CHAPTER-1

CONCEPTUAL FRAMEWORK OF CAMEL ANALYSIS

1.1 Evolution of Bank: - The term ‘Bank’ specifies an organization where people and business can invest or borrow money; change it to foreign currency etc. According to Halsbury “A Banker is an individual, Partnership or Corporation whose sole predominant business is banking, that is the receipt of money on current or deposit account, and the payment of cheque drawn and the collection of cheque paid in by a customer.”

The Origin and Use of Banks
The Word ‘Bank’ is derived from the Italian word ‘Banko’ signifying a bench, which was initiated in the market-place, where it was customary to exchange money. The word ‘bank’ is used for the commercial bank. ‘Bank of Venice’ was called the first bank, which was established in Venice, Italy in 1157 to finance the ruler in his wars. The bankers of Lombardy were famous in England. But modern banking era was begun with the English goldsmiths after 1640. The first bank was the ‘Bank of Hindustan’ in India, founded in 1770 by Alexander & Co. but this bank was failed due to the closure of, an English agency house in Calcutta in 1782. Then Bank of Bengal was established in 1806. It is considered to be first modern bank for keeping, recording, lending, and exchanging of money in the market by money lenders.

1.2 The Indian Banking System: An Overview: - As we know that that the Indian banking system is divided into three sectors which consists public, private and foreign sector banks. As per the RBI report data on 2011, there were twenty seven public sector banks: out of eight state banks (SBI & seven associates) and twenty nationalized banks, twenty nine private banks (twenty one old private banks and eight new private banks) and thirty foreign banks. The developments of liberalization and globalization have run to several changes in the Indian banking sector. The Narasimham Committee Report (1991) indicates that the reorganization process in the Indian banking sector will increase the operational efficiency of the financial institutions and because of these modifications in 1991, the banking sector of Indian economy has seen many structural changes. The access of private and foreign banks has generated competitive scenario for the public sector banks.
1.3 Role of Indian Banking Sector in present scenario: - Indian banking industry is the fastest growing industry of Indian economy; it plays an important role in the whole development of the country with mobilization of the savings & deposits and providing the loans to the various sectors of the economy. Several studies reveal that a country which has a well-developed banking system grows faster than those with a weaker banking system. The main aim of banking sector is to maintain growth, stability, soundness in the economy of a country. Therefore it is essential to measure the soundness of various banks of the country and develop suitable strategies and policies to encourage and develop efficiency among these sectors. They promote the deposits by offering high rates of interest, then converting savings, into active loans and advances among the enterprises which are directly connected with economic development. In this way, they promote the development of the priority sectors like agriculture, trade and small scale industries.

Performance evaluation of Indian Banking Sector is quite tough because there are some other factors which keeping in mind when differentiating the banks from goods to bad ones. Financial Performance of the banks is measured at two levels, one is by the internal management and supervisory level of the banks (internal ratings), and second through external rating agencies. The main aim of these internal supervisory and
regulatory rating systems is to determine the bank performance at regular internal level and keep the bank on right track. These ratings are highly confidential and make available to the internal top level bank management.

1.4 **Significance of Credit ratings in economic growth**: As we know that credit ratings can inspire the economic development of any country, enhance consumer’s access to crucial resources and assist in more skilled distribution of risk, costs and economic and financial institutions. Ratings supplied by these credit rating agencies are used by different banks, financial institutions with the objective to formulate the risk premium they will charge their customers on loans they issues and corporate bonds. A lower credit rating means a higher risk premium with higher interest rate charged to corporations and individuals. Institutions with a higher credit rating are able to raise funds at a lower interest rate, Most credit agencies use their own methodology for determining credit ratings, but only few of the popular credit ratings agencies exists, this improves a deal of regularization in the credit rating.

1.5 **Conceptual Framework of CAMEL Model**: - CAMEL model is a ratio based internal rating, monitoring, regulatory and supervisory tool to evaluate the financial condition of the banks through it’s on-site and off-site surveillance mechanism. CAMEL is systematic, methodical, and attentive tool in its assessment process. CAMEL model encourage the financial institutions transparency, evolution and transformation by using its tested methodology. It includes analysis of both qualitative and quantitative values with quantitative significant financial ratios; however qualitative approach refers to the subjective elements that assist the financial institutions operations. It is an effective internal rating tool that guides the banks, before failure happens and takes remedial actions, although CAMEL Rating System was developed by the American banking system.

The term CAMEL stands for Capital Adequacy, Asset Quality, Management quality, earnings ability and Liquidity management. The criteria for the performance of all the banks under CAMEL rating include the above mentioned.

1. **Capital Adequacy**: It evaluate whether the banks have a strong capital base for unexpected loan losses or provisions or not. It signifies the relationship between equity and risk weighted assets of the financial institutions, how to increase the equity and also
measure the ability to which the institution observes the loan losses. As we know that capital Adequacy is the first element of CAMEL framework. Capital provides a safeguard against the unexpected losses which supports the banks to survive, by overcoming the risk of bankruptcy. It reflects the ability of management to report the emerging needs for additional capital, the balance sheet structure and a financial institution’s admittance to capital markets and other sources of capital including financial assistance provided by a parent holding company. As per the RBI guidelines, Banks should have maintained minimum 9% CAR. It is computed by dividing the total of Tier-I and Tier-II capital by the risk weighted assets. While rating the capital adequacy of the banks, ratios are used to assess the banks the difference between the total assets and total liabilities is called capital. If there is any loss incurred because of NPA’S, it will create the risk on banks to meet the demand of their depositors. The Basel capital has two parts. These are, Tier one, and Tier two capitals.

**Tier I:**- Tier one is a type of capital, which is considered to be core or original capital that consist of common equity, preferred equity, convertible bonds and retain earning.

**Tier II:** Tier II capital is also known as hybrid capital because it includes that amount which is derived from issued bonds by the banks. These amounts decrease the guarantees of buyers because these are of long-term in nature.

**Ratings criteria for Capital Adequacy:**-

- A rating of A + or 1 states that a bank has strong capital base in relation to its risk profile.
- A rating of A or 2 states that a bank has a satisfactory capital base in relation to its risk Profile.
- A rating of B or 3 states that a bank has a less than satisfactory level of capital which does not support the bank’s risk profile. This rating reflects a need of improvements, though capital level exceeds minimum regulatory and statutory requirements prescribed by RBI.
- A rating of C or 4 states that bank has a deficient level of capital in relation to its risk profile which indicates the bank requires financial support from its shareholders.
- A rating of D or 5 states that a bank has a very critical deficient level of capital so, the Sustainability of the institution is quite risky and requires immediate financial assistance from the Shareholders.
2. **Asset Quality**: It indicates the quality of the assets portfolio maintained by the banks, and also assesses the portfolio of risk and the efficiency of the long term assets Asset quality. It is the second important component of CAMEL. Asset quality shows the quality of the bank’s earning assets, which is mainly of the bank’s loan and advances portfolio (credit risk, investments portfolio (market risks) and off-balance sheet items (guarantees, letters of credit and derivative instruments etc. The main aim to measuring the assets quality is to ascertain the risk involves with the advances of becoming unpaid a part of principal and interest. Weakening and development in the quality of assets is the main source of earning difference in a bank because its main function is providing loans. It has been seen that poor asset quality is the main reason of most bank failure. The factors considered by the supervisory and regulatory authorities during on-site monitoring and evaluation of the banks’ asset quality and also determine the quality of the loan sanctioned.

- Proper assessment of risk, terms and conditions should be analyzed before sanctioning the loan as well as lending is made against collateral guarantees.
- Evaluation and determination of the non-performing assets re-structured and postponed loans which are subject to administrative/legal action for collection.
- To find the chances of success for the collection of non-performing assets and receivables.

**Ratings criteria for Asset Quality**

- A rating of A+ or 1 specifies that a bank that possess strong quality of assets and credit administration policies.
- A rating of A or 2 specifies that a bank possess satisfactory quality of assets and credit administration policies.
- A rating of B or 3 specifies a bank that possesses less satisfactory quality of assets and credit administration policies.
- A rating of C or 4 specifies a bank which has deficient quality of assets or credit administration policies. The risk level of assets is significant, ineffectively controlled, and subject the bank to potential losses or, may threaten its sustainability.
- A rating of D or 5 specifies that a bank possess critically deficient quality of assets or credit an administration policy that reflects the immediate threat to the bank’s sustainability.
3. **Management Quality**: -The third component of CAMEL is management quality which examines the experience, standing and technical knowledge, honesty and integrity, willingness to keep proper regulated environment, strategic planning and the ability to keep effective internal and external leadership and monitoring, are the important factors to analyses the bank’s performance. Management quality assesses the effectiveness of the managers or staff to earn maximum from available earning assets and also to control bank costs. Management is also responsible for the overall performance of the banks and measuring the risk profile. The ratios are used to measure the efficiency and effectiveness of management. It determines whether the board of directors i.e. top management and other staff resource management are performing their assigned job or not and also evaluates their regular performance whether they provide proper guidance and all facilities to their staff or not.

**Factors are considered while rating the management’s quality is as follows:**

- Board of directors and the top management of the bank must have the abilities to determine the business activities and the risk associated with that and also make alternative plans to save the bank from future problems.
- It is the prime responsibility of management to develop and implement the plans, policies, procedures, MIS, effective leadership and risk monitoring system; an effective management must have the ability to deal with changing financial system.
- There must be proper internal and external audit for Job explanation, reward policies etc.

**Ratings criteria for Management Quality:-**

- A rating of A+ or 1 states that a bank have a strong management performance and top management have strong risk management practices against to the banks size, nature, complexity, and risk profile.
- A rating of A or 2 states that a bank have a satisfactory management performance and board may have better risk management practices against to the banks size, nature, complexity and risk profile, only minor weaknesses are exists.
- A rating of B or 3 states that a bank has a less satisfactory management performance and board may need improvement in risk management practices against the nature, size and complexity of the bank’s risk profile.
- A rating of C or 4 states that a bank has a deficient management performance and board
is incapable in determining the risk management practices against the nature of the banks activities. Here replacement of management is required.

- A rating of D or 5 states that a bank has critical deficiency of management performance. The top management and the board do not have the ability to correct problems and uses proper risk management practices.

4. **Earning Capacity**: - Earnings are the most crucial component of CAMEL to measure the performance and soundness of a bank. It helps in evaluating the performance of the banks to increase and maintain the total revenue through earnings from operations and also assess the profitability of a bank and clarify its sustainability and growth. The earnings and profitability is the fourth essential element used in the evaluation of the bank financial performance and its future growth prospects. Profitability is an essential area for the survival and existence of a bank to analyses the earnings is a quantitative measure of management’s ability to utilize the assets efficiently and also generate profits for shareholders and maintain capital soundness. Earnings helps to evaluate it financial performance through measuring return on assets, operating profits, net profits and also analysis the level of operating expenses and the exposure of earnings to market risk such as interest rate foreign exchange risk and market price risk.

**The factors considered by the supervisory and regulatory authorities to assess the quality of assets are**

- To evaluate the undistributed profits and reserves, retained earnings, profits, and their authentication whether an adequate capital are generated through this channel or not.
- To determine the quality sources of earnings and incomes, budgeting policies and Management Information Systems (MIS).

**Ratings Criteria for Earnings:-**

- A rating of A+ or 1 state that a bank has strong and sufficient earnings to support operations and conserve an adequate capital level.
- A rating of A or 2 states that a bank has satisfactory and sufficient earnings to support operations and conserve an adequate capital level.
- A rating of B or 3 states that banks earnings are need to be improved.
- A rating of C or 4 states that a bank has deficient earnings that are insufficient to support operations and need to maintain proper capital levels and allowances.
- A rating of D or 5 stated that a bank has critically deficient earnings and facing heavy
losses that represent a threat to its survivability through the loss of capital.

5. **Liquidity Management**: As we all know that the liquidity ratio states the level or limit up to which a bank is able of filling its respective liabilities. Liquidity is measured by the level of earnings, the fifth component of CAMEL Framework is liquidity, and it is an important element for both good and bad banks. All banks are highly concerned for their liquidity risk; i.e., the problem which arise due to the bank failure in meeting its current financial obligations (e.g., depositors) because of inadequate current assets such as cash and quickly cash type marketable securities. Banks generate money by mobilizing short-term savings of the people converting into deposits at lower interest rate, and then lending these funds in long-term loans at higher rates of interest, so it is quite risky for banks to mismatch their lending interest rate.

**Ratings criteria for Liquidity:-**

- A rating of A+ or 1 specifies a bank that possesses a strong liquidity position and well developed funds policies.
- A rating of A or 2 specifies a bank that possesses a satisfactory liquidity position and funds management performances.
- A rating of B or 3 specifies a bank which requires need of improvements in liquidity levels or funds management performances.
- A rating of C or 4 specifies a bank that has deficient liquidity levels or inadequate funds management performances.
- A rating of D or 5 specifies a bank that has critical deficient liquidity levels or funds management performances and the continued sustainability of the bank is quite risky.

1.6 **Significance of CAMEL Model in Banks Supervision & Public Monitoring**: Several studies have been made to analysis to measure the extent of effectiveness of private supervisory information in the regulating and monitoring of performance of banks. In case of predicting bank’s failure, CAMEL ratings are used to evaluate the overall performance of banks, due to the increasing competition with the global financial markets. It shows the exact conditions and performances of banks through on-site and off-site monitoring system. Its main goal is to provide an accurate, regular and reliable assessment of a bank’s financial statement, condition in the areas of capital adequacy, asset quality, management abilities, earnings and liquidity management. The direct
public recipients of private regulatory information, such as provided by CAMELS ratings are beneficial for the depositors, shareholders and investors of banks.

1.7 Brief Profiles of Selected Public and Private Sector Banks in India: An attempt has been made to highlight in brief the history and Profile of selected public and private sector banks under the study:

Brief Profiles of Selected Public Sector Banks (PSBs) in India:

1. **History and Profile of State Bank of India (SBI):** SBI is considered to be the largest public sector banking company in India which was established on 1 July 1955. Its headquarters is in Mumbai. As on 31 March 2016, SBI has 49,577 ATM’S & SBI group has 58,541 ATM’S and 293,459 employees.

2. **History and Profile of Bank of Baroda (BOB):** BOB is considered to be the second largest public sector banking company in India which was established on 20 July 1908 with a paid up capital of Rs. 1 million by Maharaja Sayajirao III of Baroda. It’s headquarter is in Vadodara, Gujarat. In 2015 it has a network of 5326 domestic and overseas branches in India and abroad, and over 8000 ATMs.

3. **History and Profile of Punjab National Bank (PNB):** PNB is one of the four largest public sector bank and financial services company in India which was established on 19 May 1984 by Lala Lajpat Rai. It’s headquarter is in New Delhi. It has a network of 6,968 branches in India and abroad, and over 9,656 ATMs in across 764 cities.

4. **History and Profile of Bank of India (BOI):** BOI is the fourth largest public sector bank and financial services company in India which was established on 7 September 1906 with a paid up capital of Rs. 50 lakh by group of eminent business men of Mumbai. Its head quarter is in Mumbai, Maharashtra. In December 2013, it has a network of 4828 branches in India and 56 offices in abroad, and over 8000 ATMs.

5. **History and Profile of Canara Bank:** Canara Bank is one of the multinational public sector bank and financial services company in India which was established on July 1906 with a paid up capital of Rs. 50 lakh by late shri Ammemba l SubbaRao Pai. Its head quarter is in Bangalore, Karnataka. As of November 2015, the bank had a network of 5784 branches and more than 9153 ATMS spread across India, total assets of 4.72 trillion and 53,506 employees.
6. **History and Profile of Industrial Development Bank of India (IDBI):** IDBI is a wholly owned subsidiary of the RBI under an Act of Parliament but in 1976, its ownership was transferred to the Government of India which was established in 1964 by Act of Parliament. Its headquarter is in Mumbai, Maharashtra. It had a network of 1853 branches, including one overseas branch at Dubai, and 1382 centers, 16555 employees with a balance sheet size of 3,74,372.13 cores.

7. **History and Profile of Union Bank:** Union Bank is one of the largest public sector banking and financial services company in India which was established on 11 November 1919 by Mahatma Gandhi. Its headquarter is in Mumbai, Maharashtra. As of March 2016, the bank had a network of 4196 branches and more than 6909 ATMs spread across India.

8. **History and Profile of Syndicate Bank:** Syndicate bank is one of the major and oldest public sector banking and financial services company in India which was established on 10 November 1925 with the name of Canara Industrial and Banking Syndicate Ltd. by T M A Pai, UpendraPai and Vaman Kudva. Its headquarter is at Manipal, Karnataka. As of March 2008, the bank had a network of 3682 domestic and 1 overseas branch and 27227 employees.

9. **History and Profile of Central Bank of India (CBI):** CBI is one of the oldest and largest public sector commercial banks in India which was established on 21 December 1911 by Late Sorabji Pochkhanawala. Its headquarter is in Mumbai, Maharashtra. Its total business at the end of the last fiscal amounted to 45,05,390 (approx.) million and approx. 42000 employees.

10. **History and Profile of UCO Bank:** UCO bank is one of the oldest public sector commercial banks in India which was established in 1943. Its headquarter is in Kolkata, Maharashtra. It has 34 domestic regional offices. This bank has approx.30109 employees in 2015. This bank also considered as authorized host branch for the collection of direct tax.

**Brief Profiles of Selected Private Sector Banks in India**

1. **History and Profile of Industrial Credit and Investment Corporation of India (ICICI):** ICICI Bank is considered to be the largest private sector bank in India which was established in 1994. In September 10, 1999, it has a network of 4,450 branches and 13,995 ATMs in India, and has a presence in 19 countries including
2. **History and Profile of Housing Development Finance Corporation Ltd (HDFC):**

HDFC Bank is one of the largest Private Sector financial services companies in India which were established on 30, August 1994 by Housing Development Finance Corporation Ltd. Its headquarter is in Mumbai. As of June 30, 2016, it has a network of 4,541 branches and 12,013 ATMs, about 76,286 employees.

3. **History and Profile of Axis Bank:**

Axis Bank is the third largest Private sector financial in India which was established in 1993. In the year 1994, its registered office is at Ahmedabad and corporate office at Mumbai. As of 12 Aug 2016, the bank had a network of 3,120 branches and 12,922 ATM’S.

4. **History and Profile of Yes Bank:**

Yes Bank is considered to be the fifth largest private sector bank in India, founded by Rana Kapoor in 2004. And its head office is at Mumbai. It has a network of about 600 branches and 2,000 ATMs.

5. **History and Profile of IndusInd Bank:**

IndusInd Bank Ltd is one of the new generation private sector banks in India which was established in 1994 with a paid up capital of 1 billion by Mr. Srichand P Hinduja. It’s headquarter is in Mumbai. It has a banking network of 800 branches, and 1500 ATMs as of April 2016.

6. **History and Profile of Kotak Mahindra Bank:**

Kotak Mahindra Bank is a sixth largest private sector bank in India which was established in 2003. It’s headquarter is at Mumbai, Maharashtra. As of 30 September 2014, it has a network of 641 domestic and overseas branches and about 1,159 and above ATMs and has approx. 29,000 employees.