A Case Study of the Local Bank Merger: Is the Acquiring Entity Better Off?

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Abstract

The case study involves the merger between CIMB (previously known as Bumiputera Bank Berhad) and Southern Bank Berhad (SBB). CIMB Group and Southern Bank, being the target bank is the nation's second-smallest lender, taken over by CIMB 15 March 2006. The objective of the study is to investigate whether there is any significant difference in the performance of the acquiring company (CIMB) between pre-merger and post-merger periods. This paper uses a sample period of three years crossing-over the announcement date. The performance measure is based on the daily and weekly returns are computed based on the share. Analysis on the daily returns is ranging from 30 days to 360 days, whereas, weekly returns are analyzed using a range of 7 to 78 weeks. A paired sample t-test is adopted. The findings conclude that there are no significant differences between the pre-merger and post-merger periods and hence, on average total share holder value is not really affected by the announcement of the M&A. However, the results reveal that acquiring firms are bound to experience positive returns in the long run not in the short run.

Keywords: Merger and Acquisition (M&A), Synergy effect

1. Introduction

Most of the banks mergers and acquisitions activities have focused on market-driven mergers in developed countries and become an important issue in the global business. After the Asian financial crisis 1997, merger and acquisition activities significantly affected the Malaysian banking industries and other manufacturing operations such as construction and plantation industries. Globalization and liberalization indeed increase the capacity and efficiency level of the country's financial system. Meanwhile, the development of information technology is expected to contribute to the need for a more competitive, resilient and robust financial systems in Malaysia. Therefore, Bank Negara Malaysia (Central Bank of Malaysia) proposed a major restructuring plan for its 54 domestic financial institutions to be consolidated into just six anchor institutions on 29 July 1999 (first round of bank merger). Then, it was decided that the number of anchor to be increased from six to ten in Feb 2000. However, it was later reduced to nine when Bumiputra Commerce Bank acquired Southern Bank Berhad in May 2006 and became CIMB. The other eight anchor banks are Affin Bank, Alliance Bank, AmBank, Eon Bank, Hong Leong Bank, Maybank, Public Bank and RHB Bank.

Generally, Malaysia indeed experienced a robust merger and acquisition market as the total value of M&A activities slightly increased from USD$9.1 billion (1st half of 2006) to USD$17.5 billion (2nd half of 2006) as reported in 2007. The USD$17.5 billion worth deal was largely dominated by plantation industry and CIMB takeover the Southern Bank Berhad.

When merger and acquisition activities carried out, some banks were doubtful whether the merging scheme would subsequently lead to greater efficiency and profitability. The literature argues that merger and acquisition approach could lead to three results; positive profit (Synergy or Efficiency theory), negative profit (Agency theory) and breakeven (Hubris theory). Therefore, there is a need to substantiate the extent to which Malaysia's experience in merger activities resulted in a positive outcome and the focus would be on the acquiring companies using some specific performance measures. In this regard, studies revealed that some acquiring tended to register positive returns (Ben-Amar and Andre, 2006), however, many also argued that the acquiring companies failed to sustain with positive gains (Campbell, Ghosh, & Sirmans, 2001).

The Merger activity indeed strengthened their market position and capital as well, such as the merger was designed to strengthen CIMB's consumer banking capabilities. Before the merger, Southern Bank Bhd (SBB) was said to be the best credit card retailer in Malaysia and this would add more value to CIMB's share. SBB shareholder gained more benefits, it was also said to be the 'sexiest deal' as it was offered RM4.30 a share price plus 5% dividend payment besides enjoying the redeemable convertible unsecured loans stocks (RCULS) at RM1.08 each in December 2006. In short, it was a win-win situation; the target firm received a very good compensation and value enhancement was seen in the acquiring company especially through the banking products (consumer loans, credit card, unit trusts, etc).

The purpose of the study is to examine the extent to which CIMB benefited on capital gains from its merger with Southern Bank Berhad. Specifically, this study makes an attempt to compare CIMB's returns between pre-merger and post-merger periods. Hence, the focus is on shareholder value appreciation (capital gains) that is derived from the closing prices of the acquiring company.

2. Literature Review

Current merger wave is the feature of the world industry today, either by mutual interest of the parties involved or through hostile takeovers. This wave is spreading both at national and European level, enforcing more competition in the market as explained by Barros & Cabral (2001). According to Wozniak (2012), regardless of the uncertainty of the global economic condition, business interest in M&A remains robust and strong as based on survey showing that outbound and intra-Asia M&A might increase to 59% and 53% respectively. In addition, M&A will lead to information sharing as the determinants of product differentiation and also to the middlemen to find the new ways of business directions or opportunities (Kim & Choi, 2010).

M&A activity was very much emphasized after the financial crisis 1997 due the major losses posted by the local banks. As to deal with market forces and uncertainties, the government decided to strengthen the banking operations through mergers. In order to rebuild and regain the confidence of the public as well, BNM released a merger announcement to consolidate and strengthen the financial market in Malaysia. It was noted that there was a positive market reaction to the announcement of the bank mergers and synergy effect was found after the merger announcement (Isa & Yap, 2004). Furthermore, M&A activity is very important from risk perspective by evaluating the synergy-based mergers and acquisitions might increase risk showing that systematic risk decreases in related mergers and acquisitions and it was supported by the previous studies such as Chatterjee & Lubatkin (1990) and Lubatkin & O'Neill (1987). According to Shaver (2006), systematic risk assesses the sensitivity of a firm's stock price movement to the market portfolio that incline to capture the importance of events to which all firms are subject.

Furthermore, M&A activities are to assist domestic banks to be more competitive especially in dealing with the participation of foreign investors in the domestic markets. Market-power hypothesis argues that horizontal mergers tend reduce competition within markets, thus providing increased monopoly power for the remaining firms. As a result, the remaining firms could increase prices within the market and gain excess profits (Bessler & Murtagh, 2002).

In view of the CIMB merger, there was an increase in the volume of trading and share prices since its share price passed over RM 12 and achieved the highest point at RM 12.50 on 10th May 2007. This seemed to be consistent with some studies where wealth gains could be experienced surrounding the acquisition announcements (Gugler et al., 2003).

2.1 Some Empirical Evidence on Merger and Acquisition (M&A) Activities

Based on the evaluation of the causes, consequences, and future implications of financial services industry consolidation, Berger, Demsetz, & Strahan (1999) review over 250 cases and concluded that merger activities were able to improve profit efficiency and risk diversification but there was little or no cost efficiency improvement on average. They also concluded that payments system efficiency would be potentially improved and the availability of services to small customers would be little affected.

Many companies are bound to come up with a new corporate strategy that inevitably deals with mergers and acquisitions. Stakeholders of an acquiring company tend to expect more benefits via restructuring programs especially by reducing of the number of branches in specific areas and undoubtedly, shareholder wealth maximization is the main focus main focus. The results on wealth maximization after mergers particularly on the acquiring companies are quite mixed (positive or negative returns). Some argue large positive abnormal returns were found on the target firms (Tichy, 2001; Campa & Hernando, 2006; and Otchere & Ip, 2006)

Merger activities tended to bring a positive impact on deposit growth, but did not have any effect to enhance bank profitability (Okazaki and Sawada, 2003). Their argument was based on the analysis on the Japanese banking industry before the Second World War. Huck, Konrad & Muller (2001) reveal that an M&A activity involved a 'strategic power', indicating that two-sided merger could be profitable.

Norman & Pepall (2000) examine the profitability and locational effects of mergers in the Cournot competitive market; argued that a two-firm merger was usually profitable because both merging partners could coordinate their location decisions. The results also indicated that two profitable firms' merger would reduce competitiveness, leading to higher prices and reduce consumer surplus. In short, total surplus could be enhanced by locational efficiency and the increased profits of the merging partners.

DeLong (2001) finds differentiation can be made between bank mergers that enhance value upon announcement and mergers that do not create value. The conclusion given is that mergers that have similar activity and geographically concentrated (focus mergers) tend to enhance stockholder value, while those mergers that diversify either geographically or by activities, or both, do not create value.

Moeller, Schlingemann and Stulz (2004) examine a sample of 12,023 acquisitions by public firms from 1980 to 2001, find that small firms fare significantly better than large firms when they made an acquisition announcement. The abnormal return linked with acquisition announcements for small firms exceeded the abnormal return associated with acquisition announcements of large firms. Bessler and Murtagh (2002) examine the stock market reactions to the merger announcements and found that foreign acquisitions in the wealth management and retail banking sectors created value, while foreign acquisitions in the insurance sector did not (considering 26 cross-border and 17 domestic acquisitions of other financial services in Canada, between January 1998 and June 2001). Otchere & Ip (2005) investigate the intra-industry effects of cross-border acquisition of Australian firms from 1990 to 2000 and found that target firms' rivals realized significantly positive abnormal returns.

Most mergers that took place in Malaysia focused on domestic banks were carried out on the advice of the BNM in the interest of the economy. In relation to this, Cybo-Ottone & Murgia (2000) find a positive and significant increase in the stock market value at the time of announcement of the domestic bank mergers, but however, this effect was not found on cross-border deals.

3. Data and Methodology

The study focused on the performance of an acquiring bank, Bank Bumiputera (now known as CIMB), and the target bank was Southern Bank Berhad (SBB). The study was designed to examine effectiveness of the deal by analyzing the returns of the bidder bank during the post-merger period. The sample period involved a 3-year starting from 15 September 2004 to 14 September 2007 crossing over the merger announcements date on 15 March 2006. The periods before and after the announcements date were considered as 'pre-merger period' and 'post-merger period'.

The study investigated the returns of CIMB based on its share prices on a daily and weekly basis. The pre and post period timeline was set over a 3-year period but the investigation was designed using sub-sample periods. These sub-sample period pairs (pre and post merger) were 30 days, 60 days, 90 days, 120 days, 150 days, 180 days, 210 days, 240 days, 270 days, 300 days, 330 days and 360 days. The weekly sub-samples were 7 weeks, 15 weeks, 30 weeks, 60 weeks, and 78 weeks involving pre and post-merger periods.

Fundamentally, short term period involves a period of less than one year and while above one year is considered as long term period. Hence, on weekly basis, short term period denoted 30 weeks while long term period denoted 60 weeks. As for the daily basis, long term period exceeding 270 days while short term was up to 240 days. The various sub-periods used in the study would offer more robustness check on the difference of returns (capital gains) between pre and post merger periods. This indirectly tended to offer more discussions on the value creation experienced by CIMB as a result of its merger activity. The data (mainly on the stock prices of the acquiring company) were obtained the annual reports and Kuala Lumpur Stock Exchange (now known as Bursa Malaysia)

The study examined the capital gains (returns) of pre and post merger periods and comparison was carried out accordingly using the paired sample t-test. The return could be either in the negative or positive figures and calculation basically involved a straight forward method similar to the calculation of holding period return that applies to both daily and weekly returns. The formula is as follows;

$$R = [(P_t - P_{t-1}) / P_{t-1}] \times 100$$

Where:

R = Return

P_t = current share price

P_{t-1} = Previous share price

The study also incorporated the average returns (mean scores) of each sub-period of pre and post merger periods in both short and long run. Table 1 shows the details of sub-periods of short term and long term period.

Table 1. The Sample Size of Short Term and Long Term Period of the Study

Daily (short-term)	Daily (long-term)	Weekly(short-term)	Weekly (long-term)
30 days	270 days	7 weeks	60 weeks
60 days	300 days	15 weeks	78 weeks
90 days	330 days	30 weeks	
120 days	360 days		
150 days			
180 days			
210 days			
240 days			

4. Findings and Discussion

As discussed earlier, the paired sample t-test was used to investigate whether there were any significant differences between pre and post merger periods on all the sub-samples. The significant results would conclude our argument over whether CIMB benefited from the merger activity and this was measures by its capital gains.

The findings of the daily returns on short term and long term periods are shown in Table 2 and Table 3. It seemed that there were no significant differences in terms of the returns registered by CIMB between pre-merger and post-merger period. Taking a closer look at it, CIMB registered a negative average return in the post-merger period (-0.0187% and -0.0545% respectively) during the sample period of 60 days and 90 days. However, those negative returns did not significantly differ from the positive returns in pre-merger period (0.0221% and 0.05278% respectively).

Table 2. Daily Average Returns and Paired Samples T-test

No.	Details	Paired	Average Returns (%)	Difference (%)	Significance
1.	Pre-Merger		-0.1383	0.2782	0.417
	Post-merger	30days	0.1399		
2.	Pre-Merger		0.0221		0.871
	Post-merger	60days	-0.0187		
3.	Pre-Merger		0.0528	-0.0408	0.604
	Post-merger	90days	-0.0545		
4.	Pre-Merger		0.0024		0.812
	Post-merger	120days	0.0429		
5.	Pre-Merger		1.0749	-0.1073	0.518
	Post-merger	150days	1.3487		
6.	Pre-Merger		0.0245		0.446
	Post-merger	180days	0.1312		
7.	Pre-Merger		0.1149	0.0405	0.542
	Post-merger	210days	0.1984		
8.	Pre-Merger		1.2653		0.546
	Post-merger	240days	1.7212		
9.	Pre-Merger		0.0725	0.2738	0.295
	Post-merger	270days	0.2134		
10.	Pre-Merger		0.0481		0.139
	Post-merger	300days	0.2454		
11.	Pre-Merger		0.0593	0.1067	0.238
	Post-merger	330days	0.2124		
12.	Pre-Merger		0.0699		0.377
	Post-merger	360days	0.1800		

*significant at 5% level

Table 3. Weekly Average Returns and Paired Samples T-test

No.	Details	Paired	Average Returns (%)	Difference (%)	Significance
1.	Pre-Merger		1.3782	-0.902	0.447
	Post-merger	7 weeks	0.4762		
2.	Pre-Merger		0.6778	-0.8251	0.457
	Post-merger	15 weeks	-0.1473		
3.	Pre-Merger		0.2717	0.1345	0.828
	Post-merger	30 weeks	0.4062		
4.	Pre-Merger		0.3977	0.7007	0.125
	Post-merger	60 weeks	1.0984		
5.	Pre-Merger		0.3816	0.3712	0.479
	Post-merger	78 weeks	0.7528		

*significant at 5% level

Interestingly, in most cases of the returns registered for long term period indicating that the average returns in the post merger periods were higher as compared to the returns registered during the pre-merger periods. These findings involved from 120 days to 360 days. It should also be noted that even the 30 day period, the merger activity managed to yield a positive return as compared to the negative return before the announcement of merger was made. Hence, improvement in the shareholder value was immediately visible but however, the bank suffered on negative returns in the following 60 days. This could be the adjustment time needed by the bank to deal with the market's expectation. The biggest difference found during the 30 and 270 days (0.2782% and 0.2738% respectively).

In the case of weekly returns, Table 3 presents the details as shown below. It was noted that the returns registered on a weekly basis were quite consistent with the earlier findings as given in table 2 above. It seemed that the bank experienced slightly higher returns during the pre-merger period during the 7 and 15 week periods. Improvement could be seen in 30 weeks, 60 weeks and 78 weeks where the returns registered during the post-merger periods were greater. The largest difference was found during the 60 week period (0.7007%). However, statistically, all the 5 sub-periods did not show any significant differences. Obviously, long run effect tended to play a vital role to yield greater returns as the management continued to strive for greater efficiency in the operations after the takeover.

The insignificant results on finding the differences on returns between pre-merger and post-merger period also raise some arguments and considerations. Strictly speaking, based on the results, it can be concluded that CIMB failed to gain significant returns through its merger activity though there could be a slight improvement in the average capital gains. This is could be due to the mismatch in the size of the bidder firm and target firm as pointed out by Moeller, Schlingemann, & Stulz (2004) who argue that larger acquiring firms tend to cause losses to their shareholders. In addition, when bidder firms are much larger than their target firms, the percentage gains to the bidder firms would be very low when compared to the percentage gains that go to the target firms (DeLong, 2001). Generally, shareholder returns of the target companies tend to be positive on average upon the announcement of the transactions while returns to shareholders of the acquiring companies are slightly negative on average (Campa and Hernando, 2006). The above findings were also consistent with Leeth & Borg (2000), where the acquiring companies to face lower returns after mergers.

Lack of acquisition experience of the bidder firms could also be a part of the failure reason for any M&A event. It is also argued that only firms with more experience, knowledge in regard to M&A activities, tend to succeed (Sudarsanam, 2004).

It was observed that CIMB upped its offer for the Southern Bank Bhd to RM6.7 billion and dealt with RM4.30 per share. This was higher by about 4 percent from an initial hostile offer of RM4.15. In a competitive merger situation, the acquiring companies always tend to pay more to the target companies in order to speed up and complete the process of merger. As given in the literature, Abyankar, Ho & Zhao (2006) find the standard portfolio of acquirer dominates the merger portfolio of acquirers that paid highest premiums to the target companies. From their point of view, the overpayment to the target companies may be a possible reason for the under- performance of some acquiring companies. Moeller, Schlingemann & Stulz (2004) find that the abnormal returns are associated with acquisition announcements for large firms by 2.24 percent. Besides that, they also point out the large firms offer larger acquisition premiums than small firms in the M&A activities with negative dollar synergies. Meanwhile, the on-going integration between SBB, the CIMB might need more time in order to fully realize synergistic benefits for their merger

5. Conclusions and Implications

Undoubtedly, the merger activity between the two banks seems to be fruitful only in the long run. Probably, there is some synergetic effect but however, it is important to have this synergetic effect reflected in the share price of CIMB as this plays a significant role on share holder wealth maximization. This study also argues that the effectiveness of an M&A activity is not clear though some positive outcome can be traced. In fact, ambiguity in the results obtained is always there in verifying and concluding the effectiveness of the merger activities (Havrylchyk, 2004). CIMB shows some improvement in its stock returns during the post-merger period but the evidence is inconclusive. Regardless of whatever it is, the acquiring firm should continuously enhance their commitment on customer satisfaction and reputation. It is advisable for the company to be clear of the benefits that result from a merger.

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