NOTRE DAME UNIVERSITY - LOUAIZE

MERGERS AND ACQUISITIONS IN THE LEBANESE BANKING INDUSTRY

by

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A project
submitted in partial fulfillment of the requirements
for the degree of Master of Business Administration
to the Department of Business Administration
of the Faculty of Business Administration and Economics
at Notre Dame University - Louaize

Zouk Mosbeh, Lebanon
July 2000

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Date of project presentation: July 4, 2000.

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ACKNOWLEDGEMENTS

I would like to thank my first reader, Dr. Paul Abboud for his assistance and valuable remarks.

My deepest gratitude is also addressed to Dr. Hratch Hadjetian for his kindness and interest.

My recognition goes to all my teachers throughout the years I spent at Notre Dame University - Louaize for their devotion and the knowledge they made me acquire.

Last but not least, I thank my parents for their love, continuous care and support. I would also like to send my regards to all the persons who contributed in the completion of this project.

AN ABSTRACT OF THE PROJECT OF

Stephanie Said Malaab for Master of Business Administration

Title: Mergers and Acquisitions in the Lebanese Banking Industry

The occurrence of mergers and acquisitions is not new in the United States. American companies have become accustomed since the late 1880's to such activities. Yet, nowadays, consolidations have become more important both in dollar volume and number. Corporations are making use of mergers and acquisitions as a tool to be more competitive in our fast changing world where advanced technology and globalization are affecting everything. The US banking industry is a major constituent of the consolidations taking place and which resulted in the occurrence of important mutations in the sector over the last decade.

It seems that Lebanon is also following this trend. Although in other industries consolidations are practically nonexistent, the Lebanese banking sector is witnessing an important number of mergers and acquisitions. Lebanese banks are facing many challenges: increasing local and foreign competition, more severe regulations, and a constantly developing technology. In order to survive, Lebanese banks, considered as small in size relatively to foreign ones, have to find partners with whom to consolidate.

This paper will try to provide a better understanding of mergers and acquisitions by discussing:

- the several phases of mergers and acquisitions that American companies have gone through
- the motives behind mergers and acquisitions
- the trend, motives, and regulations of bank mergers in the United States
- the occurrence, motives and regulations of bank mergers in Lebanon
- the effect of Lebanese bank mergers on the concentration.

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CHAPTER I

INTRODUCTION

Over the last four decades, mergers and acquisitions have become one of the vital tools in the hand of American companies in order to compete effectively. When done for the right reasons and in the right way, mergers and acquisitions can be very effective in helping companies deal with globalization and other changes in a fast changing world and industry.

In the United States, the banking industry is consolidating at an unprecedented pace. In the 1980's, bank failures precipitated much of the consolidation. But in the 1990's, shrinkage in the industry is more often associated with competitive factors and the changing regulatory environment.

In the past few years, it seems that the banking industry in Lebanon has also caught the fever. Since 1994, there have been more than 16 mergers and acquisitions between banks in Lebanon. It is believed that consolidations can accrue gain by achieving scale economies through cost reduction, increased market power, etc.

The issue of mergers and acquisitions is receiving the attention of many bankers, financial advisors, and analysts. It is said that many small to medium-sized banks will start searching around for partners to keep up with those that have already been part of a merger.

Also, the Central Bank is encouraging mergers between banks. It imposed a limit to open new branches to two a year, forcing banks wanting to increase their market share rapidly to either search for acquisition targets or find allies to merge with. In addition, the Central Bank is offering soft loans to merging banks.

Some at the forefront of finance deny there will be a spate of mergers happening any time soon. But Riad Salamé, Governor of Banque du Liban, says resolutely that there is one determining factor: "We (the Central Bank) think that the market will decide which banks will stay, whether they are small, medium or large, and which banks will merge (Jeffrey, 33)."

This research will try to help us have a greater understanding of the reasons, effects, and regulation of bank mergers and acquisitions. It will first discuss the several phases of the phenomenon of mergers and acquisitions in the United States throughout contemporary history (Chapter 2), then the motives behind mergers and acquisitions in general (Chapter 3), then the trend, the motives, and the regulations behind the mergers and acquisitions in the banking industry of the United States (Chapter 4) and in Lebanon (Chapter 5), and finally there is a small study made to find out whether there is a change in market concentration resulting from bank mergers (Chapter 6).

CHAPTER II

MERGERS AND ACQUISITIONS PHASES:

THE AMERICAN EXPERIENCE

Historically, four phases of mergers and acquisitions, or as they are called merger waves, took place in the United States. We are currently in the fifth wave according to Mr. Alan Greenspan, the chairman of the Federal Reserve Board. Merger activity in the United States is of an irregular cyclical nature (Green, 3). That is, these waves are characterized by periods of high merger activity followed by rather lower merger activity. The importance of these waves lies in the fact that they have altered the American industry from a collection of small to medium size businesses to multinational corporations. Each of these mergers phases occurred due to distinct causes and generated different results.

A- The First or Monopoly Phase

The first phase, the monopoly phase, was stimulated by the desire to build the large but ephemeral trusts (Green, 3). It first started after the 1883 Depression and peaked between the years 1898 and 1902. This phase placed a permanent imprint on the structure of the United States economy. It had an effect on all main mining and manufacturing industries, yet eight industries were subjected to the greater merger activity. These include: primary metal industry, food products industry, petroleum products industry, chemicals industry, transportation equipment industry, fabricated metal products industry, machinery industry, and bituminous coal industry (Gaughan, 10-13).

In this first phase, mergers were mainly horizontal the thing that lead to a monopolistic market structure. The first megamerger occurred in this first wave when J.P. Morgan created the first billion-dollar corporation, U.S. Steel, in 1901, a deal more important than all the others of that year combined (Colvin). As a result of this phase, many of nowadays' multinational corporations were created. We can cite Standard Oil, General Electric, American Tobacco Inc., Du Pont Inc., USX Corporation (previously U.S. Steel), Eastman Kodak, and Navistar International (previously International Harvester).

Many are the reasons behind the high merger activity in the first phase. On the legal side, although the Sherman Act was enacted in 1890, it did not hinder the consolidation activity going on. In addition, corporations at that time were more able to acquire capital, buy other corporations' shares, and develop their business, due to relaxed state corporation laws. The simple access to obtain capital and the relaxed rules concerning the stockholdings of corporations made it easier for corporations to acquire others.

The development of the U.S. transportation system played a major role in the creation of the first merger wave. Due to the creation of many chief railroads that linked regions to each other, the market that each corporation could serve grew larger and the intensity of competition became very strong. In order to keep their market share, many companies preferred to merge with local competitors.

The first merger phase ended with the stock market crash of 1904 and the panic of 1907. Many US banks that were financing the expansion of companies closed down.

Due to weak banking system and the declining stock market, the high merger activity at that time was brought to an end.

B- The Second or Oligopoly Phase

In opposition with the first phase where many monopolies were created and horizontal integration applied, the second phase was distinguished by the birth of many oligopolies due to the vertical integration applied (Green, 6)

This merger wave was a result of the post-World War I economic boom, which provided large amounts of capital to be invested and let the American economy keep on evolving. The vertical integration was due to the fact that the antitrust laws became more severe than during the first phase. The Clayton Act, which was originally enacted in 1914, prohibits mergers and acquisitions that are likely to result in a substantial lessening of competition. This law was brought up in order to reinforce the antimonopoly provisions of the Sherman Act. Due to the severity of the antitrust environment that was reigning, many companies merged vertically with their suppliers or customers, and the first large-scale conglomerates were created. Many industries consolidated, including utilities, communications, and autos. During this period, Samuel Insull built a utilities empire (Colvin) and a total of 4,600 mergers took place between the years 1926 and 1930. Similarly to the first phase, investment bankers encouraged the merger activity in the second phase by supplying the needed capital to finance merger deals.

As in the first phase, the second merger wave was ended by the stock market crash in 1929. Due to this crash, the consumer consumption and business investments decreased due to some financial loss of confidence. The main focus of companies was to maintain solvency, rather than expand, in order to face the fast and widespread decrease in demand.

C- The Third or Conglomerate Phase

The third phase was referred to as the conglomerate wave. Many conglomerate mergers were based on the belief that at least the management skills required by a new acquisition be alike, and in contrast with the previous two waves, during this wave, many smaller companies sought out larger ones for acquisitions (Green, 6). This period was the mania of diversification where many companies performed much of their business activities in diverse industries. Examples from this period include ITT, Gulf & Western, and LTV. On the contrary of the first and second phase, here investment bankers did not finance most of the merger deals.

The conglomerate wave was the result of many factors. First, the antitrust environment was hindering companies from expanding, especially with the newly elaborated Celler-Kefauver act in 1950, which is a modification of the Clayton Act. Second, horizontal mergers were not accomplishing the returns previously foreseen. And third, many believed in the theory of diversification which says that business cycles' risks can be reduced through diversification.

Also, during this wave, stock prices reached very high prices and the Dow Jones Industrial Average (DJIA) increased from 618 in 1960 to 906 in 1968. Because stock prices were going higher and higher, prospective bidders knew that acquisitions financed by stock will be an outstanding way to raise their earning per share without suffering from higher taxes.

This continuity of the third phase was condemned due to the downturn in the stock market and the more stringent regulatory environment in the late 1960's.

D- The Fourth or Agglomerate Phase

The fourth wave, an agglomerate one, is differentiated by acquisitions that are not functionally related in any way to the parent company. Here, the split-up merger is common. This means selling off the acquired firm's component pieces, the thing which produced a divestiture boom. Also, this phase was characterized by many hostile takeovers (Green, 6).

The merger mania that occurred in the 80's has many reasons:

- The low dollar value relative to the Japanese and European currencies, which resulted in U.S. companies looking cheaper to foreign buyers.
- The exceptional level of inflation that existed during the 1970's and early 1980's, which increased the replacement value of firms' assets even while a weak stock market reduced their market values.
- The more lenient approach toward large mergers during the Reagan and Bush administrations where "bigness is not necessarily badness".
- Major natural resource companies had the common conviction that it was less expensive to "buy reserves on Wall Street" through mergers than to explore and find them in the field.
- Efforts to protect against raiders through the use of defensive mergers.
- The expansion of the junk bond market, which made it feasible to use far more debt in acquisitions than had been possible before.

- The enlarged globalization of business, which has resulted in increased economies of scale and the creation of worldwide corporations (Brigham, 834-5)

Although most of the deals that occurred in the fourth phase were not hostile, the significant hostile confrontations that took place were the principal unique characteristic that differentiated this phase from the precedent ones. Hostile cross-border deals also increased. Many foreign acquirers had recourse to unwelcome offers for U.S. companies; the largest of these were Grand Metropolitan PLC's acquisition to Pillsbury and Beazer PLC's acquisition of Koppers Co. Hostile mergers also emerged within Europe: Nestle S.A. acquired Rowntree PLC, Siemens AG and General Electric Co. PLC jointly took over a competitor, Plessey PLC.

Some of the US's largest firms became targets of acquisitions in the fourth phase which was the phase of the megamergers, or the billion dollars mergers. Many of the inefficient companies whose management failed to provide shareholders an acceptable return were sold or broken into more efficient subunits. As a result, we can say that the fourth merger wave fulfilled the aim of regulating and controlling management since inefficient management must still take the threat of being taken over seriously.

Unlike the earlier merger phases, the fourth one was distinguished by the utilization of junk bond financing, leveraged buyouts, and aggressive takeover tactics.

1- Junk Bond Financing

Junk bonds, which are high-risk, high-yield, and low investment ratings bonds, were essential sources to finance acquisitions in the fourth phase. These bonds were particularly common with corporate raiders and hostile acquirers.

Junk bonds were crucial financing means in the mid-1980's with the acquisition of Northwest Industries, Inc. by Farley Industries, the takeover of T. Boone Picken for Unocal, Inc., the bid of Carl Icahn for Uniroyal, Inc., and Sir James Goldsmith's bid for Crown Zellerbach Corp. One of the most exposed junk bond bids was the proposal of Atlanta broadcaster Ted Turner in 1985 to take over CBS, Inc. Although Turner Broadcasting System, Inc., Turner's own company, had a net worth of about $200 million, yet it made-a-run at giant CBS with a package of securities, mostly junk bonds, carrying a face value of about $5 billion (Rock, 231).

The junk bond market collapsed in 1990 mainly because of the stock market crash in 1987 and because of the condemnation of its founder, the "junk bond king", Michael Milken (Brigham, 753).

2- Leveraged Buyouts

The leveraged buyout (LBO) is a situation in which the managers of the firm borrow heavily against the assets of the firm and purchase the company themselves (Brigham, 848).

The factors that encouraged the LBO boom are mainly depressed stock prices, the pressure on public corporations to deprive operating units, and the rapid increase in both the number and types of LBO financing sources (Rock, 355).

LBO's were structured in a way to take advantage from the value gap between the acquisition cost of unwanted corporate assets and their financial value. The LBO craze peaked in 1988 when Kohlberg, Kravis, and Roberts (KKR), took RJR Nabisco private for $24.8 billion. This was America's biggest deal in 87 years and, adjusted to inflation, would still rank between the top ten (Colvin). The number of LBO's doubled every three years from 1980 till 1988, increasing from 13 to 125 in actual numbers.

3- Takeover Tactics

Both aggressive and defensive tactics of hostile takeovers became increasingly sophisticated. Investment bankers and legal advisors reached high limits of creativity in the pursuit of their clients' takeover aspiration. With the development of each new takeover tactic, new defensive strategies evolved to adapt to the tactic. The most common takeover tool in that phase was the tender offer. During this period, hostile bidders profited from their access to the junk bond market, to acquire large amounts of debt financing to pursue megadeals.

The fourth merger phase ended in 1989 mainly because of the stock market crash of 1987 and the related collapse of the junk bond market and the failure of Drexel Burnham Lambert.

E- The Fifth Phase: 1993 – ?

In the latest stage of the fourth merger phase, the expected returns to be earned from mergers and acquisitions were not as expected due to the high prices paid in acquisitions and LBO's. This made the mergers and acquisitions rate decline until 1993.

Also, with the drop in demand due to the 1990-1991 recession, and due to the highly leveraged balance sheets resulting from the excesses of the 1980's, many companies worked on issuing equity in order to reduce their leverage.

Furthermore, the world economic outlook changed due to the many uncertainties generated by the Gulf War, the creation of the European Common market, the dismantling of the Soviet Union, and the fall of communism in Eastern Europe (Encarta). All these events were causes of the decrease in mergers and acquisitions activity.

In the middle of 1993, the DJIA rose to 3,600 the fact which encouraged potential bidders and increased their ability to pay higher prices for their acquisitions. Through the first three quarters of 1993, there were ten announced deals, each with a value of 2 billion dollars or more.

The following table lists the ten largest announced deals of 1993:

Table 1. The Ten Largest Announced Deals in 1993

Buyer / Seller	Value (in US$ Millions)
Bell Atlantic Corp. / Tele-Communications Inc.	16,000
AT&T / Mc Caw Cellular	12,600
QVC Network / Paramount	9,900
KeyCorp. / Society Cop.	7,800
Merck & Co. / Medco Containment Services	6,000
Columbia Healthcare Corp. / HCA Hospital Corp.	5,700
Costo Wholesale Corp. / Travelers Corp.	4,600
Primeria Corp. / Travelers Corp.	4,200
Tele-Communications Inc. / Liberty Media Corp.	3,800
British Telecommunications PLC/ MCI Communications	3,400

Source: Miller.

Since 1993, merger activity is increasing at a very high rate. Journalists describe the current wave as "By any measure, the biggest deal wave in history" (Colvin), and "Today's mergers and acquisitions make the 1980's look smalltime" (Miller).

Today's overcapacity is driving companies together willingly, resulting in friendly mergers, on the contrast of the Hostile takeovers of the 1980's. In addition, mostly stocks or cash, in contradiction with the junk bonds used in the 1980's, finance these deals. Table 2 illustrates the differences in acquisition between two years: 1988 and 1998.

Table 2. Difference in merger methods between 1988 and 1998

	Year 1988	Year 1998
Financing		
Stock	7%	67%
Cash	93%	33%
Total	**100%**	**100%**
Takeover		
Friendly	71%	96%
Hostile	24%	1%
Other	5%	3%
Total	**100%**	**100%**

Source: Colvin.

In addition, mergers during this phase have surpassed previous ones by dollar volume and number. In 1998, consolidations were occurring at the rate of 200 per week or more than one per hour. Also, in 1998, merger and acquisitions activity in the U.S. reached $1.6 trillion (the biggest year of the 1980's was 1989 with $600 billion), which is equal to 20% of the gross domestic product. Also, if we assume the resulting fees generated for investment bankers, lawyers, accountants, printers and restaurants amount to 5% of the purchase prices, we can say that the business of buying and selling companies represented 1% of the economy in 1998. Also, it seems that it is the size, rather than the number of deals, which is resulting in the growth of mergers and acquisitions. A 2% increase in the number of deals in 1998 over 1997 yielded to an increase of 80% in value (Smithers).

Furthermore, the current phase is characterized by the proliferation of cross-border deals. Illustrating this case were the deals between Vodafone (UK) and Airtouch Comms (US) worth $65.9 billion (Billion, November 1999, 83), between British Petroleum (UK) and Amoco (US) worth $55 billion, between Daimler Benz (Germany) and Chrysler (US) worth $40 billion, and many others (Billion, February 1999, 21).

Unlike the merger wave of the 1980's, in which financial buyers brought companies to break them up, the current wave shows companies in the same industry joining together to achieve pricing power and economies of scale (Colvin). The deals in the 1990's are more strategically oriented. For example, big supermarket chains are incurring a large number of mergers. Grocery wholesalers have thinned from 366 firms in 1986 to 97 in the beginning of 1999, with more deals expected. AT&T bought McCaw Electronics because it wanted to add a major cellular phone maker to its existing service ability in telephones. Also, Merck, one of the world's largest drug manufacturers, acquired Medco, one of the largest wholesale drug distributors, in an attempt to realize scale and scope economies and obtain a competitive edge within the pharmaceutical industry.

The following table illustrates the top ten deals of 1998 (announced, outstanding or completed):

Table 3. Top Ten Deals of 1998

Companies	Industry	Value ($million)	Announcement Date	Completion Date
1- Exxon Mobil	Oil and gas Oil and gas	86,355	01/12/1998	Pending
2- Travelers Group Citicorp	Diversified financial Bank holding	72,558	06/04/1998	08/10/1998
3- SBC Communications Ameritech	Telecommunications Telecommunications	72,356	11/05/1998	Pending
4- Bell Atlantic GTE	Telecommunications Telecommunications	71,323	28/07/1998	Pending
5- AT&T Tele-Communications	Telecommunications Cable television	69,896	24/06/1998	Pending
6- Nationsbank BankAmerica	Bank holding Bank holding	61,633	13/04/1998	30/09/1998
7- British Petroleum Amoco	Oil and Gas Oil and Gas	55,040	11/08/1998	Pending
8- Daimler-Benz Chrysler	Motor vehicles Motor vehicles	40,466	07/05/1998	12/11/1998
9- Norwest Fargo	Bank holding Bank holding	34,352	08/06/1998	02/11/1998
10- Banc One First Chicago NBD	Bank holding Bank holding	29,616	13/04/1998	02/10/1998

Source: Colvin.

According to Alan Greenspan, the first three phases of mergers and acquisitions did produce important increases in economic concentration in manufacturing as industrialization speeded up with the shift of resources out of agriculture into many new growing industries. But he views that the more recent waves do not appear to have materially distorted industry structure, perhaps due to the increased malleability of the more mature and competitive industrialized U.S. economy. The consequences from the present merger phase on concentration have yet to be determined, but, Greenspan says, there is few reasons to expect their influence will differ considerably from the merger wave of the 1980's which generated at most a small rise in manufacturing concentration.

According to the history provided from the previous mergers and acquisitions waves, we can say that the only thing that can slow this wave down is a market stumble. Deal volumes dropped sharply in September and October 1998 but snapped back when the market did. "A longer slump would slow today's stock-based deals, but could bring the LBO guys back into the picture (Colvin)."

CHAPTER III

MOTIVES BEHIND MERGERS AND ACQUISITIONS

The reasons why companies consolidate are many and always coexist. In this section, we are going to discuss the main motives behind mergers and acquisitions.

A- Synergy

During the peak of the conglomerate merger phase in the late 1960's, synergy, exaggeratedly, was known as the "2 + 2 = 7" effect. The theory behind the synergy effect states that a merged firm would engender much better results than its constituent parts would if they remained independent entities (Rock, 35).

The synergies that produce these benefits can be divided under three classifications: operating synergy, financial synergy, and strategic realignment.

1- Operating synergy

Operating synergy, or operating economies, may result from both horizontal and vertical mergers.

a- Horizontal mergers

For horizontal mergers, operating economies stem from economies of scale and economies of scope.

Economies of scale, by definition, "represent the increases in productivity, or the decreases in average cost of production, that arise form increasing all the factors of production in the same proportion" (Nordhaus, 735). In other words, as output increases, the additional cost of producing one more unit of a certain product decreases. Also, more gains accrue from the learning curve effect; as labor and management become more specialized, efficiency increases and the level and frequency of errors decreases.

Economies of scope are the "economies of producing multiple goods or services. Thus economies of scope exist if it is cheaper to produce both good X and good Y together rather than separately (735)". Economies of scope arise when significant elimination of duplicate resources is achieved. It is also the ability of two firms to utilize one set of inputs to provide a broader range of products and services.
These economies may mirror indivisibilities and better exploitation of capacity after the merger.

<u>b- Vertical mergers</u>

The act of combining firms at different stages of an industry may achieve more efficient coordination of the different levels in the case of vertical integration. The case here is that costs of communication and various forms of bargaining, and opportunistic behavior can be avoided by vertical integration (Rock, 35). In the case of backward integration, the company can reinforce its position by having lower costs. Having lower costs, the company will be able to sell at lower prices and thus have a comparative advantage over its competitors. Likewise, in forward integration, the company will have stronger marketing and retail capability and consequently lower its marketing and distribution costs.

2- Financial Synergies

Financial synergy advocates argue that the cost of capital function may be lowered for a number of reasons as a result of merger. Bankruptcy probabilities may decrease if the cash flow streams of the two companies are not perfectly correlated. The fundamental view in finance theory is that if firms could fail and new ones formed to take their place without costs, bankruptcy would not matter. But the losses or costs from the failures of firms may sometimes be considerable. These losses include two types of costs: direct and indirect ones. Direct costs are the ones related to legal and other administrative fees. Indirect costs include the loss of key managers and employees, as well as a loss of customers. Maybe the principal indirect cost of bankruptcy is the loss of an effective functioning organization that took years to develop. These direct and indirect losses are capable of reducing the value of creditor's claims and eliminate the value of shareholder's equity. As a result, as long as mergers that reduce the instability of company revenue streams can decrease bankruptcy and its attendant costs, stockholders, creditors, and society as whole would benefit (Rock, 35).

The debt coinsurance effect benefits debtholders at the expense of shareholders. Nevertheless, increasing leverage after the merger can compensate for this effect, and as a result, increase tax savings on interest payments.

Also, Levy and Sarnat emphasized that economies of scale in flotation and transactions costs may be realized between combining companies.

3- Strategic Realignment to Changing Environments

The strategic planning approach to mergers appears to imply either the possibilities of economies of scale or tapping an underused capacity in the firm's present managerial capabilities.

Another reasoning implies that by external diversification, the firm acquires management skills for needed augmentation of its present capabilities. This still leaves some questions unanswered. After all, new capabilities and new markets could be developed internally. But it may be that timing is important in capturing growth opportunities. The speed of adjustment through merger would be quicker than internal development. There may be opportunities to realize synergies in managerial capabilities (36).

B- Target Undervaluation

Some studies attribute merger motives to the undervaluation of target companies. One cause of undervaluation may be that management is not operating the company up to its potential. This is then an aspect of the inefficient management theory. A second possibility is that the acquirers have inside information. How they acquired this special information may vary with circumstances, but if the bidders possess information which the general market does not have, they may place a higher value on the shares than currently prevails in the market.

Another aspect of the undervaluation theory is the difference between the market value of assets and their replacement costs. One frequently discussed reason that firms stepped up acquisition programs in the late 1970's is that entry into new product market areas could be accomplished on a bargain basis. Inflation had a double-barreled impact. For various reasons supposedly including inflation, stock prices were depressed during the 1970's and did not recover until the latter part of 1982 as the level of inflation dropped and business prospects improved. The second impact of inflation was to cause current replacement costs of assets to be substantially higher than their recorded historical book values. These twin effects resulted in a decline of the q-ratio, defined as the ratio of the market value of the firm shares to the replacement costs of the assets represented by their shares. In the late 1970's and early 1980's the q-ratio had been running between 0.5 and 0.6. If a company wished to add to capacity in producing a particular product, it could acquire the additional capacity more cheaply by buying a company that produces the product rather than building from scratch. If firm A seeks to add capacity, this activity implies that its marginal q-ratio is greater than 1. But if other firms in its industry have average q-ratios of less than 1, it is efficient for firm A to add capacity by the purchase of other firms. For example, if the q-ratio is 0.6 and if in a merger the premium paid over market is 50%, the resulting purchase price is 0.6 times 1.5, which equals 0.9. This means that the average purchase price would still be 10% below the current replacement costs of the assets acquired. This potential advantage would provide a broad basis for the operation of the undervaluation theory in recent years when the q-ratio was low (Rock, 36-7).

C- Managerial Motives

Three main theories discuss the managerial motives for mergers and acquisitions. They are the following: the agency theory, the managerialism theory, and the free cash flow theory.

1- Agency Theory

Jensen and Meckling (1976) formulated the implications of agency problems. An agency problem arises when managers own only a fraction of the ownership shares of the firm. This partial ownership may cause managers to work less energetically than otherwise and/or to consume more privileges (luxurious offices, company cars, memberships in clubs) because the majority owners bear most of the cost. Furthermore, the argument goes, in large corporations with widely dispersed ownership, there is not sufficient incentive for individual owners to expend the substantial resources required to monitor the behavior of managers. According to E. Fama (1980), a number of compensation arrangements and the market for managers may mitigate the agency problem.

H. G. Manne states that when these mechanisms are not sufficient to control agency problems, the market for takeovers provides an external control device of last resort. A takeover through a tender offer or a proxy fight enables outside managers to gain control of the decisions processes of the target while circumventing existing managers and the board of directors. Manne emphasized mergers as a threat of takeover if a firm's management lagged in performance either because of inefficiency or because of agency problems.

2- Managerialism

In contrast to the view that mergers occur to control agency problems, some observers consider mergers as a manifestation of agency problems rather than as a solution. The managerialism explanation for conglomerate mergers was set forth most fully by D. C. Mueller (1969). Mueller hypothesizes that managers are motivated to increase the size of their firms. He assumes that the compensation to managers is a function of the size of the firm, and he argues, therefore, that managers adopt a lower investment hurdle rate. But in a study critical of earlier evidence, Lewellen and Hunstman (1970) present findings that managers' compensation is significantly correlated with the firm's profit rate, not its level of sales. Thus, the basic premise of the Mueller theory is doubtful.

As a recapitulation, agency theory suggests that when the market for managers does not solve the agency problem, the market for firms or merger activity will come into play. This theory suggests, therefore, that merger activity is a method of dealing with the agency problem. The managerialism theory argues that the agency problem is not solved, and the merger activity is a manifestation of the agency problems of inefficient, external investments by managers (Rock, 37-8).

3- The Free Cash Flow Theory

M. Jensen considers the agency costs associated with conflicts between managers and shareholders over the payout of free cash flow to be a major cause of takeover activity. Jensen defines free cash flow as cash flow in excess of the amounts required to fund all projects that have positive net present values when discounted at the applicable cost of capital. Managers of firms having such a cash flow have the choice of either distributing the free cash flow as dividends and by this means, be efficient and maximize share price. In this case, the power of managers will be reduced because the amount of resources under their control is reduced. Also, they are more likely to be subject to monitoring by the capital markets when they want to obtain more capital for additional investment. The other option is to expand in other unrelated industries. This expansion and growth above the size that would maximize value to the shareholders will increase managers' power by augmenting the resources under their control, and as management's compensation is linked to the company's growth, expansion will enlarge managers' compensations.

D- Market Power Motive

The prestige associated with "bigness" has probably contributed to the desire to expand also. Mergers may create monopolistic power by reducing the number of competing firms in an industry. The reduction in the number of competitors allows the merged firms to raise their product price. This reduction also lowers the cost of monitoring rival firms in the industry. In the case of banks, the increased market power of the surviving organization may enable it to earn higher profits by raising loan rates and lowering deposit rates (Hawawini, 30).

It should be noted here that the antitrust policies of the Federal Reserve in the United States are designed to prohibit mergers with considerably anti-competitive effects. Nevertheless, to the extent that a local market can be exploited by a merger which results in significant market power, the potential gain could be substantial.

E- Diversification

Mergers and acquisitions may increase diversification by either broadening the geographic reach of a company or enlarging the span of the products and services it offers. Also, in the case of banks, by simply adding newly acquired assets and deposits facilitates diversification by increasing the number of bank customers. Greater diversification may provide value by stabilizing returns and lowering volatility. This in turn will result in less bankruptcy costs and lower levels of risk.

F- The Tax Motive

A merger will create wealth to stockholders whenever the tax liability of the combinations is smaller than the sum of the tax liabilities of the two individual companies. Such a situation may occur if one firm has produced a loss and the other a profit. The first pays no taxes but the second does. However, the tax paid by the second will be smaller if the two firms merge because the aggregate net profit for the combined firms will be smaller than the profit of the second firm (Hawawini, 32).

Another situation producing a smaller tax liability for merged firms occurs whenever the merged firm can borrow more funds than the sum of the borrowings of the two pre-merger firms. This case occurs if the merged firms are perceived to be less risky when combined than when separated. If the borrowing power of the combined firm increases, there will be an accompanying decrease in tax liability since debt is tax deductible.

G- Inefficient Management

Many small firms, realizing that skilled management is not available to replace existing personnel who may be nearing retirement age, decide to merge, consolidate, or sell to a larger company. In fact, mergers provide a mechanism to remove poor management from target firms. The potential gains connected with acquiring a badly managed firm and improving its performance provide the enticement for acquirers to dislocate inefficient and deep-rooted management via takeovers (Hawawini, 32).

CHAPTER IV

BANK MERGERS AND ACQUISITIONS IN THE U.S.

We will begin this chapter by showing the difference between bank mergers and bank acquisitions. By definition, "a merger is a combination of two or more organizations through pooling of common stock, cash payment to the bank being acquired, or a combination of the two. In bank mergers, the managements of the two institutions typically consent (Johnson, 29)." On the other hand, "a merger is called an acquisition when one of the banks in the transaction, usually the larger, takes over the other institution and consolidates the two organizations into a single entity. The acquirer's name is usually retained and control of the decision-making process rests almost entirely with the acquirer (59)". This type of banking combination was mostly present when regional agreements have permitted the expansion of banks in many states by acquiring banks across state lines. The absorption of a smaller firm in a different industry that complements banking and helps the acquirer diversify its services is another example of an acquisition in the banking industry.

A- Trends in Mergers and Banking Structure

1- Bank Mergers

In his testimony on June 3, 1998 before the Committee on the Judiciary at the U.S. House of Representatives, concerning mergers and acquisitions in banking and other financial services, Governor Laurence H. Meyer declared that over 7,000 bank mergers took place since 1980.

Table 4. Bank Mergers and Acquisitions in the U.S., 1980-1997

Year	Number of Bank Mergers	Bank Assets Acquired (in billions of dollars)
1980	190	10.18
1981	359	34.07
1982	420	40.87
1983	428	50.05
1984	441	69.82
1985	475	67.12
1986	573	94.41
1987	649	123.29
1988	468	87.71
1989	350	43.39
1990	366	43.74
1991	345	150.29
1992	401	165.42
1993	436	103.05
1994	446	111.76
1995	345	184.44
1996	312	286.07
1997	207	140.51
Total	**7,211**	**$1,806.19**

Source: Meyer.

As we can see, the rate increased from 190 mergers with $10.2 billion in acquired assets in 1980, to 649 with $123.3 billion in acquired assets in 1987. In the 1990's, the pace of both the number and dollar volume of bank mergers has remained important. According to Meyer, "for example, if only the five largest mergers or acquisitions approved or announced since December are completed, a total of over $500 billion in banking assets will have been acquired."

The occurrence of Megamergers, or mergers among very large banking organizations, is an extremely significant aspect of current bank merger activity. However, it is worthwhile to evoke that very large mergers began to occur with upward frequency after 1980. In 1980, there were no mergers or acquisitions of commercial banking organizations where both parties had over $1.0 billion in total assets.

Table 5: Number of Large Mergers*, 1980-1997

Year	Number of Large Mergers	Number of Large Interstate Mergers
1980	0	0
1981	1	0
1982	2	0
1983	5	0
1984	6	0
1985	9	4
1986	9	6
1987	18	11
1988	14	7
1989	3	2
1990	6	2
1991	16	12
1992	23	15
1993	15	10
1994	15	11
1995	20	16
1996	26	14
1997	15	11
Total	**203**	**121**

Source: Meyer.
* Where the acquiring firm and target bank are over $1 billion in assets.

In the years 1987 through 1997, growing numbers of such acquisitions were brought, and an increasing number of these involved interstate acquisitions by bank holding companies, revealing changes in state and federal laws. The largest mergers in U.S. banking history took place or were approved during the 1990's. These include the mergers of Chase and Chemical, Wells Fargo and First Interstate, NationsBank and Barnett, First Union and CoreStates, and most important the mergers of Citicorp and Travelers, NationsBank and BankAmerica. Look at what has happened to the ten biggest commercial-banking companies as ranked in 1988 by Fortune Magazine:

Table 6. Status of Top Ten Commercial Banking Companies of 1988

Rank in 1988	Name	Status	Date
1	Citicorp	Acquired by Travelers Group	October 1998
2	Chase Manhattan	Acquired by Chemical, Kept Chase name	March 1996
3	BankAmerica	Acquired by NationsBank, Kept BankAmerica name	September 1998
4	J.P. Morgan	Still unmerged	--
5	Security Pacific	Acquired by BankAmerica	April 1992
6	Chemical Banking	Survivor, but uses Chase name	--
7	Manufacturers Hanover	Acquired by Chemical	December 1991
8	First Interstate Bancorp	Acquired by Wells Fargo	April 1996
9	Bankers Trust	Acquisition by Deutsche Bank	Announced November 30, 1998
10	Bank of New York	Still unmerged	--

Source: Colvin.

2- National Banking Structure

A steady decline in the number of U.S. banking organizations from 1980 through 1997 reflects the high level of merger activity since 1980, along with a large number of bank failures.

Table 7. Number of Banks, Banking Organizations, and Offices*, 1980-1997

Year	Banks	Banking Organizations	Number of Banking Offices	Population per Banking Office
1980	14,407	12,342	52,710	4,307
1985	14,268	11,021	57,417	4,145
1990	12,194	9,221	63,392	3,928
1991	11,790	9,007	64,681	3,896
1992	11,349	8,730	65,122	3,916
1993	10,867	8,318	63,658	4,053
1994	10,359	7,896	65,183	3,999
1995	9,855	7,571	68,228	3,861
1996	9,446	7,313	68,694	3,860
1997	9,064	7,122	71,080	3,765

Source: Meyer.
* Banks are defined as insured commercial banks; banking organizations are defined as bank holding companies and independent commercial banks; and banking offices are defined as insured U.S. commercial banks plus branches owned by insured commercial banks.

There were over 12,000 banking organizations, defined as bank holding companies plus independent banks in 1980. Banks (independent banks plus banks owned by holding companies) numbered in total nearly 14,500. By 1997, the number of organizations had dropped to nearly 7,100 and the number of banks to just over 9,000. That is, the number of organizations had fallen over 40 percent and the number of banks by over one-third. However, these trends taken by themselves hide some of the key dynamics of the banking industry. Table 8 shows some other important characteristics of U.S. banking.

Table 8. Entry and Exit in Banking, 1980-1997

Year	New Insured Commercial Banks	Failure of Insured Commercial Banks	Mergers and Acquisitions	Bank Branches (Insured Commercial Banks)	
				Openings	Closings
1980	206	10	190	2,099	267
1981	199	7	359	2,175	332
1982	316	32	420	1,575	393
1983	366	45	428	1,281	547
1984	400	78	441	1,363	869
1985	318	116	475	1,407	596
1986	248	141	573	1,250	748
1987	212	186	649	960	942
1988	228	209	468	1,509	1,042
1989	201	206	350	1,730	687
1990	175	158	366	2,722	884
1991	107	105	345	2,273	1,428
1992	73	98	401	1,644	1,675
1993	59	40	436	1,944	1,733
1994	48	11	446	2,713	1,151
1995	110	6	345	2,526	1,489
1996	148	5	313	2,487	1,870
1997	207	1	n.a.	3,122	1,636
Total	3,621	1,454	7,005	34,780	18,289

Source: Meyer.

Despite the fact that there were approximately 1,450 commercial bank failures and over 7,000 bank acquisitions between 1980 and 1997, some 3,600 new banks were formed. Likewise, while over 18,000 bank branches were closed, the same period saw the opening of nearly 35,000 new branches. Perhaps even more outstandingly, the total number of banking offices, shown in table 7 increased sharply from about 53,000 in 1980 to over 71,000 in 1997, a 35 percent rise, and the population per banking office declined. This includes former thrift offices that were acquired by banking organizations. Fewer banking organizations clearly has not meant fewer banking offices serving the public. A significant increase in the share of total banking asset controlled by the largest banking organizations has accompanied this tendency. For example, the proportion of domestic banking assets accounted for by the 100 largest banking organizations went from just over one-half in 1980, to nearly three-quarters in 1997. The increase in nationwide concentration reflects, to a large degree, a response by the larger banking organizations to the removal of state and federal restrictions on geographic expansion both within and across states. The industry is moving from many separate state banking structures toward a nationwide banking structure that would have existed already if legal restrictions had not stood in the way. The increased opportunities for interstate banking are allowing many banking organizations to reach for the twin goals of geographic risk diversification and new sources of "core" deposits. According to Meyer, the retail banking industry is moving toward a structure more like that of some other local market industries such as clothing and department store retailing. As in retail banking, clothing and department store customers tend to rely on stores located near their home or workplace. These stores may be entirely local or may be part of regional or national organizations. Thus, it should perhaps not be surprising that banks, now freed of barriers to geographic expansion, are taking advantage of the opportunity to operate in local markets throughout the country as have firms in other retail industries.

A new statutory environment and the increased opportunities for geographic diversification were not the only reasons behind the current volume of bank merger activity. Each merger is somewhat unique and probably reflects more than one motivation. For example, a recent study of scale economies in banking suggest that efficiencies associated with larger size may be achieved up to a bank size of about $10-$25 billion in assets.

Increased competitive pressures caused by rapid technological change and the resulting blurring distinctions between banks and other types of financial firms, lower barriers to entry due to deregulation, and increased globalization also contribute to merger activity. Global competition appears to be especially important for banks that specialize in corporate customers and wholesale services, especially among the very largest institutions. Today, for example, foreign-owned banks account for almost 40 percent of the U.S. domestic commercial and industrial bank loan market. Also, greater competition has forced inefficient banks to become more efficient, accept lower profits, close up shop, or – in order to exit a market in which they cannot survive – merge with another bank. Other possible motives for mergers include the simple desire to achieve market power, or the desire by management to build empires and augment compensation. Some mergers most likely occur as an effort to prevent the acquiring bank from itself being acquired, or, alternatively, to enhance a bank's attractiveness to other buyers.

Many of the above factors also motivate mergers between bank and nonbank financial firms. However, in these cases, a key fundamental factor is the on-going blurring of distinctions between what were, not very long ago, quite different financial services. Today, despite the fact that banks continue to offer a unique package of services for retail customers, it is progressively more difficult to differentiate between many products and services offered by commercial banks, investment banks, and insurance companies. Thus, we should not find it surprising that firms in each of these industries should seek partners in the others (Meyer).

3- Effect of Bank Mergers on Market Concentration

Despite the fact that there were over 7,000 bank mergers between 1980 and 1997, the U.S. banking market concentration has remained about the same. Many reasons explain this fact.

First, many mergers are between firms operating primarily in dissimilar banking markets. While these mergers may increase national or state concentration, they do not tend to increase concentration in local banking markets and thus do not reduce competition.

Second, there is new entry into banking markets. In most markets, new banks can be created easily, and some key regulatory barriers, such as restrictions on interstate banking, have been all but eliminated.

Third, the evidence tremendously shows that banks from outside a market usually do not increase their market share after entering a new market by acquisition. Studies indicate that when a large-out-of-market bank acquires a local bank, there is normally some loss of market share (Meyer). The new owners are not able to retain all of the customers of the acquired bank. Anecdotal evidence suggests that some other banks in the market mount aggressive campaigns to lure away customers of the bank being acquired.

Fourth, it is of importance to emphasize that small banks have been and continue to be able to retain their market share and profitability in competition with larger banks. Many studies show that small banks continue to perform as well as, or better than, their large counterparts, even in the banking markets dominated by the major banks (Meyer). This may be due, in part, to more personalized service.

Even though the high level of merger activity will continue, studies based on historical experience indicate that in about a decade there may still be about 3,000 to 4,000 banking organizations, down from about 7,000 today. Despite the fact that the top 10 or so banking organizations will almost certainly account for a larger share of banking assets than they do today, the basic size distribution of the industry will probably remain about the same. That is, there will be a few very large organizations and an increasing number of smaller organizations as we move down the scale. It seems reasonable to expect that a large number of small, locally oriented banking organizations will remain. Moreover, size does not appear to be an important determining factor even for international competition. Only very recently have U.S. banks begun to appear, once again, among the world's twenty largest in terms of assets. Yet those U.S. banks that compete in world markets are consistently among the most profitable and best capitalized in the world, as well as being ranked as the most innovative.

Finally, administration of the antitrust laws has almost surely played a role in restricting local market concentration. At a minimum, banking organizations have been deterred from proposing seriously anticompetitive mergers (Meyer).

Overall, the picture that emerges is that of a dynamic U.S. banking structure adjusting to the removal of longstanding legal restrictions on geographic expansion, technological change, and greatly increased domestic and international competition. Even as the number of banking organizations has declined, the number of banking offices has continued to increase in response to the demands of the consumers, and measures of local banking concentration have remained quite stable. In such an environment, it is potentially very misleading to make broad generalizations without looking more deeply into what lies below the surface.

B- Federal Regulation of Mergers and Acquisitions

1- Bank Merger Act

The Bank Merger Act (1960) was passed to clarify the antitrust policies that apply to bank mergers. The act amended the Federal Deposit Insurance Corporation (FDIC) Act to stipulate that a bank could not merge, acquire assets or liabilities of, or consolidate with another bank without prior approval of the appropriate supervisory bodies. The factors to be considered by each of the supervisory bodies include the financial factors, capital adequacy, future earnings, bank management, the community being served, and competitive effects.

In terms of the financial condition of each bank, regulators review the balance sheet and income statement of the acquiring bank, the acquired bank, and the resultant bank, that is, the bank that will emerge after the combination is complete. If one of the banks has had a poor earning record, the resultant bank is scrutinized more closely. If the acquiring bank is assuming deposits with little or no assumption of assets, the degree of leverage of the resultant bank is reviewed to determine that capital will be adequate. Particular attention is given to the adequacy of loan loss reserves. Pro forma income statements are prepared and reviewed. However, it is understood that these are merely projections and more emphasis is placed on the balance sheet of the resultant bank. Nevertheless, if future earnings can be determined to be weak, suspect, or doubtful, the application may not be approved.

Bank management is considered in terms of the ability to manage the resultant institution. This review is made somewhat easier when the management of the acquiring institution is known to the regulators performing the review. An application probably will not be approved if the resultant institution will continue with weak or unsatisfactory management. Also, particular attention is paid to the existence of any insider transactions and any inducement to any officer, director, or employee to promote or encourage the merger.

The needs and convenience of the community being served are considered in terms of the availability of banking services in the relevant geographic market (Johnson, 16-18). Another important test with respect to the community being served is the acquiring institution's compliance with the Community Reinvestment Act (CRA). Competitive factors are determined by reference to geographic market, product market, and the extent of the lessening of competition.

a- Geographic Market

The relevant geographic market consists of those areas in which the merging institutions are located and from which they derive the predominant portion of their loan, deposit, or other business. The relevant market also includes the areas where their customers may bind alternative banking services. If possible, the relevant geographic market is defined in terms of political subdivisions to facilitate statistical analysis.

b- Product Market

Product market considerations include the products offered by the resultant institution and by the competitors of the resultant institution. The competitors can include nonbank institutions.

c- The extent of the Lessening of Competition

With respect to the issue of lessened competition, the Bank Merger Act was amended in 1966 to provide the standard that all banking agencies and the Justice Department must use in assessing the impact of mergers. No merger can be approved that would result in a monopoly or that would substantially lessen competitions. The review includes an assessment of the degree of concentration among competing firms in the relevant geographic market. The measure that is used to assess the extent of lessening of competition is the Herfindahl-Hirschman Index (HHI).

In applying the HHI, the market share (in percentage terms) of each competing firm is determined and then squared. The sum of these squared market shares is the HHI. In a market in which there is only one competitor, the HHI will be 10,000 (100^2). A high HHI implies a highly concentrated market and makes it more likely that the Justice Department will challenge a proposed merger of banks. A low HHI implies a less concentrated market and the Justice Department is not as likely to challenge a bank merger. Specifically, if a combination of banks creates an HHI that is greater than 1800 or an HHI that increases by more than 200, the competitive effects of the combination will be closely scrutinized (Lash, 45-46).

Table 9. Department of Justice Guidelines for Mergers and Acquisitions

Level of HHI	**HHI < 1000 Unconcentrated Market**	**1000 < HHI < 1800 Moderately Concentrated Market**	**HHI > 1800 Highly Concentrated Market**
Change in HHI			
ΔHHI < 50	No Challenge	No Challenge	No Challenge
50 < ΔHHI < 100	No Challenge	No Challenge	Challenge, other factors
ΔHHI > 100	No Challenge	Challenge, other factors	Challenge

Source: Weston, 598.

In the case of troubled institutions, special federal provisions have been established for the cross-border acquisitions. The 1982 Garn-St Germain Depository Act permits the interstate acquisition of failed banks with assets of $500 million or more, even if such acquisitions are not consistent with state law. The competitive Equality Banking Act of 1987 widened the scope of this power to large institutions that are in danger of closing, large bridge banks, and bank holding companies with one or more banks in danger of closing with aggregate assets of $500 million or more.

2- The Interstate Banking Act

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 was passed after many earlier versions of this legislation had been defeated. The major provisions of the act are Interstate Bank Holding Company Acquisitions, Interstate Bank Mergers, De Novo Interstate Bank Branching, Foreign Bank Interstate Branching, and Interstate Bank Agency.

a- Interstate Bank Holding Company Acquisitions

Beginning in September 1995, a bank holding company (BHC), defined as a corporation established to hold the stock of one or more banks (Dalgaard, 139), may acquire banks located in any state. States may not prohibit or "opt-out" of these interstate BHC acquisitions. However, individual states may establish a minimum age of local banks (up to five years) that are subject to interstate acquisition by out-of-state BHC's.

In order to qualify, the acquiring BHC must be adequately capitalized and managed. Even if the BHC is qualified for the acquisition, the Federal Reserve Board (FRB) may not approve the acquisition if after the acquisition, the BHC will control more that 10% of U.S. insured depository institution deposits, or the BHC already has a depository institution affiliate in the host state and, after the acquisition, the acquiring BHC will control 30% or more of the insured depository institution deposits of the host state.

Even if the 30% limitation is exceeded, the FRB may approve the acquisition if the host state has established a higher limit. At the same time, a state may limit the share of deposits held within the state by any bank or BHC as long as the limitation does not discriminate against out-of-state banking organizations.

The FRB will also consider the extent of compliance with the CRA. Notwithstanding these stipulations, the act gives the FRB the authority to approve an acquisition if the target bank is in default (or in danger of default) or if the FDIC is providing assistance for the acquisition.

b- Interstate Bank Mergers

Beginning June 1997, national and state banks may merge across state lines, thus creating interstate branches. However, such mergers may not take place if the home state of one of the banks has enacted, prior to June 1997, legislation that prohibits or "opt-out" of interstate bank mergers. However, any such law will not affect mergers approved prior to the effective date of the opt-out legislation.

States may "opt-in" prior to June 1997 and also may establish a minimum age (up to 5 years) of local banks that are permitted to participate in interstate mergers. Both home states of the merging banks must have adopted opt-in legislation. A host state may not discriminate against out-of-state banking organizations in this legislation with the exception of establishing a nationwide reciprocity rule.

Such mergers can be undertaken by both affiliate banks and independent banks. Mergers may also involve the acquisition of individual branches of a bank, instead of the entire bank, only if the state in which the branches are located permits such acquisitions by statute (Johnson, 22-23).

Also applicable in interstate bank mergers are the provisions that are specified in connection with interstate bank holding company acquisitions:

- 10% and 30% concentration limitations
- Higher limits permitted by state law
- Different limits that do not discriminate against out-of-state banking organizations
- CRA compliance
- Approval of mergers involving a troubled institution

In reviewing potential mergers, the appropriate federal regulators must determine that each participating bank is adequately capitalized and well managed. Furthermore, nothing in the act affects the applicability of antitrust laws or the ability of states to charter, supervise, regulate, and examine banks within their state boundaries.

After the merger is complete, the resultant bank may continue to operate those offices that had been in operation prior to the merger. The resultant institution also may acquire additional branches in any location where the acquired bank previously could have established and acquired branches.

The branches of an out-of-state bank will be subject to the host state laws, whether the out-of-state bank has a national charter or a state charter. If the out-of-state bank is a national bank, the Office of the Comptroller will enforce applicable state laws for national banks in the host state. If the out-of-state bank is a state-chartered bank, the branches will be subject to the same laws as other state banks in the host state. However, the branches of an out-of-state state-chartered bank may not engage in any activity not permissible for a bank that is chartered in the host state (Rock, 250-51).

c- *De Novo* Interstate Bank Branching

A national or state bank may, with appropriate federal approval, establish a *de novo* branch in a state outside its home state in which it previously has not maintained a branch. However, the host state must have enacted legislation that applies to all banks and specifically permits all out-of-state banks to branch *de novo* into the host state. All state and federal laws that apply to an existing branch also apply to a *de novo* branch.

d- Foreign Bank Interstate Branching

Essentially, foreign banks are permitted to engage in interstate bank mergers and establish *de novo* interstate branches to the same extent and on the same conditions as national and state banks. However, Federal regulators may require a foreign bank to establish a U.S. subsidiary to branch interstate if the regulators determine that they can verify the foreign bank's compliance with capital adequacy guidelines only through the use of a separate subsidiary. Also, any branch of a foreign bank will continue to be subject to CRA requirements unless the branch receives only deposits that are permissible for an Edge Act Corporation.

e- Interstate Bank Agency

Beginning one year from enactment of the legislation, a bank may receive deposits, renew time deposits, close loans, service loans, and receive payments on loans and other obligations as agent for any bank of thrift affiliate, whether the affiliate is located in the same state or a different state than the agent bank. However, a depository institution may neither conduct, as agent, an activity that it is prohibited from conducting as a principal, nor have an agent conduct for it any activity that it is prohibited from conducting as principal. Also, if an out-of-state bank is not prohibited from operating a branch in host state (because of an opt-out statute), a savings institution affiliate located in the host state may act as agent for the bank.

Taken together, the provisions of the Interstate Banking Act provide a framework for a far more efficient banking system in the United States. The industry's consolidation to follow will lead to more convenient access for bank customers, more technological advancements, and better diversification of bank portfolios.

CHAPTER V

BANK MERGERS AND ACQUISITIONS IN LEBANON

Approximately ten years have elapsed since the end of the Lebanese war, and still the same question is still arising concerning the role of Lebanon in its region and specifically concerning the role to be played by the Lebanese banking sector in the forthcoming phase. Undoubtedly, the Middle East peace process and its blurred effects on development and on the economical, commercial, and monetary relations in the region, have helped in not clearly showing the role to be played by the banks until now. Although it is certain that Lebanon is not going to retrieve back the important position it had in financial services in the overall Lebanese region, due to the great development that occurred in the banking industry in the countries of the Gulf during the last two decades, yet many believe that, in the next few years, the Lebanese banking sector is going to play a very important role in its zone, mainly in Syria, Jordan, and Iraq (Iktissad, September 1999, 140).

In this chapter, we are going to discuss the phenomenon of mergers and acquisitions in the Lebanese banking sector. First, Lebanon being part of the Arab world, we will start by showing why it is difficult for banks in Arab countries to merge and differentiate their case from that of banks in the Western World. Then we will discuss the motives behind the Lebanese bank mergers and acquisitions. Finally, we will talk about the latest mutation occurring in the Lebanese banking sector as a result of the bank mergers and acquisitions process.

A- Differences Between Western and Arab Cultures Affecting Bank Mergers

Arab banks and the Arab culture are very much different from the case of developed countries with their banks and financial systems. These differences are not superficial, but they are numerous and fundamental and can be stated as follows: difference in property, difference in management, difference in political administration, and difference of the market.

1- Difference in Property

The merger of financial institution in the West is not the result of any political influence but, in most cases, follows the rule of what is better for the shareholders and the companies involved in the merger. If the potential merger would produce a positive effect for both parties, then the merger occurs and as a result, the stock prices of the two involved companies increase reflecting the acceptance of the market to such action. On the other hand, if the potential merger does not create better results or threatens the market, it would often not happen because shareholders and the market reject it. That is, there are some profitable mergers and others are not, and the final decision in the West is primarily that of the shareholders' interest and some economical indices.

There is a big difference in the nature of shareholders between Western banks and Arab ones. In the West, for example, the largest part of shareholders in the banks is represented by institutions and not by individuals, which means that these banks have conscious shareholders capable of analyzing opportunities and working with others to grab them.

On the other hand, the major contributions in the Arab commercial banks are from strong families or traditional family alliances in whose viewpoint, the merger should not only be seen from the size aspect, but one should look into its effect on the position of the owning family or the family alliance in the new formed bank, because, owning a bank in the Arab society is a proof showing the importance of the family and the fact of its being a main component in the country, especially in countries governed by royal families where the only way to have political influence is through financial institutions. This influence is often the result of previous alliances between the royal family and the families dealing in trading, the thing which affects the local system and its fragile stability. In this sense, the commercial value from the merger, even if it was important, cannot outperform the political motive behind the merger which would give greater power to the owners and increase their influence in the country, and thereby smooth their own progress in the broad sense of the word. That means that the small shareholder is practically cheated because he buys the stock looking for a financial outcome and cannot get the social and political gains that big shareholders have. In addition, the important shareholders may sometimes refuse to merge even if it was beneficial for the shareholders because they do not want to melt their local power in another larger bank (Hassan, 18-19).

2- Difference in Management

The difference between Western banks and Arab ones is not only shown in the nature of the shareholders, but it also extends to the dissimilarity of the executive power in managing the bank.

In the West, there is a clear separation between property and management, between the shareholders and the bank managers. Regarding the shareholders and the economic media, it is not important who owns the banks (and rarely does the media state the names of the largest shareholders and people in most cases do not know them) but the importance is in the chief executive officer and the managing system power compared with other competing banks. In this case, mergers occur with the support of the executive powers who own the needed experience in order to value the benefit from the merger; this is why, their decision is more important than any individual shareholder or group of shareholders.

On the contrary, in the Arab world, bank management comprises the main owners (like in the family owned banks) or the management is weak and works for the benefit of the important shareholders and in both cases, management has no role to play in the merger decision and profits resulting from Arab bank mergers are practically nil (Hassan, 19).

3- Difference in Political Administration

One of the essential factors hindering merger activity in the Arab world is the nature of the political and cultural system. In the West, the relation between the government and the financial markets is clear. The importance rests on encouraging competition and at the same time highly protecting the interest of the participants (depositors, shareholders, etc.) and the financial markets by getting rid of weak components. This is the reason why, during a decade and a half, the authorities there have put severe rules regarding the reserve ratio and liquidity, have watched closely the quality of the management chosen by the shareholders, and have set laws that protect the small investor and punishes the trading of inside information not available for all the public. All these regulations have made it very hard for banks that do not own the needed requirements to continue working. In fact, this is what happened in many industrial countries, including Japan, where many bank mergers, acquisitions, or liquidations of weak institutions occurred, creating new powerful institutions.

In contrast, the current political situation in the region is still based on political alliances in which banks (and other economical institutions pertaining to the families or the region) represent major constituent and not only neutral financial institutions. As a result, the main objective of the Arab governments is not achieving economical efficiency but keeping political and social stability in the country.

4- Difference of the Market

Another distinction to be noted is that Arab banks, on the contrary of Western ones, have many assurance clauses that make them work in a limited competition atmosphere. For example, Arab banks make easy money in the form of governmental deposits, current accounts, or short-term ones, while they also have the chance to use this money in a more productive way by utilizing it in treasury bills, or in the financing of short commercial credits. All these privileges and many others leave small to medium banks still able to achieve profits and continuously develop. Due to this situation, shareholders are not motivated to abandon this cash cow and the high returns, but their main interest would be to resist pressure exercised by large banks that want to acquire them.

Also, a major point to be noted is the big distinction of the Arab financial markets from the ones in the West whether in the United States, Europe, or even developed Asian countries. The main difference here is that the Arab banking markets are very small compared to the markets in developed countries. So the problem does not lie in the small size of the Arab banks, but in the markets in which they operate.

The principal issue is not the absence of a big bank, but the absence of large markets that would allow the existence of a big bank. This means that the needed merger in the Arab world is between the local economical and financial markets like what happened in Europe because, if we do not expand the market, there will not be any drivers for big banks to exist and consequently, no mergers between Arab banks from different countries would occur (Hassan, 20).

As a conclusion, although many financial analysts and politicians suggest its occurrence, Arab banks have many clauses that make mergers difficult to take place because it contradicts with the local economical and political system. This would not be a problem if foreign competition is prevented from entering local markets for the next few decades. But these clauses can create a major crisis when the Arab market will have to open up for foreign banks complying with the agreements with the World Trade Organization.

B- Motives Behind Bank Consolidations in Lebanon

In the last few years, many bank mergers and acquisitions took place on the local market. The reasons behind this occurrence are numerous and interrelated. We will discuss them in the following pages.

First, bankers and control commissions are having an increasing state of awareness to the importance of finding large, non-monopolistic banking units, in order to strengthen the competitive capabilities of Lebanese banks, starting by enlarging the working area and employment, utilizing more new banking technologies, and decreasing costs due to the merger effect (branches and employees) in order to increase their profitability. This is not the case of only the Lebanese market, but the whole world has been following the same steps during the same time frame. This local and worldwide phenomenon toward unification or the establishment of big size financial units are a natural result due to a national atmosphere characterized by important challenges to be facing banking institutions (and non-banking ones) due to the expansion of worldwide markets and the removal of many monetary barriers, and the increasing competition by non-banking institutions that offer the same financial and investment services and that are attracting a large portion of the general savings.

Second, there is confidence and compliance in the value and the gain from investments in the Lebanese banking sector and its current institutions, which are all following the rules of sound banking and conforming with all the circulars issued by the concerned control authorities. The sources of these investments are various and comprise Lebanese, Arabs, and foreigners. Also the nature of these investments differ since, in addition to the operations of acquisitions or mergers of competing or related companies, there is always the issuance of new shares, etc. (Association, 58).

The third motive is due to the articles present in the law No. 192/93 issued on January 4, 1993 and which has been extended until the year 2003 according to law No. 679/98. The New Bank Merger Law (which complete text is present in the appendix) includes the following incentives for bank mergers and acquisitions:

- Article 6 postulates that the Central Bank can extend to the acquiring bank soft loans, i.e. long-term loans at a low cost.

- Article 7 exempts the acquiring bank from taxes for the first year after the year in which the Central Committee of the Central Bank approved the merger request. This is under the condition that the amount exempted would not exceed the cost of the merger and would not exceed two billion Lebanese Liras. This tax exemption should be added to the acquirer's capital.
- Article 8 releases the merging banks from all fees related to the merger including the costs of stamps, registration and public notary charges, as well as the issuance of new shares.

In addition, regulations of the Central Bank limit new branch openings to two per year. This has created the incentives to buy smaller players for their branch networks, or for larger banks to buy branches from each other, as happened in 1997 when Banque Libano-Française bought three branches from Crédit Lyonnais. Also there is the law No. 125/96 related to the manner for dealing with the Lebanese banks shares, circular No. 1448/96 which illustrates the rules for the launching and trading of bank shares in the stock exchange, where the market power defines the value of the enlisted banks and speculates its future success, in addition to the publishing of clear givens that help the local or foreign investor take his decision concerning his ownership in the Lebanese banking sector (58).

The fourth driver for increased bank mergers activity is the minimum capital requirement (10 Billion Lebanese Liras for the headquarters of each bank, and 250 Million Lebanese Liras for each branch) imposed by Banque du Liban in circular No. 1437/96 on December 31, 1997. Also, banks will have to abide by circular

No. 1758 pertaining to the increase of the reserve from the current 8% to 12% in the end of the year 2001 abiding to the Basle Committee criteria (An-Nahar, 11).

The fifth motive is concerned with the yields on T-bills. Most banking institutions are owned by families who hold onto their assets and do not want to lose control of their businesses. That makes mergers very difficult. In the past few years, banks of all sizes have been sitting by themselves rather comfortably. Although they have been concentrating more on tempting customers into opening accounts, they have not had to compete heavily to stay alive in the saturated market, mainly thanks to the issuance of treasury bills. Yields for treasury bills hit a peak in 1997, when they reached 30% for two-year government paper. The banks have been more than happy to lend money to the government and collect healthy returns – while keeping their spreads high – and it is estimated that on average, more than 70% of banks' revenues come from treasury bills (Jeffrey, 30-31). While banks have been betting on paper for profits, they have been operating according to comparatively conservative standards. Their loan-to-deposit ratio in foreign currency was 55%, and 13% in Lebanese Liras in 1998. Most loans were short to medium-term. With the regained confidence in Lebanon and in the Lebanese Lira, the T-Bills rates have gone down. This decrease in rates will deplete most of the bank's profits. Small banks with two or three branches did not have high operating costs, enjoyed high spreads, and were very profitable in the past few years. As interest rates on the Lebanese Lira go down, banks will look for other profitable uses of their funds, which will naturally be in extending loans and credit facilities to the private sector. Small banks, having limited capital, will not be able to lend a big portion of their sources of funds as the lending ratios are linked to their capital base, and cannot lend a big amount without violating the Central Bank's rules and regulations. With decreasing profits and increasing operating expenses, small banks will soon not be able to operate in this changing environment, and this will eventually put a pressure on them to merge.

The sixth motive is related to the changing consumer market. Nowadays, customers have rapidly changing expectations and they have increasingly demanding and sophisticated needs. This will put pressure on banks to improve their services and offer innovative products. Lebanese people are witnessing a higher level of education and many Lebanese nationals that left the country during the war are returning back and demanding services and quality they got accustomed to while they were abroad. They are also bringing back with them expertise and knowledge in the financial instruments which are still new to the Lebanese market. This will put pressure on the bank's cost structure, as they will be forced to improve the quality of their services in order to meet changing customers needs.

Technology represents the seventh motive for banks to merge. Lebanese banks are still dramatically lagging in technology despite recent efforts to catch up. Many Lebanese banks have their back office operations still performed manually or with old computers, the number of ATM machines is very low and ATM's are not connected to large networks, telephone banking is still in its early stages, and it is also recently that SWIFT service became available in Lebanon. The increase in technological requirements in banking today is much more technical and requires hardware and software resources which are important and costly. Moreover, information systems require maintenance, servicing, and continuous updating as well as their implementation requires training of personnel and control processes. These activities considerably increase the banks' operating costs and not all banks have the resources to undertake investments in such technology (Iktissad, September 1999, 140).

The eighth driver to merge is the staff. The number and skill requirements of the bank's employees will also put pressure on the bank's cost structure. There is a clear need for much higher levels of education and different skills in the bank's staff as there is a growing demand for the creation of new financial instruments, as well as corporate and project finance. In order to attract qualified human resources, banks should offer competitive and attractive compensation packages. This will also add to the banks' operating expenses.

C- Recent Changes in the Banking System Structure

At the end of the third quarter of the year 1999, there were 68 banks operating in Lebanon, 51 of which controlled by Lebanese citizens or institutions, and the remaining 17 by foreign banks as stated in the Quarterly Bulletin issued by the Banque du Liban for the third semester of 1999. The following table shows us the structure of the financial sector in Lebanon from year-end 1993 until the third quarter of the year 1999.

Table 10. Lebanese Financial Sector Structure From 1993 Until Q3 1999

Year	1993	1994	1995	1996	1997	1998	Q3 1999
Operating Commercial Banks	74	74	74	75	72	70	68
of which Lebanese Banks	62	62	61	61	57	54	51
of which Foreign Banks	12	12	13	14	15	16	17
Medium and Long-Term Credit Banks	4	5	5	8	8	9	7
Financial Institutions	7	11	14	18	20	23	23

Source: Banque du Liban, Yearly Bulletins: 1997 p.36, 1998 p.30, Quarterly Bulletin Q3 1999 p.13.

Although we have this large amount of banks in Lebanon, in the top 100 Arab banks of the Banker Magazine, only seven Lebanese banks are listed with the first in these latter being Banque de la Méditerranée ranking 39th with a capital strength of \$4,045 Million and Banque du Liban et d'Outre Mer ranking 33rd in terms of assets amounting to \$4,580 Million. The first in the top 100 Arab banks in terms of capital is of Saudi origin, the National Commercial Bank with $24,815 Million of capital, and in terms of assets size, the Commercial Bank of Syria with assets amounting to $41,101 Million. In the following table we will list the Lebanese banks present in the top 100 Arab banks and rank them by capital strength and assets size relatively to the other Arab banks.

Table 11. Rank of Lebanese Banks in the Top 100 Arab Banks

Bank	**Capital Strength**		**Assets Size**	
	Rank	*Million dollars*	*Rank*	*Million dollars*
Banque de la Méditerranée	39	365	37	4,045
Byblos Bank	46	275	42	3,412
Banque Audi	60	178	46	2,985
Banque du Liban et d'Outre Mer	61	165	33	4,580
Fransabank	67	140	58	2,203
Banque Libano-Française	77	121	47	2,891
Crédit Libanais	92	79	70	1,456

Source: Top 100 Arab Banks, 68.

Although there has been an increasing number of bank mergers in Lebanon resulting in a lower level in bank numbers, yet we can notice that the number of branches is increasing according to the following table and the proportion of commercial banks branches per region is approximately still the same reflecting higher growth in the banking sector.

Table 12. Distribution of Commercial Bank Branches From 1993 Until Q3 1999

By Region	1993	1994	1995	1996	1997	1998	Q3 1999
Beirut & Suburbs	309 56.28%	327 56.47%	344 56.58%	358 56.74%	369 56.25%	383 57.25%	404 56.90%
Mount Lebanon	92 16.76%	99 17.10%	103 16.94%	107 16.96%	113 17.23%	113 16.89%	122 17.18%
North Lebanon	43 7.83%	43 7.43%	43 7.07%	44 6.97%	45 6.86%	67 6.88%	70 9.86%
South Lebanon	47 8.56%	48 8.29%	52 8.55%	55 8.72%	60 9.15%	60 8.97%	66 9.30%
Bekaa	58 10.57%	62 10.71%	66 10.86%	67 10.62%	69 10.52%	46 10.01%	48 6.76%
Total	**549** **100%**	**579** **100%**	**608** **100%**	**631** **100%**	**656** **100%**	**669** **100%**	**710** **100%**

Source: Banque du Liban, Yearly Bulletins: 1997 p.36, 1998 p.30, Quarterly Bulletin Q3 1999 p.13.

We will now look into the bank merger activity in Lebanon which started theoretically in 1994, but practically in 1997. In December 1997, the Central Bank approved the merger between Fransabank and Banque Tohmé after approximately three years on the ownership by Fransabank of Banque Tohmé's stocks. During the same month also, the Central Bank approved the Merger between Byblos Bank and Banque Beirut pour le Commerce which was announced in November and is considered as one of most important real merger cases that occurred in the sector. Also, in November 1997, the Central Bank had given its final approval on the merger between Banque Audi and Crédit Commercial du Moyen-Orient and the deletion of this latter's name from the list of banks after nearly four months from the preliminary agreement signature date between the two banks. The Central Bank decided, on the same date, to grant his final approval for the merger between Inaash Bank and United Bank of Pakistan after the first has acquired all the assets and obligations of the latter. In September 1997, the Central Council of the Central Bank approved the agreement between Société Générale Libano-Européenne de Banque and Banque Geagea and the deletion of the latter's name from the list of banks. This decision was taken after two months from the signing date between the two concerned banks contents of which were related to the transfer of assets and obligations of Banque Geagea to the Société Générale Libano-Européenne de Banque. Also, the Société Générale Libano-Européenne de Banque bought the branches of Globe Bank which was later on deleted from the list of banks. In July 1997, the majority of the shares of Crédit Libanais, which was previously owned by Banque du Liban, was transferred to a group of Saudi and Lebanese investors and it is now subject to Arab supervision (Association, 58-59).

Also, in 1998, the majority of Litex Bank Shares (previously under foreign control) was transferred to a Lebanese group and continued its activities under the name of National Trust Bank. Moreover, a Saudi banking group bought 10% of Bank of Beirut's capital and it was said that there were discussions between a group of Jordanian investors and North Africa Commercial Bank in Beirut to buy 50% of this latter's shares. In addition, a group from Oman bought the greater part of the shares of Crédit Populaire to become called, in August 8, 1998, B. C. P. Oriel and subject to Arab control. On the other hand, shareholders from Bank Al-Madina bought the Commercial Facilities Bank which name was amended to become United Credit Bank. Also, Banque Libano-Française bought all the branches of Crédit Lyonnais excepting the head office. In 1999, this latter bank sold all its assets and obligations to Intercontinental Bank of Lebanon and was deleted from the list of banks on October 12, 1999.

In February 1999, three banks: National Trust Bank, Unibank, and Al-Moghtareb got the final approval from Banque du Liban to merge together and create United Bank of Lebanon. Another important transaction was the merger between TransOrient Bank and Bank of Beirut. On June 23, 1999, following the approval by the Central Council of the Banque du Liban, TransOrient went through self-liquidation with a view to transfer its assets and liabilities to Bank of Beirut. TransOrient Bank was deleted from the official list of banks on July 8, 1999. Bank of Beirut had also bought five branches from MEBCO in 1998. Also, Orient Credit Bank sold all of its assets to Audi Bank and was deleted from the list on January 12, 1999. Audi Bank also had bought the 14 branches of Adcom Bank, which was self-liquidated.

On November 3, 1999, the Central Council of Banque du Liban authorized the buying by Fransabank of all the assets and debts of Universal Bank. The council gave his preliminary permission too on January 1, 1999 for the merger between Banque Libanaise pour le Commerce and United Bank of Lebanon to operate later on under the name of the latter. Also, in November 1999, the final agreement concerning the merger between Metropolitan Bank and Standard Chartered Bank was signed and activities will occur under the name of the last mentioned bank (59).

Summary of the above transactions is mentioned in the following table. Please note that the dates mentioned in above text are the official approval by the Central Bank to the merger dates while, the dates in the table are those of the merger announcement dates.

Table 13. Summary of Main Mergers and Acquisitions in the Lebanese Banking Sector

	Merged Bank	Merging Bank	Year
1	First Phoenician Bank	Crédit Libanais	1994
2	Capital Trust Bank	Crédit Libanais	1994
3	Security Bank	Banque Beirut pour le Commerce	1995
4	Geagea Bank	Société Générale Libano-Européenne de Banque	1997
5	United Bank of Pakistan	Inaash Bank	1997
6	Crédit Commercial du Moyen-Orient	Banque Audi	1997
7	Banque Tohmé	Fransabank	1997
8	Banque Beirut pour le Commerce	Byblos Bank	1997
9	14 Branches of Adcom Bank	Banque Audi	1998
10	Globe Bank Branches	Société Générale Libano-Européenne de Banque	1998
11	Orient Credit Bank	Banque Audi	1998
12	Litex Bank	ARK Group , Continued Operations under National Trust Bank Name	1998
13	Crédit Populaire	Fincorp (Shares Buying) Called later on B. C. P. Oriel	1998
14	Commercial Facilities Bank	Shareholders from Bank Al-Madina Called later on United Credit Bank	1998
15	Some Branches of Crédit Lyonnais	Banque Libano-Francaise	1998
16	Crédit Lyonnais	Intercontinental Bank of Lebanon	1998
17	Unibank Al-Moghtareb National Trust Bank	United Bank of Lebanon	1998
18	TransOrient Bank	Bank of Beirut	1998
19	5 Branches of MEBCO	Bank of Beirut	1998
20	Universal Bank	Fransabank	1998
21	Banque Libanaise pour le Commerce	United Bank of Lebanon	1998
22	Metropolitan Bank	Standard Chartered Bank	1999
23	Jordan National Bank	Bank of Lebanon and Kuwait	2000
24	American Express	Crédit Libanais	2000

CHAPTER VI

CHANGE IN CONCENTRATION RESULTING FROM LEBANESE BANK MERGERS

As we have seen in the previous chapter, the Lebanese banking sector is witnessing a remarkable mutation which solicited objective is the reduction of the number of banks and correlatively increase the size of the remaining banks (Diab, 70). Due to the decrease in the overall number of banks, a resulting increase in the market concentration will surely occur.

On the other hand, in a previous published interview, Mr. Riad Salameh, the Governor of Banque du Liban, said that the Central Bank does not encourage the mergers between large banks (Iktissad, 14). He considers that at this stage, in order to prevent imbalances in the market shares or the vanishing of competition which will result in higher prices for the banking services, consolidations should be vertical, not horizontal. He continues by saying that when there is a state of monopoly, it becomes difficult to reduce the costs of services and, on the other hand, the banking sector is unable to handle the confrontations and the magnetism that large banks produce.

In this section, we are going to find out what was the impact of the consolidations that took place in the last few years on the concentration in the Lebanese banking sector for five main variables: Total Assets, Customers' Deposits, Number of Branches, Loans and Discounts, and Profits. To achieve this, we will make use of the Herfindahl-Hirschman Index which we already mentioned briefly in a previous chapter.

A- The Herfindahl-Hirschman Index (HHI)

In 1982, and again in 1984, the Department of Justice in the United States announced new merger guidelines to supersede those issued in 1968. One major change in the 1982 guidelines was the method of measuring concentration. The previous literature had measured concentration by the share of industry sales, assets, employment, or value added of the largest four or largest eight firms. The 1982 guidelines adopted an index developed in the academic literature independently by Professor Herfindahl (1950) and Professor Hirschman (1945). The index is referred to as the Herfindahl-Hirschman Index or HHI. The index is simply the sum of the squares of the market shares of all the firms in the industry. i.e. the HHI equals:

$$HHI = S_1^2 + S_2^2 + S_3^2 + \ldots + S_N^2$$

Where: - N represents the number of firms in an industry.

- S represents the market share of each firm in the industry.

For example, if ten firms each hold a market share of 10 percent, the index would be $10(0.1)^2$ which is 0.1; in the Department of Justice use of the HHI, market shares are measured as percentages so their HHI would be $10(10)^2$ or 1,000. The maximum HHI value is 10,000. This occurs if one firm has 100 percent of the market share ($100^2 = 10{,}000$). This would represent the case of a monopolistic industry.

The theory behind the use of the HHI is that if one or more firms have relatively high market shares, this is of greater concern than the combined share of the largest four firms. An example presented with the announcement of the 1982 Merger Guidelines illustrates this point. If, in market A, four firms each hold a 15 percent market share and the remaining 40 is held by 40 firms, each with a 1 percent market share, the HHI is:

$$HHI = 4(15)^2 + 40(1)^2 = 940.$$

In market B, however, one firm has a 57 percent market share and the remaining 43 percent is held by 43 firms, each with a 1 percent market share. As with Market A, the four-firm concentration ratio is 60 percent. However, the HHI is:

$$HHI = (57)^2 + 43(1)^2 = 3{,}292.$$

Thus, market A would be considered unconcentrated while market B, with its very high HHI level, would be considered highly concentrated (Please refer to Table 9). However, the key difference from the old four-firm ratio is that HHI registers a concern about inequality as well as degree of concentration (Weston, 596-7). Yet the economic basis for either concern has not been well established. Whereas some economists hold that high concentration, however measured, causes some degree of monopoly, other economists hold that increased concentration is generally the result of active and intense competition. They argue further that the intense competition continues among large firms in concentrated industries because the dimensions of decision making over prices, outputs, types of products, quality of products, service, and so on, are so numerous and of so many gradations that collusion simply is not feasible. But there is a possibility that the value gains from restructuring result from increases in monopoly power rather than increases in efficiency.

B- Change in Concentration of Selected Variables

In order to study the change in concentration resulting from bank consolidations, the value of HHI for each variable will be computed for three distinct years: 1985, 1992, and 1998. The choice of the years was based on the following criteria.

The year 1985 was chosen representing the period when Lebanon was in time of war. The year 1992 is considered as the period where the war was over and where bank regulations were starting to be applied. Concerning the year 1998, this latter represents the current phase. Data from the year 1999 would have been preferable, but the official documents to be used were still unavailable at the time of elaboration of this study. Please note that the change in inflation and the devaluation of the Lebanese currency from year to year will not affect our results because we are computing the HHI based on the percentages of each year.

In order to compute the HHI, we needed to find the percentage market share in terms of each variable for all commercial banks operating in Lebanon. For the sake of this study, only the first 30 banks in each category were chosen because, after some preliminary calculations, it was found that the remaining ones had no significant value for the study.

1- Change in Concentration of Total Assets

a- Computation of HHI in 1985

Table 14. Ranking by Total Assets in 1985

	Bank	LL Million	Market Share (%)	(Market Share)^2
1	Banque de la Méditerranée	205.686	11.26	126.7876
2	Banque Libanaise pour le Commerce	123.534	6.76	45.6976
3	Capital Trust Bank	75.652	4.14	17.1396
4	Banque Audi	54.840	3.00	9.0000
5	Société Nouvelle de la Banque de Syrie et du Liban	53.439	2.93	8.5849
6	Mebco Bank (Middle East Banking Company)	52.924	2.90	8.4100
7	Banque du Crédit Populaire	51.910	2.84	8.0656
8	Crédit Libanais	49.815	2.73	7.4529
9	Banque du Liban et d'Outre-Mer	46.270	2.53	6.4009
10	Foreign Trade Bank	44.152	2.42	5.8564
11	The Lebanese Arab Bank	43.047	2.36	5.5696
12	Société Générale Libano-Européenne de Banque	42.160	2.31	5.3361
13	Universal Bank	40.952	2.24	5.0176
14	Banque Byblos	38.546	2.11	4.4521
15	Crédit Bancaire	36.931	2.02	4.0804
16	Jammal Trust Bank	36.470	2.00	4.0000
17	Banque G. Trad – Crédit Lyonnais	36.394	1.99	3.9601
18	Arab Bank Limited	33.810	1.85	3.4225
19	Bank al-Madina	33.758	1.85	3.4225
20	Banque de l'Industrie et de Travail	33.498	1.83	3.3489
21	Globe Bank	33.157	1.82	3.3124
22	Fransabank	32.811	1.80	3.2400
23	Banque Almashrek	30.782	1.69	2.8561
24	United Bank of Saudia and Lebanon	28.838	1.58	2.4964
25	Banque Saradar	28.437	1.56	2.4336
26	Banque Libano-Française	27.740	1.52	2.3104
27	Transorient Bank	27.713	1.52	2.3104
28	Adcom Bank (Advances and Commerce Bank)	24.965	1.37	1.8769
29	Al-Mawarid Bank	24.903	1.36	1.8496
30	Bank of Beirut and the Arab Countries	24.505	1.34	1.7956
	Total of the First 30 Banks	**1,417.639**	**77.63**	**310.4867**
	Total of the Lebanese Banking Industry	**1,826.509**	**100.00**	

Source: Baz, Bilanbanques 1986.

The HHI in terms of total assets in the year 1985 is equal to 310, which implies that, in terms of total assets, the banking industry is operating as if there were:

$$N_{A,1985} = 10{,}000 \,/\, HHI_{A,1985} = 10{,}000 \,/\, 310 = 32.25 \cong 32 \text{ Banks}$$

b- Computation of HHI in 1992

Table 15. Ranking by Total Assets in 1992

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque du Liban et d'Outre-Mer	1,273,201.241	8.8	77.44
2	Banque Nationale de Paris "Intercontinentale"	1,012,656.822	7.0	49.00
3	Banque Libano-Française	992,657.822	6.9	47.61
4	Arab Bank	984,438.836	6.8	46.24
5	Banque de la Méditerranée	958,506.570	6.6	43.56
6	Banque Audi	689,010.834	4.8	23.04
7	Fransabank	683,687.231	4.7	22.09
8	Société Générale Libano-Européenne de Banque	657,575.652	4.5	20.25
9	Byblos Bank	567,953.219	3.9	15.21
10	Bank of Beirut and the Arab Countries	540,698.419	3.7	13.69
11	Crédit Libanais	509,469.572	3.5	12.25
12	The British Bank of the Middle East	448,920.716	3.1	9.61
13	Beirut Riyad Bank	384,234.967	2.7	7.29
14	Saudi Lebanese Bank	370,445.872	2.6	6.76
15	Banque Libanaise pour le Commerce	307,826.961	2.1	4.41
16	Banque Saradar	286,036.657	2.0	4.00
17	Banque Beyrouth pour le Commerce	243,311.200	1.7	2.89
18	ABN AMRO Bank	206,813.702	1.4	1.96
19	Banque Misr Liban	203,212.688	1.4	1.96
20	Lebanon and Gulf Bank	196,314.033	1.4	1.96
21	Universal Bank	157,205.199	1.1	1.21
22	American Express	155,052.079	1.1	1.21
23	North Africa Commercial Bank	154,765.094	1.1	1.21
24	Infibank	144,473.350	1.0	1.00
25	Société Nouvelle de la Banque de Syrie et du Liban	140,314.266	1.0	1.00
26	TransorientBank	135,125.952	0.9	0.81
27	Allied Business Bank	121,391.907	0.8	0.64
28	Crédit Commercial du Moyen-Orient	115,931.002	0.8	0.64
29	Wedge Bank Middle East	114,970.454	0.8	0.64
30	Banca di Roma	114,515.662	0.8	0.64
	Total of the First 30 Banks	**12,870,717.979**	**89.0**	**420.22**
	Total of the Lebanese Banking Industry	**14,468,803.870**	**100.0**	

Source: Baz, Bilanbanques 1993.

The HHI in terms of total assets in the year 1992 is equal to 420, which implies that, in terms of total assets, the banking industry is operating as if there were:

$$N_{A,1992} = 10{,}000 / HHI_{A,1992} = 10{,}000 / 420 = 23.80 \cong 24 \text{ Banks}$$

c- Computation of HHI in 1998

Table 16. Ranking by Total Assets in 1998

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque du Liban et d'Outre-Mer	6,906,426.235	11.4	129.96
2	Banque de la Méditerranée	6,098,224.562	10.0	100.00
3	Byblos Bank	5,145,823.278	8.5	72.25
4	Banque Audi	4,501,017.420	7.4	54.76
5	Banque Libano-Française	4,360,077.656	7.2	51.84
6	Fransabank	3,321,970.599	5.5	30.25
7	Société Générale Libano-Européenne de Banque	2,866,379.524	4.7	22.09
8	Bank of Beirut	2,214,652.000	3.6	12.96
9	Crédit Libanais	2,211,522.817	3.6	12.96
10	Banque Saradar	2,145,455.617	3.5	12.25
11	Banque Nationale de Paris "Intercontinentale"	1,981,022.966	3.3	10.89
12	Arab Bank	1,909,162.081	3.1	9.61
13	Bank of Beirut and the Arab Countries	1,892,118.172	3.1	9.61
14	Banque Libanaise pour le Commerce	1,449,155.000	2.4	5.76
15	Beirut Riyad Bank	1,084,540.128	1.8	3.24
16	ABN AMRO Bank	943,791.814	1.6	2.56
17	The British Bank of the Middle East	920,455.578	1.5	2.25
18	Lebanon and Gulf Bank	817,837.047	1.3	1.69
19	Société Nouvelle de la Banque de Syrie et du Liban	599,941.117	1.0	1.00
20	Banque Misr Liban	560,033.106	0.9	0.81
21	Lebanese Canadian Bank	485,051.693	0.8	0.64
22	United Bank of Lebanon	478,603.349	0.8	0.64
23	BEMO–Banque Européenne pour le Moyen-Orient	436,376.514	0.7	0.49
24	Banque de l'Industrie et du Travail	412,185.801	0.7	0.49
25	Inaash Bank	398,628.278	0.7	0.49
26	Allied Business Bank	356,286.126	0.6	0.36
27	Al-Mawarid Bank	304,927.338	0.5	0.25
28	Bank of Kuwait and the Arab World	295,755.106	0.5	0.25
29	Near East Commercial Bank	288,218.737	0.5	0.25
30	Middle East & Africa Bank	274,990.046	0.5	0.25
	Total of the First 30 Banks	**55,660,629.705**	**91.7**	**550.85**
	Total of the Lebanese Banking Industry	**60,805,154.750**	**100.0**	

Source: Baz, Bilanbanques 1999.

The HHI in terms of total assets in the year 1998 is equal to 551, which implies that, in terms of total assets, the banking industry is operating as if there were:

$$N_{A,1998} = 10{,}000 / HHI_{A,1998} = 10{,}000 / 551 = 18.14 \cong 18 \text{ Banks}$$

d- Summary and Analysis of the Results

The values of the HHI in terms of assets for the years 1985, 1992, and 1998 can be summarized in the following graph:

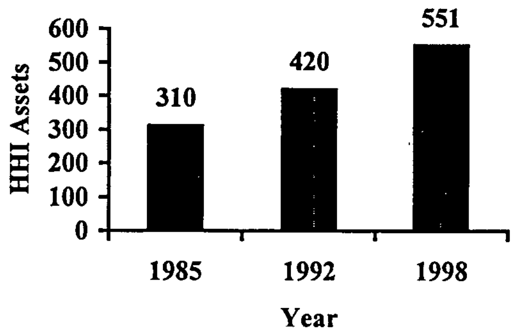

Figure 1: Concentration in Terms of Assets for 1985, 1992, and 1998.

From the above figure, it can be noticed that the concentration in terms of assets in the banking industry has increased in the last few years from 310 in 1985 to 551 in 1998, equivalent to an increase of concentration by 78% in 13 years.

This dramatic change in concentration can be attributed to the expansion in the banking sector which revealed itself to be much more reliable and the attraction of more investments and clients, mainly by the top banks. Also, the mergers which increased the assets of the merging banks like the case of the consolidation between Byblos Bank and Banque Beyrouth pour le Commerce which led to a reduction in the distribution of assets. Another reason is the enlargement of the network of branches of the more important banks.

2- Change in Concentration of Customers' Deposits

a- Computation of HHI in 1985

Table 17. Ranking by Customers' Deposits in 1985

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque du Liban et d'Outre-Mer	10,647.363	8.11	65.7721
2	Banque Libano-Française	7,833.876	5.96	35.5216
3	Crédit Libanais	6,434.858	4.90	24.0100
4	Banque Audi	5,973.156	4.55	20.7025
5	Fransabank	5,748.079	4.38	19.1844
6	Arab Bank Limited	5,663.040	4.31	18.5761
7	Banque Byblos	5,014.784	3.82	14.5924
8	Banque Almashrek	4,575.239	3.48	12.1104
9	Beirut Riyad Bank	4,316.692	3.29	10.8241
10	Mebco Bank (Middle East Banking Company)	3,970.269	3.02	9.1204
11	Bank of Beirut and the Arab Countries	3,727.648	2.84	8.0656
12	Banque de la Méditerranée	3,717.848	2.83	8.0089
13	Banque Libanaise pour le Commerce	3,545.188	2.70	7.2900
14	Banque Nationale de Paris "Intercontinentale"	3,399.212	2.59	6.7081
15	Banque du Crédit Populaire	2,928.120	2.23	4.9729
16	The British Bank of the Middle East	2,853.635	2.17	4.7089
17	Banque Saradar	2,705.667	2.06	4.2436
18	Société Générale Libano-Européenne de Banque	2,694.294	2.05	4.2025
19	Société Nouvelle de la Banque de Syrie et du Liban	2,613.748	1.99	3.9601
20	Banque de l'Industrie et du Travail	1,959.535	1.49	2.2201
21	Lebanon and Gulf Bank	1,884.702	1.44	2.0736
22	Banque G. Trad – Crédit Lyonnais	1,859.833	1.42	2.0164
23	Jammal Trust Bank	1,841.073	1.40	1.9600
24	Banque Misr-Liban	1,837.199	1.40	1.9600
25	Saudi Lebanese Bank	1,627.664	1.24	1.5376
26	Adcom Bank (Advances and Commerce Bank)	1,608.672	1.22	1.4884
27	Banca di Roma	1,583.361	1.21	1.4641
28	Banque Libano-Brésilienne	1,515.511	1.15	1.3225
29	TransorientBank	1,475.555	1.12	1.2544
30	Banque Beyrouth pour le Commerce	1,370.235	1.04	1.0816
	Total of the First 30 Banks	**106,926.056**	**81.41**	**300.9533**
	Total of the Lebanese Banking Industry	**131,336.581**	**100.00**	

Source: Baz, Bilanbanques 1986.

The HHI in terms of customers' deposits in the year 1985 is equal to 301, which implies that, in terms of customers' deposits, the banking industry is operating as if there were:

$$N_{D,1985} = 10{,}000 / HHI_{D,1985} = 10{,}000 / 301 = 33.22 \cong 33 \text{ Banks}$$

b- Computation of HHI in 1992

Table 18. Ranking by Customers' Deposits in 1992

	Bank	LL Million	Market Share (%)	(Market Share)^2
1	Banque du Liban et d'Outre-Mer	1,093,617.282	8.8	77.44
2	Banque Nationale de Paris "Intercontinentale"	922,154.890	7.4	54.76
3	Arab Bank	917,984.907	7.4	54.76
4	Banque de la Méditerranée	846,932.948	6.8	46.24
5	Banque Libano-Française	791,927.157	6.4	40.96
6	Banque Audi	641,093.775	5.2	27.04
7	Société Générale Libano-Européenne de Banque	610,807.429	4.9	24.01
8	Fransabank	566,426.889	4.6	21.16
9	Byblos Bank	479,171.885	3.9	15.21
10	Bank of Beirut and the Arab Countries	458,482.904	3.7	13.69
11	Crédit Libanais	429,529.170	3.5	12.25
12	The British Bank of the Middle East	426,563.977	3.4	11.56
13	Saudi Lebanese Bank	338,745.940	2.7	7.29
14	Beirut Riyad Bank	334,464.478	2.7	7.29
15	Banque Libanaise pour le Commerce	277,921.790	2.2	4.84
16	Banque Saradar	258,220.799	2.1	4.41
17	Banque Beyrouth pour le Commerce	213,110.737	1.7	2.89
18	ABN AMRO Bank	180,116.914	1.5	2.25
19	Lebanon and Gulf Bank	177,258.186	1.4	1.96
20	Banque Misr Liban	161,173.754	1.3	1.69
21	Infibank	138,946.201	1.1	1.21
22	American Express	125,239.850	1.0	1.00
23	Société Nouvelle de la Banque de Syrie et du Liban	124,997.216	1.0	1.00
24	Banca di Roma	112,675.029	0.9	0.81
25	Universal Bank	107,511.731	0.9	0.81
26	TransorientBank	104,381.911	0.8	0.64
27	Allied Business Bank	102,494.005	0.8	0.64
28	Wedge Bank Middle East	99,684.147	0.8	0.64
29	Crédit Commercial du Moyen-Orient	97,116.834	0.8	0.64
30	Rifbank	86,925.417	0.7	0.49
	Total of the First 30 Banks	**11,225,678.152**	**90.4**	**439.58**
	Total of the Lebanese Banking Industry	**12,402,679.473**	**100.0**	

Source: Baz, Bilanbanques 1993.

The HHI in terms of customers' deposits in the year 1992 is equal to 440, which implies that, in terms of customers' deposits, the banking industry is operating as if there were:

$$N_{D,1992} = 10{,}000 \,/\, HHI_{D,1992} = 10{,}000 \,/\, 440 = 22.72 \cong 23 \text{ Banks}$$

c- Computation of HHI in 1998

Table 19. Ranking by Customers' Deposits in 1998

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque du Liban et d'Outre-Mer	5,822,595.663	12.1	146.41
2	Banque de la Méditerranée	4,653,991.330	9.7	94.09
3	Byblos Bank	3,799,584.953	7.9	62.41
4	Banque Audi	3,657,469.416	7.6	57.76
5	Banque Libano-Française	3,537,261.511	7.3	53.29
6	Fransabank	2,587,207.376	5.4	29.16
7	Société Générale Libano-Européenne de Banque	2,446,324.518	5.1	26.01
8	Banque Nationale de Paris "Intercontinentale"	1,796,823.562	3.7	13.69
9	Crédit Libanais	1,791,896.133	3.7	13.69
10	Arab Bank	1,751,472.153	3.6	12.96
11	Bank of Beirut	1,720,287.000	3.6	12.96
12	Bank of Beirut and the Arab Countries	1,570,649.278	3.3	10.89
13	Banque Saradar	1,563,671.650	3.2	10.24
14	Banque Libanaise pour le Commerce	1,165,617.000	2.4	5.76
15	Beirut Riyad Bank	881,294.069	1.8	3.24
16	ABN AMRO Bank	813,201.686	1.7	2.89
17	The British Bank of the Middle East	804,367.378	1.7	2.89
18	Lebanon and Gulf Bank	700,424.246	1.5	2.25
19	Société Nouvelle de la Banque de Syrie et du Liban	502,340.579	1.0	1.00
20	Banque Misr Liban	465,755.609	1.0	1.00
21	Lebanese Canadian Bank	411,395.153	0.9	0.81
22	Banque de l'Industrie et du Travail	337,840.060	0.7	0.49
23	BEMO–Banque Européenne pour le Moyen-Orient	327,585.808	0.7	0.49
24	Allied Business Bank	299,582.302	0.6	0.36
25	Inaash Bank	298,166.943	0.6	0.36
26	Near East Commercial Bank	267,516.855	0.6	0.36
27	Al-Mawarid Bank	252,604.242	0.5	0.25
28	Bank of Kuwait and the Arab World	242,905.979	0.5	0.25
29	United Bank of Lebanon	235,389.720	0.5	0.25
30	Wedge Bank Middle East	221,322.905	0.5	0.25
	Total of the First 30 Banks	**44,926,545.077**	**93.4**	**566.46**
	Total of the Lebanese Banking Industry	**48,133,601.612**	**100.0**	

Source: Baz, Bilanbanques 1999.

The HHI in terms of customers' deposits in the year 1998 is equal to 567, which implies that, in terms of customers' deposits, the banking industry is operating as if there were:

$$N_{D,1998} = 10{,}000 \,/\, HHI_{D,1998} = 10{,}000 \,/\, 567 = 17.63 \cong 18 \text{ Banks}$$

d- Summary and Analysis of the Results

The values of the HHI in terms of customers' deposits for the years 1985, 1992, and 1998 can be summarized in the following graph:

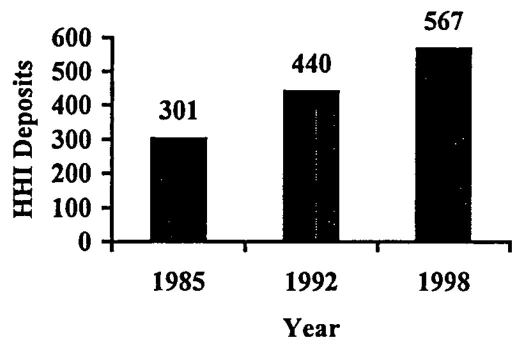

Figure 2: Concentration in Terms of Customers' Deposits for 1985, 1992, and 1998.

Concerning this variable, the HHI rose from 301 to 440 to 567 in respectively 1985, 1992, and 1998 reflecting an increase in concentration of customers' deposits.

The reasons for this increase are, in addition to the mergers which immediately increase the volume and percentage of deposits of the merging bank, the perception of customers which give them more trust in higher ranked banks. The increase in the number of branches of the latter banks and their wide spreading in all the Lebanese regions, which make them acquire a bigger number of deposits because of the ease of accessibility everywhere. Also, due to the increased competition in the banking sector, top banks became more flexible, aggressive, and innovative (new products, new technologies, better customer service). Due to economies of scale, they can have lower costs and better resources, which results in their being able to attract a higher amount of deposits, the thing that small banks cannot afford.

3- Change in Concentration of Number of Branches

For the case of the number of branches the years 1996, 1997, and 1998 were chosen in order to reflect the most recent changes resulting from the consolidations.

a- Computation of HHI in 1996

Table 20. Ranking by Number of branches in 1996

	Bank	Branches	Market Share (%)	(Market Share)²
1	Crédit Libanais	45	6.71	45.0241
2	Fransabank	40	5.96	35.5216
3	Banque du Liban et d'Outre-Mer	39	5.81	33.7561
4	Banque Libanaise pour le Commerce	38	5.66	32.0356
5	Bank of Beirut and the Arab Countries	29	4.32	18.6624
5	Byblos Bank	29	4.32	18.6624
5	Société Générale Libano-Européenne de Banque	29	4.32	18.6624
8	Banque de la Méditerranée	28	4.17	17.3889
9	Banque Audi	25	3.73	13.9129
10	Jammal Trust Bank	22	3.28	10.7584
11	Banque Libano-Française	19	2.83	8.0089
11	Société Nouvelle de la Banque de Syrie et du Liban	19	2.83	8.0089
13	Banque Beyrouth pour le Commerce	18	2.68	7.1824
14	Banque Misr Liban	17	2.53	6.4009
15	Allied Business Bank	12	1.79	3.2041
15	Beirut Riyad Bank	12	1.79	3.2041
15	TransorientBank	12	1.79	3.2041
18	Bank of Kuwait and the Arab World	11	1.64	2.6896
18	Banque de l'Industrie et du Travail	11	1.64	2.6896
20	Al-Mawarid Bank	10	1.49	2.2201
20	Arab Bank	10	1.49	2.2201
20	Bank of Beirut	10	1.49	2.2201
23	Lebanon and Gulf Bank	9	1.34	1.7956
24	Crédit Commercial du Moyen-Orient	8	1.19	1.4161
24	Crédit Bancaire	8	1.19	1.4161
24	Federal Bank of Lebanon	8	1.19	1.4161
24	Inaash Bank	8	1.19	1.4161
28	Bank Al-Madina	6	0.89	0.7921
28	Banque Pharaon et Chiha	6	0.89	0.7921
28	Banque Saradar	6	0.89	0.7921
	Total of the First 30 Banks	**544**	**81.04**	**305.474**
	Total of the Lebanese Banking Industry	**677**	**100.00**	

Source: Baz, Bilanbanques 1997.

The HHI in terms of number of branches in the year 1996 is equal to 305, which implies that, in terms of number of branches, the banking industry is operating as if there were:

$$N_{B,1996} = 10{,}000 / HHI_{B,1996} = 10{,}000 / 305 = 32.78 \cong 33 \text{ Banks}$$

b- Computation of HHI in 1997

Table 21. Ranking by Number of branches in 1997

	Bank	Branches	Market Share (%)	(Market Share)²
1	Byblos Bank	51	7.37	54.3169
2	Crédit Libanais	45	6.50	42.2500
3	Banque du Liban et d'Outre-Mer	41	5.92	35.0464
4	Fransabank	40	5.78	33.4084
5	Banque Libanaise pour le Commerce	38	5.49	30.1401
6	Banque Audi	33	4.77	22.7529
7	Société Générale Libano-Européenne de Banque	30	4.34	18.8356
8	Bank of Beirut and the Arab Countries	29	4.19	17.5561
9	Banque de la Méditerranée	28	4.05	16.4025
10	Jammal Trust Bank	22	3.18	10.1124
10	Banque Libano-Française	22	3.18	10.1124
12	Société Nouvelle de la Banque de Syrie et du Liban	19	2.75	7.5625
13	Banque Misr Liban	17	2.46	6.0516
14	Allied Business Bank	13	1.88	3.5344
14	TransorientBank	13	1.88	3.5344
16	Beirut Riyad Bank	12	1.73	2.9929
16	Bank of Beirut	12	1.73	2.9929
18	Bank of Kuwait and the Arab World	11	1.59	2.5281
18	Banque de l'Industrie et du Travail	11	1.59	2.5281
20	Al-Mawarid Bank	10	1.45	2.1025
20	Arab Bank	10	1.45	2.1025
22	Lebanon and Gulf Bank	9	1.30	1.6900
23	Crédit Bancaire	8	1.16	1.3456
23	Federal Bank of Lebanon	8	1.16	1.3456
23	Inaash Bank	8	1.16	1.3456
23	National Bank of Kuwait (Lebanon)	8	1.16	1.3456
27	Orient Credit Bank	7	1.01	1.0201
28	Bank Al-Madina	6	0.87	0.7569
28	Banque Pharaon et Chiha	6	0.87	0.7569
28	Banque Saradar	6	0.87	0.7569
	Total of the First 30 Banks	**573**	**82.84**	**337.2268**
	Total of the Lebanese Banking Industry	**698**	**100.00**	

Source: Baz, Bilanbanques 1998.

The HHI in terms of number of branches in the year 1997 is equal to 337, which implies that, in terms of number of branches, the banking industry is operating as if there were:

$$N_{B,1997} = 10{,}000 \,/\, HHI_{B,1997} = 10{,}000 \,/\, 337 = 29.67 \cong 30 \text{ Banks}$$

c- Computation of HHI in 1998

Table 22. Ranking by Number of branches in 1998

	Bank	Branches	Market Share (%)	(Market Share)²
1	Byblos Bank	51	7.06	49.8436
2	Crédit Libanais	45	6.23	38.8129
3	Fransabank	42	5.82	33.8724
3	Banque Audi	42	5.82	33.8724
5	Banque du Liban et d'Outre-Mer	41	5.68	32.2624
6	Banque Libanaise pour le Commerce	39	5.40	29.1600
7	Société Générale Libano-Européenne de Banque	30	4.16	17.3056
8	Bank of Beirut and the Arab Countries	29	4.02	16.1604
8	Bank of Beirut	29	4.02	16.1604
10	Banque de la Méditerranée	28	3.88	15.0544
11	Banque Libano-Française	22	3.05	9.3025
11	Jammal Trust Bank	22	3.05	9.3025
13	Société Nouvelle de la Banque de Syrie et du Liban	19	2.63	6.9169
14	Banque Misr Liban	17	2.35	5.5225
15	Allied Business Bank	14	1.94	3.7636
16	Beirut Riyad Bank	12	1.66	2.7556
16	Bank of Kuwait and the Arab World	12	1.66	2.7556
16	Inaash Bank	12	1.66	2.7556
19	Banque de l'Industrie et du Travail	11	1.52	2.3104
20	Al-Mawarid Bank	10	1.39	1.9321
20	Arab Bank	10	1.39	1.9321
22	Lebanon and Gulf Bank	9	1.25	1.5625
22	National Bank of Kuwait (Lebanon)	9	1.25	1.5625
24	Crédit Bancaire	8	1.11	1.2321
24	Federal Bank of Lebanon	8	1.11	1.2321
24	Bank Al-Madina	8	1.11	1.2321
24	Lebanese Canadian Bank	8	1.11	1.2321
24	United Bank of Lebanon	8	1.11	1.2321
29	BCP Oriel Bank	7	0.97	0.9409
30	Banque Nationale de Paris "Intercontinentale"	6	0.83	0.6889
	Total of the First 30 Banks	**608**	**84.24**	**342.6692**
	Total of the Lebanese Banking Industry	**724**	**100.00**	

Source: Baz, Bilanbanques 1999.

The HHI in terms of number of branches in the year 1998 is equal to 343, which implies that, in terms of number of branches, the banking industry is operating as if there were:

$$N_{B,1998} = 10,000 / HHI_{B,1998} = 10,000 / 343 = 29.15 \cong 29 \text{ Banks}$$

d- Summary and Analysis of the Results

The values of the HHI in terms of number of branches for the years 1996, 1997, and 1998 can be summarized in the following graph:

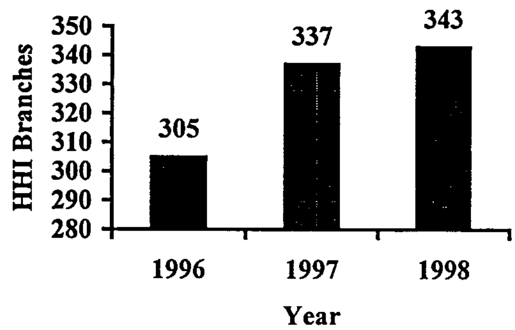

Figure 3: Concentration in Terms of Number of Branches for 1996, 1997, and 1998.

In the case of number of branches, HHI increased from 305 in 1996 to 337 in 1997, or 10.5% increase, and from 337 in 1997 to 343 in 1998, or 2% increase.

The higher increase between 1996 and 1997 is especially the result of some mergers that took place, mainly that of Byblos Bank with Banque Beyrouth pour le Commerce which increased the rank of Byblos Bank from 5th with 29 branches in 1996 to 1st with 51 branches in 1997, and the merger between Banque Audi and Crédit Commercial du Moyen-Orient which resulted in Banque Audi augmenting its branches from 25 to 33.

In 1998, the increase in concentration is lower because smaller mergers (in terms of number of branches) took place that year. The most important was the merger between Bank of Beirut and TransOrient Bank that increased the number of branches of Bank of Beirut from 12 in 1997 to 29 in 1998.

4- Change in Concentration of Loans and Discounts

a- Computation of HHI in 1985

Table 23. Ranking by Loans and Discounts in 1985

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque Libano-Française	4,240.843	6.32	39.9424
2	Banque du Liban et d'Outre-Mer	3,076.074	4.59	21.0681
3	Banque Audi	2,930.254	4.37	19.0969
4	Mebco Bank (Middle East Banking Company)	2,858.478	4.26	18.1476
5	Fransabank	2,851.232	4.25	18.0625
6	Banque Almashrek	2,822.742	4.21	17.7241
7	Beirut Riyad Bank	2,679.261	3.99	15.9201
8	Banque Byblos	2,377.461	3.54	12.5316
9	Banque de la Méditerranée	2,064.961	3.08	9.4864
10	Banque Libanaise pour le Commerce	1,877.548	2.80	7.8400
11	Banque de l'Industrie et du Travail	1,726.273	2.57	6.6049
12	Société Nouvelle de la Banque de Syrie et du Liban	1,657.371	2.47	6.1009
13	Banque du Crédit Populaire	1,587.855	2.37	5.6169
14	Bank of Beirut and the Arab Countries	1,495.963	2.23	4.9729
15	Crédit Libanais	1,432.692	2.14	4.5796
16	Jammal Trust Bank	1,423.840	2.12	4.4944
17	Société Générale Libano-Européenne de Banque	1,415.697	2.11	4.4521
18	Banque G. Trad – Crédit Lyonnais	1,357.836	2.02	4.0804
19	Banque Saradar	1,301.347	1.94	3.7636
20	Adcom Bank (Advances and Commerce Bank)	1,155.055	1.72	2.9584
21	United Bank of Lebanon and Pakistan	1,095.980	1.63	2.6569
22	Arab Bank Limited	1,047.377	1.56	2.4336
23	Banque Misr-Liban	1,003.011	1.50	2.2500
24	Banque Nationale de Paris "Intercontinentale"	986.543	1.47	2.1609
25	The Arab Libyan Tunisian Bank	927.533	1.38	1.9044
26	Litex Bank	844.811	1.26	1.5876
27	Banque Libano-Brésilienne	825.419	1.23	1.5129
28	Lebanon and Gulf Bank	824.011	1.23	1.5129
29	Capital Trust Bank	799.916	1.19	1.4161
30	Transorient Bank	799.470	1.19	1.4161
	Total of the First 30 Banks	**51,486.854**	**76.74**	**246.2952**
	Total of the Lebanese Banking Industry	**67,086.948**	**100.00**	

Source: Baz, Bilanbanques 1986.

The HHI in terms of loans and discounts in the year 1985 is equal to 246, which implies that, in terms of loans and discounts, the banking industry is operating as if there were:

$$N_{L,1985} = 10{,}000 / HHI_{L,1985} = 10{,}000 / 246 = 40.65 \cong 41 \text{ Banks}$$

b- Computation of HHI in 1992

Table 24. Ranking by Loans and Discounts in 1992

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque de la Méditerranée	524,642.125	13.0	169
2	Banque Libano-Française	281,935.841	7.0	49
3	Banque Nationale de Paris "Intercontinentale"	221,914.420	5.5	30.25
4	Banque Audi	220,199.691	5.5	30.25
5	Société Générale Libano-Européenne de Banque	212,785.317	5.3	28.09
6	Byblos Bank	192,825.307	4.8	23.04
7	Fransabank	192,159.881	4.8	23.04
8	Banque du Liban et d'Outre-Mer	176,012.003	4.4	19.36
9	Beirut Riyad Bank	163,987.869	4.1	16.81
10	Saudi Lebanese Bank	132,351.943	3.3	10.89
11	Banque Libanaise pour le Commerce	116,669.346	2.9	8.41
12	Bank of Beirut and the Arab Countries	96,874.564	2.4	5.76
13	Crédit Libanais	96,842.246	2.4	5.76
14	Lebanon and Gulf Bank	85,862.105	2.1	4.41
15	ABN AMRO Bank	84,697.753	2.1	4.41
16	Universal Bank	78,514.090	1.9	3.61
17	Arab Bank	77,551.265	1.9	3.61
18	Banque Saradar	68,618.152	1.7	2.89
19	North Africa Commercial Bank	66,205.796	1.6	2.56
20	Banque Beyrouth pour le Commerce	64,364.678	1.6	2.56
21	American Express	60,023.263	1.5	2.25
22	TransorientBank	54,973.401	1.4	1.96
23	Banque de l'Industrie et du Travail	49,643.310	1.2	1.44
24	Banque Misr Liban	46,982.934	1.2	1.44
25	The British Bank of the Middle East	46,652.135	1.2	1.44
26	Crédit Commercial du Moyen-Orient	45,288.086	1.1	1.21
27	Allied Business Bank	37,213.829	0.9	0.81
28	Bank Al-Madina	35,455.484	0.9	0.81
29	United Bank of Saudia and Lebanon	35,288.902	0.9	0.81
30	Crédit Bancaire	33,508.968	0.8	0.64
	Total of the First 30 Banks	**3,600,044.704**	**89.4**	**456.52**
	Total of the Lebanese Banking Industry	**4,039,797.338**	**100.0**	

Source: Baz, Bilanbanques 1993.

The HHI in terms of loans and discounts in the year 1992 is equal to 457, which implies that, in terms of loans and discounts, the banking industry is operating as if there were:

$$N_{L,1992} = 10{,}000 / HHI_{L,1992} = 10{,}000 / 457 = 21.88 \cong 22 \text{ Banks}$$

c- Computation of HHI in 1998

Table 25. Ranking by Loans and Discounts in 1998

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque de la Méditerranée	2,485,842.128	13.3	176.89
2	Banque du Liban et d'Outre-Mer	1,484,393.244	7.9	62.41
3	Byblos Bank	1,426,818.570	7.6	57.76
4	Banque Libano-Française	1,416,866.068	7.6	57.76
5	Banque Audi	1,296,210.818	6.9	47.61
6	Banque Saradar	974,922.889	5.2	27.04
7	Société Générale Libano-Européenne de Banque	954,280.287	5.1	26.01
8	Fransabank	878,343.926	4.7	22.09
9	Bank of Beirut	640,628.000	3.4	11.56
10	Banque Nationale de Paris "Intercontinentale"	632,480.064	3.4	11.56
11	Banque Libanaise pour le Commerce	597,617.000	3.2	10.24
12	Arab Bank	550,834.982	2.9	8.41
13	Beirut Riyad Bank	526,286.755	2.8	7.84
14	Crédit Libanais	422,525.511	2.3	5.29
15	Bank of Beirut and the Arab Countries	403,157.401	2.2	4.84
16	ABN AMRO Bank	358,857.170	1.9	3.61
17	The British Bank of the Middle East	318,703.070	1.7	2.89
18	Lebanon and Gulf Bank	272,245.499	1.5	2.25
19	United Bank of Lebanon	157,280.750	0.8	0.64
20	Banque de l'Industrie et du Travail	157,217.070	0.8	0.64
21	Lebanese Canadian Bank	134,390.766	0.7	0.49
22	Al-Mawarid Bank	131,761.629	0.7	0.49
23	Inaash Bank	131,642.125	0.7	0.49
24	Allied Business Bank	124,185.022	0.7	0.49
25	BEMO–Banque Européenne pour le Moyen-Orient	121,830.245	0.7	0.49
26	United Bank of Saudia and Lebanon	116,280.147	0.6	0.36
27	North Africa Commercial Bank	111,366.298	0.6	0.36
28	Société Nouvelle de la Banque de Syrie et du Liban	108,126.275	0.6	0.36
29	Banque Misr Liban	102,337.310	0.5	0.25
30	Bank Al-Madina	102,030.401	0.5	0.25
	Total of the First 30 Banks	**17,139,461.420**	**91.5**	**551.37**
	Total of the Lebanese Banking Industry	**18,735,181.844**	**100.0**	

Source: Baz, Bilanbanques 1999.

The HHI in terms of loans and discounts in the year 1998 is equal to 551, which implies that, in terms of loans and discounts, the banking industry is operating as if there were:

$$N_{L,1998} = 10{,}000 \,/\, HHI_{L,1998} = 10{,}000 \,/\, 551 = 18.14 \cong 18 \text{ Banks}$$

d- Summary and Analysis of the Results

The values of the HHI in terms of loans and discounts for the years 1985, 1992, and 1998 can be summarized in the following graph:

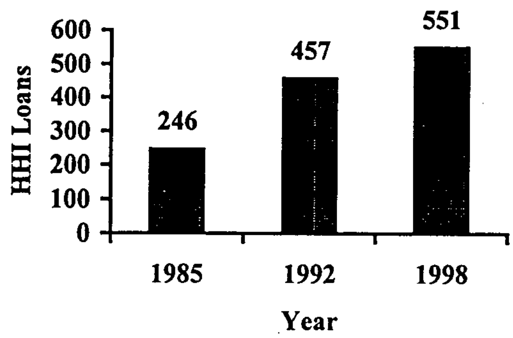

Figure 4: Concentration in Terms of Loans and Discounts for 1985, 1992, and 1998.

The above figure shows that the concentration of loans and discounts is also increasing and following the trend of other variables in the banking sector.

The shares of lending of top banks are increasing while those of small banks are diminishing due to the fact that top banks have more deposits and new products concerning loans and facilities. In addition, mergers have their effect on the result because of the accumulations of the loans of the two concerned banks in addition to their capacity of lending. For example, in 1992 Byblos Bank ranked 6th with 4.8% of the market share in terms of loans. After the merger with Banque Beyrouth pour le Commerce, this percentage increased to 7.6% and Byblos ranked third.

5- Change in Concentration of Profits

For the computation of the concentration of profits, reference was made to the years 1992 (end of the war), 1996 (direct year before mergers started), and 1998.

a- Computation of HHI in 1992

Table 26. Ranking by Profits in 1992

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque Nationale de Paris "Intercontinentale"	15,071.372	17.7	313.29
2	Banque Libano-Française	15,009.516	17.6	309.76
3	Bank of Beirut and the Arab Countries	9,039.044	10.6	112.36
4	Banque du Liban et d'Outre-Mer Arab Bank	7,025.831	8.2	67.24
5	Fransabank	6,290.253	7.4	54.76
6	Arab Bank	6,281.327	7.4	54.76
7	Banque Pharaon et Chiha	5,719.629	6.7	44.89
8	The British Bank of the Middle East	5,132.572	6.0	36.00
9	Byblos Bank	3,074.691	3.6	12.96
10	Banque Audi	2,591.782	3.0	9.00
11	ABN AMRO Bank	2,321.206	2.7	7.29
12	The Syrian Lebanese Commercial Bank	1,568.983	1.8	3.24
13	Société Nouvelle de la Banque de Syrie et du Liban	1,477.488	1.7	2.89
14	Crédit Libanais	762.219	0.9	0.81
15	Banque de Financement	701.248	0.8	0.64
16	Wedge Bank Middle East	692.472	0.8	0.64
17	Lebanese Swiss Bank	681.133	0.8	0.64
18	Crédit Commercial du Moyen-Orient	647.907	0.8	0.64
19	Banque Misr Liban	631.255	0.7	0.49
20	Allied Business Bank	625.598	0.7	0.49
21	Crédit Bancaire	554.368	0.7	0.49
22	Infibank	482.173	0.6	0.36
23	Intercontinental Bank of Lebanon	235.678	0.3	0.09
24	Banque Saradar	226.962	0.3	0.09
25	Saudi National Commercial Bank	217.047	0.3	0.09
26	Société Bancaire du Liban	197.350	0.2	0.04
27	Al-Mawarid Bank	176.654	0.2	0.04
28	Habib Bank Limited	163.916	0.2	0.04
29	Banque de la Méditerranée	149.224	0.2	0.04
30	Commercial Facilities Bank	147.294	0.2	0.04
	Total of the First 30 Banks	**87,896.192**	***103.1**	**1034.11**
	Total of the Lebanese Banking Industry	**85,280.575**	**100.0**	

Source: Baz, Bilanbanques 1993.

* The total percentage of the 30 banks is equal to 103.1 while that of the industry is 100 because some lower ranking banks had negative results.

The HHI in terms of profits in the year 1992 is equal to 1,034, which implies that, in terms of profits, the banking industry is operating as if there were:

$$N_{P,1992} = 10{,}000 / HHI_{P,1992} = 10{,}000 / 1{,}034 = 9.67 \cong 10 \text{ Banks}$$

b- Computation of HHI in 1996

Table 27. Ranking by Profits in 1996

	Bank	LL Million	Market Share (%)	(Market Share)²
	Total			
1	Banque Libano-Française	51,692.380	10.8	116.64
2	Banque de la Méditerranée	45,839.655	9.5	90.25
3	Fransabank	42,091.668	8.8	77.44
4	Banque du Liban et d'Outre-Mer	42,043.810	8.7	75.69
5	Byblos Bank	39,740.424	8.3	68.89
6	Banque Audi	30,714.429	6.4	40.96
7	Société Générale Libano-Européenne de Banque	26,000.000	5.4	29.16
8	Banque Nationale de Paris "Intercontinentale"	25,166.222	5.2	27.04
9	Arab Bank	18,082.603	3.8	14.44
10	Bank of Beirut and the Arab Countries	15,122.276	3.1	9.61
11	The British Bank of the Middle East	13,125.322	2.7	7.29
12	Banque Libanaise pour le Commerce	9,068.000	1.9	3.61
13	Bank of Beirut	7,990.267	1.7	2.89
14	Banque Beyrouth pour le Commerce	7,586.398	1.6	2.56
15	Banque Saradar	7,457.139	1.6	2.56
16	Banque de l'Habitat	7,251.817	1.5	2.25
17	Transorient Bank	7,127.986	1.5	2.25
18	ABN AMRO Bank	6,281.318	1.3	1.69
19	The Syrian Lebanese Commercial Bank	6,053.000	1.3	1.69
20	Beirut Riyad Bank	5,915.553	1.2	1.44
21	Crédit Libanais	5,509.320	1.1	1.21
22	Crédit Commercial du Moyen-Orient	4,797.367	1.0	1.00
23	Société Nouvelle de la Banque de Syrie et du Liban	4,630.356	1.0	1.00
24	Banque de Crédit National	4,280.473	0.9	0.81
25	Banque Misr Liban	4,222.990	0.9	0.81
26	Allied Business Bank	4,114.595	0.9	0.81
27	Banque de Financement	3,744.809	0.8	0.64
28	Bank of Kuwait and the Arab World	3,513.370	0.7	0.49
29	Lebanese Swiss Bank	3,477.078	0.7	0.49
30	Lebanese Canadian Bank	3,412.928	0.7	0.49
	Total of the First 30 Banks	**456,053.553**	**95.0**	**586.1**
	Total of the Lebanese Banking Industry	**480,569.300**	**100.0**	

Source: Baz, Bilanbanques 1997.

The HHI in terms of profits in the year 1996 is equal to 586, which implies that, in terms of profits, the banking industry is operating as if there were:

$$N_{P,1996} = 10{,}000 \,/\, HHI_{P,1996} = 10{,}000 \,/\, 586 = 17.06 \cong 17 \text{ Banks}$$

c- Computation of HHI in 1998

Table 28. Ranking by Profits in 1998

	Bank	LL Million	Market Share (%)	(Market Share)²
1	Banque du Liban et d'Outre-Mer	88,464.702	11.9	141.61
2	Banque de la Méditerranée	82,739.256	11.1	123.21
3	Byblos Bank	75,002.964	10.1	102.01
4	Banque Libano-Française	71,779.036	9.6	92.16
5	Fransabank	67,715.070	9.1	82.81
6	Banque Audi	56,552.452	7.6	57.76
7	Société Générale Libano-Européenne de Banque	29,690.000	4.0	16.00
8	Banque Nationale de Paris "Intercontinentale"	24,345.474	3.3	10.89
9	Banque Saradar	23,790.989	3.2	10.24
10	Bank of Beirut	21,391.000	2.9	8.41
11	Crédit Libanais	21,027.411	2.8	7.84
12	Banque Libanaise pour le Commerce	17,635.000	2.4	5.76
13	Arab Bank	16,316.117	2.2	4.84
14	The British Bank of the Middle East	14,645.453	2.0	4.00
15	Bank of Beirut and the Arab Countries	14,322.779	1.9	3.61
16	Banque de l'Habitat	13,675.632	1.8	3.24
17	Bank Al-Madina	11,088.529	1.5	2.25
18	Lebanon and Gulf Bank	9,346.862	1.3	1.69
19	ABN AMRO Bank	8,160.689	1.1	1.21
20	BCP ORIEL Bank	7,709.735	1.0	1.00
21	Bank of Kuwait and the Arab World L	5,874.200	0.8	0.64
22	Saudi National Commercial Bank	5,204.095	0.7	0.49
23	Lebanese Swiss Bank	5,129.780	0.7	0.49
24	Banque Misr Liban	4,956.721	0.7	0.49
25	Société Nouvelle de la Banque de Syrie et du Liban	4,457.127	0.6	0.36
26	Banca di Roma	4,438.000	0.6	0.36
27	BEMO–Banque Européenne pour le Moyen-Orient	4,238.023	0.6	0.36
28	Banque de Financement	4,207.666	0.6	0.36
29	The Syrian Lebanese Commercial Bank	2,731.000	0.4	0.16
30	Allied Business Bank	2,723.573	0.4	0.16
	Total of the First 30 Banks	**719,359.335**	**96.9**	**684.41**
	Total of the Lebanese Banking Industry	**746,157.383**	**100**	

Source: Baz, Bilanbanques 1999.

The HHI in terms of profits in the year 1998 is equal to 684, which implies that, in terms of profits, the banking industry is operating as if there were:

$$N_{P,1998} = 10{,}000 \;/\; HHI_{P,1998} = 10{,}000 \;/\; 684 = 14.61 \cong 15 \text{ Banks}$$

d- Summary and Analysis of the Results

The values of the HHI in terms of profits for the years 1992, 1996, and 1998 can be summarized in the following graph:

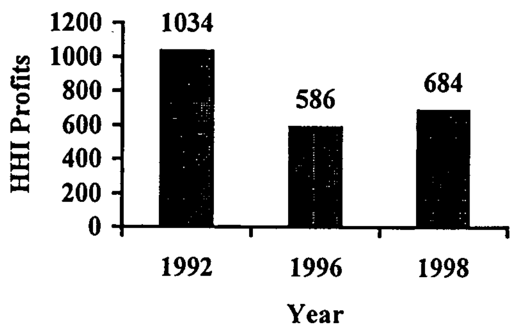

Figure 5: Concentration in Terms of Profits for 1992, 1996, and 1998.

In this case, it can be noticed that the level of concentration is fluctuating from a high of 1034 in 1985, to a low of 586 in 1996, increasing again to 684 in 1998.

The very high concentration in 1992 (industry looking as if it was constituted of only ten banks) reflects the relative chaos that was still reigning on the banking sector at the end of the war (some banks were incurring losses), before new bank regulations started to be applied.

In 1996, the concentration level dropped, reflecting the improvement in the banking sector and the better abiding to the regulations of Banque du Liban.

In 1998, the concentration increased slightly, and this time it is the result of some mergers that took place, in addition to better opportunities, better investments and management of capital by the larger banks which lead to the attraction of clients and the accumulation of profits.

CHAPTER VII

CONCLUSION

After having read these few chapters, one can say that the mergers and acquisitions activity is not a new phenomenon. As we have seen in the first chapter, the United States are currently witnessing the fifth phase of consolidations with the first phase having occurred in the late 1880's and being characterized by the monopolies it created; the second phase, an oligopolistic one, in the 1920's; the third phase took place in the 1960's and gave birth to many conglomerates; and the fourth one, an agglomerate one happened in the 1980's and was characterized by its hostile takeovers and the use of new merger tactics. But the most important phase is the current one with mergers occurring at a higher rate and with enormous dollar values.

The motives behind these mergers and acquisitions are many and include synergy, managerial motives, market power, diversification, and so on.

As we have seen, the banking industry is a major component of the merger activity that is going on. In the United States, the removal of very old legal restrictions constraining bank consolidations, technological change, and increased domestic and global competition, were among the most important motivation factors behind bank mergers. Yet, the Bank Merger Act prohibits the approval of a proposed bank merger if it would result in a monopoly or would decrease competition by limiting the services and increasing their prices.

As for Lebanon, the main motives behind the metamorphosis that is taking place are the awareness of the benefits resulting from mergers, the lower rates on treasury bills, the changing consumer market, technology, and Law No. 192/93 facilitating bank mergers. Although the Central Bank does not encourage mergers between powerful units that would create unbalanced market shares, yet the Lebanese Bank Merger Law does not take into account the anticompetitive effects that would result from some bank mergers. And as it was noticed in the study concerning the change in concentration resulting from the mergers, it is always the same twenty banks that occupy approximately the whole percentage share of each variable.

Anyway, it seems that the years to come are going to witness a higher merger activity and an increase in the capital base reflecting growing local and foreign interests in the Lebanese banking sector from one hand, and on the other hand, reflecting the need to enlarge the financial resources and capital, and decrease costs in order to finance the development, reconstruction and production projects in the country, in addition to being able of diversifying services and products offered (traditional and innovative ones), and face the numerous market risks.

It is thought that, in the next phase, the proliferation of the activities of stocks buying and consolidations in the banking industry is going to give birth to big banking entities, develop their competitive ability, and even enlarge their expansion both locally and internationally, and thus have a more important role in the current reconstruction projects taking place. It is also hoped that the benefits accompanying the increase in the size of the new units will have positive effects on the banks' clients who will enjoy more services and facilities at lower costs, the thing which will in turn enlarge the clientele base, from depositors to creditors.

However, this optimistic view is opposed to another less optimistic one based on some reports and scientific studies made, the fact which makes us suspicious about the success that bank mergers activity will have in achieving the previously expected goals and whether these consolidations will give real value to the shareholders, since concrete evidence are still minimal. Also, many mergers in foreign countries resulted in the annoyance of many clients who stopped dealing with the merging bank and went to other banks, in addition to the fact that a similar abandon by many investors resulted in a sharp decline in the value of the stocks of some bank having merger contracts. Moreover, in addition to the fact that many employees are left out without a job as a result of many banks mergers, the process of integration of the remaining employees with those of the merging banks is always difficult due to the difference in company cultures and the way work is to be done.

Anyway, it is still early to judge the success of the bank consolidations in Lebanon and making more detailed and profound studies is a must in order to reach tangible results.

APPENDIX

BANK MERGER LAW NO. 192/93

On January 4, 1993, "Bank Merger Law" No. 192/93 was issued to facilitate bank mergers. It was the second merger law after decree No. 8284 issued on September 28, 1968 aimed to organize the procedure of bank mergers in Lebanon. The clauses of the bank merger law are presented next:

Article 1

For the sake of this law, the merged bank is the bank that ceases to exist according to the stipulated procedure of this law, in which case all its assets, liabilities, obligations and rights are added to the assets, liabilities, obligations and rights of another bank called the merging bank.

Article 2

The approval of the Central Council of the Central Bank is a prerequisite for each merger of two or more banks. In order to secure this approval, the following procedure is requested:

1- The board of directors of each bank concerned with the merger sends to the Central Council, in the latter's president name, its merger approval request. The following items should be enclosed with the approval request:
   - The preliminary merger agreement among concerned banks

- The latest end of year balance sheet of each bank
- The control commissioners' revaluation report of the concerned banks
- The balance sheet of each concerned bank signed by its Chairman and on his full responsibility as at the latest month prior to the merger request

2- After consulting the Banking Control Commission, and during a delay not exceeding 60 days from the date of presentation of the merger approval request with its enclosures, the Central Council gives its initial approval / disapproval response to the merger. In the case of approval, the Central Council determines the conditions, time limits and guarantees requested for the final approval.

3- The Central Council makes its final decision concerning the merger in a period not exceeding 30 days after having received the evidence documents pertaining to the requested conditions and guarantees including the minutes of the general assemblies of the concerned banks. The final decision, if affirmative, should include deletion of the merged bank's name from the list of banks. This decision is considered final and irrevocable by any ordinary or extraordinary, legal or administrative means, including the recourse to the abuse of power.

4- If the Central Council does not take any decision after the expiry of the 60 and 30 days stated in, respectively, paragraphs 2 and 3 of this article, this delay is considered as an implicit refusal of the merger with the specified conditions in the approval request. This refusal decision is irrevocable by any ordinary or extraordinary, legal or administrative means, including the recourse to the abuse of power.

Article 3

The chairmen of the banks requesting merger, or their delegates, are allowed, subject to the prior permission of the governor of the Central Bank, to exchange only among themselves, information related to their banks' clients and their accounts. These information should be restricted to such authorized personnel who are at all times subject to the bank secrecy law whether the merger eventually takes place or not.

Article 4

1- The merging bank automatically and legally replaces the merged bank(s) in all its rights, assets, and obligations toward the public once the final approval of the Central Council has been declared. This replacement does not need the approval or notification of the holders of these rights and obligations especially concerning lease contracts, pending lawsuits, deposits, loans and corresponding personal guarantees and collaterals, and job contracts.

2- The merging bank should publish in the official gazette and in a minimum of two local newspapers, during a period of one month after the final approval, a resume of the decisions of the general assemblies that have requested the merger and the final approval of the Central Council.

3- It is allowed to terminate job contracts of some of the employees of the merged bank during a period of six months after the final approval of the Central Council under the following conditions:

a- The termination of jobs is to take place only once for all the cases with a clear declaration that the decision is taken as a result of the merger.

b- The employees whose jobs have been terminated are entitled to benefit from all the rights and benefits stated in the exercised rules and regulations and the rights and benefits stated in the collective agreement between the Lebanese Banking Association and the Lebanese Syndicate of Bank Employees.

c- In addition to these rights and benefits, the concerned employees are exceptionally entitled to an additional indemnity equal to the end-of-work indemnity. Such indemnity should not be less than the equivalent of six months salary and not exceeding the total salaries received during the last three years.

These indemnities are exempt from income taxation and the fired employees may not claim additional compensation.

Article 5

1- If, as a result of the merger, the merging bank violates articles 152, 153 and 154 of the Code of Money and Credit or the circulars of the Central Bank, the Central Council may grant the bank a period to rectify its position (this period may not be less than three years for the sake of article 154).

2- The merging bank and its shareholders are exempted from complying with legislative decree No. 87 of September 16, 1983 and its subsequent amendments if found, due to the merger, in a violating position. Such decree, however, applies to any sale of shares occurring after the merger.

Article 6

The Central Council may, if deemed necessary, grant the merging bank the needed facilities under preferential terms agreed upon between the Central Bank and the merging bank.

Article 7

During the year that follows the year during which the final merger approval has been granted by the Central Council, the council may exempt the merging bank from the income tax on part of the bank profit not exceeding the equivalent of the cost of the merger and for an amount not exceeding two billion Lebanese Pounds. This can be done only after the approval of the Central Bank and the Banking Control Commission has been granted. The concerned departments of the Ministry of Finance make sure that the merging bank has added these tax exemptions to its capital during a period of six months after the Central Council has approved this capital increase or else the merging bank is denied its entitlement to these tax exemptions. The merged bank is also exempted from the tax stated in article 45 of the income tax law in case its fixed assets have been approved to be revaluated.

Article 8

All procedures and formalities arising from the merger, including issuance of new shares, are exempt from stamp duties, registration fees, public notary and other public offices expenses.

Article 9

Other than the above-mentioned exclusions and exemptions, all applicable laws and regulations are to be followed especially those of the Code of Commerce, Code of Money and Credit, and other banking regulations.

Article 10

The articles of this law are applied to any bank that buys all assets and rights of another bank wishing to liquidate its business and delete its name from the list of banks and that takes into its responsibility all the obligations and liabilities of such bank.

Article 11

This law is to be published in the official gazette and remains in force for five subsequent years from the date of publication.

On the 16th of March 1998, law No. 679 was issued and extended the deadline of law No. 192/93 for another five more years.

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