"Performance of Islamic Banking Scheme at Foreign Banks: A Malaysian Case Study"

Luqyan Tamanni
EGA 99044

"A Research Paper submitted to the University of Malaya in partial fulfilment of the requirement for the degree of Master of Economics in the Faculty of Economics and Administration"

May 2002
Table of Contents

Abstract .......................................................................................................................... i
List of tables/figures ....................................................................................................... ii
List of abbreviation ....................................................................................................... iii
Acknowledgements ......................................................................................................... iv
Glossary .......................................................................................................................... v

1. Introduction
   1.1 Overview ............................................................................................................... 1
   1.2 About this study ................................................................................................... 3
   1.3 Objective of the study .......................................................................................... 3
   1.4 Literature review ................................................................................................. 3
   1.5 Methodology ....................................................................................................... 5

2. Overview of Islamic Banking in Malaysia
   2.1 Introduction ......................................................................................................... 7
   2.2 Expansion of Islamic banking ............................................................................. 9
   2.3 Introduction of new policies by BNM ................................................................. 10
   2.4 Islamic banking during Asian Crisis 1997-98 .................................................. 13
   2.5 Conclusion ......................................................................................................... 15

3. Overview of the Foreign Banks and their IBS Operations
   3.1 Introduction ......................................................................................................... 16
   3.2 Foreign banks in Malaysia .................................................................................. 17
   3.3 Background of each bank .................................................................................. 18
      3.3.1 HSBC ....................................................................................................... 18
      3.3.2 OCBC ..................................................................................................... 20
      3.3.3 SCBMB .................................................................................................. 22
   3.4 Participation in Islamic banking ........................................................................... 25
      3.4.1 Motive ..................................................................................................... 25
      3.4.2 Products ................................................................................................... 27
         3.4.2.1 Deposits .......................................................................................... 28
         3.4.2.2 Financing ......................................................................................... 28
      3.4.3 Customer’s base ......................................................................................... 30
      3.4.4 Parent’s bank involvement in Islamic banking ........................................... 32
   3.5 Conclusion ......................................................................................................... 33

   4.1 Introduction ......................................................................................................... 35
   4.2 Trend analysis ..................................................................................................... 36
      4.2.1 Deposits growth in Islamic banking ........................................................... 36
      4.2.2 Deposits growth at foreign banks ............................................................... 40
      4.2.3 Financing growth of Islamic banking ......................................................... 47
      4.2.4 Direction of Financing at foreign banks ..................................................... 49
   4.3 Ratio analysis ..................................................................................................... 54
      4.3.1 Return on assets ....................................................................................... 55
   4.4 Conclusion ......................................................................................................... 57

5. Concluding Remarks .............................................................................................. 58

Bibliography
Appendix
Abstract

Using trend and ratio analysis, this study analyses the performance of Islamic banking operations at three foreign banks in Malaysia i.e. HSBC, OCBC and SCBMB. Using the data from 1996-2000, it is possible to track progress and evaluate performances of the Islamic Banking Scheme (IBS) versus its conventional counterpart at these banks. It is also possible to examine the impacts of the Asian Crisis in 1997-98 to the Islamic banking operations, especially at the foreign banks.

This study concludes that, during 1996-2000, Islamic banking operations at foreign banks have been performing considerably well, during and post the crisis. On average, the deposits of the three banks' IBS grew more than 90% annually, although majority of deposits are of short term (one year or lower maturity period). Likewise, financing growth was equally impressive, growing more than 100% on the average. However, the majority of advances and loans made were on the broad property sector, especially products based on Bai' Bithaman Ajil (BBA) and Murabahah. This may put the banks at risk, should this trend continues since their liabilities were mostly of short term, while their assets were mostly long term (more than five years maturity period).

On the other hand, return on Assets (ROA) of the foreign banks' IBS was also considerably higher than that of their conventional counterparts. It shows that the Islamic banking operations have been more profitable than the conventional ones. On average, ROA of the IBS was more than 1.58%, while the conventional banking at large was only 0.80% during 1996-2000.

Finally, it should be noted that the role of Bank Negara Malaysia (BNM) in paving the way for these foreign banks to embrace Islamic banking was commendable. BNM’s policies have been instrumental ever since these foreign banks started their Islamic banking operations in the middle of 1990s.
List of Tables & Graphs

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1</td>
<td>List of products offered by foreign banks</td>
<td>28</td>
</tr>
<tr>
<td>Table 2</td>
<td>Deposit growth in percentage</td>
<td>37</td>
</tr>
<tr>
<td>Table 3</td>
<td>Deposit mobilisation by Islamic banking</td>
<td>39</td>
</tr>
<tr>
<td>Table 4</td>
<td>Deposit growth of Islamic banking at foreign banks</td>
<td>41</td>
</tr>
<tr>
<td>Table 5</td>
<td>SPI deposits at foreign banks</td>
<td>42</td>
</tr>
<tr>
<td>Table 6</td>
<td>Type of deposits</td>
<td>44</td>
</tr>
<tr>
<td>Table 7</td>
<td>Maturity structure of investment deposits</td>
<td>45</td>
</tr>
<tr>
<td>Table 8</td>
<td>Deposits by type of customers</td>
<td>46</td>
</tr>
<tr>
<td>Table 9</td>
<td>Islamic Financing growth</td>
<td>47</td>
</tr>
<tr>
<td>Table 10</td>
<td>Financing extended by Islamic banking</td>
<td>48</td>
</tr>
<tr>
<td>Table 11</td>
<td>Direction of financing by Islamic banking</td>
<td>49</td>
</tr>
<tr>
<td>Table 12</td>
<td>Direction of financing by foreign banks</td>
<td>51</td>
</tr>
<tr>
<td>Table 13</td>
<td>Percentage of financing by concepts</td>
<td>53</td>
</tr>
<tr>
<td>Table 14</td>
<td>Maturity structure of financing</td>
<td>54</td>
</tr>
<tr>
<td>Table 15</td>
<td>Return on Assets</td>
<td>56</td>
</tr>
<tr>
<td>Graph 1</td>
<td>Islamic financing by concepts as at December 2001</td>
<td>30</td>
</tr>
</tbody>
</table>
**List of Abbreviation**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBA</td>
<td>Bai’ Bithaman Ajil</td>
</tr>
<tr>
<td>BIMB</td>
<td>Bank Islam Malaysia Berhad</td>
</tr>
<tr>
<td>BNM</td>
<td>Bank Negara Malaysia</td>
</tr>
<tr>
<td>HSBC</td>
<td>Hongkong-Shanghai Banking Corporation</td>
</tr>
<tr>
<td>IBS</td>
<td>Islamic Banking Scheme</td>
</tr>
<tr>
<td>IFBS</td>
<td>Interest-Free Banking Scheme</td>
</tr>
<tr>
<td>OCBC</td>
<td>Oversea-Chinese Banking Corporation</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Assets</td>
</tr>
<tr>
<td>SCBMB</td>
<td>Standard Chartered Bank Malaysia Berhad</td>
</tr>
<tr>
<td>SPI</td>
<td>Skim Perbankan Islam</td>
</tr>
<tr>
<td>SPTF</td>
<td>Skim Perbankan Tanpa Faedah</td>
</tr>
</tbody>
</table>
Acknowledgements

Bismillāhirrahmānirrahīm

I take this opportunity to express my gratitude to the Faculty of Economics and Administration of Universiti Malaya, for showing me the conundrum and excitement in the dismal-science of economics. It is through interaction with wonderful faculty and colleagues that I learn how to model life into a function; how to simplify complicated matters (and vice versa); and how to unleash a ‘beautiful mind’ inside me.

In particular, I would like to thank my supervisor, Dr. Radiah Abdul Kader, whose unremitting supports have seen me through this journey in Islamic banking. I am also indebted to Prof. Fadzim Othman, Dr. Rohana Jani, Dr. Cassey Lee, Dr. Goh Kim Leng, Dr. Yap Su Fei, Dr. Tan Eu Chye, and certainly my guru Prof. Jomo K. Sundaram. All of them have been wonderful throughout my industrious years in UM.

I am also thankful to the Islamic banking division of the foreign banks, in particular En. Musa Abdul Malek of HSBC, Hj. Mahmud bin Hj. Buntat of OCBC and the officer of SCBMB. Not forgetting, I owe a great favour to the librarians at the University of Malaya’s Main Library, FEA and Za’aba Library and Bank Negara’s Library.

Finally, I would like to thank my companion, my wife, Murniati Mu for her continuous supports and whose sacrifices have been tremendous during my study. And to my two wonderful children, Layyina and Hayyan, I dedicate all these works – so that they may see the beauty of Islamic finance.

Glossary

Bai' Al-Dayn
It is a debt financing concept, for instance in the provision of financial resources required for production, commerce and services by way of sale/purchase of trade documents and papers.

Bai' Bithaman Ajil
The sale of goods on a deferred payments basis. In the case of loans, the borrower asked the bank to buy a product of finance a project for him. The bank will then acquire the said product and it may sell the product at a marked-up price to the customer.

Al-Ijarah (leasing)
An arrangement under which the lessor leases equipment, building or other facilities to a client at an agreed rental.

Al-Ijarah thumma Al-Bai'
Or, hiring followed by sale and purchase. It refers to two contracts undertaken separately and consequentially: Al-Ijarah/hiring or renting and Al-Bai'/Sale & purchase.

Al-Mudharabah
It refers to an agreement made between a party, who provides the capital, and another party (entrepreneur), to enable the latter to carry out business projects. The profit from this venture will be shared between the parties on a basis of pre-determined/agreed ratio (profit sharing basis). In the event of losses, the losses are borne by the provider of the funds.

Al-Murabahah
It refers to the sale of goods at a price that includes a profit margin agreed to by both parties. This price, profit margin and any other costs must be stated clearly at the time of sale agreement made. It is also called cost-plus financing.

Al-Qardhul Hasan
It refers to an interest-free loan given mainly for welfare purposes. The borrower is only required to repay the principal amount borrowed, but he may pay an extra amount as a gift (al-hibah) at his absolute discretion.

Al-Wadiah yad Dhamanah
It refers to deposits that have been deposited with another person for safekeeping. The depository must guarantee repayment of the whole amounts of deposits, or any part thereof, when demanded. The depositors, however, are not entitled to any share of the profits but the depository may provide returns as a gift.

1 Adapted from Money and Banking in Malaysia, BNM 1994.