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## Do Foreign Banks Lead in Internet Banking Services?

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### Abstract

Internet banking has been increasingly used as a delivery channel in retail consumer banking. As far as the provision of internet banking services in developing countries is concerned, foreign banks definitely enjoy distinct advantages over domestic banks due to their experiences in other, more advanced financial markets. This paper reports a study that examined the levels of retail internet banking services provided by foreign and domestic commercial banks in Malaysia over a period of two years. The study found that while foreign banks are marginally more sophisticated at information provision level, domestic banks offer a significantly higher level of transactional facilities in both years.

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### INTRODUCTION

The Malaysian commercial banking system consists of 23 banks, 13 of which are fully foreign-owned. In terms of total assets, they ranked 6th to 10th, and 16th to 23rd as at the end of 2004. Malaysian regulations (Banking and Financial Institutions Act 1989) require that all foreign banks operating in Malaysia be locally incorporated, and are subjected to the same banking rules and regulations as the domestic banks (those owned by Malaysian interests). In internet banking, however, some preferential treatment is given to domestic banks. Domestic banks were allowed to offer transactional internet banking services by 1 June 2000. On the other hand, foreign banks were allowed communicative internet banking services from 1 January 2001, and transactional services a year later (1 January 2002) (BNM Annual Report 2003). Domestic banks have therefore been given a eighteen-month headstart in the provision of transactional internet banking services.

As internationally active players, however, the foreign banks usually have greater global reach, benefiting from the diverse international exposure, and accumulated expertise, experience and other resources than any Malaysian domestic banks. The head offices of these banks are located in

sophisticated financial centres where they are actively involved in the provision of electronic banking in other parts of the world for a long time. Given the strength, expertise and experience of the foreign banks, however, the question posed in this paper is: would the foreign banks quickly overtake and become the leaders in the provision of internet banking services in Malaysia after 2002?

## METHODOLOGY

Our sample consists of only 17 banks for which data were available. They are made up of 10 domestic banks and 7 foreign banks. Five other foreign banks were excluded based on the reasons that they either did not have websites or their websites were very rudimentary with only several web pages of general introduction. This study focuses only on retail personal or consumer banking facilities, i.e. the retail banking on web. Two measurements were made, viz, at the end of 2002 and 2004. For each period, every bank's websites were examined and measured on their internet banking services for retail consumer banking.

In this study, a simple scoring system based on functionality is employed to measure internet banking services provided by the banks.

### Level 1 - Information Provision

- Informs the customer about the historical background, organisational structure, types of services and products. Some banks may provide financial statements or publish their complete annual reports electronically in this website. This level is also known as communicative services.

### Level 2 - Transactional Facilities

- Provides information on individual customer accounts in the bank, and allows customers to conduct real time banking transactions on their accounts. Services include enquiries and transfer of funds from one account to another.

### Level 3 - Online Application

- Provides facilities for opening new accounts, making loan applications, as well as applications for unit trust and insurance policies. At a higher level, the application should be entirely online, meaning that the applicant submits and has the account opened and ready for transactions.

### Level 4 - Financial Management

- Provides e-financial tools and facilities for personal financial planning and management, including loan repayment, retirement planning, and investment portfolio management. It enables the management of one's portfolios and other financial resources.

Within each level, the services offered in fact can vary considerably in terms of quantity and quality. A rating score from 0 - 3 points is therefore utilised. The more or higher quality services offered, the higher is the score. The overall score obtained by each bank is the summation of points scored for each of the 4 levels. The maximum is thus 12 points (3 points times 4 levels).

## RESULTS AND DISCUSSION

Several observations derived from an analysis of the provision of internet banking services by each of the levels are reported here:

1. In general, internet banking services are better provided at lower levels of functionality. This is true of both the domestic and foreign banks. In the case of domestic banks, for example, the average scores were 2.04, 1.59, 0.81, and 0.60 for Levels 1, 2, 3 and 4 respectively for the year of 2002. Thus, as the functionality becomes more complex in higher levels, the scores declined considerably, indicating that less internet banking services were being provided.

2. Both banking sectors obtained the highest score in Level 1 for both years. This level includes the homepage, which is the main and first page that visitors to the website will enter. It provides mainly background information on the bank. The high scores of both domestic and foreign banks in this level indicate that most banks regard this level as important introduction to their websites, and hence spend considerable time and other resources in developing it. The foreign sector, however, was consistently higher in Level 1 than the domestic sector in both years.

3. In Level 2, on the other hand, the average score for domestic banks was consistently higher than foreign banks' average in both 2002 and 2004. This appears to be the reverse of Level 1 in which foreign banks dominated in both years. Our survey of the websites therefore shows that domestic banks provided far more transactional facilities than foreign banks.

4. Our study shows that in general, most banks in Malaysia did not provide much services on online applications and financial management services (Levels 3 & 4). The domestic banks scored an average of 0.81 and 0.60 for the two levels as at the end of 2002. Although foreign banks fared slightly better, their average scores were not much higher, being 0.99 and 0.81 respectively. There was a significant improvement in 2004 at both levels for both banking sectors. Domestic banks' Level 3 scores grew significantly from 0.81 to 1.47 points by the end of 2004. This progress is indeed substantial. While the foreign banks too showed improvement in Level 3, the rate of change was slower, having moved from 0.99 to 1.29 points at the end of 2004.

## CONCLUSION

Several observations can be made from our findings. First, despite the initial restrictions imposed on foreign banks, which were designed to provide domestic banks with an early start advantage, foreign banks caught up very quickly and maintained their lead in Level 1, which is the provision of general information about the banking institution and/or its affiliated group of companies. However, beyond this preliminary stage, foreign banks did not provide sophisticated internet banking services. In fact, their overall provision of services in Level 2 was significantly below those provided by domestic banks in both years of 2002 and 2004. Despite their superior technological advantage, their services in Level 3 & 4 too were not substantially higher than those of domestic banks.

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