

**COMPARATIVE ASSESSMENT OF THE FINANCIAL
PERFORMANCE OF PRIVATE BANKS WITH THE
EXPLOITATION OF PROFITABLE OPPORTUNITIES
A CASE STUDY OF THREE PRIVATE BANKS
IN ISLAMIC REPUBLIC OF IRAN**

Farhad Hanifi

Assistant Professor, Faculty of Management, Azad University Tehran Branch, Iran

Hassan Almasi

Assistant Professor, Faculty of Management, Azad University Tehran Branch, Iran

Azadeh Safa 

MA of Financial Public Management, Azad University Tehran Branch. Iran

azadeh.safa15@gmail.com

Abstract

In the highly competitive banking, today an ability to have effective financial performance has become one of the basic needs of success, survival and profitability of banks. Thus, the identification of factors and improvement of effective factors on development of financial performance of banks has become one of the main priorities of leading banks. In this context, this study comparatively examines the status quo of financial performance of three private banks in Iran. This comparative examination was performed in six areas: resource growth, profitability, return on equity, capital structure, distribution and growth of branches and growth of deferred demands. The research is descriptive and correlational. The statistical population includes directors and employees of three banks of EghtesadNovin, KarAfarin and Persian in Tehran. Findings Shows that there is no significant difference in status quo of financial performance of these banks according to four factors of studied six factors mentioned. It seems one of the factors affecting this status has been government intervention in the form of regulatory and disciplinary policies imposed on the banks that has weakened competitive and dynamic environment among them.

Keywords: banking, financial performance, profitable opportunities, comparative assessment

INTRODUCTION

In today's highly competitive world, banking has become one of the primary needs of effective performance of small to large businesses. One of the most important factors affecting the performance of banks is their ability to finance. Hence one of the most crucial issues facing banks is how to provide and to allocate the financial resources in different sectors of the economy and between activists of this area. This makes the banking system performs efficiently in competitive environment and it can be observed the decrease of production costs, productivity improvement and employment and economic growth. On the contrary, inefficient banking system in providing and allocating financial resources will lead to waste resources and economic stagnation (Ghasemi, 2009).

One of the most important goals of private banks is to earn profits and to improve financial performance and the survival of bank depends on it. Therefore, banks try to improve the performance and to increase profits. Playing constructive role in collecting free available financial resources and directing them to profitable activities depend on their appropriate performance and resolving problems in this regards. This will lead those banks that fail to achieve this objective, gradually marginalized and removed. The banks should continually review its performance and by identifying opportunities and removing obstacles, may have in this area, improve their performance.

Assessment of the financial performance of banks can be done with a variety of indicators. Because of the extent of these indicators, it is difficult to review their use all. Therefore, you should use the indicators of the present study was aimed at investigating the 6 criteria to assess the financial performance of banks used: number of resources and deposits, profitably, return on equity, capital structure, distribution of branches and deferred demands.

The success rate for banks to improve their financial performance is in relationship to profitability. Then banks are trying to improve the indicators to gain financial resources and profit. To help achieving this, the present study assesses the financial performance of three private banks in Iran comparatively to help these banks by identifying strengths and weaknesses in this area and by providing strategies to improve their financial performance. The logical basis for selecting particular three banks is that the studied banks have been established in the time period fewer than 5 years. Then the comparing of their financial performance will be reasonable. In addition, these banks are among the main competitors of private banks in Iran having a considerable share of banking market in this country. The last reason of selecting these banks for comparing is accessibility of data required for comparing their financial performance by the researcher.

RESEARCH BACKGROUND

Commercial banks are financial institutions that collect people's frozen funds and grant banking facilities to traders, industrialists and other applicants. In fact, banks provide banking facilities to transfer resources from those who do not want or cannot participate in economic activities due to various reasons such as lack of expertise and knowledge, lack of capital and fear of risk capital to those who are in need of investing financial resources since the objective is to earn profit, it is natural that the bank should attract cheaper resources and to grant banking facilities with the maximum interests to applicants. Therefore, the primary objective of the bank, like other organizations, is to maximize the wealth of its owners.

In maximizing the wealth of shareholders, the bank management bank must decide whether to gain lower quality assets and higher income or assets with higher quality and lower risk or whether the bank should invest and grant banking facilities with long maturities and reduce its liquidity or choose assets with shorter maturities and provide high volume liquidity? These are questions that bank managers are always faced (Karimi, 2007).

The importance of financial performance of banks for survival and their profitability has caused a lot of research done on assessing the financial performance of banks and patterns and several indicators in this area have been presented. Some of the most important researches done in this area include: Hunjak (2001) provided multi-criteria model to assess bank performance. This used model is AHP (analytic hierarchy process) model. In these researches, criteria have chosen based on CAMELS rating system and are classified in four groups of liquidity, asset efficiency, profitability and capital adequacy.

Kosmidou, Pasioutas, Doumpos and Zopounidis (2006) assessed banks performance in Ukraine during 1998-2002 and for this purpose, they used discriminant analysis and logistic regression to assess performance of small and big banks. Research criteria include 13 financial ratios that are chosen based on asset quality, capital adequacy, liquidity and profitability.

Olson & Zoubi (2008) assessed performance of Islamic and usury banks using accounting ratios in Gulf Cooperation Council and thus divided 26 financial ratios into 5 groups of profitability, efficiency, asset quality, liquidity and risk and examined 141 usury banks and 96 Islamic banks.

Secme, Bayrakdaroglu & Kahraman(2009) assessed the fuzzy performance of banking in Turkey using AHP and TOPSIS. In this study, performance assessment of banks in both financial and non-financial sectors is examined. Indicators of capital adequacy, asset quality, profitability, liquidity, income and expenses structure and stock structure are examined to assess the financial performance and indicators of pricing, marketing, productivity and providing services to assess non-financial performance.

With the introduction of DEA by Charnes, Cooper and Rhodesin 1978, its application in assessing the performance and its efficiency was very impressive. This was used in whole environments to assess performance. Banks are no exception and data envelopment analysis was used widely to measure efficiency in studies of commercial banks.

These studies were done at two levels of assessing performance of one branch of bank and assessing performance between banks (Wuhung, Gwo, 2009). In this section, we mention those researches to assess performance between banks.

Mercan, Reisman, Yolalan , Emel (2003) compared the influence of stakeholders including the public, private and foreign ones on commercial banks performance in Turkey. In this research financial ratios of Turkish banks were studied during 1989-1999 using data envelopment analysis.

Halkos & Salamouris (2004) examined Creek banks performance using data envelopment analysis(DEA).This study stated that the DEA method can be used as an alternative or as a supplement to the analysis of financial ratios to assess the performance of the organization.

Ho, Zhou (2004) studied 41 Taiwanese banks to assess the effectiveness and efficiency. In this study, the two-stage DEA model was used for assessment. First, the assets needed to generate income in order to assess the efficiency and secondly, the profits generated were studied to assess the effectiveness.

Ricardo (2006) studied quality management of banks using data envelopment analysis in Brazil. In this study, 50 Brazilian banks were studied during a12-year period from 1995 to 2006. In this study, the focus is on management quality due to factors in CAMELS model (the model for the structure of assets and liabilities) that are:capital adequacy, asset quality, management quality, profitability and liquidity. In this study, four inputs were introduced, including: number of employees, labor costs, number of branches and capital costs, and two outputs including: the amount of deposits and interest income were examined in order to assess banks in quality management.

Shahooth and Battall(2006) examined cost efficiency in Islamic banks using DEA. In this study 24 Islamic banking institutions were examined and cost efficiency was examined by introducing three inputs (capital, retained earnings and deposits) and two outputs (the amount of funds and assets) as factors affecting the cost.

Kao and Liu (2008) used DEA method to measure the performance of commercial banks in Taiwan. Personnel number, physical capital, purchased funds, deposits, short-term and long-term banking facilities are six variables in this study that were examined as the input and output.

Researches in the field of assessing performance of banking industry in Iran by DEA are related mostly to assess performance of branches and few researches were studied the performance between banks that we will mention some in the following:

AzimiHosseini (2004) used DEA method to compute technical, allocative and economic efficiency of banks in Iran economy and for this purpose, 10 banks were examined during 1998-2000. The results show that the performance of specialized banks was higher than commercial banks over the years.

Naderi Karaj & Sadeghi (2005) examined 46 non-usury banks and 64 usury banks in 2001 using DEA in order to compare efficiency and performance. The results show that non-usury banking performance in 2001 was lower than usury banking around the world.

Hasanzade (2008) studied 14 banks during 1997-2004 based on structural and functional variables through using EDA. The results show that private banks have greater degree of technical efficiency than public banks.

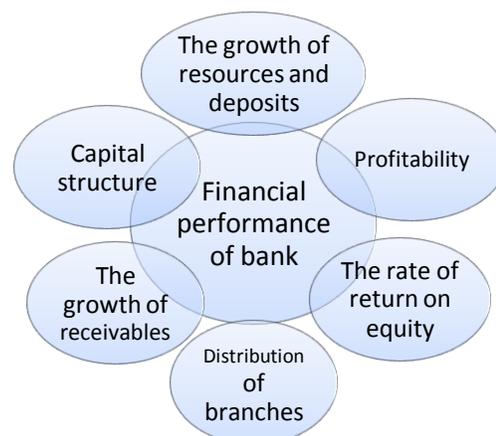
Research hypotheses

Main hypothesis: There is a significant difference between the exploitation of profitable opportunities and improving the performance of private banks.

Sub-hypotheses:

1. There is a significant difference between the growth of resources and deposits of private banks.
2. There is a significant difference between the profitability of private banks.
3. There is a significant difference between return on equity of private banks.
4. There is a significant difference between the capital structures of private banks.
5. There is a significant difference between the distributions of private bank branches.
6. There is a significant difference between deferred demands of private banks.

Figure 1. The conceptual model



RESEARCH METHODOLOGY

The research method based on data collection is descriptive survey. On the other hand, based on objective it is an applied research; given the data type it is a quantitative research. The data collection tool was a researcher-made questionnaire. The statistical population of the study consists of directors and employees of three private banks in Tehran, Iran as a total of 5520 subjects. The simple random sampling has been used as the sampling technique. The sample size is 359 subjects determined by means of Cochran formula. The study sample consisted of directors and official employees of three private banks in Tehran, Iran. In order to sample, stratified sampling was used based on the ratio of statistical population members of each of three banks. Cochran formula was used to determine the sample size.

ANALYSIS & FINDINGS

In this study, in order to investigate significant differences between the study variables, ANOVA test was used. Since the tests were performed at 95% of confidence level if a significant number of each variable is smaller than 5% and this will reject the assumption of equal means. This means there is no difference between the mean of the variable studied, To determine which bank mean differs from others, the LCD multiple comparison tests were used. In this test the mean of variables in all three banks were compared and the significance of difference can be judged based on lower and upper boundaries of each variable. In this case, if two boundaries are positive, the average difference will be greater than zero and the mean of first population is greater than second population. But if both the upper and lower boundaries are negative, the average difference will be less than zero and mean of first population is less than second population. And finally, if the positive and negative lower limit is negative, the average difference was not significant.

Table 1. the investigation of significant difference between the mean variables of three banks

Hypothesis	Variable	Component	Variance	Sum of square	df	Mean square	F	Sig.	Significant difference
1	The growth of financial resources and deposits	Development of Banking facilities	Intergroup	8.293	2	4.147	.833	.458	Disapproved
			Intragroup	59.740	12				
			Total	68.033	14				
	The growth of financial resources and deposits	Deposits growth	Intergroup	3.435	2	1.717	1.549	0.252	
			Intragroup	13.308	12				
			Total	16.743	14				
	The growth of financial resources and deposits	The growth of resources and deposits	Intergroup	5.080	2	2.540	1.319	.304	
			Intragroup	23.112	12				
			Total	23.193	14				

2	Profitability	Absolute profitability	Intergroup	4187396.778	2	2093698.389	3.717	.049	Approved
			Intragroup	8448998.333	12	563266.556			
			Total	12636395.111	14				
3	Return on equity	Return on equity	Intergroup	1689.747	2	844.873	.099	.907	Disapproved
			Intragroup	93996.374	11	8545.125			
			Total	95686.121	13				
4	Capital Structure	Equity	Intergroup	43097606.778	2	21548803.389	3.790	.047	Approved
			Intragroup	85283885.500	15	5685592.367			
			Total	128381492.278	17				
5	Distribution of Branches	The ratio of equity to total assets	Intergroup	.002	2	.001	1.504	.254	Disapproved
			Intragroup	.009	15	.001			
			Total	.011	17				
6	Growth of deferred demands	Distribution of Branches	Intergroup	.161	2	.080	.554	.586	Disapproved
			Intragroup	2.174	15	.145			
			Total	2.334	17				
6	Growth of deferred demands	The ration of deferred demands to banking facilities	Intergroup	.012	2	.006	3.258	.067	Disapproved
			Intragroup	.027	15	.002			
			Total	.038	17				
6	Growth of deferred demands	The ratio of deferred demands to outstanding banking facilities	Intergroup	.015	2	.007	2.887	.087	Disapproved
			Intragroup	.038	15	.003			
			Total	.053	17				
6	Growth of deferred demands	Deferred demand growth	Intergroup	1990.195	2	995.098	.575	.577	Disapproved
			Intragroup	20754.349	12	1729.529			
			Total	22744.544	14				

As seen in Table 1, there is a significant difference between the two variables of absolute profitability and equity among the three banks. To check out the different variables are on which banks, LCD tests were used.

Tables 2 and 3 show the results of this analysis. Given the LSD test results in Table 2, the mean absolute profitability of EN (EghtesadNovin) Bank is greater than KarAfarin bank and it is greater than Parsian bank and absolute profitability of Parsian Bank and EN bank were the same. The results of Table 3 also show the average equity of KarAfarin Bank was greater than Parsian Bank and this average about the other two banks was the same, which have been compared pairwise.

Table 2. Multiple comparison of absolute profitability variable

95 percent		Significance level Sig.	Standard error	Average deviation (IJ)	Type (J)	Type (I)
higher	Lower					
-142.2599	-1989.4067	.027	433.30765	-1065.833	Parsian	KarAfarin
832.0734	-1015.0734	.836	433.30765	-91.5000	EghtesadNovin	Parsian
1989.4067	142.2599	.027	433.30765	1065.833	KarAfarin	Parsian
1897.9067	50.7599	.040	433.30765	974.3333	EghtesadNovin	EghtesadNovin
1015.0734	-832.0734	.836	433.30765	91.5000	KarAfarin	Parsian
-50.799	-1897.9067	.040	433.30765	-974.3333	Parsian	Parsian

Table 3. Multiple comparison of equity variable

95 percent		Significance level Sig.	Standard error	Average deviation (IJ)	Type (J)	Type (I)
higher	Lower					
-613.0484	-6481.6183	.021	1376.66171	-3547.3333	Parsian	Entrepreneur
2316.7850	-3551.7850	.660	1376.66171	-617.5000	EghtesadNovin	Entrepreneur
6481.6183	613.0484	.021	1376.66171	3547.3333	KarAfarin	Parsian
5864.1183	-4.4516	.050	1376.66171	2929.8333	EghtesadNovin	Parsian
3551.7850	-2316.7850	.660	1376.66171	617.5000	KarAfarin	EghtesadNovin
4.4516	-5864.1183	.050	1376.66171	-2929.8333	Parsian	EghtesadNovin

Data analysis of each hypothesis provided the following results:

First hypothesis: In this hypothesis, the existence of significant differences in the average of the banks surveyed was assessed. Bank resources consist of bank banking facilities and deposits. Banking facilities are its assets and liabilities. So this hypothesis was examined in three parts. First, checking the resources of the private banks in this study showed no significant difference in resources of the banks. The findings also showed that there was no significant difference between average banking facilities and deposits of these banks during certain period.

The second hypothesis: In this second hypothesis, the average of profitability of private banks was compared. This hypothesis was tested in two parts: 1. The absolute profitability of bank on the basis of its net return 2. The relative profitability, means the ratio of return on total assets. The results of data analysis of first indicator show the average of absolute profitability of at least two Banks are not equal. Multiple comparison LSD test was used to rank banks. Given this test, the average of absolute profitability of Parsian bank was greater than KarAfarin bank and this was much higher for EghtesadNovin bank. But the average of absolute profitability of two banks (KarAfarin, EghtesadNovin) were the same. Second indicator, Relative profitability means how much the return on assets is. In order to calculate this ration, the net return is divided by total

assets of bank. The results show that the average of relative profitability of three banks was the same. This means all three banks have achieved the same benefit.

The third hypothesis: In this hypothesis, the average of return on equity of three private banks were examined and compared. Due to a significant figure obtained and was exceeded, it can be said the average of return on equity of three banks were the same.

The fourth hypothesis: In this hypothesis, the assessment of capital structure in private banks was done comparatively. The capital structure of these banks were compared based on two main indicators: 1. Equity 2. The ratio of equity to total assets. The results of first indicator showed that this indicator was different significantly at least in two banks. Given the results of LSD test, it can be said that the average of capital structure of Parsian bank was higher than KarAfarin bank and other possible modes are the same. The results of examining second indicator showed the equality of the average of this ration in each three banks.

The fifth hypothesis: In this hypothesis, the quality of branch distribution of banks around the country was examined by studying the number of branches in other cities to number of branches in capital city. The results showed no significant difference between averages of this variable in these three banks. This means the distribution of branches were the same in these banks.

The sixth hypothesis: In this hypothesis, the growth of deferred demands in private banks were studied and compared. This variable includes three indicators such as: the ration of deferred demands to paid banking facilities, the ratio of deferred demands to outstanding banking facilities and growth of deferred demands. The results of data analysis showed no significant difference in status of these three indicators in these three private banks.

CONCLUSIONS & RECOMMENDATIONS

Present study examined the status quo of financial performance comparatively of three private banks in Iran (EghresadNovin, Parsian, KarAfarin). The financial performance of these three banks was compared during certain period in six areas: resource growth, profitability, and return on equity, capital structure, distribution of branches and growth of deferred demands. The purpose of this study was to examine the issue of whether there was a significant difference in these three banks in the status quo. This is provided in a form of a main hypothesis and six sub-hypotheses. In the main hypothesis of this study, there was no significant difference between

profitable opportunities and improving the performance of studied private banks. To address this issue, 6 variables and 10 components were used. The results showed four hypotheses of six were not confirmed and this means there was no significant difference in the status of these four variables. About two other variables, only one of components had a different average (second and forth hypotheses). Accordingly, it can be deduced that the status quo of using profitable opportunities and improving the performance of private banks studied, have been the same to a great extent.

Data analysis showed that the performance of private banks surveyed were largely similar. Part of the reasons of this similarity could be because of liquidity growth and its same distribution in the private banks. Also, in recent years due to increasing supervision of central bank, working frameworks, guidelines and rate limits all led away private banks from the competitive context and made private banks act as public banks. In this regards, the following suggestions for improving the financial performance and profitability of these banks were provided:

1. Based on the results of the first hypothesis, examined banks were very similar in attracting resources and deposits and granting banking facilities. To create competition and dynamism in this field, it is recommended that the role of government in the field has more supervision nature that direct intervention; government intervention in the performance of private banks in different areas especially in determining the interest rate or the amount and terms of loan payments in addition to the losses incur, have made the performance of banks similar to each other and even to public banks and have weaken the competitive environment between banks. The experiences of banks liberation in other countries confirm that the private banks can act more successful in competitive environment if the intervention governmental regulation will be reduced.
2. Efforts to increase the rate of return on bank shares in the stock exchange market, according to the results of third sub-hypothesis, investors were similar in the three private banks. Perhaps because of similarity in their performance, their efficiency was the same. Therefore, improving financial performance of these companies can also raise the value of their shares.
3. Reduction of private banks reliance on branches in the capital city and changes in the distribution of branches across the country; given the results of fifth hypothesis, the distribution of branches of private banks across the country was the same. Since a large part of the country's wealth and revenue agencies are located in the capital city, banks activate the most numbers of their branches in Tehran. With this type of distribution of branches, their performance will be similar on one hand and potential financial opportunities available in other parts of country will be ignored on the other hand.

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