



THE RELATIONSHIP BETWEEN LEVERAGE AND PROFITABILITY OF  
COMMERCIAL BANKS

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## **CHAPTER 1: INTRODUCTION**

### **1.0 Introduction**

In this chapter, it discusses about the background of the study, the problem statement that related to the study, the objectives of this research, the important of this study as well as the scope and limitations in conducting this study.

### **1.1 Research Background**

A leverage ratio is any one of several financial measurements that look at how much capital comes in the form of debt or assesses the ability of a company to meet its financial obligations. The leverage ratio is important given that companies rely on a mixture of equity and debt to finance their operations and knowing the amount of debt held by a company is useful in evaluating whether it can pay its debts off as they come due. The banking literature has separately looked at the impact of leverage on various measures of profitability and on risk. Demirguc-Kunt and Huizinga (2010) find a positive relation between bank equity and profitability, explained mainly by the reduction in the cost of funding but also by cost efficiency, managerial incentives and asset monitoring.

On this study, the researcher selects the commercial bank which is local conventional banks and local Islamic banks to be a sampling because conventional banks is the highest user in Malaysia. Other than that, commercial banks also play a great role such as build a secure feeling. Mokhlis (2009), points out that secure feeling reflects the desire of banking with a stable bank and assurance of confidentiality when making a financial transaction. This implies the secure feeling includes both the security at the bank and the security of the bank. In 1830, Malaysia has started a conventional banking and since from the home financing at Malaysia had been monopolized by conventional bank. In terms of risk, the researcher chooses local commercial banks because it has a lower risk compared to foreign banks. This study will investigate the relationship between leverage and profitability in commercial banks.

Profitability is the primary goal of all business ventures. Without profitability the business will not survive in the long-run. So, it is important to measuring current and past profitability. The profitability is measured with income and expenses. Income is generated from the activity of the business. According to Waweru and Kalani, (2009) business that