

ACCELERATING MERGERS IN THE BANKING INDUSTRY AND FUTURE PROSPECTS OF ITS RESTRUCTURING

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Financial Restructuring Underway

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The year 1998 will be remembered by many Koreans as the year for financial restructuring. In particular, the restructuring of the banking industry is quite striking because the Korean people have never experienced a similar situation before.

In April, twelve financially unhealthy banks, designated as such according to their BIS capital adequacy ratios, submitted their rehabilita-

tion plans to the Financial Supervisory Commission.¹⁾ After the evaluation was finished, the rehabilitation plans of seven banks were approved conditionally, while the plans of five relatively small banks were not approved. As a result, those five small banks have been cleared out from the financial market by the P&A (Purchase and Assumption) method. On the other hand, seven remaining unhealthy banks have been given a chance for survival. They have been seeking an efficient way to strengthen their capital structures by consider-

〈Table 1〉 Financial Statistics on Banks Announcing Mergers¹⁾

(trillion won, %)

	Commercial Bank - Hanil Bank			Hana Bank - Boram Bank			Kookmin Bank - Korea Long Term Credit Bank		
	CB ²⁾	HB ³⁾	Total	HNB ⁴⁾	BB ⁵⁾	Total	KB ⁶⁾	KLCB ⁷⁾	Total
Total Assets	50.04	55.12	105.16	23.68	17.44	41.12	64.70	35.90	100.60
Capital	1.99	2.10	4.09	0.89	0.48	1.37	2.36	1.38	3.74
Number of Branches	486	456	942	111	105	216	511	45	556
Number of Employees	7,810	7,492	15,302	1,709	1,565	3,274	12,710	1,012	13,722
NPL/total loans ⁸⁾	6.88	7.00	6.94	3.30	5.15	4.18	5.30	8.48	6.43
BIS ratio	3.28	4.53	-	13.25	11.28	-	12.00	9.61	-

* Source : Banking Supervisory Unit

* Notes : 1) End of June 1998, 2) Commercial Bank, 3) Hanil Bank, 4) Hana Bank (Excluding financial statistics on Chungchong Bank which was taken over by Hana Bank), 5) Boram Bank, 6) Kookmin Bank, 7) Korea Long Term Credit Bank, 8) NPL means non-performing loans

1) In this article, an unhealthy bank is defined as one that did not meet the BIS capital adequacy ratio of 8% at the end of 1997, while a healthy bank is defined as one that did meet the ratio.

ing mergers and trying to induce both foreign and domestic capital. At the same time, relatively healthy banks, which did not submit rehabilitation plans, are seeking ways to survive under the changing financial environment.

The Recent Mergers

After the announcement of the merger between Commercial and Hanil Banks on July 31, two more mergers were announced recently. Those two pairs are Hana-Boram Banks and Kookmin-Korea Long Term Credit Banks. This series of mergers shows that most banks are now considering mergers as a key restructuring tool in line with the government's continuous wishes.

Initially, both Commercial and Hanil Banks did not give priority to a merger as a restructuring method. Instead, they tried to induce fresh capital from both domestic and foreign institutions, even though they were categorized as unhealthy banks. However, they reached an agreement on the merger as the government decided to support unhealthy banks' recapitalization only in the event of a merger. The symbolic importance of their merger is their asset size after merging. Even as separate banks, both were among the biggest in the Korean banking industry in terms of asset size. By simply adding them up, their asset size grows to above 100 trillion won, which is almost double compared to the asset size of other currently representative big banks.

While Commercial-Hanil Bank is a merger between two unhealthy banks, Hana-Boram Bank is a merger between two relatively healthy banks. The announcement of their merger was done on the basis of the strategy that the merger can become a starting point toward becoming a leading bank in the future.

The government's intention to support recapitalization if they merge was also one of the key reasons for reaching an agreement on the merger.

Nobody expected the announcement of the merger between Kookmin Bank and Korea Long Term Credit Bank. This merger is noteworthy in two aspects. First, it is the first merger between two healthy big banks. Second, it is the first merger between two banks which specialize in different banking areas. Initially, both banks did not consider mergers as a method for restructuring. However, as the government pressured Korea Long Term Credit Bank to consider a merger with unhealthy banks and the two other mergers were announced, the negotiations for the merger between the two banks proceeded further.

Upon Closer Examination

Analysts are evaluating the recently announced mergers positively for two reasons. First, the mergers are accelerating the restructuring process of the whole banking industry. Second, the mergers involve healthy banks as well as unhealthy banks.

However, in order to evaluate the three mergers more completely, we must examine at least four issues. The first issue we must discuss is whether these mergers will be successful for the recapitalization of the involved banks. In the case of mergers between unhealthy banks, the merged banks' capital structure may still not strong if the government does not provide enough support. For instance, the approximate recapitalization cost estimated by Commercial and Hanil Banks reached 8 trillion won, while the government decided to provide support of only 4 trillion won for the merged bank. On the other hand, in the case of the merger between healthy banks, it is highly

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possible to fully recapitalize because the announcement of the merger itself will be good news for inducing fresh capital.

The second issue is whether the merged banks are big enough in terms of size. In conclusion, their sizes are fair enough for first-step mergers. The three mergers produce two megabanks whose assets total more than 100 trillion won and one big bank whose assets grow above 40 trillion won, which is close to the asset size of banks that are currently categorized as big banks.

The third issue we must investigate is whether the merged banks can become economically efficient. This will be possible in the case of the merger between two banks that are specialized in different banking areas or have similar structures in terms of manpower and culture. In particular, the merger between two highly productive banks can be an opportunity for banks to be internationally competitive either by acquiring fresh capital or by proceeding to second-step mergers. However, in the case of the merger between two banks that have similar banking area or have branches located nearby one another, it will be difficult to acquire economic efficiency.

Finally, it is worthwhile to discuss a few problems found in the processing of the mergers. Since the government unreasonably forced healthy banks to merge with unhealthy banks, the mergers between healthy banks were announced too early without detailed negotiations about the conditions of the merger. Even after restructuring in the banking industry is finished, the problems of the government's intervention may remain because the government has plans to give fresh capital to banks taking a common stock. In addition, a reduction in the total number of employees will be very difficult as long as there is no social consensus made about labor market flexibility. This means that one of the most important and

necessary conditions for successful mergers has not yet been guaranteed.

Future Mergers

It is a difficult task to forecast how the remaining banks restructure to survive. One clear thing, however, is that regardless of being healthy or not, most remaining banks will continue pursuing mergers and acquiring fresh capital from both domestic and foreign sources. This expectation is given based on the government's intention that both liquidation and P&A (Purchase and Assumption) will not be used as restructuring methods. On the basis of this framework, the restructuring of the three groups of remaining banks will be slightly different. Basically, healthy banks are expected to try inducing fresh capital mainly from foreign financial institutions. However, we cannot rule out the possibility of mergers between healthy banks if the government forces them to merge with unhealthy banks as before.

The remaining unhealthy banks do not have choices for restructuring. The government's shares in one of the two banks, Korea First Bank and Seoul Bank, will be sold to foreign financial institutions. However, the other unhealthy banks will have a difficult time to find partners for mergers because no healthy bank wants to merge with an unhealthy partner and the government has objected to mergers between unhealthy banks. For these reasons, it will not be easy to induce foreign capital as well.

Finally, regional banks will try to merge with nationwide banks as a first step. It is possible for them to develop second step mergers with big commercial banks right after those big banks' first-step mergers are finished. **VIP**

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