SHAREHOLDER GAINS DURING THE BANK MERGER ANNOUNCEMENTS IN MALAYSIA

LEE MIANG HUA

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SHAREHOLDER GAINS DURING THE BANK MERGER ANNOUNCEMENTS
IN MALAYSIA

By

LEE MIANG HUA

Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,
in Fulfilment of Requirement for the Degree of Master of Science

July 2002
DEDICATION

This thesis is dedicated to all my friends especially to my beloved parents.
SHAREHOLDER GAINS DURING THE BANK MERGER ANNOUNCEMENTS IN MALAYSIA

By

LEE MIANG HUA

July 2002

Chairman: Associate Professor Dr. Muzafar Shah Habibullah, Ph.D.

Faculty: Economics and Management

This paper analyzes the shareholder gains surrounding the Malaysian bank merger announcements on 29th July 1999 and 14th February 2000. Initiated by the Bank Negara Malaysia (BNM) in the midst of financial crisis, the merger was not a market driven one in its real sense. In particular, this study measures the impact of these merger announcements on the appointed anchor bank, its target bank and combined bank. We find that all CAR$_t$ are statistically insignificant at any conventional level regardless of the category during event window of 61-day and 11-day. We believe this is because these mergers are arranged by BNM and are not market driven. There are shareholder gains during the 11-day window for the combined bank category but the finding is not statistically significant. However, they show slight positive returns but not substantial during the 61-day window. We also find that the shorter periods ie. 11-day (-5,+5) would give higher level of CAR$_t$ than longer periods ie. 61-day (-30,+30) in both initial and revised announcements. There are differences in CAR$_t$ between the initial and revised announcements even though both announcements are arranged by BNM and involved the
same banks. We believe that the differences are mainly due to greater flexibility being given to banks on merger during the revised announcement. There are also differences in cumulative abnormal returns among the categories namely anchor bank, target bank and combined bank during the 61-day window but for the event window 11-day, our finding conclude that there is at least one category of $\text{CAR}_t$ which is similar with the other categories. For both event windows of 61-day and 11-day, $\text{CAR}_t$ have a positive and statistically significant relationship with the relative shareholders' funds of the anchor bank ($\text{SHR}$) and New Anchor bank ($\text{NEW}$), and inverse relationship with the relative size of anchor to target banks ($\text{ASSET}$).
Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Master Sains

KEUNTUNGAN PEMEGANG SAHAM SEMASA PENGUMUMAN PENGGabUANGAN BANK-BANK DI MALAYSIA

Oleh

LEE MIANG HUA

Julai 2002

Pengerusi: Profesor Madya Dr. Muzafar Shah Habibullah, Ph.D.

Fakulti: Ekonomi and Pengurusan

kalangan kategori-kategori berkenaan iaitu bank peneraju, bank sasaran dan bank tergabung dalam jendala 61-hari tetapi bagi jendala peristiwa 11-hari, kajian ini merumuskan bahawa terdapat sekurang-kurangnya satu kategori CAR_t yang serupa dengan kategori yang lain, Bagi kedua-dua jendela peristiwa 61-hari and 11-hari, CAR_t mempunyai perkaitan positif dan signifikan dari segi statistik dengan dana pemegang saham bank peneraju (SHR) dan bank peneraju baru (NEW) dan perkaitan songsang dengan saiz bank peneraju berbanding saiz bank sasaran (ASSET)
ACKNOWLEDGEMENTS

I would like to take this opportunity to express my deepest gratitude to my supervisor, Associate Professor Dr. Tan Hui Boon and the other Committee members, Associate Professor Loo Sin Chun and Encik Shamsudin bin Ismail for their advice and guidance throughout the preparation of this thesis. I would also like to extend my sincere gratitude to Mr. Law Teik Hua, Ms. Chew Gim Ping and Mr. Lucius Chong for their assistance and support and to all my friends that have helped me in one way or another during the completion of this thesis.
I certify that an Examination Committee met on 11th July 2002 to conduct the final examination of Lee Miang Hua on his Master of Science thesis entitled “Shareholder Gains during the Bank Merger Announcements in Malaysia” in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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I hereby declare that the thesis is based on my original work except for quotations and citations, which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

LEE MIANG HUA

Date: 5/7/2002
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LIST OF ABBREVIATIONS

AAR – Average Abnormal Return
AFTA – Asean Free Trade Area
BAFIA – Banking and Financial Institutions Act 1989
BCB – Bumiputra Commerce Bank
BIS – Bank for International Settlements
BNM – Bank Negara Malaysia
CAR – Cumulative Abnormal Return
CDRC – Corporate Debt Restructuring Committee
DBS – Development Bank of Singapore
MRCB – Malaysia Resources Corporation Berhad
NPL – Non Performing Loan
ROA – Return on Asset
ROE – Return on Equity
RWCR – Risk Weighted Capital Ratio
SC – Securities Commission
TTRS – Two – Tier Regulatory System
VSS – Voluntary Separation Schemes
WTO – World Trade Organization
CHAPTER 1
INTRODUCTION

1.1 Background

For some time now, Malaysia has been preparing for the day when the barriers to entry will come down with the enforcement of World Trade Organisation (WTO) and Asean Free Trade Area (AFTA) liberalization rules. To further prepare itself for this challenge, the Malaysian government has taken steps to strengthen the local financial institutions through merger and consolidation of the financial industry. In normal circumstances, merger is a market driven process, which involve willing seller and willing buyer. However, the Malaysian bank merger was initiated by the two most powerful regulatory authorities in their respective jurisdictions, which are Bank Negara Malaysia (BNM) and Securities Commission (SC).

This industry-wide merger exercise which took place in year 1999-2000 has created an intensive wave of mergers that shook out the local banking sector and forever changed the country’s landscape. As a result, by 31st December 2000, 50 of the country’s 54 financial institutions had been trimmed to just 10 banking groups in the space of a few short months. BNM reported that 94% of the total assets of the domestic banking sector have rationalised and consolidated.

In general, mergers among the financial institutions have been a global trend in recent years due to the effects of the on-going process of globalisation and liberalisation. Recently, Japanese banks have merged and created among themselves four mega-banks,
which are Mizuho Financial Group, Sumitomo Mitsui Banking Corporation, The Mitsubishi Tokyo Financial Group and the UFJ Group. The creation of Mizuho Financial Group, through the merger between Dai Ichi Kangyo Bank, Industrial Bank of Japan and Fuji Bank, has put the Group as the world largest bank in term of assets. (Business Times, 3rd April 2001) In another development, the region biggest bank, Development Bank of Singapore (DBS) has acquired Dao Heng Bank in Hong Kong for around USD5.7 billion to make its presence felt in Hong Kong. All these recent mergers are part of the individual bank’s preparation for the globalization and liberalization.

In fact, this research is motivated by the significant increase in merger activities internationally as well as locally. The objective of this paper is to evaluate the effects of the bank mergers’ announcements towards the shareholder gains of the banks involved in the merger. Particularly, we would like to find out whether these announcements would create value or abnormal returns on banks that involved in the merger announcements on 29th July 1999 and 14th February 2000, including separating the effects on anchor banks and the target banks.

1.2 Development in the Banking Industry Prior to the Merger

1.2.1 Significant Events Prior to the Merger

Years prior to the industrial wide merger, the banking industry had gone through some degree of rationalization beginning with the banking sector reforms initiated after the 1985-86 recession that necessitated the injection of capital into three ailing commercial banks by BNM. One of the banks, United Asia Bank Bhd, was subsequently merged with
Bank of Commerce (M) Bhd that allowed BNM to divest its entire shareholding in the bank. The more competitive environment and the need to increase capital base have prompted two subsequent mergers in the industry. The first was between DCB Bank Bhd and Kwong Yik Bank Bhd in 1997, which gave birth to RHB Bank Bhd and the second merger, was between Chung Khiaw Bank Bhd and United Overseas Bank (M) Bhd also in 1997.

Unfortunately, the pace of mergers in the banking industry remained slow and unsatisfactory throughout the 1990s. However, the financial crisis in 1997-98 gave the much-needed push for the industry to consolidate and in June 1999, RHB Bank Bhd absorbed Sime Bank Bhd while Bank of Commerce (M) Bhd merged with Bank Bumiputra Malaysia Bhd in October 1999.

With the aim of rebuilding and strengthening the balance sheets of the commercial banks, prudential reforms were introduced. The most significant was the implementation of the Bank for International Settlements (BIS) capital adequacy framework in 1989 which replaced the minimum ‘free’ capital adequacy ratio requirement. The new capital standard requires capital to be provided for both on- and off-balance sheet assets based on their perceived level of counterparty risk. This capital-asset relationship will ensure that these elements move in tandem such that any increase in risky assets would be supported by an increase in the required level of capital. This approach effectively increases the risk sensitivity of the commercial banks in the structuring of their balance sheet. The new capital adequacy framework also saw the concept of bank holding companies being used
to reorganize bank groups in order to improve the Risk Weighted Capital ratio (RWCR) of the commercial banks. Under the RWCR framework, investments in subsidiaries are deducted from the capital base of the parent banks, thereby reducing their RWCR. Thus, a bank holding company allows the bank to divest its subsidiaries to the holding company, freeing its capital for greater loan asset expansion.

A major regulatory and legislative milestone also took place in 1989 with the enactment of the Banking and Financial Institution Act 1989 (BAFIA) which replacing the Banking Act 1973 and Finance Companies Act 1969. The introduction of BAFIA was intended to provide an integrated supervision of the Malaysian financial institutions and to modernise and streamline the laws relating to banking and all other financial institutions came under one supervisory body. Over time, growing competition in the banking system had resulted in the blurring of demarcation of business lines between the three traditional groups of banking institutions under BNM's supervision, namely commercial banks, merchant banks and finance companies. This had led to a convergence on the methodology of supervision of these institutions though the enactment of BAFIA, including discount houses and money brokers, which were previously supervised on an administrative basis, under one common legal supervisory framework.

BNM also introduce the two-tier regulatory system (TTRS) for the commercial banks in 1994, with the objective of accelerating the pace of liberalization for strong and healthy institutions. The TTSR provided the impetus for the emergence of a core of well-managed and highly capitalized commercial banks, which would be able to grasp
opportunities for innovation and face greater competition in light of financial globalization and liberalization. The system permitted well-managed banking institutions with strong financial standing to carry out specific new activities and conduct certain aspects of their operations under a more liberal regulatory environment. To qualify for Tier-1 status, commercial bank were required to meet minimum shareholders’ funds of RM500 million by end 1995, which would then be increased to RM1 billion by end 2000.

In addition, they were also required to achieve a strong rating under the CAMEL framework which evaluated five critical components of banking operations i.e.: capital adequacy, asset quality, management capacity, earnings performance and liquidity position. A total of 11 commercial banks qualified for the Tier-1 status by end 1996.

The TTRS had a significant impact on the balance sheet of commercial banks as could be seen in the substantial growth of the commercial banks’ capital and reserve from RM10 billion at end 1993 to RM25.2 billion at end 1996, due largely to new capital injection. Pressed on the need to generate high rates of return for the new capital, there was also a significant rise on the asset side of commercial banks’ balance sheets, particularly on loans extended and holdings of marketable securities which almost doubled from RM117 billion and RM26.8 billion to RM217.8 billion and RM51 billion respectively within 1993 to 1996. The TTRS was eventually abolished in 1999 due to its negative impact of inducing aspiring banking institutions to increase their asset base in a rapid manner to keep up with the required earnings on capital. The financial crisis in 1997-98 showed that
the asset quality of banks was affected as a result of the pressure to record rapid loan
growth.

1.2.2 Progress in the Banking Industry Prior to the Merger

The commercial banks are the main players in the banking system. They are the largest
and most significant providers of funds in the banking system with total loans and total
deposits amounting to RM285.1 billion and RM287.6 billion respectively as at end June
1999, representing approximately 76% and 71% of the banking system’s total loans and
deposits respectively.

As at end June 1999, there are 34 commercial banks (excluding Bank Islam Malaysia
Bhd) operating with a total of 1,735 branches nation wide, of which 13 are locally
incorporated foreign banks. There are approximately 63,889 staff employed by the
commercial banks in the country, an increase of about 53.6% since 1988.
Table 1.1: Commercial Banks in Malaysia – Malaysian Banks (RM million)

<table>
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<th>Name of Bank</th>
<th>Year of commencement of business in Malaysia</th>
<th>Total assets as at end financial year 1998/1999 (RM million)</th>
</tr>
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<tr>
<td>1. Arab-Malaysian Bank Berhad (^1)</td>
<td>1957</td>
<td>12,614.60</td>
</tr>
<tr>
<td>2. Ban Hin Lee Bank Berhad</td>
<td>1935</td>
<td>6,820.80</td>
</tr>
<tr>
<td>3. Bank Bumiputra Malaysia Berhad (^2)</td>
<td>1966</td>
<td>38,164.70</td>
</tr>
<tr>
<td>4. Bank of Commerce</td>
<td>1973</td>
<td>20,382.70</td>
</tr>
<tr>
<td>5. Bank Utama (M) Berhad</td>
<td>1976</td>
<td>7,140.90</td>
</tr>
<tr>
<td>6. BSN Commercial (M) Berhad (^4)</td>
<td>1975</td>
<td>6,565.70</td>
</tr>
<tr>
<td>7. EON Bank Berhad</td>
<td>1964</td>
<td>9,149.00</td>
</tr>
<tr>
<td>8. Hock Hua Bank</td>
<td>1951</td>
<td>4,934.60</td>
</tr>
<tr>
<td>9. Hong Leong Bank Berhad (^6)</td>
<td>1923</td>
<td>15,094.50</td>
</tr>
<tr>
<td>10. International Bank Malaysia Berhad (^7)</td>
<td>1961</td>
<td>969.00</td>
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<td>11. Malay Bank Berhad</td>
<td>1960</td>
<td>77,896.00</td>
</tr>
<tr>
<td>12. Multi-Purpose Bank Berhad (^8)</td>
<td>1957</td>
<td>7,658.50</td>
</tr>
<tr>
<td>13. Oriental Bank Berhad</td>
<td>1937</td>
<td>8,866.70</td>
</tr>
<tr>
<td>14. Perwira Affin Bank Berhad</td>
<td>1976</td>
<td>15,343.10</td>
</tr>
<tr>
<td>15. PhileoAllied Bank Bank (M) Berhad (^9)</td>
<td>1966</td>
<td>10,605.80</td>
</tr>
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<td>16. Public Bank Berhad</td>
<td>1966</td>
<td>31,581.90</td>
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<td>17. RHB Bank Berhad</td>
<td>1965</td>
<td>51,285.20</td>
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<td>18. Sabah Bank Berhad</td>
<td>1979</td>
<td>2,670.10</td>
</tr>
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<td>19. Southern Bank Berhad</td>
<td>1965</td>
<td>8,193.10</td>
</tr>
<tr>
<td>20. The Pacific Bank Berhad</td>
<td>1922</td>
<td>10,955.70</td>
</tr>
<tr>
<td>21. Wah Tat Bank Berhad</td>
<td>1955</td>
<td>724.70</td>
</tr>
<tr>
<td>22. Bank Islam Malaysia Berhad</td>
<td>1983</td>
<td>5,698.40</td>
</tr>
</tbody>
</table>

Source: Bank Negara Malaysia

\(^1\) Formerly known as Security Pacific Asian Bank Limited prior to 1994.

\(^2\) The conventional (non-Islamic) assets and liabilities of the bank had been transferred to the newly merged Bumiputra-Commerce Bank, which began operation in 1 October 1999. Bank Bumiputra Malaysia Berhad remains involved exclusively in the Islamic banking sector under the name of Bank Muamalat Malaysia Berhad.

\(^3\) Bank of Commerce Berhad (BCB) and United Asian Bank Berhad (UAB) were merged in 1991. UAB’s name was changed to Bank of Commerce (M) Berhad while the banking license of BCB was surrendered. On 1 October 1999, the bank was renamed Bumiputra-Commerce Bank Berhad following the absorption of the conventional (non-Islamic) assets and liabilities of Bank Bumiputra Malaysia Berhad.

\(^4\) Formerly known as Bank Buruh (M) Berhad prior to 1995.

\(^5\) Formerly known as Bank Buruh (M) Berhad prior to 1995.

\(^6\) Formerly known as Bank Buruh (M) Berhad prior to 1995.

\(^7\) Formerly known as Bank Buruh (M) Berhad prior to 1995.

\(^8\) Formerly known as Bank Buruh (M) Berhad prior to 1995.

\(^9\) Formerly known as Bank Buruh (M) Berhad prior to 1995.

\(^10\) Kwong Yik Bank Berhad and DCB Bank Berhad (DCB) were merged in 1997, after which DCB was renamed as RHB Bank Berhad.
### Table 1.2: Commercial Banks in Malaysia – Foreign Banks (RM million)

<table>
<thead>
<tr>
<th>Name of Bank</th>
<th>Year of commencement of business in Malaysia</th>
<th>Total assets as at end financial year 1998/1999 (RM million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 ABN AMRO Bank Berhad</td>
<td>1888</td>
<td>1,830.50</td>
</tr>
<tr>
<td>2 Bangkok Bank Berhad</td>
<td>1959</td>
<td>699.90</td>
</tr>
<tr>
<td>3 Bank of America Malaysia Berhad</td>
<td>1959</td>
<td>1,597.00</td>
</tr>
<tr>
<td>4 Bank of Tokyo-Mitsubishi (M) Berhad</td>
<td>1959</td>
<td>2,711.70</td>
</tr>
<tr>
<td>5 Citibank Berhad</td>
<td>1959</td>
<td>13,719.50</td>
</tr>
<tr>
<td>6 Deutsche Bank (M) Berhad</td>
<td>1968</td>
<td>1,879.80</td>
</tr>
<tr>
<td>7 HSBC Bank (M) Berhad</td>
<td>1884</td>
<td>25,187.30</td>
</tr>
<tr>
<td>8 OCBC Bank (M) Berhad</td>
<td>1932</td>
<td>15,882.40</td>
</tr>
<tr>
<td>9 Overseas Union Bank (M) Berhad</td>
<td>1958</td>
<td>6,460.40</td>
</tr>
<tr>
<td>10 Standard Chartered Bank Malaysia Berhad</td>
<td>1875</td>
<td>17,009.10</td>
</tr>
<tr>
<td>11 The Bank of Nova Scotia Berhad</td>
<td>1973</td>
<td>1,261.10</td>
</tr>
<tr>
<td>12 The Chase Manhattan Bank (M) Berhad</td>
<td>1973</td>
<td>1,261.10</td>
</tr>
<tr>
<td>13 United Overseas Bank (M) Berhad</td>
<td>1956</td>
<td>10,911.60</td>
</tr>
</tbody>
</table>

Source: Bank Negara Malaysia

**Note:** Formerly known as Lee Wah Bank Limited prior to 1994. Chung Khiaw Bank (M) Berhad merged with United Overseas Bank (M) Berhad in 1997.