CHAPTER FOUR

RESEARCH METHODOLOGY

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4.1 Research Methodology

Bank Negara has urged the 39 finance companies to be merged or consolidated. Six anchor companies have formed, under which smaller finance companies are expected to be merged with them. Bank-backed finance companies have indicated that they will absorb their finance arms. The economic slowdown has weakened the liquidity and balance sheet of the finance company. By merging with the stronger finance company, efficiency of operation and enlarge capital base of small finance companies will be improved. This could be a way out for small finance companies which are under capitalization and struggling in the competitive environment.

4.2 Objective Of Study

The objective of this research is to analyse the effects of mergers or consolidation of finance companies . In addition, the study will also discuss the efficiency effects of mergers between Malaysian finance companies in relation to the industry peers. An overview of finance companies consolidation process, legislation, and control will be further analysed. The issue regarding the benefits of mergers among the team up companies and how the financial service group can become leaner and more efficient through mergers will also be discussed. A literature review case study will be discussed and adopted to the local finance companies case. The effects and causes of mergers between finance companies will be analyzed . This paper will also discuss the shortcomings and difficulties faced by finance companies to be merged . Finally, the prospect of mergers between CCM and EON Finance are discussed in detail.

4.3 Scope Of Study

The analysis of this research will focus on finance company mergers. In addition, the paper will also focus on the prospect of mergers between EON Finance and CCM Berhad. To access the economic benefits of mergers or consolidation , the research will analyse the performance and background of finance company mentioned above.

Moreover, the analysis consists of financial data which were audited and published recently. A comparison is made between the participated finance company to access the post merger impact and prospect. In addition difficulties in mergers and analysing economic gains are discussed in detail.

4.4 Methodology

The data were used in this analysis mostly obtained from the secondary sources. The data were obtained from quarterly, semi annually and annually published statistical report by BNM. Data on financial performance of finance companies and banks were gathered from the published annual reports by the finance companies and banks in the local newspapers. Several part of the research was conducted in main library of University Malaya and the library of Bank Negara Malaysia.

4.4.1 Framework of Analysing Finance Company Mergers

The framework for analysing the prospect of mergers between finance companies was adopted from S.C. Myers (1976). In this case of two finance companies merging, net present value(NPV) of economic gain (benefit) is the difference between the gain and cost. In other words, the difference in the value is, between the total present value of the combined finance companies and the sum of the present value of the individual finance company prior to the mergers. Thus, the gain (G) is:

Gain = Present value (Combined A & B) - (Present Value A + Present value B)

Therefore, an economic gain (Benefit) only if the two firms worth more together than apart. Base on the above, the cost of mergers or acquiring firm is equal to the cash amount paid for the target finance company (Finance company B) minus the target finance company's value as a separate entity. Thus, the cost (C) of mergers is :

C = Cash (paid by A to B) - Present value B(Target Finance company)

Whereas the premium paid for finance company A (acquiring company) is equal to :

Cash Paid = Present value Finance Company A + cost

The cost is the premium for the mergers. Therefore the value of premium is largely depend on the result of bargaining between the owner of both finance companies . The acquiring finance company (A) will maximize the premium whilst the target finance company (B) will want to minimize it .

Therefore, the net present value (NPV) to A of a merger with B is measured by the difference between the gain and cost . If they benefit exceed the cost, and the finance company A should merge with the finance company B if its net present value is positive[14]. Therefore, it defined as :

Net Present Value (NPV) = Gain - Cost > 0

$$= PV_{AB}(\text{ combined firm}) - (PV_A + PV_B) - (\text{Cash} - PV_B)$$

[14] Richard A. brealey, Principal of coporate finance 1997, Page: 914.

It makes sense to keep an eye on what shareholders' think the gain from merging are . It is hoped that this model will influence the financial institution to revisit at their merger plan to evaluate the prospect of merging benefit. The gain from mergers may reflect economic of scale , improve efficiency and profitability.