The Relationship Between Hong Leong Bank’s Performance with Leverage and Inflation

Rosli, Aini Rafiqah

Universiti Utara Malaysia

30 March 2017

Online at https://mpra.ub.uni-muenchen.de/78500/
MPRA Paper No. 78500, posted 17 Apr 2017 09:58 UTC
The Relationship Between Hong Leong Bank’s Performance with Leverage and Inflation

Aini Rafiqah Rosli
Universiti Utara Malaysia

ABSTRACT

This paper are for recognize the relationship between risk and performance of Hong Leong Bank. Hong Leong Bank is one of the bank that have a good reputation in banking industry at Malaysia. Thus, it is important to shareholder knows the type of risk that faced by management of bank. The focused risk is leverage and external factor that are inflation by using profitability as the bank’s indicator which is by using ROA and current ratio. Aside that, the external factor such as inflation also give an impact to the performance of bank. The leverage and inflation are significant in business due to the direct and indirect relationship to the profitability. Therefore, this paper further examines if management have taken a serious step in maintaining the risk that will give any reflect to the profitability.

Keyword: bank’s performance, leverage, inflation.
1.0 INTRODUCTION

1.1 Background of Bank

They started the business on 1905 at Kuching, Sarawak with previous company’s name that known as Kwong Lee Mortgage and Remittance Company. The founder of the company is Liaw Yu Rui. Later in 1934 after world war, the company’s name change to Kwong Lee Bank and set as public listed company and open a few branch in Sarawak. In late 1977, Yang Amat Mulia Tunku Osman Ibni Tunku Temenggong Ahmad, a member of the royal family from the State of Johor, came in as a shareholder of the bank and at this period, the bank make an expansion by opening a new branch in Peninsular Malaysia such as at Kuala Lumpur in May 1978 and also at Johor Bahru. At 1982, Kwong Lee Bank Berhad was taken over by the MUI Group which is a corporate group that controlled by Malaysian business tycoon, Tan Sri Dato Khoo Kay Peng. In February 1983, Kwong Lee Bank was renamed to Malayan United Bank Berhad. On 3rd January 1994, the Hong Leong Group Malaysia acquired MUI Bank Berhad through Hong Leong Credit Berhad and renamed as Hong Leong Bank Berhad. The biggest success is when the Hong Leong Bank merge with Aeon Bank in 2011. Because of the merge, it is turn the bank into a banking group that owns more than RM45 billions assets and has expanded by open a new branches at worldwide. The following success is in 2008, Hong Leong Bank became a first Malaysian bank that enter to Chinese banking sector by held 20% shareholding in Bank of Chengdu Co. Ltd. As at the same year, Hong Leong Bank became the first and only Malaysia and Southeast Asian Bank that have given a license to incorporate and operate 100% wholly-owned commercial bank in Vietnam. The Bank has also established a representative office in Nanjing in February 2014.
1.2 Background of Study

As bank is one of financial sector. It is can’t to be estimated. It is also crucial than other sector. The profitability in Hong Leong Bank are based on their net income after tax in every year that take from their official financial statement and we divide with their total asset in order to know how they make the income from their asset such as loan, investment and etc.

On the other hand we also measure the bank’s ROE in order to know whether the shareholders in Hong Leong Bank will get a good returns or not from the net income in a year that Hong Leong bank did. It also as to know whether the bank is efficient by doing make a profit without used so much of capital. In general profitability is from net income after tax that used for calculate the ROA and ROE (Rose, 1999).

While for leverage in Hong Leong Bank as to know their debt level by analysis their total liabilities. As if their leverage in high level it may make the shareholder worried as the bank may not have sufficient liquidity to finance their debt. The shareholder are more prefer low leverage that means the Hong Leong Bank can prevent the business declined or not.

Inflation is external factor that may affect the performance of Hong Leong Bank. Based on Kosmidou, Tanna and Pasiouras (2005) they have provided much research that external factor contributed towards earning of bank. There need to identify the risk before we go further process to get the result (Muljawan, 2005).

2.0 LITERATURE REVIEW

Based on Almajali (2012) there are so much factor that may affect financial condition such as leverage, credit risk, operating efficiency ratio and etc. As the research is in order to see the relationship of leverage with the profitability, as stated by Nelson and Daniel (1991) the leverage will give an impact to the profitability of bank. To make it strong based on Ujah
and Brusa (2013) Leverage will become one of factor that shows the level degree it will affect the financial statement.

Leverage is a funds from the depositors who deposit their money that the management of bank will take to roll up the business (Qureshi, 2012). Leverage is indicate how much the asset have been financed by debt (Mwangi, 2014). If the leverage is high, it is means the bank have depend more on debt (Kale, 2014).

Leverage is important to the parties in the bank as based on Harris and Raviv (1991) the shareholders and the creditors which is mainly customer to the bank take a leverage as a serious matter as for shareholder, they have carried a higher risk to the business as they have a residual claim to the asset of the bank and be rewarded with dividend based on whether the bank make high profit or not. While for the customers, they rewarded with the interest payment together with their principal which is amount they have deposited. Almost the previous researchers as Khalid (2014), Fosu (2013) and Almajali (2012) also come with result the leverage give a positive relationship.

By Chioma, Eyisi and Ebue (2015) said the inflation have four ways in giving an impact that can give a change in profitability whereby the first ways is the cost of fund to finance the business may change, second is the increasing cost of raw material, labour and also the product, third is the amount tax that need to pay and lastly is demand level.

While the inflation based on research Waemustafa and Sukri (2015) said the inflation have given the negative relationship to the credit risk. Even the Saksonova and Solovjova (2011) came out with result the inflation is negative relationship to the profitability. As from previous study, the conclusion is GDP is give a strong impact to the ROA and ROE but not the inflation (Zeitun, 2012). As from the linear regression, it is tell the inflation also give negative relationship to the ROA of banks in Philippine (Sufian and Chong, 2008). By Vong and Chan
the result from linear model shows the inflation, GDP and real interest rate are not giving any impact to the ROA OF FIVE LARGER BANK IN Macao.

While from Ghazali (2008) the GDP and inflation give a positive relationship towards the revenue of the bank after make a research from 60 Islamic banks in 18 countries with 6 years data from each Islamic bank. In addition, by Aburime (2008) tell inflation and real interest rate is give an impact and positive relationship to the profitability of banks in Nigeria.

3.0 DESCRIPTIVE ANALYSIS

3.1 Relationship between profitability, leverage and inflation (excel)

The data used are collected from Hong Leong Bank’s financial statement in their annual report from the year 2011-2015 at their own website. Pearson correlation is used to measure the relationship between leverage ratio and inflation toward profitability ratio which is calculated in Return on Asset (ROA) and Return on Equity (ROE). Leverage is based on a mixture of shareholders equity with the debt in order to finance their business. In addition, is to measure that how much the shares or capital comes in form of debt such as loan. It is also one of the method to know the ability of the bank to meet their obligation. For inflation it is from external factor. Inflation can affect the performance of bank and also their financial. When the percent of inflation is higher, the depositors will deposit more money to the bank than make a loan and it will increase the total asset of bank.

While in profitability ratio, it is based on ROA and ROE. The ROA is how the bank’s management wants to generate income from their total asset. In the other hand, ROE is to measure how much of a profit can generate in the certain period that given the level of capital invested in the bank. The data of profitability ratio such as ROA and ROE, leverage ratio and inflation as follow:
<table>
<thead>
<tr>
<th>Year</th>
<th>Net Profit After Tax</th>
<th>Total Asset</th>
<th>Total Liability</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>807493</td>
<td>87650089</td>
<td>81082963</td>
<td>6567126</td>
</tr>
<tr>
<td>2012</td>
<td>1247280</td>
<td>140284562</td>
<td>130186051</td>
<td>10098511</td>
</tr>
<tr>
<td>2013</td>
<td>1450454</td>
<td>145500383</td>
<td>134159966</td>
<td>11340417</td>
</tr>
<tr>
<td>2014</td>
<td>1590939</td>
<td>148821876</td>
<td>136491378</td>
<td>12330498</td>
</tr>
<tr>
<td>2015</td>
<td>1775963</td>
<td>160680587</td>
<td>147252423</td>
<td>13428164</td>
</tr>
</tbody>
</table>

Table 1.1 : Net profit after tax, TA, TL and equity

<table>
<thead>
<tr>
<th>Year</th>
<th>ROA</th>
<th>ROE</th>
<th>Leverage</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>0.009213</td>
<td>0.122959</td>
<td>12.3467957</td>
<td>3.2</td>
</tr>
<tr>
<td>2012</td>
<td>0.008891</td>
<td>0.1235113</td>
<td>12.8916086</td>
<td>1.7</td>
</tr>
<tr>
<td>2013</td>
<td>0.009969</td>
<td>0.1279013</td>
<td>11.8302498</td>
<td>2.1</td>
</tr>
<tr>
<td>2014</td>
<td>0.01069</td>
<td>0.1290247</td>
<td>11.0694133</td>
<td>3.1</td>
</tr>
<tr>
<td>2015</td>
<td>0.011053</td>
<td>0.1322566</td>
<td>10.9659387</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Table 1.2 : ROA, ROE, leverage and inflation

As to calculate the ROA, the net income of bank divide with total asset of bank. For the better view, it can see from the graph below:

![Graph 1.1 : ROA](image)

From the graph, it is shows 5 years of ROA of Hong Leong Bank. As we can see, only at year 2012 the ROA are slightly decrease from 0.00921 to 0.00889. It is because the inflation
is 1.7 in 2012 that as a strong factor that customers make a loan with the bank due the total loan in that year is increasing to RM 75,997,167 from RM 38,548,822 because of the low interest rate. However, bank have faced increasing impaired loan in year 2012 and have been calculated under credit risk that will put in appendix. Furthermore in 2012, the bank are add another asset which is goodwill that may not will bring any profit to the bank but consider as asset that may called over capacity even the profit are increasing. In the next 3 years the ROA are increasing even only in small percentage. This is because 3 years from 2011-2014 the average total asset is RM 144,868,940 before jump to RM 160,680,587 in 2015 due to at that year, bank have active make an investment and buying a new fixed asset even their profit not increasing too much.

From the ROE, we can see the trend line is increasing every year and in 2012 and 2015 the ROE is increase rapidly. This trend is important to shareholders because it is shows the Hong Leong Bank is effective in using their money to generate more income that may come back to us as their return. Even there have decreasing in ROA but the ROE is increasing this is because of debt or leverage.
The graph shows leverage ratio for 5 years and from the graph we can see at 2012 the leverage ratio are increasing 0.5448 from the last year. It is tell the bank have received a higher deposit amount that may the bank decided to finance their asset by using debt. As the bank decided to do that because the equity make a little increase RM 1,279,909 from RM 1,580,107 while the amount of deposits is RM 108,939,695 from RM 65,924,094. But it may be confusing a bit because when the leverage ratio is higher means the bank needs to sell some asset to finance their business and make a less profit but it may also tell the bank have enough capital reserve in order to survive financial crisis.

In the other hand, inflation are playing an important role to the Hong Leong Bank as said by Bashir (2003) when the inflation rate are low it is means the rate is favourable that bank can attract the potential customers to make a loan as loan is one of asset and main business of bank.

3.2 Relationship between profitability, leverage and inflation (SPSS)

The dependent that used in SPSS is ROA while for independent is Leverage and inflation. As the method that used in SPSS is ENTER method.
<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Assessment</th>
<th>Relationship with profitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on asset (ROA)</td>
<td>Net income / total asset</td>
<td>-</td>
</tr>
<tr>
<td>Leverage ratio</td>
<td>Total liability / total equity</td>
<td>Positive</td>
</tr>
<tr>
<td>Inflation</td>
<td>Annual % change in consumer</td>
<td>Either Positive or negative</td>
</tr>
</tbody>
</table>

Table 1.3 : Dependent and independent variable

From the variable above, the Pearson correlation between the profitability, leverage and inflation and also correlation table shows as follow:

From the correlation table, it is shows the relationship between ROA with leverage and inflation where $P > 0.05$, Leverage is give a significant impact to bank’s ROA. But at the end result is shows relationship of ROA and leverage is -0.989 where it is based on Sarah & Muhammad (2013) it is highly negative when the value is bigger than 0.70. As the leverage and ROA are giving the negative relationship, this can tell when the Leverage are higher, the profit of bank can be higher and it is vice versa. This situation may be happened when there are so much customer are deposits their money, bank can used that money to invest and gain more profit. In addition, bank can provide a more loan to the potential customers.

For the inflation, it is not significant to the ROA but in a several small factor it may affect the profitability of bank. This may affect in part of deposit and also loan. As the inflation
rate is increasing, the amount of deposit also increasing based on financial statement of bank. It is also affect the remuneration of executive director. For the Pearson correlation, it is also shows the negative relationship to the ROA. Based on Perry (1992) it is tell the inflation can be positive or negative impact to the profitability whether it is anticipated or unanticipated to it. In addition, inflation can give a positive relationship when the country is categorized as well develop in term of their financial statement while will be negative relationship to the developing country (Alexious and Sofoklis, 2009).

<table>
<thead>
<tr>
<th>Model Summaryb</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
</tr>
<tr>
<td>1</td>
</tr>
</tbody>
</table>

Table 1.5 : Table of Model Summary

From the table above, we can say that leverage and inflation a strong independent variable to the profitability as R² is 0.999 it tells that leverage and inflation are 99.9% tell about the relationship with profitability.

**4.0 DISCUSSION AND RECOMMENDATION**

Hong Leong Bank showed a good and stable growth in 5 years from 2011- 2015 by make the profitability as the dependent. As we can see the leverage and inflation can affect the performance of Hong Leong Bank. From the finding earlier, leverage have shown a strong impact to the financial performance of the bank. As when the leverage are increasing the profitability by using the ROA is decrease and vice versa. As 3 years starting 2013 the leverage have been downward, the ROA is increasing even not in rapid condition. As stated by Waemustafa and Sukri (2016) when we have a clear result of how their financial condition, then the Hong Leong Bank will come with a more idea and suitable steps in order to encourage
make more profit and keep the leverage ratio in a safe line that not only make the business still in the sector but also to make the shareholder more convinced towards the bank. In addition by Barclay (1995) have shown a leverage give an impact to the profitability and have a significant correlation relationship between leverage and profitability.

In the other hand, inflation have played a good role to the financial statement of bank. Even based on SPSS, it is give negative relationship but still it is give an impact from deposits and loan side. But to make the business better, the bank can give a good interest rate rather by following inflation rate to the customers that wants to make a loan. To undergo with all the risk that may come in the future, bank must have a good corporate governance such as audit committee, risk management committee to analyse and go through all the process in order to keep the bank in a good condition. As the people in corporate governance must have a good experience to handle the problem and always keep updating themselves by go to seminar or talk to gain more knowledge in handling and predict the risk. As based on Waemustafa and Abdullah (2015) bank need a good corporate governance such as fairness, honesty, transparency and etc. in order to publish their financial statement so that can be reliable to others if they want to use for doing the analysis.

5.0 CONCLUSION

As the purpose of this study is to identify whether internal or external variables that will affect the profitability of Hong Leong Bank. After get the result from SPSS, it is show the leverage have a positive relationship with profitability. We can describe the leverage are affect the profitability of Hong Leong Bank. The relationship is significant and obvious where when the leverage is higher, the ROA will be decrease and also vice versa. While the inflation do not significant to the profitability but it is still consider to have a relationship with ROA since it is affect a certain part in financial statement
REFERENCES


