CHAPTER FOUR

PHILEO ALLIED BANK AND BANK PERTANIAN MALAYSIA

4.1 INTRODUCTION

Banking industry in Malaysia has a history of more than 100 years. The rapid economic development and expansion in foreign trade due to tin mining activities in the Larut district and Kinta Valley paved the way for the development of a few commercial banks in the country. The first commercial bank to be established locally is the Chartered Merchant Bank of India, London and China in Penang in 1859[1]. The booming economy also lured a few Chinese merchants to venture into the banking industry. The first local bank to be set-up locally was the Kwong Yik Selangor Banking Corporation in 1913. This was followed by Ban Hin Lee in 1935 which was owned by the Hokkiens[2]. The Indian community also set-up a bank to facilitate trades and remittances between Malaysia and India. They opened the Oriental Bank of Malaya in 1936[3]. Though our country has a long banking history, it was not until 1959 when the Central Bank of Malaysia was established under the Banking Ordinance 1958.

4.2 MALAYSIAN FINANCIAL SYSTEM

4.2.1 Banking System

The financial system in the country is divided into two major operations, the banking and non-banking intermediary system as shown in figure 4.1. The banking system comprises of Commercial Banks, Merchant Banks, Finance Companies and Discount Houses while the non-banking intermediary system consist of Development Finance Institution, EPF,

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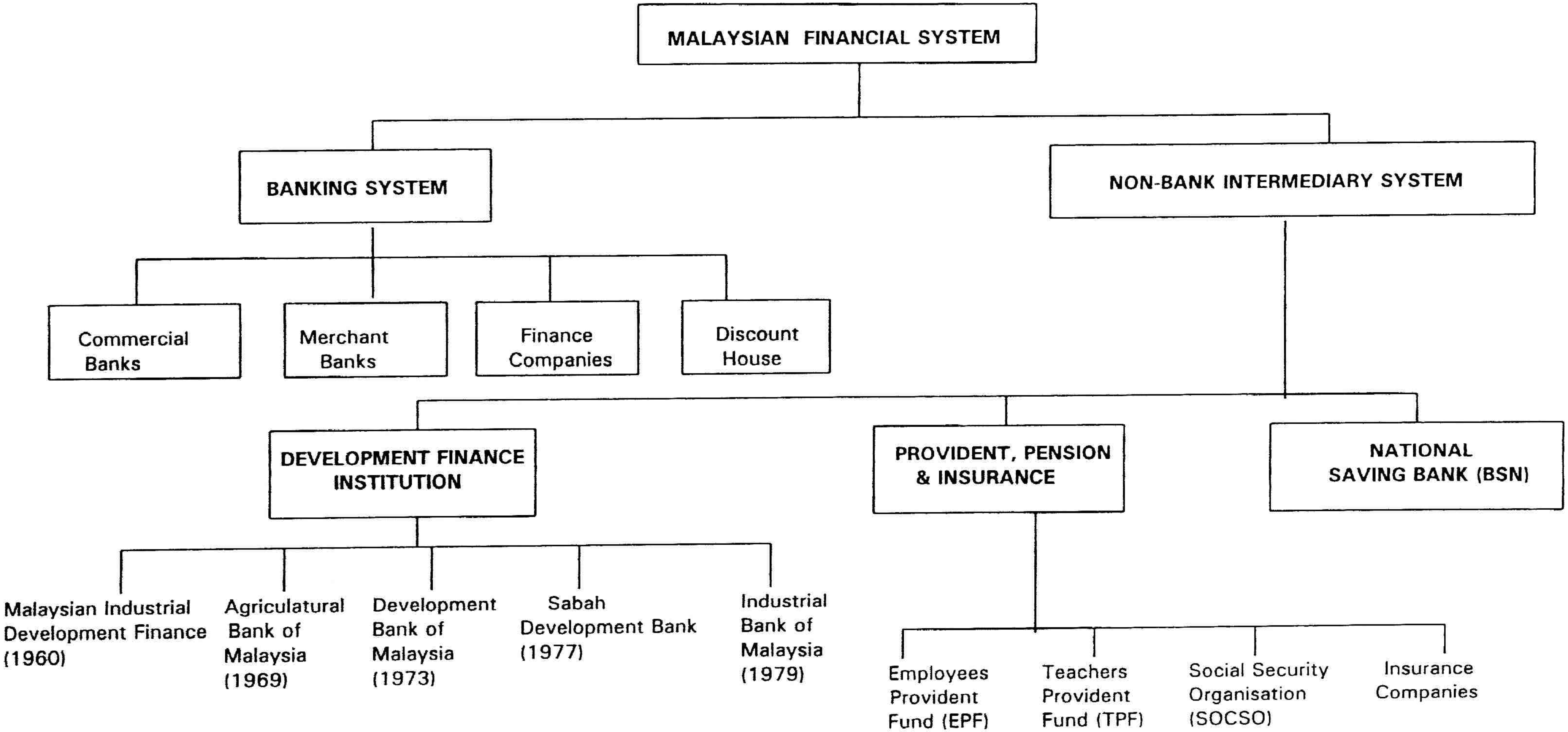
[1] Johnson Pang, Understanding Banking Service and Facilities, All You Need to Know About Banking from Deposits to Trade Settlements, Federal Publication, 1994, pgs 11-14.
[2] Cheah Kooi Guan, Financial Institutions in Malaysia, Institut Bank-Bank Malaysia, 1994, pgs 42-45.
[3] Ibid, pg 44.

Figure 4.1 THE MALAYSIAN FINANCIAL SYSTEM



Note : Figure in parenthesis indicates year of establishment

Source : Constructed from Literature Review.

Insurance Companies and National Savings Bank. The biggest group from the banking system is the commercial banks which operates within the jurisdiction of Bank and Financial Institution Act (BAFIA). As at December 1997, there are 34 commercial banks with 24 domestic and 10 foreign controlled banks (please refer to Appendix 2). However, there are only 11 Tier One commercial banks while the rest falls under the Tier Two category. Briefly, commercial banks perform the functions of credit creation in the economy. They also trade in negotiable instruments such as Repos, Bankers Acceptances and Treasury bills up to five times their capital. Commercial banks also participate in the share borrowing scheme subject to the approval of the security commission and lending to broad property sector. Apart from that banks also provide a wide range of services to customers from accepting deposits, financing trade activities, discounting bills, remittances, safe deposit boxes and other services. Tier One banks besides their original functions as mentioned above also enjoy an additional privilege of expanding their operations through branches, representative offices, subsidiaries and joint ventures.

Next are finance companies, which were set-up to provide loans, which is similar to the moneylenders. They perform similar functions to the commercial banks except that their major income are from motor vehicle and project financing. Finance companies also accept deposits from the public offering a higher interest rate compared to the commercial banks.

Thirdly are merchant banks which started in 1970's with the objective of promoting effective economic development via financing the private sector operations and other mega projects. For example, the country's first privatization project , the Kelang Container Terminal in 1986 was financed by ASEAM Bankers, a merchant bank wholly owned by the Maybank Group. Most commercial bank in Malaysia also has merchant bank services such as Arab Malaysian Bank which owns Arab Malaysian Merchant Bank, Perwira Affin's merchant bank of Perwira Affin Merchant and RHB Bank's Sakura Merchant Bank.

4.2.2 Non Bank Intermediary System

The non-banking intermediary system is divided into three major operations, firstly is the Development Finance Institution such as Agriculture Bank of Malaysia, Malaysia Industrial Development Finance (MIDF), Industrial Bank of Malaysia and Sabah Development Bank[4]. They shoulder a specific task of promoting their portfolios, for example, The Agriculture Bank of Malaysia promotes the agriculture sector in the country while the Industrial Bank of Malaysia provides financing to capital intensive and high technology industries.

Secondly are the EPF and insurance companies. EPF is formed to provide social security protection in the form of retirement fund to its members while insurance companies apart from encouraging savings also provides financial protection to their members against loss of properties, income and lives.

Finally is the National Savings Bank (BSN) which specialises in collecting of savings deposits. The BSN started in post office operations in 1888 and later was restructured in 1974 to become the current operation[5].

A stable and stringent performance of the banking industry is vital to promote the country's development. As stated earlier, banks play an important role in promoting savings, lending to the private sector, property sector and also job opportunies. Table 4.1 shows the deposits, loans and number of employees in the commercial bank's portfolio from 1990 to 1995. Deposits in commercial banks show an increase for the six years (1990-1995). The total deposits in 1990 were RM82,413 million and this figure shot up to RM196,851 million in 1995, an increase of 138.9%. The local commercial banks have a major share in the deposits as compared to the foreign banks, for example, in 1995, local banks' deposits was 78.5% while the foreign banks

[4] Ibid, pg 173.
[5] Ibid, pg 194.

Table 4.1 DEPOSIT LOANS AND WORK FORCE IN COMMERCIAL BANKS FROM YEAR 1990 TO 1995

Deposit (RM'000)	1990	1991	1992	1993	1994	1995
Local	62,047	73,828	87,313	105,434	123,845	154,575
Foreign	20,366	22,190	25,235	35,040	36,427	42,276
Total	82,413	96,018	112,547	140,474	160,272	196,851
Loan (RM'000)						
Local	59,474	70,997	77,589	86,440	104,779	137,852
Foreign	21,284	26,209	28,132	30,796	35,794	44,226
Total	80,758	97,206	105,721	117,236	159,976	182,078
Employee						
Local	34,167	37,080	40,038	43,119	47,895	51,503
Foreign	10,548	10,698	10,895	11,450	11,779	11,756
Total	44,715	44,778	50,933	54,569	59,674	63,259

Source : Bank Negara Malaysia, Yearly Report, various years.

registered only 21.5 percent. The encouraging trend enabled most commercial banks to provide more loans and financing to the private sector and other businesses. This contributed enormously to the country's 8 percent economic growth for the past ten years. Here again, the major portion of loans came from the local banks. In 1990, local commercial bank's loans share was 73.6 percent compared to only 23.3 percent by the foreign banks and at the end of 1995 the lendings by local commercial banks rose to 78.5 percent while the foreign banks participation further dwindled to 21.5% percent.

Table 4.2 further explains the details of lending by sectors given out by the commercial banks. The core sectors in the economic development have been allotted a major share from 1990-1997. They are the manufacturing, business services, construction, general commerce and transportation sectors. The transportation sector enjoyed a marked increase of borrowing from only 3.8 percent of total loans in 1990 to 48.4 percent in 1997. The sprouting LRT and Monorail projects are the main reason behind the huge hike in the loans rate. Next is the construction sector which registered 28.6 percent loan in 1997 from a mere 5.5 percent in 1990. Business services also enjoyed high loan rate in 1997 (27.1 percent) apart from general commerce (18.3 percent). All these sectors have been emphasised to achieve the country's aim to be an industrialized nation.

The crucial role played by the commercial banks and other non-banking intermediaries makes it important for them to address proper planned change. They cannot ignore the new developments as most financial institutions in Thailand, Indonesia, South Korea and Philippines collapsed due to their inability to be more proactive. Though currency crisis was a major factor, a planned change management would have minimised the impact. The Malaysian government certainly would not want to witness such a scenario here, so they have instructed banks in this country to forge a partnership through mergers.

Table 4.2 Commercial Banks' Loans to Various Sectors

	1990	(%)	1991	(%)	1992	(%)	1993	(%)	1994	(%)	1995	(%)	1996	(%)	1997	(%)
Agriculture	209	5.8	194	4.6	17	0.4	-328	7.0	-417	-10.1	32	0.9	413	10.8	907	19.9
Mining & Quarry	46	15.3	99	11.9	-86	-10.4	-171	19.5	-40	-6.3	398	76.4	-229	-25.8	66	11.0
Manufacturing	2188	5.3	3306	17.6	1600	6.8	857	3.4	1547	5.7	7723	23.9	4619	10.9	4139	8.6
Finance, Insurance & Business services	39.6	5.3	1049	11.5	1818	15.8	925	6.8	-3313	-19.5	3331	19.6	5643	23.8	9196	27.1
Construction	26.1	5.5	537	9.8	933	13.9	704	8.2	427	4.6	2090	20.1	3172	22.7	5518	28.6
General Commerce	64	0.6	513	4.4	42	0.3	261	2.0	160	1.2	3204	21.3	2218	11.6	4068	18.3
Transport	49	3.8	111	8.2	-583	-28.5	419	28.8	42.8	21.4	258	10.6	512	17.2	2013	48.4
Real Estate	122	1.4	672	7.4	799	8.1	432	3.9	-1403	-12.3	3143	29.1	2782	18.1	1364	6.5
Housing	594	7.3	1072	11.2	250	2.2	1163	9.5	174	1.2	1528	10.8	342	2.0	1392	7.5
Misc.	1111	14.0	1741	16.3	788	5.8	791	5.3	5632	31.8	4790	17.3	7004	19.4	4274	9.4

Source : Bank Negara Yearly Reports, various year.

Most common changes in the banking industry are high technology banking as practised by Phileo Allied Bank Berhad, various innovative products, excellent customer service and the most important are mergers. Mergers and restructuring in the banking industry will promote strength in their operations thus benefiting the industry and the economy on the whole.

This research will particularly study the role of managers in managing change. Both Phileo Allied Bank Berhad and Bank Pertanian Malaysia were chosen as they highlight various new changes (as discussed in 4.3 and 4.4). It will also be interesting to see how managers perform their role in managing change in different environment the public and the private sector.

4.3 BANK PERTANIAN MALAYSIA (BPM)

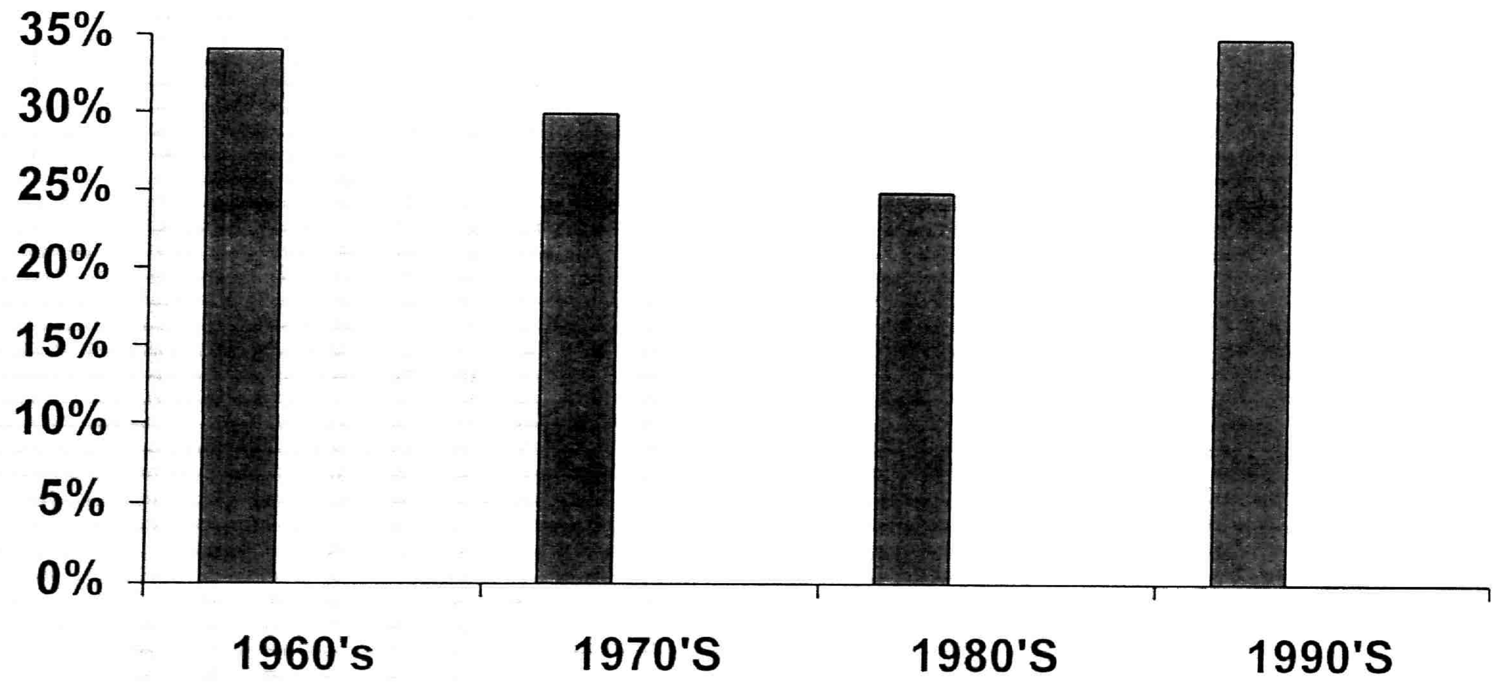
BPM was established in 1969 in Alor Setar, Kedah. It was established under the Bank Pertanian Malaysia 1969 Act with initial paid up capital of RM50 Million. The functions of BPM is comparable to most agriculture banks worldwide for example, Credit Agricole in France, Bank for Agriculture and Agricultural Cooperatives in Thailand, Bank Rakyat of Indonesia, Sparbank in Sweden and Agricultural Development Bank of Iran[6].

The main objectives of BPM are :-

1) To enhance the agricultural industry in Malaysia as agriculture has always played a significant role in Malaysia's economic development. Figure 4.2 shows the agricultural sector's contribution in the Gross Domestic Product (GDP) for 4 decades of 1960's to 1990's. 1960's shows 34 percent share of agriculture sector from the total GDP, this figure later decreased to 30 percent in 1970's and further fell to 25 percent in 1980's before rising in 1990's to 35 percent. The emphasis in

[6] *Bank Pertanian Malaysia, Dulu, Sekarang dan Masa Depan, Satu Kajian Semula Ke atas Status dan Skop Perniagaannya, BPM, 9 Mac 1994, pg 3.*

Figure 4.2 Agriculture Sector Performance for 1960's, 1970's, 1980's & 1990's



Source : Bank Pertanian Malaysia
Yearly Report

industrial and commercial sector in 1970's and 1980's contributed to the declining trend but as the population increased so was the demand for food. This is highlighted in the 35 percent share of the GDP in 1990's.

2) To provide financial assistance to any agricultural activities such as in producing and marketing efforts. BPM, however, only contributes less than 5 percent of agricultural financing for government agencies in the country. The major share is from the banking system (51 percent), 2 percent from the Sabah Development Bank and 42 percent from the Federal Land Development Authority (FELDA) as shown in figure 4.3.

3) To receive deposits and to manage investment in the appropriate sectors to gain healthy returns for its depositors. BPM is also actively involved in money market operations.

Briefly, the operations of BPM can be divided into 3 eras, the 1970-1980 (active era), 1981-1990 (passive era) and 1991 to current (aggressive era[7]).

4.3.1 Active Era

BPM officially started its operation in 1970 in Alor Setar, Kedah. Its first project was financing the MADA scheme which offered financial aid of RM652,000 to more than 272 farmers. BPM was quite active in this era. It started with as a small operation in Kedah but ended the active era with 35 branches nationwide. BPM also managed to generate its own funds of RM643.1 Million compared to only RM125.8 Million loanable fund granted by the government. In all this time, BPM did not receive any additional grants to support its administrative costs. The government as mentioned only provides loanable fund to be disbursed at 8.0-8.5 percent per year interest rate. Furthermore, they managed to record profits throughout this tenure except in 1973 and 1979. The active era without thorough planning, research and proper accounting system later

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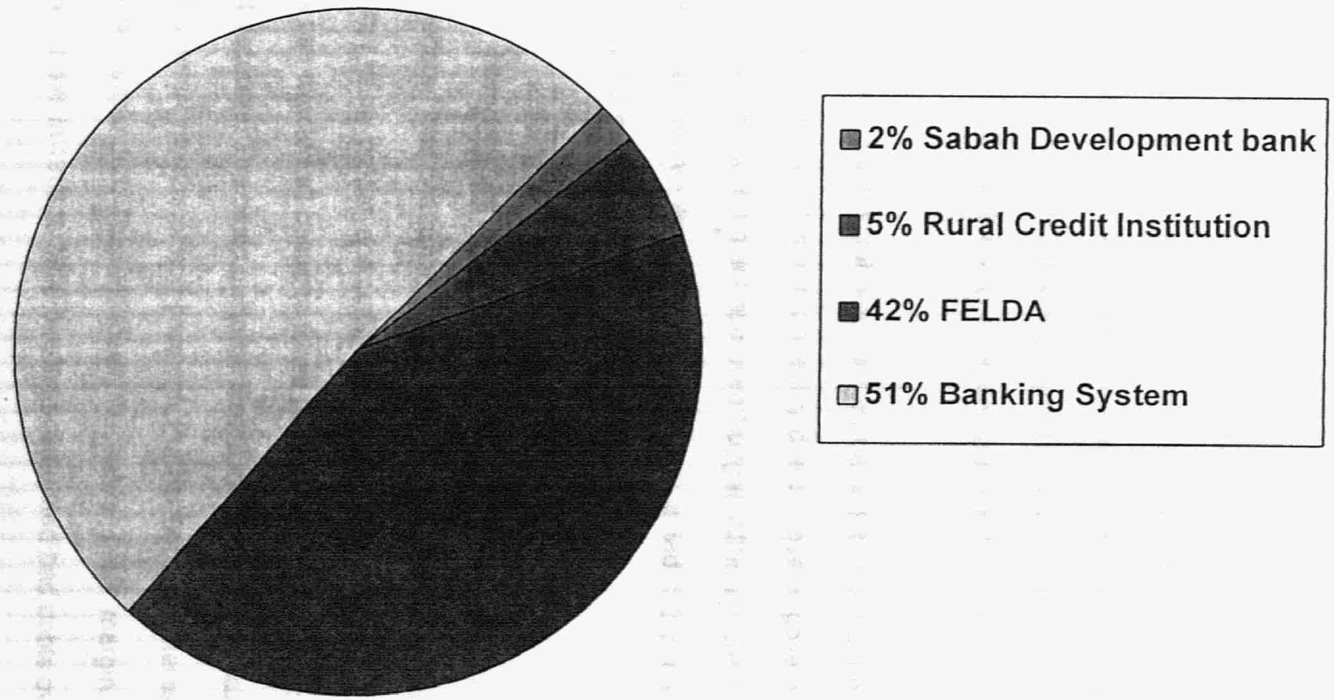
[7] Ibid, pg 5

Figure 4.3 Agricultural Financing for Government Agencies



Source : Bank Pertanian Malaysia
Yearly Report

created severe problems when it moved into the passive era.

4.3.2 Passive Era

BPM was plagued with problems during the tenure, which started from 1981 to 1990. The escalating cost of administration from RM16.7 Million in 1981 to RM38.3 Million in 1990 was a major problem. The government did not fullfil its plea to absorb 97 percent of BPM's administrative cost. They only provided grants, which could barely cover those costs. For example, in 1981 RM15.7 Million was disbursed and RM31.3 Million in 1990.

There are several other factors behind its inapt performance during these years. BPM could not perform as a commercial entity due to several governments and JPA's directions and its reliability on the government approved budget. Although BPM was supposed to charge 4 percent interest rate above its cost of funds it only levied 1-2 percent. Furthermore, adequate delinquent account provisions were not provided.

Hampered by all these problems BPM still managed to record profit when most other banks suffered loss due to the drowning economic problems. The figures were suspectable as BPM did not follow proper accounting management as stipulated by the Central Bank. The Central Bank has directed all banks to follow their guidelines in povision of non-performing loans or delinquent accounts. The basic guideline states that a loan to be classified as non-performing or delinquent after six months of non-payment. Furthermore, all interest to be earned from these loans are to be suspended. This will lower the banks' profit margin. The real standing was it suffered heavy losses in 1988 to 1990 due to accumulated bad debts over the years.

Faced with the critical situation the government sought advice from the World Bank to evaluate BPM's functions on lending options to reduce their dependency on the government, to source out their own funds and to set up proper accounting and auditing system. The World Bank's findings to the problems faced by BPM are as follows[8] :-

a) There is no continuation on the change programs by the board of directors.

b) The inflexibility in the organisation's operations especially the tight bureaucratic procedures.

c) A very poor auditing process.

d) A poor fund structure where 93% of BPM total funds is located in Klang Valley, where there is not much agricultural activities.

e) BPM major investment were from money market operations and not from its lending activities.

f) The escalating administrative cost and no proper provision for bad debts makes all its profit suspectable.

g) No proper management of change, management did not focus on specific objective.

The World Bank's findings, their recommendation and the government's efforts to instill more commercial values to BPM's operations took the bank into the current era, the aggressive era.

4.3.3 Aggressive Era

BPM initiated numerous corrective actions to instill public confidence to its operation. In order to restructure its funds portfolio in 1991, BPM started a major advertising campaign to broaden its deposits in the long run. During this era BPM introduced the various "PATRIOT" deposits with the young generation as their main target market. The fixed deposit was

[8] Ibid, pg 12

also restructured. The Patriot deposit and Ummah deposit produced extraordinary results from RM99.6 Million in 1990 to RM1,867.8 Million in 1993. All these efforts further increased their loanable funds and reduced the deficits from RM527 Million in 1990 to a positive figure of RM505.2 Million in 1993. Branches were also increased to provide better service from 60 branches in 1990 to 160 in 1993. Other major changes are as follows :-

1) Employees' Productivity

In comparison of asset per employees, BPM just managed RM750,000 in 1990 while other commercial banks recorded RM3 Million per employee. However, BPM did not retrench any of its employees. They retrained them to horn their skills and assigned them to various new challenges.

2) Technology

Computerization was severely lacking in BPM's operations. In 1991, only one branch was fully computerised. A decision was made to fully automate branches with more than 10,000 account holders. In 1991, there were 6 fully computerised branches, 1992, 24 and in 1993, 30 branches. More Patriot ATM machines were also installed in the branches.

3) Corporate Image

In order to instill more commercial values most of its branches went through a face lift process and this is evident in its headquarters. BPM also introduced more innovative products and adding new features to its existing products once every three months. It also initiated greater effort to its promotional activities. All these positioned BPM at number three on the public awareness of the bank from a survey conducted by Frank Small and Associates in 1993.

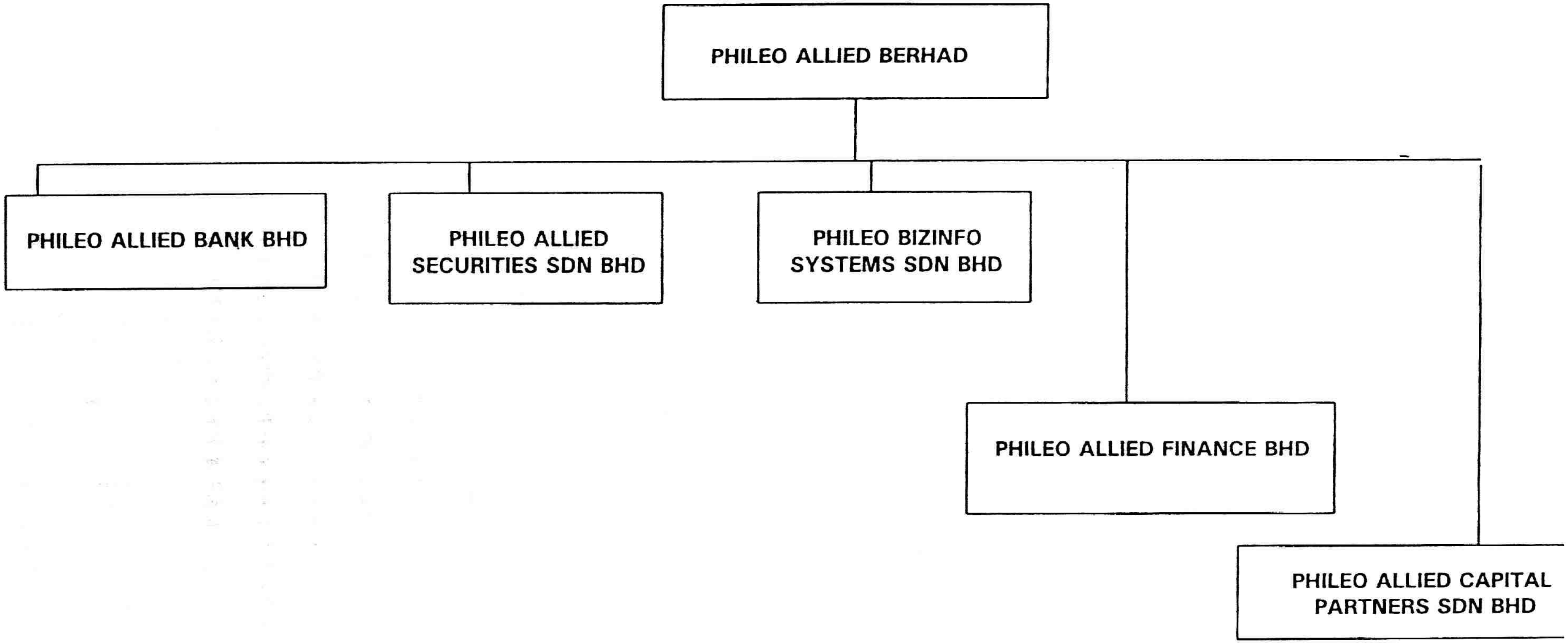
4) Staff Welfare

The participation of the workforce will ensure the success of any change programs. As BPM has many "middle-aged clerks" and "enlightened professors" initiating those changes were not easy. In order to diffuse resistance and to win their support more benefits were given to the workforce. Promotions, which were frozen for the past 12 years, were revoked. Restructuring in its organisation structure instilled more flexibility to its operations. More structured training were conducted. BPM also was represented in the international arena as its personnel was appointed to the Vice President seat in the Asia Pacific Regional and Agriculture Credit Association in Bangkok and has representatives in the Association of Development Financial Institutions in Asia Pacific in Manila.

4.4 PHILEO ALLIED BANK (PAB)

Phileo Allied Bank (PAB) was incorporated in July 1994 with its shareholders fund of RM450 Million. PAB is wholly owned by Phileo Allied Berhad, a financial company which is listed in the Main Board of the Kuala Lumpur Stock Exchange (KLSE). The commercial banking arm of Phileo Allied Berhad was further expanded by the acquisition of Petra Finance in January 1995 which was subsequently renamed as Allied Finance (Malaysia) Bhd. The overall operations of Phileo Allied Berhad is shown in figure 4.4. Briefly, their operations are divided into five major subsidiaries which operates under the Phileo Allied Berhad. They are Phileo Allied Bank Berhad, Phileo Allied Securities Sdn Bhd, Phileo Bizinfo System, Phileo Allied Finance Berhad and Phileo Allied Capital Partner Sdn Bhd. Further details on the subsidiaries and effective percentage of ownership is shown in Appendix 3.

Figure 4.4 The Phileo Allied Group of Companies



Source : Phileo Allied Yearly Reports, 1997.

4.4.1 Phileo Allied Bank Berhad

PAB is positioned among the top 10 banks in the country. Unlike most commercial banks, PAB focuses more into investment services. PAB is determining to create a market niche by providing a blend of customer oriented banking and investment services. In order to meet its objectives, PAB introduced a series of innovative financial products and services. The first of its kind was the PAL DIRECT which was introduced to the public a year after its incorporation in June 1995. This revolutionary product is termed as the "Ultimate Banking and Investment Convenience". Subsequently in August 1996 they launched the "PAL WORLD" which was officiated by the Deputy Prime Minister and Minister of Finance, YAB Dato Seri Anwar Ibrahim.

This product is an enhancement of the PALDIRECT system. It offers a comprehensive on-line banking and other services of share investing, utility bill payments, news and information, electronic shopping, travelling and other communication services. This product also offers convenience and high accessibility to the banks products and services.

4.4.2 Phileo Allied Securities Sdn Bhd (PASSB)

Phileo Allied Securities was formerly known as Peregrine Securities. It is based in Ipoh, Perak. PASSB is secured with a paid up capital of RM30 million and RM70 million in Shareholders Funds as at 31 January, 1995, making it one of the top ten stockbroking companies in the country. Besides stockbroking, PASSB also offers corporate finance and advisory services specializing in mergers, acquisitions, restructuring, placement, and underwriting. PASSB also operates worldwide with offices in Hong Kong, London and New York. PASSB is the significant contributor to the Phileo Allied Berhad groups profits. PASSB recorded a pre tax profit of RM49 million in 1997 compared to RM44.4 million in 1996.

4.4.3 Phileo Allied Finance Berhad (PAFB)

PAFB started from Petra Finance Berhad in January 1995. It has a paid-up capital of RM3.6 million to RM9.6 million in 1995. Basically, PAFB offers a full range of financing services and deposits related products. Besides that it also offers other loans such as housing loans, term loans, hire purchase, and bridging and end financing facilities.

4.4.4 Phileo Bizinfo System Sdn Bhd (PBSSB)

PBSSB was incorporated in January 1994 from Erti Tenang Sdn Bhd. PBSSB caters a fully integrated computer systems for the Phileo Allied group. As banks move into the globalized 21st century economy computer system integration is crucial for its development. So PBSSB handles all operations relating to implementation and management of the Phileo Allied Computer networks. Its major achievement is developing the PAL DIRECT and the PAL WORLD.

4.4.5 Phileo Allied Capital Partners Sdn Bhd (PACP)

PACP provides corporate and financial advisory services to various corporate clients. The advisory services are mergers, acquisitions, initial public offer, take-over, joint ventures, privatisation and other corporate services. PACP does not limit itself on advisory role, rather being a partner to its client. This will enable them to play a more important role in the advisory services to produce a win-win deal.

4.5 Phileo Allied Bank's Performance

PAB recorded a pre tax profit of RM34.7 million for 1997 a 28% increase from the previous year pre tax profit of RM27.1 million. As most commercial banking investment arm the stockbroking entity continued to be a significant contributor to the group's profit. The PASSB improved its operating revenue of RM122 million due to the high market volume in the Malaysia stock market in 1996. PASSB recorded a pre tax profit of RM49.0 million in 1997 compared to RM44.0 million in 1996.

However, the biggest achievement was the Phileo Allied Finance which recorded an increase of more than 200% pre tax profit of RM1.6 million in 1997 compared to a mere RM486,000 pre tax profit in 1996. As Phileo Allied Bank is a relatively new operation these figures are a very encouraging trend for the bank to surge ahead of its competitors in the future. In fact, it has taken all the necessary steps by introducing sweeping changes to the "dull" environment of banking. The exciting PAL WORLD and PAL DIRECT contributed enormously to its progress.

The company also granted the Employee Share Option Scheme (ESOS) as part of the groups effort to instill commitment, dedication and loyalty among its staff. The ESOS was approved by the Central Bank and the Finance Ministry in January 1997. Under this scheme all employees of the group can subscribe new ordinary shares of the company at RM1.00 each. This effort apart from instilling dedication and loyalty will enhance staff motivation in working towards the changing environment of bank as the staff now are "partners" not merely "employees".