UNIVERSITI TEKNOLOGI MARA

DETERMINANTS OF FINANCIAL PERFORMANCE OF TWO TOP BANKS IN FIVE (5) ASIAN COUNTRIES

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1.0 INTRODUCTION

1.1 Background of Study

Banking sector has grown to be the most prominent and important industry in Malaysia and every country across the globe (Pratiwi, 2012). This is because the banking industry is necessary for the economy to be function. In economic system, the banking industry plays a critical role in the development and implementation of financial policies. Hence, the stability and growth of economic for every country is depending on the strength of the banking system (Halling & Hayden, 2006). A banking system can be well-defined as a group of financial institutions that offer the financial services to the community (Aithal, 2016). The example of financial institutions are commercial banks, investment banks, retail banks, cooperative banks, and others.

This study was focused on top commercial banks in five (5) countries in Asia: Malaysia, Indonesia, Thailand, Philippines, and India. A commercial bank is a profit-oriented business that deals with money and credit. It is an authorized financial institution with two features: lending and borrowing. They lend money to individuals and businesses, as well as receiving money from them to invest or give as a loan to those in need. According to Aithal (2016), the commercial banks have a responsibility to deliver better, faster, and universal services to its customers in order to generate more money and profit. Top commercial banks have been chosen in this study because to recognized for the latest development and relevance potential of the bank. It also to understand on the determinants that can affect performance of the bank especially during global crisis. Table 1 shows the list of top banks in Indonesia, Malaysia, Thailand, Philippines, and India.

According to Dietrich and Wanzenried (2011), the ability of banks to create more money and profits is a reflection of their financial performance. The bank will have a greater financial performance when the bank has a high ability in obtaining its profits. If all the banking financial institution's performance declines, this will significantly have effect on the economy (Khalifaturofi'ah, 2021). However, the profitability of the banks is determined by its ability to create profits as measured by return on asset (ROA). Financial performance can be affected by both internal and external factors (Al-Tamimi, 2010). Internal factors are influenced by the management of the bank's policies and decision, while external factors are

influenced by macroeconomic indicators. Internal factors are based on financial ratios taken from financial statement of each bank in the five (5) countries, such as non-performing loan (NPL), loan to deposit ratio (LDR), capital adequacy ratio (CAR), and equity to total asset (ETA). Meanwhile, macroeconomic factors are based on unemployment rate, Gross Domestic Product (GDP) and inflation rate.

Financial ratios strongly influenced the financial performance of the banks. According to Fannywaty and Daryanto (2019), credit risk is measured using non-performing loan (NPL) ratio. A non-performing loan (NPL) is a loan in which the borrower has defaulted because they have failed to make monthly payment for a certain period of time. The lower the ratio of NPL, the lower the credit risk the bank bears. The higher the ratio of NPL, the more uncollected loans and the bank's profitability would decline as a result. The bank's ability to repay the depositor's withdrawal of funds to relying on loans as a liquidity source can be measured by using LDR (Permatasari & Sawitri, 2018). The loan to deposit ratio (LDR) is comparing a bank's total loans to its total deposits over a given time period to determine its liquidity. The bank will be unable to meet any unexpected funding needs when the ratio is too high due to low liquidity. Meanwhile, the bank might be unable to generate as more money as it may be when the ratio is too low.

According to Al-Sabbagh (2004), the capital adequacy ratio (CAR) is a measure of a bank's potential risk. The capital adequacy ratio is used to absorb the losses that may have to be endured by the bank (Małgorzata & Adrian Solek, 2010). Higher capital adequacy ratio will give positive impact on the banks while lower capital adequacy ratio will lead to negative impact to the banks. Equity to total asset (ETA) ratio is used to assess a bank's ability to support risky assets or produce risk. According to Fahrul et al. (2018), equity to total asset (ETA) ratio is an indicator of bank financial ratio that measures the owner's attachment and motivation to continue for holding the bank. The higher the proportion of capital owned, the more the owner's attachment or motivation to continue for holding the bank, and thus the greater the owner's involvement in improving the management of his bank's performance. There is positive relationship between capital and profitability of bank, whereby the higher the capital, the greater the profitability of bank (Pradhan, 2016).

According to a previous author, Khalifaturofi'ah (2021), they only focus on internal factors on examining the financial performance of the banks. However, this study includes external factors such as unemployment, inflation and GDP where the financial performance