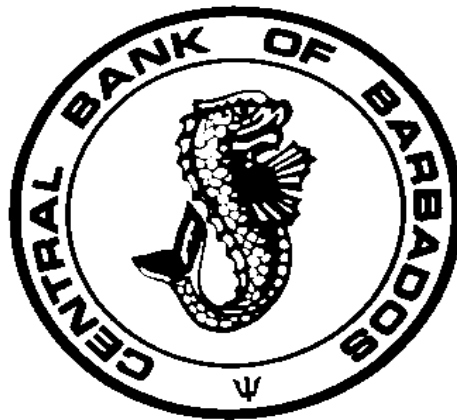


**SHOULD THE GOVERNMENT OF BARBADOS SEEK TO RE-PURCHASE THE BARBADOS NATIONAL BANK? A CASE STUDY ANALYSIS**

BY

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## **ABSTRACT**

Since the CLICO Crisis commenced in 2009, speculation began concerning CLICO's 55 per cent majority shareholding of Republic Bank of Trinidad & Tobago Ltd (RBL), which in turn controls 65.13 per cent of the shares of the Barbados National Bank (BNB). This speculation led to popular debate about the possibility, cost, benefits and other implications of the Government of Barbados repurchasing BNB.

This paper seeks to provide an objective assessment of the implications of the Government of Barbados repurchasing the BNB, through cost/benefit and performance analysis. It has significant implications for other government owned institutions with socio-economic, financial and developmental mandates.

The literature suggests that although the promotion of public policy can be enhanced if banks are publicly owned, there is a significant chance that this will also lead to corruption and government interference. These actions typically lead to inefficiencies and poor performance. The history of BNB shows that following its initial struggle it actually became profitable before it was sold to RBL, suggesting that success as a Government-owned entity may be possible.

## INTRODUCTION

If the opportunity arises, should the Government of Barbados seek to repurchase a controlling share of the Barbados National Bank (BNB)? When this issue was broached in 2009, it sparked much emotional and political debate across Barbados and Trinidad. Today, more than two years later, passions have cooled and the debate has waned; but is there any objective merit in such a take over? This paper seeks to carry out an objective assessment of this issue. At this time of financial and economic turmoil and uncertainty in the United States, Europe and the Caribbean, and with natural disasters in the news on a weekly basis, no one can say with certainty that any one government will not find itself in a position where it needs to sell some of its investments. Therefore the opportunity for the government of Barbados to takeover the BNB may not be as remote as some believe. Providing a better understanding of the issues both for and against, and the measures that may be required for such or any similar takeover to successfully achieve its goals all form part of this paper's objectives.

Over the years, Barbados' financial system has been to a greater extent characterised by the dominance of the banking sector. There are currently seven commercial banks operating on the island, of which two are regionally owned. The Barbados National Bank is one of the regionally owned banks, with the majority of its shares being held by the Republic Bank of Trinidad and Tobago (RBL). Until February 2009, it was clear that the Colonial Life Insurance Company Ltd (CLICO) owned 55 percent of Republic Bank's shares with the other 45 percent being owned by an assortment of institutional and individual investors in Trinidad and Tobago.

On 30<sup>th</sup> January 2009, the Central Bank of Trinidad and Tobago and the Ministry of Finance of Trinidad and Tobago announced their intention to bailout CLICO, Clico

Investment Bank (CIB) and Caribbean Money Market Brokers (CMMB). This was due to the fact that CIB had begun to face an unusually high level of withdrawal requests, which consequently had placed a strain on the institution's available liquid resources. Given its close relationship with CIB, CLICO suffered from contagion and was also facing liquidity problems, although nowhere near the levels of CIB. The Inspector of Financial Institutions in Trinidad and Tobago and the Governor of the Central Bank of Trinidad and Tobago therefore met with the Chairman and Chief Financial Officer of CL Financial on 7<sup>th</sup> January 2009.

In a second meeting on 13<sup>th</sup> January 2009, CLICO's Chairman formally raised the issue of possible financial assistance from the Central Bank. The solution that was proposed was that, CL Financial's 55 per cent majority shareholding of Republic Bank would be passed to state-owned First Citizens Bank. The Central Bank will take over Clico Investment Bank, assuming power to hire and fire, responsibility to pay bills, dispose of assets, and eventually to shut it down (Trinidad and Tobago Guardian, 2009).

On 4<sup>th</sup> February 2009, the Parliament of Trinidad & Tobago approved legislation to bailout CL Financial Group, and its 55 per cent majority shareholding of Republic Bank would be passed to the National Insurance Board (NIB), which will take control of the shares on behalf of the Government, ([www.Caribbean 360.com](http://www.Caribbean360.com), 2009).

Republic Bank executives expressed their concerns to Central Bank Governor about Government having a majority stake in the bank and also raised fears about having to deal with the perception of government interference. Republic Bank's Managing Director, in an interview with Newsday immediately after the meeting with the

Governor at the Central Bank said, “A lot of our customers do not want the shares concentrated in government’s hands, that was the big issue.”

In their 2010 Financial Report RBL still listed CLICO and CIB as the holders of 32 percent and 11 percent respectively, of RBL Shares. In their 2010 financial statements BNB listed the Barbados Government and its National Insurance Board as holders of 18.17 percent and 10 percent respectively, of BNB shares.

From the chronology outlined above, it is understandable why there has been so much speculation regarding the possible sale of BNB. The issue has sparked a great divide among many quarters, as some persons believe that the Government of Barbados should take this opportune time to once again take control of the bank, which is indigenously Barbadian. On the other hand, some persons believe that based on the outstanding performance of the bank there is no need for the Government to take such a costly action, especially during the ongoing global and local economic turmoil marked by severe fiscal difficulties.

A senior executive of BNB and RBL has stated that the BNB is the crown jewel of the group and is not for sale; but with the Government of Trinidad and Tobago controlling the majority shares in RBL, that decision may not rest with BNB or RBL.

Numerous comments were made concerning the cost of such an endeavour especially at this critical juncture in our economic journey. Can Barbados even afford this repurchase given its current fiscal difficulties and economic uncertainty? To address this issue we will conduct a cost – benefit analysis.

Efficiency is a central concept in economics and an analysis of BNB's efficiency when it was government-owned compared with its current level of efficiency would have been ideal. However, with the limited amount of data that is at the disposal of these researchers, we will try to assess the performance during those two ownership periods. The methodology therefore taken will be to review the literature pertaining to the performance of banks which are government-owned in order to draw from the experiences of other countries, as well as review the financial performance of the bank based on the data which is available, in order to assess if the purchase of the bank would be a sound investment.

The study is therefore organised as follows: Section two presents a review of the literature pertaining to the government ownership of banks; Sections three and four provides an economic overview of Barbados as well as the performance of its local commercial banking sector respectively; Section five analyses the BNB by providing both a historical perspective of the bank as well as its recent performance. This is then followed by an analysis of the estimated cost and payback period for the repurchase transaction. Lastly Section six presents the conclusions and recommendations of the study.

## **LITERATURE REVIEW**

The move by the Governments of the United States and other European countries to bailout or invest heavily in large banks to prevent their collapse, at the onset of the financial crisis of 2007-2009 and the on-going global economic crisis, has replenished the current stock of literature pertaining to the role of Government in the financial system (The Guardian, 2009; and Wall Street Journal, 2009). In Barbados with

only seven local banks it seems that the scale of the US/EU bailout eludes us. According to CNNMoney.com, the US government spent US\$204 billion on 746 banks, (US\$108 billion has still not been repaid). In the AIG bailout, counterparties/banks outside of the US received US58 billion out of the total US101 billion. By December 2009, the British Government had spent GBP850 billion on the UK bank bailout ([www.independent.co.uk](http://www.independent.co.uk)).

Two years later, the investment of these Governments have proven to have been the right actions to reverse the fortunes of the financial system and several of the banks involved, though the relevant economies are struggling from the large fiscal imbalances that were exacerbated by the bailouts and other monetary and macroeconomic measures. In these cases, this researcher found no evidence of Government involvement in the prudent day-to-day operations and management of the bailed out institutions.

A large part of this may have resulted from the initial outcry by leaders of unions and the business community against Government ownership; the other reason was that the vast scale of the bailout made it virtually impossible.

On the other side of the coin, the Federal Deposit Insurance was appointed receiver for approximately 381 failed banks since 2008, ([www.fdic.gov](http://www.fdic.gov)). Therefore several banks in the US and elsewhere still failed.

This gives us a better perspective on the magnitude of the problem for the US and Europe. At the same time it provides numerous examples of governments providing the capital and letting the bankers get on with the banking business. Given the history of BNB in Barbados could we realistically expect the same low level of Government

involvement if BNB is repurchased by Barbados' Government? For such guidance it is therefore necessary to examine some older studies in this area.

As it stands, there are not many recorded studies pertaining to the performance of banks after they have been taken over by the government. More specifically, a survey of the literature has indicated that it may be even rarer to find evidence of a bank, which was performing at exceptional levels, and was still purchased by a government. However, for the sake of our analysis, the current literature on the performance of public banks, i.e. in terms of efficiency and profitability, still provides an adequate basis upon which an inference may be drawn on what to expect from the possible re-purchase of the BNB by the Barbados government.

According to La Porta et al (2002), there are two broad views of the government's participation in financial markets. The first is basically from a developmental perspective and is associated with Alexander Gerschenkron (1962). Gerschenkron (1962) argues that since the second half of the nineteenth century, privately owned commercial banks had been the essential means of directing savings into the industrial sectors of several industrialised countries such as Germany. He however indicated that for some countries like Russia, which are capital-scarce, the banking sector could not succeed in attracting sufficient funds to finance large-scaled industrialisation. In such countries, the government was therefore needed to step in and, through its financial institutions, jump-start both financial and economic development. Gerschenkron's (1962) view was therefore part of a broader sentiment in development economics that advocated government ownership of firms in the strategic economic sectors (La Porta, 2002).

This view is somewhat consistent with the structuralist approach to economic development. Structuralists have argued that the structural changes needed to bring

about economic development could only be achieved by state intervention. Lewis (1950) also explicitly advocated the government ownership of banks, as part of the "commanding heights" approach whereby the government would develop certain strategic industries through both direct ownership and control over finance (Caprio et al, 2005). It may therefore be said that the development perspective of government ownership of banks highlights to a greater extent, the advantages which are associated with having such institutions, from a macroeconomic standpoint.

The alternative view of government participation is from a political perspective. This standpoint suggests that the central focus of politicians is on political rather than social objectives. Governments control banks (and other enterprises) in order to provide employment, subsidies and any other benefits to their supporters (Caprio et al, 2005). Sapienza (2004) studied the effects of government ownership on bank lending behaviour using information on individual loan contracts between Italian banks and customers over the period 1991-1995. Utilising a sample of 110,786 bank-year observations of lines of credit extended to 6,968 companies, it was found that borrowers from state-owned banks paid an average of 44 basis points less than did the borrowers from private banks. Moreover, it was also revealed that the voting patterns of regions where the loan is booked, and the party of the state bank's Chief Executive Officer, significantly influenced the price of loans.

The latter's findings are consistent with Dinç (2005) who indicated that government-owned banks increased their lending in election years relative to private banks in major emerging markets in the 1990s. Dinç (2005) however added that these actions may be influenced by political motivations other than inefficiency differences between privately-owned banks and government-owned banks.

With regards to the other empirical findings pertaining to bank ownership, some significant facts have been discovered. La Porta et al (2004) tested the two theories using global data on banks from 92 countries around the world. It was discovered that government ownership was and still is common around the world: In an average country, 59 percent of the equity of the 10 largest banks was owned by the government in 1970, and 42 percent was still state owned in 1995. Such ownership is especially common in poor countries, as well as in countries with poorly protected property rights, heavy government intervention in the economy, and underdeveloped financial systems. These findings also confirm the work of Barth, Caprio, and Levine (1999) who posit similar conclusions.

Concerning the area of efficiency, the literature has mostly indicated that privately-owned banks are more efficient than their publicly-owned counterparts. It may be noted however that there have been contradicting findings in this area. Altunbas et al (2001) investigated the scale economies, inefficiencies, and technical progress for a sample of private, mutual and publicly-owned banks in the German market. Various models were therefore incorporated to compare the cost and profit characteristics of the sample throughout the years 1989 to 1996. In general it was found that there was little evidence to suggest that private-owned banks were more efficient than their mutual or public counterparts in the German banking market. Inefficiency measures had also indicated that both public and mutual banks of all sizes had slight cost and profit advantages over private banks, a feature which might have been explained by their lower cost of funds.

This contrasts with Cornett et al (2008) who employed cash flow and accounting based measures to examine performance differences between privately-owned and

state-owned banks in sixteen Far East countries from 1989 through 2004, a period including the 1997 Asian financial crisis. The study found that state-owned banks operated less profitably, held less core capital, and had greater credit risk than privately-owned banks prior to 2001, and the performance differences were more significant in those countries with greater government involvement and political corruption in the banking system.

From the literature it can therefore be surmised that government ownership of banks can have "developmental" and "political" objectives. The studies abovementioned however tend to agree that although government ownership of banks facilitates credit being provided to those who are economically challenged within the society, this is often outweighed by the political interests of the government as it seeks re-election.

The studies above may very well provide some indicator as to what may be expected or may have to be guarded against if the Government of Barbados re-purchased the Barbados National Bank. In particular, the analysis of Cornett et al (2008) which actually attempts to make a direct comparison between the performance of the two bank structures (privately-owned and government-owned) may be the most suitable study from which inferences can be drawn about the possible nationalisation of BNB.

## **BARBADOS ECONOMIC ENVIRONMENT**

### **Economic Review**

According to the Barbados Economic and Social Report 2007, Barbados experienced six consecutive years of economic expansion up to the year 2007, where it recorded a growth in the Gross Domestic Product (GDP) of 4.3 percent. This robust

output growth helped to bring the unemployment rate to a historical low of 8.5 percent in 2007.

However, a loss in momentum by the global economy from 2008, brought on by the global financial crisis and heightened inflation, negatively impacted the economic performance of Barbados. The slowdown in the economy was concentrated mainly in the traded sectors, primarily tourism, while a decline in output of the bellwether construction industry contributed to an overall sluggish performance of the non-traded sectors. The moderation in tourism earnings, coupled with a surge in the value of fuel imports, led to a deterioration of the current account deficit, which was the largest since 2005 (Central Bank of Barbados, 2008).

Over the ensuing period, the Barbados economy went into recession with Gross Domestic Product (GDP) recorded at -0.2% and -4.7% for 2008 and 2009 respectively, and started to show signs of recovery with GDP estimated at 0.2% in 2010 (Central Bank of Barbados, 2011).

The 2010-11 winter tourist season saw a turnaround in arrivals, following the previous two years of decline. However the tourist spend was less, limiting the buildup of foreign exchange reserves, which nevertheless remained adequate at the equivalent of 20 weeks of imports. The real GDP growth for the first half of 2011 was estimated at 2.1% with growth in tourism and construction estimated at 5% and 3% respectively (Central Bank of Barbados, 2011).

### **Economic Outlook for Barbados**

According to the Central Bank of Barbados (2011), the Barbados economy remains on course to achieve modest growth of approximately 2% for 2011, provided

there is no slowdown in the tourism sector. The other major employment generating sector, construction is also expected to experience measured expansion with a resultant further decline in unemployment. Further reductions in government spending is expected as it seeks to achieve its Medium Term Fiscal Strategy (Central Bank of Barbados, 2011).

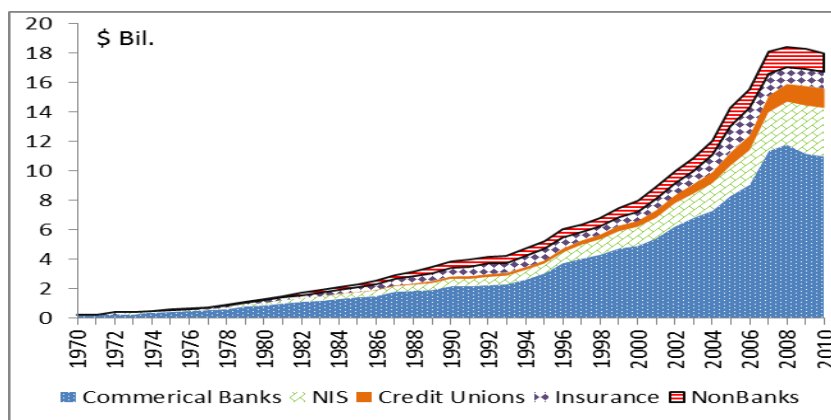
Therefore, slow economic recovery seems to be underway, but the fiscal position appears to limit the capacity of the government to make any non-critical expenditures, such as the purchase of BNB. Nevertheless, as we shall see, at the height of the recession, BNB still earned net profit after tax of \$49.4 million and \$36 million in 2009 and 2010 respectively. This resilience and continued profitability, even in a weak economic environment, many would argue, justifies the cost of \$120.5 million for a controlling stake.

## **PERFORMANCE OF BARBADOS' COMMERCIAL BANK SECTOR**

### **Assets**

Historically, commercial banks have been the leaders in the financial system; at December 2010 their assets were estimated at 140% of GDP. Total loans at banks represent over 70% of all lending, while their deposit intake amounted to 80% of all deposits. Growth in bank assets was particularly strong during the mid-1990s through 2007, which coincided with a period dominated by robust economic performance (see Figure 1). Bank operations have traditionally been concentrated on personal lending – most of which are in private dwellings (60%) – and their investment portfolio is mainly comprised of government or government-guaranteed securities. These assets are in turn primarily funded by deposit liabilities.

**Figure 1. Assets of Domestic Financial Institutions (BDS Billions)**



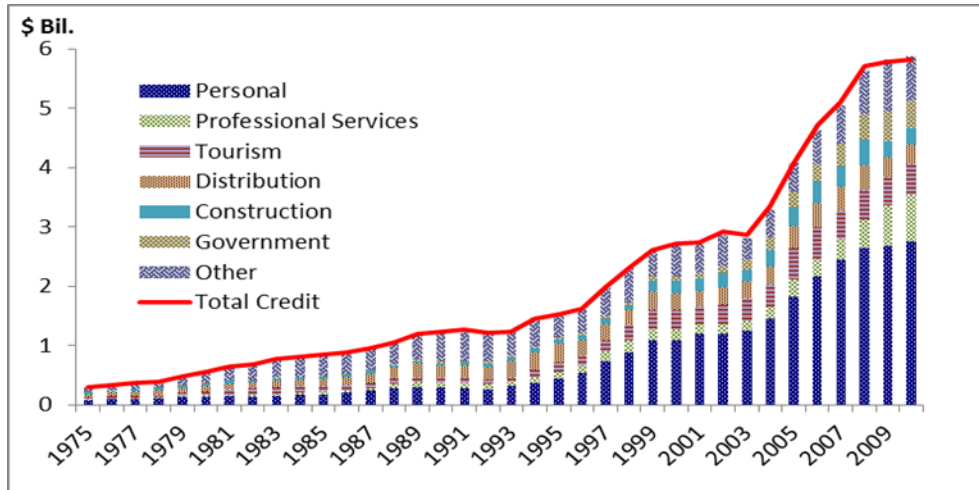
Data Source: Central Bank of Barbados (2011)

The credit orientation of the commercial banks shows a preference for the high returns of personal credit and the safety and stable returns of mortgages. From Figure 2 below, it is notable that even credit to tourism, that is so critical to our economy, is overshadowed by credit to the personal sector. Credit Unions and Finance Companies have also followed a similar trend. This means that it may be an uphill task for the government to persuade the current non-government owned banks to extend substantial credit lines at lower rates to non-traditional sectors of the economy in order to spur development and diversification in the economy. This challenge may also be inferred from the high delinquency (over 30%) and reduction in the use of government supported credit guarantee schemes. This provides an argument for a government owned bank, with a mandate to provide targeted and specially structured credit to specified economic sectors to promote government's macroeconomic strategies. There is however the counter argument that a similar function is already being performed, albeit on a smaller scale by the Enterprise Growth Fund Limited.

According to the statistics from the Central Bank of Barbados, loans and advances have traditionally comprised the bulk of commercial bank assets.

However, since 1980 there has been a persistent change in the composition of commercial bank assets.

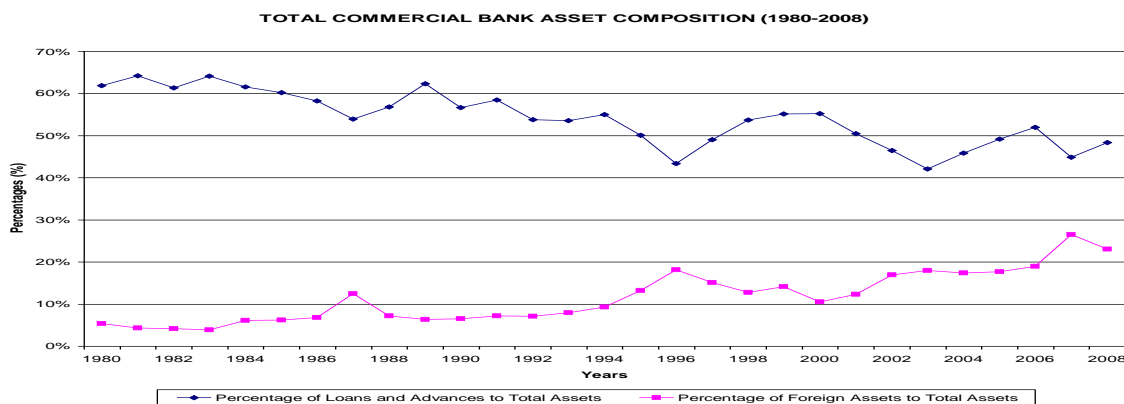
**Figure 2. Credit Distribution of Commercial Banks**



Data Source: Central Bank of Barbados (2011)

During 1980, loans and advances comprised 62 percent of total assets; however, this has declined to 48 percent in 2008. On the other hand, the share of foreign assets to total assets held by commercial banks has consistently increased from 5 percent in 1980 to 23 percent in 2008 (see Figure 3).

**Figure 3.**

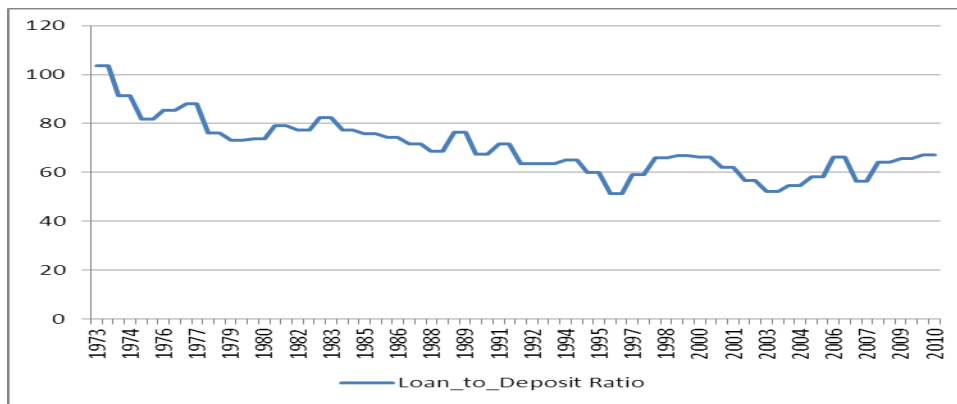


Data Source: Central Bank of Barbados

## Loan to Deposit Ratio

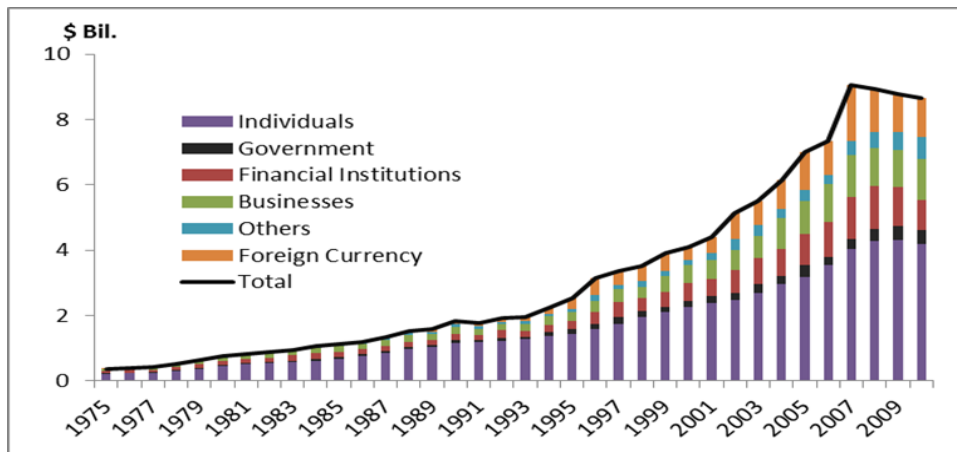
Bank lending can also be analysed using the loan to deposit ratio. Over the past four decades, the loan to deposit ratio has revealed a decreasing trend. The ratio declined from 104% during 1973 to 67% during 2008 (see Figure 4). This analysis may confirm the previous observation that over the review period, the commercial banks have been steadily reducing the amount of loans made proportionate to the deposits which they have been receiving. On the other hand it also provides evidence of the development of the solid national deposit base. That position is supported by Figure 5. below.

**Figure 4. Commercial Banks Loan-to-Deposit Ratio**



Data Source: Central Bank of Barbados

**Figure 5. Commercial Banks Deposit Distribution**



Data Source: Central Bank of Barbados

## **Liabilities**

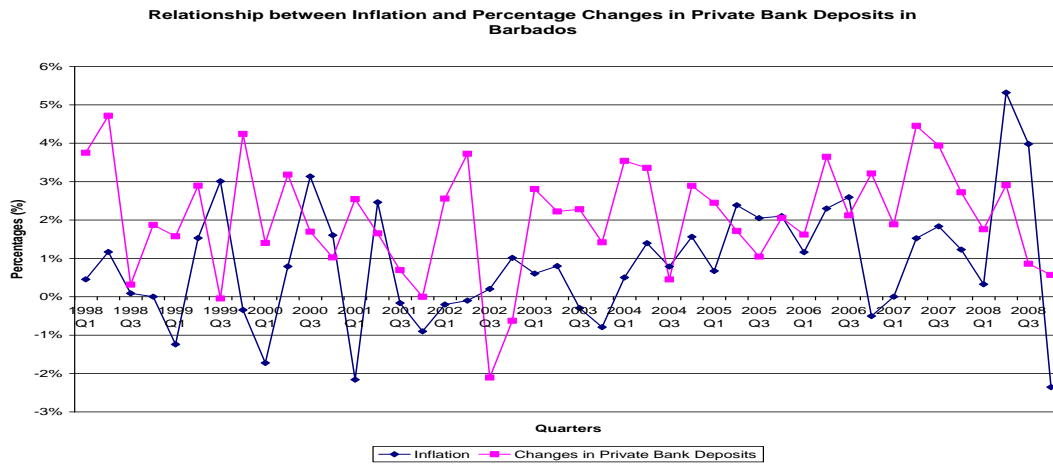
From the liabilities side, over the past three decades, commercial banks in Barbados have continued to rely on deposits as their major source of funding. Total commercial bank deposits have increased from Bds \$742.5 million during 1980, to Bds \$8,934.9 million in 2008. It must be highlighted however, that total deposits for 2008 declined by 1.3 percent from the total of Bds \$9,056.4 million recorded during 2007. Further marginal declines were also noted in 2009 and 2010.

## **Relationship between the Banking Sector and the wider Economy**

According to the IMF (2009), Barbados' banking sector has benefited from the expansion of the country's economy, and hence an increased demand for credit. A statistical analysis of the relationship between the performance of the local banking sector and Barbados' economic performance has revealed that there is a positive correlation between commercial bank assets and Barbados' economic growth. Using Pearson's Product Moment Correlation Coefficient, a correlation coefficient of 0.94 was obtained. This coefficient is very high and suggests that commercial bank assets and economic growth in Barbados almost moves in perfect unison. It must be noted however that correlation analysis does not offer an insight into the causal relationship between the two variables.

With regards to the relationship between personal bank deposits and inflation, a casual inspection over the past decade has revealed that these two variables appear to be positively related (see Figure 6). From a statistical standpoint however, although the two variables have yielded a positive correlation coefficient (0.09), this statistic is insignificant.

**Figure. 6**



Data Source: Central Bank of Barbados

The above analysis may assist in predicting the impact of a projected downturn in the Barbados economy on the local banking sector. The analysis suggests that the local commercial banking sector seems very robust and may not be adversely affected by a slowdown in the economy, as well as high inflation levels. These are significant factors which the Government of Barbados may wish to consider before re-purchasing the BNB.

## THE BARBADOS NATIONAL BANK

### History of BNB

Barbados National Bank was established on 20th March 1978 by an Act of Parliament. The institution was originally an amalgamation of government-owned financial institutions. These predecessor organisations were: Barbados Savings Bank – 1852; Sugar Industry Agricultural Bank – 1907; National Housing Corporation (Public Officers Housing Loan Fund) – 1958.<sup>1</sup>

BNB commenced its operations on 21<sup>st</sup> March 1978 and on 1<sup>st</sup> April 1978 acquired the branch assets of the banking business of Bank of America whose operations were carried on at Lower Broad Street.

A Trust Division of the Bank was established in 1981 to provide, inter alia, mortgage finance mainly to the middle and upper income clients. Barbados Mortgage Finance Co. Ltd. (BMFC), a subsidiary of the Bank, was also established to provide mortgage financing mainly to lower income clients.

In 1995, significant modifications to the Agricultural and Trust Divisions occurred during the reorganisation and restructuring of the Bank whereby the management of the agricultural portfolio and that of the Trust Division were substantially transferred to the commercial branches of the Bank. On 14<sup>th</sup> November 2000 the bank was reincorporated as Barbados National Bank Inc, a limited liability company under the Companies Act, cap 308.

### **Reorganisation and Restructuring of the Bank**

In June 1992, following a review of the Bank by the Central Bank of Barbados, and during negotiations between the Government of Barbados and the Inter-American Development Bank for an investment sector loan, the Central Bank of Barbados noted that the Bank was faced with an unacceptable level of loan losses and an illiquid situation.

The International Monetary Fund, at the invitation of the Central Bank, provided a consultancy to investigate the Bank's circumstances and recommended that certain actions should be taken. The review recommended:

1. A restructuring of the Bank from top to bottom in order to achieve objectives of being a customer-oriented, competitive, profitable commercial bank utilising modern technology and having a professional staff;
2. The streamlining of reporting structures and the recruitment of experienced commercial bankers to fill key management positions; and
3. On the question of finance, the recapitalisation of the Bank by the shareholder through the payout in full of Government-related debt and agricultural loans was recommended

The IMF also recommended that the Bank's portfolio should be managed according to prudent commercial lending principles. The report indicated that the lack of any credit strategy, poor credit decisions and follow-up over many years had resulted in a loan portfolio, which was generally in poor condition. The disastrous state of the agricultural portfolio could be attributed to the Bank's execution of government policy to support the sugar industry during a period of massive losses. The subsidy and support to the industry were masked in loans extended by the Bank on a non-commercial basis.

### **Restructuring Process**

During 1993 the main part of the agricultural portfolio was transferred to the Barbados Agricultural Credit Trust. The volume of loans transferred was \$249.7 million comprising \$111.5 million for plantations and \$138.2 million for Barbados sugar industry. The Government of Barbados issued bonds to purchase these loans totalling \$208.9 million. The shortfall of \$40.8 million represented provisions and write-downs for losses in the agricultural portfolio which the Bank had suffered and for which it received no tangible consideration.

Consequent upon the change of Government in October 1994 a new Board of Directors, was appointed in October 1994. The Board reviewed the recommendations and progress that had been made in pursuance of the restructuring exercise and made a number of strategic decisions to further implement and deepen the restructuring process of the Bank.

During 1995 and 1996, the Board of Directors strengthened the managerial capability of the Bank by approving the appointment of a senior professional banker as Managing Director, in addition to Managers in the areas of Credit Administration, Banking Operations, Human Resources and Retail Banking.

In 1995, the Board of Directors also completed its review of Management's proposals on the non-performing loan portfolio of the Bank. The non-performing loans then represented more than 30% of the Bank's loan portfolio.

To efficiently handle this non-performing portfolio, which consisted of more than 1,200 accounts, a Special Loan Recovery Department was established. Since that date many of the non-performing loans have been restructured and/or paid out and the Bank's delinquent portfolio has been reduced to less than 7% of its total loan portfolio.

In respect of the financial years ended 1993 and 1994, the Bank had to make loan loss provisions aggregating to \$20.0 million resulting in consolidated losses of \$9.0 million for 1994.

In 1995, the Bank recorded a modest profit of \$525,000, after making further loan loss provisions aggregating to \$8.0 million. The bank continued its positive performance through out the ensuing years. At 31<sup>st</sup> December 2001, it recorded consolidated profits of 19.6 million with a capital base of \$136 million and assets in excess of \$1.16 billion

and at 31<sup>st</sup> December 2002 recorded consolidated profits of 26.1 million with a capital base of \$157.6million and assets in excess of 1.259 billion.

In March of 2003, Republic Bank Limited (RBL) was successful in its bid to acquire 57 per cent of the shares of Barbados National Bank Inc. (BNB) from the Government of Barbados. The transaction was completed in July 2003. In September 2003, RBL acquired a further 7,807,561 ordinary shares increasing their share holding from 57% to 65.13%.

### **Regulatory Framework**

At the risk of sounding academic, this section serves the purpose of highlighting the sound regulatory framework in existence for commercial banks in Barbados.

The Financial Institutions Act, 1996-16 is the legislation under which commercial banks, trust and finance companies, and merchant banks are licensed and administered in Barbados. This Act establishes the statutory requirements on such areas as licensing, capitalisation, reporting and restrictions on banking activities.

Bank supervision is also undertaken by the Bank Supervision Department of the Central Bank of Barbados to assess various elements of a commercial bank's operations. This is often carried out through a dual approach of ongoing off-site monitoring and site visits (on-site examinations). The off-site process incorporates analyses of monthly and quarterly prudential returns submitted by all entities and the processing of applications as required by law. On-site assessments are undertaken on key areas inclusive of corporate governance, credit risk management, operational risk management, information technology, anti-money laundering and terrorist financing, and regulatory reporting.

Protective systems to ensure both customer and bank protection have also been regulated into the local banking system in the form of the Barbados Deposit Insurance Corporation (BDIC) as well as the lender of last resort facility of the Central Bank of Barbados. The BDIC was established under the Deposit Insurance Act-29 of 2006, and came into operation on June 8, 2007. The BDIC is administered by a Board, independent of the Central Bank of Barbados. The Corporation manages the Deposit Insurance Fund. The BDIC guarantees insurance coverage of up to \$25,000 for depositors of commercial banks and other deposit taking financial institutions licensed under the Financial Institutions Act.

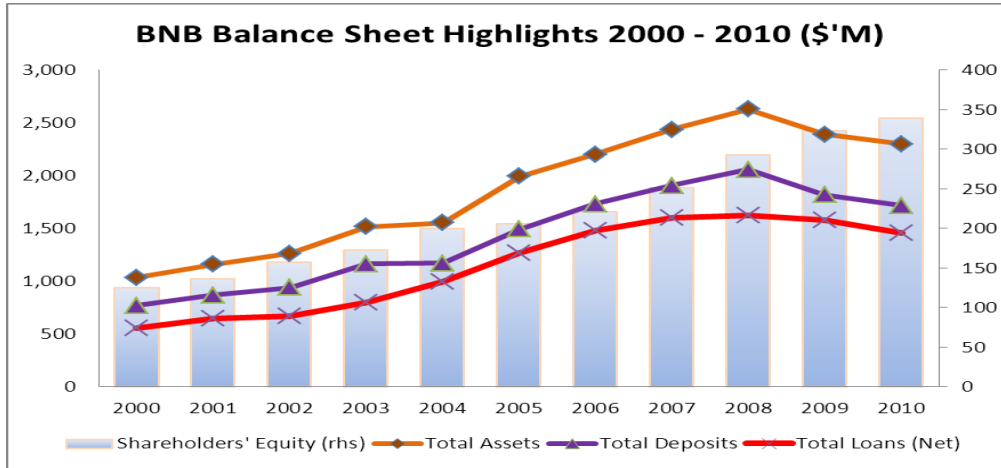
With this regulatory structure in place, no evidence was found to suggest that a commercial bank, for which the government holds a controlling interest, would require any form of government involvement in its day-to-day operations or management, beyond shareholder representation at the level of the Board of Directors.

### **Financial Performance of BNB**

Figure 7 above reveals the performance of key elements of BNB's balance sheet over the last ten years. Our research revealed that BNB started making profits from 1995 (\$525K) following the restructuring process outlined above. Recall also that RBL gained control from 2003, making 2004 the first year of BNB under RBL.

The chart shows that following the restructuring of BNB in the 1990s, the bank was well on its path to sustained growth. When it was sold to RBL, from 2004 you will notice an upward shift in the growth paths. It could be argued that RBL enhanced the Bank's already improving performance. A counter argument could also be that the improved performance was primarily the result of the prevailing favourable economic

Figure 7.

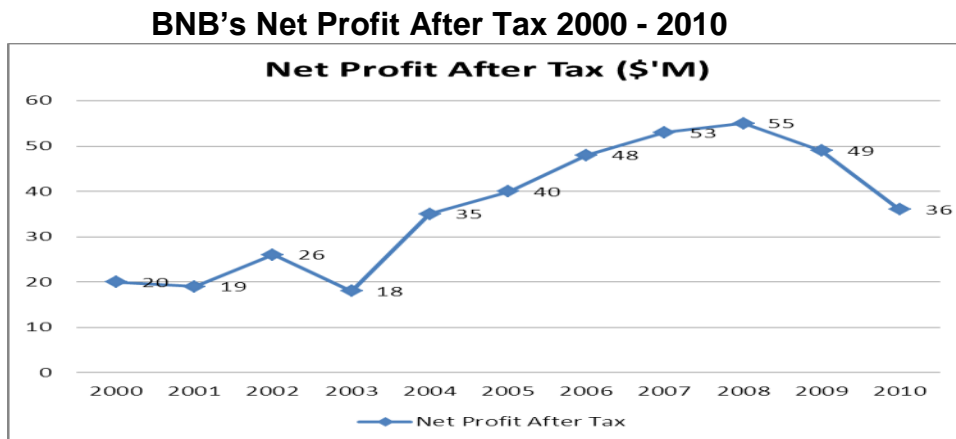


(Source: BNB's Annual Financial Statements)

conditions, not RBL; which later changed with the last recession and is also reflected in the decline in the balance sheet highlights in the last two years.

Similar arguments can be made for BNB's profits, which again were generally improving prior to the sale in 2003. They then grew at a steadier rate until the recession made its impact felt in 2009 and 2010. This chart also reflects the point made earlier that at the height of the recession the bank maintained its profitability and increased its

Figure 8.

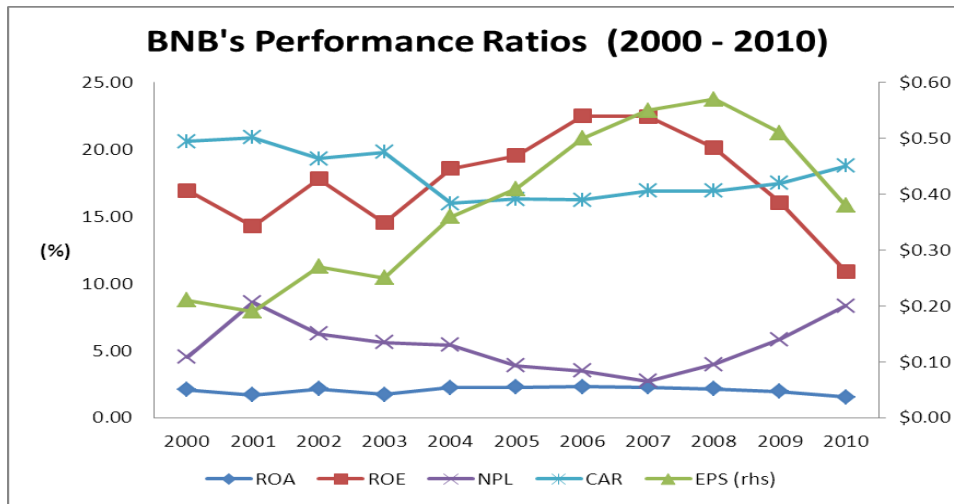


(Source: BNB's Annual Financial Statements)

shareholder value, albeit at a reduced level.

Figure 8 provides more detail about the bank's performance. The Return on Equity (ROE) and Earnings Per Share (EPS) reflect the performance in Figure 7, while the gradual decline in Return on Assets (ROA) shows a generally higher rate of asset growth compared to the rate of increase in profit over the ten years. Below we will show that Non-Performing Loans (NPLs) were below 4% in the late 1990s and Capital Adequacy Ratio (CAR) was approximately 15%. Therefore the performance of these two ratios were relatively similar under both owners, following the restructure.

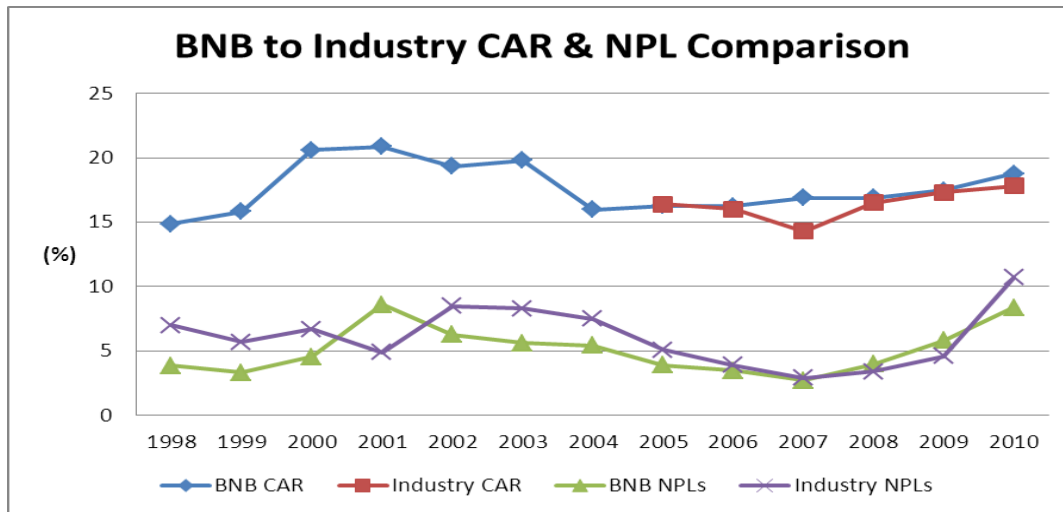
Figure 9.



### Asset Quality & Capital Adequacy Ratios

Figure 10 below provides a comparison of BNB's capital adequacy and non-performing loans ratios with those of the local banking industry for the period 1998 to 2010 (industry CAR was unavailable for 1998 to 2004). From this we note that BNB's

Figure 10.



performance in these two key areas are generally consistent with the local industry. During this 'post restructure' period the bank's NPL have generally been lower than the industry average (inclusive of the pre-2003 period, prior to its acquisition by RBL). The CAR has consistently exceeded the minimum regulatory requirement, and the NPLs exceeded the regulatory limit of 5% during and following periods of local recession.

## Profitability Ratios

### DuPont Analysis

DuPont Analysis is a technique that can be used to analyse Return on Assets (ROA) and Return on Equity (ROE). It breaks down ROA and ROE into a function of different ratios so the impact of profit margins, turnover on shareholder returns and leverage could be analysed. In brief, DuPont Analysis breaks ROE into 3 components: Net profit margin; Asset turnover; and Equity multiplier. That is:

$$\begin{aligned}
 \text{ROE} &= \text{Net Income/Equity} \\
 &= (\text{Net Income/Sales}^2) \times (\text{Sales/Assets}) \times (\text{Assets/Equity}) \text{ or} \\
 &\quad (\text{Net Profit Margin}) \times (\text{Asset Turnover}) \times (\text{Equity Multiplier}) \\
 &= \text{ROA} \times (\text{Assets/Equity})
 \end{aligned}$$

**Table 1 – DuPont Analysis**

DuPont Analysis		5-year Average	2008	2007	2006	2005	2004
ROA (%)	BNB (own estimates)	2.14	2.09	2.18	2.16	2.04	2.23
	BNB (published)	2.26	2.17	2.29	2.33	2.28	2.26
	Nova Scotia	2.30	2.36	2.17	2.17	2.40	2.42
	Overall Sector	n/a	n/a <sup>3</sup>	n/a	2.35	1.90	2.19
ROE (%)	BNB (Own estimates)	18.67	18.69	21.11	18.76	17.47	17.30
	BNB (published)	20.63	20.11	22.46	22.48	19.55	18.57
Net Profit Margin (%)	BNB	51.28	52.79	53.67	52.50	48.71	48.74
	Nova Scotia	57.26	64.42	56.93	55.23	56.84	52.89
	Overall Sector	n/a	n/a	n/a	69.66	57.18	65.07
Asset Turnover (%)	BNB	4.18	3.95	4.07	4.11	4.20	4.58
	Nova Scotia	4.04	3.66	3.82	3.93	4.22	4.57
	Overall Sector	n/a	n/a	n/a	3.37	3.32	3.37
Equity Multiplier	BNB	44.95	54.72	50.70	46.54	40.46	32.35

<sup>2</sup> For this analysis Sales has been substituted with Net Interest Income in order to generate estimates.

<sup>3</sup> Data not available at the time of analysis

Using DuPont Analysis, two important ratios, ROA and ROE, could be analysed for the profitability of the banking sector.

### Return on Assets (ROA)

The ROA is an indicator of how profitable a company is relative to its total assets. The ROA provides an idea as to how efficient the bank's management is at using its assets to generate earnings. From Table 2 above, it can be seen that in general the ROA for BNB has been less than the Bank of Nova Scotia. The average ROA for BNB over the past five years was estimated at 2.14 percent, while the Bank of Nova Scotia's average ROA was estimated at 2.30 percent. This suggests that the bank still has some room for improvement with respect to how efficiently it manages its assets. It must be highlighted however, that both banks have generally performed better than the estimated sector averages for 2004 to 2006.

### Return on Equity (ROE)

The ROE is the amount of net income returned as a percentage of shareholders equity. ROE measures a bank's profitability by revealing how much profit it generates using the money which its shareholders have invested. For BNB it can be seen from Table 2 that its ROE had continued on an increasing trend up to 2007, until declining in 2008. It must be noted that no comparison was made to the Bank of Nova Scotia since this bank does not have equity and is not publicly traded. Instead, the bank has capital which is assigned to it from its head office.

### Asset Turnover Ratio

The asset turnover ratio measures the efficiency with which the total assets of a bank are utilised to generate revenue. The higher the asset turnover ratio the better it is for the bank. In the case of BNB, its asset turnover ratio has generally been greater than both the Bank of Nova Scotia as well as the industry estimates which were developed. Of concern however, is that fact that for both BNB and Scotia, this ratio has steadily declined over the 2004 to 2008 period. This indicates that both banks have been losing efficiency in the way in which they utilise their assets in order to produce revenue. During 2004, the BNB and Scotia recorded asset turnover ratios of 4.58 percent and 4.57 percent respectively; however, during 2008 these estimates fell to 4.18 percent and 4.04 percent respectively. It can also be observed that Scotia's asset turnover ratio has been declining at a faster rate than that of BNB.

### Net Profit Margin

This metric is an indication of how effective a bank is at cost control. The higher the net profit margin is, the more effective the bank is at converting revenue into actual profit. The net profit margin is a good way of comparing banks, since these institutions are generally subject to similar business conditions. From Table 2 it can be seen that the Scotia Bank's net profit margin has been higher than that of BNB over the 2004 to 2008 period. The BNB's net profit margin has however continued to increase steadily over the review period, from 48.74 percent in 2004, to 52.79 percent in 2008. In contrast, the Scotia Bank although registering higher margins than BNB, these margins have been somewhat volatile, registering a low in 2004 of 52.89 percent and a high in 2007 of 64.42 percent.

### Equity Multiplier

The equity multiplier is a measure of financial leverage. It allows the investor to see what portion of the return on equity is the result of debt. The higher the ratio is, the more the company is relying on debt to finance its asset base. From Table 2 it can be seen that over the review period the BNB's equity ratio has continued to increase from 32.35 in 2004 to 54.72 in 2008. This suggests that the bank has been increasingly relying on debt to finance its asset base.

### Net Interest Margins and Non-Interest Income to Total Revenue

Net Income Margin (NIM) is a sign of successful management of assets and liabilities. The formula for NIM is as follows:  $NIM = \frac{\text{Net Interest Income}}{\text{Total Earning Assets}^4}$

Where:  $\text{Net Interest Income} = \text{Interest Income} - \text{Interest Expenses}$

A narrowing NIM usually indicates a profit squeeze by a bank. Additionally, very competitive banking sectors are usually characterised by smaller margins. From Table 3 above it can be seen however that the NIM for BNB is much higher than that of Nova Scotia. The NIM for BNB, although suggesting that this bank may be more profitable than Nova Scotia, it may also be an indicator that the bank is not as competitive as Nova Scotia. The smaller NIM by the Nova Scotia may be the reason why the bank's assets have been increasing at a faster rate than BNB. It can be seen however that the estimates for BNB are more in-line with the estimates developed for the overall sector.

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<sup>4</sup> An assumption was made that Total Earning Assets = Loans + Investments.

**Table 3 – NIM and Non-Interest Income to Total Revenue**

		<b>5-year Average</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Net Interest Margin</b>	<b>BNB</b>	6.47	6.38	6.18	6.20	6.43	7.14
	<b>Nova Scotia</b>	4.04	3.66	3.82	3.98	4.22	4.57
	<b>Overall Sector</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	6.48	6.76	7.35
<b>Non-Interest Income/Total Revenue (%)</b>	<b>BNB</b>	31.49	32.45	31.63	31.45	30.82	31.08
	<b>Nova Scotia</b>	34.97	38.14	35.04	34.54	34.25	32.98
	<b>Overall Sector</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	69.66	57.18	65.07

The non-interest income ratio on the other hand measures the utilisation of assets based on the non-interest income revenue that they generate. For BNB and Scotia Bank, non-interest bearing or fee activities appears to be pretty significant aspect of both banks' business portfolios. For both banks their non-interest income ratios have generally followed an increasing trend. However, it can be seen that Scotia has a higher non-interest income ratio than BNB.

## **Efficiency Ratios**

### *Cost to Income (CIR) and Loan to Deposit Ratios*

The cost to income ratio (CIR) is a ratio of operating costs and general expenses to net income. The lower the cost/income ratio, the more efficiently a company is operating. From Table 4 it can be seen that throughout the past 5 years, Nova Scotia

has had a lower CIR than BNB. This indicates that Nova Scotia it is operating more efficiently than BNB.

**Table 4 – CIR and Loan to Deposit Ratio**

		<b>5-year Average</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Cost to Income Ratio (%)</b>	<b>BNB</b>	55.15	55.82	53.01	53.57	55.19	58.16
	<b>Nova Scotia</b>	51.07	48.31	53.11	53.64	49.86	50.44
	<b>Overall Sector</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	37.05	47.66	49.80
<b>Loan to Deposit Ratio (%)</b>	<b>BNB</b>	84.52	80.50	86.73	85.61	84.89	84.89
	<b>Nova Scotia</b>	110.55	114.74	113.64	114.63	116.06	93.66
	<b>Overall Sector</b>	59.43	63.83	56.28	64.24	58.26	54.54

The loan to deposit ratio explains the efficiency of lending out money with deposits at hand. While a loan to deposit ratio which is too high is deemed somewhat risky, on the contrary, a loan to deposit ratio which is too low suggests inefficiency. From Table 4 above it can be seen that from the five-year averages, BNB and Scotia both had loan to deposit ratios which were greater than the industry average. This suggests that compared to the industry these two banks may be a risky. It must be highlighted that the very high ratios for Nova Scotia, which suggests that the bank is distributing more loans than it has deposits, could mean that the bank is financing its loan portfolio through additional means apart from deposits.

## Cost to Pay-back Analysis

We will now assess the financial burden of this transaction to the people of Barbados. Technically, the Government of Barbados owns 28.17% of BNB's 96,000,000 shares. On 20<sup>th</sup> July 2011, the Barbados Stock Exchange quoted BNB's share price at \$5.50. Assuming that there is no increase in price it would cost the Barbados Government approximately \$120.5 million (US\$60.25M) to purchase the additional 22.83% of BNB's shares to gain a 51% controlling stake from the Government of Trinidad and Tobago. Given the complexity and uncertainty of identifying and projecting future cashflows for a commercial bank we have limited our cash flow analysis related to this purchase to the initial outflow of \$120.5 million and the average dividend paid by BNB. Table 5 shows the dividends paid by BNB from 2003 to 2010. It also shows 51% of each year's dividend.

**Dividend Distribution of BNB 2003 - 10**

Year	Dividend per share	Dividend Paid (\$M.)	51% of Dividend Paid (\$M)
2003	\$0.085	8.160	4.162
2004	\$0.17	16.320	8.323
2005	\$0.19	17.280	8.813
2006	\$0.23	19.200	9.792
2007	\$0.26	23.040	11.750
2008	\$0.27	25.920	13.219
2009	\$0.25	24.000	12.240
2010	\$0.18	17.280	8.813
		151.200	77.112

**Table 5.**

This would have provided the holder of 51% of BNB's shares with an average annual dividend of approximately \$10 million. Using the Net Present Value with an annual

discount rate of 3.39% (the 6-month Treasury Bill rate at 20 July 2011) we see that it would take approximately 16 years for the Government of Barbados to recover the \$120 million paid to regain a controlling share of BNB from the average annual dividend of \$10 million.

$$\begin{aligned}
 NPV &= \sum_{t=0}^n \frac{CF}{(1+k)^t} = CF_0 + \frac{CF_1}{(1+k)} + \frac{CF_2}{(1+k)^2} + \dots + \frac{CF_n}{(1+k)^n} = -120M + \frac{10M}{(1.0339)} + \frac{10M}{(1.0339)^2} + \dots + \frac{10M}{(1.0339)^{16}} \\
 &= \$1.9
 \end{aligned}$$

## **CONCLUSION AND RECOMMENDATIONS**

This paper sought to provide a comprehensive analysis of the issue of whether the Government of Barbados should consider repurchasing the Barbados National Bank, if the institution was to be made available for sale. The approach taken for the case study consisted primarily of a review of the literature relating to bank ownership structure and their subsequent performance, information about the bank when it was under the Government of Barbados' control, the performance of the bank both prior to and since its privatisation and lastly, the cost to repurchase and the estimated time to recover the cost.

The literature reviewed basically alluded to the fact that although the promotion of public policy and socio-economic development can be enhanced if banks are publicly-owned, there is a significant chance that this will also lead to corruption as government administrations may pursue their own political agendas. The literature has suggested that these actions typically lead to inefficiencies in the banking system.

However, the recent Government bailouts in both Europe and the USA have provided clear examples of large scale Government ownership (over 50%) of numerous

financial institutions. In the absence of any evidence of government involvement, several of these banks have returned to steady profitable operations. In the case of the USA, over \$96B of the bailout funds have been repaid (CNNMoney.com). Closer to home still, it appears that the Government of Trinidad and Tobago holds a controlling share in RBL. However, there appears to be no evidence of government involvement in the day-to-day operations of RBL.

These can be viewed as macro and micro models, that government capitalisation does not have to mean government involvement, and that the greater good of the public can be served where the professional bankers are allowed to function independently.

The early history of the BNB basically supports the literature as the bank struggled under the ownership of the Government of Barbados as the instrument for implementing various support mechanisms and policies. Since its restructuring the bank has performed well and there is evidence that its privatisation has led to even better performance with the aid of robust economic growth. The firm has shown itself to be efficient and profitable, as confirmed from the analysis of key financial ratios.

This analysis has revealed that the sound performance of the bank clearly started before it was privatised and can continue even if reacquired, provided that the recommendations of the IMF are followed and that there is no government involvement beyond Board oversight.

The estimated cost of repurchase, \$120 million, can be raised from a Treasury Bill issue which can be repaid from annual dividends over a 16 year period, with no impact on the Government's current fiscal situation.

At the present time the Barbados Government's debt position along with the reluctance of our Trinidadian counterparts may preclude the repurchase, but in the

prevailing economic climate, characterised by uncertainty and lack of confidence in the USA and Europe, and the lacklustre economies of the Caribbean, the only thing that is certain is that change will come. Going forward, the opportunity for this transaction may become very real. Should this occur, based on our findings, it is recommended that the Government of Barbados repurchase the BNB and ensure that it is permitted to perform its mandate without political or government interference.

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