
MERGER AND INTEGRATION OF COMMERCIAL BANKS
- INTERNATIONAL EXPERIENCE AND ITS IMPLICATIONS FOR CHINA

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ABSTRACT

Since the 1990s, the mergers and acquisitions (**M&A**) of commercial banks have been at a climax throughout the world, and the mode of M&A has been accepted by western countries, bringing new opportunities for the development of the banking industry. In a majority of the countries of the world, the banking industry is involved in a wave of economic M&A. Developed countries, such as the United States and those in Europe, have made significant gains through mergers and reorganizations of commercial banks, whetting the appetite of many developing countries' commercial banks to become involved in such activities.

In the 21st century, through the development of the world economy and the bank and its special position in this economy, its development model has attracted significant attention. Banks will struggle to maintain their profits as the global economy slows and credit risks increase. China's interest rate liberalization is a major challenge that commercial banks are faced with, including the arduous task of smoothly adapting to the change. The banking industry contains countless bodies, and the business scope is homogenized. Moreover, fierce market competition constantly increases the management pressure in the banking industry. M&A activities have become the strategic choice of many banks.

With the widening and deepening of the opening-up and competition degree of China's financial market, domestic banks are continuously penetrated by foreign capital and are facing great challenges, and the inherent desire of M&A is constantly presented. Compared with European and American commercial banks, the commercial banks in China are in a special situation: weak market competition, too much government

intervention, more M&A aimed at preventing regional financial risks, and fewer M&A cases due to the requirements and motivations of commercial banks in the M&A activities.

The growth mode of commercial banks includes an endogenous growth model of self-accumulation and a leapfrog growth mode of equity acquisition. Until now, western commercial banks have experienced five waves of M&A activity. The development and expansion of internationally active banks are usually inseparable from equity M&A. M&A activities have become important to international commercial banks seeking to realize leapfrog growth. After reforming, listing, and expanding its capital strength, China's commercial banking industry is actively attempting to realize leapfrog growth through equity M&A. These banks are also gradually transitioning from an endogenous growth mode relying on internal accumulation to a growth mode valuing both endogenous growth and leapfrog development through and external M&A activities.

This paper summarizes the rules of the development and expansion of foreign commercial banks through strategic M&A activity by using a systematic analysis of the five waves of international commercial banks' M&A activity. This paper then puts forward the strategies of China's commercial banks as related to strategic M&A activities.

Taking the acquisition of Shenzhen Development Bank (hereinafter referred to as SDB) by Ping An Insurance (Group) Company of China (hereinafter referred to as "Ping An Group" or "Ping An") as an example, this paper summarizes the background, motivation and process of the M&A of both parties, and focuses on the analysis of synergies after the M&A. Through analysis, this paper finds that all indicators of the two

companies have obvious synergies, and Ping An Group, the leading party, has been significantly improved in terms of operation, finance, corporate culture and management after merger and reorganization.

To study the efficiency of M&A, this paper takes M&A of Wing Lung Bank by China Merchants Bank's as a case, and draws a conclusion and summarizes the suggestions of Chinese banks to improve the efficiency of merger and acquisition through empirical analysis, case study and other methods.

Based on Ping An Group's acquisition of SDB, this paper puts forward recommendations for the merger activity undertaken by China's commercial banks at the end of the paper. These recommendations consider future M&A trends in China's banking industry, the strategic choice related to future M&A activities, and the role of the government in mergers and reorganizations, particularly related to relevant policy formulations, regulatory coordination, the role that control plays, and so on.

The objective of this paper is twofold. First, this paper analyzes the current competitive pattern of China's commercial banking industry and at the same time studies the development process and M&A history of the American and overseas banking industry to demonstrate the M&A opportunities in China's commercial banking industry. Second, this paper uses a case study to discuss the M&A strategy, synergistic effects, and M&A efficiency of Chinese commercial banks.

Key Words: M&A strategy, Synergistic effect, M&A performance

ANNOUNCEMENT

I solemnly declare that the dissertation submitted is the result of my independent research work under the guidance of my supervisor. This paper does not contain any work published or written by any individual or group other than those quoted. Individuals and groups who have made important contributions to this paper have been clearly identified. I am fully aware that the legal consequences of this declaration are my responsibility.

Signature: Ren Xiaojian

Date: October 2019

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CHAPTER 1

INTRODUCTION

1.1 Research topics

This paper studies the M&A strategies, synergies, and performances of commercial banks, and investigates the M&A experiences of commercial banks in the western market environment by analyzing the M&A strategies, synergies, and performances of Chinese commercial banks in the 1990s. Highlighted is the prediction that Chinese commercial banks will usher in a wave of M&A activity.

“Every bank has a history of M&A.” The main basis of this statement is from the 1990s, during the global rise of the commercial banking M&A wave. Cross-border cooperation and M&A activity in the banking industry not only resisted economic erosion by the financial crisis but also expanded bank business scope, achieved economies of scale, and improved bank competitiveness.

M&A cases of China’s commercial banks are few, and the corresponding scale is very small. Ever since China’s accession to the WTO in 2001, the country’s commercial banks have been faced with the challenges of the internationalization and diversified operations of the global banking industry, and they have been continuously enhancing their competitiveness through M&A activity and cooperation. Influenced by traditional concepts and restricted by policies, the M&A activities of China’s commercial banks are mainly government-oriented, see the light of day solely for purposes of resolving crises faced by the banks either within or in the external environment, and exhibit no obvious profit-seeking behavior. Given the deepening of the joint-stock reform of China’s state-owned commercial banks, these banks have gradually become a special institution

that pursues the same profit maximization as enterprises do in terms of liability management. At this time, joint-stock commercial banks have also appeared one after another, and China's banking M&A activity has also become market-oriented.

1.2 Research background and motivation

Commercial banks in China have a nearly 40-year history since their establishment in 1979. China's commercial banks, as the lifeblood of the national economy, play an important role in the country's economic and financial system. Commercial banks have made impressive progress along with China's economic growth. However, the change in the social financing structure has transformed the indirect financing led by commercial banks to direct financing led by the capital market. Meanwhile, the competitive pattern of commercial banks is undergoing significant changes through the opening up and mixed operations of the financial industry.

Throughout the developmental history of commercial banks in a developed market, M&A activity represents an important way for commercial banks to achieve leapfrog development (Diaz et al., 2002; Bai Qingxian and Xue Yuhua, 2001). In view of China's commercial banking regulatory system and market patterns, in the 1990s, China's commercial banks had to cope with a wave of international banking M&A activity and solve a local crisis in the domestic financial system. Commercial banks in China have yet to usher in a massive wave of mergers, acquisitions, and reorganizations; however, with the opening up of the country's financial environment and the relaxation of commercial bank regulations, these commercial banks carry the weight of expectation to usher in a wave of M&A activity (Ge Zhaoqiang, 2005).

A wave of M&A activity by banks has swept the world fueled by the continuous

development of the global economy. Commercial banks throughout the world have stepped into the “warring states era” of bank M&A activity, merging and acquiring others or being merged and acquired (Zhou Enjing, 2012). Since the reform and opening up of China, the country’s commercial banks have made great progress in both domestic and overseas M&A activity. A series of bank M&A transactions have quietly changed the competitive pattern of China’s commercial banks, and bank M&A activity has gradually become an invisible battlefield of interbank competition. Research on the M&A activity of commercial banks in China is helpful toward summarizing the characteristics of such activity, grasping the context of such activity, and providing theoretical guidance for these transactions at the macro level, which carries certain theoretical and practical significance.

The financial assets of commercial banks explain the highest proportion in the entire financial industry. According to the latest data on China’s industrial research in 2018, the assets of China’s banking industry account for more than 90% of all of the country’s financial assets. As of May 2020, the total assets of banking financial institutions (in China) reached 299.46 trillion yuan, an increase of 10.5% over the same period of the previous year according to the data released by the China Banking and Insurance Regulatory Commission (CBIRC). The total liabilities of banking financial institutions were 273.57 trillion yuan, an increase of 10.2 % over the same period of the previous year. China’s commercial banks reported a net profit of approximately 2.84 trillion yuan in 2019, an increase of 295.8 billion yuan from 2018, or up 11.61% from the previous year.

From the perspective of business indicators, from 2003 to 2018, China’s economy

experienced a rapid growth cycle, and the comprehensive strength of the banking industry significantly improved. The first business indicator is asset expansion. At the end of June 2019, banking industry assets reached 290 trillion yuan, an increase of 10.48 times when compared with 2003-end figures—more than twice the assets of the U.S. banking industry, and its debt-to-asset ratio has been steadily declining. The second business indicator is asset quality. The China Banking Regulatory Commission (CBRC) required commercial banks to accelerate the writing-off of nonperforming loans during periods of good business performance, resulting in the “double decline” of the nonperforming loan balance and the ratio of commercial banks in the past decade, after 2003. However, in recent years, with the uncertainty of the external environment and the accumulation of financial risks, the non-performing loan balance and ratio have a "rising" trend, showing a U-shaped (or anti-J-shaped) curve. The third business indicator is improving profitability. In 2019, commercial banks achieved a net profit of 1.99 trillion yuan, up 2.61 times from 2010. From 2010 to 2019, the average annual asset profit margin (ROA) and capital profit margin (ROC) of commercial banks was 1.09% and 15.98%, respectively, and both remained high for a long period, but declining. See Table 1-1 and Figure 1-1.

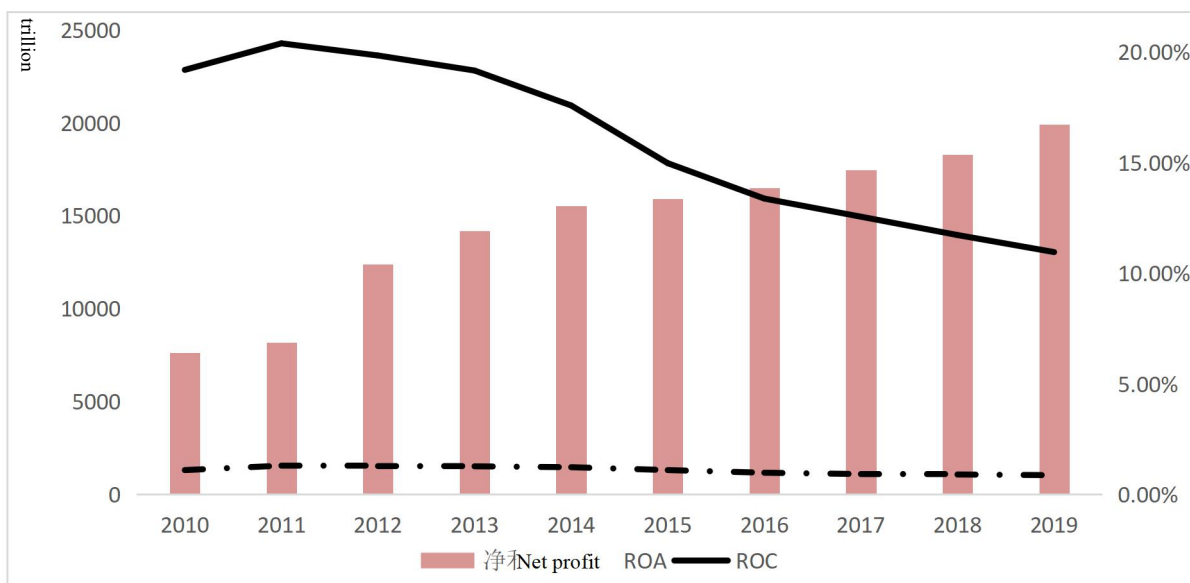
Table 1-1: Asset Scale and Asset Quality of China’s Banking Industry

Year	Asset scale (trillion)	Benchmark*	Asset-liability ratio (%)	Non-performing loan balance (trillion)	Non-performing loan ratio (%)
2003	27.66	100	96.15	25377	19.60
2004	34.60	125.09	87.65	17176	13.21
2005	37.47	135.47	95.56	13133.6	8.61
2006	43.95	158.90	94.90	12549.2	7.09
2007	52.60	190.17	94.24	12864.2	6.17

					Table 1-1, continued
2008	62.39	255.58	93.93	5602.5	2.24
2009	78.77	284.79	94.37	4973.3	1.58
2010	94.26	340.80	93.82	4993.0	1.14
2011	113.29	409.59	93.64	4279	1.00
2012	133.62	483.12	93.51	4929	0.95
2013	151.35	547.23	93.28	5921	1.00
2014	172.34	623.09	92.86	8426	1.25
2015	199.35	720.74	92.37	12744	1.67
2016	232.25	839.72	92.50	15122	1.74
2017	252.40	912.58	92.26	17057	1.74
2018	268.24	969.83	91.92	20254	1.83
2019	290.00	1048.52	91.56	24135	1.86

Note: *Benchmark index 2003 =100

Source: Website of China Banking and Insurance Regulatory Commission



Source: Website of China Banking and Insurance Regulatory Commission

Figure 1-1 : Profitability of China's Banking Industry

Since 2013, under the superposition of the deterioration in the external environment and pressure for economic transformation, China's economic growth has gradually

shifted from high-speed to medium-high growth. Moreover, the center of the economic growth has fallen back, and the banking industry has been put through the paces during economic downturns. The specific performance was as follows.

First, the growth in asset size slowed. From 2004 to 2019, the average annual growth rate of banking assets was 15.96%. In 2009, growth was 26.25%, influenced by the “four trillion” investment plan. However, at the end of 2017, banking assets grew by 8.68% from the previous year, representing a decline in the growth rate to single digits for the first time. At the end of June 2018, the annual growth rate was the lowest since 2004, at only 6.27%.

Second, the nonperforming loan balance and the ratio of commercial banks increased; in particular, the nonperforming loan balance hit a new high. At the end of 2019, commercial banks’ nonperforming loan balance was 2.41 trillion yuan—1.98 trillion yuan more than that at the end of 2012. The nonperforming loan ratio was 1.86%—0.86 percentage points higher than that at the end of 2011, and asset quality faced downward pressure.

Third, earnings growth slowed. In 2019, commercial banks’ year-on-year net profit growth rate was only 8.91%, down 82.72 percentage points from the growth rate in 2012, the peak period. Meanwhile, commercial banks’ ROA and ROC have also declined in recent years, reaching a record low of 0.87% and 11.73% in 2019, respectively.

Therefore, China’s commercial banking industry has stepped out of the “golden era” and faces the following major challenges:

(1) Chinese commercial banks are faced with serious business homogenization,^① and they use “scale” as the only competitive indicator. Early scholars studied the issue of homogenization from the perspective of competition. They believed that the homogenization of commercial banks is the result of competition, and the homogenization of competition is not conducive to the long-term development of commercial banks.

From the perspective of operation mechanism, the operation mechanism of banks for capital is based on the principle of economies of scale and the theorem of large numbers (Gumbel, 1990), and banks have the same business objectives, risk control objectives and strategy implementation path among banks (Alexander and Eatwell, 2007; Wang Jing, 2009). In China, most commercial banks started from the deposit and loan business. China's vast territory, large population and numerous institutions determine that there is always room for the development of the deposit and loan business. However, due to the encroachment and division of market share by different organizations, the business scale is very large and the space for further development is limited. The specific performance is as follows: product (Sheng Haowen, 2012), operation mode (Li Zhe, 2013), operation mechanism, spatial layout, governance structure (Wang Jing, 2009) and homogeneity of development path (Lin Shu and Ren Zhijuan, 2016). The reasons are mainly the unification and standardization of laws and regulations, accompanied by lack of innovation capacity, frequent turnover of personnel, government-led factors.

(2) The development of commercial banks is unbalanced, and the

^① Liu zhengyan et al. published an article titled, “Reasons for the Homogeneous Management of China’s Commercial Banks from the Perspective of Supervision,” in *China Foreign Capital* (2011 issue 03). In that article, they pointed out that the interest rate is not market-oriented and banks have a high degree of monopoly and lack of effective competition, which makes them lack the motivation to innovate.

technology-oriented development model is difficult to popularize. The imbalance in commercial bank development is largely reflected in the following aspects. The first is the horizontal imbalance between regions and regions. The second is denoted by the differences in risks in different business areas. The third is characterized by differences in banks' levels of management. Presently, the "Internet +" business model has indicated strong vitality. As an important pillar of the financial system, commercial banks must adapt to the banking industry's competition in the new era. Moreover, transforming commercial banks is imperative because of the emergence of e-banks, such as network banks and micro-banks. However, most small commercial banks with minimal profits cannot afford fintech-related research, development, and operations. Moreover, fintech cooperation with the big four state-owned banks and the big four Internet giants is out of reach for most banks. Without advanced technology and research and development (R&D) capabilities, most banks cannot participate in the next stage of market competition. Therefore, improving the R&D capabilities and product development of Chinese commercial banks is still the inevitable "only way."

(3) An increase in economic downside risks means that commercial banks now have higher risk control requirements. Statistics show that from 1979 to 2017, China's GDP grew by an average of 9.5% in real terms; fiscal revenue grew by 13.8% in nominal terms; industrial enterprises' total profits grew by 13.2% in nominal terms; disposable income per capita grew by 8.5% in real terms; and household savings grew by 22.8% in nominal terms. Since 2011, China's economic growth rate has slowed down after 30 years of nearly 10% average annual growth. In 2018, China's GDP increased by only 6.6% year-on-year.

In April 2015, the central bank officially launched the deposit insurance system, marking a watershed moment in China's supervision of how commercial banks control risk. According to WIND public information, by the end of 2015, the balance of nonperforming loans in China's commercial banks was 1.27 trillion yuan, up 51.2% from the end of 2014. The nonperforming loan ratio was 1.67%, up 0.42% from the end of 2014. For most small- and medium-sized banks, especially small local banks, the pressure from non-systematic risk control is strong. Once non-systematic risk occurs, the loss caused by it is in the form of not only money but also systematic financial risk and social instability. Therefore, an urgent problem for China's commercial banking industry to solve is fundamentally improving small- and medium-sized banks' ability to control risk and reduce nonperforming loans.

Finally, given the accelerated interest rate liberalization in recent years, commercial banks are facing increasingly fierce competition with respect to interest rates, which has caused commercial banks to lose the original stable deposit and loan spread income. Instead, every bank must seek out high-quality depositors and enterprises, increase their deposit interest rate, and reduce their loan interest rate, which continuously shrinks both the deposit and loan spread and banks' profits. Given the deepening of interest rate liberalization and the motivation to improve marketshare, commercial banks increase the deposit interest rate to attract more deposits, thus increasing the cost of debt. Simultaneously, with an increase in capital sources and new financial institutions, commercial banks may have insufficient demand for credit, and customers may have a certain impact on the pricing of financial products, which might even reduce banks' corresponding income and spread income. In 2015, the central bank reduced the

benchmark deposit and loan interest rates five times in a row, and commercial interest margins of commercial banks gradually narrowed, with the average net interest margin sharply declining.

Against this backdrop, the pressure on commercial banks to survive is stronger than ever. These banks also face fierce competition. After interest rate liberalization, the bank interest rate has gradually been determined by the market's supply of and demand for funds, and the interest rate is expected to increase gradually under the influence of many factors. This situation results in commercial banks constantly adjusting the interest rate to fight for marketshare. For many small- and medium-sized commercial banks, a freer market is not only less profitable but also more difficult to survive. An increasing number of big banks—with their financial resources and service capabilities—began to encroach upon the commercial banking business of urban commercial banks and rural credit cooperatives. Generally, people have the traditional belief that state-owned banks are too big to fail. China's state-owned commercial banks have been in a state of potential government credit guarantees, which results in small- and medium-sized commercial banks facing a severe test.

Chinese banking regulations are also an important factor, and China Banking and Insurance Regulatory Commission (CBIRC) has been adopting relatively tough regulatory measures against commercial banks and related enterprises. Commercial bank regulation is responsible for the supervision and management of the banking industry (and insurance industry) and related enterprises, aiming at the stability and security of the financial system, and ensuring that it can avoid large fluctuations and avoidable risks. Therefore, strengthening the close cooperation among the People's Bank of China, the

CBRC, and the China Securities Regulatory Commission (CSRC); giving full play to the advantage of public supervision; making good use of the power held by the media; improving the supervision system of commercial banks; and improving supervision transparency are conducive to the stable development of the financial industry, the protection of financial consumers' interests, and social stability. The People's Bank of China and the CBRC, as two main external banking supervision entities, play different roles. The People's Bank of China mainly supervises commercial banks through various macro policies and primarily pays attention to the macro indicators of commercial banks, as to whether the entire country's financial market is stable and whether the financial system can run smoothly, among other related issues. The CBRC mainly supervises the development of the banking system from the micro level, primarily paying attention to the micro indicators of commercial banks, among other related issues, such as whether commercial banks can operate smoothly, their risk management, and their ability to exert control.

All things considered, China's commercial banks not only face strict supervision, but also directly participate in the fierce competition. The narrowing of profitability will reduce the willingness of investors to enter the market, and then government policies and regulations will become the key. Before the regulations were relaxed, the government did not have a clear policy, because of the widespread uncertainty and obstacles, there will not be much change. On the one hand, the profitability of small- and medium-sized banks is low, and development faces a bottleneck. On the other hand, commercial banks face high entry thresholds. Capital from outside the banking industry enters and is engaged in the commercial banking business, which is faced with a relatively high threshold policy.

In view of the current regulatory system and the status quo of the industry, this paper discusses whether M&A activities can optimize the industry structure and integrate industry resources, focusing on the integration strategies of commercial banks, the display of synergies, and the effect of M&A activities.

1.3 Research significance and objectives

Since the turn of the 21st century, owing to economic globalization, financial liberalization, and the accelerated development of information technology, M&A activities of commercial banks have surpassed those of enterprises and lay claim to being the leading global enterprise M&A activities. Commercial banks, particularly small- and medium-sized ones, have entered the era of “merger or acquisition.” Why are bank M&A transactions so attractive? Taken together, the charm of bank M&A activities, in addition to helping troubled banks and maintaining the stable development of the financial system, mainly focuses on the following four aspects.

First, bank M&A activity can achieve synergies and increase bank value. Li Ping and Zhang Huiping (2002) described the experience of bank M&A in the United States from 1992 to 2002, and the results showed that most mergers and acquisitions were very successful: out of a total sample of 19 M&A of banks, 16 saw a significant increase in profitability. In particular, first, it can result in operation synergy effect. M&A activity can reduce costs, streamline the workforce, save on R&D costs, and achieve economies of scale. Second, financial synergies can be achieved; through M&A transactions, bank debt capacity can be improved, resulting in bank income flows producing diversification effects and reducing the possibility of bankruptcy. Third, M&A activity may realize the effect of differences in efficiency. Banks with higher efficiency merge with banks with

lower efficiency, which can improve the efficiency of the merged party, eliminate inefficient management, and increase profits. Fourth, market competitiveness could be improved, and market control could be strengthened. Bank M&A activities can reduce competitors, enhance control over the operating environment, improve marketshare, and increase long-term profit opportunities. However, for the tracking of bank M&A in China, the results of academic analysis believed that the merger and acquisition results are "first decreased and then increased" (Xiang Lili and Li Bin, 2003) and "insignificant" (Ding Hui, 2009), and there were differences between Chinese and American experiences.

Second, bank M&A activities can realize comprehensive operations, expand bank business scope, and disperse their operational risks. When the two financial institutions involved in a merger are in different businesses and markets, their financial products are not close substitutes, and they have no significant input–output relationship, a merger can effectively reduce and avoid operational risks and better utilize assets.

Third, through M&A activity, banks can acquire assets at prices lower than their replacement costs and achieve low-cost asset expansion. In reality, bank market value is largely underestimated because bank operations and management potential are underdeveloped; bank operations, management, and financial information are asymmetric; and differences exist between the market value and the replacement cost of assets—caused by inflation and other factors. In this case, a strong bank buying a weak bank is the equivalent of buying assets at a price below the replacement cost. After the merger, the value of the combined bank is expected to increase rapidly.

Fourth, bank M&A transactions can allow banks effectively to avoid taxes by taking advantage of underused tax breaks, using significant cash to buy banks, and converting

ordinary income into capital gains that enjoy lower tax rates. Owners of an acquired bank exchange the bank's common stock for the stock of the acquiring bank, giving up control over the acquired bank.

Thus, the significance of M&A integration for commercial banks lies in the fact that M&A activity could give small banks a way out of their survival dilemma; allow medium-sized commercial banks to expand their businesses; help competitive large enterprises enter the commercial banking field; and give play to their capital advantages. Therefore, to study the necessity of M&A activities among commercial banks in China is of great significance in predicting these banks' development trends and business types.

On the basis of related literature on bank M&A activity both at home and abroad and the related theoretical analysis, our country's banking developments were analyzed and synthesized, particularly related to Chinese commercial banks' M&A activities and their performance before and after such transactions. The analysis included careful thinking on the changes in performance and their effect on existing problems. Relevant strategies for China's commercial bank were identified to assist with the future performance of China's commercial banks and the future path of research on M&A activity in the Chinese banking system.

A commercial bank inevitably faces increasingly fierce competition from the strengthening influences of marketization. Therefore, many commercial banks achieve their long-term development through M&A activities. Although China's current M&A activities related to commercial banks are still in the initial stages, such transactions have become a significant trend. In the past, because China's banks were not strongly autonomous, with the deepening of China's financial opening-up, China's banking sector

is overwhelmed by the gradual entry of foreign banks into the market . The transformation of government functions and the government's relaxation of its controls over commercial banks enabled China's commercial banks to take a more market-oriented path, and the scale and scope of M&A activities increased. However, the problems are ominous and theoretical research behind these activities is still lacking, which has a significantly negative impact on, and is a hindrance to, Chinese commercial banks' development of M&A activities. In terms of evaluation criteria, under performance evaluation as the leading evaluation criteria, China's commercial firms in this evaluation system have been embarrassed. Therefore, the criterion for the success of commercial M&A transactions is to pass this evaluation system. We found that the relevant theoretical research and practical experience related to foreign commercial bank **M&A** activities are very important. Therefore, as a reference, the development of China's commercial banks also has certain significance.

1.4 Framework

This paper is divided into the following nine parts:

Chapter 1: Introduction. This chapter mainly introduces the research background, significance of the topic, research objectives and research framework.

Chapter 2: Literature review. This chapter systematically summarizes the relevant theoretical basis, including scope economy theory, transaction costs and M&A theory, market forces theory and synergies theory, and mainly reviews and sorts out three aspects of literature on banking M&A strategy, M&A coordination and efficiency.

Chapter 3: Research ideas and methods. This chapter firstly defines the object and problem of this paper, then defines the related concepts involved, and finally introduces

the research methods and data collection methods in detail.

Chapter 4: Commercial banking M&A: international experience. This chapter makes a detailed review of the history of banks in the international scope and focuses on the history of M&A in the American banking industry.

Chapter 5: Commercial banking M&A: China's development. This chapter focuses on the development history and current situation of China's banking industry, especially on describing the effect, strategy, mode, characteristics, motivation and other aspects of M&A of China's commercial banks.

Chapter 6: M&A synergy of commercial banks. This chapter takes the event research method as the main research method, and obtains the synergistic effect of the bank M&A in China through the detailed analysis of the M&A case of "Ping An - Shenzhen Development Bank".

Chapter 7: M&A efficiency of commercial banks. This chapter analyzes the M&A case of "China Merchants Bank-Wing Lung Bank", adopts DEA model and makes empirical analysis of the M&A efficiency among Chinese commercial banks by using secondary data.

Chapter 8: Contribution and inspiration. This chapter summarizes the main conclusions of this paper, in addition to looking forward to the prospect and trend of China's banking mergers and acquisitions, but also targeted policy recommendations.

CHAPTER 2

LITERATURE REVIEW

2.1 Theoretical basis

This chapter conducts an in-depth study of the theory of economies of scope, transaction cost theory, market force theory, and the synergetic effects of M&A activities to lay a theoretical foundation for this study.

2.1.1 Theory of economies of scope

Economies of Scope was first proposed by Panzar and Willig (1975), who believed that when an enterprise shifts from producing a single product to producing two or more products, the average cost of the enterprise will decrease. Subsequently, Baumol et al. (1982) proposed the scope economy hypothesis in conjunction with the theory, and their main achievement was to analyze the scope economy of enterprises in terms of production. At the same time, many scholars have conducted empirical tests on this hypothesis in different industries and fields. When David J.T. (1980) studied the performance of multi-product companies, the cost function showed that there was no significant correlation between the scope economy generated by diversification of an American oil company and its own business scope. Alfred Dupont Chandler Jr. (1999), in his book *Scale and Scope: Scale and Scope: The Dynamics of Industrial Capitalism*, defined a scope economy as an economy of joint production or distribution, specifically when the added scale of a single operating unit producing or distributing a single product reduced the unit cost of production or sales. There are two sources of economies of scope: one is the full utilization of tangible resources; the other is the effective utilization of intangible resources to generate scope economy (Zeng Fue et al., 2017). Economies of

scope come from the simultaneous production of multiple products, but the size of scope economy effect produced by different diversification strategies is not the same. Companies have always attached great importance to providing diversified products to meet the complex and changing needs of customers. Scholars have also made a detailed discussion on the impact of product diversification on various aspects of enterprises. In these studies, the concepts of product diversification and product variety are sometimes mixed.

When an enterprise carries out multiproduct joint production, the number of product categories is limited—and more is not better. A reasonable range always exists; the integration or diversification of the enterprise is always limited; and an optimal business combination theoretically exists. It is optional for an enterprise to engage in multi-item joint production when combining products because the production of a product does not contribute to economies of scope. However, a range of economies of scope may arise when two companies combine their production processes. The west has always maintained a balance between economies of scale and scope as noted by a summary and analysis of Chandler's economies of scale and scope—the driving force of industrial capitalism.

The scale and variety of a product are two parallel dimensions that describe the way the product (which extends to the economy) develops. When studying the latter, foreign scholars usually expounded it from the two aspects of motivation and result. In terms of motivation, neoclassical enterprise theory defines enterprise as "production function aiming at profit maximization", which is more and more inconsistent with modern enterprise development mode. For this reason, both Coase (1937) and Williamson (1981)

supplemented the single production model of neoclassical enterprise theory. The former thought that under the condition of perfect competition, the multi-market transaction cost of enterprises was better than the single commodity market. The latter mainly explained the vertical integration and related diversification of enterprises from the perspective of organizational reform, and also believed that diversification will reduce enterprise costs. But as diversity shows, more is not always better. The results show that the diversification (or multi-variety) of enterprises (or products) presents an "inverted U-shaped" relationship, which produces an "Economies of Scope" when it is in the rising range, and produces a "Diseconomies of Scope" when it reaches a critical point (Campa and Kedia, 2002).

In view of the development of the Economies of Scope theory, this paper defines the scope economy as the economic benefits that enterprises can achieve by expanding the scope of production rather than simply expanding the scale of production. When an enterprise produces two or more products, resulting in a reduction in the sum of the respective costs of each product and an increase in the sum of the profits, this is the Economies of Scope. Generally speaking, the cost reduction and benefit improvement brought by any enterprise through producing more products are the embodiment of Economies of Scope.

Specific to the financial enterprise, Cebenoyan(1990) took commercial banks under the administration of the Federal Reserve Bank of New York, which were mainly small Banks, as samples, and used box-cox function to study their economies of scope, and found that there were significant diseconomies among the five businesses of demand deposit, time deposit, real estate loan, mortgage loan and commercial loan. Ashton and

Barrow (1998) used intermediary and production methods to study the Economies of Scope of the British banking industry, and the two methods reached inconsistent results. In the intermediary law, the scope of the bank's lending and investment business is uneconomical. In the production method, the investment and deposit business of the bank has slight Diseconomies of Scope, while the lending business has significant Economies of Scope. The findings of Joseph and Loretta (2013) completed this evidence. They found that big commercial banks were not driven by the fact of being big without bankruptcy; they have Economies of Scope.

The earliest domestic research on Economies of scale and Economies of Scope of banking industry is "Economies of Scale, Economies of Scope and Macro Cost Management of Specialized Banks" published by Liu Kailian and Luo Haiyan (1990) in Contemporary Economic Science. They believed that banking industry is an industry with medium Economies of scale between those industries with insignificant Economies of scale such as agriculture and those with significant Economies of scale such as petrochemical industry and metallurgy, and has Economies of Scope in banking business. Economies of scale and scope economy do not exist independently but interdependently. Economies of Scope is different from Economies of scale, which usually means that an enterprise or production entity obtains savings from the unit cost of producing or providing a series of products (different from mass production of the same product). The savings come from departments such as distribution, research and development (accounting, public relations). Economies of Scope generally serves as the theoretical basis for an enterprise to adopt a diversified operation strategy, aiming at reducing costs, and its essence lies in the fact that multiple businesses of an enterprise can share the

remaining resources (Huang Aishe and Liao Jinzhong, 2009).

Specifically, with regard to the application of Economies of Scope in China's financial industry, Luo Haiyan and Liu Kailian (1990) analyzed Economies of scale and Economies of Scope of Bank of Communications, and for the first time proposed a qualitative analysis of the Scope economy of China's commercial banks. With the further development of China's commercial banks, especially the increase of M&A and reorganization cases, domestic scholars gradually developed from qualitative analysis to quantitative analysis of the economy within the financial sector. Zhao Yiting (2000) analyzed the current situation of state-owned commercial banks' Economies of Scope, and pointed out that the business scope of state-owned commercial banks was too narrow due to the division of operation, which was the cause of the Diseconomies of Scope of state-owned commercial banks. Yang Junwei and Hua Zhe (2000) argued that :1. To obtain Economies of scale and Economies of Scope, the key lies in the reasonable matching of resource elements; 2. the reasonable key to the matching of resource elements is to make the combination of elements spatially continuous, and not to make the elements spatially divided artificially; 3. the realization of spatial sustainability of element combination can make technological innovation and organizational innovation emerge constantly, so as to make element combination sustainable in time; 4. on the premise of spatial continuity and temporal continuity, the flow speed of elements directly affects the play of scale effect and scope effect. Du Li and Wang Feng (2002) made an empirical analysis of the operation of commercial banks in China from 1994 to 1999, and found that the Economies of Scope of commercial banks in China was positively correlated with the size of banks. Based on the research of Du Li and Wang Feng (2002),

Wang Conong and Zou Pengfei (2003) further refined and improved the empirical method of Economies of Scope in banking.

At the same time, Chinese scholars are increasingly linking economies of scope with economies of scale. Li Wenjun (1998) analyzed banks' scale and indicated that their monopoly advantages come from economies of scale and superior technical advantages. The uniqueness of the products (or services) that banks provide, along with banking's technological revolution, determine the banking industry's strong economies of scale. Zhao Huaiyong and Wang Yue (1999) analyzed the reason for which scale economies exist in the banking industry and the factors that influence their existence. The authors made the following points. First, economies of scale were used to study the relationship between changes in scale and cost-effectiveness, as well as the economies of scale that existed in the banking industry. Second, the question of whether the banking industry has economies of scale can be answered by measuring the degree of market concentration and the return on assets. The degree of market concentration and the return on assets form the two fulcrums of economies of scale. The degree of market concentration is the foundation and premise of economies of scale, and the profits from assets reflect economies of scale. Third, under the market condition of complete competition, economies of scale are correlated with the banking industry's performance. The formation of bank economies of scale is conducive toward improving performance. Fourth, banks merge and increase their concentration to expand their scale and to realize economies of scale to a large extent. Han Dongmei and Zhao Zhenquan (2002) analyzed total factor production and economies of scope of the banking industry and found that total factor production and the payment service output were highly correlated with total

asset scale. However, the financial intermediary's output was less correlated with total asset scale than the payment service output was, and the input-output ratio of payment services was higher than that of the financial intermediary. The coexistence of bank payment and financial intermediary services saves labor and capital investments, indicating that economies of scope caused by cost sharing exist in the banking industry. Moreover, banks with large total assets have a high cost-saving rate, whereas banks with small total assets have a low cost-saving rate. Banks that show large aggregate assets enjoy economies of scale from cost sharing. Yang Daguang (2003) analyzed the relationship between bank monopolies and economies of scale and concluded that bank pursuit of economies of scale creates, to some extent, conditions for monopolies but that a monopoly did not necessarily form. Therefore, our antimonopoly strategy is to restrict a bank's unlimited expansion of scale toward becoming a monopoly but not to oppose the bank's expansion of scale when it pursues economies of scale. Xu Wenbin (2006) described in his monograph "Analysis of Economies of Scope of Mixed Business in Financial Industry" that the cost of a single financial institution operating commercial bank, securities and insurance business at the same time is lower than the sum of the costs of three financial institutions operating their respective products: bank, securities and insurance company.

The crux of the diseconomies of scale and scope in China's state-owned commercial banks lies in the improper allocation of resources, the obstruction of the internal flow of factors, the interruption of the spatial continuity and time continuity of the combination of factors, which leads to the lack of conscious innovation. The lack of conscious innovation in turn worsens the combination of factors, thus entering a vicious circle. In

order to break this cycle, we must carry out reform (an external shock type innovation) and introduce a service concept and way that can improve the internal liquidity of factors in state-owned commercial banks. The introduction of customer manager system meets this requirement.

2.1.2 Transaction costs theory

The concept of transaction costs was proposed in 1937 by Professor John Coase of the University of Chicago. Its basic connotation includes typical views, such as division of trade, transaction contracts, and transaction behavior. Coase believed that the basic elements of transaction costs are information collection, cooperative determination, agreement signing and implementation, and claims after violations of an agreement. After testing this theory from both macro and micro aspects, the theoretical study of reducing transaction costs was found to be of great significance. Therefore, this theory has been broadly applied in many economic studies.

In 1937, Coase published "The Nature of the Firm" and pointed out that the application of the price mechanism is not free but rather requires a certain price. After more than 20 years of research, Coase further discussed the process of contract in his work "The Problem of Social Cost" published in 1960. He found in the process of signing and implementation of the contract, some additional payment is inevitable, and the transaction costs of thoughts, and points out that "in order to carry out a market transaction, it is necessary to find and who deals, telling people he is willing to trade and trade conditions, to negotiate, bargain, draw up the supervision of the contract, to ensure the terms of the contract to perform" as required. Thus, the connotation of transaction cost has been clear. However, Coase did not use the term "transaction fees",

but Kenneth (1969) first put forward this term when studying adverse selection behavior of insurance market and the operating efficiency of market economy, and defined it as the operating cost of market mechanism. According to the differences in the objects of concern and the way of transaction, the academic circles generally define transaction costs in the following three aspects: transaction division, transaction contract and transaction dimension.

1. Transaction division. Coase (1937), after putting forward the concept of transaction costs, further pointed out that there are not only transaction costs in the market, but also organizational costs incurred by the enterprise itself, such as administrative costs, costs of supervising contracting parties, costs of transmitting administrative orders, etc., which can also be regarded as transaction costs within the enterprise. When the enterprise expands, the transaction costs within the enterprise also expand, and when it expands to the equivalent of the transaction costs in the market, the enterprise's scale does not expand. In the social division of labor, enterprises or other organizations participate in market transactions as a unit, whose economic function is to organize the owners of several elements into a unit to participate in market exchange, so as to reduce the number of market traders, reduce the degree of information asymmetry, and finally reduce transaction costs. When Du Runping (1992) translated and extended North (1984) 's viewpoint, he pointed out that the determinants of transaction costs are generation, division of labor and degree of specialization. Sheng Hong (1992) also pointed out that in reality, people need to comprehensively consider the costs of production and transaction, and the degree of division of labor reveals the economic characteristics of production and transaction activities as well as the proportional

relationship between them. At the same time, the mode of production and the mode of transaction as well as the interaction between them and the interactive process determine the degree of division of labor and its development.

2. Transaction contract. Dahlman's (1979) study considered transaction costs from the first, second and third periods of the signing of a transaction contract, that is, before signing the contract, the resources required by both parties should be fully understood; at the time of signing, the cost of payment should be aware of; after signing the contract, it is necessary to pay corresponding costs for the execution, control and supervision of the contract. Zhang Wuchang (1999) focused on the study of transaction costs and modes as the necessary conditions for contract selection. He pointed out that in a market economy, every factor is faced with three choices: independent operation and production; Sell all; Entrust an agent with the operation of production. Whichever option is chosen, a contract that takes into account transaction costs is required.

3. Transaction dimension. Williamson (1985) proposed three basic dimensions of trading: frequency, uncertainty and asset specificity, which are the main indicators to distinguish transactions. Transaction frequency refers to the number of times a trade occurs. It can influence the choice of transaction mode by influencing relative transaction cost. The uncertainty of transaction includes the uncertainty of accidental event, the uncertainty of information asymmetry, the uncertainty of prediction and the uncertainty of behavior. The specificity of an asset refers to the extent to which it can be used for different purposes and used by different users without sacrificing production value. When commenting on the three dimensions of transaction cost theory, Wang Hongtao (2004) emphasized that the higher the asset specificity is, the higher the transaction cost involved

in the transaction cost of the specific asset will be. It can be said that the transaction dimension explains the origin of transaction costs.

It should be noted that transaction costs and transaction fees are both translated from Transaction costs, which are generally not distinguished when studying Transaction Cost theory. However, Jiang Yingming (2007) pointed out that there is a difference between transaction costs and transaction fees. Transaction costs are an overall concept, while transaction fees are a local concept. Transaction costs are the sum of transaction fees, and under the action of the market, transaction costs tend to form uneven transaction fees when they are allocated to transaction participants. Although transaction costs and transaction fees are translated from the same English phrase, the two words themselves are not given the overall or local meaning, even if there is a difference between the overall and local in the theory, it only needs to be pointed out in the research results.

2.1.3 Market power theory

Using market power theory, this paper expounds the purpose of enterprise M&A activity—to expand marketshare and obtain a favorable, dominant position in the market under conditions of intense competition. The goal of this theory is for enterprises to gain increasingly larger marketshares, and it indicates that any enterprise—after engaging in M&A transactions with its industry peers—can do so through market advantages. The acquisition of peers can increase an enterprise’s marketshare to reduce competitive market power and promote its own prospects of influencing and dominating the current market. Enterprises can also monopolize marketshare and the prices of products and then generate larger profits thanks to this market monopoly.

Comanor (1967) clearly indicated that forming a monopoly results from not only

horizontal M&A activity between enterprises but also vertical M&A activities. Enterprises or organizations seeking to achieve a monopoly merge many core enterprises in the industry chain to break through this chain and establish industry barriers that make it difficult for outsiders to enter. Thus, the entry of potential competitors is hindered and industry monopoly is realized. Weston (1998) found through research that larger companies reveal less obvious changes in profitability than do smaller companies. Larger companies have a certain dominant position in the market and form certain market forces. Thus, larger companies confirm the results of these dimensions through their consequent control over the market. A company's development scale, stability, and market dominance are closely related. Williamson (1979) pointed out in his research that enterprises are keen on mergers and continuous improvements to their production scale—not necessarily only to improve production efficiency but also to obtain or maintain their existing dominant position in the market in the long run, that is, to pursue long-term monopoly of the market. The development of the western market economy also shows that historically, quite a few groups of corporates wantonly carried out M&A activities to gain dominant positions in the market and to realize excess profits, which is common with regard to certain periods. However, during the long-term development of the market economy, M&A activity among enterprises must have a beneficial impact on improving production efficiency and reducing operational risks. Otherwise, such M&A activities will not be easy to keep afloat. At this level, the fundamental issues of production efficiency and market monopoly are involved and have decisive impacts upon enterprise size.

Subsequently, Chandler (1999) responded in detail to this proposition through two basic case studies that showed that production efficiency has a decisive influence on an

enterprise's scale. One case study was on the tobacco industry in the 1860s and the monopoly on tobacco production. Industry competition led to mergers, restructurings, and a monopoly situation. However, the case study showed that the original purpose of the monopoly was not met and that production efficiency did not improve. In another case, from the 1880s, the Swift meat group developed a bold production plan in which cattle and sheep were prepackaged at the company's west coast headquarters and then sold on the company's east coast markets. Swift's original production and sales plan was to directly transport live cattle and sheep to the east coast and sell them after processing. The company developed a revolutionary plan that met with strong resistance, mainly from shippers and sellers. However, the plan's significant cost advantage made it a success. Ten years later, Swift meat group was one of only a handful of companies in America to dominate the meat market. Based on these facts, Chandler (1999) further proposed that if an enterprise were unable to improve its production efficiency after expanding its scale through a merger, it would be unable to improve its production scale further even if it captured the dominant position as a market monopoly. In contrast, the assumption was that an enterprise increases its production efficiency after expanding its scale through a merger. Even if industry rivals are in a favorable position, they cannot prevent a further increase in the scale of such an enterprise.

These case studies showed that a monopoly causes a loss of the normal market competition mechanism. If such a loss persists for a long time, the production efficiency of dominant monopoly enterprises is reduced. As Coca-Cola executives stated, the acquisition of Pepsi made it easier for them to form an unchallenged monopoly in the global beverage market.

In Europe, the United States, and other major regions/countries, complete laws and regulations exist that restrict enterprises' monopolistic behavior because monopolies are regarded as the most significant obstacle to the development of a market economy. These countries often take legal action to prevent M&A activity from becoming dominant. However, at the same time, some theorists have proposed through research that simply improving marketshare cannot achieve economies of scale. Only when an enterprise conducts a horizontal merger in the industry or a vertical merger in its upstream and downstream supply chains and continuously integrates on this basis can it continuously increase its marketshare and simultaneously implement scale efficiency. This assumption is correct. In contrast, if an enterprise merges purely to improve its marketshare, which eventually leads to diseconomies of scale in enterprise development, these mergers will negatively affect enterprise development.

2.1.4 Synergy theory

Hiroyuki Itami (2000), a Japanese scholar, firstly expounded the meaning of "complementary" and "synergetic" in the theoretical circle through in-depth study of synergetic effect. He went on to identify synergies that would occur when the company used intangible assets to help it achieve sustainable development. The scope of this asset includes brand image, research level, customer experience, employee treatment and other aspects.

After conducting an independent study, Rumelt (1974) further deepened Ansoff's point of view and pointed out that financial management and operational management are the two main aspects that constitute the synergies, none of which are the main factors that promote enterprises to carry out mergers and acquisitions. Sirower (1997) first defined

the concept of dynamic synergies. In his opinion, the manifestation of this concept is that after the completion of the merger and acquisition, both sides of the merger and acquisition, as a whole, their total enterprise efficiency increase will be far greater than the sum of their possible increases before the merger and acquisition. Through in-depth research, Xu Mingbo (1997) believed that there are three main aspects of financial synergy after merger between enterprises: the realization of reasonable tax avoidance effect caused by merger and acquisition, the undervaluation caused by merger and acquisition of both parties, and the development expectation of both parties after merger and acquisition. Liu Wengang (1999) clearly pointed out that intangible assets should include enterprise brand, patent number, scientific research level and enterprise core culture through in-depth study of the influence of intangible assets during enterprise mergers and acquisitions.

2.2 Research summary of M&A strategy

In the west, where financial markets have a long history, bank M&A activities have been around for a long time. These countries have always been in leading global positions regarding development. In the United States in particular, M&A activities have accelerated in recent decades because of the deregulation of the banking sector in the 1980s. The financial crisis of 2007–2009 led to new research on M&A. Bank M&A activities are common; however, from the perspective of the history of global finance—particularly the history of U.S. financial markets—such activity occurred at a particular time and on a very large scale. Commercial banks’ “merger wave” in the United States from 1980 to 1985 is a typical example. From the 1920s until 2008, four **M&A** waves occurred in the United States.

The development cases of foreign banks show that creating a financial holding group that is characterized by “financial department stores” that can provide comprehensive, one-stop operation services is important for commercial banks in experiencing rebirth and vitality. For commercial banks, planning the layout in the fields of integration and collectivization is a forward-looking strategy. Using M&A activity to enter new fields and new regions is the main method of expanding business scope and improving core competitiveness. However, M&A activities are risky, with the success of an M&A transaction depending on various factors, and with an M&A strategy being crucial to ensure success. At present, the M&A wave in China’s banking industry has just started, and few M&A experiences and cases exist for reference. Therefore, relevant theories are urgently needed to provide theoretical support and practical guidance to commercial banks in their M&A activities.

From the perspective of the literature, few studies exist on commercial banks’ M&A strategies, and research from a micro perspective is even rarer in China. At present, a few studies define commercial banks’ M&A strategies in a systematic and detailed manner. Salter and Weinhold logically divided the M&A process into the stages of target determination, target enterprise search and selection, strategic evaluation, financial evaluation, negotiation and transaction, and post-merger management, and they developed an overall M&A strategic plan according to each stage. Yixinfu divided the bank merger strategy into three parts: the choice of ownership concentration, the choice of controlling rights, and the choice of timing. According to Mu Qingbang, M&A strategy includes pricing, timing, decisions based on incomplete information, initial shareholdings, and strategic interactions. The M&A strategy is viewed as a set of complex and complete

systems involving all links in the transaction process.

According to relevant studies at home and abroad and the M&A process, the choice of bank M&A strategy is divided into five parts: the choice of M&A timing, M&A target, M&A pricing, M&A payment method, and M&A integration. These five parts constitute the core of a bank's M&A strategy.

2.2.1 Motivation for commercial banks' M&A

Foreign scholars have been studying and discussing the reasons for which commercial banks engage in M&A activity. As early as 1930, King published an explanatory article in the *Journal of the American Statistical Association*. King (1930) described cases of small- and medium-sized banks that merged, and then, King carried out statistical analyses. Through these analyses, King pointed out the phenomena in the M&A market at the time as being related to the banks of America. For example, medium-sized banks are more willing than large banks to engage in M&A; acquiring listed banks is easier; and successful bank M&A transactions can increase the acquirer's stock price. "Bank M&A can save failing banks, promote rapid growth in the overall size of the banking sector, and optimize the allocation of industry resources," King concluded.

Marshall (1957) summarized seven factors of bank M&A activities depending on M&A data of U.S. commercial banks during the decade after World War II. According to Marshall, commercial banks' M&A activities are mainly manifested by four economic motives: 1. business diversification and access to market segments; 2. completing the migration from urban to rural areas; 3. strengthening existing market leadership to curb growth rate declines; and 4. further enhancing the acquirer's awareness and influence. In addition to these four motives, Marshall proposed three noneconomic factors: 1. lax

regulations of the M&A market; 2. the Intercontinental Banking Act of 1994, which abolished regional restrictions; and 3. the target company's management becoming more willing to be acquired by large banks as operating pressure increased. Mr. Marshall argued that the combination of these economic incentives and noneconomic factors led to the U.S. banking industry's "M&A boom" periods that have occurred since the 1950s. Moyer (1976) believed that large commercial banks acquire small commercial banks mainly for business development. Given the diminishing marginal returns of the factor market, borrowers' demand for loans to secure funds declines gradually, and the average income growth rate of large commercial banks tends to decline. To expand their business, big banks are more likely to acquire licenses in certain business areas by acquiring smaller banks if the regulations are strict. Simultaneously, because regional banks are limited by geographical restrictions, they are more willing to be acquired by nonlocal big banks to obtain new development opportunities when supply chain demand increases, competition intensifies, and profit margins decline. Saunders and Cornett (2018) demonstrated the possible insolvency risks of banks through the risk perspectives of commercial banks, including credit risk, liquidity risk, interest rate risk, off-balance sheet risk and operational risk, etc., and adopted m&a to diversify the risks.

Commercial banks' M&A activities have their particularities because these banks' financial business and business structures as financial institutions have their particularities. Therefore, M&A activities have a particularly prominent impact on commercial banks.

Kim et al. (2009) demonstrated that the strategic complementarity of commercial banks is conducive to the success of M&A activities. Commercial banks with a strong

business concentration have sophisticated M&A abilities. Ramaswamy (1997) found through research that commercial banks with the same goals might produce synergies and that M&A activities that have different strategic goals might hinder acquirers' development prospects. In contrast, Hawawini et al. (1990) and Clark (1988) pointed out that although the heterogeneous development model is an obstacle to the success of M&A transactions, the scale and synergy effects of large banks can effectively offset this negative effect. M&A activities might affect the acquirer, the scope of the business, and the customer. Similar and different stakeholders are affected differently. Carletti et al. (2006) analyzed banks' M&A activity before and after the enactment of the Riegle Neal Interstate Banking and Branching Efficiency Act of 1994. They found that after an M&A transaction, state-owned banks significantly increased revenues, profits, and dividends; lowered costs; and realized significant synergies. In addition, greater M&A activity resulted in better performance. Carletti et al. (2007) believed that banks' M&A activity could enhance their ability to transfer reserves, optimize their balance sheets, and gain stronger bargaining and transaction skills in the interbank market. Featherstone (1996) directly proposed that banks in rural areas would process more agricultural loans after M&A activities. Wheelock et al. (2000) proved that a bank is unlikely to fail after the establishment of the national branch system (after an M&A transaction) because the organizational layout on a larger spatial scale reduces the impact of local economic deterioration.

However, some scholars revealed that their analyses showed that other factors affect the income resulting from commercial banks' M&A. For example, James (1987) showed that the income acquired by the acquirer after a merger may be directly proportional to

the number of merger subjects and inversely proportional to the number of competitors. Simultaneously, the intensity of the competition related to an M&A transaction may directly affect post-merger performance. Featherstone (1996) argued that banking M&A transactions are determined by the time nodes of the industry cycle rather than by the subjective factors of the acquirer or target.

It is worth noting that not all scholars have a positive attitude toward commercial banks' M&A activity. Cohen et al. (1966) believed that not all parties involved in bank M&A transactions benefit. Garmaise et al. (2006) noted that community banks' M&A could easily lead to a decline in the credit quality of the communities in which the banks are located, thus affecting the subsequent operations of commercial banks. Scott et al. (2003) found that after an M&A deal, the search cost (that is, the cost of finding customers) and the operating cost of the banking business might increase, thereby reducing service quality. Kim et al. (2009) also identified that banks with the highest business concentration lose their characteristics after an M&A transaction. If anything, it could be argued that the merger actually failed. Sapienza (2002) reviewed numerous studies to analyze in detail the defects of commercial bank M&A transactions. Through a systematic analysis of the M&A cases of U.S. commercial banks from 1989 to 1995, the author found that commercial banks' M&A deals may have a negative impact—after a merger or acquisition of banks in the same geographic market, the loan interest rate generally declined sharply. However, banks with a monopoly status in a certain field increase the loan interest rate to some extent after a deal to achieve a monopoly advantage. In addition, large banks formed by M&A transactions have smaller effects on users with whom they have more complex borrowing relationships. Lenders with

relatively simple lending relationships are more reluctant to borrow from the combined bank, mainly because the new bank changes its business strategy as its size changes. Berger et al. (2004) indicated that after an acquisition, the acquirer's original market attracts more similar institutions, thereby intensifying the competition in a certain field or industry. This type of influence can be regarded as an externality of commercial bank M&A activity.

There are also some studies on the efficiency of Chinese commercial banks before and after mergers and acquisitions. For example, Xiang Lili and Li Bin (2003) proved that the merger and acquisition of commercial banks can improve the efficiency of the acquirer through the case of China Everbright Bank acquiring China Investment Bank. Liu Huihao (2000) pointed out that the M&A of commercial banks can smooth the local financial risks, provide opportunities for the expansion of medium-sized banks, and expand the business scope of commercial banks. However, the author also points out that the M&A of China's commercial banks are subject to excessive government intervention, imperfect related laws and regulations, leftover problems of property rights reform. Some domestic scholars are neutral on M&A activities and the expansion of urban commercial banks. Wu Qiong (2017) noted that in the context of interest rate liberalization, restructured urban commercial banks have advantages in the area of efficiency improvement but that the cross-regional business expansion model cannot improve efficiency. He also noted that not all city commercial banks could execute mergers and restructurings. Chen Yihong (2017) drew the following conclusions from micro research on 50 urban commercial banks. The scale, cost-benefit ratio, and nonperforming loan ratio of urban commercial banks are correlated negatively with their profitability.

Therefore, for urban commercial banks, being large does not mean higher efficiency and profitability.

The motivation of M&A constitutes the theoretical basis of M&A efficiency, and M&A efficiency is the empirical test of the motivation. Generally speaking, the M&A of commercial banks is based on the pursuit of synergies. According to the synergy's theory, M&A can enhance the value of leading M&A banks through management synergy, financial synergy and operational synergy, which is the so-called "1+1>2" effect. The generation of management synergy is based on the difference of the management level between the leading M&A and target banks. When the advanced management level of the leading M&A and target banks spills over to the target party, the management cost of both sides declines and the management synergy effect is realized (Flanagan, 2004; Weston, 1996).

Operating synergies result from economies of scale, economies of scope and falling transaction costs. The merger of the leading M&A banks and target enterprises brings about the expansion of scale, the expansion of business scope and the reduction of the specificity of assets, so as to realize the reduction of costs.

The financial synergies are derived from the tax-saving effect brought by mergers and acquisitions and the reduction of financing costs (Xiao Zhenhong, 2007). With the development of time, the pursuit of synergies can no longer fully explain the M&A behaviors of commercial banks, and the motivations for bank mergers and acquisitions gradually tend to be diversified. Cline (2003) argued that bank M&A could expand the scale of Banks, enhance their market power and reduce the number of competitors. Through M&A, commercial banks can gain market power, improve industry

concentration and strengthen market control.

M&A also results from the conflicts between management and shareholders. Based on the level of their own remuneration and the need to disperse risks, the management tends to have strong expansionism, which is especially true for managers with poor management ability. They are usually too conceited and believe that they can gain profits by controlling other enterprises through mergers and acquisitions. In addition, through merger and acquisition, the management can also consume the cash resources of the enterprise and strengthen the control over the enterprise resources (Muller, 1969; Roll, 1986; Jensen, 1986; Morck, 1990).

So, it is clear that the motivation of bank M&A cannot be completely explained by one theory, and many scholars comprehensively explain the motivation of bank merger and acquisition from a broader dimension. Mitchell and Mulherin (1996) believed that cross-border MERGERS and acquisitions, including Banks, were caused by external shocks such as technological revolution, globalization and loose government regulation. Weston and Johnson (2001) break down these factors into seven categories, including technological progress, globalization and trade liberalization, synergies, deregulation, changes in industrial organization, personal factors of entrepreneurs, and a favorable macroeconomic environment. He further classified the M&A motivations including banks into four categories: strategy-driven M&A, management-driven M&A, management-driven M&A and stock-market-ineffectiveness-driven M&A. Berger (1992) proposed that all kinds of complex merger and acquisition motivations can be divided into two categories: value maximization motivations (such as obtaining synergies, etc.) and non-value maximization motivations (such as management conceit, etc.)

2.2.2 Selection of acquisition targets for commercial banks

The choice of a commercial bank's acquisition object has also attracted the focus of many foreign scholars on primarily the nature and conditions of the acquiring banks. Featherstone (1996) indicated that large Featherstone banks or financial holding companies prefer to acquire rural banks with high marketshares and that the assets of the acquirer are generally proportional to the assets of the acquired party. Wheelock et al. (2000) studied the boom of bank M&A activity in the United States in 1985 and found that banks with small asset size, inefficient management, and a poor assets status were the first choice of acquirers. Hannan et al. (2009) also believed that from the perspective of target banks, banks with a high proportion of assets are rarely acquired, whereas listed banks are more likely to be acquired. In addition, banks with more similar and closer relationships are more vulnerable to M&A activity.

The key to whether a bank M&A transaction can produce synergistic effects, can effectively improve a bank's business performance, and can achieve the strategic goals is to correctly select the M&A target. At the opportune time, selecting the correct target is the first step. In fact, the selection of a merger target includes two parts: how to search for a merger target and how to evaluate a merger target. The former provides the target set available for M&A activity, and the latter selects the most suitable M&A object in the target set.

When compared with foreign scholars' studies on bank M&A activity, scholars of banks in China have done significant research on potential M&A targets—urban commercial banks with real problems. For example, Zhang Juan (2010) pointed out the common problems of China's urban commercial banks, including seriously unbalanced

development, overconcentration of business, and insufficient innovation of products and services. Therefore, she believed that the M&A activity engaged in by urban commercial banks is important toward solving these problems and toward achieving the purpose of operating transregionally.

(1) Search for acquisition targets

Generally, the assets of a target should be correlated with the assets of the main acquirer as reflected in channels and markets, production technology, and scientific research. Enterprises attempt to select M&A targets with asset relevance. The degree of agreement of the target enterprises depends on the degree of strategic relevance between the two enterprises. Markides and Millamson (1996) further divided corporate strategic assets into market knowledge and customer, channel, input, and process assets. Moreover, the acquisition target should be relevant to the main acquirer's strategic assets. Asset correlation includes not only asset similarity but also asset complementarity. Jeffrey Harrison (1991) et al. zeroed in on the selection of target companies conforming to the development strategy of M&A enterprises and on the resources of both sides being relevant or complementary.

The two principles of M&A activity are as follows: one is to obtain more of our own resources, and the other is to obtain complementary resources that we lack. Domestic scholars have also carried out research on the search criteria of M&A targets. Qi Ruqing (2001) noted that selecting target enterprises comprises two steps. First, the industry is determined, and then, the right enterprise is found within that industry. When selecting the target, it is recommended that the strategic motivation of the merged enterprise and its economic scale, financial status, geographical location, market position, and other factors

be considered. Qin Xijie (2002) also developed a similar perspective and suggestively noted that the search criteria include the size and nature of the target enterprise, ownership structure, geographical location, cultural synergies, etc. Zhang Jinxin (2006) noted that M&A targets be sought from the perspective of matching the resources of the two parties. He divided corporate assets into the three categories of culture, capability, and assets and believed that the core of the target enterprise selection is the evaluation of the potential synergies between the two parties. Given the development of the times, search theory was gradually introduced into the analysis of M&A target selection. Mo Xiaofang and Song Deyong (2006) applied search theory to obtain that the time probability of finding a target company follows an exponential distribution. At present, the application of search theory in M&A is still relatively rare. Determining the optimal search frequency and reducing the enterprise's search costs are directions for future research.

(2) Evaluation of acquisition targets

An evaluation of targets has the objective of selecting the best one. The financial index method is commonly employed in the evaluation of target enterprise. This index system includes stock price, tangible assets, intangible assets, corporate earnings, and relevant financial ratios, such as debt-paying ability, turnover ability, and profitability. Evaluating synergies is also the main method of evaluating a target enterprise. Synergies usually include resource-led, cultural, and strategic synergies. Yu Kai et al. (2003) constructed an optimization model of target enterprises using the analytic hierarchy process (AHP) method for the three aspects of resource, cultural, and strategic synergies. According to current studies, an evaluation system that is based on the synergy effect of

both parties is weak, but it is strong if based on the financial characteristics of the target enterprise.

2.2.3 M&A pricing and payment methods

(1) M&A pricing

After the target is selected, the pricing of that target needs to be determined. M&A pricing is not a simple process; instead, it is a complex game involving an analysis of the value of the target enterprise and the value added, an estimation of the pricing range, and negotiation pricing. Many studies exist on the valuation of target enterprises and negotiation pricing. The valuation of the target enterprise is the first step in the M&A pricing process. The net present value method is a main method for evaluating company value. This method considers that a company's pricing value comes from its future cash flows, with its return on investment potential based on cash flows.

Domestic scholars also use the discount method. Wang Feng and Xuan Guoliang (2001) developed an enterprise value evaluation method on the basis of discounted economic profits. Given the defects of the discount method, a real option evaluation method has developed gradually. Acquiring banks can design embedded real options to increase project returns. In general, the types of real options are as follows: deferred, growth, scale change, conversion, and waiver options. Ingersoll and Ross conducted research on deferred options and showed that properly delaying development can create more value. Research by Myers and Majd (1990) showed that enterprises with the right to change the scale of operations have higher values when operating conditions change than those without such a right do. The research on negotiation pricing is mainly based on game theory. The auction and bargaining models are common M&A pricing methods. In

recent years, Chinese scholars also have used game theory to study M&A pricing. Using game theory, Li Changqing (2001) et al. studied the maximum price acceptable to the acquirer and the minimum price acceptable to the target and provided the equilibrium price. Xu Chaoyang (2005) noted that the signal game could reduce the degree of information asymmetry during the negotiation process and enhance the stability of the M&A pricing process.

(2) Payment method for M&A transactions

The price acceptable to the target also includes the form of payment, or consideration. Presently, the main payment methods include cash, negotiable securities, and a mix of cash and securities. The method of payment is important because different payment methods affect the performance of the enterprise. The current key debate is about which method of payment is more conducive toward improving M&A performance—cash or securities. Some scholars believed that cash is superior to securities. For example, Andrade et al. (2001) analyzed M&A cases in the United States and concluded that payment using stock is not conducive toward improving company shareholder value and that cash payments are better than stock payments. Dong et al. (2006) believe that enterprises overrated by the market use stock payments but receive minimal excess returns. In contrast, enterprises undervalued by the market use cash payments but receive higher excess returns.

Some scholars hold opposite views. For example, Zhao Xi and Liu Jiayin (2014) stated that stock payments are better than cash payments. Companies that adopt stock payments have excess stock price fluctuations after announcing M&A deals, and their short-term financial performance improves significantly. Some scholars noted that stock

and cash payments have their own advantages and disadvantages. For example, Wang Guipu (2012) et al. studied the influence of the M&A payment method on M&A performance. The research showed cash and stock payments as fundamentally having the same effect on M&A performance, with cash payments being better in terms of debt payment ability, and with stock payments being better in terms of profitability and operating ability. The choice of payment method and the final impact on M&A performance depend on many factors. Hansen (1987) noted that when the acquirer is overvalued in the market, it usually pays in shares. Kobeissi et al. (2010) argued that managers often pay in cash to avoid diluting large shareholders. Sun Shipan (2013) et al. considered the influence of the payment method on controlling equity and debt capacity. Other studies showed that an enterprise has a larger debt capacity if its senior executives hold a large proportion of the shares and thus is more inclined to use cash payments. The specific method adopted has been observed to depend on the internal conditions of the acquirer, the intentions of the manager, and many other factors. The acquirer always weighs the threat of control rights and the constraint of debt financing when selecting a payment method.

2.2.4 M&A timing strategy

The timing of bank M&A transactions is related to the success or failure and efficiency of such transactions. The three waves of international bank M&A activity showed that banks choose or do not choose to engage in M&A transactions depending on changes in the internal and external environments. Moreover, the timing of the M&A transaction depends on the macro environment and the micro conditions.

From a macro perspective, M&A has an important relationship with the economic

cycle, stock prices, industrial activities, interest rates, and other macro variables. Research indicated that the correlation between M&A activity and stock prices is highly positive. However, Li Wenkui (2009) stated that an economic downturn is the best time for banks to engage in M&A activities—a view for which he cites the M&A history of Mitsubishi UFJ Financial Group as evidence. Mueller and Schiereck (2011) studied the role of the timing of M&A activities during economic booms and crises with the use of 72 case studies on U.S. commercial banks' M&A activities with other financial institutions. They examined the effect of value generation on the acquirer's shareholders and the effect of M&A activities on shareholder value before and during a competitor's crisis. The results showed that banks with good execution ability could create value through M&A activity.

From the micro perspective, the best timing for M&A activities is related to the level of perfection of the information from both sides. Chen Zhuming (2005) used game theory to study the timing of M&A activities and concluded that a higher scale economy parameter of the target enterprise, higher price growth, smaller fluctuations, and stronger synergy effects results in sooner M&A activities. Chen Zhuming and Yang Hua (2009) studied the optimal timing of enterprises' M&A activities that use debt under the condition of complete information through methods such as real option games. The researchwork showed that the timing of M&A activities is related to the growth rate and volatility of the target enterprise's industry, the size of the target enterprise, the price, and the sunk costs. Duan Shixia and Hu Wenxiu (2010) noted that the timing of M&A activities is related to the synergistic effect. The earlier the appearance of the synergistic effect the better the timing of the M&A activities. A more obvious synergistic effect

results in the enterprise implementing the M&A activity earlier. Mu Qingbang (2016) noted that the best timing of M&A activities is related to the relative stock price. When the relative stock price enters the mergeable range, M&A activities can be carried out, otherwise waiting options should be considered. Zhang Weiguo et al. (2014) studied M&A activities when both sides of a transaction had liabilities. They believed that the existence of liabilities reduces the income resulting from the M&A activity of master merger enterprises and delays the occurrence of such activities. He Qibin (2007) studied the timing of bank M&A activities from the perspectives of the external environment and bank financing. He noted that the economic cycle is closely related to the timing of M&A activities and that the growth stage of bank M&A transactions corresponds to the stage of economic recovery. A good institutional environment is an indispensable factor for bank M&A activities. The better a bank's financial situation the more favorable the bank M&A activity and the more mature the M&A opportunity. He also studied the timing of M&A activities from the perspective of the target company. If the Tobin's Q of the target company's industry is less than 1, it indicates that the timing for M&A activities is good. Yixinfu (2013) analyzed the two influencing factors of the external environment and bank financing and proposed that, given that goodwill acquisition entails compensation to the shareholders of the target bank, the best timing of an acquisition is only related to the relative value of the target bank.

2.2.5 M&A integration strategy

M&A activity entails the most important dynamic process after banks complete such an activity. M&A activities do not themselves bring significant benefits—the key is the question as to whether the M&A transaction can be effectively integrated to achieve

synergies and improve the overall core competitiveness. M&A decision-making and integration management have an important impact on the performance of a transaction. The value of M&A activities mainly depends on integration skills. Only when the value chain for both parties to an M&A transaction realizes a whole or a partial integration does the synergistic effect truly come into being and the value of M&A come to be revealed.

From the perspective of the framework of M&A integration, Alessandro et al. (1994) noted that the M&A integration framework should comprehensively consider strategic and organizational matching. They proposed the four integration modes of absorption, symbiosis, protection, and control. Marks and Mirvis (1998) stated that M&A integration involves five parts: strategy, organization, personnel, culture, and transaction management.

Tetenbaum (1999) adopted the perspective of a specific integration and noted that employees' attitudes and behaviors toward M&A activities have a direct impact on the final result of a transaction. A badly executed integration leads to the loss of employees and human capital. After integration, human capital management should be strengthened to enhance employees' sense of identity to the enterprise by improving communication and offering psychological counseling. Cultural differences also affect the success or failure of M&A deals and their potential. Cultural integration can adopt four modes: assimilation, integration, isolation, and destruction. The knowledge management school studied M&A from the knowledge angle. This school of thought believes that knowledge is a necessary condition for the development of enterprises, making knowledge integration key to M&A integration. Moreover, knowledge risk is a key factor in the success or failure of knowledge integration.

2.3 Review of research on M&A synergies

Zhang Qiusheng (2001), in his book *Merger and Acquisition* co-authored with Wang Dong, put forward the division sum model through in-depth study of many cases of M&A, so as to make the prediction method of synergies generated in merger and acquisition more scientific. The main realization path of this method is to discount and sum the functions played by the performance level of various synergistic effects generated by enterprises.

At the same time, Zhang Qiusheng (2003) proposed a quantitative subdivision model to aggregate the economic, financial, and management synergies generated by enterprise M&A activities. This study enabled a quantitative analysis of synergies and predicted highly accurate results. This study also simultaneously laid the foundation for follow-up research. This study resulted in a new way of thinking for the measurement of synergies in Chinese enterprise M&A activities.

Zhou Lin (2006) created a resource collaboration model. The establishment of a seed delivery model was recorded in an open environment, and the relatively complex system, as well as self-organization theories, was applied. Quantitative analysis was conducted, and the results included the reasoning for M&A transactions. Wang Qian (2006) also provided identification methods from the perspectives of finance, management, and production and operations by engaging in research on the synergy effect. He Lijuan (2012) analyzed the merger of the Shenzhen Development Bank and the Ping An Group during 2009–2011 and the post-merger key financial indicators. The study found that the Shenzhen Development Bank faced solvency deficiencies, poor operational ability, and a low net income, and highlighted the aspects of the bank to be improved, so as to

strengthen its management. Chen Lei (2013) compared more than 5 years of financial data of listed companies before and after Ping An Group's merger with Shenzhen Development Bank and concluded that the overall effect of this transaction was positive.

2.4 Research summary of M&A efficiency

In the context of the increasingly obvious trend of “financial disintermediation” in China and the long-term low operational mode of the country's real economy, the manner in which commercial banks respond to challenges and achieve transformations and upgrades has become the focus of attention. M&A activity enables companies to expand their business scale and range and represents a traditional way of enhancing one's core competitiveness, with capital markets maturing in China, and with laws and regulations increasingly being perfected. M&A activity enables commercial banks to solve problems related to the compression of the profit space, intermediary business downturns, increasing bad loans, and declines in asset quality—an important means of realizing leap-forward development. At present, the M&A activity in China's banking industry is increasing. The question of whether banks can achieve the set goals after an M&A transaction not only is a touchstone for theory but also provides important forward-looking guidance for bank M&A activity in reality. The efficiency of commercial bank M&A activities and the factors that affect this efficiency require in-depth study and analysis. This paper reviews the domestic and foreign research on the efficiency of commercial banks' M&A activities and seeks out potential future areas of research with a positive outlook.

2.4.1 Measurement of bank M&A efficiency

Different motivations for M&A have important impacts on the ultimate efficiency of

commercial banks' M&A transactions. However, in actual research, nonvalue maximization drivers cannot be quantified, and general research is based on value maximization drivers. To study the relationship between bank M&A activity and bank efficiency, defining how to measure bank efficiency is necessary. Efficiency can be measured from the perspectives of costs, profits, and production capacity (Berger and Mester, 1997). For example, the ratio between actual and optimal costs before and after an acquisition can be measured and compared from the cost perspective, whereas from the profit perspective, changes in the ratio between actual and maximum profits can be compared. From the production capacity perspective, the distance between the current production level and the production front can be measured. Through the diversification of analytical tools, accounting ratio comparisons have gradually become important toward the evaluation of bank efficiency (Chen Lu, 2005). Financial index analysis, factor analysis, data envelopment analysis, and event analysis, among other methods, are widely used.

The conclusions from the current international research results can be divided into three categories: M&A activity as improving bank efficiency, M&A activity as not improving bank efficiency, and the results of research on the effect of M&A activity as not being clear.

(1) Bank M&A activity improves bank efficiency

Berger et al. (1993) showed that bank M&A activity can improve the x-efficiency of banks and beget improvements in benefits and profit margins. Becher (2000) studied 558 M&A transactions by commercial banks from 1980 to 1997 and found that this M&A activity has a positive market value weighting effect and that relative to the United States,

European banks' M&A activity have a significantly positive effect. From the perspective of shareholder value, M&A activity in the European banking industry can often significantly improve the wealth of shareholders on both sides of a transaction and create M&A value (Wahrenburg, 2004; Diaw, 2014). Correa (2008) studied 220 cross-border M&A transactions between 1996 and 2003 and concluded that cross-border M&A performance begins to emerge 2 years later. Jens and Kevin (2009) studied the M&A activity of European banks from 1998 to 2002, and the results also indicated that bank efficiency generally improve 2 years after an M&A transaction. Kai Du and Sim (2016) studied the efficiency of bank M&A activity in emerging countries. Using panel data from six emerging countries, they found that when acquirer banks are not separated from target banks for the regression, the acquirers tend to become vulnerable after the transaction, and the target banks are increasingly the beneficiaries. However, these authors also stressed that the ultimate efficiency of the post-merger consortium would improve.

(2) Bank M&A do not make banks more efficient

Shaffer (1993) studied the cost efficiency of commercial banks that engaged in M&A activity in the United States from 1984 to 1989, using the stochastic boundary and the superlog cost functions. Research showed that bank efficiency improvement is related to bank size. When a bank's size exceeds 1 billion yuan, M&A activity increases the total cost. Kwan and Eisenbeis (1999) adopted samples from 94 U.S. commercial banks and found that commercial mergers and reorganizations have no positive effects on the stock market and that the announcement effect is not obvious. Rhoads (1998), Berger (2002), and Andrew (2001), among other scholars, also showed that bank M&A activity do not

significantly improve the x-efficiency of banks and that the costs related to M&A activity offset the potential benefits. Megginson et al. (2005) studied 260 M&A cases between 1963 and 1996 and found that mixed—horizontal and vertical—M&A activities often reduce shareholder value because of the difficulties with integration. From the perspective of cost efficiency, studies exist that support the concept that M&A fails to improve bank efficiency. For example, when measuring the cost efficiency of the European banking industry, M&A was found to reduce the cost efficiency of European commercial banks (Staikouras and Mamatzakis, 2008).

(3) The conclusion is controversial

Lin (2002) used the frontier analysis method (SFA) to analyze the M&A efficiency of commercial banks in Taiwan and concluded that M&A could effectively improve cost efficiency, whereas the data envelopment method (DEA) reached the completely opposite conclusion. If the time effect is considered, the efficiency of M&A activity shows a time-varying trend. M&A efficiency usually presents a U-shaped change, with an initial rise and then a decline, and the change time node is 2 years (Hsiao and Anna, 2010). No consensus is observed in academic circles on the impact of bank M&A activity on bank efficiency. Given a change in samples and research and measurement methods related to bank efficiency, bank M&A activities have different impacts on bank efficiency.

Domestic scholars also studied the relationship between bank mergers and bank efficiency. Wang Jian, Jin Hao, and Liang Huichao (2011) studied the M&A activity of 14 commercial banks by using the super-efficiency DEA method. Their results showed that the cost efficiency of these banks increase year by year. Guo Yan and Zhang Liguang (2011) studied cases of bank M&A activity in China from 1996 to 2009 and found

Chinese bank performance to improve after an M&A transaction and the performance differences of different banks to be revealed for a long duration. Many scholars also showed that bank M&A activity could not improve bank performance. Xu Xiaoping and Ma Qiqiang (2008) used the DEA method to analyze the 3-year post-performance of the merger among CCB, ICBC, and Pudong Development Bank and showed that the merger did not improve the efficiency of the three banks. Xu Erming and Wang Wenbin (2009) carried out an empirical study on the M&A cases of 47 banks in 12 Asian countries and showed that for the acquirer, M&A activity reduces bank efficiency and has a weak impact on shareholder wealth. Ding Hui (2009) compared the operating performance of banks before and after M&A activities, and the results show the overall performance of banks that merged or acquired to be lower than the industry average within 5 years, with a significant decline in profitability. Some studies were inconclusive. For example, Zhou Xiaochun (2003) showed that M&A activity only improves the efficiency of medium-sized banks, whereas the efficiency of large-scale banks decreases after such activities. Zhang Gan et al. (2017) showed that the different angles used to measure M&A efficiency lead to different conclusions. They used the efficiency analysis method and domestic commercial banks' mergers with insurance companies as examples and found most banks to experience a decline in efficiency during the year after the completion of the integration. When using the event analysis method, M&A activity was found to bring positive wealth effects to state-owned banks.

Given the particularity of the Chinese financial system, Chinese banks are divided into state-owned and non-state-owned banks. In terms of M&A activity, Chinese banks are also divided into government-led M&A and market-led M&A transactions. Chen Qian

(2007) used the DEA method to study bank M&A activity under government intervention and market-oriented M&A activity, and the results showed that the efficiency of M&A under government intervention is lower than that of market-oriented M&A activity, which is not conducive to the rapid realization banks' scale efficiency. Liu Liping (2009) also analyzed these two types of M&A activity using a financial analysis and DEA method. He found that M&A activity under government intervention is not conducive to improving bank efficiency, suggesting that government intervention be minimized in bank M&A activities.

2.4.2 Factors affecting the efficiency of bank M&A activities

This analysis shows that no unified view on the relationship between bank mergers and bank efficiency exists at home or abroad because M&A activity is complex and involves many factors, including exogenous and endogenous. The combined effect of these factors complicates the impact of M&A activity on bank efficiency. According to Wang Qier (2010), industrial effect, M&A mode, M&A payment mode, and M&A integration affect the efficiency of banks after an M&A transaction. The industrial effect has the strongest effect; mixed M&A efficiency is the worst; the advanced payment method is more conducive to improving M&A efficiency; and enterprises' cultural conflicts and strong employee resistance have a reductionary effect. Wang Jing and Tian Manwen (2010) noted that agency costs and government interventions affect the efficiency of M&A integration. Factors affecting the efficiency of M&A activities can be summarized into three levels: macro, M&A, and bank (Luo Le, 2013). From the macro perspective, government regulations and interventions tend to reduce the efficiency of bank M&A activities (Malatesta and Thompson, 1993). However, if the government

encouraged M&A activities and provided corresponding policy support and if the securities market developed perfectly, the efficiency of these activities would be relatively improved. From the aspect of M&A activities, the formulation and implementation of M&A strategies affects the efficiency of such activities.

If the selected target were too large, an M&A transaction would use more resources in the current period, which is not conducive to improving the efficiency of the transaction. Research showed that the scale and efficiency of an M&A transaction have a reverse change relationship (Roll, 1986). Rhoades (1998) found that when compared with large banks, small bank mergers could reduce costs and improve efficiency. Hughes (1996) also found banks with assets over \$300 million to have inefficient post-merger management. If the selected M&A target had related transactions with banks, the performance of M&A transactions would be better than that of non-related M&A transactions (Wang Yuetang, 1999; Zhang Junrui et al., 2002; Pan Jin et al., 2005).

Merger types also affect merger performance. Generally, the efficiency of horizontal and vertical mergers is higher than that of mixed M&A transactions because banks involved in a mixed M&A transaction are relatively unfamiliar with the target businesses, and achieving synergies is difficult (Jensen, 1986). Feng Genfu and Wu Linjiang (2001) found that the short-term effect of mixed M&A transactions is obvious, whereas the long-term advantage is not. However, the performance of horizontal M&A activities shows a stable upward trend. Li Qiong and You Chun (2008) also noted that in terms of M&A performance, mixed M&A transactions have the worst effect and horizontal M&A has the best effect. In addition, a more experienced acquirer results in a higher probability of an acquisition being effective (Berger, 2007). Different payment methods also affect

the performance of an M&A transaction. Becher (2000) believed that cash payments could create more value for shareholders of the parties involved in an M&A transaction. Post-merger integration has a significant effect on merger efficiency, and the integration of core competitiveness and cultural and human resources affects merger efficiency. For example, Song Yun (2004) found that cultural conflict affects merger efficiency by influencing the attitudes of employees at the target enterprise.

From the perspective of banks, the characteristics of banks engaged in M&A activities, such as bank equity structure, equity concentration, profitability, and asset size, have important effects on the efficiency of the transaction. Guo Yan and Zhang Liguang (2011) found that the larger the assets of the main acquirer relative to the target's assets the more obvious the performance improvement of the main acquirer after the acquisition. In addition, the geographic concentration of transactions also affects the efficiency of M&A activity. Berger and Deyoung (2006) showed that a greater geographic concentration of transactions results in higher value created for shareholders. Asimakopoulos et al. (2013) studied M&A activity in the European banking industry between 1990 and 2004 and found the target bank's shareholders to obtain significant positive returns, with the acquiring party's shareholders obtaining insignificant negative returns. They also found the efficiency of domestic M&A activity to be higher than that of cross-border M&A activity and the acquisitions of listed target banks to perform better than did acquisitions of nonlisted target banks. Although the connection between M&A income and bank characteristics is weak, banks the M&A activity of which results in low efficiency but diversified income are more efficient, and banks with high credit risk, low liquidity, and low efficiency are not good choices as targets. Halkos, Matousek, and

Tzeremes (2016) used domestic banks in Japan as an example and employed the DEA method to predict improvements in technical efficiency resulting from possible M&A activity. Their study found that small banks might achieve better technical efficiency from M&A activities than large banks and that the degree to which M&A efficiency improves is related to the target's geographical location.

CHAPTER 3

RESEARCH IDEAS AND METHODS

3.1 Research issue

At present, China's commercial banks have entered a period of slow growth: growth of the industrial asset scale is slowing down, the nonperforming loan ratio is increasing yearly, and the annual profit rate is decreasing. However, the number of Chinese commercial banks continues to grow, albeit at a slower pace, and competition among them is intensifying. As the central bank continues to promote interest rate liberalization, small- and medium-sized commercial banks, including urban commercial banks and rural credit cooperatives, are further squeezed out of the market. In this case, small banks' profits are significantly reduced, and they might even face losses in the future. For some medium-sized commercial banks, their capacity bottlenecks and the status quo of their respective regions hinder further business development. In this context, the acquisition of commercial banks is particularly important because M&A activity can help small banks out of difficulties, promote the development of small- and medium-sized commercial banks, and improve the overall efficiency of commercial banking resource allocation.

This paper studies whether commercial banks' M&A activities can bring new development opportunities to the competitive commercial banking industry under the current macroeconomic environment. To answer this question, this paper conducts a case study on the strategy, synergy, and performance of M&A integrations by commercial banks.

3.2 Concept definition

3.2.1 Bank M&A activity

Enterprise M&A activity occurs between enterprises. A merger refers to the legal reorganization and combination of two or more companies, through which the rights and obligations of one company are assumed by the other (or a newly established) company. A merger refers to the merger of two companies, one of which loses its legal person status, with the other becoming the surviving company that assumes the rights and obligations of both companies after the merger. A new establishment merger means that when a company is merged with another company, a new company as the legal entity is created, and the original two companies cease to have legal person status. A takeover refers to the use of cash, bonds, or other consideration to buy assets or equity in another business to gain control of that business.

From the perspective of property rights, a merger is the complete transfer of a company's property rights. However, in an acquisition, the seller still retains formal legal person property rights, and the buyer controls part or all of these legal person property rights after purchasing part or all of the ownership of the seller. To enhance the compatibility of the research, M&A activities, often referred to as M&A in academic circles, generally refers to property rights transaction activities carried out by enterprises to obtain all or part of the control rights of other enterprises.

The so-called bank M&A activities occur under the mechanism of market competition to obtain operational control of the acquired bank. The acquiring bank purchases part or all of the property rights of the target bank using compensation to realize integrated operations of the assets. China's commercial banks can quickly enter a target market through M&A activities. After an effective integration, the acquirer can enhance its scale, technology, and competitiveness.

3.2.2 M&A types

Many kinds of M&A transactions exist, and different types exist according to different classification standards. According to industry associations concerning M&A, horizontal, vertical, and mixed forms of M&A transactions exist. Horizontal M&A occurs between enterprises that produce the same or similar products or that have similar production technologies and processes, with the main purpose of expanding marketshare and gaining competitive advantages. The advantage of horizontal M&A transactions is that they can improve the use efficiency of general equipment, rapidly expand the scale of production, facilitate the unification of technical standards at a broader range, optimize the professional division of labor and collaboration, and facilitate unified sales and procurement. However, horizontal M&A transactions can easily destroy industry competition and form monopolistic entities. Vertical M&A (M&A) occurs between the main bodies of a company that have a cohesive relationship in a production or distribution process and that can achieve vertical production integration and strategic coordination. Vertical mergers can effectively solve the separation of a production process caused by specialization, reduce bargaining and performance costs, such as purchase and sales costs, and reduce moral hazards. Vertical M&A activity leads to the expansion of the organization's management level and scale and increases the cost of information, internal organization, internal incentives, and constraints. Enterprises engaged in mixed M&A activity have different industrial fields and product markets, and no production technology connection exists between industrial sectors. Hybrid mergers have the characteristics of both horizontal and vertical mergers, and their purpose is to realize a diversification strategy and reduce business risk. Hybrid M&A activities mainly

pursue economies of scope and expect to achieve the combination effect of raw material supply, R&D, production, market, intangible assets, and other aspects.

According to the classification of capital contributions, there are cash purchase, equity transaction, and integrated securities M&A activities. A cash acquisition is the acquisition using a certain amount of cash paid to the target enterprise to acquire its ownership. When the target enterprise's owner receives its cash, it no longer has equity ownership in the original company. The acquiring enterprise may use cash to purchase assets or shares of the target enterprise. Equity transactive M&A transactions refer to an acquirer that purchases the stocks or assets of the target enterprise with newly issued shares of the enterprise but does not pay a large amount of cash. The original target enterprise's shareholders (or owners) become the shareholders of the newly acquired enterprise and retain the owners' equity. A comprehensive security-type M&A transaction refers to the offer made by the acquiring enterprise to the target enterprise in the form of cash, stocks, warrants, corporate bonds, convertible bonds, and other combinations of comprehensive securities. This investment method can give play to the advantages of various securities and reduce the risk of M&A transactions.

According to the classification of M&A attitudes, there are goodwill M&A and malicious M&A. Bona fide M&A activity refers to the situation in which the top management of the companies on both sides of a transaction agree that the process can proceed peacefully through negotiations. One party is satisfied with the acquisition conditions proposed by the other party and actively cooperates to ensure that the entire process is friendly. Both parties can exchange and communicate information with each other, which is conducive toward reducing the risks and costs of the M&A activity and

improving the success rate. However, in a goodwill M&A transaction, the acquirer must sacrifice part of its interests to win the cooperation of the acquired enterprise, and the long-term negotiation and negotiation process damage the timeliness of the M&A activity, thus reducing the value of the deal. A hostile takeover is the acquisition of a target by the acquirer against the wishes of the target through a non-negotiated purchase. When the management of the target is still unknown or strongly opposed to the deal, the acquirer directly issues a takeover offer to the shareholders of the target because the target cannot obtain internal operational, financial status, and other information, resulting in valuation difficulties of the target or even the target's resistance.

Open market and non-open market acquisitions also occur. Public market acquisitions, also known as tender offers, refer to the purchase of a large number of shareholders' shares in a listed company at a certain price in the stock market to achieve the purpose of controlling the listed company. In the case of a tender offer, the acquirer has strong corporate autonomy and acts quickly; however, it must abide by the relevant laws and regulations and is restricted by market rules. A tender offer without the prior consent of the other side is the most malicious form of an M&A transaction. A nonpublic market acquisition refers to the transfer of the equity of the target to the acquirer through direct negotiations between the two parties to the transaction without going through the stock market. Most acquisitions that are agreed upon are bona fide M&A transactions because the target companies have a better understanding of, and cooperate with, the M&A process, and the risks and costs are low, but the cost of negotiating contracts is high. At present, many cases of non-open market agreements exist. China's nonpublic market acquisitions include government transfers, debt commitments, and agreements to transfer

state shares, enterprise custody, power of attorney acquisitions, and other special forms.

According to the classification of the share of M&A, controlling M&A transactions and comprehensive acquisitions exist. A holding merger refers to the acquisition of a target enterprise by the acquirer to achieve a holding, including a relative holding (becoming the largest shareholder) and an absolute holding (holding more than 50%).

A comprehensive acquisition is a transaction in which the acquirer purchases all of the equity or assets of the target, makes the target its wholly owned subsidiary, and has full ownership of its assets.

Other special types of M&A transactions exist, such as the leveraged buyout (LBO) and the management buyout (MBO), among others. The essence of the LBO is to use financial leverage to complete the deal and then to use the future income of the acquired company to repay the debt. An LBO can be large or small and is a high-risk, high-yield, and high-skill M&A transaction. An MBO is the acquisition of all or part of a company or its business departments by its managers, resulting in the company's managers becoming the owners and unifying ownership and management rights.

3.2.3 M&A theory

Early M&A theory focuses on the analysis of the motivation for engaging in M&A transactions. The main motivations are the pursuit of market control, increasing profits, reducing costs, increasing shareholder value, obtaining scale economic benefits, acquiring a business or financial synergies, achieving diversification, improving competitiveness, dispersing risk, and responding to a market failure, among others, which are economic motivations of the management goal. Keith et al. (1998) divided the motivations of an enterprise merger into three categories: economic, personal, and

strategic motivation. Economic motivation was subdivided into nine categories, including economies of scale, improved profitability, dispersal risk, reduced costs, technological economies of scale, target differential value, defense mechanism, coping with market failure, and increased shareholder value. Personal motivation is about improving performance (sales), management challenges, integration of inefficient management, and strengthened management prestige. Strategic motivation includes the pursuit of market power, acquisition of competitors, acquisition of raw materials, and establishment of entry barriers.

Keith et al. (1998) provided a relatively systematic index system to analyze the motivation of enterprise M&A activity. This system offers an excellent reference for an analysis of the motivation of China's commercial banks' M&A activities although some indicators are not applicable to the banking industry.

In real economic activities, the reasons that enterprises conduct M&A activities are diverse and complex, and the initial motivations for pursuing an M&A transaction are manifested in different forms of effects. Since the 1990s, the scale and scope of M&A activities have been larger and broader, which increasingly affects a country's economic development. Based on the existing literature, the main theories that explain the motivation and effect of M&A activities are scale efficiency theory, the market force hypothesis, the monopoly profit hypothesis, government intervention theory, taxation consideration theory, shareholder wealth maximization theory, agency theory, risk diversification theory, and efficiency theory.

3.2.4 M&A motivation

Bank M&A activities are not highly profitable and might not necessarily improve

the parties' efficiency. During a bank M&A process, direct M&A expenses (cash, equity, options, and others) and intermediary fees (approximately 2%–5% of M&A expenses) might be generated, and integration costs occur after a transaction has been completed. During the entire M&A process, excessive monopolistic actions may harm consumer interests, possibly because the scale of the deal is too large to increase operational risks and possibly because a large number of layoffs increase the social unemployment rate. Therefore, why do China's commercial banks still strive for more business cooperation or even mergers? This paper introduces the motivations of China's commercial banks' M&A activities from the following two aspects.

(1) The external environment's pressure on our country's commercial banks' M&A activity

First, financial deregulations and policy support affected enterprises' external environment. Prior to China's accession to the WTO and the Asian financial crisis, the country restricted access for foreign banks, which were not allowed to engage in RMB business even if they existed. Subsequently, many countries began to allow foreign investors to increase their stakes in their banks to ease the domestic financial crisis. The relationship between foreign banks and China's commercial banks develops according to trends in the signing of cooperation agreements, equity participation, and even mergers. Initially, China's commercial banks simply cooperated with foreign banks to compensate for their deficiencies in some businesses, such as options and swaps, by exchanging technical information. Subsequently, an increasing number of foreign banks began to set up branches in China, and they seized a share of the trial production with China's commercial banks. On December 8, 2003, the CBRC promulgated administrative

measures for overseas financial institutions to invest and buy shares in Chinese-funded financial institutions; to allow overseas financial institutions to participate in the reorganization and transformation of Chinese-funded banking financial institutions on a voluntary and commercial basis, and to regulate the conditions and procedures for investments properly. The relaxation and policy support of these regulations not only increased the urgency to compete in China's banking industry, to form strategic alliances, and to engage in M&A activity among banks but also created a relaxed and orderly environment toward this end.

Second, China's banking industry internationalized and diversified. In December 2006, the RMB business of China's banking industry was fully opened. At this point, China's banking industry faced dual competition between domestic and foreign counterparts. When compared with foreign banks, joint-stock commercial banks in China have weak capital. Emerging small- and medium-sized joint-stock commercial banks and their businesses overlapped in terms of focus and location. Moreover, the focus of China's banks is the wholesale banking business, and foreign banks have more flexible management concepts and technology not easily affected by nonmarket factors. Therefore, for China's joint-stock commercial banks to avoid competing at a disadvantage was difficult. In terms of business diversification, China's banks are also at a disadvantage because foreign banks can utilize diversification and business innovations to improve their competitiveness. Therefore, China's commercial banks can only increase their profits, reduce costs, and improve risk control technology through holdings, M&A activities, or other forms of cooperation.

Finally, China's banking industry should guard against and defuse financial risks

under the government's leadership. Government-led M&A activities of commercial banks can protect their and their depositors' interests during a crisis and enable banks to maintain their operational basis, thus defusing the crisis and playing a stabilizing role in China's financial industry. For example, since 1995, city credit cooperatives have been merged into local joint-stock commercial banks and renamed city commercial banks in 1998.

(2) Internal requirements of M&A activity of commercial banks in China

First, bank M&A activity can enable banks to expand their scale, occupy greater marketshare, and gain competitive advantages. Commercial banks in China operate similar products, and the public tends to choose banks with larger scale and better reputation. M&A transactions are the fastest way for banks to expand scale and increase marketshare, enabling banks to attract better customers and obtain monopoly profits after an M&A transaction. Moreover, the government's protection of the big banks supports them during times of crisis.

Second, bank M&A transactions can save costs and achieve economies of scale.^① At this time, cost refers to R&D, network construction, redundant salary, and information technology investment costs, which can be saved after the completion of M&A integration. Moreover, when the scale of banks increases, the cost of serving the public can be reduced, and more quality services can be provided to improve efficiency and synergies.

Third, bank M&A activities can improve target banks' risk prevention ability

^① In the 1960s, experts and scholars began to study the question of "whether bank mergers and acquisitions can create value" from the perspective of microeconomics. They generally used financial data to analyze typical M&A cases, and most of the conclusions indicate that the revenue obtained by both parties in an M&A transaction did not meet expectations, and some of the conclusions are zero or even negative. "Bank mergers and acquisitions are certainly attractive to risk takers, but they are a zero return and risky activity," he said.

through the capital adequacy ratio. Generally, banks with poor performance engage in an M&A transaction with a bank that is performing well. Through M&A activities, a bank can focus on a target's nonperforming assets, thereby optimizing its asset–liability ratio and improving its capital adequacy ratio so as to comply with the relevant requirements of Basel II and enhance its ability to resist risk.

3.3 Conceptual framework

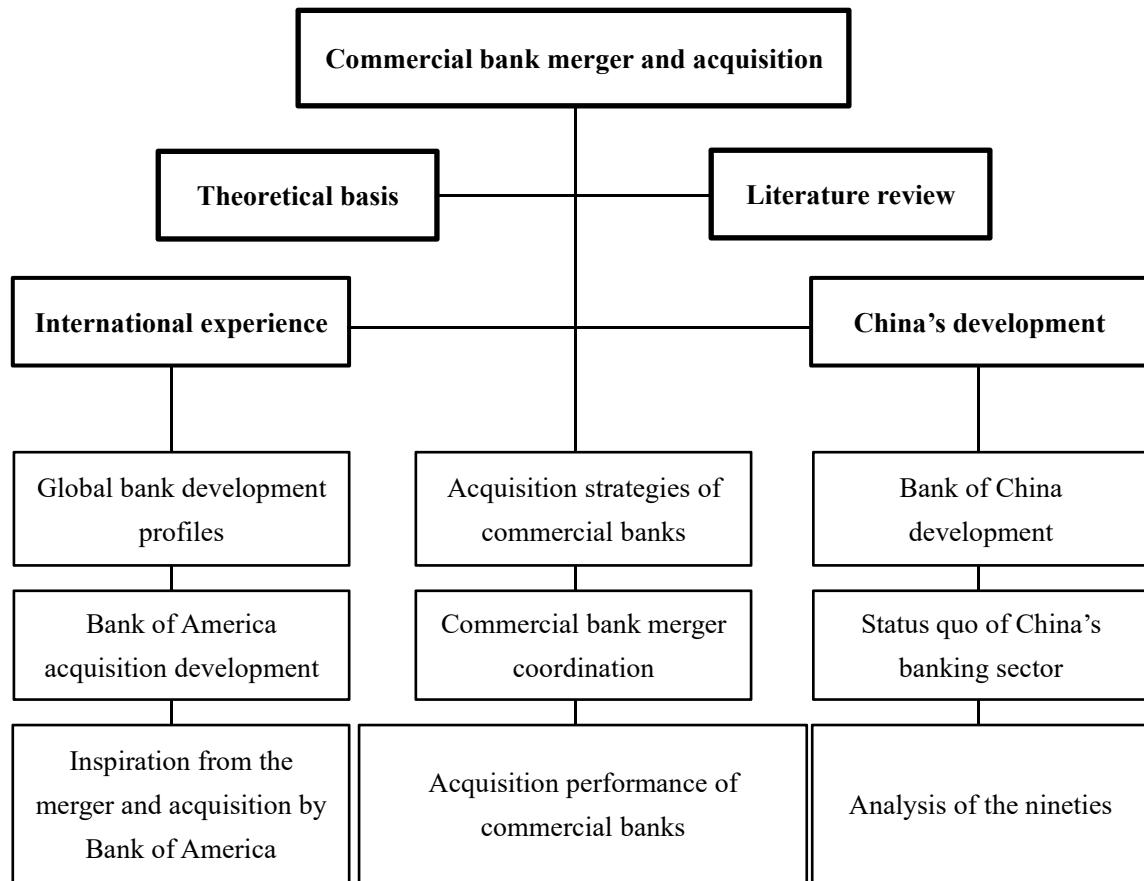


Figure 3-1: Conceptual framework

3.4 Research methods and hypotheses

3.4.1 Research methods

This paper adopts a combination of research methods. The main research methods are a combination of theory and practice.

Commercial bank merger integration is both a theoretical problem and a practical subject, and this paper traces commercial bank M&A integration theory, develops a theoretical basis for commercial bank merger integration practice, and reviews and summarizes the practice of commercial bank merger integration to provide commercial banks with a merger integration path and method.

The method includes combining normative analysis with empirical analysis of post-merger integrations of commercial banks. This paper studies the standards for successful post-merger integrations of commercial banks and analyzes the practical effects of such integrations.

The method of combining comparative analysis with comprehensive analysis is as follows. This paper compares the post-merger integration practices of commercial banks at home and abroad, and the different post-integration modes of commercial banks. Simultaneously, on the basis of a comparative analysis, the modes, paths, and ultimate goals of the post-merger integration of commercial banks are put forward.

Five main research methods exist to evaluate the synergistic effects of M&A transactions: event study, cumulative average return, financial index, average stock price, and case analysis methods. Currently, the more commonly used analysis methods are the event study and the financial index methods, introduced briefly below.

(1) Event approach

The event research method is based on the data before and after the occurrence of statistical events and uses specific techniques to analyze and measure the impact of the event. For an enterprise merger, this method pays continuous attention to the rate of return of enterprises' main shareholders, and then, it studies whether the stock prices are

higher than the rates of return to reveal the synergistic effects of enterprise M&A transactions. The research procedure for this method is divided into the following five parts:

- 1) Define events to determine the duration of an event study;
- 2) Determine the selection criteria of the samples needed for research on the event;
- 3) Use the market model method to measure the normal and abnormal returns in the event window;
- 4) Conduct estimation and inspection procedures; and
- 5) Provide a reasonable explanation of the results.

(2) Financial indicator method

According to various financial indicators publicly disclosed by both parties of an M&A transaction, changes in these indicators before and after the transaction are studied to calculate the realization of synergies between the two parties. In this process, horizontal and vertical comparisons of these financial indicators are conducted. A horizontal comparison means a comparison of these indicators with those of other enterprises in the industry. A vertical comparison is the change in these indicators before and after the reaching of the restructuring agreement by the two parties. Enterprises that carry out M&A transactions pay a considerable part of the premium costs of this process, resulting in a cash flow shortage after the reorganization. However, after industry adjustment, enterprises' return on assets improves significantly, which is mainly because of improvements in management efficiency in the later stages of M&A integration.

The financial indicator method uses information from the enterprise's annual report, including financial statements and other aspects of the enterprise's financial indexes. The

two aspects of profitability include profits and cash flows, and the relevant information includes return on net assets, return on total assets, operating profit margin, current ratio, quick ratio, asset–liability ratio, and their indicators, such as income and cash flows, including cash flow/sales income, cash flow, and cash flow/assets/average common equity index. These indexes can measure changes before and after a merger to determine the merger synergies; the fundamental concept is as follows: $\text{Synergy} = V_{ab} - (V_a + V_b)$.

3.4.2 Measurement methods of synergistic effect

Ansoff (1965) first studied the synergistic effects from the perspective of the corporate strategy. The basic connotation of the theory is that the output of the new enterprise group formed after the merger and reorganization of the original enterprises is more than the sum of the outputs of the original enterprises; this is expressed by the formula $1 + 1 > 2$. Wistone (1998) pointed out that the factors leading to an increase in total M&A value include organizational management, production and operation, financial management, the value undervaluation effect, and information resource delivery. Mainstream economists have recognized Weston's view on synergies; however, he believes that synergies mainly arise from the three dimensions of management, operations, and finance. Therefore, this paper is also based on these three dimensions, and the following is a key introduction.

Management synergy: To participate in the two sides of an M&A transaction and different management levels, the management level and ability of one of the two parties must be better than that of the other. The M&A transaction occurs, and the new enterprise's management level and ability are subject to the stronger company, and the influence of the management of the new enterprise is greater than that of the sum of the

two companies—the embodiment of management synergies. After the M&A transaction, the operational and management resources of both enterprises are optimized and allocated and so is the organizational structure. In general, an enterprise’s management ability and management level, through the company’s organizational structure and management experience, enables division and classification into general management skills that are unique to the industry. A manager with management abilities, such as one with general management abilities, has strong portability and can migrate between businesses that are part of most M&A transactions. Unique management abilities, such as property management skills, only belong within a relevant industry; in such an industry, the enterprise has a unique corporate culture, and such management skills do not apply, and cannot be migrated, to other businesses. This discussion indicates that when the two enterprises engage in M&A activities, as long as their management levels and abilities are not equal, the strong management ability of the target enterprise has to be transferred to the other party to improve the governance level of the merged entity.

Operating synergies: This effect in large part refers to improvements in operating efficiency and the earnings of both parties that arise from the merger. The reason for which M&A activities between enterprises occur frequently is that enterprises intend to enhance their strength and expand their scale through such activities to gain a dominant position in the market and capture significant profits through economies of scale. During this process, the scope of the enterprise’s market reach is expanded by the acquisition, and the cost of production is diluted. Simultaneously, the enterprise can also focus on one product to reduce the loss of time and energy that is caused by product replacement to achieve the purpose of specialized production.

Financial synergy: Such synergies occur after a merger, and the reasonable use of the relevant laws, regulations, and accounting rules enables such synergies to occur from and for both parties. A positive situation occurs through financial synergies, which arise not because the two sides after the merger improve their production and operational efficiencies but because during the integration process, the enterprise can make use of various rules that could enable the realization of reasonable tax avoidance and reductions in financing costs.

3.5 Data collection and analysis

This paper uses the data access and interview methods of data collection. The main data of this research field were collected from domestic and foreign professional academic websites, academic newspapers, and professional institutions. On this basis, combining thematic discussion data with advanced experience, development trends, and theoretical development results of foreign commercial banks' post-merger integrations, M&A integration theory and relevant theoretical research of commercial banks are enriched.

The data in this paper are partly derived from domestic and foreign authoritative academic websites (such as the National Bureau of Economic Research, www.nber.org/, www.cnki.net, www.wanfangdate.com.cn, and others), academic newspapers, survey results from relevant national institutions, and well-known foreign commercial databases, such as Lexis-Nexis, Dialog, Business Connection, and ABI information. All of the data used in this paper are from sources that are authentic, comparable, and verifiable.

The data on banking M&A transactions come from the following sources: China's capital market database and financial terminal database; annual reports of each listed

company; China's financial statistics yearbook; and bankers' competitiveness evaluation reports on China's urban commercial banks.

This article intends to collect publicly available data on Chinese commercial banks through the website of the People's Bank of China. The data collected include but are not limited to the overall incomes, profit margins, asset sizes, rejection rates, and capital adequacy ratios of Chinese commercial banks. By comparing changes in size, profits, businesses, and stock prices of specific commercial banks before and after an M&A transaction, some key cases are analyzed, and other data required for this article are collected.

This paper intends to analyze cases of M&A activities of Chinese and American commercial banks. In view of the scarcity of Chinese cases^①, we pay significant attention to cases related to U.S. commercial banks. We apply the M&A integration rules extracted from the U.S. cases to Chinese cases for verification to provide the decision-making basis for Chinese commercial banks' post-merger integration process.

^① Domestic studies paid little attention to the merger and acquisition activities of commercial banks because the equity management system of China's commercial banks is quite strict. Most commercial banks are controlled by government agencies at different levels; therefore, markets (i.e., non-government-led) mergers and acquisitions are rare. In addition, the establishment of commercial banks requires a business license from the CBRC and is subject to strict supervision by the CBRC. Therefore, mergers and acquisitions of commercial banks represent high-voltage lines of supervision.

CHAPTER 4

M&A ACTIVITY OF COMMERCIAL BANKS: INTERNATIONAL

EXPERIENCE

China's commercial banks should consider two dimensions of M&A strategies. One dimension is the purpose of M&A and includes the three levels of integration, internationalization, and optimization of the business structure. The second dimension is the requirement for an M&A target entity, which should include careful consideration of strategic positioning, industry field, geographical region, scale, strength, financial performance, management innovation, customer resources, institutional network, and other aspects. The size of the M&A target should be in line with the size of the M&A acquirer. The M&A region should place equal emphasis on the domestic and overseas markets. The M&A industry should gradually move from interbank to nonbank financial institutions to promote the M&A strategy steadily. In recent years, China's commercial banks have gradually transitioned to the endogenous growth model; realized leapfrog development; and achieved equal emphasis through M&A activities. M&A activities are expected to become the development trend of China's commercial banks in their next stage.

Commercial banks' growth mode includes the endogenous growth mode of self-accumulation and the leapfrog growth mode through equity acquisitions. Until now, international commercial banks have experienced five M&A waves. The development and growth of each active international bank cannot be separated from equity M&A transactions. M&A transactions have become an important way for international commercial banks to realize leapfrog growth. After restructuring and listing, China's

commercial banks use their capital strength and make strong, positive attempts to realize leapfrog-type growth through equity M&A transactions. Because leapfrog development and growth result from the gradual internal accumulation of endogenous growth models, the purpose of M&A strategy is to solve outstanding problems.

The chapter studies the development process and status quo of the banking industry in developed countries (mainly the United States) and sorts out the development history of commercial banks' M&A activities in developed countries to summarize the M&A integration experience that is beneficial to Chinese commercial banks' M&A activities.

4.1 Development history and present situation of international banking industry

This section provides an overview and analysis of the history and current situation of global banking.

4.1.1 International banking landscape in the 1990s

In the first half of the 1990s, the international banking industry's competitive pattern continued its development trend from the middle and late 1980s. U.S. banks dropped out of the top 10 as they continued to slide down the rankings of the world's biggest banks. The Japanese banking industry gained an overall leading advantage in terms of asset scale, capital strength, profitability, and other indicators, leading the competitive pattern of international banking during this period (see Table 4-1).

Table 4-1: Competitive pattern of the international banking industry in the 1990s

1990s		1995s		2000s	
Rank	Name	Rank	Name	Rank	Name
Nation		Nation		Nation	
1	Sumitomo Mitsui Banking Corporation	1	Sanwa bank	1	Citibank
	Japan		Japan		USA
2	Dai-Ichi Kangyo Bank	2	Dai-Ichi Kangyo Bank	2	Bank of America
	Japan		Japan		USA
		3	Fuji Bank	3	HSBC Holdings

Table 4-1, continued

3 Fuji Bank Japan	Japan	UK
4 Crédit Agricole France	4 Sumitomo Mitsui Banking Corporation Japan	4 Bank of Tokyo–Mitsubishi Japan
5 Sanwa bank Japan	5 The Sakura Bank Japan	5 Chase Manhattan Bank USA
6 Mitsubishi Bank Japan	6 Mitsubishi Bank Japan	6 Dai-Ichi Kangyo Bank Japan
7 Barclays Bank UK	7 HSBC Holdings UK	7 Crédit Agricole France
8 National Westminster Bank UK	8 Crédit Agricole France	8 The Sakura Bank Japan
9 Deutsche Bank Germany	9 Citibank USA	9 Fuji Bank Japan
10 Industrial Bank of Japan Japan	10 Union Bank of Switzerland Switzerland	10 Industrial and Commercial Bank of China China

Source: Top 1000 World Banks[R], The Banker, 1995.

First, Japanese assets continued to expand. By 1990, six banks, including Sumitomo Bank of Japan, Dai-Ichi Quant Bank of Japan, Fuji Bank, Sanwa Bank, Mitsubishi Bank, and Industrial Bank of Japan, were among the top 10 banks in the world in terms of assets. Their positions in international banking competition were further consolidated and improved.

Second, the Japanese banking industry's capital strength and profitability have improved comprehensively. In 1995, according to bank capital strength rankings, Japanese banks occupied the top six among the top 10 banks globally, with an absolute advantage in capital strength.

Third, during this period, Japanese banking financial institutions, along with the Japanese conglomerates “going out,” carried out international operations and penetrated the financial markets of the United States and Europe. On the one hand, they established branches, while on the other, they carried out M&A. The strong “offensive” of Japanese banking caused an uproar among the European and American financial circles.

In the second half of the 1990s, the international financial industry started a “big bang” characterized by financial liberalization. The international banking industry was highly competitive, and the pattern was once again greatly adjusted. During this period, the Japanese economy entered a deflationary and recessionary period, asset bubbles burst, companies suffered from malaise, and Japan fell into a “lost decade.” Japan’s banks, weighed down by bad assets and displaying a serious decline, are gradually ceding global banking leadership to the United States. At the time, in Europe, in-depth international financial liberalization and international banking gradually fueled several influential and large-scale M&A transactions that included Citigroup, JP Morgan, HSBC, ABN Amro Bank, UBS, and Societe Generale Bank. Banks and very large multinational financial groups established in Europe regained control over international banking competition.

An analysis of banks’ national properties showed that major international banks established international branches, blurring the international banking competition between countries—although many banks belong to, or are registered, in a country, they often set up many branches in outside countries as overseas branches to further strengthen their assets, profitability, and capital strength contributions. Therefore, the competitive pattern of international banking is reflected in the competition not only among the banks in each country but also in their attraction of international financial centers to international banking.

Table 4-2: International financial center international banking competition pattern in 2009

Financial center	Number of banking institution	Number of foreign banks	Proportion of foreign banks
London	422	165	39
New York	227	—	—
HongKong	199	180	91
Tokyo	204	58	28
Singapore	114	108	95

Source: Data were quoted from Tao Jundao. International financial center and world economy [M].

Beijing: China financial publishing house, 2010.

Table 4-2 clearly shows that London occupies an obvious advantage in the number of banking institutions and has high international competitiveness. Hong Kong, China, is highly competitive in the international banking industry. The country has a large number of banking institutions, with the number of foreign banking institutions accounting for as much as 91% of the total number of banking institutions. This statistic reflects Hong Kong's attraction to international banking institutions and highlights the country's important position in the competitive pattern of international banking.

4.1.2 International banking pattern since the 21st century

The British magazine *Banker* is an authority publication affiliated with the *Financial Times* newspaper group. *Banker* publishes the “the world’s 1,000 largest banks” ranking every year, which is quite authoritative. This ranking has been regarded as a gauge to evaluate the comprehensive strength of various banks. *Banker* uses the definition of tier 1 capital from the Bank for International Settlements (BIS) as an important indicator when evaluating measures of banks’ competitiveness, which include common and open reserves, retained earnings, and minority investments—also called core capital—without deducting total shareholder equity. The main purpose is to reflect banks’ capital strength and robustness. *Banker*’s annual ranking of the world’s 1,000 largest banks, initially released at the end of 2006, provides specific rankings for the global banking industry:

1. Ranked by tier 1 capital, the top seven banks are still the same as the previous year’s rankings, but the order changed. Citigroup, with tier 1 capital of \$79.4 billion, is still at the top. HSBC Holdings, with tier 1 capital of \$74.4 billion, moved from third last year to second, followed by Bank of America (\$74 billion), JP Morgan Chase (\$72.5 billion), Japan’s Mitsubishi UFJ Financial Group (\$63.9 billion), Credit Agricole (\$60.6

billion), and Royal Bank of Scotland (\$48.6 billion).

2. Ranked by tier 1 capital, the largest banking group in North America is Citigroup; HSBC Holdings in Western Europe; Mitsubishi Financial Group in Asia; Bradesco Bank in Latin America; National Commercial Bank in the Middle East; Standard Bank Group in Africa; and Sberbank in central and eastern Europe.

3. Barclays is the largest bank by total assets, followed by Citigroup in North America; Barclays Bank in Western Europe; Industrial and Commercial Bank of China (excluding Japan); Mitsubishi Financial Group in Japan; Bank of Brazil in Latin America; Bank of Hapoalim in the Middle East; Standard Bank Group in Africa; and Sberbank in central and eastern Europe.

4. The three largest banks in Western Europe are HSBC Holdings, Credit Agricole, and Royal Bank of Scotland. HSBC Holdings's tier 1 capital increased to \$74.4 billion from \$67.3 billion last year, ranking first in Western Europe and second among the world's 1,000 largest banks. Britain dominates the top seven banks in Western Europe with four. Only two German banks make the top 25 in Western Europe. A total of 286 banks in 25 EU countries are among the top 1,000 banks in the world, accounting for 40.7% of tier 1 capital, 50.7% of assets, and 37.4% of profits; they comprise the global banking industry's most important region.

5. In North America, Citigroup continues to be the industry leader. In 2005, Citigroup had tier 1 capital of \$74.4 billion, ahead of JP Morgan Chase at \$68.6 billion. In 2006, Citigroup had tier 1 capital of \$79.4 billion, which was still more than that of Bank of America, which had \$74 billion. A total of 207 banks in North America ranked among the world's top 1,000, with 197 in the U.S. and 10 in Canada. In 2006, North

American banks generated profits of \$187 billion, or 29% of the total for the top 1,000 banks. The United States still constitutes the world's second-largest banking group.

6. Japan's banking sector continues to recover and maintain steady growth. After taxes, the sector earned \$51.3 billion in 2006, up from \$32.4 billion in 2005. At present, Japanese banks have tier 1 capital of \$31.8 billion, accounting for 11.2% of the top 1,000 banks, up from 11.1% in 2005. Total assets were \$759.5 billion, or 11.9%, down from 13.2% in 2005. Overall, Japanese banks remain less profitable than their North American, Latin American, and Middle Eastern rivals.

7. Russian banks still dominate the ranking of central and eastern European banks, accounting for 17 of the top 25 banks. Moreover, with the continuous foreign M&A activity by banks in the region, this proportion is increasing. Countries in the region, such as Poland, the Czech Republic, and Hungary, have become members of the 25-nation EU, and their banks are largely foreign-owned.

Overall, when compared with the previous year, the regional distribution structure of the top 1,000 global banks remained basically stable in 2006 (see Figure 2-2). The number of U.S. banks on the list remained unchanged at 197, accounting for 19.7%. The EU had 286 banks on the list, accounting for 28.6%. Asia (excluding Japan) had 163, accounting for 16.3%. Japan had 101, accounting for 10.1%. The rest of Europe had 96, or 9.6%; the Middle East had 83, or 8.3%; and Latin America had 44, or 4.4%. These data show that regardless of ranking by tier 1 capital or by region, almost no bank that ranks at the top continuously holds the leading role of major M&A activity in the international banking industry over the years. Banks are products of continuous mergers and reorganizations, which result in large, comprehensive banks with mixed operations.

To summarize, it is easy to observe that the share of assets and profits of the 1,000 largest banks in the global banking industry increases annually. In addition to stable economic development in Europe and the United States, an increase in bank concentration is also an important factor. The shape of the international big banks at the top of the list has clearly emerged. The six largest banks, led by Citigroup, have firmly established their dominant position in the global banking industry. Each of the four of the big six, including Citigroup, HSBC Holdings, Bank of America, and JP Morgan, has tier 1 capital of more than \$70 billion. Mitsubishi UFJ Financial Group and Credit Agricole, the other two in the top six, were recently merged by Mitsubishi Tokyo Financial Group and UFJ Holdings, with tier 1 capital of more than \$60 billion each. These six giants form the first group of banks. These big six not only account for 15% of banks' total tier 1 capital and 13.1% of their total assets but also their total profits of \$110.9 billion account for 17.2% of total bank profits, which is expected to increase in the coming year. These indicators can clearly trace international banking M&A activity.

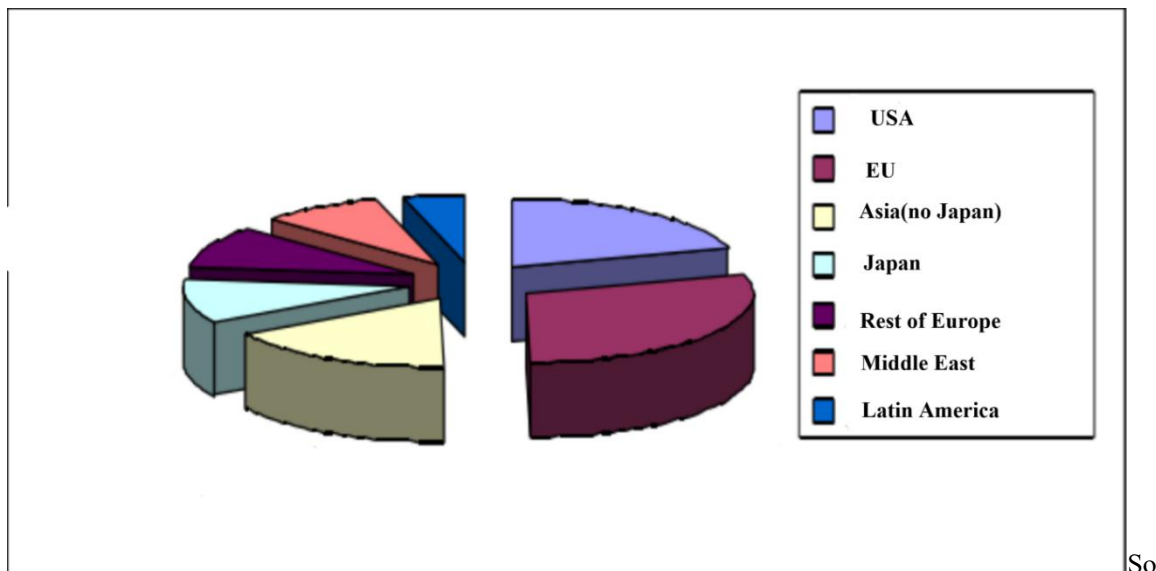


Figure 4-1: Distribution of global bank assets in 2006

source: *Banker* magazine's 2006 ranking of the world's 1,000 largest banks.

4.2 Historical analysis of strategic M&A in international banking industry

From the end of the 19th century to the present, there have been 5 M&A waves of international banking industry (Cao Jun, 2005). The first M&A wave occurred at the end of the 19th century and the beginning of the 20th century when capitalism was transitioning from free competition to monopoly. This period was an important turning point in the development of capitalism, and the emergence of large-scale enterprises objectively required the strength of large banks to match it. To adapt to the needs of the development of the situation, the first M&A wave appeared between the banks. At this time, the number of banks in various countries was large, featuring small scale is small and fierce competition. There were large individual differences among banks in capital strength, operation and management, etc., resulting in the imbalance of their competitiveness. The result of the unbalanced competition among banks lead to the occurrence of mergers and reorganizations of banks, and the overall number of banks decreases. The amount of bank mergers and acquisitions was small, mainly featuring horizontal M&A. The main motivation was to concentrate bank capital through M&A in order to achieve the effect of economies of scale. During this period, bank M&A improved the position of the banking industry in the whole economy, but the frequency, frequency and scale of M&A did not constitute a major adjustment to the banking system.

The second wave of bank M&A occurred in the 1920s during the period of economic stability between the two world wars. With the development of monopoly capitalism, production concentration in western countries had reached a very high level, and a large number of bank M&A had reduced the number of banks sharply. The rise of

the US economy after the first world war was the centre of every subsequent wave of bank M&A. During this period, regional banks in the United States used M&A to compete with the big national banks. This M&A wave was brought down by the Wall Street crash of October 1929 and the global economic crisis that followed. The characteristics of bank M&A are as follows:

First, corporate capital and bank capital merge with each other. For example, Rockefeller controlled the Bank of America and Morgan Bank founded the United States Steel Corporation;

Second, cross-industry mergers and acquisitions of securities and insurance industry began to emerge as commercial banks could concurrently engage in investment businesses such as securities and insurance;

The third is "big banks mergering small banks". Many smaller banks had gone bust or been acquired in the competition, while the larger banks had expanded their branches and businesses;

From the mid-1950s to the late 1960s, the United States, Britain, France and other economic powers began the third wave of bank M&A.

This wave of bank M&A has the following characteristics:

First, government regulation has been strengthened. After the global economy entered the Great Depression, the Western countries generally strengthened the regulation of the financial industry. For example, the United States issued a series of laws and regulations, such as "Regulation Q", which restricted the upper limit of deposit interest rate, "McFadden Act", which prohibited banks from operating across state lines, and "Glass-Steagall Act", which required banks to operate separately from securities.

Some countries also introduced laws relating to bank M&A, such as the 1962 Bank Mergers Act released by the U.S. Congress, which increased government scrutiny of bank U.S. Congress that could lead to unfair competition.

Second, the emergence of a large number of bank holding companies. Due to the strict legal constraints, horizontal mergers and acquisitions between banks and vertical M&A of financial industry are restricted. In order to avoid the control, the bank mainly established the bank holding company through the holding way to achieve the purpose of M&A.

The third is the high concentration of bank capital, the emergence of large and super-large banks.

The fourth wave of international banking M&A occurred from the mid 1970s to the early 1990s. Government deregulation, bank failures and financial liberalization are the main factors driving the banking merger and reorganization. After more than 40 years of development, the requirement of deregulation is increasingly urgent. Since the late 1970s, the competitiveness of the US banking sector declined and the fiscal and trade deficits increased, as the sacrifice of bank efficiency to maintain financial stability and limit competition among financial institutions was not conducive to economic development. In order to expand the living space and participate in the international competition, the bank strongly demands the government to loosen the regulation. As a result, the US regulatory authorities abolished "Regulation Q", liberalized the interest rate ceiling, and enacted the "Banking Act of 1980", which led to a renewed wave of bank mergers and acquisitions. In the early 1980s, a large number of bank failures occurred in western countries. For example, 181 banks failed in the United States between 1980 and 1984, which also

provided opportunities for mergers and acquisitions. The wave of financial privatisation in the 1980s swept through Europe, and Britain, France, Spain and some northern European countries entered a new round of mergers and acquisitions peak.

During this period, bank M&A showed the following characteristics: first, there are diversified merger and acquisition methods, including LBO, ESOP, Poison Pill, Scorched Earth, White Knight, Golden Parachute, Dead Swap, etc.; second, a large number of publicly listed companies were acquired. The development of the stock market made the battle between M&A and anti-merger very fierce. Hostile takeover and its defense methods were born in this period. Third, financial liberalization caused the blurring of the boundary between commercial banks and investment banks. A large number of commercial banks and investment banks merged, making universal banking an irresistible trend in Europe.

Since the 1990s, the occurrence of a large number of bank mergers and acquisitions has formed the fifth wave of bank mergers and acquisitions. The development of economic and financial globalization, increasingly fierce financial competition, deregulation and the progress of modern science and technology have promoted the formation and development of the fifth wave of M&A in the banking industry. For various motives, banks in various countries continued M&A, expanded their scale, improved their competitiveness, and enhanced their ability to resist financial risks. After the M&A, the number of banks greatly reduced. At the same time, banks were expanding even faster. In addition to M&A in Europe and the United States, which were mainly targeted at profit and competition, bank M&A in emerging market countries were frequently taking place with the main motive of saving the banking system. To prevent

the further spread of systemic risks, the government had adopted a series of measures to maintain financial stability, mainly through bank M&A. Global banking M&A have hit a record 370 billion dollars since 2007, with cross-border deals accounting for about 5%, more than double the amount in 2006, according to Dealogic, the research firm.

The fifth wave of M&A in the global banking industry has the following characteristics: first, huge number of M&A and amount of transactions. According to statistics, during the 12 years from the beginning of 1995 to the beginning of 2007, 1,189 banks in 104 countries (or regions) acquired 2,415 banks. The two banks have been targeted for 1,431 billion dollars in deals. Second, cross-border M&A has become an important form for the banking industry to enter the overseas market in addition to establishing branches or subsidiaries directly. Third, retail business has become an important target for banking mergers and acquisitions. Fourth, a considerable number of mergers and acquisitions are financed by debt such as bond issuance.

4.3 Development law of strategic M&A of international commercial banks

By reviewing the history of international banking can be found that the development history of international banking is continuously through a history of the development of strategic M&A, almost any of the big banks in the world all is through mergers and acquisitions to expand the business scope and field, constantly improve efficiency, enhance competitiveness, improve the ability to resist risk (EZhiHuan, 2004). World experience shows that M&A is an important way for Banks to become bigger and stronger. Since the 1990s, financial globalization and information technology revolution have led to intensified competition in the global banking industry, and the international banking industry has launched a wave of cross-border and cross-industry mergers and

acquisitions at an unprecedented scale and speed, which has promoted the development of Banks towards omnipotence of business and globalization of services. Such M&A has given rise to mega-banks such as Citigroup, HSBC, J.P. Morgan Chase and Bank of Tokyo-Mitsubishi.

From the perspective of the purpose of strategic M&A, the purposes of commercial banks' M&A can be roughly divided into three categories: business integration, business globalization, and business structure optimization.

(A) Citigroup

The main purpose of Citigroup M&A before 1998 was to strengthen the business strength of commercial banks. During this period, Citigroup's M&A showed significant vertical M&A characteristics. Citigroup has 13 subsidiaries, including Citibank, offering a wide range of financial services, including trust, leasing, credit card and settlement. But Citi's assets make up an absolute proportion of the group and it is mainly engaged in the typical commercial banking business. On the whole, the flower period bank before 1998 is still a commercial bank that gives priority to with credit business. Citigroup's acquisition during this period is mainly to strengthen the traditional commercial banking business and optimize the business structure. The main purpose of the M&A of Citigroup from 1998 to 2000 was to build a comprehensive operation platform. Travelers Group has formed a comprehensive business pattern across the money market, capital market and insurance market. This merger has obvious characteristics of horizontal merger. Citigroup has thus become a comprehensive financial services group integrating insurance, investment banking, securities, retail and private banking, asset management and other diversified businesses. From the perspective of business structure, the businesses of

Travelers Group and Citigroup are highly complementary. The successful merger means the birth of a financial carrier covering commercial banking, investment banking and insurance. The main purpose of Citigroup M&A from 2000 to 2003 was to expand its international business and further strengthen the depth and breadth of its business internationalization. During this period, Citigroup took expansion as the main line of business development, clearly stated that it was extremely concerned about growth, committed to achieving an average double-digit growth rate, and persisted in using merger and acquisition as the main means of expansion. Between 2000 and 2003, Citigroup acquired 50 billion dollars. This period was characterized by the expansion of its overseas business, especially its global consumer business (credit card, consumer finance and retail banking), and in 2002 the strengthening of its overseas life insurance business. From 1998 to 2003, Citigroup witnessed rapid growth through M&A. Since 2004, Citigroup has gone from a "period of rapid growth" to a "period of solid adjustment". During this period, Citibank clearly proposed to adjust its business development model, which was previously driven by large M&A, and only do M&A to "fill the gap and have more strategic value" when necessary. Most M&A during this period were focused on a single business and were characterized by a focus on strengthening and optimizing a single business to improve business returns. In several large-scale M&A, most of the M&As are targeted at domestic enterprises, which to some extent reflects the new ideas of Mergers and acquisitions that Citigroup intends to control the progress of overseas mergers and acquisitions and focus on strengthening the foundation of local business (Zhang Xingsheng et al., 2007).

(B) HSBC

HSBC was founded in Hong Kong in 1864 and officially opened in 1865. The development and growth of HSBC is also accompanied by strategic mergers and acquisitions. The development history of HSBC is actually a history of continuous development and growth through mergers and acquisitions. The M&A of HSBC is mainly carried out in the banking sector, through which the business globalization and service localization are realized, and the insurance and securities industries are also slightly involved (see Table 4-3).

Table 4-3: Overview of HSBC M&A

Year	Event
1959	HSBC acquired the British Bank of the Middle East, the largest foreign Bank in the Arab region, extended the Bank's network to the Middle East; acquired the Mercantile Bank of India.
1965	It bought a 61.5% stake in Hang Seng Bank, Hong Kong's second-largest bank.
1980	It acquired Marine Midland Bank, Inc., the 17th largest commercial Bank in the United States, and bought the rest share of the bank in July 1987.
1987	It acquired a 14.9% in the Midlands Bank, one of the UK's big four clearing Banks, and acquired more than 50% of the bank in June 1992.
1999	It merged with RNYC.
2000	It bought Credit Bank of France, which had more than 650 branches, for 11 billion dollars.
2001	It bought Australia's NRMA Building Society Limited, Turkey's Demirbank, 97% stake of Taiwan Securities Investment Trust and 8% stake in Bank of Shanghai.
2002	It bought Family International Bank for 15.3 billion dollars; Financiero Bital of Mexico, with 1,400 branches, for 19 billion dollars; 10% stake of Ping An Insurance.
2003	It bought Household International, an American firm with more than 1,300 branches in 45 states, for 14.2 billion yuan; acquired Keppel Insurance Pte Ltd in Singapore.
2004	It bought France's Credit and Commercial Bank for 11.5 billion dollars; 19.9% of Bank of Communications for 1.75 billion dollars; and a minority stake in India's UTI Bank.
2005	It further increased its stake in Ping An Group to 19.9%.
2007	It 6.3 billion dollars for a 51.2% stake in Korea Foreign Exchange Bank.

Source: Wang Lijun (2007)

4.4 History of U.S. banking M&A activity

From the end of the 19th century to the beginning of the 20th century and until now, there have been five waves of M&A activity throughout the world:

- (1) The post-depression recovery from the Great Depression of 1893 to the beginning of the 20th century;
- (2) The period of revival after WWI, from 1926 to 1930;
- (3) The period of revival after WWII, from 1954 to 1960;
- (4) In the 1980s, the world economy's recovery after the 1973 oil crisis; and,
- (5) Since the 1990s, the accelerating process of globalization.

Because M&A activity represents a process of breaking, reorganizing, and replacing old economic structures with new economic structures, the occurrence of the five M&A waves has the following two common general trends. One is the recovery stage of the economic cycle after the destructive event—a war or economic crisis—and the other is the generation period of the new revolution. Therefore, the common feature of these M&A periods is the rise of enterprise concentration.

Under the combined action of these two events, an important foundation has been laid for the “dilapidated and set up a new enterprise” situation. Enterprise M&A activity is also a “dilapidated and set up a new enterprise” process. Banks and other financial institutions are supposed to serve real enterprises. During the enterprise M&A process, banks also increase capital and expand service content and objects through horizontal or vertical M&A activity to cater to the development of transregional or transbusiness enterprises. However, during world merger waves, different countries have as many performances because of their different economic development levels, cultural backgrounds, and political regulatory environments. We use the United States as an

example to analyze banking mergers under global merger waves.

4.4.1 Four waves of bank M&A activity in the United States

1. First wave of bank M&A activity in the 1920s and 1970s

At the beginning of the 20th century, the U.S. banking industry as a whole was in a state of depression, mainly from the following two aspects.

First, in the political landscape, state independence limits horizontal mergers and economies of scale. The independence among the states in the federal system is very strong, and state governments strictly prohibit the establishment of branches. Before 1860, no banks in the United States were federally registered—only state registered banks. This restriction was legalized after the enactment of the National Banking Acts of 1863 and 1864, which stipulated that banks were forbidden to set up branches anywhere and in any form, not only across states but also within states—thus, creating the “single banking system.”

Second, from the perspective of the economic situation, the recovery after WWII and the Great Depression strengthened the government’s supervision of the financial sector, and the policy of separate operations limited banks’ vertical mergers and synergies. From 1914 to 1918, during WWI, because the United States did not become deeply involved in the colonial struggle and because the land was not invaded during the war, the country became a flourishing paradise in the billowing fire and smoke of western society. However, during the great panic of 1907 and during 1929 to 1933—the Great Depression—companies and brokerage firms collapsed, investors sold stocks, U.S. stocks fell, a large number of iron and steel enterprises filed for bankruptcy, and financial regulation in the United States tightened. Congress passed the Glass–Steagall Act in 1930,

companies providing commercial and investment banking services at the same time were banned, operations were strictly separated, and regulations were classified.

The Banking Act of 1935 capped the interest rates that banks could charge on deposits and severely limited the creation of new banks. For certain historical reasons resulting from the fact that states in the United States were not only politically independent from one another but also experienced uneven economies, to protect the interests of every state, each state's bank was required to prevent other state banks from opening branches in its state. The banking policy focused on "isolation between the states" and restrictions on the banking industry.

This type of banking system can better coordinate the relationship between banks and local governments to allow banks to serve regional economic development better. Moreover, a single bank has fewer management levels, flexible operations, and high efficiency. However, the problem is also obvious: redundant construction leads to a waste of resources, economies of scale cannot be brought into play, and geographical location becomes an important factor in restricting bank development. Ultimately, banks exist to serve the real economy during regional economic development, and regional banks' services have made important contributions to the development of regional economies. The economy itself is an extroversion; however, with the development of regional enterprises empowered to appeal, "single YinXingZhi" has become the cause of circuitous capital created by the long flow of funds process—high costs were not the reason.

At the same time, the development of capitalism has gradually become a pattern of oligopolistic capitalism from the decentralization of natural competition to the economies

of scale obtained by expanding reproduction. In this case, banking institutions that help enterprises develop also need to keep pace with the times. The decentralization and scale of small banks can no longer meet the needs of booming capitalism.

Regulation is the barrier to that need. However, confrontation with regulations was the source of financial innovation. As required by development, the government began to gradually loosen regulations (allowing banks to set up branches in the home state but not across the state), and the banking industry spontaneously created financial innovations to fight regulations.

The first innovation was the agency banking system. Also known as a correspondent banking system, the agency banking system is a private alliance formed by banks to fight the “single banking system.” Specifically, the agency banking system is an organizational form in which banks sign agency agreements and entrust each other’s banks to engage in designated businesses. Generally, this type of agency relationship is mutual. Small banks deposit money in big banks, and big banks provide various banking services for small banks. This type of relationship is similar to that between the head office and branches, which is an inevitable trend of bank development that is driven by the “invisible hand” in the market.

The second was the group banking system. This innovation led to America’s first wave of bank mergers. The group banking system refers to the establishment of equity companies by large groups or banks that control or acquire a number of independent banks. M&A activity in the form of group shareholdings is referred to as “shareholding M&A” or “holding acquisitions.” We have listed six large-scale forms of M&A activity.

In 1956 in the United States, 47 independent bank holding companies controlled

7.5% of U.S. commercial bank deposits. In 1984, 4,643 bank holding companies owned or controlled a commercial bank (holdings), and more than 698 bank holding companies owned or controlled (two or more banks' holding company) controlled 90% of commercial bank deposits. The bank group system has become the most popular form of bank organization.

Table 4-4: Bank M&A activity in the United States—First wave

Time	Both parties (The former is the acquirer)	Merge structure name
1930	Chase National Bank, Fair Trust	Chase National Bank
1954	Chemical Bank, Grain Exchange Bank Trust	Chemical Grain Exchange Bank Trust
1955	National City Bank of New York, First National Bank of New York	First National City Bank
	Manhattan Bank, Chase National Bank	Chase Manhattan Bank
	Banker's Trust, National Bank Trust	Banker's Trust
1961	Manufacturer's Trust, Hanover Bank	Manufacturer's Hanover Bank

From these characteristics, bank M&A activity during this period had a stronger cooperative nature. The advantage was that total capital could be effectively expanded, bank strength could be enhanced, and bank ability to resist risks could be improved. On the flip side, this system also weakened competition and limited bank autonomy.

Subsequently, this group banking system also had a significant impact on the development of the financial industry in the United States. After the supervision of vertical extensions of banks was relaxed, banks could establish branches. This group banking system also successfully helped banks avoid the restriction of separate operations and enabled the realization of the mixed operations of financial groups through holding groups.

2. America's second wave of bank M&A activity in the 1980s

If the first wave of M&A activity in the United States was the consequence of the second industrial revolution, the second wave of M&A activity was driven by the information technology revolution. Since the 1970s, the development of the new technology revolution represented by information technology has had a significant impact on all aspects of society.

Table 4-5: Bank M&A activity in the United States—Second wave

Time	Both parties	Merge structure name
1983	Bank of America, Seafirst Bank	—
1984	Chase Manhattan, Lincoln First Bank	—
1985	Boston Bank, Colonial Bank	—
	Boston Bank, Rhode Island Hospital Trust National Bank	—
	New England Bank, Connecticut Bank Trust	—
1986	Monarch Financial Corporation, Suburban Bank	—
	Pacific Securities, Bank of Arizona	—

In the 1980s, the United States' auto industry faced strong competition from Japan. At the same time, new technologies, such as those in steel and other traditional industries, as well as that in the semiconductor industry, indicated signs of decline. To save the U.S. economy, the Clinton administration began to implement the new industrial policy and improve the ability of enterprises to innovate. The effect was primarily reflected in the laws and policies to encourage the private sector to carry out cooperation studies; promote the industrialization of new technology; strengthen the protection of intellectual property; effectively improve the ability of enterprises to cooperate; and engage in

innovation activities from the strong integration of an enterprise’s internal paradigm shift regarding “collaboration across manufacturers.”

From the perspective of industrial structure, from the decline in the 1970s to the reemergence in the 1990s, America’s industries in the 1980s experienced an era of reform and restructuring. The strengthened links between enterprises and interenterprise cooperation also promoted further improvements in bank concentration, forming the second “merger wave” of U.S. banks. A significant driver and feature of this wave of M&A activity was leverage—one of the most remarkable inventions in the U.S. banking industry in the 1980s.

For these M&A transactions, bank loans are the most important or even the only source of funds. To guarantee the principal and interest and reduce the bad debt caused by failed M&A deals, banks require target companies to provide full mortgage loans as guarantees. High-yield junk bonds became popular as an alternative to bank loans, with companies issuing them to finance acquisitions—even hostile ones.

Table 4-6: Bank M&A activity in the United States—1987 to 1993

Time	Both parties	Merge structure name
1987	New York Chemical Company, Kosass Commercial Bank	Chemical Bank
	Pacific Securities, Rainer National Bank	
	Monarch Financial Corporation, Commercial Association Bank	
	American Bancorp, The People’s National Bank of Washington	
	Fleet Financial Group, Norstar Bank	Fleet/Norstar Group
	First Alliance, Loretta Atlantic National Bank	
1988	Bank of New York, Owen’s Bank	
	Shawmut, Hartford Nationals	Shawmut Nationals

		Table4-6, continued
	Shawmut, The Arlington Trust	Shawmut Nationals
	First Bank, Denver Central Bank	Primary Banking System
	Wells Fargo, Barclays of California	
	Pacific Securities, Bank of Ireland	
	Credit Suisse, First Boston Bank	
	North Carolina National Bank, First Republican Bank	Credit Suisse First Boston
1989	Pacific Securities, National Bank of Nevada	
1990	Central State Financial Corporation, First Pennsylvania Bank	
	First Alliance, National Bank of Florida	
	Citizen Southern Bank, Monarch Financial Corporation	Citizen Southern Sovereign Corporation
1991	Fleet/Norstar Financial Group, New England Bank	
	Chemical Bank, Manufacturing Hanover Bank	
	National Bank of North Carolina, Citizen Southern Bank Sovereign Corporation	National Bank
	Society Firm, The United States Trust	
	Bank of America, Pacific Securities	
	Key Company, Puget Sound National Bank	
	Barnett Company, Manufacturing Bank	
1993	First Bank System, Colorado National Bank	
	Banc One Company, Arizona Valley National Bank	
	Boston Bank, South Bank, Mechanical Bank, and First Agricultural Bank	

3. Third wave of U.S. bank M&A activity in the 1990s

The 1990s marked the peak of bank M&A activity in the United States, with an

average of more than 400 bank M&A transactions taking place every year. The driving force of this M&A activity lies in the integration of the global economy. Improvements in the degree of internationalization of enterprises' operations and the growth of multinational companies have also put forward higher requirements for banks' global service levels. Some financial groups have seized the opportunity of the times and have grown rapidly through M&A activities, resulting in a group of "super-universal banking groups" such as Bank of America, Citigroup, and HSBC.

Table 4-7: Bank M&A activity in the United States—Third wave

Time	Both parties	Merge structure name
1994	Society Company, Key Company	
	Bank of America, Continental Illinois National Bank	
1995	Chemical Bank, Chase Manhattan Inc	Chase Manhattan Inc
	First Bank of Chicago, NBD Bancorp	First Chicago NBD Company
	BBT Company, South National Company	
	Fleet Finance Group, Shawmut National Firm	
1996	Wells Fargo, First Intercontinental Bank	
	Central State Financial Corporation, Apex Bank	
	Boston Bank, Gulf Bank	
	First Alliance Corporation, First Loyal Bank	
	First Alliance Corporation, Central Bank	
	Fleet Finance Group, Westminster National Bank	
1997	American Bancorp, First Bank System	
	National Bank, Boatment's Bancshares	
	Washington Mutual, Great Western Finance	
	First Alliance Corporation, Signet Bank	

		Table 4-7, continued
1998	National Bank, Barnett Bank, Bank of America	Bank of America
	First Alliance Corporation, Central State Financial Corporation	
	Norwest Corporation, Wells Fargo	Wells Fargo
	Star Bank, Firststar Holdings Inc.	Firststar Corporation
	Banc One Corporation, First Chicago NBD Corporation	
	Travelers Group, Citicorp	CitiGroup Inc.
	Sunshine Trust Bank, Crestar Finance Corporation	
	Washington Mutual Bank, H.F. Ahmanson Corporation	
1999	Fleet Finance Corporation, Boston Bank	Fleet Boston Finance Corporation
	Deutsche Bank, Banker Trust	
	HSBC holding, New York Republic	HSBC Bank
	Firststar Corporation, Merchant Banking Company	
	AmSouth Bank Corporation, First National Bank of America	
2000	Chase Manhattan, JP Morgan	JP Morgan Chase
	Wells Fargo, The First Securities	
	Firststar Corporation, Bank of America	
	First Alliance Corporation	
	Standard Federal Bank, National Bank of Michigan	
	FleetBoston Finance Corporation, Apex Bank	
2002	CitiBank, Venus Bank	
	Washington Mutual Bank, Allfirst Bank	
2003	BBT Corporation, First Virginia Bank	
	MT Bank, Allfirst Bank	
2004	New port Savings Bank, Manchester Savings Bank, Tolland	New Alliance Bank

Table4-7, continued

	Bank	
	Bank of America, FleetBoston Finance Corporation	
	JP Morgan Chase, First Bank	
	Banco Popular, Quaker City Bank	
	Regional Finance Company, Planting Owners Alliance Corporation	
	Sunshine Trust, National Commercial Finance Company	
	Wachovia Corporation, South Trust	
2005	PNC Bank, Riggs Bank	
	First Capital Finance Corporation, National Bank of Ireland	
	Bank of America, MBNA Corporation	American Credit Card Service
2006	Wachovia, West Corporation	
	Regional Finance Company, MBNA Corporation	
	First Capital Finance Corporation, North Fork Bank	
	Wachovia, Golden West Finance Corporation	
	Regional Finance Company, AmSouth Bank	
2007	Citizens Bank, Republic Bank	
	Banco Bilbao Vizcaya Argentaria, Compass Bancshares	
	Bank of America, LaSalle Bank	
	State Street Corporation, Investor Financial Services Company	
	Bank of New York, Mellon Financial Corporation	New York Mellon Bank
	Wachovia, World Saving Bank	
	Bank of America, The United States Trust	
2008	JP Morgan Chase, Bear Stearns	
	Bank of America, Merrill Lynch	Bank of America Private

		Table4-7, continued
		Wealth Management Company
	JP Morgan Chase,	
	Washington Mutual Bank	

4. Fourth wave of U.S. bank M&A activity between 2000 and 2008

Many factors contributed to the merger wave in the early 21st century, among which the further development of economic globalization was one of the most important factors. This stage of mergers formed many “super banks” in the United States, such as JP Morgan Chase.

4.4.2 History of banking M&A activity in the United States

1. Bank of America

The history of Bank of America can be traced back to 1904, when its predecessor, the Bank of Italy, was founded and mainly engaged in deposits and loans in the Pacific states.

In 1929, Bank of America of California merged with Bank of Italy and became National Trust Savings Bank of America, which was controlled by a California consortium and headquartered in San Francisco.

In 1969, Bank of America was incorporated.

In 1997, the National Bank of North Carolina, a regional bank on the east coast of the United States, merged with Bank of America and became Bank of America. Bank of America then acquired Boston’s flagship bank in a \$49.26 billion stock-for-stock deal (56 cents for every share of Bank of America), credit card company MBNA for \$35 billion, and LaSalle Bank, the North American arm of SBN Amro, for \$21 billion.

In 2008, Bank of America acquired Countrywide, a mortgage lender, for \$4.1 billion, establishing its dominant position in the mortgage industry. Since then, Bank of America acquired Merrill Lynch, an investment bank with a huge network, and became a giant in the American banking industry.

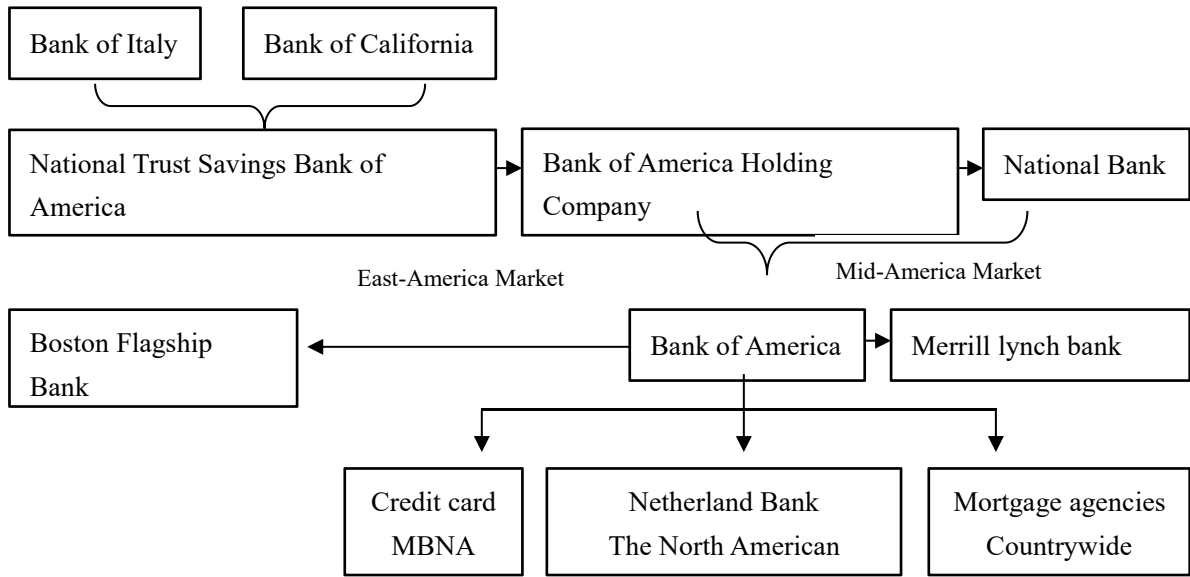


Figure 4-2: Bank of America M&A case

2. JP Morgan Chase

Chase Manhattan Bank acquired Chemical Bank in 1995 and set up an investment banking business.

Chase Manhattan Bank bought west coast investment bank Hambrecht & Quist in 1999.

Chase Bank acquired British investment bank Robert Fleming in 2000, the same year in which it merged with JP Morgan Bank to become JP Morgan Chase—the United States’ third-largest banking group, with assets of \$660 billion, revenues of more than \$52 billion, and profits of \$7.5 billion, on par with Morgan Stanley and Goldman Sachs.

In 2004, JP Morgan Chase and Bank One merged in a \$58 billion share swap,

expanding its business from New York to the midwest and increasing its presence as a strong regional bank.

In 2006, JP Morgan Chase acquired Bank of New York's small- and mid-market businesses and sold its trust business in an asset swap.

In 2008, when the U.S. subprime mortgage crisis broke out, JP Morgan Chase bought failing Bear Stearns for \$236 million, with the support of the Federal Reserve. Subsequently, JP Morgan Chase purchased most of the assets of Washington Mutual Bank for \$1.9 billion and acquired Citibank's electronic financial services company for \$380 million.

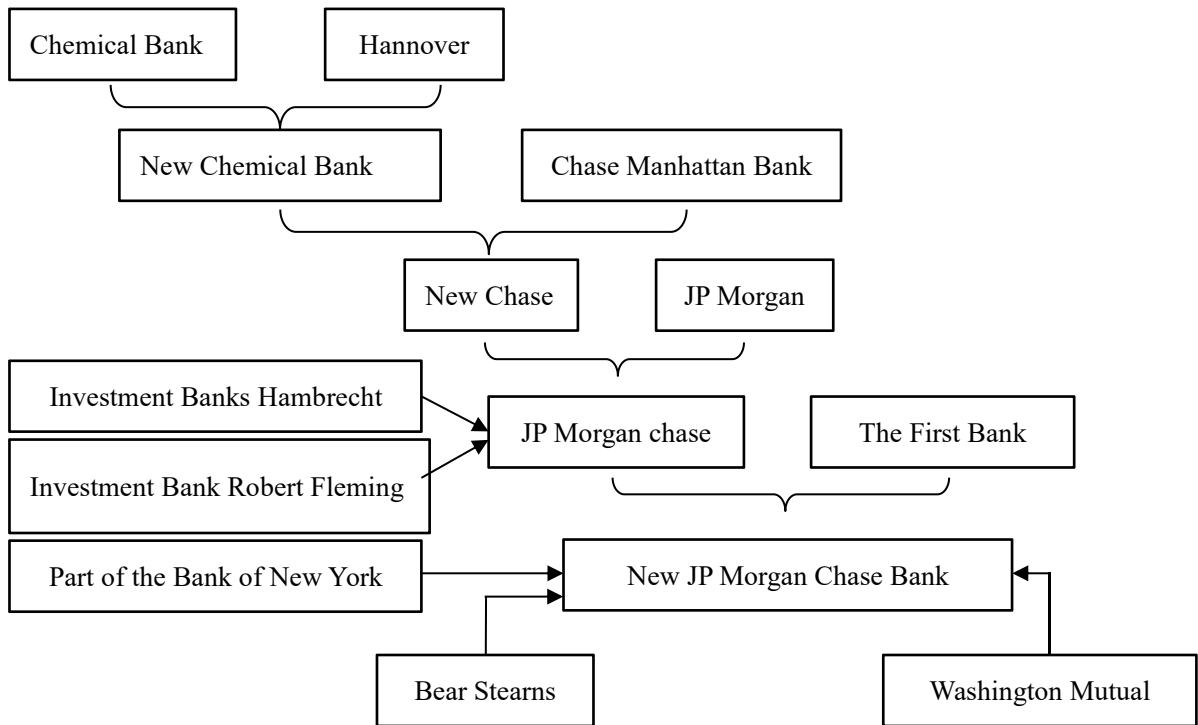


Figure 4-3: JP Morgan Chase M&A case

3. HSBC

When compared with Bank of America and JP Morgan Chase, the M&A activity path of HSBC better reflects the cross-border M&A activities that contribute to the

globalization process. From the perspective of the M&A activity path, HSBC mainly radiates to the world through Asia, especially Hong Kong, and its international business occupies an important position. HSBC's history of M&A activities began in the 1950s.

In 1959, HSBC acquired an Indian commercial bank and a British bank in the Middle East.

In 1965, HSBC acquired a 51% stake in Hang Seng Bank and became the largest bank in Hong Kong at that time.

In 1997, when the Asian financial crisis broke out, HSBC acquired the credit card businesses of Korea First Bank, Hanseong Bank, and LG, in succession.

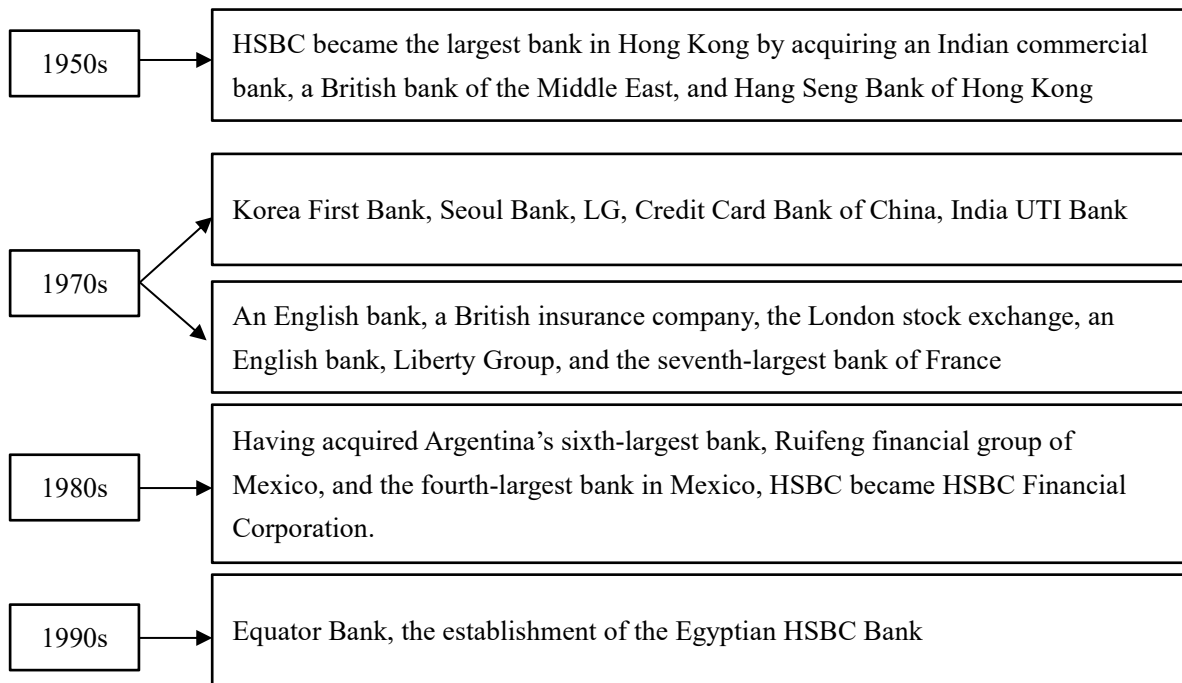


Figure 4-4: HSBC M&A history in 1950s to 1990s

HSBC acquired a 70% stake in Banca Nazionale del Lavoro in Iraq in 2000, followed by a 10% stake in Vietnam's Techbank, a 19% stake in Bank of Communications, and an 89% stake in Shenzhen Commercial Bank.

HSBC has expanded its acquisition portfolio in Asia, particularly Hong Kong. In

Asia, HSBC acquired Ublfgvkj in Tokyo and Bqmvv in Osaka. In Europe, HSBC acquired merchant bank Antony Gibbs, Britain's Midland Bank, Switzerland's Guyerzeller Bank AG, France's Commerzbank, and Poland's Polski KredytBank SA. HSBC also made other acquisitions in Australia and South America.

HSBC's acquisition method is very flexible. In terms of capital contribution methods, HSBC typically uses stock, cash, bond issuances, and other ways to raise funds. In terms of equity shares, HSBC mainly holds part of the shares, whereas wholly owned shares are supplemented. For example, when HSBC consolidated New York's Republic Bank and its subsidiary SHR Bank, it took two steps to raise capital: a \$3 billion share placement in the market, which raised approximately one-third of the funds and a bond issuance, which raised one-third of the funds. A cash payment was used for the remaining one-third of the funds.

4.5 Implications for U.S. banking M&A activity

This section discusses the lessons from U.S. banks' M&A activities that can be applied to Chinese banks' M&A activities.

In the second half of the 1990s, the large-scale bank M&A transactions led by U.S. banks represented an extreme period for the international banking industry. At the turn of the century, with global economic growth slowing, international banking M&A activities decreased. However, since 2003, M&A activities in the banking industry have increased, riding on the back of the comprehensive recovery of the global economy, particularly developed countries' economies. Overall, the international banking industry has never dropped the pace of acquisitions and mergers; the history of the development of the international banking industry can be said to be a history of M&A activity. The

enlightenment of U.S. banking M&A activity for Chinese banking M&A activity is as follows.

1. Space for time: Geographic expansion and economies of scale

Contrasting characteristics can be found for HSBC and Bank of America because starting in the 1990s, these two banks adopted completely opposite M&A strategies. HSBC expanded outward, quickly taking highs and lows in the global market. The perspective of U.S. banks centered on the home front; they saw no advantages from international business contracts under international market conditions and sought to expand their domestic businesses. Their strategies were familiar with the situation, given their own advantages, and have been successful.

2. Capital for resources: Business type expansions and synergies

As an example, HSBC has rapidly developed in the insurance and credit card markets through M&A activities, showing that M&A transactions can help banks expand rapidly and exchange capital for resources in different regions.

CHAPTER 5

COMMERCIAL BANKS' M&A ACTIVITY: CHINA'S DEVELOPMENT

This chapter studies the historical development and status quo of China's commercial banks, and analyzes the history and typical cases of China's commercial banks' M&A activity to pave the way for research on synergies and the performance of commercial banks.

5.1 Development of China's commercial banks

Chinese commercial banks represent the most important financial sector in the Chinese market. According to status and function standards, financial institutions can be divided into four types. The first type is the central bank, such as the central bank of China, or the People's Bank of China. The second type consists of banks, including policy banks, commercial banks, and village banks. The third type is the nonbank financial institutions, mainly state-owned and joint-stock insurance companies, urban credit cooperatives, securities companies, financial companies, third-party financial companies, and others. The fourth type is the foreign-funded banks, such as overseas Chinese-funded and sino-foreign joint venture financial institutions established within the territory of China.

The current People's Bank of China can be traced back to the former People's Bank of China established in Shijiazhuang, Hebei Province in 1948, and was endowed with the exclusive right of financial property right within the scope of China at the same time. In May 1949, Bank of China was established by the state as a specialized foreign exchange bank. It was not until March 1979 that the Agricultural Bank of China was restored, and at the same time, the Bank of China and the Construction Bank of China became

independent, and the construction of commercial banks and specialized banks began in China. It can be said that during the period from the founding of new China to the reform and opening up, there was no commercial bank in the modern sense in China under the completely planned economy system, and both merchants and individuals carried out production under the planned economy (Editorial Office of Financial Planning, 2013).

China's commercial banks have a nearly 40-year history since their establishment in 1979. China's commercial banks were established with a planned economy forming the backdrop. Commercial banks, which were born out of the central bank, were wholly owned and dominated by the government. Back then, the industry went through several development stages.

The first stage, a single-layer management stage, was that from 1978 to 1983. The People's Bank of China integrated the central bank and commercial banks, and its operation and management were integrated. No real banking supervision existed.

The second stage, from 1984 to 1992, was the double-decker management stage (two-tier management, which means that the central bank is responsible for supervision and that commercial banks are responsible for operations). Four specialized banks were established in 1984, mainly to exercise the functions of the central bank, the People's Bank of China, which was designed to spell out monetary policy and supervise financial regulation. No longer required to carry out business activities, the separation between the management of banks and the regulatory function formed a double-decker organization. However, at the time, China's modern financial system architecture was unclear, and the entire financial industry's regulations were focused on the People's Bank of China.

The third stage, the exploration stage of the regulatory framework, was from 1993 to

2002. Supervision of the securities market and the insurance market was taken away from the People's Bank of China and implemented by the CSRC and the China Insurance Regulatory Commission (CIRC), respectively. Supervision of the banking industry is still implemented by the People's Bank of China. Meanwhile, new progress has been made in the governance and regulation of the banking sector.

The fourth stage, the new stage of Chinese banking supervision based on risk control, has been in currency since 2003. The laws of the People's Republic of China on banking supervision and administration, passed in 2003, approved the establishment of the CBRC. This establishment marked the formation of a new regulatory framework for China's financial system and took banking supervision to a new stage. Based on realities in China, the CBRC closely tracks international financial supervision and constantly improves the country's regulatory framework by drawing upon international experience, thus opening up the practice of risk-based banking supervision.

China has more than 1,300 commercial banks and institutions, nearly one-sixth of which were established in 2011 and 2012. During those two years, the CBRC issued more than 110 commercial banking licenses each year and issued 54 in 2015 and 56 in 2016.

5.2 Status of China's banking sector

By the end of 2016, China's banking financial institutions included 4,399 legal person institutions with 4.09 million employees, total assets of 232.3 trillion yuan, and net assets of 17.5 trillion yuan.

The first echelon included three policy banks, five large state-owned commercial banks, and postal savings banks.

The second echelon included 12 national small- and medium-sized joint-stock commercial banks that could operate nationwide.

The third echelon included 3,133 city commercial banks, the operations of which in different places were subject to strict examination and approval. There were 859 rural commercial banks, 71 rural cooperative banks, 1,311 rural banks, and 1,373 rural credit cooperatives and private- and foreign-funded banks. These banks primarily operated locally.

Small- and medium-sized banks included national small- and medium-sized joint-stock commercial banks, referred to as “joint-stock banks.” This category included the 12 banks mentioned previously, which were generally department- and bureau-level units established in the 1990s with a scale of 2–6 trillion yuan and a branch network of approximately 1,000. Their capacity to accept deposits was much smaller than that of large banks. These banks were also generally controlled by provincial governments/central enterprises, mainly in the central city at the beginning of operations up to a few years before rapid expansion to other locations.

In the 1990s, the city commercial banks were reformed from the merger of the city credit cooperatives. A-share listed banks include Bank of Beijing, Bank of Shanghai, Bank of Nanjing, Bank of Ningbo, Bank of Jiangsu, Bank of Hangzhou, Bank of Guiyang, and Bank of Chengdu—a total of eight banks.

Rural commercial banks resulted from changes to rural credit cooperative amalgamations. A-share listed banks include Zhangjiagang Bank, Changshu Bank, Jiangyin Bank, Wuxi Bank, and Wujiang Bank.

Regarding banking supervision, the head office of the People’s Bank of

China/CBRC directly manages three policy banks, five large commercial banks, postal savings banks, and 12 joint-stock commercial banks. The local People's Bank of China branches/central sub-branches/sub-branches, local banking regulatory bureaus/sub-bureaus manage 133 urban commercial banks, 859 rural commercial banks, 71 rural cooperative banks, 1,311 rural banks, and 1,373 rural credit cooperatives.

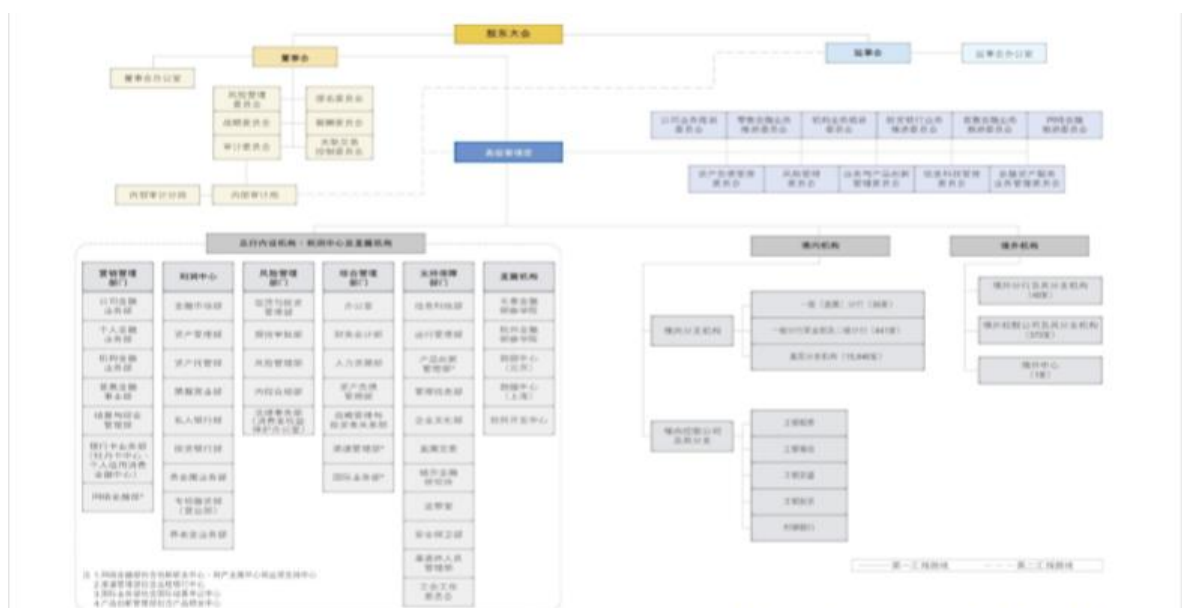
The administrative departments of commercial banks are as follows:

(1) The responsibilities of the People's Bank of China include market regulation and macro-prudential management.

(2) The responsibilities of the CBRC include the institutional supervision of banks and the supervision of corporate banking institutions, such as trust companies, financial leasing companies, and financial companies.

(3) Responsibilities of the Ministry of Finance include holding equity in financial institutions directly or through Huijin and exercising shareholder rights.

See the case of ICBC (Industrial and Commercial Bank of China) for the organizational structure of banking:



Source: Public information

Figure 5-1: Organizational Structure of ICBC

5.3 China's commercial banks' M&A strategy

(I) M&A stage

The M&A strategies of commercial banks in China can be roughly divided into two stages. Since 2006, internationalization and integration have gradually become the strategic focus of the M&A activity of major commercial banks. In the second stage, an increasing number of overseas and cross-industry M&A transactions have taken place.

1. Stages of strategic investments. Before 2006, M&A activity in China's banking industry consisted mainly of strategic capital introduction through the introduction of strategic investors. First, capital was replenished, and capital adequacy ratios were improved. Second, to achieve equity diversification, the corporate governance structure and mechanism were improved. Third, foreign banks' advanced management experience and technology were introduced to improve market competitiveness. The 2 years before 2006 were the "listing years" of China's commercial banks. In 2003, the CBRC promulgated administrative measures for overseas financial institutions to invest and buy shares in Chinese-funded financial institutions, which clearly stipulated the qualifications, proportion of shares to be bought, and the approval procedures for international strategic investors. The government's clear strategic orientation has laid the foundation for cooperation between Chinese banks and international strategic investors. In June 2004, HSBC bought a stake in Bocom, marking the beginning of the cooperation between Chinese commercial banks and international strategic investors. By November 2007, 29 foreign institutions had invested in 21 Chinese banks for a total of \$19 billion, and the large-scale introduction of international strategic investors by Chinese banks had

basically come to an end (see Table 5-1).

Table 5-1: Chinese banks introductions of overseas strategic investors

Chinese bank	Investor	Date	Stake (%)	Contents of strategic cooperation
Everbright Bank	Asian Development Bank	1996.11	3.29	Implement technical assistance projects, hire experts to diagnose the main business operations of Everbright Bank, and put forward suggestions for improvement
Bank of Shanghai	IFC	1998.8	7	SME loan
	HSBC	2001.12	8	
	HK and Shanghai Commercial Bank	2001.12	3	
Bank of Nanjing	IFC	2001.11	15	Risk control
	BNP Paribas	2005.12	19.2	Retail bank, capital market, loans for consumption, wealth management, risk management, IT, organization department, HR
Shanghai Pudong Development Bank	Citibank	2002.12	5	Credit card business
CMBC	IFC	2003.9	1.22	
	Singapore Asian Financial Holding Company	2004.11	4.55	
Industrial Bank	Hang Seng Bank	2004.3	15.98	Credit card business
	Government of Singapore direct investment corporation	2004.3	5	
	IFC	2004.3	4	
Xian City Commercial Bank	Bank of Nova Scotia	2004.6	2.5	
	IFC	2004.6	2.5	
Bank of Communication	HSBC	2004.8	19.9	Corporate governance, risk management, internal audit and control, financial accounting, asset-liability management, HRM
Shenzhen Development Bank	Newbridge Capital	2004.9	17.89	Credit card business
China	Bank of America	2005.8	8.52	Corporate governance, risk

Table 5-1, continued

Constructi on Bank				management, credit card business, retail bank
	Singapore Asian Financial Holding Company	2005.8	5.88	
Hangzhou City Commerci al Bank	Commonwealth Bank of Australia	2005.9	19.92	
	Asian Development Bank	2006.8	5	
Nanchong City Commerci al Bank	Germany Investment and Development Co. Ltd	2005.7	10	
	Stadt Sparkasse	2005.7	3.3	
	BNP Paribas	2005.1	19.2	Integrated management information system
Bank of Beijing	IGN group	2005.9	19.90	IT, risk management
	IFC	2005.9	5	
Bank of China	Royal Bank of Scotland	2005.1 2	10	Royal Bank of Scotland agreed on credit card, wealth management, insurance services, corporate governance, risk control, financial management, and other areas of cooperation
	Singapore Asian Financial Holding Company	2005.1 2	5	
	UBS AG	2005.1 2	1.61	
	Asian Development Bank	2005.1 2	0.24	
China Bohai Bank	SCB	2005.1 2	19.99	Comprehensive business cooperation
Hua Xia Bank	Deutsche Bank	2006.3	7.02	SME business
	Deutsche Bank Luxembourg	2006.3	2.88	
	Sal Oppenheim	2006.3	4.08	
ICBC	Goldman Sachs	2006.3	6.05	Risk management, capital business, corporate governance, and internal control
	Allianz	2006.3	2.36	Insurance business
	American Express	2006.3	0.47	Bank card business
Ningbo Commerci al Bank	OCBC	2006.5	12.20	Risk management, internal audit, personal banking, capital business, IT

Table 5-1, continued

Tianjin City Commercial Bank	Australia & New Zealand Banking	2006.5	20	
China Guangfa Bank	Citibank	2006.12	20	
	IBM Credit	2006.12	4.74	
China Citic Bank	Banco Bilbao Vizcaya Argentaria	2007.3	4.83	Provide expert consultant assistance and overseas training for employees
Jinan City Commercial Bank	Commonwealth Bank of Australia	2004.11	10.68	IT, credit management, risk management, marketing, financial management, capital operation, and integrated business system management

Source: Bank of Communications research report (2007).

(2) Overseas and cross-industry M&A activity

After 2006, China's commercial banks entered a stage of overseas and cross-industry M&A activity. Through overseas M&A activities, they entered new markets, expanded target customer groups, realized scale and internationalization, and expanded their breadth. Through cross-industry M&A activities, they developed a platform for comprehensive operations and improved the ability to provide comprehensive services for customers to retain more customers, grasp trends in comprehensive operations, and push forward in an in-depth manner (see Table 5-2).

Table 5-2: Overseas M&A and cross-industry M&A profiles of several banks

Bank	Event
Industrial and Commercial Bank of China	At present, it has implemented a global strategy; accelerated the implementation of M&A activities; acquired a 90% stake in Indonesia's Hilim Bank in December 2006; acquired 79.93% of the shares of Macao Seng Heng Bank in August 2007 for 4.683 billion patacas; acquired 20% of Standard

Table 5-2, continued

China	Bank of South Africa in October 2007 for \$5.449 billion; and is actively preparing for acquisitions in Australia, the Middle East, and other regions.
Bank of China	In December 2006, through its wholly owned subsidiary Bank of China Group Investment Co. Ltd., it acquired all of the shares of Singapore Aircraft Leasing Enterprise Co. Ltd. for \$965 million, clearly implementing an M&A strategy of complementary advantages and actively preparing to enter the insurance market.
China Construction Bank	In August 2006, it signed an agreement with Bank of America to acquire 100% of Bank of America (Asia) Co. Ltd. for approximately \$1.25 billion.
Bank of Communication	In December 2006, it announced the acquisition of Hubei Trust and Investment Company. After the completion of the transaction, Bank of Communication owns 85% of Hubei Trust. It plans to build a comprehensive operating platform and break through the separate management of regulatory policies.
China Development Bank	In July 2007, it announced a \$3 billion investment in Barclays Bank, in which China Development Bank has a stake of approximately 3%.
China Merchants Bank	On May 30, 2008, it signed an agreement with Wing Lung Bank in Hong Kong to acquire the 53.1% stake in Wing Lung Bank held by the Wu family, founders of Wing Lung Bank, for HK\$156.5 per share. In the first phase of the acquisition, it took a 53.1% stake in the Wu family stake for a combined RMB 17.2 billion. At the final price of HK\$156.5 per share, the full purchase

	of Wing Lung's stake would be worth more than HK\$36 billion.
China	In October 2007, it announced the purchase by cash subscription of 143 million common shares of the nonpublic development bank A shares of Shanxi International Trust. After the completion of the private placement, it held 26.5% shares of Shanxi International Trust valued at 2.34 billion yuan.
Mingsheng Banking	In October 2007, it announced the signing of an agreement with United Bank Holding Company for 20% of the company through a three-stage investment. At the same time, it actively negotiated with Jiangsu, Hebei, and other provinces to acquire urban or rural commercial banks on a large scale, which exhibited an active strategy of M&A transactions and expansion.

From the perspective of transaction subjects, large commercial banks are the subjects and main participants of M&A transactions, which are related to the environment of state-owned commercial banks' reform and listing. After strategic capital introductions, big banks have participated in overseas and cross-industry M&A activities as buyers. Medium-sized commercial banks have also gradually attempted to consolidate their market positions through M&A activities, among which China Merchants Bank and China Minsheng Bank are among the more active participants. City commercial banks are weak, participation is relatively single, and transaction amounts are small. In terms of the purpose of the M&A transactions, the M&A activity of China's commercial banks—similar to international commercial banks—is still focused on building a comprehensive business platform, expanding the domestic and foreign market space, and optimizing the business structure.

(II) M&A strategy

The M&A strategy of China's commercial banks should consider two dimensions. One is the purpose of the M&A activity, including the three levels of integration, internationalization, and optimization of the business structure. The second dimension is the requirement for the target of the M&A transaction, including strategic positioning, industry field, geographical area, scale and strength, financial performance, management innovation, customer resources, and institutional network. The basic strategies that China's commercial banks can follow to implement M&A transactions are as follows. The size of the target should be appropriate for the size of the acquirer, the target's region should place equal emphasis on domestic and overseas markets, the M&A industry should gradually move from interbank to nonbank financial institutions, and the M&A strategy should be steadily promoted.

First, in terms of regional distribution, the domestic market focuses on the Bohai economic circle, the Yangtze River delta economic circle, the Pearl River delta economic circle, and central and western regions with strong financial growth potential. The overseas market is focused on China's surrounding Asia-Pacific emerging market countries and international financial center cities.

Second, in terms of target selection, urban or rural commercial banks that meet the strategic needs of banks engaged in M&A activity should be the focus in the domestic banking industry. Foreign commercial banks that meet the needs of overseas distribution and that have strong financial investment potential should be the focus as should nonbank financial institutions that can enrich bank customer service, improve product lines, realize the cross-selling of products, and exert significant synergies. Trust, securities, insurance,

and fund companies are mainly in the domestic market, whereas asset management and fund companies are mainly in the international market. Specific strategies are provided in Table 5-3.

Table 5-3: Specific M&A strategies of commercial banks in China

Strategy type	Make the bank bigger and stronger	Realize comprehensive cross-domain management	Achieve international business development
Strategic orientation	In line with the bank's strategy, the focus should be on strategic coordination with the bank's goal of strengthening the retail banking business, developing the small- and medium-sized enterprise banking business, and improving marketshare.	Strategic coordination with banks to optimize the customer structure, expand noninterest income, and disperse business risks.	Strategic synergies with the bank's goal of improving overall risk management, learning from international practices to strengthen the bank's management, expanding international networks, and entering emerging markets.
Industry Field	Domestic urban commercial banks, rural commercial banks, and other regional banks.	Focus on domestic trust companies, regulatory securities companies, life insurance companies, fund management companies, and other institutions.	Mainly foreign commercial banks and asset management companies, and take care of insurance, securities companies, and other financial institutions.
Geographic Area	Bohai sea economic circle, Yangtze River delta economic circle, Pearl River delta economic circle provincial capitals, prefecture-level important economic cities as the main expansion areas; provincial capitals and some prefectural and municipal economic centers in the middle, northeast, and Fujian regions to expand	The major regions are big cities with a good environment for the development of financial institutions, flexible financial mechanisms, high degree of marketization and internationalization, and strong financial agglomeration, such as Beijing, Shanghai, and Shenzhen.	East Asian countries, such as Japan and South Korea, which have close economic and trade contacts with China, close geographical location, more intensive Chinese and Chinese-funded enterprises, and a high degree of economic and financial development, as well as Southeast Asian countries with great market potential and

Table 5-3, continued

	steadily. Provincial capitals and a small number of important economic towns in less developed areas in the west should be appropriately expanded.		high financial growth, such as Thailand, Vietnam, Indonesia, Malaysia, and others. According to the ripe degree of opportunity and conditions, select the United States, Australia, Russia, and other countries steadily, and appropriately select international financial centers such as Hong Kong, New York, London, Dubai, and other important international cities.
Size and Strength	Mainly small- and medium-sized banks, that is, the financial cost of a merger should not exceed the bottom line of a bank's valuation. At the same time, its size should also meet the bank's business expansion needs in the M&A area.	In terms of assets, capital, and business scale, small to medium-sized financial institutions that can meet the needs of normal business operation in terms of size of institutions and personnel are key.	A bank or other financial institution that is relatively small in size in terms of capital, operations, networks, and personnel.
Financial Performance	In principle, the capital return and growth of the acquired bank should not be lower than those of the acquiring bank, and the profitability of the acquiring bank should not be diluted.	The better the financial condition the higher the profit growth.	The management condition is good, the capital sufficiency level is high, and the asset quality is good.
Management innovation		Have strong product development and innovation ability.	With relatively advanced business philosophy and management methods; strong product innovation ability, especially for credit cards, retail banks, consumer credit, and

			Table 5-3, continued
			other retail finance; and has rich business experience and business advantages.
Customer resources	Have a good retail customer base and a considerable scale of high-quality SME customer resources.	The bank has a pool of high-quality securities; retail customers for insurance; and corporate customers for trust companies.	A number of fixed, stable, and highly loyal customer resources.
Outlets	The scale of outlets is a significant advantage in the local area, which can effectively supplement the bank's insufficient coverage of outlets in the region.	Can basically cover the key economic regions in China, and the regional distribution of its branches should be basically consistent with the distribution of the bank's main branches in order to realize the resource sharing between them.	Having the right business network scale can help the bank quickly expand the local market.

5.4 Analysis of M&A activity in China's banking sector

Since the 1990s, with the deepening of China's financial system reforms, a number of bank M&A activities have occurred in China. The main cases are as follows:

(1) In 1994, China Construction Bank acquired 40% of the equity of the Industrial and Commercial Bank of Hong Kong and changed its name to CCB.

(2) In 1995, urban credit cooperatives in many cities were merged to form the Urban Cooperative Bank.

(3) In 1996, Guangdong Development Bank acquired Bank of China Trust and Investment Company.

(4) In 1997, Hainan Development Bank merged and reorganized 28 urban credit cooperatives.

(5) In 1998, China Construction Bank took custody of China Rural Trust and Investment Corporation. China Investment Bank was merged into China Development

Bank.

(6) In 1999, China Everbright Bank acquired the erstwhile China Investment Bank as a whole.

(7) In 2000, Industrial and Commercial Bank of China acquired Hong Kong Union Bank.

(8) In 2001, Shanghai Pudong Development Bank acquired Zhejiang Ruifeng City Credit Cooperative, and Fujian Industrial Bank acquired Zhejiang Yiwu City Credit Cooperative.

(9) In 2003, ICBC acquired Fortis Bank, Bank of China Group was restructured, and China Merchants Bank acquired Panjin Commercial Bank.

(10) In 2004, Industrial Bank acquired Foshan Commercial Bank, and China Merchants Bank acquired Quanzhou Commercial Bank.

On the whole, the existing M&A transactions by banks in China are more administration- than market-oriented. Many modes of horizontal M&A exist, but few modes of vertical and mixed M&A exist. More attention is paid to the early work of M&A activities and less attention is paid to these activities' follow-up work. Domestic M&A transactions are higher in number than foreign M&A transactions, with there being other remarkable characteristics.

When compared with bank M&A activity abroad, especially in developed countries, the marketability of bank M&A activities in China is obviously insufficient. From the perspective of motivations for M&A transactions, most of China's bank M&A activities are not based on the realization of economies of scale and synergies but instead have a strong "political" purpose. This purpose is mainly to rescue troubled banks or financial

institutions in crises, curb the occurrence of regional and systemic risks, and maintain the stability of the entire financial system.

From the perspective of M&A activity, many banks participating in these transactions do not strengthen their strengths or complement their advantages through value discovery and integration according to market principles. Instead, they replace the judgment of core capital, marketshare, operating advantage, and other M&A criteria with the administrative collocation of the government.

Regarding the effects of M&A activities, although activities that placed social interests above individual interests temporarily delayed the outbreak of regional financial crises, they led to serious consequences for the acquirer banks. For example, Hainan Development Bank failed because of its acquisition of 28 credit cooperatives that were on the verge of collapse.

Therefore, bank M&A activities in our country did not play out as the economic effects of foreign bank M&A activity and system performance did. Commercial banks do not have enough power or interest in studying the implementation of M&A activity in order to realize rapid expansion and growth. The government and regulators do not fully appreciate that bank M&A activity can perfect the financial organization system and promote the role of financial system change. After years of reform, China's economy and finances have entered a special stage. In terms of numerous reform problems, the original reform measures are basically no longer effective, and new reform methods and approaches must be selected, among which bank M&A activity is one important choice.

5.3.1 Effect of Chinese commercial banks' M&A activity

In the mid and late 1990s, under the impact of international banking M&A and

restructurings, a gradual transition toward a market economy in China began to draw lessons from international experiences with mergers and restructurings to solve the domestic financial crises of local and disordered financial resource integration. This effort is allowing China's commercial bank organization system to play a role.

1. Initial results of China's commercial bank M&A and restructurings

(1) Local financial risks were smoothly defused through the following mergers: Guangdong Development Bank acquired BOC Trust and Investment Corporation, and China Construction Bank acquired agricultural development trusts and investment companies in China. The Industrial and Commercial Bank of China is hosting Hainan Development Bank's purchase as a (host) party of the takeover (escrow) party all the way through to debt restructuring, effectively protecting the legitimate interests of creditors and shareholders during the takeover (escrow) in order to prevent the financial institutions from going bankrupt and fueling huge social turbulence.

(2) These transactions provide a model for the low-cost expansion of small- and medium-sized banks in China. China Everbright Bank and Guangdong Development Bank are small- and medium-sized commercial banks, with fewer branches and outlets than many others. They might need quite a long time and a lot of money to form agency networks throughout the country or across the province. In accordance with the general model of development and through mergers and restructurings, they can use low-cost acquisitions of financial institutions on the verge of bankruptcy or mergers for the development needed. They can even use the funds for advances in dispensing the new branch network expenses to enable small- and medium-sized commercial banks to implement low-cost expansions under conditions of limited capital strength. The

successful experience of China Everbright Bank and Guangdong Development Bank will have a strong demonstration effect on other small- and medium-sized commercial banks in China.

(3) These transactions allow for the exploration of a new way to realize gradually and indirectly the comprehensive operations of commercial banks. According to China's current law on commercial banks, commercial banks are not allowed to operate financial businesses directly, such as investment banking, insurance, leasing, and trust, and their development space is greatly restricted. Currently, with international commercial banks generally developing toward omnipotence, if Chinese commercial banks do not follow the international trend to develop and diversify their financial businesses, they will be at an obvious disadvantage in international financial competition. A realistic and legal choice is to merge and restructure nonbank financial institutions to develop other financial businesses outside the traditional commercial banking business within the existing institutional framework.

(4) This paper puts forward a new topic for promoting relevant financial innovations. The preliminary practice of commercial bank M&A activities has raised a new subject for China's financial innovation. For example, nonbank financial institutions can engage in acquisitions with commercial banks to infiltrate another financial industry, make its market competitive, and greatly increase its resilience. However, at present, in our country, the market economy system is not perfect. Financial authorities' monitoring strength may have been weakened through official legislation on the comprehensive opening up of the mixed management of commercial bank control, potentially weakening financial authorities' monitoring strength. The answer to the question of how to achieve a

relative balance between maintaining the stability of the macrofinancial order and fully stimulating microfinancial efficiency requires us to, in practice, explore the degree of financial innovation in each period.

2. Current problems with the merger and reorganization of China's commercial banks

(1) The first problem is the degree of government intervention. For the past several M&A cases, except for China Everbright Bank's acquisition of China Investment Bank and the cross-border acquisition of the Industrial and Commercial Bank of China, the government has intervened strongly in other M&A activity. Currently, the market mechanism is not perfect, and macro coordination with the Government of Azerbaijan is necessary. However, significant administrative intervention may take advantage of the acquirer bank's profits, making it difficult for acquirers to preserve their operational mechanisms, and acquirers cannot fundamentally resolve existing financial risks. At the same time, excessive government intervention often causes the flow of factors to go against market rules, affecting the rational allocation of various resources and leading to an inefficient M&A process. Therefore, the results of M&A activity cannot reach optimality.

(2) The specialized laws and regulations applicable to bank M&A activity are deficient, and the relevant policies and measures are not matched. At present, only temporary regulations exist in China in relation to enterprises' general M&A activities. Moreover, the laws concerning bank M&A activities, such as commercial banking and bankruptcy laws, are only scattered within existing laws and regulations and are weakly applicable. At the same time, the government does not engage in scientific overall

planning on how to optimize commercial banks' organizational system through M&A activities and reorganizations and lacks corresponding management and coordination policies.

(3) The relatively lagging reform of property rights of wholly state-owned commercial banks weakens the motivation and effect of M&A activity. Unclear property rights relationships of China's wholly state-owned commercial banks result from the lack of a perfect corporate governance structure within banks, the softening of budget constraints, and the weak internal motivation to participate in M&A activities of both advantageous and inferior banks. Also resulting from the lack of internal motivation to engage in M&A transactions is that when financial institutions encounter a crisis, the government often matches advantageous banks with administrative intervention to buy financial institutions on the verge of collapse. This type of nonmarket- or administration-led M&A behavior pays more attention to transferring the current crisis and making exogenous adjustments and pays less attention to integrating internal resources and reforming the operations and management mechanism of both sides—an approach that may weaken the actual effect of M&A activities and restructurings on the low-cost expansion of banks.

5.4.2 M&A strategy of Chinese commercial banks

After more than 40 years of reform, China has formed a commercial banking system with wholly state-owned commercial banks as the main body; new joint-stock commercial banks as the new growth point; and local commercial banks and foreign banks as the supplement. This type of banking system was formed during the transition from a planned to a market economy. These limitations are mainly manifested in the

following aspects. First, the four major state-owned commercial banks rely on administrative power to form a high degree of monopoly, which is not conducive to reasonable competition in the banking industry. Second, the property rights structure of state-owned commercial banks is singular, and the slow reform of state-owned commercial banks in the system and new joint-stock commercial banks outside the system accelerates the incremental expansion of the formation of a significant contrast. Third, super commercial banks capable of participating in the competition in international financial markets and standardized small commercial banks that match the development of small- and medium-sized enterprises are lacking. Fourth, commercial banks basically deal with a single traditional deposit and loan business that cannot meet the requirements of diversified financial services for economic development, and the combination of industry and finance remains superficial. To optimize the organizational system of China's commercial banks further, it is necessary for commercial banks to be comprehensively integrated through mergers and reorganizations while accelerating the property rights reform and marketization process of wholly state-owned commercial banks. We believe that the M&A and restructuring activities of Chinese commercial banks should adopt the following gradual strategy of "accumulation–expansion–transcendence."

[1.] "Momentum" stage: The property rights system reform and the internal organization reconstruction of commercial banks are promoted mainly to improve the institutional environment for bank M&A activity. Since the mid and late 1990s, the M&A activities of Chinese commercial banks and contemporary western commercial banks have had very different backgrounds. Contemporary western commercial banks engaged

in M&A activities in the context of the banking industry's very clear property rights relationships, the relatively complete relevant laws and regulations, and the relatively developed economic and financial structures. However, Chinese commercial banks' current M&A activities occur amid unclear property rights relationships, relatively insufficient relevant laws and regulations, and underdeveloped economic and financial structures. Therefore, to optimize the organizational system of China's commercial banks through mergers and reorganizations, a process exists that accelerates the reform of the financial industry's property rights system and improves the corresponding institutional environment to accumulate strong potential energy for the steady promotion and virtuous cycle of large-scale future mergers and reorganizations of commercial banks.

(1) We are expected to intensify reforms of the property rights system in wholly state-owned commercial banks. We recommend that as soon as possible, four wholly state-owned commercial banks—and other financial institutions regarding resource optimizing configurations—adopt the shareholding system reform and be reorganized as state-owned holding companies, along with non-state-owned joint-stock commercial banks with various economic compositions. This adoption is expected to be undertaken to define banks' property rights into tradable finances, facilitate owners' exercise of property rights, and push through property rights trading through the property right constraints mechanism of mergers and reorganizations that inspired their intrinsic motivations.

(2) We are expected to promote the integration of the internal organizational structures of wholly state-owned commercial banks. The current organizational structure of the four wholly state-owned commercial banks is based on government agencies' administrative levels. The four levels of institutions, from central to local levels; the

three-level management mode; and one-level operation structure are adopted. The long-term extensive operational pattern results in overlapping banking institutions and layers of redundant personnel. In recent years, the four state-owned commercial banks at provincial level branches have been merged with local municipal branches. Effectively, sites have also removed mismanagement; however, provincial and local municipal branch institutions made no substantial reductions, leaving management to become too large. Grassroots management network settings and the operating costs and benefits of asymmetric phenomena still exist as do bank internal organizations and integration of large spaces.

(3) We are expected to improve the institutional environment for commercial banks' M&A activities. In China, the early stages of commercial bank M&A activities are mainly meant to resolve the emergency measures taken because of local financial risks. To optimize China's commercial bank organization system further through mergers and restructurings, such efforts must have the purpose of creating a good institutional environment. In addition to the previously described system reform of banks' property rights, the following should be pursued. First, the legal system of bank M&A activities, including detailed rules, should be established and perfected as soon as possible and should include a bank M&A activity law, bank assets appraisal management measures, financial institutions, property laws, unfair competition laws, and antitrust laws. Second, a bank deposit insurance system should be established to prevent bank M&A activity from damaging depositor interests and to protect the banking system from bank runs. Third, a sound social security system should be established to settle the reductions in personnel from the bank M&A process properly. Fourth, market rules, including market

competition rules, market entry and exit rules, and market trading rules, among others, should be further improved. Fifth, the development of the capital market should be further promoted, and the flow of financial property rights should be facilitated.

[2.] “Expansion” stage: Large-scale expansion of market-oriented commercial bank M&A activity

(1) Bank M&A activity by the government should transition to independent interbank marriages. During the early stages, most of the M&A activity of China’s commercial banks were executed with the assistance of the government to assist banks or other financial institutions on the verge of bankruptcy. Because the shareholding reforms of wholly state-owned commercial banks have been completed and government functions have been transformed, commercial bank mergers and reorganizations are expected to enter a development stage in which the two parties to an M&A transaction conduct these transactions voluntarily and independently according to market rules and their interests and development needs.

(2) Various forms of financial M&A activities have formed a tide of organizational system optimization and reorganization of China’s commercial banks. During this stage, the mergers and reorganizations of China’s commercial banks are likely to take the following forms. The first form is the complementary combination of the four state-owned commercial banks and emerging commercial banks with good performance to form a banking group with a larger scale and a flexible mechanism. Second, regional small commercial banks are to be merged to form regional commercial banks. Third, banks with various advantages are to annex inferior banks in the form of “big eating small” or “big snacks.” Fourth, cross-border M&A activities are to be pursued to expand

overseas markets. Various forms of M&A activities are expected to comprehensively promote the optimization and reorganization of commercial banks' organizational system and significantly improve the banking industry's operating efficiency.

[3.] "Beyond" stage: The mixed M&A activity between commercial banks and other financial institutions is prevailing, and the combination of industry and finance is becoming increasingly popular.

(1) Mixed M&A activities between commercial banks and other financial institutions are widespread and unchecked. Contemporary western commercial banks are developing in the direction of all-round development, whereas China's commercial banks—restricted by current laws—cannot directly engage in financial businesses, such as investment banking, insurance, trust, and leasing. After China's accession to the WTO, external competitive pressure was expected to force China's commercial banks to intensify financial innovation to manage the challenges associated with the international banking industry. Among these challenges, an increasing number of commercial banks are expected to adopt the operating strategy of indirectly realizing an all-round business through the M&A activities of other nonbank financial institutions.

(2) Combinations of industry and finance bank M&A activities gradually shape the climate. As shown by the economic development of western countries, when the economy and finance develop to a certain stage, the banking, industrial, and commercial sectors are expected to infiltrate each other (i.e., the combination of industry and finance). Under the condition of a high degree of economic monetization, the economic interdependence between banks and industrial sectors is very close. On the one hand, bank performance is largely related to enterprise production, operations, and management.

On the other hand, the pace of enterprise development is also closely related to the service quality and financial support of banks. This two-way relationship has formed the two-way impetus of M&A activities. Many large western banks have adopted the strategy of acquiring the equity of their clients, and they directly participate in, or supervise, enterprise production and operations. For example, Deutsche Bank owns 19.41% of the voting shares of Siemens. Given the development of China's market economy and improvements in the degree of economic monetization, the continuous improvement in market rules and the gradual relaxation of financial regulations are expected to put the penetration strategy of commercial banks into the industrial sector on the agenda gradually. Through the assistance of a growing capital market, commercial banks are expected to use successfully a combination of industry and finance to achieve their comprehensive economic expansion, and the relationship between banks and industrial and commercial enterprises is expected to evolve from a single debt transaction to a cross-linked relationship between debt and equity transactions. Without a doubt, China's commercial bank merger and restructuring strategy is divided into three theoretical stages. In the concrete practice of financial reform and financial innovation, bank mergers and reorganizations of these three stages may be affected by various economic, political, and social factors and the influence from different degrees of overlap. Nevertheless, during the process of optimizing and adjusting the organizational system of China's commercial banks, this type of gradual merger and reorganization strategy is still a realistic and suitable choice for China's national conditions.

5.4.3 Modes and characteristics of Chinese commercial banks' M&A

For various reasons and considerations from different aspects, different commercial

banks have adopted their own modes of M&A, and their characteristics are different in terms of other commercial banks' degrees of M&A activity. China's commercial bank M&A activities mainly has the following modes.

1. M&A activity of credit cooperatives by city commercial banks

Hainan Development Bank was established in August 1995. On December 16, 1997, the People's Bank of China announced the closure of five credit cooperatives in Hainan Province that had been substantially bankrupt, and their creditor and debt relationships were placed under the custody of Hainan Development Bank. Of the remaining 29 credit cooperatives in Hainan Province, 28 were incorporated into Hainan Development Bank. This event actually constituted the previous M&A activities of China's commercial banks. Another example is Qingdao Bank (the former Qingdao Commercial Bank), which was established on the basis of 21 urban credit cooperatives in Qingdao in November 1996. In August 1997, Weihai Commercial Bank was formed through the integration of five city credit cooperatives. These integrations are the result of the joint reorganization of commercial banks and credit cooperatives in various cities that were encouraged by the CBRC to optimize their allocation. In this mode of M&A activity, a majority of new financial institutions are formed through the integration of a number of cooperatives in a certain city, whereas most newly established financial institutions are urban commercial banks. Credit cooperatives are the products of a special historical period in China. With economic and social development as the backdrop, the disadvantages of credit cooperatives, such as small-scale, low business, and low anti-risk ability, are highlighted. On the one hand, they seek development, whereas on the other, the development of the local economy needs the support of a local bank of a certain scale. Therefore, the

occurrence of M&A activities becomes inevitable. These cases of M&A activities usually exist in the government's executive order color.

2. Joint-stock Industrial Bank mergers with urban commercial banks

In 2004, Industrial Bank acquired Foshan Commercial Bank, and Industrial Bank's Foshan branch was officially listed for business on December 6 of that year, representing China's first national joint-stock commercial bank acquisition of a city commercial bank. The acquisition and merger activities lasted for nearly a year and adopted the asset acquisition model. The state-owned assets supervision and administration commission of Foshan first removed the nonperforming assets of Foshan Commercial Bank, whereas Industrial Bank acquired normal credit and other effective assets and undertook the deposit debt of Foshan Commercial Bank. Because the acquisition was a merger by absorption, Foshan Commercial Bank's original legal personality was canceled after the acquisition. The acquisition paved the way for joint-stock commercial banks to achieve rapid development and provided a reference for the reform and development of urban commercial banks. Given the increasingly fierce competition in China's commercial banking industry, some commercial banks—particularly local ones—are at a disadvantage concerning market competition because of the restrictions on technology, scale, market, and other factors. In contrast, some joint-stock commercial banks have performed well and have expanded rapidly. To expand their business scope and market resources, these banks hope to achieve rapid expansion through the M&A activities of other banks. In this case, city commercial bank M&A activities became their best choice. The main characteristic of this mode of M&A activity is that the two sides engage in fierce market competition to obtain larger business scope and stronger competitiveness.

3. City commercial banks merged into a single commercial bank

On December 28, 2005, Huishang Bank was officially established, which is the first regional joint-stock commercial bank established through a joint reorganization of city commercial banks and city credit cooperatives. The Anhui Merchant Bank adopted the “6 + 7” restructuring mode; that is to say, it reorganized six city commercial banks from Hefei, Anqing, Maanshan, Wuhu, Bengbu, and Huaibei and seven credit cooperatives from Luan, Huainan, Fuyang, and Tongling into the Hefei city commercial bank as the main body. Dozens of other city commercial banks and urban credit cooperatives followed suit. Different from the aforementioned model wherein credit cooperatives merge to form city commercial banks, this mode of M&A mainly occurs between the cities in a province. The city commercial banks in different cities merge to form a provincial commercial bank, such as Huishang Bank and Zheshang Bank—named after provinces. However, the characteristics of their M&A activities are similar to those of credit union mergers, both of which seek development and with their M&A activity completed under the government’s guidance.

4. Equity participation and M&A activity among commercial banks

In 2006, the Bank of Nanjing took a stake in Rizhao Bank. The Bank of Nanjing acquired 18% of the shares of Rizhao Bank to become its largest shareholder. In September 2008, the Bank of Beijing signed a shareholding agreement with the former Langfang Commercial Bank (now Langfang Bank) and paid 127.5 million yuan for 19.9% of the target’s shares to become its largest shareholder. In June 2012, Shenzhen Development Bank completed all of the legal procedures to merge with Ping An Bank. Shenzhen Development Bank and Ping An Bank officially merged into a single bank,

perfectly concluding the largest financial merger in Chinese history. Given the development and maturity of the joint-stock system, most banks are joint-stock commercial banks, creating conditions for bank participation and increasing commercial banks' participation. This model of M&A transactions has gradually become mainstream. Joint-stock commercial bank participation facilitates M&A activity, and the prediction is that M&A activities among commercial banks are expected to become increasingly common in China.

5. Foreign capital shares in China's commercial banks

Since 1999, foreign banks began to participate in driving up the pace of China's commercial banking activity. In December 2003, the CBRC announced that it would allow foreign ownership of up to 25% of China's commercial banks. In January 2004, several advisories on promoting the reform, opening up, and stable development of the capital market were issued. Since then, foreign banks have gradually stepped through China's door to participate in China's commercial banks. By introducing foreign capital to own shares of China's commercial banks, these banks have learned lessons from overseas advanced bank management concepts and risk control mechanisms to improve the construction of corporate governance and internal control mechanisms; improve operations, management, and market competitiveness; and play a positive role in promoting the healthy development of China's commercial banking industry.

Foreign banks' participation in China's commercial banks enables foreign banks to expand the business of the domestic market. In contrast, some commercial banks, especially urban commercial banks, have insufficient core competitiveness and are at a disadvantage when competing in the commercial banking market. Because they are eager

to introduce advanced foreign business philosophies and risk control technologies, they actively introduce foreign capital to hold their shares, and in that manner, they enrich their capital stock or amount of capital.

6. Overseas M&A activities of China's commercial banks

Since the reform and opening up, especially in recent years, China's commercial banks have increased the pace at which they are going global, and overseas M&A activities have become increasingly frequent. For example, in July and November 2012, the Industrial and Commercial Bank of China acquired 80% of the equity of the Bank of East Asia of the United States and 80% of the equity of the Standard Bank of Argentina. The acquisition of the Bank of East Asia by the Industrial and Commercial Bank of China marks the first time that a Chinese commercial bank acquired a controlling stake in a U.S. banking institution. The acquisition of Argentina's Standard Bank marked the first time that a Chinese commercial bank entered Latin America.

Although China's commercial banks are increasingly conducting overseas M&A activities, this M&A mode also highlights its unique characteristics. In general, M&A activity is dominated by old, state-owned banks, and few joint-stock commercial banks are involved in M&A activity. In addition, M&A transactions are developing rapidly but are still small. The largest M&A case in the history of Chinese transnational M&A—the Industrial and Commercial Bank of China's acquisition of South Africa's Standard Bank, with a size of only 5.46 billion dollars—is significantly smaller than most western commercial bank M&A transactions. M&A methods tend to become diversified. The earliest M&A transactions primarily used cash to purchase equity, and then, gradually, they developed to the present, generally adopting a payment method that combines equity

and cash. In 2003, the Industrial and Commercial Bank of China paid HK\$740 million for 9% of the equity of Fortis Bank of China, which was supplemented by a cash payment. This deal represented the first time that China's banking industry acquired an overseas bank through a share placement.

5.4.4 Motives and problems of Chinese commercial banks' M&A activity

1. Analysis of the motivation of commercial banks' M&A activity

(1) As the marketization of commercial banks has been gradually promoted, each bank has gained increasing autonomy through its M&A activity and has gradually got rid of the shackles of administrative orders. After all, commercial banks are also enterprises, and all of their work centers on the ultimate goal of profit maximization. Regardless of the M&A mode that they adopt, the motives for commercial banks to engage in M&A transactions are nothing more than the following:

A. Pursuing profits: As a joint-stock enterprise, a bank's primary purpose is to pursue profit maximization and shareholder value maximization. To participate in the increasingly fierce competition among banks, banks adopt various competitive means. Among them, M&A activity does not lose its effectiveness as a means of competition. Through M&A activity, banks have reduced their competitors, expanded their business scale, and realized product integration and business complementarity. Through M&A activity, companies have integrated institutions, optimized personnel allocations, realized diversified operations, and reduced operational risks. Second, shareholders can also enjoy premium returns on stocks in the secondary market if the M&A transaction is carried out by purchasing equity securities.

B. Replenish capital: Through mergers and reorganizations, commercial banks can

integrate resources, enrich capital, improve the capital adequacy ratio, strengthen the writing-off of bad debt, and improve asset quality. Simultaneously, access to a broader source of funds is conducive to commercial banks' sustainable development, can appreciate banks' intangible assets, and can reduce the ratio of risky assets. In terms of capital sources, the advantages of urban commercial banks are much less robust than those of large state-owned and joint-stock commercial banks; therefore, this motivation to engage in M&A activity is highlighted for urban commercial banks.

C. Reduce costs: Through interbank M&A activities, banks' resources and technologies are integrated, which can significantly reduce various costs. M&A activities can also result in economies of scale, and fees are effectively reduced, thus reducing banks' operating costs. The integration of customers and channels of various banks promotes the sales volume of bank products and further dilutes costs. In addition, banks can achieve reasonable tax avoidance through overseas M&A activities, thus reducing payment costs.

D. Seek strategic development: In the face of increasingly fierce competition in the banking industry, banks need to expand their scale to obtain greater marketshare, market influence, and social attention. Through M&A activities, a bank's scale can be continuously expanded; larger banks have a stronger ability to resist risks; and they have a more sustainable and stable operation. Through overseas M&A activities, China's commercial banks can learn and master more businesses and technologies of overseas banks, improve their competitiveness, and explore ways to operate one-stop banking.

E. Diversify investments: Large commercial banks, especially state-owned commercial banks, have abundant capital and require diversified investment channels.

Through M&A activities, banks activate spare capital and broaden their investment horizons.

F. Achieve cross-regional operations: For urban commercial banks, the original intention of their establishment is to serve the local economy and support local development, and their business scope is often limited to the cities in which they are located. However, when the development of urban commercial banks achieves a certain scale, geographical restrictions strongly restrict their development. In contrast, urban commercial banks tend to serve local enterprises, which inevitably have subsidiaries or close cooperation units in other regions. Under such circumstances, cross-regional branches of urban commercial banks can effectively solve these problems. An effective and immediate method of establishing cross-regional branches is merger with commercial banks in different cities; therefore, this method is gradually being adopted by commercial banks in various cities.

G. Achieve overseas operations: For some large state-owned commercial banks, their development vision is not only limited to the domestic, they also actively implement the “go out” strategy. However, some countries have certain entry barriers for their financial industries. Through overseas M&A activities, these barriers can be bypassed to gain entry into the overseas banking industry, participate in international competitions, realize the internationalization of commercial banks, and improve international competitiveness. Overseas M&A activities represent a cheaper and more efficient way to expand overseas than that of setting up overseas branches.

(2) Incentives from outside banks

A. Customers’ overseas and cross-regional needs: Given the development of

technology and the economy, trends in regional and global economic integrations are becoming increasingly obvious. Transregional and even overseas operations are becoming increasingly common among enterprises, and these enterprises are often high-quality customers of banks and the main sources of profits. To improve customer service and prevent customer losses, banks need to achieve cross-regional and overseas operations to meet customer needs. Some enterprises seek to internationalize, and the pace of internationalization creates a series of needs, such as financing, financial consulting, and the settlement business, determining China's commercial banks' push to go abroad.

B. Financial globalization: The financial industry's globalization and liberalization are irresistible trends in the future. To meet these trends, various countries throughout the world have loosened their regulations, which not only weakens the boundaries of banking, securities, insurance, and other financial fields but also lays the foundation for banks to realize overseas M&A activities and conduct overseas operations. Faced with increasingly fierce global competition, an increasing number of banks choose to pursue overseas M&A activities to improve their chances of survival and development. At present, the world's banking industry shows several trends in capital concentration, scale expansion, comprehensive businesses, and international operations. Overseas M&A activities have become an effective channel for banking institutions to expand their markets, enhance their competitiveness, and seek new profit growth points.

C. The global financial crisis: The 2008 global financial crisis brought down a large number of overseas banking institutions and took many overseas banks to the brink of failure. Historical experience shows that in financial crisis situations, economic

recessions abound, commercial bank operations are sluggish, stock prices are seriously undervalued, and institutions can conduct M&A activities at a lower cost. During the 2008 financial crisis, M&A activities saved small- and medium-sized banks and promoted the stability of the banking system. The 2008 financial crisis can be said to have provided a good opportunity for China's commercial banks to conduct low-cost overseas M&A activities.

D. Government support: China's trade departments, banking regulators, and securities regulators, and the People's Bank of China have a clear attitude regarding the issue of overseas M&A activities of China's commercial banks, and they all support China's commercial banks' "going global" strategy. Some government departments also provide the greatest degree of support for the overseas M&A activities of China's banking industry.

2. Analysis of problems with M&A activity

(1) Government intervention

Throughout the M&A processes in the western banking industry, mergers and acquisitions represent the independent behavior of commercial banks. The government acts as a supervisor throughout the M&A process to examine whether these activities are illegal or violate public interest. In contrast, M&A activities in the Chinese banking industry better reflect the will of government agencies, especially transactions involving credit cooperatives and urban commercial banks, as well as those involving urban commercial banks that form commercial banks, and other centralized M&A models in which traces of government intervention are obvious. China's bank M&A activities are basically top-down, government-led M&A activities, and the banking industry has no

choice in the face of the government's instructions regarding these transactions. This type of nonmarket-led M&A activity rarely considers the integration of resources and the coordination of the operation and management mechanisms between the two parties, which weakens the actual effect of these transactions on the low-cost expansion of banks to a certain extent and damages the order of the bank M&A market environment.

(2) Unsatisfactory effect of M&A

Although M&A activities carried out by government executive orders have achieved the purpose of resolving financial risks, they have neglected the sustainable operation of commercial banks after the transactions have been completed; destroyed the order of the market economy; and brought about significant negative effects. At the same time, M&A activities led by the will of the government may not fit the interest demands of the acquirer and the acquiree, leading to the appearance of harmony between the two. Contradictions and frictions in corporate culture, management philosophy, and operating mechanism are inevitable and only increase internal costs.

(3) Law to be improved

The interests of both banks and their stakeholders can be guaranteed only in a sound and standard institutional framework. Regarding bank M&A activity in China's laws and regulations, system construction lags behind the need to develop practical and involved bank M&A laws. The commercial bank law, the bankruptcy law, and other laws and regulations are too general and abstract, lack operability and applicability, and cannot guide bank M&A practice.

(4) Post-merger business strategy needs clarification

China's commercial banks only consider simple scale expansions of M&A activities

and lack clear business positioning and development strategies that are more prominent in large commercial banks. Many large commercial banks engage in M&A transactions one after another, leading to homogenized competition and a vicious circle when they expand their scale. This process is very unfavorable to the healthy development of China's entire banking system. Relatively, bank M&A activity in western countries is more mature. Behind every bank M&A transaction is the result of deliberate consideration by banking institutions in combination with their development strategies and operational positioning.

5.5 Comparative analysis of Chinese and Foreign banking M&A

The basic goal of enterprises is to pursue profit maximization. Chapter 4 and Chapter 5 of this paper have sorted out the development history, motivation and results of Chinese and foreign banking mergers and acquisitions in detail. This section takes the conclusions outlined above as a starting point to make a comparative analysis of the differences between Chinese and foreign banking M&A.

5.5.1 Merger motivation

(I) Early motivations for international banking M&A

1. Horizontal M&A caused by economies of scale.

As mentioned above, with the collapse of the Bretton Woods system, the liberalization of banking competition intensified, and Banks in the United States, Japan and Europe began to participate in equity and merger with each other. The immediate result is a huge, multinational bank with economies of scale. Jiang Moran (2008) took Bank of America as an example and elaborated on the scale effect generated by mergers and acquisitions. First, it was for the purpose of expanding the operation scale, business scope and market share. The second is to try to reduce costs by integrating new

organizations. The third is for the purpose of improving asset quality.

2. Vertical M&A caused by synergies and Economies of Scope.

At present, the financial industry is operated with banks as the core. However, with the deepening of the global financial industry, driven by interests and strategies, Banks' vertical mergers and acquisitions, such as insurance, securities and investment banking, have become behaviors conforming to the development of the market. Vertical mergers and acquisitions are particularly prominent in the second wave of international bank M&A, with banks as the main initiator and financial mixed (industry-wide) groups as the main purpose. Through vertical M&A, banks not only strengthen their capital and technical strength, but also form a brand effect, gradually moving from the background to the center of the financial stage.

(II) Recent motivations of international bank M&A

1. Seek opportunities in foreign markets. The wave of global economy provides cross-border opportunities for the banking industry. Due to the obvious gap in the development level of the banking industry in various countries, it also becomes an opportunity for the top banks to implement overseas strategies. Generally speaking, the transnational strategies of the banking industry are more attracted by the preferential policies of host countries or high-income groups. By acquiring banks in countries where the economy is expected to grow rapidly and the domestic banking system is less efficient, international Banks can capture more profit opportunities.

2. Follow and serve the internationalization of customers. This is also recognized as one of the most direct motivations for cross-border mergers and acquisitions of Banks. Globalization has given birth to a large number of multinational enterprise groups, whose

huge financial needs provide a large number of business development space for banks. As a result, banks have to provide cross-border financial services in order to retain existing customers. At the same time, the degree of economic interaction between countries has gradually become one of the main motivations of international banks' transnational investment.

3. Potential operational risks of scale. Operational security is an important consideration for Banks to implement mergers and acquisitions, especially diversified operations. For the banking industry, one is that customer demand has been undergoing profound changes in recent years, with a decreasing dependence on traditional businesses and a growing emphasis on new products, new economies and new enterprises. At the same time, the outbreak of the international financial crisis has objectively worsened the living environment of Banks, and it has become a common practice to report for group warmth through mergers and acquisitions.

(III) Motivations of bank M&A in China

1. Government-led executive orders. The mergers and acquisitions in the early stage of China's banking industry were directed by the government to rescue the financial institutions in trouble and financial crisis. Such M&A is generally aimed at improving the financial sector's economic contribution through the transformation of the banking system and administrative intervention in the financial sector. Their purpose is also mostly a means for the government to deal with the crisis of the financial system and alleviate social contradictions. It can be said that this kind of merger, the two sides have almost no choice.

2. Attempt to adapt to the market economy. In China, due to the strict appearance of

separate operation and separate supervision, there is no direct and mixed m&a mode among insurance industry, banking industry and securities industry. In recent years, in order to further stimulate the vitality of the financial market and accelerate the in-depth cooperation between the insurance industry, the comprehensive operation of the insurance industry has been preliminarily realized. However, the banking industry is still dominated by horizontal M&A, most of which are transnational M&A.

(IV) Comparative analysis

1. External environment. The M&A of international banks are carried out in a relatively mature market economy environment, and the government generally does not intervene directly. Therefore, the administrative cost of M&A in international banks is low and has the characteristic of spontaneity. In Chinese mergers and acquisitions, the government issued executive orders in the early days, and even now, the government plays an important role in mergers and acquisitions. As a result, the administrative cost of M&A for banks in China is relatively high, and although the situation has been improved in recent years, it is still passive in general.

2. Acquisition area. The M&A of international Banks are basically global, that is, both domestic and international markets. Its starting point is the layout of global financial business. As long as it conforms to the bank's strategy and the principle of profit maximization, mergers and acquisitions can take place in any region of the world. However, due to the relatively strict regulatory environment in China's banking sector, there are few domestic M&A cases at this stage, most of which are overseas M&A.

3. M&A mode.

International banks are not only subject to the fact of "small fish eaten by big fish",

more often "alliance between giants ". Although a large number of commercial banks failed in the financial crisis, some of them were large in size, but those large commercial banks were spared from huge losses, and the important reason was "too big to fail". Therefore, international Banks have a strong demand for scale. However, China's bank M&A are still in the situation of "the strong one swallows the weak one", basically "providing help when others need it". As far as China's current financial development is concerned, in the absence of extreme events, the "alliance between giants " will not occur in the short term. Due to the fact that domestic commercial banks with a large size are basically state-owned holding companies, the government has been involved in many activities, and the regulators are concerned about financial stability, they lack the motivation to imitate the merger and acquisition of international banks.

5.5.2 M&A performance

(I) Social benefits

Generally speaking, international banks consider the outcome of M&A based on their own interests and pay less attention to social benefits. International banking capital's pursuit of profits and greed, once the monopoly or oligopoly forms through bank M&A, will harm the role of the free competition mechanism in the market, and increase the accumulation of risks, making it more difficult for regulation. Therefore, each round of international bank M&A ended with a worldwide or regional economic crisis. However, Chinese commercial banks are more likely to merge for the purpose of preventing risks and keeping financial stability as the primary goal, and the social benefits are often better than international banks. In the course of development, Chinese commercial banks have inevitably accumulated some risks, which include systemic risks as well as operational

risks of individual financial institutions.

In order to maintain the stability of the domestic financial system and prevent the domino effect caused by the failure of individual institutions, M&A are usually used to rescue banks on the verge of bankruptcy or other risks.

(2) Economic benefits

From the cases of Chinese and foreign banking M&A summarized above, it can be seen that the economic benefits generated by mergers and acquisitions are positive no matter they are international banks or Chinese banks, local M&A or cross-border M&A. This is mainly because bank M&A has attracted much attention. Both sides of M&A need to be cautious from intention and assessment to M&A and integration.

CHAPTER 6

M&A SYNERGY OF COMMERCIAL BANKS

This chapter analyzes the case of the merger between the Ping An Group and SDB, including a focus on the two sides and the implementation of the entire M&A process. The study is promoted, along with the main reason for the merger, acquisition, and reorganization, and an analysis of merger synergies between the two sides.

6.1 Background analysis of both parties

6.1.1 Overview of both parties

(1) Ping An of China

Ping An of China Insurance (Group) Co., Ltd. (hereinafter referred to as “Ping An”) has its headquarters in China’s first special economic zone of Shenzhen and was founded in 1988. Ping An’s founding was the birth of new China’s first joint-stock system insurance enterprise. After 30 years of unremitting efforts by a peaceful people’s struggles, Ping An has become a blended collection of financial insurance, banking, investment, and other services—a comprehensive financial services group.

Ping An shares have been listed and traded simultaneously as Shanghai A shares and Hong Kong H shares. After gradual continuous development, Ping An formed three major business areas, namely, Ping An Life Insurance and Ping An Property Insurance, a banking business represented by Ping An Bank, and an investment business represented by Ping An Assets and Ping An Trust. Ping An has gradually become a leading domestic and internationally well-known group financial company. According to its disclosed 2014 annual report, the company’s total assets exceed 4 trillion yuan, the average annual premium income is close to 400 billion yuan, and the annual profit is close to 40 billion

yuan. Ping An's current business companies and business divisions are listed in Table 6-1.

Table 6-1: Business composition of Ping An Group of China

Scope of business	Subsidiary
Insurance	Ping An of China Life Insurance Co. Ltd.
	Ping An Property Insurance Company of China Ltd.
	Ping An Endowment Insurance Co. Ltd.
	Ping An Health Insurance Co. Ltd.
	Ping An Insurance Agent Co. Ltd.
Bank	Ping An Bank Co.
	Foden Investment Credit Guarantee Co. Ltd.
Investment	Ping An Asset Management Co. Ltd.
	Ping An Trust Co.
	Ping An Securities
	Ping An Futures Co. Ltd.
	Ping An of China Insurance Overseas (Holding) Co. Ltd.
	Ping An Dahua Fund Management Co. Ltd.

(2) Ping An Bank

Ping An Bank is the abbreviation for Ping An Bank Co., Ltd., a subsidiary of Ping An Bank of China. Its predecessor was Fujian Asian Bank.

1) Birth of Ping An Bank

In December 1999, Fujian Asian Bank, the predecessor of Ping An Bank, was established as a joint venture bank in response to the government's pilot foreign investment in the financial field.

On December 29, 2003, with the approval of the CBRC, Ping An China transferred all of the shares of its original shareholders through a cooperation with HSBC Hong Kong. According to the agreement, Ping An China and HSBC each hold half of the shares of Fujian Asian Bank. Ping An subsequently raised its stake to 73% through a series of capital injections into Fujian Asian Bank, which it renamed Ping An Bank in December 2004.

2) Further development after merger with Shenzhen Commercial Bank

Shenzhen Commercial Bank was founded in Shenzhen, the first special economic zone in mainland China. Shenzhen Commercial Bank was also the first city commercial bank approved by China. In 1998, it was renamed to its current name. In December 2006, with the formal approval of the CBRC, Ping An Insurance Group of China became the largest shareholder of Shenzhen Commercial Bank through a private placement. The registered capital of Shenzhen Commercial Bank increased to 5.502 billion yuan, 89.36% of which was held by Ping An Group. In 2007, the relevant departments approved the merger plan with Ping An Bank, a subsidiary of Ping An Group. After the merger, the name of the two banks was changed to Shenzhen Ping An Bank Co., Ltd. The registered capital of the new company was 5.5002 billion yuan, and its assets were more than 100 billion yuan. A year later, the name of the company was changed to Ping An Bank; Ping An Group held more than 90% of the shares of Ping An Bank and became its actual controller.

(2) Shenzhen Development Bank

Shenzhen Development Bank Co., Ltd. (hereinafter referred to as SDB) was founded in Shenzhen, the first special economic zone of China. Its original name was Shenzhen United Credit Bank, which was formed after the integration of more than 20 rural credit cooperatives in the Shenzhen special zone. After more than 20 years of rapid development, the bank's business scope covered the entire country, and its overall competitiveness has been improving. Through the rapid development of the special zone, in 1991, SDB was the first bank in China to be listed with A shares, and the bank successfully used stock to finance the first social capital for its development.

SDB is the first commercial bank to be listed in China and has gained significant development advantages by virtue of the advantageous location of the Shenzhen special zone. At the beginning of its establishment, the bank set up more than 300 branches in 22 major cities in China, and its main business basically covers the entire country. However, given the weak economic development and rapid growth in the early stage of its establishment, SDB gradually fell into a situation of a soaring nonperforming loan ratio and unsatisfactory operating data, and its operating situation ranked last among listed commercial banks.

After many enterprise management problems, to completely eradicate these problems and simultaneously increase its comprehensive strength and excellent management methods, SDB began to learn from the west at the beginning of 2004. SDB and Newbridge Investment Group (Newbridge Asia AIVIII L.P.) in the United States engaged in a strategic cooperation, and the bank became the first onsite foreign commercial bank. As the largest shareholder, Newbridge Capital preliminarily determined a cooperation term of 5 years, and a foreign party took over the four original shareholders of the company at a cost of 1.234 billion yuan. After the completion of the acquisition, Xinqiao Group held nearly 20% of the bank's shares and became the actual holding unit of SDB.

Through the 5-year cooperation with Newbridge Capital, SDB learned excellent western management methods and made significant progress in the development of the banking business, corporate governance, business R&D, risk control, and other aspects. By the end of February 2008, SDB had 474.44 billion yuan of assets, 14.513 billion yuan of revenues, and 0.68% of nonperforming loans.

6.1.2 M&A process

The acquisition of SDB by Ping An of China began in June 2009, when the “share subscription agreement” was concluded. The entire process was implemented over more than 2 years, and its scale ranks as first among the M&A activities of listed companies in China. From the perspective of the entire M&A process, the process can be divided into three stages.

(1) Stage 1: Ping An of China became the largest shareholder of Shenzhen Development Bank

After 5 years of the strategic cooperation with SDB, Newbridge Capital exited from the arrangement and transferred its shares to SDB, which, then, signed an agreement with Ping An Group in June. The key terms of the share purchase agreement were that Ping An received the equivalent of 520 million shares of the bank in cash and that Newbridge Capital would receive 11.449 billion yuan worth of Ping An's directional issuance of 299 million H shares.

In May 2010, Newbridge Capital selected the auspicious 299 million H shares of this scheme and transferred to Ping An Group Holdings its 520 million shares in the bank. The transaction was completed, and Ping An Group held a 16.76% stake in SDB and became the bank's largest shareholder. Ping An then purchased 146 million shares for a combined 21.44% stake in SDB. The shareholding composition of SDB at this stage is shown in Table 6-2:

Table 6-2: Share composition of Shenzhen Development Bank in May 2010 (Unit: 100 million shares)

Name of shareholder	Number of shares	Shareholding ratio
Ping An Group	5.2	17%
Ping An life insurance	1.46	5%
other shareholders	24.39	78%

Data source: 2010 annual report of Shenzhen Development Bank.

(2) Second stage: Shenzhen Development Bank issued additional shares to Ping An Life Insurance

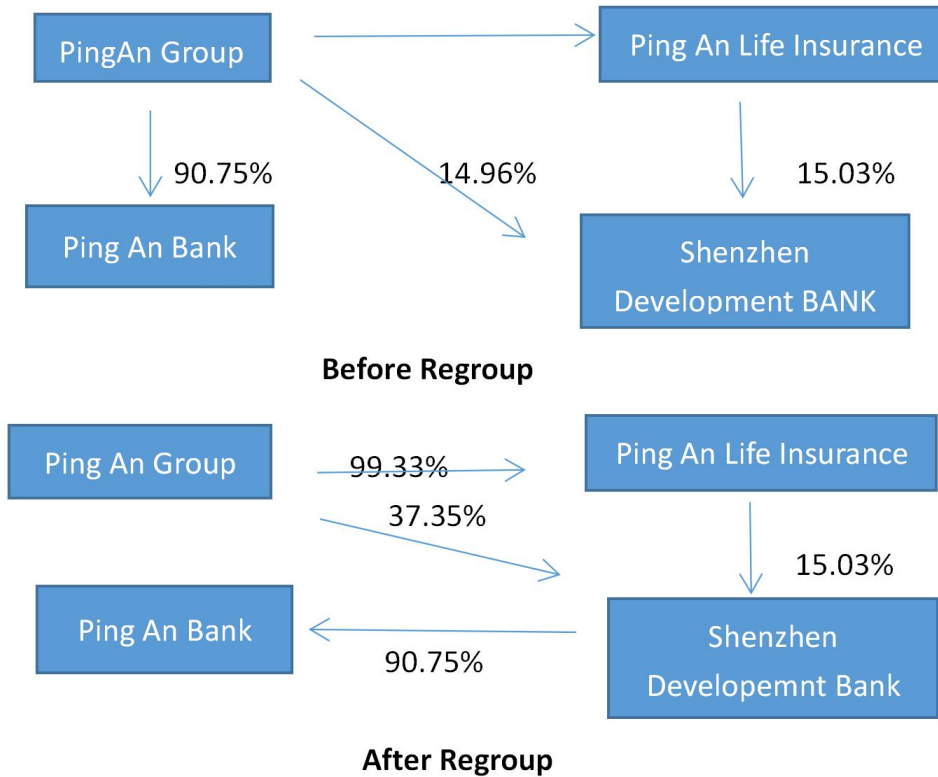
During the second stage of the acquisition, SDB issued 379 million of its shares in the takeover, taking its total shares to more than 500 million, with group holdings of 520 million shares. Ping An's H shares accounted for a high percentage of the 1 billion total shares outstanding, providing Ping An a further ownership advantage.

(3) Third stage: Ping An of China further increased its shareholding ratio and became deeply integrated with Shenzhen Development Bank

The third stage of this M&A transaction was the deep integration stage of both parties. During this stage, Ping An Group acquired 1.639 billion shares of SDB in a private placement at a cost of more than 29.1 billion yuan, including 2.692 billion yuan in cash and 90% in original Ping An Bank shares. After the initial integration between the two parties was completed in July 2011, Ping An Bank became a subsidiary controlled by SDB, whereas Ping An Group became its controlling parent company with a controlling proportion of more than half the shares.

After the completion of the integration of the two parties, each party held a general meeting of shareholders and passed relevant resolutions at these respective meetings. They decided that the original Ping An Bank should merge with SDB, cancel the original name, and change the name of SDB to Ping An Bank. As of date, the acquisition of Ping An Bank and SDB has been completed. Through the acquisition of SDB, Ping An Group has injected new energy into the development of its entire financial empire, which has provided the possibility of complementary advantages and the coordinated development of Ping An Group and SDB. Figure 6.1 illustrates the cross-shareholding situation

between Ping An and SDB.



Data source: Ping An of China annual report

Figure 6-1: Cross-shareholdings of related companies before and after M&A activity

6.2 Analysis of the motivation of Ping An’s acquisition of Shenzhen Development Bank

The merger between Ping An and SDB was inevitably affected by many drivers, including national macro policies, the financial situation, and other external factors, such as the pursuit of high profits, the promotion of their respective development activities, and the management of internal market competition factors. Therefore, this article on the motivation for the merger between Ping An Group and SDB is divided into external and internal motivations.

6.2.1 External motivation analysis

External motivation is mainly the result of an enterprise's external environment, and included the following driving factors for this M&A transaction.

(1) Development of the overall economic situation

In late 2007, the international financial crisis triggered by the subprime mortgage crisis in the United States gradually spread, and many famous international financial institutions, such as Lehman Brothers, Merrill Lynch, and American International Group, suffered successive crises and filed for bankruptcy or were acquired. The international financial crisis also had a major effect on China's economic development. The country's government adopted a series of active fiscal and monetary policies; vigorously improved the structure of the overall economy; altered the economic growth pattern; as well as altering the economy as a whole to continue its developmental momentum—China's 2008 gross domestic product was 31.68 trillion yuan, up 9.6% from the prior year. During this process, the financial industry played an important role and had to manage a new stage of development.

(2) Support of national policies

In February 2008, China issued the “11th five-year plan for the development and reform of the financial industry,” jointly formulated by the People's Bank of China, the CBRC, the CSRC, and the CIRC. This plan clearly stated that the market-oriented reform of the financial industry should be promoted further and that a market-oriented financial innovation mechanism should be established. The reform of the financial enterprises is expected to be further deepened, the property rights system and ownership structure are expected to be improved, and the transformation of operating mechanisms is expected to be accelerated.

From the national financial industry perspective, the 11th five-year plan shows that the state holds a positive and supportive attitude for the market-oriented reform of the financial industry, mixed operations, and equity acquisitions. The state encourages qualified financial enterprises to carry out market-oriented reforms and develop comprehensive financial groups. The support from economic development and national policies created the external conditions and driving factors for the M&A activity between Ping An Group and SDB, and the external motivation for the M&A was formed.

6.2.2 Internal motivation analysis

Internal motivation refers to the main driving factors of the M&A process caused by both parties' factors. The main driving factors are as follows.

(1) Withdrawal of Xinqiao Capital after the five-year cooperation with Shenzhen Development Bank

In 2004, SDB successfully engaged an international strategic investor, Newbridge Investment Group from the United States, through a transfer of 348.1033 million state and legal person shares for an investment of 1.234 billion yuan. Newbridge became the first foreign capital and first large shareholder of a Chinese joint-stock commercial bank. The cooperation term was for 5 years, and after the completion of the acquisition, Xinqiao Group owned a 17.89% stake in SDB as the largest shareholder.

As a strategic investor, Newbridge Capital's motivation for cooperating with SDB was to obtain high returns on capital and not be involved in the bank's long-term development. Therefore, after terminating the cooperation with SDB, it was inevitable that Newbridge's stake would be taken over. Xinqiao received shares from the share transfer agreement with Ping An; for cash, Xinqiao received more than four times its

investment in net income—a total of more than 11.4 billion yuan. Thus, accepting the share swap program provided for higher profits. Xinqiao actively sought an exit, which objectively provided conditions for Ping An Group to enter, creating important internal motivation for the M&A transaction.

(2) Ping An Group’s need to build a comprehensive financial group

Ping An of China is a fully licensed and comprehensive financial enterprise. Its development goal is based on the three strategic businesses of insurance, banking, and investments, creating a comprehensive financial enterprise. During the early stage of development, a merger between Fujian Asia Bank and Shenzhen Commercial Bank eventually formed Ping An Bank, which had minimal influence and limited scope—a difficult situation for a stock listed bank. According to the annual reports of Ping An Bank and SDB, by the end of December 2008, their deposit balances were 106.8 billion yuan and 360.5 billion yuan respectively, which clearly shows the significant gap in strength between Ping An Bank and SDB.

For Ping An of China to have achieved the development goals of a “financial kingdom” must have been a breakthrough in the banking industry. Therefore, Ping An constantly sought mergers to enable it to influence large national commercial banks. After the acquisition of Guangdong Development Bank failed for policy reasons, Newbridge Capital was eager to exit SDB, which provided SDB with an important M&A opportunity.

(3) Shenzhen Development Bank’s need to enhance its strength

During the five-year strategic cooperation with Xinqiao Capital, SDB—through the introduction of international cash management experience and technology—significantly

improved its operations and development as evidenced in improvements in its main operating data. Among them, SDB's RMB deposit balance increased from 166.9 billion yuan at the end of 2004 to 360.5 billion yuan at the end of 2008. The outstanding balance of RMB loans increased from 126.1 billion yuan at the end of 2004 to 283.7 billion yuan at the end of 2008. The cost-income ratio declined from 46.80% at the end of 2004 to 35.99% at the end of 2008. In addition, core data such as the nonperforming loan ratio, the provision coverage rate, and the capital adequacy ratio also improved significantly.

However, if Xinqiao Capital withdrew, SDB needed to introduce new strategic investments and partners to realize its long-term development, further enhance its strength, and manage the increasingly fierce market competition. As early as August 2008, SDB Chairman and CEO Newman stated that SDB was a better investment target for Ping An than other banks, hence SDB's strong internal motivation to cooperate with Ping An of China in an M&A transaction.

This information indicates that among the internal motivations for this M&A deal, Xinqiao Capital, Ping An Group of China, and SDB, all had strong motivations. Ping An Group hopes to expand its banking business strength and develop a comprehensive financial enterprise through the acquisition of SDB. In contrast, SDB hopes to enhance its strength and achieve long-term development by introducing new strategic investments. This M&A deal was executed under the common hope of the three parties for joint promotion and is expected to achieve a win-win-win result.

6.3 Analysis of synergy effects of M&A activity

The acquisition of SDB by Ping An of China started in June 2009 and ended in February 2012, when the two sides held a shareholders' meeting. The original Ping An

Bank was canceled, and SDB was renamed Ping An Bank Co., Ltd. This chapter adopts the view of Weston (1998) that M&A increases total value through management synergies, operating synergies, financial synergies, undervaluation effects, and information effects. Therefore, this paper—combined with the operating data of Ping An Bank of China for SDB nearly 7 years after its merger—studies the synergy effects from the three dimensions of management, operations, and finance. The main data used in this chapter, including publicly disclosed data on the former SDB from 2008 to 2011 and those of the renamed Ping An Bank from 2012 to 2014 are used as the basis for the analysis and research.

6.3.2 Management synergy analysis

Regarding actual enterprise M&A activity, both parties to a transaction have different management levels and abilities. One party must be better than the other party, which fuels M&A transactions. The new enterprise's management level and ability are expected to be subject to, and stronger than, the sum of, the two parties—the embodiment of management synergies. The main reason for management synergies is that after the transaction, the operation and management resources of both parties have been optimized, and the enterprise's organizational structure has been optimized and integrated. The post-transaction enterprise is expected to be influenced by the party with the strong management ability before the transaction, and the management ability exhibited is expected to be greater than the sum of the management abilities of each enterprise before the transaction. This paper adopts the perspective of the management synergies between Ping An and SDB and analyzes the transfer of management ability, the improvement of operational ability, and the reduction of management expenses.

1. Transfer of management ability

After the transaction, both parties' management abilities are transferred to the new enterprise. Generally, management ability is transferred from efficient managers to inefficient managers to improve the management efficiency of inefficient managers and to ensure the ultimate realization of the objectives of the merger. After the merger, Ping An took the first step to replace the original leadership and achieve initial control. In May 2010, four SDB directors resigned from their current positions and became directors of the new entity. The original chairman also resigned as chairman and director. The annual general meeting of shareholders was held in 2009, and relevant motions were proposed to appoint seven senior Ping An executives as executive directors and nonexecutive directors of SDB. Since then, Ping An has appointed five senior executives as vice presidents of SDB. In September 2012, Li Nanqing took over the post of Secretary to the President. Since then, only one senior executive of SDB was employed—Hu Yuefei, Vice President in charge of business—and Ping An took over the entire company.

The foundational management of the new entity was laid through the following activities: the exchange and integration of the SDB management team with the peaceful takeover of SDB; the implementation of the management concept; the unification of the management goal; the simultaneous integration of Ping An of China's original concepts and ideas into SDB; and the shift in management ability for subsequent upward development.

2. Improvement in operational capacity

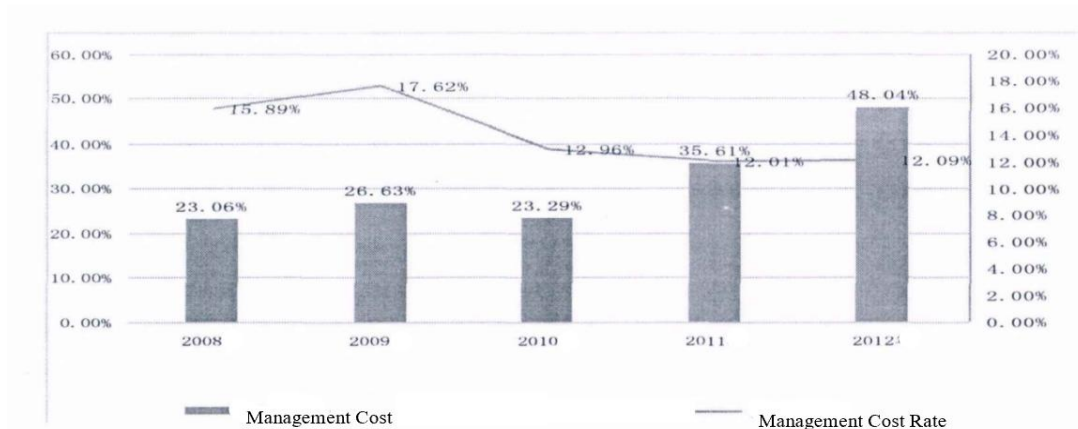
The improvement in management synergies is also reflected in the improvement in the operational capacity of SDB after the transaction. The acquisition of SDB enabled

Ping An to combine two financial institutions with highly internationalized management concepts, shares, and learned management experience. The acquisition also further expands the management advantages to improve the management level of the newly established enterprise and comprehensively improve its operations.

As one of the world's top 500 enterprises that started with insurance, Ping An of China emphasizes the pursuit of maximizing enterprise value by focusing on "competition" and "execution ability." Ping An's internal management is strict, and the execution efficiency of its employees is generally high. Although SDB had a strategic cooperation with Xinqiao Capital and had introduced advanced western management experience and management models, its employees had less internal working pressure and weak initiative. After Ping An of China acquired SDB, it introduced a new work information system that put forward specific requirements on employees' work execution, stimulated improvements in SDB's employees' execution ability, and promoted improvements in the company's operations.

3. Reduction of administrative expenses

The realization of the operational synergies between Ping An and SDB is also reflected in the key data on SDB's business expense reductions. After the acquisition of SDB by Ping An of China, the bank's management changed, and advanced management concepts and a work information system were introduced, which led to transfers in management ability and improvements in both parties' operational ability. Moreover, SDB's management fee rate declined significantly.



Data source: 2008–2012 annual reports of Shenzhen Development Bank and Ping An Bank

Figure 6-2: Management expenses and management expenses ratio of Shenzhen Development Bank from August 2008 to 2012 (Unit: 100 million yuan)

Figure 6-2 indicates that since 2009, the management costs of SDB and Ping An of China increased because of the transaction. After 2010, because the SDB management rate gradually declined, this fee was maintained at 12%, significantly lower than the fee before the transaction by 3%–4%.

The acquisition of SDB by Ping An is observed to have brought advanced management experience and a capable management team, improved SDB’s management ability and efficiency, and initially revealed the management synergies of the combined entity.

6.3.3 Management synergy analysis

Operating synergies mainly refer to the improvements in operating efficiency and earnings that are generated by a merger between two parties. M&A activities between enterprises occur frequently because the parties intend to enhance their strengths through such transactions and expand their business scope to gain a dominant position in the

market. The parties also intend to reduce costs through economies of scope to generate significant profits. Through this process, because an enterprise's M&A activities are expected to expand the scope of the market, production costs are expected to be diluted. At the same time, the enterprise can also focus on a product, reduce the production time and energy loss for a product, and achieve the purpose of professional production. The operating synergy effects of enterprise M&A transactions are expected to produce different effects in different types of M&A activities. At present, enterprise M&A activities are mainly divided into horizontal, vertical, and mixed mergers.

Horizontal M&A activity mainly refers to M&A transactions that occur with parties in the same industry, whereas vertical M&A activity is based on M&A transactions of parties that are upstream and downstream of the industrial chain. Mixed M&A activity refers to M&A transactions of enterprises that have no business or historical connection.

The case study in this paper shows that, given the main business between the two parties, both are in the financial industry. Ping An of China acquired SDB to rapidly expand its production scale and improve its economies of scale and market share. The operating synergies from the complementary advantages of both sides after the transaction improved the combined entity's overall competitiveness besides increasing profits, and aiding the implementation of economies of scope. The integration of customer resources and the influence from the following five aspects assisted in promoting the main analysis. They were as follows:

1. Enhance overall competitiveness

After a successful M&A transaction for both parties, Ping An of China generated more than 10 million interested customer groups. Therefore, the enterprise can integrate

other financial business resources within the group to sell relevant financial products to them and obtain greater economic benefits. In contrast, after the acquisition, SDB also has a significant customer resource dividend that is mainly embodied in Ping An of China, the domestic insurance industry giant. Over the years, Ping An accumulated good customer resources that, once used by Shenzhen Development Bank, generated a huge economic outlook. Ping An's 2009 annual report stated that the company had 51 million individual customers and more than 2 million corporate customers at the end of 2009 and that it brought a potential number of customer resources to SDB. After the M&A transaction, the two sides obviously formed complementary advantages, enhancing their mutual overall competitiveness.

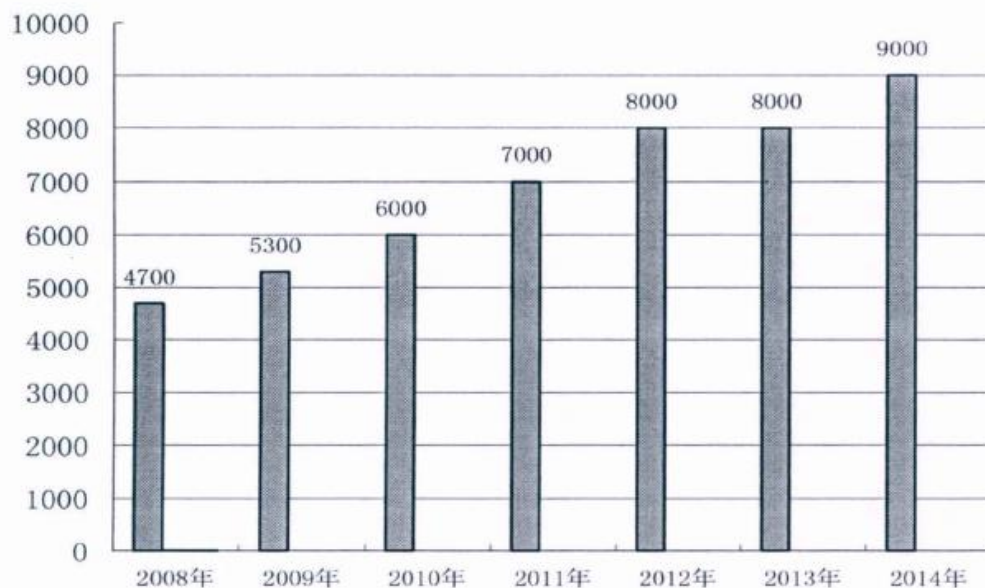
(1) Customer resources

In 2008, Ping An of China based its internal business development on the implementation of the business group's internal crossover concept of development by using its insurance, securities, trusts, banking, asset management, and many other business as the foundation. The development was based on the different circumstances and needs of clients, and groups recommended sales-related businesses to each other. For example, if customers purchase insurance products from the group, the company can further promote asset management services, investment and financial management services, and others to these customers in accordance with their asset management needs, maximizing the utilization of customer resources.

In 2011, after Ping An successfully acquired SDB, its 2011 annual report disclosed that post-acquisition cross-selling increased the significance of the advantages of both sides. In 2011, more than half of the revenues of the vehicle insurance business within the

group was generated through targeted telemarketing and door-to-door visits according to the needs of relevant customers. At the same time, for Ping An, more than 40% of the credit card sales of its banking business, more than 40% of its new deposits, and more than 60% of the new fund sales in its fund business were generated from mutual recommendations among the group's internal businesses.

By 2014, Ping An's cross-selling achieved more remarkable results. By establishing a comprehensive financial product view and customer big data analysis platform, Ping An Group dug into the potential needs of customers, developed an innovative comprehensive financial portfolio of products and services, promoted customer migration, and improved cross-selling. In the company's financial business, more than 7 million customer movements were realized in that year. Nearly 30% of the increase in users of Ping An Group during 2014 came from cross-selling. At the same time, attracted by the comprehensive financial services of Ping An Group, 1.2 million customers chose to utilize other financial services of the Group through online banking. During the entire year, the offline account manager of Ping An's life insurance group contributed 24.027 billion yuan of premium income and 159.771 billion yuan of client assets to the group from recommendations of the group's internal customer resources. Half of the vehicle insurance income, 40% of the issuance of Ping An Bank credit cards, and nearly 30% of new deposits to Ping An's property insurance also came from the sharing of customer resources within the company.

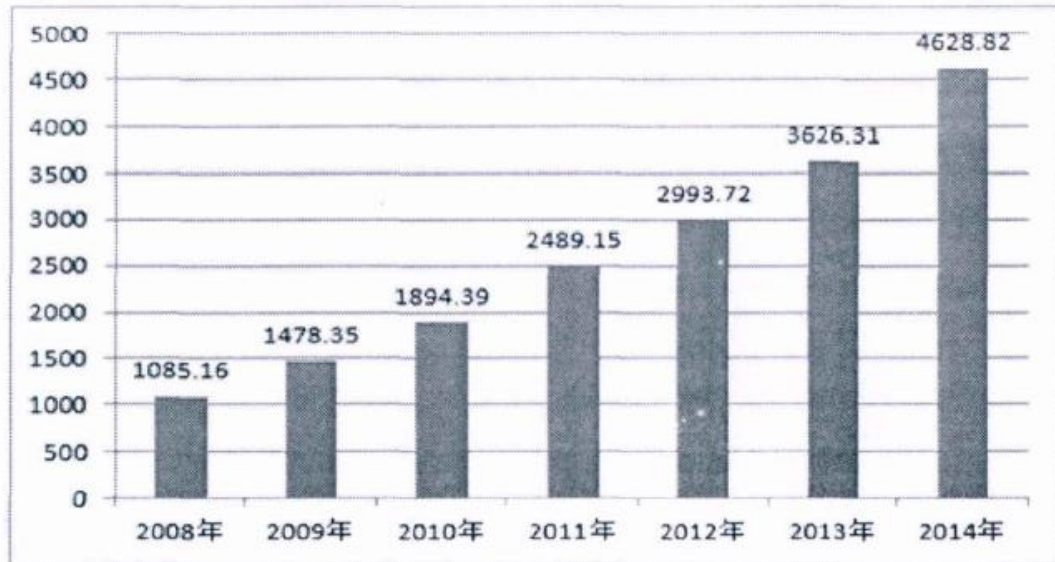


Data source: Annual report of Ping An of China

Figure 6-3: Change in the number of Ping An customers in China from 2008 to 2014 (unit: ten thousand)

Figure 6-3 shows that after the merger, Ping An Group added 30 million new individual and enterprise customers from 2010 to 2014 and that the number of customers grew faster than it did before the merger. Through this merger, Ping An Group won more customers and laid the foundation for capturing higher marketshares.

The successful realization of cross-selling within Ping An Group led to the emergence of synergy effects from the M&A transaction. From 2008 to 2014, the operating income of Ping An Group increased annually, indicating a steady development trend. For the specific situation, see Figure 6-4.



Data source: Annual report of Ping An of China

Figure 6-4: Operating revenue growth of Ping An Group from 2008 to 2014 (unit: 100 million yuan)

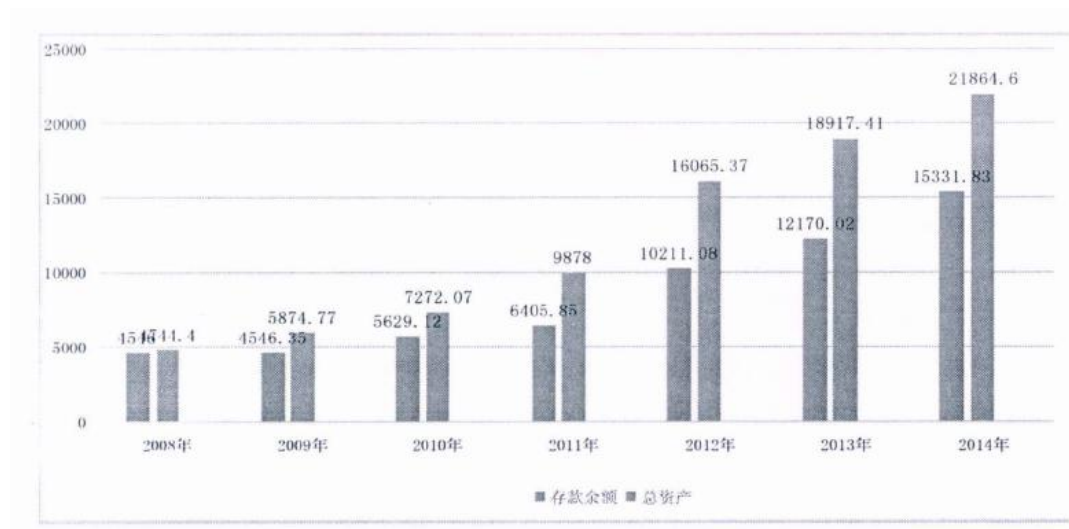
At the same time, SDB took advantage of the significant influence and brand advantage of Ping An Group. After the acquisition by Ping An Group, the total size of SDB increased significantly. SDB's total assets increased from 474.44 billion yuan at the end of 2008 to 2,186.46 billion yuan at the end of 2014, with an average annual growth rate of more than 29%. The deposit balance increased from 454.6 billion yuan at the end of 2008 to 1533.183 billion yuan at the end of 2014, for an average annual growth rate of 22.46%.

(2) Coverage and influence of Ping An's post-merger banking business are mainly reflected in the following aspects:

Before the merger, Ping An Bank had 60 branches nationwide in 2008, with the highest first-level branches in four cities, including Shanghai. In 2009, Ping An added another four first-level branches, bringing the number of first-level branches to eight. By

the end of 2009, Ping An Bank's actual business coverage was limited to Fujian and Guangdong, and it could be called a regional commercial bank. At the same time, the pace of development of SDB covered the entire country. In the 18 provinces, cities, and autonomous regions, a sub-branch was set up, bringing the number of outlets to more than 300. At this time, SDB could be said to be a commercial bank with national influence.

After completing the merger, Ping An Group and SDB complemented each other in nationwide influence as a radiating force, smoothed the bank business to extend to all parts of the country. By the end of 2014, the new Ping An Bank's business scope, which arose from its original business scope, expanded into 43 major cities, regions, and provinces across the country and through more than 700 networks—all of which are based on the effective integration of the resources of both parties. In a short period and through integration, Ping An Bank increased its business coverage, revenues, profits, and influence and became a national commercial bank in the industry of the new rich. The growth in the business of both parties after the merger can be observed in Figure 7-5, which illustrates the increase in the deposit balances.



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

Figure 6-5: Deposit balance and total assets of Shenzhen Development Bank from 2008 to 2014 (unit: 100 million yuan)

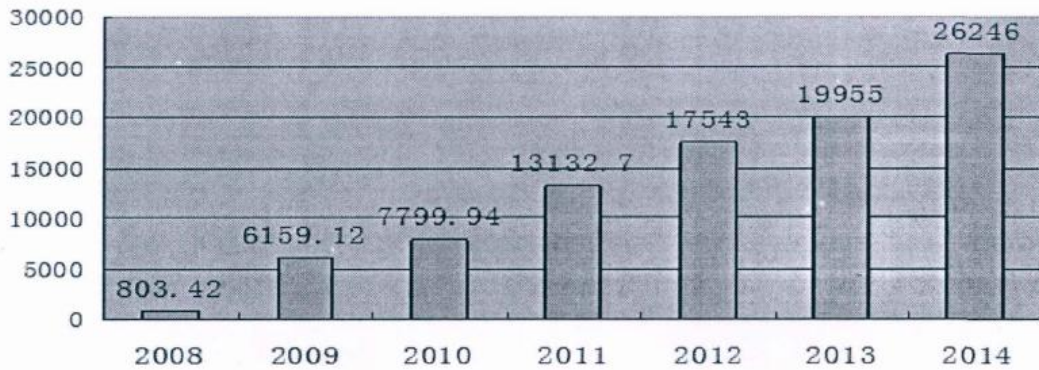
This analysis shows that through Ping An Group’s merger with SDB, both parties engaged in a cross-selling business initiative and realized complementary advantages and that Ping An introduced customer flow and cash flow to SDB, whereas SDB brought banking coverage and influence to Ping An. Through M&A market internalization, both sides are expected to significantly reduce the risk of market uncertainty and simultaneously engage in market trade integration for the enterprise’s internal trade. In addition, transaction costs for both sides were reduced and management synergies were realized, which significantly assists in promoting overall competitiveness.

2. Improvement in corporate profits

During the merger of Ping An and SDB, given the increase in their respective assets after the merger and integration, the corresponding profit assets and monopoly power over the market also increased, which improved their market competitiveness. Now, after the completion of the merger between Ping An and SDB, the direction of Ping An’s existing investment fund is expected to be more internally oriented, particularly because of the fund’s abundance. Now, after the merger, the enterprise’s internal yield is high, and the realization of its strategic target of being a “financial empire” has created a solid foundation.

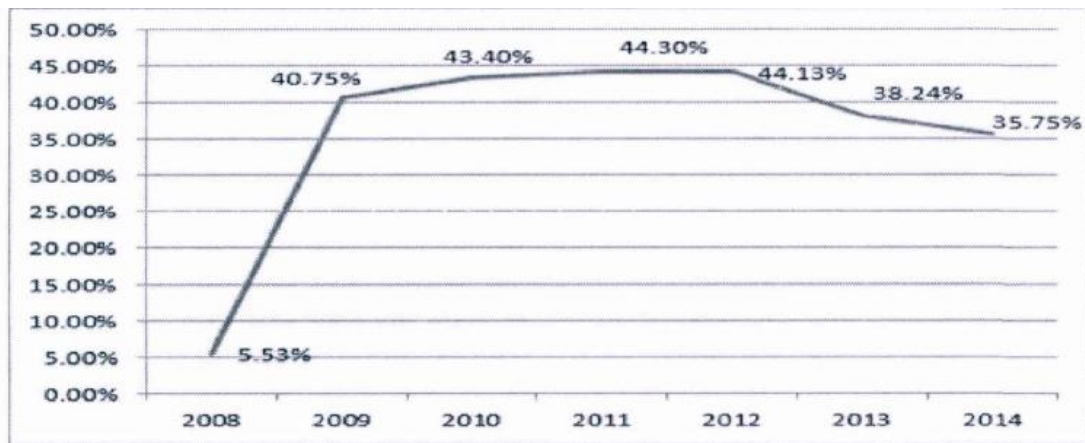
In contrast, the involvement of the mass media and propaganda with the merger between Ping An and SDB created free media publicity and better market impact and significantly enhanced the credibility of both parties. Simultaneously, the management

and business advantages and disadvantages of Ping An and SDB have not been the same. After the merger, Ping An and SDB have been able to implement complementary advantages and enhance the overall enterprise's operating efficiency. In addition, the business operating costs of both parties have reduced and the enterprise's profit margins have improved.



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

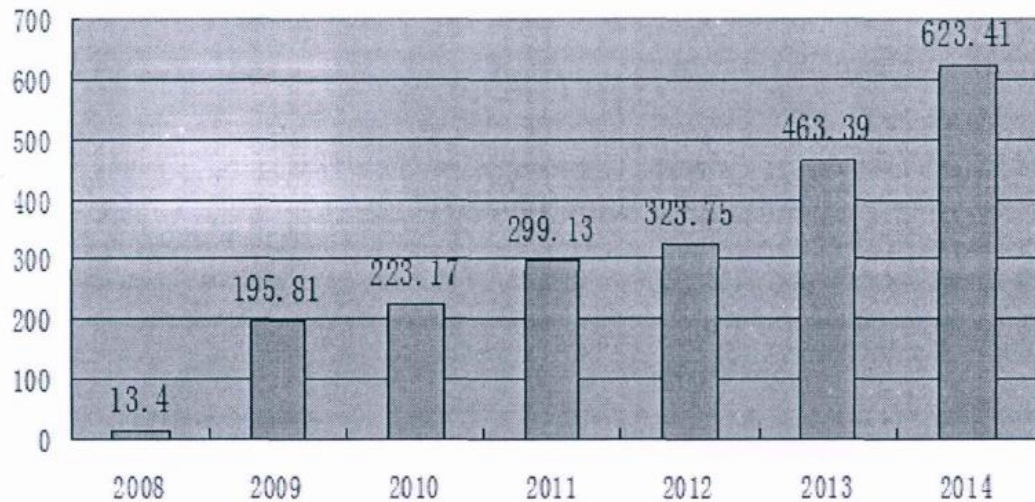
Figure 6-6: Change in operating profit of Shenzhen Development Bank from 2008 to 2014 (unit: million yuan)



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

Figure 6-7: Change in operating profit margin of Shenzhen Development Bank from 2008 to 2014

Figures 6-6 and 6-7 show that from the fourth quarter of 2008, the cancelation of SDB’s one-time large credit provisions after verification caused net profits to decline to only 803 million yuan. In 2009, SDB’s and Ping An’s injection and credit provisions declined sharply from the prior year to normal levels; annual operating profits grew to 6.159 billion yuan and eventually to 26.246 billion yuan in 2014. Local banks’ operating profits of less than 1 billion yuan grew into the billions for large commercial banks. What is more, the enterprise’s operating profit margin also increased from approximately 5% in 2008 to approximately 40% in 2009. However, after 2013, because of the external expansion of the new Ping An Bank and other factors, operating profit margins declined but remained steady at the 35%–40% level. SDB’s profits significantly improved owing to the operation synergy effect after the merger.



Data source: Annual Report of Ping An of China

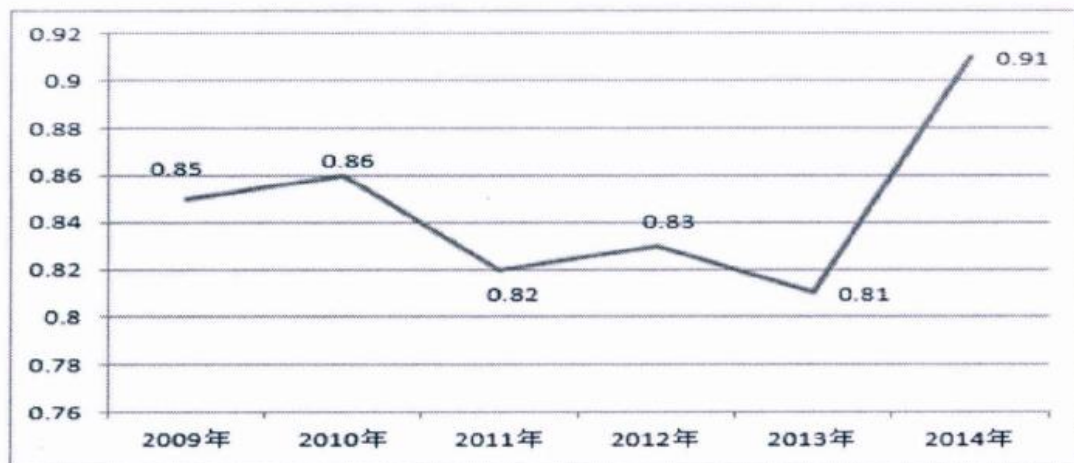
Figure 6-8: Change in operating profits of Ping An from 2008 to 2014 (unit: 100 million yuan)

Figure 6-8 shows that after the acquisition of SDB and its successful transformation into Ping An Bank, Ping An Bank’s operating profits maintained continuous and accelerating growth, from 1.34 billion yuan in 2008 to 62.341 billion yuan in 2014. The

enhanced business strength of Ping An Bank after this merger promoted the realization of financial synergies between the two parties, and Ping An's profits increased significantly.

3. Realization of economies of scope

Economies of scope refer to the economic benefits of expanding the scope of production rather than simply expanding the scale of production. In other words, when an enterprise produces more than two types of products, and the total cost of each product is lower than the original sum, total profits increase—typically referred to as economies of scope. Generally, any enterprise that produces more products and reduces costs realizes benefits and improvements, which are the embodiment of economies of scope. This section studies the scope of the economic situation of both parties resulting from the operating synergies from the acquisition of SDB by Ping An Group in terms of return on assets, asset expense ratio, and other indicators.



Data source: 2009 Shenzhen Development Bank and 2010–2014 Ping An Bank annual report

Figure 6-9: 2009–2014 return on assets of Shenzhen Development Bank



Data source: 2009 Shenzhen Development Bank and 2010–2014 Ping An Bank annual report

Figure 6-10: 2009-2014 Shenzhen Development Bank's asset expense ratio

As Figure 6-9 shows, after the completion of the M&A transaction, SDB's return on assets showed an overall improvement trend. Although the return on assets declined with the expansion after the merger from 2011 to 2013, it remained higher than 0.8 and reached 0.91 in 2014—a significant increase.

At the same time, as Figure 6-10 shows, with the completion of the M&A transaction between the two parties, SDB's asset expense ratio gradually showed a downward trend, always maintaining a value around 1.1. Although the ratio increased briefly in 2014, it did not fall out of the reasonable range.

The analysis shows that as China's Ping An Bank realized its merger with SDB, both sales and profits improved continuously. Simultaneously, as the previous analysis shows, after the merger of Ping An and SDB, operating synergies improved, and SDB's return on assets also improved through the realization of economies of scale from the merger.

6.3.4 Analysis of financial synergies

With reference to the financial synergy effect, after the merger, relevant laws and regulations can reasonably be used to create a positive financial situation, not because

both parties after the merger improve their production and operating efficiency but rather because effective use of the regulations can lead to the implementation of lower taxes and financing costs for the enterprise.

Financial synergies can benefit the enterprise, particularly through the following aspects: capital expansion, relatively lower bankruptcy risk, improved solvency, and external borrowing ability of the enterprise; more sufficient and more reasonable time distribution of internal cash inflows; more profitable investment opportunities through internal capital flows; and reasonable tax avoidance and increasing profits.

1. Enhanced solvency and reduced bankruptcy risk for SDB

After the acquisition by Ping An Group, a number of SDB's financial indicators have been significantly improved, its solvency has been significantly enhanced, and its bankruptcy risk has been reduced. This paper mainly selected the capital adequacy ratio, liquidity ratio, and deposit and loan ratio to analyze these indicators.

Before the merger, at the end of 2008, SDB's capital adequacy ratio was 8.58%, and its core capital adequacy ratio was 5.27%. By the end of 2014, SDB's capital adequacy ratio was 11.75% and its core capital adequacy ratio was 9.28%, increasing by 3.17 and 4.01 percentage points, respectively.



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

Figure 6-11: Liquidity ratio of Shenzhen Development Bank from 2008 to 2014

Figure 6-11 shows that SDB's liquidity ratio was approximately 40% before integration. After integration, SDB's liquidity ratio since the end of 2008 increased to 41.50% and remained in the region of 50% for a long period, primarily a result of conforming to the CBRC's rules. SDB's liquidity risk controls its ability to grow, as well as its debt-paying ability, which increased accordingly.

Table 6-3: Deposit and loan ratio of SDB from 2008 to 2014

	2008年	2009年	2010年	2011年	2012年	2013年	2014年
存贷款比率 (%)	78.85	79.14	72.61	73.49	70.64	69.67	65.39

Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

Table 6-3 shows that before the merger with Ping An Group in 2008, SDB's deposit and loan ratio was high—at 78.85 for the discount deposit and loan ratio—the maximum limit for commercial banks. After the merger and integration with Ping An Group, the ratio gradually decreased to 65.39% at the end of 2014. SDB's deposit reserve gradually increased, its ability to deal with a crisis improved, its solvency also improved, and its bankruptcy risk was significantly reduced.

2. Improved and more reasonably distributed cash flows of both parties

From the perspective of cash liquidity, both Ping An Group and SDB improved significantly and with more reasonable distribution.

(1) From the perspective of China's security

According to annual reports before Ping An's acquisition, Ping An's total assets were 704.564 billion yuan in 2008. The annual cash inflow from operating activities was 152.796 billion yuan, 82.2796 billion yuan of which was received from original insurance contract premiums. The net increase in the insurance deposit and investment fund was 23.712 billion yuan, totaling 112.055 billion yuan or 73.33% of the fund. In 2009, Ping An's assets totaled 935.712 billion yuan, and its total operating income was 147.835 billion yuan, of which premium income earned was 100.383 billion yuan, or 67.90% of operating income. The annual cash inflow from operating activities was 239.040 billion yuan, of which the cash received from original insurance contract premiums was 113.093 billion yuan, and the net increase in the insurance deposit and investment fund was 42.308 billion yuan, totaling 155.401 billion yuan, or 65.01% of the fund. Before 2009, Ping An Group's business cash flow was obtained from the insurance business—a single source having weak risk prevention ability. Ping An Group urgently needed to expand its sources of cash flow and enrich the entire group's cash flow channel.

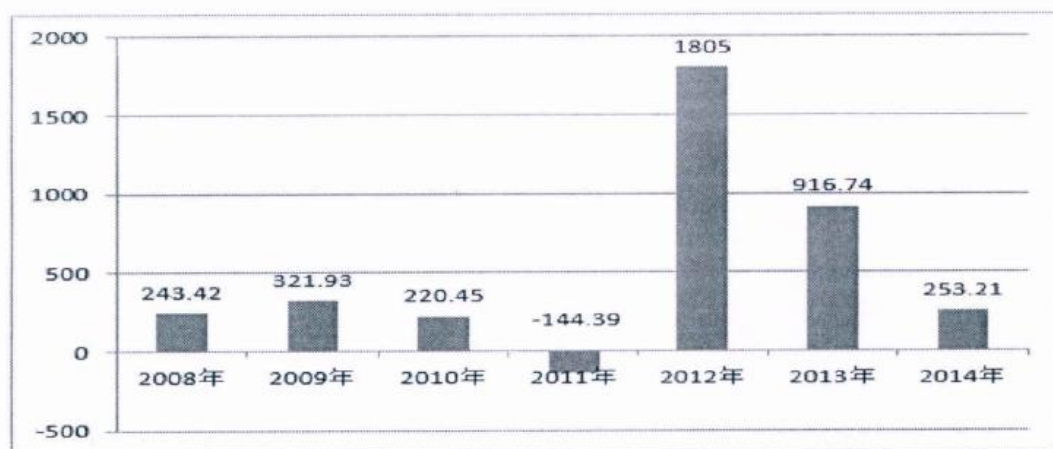
Table 6-4: Cash flow from operating activities of Ping An from 2008 to 2014 (unit: 100 million yuan)

	2008	2009	2010	2011	2012	2013	2014
Collect the cash obtained from the premium of the original insurance contract	883.43	1130.93	1587.77	2041.47	2310.45	2682.03	3280.12
Net increase in customer and interbank deposits	202.03	467.10	313.22	453.90	3489.28	2981.33	2473.92
Net increase of deposit and investment funds	237.12	423.08	446.74	360.29	338.03	317.58	209.85
Collect interest, commission and other cash	76.21	83.66	129.67	367.56	710.46	870.76	1187.17
Banking business, securities business net increase	86.41	181.72	94.04	1250.52	1871.09	229.11	-
Others	42.76	103.91	69.96	24.37	77.69	203.92	261.58
Cash inflow from operating activities	1527.96	2390.40	2641.40	4498.11	8797.00	7405.57	8352.23

Data source: Annual report of Ping An of China.

Table 6-4 shows that from 2008 to 2014, Ping An Group's cash inflow from operating was increasing, a reflection of its continuously improving operating capacity during the 7 years. In 2014, Ping An Group's cash inflow from operating activities was 835.223 billion yuan, while that in 2008 was 5.46. The cash received from the premiums of original insurance contracts was 32.812 billion yuan, and the net increase in the deposit and investment funds of insurance holders was 20.985 billion yuan, totaling 3.48997 billion yuan, or 41.78% of the cash inflow from operating activities. Customer and interbank deposits grew rapidly, reaching 247.392 billion yuan, or 12.24 times that in 2008—almost the same amount as the current premium of the original insurance contract and accounting for 29.62% of the cash inflow from operating activities. SDB's acquisition by Ping An Group increased the cash inflow from the banking business; reduced the proportion of the cash inflow from the insurance business; and diversified the original relatively single cash flow of Ping An.

(2) Shenzhen Development Bank



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

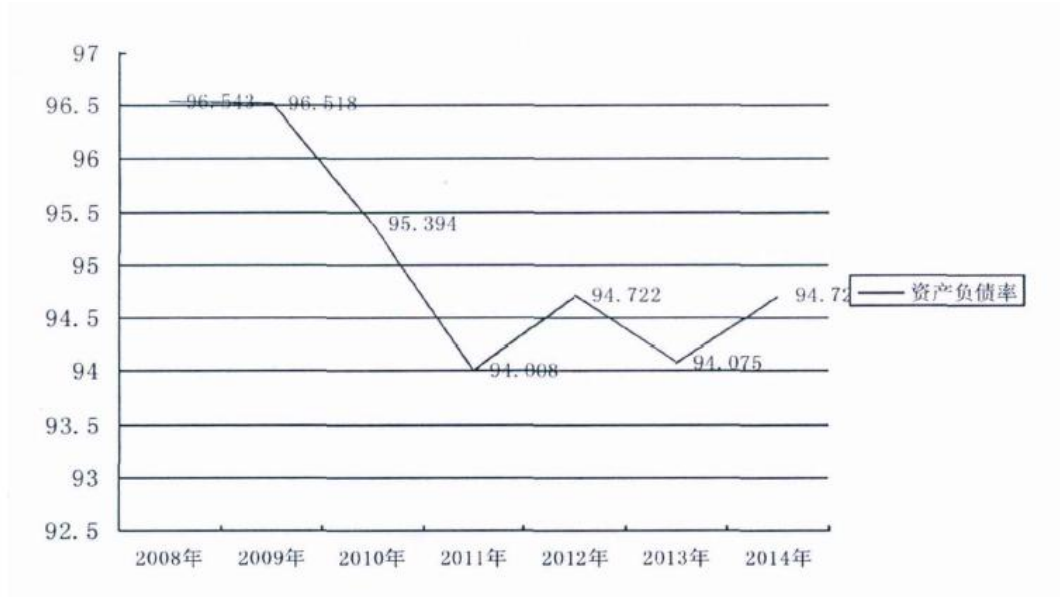
Figure 6-12: Cash flow from operating activities of Shenzhen Development Bank (unit: 100 million yuan)

After 2011, Ping An Group set up new Ping An Bank funding. Ping An Bank raised new H stock, which gradually stabilized Ping An Bank's cash flow and cash content, in addition to which operating income and operating cash inflows gradually increased to be higher than the banking industry average. Enterprises with sufficient funds can use these funds to make effective investments and simultaneously benefit from cash flow rights. The new Ping An Bank's business activities have more freedom to use their funds to conduct their business, further reducing their financial costs. After consolidation, the former Ping An Bank and SDB gradually accelerated development. In 2013, the newly established bank had sharply declining free cash flow, mainly because Ping An Bank's Xian, Suzhou, Linyi, Leshan, and Xiangyang branches, and 73 other branches, were allowed to open a branch at a cost of 45 million yuan. Therefore, during 2013, the new Ping An Bank's pace of expansion led to a reduction in cash flow, but the efforts laid a good foundation for the long-term development of the enterprise.

3. Realization of reasonable tax avoidance of Shenzhen Development Bank

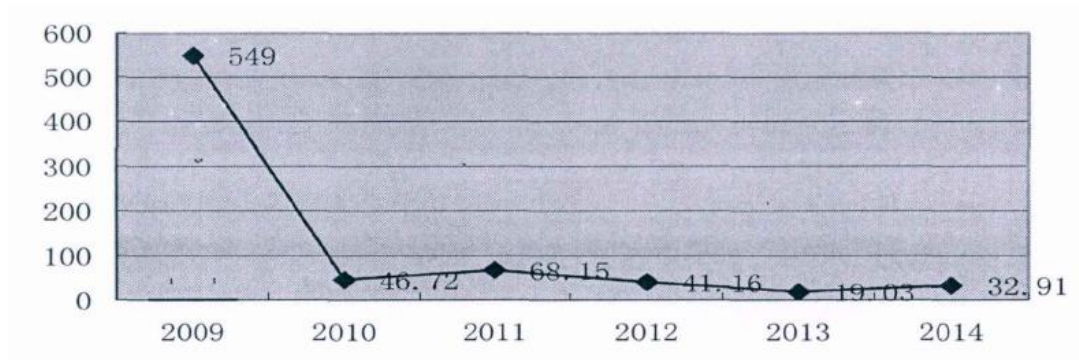
If an enterprise has a low debt ratio, it can reduce its taxes by increasing its debt. The banking industry has a high debt ratio. As Figure 6-13 shows, before SDB was acquired, its debt ratio reached 96.54%, which is high for the bank. However, in 2009, the asset-liability ratio started a declining trend. Particularly during the last 4 years, this SDB ratio has remained steady at approximately 94%, increasingly approaching the national banking industry's average. This phenomenon indicates that SDB's capital management achieved initial results, improved its capital strength, enhanced the enterprise's risk resistance ability, and laid a solid foundation for the long-term development of the

enterprise.



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

Figure 6-13: Asset-liability ratio of Shenzhen Development Bank from 2008 to 2014



Data source: 2008–2009 annual reports of Shenzhen Development Bank and 2010–2014 annual reports of Ping An Bank

Figure 6-14: Growth in income tax expense of Shenzhen Development Bank from 2008 to 2014

Figure 6-14 shows that SDB actively improved its tax structure as growth in income tax expenses declined and remained at approximately 30% in recent years. These figures indicate that after the takeover of SDB, Ping An Group's tax advantages were

continuously realized over time, along with the corresponding rights and corporate profits.

CHAPTER 7

M&A PERFORMANCE OF COMMERCIAL BANKS

This chapter uses China Merchants Bank's acquisition of Wing Lung Bank as an example to demonstrate the efficiency of commercial banks' M&A activities.

In this chapter, specific cases of M&A activity are selected for analysis and research to obtain relevant suggestions for Chinese commercial banks' M&A processes.

7.1 Background analysis of both parties

7.1.1 Relevant introduction to the acquirer

1. Introduction to the acquirer

China Merchants Bank (CMB), stock code (600036) and founded in 1987 in the Shenzhen special economic zone, is the first joint-stock commercial bank wholly owned by corporate legal persons in China and the first pilot bank to promote the reform of the banking industry outside the system. By the end of 2014, CMB achieved net profits of nearly 55.911 billion yuan, representing an increase of 8.06% from the prior year.

CMB continued to climb the list of China's top 500 banks and moved up four places in 2015 from the prior year. According to the 2014 annual report, CMB ranked 29th with revenues of 165.863 billion yuan—ranking it sixth among all domestic banks and second only to the five state-owned banks.

The Fortune 500 lists the most influential companies in the world. The list became an important indicator for world-renowned companies to judge their strength, size, and international competitiveness. China's top 500 list was launched in 2010 and covers Chinese companies listed in China and abroad. In 2015, the total revenue of the listed companies reached 30.4 trillion yuan, up 5% from 2014. Profits reached 2.7 trillion yuan,

up 6%.

Through continuous financial innovation, high-quality customer service, a stable business style, and good business performance, CMB has developed into one of the most influential commercial banks in China. CMB's 2014 annual report showed that the bank had total assets of 4.7 trillion yuan at the end of the year, up 17.8% from the beginning of the year. In 2015, CMB continued its high growth trend from the prior year. In the first quarter, CMB's operating revenue reached 50.74 billion yuan, for a year-on-year growth of 24.1%. The net profits of the entire industry was 17.22 billion yuan, up 15.2% from the prior year.

In a comprehensive rating by various authoritative institutions of banks, CMB has been among the best for many years, ranking first among joint-stock banks in China. In a 2015 list of the world's top 1,000 banks published by *Banker*, the British magazine, CMB jumped to 28th with tier 1 capital of \$49.351 billion. According to Kantar Millward Brown's 2014 BrandZ list of the most valuable Chinese brands, CMB ranked 14th with a brand value of \$6.785 billion. At the same time, CMB received global financial attention from *The Asian Banker* and other authoritative magazines, and institutions conferred CMB with accolades and appellations such as "best private banking and wealth management," the "best bank in China," "China's best retail bank," the "best small micro enterprise bank," and "the most popular with business elite banking services."

2. Introduction to the target bank

Wing Lung Bank, founded in 1933, is a well-known bank with a historical origin in Hong Kong. Wing Lung Bank is a Chinese endowment bank and has always been famous for providing comprehensive services to its customers, including a deposit and lending

business, an investment banking business, credit card services, online and mobile banking, syndicated loans, hire purchase loans, a remittance money transfer business, insurance agency, mandatory provident fund, and others. Wing Lung Bank has a glorious history of more than 80 years and operates 46 branches in Hong Kong, mainland China, Macao, and overseas. The bank employs more than 1,800 individuals. Wing Lung Bank became a member of CMB in 2008 and a wholly owned subsidiary in 2009.

7.1.2 The external environment for M&A

At the end of 2007, each large commercial bank sought an international path. At the same time, the subprime crisis affected the entire financial market and the global stock market. The international market was in a depression, the capital market situation became unpredictable, and collapses of banking giants caused the stock market to fall off a cliff. The international financial crisis also spread to the Family Bank of Hong Kong and the Wing Lung Bank, and the subprime crisis made Yonglong's business increasingly difficult. Wing Lung Bank had to sell its stakes in return for further development.

Although the international economic situation was uncertain, CMB simply wanted to develop a financial business in Hong Kong, China. Therefore, CMB had its eyes on Wing Lung Bank, a Hong Kong family bank with more than 80 years of history. Through M&A activities, CMB could enter the Hong Kong region to obtain substantial benefits.

7.1.3 Implementation process of M&A between the two banks

On May 14, 2008, CMB acquired 53.12% of Wing Lung Bank for HK\$19.3 billion, or approximately 17.2 billion yuan. CMB launched a general offer for the remaining Wing Lung shareholders at HK\$156.5 a share, or approximately 2.91 times Wing Lung's 2007 book value per share, according to bank takeover guidelines. Therefore, based on

the total equity valuation of Wing Lung Bank at HK\$36.338 billion, CMB needed to pay the remaining HK\$17.038 billion to complete the general offer.

The following table describes the entire process of CMB’s acquisition of Wing Lung Bank.

Table 7-1: Time steps for China Merchants Bank to acquire Wing Lung Bank

Time	M&A Events
May 30th	Basically determined to complete the acquisition of Wing Lung Bank for HK\$36.2 billion, CMB won
June 30th	The proposal to buy Wing Lung Bank passed with a high vote
September 5 th	The sale of 30 billion yuan of subordinated bonds was a key step in the acquisition of Wing Lung Bank
October 27	Acquisition was completed, Wing Lung Bank was suspended

7.1.4 Analysis of the significance of M&A activities

1. Strategic analysis

At the time, economic development entered a new normal, and an increasing number of banks seized current development opportunities to constantly expand the scope of their service businesses and provide quality services to attract more customers. When compared with growth through other methods, M&A activity can provide access to international capital markets and assist in developing a marketing network for the business. At the same time, M&A activity can prevent an enterprise from being the target of geography, laws and regulations, culture and language, and various other factors and can enable them to carry out services through local businesses, provide financial services, and market their financial products. Many famous commercial banks throughout the world simply choose this method of development to achieve breakthroughs in their businesses and to pursue new developments.

In contrast, from the perspective of the strategic layout, although Hong Kong and Shenzhen are only separated by a sea, CMB’s business service area was mainly mainland

China and rarely involved Hong Kong. In this sense, M&A activity was suitable for the development path of internationalization. Every commercial bank that wants to become bigger and stronger must take this mainstream path of internationalization. The strategic goal of development can be finally realized only by constantly expanding the development field and through the process of M&A activity and reorganization.

2. Analysis of the purpose of M&A activity

In the final analysis, the fundamental purpose of commercial banks' M&A activity is to obtain economic benefits. Therefore, during the implementation of an M&A transaction, it must be considered that the M&A objectives can conform to their own planning path. If the synchronization of domestic and overseas business development could be realized, it would lead to economies of scale, which was CMB's objective for acquiring Wing Lung Bank. Wing Lung Bank and CMB together could borrow Yonglong's group of customers to develop a broader scope of business and realize China's strategic target.

3. Analysis of the level of both parties

Despite its outstanding performance, CMB still has disadvantages, such as the following: (1) CMB has not fully realized the development strategy of globalization and still has low awareness of international financial and accounting standards. (2) CMB's business in Hong Kong is still not comprehensive, and few opportunities exist to enter Hong Kong, making it difficult to attract local capital to enter Hong Kong; in particular, no corresponding branch exists to carry out customer service in Hong Kong. These disadvantages were dissolved after the acquisition of Wing Lung Bank by CMB. Wing Lung Bank could be successfully stationed in Hong Kong to carry out business, learn

from local banks, improve its management ability and personnel quality, and accelerate the transformation and innovation of banks' traditional businesses.

It is more significant that the market advantages of both parties could be brought into play accordingly. For CMB, its retail banking and private banking businesses could meet the needs of its customers. Through its M&A activities, CMB can not only serve mainland customers but also high-quality potential customers in Hong Kong.

Wing Lung Bank has nearly 80 years of operating history, and it has cultivated a large number of excellent financial practitioners that can provide greater convenience to CMB in terms of personnel training and quality improvement. By training the personnel of both parties, their common development can be promoted.

7.2 Evaluation process of M&A efficiency

When evaluating the efficiency of CMB during the early and late stages of M&A activity, the following two methods are selected in the hope of finding the influencing factors that affect the efficiency of CMB's acquisition of Wing Lung Bank in a more comprehensive manner. One method is financial index analysis, and the other method is DEA analysis.

The first method, namely, the financial index analysis method, is used to research and analyze the following process. First, find M&A activity that occurred a year before and after the transaction in question, and collect 3–5 years of financial data. Then, analyze these data from four different dimensions—profitability, solvency, asset security capability, and growth ability—using different concrete financial index analyses. The four dimensions are used at the same time to analyze the specific financial indicators in order to determine relevant conclusions. To ensure the comprehensiveness of the results of the

analysis, three nonfinancial indicators were added, namely, indicators of strategic objectives, indicators of operations and management, and indicators of marketshare. Through a comparative analysis of these indicators, the efficiency factors of M&A activities of commercial banks were determined.

The second method is to use DEA analysis to evaluate the M&A efficiency of commercial banks. Through an empirical analysis, various factors affecting the M&A parties are calculated; in particular, nonfinancial indicators are quantified to make them more convincing. In this paper, the DEA method is selected to evaluate the efficiency of CMB's acquisition of Wing Lung Bank.

7.2.1 Financial index analysis method

1. Profitability dimension analysis

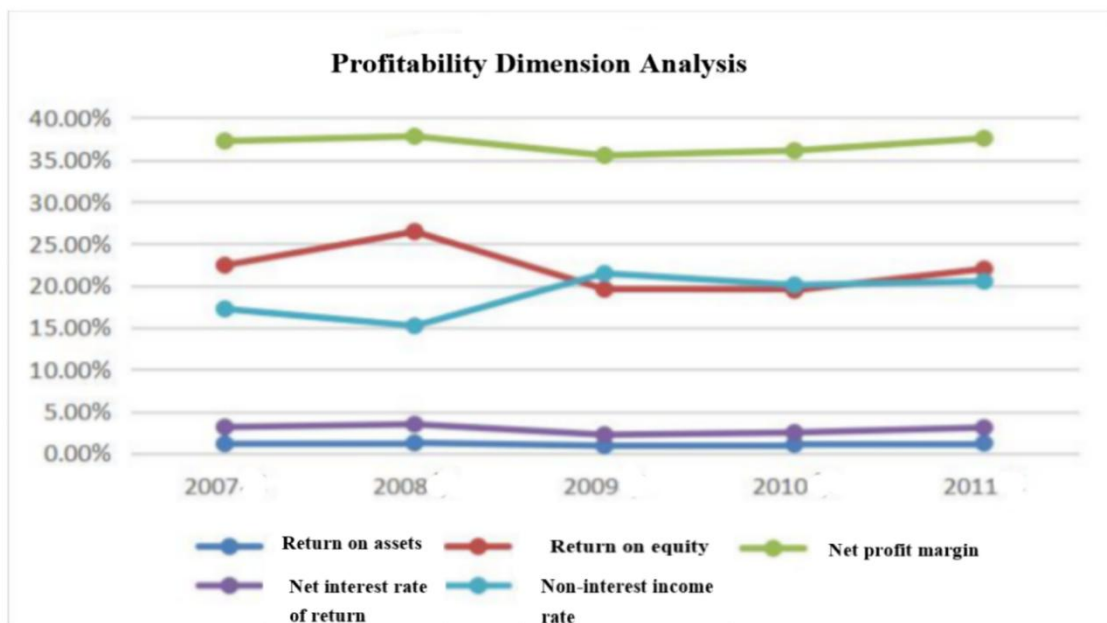


Figure 7-1: Profitability dimension analysis

Figure 7-1 clearly shows the trends in the changes in the four financial indicators in terms of profitability. Return on capital reflects commercial banks' profits using their

capital, which is an important indicator for the People's Bank of China to evaluate the economic benefits of commercial banks. A higher index indicates that the free capital of commercial banks can achieve higher economic benefits and that banks' risks will decrease accordingly. Especially the stock prices of commercial banks that have been listed have potential room to increase, which is important reference data for decision-making by both parties to the M&A transaction. The return on capital of CMB is approximately 19%–20%, which ranks among the highest of commercial banks.

Figure 8-1 also shows the overall trend in the CMB's development, which was positive except for the one blip, in 2009, a year that saw a significant downward trend. In particular, return on net assets declined by 2.77% and 6.6%, respectively, from the previous 2 years. Net profit margin declined for 2 years before the acquisition, by 1.78% and 2.43%, respectively, which caught our attention. This decline was mainly caused by the following reasons.

(1) CMB's implementation ensured a smooth handover of personnel and business units to avoid layoffs within a year and a half after the transaction through additional compensation and other tactics that increased the cost of the M&A process. Moreover, management fees increased by 40% year-on-year, which largely affected profits.

(2) The merger of Wing Lung Bank coincided with the international financial crisis, enabling the overall economic development during a recession to spread to the development of the commercial bank inevitably. However, the financial data after 2010 show that the impact of the financial crisis on travel did not last long; subsequently, financial indicators improved gradually.

(3) An analysis of financial statement data showed that the goodwill impairment

amount after the transaction was also deducted from net profits. Therefore, from this perspective, the impairment of goodwill resulting from the transaction affected CMB's net profits.

Then, from the perspective of profitability, CMB's performance is very satisfactory, especially in such an economic environment. CMB's financial performance shows that its acquisition of Wing Lung Bank created an opportunity for the bank to complete its transformation. Understandably, short-term net profits are subject to the corresponding fluctuations. A focus on the financial data from several years after the economic crisis shows that CMB's performance recovered gradually, which was also related to the business scope and customer resources of Wing Lung Bank.

2. Solvency dimension analysis

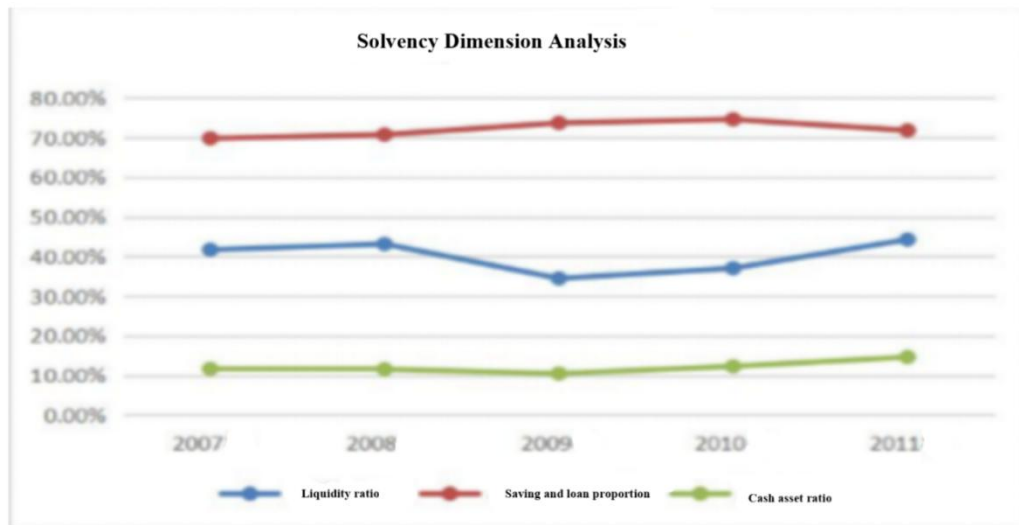


Figure 7-2: Solvency dimension analysis

From Figure 7-2, it can be concluded that from 2007 to 2011, when CMB acquired Wing Lung Bank, the liquidity ratio was always around 35%–45%. These data represent the liquidity capacity of commercial banks and that the higher the proportion the stronger

the capacity.

CMB's loan-to-deposit ratio is always around 65%–74% and the higher the figure the less liquid the bank's capital. The People's Bank of China issued a regulation that the ratio should not exceed 75% to maintain liquidity. The ratio of cash assets is maintained between 11% and 14.5% and indicates that the proportion of liquid assets is relatively large. To summarize, CMB has the corresponding solvency, and a comparison of the financial data between the early and the late stages of the M&A process shows that CMB's solvency after acquiring Wing Lung Bank has improved to some extent and that the capital maintained high liquidity as well.

3. Growth dimension analysis

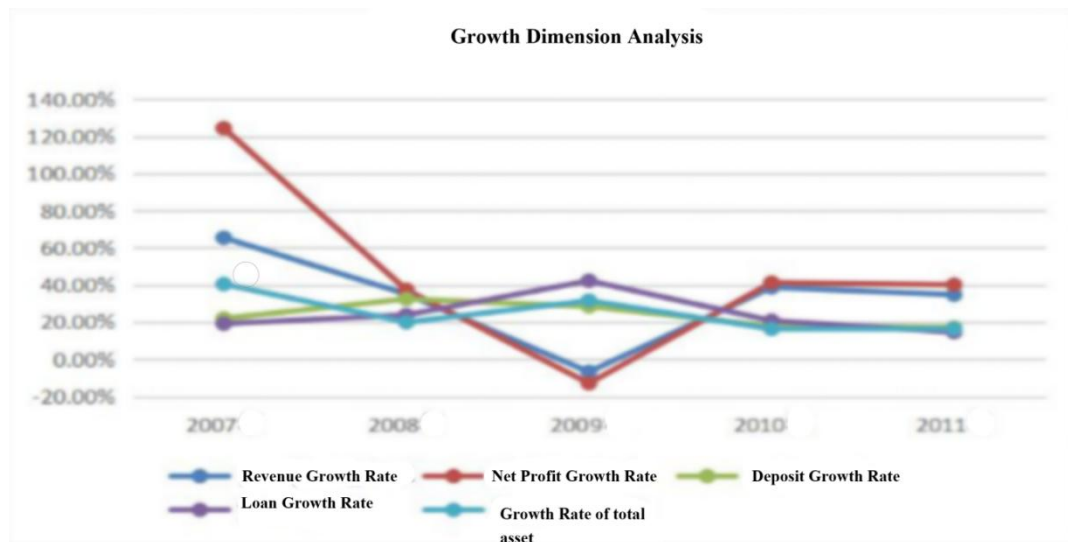


Figure 7-3: Growth dimension analysis

Figure 7-3 shows that in 2009, also the first year after the transaction, revenues and deposits increased, but net profits decreased at the same time. The growth rate also declined by 3.96%. Therefore, many people disputed the acquisition and believed that it was unsuccessful. However, what needs to be considered is that 2008 and 2009 experienced a global economic downturn and that the manufacturing industry—even the

third industry—declined significantly, resulting in a decline in the bank deposit growth rate. Because deposits are a commercial bank’s main source of income, the growth rates of operating income and net profits also decreased.

However, in the next period, a different degree of growth occurred, and a growth index with a solid basic ability to engage in travel is inseparable, even given the business after the merger. Expanding the scope of the business is significant, and after the acquisition of Wing Lung Bank, CMB's business transformed in a positive manner and pursued the path of international development. Investments were also made in R&D for new financial products to meet the needs of more customers. Therefore, we determine that CMB’s ability to develop improved after its acquisition of Wing Lung Bank.

4. Asset security dimension analysis

CMB’s financial statements from 2007 to 2011 showed that the bank’s capital adequacy ratio was always higher than the minimum required by CBRC, indicating that CMB had abundant basic capital and that it is capable of engaging in M&A activities. At the same time, CMB’s nonperforming loan ratio continuously declined after the merger. From 2007 to 2011, the nonperforming loan ratio decreased by 0.98%. Additional provisions for coverage from 2008 to 2011 increased by 176.84%, which is higher than that stipulated by the banking regulatory commission’s commercial bank regulations. This result indicates that M&A activity does not weaken the ability to resist risks but instead presents an increasingly stronger trend, suggesting that the scope of the financial risk is always under control, ensuring the continued healthy development of CMB after its acquisition of Wing Lung Bank.

7.2.2 Study of M&A efficiency based on DEA

DEA empirical analysis not only can evaluate the efficiency of commercial banks' M&A activities and determine the factors that affect such M&A activities but also can propose improvements to the efficiency of M&A activities according to the remaining variables.

By maintaining the empirical analysis method for the decision-making unit (DMU), the input and output values do not change. A mathematical programming model can evaluate using multiple input and output units of relative effectiveness, and then, based on DMU data observations, it can determine whether the DMU is DEA-efficient—that is, it can determine whether a DMU in May sets the production frontier. DEA is committed to the optimization of each individual bank rather than an overall statistical regression optimization of the banking industry. The specific process is shown in Figure 8-4.

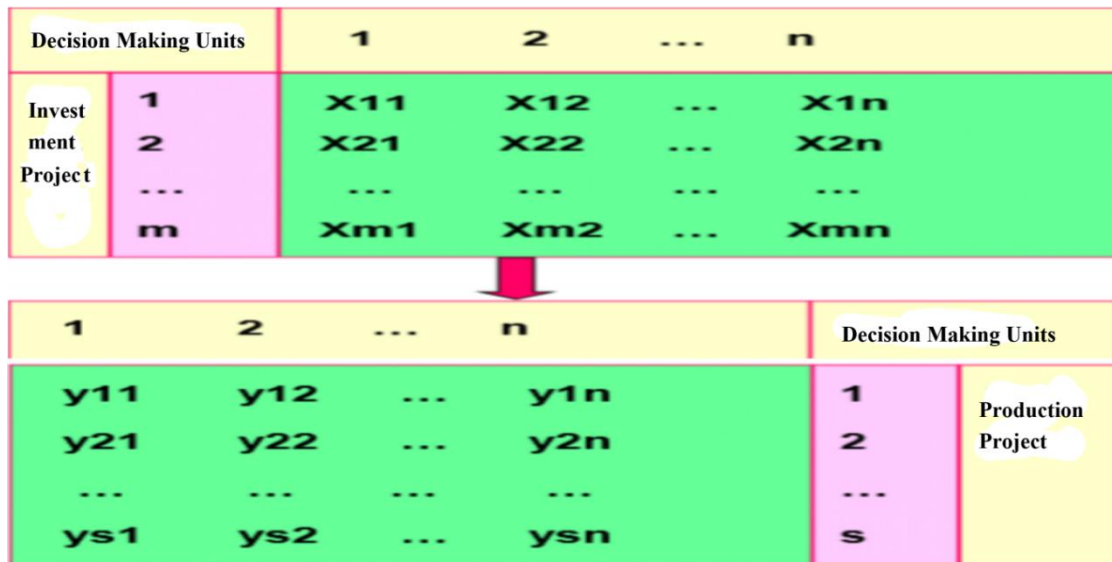


Figure 7-4: Specific process of DEA operation

DEA is a new quantitative statistical analysis method, which is widely used in the fields of economy and management, especially when dealing with multi-pole input and output, it is the pearl of statistical analysis method at the present stage. The concrete

manifestations are as follows : (1) DEA model is mainly applicable to the comprehensive evaluation of effectiveness of multi-input and multi-output, which is similar to the learning of AI neural network; (2) there is no need for standardized processing of data samples; (3) the optimal weight is obtained from the actual data of DMU terminal, which is non-subjective and objective; (4) DEA method is purely technical (mathematical) and has few interference terms. Because of the advantages of the DEA method, it is selected to evaluate and analyze the efficiency of CMB's acquisition of Wing Lung Bank. The DEA method mainly involves the following important steps:

1. Select appropriate indicators

The evaluation of the efficiency of CMB's acquisition of Wing Lung Bank starts with each subject's participation in business activities. General criteria and calculation methods are selected to calculate and analyze the financial and nonfinancial indicators of commercial banks to determine the efficiency of M&A deals during early and late stages.

To further study of M&A behavior and performance of M&A of Wing Lung Bank by China Merchants Bank, this paper adopts the event study method and combines the "Performance Evaluation Method of Financial Enterprises" issued by the Ministry of Finance in 2010 to analyze the case from four perspectives, namely, profitability, operational growth ability, asset quality and solvency.

In Article 9 of the "Performance Evaluation Method of Financial Enterprises", the performance evaluation indexes of the four types of financial enterprises are stipulated as follows:

- (1) Profitability indicators, including 6 indicators of capital profitability (ROE), assets profit margin (rate of return on total assets), profit margin, revenue, cost profit

margin, the weighted average return on net assets, mainly reflecting the financial business operation period of input and output level and earnings quality;

(2) Business growth indicators: including 3 indicators of (state-owned) capital preservation and appreciation rate, profit growth rate, economic profit rate, mainly reflecting the capital appreciation status and business growth level of financial enterprises;

(3) Asset quality indicators: including 10 indicators of the proportion of non-performing loan ratio, provision coverage, liquidity, leverage ratio, asset impairment provision to total assets ratio, current ratio, return on investment ratio, ratio of accounts receivable, net capital and net assets, net capital and risk ratios, mainly reflecting the financial enterprises occupy the use efficiency of economic resources, asset management and asset security;

(4) Solvency indicators: including 7 indicators of capital adequacy, tier 1 capital ratio, core tier one capital adequacy ratio, comprehensive solvency adequacy ratio and core solvency adequacy ratio, the net capital ratio, asset-liability ratio, mainly reflecting the financial enterprise debt burden level, solvency and the debt risk.

According to the above evaluation criteria, this paper will examine the M&A efficiency of Ping An and Shenzhen Development Bank from the above 4 aspects. The input and output indicators are shown in Table 7-2:

Table 7-2: Dimension indicators and specific measurement indicators

Profitability indicators	
Input indicator	Output indicator
Number of employees (X11)	Main business income (Y11)
Total assets (X12)	Net profit (Y12)
Amount of loanable funds (X13)	Return on total assets (Y13)

Table 7-2, continued	
Business growth indicator	
Input indicator	Profit growth rate (Y21)
Number of employees (X11)	Economic profit rate (Y22)
Total assets (X12)	
Asset quality indicators	
Input indicator	Net capital/net assets (Y31)
Number of employees (X11)	Non-performing loan ratio (Y32)
Total assets (X12)	Liquidity ratio (Y33)
Solvency indicators	
Input indicator	Capital adequacy ratio (Y41)
Number of employees (X11)	Asset-liability ratio (Y42)
Total assets (X12)	

Note: Average balance of net assets = (balance of owners' equity at the beginning of the year + balance of owners' equity at the end of the year)/2

Economic profit rate = (net profit-average balance of net assets × capital cost) / average balance of net assets × 100%

Capital adequacy ratio = net capital / on-balance sheet and off-balance sheet risk-weighted assets at the end of the period × 100%

2. Event Study

Event Study was initiated by Ball and Brown (1968) and Fama et al. (1969). Its principle is to select a specific Event according to the purpose of research and Study the changes of samples before and after the Event, which is initially applicable to the securities market and then extended to other fields. In the process of research, one must first determine what the research hypothesis is. After determining the hypothesis, the type of event, the date of the event, the estimated period and the calculation period of the event period shall be determined. The second step of the event method is to determine the event to be studied. The so-called "event day" refers to the actual date of the event, and of course, according to the development of the event study method, the event day also extends to the "event year" or "event interval".

Therefore, according to the relevant steps of the event study method and combined with the actual process of the merger of China Merchants Bank-Wing Long Bank, this paper determined that the year of the merger occurred, namely 2008, was the event year, and the event window was 2 years before 2008 and 5 years after 2008, namely, the event window was from 2006 to 2013. It should be noted in particular that the event window generally takes the event date as the central axis and selects the same time span before and after. However, due to the relatively large scale and relatively wide scope of bank mergers and acquisitions, there is not only the lag effect after mergers and acquisitions, but also the integration period in the early stage of mergers and acquisitions. Therefore, extending the time interval after merger and acquisition is helpful to examine the actual impact of M&A more objectively.

3. DEA calculation model

The X value represents the input value, and the Y value represents the output value; the calculation model is as follows:

$$\begin{aligned}
 \min \theta &= \theta_{vrs} \\
 \sum Y_j \lambda_j + S^- &= \theta X_0 \\
 \sum Y_j \lambda_j - S^+ &= Y_0 \\
 \sum \lambda_j &= 1 \\
 \lambda_j &\geq 0 \quad j = 1, 2, 3, \dots, n \\
 S^+ &\geq 0, S^- \geq 0
 \end{aligned} \tag{5.1}$$

$$\theta_{vrs} = \begin{cases} 1, & \text{the decision making unit is pure technical efficiency} \\ < 1, & \text{the decision making unit is ineffective} \end{cases}$$

$$\text{As a scale efficiency} \quad \text{When } \theta_s = \begin{cases} 1, & \text{scale is effective} \\ \neq 1, & \text{scale is ineffective} \end{cases}$$

$$\text{As a constraint, } \sum \lambda_j = \begin{cases} 1, & \text{unit scale returns unchanged} \\ < 1, & \text{unit scale returns increasing} \\ > 1, & \text{unit scale returns decreasing} \end{cases}$$

Figure 7-5: The derivation process of DEA

3. Calculation results and analysis of DEA model

To calculate the efficiency in the early and late stages of CMB's acquisition of Wing Lung Bank, the aforementioned, required input and output values from 2006 to 2013 were selected. DEA analysis software was used to calculate the results, which are provided in Table 7-3 and 7-4.

Table 7-3: Calculation results from DEA analysis software (profitability and operation capacity)

	Profitability			Operation capacity		
	Crste (Overall technical efficiency)	Vrste (Pure technical efficiency)	Scale (Scale efficiency)	Crste (Overall technical efficiency)	Vrste (Pure technical efficiency)	Scale (Scale efficiency)
2006 (Wing Lung Bank)	1	1	1	1	1	1
2007 (Wing Lung Bank)	1	1	1	0	0.811	0
2006 (China Merchants Bank)	1	1	1	1	1	1
2007 (China Merchants Bank)	1	1	1	1	1	1
2008	1	1	1	0.721	1	0.721
2009	0.768	0.984	0.791	0.421	0.591	0.763
2010	0.768	0.985	0.793	0.265	0.396	0.841
2011	0.891	0.991	0.895	0.882	0.977	0.991
2012	0.993	0.994	0.996	1	1	1
2013	1	1	1	1	1	1
Mean	0.942	0.995	0.947	0.729	0.878	0.832

Table 7-4: Calculation results from DEA analysis software (asset quality + solvency)

	Asset quality			Solvency		
	Crste (Overall technical efficiency)	Vrste (Pure technical efficiency)	Scale (Scale efficiency)	Crste (Overall technical efficiency)	Vrste (Pure technical efficiency)	Scale (Scale efficiency)
2006 (Wing Lung Bank)	0.905	1	0.905	1	1	1

					Table 7-4, continued	
2007 (Wing Lung Bank)	0.905	1	0.905	0.990	1	0.990
2006 (China Merchants Bank)	1	1	1	1	1	1
2007 (China Merchants Bank)	1	1	1	1	1	1
2008	0.922	1	0.922	0.980	1	0.980
2009	0.994	1	0.994	1	1	1
2010	1	1	1	1	1	1
2011	1	1	1	1	1	1
2012	1	1	1	1	1	1
2013	1	1	1	0.993	1	0.993
Mean	0.973	1	0.973	0.996	1	0.996

As can be seen from the data in the above table:

(1) Profitability. Before M&A year, the profitability of both sides is 1 in overall technical efficiency, pure technical efficiency and scale efficiency, which means both sides are in effective state. However, after the M&A, there was an obvious trend of first decline and then rise (overall technical efficiency: 0.768→1; Pure technical efficiency: 0.984→1; Scale efficiency is 0.791→1). The possible reason is that the merger has just been completed, and there are some problems in the integration between China Merchants Bank and Wing Lung Bank, which affect the efficiency of the merger process. However, after powerful operation and management integration, China Merchants Bank, with the help of Wing Lung's platform in Hong Kong, has continuously expanded its business scope and regained profitability.

(2) Operation capacity. Before the merger, China Merchants Bank had effective operating capabilities, but Wing Lung Bank had obvious operating difficulties in the year before the merger (2007), with the overall technical efficiency and scale efficiency plummeting to 0. In the merger year, with the original operating advantages of China

Merchants Bank, the overall technical efficiency and scale efficiency were 0.721, and the pure technical efficiency was 1. However, there was a significant decline in the following two years, and then it gradually rose until it became effective. The possible reason is that due to the impact of the financial crisis in 2008, Wing Lung Bank showed negative growth. When the M&A was announced, it quickly resisted part of the crisis by taking advantage of China Merchants Bank's capital and other aspects. However, after the merger, due to the delayed impact of the financial crisis on the one hand, and limited by the pains of resource integration after the merger on the other hand, it declined and then returned to stability and effectiveness.

(3) Asset quality. Before the merger, the asset quality of China Merchants Bank was effective, but before the merger, the asset quality of Wing Lung Bank declined. Similar to the above two points, at the beginning of the merger, there is a deviation in effectiveness, but after the integration, it returns to the effective level.

(4) Solvency. Before the M&A, China Merchants Bank's solvency was all effective, but Wing Lung Bank began to have a decline in solvency one year before the merger (2007). In the year when the M&A happened, the overall technical efficiency and scale efficiency were both 0.98, which were also caused by two reasons. The external reason was the spread of the financial crisis, while the internal reason was dragged down by the current level of Wing Long Bank. Five years after the merger (in 2013), solvency became ineffectually due to the then nationwide banking regulatory upgrades, particularly the tightening of banks' off-balance-sheet operations.

The empirical analysis method should be used to evaluate the efficiency of CMB's acquisition activity. Nonfinancial indicators are more scientific, more quantitative factors.

To reduce subjectivity, a comprehensive efficiency appraisal of content was carried out, and the method not only measures M&A efficiency but also measures the various factors that influence efficiency through a horizontal and vertical analysis (for which also it was employed). A more scientific and effective analysis of commercial banks includes a focus on changes in efficiency and the factors that influence such changes in efficiency.

7.2.3 Analysis and evaluation based on nonfinancial indicators

1. Economies of scale

$$\ln PTA = \beta_0 + \sum_{i=1}^3 \alpha_i \ln x_i + \sum_{j=1}^2 \beta_j \ln y_j + \frac{1}{2} \sum_{i=1}^3 \sum_{k=1}^3 \gamma_{ik} \ln x_i \ln x_k + \frac{1}{2} \sum_{i=1}^2 \sum_{k=1}^2 \varphi_{jk} \ln y_j \ln y_k + \sum_{i=1}^3 \sum_{j=1}^2 \eta_{ij} \ln x_i \ln y_j + \tau GDP + \omega IN + \varepsilon \quad (1)$$

(Where $\gamma_{ik} = \gamma_{ki}, \varphi_{kj} = \varphi_{jk}, \eta_{ij} = \eta_{ji}$)

According to Wang Cong and Zou Pengfei (2003) 's improvement on Du Li and Wang Feng (2002) 's measurement of the economic scope of China's commercial banks. In this paper, the measurement method adopted by Wang Cong and Zou Pengfei (2003) is mainly to add two indicators of deposit and loan interest rate difference (IN) and gross national product (GDP) so as to eliminate the influence of macroeconomic variables. The equation is set as:

In formula (1), PTA= total pre-tax profit of the bank; Y1 = total bank deposits; Y2 = total bank loans; X1 = interest income; X2 = fee income; X3 = investment income; GDP= GDP growth rate; IN= one-year bank lending rate - one-year deposit rate.

Then the discriminant factor of economies of scale is denoted as ECscale: $ECscale = \ln PTA / \ln y_1 + \ln PTA / \ln y_2$

According to formula (1), it can be concluded that:

$$ECscale = \beta_1 + \beta_2 + (\varphi_{11} + \varphi_{12}) \ln y_1 + (\varphi_{11} + \varphi_{12}) \ln y_2 + (\eta_{11} + \eta_{12}) \ln x_1 + (\eta_{21} + \eta_{22}) \ln x_2 + (\eta_{31} + \eta_{32}) \ln x_3 \quad \text{When } ECscale > 0,$$

there is economy of scale; when $ECscale < 0$, there is diseconomy of scale.

In this paper, a single cross section is used for time series regression to obtain each fitting coefficient. Then the paper uses the estimated coefficient to further calculate the ECscale of China Merchants Bank's economy of scale, and adds Industrial and Commercial Bank of China (the four largest state-owned banks) and Everbright Bank (similar joint-stock Banks) for comparison. The results are shown in Table 7-5:

Table 7-5 Economies of scale index before and after M&A of China Merchants Bank

ECscale	2006	2007	2008	2009	2010	2011	2012	2013
China Merchants Bank	0.48	0.45	0.44	0.46	0.50	0.51	0.53	0.57
Industrial and Commercial Bank of China	0.96	0.93	0.89	0.84	1.28	1.28	1.31	1.32
Everbright Bank	0.17	-0.06	-0.11	-0.04	0.11	0.13	0.15	0.22

Source: calculation by the author

It can be seen that the scale effect of the banking industry declined to some extent from 2007 to 2009, mainly due to the impact of the financial crisis. After the M&A of China Merchants Bank Wing Lung Bank, the scale effect of CMB showed a state of growth, which was also greater than 0.

2. Economies of Scope

Suppose a bank offers two types of services: investment and traditional services. Then the economic expression of scope can be obtained from formula (1):

$EC_{scope} = \ln x_1 / \ln x_3 + \ln x_2 / \ln x_3$. When $EC_{scope} > -1$, it means that the bank has economy of scope; otherwise, it is uneconomic of scope.

In this paper, reference Banks consistent with economies of scale are selected, and the results are shown in Table 7-6:

Table 7-6 Economies of scope index before and after M&A of China Merchants Bank

ECscale	2006	2007	2008	2009	2010	2011	2012	2013
China Merchants Bank	0.23	0.19	0.08	0.14	0.23	0.27	0.29	0.43
Industrial and Commercial Bank of China	1.49	1.88	1.04	1.53	2.03	2.22	2.88	3.03
Everbright Bank	0.17	0.11	-0.23	0.10	0.18	0.22	0.26	0.33

Source: calculation by the author

3. Concentration level

As for the results after M&A, Herfindahl index is selected in this paper to observe the concentration degree of industries and enterprises. The results are shown in Table 7-7:

Table 7-7 Herfindahl index before and after M&A of China Merchants Bank

ECscale	2006	2007	2008	2009	2010	2011	2012	2013
China Merchants Bank	0.054	0.055	0.055	0.054	0.054	0.054	0.055	0.060
Industrial and Commercial Bank of China	0.271	0.271	0.272	0.280	0.310	0.311	0.311	0.308
Everbright Bank	-	-	-	-	0.241	0.241	0.241	0.197
Banking sector	0.137	0.147	0.155	0.162	0.182	0.194	0.194	0.203

Note: Everbright Bank (SH.601818) went public in 2010.

Source: CSMAR database.

7.2.4 Analysis and evaluation based on non-financial indicators

1. Continuously realize strategic goals

For any commercial bank, the realization of the strategic goal of internationalization is undoubtedly the result of their continuous efforts. Wing Lung Bank gave CMB a good platform for an overseas business in Hong Kong, established a marketing model and network, and contributed a large number of outstanding business talent that could assist CMB in continuously realizing its goal of entering the international stage. After the acquisition, the overseas business continued to expand. In 2009, a representative office was set up in the United Kingdom to engage in various financial businesses. This merger significantly improved the popularity of CMB abroad and expanded its influence overseas.

2. Continuous optimization of operations and management

After the completion of the merger, Wing Lung Bank continuously improved its management abilities and various management systems, including internal control systems and various internal management process systems. According to the integration requirements of CMB, Wing Lung Bank has refined the rights and responsibilities of the board of directors and management and has continuously adjusted risk monitoring and management procedures according to the integration requirements of CMB. The approval process of the deposit and loan businesses was also simplified one step at a time in accordance with the development requirements to adapt after the merger. Wing Lung Bank constantly met the requirements of integration, engaged in active management improvements, and effectively improved its post-merger management ability.

3. Marketshare keeps increasing

From 2006 to 2008, CMB's annual pretax profits of its retail business was less than 5 billion yuan. Currently, CMB has become the first real "retail bank" in China and is also known as the "king of retail" in the market. The development of CMB's retail business is strongly related to its continuous development of the market. In particular, CMB's acquisition of Wing Lung Bank provided a platform for the development of an overseas business; continuously increased its outlets; and launched various innovative businesses, thus increasing the marketshare of commercial banks.

7.3 Summary of M&A efficiency

Two methods of analysis were used to evaluate CMB's financial and nonfinancial indicators before and after the acquisition activity. Not difficult to find was that the two parties' participation in the transaction varied. The acquisition effectively improved both the acquirer's and the target's financial and operating conditions. After the merger, the management situation changed significantly. In particular, Wing Lung Bank improved on its mismanagement of the situation and the business improved unceasingly.

For CMB, some of its financial indicators were affected by the acquisition within 1 year of closing the deal. CMB continuously adjusted its business scope, improved its business abilities, and actively carried out varied work during the later stages of the integration. The entire bank showed extremely good development prospects. This paper adopts the empirical analysis method to monitor and analyze nonfinancial indicators and found that the nonfinancial indicators that received attention showed improvement.

It can be seen that the biggest difference between China's bank M&A compared with the United States comes from motivation. M&A of US commercial banks is mainly carried out based on subjective development intentions, while the case of China is

basically carried out from top to bottom under the leadership of the government. Facing the government's M&A order, China's banking industry can be said to have no choice, or it can be said to be a dream. The reasons come from two aspects. On the one hand, most of the merged banks have operational problems. In order to protect the basic interests of the majority of depositors, especially the lower income groups, the government must borrow larger commercial banks for reorganization; on the other hand, due to strict supervision, there are few mergers and acquisitions of commercial banks in China. In order to expand the scale and scope, it seems that only through their own growth, when merger opportunities arise, these designated commercial banks will not refuse. Of course, the domestic mergers and acquisitions in China that have occurred so far have been "the big one swallowing the small one" or "the big one helping the small one ". There has not been a "the small one swallowing the big one" situation. If it occurs, whether the merger and acquisition parties have no choice is still unknown.

Judging from the results of M&A, the results of M&A of U.S. commercial banks are significantly different. There are both successful merger cases and failures, including the first decline and then the rise and the first rise and then the decline. However, judging from the results of Chinese mergers and acquisitions, it can be said that they are all successful, and there may be fluctuations in the merger stage. But by tracking the results, it can be seen that at least so far, the results of China's commercial bank M&A have expanded the scale effect and scope effect.

Therefore, this analysis not only reveals changes in M&A efficiency but also analyzes various factors that affect this efficiency. For example, from a global perspective, careful analyses of the macro environment that influences the efficiency of M&A

activities shows significant volatility in financial data a year after a transaction. A more comprehensive analysis of the factors that influence the financial data can be executed by considering the financial crisis, using a comparative analysis and comprehensive view of the financial data, and adopting various methods to establish different nonfinancial indicators.

CHAPTER 8

CONTRIBUTION AND INSPIRATION

This chapter summarizes the findings of this paper on merger and integration strategy, synergies, and commercial banks' efficiency, and points out the policy implications of this study.

8.1 Research findings and contributions

Under the current economic and political conditions, the world financial industry is undergoing a profound transformation. Given the increasingly fierce competition in the international market and the deepening of the integration of the market economy, M&A activities are generally accepted by international enterprises as a more efficient and rapid expansion method. The strategic M&A activities of Chinese commercial banks display “offensive” characteristics of being market-oriented, as shown in the case of China Everbright Bank's buyouts of investment banks; Shanghai Pudong Development Bank's acquisition of China Zhejiang Yiwu city credit cooperatives and urban credit cooperatives; Societe Generale's acquisition of Foshan; and Guangdong Development Bank's purchase of Chinese Trust. Government-led M&A transactions involving China's commercial banks are beginning to use M&A transactions actively to realize leap-forward development.

With the completion of the listing of large state-owned banks and national joint-stock commercial banks, China's banking industry is expected to gradually become polarized in many aspects that reflect the core competitiveness of the banks, such as the scale of assets and operating and management levels. Regulators actively encourage large financial institutions to participate in or hold shares in small- and medium-sized financial

institutions to prevent and diffuse the operational risks of small- and medium-sized financial institutions and improve the management level of small- and medium-sized financial institutions. The increasingly fierce market competition is expected to make more domestic banks, especially small- and medium-sized commercial banks, embark on the path of mergers and reorganizations and create a group of large banks with sufficient capital, strength, and extensive business fields to enhance the international competitiveness of China's banking industry. China's commercial banks are expected to transform gradually from the exogenous growth mode that relies on internal accumulation to the endogenous growth mode and realize leap-forward development and equal emphasis through M&A activity. In the next stage, M&A activities are expected to become the development trend in China's commercial banks.

This paper mainly uses the acquisition of SDB by Ping An Bank as the research object and studies the theories related to the synergy effects of enterprise M&A activity and the theories related to the motivation of enterprise M&A activities, such as economies of scale, market power, and transaction costs. This study found that after Ping An acquired SDB, the synergy effect between the two parties was well realized. The two parties were observed to realize initially the transfer of management ability, the improvement in operational ability, and the reduction of management costs. The two parties also improved overall competitiveness, profits, and economies of scale and realized effects, such as an improvement in the ability to pay debt, a decrease in financial expenses, and reasonable tax avoidance.

In this paper, the research on the synergies between Ping An Group and SDB resulting from the M&A process is divided into three categories, namely, management,

operations, and finance, in order to deepen the research on synergies in the M&A activity of China's financial industry, which is innovative to some extent. This article uses the acquisition by Ping An Group of SDB as an example of how to conduct research on synergies. Ping An is an integrated financial group in China and has the scale and particularity of business M&A activities. However it is with the aspects of management, operations, finance, and management after M&A that some positive measures can be infused and synergies can be realized, and this process has a synergistic effect of universality. For M&A involving enterprises of the same type in the financial industry, future management, finance, and management, among other things, after the generation of the synergistic effect provide a train of thought.

This paper made the following findings:

First, M&A is an important choice for China's commercial banks looking to go global and continue to grow. Commercial banks want to flourish, and there are many paths to choose from. Relative to other methods, M&A can break industry and regional barriers in a short period because of the laws and regulations and the various effects of an ideological culture. Acquisitions can be pursued to reduce examinations and approvals, avoid unnecessary tedious processes, reduce operating costs, and use the acquired party's employees, customers, and various resources. Such M&A activities can be smoothly carried out by local financial services business. It is also easy to obtain the trust of local customers and attract greater capital inflows through M&A activity among banks.

Second, with regard to the M&A target selection process, this article previously mentioned that an important factor that influences M&A activity is the geographical factor. M&A activities have important revelatory significance for commercial banks.

CMB's headquarters is in Shenzhen, and Wing Lung Bank's headquarters is in Hong Kong. Only a sea divides these headquarters locations; however, a geographical factors analysis shows that the conditions for an M&A transaction are very mature. These two parties have similar cultural traditions and legal systems, ensuring that these two factors did not hinder the M&A process. Therefore, Hong Kong can be used as the first choice for M&A activity, given its numerous M&A opportunities and fewer barriers to M&A efficiency.

Third, M&A opportunities should be seized, and banks should constantly integrate. For CMB, choosing such an acquisition opportunity was very good. At that time, Wing Lung Bank was faced with operating difficulties and wanted to sell its shares to survive the crisis. In addition, CMB simply sought to expand its business in Hong Kong, contributing to the merger opportunity between the two parties. When compared with mandatory acquisitions in the capital market, acquisitions through a simple agreement can significantly eliminate many problems. Moreover, the entire world was affected by the economic crisis at that time, and the M&A decisions made during this period gave CMB the opportunity to enter the international capital market and allow more customers know about its business.

This paper also studies the international experience of the M&A activity of commercial banks. An empirical analysis of M&A cases of commercial banks in China and the United States provides a basis for deciding the merger and integration of commercial banks in China.

8.2 Enlightenment and suggestions for future research

China's commercial bank M&A activity started late but showed strong development

and momentum. The scale and number of M&A transactions increased rapidly, and the methods and purposes of these transactions became increasingly diversified. Studying the M&A activity of China's commercial banks is conducive to a comprehensive understanding and grasp of this activity by commercial banks, to the healthy development of China's commercial banks, and to Chinese commercial banks going out into the world.

8.2.1 Development trend of M&A activity by China's commercial banks

A current comparison with Europe, the United States, and other developed countries shows that China's banking M&A activity needs to improve in many aspects. For example, China's bank M&A experience is relatively scarce, the degree of internationalization is inadequate, and banks' internal control plans have numerous deficiencies. These aspects largely influence the choice of Chinese banks' M&A strategies. With the acceleration of the pace of economic globalization and financial liberalization, the trends in M&A activity in the future is an important issue. In the future, the M&A activities of China's banking industry are expected to exhibit the following development trends.

First, banks are expected to have more autonomous M&A activities in the future. Given the development of the market economy in China and the degree of marketization, in the 1990s, government-led bank mergers and reorganizations were undertaken to save several financial enterprises from bankruptcy. As China phased out bad assets from financial institutions through acquisitions and reformed the financial enterprise shareholding system to enable banks' superior achievements, gradually, perfect bank governance structures and significantly improved bank business performance came to be. At the same time, according to China's commercial banks' business objective to

maximize profits and engage in market-oriented management principles, further development of the current financial industry is expected to enable banks to achieve their own leading M&A activities to meet their business development and scale needs.

2. Cross-border M&A has become a mainstream trend. The rapid development and improvements in the financial status of China's economy are expected to enable the banking industry's future M&A activities not to be limited to only to the domestic market but also to reach out to embrace cross-border transactions. In the future, China's banks are expected to carry out a large-scale overseas global buyout that can accelerate their overseas banking businesses, expand sales channels, and effectively prevent and disperse bank risks. Therefore, in the future, banks should go to the international market more often, and cross-border M&A is a major trend.

3. Small- and medium-sized banks are expected to become the main M&A targets. Given the formal liberalization of bank deposit interest rates, the era of interest rate liberalization has truly arrived. M&A activity between banks are also becoming increasingly visible. In addition, private capital can participate in the acquisition and reorganization of banks, and the equity of the banking industry is expected to show a more diversified and decentralized trend. Moreover, some small- and medium-sized banks are more likely than others to become the objects of future mergers and reorganizations.

4. Bank M&A parties are expected to take the form of financial groups. An increasing number of comprehensive financial groups are expected to exist, given the development trend of banks having mixed operations in the future. Therefore, the banking industry is expected to acquire an increasing number of other types of financial

institutions in the future to realize cross-border M&A transactions. At present, the country is considering the reform of the financial supervision system, and a system of super central banks in the future is expected to bring more guidance for cross-border M&A activity.

8.2.2 Strategic choice of Chinese commercial bank M&A activity

During the continuous reform and development of China's banking industry, the industry has formed its M&A strategy. Given the actual selection of M&A activity in China's banking industry, the selection of acquisition targets, and the arrangement of relative control rights, China's banking industry should follow these considerations when developing M&A strategies.

The first consideration is the rational layout—the formulation of the feasibility of more sophisticated M&A restructuring strategies. Given the current background of economic globalization, banks must constantly engage in mergers and reorganizations and improve their corporate governance levels to achieve their breakthroughs and developments in an increasingly fierce market competition environment. Such globalization also requires the banking industry to possess a spirit of thinking about change and a global vision. At the same time, during a specific M&A implementation process, an enterprise needs to adjust its M&A-related strategies flexibly and effectively and be familiar with the concentration of equity and reasonable control rights. The actual selection of an M&A activity has an extremely important influence on the efficiency of bank M&A transactions. If we do not pay attention or only pay attention to a certain aspect, the effect will be negative on the implementation of M&A activity in the banking industry, and enhancing the value of bank M&A transactions will be difficult.

The second consideration is that the implementations of mergers and reorganizations should be treated differently, and mergers and reorganizations between large, state-owned banks and small- and medium-sized banks should be classified. M&A activities of large, state-owned financial groups, such as Ping An Group, have a significant impact on the country's economic development. Therefore, the government should intervene to some extent, which inevitably leads to systemic financial risks. However, mergers, acquisitions, and reorganizations of small- and medium-sized banks do not entail large amounts of equity shares. Therefore, the government should reduce its intervention efforts by as much as possible; delegate; accelerate examination and approval formalities; effectively accelerate the acquisition process; make full use of the efficiency of market resource allocations; and better achieve strategic M&A development in accordance with the goal of maximizing banks' profits.

Third, the specific payment method of future M&A activity may come in the form of leveraged buyouts rather than self-owned funds. From the perspective of Ping An's acquisition of SDB, we can see that, at that time, Ping An replaced the equity of Xinqiao Capital with an equity payment and a cash payment. However, such disadvantages were also exposed. Equity payments dilute a company's control, whereas cash payments affect a group's working capital and its future development. Therefore, in future M&A activity of the banking industry, leveraged buyouts should be adopted to reduce the use of free capital to prevent the dilution of the enterprise's equity; to reduce expenditures of its capital effectively; and to increase working capital, the latter two of which are very beneficial for banks' future development.

8.2.3 China's commercial banks must grasp the timing of M&A activity

Although commercial banks' M&A activity can draw lessons from foreign experiences, it must be acknowledged that China is quite different from some developed countries. In terms of bank M&A activity in China, on the basis of basic national conditions, lessons from foreign experience can be reasonably drawn although our current M&A case was not experienced. However, going by our national conditions and best resources, we seek to summarize on the basis of the most suitable M&A methods. Simultaneously, the recovery of valuable opportunities should be grasped during the recovery phase of the global economy, reducing the cost of M&A through asset prices. Interest rates are relatively low, and banks' interests based on growth drivers increase the volume of international trade and enable their businesses to grow. These favorable factors also objectively reduce the difficulty of China's bank M&A activity and provide a relatively good environment for bank M&A activities during recent periods.

In the future, the M&A activity of China's commercial banks are expected to change the pattern of China's banking industry. Given the liberalization of China's banking industry, foreign banks are expected to participate in a large number of M&A transactions by China's commercial banks. China's commercial banks are expected to face a more severe competitive international market environment. Through this M&A process, China's financial security is expected to receive sufficient attention. Simultaneously, China's commercial banks are also expected to take advantage of overseas M&A activity and broadly participate in international banking businesses. To manage the development trend of Chinese commercial banks' future M&A activities, commercial banks need to create reasonable M&A development strategies; choose appropriate M&A models; and deepen their cooperation with foreign banks so as to take the initiative during future

commercial banks' M&A waves; and promote their development. Countermeasures and suggestions for commercial banks' M&A activities are as follows:

1. Develop a reasonable M&A development strategy

When formulating development strategies, banks should position themselves appropriately; determine regional, business, and development priorities according to their overall development goals; and carry out M&A activities in a reasonable and orderly manner. In particular, during the overseas M&A process, banks should combine their overseas expansion paths, accurately grasp potential business areas of future growth, make reasonable layouts, and carry out M&A activities in a planned and targeted manner. In addition, to expand China's banking business and enhance its banking innovation ability, engage in acquisitions, and learn to introduce new foreign banking businesses; in that order, these imperatives must receive focus and attention.

2. Choose the right M&A mode

Different types of commercial banks have vastly different objective conditions and face different degrees of control by the government. Different M&A models are appropriate for these differences; therefore, depending on the conditions faced by commercial banks, they select the most suitable M&A development strategy that enables them to actively exert a positive influence and eliminate negative effects. It is only in this way that commercial banks can promote healthy and orderly sustainable development.

3. Strengthen and improve post-merger integration

Regarding commercial banks' M&A activities, strengthening postdeal integration is very important because it determines the success of the M&A transaction. The completion of an M&A transaction does not mean its success. Integrating the banks after

the completion of an M&A deal and promoting the acquired bank to return gradually to reasonable and healthy development are the signs of a successful M&A transaction.

Bank M&A activity is continuous and is not only reflected in the simple merger of two enterprises. After an M&A transaction, how to absorb and digest the advantages of the merged enterprise and how to discard and eliminate its dregs is another test that the M&A transaction is expected to face. The effect of late integration is said to affect the effect of bank M&A activity directly and is expected to be an important factor in evaluating such activity. After an M&A transaction, the content of the integration is diverse and includes personnel reception, asset processing and operations, and even service concepts, among others. Any one of the processing steps may lead to the result that the transaction cannot achieve the desired effect.

Although the current situation in our country's bank M&A integration is often to stay in late, it may simply be to expand business scale and reduce operating costs in order to get more benefits. However, as the capital market matures, we should also observe that simple merger integrations cannot meet increasingly standardized bank M&A transactions. If banks are not prepared today, the enterprise's operations will face problems after a merger.

The integration of a bank M&A transaction includes the following aspects.

The first aspect is the integration of values. Different banks will have different business philosophies and banking cultures, which can be attributed to differences in value, particularly with respect to overseas bank M&A transactions, for which this aspect is more prominent. The value conflict based on different cultural backgrounds is expected to affect the effect of M&A activity directly.

The second aspect is the integration of organizational personnel. Inevitably, in the process of a bank M&A transaction, there are personnel changes. These personnel changes represent the flow of human resources on the one hand and management changes on the other hand. The integration of the management team will inevitably impact the previous management team. To be well prepared to better manage such an impact and maintain good job traditions, the management team must ensure efficient operations and constantly improve the working efficiency of the merger.

8.2.4 Further improvements to the capital market

Bank M&A activity must use the market as the “soil” for its progress, and all of its steps and actions must be carried out in this “soil.” Therefore, the fertility and impoverishment of the “soil” will directly affect the final effect of the bank M&A activity. If the development of the capital market can meet the expectations of bank M&A transactions, then these transactions will be carried out smoothly. In contrast, if the capital market is in chaos, bank M&A transactions will be inefficient and difficult. To enrich the soil, the following elements are indispensable: capital markets must ensure that the acquiring bank can obtain sufficient capital; they can provide banks with sufficient and reliable information; and they can improve the transparency of M&A transactions. A relatively fair and reasonable price position for bank M&A transactions can be provided, which is an ideal state in which capital markets play an active role in promoting bank M&A activity.

However, China has no such capital market; therefore, we should actively adjust the capital market and the structural imbalance in the current capital market. If the capital market can give full play to its core function of improving the efficiency of capital

allocation throughout society, it can surely guarantee the efficiency of capital use and ensure that capital can be obtained by the most competitive enterprises. At the same time, to further accelerate the speed of the market-oriented reform of the capital market, actions to pursue include, but are not limited to the following: (1) improving the transparency of listed companies; (2) perfecting capital market operations; (3) strengthening the third-party mechanism for the risk assessment of listed companies for the key public regulation of industries, such as banking and insurance companies; (4) further developing and improving corporate bonds and the corporate bond market; (5) further promoting the reform of the marketization of the capital market; (6) forming a good capital market environment to further increase the attractiveness of the capital market in China; (7) improving capital market tension to provide rich soil for bank M&A transactions; and (8) provide guarantees for the smooth progress of bank M&A activity.

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