CHAPTER SEVEN

RECOMMENDATIONS AND CONCLUSION

Chapter Seven

7.1 Recommendations

The Malaysian Finance company sector faces key strategic challenges as it grapples with the effects of the economic downturn and prepares to enter the new millennium. First, is the need to recapitalise Malaysian finance companies and resolve the problems of non-performing loans. Second, is the need to fuel economic recovery and stimulate economic activities through prudent financing activities. Third, is the need to upgrade the finance industry and prepares it for the 21st century through greater usage of technology, introduction of new financial products and services and improving efficiency and productivity.

As finance companies recognised the losses arising from the non-forming loans, certain companies experienced an erosion in their capital base. Furthermore, if finance companies continued to pull back credit, viable companies would likely face financial difficulties, resulting in a worsening of the asset quality and liability of finance companies as well as banking system. A healthy and robust finance companies' is vital for sustained economic recovery.

Recognising the critical role of a robust financial system in restoring and sustaining the growth of the economy, the government embarked as a comprehensive three pronged program to strengthen and restructure the financial system. The programme involves financial sector restructuring, mergers and consolidation and other adjustment mechanisms to alleviate adverse liquidity and economic conditions.

In view of the current situation, is recommended that the finance companies need to merge and capitalise. Therefore, mergers benefit arise when strength of one to address the weakness of the other as viewed through the eyes of customers. Besides an improved deposit base, the benefit of the merger include:

1. Higher capital base and capital adequacy ratio.
2. Improved funding cost and margins.
3. More balanced lending profile.
4. Stronger capitalisation.
5. An increased market share of branches and depositors.

Notwithstanding, finance company faces increased competition and globalisation. The stronger and well-capitalised finance company is able to create innovativeness through greater usage of technology and sustained ahead with competitiveness. Small finance companies will face challenges to compete, improve efficiency and productivity.The best alternative way for this companies are to merge and improve efficiency as well as boost capital base.

7.2 Conclusion

The merger program is one of the measures undertaken by Bank Negara Malaysia to consolidate the finance company industry which is currently the most fragmented industry. The program is also part of an overall preemptive strategy of Bank Negara Malaysia to further increase the resilience of the finance companies to withstand any risk from the slowdown in the economy. Although there are 39 finance companies, more than 70% of the finance companies are concentrated in 5 or 6 larger finance companies. The driving force behind the merger plan is to prepare finance companies for the industry's liberalisation.

Until to date, 14 bank-backed finance companies were absorbed by their banks. However, only two finance companies were merged as at January 31, 1999, that is, Sime Finance Berhad and RHB Finance Berhad.

The non bank-backed finance companies are in a slow face attempt to augur well of the Bank Negara Malaysia calls to consolidate the finance sectors. Some of the finance companies which has had identified their merger partners initially, had difficulties to merge or reluctant to merge due to numerous reasons. One of the main factor contributed to the failure of mergers or foresee obstacles hindering mergers is the escalation of non-performing loans of target firms. This has caused the 'anchor' finance companies financial strain of absorbing bad debts. Although mergers would be a positive move for the longer term but potential pose a short term earning drag on finance companies due to arising non-performing loans and higher provisions. Many of Malaysian's financial institutions are believed to be politically connected. Not withstanding, these firms want to avoid a merger plan in order to preserve their financial and political influence.

Table 7 : Finance Sector statistics(as at end June 1997 In RM million)

	Total assets	RWCR	Tire-1 Capital ratio	NPLs/Total loans
Commercial banks	438,706	10.1%	9.0%	2.1%
Finance companies	138,823	10.8%	8.0%	2.5%
Merchant Banks	39,812	13.4%	11.4%	1.2%

Source : Bank Negara Malaysia

Some of the small finance companies would face liquidation if they are not absorbed for merged by their larger rivals. Now, Bank Negara has announced that to ensure the finance company industry continue to remain sound, the minimum risk - weighted capital ratio requirement for finance companies will be raised gradually from 8% to 10% with effect from January 1, 2000; with an interim ratio of 9% to be complied by end of 1998. The minimum capital funds for finance companies will also be progressively increased from the current RM 5 million to RM 300 million by end June 1999 and subsequently to RM 600 million by end 2000. This poses another problem for firms which is unable to increase their capital base. Moreover, to ensure finance companies are well capitalised, Bank Negara initiated the merger plans. The finance company's mergers can be formulated as follows:

1. Maintaining the stability of and confidence in the financial system by ensuring the solvency and soundness of finance companies.

2. Protecting investors, borrowers and other users of the financial system against undue risks of losses and other damage that may arise from failures, fraud, malpractices, manipulations and other misconduct on the part of providers of the finance services.

3. Ensuring a smooth, efficient, reliable and effective functioning of financial markets including proper working of competitive forces.

4. Finance companies are to ensure the financial sector to be remain sound, more resilience, competitive and dynamic finance system with best banking practices, which able to;

    a) Face the challenges arising from globalisation and deregulation ;and

    b) Support and contribute positively to the growth of the economic and towards overall macroeconomic stability.

Finally, the efficiency effects of mergers between finance companies will depend on the prospect of the Malaysian economy, world's economic outlook and profitability of the company. With the inevitable liberalisation of the financial institutions, expected of intensify competitive turbulence that will result in merger trend if the finance sector has not consolidated already. The mergers in the finance companies will kick start a series of mergers among commercial banks, followed by insurance and stock broking companies. Without an industry consolidation, Malaysian finance companies are in no position to compete on an even footing with foreign owned finance companies. The study elaborates that the mergers of Finance companies will improve efficiency and profitability of the combined firms. The government mergers plan of the finance companies toward fewer, larger, better capitalised and stronger institutions, better able to compete in the international market are realistic and desirable.