Financial Performance of the State Sector Banks: A Comparative Study during the Conflict and Post Conflict Scenarios of Sri Lanka

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ABSTRACT

The purpose of this study is to compare the financial performance of the state sector banks during conflict and post conflict scenarios of Sri Lanka. The banking sector is one of the major service sectors contributing to the development of the country. Sri Lankan state banks can be divided into two major categories as commercial banks and specialized banks. Sri Lanka has two state commercial banks and few specialized banks. This study was initiated as a comparative study of financial performance of three leading state sector banks in Sri Lanka using ratio, descriptive and independent samples T-Test analysis in during conflict (years 2005 to 2009) and post conflict scenarios (years 2010 to 2013). Ratio and descriptive analysis are widely used for measuring and comparing the financial performance and position of banks. Accordingly, though some ratio analysis confirmed that state banks have recorded higher performance in post conflict period compared to the during conflict period most of the ratio analysis didn't support for this conclusion. The findings indicate that the state banks need to introduce more competitive and attractive strategies to capitalize post conflict opportunities and better achievements.

KEYWORDS: Financial Performance, State Banks

INTRODUCTION

Today, banks are playing a major role of the financial system of all the countries. Sri Lanka has two types of banks as state and private banks. State banks again can be divided into two major categories as commercial banks and specialized banks. All the financial companies and banks are monitored by the Central Bank of Sri Lanka. Commercial banks provide varieties of services like attractive deposit accounts namely fixed deposits, saving accounts, current accounts, pawning, loans, leasing etc. while specialized banks are licensed to conduct specialized banking businesses and are not authorized to accept demand deposits and deal in foreign currency. Banking sector is contributing a significant amount to the economic growth of the nation. This is because of the end of the conflict provided enormous opportunities for private and public sector to serve and do their business with 20 million of population. As a result, country's gross domestic production has reached to eight percent during the recent past years. However, there is a lack of studies investigating state banks' performances in post conflict period to identify their achievements. Therefore, this study aims to analyze and compare the financial performances of state banks during conflict and post conflict situation of Sri Lanka representing the period of 2005-2013.

LITERATURE REVIEW

An efficient financial intermediation is a prime requirement for a country's economic development. Said and Tumin (2011) attest that the banks, as the critical part of financial system, play a vital role in a country's economic development. World Bank, 2003, (cited in Seelanatha, 2010) revealed that the banking industry, which holds approximately 60% of the total financial assets, is the main intermediary in the financial services sector in Sri Lanka.

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Bank performance is the bank profitability and productivity in banking (Jeon and Miller, 2006). Various studies identified the determinants of profitability. Financial performance was measured through profitability ratios such as Gross Profit ratio, Net Profit ratio, Return on Equity (ROE) and Return on Assets (ROA). This measurement comply with the studies of Velnampy (2013).

Mian (2003) confirms the underperformance of government banks in developing countries by studying commercial banks in 100 emerging economies. Micco et al. (2007) demonstrates that government banks in developing countries tend to be less profitable compared to their private counterparts; however, this phenomenon does not exist in industrialized countries.

In the context of Sri Lanka, Seelanatha (2010) made an attempt to investigate the performance of Sri Lankan banks measured in terms of technical and scale efficiencies during 1984-2004. Additionally, Wanniarachchige and Suzuki (2010) have assessed the cost efficiency of Sri Lankan banks and the effect of competition on performance.

However, review of literature shows that there is lack of studies in investigating performance of state banks in post conflict period. End of the conflict provided enormous opportunities for the private and public sector to serve and do their business with 20 million of population. Country's gross domestic production reach to eight percent during the recent past years. However, very few studies being carried out investigating opportunities, contribution and performances of state banks after ending the years' long conflict of the country, thus this study aimed to fill this knowledge gap.

METHODOLOGY

This research selected three leading state banks of Sri Lanka. A nine years period (2005-2013) has been selected for the study. The study used annual income statements, statements of financial position and relevant reports of the banks to extracted required data for the above mentioned financial years. State banks' financial statements are audited by the Auditor General of Sri Lanka. So these data are accurate and reliable.

In this study, data are analyzed by employing ratio analysis, graphs, descriptive statistics, independent samples T-Test and non parametric alternative (Mann Whitney U Test). Statistical Package for Social Science (SPSS) 16.0 version was used in order to analyze the data and draw the conclusion.

Following are the hypothesis examined in the research.

H_1: There is a significant mean difference between the profit per employee of state banks during the conflict and post conflict periods.
H_2: There is a significant mean difference between the cost to income ratio of state banks during the conflict and post conflict periods.
H_3: There is a significant mean difference between the net interest margin of state banks during the conflict and post conflict periods.
H_4: There is a significant mean difference between the income growth ratio of state banks during the conflict and post conflict periods.
H_5: There is a significant mean difference between the Return on Assets ratio of state banks during the conflict and post conflict periods.
H_6: There is a significant difference between the Return on Equity ratio of state banks during the conflict and post conflict periods.

DATA COLLECTION AND ANALYSIS

The following section presents the result of data analysis in graphical form and at the end outcome of the hypotheses testing are reported.

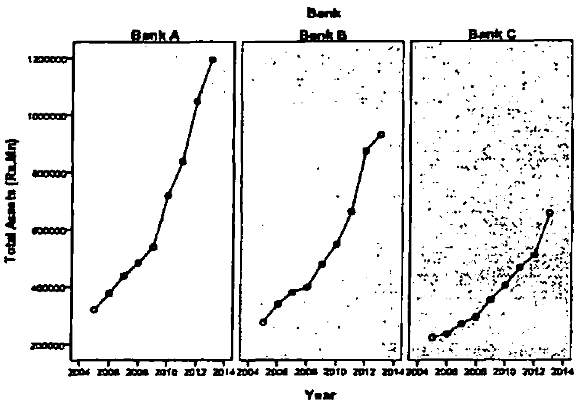

Figure 1: Comparison of Total Assets

Figure 1 shows the increases of total assets. It implies that all three banks have invested more funds in post conflict period.

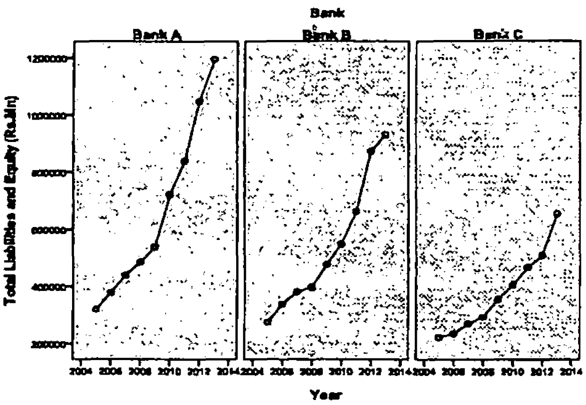

Figure 2: Comparison of Total Liabilities and Equity

Figure 2 shows that all the state banks have performed better in terms of total liabilities and equity in post conflict period.

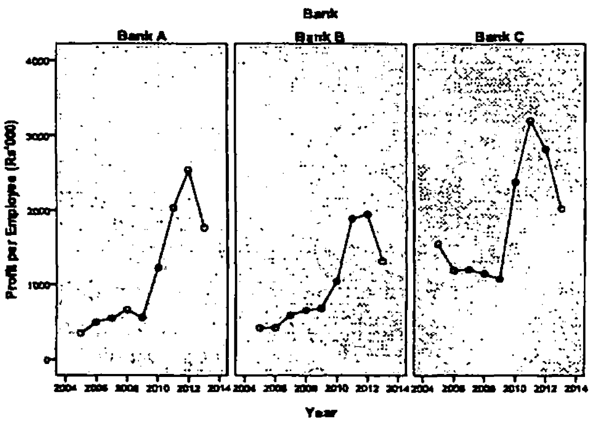

Figure 3: Comparison of Profit per Employee

Figure 3 implies that both Bank A and Bank B performed significantly better in the post conflict period but decrease the profit per employee ratio in 2013. Though Bank C performs well in first two years after the conflict, it has decreased the profit per employee in next two years. The increasing volume of the staff level or reduction in the profit could lead to these results.

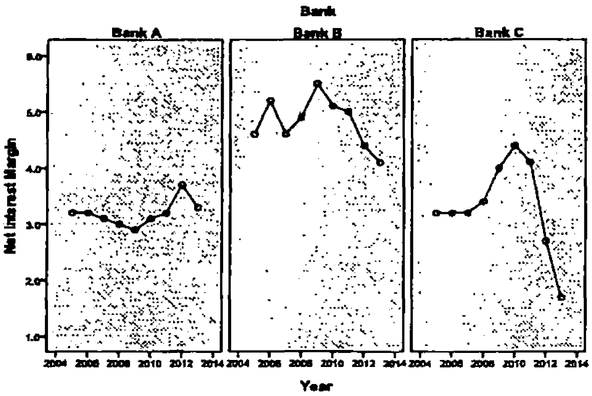

Figure 4: Comparison of NIM

The performance of banks is largely depending on the Net Interest Margin (NIM) for the year. As such, NIM is the net interest income earned by the bank on its average earning assets. Considering the Figure 4, bank C has reduced the NIM after 2009 means that it is not performing well in the post conflict period. Bank A has performed significantly well after the conflict while Bank B also hasn't perform well in that period. The decrease of the NIM of the banks in 2013 is due to the fact that Central Bank of Sri Lanka reduced the reverse repurchase rates and repurchase rates by 50 basis points in May and October 2013. Additionally, the decline in the current and savings accounts proportion of deposits also contributed to the decline in NIM.

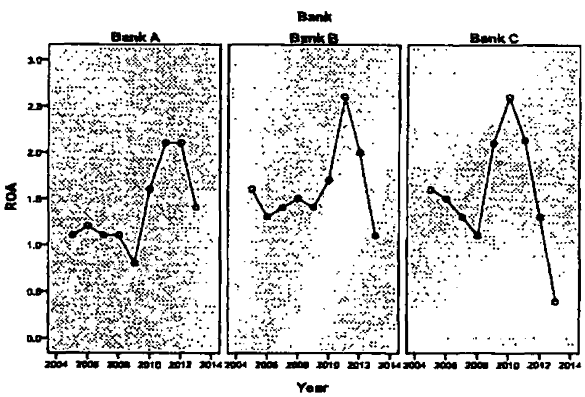

Figure 5: Comparison of ROA

According to Figure 5, it is clear that all the banks have shown a sudden increase of Return on Assets (ROA). The reason to that variation is the declining of the financial return though banks have invested more in after conflict period.

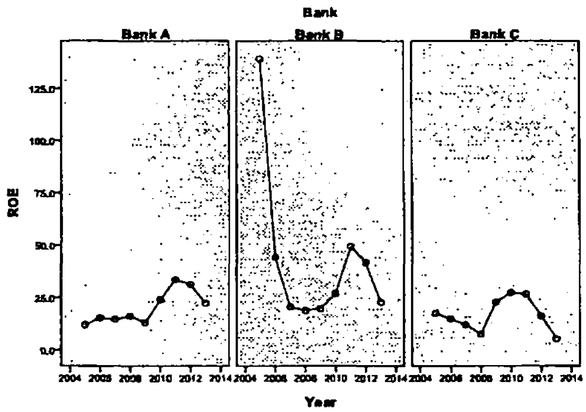

Figure 6: Comparison of ROE

According to Figure 6, all the banks have shown an improvement in Return on Equity (ROE) in years 2009 – 2011, but the ratio declines after 2011. It suggests that state banks have not performed well proportionate to the increasing volume of equity.

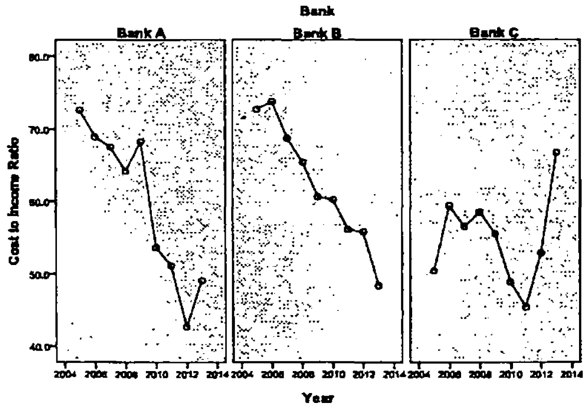

Figure 7: Comparison of Cost to Income

According to Figure 7, though other state banks have decreased the cost to income (CI) gradually, Bank C showed some increase. Its CI ratio is higher in post conflict period. That means their operating cost became higher in the recent past.

Figure 8 shows the income growth of the banks. The decline in the income growth of all the banks in years 2010-2011 may be due to the economic crisis of the world during that period. Income growth of Bank A and Bank B are remarkable in post conflict period but both the banks have decreased the income growth in year 2013. Bank C performed well after 2011 in this point of analysis.

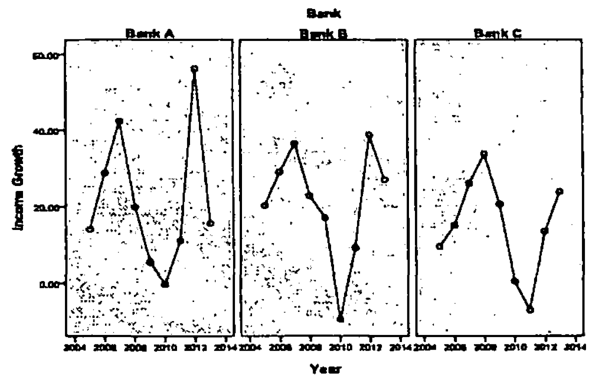

Figure 8: Comparison of Income Growth

Table 1 : Comparison of Average Annual Values

Variable	Bank	During conflict	Post conflict	Increase %
Profit per Employee (Rs.'000)	Bank A	522.4	1891.25	262
	Bank B	557.2	1550.5	178
	Bank C	1236.6	2610	111
	All three	772.06	2017.25	161
Cost to Income ratio	Bank A	68.3	49.15	-28
	Bank B	68.24	55.13	-19
	Bank C	56.06	53.48	-5
	All three	64.2	55.58	-13
Net Interest Margin	Bank A	3.08	3.33	8
	Bank B	4.96	4.65	-6
	Bank C	3.4	3.23	-5
	All three	3.81	3.73	-2
Income Growth	Bank A	22.18	20.75	-6
	Bank B	25.22	16.41	-35
	Bank C	21.11	7.78	-63
	All three	22.83	14.98	-34
ROA	Bank A	1.06	1.8	70
	Bank B	1.4	1.85	32
	Bank C	1.52	1.6	5
	All three	1.34	1.75	31
ROE	Bank A	14.16	27.75	96
	Bank B	48.48	35.15	-27
	Bank C	14.92	18.8	26
	All three	25.85	27.23	5

Table 1 shows the comparison of average annual figures of performance indicators examined. All the banks have increased ROA ratio and profit per employee by individually and collectively in after conflict period. But declining of the net interest margin suggests that compared to the increased volume of the average assets the banks have not financially performed well in the post conflict era. At the same time, declining of cost to income ratio of all the banks may be due to the technological advancements like ATMs. Income growth of the banks also shows a declining trend in post conflict period.

Table 2: Hypothesis Test Results

Variable	Bank	Sig. Value	Reject/Do not Reject H_o
Profit per Employee	Bank A	.001	Reject
	Bank B	.017	Reject
	Bank C	.009	Reject
	All three	.000	Reject
Cost to Income ratio	Bank A	.000	Reject
	Bank B	.007	Reject
	Bank C	.581	Do not Reject
	All three	.000	Reject
Net Interest Margin	Bank A	.108	Do not Reject
	Bank B	.319	Do not Reject
	Bank C	.803	Do not Reject
	All three	.827	Do not Reject
Income Growth	Bank A	.915	Do not Reject
	Bank B	.476	Do not Reject
	Bank C	.127	Do not Reject
	All three	.184	Do not Reject
ROA	Bank A	.019	Reject
	Bank B	.187	Do Not Reject
	Bank C	.861	Do Not Reject
	All three	.059	Do not Reject
ROE	Bank A	.012	Reject
	Bank B	.462	Do not Reject
	Bank C	.500	Do not Reject
	All three	.022	Reject

Table 2 presents the results of the hypotheses tests and it proves that there is a significant difference between the profit per employee (H_1 accepted) of state banks in the post conflict period compared to the during conflict period. This outcome is concluded without adjusting to the inflation. Cost to income ratio of the banks also improved significantly by individually and collectively except Bank C. However, the net interest margin (H_3 not accepted) which is the best performance indicator of the banks' financial performance or income growth ratio (H_4 not accepted) have not recorded significant progress individually or collectively in post conflict period. Performance indicators: ROA and ROE have not recorded a significant progress in post conflict period except Bank A. It suggests that only Bank A has performed significantly well in the post conflict era in terms of this point of analysis. Based on the above findings, it can be stated that the state banks have not reported a significantly well performances in most of these aspects in post conflict period compared to the during conflict period.

RESULTS AND DISCUSSION

As per country's banking sector results reveal that there is a boom in the banking sector after concluding the conflict and finding of this research support to state that this development is not mainly due to the performances of the state banks but private banks. This research reveals that state banks also perform considerably better in post conflict period in terms of profit per employee and cost to income ratio. But in terms of other financial ratios, banks have not performed significantly better in the post conflict period. For an example, not any state bank performs significantly better in the post conflict period in terms of net interest margin or Income Growth. Bank A performed well in ROA and ROE ratios but collectively state banks have not performed better in terms of these indicators.

It can be considered that technology and new investments played a better role for the state banks in post conflict period. Many internal and external facts may affect the performance of the state banks. This includes government policies and government decision on interest rates etc. Unlike private banks, state banks have to fulfill government objectives along with earning profits. So the administration of these banks has a great responsibility in balancing these objectives and performing well. It is recommended that state banks need to implement strategic plans to reduce the non-performing loans. Government also needs to play a significant role in major decision making to facilitate and provide opportunities to increase the performances of the state banks.

All three state banks covered in this research need to focus well in order to grab the benefits of new opportunities like expansion of the infrastructure developments of the former conflict zones, increased per capita income in recent period, technological advancements and ability to serve all 20 million citizen of the country etc. This research concludes that for the state banks to perform reasonably better in the post conflict period, there are lot of opportunities yet to be capitalized.

CONCLUSION

Based on the findings of the study, it can be concluded that state banks have performed better in the post conflict period than during conflict period in some aspects like profit per employee and cost to income ratio. Bank A has performed exceptionally well in terms of ROA and ROE ratios but other banks individually or state banks collectively didn't show such a progress. At the same time, independent sample t test results for financial ratios like net interest margin and income growth suggests that all these three banks have not performed significantly well in the post conflict period individually or collectively. So the state banks need to focus more on developing competitive strategies to capitalize post conflict opportunities in order to improve their financial performances while being the main contributors in the banking sector for country's development.

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