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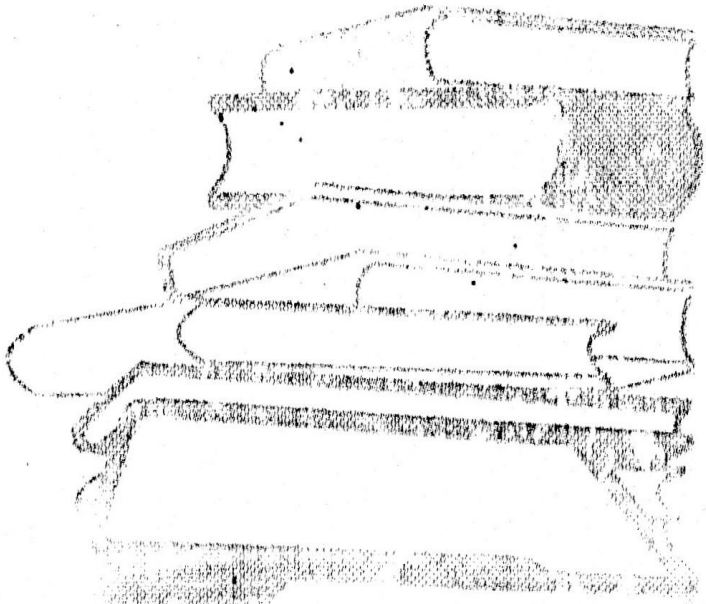

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EFFICACY OF BANK MANAGEMENT PERFORMANCE TOOLS (BMPTs)

By

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ABSTRACT

The paper aimed at identifying the pitfalls inherent in Bank Management Performance Tools (BMPTs). Ratios within the Standardized Uniform Rating System (SURS) called CAMEL were adopted while a two year Financial Summary of Diamond Bank (DB) and Universal Trust Bank (UTB) were used in the performance analysis. The analysis using these tools gave different results and divergent conclusions except for the composite rating. Quantitative and qualitative analytical approaches, among others, were recommended for a more realistic and reliable bank performance measurement.

INTRODUCTION

An economy is the 'life' of a nation, as a sovereign entity, and national and international stakeholders are always looking out for a healthy one. At one end it depends on the extent of its lubrication and at another management. The former involve the intermediation function of our banks especially the commercial and merchant banks.

The intermediation function of banks is the process of bringing together the two economic units-deficit and surplus, with a view to meeting their needs promptly. These needs, in a nutshell, are translated into savings and investment, which are major determinant of the direction of any economy. The ability of banks to satisfactorily accomplish this intermediation function depends on their effective and efficient management.

Bank management is, therefore, the composite (aggregate) and deliberate efforts of a bank to achieve their desired objectives mainly liquidity, profitability, growth and other developmental objectives. These efforts are synoptically packaged in proper and timely planning, implementation and follow-up. Essentially, a result-oriented efforts of a bank is reflected in their major objective, which are measurable. A number of performance measurement tools have been identified for measuring the

contribution of the three banks objectives to their corporate mission. These tools are called Bank Management Performance Tools (BMPTs).

Bank management performance tools is a scientific, objective and systematic method of accessing the performance of a bank in terms of liquidity, profitability, capital adequacy, growth, asset quality, etc. Capital Adequacy, Asset Quality, Management, Earnings and Liquidity, an acronym CAMEL, is used in this paper to asses the overall performance of banks selected. This is in line with Basle Accord 1988 and definition of performance as a standard means of banking conditions including bank profitability, asset quality, capitalization and lending (Samolyk, 1998:3). BMPTs will reveal the weaknesses and strengths of the banks upon which strategies are initiated for improved result. Sometimes the use of these tools may be misleading. This paper has identified the pitfalls inherent therein and the way forward for an efficient and effective bank management in Nigeria and other world economies.

MEASURING BANK PERFORMANCE

Performance ratios are used in measuring the performance of banks. Performance may be described in terms of profit, liquidity, capital adequacy, growth, asset utilization, management efficiency, etc. Whichever objective that is pursued, the relevant ratio is used in its measurement.

Generally, ratio is the relationship one item bears on another, (Okereke 1997:289). It is the purposeful identification of the financial health of a company by establishing relationships between items in her financial statements. Financial information in the financial statement of companies are in their absolute values and may not convey enough information for an informed investment decision. But when one item is related to another item in any of the financial statements, the health of the company can be ascertained with some level of confidence. For instance, if a company's current assets is seen as "very substantial" in the balance sheet. Such description should not call for celebration until it is related to current liabilities. The "very substantial" amount may not be enough to cover current liabilities. It is only when current asset ratio is calculated that the picture becomes clearer.

Ratio measures the liquidity, profitability, management efficiency, leverage, growth, asset utilization, etc of the company. Hence, we have:

Liquidity ratios (current asset ratio, Acid test ratio, cash ratio, etc).

Earnings/ Profitability ratios eg Return on asset ratio, return of equity ratio, net profit margin ratio, earnings per share, pay out ratio, dividend per share ratio, price earnings ratio, etc.

Leverage ratios eg debt equity ratio, debt asset ratio, gearing ratio, etc.
Activity ratios e.g inventory (stock) turnover ratio, average collection period ratio, fixed asset turnover ratio, etc.
Growth ratios e.g market to book value ratio, price earning ratio, etc.

The use of any of these ratios depends on the interest of creditors, management, investors, etc. It is important to state that ratios may not be all that meaningful except such ratio is compared with industrial averages, inter and intra comparism or beyond national boundaries.

In the banking industry, ratios are used within the uniform rating system initiated in 1978 by the three United States of American Bank supervising bodies, - Federal Reserve, Comptroller of Currency and Federal Deposit Insurance Corporation (FDIC). This standardized uniform rating system (SURS) is called CAMEL, which is an acronym for

"C"- Capital Adequacy: This measures the availability of sufficient capital funds to cover or protect depositors' funds with Banks.

"A"- Asset Quality: This is used to measure the recoverability or collectibility of risky assets, other off-balance sheet items and the impact of non-performing credits on the bank's capital funds.

"M" – Management: This measures management efficiency in terms of banks objectives mainly profit and liquidity, controls and checks, policies formulated, compliance to monetary guidelines, laws and other regulations. Eg. Returns to CBN. This measurement (Management) is to some extend subjective, as most of the variables are not quantifiable.

"E" – Earnings/Profitability: This is used to determine the level of profit and its supportive power for future growth of the bank. Essentially, banks are expected to operate on a profitable path. Earnings, in this context, must be based on prudential guidelines. It must be fully earned and not to be reported out of non-performing credits.

"L" – Liquidity: This determines whether a bank is liquid enough to meet its immediate and regular cash obligations like customer's deposit demands.

Banks are rated with assigned value scale according to the level of performance of the acronym, CAMEL in the ratings. It is rated as strong (1), satisfactory (2), fair (3), marginal (4), unsatisfactory (5).

After an independent analysis[1] (as shown below), and rating of each letter in the acronym, they are aggregated and the average rate obtained. The rate, say 3, will imply that the bank performance is fair. Appendix I explains each of these ratings.

This paper utilized two banks, Diamond Bank Plc (DB) and Universal Trust Bank Plc (UTB) in

the analyses, discussions and conclusion.

PERFORMANCE ANALYSIS OF DIAMOND BANK PLC (DB) AND UNIVERSAL TRUST BANK (UTB)

This analysis is based on the uniform rating system of the acronym, CAMEL defined earlier. Diamond Bank Plc and the Universal Trust Bank Financial Summary in tables 1 and 2 are used for our illustrations here.

(1) Capital Adequacy: This can be ascertained using Risk Asset Ratio (RAR). It shows the level of coverage the capital funds of the bank will give to its total assets excluding non-risk assets.

RAR is mathematically presented as

$$\frac{Gross\ Capital\ Funds}{Risk\ Assets} \times 100$$

Here, Gross capital funds consist of

For Diamond Bank Plc

2001: $RAR = \frac{4,086080}{30,139,923} \times 100 = \underline{13,55\ \%}$

2000 : $RAR = \frac{2865145}{20267771} \times 100 = \underline{14.14\ \%}$

$Average = \frac{(13.6 + 14.4)\%}{2} = \underline{14\ \%}$

But if we use equity proportion of the gross capital funds, we have equity- total asset ratio as

2001 $EAR = \frac{Equity}{Total\ \ Risk\ \ Assets} \times 100 = \frac{721050}{30139923} \times 100 = \underline{2.39\ \%}$

2000 : $EAR = \frac{Equity}{Total\ \ Risk\ \ Assets} \times 100 = \frac{721050}{20267771} \times 100 = \underline{3.56\ \%}$

$Average = \frac{(2.4 + 3.6)\%}{2} = \underline{3\%}$

But if we use loans and advances as our risk assets we have equity-loans & advances ratio as

2001 : $ELR = \frac{Equity}{Loan\ \&\ Advances} \times 100 = \frac{721050}{15377048} \times 100 = \underline{4.69\%}$

2000 : $ELR = \frac{721050}{8793273} \times 100 = \underline{8.20\ \%}$

$Average = \frac{(4.7 + 8.2)\%}{2} = \underline{6.4\%}$

the equity, debt and reserves components of the banks capital while risk assets consist of total assets plus reserves for loan losses (if any) less risk free assets (as classified by CBN).

Other ratios for determining capital adequacy include equity – total assets ratio, equity – loans and advances ratio, etc.

In Basle Accord, 8% of Capital Provision is adequate. Based on this, Diamond bank capital adequacy using Gross Capital Funds to Total risk assets can be rated 1 (strong) while UTB can also be rated strong, (1) using any of the ratios (RAR or ELR)

FOR UNIVERSAL TRUST BANK

$$2001 : RAR = \frac{Gross\ \ Capital\ \ Funds}{Total\ \ Risk\ \ Assets} \times 100 = \frac{5560}{13728} \times 100 = \underline{40.50\%}$$

$$2000 : RAR = \frac{4336}{11920} \times 100 = \underline{36.38\%}$$

$$Average = \frac{(40.5 + 36.4)\%}{2} = \underline{38.5\%}$$

Equity Total Risk Asset Ratio:

$$2001 : RAR = \frac{Equity}{Total\ \ Risk\ \ Asset} = \frac{2780}{12728} \times 100 = \underline{20.25\%}$$

$$2000 : RAR = \frac{2168}{11920} \times 100 = \underline{18.19\%}$$

$$Average = \frac{(20.25 + 18.19)\%}{2} = \underline{19.2\%}$$

Equity-Loans & Advances Ratio

$$2001 : ELR = \frac{Equity}{Loans\ \ \&\ \ Advances} \times 100 = \frac{2780}{10824} \times 100 = \underline{25.68\%}$$

$$2000 : ELR = \frac{2168}{8830} \times 100 = \underline{24.55\%}$$

$$Average = \frac{(25.68 + 24.55)\%}{2} = \underline{25.1\%}$$

(2) Asset Quality (AQ): Quality of asset of a bank is determined by the quality of their classified assets (non-performing credits). By the Prudential Guidelines for Licensed Bank of Nov. 1990 (BSD/DO/23/Vol.1/11), non-performing credit facilities are classified into three categories and % provision made as loss on the outstanding balance of such credit.

1. Substandard Credit Facilities 10%
2. Doubtful Credit Facilities 30%
3. Lost Credit Facilities 100%

Based on this, quality asset ratios can be determined using the following:

$$QA = \frac{WeightedClassifiction}{GrossCapitalFunds} x\,100$$

Unclassified (risk-free) assets are ignored in the computation of asset quality

For a hypothetical illustration, if both banks (DB and UTB) have 10% and 20% of its loans and advances being classified as substandard and doubtful respectively and N1m investment is trapped in one of the distressed banks. Then, the asset quality of the two banks is determined thus.

Asset Quality of DB **(N)'000**

2001: Substandard credit facilities 10% of 15,377048 = 153770.48
Doubtful Credit Facilities 20% of 15377048 = 3075,409.6
Lost Credit Facilities 100% of N1m = 1000

Weighted Asset Classification (WAC)

Substandard	10%	= 153770.48 x .10 = 15377.05
Doubtful	30%	= 3075409.6 x .3 = 922622.88
Lost 100% of N1m		= 1m x 1.0 = 1000
Total		= 1,077399.93

$$AQ = \frac{1077399\ .93}{4086080} \times 100 = 26\ .37\ \%$$

Universal Trust Bank **(N)'000**

2001 Substandard Credit Facilities 10% of 10824 =1082.4
Doubtful Credit Facilities 20% of 1024 = 2164.8
Lost Credit Facilities 100% of N1m 1,000,

Weighted Asset Classification (WAC)

Substandard	10% Provision	= 1,082. 4 x .10 = 108.24
Doubtful	30% Provision	= 2164. 8 x .30 = 649.44
Lost	100% of N1m	= 1000.00
Total		= 1757.68

$$AQ = \frac{Weighted\ \ Asset\ \ Classifica\ \ tion}{Gross\ \ Capital\ \ Funds} \times 100 = \frac{1757\ .68}{5560} \times 100 = 31\ .61$$

Source: Nnenwa G.O.F. (1998) Introduction to Community Banking, Readeur Publishers Ltd, Owerri.

The asset Quality determined is compared with the asset quality guideline issued by monetary authority (CBN) in order to know the rating of the bank concerned. Example of such guidelines

Ratings	AQ Guidelines
1(Strong)	0 ≤ 5%
2(Satisfactory)	5 ≤ 15%
3(Fair)	15 ≤ 30%
4(Marginal)	30 ≤ 50%
5(Unsatisfactory)	> 50%

From our calculations, Diamond Bank is rated fair while universal trust bank is rated marginal which means that DB has a better asset quality than Universal Trust Bank even though both banks will attract the attention of regulatory institutions with a view to addressing their problems.

Other performance indicators for asset quality include among others (1) % of classified weighted assets on Total (Gross) Credits. (2) Classified

weighted assets – equity ratio (WC/Equity).

It is important to state that CBN and other supervisory institutions are interested in knowing the method of assets classification by banks and through their on-site examination insures that banks do not over value or undervalue their assets. Basically, CBN examiners and supervisors are all out to look for non-performing (faulty) assets, their classification and compliance thereto.

Management 'M' in the acronym is a subjective performance indicator, as there is less scientific model in use. Basically, a banks management is rated well if (1) it has adequate capital (2) the policies and internal controls and checks are in place (3) Compliance rate to monetary policy guidelines, laws and other regulations e.g timely returns and compliance thereto. (4) Strategic plan of the bank is sound. This is with a view to identify management ability to respond to its strengths, weakness, opportunities and threats. (5) Management profile and adequacy of staff training.

The two banks can be rated 1 (Strong) and 3 (fair) respectively.

Earnings: Earnings provide information on how well management has channeled banks resources towards making profit and building up capital funds (through reserves).

A number of ratios are used here. They are:

In 2001, the two banks (DB & UTB) recorded ROA of 3.6% and 3.5% and ROE of 30% and 37.8% respectively. Based on this, earnings can be rated 3 (fair) and 2 (satisfactory) for DB and UTB respectively.

(1) $\text{Return on Assets Ratio } (ROA), = \dfrac{\text{Net Income}}{\text{Average Total Assets}}$

(2) $\text{Return on Equity Ratio } (ROE), = \dfrac{\text{Net Income}}{\text{Equity}}$

(3) $\text{Earnings Per Share } (EPS) = \dfrac{\text{Total Earnings}}{\text{No. of Shares}}$

(4) $\text{Dividend Per Share } (DPS) = \dfrac{\text{Dividend}}{\text{No. of Shares}}$

Liquidity

This is determined using the following ratios.

(1) Current Asset Ratio $= \dfrac{Current\ Assets}{Current\ Liabilities}$

This measures the ability of banks to meet short term demand deposits of depositors. This ability is quantified in terms of availability of cash or near cash instruments.

For the Diamond Bank Plc.

$$2001: Liquidity\ Measured\ by\ Current\ Asset\ Ratio\ (CAR) = \frac{27393845}{32398244} =$$

It means that current assets only provided for 84% while 16% is not provided against current liabilities.

For UTB

$$CAR = \frac{19038}{17151} = 1.1\ ie\ 1.1:1$$

This means that current assets provides more than 100% coverage for current liabilities.

From the Liquidity calculation, DB can be rated 4 (marginal) and UTB rated 1(strong).

The aggregate (composite) rating using CAMEL for the two Banks is as follows

	DB Rating	UTB Rating
C =	1	1
A =	3	4
M =	1	3
E =	3	2
L =	4	1
Total ratings	12	11

$$Average\ ratings\ \frac{12}{5}\ 2.4\ ie\ 2\ (satisfactory)\ \frac{11}{5} = 2.2\ ie\ 2\ (satisfactory)$$

From these results, the performance of DB (Diamond Bank) and UTB (Universal Trust Bank) is said to be satisfactory (2)0.

Inadequacies of BMPTS

From the above analyses, the following are evident:

(1) **Capital Adequacy**:- The use of composite figures like- Gross Capital Funds to Total Risk Asset may give a misleading result as is the case in DB. The capital is more than satisfactory using aggregate figures but when equity is related to real risk assets of the bank, loans and advances, a different result (more realistic) is obtained.

(2) **Asset Quality:-** The problem with asset quality determination is on the sincerity of banks in classifying their assets objectively. Banks have been accused on wrongful classification before weights are assigned. Such misleading classification will generate misleading asset quality and spurious conclusion.

(3) **Management:-** This has been described as the most subjective among all the performance indicators. Apart from the criteria put in place, the perception of the examiner concerning a particular bank is a major determining factors in assigning value scale.

(4) **Earnings:-** Earning ratios may not bring a clear picture of the banks performance. For instance, using ROA, the components of the total assets may be dominated by risky asset that are classified. The result arising there from will be faulty.

(5) **Liquidity:-** The use of current asset ratio (CAR) may not show the true performance of the bank especially when the components of short term funds are mainly classified assets and deposit structure dominated by the most volatile account. Such ratio may come out very fine on paper but unreliable and unrealistic in real life.

These pitfalls not withstanding, the use of the acronym, CAMEL helps in eliminating their individual drawbacks.

CONCLUSIONS AND RECOMMENDATIONS

The place of banks in lubricating the economy cannot be overemphasized. This lubrication input through its intermediation function is enhanced and successfully achieved via good bank management, which can be ascertained through

BMPTs. An acronym, CAMEL is used in this study.

The analysis using these tools is revealing. There are mix results. The use of different tools gives different performance results and divergent conclusions. The implication is that drawing conclusions and taking investment decision based on such results may be catastrophic. However, aggregate (composite) rating help to eliminate some of the pitfalls inherent in the individual's tools. Thus, culminating in a more realistic performance status for the banks. Notwithstanding, efforts should be made to be cautious of depending wholly on the results obtained whether individually or on the aggregate. Again, consideration should be given but not limited to the following.

Banks should see the results obtained from the use of these tools as a means to achieving their desired goals rather than an end. This calls for other qualitative approaches like on-site examination by Central Bank of Nigeria (CBN).

Banks should, as a matter of routine, monitor their asset portfolio with a view to identify non-performing assets and 'tighting loose nuts' associated with such assets.

Lending policies and strategies should constantly be reviewed in line with the economy, government broad objectives, the industry and other banks' publics.

Debt recovering strategies must be result- oriented and flexible.

Adequate provision must be made for non-performing assets in the banks balance sheet. Banks should be encouraged to make provisions above the policy/statutory provisions.

Adequate provision should also be made for litigations through proper asset classifications depending on the stage of such litigation.

Analysts should capitalize on the strengths of BMPTs while improving on their weaknesses.

Note:

1. Knowledge of the CBN monitory policy in asset classification is important. It is usually published on the monetary policy guidelines in any given period. Also industrial averages for the individual ratios and the composite performance rating scale should be known by the analyst.

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Table 1: Two Year Financial Summary of Diamond Bank (Abridged)

	2001 (N' M)	2000 (N' M)
Assets:		
Cash and short-term funds	17232.7	10,205.6
Short tern investments	10161.2	8311.3
Long-term investment	478.9	370.0
Loans and Advances	14,248.5	8,689.0
Other facilities	661.4	-
Advances under lease finance	467.2	104.3
Other assets	1,756.0	1,113.4
Fixed assets	2,366.8	1680.0
Total Assets	47,372.6	30473.3
Liabilities:		
Deposits and other Account	32,398.2	22464.4
Other liabilities including		
Facilities and divided payable	10888.3	5143.8
Total Liabilities	43,286.5	27,608.2
Net Assets	4086.1	2,865.1
Capital and Reserved		
Share capital	721.1	721.1
Reserves	3,365.0	2144.1
Shareholders Funds	4,086.1	2,865.1
Gross Earnings	7437.4	5582.4
Profit Before Taxation	2225.2	1,234.9
Taxation	(5.35.5)	(277.5)
Profit After Taxation	1225.2	987.4

Table 2: Two Year Financial Summary for Universal Trust Bank (UTB)

Asset:	2001	2000
Cash and Balances with other Banks	14,373	8,429
Deposits with the Central Bank	1,996	2,360
Short-term Investments	2,669	2,671
Long-term Investments	37	35
Loans & Advances (net)	8,875	8,017
Loan Loss Reserves	1,949	813
Equipment on Lease	895	145
Other Assets	495	605
Total Earnings Assets	293.43	22,262
Premises and Equipment	754	447
Total Assets	30,097	22,709
Liabilities and Capital		
Demand Deposits	10,309	6,117
Time Deposits	5,428	4,464
Savings Deposits	1,328	1,016
Other Funding Accounts	86	-
Due to Banks	2	2,460
Provision for Taxes	342	106
Dividends	443	443
Other Liabilities	7,380	5,868
Total Liabilities	27,317	20,541
Capital Paid-up	886	886
Statutory Reserves	946	636
Capital Reserves	456	454
General Reserves	492	192
Equity Stock	2,780	2,168
Liabilities and Equity Stock	30,097	22,709
Gross Earnings	6,202	4212
Pre-tax Profit	1,394	1048
Taxes	342	169
After Tax Profit	1050	879

Sources: *Data based on the bank's financial reports in Financial Standard Vol. 3 No. 57 p.16*

Appendix 1: PERFORMANCE RATING EXPLAINED

RATING 1 Strong performance
Significantly higher than average performance

RATING 2 Satisfactory
Average or above average performance adequately provides for safe and sound operation.

RATING 3 Performance faired to some degree
Considered fair
Neither satisfactory nor average but is characterized by below average quality

RATING 4 Marginal performance
Significantly below average
Weaknesses could evolve to threaten viability of bank

RATING 5 Unsatisfactory
Critically deficient and needs immediate attention
weaknesses could evolve to threaten viability of bank

Some stereotyped comments on the composite rating are:

Composite 1
Basically sound in every respect
Findings are of a minor nature and can be handled routinely
Resistant to external economic and financial disturbances
No cause for supervisory concerns.

Composite 2
Fundamentally sound
Findings are of a minor nature and can be handled routinely
Stable and can withstand business fluctuation well
Supervisory concerns are limited to the extent finding are corrected.

Composite 3
Financial, operational or compliance weaknesses ranging from moderately severe to unsatisfactory
Vulnerable to the on set of adverse business conditions.
Easily deteriorates if actions are not effective in correcting weaknesses

	Supervisory concern and more than normal supervision to address deficiencies.
Composite 4	Immoderate volume of serious financial weaknesses Unsafe and unsound conditions exist which are not being satisfactorily addressed. Without corrections, these conditions could develop further and impair future viability. High potential of failure. Close supervision and surveillance and a definite plan for correcting deficiencies.
Composite 5	High immediate or near-term probability of failure. Severity of weaknesses is so critical that urgent help from stock brokers or other financial sources is necessary Without immediate corrective actions, will likely require liquidation, merger or acquisition.

Source: Nzenwa Smarth (1998) .*Op.Cit* pp 91 - 2