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Financial Analysis by Using Profitability Ratios and Its Role in Evaluating the Performance of Commercial Banks a Sample Study Of Commercial Banks in Libya

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Abstract: *Commercial banks is one of the active institutions in the national economy and has significant role in increasing the economic activity of any state. As the primary source of financing and savings. Hence must focus on them in a process of analysis in order to determine the financial position of these banks as well as knowledge centers of power, weakness and mention decision makers in the departments of these banks what might go wrong in the future. As we know that the financial statements in some cases does not reflect the reality of the financial situation or what may be suffered by the banks in the future of the financial problems may lead to bankruptcy. Hence, it has been conducted a financial evaluation of commercial banks for the years 2013-2015. In order to see if the profitability ratios of evaluating the performance of commercial banks and stand on the financial position of commercial banks operating in Libya. And it has been reached important results illustrated the extent the great failings of commercial banks in the creation of the return from behind the huge investments, which amounted to tens of billions in deposits and credit, as well as assets. It was a set of recommendations that would increase the returns of these commercial banks mode. It was also stressed the importance of profitability ratios as the performance of financial analysis and the role played in the detection of deviations and stand on the real situation of commercial banks tools and detection strengths and weaknesses centers.*

I. Introduction

Banking and Financial Studies is considered one of the most important studies in the scientific and practical life, where the commercial banks occupies specifically within the critical importance of these studies, and they are the most important components of the financial of deposit institutions at all and the most prevalent.Commercial banks represent a pillar of the banking system, and they are coming in the second division after central banks.Bank activities are considered one of the important bases of the countries' economy for supporting of the investment projects. The most basic functions of commercial banks are acting as a financial intermediary between lenders and borrowers, where the bank collects national savings and channel them towards investment in economic projects and in line with the credit policy of the State, and according to the theory McKinnon Where the bank collects national savings and channel them towards investment in economic projects and in line with the credit policy of the State. According to the theory of (Mekinon-Show) the function of commercial banks can contribute effectively to economic growth if the government has provided an atmosphere of competition and freedom, especially if they allowed the commercial banks to pay interest on deposits and charging interest on loans to reflect the cash market conditions.Also commercial banks today is considered one of the pillars of the national economy in that it is providing guarantees for the implementation of large projects, and for its role in foreign trade financing, especially in providing letters of credit which guarantee the rights of exporters. In addition, many banking services that offered by banks to their customers, such as money orders, the collection of checks and bills of exchange, payment of salaries and wages, facilitating the IPO process stocks and bonds, and buying and selling foreign currency, debt repayment and payment receipts ... etc.

II. Research Methodology

- **The problem.**

Element of Profitability is one of the most important elements that cannot dispense on in commercial banks.Therefore, the failure to achieve will lead to the destabilization of depositors' confidence and weaken the financial position of the Bank Putting him to the risk of the bank cannot be met and therefore not being able to continue to achieve growth and the competitive advantages.

- **Research importance.**

Recognize the reality of performance in this commercial bank to identify and promote the positive aspects and treatment the negative aspects by finding solutions to it. In addition, support the management and beneficiaries to perform a strategic planning can be more effective leading the bank to earning customer satisfaction and gain competitive advantages.

- **Research Hypothesis.**

The use of profitability ratios in the analysis of financial statements of commercial banks lead to the discovery of strengths and weaknesses in these banks.

- **The aim of research.**

- Measuring the ability of the National Commercial Bank in achieve profitability by using the indicators of profitability.

- **Search limits:-**

It was selected National Commercial Bank that operating in Libya for the years 2013 - 2014 -2015.

III. Theoretical Side

- **The concept of financial analysis:**

"Financial analysis is considered one of important topics that covered by research in the past and present. It is aimed primarily to conduct detailed analysis of the data contained in the financial statements for institutions financial, and clarify its concepts and focus attention on the facts and hidden directories and behind the numbers contained in data in order to assist in the planning and organization of various aspects of activity and control it.As well as, assist in the evaluation of the financial statements in the past and present, without falling into the risk of bankruptcy and loss".[1]

"Also, financial analysis knows is that the diagnosis process of financial situation in the present or in the past for the financial institution with a view to giving indications of future status".

"In addition, It knows is that a detailed study of the data and financial statements to see their meanings and the reasons for their formation in order to find strengths and weaknesses of the financial policy of the financial institution and the extent of power or weak financial position".[2]

- **Uses of financial analysis:**

Financial analysis is used in a variety of purposes such as evaluation of the quality of management, and shows how the extent of successor failure in the financial institution to their respective owners by the preparation of future plans and helping the management to control of the assets of these financial institutions.

At present has emerged of great importance for financial analysis, where it became easy now for the managers of units economic to look to the future by the results of financial analysis to get the clear perceptions on the financial circumstances of the financial institution."Also, using the modern methods in financial analysis has become able to enter analysts endless variables in their analysis, such as interest rate risk, exchange rate of foreign currencies, which can give strong warnings about the ability of payment and altruistic".[3]

- **Tools of financial analysis:**

There are a variety of tools used in the process of financial analysis and can crystallize those instruments into three types:-

1- Horizontal analysis.

This type of analysis is done by calculating the change in the direction of the main elements of the financial statements from year to year in the form of percentages. In order to clarify the changes in terms of rates of change are calculated.

2- Vertical analysis or the relative distribution of the elements of the current financial statements.

"Vertical analysis is an analysis of the current statement by proportional distribution ratio for each statement item relative to total statement".[4]

3- Financial ratio.

1- ALchammkhi, Hamza&Jazrawi Ibrahim.(1998). Modern financial management. Dar Alsafa for publishing and distribution, Oman. p 82.

2- bdullah, AqeelJassim (1999). Evaluation of projects, "a theoretical framework and practical", Amman, Dar Majdalawi for publication, the second edition. P 57.

3- Khaldoun Sharifat(2001) "Management and Financial Analysis, Dar Wael for publication. P241

4- Khal Hamza al-Zubaidi (2002) "bank credit management and credit analysis," Warraq for publication and distribution, Oman P64.

Analysis of financial ratios: It is a set of indicators in the form of financial ratios designed to measure and evaluate the performance of financial institutions.
Financial ratios are divided into four main sections.
A- Liquidity Ratios.
Liquidity ratio measures the financial institution's ability to meet its obligations from cash available to it or any other assets that can be converted into cash in a relatively short period of time.
B- Profitability Ratios.
High profitability indicator points to higher interest rates and increased credit size and diversity of the operations of the bank and increase the volume of transactions and gains from interest rate fluctuations.
C- Activity Ratios.
This indicator helps in measuring the volume of activity in terms of the degree of employment of the money available and is expressed in a number of ratios such as the employment of available funds ratio, which measures the employment of bank deposits and equity investments in the loan.
D- Leverage Ratios.
“This describes the amount of equity in comparison to debt or the amount of earnings in comparison to debt”.[5]

- The benefits and disadvantages of use financial ratios.
First, the benefits of the use of financial ratios (Thompson, 1994, p159):-
1- Determine lost profits unrealized and opportunities of potential growth.
2- Identify potential risk rates.
3- Carry out possible improvements and identify good opportunities.

Second,“disadvantagesinherent in the use of financial ratios in the performance evaluation”:-
1- Financial ratios mean with the factors numbers quantitative character, and they do not measure the quality factors that may be appropriate to conduct an assessment performance of banks.
2- Financial ratios vulnerable to manipulation by the management, which may resort to improve certain rate before the end of the fiscal year.
3- Financial ratios are affected by different accounting procedures. Taking the bank's many methods and different accounting procedures may give misleading results in a lot of areas of analysis.
4- A lot of financial ratios are indicators of static as at the date of preparation of financial statements.

IV. Banking Profitability

- The concept of banking profitability.

“Banking profitability from accounting side is an increase in total revenue on the total costs during a certain period, but in economic terms is an increase in wealth, which includes increased revenue generated for their costs plus the opportunity costs.This means that economic profit is less than the accounting profit due to the presence of these added costs”.[6]

The banks inherently live in a state of intense competition between them in all areas and spending a lot of money in this direction. Nor can any banking system that oppose commercial banks to seek reasonable profit that the profitability is an indicator of the efficiency and optimum utilization of the resources of the country and its wealth.The bank's success depends in reconciling liquidity and earnings as the rising one of these elements affects the other and demonstrated by the disparity in the banking profit rates and this is due to two things:-[7]

- The first thing is the difference in the degree of risk among the different economic activities. If the risk rate was significant in particular activity was the profit big, and this in turn affects the bank liquidity and vice versa right.
- “The second thing is a different degree of efficiency between the managers in the same activity and when the manager is more efficient in his management of its facilities the profit rate will be high, and vice versa”.[8]

5- Assaf, Mahmoud (1979) Financial Facilities Management, Alexandria. P 48.

6- Hammad Tariq Abdel Aal, (2003) Risk Management, University House, Alexandria. P297.
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- **Banking profitability indicators.**

1- Return on Equity (ROE).

This indicator measures the rate of return earned on the investment of the owners money, and that the high ratereturn on the right of ownership is a guide to the efficient management performance, and can be a guide to high riskthat resulting from increased leverage, while its decrease refers to a careful financing.It is calculated according to the following formula.[9]

$$\text{Return on Equity} = \frac{\text{Net profit after tax}}{\text{Equity}} \times 100$$

2- Return on Deposit.

It is used to measure the success of the Bank's management to generate profits from deposits that could be obtained is calculated according to the following formula. [10]

$$\text{Return on deposits} = \frac{\text{Net profit after tax}}{\text{Total of deposits}} \times 100$$

3- Return on Total Resources.

This indicator measures the efficiency of the management of banks to generate profits from the funds available to them and of property rights and deposits, and the increase in the rate shows the bank's ability to achieve returns from investment of funds in profitable assets and measured according to the following formula[11].

$$\text{Return on Total Resources} = \frac{\text{Net profit after tax}}{\text{Deposits+ Equity}} \times 100$$

4- Return on Total Assets.

This ratio reflects the bank's ability to use its assets in generating profits, and the more this ratio increased whenever indicates that the efficiency of the bank in the exploitation of its assets.[12]

$$\text{Return on Total Assets} = \frac{\text{Net profit after tax}}{\text{Total Assets}} \times 100$$

5- Return on Capital employed.[13]

This ratio measures the net profits generated by the funds used and not all the assets in the bank, there may be some assets that have not been used. Therefore, there is a tendency to exclude these funds unused.

$$\text{Return on Capital employed} = \frac{\text{Net profit}}{\text{Capital employed}} \times 100$$

- **Analytical side.**

In this side, Iwill cover the profitability index in order to determine the performance of the commercial banks and to identify the strengths and weaknesses through this indicator.

V. The Ownership Structure Of Banks14: -

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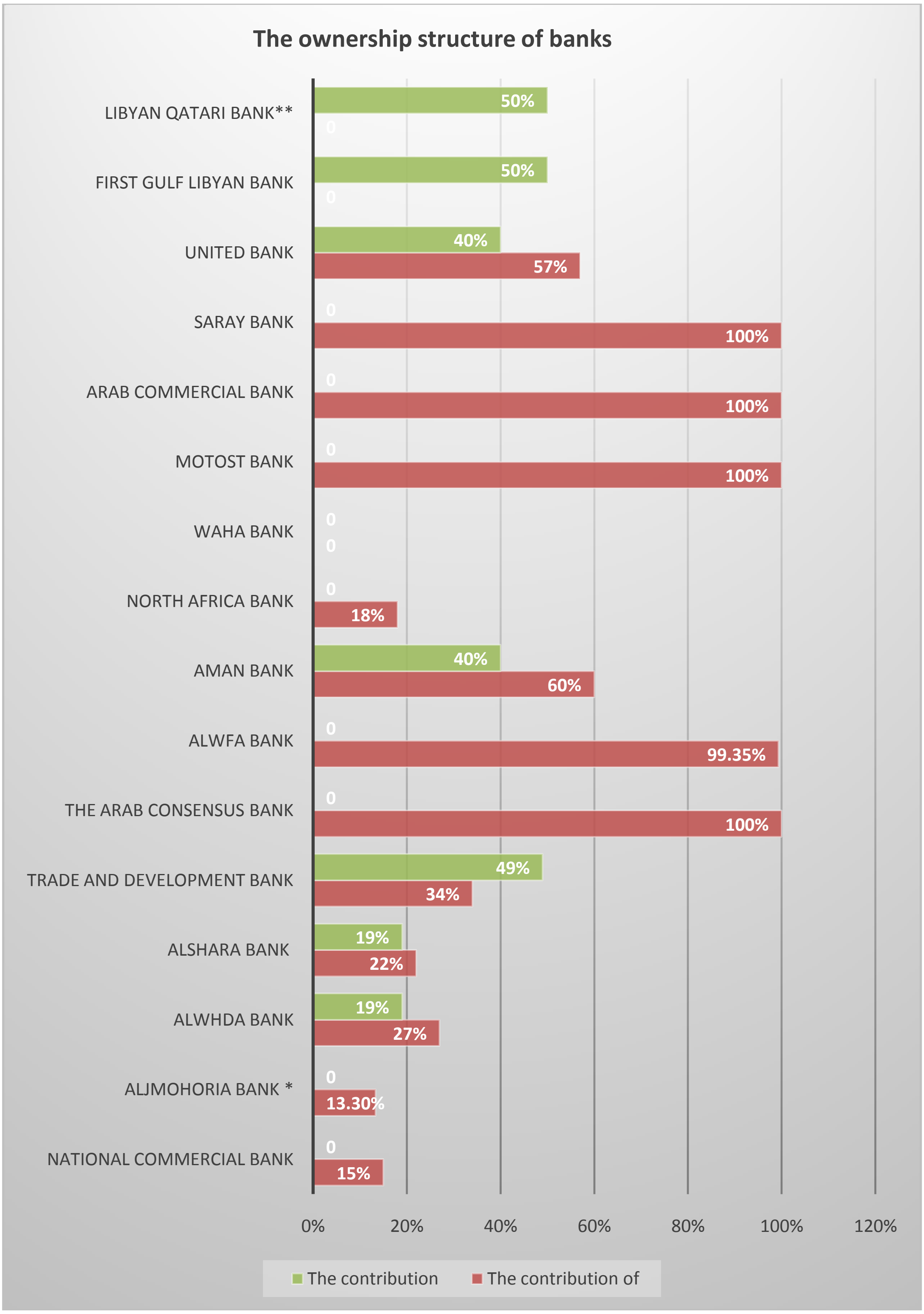
14_ Central Bank of Libya,(2008) The evolution of the most important data of commercial banks in Libya.

Commercial banks are divided into large commercial banks with public ownership, namely: Republic Bank, Sahara Bank, the National Commercial Bank, Unity Bank and the Bank of North Africa, while some banks entered into a strategic partnership with foreign banks in equity. It is, Wahda Bank with the participation of the Arab Bank of (Jordan) by 19%, and Sahara Bank with the participation of BNP Paribas (France) 19%, and United Bank for trade and investment with the participation of Ahli United Bank (Bahrain) by 40%, and the Bank of Alaman with the participation of Espirito Santo Bank (Portugal) by 40%, And the Trade and Development Bank with the participation of the National Bank of Qatar (Qatar) by 49%. The State of Qatar participated by 50% in the Libyan Bank of Qatar. Also the Emirates participated by 50% in the First Gulf Libyan Bank, where these banks acquires for the bulk of the banking market.

(TableNo. 1)

Bank	The contribution of the public sector	The contribution of the private sector	The contribution of partners Strategists
National Commercial Bank	85.60%	15%	0
Aljmohoria Bank *	86.60%	13.30%	0
Alwhda Bank	54%	27%	19%
Alshara Bank	59%	22%	19%
Trade and Development Bank	17%	34%	49%
The Arab consensus Bank	0	100%	0
Alwfa Bank	0.65%	99.35%	0
Aman Bank	0	60%	40%
North Africa Bank	82%	18%	0
Waha Bank	100%	0	0
Motost Bank	0	100%	0
Arab Commercial Bank	0	100%	0
Saray Bank	0	100%	0
United Bank	3%	57%	40%
First Gulf Libyan Bank	50%	0	50%
Libyan Qatari Bank**	50%	0	50%

* (Source: Annual Report of the Central Bank of Libya, 2014)
Alama Bank was merged with Bank Republic since 2008. ** Has not start work.

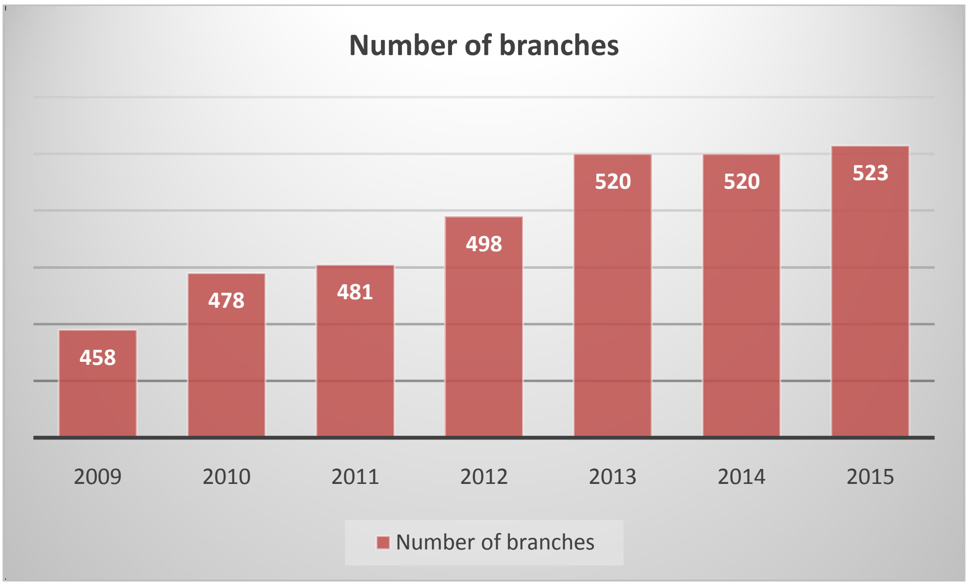


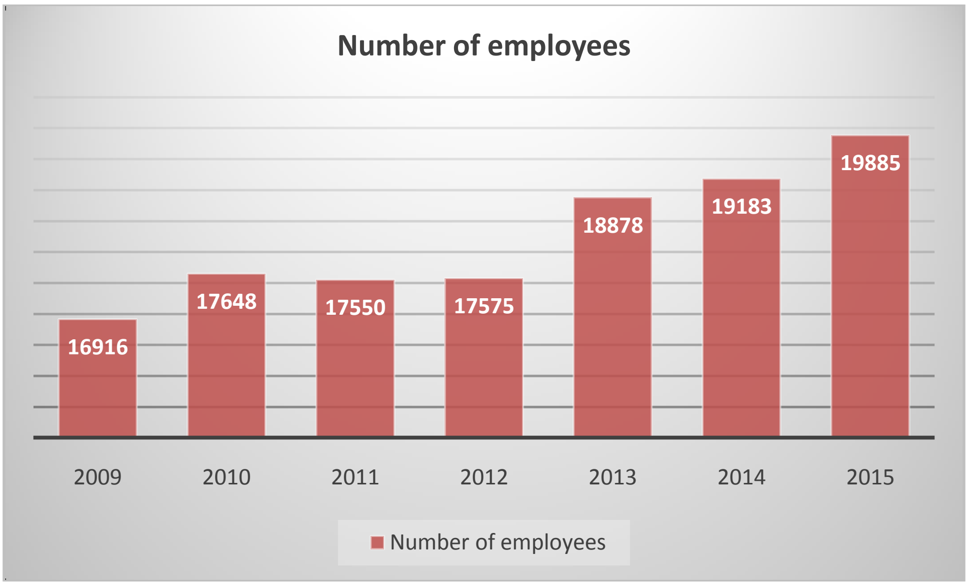
Evolution of the number of branches and banking agencies and their personnel:-

(TableNo.2)
(Source: Annual Report of the Central Bank of Libya, 2015)

YEAR	Number of branches	Number of employees

	and agencies	in the banking sector
2009	458	16916
2010	478	17648
2011	481	17550
2012	498	17575
2013	520	18878
2014	520	19183
2015	523	19885





- **Profitability ratios.**

This indicator is one of the important indicators that the banks whatever the nature of their activities and areas are for profit with a gain of applicants and owners confidence, and increase their money deposited with a key indicator to judge the efficiency of the performance of banks, and the most important indicators of profitability.

1. Return average on equity.

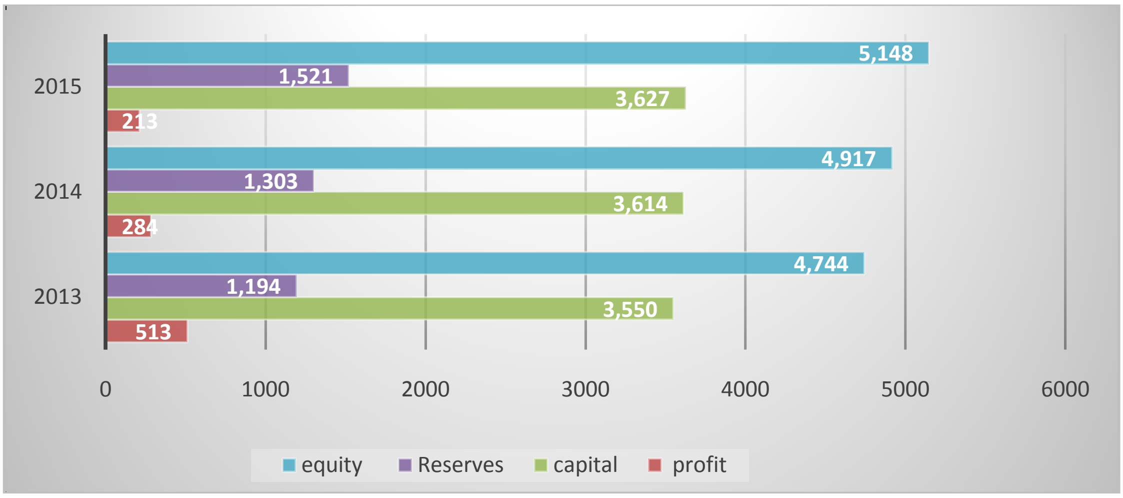
This ratio reflects the returns earned by shareholders to invest their money, which is calculated by dividing the net profit on total equity (capital + reserves) as in Table 3.

Notes through Table 3 the extent dramatic decline in the rate of return on equity, where he was in 2013 approximately 11%. It decreased in 2014 by half, reaching 5.8% rate also fell in 2015 to 4.1% and this was due

to the profit declined from 513 million dinars in 2013 to 213 million dinars in 2015 with a clear increase in total equity.
Hence the commercial banks should work on the existence of alternatives for this type of investment because yield of small compared to this the sheer volume of money

Table 3
MILLION DINARS

year	profit	Equity		Total of equity	Ratio%
		capital	Reserves		
2013	513	3,550	1,194	4,744	10.8
2014	284	3,614	1,303	4,917	5.8
2015	213	3,627	1,521	5,148	4.1



Data source of financial reports that issued by the Central Bank of Libya following commercial banks, Gomhoureya Bank, National Commercial Bank, Alwhda Bank, Sahara Bank, Unit Libyan dinar, Trade and Development Bank, North Africa Bank, Aman Bank for Trade and Investment, Waha Bank, Arab consensus Bank, First Gulf Libyan Bank, United Bank for Trade and Investment, Alwfa 'Bank, Almotoast Bank, Arab Commercial Bank, Sarai Bank for Trade and Investment.

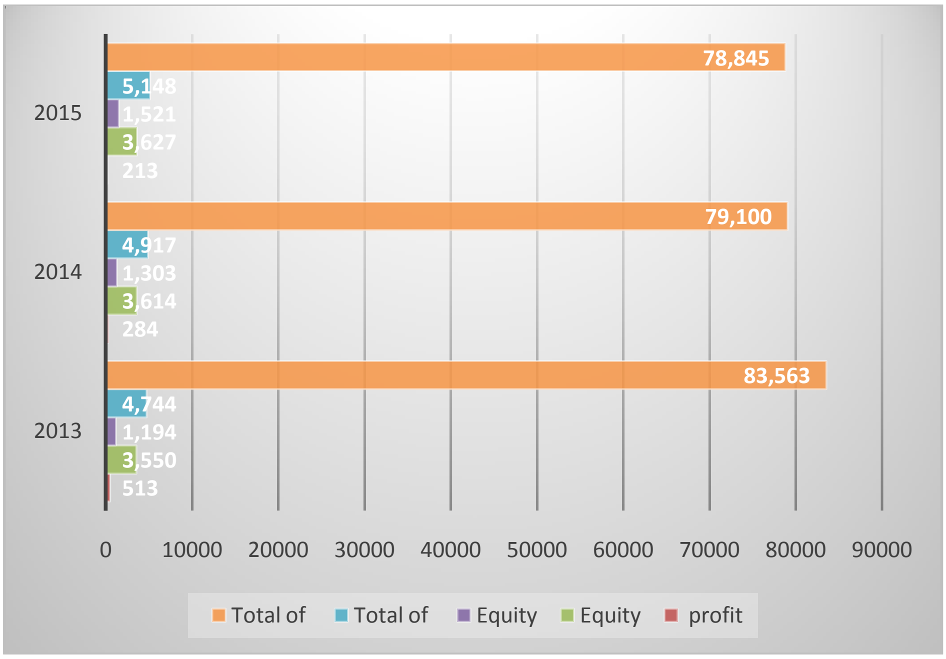
2. The rate of return on available funds.

This ratio is calculated by dividing the net profit to total deposits and equity, considering that deposits and equity represent a major source of investment banking, and this indicator is seen as an indicator for the efficiency of the bank for future planning in profit.

The following table shows the inefficiency of the future planning hand to get a return on these investments. We also note that the rate of return on the money available is negligible in terms of the rate.
In the year of 2013 was 0.6% the rate This was due to higher deposits and equity and offset by a decrease in profits where deposits exceed 83 billion dinars either equity exceeded 4.5 billion dinars, while profits do not exceed 500 million and this is a serious indication of existence a large gap between the size of investments and the yield obtained, as well as in the rest of the years.

Table 3
MILLION DINARS

The year	Net profit	Equity		Total of equity	Total of deposits	Ratio%
		capital	Reserves			
2013	513	3,550	1,194	4,744	83,563	0.6
2014	284	3,614	1,303	4,917	79,100	0.3
2015	213	3,627	1,521	5,148	78,845	0.3
Average						0.4



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3. The rate of return on deposits.

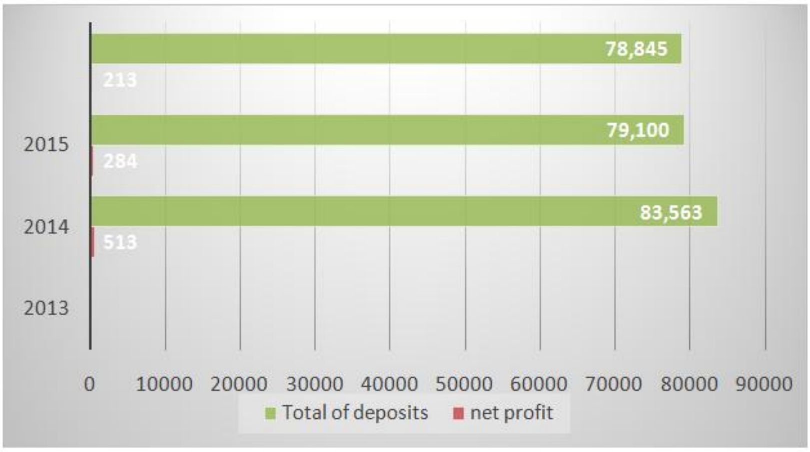
This indicator is calculated by dividing the profit on total deposits. This is an important rate for the performance of commercial banks as it shows the ability of banks to create profits by investing in deposits. Whenever this ratio was high on the banks indicate the efficiency of investment in deposits.

This low the rate too. Which it notes that the year 2013 was 0.6% and gradually decreases until it reached 0.3% in 2015. This indicator reflects the significant decline by investing in deposits. So,the commercial banks' should review of investment policy in deposits and working to diversify its investments.

Table 4

MILLION DINARS

The year	net profit	Total of deposits	Ratio%
2013	513	83,563	0.6
2014	284	79,100	0.4
2015	213	78,845	0.3



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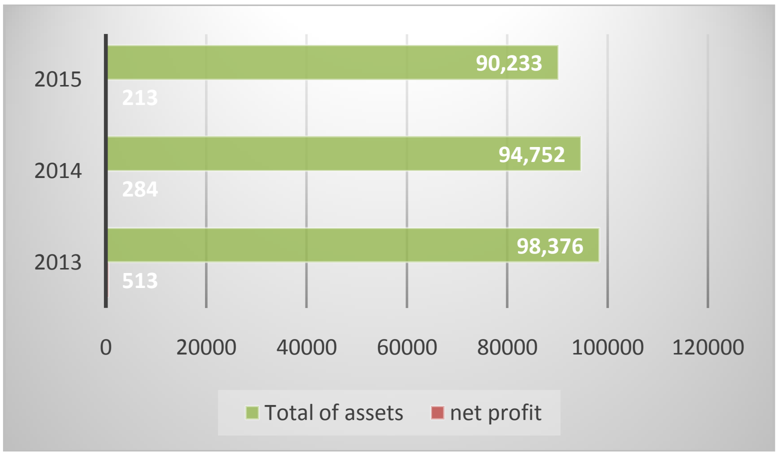
4. The rate of return on assets.

This indicator explains the extent of the ability of banks to employ the assets owned by its ability to generate profits and its efficiency during a certain period of time, in other words, the success of the bank's investment in his property and his ability to know the areas of the most feasible investment opportunities.

This indicator is no different the previous indicators in terms of decline, as it did not exceed 0.5%, and this gives an idea of simplified for how to manage the use of commercial banks to generate profits from assets, which requires re-thinking in the way of profit-generating assets and the search for the causes of this deterioration is clear profitability indicators.

Table 4
MILLION DINARS

The year	net profit	Total of assets	Ratio%
2013	513	98,376	0.5
2014	284	94,752	0.3
2015	213	90,233	0.2



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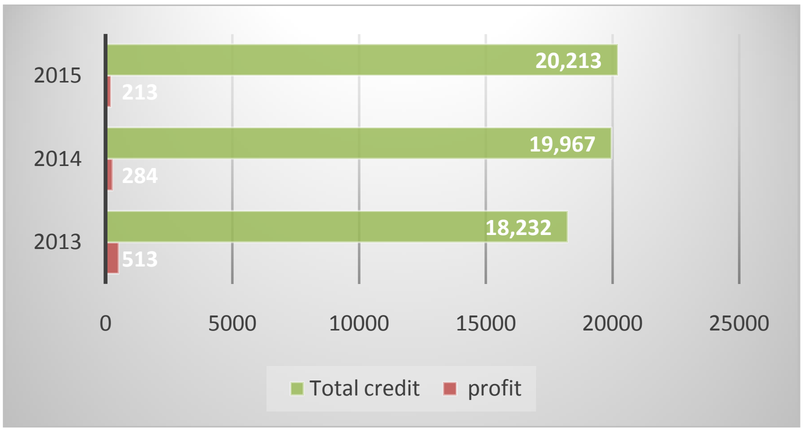
5. Indicator of net profit to total credit.

Credit is one of the key indicators to measure the profitability of the project by comparing it with a number of indicators.

This indicator confirms the weakness of the efficiency of commercial banks to generate profits through bank credit. Where notes that the rate of value in 2013 was 2.8%. It declined in 2014 to half due to lower net more profitable credit and high. Similarly, in 2015, where he arrived to 1.1% which is low when compared to the size of the credit.

Table 5
MILLION DINARS

The year	net profit	Total of credit	Ratio%
2013	513	18,232	2.8
2014	284	19,967	1.4
2015	213	20,213	1.1



Data source of financial reports that issued by the Central Bank of Libya following commercial banks, Gomhoureya Bank, National Commercial Bank, Alwhda Bank, Sahara Bank, Unit Libyan dinar, Trade and Development Bank, North Africa Bank, Aman Bank for Trade and Investment, Waha Bank, Arab consensus Bank, First Gulf Libyan Bank, United Bank for Trade and Investment, Alwfa 'Bank, Almotoast Bank, Arab Commercial Bank, Sarai Bank for Trade and Investment.

VI. Results

The results showed that a decline in the rate of return on capital despite the rise in capital of commercial banks, as well as reserves against a fall of profits and this refers not to the low returns obtained by the shareholders from behind investments in commercial banks.

1- Despite the dramatic rise in the volume of funds available to note down the returns. This indicator gives a clear picture of the futility of investing in the funds, which makes it imperative for banks review their investments.
2- High volume of deposits in commercial banks to 78 billion dinars was offset by a decrease in returns obtained Where profit amounted to 213 million dinars, and it indicates a defect which led to the weakness of the profits generated from the deposits.
3- A low rate of return assets like its predecessors and indicates an obvious defect in the functioning of commercial banks in order to get profits.
4- Profitability ratios showed the existence of a defect in commercial banks, which shows the role of this indicator in the detection of deviations and weaknesses in the commercial banks, which contributes to correcting deviations and do not continue to fall into such mistakes in the future.
5- The profitability ratios serve the financial analyst and investor in evaluating the performance of the commercial banks as well as the efficiency of its departments in the design and Implementation of financing and investment policies.

VII. Recommendations

1- We should take advantage of the financial analysis in the fight against financial corruption and administrative system by assessing performance using financial analysis tools which include the analysis ratios.
2- Work on the use of funds available and try to invest the way that ensures the largest amount of profits.
3- To diversify investment sources through the formation of investment portfolios that suit the nature of the commercial banks.
4- Benefit from the experiences of other countries in diversifying the sources of income from participating or configure local and international partnerships.
5- Review the policies imposed by the Central Bank of Libya, which limit the creation of suitable investment environment.
6- Revision of laws and regulations that limit the ability of commercial banks to create a competitive environment contribute to raise profits.
7- The commercial banks' balance between liquidity and profits and not to leave deposits idle investment.
8- Forcing commercial banks taking the results of the financial analysis and try to take advantage of them and control Implementation of the recommendations.
9- Granting financial analyst more powers to carry out accountability of those responsible for adopting the resolution in the event of non-compliance with the recommendations that should be followed.

10- The expansion of a financial analysis by the financial analysts and lack of focus on the type or types of analysis in order to detect deviations.

11- Givinganalysts more local and foreign courses which contribute to raising the efficiency of financial analyst.

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