Benchmarking on Financial Performance of Select Banks in Sultanate of Oman: An application of CAMEL Criterion

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Abstract

This study dealt with the determining the financial performance and productivity of the banks selected in Sultanate of Oman during the period 2011 to 2016. The researcher has chosen six listed conventional banks in Sultanate of Oman randomly selected through Muscat Securities Market namely Bank Muscat, Oman Arab Bank, Bank Dhofar, Ahli Bank and Bank Sohar respectively. The study has been carried out with the very familiar CAMEL criterion that assess the capital adequacy, assets quality, management capability, earning ability and liquidity position. The findings of the study would help the stakeholders to understand the performance and productivity of the selected banks for their future investment and growth. It is found on measuring the overall performance of the selected banks with CAMEL criterion that the Ahli Bank has arrived with top position with respect to its productivity and profitability and Oman Arab Bank has secured the last position.

***Keywords**:* Financial, Performance, banks, CAMEL, Significance and hypothesis

Introduction

The recession in Gulf region due to the drop of oil prices in the international market also one of the main reasons for the financial crisis in the banking industry. It is seen during the study that majority of the banks in Sultanate of Oman have managed to exist without bankrupt even during the times of financial turmoil. Economic development of a country depends on the development of banking industry. Every banking industry is backbone of that country which helps to come out from economic crisis. Banking sector had strongest impact on the world economy with the help of incredible attractiveness and other factors such as profit and competitive in nature. It is found that lots of literature work in comparing the general performance of the banking industry in Oman but only very least works have been carried out with CAMEL criterion and this work would fulfill the slackness in determining the performance analysis of banking industry in comparison to few banks selected in Oman. There is also a need at this present scenario to analyze the performance of banking industry to cut throat competition from other financial competitors.

Significance and statement of the study

The development of an economy entirely depends on the planning and implementation of available resources efficiently in overall economic environment in which banking industry occupied in an important role. The present study forms part of assessing the financial soundness of the banking industry in Sultanate of Oman which have great impact in the economic environment. Researcher explore CAMEL criterion for six years 2011 to 2016 on select banks in Sultanate of Oman. They have classified each bank's performance into various dimensions such as capital, assets quality, management, earnings, and liquidity of the financial statements to assess the financial performance, identify the banking regulations compliances and operating efficiency of the banking industry. The last criterion recently added to the CAMEL approach was sensitivity that focus more on the market risk of the banking sector.

Review of Literature

Capital adequacy ratio is very important tool that is measured to determine the bank's main capital with respect to the risk weighted assets of the banks. Capital adequacy ratio help the stakeholders to understand the capital of every bank available to set off the losses without ceasing the bank assets. Asset Quality ratio shows the percentage of nonperforming assets in the banks and the percentage of loss that could occur from specified asset group which affect the performance. Net nonperformance Assets to Net Advances ratio depicts the quality of the different assets of the bank. This would help to understand the weakening of the estimated asset's quality. Management Quality is one of the essential criterion in CAMEL approach which portrays the effective factors affecting the productivity and financial performance of the banks with few ratios namely market value to equity capital ratio, total advances to total deposits ratio, operating expenses to operating income ratio and return on net worth ratios. Earning Quality is another tool of CAMEL criterion that shows the earning capacity of the banks such as dividends funding and different innovative tactics used to survive in the competitive environment. Liquidity is another CAMEL Criterion which is one of the main factors that every bank has to maintain their liquidity position with utmost care. This would help the banks to identify the areas of pressure and to handle the situations carefully with the help of capital in local markets.

According to Manoj PK 2010 Soundness of the banking industry is one of the measures of economic development of any country which results in determining efficiency of the resources, productivity of overall activities, profitability of the various industries and finally determining the stability in banking environment. Soundness and stability of the banking industry across the Sultanate of Oman would serve as a remedy at times of crisis and it is important to study the performance of the banks across the country. Prasad et al 2011 Chowdhury 2011 analyzed the financial performance of the various banks using CAMEL criterion and concluded that the overall banking sector is sound and also ranked those banks on the basis of their soundness and performance. Manoj P K 2010, also analysed the banking sector in Kerala and summarized that the banks lag the maximum in determining the soundness of the banks but did not suggest the way out to the issues. Reddy and Prasad 2011 emphasized with the instrument of CAMEL Criterion to find out the soundness and productivity of the selected banks and also suggested remedial measures to overcome the issues identified in the study especially to the rural banks in the country.

According to Gasbarro D, Sadguna I G M and Zumwalt J K (2000) discussed the financial soundness of the banking industry during the financial calamities affected in large size that worsen the financial health of the both banking sector and also stakeholders which affected during the financial crisis of 2008 and 2010 respectively in Gulf region. That also had a great impact on the economic development of the gulf countries. Kerstein and Kozberg 2012 NG and Roychowdhury 2013 pointed out that the decline in the financial performance of the banking industry during 2008 and 2010 lead to unexpected and rapid changes in the environment of banking financial performance resulted the negative feedback on the part of the investors and also in the economy in general. Gupta PK and Jain Ashima, 2010, Singh Pakash, 2007, Shimizu Satoshi, 2010 and Ghosh Debarshi and Ghosh Sukanya, 2011 also pointed out that the strength of the banking industry is determined with the factors of leverage and it was very much lower and return on assets ratio had been seen with higher stability and moreover the non performing assets ratio was very much declining which ensured the soundness of the banking industry.

Shahchera Mahshid 2011, investigated a study on the impact of regulation on soundness of banking industry with the help of Z-score which identified that the banking industry was sound and suggestions were given by the researcher to make transparent and in terms of exchange of information for effective and sound banking system. Cole and Gunther 1995, 1998, Thomson 1992 and Cole and White 2012 incorporated that CAMEL criterion is one of the effective tool to rate banking productivity and performance which evidenced that the capital adequacy, assets quality, earnings and liquidity are very much lesser than the normal scenario during the time of recession. According to NG and Roy Chowdhury 2013 highlighted that there is positive relationship between the failure in the banking industry and loss of loan reserves. According to Merchant 2012 the comparison study resulted that the Islamic banking and conventional banking with the help of CAMEL rating helped the banks to identify the areas of weakness and the rating criterion has given the bankers to overcome the issues efficiently to stabilize the economic crisis.

Beck T 2008, the researcher compared a study on the competition stability and competition crumbliness in banking industry. It is found from the study that the higher the competition in banking sector that reduces the interest rates in the country and that ensures the customers more safer and improving financial stability whereas less competition in the banking industry always force the banks to safeguard the existing market share and that would weaken the credit worthiness of the existing customers and also ensuring risky loans. Khouaja D and Lotfi Boumediene S 2014 have analysed one hundred and fifty commercial banks in six European countries during the period of 2003 and 2008 with the CAMEL approach and opined that the factors which influence the profitability of the banking industry are very much important to have stability than the factors those influence the risk management of the banking industry.

Research Methodology

It is essential to evaluate banking performance in order to rank them according to their profitability, productivity and soundness. CAMEL criterion is a method of ratio analysis to determine the financial performance of the banking industry through capital adequacy, asset quality, management quality, earnings and liquidity. The proposed study is based on the both descriptive and analytical in nature. The main objective of the study is to measure the financial soundness of the selected banking institutions in Sultanate of Oman for the period of 2011 to 2016 from the financial statements derived from Muscat Securities Market website. Secondary sources of information in the form of banking journals, articles and other published information of banking regulations in Sultanate of Oman have been considered. The statistical tools such as F test and ANOVA test also used to find out the significant relationship among the performance of the banks and CAMEL criterion.

Research Gaps

This study is important in the banking environment as there are lack of studies on this ground to identify the CAMEL criterion on GCC and especially in Sultanate of Oman to determine the financial soundness of banks selected. This study would help to fill the gaps in the study with the very recent data obtained from the financial statements of the banks selected.

Data Analysis and Interpretation

Capital Adequacy ratios are few of the ratios those enables the banks to disclose the facts of the risk awareness to their depositors and customers. Capital adequacy ratios helps the bank to maintain adequate ratios and safeguard stakeholders trust from bankruptcy. Central Bank of Oman has determined a target of capital adequacy ratio of 12.625% which every bank try to maintain to assess their minimum capital to their risk weighted assets. The calculations shows the average net worth to total assets ratio for six years which shows that the Bank Muscat has an highest average rate of 13.3106 % and Bank Sohar has secured very least average among all other banks with 9.7560%. Net advances to total assets ratio of Bank Muscat is 24.9882% which is less comparing to other banks and Ahli Bank has scored 82.2782% as an highest. it is also found from the analysis that debt equity ratio of Bank Muscat is in top position with 5.8661% and Bank Sohar has scored 9.2669% which is least among other banks.

Capital adequacy Ratio of Bank Muscat has been identified as 16.3320% which is top ranking among the other banks and Bank Sohar has occurred 9.2680% which is least among the other banks. It is also found from the calculations that the equity to net loans of Bank Muscat secured 0.2055 with highest average whereas Bank Sohar has secured 0.1391. Liability to total assets ratio of the Bank Muscat is least about 0.3388 which has reasonable liabilities while comparing to total assets and Bank Sohar has 0.9024 which is highest among all other banks. It is also observed that overall average group ranking of capital adequacy ratio of Bank Muscat and Ahli Bank were in top position whereas Bank Bank Sohar secured the last position.

Hypothesis H_0

There is no significant difference between the performance of selected Banks in Oman and Capita Adequacy Ratios.

One way ANOVA has been calculated to find the significance level among the banks performance and the CAMEL approach. From the calculations the debt equity ratio and net worth to total assets ratios with the p values of 0.00665 and 0.00735 respectively differ significantly as the null hypothesis is rejected at 5% level of significance and it concluded that these ratios significantly different with regards to capital adequacy ratios. The rest of the ratios under capital adequacy ratios namely advances to total assets ratios, capital adequacy ratio, equity to net loans ratio and liability to total assets ratio does not differ significantly as null hypothesis has failed to reject at 5% level of significance and it is concluded the performance of the banks does not differ with regard to capital adequacy ratios. In accounting and finance, the asset quality is an essential tools to weigh the soundness of the banks. Ratios under asset quality helps to find the non-performing assets of the bank to the total assets. Moreover this ratio indicates the different types of the advances made to the customers in order to generate the component of interest income. In most of the cases it is identified assets quality calculations alarm the healthiness of the banking organization against the value of the assets. Non-performing assets are categorized against the total advances of the banks as per the guidelines of the central bank of Oman.

From the calculations it is found that Ahli banks average ratio of NPA to Advances secured first place with the minimum value of 1.4047 whereas Oman Arab Bank secured fifth place with the value of 3.2900. Moreover NPA to total assets ratio of bank Muscat during the study period secured less value of 0.8847 whereas the Bank Dhofar has secured the highest value of 3.0322 securing the last position. Another important ratio of total investment to total assets ratio indicates the level of usage of assets in the form of investments against the total advances made by the bank. This would give the exact value of the funds locked out of the total investments by the financial institutions. Higher the ratio would give an indication of conservative funds of the banks to take care investments against NPA. The calculations shows that the Bank Muscat has secured top position with the least total investments to total assets value of 3.5149 while comparing with the value of 11.6558 placing the last position among other banks. It is also observed that overall average group ranking of asset quality of Bank Muscat in top position with least average and Bank Dhofar has secured highest average with the least position.

Hypothesis H_0

There is no significant difference between the performance of selected Banks in Oman and Asset Quality Ratios.

The calculations shows that NPA to Advances ratio, the p value of 0.0000 which is less than 5% level of significance, the null hypothesis is rejected which infers that there is more significant difference between the performances of the bank. NPA to total assets ratio and total investment to total assets ratio shows p values of 5.7161 and 3.0555 respectively which fails to reject the null hypothesis. Therefore there is no significant different between these ratios and assets quality.

Every management wants their institutions to perform well to generate more profits and to sustain in the market. Management efficiency ratios would help to arrive a decision on the basis of selected tools. These ratios also would measure the effectiveness of top management and also efficiency of the management, which also help to find the risk perception.

Advances to total deposits ratio refers to the Bank's efficiency in using the funds of the customers in the form of deposits into income generating advances. The calculations shows that the advances to total deposits ratio of Bank Muscat secured the maximum of average of 129.0133 and Bank Dhofar has placed in the last position with the value of 90.0550. Operating expenses to operating income ratio shows that Ahli Bank has able to manage the expenses effectively with the least values of 38.0228 and Oman Arab Bank has unable to manage the expenses effectively with the highest average of 55.5825. Return on net worth ratio of Bank Dhofar shows highest average of 14.8450 whereas the Bank Muscat has obtained least average of 12.2422. it is observed that overall average group ranking of management efficiency, Ahli Bank has secured top position with the least average and Oman Arab Bank and Bank Sohar has secured last position with the similar averages.

Hypothesis H_0

There is no significant difference between the performance of selected Banks in Oman and Management Efficiency.

The calculations shows that advances to total deposits ratio, the p value of 0.0000 which is less than 5% level of significance, the null hypothesis is rejected which infers that there is more significant difference between the performance of the bank and management efficiency. Operating expenses to operating income and return on net worth ratio shows the p values of 1.2723 and 0.64322 respectively which are more than 5% level of significance and it is failed to reject the null hypothesis therefore there are no significance difference between the performance of the banks and those ratios while determining the management efficiency.

Ratios relating to earning capacity of the banks are important tools which helps to find the capabilities of the banks in earning consistently. These tools would give an indication of consistency and customers' reliability for future growth and sustainability. A return on total assets ratio of Bank Dhofar has secured first place with the average value of 1.6250 while Bank Muscat has secured fifth place with the value of 0.6258. Higher the ratio would convey better income generating capacity of their respective assets and better management efficiency for taking future decisions. Interest income is the main source of revenue for every financial institution and the higher the interest income out of the total income indicates better handling of funds in lending services. Bank Muscat has made the value of 86.4477 whereas Oman Arab Bank secured least income value of 69.5714. In the same way net interest to total assets ratio reflects the interest generating capacity of the bank on using their total assets. Oman Arab bank has secured 5.5676 which is highest average and Bank Muscat has secured least on the ratio of net interest income to total assets with the value of 0.8855. It is also observed that Oman Arab Bank has secured with the least average and Bank Muscat has secured last position with the maximum average value.

Hypothesis H_0

There is no significant difference between the performance of selected Banks in Oman and Earning Capacity.

Return on total assets ratios shows p values of 0.0022 and interest income to total income ratios which shows p values of 0.0049 and net interest to total assets ratio which shows p values of 0.0002. From the calculations it is found that the p values are less than 5% level of significance, therefore the null hypothesis is rejected which shows there is much difference between the performance of the bank and earning capacity and the performance of the bank. Liquid Assets to total assets ratio shows the strength of the bank on meeting their financial responsibilities. The percentage of liquid assets to total assets depict the overall liquidity position of the bank. Bank Dhofar has secured 17.9188 with the top position and Ahli Bank with the values of 5.1150 as the least value in dealing their assets into liquidity. Liquid assets to total deposits shows the liquid funds available for the deposits of the bank. Bank Muscat has secured the top position with the value of 24.9865 whereas Ahli Bank secured least value of 7.5405. Loans to deposit ratio and loans to assets ratio shows the percentage of funds used more efficiently in generating interest income out of the deposits and total assets respectively. Bank Muscat has secured 1.2901 whereas Oman Arab Bank has secured 0.9294 while calculating loans to deposits ratio. Ahli Bank has secured 81.7559 with the highest value whereas Bank Muscat secured 38.5000 while calculating loans to total assets ratio.

Cash ratio reveals the funds available at the bank against its total deposits. It is the percentage of money that every bank might have available out of the total funds contributed by the customers as deposits. The calculations shows that the bank Dhofar has secured the top rank with the cash ratio of 19.2959 and Ahli Bank has secured last in the rank with the value of 7.5405. Bank Dhofar has secured first place with least average and Bank Sohar has secured last position with lowest average.

H_0: There is no significant difference in performance of selected banks in Oman measured by Liquidity ratios. Loans to total assets ratio shows the p values of 9.1438 which fails to reject he null hypothesis which means there is no significant difference between the loans to total asses ratios to liquidity. The rest of the ratios under liquidity has p values of 0.0004 for Liquid Assets to Total assets, p values of 0.0006 for liquid assets to deposits ratios and p value of 0.0010 for loans to deposits ratio and p values of 0.0481 for the cash ratios. All the ratios shows p values of less than 5% level of significance which reject the null hypothesis. Therefore there is difference between these ratios and the liquidity position.

Conclusion

It is fact that the banking industry was forced to carry many changes in terms of their quality services to the customers and campaigning their hi-tech services to the world wife to attract the new customers in the market and to retain the existing customers with their best services. The performance of the banks have been analyzed by taking the CAMEL Criterion as the base and results have been incorporated according to the analysis. The composite rating of overall performance of the selected banks taken for the study, it is found that Ahli Bank has secured the top position with the least average of 2.51 followed by Bank Muscat with the average of 2.56 and Bank Dhofar with the average of 2.83. It is also identified that Oman Arab bank has secured highest average value of 3.30 which secured the last position in the CAMEL criterion.

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