FACTORS AFFECTING THE PERFORMANCE OF FOREIGN BANKS IN MALAYSIA

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ABSTRACT (ENGLISH)

We analyzed and compared the performance of domestic and foreign banks operating in Malaysia for the period of 5 years, from 2004 to 2008. We found that foreign banks have strong capital, but the statistics show that domestic banks more profitable. However, existing foreign banks are affecting financial services quality in Malaysia, because all banks offer better and low cost banking services for customer during strong competition. In this study used financial ratios of banks by extracting components of CAMEL Model, namely, Capital adequacy, Asset quality, Management, Earnings and Liquidity. To identify the determinants of performance of the Malaysian foreign and domestic banks during 2004-2008 years, this study has chosen multiple regression analysis.

The descriptive analysis suggested that the average ROA for the Malaysian commercial banks during the study period was about at 3.21% only. However, it is much better comparing with Asian crisis period, in the beginning of study period; commercial banks shifted their earnings and continued a constant growth thereafter. One more thing is that, in overall local banks show higher ROA than foreign banks. In conclusion, bank performance (including ROA and ROE) of commercial banks in Malaysia influenced by the capital adequacy ratio, total loans to total assets ratio, NPL to total assets ratio, interest expenses to total loans, total operating profit to revenue and loans to deposit ratio. Overall, CAMEL predicts 66.9% of ROA and 64.0% of ROE. We can say that CAMEL is good concept for evaluating bank performance

ABSTRAK (BAHASA MELAYU)

Kami menganalisa dan membandingkan prestasi bank tempatan dan bank asing yang beroperasi untuk 5 tahun (2004 sehingga 2008). Bank asing didapati memiliki modal yang kukuh, tetapi statistik menunjukkan bank tempatan lebih mencatatkan menguntungkan. Walau bagaimanapun, bank asing sedia ada tetap mempengaruhi kualiti perkhidmatan kewangan di Malaysia kerana semua bank menawarkan servis yang bagus dengan kos yang rendah kepada pelanggan ketika menghadapi persaingan yang sengit. Kajian ini menggunakan nisbah kewangan bank-bank dengan mengekstrak komponen model CAMEL, iaitu nisbah kecukupan modal, nisbah kualiti aset, pengurusan, pendapatan dan nisbah kecairan. Analisa regresi pelbagai (*multiple regression analysis*) telah digunakan untuk mengenalpasti penentu kepada prestasi bank-bank tempatan dan asing di Malaysia sepanjang tahun 2004 sehingga 2008.

Analisa deskripsi menunjukkan bahawa pulangan ke atas aset secara purata bagi bank-bank perdagangan di Malaysia sepanjang tempoh yang dikaji adalah sekitar 3.21%. Pun begitu, ia lebih baik berbanding ketika krisis kewangan Asia. Di awal tempoh kajian, pendapatan bank-bank perdagangan didapati meningkat dan kekal pada kadar yang malar. Secara keseluruhannya, bank-bank tempatan menunjukkan kadar pulangan ke atas aset yang lebih tinggi berbanding bank asing. Kesimpulannya adalah, prestasi bank-bank perdagangan di Malaysia (bagi kedua-dua pulangan ke atas aset dan ekuiti) dipengaruhi oleh nisbah kecukupan modal, nisbah jumlah pinjaman berbanding jumlah aset, nisbah pinjaman tidak berbayar berbanding jumlah aset, belanja faedah berbanding jumlah pinjaman, jumlah untung operasi berbanding hasil dan nisbah pinjaman berbanding deposit. CAMEL dapat menggambarkan 66.9% daripada pulangan ke atas aset dan 64.0% pulangan ke atas ekuiti. Dengan ini, CAMEL adalah konsep yang bagus untuk menilai prestasi bank.

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LIST OF ABBREVIATIONS

BNM	Bank Negara Malaysia
CCB	City commercial banks
CEE	Central and Eastern European
CTD	Cash to Deposit
DEA	Data Envelopment Analysis
EON	EON Bank (Edaran Otomobil Nasional)
EU	European Union
HDFC	Housing Development Finance Corporation Bank
IBS	Islamic banking scheme
ICICI	Industrial Credit and Investment Corporation of India
IDBI	Industrial Development Bank of India
IETTL	Interest Expense to Total Loans
LLATTL	Loan and Lease Allowance to Total Loans
LTD	Loan to Deposit
NIM	Net Interest Margin
NPL	Non-Performing Loans
NPLTTA	NPL to Total Assets
OLS	Ordinary Least Squares
RHB	Rashid Hussein Bank
ROA	Return on Assets
ROE	Return on Equity

SETTA	Shareholders Equity to Total Assets
TLTTA	Total Loans to Total Assets
TOPTTR	Total Operating Profit to Total Revenue
UK	United Kingdom
UTI	Unit Trust of India
VIF	Variance Inflation Factor

CHAPTER 1

INTRODUCTION

1.1 Introduction

Banks expand their operations internationally by establishing subsidiaries and branches or by taking over established foreign banks. This internationalization of banking systems has been encouraged by the liberalization of international financial markets.

According to Marashdeh, O. (2005) foreign banks were operating in Malaysia from as early as 1875 with the establishment of the Standard Chartered Bank. But, Salina, H. K. (2007) argues that the pioneers of Malaysian foreign commercial banking industry was the Chartered Mercantile Bank of India, London and China which was established in 1823 and the Standard Chartered Bank in 1875.

Since 1966 Bank Negara Malaysia has prohibited the expansion of existing foreign bank branches in Malaysia to protect domestic banks and to allow them to compete with foreign banks. However, foreign banks are free to set up representative offices in the country. In addition, from 1974, foreign banks were not allowed to establish branches in Malaysia.

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