

CHAPTER 5

CONCLUSION

5.1 Summary and Conclusion

The main objective of doing a comparative study between the performance of Islamic banks and conventional banks was to gauge the competitiveness of BIMB in a banking sector dominated by conventional banks.

This study compares the performance of Bank Islam Malaysia Berhad (BIMB) with the performances of commercial banks in terms of growth, profitability, liquidity, solvency, credit risk, earnings risk and sectoral contribution to the economy. The study period was divided into two. The first period of study was from 1989-1999 where BIMB's performance was compared with seven small to medium sized commercial banks. The second period of study was from 1997-1999 and seeks to compare the impacts of the financial crisis on BIMB and other commercial banks. For the second period, BIMB's performance was compared with fifteen commercial banks. In most of the analyses, financial ratios were used as indicators of the different aspects of bank performance.

The findings on BIMB's performance over the eleven-year period are as follows: Assets and deposits growth have been on the up trend but when compared to conventional banks, BIMB is outperformed. As for profitability, BIMB is again outperformed by most conventional banks although its profitability has been

increasing over the years. However, BIMB is found to be less risky in terms of solvency, liquidity and earnings risk. In terms of sectoral contribution, BIMB's lending priority does not differ much from conventional banks. However, BIMB's percentage contribution toward the agricultural, mining and quarrying sector is higher compared to conventional banks. This implies that BIMB have undertaken efforts to contribute to a more equitable distribution of income. Overall, it can be concluded that BIMB's performance over the eleven-year period is comparable with conventional banks.

As for BIMB's performance during the financial crisis, BIMB's recovery in terms of assets and deposits growth has been remarkable, outperforming all conventional banks. This is attributed to the substitution effect as depositors switched to BIMB because of the perceived safer and higher returns. In terms of profitability, BIMB's recovery was comparable to conventional banks. With regards to riskiness, BIMB has once again proven that it is less risky than conventional banks in terms of solvency, liquidity and earnings risks. However, BIMB's credit risk does not differ much from that of conventional banks. This is attributed to BIMB's high concentration of lending toward risky sectors like construction and real estate sector. This is similar to lending practices of conventional banks.

Overall, it can be concluded that BIMB's performance during the financial crisis has been relatively resilient. One noteworthy observation from the financial crisis is that there is a demand for Islamic banking, evidenced by the significant increase in deposits in 1999 when conventional banks were offering low interest rates. This shows that demand for Islamic banking is inversely related to interest rates offered by

commercial banks. In conclusion, the results show that BIMB is able compete with commercial banks although its performance is fairly mediocre.

5.2 Recommendations

As reported in the findings, BIMB's asset growth and deposit growth lags behind most conventional banks. This tendency is of concern because BIMB is expected to face stiffer competition in the future. In Malaysia alone, year 2000 will see the consolidation of commercial banks and finance companies into ten anchor banks as the country prepares to open up to foreign players. The future banking industry is expected to consist of banks of substantial size. To compete with these large banks, which have advantage in scale economies, BIMB will have to work on enlarging its depositor base and size.

To enlarge its depositor base, BIMB should go beyond attracting depositors who bank with BIMB purely for religious reasons. As reported in the findings, there is a demand for Islamic banking and products. This demand is found to be inversely related to interest rates offered by commercial banks. Therefore, if BIMB were to attract other depositors, it will need to provide rates of return, which are comparable with returns from other banks. Apart from attractive rates of return, BIMB could concentrate on providing efficient and time saving services by investments in information technology. Facilities like on-line and phone banking are some of the ways of attracting new depositors. All these approaches can be used to attract depositors without affecting BIMB's mode of operation as an Islamic bank.

In terms of profitability, BIMB is found to be not as profitable as most conventional banks. As suggested earlier by Samad and Hassan (1999), BIMB is restricted by religious constraints especially in its scope of investments. Furthermore, BIMB does not have the advantage of net interest income,¹¹ which contributes significantly to conventional banks' earnings. In order to improve BIMB's profitability situation, BIMB has look to other means of generating earnings. BIMB can concentrate on expanding and improving its range of financial services e.g. trusts, financial planning and underwriting facilities. These services will provide a source of revenue in terms of non-interest service fees of which permissible to BIMB in accordance with Syariah principles.

Therefore, in view of the ongoing consolidation in the banking industry as Malaysia prepares for a foreign influx of banks, BIMB will have to work on improving its financial viability in preparation for the future. BIMB has its own strengths in terms of lower risks of insolvency and earnings volatility. These are perhaps some of the strengths it could market to its prospective clients. At the same time, it will need to improve its profitability situation and range and quality of its services.

¹¹ Net interest income is the difference between the interest earned from loans/financing and the interest paid out on deposits.