Profitability of Meezan Bank Based on Balance Sheet and Operational Items

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Abstract

Commercial banks whether Islamic or conventional interest based banks are actually business entities, deal in financial transactions and their prime objective is to earn profit. Profit is the difference between revenue and expenditure of the bank. Therefore, revenue and expenses are the two most essential parts of the banking business which influence the profitability of the bank. The main objective of this paper is to find out the factors influencing the profitability of Meezan bank related to the balance sheet and operational factors for the period 2002 to 2011. The regression results reveal that Meezan bank can increase its profit by increasing its shareholders' equity and investments (balance sheet items) and administrative and operating expenses (AOE) and by expanding the net work (operational items) of the bank to other parts of the country.

Keywords: Meezan bank, Balance sheet factors, Operational Items, Profitability

Introduction

The functions of all commercial banks are accepting deposits from the people and advancing them to those who need money for various purposes. These services are provided to the people not for free because the main aim of any commercial bank whether Islamic or otherwise is basically earning and maximization of profit. The bank is said to be a successful bank if it earns abnormal profit out of its banking operations and services. Commercial banks are simple businesses or commercial concerns which provide various types of financial facilities to the clients in return for payments in one form or another (Suresh, and Paul, 2010). Profitability of a bank depends upon various factors including both the operational and balance sheet items of the bank concerned. The balance sheet is basically a statement of the firm's/bank's investment and the

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claims to the payoffs from those investments (Penman, 2008).Simply it is a statement of the bank or any business firm's financial position at a specific point in time (Brigham and Houston, 2003).The main aim of this paper is to identify both the balance sheet and operational variables influencing the profitability of the Meezan bank – a leading and full-fledged Islamic bank in Pakistan.

Profile of Meezan Bank

Meezan bank is a leading, full-fledged and one of the largest Islamic commercial banks in Pakistan. The State Bank of Pakistan (SBP) issued the first Islamic Banking license to Meezan bank in the year 2002. Since then it is offering a wide range of Islamic banking products and services to the people of Pakistan. It has established its net work in all major cities of Pakistan. There were only 10 branches of the bank in the year 2003 which increased to 275 branches all over the country in 2011.

Meezan bank is one of the largest Islamic commercial banks based on Shariah principles started its operations in 2002 with a paid up capital of Rs. 1,064 million. The total assets of the bank were only of Rs. 6,971 million in 2002 that were increased to Rs. 200,550 million in 2011. If we talk about the deposits of the bank, it were only Rs. 5,079 million in 2002 while according to the annual report of December 2011, the deposits have increased to Rs. 170,030 million – a spectacular increase in the deposits of the bank. The bank invested Rs. 856 million in 2002 while in 2011 the investments of the bank increased to Rs. 98,589 million, as shown in table 1.

Table. 1: Performance of Meezan Bank from 2002 to December 2011
(Rs. in million)

Activity	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Assets	6,971	11,102	19,697	30,676	46,439	67,179	85,276	124,169	154,752	200,550
Financing	3,532	7,397	12,340	19,741	27,031	34,576	39,528	41,710	54,195	59,156
Deposits	5,079	7,757	13,770	22,788	34,449	54,582	70,234	100,333	131,070	170,030
Investments	856	1,212	1,429	1,606	2,878	10,535	14,527	23,290	54,967	98,489
No. of Branches	-	10	30	30	62	100	131	166	223	275

Sources: Various annual reports of Meezan bank.

There are five shareholders of the bank. One of them is Pakistan Kuwait Investment Company (PKIC) which is a joint venture between Kuwait and the government of Pakistan. The share of PKIC is Rs. 340 million. Shamil bank limited of Bahrain is another shareholder which is basically a subsidiary of the Dar-Al-Maal-Al-Islami group (DMI) based in Geneva. It has a share of Rs. 276 million. Islamic Development Bank

(IDB) is another shareholder of Meezan bank which is an international financial institution helping the member countries in various fields based in Jeddah.

Table. 2: Shareholding Structure of Meezan Bank

S. No	Names of Shareholders	Rs. in million
1	PKTC	340
2	Shamil Bank	276
3	IDB	99
4	Kuwait Awqaf	88
5	Saudi Pak	49
6	General Public	212
	Total	1,069

Source: Meezan Bank annual report 2003, p. 18.

The capital base of IDB is approximately $5 billion. It has a share of Rs. 99 million in Meezan bank. Kuwait Awqaf Public Foundation is also a shareholder of Meezan bank with a share of Rs. 88 million. Saudi Pak Industrial and Agricultural Investment Company has a share of Rs. 49 million. It is a joint venture between the government of Pakistan and Saudi Arabia for promoting Industrial and Agricultural Development in Pakistan. The general public has a share of Rs. 212 million in total. The total paid up capital of the bank thus becomes Rs. 1069 million.

Data and Methodology

The study was carried out for the period since the bank started its operations in 2002 to December, 2011. The required data for the paper was obtained from the published annual reports of the bank present on its website. Some of the annual reports (i.e. 2005 and 2008) might have been corrupted by the computer virus and were not able to be down loaded from the official website of the bank; therefore hard copies of the said annual reports were obtained from one of the branches of the bank based in Islamabad. The empirical analysis of the collected data has been carried out using the multiple regression analysis technique via EVIEWS computer soft ware specially designed for social sciences.

In order to conduct the profitability analysis of the Meezan bank, the study used the following basic models:

PRF = f(C, TC, AOE, PDII, FCFOI, GBI,
NS)……..(1)
Where,
C = Constant
PRF = Profit of the bank after deducting the taxes
TC = Tax Charges
AOE = Administrative and Operating Expenses
PDII = Provision for Diminution in Investments and Impairments
FCFOI = Fee, Commissions, Forex and Other Income
GBI = Gross Banking Income
NS = Number of Staff working in the Meezan banking net work
The second regression equation is as under:

PRF = f(C, EQT, INV, OFA, FIN, DOA, NAS,
CWP)…….(2)
Where,
PRF = Profit of the bank after deducting the taxes
C = Constant
EQT = Shareholders' Equity
INV = Investment of the bank
OFA = Operating Fixed Assets
FIN = Financing-net
DOA = Deposits and other accounts
NAS = Net Assets
CWP = Capital-work-in-progress

Regression Results

- The prime objective of this paper was to identify the degree of relationship between the dependent variable 'Profit' and the independent variables for the period 2002 to 2011. The empirical regression results based on the operational items of the Meezan bank are given in table 3. The variables administrative and other expense (AOE), provision for diminution in investments and impairment (PDII), and fee, commissions, forex and other income (FCFOI) are statistically significant variables influencing the profit of the Meezan bank. The sign of the coefficient of AOE is positive which shows that higher the expenses on AOE higher will be the profit of Meezan bank. Another variable which is highly statistically significant but having negative influence on the profitability of the bank is the PDII variable. The negative sign shows that as the amount spent on the PDII increases, profitability of the bank will be adversely impacted. So, the bank should try to maintain it the minimum.

Table. 3: Regression results of equation 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TC	-0.043050	0.861227	-0.049987	0.9633
AOE	1.670822	0.919277	1.817539	0.1667
PDII	-3.696685	0.896912	-4.121571	0.0259
FCFOI	-1.138891	0.304481	-3.740435	0.0333
GBI	-0.469296	0.455417	-1.030476	0.3786
NS	0.068061	0.293637	0.231788	0.8316
C	83.42220	104.4516	0.798668	0.4829
R-squared	0.992589	Mean dependent var		933.4000
Adjusted R-squared	0.977768	S.D. dependent var		975.0150
S.E. of regression	145.3801	Akaike info criterion		12.99261
Sum squared resid	63406.09	Schwarz criterion		13.20442
Log likelihood	-57.96304	F-statistic		66.96898
Durbin-Watson stat	1.723350	Prob (F-statistic)		0.002766

The third variable which has again a statistically significant relationship with the profitability of the bank is FCFOI. As the FCFOI increases profitability of the bank is bound to decrease. Tax charges (TC) has also a negative relationship with the profit but the variable has not statistically significant impact on the profit. Gross banking income (GBI) has a very strange negative relationship with the profit. The impact of GBI on the profit of the bank is not statistically significant. Number of staff (NS) working in Meezan bank has a positive impact on the profit of the bank. As the number of staff working in the bank increases, financial services and facilities of Meezan bank is provided to a large section of population which naturally enhances the prospects of profit for the bank. The value of the Durban-Watson, which confirms or otherwise, the serial correlation among the error terms, states that there is no first order autocorrelation among the residuals.

- The regression results based on the balance sheet factors of Meezan bank are presented in table 4. The variables deposits and other accounts (DOA) and net assets (NAS) were dropped from the regression equation due to correlation between them. Variables shareholders' equity (EQT), investments (INV),

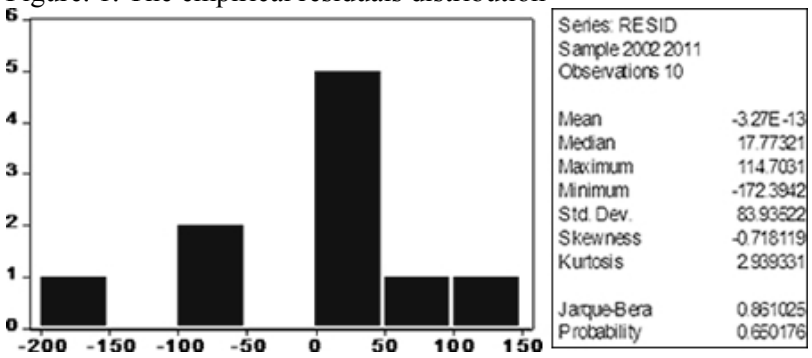
operating fixed assets (OFA) and capital work-in-progress (CWP) were highly statistically significant variables having appropriate signs. The variable shareholders' equity has a direct and statistically significant relationship with the profitability of Meezan bank. The higher the amount of equity higher will be the profitability of the bank. The other variable which also has a direct and positive relationship with profit of the bank is investment (INV). Higher the volume of investment higher will be the profitability of the bank. These results are the same as for ICICI bank in India (Manikandan*et al.,* 2011).

Table. 4: Regression results of model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EQT	0.201264	0.049652	4.053500	0.0154
INV	0.029872	0.002320	12.87505	0.0002
OFA	-0.567931	0.108942	-5.213130	0.0065
FIN	0.005017	0.006092	0.823525	0.4565
CWP	-0.625394	0.120367	-5.195749	0.0065
C	-151.5700	78.10263	-1.940652	0.1243
R-squared	0.997739	Mean dependent var		933.3000
Adjusted R-squared	0.994912	S.D. dependent var		975.0958
S.E. of regression	69.55533	Akaike info criterion		11.60583
Sum squared resid	19351.77	Schwarz criterion		11.78738
Log likelihood	-52.02916	F-statistic		352.9580
Durbin-Watson stat	2.084287	Prob(F-statistic)		0.000022

Operating Fixed Assets (OFA) as well as Capital-Work-in-Progress (CWP) has a negative and statistically significant relationship with the profitability of the bank. It means that increasing the volume of OFA is as decreasing the prospects of profitability of the bank. Therefore, the bank should try to maintain a low volume of both OFA and CWP. The variable financing net (FIN) plays a positive role in enhancing the profitability of Meezan bank, however, the impact of FIN factor is not statistically significant.

Figure. 1: The empirical residuals distribution



Moreover, on the basis of Jarque-Bera test, we can infer that the residuals of the model are nearly normally distributed, as shown in figure 1. This is also evident from the values of the skewness and kurtosis. Figure 1 reveals that the residuals of the regression seem to be symmetrically distributed. The value of the Jarque-Bera test is 0.861 and the probability of obtaining such a statistic under the normality assumption is about 65 percent, as shown above. Therefore, the paper does not reject that the error terms are normally distributed.

We also the tested Breusch-Godfrey Serial LM test for auto-correlation among the error terms. The empirical results of the test are given in table 5.

Table. 5: Breusch-Godfrey Serial Correlation LM Test

F-statistic	0.686288	Probability	0.649217
Obs*R-squared	9.97739	Probability	0.055433

According to the Breusch-Godfrey test, there is no higher order autocorrelation among the error terms of the model. R-square which is 0.99 indicates that 99 percent of the variations in the dependent variable 'profit' are explained by the included independent variables in the regression equation. It also reveals that the model is good and fit statistically.

Summary and Conclusion

Meezan bank is one of the largest Islamic commercial banks of the Islamic banking industry in Pakistan. It has achieved a remarkable success in a short period of time. The total assets of the bank were only Rs. 6,971 million in 2002 that has increased to Rs. 200,550 million in

December 2011. Profit has increased from Rs. 223 million in 2002 to Rs. 3,391 million in December 2011, an indicator of a successful bank.

The regression results based on the balance sheet factors of the bank reveal that except two variables namely operating fixed assets (OFA) and capital work-in-progress (CWP), the other variables have significant positive relationship with the profitability of Meezan bank.

The empirical results related to the operational factors influencing the profitability of the bank reveal that the variables administrative and operating expenses (AOE) and number of staff (NS) have positive relationship with the profitability, while tax charges (TC), provision for diminution, in investments and impairment (PDII) and fee, commission, forex and other income (FCFOI) have inverse relationship with the profitability of Meezan bank. Moreover, gross banking income (GBI) has also nothing to do with the profitability of Meezan bank which seems very interesting.

Given the regression results, it can be safely inferred that the bank can increase its profitability further by increasing the volume of INV, EQT, FIN and AOE and by expanding the banking net work to other suitable parts of Pakistan.

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