

CHAPTER I

INTRODUCTION

The evolution of the banking system in Malaysia has been significant. The present banking structure is sound, diversified and sophisticated. The banking system is expected to make considerable progress in view of the growth of the Malaysian economy. The banking industry operates in a highly regulated environment. It has to follow rules and regulations laid down by the Central Bank (Bank Negara Malaysia). These regulations include statutory reserve requirements, liquidity requirements and direction of bank lendings. Of late the Central Bank is continuing its policy to deregulate the banking industry to promote competition and enhance efficiency in the industry without compromising prudential standards.

The years of rapid economic growth, particularly 1990 - 1993, provided a period of opportunities and challenges for the commercial banking industry. It was a period of opportunities as the buoyant economy presented the industry with a strong platform to strengthen its financial health; and a period of challenges as the industry geared itself towards greater competition. As stated in Bank Negara's 1993 annual report, one of the likely challenges which would appear in the near future is greater competition from within the banking system itself.

The higher level of competition is not only faced by the banking industry in Malaysia. It is becoming the most influential factor to the structure and activities of the banking system around the globe. In the United Kingdom for example, increasing competition has pushed British banks into greater customer oriented and competitive behaviour. In other countries, the industry has been transformed from its traditional staid image to that of a vibrant and dynamic environment (Robertson,1989).

As a result of greater competition and changes in market conditions, the true test of a growing bank is its ability to create meaningful new services that are keenly attuned to the ever-changing financial requirements of its customers. Development in the retail banking technology reveals the tactics and strategies that banks, large and small, can use to realign their retail banking organisational structure. It is on how banks must make the transformation from passive, account-holding, transaction-processing in situations to aggressive customer-focussed plus service oriented organisations. The practical core of retail banking is that bank technology must be perfectly pitched to the needs and expectations of the customers. Everything the bank of the 90s does must serve or benefit the customer --- at a profit to the bank.

As in today's swiftly moving environment, bankers can no longer uphold the traditional belief that only corporate and commercial customers bring income to the bank. They must realise that small business and retail customers are also

potentially profitable markets for commercial banks. This is because firstly, both these customers are dependent on commercial banks for their financing needs, and secondly, because meeting these needs will help build the economy which in turn benefits the banks as loans and deposits.

The banking industry is changing dramatically especially in retail. The future size and shape of bank networks present both a puzzle and a challenge as the market and technology are transforming the industry through Automatic Teller Machines (ATM) arrangements, credit cards, telephone and interactive home banking amongst other innovations. Thus tremendous opportunities exist in the retail banking sector for the bankers. Recent development in retail banking gives banker the tools to make the informed decisions and strategic choices which are right for the bank. In this competitive financial services market, the extensive product knowledge and winning competitive strategies are critical keys to success.

1.2 OBJECTIVES OF STUDY

Banking is going through a revolution. In the past, banks provided a product rather than a service. The industry was tightly-knit, and highly regulated. The bank manager was sometimes seen as a petty dictator, summoning customers to his office rather than going out to theirs. Competition has changed all that. Bankers today talk of managing relationships with their clients and being service driven.

Bankers have realised that to keep clients, they need to offer a complete range of services and products in their retail banking structure. Within this context, Bank of America is constantly seeking to extend its capabilities to develop new skills, new talents, and better ways of serving its customers in Malaysia. Significantly, in recent years, Bank of America's efforts have resulted in a number of innovations in banking concepts which even at this very moment are being researched and implemented to provide improved financial services.

There is no serious retail business effort being undertaken by Bank of America Malaysia. Nonetheless, there is an existing deposit base of approximately 2,800 retail customers generating RM576 millions (as of December 31, 1990). There is also a small retail portfolio consisting of a liquidating portfolio of "preferred customers" deposits and loans and a small group of corporate-related individual loans. There is also an existing base of non-interest revenue generated from account service charges, fees and commissions charged on retail transaction services (travellers cheques, remittances, foreign currencies, drafts, etc.) and retail related forex earnings. A breakdown of its 1993 fee and spread revenue by retail products is summarised in Appendix A.

As Bank of America Malaysia does carry on some aspects of retail business, they are well aware that they cannot permit the bank to drift as the bank is faced with new opportunities and competitive challenges. They know that they must plan a deliberate response to the developments of the financial revolution. This

must be carefully researched and thought through. It is with this background of the need to penetrate the retail banking sector that this research was first contemplated. Further analysis and probing reduced any reasonable doubt that the retail banking sector has been, is and will be the main core of the commercial banking's progress.

This study was initiated to assess the feasibility of developing retail banking as a strategy for maintaining and growing the profits derived from Malaysia. Thus, it is the objectives of this study to examine the retail banking services and opportunities available to Bank of America Malaysia and to recommend strategies Bank of America Malaysia may usefully initiate to become adept in providing financial services to meet the changing demands of the marketplace.

In the 1990s, the retail business should receive especially strong consideration for expansion and there are three key reasons for this :

1. *Retail Lending Produces Higher Spreads.* According to David Blackman, Country Manager, Bank of America Malaysia, spreads in wholesale banking have deteriorated in recent years as some large investors have gained easy access to credit bases and have chosen to bypass commercial banks. The rise in commercial paper issuance attests to this. Wholesale banks often provide backup lines of credit for commercial paper; but this is small comfort in the face of intense pressure on spreads across the board as the result of this new type of disintermediation.

2. *Retailing Is Productive In Fee Income.* Fee income arising out of activities that are not asset intensive which are usually associated with wholesale and merchant banking, are also available in retail banking. The retail banker may look forward to servicing fees on consumer loans and mortgages that have been sold, brokerage fees, and other services. Such fee-for-service income will be crucial for a satisfactory return on equity. Moreover, the more services that can be sold through the counter, the less overhead cost that is attached to each function.

3. *Retail Deposits Are More Stable And Less Costly.* Recent financial results, as the case for Bank of America Malaysia, show that the return on assets (ROA) is higher with a high proportion of consumer-type deposits than for those whose funding comes predominantly from the money market. Generally, retail banks to which household and smaller businesses bring their funds, usually have a better ROA than the big money banks which depend on their abilities to buy liquidity in large chunks and note issues.

1.3 METHODOLOGY

Bank of America Malaysia does carry on some aspects of retail business. As they are expanding this highly profitable business, it is better to look at the market, gauge its needs, then formulate a retail programme that fits both the market and the bank. If Bank of America Malaysia is to be comfortable with their expansion, they need to raise several questions :

- Where are we now ?
- Where do we want to go ?
- What are our strengths and weaknesses and the threats to us from competition, customer, and regulations ?
- How do we get to where we want to be ?

These basic questions shall form the analytical framework for this research. The diagram in Figure 1.1 sets forth the core elements of the analytical frame, the influences that impinge on them both inside and outside the bank, and an indication that all of these forces are conditioned by the social and economic parameters of the market environment.

Influences	Core Elements	Influences
Current Market Shape	Retail Banking Products	Competition
Pricing Tiers	Delivery Services	Customer
Growth Potential		Technology

Figure 1.1 Analytical Frame For Research

The basic questions must be asked about each of the core elements, taking into account of internal influences, external threats, and the changing state of the retail business. For the transaction services Bank of America Malaysia provides, what is the share of market the bank holds ? Who are the bank's customers ? Is the bank's transaction technology consistent with the customers' needs ? Who are the competitors ?

Knowledge of these underlying sources of competitive pressure provides the groundwork for a strategic analytical methodology. They highlight the critical strengths and weaknesses of Bank of America Malaysia, in positioning itself in the industry and clarify the areas where industry trends promise to hold the greatest significance as either opportunities or threats.

Apart from preliminary literature review, the study was conducted from May 23, 1994 to June 10, 1994. The research for this study consisted primarily of unstructured personal interviews and briefing sessions with internal bank executives of Bank of America Malaysia, as well as with external contacts including industry experts, competitors, regulatory advisors, finance company manager, etc. The interviews successfully obtained usable data from 15 organisations so as to confirm the potential growth in the retail banking sector and its regulatory constraints. Information collected were types of retail products, market structure and competition, management strategies and priorities, potential economic and business growth, delivery systems, policies and regulatory matters.

We too obtained information and documentation on the banking environment from government institutions such as Bank Negara, the Ministry of Finance, and the Department of Statistics. We also interviewed current Bank of America Malaysia's customers on the type of products and services currently used and the potential demand for future products. A list of institutions interviewed is shown in Appendix B. A more detailed explanation of assumptions and calculations is outlined in Appendix C.

1.4 SCOPE OF STUDY

This research on the retail banking opportunities is to be confined to Bank of America Malaysia Berhad and its retail banking sector, but it is inevitable that the writer has to touch on some other elements of banking as well (in Chapter II) because both are part and parcel of the total banking system in Malaysia. Bank of America Malaysia's full service bank need not mean the presentation of every product in the book. However, "full service" must be able to provide an ample bundle of related financial products at an appropriate level of service for the particular market if it is to capture the customer.

1.5 SIGNIFICANCE OF STUDY

The recommendations put forth in this report are the results of a three week field work analysis, product by product of the potential business opportunities. The

findings will reach well into Bank of America Malaysia's retail banking operations structure for many possible services and products as well as for distribution channels. This is to provide new insights into the opportunities available in the Kuala Lumpur market. It is within this context that Bank of America Malaysia can incorporate the findings in their retail banking strategy and in turn strengthen its retail business structure and reap in higher revenues. These findings can also be used to assess the future trend, the strength of Bank of America Malaysia in comparison with its competitors and to direct the management's effort on key factors in improving the performance of the bank.

In short, a truly contemporary Bank of America is in the making, one that is dynamic in spirit and progressive in outlook. To complement the dynamic spirit that now motivates all operations of Bank of America Malaysia, they have adopted a contemporary look that reflects excellence in services, progressiveness of their people and the innovative spirit of the bank as a whole.

1.6 LIMITATIONS

Initial attempts to obtain literature on retail banking and its developments proved to be a difficult task as there were not many references available in the library of University of Malaya. In view of this, further resort to libraries at Bank Negara, Bankers Institute of Malaysia, and SEACEN Research and Training Centre had benefitted the writer as more references were available at these professional bodies.

Extractions from these literature are rightfully quoted in the text.

It was not an easy task to fix appointments for interviews with the personnel of other banks because most of them were having busy schedules. For this reason, some appointments were rejected. The writer was fortunate to have the assistance of some personnel of Bank of America Malaysia for arranging the interviews. Even then, during the interviews we could not discuss in depth due to time constraint and confidentiality of certain issues and policies.

In spite of the few set-backs encountered during the research project, the writer felt that it was challenging as well as a rewarding experience.

1.7 ORGANISATION

The study consists of five chapters, including this one (Chapter I), which serves as an introduction to the research paper.

The second chapter gives a brief introduction to the banking industry in Malaysia and a review of literature on retail banking.

Chapter three and four deal exclusively on the analysis and findings of the retail banking opportunities available to Bank of America Malaysia in its effort to remain in the mainstream of increasing competitive advantage in its retail banking

business. Chapter three covers the situational analysis permitting Bank of America Malaysia to venture into the retail business while chapter four covers a detailed analysis of selected retail products, services, and delivery vehicles currently existing in the Malaysian market

At the end of the report, we make our recommendations on which retail products and services Bank of America Malaysia should offer and discuss strategies associated with each.