1.1 Introduction

After 10 years of strong economic growth, the overheated Malaysia economy has eventually embarked on a downtrend. It started in March 1997 when the so-called the 'bubble' of property sector in Thailand burst. It then followed by the speculators' attacks on the Asean currencies, Indonesia economic and social crisis, South Korean financial turmoil and others.

In Malaysia, currency turmoil started when our currency was under the attack of speculators in July 1997 after the de-facto devaluation of both Thailand baht followed by Philippines peso. As at end of 1997, Ringgit has depreciated by approximately 35% as compared to US Dollar and other major currencies. In fact, the lowest rates since adopting the floating rate regime in 1975 was recorded in early 1998. For instance, Ringgit was traded at RM4.88 against the US Dollar on 9 January 1998 and RM7.92 against pound sterling on 7 January 1998. As an open economy, the Ringgit depreciation had transformed into economic problems. These included imported inflation; hikes in general price level and production costs, corporate failures and unemployment. These problems increased the perceived business and investment risks in the economy and subsequently short-term fund will flowed out from the economy. In the mean time, external debts by government as well as corporate bodies became more expensive in foreign currency terms.

In order to put the economy back to its track, the government has introduced and implemented various measures. These included reducing the current account deficit in the balance of payments, increasing the fiscal surplus through significant cutbacks in government expenditures, reducing credit growth and containing inflationary expectations by tightening monetary policy. In addition, the financial system, which has been characterised as the financial health of the country, has also been given special measures in order to strengthen its health.

Among the sectors that were significantly affected by the above crisis, finance company has been one of them. In Malaysia, there are 39 finance companies as at end of 1997. Collectively, they become the second largest mobilisers of deposit fund in the country after commercial banks, as well as the second most important institutional source of private sector credit. Hence, their financial health during this 'bad' time is vital in order to continue to mobilise the deposit fund. In the early of 1998, Bank Negara Malaysia has instructed the 39 finance companies to embark on a merger exercise; the deadline given was end of March 1998. This move was intended to strengthen the financial position of the finance company sector, especially those finance companies that are facing tight liquidity and low asset quality (high non-performing loans).

Besides, the tight monetary policy especially on private sector credit has restricted the loans and credit growth for the finance companies. This has imposed constraint on the source of revenue. Meanwhile, the tight liquidity in the banking system has pushed up the interest rate or the cost of fund for the finance companies. This further eroded the slim profit margin before taking into consideration the bad debt provision.

Before the finance companies can properly digest the consequences of the financial crisis and prepare the right strategies to weather through the rainy days; the Government has on September 1998 introduced the capital control and fixed exchange rate policy. It then reversed the monetary policy to boost credit growth in order to stipulate domestic expansion. With these drastic changes, can the finance companies now cope with what the policy maker required while their backyards are on fire? Will they be tightly constraint by the liquidity position, high non-performing loans and the merger activities, which have yet to be crystallised?

1.2 The Objectives of the Study

The purposes of this research project are:

1. To analyse and identify the possible weaknesses and problems faced by the finance company sector under the current scenario.

2. To analyse and identify the threats and opportunities faced by the finance company sector under the newly emerged industry structure.

1.3 Organisation of Study

Section 1 highlights the purposes of the research project, its coverage as well as the methodologies employed. Section 2 covers the overall phenomena of finance companies in Malaysia. This includes the finance company's brief history, its role in the banking system, business activities, sources and applications of fund, growth, performance and it legislation framework in Malaysia. A general comparison with commercial banks, merchant banks and the whole banking system will be made.

Section 3 analyses and identifies the possible weaknesses and problems faced by the finance company sector under the current fluctuating circumstances. The research areas included the finance companies' liquidity position, capital adequacy, interest sensitivity, deposits and lending structures, cost and revenue, asset quality, management efficiency, profitability and competition.

Section 4, analyses the newly emerged industry structure. The section also analyses and identifies the threats and opportunities faced by the finance companies sector after the possible mergers. The industry structure, competitions, business directions of the post-merger companies is analysed.

Section 5 provides the recommendations and suggestions to the finance companies.

1.4 Data and Methodology

As finance company sector is a highly regulated industry, only publicly available data and information will be used and analysed. For the industry data, information will be gathered from Bank Negara bulletins and others publications, and publications from Association of Finance Companies Malaysia (AFCM). Individual finance company information can be obtained from annual report of the companies and newspapers.

As this is a consultancy type of research, various kinds of analytical tools will be employed. The major one will be the comparison of data among individual finance companies and among industries. Besides, financial ratio analysis will be adopted where necessary. For individual finance companies, the respective annual reports will be analysed.

The research managed to obtain 29 finance companies' 1997/98 annual financial reports. These 29 companies represented 74.4% of all the 39 finance companies currently in the industry. As the industry is highly concentrated and the top 10 largest finance companies have been included among the 29, the effective coverage of the data is very high. Based on the industry data from Bank Negara and AFCM, it is estimated that the 29 finance companies accounted for as much as 84.7% of total assets, 85.3% of total loans and 93.5% of total deposits in the industry for the year 1997/98 (Table 1.1).

Besides, the 11 anchor and core companies as listed by Bank Negara for the proposed merger scheme are all included in the coverage. Their respective merger partners, 10 out of 14 are also included in the data coverage. This is vital to this research as these are the finance companies that represent the

TABLE 1.1 Survey Data Coverage

	Survey Data	Industry Total	Coverage (%)
Number of Finance Companies	29	39	74.4
Number of Branches	1,044	1,160	90.0
Number of Employees	25,422	27,937	91.0
Total Assets (RM mil)	129,089	152,404	84.7
Total Loans (RM mil)	87,514	102,546	85.3
Total Deposits (RM mil)	109,959	117,600	93.5

Source: AFCM, 1997 Annual Report and Directory

future movement of the industry after the proposed merger. The merger scenario will be further elaborated in later section.