
Comparative Performance Analysis of Conventional and Islamic Banks in Nigeria Using Camel Rating Model

Abstract:

This study examined financial performance of Conventional and Islamic banks in Nigeria using CAMEL rating model from 2012 to 2022 using quantitative data collected from the bank's annual financial statements. The study adopted an ex-post facto research design. Two banks were purposely sampled by the study. Descriptive and inferential statistics was also used as tool of analysis to examine the trends of performance (CAMEL) between the banks using mean, minimum, maximum and standard deviation and also to check the relationship between the variables. Further, in inferential statistics, t-test was conducted to test the significant variation and the effect of independent variables on the dependent variable. The results showed the existence of low and negative trends in the quality of earnings of both banks. It also showed trends of performance between the two banks are significantly affected by all the CAMEL components. Moreover, results from t-tests showed a significant variation of three CAMEL parameters and the acceptance of alternative hypothesis. The study recommended the management of both bank should put more effort to mitigate the negative return volatility of the banks. Both bank need to have strong liquid-based or near liquid e.g., short-term securities (government bonds

Keywords: *Financial Performance, Conventional Bank, Islamic Bank, CAMEL Rating Model.*

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INTRODUCTION

The stability and growth of any economy to a great extent depend largely on the stability and growth of its banking sector (Sahay et al., 2015). Banks play important role by mopping up idle resources from firms and households for lending to all sectors of the economy. Well-capitalized and efficient banks are therefore prerequisite for nation's growth and development (Gupta & Mahakud, 2020). The importance of banks to national economic development is widely acknowledged in literature see Lawrence (2017), Riegler (2023). Furthermore, banks boost capital formation, create development and are catalysts for public-private partnership. Specifically, banks create access to finance through intermediation role and contribute to the rising of individual living standards by way of granting facilities to households as well as mortgage financing. (Omri, 2020) provided evidence supporting the positive influence of financial sector on economic development, in the process of creating new firms in an economy. Overall, through their intermediation role, banks promote the effective use of a nation's capital stock in combination with labour to provide services and produce goods which in turn generate multiple effects creating employment and thereby increasing economy's aggregate demand and supply. (Ben Ali et al., 2018) also provided evidence suggesting banking sufficiency as critically important to the development of an economy. There is established amount of literature extensively documenting the critical importance of an efficient banking sector to sustainable economic growth, important among which are Afang (2016), Innocent et al. (2019), Zavadska (2021), Yaboah, Oppong and Bean-Nuakoh (2017), Tekilu, Wandaferau and Jibril (2018) and Abubakar and Musa (2013).

The incapability of the banking sector to effectively perform its functions as intermediary and inability to control financial challenges that are experienced hitherto have been a crucial concern (Maude & Dogarawa, 2016).

However, giving the observed keen competition coming from the sector, it is truly bothersome to note that a significant proportion of the public are not aware of the importance of bank performance evaluation as today we have several categories of banks catering to various niches. Moreover, there are institutions saddle with the responsibility to monitor the financial condition of banks and other licensed deposit taking financial institutions through both on-site examinations and off-site surveillance to ensure the sustenance of public confidence in ensuring financial system sustainability (CBN, 2022). An unstable banking system on the other hand may distort the linkage between inflation, interest rate and economic activity and thereby complicate monetary policy decision making. To this end, this study aim to empirically examine and measure the financial performance of Conventional and Islamic banks in Nigeria using CAMEL rating model.

RESEARCH METHODS

This study used CAMEL rating model as earlier defined to examine the financial performance of the sampled banks. The CAMEL variables would be examined on how they impact on the two banks' financial performance. This was done to avail in-depth analysis on the relationships between the variables specified and to determine the objectives of the study. Finally, to determine the contribution of each fundamental variable on the financial performance of each selected banks.

Research Design

The nature of this research work made it imperative for secondary data to be used, which consist of quantitative data collected from the bank's annual financial statements. Moreover, in an attempt to explain the difference between dependent variable and independent variables, and to establish the effect of independent variables on the dependent variable, this study takes ex-post facto analysis dimension. Where CAMEL components were examined on how they impact on the financial performance of the the banks.

Sample Size and Sampling Techniques

The sampling technique adopted by the study is purposive sampling technique. Simply because the 28 fully licensed commercial banks in Nigeria 26 conventional and four was Islamic bank. They served as the study sample. Note that only one Islamic bank has 12 years of operation which was selected by the study. Equally, one Conventional bank and one Islamic bank have been drawnd as the study sample. Furthermore, annual financial reports for the period from 2012 to 2022 have been collected from the annual financial statement published by the two banks.

Data Analysis and Discussion of Findings

The dependent variable for this study is financial performance while five variables consisting of five CAMEL components were used as explanatory variables. The table below showed descriptive information of CAMEL variables (capital adequacy, asset quality, management efficiency, earningquality and liquidity) at different level of mean values, the minimum, maximum and standard deviation. This study examined the financial performance of Conventional and Islamic banks in Nigeria.

RESULTS AND DISCUSSION

Discussion of Descriptive Statistics

A cursory look at the period under review (2012-2022), it is observed that the average value of capital adequacy ratio (CAR) of the two banks computed by the bank's Regulatory Capital/Risk-Weighted Asset or Total Equity/Total Assets as cited by Keffala (2021) shows all the banks have met the minimum requirement of 10.5% and 10% under Basel III accord and CBN respectively. For the IB, it demonstrates a significant rise to 40.32%, above the minimum requirement, with a minimum and maximum rate of 7.64% and 87.02% respectively.

For the CB, the ratio represents a mean (average) of 97.46%, with a minimum of 2.02% and 201.59% as maximum values. This higher value of ratio indicates the bank has minimum risk. This is consistent with the opinion of (Shrestha, 2021) who opined that a bank capital is considered sufficient if it is enough to cover customers' withdrawal needs and protect depositors against total or partial loss of deposits in the event of liquidation or losses.

However, the asset quality ratio (AQR) of the IB measured by the Non-Performing Financing to Total Financing as cited by (Horsak et al., 2017) showed an average of 5.07% and minimum of 1.18% and 10.87% as maximum value. This signifies that, the lower ratio posed a low risk to the bank. On the other hand, the ratio of Non-Performing Loans (NPLs) /Gross Loans are used to measure the level of bank's credit risk. It is observed that the average value of the CB bank's AQR depicts an average of 316.27% and 1.66% as minimum, 997.72% as maximum values respectively. Total loans are valuable values that give a perfect view of the quality of asset of banks but large ratios of NPLs distort the overall performance of banks (Yurttadur et al., 2019). Moreover, as a measure of estimating the value of banks' overall performance, represents a bank's operating expenses in relation to its operating income as a percentage, the Cost-to-Income ratio (CIR) of IB known as efficiency ratio, is on the average value of 236.11% and a minimum negative value of -70.51 and, 910.64% as maximum. For CB, the observed mean value (average) of managerial efficiency (MER) of the bank recorded at 72.99%, while 9.70% is a minimum value and 141.96% at maximum percentage during the study period. It is generally agreed that, rising costs at higher rates than income rates highlighted potential danger for firms. Equally, lower rates denote higher efficiency and doing profitably well. CIR served as yardstick when comparing productivity and efficiency (Widiarto & Emrouznejad, 2015).

Furthermore, the average ratio of earnings-generating capacity of the two banks measured by ROA and ROE as cited by Wanke, Azad, Barros and Hassan (2016) depicts an average of 15.59% and a negative minimum value of -7.85% and 160.23 % as maximum value for IB. As for CB, the bank recorded a negative average value of -50.82% and a negative minimum value of -342.32% and 80.04% as maximum respectively. It is generally agreed that, quality of earnings gives a perfect view of the firm's overall performance. With this negative numerical values the bank's earnings during the study period, is often a red flag as far corporate governance. It is argued that one of the major causes behind banks failures is insufficient liquidity. The last components of the CAMEL model for this study is liquidity, computed by LA/TA, LA/TD, TL/TA, or LA/Short-term Liabilities as cited by Ferrouhi (2014). The results however showed that the IB banks' liquidity position represents an average value of 58.64%, 23.30% as minimum and 78.01% as maximum. For the CB, the mean stands at 65.64%, while the minimum value can be noted at 16.12% and the maximum value of 104.93% percent. Majeed and Zainab (2021) explain further that, higher liquidity of banks determines their ability to manage liquidity crises.

CAMEL Ratio Analysis

The figure analysis uses line graphs in depicting the trends of performance between the two banks indicated by CAMEL components.

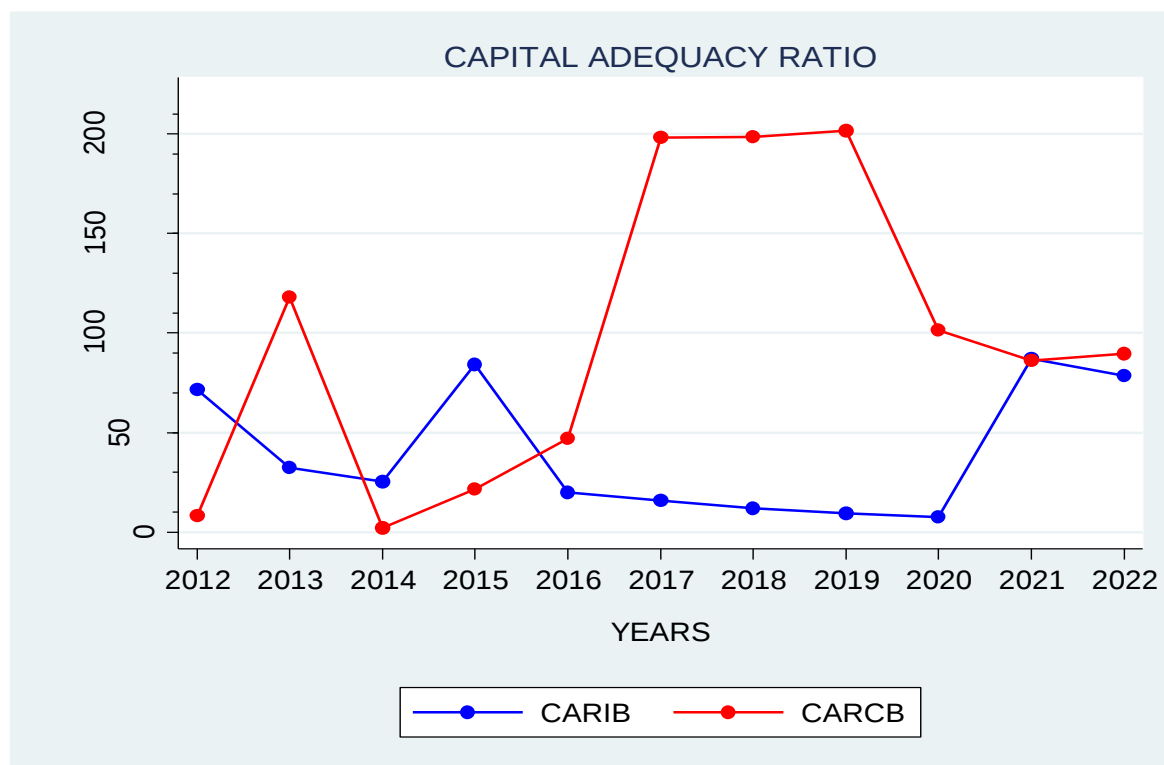


Figure 1 Combined Ratio (figure) Analysis of IB and CB

A cursory look at the line graphs from the descriptive analysis, it is observed that, in 2012, the capital adequacy ratio (CAR) of IB stood at 72%, and that of CB is at 8%. The ratio decreases drastically to 32% in 2013 and to 25% in 2014. For that of CB, the ratio increases to 118% in 2013 but decreased to 2% in 2014. In the year 2015, the ratio of the IB recorded an impressive height to about 84%, before nosedived to 20% in 2016. The ratio decreased sharply for four consecutive years to 16% in 2017, 12% in 2018, 9% in 2019 and to 8% in 2020 respectively. Similarly, CAR of the CB increases for five straight years to 21% in 2015, 47% in 2016, 198% in 2017, 199% in 2018, and 202% in 2019 before it decreased and fluctuated to 104% in 2020, 86% in 2021 and 90% in 2022. For IB, the ratio geared up to an unprecedented height to 87% in 2021 but slightly decreased to 78% in the financial year of 2022.

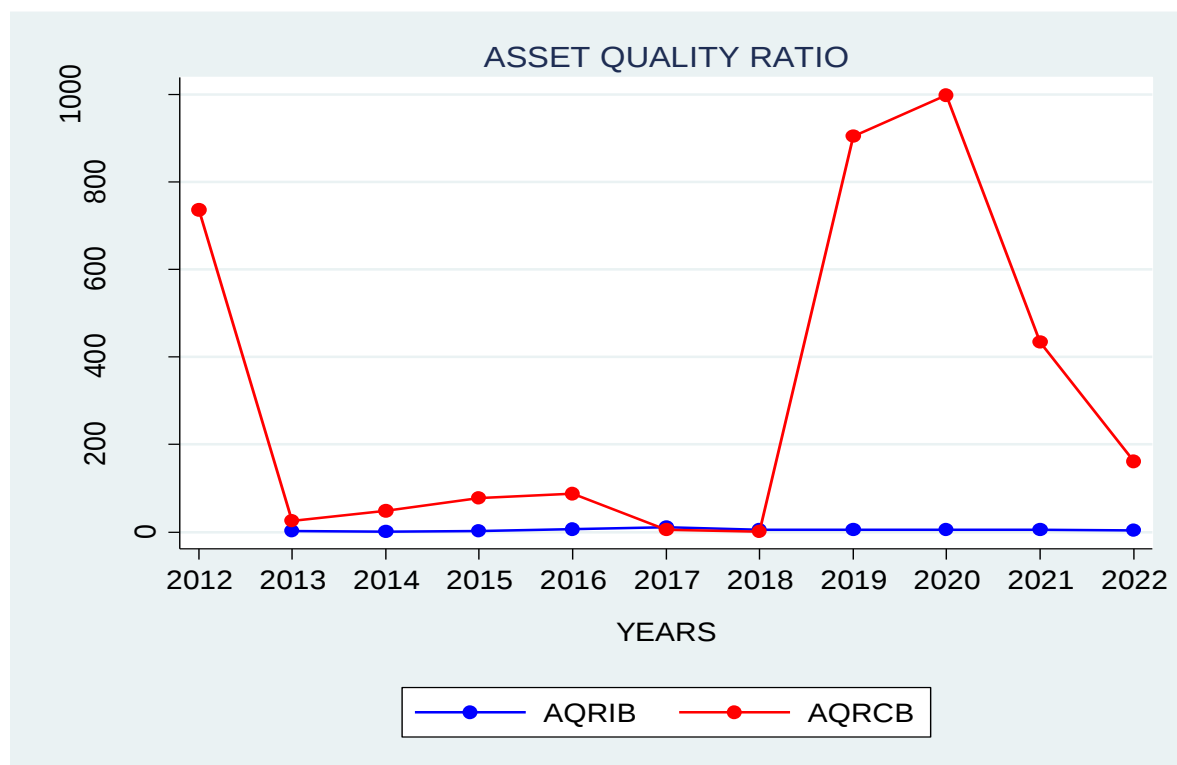


Figure 2

Similarly, figure 2 above, represents the trends of quality of return (AQR) earned by the banks on their assets. The AQR of the IB was at 2% during the year 2013, later dropped to 1% in 2014. The ratio remained steady, marginally increasing to 3%, 7% and 11% in the financial year of 2015, 2016 and 2017 respectively. For that of CB, the ratio recorded an impressive grow to 735% in 2012, decreased to 26% in 2013, before moving up in 2014 to 49%. It increased to 77% in 2015, and further grew up to 87% in 2016. Moreover, for IB, the ratio exhibited a downward trend to 6% in 2018, 5% in 2019, 6% in 2020, and 6% in 2021 and further dropped to 4% in 2022. Furthermore, in 2017, the ratio of CB recorded at 5%, and 2% in 2018. The ratio marginally increases to 904% in 2019, 998% in 2020, 434% in 2021 and 151% in 2022. Poor position of the quality of asset affects banks' capital and therefore making it more difficult for the banks to support viable customers.

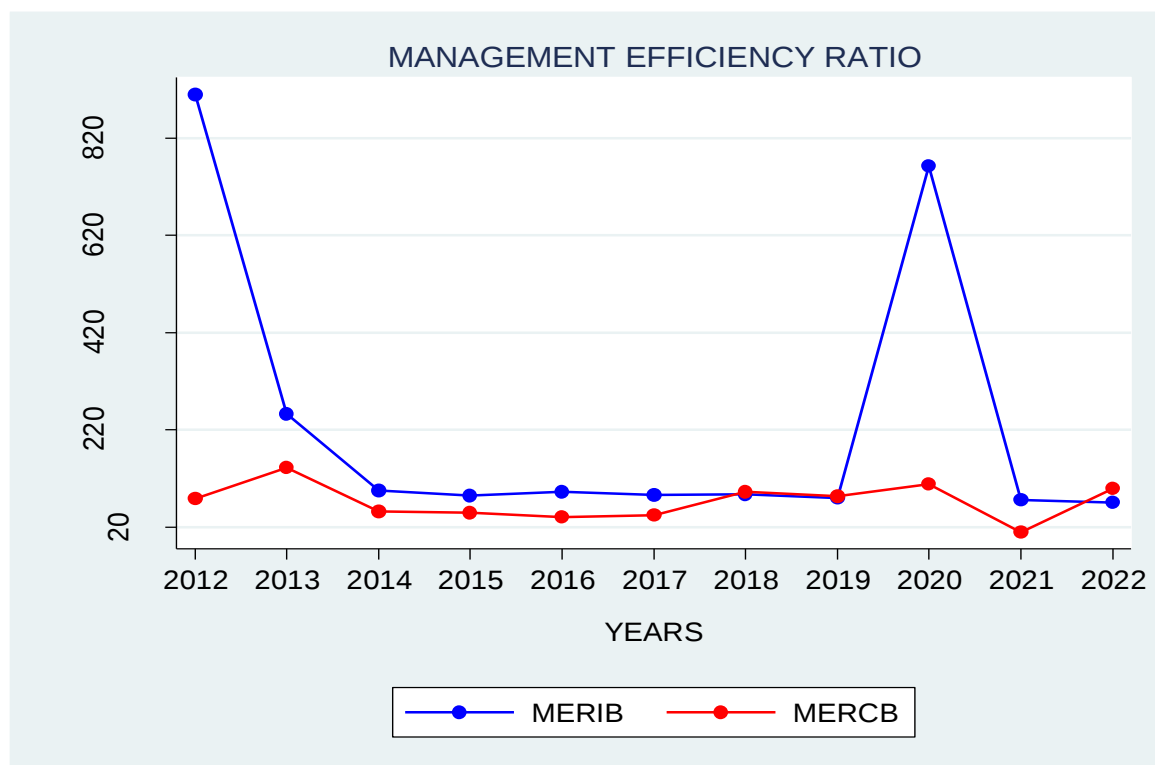


Figure 3

As a measure of quality of asset, cost-to-income ratio (CIR) is a key matric of measuring profitability and operational efficiency of banks. Figure 3 above highlighted the efficiency of managerial position (MER) of the two banks as the IB banks' MER ratio documented at 910% in 2012. The high values of CIR distort the profitability of the banks. On top of that, the bank improves its CIR and increases its revenue without increasing its costs. This can be noticed, in year 2013, the ratio sharply decreased to about 250%; it further dropped to 96% in 2014, 84% in 2015, 95% in 2016, 84% in 2017, 87% in 2018, and 80% in 2019 respectively. The MER of the CB was 79% in 2012, it increased to 142% in 2013, sharply decreases to 52% in 2014, 50% in 2015, 41%, 45%, 93% and 83% in 2016, 2017, 2018 and 2019. In year 2020, the MER of IB and CB, skyrocketed to around 762% and 109% this could be the aftermath of COVID-19 pandemic before dropping to 75% in 2021 and to it is lowest at 71% in 2022. The lowest MER for the CB is 10% in 2021 and 99% in 2022.

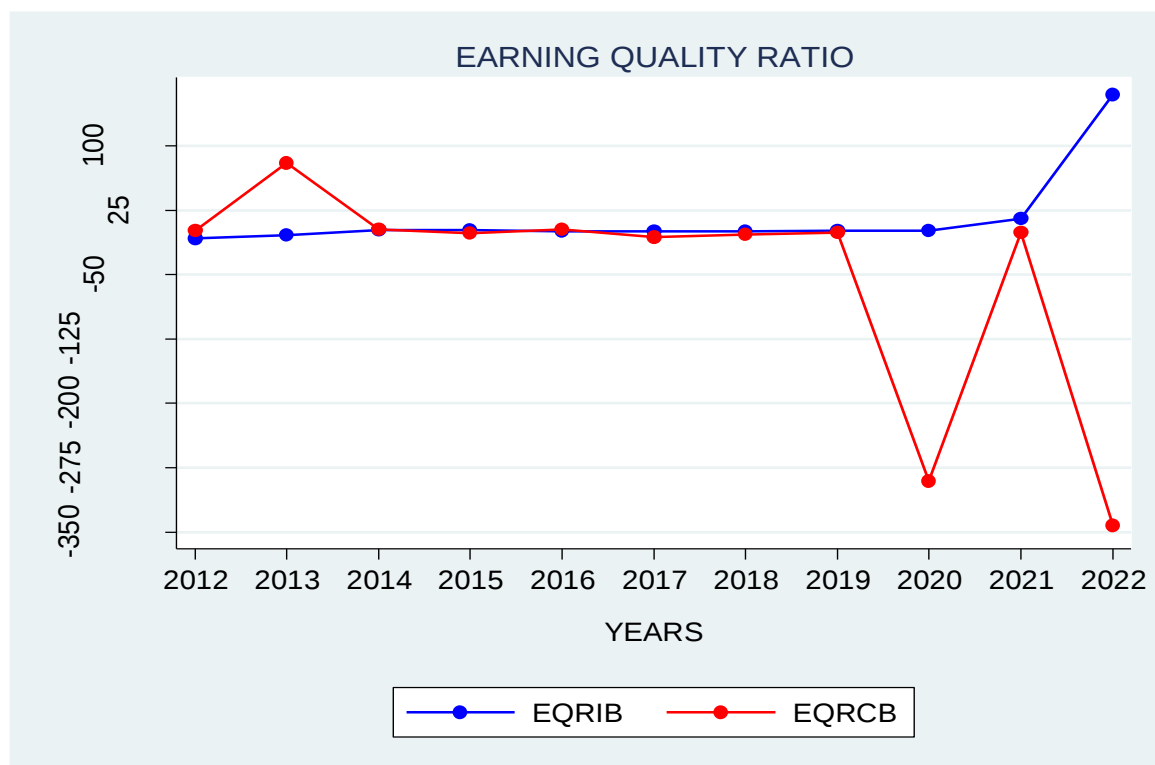


Figure 4

The lower values of the Islamic Bank profit is attributed to the fact that, 2012 was the starting year of operation of the bank, as the bank recorded a negative earnings ratio of -7.84% in 2012 and -4.116% in 2013. For Conventional Bank, the Earning Quality Ratio (EQR) hit 1% in the financial year of 2012, increases to 88% in 2013, dropped to 3% in 2014. The bank recorded a negative EQR with -1% in 2015, before bouncing back to record 3% in 2016. For six straight years the bank (CB) reported negative values of -6%, -3%, -1%, -290%, -1% and -342% in 2017, 2018, 2019, 2020, 2021 and 2022. On the other hand, the earnings capacity of Islamic Bank, had improved in a slow face as the bank recorded 1.7% in 2014, 1.7% in 2015, 1.55% in 2016, 1.24% in 2017, 1.24% in 2018, 1.55 in 2019 and 1.55 in 2020. The ratio further improved up to 15.39% and 160% in 2021 and 2022 respectively.

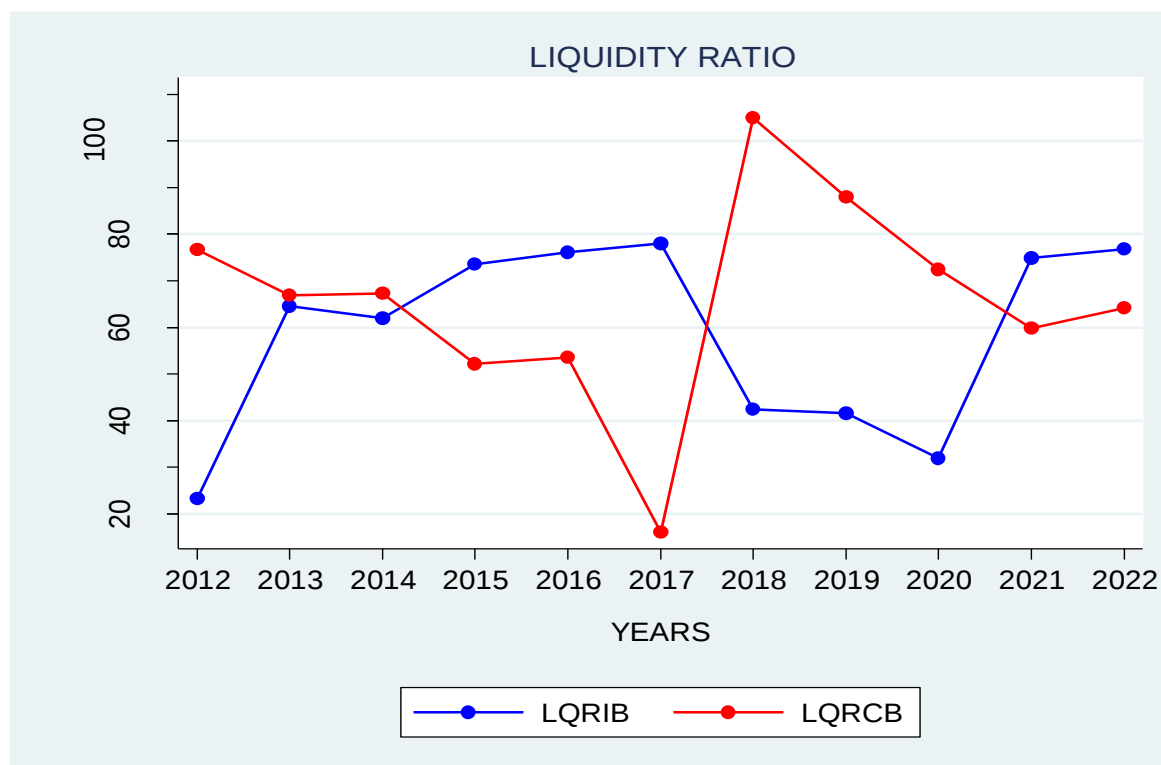


Figure 5

The liquidity ratio of IB computed by the percentage of TD/TA in this study spanned eleven years. The liquidity ratio of the bank posited at 23% in 2012, increases to 65% in 2013, and 62% in 2014. The trend further increases to 74% in 2015, 76% in 2016. In 2017, the liquidity position depicts at 78% before nosedived to 42% in two consecutive years of 2018 and 2019 respectively. In 2020, the ratio descended to 32% but the ratio indicated an impressive double-digit growth to 75% in 2021 and 77% in 2022 financial year. The liquidity position of CB was at 77% in 2012, it stagnated at 67% in 2013 and 2014. Decreases to 52% in 2015 and slightly increased to 54% in 2016, depleted to 16% in 2017. In the year 2018 the liquidity position marginally increased to 105% but decrease to 88% in 2019, 72% in 2020, 60% in 2021 and 64% in 2022.

CONCLUSION

From the findings, the study concluded that capital adequacy, earning quality and liquidity ratios exert significant positive influence on raising the financial performance of the both bank. This is in consonance with the study expectation where two independent variables are expected to contribute positively to the quality of earnings of the banks. The capital adequacy ratio functioned in various ways such as providing cushion against losses not covered by current earnings. From the analysis, Conventional Bank performed better than Islamic Bank in terms of adequacy of capital. Asset quality of the two banks was found to have positive effect on the financial soundness of the banks implying that the two banks should manage their asset book well and invest in credit risk management systems.

. On managerial effectiveness, Conventional Bank does excellently well as managerial inefficiency was found during the study period in Islamic Bank, this showed that the bank's operational expenditures to its size is higher. The distorted profitability of the bank was as a result of the higher cost-to-income ratio.

Moreover the results of this study have shown the existence of low and negative trends in the quality of earnings of both banks. Islamic Bank's earnings improve positively well, compared to that of Conventional Bank. It is expected that management of the both bank should put more effort to mitigate the negative trends as quality of earnings captures useful economic information in order to effectively evaluate firm's performance strength.

In the realm of finance, one of the major causes behind banks failures is insufficient liquidity. Liquidity position of the two banks was found to exert positive influence on the financial soundness of both banks. Basel III (2008) defined liquidity as the ability of a bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses.

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