Financial Risk and Performance: Empirical Evidence from OCBC Bank (Malaysia) Berhad

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ABSTRACT

Banks are only one part of a vast financial system of markets and institution that circle the globe. Malaysia have resulted to positive outcomes for the financial system for the recent developments in the banking sector. Today, the financial sector has witnessed a revolution from the traditional role of being an enabler of economic growth to turn out to be a vital source for its own growth and expansion. This paper examines the factors affecting risk and performance in the banking institution and identify key factors influencing risk in bank operation in Malaysia.

Key words: banking institutions, risk, performance, profitability

1.0 INTRODUCTION

BACKGROUND OF THE COMPANY – OCBC BANK MALAYSIA BERHAD

Malaysia have resulted to positive outcomes for the financial system for the recent developments in the banking sector. Now, the financial sector has witnessed a revolution from the traditional role of being an enabler of economic growth to turn out to be a vital source for its own growth and expansion. The banking sector nowadays offers employment for at least 123,000 citizens of the country.

Despite the global financial challenges within the first decade of the 21st century, for eight subsequent years, the Malaysian banking sector has been consistent on a solid financial ground having a risk-weighted capital ratio of at least 13 percent and constant profitability. According to IMF report, domestic banking enterprises are embarking on strengthening their domestic performance and expand their scope of operations beyond the country. Now, there are eight Malaysian banks and 19 foreign bank that have expanded their operations to 10 states within the region.

OCBC Bank is one of the foreign bank in Malaysia and the longest settled Singapore bank, framed in 1932 from the merger of three nearby banks, the most established of which was established in 1912. It is presently the second-biggest money related administrations amass in Southeast Asia by resources and one of the worlds most profoundly evaluated banks, with an Aa1 rating from Moody's. Perceived for its budgetary quality and soundness, OCBC Bank is reliably positioned among the World's Top 50 Safest Banks by Global Finance and has been named Best Managed Bank in Singapore and the Asia Pacific by The Asian Banker.

OCBC Bank offer a broad array of specialist financial and wealth management services, ranging from consumer, corporate, investment, private and exchange banking to treasury, insurance, asset management, stockbroking services and many more.

2.0 LITERATURE REVIEW

The previous study show that conventional banking credit risk are significantly affected by loan exposure to risky sectors, regulatory capital, loan loss provision and risk-weighted assets while management efficiency, risk-weighted assets and size of total assets have significant influence on credit risk of Islamic banking. (Ahmad & Ahmad, 2004)

Moreover, the researcher found that liquidity risk is the internal determinant of bank performance. There are many of liquidity risk include components of liquid assets and dependence on external funding, supervisory and regulatory factors and macroeconomic factors. Besides, the study also find that liquidity risk may lower bank profitability (ROAA and ROAE). (Shen, Chen, Kao, & Yeh, 2009)

Furthermore, with clear comprehend of the risk creation process in equity based financing, it permits management to set up the reasonable and appropriate risk management process, and further energize standard of profit and loss sharing, which is the major concentration of Islamic banks. (Waemustafa & Sukri, 2016)

From the previous study demonstrates that there are different factors which is influence Islamic banks credit risk as prove in ISCON which another variable tried in the review indicates biggest impact estimate on credit risk development in Islamic banks, in this manner future research ought to be founded on Islamic banks one of a kind trademark while deciding variables that to be incorporated into the condition with a specific end goal to decide credit risk for Islamic banks more exhaustive way. (Waemustafa & Sukri, 2015).

Waemustafa and Abdullah, 2015 found that an effective Shariah Supervisory Board Board does not have momentous bearing towards the choice of mode of financing in but their remuneration has. Naturally, this finding may give some knowledge towards the thought of 'restorative reason' for controller, arrangement producer and another specialist on the adequacy and the presence of board in Malaysia particularly while joining Shariah Supervisory Board as a major aspect of the corporate administration component.

3.0 DESCRIPTIVE ANALYSIS

3.1 Risk Assessment

3.1.1 Credit risk

Years	2011	2012	2013	2014	2015
Credit ratio	0.01969	0.01386	0.02004	0.01516	0.01390

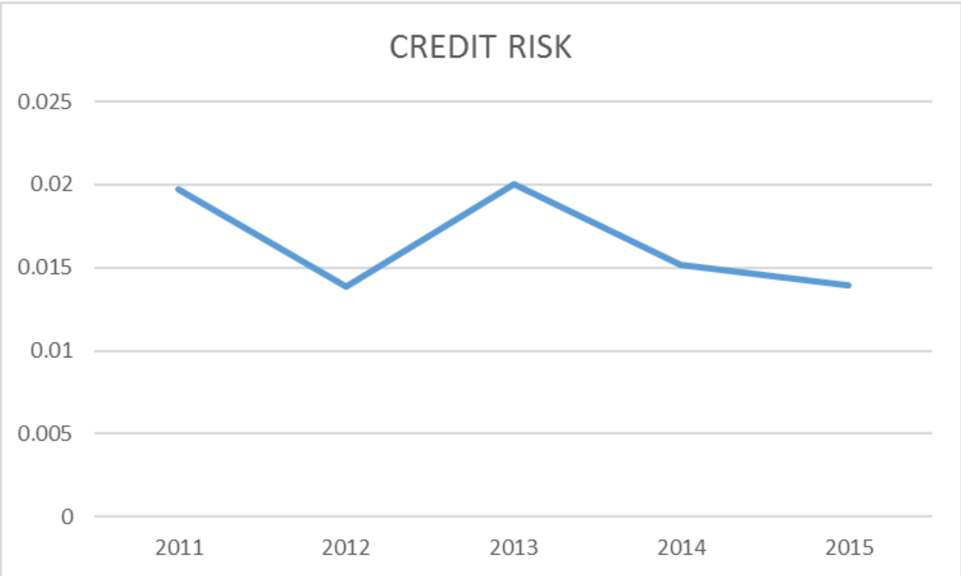

Figure 1: Credit risk ratio

The significance of credit quality ratios is somewhat self-explanatory. If a bank's credit quality is in decrease because of non-performing loans and assets increases, the bank's earnings and capital may at risk. A non-performing loan can be determined when a loan where payments of interest or principal are overdue by 90 days or more, and it is typically presented as a percentage of outstanding loans. Net charge-offs represent the distinction in loans that are written off as unlikely to be recovered (gross charge-offs) and any recoveries in previously written-off loans.

3.1.2 Liquidity Risk

Years	2011	2012	2013	2014	2015
Liquidity ratio	1.08390	1.08158	1.07876	1.07638	1.07364

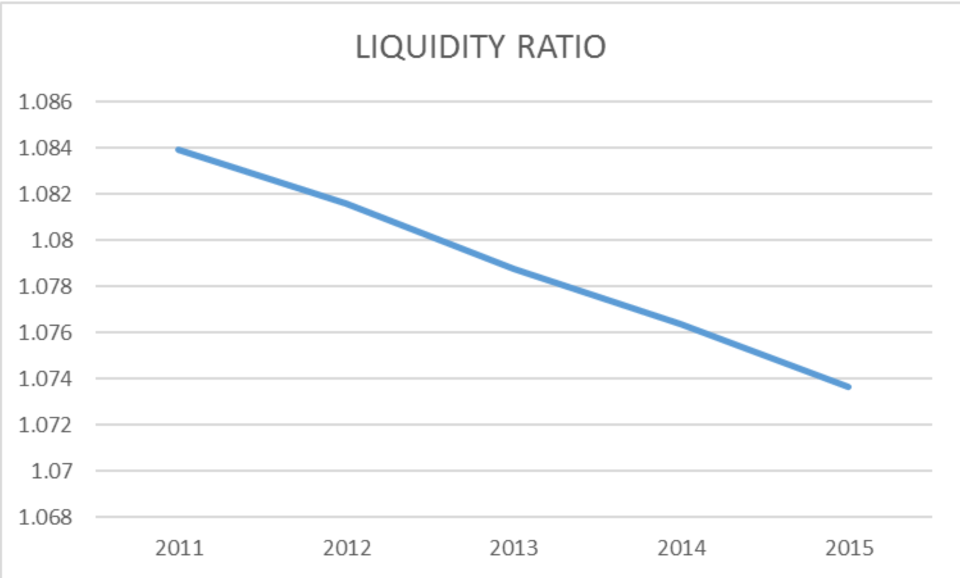

Figure 2: Liquidity risk

Tracking the liquidity ratios helps an investor assess the health of a company. The liquidity ratio for this bank show a decline from year to year. Generally, a low liquidity ratio could suggest problems with inventory management, ineffective or lax standards for collecting receivables, or an excessive cash burn rate. A low liquidity ratio indicates that a company is not able to meet its short-term obligations.

3.1.3 Operational risk

Years	2011	2012	2013	2014	2015
Operational ratio	0.38855	0.42427	0.41974	0.43736	0.44439

Figure 3: Operational risk

Operational risk can be direct or indirect losses incured from inadequate or failed internal processes, people and also systems or from external events (Kuehn & Neu, 2002). The trend shows that the operational risk is increase from year 2011 to 2015. This tells that the bank is inefficient in operation and incurred more expenses.

3.1.4 Financial risk

Years	2011	2012	2013	2014	2015
Financial ratio	11.91774	12.25675	12.69586	13.09215	13.57933

Figure 4: Financial risk

Financial risk ratio can be used to assess a company's capital structure and current risk to evaluate relation of the company's debt level. The financial ratio in this bank show increasing trend by years. This can explain ability of the bank to manage its outstanding debt is not effectively. Debt levels of the bank and debt management also interrelated impact a company's profitability since funds required to service debt reduce net profit margin and cannot be invested in growth.

3.2 COMPANY PERFORMANCE

3.2.1 Return on Assets

Years	2011	2012	2013	2014	2015
ROA	0.01637	0.01407	0.01497	0.01224	0.01214

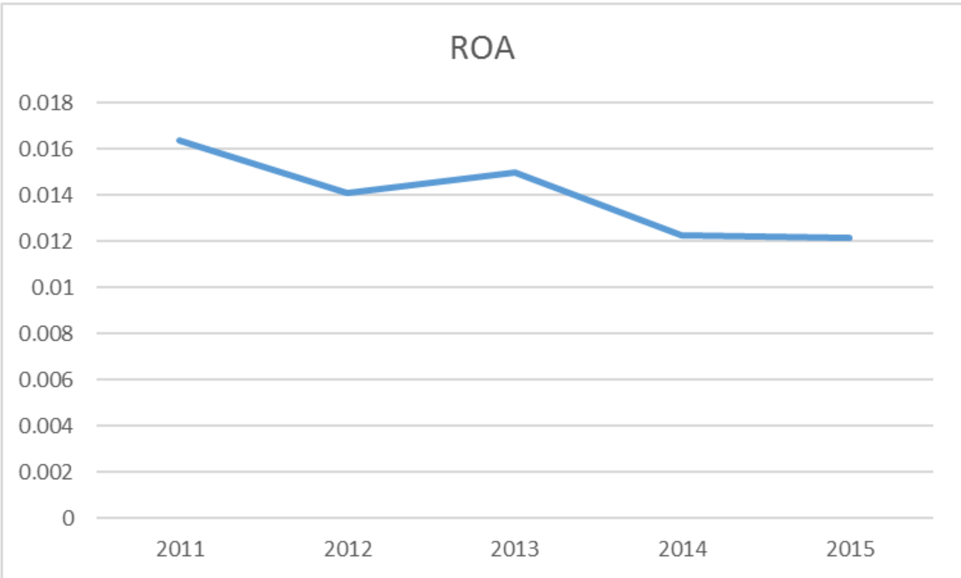

Figure 5: Return of Assets (ROA)

Investor will look Return on Assets ratio (ROA) and gives an idea of how efficient management is at using its assets to generate profit. ROA also can gives investors an idea of how efficiently the bank is converting their cash to invest into net income. The figure show that the bank's ROA ratio is decrease but constant from 2014 to 2015. A low return on assets can be indicates the bank is inefficient use of their assets.

3.2.2 Return on Equity (ROE)

Years	2011	2012	2013	2014	2015
ROE	0.15742	0.14546	0.15433	0.13367	0.13244

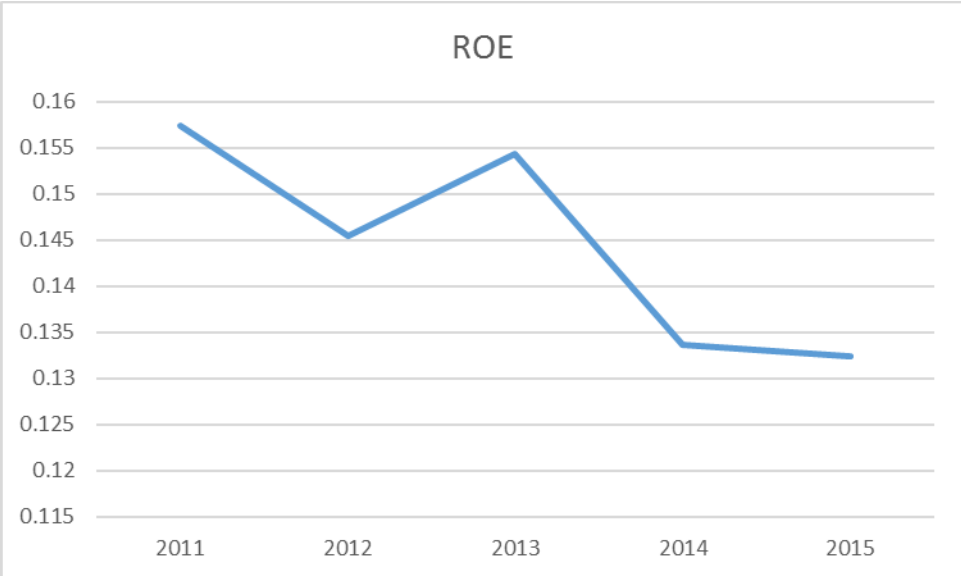

Figure 6: Return on Equity

Investors use the ROE ratio to measure of the amount of a company's income that is returned as shareholder equity from key profitability ratio. From 2011 to 2012, the ratio show decrease but increase back in 2013. After 2013, the ratio decline until end 2015. Overall, ROE in this bank show decrease trend. This show the bank do not manage well their equity. This metric show the investor how adequately an enterprise is at producing benefit from the cash that value financial have put into the business. ROE is figured by dividing net income by aggregate shareholder value.

Table 1: Correlation Matrix OCBC Bank Specific Risk Determinants to Profitability

Pearson correlation	ROA	ROE	GDP	Inflation	Liquidity risk	Leverage	Operating	Credit risk
ROA	1							
ROE	.983**	1						
Sig	0.003							
GDP	-.346	-.425	1					
Sig	.569	.475						
Inflation	.185	.089	.468	1				
Sig	.766	.887	.427					
Liquidity risk	.886*	.838	.054	.182	1			
Sig	.045	.076	.932	.769				
Leverage ratio	-.884*	-.841	-.058	-.173	-0.999**	1		
Sig	.047	.074	.926	.781	.000			
Operating risk	- .959**	- .898*	.137	-.412	-.903*	.894	1	
Sig	.010	.039	.826	.491	.036	.041		
Credit risk	.805	.841	-.459	.383	.506	-.510	-.748	1
Sig	.101	.075	.437	.524	.385	.380	.146	

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Table 2: Coefficient Stepwise Regression analysis for OCBC Bank Specific Risk Determinants to Profitability

Variable	B	t	Sig
ROE	.983	9.338	.003
GDP	.089	.692	.561
Inflation	.099	.904	.461
Liquidity risk	.209	1.135	.374
Leverage	-.193	-.989	.427
Operating ratio	-.393	-4.360	.049
Credit risk	-.075	-.323	.778

Liquid to profitability

When interpreting the Pearson's correlation shown in the table, it says that, there is a positive relationship between liquidity ratio and ROA at .886. In fact, it was found a significant positive relationship between the indicators. This may indicate that from one year to another, liquidity is a consequence of ROA, the bank that could reach positive income results over a certain year could keep a higher liquidity level on the following year (Vieira, 2010). Also, the highly significant and positive correlation between credit ratio, shows that the liquidity ratio is highly dependent of its own previous year ratio. The same can be said about profitability for instant, for the bank of the sample the liquidity and profitability ratio was quite stable through the years. In addition, the changes of liquidity to profitability is not too many different compared to leverage and operating with the t value =1.135. The study from Allozi & Obeidat, 2016 the relationships can be interpreted that the increase in the return on assets is reflected positively on the current assets in general and on the net working capital in particular.

GDP to profitability

Macroeconomic variables, such as GDP growth and inflation do affect the profitability performance. The findings from previous studies who found that GDP growth and inflation do clearly affect the performance of the banking sector. San & Heng, 2013 found that Inflation and GDP growth are profitability determinants for banks in UK. But, for Malaysian commercials banks, GDP growth and inflation are not determinants of profitability in any model measure by ROA and ROE. The researcher believes that banks operating in different macroeconomic environments will be influence by different macroeconomic variables. In addition, the impact of GDP to profitability is low with the t value .692 compared to liquidity.

Table 3: Anova Regression Analysis for OCBC Bank Specific Risk Determinants to Profitability.

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	1	.000	87.200	.003[b]
	Residual	.000	3	.000		
	Total	.000	4			
2	Regression	.000	2	.000	314.789	.003[c]
	Residual	.000	2	.000		
	Total	.000	4			

a. Dependent Variable: ROA
b. Predictors: (Constant), ROE
c. Predictors: (Constant), ROE, Operating Ratio

Table 4: Stepwise Regression Analysis for OCBC Bank Specific Risk Determinants to Profitability.

Model Summary[c]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.983[a]	.967	.956	.000380938057000	
2	.998[b]	.997	.994	.000143960444000	2.237

a. Predictors: (Constant), ROE
b. Predictors: (Constant), ROE, Operating Ratio
c. Dependent Variable: ROA

Operate to profitability

From the table 4 method shows that R value is .983 and shows a high degree of correlation between variables. R square is .956 and indicates that 95.6% of variation in ROA is interpreted by independent variable Operating ratio. Moreover, ANOVA test for all models show that ROE has the highest F-value, 314.789, followed by ROA, 87.200 All models have the significant value of F as 0.000 (0.000 is lesser than 0.05) which indicates that all models are good models to measure banks profitability (San & Heng, 2013). For the relationship between profitability and operate can be measured with p value more than 0.10 that showed negative insignificant relation to profitability in 7 out of 8 measurement tested. This bank is not sufficient to manage their operating income and operating expenses. The bank will difficult to maximize their yearly profit because of the increasing operating expenses that give bad impact to the bank.

4.0 DISCUSSION AND RECOMMENDATION

4.1 Discussion

The performance of OCBC Bank from year 2011 to 2015 show that unfavourable in performance of liquidity and operational by the year. The bank is not effective in term of convert their asset into cash to make a debt settlement. Also, the bank does not efficient in manage their expenses and it will impact the profit and bank performance. ROA is one of the indicator that measure the profitability for this bank and its show the bank profit it unsatisfactory. For the operating ratio also show that the bank is inefficient in operation and incurred more expenses. Many improvements and reforms that need to be done by the bank to achieve their goals and maximize the profitability of banks.

4.2 Recommendation

4.2.1 Improvement in Corporate Governance practice.

Corporate governance will affect the bank performance. Consistent with the prior literature, previous study indicate that good corporate governance generally improves bank financial performance and has positive effects on market valuation (Peni & Vähämaa, 2012). The stability and survival of any monetary area relies on upon the nature of its corporate governance. In spite, a few changes put to reinforce this area, banks were still to prone failure. The loss related with this failure is enormous on their notoriety and mechanical development. Good corporate governance structure that improves consistence and endorse rebelliousness to corporate governance codes becomes imperative. The bad quality in boards was a main reason for deterioration performance of the bank. The growing liability of boards and the increasing complex subjects that directors are adept and well-informed to manage the board's deliberations. There are many key for improvement in corporate governance such as expertise of non-executive board members, manage conflict of interest and supervision and risk oversight procedure and policies.

4.2.2 Improvement in Liquidity

An exact measurement of liquidity therefore requires going beyond the technical liquidity indicated by the stock flow approach to an assessment of the stock of circumstances under which a bank could come under pressure likely to affect worthiness in the market place. Liquidity can be calculated either as a stock at a point in time or as a flow over time. The most widely used is the stock approach. One of the approach is the loan/deposit ratio which is the most famous and commonly used measure in commercial banking (Miko, 2010)**.** Significantly, the success of a bank depends upon the degree of confidence it can in still in the minds of its depositors. If the depositors lose confidence in the ability of their bank to repay depositors, the very existence of the bank will be at stake. So, the bank must be prepared to meet the claims of the depositors by having enough cash. Among the various items on the assets side of the balance sheet, cash on hand represents the most liquid asset followed by cash with other banks and the central bank.

4.2.3 Improvement in Credit risk

A high level of credit risk in bank means more than simply meeting regulatory requirement and the aim is rather to enhance the risk and return of the bank performance in credit assets. To achieve the bank's goal and maximize the profits, it is important to measure how mush a single obligor in a portfolio contribution plays an integral role in risk-sensitive loan prising and portfolio optimization. Moreover, a comprehensive risk analysis based on the 5Cs of credit would include this type of analysis and capture risk from other factors. The bank must look at the conditions would have indicated that the market environment and the state of the economy were in bad conditions. Other element that bank can consider is industry comparisons. Performance ratios are more meaningful when viewed in context of the borrower's industry.

5.0 CONCLUSION

As conclusion, OCBC Bank face many risks such as liquidity risk, operational risk and credit risk. The bank also can manage all the risk and try to mitigate and manage the risk. All the risk is difficult to avoid and the bank must handle wisely to avoid many losses and will impact the profitability of the bank. For the liquidity and operational risk, the bank has problem to settle the obligation and operate efficiently. Every year, the bank try to improve their performance with manage their risk and maintain their profit. The findings suggest several implications. First, considering that credit risk in OCBC Bank remain high and this need attention to risk management in this bank especially in the factors that have significant impact on bank credit risk. Second, corporate governance in the bank also give impact to the performance of the bank. The board should be greater and adequate disclose all the important information when reporting. It will help investors to evaluate and interesting to invest in this bank.

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