CHAPTER 3: RESEARCH METHODOLOGY

3.1.0 Data and Methodology

This study uses data collected from several sources. We analyzed merger results by comparing financial ratios, profit and loss and balance sheet results of anchor banks between Jan 2000 and December 2001(i.e. pre and post merger period). We have also included some latest information (financial and non-financial) on banking institutions up to April 2002 to continue tracking banks performance. A list of bank mergers and other related data were obtained from an online database maintained by BNM, BNM annual reports and from, monthly and quarterly bulletins (various sources). The remaining information were compiled from, Audited and Interim Financial Reports of the banks under review, Investors Digest, NST and The Star website, the internet and magazines e.g. Business Times, The Edge, Bankers Journals etc. Share prices of Banking Institutions were obtained from the Kuala Lumpur Stock Exchange. For academic information on mergers we used a number of financial and accounting textbooks and the MASB standards.

We used accounting ratios to analyze various values like shareholder value, cost to income ratio, EPS, CCR, share price, net asset value and RWCR.

Our sample comprises of 6 major banking groups, as they constitute 85% of domestic banks in terms of assets. Although our main focus is on the 6 major banks, we have also included all the banks' information in our dissertation without which this study would be incomplete. The time frame of the study covers the period from Jan 2000 to April 2002.

We sought opinion on the merger exercise from a number of research analysts who track banks' performances. Financial data of the banks were obtained from their annual reports and quarterly reports. These data were analyzed using the under mentioned ratio calculations.

3.2.0 Shareholder value

Shareholder value (SHV) is represented by the worth of the shareholders' stakes in the company. It may be derived by subtracting debt from a company's market value. For public-listed companies, SHV can be derived by multiplying the total number of common shares by the market price. To judge whether the merger or acquisition has brought any improvement, we should look at how much shareholder value has been added. The value created in an M&A consists of the incremental revenue enhancements and cost reductions afforded by synergy between the parties to the M&A. To conduct a synergy analysis, companies should aggressively identify and quantify many inputs the most important of which is due diligence. Due diligence provides an excellent opportunity to not just examine the legal and financial issues of the M&A, but also to 'operationalise' the M&A. One critical goal of due diligence should be to identify, validate and quantify the strategic and operational synergies the M&A might create. M&As adds to shareholder value when operating, financial and tax synergies are achieved, resulting in an increase in the quantity and quality of earnings and cashflow.

The basic objective of an M&A exercise should be to increase shareholder value or a more technical term "to create a value-creating sustainable competitive advantage," says Alfred Rappaport in his book 'Creating Shareholder Value.'

3.3.0 Earnings Per Share (EPS)

In most merger negotiations, managers and shareholders give great weight to the impact of mergers on EPS. The EPS of a company is the amount of net profit after tax but before extraordinary items earned for equity attributable to each equity share in the accounting period concerned (MASB 1)

3.4.0 Market Price (MP)

The market price of a share is determined by the forces of supply and demand in the Stock Exchange. In an efficient market, the market price of a firm's stock is deemed to reflect all the information about a company, for instance its earnings, dividends and any clues as to its future performance. Hence market price is expected to have a significant influence on the terms of merger in a negotiation.

Analysts argue however, that in an efficient and imperfect market where the shares of a company are thinly traded, a share has an immediate intrinsic value that may not be reflected in the current market price. They point to factors such as the economic climate in which a particular company has to operate, the assets, operating and borrowing costs, turnover, accounting practices which might influence the nature of the firm's true earnings and hence its market price.

Despite these arguments, market price represents the floor value of a company as, for a number of reasons, the offering price placed on a firm usually exceeds its current market price; the difference in margin being dependent on the negotiating skills and bargaining power of the parties concerned. For example, the value of control, the ability to realize tax advantages (Lease McConnell and Mikkelson 1983) and the existence of non-published information may add values above the current market price.

3.5.0 Price Earnings Ratio (P/E)

The PE ratio of a company is the ratio of the current market price of its share and its annual earnings. It is an indication of the number of years that the company would take for it to recover a shareholders' investment in its shares bought at the current market price.

What is important in determining the values that will be established in a merger is the earnings growth potential of a firm as reflected in PE ratios. For e.g., a PE ratio of 20 means investors are discounting the equivalent of 20 years of current EPS.

However a high PE ratio is not a definite indicator that future earnings will also be high. Studies have shown that a company's past earnings give no clue to future earnings.

3.6.0 Net Asset Value

Net asset value per share refers to the fair value of the underlying assets of a company less all its liabilities and divided by the number of its shares. This variable constitutes an important consideration in a merger negotiation where the acquiring company needs to dispose of some of the assets acquired and discharges some of the liabilities. The amount of liquidity that can be obtained, the use of the acquired firm's assets and earning power to borrow funds are likely to have an influence on merger terms. This is especially so when the net asset value per share substantially exceeds the market price or if the market price does not represent the real value of the company. It is also possible that despite a low earnings record, a firm's assets may, under effective management, achieve normal earning power again thereby increasing the market value of the firm.