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Analysis of Financial Health of the New Private Sector Banks in India through CAMEL Rating System

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Abstract : *The measurement and assessment of profitability, productivity, efficiency and effectiveness of the commercial banks has become the need of the hour in this competitive business environment. The basic idea behind this measurement is to judge the overall health and financial soundness of the banks. Different approaches and models have been employed by various researchers to measure the financial soundness of the banks of which the CAMEL rating system has been employed by most of the scholars and hence this system has gained popularity. An attempt has been made in this paper to analyse the financial soundness of the new private sector banks in India by using the CAMEL Model. The required data were collected for a period of eight years, that is, from 2005-06 to 2012-13. The reason for the selection of 2005-06 as the base year is due to the fact that the YES Bank was established only in 2005. The descriptive statistics like Percentage Analysis, Averages, Mean, Standard Deviation and Ranking Technique have been used to anayse the data and arrive at meaningful conclusion. The results show that Kotak Mahindra Bank is at the top position under the capital adequacy parameter, while the Development Credit Bank (DCB) is at the bottom. Under the asset quality parameter, the YES Bank holds the top rank while the DCB holds the lowest rank. Under the management efficiency parameter, top rank is achieved by AXIS Bank and the lowest rank by DCB. In terms of earning quality parameter the ICICI Bank is on top, while the DCB at bottom. Under the liquidity parameter, the Kotak Mahindra Bank stands on the top position and the ICICI Bank is on the lowest position. It is important to note that the YES Bank is at the first position with overall composite ranking average of 2.5 closely followed by the AXIS Bank with overall composite ranking average of 3.1. The DCB holds the bottom rank with overall composite ranking average of 6.4.*

I. INTRODUCTION

Banking sector is one of the fastest growing as well as most complex sectors in India. It serves as the backbone of the Indian economy. Indian banking sector is one of the healthiest performers in the world banking industry seeing tremendous competitiveness, growth, efficiency, profitability and soundness, especially in the recent past.The liberalization process of Indian economy has not only made the entry of new private banks but also allowed the foreign sector banks to increase their branches in the banking sector. Thus, the restructuring of public sector banks and the emergence of new banks in the private sector as well as the increased competition from foreign banks, have improved the professionalism in the banking sector. The increased presence of the private and foreign banks during the past decade has made the market structure of the banking sector more complex in terms of competitive pricing of services, narrow spreads, and improving the quality of the services. The new private sector banks, which had dominated the banking sector for decades, are now feeling the heat of the competition from public sector, old private sector and foreign banks.

The present paper attempts to analyse the financial soundness of the new private sector banks in India by using internationally accepted CAMEL Rating Parameters. CAMEL is an acronym of five measures (Capital Adequacy, Assets Quality, Management Soundness, Earnings Quality, and Liquidity). In this study, different kinds of ratios which reflect the soundness of the banks are used under each parameter of the CAMEL Model for measuring the financial health of the new private sector banks in India.

II. LITERATURE REVIEW

The analysis of the efficiency of the public and private sector banks in India reveal that on an average Karur Vysya Bank was at the top most position followed by Andhra bank, Bank of Baroda. Also it is observed that Central Bank of India was at the bottom most position (Prasad et,al.,2011). The Mahindra Bank is on the top position in terms of capital adequacy followed by ICICI bank. SBI has the highest NPA level among their peer group followed by ICICI bank. PNB has earned highest grading for management efficiency. Earning quality of SBI and PNB are on top. Kotak Mahindra and ICICI are the most efficient in managing their Liquidity. The overall combined performance shows that the SBI is ranked first followed by PNB and HDFC bank (Santhosh Kumar et.al., 2014). As far as the performance of the nationalized banks is concerned, Andhra bank was at the top most position followed by Bank of Baroda and Punjab & Sindh Bank. It is also observed that Central Bank of India was at the bottom most position (Prasad and Ravinder, 2012). The liquidity position of both the SBI and ICICI is sound and does not differ significantly (Bodia, 2006). The aggregate performance of IDBI is best among all the new private sector banks followed by UTI (Sanjay and Bhayani, 2006). The SBI has an edge over its counterpart ICICI in terms of assets quality, earning quality and management quality. The liquidity position of both the banks is sound and does not differ significantly (Bolda and Verma, 2006). The Comparison of the performance of public and private sector banks has revealed that there is no significant difference between performance of public and private sector banks (Prasad, 2012).

III. OBJECTIVES

The major objectives of the study are as follows:

1. To understand the various theoretical aspects relating to the measurement of financial soundness of the commercial banks.
2. To analyse the financial soundness of the new private sector banks in India.

IV. METHODOLOGY

The CAMEL rating system has been employed to analyse the financial soundness of the new private sector banks in India. The study is based on the secondary data only. The required data were collected for a period of eight years, that is, from 2005-06 to 2012-13. The reason for the selection of 2005-06 as the base year was the fact that the YES Bank was established only in 2005. The ratios depicting the CAMEL parameters were calculated with the help of the information collected from various sources. The important sources include Annual Reports of the study units, RBI Annual Reports, Report on Trend and Progress of Banking in India, RBI Bulletins, and the Profile of the banks published by the RBI. The other sources include books, journals, magazines, websites and the like. The descriptive statistics like Percentage Analysis, Averages, Mean, Standard Deviation and Ranking Technique have been used to anayse the data and arrive at meaningful conclusion.

Analytical Framework – CAMEL Rating System

The analysis of banking performance has received a great deal of attention in the banking literature. Many methods are employed to analyse the banking performance, the most popular of which is the CAMEL framework developed in the early 1970s by the Federal Regulators in the USA. CAMEL is basically a ratio based model for evaluating the performance of the banks. Under CAMEL rating system, banks are required to enhance capital adequacy, strengthen asset quality, improve management, increase earnings, and maintain liquidity.The CAMEL rating system provides means to categories the banks into different groups on the basis of the overall health and financial status. The different parameters used in measuring the overall health and financial soundness of the banks include Capital Adequacy (C), Asset Quality (A), Management Efficiency (M), Earnings Quality (E) and Liquidity (L). Therefore, the present study attempts to measure the efficiency of the new private sector banks in India by using the CAMEL rating system. The various indicators used under the CAMEL system for measuring the efficiency of the study unit are presented in Table 1.

TABLE 1
Indicators Used in CAMEL Rating System

Sl.No	Indicators	Ratios
1	Capital Adequacy	Capital Adequacy Ratio
2	Asset Quality	Net Non-performing Asset to Net Advances
3	Management	Profit Per Employee (PPE) Business Per Employee (BPE)
4	Earnings	Return on Assets (ROA)
		Non-interest Income to Total Assets
5	Liquidity	Cash –Deposit Ratio

The conceptual frameworks of the ratios that have been used under each parameter of the CAMEL Model are briefly presented below.

Capital Adequacy Ratio

Capital adequacy ratio (CAR) is a measure of a bank's core capital expressed as a percentage of its risk-weighted asset. This ratio indicates the bank's capacity to meet the time liabilities and other risks such as credit risk, operational risk and the like. Banking regulators in most countries define and monitor CAR to protect depositors, thereby maintaining confidence in the banking system.

The higher the CAR, the stronger the bank is and thebetter security for investors is ensured. The commercial banks need to maintain 11 per cent capital adequacy ratio as per latest RBI norms. CAR = (Tier-I Capital + Tier-II Capital) / Risk Weighted Assets (www.wikipedia.com).

Net NPAs to Net Advances

The net NPAs to net advances is the most commonly used standard measure to assess the assets quality of the banks. The ratio measures the net NPAs as a percentage of net advances. Net NPAs = Gross NPAs – Net of provision on NPAs – Interest in Suspense Account.

Profit Per Employee (PPE)

The profit per employee is an important tool to measure the efficiency of the human resources available with the banks. It shows the surplus earned per employee. Higher the ratio, the better it is for the bank. It is computed by dividing the profit after tax earned by the bank by the total number of employees.

Business Per Employee (BPE)

Business per employee shows the productivity of human force of the banks. It is used as a tool to measure the efficiency of employees of a bank in generating business for the bank. It is calculated by dividing the total business by total number of employees. Higher the ratio, the better it is for the bank.

Return on Assets (ROAs)

The return on assets of a company determines its ability to utilize the assets employed in the company efficiently and effectively to earn good returns. This ratio measures the percentage of profits earned per rupee of assets and thus is a measure of efficiency of the company in generating profits on its assets. Higher ratio indicates efficiency of management in employing its funds efficiently and economically.

Non-Interest Income to Total Assets

The non-interest income to total assets measures the income from operations other than lending as a percentage of the total assets. Non-interest income consists of income from commission, net profit (loss) on sale of investment, fixed assets, fee-based income and miscellaneous income.

Cash to Deposit Ratio

Cash to deposit ratio depicts the availability of average cash balance against total deposits in a bank. It is the amount of money which should be available in as a proportion of the total amount of money deposited by the customers. It ensures prompt repayment of money to customers on demand. Cash to Deposit Ratio = (Cash in hand + Balances with the RBI) / Deposits.

Composite Ranking of the Overall Performance of the New Private Sector Banks

At the outset, ranks were allotted to each parameter under the CAMEL Rating System. Later on, an attempt has also been made to assess the overall performance of the New Private Sector Banks in India. The composite ranking and the results are presented in Table 2.

Table 2
Composite Ranking

Composite Ranking of Overall Performance							
Name of the Bank	**C**	**A**	**M**	**E**	**L**	**Average**	**Rank**
AXIS Bank	5	3	1.5	0.5	4	3.2	3
DCB	7	7	7	7	4	6.4	7
HDFC	4	0	4.5	4	4	3.7	5
ICICI	3	4	3	1	7	3.6	4
INDUSIND	6	6	4.5	5	6	5.5	6
KMB	1	5	6	0.5	1	3.1	2
YES Bank	2	1	1.5	6	2	0.5	1

Source: www.rbi.org

Table 2 shows that the Kotak Mahindra Bank is at the top position under the capital adequacy parameter, while the Development Credit Bank (DCB) at the bottom. Under the asset quality parameter, the YES Bank holds the top rank while the DCB holds the lowest rank. Under the management efficiency parameter, top rank is achieved by AXIS Bank and the lowest rank by DCB. In terms of earning quality parameter the ICICI Bank is on top, while the DCB at bottom. Under the liquidity parameter, the Kotak Mahindra Bank stands on the top position and the ICICI Bank is on the lowest position. It is important to note that the YES Bank is at the first position with overall composite ranking average of 2.5 closely followed by the AXIS Bank with overall composite ranking average of 3.1. The DCB holds the bottom rank with overall composite ranking average of 6.4.

Summary and Conclusion

The new private sector banks are playing an important role in the overall development of a nation. In the competitive business environment, measurement of financial soundness of the banks has grown in significance. The measurement and analysis of financial health of the India's new private sector banks reveals thatKotak Mahindra Bank is at the top position under the capital adequacy parameter, while the Development Credit Bank (DCB) at the bottom. Under the asset quality parameter, the YES Bank holds the top rank while the DCB holds the lowest rank. Under the management efficiency parameter, top rank is achieved by AXIS Bank and the lowest rank by DCB. In terms of earning quality parameter the ICICI Bank is on top, while the DCB at bottom. Under the liquidity parameter, the Kotak Mahindra Bank stands on the top position and the ICICI Bank is on the lowest position. It is important to note that the YES Bank is at the first position with overall composite ranking average of 2.5 closely followed by the AXIS Bank with overall composite ranking average of 3.1. The DCB holds the bottom rank with overall composite ranking average of 6.4.

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