Factors determining retail banks performance: Case study Ubank

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DECLARATION

I, **Buhle Mdakane**, declare that this research report is my own work except as indicated in the references and acknowledgements. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the North-West University, Mafikeng Campus. It has not been submitted before for any degree or examination in this or any other University.

Signature ----------

Signed at .....

On the ..... day of ..... 2012.

DEDICATION

I dedicate this work to the Mdakanes, especially my grandmother Dora Sphelile Mdakane, for always being a strong inspiration in the journey of my life. Your teachings and your life stories have always directed me and they always make me look back and remember where i come from, which is very far and different to where i am going. My daughter Bandile Mdakane, mommy loves you and thank you for understanding that i had to be away from you in order to fulfil this goal.

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May god bless you.

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ABSTRACT

The study is a case study and it investigates the factors that determine the performance of retail banks in South Africa, and follows a case study approach in which Ubank is the focus. The purpose is to rank the identified factors in their order of importance for management's focus on improving the bank's performance. Performance is examined in terms of the bank's profitability and growth. This research utilizes secondary data analysis. The quantitative method is used by critically analysing the financial statements of Ubank, as well as the South African economic conditions. The ANOVA test is used as a tool of analysing the relationship between performance and identified factors, and for testing the significance of the identified factors.

The study has found that the bank specific characteristics such as the bank size, return on average assets, market structure, capitalization, corporate governance, information technology, efficiency, credit risk and non-performing loans, are the factors that are relevant in the performance of banks. The macroeconomic factors that impact on the performance of banks are inflation, gross domestic product of the country as well as the banking regulations. The most significant factors were monthly average assets, cost inefficiency and the capital strength was insignificant in the study. The study concluded that poor performance of Ubank results from the imbalance on the focus on identified factors. It further showed that the poor management of the bank's credit system, decreasing market share and poor positioning also contribute to its performance results compared to its competitors.

The recommendation to management was to increase the product offering of the bank through the development of products and services that meet the customer's expectations. The benchmarking of its technology with the leaders in the banking sector and the development of value adding marketing and business development strategies were recommended. Lastly, the compliance to the banking regulations.

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1. CHAPTER 1: INTRODUCTION

The purpose of this study was to investigate the factors that determine the performance of retail banks in South Africa. This investigation was conducted as a case study on Ubank previously known as Teba Bank. The aim was to identify the most important factors in their order of importance as to help retail banks to prioritize for the sake of improved performance. The reason for the order of importance is to enable banks to give high priority on the critical identified factors and less priority to the least important ones. Performance in this study refers to profitability and growth.

The South African banking sector was negatively affected by the credit crisis that took place in the period of 2007 to 2009. The financial crisis made it important for banks to review their performance. The impact was on the banks finances and operations which led the bank's management to engage in cost cutting activities through laying off employees and minimising specific operational activities. Due to the emergency in managing the crisis, the cost cutting was effected on functions that led to poor performance rather than sustaining profitability.

This study is consists of six chapters. The first chapter introduces the research by specifying the objectives of the study, the background of the retail banks as well as methods of data collection and analysis. This chapter also acknowledges the limitations to the study. The second chapter reviews selected literature in banking performance. The chapter is vital in identifying the factors that are important for the improving the performance of banks. It further identifies possible recommendations on how managers should focus and better the banks performance from the selected literature. The third chapter explains data gathered for the purpose of the study as well as the method of analysis. The fourth chapter presents the results of the analysed data and examines Ubank's performance. The fifth chapter discusses the findings and provides the challenges that are faced by Ubank and the evolution in the South African banking sector. The final chapter concludes the study by summarising the findings and by providing the recommendations to the bank for the improved performance.

1.1 Background and Context

The core activity of retail banks is to act as intermediaries between depositors and borrowers. They provide deposits and loans to the customers, and manage their assets and liabilities to maximise profits. Their second core activity is to offer liquidity according to their customer's preferences through ensuring convenience in access of customer's funds anytime (Heffernan: 2009). Retail banks distinguish themselves from each other by product pricing, customer service and operational excellence from a customer perspective.

Due to globalisation that affected the South African banking sector and the industry attractiveness, retail banks are facing intense competition from all over the world, both from financial and non financial institutions. The South African banking industry is regarded attractive because of deregulation and less barriers to entry. Companies such as Woolworths, and Virgin Credit, for example, increase competition against retail banks. This is more so because these banks rely on retail and mass markets. The regulation in the South African banking industry makes it possible for the increased competition, provided the new enterers comply to the banking regulations.

Retail banks in South Africa are regulated by the Banking Legislation of South Africa, National Credit Act of 2007, Financial Advisory Intermediary Services Act 37 of 2002 and Basel III. The reason for their close regulation is because they are among the leading repository of the public finance, the loss of these funds due to crime or bank failure can be very catastrophic to many individuals and families. Due to the most of the public's lack of in depth financial expertise to correctly evaluate the riskiness of a bank; the regulatory agencies are responsible for gathering and evaluating information needed to assess true conditions of banks and to protect the public against losses (Hudgins 2008).

Retail banks in South Africa are made up of Ubank, previously known as Teba Bank, African Bank, Capitec and many others that will not be referred to in the study. Their target market is the mass lower and medium class market. These regional banks offer personal loans with interest rates determined by each bank, debit cards and ATM services and funeral policies to their

clients. They are competing for the similar client base through customer service, location, speed, availability, cost and reliability of their services and products.

Ubank, as a case study is the 9th largest South African Bank in terms of asset size and is the 8th most recognized brand in South Africa. Ubank offers paymaster functions for gold and platinum mines, savings accounts including linked accounts for worker's spouses, fixed deposits, microloans known as Makoya Loans, provident backed housing loans, ATM cards and funeral insurance in joint venture with Metropolitan Life (Ubank 2010).

The bank is increasing its distribution channels to ensure accessibility for its target communities. Amongst the mentioned products the bank generates 83% of its income from loans known as Makoya. According to Ubank's profile in their website, this is the product that has mainly sustained the bank's profitability from its existence (Ubank 2010). As a Front End Manager at Ubank, the researcher in this study is entrusted with growing the business. This study will increase the researcher's capacity by focusing on the important and specific areas for achieving the organizational goal of growth.

1.2 Problem Statement

Retail banks regard and focus on sales as the core of their business success and profitability, ignoring other success factors. Retail banks engage into day to day operational activities that do not add value in improving their performance because of the lack of correct findings. They invest limited resources and technology in activities that do not improve their performance, if they do, only in the short run. At the end they find that the focus of improving their performance have not been on the relevant factors that are worth investing in. This action alone leads to the drawback in the retail banks financial performance and growth.

For example, in 2009 Ubank invested in a new oracle system and the new brand costing R75million with the aim of improving their financial performance through improved speed of transacting and increasing the market share through the new brand. They further expanded to service the retail and mass market over and above the mine market during the same period. The

question still remains whether the bank's performance was improved after that financial decision.

Retail banks continuously develop new products and services after intensive research involving their customers, in most cases the outcome of the product development ends up benefiting the customers without the corresponding financial benefit to the bank. The increasing level of competition in the banking industry leads to banks imitating each other's operational styles without taking into consideration the suitability of the style to their business and customers and the overall performance. This is one of the problems that will be addressed by identifying and critically analyzing the success factors that are relevant to improve the performance of Ubank.

Although studies have been conducted on the performance and efficiency of banks none of them has focused on Ubank. The reason the studies provide for the bank's exclusion is that its information is not fully available to the public. This does not give Ubank an opportunity to be exposed to the public, scholars and the market view in relation to their performance.

1.3 Research Objectives

This studies research objectives were:

- to determine the factors that significantly contributes to the performance of retail banks.
- to allocate weight to each determined factors and
- to assist Ubank to focus on the identified factors for improved performance

Research sub – questions:

The sub- questions that the research aims to answer are the following:

- What factors significantly determine the performance of retail banks?
- What is their order of importance?
- What should managers do in order to focus on the identified factors?

1.4 Literature review

Text and numerical data on performance of retail banks was studied to provide a theoretical background on which to base the practical findings of the study. Generally, the literature reviewed in this research focused on previous studies conducted pertaining to leadership and governance, customer service, profitability, operational efficiency, bank size, market share and risk management and their relationship to the performance of banks.

1.5 Significance of the study

The study aims to close a gap by assisting Ubank in determining the areas of focus and improvement in its practice to improve performance besides sales. It fills the gap of resource and time allocation towards the strategic direction of the bank. Additionally, it will help Ubank to identify the gaps and development needs associated with the discovered factors, and implementation where necessary and possible.

1.6 Research Design and Methodology

The research was conducted using the quantitative research method to gather data. The quantitative data included the financial statements of Ubank for the period of three years. The financial statements consisted of Ubank's income statement, balance sheet, statement of cash flow, deposits, loans and savings book. The research design chosen for this study is both descriptive and explanatory which will help to explain the current condition of the bank.

Electronic journals provided by the university on the current performance on banks, the theories on the factors contributing to the banks performance, how is the retail banks performance measured, the core and secondary functions of banks, the impact of risk and fraud on their performance were also reviewed.

Business and financial reports and newspapers were used for gathering literature on the daily activities of the retail banks that impact on their performance, as well as the weekly banking update report available from Ubank regarding all the retail banks latest information. Text books on modern banking management style and decision making processes in the banking industry have been used to analyse the impact of management and decision making in the retail banking environment.

1.7 Representative Sampling

Data was gathered from Ubank's financial statements which is the bank that the case study will be conducted on. The representative sample was the Klerksdorp Region since it is one of the large regions within Ubank.

The organisation's financial statements were used as secondary data for the quantitative purpose of the research. Data was gathered by accessing the regional bank's websites for the published financial statements. In instances where there are no recently published financial statements, the author requested them personally from management. The credit data and other information relevant to their current performance was requested personally by the author.

1.8 Ethical Requirements

Permission to obtain information from the bank's decision makers was obtained by submitting a letter from the Graduate School as a research student. The intentions of the study were verbally explained to the decision makers as well as the benefit to them. The ethical clearance was done by the university after submitting the intentions of the study.

The organisation's confidential information will not be disclosed by the author to the competitors and public without the consent of the decision makers. The author abode by the confidentiality clause to protect the bank's internal and client's information.

1.9 Delimitations of the study

The research focused on the retail banks in the North West Region, with focus on Ubank which is most dominant in that region because of the nature of its core business which is servicing the mining sector. The limitation to the study was that the financial data used, only reflects the performance of one region and it might not be the true reflection of the overall bank. The views of the employees and management were excluded since the methodology that was used was limited to quantitative.

2. CHAPTER 2: LITERATURE REVIEW

The literature reviewed in the study critically analyses the previous work by researchers and scholar in the field of banking performance. It includes the various factors that determine performance of banks worldwide, but focus on those that are closely related to the South African banking context. The chapter presents firstly, the importance of evaluation and its effect as a tool that banks use to determine the performance factors. Secondly, it classifies and analyses the identified factors from evaluation into bank specific characteristics and macroeconomic factors. It further explains the impact of the identified factors on performance. It addresses the important arrears and actions that bank managers should focus on in order to improve the performance of banks. Lastly, it explains the banking regulations that impact on the performance of banks.

2.1 Performance evaluation as a factor determinant

The importance of evaluation of the bank's performance in order to continuously improve their functions and monitor their financial condition, is emphasised in a study by Paradi et al (2011), because of the existence of an increasing competitive banking markets. The banking institutions, as the principal sources of financial intermediation and channels of making payments, they play a vital role in a country's economic development and growth.

The importance of evaluation is further expressed by Van der Westhuizen (2010, p.69), because over the past decade bank profits have been under considerable pressure due to various factors. Banks failed to provide financial services to a large number of people and also demonstrated the inability to introduce new financial products. During 2000, the bank's operating costs outgrew income while experiencing increased staff costs. He feels that if there was regular evaluation of performance, the factors that led to considerable pressure would have been identified and managed in time.

There are numerous techniques the authors identified that are used to measure bank's performance, even though some face challenges due to the complexity of the industry. The complexity of the banking industry in terms of various sizes, different products and service offering, different customer base and economic regions and increases the complexity in

measuring performance. Techniques such as ratios, regression analysis and indices are effective in measurement in many circumstances, but they also possess a number of inherent limitations making them unsuitable for fully reflecting the increasingly complex nature of banking.

A study that was conducted by Carg et al (2004) which analysed the various methods of measuring business performance in the South African banking sector discovered that the commonly used methods were financial ratios and frontier analysis methods which are data envelopment analysis and stochastic frontier analysis. The shortfall in these commonly used methods was that the former does not capture the long term performance and it aggregates many aspects of performance such as operations, marketing and financing. The latter method's shortcoming is that it separates the better performing banks to the poor performing banks. A study by Oborholzer et al (2010) is one of the examples of the use of the data envelope analysis and stochastic frontier analysis in South Africa.

Oborholzer et al (2010) concluded that the return on average assets is the commonly accepted measure of performance in the banking industry. The methods commonly used in the banking sector identified the most important factors for bank performance as being organisational profitability, sales growth, level of innovation, return on asset, customer satisfaction and the growth in the number of employees. The results of the study suggested that the non financial dimensions namely customer image, loyalty and product service innovation are not valid dimensions for measuring performance while the business growth and profitability are relevant factors. The study confirmed business growth as the key measure in South African banking context.

The studies highly recommended the use of efficient production frontier based models, which estimates how well a firm performs relative to the best firms if they are doing business under the same operating conditions. The main advantage of this model over other approaches is that it removes the effects of difference in prices and other exogenous market factors, and produces an objectively determined quantitative measure (Paradi et al 2011, p.7).

Additional information of banking performance on the other hand generally uses comprehensive information from financial statements to determine the determinants of bank profitability,

measured by return on assets and return on equity, this is a view from the works of Zoubi and Olson (2011, p.95). Adding on the above view, Asaftei (2008, p.2337) points out that the firm's performance is measured by the return on assets (ROA) accounting ratio, defined as the traditional corporate finance and accounting model used to analyse a firm's performance by incrementally dividing each accounting ratio into underlying profit drivers. In the study there is nothing mentioned about the accuracy of the return on assets as an evaluator of performance.

If one looks at the literature on evaluation, the basis of evaluation being the determinant of performance factors is expressed in the relationship between the results of the studies and profitability. The results of the study by Paradi et al (2011) which evaluated performance on three dimensions which are production, profitability and intermediation, showed that efficiency improvement can be achieved through cost saving. Thus, cost saving is a factor that determines performance of a bank. It further showed no significant relationship between intermediation, production and profitability, that suggest that they are not factors that determine performance.

However, results for other studies showed factors such as costs, bank size, dependence on loans for revenue, liquidity as having a significant relationship with profitability (Zoubi and Olson 2011, p.96). The accounting and economic based approach was used in the evaluation in this study compared to the efficient production frontier used by Paradi et al (2011). There is a possibility that the evaluation model or approach used might be important in identifying the factors, based on the difference in outcomes from the two studies above.

Additional factors of performance are identified through evaluation using an empirical model. The three interrelated factors to bank performance were financial reform process, the degree of competition and the risk taking behaviour of banks (Brissimis et al 2008, p.2674). The factors that impact on performance were measured using productivity, non interest margins and competition. In contrast to the study by Paradi et al (2011), which found productivity not being a factor, this study showed that there was a significant relationship between profitability and productivity.

Complexity in evaluating performance was affirmed in the study when evaluating competition because of the various degrees of competition defined by perfect competition and monopoly, and

changes during the period when the study was conducted (Brissimis et al 2008, p.2674). The solution to overcoming complexity was suggested by Zoubi and Olson (2011, p.95), who state that studies focusing on an individual country or region should examine bank specific factors of profitability such as size, revenue growth, risk and control of expenses.

The literature on the evaluation of performance does not give a specific indication of the most appropriate measure to identify the performance factors. Looking at the difference in the results of each evaluation, there is a possibility that different approaches yield different results. A factor in one study is not a factor in the next study, bringing no consistency in determining the factors in all the studies reviewed in the previous paragraph. More studies which have been conducted in identifying the factors that determine performance have analysed the bank specific characteristics and macroeconomic factors and their impact on performance.

2.2 Bank Specific characteristics and their impact on performance

Bank specific characteristics are internal factors that are under the bank's control. The internal determinants encompass management decisions made by the bank, the bank's level of liquidity, loans provisioning policy, bank size, capital adequacy and expense management (Chen and Liao 2010, p.819). Chen and Liao argue that identifying key factors influencing bank profitability plays a vital role in improving the internal management of banks and in setting bank policies (2010, p. 819).

Additional internal factors of profitability as bank's specific characteristics are defined as bank's total assets, the cost to income ratio, the ratio of equity to assets and the ratio of bank's loan divided by customers and short term funding. The authors further examination of the impact of banks performance in European markets showed the bank specific factors such as capital strength and efficiency in expense management, in addition to bank's total assets, the cost to income ratio, the ratio of equity to assets and the ratio of bank's loan divided by customers and short term funding (Pasiouras and Kosmidou 2007, p.226).

2.2.1 Accounting Based Internal Factors

Return on assets is the most common accounting based factor that banks use to measure performance; it is defined as the net profit divided by total assets and represents the earnings performance of a bank based on total assets (Chen and Liao 2010, p.819). It is further defined by Oberholzer et al (2010) as a performance measure that combines both the income statement and balance sheet. It is regarded as the most important determinant of the bank's performance by Pasiouras and Kosmidou (2007, p.226), because it gives the true reflection of the bank's performance. In contrast, other studies recommend the forward looking methods over accounting based method because they analyse the long term performance of the bank (Jonghe and Vennet 2008, p.1821 and Herrero et al 2009).

The ultimate measure of bank's performance is regarded as the return on equity which is the value of the bank's ordinary shares. The importance of the return on equity (ROE) is recognised when used in conjunction with the return on assets so as to show the profitability efficiency of the bank. The return on assets (ROA) is more suitable for selecting the input and outputs rather than being the true performance indicator (Cronje, 2007, p.14).

The limitation to using the accounting based approach is that rather than capturing the long run equilibrium behaviour, it reflects the short run performance. It is backward looking by nature as it reflects the relative success of past investments and operational decisions (Jonghe and Vennet 2008). This limitation contradicts the return on assets as being the most important determinant as per findings by Chen and Liao (2010, p.825).

The impact of the return on assets on the bank's performance gave different results on profitability, because in the studies by Chen and Liao (2010), Pasiouras and Kosmidou (2007), Zoubi and Olson (2011), it was used as a dependent variable. The difference in results is given by the use of different independent factors in the studies. The common outcome regardless of the different independent factors was an increase in return on assets accompanied by an increase in profitability and vice versa.

The balance sheet structure of the bank also represents the earnings of the bank based on total assets. The structure with a larger share of loans to total assets implies more interest revenue and is positively related to profitability. In terms of liabilities the structure with a larger proportion of deposits increases profitability because it constitute stable and cheaper funding compared to borrowed funds. Both loans and deposits are assets of the bank. (Herrero et al 2009, p.2082). The relationship between the balance sheet structure and profitability is further affirmed by Chen and Liao (2010) as negative, they argue that if the bank undertakes on activities that are off balance, the more its profits will decrease. Studies by Chen and Liao (2010), Pasiouras and Kosmidou (2007), Zoubi and Olson (2011) do not consider the balance sheet structure as an accounting base even though its measure is closely related to return on assets .

2.2.2 Bank Size

The studies conducted on bank size as a factor showed different results on its relationship to profitability for example, Chen and Liao (2010), Ray and Das (2010), Herrero et al (2009), Asaftei (2008) and Samad (2008). Larger banks are found to experience the diseconomies of scale in their operations and they have a negative relationship with profitability. On the other hand Pasiouras and Kosmidou (2007, p.228), they argue that the banks that are larger in size benefit from economies of scale which reduces the cost of gathering and processing customer information and experience increased profits. The consistency on the findings on the bank size and profitability is found in the study by Chen and Liao (2010), where they have similar findings to the above study regarding the economies of scale. In contrast, Ray and Das (2010, p.303) with regard to bank size, argue that smaller banks experience lower profits.

In contrast to Ray and Das (2010), the other studies, Herrero et al (2009, p.2082) and Asaftei (2008, p.2337) find that larger bank sizes are seen to have a positive relationship with profitability, compared to smaller and medium sized banks. The reason for that argument is that firstly, larger size banks are able to reduce costs because of the economies of scale and more diversified opportunities allows for the increased returns and lower risks. Secondly, larger banks benefit from higher production of traditional outputs such as consumer lending, because they compliment the low interest margins with increasing amounts on non interest income from traditional and non-traditional products. The size of the bank is influenced by the market

structure; small and larger banks are differently affected by the changes in the market structure (Samad 2008, p.181).

2.2.3 Market structure

Herrero et al (2009, p.2082) and Chen and Liao (2010, p.821), remark that the performance of banks is viewed as dependent on their market power and structure. Herrero et al (2009) and Chen and Liao (2010) assert that the higher the degree of market power the higher is their profitability. The findings of these studies supported the statement that performance of banks is viewed as dependant on their market power, because the banks with a higher degree of market share were found to have less overall risk exposure and an increased loan portfolio risk, which increases profits. Another element of market share that increases profits is firms under a pure monopoly or monopolistic competition. Firms under pure monopoly or monopolistic competition have a significant market share and thus, have control over the price of the product. In that case, price exceeds the marginal cost and leads to supernormal profits. The notion is, the higher the concentration of market share, the higher the economic profits (Samad 2008, p.183).

Managers of institutions enjoying market power exploit their leverage over consumers by artificially raising the prices of services they provide, thus market power enhances financial performance (Grifell – Tatje 2011, p.74). Grifell – Tatje (2011) further remarks that the nature of competition, primarily in product markets, influences economic and financial performance. As competition increases, the pricing power declines and financial performance deteriorates regardless of its impact on economic performance. Therefore managers enjoying the market power need not to strive to maximize profits.

Banks with larger and stable market share experience persistence of profits for a long time, provided there is existence of competition barriers, such as government regulations, high entry costs, and the potential existence of market power. Other studies by Herrero et al (2009, p.2082) and Chen and Liao (2010) brought findings that differ in persistence of profits. These studies argue that despite restraint on competition by bank regulators, temporary profits tend to be temporal rather than permanent. Further, the persistence on profits is seen stronger for banks with below average performance, highly diversified and having private ownership as opposed to

the stable and larger market share banks in the previous studies (Goddard et al 2011, p.2882).This brings the dimension of regulation and competition in the market structure.

Deregulation has been analysed in several studies as a factor that determines the performance of banks and their impact. Studies by Brissimis, Delis and Papanikolaou (2008), Delis (2012,) and Cunat and Guadalupe (2009) found conflicting results. The first study by Brissimis et al (2008, p.2674) found the impact of deregulation to have increased competition and worsened the banking performance while increasing the risk of failure. The results of the relationship between competition and performance showed that competition does not significantly enhance performance; the results were negative during the analysis. Similarly, the study by Cunat and Guadalupe (2009, p.497) produced findings that banking deregulation reduces barriers to entry and therefore leads to higher levels of competition that reduces the average profits of the firm for a given share of the market.

On the other hand, the study by Delis (2012) showed improved performance through increased efficiency, improved growth and the important element was larger market power. Delis further associates deregulation with financial reform that competition brings and the positive impact it has on competition because it leads to the development of new banking products and alternative sources of funds, further leading to increased liquidity. This contrast Manlagnit (2011, p.33) who argues that fostering competition in the banking system increases the operating costs associated with compliance to the new regulations. An increase in competition through the implementation of banking reforms seems to negatively affect the performance of banks by incurring more costs associate with implementation techniques and practices in compliance with the deregulation. This suggests that deregulation has mixed results from the reviewed work.

2.2.4 Structure - conduct hypothesis and efficient structure hypothesis

The market structure is further analysed using the structure - conduct hypothesis and efficient structure hypothesis. Jonghe and Vennet's (2008, p.1833) results of the study showed that the market power hypothesis which is similar to efficient structure hypothesis, claims that only

banks with a larger market share, irrespective of market concentration, are able to exercise market power and earn abnormal profits. The literature reviewed by the authors in the similar study suggested the opposite, which is the structure conduct hypothesis as the one that yields a positive relationship between profitability and the market structure and reflecting non-competitive pricing behaviour in more concentrated markets.

The appropriateness of the conduct structure hypothesis is confirmed by Samad (2008, p.183) in his finding which states that the profitability of the firm is dependent on the market structure and level of competition, where the higher concentration ratio lead to higher profitability. The efficient structure hypothesis in the same study challenged the first hypothesis, by putting emphasis on superior efficiency as an explanation for a firm's profit. According to this hypothesis there is no relationship between concentration and profitability as opposed to the conduct structure hypothesis. The results of the study reject the conduct structure as determining bank performance but rather the efficient structure.

The study by Herrero et al (2009) affirms the findings by Samad (2008) on efficient structure hypothesis as it observes a bank's higher interest margin could be attributed to more operational efficiency, better management and better technologies. This contradicts the study by Jonghe and Vennet (2008) on structure conduct hypothesis, by considering the positive relationship between interest margin and concentration as reflecting non - competitive price behaviour. In contrast other studies by Herrero et al (2009) and Chen and Liao (2010) argue that concentration is not an important factor in the hypothesis but only the market share.

2.2.5 Capitalisation

A study by Herrero et al (2009, p.2081) gave reasons for a positive relationship between higher capitalization and profitability as firstly, capital can be considered a cushion to raise the share of risky assets, such as loans. Second, banks with a high franchise value measured in terms of capitalization have incentives to remain well capitalized and engage in prudent lending. Thirdly, although capital is considered to be the most expensive bank liability in terms of expected return, holding a relatively large share of capital is an important signal of creditworthiness. Finally, a well capitalized bank needs to borrow less in order to support a given level of assets.

In addition to the reasons given, Hsiao et al (2010, p.1464) point out a positive relationship between banking efficiency and capital adequacy, in finding that banks with substandard or marginal capital adequacy ratios have higher operating costs. The findings are consistent with the notion that well capitalized banks are perceived to be relatively safe and have better credit risk management practices, which in turn lower their cost of borrowing, and thereby lead to enhanced efficiency from the studies of Pasiouras and Kosmidou (2007), Herrero et al (2009) and Fiordelisi et al (2011). The contradiction to the above argument is brought by Bonfim (2008, p.282) who argues that holding excessive or enough capital limits the risk for depositors and reduces insolvency risk but holding excessive capital is costly and it limits efficiency.

The benefits for highly capitalized banks are efficiency and they have no incentive to build additional capital while increasing their risk levels and the fact that capital is costly leads to them increasing their level of risk to maximize revenues (Fiordelisi et al 2011, p.1316). The results of the study also showed that increases in bank capital precede cost efficiency improvements, and also indicate that better capitalized banks are more likely to reduce their costs compared to their thinly capitalized counterparts. This is confirmed by the findings by Pasiouras and Kosmidou (2007) and Herrero et al (2009).

Hsiao et al (2010), Pasiouras and Kosmidou (2007), Herrero et al (2009), Fiordelisi et al (2011) and Bonfim (2008) who worked on capitalization only focused on the reasons for capitalization and the benefit it has on the performance of the bank. The exception to the study was brought by Fiordelisi et al (2011) who looked at why banks are thinly capitalized and the motivation for that decision. Fiordelisi, Marques – Ibanez and Molyneux (2011, p.1324) argue that banks might be thinly capitalized because they are inefficient and might seek to balance higher operating costs with lower funding via expensive capital. These banks might eventually build capital while increasing their level of risk. Alternatively, banks might be thinly capitalized because they are efficient and have no incentive to increase their level of capital with respect to their loans and investments, as higher levels of efficiency provides them with buffer to build up capital in the future if needed.

Capitalisation is viewed by Fiordelisi et al (2011) as important for banks which want to minimize their costs of funding, borrowing and operational cost. There is no specific study that focused on

how banks should improve their capitalization so as to improve their performance or profitability. The focus of this literature was based on already capitalized and thinly capitalized banks with their benefits and consequences. The assumption is that management decision and ownership known as corporate governance plays a vital role in placing a bank in a well capitalized state.

2.2.6 Corporate Governance

A study by Moffett et al (2012, p.36) defines corporate governance as the relationship among stakeholders used to determine and control the strategic direction and performance of an organization. The single overriding objective of corporate governance is the optimization over time of the returns to shareholders. Westman (2011, p.3300) identifies impact of management and board ownership, which are at the core of the efficient corporate governance system, on bank's profitability. Westman (2011) does not specify the impact whether it is negative or positive from his findings. Whereas Jonghe and Vennet (2008, p.1829) specify that banks with better management will have higher values and profitability.

Weak corporate governance results are pointed out in the works of Herrero et al (2009, p.2081) as low assets quality and high liquidity which hampers profitability and the separation of ownership and control. Although economic theory by Moffett et al (2012) assumes the maximization of shareholder value, bank managers may not maximize the value of the firm when there is separation of ownership and control. Akindele (2012, p.106) adds that the major objective of bank management is to increase shareholder's return and optimizing bank performance. In further analyzing the impact of corporate governance on banks performance, Moffett et al (2012) defines agency problem as the failure to align the goals of the managers to the shareholder's and the strategy of the bank. It is further defined as failure to decide whether the bank should focus on traditional banking operations of deposits and loans, or non- traditional commission and fee generating bank operations.

Corporate governance has a positive relationship to risk management because it is the result of lax governance. Risk management is defined by Akindele (2012, p.104) as the process by which managers satisfy their needs by identifying key risk measures, choosing which risks to reduce

and which to increase by what means, and identifying the monitoring criteria. Poor risk management impacts on the capital strength and allocation for the bank, on the non-performing loans and loan loss provision, which all indicate the ability or the inability of the decision makers in managing the funds of the shareholders. The benefits to the banks who have well managed risk management are the increase in their reputation and opportunity to attract more customers in building their portfolio of fund resources. Secondly, it means banks are in line with the regulation and lastly they are able to increase their efficiency and profitability (Akindele 2012, p.106).

Factors creating agency problems are defined by Westman (2011, p.3301) as a reduced depositor's incentive to monitor banks, due to the deposit insurance that covers the potential losses of depositors. Also, the complexity and opaqueness of larger and non-traditional banks leads to reduced monitoring by outsiders. Also, the extraction of private benefits, where managers derive private utility by controlling the company and engaging in on _the _job private consumption creates the agency problem. The solution is suggested by Akindele (2012, p.109) that bank managers and insider owners should all be involved in the alignment of the bank's interest. Banks should shift the focus from maximising their own wealth or their return on investment and take into consideration that business people are risk averse.

Moffett et al (2012), Westman (2011) and Jonghe and Vennet (2008) emphasize the importance of effective corporate governance to eliminate agency problems in banks. However, this requirement increases disclosures which can have a negative impact on efficiency due to direct costs of making additional disclosure, maintaining investor relations department, additional time, and the release of sensitive information to competitors (Pasiouras et al 2009).

The impact of corporate governance in the banks' profitability is given by the financial ratios such as capital strength and non performing loans and credit risk. The higher capital strength indicates the bank's obedience to the rules and regulations that protect the public interest. The higher non-performing loans and credit risk ratio indicate that it is the reckless lending of the bank which threatens the shareholders return (Akindele 2012).

2.2.7 Profit and cost and operational efficiency

Investigation of the bank efficiency is regarded as of vital importance from both the microeconomic and macroeconomic point of view by Staikouras et al (2008). Staikouras et al (2008, p.484) further regard the micro perspective issue of banking efficiency crucial, given the enhancement of competition due to the increase in the presence of foreign banks, and the improvement in the institutional, regulatory and supervisory framework. In the macroeconomic perspective the importance is from the influence the banking industry has on the cost of financial intermediation and the overall stability of the financial system.

In agreement with Staikouras, Mamatzaki et al (2008) in the South African context, the extreme exchange rate volatility during 2002 – 2004 and the National Credit Act no 34 of 2005 requires banks to focus on efficiency, and they constitute the macroeconomic environment for the banks. The further push towards efficiency improvement also originate from internal factors like negligence, fraud, internal system failures and incompetence as they negatively impacting on the bank's performance (Cronje 2007, p.11).

Most of the reviewed literature analysed cost efficiency more than the proficiency of the banks. Westman (2011) defines cost efficiency as technical efficiency which is the ability of the firm to maximize output from a given set of inputs and allocates efficiency, which is the ability of a firm to use its inputs in cost minimising proportions. The affirmation of the definition is found in a study by Hsiao et al (2010, p.1461) where they argue that efficiency is an ability of the bank to minimize costs, develop new products, new services and technological innovation. Ray and Das (2010, p.297) advise that in improving cost efficiency of banks, technical efficiency is found to be more important of a source in potential reduction of costs than achieving an optimum size of production to minimize average costs, which is in line with the definition by Westman (2011). Better capitalization is reintroduced as an incentive for banks that can further reduce their costs and achieve bank improved cost efficiency (Fiordelisi e al 2011).

An examination of the impact of efficiency on profitability in Middle East and North Africa (MENA) countries by Zoubi and Olson (2011, p.102) showed cost efficiency as a significant factor rather than profit efficiency in explaining profitability. In their study, profit efficiency was

defined as net income minus provision for loan losses. However, Ray and Das (2010, p.297) regard minimising costs as equally important as maximizing profits. A study on efficiency and its problem loans by Manlagnit (2012, p.24) show that cost efficiency has a negative relationship with problem loans. This is caused by managers who are risk averse and allocate fewer resources in credit evaluation and monitoring thus incurring lower risk which in turn leads to lower returns. Manlagnit adds that the larger banks are more cost efficient than smaller banks (2012).

Studies on problematic loans by Hsiao et al (2010) and Fiordelisi et al (2011) argue that non–performing loans lead to lower efficiency because of increased expenses associated with managing them. Changes in bank risk might also affect the bank's efficiency, for example, increases in bank risk may temporally precede a decline in cost efficiency related to higher costs of dealing with more non–performing loans. Hsiao et al (2010) and Fiordelisi et al (2011) further associate poor quality loans with poorly managed banks.

Rossi et al (2009, p.2219) advise that diversification to other industries by banks dumpens the cost efficiency because having a diversified portfolio with a large number of individual clients in various industries increases monitoring costs. On the other hand diversification yields positive results on profit efficiency because the risk adjusted return become higher for a well diversified portfolio.

On the other hand, the argument is that the operational efficiency in the banking industry alone does not improve their performance even though it is one of the important elements of cost and profit efficiency (Lee et al 2011, p.690). The impact of operating efficiency towards improving cost efficiency is explained by Oduor et al (2011, p.230) as they specify that the costs that banks incur on their expenses tend to increase and fall with the operational efficiency which banks carry out their business, and they translate to lower or higher lending rates depending on the level of efficiency.

In addition, operational efficiency is defined by Lee et al (2011, p.691) as advances in information and processes that dramatically alter banking operations by automating many activities such as assessing creditworthiness of loan customers, serving deposit customers,

processing payments and many of their daily routine operations. Lee et al (2011) further add that banks should not only focus on improving cost and profit efficiency, but should also focus on their responsiveness and reliability which is operational efficiency improvement.

The studies by Lee et al (2011) and Oduor et al (2011, p.230) show a positive correlation between cost efficiency and operational efficiency, and less is said about profit efficiency. Profit efficiency is only viewed as an outcome when the other two efficiencies have a negative relationship. Lee et al (2011), Oduor et al (2011) and Rossi et al (2009) did provide factors of cost efficiency and how it can be achieved. The assumption is that the profit efficiency is the reversal of cost efficiency. The importance of credit risk management especially on problematic or non performing loans was mentioned several times by the authors as a cause of low efficiency. Operational efficiency is further analysed using technology.

2.2.8 Information Technology as an improver of operational efficiency

An empirical study by Hinson et al (2011, p. 272) conducted in Ghana is used to analyse the relationship between investments in information technology and associated effects on firm performance. However, research findings by Hinson et al (2011, p.272) suggests that there is inconsistent evidence that information technology investments lead to a significant increase in operational efficiency. The results of this study found that information technology investment has a negative impact on the productivity of an organization because of inefficient allocation of management resources. Elasticity of other management activities like marketing, research and development (R&D), advertising and other capital on firm performance are greater than the elasticity of information technology capital.

The second finding by Kim et al (2009, p.680) asserted that a significant positive relationship between information technology investment and firm performance exists. As firms invest more in information technology, their operational efficiency correspondingly increase. The study further indicated that investment in information technology could be used to gain competitive advantages and increase market share via sales growth. This happens when information technology is used as an enabling technology to better meet market demand like customer

relationship management system, and to spawn new businesses like new IT-based auxiliary products and services (Kim et al 2009).

Hinson et al (2011), Kim et al (2009, p.680) add that due to the improved operational efficiency from information technology, banks have moved quickly to invest in technology as a way of controlling costs, attracting customers and meeting the convenience and technical expectations of their existing customers. Instalment of customer friendly technology has become commonplace in recent years as a way of maintaining customer loyalty and increasing market share.

2.2.9 Technological readiness and customer expectations

The intense competition and the increased need to improve technological efficiency drives banks into implementing changes without analysing the readiness of customers for those changes and their expectations from the banks. The continuous innovation in the South African banking sector does not only penetrate the existing markets or create new ones, but it also closes the gap of the unbanked market, particularly the cell phone banking and ATMs. However, the limitation to the technological innovation is the self-service that it brings that causes frustration to other customers than the need for establishing the technological readiness becomes important. Berndt et al (2010, p.50) add that despite the benefit of technological innovation, there is mounting evidence that consumers are becoming more frustrated in dealing with technology – based products and services, and customers are seeking better balance between technology and personal contact. A number of studies according to Berndt et al (2010) from their investigation show that there is a lot of technophobia among customers.

Technological readiness is defined by Berndt et al (2010) as people's propensity to embrace and use new technologies for accomplishing goals at home and work. Knowing technological readiness of customers is important in developing technology strategies and management of the link between customer and technology. In South Africa, the banking market is regarded as sophisticated, yet the survey in the study conducted in 2007 indicated that 42% of the population has never heard of cell phone banking and 28% did not know what it meant in practise (Berndt et

al 2010, p.52). This poses a danger of banks investing innovations that customers are not ready for.

Readiness is linked to customer expectations because for banks to thrive in both service and product delivery they must be in line with customer expectations. Service quality is a crucial aspect of the customer experience and understanding customer expectation is the first step. Banks must take into consideration the differences in cultures and consumer behaviours in the market when innovating (Bick et al 2009, p.13). Involving customers in product, service and technology decision making is important because the banks will have an opportunity to identify the need of closing the readiness gap if it exists. In the case of Ubank, debit cards were introduced to the customers as part of technological innovation in 2009. This kind of late technological adjustment one would argue was a result of technophobia. The number of clients using savings books is still more than the ones that take debit cards. Equally the numbers of customers returning their debit cards to be exchanged for books are increasing on daily basis.

2.2.10 Credit Risk

Credit risk is defined by Garcia, Gimenez and Guijarro (2012, p.1) as the unexpected changes in value associated with changes in credit quality. It has been a focal point in the recent years in the banking industry due to the international financial crisis that has affected a large number of financial institutions. Bonfim (2009) suggests that understanding the determinants of credit risk is important for financial stability given the weight loans have on the banks assets. A clear understanding of the credit drivers gives banks the ability to predict if and when a customer default on its credit liability. Bonfim (2009, p.281) adds that the bank specific characteristics and macroeconomic developments are important in explaining the evolution of the credit risk overtime.

The results of the study by Bonfim (2009, p.283) confirmed the macroeconomic development as a determinant of credit risk by showing that most credit risk in banks is built up during periods of strong credit growth and start to materialize only when the economy hits a downturn. Furthermore, the results showed that an increase in credit overdue is usually preceded by interest rates increase. The study on the effect of the bank credit risk on the business cycle by Marcucci and Quagliariello (2009, p.1625) showed that the banks with lower asset quality are heavily

impacted during bad economic times than the less risky ones. There the asset quality is also important in managing credit risk.

The bank's credit risk is determined by the bank's loan portfolio, which is the group of customers which the bank extends its lending services to. In the bank and customer relationship There are many contributions that assist banks in deciding which customers it wants to focus on based on their default probability or large exposure limit associated with servicing relatively larger customers (Haas et al 2010, p.389). However the impact of the customers deciding on the banks they want to work with is not emphasised in studies on portfolio determination. Banks are argued to use internal and external rating models to classify borrowers according to their risk because capital requirements can be determined based on the identified credit exposure (Bonfim 2009).

Chiesa (2008), Hakenes and Schnabel (2010, p.309) introduced a new dimension to the credit risk management which is credit risk transfer (CRT), where banks issue loans and transfer the risk to the third party which is a non – bank institution like insurance companies. Chiesa (2008) describes CRT as leading to a desirable redistribution and better diversification of credit risk. The credit risk transfer reduces the monitoring and screening role of the banks which lowers the loan default probability, thus harming the stability of the financial sector. The reduced monitoring causes banks to produce poor quality loans because of the financial guarantee that is brought by the third party in case of default by customers. On the other hand the results of this study showed the benefits of CRT as providing banks with excessive credit enhancement and financial intermediation. CRT increases cost efficiency because the amount of capital per unit of lending can be used to raise more outside funds and expand its lending.

2.2.11 Non- Performing Loans

The bank specific characteristics that lead to the non performing loans are identified by Louzis et al (2012, p.1015) as bad management which is linked to the poor skills in credit scoring, appraisal of pledged collaterals and monitoring borrowers. In contrast, the credit scoring is argued by DeYong et al (2008, p.118) as the factor that does not improve the accuracy of the bank's information about borrowers and the bank's ability to make correct lending decisions, however it provides a well defined information set at less expense to the bank and permit faster

decision making on loan applications. The impact of credit scoring on non performing loans is not guaranteed. The second bank specific factor is skimping hypothesis where high measured efficiency causes increasing number of NPLs. According to this view there exists a trade off between allocating resources for underwriting and monitoring loans and measured cost efficiency. The third factor is the low capitalization of banks where managers increase the riskiness of their loan portfolios when their banks are thinly capitalized, thus increasing NPLs.

Non – performing loans have been associated with cost inefficiency due to the higher costs of managing and monitoring. The cost inefficiency of managing non performing loans is caused by the activities that banks engage in, in order to minimise them. These activities include writing non performing loans to bad debt, taking additional precautions to preserve the high quality of loans, managing financial risk and analyzing and negotiating possible workout arrangements (Hsiao et al 2010).

Actually, all the studies that examined non performing loans had no positive conclusion towards its impact on performance and profitability of banks. Albertazzi and Gambacorta (2009, p.393) and Festic et al (2011) found that bad economic conditions can worsen the quality of the loan portfolio, and generate credit losses, which eventually reduce bank's profits. They further argued that common exposure to macroeconomic risk factors across banks is a source of systemic risk that influences the quality of a loan portfolio, which can be expressed as the ratio of non-performing loans to total gross loans. An increasing ratio may be a signal of deterioration in banking sector results. In theory, the risk of credit expansion and the non-performing loans to total loans (NPL) ratio is expected to be procyclical within economic factors. The study by Glen and Mondragon-Velez (2011, p.151) that analysed the relationship between bank loan portfolio performance and business cycle, measured through GDP growth and lending rates, showed the main business cycle-driver of performance as GDP while the lending rates follow.

The impact of macroeconomic conditions on non performing loans is explained by Louzis et al (2012, 1014) as during the booming period banks continued to extend credit to lower quality debtors and when recession hits the non performing loans increase. The acceleration in NPL is due to the high probability of default from these low quality debtors because they face an increased risk of unemployment and being unable to settle their obligation. Additionally, banks

charge higher interest rates to these risky borrowers. The affirmation to the macroeconomic impact is further given by Bonfim (2009) who explains that the periods of strong economic growth are usually followed by robust credit growth and later followed by an increase in default rates as a consequence of the imbalance generated in those periods. During the economic growth period there is a tendency of excessive risk taking behaviour by banks which materializes in an increase of credit overdue in economic down turn.

As part of bad loans management, banks provide the loan loss provision which is a tool extensively used for the purpose of risk management, reducing earnings volatility and enhancing managers compensation. Loan loss provision reflects the future losses on loans in their existing portfolios. Since these future losses cannot be estimated with certainty the banks use their own discretion to set the provisions. This study argues that the loan loss provision influences capital management and earnings of the bank. The reason is that the provision is derived from the capital and the earnings of the bank, and higher provision is associated with bank failures. The loan loss provision has been proven to be an estimated figure, but the study by Anandarajan et al (2005, p.49) found no relationship between loan provision and the quality of the loan portfolio, riskier portfolios do not generate higher loan loss provision. Banks raise the provision during the periods where they experience higher operating income and when they increase the branch network as it becomes complicated to monitor credit related activities in various branches (Anandarajan et al 2005, p. 49).

The studies showed a negative relationship between non performing loans and profitability, performance and efficiency of the banks. This shows that in determining the factors that improve performance in the current study, non performing loans are critical as a factor because their existence and poor management leads to the deterioration of the bank.

2.3 Macroeconomic factors

In the beginning of literature review in this study, the factors that were identified by various studies on evaluation revealed the macroeconomic or external factors, as a determinant of performance for banks. Pasiouras and Kosmidou (2007) defines macroeconomic factors as external determinants that encompass factors beyond the bank's control, such as the legal

environment, the state of the economy in which the financial institution operates, changes in national governance and the impact of globalization. Additional studies by Pasiouras and Kosmidou (2007), Staikouras et al (2008) and Herrero et al (2009) showed macroeconomic factors such as inflation, Gross Domestic Products (GDP) of a country, financial markets and real interest rates as important in determining the performance of banks. The macroeconomic factors were used as independent variables in their studies.

The relationship between findings differed per study Herrero et al (2009) found the inflation, an increase in the country's GDP and higher real interest rates to be positively related to the improved performance of banks, and the volatility in interest rates to reduce profitability. They further add that inflation is generally associated with higher profitability as it implies additional earnings from float, which tend to compensate for the higher labour costs. Whereas Staikouras et al (2008) in their study found no significance in economic growth and banks profitability, and that economic growth is only significant towards improving the asset quality through fostered new lending.

Pasiouras and Kosmidou (2007) found the opposite in their study where they view the relationship of one of the macroeconomic factors inflation to have both the negative and the positive relationship towards the bank's performance. They argue that the results depend on whether the inflation is anticipated or not. If anticipated, banks can timely adjust interest rates, which results in revenues increasing faster than costs with the positive impact of profitability. If unanticipated banks may be slow in adjusting interest rates leading to increased banks costs than banks revenue. This consequently has a negative impact on bank profitability.

According to *Engineering News* (06 June 2011), the South African economy is set to grow at 4.3% in 2012 which is above its potential growth rate, after expanding by 3.6% in 2011, according to the economic outlook update. The report estimated that the SA's interest rates would start to rise before the end of 2011 after being lowered by 6.5% since 2008. The repo rate rose in November 2011 to 6%. South Africa recorded a budget deficit of 5% of gross domestic products (GDP) in 2011, and 4.5% is estimated for 2012.

The studies by Pasiouras and Kosmidou (2007) and Herrero et al (2009) emphasised the importance of taking the macroeconomic environment that the banks operate in, in order to give a full view of how they perform. Even though these factors are beyond their control, the studies showed that, if well prepared for they can respond positively to profitability. There are generally various factors that constitute macroeconomic environment but they were not taken into consideration by the authors in their studies. They did not give a reason why the utilized ones are most important over the neglected ones. The assumption is that they yield similar results as the used ones.

2.3.1 Recommendation to bank management in improving performance

The literature reviewed analysed the impact of the identified factors and their relationship to the performance of banks. Some factors such as high capitalization, larger and smaller bank sizes, anticipated inflation and good corporate governance showed a positive relationship to the performance of banks. While factors such as non–performing loans, bank size showed the negative relationship. The difference in results showed a gap in the improvement of performance from the previous studies. This section of literature identifies arrears of focus for bank management from the works of other researchers. Pasiouras and Kosmidou (2007) argue that the responsibility for maintaining profitability is not only limited to managers, but as well extends to various stakeholders such as government, central banks and other financial authorities.

2.3.2 Competitive Advantage

Product mix plays a more important role in providing competitive advantage and improves the performance of banks, and stock market investors perceive a large market share as a competitive advantage. The results of this study by Jonghe & Vennet (2008) also showed the expansion into the new product dimensions as a competitive advantage. Jonghe & Vennet (2008, p.1830) further advise that the extent to which banks diversify to other business lines, soften competition and affects the bank's long run valuation positively. Horizontal differentiation is found to increase the charter value of banks, it may also induce them to hold sufficient levels of capital in order to protect valuable franchises, thereby increasing stability of the banking system.

On the other hand, with regards to expansion, Westman (2011, p. 3301) finds that diversified banks appear to be less profitable than focused banks, particularly in terms of risk-adjusted profitability. In the sample of small community banks, it is found that there is little benefit, measured as risk adjusted profitability, form diversification across unrelated banking activities. Industrial and sector diversification of loan portfolios both reduce the return while increasing the risk. In the case where there is a positive impact of diversification on profitability, the benefit is offset by negative impact of greater risk of non–traditional banking operations.

2.3.3 Performance based compensation

The impact that competition has on the executive pays or compensation, and its effect on improving performance is central to the present study. Cunat and Guadalupe (2009, p.495) assessed the effect of changes in product market structure or competition on executive pays in the financial sector. The change was observed after substantial deregulation had taken place in the 1990s that altered the nature and intensity of product market competition by lowering entry barrier that led to an increase in competition in deregulated sectors.

Cunat and Guadalupe (2009, p.496) shows that regulated utilities pay lower wages than the unregulated sectors, and also indicate that they provide less sensitive compensation packages. Competition affect the contract offered to the agent through two channels. Firstly, the higher level of competition increases the marginal return in terms of an increased market share to cost – cutting activities or productivity improvements for instance, if the elasticity of substitution between goods is higher under higher competition. Therefore, the contract should provide steeper incentives to induce the manager to exert more effort.

On the other hand, a higher level of competition reduces the average profits of the firm for a given share of the market. For this reason, firms should make their incentives contracts flatter under more competition. Competition might also increase bankruptcy risk, which, if there is a cost to managers losing their jobs, raises implicit incentives, thus reducing the need for explicit ones. This would reduce the slope of performance contracts.

The results of the study by Cunat and Guadalupe (2009) showed that the total pay stayed constant or marginally increased following the deregulations, but this moderate increase reflects strong differential trends in the fixed and variable components of pay. It provides substantial evidence of a reduction in the fixed component of pay and an increase in the sensitivity of pay to performance, implying that as competition increases, the managers are faced with steeper incentives to increase firm performance.

This study gives an indication that managers should compensate according to the degree of competition to improve the individual performance of employees which in turn improves the overall performance of the bank.

2.3.4 Non – Performing Loans management

To mitigate the problematic loan problems, Festic et al (2011) suggests that all the relevant determinants of the loan portfolio quality such as gross domestic product, purchasing power parity, liberalization of the banking sector, financial deepening, the loan to assetration, the deposit to loan ratio, market concentration, compensation to employees, demand of households should be taken into consideration.

The managers are advised to monitor the country's economic conditions because they signal the performance of banks, especially the credit risk and non-performing loans ratio. This will allow them to be proactive in managing the unforeseen circumstances (Albertazzi and Gambacorta 2009). Supervisors are advise to underline the importance of setting comprehensive supervisory standards on risk management bank wide, because the studies has shown that bad management leads to the deterioration in the loan quality (Rossi et al 2009, p. 2219).

2.3.5 Agency problem management

Agency problem materialize through extraction of private benefits, where managers derive private utility by controlling the company and engaging in on–the-job private consumption (Westman 2011, p. 3302). As a solution Pasiouras et al (2009) recommend that a powerful supervisor could enhance the corporate governance of banks, reduce corruption in bank lending, and improve the functioning of banks as financial intermediaries.

By contrast, the private monitoring approach argues that powerful supervision might be related to corruption or other factors that impede bank operations, whereas regulations that promote market discipline through private monitoring from depositors, debt holders and equity holders, will result in better outcomes for the banking sector (Pasiouras et al 2009). Thus, under the private monitoring empowerment view, it is expected that improved private governance of banks will boost their functioning and consequently their efficiency.

2.3.6 Liquidity Management Improvement

Liquidity management is a process of managing assets and cash flow to maintain the ability to meet current liabilities as they become due. Without the required liquidity, the bank can be technically insolvent. Therefore the lower the value of the liquidity ratio, the more liquid the bank is; there is a positive relationship between liquidity and performance (Pasiouras & Kosmidou, 2007, p. 227).

Liquidity ratios correlate significantly and positively with net interest margin, return on assets and equity, which indicates that an increase in bank liquidity ratio tends to enhance the bank's profitability. Furthermore, banks with better profitability are positively and significantly correlated to their opportunity costs (Chen and Liao 2011).

2.4 Regulations that impact on bank performance

The South African banking sector is regulated for the benefit of shareholders, customers and the banks themselves. The interests of the shareholders of the banks are protected by the KING REPORT GOVERNANCE III 2009. The customers and banks are regulated by the National Credit Act of 2007 from reckless and higher costs of lending of banks and over indebtness of consumers. The banks are further regulated by the BASEL III which is an international framework for liquidity risk measurement, standards and monitoring. All these regulations influence the performance of banks.

2.4.1 National Credit Act 34 of 2005

The decision of consumer lending is further regulated by the National Credit Act 34 of 2005. The main purpose of the Act is to promote a fair and non discriminatory marketplace for access to consumer credit and for that purpose to provide for the general regulation of consumer credit and improved standards of consumer information so that consumers can make fully informed decisions before entering into debt. Additionally this is done to promote responsible credit granting and provide for debt reorganisation in cases of over indebtedness.

The new law and regulations, initiated by the Department of Trade and Industry (dti) were designed to solve specific problems in the consumer credit market (only credit-related issues are within dti's mandate), including the high cost of credit. They were not designed to address the broader issue of increasing access to finance. The National Credit Act brings South Africa's credit legislation on par with similar legislation in developed countries. It is aimed at reducing undesirable credit practices significantly, but it may take some time for the financial system to adjust and then expand under the new law. The National Credit Regulator is tasked with reporting on progress in developing the credit market, but the sector would also benefit from an independent assessment of whether access to credit has improved from the perspective of the clients. The effect impacts significantly on the micro lending industry and banks (Groen and Louw 2006).

International experience in both developed and developing financial systems shows that price controls are not an optimal mechanism for managing the problem of the high costs of credit. The reckless lending and disclosure regulations together with the transparency rulings of the National Credit Regulator should be enough to promote competition and bring rates down (Groen and Louw 2006).

2.4.2 Basel III of 2010

Basel III is an international framework for liquidity risk measurement, standards and monitoring with the purpose of strengthening global capital and liquidity rules with the goal of promoting a more resilient banking sector. The objective of the reforms is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, thus reducing the risk of

spillover from the financial sector to the real economy (Basel Committee on Banking Supervision, 2010).

The need for the Basel committee arose after the economic and financial crisis which began in 2007, and became so severe that the banking sectors of many countries had built up excessive on and off-balance sheet leverage. This was accompanied by a gradual erosion of the level and quality of the capital base. At the same time, many banks were holding insufficient liquidity buffers. The banking system therefore was not able to absorb the resulting systemic trading and credit losses nor could it cope with the reintermediation of large off-balance sheet exposures that had built up in the shadow banking system (Basel Committee on Banking Supervision, 2010).

The crisis was further amplified by a procyclical deleveraging process and by the interconnectedness of systemic institutions through an array of complex transactions. During the most severe episode of the crisis, the market lost confidence in the solvency and liquidity of many banking institutions. The weaknesses in the banking sector were rapidly transmitted to the rest of the financial system and the real economy, resulting in a massive contraction of liquidity and credit availability. Ultimately, the public sector had to step in with unprecedented injections of liquidity, capital support and guarantees, exposing taxpayers to large losses (Basel Committee on Banking Supervision, 2010).

The reforms raise both the quality and quantity of the regulatory capital base and enhance the risk coverage of the capital framework. It initiated specific rules for compliance by banks in improving their performance which includes raising the quality of capital, consistency and transparency of the capital base, enhancing risk coverage, management of excess credit growth, Introducing a global liquidity risk management standard (Bank for international settlements December, 2010).

2.4.3 King Report III Governance of 2009

The purpose of the King Report III of 2009 is to promote the annual reporting of companies on their bottom line profits, how a company has both positively and negatively affected the economic life of the community in which it operated during the year under review, and how the

company intends to enhance those positive aspects and eradicate or ameliorate the negative aspects on the economic life of the community in which it will operate in the year ahead.

The key principles of corporate governance are effective leadership where leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour with regard to sustainability performance. Sustainability is one of the most important sources of both opportunities and risks for businesses. Innovation, fairness, and collaboration which are key aspects of any transition to sustainability where innovation provides new ways of doing things, including profitable responses to sustainability, fairness is vital because social injustice is unsustainable, and collaboration is often a prerequisite for large scale change. Lastly, integrating sustainability and social transformation in a strategic and coherent manner which gives rise to greater opportunities, efficiencies, and benefits (King Report Governance, 25 February 2009).

In the banking context the King III is relevant in emphasizing the need for the board to oversee the review of internal financial controls to ensure the integrity of financial information being published by companies. It encourages the proper fraud reporting systems to be put in place in order to manage the fraud risk internally and externally. The members of the audit committee should understand the company's overall exposure to IT risks from a business perspective including the areas of the business that are most dependent on IT for their effective and continual operation to mitigate information technology risk. The compliance by banks on the requirements of the report ensures that the risks and challenges that can hinder performance are identified and monitored in time by the management. This is crucial for improving performance because the factors that seek attention will be monitored (King Report Governance, 25 February 2009).

2.5 Conclusion

This chapter has looked at the secondary information on factors that determine the performance of banks. It also presented various evaluation methods that are relevant in the banking industry to measure the performance of banks. Previous studies reviewed in this study gave an indication of the expected performance of banks through the relationship between variables. A number of factors have been put forward with the following themes: performance evaluation, accounting based internal factors, bank size, market structure, capitalization, corporate governance,

efficiency, non-performing loans and macroeconomic factors. It also provided guidelines for managers in performance improvement.

The next chapter will investigate the factors that determine the performance of banks in the South African context, focusing on Ubank as a case study.

CHAPTER 3: RESEARCH METHODOLOGY

This chapter discusses the research methodology used to address the research questions, the instruments used in the data collection and the method for data analysis. Ubank Klerksdorp region's data was used as the case study for this research. The rational for utilizing Klerksdorp is that it is one of the biggest regions in terms of size and the number of branches in Ubank. The findings of the study could be easily related to the overall bank because of the region's size.

3.1 Research Methodology

A case study approach was used in this research. The choice for this approach was influenced by the attempt to understand the complex performance problems, their causes and their mitigation in Ubank. The approach is considered the most suitable method for this study by the researcher because it allows for the in-depth focus in the complex performance problems in the bank.

The performance of Ubank was studied because of their recent expansion. In January 2010, Ubank expanded from being a mineworkers' bank into retail banking. According to the Chief Executive Officer, Mark Williams, the expansion opened doors for excessive competition that the bank has never experienced from existing retail and commercial banks and the performance of the bank dropped drastically. Ubank in 2010 October invested R75 million on name change, branding and marketing from being Teba bank to Ubank. This financial decision has not yet put the bank to where it wants to be in terms of its vision of being the workers bank of choice.

3.2 Research Design

This study used a descriptive and correlation research design. The descriptive method was effective in analyzing and measuring the current performance of Ubank. This method enabled the researcher to identify the performance factors as per literature reviewed in the previous chapter. The performance was measured using various profitability ratios and bar charts.

The correlation method was used to determine the relationship among variables using an analysis of variance model. The purpose of the correlation research is to describe relationships among

variables, or predict a criterion variable, or to test a model of the interrelationships among variables used to predict a variable (Locke et al 2010).

The expectation from the analysis of variance is that positive relationships should lead to profitability, because that would confirm the identified factors in literature as the relevant factors that managers should focus on in managing the bank. The negative relationships outcomes from the results should identify the gap for Ubank managers to shift their focus into performance improving factors. The results should further indicate the weight and order of importance that should be given or allocated to each performance factor.

3.3 Research Design Justification

The descriptive and correlation methods are suitable for this study because the data collected requires a method of analysis among variables, to bring the information to a manageable form to enhance understanding. The analysis of variance test instrument which analyses the correlation between the identified dependent and independent variables in the study, is one of the recommended tools in the definition of the two methods. In the literature, Samad (2008) recommended the use of the analysis of variances test in measuring the performance of banks especially when using dependent and dependent variables as performance, which is the case in the current study.

Paradi et al (2011), regards the ratios and analysis of variance test as effective techniques to measure the efficiency of the firm, provided that the nature of the banking industry is not complex. In this study the complexity is reduced by measuring the consolidated performance of a single region, thus the ratios and analysis of variances are relevant techniques.

3.4 Data Source

The bank in this study is one of the retail banks in South Africa which is ranked the 9th largest bank in terms of asset size and is the 8th most recognised banking brand in South Africa. Ubank has been offering paymaster functions for the gold and platinum mines, savings accounts including linked accounts for workers' spouses, fixed deposits, microloans (Makoya Loans),

provident backed housing loans, ATM cards and funeral insurance since it obtained its banking license in 2000.

In 2010 Ubank opted for the growth strategy to service the mass retail market. That decision called for new products development and operations to meet the needs of the retail market. Ubank is increasing its distribution channels to ensure accessibility for its target communities. Amongst the mentioned products the bank generates 83% of its income from loans known as *Makoya* loans. According to Ubanks profile in their website, this is the product that has mainly sustained the bank's profitability from its existence.

The bank's vision is to become the "Workers bank of Choice" by offering operational excellence, customer service excellence, developing the people and the business and contributing to the communities. The data provided by the bank is based on their entire Klerksdorp branch network from the period ranging from January 2009 to January 2012. The total number of branches is reduced to 6.

3.5 Data Sample and Collection

The financial records of Ubank Klerksdorp were examined to obtain information regarding the financial performance of the bank. Data was extracted from the region's annual financial reports, financial statements entailing the balance sheet, income statement and cash flow statements. The financial statements reviewed are from the period of January 2009 till January 2012.

The credit data was collected from the loan book and credit department of Ubank in the Head office in Johannesburg, Sunninghill. The financial data was used to calculate and evaluate performance, liquidity risk and management, non-performing loans rate, credit risk, efficiency, capitalization and profitability of the bank.

3.6 Data Analysis

The use of various financial ratios in measuring performance is recommended by Oborholzer et al (2010) who argued that they provide different answers in relation to orgarnisational performance and no single ratio provides an adequate indication of the bank's performance.

According to Garg et al (2008) the caution must be given to the combination of the subjective and objective measures that are brought by the financial ratios. They further advise that in South Africa, it is regarded as the commonly acceptable measure in the banking sector.

The following variables were used to analyse the financial performance of Ubank.

3.6.1 Dependent variable

This study used return on average assets (ROAA) as a dependent variable to evaluate Ubank's profitability. Return on average assets is the net profits expressed as a percentage of total assets. It shows the profits earned per rands of assets and indicates how efficiently the bank's assets are being managed to generate revenues (Chen & Liao 2010).

3.6.2 Independent variables

Set of bank specific characteristics variables were used in the study as independent variables. Internal independent variables are classified as:

- Liquidity ratio (LOFUND)
- Average Monthly Assets
- The ratio of equity to assets or Capital Strength (EQSA)
- Credit risk ratio (CRISK)
- Inefficiency Ratio
- Non Performing Loans Ratio (NPL)

3.7 Data Analysis Tool: ANOVA test

ANOVA test is the statistical technique for comparing means for multiple independent populations by partitioning the total variation into variability within groups and variability between groups (Cuevas et al 2004). In this case the ANOVA test was used to compare the average values of the financial data of the last three financial years which stretch from 2009 to 2012. The dependant variable Y in this study was return on average assets, and the independent variables X, were liquidity ratio, average monthly assets, inefficiency ratio, capital strength ratio, non-performing loans ratio and credit risk ratio.

The p – value in the ANOVA test indicates the probability of getting a mean difference between the groups as high as what is observed by chance. The lower the p-value, the more significant the difference between groups. If the probability value (p – value) is less than 5% level of significance, than there is a significance difference in population values, otherwise there is a null hypothesis. *P* is the area of the tail outside the value given by the ratio, and if it is small, we can reject the null hypothesis that *X* has no effect on *Y* (Cuevas et al 2004).

3.8 Theoretical expectations on variables

3.8.1 Liquidity Ratio

The relationship between liquidity management and performance was measured by the ratio of liquid or current assets to current liabilities. Included in liquid assets was the loans and short term funding of the bank. This ratio shows the relationship between comparatively illiquid assets (loans), and comparatively stable funding sources (Pasiouras and Kosmidou 2007).

The expectation from this ratio is that it should specify the process the bank uses to manage its assets and cash flow to maintain the ability to meet current liabilities as they come due. From the literature an increase in liquidity reduces the bank's liquidity risk and liquidity premiums charged on loans.

3.8.2 The ratio of equity to assets or Capital strength

The ratio of equity to assets is used as a measure of capital strength. It is measured by total equity divided by total assets. The expectation from this variable is a positive relationship between performance and the ratio of equity to assets, given by a higher ratio.

3.8.3 Credit risk ratio

Credit risk as a factor is measured by the loan loss provisions to net loans ratio and capital strength which is equity divided by total assets. The literature argued that the ratio of loan defaults to total loans have a negative impact on bank performance.

3.8.4 Inefficiency Ratio

Inefficiency is used to measure the impact of efficiency in expenses management on banks performance. It is measured by operating expenses divided by gross income. This ratio shows the cost of running the bank against the revenues, and is expected to have a negative relationship with the bank's performance. The positive relationship is expected to happen when the costs exceed the revenue of running the bank.

An increasing inefficiency ratio is bad because it means the bank is spending an increasing amount of money on expenses. The opposite means the bank is keeping the costs low. 50% or less is considered optimal.

3.8.5 Non Performing Loans Ratio

Non-performing loan ratio (NPL) is a ratio of non-performing loan to total loans. Higher non performing loan (NPL) indicates the deterioration of the bank's profits.

3.9 Conclusion

This chapter discussed the methodology that was used to collect, and analyse data from Ubank, as well as the source of data. The regression analysis was discussed with its advantages and limitations in justifying using it in this study. The theoretical expectations were also explained briefly. The next chapter will present the data and interpret the findings from the analysis based on the collected data.

CHAPTER 4: DATA PRESENTATION AND ANALYSIS

This chapter aims to analyse the presented information regarding the financial data of Ubank. The analysis is based on the previously identified ratios which were liquidity, capital strength, credit risk, efficiency and non performing loans. The analysis process began with calculating the ratios and the comparison of average values of the financial data was determined using the analysis variance test. The description of the performance was presented using bar charts. The statistical software used for carrying out calculations was Microsoft Excel.

4.1 Liquidity Management Analysis

The liquidity ratio measured the ability of the bank to meet its current liabilities with its current assets as they became due. The results of average liquidity in Table 4.1 shows that Ubank was highly liquid in the period of 2009 – 2010, and the liquidity decreased since 2010 – 2012. The results shows that the bank currently has a high ratio of liabilities that its current assets cannot cover. This is mainly due to failure to collect outstanding debt from customers and that the bank is holding excessive term deposits, savings, 32 days accounts which are liabilities than it holds liquid assets. Appendix A, confirms that the bank fails to collect outstanding liabilities especially in the period of 2011 – 2012 where most of the monthly liabilities are represent by a minus sign. The negative 344.66 average liquidity ratio represents the poor management of the banks liquidity management.

Table 4.1 results further show that if the bank can improve the collection of the outstanding liabilities represented by a negative signs throughout the period analyses, the liquidity ratio would be in an increasing measure as opposed to the decreasing one. This is represented by the results of average liquidity ratio if negative ratios are ignored.

Table 4.1: Liquidity Ratios During 2009 - 2012

	Liquidity Ratios		
Month	**2009 – 2010**	**2010 - 2011**	**2011 - 2012**
March	35.23	20.59	77.88
April	26.69	18.50	-2807.01
May	9.60	49.29	102.01
June	-57.51	38.19	139.61
July	63.90	-22.05	-87.58
August	28.35	81.60	-16.93
September	-24.86	140.03	55.91
October	25.59	-85.13	309.48
November	13.88	257.84	-277.63
December	-48.17	-40.46	-32.29
January	8.60	-106.65	-1254.66
February	298.35	-49.35	
Average Liquidity Ratio	**31.64**	**25.20**	**-344.66**
Average Liquidity Ratio (if negative ratios are ignored)	**56.69**	**86.57**	**136.98**
Average Monthly Assets	**58306474**	**57246633**	**89266281**
Net Profit After Tax and Dividends	**31450360**	**32842774**	**35244227**
Return on Average Assets (ROAA)	**54%**	**51%**	**39%**

4.2 Return on average assets (ROAA)

The monthly return on average assets represents the profitability of the bank since they measure the percentage of net profits expressed as a percentage of average assets. Figure 4.1 shows that the returns on average assets have been decreasing since the period of 2009 till 2012. A decrease in the company's return on assets is negatively associated with improved performance. The results in table 4.1 shows a decreasing liquidity ratio which is one of the factors in the

deteriorating performance of Ubank since 2009 to 2012. This shows a positive relationship between liquidity management and profitability of the bank.

On the other hand the analysis of variance (ANOVA) test in Table 4.2 was used to compare the average monthly assets from 2009 until 2012. Since the p-value (2.3949E-08) is less than 5% level of significance, then there is a significant difference of the average monthly assets. Figure 4.1 below justifies this research finding. Therefore the return of average assets is one of the factors that determine the performance of Ubank because of its significance. In figure 4.1 and table 4.1, the average monthly assets of the bank are increasing while the liquidity ratio and return on average assets is decreasing on yearly basis. This shows a negative relationship among these variables.

Figure 4.1

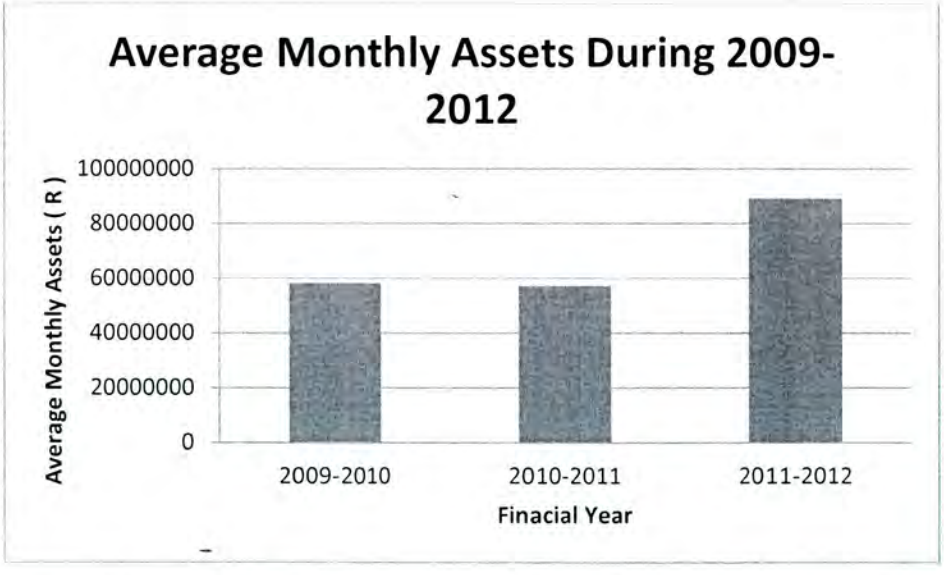


Figure 4.1 shows that the average monthly assets have increased since 2009.

Table 4.2: Comparison of Average Monthly Assets by Analysis of Variance (ANOVA)

Anova: Single Factor

SUMMARY

Financial Years	*Count*	*Sum*	*Average*	*Variance*
2009-2010	12	699677685.7	58306474	1.65424E+14
2010-2011	12	686959594.3	57246633	1.60038E+14
2011-2012	11	981929088.5	89266281	1.7375E+13

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*
Between Groups	7.48626E+15	2	3.7431E+15	3.1909E+01	2.3949E-08
Within Groups	3.75383E+15	32	1.1731E+14		
Total	1.12401E+16	34			

4.3 Inefficiency Ratio

The results in Table 4.3 shows that the average inefficiency ratio was constant between the period of 2009 – 2011 at -0.33. The significant decreased in efficiency was experienced in the period of 2011 -2012 with a mean of -0.08. The results in Appendix B shows that during the period of 2011 – 2012, the revenue generated was more or less the same as of the previous years, but a drastic decline in the operating expenses was observed during the same period. During the period of 2010 the bank started a cost savings exercise of which the positive results showed in the 2011 – 2012 financials.

The analysis of variance (ANOVA) test in Table 4.4 was used to compare the average monthly inefficiency ratios from 2009 until 2012. Since the p-value (1.01E-13) is less than 5% level of significance, then there is a significant difference of the average monthly inefficiency ratios. Figure 4.2 below justifies this research finding.

Table 4.3: Inefficiency Ratios During 2009 - 2012

	Inefficiency Ratios		
Month	**2009 – 2010**	**2010 - 2011**	**2011 - 2012**
March	-0.35	-0.32	-0.08
April	-0.37	-0.37	-0.08
May	-0.37	-0.36	-0.09
June	-0.20	-0.39	-0.07
July	-0.21	-0.37	-0.07
August	-0.36	-0.27	-0.09
September	-0.34	-0.31	-0.08
October	-0.36	-0.26	-0.08
November	-0.37	-0.29	-0.07
December	-0.36	-0.26	-0.08
January	-0.28	-0.35	-0.09
February	-0.40	-0.46	
Average Inefficiency Ratio	**-0.33**	**-0.33**	**-0.08**

Table 4.4: Comparison of Average Monthly Inefficiency Ratios by Analysis of Variance (ANOVA)

Anova: Single Factor

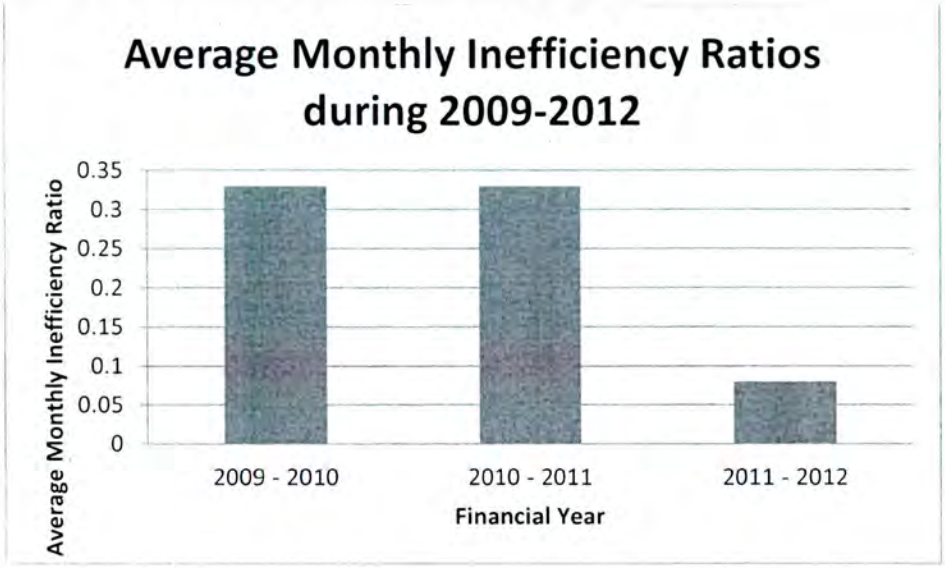
SUMMARY

Financial Years	*Count*	*Sum*	*Average*	*Variance*
2009 - 2010	12	-3.97	-0.33083	0.004245
2010 - 2011	12	-4.01	-0.33417	0.003663
2011 - 2012	11	-0.88	-0.08	6E-05

ANOVA

Source of Variation	*SS*	*Df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	0.480971	2	0.240485	87.86529	1.0 1E-13	3.294537
Within Groups	0.087583	32	0.002737			
Total	0.568554	34				

Figure 4.2



4.5 Capital Strength

Table 4.5, Appendix C and figure 4.5 describe the decreasing capital strength of Ubank since 2009 to 2012 from 0.34 to 0.20. Even thought the decrease is not significant according to the p value of [0.145263] which is more than the 5% cut off, but this has a negative impact on performance of the bank. The average capital strength decrease is influenced by the low value of equity compared to its assets, which is supported by Appendix C below.

The analysis of variance (ANOVA) test in Table 4.6 was used to compare the average monthly capital strengths from 2009 until 2012. Since the p-value (0.145263) is more than 5% level of significance, then there is no significant difference of the average monthly capital strengths.

Table 4.5 : Capital Strengths During 2009 - 2012

	Capital Strengths		
Month	**2009 - 2010**	**2010 - 2011**	**2011 - 2012**
March	0.03	0.07	0.04
April	0.07	0.11	0.07
May	0.11	0.16	0.10
June	0.20	0.20	0.13
July	0.24	0.24	0.16
August	0.30	0.26	0.21
September	0.38	0.33	0.23
October	0.42	0.38	0.26
November	0.51	0.40	0.32
December	0.56	0.46	0.36
January	0.56	0.38	0.37
February	0.72	0.41	
AverageCapital Strengths	**0.34**	**0.28**	**0.20**

Table 4.6: Comparison of Average Monthly Capital Strengths by Analysis of Variance (ANOVA)

Anova: Single Factor

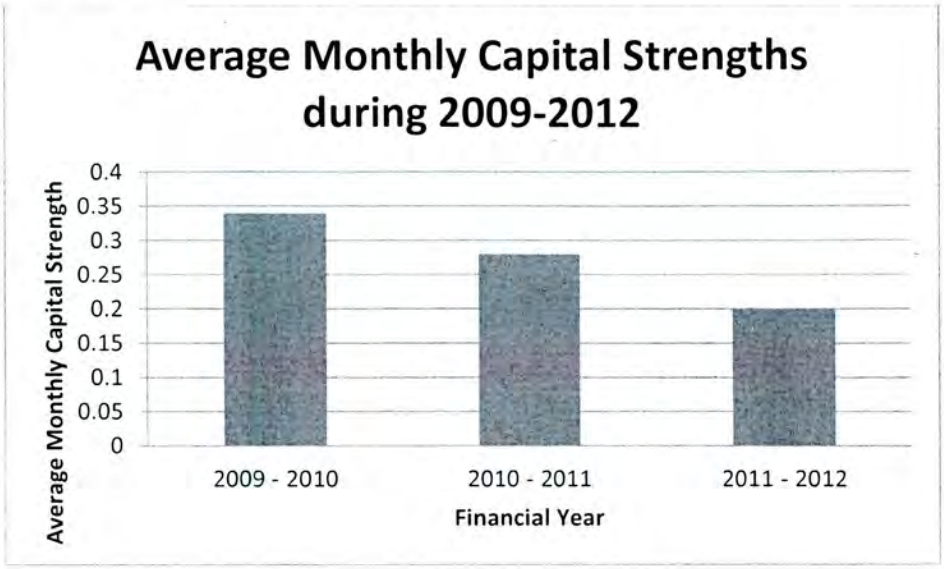
SUMMARY

Financial Years	*Count*	*Sum*	*Average*	*Variance*
2009 - 2010	12	4.1	0.341667	0.048288
2010 - 2011	12	3.4	0.283333	0.016533
2011 - 2012	11	2.2	0.204545	0.013227

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	0.108323	2	0.054161	2.050334	0.145263	3.294537
Within Groups	0.845306	32	0.026416			
Total	0.953629	34				

Figure 4.3



4.7 Non Performing Loans

The non performing loans ratio of the bank in Table 4.7 is given by 7% since 2009 – 2012. The disadvantage in the ratio below is that it cannot be compared to the previous years because the information provided for analysis is accumulating annually. The acceptable non performing loan ratio for Ubank was not provided. The 7% does show that the bank is experiencing difficulties in fully collecting from its debtors. The recovery of debt is also confirmed by the poor liquidity ratio in table 4.1. This ratio affects the bank's return on average assets and liquidity management negatively. The results indicate the deterioration in the banks' profits due to outstanding debt that would increase profits if recovered.

Table 4.7: Non-Performing Loans Ratio

Balance (R).	Non-Performing Loan (R)	Non-Performing Loan Ratio
80758188.89	5894159.85	0.07

4.8 Credit Risk

Table 4.8 shows that the provision for loan loss is 4% in Ubank since 2009 – 2012. The financial disadvantage from these results is that the 4% of the banks income is used as provision of the loan loss instead of increasing the overall profits of the bank. The trend of this ratio might increase due to the current ratio of non-performing loans in Table 4.7 which is 7%. The results show a negative relationship between the credit risk and the average return on assets, because the profitability of the bank has been decreasing from year to year.

Table 4.8: Credit Risk Ratio

Balance (R)	Impairments	Credit Risk Ratio
80758188.89	3591791.88	0.04

4.9 Liabilities (Term Deposits and Savings)

Liabilities are made up of Term deposits and savings from customers which the bank have custody over. They are regarded as liabilities because in the short and long run the bank has to pay them back to the customers on their demand.

4.9.1 Savings

Figure 1 below shows that the bank has been receiving a small number and amounts of new savings for the period of 2010 till mid 2011, averaging 500. The savings are inclusive of daily deposits, salary payments, short term savings of not more than 12 months. In late 2011 the bank experienced a high of 2500 savings followed by a low in early 2012 of below 500. The savings of the bank are currently decreasing.

Figure 2 which presents the already existing savings accounts shows that the bank has sustained savings of 40 000 for the period of 2010 until early 2011. The decrease in these savings has been observed to be consistent since early 2011- 2012.

Figure 4.5

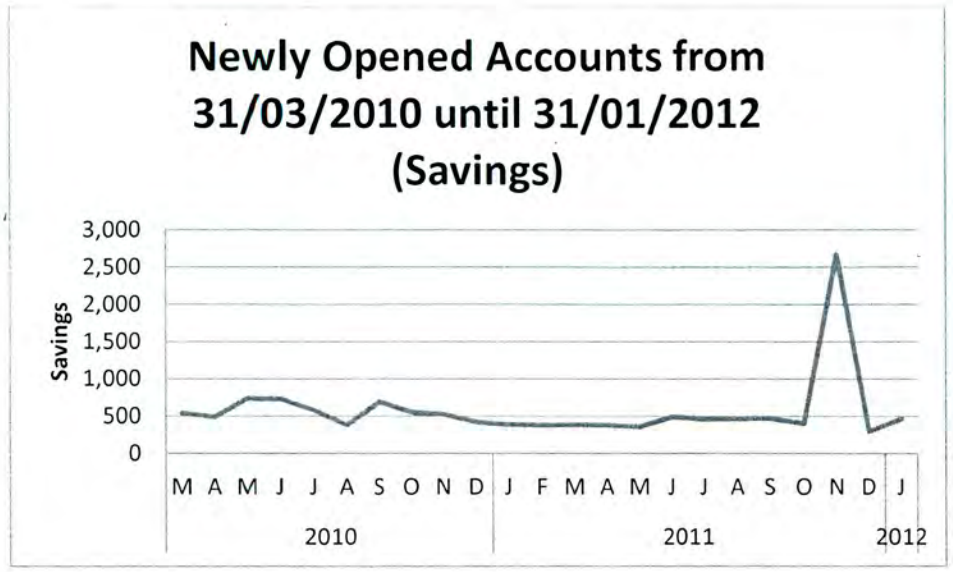


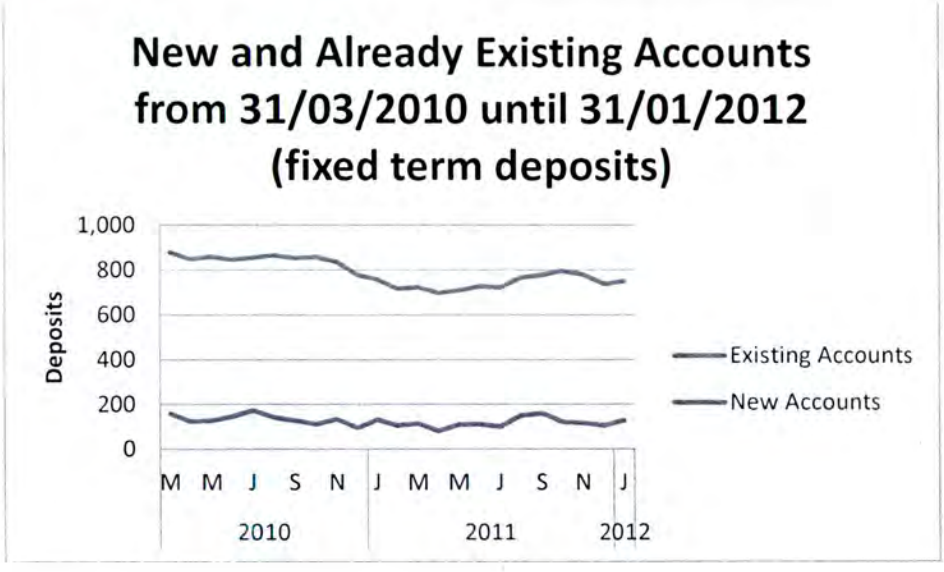
Figure 4.6

4.9.2 Term Deposits

Term deposits are deposits from customers which are fixed for the period agreed upon by the customer and the bank. They range from the period of three months to three years with interest applicable based on the term of the deposit and the value. Figure 3 below shows the combination

of newly opened deposits and already existing ones. The new deposits from the period of 2010 till 2012 are fluctuating in the range below 200. The existing ones in 2010 were consistent at the range of 900 to 800, and a decrease is observed in 2011 to 650 accounts and a pick in 2012 followed by a low of below 800. Therefore, currently, the deposits are low compared to 2010.

Figure 4.7



4.9 Summary of the results

All the variables were significant at a level of below 5% p – value with the exception of capital strength in table 4.5, 4.6 figure 4.3 with a p- value of .145263 or 14% which is above the 5% level which indicates the insignificance in the difference in averages. Inefficiency ratio and average monthly assets are the main determinants of the bank's performance because of their relatively higher significance represented by 1.01E- 13 for inefficiency and 2.3949E- 08 for average monthly assets.

The results of the return on average assets were in the decreasing measure from 2009 to 2012, which was determined by total assets and net profits. Even though the total and average assets increased year to year as in table 4.1, the return on assets decreased. This showed that an increase in assets without a corresponding increase in net profits does not increase the profitability of the

bank. The literature on return on assets by Chen and Liao (2010), Pasiouras and Kosmidou (2007), Zoubi and Olson (2011) argued a positive relationship between average assets and profitability, which is contradicted by the findings in Ubank.

The literature by Herrero et al (2009) and Chen and Liao (2010) on balance sheet structure was confirmed by the result finding in table 4.1 and figure 4.2, where the larger share of total assets which were R1738866368.50 to total loans which were R80758188.89, led to a decrease in profitability represented by return on average assets during the period under observation.

The liquidity management was not expressed in terms of the ANOVA test but its correlation to the profitability of the bank was shown in its positive relationship with return on average assets. A decrease in liquidity ratio was accompanied by a decrease in return of assets from 2009 to 2012, shown in table 4.1 above. The results on liquidity management confirmed the finding in the literature of its positive relationship with profitability.

A decrease in the inefficiency ratio was observed from the results from 2009 to 2010 table 4.3 and figure 4.2. The relationship between inefficiency ratio and return on average assets was positive in Ubank results instead of negative that was suggested by literature on efficiency. Appendix B confirms the study by Paradi, Rouatt and Zhu (2011) which suggested that efficiency can be achieved through cost saving and that cost saving is an important factor of bank performance.

Capital strength results showed null significance presented in table 4.5, 4.6 and figure 4.3 above. The finding contradicts the literature studied that argued that reduced inefficiency is negatively related to capital strength, since the Ubank results showed a positive relationship of a decrease in inefficiency with a corresponding decrease in capital strength.

Non- performing loans ratio from 2009 to 2011 was found to be 7% in an accumulative measure on yearly basis given by table 4.7. According to literature on non performing loans, the NPL ratio is closely related to the cost efficiency of the managing them. In the results the expenses of the bank decreased from 2009 to 2012, indicating that the NPL also decreased with the expenses

since they are in correlation. The NPL results also confirmed the literature on its negative relationship to profitability of the bank in table 4.1.

The credit risk results in table 4.8 showed 4% of which is also in an accumulative measure on yearly basis, making it difficult to compare the performance of the bank in this regard. The credit risk is highly associated with capitalization of the bank by literature. Since the capital strength of Ubank is decreasing in table 4.5 and 4.6, the credit risk is increasing.

The bank's newly opened savings accounts are decreasing in numbers as well as the already existing ones. The existing term deposits that are existing are decreasing steadily on yearly basis, whereas the new deposits are very poor fluctuating below 200 accounts per month. This implies that the bank attracts 200 new customers on monthly basis.

The other factor which is corporate governance which was not directly measured and analysed by the ANOVA test was presented from the current results based on the information on literature. Literature on corporate governance viewed weak governance as being observed on the banks poor asset quality and high liquidity. The findings in table 4.1 showed high asset quality and low liquidity which assumes that Ubank has strong corporate governance in place.

4.10 Conclusion

This chapter presented the findings from Ubank financial data from the period of 2009 till 2012. The analysis was based on ratios and the p value of the ANOVA test that indicated the level of significance of the variables. The results were presented per variable and further collectively in the summary. The determined relationships were compared to those of the literature for confirmation and contrasting purposes.

CHAPTER 5: DISCUSSION OF FINDINGS

The study conducted an analysis of Ubank's performance using financial ratios and ANOVA test regression method that analysed the previous and current performance of the bank, focusing on the significance of the identified factors. Firstly, the study investigated the return on average assets as the performance measure using the financial ratio analysis. The return on average assets reflected the profitability of the bank. Secondly, the effect of liquidity management and average monthly assets on the performance of the bank was measured. Thirdly, the study examined the interrelationship between inefficiency ratio, capital strength ratio, non performing loans ratio, credit risk ratio and bank performance.

The identified factors in the study for both dependent and independent variables were in consistency with the factors identified in the previous studies regarding bank performance. Factors such as cost efficiency, bank size, loans revenue and losses and liquidity management were identified as having a significant relationship with profitability by Zoubi and Olson (2011) in their study.

5.1 Return on average assets (ROAA)

The study found that the returns on average assets were decreasing on yearly basis from 2009 till 2012. Despite the fact that the bank achieved profits during the period under observation the profits were in a decreasing trend. Asfatei (2008) and Zoubi and Olson (2011) recommended the return on average assets as a suitable measure for performance evaluation. According to Asfatei (2008) and Zoubi and Olson (2011) return on average assets suitable for performance evaluation when the study is evaluating the performance of a single region. Pasiouras and Kosmidou (2007) recommended it as the most important determinant of bank performance because it gives the true reflection of the bank's performance.

The results on the current study on the interrelationship between ROAA and other factors showed different results based on the outcomes of other factors. There is no overall standard outcome unless they are compared. This finding is in contradiction with the finding by Chen and

Liao (2010) who argued that the ROAA gives a common outcome regardless of the independent factors, which is an increase in profitability.

5.2 Liquidity management and bank performance

The study used the secondary financial data current assets and liabilities to determine the liquidity ratio, of which its results were used for the discussion. The significance of this factor was not tested by the ANOVA method. The presented results showed a consistent decrease in the liquidity ratio when the negative figures on the liabilities side were taken into consideration. The opposite results were given which was an increase in liquidity ratio when the negative figures on the liabilities were ignored. The true reflection of the performance of the liquidity is given by the first results (taking negative liabilities into consideration).

The profitability of the bank which is ROAA showed a decrease while the liquidity ratio was decreasing. This showed a negative relationship between the two. This finding is in contradiction with the study by Pasiouras and Kosmidou (2007) and Chen and Liao (2011) who argue that the liquidity ratio correlates significantly and positively with return on average assets and equity, which indicates that an increase in bank liquidity ratio tends to enhance the bank profitability.

The possible explanation for this finding is that the bank is failing to effectively collect form its debtors in time to meet the liabilities as they become due. It shows the poor quality management of the cash flow of the bank. The bank is also failing to monitor and manage acceptable liquidity ratio of 2:1, which means that the current assets should double the current liabilities.

5.3 Average monthly assets and bank performance

Monthly assets are inclusive of loans and short term investments of the bank. In the findings the average monthly assets are increasing on yearly basis and they are significant to the performance of the bank given by 2% p- value. The relationship between the average monthly assets and ROAA is negative, given by the increase in them followed by the decrease in the ROAA. Even though the findings show the average monthly assets as significant but their contribution does

not control the overall performance of the bank. This shows that they are dependent on the performance of other factors positively.

The finding of the negative relationship above is in contradiction with the findings of Herrero et al (2009), who suggested that a structure with higher total or average assets implies increased profitability. The opposite was also argued by Chen and Liao (2010) who suggested that the increased assets are negatively related to the profitability of the bank, which is in consistence with the current findings. An increase in average monthly assets can be explained by an increase in the loan book of Ubank on yearly basis and short term investments. Its significance explains it as the important factor in determining the performance of banks.

5.4 Inefficiency ratio and bank performance

The results showed the decrease in the inefficiency of the bank since 2009 to 2012 with a significant decrease taking place between 2011 and 2012. Therefore the relationship between inefficiency is positive as opposed to the negative relationship as per the expectation in chapter 3. The significance of the inefficiency ratio compared to other ratios was the highest given by 1% in table 4.4. The highest level of its significance translate it into being the most important determinant of the bank performance, which contradicts the studies by Pasiouras and Kosmidou (2007) above which regarded ROAA as the most important determinant.

This finding is consistent with the finding by Lee et al (2011) who recommended that the operational efficiency is one of the most important elements of cost efficiency, but alone, it does not improve the performance of the bank. The common factor regarding the mentioned study is that the findings of the current study proved that a drastic decrease in inefficiency did not impact positively on the RQAA.

The studies on bank size and profitability by Chen and Liao (2010), Ray and Das (2010), Herrero et al (2009), Asaftei (2008) and Samad (2008) argued that larger banks benefit from reduced costs through economies of scale and diversification. Whereas the results of the reduced costs from reduced inefficiency in Ubank did not have a direct positive impact on profitability, this concludes that benefit from efficiency does not determine the size of the bank nor related to the

size of the bank. The literature consulted for this study further argues that banks with a larger and stable market share experience persistence in profits over time. From the results in table 4.1 the persistence in decreasing profits experienced by Ubank over the period of three years is an indication of the absence of large and stable market share.

The possible explanation of the above findings is that in the period of 2011 – 2012 the ROAA was the lowest compared to other years. The drastic decrease in inefficiency during that period contributed significantly to the performance. The assumption is that if the bank did not experience that highest level of decrease, the ROAA would have been negative. The further explanation of the decrease in this ratio is given by Lee, Cheng, Yeung and Lau (2011) who suggested that a decrease in inefficiency means that the bank lowered the quality and standard of advances in information, quality of banking operations and technology, credit monitoring systems and other daily routines. This suggests that the quality of service in Ubank decreased with the reduction in its inefficiency.

5.5 Capital Strength

The results show the capital strength remaining constant between 2009-2010 and decreasing from the period of 2009 since 2012 in table 4.5 and figure 4.3. The results showed a negative relationship between capital strength and profitability. A decrease in capital strength was accompanied by a decrease in ROAA. The capital strength was the only factor which was insignificant in the study given by 14% in table 4.6. The insignificance regards it as not being a relevant factor in determining the performance of the bank.

This finding is in contradiction with the study by Herrero et al (2009) who gave a reason for a positive relationship between higher capitalization and profitability as a cushion to raise the share of risky assets, such as loans. The contradiction is further found in the reason the authors gave because in the study, the bank's average assets increased with a corresponding increase in its capitalization. This proves that there is no existence of a relationship between assets and capitalization. The further contradiction to the study was brought by Fiordelisi et al (2011) who found that the reduced costs and improved efficiency is an incentive for better capitalization,

which is not the case in the current study of Ubank. The bank inefficiency decreased as well without a corresponding increase on capitalization of the bank.

5.6 Non Performing Loans and bank performance

The non performing loans ratio showed 7% in table 4.7 which could not be compared because of its accumulative nature between 2009 and 2012. The difficulty in interpreting the NPL ratio results is affirmed in the findings of Albertazzi and Gambacorta (2009) and Festic et al (2011) where they found neither positive nor negative conclusion towards the impact of the NPL on performance and profitability.

Based on the study by Hsia et al (2010) who confirmed a negative relationship between the increasing NPL ratio and the performance of the bank because of the costs of activities associated with managing them, the assumption is that the NPL at 7% is decreasing since the ROAA and the inefficiency ratio decreased. Assuming that the cost associated with their management indicate their level of availability, the higher the costs the higher the number of NPLs. The assumption of the decrease in NPL ratio is further supported by Malganit (2012) who argued that cost efficiency has a negative relationship to problem loans.

5.7 Credit risk ratio and performance

The credit risk results in table 4.8 showed 4% of which is also in an accumulative measure on yearly basis, making it difficult to compare the performance of the bank in this regard. The findings from the studies by Pasiouras and Kosmidou (2007), Herrero et al (2009) and Fiordelisi et al (2011) showed that well capitalized banks are perceived to be relatively safe and have better credit risk management practices. This in turn lowers their cost of borrowing, and leads to enhanced efficiency. Based on this finding, the assumption is that the 4% credit risk ratio is increasing because the bank experienced lower capitalization; therefore the credit risk ratio is increasing.

Marcucci and Quagliariello (2009) added that the banks with lower asset quality are highly impacted during bad economic times than the less risky ones. Therefore the asset quality is also

important in managing credit risk which is not the case in this study because the average monthly assets were found to be increasing and the non performing loans ratio is assumed to be decreasing. Taking into consideration that the NPL loan ratio turns into credit risk ratio if the bank fails to recover these outstanding loans. In the future he 7% will have to be written off in the loan loss provision account which increases the credit risk of the bank and decrease its credit worthiness.

The credit risk ratio supports the statement by Chiesa (2008), Hakenes and Schnabel (2010) who argues that reduced monitoring causes banks to produce poor quality loans because of the financial guarantee that is brought by the third party in case of default by customers. Ubank does have a third party insurance in place and according to the above authors this insurance increases cost efficiency because the amount of capital per unit of lending can be used to raise more outside funds and expand its lending. The improvement in the cost efficiency ratio in the study is an indication of the reduced monitoring costs by the bank.

5.8 Liabilities (Term deposits and savings)

The liabilities of the bank represents the summation of its market share and it is a variable that banks would normally not reduce (Cronje, 2007). The reduction in this variable as given by the results in chapter four is an indication of the decrease in the market which threatens the profitability of Ubank. Liabilities are important in improving the profitability of the bank because they enhance the credit expansion especially the term deposits. The bank uses the term deposits to issue loans which become the capital injection to the balance sheet of the bank. A decrease in liabilities limits the credit expansion of Ubank.

The savings of the bank represent both the interest received income of the bank as well as the number of customers. Transactional charges from the existing end the new accounts play an important role in improving the financial performance of Ubank. The results show that the bank is experiencing a decrease in its interest income and the number of customers. Implying that since 2010, the bank does not exceed 200 new customers per month.

5.9 Macroeconomic factors

The macroeconomic factors were not measured in the study, but the performance results were related to the South African estimated and current performance provided by the literature. The overall performance of Ubank based on the ROAA indicated profitability throughout the years that were under observation. The gross domestic product and the interest rates in South Africa were predicted to rise in 2011 and were predicted to rise further in 2012. This finding of the positive correlation among Ubank's profitability, GDP and interest rates in the study is supported by the works of Herrero et al (2009) who argue that an increase in GDP and interest rates is positively related to the improved performance of banks, but the vitality reduces its profitability.

In literature, the risk of credit expansion and the non-performing loans to total loans (NPL) ratio is expected to be procyclical within an economic factors (Albertazzi & Gambacorta 2009). The current ratio of credit risk and non performing loans are not comparable; therefore, the economic conditions will give more assumptions in their analysis. Given that the South African economy is in the growth stage due to an increase in GDP and interest rates, the credit risk in Ubank is assumed to be increasing. This assumption from the study by Bonfim (2009) who advised that most credit risk in banks is built up during periods of strong credit growth and starts to materialize only when the economy hits a downturn. He also added that the credit overdue is usually preceded by interest rates increase, which is the current case in the South African economic conditions.

The impact of macroeconomic conditions on non performing loans is explained by Louzis et al (2012) as during the booming period continues banks extend credit to lower quality debtors and when recession hits the non performing loans increase. Based on the above explanation in Ubank, the current ratio of non-performing loans is from the previous recession period that affected the country in the period prior to the ones used in the study. The continuous increase in assets which are loan inclusive in the study, agrees with the explanation above that during the economic boom banks extend more credit. This is further affirmed by Staikouras et al (2008) who argue that economic growth is only significant towards improving the asset quality through fostered new lending.

5.10 Factors in their order of importance

The p – value from the ANOVA that was used to analyse the financial data indicated the level of significance factor. The only factors that are shown in the order of importance are those that their significance was tested. The findings show the following order of importance, the first being the most important factor as per p – value.

Table 4.9

Factor	*P – Value*
Inefficiency Ratio	1.01E-13
Average Monthly Assets	2.3949E-08
Capital Strength	0.145263

5.11 Challenges facing Ubank

The current performance which is the decreasing trend in the ROAA and most of the ratios may originate from the challenges that are facing Ubank.

5.11.1 Shrinking market share

Ubank is experiencing a challenge of losing its mining customers, which forms the dominant and core client base for Ubank. The mining customers have sustained the bank since its existence and the product development has always been around meeting their unique needs. Since June 2009, the mining industry in Klerksdorp and neighbouring areas in the North West started retrenching and closing down some of its mines.

In June 2011, Simmer and Jack Mines cut 1200 jobs across the board at all levels of employment as part of their restructuring process at its Buffelsfontein gold mine. In May 2011, Impala Platinum was planning on cutting jobs in one of its underperforming mines Marula, there was no number of jobs that was mentioned. Anglo Gold Ashanti and Pamodzi mines in 2009 to 2010 were closing down some of their operations in the Klerksdorp region which resulted in a number of Ubank customers being unemployed (Minning Report 27 May, 2011).

That decision impacted negatively on Ubank because from 16 branches in the region, they are now reduced to only 6 branches. The operating mines do not hire anymore but only retrench, exhausting the Ubank customer base further on yearly basis. The reduction of customers due to retrenchment directly related to the rate of non-performing loans and the loan loss provision for the bank, since most retrenched customers can no longer maintain their debt.

The shrink in the market share is also brought by excessive competition nationally and internationally. Nationally, all commercial banks are targeting clients who do transactional banking. This is the main target market for Ubank. Furthermore the focus is on the under banked and unbanked which is consist of a market estimated to be about R12 billion according to FNB. In fulfilling the goal of reaching the unbanked, FNB intends to open 150 branches in rural areas by the end of 2011 targeted only at the unbanked and low income retail market under its easy plan model. ABSA, Standard Bank and Nedbank have already developed the new delivery models including mobile banking to reach the retail ad low income market.

The competition pressure experienced by Ubank is not only limited to local competitors, but extends to international banks. The State Bank of India has already existing corporate banks in South Africa. In 2011, they opened additional four banks for retail market. The bank sees itself prospering regardless of the saturated South African market and because the country has a high concentration of non resident Indians (Business Day 17 June, 2011).Global bank's keenness on entering the South African market was confirmed by PricewaterCoopers and Accenture in their financial report, where they advised that there is a still a lot of foreign interest by global banks who seek to enter the local market. They may also want to enter the SA market through different

business models using partnerships with banks, retailers and telecommunications companies. The interest from foreign banks originate from the ranking of the SA's banking system as number six in the world in 2010 by the World Economic Forum competitiveness study (Business Live 31 July, 2011).

ABSA in January 2012 took another step towards offering basic and affordable banking products to entry level clients with the launch of its Transact account. According to Lawrence Twigg, managing executive in ABSA (Business Web 31 January, 2012), the product is the cheapest in the market and it comes with lower costs and charges beats the competitors, according to the. ABSA bank currently has 36% market share in the entry level client base, posing a threat to Ubank (Business Web 31 January, 2012).

5.11.2 Lack of proper geographical representation nationally and internationally

Ubank branches are only represented in small numbers mostly in the mining outlets and the mining regions. The bank has 34 branches in towns that are accessible to both mine workers and retail customers in four provinces. The representation internationally is only in the borders of Lesotho, Mozambique and Botswana through an agency. This causes frustration to customers because when they leave their work places they struggle with finding Ubank services. This is more especially since the mine workers who are mainly from other neighbouring countries like Mozambique and Lesotho. When travelling home, they end up using competitors services and that exposes them to the opportunity of being attracted to competition which is presented internationally. In the retail customers perspective, the lack of proper presentation in the market stimulates the desire for competing brands. Especially since competitors like Capitec, Absa, FNB, Nedbank are expanding aggressively in urban in rural areas to make their presence felt in South Africa.

Capitec bank has opened its 500th branch in Sandton in January 2012 with the aspiration of opening new 250 branches within the next three years. The lender who provides unsecured loans and transactional savings accounts aims to double the number of point of sales terminals by installing 5000 a month. It already has 10 000 point of sale terminals that allow clients to

withdraw cash, check balances and make loan payments. First National Bank has opened 150 branches in 2011 targeting the lower income market and the unbanked. Standard Bank as have opened 7500 bank shops for the previously disadvantaged communities, in addition to 50 loan centers opened along high – density commuter routes.

Absa bank over and above the branch representation they have, the bank is teaming up with smaller merchants and grocery retail shops to enable customers to conduct banking transactions in these merchants (Business Day 28 June 2011). On the other hand Ubank had plans of expansion in 2010 where the bank opened retail branches in Kempton Park, Soshanguve, Johannesburg, Matatiele, Brits and other areas in the Gauteng and Eastern Cape Provinces. This expansion was very narrow and the bank has not yet communicated any plans of further expansions in the near future.

This expansion from competition is threatening the customer base of Ubank because customers are always after convenience and easy access to their banking. It makes it easier for the Ubank clients to switch banks. The lack of proper geographical representation is directly associated with operational inefficiency in this study. Failure of the bank to build additional branches where there is existing customers and potential customers, improved the cost inefficiency of the bank, but at the same time it left the needs of the customers unattended to and opened a gap for competition.

5.11.3 Poor credit systems

Ubank has got poor credit criteria to identify customers that are creditworthy and the payment period for the bank is too short compared to its competitors. In the Klerksdorp region, there is only one credit employee who is expected to collect outstanding debt from the whole region and resolve queries for the customers as well as opposed to the sales team consisting of 16 people who make the credit sales.

This challenge directly influences the liquidity management of the bank, because the bank lends more and collect less from its customers, this affects the cash flow. The financial risk is increased as well for customers who have investments with the bank since the loan funds are

from investments. The risk of investor clients not being able to receive their funds as they become due is possible because of poor liquidity.

5.11.4 Lack of training and development of employees

Ubank has since 2009 reduced the training budget in the Klerksdorp region. New employees learn through observation instead of professional training. The lack of employee training lessen the quality of customer service and skill in the bank. When employees are not developed, they fail to meet up with the challenges the competition brings in the industry.

5.11.5 Innovations from competitors

The performance of Ubank is also influenced by the innovations and creativity from competition. The cause of the impact is developed from all the banks fighting for a stake in the market. In the past the market share was segmented for specific banks, for example the lower income customer base was a target for retail banks like Postbank, Capitec and African bank, whereas currently even the commercial banks are foreseeing growth opportunities in the retail market space, especially at the entry level market share. Banks have to be innovative; otherwise they will remain with the risk of being left behind by rivals.

5.11.6 Product offering

One of the aspects that banks are competing in is product offering. Product offering entails providing the customers with newly developed and relevant products that exceed their needs and being one step ahead of competition in product offering. It begins with identifying the need or improving and extending the ways of fulfilling the already existing need together with the tools. FNB, Absa, Nedbank, Capitec, Standard bank are offering their services using branch network, internet, cell phone banking, kiosk, and remote branches network. FNB in gaining competitive advantage because they have added a unique product from competitors which is a digital product offering consisting of Smartphone and tablets. The market for the digital services is expected to

increase in the future since the prices of tables and smart phones are decreasing. This innovative product offering sets them apart (Business Day 13 February, 2012).

Capitec has extended its credit offering value to its customers from R120 000 to R150 000 including the loan repayment period. FNB in meeting the needs of its lower income earners who end up loaning from Ubank, Capitec and African banks, is offering loans as little as from R250. This is done through opening doors to customers who never qualified for formal credit to start building their profiles in order to qualify for bigger loan amounts in the future. The bank has a product offering of credit cards that will be available in 2013 to its qualifying customers (Business Day 14 June, 2011).

The innovation in this regard is not only limited to the products but also to services, Capitec has been opening its branches over the weekend for longer hours. The aim was to catch the large number of people that visit the malls over the weekend, and provide convenience to those who can't access banks during the week. The operating hours are extended from 12h33 to 14h00. Nedbank was in the process of implementing that during the similar period (Business Day 20 July 2011).

The benefit of product offering is the retention of clients because they have a wide choice to select the products that are suitable for their needs. It also closes the gap of competitors in offering the newly developed products to the clients of the bank. It also increases the confidence and integrity of customers in knowing that the bank cares about them. Ubank's product offering is more mine workers based rather than retail customers; therefore, the bank needs to improve on its product offering.

5.11.7 Innovative service delivery

Banks have made their way into the urban townships where competition is very intense based on the service delivery strategy each bank chooses to follow. Additionally, the political pressure is being brought to bear on banks to extend access to financial services. Nedbank and Standard Bank have small tents in the townships with the aim of signing up customers, and Absa have its

dressed down branches branded '1234', meaning the number of products you can obtain from these branches.

Standard bank was promoting in South Africa their new mobile banking product which it is uses to deliver its services at the townships. New accounts are opened by a team of 40 agents fanned out across the townships using a smart phone. Clients are given a bank card while their ID's, pictures, proof of residence and declaration forms are captured on the phone digitally and sent to head office, the process takes five minutes. With the accounts opened, clients can use their cell phones to make deposits, payments, transfers and withdrawals at any bank shops installed in the townships across the country. The bank is still the leader in this innovation without any competitors copying its style as yet *(*Business Day 1 August 2011*)*.

Nedbank is using tents armed with generators to extend its services to the unbanked customers. These innovations from competitors are negatively impacting on the performance of Ubank, in both its mining and retail space. The competitors are engaging every creative act to gain the customers in the most effective and convenient manner, that includes the customers of Ubank. The South African bankers understand their value and importance in the banks and their lifestyle has become so busy and technologically based; they relate better to institutions that follow them and do their best in meeting their needs.

5.12.8 Technology

According to the Business day (28 June 2011), South Africa's top four banks will spend more than R30 billion over the next three years upgrading their information technology systems as part of strategies to improve competitiveness. These banks also want to comply with tighter regulations, improve efficiency and tighten defences to combat cyber crime such as fraud. This spending will be one of the highest by banks in the recent years. The banking analysts in South Africa say the major lessons from the recent global financial crisis was the need for robust IT systems and the banking executives have identified this area as needing focus in the future. Most banks identified a number of technological weaknesses in legacy issues, integrated business

process management and card fraud. In February 2012 FNB was regarded as the leader in the digital and technological space among the country's banks.

The technological improvement improves the financial performance of the competing banks especially in the mentioned arrears like fraud. These banks are willing to take the risk of increased pressure on already existing high costs that they are experiencing in order to benefit in the long run. Since 2009 banks have been experiencing a financial loss from the card cloning fraud that has saturated the banking industry. The banks that have invested in technology in debit card improvement through installing a chip device on their customers cards, are now benefiting from their investment financially. However those that did not act technologically are losing millions a year in refunding the stolen amounts to their customers.

5.10 Conclusion

This chapter discussed the findings of the results that were presented in chapter 4. The possible explanations for the results were also discussed in comparison to the previous studies that were reviewed in chapter 2. The challenges that influence the performance of Ubank were also discussed. The next chapter will conclude the study and recommend future studies to be conducted on bank performance to close the gaps in the current study.

CHAPTER 6: CONCLUSION AND RECOMMENDATION

The purpose of the study conducted was to determine the factors that contribute to the performance of Ubank in the Klerksdorp region. The study further aimed at identifying the factors and presenting them in their order of importance based on the findings of results. This chapter concludes what the study achieved and provides recommendations to fill the gaps in the Ubank performance and future research areas.

6.1 Overview of chapters

Chapter 1 provided a background context for the research, the objectives the researcher wanted to achieve with the study, the problem statement and the method of literature review and data collection. Chapter 2 reviewed the literature on banking performance to discover the various views of various scholars on this topic. The findings on literature were used as the guideline in identifying the factors that determine performance. Chapter 3 discussed the research methodology, design and sample data and its source in fulfilling the question of how the research was to be conducted. In chapter 4 the results from Ubank financial data analysis were presented. Chapter 5 discussed the findings from chapter 4 in detail.

6.2 Limitations to the study

The limitation was provided by the method of data analysis used. The method presented the results based on the current and previous performance of the bank, without forecasting the future performance which would have been useful for recommendation. The study focused only in the Klerksdorp region which might not be the true reflection of the performance of the overall bank. The only data analysed was secondary which gives no guarantee in its accuracy and reliability.

6.3 Research questions answering

The purpose of this study was to answer the questions and sub- questions presented at the beginning of the study. The questions and sub- questions were as follows.

6.3.1 What factors significantly determine the performance of retail banks? Case study being Ubank?

The research gave a number of factors that are important for the performance of banks and those factors were not only limited to the South African context; but are important in the worldwide banking. As the study narrowed the context focused on the South African banks. This question was answered clearly.

6.3.2 What is their order of importance?

The study gave the order of their importance by providing the significance of some identified factors. In this regard, the study failed to fully address this question because not all identified factors were measured in terms of their significance. The question still remains whether the other factors significant or not. During the study there was no indication of non-importance of not measuring certain factors. The shortfall emanated from the method of data analysis tool which could not cater for non-financial factors.

6.3.3 What should managers do in order to focus on the identified factors?

This question was answered clearly based on advice from the previous studies, the presentation of the results and the current trends that are taking place in the banking industry. Therefore the answering of the research questions by the study was satisfactory.

6.4 Conclusion

The findings include the points below:

(i) The return on average assets which represents the profitability of Ubank was decreasing since 2009 till 2012. The reason for the observed decrease is associated with the small number of new deposits and savings on yearly basis and the depletion of the existing deposits and savings. As loans constitute the assets of the bank, the

assumption is that the bank is no longer issuing a larger number of loans to its customers as in the past.

(ii) The liquidity ratio also decreased for the similar period and it showed a negative relationship with the performance of the bank. The reason for the liquidity pressure is caused by the existence of non-performing loans, which is an indication of the bank's failure to collect and pay its outstanding creditors. The decrease in capital caused liquidity pressure because the bank does not have enough excess funds to meet its liabilities when the debtors fail to meet their obligation.

(iii) The average monthly assets increased during 2009 to 2012 and showed a positive relationship towards the banks performance and profitability

(iv) Inefficiency ratio was highly significant and it decreased during the period, it showed a positive relationship towards profitability. The reason for the performance of the inefficiency ratio is associated with the cost saving activities that the bank engaged in, as well as the existence of the non performing loans. This implies that the bank saved costs in monitoring and managing their debtor of which is costly.

(v) Capital strength was insignificant and it decreased throughout the period of 2009 – 2012. The capital strength is associated with credit risk, because the bank has to make provision for its debtors, that impact on its capital strength. The other reason is the decreasing ROAA which represents the profits of the bank. Without enough profits, the bank cannot have enough reserves.

(vi) Non- performing loans ratio was found to be decreasing based on the results of other factors and the performance of the bank.

(vii) Credit risk ratio was found to be increasing due to the decrease in capital strength and the available non performing loans.

The findings showed that Ubank performed poorly between 2009 and 2012. They also showed that the factors that are increasing in ratios, alone cannot improve the performance of the bank. All the factors need to meet their expected outcome for the overall performance to improve. According to the results the trend is decreasing consistently which poses a threat to the bank's financial position in the future if it is not managed efficiently. The findings confirmed that banks that strike the balance in managing the identified factors a higher advantage in increasing their performance.

The study showed that after South Africa experienced a financial crisis period in 2007 till 2009, Ubank focused most of its resources towards minimising its costs and neglected other factors. The bank focused on maximizing its output or service delivery with limited resources. This was shown by a decreasing trend in their inefficiency ratio. The negative impact from this finding was the lower and unstable market share which was not measured by the financial data, but was discussed in literature as having a correlation with efficiency. Furthermore, the low market share is mainly associated with the lack of superior and excellent customer service especially with the increasing competition in the banking industry.

The findings also confirmed that Ubank's credit management and their lending criteria require improvement. This was supported by the ratio of non-performing loan and credit risk. The study showed the importance of the bank to balance its focus on all the identified factors because they all contribute to the overall performance of the bank effectively.

6.5 Recommendations

6.5.1 Market opportunities

Ubank should look into the expansion of the personal banking to meet the needs of the young and middle aged customers since they form the largest demographic group within the banking industry. Ubank will need to consider the appropriate mix of products and services they can deliver and manage which will be supported by the availability of technology. The banks that have a fully developed needs-based customer value proposition, understand that packaging an

appropriate set of products and services together. Some of which might be white labelled from others adds more value than providing a limited range of fully-owned products and services.

6.5.2 Insurance

The recommendation in the product expansion is the introduction of the insurance policies not only for death cover but also for life cover. This would be beneficial to both the bank and its clients because after the credit crisis in South Africa the consumers are determined not to be vulnerable in their finances. For Ubank, the insurance will provide a stream of income for a longer period of which can be used to generate more income through lending. The life covers have potential of improving the bank's capital.

6.5.3 Educational loans

The bank should also look into developing loans well structured for funding the education of consumers. Consumers' needs of education has expanded from educating their children but into developing themselves as well. In most cases parents provide for their children's education in advance, but the evolution in the workplace has created an immediate need for them to empower themselves. Ubank can take this as an opportunity to cater for this need through product expansion.

6.5.4 Wealth preservation

South Africa is going through a recovery stage where people are able to repay their debts regardless of the reconciliation. The need for professional advisory from consumers should develop in order for them to preserve the remaining wealth and assets they own. The bank can take this opportunity to implement the relationship management and portfolio management division to service this need.

6.5.5 Strategy

To prevent the consistent downward trend in its profitability, the bank should revisit its strategies on financial, internal business and customer perspective to improve the current position of the bank. Strategy is defined by Wheelen and Hunger (2004) as the road map by which an

organisation moves from a current state of affairs to a future desired state. It allows a company to position itself effectively within its environment while constantly monitoring the changes that can affect it. In moving from where the bank is, to where it wants to be, Ubank must first address its balance sheet structure since its loans, savings and deposits which constitute a bigger proportion of their assets are under pressure. This was given by non performing loans rate, decreasing savings and deposits in chapter 3.

As the current ratio of the average monthly assets is increasing, in the long run it might threaten the profitability of the company since the assets are decreasing. This shows that the bank's assets are currently sustained by the existing business which will be depleted in the future. In addressing the issue of the assets under pressure, the bank needs an effective sales strategy to boost its sales. The development of this strategy begins with placing appropriately skilled people and compensating them fairly and transparently in order to drive the success of the bank.

The vertical and horizontal growth strategy is advisable for Ubank since they are not sufficiently geographical represented in South Africa. The banking industry is taking advantage of the unbanked market, therefore this growth strategy will expand the customer base for the bank. The horizontal growth will increase the network for the bank through collaborating with industry leaders in expanding the brand and developing new services that the bank cannot currently cater for. With the recommendation of new divisions like insurance, educational loans and wealth preservation above, the horizontal growth will be a good starting point for the bank.

6.5.6 Competitive position review

The future belongs to organisations that can first identify the market segments where they can add value and where there are customers willing to pay for their products, and then have the courage to invest in these businesses while shrinking others. This will lead to the competitive advantage which is a creation of a system that has advantage over competitors and allows customer value creation in an efficient and sustainable manner (Heizer and Render 2009). The success of the review is based on the bank's ability to strategically analyse its environment and its interactions, by identifying its strengths, opportunities, weaknesses and threats.

Ubank used to practice monopoly in the mining industry by adding value that competitors could not provide. Currently the mining market is saturated with competition and Ubank is gradually being pushed out because of the newly developed operational strategies brought by competitors. Taking into consideration that the mining banking is not regulated and differentiated from retail banking, makes it easier for competitors to access it and apply their commercial and retail business practices. The importance of reviewing the competitive position for Ubank is brought by the decrease it is experiencing in the mining market and the lack of growth it is experiencing in the retail market. The bank should identify its core competencies that differentiate them strategically from competition. The recommendation in implementing this strategy will be to review the current mission, goals and objectives of the bank.

6.5.7 Cost reduction as a competitive advantage

As observed in chapter 3 Ubank has done well in decreasing its costs, even though some of the factors were negatively impacted by the exercise, the bank still made profits. This shows that even after removing or downscaling certain activities from the value chain the bank was still able to render the services to its customers. It is recommended that the bank to take advantage of the success of the cost saving exercise and use it as strategy of being the cost leaders in the market which will differentiate them and attract more customers. This can also add value in the improvement of its performance.

6.5.8 Overall Recommendations

It is recommended that the bank identifies the business performance measurement framework that will monitor, control, drive improvement, achieve alignment with the bank's goals and objectives, reward and discipline for improved performance. The framework should also strive to strike a balance in profits, growth and control. The regular measurement and evaluation of the performance of the bank is recommended in order to manage any challenges in time before they spread throughout the years.

To close the gap in the findings of this study its failure to measure all the factors significance, further research is recommended that will effectively analyse the non accounting factors that

were identified in the study. Further research must also take into consideration the impact of the macroeconomic factors in determining the factors of performance. The recommendations to the management of Ubank towards improving the performance are, to focus on improving the competitive advantage of the bank through product development, product mix and expansion to other business lines in order to spread the business risk.

The management should also practice performance-based compensation to enhance the performance of the bank through individual employees. They should closely monitor the macroeconomic factors because they impact negatively credit risk and non performing loans. The benchmarking of its technology with the leaders in the banking sector and compliance to the banking regulations is also recommended.

Equally the management should work towards improving the corporate governance of the bank because it is vital in the alignment of the bank's goals with performance. Lastly, to prevent insolvency, management should improve the management of the liquidity of the bank.

6. 6 Summary

This chapter summarized the chapters in the study and the findings. It also discussed the recommendations for further research and for the management of Ubank in improving the performance of the bank.

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8. APPENDICES

APPENDIX A

	2009 - 2010		2010 - 2011		2011 - 2012	
Month	**Current Assets**	**Current Liabilities**	**Current Assets**	**Current Liabilities**	**Current Assets**	**Current Liabilities**
March	82263649.57	2335130.82	39803791.4	1933523.12	83694380.89	1074703.1
April	78313962.21	2933770.64	47360075.45	2560274.91	84048588.1	-29942.36
May	73032509.49	7605948.74	47454030.45	962811.15	86362121.25	846578.01
June	56758312.08	-987006.69	47823320.71	1252375.7	90752374.81	650057.3
July	61107512.91	956246.21	51121591.72	-2318457.11	92970815.93	-1061573
August	56201374.06	1982258.71	57743574.47	707683.84	85583454.69	-5053771.
September	51190628.68	-2059549.48	54352061.52	388151.87	91015816.99	1627774.3
October	51306412.16	2005097.8	57022244.33	-669844.77	95710772.6	309258.53
November	46822341.65	3374519.19	61201033.71	237362.51	87478754.2	-315087.1
December	46868809.51	-972966.54	61887335.09	-1529557.52	89600430.83	-2774701.
January	52101983.76	6057888.19	80741492.8	-757067.75	94711578.19	-75487.57
February	43710189.65	146504.84	80449042.67	-1630233.75		

APPENDIX B

	2009 - 2010		2010 - 2011		2011 - 2012	
Month	**Operating Expenses (R)**	**Gross Income (R)**	**Operating Expenses (R)**	**Gross Income (R)**	**Operating Expenses (R)**	**Gross Income (R)**
March	-1533614.43	4392899.32	-1328414.96	4150381.72	-351773.71	4435593
April	-1424315.6	3825503.38	-1335446.78	3613866.34	-357019.12	4289666
May	-1532595.71	4088951.14	-1348182.39	3730947.63	-399142.67	4284002
June	-833059.64	4215634.97	-1458485.12	3697474.09	-322326.25	4328956
July	-846560.05	4057184.34	-1375572.83	3723534.67	-320530.2	4464228
August	-1340681.89	3733584.69	-1174408.09	4318406.19	-430375.9	4768027
September	-1260068.17	3654933.91	-1345786.93	4327207.21	-397180.1	4796533
October	-1304728.47	3576144.02	-1096639.75	4292158.97	-415278.52	4925679
November	-1319100.79	3583799.51	-1299477.99	4512363.08	-365839.27	4946008
December	-1444057.87	4011380.09	-1453346.27	5520432.49	-432046.18	5305098
January	-1202390.55	4286629.2	-1022447.37	2938246.69	-415865.07	4718523
February	-1388437.91	3453326.32	-1923593.63	4179557.31		

APPENDIX C

	2009 - 2010		2010 - 2011		2011 - 2012	
Month	**Total Assets (R)**	**Total Equity (R)**	**Total Assets (R)**	**Total Equity (R)**	**Total Assets (R)**	**Total Equity (R)**
March	82263650	2859285	39803791	2821967	83694381	3189601
April	78313962	5260473	47360075	5100386	84048588	5839774
May	73032509	7816828	47454030	7483152	86362121	8635414
June	56758312	11199403	47823321	9722141	90752375	11586449
July	61107513	14410028	51121592	12070102	92970816	14645474
August	56201374	16802931	57743574	15214100	85583455	17877219
September	51190629	19197796	54352062	18195521	91015817	21192217
October	51306412	21469212	57022244	21391040	95710773	24638436
November	46822342	23733911	61201034	24603925	87478754	28167345
December	46868810	26301233	61887335	28671011	89600431	31937360
January	52101984	29385471	80741493	30586811	94711578	35244227
February	43710190	31450360	80449043	32842774		

APPENDIX D :SAVINGS ACCOUNTS

Year	Month	New Accounts
2010	M	542
	A	491
	M	736
	J	728
	J	576
	A	381
	S	691
	O	551
	N	523
	D	419
2011	J	387
	F	379
	M	381
	A	376
	M	358
	J	492
	J	456
	A	466
	S	469
	O	400
	N	2,665
	D	296
2012	J	463

APPENDIX E: Already Opened Accounts (Savings) from 31/03/2010 until 31/01/2012

Year	Month	Existing Accounts
2010	M	46,119
	A	46,190
	M	46,146
	J	46,554
	J	46,694
	A	46,614
	S	46,866
	O	47,046
	N	46,732
	D	46,685
2011	J	46,579
	F	46,566
	M	43,547
	A	41,618
	M	40,543
	J	40,313
	J	39,958
	A	39,743
	S	39,394
	O	39,119
	N	41,210
	D	40,843
2012	J	40,735

APPENDIX F : New and Existing Accounts (Term Deposits) from 31/03/2010 until 31/01/2012

Year	Month	Existing Accounts	New Accounts
2010	M	877	158
	A	848	123
	M	860	128
	J	845	146
	J	855	173
	A	865	141
	S	853	128
	O	858	112
	N	837	133
	D	777	96
2011	J	758	131
	F	717	105
	M	723	115
	A	697	80
	M	708	109
	J	728	110
	J	722	100
	A	765	150
	S	778	159
	O	796	120
	N	779	116
	D	737	105
2012	J	750	127