Determinants of Commercial Banks' Profitability in Malaysia

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Abstract

This study aims to examine the relationship between non-performing loans (NPLs) and commercial banks' performance in Malaysia, alongside other factors. It considers the effect of NPLs, cost efficiency and bank size on commercial banks' profitability by using panel data regression (Pooled OLS model), covering the period of 2010-2015. The findings of the study show that NPLs and cost efficiency have a significant negative relationship with commercial banks' performances in Malaysia. On the other hand, bank size is found to have a significant positive relation with commercial banks' performances in Malaysia. Several policy and strategic implications are outlined: the continuing need to manage credit risk, reduction of non-core lending activities, improvement of systems transparency, cost control, and more lenient competition and anti-trust policies.

Keywords: profitability, non-performing loans, banks

JEL Codes: C23, G21, G28

Introduction

Over the past two decades, following the Asian Crisis of 1997-98, the Malaysian banking sector has been subject to multidirectional and conflicting developments. On one hand, deregulation, greater competitive pressures from overseas players, disintermediation, and the shift by consumers towards high yielding deposits have posed challenges to Malaysian banks and undermined their profitability. On the other hand, solid economic growth, the strengthening of the middle class, and the rise of consumer culture have had positive effects on profits. Technological and financial innovation have reduced profit margins, but improvements in operational efficiency have had a positive impact on profits (Guru, 2002).

Most recently, Malaysia's banking sector has remained strong and resilient through the ever-changing economic environment: despite a weak energy sector, subdued aggregate demand, certain quality deterioration from the overseas and commodity-related and real estate portfolios, capital and liquidity continue to cushion the negative influences. Combined with tough prudential regulations, this has resulted in a low level of impaired loans (Sufian, 2009; Standard and Poors, 2017). Despite this, it is acknowledged that adverse changes in the international financial markets, increased volatility in Malaysian currency, and other 'black swan' events may reverse favourable trends and lead to the accumulation of non-performing loans (NPLs).

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