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First and second-generation commercial banks in Bangladesh: A comparative financial analysis

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Abstract

Purpose: This study assesses the overall performance of commercial banks in Bangladesh by classifying them into first- and second-generation groups.

Research Methodology: The investigation encompassed secondary data from 2016 to 2020, along with a meticulous examination of the ratios of ten banks during that timeframe. Standard software such as the Microsoft Office package was utilized for conducting horizontal, vertical, and rational analyses. Return on assets (ROA), return on equity (ROE), and net profit margins are the primary metrics used to assess overall performance.

Results: Research indicates that the first generation excels in certain instances, while the second generation performs at its peak capacity in other cases. Therefore, a comprehensive outcome exists.

Implications: These indicators offer a concise and influential message to all stakeholders that may shape their decision-making process.

Limitations: It may be beneficial to consider a longer timeframe and gather insights from interviews with industry professionals for subsequent studies. Other factors to consider include customer insights, industry conditions, the nation's economy, monetary policy, and the global trade situation.

Novelty: This study focuses on the influence of employee retention on organizational performance in a service-oriented government institution.

Keywords: *First-generation, Second-generation, Return on equity, Economies of scale, Opportunity cost*

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1. Introduction

Commercial banks have a vital economic function in enabling the flow of funds through capital formation and loan provision. Commercial banks are responsible for the collection of small deposits from businesses throughout the economy that have extra funds, the promotion of capital formation, and the provision of loans to enable entities who do not have adequate finances to borrow money for investment and consumption to establish a favorable environment. Banks contribute to the expansion of the economy by enabling individuals and organizations within a community to spend more than their present income level. By utilizing credit creation, banks can increase the value of their deposits and issue loans on a larger scale. Additionally, banks serve the purpose of initializing a larger deposit base than they currently hold from surplus units. A sizeable number of people who are part of the official financial system and contribute to poverty reduction are included in this category. According to Akber and Jumman (2023), consumption banks' economic growth is facilitated. This is because consumption plays a significant part in the Gross Domestic Product (GDP), which eventually contributes to progress in economic development. A commercial bank is responsible for supporting the implementation of the monetary policy established by the central bank. Additionally, it plays a role in preserving financial stability by regulating interest rates and inflation in the market. The principal institutions that serve as depository institutions are commercial banks (Madura, 2012). They play a vital role in enabling payments, safeguarding funds, and providing guidance to customers.

As the primary depository financial institutions, they accumulate funds and extend business loans. Their primary source of income is the disparity between the interest rate at which they lend money and the rate at which they bounce funds back from borrowers. After deducting others' operating costs from this interest spread, they come up with a net income. Additionally, they assume a significant role in the capital market by establishing themselves as institutional investors. In addition to participating in the seasonal equity offering, they provide assistance to other businesses in the process of raising capital for the first time (in the form of an initial public offering) on the stock market. Moreover, they facilitate the exchange of currencies and issuance of letters of credit, which in turn makes international trading more convenient. They act as reliable entities for both the importer and exporter, both of whom are involved in the transaction. Several commercial banks are involved in investment banking, and they frequently act as underwriters and counsel corporations to increase the likelihood of obtaining sufficient money from the primary market. Commercial banks, in addition to carrying out the obligations stated above, play an essential role in preserving financial stability at the national level and within the financial market of the economy. In the context of Bangladesh, a nation that is undergoing rapid development, it is of utmost importance to have a healthy financial industry and strong financial institutions for the country to function at its fullest potential.

Measuring the performance of this sector from the perspective of COVID-19, particularly before and after the phenomenon, could produce an output that is both instructive and helpful, allowing one to gain insight into comparative analysis.

2. Literature Review

Tarawneh (2006) used two dependent factors to evaluate a company's financial successTarawneh (2006). These variables are the Return on Assets (ROA) and volume of intent income. Their size, which is determined by their total assets; asset management, which is measured by the asset utilization ratio (calculated by dividing operating income by total assets); and operational efficiency, which is measured by the operating efficiency ratio (calculated by dividing total operating expenses by net income) are the independent variables. Banks’size is determined by their total assets.

A study conducted by Ahmeti, Hoti, and Alshiqi (2014) examined the financial performance of Kosovo's banking system. This study aimed to evaluate the quality of financial indicators that contribute to meeting all regulatory requirements.

One is able to obtain a variety of ratios that are helpful in evaluating an organization's financial performance by looking at the published financial statement. Some of the financial ratios that are used to classify financial institutions in Pakistan are return on equity (ROE), return on assets (ROA), total assets, total equity, earnings per share (EPS), current ratio, capital ratio, return on capital employed (ROCE), and administration expenses to profit before tax ratio (Raza, Farhan, & Akram, 2011). These ratios were used to determine the performance of financial institutions.

An investigation was conducted by Akber and Barua (2021), who compared nine Non-Bank Financial Institutions (NBFIs) that were operational in Bangladesh during 2016 and 2019. Financial ratios and other indicators were used for this study. This study’s findings suggest that the efficiency ratio, as opposed to the liquidity ratio, capital ratio, and other financial indicators, is the most important factor in determining the success of non-bank financial institutions (NBFIs) in terms of generating returns (as opposed to other financial indicators). The findings of this study suggest that non-bank financial institutions (NBFIs) should place a higher prioritize loan selection and endeavor to improve their reputation by providing services that are more efficient.

Duncan and Elliott (2004) stated that there is a positive correlation between customer service quality scores and financial performance. These metrics include return on equity (ROE), capital adequacy ratio

(CAR), and net interest margins (NIM). Tandon, Chaturvedi, and Vidyarthi (2017) conducted research in the identical domain. His research demonstrates the correlation between non-performing loans and their detrimental effects on bank profitability. He concentrated on the precise macroeconomic factors that influence banks. Ultimately, he concluded that greater focus must be placed on NPL (non-performing loan) management to enhance profitability.

Alsamaree (2013) conducted research in the field of commercial banking in Kuwait between 2007 and 2010Alsamaree (2013). Through his research, he established that Kuwaiti banks were able to successfully navigate the crisis and capture the interests of the National Bank of Kuwait. This was accomplished by strategically allocating profits across the institutions.

The DEA was utilized in the research that Fukuyama (1995) carried out in Asian nations to investigate and assess the effectiveness of banking systems. As a component of his research, he investigated the efficiency of 143 Japanese financial institutions. He concluded that the proportion of pure technical efficiency was approximately 86%, while the proportion of scale efficiency was approximately 98%. Therefore, it may be deduced that the fundamental reason for total technical inefficiency is inefficiency, which is solely technical.

Nurullah et al. (2024), conducted in Indonesia over 67 banks revealed that DPR, total assets, and asset growth significantly impact the profitability of banking organizations, as evaluated by ROA and NPM. Management must prioritize these elements when making decisions and formulating business plans.In 2022, Forozandeh (Forozandeh, 2022) conducted an analysis of the banking system that could benefit from the application of queuing theory to enhance its efficiency. By employing a meticulous analysis technique, he offers innovative methods to optimize bank queuing systems, thereby enhancing the overall banking performance. According to the results, the suggested approach yields the highest level of customer happiness and optimizes earnings. The results allow decision makers to acquire valuable insights into the behavior of the system. Phina, Patrick, and Nwabuike (2022) established that emotional resilience has a substantial influence on the performance of employees in commercial banks in southeast Nigeria. The study determined that the emotional literacy of employees, and consequently their emotional resilience, has an impact on their performance in banks. This is because individuals with diverse mindsets and temperaments are assembled to collaborate as a team to enhance the company.

Phina, Ogechukwuand, and Shallom (2021) demonstrated in their study that there is a noteworthy correlation between Career Development Climate and Employee Commitment in Microfinance Banks in Southeast Nigeria. Additionally, they establish a significant correlation between Teamwork Climate and Absorption in Microfinance Banks in Southeast Nigeria. Emmanuel (2021) also suggested that an organization's failure to promote a positive internal working environment, provide satisfactory working conditions, maintain an organized workplace, and involve employees in decision-making processes can have detrimental effects on productivity and impede the achievement of organizational objectives. Bank management should be aware of employee turnover as it has a direct impact on bank customer service and overall profitability. A study conducted by Zahedy, Jafari, and Ramezan (2021) found that safe and healthy working conditions and organizational conflict are the most significant elements, whereas job satisfaction and pay/benefits are the least significant factors.

The purpose of the research that was carried out by Efendi, Putri, and Dungga (2019) was to analyze the relationship between Return on Equity (ROE) and Total Assets Turnover (TATO) in the context of the automobile industry in Indonesia. DER and TATO were found to have a considerable impact on ROE, both individually and jointly, according to the statistical tests conducted for the study.
Because of the separation of ownership, corporate governance is an extremely important factor in ensuring that banks can carry out their operations correctly. The size of the board of directors and the presence of an audit committee were shown to have a statistically significant negative impact on the performance of the bank, according to the findings of a study that was carried out by Ashenafi in the year 2013 On the other hand, the size of the bank had a favorable effect on performance, which was consistent with the statistical analysis.

2.1 Overview of the Banking sector and customer satisfaction

Over the past few years, the banking industry in Bangladesh has undergone substantial expansion and transformation. The sector has become more competitive because of regulatory restrictions, innovations in financial and technological systems, and the arrival of banks from other countries. The financial performance of commercial banks in Bangladesh improved as a result of this development. CAMEL is a framework that assesses numerous aspects of a bank's performance, including capital sufficiency, asset quality, managerial efficiency, earnings quality, and liquidity. These changes were examined by using the CAMEL framework. However, even though the CAMEL framework might provide good improvements in the financial performance of commercial banks in Bangladesh, it is essential to consider that the increased competition and regulatory requirements might have also resulted in difficulties for smaller, local banks. These financial institutions might have difficulty keeping up with the rapid speed of technological advancement, and they might also have trouble meeting norms for capital adequacy and asset quality. Additionally, the admission of foreign banks might potentially lead to a concentration of resources and power in the hands of a few larger banks owned by foreign entities. This would limit the prospects for growth and development available to local banks. Furthermore, greater competition may also result in risk-taking behavior and aggressive lending practices, which may potentially lead to an increase in the number of loans that are considered non-performing and financial instability in the banking system.

Customers, who are the primary source of revenue for banks, are the most important factors that these institutions should consider. Several aspects affect the level of customer satisfaction in the banking industry. These factors are critical in determining the overall success of an industry. These aspects include the level of customer care provided, ease with which banking services may be accessed, and variety of financial products made available by banks. A great customer experience can be significantly influenced by factors such as the prompt and efficient resolution of client inquiries, provision of customized attention, and presence of a welcoming banking atmosphere. In addition, it is vital to make financial services accessible to customers through both physical branches and digital platforms to meet various requirements. Customers have a wide range of financial needs, and this bank can meet all these needs by providing a variety of products and services, including savings accounts, loans, investment products, and insurance alternatives. This helps to increase customers' overall happiness with the bank. Additionally, the convenience with which transactions may be completed and the security measures in place are factors that add to the pleasure of customers.

2.2 Examining financial performance metrics and bank management

Financial planning is mandatory for any company or organization. A single person cannot run a business or organization on its own. Instead, they have shareholders who elect the board of directors to monitor operations and appoint management. The board is responsible for decision making. An individual handles the entire process of financial planning, which necessitates the utilization of financial performance indicators. One of the most important aspects of any business or organization is its financial success. In order to make well-informed judgments about long-term and short-term financial planning, capital budgeting, financial statements, analysis, and other related matters, the management, in their capacity as a diligent researcher, carefully considers the financial performance of a firm and company. Finance performance is an essential component of each company and organization.

A company 'sor firm's financial performance is a valuable indicator that may be used to evaluate the standing of the company or firm, allowing for comparisons with other organizations and indicating areas in which improvements are required. This study offers insights into the financial components of a company in operation. Companies' financial statements contain a wealth of information on many indicators of financial success. By employing the income statement, balance sheet, and cash flow statements, businesses can utilize a variety of approaches, including horizontal, vertical, and ratio analysis, to properly evaluate their potential for growth, define goals, and improve profitability.

Many different approaches can be taken when measuring financial success; nonetheless, it is essential to consider all measures collectively. It is possible that it would be beneficial for individuals with an inquisitive mind to investigate financial accounts, margin expansion rates, or any lowering debt. Many different parties have a stake in a firm, including trade creditors, bondholders, investors, employees, and management. It is in the best interest of every organization to carefully monitor the financial performance of a commercial enterprise. Researchers can gain insights into a company's financial performance by analyzing the data supplied in the company's annual report. Researchers can gain insights into performance, cash flow, and numerous ratios by conducting a comprehensive analysis of the data.

2.3 Objective of the study

The major objective of this study is to provide a complete overview of the financial services sector in Bangladesh, with an emphasis on institutions that are considered to be of the first and second generations. To accomplish this goal, a comparative investigation of the performance of banks from both eras was conducted. Not only will this endeavor result in benefits for investors and customers, it will also be beneficial for the financial sector of the economy as a whole. Considering that commercial banks are the key actors in the financial sector, this study also emphasizes improving the operational and technological aspects of banks to guarantee that transactions within the sector are carried out without interruptions.

2.4 Implication of the study

For policymakers to take appropriate actions to remedy this situation, they must conduct a thorough investigation of the lack of generation banks and the factors responsible for their absence. For the economy to function at its full potential, it is necessary to narrow the gap between these two generations. It is possible that the economy has reached a condition of lasting prosperity because of the facilitation of optimal performance among essential stakeholders in the financial sector. The personnel of the industry could gain a comprehensive understanding of which characteristics of the first generation of banks are superior to those of the second generation by evaluating the study. They could also make an effort to focus more on the qualitative aspects of one generation and draw benefits to the banks of other generations.

3. Methodology

To achieve the best possible outcomes, this study used a quantitative research approach. The use of secondary data constitutes the vast bulk of the data utilized for performance analysis. The official publications of various financial institutions, including their balance sheets, income statements, and other appendices, were sources of secondary data. To conduct a comprehensive analysis, data spanning the years 2016 to 2020 were gathered and carefully studied, with a particular emphasis placed on the ratios of ten banks operating during that time period. The justification for selecting this timeframe is based on the Covid-19 pandemic. Thoroughly analyzing the pre-existing conditions of this occurrence could provide valuable insights into the performance of these banks both before and after the onset of the epidemic. By identifying the segment, we can readily compare the performance of one industry with that of the others. For the purpose of horizontal, vertical, and rational analysis, common software such as the Microsoft Office package was utilized. Secondary data were collected from the annual financial statements of several different banks in Bangladesh. Subsequently, a comparative investigation of the financial performance of banks owned by the first and second generations was carried out.

3.1 Sample Size & Sources of Data

The data consist of 10 1stgeneration banks (AB Bank Ltd., IBBL, The City Bank, Agrani Bank Ltd., United Commercial Bank) and 2nd generation banks (SIBL, Southeast Bank Limited, Eastern Bank Ltd., Prime Bank, Dhaka Bank Ltd.) banks for the period from 2016 to 2020. Information was collected from various secondary sources, including (1) annual reports of different 1stgeneration and 2nd generation banks for the period 2016 to 2020, (2) prospectus issued from 2017 to 2020, and (3) press releases from DSE from 2016 to 2020.

3.2 Performance Measurement Indicators

To evaluate financial performance, we use the following ratio analysis:

1) Efficiency / Profitability ratios: Return on owners' equity (ROE), Return on Assets (ROA), Earnings per Share (EPS)

2) Liquidity Ratio: Cash Ratio, Loan to Asset
3) Capital / Leverage ratio: Debt to Equity Ratio, Debt to Asset Ratio, Capital Intensity Ratio
4) Financial measures: net profit margin, total asset turnover, investment deposit ratio, and cost of income ratio.

4. Result and discussions

Time series data were used for five years, 2016-2020, to obtain an adequate and clear outcome and draw a conclusion in addition to ratios such as ROA, ROE, Net profit Margin, EPS, Cost of income, investment deposit, cash ratio, loan to assets, debt to equity, debt to assets, total assets turnover, and capital intensity ratio.

4.1 Return on Asset

The term "return on asset" refers to the amount earned per unit of asset utilized. The term ‘earning capacity’ refers to the ability of commercial banks to generate income from their assets (Rose, 2002). Second-generation banks’ return on assets (ROA) is superior to that of first-generation banks. The average performance of the 2nd generation bank over five years is 0.0077, whereas the 1st generation bank's is 0.0047, showing that the 2nd generation bank have a higher ability to utilize their assets effectively.

4.2 Return on Equity

Return on equity is a metric used to assess a company's financial performance (Rose, 2002). The calculation involves dividing net income by shareholder equity.

The return on equity (ROE) of the 1st generation bank is superior to that of the 2nd generation bank. The average performance of first-generation banks over five years was 0.39, whereas second-generation banks had an average performance of 0.07. This indicates a satisfactory level of profit relative to bank equity.

4.3 Net profit margin

It provides the profit per dollar of sales and is calculated by dividing the net profit by sales (Besley & Brigham, 2008). It measures the extent to which revenue can be effectively converted into net profits.
The net profit margin of the 2nd generation bank is higher than that of the 1st generation bank. The 2nd generation bank has an overall average performance of 1.60 over five years, while the 1st generation bank maintains a performance of 0.10, which is lower than that of the 2nd generation bank.

4.4 Earnings per Share

Earnings per share refer to the earnings generated by a corporation for each share. This metric assesses a corporation’s operational effectiveness (Besley & Brigham, 2008).

Second-generation banks’ earnings per share (EPS) are preferable to first-generation banks. The average performance of the 2nd generation bank over five years was 2.67, whereas the 1st generation bank had a lower performance of 2.35. The result indicates that the 2nd generation bank offers higher returns to their investors than the amount invested.

4.5 Cost of Income

This ratio is referred to as efficiency ratio. Banks strive to minimize them. The calculation involved dividing the net operating cost by the operating income.

Based on this criterion, first-generation banks are superior to second-generation banks. The mean performance of the 2nd generation bank over five years was 5.53, whereas the performance of the 1st generation bank was 0.54. First-generation banks operate more efficiently, while maintaining excellent client service standards.

4.6 Investment Deposit

The calculation involves dividing the investment by the total deposits held by banks. This indicates the proportion of deposits allocated to investments by commercial banks. The average investment for the 1st generation bank is 4.05, whereas for the 2nd generation bank, it is 0.33.

4.7 Cash Ratio

denotes the amount of cash that the bank possesses to settle its immediate financial obligation. The cash ratio of the 1st generation bank surpasses that of the 2nd generation bank. The mean cash balance for the 1st generation bank over five years is 0.08, whereas that 2nd generation bank's is 0.03 to their short-term liability.

4.8 Debt to Equity Ratio

The debt-equity ratio is a financial metric that quantifies the extent to which an owner's capital can offset debts owed to creditors. As these ratios increase, more money must be secured by the company's capital. Higher ratios expose firms to greater risk by suggesting that they are acquiring more debt from the market relative to their ownership stake.

The debt-equity ratio of the 1st generation bank exceeds that of the 2nd generation bank. The cumulative ratio of first-generation banks over five years was 14.89, while that of second-generation banks was 11.23. Second-generation banks face a lower debt-to-equity burden than first-generation banks.

4.9 Debt to Asset Ratio

The debt ratio is a financial metric that indicates the proportion of a firm's assets that creditors finance (Besley & Brigham, 2008). The cost-to-income ratio of 2nd-generation bank is greater than that of 1st-generation bank. The average ratio of the 2nd generation bank over the past five years was 0.92, whereas the 1st generation bank had an average of 0.75.

4.10 Total Asset Turnover

The Total Asset Turnover is a ratio that quantifies the efficiency of all assets in generating sales by measuring the sales volume relative to total assets. This ratio elucidates the level of effectiveness with which a corporation employs its assets to generate profits (Harahap, 2013). An excellent ratio indicates efficient utilization of assets to create income for the company.

The Total Asset Turnover Ratio of the 2nd generation bank exceeds that of the 1st generation bank. The average performance of the 2nd generation bank over five years is 0.62, whereas the 1st generation bank have a performance of 0.05, which is lower than that of the 2nd generation bank.

4.11 Capital Intensity Ratio

quantifies the assets required to earn US$ 1 income. This ratio also quantifies the efficiency of asset use and the capital requirements for operating an institution to produce revenue.

The Capital Intensity Ratio of second-generation banks surpasses that of first-generation banks. The mean performance of the 1st generation bank over five years was 18.46, whereas that 2nd generation bank was 16.15. Second-generation banks require less capital to create income than first-generation banks.

4.12 Comparison of the financial performance of 1st and 2nd generation bank

The market position of 1st and 2nd generation banks are evaluated by scoring based on the financial ratio of different 1st and 2nd generation banks in Bangladesh. Here, scoring is based on the performance of different measurements. The best performer will score 1, and the lowest score is 9. Here, the score is given by,

1 = Best Performer

2

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9 = Worst Performer

If the value of any measurement is unavailable, the performer obtains a score of nine for non-performance or undesirable performance.

4.13 Recommendations

Bangladesh's progress has been significantly influenced by the establishment of commercial banks. The financial industry in Bangladesh has reached a level of development sufficient to support sustainable development. The incremental growth of this industry is depicted clearly and accurately manner in this report. This study also discusses the disparities in performance between the two generations of banks, as well as the ways in which these discrepancies may have an impact on the decision-making process of policyholders and other stakeholders.

Compared to the first generation of banks, second-generation banks demonstrated a much higher overall performance. Regarding the consistency of their return on assets, equity, and net profit margin, second-generation banks perform better than first-generation banks. Because these three essential ratios have a direct influence on net profit, first-generation banks should prioritize providing a wide range of services to their customers to keep their net profit stable. If they do, they would be able to make the most efficient use of their fixed assets. It may be useful to execute methods such as increasing the amount of financial leverage, increasing profit margins, optimizing asset turnover, distributing surplus cash, and minimizing tax liabilities in order to improve the return on equity (ROE) of a first-generation bank. In addition, second-generation banks demonstrate effective service delivery and achieve high levels of client satisfaction according to a qualitative evaluation. It is possible that this is why they surpass the first generation in a variety of quantitative aspects.

First-generation banks can concentrate resources on establishing operational efficiency to decrease expenses, which is a method that is often adopted. This allows them to improve their cost-to-income ratio. Nevertheless, banks should not ignore the revenue component of the equation because despite the fact that the industry is already at an advanced stage, there is still a substantial amount of room for improvement in that particular domain, notably in the onboarding process. It is possible for them to restructure their debt to change their debt-to-equity ratio. The first generation should focus on the quality of the services they deliver and the response of the customer.

5. Conclusion

The purpose of this study is to investigate the efficiency of first- and second-generation banks in Bangladesh between 2018 and 2022 by utilizing a variety of performance evaluation techniques and methodologies. Several different ratio studies have been utilized to evaluate the financial performance of first- and second-generation banks in Bangladesh. At the end of the day, we determined the ranks of the selected first- and second-generation banks by analyzing their performance using ratio analysis. This study provides evidence that the financial performance of first- and second-generation banks in Bangladesh gradually deteriorates. The thriving presence of a number of domestic and foreign enterprises in Bangladesh presents both first-generation and second-generation banks with considerable opportunities for expansion. Despite facing distinct problems, these banks have significant growth potential. These businesses can flourish and expand in Bangladesh because the country's economy provides an atmosphere conducive to their success. For Bangladesh, a nation that is undergoing rapid development, it is absolutely necessary to have a healthy financial industry as well as strong financial institutions for the country to realize its full potential.

The financial industry works as the backbone of a country's economic development. Given that some businesses are still in the initial stages of creating an impression in the global market, it is imperative that they develop a solid reputation immediately. To boost the amount of goods imported and exported within the economy, the banking sector needs to operate as a trustworthy intermediary while maintaining a healthy level of caution. Banks of the first and second generations are looking forward to obtaining help from the government and the market in the coming year to improve their ability to compete on an international level. As a result of the inaccessibility of data from other institutions, the findings were entirely extracted from the information provided by ten banks. A number of banking activities that have a substantial impact on the financial performance of both first- and second-generation banks are examined in this study, which offers managers essential insights into these operations.

5.1 Recommendations

Bangladesh's progress has been significantly influenced by the establishment of commercial banks. The financial industry in Bangladesh has reached a level of development sufficient to support sustainable development. The incremental growth of this industry is depicted clearly and accurately manner in this report. This study also discusses the disparities in performance between the two generations of banks, as well as the ways in which these discrepancies may have an impact on the decision-making process of policyholders and other stakeholders.

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