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Analysis of Financial Performance of Private Banks in Pakistan

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Abstract

This study deals with financial performance of private banks in Pakistan. The data is collected from Financial Statements Analysis of Financial Sector issued by State bank of Pakistan. The sample size consists of top ten Private commercial banks of Pakistan. We used Regression analysis and correlation technique in order to address the issue. Bank size and Operational Efficiency is negatively related with ROA and positive relationship was found with Assets management ratio. While, Bank size is positively related with Interest Income and Asset Management and Operational Efficiency is negatively related with Interest Income.

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1. Introduction

Financial sector is imperative for economic growth and industrialization via channeling funds, providing proficient financial system, sociable investor's treatment, and optimal utilization of resources (Raza, 2011). Banking sector in any economy is performing the major role in these regards. Banking sector plays a significant role in channeling funds to industries and contributing towards economic and financial growth and stability. A well-established banking sector can absorb major financial crisis in the economy and can provide a platform for strengthening the economic system of the country (Aburime, 2009). Pakistani banking sector has undergone through severe changes since its independence. Initially the banking sector of Pakistan has faced lot of problems like, lack of resources, political uncertainty, lack of skilled human resource and socioeconomic catastrophe, which affected the efficient working of banking sector. But State Bank of Pakistan (SBP) took initiatives by introducing SBP Act, 1956 to promote private sector banks, followed by privatization of 1992 motivated local and foreign investors in setting private sector banks and financial institutions. Currently, Pakistani banking sector consist of 44 banks with 9,399 branches and Rs. 11,778.6 billion assets, including 5 public sector banks, 23 domestic private banks, 12 foreign private banks, 4 specialized banks. Today, almost 80 percent of the banking assets held by the private sector banks

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in Pakistan (SBP, 2011). The objective of this study is to analyze the financial data of Pakistani private banks for the financial periods 2006-2010. In addition, to study the relationships among measures such as bank's size, operational efficiency, asset management, return on assets, interest income, and to discuss their influence on the bank's performance.

2. Literature Review

Tarawneh (2006) found that the banks having high total capital, deposits, credits, or total assets does not always means that has healthier profitability performance. The operational efficiency and asset management, in adding to the bank size, positively influenced the financial performance of these banks. In the light of his empirical study he concluded that the operational efficiency and asset management, in addition to the bank size, strongly and positively influenced financial performance of the banks. Ahmad, (2011) in his study of the financial performance of seven Jordanian commercial banks used ROA as a measure of banks' performance and the bank size, assets management and operational efficiency as three independent variables affecting ROA. He concluded that there is a strong negative correlation between ROA and bank size and with operational efficiency, while, find positive correlation between ROA and asset management ratio. Khizer et.al. (2011), in his study about profitability indicators of banks in Pakistan for the period of 2006-2009 find that profitability is directly and positively affected by operating efficiency, assets management ratios, and size when using ROA as profitability indicator. The association between profitability and other indicators is different, when using ROE as profitability indicator. ROE is positively related with assets management and negative association is find with size and operating efficiency. Sidqui and Shoaib, (2011) concluded in their study "Measuring performance through capital structure in Pakistan" that size of the bank plays an important role in determining the profitability of the bank using ROE as profitability measure. In addition, Tobin's Q model was also used in the study to measure banks profitability and performance and found direct and positive relation with the size of the banks, the leverage ratio and Investments by banks in assets. Rizivi (2001) conducted a study to analyze the productivity of banking sector in Pakistan through 1993-1998 using Data Envelopment Analysis. According to his productivity indices the Pakistani banking sector is performing poor due to technological regress and suboptimal combinations of services and products. This should be overcome by providing value added services and increase customer base.

3. Research Methodology:

3.1. Data

Data has been collected from Financial Statement Analysis of Financial Sector 2006-2010 issued by State Bank of Pakistan. Top ten Private commercial banks were taken as a sample for the purpose of analysis of financial performance, which hold 60% market share.

Table 1. Explanation of Variables

Type	Variable	Proxy	Sign
Dependant	Return on Assets	Net Income /Total Assets	ROA
Dependant	Interest income	Interest received – Interest Paid	IN
Independent	Size	Total Assets	BS
Independent	Asset Management	Operational Income/Total Assets	AM
Independent	Operational Efficiency	Total Operating expenses / Interest Income	OE

3.2. Model of Study

In this study we will use following regression model.

- ▶ $ROA = \beta_0 + \beta_1 (BS) + \beta_2 (AM) + \beta_3 (OE) + \epsilon$
- ▶ $IN = \beta_0 + \beta_1 (BS) + \beta_2 (AM) + \beta_3 (OE) + \epsilon$

4. Results and Discussion:

4.1. Descriptive Statistics

Table 2. Results of Descriptive Statistics

	ROA	IN	BS	AM	OE
Mean	0.011762	15.90470	19.19761	0.017200	1.379372
Median	0.012850	16.01825	19.35652	0.018300	1.303000
Maximum	0.037200	17.42192	20.36485	0.054100	4.812100
Minimum	-0.061500	14.03071	16.69094	-0.076800	0.442400
Std. Dev.	0.013906	0.878778	0.758796	0.019055	0.626908
Observations	50	50	50	50	50

The mean value of ROA is 0.011762; this shows that percentage of ROA is 1 % which is very low while the standard deviation is 0.013906. The mean value of Interest income (IN) is 15.90470, this shows that percentage is more than 100 which indicate the very high value of Interest income while the standard deviation is 0.878778. Bank size (BS) measured as Ln (explain) of total assets registered a very high mean of 19.19761 while standard deviation is also high 0.758796. The mean of Asset management (AM) is 0.017200 and its standard deviation is 0.019055. The mean of Operational Efficiency (OE) is 1.379372 and its standard deviation is 0.626908.

4.2. Correlation Analysis

Table 3. Results of Correlation

	ROA	IN	BS	AM	OE
ROA	1.000000	0.367797	0.298680	0.986983	-0.913402
IN	0.367797	1.000000	0.892418	0.431248	-0.404140
BS	0.298680	0.892418	1.000000	0.350509	-0.321225
AM	0.986983	0.431248	0.350509	1.000000	-0.917029
OE	-0.913402	-0.404140	-0.321225	-0.917029	1.000000

The value of correlation between ROA and Bank size (BS) is 0.298680. The result of correlations indicates a weak positive correlation between dependent variable (ROA) and independent variable (BS), which is 29.8 percent. It is also clear from correlation test there is a very strong positive correlation between dependent variable (ROA) and Asset management (AM) which is 98%. While the relationship between dependent variable (ROA) and independent variables is -91 percent which shows high negative correlation. This result of correlation between Interest Income (IN) dependent variable and Bank size (BS) shows a strong positive correlation, which is 89%. It is clear from correlation test that there is a moderate correlation between dependent variable Interest Income (IN) and Independent variable Asset Management (AM) that is 43%. The test indicates the moderate negative correlation between dependent variable Interest Income (IN) and independent variable Operational Efficiency (OE) that is -40%.

4.3. Regression Analysis

Table 4. Results of Regression Analysis (Dependant Variable ROA)

Variable	Coefficient	Std. Error	T-Statistic	Prob.
C	0.041023	0.015751	2.604405	0.0124
LOG (BS)	-7.9405	0.000813	-0.097689	0.9226
AM	0.005504	0.000767	7.174953	0.0000
OE	-0.012225	0.002228	-5.487629	0.0000
R-squared	0.864417	F-statistic	95.63317	
Adjusted R-squared	0.855378	Probe (F-statistic)	0.0000	

4.3.1. ROA with independent Variables

4.3.1.1. Bank Size

Bank size shows negative relationship with ROA with a coefficient of -7.9405. This result indicates that with a 1 percent increase in the firm's bank size, there is -7.9405 Percent decrease in ROA of a firm. There is an insignificant relationship between ROA and bank size. Thus we reject our first hypothesis about ROA and Bank size.

4.3.1.2. Asset Management

According to the results, Asset Management is positively related with ROA with a coefficient 0.005504. The regression co-efficient is also found to be statistically significant with the level of significance of 0%. Therefore we confirm our second hypothesis is accepted.

4.3.1.3. Operational Efficiency

According to the results, Operational Efficiency found to be negatively related with ROA with coefficient -0.012225. However the relation in this study proves to be statistically significant with 0% level of significance, which makes the third hypothesis to be accepted.

Table 5. Results of Regression Analysis (Dependant Variable IN)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5.541637	1.598519	-3.466732	0.0012
LOG (BS)	1.146757	0.080759	14.19967	0.0000
AM	-6.239817	6.849973	-0.910926	0.3671
OE	-0.370711	0.207162	-1.789472	0.0801
R-squared	0.839906	F-statistic	80.44385	
Adjusted R-squared	0.829465	Probe (F-statistic)	0.000000	

4.3.2. Interest Income with Independent Variables

4.3.2.1. Bank Size

It has been observed that Bank size (BS) is positively related with Interest Income (IN) with a coefficient of 1.146757. There is a strong significant relationship between Interest income and bank size at 0% level of significance. Thus we reject our fourth hypothesis about Interest income and Bank size.

4.3.2.2. Asset Management

The result indicates that Asset Management is negatively related with Interest Income with very high coefficient -6.239817. However, the regression co-efficient is found to be statistically insignificant.

4.3.2.3 Operational Efficiency

According to the results, Operational Efficiency is negatively related with Interest Income with coefficient - 0.370711. The relation in this study proves to be statistically significant which confirms that the sixth hypothesis is accepted.

5. Conclusion:

This study examines the impact on the financial performance of Pakistani private commercial Banks. Top ten Private commercial banks were taken as a sample for the purpose of analysis of financial performance. Returns on asset and interest income were taken as dependent variables while bank size, asset management and operational efficiency were taken as independent variables. Results showed that the ROA of the banks were strongly and negatively influenced by the bank size. Operational efficiency is negatively related with the ROA and results also showed that it was statistically significant so third hypothesis is also accepted. Other dependent variable interest income of the banks was strongly positive influence by the bank size and is statistically significant. Interest income showed negative relation with the operational efficiency and results were also statistically significant. On the practical dimension, this study is helpful for bankers in their decision making to increase the bank financial performance.

Acknowledgements

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