MALAYSIAN BANK MERGERS: THE VIEWS OF BANKERS AN[illegible] T[illegible] PUBLIC ON MEETING [illegible]

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BANKERS AND THE PUBLIC ON MEETING
GLOBALIZATION

BY

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ABSTRACT

The merging of the Malaysian banking sector will have a profound impact on the lives of Malaysians. This thesis aims to research the views of bankers and the public on the effect of the merger. It has already been established that the move by the government to merge the banks will have a significant effect on the Malaysian economy. However, no real study has been carried out as to its actual effect to the Malaysian population and the banking sector. The significance of this research establishes how the merger will affect the daily lives of the average Malaysian. Using a questionnaire survey, the reaction of the general population and bankers towards the merger and its ability to meet globalization were analyzed. The findings show that since the merger, the general operations of the banks have improved, the competition level among banks has increased, the resources of the banks have improved, the quality of services offered by the banks were affected, the bank employees were generally happy about the merger and that the merger would help local banks in meeting globalization. However, the merger caused a lot of inconvenience to the customers.

APPROVAL PAGE

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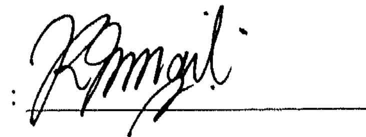
I hereby declare that this project paper is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by reference notes and a bibliography is appended.

Date : 26.06.2001 Signature : 

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To the gifts in my life, Allah,

my parents, my family and loved ones,

and to the angels who have passed

through my life, quickly or over time,

and the blessings they've brought me.

With all my love,

and with all my heart,

Forever and a day.

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TABLE OF CONTENTS

Abstract		2
Approval Page		3
Declaration		4
Copyright Page		5
Dedication		6
Acknowledgement		7
Table of Content		8
List of Tables		11
CHAPTER ONE:	INTRODUCTION	
1.1	Background of the Study	13
1.2	Statement of the Problem	14
1.3	Objectives of the Study	15
	1.3.1 General Objective	16
	1.3.2 Specific Objective	16
1.4	Significance of the Study	16
1.5	Limitation of the Study	17
CHAPTER TWO:	LITERATURE REVIEW	
2.1	Introduction	18
2.2	Merger Theories	21
	2.2.1 The Market for Corporate Control	22
	2.2.2 Tax Reason	22
	2.2.3 Synergy	23
	2.2.4 Financial Market Inefficiencies	23
	2.2.5 Managerial Motives	24
2.3	Bank Takeover Theories	25
	2.3.1 Value Maximizing Motives	25
	2.3.2 Non-Value Maximizing Motives	26
2.4	Types of Merger	27

	2.4.1 Horizontal Mergers	27
	2.4.2 Vertical Mergers	28
	2.4.3 Conglomerate Mergers	28
2.5	Reasons for Bank Merger	28
	2.5.1 Profit Potential	30
	2.5.2 Risk Reduction	30
	2.5.3 Rescue of Failing Banks	31
	2.5.4 Tax and Market Positioning Motives	31
	2.5.5 Cost Saving or Efficiency Motives	31
	2.5.6 Other Motives	32
2.6	Methods of Consummating Merger Transaction	32
2.7	Why Do Mergers Fail?	33
2.8	Public Benefits	35
2.9	Conclusion	36
CHAPTER THREE:	METHODOLOGY	
3.1	Research Design	37
3.2	Population and Sampling	38
3.3	Measurement and Instrumentation	38
3.4	Data Collection	39
3.5	Analysis of Data	40
3.6	Hypotheses	40
CHAPTER FOUR:	RESULTS OF THE STUDY	
4.1	Introduction	41
4.2	Overview of Data Gathered	41
	4.2.1 Background of the Respondents	42
4.3	Consistency of Responses	45
4.4	Test of Hypotheses	46
	4.4.1 Results for General Operations	47
	4.4.2 Results for Competition	57
	4.4.3 Results for Resources	62

4.4.4 Results for Services 66
4.4.5 Results for Inconvenience 74
4.4.6 Results for Employment 80
4.4.7 Response to meeting the needs of globalization 83
4.5 Conclusion 89

CHAPTER 5: SUMMARY, CONCLUSION AND RECOMMENDATIONS
5.1 Summary 91
5.2 Conclusion 92
5.3 Limitation of the Study 94
5.4 Future Research and Recommendations 94

APPENDICES APPENDIX A 95
APPENDIX B 98

REFERENCES 101

LIST OF TABLES

Table 1	Gender Classification of the Respondents	42
Table 2	Age Classification of the Respondents	43
Table 3	Education Level Classification of the Respondents	44
Table 4	Employment of Respondents from the Public	44
Table 5	Correlation between response to question 3 and question 10	45
Table 6	Correlation between response to question 2 and question 9	46
Table 7	General Operations, Question 1: The past bank merger improved the confidence level of general population	48
Table 8	General Operations, Question 2: The merger will be successful in meeting globalization needs	49
Table 9	General Operations, Question 3: The final number of anchor banks is too many	49
Table 10	General Operations, Question 4: The merger happened at an appropriate time	50
Table 11	General Operations, Question 5: The merger was a correct step towards economic recovery	51
Table 12	General Operations, Question 6: The merger was a correct step towards meeting globalization needs	52
Table 13	General Operations, Question 7: The merger affected the population in a positive manner	52
Table 14	General Operations, Question 8: The merging of the Malaysian banks was an expected move	53
Table 15	General Operations, Question 9: Mergers will not help to meet globalization needs	54
Table 16	General Operations, Question 10: The final number of anchor banks is too few	54
Table 17	Test of Hypothesis 1 – Bankers	55
Table 18	Test of Hypothesis 1 – Public	56
Table 19	Competition, Question 1: Lesser number of banks will increase the competition level	58
Table 20	Competition, Question 2: The smaller number of banks will erode/reduce customer priorities	59
Table 21	Competition, Question 3: Lesser number of banks is good for the public	59
Table 22	Test of Hypothesis 2 – Bankers	60
Table 23	Test of Hypothesis 2 – Public	61
Table 24	Resources, Question 1: Having a few large banks is better than having many smaller banks	63
Table 25	Resources, Question 2: A bigger and stronger bank will be better for the economy	64
Table 26	Test of Hypothesis 3 – Bankers	64

Table 27	Test of Hypothesis 3 – Public	65
Table 28	Services, Question 1: The size of loans has improved since the merger	67
Table 29	Services, Question 2: Requirements for loan approvals have been eased since the merger	67
Table 30	Services, Question 3: The terms of loans is now more relaxed	68
Table 31	Services, Question 4: Increase in online services will help meet globalization needs	69
Table 32	Services, Question 5: Banks are now able to provide better and more efficient services	70
Table 33	Services, Question 6:Transaction cost has reduced since the merging	70
Table 34	Services, Question 7: Banks now provide more competitive services	71
Table 35	Test of Hypothesis 4 – Bankers	72
Table 36	Test of Hypothesis 4 – Public	73
Table 37	Inconvenience, Question 1:Did customers who had individual accounts in two banks that merged, e.g. Bumiputra Commerce, complain about confusion in monetary transaction, i.e. bank statements	75
Table 38	Inconvenience, Question 2: Customers complained that the current exercise of changing ATM cards cost some problems to them	76
Table 39	Inconvenience, Question 3: Existing contractual agreement with the bank will be effected by the merger (i.e. loan agreements)	77
Table 40	Inconvenience, Question 4: Change in customer service affected the customer service in the banks	78
Table 41	Test of Hypothesis 5 – Bankers	78
Table 42	Test of Hypothesis 5 – Public	79
Table 43	Employment, Question 1: Bank employees were generally demoted from their position after the merger	80
Table 44	Employment, Question 2: Bank employees are happy about the merger	81
Table 45	Employment, Question 3: Bank employees were given better incentive packages after the merger	81
Table 46	Test of Hypothesis 6 – Bankers	82
Table 47	General Operations, Question 2:The merger will be successful in meeting globalization needs	84
Table 48	General Operations, Question 6: The merger was a correct step towards meeting globalization needs	84
Table 49	General Operations, Question 9: Mergers will not help to meet globalization needs	85
Table 50	Services, Question 4: Increase in online services will help meet globalization needs	86
Table 51	Test of Hypothesis 7 – Bankers	87
Table 52	Test of Hypothesis 7 – Public	88
Table 53	Results of the hypothesis	89

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

The financial services industry is consolidating around the globe through mergers and acquisitions. They are occurring at a torrid pace in the United States, and may occur at a rapid pace in the near future in the Europe under the monetary union to create larger and better capitalized financial entities. However, in Asia, mergers and acquisitions are more of a solution to stay afloat. They are the continent's answer to its 1997 financial distress.

In Malaysia, banking mergers and acquisition activities are not new. Commercial banks have begun to acquire financial companies since mid 60's.[1] They merge with each other to complement their activities. They believe that mergers and acquisitions within the financial circumference to form alliances would create greater financial diversification, resulting in highly lucrative returns. Besides that, the formation of strategic alliances seems to be the most realistic step they have to take in order to face increasingly fierce competition.

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[1] Hawawini, G. & Swary, I., Merger and Acquisition in the U. S Banking Industry: Evidence from the Capital Markets, North-Holland, Netherlands, 1990, pp. 75.

As for now, the number of financial mergers and acquisitions in Malaysia is rising due to financial crisis. The devaluation of the local currency, in particular, does have an adverse effect on the banks because their liabilities are in foreign currency. So is the foreign debt that is relatively small. A decline in stock market value had a similarly undesirable impact. Hence, banks need to obtain greater resources that include skills, technology, risk management and efficient distribution systems that could prevent them from collapsing. Mergers are capable of providing these resources.

Since bank merger and acquisition activities have attracted much attention especially in the United States and some other parts of the globe, it will be interesting to look into the local scenario. What is the track record of the Malaysian's bank mergers? What impact do they have on the public? Hence, this study is designed to evaluate the merger and acquisition activities that have taken place within the local banking industry in the decade.

1.2 Statement of the Problem

The last financial crisis has again clearly highlighted the vulnerabilities of a fragmented domestic sector. Many of these banking institutions were small and survived mainly as niche players. We saw rapid deterioration in the performance of the finance company industry during the financial crisis. Growing competition and strong pressures emerging from the external front to further liberalize the banking sector has also clearly shown that our domestic banking sector can no longer remain protected. In fact, it is

critical that our domestic banking sectors gear itself and be able to meet the challenges and competition arising from the increasing globalization and technological advancements in the areas of banking services. Furthermore, we can see that the current trend in the global markets is the rapid consolidation of banking institutions, especially in the United States of America and Europe. This helps them to take advantage of economies of scale and tap potential synergies, in order to compete more effectively and efficiently in the global environment

As such, the problems to be tackled by this study can be outlined as follows:

1. Is the merger advantageous to the general public or not?
2. How will these changes affect the customers?
3. Do the mergers meet with the rising threat of globalization?
4. Have the services of the banks been affected since the merger?
5. Are customers receptive or not towards the merger?

1.3 Objectives of the Study

The objectives of the study can be divided into two, i.e. the general objective and the specific objectives.

1.3.1 General Objective

The general objective of this study is to analyze the views of the bankers and the public on the mergers and on it meeting globalization.

1.3.2 Specific Objectives

The specific objectives of this study are as follows:

1. Have the general operations of the bank improved since the merger?
2. Has the competition level among banks increased since the merger?
3. Have the resources of banks improved since the merger?
4. Has the quality of the services offered by the banks improved since the merger?
5. Did the merger cause inconvenience to the customers?
6. Are the bank employees happy about the merger?
7. Will the merger help the local banks to meet the needs of globalization?

1.4 Significance of the Study

As has been mentioned, the merging of the Malaysian banking sector will have a profound impact on the lives of Malaysians. This thesis aims to research these effects. It has already been established that the move by the government to merge the banks will have a significant effect on the Malaysian economy. Although studies have been carried

out on the economic effects of the mergers on the banks, no real study has been carried out as to its actual benefit to the Malaysian population. The significance of this research is to establish how the merger will affect the daily lives of the average Malaysian. This study will contribute towards a theoretical advancement on the effects of bank mergers on the general population as well as on bankers.

1.5 Limitation of the Study

The field of bank mergers is very broad; therefore this study is only limited to the effects of mergers on the general population as well as on the bankers. Bank mergers is a relatively new topic in Malaysia; as such the availability of local literature on the topic is expected to be a limiting factor. Since mergers deal with the general population there might be problems with getting an accurate response. Bankers might also be cautious in their answer for fear that their response might jeopardize their position.

CHAPTER 2

LITERATURE REVIEW

This chapter provides a review on mergers and acquisitions theories, the reasonable motives for mergers and acquisition activities, bank takeover theories, and the wealth and performance effect of mergers and acquisitions on the acquirers and targets companies.

2.1 Introduction

According to Penrose (1959), a merger is any method of combining existing firms and the larger enterprise is established. No distinction is made between mergers and acquisitions because the effects of the two are virtually indistinguishable (Singh, 1971). Throughout this paper, the term merger, acquisition and takeover are used interchangeably.

Based on Green (1990), the phrase "merger and acquisition" or M&A is in reality a reference to two categories of merger activity: mergers by consolidation and mergers by acquisition. The definition of mergers includes both consolidation and acquisition. Consolidation implies the combining of two or more firms submerging their identity into a new corporate entity, while acquisition involves the purchase of one or more firms by the company, which retains its corporate identity.

Dodd (1994) explained that "an acquisition or takeover occurs when one company acquires from another company either; a controlling interest in the company's shares to a business operation and its assets. By purchasing a company, the buyer acquires its liabilities as well as its assets; it also requires the tax losses that the purchased company might have accumulated to set off against future profits."[2]

A research carried out by Mansor (1994) states that "acquisition may be considered as a desirable corporate strategy because they promote efficient management and better utilization of nation's resources." Furthermore, the research, states "management can act as an effective market monitoring device over companies performances. Managers are forced to maximize efficiency and performance, thereby maximizing value for their shareholders. Properly conducted acquisition could also bring benefits in the form of better utilization of the acquired company's resources and realization of synergistic gains."[3]

"Mergers and acquisitions are complex and multivariate" as emphasized by Collier, Cooke and Glyn (1988). "Acquisition may be classified into efficiency, inefficiency, strategic and monopoly. Efficiency is presumed to occur if value is increased to shareholders and includes synergy, market share acquisitions, and the acquisition of assets to a discount. Inefficiency may be a reason for acquisition as the reward to the management, are highly correlated with asset size rather than profitability. Strategic

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2 Dodd, A., What's It All About, Malaysian Business, June 16, 1994, pp.63.

3 Mansor, M.I., How M & A Can Create Wealth, Investors Digest, Mid September,1994, pp. 90-91

reasons are also important which include the acquisition of growth, the reduction in capacity and opportunities for accounting manipulations. Finally, domination of a market is also a reason although controls over the abuse of such positions is encompassed in the legislation."[4]

Bittel and Ramsey (1990) state, "Acquisitions may be carried out for a variety of reason. Among them may be diversification of product lines and acquisition of management talent, or improvement operating incomes as a result of economies of scale of operation. As a result of growth acquisition, financing is made easier through the public securities market. Financial management plays a key role in negotiations for acquisitions as to how such acquisitions are to be financed." Furthermore, they added, "there are many reasons for the dramatic increase in acquisition activity. The most often cited is that it is often cheaper to buy assets than build them (which also avoids the problems of increasing industry productive capacity)."[5]

According to Rose (1995), "the most important goal of any bank merger should be to increase the market value of the surviving firm so that its stockholders receive higher returns on the fund they have invested in the bank. Thus, a merger is beneficial to stockholders in the long run if it increases a banks stock price per share."[6]

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[4] Collier, P.A., Financial and Treasury Management, Butterworth Heinemann, 1988, pp. 89.

[5] Bittel, L.R., & Ramsey, J.E., Encyclopedia of Professional Management, Grolier International, 1990, pp. 105.

[6] Rose, P.S., The Distribution of Outcomes from Corporate Mergers: The Case of Commercial Banking, Journal of Accounting, Auditing and Finance, X, no.2, March 1995, pp 15.

Whatever its motives, each merger is simply a financial transaction that result in the acquisition of one or more banks by another banking institution. The target bank, usually the smaller of the two, gives up its charter and adopts a new name, usually the name of the acquiring organization. The asset and liabilities of the acquired bank are added to those of the acquiring bank. A merger normally occurs after the management's of the acquiring and acquired organizations have struck a deal. The proposed transaction must then be ratified by the board of directors of each organization and possibly by a vote of each firm's common stockholders.

2.2 Merger Theories

There have been many theories put forth to explain the general nature of merger activity. It is generally conceded that merger activity is dependent on the state of the economy (Rueber and Roseman, 1969; Globerman, 1977; Rose, 1978; Mueller, 1980). It increases during expansionary phases and decreases in deflationary periods. When undertaking a merger search, management will consider element from both the internal and external environments of the firm (Beckenstien, 1979).

Internal factors include the general character of the firm, size of asset of employment strength, the liability to generate expansion or operating capital internally, the current state of its production technology, allocation of resources among various product manufactured, and the adaptability and expandability of its organizational structure. On the other hand, externally generated considerations include the extent of competition in

various product lines, present and potential size of market demand, production process and technologies employed by competing firms. In addition, the conditions in the labor and capital markets, government legislation related to the business environment, and import tariffs and other areas of public concern are also taken into considerations.

2.2.1 The Market for Corporate Control

The basic premise of this theory is that a merger represents the exchange of an inefficient management for a more efficient one. Takeovers are used by groups external to the firms who believe the firm could be made more efficient through an exchange of management. This is based on the supposition that the markets valuation of the firm's worth is adequate measure of managerial efficiency. Firms that are less efficiently run will be undervalued. The groups that successfully wins control of the firm gains the difference between the old value and the new value imputed by the market because of the increase in efficiency. This theory had some empirical evidence support (Nelson, 1959; Milicher, Ledolter and D'Antonio, 1983) but is also challenged by others (Ravenscraft and Scherer, 1988; Caves, 1987).

2.2.2 Tax Reason

Mergers must generate tax savings significant enough to offset the cost of a transaction if this is a motivation for acquisition. Warshawsky (1987) provides three principal sources of tax savings. They are a carryover of net losses, an increase in

leverage and a change in the tax basis in asset depreciation. However, the problem with using taxation as a primary motive for acquisition is that such savings may be obtainable through other means. Taxes are probably a secondary consideration at best (Green, 1990).

2.2.3 Synergy

The valuation gap created by coordination gains is commonly called synergistic enhancements. Synergy results when the profitability of a combined unit is greater than the profit that would have been realized had the merged units remained independent. These efficiency gains are realized at both operational and firm levels. Market structure valuation gaps revolve around the gains that are realized through the reduction of competition in an industry.

Although the logic underlying the potential synergistic-type benefits accruing from mergers is secure, empirical evidence shows that expected performance gains are often not realized (Laiken, 1973; Baesel and Grant, 1979; Caves, 1987).

2.2.4 Financial Market Inefficiencies

If financial market inefficiency reflects the true value of a firm over a long period, differential evaluations of the firms worth may occur (Green, 1990). Gort (1969) has postulated an economic disturbance theory, which focuses on discrepancies in valuation between insider and outsider to the firm.