The Role of Performance of Privately Owned Banks in Economic Growth of Iran

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Abstract: The economists have always been facing this question that the economic growth will create demand for development of financial foundations, but based on a new point of view, today they believe that financial development is one of the keys to achieve long-term economic growth. With regard to the foregoing, the present research has been conducted in line with this question by proposing two main hypotheses and five minor hypotheses to study the role of financial systems with focus on private banks in the economic growth of the Islamic republic of Iran. To study for confirmation or not confirmation of research hypotheses, the statistical population was selected from among private banks including: Eghtesad Novin, Parsian, Karafarin, Saman, Pasargad, and Sarmayeh. In the descriptive statistics section, bank system performance and also financial development measurement indices were used. The information obtained through SPSS software was analyzed. In this process inferential statistics indices including Spearman correlation test, Pierson correlation test, David Watson test, independent t test, variance analysis F and linear regression chart were used. The obtained results indicate that all variables discussed in the research hypotheses have had definite influence in the economic growth of Iran. The cash indices of private banks had the most influence with .0882 units; while monetary development indices had the minimum influence with 0.142 units.

Key words: private bank, financial development, economic growth, profitability, cash, and investment

INTRODUCTION

The financial markets have the duty to reduce the expenses of exchange, information and operations and in this way, they direct the savings of the society toward the most efficient investment projects (Karimi, S., 2008).

The financial system consists of different subsets. In the present research we will deal with study of one of these subsets, i.e. financial institutes with focus on the bank. In recent years, the experimental literature of the growth of efficient financial systems has formed with inspiration from the existing literature of economic growth (Faraji, I., 2001; Dehghani, E., 2008; Goldsmith, R.W., 1969). The idea of this formation is hidden in the way of performance of banks. The idea of formation is also hidden in the way of performance of banks. By enabling the possibility of transfer of money among economically active entities and obtaining resources from investors and allocating them to accredited economically active entities that need these sums, the banks have eased the business cycle and hence the risk is distributed among all members of economic system. Hence the economic growth is boosted under the shadow of proper performance of these foundations. But as the banks are effective and important and have a positive role in the economic growth, they are also capable of making financial instability in case of not having appropriate efficiency (Majedi, E. and H. Golriz, 1994; Mckinnon, R., 1973; Shaw, E.; 1973; Gurley, J.G. and E.S. Shaw, 1995).

Efficient financial systems identify and finance the appropriate business opportunities, equipment of savings, coverage and variation of risk, and also facilitating the commodity exchanges and services, and expand investment opportunity (Shaffer, S., 2002; Verbruyge and et al., 1999). On the other side, increased efficiency of financial system will finally provide the ground of more economic growth, by improving allocation of resources, promotion of investment and facilitating investment accumulation. Also efficient financial system will decrease the obstacles of foreign financial supply and by facilitating the conditions for access of manufacturing and industrial units to foreign investments the ground of expansion of investment and more economic growth are prepared (Mirshahi, S., 2004).

Establishment and development of private banking, (Pajoyan, J., 2000) is among the cases that has notably helped improving the status of Iranian banking industry. With regard to high flexibility and variation in presenting banking services, private banking has had a determining role in promotion of banking level (Zare Eskandari, D., 2006).

It is worth mentioning that during 2001 to 2007, six private banks have been established in the Iranian banking systems which have managed to absorb 22% of bank resources, only through a few branches. This is a big achievement for the private banking system of Iran in comparison to 1800 branches of governmental banks and their 78% share in bank resources.

One of the achievements of private banks is to more toward e-banking. Due to providing the required beds, these banks have moved toward Corebanking. Among other changes, we can refer to deposit activities, variety in profitability and introducing new deposit accounts, private banking and participation banking.
Another change is using modern banking and exploiting modern means such as internet-based banking, mobile bank, providing different kinds of credit cards, debit cards, purchase cards and also services such as telephone bank, SMS, fax, SATNA and PAYA. With these services, the customer no longer needed to refer to the bank branches and could easily receive their desired services by different means. In presenting financial supply services, the weakness of connection between economic growth and financial development in oil countries is due to weakness of investment accumulation and investment return. With due regard to the role of financial foundations in the economic development, it seems that a great part of expansion of Iranian financial system owes to development and protection of private banks (Nazari, M., 2001).

Private banks have a high potential to enter and equip financial resources in modern markets, which providing the required legal and operational beds by main participants such as Central Bank and Bourse organizations will facilitate and expedite these processes.

In the short time from their activity, private banks have managed to realize many of their key objectives such as improving the status of manpower, amending the status of branches network, reducing the expenses of rendering services, increasing efficiency of bank network, expansion of variety of bank services, improving quality of services and increasing the pace of rendering services.

The degree of success of bank system and finally expediting the economic growth depends on heeding to the factors that are effective in making appropriate environment for banking operations. The most important constituting elements of such environment are:

1. Trust and confidence among banks, people and the government (Nadali, M., 2008)
5. Reducing the share of government in financial activities for incumbency and or using facilities of bank system
6. Independence of Central Bank
7. Global jump in the field of financial communications

MATERIALS AND METHODS

Regarding by conducting this research, the researcher’s aim is to study performance of private banks in the economic growth of Iran, we could say that this researcher is descriptive and its type is applied (Bazargan. E., 1996; Naderi, E. and M. Seif Naraghi, 1994) and the method of performing it is based on comparison of statistics and indices used in the field of bank system performance and financial expansion among six private bank of Iran including Eghtesad Novin, (Eghtesad Novin bank. Annual report and financial statements. 2002-2007) Parsian, (Bank Parsian. Annual report and financial statements. 2002-2007) Karafarain, (Bank Karafarin. Annual reports and financial statements. 2002-2007) Saman, (Bank Karafarin. Annual reports and financial statements. 2002-2007) Pasargad (Bank Pasargad. Annual report and financial statements. 2005-2007) and Sarmayeh (Bank Sarmaye. Annual report and financial statements. 2005-2007) during 2002 to 2007. Also in order to gather information about theoretical topics, we used secondary data including library method, for use in theoretical topics, specialized books, articles, magazines and specialized bank quarterlies. To gather data, we used annual reports of bank system performance and the statistics presented by Central Bank, (Nadali, M., 2008) balance sheets and financial statements of private banks (Omidinejad, M., 2007; Omidinejad, M., 2008).

Analysis of Data:

Analysis of information and data was made in two ways of descriptive and inferential statistics, using SPSS (statistical package for social science) computer software. (Mominejad, M., 2007) In descriptive statistics section, the indices related to performance of bank system and the ratios related to measuring development of financial sector among six private banks were descriptively studied for the period between 2002 and 2007 and have been compared with each other. From this respect descriptive statistics has notably helped to clarify the status of dispersal of the gathered data. In inferential statistics section, to study research hypotheses, various statistical tests such as Kolmogrov-Smirnov test, Pielson correlation test, Spearman Correlation Test, Regression test and Watson test.

1. The Indices Related to Performance of Bank System:

One of the most important topics in identifying the issues facing the banks is study of the performance of financial zones and their financial indices, in order to study the influence of their performance in economic growth. For this purpose, in this section, some financial ratios are introduced (Mojtahed, A., 2008).
1-1. Profitability Ratios:

Return On Assets (ROA): is gained by dividing net profit by total assets and indicates the profit gained from the value of each unit of asset. If this ratio is low, it will prove that the bank has not favorably used its assets. The standard ratio for ROA is one percent.

Return On Equity (ROE): this ratio is gained by dividing profit after tax subtraction by the total average investment (equity) and indicates net income by each unit of share. If this ratio shows an ascending process it will indicate high efficiency of operations. The ratio of ROE is 15% on standard level.

Net Interest Margin Ratio (NIM): to calculate this ratio in Iranian banks, due to applying and implementing usury-free banking and removing interest and replacing profit, division of “bank profit share and attorney fee” by the assets of each bank is used. The ratio of NIM is 4.5 percent on standard.

Commission Income Ratio: Commission makes part of the bank’s main incomes. This ratio is calculated through dividing net commission by the calculated assets and the bank’s success to present services and the gained commission.

Cost Ratio: one of the important scales to diagnose efficiency of a bank is the ratio of cost to total income. This ratio shows that how many percent of the bank’s operational income is made of administrative expenses (including personnel expenses, necessities, rental, depreciation, assets’ insurance, …). It is obvious that the less this ratio, the bank will be more efficient as concerns the expenses.

1-2. Cash Ratios:

Loan to Assets Ratio: the ratio of loan to assets is one of the mediate ratios that are calculated through division of the loans granted to the total assets. This ratio shows that how many percent of total assets have been granted to applicants as loan. The higher this ratio, the less will be the bank cash.

Deposit to Assets Ratio: the second ratio that has been calculated to explain the performance of banks as a mediate for the sums is the ratio of deposits, which is calculated through dividing the deposits by the assets.

1-3. The Ratios of Investment:

Equity Ratio: this ratio indicates the bank’s protection power by the owners of the shares invested in the bank. The higher this ratio, it will show higher stability power. The average standard of global bank of this ratio is 15%.

Investment Sufficiency Ratio (Tier): in banking status and as regards banking regulations, the ratio of investment sufficiency is one of the key indices in evaluation of financial health of bank. Such ratio is gained through dividing basic investment by the balanced assets based on the risk coefficients. As concerns regulations, the minimum ratio of investment sufficiency is 8%. (Shabani Balanchi, I., 2001)

2. Financial Development Indices

2-1. Bank Section Development

The share of governmental sector in the country’s banking industry: in order to indicate the amount of participation of privately owned banks in the state banking industry, we can use the share of deposits and credits granted by these banks from the reciprocal variables in the bank network. (Bank Sarmaye. Annual report and financial statements. 2005-2007).

The share of non-governmental sector in bank facilities: the quota of credits granted to non-governmental sector from the total granted credits, is one of the indicators that is used in many studies for measurement of financial development. To evaluate how to direct the credits to governmental and non-governmental sectors, the debt of non-governmental sector to banks from the debt of governmental sector and non-governmental sector is used.

The ratio of assets of banks and credit institutes to the assets of bank system: this ratio shows the relative importance of investee financial institutes. The index that is with the said component is the share of internal assets of banks and non-governmental credit institutes from the total bank system assets.

The degree of concentration of banks: one of the indices of the degree of concentration in bank sector is the quota of deposits of the first three banks- which own the highest share of deposits in the bank network from the total deposits of non-governmental sector in bank network. High degree of concentration may indicate no competition and inefficiency of bank network.

2-2. Monetary Development and Monetary Policy Making Quality:

In the second aspect of financial development dimensions, the indices related to the role of monetary policies in financial development are studied.

Financial Depth: the ratio of cash to current internal gross production, as a common standard to evaluate the depth of financial system and the size of financial mediation section.

Government bonds sold by central bank based on monetary base: the ratio of bonds sold by central bank based on monetary base is an index of expansion of indirect monetary policies.
Credits Control: one of the other means of implementing monetary policies in order to influence the real section of economics. Whereas credits control is one of the obstacles in optimal allocation of resources and financial development, decrease of this ratio shows more financial development.

Interest rate freedom: to clarify the interest rate freedom component, real interest rate changes and bank deposits are considered. Positive real interest rate shows more freedom of interest rate.

Results:
Comparing the ratios of profitability, cash and investment, which are among the indices related to the function of bank system, indicates that the function of privately owned banks and financial development reciprocally influence each other and there is a significant relationship between two variables. In another words, a unit of change in the function of privately owned banks will lead to 0.542 changes in the financial development of Iran.

Comparing development of bank sector and development of monetary section, which are indices for measurement of financial development indicate that there is a significant relationship between financial development and economic growth and this means that financial development and economic growth will influence each other reciprocally. In other words, changing development of financial systems will cause 0.64 changes in the economic growth of Iran.

Study of the ratios of asset efficiency, investment efficiency, net profit margin, the commission to the assets and the ratio of expenses to income, which are among profitability indices of privately owned banks, indicates that there is a significant relationship between two profitability variables of private banks and financial development, and these two variables influence each other reciprocally. In other words, every unit of change in the profitability of privately owned banks will cause 0.352 changes in the financial development of Iran.

Study of the ratios of loan to assets and deposits to the assets, which is among cash indices of banks indicate that there is a significant relationship between cash and financial development and these two variables influence each other reciprocally. In another words, every unit of change in cash of privately owned banks will cause 0.0882 changes in the Iranian financial development.

Study of the ratio of equity to the total assets and the ratio of sufficiency of investment, which are among investment indices of privately owned banks indicate that the direction of influence between the two variables is direct and this means that the investment of privately owned banks has a direct effect on financial development. In other words, every unit of change in the investment of private banks will cause 0.814 changes in the Iranian financial development.

Study of the share of deposits and debts of non-governmental sector to privately owned banks, asset of privately owned banks, and the degree of concentration of banks, which are among the indices of development of bank sector, indicate that the direction of influence between the two variables of bank sector development and economic growth is direct. In another words, every unit of change in development of bank sector will cause 0.142 changes in the economic growth of Iran, which demands the necessity of planning in order to increase the number of bank branches and consequently increasing the deposits for more influence in the economic growth.

Study of financial depth, control of credits, balance of bonds sold by central bank and freedom of interest rate, which are all among the indices of measuring development of monetary section and the quality of monetary policy making, indicate that the direction of influence between two variables of hypothesis is direct and this means that developing the monetary section and quality of monetary policy making directly influences the economic growth. In other words, each unit of change in development of monetary section and quality of monetary policy making will cause 0.287 changes in economic growth.

Discussion:
In the long-term look, the monetary variables of Iran show an inappropriate growth compared to the volume of economic activities. These policies caused big problems and challenges, as:
1. Lack of commitment of government to monetary regulations notified in the field of cash growth, facilities interest rate, credits interest rate.
2. Lack of confidence and insecurity of decisions is the factor that reduces economic productivity growth, which in turn is the main root of low economic growth of the country.
3. Inappropriate increase of the volume of credits with the wrong belief that more credits in macro level guarantees growth of productions will cause creation of deposit and increase of cash in the country.
4. The imperative role of real interest rate, spoils the deposits of depositors in favor of loanees and or the inefficient banking system of Iran.
5. Although for legal regulations and its traditional status, central bank of Iran enjoys a good degree of independence, but in practice, during the recent years, rapid replacement of financial managers and officials of bank together with the dictated monetary decisions and policies all indicate weakened degree of independence, which is an inappropriate process.
6. Appropriate policies of central bank to receive its claims from the government and issuing bonds appears to be successful to some extent, according to the conditions that seem to be compulsory. (Shabani Balanchi, I., 2001).

Profitability of state owned bank toward privately owned bank and inefficiency of their managers compared to privately owned banks is in a lower level (Cornett, M.M., S. Khaksari and H. Tehranian, 2003). The government ownership will slow down financial markets, economic growth and monopoly. If the function of private banks leads to increase of the ratios of profitability, received commission and sufficiency of investment and reduce the lever ratios and will bring more profit for the shareholders (Laporta, R., F. Lopez-de-silanes and A. Shifler, 2002). Also private banks have a higher technical efficiency compared to state owned banks (Hasanzadeh, E. and Z. Soltani, 2007).

Regarding the topics mentioned in research literature and the results obtained through analysis of information, the following cases are recommended for more efficiency of financial system of Iran:

1- Freedom of interest rate, particularly because the previous studies indicate that proper enforcement of usury-free banking operations is due to freedom of interest rate.
2- Remove all credit ceilings.
3- Reduce the legal reserves of banks up to international standards level (Farzinvash, A. and S. Farahanifard, 2001).
4- Transfer the activity of numerous commercial banks and the scope of activity to outside.
1- Expand financial market (Karimi, S., 2008).
2- Central banks should be independent and applying monetary policy by indirect means and particularly open market operations.
3- Providing necessary beds for participation of private banks in Iran with the aim of expanding competition and efficiency in supplying financial services in Iran, expanding international and regional banking with collaboration of privately owned and state owned banks with the banks in other countries and privatization of state owned banks and beginning integration and purchase in the banking industry and financial market of Iran in order to increase competition and efficiency in this market (Bonin J. and et al, 2002, Bonin, J. and et al, 2005).
4- Expanding the culture and knowledge of investment in the financial market in micro level of families and agencies by identification and introduction of financial means and training on how to use them and also introducing and identifying active financial foundations (Greenwood, F. and B. Jovanovic, 1990).

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