The cost efficiency effects of involuntary bank mergers: Empirical evidence from Malaysia

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Abstract

Much of the merger and banking efficiency studies is centered on the market driven or voluntary merger. Thus, the uniqueness of Malaysian merger policy offers an interesting platform for this study to embark on. The merger in Malaysia is unique as all the domestic banks were enforced to merge by the government in year 1999 after years of persuasion with little success. This study attempts to quantify the impact of the involuntary merger on the cost efficiency gains over the 1990-2005 periods. Firstly, several tests have been performed to investigate whether it is best to envelope data with a common frontier of data envelopment analysis (DEA) or by separate frontiers. Secondly, this paper assesses the cost, allocative, technical, pure technical and scale efficiencies of Malaysian banking industry as the results of the merger. In general, the results suggest that the enforcement of the bank merger policy has resulted in an improvement of bank efficiency levels.

Keywords: involuntary mergers, efficiency, banking, Malaysia

JEL Classification: M21

1. Introduction

Bank mergers are claimed to be the sources of efficiency gains from the realization of economies of scale and economies of scope, the removal of overlapping services and the increasing awareness of innovative banking tools; however, one needs to read over the assertions with caution. It is due to the fact that much of the prior research has focused on the market driven merger or the voluntary merger. At the one hand, the voluntary bank merger refers to the process by which two or more banks merged and become one new entity. The merger takes place without any objection from the shareholders and the board of both banks. The purchase is considered done once the acquirer purchased the shares of the target bank. On the other hand, involuntary merger refers to the merger of a firm that is insolvent or in danger of insolvency and it is initiated by the government or the authority.

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