

**THE EFFECT OF MERGERS ON THE EFFICIENCY OF COMMERCIAL BANKS:
EVIDENCE FROM MALAYSIA**

A thesis submitted to the Faculty of Finance and Banking in fulfillment of the
requirements for the degree of Master of Science (Banking),

Faculty of Finance and Banking,

Universiti Utara Malaysia.

By

Muhammad Hafiz Bin Desa

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ABSTRAK

Disertasi ini mengkaji kesan penggabungan terhadap kecekapan bank-bank perdagangan di Malaysia dari tahun 1995-2005. Kami menggunakan pendekatan sempadan bukan parametrik iaitu Data Envelopment Analysis (DEA), untuk menganalisa kecekapan bank-bank dalam tempoh semasa kegawatan, sebelum penggabungan, semasa penggabungan dan selepas penggabungan. Untuk perbandingan kecekapan bank-bank tempatan, sembilan bank-bank asing juga dikaji. Keputusan menunjukkan sebelum krisis kewangan, bank-bank asing lebih efisien berbanding bank-bank tempatan. Tanpa diduga, bank-bank tempatan lebih efisien berbanding bank-bank asing semasa krisis ekonomi dengan purata skor kecekapan masing-masing 96.6% dan 78.9%. Ini membuktikan sepuluh bank-bank tempatan yang telah dipilih oleh Bank Negara Malaysia sebagai peneraju bank-bank perdagangan tidak dipengaruhi oleh krisis kewangan pada 1997. Namun, bank-bank tempatan kurang efisien semasa tahun penggabungan berbanding bank-bank asing. Ini disebabkan beberapa bank yang mengambil alih bergabung dengan bank-bank yang lebih lemah, yang mana ianya mempengaruhi prestasi bank-bank tersebut. Penggabungan kelihatan membenarkan bank-bank yang cekap mengambilalih bank-bank yang lemah, maka ianya membantu meningkatkan kecekapan input. Bank-bank yang tidak cekap semasa tahun penggabungan adalah disebabkan oleh pengintegrasian sistem dan teknologi di lokasi dan kawasan yang berlainan. Keputusan juga menunjukkan bahawa bank-bank yang cekap adalah tidak dipengaruhi oleh saiz kerana bank-bank kecil dan sederhana adalah lebih efisien. Secara umumnya, kecekapan bank-bank tempatan bagi tempoh lima tahun sebelum dan selepas tahun penggabungan masing-masing ialah 92.3% dan 97.2%. Keputusan juga menunjukkan bank-bank tempatan Malaysia memperoleh purata kecekapan 100% pada tahun 2005. Secara keseluruhannya, kajian ini telah membuktikan bahawa program penggabungan bank-bank di Malaysia adalah berjaya.

ABSTRACT

This paper studies the effect of mergers on the efficiency of commercial banks in Malaysia from 1995-2005. We utilise the non-parametric frontier approach, Data Envelopment Analysis (DEA), to analyse the efficiency of banks during the financial crisis, the merger year, and the pre-and post merger periods. To make comparison of the efficiency of domestic banks, nine foreign banks are also included in the sample. Results show that before financial crisis, foreign banks were more efficient than domestic banks. Surprisingly, domestic banks had a higher efficiency level than foreign banks in the crisis year with an average technical efficiency score of 96.6% compared to 78.9%. It is evidence that 10 domestic banks selected by Bank Negara Malaysia to be the anchor commercial banks were not really affected by financial crisis which hit the country in 1997. However, domestic banks were inefficient during merger year compared to foreign banks. This was due to some of the acquiring banks merged with weaker banks and influenced the bank's performance. Mergers seem to allow efficient banks to gain control of weaker banks, thus helping them to increase input efficiency. The inefficient banks in merger year were also influenced by integrating system and technology in different location and geographical area. We find that efficient banks are not determined by size as small and medium banks are more efficient. The technical efficiency of domestic banks in five years before and five years after the merger were 92.3% and 97.2% respectively. The results also reveal that Malaysian domestic banks experienced an average efficiency of 100% in year 2005. Overall, this study has established that the merger programme in Malaysia was successful.

ACKNOWLEDGEMENTS

Alhamdulillah, all praise to Allah the Al-Mighty for the blessing and opportunity bestowed upon me to undertake my MSc. Blessing and salutation also is on Prophet of Allah, Muhammad S.A.W. Thanks also for the strength and courage granted to me to accomplish my study.

I would like to express my gratitude and appreciation to the Faculty of Finance and Banking of Universiti Utara Malaysia (UUM), especially to Dr. Rohani Md Rus and Dr. Kamarun Nisham Taufil Mohd of their continuous guidance in preparing this thesis and reviewing my project paper.

My deepest thanks to the Dean of Faculty of Finance and banking, Assoc. Prof. Dr Nor Hayati Ahmad and lecturers for their help and cooperation given during preparing and finishing this thesis. My gratitude also to Mr. Fadzlan Sufian from CIMB Bank for his help in sharing his great knowledge in DEAP version 2.1.

I would like to dedicate my thesis and special thanks to my parents Haji Desa bin Senawi and Hajjah Che Onin binti Che Dat for their support and constant encouragement throughout my MSc study. I would also like to thank all my colleagues at Citigroup Trade Services (M) Sdn Bhd for their constant words of encouragement.

Last but not least, thanks also to all my friends, who had encouraged and supported me during the process of completing this thesis.

Thank you to all of them.

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CHAPTER 1

INTRODUCTION

1.1 CHAPTER OVERVIEW

The rationale of this chapter is to provide the main objectives and aim of this study. This chapter covers a brief introduction of commercial banking overview before and after mergers. We also discuss in relation to economic crisis in 1997 that prompted to mergers of financial institutions.

1.2 MALAYSIAN BANKING AT A GLANCE

The banking system in Malaysia is vibrant, strong and profitable. In fact, the banking system is at the strongest position since the financial crisis. Substantial enhancements in the areas of corporate governance and risk management standards have reinforced the high level of capital, improving asset quality and strong profitability.

These enhancements have enabled the banking institutions, particularly the Malaysian domestic banks to remain competitive and to offer different products and value-added services to customers. The major competition today is the soundness and scrambling of foreign banks to offer products based on the Islamic principles which indicates that customer's demand is the priority. The threat of competition forces banks to focus on their effectiveness in providing financial services and in offering the increasing demands from customers. This situation requires an appropriate assessment of

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Hong Leong Bank Bhd
<http://www.hlb.com.my/>

Malayan Banking Bhd
<http://www.maybank.com.my/>

Public Bank Bhd
<http://www.publicbank.com.my/>

RHB Bank Bhd
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Southern Bank Bhd
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Citibank Bhd
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<http://www.db.com/malaysia/>

HSBC Bank (M) Bhd
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OCBC Bank (M) Bhd
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