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The optimal strategies for the banking sector in Iraq - reality and challenges

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Abstract
The research aims to identify and understand the challenges and difficulties facing the Iraqi banking system and propose appropriate solutions. The banking and financial sectors are characterized by rapid development and high competition, leading to the emergence of new financial institutions and banking mergers. Financial globalization has introduced new challenges in the financial world, which the Iraqi banking system must confront and overcome, especially after recent environmental changes (political, economic, and social). The research is based on the hypothesis that there is a gap and deficiency in the Iraqi banking sector that needs development. Necessary measures should be taken to reduce the gap through the adoption of development requirements and proposals. The study focuses on using financial tools to analyze data and measure banking efficiency through the return on equity model in the banks under study, presenting and commenting on these results. The research concludes that there is a delay in the performance of the Iraqi banking system and recommends that the Iraqi banking system should keep pace with environmental changes and adhere to the application of international standards.

Keywords: Banking sector in Iraq, optimal strategies, reality and challenges

Introduction
The banking sector is the primary entity responsible for financing various activities, whether economic, social, or political, in accordance with the procedures and instructions of the central bank and in line with general financial policy. However, this sector has faced many challenges and obstacles recently, hindering its activities due to global transformations in banking developments and the shift from traditional banks to electronic and comprehensive banks. Therefore, the Iraqi banking sector must keep up with these transformations, adapt to them, and take advantage of existing environmental opportunities while avoiding threats to achieve various banking reforms. This can be done by utilizing Law No. (56) of 2004, which granted more independence, flexibility, and efficiency to banks. It is essential to identify the problems and obstacles in the banking sector resulting from reforms in different countries and to measure banking efficiency using the return on equity model for the banks under study.

Research Methodology
Research Problem
Due to technological and banking developments and financial globalization in the banking sector and financial liberalization after 2003, challenges and obstacles have emerged affecting the Iraqi banking sector, impacting banks that lack banking efficiency, leading to competition and market withdrawal or mergers with other banks.

Research Importance: The importance of the research is highlighted through the following:
1. It provides an analysis of a sample of the banking sector for the period 2010-2014.
2. It contributes to the development of the Iraqi banking sector and achieving banking efficiency.
3. It identifies banking efficiency indicators in the surveyed banks, helping other banks benefit from these indicators' ratios.
4. It determines the problems facing the Iraqi banking sector.

Research Objectives

The research aims to achieve several objectives, including:

1. Identifying and understanding the challenges and difficulties facing the Iraqi banking system and proposing suitable solutions.
2. Determining the level of banking efficiency in the surveyed banks.
3. Understanding the role of the central bank's independence in managing monetary policy for banking sector reforms.
4. Identifying the reality of the Iraqi banking sector and its success requirements.

Research Hypothesis

The research is based on the hypothesis that there is a gap and deficiency in the efficiency of the private Iraqi banking sector that needs development, and necessary measures must be taken to reduce the gap through the adoption of development requirements and proposals.

Research Boundaries

- **Spatial Boundaries:** Represented by Ashur International Bank and Baghdad Bank operating in the Iraqi banking sector.
- **Temporal Boundaries:** Represented by the analysis of available data in the surveyed banks for the period 2010-2014.

Research Method

The research uses financial analysis of the available data in banks by measuring banking efficiency based on the return on equity model for the banks under study.

Theoretical Framework

Iraqi Banking Sector: A Historical Overview

Iraqi banks originated as financial institutions aimed at managing all financial dealings. Compared to other Arab countries, Iraq was among the first to use banks for facilitating financial operations. The first foreign bank branch in Iraq was the Ottoman Bank in 1892, followed by the Eastern Bank in 1912 and the Shahinshahi Bank in 1918. The 19th century saw the development of the private banking sector, which included several Iraqi banks and branches of Arab and foreign banks. The governmental banking sector began with the establishment of the Industrial and Agricultural Bank in 1935, followed by Rafidain Bank in 1941 and the Central Bank of Iraq in 1947. The private banks were nationalized in 1964, and the Iraqi Commercial Bank was merged with Rafidain Bank in 1974. The establishment of Rashid Bank in 1988 and the issuance of Law No. 12 of 1991 allowed the private sector to establish private banks, growing from 36 banks in 1992 to 36 banks by 2010.

Iraqi Banking Sector Structure

The Iraqi banking sector includes various banks under the management of the Central Bank of Iraq, as shown in the organizational structure below.

The Reality of the Iraqi Banking Sector

The Iraqi banking sector works to attract savings from those with financial surpluses and investors (referred to as surplus owners) and transform them into loans or investments for those with financial deficits. The sector witnessed significant development after 2003 following the enactment of Laws No. 56 and 94 of 2004, which granted banks the authority and freedom to make decisions. The number of banks increased from 16 in 2003 to 47 in 2012. Private banks entered external banking operations such as opening letters of credit and issuing guarantees, while the Central Bank of Iraq implemented regulations and procedures encouraging private banks. Despite the limited capital and outdated banking and administrative systems of private banks, they have played a vital role in financing private activities, highlighting the inefficiencies of government banks. The Iraqi banking sector needs to keep up with recent banking developments, transition to electronic banking, and adopt modern banking systems. The sector must focus on investment, attract local and foreign savings, and improve efficiency and effectiveness, particularly after the issuance of Law No. 49 of 2004, which permits foreign banks to operate in Iraq through various forms.

Independence of the Central Bank of Iraq

The independence of the Central Bank means separating its monetary policy management from the interventions of the executive authority to avoid using monetary policy to finance the state's budget deficit. Several central banks globally have achieved independence, such as in Switzerland, Germany, and the USA, leading other countries to follow suit, including France, New Zealand, and some developing countries. Central bank independence entails granting complete freedom in managing monetary policy, free from political pressures and allowing the central bank to focus on maintaining price stability as its primary objective.

Problems Facing the Iraqi Banking Sector and Solutions

Problems

1. The number of banks relative to the population is low, with one bank covering 46,632 people, compared to the global standard of one bank per 10,000 people, indicating weak banking awareness.
2. Many private banks are family-owned, leading to conflicts of interest and weak banking awareness among some capital owners, risking these banks' failure.
3. Lack of supporting institutions for the banking system, such as deposit insurance companies or credit insurance offices.
4. Inadequate banking services in terms of quantity, type, procedures, and speed of delivery.
5. Weak technological tools and lack of modern communication means required for new operational mechanisms.
6. Issues with damaged and burnt documents relating to borrowers and debtors.
7. Counterfeit currency issues, particularly with the 14th print issued by the Central Bank of Iraq.
8. Problems with cash transport from the main administration to branches, including theft and instability, especially in hot areas.
9. Government banks performing secondary tasks at the expense of their main functions, such as distributing retirees' salaries.

Solutions

1. Encourage Iraqi banks to partner with foreign banks

and merge small banks.
2. Keep up with modern banking developments, especially in developed countries, and adopt information systems and banking technology for flexible and efficient operations.
3. Diversify investments to avoid potential losses and build efficient investment portfolios.
4. Encourage government and private banks to provide easy loans to customers and maintain good customer relationships.
5. Restructure government and private banks according to recommendations from World Bank teams and Iraqi banking experts.
6. Reorganize government banks to focus on their primary objectives instead of just distributing retirees' salaries.
7. Simplify and facilitate banking transactions.
8. Develop banks and transition from traditional banking to electronic banking.
9. Increase the number of bank branches to meet the global standard of one bank per 10,000 people.
10. Enhance external relations and expand activities beyond state borders.
11. Revise the organizational structures of banks to meet work requirements.

Banking Efficiency

Efficiency is one of the most important measures used by organizations to evaluate performance, aiming to achieve the highest possible return using available material, human, and financial resources. Banking efficiency is a key performance indicator, representing the ratio of total costs to specific outputs provided by the banking system, indicating the cost of service. Efficiency is used for performance comparison, calculated as the ratio of outputs to inputs, with higher ratios indicating higher efficiency. A bank is considered efficient if it can direct its available resources to achieve the highest possible returns with minimal waste.

Practical Framework

Research Field

The research field comprises the Iraqi banking sector, where annual reports of the surveyed banks were collected, along with all available data and information. The study focuses on four banks operating within the Iraqi banking sector over five years (2010-2014), relying on annual reports published by the Iraqi Stock Exchange for analysis.

Historical Overview of the Banks under Study

Table 1: Provides a historical overview of the banks' establishment, initial capital, and number of branches:

Bank	Establishment Date	Initial Capital (Million IQD)	Number of Branches
Iraqi Commercial Bank	11/2/1992	150,000,000	10 branches
Dar Al-Salam Bank	7/12/1998	200,000,000	11 branches
Mosul Bank for Development and Investment	23/8/2001	1,000,000,000	17 branches
Baghdad Bank	18/2/1992	100,000,000	41 branches

***Source*:** Researchers' preparation based on annual reports of the surveyed banks from the Iraq Stock Exchange for the years (2010-2014).

Measuring Capital Adequacy and Developments

To measure and analyze capital adequacy and the developments that have occurred during the research years, the researchers used the base year as the starting point for analysis to determine capital developments and then calculate the total rate of change as shown below:

- Change Index = (Required Year Capital - Base Year Capital) / Base Year Capital * 100%
- Base Year = 2010
- Total Rate of Change = Sum of Change Indicators / Number of Years * 100%

Table 2: Capital Adequacy and Developments (Branches of the Bank)

Years	Capital Adequacy Indicator (%)	Central Bank Minimum (%)	Capital (Billion IQD)	Change Index (%)
Iraqi Commercial Bank				
2010	57	15	60	0
2011	56	15	100	66
2012	41	15	100	66
2013	48	15	150	150
2014	76	15	250	316
Total Change Rate	55.6	-	-	584%
Trend	Increasing higher than the minimum required by the Central Bank	-	Increasing	
Dar Al-Salam Bank				
2010	106	15	72	0
2011	66	15	105.8	47
2012	75	15	105.8	47
2013	139	15	150	108
2014	122	15	250	247
Total Change Rate	221	-	-	101.5%
Trend	Increasing higher than the minimum required by the Central Bank	-	Increasing	
Mosul Bank for Development and Investment				
2010	65	15	50	0
2011	69.6	15	75	50
2012	120	15	100	100
2013	136	15	202	304

2014	149	15	202	304
Total Change Rate	107.9	-	-	189.5%
Trend	Increasing higher than the minimum required by the Central Bank	-	Increasing	
Baghdad Bank				
2010	24.6	15	100	0
2011	37	15	112.9	13
2012	55	15	175	75
2013	59	15	250	150
2014	57.53	15	250	150
Total Change Rate	46.6	-	-	97%
Trend	Increasing higher than the minimum required by the Central Bank	-	Increasing	

Source: Researchers' preparation based on annual reports of the surveyed banks from the Iraq Stock Exchange for the years (2010-2014).

Capital Adequacy Analysis

The table above shows the adequacy of the banks' capital, maintaining percentages higher than the Central Bank's minimum requirement of 15%. The analysis indicates a significant increase in capital across the surveyed banks, reflecting growing profitability that encourages shareholders and owners to increase capital to expand and grow in the market.

Study Model Determination

Financial ratio analysis is one of the most important tools for measuring banking efficiency. The study relies on the ROA (Return on Assets) model as an objective model for evaluating profit efficiency and expenses. The model includes several indicators used in the analysis:

- Profit Margin (PM) = Net Income / Total Revenue * 100%
- Asset Utilization (AU) = Total Revenue / Total Assets * 100%
- Equity Multiplier (EM) = Total Assets / Equity * 100%
- Return on Assets (ROA) = Profit Margin * Asset Utilization * Equity Multiplier * 100%
- Return on Equity (ROE) = Profit Margin * Total Assets * 100%

Table: Efficiency Indicator Calculation Based on ROA Model (Branches of the Bank)

Table 3: Efficiency Indicator Calculation Based on the Return on Equity Model (First Contribution) Iraqi Commercial Bank (Bank Branches)

Years	**Profit Margin % (PM)**	**Asset Utilization % (AU)**	**Return on Assets % (ROA)**	**Equity Multiplier % (EM)**	**Return on Equity % (ROE)**
2010	1.088	5.9	2.22	2.159	14
2011	3.785	0.7	9.3	1.830	5.3
2012	1.826	2.4	5.3	2.049	9.2
2013	7.989	0.3	2.7	1.703	4.5
2014	25.223	0.08	1.1	1.579	3.2
Average	7.9822	1.876	4.124	1.864	7.24

Dar Al-Salam Bank (Bank Branches)

Years	**Profit Margin % (PM)**	**Asset Utilization % (AU)**	**Return on Assets % (ROA)**	**Equity Multiplier % (EM)**	**Return on Equity % (ROE)**
2010	1.769	0.1	8.1	7.004	1.6
2011	3.522	0.3	2.8	7.196	9.8
2012	30.915	0.07	2.1	5.466	12.7
2013	39.738	0.05	2.8	4.251	9.7
2014	75.353	0.018	6.2	4.620	6.4
Average	30.2594	0.1076	4.4	5.7074	8.04

Mosul Bank for Development and Investment (Bank Branches)

Years	**Profit Margin % (PM)**	**Asset Utilization % (AU)**	**Return on Assets % (ROA)**	**Equity Multiplier % (EM)**	**Return on Equity % (ROE)**
2010	47.404	0.1	8.8	2.88	15.8
2011	34.8	0.012	8.8	2.90	11.9
2012	23.428	0.014	1.1	2.12	7.3
2013	26.6	0.03	1.2	2.14	14.8
2014	21.115	0.02	7.3	1.324	6.0
Average	30.6694	0.0352	5.44	2.2728	11.16

Baghdad Bank (Bank Branches)

Years	Profit Margin % (PM)	Asset Utilization % (AU)	Return on Assets % (ROA)	Equity Multiplier % (EM)	Return on Equity % (ROE)
2010	12.7938	0.1	1.22	8.090	11.5
2011	18.777	0.013	1.5	6.276	15
2012	16.947	0.0114	2.2	6.275	12.1
2013	43.482	0.041	7.6	6.059	11
2014	12.6	0.0119	2.3	6.249	9.5
Average	20.91996	0.03546	2.964	6.5898	11.82

Source: Researchers' preparation based on annual reports of the surveyed banks from the Iraq Stock Exchange for the years (2010-2014).

Efficiency Indicator Analysis: The table above shows the calculation of efficiency indicators for the surveyed banks based on the ROA model. The analysis indicates variations in profit margins, asset utilization, and return on assets across the banks. For instance, the Iraqi Commercial Bank had a high profit margin in 2014 (25.223%), while Dar Al-Salam Bank had a high profit margin in 2013 (39.738%). The Mosul Bank for Development and Investment had the highest average profit margin (30.6694%) among the surveyed banks. In terms of asset utilization, the Iraqi Commercial Bank had a relatively higher average (1.876%) compared to other banks. Regarding return on equity, the Baghdad Bank had the highest average (11.82%).

Risk Analysis

The second part of the study involves determining and measuring risks associated with banking efficiency using the following indicators:

1. Credit Risk = Total Loan Provisions / Total Loans
2. Liquidity Risk = Total Deposits / Total Assets
3. Interest Rate Risk = Interest-Sensitive Assets / Total Assets
4. Capital Risk = Total Equity / Total Assets
5. Operational Risk = Cash Credit / Total Deposits

Table 4: Risk Indicators Calculation Based on ROA Model (Branches of the Bank)

Bank	Year	Credit Risk (%)	Liquidity Risk (%)	Capital Risk (%)	Operational Risk (%)
Iraqi Commercial Bank	2010	9	39	4.6	40
	2011	42	33	5.4	90
	2012	18.6	38	4.8	200
	2013	11.7	28	5.8	400
	2014	4.8	26	6.3	590
Average		17.22	32.8	5.38	264
Dar Al-Salam Bank	2010	5	8	1.4	290
	2011	2.5	82	1.3	300
	2012	1.94	76	1.8	200
	2013	6	70	2.3	500
	2014	2.376	52	2.1	290
Average		3.5632	57.6	1.78	316
Mosul Bank for Development and Investment	2010	2.1	81	3.4	430
	2011	1.7	60	3.4	520
	2012	1.01	51	4.7	830
	2013	3.4	48	4.6	570
	2014	3.6	20	7.5	230
Average		2.362	52	4.72	516
Baghdad Bank	2010	1.03	83	1.2	220
	2011	1	79	1.5	210
	2012	2.1	80	1.5	140
	2013	1.8	78	1.6	150
	2014	1.9	81	1.6	150
Average		1.566	80.2	1.48	174

Source: Researchers' preparation based on annual reports of the surveyed banks from the Iraq Stock Exchange for the years (2010-2014).

Risk Analysis

The table above shows the calculation of risk indicators for the surveyed banks based on the ROA model. The analysis indicates variations in credit risk, liquidity risk, capital risk, and operational risk across the banks. For instance, the Iraqi Commercial Bank had a high average credit risk (17.22%) compared to other banks. In terms of liquidity risk, Dar Al-Salam Bank had the highest average (57.6%), while the Iraqi Commercial Bank had the lowest average (32.8%). Regarding capital risk, the Baghdad Bank had the lowest average (1.48%). In terms of operational risk, the Mosul Bank for Development and Investment had the highest average (516%), while the Baghdad Bank had the lowest average (174%).

Conclusions and Recommendations

Conclusions

1. The surveyed banks strive to achieve banking efficiency by utilizing all available resources to achieve profitability and increase capital, as indicated by the research findings showing a gradual increase in capital.
2. There are variations in the extracted efficiency indicators, such as profit margins and liquidity risk indicators, as well as differences in returns.

3. Private banks support the Iraqi banking sector better than government banks, as government banks are more restricted in their activities.
4. Baghdad Bank and Mosul Bank for Development and Investment achieve better returns on equity compared to Dar Al-Salam Bank and Iraqi Commercial Bank.
5. The Iraqi Commercial Bank has lower liquidity risk compared to other banks, which is related to achieving profitability.

Recommendations

1. Emphasize the diversification of investment portfolios and not just focus on sources of banking revenue and reliance on borrowing and deposits.
2. Conduct accurate and comprehensive studies on the costs related to banking activities and services provided by banks, and compare them based on the principle of lower cost and higher returns.
3. Focus on employees and their training to improve banking efficiency, particularly in financial and banking sectors, and emphasize continuous development of employees' skills and qualification in efficient banking operations and utilizing modern technology.
4. Adopt concepts of disclosure and transparency in the Iraqi banking sector by encouraging banks to publish financial and banking information and hold courses, seminars, and conferences related to their development.
5. The central bank should adopt modern and advanced methods to monitor banks' operations and assess their actual performance using linear programming systems and data development techniques.

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