

CHAPTER ONE

BUMIPUTRA-COMMERCE BANK BERHAD (BCB)

1.1 BACKGROUND OF THE COMPANY

Bumiputra-Commerce Bank Berhad is the result of a merger between Bank Bumiputra Malaysia Berhad and Bank of Commerce (M) Bhd, on October 1, 1999. It was a merger of two banks with complementary strengths, one with a strong corporate presence and the other with a large branch network and retail customer base. The result is a new bank with combined banking experience of over 100 years, poised to be one of the largest and most progressive financial institutions in Malaysia.

Bumiputra-Commerce Bank group has an asset base of RM63.2 billion, gross loans and advances of RM39.5 billion and customer deposits of RM44.6 billion. The shareholders' funds amounts to RM3.99 billion. The Bank has one of Malaysia's largest network of over 300 branches, retail service and Bureau de Change outlets. The bank employs about 9,500 staff nationwide servicing a customer base of more than 4.5 million. It also has the distinction of having the largest 24-hour ATM network of over 715 ATMs located throughout the country. TABLE 1.1 illustrates BCB's corporate history developments.

TABLE 1.1

SCHEDULE OF BCB'S CORPORATE HISTORY DEVELOPMENTS:

- **1924** : The company starts operations as a family-owned bank in Kuching, Sarawak.
- **1956** : It is incorporated as Bian Chiang Bank Bhd on 24 Dec.
- **1972** : United Asian Bank Bhd (UAB) is incorporated on 30 Dec. It takes over the business of three Indian-owned banks – Indian Overseas Bank Ltd, Indian Bank Ltd and United Commercial Bank Ltd.
- **1975** : Fleet Group Sdn Bhd acquires 100 per cent equity of Bian Chiang Bank.
- **1979** : Morgan Guaranty International Finance Corporation, a subsidiary of Morgan Guaranty Trust Company of New York, acquires 30 per cent of Bian Chiang Bank's issued share capital. Head Office of the bank is transferred to Kuala Lumpur and name is changed to Bank of Commerce Bhd (BOC).
- **1986** : BOC acquires 51 per cent stake in Commerce International Merchant Bankers (CIMB).
- **1988** : CIMB establishes CIMB Securities Sdn Bhd in January. Also sets up first property unit trust in First Malaysia Property Trust Managers.
- **1991** : UAB and BOC merge. BOC's commercial banking business is transferred to UAB. BOC changes to holding company, Commerce Asset-Holding Bhd (CAHB), and UAB is renamed Bank of Commerce (M) Bhd.
- **1999** : CAHB enters into a Share Exchange Agreement with shareholders of Bank Bumiputra Malaysia Bhd (BBMB) namely, Minister of Finance Incorporated (MOF) and Khazanah Nasional Bhd for merger of BBMB on 8 Feb. Merger gives MOF and Khazanah 30 per cent stake in CAHB. Merged entity is renamed Bumiputra-Commerce Bank Bhd (BCB). BBMB becomes Bank Muamalat Malaysia Bhd, the second Islamic bank in the country.
- **1999** : Harmonisation of BBMB's and BOC's ATM services on 5 June.
- **1999** : Completion of BBMB share acquisition and commencement of put option to sell non-performing loans from ex-BBMB business to special-purpose vehicle Danaharta Urus Sdn Bhd on 30 August.
- **2001** : Target date (2 June) for completion of integration of information technology system.
- **2001** : Expiry date (30 July) of put option granted to BCB on any qualifying loans.

Source Malaysian Business Times: June 1st, 2001

The major institutional shareholders of CAHB are Khazanah Nasional Bhd with 15 per cent, the Minister of Finance Incorporated with 17 per cent, Employees Provident Fund with 9 per cent and the Civil Service Pension Fund with 2 per cent. The corporate shareholders are Renong with 12 per cent and New Straits Times Press Bhd with 13 per cent.

TABLE 1.2

BCB's Annual Report.

Fact File	
Adjusted Paid-Up Capital : RM1.184 billion	
Directors	
	Datuk Mohamad Desa Pachi (chairman)
	Dr. Rozali Mohamed Ali (exec. director)
	Datuk Anwar Aji
	Shuzaboru Eto
	Mohd Salleh Mahmud
Substantial Shareholders	
Minister of Finance Inc (MOF)	16.75
Khazanah Nasional Bhd	15.03
Pitisan Sdn Bhd	
(New Straits Times Press Bhd)	12.85
Fleet Group Sdn Bhd (Renong Bhd)	12.16
Employee Provident Fund	9.30
The Sanwa Bank Ltd	4.56
The capital Group Co Inc	2.40
Civil Service Pension Fund	2.24
Latest Pre-tax Profits : RM234.7 million for the 3 months ended 31 March 2001.	

Source :BCB's Annual Report

The merger with BBMB was viewed favourably as it enabled BOC to expand its commercial-banking business, especially retail banking, while BBMB had a strong presence with its vast number of branches as in Table 1.3 and 1.4. BCB's long-term prospects in the country's financial scene are bright.

TABLE 1.3

THE NEW BANK WILL BE THE SECOND LARGEST IN MALAYSIA

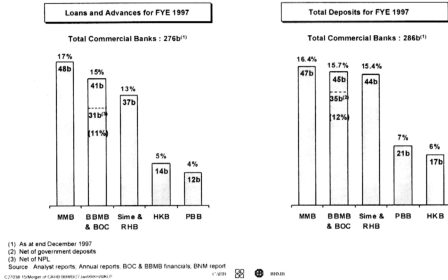
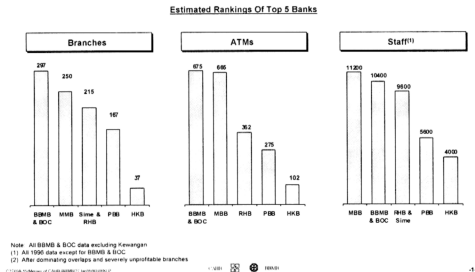


TABLE 1.4

THE COMBINED NETWORK ECLIPSES MAYBANK



Source : BCB Merger Documents

ISLAMIC BANKING

Bank Muamalat Malaysia Bhd, the second Islamic Bank was created from the enlarged Skim Pemanduan Islam (SPI) Department within BBMB. The objective of its formation is to provide a much-needed second Islamic bank in the country, in response to the challenge to grow Islamic banking as an alternative form of banking in Malaysia. Bank Muamalat was handed over to Ministry of Finance Inc./ Khazanah Nasional Bhd. at the end of 1999.

BCB retains a 30% equity in this Islamic Bank and provides it with IT support services. In addition, BCB has established Islamic banking windows to retail Bank Muamalat's Islamic banking services at 56 of its branches. Bank Muamalat started its operations in September 1999 has 40 branches and 5 service centers strategically located to serve a customer base of about 700,000.

1.2 ORGANIZATION STRUCTURE OF THE BANK

The Bumiputra-Commerce Bank's organization model is based on the following four main four key elements as in TABLE 1.5 to enable the bank to respond to the globalization and liberalization of the Financial Services Industry in 2003.

In order to have a lean organisation structure and to enhance decision-making, it must be a simplified structure with clear responsibilities and accountabilities to facilitate a limited number of direct reports and reporting levels. All the networks are aligned with the various customer groups to maintain the customer focus at point-of-sale.

TABLE 1.5

**THE NEW ORGANISATION STRUCTURE BASED ON FOUR KEY
ELEMENTS HAS BEEN ADOPTED**
Key Elements Of The Group Structure

1. Simplified structure with clear accountabilities
 - Limited number of direct reports and reporting levels
 - Integrated group and commercial bank structures
2. Autonomous businesses focused around customer groups which co-ordinate all relevant product and channel offerings
 - Consumer including Small Business
 - Business
 - Wholesale including Treasury, Investment and Corporate Banking
3. Networks aligned with these customer groups to maintain the customer focus at point-of-sale
 - Separate consumer branches, commercial and corporate centers
 - Shared back office, transaction facilities (consumer branches)
4. A shared, but contestable operations infrastructure
 - Potential to out-source/develop joint-venture operations
 - Potential to undertake third party processing

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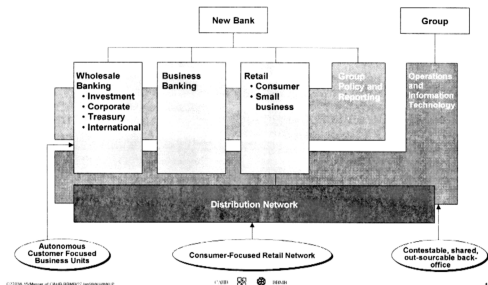
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Source: BCB Merger Documents

BCB's business focuses on its technological capabilities to facilitate customer service and innovative products, backed by efficient and cost effective IT based processing by restructuring and realigning of the retail network operations. Separate consumer branches, commercial and corporate centers are developed to enhance the service process. In addition, the Processing Division's operations are re-aligned to cater as a shared back office transaction facilitator for the three SBU's. (Strategic Business Units) such as the Wholesale Banking, Business Banking and Retail Banking. The Group Policy and Reporting Division and Operations and Information Technology to provide services to the entire CAHB Group. (Commerce Asset Holdings Berhad) as in Figure 1.1.

FIGURE 1.1

A NEW ORGANISATION WILL SUPPORT THE CUSTOMER FOCUS



Source: BCB Merger Documents

1.3 BUSINESS STRUCTURE OF THE BANK

The Bank is organized into three key functions: 1) Sales and Service, 2) Policy and Control and 3) Processing (Operations and Information Technology). The detailed group structure breakdown is shown in FIGURE 1.2 below.

1) SALES AND SERVICE

The Bank is organized into 3 distinct customer groups: Wholesale Banking (Corporate & Institutional Banking), Retail Banking and Business Banking.

- The Retail Banking group is structured in a "hub and spoke" configuration to allow the retail group to be more customer-focussed, while reinforcing and expanding over time the Bank's geographic coverage.

- Segregation of the Corporate and Business Banking groups allows better focus and dedicated service to be directed to the different needs of each customer groups.
- Corporate Banking focuses on the conglomerates and larger Malaysian organizations while Business Banking caters for the middle market and smaller commercial accounts.
- A special unit called Japanese Desk dedicates its efforts towards providing a high level of financial services to Japanese corporate businesses in Malaysia. An Executive Advisor seconded from the Sanwa Bank in Japan oversees the unit's initiatives.

2) POLICY AND CONTROL

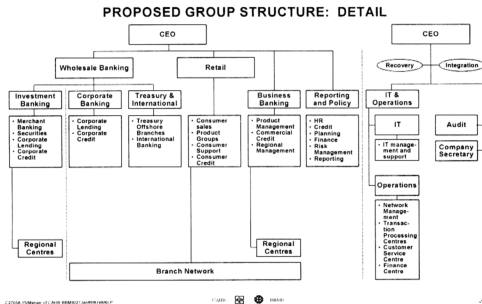
- Provides the administration support that ensures consistency in policy and the control of operations.

3) PROCESSING (OPERATIONS AND IT)

- Implemented to leverage economies of scale in processing activities to gain a competitive edge. The bank aims to achieve a high level of specialization and efficiency with high volume, speedy processing of financial transactions. It aspires to become a low cost provider of mass-market financial services.
- Centralized processing frees the sales and marketing business groups from back office operations and enable them to effectively concentrate on delivering focussed customer service.
- In addition to the branches, the Bank has established 15 new Business Banking Centers that focus on business banking needs of customers. These are supported by a network of 24 strategically located Trade Finance Centers nationwide and are manned by highly competent and knowledgeable trade services specialist.

•A well-equipped Call Center provides consumer-banking support. 40 specially trained full time bank officers handles phone banking services and answers customers' queries from 7am to 11pm daily, seven days a week. The Bank's Call Center was recognized with a Bronze Award in the commercial category by the Call Center Association of Malaysia in its recent annual evaluation of the top call centers in the country. It was selected for its high levels of accessibility, courtesy, product knowledge, greeting quality and communications skills to over 50 centers.

FIGURE 1.2



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Source: BCB Merger Documents

1.4 Vision and Mission Statements

BCB's vision and mission statement is to dominate the local financial market and to be a new financial services landscape. The newly merged bank has been designed not to be an aggregation of its former component of banks but to be re-invented to be a modern financial services provider that could respond effectively to the challenges of globalisation. The year 2001 will be the starting point for the transformation of the newly created bank's identity to be a new financial icon in the Malaysian banking landscape.

During the year 2001, BCB would have completed the merger integration programmes and the transformation of the bank into a single large integrated entity operating as a major financial services provider in the country. The goal is to create a world-class provider of financial services that will dominate the retail, business and corporate banking sectors in the country.

1.5 Strategic Plans

The strategic focus of the Bank during the first year after merger was to accelerate the integration processes. This in line with this major initiatives and projects launched to integrate and refine the infrastructure as well as build the requisite capabilities to enable the Bank compete in a consolidated, liberalised and deregulated marketplace. Most of the strategic initiatives and projects have delivered the targeted results or have reached the targeted milestones towards completion. The IT integration is targeted for completion in mid-2001.

The Bank has a head start over most other domestic banks in the consolidation process and intends to capitalize on it to build market dominance. The strategic theme for the year 2001, which will be the Bank's second year of merger, is accelerating the Bank's transformation for market dominance.

The Bank's strategies shall be as follows:

- Moving to One Operating Platform
- Accelerating growth
- Enhancing the Bank's competitive position
- Building e-banking capabilities and seizing opportunities in e-commerce

1.6 Current Situation of the Bank as per the CEO

"Mergers are always difficult. Somebody once said that 70,000 decisions have to be made on the spot ... and not next week or next month," remarks Dr. Rozali Mohamed Ali, the Executive Director of Commerce Asset-Holding Bhd (CAHB) and the Managing Director of Bumiputra-Commerce Bank (BCB). "Fortunately, we had a good team to see it through".

Commerce Asset-Holding Bhd (CAHB) Executive Director, Dr. Rozali Mohamed Ali is not exactly new to bank mergers. Before BCB was formed from the link-up between Bank of Commerce Bhd (BOC) and Bank Bumiputra Malaysia Bhd (BBMB), he oversaw BOC's merger with United Asian Bank in 1991, together with Datuk Md Nor Yusof. Md Nor, then BOC president, is now managing director of MAS after resigning as BCB president-cum-chief executive officer in May 2000.

Heading the second largest banking group, which CAHB has now become is no easy task. Expectations are high. The job has been made more difficult for Rozali, 52, who obtained his doctorate in engineering from the prestigious Imperial College in London, as he has to deal with a perception problem besieging the group. However, Rozali, who heads the Association of Banks Malaysia and sits on the newly formed Energy Commission, confronts the issues head on.

BCB's latest results are well within market expectations. Do you expect the trend to continue?

"All ingredients are in place for the merged entity to continue to do well. We have adopted a rather low-profile stance since we started the merger some 18 months ago. We have done a rather extensive reconfiguration of the bank. We felt it was necessary as the economic environment is such that it is important that we concentrate on the business of banking. A key parameter is that there be continuity in operations."

"But we also knew we had to build the bank along new operating lines. As the economy grows, customers require different kinds of financial services. They demand that we do it efficiently. In many ways, the older models are no longer suitable. So it has been as much a process of transformation as it has been a merger. We are beginning to see the end of the process of integration and transformation. And the most recent results bear out the validity of what we have done. Barring unforeseen circumstances, we should be among the better performers as far as banking and financial services as concerned."

The bank is being built around new parameters. Can you cite some examples?

"We now operate in a clearly defined structure. We have three strategic business units and two corporate units. Each is autonomous as far as possible. They operate as highly focused banks of their own. They are encouraged to have their own balance sheet, and own profit & loss statements for purpose of internal controls and monitoring of efficiency. This we believe is unprecedented in this country. The model has acquitted itself quite well."

"Another example is the way we have configured the branch network. We moved quickly into a hub-and-spoke structure. There is clear line of

communications and reporting. Unlike the traditional structure where every branch is like a little bank, now every branch is part of a network. We have also rebuilt our IT system. It is configured in such a way that it will be able to serve the needs of the bank for years to come without the need for extensive changes. We have also strengthened our communications network, which is a key thing for banks with branches. All these and more are essentially to make the new bank look very different."

The group's cost-to-income ratio is higher than industry standards. The last merger with United Asian Bank took some six years to bring it down to a more palatable level of less than 40 per cent. How long do you think you will take?

"We started with 56 per cent but we had committed to spending a lot on developing the bank. So it is not surprising that the cost did not decrease immediately. But since the fourth quarter of 1999, the ratio has steadily come down and should be under 40 percent within a year or two. It is not easy to bring down the ratio. But the worst thing that can happen in any merger is when cost-to-income ratio balloons. It think there is evidence to show that it did not happen in our merger."

With the Financial Master Plan in place, where do you see the BCB positioning itself. Would BCB consider further mergers?

"We aim to be an important part of the banking sector. I think the way forward is quite clear, even if we choose not to embark upon further consolidation. But we also think that the pressure for consolidation will become stronger and that it will be driven more by the market than by regulators. If that happens, we have to assess our position carefully. We have no particular plans (to consolidate further)."

Are you expecting any capital expenditure?

"There is no major expenditure for this year. A lot of transformation and merger cost is past us. One major milestone was on June 2, when we integrated the IT systems. We expect costs to come down and income and revenue to go up. "

While the group is now second largest, it could end up third largest if merger plans between RHB Bank and Utama Bank go through. Do such numbers mean anything to you?

"No, actually they do not bother us. It is important to have scale. It is no good to be 10th largest. Having said that, once you're in the top three or four, the difference is how good and efficient you are in conducting business that will determine how much returns you get."

1.7 Evaluation of the Financial Performances

The Bank's audited Profit & Loss accounts and Balance Sheet for the last two years as in Table 1.6 and Table 1.7.

TABLE 1.6

BUMIPUTRA-COMMERCE BANK BERHAD		
AUDITED INCOME STATEMENT		
FOR THE YEAR ENDED 31/12/2000		
	2000 (RM'000)	1999 (RM'000)
Interest Income	3,221,175	1,753,857
Interest Expense	(1,770,474)	(1,170,579)
Net Interest Income	1,450,701	583,278
Loan Loss and Provision	(489,237)	(334,197)
Non-Interest Income	961,464	249,081
Net Income	488,139	210,346
Overhead expenses	1,449,603	459,427
Profit Before Taxation and Zakat	520,785	123,646
Taxation	(183,000)	(796)
Zakat	-	-
Net Profit for the financial year	337,785	122,850
Earnings per share – Basic (sen)	20	12

SOURCE: BCB, ANNUAL REPORT 2000

TABLE 1.7

AUDITED BALANCE SHEET AS AT 31/12/2000		
	2000 RM'000	1999 RM'000
ASSETS		
Cash and short term funds	5,645,371	8,384,891
Deposits and placements	3,144,092	1,381,923
Dealing securities	2,332,722	2,165,974
Investment securities	8,483,822	9,424,951
Loans and advances	33,291,356	28,879,621
Other assets	2,523,979	4,854,942
Statutory deposits	1,138,412	1,116,855
Investment in subsidiary companies	1,102,804	516,450
Amount owing by holding company	116,679	120,175
Fixed Assets	453,273	439,304
Total Assets	58,232,510	57,285,086
LIABILITIES AND SHAREHOLDERS' FUNDS		
Deposits from customers	43,157,282	39,774,458
Deposits and placements of financial institutions	3,783,151	4,306,264
Obligations on securities sold under repurchase agreements	2,028,889	3,720,022
Bills and acceptances payable	1,766,066	2,659,361
Other liabilities	3,060,004	2,649,234
Subordinated loan stocks	600,000	600,000
Irredeemable Convertible Unsecured Loan Stocks	355,651	355,654
Total Liabilities	54,751,043	54,064,993
Share capital	1,708,305	1,708,302
Reserves	1,773,162	1,511,791
Equity shareholders' funds	3,481,467	3,220,093
Preference shares	-	-
Total Shareholders' Funds	3,481,467	3,220,093
Total Liabilities and Shareholders' Funds	58,232,510	57,285,086
<u>Commitments and Contingencies</u>	12,108,951	7,388,886
<u>Net tangible assets per share (sen)</u>	204	189

BCB recorded a profit before taxation of RM 520.8 million in 2000 from RM 123.6 million a year ago. The reason the performance figures are not comparable is because the financial statements for the preceding year only accounted for the three months operations of the former BBMB. Despite the generally weak loan growth in the banking industry as a whole, BCB had registered a loan growth of 13 percent, which was well above the industry average of 8 percent.

The overhead expenses for 2000 was RM 1,056.2 million compared to RM 365.4 million in the previous year. The reason for the increase was the inclusion of BBMB's twelve months of overhead portion. The high overhead cost structure inherited from the legacy BBMB operations and the need to run two computer systems and processes concurrently until the migration to a single system resulted in a high cost-to-income ratio for BCB.

For the year the cost-to-income ratio was at 47.8 percent. The bank has taken steps to further improve its operational efficiency which was realised when the computer systems migrated to a single operating platform in June 2001. BCB's target is to reduce the cost-to-income ratio within 35 percent over the next two years.

TABLE 1.8 below highlights the comparative ratios of the Maybank VS BCB in 1999.

TABLE 1.8

MAYBANK VS BCB BANK COMPARISON		
	MAYBANK	BANK
Pre-tax Profit/Average asset (ROA) %	0.93	0.6
Pre-tax Profit/Equity (ROE) (Sen)	10.71	10.0
Pre-tax Profit/Per employee (RM1,000)	62.0	27.0
Non-Interest Income/Net Int. Income %	32.9	30.7
Profit per employee (RM'000)	62.0	27.0
Staff cost per employee (RM'000)	43.0	20.0
Non-performing loan/Total loan %	3.0	1.6
Cost/Income %	28.9	39.5
Deposit mix – Current Account %	18.4	20.4
• Fixed Deposit %	16.2	6.5
• Savings Account %	65.5	73.1

Source: BCB Business Plan

As BCB is the second largest bank in the country after Maybank, hence the ratios are compared with Maybank's figures. The productivity ratio of profit per employee and cost per income highlights of Maybank has RM 62,000 compared to BCB of RM 27,000. This means that Maybank is more efficient in managing it's employees' productivity compared to BCB. The other ratio that has a large variance is the Cost-to-income ratio, which is 39.5 percent compared to 28.9 percent for Maybank. The reason for the large difference was the additional costs incurred during the three months of the merger exercise.

Banks, analysts and investors use the Cost-to-income ratios extensively to benchmark the banking efficiency. This ratio measures operating costs as a proportion of total (net interest and non-interest) income and the lower the costs as a proportion of income signals greater efficiency. As a result, banks generally strive for greater efficiency because it strongly correlates with overall profitability.

TABLE 1.9

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR CAHB GROUP					
For the year ended 31 Dec					
	1996	1997	1998	1999	2000
Pre-tax profit (RM mil)	473.44	324.47	102.45	445.56	830.03
Net after-tax profit (RM mil)	267.56	180.72	79.85	386.04	518.45
Earnings per share (sen)	49.04	26.06	10.24	42.1	44.10
Net tangible asset (RM)	5.85	4.03	4.11	3.96	4.39
Return on paid-up capital (%)	49.04	26.06	10.24	42.61	44.10
Return on shareholders' funds (%)	15.35	5.72	2.48	8.22	9.78
Total deposits (RM bil)	14.67	17.61	17.99	51.74	53.96
Total lendings (RM bil)	1.40	14.44	15.11	32.44	36.69

Source: Annual Report

The Return on Equity ratio (ROE) is a profitability ratio that expresses earnings as a percentage of net worth on the balance sheet. BCB should strive to achieve a ROE of at least 25 to 30 percent as shown in FIGURE 1.3. BCB's current ROE is about 15 percent, which, means that it less efficient is utilizing the shareholders funds in generating profits. FIGURE 1.4 shows the relationship between the ROE, cost and income level. As a result if BCB wants to achieve a 20 to 25 percent in its ROE, it should try to balance by

reducing it's cost by 15 to 30 percent or maximizing it's profit by 10 to 30 percent.

FIGURE 1.3

THE NEW BANK SHOULD TARGET A 20-25% ROE
Top Quartile Peers Have Generated Average Returns Of 30% On Equity

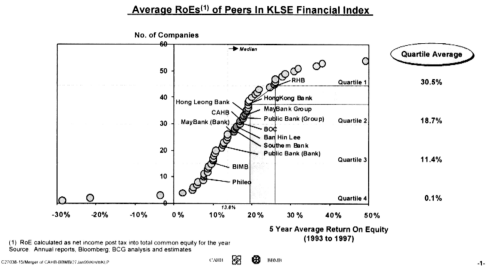
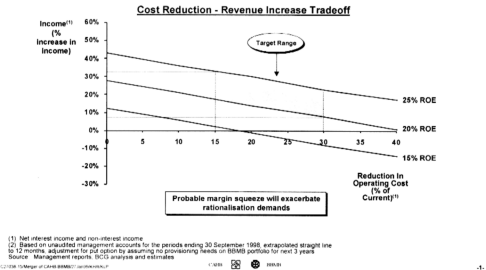


FIGURE 1.4

ACHIEVING A 20-25% ROE IMPLIES A 15-30% COST REDUCTION
AND A 10-30% INCREASE IN INCOME⁽¹⁾



Source: BCB Merger Documents

HOWEVER, PERFORMANCE IMPROVEMENT WILL BE REQUIRED
A Number One Infrastructure ... Number Two Share ... But Number Four Performer



(1980), Fry 1982), Morone (1989) noted that technology provides a firm the opportunity of a source of competitive advantage.

1.9 Research Objectives

The primary objectives of this study is to evaluate and critically analyse how BCB manages to bridge its Business and Technology gap after the merger to:

- i) increase efficiency and profitability
- ii) increase customer service
- iii) improve current business processes