FINANCIAL DUE DILIGENCE IN INCREASING COMPANY VALUE THROUGH BANKING MERGERS AND ACQUISITIONS DURING COVID-19

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Abstract

The COVID-19 pandemic took an enormous effect on the company's ability to survive, and the most popular way to survive was through mergers and acquisitions (M&A), which in Indonesia, was triggered by the stipulation of Financial Services Authority Regulation (POJK) Number 12/POJK.03/2020 on Commercial Bank Consolidation. Thus, M&A activities in the Indonesian Banking industry increased, concerning the role of engaged auditors as practitioners who have competency in conducting financial due diligence (FDD) through critical aspects that are directly and not directly affected by pandemic conditions. This research focused on FDD process evaluation to support the aims of reducing failure of M&A by confirming the veracity of data, so it could prevent loss and create value for shareholders. To understand the practice, concurrent mixed method research was applied to the acquisition case of PT Bank Mayora (Mayora) by PT Bank Negara Indonesia Tbk (BNI) through interviews and documentation. The evaluation of this research is not only within the scope of M&A in previous research but carries the banking industry's FDD to comply with POJK during the COVID-19 pandemic. The study finds some new aspects to contribute wider points of view for auditors in conducting FDD, including technology-based FDD development of processes and procedures.

Keywords: company value, financial due diligence, mergers and acquisitions

INTRODUCTION

COVID-19 brought the largest impact on the world's economy, society, politics, and health in the 21st century. The impact drove business failures for several industries all over the world, especially hospitality, tourism, and transportation. According to Financial Times, in 2020 after the vaccine was released and lockdowns were loosened up, the most popular way to survive business during COVID-19 is through mergers and acquisitions (M&A). This was proven by the increase of M&A deal amount in the United States during October 2020, which increased by 32,7% compared to 2019 and 24,6% compared to 2018 (Kooli & Lock Son, 2021) thus labeled as the "strongest third quarter for M&A in two decades".

Even though most M&A was done by experienced, established, and credible entities, sometimes they do not achieve the results following their business growth agenda. Several sources of business literature consistently state that M&A, without any support from the due diligence process in several aspects such as finance, law, business, operations, and human resources, had been a consistent failure in the last 30 years (Gole & Hilger, 2009). Three possible managerial reasons could be put forward for the lack of improvement in M&A performance over the years are non-value maximizing motive, academic research has not been widely used as a reference by practitioners, and research related to due diligence is still being developed using a variety of analytical media (Cartwright & Schoenberg, 2006). These reasons led practitioners and academics constantly develop good M&A strategies for companies. For acquirers, due diligence generally places more emphasis on the financial aspect, or Financial Due Diligence (FDD). This is inseparable from the expression of 'corporate finance' which refers to the objectives of the acquiring company, namely the mechanisms and processes by which M&A aims to increase capital or increase the money value for operations and growth. Capital can be obtained in various ways, such as by issuing shares or debt securities, or by providing loans and banking facilities. The mechanisms and processes can be private or public, depending on the company's financial objectives (Spedding, 2009). Thus, the value of capital can also be increased or maintained when businesses are merged, acquired, or restructured.

In line with the rapid development of globalization and the COVID-19 pandemic, the FDD procedure system has developed into an online process. With the development of systems and procedures, there is a possibility that the process will be a contemporary system that continues and slowly becomes the standard carried out in the FDD process. In general, FDD is carried out by auditors in the form of an Agreed Upon Procedure (AUP) engagement whose form and scope are all customized according to the needs of the company. AUP has standards listed in the Related Service Standards Number 4400 which guide the practitioner's professional responsibilities when performing an engagement with agreed procedures for financial information and guides the form and content of reports issued by the practitioner concerning the engagement.

The study was focusing on the Indonesia banking industry behavior, while the M&A number increased during the COVID-19 pandemic was triggered by the stipulation set by Financial Services Authority (Otoritas Jasa Keuangan) through Peraturan Otoritas Jasa Keuangan No 12/POJK.03/2020 on Commercial Bank Consolidation (OTORITAS JASA KEUANGAN REPUBLIK INDONESIA, 2020) and No 12/POJK/03/2021 on Commercial Bank (OTORITAS JASA KEUANGAN REPUBLIK INDONESIA, 2021). These stipulations regulate the change of Bank grouping which was originally based on commercial bank business activities, BUKU (Bank Umum Kegiatan Usaha) to bank group based on core capital, KBMI (Kelompok Bank berdasarkan Modal Inti). This change brought significant effect to BUKU 1 and 2 banks, for they are required to top up their core capital from less than Rp.1 trillion to a minimum of Rp. 3 trillion before the end of December 2022 or they have to convert to Bank Perkreditan Rakyat (BPR). Henceforth new bank establishment after the enactment of the regulation is obliged to invest of minimum Rp. 10 trillion in the core capital. As the behavior is in line with the Institutional Theory, the pandemic condition has mostly become a problematic consideration for financial and company value, adding to the recent POJK issued by the regulator, the possibility of M&A failure would be higher than the normal condition, so FDD should be done extra carefully for the sake of creating or maintaining company value.

Several big banks had done acquisitions during the pandemic, for example, Bank Bukopin - Kookmin Bank (2020), Bank Permata - Bangkok Bank (2020), Bank Syariah Mandiri, BRI Syariah, and BNI Syariah to PT Bank Syariah Indonesia Tbk (BSI) (2021), and the latest is BNI - Bank Mayora (2022). This paper will focus on the case study of the BNI – Bank Mayora acquisition based on data obtained from the interview result of the acquirer's management and several auditors experienced in doing banking FDD. The purpose is to evaluate and understand how the process of FDD must be carried out in reducing the risk of M&A failure to increase company value and then evaluate the ways of carrying out the process. As to increase the chances of successful M&A, especially in the force majeure conditions of the COVID-19 pandemic and the effectuation of POJK, additional points of view in FDD are considered obligatory. Thus, the evaluation result by interviews and documentation will be applied to the target's data and might be of reference benefit to business dealers, analysts, accountants, and scholars. An analysis is also carried out from a theoretical point of view, concerning the organizational behavior of Neo Institutional Theory (NIT) and signaling theory.

LITERATURE REVIEW

Theoretical Review

Neo Institutional Theory (NIT) explains that organizations could change goals and practices due to both internal actors and environmental conditions that limit their ability to thrive (DiMaggio & Powell, 1983). NIT has two branches, namely institutional logic initiated by Friedland and Alford (1991), and isomorphism initiated by DiMaggio and Powell (1983). In institutional logic, every institution is believed to have two elements, material and symbolic. Material elements are structures and practices, while symbolic elements are ideas or concepts and meanings (Greve & Man Zhang, 2017). The two elements are interconnected and complementary to each other, in which the material of practice contributes meaning to the symbolic. In this case study, materials are all routines, procedures, and employees working in banking institutions, while symbolic is depicted in regulations and guidelines that are generally accepted and must be obeyed, for example, POJK, PSAK, SOP, and other government regulations.

Furthermore, DiMaggio and Powell (1983) explained the concept of Institutional Isomorphism where this organizational variation will become more and more homogeneous due to the adoption of practices, structures, and behaviors that are similar to those of a better organization. Three things drive the isomorphism alignment process, namely:

- Coercive, the changes that occur due to pressure from other organizations or competent authorities in the form of regulations. Mayora was forced to adjust the KBMI according to the POJK, so they had to find a strategic partner.
- Mimetic, tendency to align other organizations in the face of uncertainty. In this case, the target aligns all of its objectives, behavior, and structure with the POJK.
- Normative, professionalism involves managerial behavior in controlling the conditions and methods of work in building the cognitive basis and legitimacy of their work. FDD is carried out by the acquirer according to their professional duties and responsibilities.

It is necessary to be aware of the backlash of this concept according to anomie theory, that most people strive to achieve culturally recognized goals. A state of anomie develops when access to these destinations is blocked for entire groups of people or individuals (Messner & Rosenfeld, 2017). If this happens, there will be post-M&A stagnation or failure.

The signaling theory was first introduced by Spence in 1973, and mainly explained the market behavior of the signaling party which can influence the signal receiver to change his perspective and behavior (Gambetta, 2008). The main result of this theory is a solution in which at least some truth is transmitted and provided among the signals, if it were affordable enough to be transmitted, it is relatively profitable for the signaler. The signaling theory has been widely used in accounting and auditing studies which suggest the management signals, investors, about the company's condition through the disclosure of aspects in financial statements. In the case of signaling theory, Mayora applied it in disclosing its financial performance through easily accessible annual reports by investors and stakeholders. This theory is in line with NIT, considered as a trigger for the FDD process tendency to adjust and align the organization with professional considerations on risk management, therefore FDD was considered essential in BNI's investment actions towards Bank Mayora.

By combining these two theories, the research problem framework of this case study could be visualized in Figure 1, on how effectively FDD should be executed to reduce risk and increase company value, specifically during the COVID-19 condition.

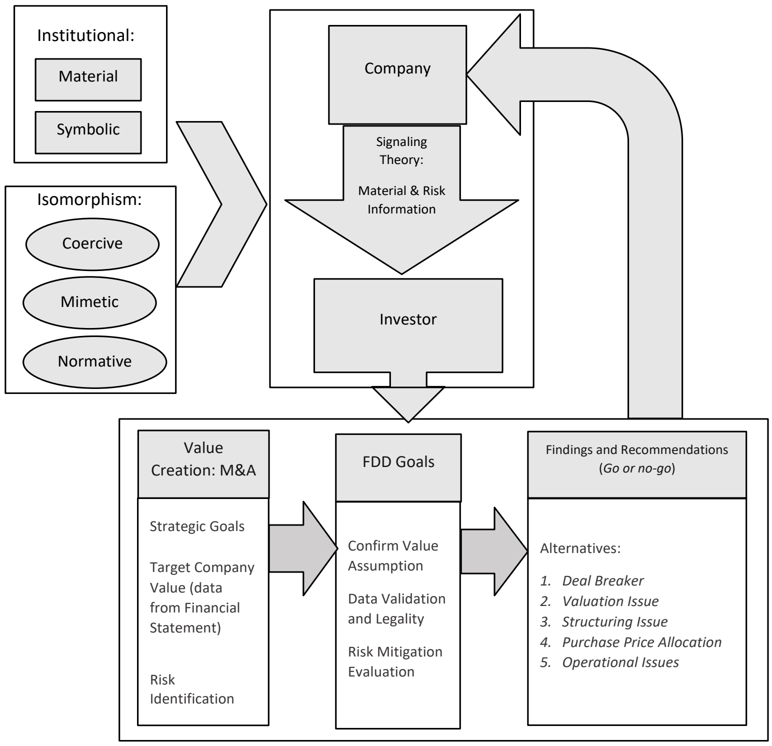

Figure 1

Case Study Research Framework

Source: Processed data

Banking Regulation

The government through Financial Services Authority (Otoritas Jasa Keuangan) conducted continuous assessments of the bank's resilience, including considering the conditions of the COVID-19 pandemic so that corrective measures and economic stimulus were taken by issuing several new regulations.

POJK Number 12/POJK.03/2020 on Commercial Bank Consolidation divided the grouping based on Core Capital (KBMI) with a minimum Core Capital of Rp3,000,000,000,000.00 (three trillion rupiahs) which must be fulfilled by December 31, 2022. Further, POJK Number 12/POJK.03/2021 on Commercial Bank was released to regulate minimum core capital for new bank establishment of Rp. 10 trillion and increase the bank's core capital requirements for Indonesian legal entity banks including digital banks.

POJK Number 11/POJK.03/2020 concerning National Economic Stimulus as a Countercyclical Policy for the Impact of the Spread of Coronavirus Disease 2019, was updated twice in POJK Number 48/POJK.03/2020 and POJK Number 17/POJK.03/2021. This was a form of economic stimulus in the form of credit restructuring or financing that could be carried out on loans or financing provided before or after debtors were affected by the spread of COVID-19 including micro, small and medium business debtors.

Previous Researches

Kooli and Lock Son (2021) in their journal "Impact of Covid-19 on Mergers, Acquisitions & Corporate Restructuring" analyzed trends in business behavior during the pandemic. At the beginning of the lockdown, the M&A business strategy was booming again in the fourth quarter of 2020. The M&A is carried out to provide opportunities for businesses to change and innovate, and to realign their strategic paths to address the current mismatch between the company's value proposition and the evolving needs of the business environment (Kooli & Lock Son, 2021). Therefore, the due diligence needed as a part of M&A is increasing, following the numbers of M&A growth.

Full automation in FDD is not fully implemented yet, but an approach can be taken using big data, special search engines, or machine learning to optimize efficiency, time spent, and required personnel capacity (Weiss, Plesea, Olaru, and Bothe, 2021). In the end, this led to the evolution of the due diligence process for tighter supervision, the adoption of virtual forms, and technology-dependent due diligence activities.

Mergers and Acquisitions (M&A)

While a merger is when a company takes or buys the assets and debts of the target company so that company owns at least 50% of its shares, an acquisition is the takeover of a company by buying shares or assets of the company to take control (Weston & Weaver, 2001). Practically, M&A is one of the most high-risk investments as described by Gole & Hilger (2009) through the three main parts of identified risks during the M&A process:

1. In selecting, screening, and evaluating target candidates, risks are closely related to strategic planning in business development and value creation for shareholders.
2. In the process of negotiating the determination of the contract, risks are closely related to a due diligence process in identifying and confirming the company value to be acquired.
3. In the integration and post-deal assessment, risks are related to operational processes of adjustment to the conditions of the target company and the acquirer to achieve company goals.

Financial Due Diligence (FDD)

FDD aims to verify whether all books and other financial records are up-to-date and carried out accurately to be able to see business prospects, which are not visible from historical records or accounts that run from time to time (Spedding, 2009). According to Gole and Hilger (2009), the objectives of FDD in M&A are to detail value creation opportunities through the identification of key risks from two basic questions: What is the target value, and at what cost? Some identified risks during the FDD process are (1) the narrow scope and the limited period;

(2) choosing the target carelessly to achieve the company's target, even though it is not in line with the goals and objectives of the organization; (3) too many perspectives in the M&A due diligence process could cause fragmented and uncoordinated point of view; (4) findings could create fear that the acquirer would cancel its M&A plan and tend to be considered as “immaterial”; (5) acquirer is focusing on risk mitigation without any thoughts of value creation. Thus, FDD could reduce any biased data if planned and executed carefully.

FDD Perspectives on COVID-19 Condition

Generally, COVID-19 had effects on certain financial aspects regardless of the business industry, mostly related to going concerns such as sales, revenue, cash flow, and expenses. Below is the detailed scope (KPMG, 2020):

- Financial report, as of in the disclosures of going concern, subsequent events, accounting estimates and fair value measurement, and revenue recognition.
- Revenue and margins, this scope is related to assessment due to loss of customers, demand, and closure of business activities.
- Employee cost, concerning employee liabilities and actuarial adjustment.
- Other direct and indirect overheads, related to any expenses that occurred due to COVID-19, for example, medicals and discretionary expenses.
- Cash flow and working capital, as related to the account of disruption in revenue and payments cycle to preserve cash.
- Debts and covenants are mostly related to the relief provided by banks and regulators on renegotiation, rescheduling, or any moratorium repayments.
- Property, plant, equipment (PPE), and intangibles are included in the scope of impairments.
- Other matters, related to onerous contracts, liquidated damages, income taxes, and impairment of right-to-use leases.

While in the audit point of view according to KPMG (2020), auditors should pay special attention to audit evidence and management judgment on estimation or adjustment regarding subsequent events. Specifically, in financial services and banks, additional operational perspectives are credit stress, operational restructuring, and digitization.

METHODE

Research Methodology

This research was a single case study on the evaluation of the existing FDD process to be applied during COVID-19 pandemic conditions, especially in the banking industry, which is being actively updated by regulators in Indonesia. Generally, the research objective was directed to the scope and procedures of FDD during the COVID-19 pandemic to achieve M&A goals set by the company.

Both qualitative and quantitative approaches were used through concurrent mixed methods. The quantitative approach is more related to data collection, while the qualitative approach is related to the subject's understanding and interpretation of the meaning of the data (Donatus, 2016). The “developmental” goal for mixed methods research is when the results of using one type of data collection technique inform or guide the use of another (Sandelowski, 2000). In other words, quantitative techniques are used to measure descriptions, validate and make formal generalizations (Template: QUAL>quan).

There are two kinds of instruments used, semi-structured interviews and documents. To maintain the validity of the data, the within-methods triangulation was carried out by triangulation of sources, by interviewing several different informants and triangulation method, and by conducting in-depth interviews and document review (Moleong, 2014). In interviews, respondents could develop the questions and were conducted to obtain an explanation regarding the form of the procedure and the scope of the respondents' perspective on M&A and FDD during the COVID-19 pandemic.

The data used were primary and secondary data. Primary data was obtained from direct interviews with acquirer management (BNI) and 10 auditors who had experienced FDD for more than 5 years in the banking industry, while other secondary data such as financial reports and the latest news were accessed through printed and electronic media, both regarding acquisition plans and the latest trends in digital banking practices and banking regulations.

Content analysis was used in this research as a mixture of quantitative and qualitative methods with the initial use of qualitative data in the form of text which was then made assumptions by coding and interpreting the results or in the form of descriptions (Liamputtong & Ezzy, 2005). From the results of content analysis, a thematic analysis was carried out, in which the qualitative data were determined by patterns and themes through data that had been collected, usually in the form of interviews, to explore what happened to a phenomenon.

Figure 2 as the methodology framework explained that company selection was determined through media documentation, then the M&A management interview and documentation were done to understand the M&A process as a corporate action actualization. Thus, the critical points of the FDD scope were drawn from management interview results to be applied to auditors' interviews and then compared to Mayora’s annual data financial report from 2019 to March 2022.

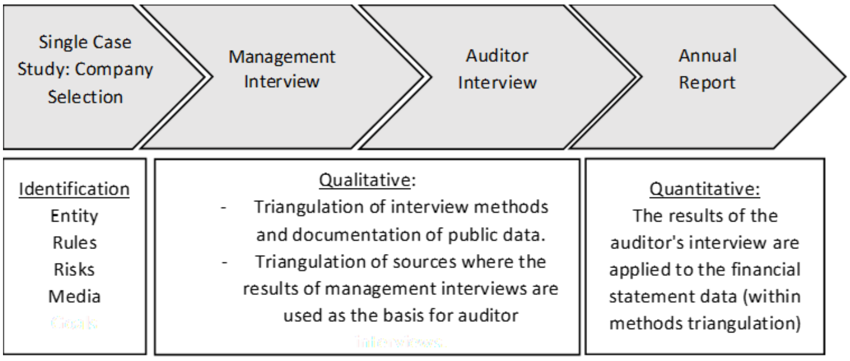

Figure 2
Methodology Framework

Source: Processed data

Analysis Unit

The case study raised the acquisition of PT Bank Mayora (Mayora) by PT Bank Negara Indonesia (Persero) Tbk (BNI) to be BNI's digital bank focusing on micro, small and medium enterprises, and online loans. BNI was one of the four banks that are included in the KBMI 4 group together with PT Bank Mandiri (Persero) Tbk, PT Bank Rakyat Indonesia (Persero) Tbk, and PT Bank Central Asia Tbk. with a total capital of Rp113 trillion in December 2021 (PT Bank BNI Tbk, 2022). Mayora as the acquired bank was owned by the International Finance Corporation (IFC) in 2015 by becoming a 20% shareholder or Rp 290 billion in number. BNI chose Mayora as a target out of 53 candidates in the same level in the BUKU 2 category with Tier 1 Core Capital of more than Rp. 1 trillion to Rp. 5 trillion, as of September 2020, with consideration of self-assessment on Risk-based Bank Rating in the last three years complying to POJK Number 4/POJK.03/2016 as Table 1 follows (PT Bank Mayora, 2022):

Table 1
Mayora's Risk-based Bank Rating Summary Period 2019 - 2021

No	Criteria	Condition 31 Des 2019 – 31 Des 2021
1	Risk Profile	
	a. Credit Risk (17,5%)	Risk Rate "Moderate"
	b. Market Risk (10%)	Risk Rate "Low to Moderate"
	c. Liquidity Risk (15%)	Risk Rate "Low to Moderate"
	d. Operational Risk (15%)	Risk Rate "Low to Moderate"
	e. Legal Risk (7,5%)	Risk Rate "Low to Moderate"
	f. Strategic Risk (15%)	Risk Rate "Low to Moderate"
	g. Compliance Risk (10%)	Risk Rate "Low to Moderate"
	h. Reputation Risk (10%)	Risk Rate "Low to Moderate"
2	Good Corporate Governance (GCG)	Rate 2 ("Good")
3	Profitability	
	a. ROA (Return on Asset)	Stable with an average of 0,3%
	b. ROE (Return on Earnings)	Stable with an average of 1,96%
	c. NIM (Net Interest Margin)	Stable with an average of 3,17%
	d. BOPO (Operational Expense to Operational Revenue)	Stable with an average of 95,43%
4	Capital Adequacy Ratio	Stable with an average of 26,39%

Source: Processed data from Mayora Annual Report

BNI had officially taken over the ownership of Mayora's shares on Wednesday, May 18, 2022, by injecting new capital and taking over the IFC's shares. This refers to the Indonesia Stock Exchange (IDX) disclosure of information through Letter Number KMP/7/2158 dated May 19, 2022 (Primadhyta, 2022). Therefore, the composition of shares in Mayora is owned by BNI as much as 63,92%.

RESULT

Acquirer's Interview

An interview session with the management of the acquirer (BNI) was carried out to understand the flow of corporate action decision-making, selecting auditors responsible for the FDD process, and selecting a bank candidate as the target (Mayora). BNI management was represented by the Strategic Planning Division in explaining several important determination points of FDD carried out by auditors so the value of the company would be increased. The flow that can be concluded was as follow:

- Strategic Planning

Corporate Action was carried out to increase the company value as a strategic step for the company in dealing with tight competition and pressure. Strategic steps were determined through the General Meeting of Shareholders to approve the action plan previously decided through representatives of the board of directors and commissioners as depicted in below Figure 3. From the strategic assessment, mission and goals were set for new digital business development based on environment, market, competition, strengths, and weaknesses. Investment purposes were drawn to develop market, customers, and resource control in form of acquisition investment.

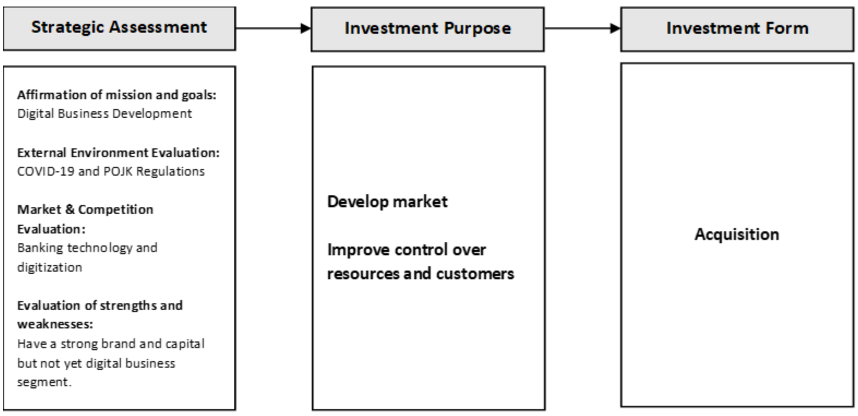

Figure 3

Illustration of Management Strategic Planning Process Flow

Source: Processed data from interview result

- Risk Identification and Mitigation

Some risks identified during the process of M&A phases are listed in Table 2 below:

Table 2

Risks Identified During M&A

M&A Phase	Risks	Risk Mitigation
Targeting Screening Evaluation Bidding Due Diligence Contracting	Wrong decision on chosen target due to lack of material matters.	Confirming data to OJK.
	Paying too much in the acquisition process.	FDD process conducted by independent auditors.
	Lack of integration planning, knowledge, and resources in the formation of a new digital bank.	Prepare plans and targets for implementing technology infrastructure in core banking.
	Missed material matters during financial due diligence.	Prepare scope, list, and sufficient period for the financial due diligence process. Monitoring the FDD process by requesting regular reports.
Integration Post-assessment deal	Business development plans are not in line with the vision, mission, and condition of the target.	Planning the phase and targets for the transition process.
	Slow M&A execution.	Determine the timeline for the M&A process.
	Culture clash	Set the tone from the top.
	Employee turnover	Agreement with target shareholders regarding employee liability.
	Failed to create value for shareholders.	Carry out careful strategic planning.

Source: Processed data from interview result

- Target Selection Process from Existing Candidates

Candidates were determined approximately 1 to 2 years before the M&A was executed. Some of the main criteria for selecting candidates were capital strength, credit portfolio health, financial ratios, the character of the target bank, organizational structure, and shareholder composition. These criteria lead to acquisition cost determination.

- Considerations for Auditors of FDD Engagement

Within one month tender of the FDD project, the identity of the target bank had not been informed and three auditor candidates were chosen from the big four public accounting firms. In this phase, management and auditors evaluate each other before the engagement to assess and understand the business process of the FDD target.

- Scope and Process of FDD

As decided but not limited by BNI, the scope of FDD usually relates to Accounting Principal Standards, Operational on Compliance, System, and Performance, and Taxation on Compliance and Exposure. During the COVID-19 pandemic, all procedures carried out by auditors might be done online or by strict health protocols.

For further FDD practice analysis in auditors' interviews, the points depicted in Table 3 showed the aspects scopes that are usually pinpointed during the process as informed previously by the interview of the acquirer's management.

Table 3

Scope For Auditor's FDD Process

GENERAL INFORMATION	FINANCIAL ASPECTS	OPERATIONAL ASPECTS	TAXATION ASPECTS
Client engagement considerations	Productive Asset Quality	Core Debtors	Tax Clearance
Introduction to business cycle	Liability	Collectability	Tax Exposure
Overcoming a lack of knowledge	Other Assets and Other Liabilites	Permits	Commitment & Contingency
FDD as guarantor of M&A success	Core Capital	Legality and Bank License	
FDD processes during COVID-19	Unrecorded Liabilities to Company's Commitment	Bank Products	
	Financial Performance Measurement	Operational Performance	
		IT Network & Structure	
		Organizational Structure and Minutes of the General Meeting of Shareholders	
		OJK Examination Results	
		Bank Business Plan	
		Internal Control	
		External Audit Opinion	

Source: Processed data from interview result

Auditor's Interview

In the banking industry, the FDD service included in Agreed-Upon Procedures (AUP) with short engagement durations carried out by OJK licensed auditors and aims to help clients understand the market, assess the impact of regulatory changes, screen candidates, and uncover hidden risks and opportunities. Specifically, the FDD process communicates advice from its report.

General Information

Auditors usually conduct client assessments before engagement and perform an introduction to the business cycle before carrying out the FDD process. Experienced auditors assigned to FDD might finish the process in 2 weeks to three months, depending on the size of the entity. In special cases, auditors could assign experts for support, such as due diligence in legality, business processes, and human resources. Several criteria to be considered that an FDD is successfully implemented are (a) generating business valuation based on actual conditions to avoid inappropriate presentation values; (b) generating a cheap buyer perception and expensive seller perception; (c) being able to increase the value of the company in line with the business strategy that has been set before. An additional process to pinpoint the condition affected by COVID-19 includes how to get audit evidence by adding samples and online processes, observing unusual movement including valuation of assets, observing subsequent events that need special adjustment, any consideration regarding the going concern of a company, and the compliance to government regulation.

Financial Aspects

Productive Asset Quality

FDD was conducted by confirming the data validity of placement at other banks and Bank Indonesia. Minimum Statutory Reserve (Giro Wajib Minimum (GWM)) was also considered stable and always met the minimum requirement according to Bank Indonesia Regulation Number 20/3/PBI/2018 with the renewal Number 23/16/PBI/2021. Mayora showed consistency from 2019 to March 2022 as stated in Table 4.

In line with the issuance of POJK Number 17/POJK.03/2021 concerning the Second Amendment to POJK Number 11/POJK.03/2020 on National Economic Stimulus as a Countercyclical Policy for the Impact of the Spread of Coronavirus Disease 2019, as of December 31, 2021, Mayora had restructured 373 debtors with a total outstanding of IDR 879.32 billion. Restructuration was done by deferring interest, loan principal, and penalties according to the conditions of each debtor and seeking voluntary submission of collateral to settle non-performing loans. Mayora conducts special monitoring of restructured loans to stabilize their performance as shown in Table 4 of the last three years of Non- Performing Loan (NPL). In 2021, Mayora chose to be more conservative in channeling new loans amid the potential for increased non-performing loans after COVID-19. Thus, interest income decreased but not much than 10% as shown in Table 4 of Net Interest Margin (NIM).

Table 4

Bank Mayora's Asset Quality Ratio 2019 – March 2022

Ratio	2019		2020		2021		Mar 2022	
	Achievement	Minimum	Achievement	Minimum	Achievement	Minimum	Achievement	Minimum
GWM - Rupiah	6,91%	6,00%	3,64%	3,50%	3,68%	3,50%	10,32%	5,00%
GWM - Forex	9,31%	8,00%	5,94%	4,00%	4,29%	4,00%	4,55%	4,00%

Ratio	2019	2020	2021	Mar 2022	CAGR	Average
NPL - Gross	3,70%	3,19%	3,42%	3,63%	0%	3,49%
NPL - Nett	2,85%	2,11%	2%	2%	-7%	2,27%
Net Interest Margin (NIM)	4,79%	3,85%	3,33%	3,08%	-10%	3,76%

Source: Processed data from Mayora Annual Report

Liability

FDD of deposits from customers and other banks focused on the principle of existence, which is to ensure that all customer data was recorded correctly. The process involved confirmation and document checks based on Know Your Customer (KYC) principle. Mayoras's liquidity ratio was depicted in Table 5 of the Loan to Deposit Ratio (LDR) in the last three months and showed that the liquidity ratio had improved by around 13% since 2019.

Table 5

Bank Mayora's LDR Ratio 2019 – March 2022

Ratio	2019	2020	2021	Mar 2022	CAGR
LDR	77,93%	66,39%	47,25%	44,76%	-13%

Source: Processed data from Mayora Annual Report

Other Assets and Other Liabilities

Foreclosed Collateral (Agunan Yang Diambil Alih (AYDA)) checkpoints were the status of the ownership documentation, legality of the Deed of Granting Mortgage (Akta Pemberian Hak Tanggungan) submitted to the bank, location of the collateral, recognition following PSAK 16, and impairment and fair value measurement in other assets items. Meanwhile, by referring to POJK Number 33/POJK.03/2018 concerning Earning Asset Quality and Establishment of Allowance for Earning Assets for Rural Banks, the value of the collateral was calculated as a deduction in the formation of Allowance for Earning Assets Write-Off. Allowance on loans with bad quality for collateral should be set at a maximum of 50% of the collateral value calculated after a period of 2 years to 4 years since the determination of the credit quality. The value of Mayora's AYDA had decreased from year to year in line with Gross NPL which scored below 4%, indicating better quality of credit assets.

Core Capital

Auditors might recalculate the Minimum Capital Adequacy Requirement ratio involving involves Risk-Weighted Assets (RWA) for credit risk buffer compliance according to POJK Number 11/POJK.03/2016, where Main Core Capital Ratio of at least 4.5% of RWA; Core Capital Ratio of at least 6% of RWA; and Maximum Complementary Capital Ratio equals to Core Capital Ratio. Mayora's ratio complies with the POJK as shown in Table 6 below:

Table 6

Mayora's Minimum Capital Adequacy Requirement Ratio

Description	2021		2020		2019	
	In Million Rp	Ratio	In Million Rp	Ratio	In Million Rp.	Ratio
RWA	3.829.379		4.764.196		5.172.060	

Main Core Capital	1.139.308	29,75%	1.181.942	24,81%	1.085.626	20,99%
Additional Core Capital	-		-		-	
Complementary Capital	3.798	0,10%	19.053	0,40%	24.616	0,48%

Source: Processed data from Mayora Annual Report

Unrecorded Liabilities to Company's Commitment

This scope is related to the company's commitment to employees, whether or not those liabilities were recorded, in respect of amounts payable to or in respect of employees. Auditors should consider any additional provisions such as future commitments, specific arrangements, contractual obligations, and retirement pensions. Usually, M&A would choose the assumption of termination of employment for all employees because the going concern aspect of the company being acquired is no longer valid. If there were obligations that must be resolved immediately, it should be the responsibility of the former shareholders.

Financial Performance Measurement

FDD was carried out by recalculating financial ratios in the Annual Report, which showed Mayora's good condition, as listed in Table 7, from the last three years:

Table 7

Financial Performance Ratio 2019 – Mar 2022

Ratio	2019	2020	2021	Mar 2022	CAGR
Capital Adequacy Ratio (CAR)	21,47%	25,21%	29,85%	34,55%	13%
Allowance for Impairment Losses of Financial Assets against Earning Assets	0,61%	1,07%	1,22%	1,21%	19%
Non-Performing Loan (NPL) Gross	3,70%	3,19%	3,42%	3,63%	0%
Non-Performing Loan (NPL) Nett	2,85%	2,11%	2%	2%	-7%
Return on Assets (ROA)	0,25%	0,21%	0,47%	0,74%	31%
Return on Equity (ROE)	0,96%	1,09%	2,67%	5,06%	52%
Net Interest Margin (NIM)	4,79%	3,85%	3,33%	3,08%	-10%
Operating Costs to Operating Income	97,31%	97,21%	92,27%	87,66%	-3%
Loan-to-Deposit Ratio (LDR)	77,93%	66,39%	47,25%	44,76%	-13%
Giro Wajib Minimum (GWM)-Rupiah	6,91%	3,64%	3,68%	10,32%	11%
Giro Wajib Minimum (GWM)-Valas	9,31%	5,94%	4,29%	4,55%	-16%
Nett Foreign Exchange Position	0,74%	0,52%	1,91%	1,99%	28%

Source: Processed data from Mayora Annual Report

Operational Aspects

This section concluded from compliance with Financial Services Authority regulation (POJK) as explained in below Table 8:

Table 8

Mayora's Compliance on POJK During 2019-2021

No	Criteria	Regulation	Mayora's Condition
1	Core debtors	POJK No. 32 /POJK.03/2018 on Maximum Lending Limit: Nominal provision of funds to 1 (one) borrower or 1 group of borrowers other than related parties is 10% or more of the core capital (tier 1) of the Bank.	2019: 10% (comply) 2020: 8% (not comply) 2021: 10% (comply)
2	Collectability	Bank Indonesia Regulation No 14/15/PBI/2012 Allowance for Impairment Losses: General reserves for Earning Assets are set at least 1% of Earning Assets that have current quality.	2019: 0,61% (not comply) 2020: 1,07% (comply) 2021: 1,22% (comply) Mar 2022: 1,21% (comply)
3	Legality and Bank License	POJK No. 12/POJK.03/2021on General Bank: reporting and requirements from OJK	Comply with all permits of legal regulations in the Republic of Indonesia and provides compliance training to employees.
4	Bank Products	POJK No. 13/POJK.03/2021 Operation of Commercial Bank Products: plan on new products within one year.	Considering product brand and characteristic adjustment post-M&A that should survive in the future.
5	Operational Performance	SEOJK No. 12/SEOJK.03/2021 on Commercial Bank Business Plan	In 2019, Net Income Before Tax was still significantly below the target (46,02%), due to adjustments to the new regulation, adding to the allocation for reserves and writing off of unproductive assets. In 2021, CAR is still far below the target (66,59%) due to changes in the capital increase strategy where the initial top-up plan from existing shareholders will be replaced by BNI's plan to channel new investment funds. The business plan for 2022 is not yet published.
6	IT Network & Structure	SEOJK No. 21/SEOJK.03/2017 on Application of Risk Management in the Use of Information Technology by Commercial Banks	Provides operational servers for backups, server scope for owned branches, and Disaster Recovery Plans. IT Risk Management review report is submitted to OJK every 3 years,

No	Criteria	Regulation	Mayora's Condition
			usually audited by an independent company (IT assessor).
7	Organizational Structure and Minutes of the General Meeting of Shareholders	POJK No. 55/POJK.03/2016 on Implementation of Good Corporate Governance for Commercial Banks	Mayora in the last 3 years of Annual Reports, stated full compliance with GCG.
8	OJK Examination Results	POJK No. 55/POJK.03/2016 on Implementation of Good Corporate Governance for Commercial Banks	Due to COVID-19 and OJK recommendations, the Bank revised the 2021 Bank Business Plan. Prepared a Sustainable Finance Action Plan which was first carried out at the end of 2019 for the implementation of the 2020-2024 period and has been submitted to OJK.
9	Bank Business Plan	POJK No. 5/POJK.03/2016 on Bank Business Plan	There are no findings of non-compliance.
10	Internal Control	POJK No. 1 /POJK.03/2019 on Implementation of the Internal Audit Function in Commercial Banks	During 2021, the Internal Audit Division utilizes the MyAudit Information System to record audit results so that auditees and Directors can easily access and respond to them. There were findings in procedures in 2021 due to a lack of several procedures' implementation understanding. All findings have been directly corrected.
11	External Audit Opinion	POJK No. 13/POJK.03/2017 Use of Public Accountants and Public Accounting Firms in Financial Services Activities	Obtained Unqualified Opinion from 2019 to 2021. Some points that might be required are the opening balance of the concerned accounts, management letters submitted by external auditors to OJK, and adjusting journal work papers at the end of the audit year, for example, accruals, reserves, and taxation accounts.

Source: Processed data from Mayora Annual Report

Taxation Aspects

The first scope was clearance and compliance with tax regulations, the principle of self-assessment, and the principle of deduction and collection within the company. Mayora's annual report stated that Withholding Taxes (WHT) article 4(2), 21, 23, 25, 26, and 29 were paid and reported regularly, accurately, and on time to the registered tax office.

The second scope was exposure due to commitment and contingency, about any tax penalties or interest due to mistakes in reporting or calculation from the past 5 years. In the annual report, it was stated that during the fiscal years 2014, 2015, and 2016 Mayora received an Underpayment Tax Assessment Letter for Corporate Income Tax, WHT article 21 and WHT article 23, which had been partially paid while the remaining, until December 31, 2021, was still in the process of the appeal court. There was no mention of any errors related to fiscal corrections and the use of tax incentives. This awaiting court decision related to commitment and contingency might affect Mayora's value by around Rp. 5 billion.

Emphasizing on Pandemic Related Procedure

Overall, from the general procedures conducted by auditors, there were some points to be emphasized and applied as below points:

1. Going concern and subsequent events, concerning cash flow, profit and loss, and core capital. From 2020 to 2021, Mayora stated no significant effect on the existing business condition.
2. Cash flow health, the result showed Mayora had a 7.69% decrease in net cash from 2019 to 2020, but they had a 46% increase from 2020 to 2021 which shows a good performance. Loan to Deposit Ration was stable for 3 years with an average of 59.08%.
3. Revenue recognition, concerning interest income, there was a 3.04% increase in 2020 and a 9.49% decline in 2021. However, the expense-to-revenue ratio was stable for 3 years with an average of 93,61%.
4. Credit given, concerning loss impairment and Non-Performing Loan (NPL). Mayora's balance of Allowance for Impairment Losses (CKPN) of financial assets recorded on the Balance Sheet in 2021 was Rp98.36 billion, an increase of 23.12% from the previous year which was Rp79.89 billion. The NPL ratio increased to 3.41% in 2021 from 3.09% in 2020 and remained stable for 3 years with an average of 3.49%. As of December 31, 2021, Mayora had restructured 373 debtors with a total outstanding of Rp. 879.32 billion out of a total of Rp. 3.5 trillion.
5. Other Assets, concerning AYDA, there was an increase in AYDA of 2.99% from 2020 to 2021. Acceleration of AYDA sales was carried out by collaborating with property agents and other efforts such as offerings to employees within the MAYORA Group and Bank partners.
6. Employee Liabilities, concerning Mayora's employee benefits, there was an increase in post-employment benefits liabilities by 13% from 2020 to 2021, where there is a decrease in the number of employees by 5%.

7. Operating expenses, concerning COVID-19-related expenses, there was a 10% reduction in discretionary expenses, in line with an increase in the Expense to Revenue ratio of 4.94% from 2020 to 2021.
8. Corporate Action, concerning the revised 2022 Banking Business Plan on COVID-19 condition and digital transformation plan in the banking industry. The 2022 business plan mainly discussed the takeover by PT Bank Negara Indonesia (Persero) Tbk and the transfer of shares from International Finance Corporation.
9. Tax Payable, concerning fiscal correction in 2021 which caused a 50.5% increase in tax payable related to employee liability. There is a tax exposure possibility due to an ongoing appeal process from the fiscal years 2014, 2015, and 2016. Mayora did not experience significant differences in the use of COVID-19 tax incentives from the government.
10. Core Capital, concerning Mayora's Capital Level as reflected in the CAR at the end of 2021 increased to 29.85% compared to 25.21% at the end of 2020. The achievement of this CAR was consistently above the minimum required ratio of 9% - 10%.
11. Asset value estimation did not apply to Mayora because there was no change in method or revaluation of asset value.

The result of the interview showed that the FDD procedure during the COVID-19 pandemic was an integral part of the general procedure. This additional procedure requires an in-depth analysis that affected each other in each aspect as shown in Figure 4.

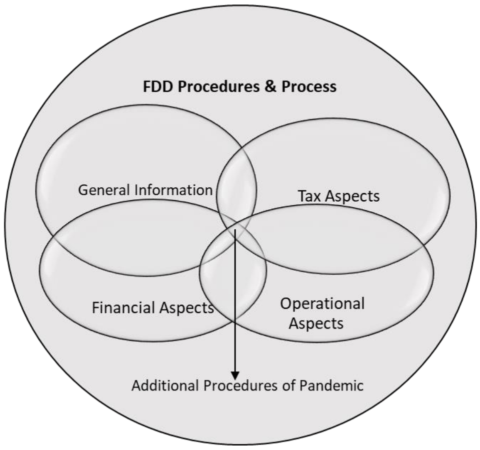

Figure 4

Visualization of FDD Process & Procedures during COVID-19

Source: Processed data

Findings and Recommendations

The nature of the findings (Sensi, 2010) could be divided into 5 categories as follows: (1) Deal Breaker, doubts arise over the feasibility of continuing the proposed transaction so that it tends to thwart the transaction; (2) Valuation issues, the emergence of justification for significant adjustments in pricing and transaction structure; (3) Structuring issues, legal or technical problems in terms of restructuring the entity as a result of transactions and transformations that will be carried out; (4) Purchase Price Allocation, which confirms confidence in accounting records that have an impact on transaction restructuring; (5) Operational Issues, if the operation was considered seriously inadequate, it might drive back to deal breaker. The case showed that FDD was carried out with a good conclusion, since Mayora was officially acquired on May 2022. BNI's plan in the next 2023 is a new brand name and products that aim to result in a transition of product types and services to be fully automated through applications accessed via cellular or network.

From the analysis, both Neo Institutional Theory and Signaling Theory resulted in behaviors as visualized and explained in Figure 5 below.

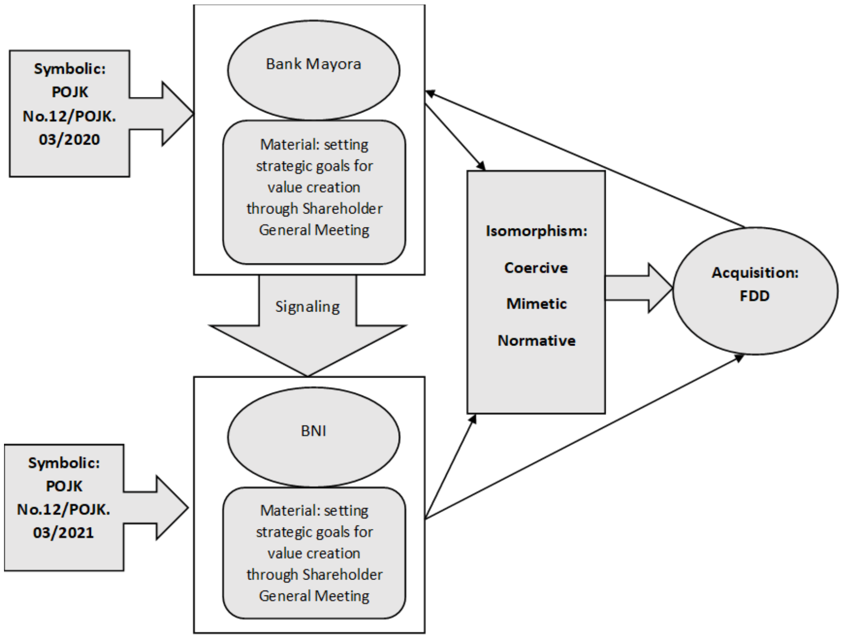

Figure 5

Case Study Visualization

Source: Processed data

By symbolic, Mayora should meet core capital in POJK No.12/POJK.03/2020 concerning Commercial Bank Consolidation, while BNI had a strategic goal of increasing market share in digital banks, conforming POJK No.12/POJK.03/2021 Regarding Commercial Banks. Mayora then signaled complete information to investors through annual reports that could be accessed by the public, as well as through several electronic media that were easily obtained through search engines. In material scope, Mayora and BNI adjusted internally through strategic planning and decisions determined through the shareholder meetings and implementation from the top to the lower levels. Isomorphism in the behavior of larger organizations showed domination to the smaller ones, hence their employees tend to have more positive expectations of M&A, while members of smaller organizations expect to be dominated and will tend to have behaviors that lead to anxiety over uncertainty (Seo & Hill, 2005). At this level, the compromise process occurs in the acquisition process, including the FDD process that must be carried out by BNI to confirm the value of Mayora's acquisition.

CONCLUSIONS

From the case study evaluation on the implementation of FDD to increase company value during the COVID-19 pandemic, several things could be concluded as follows (1) In creating corporate value, corporate behavior is influenced by the two branches of Neo Institutional Theory, namely Institutional Logic and Isomorphism through Signaling Theory to encourage company organizations to become more homogeneous in their strategic planning, complying with POJK which encourages banking companies to adapt to each other through M&A investment channel; (2) In terms of the audit process, four things must be considered in the FDD process during the COVID-19 pandemic, namely the scope limitation in audit evidence, going concern as the basis for assessing and selecting audit evidence, subsequent events related to adjustments that affect financial statements and accounts affected, especially those that are subject to management's judgment; (3) In terms of the overall FDD process, general procedures that must be emphasized include aspects of general information, financial aspects, operational aspects, and taxation aspects. (4) Some account points that are directly affected by the effects of the pandemic from all general procedures are accounts that require reassessment and estimation, cash flows, core capital, productive assets, operating costs, employee benefits obligations, commitments and contingencies, as well as tax payable and obligations to third parties. (5) Findings and recommendations from the results of the FDD by the auditors can be a determining factor for the go or no-go and value adjustment; (6) From the results of the overall evaluation of this research, it can be concluded that an effective FDD process during COVID-19 is the same as the general process, but with several aspects that must be considered carefully and might support development in terms of digital and real-time technology.

In the medium term, the auditor should be aware of the regulations that may be enacted during the carried out FDD procedure and might change the scope and determination of company value. Auditors should anticipate regulatory rapid changes by considering partnerships with tech players to support a more accurate and efficient FDD process.

Regarding regulations, the M&A management might need to monitor economic developments and government regulations in setting business development plans. This could encourage further research on the application of regulatory changes in businesses, especially the shift towards technology-based M&A and FDD processes post-COVID-19.

Limitations in this paper were the scope of due diligence that focused on finances for the banking industry in Indonesia during COVID-19, confidential data of target and acquirer management could not be disclosed, certified auditors experienced in banking FDD are quite limited, auditors familiar with any technology-based FDD are limited, and target data could be acquired only based on Annual Reports released in the website.

The results of the FDD evaluation process in this case study could provide some future recommendations. Recommendations were grouped into action plans in three timeframes of short-term, medium-term, and long-term for auditors, management of the M&A company, and for further research. In the short term, auditors might consider implementing FDD in a shorter time with the support of technology to focus the process in a direction that affects the company value, for example, liquidity on cash flow, capital structure, cost of debt, accounting estimates and consider carefully whether going concern, the emphasis of matter, as well as subsequent events related to pandemic conditions, are indeed based on the actual state of the entity. From an M&A management point of view, it would be better to choose an experienced and officially certified FDD auditor from the authority to carry out the process independently and be familiar with technology-based FDD. This could encourage further research to evaluate the effect of information technology transformation on the M&A process in corporate management and FDD.

In the long term, auditors might prepare a fully digital transformation plan for the FDD process such as developing a toolkit that defines security and accuracy controls over data validity for working from anywhere. Public Accounting Firms are also encouraged to plan training for auditors to prevent culture shock due to digital transformation. For the M&A management, considering a business segment that prioritizes fully digital technology might be a good opportunity to survive during the times. Acquirers could expand business by minimum costs, for example, instead of establishing a new company, it is preferred to acquire an existing small to medium-scale company but with a healthy financial condition for acquisition cost savings. This might encourage further research related to the effect of information technology application that has been fully implemented in the company concerning the achievement of the strategic goals by executing a technology-based FDD process in the M&A.

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