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Factors Affecting the Banks Profitability in Jordan between 2015 and 2020

Sahoum Aljazzazen

University of pecs- Faculty of business and economics
Eng.sahoum@hotmail.com

Abstract: This study aimed to examine the internal and external factors affecting commercial banks' profitability. The internal factors comprised in the independent variables are: asset quality, capital adequacy, management quality, liquidity, bank age, and bank size. On the other hand, the external factors include GDP growth, inflation, and interest rate. The dependent variable is the commercial banks' profitability measured by Return on Assets (ROA). The researcher used the descriptive-analytical approach. The study population consisted of all the commercial banks listed on the Amman Stock Exchange (ASE) which amount to (13) banks, and the sample included all the population's elements. Financial data were collected from the financial statements of commercial banks listed on the ASE (2015-2020) to measure several internal and external factors affecting profitability. The data were processed using the Statistical Package for Social Sciences (SPSS) version 22. This study concluded that the internal factors have a clear impact on the profitability of commercial banks and that GDP growth is one of the external factors that affect profitability. The remaining variables that have been studied (i.e., the bank age, liquidity, bank size, inflation, and the interest rate) do not affect the profitability of commercial banks.

Keywords: profitability, ROA, asset quality, GDP, inflation, interest rate, Jordan, commercial banks.

1 Introduction

The banking sector throughout the world has witnessed some profound changes due to innovations in technology and globalization that have created a robust competitive environment. Therefore, this sector has to deal with the challenges and the increase in the growth opportunities in order to increase its profitability. Thus, the performance of banks is deemed to have an impact on investment and corporate growth, industrial expansion, and economic development. Moreover, profitability is necessary to maintain economic activity and achieve returns for shareholders; therefore, factors affecting profitability and performance in the banking sector have attracted the interest of academic researchers as well as the management of banks and financial markets (Sheefeni, Peyavali, 2015).

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Profits maximization is one of the main goals that commercial organizations, including commercial banks, seek to achieve. This is because realizing these profits enables banks to maintain their continuity, support their financial position, and increase their ownership rights and solvency. Commercial banks play a crucial role in allocating economic resources in countries, and their primary contribution to the country's economic growth is through the provision of funds to investors. For that, profitability is a key element as it increases the depositors' confidence in banks and prospective investors and encourages venture capitalists to subscribe to the bank.

Profitability is usually used to measure the bank's management performance, and it gives vital signs to regulators that the bank is operating accurately. It provides an overview of the adequacy of this bank in managing its projects, besides that it constitutes a measure of the investment effectiveness, operational performance, and financing policies followed by the bank management to ensure the existence of a sector (Nuriyeva, 2014). Healthy, reliable, and stable bankers, assessing and analyzing the banking sector profitability listed on the ASC are paramount to identify weaknesses and address them. Especially in light of the significant structural, legislative, and institutional changes after the financial crisis, profitability in the global and international banking sector was positively impacted by a grouping of the internal and external elements (Dahiyat, 2018).

This research consists of several sections starting with the introduction, followed by the literature review related to the topic of the research. The third section presents the methodology used in the research, including the study model, procedural definitions, and the study hypothesis. In the next section, the data is analyzed and the results are presented according to the study's objectives, which is the study of factors affecting the profitability of commercial banks. Finally, the last section presents the conclusions of the study

2 Literature review

Profitability is the company's ability to generate profits; these profits are essential from the creditors' standpoint because they are the only source of funds to cover the debt. Management uses the profit to measure profitability analysis (Gibson, 2010). The primary objective of commercial banks is to achieve higher returns and provide services to customers; therefore, commercial banks must play this role and take care of this responsibility with all their financial strength. In addition, liquidity must be provided to meet any contingency, maintain continuity, economic growth, banking progress, and achieve shareholders' interests (Michael and Osamwonyi, 2014).

Commercial banks enjoy several functions different from other financial institutions (Gibson, 2010). The banking sector in Jordan has made moral development in a short period compared to other developing countries, especially thanks to the

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attention which has been given to this sector by the authorities in Jordan. Despite the financial crisis in Jordan and the unstable global conditions, this sector has been largely managed to sustain its stability. The policies adopted by the Central Bank of Jordan have enabled maintaining reliable and robust finance sectors and provide a stable investment atmosphere (Dahiyat, 2018).

The annual report for the year 2020 issued by the Central Bank of Jordan stated that the Jordanian economy has a high capacity to adapt to the surrounding developments and continue its positive performance during the year (2020). Despite all challenges faced, including the region's surrounding political and economic conditions, the real GDP growth reached 2.0% inflation 3.3%, and the general budget deficit reached 2.6% of output. Regarding the activity of licensed banks during 2020, the leading indicators witnessed a performance improvement, as evidence that the total assets/liabilities of banks witnessed a growth of 1.5% to reach 49.1 billion Jordanian dinar, credit facilities balance increased by 8.0% to reach 24.7 billion Jordanian dinar. Credit to the private sector increased by 9.3% to reach 21.7 billion Jordanian dinar. The total balance of deposits in licensed banks increased by nearly 33.9 billion Jordanian dinar compared with the end of 2019, while interest rates on credit facilities witnessed a similar increase on the level of the interest rates on deposits, followed by the rising interest rate margin (Jordan, 2020).

3 Problem statement

Banks play an essential role in facilitating financial transactions through converting deposits into investments and achieving monetary balance by implementing the Central Bank's policies. Profitability is an important performance indicator, and it is the main objective that banks seek to achieve and enhance. Based on this significance of the profitability, it was necessary to study the main internal and external factors affecting the banks' profitability and give ground to help decision-makers. Therefore, the study seeks to identify the most critical factors that affect the profitability of banks through answering the following question: what is the impact of the internal factors (asset quality, capital adequacy, management quality, bank size, liquidity) and the external factors (GDP growth, inflation, and interest rate) on banks profitability?

4 Research objective

The main objective of this study is to know and analyze the internal and external factors (asset quality, capital adequacy, management quality, bank size, liquidity,

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bank age, GDP growth, inflation, and interest rate) affecting the profitability of commercial banks listed on the Amman Stock Exchange, for the period (2015-2020). And based on the findings, conclusions will be summed to reach a set of results and recommendations that can help maintain and increase profits, as a source of reassurance for investors and stakeholders, and knowledge of strengths and correction of weaknesses.

5 Research Method

The researcher relied on the descriptive-analytical method in conducting this study to identify the factors affecting profitability in commercial banks listed on the Amman Stock Exchange. The descriptive-analytical approach is not limited to the process of describing the problem only. Rather, it works on analyzing, measuring, and interpreting the data, arriving at an accurate description of the problem and its results, and providing solutions and suggestions to correct its weaknesses.

The Statistical Package for Social Sciences (SPSS) software V22 was used to conduct the descriptive analysis and test hypotheses.

5.1 Data collection and sample

To achieve the study objectives, the data has been collected through the following methods:

1. Primary data: It is represented by the financial statements of commercial banks listed on the Amman Stock Exchange from 2015 to 2020.

2. Secondary Data: The previous studies, including journals and articles, and websites relevant to this study subject.

The study sample was identified based on its conformity with the study criteria and the period covered by the research. The study sample included (13 banks) (Exchange, 2020). The study stipulated that the bank must be listed on the Amman Stock Exchange, and that it has the necessary data to measure the variables of the study. In addition, the bank must be operating and continuing to practice the activity from 2015 to 2020, which is the period covered by the study. After reviewing the criteria mentioned above, it was found that all banks meet the study criteria.

5.2 The study variables Definitions

- **Asset quality:** Credit facilities are the most critical part of a bank's assets and a source of income, and they are expected to affect profitability. This ratio is measured by non-performing loans (Olweny, Tobias, 2011).

- **Capital Adequacy:** The bank's ability to absorb any losses arising from risk or some significant macroeconomic differences (Olweny, Tobias, 2011).
- **Management quality:** The efficiency of management is of great importance to the profitability of a bank as it is aware of the bank's ability to cover its operating expenses from the realized income and is calculated as an operating cost on total revenue (Brahmaiah and Ranajee, 2018).
- **Bank size:** The total assets of a bank are measured by the natural logarithm of the asset (Brahmaiah and Ranajee, 2018).
- **GDP Growth:** The group of finishing goods and services of any kind produced in a given country locally over one year (Brahmaiah and Ranajee, 2018).
- **Liquidity:** It is the bank's ability to meet its obligations to creditors, and it occupies particular importance in assessing the bank's solvency.
- **Inflation:** It is an economic phenomenon and it means a rise in the general level of prices, because of the increase in the amount of money (Brahmaiah and Ranajee, 2018).
- **Interest rate:** It denotes the cost of capital or credit during the year debt, and it is calculated as a percentage. (Tariq, 2014).

The financial statements listed on the ASE have been relied upon through the annual financial disclosure reports (2015- 2020) as the primary data collection tool. Table (1) shows the calculations to obtain data for each dependent and independent variable.

Table (1): Research variables measurement

Dimension	Type	Measuring
Assets Quality	Indep.	= Low provision for credit facilities / Net interest income
Capital Adequacy	Indep.	= Total equity / Total assets
Management quality	Indep.	Profit margin = Net income after tax / Total revenue
Bank's Size	Indep.	= Logarithm of assets
GDP Growth	Indep.	The rate of GDP growth found in the Central Bank's annual report
Inflation	Indep.	Percentage calculated in the Central Bank report
Profitability	Dep.	Rate of return on assets = net income after tax / total assets

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5.3 Research Model

To achieve the desired objectives of this study and to know if there is a statistically significant impact, the following model (Fig. 1) is designed and represents the relationship between the main variables in the study:

Independent variables: Internal factors: asset quality, capital adequacy, management quality, bank size, liquidity, and bank age; External factors: GDP growth, inflation, and interest rate.

Dependent variable: commercial banks profitability measured by Return on Assets (ROA).

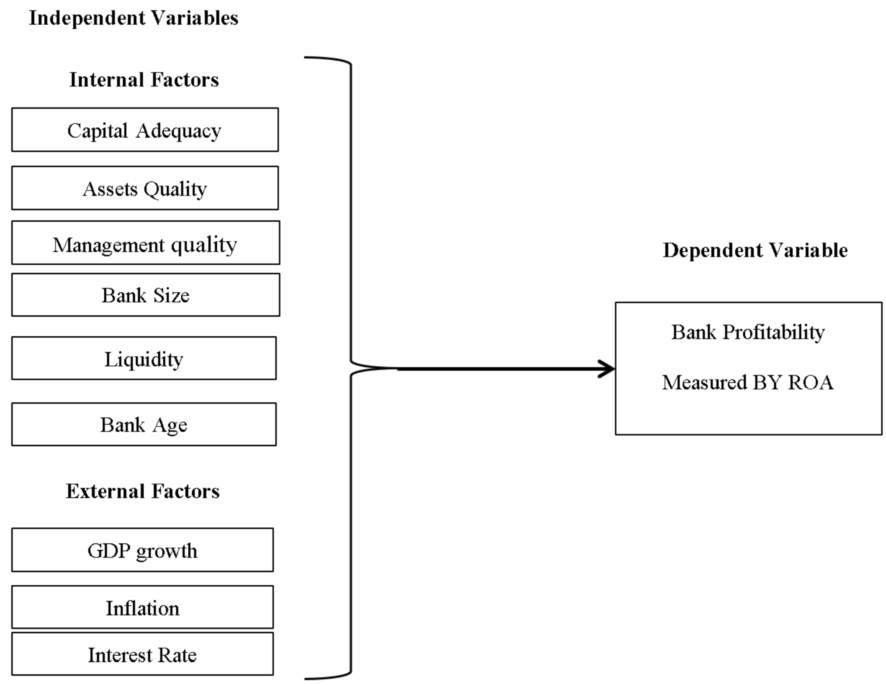

Figure 1: Research model

The following hypothesis was formulated in line with the objectives of the study.

HO: There is no statistically significant effect of the internal and external factors at the significance level (α≤0.05) on the profitability of Jordanian commercial banks.

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6 Results:

The mean and standard deviation were extracted to describe the study results for both independent and dependent variables during the period 2015-2020, as shown in Table (2).

Table (2): Descriptive Statistics

Variable	Mean	S.D.	Min	Max
Asset Quality	0.7761	0.32142	0.00	1.74
Capital Adequacy	0.1407	0.02804	0.04	0.22
Management quality	0.3051	0.10606	0.01	0.58
Bank Age	43.88	16.643	17	88
Liquidity	0.6120	0.12639	0.45	1.21
Bank size	9.3590	0.39530	8.68	10.41
GDP growth	0.0250	0.00411	0.02	0.03
Inflation	0.0245	0.01809	0.009-	0.056
Interest Rate	0.0275	0.00519	0.015	0.04
ROA	0.0127	0.00479	0.00	0.02

Table (2) indicates that the arithmetic mean for asset quality is (0.7761) with a standard deviation of (0.32142), while the arithmetic mean for the capital adequacy is (0.1407) with a standard deviation (0.02804). The arithmetic mean for management quality is (0.3051) with a standard deviation of (0.10606), while the arithmetic mean of the bank age is (43.88) with a standard deviation of (16,643). The arithmetic mean of liquidity is (0.6120), with a standard deviation of (0.12639). For the bank size, its arithmetic mean is (9,359, with a standard deviation of (0.3953). In contrast, the arithmetic mean of GDP growth amounts to (0.0250) with a standard deviation of (0.00411), while the arithmetic mean of inflation is (0.0303) with a standard deviation of (0.01809). The arithmetic mean of the interest rate is (0.0438) with a standard deviation of (0.00519). For the dependent variable, the profitability of Jordanian commercial banks achieved an arithmetic mean at (0.0127) and a standard deviation of (0.0047).

To ensure that this condition is met, the variance inflation factor (VIF) and the permissible variance (Tolerance) were extracted as shown in Table (3). The allowable tolerance of variance for the independent variables was less than (1) and greater than (0.01), and the values of the VIF were less than (5); and this denotes that there is no high correlation between the independent variables. Therefore, this

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indicates the acceptance of the values and is suitable for conducting linear regression analysis (Hair *et al.*, 2018).

Table (3) VIF and Allowable Variance (Tolerance) for the independent variables

Variable	Asset Quality	Capital Adequacy	Management quality	Bank age	Liquidity	Bank size	GDP growth	Inflation	Interest rate
VIF	1.623	1.233	1.339	2.066	1.388	2.081	1.536	1.555	1.105
Tolerance	0.616	0.811	0.747	0.484	0.721	0.481	0.651	0.643	0.905

To confirm the previous results, Pearson's correlation coefficients between the independent variables were used to ensure that there are no high multiple linear correlations between the independent variables and the results shown in Table (4).

Table (4): Independent variables Correlation coefficients (Pearson) Matrix

	Asset Quality	Capital Adequacy	Management quality	Bank age	Liquidity	Bank size	GDP growth	Inflation	Interest rate
Asset Quality	1								
Capital Adequacy	0.109	1							
Management quality	*0.303	0.153	1						
Bank age	*0.227	-0.147	-0.147	1					
Liquidity	-0.159	*0.288	0.087	0.072	1				
Bank size	*0.229	-0.050	0.017	**0.687	0.053	1			
GDP growth	0.134	0.125	0.158	-0.081	**0.295	-0.088	1		
Inflation	*0.269	0.113	0.179	-0.067	0.192	-0.091	**0.495	1	
Interest rate	0.096	0.114	-0.055	-0.042	0.079	-0.065	-0.158	0.049	1
*Significant at the level of significance 0.05									
** Significance at the level of significance 0.01									

As shown in Table (4), the highest correlation among the independent variables is (0.687) between the bank size and the bank age. In contrast, the correlation coefficient values between the other independent variables were less than that, indicating the absence of the correlation of high multiple linearities among the independent variables, as their values were less than (80%). Therefore, the sample is free from the problem of high multiple linearities (Dodge, 2008).

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Hypothesis testing

The results as show in Table (5) below indicate that the predictor variables of ROA are significant because the p-value is less than 0.05. The value of R-squared in the model is 41.4%, which endorses that the explanatory variables explain 41.4% of the factors affecting the dependent variable (bank profitability), measured by ROA, where 58.6% of the explanations come from variables not included in this research.

Table (5): the multiple linear regression and model summary

Model Summary					
R			R^2		
0.797			0635		
ANOVA					
Model		DF		F	Sig F
Regression	0.001	9	0.00	13.167	0.00*
Residual	0.001	68	0.00		
Total	0.002	77			
Coefficient					
Model	B Slope	SD	Beta	T	T Sig
Constant	-0.009	0.012		-0.733	0.466
Asset Quality	-0.005	0.001	-0.313	-3.351	*0.001
Capital Adequacy	0.076	0.014	0.447	5.493	*0.00
Management quality	0.019	0.004	0.430	5.076	*0.00
Bank Age	4.777	0.00	0.017	0.158	0.875
Liquidity	-0.012	0.003	-0.307	-3.554	*0.001
Bank size	0.00	0.001	0.028	0.262	0.794
GDP growth	0.392	0.106	0.336	3.705	*0.00
Inflation	-0.005	0.024	-0.019	-0.206	0.838
Interest Rate	0.058	0.071	0.063	0.812	0.419
F tabulated = (K-1) – (n-1) = 2.04					
T tabulated (at DF=1) = +/-1.991					
*Significant at the level of Significance $\alpha \leq 0.05$					

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The results in Table (5) indicate that there is a statistically significant effect at ($\alpha \leq 0.05$) level of internal and external factors on the profitability of Jordanian commercial banks listed on the ASE. The F-value of 13.167, which is greater than its tabular value (2.04), represents the significance of this model at a degree of freedom (68/9). The value of R^2 of (0.635) indicates that internal and external factors have explained (63.5%) of the changes in the profitability of Jordanian commercial banks among (36.5%) of other factors that were not included in the study model.

The correlation coefficient R = 0.797 indicates a strong relationship between the (internal/external) factors and the profitability of the Jordanian commercial banks listed on the ASE. It is evident from the results of the partial analysis of this hypothesis that (capital adequacy) had the greatest impact among the internal factors in the dependent variable (bank profitability), as shown by the value of its beta coefficient ($\beta = 0.447$). This effect reinforces the (T) (5.493) calculated value, more remarkable than its tabular and significant level.

Management quality came in the second place in terms of its effect on the profitability of the Jordanian commercial banks listed on the ASE, as the value of its beta coefficient reached ($\beta = 0.430$), and this effect is reinforced by the value of T calculated (5.076), which is greater than its tabular value, at a significant level (Sig =0.00). GDP growth, which is one of the external factors, is ranked third in terms of its effect, as the value of its beta coefficient reached ($\beta = 0.336$), and this effect is reinforced by the calculated value of (T) (3.705), which is greater than its tabular value, with a significant level of (Sig = 0.00). The asset quality, which is one of the internal factors, is ranked forth in terms of its effect, as the value of its beta coefficient amounted to (- ($\beta = 0.313$), and this effect is reinforced by the calculated value of (T) -3.351, which is higher than its tabular value, with a significant level of (Sig = 0.001).

Liquidity, which is an internal factor, is ranked fifth in terms of its effect, as its beta coefficient reached ($\beta = 0.307$); and this effect is reinforced by the value of T calculated (-3.554, which is greater than its tabular value, at a significant level of (Sig = 0.001). On the other hand, the rest of the variables covered in this study did not indicate any contribution to the effect on the profitability of banks, where the significance level values were greater than (0.05); and the calculated T value for is less than its tabular value as shown in Table (5).

Based on the foregoing, we reject the null hypothesis (HO) and accept the alternative hypothesis (Ha), as it has been proven that there is a statistically significant effect at the significance level of ($\alpha \leq 0.05$) of internal and external factors on the profitability of Jordanian commercial banks listed on the Amman Stock Exchange.

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7 Discussion

The study (Nuhiu, Hoti and Bektashi, 2017) proved that there is an impact of asset quality on profitability measured by the rate of ROA, the rate of ROE, and the interest margin. This is consistent with the findings of this current study. Capital adequacy measures the ability of the banking sector to absorb any losses arising from a risk or some major imbalances in the overall economy. Most studies use an alternative to the capital adequacy ratio, the ratio of total equity to total assets, which indicates that the bank's total assets are financed by its shareholders (Petria, Capraru and Ihnatov, 2015). The capital adequacy also shows the bank's financial strength and financial position in line with the ratios of equity and debts. It was calculated in a study (Myktybekovich, 2013) by dividing the equity by the total assets. A bank's capital acts as a safety net during adverse conditions, and capital ratios correlate directly with profitability. If the banks aim to improve profitability, they must maintain an appropriately high capital because the high capital ratio enables them to avoid unexpected losses. If this ratio is high, it indicates that banks are working conservatively and providing some potential investment opportunities (Mbekomize and Mapharing, 2017).

The GDP rate is one of the best variables to determine the economic performance. It was chosen as an external variable or the so-called macroeconomic variable to show its relationship with the profitability index (Myktybekovich, 2013) (ROA). A study (Petria, Capraru and Ihnatov, 2015) also showed that this variable is used as a proxy for measuring economic activity. That is, when the total is high, the loan demand increases, and greater profits can be achieved. Conversely, if the GDP growth slows down, banks face increased credit risks and increased provisions, and thus profitability decreases. In addition to the GDP rate, inflation also is an important factor for the profitability of commercial banks, and its impact depends on the bank’s income or profits in the event that the bank’s operating costs are higher than the inflation rate. This is why the effect of inflation depends on the macroeconomic rigidity that allows accurate prediction of inflation (Tariq *et al.*, 2014).

This study showed a statistically significant effect of the management quality on the profitability of commercial banks listed on the ASE, as measured by the profit margin, equal to the total property rights divided by the total revenues. The results of the study (Nuhiu, Hoti and Bektashi, 2017) were in agreement with the results of this current study, as the profitability of commercial banks depends mainly on the efficiency of management. Also, in the same regard, the study of (Ramadan, Kilani and Kaddumi, 2011; Myktybekovich, 2013; Petria, Capraru and Ihnatov, 2015) was similar to this study's results as it was proven that there is a clear and tangible effect of management efficiency on the profitability of commercial banks. However, the results of this study showed that there is no effect of the bank age on the profitability of Jordanian commercial banks listed on the ASE and that the experience of these

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banks over these years has no relationship with profitability. This result differed from the result of the study (Muda, Shaharuddin and Embaya, 2013), which concluded that there is an impact of the bank age on local and foreign Islamic banks. Still, the study (Samad, 2015) agreed that macroeconomic variables do not affect profitability. In contrast, the study (Sheefeni, 2015) disagrees with the result of this current study as found that there is an effect of inflation on the profitability of commercial banks.

Conclusion

This study extends previous studies which have addressed the impact of some internal and external factors on the profitability of Jordanian commercial banks. Still, this study was distinguished from most of the previous literature in terms the number of factors it covers, as it included six internal factors, namely, asset quality, capital adequacy, management quality, age of the bank, liquidity, size of the bank, and three external factors consisting, namely, GDP growth, inflation rate, interest rate during the relatively recent period (2015-2020). This research relied on the descriptive-analytical method. The study population consisted of all commercial banks listed on the Amman Stock Exchange, to examine the factors affecting their profitability.

In light of the research's results, a set of recommendations can be made. The most important is the need to pay attention to the variables affecting the profitability and improve them. Moreover, the study recommends paying attention to management quality because of its effect on enhancing the profitability of commercial banks. Furthermore, the researcher recommends conducting more studies, especially on factors not addressed in this study, such as deposits and credit risk, to see their impact on the profitability of commercial banks; additionally, this study recommends measuring the effect of the study variables on the profitability of commercial banks through using different dependent variables on the rate of ROA.

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