COMPARATIVE ANALYSIS OF KOREAN BANKS' PERFORMANCE

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The purpose of this paper is to analyze Korean banks' performance which is reflected on their financial statements and to provide some comments to improve their banking business. This study is carried out by comparing the eight Korean banks' past five years performance results with other banks in the State of California. Other banks include Asian banks other than Korean banks owned by such Asians (e.g., Chinese and Japanese) and American banks owned by other ethnic groups of Americans (e.g., "white" American). Comparative financial analysis indicates that Korean banks are relatively conservative in managing operations and lending and are more actively involved in their services for international business and sales activities in SBA loans. The analysis also indicates that Korean banks' loan quality is relatively low and their loan market appears to have been saturated. We recommend on the basis of the analysis that Korean banks adopt a more active marketing strategy to expand and create their own market, consider tighter control for their operations with understanding banking regulations (e.g., Financial Institutions Reform, Recovery, and Enforcement Act) and adopt the loan policy in a way that they can make a loan decision with more reliable cash flow analysis.

Background for Korean Banks

The first Korean banking started with the establishment of California Korea Bank (CKB) in the Los Angeles area by opening its Olympic office in 1974. The Bank was founded by Korea Exchange Bank, one of the major banks in Korea, to provide banking services for mainly Korean immigrants who needed capital assistance to establish their own businesses.

Responding to a rapidly growing Korean population in the Los Angeles area in the 1980's, several new Korean banks were established. Wilshire State Bank (WSB) opened its Wilshire office in 1980. Two years later, Hanmi Bank (HMB) opened its Olympic office. In the same year, Hanil Bank, one of the major banks in Korea, bought the majority of stock of First State Bank of Southern California (FSB) and opened its Garden Grove office. In the late 1980's, three other new Korean banks (California Center Bank (CCB) in 1987; Seoul Bank of California (SBC) in 1988; and United Citizens National Bank (UCNB, newly named as "Nara Bank" in 1989) were established in the area of Korean town where most Korean businesses are conducted. Following those banks, Saehan Bank (SAB) was newly established and opened its Olympic office in 1991.

During the past 20 years, the Korean banks have rapidly grown and expanded their service area from mainly Koreantown to the outskirts of Los Angeles such as Hacienda Heights, Cerritos, Gardena and Garden Grove. As of today, there are 33 Korean commercial banks' offices in the Los Angeles area. In addition, CKB opened its San Francisco office in 1989. These banks primarily provide their services for their local communities. These bank offices consider Korean owned businesses located in the Los Angeles area as their major target market. These offices are staffed with 904 employees as of today.

These Korean commercial banks have enjoyed the financial benefits which result from the growing Korean population in the Los Angeles area. To see the financial changes of Korean commercial banks, we collected all the eight banks' annual reports which include the past five years financial information. We consolidated these banks' assets, loans, deposits and shareholders' equity for each of the past five years (1989 - 1993). The results of the summary are presented in the attached table. The consolidated data indicates that the banks' assets and equity increased by 27.9% and 49.6% over the past five years, respectively. During this same period, the banks' loans increased by 28.9% while their deposits did by 25.8%.

However, the consolidated data indicates that the growing trend of the banks' assets, loans and deposits was reversed starting in 1992. The banks' total assets had grown to about $1.36 billion dollars until 1991. The assets started declining in 1992 ($1.31 billion in 1992 and $1.28 billion in 1993). These trends are similar to the banks' loans and deposits.

Other noticeable facts include that all the Korean banks except for UCNB were organized under State of California Charters and their chief executive officers (except for WSB) were hired from external banks in the past few years.

Financial Ratio Analysis - Comparative Analysis

For the purpose of comparative analysis of Korean banks' performance, we selected seven Korean banks. We excluded FSB since several branch offices of FSB provide their services primarily for non-Korean businesses. These selected banks were compared with non-Korean Asian banks (mainly Chinese and Japanese banks) and American banks majority owned by White Americans in terms of their assets size in 1992. These pair-matched samples are intended to control for the bank size so that meaningful comparative analysis of performance may be made.

For those selected banks, we collected the performance ratios over the past five years (1988 - 1992) from Sheshunoff Information Services Inc.'s "Five Year Summary of Performance" (1993). For the purpose of analysis, each bank group's performance ratio is summarized for each year of the past five years in the form of the simple average ratio. These summarized data are presented with the attached tables.

We selected several financial ratios which indicate the results of banks' performance. The ratios for this study include those of core capital to total assets, interest spreads, noninterest income to average assets, overhead expenses to average assets, domestic loan growth, domestic loans to deposits, net charge-offs to average loans, nonperforming loans to gross loans, and return on assets. The following analyses those ratios with emphasis on Korean banks' performance over the past five years.

Ratio of core capital to total assets

The average ratio of core capital to total assets for Korean banks for the past five years is about 10.04 %. This ratio is higher than that of American banks (about 6.86%), while it is lower than that of other Asian banks (11.36%). It appears to indicate that Korean banks are more conservative in managing operations than American banks while they are more aggressive than Asian banks. It may also indicate that Korean banks have more room to deal with liquidity and earnings problems than American banks. It may also indicate that the regulatory core capital requirement ratio is higher for Asian banks than for American banks.

Interest spreads

The past five years' average ratio of interest spreads is 5.87%. The ratio is higher than that of other Asian banks (4.93%) but lower than that of American banks (6.67%). This ratio indicates that Korean banks may charge higher interest for loans and/or pay less interest for public borrowings (i.e., deposits) than other Asian banks. However, they may charge less interest and/or pay higher interest than American banks.

Ratio of noninterest income to average assets

The average ratio of Korean banks is the highest (1.89%) among the three groups. Its ratio more than doubles, compared with other Asian banks. It may indicate that Korean banks are more actively involved in their services for international business and sales activities in SBA loans than the other banks.

Ratio of overhead expenses to average assets

Korean banks' average ratio is the highest (5.91%) among the three groups. Other Asian banks' ratio is 3.96% while that of American banks is 5.65%. It may indicate that the operation of Korean banks may not be as efficient as that of the other groups, especially other Asian banks.

Domestic loan growth ratio

Korean banks have grown most rapidly in their loans among the three groups for the past five years. Their loan growth ratio exceeds 30 % from 1988 to 1990, compared with about 20 % growth rate for their counterparts. However, such growth rate fell down to about 10% in 1991 which is lower than the growth rate of American banks. These growth ratios indicate that Korean banks were more severely affected by the recent recession and a series of Los Angeles disasters including the 1992 civil unrest, widespread conflagrations in 1993 and the recent Northridge earthquake.

Ratio of domestic loans to deposits

The ratios of Korean banks have been the lowest among the three groups over the past five years. Their average ratio is about 76% while those of other Asian banks and American banks are 88% and 80%, respectively. This lowest ratio may indicate that loan demand from Korean banks is relatively low. It may also indicate that Korean banks have more conservative lending policy than the other two groups.

Ratio of net charge-offs to average loans

The ratios of Korean banks have been similar to their counterparts prior to 1992. However, the ratio (1.89%) was the highest among the groups in 1992. This highest charge-off ratio indicates that the Korean banks' market has been severely damaged from the recent recession and the series of recent disasters in the Los Angeles area and thereby their borrowers have not been as able to pay their obligations.

Ratio of nonperforming loans to gross loans

The average ratio of Korean banks over the past five years is similar to other banks. Their ratios were the lowest until 1990. However, their ratios became the highest among the groups beginning in 1991. It indicates that Korean banks' borrowers have become difficult in paying their payments as results of the above mentioned recent economic condition in the Los Angeles area. It also indicates that Korean banks' future charge-offs may be the highest among the groups.

Comments on Korean Banks' Performance

This section provides some comments on Korean banks' performance over the past five years as reflected in the banks' financial data. Our major emphasis is on the issue of why Korean commercial banks' performance has not been as good as other banks. We attempt to relate the results of financial analysis to Korean banking practices which we personally observed and/or obtained from various sources (e.g., Korean newspapers, Wall Street Journal articles, management discussion in banks' annual reports and personal interviews with Korean banks' top management) available to us. As such, our comments are quite subjective.

Several factors may contribute to Korean banks' negative rate of return over the past five years. Most Korean banks' annual reports indicate that their recent performance results are due to downscaled Korean businesses as a result of recent uncontrollable economic disasters such as a prolonged recession in the State of California, the 1992 Los Angeles civil unrest and the great fires in 1993. As discussed in the above section, these may have severely affected Korean banks since major borrowers of Korean banks have been seriously damaged because of these disasters. However, it is believed that those are not the only factors. The following will discuss some areas which have contributed to such negative returns.

Increased Market Competition

As indicated in the background section, Korean banks have grown within a relatively narrow geographical area to serve the same customers (Korean owned businesses). Also, as results of several economic disasters, Korean businesses were severely downsized. As a result, competition has become severe among Korean banks. In addition, the Korean market was threatened by the major American banks (e.g., Bank of America). These banks have attempted to attract Korean owned businesses by providing more convenient services using high-tech.

Marketing Strategy

Korean banks have been marketing-oriented in their strategy to promote their growth as reflected in domestic loan growth ratio analysis. However, their growth has depended on the growth of Korean businesses. As long as there are enough demands for bank services and there is no severe competition, the banks may have the opportunity to grow without any creative activities while waiting for their customers. However, as mentioned above, Korean markets have gotten more competitive starting in the beginning of 1990s. Thus, such passive banking strategy may not be good enough. Their market orientation should be more active in seeking their potential customers and more valuable products.

Inefficient Management Operation

Korean banks have had a relatively weak control in their bank operations as reflected in the highest ratio of overhead expenses to average assets. This implies that Korean banks' management have not been as efficient as other banks. This may result from several factors such as high turnover in top management of Korean banks as indicated in the section of "Background for Korean Banks" and the lack of bank management experience including professional knowledge of the banks' boards of directors.

It may also result from the recent 1989 Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) which amended the Community Reinvestment Act (CRA) enacted by Congress in 1977. The FIRREA requires that the federal financial supervisory agencies evaluate an institution’s CRA performance based on a four-tiered descriptive rating system (i.e., “outstanding,” “satisfactory,” “need to improve,” and “non-compliance”). Since then, the bank regulatory agencies evaluate the banks’ degree of compliance with CRA which encourage the banks to help meet the credit needs of their local communities, including low and moderate income neighborhoods.

Since all Korean banks’ target markets are Korean-owned businesses, it was not easy for the Korean banks to comply with such requirements. As a result, several Korean banks were criticized as “need to improve” in the last few years. To cope with such problems, Korean banks have spent lots of resources which resulted in increasing Korean banks’ overhead costs.

The authors obtained the Korean banks’ most recent CRA ratings and those for some of the sampled American banks used for the previous section. The data indicates that two Korean banks were rated as “need to improve” and the remaining six banks were rated as “satisfactory” while all of the American banks were rated as “satisfactory.”

Lending Practices

As reflected in financial analysis, Korean banks have the highest loan charge-offs and nonperforming loan ratios among the three groups studied in this study. This may result from the downscaled Korean businesses as a result of recent economic disasters in the Los Angeles area as mentioned earlier. However, it may also result from Korean banks’ weak lending practices. In general, bankers are suggested to consider the following six aspects of borrowers when they make lending decisions: capital, coverage, capacity, circumstances, collateral and character (Barrett, 1990). These suggested items indicate that cash flow analysis is an essential part of the loan application evaluation. However, Korean banks’ lending practices have not been based on proper analysis of borrowers’ future cash flows from their businesses. Rather, they have relied heavily on the estimated value of borrowers' collateral.

Several chief credit officers of Korean banks indicated that such lending practices have resulted from the lack of understanding of Korean businessmen regarding usefulness of financial statements. They also indicated that it would be almost impractical for Korean banks to request their customers to provide the reliable financial statements because this request burdens Korean businesses with extra financial costs. As a result, one of the CEOs stated at his inauguration that Korean lending practice has been nothing different from lending practices conducted by small pawn shops.

It is suggested that the Korean banks should discipline their customers in such a way that these customers can provide reliable financial information. Fortunately, there are several educational seminars conducted in Koreantown including the accounting education for non-professional businessmen by several institutions (e.g., UCLA Korean Business Extension Course). The banks should design the seminar programs together to educate their potential borrowers with such institutions.

References

Barrett, Gene R. (1990, April). "What Bankers Want to Know Before Granting a Small Business Loan," *Journal of Accountancy:* 47-53.

Table 1.

Korean Banks Background Data

	Inception Year	Service Area	CEO	Charter	Office	Employees
CKB	1974	State	1992	State	11	260
HMB	1982	Local	1994	State	6	190
CCB	1987	Local	1993	State	6	169
WSB	1980	Local	1992	State	3	70
SBC	1988	Local	1992	State	1	35
UCNB	1989	Local	1994	National	1	56
SAB	1991	Local	1991	State	1	35
FSB	1982	Local	1991	State	5	89
				Total	**34**	**904**

Table 2.

Summary of Consolidated Financial Data for Eight Korean Banks (in thousands)

Year	Assets	Loans	Deposits	Equity
1989	999,082	667,592	906,167	77,684
1990	1,227,829	873,886	1,116,262	91,172
1991	1,363,812	969,282	1,216,015	106,879
1992	1,310,430	895,337	1,165,952	115,649
1993	1,277,957	860,556	1,140,377	116,243

Table 3.

Comparative Analysis of Performance

A. Ratio of Core Capital to Total Assets (%)

Year	Korean Banks	Asian Banks	American Banks
1988	10.668	11.922	6.319
1989	10.820	10.256	6.113
1990	8.643	9.513	6.794
1991	10.004	13.646	7.427
1992	10.061	11.453	7.629
Average	**10.039**	**11.358**	**6.856**

B. Interest Spread (%)

Year	Korean Banks	Asian Banks	American Banks
1988	5.838	5.388	6.663
1989	6.518	5.428	7.023
1990	6.433	4.607	6.630
1991	6.159	4.400	6.337
1992	6.424	4.849	6.710
Average	**5.874**	**4.934**	**6.673**

C. Ratio of Noninterest Income to Average Assets (%)

Year	Korean Banks	Asian Banks	American Banks
1988	1.700	0.796	1.216
1989	1.400	0.970	1.406
1990	1.742	0.538	1.759
1991	2.070	0.774	1.821
1992	2.554	0.804	1.126
Average	**1.893**	**0.776**	**1.466**

D. Ratio of Overhead Expenses to Average Assets (%)

Year	Korean Banks	Asian Banks	American Banks
1988	6.564	4.360	5.656
1989	5.807	3.748	5.537
1990	5.273	3.283	5.670
1991	5.903	4.117	5.811
1992	6.006	4.274	5.579
Average	**5.911**	**3.956**	**5.651**

E. Domestic Loan Growth Ratio (%)

Year	Korean Banks	Asian Banks	American Banks
1988	33.150	22.760	18.040
1989	101.800	13.660	20.930
1990	39.130	20.780	20.660
1991	10.100	5.467	10.810
1992	11.700	13.086	3.243
Average	**39.176**	**15.151**	**14.737**

F. Ratio of Domestic Loans to Deposits (%)

Year	Korean Banks	Asian Banks	American Banks
1988	67.080	95.200	72.543
1989	77.200	78.380	78.786
1990	80.330	88.000	82.057
1991	77.860	85.660	84.500
1992	78.730	93.200	80.900
Average	**76.240**	**88.088**	**79.757**

G. Ratio of Net Charge-offs to Average Loans (%)

Year	Korean Banks	Asian Banks	American Banks
1988	0.702	0.030	0.331
1989	0.282	0.164	0.380
1990	0.143	0.080	0.376
1991	0.330	0.813	0.416
1992	1.889	1.243	0.620
Average	**0.669**	**0.466**	**0.425**

H. Ratio of Nonperforming Loans to Gross Loans (%)

Year	Korean Banks	Asian Banks	American Banks
1988	0.974	1.782	2.170
1989	0.613	1.538	1.534
1990	0.670	1.985	1.009
1991	3.166	1.706	2.031
1992	4.200	2.699	2.950
Average	**1.925**	**1.942**	**1.939**