CAMEL MODEL: A TOOL TO MEASURE PERFORMANCE OF BANKS

Swati Goyal

Abstract
CAMEL method was devised as a supervision tool. Regulators assess the financial condition of banks through on-site and off-site surveillance. CAMEL is methodical and attentive in its evaluation process, pursuing meaningful analysis that clearly identifies the institutions strengths and challenges in all financial and managerial areas. CAMEL encourages institutional transparency, evolution and transformation through a tried and tested methodology. This paper gives the importance of CAMEL Model and reviews many studies related to it. An attempt has been made on the usage of CAMEL Model in an Indian Banking Sector because there is a need for a modern performance evaluation system for Indian banks.

INTRODUCTION

The CAMEL model incorporates analysis of both quantitative and qualitative values, with quantitative meaning financial ratios while qualitative referring to the subjective elements driving the Financial Institution's operations. The depth and quality of the CAMEL analysis fundamentally depends on the availability of financial performance information. That is why the CAMEL is methodical and attentive in its evaluation process, pursuing meaningful analysis that clearly identifies the institutions strengths and challenges in all financial and managerial areas. CAMEL encourages institutional transparency, evolution and transformation through a tried and tested methodology.

CAMEL (s) thus provide a measurement of a bank's current overall financial, managerial, operational, and compliance performance. It is supposed to allow regulators to identify ailing banks, before failure happens and take corrective actions. Although CAMEL was initially devised for the American banking system, similar methodologies have been developed by various supervisory authorities.

In 1994, the RBI established the Board of Financial Supervision (BFS), which operates as a unit of the RBI. The supervisory mechanism was realigned to suit the changing needs of a strong and stable financial system. The supervisory jurisdiction of the BFS was slowly extended to the entire financial system barring the capital market institutions and the insurance sector. The BFS has also established a sub-committee to routinely examine auditing practices, quality, and coverage. In 1995, RBI had set up a working group under the chairmanship of Shri S Padmanabhan to review the banking supervision system. The Committee gave certain recommendations and suggestions relating to a rating system for domestic and foreign banks based on the international CAMELS model combining financial management, systems and control elements, which were introduced for the inspection cycle commencing from July 1998. It was recommended that the aggregates should be rated on a five point scale (A to E) based on the lines of international CAMELS rating model. CAMELS evaluate banks on the following six parameters:

(a) Capital Adequacy: Capital adequacy is measured by the ratio of capital to risk-weighted assets (CRAR). A sound capital base strengthens the confidence of depositors.

(b) Asset Quality: One of the indicators for asset quality is the ratio of non-performing loans to total loans (GNPA). The gross non-performing loans to gross advances ratio is more indicative of the quality of credit decisions made by bankers. Higher GNPA is indicative of poor credit decision-making.

(c) Management: The ratio of non-interest earnings to total assets (MGTN) can be one of the measures to assess the working of the management. This variable includes a variety of expenses, such as payroll, workers compensation and training investment, reflects the management policy stance.

(d) Earnings: It can be measured as the return on asset ratio.

(e) Liquidity: Cash maintained by the banks and balances with central bank, to total asset ratio (LGD) is an indicator of bank's liquidity. In general, banks with a larger volume of liquid assets are perceived safe, since these assets would allow banks to meet unexpected withdrawals.

(f) Systems and Control
Each of the above six parameters are weighed on a scale of 1 to 100 which contains a number of sub-parameters with individual weighting.

Table: 1.1: Capital Adequacy Ratio

<table>
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<tr>
<th>Capital Adequacy Ratio (%) =</th>
<th>Paid in Capital + Reserve Funds + Net Profits</th>
<th>x 100</th>
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<tbody>
<tr>
<td>Total Assets</td>
<td>Loan loss</td>
<td>Provision</td>
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Risk-free assets should include: (i) Cash on hand; (ii) Due from Banks; (iii) Interbank loans; (iv) Government guarantees; and (v) Investments in government securities, etc.


Review of Literature

Winkler D and Tanko M (2008) studied the adequacy of CAMEL in capturing the overall performance of a bank. Despite the continuous use of financial ratio analysis on banks performance evaluation by banks regulators, opposition to its thrust with opponents coming up with new tools capable of flagging the over-all performance (efficiency) of a bank. The data for the research work is secondary and was collected from the annual reports of eleven commercial banks in Nigeria over a period of nine years (1997 - 2005). The purposive sampling technique was used. The findings revealed the inability of each factor in CAMEL to capture the full performance of a bank.

Gupta R K and Kaur S (2008) conducted the study with the main objective to assess the performance of Indian Private Sector Banks on the basis of CAMEL Model and gave rating to top five and bottom five banks. They ranked 20 old and 10 new private sector banks on the basis of CAMEL model. They considered the financial data for the period of five years i.e. from 2003-07. The major findings according to the CAMEL Model revealed that HDFC was on the top of all the private sector banks in India followed by the Karur Vysa Bank and Tamilnadu Mercantile Bank. The Global Trust Bank and the Nedungadi Bank episodes were examples for mismanagement.

Bhayani S (2006) analyzed the performance of new private sector banks with the help of the CAMEL Model. Four leading private sector banks - Industrial Credit & Investment Corporation Limited, Housing Development Finance Corporation (HDFC), Unit Trust of India (UTI) and Industrial Development Bank of India (IDBI) - had been taken as a sample. After making an analysis, the author has assigned ratings to all the banks on the basis of parameters of CAMEL Model. The data of five years, i.e., from 2000-01 to 2004-05, were used. The findings of the study revealed that the aggregate performance of Industrial Development Bank of India was the best among all the banks, followed by Unit Trust of India.

Bodla B S and Verma R (2006) studied the performance of SBI and ICICI through CAMEL Model for the period 2000-01 to 2004-05. It was found that SBI has an edge over its counterpart ICICI in terms of Capital Adequacy. However, the opposite is true regarding assets quality, earning quality and management quality. The liquidity position of both the banks was sound and did not differ significantly.

on the basis of CAMEL Model. For the purpose of the study data set published by joint venture banks in their annual reports were used. It was concluded that the health of joint venture banks was better than that of the other commercial banks. In addition, the perusal of indicators of different components of CAMEL indicated that the financial health of joint venture banks was not so strong to manage the possible large scale shocks to their balance sheet and their health was fair.

Kapil S and Kapil K N (2005) examined the relationship between the CAMEL ratings and the bank stock performance. The viability of the banks was analyzed on the basis of the Off-site Supervisory Exam Model—CAEL Model (C for Capital Adequacy, A for Asset Quality, E for Earnings, L for Liquidity). The M for Management was not considered in this paper because all Public Sector Banks (PSBs) were government regulated, and also because all other four components—C, A, E and L—reflect management quality. The remaining four components were analyzed and rated to judge the composite rating. On the basis of their findings, the study argued the disclosure of the bank supervisory information like CAMEL, ratings, to facilitate correct pricing of the bank stock.

Sarker A (2005) examined the CAMEL Model for regulation and supervision of Islamic banks by the central bank in Bangladesh and reviewed the CAMEL standard set by the BASEL Committee for off-site supervision of the banking institutions, their consistencies and inconsistencies under an Islamic setup and had put forward a Sharia Matrix for the first time to elicit comments and suggestions from the Sharia experts and expert Islamic bankers. This study enabled the regulators and supervisors to get a Sharia benchmark to supervise and inspect Islamic banks and Islamic financial institutions from an Islamic perspective. This effort added a new 'S' to the CAMELS rating system as Sharia. Modelling CAMELS has become 'CAMELSS' rating system.

Gasbarro D, Sadguna I and Kenton J (2004) examined the changing financial soundness of Indonesian banks during the crisis. It showed that during Indonesia's stable economic periods, four of the five traditional CAMEL components provided insights into the financial soundness of Indonesian banks. The panel data results indicate the systemic economy-wide forces must be explicitly considered by the rating system.

Said M J and Saucier P (2003) examined the liquidity, solvency and efficiency of Japanese Banks. Using CAMEL rating methodology, for a representative sample of Japanese banks for the period 1993-1999, they evaluated capital adequacy, assets and management quality, earnings ability and liquidity position. They quantified the bank's managerial quality by calculating X-inefficiency using data envelopment analysis (DEA). They identified the sub-group of failed or recapitalized banks with mean tests and proximity estimates, to explain the reason of CAMEL variables to predict and explain distress.

NEED FOR THE STUDY
Significance of performance evaluation in an organization, for sustainable growth and development, has been recognized since long. This calls for a system that first measures and evaluates the performance, and then brings out the strengths and weaknesses of the organization for the purpose of further improvement. It has been observed that the evaluation of the financial performance alone is not sufficient for the present day organizations. The situation is not different even for financial institutions like banks. So, this research is an attempt to describe the need for a modern performance evaluation system for Indian banks.

Economic development of any country is mainly influenced by the growth of the banking industry in that country. The CAMEL Model is used to judge the performance of the banks. The model tells us about the profitability and the soundness of the bank. It tells us the best performing bank according to the parameters of the model. When, so many banks are bankrupt, it is necessary to know the liquidity position of the bank. The CAMEL model is a comprehensive model that tells us about the Capital Adequacy, Asset Quality, Management, Earnings and Liquidity position of a bank.

CONCLUSION
In today's scenario, the banking sector is one of the fastest growing sectors and a lot of funds have been invested in Banks. The new private sector banks, which were started during the liberalization period, have reached a remarkable position due to their high level of technology, core banking and aggressive marketing strategies. To excel, banks need to focus on developing innovative products, customer loyalty and high standards of service quality. So, Indian banking industry is going to face stiff competition. Also today's banking system is becoming more complex. So, there is a need to evaluate the performance of the banks. There are many models for evaluating the performance of the banks, but this study focuses on the importance of the CAMEL Model to evaluate the performance of the banks. CAMEL analysis is generally conducted with an objective to improve organizational performance (such as efficiency and profitability) and to establish a baseline before entering a phase of change or evolution.

REFERENCES:

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