Chapter 5

Summary and Conclusion

The final chapter presents the conclusion and summary of this research. Then, suggestions for further study are presented. Finally, this chapter ends with valuable implications and recommendations.

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5.1 Summary and Conclusion

Capital ratios i.e. leverage ratios and gross revenue ratios are simple and not costly predictors of banks failure. Though these ratios are short term indicators to predict bank failures within 1 to 2 years, the tenure depends on the tenure of assets deterioration and the rate of capital depletion to absorb these losses.

Risk Weighted Asset ratio is a more sophisticated model but is costly and time consuming. This ratio is able to predict bank failure over a longer horizon. This ratio is not popular as the ratio is to dynamic changes in products that make it obsolete fast. Additionally, banks would have already been alerted by the early warning indicated by the shorter term capital ratios and would not rely on the risk weighted asset ratio as an indicator of Bank failure.

Secondary ratios i.e. return on assets ratios and return on equity measure the volatility of earnings to indicate the efficiency of the returns. Deterioration of these ratios should alert equity holders to investigate the profit margin.

Our findings reveal that the leverage ratio mean for Foreign Conventional Banks in Malaysia is the highest followed by Local Conventional Bank and then by Islamic Banks during the period of study. Foreign Conventional banks capitalization is higher due to lower total asset composition compared to Local Conventional and Islamic Banks owing to the shift on reliance to fee based income instead of the conventional interest based income.

Though Local Conventional and Foreign Conventional Bank standard deviation trend is on the rise in 2009 indicating higher risk to bank failures, these Banks are far from being icons of bank failures in view that the mean and median of the three banking institutions hover around 6% - 8% close to minimum adequacy ratio of 8% which includes tier 1 and tier 2 capital as per Basel II requirement.

Foreign conventional banks recorded highest gross revenue mean with higher corresponding standard deviation trend especially in 2009 indicating riskier revenues compared to local conventional and Islamic banks.

Return on assets ratio for Foreign Conventional Banks' mean declined but standard deviation trend rose marginally but still lower than local conventional banks indicating lower level of risk in Foreign conventional banks.

Foreign conventional banks return on equity ratio also deteriorated with corresponding decline in standard deviation trend displaying lower volatility. Local conventional banks return on equity ratios mean initially declined and rebounded but the standard deviation rose steadily indicating higher levels of risk compared to foreign conventional and Islamic banks in tandem with the global financial crisis.

The comparison between Foreign Conventional Banks, Local conventional Banks and Islamic banks indicate that Islamic Banks are more stable and least impacted by the global financial crisis followed by Local Conventional banks and thereafter Foreign Conventional Banks. This could be attributed by Islamic model that prohibits interest (riba) also prohibits entering into transaction with excessive uncertainty (Gharar) wading away inherent risk.

Islamic banks also refrain from Mortgage Back Security and derivative trading that deemed to be risky investments that lead to the sub prime crisis. However, foreign conventional banks and local conventional banks engage in derivatives closely monitored by Bursa Malaysia Derivatives Clearing Berhad. Thus, Foreign and Local Conventional Banks are not exposure to securitization risky derivative transactions.

In short the banking system in Malaysia is well regulated and monitored with strong monitory and financial development policies. Thus, the banks in Malaysia are still liquid. The effect of the credit crunch arising from the global financial resulting in bank failure is remote.

5.2 Suggestions for Future Research

The research should be extended by using another approach that the Risk Weighted Assets Ratio. Though this ratio is complex, costly and the dynamics are constantly changing, Risk Weighted Asset ratio is a more sophisticated model but is costly and time consuming. This ratio is able to predict bank failure over a longer horizon

Risk weighted Asset ratio also more reflective of risk as more capital needs to be charged for riskier assets. Thus, banks would be discouraged from holding risky assets and can increase the risk weighted ratio without raising capital. The ability of this ratio to distinguish between risky and safe banks is a more effective predictor of bank failure than simple ratios.

Future research should also be conducted to develop Islamic Banking in Malaysia to compete in the international arena. Islamic Banking in Malaysia needs to refurbish its' product offerings to a more innovative spread to increase profitability.

5.3 Implications and Recommendations

To develop Islamic Banking in Malaysia the following propositions needs to be addressed.

Islamic and conventional banking are two different business models. To develop the Islamic banking business in this country, Islamic banking should be perceived as another financing option, an alternative to conventional finance. Thus, the Islamic banking business needs to be operated from a separate formal network from the conventional banks and not leveraging on the conventional bank branches to have a separate entity perception.

Islamic banking products need to be more competitively priced to gain advantage over Conventional bank products.

Islamic Banks have to be more proactive in coming up with more genuine Islamic products instead of just coming up with adaptations of products offered by conventional banks. Sukuk is an example of a truly genuine Islamic product that has succeeded in garnering international interest. This product would be able to link Islamic financial institutions with the international Islamic financial market arena.

The recent global financial crisis has enabled Islamic finance to be strategically position as a stable form of financial intermediation. It is necessary for customer education and awareness programmes to elevate the level of financial literacy of consumers on the distinct nature and inbuilt strengths of Islamic banking.

To increase specific legal provisions such as tax exemption for Islamic financing offerings would steer consumers demand towards Islamic banking.

A talented workforce is the engine to spur innovation and achieve breakthrough inventions. Islamic banks need to continually strive to develop a pool of talents within the Islamic finance industry instead of tapping from Conventional bank talents who may not be able to truly change their hats fast enough.

Islamic banking is not only motivated by religious requirements but is also about transparency, ethics and fairness, as well as promoting entrepreneurship and sharing of risks between financiers and customers. Firstly, there is a crucial need for the Muslim community to support demand for Islamic financial products. Secondly, Non Muslims need to be educated that there is no need to be apprehensive over the name ‘Islam’ if products offered appeal to them. Infact if the word ‘Islam’ may be replaced with ‘Shariah’ to sooth the uneasiness .