

Financial Services: A Projection of Best Emerging Bank in Sultanate of Oman

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The primary aim of this research is to predict the best emerging bank from Sultanate of Oman on the basis of their past and current financial performance. To address the above objective, quantitative and qualitative data is collected & collated on the aspects like growth in assets, profitability, geographic reach, strategic relationships, share prices, economic growth.

Field of Research: Banking in Emerging Markets

Key Words: Emerging Markets, Correlation, Regression, Share Price movements, Challenges & opportunities

1. Introduction

The global economy continues to be challenged by rising interest rates and oil prices, banks are under increasing pressure to provide more sophisticated levels of service spanning multiple markets for less. Increasingly, survival is not just about being the largest, most profitable or most well-capitalized bank. Geographical diversification, product innovation, depth and breadth and a well-diversified earnings base are all essential ingredients for withstanding the economic shocks of high interest rates, customer defaults on loans and reduced consumer and corporate appetite for borrowing.

Evaluation of bank performance is important for all parties: depositors, bank managers and regulators. In a competitive financial market bank performance provides signal to depositor-investors whether to invest or withdraw funds from the bank. Similarly, it flashes direction to bank managers whether to improve its deposit service or loan service or both to improve its finance. Only those banks with the capital to invest in technology and a global footprint, combined with local market knowledge and a well-trained staff that are able to anticipate customer's needs, are likely to remain dominant players for years to come.

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Emerging markets continue to present both opportunities and challenges for investors, and nowhere is this better reflected than in the areas of emerging market banking. This research analyzes the four local banks in Oman in emerging market to predict the best emerging bank in Oman on the basis of their past and current performance with respect to shareholders and customers.

2. Banking Industry in Oman

Banks in Oman now have an important role to play in economic development of the country by promoting private sector activities and mobilizing resources for financing productive sectors of the economy, in addition to extending credit to the citizens. There has been a gradual shift in focus of bank financing from the predominance of personal loans to industrial financing and in the development of the services sector. Even so, attracting is the domestic funds which are currently being invested outside the country are to be diverted and mobilized towards private sector investments is an opportunity which commercial banks in Oman would not like to miss out on.

The Omani banking system has expanded over the years. All the Omani banks operate under the umbrella of the Central Bank of Oman, the sole regulator and supervisor of the industry in the country. Currently, the banking sector in Oman consists of a network of 16 banks, divided into 5 local commercial banks, 8 branches of foreign commercial banks, and 3 specialized local banks. Another local bank is expected to start operations in November 2006. Oman's newest commercial bank, Bank Sohar, will launch on November 4 an initial public offering of 40% of the paid-up capital of the company worth RO20mn. Bank Sohar, which will be the sixth local bank for Oman, had to increase its capital from RO20mn to RO50mn in line with the Central Bank of Oman's decision to raise the minimum capital of local banks to ROR50 million.

Strong economic performance, liberalization of the economy, diversification, major infrastructure developments, accelerated privatization program, the in-flow of foreign direct investments (FDI), and favorable demographics with strong population growth and high percentage of youth were the driving forces for banks' growth. Accordingly, the banking industry in Oman enjoyed an outstanding year in 2005, and continued its positive momentum in 2006. Total deposits of commercial banks expanded by 24.2% from RO3.8bn at the end of FY05 to reach RO4.7bn at the end of FY06, while total bank credit increased by 20.6% from RO3.9bn at the end of FY05 to reach RO4.7bn at the end of FY06.

The banking sector in Oman is dominated by four local banks, Bank Muscat, National Bank of Oman, Oman International Bank and Bank Dhofar which accounted for 81%of total banking assets, 90%of total deposits and 91%of total banking credits as of 2006. These banks also dominate the banking

industry by virtue of their size, reach and coverage as they operate 270 branches spread all over the country.

3. Methodology and Data Analysis

In selecting the winning bank the following factors are considered that range from quantitative objective to the informed subjective. Taking these factors into consideration, we have identified the best bank in Oman. In selecting this top bank, we considered factors that range from the objective to the informed subjective. Objective criteria included growth in assets, profitability, geographic reach, strategic relationships, new business development and product innovation. Subjective criteria included the opinions of equity and credit-rating analysts, banking consultants and others in the industry.

The research is explorative and descriptive in nature. Quantitative information like ratios, correlation and regression were used by the researchers to analyze the performance of banks in Oman. The researcher felt that only ratios may not infer the performance of banks, so in addition, they tried the regression analysis as well.

(1) Comparing 2006 Results

Looking at 2006 numbers, Bank Muscat is clearly the number one bank in Oman by virtue of its size, constituting 51% of the combined assets of the five banks under our coverage, and 41% of the combined assets of all commercial banks in Oman in 2006. Bank Muscat also accounts for 26% of branch network in Oman and around 40% market share of the ATM network in the Sultanate. In terms of the banks' performance in 2006, all bank's performed well on the back of strong macroeconomic conditions.

Key Indicators for Financial Year 2006

| <i>In Omani Rials Millions</i> | Bank Muscat | National Bank Oman | Oman International Bank | Bank of Dhofar |
|------------------------------------|------------------------|-------------------------------|------------------------------------|---------------------------|
| Loans and advances | 1,953 | 788 | 593 | 595 |
| Total assets | 2,955 | 1,082 | 920 | 667 |
| Customer Deposits | 1,817 | 817 | 685 | 497 |
| Total Deposits | 2,180 | 834 | 782 | 568 |
| Paid-up Capital | 83.2 | 80 | 75.5 | 46.1 |
| Equity | 320 | 185 | 125 | 93 |

(2) Correlation and Regression Analysis

Correlation has been used to find the link between share prices of banks and the volume traded on the stock exchange. This analysis is done to predict the relationship between the performance of banks in terms of market price and the volume of shares traded in a particular period. This is the basis for further analyses namely scatter graph and line of best fit.

Regression analysis is used to model the relationship between a response variable and one or more predictor variables. The other use of regression technique is using the results as an indicator of performance of a unit. The regression equation was formed taking the variables; volume of transactions traded depends on EPS, Market price, Banks' profit. That is, Volume of transactions (Y) = Intercept + Earnings price per share + Market price + Banks profit over the years. Apart from these, the researcher also used graphs to predict the trend of share price movements

The correlation analysis clearly indicates that share prices and the volume of transactions are positively correlated. The correlation indicates that market takes up strong form of market representing all information in the market prices. In tests for the period 2001-2006 period, large positive correlations for return horizons beyond a year suggest that predictable price variation which is due to sustained mean price over this period. Predictable variation is estimated to be about 30% over 3 to 4 years for the banking sector. On the basis of the correlation analysis, it is determined that share price movements contribute a lot for the rise in volume of transactions as well as the index. Of the correlation values, *Bank Muscat and National Bank of Oman* exactly get the value of +1 indicating that the market prices are demand-supply driven and change in market price makes an equal amount of change in the volume of transactions.

Correlation and Regression analysis of Share prices from 2001 - 2006

| BANK MUSCAT | |
|--------------------------------|------------------------------|
| Correlation Analysis | 0.9993148 |
| Linear Regression Equation | $Y = 778706.68 - 28807.41x$ |
| OMAN INTERNATIONAL BANK | |
| Correlation Analysis | 0.982987547 |
| Linear Regression Equation | $Y = 778706.68 - 28807.41x$ |
| NATIONAL BANK OF OMAN | |
| Correlation Analysis | 0.997508083 |
| Linear Regression Equation | $Y = 2082382.64 - 60885.61x$ |
| BANK DHOFAR | |
| Correlation Analysis | 0.982126493 |
| Linear Regression Equation | $Y = 170914.5 - 6914.7x$ |

(3) Market Efficiency through regression technique

The market efficiency can be predicted using different techniques. Perhaps the simplest way would be finding the best fit linear regression i.e. projections depending on the linear regression equation and comparing it with the actual. The slope of all the banks indicate negative values which indicates that decrease in price of 1% causes approximately 34% of change in the volume of transactions. This linear regression clearly indicates that the securities market absolutely takes up the weak form of efficiency.

| BANK MUSCAT | | | | | | |
|-------------|------------|---------|-------------|-----------|-----------------|-----------------|
| Year | Mean Price | Volume | Estimations | A-E/A | Efficiency Rate | Price Movements |
| 2003 | 4.5 | 3000000 | 649073 | 0.7836422 | 78% | |
| 2004 | 6 | 3500000 | 605862 | 0.8268965 | 83% | 33% |
| 2005 | 8.5 | 4500000 | 533844 | 0.8813681 | 88% | 42% |
| 2006 | 10 | 5000000 | 490633 | 0.9018735 | 90% | 18% |

| OMAN INTERNATIONAL BANK | | | | | | |
|-------------------------|------------|---------|-------------|------------|-----------------|-----------------|
| Year | Mean Price | Volume | Estimations | A-E/A | Efficiency Rate | Price Movements |
| 2003 | 2 | 600000 | 285754 | 0.52374368 | -52% | |
| 2004 | 3 | 700000 | 256507 | 0.63356126 | -63% | 50% |
| 2005 | 4.5 | 1000000 | 212637 | 0.78736289 | -79% | 50% |
| 2006 | 3.2 | 800000 | 250658 | 0.68667777 | -69% | -28% |

| NATIONAL BANK OF OMAN | | | | | | |
|-----------------------|------------|---------|-------------|------------|-----------------|-----------------|
| Year | Mean Price | Volume | Estimations | A-E/A | Efficiency Rate | Price Movements |
| 2003 | 2.5 | 5000000 | 1930169 | 0.61396628 | 61% | |
| 2004 | 2.4 | 4500000 | 1936257 | 0.56972063 | 57% | -4% |
| 2005 | 4.5 | 8000000 | 1808397 | 0.77395033 | 77% | 88% |
| 2006 | 5 | 9000000 | 1777955 | 0.80244949 | 80% | 11% |

| BANK DHOFAR | | | | | | |
|-------------|------------|--------|-------------|-------|-----------------|-----------------|
| Year | Mean Price | Volume | Estimations | A-E/A | Efficiency Rate | Price Movements |
| 2003 | 2.5 | 400000 | 153627.75 | 0.6 | 60% | |
| 2004 | 3.5 | 500000 | 146713.05 | 0.7 | 70% | 40.0% |
| 2005 | 5.2 | 700000 | 134958.06 | 0.8 | 80% | 50.0% |
| 2006 | 3 | 500000 | 150170.4 | 0.7 | 70% | -40.0% |

To test its efficiency and to examine how the banks react to this securities market, a further analysis has been done using efficiency rate computed by comparing the projections made using linear regression with the actual volume of transactions. The market efficiency of National Bank of Oman has

been consistently showing an increasing trend from 61% to 80% which exactly goes with the market. The market price movements from negative rate of -4% to 11% over the four periods, National Bank of Oman has been growing consistently and the market is exactly reacting to the performance of the bank. For the Oman International Bank, the market efficiency rate has been estimated as negative rate of 69% and this has been there persistently and the comparison with the price movements illustrates clearly that the market is responding adversely to the information like from 50% positive to 28% negative.

The Bank Dhofar's efficiency rate has not been taking up an increasing trend as it goes up and down within the range of 60% to 80%. This indicates that the performance has been widely fluctuating over the different periods. And the market price movements also indicate a variation of 100% change over the four periods from 40% positive to negative 40%. The results explain that the bank has to concentrate on sustaining the performance to avoid such wide fluctuations take place in the market.

The Bank Muscat's efficiency has been measured as 90% which has grown from 78% over the four periods. It indicates clearly that the bank's performance has been consistently well. The market price movements over these periods also indicate a positive relationship but with a slight fall from 2005 to 2006. But on an average Bank Muscat has been indicating clearly that its performance has never failed to create widest breadth in the market.

To summarize, the results of the market efficiency and investors response to these banks have been clearly indicating that the stock market fluctuations highly depending on the market price in turn on the performance of the banks. The performance of Bank Muscat has been consistently showing an upward trend which ultimately makes the share markets to grow horizontally and vertically.

(4) Earnings per share and Price earnings ratio analysis

The EPS of Bank Muscat has been showing an increasing trend since 2001 and an average growth in EPS 52%. The growth rate in EPS of Bank Muscat is above the market growth rate and which is a positive indicator to the investors. The growth rate in EPS of Oman international Bank has been 30% which is on par with the industry growth. But compared to bank Muscat the growth rate is less. The EPS of national bank of Oman has been negative since 2001, but from the year 2004 it starts showing a positive value which is not comparable.

The growth rate shown in EPS of NBO also amounts marginal. This is negative point in the securities market which would pull the market price of NBO down drastically. The EPS analysis of the Bank Dhofar also shows a positive growth to the extent of 33% but still on par with the industry growth rate.

The price earnings ratio of Bank Muscat only showing an upward trend indicating that the market incorporates all the relevant information. As far as the P/E ratios of other banks are concerned it has not been stable. This indicates the investors of the banks are deeply concerned about the performance. Market for these banks exhibit a high volatility which in turn affecting the rate of return expected by the investors.

(5) Intrinsic Value of Shares

Intrinsic value of the share of these banks have been calculated using the formulae = Earnings per share X Industry average P/E Ratio

Intrinsic Value of Shares based on Earning Per Share

| BANKS | EPS 2006 | INDUSTRY AVERAGE P/E RATIO | MARKET PRICE | INTRINSIC VALUE |
|----------------------------|---------------------|---|-------------------------|----------------------------|
| BANK MUSCAT | 0.70 | 16.00 | 10.40 | 11.20 |
| NATIONAL BANK OF OMAN | 0.38 | 16.00 | 5.80 | 6.08 |
| BANK DHOFAR | 0.50 | 16.00 | 3.60 | 8.00 |
| OMAN INTERNATIONAL BANK | 0.36 | 16.00 | 3.41 | 5.76 |

The above analysis indicates that the bank Muscat is the only bank whose share prices are quoted on par with the intrinsic value of the share. The other bank market price is very low compared to the intrinsic value which indicates that the demand and supply factors of those banks are varying widely and making a huge impact on the volume of transactions. The above intrinsic value analysis also clearly indicates that the bank Muscat is the leading bank in the banking industry in Oman.

(6) Technical Analysis of Banks

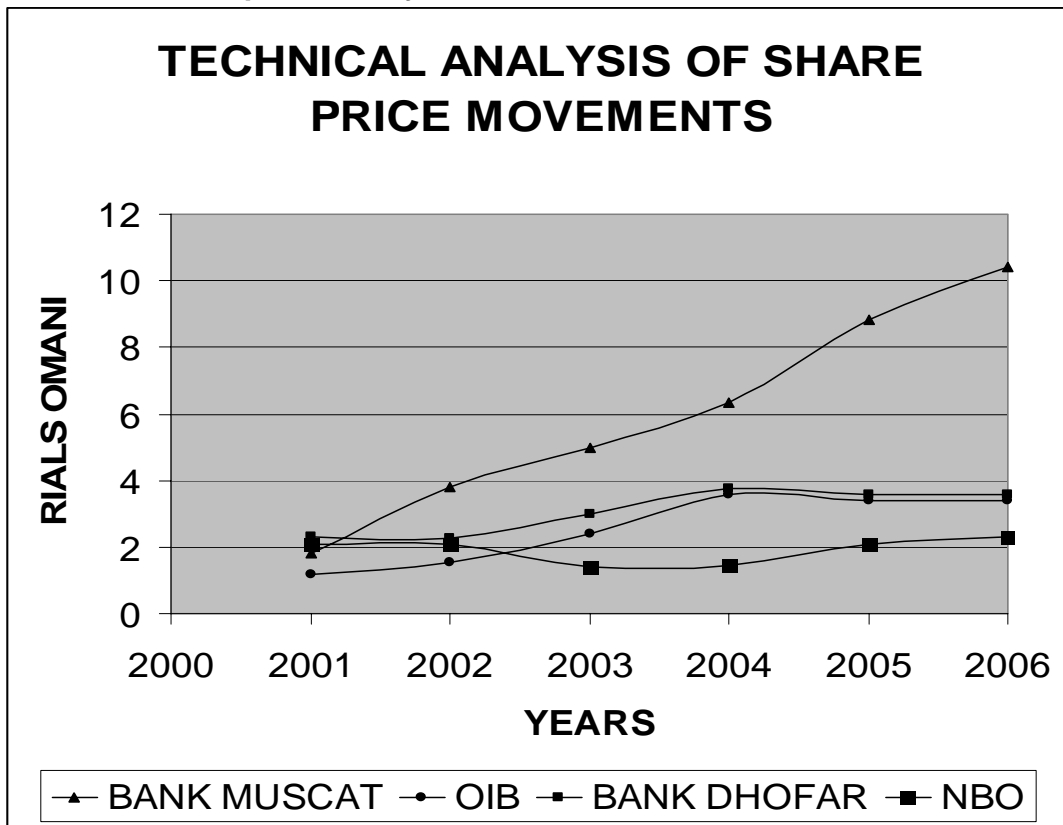
Technical analysis assumes that the share market repeats the history and the trend existed in the previous periods will come again. Using this principle an attempt has been made to identify the share price movements of the banks over the six years from 2001 to 2006 using line chart.

Share Prices of Omani Banks from 2001 - 2006
(Omani Rials)

| YEAR | Bank Muscat | Bank Dhofar | Oman International Bank | National Bank of Oman |
|------|-------------|-------------|-------------------------|-----------------------|
| 2001 | 1.80 | 2.32 | 1.20 | 2.10 |
| 2002 | 3.80 | 2.26 | 1.55 | 2.09 |
| 2003 | 4.97 | 3.00 | 2.38 | 1.39 |
| 2004 | 6.35 | 3.75 | 3.57 | 1.46 |
| 2005 | 8.83 | 3.60 | 3.39 | 2.10 |
| 2006 | 10.4 | 3.60 | 3.41 | 2.31 |

Source : Muscat Securities Market

Graphical Analysis of Share Price Movements



The graph shows that the bank Muscat is the only bank having an **increasing trend**. It indicates that the market is perfectly assuming the weak form. Though the line chart of OIB, NBO and Bank Dhofar shows an upward trend but they indicate that such an increasing trend is not due to the performance of banks only. So this analysis also proves that the bank Muscat is the leading banker in the banking sector.

4. Conclusion

This analysis is a post mortem analysis of banks over the last Five years. But in practice this gives an overview of the performance of banks on different parameters used. An attempt has been made to analyze the performance of banks using Price Earnings ratios as well as statistical models. The results were also tested using fundamental and technical analysis of security analysis.

The results clearly prove that Bank Muscat is the leading bank in the Banking Sector in Oman. It has got a very good lead in terms of Earning Per Share, Price Earnings ratio and peer analysis. This is also supported by the positive correlation values and the positive regression values. The technical chart also shows that the shares of bank Muscat responds to all kind of information and represents the true value to the investors. In order of the standing each one has been evaluated and analyzed below in terms of their performance.

The other banks follow the lead. The performance of other banks is par with the industrial performance. Though National Bank of Oman has reported negative Earnings per Share in first three years period of analysis but later showed an increasing trend. This clearly makes it to the investors that environment in sultanate of Oman for the banking sector has been favorable and appropriate for everyone who is concerned.

Bank Muscat being in the leadership position in the Oman banking sector will face pressure from the coming of new local banks and international banks in the banking arena. The bank seems to be aggressive in cross-selling its products and services and we believe that the bank has the critical mass of branch network which it can use for cross-selling initiatives. We believe that Bank Muscat will be maintaining its leadership position in the medium term but can expect pressure on margins with competition increasing in the banking sector. However, it will continue to look at opportunities abroad through its subsidiaries. The bank is augmenting its presence in the home-loan market and is forging alliances with various developers to provide home-finance for their projects

National Bank of Oman is a turnaround story as the bank rebounded from the losses it registered in 2003 to record strong growth in 2004-06 periods. The bank had a major problem of NPL which have been reduced but are still at higher levels compared to its peers. The bank which tried to manage its loan-book in the past became aggressive in 2006 to grow its loan portfolio through prudent lending mechanism and we expect the growth in loans to be strong in the medium term. NBO has shown intent to diversify its income stream and decrease its reliance on increasing risk assets as a driver for growth.

Oman International Bank has been innovative in introducing new products and services. The bank is known as an innovative bank with a long list of firsts to its name, the first bank in the Gulf region to offer mobile banking

service, the first Omani bank to issue a Visa Card, and it is the only bank at present in Oman which enjoys the advantages of having a fully automated branch network. As per management, Oman's economy is booming and there is a great potential for banking business with high expenditures being put in the tourism projects, infrastructure projects, privatization of power companies and oil refineries. Oman International Bank is planning to capitalize on the booming economy by focusing on project financing which will be one of the core activities going forward.

Bank Dhofar is actively looking to expand its base in the lucrative retail banking segment as in financial year 20066 it restructured its consumer banking division to meet the upcoming competition. The bank is focusing on expansion along with diversification of distribution channels. The bank intends to have more aggressive targets and intend to come out with innovative, value-added products and services for both retail as well as institutional clients.

There has been a gradual shift in focus of bank financing from the earlier predominant personal loans to industrial financing and in the development of the services sector. Even so, attracting domestic funds currently being invested outside and channeling them towards private sector investments is an opportunity which commercial banks in Oman would not like to miss out on. Oman's economy is set for another growth phase, and the potential for increased lending opportunities are reasonably bright in the face of the government's commitment to the long term goal of economic diversification, and the increasing liquidity levels and fiscal surplus arising from high oil prices in the region

The banking industry in Oman exhibited strong performance in 2006 on the back of strong macro-economic conditions, going forward we expect the banking industry in Oman to gain further momentum. We believe that the same conditions which made 2006 a remarkable year are likely to prevail in 2007 as well. The government is initiating privatization of state-owned industries and wants an active private sector participation in financing and operating new projects. Banks in Oman are now active participants in the economic development of the country by promoting private sector activities and mobilizing resources for financing productive sectors of the economy, in addition to extending credit to the citizens.

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