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Research Paper Commerce

FINANCIAL PERFORMANCE OF PRIVATE BANKS IN INDIA

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ABSTRACT

As the financial sector is growing from time to time in India the level of their financial performance in the sector also is growing from time to time. Even if there are many privately owned banks in the country majority of the market share of the banking sector is dominated by governmentally owned commercial bank of India. This study will try to analyze the financial performance of three of the privet banks that are operating in the country using the CAMEL approach in order to have the glimpse of image how the privet sector of the bank in the country is operating in the financial sector.

KEYWORDS : financial, commercial bank of Ethiopia, CAMEL approach

1. Introduction

The main objective of financial institutions is to act as an intermediary between those who have funds and those who seek funds for running their business or for personal use. For performing this activities the financial institution needs to have a proper management that is efficient in mobilizing the banks resource in proper manner, a capital that is used as resource to render the service, proper amount of revenue that will exceed the cost of operation, a proper system that will safeguard the asset of the business and an adequate financial position to settle claims at the time of liquidity.

The objective of Indian financial institutions has been shaped based on the ideology that the governments ruled the country adopt. As stated by Geda (2006) under state socialism (1974-91), popularly referred to in Indian as the „Derge regime', financial institutions were basically executing the economic plans outlined by the central planning organ. In that period regulation and supervision were not critical because the national plan regulated and directed the activities of financial institutions. Moreover, financial institutions were directed to finance some public projects that may not have passed proper financial appraisal but were simply based on either ideological grounds or „merit wants' arguments.

Following the removal of derg regime in 1991 the socialistic ideology has been changed by market oriented policy. These open a door for new phenomena in the financial sector which resulted in decision making freedom by the financial institutions. So in this paper the researcher will try to assess the financial performance of Private banks in India using the CAMEL approach.

The six factors are represented by the acronym "CAMELS".The six factors examined are as follows:

C-Capital adequacy

A-Assets quality

M-Manangement quality

E-Earnings

L-Liquidity

S-Sensitivity to Market Risk

Bank supervisory authorities assign each bank a score on a scale of one to five for each factor. If a bank has an average score less than two it is considered to be a high-quality institution while banks with scores greater than three are considerd to be less-than-satisfactory establishments. The system helps the supervisory authority identify banks that are in need of attention.

2. Literature review

Different researchers used CAMEL model to evaluate the financial performance of different banks. Adesina(2012) has used CAMEL model to make comparative evaluation of the banking sectors performance in Nigeria. In his study Adesina has tried to determine the soundness/safeness of the banks by ranking the banks based on their CAMEL ratio. Vivid V. Tuna (2013) used a CAMEL model for making a comparative analysis between two banks in Indonesia to determine level of health of the banks. At the end of its study he concluded that he didn't get any significant difference between the two banks in their financial soundness.

On the other hand Prasad, K.V.N. and Ravinder, G.(2012) has used camel model to analyze the financial performance of nationalized banks in India. In their study they analyzed the camel ratios of 20 bank and they ranked these banks based on their performance. Reddy (2012) had conducted a research to examine the Relative performance of commercial banks in India by applying camel model. In his study Reddy took 26 public, 19 domestic private sector and 16 foreign banks. After analysis, reddy concluded that public sector banks have significantly improved

indicating positive impact of the reforms in liberalizing interest rates, rationalizing directed credit and Investments and increasing competition during the study period.

Dash, Mihir and Das, Annyesha (2009) used the camel approach to analyze the Indian banking industry. In their analysis they take sample of fifty-eight banks operating in India, of which twenty-nine were public sector banks, and twenty-nine were private sector/foreign banks. The study covered the financial years 2003-04, 2004-05, 2005-06, 2006-07, and 2007-08 (i.e. prior to the global financial crisis). At the end they concluded that private/foreign banks fared better than public sector banks on most of the CAMELS factors in the study period. The two contributing factors for the better performance of private/foreign banks were Management Soundness and Earnings and Profitability.

3. Methodology

This study uses the CAMEL approach to evaluate the financial performance of private banks in India. In this study the financial statement of 3 private commercial banks that are operating in the country will be analyzed. The analysis will be made on the financial statements of the banks for the period of 2008- 2012.

Her different categories of CAMEL ratios will be calculated for the banks and the analysis will made based on the outcome to determine the achievements of the banks in capital adequacy, asset management, management efficiency, earning quality and liquidity. The results will be presented in tables for easy understanding for the readers.

4. Camel framework

The CAMEL model incorporates analysis of both quantitative and qualitative values, with quantitative meaning financial ratios while qualitative refers to the subjective elements driving the financial institutions operations. Being inter-related, the elements in the CAMEL model cannot be applied singularly. In CAMEL ratio it con-

sists of five categories of ratios which are used to evaluate the financial performance of financial institutions.

4.1.Capital Adequacy

Capital adequacy has come forth as one of the prominent indicators of the financial health of a banking system. It is very useful for a bank to conserve & protect stakeholders' confidence and preventing the bank from being bankrupt. The requirement for additional capital is indicated by capital adequacy. It also reflects whether the bank has enough capital to bear unexpected losses arising in the future and bank leverage. In this study the following ratios will be used:

1. Capital to Risk Weighted Assets Ratio (CRAR)
2. Debit Equity Ratio (D/E)
3. Advances/ asset ratio

4.2. Asset Quality

Asset quality signifies the degree of financial strength of and risks in a bank's assets, mainly loans and investments. The maintenance of asset quality is a fundamental feature of banking. A broad evaluation of asset quality is one of the most important components in assessing the current situation and future viability of a bank. Some of the ratios used in this study are

1. Net NPAs to Net Advance
2. Asset utilization ratio
3. Total investment to total asset

4.3. Management efficiency

Management efficiency is another essential component of the CAMEL model that guarantee the growth and survival of a bank. Management efficiency means adherence with set norms, ability to plan and respond to changing environment, leadership and administrative capability of the bank.

1. Total advances to total deposits

2. Business per employee

3. Profit per employee

4.4.Earning quality

The quality of earnings is a very important criterion which represents the quality of a bank's profitability and its capability to maintain quality and earn consistently. It primarily determines the profitability of bank and explains its sustainability and growth of future earnings.

1. Interest income to total income

2. Non-interest income to total income

3. Return on asset

4.5.Liquidity

Risk of liquidity can have an effect on the image of bank. Liquidity is a crucial aspect which reflects bank's ability to meet its financial obligations. An adequate liquidity position means a situation, where organization can obtain sufficient liquid funds, either by increasing liabilities or by converting its assets quickly into cash.

1. Liquid asset to total asset

2. Liquid asset to demand deposit

3. Liquid asset to total deposit

5. Parameters used

To rate the banks performance based on the ratios can be explained on the following table

	Capital adequacy	Asset Quality	Earnings	Liquidity
Strong	>15%	0 - 5%	> 3%	> 20%
Satisfactory	8.1 - 14.9%	5.1 - 10%	2 - 2.9%	16 - 20%
Fair	7.1 - 8%	10.1 -15%	1 - 1.9%	15%
Marginal	5 - 6.9%	15.1 - 20%	0- 0.9%	9 - 14%
Unsatisfactory	< 5%	> 20%	Net loss	< 9%
Statutory requirement	8%	15%	1.90%	15%

6. Result and analysis

6.1. Capital adequacy

The capital adequacy of AIB is higher than that of the rest of the banks. This shows that AIB's ability to absorbing losses arising from risk bearing assets. While in debit equity ratio DB has the highest ratio which shows the bank's higher debt leverage as compared to the remaining banks.

On the side of Advances/ asset ratio UB has the highest ratio whish indicates the banks aggressiveness in lending to customers which ultimately results better profitability for the bank as compared to the other banks.

Tabel-2: Capital Adequacy

Banks	Capital adequacy ratio	Debit equity ratio	Advances/ asset
DB	13.85	9.47	46.49
AIB	25.66	8.13	44
UB	19.54	7.32	47.35

(Source: researchers own computation)

6.2.Asset Quality

As it is seen in table-2 all banks have negative Net NPAs to Net Advances but AIB has the lowest ratio which indicates that the bank has the highest quality of managing its asset for the benefit of its share holders as compared to the other banks. With respect to Total Investments to Total Assets Ratio DB has the highest ratio which shows that DB has put a large amount of asset on investment as against advances much more than AIB and UB. As to Asset utilization AIB has the highest ratio which indicates the banks capability of using it asset effectively for the purpose of generating return for stock holders.

Table-2: Asset Quality

Banks	Net NPAs to Net Advances	Total Investments to Total Assets Ratio	Asset Utilization Ratio
DB	-0.42	8.02	8.57
AIB	-1.20	0.146	9.25
UB	0.65	0.118	8.46

(Source: researchers own computation)

6.3. Management Efficiency

As it is seen in table-3 UB has the highest Total Advances to Total Deposit when compared to the remaining other banks. This shows that UB management is efficient in converting its deposits that is made by its customers in to high earning advances compared to other banks. While in the case of profit per employee DB has the highest which indicates the banks management efficiency of using its human resource for the purpose of generating revenue as compared to AIB and UB.

As to business per employee DB has the highest business per employ-

ee. So we can say that DB"s management is efficient in using its human resource for the purpose of generating revenue when compared to AIB and UB"s managements.

Tabel-3: Management Efficiency

Banks	Total advances to total deposit	Profit per employee (In dollar)	Business per employee (In dollar)
DB	57.56	7,856.98	326,976.16
AIB	58.29	5,548.68	206,475.64
UB	61.09	5,840.86	252,548.77

(Source: researchers own computation)

6.4. Earning Quality

As to interest income to total income UB has the highest ratio which showed that it generate a high percentage of its income from interest collected from customers as compared to the remaining banks. With regard to Non-Interest income to Total Income AIB has the highest this shows that AIB have a high capacity of generating income from informal operations of the bank. As to return on asset AIB has the highest as compared to the other banks. This shows the banks efficiency in utilizing its asset efficiently for the purpose of achieving organizational objective.

Table-4: Earning Quality

Banks	Interest Income to Total Income	Non-Interest income to Total Income	Return on Asset
DB	53.88	46.12	3.02
AIB	53.14	46.86	3.2
UB	57.47	42.53	2.83

(Source: researchers own computation)

6.5. Liquidity

UB has the highest liquid Asset to Total Asset and it shows that it has the highest liquidity capability among the other banks. As to liquid asset to total deposit AIB has the highest ratio which indicates that AIB has the highest ability of covering total deposit of its customers at the time of liquidation. With regarding to liquid asset to Demand deposit DB has the highest ratio .This shows that DB has the highest ability to honour the demand from depositors during a particular year better than AIB and UB.

Table-5: liquidity

Banks	Liquid Asset to Total Asset	Liquid Asset to Total Deposit	Liquid Asset to Demand Deposit
DB	40.81	50.43	180.56
AIB	40.2	52.91	230.76
UB	46.05	59.16	196.23

(Source: researchers own computation)

7. Conclusion

The strength and weakness of a particular financial institution depends up on its financial performance. Financial performance also can be used as a parameter to measure the achievement of the bank in the industry it operates.

During the process of evaluation of performance of the three privet Banks my study highlighted that, the different banks have obtained different ranks with respect to CAMEL ratios. So my study concluded that in terms of capital adequacy ratio parameter UB is at the top position, while DB got lowest rank. The possible reason for this was the poor performance of DB in Capital

Adequacy, Debit equity, and Gov. Security to Total Investments ratios. In terms of asset quality parameter, AIB held the top rank while UB held the lowest rank. The possible reason for this was the poor performance of UB in Total Investment to Total Assets Ratio and Asset Utilization Ratio. Under management efficiency parameter it is observed that top rank taken by DB and lowest rank taken by AIB. AIB scored the lowest position due to its poor performance in profit per employee and business per employee. In terms of earning quality parameter the capability of AIB got the top rank while DB was at the lowest position. The possible reason for this was the poor performance of DB in Non-Interest income to Total income, Net profit to Total asset, Interest Income to Total Income and mainly in spread ratio. Under the liquidity parameter UB stood on the top position and DB was on the lowest position. The possible reason for this was the poor performance of DB in Liquid Asst to Total Deposit, Liquid Asset to Demand Deposit and Approved Securities to Total Asset ratios.

So based on the analysis AIB needs to improve its position with regard to Management

efficiency, DB should also improve its Earning Quality, Capital Adequacy and Liquidity ratio while UB should improve its Asset Quality ratio. But with the overall performance AIB has at the top place while UB and DB become 2 nd and 3 rd respectively.

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