M&A STRATEGIES IN THE FINANCIAL INDUSTRY

by Sung-Soo Kim

Reform of the Financial Sector Needed

According to a report by the International Institute for Management Development (IMD), the Korean financial industry ranks 40th among the 44 countries surveyed in terms of competitiveness, which attests to the underdevelopment of the Korean financial industry. In the course of Korea's economic development, the Korean financial sector mainly played the role of a monetary distributor for the real sector. This caused the financial industry to lag behind the real sector of Korea's economy in terms of development.

As Korea has now become a member of the Organization for Economic Cooperation and Development (OECD), the Korean financial market is now being opened widely. In addition, foreign financial companies are now able to establish their own subsidiaries in Korea. Thus, domestic financial institutions must now go head to head against tough foreign companies, and the destiny of the Korean financial industry is not optimistic because of the lack of its competitiveness.

Therefore the Korean government has recently undertaken several measures to make financial institutions more competitive. One of the more notable was the establishment of a Presidential Commission on Financial Reform which will be expected to push harder for the restructuring of the local financial industry. The advisory committee will promote the adjustment of business area lines and inter-bank mergers as an enlargement strategy.

Why Allow Mergers and Acquisitions?

The merger and acquistion (M&A) strategy in the local financial industry is needed for the following reasons. First, it will make the domestic financial market more efficient. Up until now, poorly managed financial institutions did not fail because the government provided them safety liquidity for the safety of the local financial system. But now there is the deposit insurance system, which will prevent bank runs by depositors in the event of bankruptcy of poorly managed institutions. Therefore the M&As should be allowed for the efficient exit of poorly managed financial institutions.

Second, the M&A strategy will boost the competitiveness of the financial industry. The managers of institutions will need to show good business performances; otherwise they face the threat of merger and acquisition. And by merging with another institution, they will gain economies of scale and economies of scope. The consolidation of operations and staffs will allow the resulting institution to take advantage of the reduced people cost and thus enhance its competitiveness. Therefore the M&A strategy is expected to have a cost-down effect, a market share effect, and a business diversification effect.

Third, M&A activities will enable domestic institutions to enlarge their capital and better compete with foreign financial companies. At present, domestic banks are relatively small in terms of capital, assets, or any other relevant indicator. Korea doesn't have a single bank which ranks among the top 100 in the world by any of these standards (See Table 1). It is for these reasons that

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〈Table 1〉 World Ranking of Korean Banks (As of 1995)

(unit : million dollar)

Name of Bank	Strength		Size		Soundness		Performance	
	Tier One Capital	Ranking	Assets	Ranking	Capital / Asset Ratio	Ranking	ROE	Ranking
Hanil Bank	2,799	128	37,270	173	7.51	343	4.9	804
Korea Exchange Bank	2,433	144	46,238	146	5.26	621	10.5	640
Cho Hung Bank	2,349	149	35,911	180	6.54	455	7.8	722
Korea First Bank	2,232	154	35,151	184	6.35	477	1.2	874
Commercial Bank	2,026	168	31,178	208	6.50	462	7.5	727
Seoul Bank	1,778	184	44,420	152	4.00	791	n/a	n/a

Source: The Financial Times, *The Banker*, Jul. 1996.

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the government is so very interested in the M&A of banks and made the legislative arrangements for the M&A of financial institutions last fall.

Elsewhere in the World

Let us look at M&As in the financial industries of other countries. In the United States, M&A activities have been from the late 1980s due to financial deregulation, the broadening of state business areas, restructuring processes, and the settlement of poorly managed financial institutions, among other reasons. During the period between 1990 to 1994, an average of 423 bank M&As occurred each year. In particular, 15 large-scale (asset size of over $10 billion) bank M&As happened on average per year. Large-scale banks with stable management would make autonomous mergers into bigger bank. For example, through a merger with Chemical Bank last year, Chase Manhattan emerged as the largest bank in the United States. In the process of the bank merger, the new Chase saw a reduction of 12,000 workers and a closure of about 100 branches. Such a downsizing has ultimately resulted in a hike in the efficiency and international competitiveness of the new Chase.

In Japan the collapse of the bubble economy in the early 1990s resulted in a number of poorly managed banks being merged into superior banks. Inter-bank mergers also occurred to boost their size and also their competitiveness relative to U.S. and European banks. The primary example is the Tokyo-Mitsubishi bank. In April 1996, the Tokyo bank and the Mitsubishi bank merged to form the largest bank in the world in terms of asset size.

〈Table2〉 Primary Examples of Foreign Bank Mergers

	Merged Bank	Merging Bank	Bank After Merger	Year
	Chemical(27)	Chase Manhattan(37)	Chase Manhattan[20]	95
USA	First Union(74)	First Fidelity(149)	First Union [81]	〃
	First Chicago(76)	NBD(102)	First Chicago NBD	〃
	Mitsui(21)	Taiyo Kobe(34)	Sakura[10]	90
Japan	Kyuwa(50)	Saitama(66)	Asahi[32]	91
	Mitsubishi(9)	Tokyo(22)	Tokyo-Mitsubishi[1]	96

Note: The numbers inside the parentheses ( ) represent their world rankings in terms of asset size at the time of the merger. The numbers inside the brackets [ ] represent their world rankings as of July 1996.

Possible in Korea?

In Korea, the M&As of firms are a relatively less common phenomenon, partly because of cultural differences with the West. However, the government has already cleared all legal barriers to the merger of financial institutions last year through the amendment of the Financial Industry Restructuring Act and the Security Trading Act. Last year there were many mergers between mutual savings & finance companies in which small and poorly managed companies were merged into superior ones. This year the winds of M&A are expected to blow into the area of securities companies and insurance companies. Especially in the banking area, there have been various merger scenarios among banks. As an effective way to sharpen the international competitiveness of the local financial industry, the government is striving for the restructuring of the domestic financial industry.

However, it is not guaranteed that consolidations will really provide the economic ability to drive down costs. Especially in Korea, sharing a similar corporate culture is a key to success in the merger or acquisition of banks. For example, the Seoul Bank and Korea Trust Bank were merged into the Seoul Trust Bank in 1976, but that merger turned out to be a failure due to a lack of harmony among the departments. Therefore, despite the government's wish to create giant banks through mergers and acquisitions, South Korean banks are likely to struggle independently for some time until the losers cry out to be rescued. VIP

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