FOREIGN BANKS ENTRY AND DOMESTIC BANKS PERFORMANCE IN MALAYSIA

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UNIVERSITI UTARA MALAYSIA

JUNE 2011

FOREIGN BANKS ENTRY AND DOMESTIC BANKS PERFORMANCE IN MALAYSIA

By

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Thesis submitted to the Centre for Graduate Studies,

Universiti Utara Malaysia,

in Fulfillment of the Requirement for the Degree of Master

of Science (Banking)

OTHMAN YEOP ABDULLAH
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ABSTRACT (BAHASA MELAYU)

Malaysia mnegakui bahawa pembukaan sektor kewangan domestik terhadap persaingan asing akan memberi sumbangan terhadap mewujudkan sektor kewangan yang lebih cekap, kompetitif dan pasaran didorong, secara lansung, membolehkan sektor ini memainkan peranan yang lebih cekap dan berkesan dalam ekonomi. Tujuan dari penelitian ini adalah untuk menilai kemampuan bank tempatan Malaysia dalam pertemuan dengan cabaran baru. Penyelidikan ini akan mengkaji kesan bank-bank asing terhadap prestasi bank-bank tempatan dalam hal keuntungan. Kajian ini juga menggunakan regresi berganda untuk menganalisis data dari tahun 2000 hingga 2009 untuk bank-bank tempatan dan asing. Keputusan kajian menunjukkan bahawa terdapat hubungan positif antara keuntungan dan penunjuk dalaman yang berasal dari nisbah kewangan untuk bank tempatan dan asing. Selain itu, analisis tersebut menggambarkan bahawa ada hubungan linear antara prestasi keuntungan bank tempatan dan bank asing. Hal ini membuktikan bahawa bank asing mempunyai hubungan dengan perubahan keuntungan bank-bank tempatan.

ABSTRACT (ENGLISH)

Malaysia recognizes that the opening up of the domestic financial sector to foreign competition would contribute towards creating a more efficient, competitive and market driven financial sector, thus, enabling the sector to play a more efficient and effective role in the economy. The objective of this study is to evaluate the capabilities of the Malaysian local banks in meeting up with its new challenges. This paper will examines the effects that the foreign banks have on performance of local banks in term of profitability. The study used multiple regressions to analyze the data from year 2000 to 2009 for local and foreign banks. The result shows that there are positive relationship between profitability and internal indicators that derived from financial ratios for local and foreign banks. Other than that, the analysis illustrate that there are linear relationship between profitability performance of local banks and foreign banks. It sustain that foreign banks have a relationship with the profitability changes by local banks.

ACKNOWLEDGEMENTS

A very grateful to ALLAH s.w.t. with all His guidance and blessing finally I have completed my paper as a dissertation to obtain my Master Degree. Special thanks to my dear supervisor Mdm Faoziah binti Idris for all her guidance, understanding, attention, kindness and encouragement. Her supervision, ideas, guidance, critics and examination of the thesis have been an enormous help. Words alone cannot express my greatest appreciation and gratitude to her. I'm very grateful from her not only for his assistance, but also she is great person as a human. I've never forgotten such kind of people.

A huge acknowledgement to my beloved parents Mat Zam Din and Roseni Hj Aris for all the support, love and understanding to me. I would like to express my high appreciation to all my lecturers of College of Business, especially lecturers of the Division of Finance and Banking. Lastly sweet thanks to all my friends that involve direct or indirectly helping me to complete the paper. May ALLAH bless all of you. Finally, I hope this study could add a new knowledge on comparative profitability between local banks and foreign banks.

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CHAPTER ONE

1.0 BACKGROUND OF THE STUDY

1.1 Introduction

The entries of foreign banks in Malaysia are very intensive, especially in 1990s where the financial liberalization was taking place. As such, the presence of foreign banks is debating whether the performances of the domestic banking sector are affected. However, the presence of foreign banks to certain extent has provided some advantages to the domestic banking sector. For example, most of the past studies suggest that the local banks indirectly get the benefit of being more efficient in the financial system through competitions. As foreign banks promote quality services and improved pricing, it helps to improve the country's economic positions and attract more foreign investment.

Studies by Okuda (2004); Claessens *et a.l,* (2000) and Negishi and Inoguchi, (2006), revealed that the presence of the foreign banks in the local market reduce the profits of domestic banks. It improves the operational efficiency of domestic banks due to reduction in operational expenses. It also promotes new financial services and technology into the markets and finally it tends to reduce the credit quality of domestic banks, which could lead to financial system instability.

In Malaysia, the presence of foreign banks started during 1980s. Nevertheless, the significant presence of the foreign banks has been an important benchmark for the domestic banks to measure their performances. However, only recently, the East Asian economies are welcoming the liberalization process in banking sector in order to boost the markets.

Malaysia recognizes that the opening up of the domestic financial sector to foreign competition will contributes a more efficient, competitive and market driven financial sector. By doing so, the banking sector are to play a more efficient and effective role in supporting the economic growth of the country. Hence, the domestic banking institutions are moving forward in order to build the capabilities for expanding and providing new services in line with the foreign banks.

The Governor of Bank Negara Malaysia stated that "*As such, the foreign banks have generally been better able at identifying and reacting to changes in the market much faster than most domestic banking institutions. They are able to open new distribution channels that operate beyond the traditional delivery methods for financial services. Using new delivery systems and largely relying on new technologies, foreign banks have generated a more competitive environment for the domestic banks. Progress has nevertheless been achieved as the gap between domestic banks and foreign banks in terms of return on assets has narrowed*" (Zeti, 2002).

This study attempt to examine the effects of foreign banks entry towards the performance of local banks in Malaysia. The study period includes the pre- and post-financial crisis during 2008. Previously, the participation of the foreign equity in banking sector was relatively small. This is due to the central bank policy that is favorable towards the local banks. Hence, the local banks were protected based on the equity that enables them to compete with the foreign banks successfully. For example, Financial Sector Masterplan in 2001 was introduced to strengthen the financial market through promoting consolidations between local institutions.

1.2 Problem Statement

In Malaysia, there are twenty-five commercial banks operating which include nine local banks and sixteen foreign banks (BNM, 2011). The Governor of Bank Negara Malaysia has announced its intention to reissue and grant new banking licenses to foreign banks specifically in foreign exchange market which involved banks from Japan, France, United Arab Emirates and Indonesia. In April 2010, a locally – incorporated company has been approved by Ministry of Finance. The issuance of the commercial banking license was basically shared by Bank of Baroda (40%), Indian Overseas Bank (35%) and Andhra Bank (25%). This license is issued as a reinstatement of a commercial banking license to an Indian bank, which previously operated in Malaysia and was affected by the requirement under the Banking Act 1973. (BNM Bulletin, 2010).

The existence of the foreign banks in Malaysia can develop the international linkages by facilitating international trade among the countries. It also helps introduce a variety of financial products and services in the banking industry.

However, policymakers and politicians believed that such entries would not have significant effects on the local Malaysian banks, especially after the banking sector reforms under the Financial Sector Masterplan program. Consequently, after the process of bank restructuring, the current local banks compositions are deemed to be matured and ready to meet the challenges of the foreign banks.

Hence, the objective of this study is to evaluate the capabilities of the Malaysian local banks in meeting up with its new challenges. This study will examines on the effects of the foreign banks presence on the performance of the local banks in terms of profitability.

There are many empirical studies examined the effects of foreign bank entry on local bank performance in European countries. Nevertheless, few studies were centered on countries in Asian region such as Thailand (Chantapong, 2003; Okuda, 2004) and Philippines (Unite and Sullivan, 2003). Indeed, other than a study done by Negishi and Inoguchi (2006), not many formal written researches done on the effect of foreign bank entry into the Malaysian banking market.

1.3 Research Questions

This study attempts to answer the following questions:

1) What is the profitability trend of the foreign and local banks in Malaysia?
2) Is there any significant effect on the local banks profitability due to the entry of foreign banks in the country?
3) Is Net Interest Margin of foreign banks better than the local banks?

1.4 Research Objectives

The purpose of this study is to examine the effect of foreign banks participation on the performance of the Malaysian local banking sector. The four specific objectives of this study are as follows:

1) To analyze and compare the trends of profitability for foreign and local banks in Malaysia from year 2000 to 2009.
2) To determine the relationship between internal indicators (NIM, EBITA, OE, SPREAD) and the profitability of foreign and local banks.
3) To compare the Net Interest Margin of both local and foreign banks.
4) To determine relationship between local and foreign banks profitability performance.

1.5 Significance of the Study

For academician, this study could enhance the findings of existing literature. It provides a better understanding of the Malaysian local banks performances amidst competitions from its foreign counterparts. Apart from academicians, practitioners would also benefit from this study as they would be more prepared to face the upcoming challenges, especially when foreign banks are entering the markets.

As for government policymakers and regulatory agencies such as Bank Negara Malaysia, this research would provide insight on the issue, thus improving existing laws or implementing new ones especially in regards to governing foreign banks' transactions.

1.6 Scope of the Study

This study examines the performance of Malaysian local banks against their foreign counterparts from 2000 to 2009. This study analyses the effects of foreign banks entry into the local market. Claessens *et al.* (2000) in their work looks at the banks' performances in terms of net interest margin, non-interest income, overheads and net profit. The scope of study focuses on profitability trends in terms of return on assets (ROA), return on equity (ROE), net interest margin (NIM), earnings before interest and tax (EBITA), overhead expenses (OE), and interest rate spread (SPREAD).

1.7 Limitations of the Study

There are some limitations while doing this study. The limitations are as follows:

i. The study faced with limitations on the data secrecy and confidentially. It makes the researcher difficult to gather the data. For example, some of the annual reports that published in the internet are restricted with the company's procedure on downloading the data.

ii. Besides that, the availability of the data sources is one of the major limitations. For example, the annual report for the company that is not available by the sequence years.

1.8 Organization of the Thesis

The remainder of the study is organized as follows. In Chapter Two, it briefly reviews prior related studies of Asian banking markets and profitability performance of banks. Chapter Three is describing the adopted Methodology for evaluating the impact of foreign banks on the performance of selected local banks. Finally, Chapter Four consists of analyzing the results and Chapter Five provides the conclusions and recommendations.

CHAPTER 2 :

LITERATURE REVIEW

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

There are various studies have been done on the effect of foreign banks towards domestic banks looking at either across countries (Claessens *et al.*, 2000), selected region (Negishi and Inoguchi, 2006) or on a particular country (Okuda and Rungsomboon, 2004).

The studies vary on different scope of performance such as the profitability, efficiency and operations of the local banks. The result can be considered as positive impact to local banks in the long run though it has proven to negatively affect the domestic market in a short run (Hermes and Lensink, 2002).

2.2 Financial Intermediation

Financial Intermediary consists of financial institutions that act as a channel in connecting two parties or agents in supply and demand of funds. The example of classic financial intermediary is banking system that convert deposit to loans.

There are three reasons why financial intermediaries exist, firstly because the different requirement between lenders and borrowers. The banks will act to reconcile the conflicting requirement between lenders and borrowers such as in deposits transaction.

Secondly, financial intermediaries will reduce the transaction cost involved. For example, the lenders need to deal directly to the borrower in order to make sure the borrower can repay the amount borrowed. Therefore, much cost incurred such as verification costs, monitoring costs, and enforcement costs.

Finally, the financial intermediaries will overcome asymmetric information that leads to two main problems which are adverse selection and moral hazards. The situation of asymmetric information is where one party has more information than other parties such as the lender have more information about the borrower.

Diamond (1984) stated that there are three ways of contracting arrangement between borrowers and lenders which are no monitoring, direct monitoring via investors and delegated monitoring via an intermediary. The monitoring cost per loan remains the same but the monitoring cost per transaction is expected to fall. The intermediaries maintain the well diversified portfolio so that the return to the investors is almost riskless

2.3 Banks Profitability and Performance

Chantapong (2003) and Okuda (2004) have done a study on the performances of Thailand's domestic and foreign banks. Both studies provide different insights on the relationships of these banks. In the work of the former, it was found that foreign banks were more profitable than domestic banks, however, the position improves following the Asian crisis and the profitability gap were further lessen post crisis period.

Meanwhile, in Okuda's work, it was found that as the foreign bank presence increased, the domestic banks' overhead expenses and interest spread increases whilst profit declines. In addition, Okuda also noted that 'initially, competitions from foreign banks will negatively affect the performance of domestic banks however these banks' performance would improve over time'.

Over the years, many studies have been carried out to determine profitability of banks. Said and Tumin (2011) in their research examine the effect of some internal indicators towards the commercial banks in Malaysia and China. These factors include the credit, capital, liquidity and operating expenses of the banks in terms of their size and performance.

The performance is determined by using profitability ratios return on asset (ROA) and return on equity (ROE). The research shows that there are dissimilar effects on the ratios used in determining the performance of the banks exclude the capital and credit ratios. The Malaysian banks' performance did not influenced by operating ratios; meanwhile China banks have a positive relationship with the profitability and capital strength.

In comparing the trend of banks, Zakariya (1998) compared the performance of Bank Islam Malaysia Berhad (BIMB) with the conventional banks by using ratios that represents capital structure, assets and deposit structure, and profitability. He found that the progress made by BIMB was encouraging and the experiences was somewhat similar to those of Islamic bank's other countries.

Rosly *et al.* (2003) study the performance of Islamic and mainstream banks in Malaysia. The study found that Islamic Banking Scheme (IBS) banks have recorded higher return on assets (ROA) as they are able to utilize existing overheads carried by mainstream banks. As they lower their overhead expenses, it is found that the higher ratio for IBS banks does not imply efficiency.

A research on Performance of Korean Banks done by Hong & Huh (1995) analyzed Korean banks performance which is reflected on their financial statements and to provide comments to improve their banking business. The 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.

A research done by Naceur (2003) shows that there are few indicators that gives impact towards the net interest margin and profitability performance in Tunisia banking industry. The factors are individual characteristics of the commercial banks, financial system and the external indicators which are macroeconomics factors.

The findings outcomes show that the high net interest margin and large overheads have a significant relationship while it is negatively correlated with the size of banks. The determinants of the external indicators, the net interest margin and profitability have negative relationship with inflation and growth. It is noted in the research "Stock market development has a positive effect on bank profitability. This reflects the complementarities between bank and stock market growth. Therefore, it is found that the disintermediation of the Tunisian financial system is favorable to the banking sector profitability.

2.4 Effects of Foreign Banks in Domestic Banking Market

Claessens *et al.*, (2000) examined the extent and effect of foreign banks in domestic market and also investigated the difference of profitability, overhead, taxation and net interest margin between the foreign banks and the domestic banks. It was found that in developed countries foreign banks have lower profits than domestic banks. However, when it comes to developing countries, higher profits were recorded for foreign banks compared to domestic banks. It was also found that an increase in foreign presence results to reduction in profitability and margins for domestic banks.

Okuda and Rungsomboon (2004) investigated the impact of foreign entry to domestic banks in Thailand. Data on 17 domestic banks from Year 1990 till 2002 were used. The research examined the factors contributing to the bank's performance, including the foreign ownership of banks, financial regulations and market structure.

It was found that the increase presence of foreign banks led to rise in overhead expenses; increase in interest spreads and decline in profits. It was also found that in short run foreign bank presence has negative impact on domestic banks. However, in the long run, it has improved the performance of domestic banks.

Clarke *et al.* (2001) found that allocation of credits to the private sector may be improved since as the pricing and evaluation of credit risks is expected to be more sophisticated.

Denizer (2000) investigates foreign entry in Turkey's banking sector and reflects that the net interest margin, overheads costs and return on assets are in relation to foreign ownership. It is also found that foreign bank entry creates a strong competitive effect on banking sector, whereby the return on assets and overhead costs are reduced.

Chung *et al.* (2009) includes the net interest margin in their research titled "Impact of Foreign Bank Entry on the Performance of Chinese Banks". The ratios involved in the research are return on assets (ROA), net interest margin (NIM) and the cost to income ratio (COSTInc).

The research found that, "the opening-up policy is correct from a macro perspective, however, for banks that have introduced FSI, determining the reasons for improvements in performance being inhibited is more important than releasing more shares to foreign investors".

A study on evaluating local and foreign banking performance in Central and Eastern Europe done by Havrylchyk found that the foreign banks actually earns higher profits than the local banks especially the Greenfield institutions. The study divides the banks into three groups which are Greenfield, Takeover and Domestic banks.

The result shows that the Greenfield institutions performed better in profitability than domestic and takeover banks. Other than that, the macroeconomics also did not affect the profits of foreign banks in a significant manner. The study concludes that among the three types of banks only domestics that experienced higher profits by concentrating on the banking markets.

A research titled "Foreign Bank Presence, Domestic Bank Performance and Financial Development" by Hermes and Lensink used data for the period 1990 to 1996. They found that there is a relationship between the entry of foreign banks and the increase in costs and domestic banks' margin. The results also showed that the effect is not only happen to the low level but also the higher level of financial development.

They also determined that domestic banks have an advantage of being in the domestic financial markets due to the strong market power. Since the foreign banks enter the market, domestic banks need to be more advance by applying the modern techniques with current practices. Hence, it will lead to the increased in interest rate margin and cause the banks received a higher income.

2.5 Net Interest Margin (NIM)

In determining net interest margin, Ho and Saunders (1981) model have been applied in order to evaluate the factors that affect it. The study done by Zhou and Wong (2008) explain the empirical determination of China commercial banks from year 1996 to year 2003. The outcomes stated that some of the factors that affecting the net interest margin are in terms of operating, market structure, interests payments, and management efficiency.

Other than that, Ho and Saunders' model was also used by Ugur and Erkus for their study in Turkist for commercial banks. The results show an insignificant relationship between bank's market share and management quality with net interest margin for local and foreign banks. Meanwhile the operating costs, risk aversion and bank size have a significant relationship with net interest margin.

In comparing the trend of NIM by local and foreign banks, the results show that foreign banks have higher NIM than local banks. The external factors which are the macroeconomics variables used in the study shows that the inflation rate has a positive result in explaining the spread.

CHAPTER 3 :

RESEARCH METHODOLOGY

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains about methods used in this study specifically the theoretical framework, hypothesis, research design, data collection, data analysis and methodology and model specification.

There are many different statistical techniques that have been used in the analysis of the bank performance. Therefore, this study used the financial statements of all sample banks to conduct analysis.

3.2 The Theoretical Framework

This study is using a framework to examine the influence of independent variables which are Return on Asset (ROA), Gross Profit Margin (GPM), Net Profit Margin (NPM) and Net Interest Margin (NIM) on the Profitability of the selected banks.

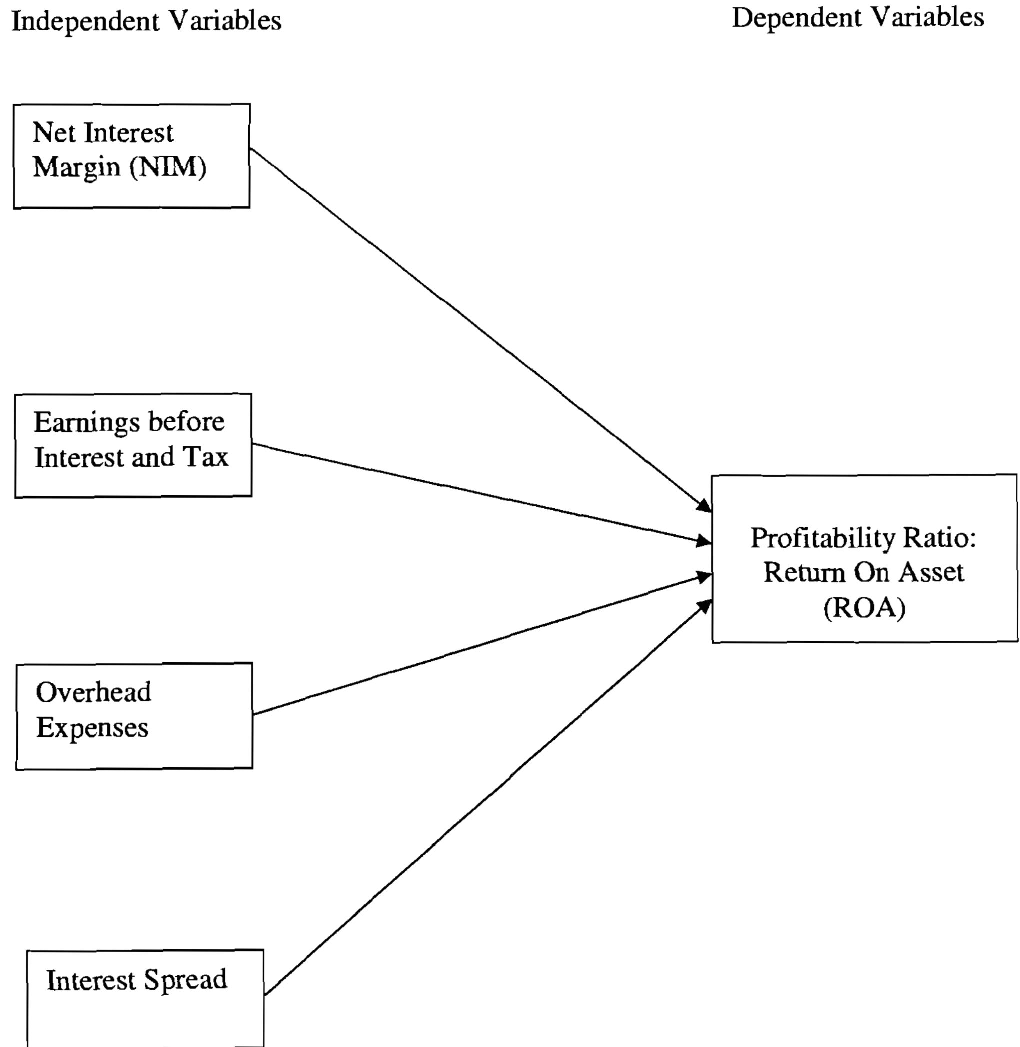


Figure 3.1 Theoretical Framework

3.3 Hypothesis

3.3.1 Relationship between ROA and internal indicators

H_1 : There is relationship between ROA and internal indicators.

H_0 : There is no relationship between ROA and internal indicators.

3.3.2 Relationship between Local banks and Foreign Banks

H_1 : There is relationship between the effects of foreign banks towards the performance of local banks.

H_0 : There is no relationship between the effects of foreign banks towards the performance of local banks.

3.4 Research Design

The study is designed to test the hypothesis. The two types of variables used in this research are Independent variable and Dependent variable. The study determines the profitability performance of the local banks after the entries of foreign banks. Therefore, the profitability ratios are used as the independent variables in this study.

The dependent variable used in the study is the profitability of the banks in terms of Return on Asset (ROA) (Abdel Hamid, 2003). However, in order to evaluate the trend of profitability, Return on Equity (ROE) will be used as one of the subject. Meanwhile the independent variables used in the study are (Okuda, 2004):-

i. Net Interest Margin
ii. Earnings Before Interest and Tax / Total Asset
iii. Overhead Expenses / Total Asset
iv. Interest Spread

3.4.1 Return on Asset (ROA)

Describe as an instrument to measure the profitability of a company in term of its total assets. It gives a reflection of how proficient the management in using the assets to generates earnings.

$$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$$

3.4.2 Return on Equity

Return on Equity is used to measure the company ability to generate a possible dividend for the capital invested by the shareholders of the company. This ratio measures on how efficient the company can generates profit by using money invest by shareholders.

$$\text{ROE} = \frac{\text{Net Income}}{\text{Equity}}$$

This study also used four independent variables derived from a few financial ratios. The independent variables are Net Interest Margin (NIM) ratio, Earnings Before Interest and Tax (EBIT) ratio, Overhead Expenses (OE) ratio, and Interest Spread ratio. (Okuda *et al.*, 2004)

3.4.3 Net Interest Margin

Net Interest Margin is a tool that can measure the company's effectiveness in making investment decisions as compares to its situation of debts. The formula for the calculation as per below:-

$$\text{Net Interest Margin} = \frac{\text{Interest Income (Investment Returns)} - \text{Interest Expenses}}{\text{Total Assets (Average Earning Asset)}}$$

3.4.4 Earnings Before Interest and Tax

$$EBITA / TA = \frac{\text{Earnings Before Interest and Tax}}{\text{Total Asset}}$$

3.4.5 Overhead Expenses

$$OE = \frac{\text{Overhead Expenses}}{\text{Total Assets}}$$

3.4.6 Interest Spread

$$SPREAD = \frac{\text{Interest Income}}{\text{Total Loan}} - \frac{\text{Interest Expense}}{\text{Total Deposits}}$$

3.5 Data Collection

3.5.1 Data Sampling

The data used in this study is a secondary data. A sample of data for financial ratios is obtained from the annual report of selected banks. The data collected consists of balance sheet and income statement for every year from 2000 until 2009.

3.5.2 Sample Description

The data involved local and foreign banks which selected according to the size of banks. Therefore, for local banks three of the largest banks and one small bank chosen in order to look at the effects for different size of banks. Meanwhile for the foreign banks, two largest foreign banks in Malaysia are involved. The selected banks are:

Local Banks

i. Maybank Berhad

i. CIMB Berhad

iii. Hong Leong Bank Berhad

iv. Ambank Berhad

Foreign Banks

i. Citibank Berhad

ii. Standard Chartered Bank

3.6 Data Analysis and Methodology

According to the study, the variables used are profitability ratios in order to analyzed using Multiple Regression method. The regression used to show the significant relationship between two variables. In the regression analysis, one equation will be developing to relate between independent and dependent variables.

The analyses involved in this study are coefficient of determination (R^2), ANOVA, and t-test. Coefficient of determination used in order to explain the changes in the dependent variables meanwhile ANOVA used to test the null hypothesis. F-test in this study used to determine the significant relationship of the regression model. In t-test, the analysis is based on the significant relationship between dependent and independent variables.

3.7 Model Specification

This study is adopting the model used by Okuda and Rungsomboon (2002). The method used in this study is Multiple Regression method which to evaluate the relationship between entry of foreign affect the profitability performance of banks in Malaysia. The dependent variable used is the profitability performance ratio (ROA) meanwhile the independent variables are selected financial ratios.

The regression use to determine the relationship as per below model:-

$$ROA = \beta_O + \beta_1 NIM + \beta_2 EBITA + \beta_3 OE + \beta_4 SPREAD + \varepsilon$$

β_O	=	The constant number of equation
NIM	=	Net Interest Margin
EBITA	=	Earnings Before Interest and Tax / Total Asset
OE	=	Overhead Expenses / Total Asset
SPREAD	=	Interest rate Spread
ε	=	Error Term
β_1	=	1, 2......4 is the coefficient of independent variables

Hence, to determine the relationship between the variables, all of the independent variables are enter at once in the equation. It is to evaluate the most significant independent variables in profitability performance during the period. Results from the equation can be determine by looking at the R^2, significant-F, and β. The determination of the relationship between variables can be looked at the 2-tailed significant correlation.

3.8 Summary of The Chapter

The methodology used in this study is explained in this chapter together with the theoretical framework and the variables selected. Other than that, the hypothesis and the model to be tested in this study are also explained.

CHAPTER 4 :

RESEARCH FINDINGS

CHAPTER FOUR

4.0 RESEARCH FINDINGS

4.1 Introduction

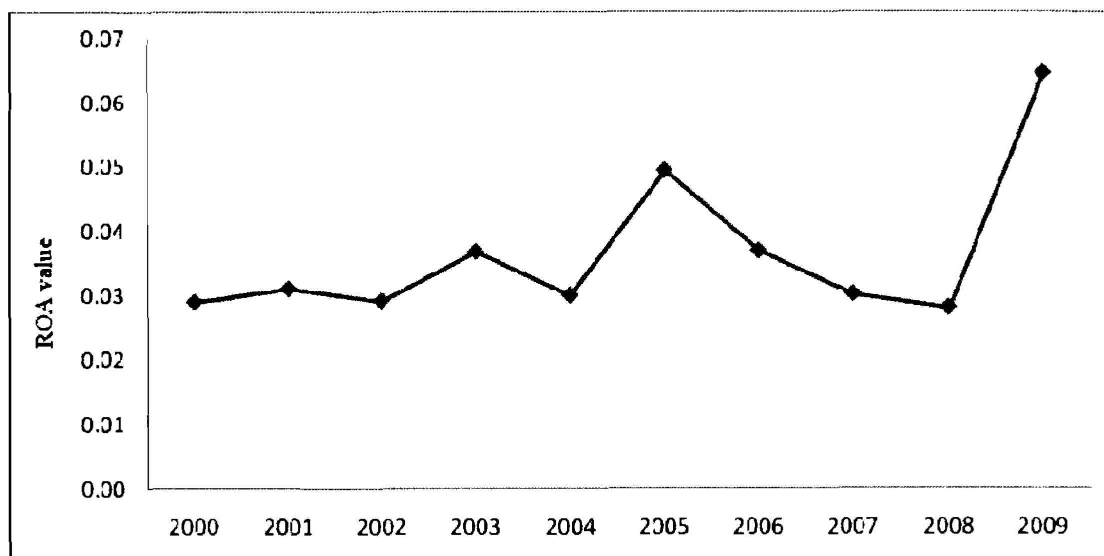
This section will discuss the findings from the research that have been done on local and foreign banks. This chapter is divided into four parts - profitability trend analysis, net interest margin trend analysis, multiple regression analysis and finally descriptive analysis.

4.2 Profitability Trend Analysis

4.2.1 ROA

The local banks selected in the study are Maybank, CIMB, Hong Leong Bank and Ambank meanwhile the selected foreign banks are Citibank and Standard Chartered Bank. The ratios were calculated using the net income and total assets for the period of ten years from 2000 to 2009. ROA is the dependent variables for the study as it is one of the profitability indicators in determining the performance. In trend analysis, the data used is average ROA for local and foreign banks.

Figure 4.1 ROA values for Local Banks



From Graph 4.1 above, ROA trend for local banks shows inconsistent movement. The lowest ROA is 2.80% in year 2008 meanwhile the highest ROA is 6.46% in year 2009. It shows the increasing net income and total assets of local banks after a constant drop from year 2005 till 2008. The average of ROA for local banks is 3.60% in ten years.

Figure 4.2 ROA values for Foreign Banks

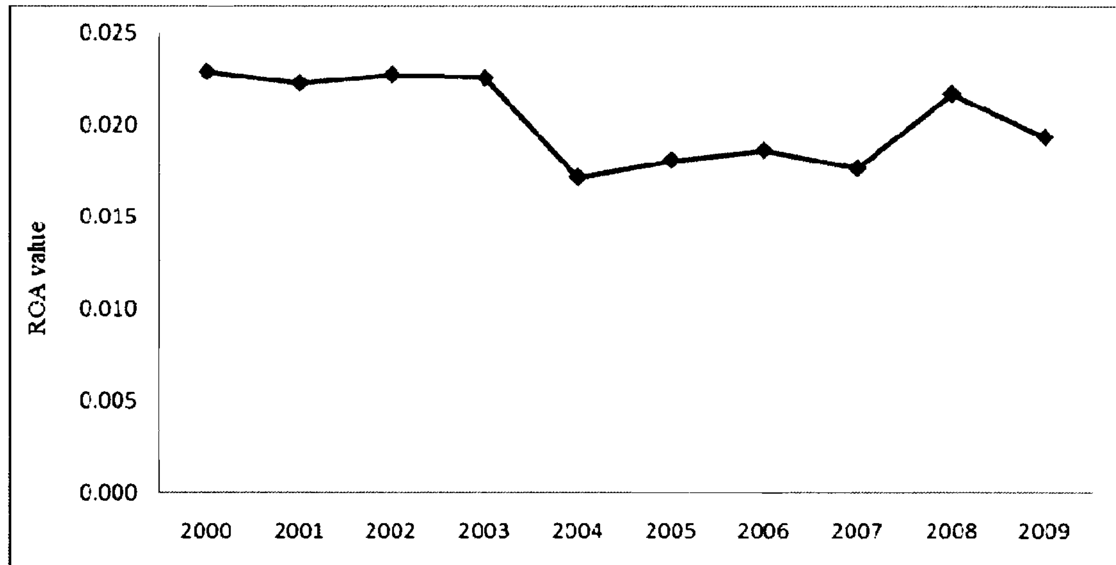


Figure 4.2 shows the decreasing trend of ROA for foreign banks from year 2000 to 2009. The lowest ROA is 1.71% in year 2004 meanwhile the highest ROA is 2.29% in year 2000. The decreasing trend is basically caused by the effect of the financial crisis in 2007. However, in 2008 the ROA starts to increase at 2.17% and decrease again in 2009 at 1.93%.

Table 4.1 ROA for Local and Foreign Banks

YEARS	ROA LOCAL	ROA FOREIGN
2000	0.0289	0.0229
2001	0.0310	0.0223
2002	0.0291	0.0227
2003	0.0368	0.0226
2004	0.0299	0.0171
2005	0.0494	0.0181
2006	0.0369	0.0186
2007	0.0302	0.0176
2008	0.0280	0.0217
2009	0.0646	0.0193

Figure 4.3 ROA Trend Comparisons between Local Banks and Foreign Banks

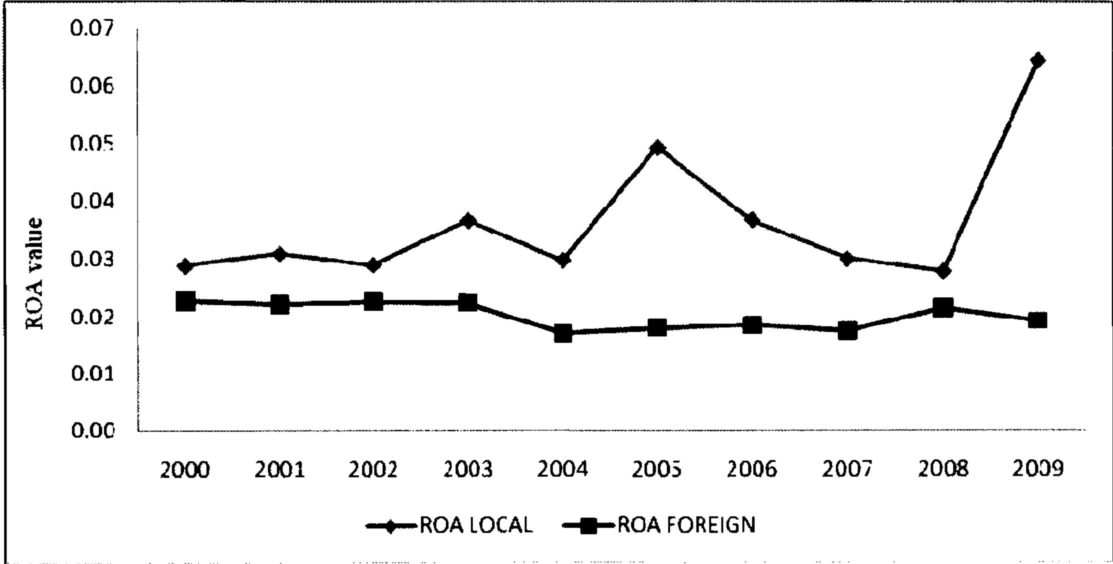


Table 4.1 stated the average ROA for both categories that favorable from year 2000 to 2009. Figure 4.3 shows that ROA for local banks is higher than foreign banks especially in year 2005. It also determined that ROA for local banks is more stable than foreign banks as the total net profit and total assets for local banks are better than foreign banks.

The trend between local and foreign banks also is synchronized throughout ten years especially from 2003 to 2006 where the downward trend occurs in both situations. In 2009, there is huge gap between local and foreign banks ROA at 4.5%

4.2.2 ROE

In evaluating the efficient of company to generate profit from the money invested, ROE for every sample banks are collected for every year. The ROE ratios also calculated in average figure as stated in Table 4.2

Figure 4.4 ROE values for Local Banks

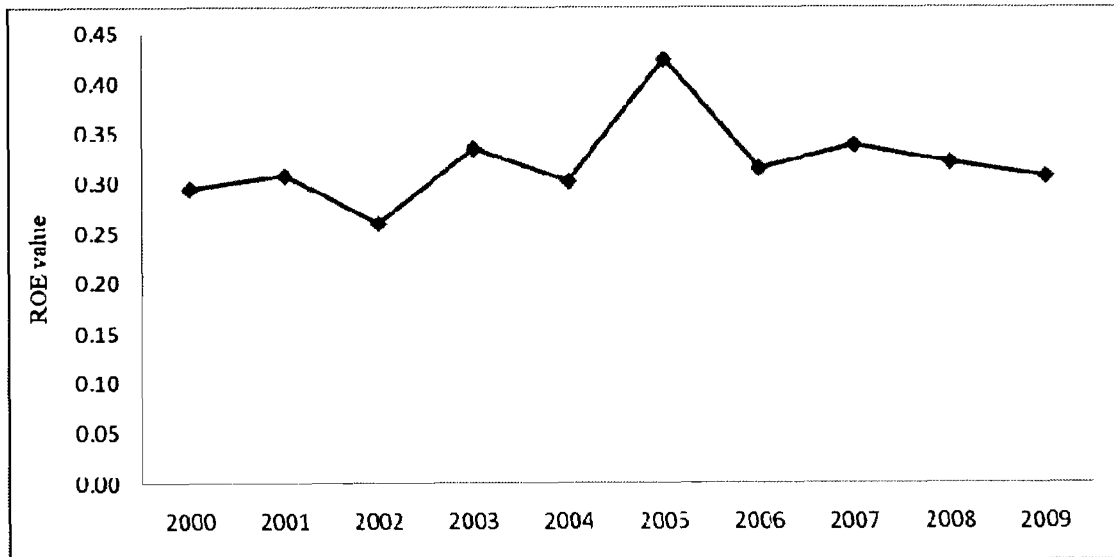


Figure 4.4 shows a trend analysis for ROE for local banks from year 2000 – 2009. There is huge decrease from year 2005 to year 2006 that is from 4.24% to 3.15% in year 2006. The highest ROE for local banks is 4.24% in year 2005 meanwhile the lowest ROE is 2.59% in year 2002. The highest ROE shows that local banks have comfortably establish in order to gain from their capital ownership.

The average value for ROE local is 3.21%. The higher ROE acquirement shows that there is better management performance. Overall, the values are inconsistent from 2000 to 2009.

Figure 4.5 ROE values for Foreign Banks

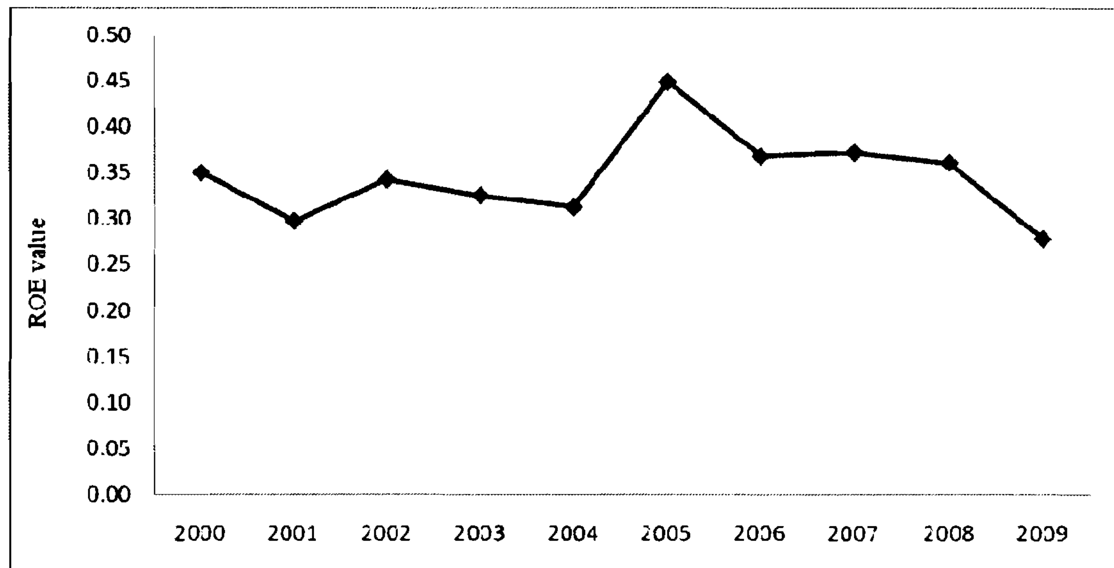


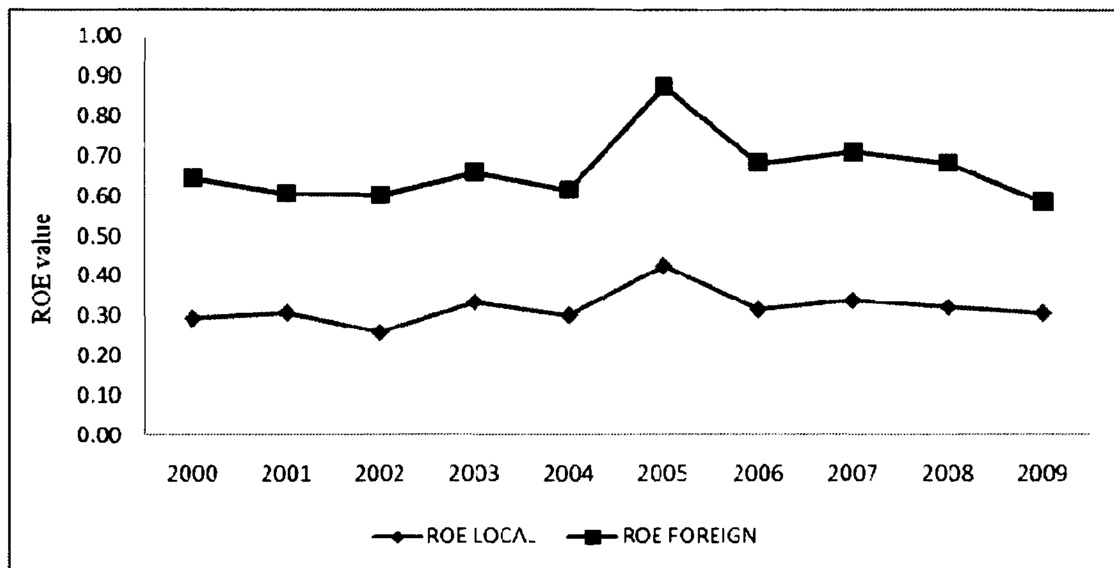
Figure 4.5 shows a fluctuate movement for ROE foreign banks between 2000 and 2009. The value is ranged from the lowest 27.83% and the highest 44.86% in year 2005. The average value for ROE foreign banks is 34.55% for term 2000 until 2009.

There is also a slightly decrease in latest five years and it drops almost 8.09% from year 2005 to 2006. The highest value was increased from 31.25% in year 2004 which was a huge increase between ten years. In other words, the increase in ROE shows that foreign banks have more efficient in management of asset in converting their asset into earnings.

Table 4.2 ROE for Local and Foreign Banks

YEARS	ROE LOCAL	ROE FOREIGN
2000	0.2946	0.3499
2001	0.3079	0.2976
2002	0.2598	0.3425
2003	0.3347	0.3250
2004	0.3021	0.3125
2005	0.4244	0.4486
2006	0.3152	0.3677
2007	0.3384	0.3719
2008	0.3209	0.3607
2009	0.3072	0.2783

Figure 4.6 ROE Trend Comparisons between Local Banks and Foreign Banks



From the figure 4.6, the comparison of ROE for both local and foreign banks shows that the trend are the same. Other than that, the foreign banks have greater ROE values compared to local banks throughout the years. Therefore, foreign banks does not give any impact on the local banks.

4.3 Net Interest Margin Trend Analysis

Table 4.3 NIM for Local and Foreign Banks

YEARS	NIM LOCAL	NIM FOREIGN
2000	0.0172	0.0169
2001	0.0166	0.0153
2002	0.0161	0.0156
2003	0.0160	0.0166
2004	0.0138	0.0116
2005	0.0147	0.0120
2006	0.0148	0.0125
2007	0.0149	0.0121
2008	0.0166	0.0118
2009	0.0153	0.0121

Net Interest Margin is a ratio that used to determine the performance of banks whether the banks are making a right decision in investment compared to the loan given to the customers.

Based on Table 4.3, the table shows NIM for local banks and foreign banks from year 2000 to 2009. The highest NIM was in year 2000 by local banks meanwhile the lowest NIM was in year 2004 by foreign banks. The average NIM for local banks is 1.56% and 1.36% for foreign banks.

Figure 4.7 NIM Trend Comparison Between Local Banks and Foreign Banks

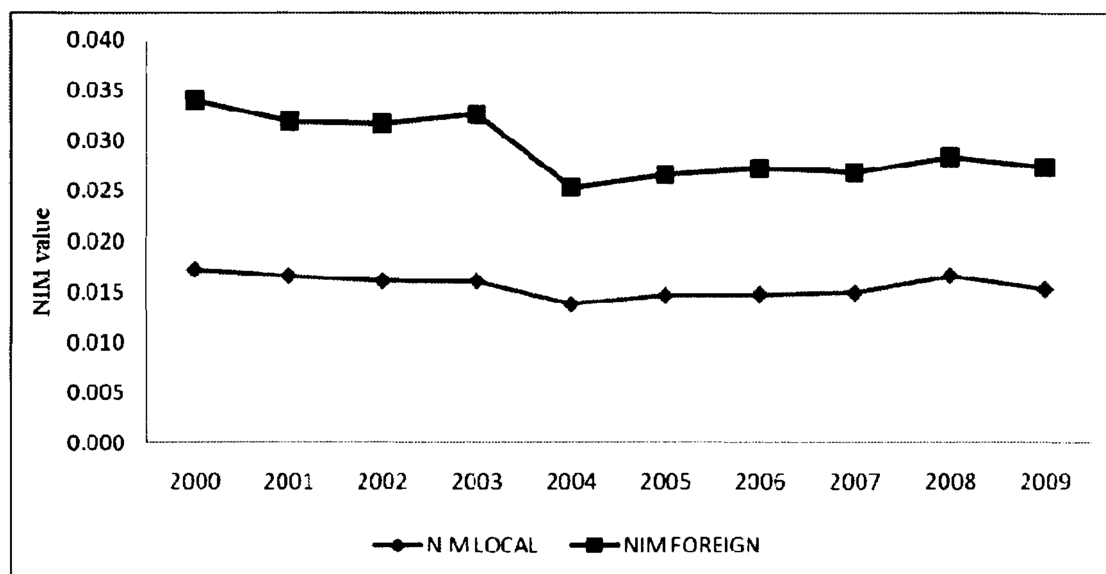


Figure 4.7 shows Net Interest Margin from 2000 to 2009. The local and foreign banks have inconsistent movement with a decreasing trend for the period of ten years. Other than that, the NIM for local banks was higher than NIM for foreign bank except in 2003, foreign banks experienced higher NIM than local banks.

The first four years which is from year 2000 to 2003, the NIM is above the average of 1.36% for foreign banks and 1.56% for local banks. In 2004, NIM for all the banks starts to decrease below the average and it is because at this point of time the banks need to increase the interest for deposit and decrease the interest for loan. Other than that, the average gap between local and foreign banks is about 0.3% from year 2004 to 2009.

4.4 Multiple Regression Analysis

This chapter discusses the findings of Multiple Regression analysis for local and foreign banks. The dependent used in the analysis in ROA for local banks only. It is because the analysis is about the relationship between foreign banks towards local banks profitability. Therefore, the independent used are NIM, EBITA, OE and SPREAD from local and foreign banks.

The first analysis is to determine the relationship between internal indicators and profitability performance of local banks. Then, the second analysis is to determine significant relationship between foreign banks and the internal indicators such as NIM, EBITA, OE and SPREAD. Finally, the third analysis determines the impact of foreign banks and local banks together towards the profitability of local banks.

4.4.1 ROALOCAL and Local Banks

Table 4.4 Model Summary ROALOCAL and Local banks.

	Coefficient	Std. Error	t-ratio	p-value
const	.030	.006	4.548	.006
NIMLOCAL	-1.263	.501	-2.521	.053*
EBITALOCAL	1.039	.076	13.719	.000***
OELOCAL	.031	.053	.584	.585
SPREADLOCAL	-.040	.088	-.461	.664
R^2	.995	P-value (F)	241.027	
Adj. R^2	.991	Durbin Watson	2.823	

Note: *, ** and *** indicate significance levels of 10%, 5% and 1% respectively

In Table 4.4, ROA is the dependent variable while the independent variables are NIM, EBITA, OE and SPREAD. The multiple regression results show adjusted R^2 is .991 or 99.1%. Therefore, the regression equation is almost perfect where 99.1% changes in dependent variable are explained by the independent variables. The coefficient of determination (R^2) for this regression equation is .995, meaning that it explained 99.5% of the possible variation in the dependent variable.

H_0 : There is no relationship between ROA and internal indicators.

To determine the significant of regression model, the F-value have been observed. The test determines whether the ROA regressions over independent variables are significant or not. According to the result, F value is 241.03 and significant level is 0.000 or 0%. The test proves that there is linear relationship between dependent and independent variables. Therefore, the null hypothesis is rejected. In other words, the independent variables NIM, EBITA, OE or SPREAD have relationship with ROA. The Durbin-Watson shows 2.823 where no serial correlation between independent variables and ROA. Therefore, the result meets the equation assumption.

The results stated that the independent variables EBITA and OE have positive relationship with ROA. The other variables are NIM and SPREAD which have negative relationship with ROA. Therefore, it explained all the variables as expected. The highest Beta value is 0.953 for EBITA. It shows that EBITA has greater influence on ROA rather than other variables. EBITA are directly related with ROA as one of the indicator for profit thus, the higher EBITA leads to increase in ROA.

$$H_0 \quad : \quad \beta_i \quad = \quad 0$$

Table 4.4 also shows t-value and significant level (sig) at the 95% level of confidence and α at 0.5 (5%) with 2-tailed test. However, level of significant for NIM, OE and SPREAD are above 5% compared to EBITA. The null hypotheses for the three variables are accepted. Hence, there is only one variable that reject null hypothesis and it is .000 significance level. It can be conclude that only EBITA have directly related with ROA while the other variables have indirectly or not related with changes in ROA.

4.4.2 ROAFOREIGN and Foreign Banks

Table 4.5 Model Summary ROAFOREIGN and Foreign Banks

	Coefficient	Std. Error	t-ratio	p-value
const	.002	.003	.771	.476
NIMLOCAL	-.530	.342	-1.549	.182
EBITALOCAL	.238	.152	1.570	.177
OELOCAL	2.217	.534	4.154	.009***
SPREADLOCAL	-.043	.045	-.956	.383
R^2 .949		P-value (F)	23.225	
Adj. R^2 .908		Durbin Watson	3.206	

Note: *, ** and *** indicate significance levels of 10%, 5% and 1% respectively

In Model of Multiple Regression test, ROA is the dependent variable and the other five variables are NIM, EBITA, OE and SPREAD. Table 4.5 shows that value of R^2 is 0.949 or 94.9%. Meanwhile adjusted R^2 is 0.908 or 90.8%. Therefore, it explains about 90.8% by the independent variables in the model.

H0 : There is no linear relationship between ROA and the internal indicators.

F-test applied in order to determine the significant of the regression. The results will show the significance of ROA to the independent variables. According to the Table 4.5, F value is 23.225 and the significant level is 0.002 or 2%. Hence, the null hypothesis is rejected and there is linear relationship between ROA and the independent variables. It also means that one of the independent variables (NIM, EBITA, OE or SPREAD) have significant relationship with ROA.

Then, t-test applied to test the significant relationship between ROA and independent variables at the 95% level of confidence and α at 0.5 with 2-tailed test. In Table 4.5, it shows the value for t-value and significant level which stated two variables have positive relationship with ROA which are EBITA and OE. Meanwhile NIM and SPREAD have negative relationships with ROA. This result is consistent with analysis for ROALOCAL where it is as expected in the study. The Durbin Watson stated 3.206 which indicate the negative autocorrelation for the equation since the values is towards 4.

The highest Beta value is 1.344 for OE. It means that OE has a greater influence to the ROA besides the other variables.

$$H_0 \quad : \quad \beta_i \quad = \quad 0$$

There are three variables that have level of significant value over than 5%. The variables are NIM, EBITA and SPREAD. The independent variables OE have significant relationship because its value is lower than 0.05. The other three variables have to accept null hypothesis. NIM is not a significant predictor of ROA for foreign banks is due to reason that there is no direct relationship between ROA and NIM. This is also consistent with NIM for local banks which are also not a significant predictor for ROA local banks (Havrylchyk, 2005), (Ilhomovich, 2009). NIM for foreign banks are consistent with results for local banks. Meanwhile, OE or overhead expenses have significant relationship with ROA because any changes in OE with lead to changes in ROA.

4.4.3 ROALOCAL with Local and Foreign Banks

The following analysis covers one of the objectives which are to determine relationship between local and foreign banks profitability performance.

Table 4.6 Model Summary ROALOCAL with LOCAL and Foreign Banks

	Coefficient	Std. Error	t-ratio	p-value
const	.046	.001	60.009	.006
NIMLOCAL	-1.021	.066	-12.672	.021**
EBITALOCAL	.943	.002	252.541	.001***
OELOCAL	-.037	.002	-8.345	.053*
SPREADLOCAL	-.265	.011	-20.683	.014**
NIMFOREIGN	.572	.020	19.129	.017**
EBITAFOREIGN	.053	.010	5.035	.083*
OEFOREIGN	-1.120	.044	-24.236	.011**
SPREADFOREIGN	.377	.012	35.472	.012**

R^2	.997	P-value (F)	5643.64
Adj. R^2	.992	Durbin Watson	3.370

Note: *, ** and *** indicate significance levels of 10%, 5% and 1% respectively

ROA is the dependent variable and NIM, EBITA, OE and SPREAD for LOCAL and FOREIGN banks are the independent variables in the above model summary. Coefficient of determination, R^2, is one of the ways used in expressing the level of prediction accuracy. It is the ratio of the sum of squares regression to the total sum of squares. Thus, the R^2 value is a single measure of overall predictive accuracy.

From table 4.6, it shows R^2 and adjusted R^2 results as 0.997 and 0.992. It means that the regression model almost perfect predicted the dependent variable. In other words, there is 99.2% change in ROA is explained by the independent variables. For the time series analysis to test the autocorrelation, the study applied Durbin Watson test. The test result stated 3.370 which mean the negative autocorrelation for the equation.

H_0 : There is no relationship between the effects of foreign banks towards the performance of local banks.

In this analysis, F-test is applied on the model to determine the significant of regression. Based on the results in table 4.6, the F-value is 5643.64 and significance level is 0.003 or 3%. The significance level is lower than 5%, so the null hypothesis is rejected. Therefore, there is linear relationship between ROA and independent variables. It is predicted that return on asset of banks is determined by the internal indicators such as earning before interest and tax and the other variables.

Other than that, t-test is also applied to the model in order to know the significant relationship between dependent and independent variables at the 95% level of confidence and α at 0.5 with 2-tailed test.

Table 4.6 shows the t-value and significance level. The findings are four variables have positive relationship with ROA which are EBITALOCAL, NIMFOREIGN, EBITAFOREIGN, SPREADFOREIGN. The other four variables have inverse relationships with ROA are NIMLOCAL, OELOCAL, SPREADLOCAL and OEFOREIGN. The highest Beta value is 0.764 for EBITALOCAL which means EBITALOCAL have bigger influence to ROA.

$$H_0 \quad : \quad \beta_i \quad = \quad 0$$

The coefficient analysis stated that all of the independent variables are significant with the dependent variables. However, the significant value for the independent level is different where two variables that has 10% significant level, only one variables has 1% significant level while the remaining variables have lower than 5%. Therefore, all the variables have to reject null hypothesis. In addition, all the independent variables have relationship with dependent variable. OE and EBITA for banks are perfectly as per assumptions that these variables are directly gives effect to profit of banks. From the analysis, it can be conclude that foreign banks do affect the local banks profitability performances.

CHAPTER 5 :

CONCLUSIONS & RECOMMENDATIONS

CHAPTER FIVE

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter will conclude all important findings the study. Apart from that, it highlights several limitations of the research. Finally, this chapter also provides some recommendations for improvements and future studies.

5.2 Conclusions

The study was designed to determine the indicators that affect the profitability of the banks and do the foreign banks give impact towards the profitability of local banks. Therefore, the conclusions that can be derived from this study are discussed as follows:

Firstly, the results of the study shows that the trend analysis of ROA and ROE for local and foreign banks are having horizontally movement in the first five years and start to decrease during the financial crisis period in year 2007 and 2008. Then, the ROA start to rise back due to the increase in profits and total assets of the banks.

For ROE, the local banks experienced slightly lower compared to foreign banks. In year 2007, ROE for both local and foreign banks start to have downward sloping due to decreasing in net income of the banks.

Secondly is the comparison trend analysis for NIM between local and foreign banks. The result shows that during the early period, local and foreign banks were having flat movement and continue to a dramatically down sloping especially in year 2003 to 2004. Thereafter, the banks having a positively increase until year 2009.

Other than that, the results also shows that NIM for foreign banks are greater than the local banks. It means that foreign banks are more efficient in making decision on investment especially in dealing with interest for debt.

Thirdly, the result of hypothesis testing shows a linear relationship between dependent variable and a set of independent variables for the analysis of profitability performance and internal indicators. For the local banks the regression equation shows that it is 99.1% changes in dependent variables are explained by the independent variables. Therefore, there are one significant variable which is EBITA while another three variables failed to reject the null hypothesis.

Besides that, foreign banks have different analysis results with local banks where only one variable has significant relationship with ROAFOREIGN while the remaining variables are insignificant. The significant variable is OE that has positive relationship with ROA for foreign banks. The regression results explained about 90.8% by the independent variables.

Finally, there is the analysis towards the relationship between profitability performance of local banks and foreign banks. Therefore, the analysis determines that there is a linear relationship between local banks profitability performance and foreign banks. There are almost perfect changes in ROA are explained by the independent variables which are 99.7%. The F-test shows a significant result, thus, there is a linear relationship between ROA for local banks and all independent variables.

Therefore, the research support that the foreign banks have a relationship with the profitability changes by local banks which is consistent with the results found by Denizer (2000), Chantapong (2003), Okuda (2004) and Chung *et al.* (2009).

5.3 Recommendations

In order to measure the quality of research in profitability, some adjustment can be made through several methods. In future, this research can be more thorough if the number of local banks and foreign banks included in the model. The sample of banks also can be selected through several relevant criterions.

Other than that, the dependent variable, ROA and independent variables can be explained by making much more indicators, such as, Gross Domestic Products, Consumer Price Index, and Loan Loss Provision. It also suggested that to add more variables which cover the internal and external indicators of the banking systems. In addition, the future study need to extent more years of study with more commercial banks included.

Islamic banking and financial institutions in Malaysia are in development stage, thus, allows many foreign Islamic banks to be open here. However, after 26 years establishment there is limited study done on Islamic banking especially to evaluate effects of foreign Islamic banks towards domestic Islamic banks in Malaysia. It is one of the potential areas to be researched.

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