level of profit margin.
- 5.2.5 Interest expense ratio of EBL is highly fluctuating during the study period. EBL seems unable to control over cost of deposits with its increased volume to maximize the profitability.
- 5.2.6 Since the overall trend of provision for loan loss ratio is sloping downwards abruptly during the study period, it is concluded that EBL has focused on maintaining good quality of loan and minimizing non-performing loan at

lower level as it indicates management's perception of the quality of the bank's loan.

- 5.2.7 There are high fluctuations in non-interest expense ratio over the study period in spite of decreasing trend line of the ratio. These fluctuations and high level non interest expense ratio indicate that EBL is not getting control over non-interest expenses during the study period.
- 5.2.8 The trend of assets utilization of EBL is found to be decreasing during the study period. AU of EBL is below the average AU during three fiscal periods which indicates the lower assets utilization level of EBL. Hence it is concluded that EBL is inefficient in mobilization its resources to the optimum level to generate interest income and non-interest income.
- 5.2.9 Both the Interest income ratio and non-interest income ratio of the bank are in decreasing trend with high fluctuations during the study period contributing to decreasing trend in assets utilizations. Hence it is concluded that the bank is not putting maximum effort in mobilizing its resources to generate interest income and non-interest income.
- 5.2.10 Based on the correlation analysis between net income and return on equity and net income and total assets, it is concluded that there exists significant relationship between net income and total equity capital and net income and total assets.
- 5.2.11 The correlation analysis between net income and total operating income signifies the positive correlation between net income and total operating incomes of EBL during the study period. Similarly from the study it is concluded that there is positive and significant relationship between total operating income and total assets.

5.3 Recommendations

The following recommendations are made based on the conclusions obtained from the financial performance analysis of Everest Bank Limited in the framework of Return on Equity.

- 5.3.1 Overall profitability as represented by return on equity has been found to be in increasing trend during the study period. However it is below the average during the two fiscal periods. Hence it is recommended to manage and mobilize shareholders equity effectively to increase its overall profitability to compete in the market.
- 5.3.2. Although the overall trend of ROA of EBL is increasing during the study period, it is below the average through out the study period. Hence it is recommended to concentrate on optimum utilization of its assets to generate higher level of return on assets.
- 5.3.3 Higher level of EM with increasing trend indicates the use of more leverage to fund its assets. As EM represents a risk measure, the increasing trend in EM indicates the increasing level of capital risk of the bank. Hence, it is recommended to the management of the bank to be aware of the increased level of capital risk.
- 5.3.4 During the study period high fluctuations are observed in profit margin of the bank, it is recommended to maintain lower level of expenses to obtain higher level of profit margin. During the study, non-interest expenses of the bank found to be very high. Hence it is recommended to focus on maintaining lower level of the same because the better the expense control, the more profitable the bank.
- 5.3.5. The trend of assets utilization is decreasing with the decreasing trend in its contributing components interest income and non-interest income during the study period and below the average except in the fiscal year 2007/08. This justifies that the bank is not putting maximum effort in mobilizing its resources to optimum level to generate revenue. Hence, it is recommended to put maximum effort on optimum utilization of the resources to obtain higher level of assets utilization.

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APPENDIX-I

Balance Sheet of EBL from Fy 2004/05 to 2008/09

Fiscal Year	Fy2004/05	Fy2005/06	Fy2006/07	Fy2007/08	Fy2008/09
Capital and Liabilities					
Share Capital	518000000	518000000	518000000	831400000	838821000
Reserve and Surplus	314617365	444808301	683515266	1089837580	1364804055
Debenture and Bonds	300000000	300000000	300000000	300000000	300000000
Loan and Borrowings					312000000
Deposit Liabilities	10097690989	13802444988	18186253541	23976298535	33322946246
Bills Payable	17777860	15805995	26776480	49429700	148655592
Proposed and unpaid dividend	23527388	114666758	68146323	140790370	230524766
Income Tax Liabilities	3312244		15278110	41143107	20522280
Other Liabilities	457590572	763558645	1634604580	720443592	378574715
Total Capital and Liabilities	11732516418	15959284687	21432574300	27149342884	36916848654
Assets					
Cash in Hand	192590297	259347645	534996791	822989425	944695793
Balance with Nepal Rastra Bank	779669004	1139514873	1178198197	1080914554	4787163541
Balance with other banks & financial institutions	77729907	154104976	678225606	764067851	432511829
Money at call and short notice	570000000	66960000		346000000	
Investments	2128931852	4200515220	4984314586	5059557544	5948480273
Loan Advances and Bills Purchased	7618671476	9801307676	13664081664	18339085562	23884673616
Fixed Assets	134068090	152089805	170097452	360512480	427157451
Non-Banking Assets	24570614	7436642			
Other Assets	206285178	178007850	222660004	376215468	492166151
Total Assets	11732516418	15959284687	21432574300	27149342884	36916848654

Balance Sheet of HBL from Fy 2004/05 to 2008/09

Fiscal Year	Fy2004/05	Fy2005/06	Fy2006/07	Fy2007/08	Fy2008/09
Capital and Liabilities					
Share Capital	643500000	772200000	810810000	1013512500	1216215000
Reserve and Surplus	898246461	993975616	1335689655	1499479102	1903665537
Debenture and Bonds	360000000	360000000	360000000	860000000	500000000
Loan and Borrowings	146048286	144624897	235967811	83177973	–
Deposit Liabilities	24814011984	26490851640	30048417756	31842789356	34681345179
Bills Payable	68399189	73577730	91303206	102669796	113509140
Proposed and unpaid dividend	80120166	238409026	130939748	263076319	162096954
Income Tax Liabilities	3250506		11913476	19131036	10163115
Other Liabilities	404581281	386750763	494099459	491695555	733327144
Total Capital and Liabilities	27418157873	29460389672	33519141111	36175531637	39320322069
Assets					
Cash in Hand	286529934	305428144	177242226	278183489	473759695
Balance with Nepal Rastra Bank	1604148857	1096253097	1272543067	935841697	2328405821
Balance with other banks & financial institutions	123792166	315671095	307555959	234117704	246361272
Money at call and short notice	441080900	1005280000	1710023859	518529500	1170793650
Investments	11692341559	10889031449	11822984558	13340176785	8,710,690,646
Loan Advances and Bills Purchased	12424520646	14642559555	16997997046	19497520482	24793155269
Fixed Assets	295822023	540824021	574060430	795309700	952196395
Non-Banking Assets	31929675	21732523	12766060	10306683	22694688
Other Assets	517992113	643609788	643967906	565545597	622264633
Total Assets	27418157873	29460389672	33519141111	36175531637	39320322069

Balance Sheet of NSBI from fiscal year 2004/05 to 2008/09

Fiscal Year	Fy2004/05	Fy2005/06	Fy2006/07	Fy2007/08	Fy2008/09
Capital and Liabilities					
Share Capital	431865600	640236100	647,798,400	874527840	874527840
Reserve and Surplus	257147460	342137628	515,492,451	540116972	838079355
Debenture and Bonds		200,000,000	200,000,000	200000000	200000000
Loan and Borrowings	469628863	612428650	815365219	1627480190	727466283
Deposit Liabilities	8654774214	11002040633	11445286030	13715394960	27957220794
Bills Payable	31123670	46238743	48855749	75115471	62947325
Proposed and unpaid dividend	3878232	35469706	91024235	12228852	24904649
Income Tax Liabilities					
Other Liabilities	114603212	157287664	137378475	142581889	231535550
Total Capital and Liabilities	9963021251	13,035,839,124	13901200559	17187446174	30916681796
Assets					
Cash in Hand	143749918	244187671	287530644	308101599	652027266
Balance with Nepal Rastra Bank	390025828	626123385	556678464	403810203	444138596
Balance with other banks & financial institutions	189969554	247847352	278481119	631048524	807740259
Money at call and short notice	123112500	363200000	350000000	304012877	
Investments	2607680003	3610775484	2659452919	3088886918	13286181660
Loan Advances and Bills Purchased	6213878776	7626736137	9460450701	12113698428	15131747944
Fixed Assets	66451924	66711798	97218804	120222259	253580695
Non-Banking Assets	7254994	24555992	3847024		
Other Assets	220897754	225701305	207540884	217665366	341265376
Total Assets	9963021251	13035839124	13901200559	17187446174	30916681796

Balance Sheet of Nabil Bank Limited from Fiscal Year 2004/05 to 2008/09

Fiscal Year	2008/09	2007/08	2006/07	2005/06	2004/05
Capital & Liabilities Schedule.					
Share Capital	965,747,000	689,216,000	491,654,400	491,654,400	491,654,400
Reserves and Surplus	2,164,493,637	1,747,982,989	1,565,395,315	1,383,340,017	1,165,983,908
Debentures & Bonds	300,000,000	240,000,000	-	-	-
Borrowings	1,681,305,000	1,360,000,000	882,572,500	173,201,710	17,062,680
Deposits	37,348,255,840	31,915,047,467	23,342,285,327	19,347,399,440	14,586,608,707
Bills Payable	463,138,615	238,421,890	83,514,820	112,606,736	85,419,747
Proposed & Unclaimed Dividends	361,325,024	437,373,004	509,417,925	435,084,062	361,221,024
Income Tax Liabilities	80,232,454	38,776,869	-	34,604,855	15,345,023
Other Liabilities	502,899,934	465,940,930	378,552,721	352,079,858	340,786,604
Total	43,867,397,504	37,132,759,149	27,253,393,008	22,329,971,078	17,064,082,093
Assets					
Cash Balance	674,395,434	511,426,584	270,406,987	237,818,512	146,352,555
Balance with Nepal Rastra Bank	2,648,596,348	1,829,470,769	1,113,415,436	318,358,771	389,705,047
Balance with Banks/Financial Institutions	49,520,689	330,243,702	16,003,428	74,061,305	23,323,012
Money at Call and Short Notice	552,888,297	1,952,360,700	563,532,632	1,734,901,943	868,428,307
Investment	10,826,379,001	9,939,771,428	8,945,310,567	6,178,533,108	4,275,528,208
Loans, Advances and Bills Purchased	27,589,933,041	21,365,053,318	15,545,778,730	12,922,543,153	10,586,170,002
Fixed Assets	660,988,986	598,038,998	286,895,224	319,086,147	361,235,392
Non Banking Assets	-	-	-	-	-
Other Assets	864,695,708	606,393,650	512,050,004	544,668,139	413,339,570
Total	43,867,397,504	37,132,759,149	27,253,393,008	22,329,971,078	17,064,082,093

APPENDIX-II

Income Statement of EBL from Fiscal Year 2004/05 to 2008/09

Fiscal Year	Fy2004/05	Fy2005/06	Fy 2006/07	Fy 2007/08	Fy 2008/09
Interest Income	719297855	903411137	1144408308	1548657132	2186814992
Interest Expenses	299565269	401397351	517166241	632609264	1012874353
Net Interest Income	419732586	502013786	627242067	916047868	1173940639
Commission and Discounts	78130046	88163454	117718162	150264074	202094446
Other Operating Income	31479208	48902381	67967525	79133767	106403694
Exchange Income	27077784	23073780	28404544	64452378	62526819
Total Operating Income	556419624	662153401	841332298	1209898087	1544965598
Staff Expenses	60597367	70924675	86118226	157957084	186919870
Other Operating Expenses Exchange Loss	129067225	143562167	177545649	233766645	292010522
Operating Profit Before Provisions for possible loss	366755032	447666559	577668423	818174358	1066035206
Provisions for possible Losses	88926593	70465665	89695764	99340505	93084880
Operating Profit	277828439	377200894	487972659	718833853	972950326
Non-Operating Income /Loss	2974088	2959467	1315211	4519287	5005256
Write-back from loan loss Provision	5252936		11686657	20201067	8044170
Profit from regular activities	286055463	380160361	500974527	743554207	985999752
Profit /loss from transaction of extraordinary nature	5252936		-795224	-18998727	-5549170
Profit after inclusion of all types of transaction	280802527	380160361	500179303	724555480	980450582
Provision for Staff Bonus	28080253	34560033	45470846	65868680	89131871
Provision for Income Tax					
-This Year	81914477	106753311	144368164	216913302	276864301
Less: Deferred Tax Assets	-2593186	-1556081	-13931012	-9445115	-24278437
Net after deffered Tax	79321291	105197230	130437152	207468187	252585864
Net Profit	168214611	237290936	296409281	451218613	638732757

Income Statement of HBL from Fiscal Year 2004/05 to 2008/09

Fiscal Year	Fy 2004/05	Fy 2005/06	Fy 2006/07	Fy 2007/08	Fy 2008/09
Interest Income	1446468083	1626473819	1775582617	1963647472	2342198179
Interest Expenses	561963770	648841818	767411247	823744838	934778015
Net Interest Income	884504313	977632001	1008171370	1139902634	1407420164
Commission and Discounts	132815882	165447872	193224228	187819983	284302277
Other Operating Income	41300617	52324749	40328872	62103241	46342872
Exchange Income	137300987	198130134	151637322	207669178	249982606
Total Operating Income	1195921799	1393534756	1393361792	1597495036	1988047919
Staff Expenses	178589357	234588969	272225308	292213138	360980641
Other Operating Expenses	277375035	329699087	341561021	344320784	398316566
Exchange Loss					
Operating Profit Before Provisions for possible loss	739957407	829246700	779575463	960961114	1228750712
Provisions for possible Losses	73898230	145154520	90688827	6007608	68805514
Operating Profit	666059177	684092180	688886636	954953506	1159945198
Non-Operating Income /Loss	2794642	1887070	3493278	9700477	3810145
Write-back from loan loss Provision		56561901	412654152	131682971	19484655
Profit from regular activities	668853819	742541151	1105034066	1096336954	1183239998
Profit /loss from transaction of extraordinary nature	-88253189	-2902317	-315890702	-52614217	-9973406
Profit after inclusion of all types of transaction	580600630	739638834	789143364	1043722737	1173266592
Provision for Staff Bonus	58060063	67239895	71740305	94883886	1066599
Provision for Income Tax					
-This Year	214265396	214941243	225580154	312970332	340776052
Less: Deferred Tax Assets					568826
Net after deffered Tax					-27573620
Net Profit	308275171	457457696	491822905	635868519	752834735

Income Statement of NSBI from fiscal year 2004/05 to 2008/09

Fiscal Year	Fy 2004/05	Fy 2005/06	Fy 2006/07	Fy 2007/08	Fy 2008/09
Interest Income	578372070	708718614	831116781	970512681	1460445686
Interest Expenses	258430003	334770096	412261744	454917713	824700275
Net Interest Income	319942067	373948518	418855037	515594968	635745411
Commission and Discounts	42568260	40753985	52591560	50917830	78836624
Other Operating Income	11275211	7136575	12601352	19557259	52790137
Exchange Income	32357149	43060315	49463539	51989275	61294299
Total Operating Income	406142687	464899393	533511488	638059332	828666471
Staff Expenses	37582219	50539528	53232464	74890269	121989160
Other Operating Expenses	90628615	99214082	120111581	152379842	223965592
Exchange Loss					
Operating Profit Before Provisions for possible loss	277931853	315145783	360167443	410789221	482711719
Provisions for possible Losses	193243637	146656796	59376948	57463909	40345336
Operating Profit	84688216	168488987	300790495	353325312	442366383
Non-Operating Income /Loss	1442831	-2926272	-256759	-271006	2516407
Write-back from loan loss Provision	52972631	54177763	78515105	29782580	198672788
Profit from regular activities	139103678	219740478	379048841	382836886	643555578
Profit /loss from transaction of extraordinary nature					-156220828
Profit after inclusion of all types of transaction	139103678	219740478	379048841	382836886	487334750
Provision for Staff Bonus	13910368	19976407	34458986	34803353	44303159
Provision for Income Tax	67806676	82762098	89681011	100262775	126658096
-This Year	67806676	66120456	86704011	105745947	133123502
Less: Deferred Tax Assets		16641642	2977000	870463	2582900
Net after deffered Tax				6353635	9048306
Net Profit	57386634	117001973	254908844	247770758	316373495

Income Statement of Nabil Bank Limited from Fiscal Year 2004/05 to 2008/09

Fiscal Year	2008/09	2007/08	2006/07	2005/06	2004/05
Particulars					
Interest Income	2,798,486,196	1,978,696,727	1,587,758,714	1,309,998,500	1,068,746,769
Interest Expense	1,153,280,052	758,436,212	555,710,109	357,161,304	243,544,611
Net Interest Income	1,645,206,144	1,220,260,515	1,032,048,605	952,837,196	825,202,158
Commission and Discount	179,693,027	159,319,857	150,608,550	138,293,913	128,376,550
Other Operating Income	144,164,143	94,359,475	87,574,553	82,897,862	56,440,760
Exchange Income	251,919,712	196,487,415	209,926,167	185,483,662	184,878,868
Total Operating Income	2,220,983,026	1,670,427,262	1,480,157,875	1,359,512,633	1,194,898,336
Staff Expense	339,897,913	262,907,576	240,161,275	219,780,853	199,516,217
Other Operating Expense	265,158,033	220,750,570	188,183,330	182,696,413	190,299,470
Exchange Loss	-	-	-	-	-
Operating Profit before Provision for Possible Losses	1,615,927,080	1,186,769,116	1,051,813,270	957,035,367	805,082,649
Provision for Possible Losses	45,722,434	64,055,186	14,206,365	3,769,541	8,662,150
Operating Profit	1,570,204,646	,122,713,930	1,037,606,905	953,265,826	796,420,499
. Non Operating Income /(Expense)	2,190,102	24,083,737	5,280,641	735,324	(48,089)
. Provision for Possible Losses Write Back	10,617,867	11,100,529	10,926,317	7,729,444	4,454,762
Profit from Regular Activities	1,583,012,615	1,157,898,196	1,053,813,863	961,730,594	800,827,172
. Income/(Expense) from Extra-ordinary Activities	43,521,866	39,990,808	40,736,694	26,073,578	41,156,398
Profit from All Activities	1,626,534,481	1,197,889,004	1,094,550,557	987,804,172	841,983,570
. Provision for Staff Bonus	147,866,771	108,899,000	99,504,596	89,800,379	84,198,357
. Provision for Income Tax	447,614,612	342,521,610	321,086,263	262,741,444	237,671,128
Current Tax	470,701,921	340,625,244	314,526,570	262,562,561	239,149,464
Prior Period Tax	918,745	52,872	6,559,693	178,883	(1,478,336)
Deferred Tax	(24,006,054)	1,843,494	-	-	-
Net Profit/(Loss)	1,031,053,098	746,468,394	673,959,698	635,262,349	520,114,085

APPENDIX-III

Trend values of Return on Equity for the period of 2004/5 to 2008/9 of EBL

Year (1)	ROE (Y)	x=1.2006/07	x ²	XY	Trend Values (Y)
2004/05	20.20	-2	4	-40.40	21.12
2005/06	24.64	-1	1	-24.64	23.00
2006/07	24.67	0	0	0	24.40
2007/08	23.49	1	1	23.49	26.04
2008/09	28.98	2	4	57.96	27.68
N=5	Y=121.98	X=0	x²=10	XY=16.41	

The equation of trend line is,

$$Y = a + bx \dots \dots \dots (I)$$

The normal equations to find the values of a and b are:

$$Y = Na + b \sum x \dots \dots \dots (II)$$

$$\sum xY = a \sum x + b \sum x^2 \dots \dots \dots (III)$$

Now, solving the equations to obtain the values of a and b,

from equation (II)

Since, $\sum x = 0$

$$a = \frac{\sum Y}{N}$$

$$\text{or, } a = \frac{121.98}{5}$$

$$= 24.40$$

Thus, a=24.40

from equation (III)

Since, $\sum x = 0$

$$b = \frac{\sum xY}{\sum x^2}$$

$$\text{or, } b = \frac{16.41}{10}$$

$$= 1.641$$

Thus b=1.641

Now,

The trend line is:

$$y = 24.40 + 1.641x$$

APPENDIX-IV

Calculation of Correlation between Net Income and Total Equity Capital

Fiscal Year	Net Income(X)	Total Equity Capital(Y)	XY	X ²	Y ²
2004/05	1682	8326	14004332	2829124	69322276
2005/06	2372	9628	22837616	5626384	92698384
2006/07	2964	12015	35612460	8785296	144360225
2007/08	4512	19212	86684544	20358144	369100944
2008/09	6387	22036	140743932	40793769	485585296
d X =179171		d Y = 712171	dXY=2998828841	dX ² =783927171	dY ² =11610671251

Correlation Coefficient is calculated by using following formula:

$$r = \frac{N\sum XY - \sum X \sum Y}{\sqrt{N\sum X^2 - (\sum X)^2} \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

$$= \frac{5 \times 2998828841 - 179171 \times 712171}{\sqrt{5 \times 783927171 - (179171)^2} \times \sqrt{5 \times 11610671251 - (712171)^2}}$$

$$= 0.99$$

Calculation of Probable Error (PE)

$$PE = 0.6745 \times \frac{1-r^2}{\sqrt{N}}$$

$$= 0.006$$

$$6PE = 6 \times 0.006$$

$$0.036$$

APPINDIX-V

Calculation of Ratio of NABIL BANK Limited

Calculation of Return on Equity of Nabil Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	520114085	635262349	673959698	746468394	1031053098
Total Equity Capital (Rs In 00,000)	1657638308	1874994417	2057049715	2437198989	3130240637
ROE (%)	31.38	33.88	32.76	30.63	32.94

Calculation of ROA Nabil Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	520114085	635262349	673959698	746468394	1031053098
Total Assets(Rs In 00,000)	17064082093	22329971078	27253393008	37132759149	43867397504
ROA (%)	3.05	2.84	2.47	2.01	2.35

Calculation of Profit Margin Nabil Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	2008/09
Net Income (Rs In 00,000)	520114085	635262349	673959698	746468394	1031053098
Total Operating Income(Rs In 00,000)	1194898336	1359512633	1480157875	1670427262	2220983026
PM(In %)	43.53	46.73	45.53	44.69	46.42

Calculation of Assets Utilization Nabil Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	2008/09
Total Operating Income(Rs In 00,000)	1194898336	1359512633	1480157875	1670427262	2220983026
Total Assets(Rs In 00,000)	17064082093	22329971078	27253393008	37132759149	43867397504
AU(%)	7.00	6.09	5.43	4.50	5.06

Calculation of Equity Multiplier of Nabil Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Total Assets(Rs In 00,000)	17064082093	22329971078	27253393008	37132759149	43867397504
Total Equity Capital (Rs In 00,000)	1657638308	1874994417	2057049715	2437198989	3130240637
EM (times)	10.29	11.91	13.25	15.24	14.01

Calculation of Ratio of Nepal SBI Bank Limited

Calculation of Return of Equity of Nepal SBI Bank Limited.

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	57386634	117001973	254908844	247770758	316373495
Total Equity Capital (Rs In 00,000)	689013060	982373728	1163290851	1414644812	1712607195
ROE (%)	8.33	11.91	21.91	17.51	18.47

Calculation of Return on Assets of Nepal SBI Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	57386634	117001973	254908844	247770758	316373495
Total Assets(Rs In 00,000)	9963021251	13035839124	13901200559	17187446174	30916681796
ROA (%)	0.58	0.90	1.83	1.44	1.02

Calculation of Profit Margin SBI Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	2008/09
Net Income (Rs In 00,000)	57386634	117001973	254908844	247770758	316373495
Total Operating Income (Rs In 00,000)	406142687	464899393	533511488	638059332	828666471
PM(In %)	14.13	25.17	47.78	38.83	38.18

Calculation of Equity Multiplier of SBI Bank Limited

Year	FY2004/05	FY2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Total Assets(Rs In 00,000)	9963021251	13035839124	13901200559	17187446174	30916681796
Total Equity Capital (Rs In 00,000)	689013060	982373728	1163290851	1414644812	1712607195
EM (times)	14.46	13.27	11.95	12.15	18.05

Calculation of Assets Utilization of Nepal SBI Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	2008/09
Total Operating Income(Rs In 00,000)	406142687	464899393	533511488	638059332	828666471
Total Assets(Rs In 00,000)	9963021251	13035839124	13901200559	17187446174	30916681796
AU(%)	4.08	3.57	3.84	3.71	2.68

Calculation of Ratio of Himalayan Bank Limited

Calculation of Return of Equity of Himalayan Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	308275171	457457696	491822905	635868519	752834735
Total Equity Capital (Rs In 00,000)	1541746461	1766175616	2146499655	2512991602	3119880537
ROE (%)	20.00	25.90	22.91	25.30	24.13

Calculation of Return on Assets of Himalayan Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Net Income (Rs In 00,000)	308275171	457457696	491822905	635868519	752834735
Total Assets(Rs In 00,000)	27418157873	29460389672	33519141111	36175531637	39320322069
ROA (%)	1.12	1.55	1.47	1.76	1.91

Calculation of Profit Margin of Himalayan Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	2008/09
Net Income (Rs In 00,000)	308275171	457457696	491822905	635868519	752834735
Total Operating Income(Rs In 00,000)	1195921799	1393534756	1393361792	1597495036	1988047919
PM(In %)	25.78	32.83	35.30	39.80	37.87

Calculation of Equity Multiplier of Himalayan Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09
Total Assets(Rs In 00,000)	27418157873	29460389672	33519141111	36175531637	39320322069
Total Equity Capital (Rs In 00,000)	1541746461	1766175616	2146499655	2512991602	3119880537
EM (times)	17.78	16.68	15.62	14.40	12.60

Calculation of Assets Utilization of Himalayan Bank Limited

Year	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	2008/09
Total Operating Income(Rs In 00,000)	1195921799	1393534756	1393361792	1597495036	1988047919
Total Assets(Rs In 00,000)	27418157873	29460389672	33519141111	36175531637	39320322069
AU(%)	4.36	4.73	4.16	4.42	5.06

APPENDIX-VI

Calculation of Average Ratio

Average of Ratios for fiscal Year 2004/05

Selected Bank	EBL	NABIL	NSBI	HBL	Average
ROE (%)	20.20	31.38	8.33	20	19.98
ROA (%)	1.43	3.05	0.58	1.12	1.55
Profit Margin (%)	30.23	43.53	14.13	25.78	28.42
AU (%)	4.74	7.00	4.08	4.36	5.04
Equity Multiplier(times)	14.09	10.29	14.46	17.78	14.16

Average of Ratios for fiscal Year 2005/06

Selected Bank	EBL	NABIL	NSBI	HBL	Average
ROE (%)	24.64	33.88	11.91	25.90	24.08
ROA (%)	1.49	2.84	0.90	1.55	1.70
Profit Margin (%)	35.83	46.73	25.17	32.83	35.14
AU (%)	4.15	6.09	3.57	4.73	4.64
Equity Multiplier(times)	16.58	11.91	13.27	16.68	14.61

Average of Ratios for fiscal Year 2006/07

Selected Bank	EBL	NABIL	NSBI	HBL	Average
ROE (%)	24.67	32.76	21.91	22.91	25.56
ROA (%)	1.38	2.47	1.83	1.47	1.79
Profit Margin (%)	35.23	45.53	47.78	35.30	40.96
AU (%)	3.93	5.43	3.84	4.16	4.34
Equity Multiplier(times)	17.84	13.25	11.95	15.62	14.67

Average of Ratios for fiscal Year 2007/08

Selected Bank	EBL	NABIL	NSBI	HBL	Average
ROE (%)	23.49	30.63	17.51	25.30	24.23
ROA (%)	1.66	2.01	1.44	1.76	1.72
Profit Margin (%)	37.30	44.69	38.83	39.80	40.16
AU (%)	4.46	4.50	3.71	4.42	4.27
Equity Multiplier(times)	14.13	15.24	12.15	14.40	13.98

Average of Ratios for fiscal Year 2008/09

Selected Bank	EBL	NABIL	NSBI	HBL	Average
ROE (%)	28.98	32.94	18.47	24.13	26.13
ROA (%)	1.73	2.35	1.02	1.91	1.75
Profit Margin (%)	41.34	46.42	38.18	37.87	40.95
AU (%)	4.18	5.06	2.68	5.06	4.25
Equity Multiplier(times)	16.75	14.01	18.05	12.60	15.35

Average Ratios for the study period

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
ROE (%)	19.98	24.08	25.56	24.23	26.13
ROA (%)	1.55	1.70	1.79	1.72	1.75
Profit Margin (%)	28.42	35.14	40.96	40.16	40.95
AU (%)	5.04	4.64	4.34	4.27	4.25
Equity Multiplier(times)	14.16	14.61	14.67	13.98	15.35