

A Comparative Study on Financial Performance of Foreign and Domestic Commercial Banks in Sri Lanka: An Application of CAMEL Rating System

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Keywords: *Financial Performances; Commercial Banks; CAMEL Rating System*

Introduction

Banks are playing a major role of the financial system of all countries as well as in Sri Lanka. Sri Lankan banking system can be divided into two as commercial banks and special purpose banks. This study aims to find the performance of the foreign commercial banks in Sri Lankan economy and compare it with domestic commercial banks. To provide a satisfactory service to the customers, each institute should be aware of their turning points. In the view of customers, it is very important that the awareness of the possibility of negotiation with the institutions. This study considers performance of those banks by using various indicators which is not focused in the previous literature.

There are a number of studies in this area. They have focused different aspects of the banking sector. A comparative study on state and private sector commercial banks in Sri Lanka for the time period of 2008-2012 has been conducted by applying CAMEL rating system (Anojan and Nimalathasan, 2014). In the study they have stated that private sector banks are better than state banks in the performance of capital, earning to the asset quality and management soundness of the banks in Sri Lanka.

Objective

Although there are various financial reports prepared by the Central Bank and each banking institutions, there is no a comparative study among foreign and domestic commercial banks in Sri Lanka. The overall objective of this study is to compare the financial performance of foreign and domestic commercial banks in Sri Lanka by using CAMEL rating system.

Methodology

Researcher selected three foreign banks and three domestic banks for the study. Hongkong and Shanghai Banking Corporation of Sri Lanka (HSBC), Standard Chartered bank of Sri Lanka and Citibank Sri Lanka were selected to represent the foreign bank sector. Sampath bank PLC, Commercial bank of Ceylon PLC and National Development Bank PLC (NDB Sri Lanka) were selected for the domestic sector. The data was analyzed by applying ratio analysis which is a supervisory rating system originally developed in US to classify a bank's overall condition. This rating system was extensively used by many researcher in assessing the efficiency of financial institutions. The variables are Capital Adequacy, Assets Quality, Management Soundness, Earnings and Liquidity. Data for the study was collected for the time period of 2008-2014. Interpretation of the ratio analysis is given in Table 1.

Table 1: Ratio Analysis of CAMEL Rating System

Aspect	Ratio/s	Formula
Capital Adequacy		$\frac{\text{Equity Capital}}{\text{Total Assets}}$ (>4.6%)
Assets Quality		$\frac{\text{Loans \& advances}}{\text{Total Assets}}$
Management Soundness		$\frac{\text{Operating cost}}{\text{Profit after tax}}$
	Return on Assets (E1)	$\frac{\text{Net profit after tax}}{\text{Total assets}}$
Earnings	Net Interest Margin (E2)	$\frac{\text{Net interest income}}{\text{Total Assets}}$ (>4.5%)
	Net Profit Margin (E3)	$\frac{\text{Profit after tax}}{\text{Total loan \& advances}}$
	Diversification Ratio (E4)	$\frac{\text{Non-interest income}}{\text{Total income}}$
Liquidity	Loan to Deposit Ratio	$\frac{\text{Total loans}}{\text{Total deposits}}$ (<80%)

Results and Discussion

In order to fulfill the objectives of the study, data were collected from secondary sources mainly from annual financial statements of selected banks. Mainly Fitch Rating Lanka annual reports were used to collect relevant data from foreign sector commercial banks. Calculated final ranking with average ratios using those data are given in Table 2.

Table 2 shows the ranking of the banks according to the CAMEL rating system. Sampath bank and Standard Chartered bank can be ranked as first according to the above results. Commercial bank, NDB bank and Citibank can be ranked as second and it becomes clear that HSBC is the last. Next we compares the performance of the foreign and domestic sector banks and results are given in Table 3.

According to the above results, domestic sector banks perform well in assets quality, management soundness and liquidity while foreign sector perform well in capital adequacy and earnings. Accordingly, it can be concluded that domestic sector banks stand forward in the overall financial performance of commercial banks in Sri Lanka during last few years.

Table 2: Final ranking with average ratios of selected banks

	Commercial Bank (%)	Sampath Bank (%)	NDB Bank (%)	HSBC (%)	Standard Chartered Bank (%)	Citibank (%)
Capital Adequacy	9.54	7.62	10.18	10.7	17.71	31.11
Rank	5	6	4	3	2	1
Assets Quality	58.27	64.11	69.19	47.2	56.74	42.52
Rank	3	2	1	5	4	6
Management Soundness	20.75	30.64	14.86	15.43	9.85	15.14
Rank	2	1	5	3	6	4
Earnings	6.24	5.79	8.63	10.25	13.78	15.76
Rank	5	6	4	3	2	1
Liquidity	71.89	79.12	56.19	55.69	71.98	49.93
Rank	3	1	4	5	2	6
Final Rank	3	1	3	6	1	3

Table 3: Comparison between foreign and domestic sectors

	Domestic Sector (%)	Foreign Sector (%)
Capital Adequacy	9.11	19.84
Rank	2	1
Assets Quality	63.86	48.82
Rank	1	2
Management Soundness	22.08	13.47
Rank	1	2
Earnings	6.89	13.26
Rank	2	1
Liquidity	69.07	59.2
Rank	1	2
Final Rank	1	2

Conclusion and Recommendation

This study was conducted with the aim of comparison of the financial performance of foreign and domestic sector commercial banks using CAMEL rating system in Sri Lanka. According to the findings, it can be stated that domestic sector banks are better than foreign sector banks in the performance of assets quality, management soundness and liquidity while foreign bank sector is better in capital adequacy and earnings. Accordingly, it can be concluded that domestic sector has a better performance than the foreign sector in the financial performance of commercial banks in Sri Lanka. In the case of capital adequacy, domestic banks should avoid furthermore debt capital in the future. In assets quality, foreign sector should take necessary steps to recover the loans and advances from the customers. NDB and Standard Chartered banks need to increase the total income of the banks. In the case of bank's earnings, domestic sector should work hard in order to raise the total income. To stipulate the liquidity position NDB, HSBC and Citibank would give priority to increase the source of current assets.

References

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