ASSET AND LIABILITY MANAGEMENT: COMPARATIVE STUDY OF CONVENTIONAL AND ISLAMIC BANKS IN MALAYSIA

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1.0 Background of the Study

- Islamic banking system had already started making its mark since almost 40 years ago, however, its existence has only been given due notice during the 2007/2008 global financial crisis.
- The stability and resilience of Islamic banking system during the financial crisis attract many policy makers, bankers and investors to consider Islamic banking system as an alternative to the Conventional banking system (Maher Hasan and Jemma Dridi, 2010; Beck, Demirguc-Kunt and Merrouche, 2010).

1.0 Background of the Study (Con't)

- Some researchers believe that the Islamic principles practiced by the Islamic banks, such as ethical conduct and prohibition to sell asset which is not owned, have protected the Islamic banks from the financial crisis (Maher Hasan and Jemma Dridi, 2010).

1.0 Background of the Study (Con't)

- This claim is also supported by many researches that have been done recently in comparing the stability, efficiency, performance and profitability of Islamic banks as opposed to Conventional banks, especially during the 2007/2008 global financial crisis.

1.0 Background of the Study (Con't)

- For instance, the research done by Aniss Boumediene and Jerome Caby (2009) on the aspect of profitability and returns, found that the Conventional banks' returns were more volatile as compared to the returns of Islamic banks because of the nature of liabilities and the principle of profit and loss sharing by the Islamic banks.
- Additionally, according to the research done by Maher Hasan and Jemma Dridi (2010), the profitability of Islamic banks was not affected as much as the Conventional banks as a result of the Islamic banks' business model.

2.0 Problem Statement

- Thus, in order to add to the literature of comparing the performance of both the Conventional banking system and the Islamic banking system, this research will compare the asset-liability management of both banks, in terms of its interest rate risk, credit risk and liquidity risk, before and after the period of the 2007/2008 global financial crisis.

2.0 Problem Statement (Con't)

- According to Tariqullah Khan and Habib Ahmed (2001), the Islamic banking system is faced with a unique risk because of its composition of asset and liability, which is believed to be different from the risks that the Conventional banking system is facing.

2.0 Problem Statement (Con’t)

- There is no study found comparing the asset liability management of the Conventional banks and the Islamic banks pre- and post-2007/2008 global financial crisis.

3.0 Objectives

- Main objective is to find out whether there is any significant difference between Conventional banks and Islamic banks in Malaysia in terms of the asset and liability management.
- The secondary objectives are as follows:
  - To find out whether there is any significant difference between Conventional and Islamic banks in terms of interest (profit) rate risk management.
  - To find out whether there is any significant difference between Conventional and Islamic banks in terms of credit risk management.
  - To find out whether there is any significant difference between Conventional and Islamic banks in terms of liquidity risk management.

4.0 Research Questions

- The main research question is “Are there any significant difference between Islamic banks and conventional banks in adopting asset and liability management system?”
- The main research question can be further divided into three sub-questions. They are:
  - Is there any significance between IBs and CBs in terms of the interest (profit) rate risk management / credit risk management/ liquidity risk management?

5.0 Conventional Banking

- A Conventional banking system is a banking institution that acts mainly as a financial intermediary. It borrows from savers that have surplus of funds in exchange of borrowing interest rate and then lend them out to borrowers in an exchange for lending interest rate. Thus, the difference between the borrowing rate and the lending rate of interest becomes the profit for the Conventional banks.

5.0 Conventional Banking (Con't)

- The borrowing and lending activities make the relationship of the Conventional banks and its clients as creditor and debtor. In addition to that, the Conventional banks do not carry or possess any equity or assets as the Conventional banks are not involved in trading business or a partnership, but only as a financial intermediary.
- Thus, there is no requirement for the Conventional banks and its clients to exchange real goods or services when making a transaction (Mohamed Hashem Rashwan, 2010).

6.0 Islamic Banking

- An Islamic banking system is banking institution that accepts deposit but it does not accept borrowing and lending on the basis of interest, as the Shariah strictly prohibits it as Riba.
- The Islamic banking system gives out funds on the basis of profit-and-loss sharing contracts (Mohamed Hashem Rashwan, 2010).
- Difference
  - Interest free and Shariah compliance

7.0 Development of Hypotheses

- H_A: There is a significant difference between the Conventional banks and Islamic banks in terms of adopting asset liability management policy.

7.0 Development of Hypotheses (Con’t)

- H_{1a}: There is a significant difference between the Conventional banking system and Islamic banking system in terms of interest (profit) rate risk management.
- H_{2a}: There is a significant difference between the Conventional banking system and Islamic banking system in terms of credit risk management.
- H_{3a}: There is a significant difference between the Conventional banking system and Islamic banking system in terms of liquidity risk management.

8.0 Sample

- The research will be carried out on the asset liability management aspect of both Conventional banks and Islamic banks in Malaysia in terms of the interest rate risk, credit risk and liquidity risk. To date, there are 17 Islamic banks and 25 Conventional (commercial) banks, as stated by the central bank of Malaysia, Bank Negara Malaysia. But because some of the data availability issue, the total of 20 Conventional banks will be used. The ratios will be extracted from BankScope from the year 2006 to 2010.

9.0 Variables

- Interest rate risk:
  - Net Interest Margin (NIM) = net interest (profit) income / average total assets
  - Net Interest Income (NII) = interest income – interest expenses
- Credit risk:
  - Equity / Total Assets (ETA)
  - Equity / Net Loans (ENL)
- Liquidity risk:
  - Liquidity Ratio (LR) = liquid asset / short term deposits and funding
  - Net Loans to Total Asset Ratio (NLTA)

10.0 Statistical Methods

- Descriptive statistics
- T-test

11.0 Findings

- H_{1a}: There is a significant difference between the Conventional banking system and Islamic banking system in terms of interest (profit) rate risk management.
  - Not supported

11.0 Findings (Con’t)

- H_{2a}: There is a significant difference between the Conventional banking system and Islamic banking system in terms of credit risk management.
- Not supported (ETA) but Supported (ENL)

11.0 Findings (Con't)

- H_{3a}: There is a significant difference between the Conventional banking system and Islamic banking system in terms of liquidity risk management.
- Not supported

8.0 Summary Findings & Conclusion

- H_A: There is a significant difference between the Conventional banks and Islamic banks in terms of adopting asset liability management policy.
  - Not supported

9.0 Limitation and Area for Future Research

- Limitation……….Variables
- Area for future research………Interview