Libyan International Medical University

Faculty of Business Administration

Department of Finance & Banking

Graduation Project

Examination the Impact of Market Structure and Bank Specific on Profitability of Gcc Banks

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Introduction

- In terms of the financial sector, gulf countries' economies are mostly at the beginning of development. Capital markets in these countries are considered to be in early stages, whilst the banking industry is taking the control of its financial sector .

- The goal of this study is to examine banks' profitability in the context of structure conduct performance (SCP) in the gulf cooperation council (GCC) economies over the period 2000 to 2012.

Objectives Of The Study

- The goal of this study is to examine SCP hypothesis in an integrated model to identify the major determinants of profitability in the GCC banking sector from 2000 to 2012.

- To examine the impact of bank-specific variables on profitability of GCC banks.

- To provide recommendation and implications that will be beneficial for different stakeholder.

Importance of The Study

- Examining market structure drives in Gulf banks' profitability is very critical in terms of the policy implications aiming at reshaping these countries' banking systems.

- An efficient Allocation of investment funds as well as developing these economies in the long run is very important for transforming the economy from oil-based economy to market-based economy.

- There are few studies examined this region and therefore, this study provides missing information and facts about the banking sector performance in GCC.

Research Problem

- The Gulf States' financial industry is still in its early phases of growth. These countries' capital markets are inefficient, underdeveloped, and in many cases non-existent, while the banking industry in this region continues to dominate their financial sector .

- The banking industry in the Gulf is a driving force in these economies, supplying funding for private and public investment projects as well as financing government deficits.

Literature Review

- The revision of 12 paper aimed at examining the determinants of profitability in different markets and compares them to the economic determinants of cost and profit efficiency over the course of a year.

- The reviewed studies revealed that the higher the market concentration, the higher the profitability, and that capital adequacy leads to improved profitability, and that there is a positive relationship between the loan ratio and bank profitability.

- On the other hand, the studies revealed that the higher the cost, the lower the profitability, and that bank size leads to reduced profitability, there is a negative relationship between asset quality and bank profitability.

Research hypothesis

H_1: A higher market concentration increases the profitability of banks in GCC

H_2: There is a negative relationship between the cost management and bank's profitability.

H_3: There is a negative relationship between the size and bank's profitability

H_4: Capital adequacy leads to an improvement in bank profitability.

H_5: Asset quality and bank profitability have a negative relationship.

H_6: The loan ratio and the bank's profitability have a favorable relationship.

H_7: There is a positive relationship between macroeconomics and bank profitability.

Methodology And Model

- This study uses panel data analysis to examine whether market concentration and other bank-specific variables affect profitability of banks in GCC economies.

- Banking data has been collected from 43 banks during the period (2000-2012) from bank scope database.

Table1: Dependent and Independent variables used in the study.

ROAA	The return on average assets is calculated by dividing the net after-tax income by the average total assets.
ROAE	ROE (Return on average equity) is a measure of the return on investment made by shareholders.
NIM	Net interest margin to average total assets.
SIZE	Total assets are a proxy for bank size since they include earning assets, cash and due from banks, repossessed real estate, fixed assets, and goodwill.
COST	The cost-to-income ratio (C/I). It gives information on the management's efficiency in terms of costs relative to revenues generated. Higher ratios suggest ineffective management.
EQAS	Equity in relation to total assets This variable computes capital adequacy as equity divided by total assets. High capital asset ratios imply minimal leverage and, as a result, reduced risks.
LOARESG	The loan loss reserves to gross loans ratio is used to assess credit quality and credit distribution.
CR	Index Herfindahl-Hirschman (HHI). The HHI is a measure of market concentration within the sector and is used to gauge the level of rivalry among banks.
GDPGR	The real gross domestic product (GDP) growth.
INF	The real inflation rate.
LOFUND	This is a measure of liquidity estimated as loans to deposits and short-term funding. Higher ratios signify less liquidity.

Source: *BankScope and the World Bank Database*

Methodology And Model

In equation (1) this study use, Return on average assets is the net after tax divided by average total assets.

$$ROA_{it} = \alpha_0 + \alpha_1 CR_{it} + \beta_1 COST_{it} + \beta_2 EQAS_{it} + \beta_3 SIZE_{it} + \beta_4 LOFUND_{it} ++ \beta_5 LOARESG_{it} + Y_8 GDPGR_{it} + Y_9 INF_{it} \quad \textbf{(1)}$$

In equation (2), return on average equity is used as a dependent variable representing profits of banks, as Well as steps of eliminating variables, repeated respectively:

$$ROE_{it} = \alpha_0 + \alpha_1 CR_{it} + \beta_1 COST_{it} + \beta_2 EQAS_{it} + \beta_3 SIZE_{it} + \beta_4 LOFUND_{it} ++ \beta_5 LOARESG_{it} + Y_8 GDPGR_{it} + Y_9 INF_{it} \quad \textbf{(2)}$$

In equation (3) the net interest margins (NIM) are considered a measure of operating income of banks, this variable has been investigated, as it relies on factors tested above to see whether these factors impact this variable or not:

$$NIM_{it} = \alpha_0 + \alpha_1 CR_{it} + \beta_1 COST_{it} + \beta_2 EQAS_{it} + \beta_3 SIZE_{it} ++ \beta_4 LOFUND_{it} + \beta_5 LOARESG_{it} + Y_8 GDPGR_{it} + Y_9 INF_{it} \quad \textbf{(3)}$$

Results

Table2: Results of OLS Regression with ROAA as the dependent variable.

Variables	ROAA		
	Model 1	Model 2	Model 3
CR	-.061 -1.646	-.042 -1.158	-.022 -.626
COST	-.424 *** -11.836	-.458 *** -12.856	-.431 *** -11.940
EQAS	.317 *** 8.122	.364 *** 9.348	.332 *** 8.510
SIZE	-.124 *** -3.390	-.087 ** -2.357	-.127 *** -3.424
LOFUND	-.080 ** - 2.236	___	-.092 ** -2.572
LOARESG	-.163 *** -4.437	-.152 *** -4.413	-.142 *** -4.383
INF	___	-.191*** -5.279	___
GDPGR	.111 *** 3.124	.116*** -5.279	___
Adjusted R Square	.423	.447	.414
F Statistics	58.124	63.807	65.126

Results

Table3: Results of OLS Regression with ROAE as the dependent variable

	ROAE		
Variables	Model 1	Model 2	Model3
CR	-.065 -1.513	-.083 -1.919	-.043 -1.048
COST	-.443 *** -10.504	-.408 *** -9.703	-.415 *** -9.819
EQAS	-.038 -.827	-.078 -1.697	-.062 -1.357
SIZE	-.065 -1.488	-.102 ** -2.374	-.105 ** -2.414
LOFUND	___	-.104 ** -2.472	-.117 *** -2.772
LOARESG	-.126 *** -3.100	-.144 *** -3.345	-.167 *** -3.938
INF	.123 *** 3.004	___	___
GDPGR	-.192 *** -4.487	.114 *** 2.750	___
Adjusted R Square	.225	.205	.196
F Statistics	23.653	21.128	23.108

Results

Table4: Results of Panel Regression with NIM as the dependent variable

	NIM		
Variables	Model 1	Model 2	Model3
CR	-.016 -.371	-.001 -.020	-.044 -1.118
COST	-.143 *** -3.493	-.141 *** -3.188	-.138 *** -3.371
EQAS	.124 *** 2.781	.255 *** 5.277	.113 ** 2.540
SIZE	-.231 *** -5.524	-.218 *** -4.786	-.230 *** -5.469
LOFUND	.342 *** 8.359	——	.351 *** 8.608
LOARESG	.052 1.233	-.052 -1.222	.068 1.660
INF	——	-.037 -.822	——
GDPGR	-.082 ** -2.033	-.120 *** -2.804	——
Adjusted R Square	.249	.152	.244
F Statistic	26.784	14.986	30.382

Results

Banking profitability in GCC has been decreased but it insignificant there for SCP has not been accept.

Cost management it was also found that there is a negative relationship between it and the profitability of banks.

Capital adequacy, the results showed that the relationship between it and the profitability of banks is a direct positive relationship.

Lofund was also tested and found that there is a negative relationship between it and the profitability of banks.

There is also size, after testing it turns out that the relationship between it and the profitability of banks is negative.

After testing loan loss reserves to total loans, it became clear that the relationship between loan loss reserves to total loan and banks' profitability is a negative inverse relationship.

The inflation variable was also examined and found to have a negative relationship with the bank's profitability.

The GDP variable was measured, and it was discovered that there is a positive relationship between it and profitability.

Limitation

- The limitations of this study cover only a limited period, 2000-2012.

- This study covered only a part of the variables that affect profitability, other variables were not examined such as the ownership of banks, regulations quality and rule of law.

- This study has used financial data obtained from financial statements of different banks in various countries, and thus those financial statements could be exposed to differences in accounting standards for each bank.

Policy Implications

- An empirical analysis that investigated the impact of market focus on profitability showed a negative relationship for regulators to reduce market concentration to increase profitability.

- In respect to capital adequacy, the findings indicate that well- capitalized banks are more profitable, implying that regulators in the gulf region must guarantee that banks are adequately capitalized in order to generate higher profit and growth in the sector, resist possible financial crises, and prevent bankruptcy.

- The size of the bank in terms of total assets in the economies of the GCC region contributed to the decrease in profitability, which indicates that the larger banks were less profitable than the smaller ones, and this fact is considered important for regulators, policymakers and bank managers. With regard to cost, regulators and bank managers must reduce costs to obtain increase profitability and safeguard stability.

Recommendation

It is recommended that future studies go further to verify the commercial banks and Islamic banks in the gulf countries and to discover whether there are differences in profitability and returns.

Future studies may include more variables that have not been investigated such as foreign ownership, regulations quality and extending the study period to include the impact of covid-19 on the financial performance of banks.