

# A Note on the 1999-2002 Malaysian Banking Consolidation



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**ABSTRACT** In this article, a brief history of the 1999-2002 Malaysian banking consolidation is presented together with the economic rationale for the mergers. These were guided mergers where the government encouraged one financial institution, typically a weaker entity, to merge with another, typically a stronger entity. Guided mergers are widely accepted by Malaysian and other Asian policy-makers as a strategy to resolve banking problems. In the case of Malaysia, such an initiative came from the Malaysian government and its regulatory agencies in the aftermath of the 1997 East Asian financial crisis. Similarly, government pressures and intervention have also been used in Europe, Japan and the US to strengthen banking groups. For instance, mergers were used in the US to resolve its savings and loan crisis in the 1980s, and in Sweden and Norway to resolve their debt crises in the 1990s.

THE NATURE OF the Malaysian banking consolidation during the 1999-2002 period has generated interest among local and foreign academicians. The reason is simple: for the first time the market witnessed the massive consolidation of a banking industry that was successfully completed in less than 2 years. The post-crisis merger and acquisition activities in Malaysia might have been a natural market response to the 1997-98 banking crisis. However, the banking consolidation would have not happened at such a speed without strong government influence. Between 1999 and 2001, about 50 financial institutions were coerced to merge into 10 large banking groups with each group comprising a commercial bank, usually, a finance company and a merchant bank. Unlike market-driven mergers, the pressure to merge came from the government which was concerned about the systemic stability of the country's financial markets following the 1997-98 crisis. There was optimism that the level of efficiency and productivity of domestic financial institutions, in particular, would greatly improve following the mergers.

In the late 1980s and early 1990s, the Malaysian banking authority had made futile efforts, such as introducing TTRS, to urge small domestic banks to merge with their larger counterparts (Bank Negara Malaysia, 1999). Only two market-oriented mergers resulted during that period.<sup>1</sup> The 1997/8 banking crisis left the smaller and weaker institutions with little choice but to seek merger partners. The sharp drop in the country's economic growth in the second half of 1997, followed by further growth decline in 1998 left several domestic financial institutions with very poor quality assets (Murakami, 1998). Finance companies were the worst hit, with most of them becoming insolvent. To avert failure, the government encouraged smaller finance companies, encumbered with high levels of non-performing loans and capital deficiencies, to merge with the larger ones or be absorbed by their bank holding companies. In January 1998, the government requested six large finance companies to acquire small and medium-size ones (BNM, 1998). The acquisition programme also saw two banking groups acquiring two finance companies.<sup>2</sup> As for the other 14 finance companies (including the foreign-owned institutions), they were absorbed by commercial banks within their group.

Following the success of the finance company mergers, the government then embarked on a consolidation and rationalisation exercise for the whole banking sector. On 29 July 1999, the central bank announced a massive consolidation of all domestic commercial banks, finance companies and merchant banks. In this first announcement, six domestic commercial banks were suggested as the acquiring banks: these were the ones that would continue following the consolidation. Their merging partners were also named (see Table 1). The government's initial approach provoked serious criticisms. Significant differences in ownership structure, size, reputation and earnings of the acquirers and their merging partners caused the announcement

1 They were mergers between Kwong Yik Bank Bhd and DCB Bank Bhd, and between Chung Khiaw Bank (Malaysia) Bhd and United Overseas Bank (Malaysia) Bhd.

2 The two banks were Affin Holding Bhd and Bank of Commerce (M) Bhd, where they each acquired a majority stake in ACF Holdings Bhd and MBf Finance Bhd respectively.

to be poorly received by a majority of the banks' shareholders (Ahmad & Ling, 2000).<sup>3</sup> The mergers were also viewed as politically motivated, particularly as the government handpicked the original six acquirers and their potential targets (Chin & Jomo, 2001).<sup>4</sup> Most importantly, the mergers were not market driven as the banks were not allowed to find their own partners.

On 12 October 1999, the then Malaysia's prime minister, Tun Dr Mahathir Mohamad, announced that the merger plan would be revised, where banks could form their own merger groups and choose their own leader for the group merger process.<sup>5</sup> The banks then had until 31 January 2000 to submit their merger proposals. On 14 February 2000, Bank Negara Malaysia confirmed its approval of 10 large banking groups with the acquirers and their respective targets (see Table 2). Each group consisted of at least a commercial bank, a finance company and a merchant bank. The deadline for the consolidation exercise was set for December 2000. To ensure that they were well capitalised, BNM also imposed a 31 December 2001 deadline for these groups to hold a minimum capital of RM2 billion. This deadline was later extended to 30 June 2002. Banks that had not achieved this minimum capitalisation would be in contravention of Section 14 of the Banking and Financial Institution Act. The 1999-2002 mergers took place among domestic banks since foreign participation is limited to maximum 30% ownership. The banking consolidation was complete by mid-2002.<sup>6</sup>

This rapid pace of consolidation has

invigorated the debate over whether mergers would have a beneficial impact on the Malaysian banking sector and on the public as was the case in the US in the mid-1990s.<sup>7</sup> For bank regulators and policy-makers in Asia, mergers and acquisitions prove to be one of the solutions to banking problems (Shih, 2003). Hence, the massive restructuring of the banking industry in Malaysia and elsewhere after the 1997/8 Asian economic crisis was spurred by the hope of increasing competition and efficiency as well as promoting greater stability and soundness of each country's financial system. Such consolidations reduce the number of banking firms and thereby, eliminate excess capacity. Undoubtedly, in theory, the merger plan was desirable because the banking sector had too many banks for a small economy (Jayasankaran, 1999) and several banks had repeatedly suffered from severe non-performing loan problems, which may have arisen partly from inefficiency.

Another reason was increasing pressure from the World Trade Organisation that local financial markets allow easier foreign bank entry (BNM, 1999). At the same time, creating a smaller number of bigger banking groups may pose problems for the safety and soundness of the banking sector. Shareholders and stakeholders expect more pronounced government intervention because of the 'too-big-to-fail' (TBTF) doctrine. Amihud and Miller (1997) argue that "the policy may exacerbate the results of a bank crisis because it may induce large banks to take unreasonable risk" (1997; p10). Furthermore, the stock returns of large institutions are

- 3 BNM acknowledged the strong objections from the banking community on the July merger programme especially pertaining to the number and composition of the banking groups and time frame (BNM press release, 20 October 1999). Moreover, there were speculations that the July proposal victimised bank owners close to former Deputy Premier and Finance Minister Anwar Ibrahim who was serving a 6-year jail term (Jayasankaran, 1999). Three of the six banks were popularly regarded as state-owned banks. The Governor of BNM publicly commented that "the Asian Wall Street Journal, while appreciating the benefits of the merger in the long run, gave a racial slant to our mergers...the opposition leaders were quick to jump on the issue...some analysts appear to question the motives of the mergers". (*The Star*, 11 August 1999).
- 4 The six acquiring banks were Maybank (government-linked); Multi-Purpose Bank Bhd (controlled by associates of ex-Finance Minister Daim Zainuddin); Bumiputra-Commerce Bank Bhd (government-linked and operated by an associate of Daim); Perwira Affin Bank Bhd (controlled by the Armed Forces Cooperative); Public Bank Bhd (controlled by entrepreneur Teh Hong Piow); and Southern Bank Bhd (controlled by the family of casino owner Lim Goh Tong) (Shameen, 1999; Shanmugam & Nair, 2003).
- 5 The Prime Minister of Malaysia made the announcement during his trip to London in early October 1999. *The Business Times* (13 October 1999) commented that it was "...a move seen to appease ethnic Chinese unhappiness over the controversial merger plan..."
- 6 The final merger was between RHB Bank Bhd and Bank Utama (Malaysia) Bhd on 20 March 2002 with the latter attaining anchor bank status. This resulted in a successful completion of the Malaysian domestic banking consolidation programme.
- 7 Between 1984 and 1994, US bank mergers increased dramatically which resulted in the number of banks falling by 28% during that period; and there are many studies that investigate the efficiency gained from the mergers.





**Table 1: The Initial 6 Acquirers and their Respective Targets Proposed by Bank Negara Malaysia on 29 July 1999**

Acquirers and their Subsidiaries	Targets
Multi-Purpose Bank Bhd (Alliance Bank Malaysia Bhd)	Sabah Bank Bhd International Bank Malaysia Bhd Bolton Finance Bhd Sabah Finance Bhd Bumiputra Merchant Bankers Bhd Amanah Merchant Bank Bhd RHB Bank Bhd RHB Sakura Merchant Bankers Bhd Sime Bank Bhd MBf Finance Bhd PhileoAllied Bank (Malaysia) Bhd Oriental Bank Bhd
Bumiputra-Commerce Bank Bhd - Bumiputra-Commerce Finance Bhd	Commerce International Merchant Bankers Bhd Credit Corporation (Malaysia) Bhd Hong Leong Bank Bhd Hong Leong Finance Bhd
Malayan Banking Group - Mayban Finance Bhd - Aseambankers Malaysia Bhd	The Pacific Bank Bhd Sime Finance Bhd Kewangan Bersatu Bhd EON Bank Bhd EON Finance Bhd Amanah Merchant Bank Bhd Delta Finance Bhd Malaysian International Merchant Bankers Bhd
Perwira Affin Bank Bhd - Affin Finance Bhd - Perwira Affin Merchant Bank Bhd	BSN Commercial Bank (Malaysia) Bhd BSN Finance Bhd BSN Merchant Bank Bhd Arab-Malaysian Bank Bhd Arab-Malaysian Finance Bhd Bank Utama (Malaysia) Bhd
Public Bank Bhd - Public Finance Bhd	Hock Hua Bank Bhd Sime Merchant Bankers Bhd Wah Tat Bank Bhd Interfinance Bhd Advance Finance Bhd
Southern Bank Bhd - Southern Finance Bhd - Southern Investment Bank Bhd	Ban Hin Lee Bank Bhd Cempaka Finance Bhd Perdana Finance Bhd City Finance Bhd United Merchant Finance Bhd Perdana Merchant Bankers Bhd Perkasa Finance Bhd
6 acquirers (7 subsidiaries)	43 targets

Source Bank Negara Malaysia, Annual Report 1999

**Table 2: Final 10 Acquirers Approved by Bank Negara Malaysia and their Respective Targets and Subsidiaries on 14 February 2000**

Acquirers	Banking Institutions in the Group	
	Subsidiaries	Targets
Alliance Bank Malaysia Bhd <sup>a</sup>		Sabah Bank Bhd International Bank Malaysia Bhd Bolton Finance Bhd Sabah Finance Bhd Bumiputra Merchant Bankers Bhd Amanah Merchant Bank Bhd
AmBank (M) Bhd <sup>a</sup>	Arab-Malaysian Finance Bhd	MBF Finance Bhd
Bumiputra-Commerce Bank Bhd <sup>b</sup>	Bumiputra-Commerce Finance Bhd	Commerce International Merchant Bankers Bhd Bank Bumiputra
EON Bank Bhd	EON Finance Bhd	Oriental Bank Bhd City Finance Bhd Perkasa Finance Bhd Malaysian International Merchant Bankers Bhd
Hong Leong Bank Bhd	Hong Leong Finance Bhd	Wah Tat Bank Bhd Credit Corporation (Malaysia) Bhd
Malayan Banking Group	Mayban Finance Bhd Aseambankers Malaysia Bhd	PhileoAllied Bank Bhd The Pacific Bank Bhd Sime Finance Bhd Kewangan Bersatu Bhd
Perwira Affin Bank Bhd	Affin Finance Bhd Perwira Affin Merchant Bank Bhd	BSN Commercial Bank Bhd BSN Finance Bhd Asia Commercial Finance Bhd BSN Merchant Bank Bhd
Public Bank Bhd	Public Finance Berhad	Hock Hua Bank Bhd Advance Finance Bhd Sime Merchant Bankers Bhd
RHB Bank Bhd	RHB Sakura Merchant Bankers Berhad	Bank Utama (Malaysia) Bhd Delta Finance Bhd Interfinance Berhad
Southern Bank Bhd	Southern Finance Company Bhd / Southern Investment Bank Bhd	Ban Hin Lee Bank Bhd Cempaka Finance Bhd Perdana Finance Bhd United Merchant Finance Bhd Perdana Merchant Bankers Bhd
10 banks	11 financial institutions	35 financial institutions

Source Bank Negara Annual Report 2001.

Note:

- a AmBank (M) Bhd and Alliance Bank Malaysia Bhd were previously known as Arab-Malaysian Bank Bhd and Multi-Purpose Bank Bhd respectively.
- b Bumiputra-Commerce Bank Bhd was created from the merger between Bank of Commerce (M) Bhd and Bank Bumiputra Malaysia Bhd, the second largest banking institutions prior to the 1997 crisis. The latter suffered from non-performing loans and was rescued by the Bank of Commerce (M) Bhd. The mergers between Bank of Commerce (M) Bhd and Bank Bumiputra Malaysia Bhd as well as RHB Bank Bhd and Sime Bank Bhd happened in 1999, prior to the government merger announcement in October 1999.



found to be positively correlated (Nicolo & Kwast, 2000). Shih (2003) also argues that mergers of a failing bank with a healthier one will neither resolve banking problems nor reduce the probability of bank failure.

On that note, there is no guarantee that bank efficiency and safety would improve with mergers as proven in past empirical studies based on the US bank mergers. Empirical work on the Malaysian financial institutions mergers is scarce since bank mergers were very rare in Malaysia prior to the 1999-2000 banking consolidation programme. Of the Malaysian studies, several concentrate on the stock market reaction to bank merger announcements. For example, Lee (2002) calculates the abnormal stock returns surrounding the merger announcements on 29 July 1999 and 14 February 2000. He reports no significant gains in the cumulative abnormal returns of stocks across the announcement periods. Another paper by Tan and Hooy (2004) finds that the proposed 1999-2000 merger programme adds stability to banks' stock prices and returns. Their study also indicates the presence of persistency positive risk returns and asymmetrical news effects in the bank stocks before the announcement.

Given that the 1999-2000 merger programme was only completed in 2002, it is still early to evaluate overall benefits, particularly in respect of efficiency gains. Long lags do occur between merger and value gains. On average, cost savings would be fully realised within 2 to 3 years (Rhoades, 1998). This is particularly so for Malaysia given that the merging parties were not allowed to retrench employees for 2 years after the merger exercise was completed.<sup>8</sup>

Nevertheless, there are already a few post-merger studies on the extent of productivity change of the 10 Malaysian acquiring banks with results varying across the studies. For example, Krishnasamy, Ridzwa and Perumal (2004) utilise the Data Envelopment Analysis (DEA) and the Malmquist total factor productivity index to measure individual bank efficiency and productivity changes over the period 2000-2001. They report that 8 of the 10 acquiring banks enjoyed an increase in total factor productivity attributed mainly to technology rather than technical efficiency change. Conversely, Mat-Nor and Hisham

(2003), using DEA analysis on bank annual reports for 2000 and 2001, discovered that mergers did not contribute to any significant increase in efficiency of Malaysian commercial banks. The differences in the post-merger efficiency improvements are expected, given that the bank mergers were only completed in 2002. The cost savings, as described earlier, would be fully realised within 2 to 3 years. A longer period of study, therefore, should provide a better picture. Further, more empirical studies on the benefits of consolidation should be initiated.

In conclusion, the Malaysian government had little choice but to push for a complete restructuring of its banking industry after the 1997 Asian crisis. The final merger was between RHB Bank Bhd and Bank Utama (Malaysia) Bhd on 20 March 2002, with the latter attaining anchor bank status. This resulted in the successful completion of the 1999-2002 Malaysian domestic banking consolidation programme. Whether the 1999-2002 banking consolidation is effective in preventing future banking crises is yet to be seen. **EJM**

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8 Instead, an attractive retrenchment scheme and opportunity for diverse options of relocation were offered to the employees. Besides that, a comprehensive retraining and re-skilling programme was developed to facilitate a smooth transition of the staff into new areas in the financial industry and to other industries (Shanmugam & Nair, 2003).

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