A Financial Performance Comparison of Public Vs Private Banks: The Case of Commercial Banking Sector of Pakistan

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Abstract

Commercial banks are major component of financial sector and take part in the growth of economy. To compare the financial performance of public banks and private banks which were working in Pakistan during the period of 2006-2009 is intend of this study. Bank size and financial ratios are taken as variables such as efficiency / profitability ratios, capital / leverage ratios, liquidity ratios and asset quality ratios. Study concludes that ranking of banks differ as the financial ratio changes and intend of this study is fully academic. Extension in the period of analysis may tend to further study.

1. Introduction

Financial system is serving as back-bone in a country and a good facilitator for financial institutions. Ahmad, Raza, Amjad, & Akram, (2011) said that institutions are components of a good financial system and they assist the investors for investment to attain an efficient capital and money market in a country. State Bank of Pakistan (SBP) as well as Securities and Exchange Commission of Pakistan (SECP) is also working for the development of a good financial system (Alam, Raza, & Akram, 2011). Therefore, Commercial banking sector – as a major component of financial system – has an ample share in the financial and economic growth of a country. Aburime, (2009) said that a lucrative and profitable commercial banking sector is capable to tolerate the adverse distress and adds the strength and power in the economic system. A profitable and sound commercial banking sector is at a better point to endure adverse upsets and adds performance in financial system (Athanasoglou, Brissimis & Delis, 2008).

In 1947, there were only 5 commercial banks in Pakistan after mergers and acquisitions. The lack of momentum of growth is due to the lack of capital, socioeconomic and political instability. Therefore, many redical measures were taken up by SBP for the establishment and growth of commercial banks in Pakistan and many foreign investors were encourages due to the privatization of banks in 1992. This study intends to cram the financial data of public and private banks which were working in Pakistan during the period of 2006-2009 to classify the public and private banks on the basis of bank size and financial ratios such as efficiency / profitability ratios, liquidity ratios, capital / leverage ratios and asset quality ratios. Section 1 describes the introduction, section 2 contains the literature review, section 3 defines the methodology, analysis and results are compiled in section 4 and conclusion is explained in the last section.

2. Literature Review

The operating efficiency has an affect on the bank size. Pilloff and Rhoades (2002) said a positive relationship exist between the profitability and bank size. Sufian (2009); Molyneux and Seth (1998); Ramlall (2009) also found an affirmative relation of bank size and examine the dependence of bank size upon economies of scale because smaller banks were less profitable than larger banks. Whereas Koasmidou, (2008); Spathis, Koasmidou & Doumpos, (2002) found empirically a negative relation exist between bank size and profitability.

Bank size and financial ratios such as efficiency / profitability ratios, liquidity ratios, capital / leverage ratios and asset quality ratios are effective tool to classify the public and private banks and these ratios are also suggested by SBP statistical bulletin to evaluate the financial performance of banks. Financial measures such as return on assets (ROA), interest margins (IM), and capital adequacy (CA) has positive relation with customer service quality (Elizabeth & Elliot 2004). Raza, Farhan, & Akram, (2011) classified the investment banks in his study using return on total assets (ROA) and return on owners' equity (ROE). Effectiveness and effeciency are the independent factors (Tarawneh, 2006); (Raza, Farhan, & Akram, 2011). There is no boundness that efficient bank also has effectiveness always.

2. *Methodology*

All the data for this study have been collected from the websites of public and private banks, State bank of Pakistan (SBP) and financial statement analysis 2006-2009 of all financial sectors to accomplish the purpose of this research study. There were four public banks and twenty five private banks which were working and all banks are selected for analyses (see appendix). Average of four years ratios is calculated to compare the financial performance of public banks with private banks which were working in Pakistan during the period of 2006-2009. These financial ratios are divided in four categories.

1. Bank Size or Total Assets
   Financial Ratios:
2. Efficiency / Profitability Ratios
     i.   Spread Ratio
     ii. Net Interest Margin Ratio
     iii. Return on Owners' Equity Ratio
     iv. Return on Total Assets Ratio
     v.   Non Interest Expense to Total Income Ratio
3. Liquidity Ratios
     i.   Cash and Cash Equivalents to Total Assets Ratio
     ii. Investment to Total Assets Ratio
     iii. Advances to Total Assets Ratio
     iv. Total Liabilities to Total Assets Ratio
4. Capital / Leverage Ratios
     i.   Capital Ratio
     ii. Break up value per share
     iii. Deposits to Equity Ratio
5. Asset Quality Ratios
     i.   NPLs to Gross Advances
     ii. NPLs to Equity Ratio

3. **Analysis and Results:** Comparison of Public and Private Banks on the basis of Bank size and Financial Ratios

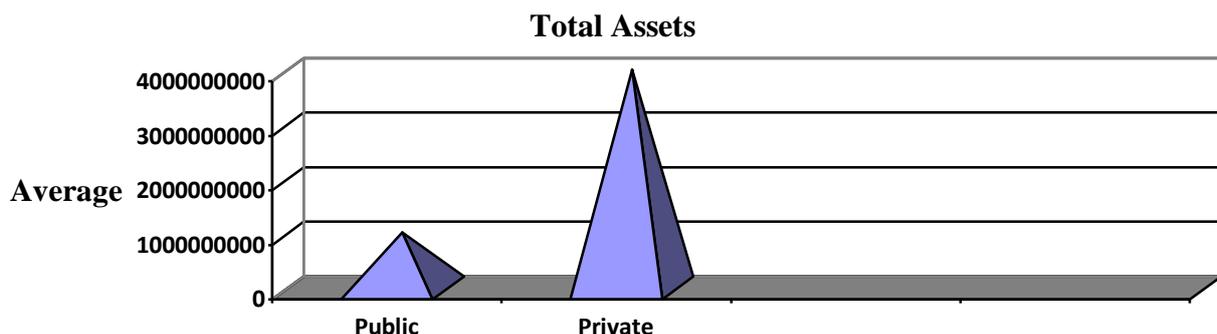| Table 01: Total Assets (Rs. 000)				
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	836160462	1035893081	1042310156	1179210512	1023393552.75
Private	2982464260	3835719200	4236005357	4925967570	3995039096.75

Figure 01

Total Assets

Table 01 and figure 01 are showing the data regarding bank size of public and private banks which were working in Pakistan during the period of 2006-2009. Bank size means the total assets of the banks. A lot of difference exist between the total assets of public and private banks due to difference in the number of banks.

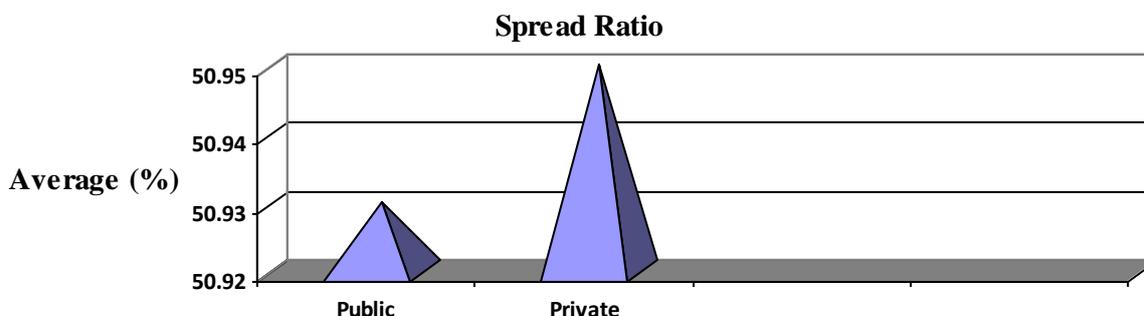| Table 02: Spread Ratio (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	60.57	53.78	48.28	41.09	50.93
Private	56.71	52.12	48.9	46.07	50.95

Figure 02

Table 02 and figure 02 are describing the spread ratio of public and private banks which were working in Pakistan during the period of 2006-2009. It is an income statement ratio and showing the gap between the rates charged on loans and paid on deposits and can be calculated by dividing the total interest earned with total interest paid. There is a minor difference between the spread ratios of both the banks but private banks have high spread ratio than public banks.

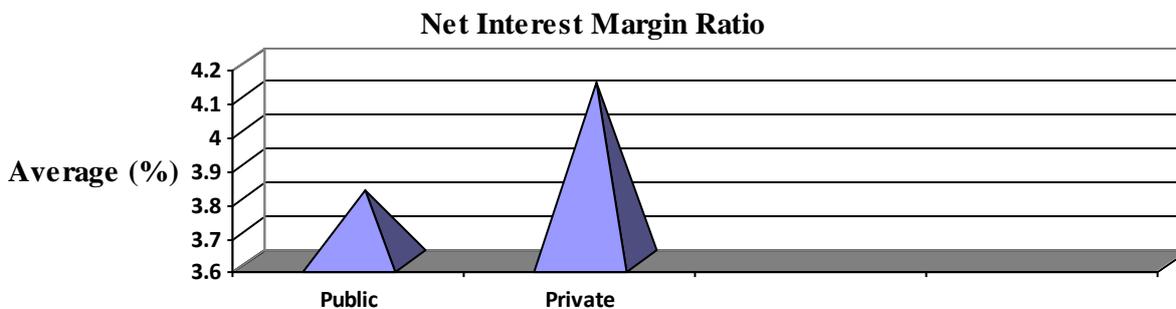| Table 03: Net Interest Margin Ratio (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	4.23	3.7	3.82	3.48	3.81
Private	4.02	3.91	4.28	4.29	4.13

Figure 03

Table 03 and figure 03 are containing the data regarding net interest margin ratio of public and private banks which were working in Pakistan during the period of 2006-2009. It is an income statement ratio and can be calculated by dividing the net interest income with total assets to signify earning capacity of banking sector through core banking activities after utilization of all the assets. Here, private banks have high net interest margin ratio than public banks.

Table 04: Return on Equity (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	0.31	0.26	0.06	0.07	0.18
Private	0.21	0.15	0.09	0.09	0.14

Figure 04

Return on Equity (ROE)

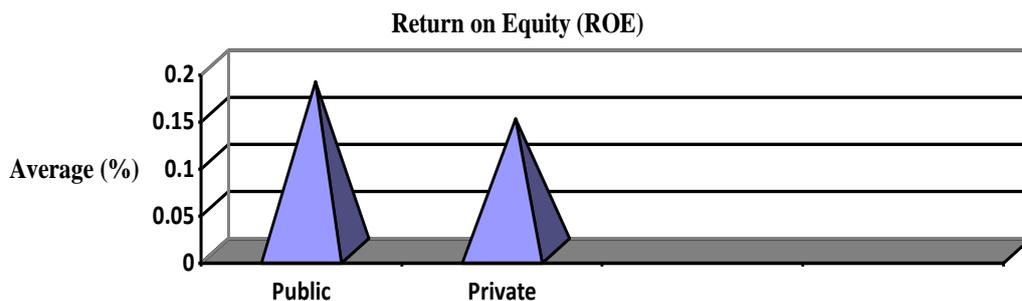   Table   04

and figure 04 are demonstrating the data related to return on equity (ROE) of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is a direct measure to know the returns to owners and can be calculated as the percentage of after tax net profit to total owners' equity. Here, public banks have high ROE than private banks which means they are paying high returns to owners than private banks.

Table 05: Return on Assets (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	2.53	2.3	0.54	0.63	1.50
Private	1.79	1.34	0.82	0.8	1.19

Figure 05
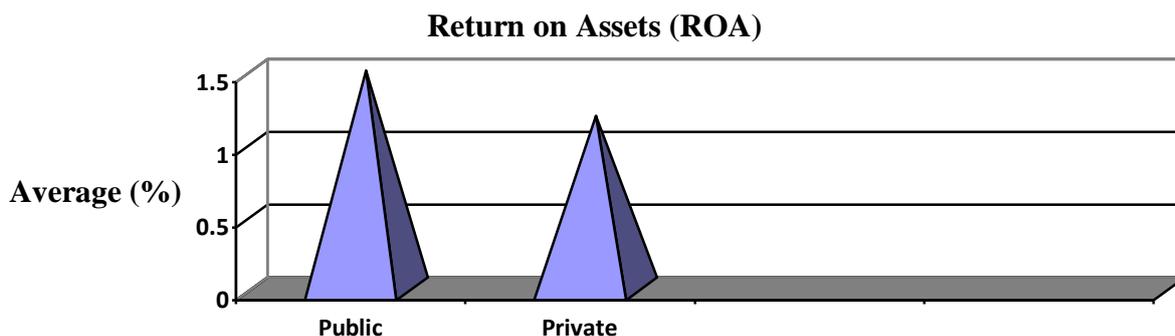
Return on Assets (ROA)

Table 05 and figure 05 are displaying the data related to return on assets (ROA) of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to know the earning capacity of profit of a bank by using its assets and can be calculated as the after tax net profit percentage to total assets. Here, public banks have high ROA than private banks which means they are using their assets efficiently than private banks.

Table 06: Non-Interest Expenses to Total incomes (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	21.91	19.31	22.97	22.5	21.67
Private	26.88	27.42	26.37	26.48	26.79

Figure 06

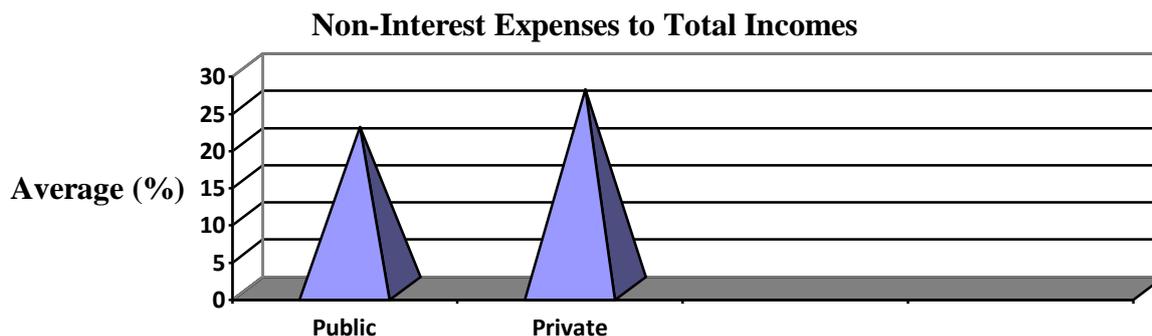**Non-Interest Expenses to Total Incomes**

Table 06 and figure 06 are depicting the data regarding non-interest expenses to total incomes of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to know the management efficiency related to the resources application in the bank related to expenses. It can be calculated as non-interest expenses percentage to total incomes and also known as overhead expense ratio. Here, public banks have high non-interest expenses ratio than public banks which means public banks have less expenses than private banks.

Table 07: Cash & Cash Equivalents to Total Assets (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	17.15	14.94	15.7	13.77	15.39
Private	12.42	10.73	10	9.87	10.76

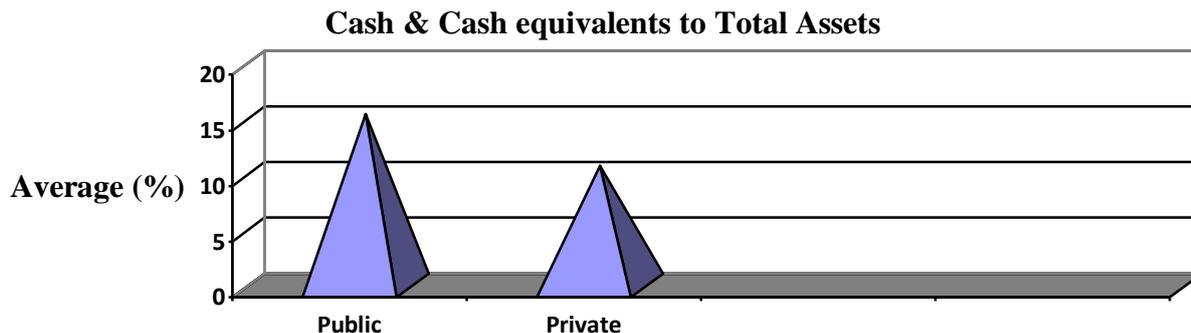**Figure 07**

Cash & Cash equivalents to Total Assets

Table 07 and figure 07 are containing the data related to cash and bank balance to total asset of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to know the total assets' percentage available in the bank in form of the highly liquid assets. Here, public banks have high ratio than private banks which means they have more assets in highly liquid form than private banks.

Table 08: Investment to Total Assets (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	21.51	28.61	19.65	22.25	23.01
Private	18.7	24.42	19.97	27.11	22.55

Figure 08
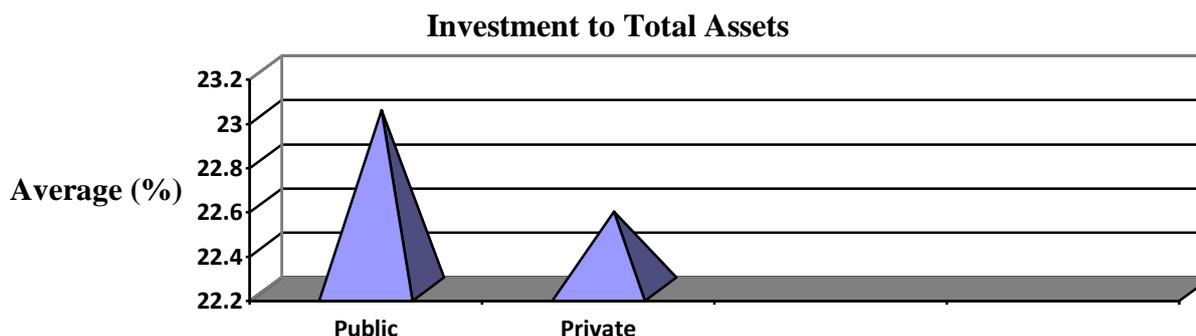

Investment to Total Assets

Table 08 and figure 08 are showing the data related to investment to total assets of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to recognize the segment of total assets which are used for investment in different areas. Here, public banks have the high investment to total assets ratio than private banks which means public banks make more investment than private banks from their assets in other areas.

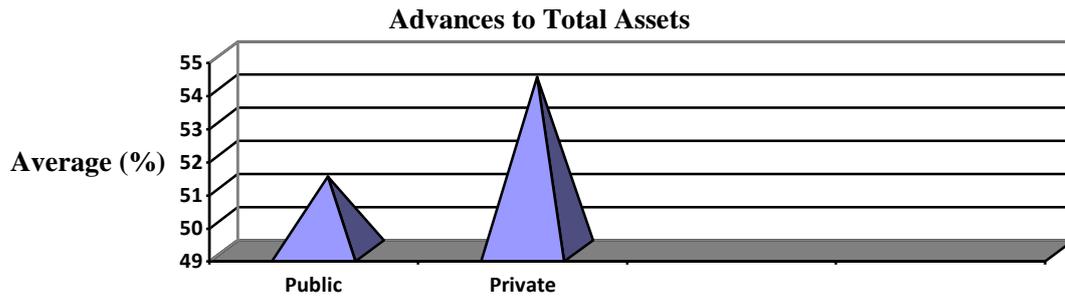| Table 09: Advances to Total Assets (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	51.39	47.06	53.79	52.75	51.25
Private	56.86	53.03	57.52	49.61	54.26

Figure 09

Advances to Total Assets

Table 09 and figure 09 are depicting the data regarding advances to total assets of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to identify existing relationship among advances of bank and its total assets and it can be calculated by dividing net investment with total assets. Here, private banks have high ratio than public banks which means that private banks grant more loan or advances than public banks.

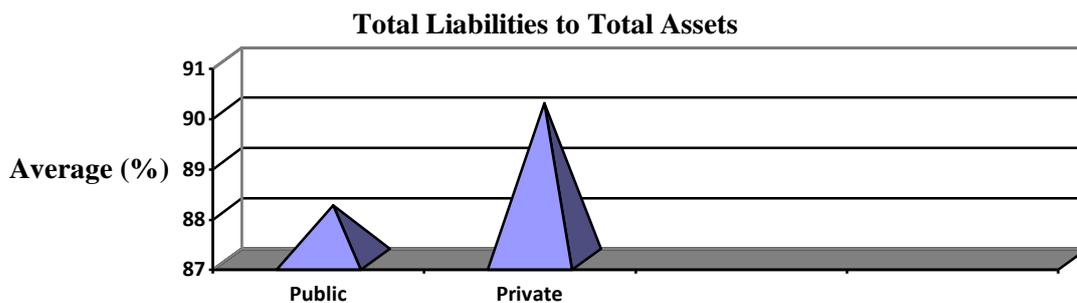| Table 10: Total Liabilities to Total Assets (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	87.8	86.26	89.26	88.95	88.07
Private	90.65	89.84	89.93	89.97	90.10

Figure 10

Total Liabilities to Total Assets

Table 10 and figure 10 are showing the data related to total liabilities to total assets of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is also known as debt to asset ratio which is used to know that what percent of total assets are financed through debt. Here, private banks have high ratio than public banks which means the assets of private banks are more financed through debt than public banks.

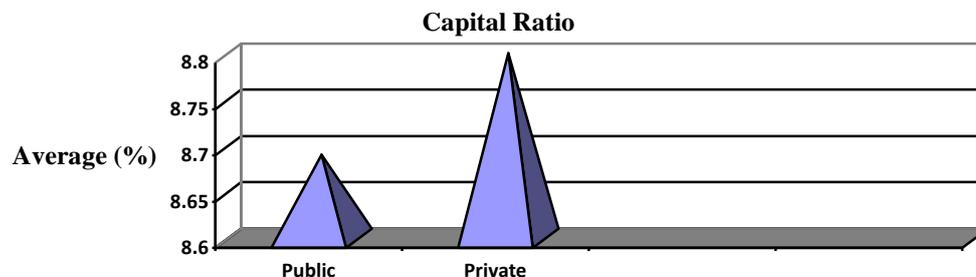| Table 11: Capital Ratio (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	8.06	8.78	8.95	8.98	8.69
Private	8.34	8.75	9.1	9.02	8.80

Figure 11

Capital Ratio

Table 11 and figure 11 are showing the data related to capital ratio of public and private banks which were working in Pakistan during the period of 2006-2009. It is a balance sheet ratio which is used to know how much assets are financed through capital. Here, private banks have high ratio than public banks which means the assets of private banks are more financed through capital than public banks.

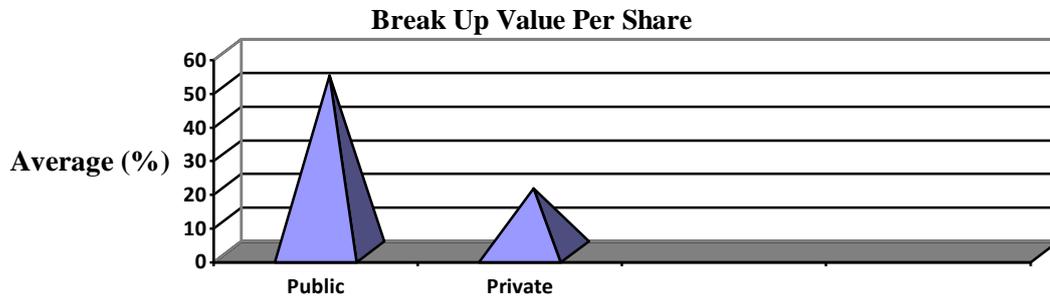| Table 12: Break up Value per Share					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	54.87	54.57	50.28	49.65	52.34
Private	21.16	18.32	18.26	17.71	18.86

Figure 12

Table 12 and figure 12 are containing the data regarding break up value per share of public and private banks which were working in Pakistan during the period of 2006-2009. It is net worth of a share and used to know the financial soundness of company. Here, public banks have high ratio than private banks which means that public banks are more financially sound than private banks.

Table 13: Deposits to Equity Ratio (Times)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	9.88	8.94	8.79	8.74	9.09
Private	9.14	8.67	8.42	8.26	8.62
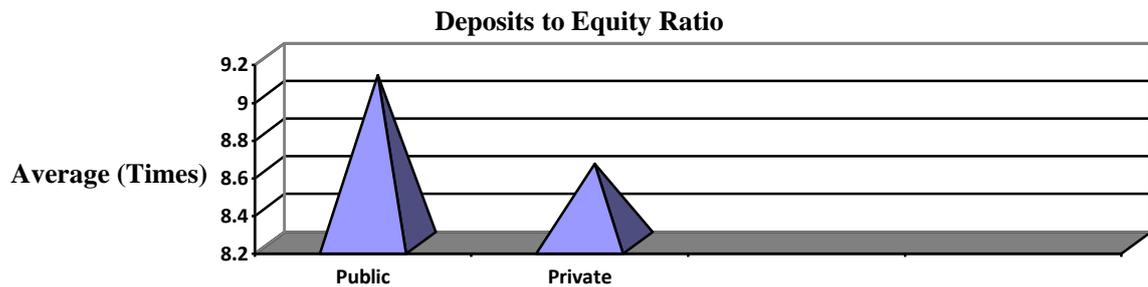
Figure13

Table 13 and figure 13 are demonstrating the data regarding deposits to equity ratio of public and private banks which were working in Pakistan during the period of 2006-2009. It is a balance sheet ratio which is used to know the relationship between total account holders' deposits and total owners' equity. Here, public banks have high ratio than private banks which means account holders deposit more in public banks than private banks.

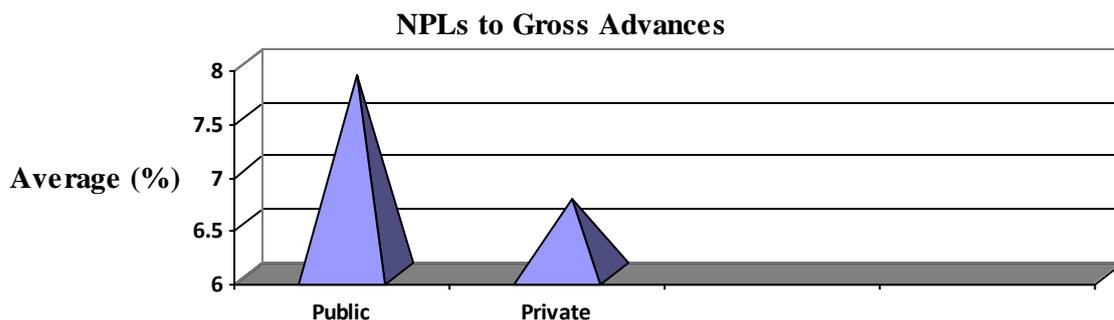| Table 14: NPLs to Gross Advances (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	9	8.36	7.34	6.75	7.86
Private	5.27	6.01	7.15	8.42	6.71

Figure 14

Table 14 and figure 14 are depicting the data related to NPLs to gross advances of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to know the asset quality which is based on loan portfolio. Here, public banks have high ratio than private banks which means the asset quality of public banks is better than private banks.

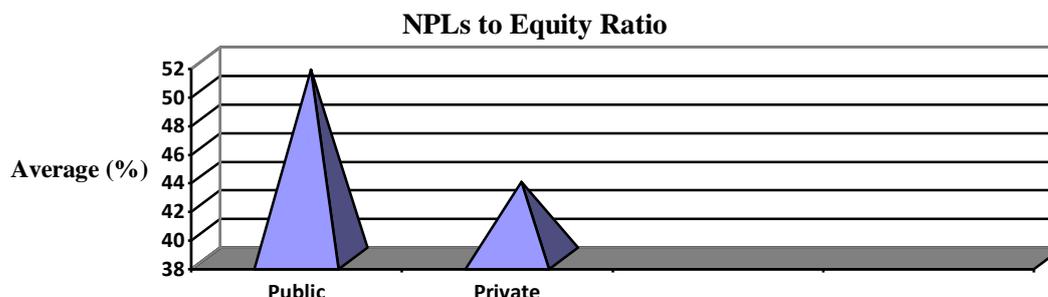| Table 15: NPLs to Equity Ratio (%)					
Bank	**2006**	**2007**	**2008**	**2009**	**Average**
Public	62.11	48.42	49.53	44.76	51.21
Private	37.27	38.17	47.89	50.05	43.35

Figure 15

NPLs to Equity Ratio

Table 15 and figure 15 are showing the data regarding NPLs to equity ratio of public and private banks which were working in Pakistan during the period of 2006-2009. This ratio is used to indicate the exposure by non-performing loans to owners. Here, public banks have high ratio than private banks which means public banks are efficient than private banks.

Table 16: Ranks of Public and Private Banks based on Bank Size and Financial Ratios		
Financial Ratios	**Public Banks**	**Private Banks**
Bank size	2	1
Efficiency / Profitability Ratios:		
1. Spread ratio	2	1
2. Net Interest Margin Ratio	2	1
3. Return on Owners' Equity	1	2
4. Return on Total Assets	1	2
5. Non-Interest Expenses to Total Income	2	1
Liquidity Ratios:		
1. Cash & Cash Equivalents to Total Assets	1	2
2. Investment to Total Assets	1	2
3. Advances to Total Assets	2	1
4. Total Liabilities to Total Assets	2	1
Capital / Leverage Ratios:		
1. Capital Ratio	2	1
2. Break up value per share	1	2
3. Deposits to Equity Ratio	1	2
Asset Quality Ratios:		
1. NPLs to Gross Advances	1	2
2. NPLs to Equity Ratio	1	2

5. Conclusions

On the basis of results and analysis, public and private banks has different ranking based on bank size and each financial ratio categories such as efficiency / profitability ratios, capital / leverage ratio, liquidity ratios, and asset quality ratios.

  a. Based on bank size, private banks are at first, and public banks are second.
  b. Based on efficiency / profitability ratios, public banks are at first on the base of return on total assets (ROA) and return on owners' equity (ROE). Whereas, private banks are at first on the base of spread ratio, non-interest expenses to total income ratio and net interest margin ratio.
  c. Based on liquidity ratios, public banks are at first on the base of cash & cash equivalents to total assets ratio of bank and investments to total assets ratio. Whereas private banks are at first on the base of advances to total assets ratio and debt to assets ratio.
  d. Based on capital / leverage ratios, public banks are at first on the base of break up value per share and deposits to equity ratio. Whereas private banks are at first on the base of capital ratio.

    e.   Based on asset quality ratios, public banks are at first and private banks are second.

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Appendix

Public Banks	Private Banks
First Women Bank Limited	Allied Bank Limited
National Bank of Pakistan	Arif Habib Rupali bank Limited
The Bank of Khyber	Askari Bank Limited
The bank of Punjab	Atlas bank Limited
	Bank Islamic Pakistan Limited
	Bank Al-Falah Limited
	Bank Al-Habib Limited
	Dubai Islamic Bank Pakistan Limited
	Dawood Islamic Bank Limited
	Emirates Global Islamic Bank
	Faysal Bank Limited
	Habib Bank Limited
	Habib Metropolitan Bank
	J.S Bank Limited
	KASB Bank Limited
	MCB Bank Limited
	Meezan Bank Limited
	My Bank limited
	NIB Bank Limited
	SAMBA Bank Limited
	SILK Bank Limited
	Soneri Bank Limited
	Standard Chartered Bank Limited
	The Royal Bank of Scotland Limited
	United Bank Limited