Financial Analysis of Afghanistan International Bank

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Abstract:

Afghanistan International Bank (AIB) is one the Afghanis commercial banks, its head office in Kabul. The bank has seven branch offices in the major cities of the country. AIB has international shareholders, two Afghan business groups, and one Afghan/American business group. It opened in 2004.

Vision: We aspire to remain the most reputable financial institution and bank of choice in Afghanistan.

Mission: Our mission is to foster economic development in Afghanistan, to be a catalyst for growth, and ultimately contribute to the prosperity of the country and its people.
We strive to adhere to international best practices in corporate governance, financial and risk management (including anti-money laundering and 'know your customer'), customer service, operations, information technology, and internal controls. A major factor in our success is dedication to staff development and training within a culture of integrity and professionalism.

Financial statements are made and organized by board of directors in order to report to shareholders in releasing of their stewardship function and also to corporate law directs the responsibility of laying down prior to yearly shareholders general meeting, profit and loss account should be included in the balance sheet and auditor's report should be attached thereto

Keywords: Bank, Financial statement, analyze

JEL Classification Codes: G10, G21, G24

Introduction

Afghanistan is considered one of the poor countries in the globe, without any proper infrastructure in different dimensions, Banks are one of the most important factors which can bring vital changes in the living of people by issuing logical loans and offering different kinds of financial opportunities for entrepreneurs, This research unveils the financial position of one of the most credible banks in Afghanistan (Afghanistan International Bank), meanwhile the first chapter covers background of the study, statement of the problem, research questions, and justification of the study, objective of the study, research methodology, and significance of the study, scope of the study, limitation and organization of the study.

Company Profile

Afghanistan International Bank (AIB) is one the Afghanis commercial banks, its head office in Kabul. The bank has seven branch offices in the major cities of the country. AIB has international shareholders, two Afghan business groups, and one Afghan/American business group. It opened in 2004.

AIB operates primarily as a commercial wholesale bank and targets, among others, multilateral organizations, UN entities, NGOs, embassies, foreign military forces, Afghan governmental institutions, foreign and domestic companies, to become their clients.

The bank operates from AIB House, which is located in Shahr-e-naw of Kabul City. Bank has its branchesin MazareSharif, Herat, Kandahar, Jalalabad, Kunduz PoleKhumri, Helmand, Nimruz, and Kabul City.

Afghanistan International Bank's assets are at approximately US $80 million. The Wall Street Journal has described the company as "one of the country's biggest lenders" (in Afghanistan).

1.1.1 Vision

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1.1.2 Mission

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Problem Statement

In every entity particularly banking sector financial performance plays an essential role, defines competitiveness, opportunities of the business, and economic interests of the company’s management and reliability of current and future contractors. Therefore, financial performance analysis and identification of their weakness and strength using financial performance pointers has its own contribution to the shareholders, the regulator (the government), management, the public (customers of the bank), the financial sector, and the entire economy.

The main purpose of financial statement is to provide information about the financial position, performance and changes and changes which occurs in financial status of an enterprise that is useful for subscribers’ economic decisions.

Although very little research have been conducted on financial performance analysis of banks, such as insurance, performance comparison between the government and private banks, and other financial institutions, this kind of analysis in the case of Afghanistan international bank (AIB) I believe is still not unveiled.

The most important point about this research is to analyze the financial position of Afghanistan International Bank.

Research Questions

The research contains the following questions:

1- What is the position of various elements financial trend in the financial statements look like?
2- Is the bank in a good position in term of liquidity?
3- Can the bank survive in the market with its current financial position?

Research Objectives

1.1.1 **General Objective**

General objective of the research is to analyze financial performance of AIB bank from different aspects.

1.4.2 **Specific Objective**

- To study and analyze various elements financial trend in the financial statements of AIB.
- To analyze risk and solvency position of AIB during four years.
- To analyze liquidity of AIB during multiple years.

Significance of the Study

This research will be effective and essential for different people, as this research rotates around a vital issue of business scenario, the following can be the significances of this research.

1- It gives insight about the financial position of one of the important banks of Afghanistan.
2- To add vital knowledge for both academicians and practitioners.
3- As AIB is one of the key banks in the territory, then its financial performance can replicate the situation of banking in Afghanistan.

Literature Review

Neely et al., (1997), stated that “the financial system and banking issues and problems turned to be critical and essential the quick past years over the globe. Both financial sector and banking are really defenseless against the systemic crises which impacted to the eruption of costly safety nets, as a person who have deposit insurance schemes with well-known moral problem. It has been told that there are several evidence that banks are “black boxes” due to the week clearness or in other words transparency and banks not ready and not willing to unveil the information”.

Kosmidou, K. (2008), argued that “Indicators of nonperforming loans and business being fails are also usually available only at low rate, if at all; the latter are also made less informative by banks desire to hide their problems for as long as possible.” This means that it is needed to use as fully and complexly as possible all available financial information from the official financial statements of banks for making financial analysis of banks’ performance.

Bernstein and Wild, (2000), mentioned that “Financial statements are made and organized by board of directors in order to report to shareholders in releasing of their stewardship function and also to corporate law directs the responsibility of laying down prior to yearly shareholders general meeting, profit and loss account should be included in the balance sheet and auditor’s report should be attached thereto”.

Khan, M Y, (2007), stated that "Analysis of financial statements reveals important facts concerning managerial performance and the efficiency of the firm. Broadly speaking, the objectives of the analysis are to apprehend the information contained in financial statements with a view to know the weaknesses and strengths of the firm and to make a forecast about the future prospects of the firm thereby, enabling the analysts to take decisions regarding the operation of, and further investment in, the firm".

Jagels, et al., (2003), mentioned that "Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the various items of the balance sheet and the profit and loss account. Financial analysis can be undertaken by management of the firm or by parties outside the firm, viz. owners, trade creditors, lenders, investors, lab our unions, analysts and others". The nature of analysis will differ depending on the purpose of the analyst.

Fabozzi, et al., (2003), mentioned that "However, when a relationship is established between two numbers figuring in the three financial statements, i.e., balance sheet, income statement, and cash flow statement, one can make an assessment regarding the phenomenon. Ratio analysis involves calculation and interpretation of financial numbers by relating them in a logical manner in order to assess the strengths and weaknesses underlying the performance of an enterprise. We calculate ratios because in this way that we get a comparison that may prove more useful. In order to comment on the quality of a ratio one has to make a comparison with some standard or benchmark".

Iqbal et al., (2005), stated that "Profitability ratios are generally considered to be the basic bank financial ratio in order to evaluate how well bank is performing in terms of profit. For the most part, if a profitability ratio is relatively higher as compared to the competitor(s), industry averages, guidelines, or previous years' same ratios, then it is taken as indicator of better performance of the bank. In the banking literature, different scholars in measuring bank performance have used many profitability ratios".

Samad and Hassan (2000), mentioned that "It measures the operating profitability of the bank with regards to its total operating expenses. Operating profit is defined as earnings before taxes and operating expenses means total non-interest expenses. The ratio measures the amount of operating profit earned for each dollar of operating expense. The ratio indicates to what extent bank is efficient in controlling its operating expenses. A higher PER means bank is cost efficient and is making higher profits".

Peters, Raad and Sinkey, (2004), argued that "Net interest income is the difference between interest income and interest expense. It is the gross margin on a bank's lending and investment activities. The higher the ratio the cheaper the funding or the higher the margin the bank is obtaining. A bank's net interest margin is a key performance measure that drives ROA".

Samad and Hassan (2000), mentioned that "These ratios measure ability of the firm to meet its short-term obligations, maintain cash position, and collect receivables. In general, sense, the higher liquidity ratios mean bank has larger margin of safety and ability to cover its short-term obligations. Because saving accounts and transaction deposits can be withdrawn at any time, there is high liquidity risk for both the banks and other depository institutions. Banks can get into liquidity problem especially when withdrawals exceed new deposit significantly over a short period of time".

Data and Methodology

3.1 Research Design:

As the core focus of the study is on the description of data and awareness in the facts, the research design most sound and logical for the study was case study, quantitative and descriptive Research Design.

3.2 Population:

As this case study was on Afghanistan International Bank financial performance, so the numbers for analysis was taken from the bank annual report which is being published annually on their official website. www.aib.af

3.3 Sampling Size:

In total four years financial report was extracted from the bank site.

3.4 Sampling Technique:

Among multiple years of financial report allocated on the bank website, I have taken latest four of them for the study.

3.5 Source of Data:

I have taken the data from secondary sources, I have used observation and reviewing existing data techniques for my research.

3.5.1 Secondary Data Collection:

Secondary data was collected from article, publications, various websites most importantly AIB website, text books, journals, newspapers, internets and other writings.

3.6 Data Analysis:

I have chosen ratio analysis for being aware of Afghanistan international bank financial performance, mainly liquidity ratio, solvency ratio and profitability ratio which are the most important indicators of financial position.

Findings and Analysis

Ratio Analysis

As it was already mentioned, a bank's balance sheet and income statement are valuable information sources to evaluate financial strengths and weaknesses of a bank and its business trends. Although the birr amounts found on these statements provide valuable insights into the financial performance and condition of the bank, the researcher typically use data from them to develop financial ratios to evaluate the bank financial performance. In all of the remainder of this chapter, the researcher undertakes key ratios commonly used by bank analysts to evaluate different dimensions of financial performance of Afghanistan International Bank, including liquidity, profitability, and credit risk & solvency in comparison with the industry average over four years.

4.1 Liquidity Ratios

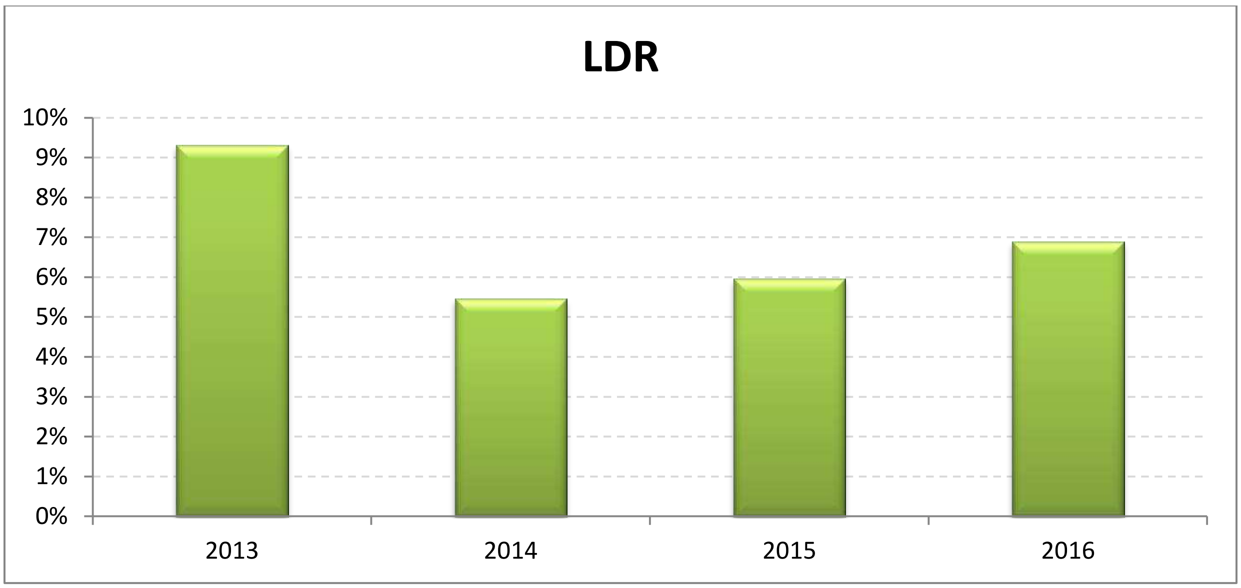
The liquidity ratios measure the capability of bank to meet its short-term obligations. Generally, the higher value of this ratio indicates that firm has larger margin safety to cover its short-term obligations. Among the various liquidity measures, the study uses the following three liquidity ratios.

4.1.1 Loan to Deposit Ratio (LDR)

Loan to deposit ratio indicates the percentage of the total deposit locked into non-liquid asset. A higher loan deposit ratio indicates that a bank takes more financial stress by making excessive loan. Therefore, lower loan deposit ratio is always favorable to higher loan deposit ratio. This low value of loan deposit ratio also indicates effectiveness of mediation function of bank.

	2013	2014	2015	2016
LDR	9%	5%	6%	7%

Table 1



Graph 1

Interpretation

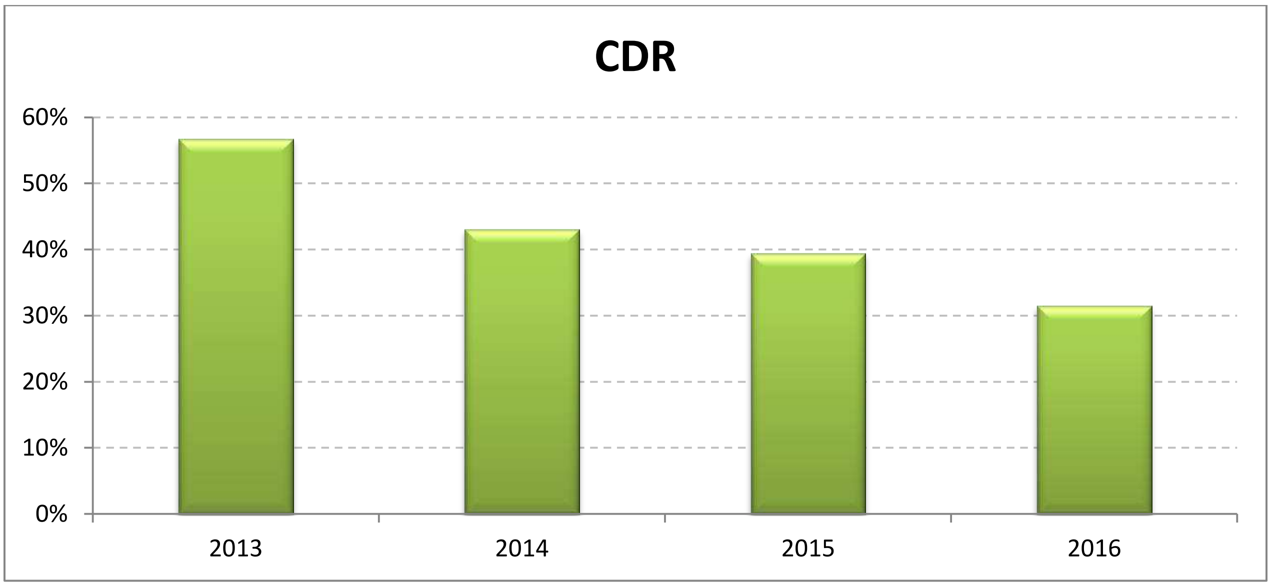
The above chart obviously shows that AIB was in good position through out these specific four years in term of liquidity, although it was a bit higher in the beginning but turned better in the two middle years, meanwhile as per our country political stability is concerned LDR may increase, because the interest to invest in the country is degraded.

4.1.2 Cash Deposit Ratio (CDR)

Another measure of liquidity of the bank is the cash to deposit ratio. The higher the ratio the better is the liquidity position of the bank, therefore, the more is the confidence and trust of the depositors in the bank as compared to the bank with lower CDR.

	2013	2014	2015	2016
CDR	57%	43%	39%	32%

Table 2



Graph 2

Interpretation

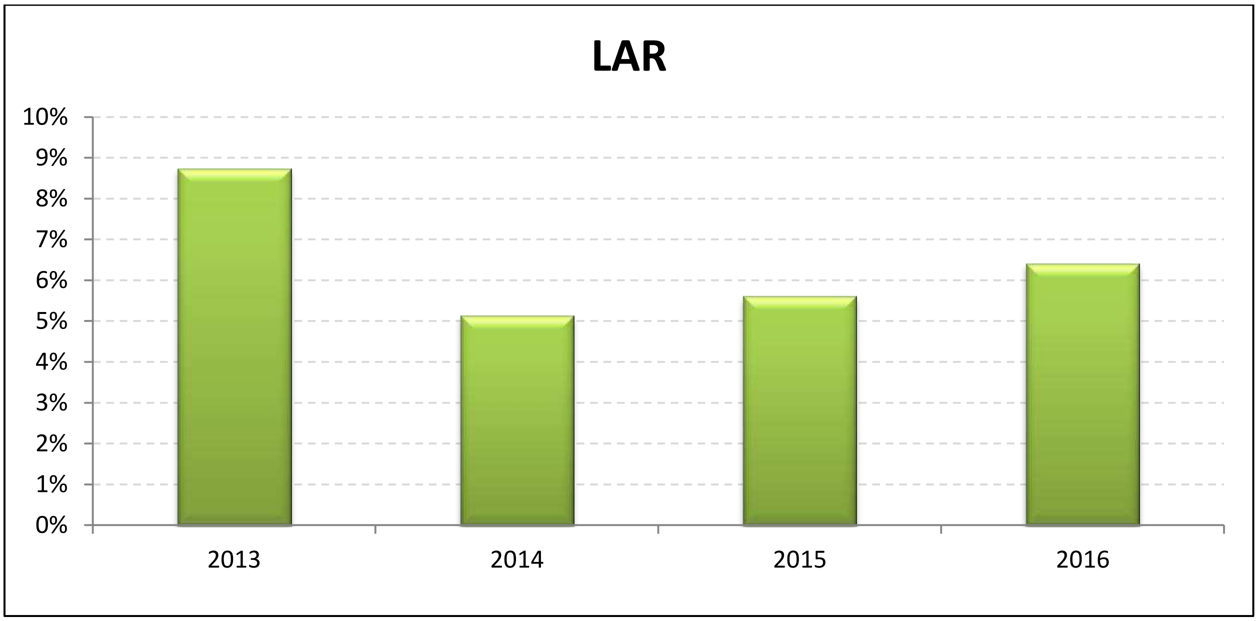
As we can clearly see in the above plot is the drastic decrease in the bank CDR, which is obviously due to depositors trust on banks and also the general situation of this territory which seems to be escalated toward ambiguous future, furthermore if the trend goes on the same path then it would be really difficult for the bank to survive in the market.

4.1.3 Loan to Asset Ratio (LAR)

The loans to assets ratio measure the total loans outstanding as a percentage of total assets. The higher this ratio indicates a bank is loaned up and its liquidity is low. The higher the ratio, the more risky a bank may be to higher defaults.

	2013	2014	2015	2016
LAR	9%	5%	6%	6%

Table 3



Graph 3

Interpretation

LAR of AIB is on decreasing trend over these four years, this decreasing trend of AIB LAR during these years indicates that AIB was doing well with its loans, and are efficient on managing their loans. Meanwhile AIB is taking by making excessive loans and holding less liquid assets during the periods. However, this is an indication of potential betterment in profitability and conforms to our results drawn from profitability ratios of AIB for the period.

4.2 Profitability Ratios

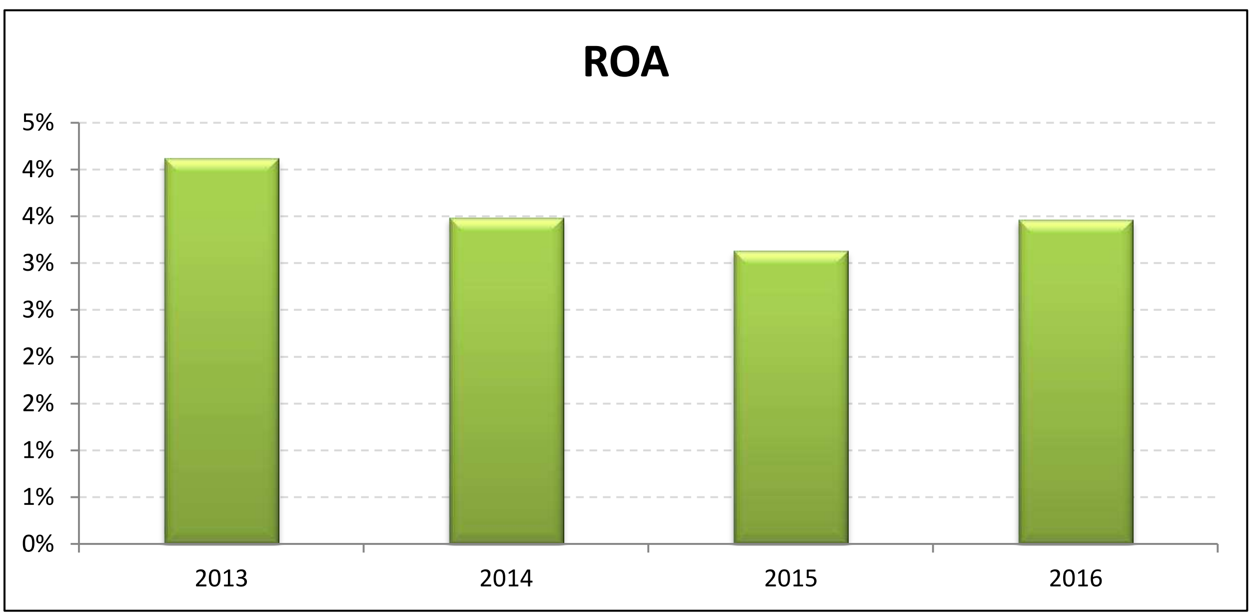
Profitability is a management concept with the objective of assessment bank's results from efficiency point of view both for entirely activity and for differently management compounds. From conceptual point of view, profitability represents the modality to achieve the major goal of bank's activity, respectively the maximization of profit in minimization risk conditions. In order to see how AIB has profitable in comparison with the industry average over seven years under the study, the study uses five profitability ratios namely, Return on assets (ROA), Return on Equity (ROE), Profit Expense Ratio (PER).

4.2.1 Return on Assets (ROA)

ROA is defined as the ratio of profit after tax to total asset. It reflects the efficiency with which banks deploy their assets. The higher the ROA, the most profitable is the bank.

	2013	2014	2015	2016
ROA	4%	3%	3%	3%

Table 4



Graph 4

Interpretation

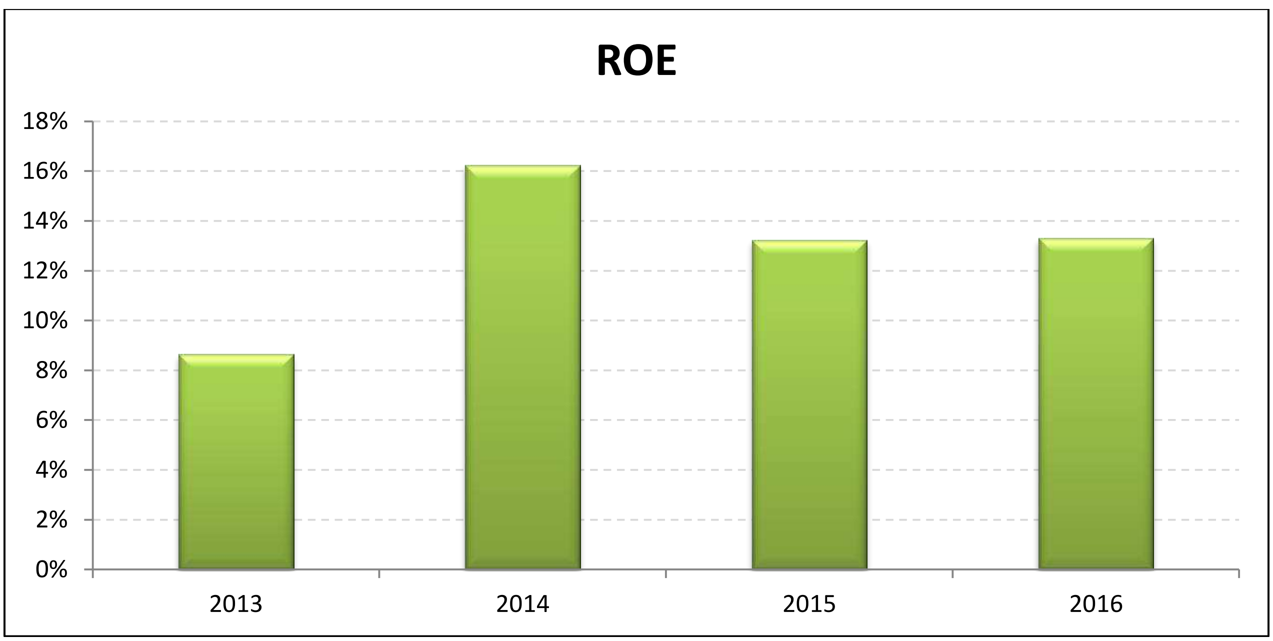
As we can observe on the above chart is that ROA of AIB is quite stable in the analyzed four years, meanwhile as per the percentage is concerned the profitability seems to be so low, the reason might be due to high expenses.

4.2.2 Return on Equity (ROE)

This ratio indicates how bank can generate profit with the money shareholders have invested. The higher value of this ratio shows higher financial performance. Like ROA, this ratio is also indicator for managerial efficiency.

	2013	2014	2015	2016
ROE	9%	16%	13%	13%

Table 5



Graph 5

Interpretation

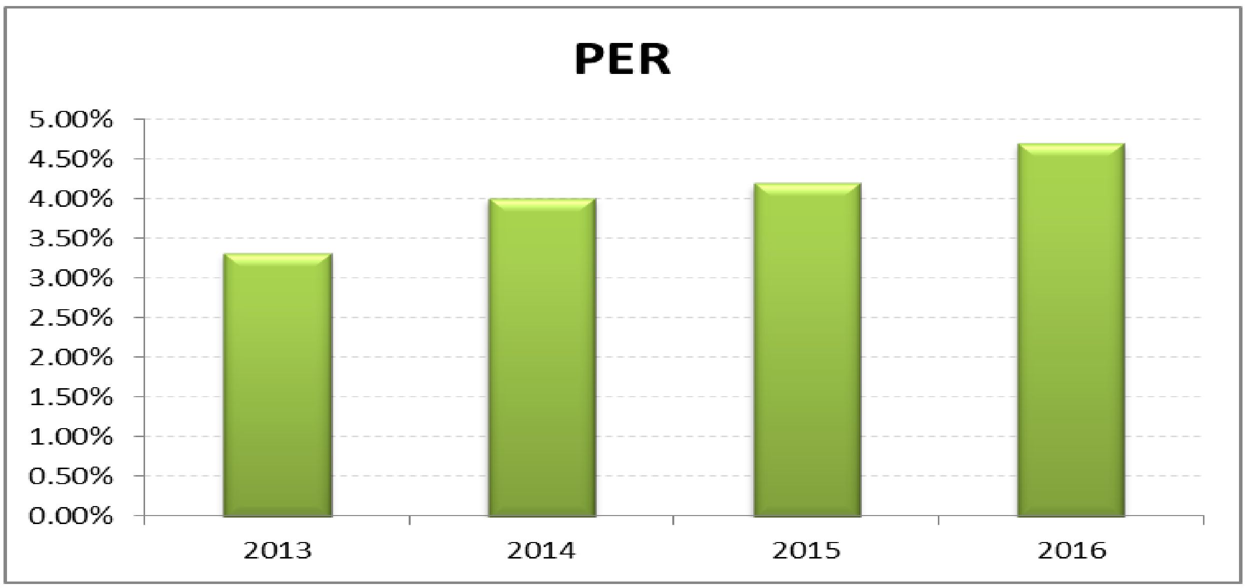
The percentage in the above chart indicates that although ROE wasn't that good in 2013 but it had quite good improvement in the coming year, and decreased a bit in the consecutive years.

4.2.3 Profit Expense Ratio (PER)

This ratio indicates profitability of the firm with regard to its total expenses. A high value of this ratio indicates that bank could make high profit with a given expenses.

	2013	2014	2015	2016
PER	3.32%	4.01%	4.20%	4.70%

Table 6



Graph 6

Interpretation

The above graph indicates that AIB is doing well in term of PER comparing to the past years, and obviously the profitability is growing significantly better year on year, as per the information I have AIB is doing the best in the market comparing other banks in the market.

4.3 Risk and Solvency Ratios

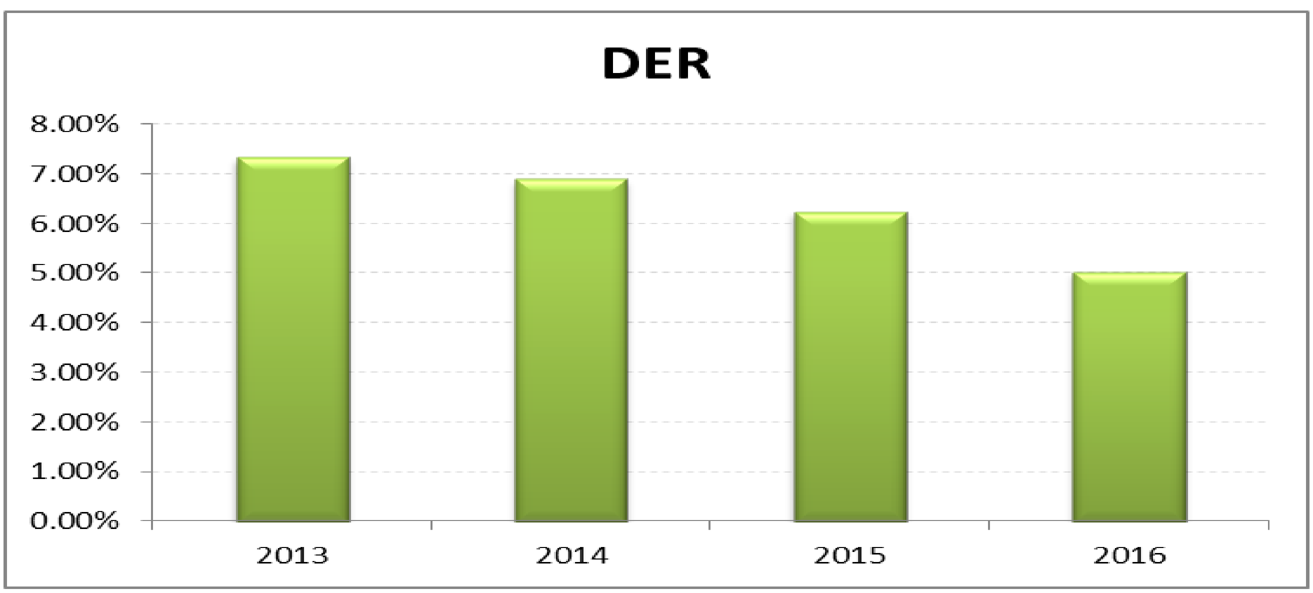
The risk and solvency ratios measure the extent to which a firm relies on debt financing rather than equity financing. These ratios are also referred to as gearing, debt, or financial leverage ratios. These ratios determine the probability that the firm default on its debt contacts. The more the debt a firm has the higher is the chance that firm will become unable to fulfill its contractual obligations. The following ratios measure for risk and solvency were used for the study.

4.3.1 Debt to Equity Ratio (DER)

This ratio indicates the proportion of assets financed with debt. A high value of this ratio provides indication that firm involves in more risky business.

	2013	2014	2015	2016
DER	7.33%	6.89%	6.24%	5.03%

Table 7



Graph 7

Interpretation

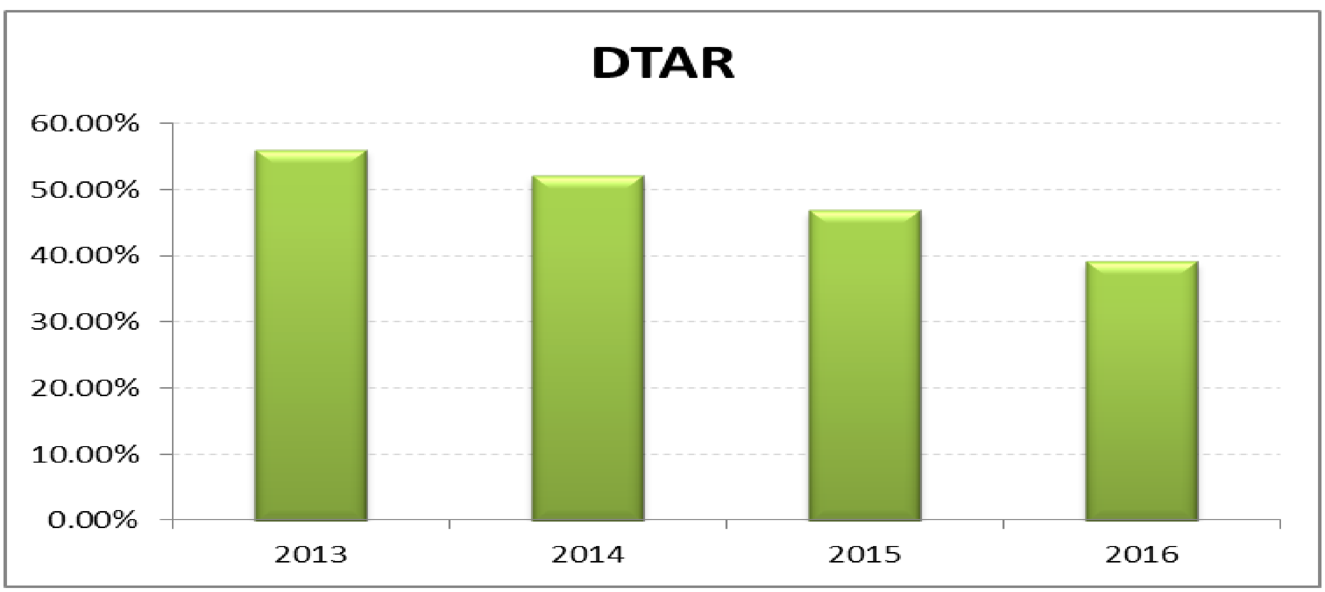
Debt to equity ratio of AIB decreased from 7,33% to 6.89% and eventually ended up to 5.03% by end of 2016, the downward trend in DER of Afghanistan International bank shows that deposits base of the bank is decreasing more than its equity base.

4.3.2 Debt to Total Assets Ratio (DTAR)

DTAR measures ability of the bank capital to absorb financial shocks. This ratio indicates the proportion of assets financed with debt. A high value of this ratio provides indication that firm involves in more risky business.

	2013	2014	2015	2016
DTAR	56.02%	52.11%	46.87%	39.09%

Table 8



Graph 8

Interpretation

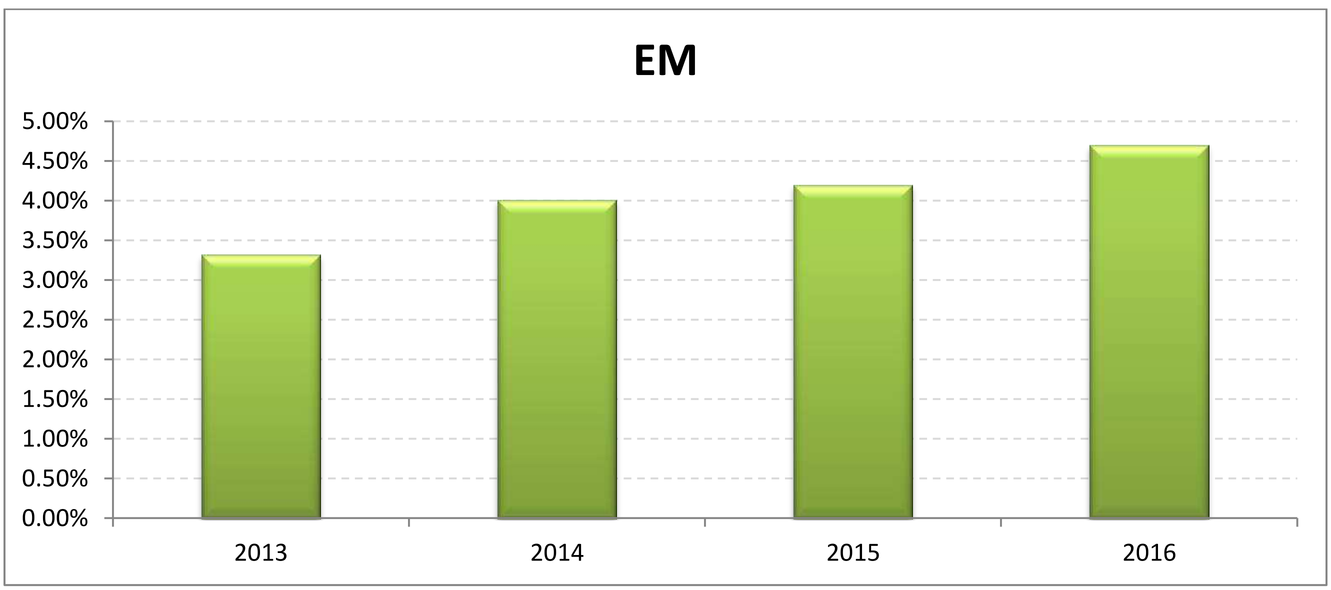
As we can clearly see in Table 8 and Graph 8 that DTAR is increasing year on year which is not a good indicator of business for the bank, but still based on some information AIB is doing much better than other banks exist in the industry.

4.3.3 Equity Multiplier (EM)

This ratio shows how many dollars of assets must be supported by each dollars of equity capital. The higher value of this ratio indicates signal for risk failure.

	2013	2014	2015	2016
EM	4.21%	4.03%	5.15%	5.79%

Table 9



Graph 9

Interpretation

The analysis of equity multiplier further proves that AIB to be less risky and more solvent, this result is consistent with our results found in DER and DTAR for Afghanistan

International Bank, no surprise, but EM is also exhibiting similar behavior as of DER. Which further verifies that relative to debt, equity base is increasing more in AIB.

Conclusion and Recommendation

5.1 Conclusion

At this point, the financial analysis has been made in attempting to draw some rough conclusions on the performance of AIB. One of the main points to understand about the financial analysis is that all the information that would be conclusive judgment about what is going on in the company is found in the financial statements and interview with the concerned staff.

From the brief explanation and illustrations of four years, financial statements of AIB have been used to analyze the financial performance and their trend for the years under study (2013-2016).

Examination of the empirical analysis makes it possible for the researcher to shed some light on his findings and draw some conclusions. Some of the findings of the study include the following:

- From the common size analysis of Income Statement, Operating income before Tax in 2013 was lesser comparing to the other years. This was because of low Interest Expense, Salaries and benefits, and general and administrative expenses in this year.
- From the common size analysis of Balance Sheet, Total Loans, and

Advances of the bank had covered largest portion of total assets in all the years under the study, On the other hand, Total Deposit had covered largest portion of total liabilities in all the years under the study.

- The researcher analysis of liquidity measures indicates that AIB is good in term of liquidity in the market. Findings also show that this increasing trend is due to increase in its deposits base, which can be considered a positive, and a good sign for the AIB in that it is making inroads into the society.

Moreover, this shows that level of trust and confidence of the people is increasing in AIB with the passage of time.

- Examination of all profitability measures, Return on assets (ROA), Return on Equity (ROE), Profit Expense Ratio (PER) and Return on Deposit (ROD) indicates that AIB is profitable.

- Like in profitability, and risk & solvency measures, AIB is found to be efficient in terms of generating income or Income Expense Ratio (IER) and managing their expenses or Operating Efficiency (OE). In contrast, AIB is more efficient in terms of utilization of their assets or Asset Utilization (AU) ratio. Although, Income Expense Ratio (IER), and Operating Efficiency (OE) suggest that AIB is significantly efficient but increasingly converging towards that of industry average, during 2013-2016. This gives us some insight regarding AIB's improvement in generating income, utilization of assets, and effective management in controlling expenses.

5.2. Recommendations

The following recommendations, based on the above research findings, are forwarded below in order to enhance the financial performance of commercial banks:

Analysis has shown that AIB indicates the tendency of comparatively more increase in deposits than loans. This may indicate that AIB has conservative lending policy over the period under the study. This may be solved by revising the lending policy of the bank, such as maximizing the approval limit of branches and districts, appointing trained managers and loan officers. Since 2013, Loans and advances of AIB decreased because the Da Afghanistan Bank set a maximum outstanding loan limit to all banks in the country to control inflation. If this continues, the bank may become more liquid and be obliged to discourage deposit to decrease their interest expenses and this will adversely affect the overall economy.

The regulatory body has to think over it and take a corrective action.

Overall, all results of profitability measures results indicate that AIB is profitable in the market, therefore the bank should work on keeping the momentum to move towards better return because this is the means to assure its survival in the market.

The number of commercial banks has been increasing from time to time. The intensive and continuous increasing competition in the financial service market creates a need for an access to information that would allow evaluating commercial banks operating in this market. In Afghanistan there is no adequately compiled data and bench marks to evaluate the performance of commercial banks. The regulatory body (Da Afghanistan Bank) or other concerned bodies have to take the responsibility.

Finally, the financial performance indicators, i.e. financial ratios, independently are not enough to measure the performance of commercial banks. Thus, alternative financial measures such as Data Envelopment Analysis (DEA) shall be considered by further researchers.

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