Report into barclays financial performance analysis

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BUSTER

The following report is aimed at comment the findings of Barclays PLC financial performance analysis. The first section presents an internal and external analysis. The second comments a series of financial ratios. Finally, the last section concludes.

Introduction

Banks are an important part of the financial system. They channel financial resources from individuals who have surpluses to individuals who lack capital. Banks transfer these assets in the form of loans. Loans are evaluated and classified according to the default probability (risk). In this manner, Banks assure that lenders invest their wealth in trustable projects, that is, economically viable (Arnold, G., 2008). Banks, then, subside the research task from lenders and allow them to get a safe and constant return rates in a determined timeframe and conditions (Valdez, S., 2007).

As any business, Banks are aimed at increasing the wealth of the owners. Banks employ accounting systems and economic models to measure their financial performance. Accounting and economic models evaluate: 1) whether the wealth of the owners is augmenting, and 2) at what extent (Atril, P., McLaney, E., 2008). They provide several financial indicators which help business' management to control the enterprise performance; among them, the financial ratios are widely used. The purpose of this report is to comment the findings discuss how bank (Barclays PLC) overall performance should be evaluated. The first section presents a review of Barclays' internal and external performance. The second section evaluates Barclays' financial performance. Finally, the last section concludes.

A review of Barclays' internal and external performance

Barclays is one of the worldwide leaders in financial services. It was founded in 1690 in the UK. Barclays has operations in 50 countries spanning over Europe, the US, and Africa. Its headquarters are located London, UK and employs 153, 800 people worldwide (BARCLAYS, 2009).

Barclays' retail banking includes personal customers, home finance, local business, consumer lending and financial planning (DATAMONITOR, 2010).

Internal performance

Barclays' capital strength has provided the company with resilience to cope adverse market conditions. For example, the company's liquidity pool increased to £127 billion at 31st December 2009 from £43 billion in 2008. Hence, cash flows allow the bank to negotiate better selling conditions in their product portfolio (BARCLAYS, 2009).

Barclays has kept its lending growth volume regardless global economic situation. The bank has reduced its derivative assets; therefore, its balance sheet size has been reduced (BARCLAYS, 2009).

However, Barclays' operations are threatened by its weakness in cost management. Its subsidiaries in Western Europe registered detrimental costs in 2009. Thus, the bank may face difficulties in its expansion plans (BARCLAYS, 2009).

On the other hand, Barclays' mobile banking services have experienced a significant growth due to smart phones popularization. This new service portfolio is likely to reduce workload in bank's branches; therefore a

significant cost reduction may be achieved during the fiscal year 2010. Even though, internet and credit transaction fraud has also risen. Hence, information security investments may undermine cost management accomplishments (BARCLAYS, 2009).

Barclays is pursuing to expand its operation in India and UAE. Even the bank has been present in both countries since 1970's; it does not have a considerable penetration. These markets have attractive conditions to increase the bank market share. Therefore, an expansion strategy for India an UAE is foreseeable (BARCLAYS, 2009).

External performance

Barclays' impairment losses in 2009 affected bank's profitability. This effect was present despite balance sheet size reduction. Disposal of these legacy assets is one of the main bank's objectives for fiscal year 2010 (BARCLAYS, 2009).

UK government legislation regarding Asset Protection is aimed at improving customers' trust by clearing up bank's balance sheets. However, there is no a complete strategy on this matter. These uncertainties add pressure on financial markets, making difficult bank's capitalization. Besides, a more competitive environment will be roomed (BARCLAYS, 2008).

Finally, mergers and consolidation in banking industry will make more difficult, for Barclays, to adjust pricing levels and protect their market position. However, Barclays has the resources and skills to tackle challenging business environments (BARCLAYS, 2009).

Barclays' financial performance

ROE

ROE ratio presents negative trend in the last three years. The cause of this behaviour was the increase in the operation costs, 25%, plus a drop of 25% in the interest income. The net effect was a drop of drop of 77% in the net income in 2009. In 2008, Barclays acquired Lehman Brothers, thus, the total financial figures of the bank were affected. This buy clarifies the abrupt changes in costs and interest incomes. Positive results of this acquirement may be reflected in one or two years; it can be said that this normal behaviour of acquirements (BARCLAYS, 2008).

ROA

ROA was also hit by the Lehman Brothers effect; the indicator fell 50% from 2007 to 2009. Total assets were duplicated during 2008 and the net income after taxes was a little bit higher than in 2007. However, in 2009, Barclays made a restructuration in its total assets and was able to reduce them a 44%, that is, total asset were almost the same than in 2007. Unfortunately, net income after taxes also dropped 44%. ROA indicator was, then, almost the same than in 2008. ROA hid the company efforts to align the bank to the pre-acquisition levels (BARCLAYS, 2009).

Net Interest Margin

Net interest margin improved in 2009. It surpassed 2007 value. Assets are producing more Interest profit than in 2007. This can be interpreted as a positive effect of the Lehman Brothers acquisition, since the asset combination is generation more income. However, the increment in

operation costs undermined the net effect of these results (BARCLAYS, 2009).

DuPont

This indicator clearly shows the Lehman Brothers acquisition effects. The equity multiplier registered a growth during 2008. The net profit margin was almost 300% higher than in 2007. However, the asset utilization went down 518%. The net effect was a low ROE (BARCLAYS, 2008).

In 2009, the equity multiplier, and net profit margin felt down 49. 48%, and 63. 45% respectively; whereas, asset utilization grew 281%. Even though, ROE ratio was the lowest one in the studied period. This erratic behaviour was caused by the total asset amount. Each indicator by itself does not provide enough information regarding how well the company is doing it. For instance, asset utilization seems to be worst than in 2007, therefore, the implication would be that acquisition was a bad deal for the bank. In the case of the Equity multiplier, the conclusion would be the same. But, the net profit margin figure seems more realistic and clearly shows that a growth of 10% in two years justify the buy (BARCLAYS, 2008).

The ultimate result is indicating that the new company is expected to have a return in equity of 6. 28%. However, this metric does not include dividend amounts; thus, investing in the new Barclays firm may still be attractive. DuPont exercise shows that any indicator does not have all information at glance, thus, they should be used in combination in order to provide relevant and useful information. By decomposing ROE in three different ratios, it is possible to understand the effect of total assets and the operating revenue

into the company's investing profile. Besides, it is clear the effect of the increment in the cost of the sales and operations. From the graph, it can be seen that Lehman Brothers firm made a massive sales and their expenses were under control. However, it can be inferred that liquidity may be one of the relevant factors that pushed former owners to sell it. This thesis is aligned to the main causes of the 2007's global financial crisis. Therefore, the acquisition was justified and was a good opportunity to improve the bank's financial performance (BARCLAYS, 2009).

Net Interest Margin

This ratio shows a negative trend. The lowest value was registered in 2008. However, during this year the interest income registered the highest value during the period. In 2009 the interest income dropped 24. 18% but asset were reduced almost 50%. Even though, they continued 12. 34% above the 2007 value. The net effect was 25. 24% below the 2007 mark. It is important to say that 2009 is a good result and shows how the bank is trying to move the new company to the levels in which the former one was operating. It can be inferred that the strategy is to stabilize the bank and then increase the profits. Acquisition was, again, the event that impacted the ratio behaviour (BARCLAYS, 2009).

Earning base

Earning base is indicating that bank is acquiring more assets which are directly implied with the profit generation, that is, that it is lending more money to customers. It is clear that in 2008, due to acquisition, the bank owned a series of assets which were overloading the cost structure. In 2009, the situation improved since assets were re-structured and their number was

reduced. This indicator should not be higher than 50%. The rational is that bank's earning assets are loans, thus, bank should ensure they payment of those loans whit its assets. Therefore a healthy ratio level may be around 50% (BARCLAYS, 2009).

Operating Efficiency Ratio and Wage ratio

The operating efficiency ratio shows that bank is struggling with its operating expenses. In 2007, the ratio was 187%, which means that bank was investing two resource units to produce one. In 2008, this indicator grew almost 2. 5 times. However, the bank made a very good effort and reduced the figure 32%. When wage ration is included in the analysis, it presents a drop in 2008, due to redundancy. However, the operation expenses did not diminished; therefore the operation efficiency ratio did not improve. It can be implied that work force is not the biggest expense, as many author claim, but a combination of inefficient process and asset sub-utilization. Unfortunately, annual reports did not provide deep information (BARCLAYS, 2008, 2009).

Interest Income / Total Assets and Interest Rate Risk Ratio

The first ratio provides information regarding how much interest income is produced by the total assets that bank owns. This indicator shows a growing trend with a little drop in 2008 due to the total assets acquired from Lehman Brothers. Thus, Barclays is improving its asset utilization.

Talking about interest risk ratio, this indicator should be ideally around 100% to ensure that all loans are backed up with assets. However, the bank registered values below 10%. On the other hand, this indicator also shows a

growing trend, which means that this figure is going to improve in the future. This indicator also supports the 2008 acquisition (BARCLAYS, 2009).

Liquidity Risk Ratio

Cash is the blood of the business. This ratio is relevant because indicates the capacity of the bank to convert its asset in cash. This indicator showed a negative trend with a peak in 2008. Its value has never been below 90% which indicates that bank has no cash flow issues. However, it highly depends in the asset restructuration. According to the 2009 annual report, asset management is one of the key objectives of the current management board. Thus, liquidity risk ratio will improve during the next years (BARCLAYS, 2008).

Capital Risk Ratio

Capital risk ratio shows at what extent the bank is prepared to afford its long term compromises. Values on this indicator shows that bank is in a very good position since its long term compromises do not represent a high percentage of its total assets; the lower this indicator the best. However, it shows a growing trend accelerated by the 2008 acquisition. It can be inferred that management team is trying to either improve the bank resource availability, by long-term instruments, or restructuring the acquisition cost. The peak in 2008 can be explained by the heterogeneous asset combination post-acquisition (BARCLAYS, 2008, 2009).

Conclusions

After analysing Barclays' bank ratios, it can be inferred that the acquisition of Lehman Brothers was an organic growth during crisis times. Thus,

Barclays took advantage of the economic situation in 2008. Its solid cash figures allowed the bank to reject the bail-out plan from the UK's government. This action increased the customer preference for the bank.

After acquisitions, the ratios tend to show bad results. However, this is somehow expected, since new components are added to the operation and a new organization is created. In the case of Barclays, these variations were not significant to the overall company performance.

Finally, internal and external performance measurement is a complementary part of the ratio analysis. Ratio analysis is highly dependent on accounting information and the standards to gather that info. Thus, the results may vary if another set of accounting rules is applied. Internal and external performance measurement provides the background information to understand the number, trends and behaviours of the ratio result. Hence, both analyses are complementary rather than exclusive. Ratios provide a standard and normalized way to compare and analyze information, but they are meaningless by themselves. Ratio value is important, but it adds nothing to management process if it is not translated into coherent and relevant series of events which explain the root cause of that percentage. Thus, a good selection of indicator and measurements will guide the company to better results.