

**A STUDY ON THE PERFORMANCE OF
MALAYSIAN COMMERCIAL BANKS**

A Thesis submitted to the Graduate School in partial
fulfilment of the requirements for the degree
Master in Business Administration
Universiti Utara Malaysia

by
Fader Abdullah



**Sekolah Siswazah
(Graduate School)
Universiti Utara Malaysia**

**PERAKUAN KERJA KERTAS PROJEK
(Certification of Project Paper)**

Saya, yang bertandatangan, memperakukan bahawa
(*I, the undersigned, certify that*)

FADER ABDULLAH

calon untuk Ijazah
(*candidate for the degree of*) Sarjana Pentadbiran Perniagaan

telah mengemukakan kertas projek yang bertajuk
(*has presented his/her project paper of the following title*)

A Study on the Performance of Malaysian Commercial Banks

seperti yang tercatat di muka surat tajuk dan kulit kertas projek
(*as it appears on the title page and front cover of project paper*)

bahawa kertas projek tersebut boleh diterima dari segi bentuk serta kandungan,
dan meliputi bidang ilmu dengan memuaskan.
(*that the project paper acceptable in form and content, and that a satisfactory
knowledge of the field is covered by the project paper*).

Nama Penyelia
(*Name of Supervisor*) : Dr. Yusnidah Ibrahim

Tandatangan
(*Signature*)

Tarikh
(*Date*) : 12 Jun 2001

PERMISSION TO USE

In presenting this thesis in partial fulfilment of the requirements for a post graduate degree from the Universiti Utara Malaysia, I agree that University Library may make it freely available for inspection. I further agree that permission for copying of this thesis in any manner, in whole or in part, for scholarly purposes, may be granted by my supervisor(s) or, in their absence, by the Dean of the Graduate School. It is understood that any copying or publication or use of this thesis or parts thereof for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to Universiti Utara Malaysia for any scholarly use which may be made of any material from my thesis.

Requests for permission to copy or to make other use of materials in this thesis, in whole or in part, should be addressed to:

**Dean of Graduate School
Universiti Utara Malaysia
06010 UUM Sintok
Kedah Darul Aman**

ABSTRACT (BAHASA MALAYSIA)

Penilaian prestasi bank adalah penting dalam mana-mana pasaran kewangan yang kompetitif. Prestasi bank dapat memberi isyarat kepada penyimpan/pelabur samada untuk melabur atau mengeluarkan wang dari bank. Pada masa yang sama, ia dapat memberi petunjuk kepada pengurus bank samada untuk menyediakan perkhidmatan deposit atau pinjaman supaya prestasi bank dapat dipertingkatkan.

Kajian ini telah menganalisa prestasi bank-bank perdagangan di Malaysia untuk satu jangka masa selama 13 tahun dari 1985 sehingga 1997. Perbandingan prestasi bank-bank perdagangan tersebut telah buat di antara dua jangka waktu: 1985 sehingga 1990 dan 1991 sehingga 1997. Penyata kewangan gabungan telah diperolehi untuk tujuan ini. Enam dimensi prestasi telah diberi perhatian, iaitu perolehan, keciran, risiko, solvensi, kecekapan dan keuntungan, yang mana telah diukur menggunakan nisbah-nisbah kewangan. Ujian-T diguna untuk menguji sama ada terdapat perubahan yang signifikan dalam setiap aspek prestasi ini di antara dua tempoh tersebut.

Perbandingan analisis kewangan menunjukkan bahawa terdapat peningkatan yang signifikan dalam prestasi pendapatan serta kecekapan dan keuntungan bagi bank-bank perdagangan tersebut di antara tahun 1991 sehingga 1997. Kecekapan pengurusan bank dalam aspek aset dan tanggungan telah meningkat dan telah menyumbang kepada prestasi dalam tempoh kedua. Pendapatan bukan faedah, peruntukan pinjaman rugu, margin faedah bersih dan nisbah kecekapan telah dikenalpasti sebagai komponen-komponen penting yang telah menyumbang kepada prestasi pendapatan bank.

ABSTRACT (ENGLISH)

Evaluation of bank performance is important in any competitive financial market. Bank performance provides signal to depositors-investors whether to invest or withdraw funds from the bank. Similarly, it gives directions to bank managers whether to provide deposit or loan services in order to improve the performance of the bank.

This study has analysed the performance of the Malaysian commercial banks for a 13 years period from 1985 to 1997. Comparison of the performances of the commercial banks was carried out between two periods; 1985 to 1990 and 1991 to 1997. Consolidated financial statements of the commercial banks have been gathered for this purpose. Six dimensions of performance were emphasized, namely earning, liquidity, risk, solvency, efficiency and profitability, of which are measured by financial ratios. T-test was used to test the significance of changes in each of these aspects of performance between the two periods.

Comparative financial analysis indicates that there were significant improvements in the earning, efficiency and productivity performances of the commercial banks during 1991 to 1997. The bank's managerial efficiency in assets and liabilities has improved and has contributed to the performance during the second period. Non-interest income, loan loss provision, net interest margin and efficiency ratio have been identified as the important components that contributed to the banks' earning performance.

ACKNOWLEDGEMENT

I would like to express my appreciation to my supervisor, Dr Yusnidah Ibrahim for her supervision of the project. Her ideas, guidance, critical review and examination of the report have been an enormous help.

I would like to thank my wife, Ku Ruhana, who is the source of my inspiration and motivation. Thanks for your patience, sacrifice and support.

Finally, I wish to thank some of my friends for all the little help here and there, especially Ahmad, Sarani, Fauziah, Nor Iadah and Azuraliza. I am indeed grateful for the opportunity to work with all of these great and wonderful people.

TABLE OF CONTENT

PERMISSION TO USE	ii
ABSTRACT (BAHASA MALAYSIA)	iii
ABSTRACT (ENGLISH)	iv
ACKNOWLEDGEMENT	v
TABLE OF CONTENT	vi
LIST OF TABLES	vii
LIST OF FIGURES	viii
LIST OF ABBREVIATIONS	ix

CHAPTER 1: INTRODUCTION

1.1 Problem Statement	3
1.2 Research Objective	4
1.3 Significance Of The Research	5
1.3.1 Impact of government policies and regulatory changes	6
1.3.2 Effects on shareholders, depositors, investors and bank managers	6
1.3.3 Commercial banks' ranking	7
1.3.4 Mergers effect on banks' performance	7
1.4 Research Scope, Assumption And Limitation	7

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction	9
2.2 The Development And Activity Of Commercial Bank	9
2.3 Bank Performance	10
2.4 Performance Of Commercial Bank	13
2.5 Performance Of Other Types of Bank	15
2.6 Financial Ratio Analysis	16
2.6.1 Earning ratio	17
2.6.2 Liquidity ratio	20
2.6.3 Risk and solvency ratio	22
2.6.4 Efficiency and productivity ratio	24

CHAPTER 3: RESEARCH METHODOLOGY	
3.1 Introduction	27
3.2 Data Source	28
3.3 Analysis Method	28
CHAPTER 4: ANALYSIS OF RESULTS	
4.1 Introduction	30
4.2 Earning Performance	30
4.3 Liquidity Performance	34
4.4 Risk And Solvency Performance	36
4.5 Efficiency And Productivity Performance	38
CHAPTER 5: CONCLUSION	
5.1 Introduction	44
5.2 Summary Of Findings	44
5.3 Recommendation For Further Work	46
REFERENCES	47

LIST OF TABLES

Table 4.1a : Earning Ratios for Period 1	32
Table 4.1b : Earning Ratios for Period 2	32
Table 4.2 : Earning Performance	33
Table 4.3a : Liquidity Ratios for Period 1	34
Table 4.3b : Liquidity Ratios for Period 2	35
Table 4.4 : Liquidity Performance	35
Table 4.5a : Risk and Solvency Ratios for Period 1	37
Table 4.5b : Risk and Solvency Ratios for Period 2	37
Table 4.6 : Risk and Solvency Performance	37
Table 4.7a : Efficiency and Productivity Ratios for Period 1	39
Table 4.7b : Efficiency and Productivity Ratios for Period 2	39
Table 8 : Efficiency and Productivity Performance	40

LIST OF FIGURES

Figure 1 : Earning Performance for ROAA, ROAE, YOEA and EAC	33
Figure 2 : Earning Performance for NIM, NIITAA, NIETAA, PTITAA, LLPTAA and NLLTAL	34
Figure 3 : Liquidity Performance for LTD and CA	36
Figure 4 : Liquidity Performance for CTD and CR	36
Figure 5 : DTE, EM and LTD Ratios Performance	38
Figure 6 : ETA and DTTA Ratios Performance	38
Figure 7 : IIPE and NIEPE Ratios Performance	42
Figure 8 : NIIPE and PTPPE Ratios Performance	42
Figure 9 : DPE, LPE and AAPE Ratios Performance	43
Figure 10 : OPTTR, NIITTR, ER and PTPTTR Ratios Performance	43

LIST OF ABBREVIATIONS

AAPE	: Average Asset per Employee
BNM	: Bank Negara Malaysia
CA	: Current Asset
CR	: Current Ratio
CTD	: Cash to Deposit
DEA	: Data Envelopment Analysis
DPE	: Deposit per Employee
DTE	: Debt to Equity
DTTA	: Debt to Total Asset
EAC	: Earning Asset Cost
EM	: Equity Multiplier
ER	: Efficiency Ratio
ETA	: Equity to Asset
IIPE	: Interest Income per Employee
LLPTAA	: Loan Loss Provision to Average Asset
LPE	: Loan per Employee
LTD	: Loan to Deposit
LTD	: Loan to Deposit
NIEPE	: Non-Interest Expenses per Employee
NIETAA	: Non-Interest Expenses to Average Asset
NIIPE	: Non-Interest Income per Employee
NIITAA	: Non-Interest Income to Average Asset
NIITTR	: Non-Interest Income to Total Revenue
NIM	: Net Interest Margin
NLLTAL	: Net Loan Loss to Average Loan
OPTTR	: Operating Profit to Total Revenue
PTITAA	: Pre-Tax Income to Average Asset
PTPPE	: Pre-Tax Profit per Employee
PTPTTR	: Pre-Tax Profit to Total Revenue
ROAA	: Return on Average Asset
ROAE	: Return on Average Equity

US : United States

YOEA : Yield on Earning Asset

CHAPTER 1

INTRODUCTION

The commercial banks are the main players in the banking system. They are the largest and the most significant providers of funds in the banking system and the most active sector in the economy as well playing an active role in the economic development. The total amount of loans and total amount of deposits as at middle of 1999 amounted to RM285.1 billion and RM287.6 billion respectively, representing approximately 76% and 71% of banking system's total amount of loans and deposits. There are 38 commercial banks (excluding Bank Islam Malaysia Berhad) of which 13 are locally incorporate foreign banks in Malaysia as at June 1999 and operating with a total of 1,735 branches with 63,889 staff employed.

In the past 15 years, the banking industry has faced growing competition in financial services, economics downturn as well as economics growth, at same time has undergone substantial deregulation and changes. Information technology also has played an important role, where bigger size commercial bank has invest in information technology more in order to provide better services as well as product innovations.

Over the past two decades, substantial research by researchers and economists from over the world has gone into evaluating the efficiencies of financial institutions. The majority of the studies were published in the 1990s, highlighting the importance and greater frequency of this research in recent years.

Evaluation of bank performance is important for all parties such as depositors, bank managers and regulators. In a competitive financial market, bank performance provides signal to depositor-investors whether to invest or withdraw

The contents of
the thesis is for
internal user
only

REFERENCES

Ahmed, A.M. and Khababa, N. (1999) "Performance Of The Banking Sector In Saudi Arabia", *Journal Of Financial Management & Analysis*, Vol. 12, No. 2, pp. 30-36.

Barr, R.S., Killgo, K.A., Siems, T.F. and Zimmel, S. (1999) "Evaluating The Productivity Efficiency And Performance Of US Commercial Banks", *Federal Reserve Bank Of Dallas Report*, pp. 1-40.

Bell, F. and Murphy, N. (1967) "Costs in Commercial Banking: A Quantitative Analysis of Bank Behaviour and Its Relation to Bank Regulation", *Research Report #41*, Federal Research Bank of Boston, MA.

Berg, S.A., Forsund, F.R. and Jenson, E.S. (1991) "Technical Efficiency of Norwegian Banks: The nonparametric approach to Efficiency Measurement", *The Journal of Productivity Analysis*, Vol. 2, pp. 127-142.

Berger, A.N. and Humphrey, D.B. (1992) "Measurement and Efficiency Issues in Commercial Banking" In *Output Measurement in the Service Sectors*, edited by Zvi Griliches, pp. 245-300.

Chen, T. and Yeh, T. (2000) "A Measurement Of Bank Efficiency, Ownership And Productivity Changes In Taiwan", *The Service Industries Journal*, Vol. 20, No. 1, pp. 95-109.

Davidson, S. (1997) "Measuring Profitability", *America's Community Banker*, Vol. 6, No. 10, pp. 48-51.

Frei, F.X. and Kalakota, R. (1999) "Process Variation As A Determinant Of Bank Performance: Evidence From The Retail Banking Study", *Management Science*, Vol. 45, No. 9, pp. 1210-1220.

Kimball, R.C. (1997) "Innovations In Performance Measurement In Banking", *New England Economic Review*, pp. 23-38.

Lehner, J.C. (1999) "Bank Performance Affected By Changing Interest Rates", *Texas Banking*, Vol. 88, No. 8, pp. 18-19.

Mester, L.J. (1994) "How Efficient Are Third District Banks", *Business Review – Federal Reserve Bank Of Philadelphia*, pp. 3-16.

Oral, M. and Yolalan, R. (1990) "An Empirical Study on Measuring Operating Efficiency and Profitability of Bank Branches", *European Journal of Operational Research*, Vol. 46, pp. 282-294.

Pak, H.S. and Huh, S.K. (1995) "Comparative Analysis of Korean Banks' Performance", *The Cal Poly Pomona Journal of Interdisciplinary Studies*, Vol. 8, pp. 143-150.

Parkan, C. (1987) "Measuring the Efficiency of Service Operations: An Application to Bank Branches", *Engineering Costs and Production Economics*, Vol. 12 (2), pp. 237-242.

Putnam, B.H. (19983) "Concept of Financial Monetary", *Federal Reserve Bank of Atlanta Economic Review*, pp. 6-13.

Rangan, N., Hassan, Y.A., Pasurka, C. and Grabowski, R. (1988) "The Technical Efficiency of US Banks", *Economics Letters*, Vol. 28, pp. 169-175.

Resti, A. (1994) "Bank Efficiency and Return to Scale: A Data Envelopment Analysis of Italian Banks' Journal of Political Economy, Vol. 102 (2), PP. 269-291.

Sabi, M. (1996) "Comparative Analysis of Foreign and Domestic Bank Operation in Hungary", Journal of Comparative Economics, Vol. 22, pp. 179-188.

Samad, A. and Hassan, M.K. (1999) "The Performance Of Malaysian Islamic Bank During 1984 – 1997: An Exploratory Study", International Journal Of Islamic Financial Services, Vol. 1, No. 3, pp. 1-15.

Sarker, M.A.A. (1999) "Islamic Banking In Bangladesh: Performance, Problems & Prospects", International Journal of Islamic Financial Services", Vol. 1, No. 3, pp. 1-24.

Seiford, L.M. and Zhu, J. (1999) "Profitability And Marketability Of The Top 55 US Commercial Banks", Management Science, Vol. 45, No. 9, pp. 1270-1288.

Sherman, H.D. and Gold, F. (1985) "Bank Branch Operating Efficiency", Journal of Banking and Finance, Vol. 9, pp. 297-315.

Siems, T.F. and Barr, R.S. (1998) "Benchmarking The Productive Efficiency Of US Banks", Federal Reserve Bank Of Dallas: Financial Industry Studies, pp. 11-24.

Walter, J.R. and Welker, D.L. (1990) "Fifth District Bank Performance", Economic Review (Federal Reserve Bank Of Richmond), Vol. 76, No. 4, pp. 20-30.

Wheelock, D.C. and Wilson, P.W. (1999) "Technical Progress, Inefficiency And Productivity Change In US Banking, 1984 – 1993", Journal of Money, Credit and Banking, Vol. 31, No. 2, pp. 212-234.

Yue, P. (1992) "Data Envelopment Analysis and Commercial Bank Performance: A Primer with Applications to Missouri Banks", Federal Reserve Bank of St. Louis, pp. 31-45.