

# ARE OUR BANKS UP TO IT?

With full globalisation and liberalisation getting nearer by the day, are local banks really prepared?

By Arman Ahmad

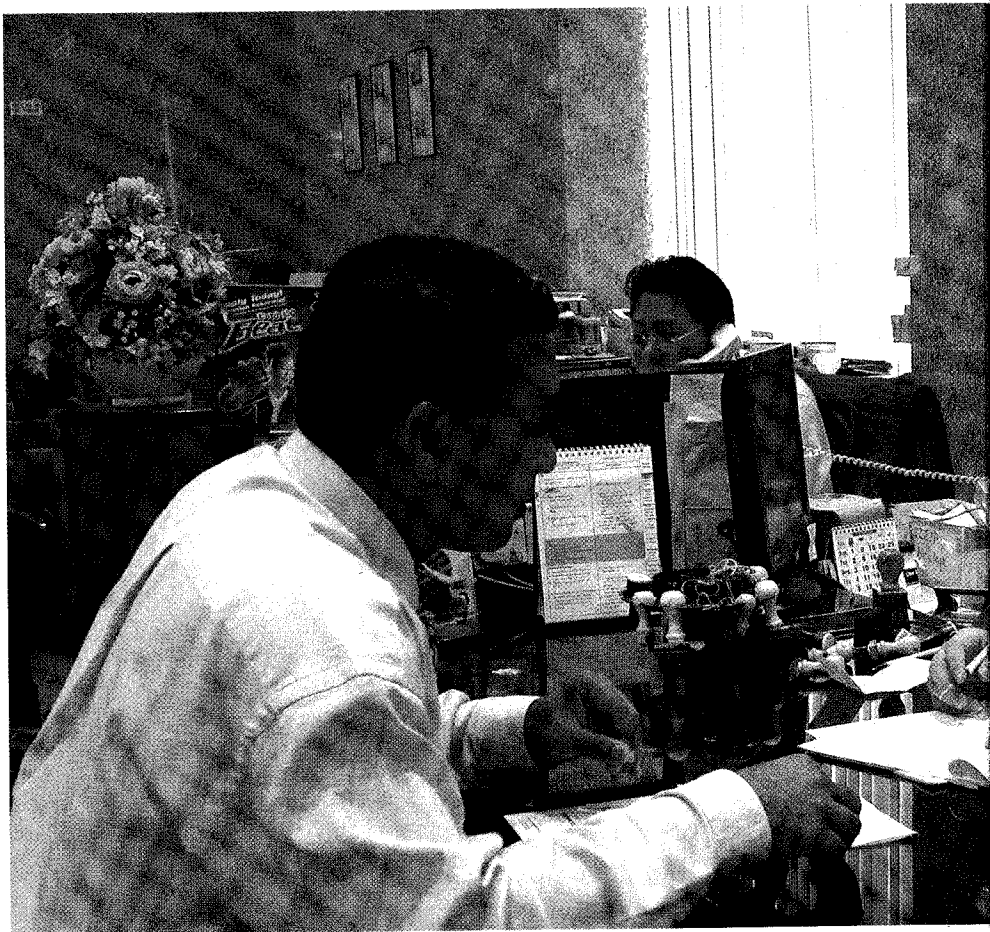
**T**HERE has been a debate by the authorities and industry players on the need for local banks to increase their size and competitiveness to survive globalisation and liberalisation of the financial sector.

The issue is a sensitive one as it involves a crucial sector of the economy and touches many political nerves. The argument has always centred on whether local banks are ready for open competition with the larger and highly capitalised foreign banks.

It is even doubted if local banks will ever have a fair and level playing field as they are in a significantly different league from the foreign banks.

But at the end of the day, everybody recognises that competition from foreign banks is inevitable.

The authorities, in particular Bank Negara Malaysia (BNM), have started to move in this direction. BNM decided, in December last year, to allow locally incorporated foreign banks (LIFBs) to set



up four additional branches each.

The move saw three LIFBs – OCBC Bank Bhd, HSBC Bank Malaysia Bhd and Standard Chartered Bank Malaysia Bhd – announcing their intentions to increase their branches, with OCBC saying it will set up the four this year, two in the Klang Valley and one each in Sarawak and Penang.

TA Securities, in a research note, says foreign banks have a 20% to 25% share of total loans in the domestic banking

industry and are targeting a larger piece of the business.

There are currently 13 LIFBs in Malaysia. Analysts say BNM's move is in line with the country's financial masterplan and will stoke further competition between the players.

Says CIMB Securities in a research report: 'Finally, the central bank is giving foreign banks more operating flexibility, including the nod for new branches. The speed of the approvals is a strong signal of

the regulator's commitment to liberalisation. The liberalised market will trigger fiercer competition from the already more-efficient foreign banks. Smaller banks could lose their grip on the auto loans market, which is virgin territory for the foreign banks.'

CIMB Securities, which is 'neutral' on the sector, adds that it believes the financial sector's second wave of consolidation has begun. 'Three pressures – tougher environment, increasing scale of local banks and the central bank unleashing

It says the speed at which the foreign banks' branch expansion plans were approved is not only an indication of their strong desire to expand, but is the strongest signal yet that the central bank is really pushing for speedier liberalisation.

CIMB notes that the return on equity (ROE) of local banks is very much below that of the top five foreign banks – at an average of only 8.4%, compared to the latter's 21.8%.

Standard Chartered has the highest ROE of 24.5%, followed by HSBC Malaysia with 23.6%. Of the local banks, even the most capital-efficient, Public Bank Bhd, has its ROE at 17%, seven points behind the best foreign player.

Not surprisingly, the ROE of smaller banks like EON Capital and Affin Bank are below average, while Alliance Bank's

'The increased competition will be moderated by Malaysia's large and open monetary system which is large enough for everybody, and opportunities the country's huge deposit base and financial services ranging from unit trusts, venture capital and fund management offer,' he says.

'Another increasing potential is the Islamic banking market where Malaysia is positioning itself as the regional Islamic financial hub,' adds Yeah.

He says the increasing competitive landscape of the financial sector will force local banks to be more aggressive and innovative to survive. This will help rather than hurt them and boost their efficiency, and hopefully their bottom lines, in the longer term.

Analysts and industry observers say competition is only going to intensify in the

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*Analysts say apart from good service, how well local banks will fare in a fully liberalised market will also depend on their innovativeness*

more foreign competition – will push smaller banks into a corner, forcing them towards consolidation with bigger banks,' it says.

According to CIMB, the first pressure weighing on smaller banks is the tougher climate of rising interest rates, slowing loans growth and declining margins.

annualised ROE is still negative.

RAM Consultancy Services Sdn Bhd's chief economist and managing director, Dr Yeah Kim Leng, says local and foreign banks can co-exist without significantly hurting each other's business.

'One should not just look at foreign banks putting the heat on local banks by giving them more competition but also the fact that it encourages more cross-border trading and financing activities,' he says.

'Even if it does increase competition, it is good in terms of helping to increase foreign direct investment (FDI) as well as attract more foreign companies that require these banks. This will also indirectly ease foreign investment entry to Malaysia.'

Furthermore, adds Yeah, cooperation between local and foreign banks in loan syndication is not uncommon.

Yeah says the local and foreign banks have different expertise and strength as well as business focus, with foreign banks targeting bigger borrowers like multinational companies (MNCs).

coming months as loans growth is expected to slow down in light of creeping interest rates.

BNM has increased the overnight policy rate (OPR) twice this year to 3.5% to counter inflationary pressures. The investment fraternity expects the rate to rise by another 50 basis points by the year's end, bringing the OPR to 4%.

'We believe the anticipated OPR increases of up to 50 basis points for the rest of the year will slow down loans growth from 8.6% in 2005 to 7% this year,' says CIMB Securities.

'The cumulative impact of the recent and expected interest rate hikes, along with the higher base effect, will drag down loans growth. We estimate that a 1% point rise in the BLR to 7% would raise monthly housing loan payments by 9.7%,' it adds.

Overall, analysts say local banks have to buck up to meet increasing competition from their foreign counterparts. How well they fare will depend on their innovativeness and management, they say. **mb**