

Consolidation in Banking Industry – A Cross Country Experience

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 early1990s. 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 to1995. 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&A activity accelerated in recent years, in some other countries, it slowed 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.

Key Words: - Consolidation, Mergers, Acquisitions, Absorption, Takeover

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.

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.

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

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 that have driven the US banking consolidation are as follows:

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.

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.

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 around 30% cross-border M & As out of the total consolidation activity in the EU banking sector in the period 2001-06.

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 downsize, 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 **Mexico**, 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.

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 & 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.

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&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 & 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. 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.

Table 1, 2, and 3 shows that the 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&A activity accelerated in recent years, in some other countries, it slowed down. However, the value of M&A increased manifold in several countries, including those where M&A activities slowed down shows Table 1.

Table 1: Cross-border Bank Mergers 1985 to 2006

	Europe	Americas	Africa/ Middle East	Asia	Austral- Asia	Total M&A
Number of Bank Mergers	7,774	10,318	514	1,737	413	19,506
Cross-border Mergers	3,131	1,347	266	784	220	5,748
Cross-border as % of total	40.3	13.1	51.8	45.1	53.3	29.5

Table 2: Cross-border Bank Mergers 1985 to 1995

	Europe	Americas	Africa/ Middle East	Asia	Austral- Asia	Total M&A
Number of Bank Mergers	3,064	5,082	137	440	158	8,356
Cross-border Mergers	1,005	442	65	221	90	1,823
Cross-border as % of total	32.8	8.6	47.4	50.2	56.9	21.8

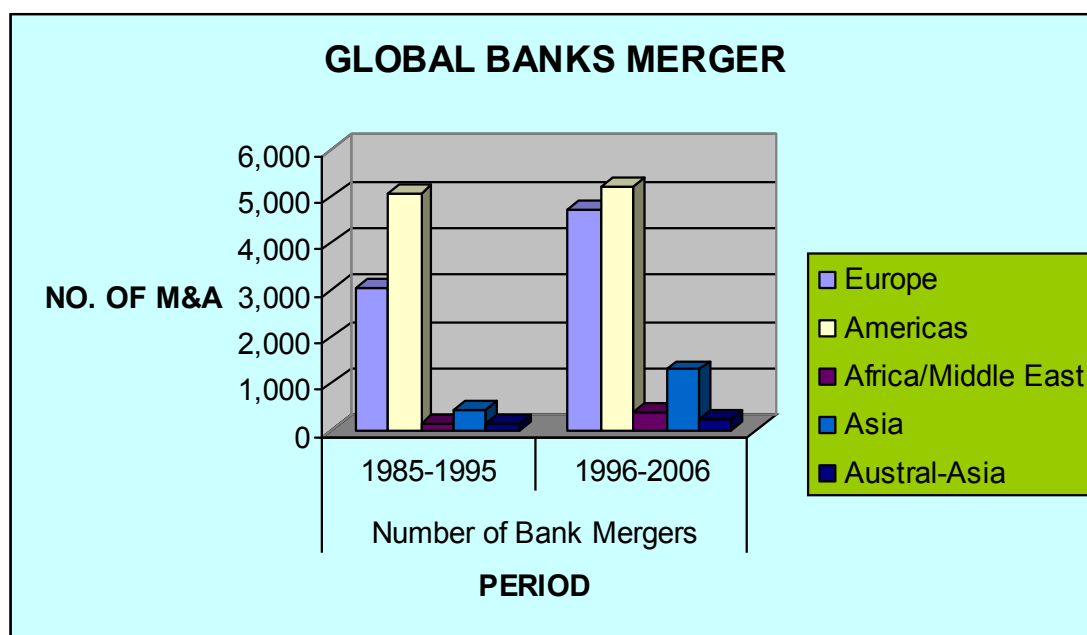
Table 3: Cross-border Bank Mergers 1996 to 2006

	Europe	Americas	Africa/ Middle East	Asia	Austral- Asia	Total M&A
Number of Bank Mergers	4,710	5,236	377	1,297	255	11,147
Cross-border Mergers	2,216	905	201	563	130	3,925
Cross-border as % of total	47.0	17.2	53.3	43.4	50.9	35.2

SOURCE: Buch Claudia M. and De Long Gayle L. "Banking Globalization: International Consolidation and Mergers in Banking", January 2008

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

Figure 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.

Figure 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.

Table 4: Cross-Country Bank Mergers & Acquisitions and its Values

Country	Number		Value (US \$ million)	
	1995-1999	2000-04	1995-1999	2000-04
UK*	7	62	1,137	20,376
Germany*	22	64	13,100	34,023
Italy*	36	121	12,953	1,53,345
Japan*	18	58	8,892	41,069
Hong Kong	0	14	0	-
Singapore	8	8	2,900	11,400
Korea	11	7	14,360	27,410
Indonesia	1	0	-	0
Malaysia	2	16	20	3,020
Philippines	2	13	6,900	17,740
Thailand	5	2	57,700	28,000
Chile	5	6	870	1,220
Colombia	9	11	40	330
Mexico	8	5	81,900	1,70,800
Czech Republic	9	3	-	-
Hungary	11	9	8,620	17,990
Poland	23	30	-	-

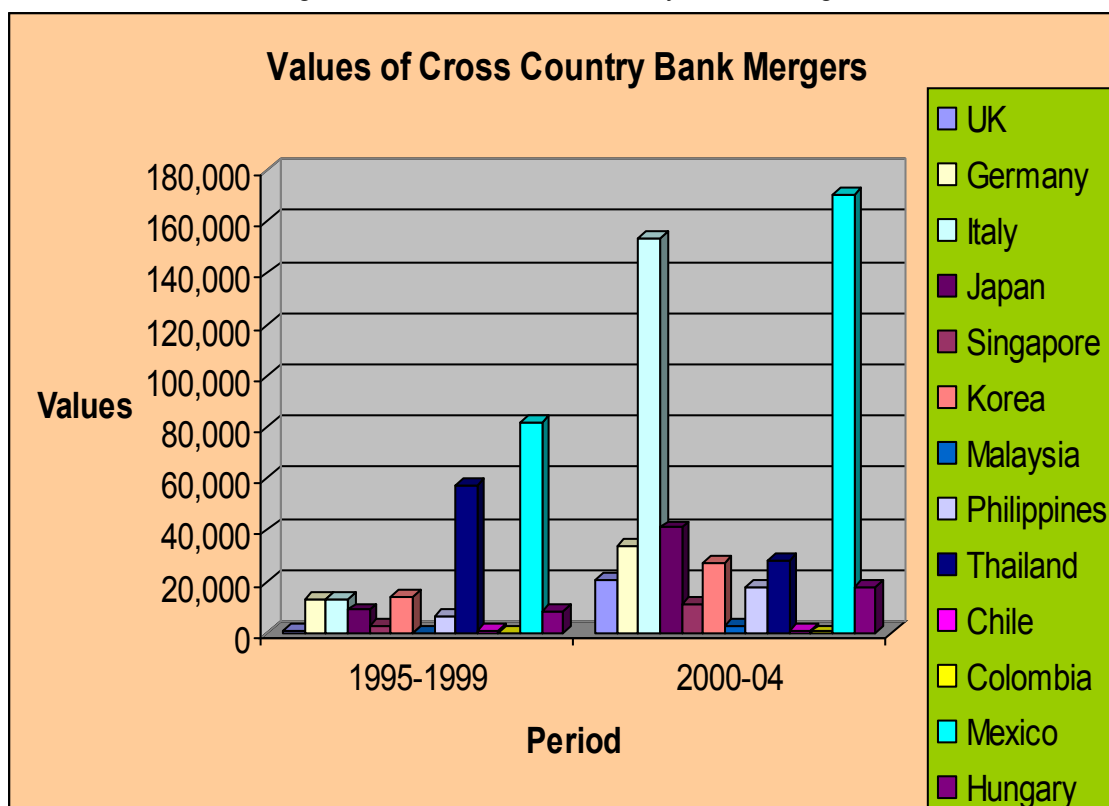
* Based on Bloomberg database for the sub-periods 1997-2000 and 2001-2007. Value may not necessarily represent amount of all details.

- Not Available.

SOURCE: Report on Currency and Finance 2007-08

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Figure 2: Values of Cross-Country Bank's Merger



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Table 5 shows the banking consolidation resulted in a substantial decline in the number of banks in many emerging market and advanced economies in between 2001 to 2005. Figure 3 shows decreasing trend of commercial banks in advanced and emerging economies.

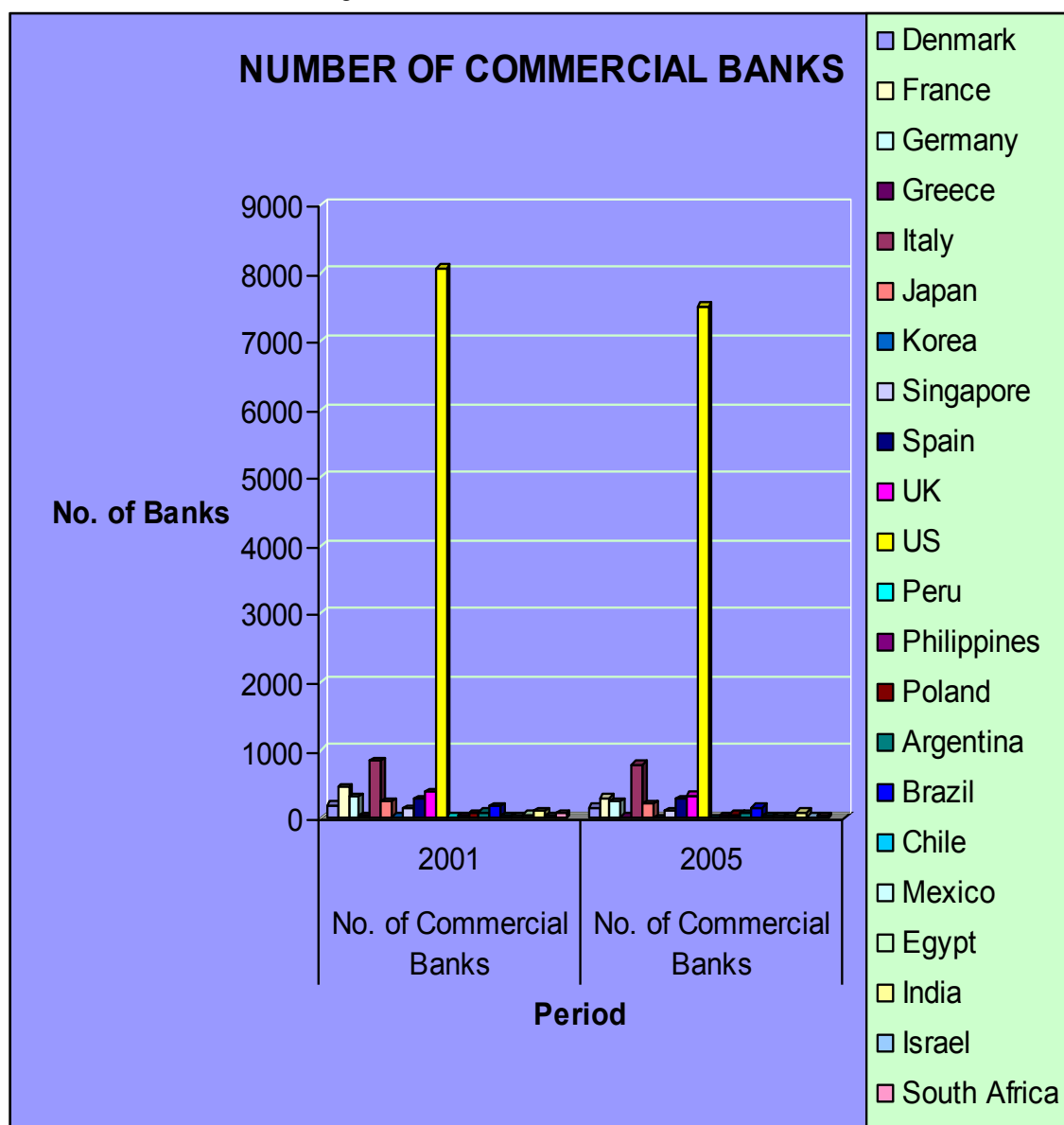
Table 5: Numbers of Commercial Banks

Country	Bank (2001)	Bank (2005)	% Variation
<i>Advanced Economies:-</i>			
Denmark	190	161	-15.3
France	444	294	-33.8
Germany	304	251	-17.4
Greece	44	21	-52.3
Italy	830	784	-5.5
Japan	234	215	-8.1
Korea	20	13	35.0
Singapore	128	110	-14.1
Spain	285	272	-4.6
UK	398	333	-16.3
US	8,075	7,515	-6.9
<i>Emerging Economies:-</i>			
Peru	15	12	-20.0
Philippines	42	41	-2.4

Poland	69	54	-21.7
Argentina	86	71	-17.4
Brazil	180	161	-10.6
Chile	27	26	-3.7
Mexico	32	29	-9.4
Egypt	53	43	-18.9
India	100	88	-12.0
Israel	26	15	-42.3
South Africa	59	34	-42.4

SOURCE: Report on Currency and Finance 2007-08

Figure 3 Numbers of Commercial Banks



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. 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.

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