CHAPTER 6 - Examining whether the banking sector of Singapore, Thailand and Indonesia has achieved the desired characteristics proposed under FSMP

In line with globalization, BNM had carefully developed some strategies, outlined under FSMP, in preparing the Malaysian banking sector towards a more competitive banking environment. It was considered that a strong and competitive banking sector should possess 5 characteristics that are regarded as most desirable. Guided by these characteristics, the following sections attempt to examine if these characteristics are already present in the banking sector of Singapore, Thailand and Indonesia.

6.1 Singapore

Singapore's banking system is at the forefront in the ASEAN region and also plays the leading role in the regional banking industry. Its well-managed, safe and efficient banking system is certainly a good learning experience for many of its ASEAN counterparts. Table 15 below outlines an assessment on the characteristics of Singapore banking sector against the 5 desired characteristics proposed by FSMP.

Table 15 : Assessment of the Characteristics of Singapore Domestic Banking Sector Benchmarking against the Desired Characteristics proposed under FSMP

Desired Characteristics Proposed by FSMP	Current Position of Singapore Banking Sector
Efficiency	1. MAS had on 17 May 1999 implemented a 5-year liberalization program that allowed greater involvement of foreign players in the domestic banking market besides lifting the foreign ownership restriction of 40% which will promote a more open and competitive

environment, thus improving the efficiency of domestic banks through competition.

2. Qualifying foreign bank (QFB) licences will be issued, which allow for off-site ATMs, co-sharing of point of sale, ATM and online direct debit networks, branch relocation and the establishment of new branches (Patrick Kay, 2002). Such approach will certainly encourage competition in the banking industry hence stimulating and improving efficiency of banks in the industry.

3. Singaporean banks despite being relatively small in Asian terms, with just 1.5% of total assets in Asia and under 2% of total deposits and loans in 2000 are more profitable than many of their peers, generating almost 10% of total profits of Asian banks in 2000 (2001 Asiaweek Financial 500 survey).

4. The local banks in Singapore are unlike those in developing countries, where foreign banks enjoy a large margin of supremacy in terms of technology, processes and capital. There are also no 'flight to quality' issue in Singapore. Singapore local banks are strong and well capitalised with a large customer base, wide distribution channels and competency in electronic banking.

5. There are currently only 3 large Singaporean-owned banking groups (Development Bank of Singapore Ltd (DBS), Oversea-Chinese Banking Corporation Ltd (OCBC) and United Overseas Bank Ltd (UOB)), from 10 domestic retail banks a decade ago. The consolidated and larger group allow these local banks to gain in terms of economies of scale, better management integration, larger asset based in order to be more competitive.

6. Singapore banks had taken great initiative in attracting and developing talents. For example, the establishment of Financial Network for Excellence in Training in enhancing workforce capabilities within the financial sector[26].

7. Figures M and N present profitability ratios for the Singapore domestic banks from 1997 to 2001.

Figure M : Average ROA*(%)	1997	1998	1999	2000	2001
	0.88	0.62	1.17	1.69	1.02

Figure N : Average ROE*(%)	1997	1998	1999	2000	2001
	7.67	5.55	10.36	15.8	10.1

* Statistics include the 5 Singapore domestic banks (DBS, OCBC, UOB, OUB, KTL)
Source : Extracted from Moody's Singapore Banking System Outlook Report, December 2000

[26] Statement by Mr. Thaman Sanmugaratnam, MD of MAS, delivered at the MAS Annual Report 2000/2001 media conference on 12 July 2001.

	Figures M and N above show an increasing profitability of the Singapore banking sector except for 2001 where profits had declined in 2001. Generally, the performance and profitability of Singaporean banks had been impressive and are expected to improve even further.
Effectiveness	1. Singapore had since 1970 provided tax incentives to stimulate the growth of the financial sector. 2. Singapore's banking industry embraced computerisation since 1970s while many other developing countries in South East Asian have only embarked on computerisation much later. 3. Great efforts in the following financial innovations, gradually replacing the conventional price-cutting and legal fees subsidy techniques (Patrick Kay, 2002): • offering interest rate offset features - allowing mortgage customers to offset their mortgage interest with their deposit accounts • waiving the pre-payment penalty • offering a first month waiver on the loan instalment • offering retrenchment insurance
Stability	1. Singapore banks are known for their conservative stance in classifying and granting loans. In fact, Singapore banks routinely over-provided for and wrote off bad and doubtful debts under the close monitoring of MAS. As such, Singapore's banking system had been stable and strong against external shocks. 2. <u>Figure O : Total Risk Weighted Ratio* (Average) (%)</u> <u>1997</u> <u>1998</u> <u>1999</u> <u>2000</u> <u>2001</u> 17.44 18.54 20.42 20.9 18.2 * Statistics include the 5 Singapore Domestic banks (DBS, OCBC, UOB, OUB & KTL) *Source : Extracted from Moody's Singapore Banking System Outlook Report, December 2000* Figure O shows that Singaporean banks' CAR had been improving steadily with a slight decline in 2001 due partly to the unstable world economy. 3. Due to extensive regional expansion, Singapore banks are exposed to greater risks as evident by the increased level of NPLs at their new subsidiaries during the 1997/98 financial crisis.
Robust Financial Institutions	1. MAS is providing a high level of transparency in its regulations, raising disclosure standards and fostering market discipline in the banking industry. Accounting practices that are adopted are consistent with international standards where local banks are required to stop the practice of maintaining hidden reserves but to disclose the market value of their investments. Banks also have to disclose the level of their NPLs as well as past and future provisions.

	2. Singapore's banking disclosure is rated among the best in the world and it follows disclosure benchmarks in the IAS 30 "Disclosure in Financial Statements of Banks and Similar Financial Institutions" issued by the International Accounting Standards Committee in 1990 (Nguyen, 1998). 3. Loan portfolios remain heavily concentrated on the property sector which is very sensitive to external changes.
Prudential Regulations	1. MAS has shifted its emphasis in overseeing the banking sector from regulation to supervision. MAS adopts a risk-focused approach to bank examination to minimise systemic risk rather than safeguard each and every individual institutions. The approach focuses on the institution's management quality and processes, risk management and internal control systems instead of detailed transaction testing (Nguyen, 1998). This is indeed a banking liberalization policy.

6.1.1 Summary of Analysis

Singapore banking sector is regarded as having achieved a satisfactory level of efficiency. The 3 consolidated and large local banking groups in Singapore have resulted in strong asset base hence providing them with cushion from external shocks. In addition, these consolidated groups can achieve cost efficiencies through economies of scale while gaining more pricing power. In expanding market share, Singapore banks had actively participated in consolidation and overseas acquisition. As s result, Singapore's DBS now rank 24th in Asia in asset size, UOB 33rd and OCBC 48th, when comparing the post-acquisition data to 2001 Asiaweek Financial 500 rankings (www.usembassysingapore.org.sg 2002). A report in the Straits Times newspaper noted that if Singapore's three local banks were merged into one, the combined entity would rank as the largest Asian bank ex-Japan and ex-China.

Singapore banking sector's efficiency had also been achieved through foreign competition. Foreign presence in Singapore banking sector is very high with 114 foreign banks and only 3 local banking groups. As supported by MAS which asserted that competition and not protection, was the best way to foster the development of strong and large local banks, such approach had proven to be effective as shown in the improvement in the profitability and efficiency ratios in figures 19, 20 and 21 above. In fact, Singapore banks accounted for almost 10% of banking profits in Asia in 2000[27].

In terms of effectiveness, Singapore banking sector had long computerised its banking system while efforts to promote financial innovation are intensified. While many other Southeast Asian countries are only starting to invest in internet banking, Singapore banks had long been implementing internet banking.

In the context of stability, the overall capital reserves continue to be well above the mandatory 12% capital adequacy ratio (18.5%[28] for UOB; 17.4%[29] for DBS and 18.8%[30] for OCBC). While many other countries in East Asia suffer from the 1997/98 financial crisis, Singapore banks remained sound hence demonstrating their ability to withstand external shocks.

Although regarded as providing high level of transparency and being rated among the best in the world in terms of disclosure, MAS is still generally secretive and reserved in making some information available to the public such as balance sheet

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[27] Singapore's Retail Banking Sector : At a Crossroads, www.usembassysingapore.org.sg, 2002
[28] UOB Annual Report
[29] DBS Annual Report
[30] OCBC Annual Report

and income and expenditure statement of its overall banking system. While data were available for its domestic banks, access to the foreign banks' statistics is limited. This has made analysis and research on its overall banking system very difficult. In fact, many reports and papers by world renowned consulting firms are only based on Singapore domestic banking system and not the overall banking system which include also foreign banks, merchant banks and finance companies.

In conclusion, with the strong ratings and comments from world famous rating and research companies, it is undoubted that Singapore banks have been well-run, financial strong and profitable, hence have generally attained the 5 desired characteristics proposed under FSMP.

6.2 Thailand

Thai banks were affected badly by the financial crisis in 1997. As such, the focus was on reviving the banking sector in order to stabilise the industry against future shocks while boosting the economy as a whole. Hence, strategies to improve the domestic banking sector for globalization were not given the most attention. Table 16 below outlines the current characteristics of Thai banks benchmarking against the 5 desired characteristics.

Table 16 : Assessment of the Characteristics of Thailand's Domestic Banking Sector Benchmarking against the Desired Characteristics proposed under FSMP

Desired Characteristics Proposed by FSMP	Current Position of Thai Banking Sector
Efficiency	1. Thai banks have not been active in enhancing their efficiencies through foreign competition in the banking sector. In fact, Thailand had restricted entry almost completely, such restriction on competition has caused Thai banks to be highly concentrated with the three largest banks accounted for over 40% of financial system assets at end-1998 (BOT Supervision Report 2000). 2. The restrictions on foreign ownership of commercial banks had recently been relaxed by allowing 100% shareholding for foreign investors who assisted in resolving the ailing banking institutions (BOT Supervision Report 2000). However, the intention for such liberalisation was not to promote efficiency but rather to attract new capital. 3. Consolidation exercise is currently undertaken as part of financial restructuring package in strengthening the banking sector. Besides merger, weak banking institutions were also intervened or privatized with an aim to improve cost-efficiencies, credibility and competitiveness in the domestic banking system. In fact, there are still too many local commercial banks in the banking industry. There are currently 13 local[31] commercial banks when a smaller number of merged and big local banking groups would be desirable in terms of efficiency, stronger asset base and competitiveness.

[31] Locally-incorporated commercial banks consist of private banks majority owned by Thais, private banks majority owned by foreigners and stateOowned banks.

	4. Locally-incorporated Thai banks have recorded a lower ROA when compared to branches of foreign banks (BNM Supervision Report 2000). 5. Thai banks currently adopt the "Fit and Proper" criteria in selecting their management personnel. Strict requirements on qualification and clean background are imposed on particularly senior-positions. Great emphasis are also placed on employees' career development, clearly indicating Thai banks' approach towards human resources development. 6. There is an upward trend of non-interest income since 1996, with an increase from 8.1% to 18.1% of total revenue by the end of 2000. Most of the non-interest income comprised of fee-based income from fund transfer, ATM cards, as well as capital gains from the sale of assets (BOT Supervision Report 2000).
Effectiveness	1. The number of ATM cards and machines had been increasing since 1996. ATMs can now render a wide ranger of services, not only withdrawal of cash but also transfer of money and payment of utility bills. 2. Even though still at an early stage, internet banking is highly encouraged as a new delivery channel for banking products. As of end-December 2000, 10 commercial banks (4 locally-incorporated banks and 6 branches of foreign banks) and one finance company provide internet banking services (BOT Supervision Report 2000). 3. Commercial banks had not acquired sufficient know-how, skills, expertise or human capital to exercise prudent asset-liability management and risk control (Kawai & Takayasu, 1999). 4. Thai banks' management of information system had improved when it became the 21st country to meet the specifications of the Special Data Dissemination Standard, established in May 1996 by IMF (Watanagase, BIS Paper No. 4).
Stability	1. The ratio of capital to risk asset of commercial banks averaged 13.2% in the first 11 months of 2001 compared to 12.1% in 2000. The ratio of tier-1 capital to risk assets increased from the average of 8% in 2000 to 8.6% in 2001. Commercial banks generally maintain higher capital adequacy ratio than required following the slower economic growth (Annual Economic Report 2001). 2. NPLs locally incorporated banks are still high reaching a peak in 1999. The situation had since improved with NPLs declining gradually in relation to total credit in 2000 (BOT Supervision Report 2000).
Robust Financial Institutions	1. Thai banks' lending practices were largely collateral based with little attention paid to cash flow or analyses of project feasibility. As a result, the domestic banking sector has excessive lending without

	prudent management of assets and liabilities 2. Inadequate regulatory and supervisory frameworks. Prudential regulations, especially in the area of loan classification and provisioning were inadequate. 3. Thai banks' average operating expenses are similar to those in other East Asian economies and slightly lower than those in many developed countries, except for Japan. However, this does not mean that Thai banks are efficient in managing cost and expenses, this actually reflects inadequate investments in risk management and internal control management system. As a result, cost were low but at the expense of risk management practices (Kawai & Takayasu, 1999). 4. Thai banks are currently promoting the practice of good corporate governance by encouraging greater transparency especially on disclosure of information on NPLs. Sound lending practices are also encouraged by limiting bank' lending to related companies. 5. A 10-year Master plan is currently being drafted to chart the most suitable policies and directions for Thailand's financial sector in order to improve competitiveness in a globalised world
Prudential Regulations	1. Realising the weaknesses in auditing and disclosure practices which had caused underreported lending to related parties as evident from the financial crisis 1997/98, credit underwriting and loan review process had been improved, requiring loan review officers be independent from committee who are responsible for credit risk management, credit extension or audit after the loans have been extended (BOT Supervision Report 2000). 2. BOT had revised and upgraded its supervisory standards to be consistent with international best practices. New policies include guidelines on accruing interest income, asset valuation, loan review, asset classification and provisioning (BOT Supervision Report 2000). 3. Both on-site examination and off-site monitoring are adopted in supervising banking institutions. However, the skills required for these supervisory exercises were generally lacking. 4. BOT has changed the emphasis of its supervision to be more risk-focused and less on verification of transactions (Watanagase, BIS Paper No. 4). The new risk-focused approach will continue to assess banking institutions based on the CAMEL framework but with specific focus on risk management.

6.2.1 Summary of Analysis

Generally, Thai banks have not achieved a satisfactory level of the 5 desired characteristic proposed by FSMP. Thai banks are still concentrating on restructuring exercises in the aftermath of the 1997/98 financial crisis. However, it can be deduced from Table 16 above that Thai banks are starting to focus on improving competitiveness in preparing themselves for globalization.

In terms of profitability, Profitability of the banking sector has improved slightly by recording a smaller loss of only 4.5 billion Baht (BOT Annual Report 2000) in 2000 from a loss of 434.7 billion Baht in 1998 (BOT Annual Report 2000). It is expected that the future trend for ROA of the Thai banking system should show an improvement as provisioning costs should decline, allowing net operating income to increase (BOT Supervision Report 2000).

In terms of effectiveness, Thailand is still lagging in moving towards a full-fledged integrated banking system and financial innovations are also limited with very few introductions of new delivery channels. Good corporate governance has also increasingly becoming a major focus in the Thai banking sector.

In building a robust financial institution, the old approach of supervision and examination which emphasized on the assessment of banking institutions' present condition was replaced by the new approach which looks more at the present and future financial condition as well as risk management system.

6.3 Indonesia

Indonesian banks were among the worst hit by the 1997 Asian financial crisis resulting many banks to run into losses and some were even forced to close down. Despite various measures and effort to safe and improve the situation, the Indonesian banking sector is still very weak and attention was focused on restructuring and reforming the banking sector rather than improving their competitiveness. Table 17 summarizes the current characteristics of Indonesian banking sector in examining whether the 5 desired characteristics proposed under FSMP are present in the Indonesian banking sector.

Table 17 : Assessment of the Characteristics of Indonesian Domestic Banking Sector Benchmarking against the Desired Characteristics proposed under FSMP

Desired Characteristics proposed by FSMP	Current Position of Indonesian Banking Sector
Efficiency	1. There is a severe shortage of high-calibre and experienced staff in the area of supervision as well as other areas in the banking industry. 2. Bank recapitalization program and restructuring of NPLs have completed in 2000. As such banks are expected to be able to recover from the financial crisis and resume their internediary function in lending to the real sector (BI Annual Report 2000). 3. As at the end of 2000, the number of commercial banks declined from 164 to 151 following the merger of nine taken over banks and the merger of two joint venture banks. Similarly, the number of rural banks too had reduced significantly with 96 rural banks shut down, 10 had their licenses revoked and 79 rural banks issued approval in principle for sharia operations. 4. There was an improvement in the overall performance of commercial banks as reflected in growth in total assets, funds, loans, earning assets quality, capital and profitability. 5. Figure P below presents some banking sector indicators from 1998 to 2001.

Figure P : Indonesian Banking Indicators

	1998	1999	2000	2001
	Trillions of rupiah			
Total Assets	895.5	1006.7	1030.5	1099.7
Deposits	625.4	617.6	699.1	797.4
Credits	545.5	277.3	320.4	358.6
NPLs –Net (%)	34.7	7.3	5.8	3.6
Capital	-129.8	-41.2	53.5	62.3
Profit (Loss)	-178.6	-91.7	10.5	13.1
ROA	-19.9%	-9.1%	1.02%	1.2%

Source : BI Annual Report 2000 and 2001

From Figure P, it can be shown that Indonesian banking sector had been running huge losses in 1998 and 1999, following the Asian financial crisis. However, profitability had improved in 2000 and 2001 with an improving ROA though still generally low compared to the banking sector of other countries in the region. Other indicators had also shown improvement since the Asian financial crisis demonstrating the positive results of the various reform measures undertaken by the Indonesian government. Generally, Figure P shows improvement of the Indonesian banking sector in the various aspects and a general indication of efficiency, effectiveness and stability. However, when compared to other countries in the region, the Indonesian banking sector is far less competitive and continuous effort to strengthen the banking sector is of utmost importance in a increasingly globalised banking environment.

6. Although Indonesian banks were historically profitable, a closer examination of performance ratios suggest that returns were in fact average when compared with their counterparts in other countries. ROAs for all banks hovered just above 1% since 1995 (Chou, 1999).

Effectiveness

1. There is a shortage of high-caliber and industry expertise while training and education systems are still lacking.
2. Financial innovation is generally lacking and investment on technology is also very limited as the majority of funds are currently allocated towards restructuring exercises.
3. Only very few banks have started to embark on internet banking when this is already very common in Singapore and even Malaysian banks are already moving towards this direction.
4. Banks' operational revenues continue to rely heavily upon interest income from bonds, due to the dominance of bonds in banks' productive assets.

Stability

1. Although NPLs declined overall to 23.9%, the NPLs remained above the 35% limit at some banks (BI Annual Report 2000), indicating the relative instability of the banking sector.

	2. Bank capital returned to a stronger position at a positive Rp53.5 trillion following the completion of the recapitalization program. Despite stronger capital position, some banks still reported a CAR below 4.0% mostly due to low levels of lending and the consequent inability to cover operating costs. 3. Stress tests are carried out regularly to measure how far the changes of exchange rates and interest rates will influence CAR. This test is based on a standardized methodology from BIS (BI Quarter IV 2000 Banking Report).
Robust Financial Institutions	1. The focus was banking policy remained firmly on the continuation of efforts to accelerate the bank restructuring exercise while complying to the various agreements reached with the IMF, World Bank and Asia Development Bank after the financial crisis. 2. Banking infrastructure was improved through the expansion of rural banks and sharia banking. The development of sharia banks were intensified wherein amendments were made to the banking regulations, the development of monetary instruments and human resources development for sharia banking. 3. Significant expansion took place in sharia banking, with branch networks up from 37 offices in 1999 to 119 offices in 2000. However, growth in sharia banking remains constrained by the lack of trained human resources and low public awareness of sharia banking. 4. The Government had long been allocating subsidized credit to "priority" sectors, which had restricted banks' ability to allocate credit efficiently. Besides, the problem of "connected lending" is also common, thus further increasing the banks' credit risk.
Prudential Regulations	1. In an effort to improve corporate governance, Indonesian banks adopt the "fit and proper" test in the selection of top-position personnel. 2. To strengthen the supervision of rural banks, several measures were adopted to improve the enforcement of laws and regulations through training, seminars and exposure visits for bank examiners (BI Annual report 2000). 3. Bank supervision will no longer focus only on compliance, but will also include risk-based supervision. This new system of supervision is based on 25 Core Principles for Effective Banking Supervision which is internationally standarrdized by the IMF. 4. Although the prudential regulations for banks are generally up to the international standards, however, their implementations are usually delayed. 5. In addition to qualitative assessment of management performance, BI

	adopts on efficiency measurement model, which is a simple cost/income ratio. In fact, more sophisticated quantitative models should be considered in order to reveal both allocative and technical efficiency of the banks (Chou, 1999). 6. The financial accounting standard for banks reporting requirements are only fairly comprehensive and roughly in line with international standards. 7. CAMEL framework is used as a measure of banks' performance but the information is not publicly available.

6.3.1 Summary of Analysis

Indonesia is far from reaching a desired level of efficiency despite Bank Indonesia's continuous effort to enhance the national payment system to ensure that it is efficient, fast, secured and reliable in order to support the effectiveness of monetary policy and the creation of a healthy banking system. This is because focus was placed more heavily on bank restructuring

Overall recovery and efficiency had yet to be achieved as some banks still facing difficulties over compliance with the CAR and NPLs despite the overall improvement in the banking industry. Effectiveness is also generally low because Indonesian banks are still heavily reliant on interest income from bonds when many other countries' banking sector, including Malaysia had directed their focus on non-interest income. Political and uncertainty in Indonesia had made restructuring effort even more difficult causing the progress to slow down.

As may be noted from chapter 4, some key data on Indonesian banks were not available causing comparison to be incomplete. As such, greater public disclosure of banks performance, income and balance sheet will help delegate some of the regulatory responsibilities to the more efficient market as poorly run and inefficient banks will automatically be penalized by the general public.

In conclusion, Indonesian banks are still rather weak and inefficient. Much effort would be needed before they can achieve the 5 desired characteristics proposed under the FSMP.