Global Banking Operations and Strategy

Abstract

The report has analysed the financial performance of Royal Bank of Scotland (RBS) with the help of CAMELS approach. Each of the aspects of CAMELS have been analysed from the perspective of RBS. Based on this discussion, it has been found that financial leverage of the bank has declined drastically. Moreover, the analysis has also identified that the banks have been able to recover the interest payments from the banks.

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Analysis of financial position of Royal Bank of Scotland by CAMELS Approach

CAMELS Approach is one of the useful approaches for analyzing financial position of a financial institution. It is widely used for evaluating the risks that are associated with the different operations of a bank (Das and Sy, 2012: Said, 2003). The approach helps assists the banks to evaluate its creditworthiness. In this section of the paper the financial position of Royal Bank of Scotland (RBS) is analysed by applying CAMELS approach.

The factors of CAMEL approach are analysed with respect to RBS data that are obtained from its Annual Report over the 5 years (2008-2012).

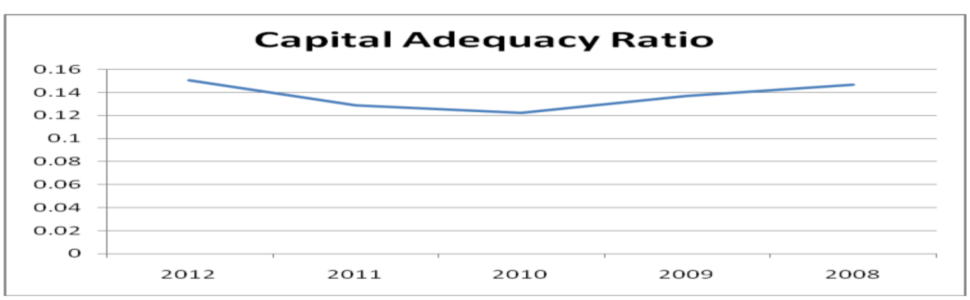
Capital Adequacy

RBS has to ensure that their depositors do not lose their confidence on the bank which may lead to bankruptcy (Saunders and Marcia, 2004). The following ratios are calculated to evaluate the capital adequacy of RBS (Refer to Appendix 1 for the calculation of ratios) (Bhayani, 2006)

Capital Adequacy Ratio (CAR)

The ratio helps RBS in identifying the reasonable level of loss that it can absorb due to the operational loses. It also examines its capacity to meet the losses (FDIC, 2007: Prasuna, 2003).

Figure 1: Capital Adequacy Ratio



(Source: Author's creation)

From the above figure it is evident that the CAR of RBS has been fluctuating over the years. The highest CAR has been 15% (in 2008 and 2012). The capital resources of RBS comprise Tier 1 and Tier 2. Thus, it can be inferred that 15% of capital (Tiers) of RBS is needed for protecting its risk weighted assets in 2012 (Hilbers, Krueger and Moretti, 2000).

Debt Equity Ratio

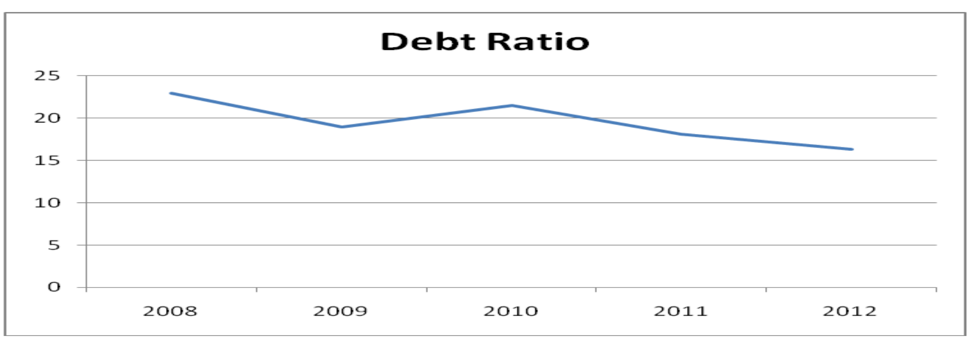
The debt equity ratio identifies the degree of leverage of RBS. The ratio helps in identifying how much cash is financed through debt and equity (Black, 2004).

Debt ratio = Total liabilities/ Shareholder's equity

The table below highlights the debt equity ratio of RBS:

	2012	**2011**	**2010**	**2009**	**2008**
Debt-equity ratio	16.32%	18.10%	21.5%	18.97%	22.91%

Figure 2: Debt Ratio



(Source: Author's creation)

From the above figure it can analysed that the debt equity ratio of the bank has decreased over the years from 2008 to 2012. It can be noticed that RBS has been aggressive in 2008 regarding financing. However, the decrease in the debt equity ratio reflects the fact that RBS has become more conservative in financing its capital through debt (Grier, 2007).

Asset quality

The asset quality is a vital factor for gauging the strength of a bank (Pastory and Mutaju, 2013). The main aim is to ensure the component of non-performing asset as percentage of total asset (Refer to Appendix 2 for the calculation of ratios).

Net Non performing asset (NNPA) to Total Assets

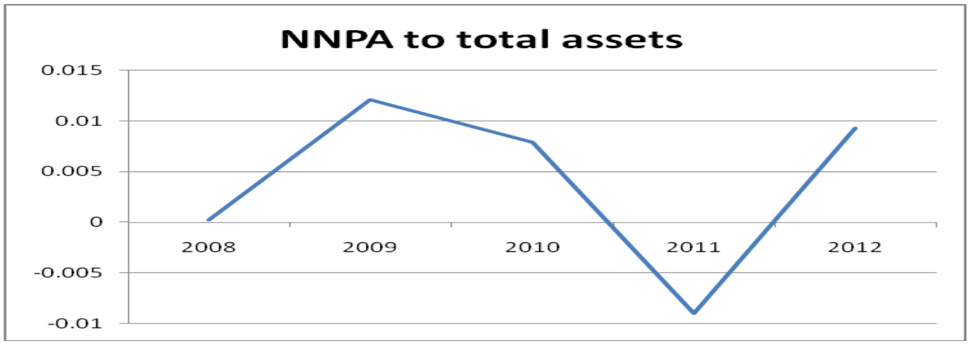
The ratio gauges the efficiency of the bank for assessing its credit risk and debt recovery (Wagner and Knaup, 2008). NNPA refers to the loans that are about to become default once the borrower fails to make the interest payment (Godlewski, 2003).

NNPA to Total assets = NNPA/ Total asset

The table below elaborates the NNPA to total assets of RBS:

	2012	**2011**	**2010**	**2009**	**2008**
NNPA to total assets	0.009	-0.008	0.007	0.012	0.0002

Figure 3: NNPA to Total assets



(Source: Author's creation)

From the above figure it is evident that the net performing asset has decreased over the year which means the numbers of customers who are not able to pay the interest have decreased. This reflects the fact that RBS has been performing well over the 5 years (Hoshi, Kashyap. and Scharfstein, 2009).

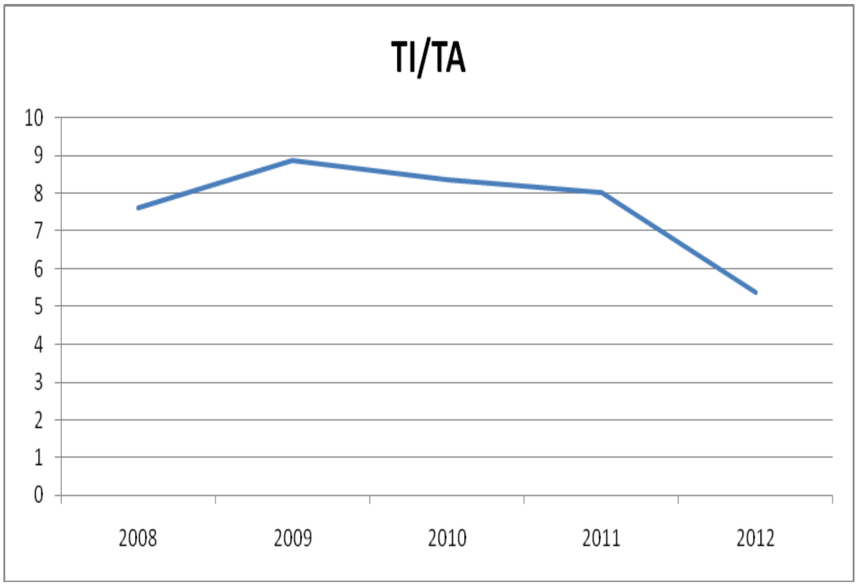
Total investment to Total assets (TI/TA)

The ratio indicates the extent of deployment of the assets in investment against advances (Koch and MacDonald, 2009: Royal Bank of Scotland, 2014a).

The table below highlights the TI/TA value of RBS:

	2012	**2011**	**2010**	**2009**	**2008**
Total investment to total assets	5.37	8.03	8.37	8.88	7.61

Figure 4: TI/TA



(Source: Author's creation)

From the above figure it is evident that the bank has concentrated in investing their assets over the years so that they can earn profitable return out of it. However, according to the graph, the total investment has reduced over the years. The decrease in total assets may be predicted as the increase in liabilities for the bank over the years.

Management Quality

The ratios to measure the management efficiency of RBS are elaborated below (Refer to Appendix 3 for the calculation of ratios).

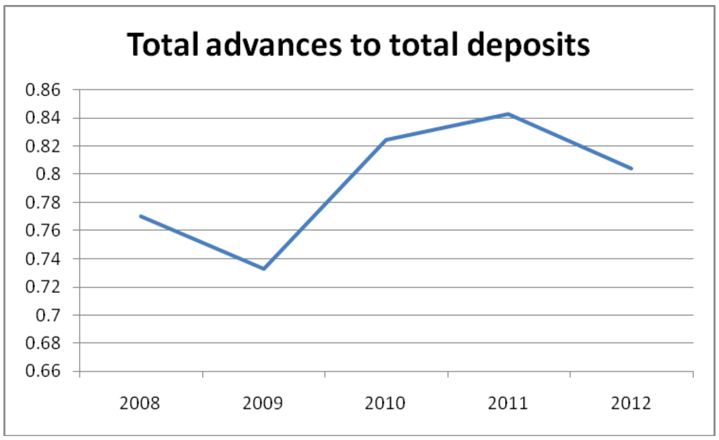
Total Advances to Total Deposits

The ratio helps to measure the efficiency or capability of the management of RBS in converting the deposits that are available to the bank in to higher earnings (Sharma, 2008).

The table below highlights the Total advances to total deposits value of RBS (Royal Bank of Scotland, 2014b):

	2012	**2011**	**2010**	**2009**	**2008**
Total advances to total deposit	0.803	0.842	0.824	0.732	0.770

Figure 5: Total advances to total deposits



(Source: Author's creation)

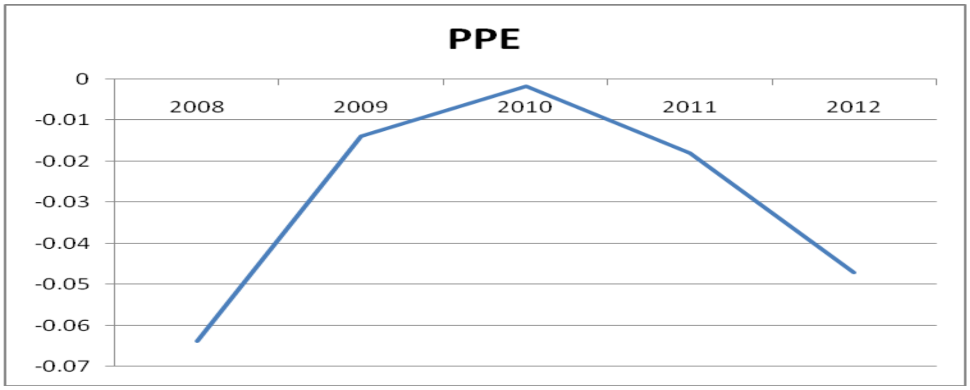
The above figure elaborates that the management has efficient enough to convert the deposit in to higher earning since the above mentioned ratio has increased over the years. The increase in the ratio indicates that RBS has grown its cash deposits by increasing the numbers of depositors (Gupta, 2008).

Profit per employee (PPE)

The ratio indicates the surplus earned by the employees of RBS.

PPE = Profit after Tax (PAT)/ Number of employees

Figure 6: PPE



(Source: Author's creation)

From the figure above it is evident that the company is encountering loss for the last five years and thus it can be inferred that the number of employees have decreased over the period which lead to less productive operation; and thus the loss increased for the same.

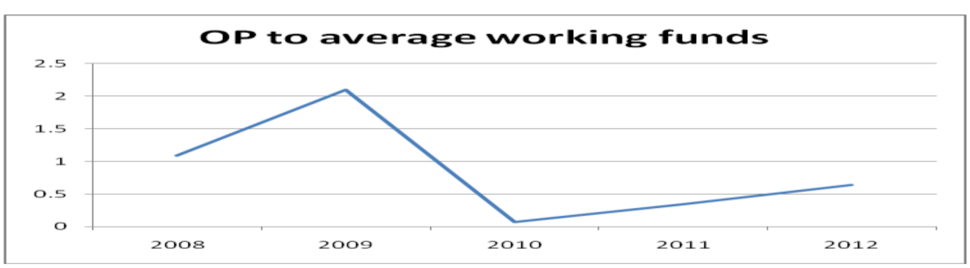
Earning quality

The earning quality is very important for any bank since it determines its ability to earn in a way consistent manner (Refer to Appendix 4 for the calculation of ratios).

Operating profit to average working funds

The ratio indicates the amount of profit that is earned by RBS from its operation.

Figure 7: OP to average working funds



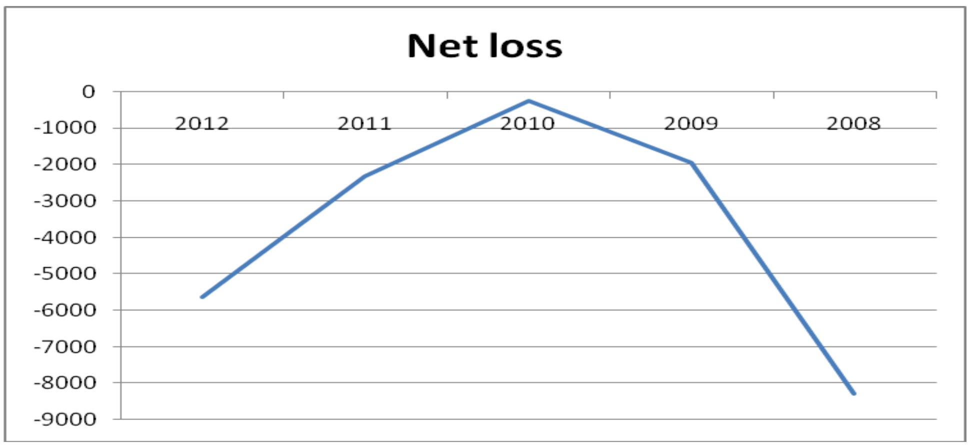
(Source: Author's creation)

From the above figure it is evident that the operating expense of the bank is lower the operating profit.

Percentage growth in net profit

It indicates the variations in percentage of profit over the previous years.

Figure 7: Net Loss



(Source: Author's creation)

From the above figure it is evident that the bank has encountered loss over the five years which indicates the fact that its performance has been very weak to sustain in long run. There is no growth in profit since the bank is encountering loss over the years.

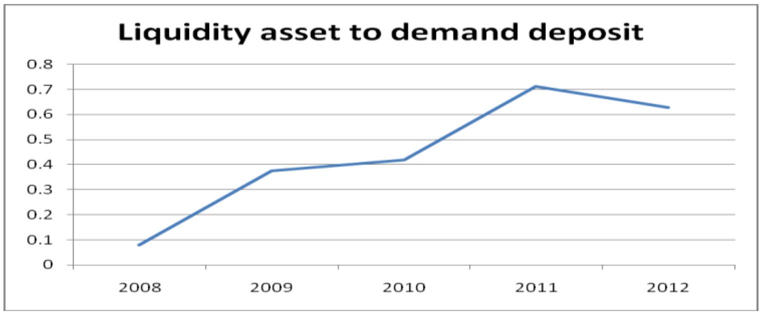
Liquidity

The risk of liquidity is very harmful for the image of a bank (Refer to Appendix 5 for the calculation of ratios).

Liquidity assets to demand deposits

It gauges the ability of the market to meet the demand of the depositors.

Figure 8: Liquidity asset to demand deposit



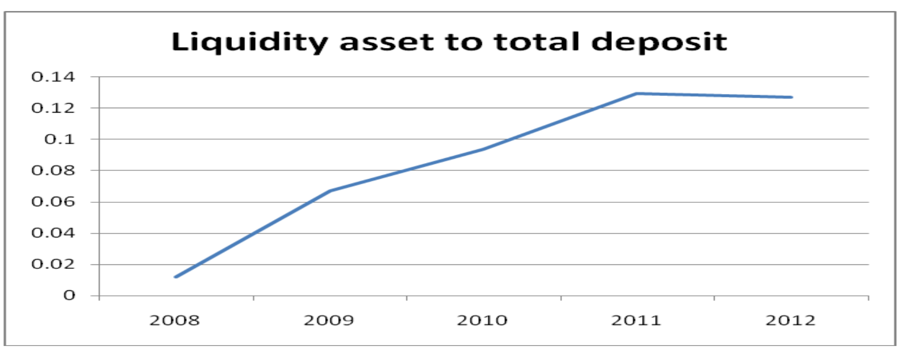
(Source: Author's creation)

The above figure elaborates the fact that the bank has the capability to meet the demand of the depositors by providing them with demand deposit option. The increase in the demand has made the bank stronger to enhance the facility (Treasury Committee, 2012).

Liquidity assets to total deposits

It gauges the liquidity of the bank against the total deposits made by the depositors.

Figure 1: Liquidity asset to total deposit



(Source: Author's creation)

It is evident from the above figure that the bank has increased its total deposit level over the years and thus its operation is strong enough to access the demand of the depositors.

Sensitivity to market risk

The changes in interest rate, foreign exchanges changes, equity prices and commodity prices may lead a bank to a financial weak position. The following table elaborates the foreign currency exposure that is encountered by RBS:

Year	Foreign currency exposures
2012	17922
2011	17875
2010	17725
2009	17879
2008	17756

(Source: Authors Creation)

The table above elaborates the level of foreign currency exposure of the bank. It reflects that the change has not been significant during the period of five years. However, it is observed that the bank encounters 5% rise in strengthening the effect of the foreign currency against the sterling. This has resulted in gain of 1.3 billion between the period 2010 and 2011. In 2012, the group had recorded loss of 0.9 billion pounds due to the strengthening of sterling against dollar and euro. Thus, these movements are difficult to predict from before and these vary remarkably depending upon the global movements.

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Appendix 1- Capital Adequacy

Capital Adequacy Ratio (in £ million)					
	2012	2011	2010	2009	2008
Tier 1 capital	57.1	57	60.1	76.4	69.8
Tier 2 Capital	12.1	8.5	9.8	15.3	32.2
Total	69.2	65.5	69.9	91.7	102
Risk weighted assets	459	508	571	668	695
Capital Adequacy Ratio	0.150762527	0.128937	0.122417	0.137275	0.146763

Debt Ratio					
	2012	**2011**	**2010**	**2009**	**2008**
Total Liabilities	**1241**	**1430**	**1376**	**1442**	**2154**
Shareholder's equity	**76**	**79**	**64**	**76**	**94**
Debt Ratio	**16.32894737**	**18.10126582**	**21.5**	**18.97368421**	**22.91489362**

Appendix 2 – Asset Quality

NNPA to Total Assets					
	2012	2011	2010	2009	2008
NNPA	14	-13	11.5	18.4	0.48
Total assets	1506	1453	1452	1522	2218
NNPA to total assets	0.009296149	-0.008947006	0.00792011	0.012089356	0.000216411
	2008	2009	2010	2011	2012
NNPA to total assets	0.000216411	0.012089356	0.00792011	-0.008947006	0.009296149

	2012	2011	2010	2009	2008
Total investment	8100	11675	12162	13516	16895
Total assets	1506	1453	1452	1522	2218
TI/TA	5.378486056	8.035099794	8.376033058	8.880420499	7.617222723

Appendix 3 – Management quality

Managemnent quality					
	2012	**2011**	**2010**	**2009**	**2008**
Total advances	500	515	502	554	691
Total deposits	622	611	609	756	897
Total advances to total deposits	0.803859	0.842881	0.824302	0.732804	0.770346

PPE					
	2012	**2011**	**2010**	**2009**	**2008**
Profit after tax	-5634	-2317	-239	-1928	-8296
Number of employees	119200	127500	130500	130450	129971
PPE	-0.04727	-0.01817	-0.00183	-0.01478	-0.06383

Appendix 4 - Earnings quality

Operating profit to Average working funds					
	2012	**2011**	**2010**	**2009**	**2008**
Operating profit (OP)	-5165	-1190	-399	-2647	-2569
Average Working funds	-8000	-3500	-5400	-1258	-2356
OP to average working funds	0.645625	0.34	0.073889	2.104134	1.090407

Percentage growth in net profit					
	2012	**2011**	**2010**	**2009**	**2008**
Net loss	-5634	-2317	-239	-1928	-8296

Appendix 5 – Liquidity

Liquidity					
	2012	**2011**	**2010**	**2009**	**2008**
Liquid assets	79	79	57	51	11
Demand deposit	126	111	136	136	136
Liquidity asset to demand deposit	0.626984127	0.711711712	0.419117647	0.375	0.080882353

Liquidity asset to total deposit	**2008**	**2009**	**2010**	**2011**	**2012**
Liquid assets	11	51	57	79	79
Total depoists	897	756	609	611	622
Liquidity asset to total deposit	0.012263099	0.067460317	0.093596059	0.129296236	0.127009646