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MERGER AND ACQUISITIONS : AN OVRVIEW OF BANKING INDUSTRY

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Abstract

Mergers and Acquisitions have been viewed as a vital stratagem by corporate world to reap the benefits like economies of scale, avoid the competition, multiply the power, reduce the costs and maximize the profits. M&A, as a strategic tool to widen the business landscape, was first adopted by the firms in late 1800s in USA but in the last half a century, there have been numerous Mergers and Acquisitions around the globe. Hence to understand the significance of M&A arrangements, several studies have been dedicated. This study attempts to examine and understand the contributing factors in the success as well as in failures of the M&A particularly in the banking sector by analysing the history and available literature to Mergers and Acquisitions.

KEYWORDS : *Merger, contributing factors, successful and failed M&A, banking industry*

INTRODUCTION

A corporate unit is established with obvious intentions of earning profits to maximum, to increase assets base and also to expand and grow in size, products, customer base and come out as most efficiently run enterprise. Hence to attain maximum efficiency, optimum use of available resources becomes essential. Each enterprise has to incur certain basic expenditure on administrative office, office equipments, furniture, internet, administrative staff and so on. So, when two or more enterprises come
together, (a) replication of expenses can be avoided, (b) energy in the form of money and time spent on marketing to attract same customers can be reduced to less than half and (c) money thus saved can be utilized for expanding the business.

Moreover, the enterprises inclusive of banks today, face ever increasing competition and ever growing demands of aware consumers. Hence they strive to find new techniques and tools to survive and win the cut throat situations. Mergers and Acquisitions seem to be the solution to all such questions andreduce hurdles of an organisation to achieve goals like cutting the competition, increasing the customer base, reducing costs by avoiding duplication, improving the profitability, strengthening the size thus preventing new emergence of competition.

MERGER

Merger can be defined as a combination of two or more companies into a single company where one company survives and the others lose their corporate existence. The survivor acquires all the assets as well as liabilities of the merged company or companies.

Merger is also defined as amalgamation which is termed as a unification of two or more existing companies. Though in amalgamation two companies come together to form a new business entity, in merger one company acquires the other and the other ceases to exist.

ACQUISITION

It is termed as a corporate action in business field, in which a company buys most, if not all, of the target company's ownership stake so as to assume control of the target firm. Acquisitions can be either friendly or hostile. An acquisition is said to occur if one corporation buys either assets, net assets or Stock of another corporation.-Robert N. Anthony.

TAKEOVERS

A Takeover takes place when an individual, group of individuals transactions, directly by becoming the owner of those assets, or indirectly by obtaining control of the management of the company. Takeovers and Acquisitions can differentiated on the basis of element of willingness of the seller and buyer involved in the deal.

CONSOLIDATIONS

Eric L. Kohler defines consolidation as the "combination of two or more enterprises, accomplished by the transfer of net assets to a new corporation organized for that very purpose". Consolidation normally takes place between two organisations of the same size. Both enterprises extinguish and a new entity is created.

TYPES OF MERGER

HORIZONTAL MERGERS

A Company merges with another company that offers similar product line and services to the final consumers. This situation arises when the companies are in the direct competitions and merger helps in eliminating direct competition and resulting in enhancement of market share combining with revenues and profits.

The most prominent example is merger of Disney with Steve Jobs-led Pixar in 2006 and came up with films like "Toy Story", "Finding Nemo", "The Incredibles" and "Finding Dory" spawning billions. Disney also purchased Marvel in 2009 for taking the advantage of the intellectual properties.

VERTICAL MERGERS

Here the merger is between two companies producing separate services and component along the value chain for a final product. For e.g. A textile company merging with raw material supplying company. Such mergers secure a continuous and uninterrupted supply of essential raw materials and also restricting the same supply to rival competitor. In 2002, eBay (EBAY) purchased the online payment gateway PayPal Holdings (PYPL) for $1.5 billion, to incorporate the service of the online payment gateway to create more value to its brand.

CONCENTRIC MERGERS

The merger is between the firms that serve the same customers in a specific industry, offering different products and services that are complementary to each other. For e.g. a firm producing DVD's would merge with a firm producing DVD players. These mergers help the companies to diversify by extending the product lines and offer the customers with convenience of one-stop shopping offer. Google purchased Android in 2005. Today, Android is the top mobile operating system in the world, powering 82 percent of all smartphones through mid-2015. Since Android also heavily incorporates Google's products and services, it has given Google incredible mobile search engine share.

CONGLOMERATE MERGER

This type of merger refers to a merger between two companies which are operating in completely different industry and have no relevance of production stages. It is just a unification of business from different vertical under a single flagship entity. ICICI Ltd. merging with Mahindra Tractor is a prime example of such mergers. The largest merger in U.S. history , in 1998, Exxon, the largest U.S. oil producers and Mobil Corp., came to be known as Exxon Mobil Corp. is another such illustration.

REVERSE MERGER

In a merger where a healthy company merges with a financially weaker company and the former company is dissolved, is termed as a Reverse merger. Moreover, when a parent company unites with its subsidiary company, it is known as Reverse merger. A Reverse merger also takes place when a private company becomes a public company by acquiring it.

CO-GENERIC MERGER

Co-generic merger takes place when two companies are existing in the similar industry but offering dissimilar products. Such mergers take place to take advantage of parallel distribution channels, coinciding technologies or alike production processes. For e.g. merger between Citicorp and Travelers Group forming a new company Citigroup between 1998-2001. Both the companies operated in financial services industry but offered different product lines.

TRIANGULAR MERGER

A Triangular merger is termed as such due to its regulatory and tax reasons. It is a three way arrangement in which the target company merges with a subsidiary of the acquirer company. There can be reverse and forward triangular mergers. The deal is forward when the subsidiary company survives whereas the deal is reverse when the target company survives.

BANKING INDUSTRY :

A sturdy banking sector is precondition to economic growth and development in a developing country. A robust and well-organized banking system facilitates the effective apportionment of resources to individuals, organisations, and projects that can use those resources effectually. Access to capital is essential, among other reasons, for the undertaking of infrastructure projects by the government; entrepreneurial activities and job creation by citizens; and improvements to agricultural output and technology use by farmers. Banks promote capital formation, investment in new enterprises, promotion of trade and industry, savings, and development of agriculture.

HISTORY OF M&A IN BANKING INDUSTRY

For strengthening the banks, policy of mergers and acquisitions was adopted. Here it is essential to know the history of bank M&A and how M&A became popular growth strategies for bank leaders **(Huang & Marquis, 2010).** In the 1920s, U.S. commercial bank leaders were able to invest in securities without any restriction (Crawford, 2011). No rules or regulations led to immense speculations among banks as bank leaders sought to exploit the stock and bond opportunities from the investment market **(Crawford, 2011**). The unrestricted investment activities of the banks culminated into the stock market crash of 1929 (Crawford, 2011). Depositors lost monies, and over 9,000 banks failed between 1930 and 1933. Several congressional hearings took place, and finally, the Banking Act of 1933 (Glass-Steagall Act) was passed on June 16, 1933 (Crawford, 2011).

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The Banking Act of 1933 restricted financial products banks could offer and geographic locations where banks could operate (Huang & Marquis, 2010). The act sought to prevent conflict of interest between the investment and commercial banks' lines of business and discouraged the inter-state branching of banks (Crawford, 2011). Enacting the act and creating the Federal Deposit Insurance Corporation (FDIC) helped to restore public confidence in the banking sector (Crawford, 2011).

The Riegle-Neal Interstate Banking and Efficiency Act of 1994 repealed the restrictions on the inter-state branching of banks, and the Gramm-Leach-Bliley Financial Modernization Act of 1999 repealed the Glass-Steagall**restrictions (Baker, 2009). The introduction of the Gramm-Leach-Bliley Financial Modernization Act** spurred M&A among banks and integrated the banking and insurance sectors of the economy. Bank leaders moved away from creating bank holding companies in states to moving across state lines to merge and acquire other banks **(He & Zhao,** 2014). The deregulation of the banking industry spurred the consolidation of banks through M&A **(Huang & Marquis**, 2010). Bank leaders looked at size, growth opportunity, efficiency, and regulatory and supervisory framework as they sought to merge banks (**Gaganis, Pasiouras, &Tanna, 2011**). Gaganis et al. (2011) examined over 400 commercial banks that underwent M&A and sought to determine why the mergers were necessary. The findings were consistent with the results of past research that strategic M&A generates capital, creates cost efficiency, profitability, and growth opportunities.

THE FINANCIAL CRISES

The financial crises of 2008 brought a change of events in the financial service industry. The crisis reached its height with the failure of Lehman Brothers in September 2008 **(Allen &Carletti, 2010)**. According to Allen and Carletti (2010), the crisis was engineered by the unrealistic inflated valuation of the real estate market in the United States and other countries, loose monetary policy (which made credit cheap and easy to access), and global imbalance in the financial markets. Subprime lending, weak regulatory structures, and high leverage in the banking sector exacerbated these issues.

As the crisis mounted, the financial industry experienced liquidity squeeze. With the tightening of credit, banks began to experience higher levels of delinquencies from loan customers. This situation put pressure on banks for liquidity because the banks relied on paying loan customers to meet obligations to the depositors. Consequently, according to Beccalli and Frantz (2012), bank leaders sought to increase their capital positions and turned to M&A to stay in business. Bank leaders also merged banks to save failing banks from collapsing and causing more harm to the financial system. As the financial crises heightened, the financial regulators increased the pace at which merger requests were approved to abate the effect of failing banks on the economy of the United States.

This review of history of banks illustrates why M&A are relevant and the issues associated with bank mergers; for instance, social identity issues were not envisioned when bank mergers were initially thought of and created.

M&A IN BANKING INDUSTRY

Several M&As have taken place in the banking sector and numerous studies and researches have been carried out till date to evaluate the performance and to test how far these deals have turned out to be successful. This paper attempts to review some studies and finds that the works show typically contrasting results.

SUCCESSFUL MERGERS : CONTRIBUTING FACTORS

REMOVAL OF OPERATING INEFFICIENCIES AND REDUCTION OF PROCESSING EXPENSES

Several bank leaders resorted to M&A as growth strategies (**Phillips & Zhdanov, 2013). Malul, Meydani, and Shoham (2012)** found that bank leaders and managers gained more market share and maximized profit through M&A. M&A also became a way to eliminate operating inefficiencies and reduce processing expenses for banks**(Assaf, Barros, &Ibiwoye, 2012; Baker, 2009; Bernard, Fuentelsaz, & Gomez, 2010).** While bank leaders were taking advantage of the deregulated environment, effective preparations were not made to adequately integrate employees who were acquired in the M&A process. As a result, no adequate strategies were implemented to address the social identity issues that arose with M&A.

ECONOMIES OF SCALE

Taking advantage of economies of scale is a primary driver of bank mergers in the United States **(Wheelock & Wilson, 2012).** Wheelock and Wilson (2012) conducted their study using local polynomial estimators and data obtained from United States banks from 1984 to 2006. The researchers found that the trend for banks to merge to take advantage of economies of scale would continue unless government institutions intervened.

STRONGER BRAND RECOGNITION

In another study used to examine M&A as a strategy, **Lambkin and Muzellec (2010)** found that the acquirer company (with the stronger brand recognition than the acquired company) should consider renaming the acquired company to bear the same name as the parent company. Renaming the acquired company can convey to the market that ownership and management have changed for the acquired company. The researchers posited that following this strategy could help bank leaders achieve successful M&A.

UNIQUE PRODUCT OFFERINGS& PRODUCT DIFFERENTIATION OPPORTUNITY

Hoberg and Phillips (2010) also examined why bank M&A are necessary by investigating firms that merged to take advantage of similar, but unique, product offerings. Hoberg and Phillips found that firms with similar product market language are more suited to enter into merger transactions. M&A in competitive product markets yield increased stock returns and growth for the firms. If targets are unique from acquirer's rivals, stock returns and growth will be high because acquiring firms take advantage of the product differentiation opportunity presented by M&As (Hoberg& Phillips, 2010).

KNOWLEDGE TRANSFER

Successful implementation of M&A provides the opportunity for knowledge transfer between the merging firms **(Azan & Sutter, 2010; Holland &Salama, 2010**). Using the merger between the Roche Consumer Health division and Bayer as a case study, Azan and Sutter (2010) examined M&A from a knowledge transfer perspective. The researchers explored the knowledge variable in the Hellenic Post-Merger Integration (PMI) of the two companies, and they investigated whether the stakeholders considered knowledge transfer as a key driver in deciding whether to undertake the merger. The researchers conducted the research six months after the conclusion of the merger process and found that knowledge transfer and synergy were the reasons for the merger. Bank leaders tend to focus on the benefits of M&A and overlook the strategy necessary to accomplish successful M&A. Lack of specific strategies aimed at overcoming issues (e.g., social identity problems that arise after M&A) exacerbate the failure rates of M&A **(Baker, 2009).**

SYSTEMATIC RISK AND IMPROVED COST EFFICIENCIES

Examining M&A as a strategy is important to give insight into the primary reasons bank leaders chose to merge banks and important issues left unaddressed in their decision process. In this context, **Fethi, Kumbhakar, Lozano-Vivas, and Shaban (2011)** examined the effectiveness of the merger processes in European banks from 1998 to 2004. Fethi et al. used the stochastic cost frontier approach to estimate the efficiency in profitability and examined any improvements in cost, return on assets, and return on equity to validate these cost benefits as good reasons for undertaking an M&A. Results of the study indicated **improved cost efficiencies** from M&As. **Evripidou (2012)** found market power as the reasons for mergers. Evripidou examined pre-merger and post-merger data from two merged airline companies. Results showed decreased post-merger systematic risk and improved cost efficiencies. In contrast, **Behr and Heid (2011**) studied German banks that underwent M&A from 1995 to 2000. Behr and Heid examined the effects of the mergers on profitability and cost efficiency but found a neutral effect of mergers on both accounts.

INCREASED VALUATION–TAKEOVER BY STRONGER CURRENCY COUNTRY

Erel, Liao, and Weisbach (2012) analyzed a sample of 56,978 cross-border mergers from 1990 to 2007 for evidence of increased valuation after merger. Results indicated that the increased valuation of merged banks could be the primary motivator of a merger. Erel et al. also found that firms in countries with booming stock markets tend to be the acquirers in merger deals. Firms from countries with stronger currencies also tend to be the acquirers, and firms from weaker-performing economies are targets for merger deals (Erel et al., 2012). Examining why M&A are necessary, **Jog and Zhu (2012)** studied large samples of M&A data from emerging countries. Results indicated that target firms benefit from cross-border M&A and cross-border M&A results to reduced risks for the target firm and increases the stock valuation. This assertion was further validated in other studies **(Bhuyan, Ng, &Vaziri, 2010; Goto, Nogata, & Uchida, 2011; Olowe, 2011).**

INCREASED VALUE RESULTING FROM THE ANNOUNCEMENT OF M&AAcquiring banks benefit from increased value resulting from the announcement of M&A. Bhuyan et al. (2010) examined valuation effect of the merger announcement on banks based in the United States and Europe from 2004 to 2010. The researchers used traditional event study method to conduct the study, and results showed 0.3% and 0.8% increases in wealth valuation for merged banks in the United States and Europe, respectively (Bhuyan et al., 2010).

STRONG COMPETITIVE INTERACTION AMONG FIRMS AND PERCEIVED LOW COST FOR RESTRUCTURING

M&A as a strategy have created competitive advantages for banks that had the resources to take advantage of the opportunities (**Mylonakis, 2006). Bernile, Lyandres, and Zhdanov (2011)** examined why firms embark on horizontal mergers. Bernile et al. evaluated empirical evidence based on parametric and semi-parametric regression analysis and found that motivators for undertaking M&A include strong competitive interaction among firms and perceived low cost for restructuring and merging the firms. Bank leaders acquire securities' firms to bolster market share **(Papaioannou, 2011).**

CONCENTRATION ON INCREASING THE DIVERSITY

Sharma (2010) examined M&A in the United States banking industry involving the formation of mega banks by using event study methodology and accounting performance techniques to determine the valuation affects of structural changes. Acquisitions that concentrated on increasing the diversity of the business earned the highest abnormal returns. However, other types of mergers neither created nor destroyed shareholder value.

Some of the studies examined above highlighted the benefits of M&A. Others contend that M&A do not create wealth and do not add value to the merged organization **(Liargovas&Repousis, 2011; Samet, 2010).** This review of literature also revealed that proponents of M&A often do not prepare for the social identity issues that may arise after M&A, and as a result, the goals of several M&A are not attained (Baker, 2009).

FAILED MERGERS: CONTRIBUTING FACTORS

CORRUPTION, FRAUD, AND INSIDERABUSES

Ebimobowei and Sophia (2011) examined the M&A that occurred in the Nigerian banking industry. Using the exploratory research method, the researchers sought to determine the efficacy of the wave of mergers that

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reduced the number of banks in Nigeria from 89 to 25 banks. The aftermath of the mergers resulted in more troubled banks and not stronger and better-capitalized banks, which was anticipated before the M&A. Ebimobowei and Sophia found that corruption, fraud, and insider abuses were some reasons the mergers failed.

INCOMPATIBLE MANAGEMENT CULTURE, MARKETING STRATEGIES, AND EXCESSIVELY OPTIMISTIC FINANCIAL PROJECTIONS

Sagner (2012) found that incompatible management culture, marketing strategies, and excessively optimistic financial projections are reasons some M&A fail. Individuals implementing M&A should examine the corporate cultures of the merging firms and align them to facilitate synergy. Also, marketing strategies should be realigned to reflect the vision and direction of the new company, and merger leaders must refrain from making overly optimistic financial projections and avoid setting unattainable goals.

POOR COMMUNICATION TO EMPLOYEES

Employees of merged banks should be informed in a timely manner. Well-timed communication can help eliminate or minimize speculation and gossip (Addison & L1oyd, 1999). **Addison and L1oyd (1999**) found that the following are primary factors for successful M&A: vision and mission, cultural consideration, teamwork, contingency plans, effective and timely communications, employee education, rewards and recognitions of success, and mechanism monitoring.

TREATING EMPLOYEES AS COST ELEMENTS

The human resources aspects of M&A should be addressed as seriously as are the expected financial returns (**Adjei-Benin &Sanda, 2011; Bhal, Bhaskar, & Mishra, 2012)**. M&A leaders focus on meeting the financial returns expected by investors and emphasize cost cutting, but in the process, leaders may treat employees and payroll as part of the cost elements instead of important drivers of the company's success.

LACK OF VISION

Kalpic (2008) found that bank leaders sometimes embark on M&A efforts to benefit from the competitive advantage and profits that can result from mergers. In the process, bank leaders fail to define the direction of the new company; lack of vision and direction keep the merged companies from optimizing the combined strength. Managers of M&A should define and communicate the vision and mission of the new firm (Addison & L1oyd, 1999).

CULTURAL DIFFERENCES

For international mergers, merging banks should pay attention to national and cultural differences and the potential for knowledge transfer (Sarala&Vaara, 2010; Steigner& Sutton, 2011). Steigner and Sutton (2011) examined if cultural differences between bidder and target banks affect the internationalization benefits of a cross-border merger. **Steigner and Sutton** found that cultural differences affect the performance of bidder banks after M&As. Organizational and national cultural differences can create social identity issues and can provide an opportunity for knowledge transfer (**Bjorkman, Sarala, Stahl, &Vaara, 2010**). Cultural differences are viewed as dividers between employees of acquiring companies and employees of acquired companies, but these differences also provide opportunities for cultural learning (Bjorkman et al., 2010). **Bjorkman et al**. argued that the effects of organizational culture and national culture are different.

BOTH MERGER PARTICIPANTS ARE RELATIVELY INEFFICIENT

Akhavein et al. (1997) found little change in cost efficiency but an improvement in profit efficiency of large US banks from 1980-90 following M&A, especially when both merger participants were relatively inefficient prior to the merger. Also, after merging, banks tended to shift their portfolios to take on more loans and fewer securities. They attribute gains in profit efficiency to the benefits of risk diversification: larger banks have more diversified loan portfolios and lower equity-asset ratios.

WEAK GOVERNANCE

If acquiring banks have weak governance, equity values of banks, on average, do not display positive returns upon the announcement (**Piskula, 2011).** Using the commercially sold governance index from Institutional Shareholder Services, Piskula (2011) measured the governance strength of several banks involved in M&As. Piskula selected banks that were involved in M&A from 2001 to 2006 from the comprehensive Thomson Reuters SDC merger database. Upon announcing M&A, inferior stock market reactions occurred in banks with weak governance, and positive reactions were evident for banks with strong governance (Piskula, 2011).

Strategic objectives and reasons for merger

INCREASE IN SHAREHOLDER VALUE

The aim of most bank mergers in the United States is increase in shareholder value, but **Mehrotra, Spronk, Steenbeek, and van Schaik (2011**) found that mergers in Japan often do not result in increases in shareholder value. Mehrotra et al. studied 91 mergers in Japan from 1982 to 2003 and found that mergers in Japan are determined by the demands of creditors, whereas in the United States, shareholder interests are the primary drivers of M&A. The differing research findings perhaps present an opportunity for further research.

GLOBAL DIVERSIFICATION

M&A have also become a viable tool for internationalization of banks (**Amine, Khan, Uddin, &Zaman, 2011**). Small banks facing financial difficulties sought strategically to merge with the bank that offered them the best synergy (Baker, 2009; Mili&Sahut, 2011). Solvency, size of the firm, and efficiency levels are primary determinants of acquisition opportunity (**García-Suaza Gómez-González, 2010**). Successful implementation of M&A provides opportunities for global diversification that attracts favourable valuation for the merged firms (**Hankir, Rauch, & Umber, 2011; Li, Qiu, & Wan, 2011).**

INCREASE MARKET PENETRATION

Bank leaders diversify risks and increase market penetration via M&A. The goal is to eliminate competition and strengthen their positions in the marketplace by increasing presence in more locations and provision of more diverse products. Acquiring more financial institutions to increase market penetration and eliminate competition did not always work out as it was initially envisioned.

CONCLUSION

Numerous studies have been carried out to determine if Mergers and Acquisitions have been successful in fulfilling the objectives or have been further damaging. The study is aimed to appraise the literature to study Mergers and Acquisitions particularly history of the banking industry, its phases, motives, to find contributing factors of successful mergers and failed merges. The study started with an aim to understand the banking industry and motives and reasons behind M&A and also to find the results post merger.

The contrasting outcomes reveal,great care should be excercised while using M&A in banks. Effective preparations must be made to adequately integrate employees who are acquired in the M&A process. Adequate strategies should be implemented to address the social identity issues that arose with M&A. Appropriate attention must be paid to several issues. Various studiesindicated that human resources remain a thorny issue, which has the potential to derail any merger if not approached and managed strategically and effectively. Human resources management is a vital part of any M&A process, but often ignored (**Anifowose, Atiku, &Genty, 2011).**

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