The Relationship of RHB Bank Berhad's Profitability with Leverage and Size (Total Asset)

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ABSTRACT

This paper aims to recognize the relationship between profitability and performance of RHB Bank Berhad. RHB bank is one of the local bank in Malaysia and the bank was well known in local country. Therefore, knowing the action taken by the management to increase the profitability and the performance of RHB Bank. The focused of this study is leverage and internal factors that are size by indicate the performance and the profitability measurement of the company, such as ROA, ROE, and etc. Aside from the profitability of the bank, size of the company is also considered to have the relationship with performance. Size and leverage are significant in business due to the direct and indirect relationship to profitability, therefore, this paper is to examine if the management have taken an appropriate decision making to increase their asset that will be reflected to the profitability and growth trend of the company.

Keyword: banks's performance, leverage, Size

1.0 INTRODUCTION

RHB Bank Berhad provides commercial banking and finance related products and services in Malaysia. The company operates through Corporate and Investment Banking, Retail Banking, Business Banking, Treasury and Global Markets, International Business, and Support Centre and Others segments. The Corporate and Investment Banking segment provides funding or lending, and offshore banking services to public listed corporations and its related entities, multinational corporations, financial institutions, and government and state owned entities. This segment also offers investment banking products and services, and stockbroking services. The Retail Banking segment provides credit facilities, including mortgages, non-residential mortgages, hire purchase, purchase of securities, credit cards, and other personal loans and financing, as well as remittances, deposits collection, and investment related products to individual customers. The Business Banking segment offers deposit collection and funding products and services to small and medium sized enterprises, and wholesale clients. The Treasury and Global Markets segment engages in trading in fixed income securities and foreign exchange, derivatives trading and structuring; managing customer-based foreign exchange and money market transactions, and funding and investing in ringgit and foreign currencies. The International Business provides commercial banking related products and services tailored to the specific needs of the customers in Singapore, Thailand, Brunei, Cambodia, and Lao. The Support Centre and Others segment offers nominee, property investment and rental, and other related financial services. RHB Bank Berhad also provides Islamic banking products and services. The company is based in Kuala Lumpur, Malaysia.

Pursuant to the Group Corporate Restructuring Plan, RHB Bank Berhad is now the ultimate holding company of the RHB Banking Group effective 13 June 2016. It has been listed (in place of RHB Capital Berhad, the former ultimate holding company of RHB Banking Group) on the Main Market of Bursa Malaysia Securities Berhad on 28 June 2016. RHB Bank is the country's oldest and first local bank with the incorporation of the Kwong Yik (Selangor) Banking Corporation (Kwong Yik Bank) in July 1913. The Group is involved in commercial banking and finance related business, Islamic banking, investment banking, stock broking, leasing, offshore banking, offshore trust services, property investment, general insurance, unit trust management, asset management and nominee and custodian services. RHB Bank today has over 380 delivery channels including a network of branches and offices located regionally in Malaysia, Singapore, Thailand, Brunei, Cambodia, Laos, Myanmar and Vietnam.

2.0 LITERATURE REVIEW

Determinants of bank profit can be divided between internal external circumstances. Internal determinants of bank profitability can be defined as those factors that are influenced by the bank’s management decisions and policy objectives. Management effects are the results of differences in bank management objectives, policies, decisions, and actions reflected in differences in bank operating results, including profitability. According to Waemustafa and Abdullah (2015) current financing nowadays is still injustice banks have difficulty to achieve their main objective

Pandey (2004) define that the firm size in terms of total assets held by an organization. The size play an important role to determine what kind of relationship the firm needs to increase their profitability and performance. Dittmar (2004) emphasized that the size will interact the profit, for large banks they will be less susceptible to bankruptcy because they have more diversified than small banks. Thus, the lower level of bankruptcy will enable large banks to take more debt. The larger or the greater the banks, the will be a great influence on its own shareholder. The growing influence in economics nowadays indicate banking industry to compete towards other banking industry in order to lead the market, earn profitability and influence others. The larger the size of conventional banks allows them to gain in economics of scale while reducing their transaction costs. This advantage allows conventional banks to generate more profit where there is high return on asset based on Waemustafa and Suriani (2016). According to Doreen (2011), The Economic growth also take place on the growth in the size of existing firm (Kumar, 2011).

According Afza and Hussain [2011, p. 220) recognise that debt is a way to interact with investor interest' and gain trust. If the banks issued debt, it provide a signal to the market that the banks is in a good condition and expecting a positive financial cash flow in the future. The higher the level of debt, the more confident the manager in the future cash flow but there are an impact of under-pricing equity. If to much equity that was being issued instead of debt for financing a new project, investor will not be interested and assume the situation as a bad signal. Bank use a combination of equity and debt to finance investments in assets. The management will makes choices to gain financing influences the capital structure. Modigliani and Miller (1958) find that under a certain situation or circumstances the capital structure will be irrelevant, the total cash flow will be no different going to debt and equity holder, there will be no difference in total value by altering the debt to equity ratio.

Based on the study, leverage are correlated with the industry characteristics. According to Huyghebaert (2006) financial leverage is the use of fixed cost financing and leverage was always a choice item. The study also identify that if leverage is increasing with fixed asset and decrease with growth opportunity and corporate income tax has negative although it give a small effect on the banks financial leverage. There will be no banks or firm required to have a long-term debt and financial leverage are employed to increase the return to the common stock shareholders shares. Nguyen and Neelakantan (2006) found that leverage is positively are related to the firm size and growth and negatively related to tangibility. As a proof Chan and Chen (1991) supported the prediction made, they identify that within the examine industry the smaller the firm they had more leverage, and the large the firm the leverage will be smaller.

Morellec (2001) and Myers and Rajan (1998) state that leverage level will not increase asset liquidity for a reason. Morellec (2011) argues that there are a positive relationship between the leverage and liquidity when assets are bind to a debt contract as a collateral function, it will hinder the managers selling asset without permission. The higher the asset liquidation values and the low liquidation cost manager are more possible manager will sell the assets, and will reduce the values of the asset, where it will give disadvantage to the debt holder.

Return on asset (ROA) are important in the banking industry. By analysing the ROA differences of each banks, we will be able to verify the profitability made by the bank in some way that are related to the liquidity levels. ROA is calculated by dividing the net income of each period over the total assets of the firm. However ROE would not a good comparison because the small and the negative equity level of some firm would generate distorted indicators to profitability. Since net income and total assets can be found in the annual income statement, it will be difficult to make a table for the ratio.

The relationship between size and leverage is very important to increase the banks performance and profitability. Size had been one of the most variable that is commonly used to explain the level of the banks debt. Many research had been made that size is positively related to the debt as a source of financing. The stronger the banks in the market, the more information about size is expected to be available, which reduces the level of information asymmetries in the market, making it possible to obtain financial resources from lenders. Tangible assets can be represented as a real guarantee that can be offers to the creditors. According to Gregory and Tenev (2011) total asset will influence the level of dent, which rise with the increase of warranties that was offered by banks to satisfy it obligation that arise from the contractual debt. Gonenc (2005) have argued that the size of the firm and financial leverage are positively correlated. Large firms may favor equity financing than debt financing due to the relativity of the cost of equity financing owing to asymmetric information which is small for such firms.

Banks may also be enjoying some reputation advantage among prospective investors especially, as a result of their consolidation in the market.

3.0 DESCRIPTIVE FINDING

The data used are collected from RHB bank financial statement from year 2011 to 2015 available from RHB bank website. Pearson correlation are used to measure the relationship between Size and leverage towards the profitability ratio which are calculated in Return on Asset (ROA) and Return on Equity (ROE). Leverage is the amount of debt used to finance a firm's assets. A firm with significantly more debt than equity is considered to be highly leveraged. In additional, leverage is to measure how much is the share or capital that come from debt such as loan. Leverage also one of the banks method to identify their ability and performance. For size it interact with business profit, size of a business was measured using total asset, which fixed asset plus current assets. Size also can affect the performance of the banks performance and also it will affect their financial. If the size of the banks is in a good condition, it will raised the reputation and will interact investor to invest in banks.

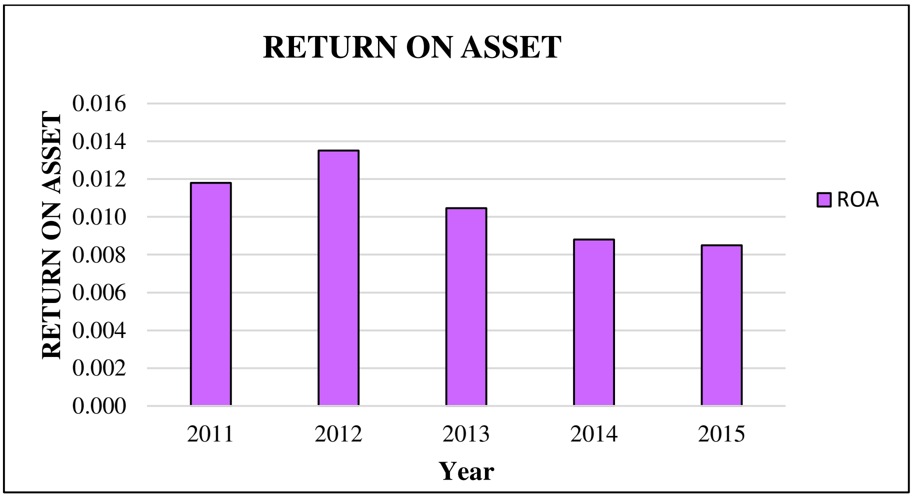
While in profitability ratio, was based on ROA and ROE. ROA will be able to verify the profitability made by the bank in some way that are related to the liquidity levels. In other hands ROE are used to measure how much profit that can be generated in a certain period that the level of capital invested in the bank. The extracted data are as follow:

YEAR	ROA	ROE	Total Assets	Total Liabilities	Equity
2011	0.012	0.015	120507417	96781757	9642596
2012	0.014	0.015	120731463	110921450	9810013
2013	0.010	0.011	145573549	133497383	12076166
2014	0.009	0.010	172134201	158447870	13686331
2015	0.008	0.009	181000966	166154796	14846170

Table 1.1

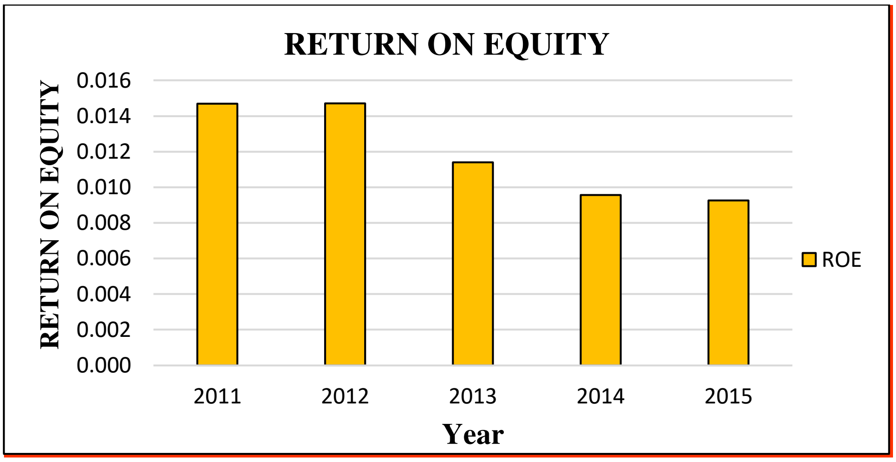
YEAR	ROA	ROE	Size	Leverage
2011	0.012	0.015	120,507,417	10.03689847
2012	0.014	0.015	120,731,463	11.30696259
2013	0.010	0.011	145,573,549	11.05461642
2014	0.009	0.010	172,134,201	11.57708885
2015	0.008	0.009	181,000,966	11.19176165

Table 1.2



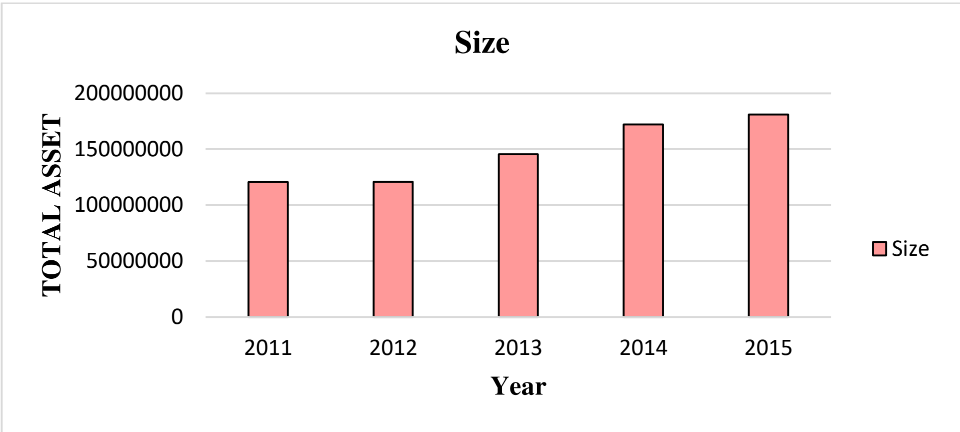
Graph 1.1: Return on Asset

The graph generally shows that the percentage of Return on asset (ROA) for RHB Bank Berhad from year 2011-2015. This trend of the graph is fluctuate year by year. In 2011 the ratio is 0.12 and increasing in 2012 with 0.14 then back in decreasing starting from 2013 until 2015. In 2013 the ratio is 0.10, for 2014 the ratio is 0.09 and in 2015 the ratio keep decreasing with ratio 0.08.



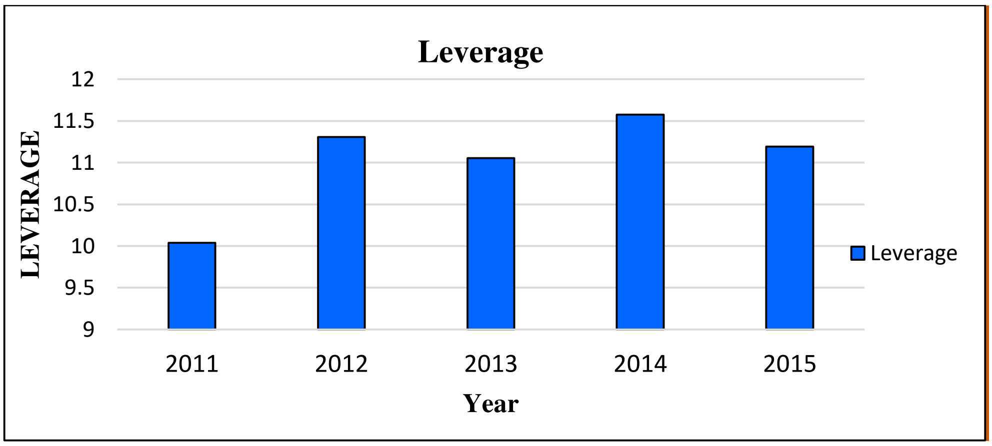
Graph 1.2: Return on Equity

The graph above shows RHB Bank Berhad Return on equity from year 2011- 2015. Based on graph it shows that the Return on equity for RHB Bank is decreasing from year 2011-2015. In 2011 and 2012 the ratio is 0.015 and decreasing in 2013 with 0.011. In 2014 and 2015 the ratio keep decreasing with ratio 0.010 and 0.009.



Graph 1.3: Size

The graph shows the size (total asset) of RHB Bank Berhad from year 2011- 2015. Based on the bar graph trend above, it shows that the size of the RHB Bank keep increasing year by year. In year 2011 the amount of total assets for RHB Bank Berhad is RM120, 507,417.00 then in 2012 RHB Bank increased the size of the asset by RM 120,73,1463.00. In 2013 and 2014 RHB bank increase the size of it asset and increased the total asset amount drastically and the amount is RM145, 573,549.00 and RM172, 134,201.00. In the 2015 the amount of the asset purchased by the RHB bank is RM181, 000,966.00



Graph 1.4: Leverage

The bar chart above shows the leverage risk ratio from year 2011-2015. In the 2011 ratio it shows the lowest ratio among the other year which is10.03 then increased in with readings of 11.30. Then in 2013 the leverage ratio decreased to 11.05 and increased gain in 2014 which is 11.57. IN 2015 again the leverage ratio decrease from previous year and the amount of the ratio become 11.19. This clearly shows that RHB bank is not in a good performance because we know that leverage was measured to indicate how the company managed their business to cover their liabilities with capacity asset that they have. So RHB Bank Berhad prove that they are lack in financial strength where they couldn't manage to control their debt that if fluctuate from year to year

Relationship of Size and leverage ratio to profitability

From the variable above, the Pearson correlation between the profitability, size and the leverage using current ration can be computed using IBM SPSS data system.

Regression also used to show the relationship of one independent variable to one or more variable dependent or responding variable. The dependent variable is (Y) is ROA while independent variable (X1, X2) are size and leverage with confident 95% confident level.

Correlations

		ROA	Size (total Asset)	Leverage
Pearson Correlation	ROA	1.000	-.951	-.346
	Size (total Asset)	-.951	1.000	.576
	Leverage	-.346	.576	1.000
Sig. (1-tailed)	ROA	.	.006	.284
	Size (total Asset)	.006	.	.155
	Leverage	.284	.155	.
N	ROA	5	5	5
	Size (total Asset)	5	5	5
	Leverage	5	5	5

Table 1.3

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.983[a]	.965	.931	.000552741048493	2.194

Table 1.4

Size (Total Assets). From the regression result of ROA to Size, where p>0.005, ROA is likely not giving any significant impact on the size. The end result of Pearson correlation shows generally significant correlation with all of the variable, where size and all profitability measure (leverage) show highly negative correlation except for ROA which shows weak negative correlation to size. Negative correlation coefficients implement that the return of the company is likely become higher when the liquidity is lower and vice versa. It is possible that the credit risk activity of RHB Bank Berhad may boost the performance and effectiveness of the company that is to increase their profitability and performance.

The relationship between ROA and size of the company, is measured using Pearson correlation coefficient, with the result of -0,951. The strong negative relationship between ROA and Size means the size of the company increasing while the liquidation rate is high. It can possibly explain that the more asset purchased by the company it contribute mainly by increasing in ROA. The more fixed asset and current asset purchased by the company the more stable the financial position to increase their profitability and their performance.

Leverage Ratio. From the regression result of ROA to leverage, where $p>0.005$, ROA is likely not giving any significant impact on the size.

The result of leverage ratio shows that ROA and leverage based on Pearson correlation coefficient result it shows that the relationship between ROA and leverage shows significant negative correlation. Increase in leverage it may cause a lot of debt that may be faced by the company. In order for the company to identify the amount of leverage in the company, RHB bank Berhad have to calculate total liability divided by the total equity in order for the company to identify the leverage that the company retain, and how much capital that they have to prepare in order to pay leverage.

The relationship between the company ROA and leverage, are measured using Pearson correlation coefficient, with result of -0.346. The stronger the negative relationship between ROA and leverage means the company are free from debt and gain more capital. Based on this result it shows that RHB Bank Berhad in increasing their company profitability and performance.

4.0 DISCUSSION

Overall from the data Findings from years 2011-2015 RHB bank Berhad has showed that size and leverage play an important role in the company performance and profitability. Size and leverage gave the company a strong impact to Return on Asset (ROA) since the P value is 0.001. In data findings it shows that the relationship between the ROA and leverage is in a negative relationship, if leverage is higher than profit of the bank is decrease and vice versa. The study shows that until 2015 RHB Bank Berhad is in a good financial position to achieve their profitability. According to Waemustafa and Abdullah (2015) shows banking system nowadays still cannot be expected to be completely free from injustice on the interest base system, due to this it may be difficult for banks to achieve its objective.

On the data finding earlier, RHB bank berhad have shown that leverage gave a strong impact to their financial profitability and performance. When leverage is decreasing the profitability using ROA is increasing Vice versa. Leverage is calculated as a debt, but without leverage RHB banks don't have any sufficient amount to invest in several industry as the deposited money from depositor is under liability that we calculated in leverage.

Furthermore, to increase the size of the RHB bank berhad asset and at the same time to achieve the objective of the company the RHB Bank managements should play an important role. In order to achieve the objective, accounting department and auditor department should play an important role, where both of the management department should be wise in decision making related to the company total assets. If the management make a wrong decision it may affect the performance and at the same time it will affect the profitability of the company.

5.0 CONCLUSION

In conclusion Bank industry is unique industry which contain stricter regulation structure. As the purpose of this study is to identify the internal and the external factors that affect the profitability and performance of the RHB Bank Berhad. After the data findings using SPSS system, it shows that leverage have a negative relationship with the Return on Asset. The relationship is obviously shows that id leverage is increasing, the level of ROA will be decreasing and vice versa. Size also may give an impact to the profitability and performance of the RHB Banks, Size still closely related to the ROA since it may affect the profitability of the company.

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