CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusion

This study is carried out to investigate the impact of a bank's credit risk management practice on the bank's performance. As explained previously, this study uses four variables to indicate the credit risk management practice of the bank, which are loan loss reserve ratio (LLR), loan loss provision ratio (LLP), non-performing loan ratio (NPL) and net charge-off ratio (NCR). On the other hand, the bank's performance is represented by the bank's stock price. This study argues that banks' good credit risk management practice may influence banks' better performance. The argument is supported by various studies from previous researchers and regulatory documentation, as explained in Chapter 3. The focus of this study, which is the need for a robust bank's credit risk practice, is aligned with Basel Committee's requirement to ensure bank's sustainability. The banks' resilience during financial shocks may influence the investors' confidence in the banks' performance.

The findings from this study suggested all the variables represented credit risk management practice of the banks are significant to influence the bank's performance. NCR and LLP have a negative relationship with the bank's performance, while LLR and NPL positively correlate with the bank's performance. The models are fit to be usedfor the dataset since the model is free from autocorrelation and heteroskedasticity problems. The independent variables also show no multicollinearity problems, indicating the variables are distinctive to explain the dependent variable. Even though NPL contradicts the theory that low NPL indicates better credit risk management and hence better performance, the individual investigation on this variable with the bank's performance found that the result is consistent with the theoretical ideology.

This study suggests the contradictions of the results might be due to various reasons, such as a high correlation between NPL and LLR. This situation might interrupt the results produce by NPL. Nevertheless, since multicollinearity does not show problem with these two variables, this study decides to retain NPL in the model. However, this study suggests future researchers to further investigate NPL with the bank's performance.

Other than that, LLP also shows opposites result than the theoretical background. In theory, the higher the LLP, the higher the ability of the bank to survive during dire financial times, hence higher bank's performance as compared to lower LLP bank. However, this research argues that lower LLP might be due to the higher defaults' occurrence in the banks since the dataset includes the year of pandemic Covid 19, which is 2020. In 2020, Malaysian economies were severely hit, especially when the government took strict measures to control the spread of the virus in the community. Hence, the fluctuation in the economy has caused the rise of unemployment, defaulters, and bankruptcies. Regarding that, the banks may have lower LLP during the pandemic to cover the defaulters even though the volume in the stock market is high. Hence, this study recommends future researchers to analyze the characteristic of LLP during an economic downturn and its relationship with the bank's performance.

This study also has few limitations, which are subject to future improvement. Firstly, the data is constrained to commercial banks that are listed in the Malaysian Stock Exchange only. In order to get general views of the implication of the independent variables to the bank's performance, this study suggests future researchers to expand the scope of the data, such as include data from other countries or consider data from other entities. By doing that, generalization of the variables can be tested. Secondly, this study only uses four variables that were selected based on the literature findings. The selection of these variables also contrasts with variables that are used by most of the researchers which are PD, EAD and LGD. PD, EAD and LGD are variables use in Basel II guidelines to determine the bank's internal and external rating systems. Since Basel Committee has an incredible establishment, using these three variables on the bank's credit management practice is non-questionable. Hence, the analysis of the four variables—LLP, LLR, NPL and NCR utilized in this study will be an added value to the credit risk research area. Furthermore, other researchers may investigate more

variables that indicate credit risk exposure of the banks to gather more information on the impact of credit risk practice on the bank's performance.

Overall, this study answered the questions listed in Chapter 1 regarding the impact of credit risk practice on the bank's performance. In fact, individual analysis on the variables has been done to deepen the study on the relation of the variables with the credit risk elaboration and hence the bank's performance. The findings are beneficial to the investors to investigate the potential of each credit risk variables to influence the bank's stock price performance. In addition, the findings from the variable also may help the banks to observe their credit risk exposure in order to ensure their sustainability.