

## THE GLOBAL BANK MERGER WAVE: IMPLICATIONS FOR DEVELOPING COUNTRIES

GARY A. DYMSKI

This paper reconsiders causes and implications of the global bank merger wave, especially for developing economies. Previous studies of the global bank mergers—that is, mergers between banks from different nations—had assumed that these combinations are efficiency-driven, and that the U.S. case defines the paradigm for all other nations' banking systems. This paper argues that the U.S. experience is unique, not paradigmatic, and that bank mergers are not efficiency-driven; instead, this merger wave has arisen because of macrostructural circumstances and because of shifts over time in banks' strategic motives. This paper argues that large, offshore banks often engage in cross-border mergers because they want to provide financial services to households and firms that have reached minimal threshold wealth levels. For developing economies, this suggests that cross-border acquisitions of local banks by offshore banks will have mixed effects; and it cannot be assumed that the net social impact is positive.

### I. INTRODUCTION

**T**HIS paper reconsiders the causes and implications of the global bank merger wave, especially for developing economies. Most of the academic studies on this bank merger wave have focused on the United States. Studies on cross-border mergers (Demirgüç-Kunt, Levine, and Min 1998; BIS 2001) largely consider the developed economies, with just a few (Claessens and Jansen 2000; Clarke et al. 2001) examining cross-border financial mergers in developing economies. All of these studies almost invariably rely on two maintained hypotheses: first, that a set of common “microeconomic” forces—economies of scale and scope, unleashed by deregulation and driven by technical change—underlies this global financial merger wave; second, the U.S. merger wave constitutes the global paradigm. The links between mergers, efficiency, and U.S. experience are demonstrated in the case of the large U.S. banks; for after undergoing continuous consolidations since 1981, these banks have become more profitable than other regions' large banks.

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TABLE I  
SUMMARY OF STATISTICS FOR LARGE FIRMS BY REGION (MAY 31, 2001)

	Market Value (U.S.\$ Million)	Assets (U.S.\$ Million)	Profits per U.S.\$1,000/ Assets	Book Value of Equity Relative to Assets	Equity Price/ Book Value
Financial firms (listed in the <i>Business Week's</i> "Global 1000")					
United States	1,026,605	4,651,006	11.5	7.63	3.29
Canada	75,670	846,590	7.0	4.28	2.09
Britain	368,003	2,586,305	8.6	5.27	2.83
Continental Europe	707,823	8,067,243	5.7	3.36	2.90
Japan, Hong Kong, Singapore	174,361	1,762,367	2.7	6.12	0.99
Nonbank financial firms (listed in the <i>Business Week's</i> "Global 1000")					
United States	1,218,069	5,180,213	12.2	8.52	3.55
Canada	46,958	204,995	13.8	9.38	2.55
Britain	108,485	777,700	4.7	7.36	2.59
Continental Europe	405,909	2,126,245	8.8	6.68	7.37
Japan, Hong Kong, Singapore	352,824	2,468,096	7.7	9.90	1.59

Source: *Business Week's* "Global 1000," July 2001. Web-published at <http://www.businessweek.com/>.

Note: Averages are computed using market value of equity shares as weights.

Table I illustrates this point, using profits per U.S.\$1,000 of assets as a benchmark. The fact that the size of the largest U.S. banks has recently increased relative to the U.S. market, while the largest banks in other national areas are smaller relative to their national markets (Table II), suggests that mergers elsewhere may lead to efficiency gains in other nations.

These maintained hypotheses suggest that the largest and most efficient banks, especially those from the United States, should be given full scope to become engaged in global mergers—that is, in consolidations involving cross-border acquisitions of banks (Agénor 2001). This could lead to a global homogenization of banking, dominated by efficient institutions. Berger, DeYoung, Genay, and Udell (2000) develop an argument of precisely this type: they assert that since only the largest and most efficient banks are able to enter and succeed in foreign markets over a sustained period, global acquisitions (and entry more broadly) may enhance global banking efficiency. This has a powerful implication for developing economies. For a global bank merger wave dominated by large overseas banks should, by enhancing efficiency, create a sounder and less crisis-prone banking sector. Therefore, cross-border bank consolidation should provide some protection against another East Asian financial crisis.<sup>1</sup>

<sup>1</sup> Some studies have found empirical evidence that foreign banks' entry may, however, reduce small businesses' access to credit in developing economies (see Clarke et al. 2002).

TABLE II  
RELATIVE BANK SIZE CLASSIFIED BY NATIONAL AREA AND GLOBAL SIZE

## A. National or Regional Bank Holding Company Assets

	United States			Europe	Asia	Latin America
	June 30, '97	June 30, '00	June 30, '01	June 30, '99	June 30, '00	June 30, '99
Ratio of top 3 banks to:						
Top 10	0.45	0.55	0.60	0.40	0.38	0.52
Top 25	0.31	0.43	0.47	0.16	0.25	0.34
Ratio of top 10 banks to:						
Top 25	0.68	0.77	0.79	0.40	0.67	0.66

## B. Global Bank Holding Company Assets, May 2001

	Global	United States	Europe	Asia	Latin America
Ratio of top 3 banks to:					
Global top 10	0.40	0.30	0.27	0.32	NA
Global top 25	0.22	0.16	0.15	0.17	NA
Global top 50	0.15	0.11	0.10	0.12	NA
Ratio of top 10 banks to:					
Global top 25	0.54	0.36	0.39	0.25	NA
Global top 50	0.37	0.25	0.27	0.18	NA

Sources: For national banking asset data: (1) United States—Banking Information Center, Federal Reserve Board; (2) Europe—*Financial Times* “Global 500”; (3) Asia—*Asia Weekly*, September 15, 2000; and (4) Latin America—<http://www1.investnews.com.br/Milmaiores/>. For global banking asset data: *Business Week*’s “Global 1000” as of May 31, July 2001.

- Notes: 1. In each column in the top section bank holding company (BHC) assets are computed within a given national area. In the columns in the bottom section BHC assets are computed against the largest BHCs globally.  
2. NA = not available.

In this paper we propose an explanatory framework that challenges the maintained hypotheses that global mergers are efficiency-driven and that the U.S. case could become the paradigm for all other nations’ banking systems. The first hypothesis is questionable because the literature finds little empirical evidence of links between mergers and financial firms’ performance, measured in terms of either profitability or operating efficiency (Berger, Demsetz, and Strahan 1999; Dymski 1999; Rhoades 2000). Efficiency effects are also weak in European bank mergers (OECD 2000). In studies on cross-border mergers, the same conclusion has been reached, for example, Claessens, Demirgüç-Kunt, and Huizinga (1998) and Demirgüç-Kunt and Huizinga (1998) showed that cross-border entry by multinational banks has not increased profit rates in these markets. And the U.S. experience cannot be a global paradigm because U.S. banks’ very dominance in global financial

markets does not leave similar niches available for other nations' banks; instead, other nations' banks share a global financial terrain in which U.S. banks *are* dominant—an especially crucial consideration for banks in developing economies.

The explanatory framework proposed here attributes bank mergers to macrostructural circumstances and banks' strategic motives as goal-seeking firms. Macrostructure here refers to the key elements of banking firms' environment—the pace of macroeconomic growth, the size and distribution of domestic income, and the size and strength of domestic financial markets. This framework builds on concepts related to mergers and acquisitions that have occurred in the fields of industrial organization and strategic behavior, some of which are summarized in the paper by Cantwell and Santangelo in this volume. These authors argue that mergers and acquisitions are triggered either by factors that enhance corporate competitiveness, or factors that respond to changes in the market and regulatory environment. Competitiveness-driven mergers entail efforts to enhance market power, to defend market position, to gain synergies and/or economies of scope, or to reduce transactions and information costs. Environmentally driven mergers represent responses to regulatory shifts, efforts to gain access to new technologies, and attempts to overcome capital-market inefficiencies.

Previous studies on bank mergers have ignored the fact that banks are firms, and as such must develop strategies in changing and uncertain environments. These studies implicitly assume that financial market equilibria dictate what financial-market optima are, and aim of homogeneous best practices.<sup>2</sup> The evidence for this assumption is limited. Economies of scale considerations justify, at best, mergers of moderate-size banks. Recurrent market meltdowns and loan-loss episodes suggest that best practices are elusive, if not time- and location-specific.

The macrostructural environment has a controlling effect on what kinds of global (cross-border) bank mergers are feasible, and which are undertaken. Nations' banks can implement cross-border purchases only if they have access to capital markets—and this access varies widely from nation to nation. Nations' banks are targets for acquisition only insofar as they offer customer bases and/or assets that fit into the strategic orientation of acquiring overseas banks. Brazil's banking markets offer different strategic opportunities from those of, say, the United States or the Republic of Korea.

This argument leads to a reconsideration of what banking is. Previous studies on bank mergers implicitly define banking as a fixed set of activities, which can be performed poorly or well. Banks are essentially harvesters of preexisting, if tech-

<sup>2</sup> Ennis (2001) uses an information-theoretical approach to banking to demonstrate that banks of different sizes, and banks with different business models, can persist despite the ongoing merger wave. The models on which he relies do not, however, incorporate bank strategy; in this approach, banks' optimal behavior is largely dictated by the particularities of the information and risk environment within which they operate.

nologically dependent, opportunities for conducting transactions and accumulating wealth by buying and trading claims on financial assets. The alternative concept developed here considers banking as a seeding and cultivating activity. Opportunity sets in banking markets evolve endogenously, banking market outcomes are open, and efficiency in the sense of Pareto dominance cannot be well defined. This paper argues that large banks are increasingly engaged in harvesting activities and, not in seeding and cultivating activities. Consequently, their role in local markets consists fundamentally of servicing the financial needs of households that have already passed minimal threshold wealth levels; it is not their duty to cultivate the growth of new businesses and hence of a new population of prosperous households.

*Implications for developing economies.* Many analysts were confident in the early 1990s that eliminating obstacles to price movements and capital and goods flows would secure sustained growth for developing economies. This confidence has been shaken since the mid-1990s—the Mexican peso crisis of 1994, the East Asian financial crisis of 1997–98, the Russian and Brazilian currency crises of 1998–99. International Monetary Fund (IMF) and World Bank economists now assert that open cross-border flows of capital must be accompanied by improved financial governance. This can involve better prudential control of domestic banks in developing countries, but such control may be prone to inefficient rents demanded by powerful local constituencies (Agénor 2001). Acquisitions of developing-economy banks by megabanks provide another path to better governance, since implicitly megabanks are more efficient, more market-oriented, and regulated by more experienced national banking authorities. Therefore, providing maximum scope for the global expansion of first-world megabanks could, in this concept, secure universally higher welfare levels.<sup>3</sup> This opinion is challenged here. Megabanks' expansion into developing economies contributes definitely to the increase of the welfare for some economic units located there, but it cannot be assumed that all will benefit, or that the net impact when summed across society will be positive.

The remaining sections are organized as follows. Section II presents a model of global financial mergers. Section III discusses bank mergers in the United States, and then Section IV takes up the Western European case. Section V discusses global bank mergers involving East Asia, and Section VI considers the situation of Latin America. Section VII concludes.

## II. A MODEL OF GLOBAL FINANCIAL MERGERS

We begin with the relationship between mergers and bank strategies, and then consider the role of macrostructural factors. In strategic terms, we can distinguish be-

<sup>3</sup> Crystal, Dages, and Goldberg (2002) present this argument on the basis of comparisons of foreign and domestic banking firms in selected Latin American nations, using ratings agency and balance sheet data for the 1997–2000 period. These authors indicate that their data are fragmentary.

tween defensive and offensive financial mergers. *Defensive mergers* involve efforts to preserve core bank activities in given market areas in the face of heightened external competition. Costs can be cut by eliminating workers or closing duplicate offices. Defensive mergers may also enable the surviving entity to offload bad debts, declare capital losses, and even become “too big to eat.” Some gains from geographic diversification may also result. *Offensive mergers* involve efforts to expand the range of bank activities—by penetrating new product markets, capturing new customers within market areas, or penetrating new geographic markets. Recalling the Cantwell and Santangelo framework, environmentally driven mergers can be considered to be defensive in motivation, and strategically driven mergers as offensive. Obviously, the first phase of the U.S. merger wave was clearly environmentally driven, and the third was competitively driven. Both sets of merger motivations can be observed simultaneously in the same market area, or even in the same transaction: for example, Norwest’s merger with Wells Fargo was offensive and strategically driven for the acquisition of Norwest, and defensive for the acquired Wells.

In the case of global bank mergers, we can refine the environmental/competitive distinction. Environmental factors for these mergers largely encompass macrostructural factors. The term “environmental” emphasizes the elements surrounding a given firm in a given industry—the number of competitors, the severity of regulatory restrictions, and so on. The term “macrostructural” incorporates these factors, but also key elements of national or regional market structure: the size of the firm relative to its national or regional market, and the scale of the national or regional market relative to the world market. The national or regional macroeconomic growth rate is one of the factors. Also relevant is the presence or absence of robust capital markets within national or regional borders. Banking firms will not all rely on one common set of capital markets. If they did, capital-market access and capacity would be identical across all banks. But the access-to-capital playing field is not level, and banks have differential access to the funding capacity of different financial centers.

This leads us to examine the role of strategy in global bank mergers. Since banking firms are engaged in a variable set of activities, competitively driven impulses are always present in merger decisions. Banks’ strategies arise through a sequence of structurally bounded, interlocking choices about different aspects of banking business. Two key strategic elements are the means of revenue extraction and the method of customer identification. Will the emphasis be on capturing customers from whom the bank expects to derive business over a period of time, or on services that generate maximal revenues at a point-in-time? In the former approach, the bank must meet basic customer needs and offer whatever new services they demand, even while shaping customers’ preferences and habits and using cross-subsidies to hold them. Point-in-time revenue extraction involves services—wire transfers, loan creation and funding, underwriting, and so on—provided without an

expectation of customer retention. In part this implies that fees must be extracted up front. This approach is especially important for banks that target customers seeking up-to-the-minute instruments (such as state-of-the-art methods for removing risk) or scarce market facilities (the ability to underwrite or provide bridge financing for a U.S.\$30 billion merger).

A third strategic element is whether to focus on wealth management or loan production. Here we adapt a distinction made in ECLAC (2001) between customer-seeking and production-seeking foreign direct investment. While designed to capture real-sector applications, this distinction lends insight into the case of financial services. In the banking realm, “customer-seeking” merger or acquisition (the equivalent of foreign direct investment via the purchase of a local firm) corresponds to a bank purchase aimed at increasing liabilities—that is, deposit accounts and other wealth-management tools. A “production-seeking” merger, by contrast, is aimed at increasing loan production. Customer-seeking entry need not be balanced by new loan production, since the assets attracted can be matched against credit and financial-market paper originating in other national markets.

A fourth element of strategy is whether to establish linkages with other banking firms so as to share risks and save on fixed costs. A bank can either compete with other firms in some or all markets, build alliances, or eliminate its competitors by taking them over. If mergers or acquisitions are not feasible (perhaps because of limited access to capital), alliance building may be strategically superior to competition.

Taken together, macrostructural and strategic factors enable to determine what financial mergers are feasible in any time and location, and what factors explain whether these feasible options are taken. Three baseline macrostructural factors control banks’ strategic options:

- First, the national regulatory regime and inherited national banking structure determine possible domestic combinations, while the international regulatory framework and the comparative situation of different national markets generate possible cross-border mergers.
- Second, the macroeconomic growth rate and market size dictate the cash flows and accumulated wealth stocks to which banks have access domestically, providing a baseline for banks’ balance-sheet health. Banking-market size, in turn, depends on the distribution of income and wealth among households, the number of households, and the number and financial capacity of nonfinancial firms.
- Third, any national/regional banking sector’s capacity to undertake mergers depends on the amount of their retained earnings, the presence of state funds to underwrite bank mergers, and banks’ proximity to robust equity markets. These factors are combined to dictate the availability of private and/or public capital to underwrite takeovers.

The first set of factors determines whether banking firms can contemplate merg-

ers on the basis of their own national markets. The second set of factors determines whether feasible mergers will enhance competitive viability. The third set of factors determines whether feasible mergers can be financed. Note that since financial firms' retained earnings are typically small, and governments seldom underwrite bank mergers, access to equity markets is the key determinant in obtaining required finance. If the domestic equity market is weak, then underwriting must occur offshore, reducing the chances of completing mergers within a given national market. Overall, then, the scale of the firm and of the national market in which it operates, together with its access (or lack thereof) to capital markets, determines the scale on which it can make merger/partnership plans. For example, very large firms can contemplate mergers where somewhat smaller ones must attempt to construct cross-shareholdings and/or alliances. Therefore, the degree of national "hegemony" implicitly underlies firm strategies, including merger plans.

### III. A BASELINE CASE: THE U.S. BANK MERGER WAVE

This paper begins with U.S. merger experience, since it is held up as a paradigm for banking systems elsewhere.<sup>4</sup> While this merger wave is often considered to be a simple response to the generalized condition of "overbanking," it has had several distinct phases, each linked to a particular set of macrostructural and regulatory conditions and banking-firm strategies.

Prior to the U.S. bank merger wave, banks operated with long-standing geographic restrictions: they could not expand their branch networks when market opportunities arose outside their market areas. A sustained period of banking distress began in 1981. The thrift industry collapsed; and many banks also experienced distress in the early 1980s due to credit problems ranging from Latin American loans, to loans in oil-rich domestic areas, to loans for commercial real estate and corporate mergers. These failing or troubled institutions were often taken over by expansion-oriented commercial banks, Nationsbank grew through astute acquisitions during this period. Government-assisted mergers accounted for the majority of the bank mergers in the United States between 1982 and 1989.

This period of distress mergers led to a shift in regulatory philosophy. Until this period, regulators guided by the antitrust law and the Bank Holding Company Acts of 1956 and 1970 placed firm restrictions on bank activities and expansion, using the criterion that firms with monopolistic power will exploit it. In this period, many regulatory economists adopted the Chicago "new learning" approach, which shifts attention from monopoly position to "contestability." Regulatory tests for market power were weakened, permitting federal regulators to override product-line and geographic restrictions in approving distress mergers. The Federal Reserve in par-

<sup>4</sup> This section draws heavily on Dymski (1999).

ticular used regulatory flexibility to force “modernization” in U.S. banking laws. Bank regulators increasingly operated on the premise that the industry is overbanked and financial innovations have made capital and credit universally available.

Meanwhile, banks were inventing new sets of strategies due to increasing pressures on both sides of their balance sheets: mutual funds attracted the savings of many wealthy and middle-class households; and many larger nonfinancial corporations began to borrow directly, at lower cost, in commercial-paper and corporate bond markets. Large banks were especially affected by these customer-base losses. Banks adopted two strategic approaches to this dual attack.

One approach was the emergence of an upscale retail banking strategy. Banks using this approach identify a preferred customer base to which they can deliver both traditional banking services—short-term consumer loans, long-term mortgages, depository services—and nontraditional services such as mutual funds, insurance, and investment advice. This strategy has been under development since the late 1970s, pioneered by banks such as Citibank and Wells Fargo. Whereas cross-subsidies were previously extended between customer classes within product lines, cross-subsidies are now implemented between product lines within customer classes. Fees and charges are reduced for desired customers who wish to purchase multiple banking services, while fees are increased for customers using only basic banking services.

A second and related approach was a shift away from maturity transformation and interest-based income, and toward maturity matching, secondary market sales, and fee-based income. Much of the revenue from upscale households takes the form of fees, encouraged by the growth of secondary loan markets and of banks’ involvement in household portfolio management. Large banks also shifted their focus in servicing business customers: for smaller businesses, they now provide primarily transaction services; for the larger firms that obtain their primary financing elsewhere, banks provide a variety of risk-management services—including financial derivatives, foreign exchange hedging, and contingent loan agreements (lines of credit). The proportion of interest expenses within banks’ overall expenses has declined since 1982; noninterest income has been an increasing share of bank income since 1978 (DeYoung 1994).

These shifts toward desirable upmarket customers and toward fee-based services are mutually reinforcing: the customers most sought by banks are targeted for the receipt of standardized financial services—credit cards, specialized deposit and investment accounts, and mortgage loans. Both strategic shifts lead to bank mergers aimed at market expansion. Banks can initially increase revenues by identifying more fee-generating customers within their market areas, and then by providing more services for the financial needs of their core customers. Once the existing customer base is saturated, growth depends on a spatial extension of the customer base. This can be achieved either by purchasing existing banks and the customers that use them, or by building new branches in other banks’ market areas. These two

strategic options are substitutes. Mergers have been favored over “bricks and mortar” expansion: the latter has been freely permitted only since 1994, and is generally more expensive than buying other banks’ branch networks. About half of the 6,350 bank mergers after 1980 were indeed market-extension mergers, aimed at penetrating new geographic markets, with an increasing proportion after the mid-1980s.

Fee-based banking leads banks to consider mergers aimed at product-line expansion. A bank seeking to generate fees by servicing financial transactions can expand its fee income by servicing more transactions or more elements of those transactions. Therefore, mergers with insurance providers, brokerages, investment banks, and others enhance the range of fee-generating activities. Acquiring firms can then offer “one stop shopping” for financial services, since they have purchased other firms’ expertise.

Large banking firms have led the second phase of the U.S. bank merger wave because they have most aggressively pursued upscale-retail and fee-based strategies. Since these banks are not more efficient or more profitable than the smaller banks they are purchasing, earnings increases have not financed these acquisitions, while Wall Street has. Wall Street’s analysts have adopted the concept of banking industry excess capacity; and brokers and underwriters have earned substantial fees from the equity issues that have provided the cash needed to sweeten offers for target banks’ equity shares (Serwer 1995).

Wall Street’s support for bank mergers is based on the premise that they enhance banks’ shareholders’ franchise value. This premise has some validity, despite the weak relationship between the bank size and operating efficiency. Franchise value consists of the leverage-adjusted returns from banks’ business activities, adjusted for value added by public subsidies. When acquiring banks pay cash for acquired banks’ shares, their leverage increases—and as long as net profits are positive, the increased scale of bank operations alone enhances returns and thus increases franchise value. Such cash-for-equity deals are relatively rare in bank mergers. But the more common equity-for-equity swaps used in bank mergers can enhance franchise value, as Boyd and Graham (1991) and Hunter and Wall (1989) have pointed out, by increasing the value of banks’ public subsidies—in particular, the value of banks’ deposit insurance and of their implicit too-big-to-fail guarantee.

At the same time, Wall Street is not indifferent to merging banks’ operational efficiency. Merging banks typically promise to cut costs by consolidating operations and reducing staff. This is seldom the case: usually, the number of back-office staff members grows, while that of branch staff members decreases. Furthermore, larger banks are capable of making bigger mistakes in loan commitments. Therefore, Wall Street is chronically disappointed with banks’ cost-cutting efforts and is occasionally frightened by loan-loss disasters. Consequently, analysts’ perceptions of bank fundamentals, and hence Wall Street’s support for mergers, are unstable.

This compromises large banks' ability to play the merger game. For example, in mid-1995, Nationsbank was hobbled in its merger activities because its inability to deliver the 15–18 per cent return on equity earned by other large banks was reflected in its price-earnings (P/E) ratio. Its situation improved in 1996, and Nationsbank took over Boatmen's Bancshares. Bank stock prices grew steadily through 1997 and 1998, as Wall Street began betting on takeover gains. Exploiting this opportunity, Nationsbank used equity swaps to take over BankAmerica in a 1999 "merger of equals." The new entity (renamed Bank America) immediately experienced huge losses in the 1998–99 Russian and Brazilian financial crises.

The pace of mergers aimed at the U.S. retail banking market slowed after 1997, as the Asian crisis led to a broad decline in bank equity prices. Nonetheless, a new phase in the bank merger wave began that year: mergers aimed at attaining (or consolidating) megabanks' global reach. Increasingly, megabanks are competing to service upscale customers across borders. Some megabanks are also competing for the investment-banking business of the "bulge bracket" nonfinancial megacorporations, which have been locked into their own global merger and consolidation wave.

Ironically, this new phase has involved few U.S. megabank takeovers of offshore megabanks. The largest case is Chase's acquisition in April 2000 of the British investment-banking house Robert Fleming Holdings for U.S.\$7.7 billion; but this was soon dwarfed by its purchase in September 2000 of J. P. Morgan, the fifth largest U.S. commercial bank, for U.S.\$36 billion. This pattern of U.S.-based combinations of megabanks began in earnest in 1997, up to April 1998, when Citicorp and Travelers Group, the insurance giant, created the world's then-largest financial services firm with a U.S.\$70 billion deal. These mergers aim at creating different versions of the financial supermarket.<sup>5</sup> Nonbanks reacted aggressively; they began to offer banking—or bank-like—services to the upper end of banks' retail customer base.<sup>6</sup> One example is Morgan Stanley's purchase in February 1997 of Dean Witter, Discover, the third largest U.S. retail broker and a leading credit-card provider.<sup>7</sup>

<sup>5</sup> These mergers apparently seek economies of scope, though empirical evidence of such economies has not been established (see the sources cited in footnote 1). The *Economist* (April 11, 1998, p. 11) registered its skepticism as follows: "Many companies have tried . . . to market both insurance policies and savings accounts, or to offer business customers both traditional bank loans and share underwriting. The success stories are few. Cross-selling . . . is easy in theory, but turns out to be extremely hard to do. . . . Or perhaps, not for the first time, the world's leading financiers are mistaking size for profitability."

<sup>6</sup> Schwab executive Tom Decker Seip bluntly stated: "The banks would like to take my customers. I do not want all of their customers. I just want the rich ones." Also see *Economist*, March 17, 2001, p. 75.

<sup>7</sup> The *Economist* (February 8, 1997, p. 81) speculated that this purchase promised "the kind of one-stop financial shop that big banks have long aspired to build but have largely failed to. It seems improbable that low-margin checking accounts have a place in this shop. Until now, conventional wisdom had been that the commercial banks, rich after years of record profits, would take the lead in creating consumer-finance conglomerates. Morgan Stanley's maneuver has raised the possibility that they may be left by the wayside."

This new phase in mergers has also seen megabanks' entry into the United States. In the early 1980s, several U.K. and Japanese banks entered New York and California retail banking markets. Foreign bank entry into U.S. investment banking began in 1988 when Credit Suisse took First Boston private. Little more happened until the late 1990s, after financial crises had weakened some previously strong players. In February 1999, Deutsche Bank (DB) took over the stumbling Bankers Trust as a means of building up trading and investment banking capacity.<sup>8</sup> In July 2000, Switzerland's UBS purchased the brokerage firm PaineWebber for U.S.\$12 billion. A month later, Credit Suisse First Boston (CSFB)—already a global presence in investment and private banking, insurance, and asset management—agreed to acquire the brokerage firm Donaldson, Lufkin, & Jenrette. This move was designed to put CSFB into the first tier of corporate underwriters, along with Goldman Sachs and Morgan Stanley Dean Witter.<sup>9</sup>

U.S. bank mergers have thus been triggered by three factors: some banks' failure or near-failure, combined with opportunistic competitors interested in adding market share; the spread of upscale retail banking as a dominant service-delivery method; and a quest for global reach, especially for "bulge bracket" banks. The U.S. merger wave's spread across national borders now constitutes a threat to other nations' bank customer bases and revenue streams.

What are the implications of this multifaceted U.S. merger wave for understanding bank mergers elsewhere in the world? Three factors make the U.S. merger wave special: first, the existence of such a large number of banks due to the U.S.'s frontier legacy and geographic immensity; secondly, the large size of the domestic banking market, and the prosperity of many banks within this market; third, the presence of the world's dominant set of capital-market institutions. Given the willingness of the U.S. government to underwrite takeovers, the large number of bank and thrift failures in the 1980s created choice acquisition targets for merging banks interested in new markets. The large number of mergers launched in pursuit of upscale retail banking can be attributed to the large size of the U.S. middle market and the proximity of Wall Street. Megabanks' use of mergers to become bigger underscores the desperate competition among megabanks for the business of megafirms.

U.S. merger experience then falls into several distinct historical and strategic patterns. These are illustrated in Figures 1 and 2 and in Table II. Figure 1 lists the twenty-five largest bank holding companies as of May 1997 in order of asset size. The asset size of each institution that remained as of May 2001 is also shown. Combinations are indicated with arrows—directional solid-line arrows for domes-

<sup>8</sup> For example, the *Economist* (June 3, 2000) carried an ad by Deutsche Bank Alex. Brown (Alex. Brown was acquired by Bankers Trust in 1997) entitled, "No one puts it all together like Deutsche Bank," emphasizing Deutsche Bank's emergence as the leading global investment bank.

<sup>9</sup> Recent purchases of U.S. banks by foreign-owned banks include the entry of many East Asian—especially Taiwanese—banks into heavily Asian American retail banking markets in Los Angeles.

tic takeovers, heavy broken lines for overseas takeovers. Figure 1 indicates that U.S. mergers have largely occurred *within* size classes: the largest megabanks have merged with others, while large middle-ranking banks have also been one another's merger partners. This suggests some strategic differentiation—the three largest bank holding companies (Chase, Citibank, and Bank America) are aiming at comprehensive global coverage in both consumer and investment banking, while the banks just below them are largely conducting regional consumer banking operations emphasizing upscale retail banking. Eleven of the twenty-five holding companies shown had merged during the 1997–2001 period. One clear trend is that the size of the leading U.S. banks increased relative even to that of other large U.S. banks. Figure 2 lists the twenty-five largest bank holding companies as of 1997, 2000, and 2001. This experiment demonstrates that the asset size of banks at positions ten through twenty-five did not change appreciably. The top ten banks *have* grown substantially, especially the top three bank holding companies have grown immensely. Table II's figures for relative U.S. bank sizes lead to the same conclusion, using ratios. We now look into patterns elsewhere in the world.

Fig. 1. Patterns of Consolidation among U.S. Megabanks, 1997–2001

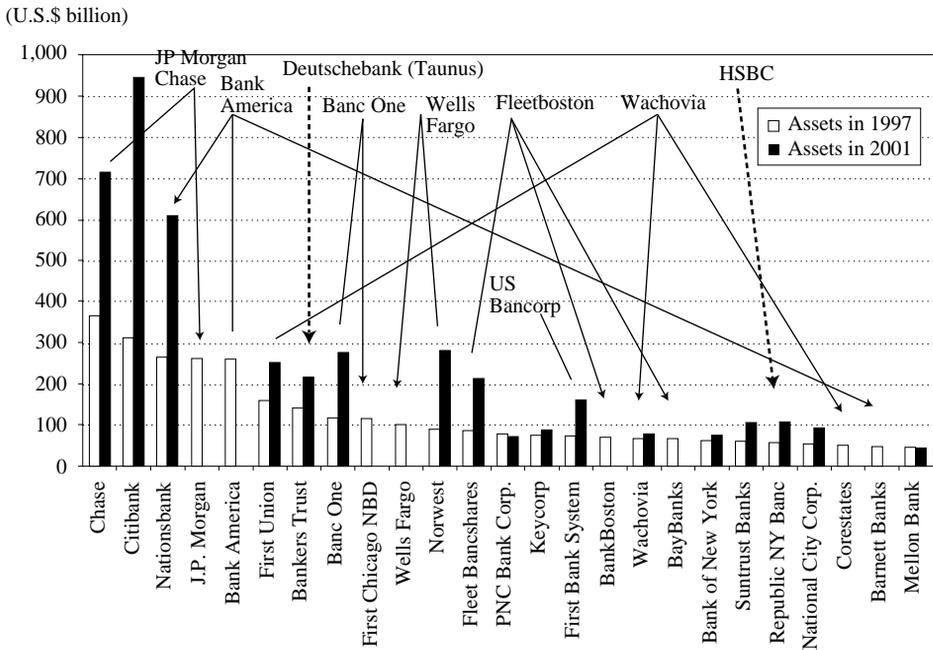
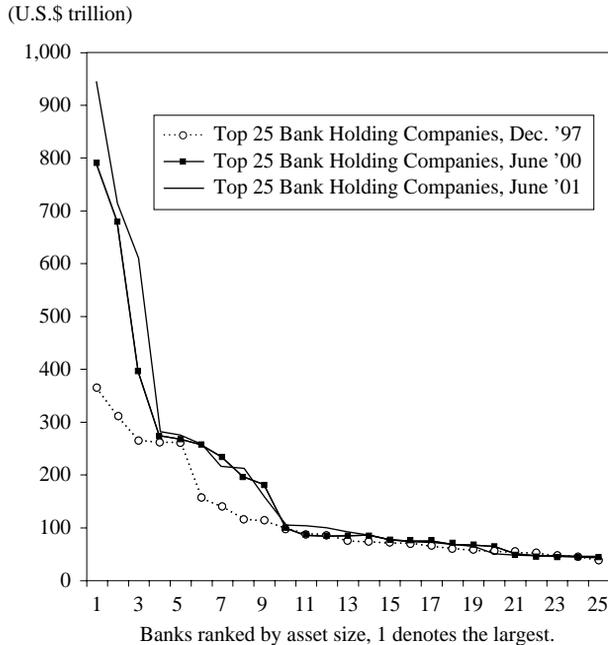


Fig. 2. Comparison of Asset Size of Top 25 Bank Holding Companies, 1997–2001



Sources: National Information Center, Federal Financial Institutions Examination Council (FFIEC); Federal Deposit Insurance Corporation (FDIC).

#### IV. WESTERN EUROPEAN BANKING AND THE GLOBAL BANK MERGER WAVE

The macrostructure underlying Western European banking provides an ambiguous backdrop for bank mergers. On the one hand, Europe is a huge market with many prosperous middle-market customers; macroeconomic growth and income levels are generally high; deregulations since the mid-1980s, and the coming integration of European markets (Mullineux and Murinde 2001), have resulted in growing customer bases for expansion-oriented banks. On the other hand, established corporate practices have discouraged mergers and also discouraged historically restricted arms-length, market-based allocations of funds in credit markets. For example, large French banks were government-owned until recently, and large German banks were engaged in cross-shareholding and long-term relationships with large corporations. Differences in the banking systems and regulations have also prevented cross-bor-

der mergers, as have differences in bank culture from country to country. There are high entry costs to cross-border mergers, ranging from regulatory and cultural hurdles to the inability to cut costs by closing redundant branches. This context, in turn, led to passive bank strategies.

Until recently, these factors blocked bank mergers.<sup>10</sup> European banking was characterized by substantial fragmentation and strong home-country advantages: banks specialized in bond issues and currency transactions in their home nations (Dermine 1996). In larger nations, home-country advantage combined with high and relatively stable income flows implied the existence of stable profits. This situation changed because the economic logic by which nonfinancial corporations and banks remained closely linked began to break down. Two factors were external. First, U.S.-based firms were able to penetrate European financial markets, especially in investment banking activities. This resulted in the dismantling of the “webs of national influence built up over decades.”<sup>11</sup> Second was the launching of the European Monetary Union and the introduction of the Euro. These two factors led to a strategic shift by large European banks: they went on a merger tear. *Time International* (March 22, 1999, p. 50) observed: “Banks within domestic markets are beefing up in preparation for the next stage: a slew of cross-border banking tie-ups between the remaining players.” Many, though not all, of these mergers have been cross-border ones. These have involved banks in two categories: those from small-market European nations, which have had to expand abroad to attain a globally competitive scale; and megabanks from large-market European nations.

One example of an ambitious small-market bank is ABN Amro of the Netherlands. This bank resulted from the merger of Algemene Bank Nederland (ABN) and Amsterdam-Rotterdam Bank a decade ago (*Euromoney*, December 1999). Algemene Bank Nederland in particular had an established international network. The merged entity closed many branches and cut other costs, boosting its net revenue. Algemene Bank Nederland Amro has moved simultaneously in two different strategic directions. First, it looked for available niches in domestic and global securities markets. It was the first bank to issue securitized paper in the Netherlands (September 1997), and it pioneered web-based bond sales (March 2001). It has also expanded its brokerage and market presence opportunistically: for example, it entered the hedge-fund market by hiring former floor traders from consolidating exchanges (*Dealers Digest*, February 26, 2001).

<sup>10</sup> The *Economist* (March 13, 1999, p. 19) summed up European banks’ cross-border merger problems as follows: “Cross-border mergers are doubly difficult. There is little overlap between banks from the different countries and the logic here is different: less cost cutting, more revenue generation. Yet that is precisely why banks are hesitant. Buying a bank in another country with another language and another legal system is a risk that few want to take. . . . full mergers have proved difficult.”

<sup>11</sup> *Economist* (June 23, 2001, p. 58). This article noted that Mediobanca, the largest Italian investment bank, was sixth in volume in Italy in 2000.

Second, ABN Amro has moved aggressively to expand its cross-border consumer-banking operations, especially in Asia and Latin America. Being one of the few cross-border banks engaged in consumer banking, its approach is equivalent to the upscale retail banking discussed above. As the *Harvard Business Review* (May/June 1999) put it: “Consumer banking is a loosely defined notion. ABN AMRO Bank defines it as providing financial services to the affluent sector in a given market. At the lower end of the socioeconomic scale, consumer banking borders on mass retail banking; at the high end, on private banking”<sup>12</sup> (p. 169).

Algemene Bank Nederland Amro acquired a major interest in Thailand’s Bank of Asia in early 1998, and in mid-1998 became the first international bank in Kazakhstan. In late 1998, ABN Amro became the first Dutch bank allowed to operate in Beijing, and it also bought Banco Real, the fourth largest bank in Brazil, for U.S.\$2.1 billion.<sup>13</sup> It also operates branch networks in Costa Rica, Guatemala, Hungary, and South Africa. In the United States, ABN Amro sold its New England-based European American bank to Citibank (*Banker*, March 2001), allowing it to focus on its strengths in the U.S. Midwest (where it owns LaSalle Bank in Illinois and Standard Federal in Michigan).

Another ambitious Dutch bank, Internationale Nederlanden Group (ING), has also used mergers to become a large-scale “financial supermarket” that, like Citigroup, combines insurance and commercial banking. Internationale Nederlanden Group was created by a 1991 merger; like ABN Amro, the merged bank had a base in Latin America. It bought Barings in 1995, after that bank had been ravaged by Nick Leeson’s exchange speculation, and later Equitable of Iowa. At the end of 1997, it bought Cruz Blanca Securos de Vida, a Chilean life insurer, and BBL of Belgium. It has also purchased banking assets in Germany. Internationale Nederlanden Group has built up its market capitalization, which since 1999 has been surpassed in Europe only by UBS. Internationale Nederlanden Group has thus far not succeeded in using this war chest to enter the top echelon of European megabanks. Its attempt to buy Crédit Commercial de France (CCF) was rebuffed in December 1999, despite an offer 15 per cent over CCF’s market value.

This reflects another idiosyncrasy of the European situation—the resistance of banks in many national markets to cross-border mergers. There were no takeovers of French banks until HSBC of the United Kingdom bought CCF in April 2001.

<sup>12</sup> This article goes on to note that Citibank and HSBC are among the few global banks competing in this banking market, and observes: “The formula ABNAMRO Bank will apply to the international consumer business could be summarized as ‘business class banking,’ appealing to the higher market sophistication and service sensitivity of their target group. . . . In general, the bank is developing a business class concept based on relationship, convenience, and trust that will place it close to its customers. ABN AMRO Bank expects to be one of, at most, a handful of financial institutions working towards achieving the ambition of building an international consumer banking brand.”

<sup>13</sup> Algemene Bank Nederland has conducted investment banking in Latin America for eighty years, but never before commercial banking.

Most mergers, even the largest, have been defensive combinations within domestic borders. This was the case with the March 1999 bid by Banque Nationale de Paris (BNP) to acquire both Paribas and Société Générale, just after these two institutions had publicly affirmed their interest in a “marriage of equals.” Since Paribas was an investment bank, while the other two were primarily commercial banks, this merger offered the prospect of both cost-cutting and product-line expansion.<sup>14</sup> However, a strong public controversy erupted over BNP’s aggressive offer. In June 1999, BNP succeeded in buying Paribas. This has not worked out well; since Paribas had no branch network, few cost economies were available on the commercial-banking side; and a mass exodus of personnel occurred on the investment-banking side. In May 2001, BNP purchased BancWest of Hawaii to boost its private-banking, asset-management, and insurance activities in the United States, and to pave the way for further expansion in U.S. banking markets.

Italy’s banks similarly have been engaged in a series of defensive mergers. In March 1999, Italy’s two largest banking groups made merger bids—UniCredito Italiano for Banca Commerciale Italiana (BCI), and Sanpaolo IMI for Banca di Roma. Both were motivated by cost-cutting considerations, and aimed at increasing market capitalization. In June 1999, Italy’s fourth largest bank, Banca Intesa, merged with the fifth largest, Banca Commerciale Italiana (BCI). Italy’s defensive bank consolidations have occurred very recently because many large banks have only recently been privatized. Spain’s defensive consolidations have been underway for far longer. For example, Banco Central Hispanamericano (BCH) was created in 1992 by a defensive merger made in light of the emerging single European market. In January 1999, the largest Spanish bank, Banco Santander, consolidated its position by merging with BCH, then—third largest. The second largest Spanish bank, Banco Bilbao Vizcaya, was created by a merger of two Basque banks in 1988. These defensive mergers throughout Europe have led to branch closings, cost cutting, and increases in market capitalization. These two large Spanish banks, while well capitalized due to sizable earnings in their isolated domestic market, have not attempted to expand into other European nations; instead they have used acquisitions to take a leading role in Latin American banking markets (ECLAC 2001, Table I.12).

This brings us to the second category of cross-border European mergers—those by megabanks seeking global scale in investment banking, namely, by becoming able to service megacorporations and to underwrite “bulge bracket” issues. German banks, which have a miniscule share of their nation’s deposit market (state banks dominate it), have been the leaders in these efforts to join the “bulge bracket.” Even these efforts can be interpreted as defensive reactions to market shifts. In the post-

<sup>14</sup> Crédit Agricole, a mutual bank whose asset size is among the world’s largest, is also seeking defensive merger partners (*Economist*, July 21, 2001).

war German industrial model, large banks provided long-term finance to large industrial companies, in relationships cemented by cross-shareholding and managerial consultation. Banks' deposit bases have stagnated, however, as wealthholders shifted into nonbank savings vehicles. As elsewhere in Europe, Germany's largest banks have responded to these pressures and to the prospect of European liberalization by a series of actual and attempted mergers, including the failed mid-1999 merger attempt of Germany's largest banks, DB and Dresdner. These mergers are expected to lead to tighter credit limits, as merging banks shrink through cost-cutting (*Euromoney Institutional Investor*, May 5, 2000). This has pushed nonfinancial firms to seek a higher share of their financing in direct-credit markets, weakening bank/corporation relationships and pushing European firms and banks ever more toward the U.S. corporate financing model. And European firms' mergers have been largely underwritten by U.S. investment banks—providing a target for the European banks (such as CSFB, DB, and Loyds TSB) that have aimed at joining their ranks.

Dresdner, after several unsuccessful merger attempts, was finally bought by Allianz, the world's second largest insurer, in April 2001; this combination represented an effort to create what the *Wall Street Journal* (April 2, 2001, p. A17) termed a "banking, insurance, and asset-management colossus"—a German Citigroup.<sup>15</sup> Deutsche Bank has been seeking a successful formula for some time. It has trimmed its retail-branch staff by one-fifth since 1992. Deutsche Bank bought British merchant bank Morgan Grenfell in 1989; but this resulted in a disaster due to a clash of management cultures. Deutsche Bank then spent billions buying investment-banking talent, only to lose out when its proficient high-tech team left for CSFB in 1998. Then, in mid-1998, it took over Bankers Trust for U.S.\$9 billion—a move that, as noted above, led other European megabanks to hunt for blue-chip U.S. investment banks such as JP Morgan, Paine Webber, and Lehman Brothers. Deutsche Bank eventually succeeded in its long quest when *Euromoney* (July 2000) named it the leading global bank.<sup>16</sup> *Fortune's* Guyon (2000) observed: "The bank may still be called Deutsche, but the center of gravity has clearly moved from the old-line German commercial bankers in Frankfurt to a polyglot team of investment bankers headquartered in London . . . transform[ing] it into a money machine that has finally brought Deutsche within spitting distance of investment banking's perennial leaders, Goldman Sachs and Morgan Stanley."

<sup>15</sup> The same *Wall Street Journal* article quoted Donald Moore, chair of Morgan Stanley Group Europe, as follows: "This is not about banks getting into insurance or insurers getting into banking. This is about products, customers, and distribution."

<sup>16</sup> This article noted that DB "has recently addressed one of its most glaring weaknesses—lack of critical mass in the US—through acquiring Bankers Trust, the integration of which, so the evidence now suggests, has progressed more smoothly than the bank dared hope. . . . In 1998, Deutsche realized it needed to address its weakness in the US, where 60% of global investment banking fees are generated" (p. 33).

## V. EAST ASIAN BANKING AND THE GLOBAL BANK MERGER WAVE

Any analysis of Asian financial capital must begin with Japan, whose economy and financial institutions dwarf those in the rest of East Asia. Japanese main banks have historically had the same intimate relations with industry as did large German banks. Strong governmental leadership and *keiretsu* groups kept large banks' financial resources, which were based on workers' high saving rates, harnessed to corporate and government goals. The strong performance of Japan's corporations led its banks to seek out new investment outlets, including real estate and equity in the late 1980s. This contributed to the bursting of Japan's bubble economy, leaving Japanese banks with a huge and intractable volume of nonperforming and insolvent loans. The large-bank sector as a whole became insolvent.

One response to this bank insolvency crisis has consisted of further deregulation—including the Big Bang and the encouragement of foreign direct investment and mergers (*Japan Economic Institute Report*, No. 23, June 20, 1997). Motivated largely by distress, Japan's large banks have been engaged in a series of defensive mergers, accompanied by government assistance in unloading bad debt.<sup>17</sup> In 1990, Mitsui Bank and Taiyo Kobe Bank formed Sakura Bank. In 1991, Kyowa Bank and Saitama Bank created Asahi Bank. A potential merger between Daiwa—damaged by a bond-trading scandal involving its U.S. affiliate—and Sumitomo was undermined when Sumitomo's hard bargaining violated prevailing industry norms. In April 1996, the Bank of Tokyo and Mitsubishi Bank merged into then-largest Bank of Tokyo-Mitsubishi.

These “bigger is better” mergers did not resolve the large-bank sector's problems: gains in microeconomic efficiency were minimal, and these banks' inability to lend compromised any possible economic recovery. In 1999, a further round of defensive mega-mergers was initiated. The Industrial Bank of Japan (IBJ), Fuji Bank, and Dai-Ichi Kangyo Bank were combined to form Mizuho Financial Group, the world's largest bank, in August 1999. Two months later, Sakura and Sumitomo were combined into Sumitomo Mitsui. In March 2000, Sanwa, Tokai, and Asahi agreed to merge into one entity, also called Sanwa Bank. A month later four institutions—Bank of Tokyo Mitsubishi, Mitsubishi Trust, Nippon Trust, and Tokyo Trust—agreed to form the Mitsubishi Tokyo Financial Group. Only the Sumitomo Mitsui partnership has yielded a unified leadership structure. Because these banks have not overcome strategic paralysis, these mergers can yield at best gains from cost-cutting measures.

A decade into the postbubble period, virtually all large Japanese banks have been

<sup>17</sup> Dai-Ichi Bank and Nippon Kangyo Bank began the consolidation movement among large Japanese banks in 1971 when they merged to create Japan's then-largest bank, Dai-Ichi Kangyo Bank.

merged or suggested for merger.<sup>18</sup> Many analysts favor more mergers and deregulation, even while not being hopeful that these steps will either solve banks' bad-debt problems or restore Japanese macroeconomic growth (Helweg 2000).<sup>19</sup> The surviving large Japanese banks have gradually cut their links to the large nonfinancial firms with which they were former partners. This continuing crisis at home, exacerbated by the Asian financial crisis, has also prevented Japanese banks from acquiring banking assets abroad; indeed, Japanese-owned banks' presence in U.S. markets has been cut, even while U.S. investment banks—Merrill Lynch and Ripplewood Holdings—have successfully penetrated the Japanese market (Rowley 2000).

Table III and the accompanying Figure 3 illustrate this pattern using data on the firms listed in *Business Week's* annual "Global 1000" rankings.<sup>20</sup> Table III presents data on asset size and market values for all the listed firms, and then for banking firms, from the United States and from other areas in the world. The growth in U.S. banks' market values reflects both rising capitalization and rising market-to-book value premia. Figure 3 shows the dramatic surge in the global presence of U.S. banking firms; this sector's market value increased almost tenfold between May 31, 1989 and May 31, 2001. The market value of the European and British banks also grew rapidly, though less than that of the U.S. banks, while the market value of the Japanese banks was cut nearly in half.

Most of the cross-border mergers among non-Japanese East Asian banks involve distress mergers in the wake of the financial crisis. This scenario has been played out in all the nations affected by the Asian financial crisis of 1997–98. Consider Korea, which had a government-regulated financial system: banks did not have distinct strategies, but instead operated as instruments of government credit allocation (Crotty and Dymski 2001). The effectiveness of the Korean financial system in promoting Korea's rapid growth rate was widely acknowledged. Two U.S. banks—Bank America and Citibank—had limited operations in Korea, but otherwise no foreign banks operated domestically. The Korean system changed in the mid-1990s, when Korea bid to join the OECD. A condition of membership was financial deregulation. Korea's government permitted the creation of twenty-four merchant banks

<sup>18</sup> In September 2001, the government encouraged Daiwa to merge with Asahi. Mitsui Trust merged with Chuo Trust in 1999. In March 2001, a merger of Toyo Trust with Sanwa and Tokai was announced.

<sup>19</sup> Cleansing balance sheets of "old" problem debts is one thing; "new" problem debts due to the stagnant pace of economic activity is another. The *Far Eastern Economic Review* (October 4, 2001, p. 66) notes, "Between September 2000 and March 2001, Japan's 16 biggest banks sold or wrote off a hefty ¥4.4 trillion worth of loans to borrowers classed as either 'bankrupt' or 'probable bankrupt.' Yet despite the disposals, the amount of loans in those categories barely fell at all, only declining to ¥11.7 trillion from ¥12.7 trillion as more borrowers failed to service their debts."

<sup>20</sup> Since the late 1980s, *Business Week* magazine has presented an annual ranking of the one thousand largest firms worldwide based on their global market value. Figures are calculated as of May 31 in each year's survey. Mutuals and state-owned firms were excluded.

TABLE III  
 MARKET-VALUE STATISTICS FOR FIRMS LISTED IN *BUSINESS WEEK*'S "GLOBAL 1000," 1989–2001

	Market Value					Market Value/Book Value				
	1989 (U.S.\$ Bil.)	1997 (U.S.\$ Bil.)	% Change, 1989– 97	2001 (U.S.\$ Bil.)	% Change, 1997– 2001	1989	1997	% Change, 1989– 97	2001	% Change, 1997– 2001
All listed firms:										
United States	1,808	5,423	14.7	9,552	15.2	3.1	5.8	7.9	3.9	–9.3
Canada	81	171	9.8	306	15.6	2.8	2.9	0.3	2.4	–4.4
Britain	346	889	12.5	1,399	12.0	4.1	5.7	4.1	2.5	–18.3
Continental										
Europe	408	1,696	19.5	2,880	14.2	4.1	5.1	2.7	3.5	–9.1
Japan, Hong Kong, Singapore	2,056	1,695	–2.4	1,935	3.4	6.9	4.0	–6.5	2.5	–11.6
Financial firms only:										
United States	261	1,182	20.8	2,245	17.4	1.6	2.5	5.9	3.4	7.9
Canada	34	68	9.1	123	16.0	1.5	2.1	4.8	2.3	1.9
Britain	106	388	17.6	476	5.3	1.4	2.8	9.2	2.8	0.3
Continental										
Europe	196	627	15.6	1,114	15.4	2.0	2.1	0.5	4.5	21.6
Japan, Hong Kong, Singapore	993	836	–2.1	527	–10.9	5.4	2.1	–11.0	1.4	–10.1

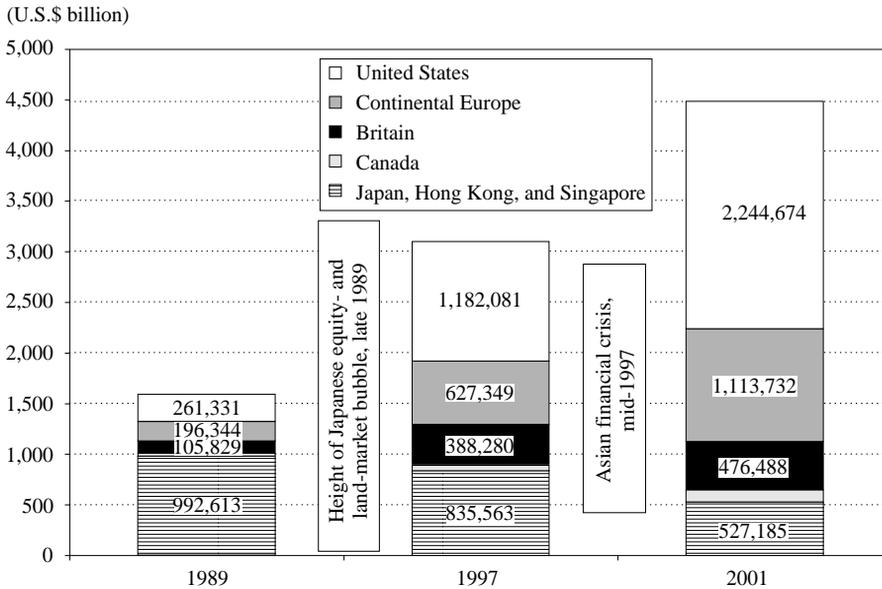
Source: *Business Week* (various issues).

Note: Averages are computed for annual averages, using market value of equity shares as weights.

as vehicles for deregulated banking activities. These merchant banks were used both to finance the expansion of Korea's chaebols into overseas production and to become engaged in offshore speculation. The overextension of the chaebol production plans and the currency collapses led to a currency crisis and then to an IMF agreement, which was signed on Christmas Eve 1997. Subsequently, industrial and financial restructuring became imperative.

Korea's banking system was decimated by the dynamics of default and destabilization: by March 1998, its collective net worth fell below U.S.\$1 billion. Policy changes encouraged mergers of Korean financial and nonfinancial firms with offshore and domestic firms, and enhanced foreign investment in Korean firms was also promoted. According to the Samsung Research Institute, five of the twelve largest Korean banks are now majority foreign-owned; another two have foreign ownership participation. The companies participating as owners of Korean banks include JP Morgan, Bank of America, Commerzbank, Allianz, Goldman Sachs,

Fig. 3. Market Value of Financial Firms Listed in *Business Week*'s "Global 1000," Classified by Global Areas, 1989–2001



Bank of New York, and ING. The focus of these retooled banks is on upscale banking customers.<sup>21</sup>

The cross-border merger experiences elsewhere in most of the other Southeast Asian nations (leaving aside the People's Republic of China and Hong Kong) resemble Korea's: distress mergers involving foreign partners buying up banking assets for cut-rate prices. HSBC has been especially aggressive in buying banks through such purchases.<sup>22</sup> The two Asian exceptions to the crisis-driven distress scenario are Singapore and Taiwan. The banks of both countries largely avoided the effects of the Asian financial crisis. The numerous banks in Taiwan (see Table IV) have largely remained intact, and as noted, have in some cases expanded into Asian American markets in the United States. Singapore's cash-rich banks have, by contrast, purchased other Asian banks. United Overseas Bank (UOB) and the Development Bank of Singapore (DBS) in particular have been active in cross-border acquisitions. United Overseas Bank acquired, among others, Thai and Philippine banks;

<sup>21</sup> According to the *Far Eastern Economic Review* (August 23, 2001, p. 44): [CEO] "Kim wants to turn Kookmin into a retail colossus by leveraging its lucrative credit-card and home-mortgage businesses. He envisages a move away from mass clients to private banking for the affluent. A key shift will be toward personalized financial services like selling insurance through bank branches and managing mutual funds."

<sup>22</sup> HSBC has been acquiring banking assets worldwide. Its acquisition of a French bank was noted above; HSBC also acquired a Brazilian bank in 1997 (Bamerindus), Seoulbank of Korea in 1999, and Republic National Bank of New York in 1999 (*Economist*, May 15, 1999).

TABLE IV  
FINANCIAL RATIOS FOR COMMERCIAL BANKS IN ASIA AND AUSTRALIA

		Total Loans as % of All Assets for:			Assets of the 10 Largest Banks as % of All Bank Assets
		All Banks	10 Largest Banks	All Other Banks	
Japan	1999	62.2	61.5	63.1	55.6
	2000	63.1	61.7	64.9	56.0
.....					
Other East Asian nations ("Four Tigers"):					
Hong Kong	1999	49.6	48.1	55.7	86.4
	2000	44.2	42.5	55.7	87.2
Singapore	1999	73.0	NA	NA	
	2000	69.6	NA	NA	
Korea	1999	45.6	48.1	30.8	85.6
	2000	54.4	56.6	44.7	82.1
Taiwan	1999	66.8	66.8	66.8	48.2
	2000	66.1	65.8	66.4	48.5
.....					
Southeast Asian nations:					
Indonesia	1999	52.4	50.1	59.0	73.8
	2000	18.9	15.9	38.7	86.8
Malaysia	1999	64.9	64.8	65.2	69.5
	2000	60.5	59.8	62.5	73.1
Philippines	1999	54.5	54.2	55.4	77.8
	2000	49.0	48.1	52.7	80.6
Thailand	1999	72.0	72.0	72.6	93.6
	2000	70.2	70.7	59.0	95.7
.....					
China	1999	60.2	61.3	41.5	94.5
	2000	58.5	59.4	41.0	95.0
Bangladesh, India, Sri Lanka	1999	39.9	38.5	42.3	64.4
	2000	39.1	37.4	42.1	63.9
Australia, New Zealand, Papua New Guinea	1999	68.1	67.0	78.6	90.2
	2000	70.4	69.5	78.3	89.6

Source: "The Region's 500 Largest Banks," *Asia Weekly*, September 15, 2000.

Notes: 1. Only 8 banks are listed for Singapore. Total banks listed for other nations or areas are as follows: Japan, 145; Hong Kong, 26; China, 22; Korea, 18; Taiwan, 48; Indonesia, 36; Malaysia, 33; Philippines, 26; Thailand, 13; Bangladesh, India, Sri Lanka, 84; Australia, New Zealand, Papua New Guinea, 31.

2. NA = not available.

DBS, Southeast Asia's largest bank, bought banks in the Philippines, Thailand, and Hong Kong. Interestingly, the Singaporean government has persuaded the four largest Singaporean banks to merge into two, so as to ensure their survival as global competitors.<sup>23</sup>

<sup>23</sup> Low (2001) gives a detailed discussion of these Singaporean mergers.

TABLE V  
FINANCIAL RATIOS FOR BANKS IN THE AMERICAS

		Total Loans as % of All Assets for:			Assets of the 10 Largest Banks as % of All Bank Assets
		All Banks	10 Largest Banks	All Other Banks	
25 largest U.S. bank holding companies:					
All <sup>a</sup>	1999		53.2		
	2000		51.3		
European-owned	1999		15.8		
	2000		24.9		
HSBC	1999		42.0		
	2000		51.5		
Domestically owned	1999		55.9		
	2000		53.1		
Commercial banks <sup>a</sup>	2000	61.2	58.6	63.7	49.4
Commercial banks in Latin America:					
Argentina	1999	58.2	62.5	49.5	
	2000	70.3	72.5	64.9	70.4
Brazil	1999	20.8	19.9	24.3	
	2000	21.6	20.3	25.6	67.0
Chile	1999	31.1	27.0	41.3	
	2000	27.1	25.2	32.2	72.9
Colombia	1999	57.2	55.2	60.8	
	2000	49.4	44.5	59.1	66.8
Ecuador	1999	66.7	67.3	65.0	
	2000	33.7	33.1	35.6	77.0
Mexico	1999	69.0	69.6	57.2	
	2000	52.2	52.2	51.7	94.9
Venezuela	1999	50.9	52.1	46.6	
	2000	42.5	41.6	45.2	75.2

Source: lanota.com, Superintendencias de Bancos de Venezuela, Colombia, Chile, Ecuador, Banco Central de Brasil, Comisión Nacional Bancaria y de Valores de Mexico y Asociación de Bancos del Peru.

Note: Data are compiled as of December 31 unless otherwise noted.

<sup>a</sup> Figures apply to the twenty-five largest and not ten largest banks.

The impact of these mergers in East and Southeast Asia is to highlight the shift away from government-determined credit allocation with largely homogeneous deposit instruments, and toward upscale retail banking with market-driven loan decisions. As the head of a bank trade association in Tokyo told the author in July 2000, “We are looking for profitable customers.” Competition for upper-income customers with foreign institutions such as Citibank has reinforced this shift. Table IV depicts some of the quantitative aspects of this behavioral shift. It shows that one trend was linked to these consolidations—an increase in banking concentration

in Southeast Asia (as measured by the share of banking assets held by the ten largest institutions). Table V shows that the largest banks in the United States have systematically lower loan-to-asset ratios than smaller banks—a predictable consequence of the strategic shifts discussed in Section II.<sup>24</sup> Table IV shows that only in Hong Kong and Indonesia do the largest banks have systematically lower loan-to-asset ratios than other banks. This is not surprising: first, global megabanks (which have led the shift away from traditional lending) have largely failed to purchase assets in East and Southeast Asia; second, even after merging, since many banks have remained saddled with bad-loan problems, their post-merger behavior has often remained tightly constrained. In any event, these data suggest that Asian mergers may aim at both customer- and production-seeking.

## VI. LATIN AMERICAN BANKING AND THE GLOBAL BANK MERGER WAVE

Latin American banking prior to liberalization was comprised primarily of two clusters of bank types: family-owned financial groups and state-owned institutions. The latter typically had distinct functional responsibilities and played a key role in national development strategies. As in Korea, a few multinational megabanks had limited operations in Latin American markets, often as a colonial or neocolonial legacy. These nations' involvement with offshore multinational banks increased dramatically in the late 1970s in the Latin American debt buildup. Loan defaults by borrower nations led to substantial pressures on these nations to liberalize, and to the "Lost Decade" of stagnation, with some nations experiencing recurrent hyperinflation. Stagnant growth and foreign-exchange shortages weakened domestic banks and eroded domestic loan markets. By the early 1990s, these nations had substantially liberalized their financial markets and relaxed their rules on foreign ownership of domestic corporations, including banks. This led to rounds of overseas bank acquisitions across Latin America in the 1990s and 2000s.

The most dramatic case is that of Mexico. Economic liberalization led Mexico to privatize key national and state banks in the early 1990s, including its three largest banks—Banamex, Bancomer, and Serfin—on which we focus here. Mexican investors bought all three institutions. Questionable loans and involvement in drug-money laundering weakened these institutions, the peso's plunge in December 1994 hammered them. All the three banks found foreign institutions to bolster their equity position—Banamex agreed to form an alliance with Aegon of Holland in October 1995, GE Capital and J.P. Morgan provided financial lifelines to Serfin in 1995 and 1996, and two Canadian banks and Aetna bought equity stakes in Bancomer in 1996.

<sup>24</sup> A comparison of Tables IV and V also reveals that most of the Asian nations' banking systems are more concentrated than that of the United States.

The Mexican government took steps to support these weak institutions: for example, in December 1995, it agreed to take over Banamex's bad loans, and in 1997, it wrote off bad mortgages. The performance of these banks improved; but starting in July 1996, Serfin and Bancomer were implicated in drug-money laundering. These two banks were found guilty in a U.S. court in March 1999; Serfin was seized by the government in July 1999. Its bad loans were sold off in October 1999. As of December 1998, foreign banks were permitted to become majority owners of Mexican banks. Serfin, in which HSBC had bought a stake in 1997, was sold to Santander in May 2000. Banamex competed with Banco Bilbao of Spain for Bancomer, but lost out. Bancomer was purchased by Banco Bilbao in June 2000, with an offer of approximately U.S.\$1.4 billion. Aetna then sold out its stake in Bancomer in September 2000. Citigroup took over Banamex in July 2001; in November 2001, it announced layoffs of 7,800 workers. In January 2002, Aegon sold its stake in Banamex to Citigroup.

Actually, the interaction of financial crises and government support paved the way for deep cross-border penetrations into Latin American banking markets (some of which have been discussed above). In Mexico, European, Asian, and U.S. banks accounted for 78 per cent of all the banking assets in 1999 and for 79.8 per cent in 2000.<sup>25</sup> The Mexican case was extreme because it alone experienced a mid-1990s currency crisis; nonetheless, foreign banks have encroached throughout South America (ECLAC 2001, Table I.12). In Argentina, foreign banks accounted for 24.6 per cent of the 1999 banking assets, and for 28.5 per cent of the 2000 banking assets. In Brazil, foreign banks accounted for 20.4 per cent of the banking assets in 1999 and for 33.6 per cent in 2000; in Chile, for 39.3 per cent in 1999 and for 44.6 per cent in 2000.

Algemene Bank Nederland Amro's U.S.\$2.1 billion purchase of its fourth largest bank, Banco Real, in 1998, led one industry source to comment: "Brazil is a large market which has been able to attract the attention of foreign banks that feel they've run out of growth opportunities at home. . . . Latin American banks have been eager to pursue mergers because of earnings difficulties, high levels of nonperforming loans, and inadequate capital" (*Mergers & Acquisitions*, September/October 1998, p. 8). Nonetheless, Brazil has constituted a partial exception to this pattern of overseas takeovers of weak domestic banks.<sup>26</sup> Some of its domestic banks performed well after the Real plan was implemented in 1994, they have been able to reverse some foreign entry into Brazilian banking markets. Itau bought out BFB, a subsidiary of the French *Crédit Lyonnais*, in July 1995; and in December 2001 it announced plans to purchase *Banque Sudameris*, a subsidiary of *IntesaBci*

<sup>25</sup> These percentages are based on the 333 largest Latin American banks as of 2000, see Table V.

<sup>26</sup> Carvalho (2001) and De Paula (2002) provide detailed information on foreign bank entry into Brazil. McQuerry (2001) discusses the impact of macroeconomic instability and reform on Brazil's banking sector.

SpA of Italy. When virtually all of Brazil's state banks became insolvent, they were offered for sale in what turned into a competition between domestic and overseas banks. Banco Bradesco acquired Banco do Estado da Bahia in June 1999, and Banco Mercantil do Sao Paulo in January 2002; Itau merged with Banco do Estado do Parana in October 2000; but ABN-Amro acquired Banco do Estado de Pernambuco in November 1998, and Santander bought the largest of the state development banks, Banespa, in November 2000.

The impact of foreign bank entry on banking practices is stronger than in Asia. The entry of overseas banks into Mexico and Brazil reflects primarily customer-seeking motives. Production (loan)-seeking mergers are problematic both because of national banking crises and because recurrent hyperinflation had eroded banks' willingness and ability to make loans. Brazil, exposed to chronic hyperinflation, has an extremely low loan-to-asset ratio (indeed, it is as low as that for South Asia, as shown in Table IV); so do Chile, Ecuador, and Venezuela. Latin American commercial-banking markets are highly concentrated, as Table V shows. In Brazil, Chile, and Colombia, the ten largest banks have significantly lower loan-to-asset ratios than do other banks.

Therefore, foreign banks entering Latin America are looking for profitable customers, as in Asia; and they are even more reluctant to become engaged in loan-making activities than are foreign banks entering Asian markets.<sup>27</sup> The recent Argentinian crisis indicates the hazards in Latin American banking. Four of the top five commercial banks in Argentina are foreign-owned, and the recent crisis has made them reconsider their position(s) in Latin American markets. FleetBoston considered pulling out and writing off its entire Argentinian banking position, so did the Spanish banks BBV and Santander. Ironically, large overseas banks' losses in Argentina have given domestic Brazilian banks an edge in acquiring middle-level banks and consolidating their position(s). The Spanish banks in particular have been hard-hit by this crisis, in the same way as J.P. Morgan and other U.S. banks. The February 2002 edict preventing bankers from leaving Argentina only reinforced the gap between the ideal of an easily reversible investment decision and a protracted standoff. The profitable customers may be there in Argentina, or elsewhere in Latin America, but these microagents are enmeshed in troubled macrostructures.

## VII. CONCLUSION AND DISCUSSION

*The global scenario.* Mergers and acquisitions have become the primary means of bank expansion, especially for banking firms seeking the commanding heights in

<sup>27</sup> The entry of Spanish banks is a possible exception: these banks' strategy of penetrating virtually all Latin American countries indicates that they have considered that Latin America is a regional market, and not just a terrain for plucking desirable customers.

global financial markets. Our review of bank mergers across the world illustrates the relevance of the model developed in Section II: macrostructural factors determine the options—including mergers—available to banking firms; a variety of banking strategies can lead to bank mergers, depending on banks' methods of extracting revenue, their approaches to identifying and relating to customers, and their access to capital markets and to banking alliances.

In general, the more important is distress in motivating bank mergers, the less important are strategic elements. Since defensive mergers also involve efforts to protect market share, they tend toward strategic conservatism. The banks capable of strategic innovation are those with resources and access to capital. Access to capital, in turn, has involved two very different scenarios. Some firms—notably large U.S. banks—have been able to draw on the large and booming U.S. equity markets. Table I depicts this pattern. Focusing on the *Business Week's* "Global 1000," U.S. banking firms are well capitalized in terms of both book value *and* the market value of their shares relative to book value. As a result, the market value of U.S. banks' equity shares relative to their assets is far larger than that for banks in other regions of the world. As Table I shows, U.S. nonfinancial corporations have also enjoyed this advantage. These global financial imbalances explain why non-U.S. banks interested in global investment-banking presence have consistently entered U.S. markets.

Despite the increasingly homogeneous global financial regulatory architecture (Mullineux and Murinde 2001), there is little indication of homogenization in the circumstances triggering mergers, in the strategic impetus behind mergers, or in the capabilities and scope of the surviving institutions. Several banks—HSBC, ABN Amro, and to a lesser extent Citibank—are engaged in a global version of upscale retail banking. Another small group of competitors—among which Deutsche Bank, Chase, again Citibank, CSFB, and ING—are seeking dominance in investment banking. Other banks are focusing on regional or national markets. Some are attempting to work off balance-sheet problems. There is no evidence that a small set of truly global and universal banks is emerging. The *Economist* put this very well:

Even if the most ambitious plans in France, Germany and Japan came to fruition, they would at best create "national champions." In the United States, First Union and its arch-rival, Bank of America, are each concentrating on building a pan-American structure. Only Citibank, which caters to a tiny, upmarket clientele in most countries, and the Sino-British HSBC, which lacks a substantial American retail presence, are true "global" retail banks. There are few signs of traditional banks rushing to follow. (*Economist*, August 28, 1999, p. 55)

The strategic and structural factors emphasized in this paper explain this absence of truly "global" banks. In the United States and elsewhere, banks are making strategic thrusts toward segmenting markets and choosing the customers they want.

Even in the prosperous United States of the 1990s, a significant proportion of the population has remained “unbanked” and served by informal financial arrangements. This undesired cohort is proportionately larger in less developed countries, the global trend toward the bifurcation of wealth and income is increasing both the ranks of high-value customers and of those without sufficient assets to attract banks’ interest. Turning to structural considerations, the shifting challenges presented to goal-seeking firms by evolving regulatory frameworks and macroeconomic conditions are not leading to a global rest-state. To the contrary, crises and imbalances are not only recurrent, but defining, features of the global neoliberal economy. The ability of banks in any region of the world to “go global” depends on the sustained prosperity of their regional base.

Here the magic bullet through the latter 1980s and 1990s has been Wall Street. Efforts to consolidate European exchanges have failed thus far (*Economist*, December 16, 2000). European markets account for a relatively small amount of global financial-center activity; for example, the City of London accounted for 18 per cent of the global loan volume in 2000. This advantage is by no means predetermined, but reflects current geopolitical patterns and global political economic power (Dymski 2002). Perhaps the defining aspect of this Wall Street advantage is the market value premium enjoyed by U.S. firms, including banks. While the largest banks in the United States, Europe, and East Asia are similar in size, Tables I and III show that U.S. banks have a substantial lead in the market value of their equity. This provides a tremendous advantage in individual banks’ pursuit of specific merger targets; but overall it represents a large source of national comparative advantage. Figure 3 documents the intimate linkage between the strength of national economies and the strength and strategic circumstances of banking firms.

*The developing economies and bank mergers.* The Mexican peso crisis of 1994, the East Asian financial crisis of 1997–98, and the Russian and Brazilian currency crises of 1998–99 forced even market-oriented economists to reconsider the desirability of financial liberalization and free financial flows. For example, Espinosa-Vega, Smith, and Yip (2000) argue that developing economies may grow faster if they impose some restrictions on cross-border capital movements. Calvo (2000) demonstrates that opening up derivatives markets for developing economies can reduce economic welfare. Most notably, economists at the World Bank and the IMF have found that financial liberalization increases the probability of banking crisis (Demirgüç-Kunt and Detragiache 1998), and that financial crises’ contagion effects are large and costly. The IMF interpreted the Asian crisis as demonstrating that “weaknesses in financial systems and, to a lesser extent, governance” (IMF 1998) can undermine otherwise robust economies.

So while IMF and World Bank policymakers have increasingly questioned whether open cross-border flows of capital have positive effects on national economies, they

agree that improvements in financial governance are needed for a sound and prosperous global economy. Here the need for protection from financial instability and collapse meets the global merger wave: consolidations among banking firms evidently enable to achieve the required modernization and to alleviate these shortcomings. Therefore, a global bank merger wave could, in principle, ensure that more open markets and freer cross-border flows lead to universally higher welfare levels.

But here is where recent historical experience should be the guide, not models assuming the existence of financial-market efficiency. The argument that macroeconomic stability can be achieved through alternative microeconomic structures is problematic. The evolution of financial structures is being driven by consolidations, not by regulatory frameworks, and the pattern of consolidations reflects macrostructural circumstances. In short, it is not possible to insulate microeconomic forces from macroeconomic booms and busts; to the contrary, macrostructural trends invariably influence the emerging shape of microeconomic possibility.

The spread of the global merger wave in banking has transformed banking, and the economic functions of banks. Bank mergers in the United States have facilitated the transformation of U.S. banks from integrated savings-investment mechanisms focused on local markets to differentiated service providers that feed liabilities into widely dispersed and reversible assets. The separation of customers from production facilities is, of course, endemic to the cross-border movements of firms and capital. It can imply a loss of banks' functional role of credit-provision in large portions of an economy.<sup>28</sup> As discussed above, mergers can be classified as either customer seeking, production seeking, or both. The megabanks now growing so aggressively via mergers are seeking customers, not production sites—upscale households with substantial incomes and wealth, as customers for the fee-based products and securitized instruments they prefer to sell. They are not seeking global sites for loan production in the same way. Indeed, many environments with desirable liability-side customers lack viable prospects for broad-based loan production. Allowing the operation of large U.S. megabanks in Brazil will not transform Sao Paulo into the kind of lush terrain for middle-market loan-making that these banks find in Southern California. Instead, merging banks' entry into such markets has to be considered at this stage as one more factor exacerbating uneven economic development across the world.

<sup>28</sup> The loss of economic role is not equivalent to institutional demise: in both Japan and Brazil in the 1990s, banks generated positive cash flows without making loans; instead they invested low-cost deposits in securities emitted by deficit-financing governments. This placement of government paper, of course, constitutes an economic role of another kind.

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