FINANCIAL PERFORMANCE OF PUBLIC AND PRIVATE SECTOR BANKS IN INDIA USING CAMEL MODEL

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ABSTRACT *The economy and growth of any country is basically depends on strength and efficiency of financial system, which, in turn, depends upon a sound banking system. A supervisory mechanism is required to assess the performance of the banking system. In this paper CAMEL rating approach is used to analyze the comparative performance of public and private sector banks in India for the period of 2010-12. CAMEL is basically a ratio based model for evaluating the performance of banks..*

Keywords: *CAMEL Approach, Financial Soundness, Public sector banks, Private sector Banks.*

Introduction

Banks are playing an important role in the economic development of a country in mobilization of savings and deployment of funds to the productive sector of the economy. Therefore banks should be given more attention than any other type of economic unit in an economy. The regulators have augmented bank supervision by using CAMEL. CAMEL is an acronym for six measures capital adequacy, assets quality, management soundness, earnings, liquidity and sensitivity to market risk. In this analysis the six indicators which reflect the soundness of the institution framework are considered for evaluating the performance and financial soundness of the activities of public and private sector banks. Soundness of the banking sector is synonymous with efficiency, productivity, profitability, stability and a shock free environment. The period taken for this study is from 2010-12 by comparing the public and private sector banks in India.

Review of literature:

CAMEL approach has been used for the Continuous process of evaluation of the bank's financial performance both in public sector and private sector by several academicians, scholars, administrators and even policy makers in different perspectives and in different periods

Prasuna (2003) analyzed the performance of Indian banks by adopting the CAMEL Model. The performance of 65 banks was studied for the period 2003-04. The author concluded that the competition was tough and consumers benefited from better service quality, innovative products and better bargains.

Prasad *et al.,* (2011) has evaluated the performance of banking sector using CAMEL model for the period 2006-2010. The study has shows that Andhra Bank was at the top most position followed by Bank of Baroda and Indian Bank also it observed that Central Bank of India was at the bottom most position followed by UCO bank and Bank of Mysore.

Siva and Natarajan (2011) empirically tested the applicability of CAMEL and its consequential impact on the performance of SBI Groups. The study found that CAMEL scanning helps the bank to diagnose its financial health and alert the bank to take preventive steps for its sustainability.

Jha and Hui (2012) compared the financial performance of different ownership structured commercial banks in Nepal. The result shows that public sector banks are significantly less efficient than their counterpart, however domestic private banks are equally efficient to foreign-owned (joint venture) banks.

Misra and Aspal (2013) studied the performance of State Bank group and opined that there is no statistically significant difference between the CAMEL ratios. It signifies that the overall performance of State Bank group is same; this may be because of adoption of modern technology, banking reforms and recovery mechanism.

Objectives:

The Prime objective of the study is to analyze and compare the financial soundness of the public sector banks and Private sector banks

Methodology

The comparison of the financial soundness and infer about convergence of the public and private sector banks operating in India have been analyzed by using internationally accepted CAMEL supervisory model. The data used for this study is mainly secondary data collected from bank's balance sheet and annual reports for the period of three years (2010 to 2012). More information is also collected from Reserve Bank of India, related journals and websites.

Data and Analysis

Capital Adequacy

It indicates competency of capital for the banks to absorb unexpected losses in the future and bank Leverage. It is required to maintain depositors' confidence and preventing the bank from going bankrupt. It reflects the overall financial condition of banks and also the ability of management to meet the need of additional capital. However following ratios are taken to measure capital adequacy

i. Capital Adequacy Ratio (CAR)
ii. Debt-Equity Ratio (D/E)
iii. Advance to Assets Ratio (Adv/Ast)
iv. Government Securities to Total Investments (G-sec/Inv)

Table. 1. Analysis of Financial soundness in Public and Private sector Banks.
Capital Adequacy

S. No.	Particulars/Year	Public sector Banks				Private Sector Banks			
		2010	2011	2012	Mean	2010	2011	2012	Mean
i	Capital Adequacy ratio	13.30	13.08	13.23	13.20	17.40	16.46	16.21	16.69
ii	Debt equity ratio	1.30	1.36	1.30	1.32	1.24	1.34	1.90	1.49
iii	Advances to assets ratio	61.55	63.23	65.31	63.36	50.80	52.38	52.44	51.87
iv	Govt. Securities to total investment	83.63	81.48	83.64	82.92	68.11	62.36	66.05	65.51

Capital adequacy ratio being the strength of banks, RBI stressed that banks should have 9% CAR. It indicates that banks have higher CAR reveals better financial position. From the analysis it is found that the CAR according to Basel II norms, both the sector of banks have maintained more than the prescribed ratio of 9. Private sector banks proved to be good in CAR position (16.69) than Public sector Banks (13.20)

Debt equity ratio indicates the degree of leverage of banks. It indicates how much of the bank business is financed through debt and how much through equity. The present study, it was found that private sector banks have higher ratio (1.49) than its counterpart of public sector banks (1.32)

Advances to assets ratio denotes the relationship between total advances and total assets. This is the indicator of allocation of resources for lending to get better profitability. Higher ratio is preferred, from the above table it is found that public sector banks are the top position with highest ratio (63.36) as compared to the private sector banks (51.87)

From the above table it is also found that the Government securities to total investment is high in public sector banks (82.92) than Private sector banks (65.51). Since, Government securities are risk free in nature, Public sector banks have lesser risk than its counterparts.

Assets Quality

The asset quality indicates the type of debtors of the bank the quality of assets in an important parameter to gauge the strength of bank. It is to ascertain the component of non-performing assets (NPAs) as a percentage of the total assets. Hence a bank has able to decide advances to generate interest income. The following are the ratios:

i. Net NPAs to Total Assets (NNPAs/TA)
ii. Net NPAs to Net Advances (NNPAs/NA)
iii. Total Investments to Total Assets (TI/TA)
iv. Percentage Change in NPAs

Table. 2. Analysis of Financial soundness in public and Private sector Banks.
Assets Quality

S. No.	Particulars/Year	Public Sector Banks				Private Sector Banks			
		2010	2011	2012	Mean	2010	2011	2012	Mean
i	Net NPA to Net Advance	1.10	1.16	1.66	1.31	0.96	0.59	0.54	0.70
ii	Total investment to Total Assets ratio	27.15	25.10	24.91	25.72	30.77	30.18	31.33	30.76
iii	Net NPA to Total Assets	0.67	0.68	0.98	0.78	0.55	0.32	0.26	0.38
iv	Percentage change in Net NPA	40.13	21.68	63.84	41.88	-14.11	-30.47	-0.68	-15.09

Internationally accepted bench mark value for Net NPA ratio is 1. From the above table it is noticed that Private sector banks has low risk as compared to public sector banks which is have lesser ratio than 1

Lower Net NPA to total assets ratio is the sign for good level of performance of a bank, for the period of three years (2010-2012) lower ratio (0.38) identified in private sector banks indicates favorable trend and observed that private sector banks have better precautionary measures starting from selection of customers for lending. In this case the public sector banks have higher ratio of 0.78.

The ratio between total investment and total assets of the bank is the tool for identifying the percentage of total assets locked up in the bank's investment. It was revealed that the private sector banks have higher ratio (30.76) as compared to Public sector banks (25.72) and have conservatively kept a higher cushion of investment to guard against NPAs.

Percentage change in NPA is an internal tracking system to follow the movement of NPAs over previous years. Private sector banks have better system of reduced NPAs for the study period. It is found from the negative trends in private sector banks than positive trends found in public sector banks.

Management Efficiency

Management efficiency involves subjective analysis to measure the efficiency and effectiveness of management in the view of generating business (top-line) and in maximizing profits (bottom-line). various ratios used for analyzing management efficiency are

i. Total Advances to Total Deposits (TA/TD)
ii. Profit per Employee (PPE)
iii. Business per Employee (BPE)
iv. Return on Net worth (RONW)

Table. 3. Analysis of Financial soundness in public and Private sector Banks.
Management Efficiency

S. No.	Particulars/Year	Public Sector Banks				Private Sector Banks			
		2010	2011	2012	Mean	2010	2011	2012	Mean
i	Total Advances to Total Deposits	74.04	76.55	78.83	76.48	71.05	73.03	74.96	73.01
ii	Profit per Employee	5.30	5.90	6.40	5.87	7.00	8.10	9.20	8.10
iii	Business per Employee	864.30	1016.70	1146.80	1009.27	772.70	826.00	862.30	820.33
iv	Return on Net worth	17.47	16.90	15.33	16.57	11.94	13.70	15.25	13.63

By adopting the total advances to total deposits ratio, a bank can take decision for converting the deposit to high earning advances. The average ratios cumulatively between public sector and Private sector banks are 76.48 and 73.01 respectively. Hence public sector banks have high efficient and ability to earn rich from advances.

Business per employee is the measure to examine how efficiently human forces of the bank contribute to the business of the bank. During the study period public sector banks have higher business per employee of Rs. 1009.27 lakhs indicates better progress than private sector banks having Rs. 820.33 lakhs

Profit per employee shows the surplus earned per employee. Higher the ratio shows the higher efficiency of management. During the study period it was found higher in private sector banks of Rs. 8.10 lakh than Rs. 5.87 lakh in Public sector banks

Earning Quality

The quality of earnings is an important criterion of the banks capability to earn profit consistently. It also determines the sustainability and growth of earnings in future. The following ratios explain the quality of income generation.

i. Operating profit to Total Assets
ii. Net Profit to Total Assets
iii. Interest Income to total Income
iv. Net interest Margin to total assets

Table. 4. Analysis of Financial soundness in public and Private sector Banks.
Earning Quality

S.No.	Particulars/Year	Public sector Banks				Private Sector Banks			
		2010	2011	2012	Mean	2010	2011	2012	Mean
i	Operating profit to Total Assets	1.73	1.66	1.66	1.68	2.50	2.41	2.29	2.40
ii	Net Profit to Total Assets	0.91	0.89	0.89	0.90	1.11	1.07	1.00	1.06
iii	Interest Income to total Income	86.78	86.76	86.72	86.75	82.99	83.11	83.53	83.21
iv	Net interest Margin to total assets	23.84	22.61	21.96	22.80	26.96	26.62	26.78	26.79

Operating profit to total assets indicates the quantum of a bank can earn from every rupee spent on working funds. During the period of study, private sector banks have higher ratio (2.40) than public sector banks (1.68) revealed that the assets has been efficiently used by private sector banks.

Net profit to average assets ratio found to be higher in private sector banks (1.06) than public sector banks (0.90), it indicates that the private sector banks have better income generating capacity.

The public sector banks shows higher average ratio of interest income to total income of 86.75 than its counterpart of Private sector banks noticed about 83.21. It indicates public sector banks have better ability to generate income through its lending.

Net interest Margin to total assets is measure of Bank's core income. During the study period it was noticed that private sector banks have higher ratio (26.79) than public sector banks (22.80) which indicates higher spread of core income prevailed in Private Sector Banks.

Liquidity

Liquidity is a crucial aspect which reflects bank's ability to meet its financial obligations. Among assets cash and investments are the most liquid of a bank's assets. Bank has to take a proper care to hedge the liquidity risk; at the same time ensuring good percentage of funds invested in high return generating securities, so that it is in a position to generate profit with provision liquidity to the depositors. The ratios used to measure Liquidity are:

i. Liquid Assets to Total Deposits (LA/TD)
ii. Liquid Assets to Total Assets (LA/TA)
iii. Liquid Assets to Demand Deposits (LA/DD)
iv. Government securities to Total Assets (G-Sec/TA)
v. Approved Securities to Total Assets (AS/TA)

Table. 5. Analysis of Financial soundness in public and Private sector Banks.
Liquidity

S.No.	Particulars/Year	Public sector Banks				Private Sector Banks			
		2010	2011	2012	Mean	2010	2011	2012	Mean
i	Liquid assets to total assets	8.90	9.15	7.55	8.53	9.95	8.42	6.39	8.25
ii	Liquid assets to total Deposits	10.70	11.08	9.12	10.30	13.92	11.74	9.13	11.60
iii	Liquid assets to Demand Deposits	107.20	118.16	118.63	114.66	85.10	74.08	64.62	74.60

iv	Approved Securities to Total Assets	0.113	0.059	0.017	0.063	0.027	0.006	0.001	0.012

The ability of a bank to meet immediate cash requirement can be from demand deposits easily. Demand deposit offer higher liquidity to the depositors and hence banks have to invest these assets in highly liquid form. Public sector banks have higher ratio of 114.66 than private sector banks (74.60), which indicates higher liquidity positions found in public sector banks.

The ratio of Liquid assets to total assets is the measure of overall liquidity position of the banks and it was found highest in public sector banks (8.53) over private sector banks (8.25) and have higher liquidity position.

Liquid assets to total deposits ratio reflects the ability of bank to honor the demand from depositors during a particular year. The ratio is high in Private sector banks (11.60) than in Public sector banks (10.30). Hence private sector banks provide higher liquidity for depositors because it has invested these funds in highly liquid form.

The ratio of Approved securities to total assets is the measure of overall liquidity position of the banks and it was found highest in public sector banks (0.063) over private sector banks (0.012) and have higher liquidity position.

Conclusion

Banking Sector in India is a key initiative for the economic development and fulfills the financial objectives of the people of Indian economy. Public and Private sector banks occupies a major part in the banking sector in India and custodian for customer's money.

The financial performance of public sector banks are better when compared to private sector banks. NPA is higher in Public sector banks due to compulsory allocation of funds to Priority sector. Private sector banks have low NPA because of its scrutiny mechanism in lending operations.

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