CHAPTER THREE
LITERATURE REVIEW

3.1 The Context: Malaysian Economy And The Banking Industry

In the past six years Malaysian economy has been undergoing tremendous growth, at the rate of 8% to 9% annually (Bank Negara Malaysia, Annual Report 1991-1997). This achievement was the result of successful implementation of structural adjustment measures, undertaken between 1987 and 1990, to bring the economy out of the deep recession experienced in 1985. Bank Negara Malaysia data indicates that the Gross National Product (GDP) and Real Gross Domestic Product increased by 8.1% and 8.2%, respectively, for the year 1996. The main source of growth in 1996 was stronger activity from the manufacturing, construction, services and mining sectors.

However an unexpected currency turmoil during the second half of 1997 has caused the growth to drop to only 7.8%. Since then the Malaysian Ringgit has become unstable and has been floating around RM 3.50 to RM 5.00 per US dollar. Another economic indicator, the Composite Index of KLSE fell from 1300 points to 320 points region in Aug 1998 (The New Strait Times Jan 97-Aug 98). Meanwhile the interest rates has been fluctuating since then and there have been conflicting opinions as to the direction on the interest rate movement.

The regional instability that hit Asian countries led to large outflow of funds as concerned foreign investors fled these countries. Banks and Equity markets were badly affected as they were not enough capital in the market to finance projects. Hugh projects like Bakun Dam were deferred to an indefinite period. As a measure to bring back the economy back to a stable condition, the Prime Minister has appointed Tun Daim Zainuddin as the Special Minister in the
Prime Minister's Department and given him the authority to do whatever necessary. One of his first moves was to reduce the Statutory Reserve Requirement to 8% from previous 10%.

Year 1998 is expected to be unfavourable year for the Malaysian economy. The GDP growth is expected to grow within a range of -1% to -2%. The manufacturing, construction and service sector are expected to be badly hit and the unemployment rate to increase.

3.2 Assessment Of Commercial Banks In Malaysia

The Banking and Financial industry are undergoing rapid changes arising from measures undertaken by BNM to embark on financial reforms and other environmental changes in the market place. There are 34 commercial banks with a network of 1412 as at end of 1997. Traditional products and services, such as deposits accounts and commercial loans which were formally provided by commercial banks are now available in different forms from a variety of non-commercial entities.

The commercials banks (including Bank Islam) represents the largest group of the Financial institution in the country. At the end of 1996, total assets of the banking industry amounted to RM 915.2 billion of which RM 362.1 billion or approximately 40% belonged to 35 commercial banks. In terms of deposit, the commercial banks accounted for some RM 243.9 billion and earning a pre-tax profit of RM 6.2 billion (Bank Negara Malaysia, Annual Report 1996).

Being the largest group in the Financial Institution the performance and behaviour pattern of commercial banks will effect the stability and soundness of the financial system. The Malaysian financial institution is governed by the Banking And financial Act 1989 (BAFIA). The BAFIA provides an integrated supervisory system for all financial institution. With the enactment of BAFIA, it provides BNM sufficient legal powers to carry out financial reforms.

For the past two and a half decades, the landscape of the banking system had also transformed greatly. There was a broadening and deepening of the
financial structure as the economy grew in size, complexity and sophistication and the demand increased for new financial services and instruments.

The bigger commercial banking groups have also gone into stock broking, leasing, factoring and property trust, asset management, venture capital, insurance, merchant banking and finance company. Overall the trend of the commercial banks are towards the entire range of diversified financial services termed as Universal Banking.

In 1994, BNM in a move to further develop a core of strong and well capitalised banking institution and at the same time, to accelerate the pace of financial liberalisation has introduce the two tier banking environment. The tier one banking institution which is considered as the strong one is allowed to operate on a more liberal basis. Currently there are 11 tier one commercial banks in the country. BNM in their recent meeting with all the financial institution has proposed to look into the possibility of merger among the banks in order to sustain market dominance and reap the benefit of synergy as the industry is poised to experience slower growth as a result of weak economy of the country.

With the establishment of Labuan as an International offshore financial centre, some of the commercial banking institution have also expended into the field of offshore private banking, international portfolio, advisory services.

In the industry, computerisation and reengineering are being seen as a strategic tool. Millions of Ringgit worth of investment are being poured annually into computerising and reengineering the industry to gain the competitive edge. Expanding overseas is also another growth path being pursued and presently the Asian region are being seen as viable markets to penetrate.

The year 1995 shows commercial banks lending jumped RM 42.1 Billion. The most significant amount of 28.8 % or RM 12.1 Billion of the increase in loan extended in 1995 was channelled into the broad property sector which
comprise of construction, real estate and industrial housing. Other sectors which attracted large increases in credit facilities were the finance, insurance and business services (38.9 % increases) and general commerce (26.5 % increases) (Bank Negara Malaysia, Annual Report 1995).

As for 1998 the banking industry is poised to experience a softer growth as a result of weakening of the country's economy. Construction and manufacturing sectors are badly hit. Companies are going bankrupt and unable to pay back loans. Percentage of Non Performing Loans are on the rise and banks are sceptical in giving out new loans. Inter bank borrowing rates has gone up causing the operating cost as a whole to increase. Banking Industry as a whole need to re-look into the ways of doing business in a different way than the norms to reduce cost and attract more depositors. BUSINESS PROCESS REENGINEERING might come handy at the prevailing situation.

3.3 Business Process Reengineering

There are various definitions of business process reengineering (BPR) according to different management experts. Below are some of the more distinguished definitions:

- "A holistic approach whose purpose is to align a business with the needs of its customers" (Texas Instruments 1994)

- "The fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance such as cost, quality, service and speed" (Hammer and Champy 1994)
• "An intensive customer focused, top down management effort to establish 'breakthrough' in the performance capabilities and therefore the value of the processes" (Player & Keys 1995)

• "The redesign of process from scratch. It is acknowledging that the way things have been done in the past is not sacrosanct, and that a new competitive environment and new technologies require radical new ways of doing things, not merely doing the same old things of the past at lower cost or in better ways." (Allen 1994)

3.4 The Principles Of Business Process Reengineering

Reengineering is about achieving a significant improvement in processes so that contemporary customer requirements of quality, speed, innovation, customisation and service are met. This entails seven new rules of doing work as proposed by Hammer relating to who does the work, where and when it is done as well as information gathering and integration.

According to Hammer (1990) the seven principles of BPR are:

1. Organise Around Outcomes, Not Tasks
   Several specialised tasks previously performed by different people should be combined into a single job which is performed by an individual "case worker" or "case team". The new job created should involve all steps in a process that creates a well-defined outcome. Organising around outcomes eliminates the need for handoffs, resulting in greater speed, productivity and customer responsiveness. It also provides a single knowledgeable point of contact for the customer for ease of reference.

2. Have Those Who Use The Output Process Perform The Process
   People closest to the process should perform the work as they know what they need from the process best. For instance, employees can
make some of their own purchases without going through purchasing department, customers can perform simple repairs themselves and suppliers can be asked to manage parts inventory. Relocating work in this fashion eliminates the need to co-ordinate the performers and users of a process. However, this work change shifts work across traditional intra and inter-organisational boundaries.

3) **Merge Information - Processing Work Into The Real Work That Produces The Information.**

People who collect information should also be responsible for processing it. It minimises the need for another group to reconcile and process that information and greatly reduce errors by cutting the number of external contact points for a process.

4) **Treat Geographically Dispersed Resources As Though They Were Centralised.**

Information technology now makes the concept of hybrid centralised / decentralised operations a reality. It facilitates the parallel processing of work by separate organisational units that perform the same job while improving the company's overall control.

5) **Link Parallel Activities Instead Of Integrating Their Results**

Parallel activities should be linked continually and co-ordinated during the process to minimise and avoid rework, high costs and delays in the final outcome of the overall process.

6) **Put The Decision Point Where The Work Is Performed And Build Control Into The Process.**

Decision making should be made part of the work performed. This is possible today with a more educated and knowledgeable workforce plus decision-aiding technology. Controls are now made part of the process. This vertical compression results in a flatter but more responsive organisation.
7) Capture Information Once - At The Source

Information should be collected and captured in the company's on-line information system only once at the source where it was created. This approach avoids erroneous data entries and costly re-entries.

The above principles can only provide some essential guidelines for reengineering efforts. However, no two companies can undertake reengineering in identical ways. The principles of BPR as stipulated above are based on a common platform of the innovative application of information technology. But creating a new process requires more than a creative application of information technology as we will see in the BSN Commercial Bank case.

3.5 The Six Key Steps In Business Process Reengineering

The following steps proposed by Chase and Aquilano (1995) will be a resourceful guidance in Reengineering the BSN Commercial Bank.

Step 1 State a Case for Action

The need for change should be effectively communicated to company employees through educational and communication campaigns. Two key messages should be articulated:

a) A need for action

  e.g. "Here is where we are as a company, and this is why we can't stay here." (Hammer and Champy 1994, pp. 149).

b) A vision Statement

  e.g. "This is what we as a company need to become." (Hammer and Champy 1994, pp. 149)

The objectives for reengineering must be in the form of a qualitative and quantitative vision statement. These objectives can include goals for cost
reduction, time to market, quality and satisfaction levels and financial indicators. The objectives can be used to measure progress and to constantly spur ongoing action.

**Step 2  Identify the Process for Reengineering**
All major processes in an organisation should be initially identified. However, the major processes should be reengineered according to the company's need for improvement and should not reengineer at the same time. The selected process should have a manageable reengineering project scope with well defined process boundaries. Though all processes in organisations are interrelated, the limits of the current change effort must be identified.

**Step 3  Evaluate Enablers of Reengineering**
Information technology and human / organisational issues act as enablers of the reengineering process. Technology evaluation has now become a core competency required by all companies. Companies should develop the ability to evaluate current and emerging information technology and identify creative applications to redesign their existing processes. This can be seen in this case where BSN Commercial Bank can reengineer its processes by using information technology and organisational aspects as its enablers. The current organisational culture should also be evaluated in light of the impending change brought about by reengineering. Participative and customer - oriented cultures provide a suitable environment for further change.

**Step 4  Understand The Current Process**
The current process must be diagnosed as a means to understand it and its underlying assumptions. Broad performance parameters of existing processes must be determined. However the process must not be overstudied and reengineers should move quickly on to redesign.

**Step 5  Create A New Process Design**
Process redesign requires a new beginning and creative innovation. Reengineers should suspend current rules, procedures and values as to
create new process designs. Principles of reengineering should also be utilised.

Step 6 Implement The Reengineered Process

Leadership is crucial to the entire reengineering effort. The extent of change necessitates the direct and continued engagement on the part of senior executive and senior management steering committee. Process reengineering teams are responsible for implementing new designs. However support from all business units are crucial to success because implementation changes accountabilities of the line managers while expecting them to deliver on the improvements. Training employees is essential to perform new skills in new environment. The reengineered process design forms the basis for a pilot project that is followed by a phased introduction. Post implementation assessment is usually made in relation to the objectives defined at the beginning of the reengineering project.

3.6 Characteristics Of Reengineered Business Processes

Champy (1995) identifies the following 8 major characteristics of reengineered business processes, which can be used as a check point for BSN Commercial Bank.

- Several distinct jobs or multiple sequential tasks are integrated and compressed into one and the responsibility is assigned to one person known as the case worker. In situations where all the steps of a lengthy process cannot be integrated in one job performed by a single person, a case team is formed comprising of a group of people who have among them all the skills that are needed to handle the process.

- Workers are empowered to make decisions. Vertical compression refers to points in a process where workers used to have to go up the managerial
hierarchy for an answer, they now make their own decisions, thus creating a flattened organisation.

- Steps in the process are performed in a natural order. "delinearizing" processes refers to work sequenced in terms of what needs to follow rather than traditionally waiting for the 1st person to complete task 1 before passing the output to 2nd person to do task 2.

- Multiple versions of the same process, each one tuned to the requirements of different market, situations or inputs. Beginning with a "triage" step to determine which versions works best in a given situation e.g. straightforward case, medium hard cases and difficult cases.

- Shifting of work across organisational boundaries. Work is performed where it makes the most sense rather than organised around specialists in independent departments and then later integrating related pieces of work.

- Checks and controls (non value adding work) are reduced. Controls are only used to the extent that they make economic sense. Instead of tightly checking work as it is performed, reengineereed processes often have aggregate or deferred controls which tolerate modest and limited abuse.

- Reconciliation is minimised by cutting back the number of external contact points that a process has, thereby reducing the chances of inconsistent data requiring reconciliation.

- Single point of contact. Case Manager or empowered Customer Service Representatives are able to answer the customer's questions and solve customer problems. Act as a buffer between a complex / dispersed process requiring a large team and the customer
Hybrid centralised / decentralised operations are prevalent whereby combining the advantages of centralisation and decentralisation with the enablement of information technology.

3.7 Benefits Of Business Process Reengineering

According to Hammer and Champy (1994), most companies which have reengineered recognised benefits gained from three major aspects i.e. Customers, Competition and Change (also known as three C's).

a) Customers
Customers of reengineered companies have increased demands and command sophistication in the delivery of the company's products and services. Customers' quality and service expectation on the company have also increased. All these are the results of the efficiency and effectiveness in delivering products and services to the market place by the reengineered business processes. By reengineering companies are able to identify and practise a better way of doing work in all its business units, thus satisfying customers' needs and demands tremendously. Customers' perception on the reengineered company is brought to higher ground and subsequently customer's expectation is changed. Reengineered companies experienced a dramatic increase in its sales, service and product quality, flexibility and speed in delivery.

b) Competition
Reengineered companies are able to compete successfully in the global market as they are flexible in producing its products and services to cater to the various needs and demands of the different markets in the world. These companies are able to get a niche market in their respective field as they have the competitive advantage to compete successfully in the open market. Technology plays an important role in the reengineering process and information technology in particular act as a catalyst in gaining the competitive edge.
C. Change

Business Process Reengineering involves accelerated but constant, pervasive and persistent change in the company. Change management and paradigm shifts are some of the critical areas that need the arrangement and commitment from the senior management in order for the reengineering process to take place throughout the organisation. Therefore, reengineering enables a company to change its current work processes to a more efficient and better way of working. With the change, comes together the flexibility in adapting to new changes and environment thus, enforcing the ability to react competitively in response to new or different market changes.