

PERFORMANCE ANALYSIS OF OMAN'S BANKING SECTOR USING SELECT FINANCIAL INDICATORS

Ramanadh Kasturi*

Abstract *During the last decade, the banking sector of Oman has shown consistent growth despite the global financial crisis. The growth is likely to continue amid fluctuating oil prices and other threats affecting the global economy and the Middle East. Sultanate of Oman is a member of GCC in the Middle East, chiefly an oil-exporting country and expanding the non-oil sectors as an alternative to meet the economic growth and development. The financial system of the economy is pre-dominantly supported by banking sector, which holds more than 90% of total assets in the system featured with dominance of domestic private sector banks with a considerable stake of the government. This paper is intended to study the financial performance of banking sector of Oman during 2007-16 as an initial study to understand the performance of the sector, and to identify and explore the possibilities for further research using selected measures of financial performance.*

Keywords: *Performance, Banking Sector, Oman, Select Indicators*

INTRODUCTION

Financial services of an economy help in exchanging the funds between borrowers and lenders. The size and importance of the organized financial-services sector depends on the level of domestic savings and their movement towards various sectors, which require funds for expansion and growth. There exists a strong relationship between financial intermediation and per capita income (Bogdan DIMA et al., 2013)¹. Studies on the impact of financial intermediation on economic growth revealed that there is a positive association between the both.² Sultanate of Oman is in northeast of Middle-East Asia with a population of 2.52 million with GDP growth rate 5.7% at constant prices. The country has achieved a rank of 52 in Human Development Index and recorded with a per capita income of US \$15,645 at the end of 2015. Domestic savings of the economy stood at 39.46% of GDP at the end of 2015.

The domestic savings as a proportion of GDP in Oman have been fluctuating over a decade, and are registering negative growth in some recent years. The average annual growth rate in domestic saving was found to be 5.6% between 2007 and 2015. During the study period, Oman economy has shown 7.5% average annual growth rate in GDP at Current Market Prices with 38.7% average contribution of services sector to GDP at current market prices and the contribution of financial intermediation was accounted for 4.4%. The services sector

has recorded an average annual growth rate of 10.7% with a CAGR of 11.8%. The year 2009 has registered a spectacular growth of 39.6% in services sector. In the same year, financial intermediation has grown by 64.1%. The average annual growth in the financial intermediation services were found to be at 12.5% with a CAGR of 13.9%.

LITERATURE REVIEW

Relationship between financial intermediation and economic growth has been an important area in economic research and several studies have been made to find the extent and dimension of its impact on economic growth (Bogdan DIMA et al., 2013). Abdulla Al-Hassan et al. (2010) noted that the banking sector of Oman is the smallest in Gulf region that accounts for 66% of GDP and is a highly concentrated wherein the top three banks hold more than 65% of the assets in the sector and the share of foreign banks is 12%. Growth in bank credit was low during 2003-08, hovering around 20%. The banking sector is highly exposed to household sector with 40% concentration of credit to the sector. Macroeconomic, prudential, and institutional variables have a bearing on the efficiency of financial institutions (David A. Grigorian et al., 2002). Well-capitalized banks are likely to generate better efficiency and higher rates of intermediation. They contradicted the conception that prudent norms are detrimental to efficiency identifying specific measures of

¹ Bogadan DIMA et al., Financial Intermediation and Economic Growth, The Journal of Economics and Business V6, Issue 20, pp. 127-138.

² Ross Levine et. al., Financial Intermediation and Growth: Causality and Causes, Journal of Monetary Economics, 46(2000), pp. 31-77, Elsevier Science B.V.

* Lecturer, Department of Business Studies, Salalah College of Technology, Salalah, Sultanate of Oman.
Email: ramanathkasturi@yahoo.com

performance in support of their contradiction. They found that privatization of banks did not significantly improve the efficiency of banks. Exogenous components of financial intermediation positively associated with economic growth (Ross Levine et al., 1999). Their study suggests that specific legal and accounting reforms can influence financial intermediary development and thereby accelerate economic growth. Smitha Roy Trivedi (2015) examined the impact of innovation and diversification in non-interest income on the profitability of banks. Her study identified significant difference in income generation and profitability in private sector banks and foreign banks from public sector banks due to diversification from interest income. A study on fundamental analysis of the health of banking sector during the past decade can be worth understanding the performance trend and identifying the areas for improvement.

METHODOLOGY

The study uses simple averages, average annual growth rates, and compound annual growth rates to analyze the data

mainly collected from the data available from the Central Bank of Oman (CBO) and the National Center for Statistic and Information.

PERFORMANCE INDICATORS OF BANKING SECTOR DURING 2007-16

Banking comprises 94% of the country's financial system in terms of its assets and there is a scope for improvement in the contribution of non-banking financial services in the economy. Banking sector of the economy is featured with dominant seven domestic banks along with the presence of nine foreign banks. The network of local banks had 470 branches operating within the country and five branches and two representative offices abroad.³ Six out of seven conventional banks are listed in the Muscat Stock Exchange signifying that they are operating as widely held companies and have great space for enhancement in terms of capital and asset expansion. All these banks are operated in the private sector with a minor stake of the government.

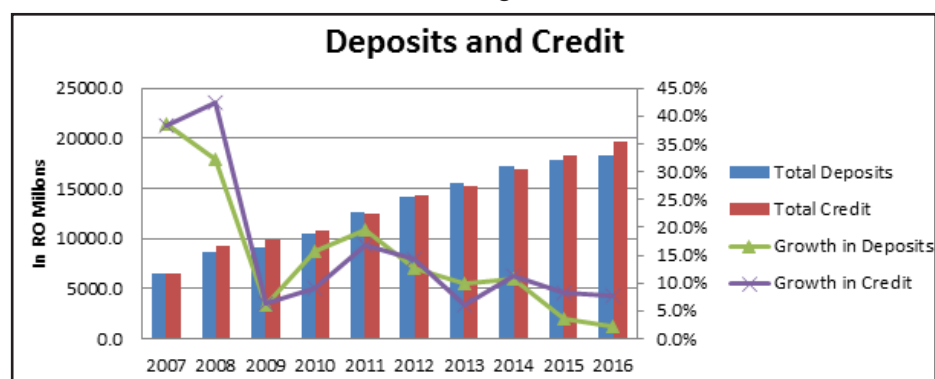


Fig. 1: Deposits and Credit

The deposits of the banks have grown from RO 6.49 bn to 18.25 bn and the credit has grown 6.5 bn to 19.7 bn. The average annual growth rates in deposits and credit were noticed at 66.3% and 67.8%, respectively. This growth outnumbers the growth of banking sector in many developing and fast-growing nations. Credit comprises 68% of total assets followed by securities with 11.8%. Growth rates in deposits and credit have been declining over the period and the growth in deposits was less than the growth in credit in recent years. These indicate a need for banks to promote their deposit products to meet the demand for credit.

Credit-deposit ratio (CD Ratio) of the commercial banks during most of the years was more than 100%, signifying a greater demand for credit and growth than savings. This could result in low liquidity and provisioning from capital or earnings of banks for liquidity as well as credit risk. A CD ratio of 80–90% is suggested to accommodate the contingencies and the risks in intermediation. There is a potential for higher growth in the economy than has been realized over the years.

Cash, deposits with CBO, and dues from banks abroad show the strong liquidity position of the sector.

³ CBO Annual Report 2016

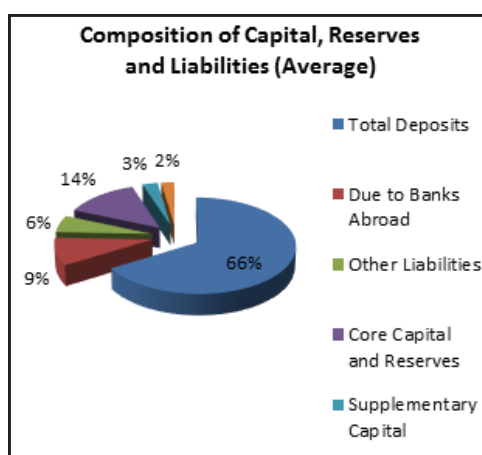


Fig. 2: Composition of Capital, Reserves and Liabilities

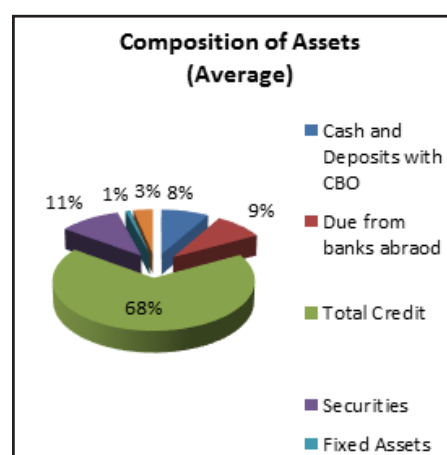


Fig. 3: Composition of Assets

The sources side of the banking sector revealed 66% of liabilities in terms of deposits in the sector followed by 14% of core capital and reserves. The CDR of the sector was greater than 100% except for the years. It is worth noting

that the commercial banks in Oman do maintain a higher capital adequacy ratio than the prescribed ratio as per Basel III norms and the norms set by the CBO.

PERFORMANCE OF THE COMMERCIAL BANKS.

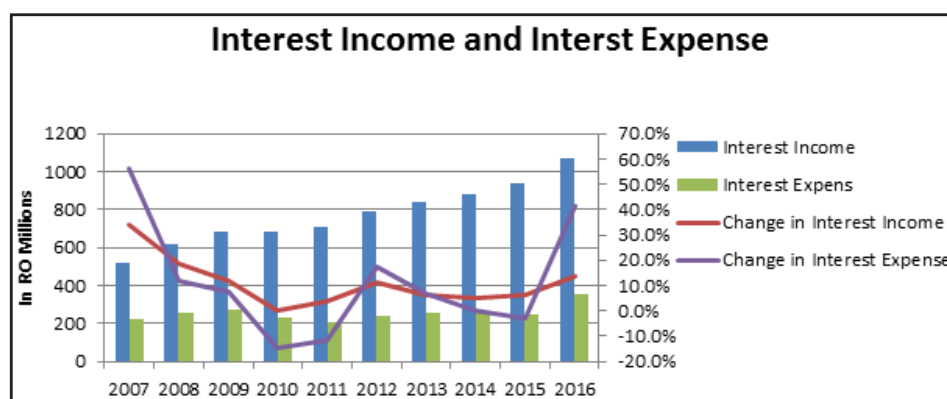


Fig. 4: Interest Income and Interest Expense

The commercial banks of Oman have shown a steady performance during the decade in spite of oil price shocks. The ratio of net interest income to gross income varied from 59.9% to 67.7% with an average of 64.4% during the study period. Net interest income makes nearly two-thirds of the gross income of the banks. Net interest income of the banks has registered an average annual growth rate of 11.6% and a CAGR of 10.5%.

Composition of gross income of the banks shows that interest income makes an average of 64.4% followed by 22.8% income from securities and others, 8.2% fee-based income, and 4.6% income from foreign exchange transactions.

This data indicate that there is a need for innovation in the banking sector of the economy to raise its fee-based income through diversification of services to the extent these are practical and economical in the economy. Innovation with an aim to increase the fee-based income, albeit being a panacea for mitigating the banking risks, can certainly help the banks to improve their profitability.⁴

On the other hand, interest expense marks up to an average of 33.7% to interest income. Interest expense to interest

⁴ Smita Roy Trivedi, Banking Innovations and New Income Streams: Impact of Banks' Performance, Vikalpa 40(1), pp28-41, SAGE Publications.

income ratio has declined from 43.6% to 33.1%. Interest expense has been found with an average annual growth rate of 11.1% and a CAGR of 8.4%. In 2010, the growth interest expense was almost zero and less than 5% growth has been noticed in the years 2011 and 2014.

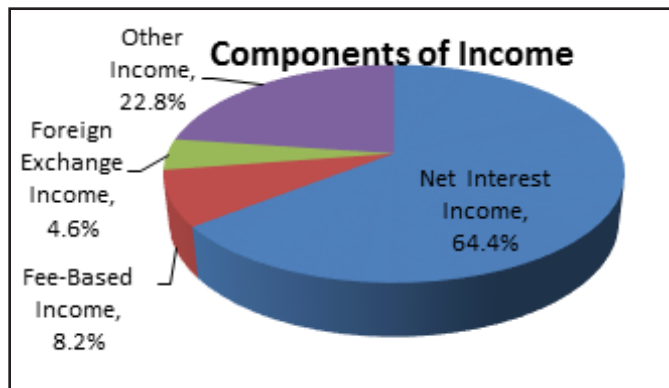


Fig. 5

Operating expenses to gross income varied from 38.7% to 44.5% with an average of 41.9%. These have grown at average of 13.4% annually and the CAGR was found to be 11.1%. It is worth noting that the increase in operating expenses is rising sharper than the growth in interest income and gross income.

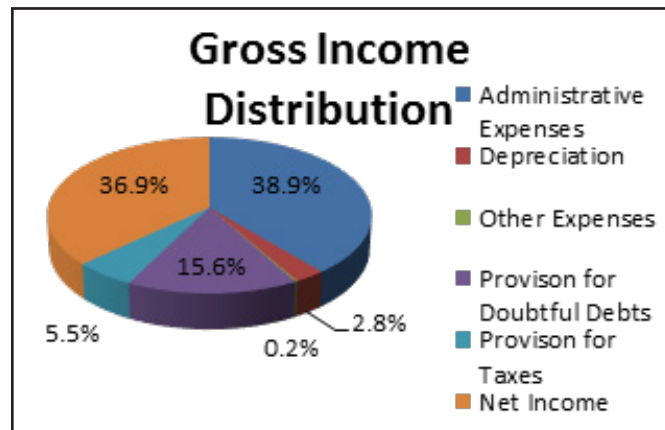


Fig. 7

The net interest margin of the banks was found to be declining, varied from 4.5% to 3.6%. A sharp fall in the year 2008 was followed by a consistent decline from 2009 onwards.

There is a concern for squeezing of net interest margin and rising operating expenses of the banks over the period of observation.

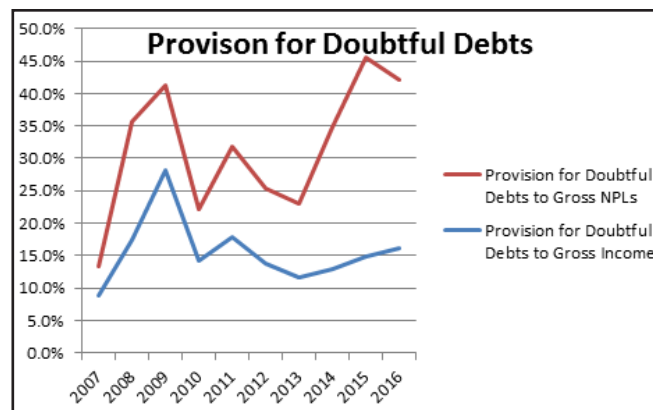


Fig. 8: Provision for Doubtful Debts

Shadowing the growth in quantitatively measurable fundamentals, the quality of growth is a concern for the sector. The study reveals that provision for doubtful debts has been rising. The average annual growth rate in such provisions was found at 24%. Banks have increased their provisions against doubtful debts considerably as a measure of credit risk management and these resulted in sharp rise in provisions from 2014 onwards.

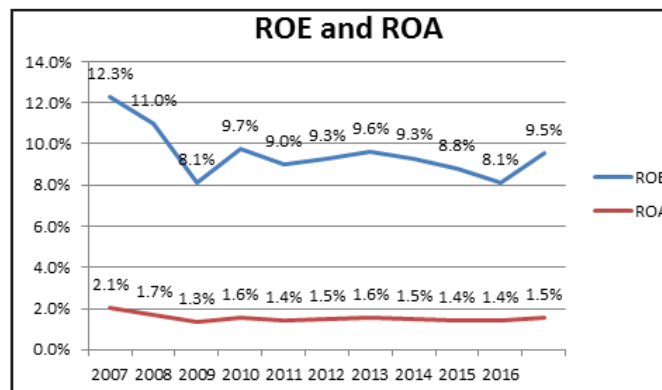


Fig. 9: ROE and ROA

*ROE is calculated as a ratio of Net Income to sum of Core capital and Supplementary Capital

The return on equity (ROE) has varied between 12.3 and 8.1% until 2014 and there is an overall decline in ROE during the period of observation. The decline in ROE is due to raising operating expenses and provisions for doubtful debts. However, the growth in operating expenses has significantly slowed down in recent years while the provision for doubtful debts was fluctuating from year to year. The growth in total capital was found at an average of 17.6% per annum while the growth in net income was found to be 9.7%. If the trend continues, ROE can be weaker in the forthcoming years. Return of Assets (ROA) has declined from 2.1% to 1.5%

during the period. Assets in the sector have grown at an average of 14.8% per year. Except for a decline in the year

2016, the whole period has seen an increase in total assets of the banks.

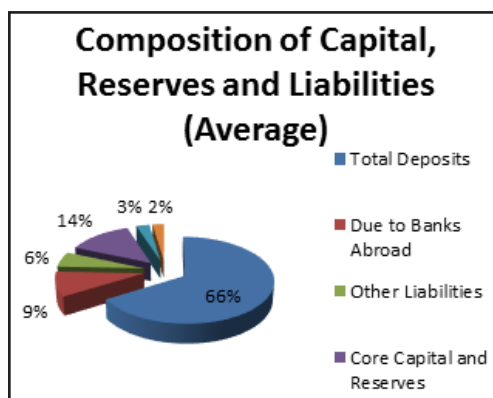


Fig. 10: Composition of Assets

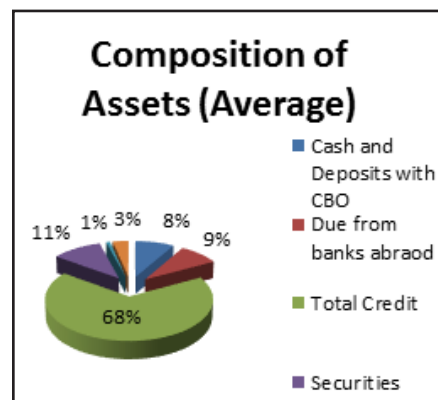
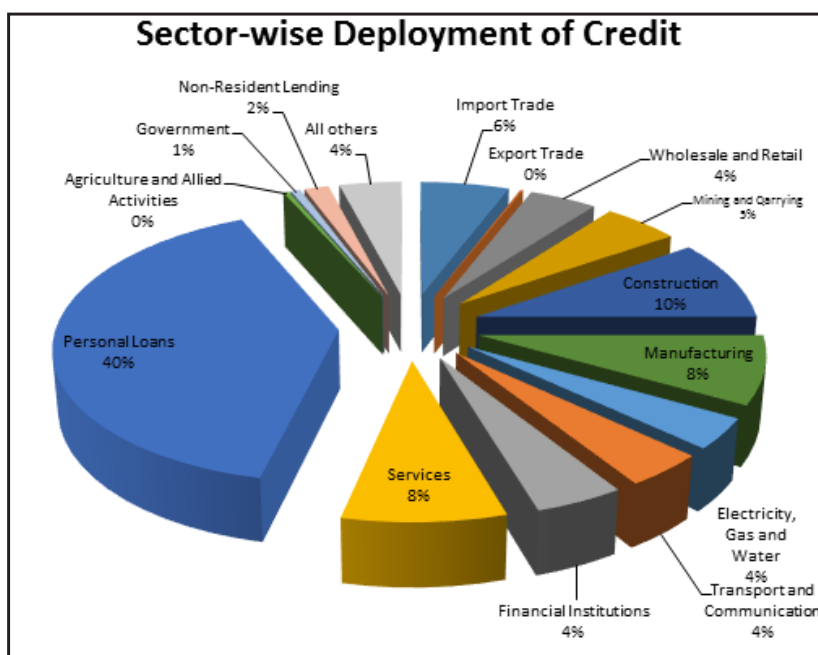


Fig. 11: Composition of Capital and Liabilities

Credit comprised 68% of total assets followed by securities with 11%, cash and deposits with CBO with 8%, signifying sufficient liquid assets. Capital and liabilities revealed 66% of deposits in the total followed by 14% core capital and reserves, and 3% supplementary capital. A further analysis of maturity profile of the bank loans is required for examining the liquidity risk of the banks.

Analysis of bank credit to various sectors during the study period revealed that majority of the bank credit is provided

to personal needs, which may also include the loans for small entrepreneurs who operate as family-owned businesses in various sectors of the economy. Other major sectors for bank credit include construction 10%, services 8%, manufacturing 8%, import trade 6%, and mining and quarrying 5%. These sectors attract nearly 77% of the bank credit and the each of the remaining sectors attracts less than 5% of bank credit totaling to 23% of the bank credit. These figures indicate low penetration of bank credit in manufacturing and services sectors.



The average annual growth of credit to various sector was calculated from the data, which reveals that government sector, transport and communication, non-resident lending,

construction, mining and quarrying, and service sectors are growing faster than other sectors in terms of bank credit.

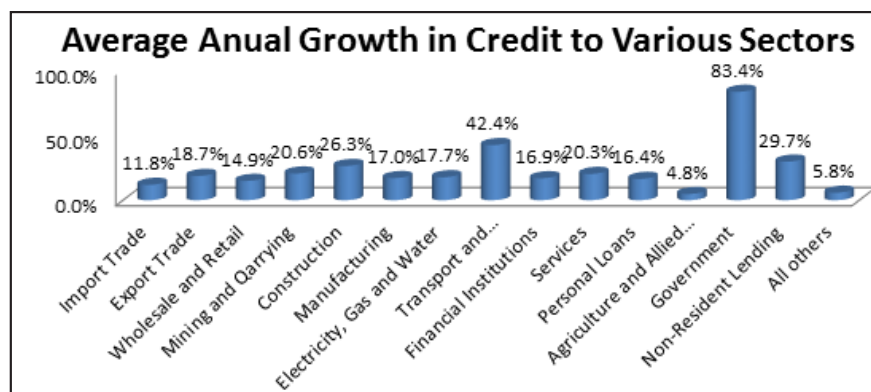
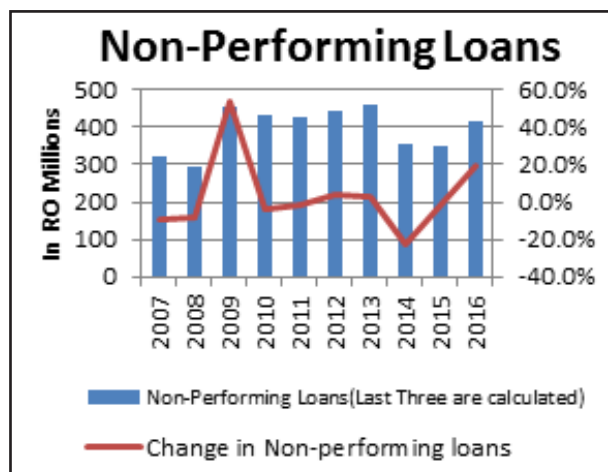


Fig. 13: Growth in Credit to Various Sectors

The amount of non-performing loans in the sector varied between RO 294 million and RO 458 million during the period. Both the NPLs and NPL ratios remained low compared to international standards according the Financial Stability Report 2013. There was a mixed trend in the growth of NPLs where some years have shown a decline. The average annual growth in NPLs was found at 3.2%. Years 2009 and 2016 have registered highest growth rates in NPLs with 54.1% and 18.9%, respectively. A sharp decline was noticed in 2014.

To improve the situation, it was suggested that there is a need for credit-rating agency in Oman for assessing the credit worthiness of retail borrowers. This can help in mitigating the un-systemic credit risk in lending for the banks. The net NPLs have shown a decline over the period due to provisioning, and comprise 2% of banks' capital, pose no serious threat to the sector.



Gross NPLs as a percentage of gross loans varied between 1.9% and 3.5%. The average NPLs for the study period was found at 2.5%. Year-on-year changes in the in GNPLs were stable during 2010-2013 declined during 2014 and have seen a sharp rise in later years.

SUMMARY FINDINGS

- Assets in the banking sector have grown at an average of 14.8% per year with a compound annual growth rate of 11.3%.
- Deposits of the banks have grown at an average of 15.1% and with a CAGR of 12.2%.
- Bank credit has grown at an average 16% per year with a CAGR of 13.1%.
- Banks maintained an average credit-deposit ratio of 102%.
- Interest income has increased at an average of 11.1% per year and with a CAGR of 12%. Interest income has been found to be volatile.
- Operating expenses are growing at an average of 13.4% with a CAGR of 11.1%. The growth in operating expenses is sharper than the interest income and gross income.
- Asset quality remained intact with an overall decline in gross NPL ratio to gross loans during the period.
- Growth in interest income slowed in the middle of the period and growth in interest expense hindered in recent years expect for the year 2016.
- Net interest to gross income ratio was found at an average of 64.4%.

CONCLUSIONS AND SUGGESTIONS

The banking sector of the economy is found to be resilient and well managed in spite of global financial crisis and oil-price shocks. Non-performing loan losses are being controlled well even in the absence of credit information bureaus and credit-rating agencies for personal loans. Banks have maintained sufficient provisions for non-performing loan losses and the profitability is moderate. Operating

expenses and provisions for doubtful debts have been rising squeezing the net income of the banks. As a result, the ROE and ROA have been decreasing. Nearly two-thirds of the gross income for banks is derived from net interest and there is a need to innovate to improve earnings from fee-based services. Banks need to evolve methods to compete with non-bank exchanges to tap the potential market.

High exposure to personal loan sector, which is more profitable and more risky, is a concern but the data available could not identify the proportion of loans being made for consumption and entrepreneurial needs of individuals who run their family business. Growth in deposits has hindered and less than the growth rate in credit, which may lead to liquidity problems in the years to come. Efforts to rise the deposits by banks through various schemes are commendable and may ease the liquidity position. Banks may actively involve in identifying opportunities for entrepreneurship in emerging sectors of tourism and non-oil export-oriented manufacturing and trade activities and encourage innovations in existing businesses of other sectors.

REFERENCES

- Dima, B., & Opreș, P. E. (2013). Financial intermediation and economic growth. *Timisoara Journal of Economics and Business*, 6(20), 127-138
- Sahoo, S. (2014). Financial intermediation and growth: Bank-Based versus market-based systems. *Margin: The Journal of Applied Economic Research*, 8(2), 93-114. Sage Publications.
- Al-Hassan, A., Khamis, M., & Oulidi, N. (2010). The GCC Banking Sector Topography and Analysis, IMF working paper on Monetary and Capital Markets Middle East and Central Asia Departments, April 2010.
- Grigorian, D. A. (2002). Determinants of Commercial Bank Performance in Transition: An Application of Data Envelopment Analysis, World Bank Policy Research Working Paper 2850, June 2002.
- Levine, R., Loayza, N., & Beck, T. (2000). Financial intermediation and growth: Causality and causes. *Journal of Monetary Economics*, 46(2000), 31-77. Elsevier Science Publication, 31-77.
- Trivedi, S. R. (2015). Banking innovations and new income streams: Impact on banks' performance. *Vikalpa*, 40(1), 28-41. IIM Ahmedabad.
- Siddik, M. N. A., Kabiraj, S., & Joghee, S. (2017). Impact of capital structure on performance of banks in a developing economy: Evidence from Bangladesh. *International Journal of Financial Studies*, 1-18.

	Cash and Deposits with CBO	Due from banks abroad	Total Credit	Securities	Fixed Assets	Other Assets	Total Assets/ Liabilities	Total Deposits	Due to Banks Abroad	Other Liabilities	Core Capital and Reserves	Supplementary Capital
2007	666.7	1350.2	6505.4	1401.5	73.8	338.0	10335.7	6491.4	1110.5	776.2	1458.2	282.7
2008	1430.4	1604.6	9256.7	996.9	99.2	390.6	13778.4	8579.2	1920.3	918.1	1801.0	333.7
2009	779.4	1393.5	9834.4	1814.9	110.5	266.2	14198.9	9090.7	1767.9	707.1	1906.5	444.9
2010	1520.3	1173.5	10724.3	1471.4	177.2	581.0	15647.7	10516.8	1201.6	934.2	2116.6	427.1
2011	978.9	1794.8	12514.9	2200.0	180.7	738.3	18407.6	12573.3	1433.2	992.7	2302.7	636.0
2012	1568.0	1889.5	14319.6	2133.5	176.5	768.6	20855.7	14171.7	1687.4	1179.1	2712.8	572.5
2013	1537.7	1876.7	15177.4	2550.3	189.0	1024.5	22355.6	15586.2	1352.0	1214.6	3009.0	633.1
2014	1979.0	1826.5	16898.4	2912.9	209.7	994.9	24821.3	17278.9	1547.4	1502.4	3244.2	651.4
2015	4057.1	1717.9	18315.7	3046.8	216.6	835.1	28189.2	17873.0	3809.0	1389.6	3765.7	707.6
2016	2511.0	1400.4	19704.6	2433.6	225.3	776.9	27051.8	18253.7	1935.8	1487.1	4068.0	617.7

Source : Annual Reports of CBO

Appendix 2: Combined Income Statement

	Interest Income	(Interest Ex-pense)	Net Interest	Foreign Exchange Earnings	Fees and Commissions	Other Income	Gross Income	Operating Expenses	Administration	Depreciation	Others	Gross Profits	Provision for doubtful debts	Profits after provisions	Provision for Taxes	Net Profit after Provisions & Taxes
2007	517.2	225.3	291.9	19.0	36.2	128.3	475.4	183.8	171.9	10.5	1.4	291.6	42.6	249.0	35.3	213.7
2008	614.4	252.4	362.0	25.7	50.3	166.6	604.6	226.3	212.0	14.2	0.1	378.3	104.9	273.4	39.3	234.1
2009	685.5	271.0	414.5	25.1	52.4	170.4	662.4	248.6	230.3	18.1	0.2	413.8	186.5	227.3	36.5	190.8
2010	685.8	231.3	454.5	39.6	54.4	123.0	671.5	292.5	270.0	22.3	0.2	379.0	95.7	283.3	35.6	247.7
2011	711.3	204.5	506.8	29.6	60.5	167.5	764.4	326.4	294.6	26.1	5.7	438.0	136.0	302.0	38.0	264.0
2012	789.7	240.3	549.4	34.9	59.5	176.1	820.0	359.6	330.4	25.5	3.7	460.3	113.5	346.8	41.5	305.3
2013	841.1	256.5	584.6	34.3	64.5	223.4	906.8	399.6	370.4	28.0	1.2	507.2	105.6	401.6	50.3	351.3
2014	881.2	257.0	624.2	47.7	83.3	208.8	964.1	428.6	400.9	27.3	0.4	535.5	124.0	411.5	48.6	362.9
2015	936.3	250.07	685.6	59.6	104.9	219.3	1069.4	465.9	437.1	27.9	0.9	603.5	158.8	444.7	51.3	393.4
2016	1067.3	353.2	714.1	64.2	98.0	207.8	1084.1	472.6	441.9	29.5	1.2	611.5	174.4	437.1	57.8	379.3

Source: Annual Reports of CBO

Appendix 2: Sectoral Deployment of Bank Credit

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Import Trade	505.4	655.3	558.7	637.9	608.2	765.6	684.4	873.1	1078.6	1146.00
Export Trade	26.9	24.5	8.7	11.5	16.8	26.1	64.2	25	13.8	13
Wholesale and Retail	238.4	423.9	582.1	598.8	646.6	674.4	629.8	647.2	631.9	675.7
Mining and Quarrying	396.7	459.7	552.1	579.1	734.3	747.3	584.5	719.4	808.4	902.7
Construction	376.2	809.7	896.1	1078.1	1215.7	1347.8	1480.1	1771.9	2089.4	2274.8
Manufacturing	623.3	858.1	766.6	853.1	962	1035.7	1226.9	1431.1	1458.1	1523.7
Electricity, Gas and Water	176	202.3	275.3	340	434.3	666.1	772.7	826.7	758.3	792.3
Transport and Communication	55.5	158	161.2	264.5	720	798.5	1009.1	1134.5	999.9	782.4
Financial Institutions	277.3	446	407.5	456.9	511	612.2	672.5	712.4	920.7	1007.3
Services	370.6	707.6	802.9	959	1051	1265.9	1288.8	1437.5	1500.8	1689.4
Personal Loans	2599.7	3569	4009.8	4284.7	5027	5804.4	6080.9	6655.5	7333.8	7898
Agriculture and Allied Activities	40.6	42.4	42.1	40.6	35.9	49.2	45.6	53.8	57.6	57.4
Government	239.5	28.2	71.8	47.9	32.9	31.3	18.4	21.7	12.1	107.3
Non-Resident Lending	169.6	188.4	188.7	197.3	221.7	174.3	165.8	199.6	192.5	261.8
All others	609.7	683.6	510.8	374.9	297.5	320.8	453.7	389	459.7	572.9
Total	6505.4	9256.7	9834.4	10724.3	12514.9	14319.6	15177.4	16898.4	18315.7	19704.6

Source: Annual Reports of CB