Comparative Profitability Analysis of Islamic Banks and Conventional Banking in Oman - A Case study of Bank Nizwa and Bank Dhofar

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Abstract

The banking industry of Oman is a highly enhancing industry with 17 licensed banks. The Central Bank of Oman is the primary regulator of the banking industry of Oman and all the essential factors like fixing interest rates, issuing bonds and more are the responsibilities of this bank. This study was conducted to determine the financial performance of two renowned banks of Oman. Bank Nizwa and Bank Dhofar are the key banks in Oman. The present study is important because it will focus strictly on the banking sector of Oman. In order to conduct the present research study, the performance of four profitability ratios namely net profit margin, ROA, ROE and ROCE will be estimated for the last five years i.e. 2013 to 2018 for both the banks.

Keywords: profitability, financial ratios, financial statements, return on assets, return on equity, return on capital employed

JEL codes; G21, M41, O53

1.1 Introduction

The banking industry of Oman is a highly enhancing industry with 17 licensed banks. The Central Bank of Oman is the primary regulator of the banking industry of Oman and all the essential factors like fixing interest rates, issuing bonds and more are the responsibilities of this bank. The overall assets of this industry are over $70 million and some of the banks operating in this industry are known for offering some innovative products and services to the residents of Oman. Some of the top banks in Oman are Bank Muscat, Bank Dhofar, National Bank of Oman, Oman Arab Bank, Bank Nizwa and more.

Bank Nizwa is Oman’s first Islamic bank which had started its banking operations formally from the beginning of 2013. This bank offers a set of innovative products and services with its focus entirely on Islamic banking activities. Bank Nizwa is expanding itself all over Oman and currently has 12 branches in the country(Banknizwa.om, 2019). The headquarters of Bank Nizwa is at Muscat. Though it is known for its Islamic banking operations, the regular banking services offered by this bank are also creative in nature. Some of the regular services offered by Bank
Nizwa are corporate banking, treasury banking and retail banking. There are over 300 dedicated employees working in various branches of Bank Nizwa.

On the other hand, Bank Dhofar is recognized across Oman for offering easy banking services to its customers. This bank was established in 1990 i.e. 29 years ago and it is currently having 70 branches across the country (Bankdhofar.com, 2019). This bank too offers some of the regular banking services like corporate and retail banking, investment banking and more. In the present research study, the financial statements of Bank Nizwa will be analyzed to compare the overall profitability of both the banks.

1.2 Research Problem

In the last few years, a lot of research studies have been conducted on the basis of the comparison of financial statements of two organizations. However, most of those research studies have focused on many ratios and not on the profitability ratios only (Nobes, 2014). Further, very less numbers of studies have been conducted in the past which are revolving around the banking sector of Oman. It was needed for a long time to conduct a research study which focuses specifically on the banking industry of Oman. Hence, in the absence of a study which evaluates the patterns of the banking industry of Oman, it becomes really difficult for the researchers as well as the financial analysts to know more about the banks operating in this industry and also how their financial and operating performances are taking place. The financial analysts can neither compare the performances of these banks, nor can they forecast about their future performance without a research study on this particular industry. It is also difficult for the shareholders of these banks to understand if they should invest in these banks or not.

1.3 Need for the Study

The present study is important because it will focus strictly on the banking sector Oman. The financial statements of two major banks of Oman i.e. Bank Nizwa and Bank Dhofar will be compared to understand which bank is stronger financially (Bankdhofar.com, 2019). It is expected that the findings of this study will be helpful for the researchers who will explore the banking and finance industry of Oman. Further, the stakeholders of Bank Nizwa and Bank Dhofar will also be benefitted from the findings of this study (Banknizwa.om, 2019). Once this research is successfully conducted, it is expected that the researchers will be able to get a more detailed view of the financial scenario related to the banking industry of Oman.

1.4 Objectives

The objectives of the present research study are as follows;

- To analyze the financial statements of Bank Nizwa and Bank Dhofar from the perspective of profitability
- To compare the financial statements with respect to profitability in order to determine which bank is more financially stable between Bank Nizwa and Bank Dhofar
1.5 Hypotheses
The research hypotheses related to the present research study are as follows;
H0 : Profitability is directly related to the improvement of financial performance of Bank Nizwa and Bank Dhofar
H1 : Profitability is not directly related to the improvement of financial performance of Bank Nizwa and Bank Dhofar

1.6 Research Methodology

The scope of the present research is that it would highlight specifically on the banking and finance sector of Oman. Hence, a lot of new factors will be acquired by the researcher which can be applied for further investigations in the future (DeFusco et al. 2015). In order to conduct the present research study, the performance of four profitability ratios namely net profit margin, ROA, ROE and ROCE will be estimated for the last five years i.e. 2013 to 2018 for both the banks i.e. Bank Dhofar and Bank Nizwa. After that the ratios will be compared to analyze the financial position of these two banks (Kumar, 2019). The present research study will strictly be based on secondary datasets. These datasets will be collected from official websites of these two banks i.e. https://www.banknizwa.om/ and https://bankdhofar.com/. The financial statements of these banks from 2013 to 2018 will be downloaded from these websites. For the present research, the researcher will use SPSS tool to compare the financial performance of the two banks (Silverman, 2016). Further tables, bar charts and line charts will also be used by the researcher to achieve desirable results.

2. Literature Review

Definition of profitability

Profitability is defined by an income which is earned by an organization by utilizing all its resources and minimizing its expenses. To describe in a simpler way, profitability is defined as the capability of income generation for an organization from its various operations. When the financial statements of two companies are analyzed, profitability becomes a major building block of such analysis (Williams & Dobelman, 2017). An organization with higher profitability indicates better financial capability of that organization compared to an organization with lower profitability.

Important profitability ratios and their measurements

When the financial statements of two organizations are analyzed, then a set of profitability ratios are used to compare the profitability of those organizations. The major profitability ratios which are the indications of overall profitability of an organization are net profit margin, return on assets, return on equity and return on capital employed (Robinson et al. 2015). A brief description is given below about these four profitability ratios;

Net Profit Margin – Net profit is measured by deducting the expenses of an organization from its gross profit. The net profit margin ratio is measured by dividing this net profit with the overall...
sales revenue of an organization (Robinson et al. 2015). It is an important type of profitability ratio and should increase continuously for ensuring overall success of an organization. This profitability ratio gives an important indication of the financial health of an organization. It also becomes an effective forecasting tool at times. By tracking the movements of this ratio, organizations become aware of how much effective their current business practices are and how they can change their operations in the future to increase net profit margin further. Net profit margin also becomes an important indicator for the investors and shareholders of an organization (Lacinka et al. 2018). Through this ratio, they successfully assess the return they can achieve from the organization in the future.

**Return on Assets (ROA)** – the ROA ratio measures the capability of an organization to generate income from its various assets. This ratio is measured by dividing the net income of an organization with its total assets (fixed and current). An organization with higher ROA is considered as more efficient in managing its assets (Nobes, 2014). In most of the cases it is observed that ROA of organizations are dependent on the overall growth or failure of the industry. Hence, by comparing the ROAs of previous years and current year, some major insights can be acquired by organizations. Investors get idea regarding how much they should invest in an organization and how much percentage of return they should receive. Investors always look for opportunities where they can invest less and earn high return and ROA helps in assessing that factor (Rostami et al. 2016). One advantage of ROA over ROE is that it takes into account the debt of an organization.

**Return on Equity (ROE)** – The ROE ratio measures the capability of an organization to generate return from its equity shareholders (Coates IV, 2014). This ratio is measured by dividing the net income of an organization with the equity of shareholders. The estimation of ROE and drawing interpretations for the future success of a business is often difficult. However, on successful estimation, some major factors can be identified by calculating the ROE of an organization. The concept of ROE is also related to the concept of retained earning which is a major factor for organizations. Organizations use their retained earnings for the purpose of distributing dividend or for the purpose of infrastructural development (Kijewska, 2016). And by successfully calculating ROE, an organization can easily get its retention ratio. However, as discussed above, ROE does not take into consideration debt which is a limitation of this ratio.

**Return on Capital Employed (ROCE)** – the final profitability ratio mentioned here is ROCE. This ratio is measured by dividing the earned return with the total capital employed by an organization. Higher ROCE ratio indicates better profitability (Wahlen et al. 2014). The need for ROCE is most important in those cases, when two organizations are compared in a capital-intensive industry. For the organizations operating in such industries, it is difficult to analyze their performance based on other profitability ratios like ROE, ROA and more. As these industries are capital intensive, an organization is only considered as profitable if it has earned enough return from the initial capital employed (Afrifa and Padachi, 2016). One such industry is the telecom industry. Investors of such companies also depend highly on ROCE ratio to make their investment decisions.
Needs for financial statement analysis

By analyzing the financial statements of an organization, researchers are able to identify how various financial parameters related to the organization have changed for a specific period of time (DeFusco et al. 2015). Based on such analyses, it becomes easier for the researchers to identify the financial position of that organization in the market and he can derive some meaningful conclusions.

3.1 Bank Nizwa

The establishment of Bank Nizwa came with the Central Bank of Oman, which initially approves Sheikh Saud bin Ali Al Khalili in this bank's license. Sheikh Saud bin Ali Al Khalili and 92 other Noman people, companies and founder of Pension Funds Bank are shareholders. The bank is Nizwa-Oman's first dedicated Islamic bank, with the complete Islamic process of products and services. According to the bank issued by Bank of Oman (CBO) and Royal Decree No. 114/2000, the portfolio of commercial banks offers full portfolio of services. The founders set an empowerment committee to represent them and to help manage the establishment of a bank according to a licensed Islamic terms. The committee consisted of five people, including Ahmad Bin Saif-ul-Rahi, formed in the Establishment Committee. After starting its operation in January 2013, the bank now provides a full range of banking solutions for individuals, small and medium-sized organizations, corporations and government agencies.

3.2 Bank Dhofar

Bank Dhofar is playing an important role in the economy of Oman. It is the second largest bank of Oman. As the second largest bank of Oman (from the value of the market), Bank Dhofar has achieved the status of the financial institution with a strong commitment to stability and development. Apart from traditional banking products and services, the bank offers many electronic banking services such as Internet Banking, Phone Banking, SMS Banking, Cash and Payment Machines. By Wholesale Banking, Bank Dhofar tries to provide high-quality services to its target customers through a team of highly motivated, skilled personnel motivated, the most favorite, professional and reliable corporate bank.

Data Analysis and Results

This study aimed to determine and compare the financial performance of Bank Nizwa and Bank Dhofar. These both banks are the key banks in Oman. To compare the financial performance of Bank Nizwa and Bank Dhofar, I calculated the profitability ratios. There are four type of profitability ratios. These return on assets, return on equity, operating profit margin and net profit margin.

4.1 Profitability Ratios

In this study, I have calculated four types of profitability ration. These return on assets, return on equity, operating profit margin and net profit margin.
Return on Assets

Return on Assets are calculated by dividing the net income on the total average assets. This ratio is used to determine that how efficiently the assets of the company are used to generate the profits. This ratio is closer to 1 means the good return on assets.

The Data of profitability of Bank Nizwa was given to the following table. The results demonstrated that in 2014, the bank was bearing loss which was decreased in 2015. In 2016, the company return on assets became zero. In 2017 and 2018, it is little bit increased. Overall the return on assets of Bank Nizwa was not good.

Table 1: Return on Assets of Bank Nizwa

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.01</td>
<td>0.01</td>
<td>0.00</td>
<td>(0.02)</td>
<td>(0.03)</td>
</tr>
<tr>
<td>Net income</td>
<td>7,511,603</td>
<td>3,786,500</td>
<td>109,722</td>
<td>(5,260,242)</td>
<td>(7,708,761)</td>
</tr>
<tr>
<td>Total average asset</td>
<td>872,167,540</td>
<td>697,302,971</td>
<td>515,995,377</td>
<td>346,094,102</td>
<td>253,105,933</td>
</tr>
</tbody>
</table>

On the other hand when I calculated the return on assets of Bank Dhofar, it has been observed that return on assets of Bank Dhofar was 0.01 that remained consistent from 2014 to 2018. But overall the return on assets of Bank Dhofar were also not good. That showed as the bank has assets but these assets are not fully used to generate the profits.

Table 2: Return on Assets of Bank Dhofar

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>Net income</td>
<td>50,281</td>
<td>47,627</td>
<td>48,754</td>
<td>47,138</td>
<td>45123</td>
</tr>
<tr>
<td>Total average asset</td>
<td>4,213,490</td>
<td>4,246,710</td>
<td>3,952,043</td>
<td>3,593,061</td>
<td>3,194,127</td>
</tr>
</tbody>
</table>

Return on Equity

The return on equity showed that the bank was in loss in 2014. This loss decreased in 2015 and in 2016 the return on equity became zero. In 2017 the return on equity became better which further improved in 2018.

Table 3: Return on Equity of Bank Nizwa
The return on equity of Bank Dhofar was comparatively better than the return on equity of Bank Nizwa. In 2014, the return on equity of Bank Dhofar was 0.14 that was greater than Bank Nizwa. In 2015 return on equity of Bank Dhofar was decreased to 0.13. Till 2018, it continuously decreased and reached to 0.09 but it was greater than the return on equity of Bank Nizwa.

Table 4: Return on Equity of Bank Dhofar

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Equity</td>
<td>0.09</td>
<td>0.10</td>
<td>0.12</td>
<td>0.13</td>
<td>0.14</td>
</tr>
<tr>
<td>Net income</td>
<td>50,281</td>
<td>47,627</td>
<td>48,754</td>
<td>47,138</td>
<td>45,123</td>
</tr>
<tr>
<td>Total average Equity</td>
<td>542,662</td>
<td>471,507</td>
<td>418,500</td>
<td>361,029</td>
<td>321,213</td>
</tr>
</tbody>
</table>

Operating Profit Margin

Operating profit margin determine the ratio of operating income with the perspective of the company sales. The results declared that Bank Nizwa was bearing great operating losses in 2014. These losses changed into profit in 2016. In 2017, the operating profit margin further increased and reached to 38.53%.

Table 5: Operating profit margin of Bank Nizwa

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit margin</td>
<td>38.53</td>
<td>26.67</td>
<td>0.63</td>
<td>(45.90)</td>
<td>(116.33)</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>10,439,687</td>
<td>5,972,096</td>
<td>109,722</td>
<td>(5,468,393)</td>
<td>(8,745,468)</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>27,097,801</td>
<td>22,391,712</td>
<td>17,379,039</td>
<td>11,912,964</td>
<td>7,517,719</td>
</tr>
</tbody>
</table>
The operating profit margin of Bank Dhofar was better than the Bank Nizwa. In 2014, that profit margin was 80.59 which were increased till 2016 and reached to 109.19. That profit margin decreased till 2018 and reached to 56.89.

Table 6: Operating profit margin of Bank Dhofar

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit margin</td>
<td>56.89</td>
<td>58.28</td>
<td>109.19</td>
<td>83.45</td>
<td>80.59</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>134,124</td>
<td>126,927</td>
<td>204,373</td>
<td>127,351</td>
<td>120,321</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>235747</td>
<td>217,788</td>
<td>187,170</td>
<td>152,604</td>
<td>149,303</td>
</tr>
</tbody>
</table>

Net profit Margin

The net profit margin of the Bank Nizwa showed that in 2014, the company was bearing loss, but till 2016, the bank became successful in managing its net profit margin. In 2018 it has reached to 0.28 that is the good in its ratio with the sales. This was also greater than the net profit margin of the Bank Dhofar.

Table 7: Net profit margin of Bank Nizwa

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit margin</td>
<td>0.28</td>
<td>0.17</td>
<td>0.01</td>
<td>(0.44)</td>
<td>(1.03)</td>
</tr>
<tr>
<td>Net Profit</td>
<td>7511603</td>
<td>3786500</td>
<td>109722</td>
<td>-5260242</td>
<td>-7708761</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>27097801</td>
<td>22391712</td>
<td>17379039</td>
<td>11912964</td>
<td>7517719</td>
</tr>
</tbody>
</table>

The Bank Dhofar was getting good net profit margin. In 2014, it was 0.30 but with the passage of time it decreased to 0.21 which was the less than the net profit margin of Bank Nizwa. In this way, even the Bank Nizwa was having lower assets but its increased its net profit margin.

Table 8: Net profit margin of Bank Dhofar

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit margin</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
5.1 Conclusion

This study was conducted to determine the financial performance of two renowned banks of Oman. Bank Nizwa and Bank Dhofar are the key banks in Oman. Bank Nizwa is Oman's first Islamic bank which had started its banking operations formally from the beginning of 2013. This bank offers a set of innovative products and services with its focus entirely on Islamic banking activities. On the other hand, Bank Dhofar is recognized across Oman for offering easy banking services to its customers. This bank was established in 1990 i.e. 29 years ago and it is currently having 70 branches across the country (Bankdhofar.com, 2019). The present study is important because it will focus strictly on the banking sector Oman. The scope of the present research is that it would highlight specifically on the banking and finance sector of Oman. In order to conduct the present research study, the performance of four profitability ratios namely net profit margin, ROA, ROE and ROCE will be estimated for the last five years i.e. 2014 to 2018 for both the banks i.e. Bank Dhofar and Bank Nizwa. In this study, I have calculated four types of profitability ratios. These return on assets, return on equity, operating profit margin and net profit margin. Return on assets of the Bank Dhofar and Bank Nizwa was not good. These were close to zero. The return on equity showed that the bank was in loss in 2014. This loss decreased in 2015 and in 2016 the return on equity became zero. In 2017 the return on equity became better which further improved in 2018. The return on equity of Bank Dhofar was comparatively better than the return on equity of Bank Nizwa. The results declared that Bank Nizwa was bearing great operating losses in 2014. These losses changed into profit in 2016. The operating profit margin of Bank Dhofar was better than the Bank Nizwa. The net profit margin of Bank Nizwa were greater then Bank Dhofar in 2018.

5.2 Recommendations

Finally, banks must reach their profits, which they look at their equality prices. This estimates their contribution to interest rate and future market income. Some banks say that the stock market has inadvertently attracted their relationship, at the time when negative CCB rates are so low on other investments. In other words, the market should be happy to be profitable. But according to the ECB, it appears that the impact of risk rate on bank equality has almost never happened.

Like all businesses, banks benefit from making money more than those costs that they spend. A large portion of the bank's profit comes from the fee that it is interested in its services and its assets to earn revenue on its assets. Its major costs are its responsibilities.
One of the main assets of the bank is loans of individuals, businesses, and other organizations and other institutions and their securities, while its major responsibilities are its reserves, and the money that is being sold from other banks or in the commercial paper. They are money Market.

Assets are generally used to generate income. Loans and securities are a bank's assets and is used to provide maximum bank revenue. However, in order to buy lending and securities, the bank must have money, which is basically the bank's owners of the bank's capital, the depositors, and the money to sell them from other banks or to the security of the lender. Smart planning helps the banks to adapt the problems and changes faced by the banking industry, while allowing banks to set goals and measure the performance. Set measuring goals to monitor how your plan is being done. Then review that how much banks have been accomplished from the stated planning so that bank can learn from past experience and make continuous improvements.

References


