

# CHAPTER 1

## INTRODUCTION

### 1.1 Background of Study

This study explored the situation of the Asian Financial Crisis (AFC) and the Global Financial Crisis (GFC) related to banking performance. A number of articles that mentioned about the AFC and GFC (discussed in Appendices 18 and 19 for the second portfolio that focuses on finding the data. In this study, 17 studies on the AFC and 16 studies on the GFC that are related to the changing performance of the banking sector in Malaysia were collected) showing the decreasing performance of the economy, especially in the banking sector.

According to Kogid et al (2009), the situation of the declining performance of the banking sector impacted by the AFC; was caused by the contagion crisis from neighboring countries, Thailand and Singapore, which then occurred in Malaysia. The beginning crisis in the mid 1997, happened in Asian countries which also caused the economy of Malaysia to become weaker due to many factors (Kogid et al., 2009). Some causes of AFC came from business network (Kogid et al., 2009), increasing Non-Performing Loans (NPL) (Furuoka et al., 2012), different policies environment (Zumkehr & Andriese, 2008), macroeconomic and financial policies (Sundaram, 2007), Foreign Direct Investment (FDI), Gross Domestic Product (GDP) growth, inflation rate, and unemployment rate (Mohamed Ariff & Syarisa Yanti, 1999). However, Malaysia is one of the Asian countries that has been praised on the impressive recoveries by focusing on capital control (Zumkehr & Andriese, 2008).

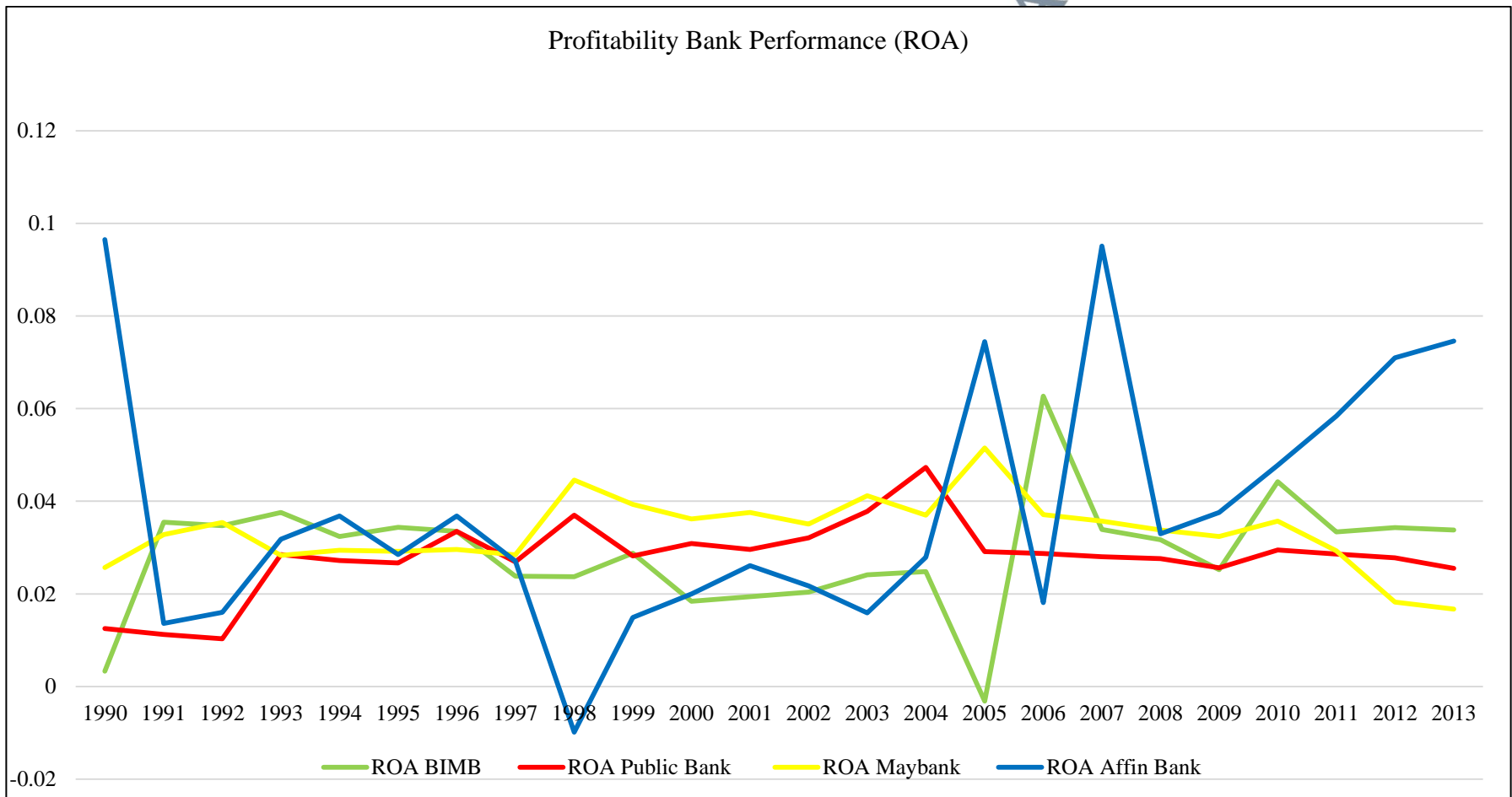
The Malaysian government already took action on the situation of the AFC. After ten years of recovery plans of the AFC by implementing engineering, financial system, corporate sector and capital control, the Malaysian economy has a stronger and greater economic flexibility that enables a new growth and sustained developmental momentum (Zaherawati Zakaria et al., 2010).

The financial crisis often follows a similar patterns and are often preceded by similar developments (Bernhardtson & Billborn, 2010). This study identified that, the phenomenology of crisis was not only impacted by the AFC, and but also the GFC that caused a decreasing performance of the Malaysian economy. Although the global crisis was originated from Asia, the direct damage to the financial sector in Asia had been much less than in Europe and the US (Kawai, 2009). The Malaysian government has learned something after the AFC, by developing an effective regulatory, supervisory and surveillance frameworks, strengthening the governance, focusing on risk management practices, developing robust financial infrastructure, supporting a resilient banking system, and facilitating intermediation activities despite the difficult environment (Muhammad Ibrahim, 2009). Some impacts of the GFC on banking performance can be identified, such as:

1. By looking at the exchanges of export, industrial production, GDP growth, stock price index, NPL, foreign exchange rate, policy interest rate, and fiscal stimulus. (Kawai, 2009)
2. By looking into the quantity of money, real economy factor, GDP, employment, price stability, growth, trade, and distributive equity, and policy variables (Choudry, 2010)

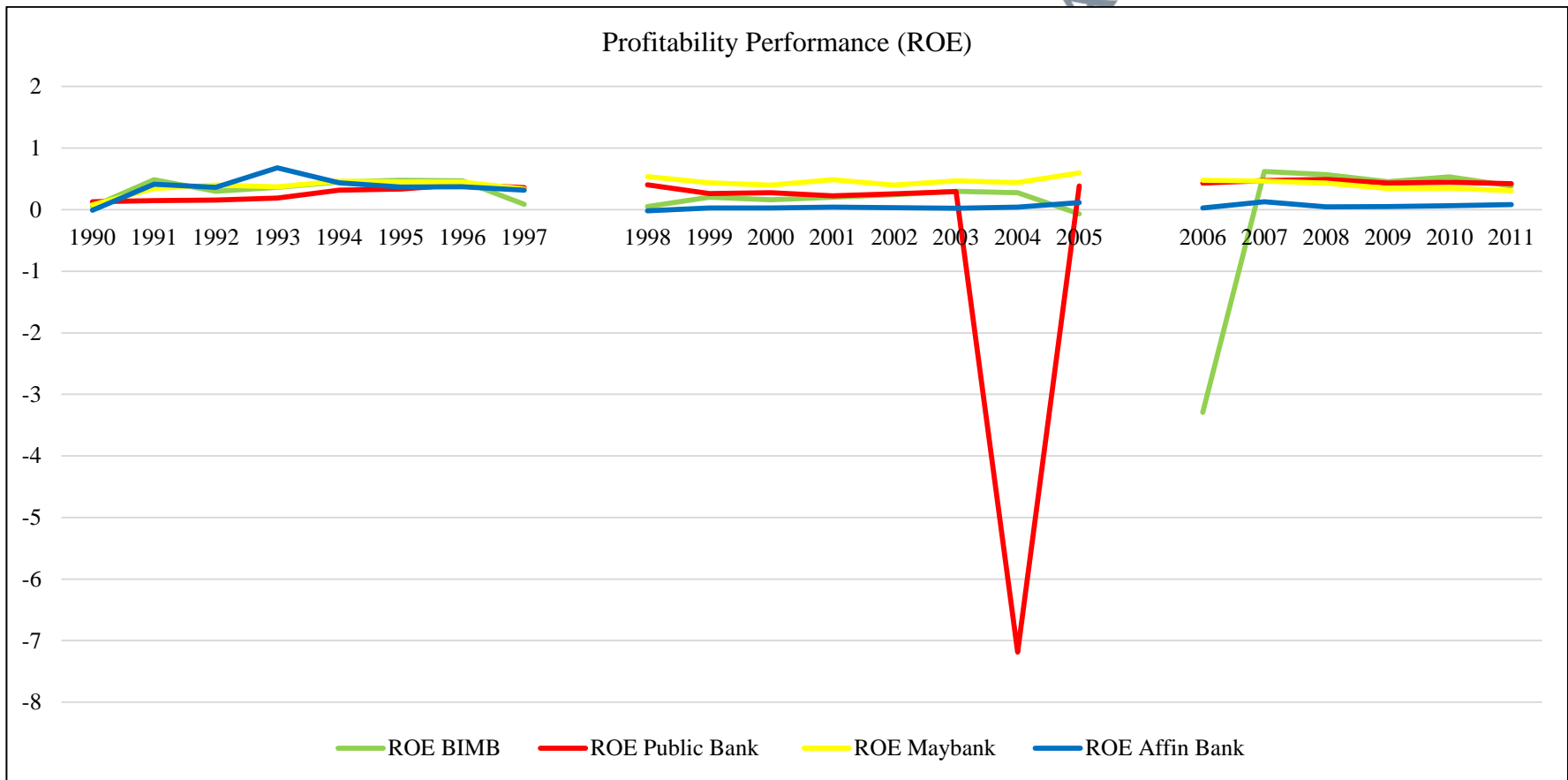
3. The impact on domestic money and debt markets, financial stability, and the transformation of financial system (Muhammad Ibrahim, 2009)
4. By looking at the information on profitability, liquidity and credit risk (Mohamed Yusuf & Salina, 2012).

Figures 1.1 and 1.2 are the comparative information based on the report of published document that shows the declining performance during the AFC (occurred between 1997 to 1998) and the GFC (occurred between 2008 to 2009).



Source: Bursa Malaysia Annual Report (10 November 2014)

Figure 1.1: ROA Value for Bank Islam, Maybank, Public Bank, and Affin Bank



Source: Bursa Malaysia Annual Report (10 November 2014)

Figure 1.2: ROE Value for Bank Islam, Maybank, Public Bank, and Affin Bank

The highlight of financial crises, such as, the AFC, which started in mid-1997 and followed by the GFC in 2008, is some decreasing performance on banking performance (following the facts in Figures 1.1 and 1.2). The green line of on the graphs in Figure 1.1 and 1.2 (pages 4 and 5), indicates the Bank Islam's performance that shows a declining performance during the AFC and GFC. Bank Islam has also suffered during the AFC and GFC in a way that is, no different than conventional banks. Therefore, this study intended to explore the cause of the decrease in the performance of Bank Islam.

To identify the decrease in the performance during the AFC and GFC, there are a number of researchers who mentioned the usefulness of quantitative and qualitative methods. For the quantitative approach, some methods use the model of Z-score by Altman (in Heine, 2000). The category of the signs of distress has also been introduced by Blank et al. (2009) or based on macroeconomic indicators (Ali, 2007), profitability, liquidity, credit risk (Kumbirai & Webb, 2010; Mohamed Yusuf & Salina, 2012) or signs of distress proposed by Yakola (2014). For the qualitative approach, Tabash & Dhankar (2014) used the analysed data from published documents (balance sheet, income statement, and cash flow statement) that had been analysed during the crisis.

This study aimed at disclosing the indicators that caused the decrease in the performance of Bank Islam during the AFC and GFC. Yakola model was chosen to identify the causes of the declining performance of Bank Islam during the AFC and GFC. Using Yakola's model, it will show the indicators of changes experienced by Bank Islam via four indicators to detect the signs of distress, such as working capital/liquidity (with 7 indicators), financial (with 9 indicators), profitability and industry outlook (with 6 indicators), and employees (with 3 indicators). The Yakola's model identified the cause of the declining performance during the AFC and GFC, and

it is the background of research problem to collect the valuable information on Bank Islam's performance. This study sought the true situation of Bank Islam during the AFC and GFC.

After the financial decline period, practitioners have continued to design a strategic management by designing a model (Pearce II & Robbins, 1993). These actions will transform the situation from a declining performance into a profitable performance through the recovery process. These processes need an action of turnaround strategies. According to Wittig (2017), crisis and turnaround are parts of a firm's lifestyle. Even the process involves high risk for the continuation of a firm, it provides dynamic changes and a renewal of the corporate identity.

Pavelko (2017) states that turnaround is a saving program for a projects that is in trouble and making it successful. A turnaround plan is the new program plan of a firm for the program being saved. He also comments that to conduct the successful of a turnaround, it needs a compromise and an intense cooperation is essential for the program to get out of trouble and be back on track. Wittig (2017) posits that there is a venture beyond the strategic and operational management challenges in turnaround situations and, to investigate the underlying structure of the turnaround process in depth would be unfeasible outside a dedicated scientific of different cases. Management will do an evaluation on a program independently and this evaluation is to determine the extent and cause of its poor performance (Pavelko, 2017).

Bank Islam Malaysia Berhad (known as BIMB or Bank Islam), had been seriously affected by the AFC in 1997/98, followed by the GFC in 2007/08, struggled but turned itself into a growing and profitable bank (Norhayati & Mohammad, 2011; Asma' Rashidah et al, 2011; Fadzlan Sufian et al., 2014; Jan & Marimuthu, 2016; Said,

2011; Siti Rohaya & Norsilawati, 2012). Bank Islam as the oldest Islamic bank that has been operating since 1984, may detect one or many causes of its declining performance, and may also provide a strategic management to perform a recovery process by following the policy.

The turnaround process should be focused on both strategy and process (Pretorius & Holtzhausen, 2008). Pavelko (2017) avows that changes during the turnaround process will impact on the internal and external factors in order to bring the program back on track. The challenges cannot be overcome only on a daily development, but also slipping development of milestone dates by large durations, budgeted costs by large amounts, or some combination of these. There are many turnaround strategies to bring a better performance for the firm, such as:

1. The manager who should be focused on successful turnarounds are dependent on overcoming some universal liabilities (such as liabilities of legitimacy, resource scarcity, leadership capacity, strategy options, data integrity, and integration) (Pretorius & Holtzhausen, 2008).
2. Four categories of a strategic management of for the turning process such as environmental scanning, strategy formulation, strategy implementation, and evaluation, and control. Environmental scanning focuses on gathering information from external factors (from opportunities and threats) and internal factors (from strengths and weaknesses). Strategy formulation focuses on developing long-range plans, strategy implementation focuses on operational strategy into action, and evaluation and control focuses on monitoring performance (Wheelen et al., 2012).

3. There are six turnaround strategies based on the literature review as being effective strategies for focusing sustained recovery firms for the period of performance decline. Schoenberg et al. (2013) indicate four of the content or main objectives of the turnaround, namely, cost efficiencies, asset retrenchment, a focus on the firm's core activities and building for the future. The remaining two objectives accompanying change processes are required for implementation: Reinvigoration of firm leadership and corporate culture change.
4. Wittig (2016) describes that the turnaround plan is a turnaround strategy that consists of restructuring moves aimed at overcoming the diagnosed crisis and crisis contribution factors. He divided the turnaround plans into the process and content of turnaround management. The process of turnaround management includes retrenchment and recovery moves. The content of turnaround management is classified into four main categories: Operational, managerial, portfolio, and financial restructuring moves.
5. Pavelko (2017) elaborates on a turnaround plan as being part of the job of the Turnaround Team's task that leads to creating the planning of details after the top-level planning is approved. The basic outline for a Program Plan contains executive summary, organization, scope management, schedules, cost, quality, human resources, program interfaces, risk management, procurement, program information management, and references (potential)

There are many similarities in the turnaround strategies performed by firms, but they are mostly based on process and content-oriented strategies as described by Schoenberg et al. (2013).

By studying this phenomenon, the study aimed to expose the recovery process of Bank Islam in turning itself around, thus a better understanding could be provided in how an Islamic bank could be affected by external factors, such as financial crises and is still able to operate; and compete; within a challenging market, regulatory conditions, and turbulent economic environment.

## **1.2 Research Problems**

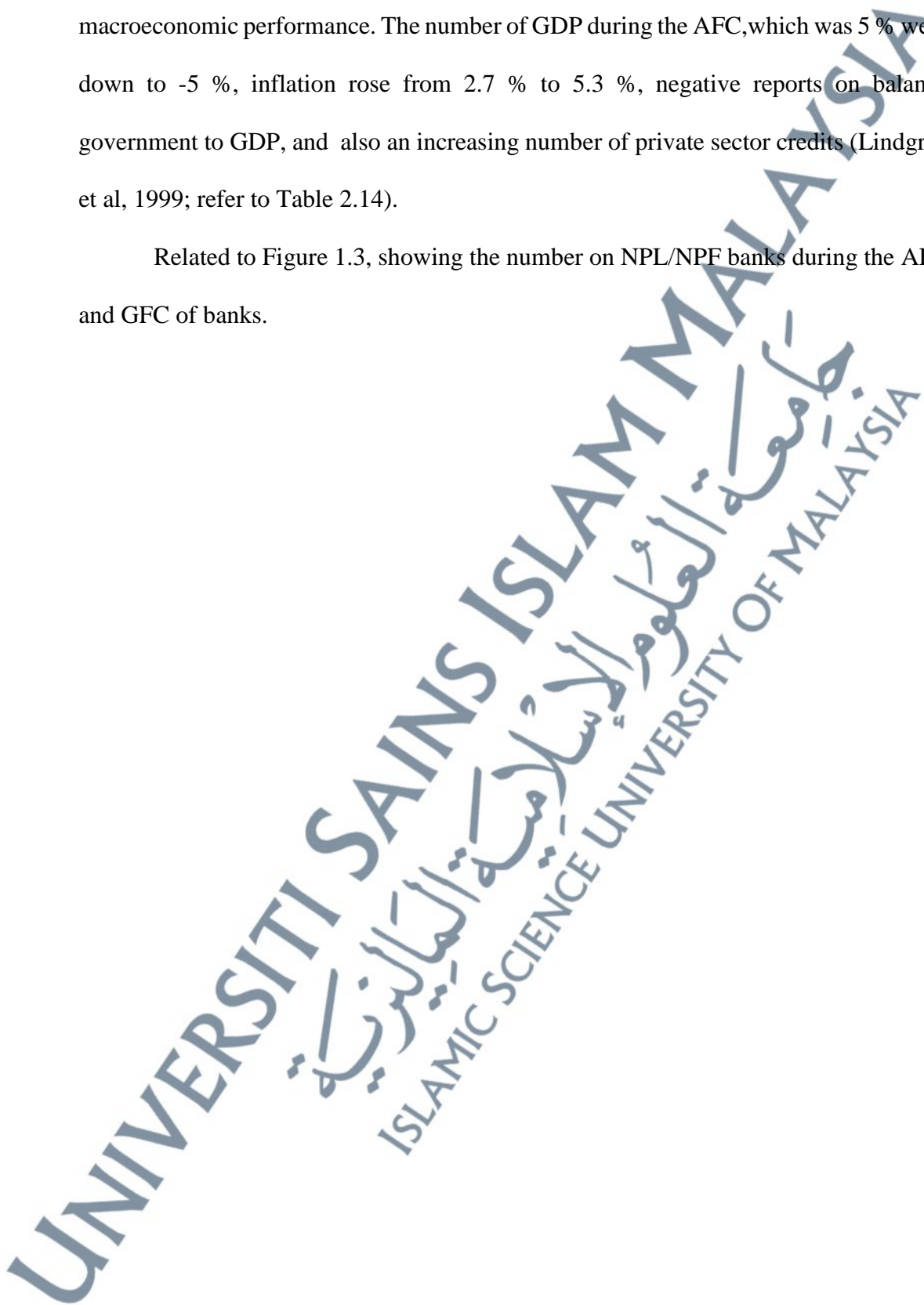
The study attempted to fill in the gap on the question of Bank Islam's performance: Did its turnaround strategy and implementation bring the bank from an unprofitable to a sustained profitable performance?

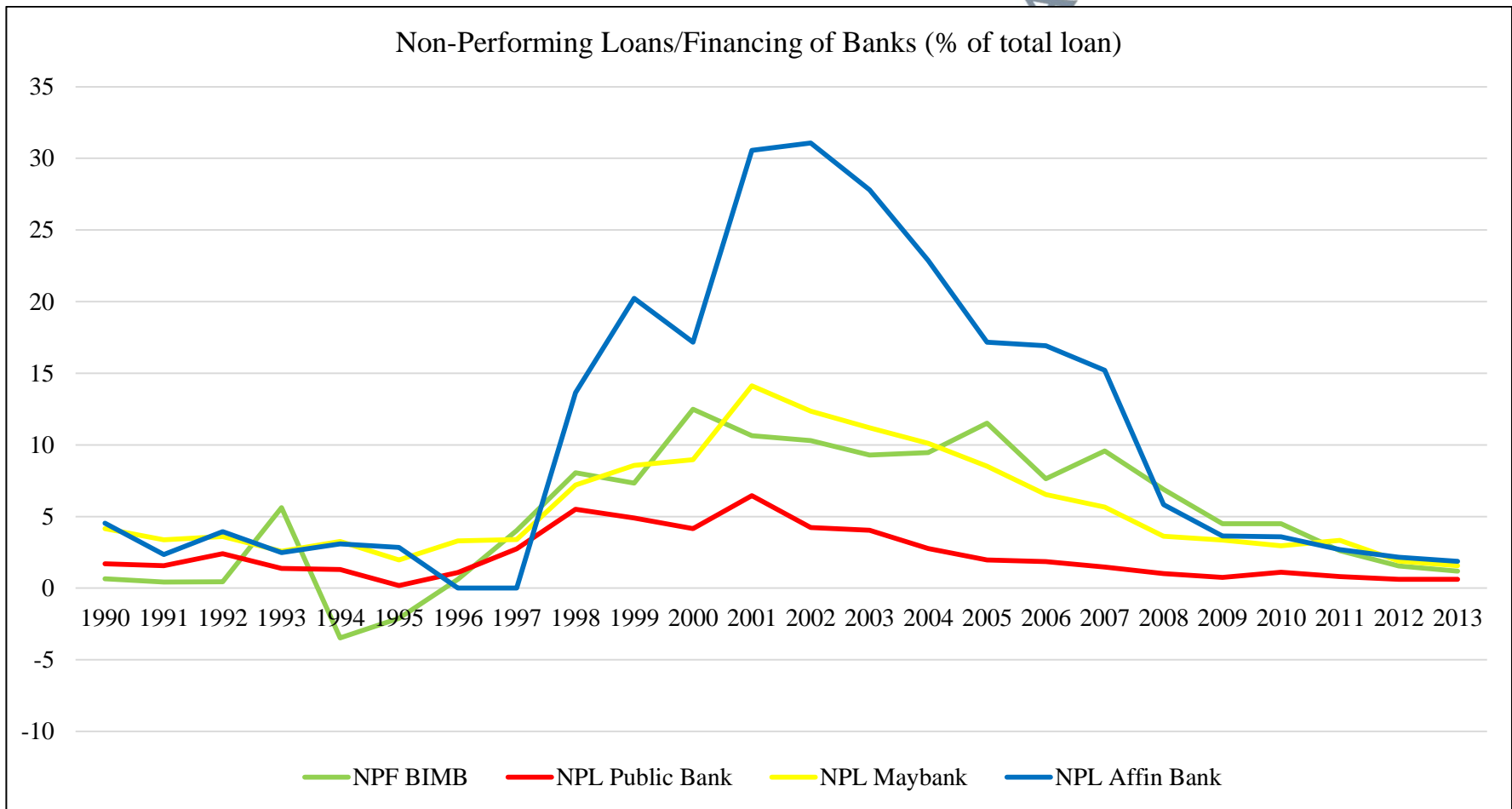
This study aimed to examine the management of Bank Islam from the first year of its establishment and continues to be susceptible to the market and general macroeconomic factors. In this context, it was the first time in its history since 1984, i.e., 13 years after its establishment that the bank's profitability reduced during the AFC, which thereafter consequently impacted the bank's performance. Every bank will have managerial actions regarding a turnaround strategy for the bank. This is not only due to the AFC, the bank also has to face the financial challenges of the GFC, much like other banks (Nor Hayati & Mohamad Akbar Noor, 2011; Romzie Rosmana, et. al., 2014; Salina & M. Shabri, 2010).

The AFC that took place in 1997 had done serious damages to the banking sector in Malaysia. Various measurements were taken by the government, including capital control and the setting up of Danaharta, which managed to bring back the economy on a stronger platform that led to the recovery and growth of the economy, and the banks (Cheng & Sayed Hossain, 2001; Mohamed Ariff & Syarisa Yanti, 1999; Zaherawati

Zakaria et al., 2010). When the AFC attacked Malaysia, the country had the macroeconomic performance. The number of GDP during the AFC, which was 5 % went down to -5 %, inflation rose from 2.7 % to 5.3 %, negative reports on balance government to GDP, and also an increasing number of private sector credits (Lindgren et al, 1999; refer to Table 2.14).

Related to Figure 1.3, showing the number on NPL/NPF banks during the AFC and GFC of banks.





Source: Bursa Malaysia Annual Report (10 November 2014)

**Figure 1.3:** NPF/NPL value for Bank Islam, Maybank, Public Bank, and Affin Bank

If the banks get the bad loan provision, which causes the number of NPL to increase, this will impact asset management companies. Furuoka et al. (2012) reveals that when a bank suffers from the increase of NPLs, this will cause tight liquidity conditions. Due to the crisis, some banks in Malaysia were forced into merger and consolidation exercise by the government (see Appendices 1, 2, and 3 about the position banking during crisis).

Muhammad Ibrahim (2009) states that government reformed the financial sectors after the AFC, reinforcing the strong fundamentals supporting the financial sector in Malaysia. When the GFC happened, Malaysia was ready for the situation of financial crisis. For banking performance, it was not bad compared to the previous crisis. Following the continuity of Danaharta Nasional Berhad that focuses on bad loans from financial institutions, Danamodal Nasional Berhad focuses on recapitalising banking institutions, and the Corporate Debt Restructuring Committee focuses on restructuring large corporate debts. Those actions were designed by Bank Negara Malaysia (BNM) as an active role mechanism for dealing with the situation of AFC. BNM also designed and implemented the selective exchange control measures introduced in September 1998 to control the instability of the Malaysian economy from international financial markets and restore stability in the ringgit exchange rate (Bank Negara Malaysia, 2003).

Zeti Akhtar Aziz (2009) propounded for BNM to give attention on Islamic Finance, especially after the crisis. An Islamic bank has a different system compared to that of conventional banks (Azid et al., 2007; Mehran et al., 2011; Ahmad, 2014; Nomani & Rehnuma, 1994; Sarker, 1999).

The establishment of Islamic finance as part of the global financial system was directed to the arising of the financial stress from global financial instability and global economic activity. BNM creates the structures, standards, and regulatory regimes for the Islamic finance to facilitate the cooperation and collaboration in global financial stability (Zeti Akhtar Aziz, 2009). The combination of indiscriminate lending, excessive risk-taking and overzealous financial innovation hit the financial crisis. However, Islamic finance professed the outstanding performance from the GFC as a stable form of financial intermediation. The resilience of the Islamic financial institutions during the crisis came from intrinsic strengths embedded in Islamic finance compliance to Sharia principle (Zeti Akhtar Aziz, 2009). There are two essential requirements of Islamic finance:

1. Productive economic activity (such as Islamic finance business model, financing or equity) creates the financial transaction from a legitimate income and wealth and grows the expected Islamic financial assets.
2. There is a mutual risk sharing based on profit sharing for the purpose to undertake the appropriate due diligence on the viability of business proposals and to safeguard Islamic finance from the potential risks of financial stress.

Mohamed Yusuf & Salina (2012) state that Islamic banks have a better performance during the GFC. According to these researchers, Islamic banks have a better performance on credit because they are newcomers in the market. It is related to maintaining the lower percentage of assets attached to loans (loan to asset ratio) by Islamic bank, compared to conventional banks.

This study points out the essential of changes in Bank Islam, the indicators that bring a declining performance during and after the financial crisis. Other studies that show a declining performance of Bank Islam are mostly quantitative studies (please see Appendix 24 for the details of list of previous study that related the research), such as:

1. Profitability, liquidity, risk and solvency, and community involvement (Samad & Hassan, 1999; Mohamed Yusuf & Salina, 2012; Siti Rohaya et al., 2012).
2. Stock market (Nashirah & Sofian, 2017; Said, 2011).
3. Using comparative analysis on the cost, revenue, and profit efficiency (Bader et al., 2008).
4. Analysis of efficiency performance (Nor Hayati et al., 2010; Fadzlan Sufian et al., 2014).
5. Corporate governance challenges (Grassa & Matoussi, 2014).

However, using Yakola's model can show the cause by different indicators, such as working capital/liquidity, financial, profitability and industry outlook, and employees. This model will attest to the situation of declining performance of Bank Islam. This study also discloses the changes of Bank Islam during the implementation of the strategic management by the Turnaround Plan (TP) and the development Bank Islam after the implementation.

Becerra (2009) claims that the roots of strategic management can be traced back to the core course, typically called business policy which used to be part of most programs before it was converted to strategic management at the end of the 1970s.

From the point of view of business policy, the study outlined the responsibility for the role of the senior management, the critical issues that impact the overall

organization, and the decisions that decide its course. Strategic management was then often seen as an art involving technical expertise rather than a discipline to be extended by empirical research (Becerra, 2009).

Wheelen et al. (2012) reveal that strategic management is a collection of management decisions and actions that decide the long-term success of a company. This covers environmental scanning (both external and internal), strategy formulation (strategic or long-range planning), strategy implementation, and evaluation and control. The strategic management analysis, thus stresses the monitoring and evaluating of external opportunities and threats in the context of the strengths and weaknesses of the organization. Strategic management, originally named business policy, covers subjects such as strategic planning, environmental scanning, and industry analysis (Wheelen et al, 2012)

Becerra (2009) infers that strategic management was often seen as an art involving technical expertise rather than a science to be extended by empiric research. Becerra (2009) discloses that the firm can be sustained in the long term when top managers in an organization has to deal with strategic decisions that deal with the long-term direction of the firm. In other words, the implementation of the strategy provides an understanding of the value of the firm, the boundaries, and understand overall the performance. Becerra (2009) describes that strategy does not yet have a central philosophy on the firm's action and also on the market performance at this point, while the whole discipline somehow deals with an applied and instrumental viewpoint on the behavior of the firm and their effects on bussiness performance. Becerra also propounds that the area of strategic management has not been able to selectively digest the vast literature on the firm's economic philosophy and apply it to its own strategic decision-

making objectives. It should be argued that the approach does not yet have a central theory of what firms do and their success in the market, even though the whole area somehow deals with an applied and instrumental viewpoint on the behavior of the firms and their consequences for business performance.

This study then assured and commended a long term strategy of Bank Islam from the point of view of the people who have no experience with Bank Islam. Even the level manager can also learn and grasp the effectiveness of the strategies of Bank Islam. In order to evaluate the success of deteriorating banking in a financial crisis scenario, researchers have used some tool of detection as a partial observation since there is a lot of vast literature on strategic strategy. This study allows for a structured map of state-of-the-art ideas in strategic management of Bank Islam by the identification of signs of distress by Yakola (2014) and turnaround strategies by Schoenberg et al (2013).

### **1.3 Research Questions**

For the present study, there are five research questions as follows:

1. What was the impact of the financial crisis on the banking industry as a whole and Bank Islam in specific? Were the impacts different compared to conventional banks?
2. Which aspects of assets and liabilities affected Bank Islam the most during the financial crisis on the banking industry? Was the impact on assets and liabilities similar between Bank Islam and the conventional banks?
3. How did Bank Islam react to and face the financial crisis in 1997 and 2008? Were there changes in organizational structure and did the systems meet the challenges?

What was the emphasis of the changes in terms of risk management, business expansion, and growth?

4. How did Bank Islam manage the assets and liabilities to prepare for recovery/turnaround after the financial crisis?
5. What was the management strategy that Bank Islam employed during and after the financial crisis to recover itself in growth and performance? Were there changes in business strategy, financial structure, and ownership?

#### **1.4 Research Objectives**

These research objectives of the study were achieved by answering the research questions. The main objective of the present study was to understand the turnaround strategy of Bank Islam, with a particular focus on its rise from the severe impact of the financial crisis to becoming profitable and remaining competitive in the market. To answer the research problems, the present study was guided by three objectives as follows:

1. To highlight the impact of the financial crisis on Bank Islam's performance compared to that of the conventional banks. And to identify what organizational aspects that Bank Islam took to recover from the financial crisis, in particular the business strategy, risk management.
2. To identify the managerial action undertaken by the bank to turnaround the performance in terms of assets and liabilities management, organization system, and process.
3. To determine the strategic management and change indicators that influenced the bank's recovery process and associate the performance to its strategies.

### **1.5 Significance of Study**

The study used evidence presented in Figures 1.1, 1.2, and 1.3 to support the declining performance during the AFC and GFC, where Bank Islam was significantly affected by the financial crisis. From the above-mentioned evidence, it also shows that not only Bank Islam was affected, but there were also three other conventional banks (Maybank, Public Bank, and Affin Bank) that were affected by the financial crisis. This study highlights the declining performance of Bank Islam by following the signs of distress based on the Yakola's model (2014). Apart from that, the study identifies the method used by Bank Islam to recover its firm after the financial crisis by using the turnaround strategies model by Schoenberg et al. (2013). Theoretically, the study provides the understanding in the process of the declining performance and recovery processes that brought success to Bank Islam's turnaround strategy. This study is also important for practitioners or managers to learn the whole process of signs of distress by Yakola and turnaround strategies by Schoenberg et al. For policymakers, the study discloses how Bank Negara implements certain policies to allow the banking industry, which includes Bank Islam to exercise their turnaround strategies.

### **1.6 Scope of the Study**

The Malaysian banking system was introduced in 1867 by Mercantile Bank, in 1875 by Chartered Bank, and in 1884 by Hong Kong Bank. Bank Negara was then introduced in the 1960s to help control the financial institutions of the country (Victor, 2015).

In 1959, under the Central Bank of Malaysia Act 1958, Bank Negara Malaysia (BNM) was established (new legislation enacted in 2009). The central bank is tasked

with ensuring monetary and financial stability and maintaining supervision of the country's payment system. The finance market of Malaysia is now distinctly composed of both conventional and Islamic financial services. On 1 March 1983, the Malaysian government incorporated Bank Islam to launch the firm after four months later, on 1 July 1983 (Bank Islam Annual Report , 1984).

Its aims and values are Islamic law under the guidance of the Malaysian government as a policy for the Malay Muslims to obtain support. Following Bank Islam's encouraging results, the Malaysian government set its objective to make Malaysia one of the most important centers in the world in 1993 (Saleh et al., 2019).

In 2005, the competitive extension of Malaysia's Islamic financial system into the global Islamic financial world began (Bank Negara Malaysia Annual Report<sub>a</sub>).

In meeting the changing demands of the modern economy, the rapid growth of the domestic Islamic financial system, accentuated by a substantial expansion and advances in Islamic banking and finance, has become increasingly more important. The ability of Islamic banking institutions to plan and offer products with appealing and creative characteristics at the rates that are comparable with traditional banking products has drawn Muslim and non-Muslim clients alike, indicating the ability of the Islamic banking sector to serve as an efficient means of financial intermediation (Bank Negara Malaysia Annural Report<sub>b</sub>).

If compared to other conventional banks which have evolved longer than Bank Islam, for example (several conventional banks which are a comparative sample for this study), Maybank was incorporated on 31 May and began operations on 12 September 1960 in Kuala Lumpur (Maybank Annual Report, 2013). In 1966, Tan Sri Dr Teh Hong Piow founded the Public Bank. On 31 May 1975, in Malaysia, Affin Holdings

Berhad (AHB) was incorporated. Compared to Maybank, which has a gap in operational years younger than 23, 17 years younger than Public Bank, and 8 years younger than Affin Bank, compared to the results of Bank Islam.

The approved capital of Bank Islam is 500 million, split into 500 million ordinary shares, each worth one Malaysian dollar. The bank began with a paid up capital of M \$80 million in 1983. It held a monopoly role at the time in the domestic Islamic banking industry. After a 10-year period (in 1993), Bank Islam's financial wealth stood at US\$53 million. As the government of Malaysia has invested 37.5 percent of its paid-up money, Bank Islam can be seen as a semi-public sector financial institution. Bank Islam has to adhere to the same regulatory guidelines on the prudential front as other banks selling conventional banking products. A minimum risk-weighted capital ratio of 8 %, effective on 1 January 1992, is expected to be observed by the bank (Khiyar, 2012).

Islamic banking has a banking structure based on Islamic laws whose standards of operations and practices (Nooraslinda Abdul Aris, et al, 2013). The basic distinction between Islamic and conventional banks is that all Islamic banks' operations are carried out without the inclusion of elements of *riba*, which is strictly forbidden in Islam. However, there are also other distinctions that conventional banks profit from in all their operations. In comparison, Islamic banks are based not only on profit, but also on faith. They must abide with its ideals since they are based on the faith of Islam, adding more emphasis on religious values. However, they are supposed to benefit from their business dealings at the same time. According to Nooraslinda Abdul Aris et al. (2013), the Islamic banking system must find a balance in its business priorities between profit and faith that the bank is defeating the very aim of its life by achieving one element and not the other. The bank is a disappointment as an Islamic entity by being a profit-wise

success, yet by neglecting the rules of Sharia enforcement. The healthy equilibrium between its two major traits, benefit and faith, is essential to the bank's growth and sustainability. Tables 1.1 and 1.2 contain some distinctions between conventional and Islamic banking.

**Table 1.1:** The Differences between Conventional and Islamic Banks

No	Aspects	Conventional Banks	Islamic Banks
1	<b>Functions and operating modes</b>	Fully based on man-made principles.	Must be based on <i>Shari'ah</i> principles.
2	<b>Investor assurance</b>	Predetermined rate of interest.	Investor as capital provider and management as entrepreneur and share the risk, hence profit rates are only indicators.
3	<b>Rules of accounts</b>	Governed by product terms and conditions.	Governed by undertaking contracts, determining the terms, and conditions.
4	<b>Fundamental function</b>	Lending and borrowing with compounding interest.	Participation in partnership business. Important to understand the customers' business.
5	<b>Relationship</b>	Creditors and debtors.	Could be: <ul style="list-style-type: none"> <li>• Partners,</li> <li>• Investors and traders,</li> <li>• Buyers and sellers.</li> </ul>
6	<b>Deposits rate and guarantee</b>	Fixed interest rates and deposits are fully guaranteed.	Non-guaranteed return may be given as <i>hibah</i> (gift) and rate of return must be indicative rate. Only <i>wadiah</i> deposit accounts are guaranteed.
7	<b>Loan/financing rate</b>	Usually based on floating rates, BLR +/- rates.	<ul style="list-style-type: none"> <li>• Fixed profit mark-up (<i>Bai Bithamin Ajil, Murabahah</i>)</li> <li>• Floating profit rates (<i>Musharakah, Ijarah</i>)</li> </ul>

Source: (Nooraslinda Abdul Aris, et al., 2013)

**Table 1.2:** Differences between Islamic and Conventional Banking System

No	Aspects	Islamic Banking	Conventional Banking
1	<b>Function</b>	Custodian of good Entrepreneur Financier	Lender Borrower
2	<b>Deposit</b>	Safe custody Investment	Interest based deposit
3	<b>Loan/Finance</b>	Debt financing Equity financing	Interest based loan
4	<b>Interest</b>	Interest free Profit is the main income	Interest as the main income
5	<b>Act/Law</b>	Islamic Banking Act 1983 <i>Sharia</i> Law	Bank and Financial Institution Act 1992, Civil Law
6	<b>Others</b>	Free from prohibited elements	-

Source: Islamic Banking Act (1983)

Nik Aiman et al. (2013) state that *riba* was strictly prohibited by Islamic banking in order to create justice in the economic system and to eradicate any form of exploitation and unfair practices. They further explain the gaps between the two financial systems:

1. The financier is assured of securing the principal loan and the positive return from the loan in a *riba*-based debt financing (conventional financial system) without sharing any chance of failure, while the entrepreneur is not assured of such a return despite the hard work. This positive return on the loan has no risk-sharing aspect, as in the case of default payment, the financier has the right to sell the collateral to recover the loan. The Islamic financial system is, therefore, compelled to prevent any such aspect of injustice from happening in the system.
2. In the sense of the *fiqhul-mu'amalat* rule, financial institutions are required to carry out all their financing activities (Islamic business transaction). This is to ensure that justice in contracts is established and that unfair exploitative elements, such as *riba*, *gharar* elements (uncertainty), *maysir* (gambling) and speculation are avoided. In the business sense, these verses suggest that Islamic financial institutions must treat their customers equally and encourage banks to reasonably share revenue and resources, while setting profit-sharing ratios with their investors and business partners.

Several studies have been carried out to analyze the performance of Bank Islam in another Islamic banking facility in Malaysia or in another region, but still in the field

of Islamic banking. The comparative performance between Islamic banking and traditional banking based on some metrics was also compared.

Merriam (2009) defines that in the postmodern world, study is one where the modern world's logic, scientific method, and certainties no longer hold. No one variable is favored or more powerful than another by embracing the world's diversity and plurality. Postmodern research is highly experimental, playful, and innovative, consistent with this viewpoint, and no two postmodern studies look alike. Merriam (2009) reveals that a single case or small, non-random, purposeful sample is chosen in qualitative research precisely because the researcher wants to understand in depth the particular, not to find out what is normally true of the many.

So this research took the uniqueness of Bank Islam as a single case by witnessing and attesting to the signs of distress in Bank Islam during the assault on the financial crisis and also the recovery performance of Bank Islam based on many facts to support the long-term findings.

### **1.7 Motivation of Study**

The motivation of this study was to see how well Bank Islam has done, especially after learning about the differences in management between Islamic and conventional banks (as listed in Tables 1.1 and 1.2.) The barrier movement is more for Islamic banking due to the adherence to religious laws and Sharia compliance. However, Islamic banking, specifically Bank Islam, still continues to operate the business after the financial crisis attack by implementing a Turnaround Strategies to develop and grow the business.

Quantitative and qualitative data can be used as a proof of Bank Islam's success, such as the signs of distress model developed by Yakola (2014) in response to the financial crisis and the turnaround model developed by Schoenberg et al. (2013) during the recovery period.

According to Eisenhardt & Graebner (2007), the research issue is generally broadly defined within the framework of an established theory, and the rationale is focused on the ability qualitative data to provide insight into complex social dynamics that quantitative data cannot easily disclose. According to Merriam (2009), when public records, personal documents, and physical material already present in the research setting are included in a report, what is generally referred to are public records, personal documents, and physical material that are already present in the research setting. They also contain much that is irrelevant to the research since they were not created for that purpose. On the other hand, they may contain hints, even surprising insights, into the phenomenon under study. The majority of researchers believe they are well worth the time and effort to find and investigate. This group of records also contains the investigator's quantitative results. Projective evaluations, attitudinal indicators, content assessments, and longitudinal evidence from surveys on a range of subjects can all be used to help a qualitative investigation.

This study used Bank Islam as a single case for a long-term review of performance changes from 1984 (the year the Bank Islam was founded) to 2014 (the year the observation ended), focusing on the performance of signs of distress that trigger the declining performance and the performance of the recovery process through the implementation of turnaround strategies.

Single-case analysis, according to Eisenhardt & Graebner (2007), “usually exploits opportunities to investigate a significant phenomenon under rare or extreme circumstances (page 27).” However, single-case studies can richly explain the nature of a phenomenon (Siggelkow, 2007; Eisenhardt & Graebner, 2007). Merriam (2009) states that in qualitative research, a single case or limited, nonrandom, purposeful sample is chosen precisely because the researcher wishes to understand the particular in detail, not to find out what is generally true of the many.

Based on previous studies, there has not been a very specific study that can recognize the change in a business unit in making a turnaround (Pearce II & Robbins, 1993; Mokhtar et al., 2007; Hopfmueller, 2010; Faghfour, 2013; Kiyanjui & Ngugi, 2014; Lawrence, 2015; Schoenberg et al., 2013; Yakola, 2014).

Using the Yakola and Schoenberg models, this study compiled the changes made by Bank Islam. This study, which is based on Yakola’s signs of distress model, aimed to highlight the financial distress that Bank Islam encountered following the AFC and GFC. Working capital/liquidity, financial, profitability, and industry outlook as well as employees are all indicators that the model uses to identify declining results. Aside from that, this study discusses the process of a turnaround based on Schoenberg et al. (2013) model, which successfully restored Bank Islam’s viable performance following the financial crisis, and then introduced the turnaround strategies model from Schoenberg et al. (2013), which implements the turnaround process in two steps, namely content-orientated and process-orientated strategies. Schoenberg’s most convincing model depicts not just the financial but also the organisational framework of the turnaround.

## **1.8 Limitation of Study**

This study has shortcomings, including the fact that it only looked at a single case, which was Bank Islam. The aim was to use a single case study to evaluate the performance of Bank Islam from 1984 to 2014.

The data were gathered using public records from Bank Negara Malaysia's official website, electronic data references and books from Bank Negara library, the Bank Islam's official website, and the Tun Seri Lanang Library's official website. The indicators required in Yakola's signs of distress model and the Schoenberg et al.'s turnaround model were used to collect the data.

As compared to the previous report, this report focuses on gathering all information on the improvements in Bank Islam's results and not only quantitative research, but also qualitative data on Bank Islam's performance, such as Yakola's indicator sign of distress and Schoenberg et al.'s turnaround model.

The study's emphasis was on the turnaround process, which was to explore the fundamental structure of the turnaround process at a depth that would be impossible outside of a dedicated scientific study in strategic and organisational management issues in turnaround situations. Sudarsanam & Lai's (2001) these were the first to integrate financial and strategic management perspectives (Eichner, 2010) in turnaround research (Wittig, 2016).

## **1.9 Operational Definitions**

### **1.9.1 AFC and GFC**

The definition of AFC and GFC is related to financial instability which occurred on 2<sup>nd</sup> July 1997 and 2007 (Furuoka et al., 2012; Kawai, 2009; McKibbin & Stoeckel, 2009;

Merrouche & Nier, 2010; Kaplan & Rodrik, 2002; Mcguire & Conroy, 1998; Ping, 2007; Toth, 2011). The financial crisis led to the declined performance of businesses, thus affecting the banking performance. The AFC began from Thailand and created the contagion effect. At the same time, Malaysia also suffered an economic downturn during the AFC, but Malaysia refused the IMF support. The Malaysian government reformed several policies to strengthen the economy, stabilized the currency of Ringgit Malaysia (Cheng & Sayed Hossain, 2001; Furuoka et al., 2012) and set up a financial institution named Dana Harta (Wee, 1999). However, the GFC in the U.S (Athukorala, 2010) and Malaysia still imposed a capital control to fix the exchange rate (Abidin & Rasiah, 2009).

### **1.9.2 Business Performance**

Changes in business performance caused by the AFC and GFC impacted the business cycle (Burn, 1969) where every country experienced different changes in the business pattern (Bidabad, 2010), increment and decrement in business profit, investment, and credit (Zarnowitz, 1999).

### **1.9.3 Profit**

Profit is one of the useful indicators that highlight the performance changes in business (Ibrahim, 2016). The study shows that banking performance changes in terms of profitability, such as ROA, ROE, and ROI. The profitability is the measurement of managerial efficiency (Norhidayah et al., 2011; Samad & Hassan, 1999) and the efficiency of bank operations (Kabajeh et al., 2012).

#### **1.9.4 ALM (Asset Liability Management)**

Most financial institutions evaluate the performance based on ALM to control the risks due to changes in business performance (Dedu & Vasilache, 2008; Elliot, 2010). The definition of ALM is a strategic balance sheet that relates to a bank's liquidity and the bank's risk management framework (Choudhry, 2017).

#### **1.9.5 Sign of Distress**

This study highlights the signs of distress by Yakola (2014) by 4 indicators such as working capital/liquidity, financial, profitability, and industry outlook as well as employees. Sign of distress is an indicator that identifies a declining performance that will bring losses to the business. After identifying signs of distress, the firm should provide a turnaround strategy to recover their business.

#### **1.9.6 Turnaround Strategy**

Turnaround strategy is to recover after a threatening situation in the firm (Pretorius & Holtzhausen, 2008), to refrain the firm from bankruptcy and liquidation (Faghfour, 2013), to find several options in business crisis turnaround strategies, and strategic recovery activities (Schoenberg et al., 2013) as well as the way to change the fortunes of firm by doing different strategies (Angwin et al., 2015). This study highlights the recovery performance by following the turnaround strategies by Schoenberg et al. (2013) with content-orientated and process-orientated strategies.

#### **1.10 Conclusion**

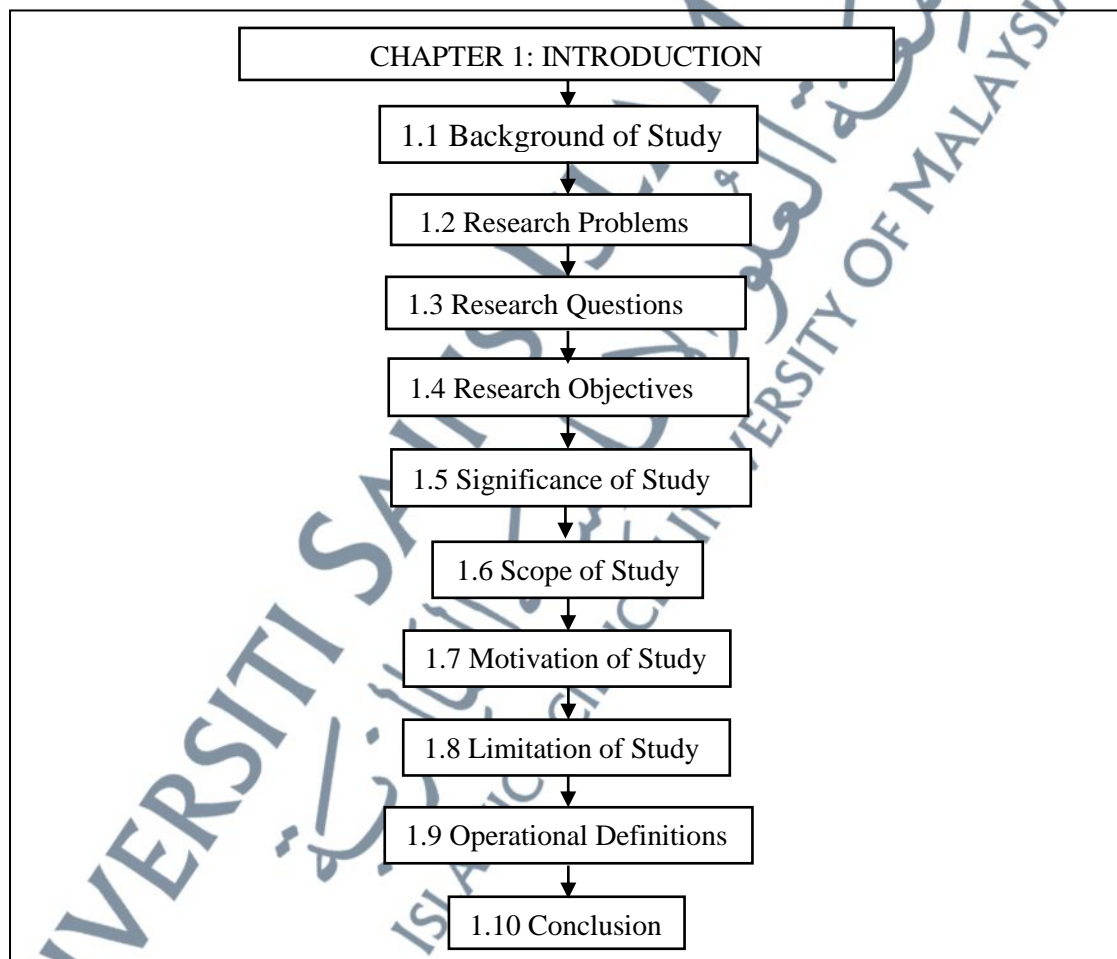
The situation of the Asian Financial Crisis (AFC) and the Global Financial Crisis (GFC) as they relate to banking performance was investigated in this study as the

background of the study. The Malaysian government was already taking steps to address the AFC situation. After ten years of recovery plans implemented by the AFC in the areas of engineering, financial system, private sector, and capital management, the Malaysian economy is stronger and more flexible, allowing for new growth and continued development momentum. Financial crises always follow the same trend and are followed by similar events. The highlighting of financial crises, such as the AFC, which began in mid-1997 and was followed by the GFC in 2008, had resulted in some declines in banking results (following the fact in Figures 1.1 to 1.3). Practitioners have started to design a strategic management by design a model since the financial downturn (Pearce II & Robbins, 1993). Over the course of the recovery period, these activities will turn the situation of deteriorating output into a productive performance. These procedures necessitate the implementation of turnaround strategies.

By focusing on the five research questions and three research objectives to explain the performance of Bank Islam based on the signs of distress by Yakola (2014) and turnaround model, the study attempted to fill in the gap for the question on Bank Islam's performance through the turnaround strategy and its implementation that brought the bank from an unprofitable to a sustainable, profitable performance. Functions, deposit, finance, interest, and act/law are just a few of the differences between Islamic and conventional banks. Even though Bank Islam has many restrictions compared to conventional banks, it can still pursue performance. Yakola (2014) uses a different model to determine the cause of declining performance by sign of distress, which indicates that performance based on working capital/liquidity, financial, profitability, and industry outlook, as well as employees. The model not only provides quantitative but also qualitative indicators for determining the cause of Bank Islam's

declining performance. Schoenberg et al. (2013) introduced the turnaround strategies model, which divide the turnaround process into two steps: Content-orientated and process-orientated strategies. Schoenberg's most convincing model depicts the turnaround's financial and organisational framework. This study presents Bank Islam as a single case study with a long-term analysis from 1984 to 2013.

The background of the study, research problems, research questions, research objectives, significance of the study, the motivation of study, limitation of study operational definition, and conclusion are depicted in Figure 1.4.



Source: Developed for this Study

**Figure 1.4:** A Diagram Outline of Chapter 1