ISSN No. 2347 – 856X

CAMEL ANALYSIS OF NBFCs IN TAMILNADU

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Abstract
Financial intermediation is a crucial function of Banks, Non Banking financial companies (NBFCs) and Development Financial Institutions (DFIs) the post reform period in India is characterized by phenomenal growth of NBFCs complementing the role of banks in mobilizing funds and making it available for investment purposes. During the last decade NBFCs have undergone wide volatility and change as an industry and have been witnessing considerable business upheaval over the last decade because of market dynamics, public sentiments and regulatory environment. To evaluate the soundness of NBFCs in Tamil Nadu over a decade, the authors made an attempt of CAMEL criteria for analysis of selected Companies. For this purpose, out of 36 NBFCs in Tamil Nadu 4 Government Companies, 13 Small Companies and 13 Small Companies and another 13 Top Companies were selected as sample respondents on the basis of multi-stage random sampling, To evaluate soundness of each NBFCs through Capital Adequacy, Asset Quality, Management quality, Earnings and Liquidity, Based on findings the suggestions were offered to overcome the difficulties face by selected NBFCs in their development.

Introduction
To a vast country like India, with a diversified economic structure, multi-agency approach is adopted in the financial sector under which the savings and credit requirements of various sections of population are met. Thus both commercial banks and NBFCs have come into play in shaping the economy of the country. The Non-banking financial services Industry in the private sector in India is represented by the mix of a few large companies with nationwide presence, and a large number of small and medium sized companies with regional focus. These NBFCs provide a variety of services including fund based and fee based financial services to customers in retail and non retail markets.

Objectives
The main objective of this paper is to examine the soundness of the selected NBFCs in Tamil Nadu by using CAMEL model.

Data and Methodology
- For intensive analysis a sample of 30 NBFCs among 36 NBFCs in Tamilnadu have been selected using multi-stage stratified sampling techniques. The main sources of data have secondary data in collected from published annual reports of the selected companies.
- Out of 36 NBFCs mobilizing deposits in Tamil Nadu, about 30 NBFCs have selected as sample for this study. Out of which 4 are Government Companies, 13 are Small Companies and another 13 are Top Companies selected as the respondents for the study.
- The research has been carried out the NBFC sector during the period of 2003 to 2012. More specifically the research proposes to study the NBFC sector in three different time spans 2003, 2007 and 2012

CAMEL Criteria for Analysis of Selected Companies
Most analysts and credit rating agencies go by the CAMEL model when they evaluate the soundness of NBFCs. The acronym: **‘C’** stands for capital adequacy, **‘A’** stands for asset quality and asset profile in

the context of evaluating NPAs, **'M'** for management quality of the NBFC, **'E'** stands for earnings and 'L' for liquidity. The various marks given for each item it this analysis is discussed overleaf:

a. Capital Adequacy

To assess the adequacy of capital the following rations were used

i. Capital to Risk Weighted Assets Ratio.

Reserve Bank has stipulated 12 per cent CRAR for equipment leasing and hire purchase companies with credit rating and 15 per cent for those without rating as adequate for accessing public deposits. Taking this as a benchmark, this analysis has assigned marks for assessing soundness.

ii. Ratio of retained earnings to net profit

Companies plough back their profits to strengthen the fundamentals of the company Guidelines are prescribed by the Companies Act, 1956 and Reserve Bank of Indian Act 1934 for transferring profits in to general reserve and statutory reserve. Taking these in to account, the ratio at one has been assigned the highest mark.

iii. **Yearly Growth in Capital Funds**

Companies raise capital by issue of shares and continuous injection of capital will ensure adequacy of capital to meet contingencies as and when they arise and also help in meeting CRAR requirements when the assets of the company increase. An annual increase of five more has been allotted the highest mark.

iv. Public deposit as a percentage of owned funds

Reserve Bank linked acceptance of public deposits to net owned fund along with CRAR and credit rating. The leverage ratio of three times was given as the maximum points.

b. Asset Quality

Net NPA is taken as a criterion for assessing the soundness of the NBFCs, Any NPA level below 5 per cent is considered as good for this analysis.

c. Management Excellence

The key to success of any enterprise is the quality of its management, which should reflect in high level of transparency and integrity in its policies and practices. With this in view, management formulates policies and ensure these are translated in to techniques and strategies to achieve results. Corporate governance is a system by which businesses are monitored, managed and controlled in a transparent manner. Good corporate governance is one that encourages symbiotic relationship among shareholders, executives and Board of Directors. Companies that are managed efficiently earn profits, which are shared among shareholders and stakeholders (public deposit holders and employees). Credit rating is considered as an important parameter for assessing the management and this has been taken into account. Credit rating agencies while rating an instrument, rate the management also and therefore this is taken as an yardstick to measure management.

d. Earnings

Health of any company depends on its earnings and profitability. Earnings are dependent on proper deployment of funds and its efficient recovery. Earnings when retained increase the net worth of the NBFC. In order to build up capital by way of reserves through retained earnings, a company should have sufficient

e. Liquidity

Liquidity is an important indicator of financial management. More particularly, for banking institutions such as NBFCs it is a critical issue, as the confidence a company enjoys in the market depends directly on its successful liquidity management practices. It shows the ability of the company to pay its present and future depositors as and when claims arise. Liquidity of a company to meet its cash obligations at any point of time, more particularly, in the short run. Two important criteria, one liquid assets ratios and the other cash and bank balances to public deposits was taken as indicators of liquidity.

Results of the Analysis

Based on the criteria given above and using cross tabs the following result is arrived at

1. In the case of government companies, their areas of risk appear to be asset quality, management and liquidity in that order but their capital base appears to be satisfactory.
2. In the case of small companies, management and liquidity appear to be areas of risk and their capital base seems to be eroding.
3. For top companies assets and earnings appear to be satisfactory and their management quality has improved during the period of research.
4. Taking all the factors, the overall performance has shown an improvement for all categories of companies. The satisfactory and very satisfactory category has
5. Increased in the case of government and top companies from 32 per cent and 63 per cent to 45 per cent and 74 per cent respectively and the position of small companies has remained at 49 per cent. On the whole management is the area that needs greater concentration for all categories of companies.

Taking the total score for all factors of CAMEL viz capital, Asset, Management, Earnings and Liquidity, the trend shows that

a. Government companies

(i)The soundness of Government companies has improved in the post 2007 era when compared to the pre 2007 period as they continued to enjoy the patronage of the government.

b. Small companies

1. The number of companies in the satisfactory and very satisfactory category is
2. the same in 2003 and 2012 (49 percent of companies)
3. The very risky category is on the increase from 31 to 38 per cent in the post 2007 period, showing that conscious efforts needs to be made to reduce this category.

c. Top Companies

1. The number of companies in the very satisfactory category has increased during the period but has fallen from a peak of 65 per cent of companies during the years 2007 and 2012.
2. The number of very risky companies at 23 per cent on 2012 was needed to be rectified so that economic development was not hindered.

d. All companies

1. In the year 2003 companies in the risk zone was around 47 per cent and this has been reduced to 41 per cent after the 2007 regulation.
2. The number of companies in the very satisfactory zone has been reduced from the 2007 position from 49 to 46 per cent.
3. The number of companies in the satisfactory zone has increased from 4 per cent to 13 per cent.

Suggestions

1. To move away from public deposits as a major source of funds to debentures
2. To need to safety nets in resource mobilizations of NBFCs in the form of emergency liquidity assistance by creation of a refinance institution to give short-term funds.
3. Reserve Bank may (i) effectively control, supervise, advice and guide NBFCs specially Government companies by compulsory inspection.

Table .1 : The overall Raking Parameters to Find the Soundness of NBFCs

Supervisory rating	**Marks**	**Marks**
Capital		**25**
CRAR	10	
Ratio of retained earnings to Net Profit	5	
Public deposit as a% of owned fund	5	
Yearly Growth in capital funds	5	
Asset Quality		**15**
Net NPA	15	
Management		**25**
Compliance with Companies Act Provision	5	
No of committees	5	
Adverse remarks by Auditors in the Annual report/ Adverse comments of Rating Agencies	5	
Credit Rating	10	
Earnings		**20**
Return on assets = PAT/Total Assets	10	
Return on equity = PAT / Equity	10	
Liquidity		**15**
% of Liquid assets to Public Deposit	10	
Bank & Cash balances to public deposits	5	
Total	**100**	**100**
Soundness of company		
>71	Very satisfactory	
61-70	Satisfactory	
51-60	Moderate risk	
<50	Very risky	

The result based on the CAMEL for the three time slots are indicated below.

Table No.2 A Soundness of companies based on CAMEL – Criteria – wise

(No of companies as a% to that category)

	Capital			**Asset**			**Management**			**Earnings**			**Liquidity**			**Total**		
Government	2003	2007	2012	2003	2007	2012	2003	2007	2012	2003	2007	2012	2003	2007	2012	2003	2007	2012
Very Satisfactory	75	75	0	0	0	25	0	0	0	25	25	25	0	0	0	5	0	25

Satisfactory	0	0	75	0	0	0	0	0	25	25	0	25	0	0	0	5	0	25
Risky	25	0	25	0	0	0	25	75	25	25	50	25	0	0	0	15	25	15
Very Risky	0	25	0	100	100	75	75	25	50	25	25	25	50	50	50	50	45	40
Small																		
Very Satisfactory	77	77	38	69	46	46	8	8	8	77	77	46	0	38	54	46	49	38
Satisfactory	15	15	46	0	23	0	0	0	8	0	0	0	0	8	0	3	9	11
Risky	0	0	0	0	0	0	15	31	31	0	0	31	0	0	0	3	6	12
Very Risky	8	8	15	31	31	54	77	62	54	23	23	23	100	54	46	48	35	38
Top																		
Very Satisfactory	69	54	15	100	100	92	15	8	46	100	100	92	8	38	62	58	60	62
Satisfactory	15	15	23	0	0	0	8	38	31	0	0	8	0	0	0	5	11	12
Risky	0	23	15	0	0	0	15	15	0	0	0	0	0	0	0	3	8	3
Very Risky	15	8	46	0	0	8	62	38	23	0	0	0	92	62	38	34	22	23
All																		
Very Satisfactory	73	67	23	73	63	63	10	7	23	80	80	63	10	40	57	49	51	46
Satisfactory	13	13	40	0	10	0	3	17	20	3	0	7	0	3	0	4	9	13
Risky	3	10	10	0	0	0	17	30	17	3	7	17	0	0	0	5	9	9
Very Risky	10	10	27	27	27	37	70	47	40	13	13	13	90	57	43	42	31	32

Source : Calculated from secondary data.

The following table gives the position of all companies for all the years after combining all the factors taken for the study.

Table No.3 Soundness of companies based on CAMEL (No of companies as a% to that category)										
Year	**2003**	**2004**	**2007**	**2006**	**2007**	**2008**	**2009**	**2012**	**2011**	**2012**
Government										
Very Satisfactory	30	30	25	25	30	40	40	30	40	20
Satisfactory	5	5	10	10	0	5	5	15	5	25
Risky	20	25	20	20	25	10	20	15	15	15
Very Risky	45	40	45	45	45	45	35	40	40	40
Small										
Very Satisfactory	46	48	46	48	49	54	49	51	52	38
Satisfactory	6	5	12	11	9	9	11	9	5	11
Risky	6	3	3	3	6	6	8	9	9	11
Very Risky	42	45	38	38	35	31	32	31	34	38

ISSN No. 2347 – 856X

Top										
Very Satisfactory	58	58	66	66	60	63	68	68	63	62
Satisfactory	5	5	6	5	11	12	9	6	8	12
Risky	8	12	8	8	8	3	6	6	9	3
Very Risky	29	25	20	22	22	22	17	20	20	23
All										
Very Satisfactory	49	50	52	53	51	56	56	55	55	46
Satisfactory	5	5	9	8	9	10	9	9	6	13
Risky	9	10	7	7	9	5	9	9	10	9
Very Risky	37	35	31	32	31	29	26	27	29	32

Source: Prepared from Secondary data

Conclusion

This analysis shows that RBI regulation has ensured that only serious players with commitment are in business and other fly by night operations and not so serious players have quit the market. Consolidation and restructuring have changed the profile of the sector. Today's players are larger, stronger and compete on multiple platforms.

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