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BANKING FRAGILITY SECTOR INDEX AND DETERMINANTS: A COMPARISON BETWEEN LOCAL-BASED AND FOREIGN-BASED COMMERCIAL BANKS IN MALAYSIA

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Abstract. A series of crises have led to banks' liabilities and assets side into being fragile and ultimate in a bankruptcy state. It is pertinent that banks are able to recognize the early distress stage and identify factors influencing their fragility. Thus, this paper attempts to track the trend of the bank fragility of locally-based and foreign-based commercial banks operating in Malaysia using the Banking Sector Fragility (BSF) Index. In addition, using the constructed Banking Fragility Sector Index, this paper also intends to identify the determinants of the bank fragility of these groups of banks. The study covers the period between 1996 until 2011. A sample of seven local-based commercial banks and eight foreign-based commercial banks are identified. Information gathered from the BSF index constructed indicates that the local-based commercial banks are in more fragile phase during the financial crisis of 1997 relative to the world crisis of 2008. On the contrary, foreign –based commercial banks operated in Malaysia are hardly affected by the financial crisis of 1997. In fact, the world crisis of 2008, particularly between 2010 until 2011 appears to have an impact on these banks. The estimated results of the Pooled Ordinary Least Square (POLS) regression model suggest that asset quality management, management quality and sensitivity to the market risk are the main factors of bank fragility for local-based commercial banks while foreign-based commercial banks are not affected by any of the determinants. Macroeconomic factors (interest rate and gross domestic product) are not the cause of bank fragility for both groups of banks.

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