CREDIT RISK AND OPERATIONAL RISK DETERMINANTS OF CONVENTIONAL AND ISLAMIC BANKING IN MALAYSIA AND BAHRAIN

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ABSTRACT

The focus of this study on both Islamic and conventional banks is to consider the unique duality banking system in the countries. Data is obtained from annual reports and websites of selected banks. Financial statements for 10 years beginning from 2009 until 2018 were used for extracting data for analyzing the credit and operational risk using E-view software. Furthermore, panel data analysis were used in combination with time series and cross section. The findings reveal that the determinants of credit risk and operational risk are difference between banking in Malaysia and Bahrain. The banking system will have a solid risk management system that will assist Malaysia and Bahrain to develop a strong economy as well as the possible adoption of risk management by the international banking system.

Keywords: *Credit Risk, Operational Risk, Performance, Banking*

RESEARCH HIGHLIGHTS

According to Athanasoglou et al. (2008), banking institutions or financial institutions that face risks can affect profitability and performance. Simultaneous studies of key risks, the challenges to manage banking institutions are clearer (Aziz 2017). Therefore, management needs to be aware of the circumstances and situations that occur in each activity or transaction and this study is to look at the determinants of credit risk and operational risk. Many previous studies have discussed risks and performance. Using the return on equity (ROE), Dhidha (2012) reviews three types of risks namely credit risk, operational risk and liquidity risk with performance against 4 Islamic and conventional banks in Kenya. While research by Muriithi (2016) relates to the impact of financial risks on the performance of conventional banking in Kenya measured by using ROE. Therefore this study is to find out the relationship between risk determinants and performance.

Research Objectives

The main objective of this study is to identify efficiency management factors, capital structure factors, lending structure factors and bank size that influence credit risk and operational risk in Islamic and conventional bank. Beside that, this study also analyses effect of these risk to performance in banking.

Methodology

The population and sample of this study comprises all Islamic banking and conventional banking in Malaysia and Bahrain. The data for this study were obtained from the financial reports of each bank obtained from the website, Central Bank of Malaysia information center and Bahrain Central Bank. According to Bank Negara Malaysia (BNM) website, conventional banking in Malaysia is 28 and 16 Islamic banks. Therefore, this study only uses 21 conventional banking as 7 unsigned banks are due to the establishment of a new banking system. While for Islamic banking, all were taken as a sample of the study. Sample selection for banking in Bahrain is based on the Central Bank of Bahrain. Thus, the banking sector in Bahrain studied as many as 12 conventional banking and 18 Islamic banking.

Annual data taken from 2009 to 2018. This year was chosen because the average establishment of Islamic banking in Malaysia and Bahrain began in 2009. Where before 2008 Islamic banking had no data required to test the study variables. The financial reports and annual reports for each selected bank are the main source of this study. Thus the data of this study is a combination of time series and cross section.

Results

1. The findings found that there were differences in credit risk factors for banking in Malaysia and banking in Bahrain.
2. Management efficiency, Debt to equity and Size have very strong relationship with operational risk for all bank in Malaysia and Bahrain.
3. Credit risk and operational risks have a very significant relationship with banking performance using ROA and ROE

Findings

The findings reveal that the determinants of credit risk and operational risk are difference between banking in Malaysia and Bahrain. Capital structure, lending structure and bank size are very significant factor to credit risk. While, factors that effect operational risk is capital structures. Further results indicate that credit risk have a positive relationship with performance while operational risk have a negative correlation with performance. All banks in Malaysia and Bahrain shows that credit risk and operational risk have strong relationship with performance.

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