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HISTORY OF BANKING MERGERS

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1. WHY WAS THERE A NEED FOR BANK MERGER IN THE WORLD?

The motives of consolidation have depended on firm characteristics such as size or organisational structure across segments, or even across lines of business within a segment **(BIS, 2001).** M&As in developed countries are mainly driven by market forces whereas in many emerging market economies (EMEs), mergers and amalgamations have often been driven by governments in order to restructure the banking systems in the aftermath of crisis . In the late 1990s, the banking systems of many emerging market economies were highly fragmented in terms of the number and size of institutions, ownership patterns, profitability ,competitiveness, use of modern technology, and other structural features. Very often, three or four large commercial banks coexisted with a large number of smaller urban and rural banks, many of them family-owned (especially in Asia) or under the influence of the public sector (as in Latin America and central Europe). In general, few commercial banks, even larger ones, were listed on a stock exchange. Profitability varied widely, with some banks earning high gross returns but operating very inefficiently, and others competing fiercely for a narrow segment of the market. Likewise, while some banks used advanced technology and financial innovation, many were still struggling with basic operations such as credit risk assessment and liquidity management. In this environment, bank mergers were considered to be a potentially important vehicle for improving the structure and efficiency of the banking industry. They were expected to derive both cost reductions (from economies of scale, improved organizational efficiency, lower cost of funding, greater risk diversification, and economizing on capital) and revenue gains (by exploiting economies of scope, making large deals possible, etc). In many crisis-hit countries, mergers and acquisitions were seen as an exit strategy for weak banks; while in others, officials wanted domestic banks to be large enough to compete with foreign entrants. In Indonesia, Malaysia and Thailand the trend emerged because of post –crisis weeding out of financial institutions.

Singapore has pursued a different, facilitative approach, the authorities launched a phased opening-up of the domestic financial market in 1999; to grab the opportunity to become an Asian financial hub. The policy involved encouraging the local banks to

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engage in mergers and takeovers in a bid to realize economies of scale, as well as to strengthen their capability to invest in technology and management systems and to attract talent. However, the authorities did not seek to influence the outcome of mergers and takeovers, letting the new configuration be determined by market forces **(BIS Papers No 28 47).** In US, about 25 -30 % of the banks have closed or merged due to consolidation in the last two or three decades **(Nitsure,2008)** In emerging market economies, there is more inclination towards private and foreign owned structures, with fewer commercial banks and often smaller number of branches. It was widely believed that consolidation would enable banks to enhance efficiencies and increase revenues through expansion. Globalisation and deregulation led to decline in bank spreads, and consequently, profitability. In order to offset the decline in profitability and the need to grow volumes, there were mergers between banks and between banks and non-banks to reap the benefit of economies of scale and scope. For example in US restrictions have been removed on interstate and intrastate banking and deregulation of interest rates in 1980s and early 1990s, provided an impetus to merge across geographies. **Jones et al. (2005)** showed that consolidation in US banking industry led to a reduction in number of banks and thrift organizations over the last 20 years. In Japan little consolidation took place in 1990s and there was modest reduction in banks in 1990s following some bank failures.

2. HISTORY OF BANKING MERGERS IN EUROPEAN UNION:

- In the year 1997, Union Bank of Switzerland merged with Swiss Bank.
- In 1998, Banque Nationale de Paris (BNP) of France went through a merger with Banque Paribas and a new bank was formed with market capital of $688 billion.
- In the same year of 1998, the merger between Hypobank and Bayerische Vereinsbank, created a new banking institution which became the second largest bank in Germany.
- In 1999, Banco Santander acquired Banco Central Hispano and became the largest bank in Spain.
- In the same year of 1999, Bank Austria did a merger deal with Creditanstalt Bankverein and became the largest bank in Austria.
- In 2000, UBS of Switzerland acquired US Investment Bank Paine Webber.
- In the same year of 2000, Credit Suisse of Europe acquired Donaldson, Lufkin and Jenrette.
- Recently, in 2007, two Italian Banks, UniCredit and Capitalia merged and became the second largest bank in Europe after HSBC.

3. MAJOR ACQUISITION THAT TOOK PLACE IN PAST YEARS:

3.1 BANK OF AMERICA ACQUIRED MERRILL LYNCH:

Bank of America a financial holding company under the bank holding company act (BHCA) requested to acquire Merrill Lynch Inc. and its subsidiary in Istanbul, Turkey and New York. Bank of America paid $2.43 billion to shareholders who claimed that bank made false statement about company's health. Investigation by competition commission stated that Merrill Lynch reported a profit of $2.1billion for second quarter of 2007. Suddenly in third quarter profit turned into losses due to the bad accounting practices by Merrill Lynch. Company was not reporting the actual values of its bad investment. As Merrill Lynch's unethical practices were revealed, it was forced to ultimately report its real financial position.Bank of America board failed to perform its fiduciary duties to its shareholders in its merger with Merrill Lynch.

This claim was made on the basis of the following facts:

a.) Boards prioritization of retailing its position at the expense of shareholder's value.
b.) Bank of America's failure to conduct proper due diligence prior to acquisition of Merrill Lynch.
c.) Bank of America's failure to maintain transparency regarding Merrill Lynch's financial situation.
d.) Unethical executive compensation.
e.) Bank of America also did not disclose an agreement to pay $5.8 billion of bonuses to Merrill employees, in the face of huge losses at the investment bank.
f.) Bank of America Corporation (BAC) after buying Merrill lynch posted a loss of about $2.4 billion in for the quarter ending December 2008. Bank of America also lost about $1 billion for the third quarter of 2009. For the period, BAC reported that its personnel costs and operating costs increased to $16.3 billion from $11.7 billion previous year, mainly due to Merrill Lynch acquisition. Merrill Lynch continues to be a loss making centre for BAC as mentioned BAC in its 10Q of Q3 09 -"net loss increased as higher gains on the sale of debt securities and higher equity investment income were more than offset by the negative credit valuation.

3.2 ACQUISITION OF FORTIS BELGIAN AND LUXEMBOURG ASSETS BY BNP Paribas:

BNP Paribas is present in Belgium and Luxembourg in credit cards through its subsidiary PFB, which issues cards under the Master card label and Aurora brand. The Commission's concerns centred on credit cards as a payment instrument as well as on the provision by the Parties of credit to consumers through the cards. The

Commission's concerns do not relate to the acquiring side of the market The Commission's investigation indicated that in Belgium the merged entity would have become by far the largest player in card issuing and the related provision of credit, and that the concentration, as initially notified, would have reduced choice in the market, both from the standpoint of commercial partners involved in distribution and co-branding arrangements with card issuers and from the viewpoint of the final cardholder. Further clearance was granted if BNPP’s divestment of BNP’s Belgian consumer card subsidiary. Divestment would substantially offset the increase in market share due to the merger on the problematic markets and would maintain robust competition to the benefit of the number of market in which the overlap of the parties was limited.

4.2 BANCA ANTONVENETA (BA) ACQUIRED BY DUTCH ABN AMRO AND BANCA NAZIONALE DE LAVORO ACQUIRED BY BANCO BILBAO VIZCAYA ARGENTINA (BBVA)

These two cases are from Italy and both the deals were earlier blocked by competition commission in Italy and Government of Italy. Although acquisition of Banca Antonveneta (BA) was later approved but merger review process was delayed and it increased uncertainty and risk for ABN Amro. Second deal failed after Banco Bilbao Vizcaya Argentina (BBVA) withdrew its takeover bid in response to a counterbid by Italian insurer Unipol for BWL. Deals were blocked to protect local banks from foreign investors, EU commission brought actions against Italy for infringement of the principle of the free movement of capital and freedom of establishment. Merger control is not only a barrier to cross border consolidation in Europe but it constitutes a systematic barrier to cross border consolidation in Europe. Regulators also blocks cross border mergers and acquisition. Refusal of Acquisition of Banca

Antonveneta was vetoed by the Portuguese government. The grounds of Refusal were:

i. Late and incomplete notification.
ii. Absence of a transparent and complete structure.
iii. Necessity to protect national interest.

4.3 PNC FINANCIAL SERVICES MERGER WITH NATIONAL CITY BANK:

PNC, with total consolidated asset is about $145.6 billion, which is the 14th largest depository organisation in US. National City with total consolidated assets of approximately $143.7 billion is the 16th largest depository organisation in US. On fulfilment of this proposal and considering all the uncertainty, PNC would become the eighth largest depository organisation in US. PNC would control total assets of

about $174.8 billion. In Ohio it will become the largest depository organisation. The BHC Act (bank holding company act) has to investigate some of the competition issues in this merger.

i. To reduce potential adverse effects on competition in the Pittsburgh market PNC has proposed to divest 50 of National city bank branches that accounts for $3.5billion deposits.
ii. PNC proposed to merge with second big depository organisation (in some areas) and all other competitor have relatively smaller market share in those areas. Review took time because size of those institutions relative to other market competitor.
iii. In conducive analysis board generally don't adjust market deposits to exclude specific types of deposits. But in this case it was advice to do that.

4. MAIN FINDINGS OF THE MERGERS AND ACQUISITIONS IN US AND EU

a) During mergers banks should maintain transparency with their shareholders, employees and government. As we have seen that during merger of Merrill lynch and Bank of America transparency was not maintained with the shareholders. Banks should not merge on the expense of shareholders value. Lack of due diligence can create problems in future. When shareholders owns shares in a bank/company they become owner of the company up to the amount they have invested so they have all the right to know about the merger details and the financial condition of the target bank they are planning to own.
b) Commission generally don't restrict the merger on the basis of number of deposits held by the bank or number of branches banks have but in some special cases commission can do that if it raises competition issue.
c) Sometimes commission objects the merger in order to keep the nations interest. This type of restriction has been noticed in cross border merger where merger of any bank with a big player can eliminate local banks.
d) When two big players merge together then to reduce the potential adverse effect on competition because of low market share of bank in a particular area commission notify the big players to reduce the number of shares and deposits held by them.
e) In some cases commission's concern do not relate to acquiring side of the market. Mergers in the problematic area can be offset by divestment and competition can be done fairly.
f) In most of the cases discussed above got permission for merger under special circumstances and under certain conditions.

5. MERGERS AND ACQUISITION EXPERIENCE OF INDIA (post 2000)

Merger year	Target bank	Acquirer	Motive
2000	Times bank Ltd	HDFC Bank Ltd	Voluntary merger
2001	Bank of Madura	ICICI Bank	Voluntary merger
2002	ICICI Ltd	ICICI Bank	Universal banking objective-merger of financial institution with bank
2002	Banaras State bank Ltd	Bank of Baroda	Forced merger-restructuring of weak bank
2003	Nedungadi Bank Ltd	Punjab National Bank	Forced merger-restructuring of weak bank
2004	IDBI Bank Ltd	Industrial development bank of India	Universal banking objective-merger of financial institution with bank
2004	South Gujarat local area bank	Bank of Baroda	Forced merger-restructuring of weak bank
2004	Global trust bank	Oriental bank of commerce	Forced merger-restructuring of weak bank
2005	Centurion bank	Bank of Punjab	Voluntary merger
2006	Ganesh bank of Kurandwad	Federal bank	Forced merger-restructuring of weak bank
2006	United western bank	Industrial development bank of India	Forced merger-restructuring of weak bank
2006	Lord Krishna bank	Centurion bank of Punjab	Expansion of size voluntary merger
2006	Sangli bank	ICICI bank	Voluntary merger
2007	Bharat overseas bank	Indian overseas bank	Regulatory intervention

6. RECENT MERGERS AND ACQUISITION NEWS IN INDIA:

i.) The Indian banking industry may see a few mergers and acquisitions (M&A) deals this year, ahead of the banking regulator releasing the licensing norms for new banks that are expected to open for business in the next two years.

ii.) At least three new generation private sector banks**— HDFC Bank Ltd, Kotak Mahindra Bank Ltd and IndusInd Bank Ltd** have set their eyes on acquisitions.

iii.) **Kotak Mahindra Bank** has already created a war chest for acquisitions by selling 4.5% stake in the bank for $296 million (around Rs1, 400 crore today) to Sumitomo Mitsui Financial Group Inc. Its vicechairman and managing director Uday Kotak has previously said that he is “sniffing around” for acquisitions.

iv.) **ICICI Bank Ltd**, India’s largest private sector lender, is in the process of acquiring Bank of Rajasthan Ltd for its 463 branches. ICICI Bank had earlier acquired Bank of Madura Ltd and Sangli Bank Ltd, again for their branches, and their presence in southern and western India, respectively.