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Change Management in Financial Efficacy of Banks: Evidence from Oman

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Abstract: Banking and financial sector assume a crucial role in enhancing economic development. During 1990s, when GCC countries underwent major economic reforms, the private sector had to play a leading role by participating in the economic development activities such as designing and implementing private programs in which the private sector can significantly contribute. Since the role of private sector has expanded, their financial requirements have increased. This gap was largely filled in by the banking sector for capital market has not been so effective in the Gulf region. Thus, Banking sector reforms have forced the banks in Gulf region to be more focused on satisfying customers developing new operating models, defining new business strategies to achieve operational efficiency in the changing environment. When it comes to Oman, the banking system is sound and efficient. A major challenge being faced by the banks in Oman is to manage the operational and strategic changes that are increasingly taking place after 1990 when major economic reforms were introduced. Efficient change management is the driving and resisting force for achieving the bench mark target in all functions of banks. The purpose of the study is to measure the financial efficacy of commercial banks in Oman after 1990s in the process of their way of handling the changes.

Keywords: Change management, commercial banks, financial performance, profitability

INTRODUCTION

The financial system in Oman headed by the Central Bank of Oman comprises commercial banks, non-banking financial and leasing companies, insurance companies, pension funds, money exchanges and of course the capital market. Since the functions of capital market are not much efficient, the banks, playing a predominant role in strengthening the financial system in the country, account for 90% of the contributions of the financial sector as a whole. As of now, the Omani banking system consists of 17 commercial banks, of which seven are locally incorporated and ten are branches of foreign banks. In addition, there are two specialized banks operating in the country, one catering to development of projects and the other providing mortgage loans. Banks in Oman operate in a deregulated and competitive environment.

The financial systems in Oman primarily bank-based and capital markets are relatively underdeveloped. Since 1990s, several reform policies have been undertaken to liberalize financial markets, deregulate the banking sector, promote efficiency in the financial systems and achieve regional economic integration. Oman, after WTO has been committed, allow foreign ownership in business entity including banks up to 70%. Moreover, branches of foreign banks are also permitted. There are no restrictions on repatriation of profit or capital since Oman has an open capital account. Tax holidays are initially available for up to five years, which can be extended for a period of another five years in certain cases. The recent initiative of the government to tax uniformly both domestic and foreign companies would also benefit the banking sector. The banking system has evolved over the years with new dynamics brought about by globalization, liberalization and technological innovations. In Oman, the banking industry has been witnessing significant growth in recent years, mainly due to sustained increase in oil prices, efforts to diversify the economy, implementation of large industrial, real estate and infrastructure projects and growing emphasis on the private sector.

Total assets of the commercial banks in Oman have grown at an annual average rate of about 38% during the last five years. Banks credit during the same period has remained stable in the range of 65-70% of the total assets. There has been a steady decline in the gross non-performing assets as a percentage of the total assets from nearly 10% in 2004 to 2.1% in 2008, before rising marginally in 2009 due to cyclical downturn of the economy. System-wise capital adequacy ratio for commercial banks as a percentage of the total risk weighted assets remained at a satisfactory level of around 15% as against the minimum regulatory requirement of 10%.

Statement of the problem: Though the Omani banking system witnesses a steady growth in the recent past, it has to achieve its operational efficiency similar to that of its western counterparts. However, with the present institutional frame work of the financial system, the

growth of capital, debt and derivative markets is not possible in the future. The financial system remains bank-dominated. As banks have to operate with a thin spread, they have to improve efficiency, upgrade technology, train their manpower and above all, strengthen risk assessment as well as risk mitigation mechanisms. Traditional banking would give way to more and more electronic banking. The customer may like to purchase those services that meet his requirements in terms of privacy and secrecy.

The transformation of modern banking system from the traditional one provides tremendous business opportunities for the banks. However it also raises new challenges for banks and regulators. The Omani banking system was relatively less affected by the recent global financial crisis as there was no direct exposure to derivative products. This is not a positive sign of development of the financial system in a country. The Financial market has to be strengthened by introducing all possible financial products. Commercial banks have to understand the associated risks while dealing with such exotic financial products and operating in the complex financial markets. Regulations are to be fine-tuned from time to time depending on circumstances. Keeping these challenges in mind, an attempt has been made in this study to examine as to how strong the financial endurance of the commercial banks in Oman which would decide their ability to respond to the changes taking place in the global financial system.

Objectives of the study: The major objective of the study is to analyze the financial performance of the selected banks operating in Oman. The following are the specific objectives:

- To review the performance of banks in Oman
- To analyze the financial position of selected banks.
- To offer suggestions for improving the performance of the banks.

DATA AND METHODOLOGY

To accomplish the objectives of the study, secondary data were used. The data are collected from bank records, published and unpublished financial reports, journals, magazines and websites. The study covers a period from 2007 to 2011. The sample, drawn under convenient sampling, constitutes Al Ahli Bank, Bank Dhofar, Bank Muscat, Bank Sohar, HSBC Bank Oman and National bank of Oman. Financial performance of these banks is analyzed for a period of five years with the help of financial ratios and regression analysis.

REVIEW OF LITERATURE

Hong and Sung-Kyoo (1995) examine the performance of the Korea banks. The results of the study covering the period from 1988 to 1993 are compared with other banks in California, Asian banks. Comparison of results indicate that the Korean banks are relatively conservative in managing and lending operations and more actively involved in services for sales activities in SBA loans and international business. The analysis also indicates that the quantity of Korean banks' loan relatively low. The study recommends that the Korean banks have to build more active marketing strategy to expand and create their own market; consider tightening oversight of its operations with an understanding of banking systems and adopt a reliable policy in lending loans.

Michelle *et al*. (1997) analyze the performance of commercial bank in the United States in comparison to the banks in the rest of the world. Commercial banks failed in the United States since the great depression, while banks in most countries fared well. They found that the restrictions on branching resulted in a narrow and economically declining trend for banks growth in the 1980s and early 1990s. These restrictions are certainly one of the important reasons that guided U.S. banks to local economic distress. The goal of the research is to suggest how the legislation can be changed to change the future structure of the banking industry in the United States. The results confirm that the effect of branching restrictions on banking and market performance in the past is significant. The Data are collected from all insured U.S commercial banks for the period from 1980-1995.

Simon and James (1999) investigate the financial performance of the US banks in the situation of the merger and acquisition. The US banking industry has experienced rapid consolidation and integration of operations during the study period. The data are obtained from the merger file at the Federal Reserve Bank of Chicago, which contains 8032 bank mergers between 1985 and 1997. The results indicate that the mergers are due to globalization, technological advances and regulatory policies. The merger makes banks more profitable and thus reduces the probability of insolvency. The merger also helps to reduce the overall costs. Increased diversification leads to increase revenue if the banks are more attractive to customers.

Hirtle (2007) studies the impact of network size on bank branch performance. The increase of U.S. bank branches has continued steadily over time. Further, the study analyses the implications of these developments by examining a series of simple branch performance measures. The findings are that the banks with 100 to 500 branches called mid-sized networks have lower bank-average deposits per branch and roughly equal volumes of small business loans per branch, but no reduction in net deposit costs, relative to banks with larger branch networks. When compared to banks with 100 or fewer branches, mid-sized branch networks have lower bank-average deposits and small business loan volume per branch, but have lower net deposit costs.

The analysis shows no systematic relationship between branch network size and overall institutional profitability. The results imply that mid-sized branch networks may be at a competitive disadvantage especially relative to the very largest branch networks.

Steven *et al*. (2006) examine the effects of market entry and privatization on margins and costs of banks in the post-communist transition. They are of the opinion that revenue and cost functions would change with the passage of time. So they divided the data into three sub-periods. In the first sub-period (1995-1998), the privatized banks have earned higher margins than other banks, while foreign banks which are newly started have had lower marginal costs. In the third sub-period (2002-2004), foreign banks remain low marginal cost service providers, while privatized domestic banks have the widest margins. Subtracting marginal costs from margins to calculate mark-ups, an indication of demand for services, shows that initially privatized banks had the largest mark-ups. However, by the third sub-period, differences among private banks diminish. In comparison to private banks, state banks persistently under-performed in controlling costs and attracting demand. The results indicate that foreign banks entry promotes lower costs and that privatization and market entry encourages more demand for services.

Kosmidou *et al*. (2005) investigate the principles of banking services in the single European financial market. This study makes an attempt to assess the performance and efficiency of commercial and cooperative banks in Greece for the period 2003-2004 and analyze the strengths and weaknesses of banks compared with their competitors. The data source includes 14 commercial banks and 16 cooperative banks operating in Greece. Data from the financial statements of the banks for the period 2003 and 2004 have been collected. Results obtained indicate that commercial banks were able to attract more customers and improve financial indicators and thus become more competitive and increase their profits. With regard to the cooperative banks in Greece, the conclusions are not very uniform, because there are banks with significant increase in profits and increase in market share while there are some banks with poor financial performance.

Mircea and Esteban (2012) examine the banks performance in the presence of risk. Data are collected from the banks of Costa Rica during 1998-2007. Important results of the study are that the improvements in performance and follow-up regulatory changes reflect positively on banks' profits. In addition, the capital adequacy ratio affects positively the bank financial performance, the net interest margin. This confirms that the monitoring costs and the presence of higher levels of capitalization lead to enhanced performance. The results also indicate that the appointment of executives from outside the bank leads to improved operational efficiency.

Kolapo *et al*. (2012) have studied the quantitative impact of the credit risk on the performance of commercial banks in Nigeria during the period from 2000-2010. Five banking companies are selected on a cross-sectional basis for eleven years. Financial measures like return on assets, non-performing loans to loans and advances, the proportion of total loans and advances to total deposits and the proportion of loss provisions loans to performing loans are used for measuring credit risk. Regression Model is used to estimate determinants of profit function. The results show that the impact of the credit risk on the bank's performance compared to return on assets of banks is fixed even though the degree to which the affected individual banks are not captured by the method of analysis used in this study. It is found that the 100% of non-performing loans reduce the return on equity by about 6.2%; an increase of 100% in provisions for loan losses also reduces the profitability of about 0.65. While the increase of 100% in total loans and advances lead to increased profitability by about 9.6%. Based on these results, the study recommended that it is desirable for banks in Nigeria to enhance its capabilities in the analysis of credit and loan administration. The regulatory authority should pay more attention to the banks' compliance with the relevant provisions of the law of other financial institutions and banks.

ANALYSIS AND INTERPRETATION

Ratio analysis is used to review the performance of the selected banks in Oman. The results are summarized below:

Table 1 lists the ratios of advances to assets from 2007 to 2011. This ratio estimates the banks' ability to lend as against their assets. The ratio ranges from 73 to 87% of Al Ahli Bank, 86 to 88% of Bank Dhofar, 85 to 88 % of Bank Muscat, 88 to 91% of Bank Sohar, 83 to 88% of HSBC Bank Oman and 83 to 86% of National Bank of Oman. There is an increasing trend in the ratio of advances to assets. It indicates that most of the banks seem to be aggressive in lending which ultimately results in better profitability.

Table 2 exhibits the ratios of capital to deposits for the select banks from 2007 to 2011. The ratio of capital to deposits measures the ability of banks to meet the contingencies of repayment of deposits on time. The ratio ranges from 16 to 53% of Al Ahli Bank, 15 to 19% of Bank Dhofar, 15 to 21% of Bank Muscat, 11 to %14 of Bank Sohar, 15 to 24% of HSBC Bank Oman and 17 to 22% of National Bank of Oman. There is a decreasing trend in the ratio of capital to deposits of these banks which means that the bank's ability to meet the contingencies of repayment of deposits on time needs to be strengthened.

Table 1: Ratio of advances to assets

Year	Al Ahli Bank	Bank Dhofar	Bank Muscat	Bank Sohar	HSBC Bank Oman	National Bank of Oman
2011	87	88	87	91	88	85
2010	87	86	86	91	85	83
2009	85	86	87	90	84	84
2008	81	86	88	89	83	86
2007	73	88	85	88	85	83

Table 2: Ratio of capital to deposits

Year	Al Ahli Bank	Bank Dhofar	Bank Muscat	Bank Sohar	HSBC Bank Oman	National Bank of Oman
2011	18	15	16	11	15	18
2010	16	18	18	11	21	22
2009	20	19	15	12	23	19
2008	27	19	15	13	24	17
2007	53	16	21	14	20	21

Table 3: Ratio of capital to working funds

Year	Al Ahli Bank	Bank Dhofar	Bank Muscat	Bank Sohar	HSBC Bank Oman	National Bank of Oman
2011	44	96	100	76	-155	68
2010	96	69	97	59	63	72
2009	61	102	111	44	66	88
2008	65	59	62	72	64	91
2007	80	77	95	-13	57	83

Table 4: Ratio of customer deposits to total deposits

Year	Al Ahli Bank	Bank Dhofar	Bank Muscat	Bank Sohar	HSBC Bank Oman	National Bank of Oman
2011	90	96	84	96	97	88
2010	72	94	78	94	90	91
2009	92	92	66	93	90	85
2008	88	92	66	75	88	83
2007	83	88	73	67	91	81

Table 5: Ratio of return on average net worth

Year	Al Ahli Bank	Bank Dhofar	Bank Muscat	Bank Sohar	HSBC Bank Oman	National Bank of Oman
2011	15	6	12	11	14	12
2010	14	15	13	9	10	10
2009	9	12	3	8	13	8
2008	7	13	13	-2	17	18
2007	3	21	13	-5	17	19

Table 3 shows the ratio of capital to working funds. The ratio ranges from 44 to 96% of Al Ahli Bank, 59 to 102 % of Bank Dhofar, 62 to 111% of Bank Muscat, -13 to 76% of Bank Sohar, -155 to 66% of HSBC Bank Oman and 68 to 91% of National Bank of Oman. The ratio is declining over the period of time which indicates that there is a room for improving the overall operational efficiency of the selected banks.

The ratio of customer deposits to total deposits of the selected banks is explained in Table 4. This ratio measures the liquidity of the banks. It ranges from 72 to 92% of Al Ahli Bank, 88 to 96% of Bank Dhofar, 66 to 84% of Bank Muscat, 67 to 96% of Bank Sohar, 88 to 97% of HSBC Bank Oman and from 81 to 91% of National Bank of Oman. There is an increasing trend in the customer deposits. Hence, the banks enjoy better liquidity.

Table 5 lists the ratio of return on average net worth. The ratio ranges from 3 to 15% of Al Ahli Bank, 6 to 21% of Bank Dhofar, 3 to 13% of Bank Muscat, -5 to 11% of Bank Sohar, 10 to 17% of HSBC Bank Oman and 8 to 19% of National Bank of Oman. The range of ratios indicates that the return on net worth is not much impressive.

The range of ratios of liquid assets to working fund has been recorded in Table 6. The range of ratios shows a decreasing trend for all banks except Bank Sohar. It ranges from 14 to 193% of Al Ahli Bank, from 71 to 114 % of Bank Dhofar, from 77 to 102% of Bank Muscat, -31 to 159% of Bank Sohar, from -23 to 119% of HSBC Bank Oman and from 76 to 121% of National Bank Of Oman. The trend is unstable for all banks. So the banks have to take care of the required level of liquid assets to pay their current dues on time.

REGRESSION RESULTS

Regression analysis between the independent variables calculated as ratios namely, credit deposit ratio, total investment to total deposits, interest income

Table 6: Ratio of liquid assets to working funds

Year	Al Ahli Bank	Bank Dhofar	Bank Muscat	Bank Sohar	HSBC Bank Oman	National Bank of Oman
2011	22	89	95	159	-23	96
2010	68	74	94	66	119	106
2009	193	114	77	35	95	76
2008	26	95	102	74	118	107
2007	14	71	82	-31	53	121

Table 7: Regression analysis of Al Ahli bank

	Regression coefficient	S.E.	"t" value
Credit deposit ratio	-0.0013	0.0033	-0.393
Total investments to total deposits	-0.0025	0.0024	-1.041
Interest income to working funds	-0.0263	0.0844	-0.311
Non-Interest income to working funds	1.6005**	0.4746	3.372
Non-Interest expenses to working funds	-0.0023	0.0234	-0.067

** Significant at the 0.01 level; * Significant at the 0.05 level; Constant: 1.2832; R^2: 0.876**; F-value: 7.165**

Table 8: Regression analysis of bank Dhofar

	Regression coefficient	S.E.	"t" value
Credit deposit ratio	-0.0089	0.0163	-0.548
Total investments to total deposits	-0.0003	0.0004	-1.002
Interest income to working funds	-0.6612	0.3617	-0.828
Non-Interest income to working funds	0.2156*	0.0914	2.359
Non-Interest expenses to working funds	-0.0023	0.0234	-0.067

** Significant at the 0.01 level; * Significant at the 0.05 level; Constant: 0.21519; R^2: 0.789*; F -value: 2.599*

Table 9: Regression analysis of bank Muscat

	Regression coefficient	S.E.	"t" value
Credit deposit ratio	-0.0325	0.08414	-0.386
Total investments to total deposits	0.09479	0.1661	0.785
Interest income to working funds	0.0853	0.0584	0.886
Non-Interest income to working funds	0.0076**	0.0008	2.634
Non-Interest expenses to working funds	-0.0205*	0.00598	-3.437

** Significant at the 0.01 level; * Significant at the 0.05 level; Constant: 0.34923; R^2: 0.834**; F-value: 5.625**

to working fund, non-interest income to working fund and non-interest expenses to working fund and the dependent variable net profit to working fund has been performed. The results are summarized below.

Table 7 explains the regression results worked out for Ahli Bank. The non-interest income to working fund ratio has a significant effect on net profit to working fund at 1% level. All other variables do not have significant effect on the dependent variable. From the regression coefficients, it is observed that the credit deposit, total investment to total deposits, interest income to working fund and non-interest expenses to working fund have negative effect on net profit to working fund and all other variables have positive effect on net profit to working fund. The model explains 88% variation in the bank's financial performance over the period of study. The R^2 value has been tested for its significance with the help of F test which suggests that the model is significant at 1% level.

The regression results for Bank Dhofar have been shown in Table 8. Again, the non-interest income to working fund ratio has a significant effect on net profit to working fund at 5% level. Except this, all other variables do not have significant effect on the dependent variable. The credit deposit, total investment to total deposits, interest income to working fund and non-interest expenses to working fund have negative effect on net profit to working fund and all other variables have positive effect. The model explains 79% variation in the bank's financial performance. According to the R^2 value, the model is significant at 5% level.

Table 9 consolidates the regression results of Bank Muscat. The non-interest income to working fund ratio has a significant effect on net profit to working fund at 1% level and non-interest expenses to working fund ratio has a significant effect on net profit to working fund at 5% level. Except these variables all other variables do not have significant effect on the dependent variable. 83% variation in the bank's financial performance has been produced by the model and the model is significant at 1% level.

Table 10 presents the regression results of Bank Sohar. The explanatory variables do not have significant effect up on the net profit to working fund.. The total investment to total deposits, interest income to working fund have negative effect on net profit to working fund and all other variables have positive effect on net profit to working fund. The model explains only 65% variation in the bank's financial performance over the period of study. The model is significant at 5% level.

Explanatory variables do not exert significant impact up on the dependent variable, according to the

Table 10: Regression analysis of bank Sohar

	Regression coefficient	S.E.	"t" value
Credit deposit ratio	0.0487	0.0866	0.562
Total investments to total deposits	-0.0987	0.1702	-0.580
Interest income to working funds	-0.0943	0.0802	-1.139
Non-Interest income to working funds	0.1131	0.0861	0.778
Non-Interest expenses to working funds	0.0002	0.0002	1.392

** Significant at the 0.01 level; * Significant at the 0.05 level; Constant: 0.34923; R^2: 0.651*; F-value: 2.865*

Table 11: Regression analysis of HSBC bank Oman

	Regression coefficient	S.E.	"t" value
Credit deposit ratio	0.0092	0.0077	1.195
Total investments to total deposits	0.0892	0.0579	1.541
Interest income to working funds	-0.0996	0.1125	-0.886
Non-Interest income to working funds	0.0007	0.0003	1.617
Non-Interest expenses to working funds	-0.0930	0.0583	-1.595

** Significant at the 0.01 level; * Significant at the 0.05 level; Constant: -0.2074; R^2: 0.743*; F-value: 2.453*

Table 12: Regression analysis of national bank of Oman

	Regression coefficient	S.E.	"t" value
Credit deposit ratio	-0.0047	0.017	-0.285
Total investments to total deposits	0.0044	0.0043	1.248
Interest income to working funds	0.6011	0.3426	1.754
Non-Interest income to working funds	0.0282**	0.006	4.702
Non-Interest expenses to working funds	-0.1339*	0.0521	-2.573

** Significant at the 0.01 level; * Significant at the 0.05 level; Constant: 0.0381; R^2: 0.439**; F-value: 13.124**

regression results of HSBC Bank Oman presented in Table 11. The interest income to working fund and non-interest expenses to working fund have negative effect on net profit to working fund and all other variables have positive effect on net profit to working fund. The model explains 74% variation in the financial performance of the bank. The R^2 value suggests that the model is significant at 5% level.

Regression results of National Bank of Oman are consolidated in Table 12. The non-interest income to working fund ratio has a significant effect on net profit to working fund at 1% level and non-interest expenses to working fund ratio has a significant effect on net profit to working fund at 5% level. Except these variables all other variables do not have significant effect on the dependent variable. The model explains 44% variation in the bank's financial performance. F test signifies the model at 1% level.

CONCLUSION

The study provides empirical evidences on the performance of banking sector in Oman that builds a basis for the improvement of banking sector in Oman. The study also identifies the scope for further improvement of Islamic banking sector in the country. GCC countries had undergone a series of bank reforms since early 1990s which noticeably changed the competitive structure and operating environment of the banking industry in the gulf region (Ariss *et al*., 2007). So the banks in Oman are expected to provide efficient services to withstand the increasing competition from private operators. Since the growth, efficiency and competitive environment of the financial sector are vital for economic integration and development of the country, it is imperative to improve the efficiency of banking system in Oman.

In the process of providing efficient services to the public at large, the banking sector in Oman has already considered converting their conventional service package into Islamic principle-oriented services. Islamic banking is guided by *Shariah* principles which prohibit interest payment (riba). Islamic banks use Profit-and-Loss Sharing (PLS) instruments which do not guarantee a pre-determined profit to depositors and Islamic banks offer some fee-based services. The main suggestion from the results of the study is that the banks in Oman have got to target transactional efficiency in their regular operation so as to ease the friction in financial (mobilizing deposits) and investment functions (lending loans and other investments) of the banks which would result in enhancing the overall performance of banking sector in the country.

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