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Consolidation in Banking Industry – A Cross Country Experience

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Authors' contributions

This work was carried out collaboration between both Authors. Authors SS and BKT performed the whole research work together. There was no water –tight division of work when it was being done. Authors SS and BKT wrote the first draft of the paper. Authors SS and BKT read and approved the final manuscript. Both authors read and approved the final manuscript.

Original Research Article

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ABSTRACT

Aims: This Briefing Paper aims to know mergers and acquisitions activity in banking sector all over the globe.

Study Design: Cross-sectional study.

Place and Duration of Study: Selecting Countries of the World with different time period.

Methodology: The analysis has been made on the basis of regression equation and percentage with digram and figure.

Results: Number of international bank mergers has steadily increased overtime, but the percentage of bank mergers that are cross-border has been small. The percentage climbed during the late 1980s to reach a plateau around 15 percent in the early 1990s. Between the mid-1990s and 2000, the share grew steadily to reach almost 30 percent in 2000. After a dip between 2001 and 2003, the percentage of cross-border mergers grew to over 35 percent in 2006. Table looks further into the regional structure of cross-border M&A in banking. It shows that Europe and the Americas experienced a significant growth in the share of cross-border bank mergers in the years 1996 to 2006 compared with to the years 1985 to 1995. Asia, Africa/Middle East and Australasia, saw no significant change in the percentage of bank mergers represented by cross border transactions. While in some countries M and A activity accelerated in recent years, in some other countries, it slowed

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down.

Conclusion: The goal of a bank merger is to increase the bank's value in one way or another. Consolidation in banking industry is the need of the hour. A lot of companies have merged with other companies to make a mega company. Consolidation will positively amplify the business prospects of the industry in the domestic as well as international market place. "Collectiveness is strength" will hold true on consolidation in Banking Sector. The pressures on capital structure to meet prudential capital adequacy norms necessitate the need for Consolidation in the banking industry. Consolidation will provide banks the 'size advantage'. There is a need for consolidation in the banking industry to compete for the pie in the domestic as well as global market. No doubt everyone knows the criticality of the issue and urgent requirement of mergers in banking sector, But then river also have to face various rocks, pebbles and other interruptions in its natural flow and so does Banking sector has to face various challenges for mergers.

Keywords: Consolidation; mergers; acquisitions; absorption; takeover.

1. BACKDROP

Consequent to economic liberalization, financial deregulation, globalization and technological revolution, unprecedented changes have taken place in markets worldwide. The instability of the business environment has altered the ways and means by which transactions are carried out. Perpetual existence of an enterprise has become very difficult, given the complex and fluctuating nature of the surrounding environment. There is thus, a need for almost continuous reshuffling of business organizations. Profitable growth can be achieved internally by developing new product lines, expanding existing capacity, acquiring new assets, moving on to technologically advanced equipment and appreciating the need for investments in research and development. Alternatively, the growth process can be facilitated through various forms of corporate combinations such as absorptions, acquisitions, amalgamations, de-mergers, divestures, joint ventures, leveraged buyouts, mergers, sell-offs, spin-offs, strategic alliances, takeovers, and so on [1,2,3].

Banking consolidation is big news these days, with a new mega merger announced almost every month. Consolidation in the banking sector should largely be synergy-driven to acquire a quantum jump in the performance of the combined entity ($2+2 \geq 5$). It can be achieved by combining complementary strengths, giving a better geographical spread, serving a larger number of customers in a better way with more diversified products and skills, realizing the opportunities for cross-selling, containing the cost of the merged entity, reduced competition, better utilization of available resources and deriving economies of scale.

2. REVIEW OF LITERATURE

American Bar Association, "Bank Mergers and Acquisitions: A Handbook Book" (2007), this paper presents a general model of bank merger review that are unique to banking institutions such as the statutory framework, banking agency review, and Justice Department standards and draws on learning from recent transactions in which one or more of the reviewing agencies raised concerns. Its focus is practical; complementing the Antitrust Section's other publications on merger review including Mergers and Acquisitions, and the Pre-merger Notification Practice Manual etc. Bernulf Bruckner, Jonathan O'Shea, "Mergers in European Banking: A Managerial Perspective" (2006), presents an introductory overview

of the current situation in the European banking industry, and a classification of M&A activity is also offered. Although this classification covers activity across a broad spectrum of sectors and industries, the case studies, which form the central part of this study, focus on the banking sector. Two cases from the European banking sector are examined in detail. First, a domestic UK merger is analyzed, namely the fusion of Halifax and Bank of Scotland. Secondly, in contrast to the first case, a cross-border deal, namely the marriage of Bank of Austria with Germany's HypoVereins bank, is also examined. Elena Carletti, Philipp Hartmann and Giancarlo Spagnolo, "Implications of the Bank Merger Wave for Competition and Stability" (2002), discusses implications of consolidation in the banking sector. The authors state that market power/domination and competition issues need to be carefully evaluated before going in for bank mergers because such mergers could have a special relation with the financial stability of the country. Overall, the article stresses that competition considerations need to receive enough consideration, before a bank merger takes place. Eric J Gouvin, "Bank Mergers in North America: Comparing the Approaches in the United States and Canada" (2006), The US and Canada have adopted different approaches to the approval of large bank mergers. The book provides the comparison of the approaches. The US approach places most of the discretion in the hands of administrative agencies like the Federal Reserve Board, Comptroller of Currency, the Federal Deposit Insurance Corporation, etc., while the Canadian process will not permit any bank merger to go through regardless of the guidance eventually provided by the Department of Finance. The process is designed in a way that political sentiment will sway decisions on these matters and, given the current political climate; there is little chance that a member of the cabinet is likely to support bank mergers in any form. Ebodume Epizitone Anabi, "Do Mergers and Acquisitions Improve Efficiency of the Banks? - DEA approach in the case of European banks" (2007), this study analyses technical efficiencies of 134 individual bidder banks across 11 European countries before and post merger during the period 1994-2001. The non-parametric Data Envelopment Analysis (DEA) approach is applied to detect potential efficiency gains resulting from bank mergers. The study employs the intermediation model of the production process of the banking firm. It finds that consolidation in the banking sector is beneficial and mergers appear to have improved efficiency. The analysis also indicates that savings banks have benefited the most from M and As and that the German banks have experienced smaller efficiency increases compared to the banks of the other countries of study. Fadzlan Sufian, "Mergers and acquisitions in the Malaysian banking industry: technical and scale efficiency effects" (2009), this paper investigates the effects of mergers and acquisitions on Malaysian banks' technical and scale efficiency employing an event study with a three-year window analysis together with the non-parametric frontier approach, Data Envelopment Analysis (DEA). The results suggest that the merger has resulted in a higher mean technical efficiency of the Malaysian banking sector post-merger. In five out of the seven merger cases, the empirical findings suggest that the acquirers were relatively more technically efficient. The empirical findings also suggest that the acquiring banks' mean technical efficiency improved (deteriorates) from the merger with a more (less) efficient bank in five out of the seven merger cases analyzed. Gary A Dymksi, "The Global Bank Merger Wave: Implications for Developing Countries" (2004), discusses the types, causes and implications as well as numerous limitations of global bank mergers. It analyzes whether developing countries really benefit from cross-border mergers, and if so, to what extent. The article argues that large banks have traditionally and increasingly engaged in harvesting, not seeding and cultivating activities. It also brings out the differences between defensive and offensive mergers that have come in. Mishra Shashidhar, "Bank Mergers: Is it the right solution?" (2006), mentions phase of transition in the Indian banking sector which has added technological orientation in their services like, enhancing retail loan portfolio, reducing NPAs adopting other latest technologies to improve their performances etc. Mergers of two public

sector banks with two weak banks, The Punjab National Bank and Andhra Bank with Nedungadi and Centurion Bank respectively are examples of reviving weak banks. Strong public sector banks have the social as well as, business responsibilities to take over weak banks as a long-term business proposition and also to protect the interest of innocent depositors and good borrowers of the weak banks. The author argues that value enhancing mergers are welcome, but one has to take care of the risks inherent in the mergers of unequals, as, in the long-term, mergers may not be a permanent solution for the sick banks, as they need to make concerted efforts to enhance their productivity to sustain themselves in future. Mishra Santap Sanhari, "Consolidation in the Banking Industry: Global Perspective" (2008), this book deals with the most critical element of Bank Consolidation Issues and Evidence, Privatization, Consolidation and the Increased Role of Foreign Banks, Bank Mergers and Crime: The Real and Social Impact of Competition in the Credit Market, Banking Consolidation and Small Business Lending, A Review of Recent Research Impact of Bank Mergers on Asian Stock Market: A Review, Value Creation by Domestic and Cross-border M and A Transactions in the European Banking Market, Rebuilding the Indonesian Banking Sector - Economic Analysis of Bank Consolidation and Efficiency, etc [4,5,6,7,8,9,10,11,12].

Thus, the above review of the studies as a whole gives a very mixed picture of M and A in banking industry. Although there is a plethora of research literature on bank merger, most of the researchers studied only country wise wave of bank mergers. The present work is a humble attempt to make a comprehensive study on M and A in banking sector on worldwide frame.

3. OBJECTIVE OF THE STUDY

The main objective of this study is to know mergers and acquisitions activity in banking sector all over the World.

4. RESULTS AND DISCUSSION

The United States banking sector is a classic example of a steady transition of a fragmented market to one the last few decades. At year-end 1984, there were 15,084 banking and thrift organizations. By year-end 2006, this figure declined by 51% to 7,479. Deregulation combined with the bank's drive to expand market share has led to significant consolidation since the early 1980s. Some of the acts [1,5,13] that have driven the US banking consolidation are as follows.

4.1 Reigle-neal Interstate Banking and Branching Efficiency Act of 1994

This act permitted bank holding companies to acquire banks in any state and since 1997, allowed interstate bank mergers.

4.2 Gramm-leach-bliley Act of 1999

The act authorized financial holding companies (FHCs) to engage in a full range of financial services such as commercial banking, insurance, securities and merchant banking.

Consolidation in the US banking sector was also accompanied by a phenomenal growth in the sector. Commercial bank assets, as a percentage to GDP, increased to 75% in 2006

from 55% in 1994. However, compared with the banking systems of most developed countries, the US banking sector is still highly fragmented. There are numerous smaller players that try to compete with industry leaders in terms of pricing and services. A peculiar feature of the US banking industry is the way it is divided into different asset sizes, ranging from less than USD 100 million to greater than USD 100,000 million. Distributed by size, nearly all the decline over the years occurred in the community bank sector (organizations with less than USD 1 billion in assets), particularly among the smallest size group (less than USD 100 million in assets). Yet the community banking sector still accounts for 94% of the banking organizations.

4.3 Europe

Europe saw fairly hectic activity too, and would have probably seen even greater M&A activities had not heterogeneous banking regulation held up cross border mergers. Among recent deals are the takeover of Abbey National (UK) by Banco Santander (Spain) in 2004, Uni Creditos (Italy) acquisition of Hypo Vereins bank (Germany), ING's acquisition of Barings, Equitable of IOWA, and earlier, the mergers between Credit Agricole and Banque Indosuez in France, Dresdner bank with Advance Bank and Kleinwort Benson Iberfomento of Germany, etc. During the period 2001-05, the total number of EU credit institutions decreased by 12% while assets increased by 33% indicating an ongoing trend toward creating larger credit institutions. There were around larger credit institutions. There was [9,10] around 30% cross-border M and As out of the total consolidation activity in the EU banking sector in the period 2001-06.

4.4 Latin America

In Argentina, bank mergers were driven largely by financial sector liberalization and tightening of prudential norms in the early 1990s. Most mergers took place between banks with complementary strengths in different regions, as against mergers involving overlapping operations because the latter posed problems such as employee downsizing, losing customers to counterparts, etc., during attempts made to rationalize the overlapping activities. As a result, the number of banks declined from 180 in 1994 to 102 in 2000. This, in turn led to the rise in the share of the top ten banks in the total deposits from 75% to 81% during the same period. In Brazil, the family-owned banks are probable takeover targets due to their inefficient management though the family ownership structure makes it a tough task. The entry of foreign players and increasing privatization is anticipated to lead to more such acquisitions in future. In Chile, the concentration level of banks has been moderate as compared with other Latin American nations. However, the country has gradually embraced consolidation, resulting in a higher penetration of banking offerings. Bank loans, as a percentage of GDP, increased from 52% in 1992 to 70% in 2000. Besides, consolidation in Chile has also led to the emergence of universal banks, which provide a wide range of financial services. A linked outcome of the bank concentration is an increase in the proportion of fee-based income and declining transaction costs. Notably, the number of NBFCs reduced from 4 in 1992 to just 1 in 1999. The late 1990s brought the Colombian financial system closer to universal banking. By early 2000, financial conglomerates owned about 70% of the total bank assets. These conglomerates comprised commercial banks, financing companies, savings and loans corporate, leasing companies and insurance companies, among others. Besides there were no restrictions imposed on the fusion of credit intermediaries with non-bank institutions. In Mexico, [5,21] consolidation mainly took place due to lack of capital after the banking crisis in 1995. As domestic players were not in a

position to provide the required funding, regulations governing the entry of foreign player were eased. In 2004, the top 5 banks controlled approximately 80% of the total banking sector assets. The number of banks reduced from 36 in 1994 to 23 in 2000.

4.5 The Asia-Pacific Region

The banking sectors in countries in the Asia-Pacific region have not witnessed any common trend. While the concentration seen in the Australian banking system remains the same over the past decade due to the existence of the four-pillar policy, the Chinese banking industry has witnessed the deteriorating market share of the big-four State-owned Commercial Banks (SOCBs) over the years. On the other hand, the number of financial players in Singapore has been shrinking over the past decade due to financial sector liberalization and the influence of the global consolidation trend. The Government Australia has maintained four-pillar policies that prohibit mergers between the "Big Four" banks, namely, Commonwealth Bank, National Australia Bank, Westpac and the Australia and New Zealand Bank. This was done with a view to maintain competition within the domestic market. However, there is an ongoing debate in Australia over whether this four-pillar policy would be sustainable in the long-run as it prevents them from increasing their scale and efficiency level. As of June 2007, the top four banks accounted for around 80% banking assets.

'Big-four' state-owned banks dominate the Chinese banking industry, accounting for nearly 50% of the total banking assets as of 2007. ICBC, Bank of China, China Construction Bank and Agricultural Bank of China have collectively contributed to China's economic development and reforms by providing the requisite funding support for various infrastructure projects neglected by private capital, thereby, promoting balance economic development. The Chinese banking sector can be considered a three-layered hierarchy, with the Big Four state banks at the top, followed by the 13 joint stock commercial banks and the 117 city commercial banks at the bottom.

The Government of Malaysia believed that bank mergers could effectively offset future banking system crises as well as equip home-grown entities to compete with international banks. In April 2000, it envisaged merging 55 financial institutions into 6 banking groups, each with an anchor bank chosen by the government to control the group. These institutions included commercial banks, merchant banks and finance companies.

Indonesia witnessed large scale infusion of public funds into the banking system through a specialized restructuring agency. Regulatory forbearance was also present in good measure to facilitate bank recovery. As against Basel Capital adequacy norm of 8%, banks were allowed to operate with 4% as an interim measure. Only banks which had Capital Adequacy ratio reduced to below 25% were marked for immediate closure. Consolidation among banks was actively encouraged and FDI was allowed up to 99%. Net result was that the number of banks in Indonesia which stood at 239 in 1996 came down to 138 in 2003. In Indonesia, after the financial crisis, four of seven existing banks consolidated into a new bank (Bank Mandiri), which controlled nearly one-fourth of the total commercial bank deposits. Besides, in 2000, eight private banks taken over by the Indonesian Bank Restructuring Agency were merged into one Bank, Bank Danamon. Consolidation was most visible among private banks with the number of such banks coming down from 164 to 76 during the period. Post restructuring, the banks are now healthier and their branch network and coverage has increased significantly in recent years.

In the late 1990s, the Government of Korea envisaged consolidation in the form of a three-tier banking system-the first tier comprising few mega banks operating as universal banks, offering a full range of financial products; the second tier of several medium-sized banks providing retail banking and housing finance and the third tier comprising small regional banks operating in specific regions. In 2000, the concept of Financial Holding Companies (FHC) was introduced in Korea to promote consolidation by passing the Financial Holding Company Act. Healthier banks were induced to merge with the prospect of increasing their market share, while weaker banks came together under a separate FHC umbrella to convert themselves into large, financially viable entities. The FHC model reduced the number of individual financial institutions specializing in specific businesses while enabling banks to offer other services such as insurance, broking and asset management. This enlarged the scale and scope of business of FHCs and made them more competitive.

Japan is a country which has witnessed a virtual collapse of the banking system along with economic stagnation which lasted over 15 years. Japan had some of the leading names in global banking arena. The economic slowdown saw the NPA levels going up over the roofs and the banks virtually looking for governments support. Needless to say, the low interest rate regime (near zero rates) would have eased their sufferings somewhat. However, the banking system has recovered in recent years helped by liberal financial assistance from the government and an environment of extremely loose monetary policy. Consolidation process which was kicked off as restructuring strategy has resulted in emergence of three large banks viz. Mitsubishi UFJ, Mizuho and Sumitomo Mitusui. Today NPA levels have come down to an acceptable level of 1% from a peak level of 8.4% in the year 2002. Capital adequacy ratios have improved above the Basel benchmark of 8%. Banks have started showing profits and there is a pick-up in their credit portfolio. Japanese banks may still have a long way to go as their ratings continue to be low and they are heavily dependent on interest income with heavy reliance on low margin corporate loans. Another interesting development taking place in Japan is the government move to privatize the postal agency, which doubles as a financial institution that holds the world's largest pool of household savings. The Housing loan Corporation managing the advances of the postal agency had, at one time, nearly 50% of all mortgage loans in Japan. As part of privatization this corporation is being wound up with the assets getting transferred to the banking system.

The banking structure in Hong Kong has been relatively more static as compared with a few other mature markets. The local banks are inclined to acquire a gateway to China, which is another reason for them to increase their scale, they have to meet the size criterion of at least USD36 million worth of assets to be eligible to establish a branch in Mainland China. Few examples of bank mergers in the last few years are acquisition of the First Pacific Bank by Bank of East Asia and that to Dao Heng Bank by DBS HK Ltd.

Thailand has implemented a financial sector master plan aimed at removing obstructions to M and A and also allows FDI flow to strengthen the banking system.

Five major banks continue to dominate the banking sector of Singapore since the 1960s, namely, Development Bank of Singapore (DBS), Overseas Chinese Banking Corporation (OCBC), United Overseas Bank (UOB), Keppel TatLee Bank and Overseas United Bank. The mergers among these five banking groups led to the formation of three main financial groups, namely, OCBC, UOB and Keppel. M and A continues to characterize the banking sector of Singapore since the 1970s and 1980s. This concentration of financial activities within the major banking groups has intensified with the assimilation of finance companies,

catering to merchant banking, securities and insurance, thereby creating an oligopolistic pattern.

Over the last one and a half decade, the banking sector in India has not only grown in terms of size but also matured, diversified and consolidated to contribute towards building a robust financial system. The Global mantra Liberalization, Privatization and Globalization (LPG) process which was started in early 1990s has brought so many changes in the economic scene of the country. This process of economic reforms has brought competition not only from India but also from overseas. In order to compete with these competitors, Indian corporate sector has tried to reorganize and restructure the companies by adopting various strategies. These strategies include Mergers and Acquisitions. Consolidation of banks through Mergers and Acquisitions is not a new phenomenon for the Indian banking system. It has been going on from the early days of modern banking through the setting up of English Agency House in the 18th century; the most significant merger was that of the three Presidency banks, founded in the 19th century, in 1935 to form the Imperial Bank of India (renamed as State Bank of India in 1955). Because of bank failures and amalgamations the number of reporting commercial banks declined from 561 in 1951 to 89 in June, 1969. Merger of banks took place under the direction of the Reserve Bank of India during the 1960s. [5,14,15,16,17,18,19,20] During 1969 to 2013, 37 banks, both in the public and private sectors, were merged with other stronger banks. There have also been mergers between private sector healthy banks, driven by the business and commercial considerations. However, merger of public sector healthy banks have not taken place till now.

Fig. 1 show that number of Bank's M and A cases increased in all over world between 1985 to 2006.

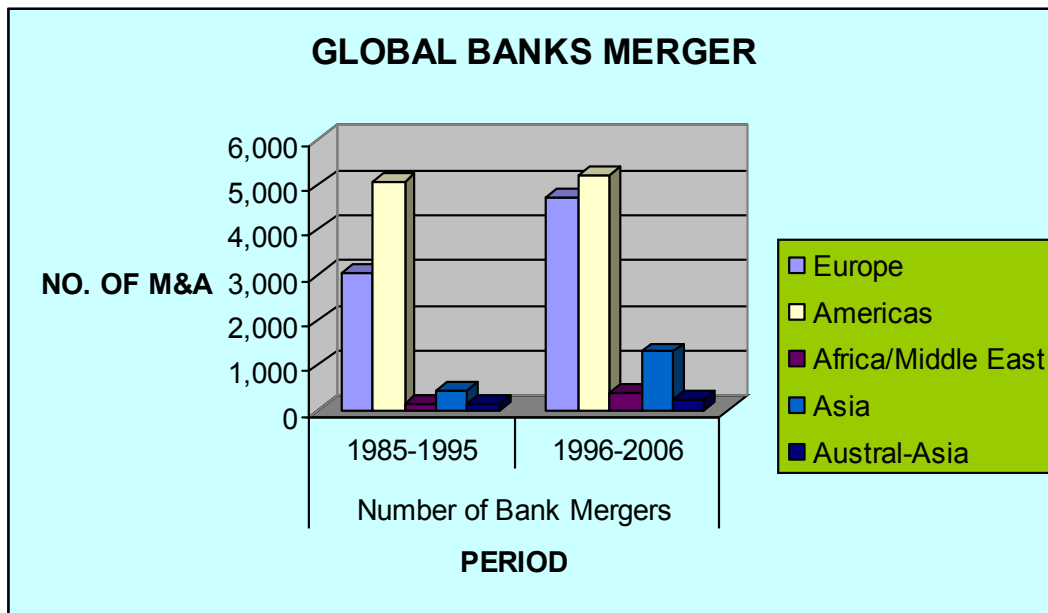


Fig. 1. Global Bank Mergers 1985 to 2006

In most of the emerging economies, consolidation has mostly been government-led than being market-driven. In Latin America, most government-led mergers took place following the Latin American crisis in the early 1980s whereas in the South-East Asian economies, these mergers happened after the Asian financial crisis in the late 1990s. However, on account of deregulation, privatization and the entry of more and more foreign players the scenario is gradually undergoing a change. In certain mature financial markets such as Singapore and Hong Kong, consolidation is viewed from the point to competitiveness. The European banking industry is characterized to a large extent by cross-border consolidation mainly due to deregulation, market integration and the adoption of a single currency in the European Union (EU). Meanwhile, the US banking industry has consolidated over the past decade due to favorable regulatory measures that facilitated interstate bank mergers.

Fig. 2 shows increasing trend of Values of Cross-Country Bank's Merger that shows Values of Cross-Country Bank's Merger increased in all countries between 1995-99 to 2000-04.

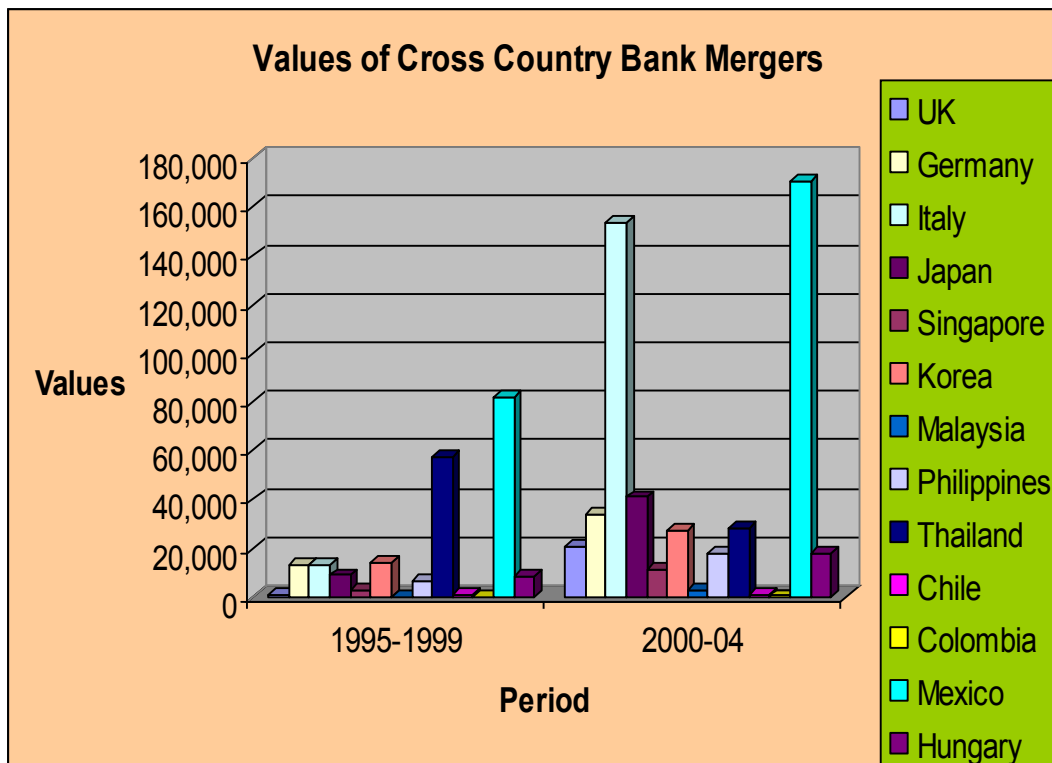


Fig. 2. Values of Cross-country Bank's Merger

Fig. 3 shows decreasing trend of number of banks all over the World.

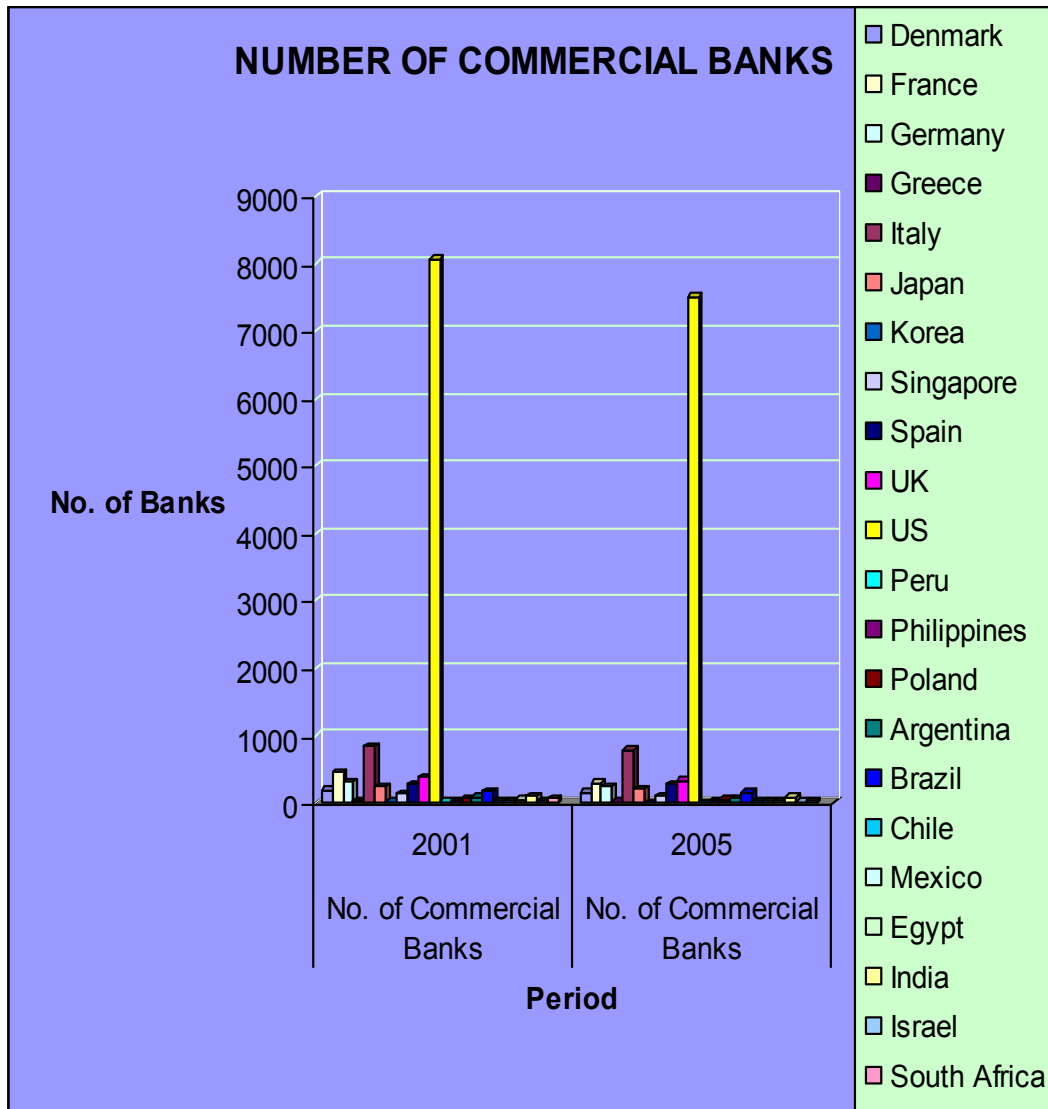


Fig. 3. Numbers of Commercial Banks

5. CONCLUSION

The goal of a bank merger is to increase the bank's value in one way or another. Consolidation in banking industry is the need of the hour. A lot of companies have merged with other companies to make a mega company. Consolidation will positively amplify the business prospects of the industry in the domestic as well as international market place. "Collectiveness is strength" will hold true on consolidation in Banking Sector. Banking consolidation is big news these days, with a new mega merger announced almost every month. The financial services industry around the globe is consolidating. Starting in the

United States (US) in the 1980s, a wave of bank merger reached Europe in the 1990s. Over the past two decades, deregulation in the banking industry has generated a sweeping trend of bank mergers and acquisitions, which has changed the banking landscape across the world. The change in banking structure is especially notable in the United States, which used to be characterized by a large number of small banks. The pressures on capital structure [20] to meet prudential capital adequacy norms necessitate the need for Consolidation in the banking industry. Consolidation will provide banks the 'size advantage'. There is a need for consolidation in the banking industry to compete for the pie in the domestic as well as global market. Off late the Indian banking industry has realized that size matters a lot when it comes to face the competition in the banking industry and rise to global standards. Size would bring along with it economies of scale by bringing down the transaction costs. Mergers and Acquisitions would help build up financial strength, capture larger portion of the growing retail business and secure better regional presence. Bank mergers are not as easy as it seems on the paper. No doubt everyone knows the criticality of the issue and urgent requirement of mergers in banking sector, But then river also have to face various rocks, pebbles and other interruptions in its natural flow and so does Banking sector has to face various challenges for mergers.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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