

Chapter 6

Conclusion and Recommendation

6.1 Introduction

From this study, our analysis show that there is an increase in Return On Assets (ROA) after the merger exercise whilst Return On Equity (ROE) and Cost Efficiency Ratio (CER) post only slight increase. These results do not give a clear cut conclusion that domestic mergers enhance the performance of the banking industry. These measured changes between the pre merger and post merger period may not be solely due to the merger. In this chapter, factors that may improve bank performance such as enhancing distribution channel, cost efficiency, embracing e-banking, outsourcing and Islamic banking will be discussed.

6.2 Recommendation

Other measures of performance improvement apart from ROA, ROE and CER do no limit to mere calculation and empirical studies. Banking Institutions (BIs) can also take into consideration the following soft skills to improve performance. In order to ensure that the banking industry effectively aligns itself to the country's vision, there are many other factors that require our detailed attention. Initial efforts and changes may be uncomfortable, but with practice, can lead to geometric improvements in performance efficiencies, profitability, and in the long term, viability. Hence, the study of the effectiveness of domestic bank mergers needs to take into consideration the other factors that have a strong impact on the performance of the domestic banks, particularly after the merger exercise. These usually involve the improvement or introduction of services and products alike.

6.2.1 Distribution Channel

Consumers are now increasingly embracing new technology, looking for ways of simplifying their life and progressively turning to “armchair banking” (banking without leaving their home). Given the way that consumers are changing in their attitudes, the challenge of today’s provider of services hinges in creating an environment which establishes a consistent and positive consumer experience. The goal which BIs should set for themselves is to create services to cater to the needs of the customers – any time, anywhere and any channel. The choice of channels is important and BIs need to build on channels that meet the needs of large group of customers in a cost effective manner. The potential impact on profitability of each channel over time is critical in ensuring the development and performance of the distribution channel.

One of the most recent banking developments saw BIs take huge steps towards improving channel distributions when Central Bank approved ‘Interbank Giro’ which allows transfer of funds between banks of the GIRO network. This new service even included one foreign bank (Citibank), a convenience which was long overdue. Currently, thirteen financial institutions are involved in this service. Although this service does not involve the physical merger of these financial institutions, it does show integration, and one that will definitely improve bank profitability and efficiency as less customers will need to walk into the physical branch to perform a transaction. This study definitely will argue that with less customer traffic, banks have more time to focus on revenue-generating activities instead of day-to-day service requests. This is one of the best and most recent examples available this year.

6.2.2 E-banking

The changing of consumer behavior will see a shift from transaction focus to relationship focus. Customer management will become increasingly important. Maximum use of technology to support processes has enabled a shift to shared standard platforms ('e-frastructure') for all stakeholders in the financial services industry. A continued disintermediation of financial services which will lead to lower transaction costs to customers. Most financial services will be offered via Internet where drivers, premises, services and device accounts for its critical success factors. E-banking should build a sustainable business model, secure flexible budget and funding, simplify processes and implementation; adopt 'Keep It Simple' concept. The Financial Process Exchange (FPX), which was introduced this year, allows businesses and consumers to make payments for e-commerce from participating banks. Subsequent to the full implementation of the migration from magnetic stripe automated teller machine (ATM) and credit cards to the higher security chip based card, there has since been fewer of fraud cases related to cloned ATM cards.

6.2.3 Enhancing Operational Efficiency and Cost Competitiveness

Cost competitiveness is the ability to produce at a cost below that of the competition (for a similar product); or, to deliver a product/service with added value or premium service to customers at a cost that is perceived to be value for money. Banks must perform at a cost-effective level. To have competitive advantage in the marketplace a bank's operational cost must be lower than its nearest competitor. To enable cost competitiveness and achieve operational efficiency, banks need to look at systems, people, operations, and technologies.

Next, banks need to look at operations and ask – “how can we develop operational synergy within the Bank, with the Group, our strategic partners, our suppliers and our customers?” They may adopt centralisation, regionalisation, strategic alliance and other approaches. Banks need to look at technology and ensure that the information technology and business working in tandem are financially stable, or having proper service level agreements in place.

6.2.4 Outsourcing Backroom Operations

The predominant reason for current outsourcing of non-core activities in Malaysia is the lowering of costs. Outsourcing among global banks has been around for some time, i.e., US banks have outsourced their activities since the 1980s. The quest for greater efficiency, improved sales force effectiveness and cost competitiveness has led to centralisation/outsourcing of back office operations. A key to recognising the need for outsourcing is when the business needs of the bank exceed its capabilities.

Benefits of outsourcing include increasing and sustaining the bank’s performance, especially financial performance, improved operational efficiency and productivity, allowing the bank to concentrate on core business, achieve cost reduction, allow the bank to compete on a more global scale, increase shareholders’ value, and improve client service by use of technology. This truth is more likely felt by the smaller merger party who might have been financially or physically unable to outsource some of its core activities.

A successful outsourcing strategy takes into account all aspects of the organisation. However, change strategies often ignore the human resource dimension.

6.2.5 Islamic Banking

Malaysia is at the forefront of global Islamic Banking industry, dated back in 1963 with the establishment of Tabung Haji. Malaysia's first full-fledged Islamic commercial bank was established in July 1983 (Bank Islam Malaysia). Malaysia accounted for 8% of global Islamic financial assets or US\$15 billion of the US\$180 billion global Islamic assets in 2001. Malaysia is the only Islamic finance market that offers Islamic capital market instruments. Other front-liners are Bahrain, Iran, Sudan, and Pakistan.

Asset growth has been more rapid in Malaysia than in other parts of the world. Market share of Islamic banking in the total banking system is growing steadily. It aims to achieve twenty percent market share of the total banking system's assets and deposits by 2010.

Malaysia aspires to achieve excellence in Islamic banking through best practices, operational efficiency, accounting and legislation. Best practices encompasses going back to the basics of Islamic principles, building customers'/investors' confidence, developing equitable financial instruments, education and training. Accounting and legislation issues to be addressed include transparency in disclosure, different interpretation of Syariah principles, and harmonisation of interpretation and standards.

Islamic banking needs a global benchmarking process, to ensure unified banking practices and universal acceptance across regions. Benchmarking is also required to quantify operational efficiency, and in order to streamline accounting process, product types, interpretation of standards and principles, and legislation structures. International Monetary Funds (IMF) has initiated the formation of Islamic Financial Services Board to promote international standards in the Islamic banking industry.

6.3 Conclusion

Mergers and acquisitions will continue to be seen in the Malaysia banking scene. The greater amount of resources available through the merger should be managed well and fully utilised to allow banks to cater for the demands of the larger pool of customers in a more effective and efficient manner (Global Finance, Jan 2003).

Mergers and acquisitions help banks restructure in a way that gives them superior organisational capabilities, resulting in a sustainable competitive advantage. But, mergers and acquisitions are not a solution for all banking sector ills. It is no substitute for poor asset management, lax management and lack of an integrated human resource strategy. Banks should learn to re-invent themselves and re-orient their organisation to suit the fast changing environment. Or else, they would be left behind and overshadowed by the new entrants (The ICFAI University Press, 2001). Being a world-class bank does not necessarily mean being large in size, but in being productive and in efficiently managing its capital and resources.

Foreign banks will still have a role to play in the domestic scene, as they are an equal ally in the development of the Malaysian financial sector as a whole, while at the same time they offer a competitive benchmark against which the domestic banks can measure themselves. Foreign participation has been here since banking activities was first established in Malaysia. Domestic banks have increased their market share regardless the presence of foreign banks. Foreign players have brought new developments associated with new technology and other expertise into local banking system. In fact, foreign banks also played a role in facilitating local banking integration with the international economy.

Bank Negara Malaysia will continue to play a role in the further development and regulation of the industry. However, it should play a less hands-on role in the banking

sector and leave the market to regulate the financial sector. It is hoped that the Malaysian financial sector becomes increasingly more mature so that BNM will only have to regulate the sector based on the broader parameters, without being bogged by micro issues which should be better handled by the players themselves.

We would recommend that future research take into consideration other non-financial factors such as organisational strategy, management team, quality of products and services offered, number of branches, marketing and promotional effort and many more. Where financial factors are concerned, research should, where possible, include a wide timeframe for any study conducted. Hence, given the narrow time frame and limited resources to accounting data, our results may not accurately reflect the degree of effectiveness of the domestic bank mergers.

In conclusion, as this paper aims to measure the effect of domestic bank mergers on the performance of Malaysian banks, we found that, statistically, there is an improvement in ROA following the mergers of domestic banks, but only a slight improvement in ROE and CER as compared to their corresponding pre merger counterparts.

Macroeconomic stability and conducive business environment is essential to support a meaningful and more lasting increase in the performance of the banking sector. Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the dialogue with banking institutions said, “The banking system in Malaysia today is vibrant, strong and profitable. In fact, the banking system is at its strongest position since the financial crisis”. Also she mentioned, “The foundations for strong performance have now been well established for the domestic banks” (Bank for International Settlements Review, 2005). Hence, consolidation of the domestic banking sector, which forms a part of the Seventh Malaysia Financial Sector Masterplan, but not limited to, served the country’s objective to develop

a dynamic, competitive, effective and resilient banking sector by reaping the benefits of group mergers.