UNIVERSITI TEKNOLOGI MARA

BANK SPECIFIC FACTORS, EARNING AND CAPITAL MANAGEMENT TOWARDS LOAN LOSS PROVISION: A SEGREGATION APPROACH ON BANK SIZE

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ABSTRACT

Loan loss provision (LLP) is the amount that is provided by the banking institution to cater to loan loss that occurs when the borrower does not make payment on time within 90 days or three months consecutively. LLP is the provision that should be set by Malaysian Banking System (IAS 39 / MFRS 139) and it would be an accrual item that should be done as well. Up until today, there is no specific allotment of LLP. The aim of this research is to determine the impact of earnings management and capital management with the presence of banking specific factor towards the loan loss provision (LLP) of the commercial banks via segregation approach on bank size from 2009 to 2017. In order to achieve the objective of this study, Malaysia, Indonesia, Mexico and Panama are the countries that were selected to be tested. The empirical findings based on the Pooled Ordinary Least Square (Pooled OLS) with robust New-west Standard Error for Malaysia, Indonesia and Mexico, and Fixed Effect (FE) with Heteroscedasticity and autocorrelation for Panama recommend that earning management and return on asset have a statistically significant impact on loan loss provisions. The finding of this study found that the proxy of earning management, earning before tax and provision are positively related to loan loss provision. Surprisingly, the variables of capital management are found insignificant in all countries. With respect to the bank specific factor on the loan loss provision for all countries, it revealed that from the overall perspective of the result, the different obvious factor with different country that have really contributed to the loan loss provision are return on asset, total loan, size and loan growth. Based on the findings of segregation approach on bank size, specifically on large bank for all countries, EBTP is the most important indicator to contribute towards the LLP allotment decision. Meanwhile, in small bank, it is revealed that EBTP, CAP and ROA are the crucial factors to motivate the allocation of LLP decision. Surprisingly, the result shows that the type of significant variables is similar towards LLP, which are EBTP, CAP, ROA for Indonesia and Panama for large and small bank respectively. It revealed new findings in this study.

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CHAPTER ONE
INTRODUCTION

1.1 Background of the study

Bank Negara Malaysia is mandated to foster the stability of banking systems across the nationwide. It has been said that this stability is depending on a sound financial system that leads to a sustainable economic progressive (Bank Negara Malaysia, 2018). A backstory of global financial crisis in 2007 thus provides a significant vulnerable gained towards greater prominence impact on central bank's agenda. Which are the agenda of the central bank being to promote monetary and financial stability. This is planned for giving an encouraging environment to the sustainable development of the Malaysian economy. Despite the advancement of banking systems, an issue pertaining to the bank's solvency on credit risk remained unsolved. It is well known that banks' solvency is susceptible to credit risk shocks as a consequence of poor loan quality. Therefore, monitoring the interaction between the health of financial institutions and macroeconomic stability becomes a necessity given the interlinkages of financial systems. The experience with the business cycle in the developing economies shows that non-performing loans rise as the recession progresses while they peak after the end of the recession. In this respect, the non-performing loans in the banking institution are expected to reach very high levels during the years of crisis by 2007-2008, given that the global crisis caught most of the respective economies overheating with unprecedented credit expansion. The key motivation of this study is to further investigate the deterministic factors propelling the banking sector across country loan loss provision. During the years of crisis, the most affected was banking institution, which is why it is known as banking crisis. Banking crisis comprises financial market risk and credit risk (Nikolaidou & Vogiazas, 2013).

Banks act as the financial intermediary where assisting every single customer or the depositors taking their position through saving activities and reinvested it back by the bank, which is considered as the large aggregate loan, created to make profit. Despite that, the bank has to hold some risks from the loan portfolio investment when it involves low interest rate as well as excessive credit risk and losing the amount of principal investment. Therefore, the banking institution should comply with accounting