



RESEARCH ARTICLE

LOST ON THE JOURNEY: A CRITICAL REVIEW OF AMANA BANK'S PROGRESS

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ABSTRACT

“This IPO is for investors who really want to buy our share and be benefitted in the medium term. If someone intends on punting with the IPO, we are not the bank for such people. With punting, we feel that a customer does not become a shareowner.” (FT.lk, 2013) The above statement was mentioned by the former MD/CEO of Amana Bank (“The Bank”) FaizalSalih in the end of the year 2013 when the bank started floating its shares in initial public offering (“IPO”) under the slogan: “Own your share in our journey of success”. The aim of this study is to critically review the progress of the bank based on its strategies, financial position and performance and to provide suggestions on the way forward. Amana Bank is operating in one of the high growth industry of Islamic banking (Consultancy.UK, 2016). However, it appears that so far the bank is following a very narrow path when it comes to its strategies and competition. This narrow view has impacted its share and financial performance and position. In order to overcome this struggle, it has to broaden its view to understand the real competitors and focus on wider customers. It also has to consider the impact of growing financing alternatives such as financing provided by vehicle dealers, Mutual funds, Insurance schemes and Sharia-compliant fund management companies while keeping a close eye on the political changes in the form of threats and mega projects in the form of opportunity for the bank. As a result of these internal and external environmental comprehensions, Amana Bank can deploy many strategies to revamp its journey towards success. This study suggests rebranding or repositioning of the bank while addressing its operational inefficiencies as one of the recommendation. The case of Amana bank provides many insights to Islamic banks that operate in an environment where the majority of the customers do not fall into religious sentiments such as the importance of services and customer care. It also shows the impact of clear future strategies in firm’s market value.

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INTRODUCTION

Amana Bank

Amana Bank PLC (“The bank”) is commonly known as Amana, Incorporated in 2009 as Public Quoted Limited Liability Company. It got License from the Central Bank of Sri Lanka to operate under commercial banks. It is the only bank in Srilanka focusing entirely on Sharia¹-based commercial banking services operating on a profit sharing business model. It operates mainly on Consumer banking and SME banking products. However, it also provides trade, lease, and other treasury products as well.

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¹ Sacred law revealed by God Almighty
<http://www.cimaglobal.com/Documents/Islamic%20finance/2011/Guides/Glossary.pdf>

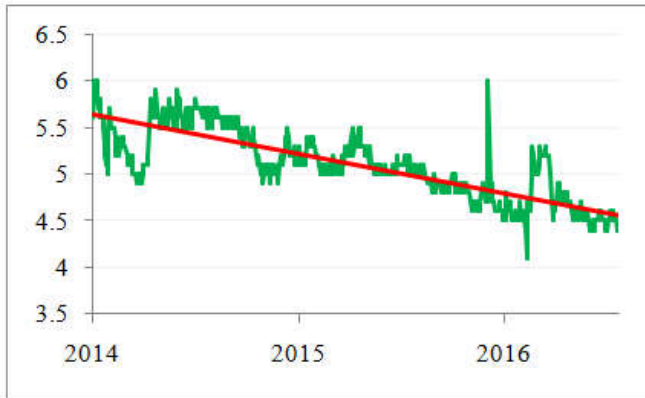
All Positives for Amana’s Journey

It seems that Amana has the main ingredient to pursue the journey of success with all green lights indicating in its industry. As per analyst reports, it is in an industry where the global and the local conditions seem encouraging. As per Consultancy. UK (2016), the Global Islamic finance industry is set to rise from current levels of US Dollar 1.8 trillion to 3 trillion by the end of the year 2018.

The Islamic finance industry is considered as one of the fastest growing industry in the world bringing a lot of opportunities to this sector (Consultancy. UK, 2016). The Islamic Finance industry in Srilanka as well expected to grow a minimum of 15% per annum with an expected current market size estimated at LKR 150 Billion (NDB, 2015). In the meantime, Moody's outlook provided a stable outlook for the banking sector of Sri Lanka despite an anticipated squeeze on returns (Moody's, 2015).

What is going wrong in the Journey?

Despite all the positive signs, Amana's journey does not seem to be a very comfortable one. A careful review of the bank's journey highlighted many factors contributing in its current shaky journey, such as the narrow view of competition, product offering, and customers coupled with poor financial and share performance. As shown in the graph below only a downward trend can be noticed in the share performance of the bank since the Initial Public Offering (IPO).



Source: (Markets.Ft.com, 2016)

Figure 1. Amana bank closing share price performance from IPO till Aug 2016

It appears that the bank is traveling on a highway with many lanes viewing it as a dual carriage road, as it is considering the Islamic windows opened by conventional banks such as Al Fadhala by the Commercial bank as its competitor. However, an analysis of industry indicates that these windows are mere retaliation for the entry of Amana by the conventional banks to retain its customers. Below table provide the list of Islamic banking Window operated by conventional banks in Srilanka.

Table 1. Islamic Banking Windows of Major Conventional banks in Srilanka

Conventional Bank Name	Islamic Bank- Window
Commercial Bank	Al Adalah
Bank of Ceylon	An Noor
Hatton National Bank	Al Najah
National Development Bank	Shareek

Source: Compiled by the case write

Further, in recent past Amana signed many agreements with Exchange houses in the Gulf region such as the agreement with Zaman Exchange in Qatar (Gulf-Times, 2016). It is evident from this recent focus that the bank is drifting away from its key core competence of operating under a purely Islamic finance model providing innovative products and services. Amana is also not reaping the first mover advantage benefits by continually failing to promote this model. Moreover, if you walk into any Amana branch, you will immediately notice that the bank is not attracting the majority of the customers who choose their banking based on services, quality and the ethical concepts rather than mere religious credentials. Conversely, at first look financial achievements of the year 2015 claimed by the board appears to be promising (Dailynews.lk, 2016). However, a close analysis indicates that although by growth Amana is showing favorable numbers by growing in total assets 37% year on year and profit before tax 374% year on year beating industry averages, the returns are appearing to be well below the general return generated by the banks. As

depicted in the table below the commercial banking sector of the country generated between 1%-1.9% Return on Assets (ROA) and between 10%-20% Return on equity (ROE) while Amana was able to generate only 0.33% ROA and 2.78% ROE. A detailed analysis of the financial performance and position is given in the Exhibit 1.

Table 2. Return on Equity (ROE) and Return on Assets (ROA) of Major Srilankan commercial banks compared with the Amana Bank

Bank Name	ROE	ROA
Amana	2.78%	0.33%
Commercial Bank	16.90%	1.42%
BOC	22.20%	1.70%
Peoples Bank	27.10%	1.80%
Sampath	18.42%	1.28%
HNB	16.79%	1.61%
Seylan	15.62%	1.40%

Source: Compiled by the case write based on the year 2015 Annual Report of the respective banks.

Shareholders of Amana cannot be satisfied with above performance, especially the strategic shareholders whom as depicted in the table below are making a higher return on their banks than what Amana generates. Therefore, purely from a shareholder's point of view, it is not viable to continue the investment unless there is a change expected in the future returns. Even the other general shareholders appear not to have a much positive view in the future of the bank. Thus, the share Amana shares are trading at 5 Rupees for most of the period much lower than the IPO price of 7 Rupees.

Table 3. Amana Bank's Strategic Shareholder's ROA and ROE

Shareholders Name	% Holding	ROE	ROA	FY
Bank Islam Malaysia Berhad	14.44%	17.60%	1.43%	2015
AB Bank Limited	14.44%	6.70%	0.54%	2015
Bangladesh Akbar Brothers (Pvt) Limited	9.98%	NA	NA	
Sri Lanka Islamic Development Bank	9.62%	NA	NA	
Saudi Arabia Expolanka Holdings PLC	7.22%	11.02%	6.38%	2015

Source: Compiled by the case write based on year the 2015 Annual Report of the respective shareholders.

In addition to the low income due to the narrow views of the bank, increased cost due to lack of operational effectiveness and poor services also contributing to the lower returns. Amana does not yet fulfill many services that are currently presumed to be basic such as credit card and mobile banking. Further, analyzing the deposit rate offered by Amana proves its ineffectiveness in operational costs; although lower deposit rates are given by the bank compared to the other banks still it's unable to widen the gap between the bank's cost and income to generate acceptable returns.

Table 4. Deposit rate provided by Amana compared to the Commercial Bank of Ceylon

Account/Deposit type	Amana Bank	Commercial Bank
Savings Account	2.76% p.a	4.00% p.a
3 Month Term Investment (Profits at Maturity)	6.25% p.a	9.50% p.a
6 Months Term Investment (Profits at Maturity)	7.25% p.a	10.00% p.a
1 Year Term Investment (Profits at Maturity)	8.01% p.a	10.00% p.a

Source: (Commercial Bank, 2016), (Amana Bank, 2016)

How to pursue the Journey of success

It is said that understanding any problem clearly is half-resolved. In order to resolve the issues the bank has to broaden its view, as such, it should recognize that due to the distinct nature of the business where it is operating it has to face two sides in its extended industry while keeping a vigilant eye on any opportunities and obstacles. Then, it has to review and align its business model by either rebranding or repositioning while addressing the operational inefficiencies.

Recognizing the Double sides of the Journey

A broader view of the industry will indicate two distinct types of competition, customers/suppliers and substitutes the bank has to consider. As for the competition, the bank's real competition starts with highly competitive Srilankan commercial banking industry where there are almost 25 licensed commercial banks. Many of these banks are well established while some are supported by the government such as Bank of Ceylon. The graph below shows the banking sector by total assets compared to Amana bank. Moreover, sometimes the bank also has to compete with other industries for its product offerings, such as the competition with leading leasing companies. In the meantime, Amana has to consider the potential competition from established Islamic banking industries from the Middle East and Far East Asia, especially due to the intense competition these banks face in their respective market had forced them to seek opportunities in the developing economies with upcoming projects such as Srilankan economy. Amana also has to deal with two different type of customers, the first type is those who based their choice on the religious view and the others are whose choices are based on services, quality and ethical values carried by the banking products and its principal. The first type of customers can be attracted easily and will be ready to pay a premium for the products and service by merely having a Sharia board with renowned scholars. However, this customer segment is very small. The second type of customers is difficult to attract and retain as they have many alternatives available in the market with a very low switching cost and even sometimes incentives to switch.

Since Amana depends mostly on its customer deposits, its customers are also having a key role as suppliers. Therefore, customers are one of the most crucial sectors that the bank needs to address on a continuous basis. Moreover, since Amana uses the banking infrastructure of established commercial banks such as for remittances and ATM it has less preferential deals as these banks are also competing in the same industry. Amana has to consider the growing preferred financing provided by electronic outlets and vehicle dealers in addition to the other alternatives available in the market such as Insurance schemes and investment in Mutual funds. Additionally, the bank also has to be concerned about Sharia-compliant fund management companies regulated under the Securities & Exchange Commission (SEC) and Takaful products as well.

Identifying Opportunities and obstacles of the journey

Once the wider industries are understood and clear plans are set to overcome the hurdles, there are some additional crucial matters Amana has to face while in its business journey. Firstly, it has to keep a very close eye on government

regulations and monetary policies of the country which makes a huge difference in the banking industry's operations and its profitability. These can change drastically in developing nations such as Srilanka, especially due to political changes and covenants requirements of the borrowings. For Instance, Amana was under great pressure not long ago when the previous government issued a guideline to consolidate the banking sector. Although the current government had put this on hold, these kinds of regulatory changes will affect a small player like Amana in the industry more than any others. Secondly, it has to monitor the wider opportunities available in the country such as Colombo Metro Development Project. Amana bank can take a big stride in the industry if it can manage to lead a project financing via Islamic finance concept such as Sukook² using Islamic banks in the Middle East and Far East Asia who are looking for an opportunity to enter markets in South Asia. Finally, in recent years, ethical practices and corporate social responsibility concepts are getting more attention among the public, this is a great opportunity for the bank to capitalize and promote its banking model highlighting the moral and ethical principle. Below table provide a brief SWOT analysis of the bank.

Table 3. Amana Bank's SWOT Analysis

Strengths	Weaknesses
Core Competencies	Core Competencies
- Islamic Banking	- Failing to use Islamic banking to achieve competitive advantage
Financial Health	Financial Health
- Strong Growth	- Very Low ROE and ROA
- Strong Cash flows with almost 0% Non-Performing assets (NPA)	- Poor Share performance
	Management Culture
	- Tall organization structure
	- Lack of operational effectiveness
Opportunities	Threats
- Infrastructure projects to introduce Products such as Sukook and other new products.	- Changes in Central bank requirements on minimum capital.
- Increased ethical awareness	- Changes to the tax structure.
	- No Income generating options for excess fund.
	- Trading companies own financing systems gaining popularity.

Source: Case writer.

Once the views are broadened and the issues are identified in the journey, now the bank can focus on its internal models and strategies; let us call it the vehicle of the journey.

Re-design the vehicle to suit the Journey

To begin with, Amana has to review its business model and start revisiting it. The review should align the bank vision of becoming a leader in equitable finance solutions to the model. Further, it has to review how each product offering is contributing to the bank's vision and its returns. Any products that are not contributing need to be either revamped or discontinued. Then, the bank will have to either rebrand itself or reposition in order to start competing to attract general customers who do not base their choice on Islamic credentials. In both cases, the bank has to promote ethical sustainable banking concept. If the bank decides to rebrand, it can follow

² Certificates of investment – Alternative for bonds
(<http://www.cimaglobal.com/Documents/Islamic%20finance/2011/Guides/Glossary.pdf>)

other Islamic banks that rebranded their names to common name removing 'Islamic' in order to attract the general customers. For Instance, Dubai-based Noor Islamic Bank changed its name to Noor Bank (Reuters, 2014).

Exhibit1.Amana Bank's Financial Performance and Position for Year 2015/2014

Profitability (LKR Million)	2015	2014	% Change
Financing Income	2,886	2,408	20%
Financing Expenses	1,405	1,198	17%
Operating Expenses	1,693	1,575	7%
Profit/(Loss) Before Tax	219	-80	374%
Profit/(Loss) After Tax	159	-80	299%
Position at the Year End (LKR Million)			
Shareholders' Funds	5,723	5,026	14%
Deposits	38,608	29,224	32%
Advances	33,074	25,427	30%
Total Assets	47,882	34,898	37%
Information per Share (LKR)			
Earnings	0.13	-0.06	317%
Net Asset Value	4.58	4.02	14%
Market Value	5.6	5.2	8%

Source: (Amana Bank, 2015)

Although Amana bank does not have Islamic in it, the name itself sounds Islamic. Therefore, it can rebrand with a common name like "The Pearl Bank" for instance. If Amana opts to reposition itself without rebranding, the bank will have to educate the general customers on concepts of Islamic banking and underlying structure while attracting via quality services and innovative products based on ethical principles in order to gain on its banking model. It has to increase the awareness of the ethical concept of Islamic banking by marketing, promotions arranging seminars and workshops. Finally, while Amana focuses on its strategic initiatives to position itself as a fully fledged Islamic banking it has to give considerable attention to current operational ineffectiveness as well.

The bank has to become competitive in its products and services offerings. The strategic direction and becoming effective & efficient has to go hand in hand in order to achieve

better returns. It may take some time to implement all these directions. However, once the bank understands the extended industry, opportunities, obstacles, and position itself to tackle those with proper business model it can be achieved. Once the road is known and the vehicle is suiting a long journey, then it will be a successful journey.

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