

An Assessment of Financial Performance of Banks: A Case of the Nainital Bank Ltd.

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Abstract – Banks play an important role in the economic development of every nation. They have control over a large part of the supply of money in circulation. The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial sector, which plays a vital role in the functioning of an economy. It is very important for economic development of a country that its financing requirements of trade; industry and agriculture are met with higher degree of commitment and responsibility. Thus, the development of a country is integrally linked with the development of banking. Financial performance of banks is generally assessed through calculating the ratios, and profitability ratios play an important role in assessing financial performance. This study aims to assess the financial performance for last five years of the Nainital Bank Ltd., a subsidiary of bank of Bdoora, headquartered at Nainital, Uttarakhand. Altman's Z score model & Camel's rating methods has been used for calculating the appropriate results.

Key Words: The Nainital Bank, Financial Performance, Z Score, Camel's Rating

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INTRODUCTION

Nainital Bank was established in 1922 by the veteran freedom fighter Late Bharat Ratna Pandit Gobind Ballabh Pant and few other prominent personalities in Nainital. The operations of the Bank were confined to the Kumaun region of the erstwhile Uttar Pradesh, till 1973, having 9 branches only. In the year 1973, RBI directed that Bank of Baroda, should manage the affairs of Nainital Bank Ltd. The Bank was included in the 2nd schedule of Reserve Bank of India Act, 1934 on 28th November, 1978. Original Share holding of BOB was 30%, currently it is 98.57%. Bank has been earning continuous profits since 1973.

Business undertaken by the bank is very simple in nature as Bank has no active treasury, no securitization exposure, no Forex business and does not have any subsidiary of its own. The business affairs of bank is supervised and controlled by Board of Directors consisting of representative from different fields. The chairman and CEO of the bank is a scale-VI officer (Deputy General Manager) of Bank of Baroda on deputation for 3 years term. The Nainital Bank has 139 branches in all in U.P., Uttarakhand, Haryana, Rajasthan and Delhi.

The economy of the country largely depends on the financial system of the country by providing necessary resources for the development and growth of different sectors of economy, viz., agriculture, industry, services and transport etc. Financial system inter alia comprises of banks, capital market and money market etc. Banks ensure the stability of economy as central/major part of financial system. Health of banking system is necessary pre condition for healthy economy. Stability and soundness of banks is measured in terms of financial performance of banks. Nowadays assessment of financial performance of banks has gained paramount importance due to the dynamic and volatile environment of business, high competition and increasing risk leading to insolvency of business, like financial crisis of US banks in 2008 (Kumar Krishna and Kavita, 2017)¹. Good financial performance of banks is an indicator of consistent growth and it ensures security to depositors, shareholders, employees and economy. The menace of non-performing assets has dented profitability of banks in two pronged manner by not booking profit for non-performing accounts and by providing from the profits for those NPAs and simultaneously keeping aside the capital for unforeseen events through capital adequacy measure as a statutory

requirement under RBI regulations. Basel norms have been designed to strengthen the international banking system.

Thus, assessment of financial performance has become imperative in today's world of uncertainty, risk and competition.

LITERATURE REVIEW

In literature many studies focus on financial performance of banks.

Ramachandran A and Kavitha N (2009) presented a census study of profitability of all the scheduled commercial banks of India for a period of 10 years. It further divides this period of 10 years into two parts. It uses step by step multiple regressions for analysis. Bank-wise suggestions have been given to increase the profitability of different banks.

Uppal R.K. and Juneja Amit (2012) have analyzed the performance of Indian Banks by dividing it in 4 groups, *i.e.*, public sector banks, old private sector banks, new private sector banks and foreign banks in respect of various parameters of the balance sheet.

Dr. Khalil Elian Abdelrahim (2013) has studied the credit risk management in Saudi Banks in detail through CAMEL model. It has concluded that capital adequacy, asset quality, management soundness and earnings have a significant effect on effectiveness of credit risk management while liquidity has a significant positive impact, whereas size of bank has a strong negative impact on effectiveness of credit risk management.

Githaiga Joyce Wangari (2015) has attempted to investigate relationship between determinants of credit risk management and financial performance of commercial banks in Kenya by use of CAMEL indicators. Secondary data was analyzed with multiple regression techniques. It was found that CAMEL parameters have strong impact on financial performance of banks.

Kumar Krishna and Kavita (2017) analyzed financial health of selected Indian Commercial Banks through Altman's Z-Score Model for a period of 8 years (2009-2016). Overall Z-Score was calculated on the basis of liquidity position, retained earnings, profitability and equity ratios of the banks.

Rahman Md. Zahidurand and Islam Md. Shohidul (2018) evaluated the performance of banking sectors of Bangladesh by taking a sample of 17 private commercial banks and considering the data from annual reports for 2010-2016. Comparative analysis showed that the Eastern Bank topped the list of the selected banks in performance compared through CAMELS method.

OBJECTIVE

Objective of this study is to assess the financial performance of The Nainital Bank Ltd. For last five years on the basis of Altman's Z score & Camel's rating.

Z score Model

Mainly the following tools are used for this purpose:

- Altman's Z score Model** – This tool is known as multiple discriminate analysis for evaluation of possibility of solvency within a period of two years with high accuracy. It was first evolved in 1968 for manufacturing companies, but in 1983 it was revised for private firms. The latest version is the revised one (1993) for emerging firms and non-manufacturing firms including four variables namely working capital to total assets ratio, retained earnings to total assets ratio, earnings before interest and taxes, book value of equity to total assets.

The equation for Z score is as under:-

$$Z = 6.56X_1 + 3.26X_2 + 6.73 X_3 + 1.04X_4$$

X_1 = Capital to total assets ratio

X_2 = Retained earnings to total assets ratio

X_3 = Earnings before interest and taxes to total assets ratio

X_4 = Book value of equity to total assets ratio

The interpretation of Z score is given in table below:-

Z – Score	Interpretation
$Z > 2.60$	Non bankrupt firms, safe zone
$1.1 < Z < 2.60$	Difficult to predict, grey zone
$Z < 1.10$	Bankrupt firm, distress zone

- CAMELS Method** – The main objective of banking supervision by RBI is to ensure depositors interest and financial stability. RBI has adopted CAMELS framework for supervision of banks including evaluation of performance with reference to the following:

- Bank's Financial Performance** – It highlights asset quality, solvency, capital adequacy, earning performance and liquidity.
- Management and Operating Conditions** – It focuses on management (board and senior

management) systems and internal controls including risk management control strategy.

- iii. **Compliance to Regulations** – It assesses timely submission of various reports including integrity of reporting and compliance to various RBI guidelines.

Under CAMEL framework, annual financial inspection of RBI findings are recorded and on the basis of scores obtained by them a supervisory rating of public/private sector bank is done by RBI. Prompt corrective action triggers are activated on the position of capital adequacy ratio, net NPA and ROA. The objective of CAMEL rating is to take stock of bank's financial, operational and managerial position. It utilizes financial reports and other related information as base material for making analysis. In reviewing these ratios the benchmarks as well as the trends are to be considered. It reevaluates management practices in combination with performance measures.

Composite Rating: The CAMEL rating components are allocated different weights and final judgment rests on a scale from 1 to 5. The meaning of each rating is summarized below:

1. **CAMEL Rating Grade-1:** Rating grade 1 signifies sound banking in all respects. It is a depiction of strong performance and risk management practices and the positive trends for key performance measures and in the compliance area.
2. **CAMEL Rating Grade-2:** Rating grade 2 indicates towards fundamentally sound bank with some moderate weakness. It evidences the identification of risks in a prudent manner and mitigation of those risks accordingly. The risk mitigation measures and performance indicators are positive and banks sound business operation is not affected. Hence the weaknesses are managed well and the compliance of laws and regulations is also done regularly.
3. **CAMEL Rating Grade-3:** Rating grade 3 depicts the presence of functional weaknesses causing supervisory concern to set right the difficulties. Such banks do not comply with regulations and the performance does not need expectations and management lacks the ability to overcome weakness efficiently.
4. **CAMEL Rating Grade-4:** Rating grade 4 expresses serious or moderate operational failure that can question future viability of banks. Bank's risk management is operative on a lower efficiency scale. Key performance

indicators are also negative which threaten the bank's existence. Laws and regulations are also not complied with. Although the potential for failure is not yet imminent but it has a high potential in future. Supervisory review is very much attracted in such cases.

5. **CAMEL Rating Grade-5:** Rating grade 5 signifies critical financial weakness leading towards high possibility of failure in near future. The viability of bank is threatened by unsatisfactory performance and serious financial restructuring is needed. Management is not able to combat with the volume and severity of problems.

The six parameters of CAMEL rating are measured through different variables. Researchers decide by their experience to choose the option of variables based on intuition and knowledge.

ASSESSMENT OF FINANCIAL PERFORMANCE OF NAINITAL BANK

Financial performance and solvency of Nainital Bank for last three years, has been assessed by Altman's 'Z' Scores

Calculation of 'Z' Score

Particulars	2013	2014	2015	2016	2017
Total Assets	4,318.09	5,342.59	5,977.93	6,084.39	7,699.69
Current Assets	1,567.07	2,087.66	2,609.54	2,290.28	3,270.12
Current Liabilities	898.16	1,574.13	1,552.89	1,504.36	1,669.65
Demand Deposit	211.87	264.22	289.18	235.62	300.84
Savings Banks	1,255.28	1,428.09	1,546.93	1,616.67	2,016.94
Savings Banks @ 25%	313.82	356.27	386.73	404.17	504.24
Term Deposit	2,256.48	2,960.27	3,507.92	3,458.30	3,458.30
Term Deposit maturing within 1 year	372.47	953.64	876.98	864.58	864.58
Working Capital	668.91	513.53	1,056.65	785.92	1,600.47
Profit after Tax	51.06	65.42	67.18	46.97	48.46
Income Tax	23.75	29.00	29.15	19.55	27.01
Interest Paid	246.10	268.72	337.71	359.28	374.49
Interest Paid	246.10	268.72	337.71	359.28	374.49
Earnings before Interest & Tax (EBIT)	320.91	363.14	434.04	425.80	449.96
Cash & Balances With Reserve Bank of India	184.43	219.18	274.27	297.00	284.85
Balances with Banks & Money at call and Short Notice	889.07	1,457.03	1,684.92	1,503.43	1,862.74
Investment	1,035.60	1,139.74	1,378.15	1,381.41	2,104.48
Securities under AFS	493.57	411.45	650.35	489.85	1,122.53
Dividend Paid/Proposed	17.26	17.26	17.82	16.20	20.38
Retained Earning	33.80	48.16	49.36	30.77	28.08
Book Value per Share (Rs.)	59.36	65.97	71.86	76.68	73.51
Z Score	4.82	4.39	4.95	4.61	5.04

Notes

Liquid assets consists of: cash, balances with RBI, balances in current accounts with banks, money at call and short notice, inter-bank placements due within 30 days and securities under "held for trading" and "available for sale" categories excluding securities that do not have ready market.

Retained Earnings = Profit after Tax - Dividend Paid/Proposed

The Z scores calculated for Nainital Bank for Years 2012-13, 2013-2014, 2014-15, 2015-16 and 2016-17 are 4.83 ,4.39 , 4.95, 4.61 and 5.04 respectively which are above 3 which means

that there is no risk of solvency for Nainital Bank in near future.

CAMEL Analysis

Nainital Bank's performance for years 2012-13 to 2016-17 in terms of CAMEL framework has been calculated as under:

Capital Adequacy

Particulars	2013	2014	2015	2016	2017	Average	Marks Allotted
CAR	14.43	15.13	14.86	15.69	12.78	+14.6	1
Advances/Assets	0.50	0.46	0.43	0.44	0.42	-0.45	3
Govt. Securities/Investment	0.70	0.81	0.77	0.84	0.82	+0.79	3
Debt/Equity	9.77	11.00	11.08	10.58	11.96	+10.88	2

Average Marks for Capital Adequacy – 2.25

Asset Quality

Particulars	2013	2014	2015	2016	2017	Average	Marks Allotted
Net NPA/Total Assets	0	0	0	0.00	0.01	0.002	1
Net NPA/ Net Advances	0	0	0	1.05	1.25	+0.46	1
Total Investment/Total Assets	0.24	0.21	0.23	0.23	0.27	0.24	1
Gross NPA/Advances	3.09	2.47	2.98	4.42	5.01	+3.79	1

Average Marks for Asset Quality – 1.00

Management Quality

Particulars	2013	2014	2015	2016	2017	Average	Marks Allotted
Total Advances/ Total Deposit	58.43	53.12	48.59	51.57	47.86	-51.91	3
Profit per employee	0.07	0.09	0.09	0.07	0.07	+0.08	3
Business per employee	7.48	8.73	9.88	10.78	12.71	+9.92	2
Total Expenses/Total Income	0.88	0.86	0.88	0.92	0.92	+0.89	2

Average Marks for Management Quality – 2.50

Earning Quality

Particulars	2013	2014	2015	2016	2017	Average	Marks Allotted
Net Interest Margin	3.73	3.71	3.20	3.02	2.80	-3.29	1
Return on Equity	14.00	16.38	15.12	9.54	9.22	-12.85	3
Return on Asset	1.30	1.48	1.26	0.80	0.73	-1.11	1
Dividend/Net Profit	0.29	0.23	0.22	0.28	0.35	-0.27	3

Average Marks for Earning Quality – 2.00

Liquidity

Particulars	2013	2014	2015	2016	2017	Average	Marks Allotted
Cash/Total Asset	0.04	0.04	0.05	0.05	0.04	-0.044	1
Government Security / Total Asset	0.17	0.17	0.18	0.19	0.22	+0.186	2
Cash / Total Deposit	0.05	0.05	0.05	0.06	0.04	-0.050	1

Average Marks for Liquidity – 1.33

Market Sensitivity

Since there is no active treasury in Nainital Bank and Nainital Bank is having all the systems and procedures prescribed by RBI and in the line with

Bank of Baroda therefore we have given 1 mark for average marks for sensitivity to market.

Average Marks for Sensitivity to Market - 1.00

CAMELS Score = 0.2 x Average Marks for Capital Adequacy + 0.2 x Average Marks for Asset Quality + 0.25 x Average Marks for Management Quality + 0.15 x Average Marks for Earning Quality + 0.1 x Average Marks for Liquidity + 0.1 x Average Marks for Sensitivity to Market

$$= 0.2 \times C + 0.2 \times A + 0.25 \times M + 0.15 \times E + 0.1 \times L + 0.1 \times S$$

$$= 0.2 \times 20.25 + 0.2 \times 1 + 0.25 \times 2.50 + 0.15 \times 2.00 + 0.10 \times 1.33 + 0.1 \times 1$$

$$= 1.808 \text{ (say 2.00)}$$

The weights in the formula for C, A, M, E, L and S are as per RBI prescription.

Marks allotted are researcher's own calculations.

FINDINGS AND CONCLUSION

Kumar Krishan and Kavita (2017) have analyzed Altman's 'Z' score for different banks and concluded that financial health of banks under study is strong and satisfactory. Researchers found average 'Z' score for SBI, BOB, ICICI and Kotak Mahindra Bank (from 2009 to 2016) to be 6.191, 5.656, 4.997 and 4.995 respectively. The 'Z' score computed in this study for Nainital Bank is 4.82 (for 2013), 4.39 (for 2014), 4.95 (for 2015), 4.61 (for 2016) and 5.04 (for 2017) which is very high than required therefore it can be safely inferred that for next 2 years bank is not going to fail or to be liquidated except for external reasons. Mittal Manish and Dhade Arun (2009) analyzed awareness of CAMELS amongst bank employees in India in public, private sector and foreign banks and found the comparative awareness to be 83%, 43% and 93% respectively. Saji Thazhungal Govindan Nair and Sableyeibiyo Asghede (2015) found that BOB was fundamentally sound with some minor flaws in certain areas (mortgage weakness). They had computed CAMELS composite score of Bank of Baroda to be 2.28. Nainital Bank's CAMELS composite rating (average) had been calculated to be 1.80 which can be easily approximated to 2. The rating 2 is awarded to banks with relatively good performance profile and only minor flaws in their operations are present. Going into the further details the challenging areas identified for improvement are advances, investment in government securities, profit, return on equity and dividend upon net profit. It is easily inferred that the growth in advances will change the ratings as it will also change the investment pattern of bank and profits. If bank enhances its credit portfolio in quantity and quality

both its return on advances will also increase leading to increase in return on equity and dividends.

Z score & Camel's Score are static approaches as these do not capture the changes between the yearly intervals. In depth analysis of investment & advances portfolio can also give new insights for financial performance of banks for further research.

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