

## **CHAPTER 1- INTRODUCTION**

Malaysia's banking sector has undergone tremendous developments and significant evolutionary changes over the past decade. The drive for excellence in the banking industry is a matter of priority, given that the well being of the banking sector is integral to the health and prosperity of the Malaysian economy. The latest advancements in information technology and globalization as well as financial sector liberalization have created many challenges for the Malaysian banking institutions hence increasing the Malaysian government's commitment to progressively liberalize the banking sector, with the understanding that failure to do so will jeopardize the economy's participation in the global economy. In response to globalization, the Financial Sector Masterplan (FSMP) was drawn up to design a new financial landscape that is more competitive and market-driven as we approach an increasingly globalized world.

This paper critically examines the competitiveness of Malaysian banking sector relative to Singapore, Thailand and Indonesia. First, the cross-country comparison provides insights into the relative competitiveness and efficiency of the domestic commercial banking industry among these countries. Second, the time-series analysis reveals how the overall Malaysian banking sector has performed over time, it also captures the effect of the Asian financial crisis on banking production.

Briefly, this research paper is structured as follows : Chapter 1 gives a brief introduction of this research as well as the research objectives and research

methodology. Chapter 2 reviews the literatures on banking sector competitiveness and globalization. A comparison of the structure of banking system of Malaysia, Singapore, Thailand and Indonesia is made in the following chapter. Chapter 4 examines the competitiveness of Malaysian domestic commercial banking industry in relation to some selected countries in the region by comparing and analysing some financial ratios. Chapter 5 analyses the current position of the Malaysian banking sector in the mirror of FSMP. Chapter 6 then examines whether the desired characteristics proposed under FSMP have existed in Singapore, Thailand and Indonesia. Chapter 7 concludes.

### **1.1 Rationale of the Research**

The new millennium is characterized by the emergence of a borderless world (Ohmae, 2000). Barriers to trade and financial flows are greatly removed given the efforts of Governments to liberalize their economies in line with the agreements reached at the Singapore meeting in 1995 of the World Trade Organization (Asian Development Bank, 1997). The tremendous advances in technology, in particular global satellite communications, have eroded the efforts of developing countries seeking continued protection for the financial and trade sectors.

A strong, efficient and stable banking system is a pre-requisite for a sustainable economy, since only a viable and resilient banking system can allocate and mobilise domestic resources efficiently and effectively within the economy. In the era of rapid pace of globalization and increasing competition from foreign banks, the survival and competitiveness of local banks is of great importance. This research is therefore

considered timely as the outcome could contribute in assessing the current strength and weaknesses of Malaysian banking sector in comparison with some countries in the region, hence serves as a basis for the formulation of appropriate policy approaches in building a more resilient and efficient banking sector in Malaysia.

## **1.2 The Research Objectives**

This research aims at identifying the competitiveness of Malaysian banking sector while great emphasis and attention will be placed on the recommendations proposed under FSMP in enhancing the domestic banking sector's capacity and capability in an increasingly more competitive environment and subsequently towards greater international integration under globalization.

For the purpose of this study, the research objectives are:

- i. To compare and analyse the competitiveness and performance of the domestic commercial banks of Malaysia, Singapore, Thailand and Indonesia.
- ii. To examine the current state of Malaysian banking sector in the light of FSMP.
- iii. To examine whether the desired characteristics proposed under FSMP are already present in the banking sector of Singapore, Thailand and Indonesia.

## **1.3 Research Methodology**

This study examines the banking industry's competitiveness in 4 Southeast Asian countries, namely Malaysia, Singapore, Thailand and Indonesia.

The main focus of the research is an analysis of the Malaysian banking system and its relative competitiveness in the globalised world. As such, cross-country comparison will be used to compare the structure of Malaysian banking system to that of Singapore, Thailand and Indonesia. Financial ratios indices, particularly the ratios under the CAMEL<sup>1</sup> framework will be used as indicators of competitiveness of the banking sector in the above mentioned four countries from 2000 to 2001, henceforth, identifying the critical gaps in these banking systems while determining the areas for improvement in the Malaysian banking system. Tables and graphs will also be presented in order to provide a clearer picture of the situation and the most preferred direction of the banking sector in Malaysia.

Data<sup>2</sup> for the domestic commercial banks of the four countries were obtained from the respective country's central bank annual reports as well as other monthly and periodic statistical reports of these countries while some were downloaded from the website of the respective banks<sup>3</sup>. The balance sheet, income and expense statements, assets, capital, NPLs and other relevant data of the domestic commercial banks were collated for years 2000 and 2001. The original data were expressed in the respective country's currency and for ease of comparison, some of these data were converted to US Dollar. In presenting descriptive statistics for the respective countries' domestic banking sector, these data were later used to calculate financial ratios under the CAMEL framework that is commonly used in assessing the performance and competitiveness

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<sup>1</sup> CAMEL is the acronym for Capital Adequacy, Asset Quality, Management quality, Earnings performance and Liquidity position.

<sup>2</sup> Some data are annualized estimates based on partial year information due to the differences in financial year end for accounting.

of the respective banking sector. These parameters are then used as framework for analysis of the Malaysian domestic banking sector's competitiveness and performance in comparison to some countries in the region.

Extensive analysis and study will be carried out on FSMP to compare the existing characteristics of the Malaysian banking sector against those characteristics proposed under the FSMP. In this regard, time series analysis will be carried out to study the performance of Malaysian banking system over the period 1996 to 2001. Analysis will also be made on the current characteristics of the banking system of Singapore, Thailand and Indonesia benchmarked against the desired characteristics proposed under the FSMP.

Specific primary information of the research is obtained from the various annual reports and official releases of the Central Bank of the respective countries and other international institutions such as Asian Development Bank, World Bank and the International Monetary Fund. Other macroeconomic data are obtained from journals, reports, magazines, newspapers and the internet.

#### **1.4 Scope and Limitations of the Research**

The research only selected a few countries for comparison i.e. Singapore, Indonesia and Thailand while a comparison with other countries in Asia would better reflect Malaysia's position and strength in the era of globalization.

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<sup>3</sup> Research does not cover foreign banks, branches and agencies that are wholly owned by foreign banks. Hence, all of the sample banks are locally owned.

Every effort has been made to incorporate the latest development that is relevant to this research as well as to support this research with the latest statistical data. However, this effort has been constrained in some instances by the lack of up-to-date and publicly available data for some countries particularly Indonesia (such as balance sheet and income and expenditure statement). As such, the comparison of competitiveness was only on local commercial banks while a comparison of the overall banking sector would better explain the strength and competitiveness of the banking sector of the countries.