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Is bigger really better?

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THE push towards local bank mergers is designed to create mega banks which are capable of withstanding the onslaught of foreign competition. Or so the argument goes.

But is big necessarily better? Can the merged entities take on the giants in the international banking arena?

History has shown that in the local banking sector, the bigger boys have not fared any better than the smaller ones. During the recent recession, the Malaysian banking sector was badly hit. Both the big and small banks were reeling from the effects of non-performing loans (NPLs). To compound their woes, there was a significant flight of funds from Malaysian-owned banks to foreign-owned ones.

These factors hastened Bank Negara Malaysia's move in pressing local banks to merge. It reckoned that Malaysians would at least have more confidence in their own larger banks than in the smaller ones. Bank Negara would also find it easier to supervise a smaller number of banking entities.

But some think that the key lies not so much in size but rather, in the level of efficiency and integrity. 'Bigger is better if the merged entity is more efficiently run,' says ex-banker Tan Sri Ramon Navaratnam. 'It can then take advantage of the economies of scale. Bigger banks can also have more access to resources.'

Ernst & Young executive chairman Nordin Baharuddin agrees. He feels a large capital base will go a long way in a bank's ability to compete with the big boys. 'But we must ensure there is efficiency. Risk management must also be tight.'

Being big, however, does not necessarily mean being financially stronger - at least not in the case of Bank Bumiputra Malaysia Bhd (BBMB). Although it was the second largest bank in the country in terms of size, it had to be rescued three times from going under. Industry observers point out that besides its social obligations, BBMB's efficiency level may not have been up to mark, thereby rendering it vulnerable in a recession. They point out that the smaller Public Bank managed to pull through the recession with a below average level of non-performing loans.

Nordin says the quality of customers is also an important factor. 'We have seen how some big banks can go under owing to the quality of their customers. There is also a need to have a diversity of borrowers.'

In the push towards mergers, there are some who feel there will always be opportunities for the smaller banks to exploit, and thus survive. Boston Consulting Group vice-president and director Stefan Brand believes that while Bank Negara is right in wanting banks to merge, size is irrelevant and there is no correlation between size and performance. 'Size can play a role in a specific function in a bank,' he says. 'For example, a bank can grow big in IT and carve a niche for itself. There will always be room for small banks if they can pick their turf.'

Another consultant, requesting anonymity, says mergers may eliminate the niche of small banks. Take the example of Sarawak-based Hock Hua Bank, he says. 'Their niche is serving small businesses in Sarawak. They may not be really interested in serving international clients. There is also a worry that customers of such small banks may not be serviced as well as before.'

The consultant adds, 'Australia consolidated its banking sector into four large banking groups. At the same time, the government encouraged

smaller regional banks in the outskirts and discouraged the four large banking groups from competing with them.'

In any event, being big still means a better chance of not getting mauled by the big international boys. Malaysia's largest bank, Malayan Banking Bhd (Maybank), is nowhere near the top 150 institutions in the world. It was ranked 155 by the London-based magazine The Banker in July 1999 (see table). Indeed, Prime Minister Datuk Seri Dr Mahathir Mohamad recently pointed out that even by merging, the largest banking groups in Malaysia would still be no match for the foreign banks.

But that does not mean a relatively small economy like Malaysia should have 36 commercial banks competing against each other. 'Better bigger than smaller,' says Navaratnam. 'At least in being bigger, banks can spend more on research & development and have a cutting edge. They will also be able to develop new products.' He cites Phileo Allied Bank which has broken new ground in information technology. 'If it were bigger, it would have been able to do much more.'

It's a moot point whether mergers are advantageous or not, but one fact is indisputable: Malaysia, like so many other countries, will have to open up its banking sector come 2003. The World Bank is of the view that competition improves incentives for both banks and their customers. Its World Development Report 1999/2000 summary states that allowing foreign banks to enter a country, especially when a sound regulatory system is in place, boosts regulation as high quality risk management standards, regulatory practices and trained managers are imported.

The World Bank says that in a world where financial markets continue to go global, developing countries need to work towards becoming good homes for long-term foreign investments.

But in the end, survival depends on the individual bank. 'We must learn from past mistakes,' says Navaratnam. 'A banking culture was lacking. There was overlending to certain sectors.'

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