BANK MERGERS IN LEBANON

"THE CASE OF SECURITY BANK AND BANQUE BEYROUTH POUR LE COMMERCE

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ABSTACT

This research project tackles "Merger", a topic which is nowadays widely spread in the media and throughout some nations. Merger is really wide topic because it can take place between companies, banks, financial institutions or it can be a combination of all. In addition, it can be between institutions in the same country or overseas. Therefore, the research focused on one specific area, the bank merger activity which is actually taking place in an emerging markets Lebanon. To conduct this study, both primary (interviews, newspapers, magazines and Central Bank publications), and secondary sources (books, dictionaries) were used.

The project is an in-depth study of merger; mainly, its motives, types and directions. It analyses the banking sector in Lebanon, its development throughout three episodes pre-war, war and post war, as well as its unique characteristics and suggests the need for banks to merge in order to form strong units that are more effective and efficient and are able to face the challenges of the future.

In order to support the need for merger a real life case study was discussed: the merger between Banque Beyrouth pour le Commerce and Security Bank. The motives behind merger were identified from the point of view of each bank, the merger process was described and at the financial statements of both banks were analysed before and after merger in order to assess the outcome of this merger.

However, one case study is not enough to generalise the conclusions derived and further studies needs to be conducted in order to assess merger and to analyse its effect on the future performance of banks.

DEDICATION

TO MY PARENTS,
MY HUSBAND ZOHEIR, AND TO MY
LOVELY DAUGHTER MARIAM
WITH ALL MY LOVE

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I would like to thank all those who helped me in accomplishing my project, and supported me

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CHAPTER I

INTRODUCTION

1.1- General overview

The merger activity is sweeping across the nations bringing into being big names and huge companies with considerable amount of assets.

Among the many examples available, one would cite the merging of Chase Manhattan and Chemical Bank in the United States in April 1996 , and the merging of Mitsubistchi Bank (US$ 458.9 billion assets) with Bank of Tokyo (US$ 242.2 billion assets) that resulted in the formation of the world's largest bank: Bank of Tokyo Mitsubitchi which will command deposits of more than half a trillion dollars.[1]

The questions that arise here are: What is the meaning of Merger and why more and more companies and financial institutions are adopting this strategy?
The attempt to answer this question starts with a general overview of today's business environment and the factors influencing organizations and affecting the way they conduct their business.

In this age of change, the world has witnessed many technological advancements, intense competition, and a trend towards globalization of markets. In face of these challenges, some firms have been driven out of the market, while the role of others has been reduced to relative unimportance, yet, others have maintained their position and were strong enough to face competition.[2]

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[1] - C. Micheal, "90s Merger Mania on the move". *Khalige Times*, June 26,1995, p.29.
[2] - David & Linowes, *Manging Growth through Acquisition.* (U.S American Management Association Inc. 1968), p.45-46.

"A Corporate Business that does not grow has already started to decay"[3]. The distinctive feature here is **growth**. In fact, companies should grow not at a gradual pace that is forced upon them by external pressure, but rather through aggressive planning and forecasting. They should make a thorough scanning of their environment and not just passively react to it, but rather proact and anticipate the future to "take a hand in shaping the world in which the organization finds itself".[4]

Urged by this wind of change and the need for growth, some managers increasingly see "the quantum leap" of a big merger as their best chance for survival and growth in a fast changing market place which requires constant attention to the future. For example, Kuwait Investment Projects company (KIPCO) is contemplating a Merger involving Burgan Bank, Al Ahli Bank and Bank of Kuwait and the Middle East (BKME). KIPCO is seeking a foreign partner to help it merge those banks into a single three billion dinar ($ 10 billion) institution and revive a stagnant banking sector.[5]

In fact, the merger activity has increased tremendously in some nations such as United States to the extent of creating a "Merger Boom" or a "Merger Mania" that is reshaping the various industries: Banking, defense, technology and communications.

However, in other nations, the merger activity is still at its preliminary stages; for instance, in the Arab world, mergers are relatively absent in some countries, while in others, it is considered only as a solution to Bank's failure . As Kamal Ahmadieh from Al Mawarid Bank in Lebanon replied when asked about the possibility of his bank negotiating merger with another: "The bank is not ready to negotiate a merging case because it is not currently facing a problem. The bank would consider merging only as a "buyer" and with a bank of a smaller size".[6]

A merger is defined as a mutual agreement between two companies to combine together, where each one loses its identity in the new Company, formed by the combined assets of both companies. Like any other strategy, merging involves risk and

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[3] - David & Linowes, p.67.

[4] - Ibid, p.46.

[5] - Rewter, "Kuwait firm seeks partner in Bank Merger Plan", *Khaleej Times*, December 1995, p.19.

[6] - Interview with Mr Kamal Ahmadieh, Principal Manager of Credit and Legal department, Al Mawarid Bank SAL.

change. The risk in the sense that it requires huge investments both financial and non financial (manpower, time, managerial skills...) whose desired objectives and benefits are not directly derived in some cases, while in others, they may not be attained at all.

In fact, considerable amount of money is spent on acquiring the company, enough time will be spent in negotiating and implementing the deal, and the end result may be failure due to several factors, such as, acquiring wrong target, clash between the employees of the two companies, and internal conflicts.

Second, this strategy requires restructuring of the organization as well as changing its culture. People by nature fear change and tend to resist to it. Sometimes, it takes years before reaching total harmonization of human resources, and in some cases it cannot be reached at all. For instance, employees belonging to one merged company formed by the merging of two others, and working in the same premises may still refer to each others as Bank A and Bank B.

Merger, therefore, should be considered a crucial business activity or decision and not a "part-time" job. It requires strategic planning, dedication, commitment and a fair allocation of resources. Unless well planned and implemented, this strategy may lead to huge losses.

1.2- Purpose of the research topic:

The research aims at understanding the meaning of merger, its motives, its processes and the successful strategies to achieve it. It will study the merger activity in Lebanon, precisely the banking sector and will focus on the need for banks to merge in the light of the changing market place (Deregulation and globilization of markets) and the intense competition they will face in the future (Competition from local and foreign banks as well as from financial institutions).

It also aims to find out whether merger will be the best solution to achieve Banking Reform after the series of crisis, mainly war and banks failure, that greatly affected the Banking sector.
The research finally tries to apply the concepts under study to a real life case from the Lebanese banking sector, namely the merger of Banque Beirut pour le Commerce (BBC) and Security Bank of Lebanon (SBL).

1.3- Limitations of the study:

- The study will tackle merging in general, but will concentrate on the merging activity in one industry, "The Banking Industry". Therfore ,the results cannot be generalized to all kinds of industries.

- There will be no population study but rather a case study. Thus, the discussion and the results will be limited to the specific institutions under study (i.e BBC and SBL).

- The bank secrecy law, and the confidentiality of some agreements and decisions will present some obstacles to free disclosure of information.

1.4- Construction of the project:

This research starts with a brief introduction of the topic and the purpose it aims to achieve.
The first part of chapter 2 presents an overview of the Lebanese banking sector (during the pre-war and post-war period), its major characteristics, its role in the Reconstruction phase and finally the challenges it will face in the future and how to face them. The second part of chapter 2 begins by defining mergers, acquisitions, and consolidation in addition to the various directions and types of mergers. The rest of the chapter will be an in depth search into the motives behind mergers and the various

stages of the merging process. The chapter will also identify common strategies for a successful merger as well as the rules and regulations affecting this process. Chapter 2 ends with a list of the arguments in favour and against merging.

Chapter 3 clarifies the methodology used in conducting this research study.

Chapter 4 is devoted to present a case study about the merging of Banque Beirut pour Le Commerce and Security Bank. It will discuss in depth the motives behind such process, and the results and benefits derived from it.

Finally, the project presents a summary of the major findings and ends with some recommendations and suggestions.

1.5- Final Comment

Merging is an important managerial decision. It should be considered as a mean and not as an end by itself. However, it is not a magic tool that will solve all the problems and lead to growth. Companies that seek to contemplate Merger should carefully plan and take that decision in line with their overall corporate strategies subject to their available resources.

CHAPTER II
LITERATURE REVIEW

2.1- Overview of the Lebanese Banking Sector

The first part of this chapter will present a general overview of the Lebanese banking sector by focusing on the main events that affected it and the major challenges it will face in the future. Consequently, the chapter will highlight the need for banks to combine and merge together in order to form a stronger and healthier sector.
First one would start by defining banks and their role in society.

2.1.1- Definition of a Bank

Article 121 of the Lebanese Money and Credit Law defines the commercial bank as any establishment whose main function is to use on its own risk the money received from the public for extending credits.

Thus, unlike other establishments, only banks are given the right to get money in the form of deposits from the public and are considered owners of this money. Yet, they have the liability to return it back to depositors upon demand or upon an advanced preset agreement. Therefore, banks are considered the custodians of the community's money as well as the suppliers of its liquidity.[7]

2.1.2- Role of Banks in Society

Commercial banks perform a number of interrelated functions many of which are necessary parts of the private free enterprise system. Commercial banks bring into being the most important ingredient of the money supply demand deposit, through the

[7] - H. Grosse & G. Hempel, *Management policies for commercial banks*, (U.S: Prentice Hall Inc. 1980), p.3.

creation of credit in the form of loans and investments.[8] Given their important role, banks are highly regulated by the Central Bank as well as by rules and regulations in order to ensure their healthiness and to safeguard the public interest and society's welfare.

2.1.3- Overview of the Banking Sector

The overview of the Banking Sector will focus on three main periods:

- Pre-war period: 1970 till 1975
- War period : 1975 till 1990
- Post war period: 1990 till 1996

a- Pre-war period:

Lebanon has played a major role in the Middle East and the Arab Region for many years due to its strategic location and its free economic system.

In fact, during the period between 1970 and 1975, Beirut became an important financial center and an attractive area for investment due to several factors: Freedom of exchange, free movement of funds, liberal taxation, and the bank secrecy law.

Therefore, one notices the importance of the Lebanese Banking Sector and the role it plays in the economy. That's why regulatory authorities issued many rules and regulations such as code of Money and Credit in order to ensure the application of the laws in the banking operations.

b- War period

However, the year 1975 brought a total change to Lebanon which was the beginning of a civil war that lasted more than sixteen years. Thus, investments that were previously considered safe and profitable began to indicate signals of danger and insecurity due to the unstable political environment. The civil war affected almost all the sectors at various degrees, namely tourism which used to attract people from

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[8] - Grosse & Hempel, p.3.

various countries and was a major source of income to the government. Yet, the banking sector was the least affected by war especially between 1975 and 1982 until the country witnessed an additional threat, the Israeli Invasion. In fact, this period was characterized by huge losses (death of people, destruction of buildings both commercial and residential, ...). Besides, the political instability and the social insecurity lead even to the paralyzation of all activities (closing of shops, companies, and educational institutions) for several months accompanied with a trend of migration from Beirut to more or less safer areas in the country and in many instances to other countries such as Cyprus, Canada and the Gulf.

Another major effect of the crisis was on the Lebanese pound which started devaluating in the face of the U.S Dollar.

As a result, the banking sector started suffering due to decreasing liquidity, depreciating capital base, increasing doubtful debts and interest rates along with the additional burden on management and employees who had to operate in an insecure environment, to manipulate risk, to safeguard depositor's rights, and to survive.

Given the prevailing conditions, some foreign banks were obliged to close their offices in Lebanon such as Bank of Tokyo. But the Banking Sector continued operating and showing relative growth until it was hit by a serious crisis manifested by a trend of banks' failure starting with First Phoenician Bank between 1983 and 1984, followed by Mashreq Bank and its Banking group such Capital Trust, Credit Libanais, Bank of Kuwait and the Arab World, Intra Co. for Investment, and Middle East Banking Corporation (Mebco). Banks' failure was like a disease that spread through various units such as Libano-Arab, Uromaid, Globe Bank, Tohme bank and Libano Brazil.[9]

In general bank failure means the closing of an insolvent bank by a chartering agency, (Such as B.D.L in Lebanon). Only a state banking commissioner, the primary regulator of a state chartered bank, or the comptroller of the currency who regulates national banks can make the decision to close a bank.

[9] - " The Banking sector: Improvements and Complications", *Al Mouraqueb Al Inmaii*, Volume 11, August 1992, p.19.

The war period was characterized by several crisis and events among them the civil war, the Israeli Invasion, Banks failure, depreciation of the Lebanese pounds and the closing of foreign banks. As seen, these crisis shaked the banking sector and greatly affected the depositors sense of trust and security in this sector and urged regulatory authorities and the Central Bank to take effective steps to reform it.

c. Post war period:

The post war period starts with the end of 1990 and beginning of 1991, where political and social stability were relatively reestablished after 16 years of war, and the economic situation started showing some improvement. Therefore, an official plan was set for the reconstruction of Lebanon and various measures were taken in order to establish banking reform after many years of crisis and banks' failure.

As reported by Al Massaref al Arabia (November 1992), the reconstruction of Lebanon will go through three main stages:

- Stage 1: between 1991 and 1995 is referred to as emergency reconstruction.
- Stage 2: between 1996 and 1999 is the period of economic improvements.
- Stage 3:Which starts in year 2000 is the stage of economic prosperity and development.[10]

The first stage begins with the year **1991** which was characterized by several positive indicators, the most important of which are:

1. Increase in the economic activity manifested by an increase in GDP by more than 27%.
2. Increase in the volume of local and foreign investments mainly from Arabs such as Saudis and Kuwaitis that invested approximately $ 220 million in constructions and Real Estate.

[10] - "The Banking activities: Enviromental reform", *Al Massaref al Arabia*, November 92, p.194.

3. Improvement in the financial and monetary position manifested by the appreciation of the Lebanese pound from LL 1,110 per U.S Dollar in beginning 1991 to LL 880 per U.S Dollar at year end.

As far as the banking sector is concerned, the banking reform consisted of three main steps:

- Issuance of the Banking Reform law.
- Formulation of Bank Merger law.
- Establishing measures for meeting capital adequacy standards and preserving the capital base of banks.

First, the Banking Reform law, known as the law 110/91, has established the framework for Banks' self liquidation.[11] This law has given the right for the banks' owners to apply for self-liquidation, and in case of approval by Central Bank, they are given the opportunity to benefit from the deposit insurance institution that will settle part of the depositors' balances.

The law aimed at decreasing the number of operating banks in line with the view of "Overbanking" in the Lebanese banking sector; Therefore, the law recognized the need for the fusion of the various banking units and the exit of weak ones to form stronger and healthier banking sector.

In fact, in the second stage, a law facilitating bank mergers has been issued giving the right for Central Bank to approve it or decline it.

In the last stage of the Banking Reform, the Central Bank has urged Banks to the need for reaching the international standards for capital adequacy as set by the Basle agrrement at the end of 1993. Banks were given time to increase their capital in order to reach 8 % of assets.

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[11] - Ibid, p.197

All these steps aimed at improving the banking sector to become stronger and more "transparent" in order to be able to play again its previous role as an important financial center in the Middle East and to attract again foreign banks and investors.

As the year 1991 was the beginning of a new era in the Lebanese history, **1993** witnessed major economic improvements reflected by the various indicators and statistical figures, the most important of which are:

- The appreciation of the Lebanese pound from 1838 per US Dollar at the end of 1992 to 1711 per US Dollar in 1993 prompted the conversion of large sums of foreign currencies to Lebanese pounds. The year 1993 also witnessed an acquisition trend of some banks, among them, we list:
  - Near East Bank, was acquired by a holding Co. whose shares are largely owned by Khaled Bin Mahfouz of National Commercial Saudi Bank.
  - Commerce Bank was acquired by Mohammed Sakr, the Sahel Investment co., Hikmat Nouweihed and Issam Khalaf.
  - Globe Bank was acquired by Société Générale, that obtained a loan from the Central Bank for LL. 7 billion.
  - Bank Thomé was acquired by Fransabank that received a loan from Central Bank for LL. 8 billion.[12]

- An increase in the aggregate deposits of commercial banks from $ 7.9 billion at the end of 1992 to $ 10.9 billion at the end of 1995.

- Increase in the capital of Banks by approximately 100% to reach $ 260 million.
- A change in the Income Tax law allowed banks to reevaluate their assets and pay 1.5 % tax instead of 12%. This shows the government effort to provide incentives for Banks to allow them to meet International Standards and to ultimately reestablish reform in the sector.

[12] - Banque Audi SAL, *"The commercial Banking Sector"*, December 1993, p.53,54.

- Lebanese banks (operating in Lebanon) contributed and, for the first time in the issuance of SOLIDERE's shares. The majority of the total subscription amounting to $ 92 million was confined to Lebanese and mixed banks such as Banque Libano-Francaise, Banque Audi and Mediterrannée. Due to the success of this issue and the ability to attract funds, these banks are studying the possibility of establishing financial institutions.

At the same time, other failed banks were helped by Central Bank to find a remedy to their problems at the least cost and damage possible, either by floating or liquidating them, such as Euromed, Arab Lebanese Bank, Mebco, and Foreign Trade Bank.

As was seen, the year 1993 was an important year because banks have started adopting the acquisition strategy in order to solve or avoid banks failure. At the same time, we see the central Bank efforts to help those banks willing to acquire "problematic banks" by extending loans to them.

With the increased political and social stability in **1994** and the Hariri government's effort to strengthen the Lebanese pound and stabilize the economic situation, more trust and hope in Lebanon's potential to play again an important role in the Middle East Region has been established. This trust was mainly manifested by the plans of foreign banks to reestablish themselves in Lebanon through branches or via representative offices after 16 years of war. In fact, credit Lyonnais returned to Lebanon after two years of negotiation that resulted in floating of "Euromed Bank" and established a new bank "Credit Lyonnais SAL" whose 89% shares are owned by Credit Libanais-France.[13] Euromed customers will get back their deposits plus interest except for those holding deposits in LL. (representing 1/3 of deposits). Besides, the French Institutions Paribas and SSF are showing interest in the Lebanese Financial market. Paribas will open a branch whereas the latter will open a representative office.

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[13] - H.Tian, "The return of International Banks to Beirut", *Al Mal wal Alam*, Issue no. 103, January1994, p.31.

During this year also, the Saudi National Commercial Bank which is a branch of the main bank in Jedda, decided to resume its operation and increase its presence after the end of the war period. This bank is considered the bigesst bank in Saudi Arabia, and one of the important banks in the region with respect to its assets amounting to 63.7 billion Saudi Rial and its solvency of 14% which exceeds the 8% required rate of Basle Agreement.

The return of this bank is an important indicator of the trust of Saudi Arabia in the future of Lebanon and the potential of the Bank to play an effective role as an intermediary between the Saudi and Lebanese working in Saudi Arabia and the Lebanese market.[14]

The return of foreign banks has continued in **1995** with City Bank opening a representative office in March 1995 followed by the bank of Tokyo that intended to resume its operations in Beirut in April 1995 after ceasing operations for 19 years.

In summary, one can observe that the end of the civil war as well as the political and social stability have allowed the regulatory authorities to set effective measures to reestablish banking reform in Lebanon starting with finding solutions to banks failure. As a result, one has witnessed a waive of foreign banks that are opening branches or representative offices in Lebanon which reflect more trust in the banking sector and its ability to play its previous role.

The question that arises here is whether foreign banks present a threat to Lebanese banks and how can banks face the challenges of the future. The following part of this chapter will provide an assessment of the Banking sector and its characteristics in order to identify the areas that need to be improved and the changing role that banks are expected to play in the future.

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[14] - H. Al Hussami, "The return of Saudi National Commercial Bank to Beirut", *Al Mal Wal Aalam*, Issue nb. 103, January 1994, p.31.

2.1.4- CHARACTERISTICS OF THE LEBANESE BANKING SECTOR

Banks in Lebanon operate in open market that allows freedom of exchange and transfer of funds. Unlike other surrounding countries such as Syria, Israel and Cyprus where restrictions are imposed. Yet, Lebanese banks are bounded by the secrecy law which restrains them from revealing information about their clients. This law was an important factor that helped the banking sector during war in the sense of securing some foreign as well as local investments.

Another characteristic is "overbanking" meaning that the number of banks operating in Lebanon is relatively high as compared to the population or to the smaller market size after war. With respect to the population, statistics show that there is one bank for every 30,000 persons and one branch for every 3800 persons, and the total number of operating banks is relatively high (72 banks as at 31-12-1995).[15] However, twenty banks pocess 82.6 % of the total market share.

In addition, the market in which banks operate has decreased in size due to the economic situation and the inability of Lebanon to play its previous role as a financial center in the Middle East Region.[16]

Table 2.1 shows the market share of the first 20 banks in Lebanonaccording to their customers' deposits

Table 2.1- ***Concentration by Size of Bank***

	1975	**1990**	**1994**
First five banks	27.1%	30.7%	37.1%
First ten banks	46.2%	51.3%	62.5%
First twenty banks	69.3%	75.7%	82.6%

15 - Bilan Banques 1995, *Banks Merger*, (1992), p.88

16 - Institute of Money and Banking, *Bank Mergers in Lebanon*, (Beirut: AUB, 1990), p.13.

A final characteristic is that the majority of the banks operating in Lebanon are family owned businesses, run by the shareholders who are members of the board of directors of these banks. A family owned business means that the management of these banks is transmitted from one generation to another which implies the possibility of having inadequate or "aging" persons in higher managerial position. These persons, with some exceptions, will seek profits by all possible means, thus leading to the possibility of unethical behavior on the part of these persons in the sense of issuing fictious entries or realizing unrealisticlly high profits.[17] In fact, the majority of banks failure are attributed to unethical behavior on the part of their management.

What is needed is more concentration on a harmonious group of people running the banks rather than on individuals to the extent that banks' name are associated with the names of their managers.

Later on, the researcher will see how these characteristics can play a role in facilitating mergers or in hindering it.

2.1.5- CHANGING ROLES OF BANKS

The world is witnessing nowadays the beginning of significant changes in the traditional way of banking in this century. These changes led to the "New banking", the banking that resulted from the dynamic forces that swept the "traditional marble edifice of the once tradition bound banking industry".[18]

Traditional Banking is characterized by the following:

1. Resistant to change
2. A follower in responding to changing market needs.
3. Conservative in credit decisions.
4. Tied to business rather than to consumer credit and banking needs.
5. Paying low salaries in comparision to other economic sectors.[19]

The following section will present a comparison between the traditional and the new banking in Lebanon.

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17 - Institute of Money and Banking, p.27.
18 - Commercial bank Management, p.7-8.
19 - Ibid, p.4-5.

First, during the war period, banks were striving to survive and overcome the various crisis that hit Lebanon and its banking sector. So the banks' main function was limited to the traditional role of accepting money in the form of deposits from people having excess money or trying to save, and extending those funds in the form of loans to others. In short, they were considered as "saving box".
But now banks should go beyond this traditional role and participate in project financing, fund management, and provide consultancy to customers to help directing their investments.

Second, banks were very conservative in extending credits, and the majority of facilities were extended for commercial purposes and for shorter maturities (less than one year). These facilities were also restricted to a specific category of people, who in some cases did have money, but preferred not to take the risk on their own. Those people could even earn profit from paying interest on debt which is tax deductible. In other cases, people who were not creditworthy were benefiting from banks' facilities due to some personal relationship with the managers of the bank.

Third, banks' main source of income and huge profit margin were mainly derived from the spread between Debit and Credit rates. For instance, 11% Debit rate on US $ vs. 5% Credit interest.[20]

Fourth, Banks were developing and selling products without careful consideration and attention to changing market conditions and changing customer needs.

Finally, skilled people were resorting to employment in companies and industries rather than Banking because of the higher salaries paid.

[20] - S. Hammoud, "1993, The year of preparation of projects, 1994, the year of their launching", *Al Mal Wal Aalam*, Issue nb.103, January1994, p.26.

But nowadays, banks are expected to play a different and more important role mainly in the reconstruction of Lebanon. However, this requires several steps and major improvements.

1- Developing the financial market:

The rehabilitation of the infrastructure should be done in order to be able to attract business and investors in the first stage, and Lebanese people living outside, Arabs and others as well as their wealth and capital at a later stage. To benefit from these potential financial resources, investments should to directed towards an organized financial market.

In an emerging market such as Lebanon, the public sector especially in the initial stage, will resort to establishing a financial market due to several reasons:
First, it facilitates the transition from variable sources of income (debt from loans) to more stable sources (owing shares or equity in companies).
Second, it gives the possibility of raising capital through equity (by issuing shares) rather than bearing the burden of debt financing and interest payment.
Third, it allows reallocation of ownership from the minority of people (as it is the case in bank financing) to the public at large.

Therefore, efforts should be made nowadays to reveive Beirut financial market. This market was established in 1920, and played a major role in the region until it was closed in 1988 during war. At that time, 40 companies were listed on its board. Efforts are made nowadays to reestablish this financial market starting with Solidere, Sibline Cement and some banks.[21] Banks can play an effective role in developing companies as they did for Solidere or by trading in the exchange market for their own account or on behalf of their clients.

[21] - N. Al Saiidi, "Beirut Financial Market will resume operations within six months", *Al Mal Wal Aalam*, January 1994, p.36.

2- Monitoring maturities between the sources and uses of funds:

Banks should try to match and monitor the maturities between the sources and uses of funds, i.e. between deposits received from the public with their own placements and investment with other banks. In fact, fixed deposits in Lebanon, irrespective of their maturities could be broken at any time, if any economic or political event takes place. The average life of a deposit in Lebanon is estimated to be between 45 and 60 days.

3- Diversifying the lending policies:

Facilities extended by banks should go beyond the commercial lending to cover other areas and sectors such as industrial, agricultural, housing etc. that were totally neglected by banks during war due to the high inherent risk and the conservative lending policies of banks. Thus banks should diversify their sources of income and shift from interest based sources to fee based income derived from service related product such as Letter of credit (L.Cs) and letter of guarantees (L.Gs) etc...[22]

4- Becoming more Customer oriented:

Banks should become more customer oriented and constantly be aware of changing customer need and promptly respond by developing products and services that satisfy them. Banks nowadays should also try to attract skilled staff by offering them good pay and and fringe benefits.

In conclusion, "the new banking" projects an image far different from that of traditional banking. The modern bank attempts to stress the concept of a friendly, local banker offering a wide range of financial services to the public. In many communities, bankers are becoming innovators in providing previously unavailable services.[23]

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[22] - Hammoud, p.37
[23] - Commercial Banking Management, p.37.

2.1.6- ROLE OF BANKS IN THE RECONSTRUCTION OF LEBANON

In the light of the free and open economic system, the freedom of exchange, the bank secrecy law and the social and political stability, manifested by a lower country risk as categorized by Euromoney, there is no doubt that the Banking Sector will play a new and important role in the reconstruction of Lebanon. In fact Lebanon's risk has decreased for 116 degrees in September 1994 to 67 in September 1995 which shows more trust in the future of Lebanon.[24]

The new role of banks can mainly be manifested in three ways:

1. Financing the various productive sectors such as agricultural, industrial, and touristic.
2. Financing the reconstruction projects.
3. Developing the role of financial markets.[25]

Financing the reconstruction projects requires huge investments amounting to approximately US$ 25 billion because it involves rehabilitation of roads and power stations, transportation, electricity and water, telecommunication, health and education. To do so, banks should improve their capital base, direct their investment towards long maturities and combine together in order to be able to participate in the rehabilitation of the infrastructure.

In fact, no single bank can afford financing these projects on its own especially at this stage. Therfore banks should form a kind of agreement or consortium to extend syndicated loans in which many banks participate in the financing of a certain project according to some preset rules and terms and sharing of responsibilities, losses and risk.

Another issue is that the majority of banks deposits are short and medium term whereas the reconstruction projects usually require long term financing. Therefore,

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24 - R. Audi, "banks are preparing themselves to play their role in the reconstruction ", *Al Safir, the banking section*, December 1994, p.10.

25 - Ibid, p.10.

banks should be careful in extending these facilities because they have to monitor and match the maturities between the deposits received and their investments with other banks and financial institutions, at the same time discouraging people from withdrawing their deposits and directing investment towards longer term by providing higher interest rates on deposits with maturities of more than one year.

At the same time, the Central Bank should decrease the restriction on banks in terms of their Treasury Bills subscription (it was decreased from 60% to 40%) which leaves them with a greater portion for investments.

The financial market provides flexibility to the investor for choosing among several financial instruments (C.D, commercial papers, swaps, future...) with various degrees of risk, return, maturities and liquidity terms. It gives him the possibility of acquiring and disposing of these instruments by trading them in the market.[26]

Establishing a financial market is an important step in developing an emerging market like Lebanon because it offers many benefits. Yet, it presents a channel through which investments which were previously confined to banks, will be directed.

2.1.7- Challenges facing the banking sector:

The banking sector is entering a new era full of challenges. The ability to face these challenges and overcome them will be the distinctive feature between strong and weak banks and the key of success and survival. Besides the ability to help in the Reconstruction of Lebanon, banks will face competition mainly from 4 sources:

- *Competition from local banks:* The local banks especially the top ten are competing between each other to acquire a bigger share of the market in terms of customers, amount of loans, and deposits by providing wider variety of products

[26] - A. Safar, " The Banking system and the development of Beirut Financial Market", *Al safir*, November 1994, p.16.

and services. It is worth to note that the top ten banks have approximately 63 % share of the market whereas the rest 69 banks all together have 37 % only.[27]

Banks should complete between themselves not just on interest rates basis but rather on their ability to provide a wider variety of products and services.

- *Competition from foreign banks:* As stated earlier in the chapter, foreign banks have started to reestablish themselves in Lebanon after the war. These banks are better equipped with technological tools and a wider range of product and services. However, as Francois Bassil said "Lebanese banks, have sustained and survived the various crisis during war, whereas foreign banks did shut down and discontinued their operations. Therefore it is not fair to allow these foreign banks to come and compete with Lebanese banks, because they will constitute a threat to them". If they are monitored and regulated by the Central Bank, Foreign banks can be considered as an incentive to local banks to reorganize themselves. Therefore, it is necessary for banks to combine together and to compete among themselves to provide better services and advanced technological equipments.[28]

- *Competition from the financial market:* As explained in the previous part, banks will face competition from the Financial market by attracting some of the investments and deposits (both local and foreign) which were previously totally directed to the banking sector, and by participating in the lending and financing functions which were previously totally confined to banks.

- *Competition from Israel:* There are various points of view concerning this issue and whether Israel will be a real threat or not. In fact, Mr. Farid Rouphael (Head of BOD of Banque Libano-Francais) believes that in case of peace agreement, Israel will be a strong competitor to Lebanon because it is characterized by a small number of big financial institutions in addition to the external strong support. Dr Hicham Bisat (Regional Manager of Arab Bank Plc.) also thinks that the number of

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[27] - Bank Audi, "The Banking sector in Lebanon: Retrospective, Present, and Prospective overview", *Economic Analysis Unit*, January1996.

[28] - F. Bassil, "The Banks of the 90s' are different from those of the 60s", *Al Safir*, December 1994, p.6

banks operating is relatively high (72 banks) as compared to other surrounding countries. For instance, the assets of the first bank in Israel exceed three times the assets of the combined banks operating in Lebanon. In other words, due to the small size of the banking sector in Lebanon and the high number of operating banks as compared to other surrounding countries, Lebanon cannot compete on a quantitative basis but rather on qualitative one. Francois Bassil, the head of the Banks Control Commission, had a different view, he doubts the ability of Israel of competing with Lebanon financially due to several reasons mainly its controlled economy and its society which is military oriented as opposed to the flexibility of the Lebanese people as well as the Banking rules and regulations applied in Lebanon.

2.1.8- IMPROVEMENTS OF VARIOUS AREAS TO FACE THE CHALLENGES:

As seen, the banking sector is facing many challenges and banks are expected to shift from the traditional way of running their business to a new improved and professional way of performing banking operations.

To do so, they should develop and adjust their procedures and improve various areas mainly communication, technology, product and services, and finally human resources and management.

a) <u>Communication:</u>

A good communication Network should be established in order to link banks with their branches and provide on line- real time mode of information transmission. For example, a customer operating from one branch gets his record updated immediately through all the branches. In addition, the use of electronic mail will also provide speed in the transmission of information and communication of messages between branches. Another network will also link all the banks together to facilitate the accurate, safe and adequate transfer of information between them.

b) Technology:

The use of technology varies from one bank to another. Some use relatively advanced computer software and hardware such as the Arab Bank while others are still totally or partially using the manual system even in this "computer age" such as Banque Libanaise pour le Commerce.

In addition, developing in house computer programs is becoming more and more costly and time consuming and sometimes, inefficient due to fast technological obsolescence. Therefore, some banks are resorting to ready made packages by adjusting them according to their specific needs.

In fact, the adoption of technology imposes a big burden on banks mainly on small ones who have limited financial resources. If one takes the example of ATM service which provides more facilities and flexibility to the customer by allowing him to access his account even after banking hours which are usually short (from 8.30 AM to 12:00 PM), unfeasible, and conflict with his working hours; One sees that only two bank The Arab Bank PLC and The British Bank of the Middle East, among 79 banks operating in Lebanon are providing this service, whereas one notices that it is widely spread in UAE where some ATM also provide the possibility of depositing cash and cheques, requesting cheque books and statements as well as paying electricity and water bills.

Another example is Credit Cards which can be used for point of sale purchase. They make people less and less dependent on cash and allow more flexibility. These services are provided by only a small number of banks.

Banks should adopt more technology in order to improve their products and services and provide quicker and more accurate information to clients. However, the adoption of technology necessitates huge investments that small and big banks cannot afford on individual basis. For instance, an ATM machine costs approximately $ 75,000. A good solution to this problem would be an a greement between various banks to share ATMs.

It is true that these services will impose burden on banks but, in the long run, they will lead to more benefits and cost savings by reducing the customer turnover to branches for daily and routine transactions, thus the employees' time would be better invested in providing better quality of service. This will ultimately help them to face the challenges of the future and to meet competition.

c) **Products and Services:**

In order to face the challenges of the future, banks need to bring into being new and innovative products and services, among them, one lists:

1. syndicated loans: Banks should offer syndicated loans in which a number of banks would agree together to provide financing for the reconstruction projects.

2. Consumer loans: Due to the deterioration of the social and economic situation (mainly inflation and depreciation of the Lebanese pound) during and after war, people in the Middle and lower classes are finding more and more difficulty in acquiring some of the essential elements for a good and normal way of living standard. Therefore, the need arises for consumer loans (car loan, housing loan, educational loan) to this class of society that was previously neglected by banks that concentrated more on loans to enterprises of various sizes, with financial strength and the ability to provide collateral to cover their loans. Byblos Bank was the first bank to realize this need and responded directly by extending consumer loans. It is worth also noting that this bank was the first bank who took a step forward and issued CDs in US$ at 6% which was accepted by the market and proved to be good business.

3. Providing consultancy services, assets and portfolio management: Banks should offer their clients information about the investment opportunities available (mutual funds, trust funds...), the rate of return offered as well as the degree of risk involved.

4. Participating in the financial market: Banks should introduce new instruments to the financial market such as future, options and swaps.

5. Establishing private or priority banking: Banks should establish Pivate Banking sections to deal with a special category of people who have financial potentials.

6. Offering Telebanking services to customers: This allows clients to access and monitor their account through the phone.

7. Providing electronic transfer of funds using swift.

Some banks have started providing some of these products and services. However, they need to develop them still further and prepare adequate staff to provide them in a professional way.

d) Human Resources and Management:

During the war and due to the migration of people, banks found difficulty in recruiting adequate and skilled staff to perform the job to the extent that we saw people without banking knowledge and even without university degrees working in this sector. In addition, other graduates who were not able to find a job in their own field (lawyers, engineers...) were seeking an opportunity in this sector. But now banks have realized the need for skilled human resources who are young, ambitious and dynamic to perform the job in a more professional way. Therefore, they are recruting university graduate with business or banking background to gradually replace old staff. Banks are also becoming more customer oriented. Therefore, they are providing extensive training programs and seminars to better equip the employees with a wider banking knowledge to ultimately lead to more customer satisfaction and higher profits to the bank.

A very good example is Banque Audi SAL, that recruited in 1993, 30 AU B and BUC graduates holding masters degrees in business and provided them with two years extensive program covering the various areas and departments of the bank. It is also worth noting that the bank is providing approximately 23,000 hours of training per year to its various staff in the various positions from higher levels to clerical ones. Banks have also realized the important role of the human factor in a service industry providing service and some have started adopting new managerial styles such as Strategic Management and MBO (management by objectives) which reverse the traditional pyramidal hierarchy from Top-down to other directions (vertical, horizontal and down up) to allow the participation of lower levels of management in putting objectives and it also allows communication and teamwork between their various levels.

Banks have also started restructuring themselves by establishing new organizational charts, defining rules and procedures, job descriptions, line of authorities and searching for suitable persons to fill the vacancies and the various positions.

All this would enable banks to move from the idea of one man show to the concept of team work or a group whose members are aware of the new managerial styles and who are able to monitor change rather than just reacting to it. For example, Banque Audi SAL, has an economic unit whose main function is to scan and monitor the various changes (political, economic, social...) occurring in the market and to continuously incorporate these changes in the overall objectives and targets of the bank.

2.1.9- FINAL COMMENT

Banks nowadays have to develop themselves by improving several areas such as communication, technology, product and services, human resources and Management in order to play a role in the economic development as well as in the reconstruction of Lebanon and to be better equipped to face the challenges of the future. During the previous presentation, the idea of cooperation and combination have been constantly stressed in the light of the changing market conditions and the challenges and threats available. Based on this, one sees an urgent need for banks mergers to occur in order to achieve a better, healthy and sound banking system. But the questions to be asked here is why didn't we witness in the past a Merger movement in Lebanon? How do we expect that the merging activity would evolve in the future,would merger be a solution to Overbanking in Lebanon, and finally what are the factors that would either facilitate or hinder it?

The next part of the chapter will focus on merging as well as on its various aspects (motives, process...). The chapter will also attempt to provide some possible answers to the questions raised here.

2.2- BANK MERGERS:

2.2.1- INTRODUCTION

Organizations operate in a dynamic environment that is constantly witnessing the emergence of new technologies, markets and products as well as political, economical, demographical and social changes. The key word here is change and the ability to adapt to it and not just react to it. Organizations are constantly faced with the need to manage change through various means: changing their organizational structure, adjusting their strategies and plans, and innovating their product and services. Whatever the means used, the end result is to meet competition, survive and be profitable in this changing environment.

The business environment nowadays is dominated by growth which is a strategy involving change. In fact, beyond the making of profits, the two main objectives of most organizations are: constant growth and the creation of new challenges in order to maintain the continuity of the firm's life and to meet competition.[29]

Corporations grow in two basic ways: Internally and externally.

[29] - Linowes, p.41.

Internal growth comes from consistently good performance month after month and year after year. It is the most common and the least dramatic type of growth.
The other basic way to grow is by external expansion, which involves merger, acquisition, consolidation and alliance. These strategies means plunging into a new product or a new market, the immediate exposure of which is very broad and the time for getting the ultimate returns and deriving benefits is relatively long.

In Lebanon, Mergers and Acquisitions, terms which were not common 10 years ago are nowadays widespread in the market as organizations are moving towards consolidation and mergers, and as the markets are moving towards globalization and deregulation.

2.2.2- DEFINITIONS:

There are various ways for companies to combine together. This may occur through alliances, consolidation, acquisition or merger. We will start first by defining each method but all our analysis will be mainly concentrated on mergers and acquisitions especially in the banking industry.

a) Alliances:

A firm will form an alliance with another firm in order to bring together specific skills and resources in such ways that may complement each other, without the complication and expenses associated with a merger. It is commonly referred to as Joint Ventures. [30]

b) Consolidation:

Means the dissolution of two or more companies, of the same scale, standard and importance who will combine to form a new organization. and the participating companies will loose their individual identities.[31]

[30] - L. Nevaer, *Strategic Corporate Alliances*, (NY: 1990),p.33.
[31] - Arab Banks Association, p.72-73.

c) Acquisitions:

An acquisition is a structured transfer of one firm assets to another in an agreed and orderly manner. In many instances, these assets are all inclusive and constitute the acquired firm in its entirely. They include a firm's physical plant, materials, skills, technologies, markets and employees. The acquiring company, considered the parent company, will pay for these assets through a combination of cash, stocks, debt loans or even by exchanging assets with the target firm.

The acquired company is considered the subsidiary and may be allowed to keep its name. For example Emirates Bank in UAE acquired Middle East Bank, the latter continued to operate under its own name.

d) Mergers:

A merger can be considered to be a mutual agreement of sorts between two firms to join together to create a new company in which each one will lose its independence.[32]

As defined by article 192 of the Lebanese CMC (Code of Money and Credit), the merged bank is the bank that disappears and thus all its assets, its rights, its liabilities and commitments are transferred to the assets, rights, liabilities and commitments of the other bank called the merging bank.[33]

Corporate expansion by merger may take place in a variety of directions, it may be of different types, it may designed to achieve a variety of objectives, it may use a variety of financing methods and it may fail for a variety of reasons.[34]

2.2.3- THE VARIOUS DIRECTIONS OF MERGER:

The following section will identify the various directions that a merger can follow. It can be horizontal, vertical, congeneric , conglomerate or diversified.

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32 - Nevaer, p.73.

33 - Ministry of Finance, Code of Money and Credit, Law nb. 192, "Facilitating banks Mergers", p74.

34 - W. Alberts and J. Segall, *The Corporate Merger*, (US: The University of Chicago Press Ltd, 1969), p101.

a) Horizontal: In a broad sense, horizontal merging means merging with competitors. This type of merging usually involves expanding the geographic scope of market coverage or perhaps the development of a broader line of similar products.[35]
Horizontal merger in the banking industry occurs when two banks of the same type and activity combine together. i.e. commercial Banks, private banks.

For example, the combination of two banks located in different markets may result in a wider market coverage and ultimately more customer satisfaction and better accessibility to the bank's wider variety of products if the two banks have somehow different product.

b) Vertical: It implies merging with suppliers or distributors. This type of merger occur in order to take advantage of the profits formally accruing to suppliers or to customers.[36]
A vertical merger between banks occur when small banks in suburb areas combine with one main bank in a big town or in the capital in such a way that the small banks and their branches become related to the main bank.

c) Conglomerate: Merger of this kind occur when a group of banks present in the same region or state combine together to form one unit.[37]

d) Congeneric : This type of diversification occurs between financial institutions working in related fields such as Banks and Insurance Companies, if the laws of the country concerned allow it.

e) Diversified Merger: It occurs when a company combines with another one outside the industry.

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35 - Alberts and Segall, p.101.
36 - Alberts and Segall, p.101.
37 - Alberts and Segall, p.101.

It is worth mentioning that vertical, conglomerate congeneric and diversified merger cannot be applied to Lebanon at least at this stage due to several factors mainly the size of the country and the prevailing rules and regulations.

A horizontal Merger is very unlikely to occur at this stage also because of the family owned type of business that is prevailing in the banking sector.

Managers running these banks fear to lose some of their power and control if they cooperate with other banks. Unless there is segregation between ownership and administration, there is a doubt that this type of merger will take place.

Therefore, the number of mergers that will occur in the Lebanese Banking Sector in the near future is very small as compared to other countries such as US and Europe. A merger will be used mainly (by some big banks) to solve the problem of a troubled bank. A bank is referred to as "troubled bank" when it no longer has the ability to presume its regular business operations without seeking the assistance of the Central Bank as a "Lender of last Resort" for liquidity.[38]

If one looks throughout the history of the banking sector, one can identify two main reasons for the absence of merger activities in previous years:

1. War and all its related problems and effects: During the war period, organizations usually think of ways to survive and maintain their assets and positions. Merger, being a form of growth, wouldn't occur at that time.
2. The absence of rule and regulations that encourage and present benefits to the merging banks.

2.2.4- THE VARIOUS TYPES OF MERGERS

Whatever direction it may take, a merger can be of different types. It can be either friendly, hostile or forced merger. This mainly depends upon the overall economic situation in general, upon each partner position, their relationship between

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[38] - M. Halawi, *Banking reform and Mergers in Lebanon: Analysis and evaluation*, (Beirut: AUB,1994), p.12.

each other and between them and the regulatory authorities in the concerned region or country. Besides, the rules and regulations in a certain area may either facilitate and organize one or all of these types or they may hinder it. For example, in Lebanon, during the war, there were few laws tackling mergers because of the economic and social instability in the region and because the regulatory authorities were not putting restrictions on the number of branches, and were aiming at increasing the number of banks. However, after the war, authorities issued new laws and adjusted old ones in order to organize the merger activity and to facilitate it especially for troubled banks.

a) Friendly merger: Occurs when two organizations agree to combine together. The merging bank in this case will present an offer to buy the concerned bank. The management of each bank will send a notice to the shareholders' to approve the merger. In case of approval, the two banks will agree on the terms of payment whether by cash or by exchange of shares.[39]

b) Hostile takeover : This occurs when the management of the merged bank refuses merger because the prices offered are lower than the real value of the firm or because they want to preserve their independence. In this case, the merging bank will present a tender offer to the merged bank's shareholders without their management approval and it may request them to sell their shares at a certain price or it can buy them through the stock exchange market.

d) Forced merger: This occurs when the monetary authorities use merger as a weapon for banking Reform by driving the problematic banks, insolvent or under liquidation, into merger. To achieve this, the authorities will issue laws that will motivate banks to merge by presenting tax benefits and extending loans. For instance, the Central Bank extended a loan to Societe Generale Libano-Europeenne de Banque Sal to acquire Foreign Trade Bank.

Some argue that merger decision should be a voluntary decision taken by the company especially if the firm is operating in a free economic system, otherwise,

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[39] - Arab Bank Association, p.81.

violation of this law will occur if authorities impose it. On the other side of the spectrum, one sees there are others who consider that authorities should interfere and take action in order to clear the banking sector from banks failure and thus preserve the right of depositors and protect the social welfare of the region. Therefore, one can infer that forced merger is likely to take place at this stage in Lebanon because it will be used by the regulatory authorities as a weapon to clear the banking sector from the remaining troubled banks. However, one will not expect friendly mergers to occur in the near future due to the distinctive features of the Lebanese Banking Sector mainly being family owned type of business.

In conclusion, it is important to note here the need for rules and regulations that will organize mergers in order not to hurt societal welfare by minimizing or eliminating competition through the formation of cartels and the emergence of few big companies having monopolistic or, oligopolistic power. For example, the United States authorities issued the merger act as well as Anti-trust laws in the aim of controlling the merger activity in the country that affected the competition in the market.

2.2.5- MOTIVES BEHIND MERGER

In the previous section, the various directions and types of mergers were exposed. But why banks choose to merge rather than grow internally?
To answer this question, one should present the main motives behind the merger as well as a comparision between internal and external growth. Next, an examination of the conditions under which each type of growth is emphasized.

When considering a merger, some managers seek profit as their main motive, while others perceive growth, yet others resort to it because they seek bigness and aim to derive the economies of scale and scope associated with it. The following part will identify the main driving forces to merger.

2.2.5.1- Profit:

The main motivation behind a merger or an acquisition activity is to improve a firm's profitability by acquiring another company's products, markets, customer base, manufacturing efficiencies, assets and research and development facilities, or by simply eliminating some of the competition.[40] In fact, when a company decides to merge with, or acquire another firm, it has committed itself to huge investments both financial and non financial and therefore expects to achieve profits and derive some benefits from it. However, some managers will undertake merger even if they do not promise profits and increase in shareholders' wealth,[41] because they consider merger a quick way to grow. Some studies conducted by Muller and Ravenscraft and other researchers have rejected the hypothesis that merger leads to increased profitability. Among the six studies that measured the effects of mergers over the post-world war II period, only one was found to increase profitability.[42]

2.2.5.2- Growth :

The attractiveness of the presumed merits of merger activity is the assumption that a given merger will enhance growth potential of the acquiring company and will present some additional benefits not derived if the company resorts to internal growth[43].

Most of the reasons for merger are related to the immediacy with which investment in merger starts to produce revenue and profits. As opposed to this, the investment in plant and equipment to achieve internal growth may involve a protracted waiting period.[44]

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40 - J. Revell, *Mergers and the Role of Large Banks* (U.K: The Institute of European Finance, 1987), p.16

41 - Linowes, p.70.

42 - D. Mueller, Mergers, p.702

43 - Nevaer, p.19

44 - Alberts and Segall, p.65.

In fact, when a company merges with another firm, it will acquire its equipments, staff, management expertise and many other related benefits such as goodwill, license, and customer base which are important elements in the banking sector.

If two banks are spread in different geographical areas, this will result in a wider market coverage. However, if the two banks have branches located in the some area, one of them can be closed and sold or it can be transferred to another place if the laws of the country allow it, as in the case of Credit Populaire which was acquired by Banque Audi that got an approval from Central Bank to use the license of some of the branches acquired and to operate them in other locations.

Some argue that Internal and external means for expansion are not mutually exclusive. As a matter of fact, they are mutually compatible and desirable. In some cases the acquisition of a company in a related field creates the impetus for internal growth.[45]

However, there are some factors that will affect a company's decision between internal and external growth. Among them, are:[46]

1. The need to penetrate a market on time.
2. The exhaustion of internal investment opportunity.
3. The business cycle .
4. The market conditions.
5. The laws of the country.

1. Need to penetrate the market:

If a company needs to penetrate a new market in order to meet competition, it may find that their merger plans will come to fruition sooner than their plant building programs. Indeed, if its plant - building program encounters delays, a firm might accelerate merger efforts to achieve growth targets on schedule. Delays in a plant building program might cause a firm, which previously had

[45] - Linwes, p.46-47.
[46] - Alberts and Segall, p.65

not considered mergers, to turn to them as the means for meeting growth schedules.

2. *Exhaustion of Internal Investment opportunities:*

Some suggest that the desire for merger may be less urgent if the various firms are operating at less than full capacity, and independent, immediate, and profitable expansion may be possible.

One important reason for merger may have been the exhaustion of profitable investment opportunities in one industry or country. Therefore, the acquisitions of another firm will enhance future prospects. Another reason may be to forestall losses in one's industry against profits in another industry.

3. *The Business Cycle:*[47]

It has been observed that in planning for expansion, the time horizon used is ordinarily much longer than the cycle. The pressures of the cycle may lead banks to invest in either form of growth mainly in the expansion phase.

In fact, when analysing the relationship between merger activity and the business cycle, It was found that mergers responded positively and with high consistency to the business cycle. Merger peaks were expected to occur at a fairly advanced stage of expansion, and more specifically, after firms have exhausted the opportunities for profitable internal expansion. Therefore, one can predict to find peaks in internal expansion coming before those in mergers.

4. *Market conditions:* [48]

The economic factors that lead to merger or plant investment are likely to be more decisive to a firm in a period of increasing activity than in a slack period. In fact, it was observed that young firms or those in rapidly growing industries may have sufficient opportunities to grow internally so that they need not resort to mergers to achieve profits. Mergers to increase or to avoid declines in

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[47] - L. Alameddine, *Profit Motives for Commercial Bank Mergers in Lebanon,* (Beirut: AUB,1988), p.29.

[48] - Alberts and Segall, p.56

company size are most likely for mature firms in slow-growing or declining industries with sufficient cash to finance this type of expansion .

5. *The laws of the country*

Banks may resort sometimes to mergers if the country imposes restrictions on the development of new branches. For instance, some legislations passed in US have restricted interstate banking and the formation of large national banks.

2.2.5.3- Customer needs:

As the customers become more geographically spread and as the size of its large clients increases, a bank must grow in line with them or lose them to other banks. If this cannot be achieved through internal growth, the bank has to resort to merger as a tool to provide the funds and the variety of products needed by their large customers.[49]

Given the fact that the amount of facilities that can be given to any single customer is proportional to the bank's capital, lending limits can be increased through merger because of increasing capital base.

In Lebanon, the amount of facilities that can be granted to a single customer cannot exceed 10% of the bank's capital provided that sufficient security is taken from the client.

2.2.5.4- Synergy factors:

In its origins, synergy means "working together". In the literature of mergers, it is used to indicate complementarity between the partners.[50]

Synergy can be achieved through merger if the production, administrative and marketing costs of the merged firms are smaller than the sum of these costs for the two

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[49] - Revell, p.18-20.

[50] - Ibid, p.93

individual firms before their merger. When combining together, banks expect that their joint organization will be more profitable than the total of the operations of each company separately.

The following formula can be used to measure synergy.

[(PVAB - (PVA + PVB)] - (Cash - PVB)

Where:

PVA = present value of company A

PVB = present value of company B

PVAB = present value of A & B combined.

Cash = cash paid by A to acquire B.

If the net result is positive, then there will be synergy, and the merger would be beneficial for both parties.[51]

2.2.5.5- Market power factor: [52]

Banks tend to undertake merger because of the prestige associated with "bigness", the public confidence, and the power element derived from it. The fact that large banks are usually allowed by the market and the supervisory authorities to have lower capital ratios than small banks can be explained by the fact that risk is thought to be less, although in this case, the market may feel that the real gain is that the authorities are unlikely to let a really large bank to fail.

For example, the supervisory authorities protected BLOM - Banque du Liban et d'outre Mer, when rumors spread around the country regarding the financial well being of this bank.

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[51] - Halawi, p.67-68.

[52] - Revell, p.275

Besides, banks tend to resort to merger in the aim of increasing their size, widening their products, services and distribution channels, diversifying their income sources and taking advantage of economies in risk-bearing. A large portfolio of risks is more efficient than a small one, and one possible explanation of continued mergers is a desire on the part of large banks to further reduce their exposure to risk.

2.2.5.6- Competition:

Some banks combine together in order to increase their market share and to gain a competitive edge in the market to face local as well as foreign banks.

2.2.5.7- Competent management:

A careful study of capital market returns and betas before and after mergers performed by Mandelker (1974) led to the following conclusion: "Our results for the acquired firms are consistent with the hypothesis that mergers are a mechanism by which the market system replaces incompetent management".[53]

As applied to Lebanon, bank mergers will play a role in the elimination of incompetent management that was prevailing in some banks due to war and family type of business and will also facilitate the transition from the concept of one man show seeking personal benefit to the idea of a group of people managing the bank . In fact, Marnis (1964) and Manne (1965) hypothize that mergers increase efficiency by replacing management that fail to maximize shareholders' wealth.[54]

2.2.5.7- Economies of scale:

The theoretical concept of the economies of scale refers strictly to the relationship between the costs of an organization and its output as the outputs change. The costs involved can be quantified, but the argument moves into a different field,

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[53] - Ibid, p.94.
[54] - Mueller, p.701.

when we look at some of the intangible advantage of size that cannot be measured. The concept of economies of scale is represented by a cost curve which portrays cost at each level of output. The theory states that the average cost falls, as output increases (economies of scale) to reach a point after which cost will increase as output increases; this is the part of decreasing returns of scale.[55]

It is believed that by merging, banks can take advantage of some economies of scale manifested by greater efficiency through increase in the size of the bank, cutting of some costs (redundant operations, spreading costs over a wider range of related products...).

However, economies of scale take many years to be achieved, their realization depends above all on the quality of management. By reaching the optimum size, the bank can achieve economies of scale. Yet, it is difficult to determine the optimum size of a bank.

Economics of scope can also be achieved because it arises from the jointure or interdependence of services or products. It is associated with joint products which can be defined as products that have certain costs in one or more market. The common use of information for many services are good examples.[56]

Because of economies of scope, large banks can provide each service more efficiently and at a lower cost for comparable quality than "a specialist provider of that service by cross-subsidizing one activity that is beset by efficient specialist competitors from the profits generated by another activity in which they don't face competition".

As seen, economies of scale and scope depend on a relationship between average costs per unit and the level of output. However, Kinsella states five characteristics of banking that make its output difficult to define:[57]

1. It is a service industry, with no measurable physical product.

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[55] - Revell, p.59.
[56] - Ibid, p.264-265.
[57] - Nevaer and Deck, p.15.

2. Each bank is a multi product firm.
3. Many of the services are joint or interdependent.
4. It is labor - intensive.
5. It is subject to government regulations that affect all or some of its costs, prices and level of output.

The underlying reason for any merger or acquisition is to improve the profitability and growth potential of a given firm, be it short- term and long-term. This benchmark can be an effective tool, if not an exclusive one, to evaluate the success of failure of this type of strategy.[58]

In the previous part, we identified the main motives behind mergers. The most important of which were profits, growth and economies of scale and scope. Other motives like customer needs, market power factor, competition, synergy benefits and competent management were also stated. However, it is worth noting that small banks cite somehow different reasons for mergers than big banks.

Small banks willing to sell out or be merged with other banks typically cite such reasons as:[59]

1. Advancing age of Management and failure to provide successor Management.
2. Attractive terms (price), well above limited local markets.
3. Desire to provide more effective competition to larger neighboring banks.
4. Failure to keep up with aggressive competition.
5. Inability of small banks to meet borrowing needs of customers.
6. Loss of business through acquisition of local concerns by national industries.
7. Greater fringe benefits and compensation paid to employees by larger banks.

Banks seeking to acquire other banks may be doing so for one or several of the following reasons:

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[58] - H. Crosse and G. Hempel, *Management Policies for Commercial Banks* (US: Prentice Hall Inc.1980), p.25-26.

[59] - Crosse and Hampel, p.28.

1. Need to increase volume of retail business,
2. Need or desire to better service existing business,
3. Need or desire to follow customers to the suburbs,
4. Desire to expand lending limits,
5. Normal urge to accelerate growth,
6. Desire to improve earnings.

Finally, one can see that the factors causing mergers between banks are not constant but differ according to the stage of development of a banking system, the market conditions and the business cycle. In some cases, it is seen that the emergence of banks crisis can be a motive for merger as the case of mergers that occurred in the banking sector in Lebanon and are likely to occur in the near future.

2.2.6- THE MERGING PROCESS

The decision to undertake merger appears to be an immediate and decisive step towards achieving a certain objective or solving a certain problem. It is on the contrary, only the beginning of a long process.

The merger process is not a part time job, it should be given enough time, effort and money and must be assigned to professional persons.[60]

2.2.6.1- Stages of Merger:[61]

Merger consists of three main stages:

Stage 1: Searching for the need for merger and the reasons that arise this need.

Stage 2: the measures considered to adopt merger.

Stage 3: The way to fulfill or achieve this need.

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[60] - Linowes, p.69.

[61] - Institute of Money and Banking, p.27.

Stage 1:

It is a crucial step because it helps the company in seeking for the motive behind the decision to merger. This will facilitate the identification of the problem to be solved or objectives to be achieved.

Besides, the decision to merger should be taken in line with the overall objectives of the firm. Unless clear objectives are set for the merger, the company may be loosing direction, time, effort, money will be wasted and the merger may be doomed to failure because it was unable to achieve what was expected from it.

Before embarking into merger or acquisition, the organization should undertake a systematic self analysis in order to identify its own strengths and weaknesses or to uncover some hidden deficiencies that should be corrected before proceeding into the merger route. "Without such self analysis, the growth minded company will travel the acquisition route at its perils".[62]

The company's self - analysis proceeds through various steps which covers many areas among them:

a) Function by function survey:

Here an analysis of the various functions: Product, production, marketing, but mainly finance and management, takes place. First, it is essential to analyze the financial affairs of the business in order to identify the total funds available for expansion, the limit at the disposal of Management and the amount of return that the company presently earns on its funds.

Second, it is crucial to evaluate, as objectively as possible, the general philosophy of management to see whether it is receptive to change and performs actively and vigorously. In fact, a Management's desire to make an acquisition is no indication that it has the capacity to cope with such a major undertaking.

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[62] - Linowes, p.59.

A thorough analysis and probing may sometimes reveal that management does not possess the courage nor the ability to take the merger plunge.[63]

b) Unique organizational attributes:

The identification of the distinctive attributes of a Company whether financial or non financial is an important factor in considering merger because it will affect the whole company. This will act as a positive point towards achieving merger that will spell the difference between success and failure of the merger. The unique attributes that a company possesses may reflect the ability of its executives to make decisions, and have the courage to act decisively, or the ability to operate under severe price fluctuations. It may be the perceptiveness in detecting new consumer trends as well as the familiarity with financing techniques and institutions.
One can state here that self analysis is a "must" in laying some foundation for the later phases of the acquisition program.[64]

Stage 2:

It starts with setting the criteria for a merger:

- Type of business and industry
- Size of the Company.
- Profits
- Methods of payment
- Management and personnel

In defining these criteria, the Company should make frequent reference to its self analysis.

[63] - Ibid, p.60-64.
[64] - Linowes, p.64.

Stage 3:

In order to fulfill the need for merger, the firm will start looking into a company that satisfies the criteria set in the previous stage.

2.2.6.2- Aspects of Merger:

Once the target firm is identified, one identifies two aspects of a merger:

- The tactical aspects.
- The strategical aspects.

The tactical aspects of a merger include:[65]

1. Price negotiation.
2. product analysis
3. Evaluation of the status of the company to be acquired in its industry.
4. Determination of asset values and liabilities.
5. Legal matters.
6. Terms of payment for the purchase.
7. Relationship with retiring executives of the company to be acquired.

It is these aspect of acquisition that so often monopolize attention during merger negotiations at the expense of strategical matters.

The strategical aspects of a merger involve the long term relationships between the acquired company and the acquiring company. It consists of setting plans for consolidating production facilities, sales, distribution channels, research and development ...It also includes setting marketing strategies, centralized and decentralized controls. All this is designed to carry the resulting complex at least three years beyond date.

[65] - Linowes, p.69.

2.2.6.3- Difficulties facing merger:

There are various difficulties facing the merger process mainly financial and legal.

1. Financial:

First, the valuation of the firm to be acquired is an important step in the merging process because it will help determine the price that will be paid.
To determine the price to be paid, a careful valuation of the firm to be acquired should be conducted and the expectation of the Management should be set. In fact, mergers reflect differences in expectation regarding the future profit stream of the acquired unit. Richard Roll (1986) has hypothesized that the market for corporate control is characterized by the "winners curse". The company whose management has the highest expectations of the profit potential of the target firm, wins the bidding but pays more than its profit potential justifies.[66]
The valuation involves the firm as a whole, its assets (both tangible and intangible), its liabilities (balance and off balance sheet items). However, the difficulty lies mainly in the fact that the assets are recorded at book value and not at their real market value. Whereas the intangible assets such as license, good will, are difficult to valuate and involve a lot of subjectivity. As far as the loans are concerned, the existence of doubtful debt makes their valuation difficult. To solve this issue, some suggest that these debts will not be included in the merging process but rather handed over to a company formed by the merging or the merged bank which will take the responsibility of collecting these loans. In addition the off-balance sheet items such as letter of guarantees present some difficulty in pricing. This is because this kind of obligation is considered pending and contingent; moreover, it may be realized or not.

In case of acquisition, the valuation should be done for the company to be acquired whereas in case of merger, complete valuation for the banks should be done.

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[66] - Mueller, p.701.

The value of the firms will be inputed into benefit and cost equations in order to determine whether the merger process will be beneficial or not.

Benefit = (value of bank A + value of bank B) - value (A) - value (B)

Cost = price of B - value of B.

Where (A) is the merging bank, and (B) is the merged bank.

Merging would be beneficial if benefits exceed costs.

This equation can be adjusted to include other cases such as if the payment is done through shares and assets instead of cash.[67]

It is worth noting finally that valuation is a difficult step in merging because it needs time and money (A special person must evaluate the firm and his work will be supervised by auditors). Besides, the financial statements of the banks may not reflect the true situation of the institution, therefore distortion of data is likely to occur. Finally, valuation includes an element of subjectivity which may lead to overestimation or underestimation of the firm.

2. *legal aspects:*

After agreement has been made on the value of the two banks, the price to be paid and the mode of payment, the next stage is to take the legal steps to formalize the deal. In Lebanon, the steps prescribed in the Bank Merger Law are:

1. The deal should be put in legal terms in order to be presented and approved by the Board of Directors (BOD) of the two banks. The formalization of this agreement will depend upon the approval of the extraordinary general assembly of shareholders of each bank with 75% of shares attending.

2. The merger agreement will be sent to the Central Bank for approval.
   To this agreement, the following documents should be attached:
   - Preliminary merger contract that is subject to approval

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[67] - Arab Banks Association, p.83.

- Balance sheet for the previous financial year for the banks concerned.
- Auditors' report about the revaluation of balance sheet items.
- The financial position of each bank as of the end of the month preceeding the merger application, signed by its BOD and on its own responsibility (since they are unauditted statements).

3. The Central Bank will give a preliminary approval or refusal of the merger proposal within 60 days of the application date. In case of approval, the Central Bank will state the conditions, the time period and the guarantees required for the final decision.

4. The Central Bank will take his final decision within 30 days after presentation of the required documents. In case of approval, the merged bank will be deleted from the list of banks. This decision is final and not subject to any negotiations.
5. If the 60 and 30 days, referred to previously, pass without any final decision from Central Bank, it means an indirect refusal of the merger proposal under the existing conditions.[68]

It is worth noting here that the merged bank ceases to exist and is replaced by the merging bank who will take the responsibilities of all the assets and liabilities. So mergers lead to problems concerned with renuwal of the lease contracts of buildings, offices... This occurs because the new banking unit has a new and seperate moral identity from the old unit.[69]

As seen, the merger decision is subject finally to the discretion of the Central Bank. However, it can issue some rules and laws that will present an incentive to the merging bank by taking advantage of the benefits presented, among them:[70]

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[68] - Ministry of Finance, p.74.
[69] - Halawi, p.77.
[70] - Ministry of Finance, p.113.

- The Central Bank can give soft loans to the merging bank if the necessity arises.
- The Central Bank can exempt the merging bank from the income tax up to an amount equal to its tax liability on part of its revenues on condition that this will not exceed the cost of the merger operation.
- Within six month following the Central Bank's approval of merger, the merging bank can end the work contract of a number of the merged bank employees, if they are given all their rights, benefits and advances.
- The Central Bank has allowed the merging bank to readjust its position within three years if the merger resulted in a disharmony with the articles 152, 153, and 154 of the Code of Money and Credit .

During the merging process, some issues of the bank secrecy law will arise and may also cause conflicts. According to this law, information about customers should not be disclosed to third parties. However, during the merging process, the banks involved need to share information about their customers (deposits, loans outstanding, doubtful debt). Article three of the law 192 has allowed banks to share information about their customer accounts, and other related matter during the merging process.

The second issue involved here is the transfer of accounts. When a merger occurs, the relationship between the merged bank and its customers legally ends. Thus, it may be considered illegal to transfer customers' accounts to the new banking unit of the merging bank without the prior consent of all customers.[71] However, this seems unfeasible and time consuming especially if the bank possesses a wide customer base spread geographically, some of them would have changed their address, or even left the country. This makes contact with all these customers and getting their approval a difficult job especially if mail services are absent or inefficient.

Therefore, rules, regulations and laws should be reviewed and adjusted in order to take into account the changes that occurred in the market and specifically in the banking

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[71] - Halawi, p.76.

sector in the aim of motivating and organizing the merger activity that is likely to occur in the future.

3- Technical Aspects

After all the negotiations have taken place, the approval received, and all the legal procedures completed, a further and difficult step will follow. It is the actual consolidation of the banks and the issues that might arise and reorganization.

- *Branches*

The merging bank will try to rationalize the branches acquired in order to identify the branches that need to be closed or reallocated

It will also consider closing of same overlapping or duplicated branches as well as altering, rebuilding other branches.

- *Computer systems*

Every bank has a different computer system (hardware and software). Thus, when two banks merge together, their system may be totally incompatible and the use of technology may differ in the two banks. One bank may be using high-tech equipments and advanced up to date computer system, whereas the other may be still using the manual system completely a partially or it may be using a somehow obsolete and slow system.

A decision should be taken here in order to adopt one of the two system or to make these systems compatible with each others if this is possible and feasible.

- *Accounting system*

Every bank adopts a somehow different accounting system to maintain his accounts for instance, one bank may be applying the straight line method of depreciation, while the other may be using double declining method . Besides, each bank may use different terminologies and classifications for these account.

The difficulty lies in the ability to recombine these accounts and unify the accounting system, otherwise redundancy and errors are likely to occur. The formal accounting unification does not usually take place until the big of the next financial year[72] .

One should note here that there are some accounting issues that arise during a certain merger:

- During the merging process, the two banks will agree on a specific date for closing the account of the merged bank. However, there is a period, often of several months, between the date of closing the accounts and the actual execution of the merger because it is difficult to be precise about the date of a merger. Therefore a question arises about how to account for the debts that arise during this period?

  Article No. 265 of the French law states that the financial obligations of the merged unit would be transferred to the merging unit as of the actual execution date, the date when the new unit is registered in the commercial register and the merged firm is dissolved. Article No. 211 and 212 of the Lebanese Commercial law have adopted the same entry to account for these debt[73] .

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72 - Revell, p.96.
73 - Halawi, p.80.

- *Rules and Procedures:*

Each bank has its own set of rules and procedures that guide the various operations and affect the way work is performed. The formulation and the agreement of the two banks on a new set of procedures is time consuming and may cause conflicts towards the full operational integration of the bank. This process may take several years.

- *Managerial Aspects.*

Merger is believed to be a strategy by which the merged bank will attract competent managers and eliminate inefficient ones. The question that arises here is how these new managers, and officers will be allocated to the various positions and departments of the bank, and how old ones will be reallocated to establish equilibration within the firm.

It is worth noting here that internal conflicts may arise as a result of power struggles from within the organization[74]. To resolve this, authority should be evenly distributed within the newly organized company.

Management should be competent in order to be able to manage the various changes occurring within the organization and resolve the conflicts and problems that might arise due to higher volume of operations.

- *Human Resource*

Employees are the most valuable assets for any bank, yet the most difficult to combine during merger because they are usually resistant to change. The situation becomes more accentuated when the banks have different sizes.

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[74] - Nevaer, p.76.

The employees of the smaller bank will have low moral and will feel demotivated due to the fact that they have been acquired by the other bank whose employees have higher power (derived from the size of their bank) and may enjoy preferential benefits (not accessible to them).
An attitude of "Us - versus - Them" is likely to be prevalent withn the organization if higher Management is already suffering from power struggle and if no enough support is given to employees, or if no enough effort is made to make the harmonization smoother.

Problems arise also in dealing with the human resources issues because each bank adopts different incentives, bonus, motivation, performance appraisal and recruitment schemes. A situation occurred when the human resources department was subdivided into three parts: one for the employees of bank A, one for the employees of bank B, the last one for the employee of the new bank (merging of bank A and bank B).

As we have seen, the merger process is not an easy process, it involves many negotiations and approval and it may consume a huge part of the Management time. Merger is a step by step process, however; it may encounter some difficulties and obstacles that should be overcomed in order to proceed ahead in the process.The problems may be financial, legal, technical, managerial or related to human factor.

In summary, the merging of two banks will result in the combination of one banking education with another different one, i.e different managerial directions and different set of objectives. For a merger to be successful, there should be a domination of one banking education[75]. The following section will present the major criteria for a successful merger.

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[75] - Arab Banks association, p.100:

2.2.7- COMMON STRATEGIES FOR A SUCCESSFUL MERGER

1. Long term corporate commitment

Merger involves reorganizing of the firm and changing its corporate culture. The benefits of merger are not always immediately apparent because it is a strategy that involves reorganization of the firm and changing its corporate culture. These

changes can be faced by resistance which takes time to settle. Therefore management of the merging organisation must be patient and committed to the long term success of this corporate strategy, and must set clear and realistic objectives to achieve them. Merger requires huge investments but profits may suffer in the short term because funds are channeled towords relocation, expansion efforts or facility improvement [76].

2. Equal distribution of resourses

Before undertaking merger, the proper mix of resources (financial and non financial) should be defined. During the merging process, the company should develop a post merger resource allocation in line with the corporate goals and strategies in order to facilitate the combination of the two banks. In fact, banks tend to have similar assets, resources and product areas. Some of them need to be consolidated such as closing down of overlapping offices, integrating the bank office systems, and merging similar operations[77].

The successful integration of two firms' resources and assets is a key element to the merger success.

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[76] - Nevaer, p.74.
[77] - Ibid, p.75.

3. Equal distribution of authority

The key ingredient to merger success is the effort of the management to distribute authority within the firm, otherwise internal conflicts, power struggles, clash of corporate culture are likely to occur and may lead to failure of the merger or may present an obstacle to the harmonization process [78].

5. Focus on individual corporate strength

By relying on Individual Strength, the firm will make the best use of its assets, its management expertise and the potential synergy expected from the merger.

6. Open communication channels

The two banks should constantly share information between them throughout the merger stages starting from the negotiation stage to the implementation and post implementation stage.

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[78] - Ibid, p76.

CHAPTER III
METHODOLOGY

This chapter will present the methodology used in the collection of data needed for conducting the research study.

The project aimed to shed light on the merger strategy and the possibility of its adoption by the Lebanese banks. But since this strategy is adopted on a limited scale and by a very limited number of banks, the researcher resorted first to analysing the various aspects of this strategy and second to focusing on one actual case study that was taking place at the time of conducting the study. However, the conclusion derived from the case cannot be generalized ; further cases that are likely to occur in the future need to be analysed. In addition, we need to observe the long term effect of the merger strategy on the concerned banks i.e (Banque Beirut Pour Le Commerce and Security Bank) as well as on the economy as a whole in order to judge its success or failure.

To conduct this study, the researcher tried to explore various sources of data in order to derive, the information needed for The analysis of the Topic. Among the various sources used, we list three main types:

- Primary Sources
- Secondary Sources
- Case Study

3.1- PRIMARY SOURCES

The data collected from primary sources depended mainly on questionnaires and interviews.

The first set of questionnaire (Appendix I) covered the managers of the some banks in Lebanon in an attempt to formulate an opinion about the probability of these managers in adopting the merger strategy

The interviewees were asked mainly about the challenges facing the banking sector, how do they perceive the role of the banking sector in the reconstruction of Lebanon, whether they consider merging a good solution, and whether they are willing to negotiate a merging case with another bank.

The second set of interviews (Appendix II) were conducted with the higher managerial levels in the concerned banks (BBPC and Security Bank) in order to get a general idea about the merging process that took place.

Detailed interviews were conducted with key persons in both banks, those that were in charge of supervising this process step by step from negotiation to the agreement, till the final implementation. Taking the opinion of both parties helped to reveal the different points of view of the merged and the merging bank.

The questions asked here focused on the motives behind the merger, the various difficulties faced during the process, and how the merger affected the performance of the bank.

The list of interviewees is as follows:

- Mr. Kamal Ahmadieh, Principal manager for the credit and accounting department, Al Mawarid Bank SAL.
- Dr Hicham Bisat, Regional Manager- Lebanon, Arab Bank SAL.
- Mr Fawaz Huchaymi, Executive manager, Banque Beirut pour le Commerce SAL.
- Mr Hassan Jaber, Manager L/C Department, Security Bank SAL.
- Miss Nuhad Tahan, Internal Audit, Security Bank SAL.

3.2- SECONDARY SOURCES

The secondary sources included books, periodicals, and newspapers, as well as previous studies that were conducted on this topic.

The books were used in order to understand the merging concepts, the various types of mergers, the motives behind it, and the guidelines for the success of this strategy. This presented the ground on which the study was based. However, the data derived from books alone was not sufficient due to the obsolescence of some information. That is why it was backed up by new issues and events occurring in the market collected from newspapers and magazines. In addition, up to date information about actual merger cases that are taking place in the world were collected from the TV news mainly CNN.

3.3- CASE STUDY

The case study is an attempt to apply the theoratical concepts presented in the second part of chapter to a real life case. It is the merging that occurred between Banque Libanaise pour Le Commerce and Security Bank. The choice of these banks does not present the ideal case, but was mainly due to the fact that it is the first attempt of two banks to merge after the end of the war period.

CHAPTER IV

CASE STUDY

The case study starts with a general overview about the background of each bank followed by a presentation of the motives behind merger, the merging process as well as the difficulties facing it.

4.1 BACKGROUND OF EACH BANK:

4.1.1 Security Bank:

Security Bank of Lebanon S.A.L. was previously the Bank of Credit and Commerce International (Lebanon) S.A.L. (BCCI), an affiliate of BCCI overseas. When the Central Bank of London suspended the operations of BCCI overseas on July 5, 1991 due to the bankruptcy case, BCCI (Lebanon) that had its placements with its affiliates, was forced to close its office. After two years of negotiations, the bank resumed its operations on June 24 1993, under the name of Security Bank of Lebanon (SBL). SBL started operating with a capital of LL 3,900,000 and with the same number of branches (i.e. four branches and the head office). Some employees were laid off but were compensated with a maximum of 24 monthly salary per employee. In addition, the majority of depositors became shareholders.

When SBL started operating, the financial situation of the bank was as follows:

Deposits $ 23 million	Advances $ 15 million
Cash $ 6,740,000	Provision $ 5 million

Cash shortage 25%

Therefore, SBL was requested by BDL to meet the following requirements:

1) Shareholders should provide $ 10 million as subordinated loans against the advances.

2) The capital should be increased from LL 20 million to 1,950 million by issuing 10,000 shares at LL 195,000 per share.

3) The capital should be increased by $ 1 million before the end of 1993. (i.e. six months from the day of opening SBL).

However, due to the loss of confidence in the bank, SBL found difficulty in attraching new clients. Therefore, the amount of new deposits was negligeable as compared to the high amount of overhead expenses.

Up to November 1994, the bank was able to acheive profits because it was putting all its efforts for collecting part of the advances and to negotiate the settlement of the others.

On November 1994, the Central Bank requested from SBL to consider all interest received from overdrafts as unearned interest.

In addition, BDL freezed all facilities, considered them bad debts and did not allow SBL to extend new facilities.

SBL was therefore deprived from earning interest, fees and commissions on facilities that present a major source of income to the bank. At the same time, SBL could not escape the huge expenses incurred especially those that are fixed such as water, electricity, maintenance, salaries...

All these factors greatly affected the bank that began loosing starting December 1994. Shareholders were eager to sell their shares and the bank was facing two options: liquidation or merger.

4.1.2 Banque Beyrouth pour Le Commerce (BBC)

It was established in 1961 by Istphan Nassouh and oprated during its first ten years, through 5 branches, as a savings and loan institution.
In 1971, the bank that was purchased by Rifaat El Nimr and a group of Arab investors, started operating as a commercial bank.
The war of 1975 affected the bank and hindered its expansion plan. However, the bank was able to maintain its position in the market.

BBC is nowadays geographically spread around the country through a network of 16 branches and a main-office in Beirut. Its capital has been raised since 1961 from LL 2 million to 15 billion in October 1995.
BBC was ranked in 1994 as 17 by customers' deposits ($ 229 million) and as 16 by net financial income.

BBC wanted to expand its operations in order to grow and maintain its position in the market. However, it was approached by a major shareholder of SBL, Akram Hachem (54% of the shares) who was willing to sell his shares to BBC.
BBC, in his turn, was willing to acquire up to 67% of the shares at the first stage but was aiming to gradually acquire the remaining shares at a later stage.

Therefore, the first negotiations between BBC and SBL started as a sales agreement of shares. Further discussions led to the formulation of another agreement which consisted of the total acquisition of BBC to SBL. This agreement was later identified as "Merger".

4.2 Motives Behind this Merger:

What were the main motives behind this merger?
To answer this question, one should look from two perspectives that of the Security Bank and that of Banque of Beirut Pour le Commerce.

Well, for the merging bank, BBC, the main motive was the expansion of the bank size because it will reflect a kind of "Prestige" and strength to the bank. BBC can expand and spread geographically by using the license of Security Bank in locations other than the original ones. The bank also expects to derive the benefits from this strategy within two to three years. The acquisition of Security Bank was chosen rather than opening new branches because the bank will take advantage of the client base already existant. As Mr. Fawaz Huchaymi, the Executive Manager of BBC, declares: "It takes more time, effort, and money to acquire new customers rather than maintaining existing ones and convincing them to shift to the new bigger and stronger bank".

However, the hidden motive for this merging, which was not declared, is profit. In fact, unless good profit potential and benefits from BDL (tax exemption, loans...) were expected, BBC would not have ventured in acquiring a bank under liquidation for the sake of saving it from its crisis.

As far as Security Bank is concerned, the main motive to accept the merger is that the prices both financial and social that it has to pay if it is acquired will be less than the price of Self-liquidation.

4.3 The Merger Process

As has been stated earlier, in the second part of chapter 2 (section 2.2.6), the merger process passes through three stages.

The first stage begins with the identification of the needs and motives for merger.

The second stage consists of setting the criteria for the merger such as the type and size of the merged company, the profits expected, the mode of payment ...

In this case, BBC aimed to expand the size of the bank and decided to merge with another bank of a smaller size and under liquidation (SBL).

The final stage will set the various steps to be followed to acheive the merger. Given the fact that only the Central Bank has the discretionary power to approve a merger or to close a bank, BBC and SBL had to follow the legal procedures set in the law no. 192 facilitating bank mergers.

In fact, the merger process between BBC and SBL followed several steps before reaching the final agreement. It started first in July 1994 with negotiations between the two banks:

Step 1:

- On the 25th of April 1995, a meeting was held between that Manager of Security Bank and the Board of Directors of BBC in order to discuss the merger of the two banks and the possible ways to acheive it in accordance with the law no.192 dated January 4, 1993 that aims to facilitate merger.

- On April 5, 1995, SBL sent a letter to BBC stating the Board's approval on the merger according to the Bank Merger law no.192 (Appendix III).

Step 2:

- It consisted of the approval of the majority of the shareholders of each bank on the merger. The agreement was communicated to BDL in order to formulate its preliminary approval (Appendix IV).

- On April 8, 1995 the central council of the Central Bank issued its preliminary approval on the merger subject to the fulfillement of the following conditions and requirements: (Appendix V)

1- Presentation of a report organizing the merging process,

2- Approval of the shareholders of Security Bank on the merger with BBC and on the liquidation of SBL,

3- Approval of the shareholders of BBC on the merger with SBL as well as on the merger report, 4- Presentation of the following documents:

a- Approval of the extraordinary general assembly meeting of the shareholders of SBL;

b- Deletion of Security Bnak from the list of banks.

It is worth noting here that the prelimary approval of BDL included an article that consisted of an obligation of BBC to extend liquidity to SBL, if the need arises, starting April 8, 1995 (i.e. the date of the preliminary approval on the merger).

Step 3:

On June 19, 1995, the central bank obliged BBC to resolve the conflict with SBL staff, otherwise, merger will not occur.

BBC didn't have any choice because they have already started to extend liquidity to SBL. If the merger did not occur, BBC will loose all this money.

On June 30, 1996 BDL issued its final approval based on the shareholders' approval of both banks. As a result, Security Bank was deleted from the list of banks.

Step 4:

The final step was a very important and critical part of the process because it involves the combination of the branches, operations, procedures, EDP, and accounting systems and the most important of all the human resources and management.

In order to facilitate the merging process, a representative of BBC was present in Security Bank for nearly three months in order to:

- Supervise the process and operations of Security Bank;
- Acquire a better knowledge of SBL system;

It was found out that Security Bank, unlike BBC, uses a decentralized system in handling operations. Therefore, in order to unify the system, centralization was used by adjusting some existing procedures and discontinuing others. For example, the credit facility system was centralized by transferring all the advances of SBL to BBC head

office. Besides, Security Bank was suffering from a high amount of doubtful debts. Legal procedures were set in order to facilitate the collection and the clearence of these debts. Yet until now, no committee was assigned to collect these debts still awaiting the final resolution of the court.

4.4 ROLE OF CENTRAL BANK IN THE MERGER

The Central Bank, BDL, played an effective role in organizing the negotiations, encouraging both banks, supporting them to reach the final agreement and safeguarding the banking sector as well as the depositors welfare from the damage of SBL failure and its self-liquidation.

In fact, the Central Bank encouraged BBC to merge by offering it loans and some exemptions, among them we list:

1- The Central bank approved to give BBC a loan of LBP 19 billion at an interest rate of 60% of the nominal interest rate on Treasury Bills for one year. This loan is repayable within 8 years.

2- BBC will be exempted from exceeding the credit limit in foreign currencies and from the penalty on the lower solvency ratio for two years from the date of using the loan on condition that it is due to the merging process.

3- The Central Bank allowed BBC to use the license of some or all the branches of Security Bank in different locations within two years from the date of using the loan on condition that it will present the request to Central Bank for approval.

4.5 THE MAIN DIFFICULTIES FACED IN THIS PROCESS

a- The shareholders:

A group of SBL shareholders representing approximately 10% of the shares, formed a strong opposition to the merger operation. This opposition did try hard to abort all efforts by BBC to acquire SBL as planned.

Their main argument was that the operating losses incurred by SBL can be reverted back by injecting more capital. In fact, after studying SBL's profile in December 1994, BDL requested the bank to rebuild its capital in order to be able to continue operating. The bank therefore requested the auditors to prepare a feasibility study that includes the various steps required to rebuild SBL's capital. Meanwhile, negotiations for the purchase of shares was taking place.
Shareholders, who were trying to adjust their bank's position, were suddenly faced with the option of selling their shares (i.e. accept the merger) or liquidate the bank.

In addition, the shareholders were requesting cash rather than BBC shares in return for their shares. Yet, they didn't get anything because the net market value of SBL was evaluated as nil. Thus, the value of each SBL share is also nil.

b- The personnel:

Some of Security Bank Staff were afraid of losing their jobs as a result of merger while the others, who will remain, were afraid of not being able to adapt to the new system that they were not used to and the difficulty of establishing good relationship and harmony with the staff of the other bank that is strong and in a good condition unlike theirs.

All the employees got remunerations between 21 up to 36 times salary per employee. In fact, BBC paid LL 2.7 billion as compensations to SBL staff. SBL employees were almost satisfied with the benefits they received and considered

them as fair. If the bank was liquidated, employees will get a maximum of six months salary per employee.

In a real merger, the two banks will divide the managerial positions between themselves according to a certain agreement. However, in this case, and out of 82 employees of SBL, BBC was prepared to retain the services of 11 only who will be allocated to the various branches of the bank.

c- Valuation:

The most difficult part of the merger is to determine the value of each item of the balance sheet.

For example, 90% of the loans portfolio was classified as doubtful debts and \$8,186,000 subordinated loan was transferred to a non interest bearing account with BBC. Any excess amount collected from these doubtful debts will go to the benefit of BBC.

The valuation of assets also involves a lot of subjectivity. In fact, it was found later on that there was underestimation of SBL's assets and an overestimation of doubtful debts. Therefore, some of the shareholders filed a law suit which is still pending in court. However, the Central Bank stopped the soft loan for BBC in order to check the matter of SBL assets underestimation.

4.6 FINANCIAL ANALYSIS

In order to evaluate the merger case, one has to see its effect on the financial position of BBC.This can be done by comparing the balance sheets of BBC before and after merger i.e. 1995 vs.1994.(Pages 71-72).

The major points identified in this comparison:

- An increase in treasury bills by 28.38 % from 1994 to 1995 due to an increase in investment in TBS.

- An increase in loans to customers from 25.9 % to 54.81 % in 1995 due to an increase in short term loans by approximately 50 % and a major increase in medium and long term loans by 80.96 % in 1995.

- A considerable increase in miscellaneous debtor accounts from -27 % in 1994 to 252.66 % in 1995 due to the acquisition of SBL debts as a result of the merger.

- A major increase in non financial fixed assets from 25.4 % in 1994 to 147.82 % in 1995 due to the acquisition of SBL fixed assets as a result of the merger.

- All these factors led to an increase in total assets by 32.07 % in 1995. However,this increase is less than the 34.9 % in 1994 as compared to 1993.

- BBC acquired all the assets of SBL as well as their engagement by signature that increased by 330.82 % (as compared to 1.7% in 1994) and their real securities by 96.48 % (as compared to 6.15% in 1994).

- As far as the liabilities are concerned,an important item, Central Bank, that was showing zero balance in previous years, is showing a balance of LL 19,000,000 in 1995 which represents the amount of the loan extended by the central bank to BBC in order to help the merger process.

- An increase in banks and financial institutions by 39.29 %(which is less than last year increase of 52.4 %).This increase is mainly due to an increase in time deposits and borrowings by 1734 % vs -57.7 % for 1994.

- It is worth to note in here that deposits from customers remained nearly constant 30.11 % in 1995 vs. 29.8 % in 1994. This implies that BBC did not benefit ,as planned, from the customer base existant in SBL. In fact, most of the depositors withdrew their money within two weeks after the preliminary approval of the merger.

- A considerable amount of provisions for risk and expenses (LL 6,676,932,000) was accounted for in 1995 i.e.an increase of 387.77 % over last year figure.This is due to the fact that 90 % of the loan portfolio of SBL was estimated as doubtful debts.

- We also notice a considerable increase in the capital of the bank from LL 8,000,000 million to LL 15,000,000 million i.e. an 87.5 % increase vs. 33.00 % increase in 1994. BBC's effort to increase its capital base reflects a sign of strength of the bank as well as its ability to face the future.

- Concerning the profitability of the bank, it is worth noting that there was a decline in the profit by 33.93 % vs. a considerable increase of 573.90 % for the previous year. However,this does not imply that the merger was not profitable for two main reasons:

  1- One should bare in mind that the merger occured nearly in the middle of the year,i.e.nearly only five months have passed. This implies that it represents a short time which is not sufficient to evaluate a merger that is a long term strategy.Only time will tell whether this managerial decision was beneficial.

  2- In any expansion plan, profits may be harmed on the short term because the company has to make huge investments at the beginning. In this case, BBC had to pay LL 2.7 billion as compensations to all the employees of SBL as a result of the merger. In addition, BBC was obliged ,according to the preliminary agreement on the merger , to extend liquidity to SBL when it is needed. These expenses incurred will be reflected in a decrease in the profit.

The ratio analysis revealed the following points:

1. The capital adequacy ratio, before merger, was equal to 9.41% which is greater than the 8% ratio requested by the central bank. This implies the ability of BBC to meet short term requirements for liquidity from their own capital.

2. The net liquid assets to deposits and treasury bills to deposits remained nearly constant.

3. The total assets to capital ratio has decreased from 54.69 % in 94 to 38.52 % in 1995. This due to the fact that the increase in capital was greater than the increase in total assets.

4. The return on shareholders' equity decreased from 0.37 % in 1994 to 0.14 % in 1995 due to the decrease in the profit (as previously explained).

Banque Beyrouth pour le Commerce Sal

Balance Sheet and Contra accounts
December 31, 1995

Assets

	LL Million 1995	1994	95/94
1- Cash and central bank	41,717,340	40,872,808	2%
2- Lebanese treasury bills	235,304,439	183,280,852	28%
3- Banks and financial institutions	103,467,796	81,061,522	28%
- Current accounts	36,033,423	41,786,097	-14%
- Loans and time deposits	67,434,373	39,275,425	72%
4- Head office and branches, parent company and foreign sister financial institutions and subsidiaries	-	-	
- Current accounts	-	-	
- Loans and time deposits	-	-	
5- Commercial bills discounted	4,647,923	4,137,767	12%
6- Loans to cutomers *	156,980,982	101,404,207	55%
- Short term loans	*132,101,277*	*88,336,410*	*50%*
- Medium and long term loans	*24,879,705*	*4,751,571*	*424%*
- Debtor accounts against creditor accounts	-	*8,316,226*	*-100%*
7- Bank acceptances	10,466,412	14,927,008	-30%
8- Marketable securities	-	-	
9- Miscellaneous debtor accounts	9,119,144	2,585,782	253%
10- Regularization accounts	4,910,350	3,916,184	25%
11- Financial fixed assets	1,335,211	1,343,052	-1%
12- Non financial fixed assets	9,909,503	3,998,657	148%
13- Revaluation variance	-	-	
Total assets*	**577,860,109**	**437,527,839**	**32%**
Contra accounts			
14- Engagements by signature received	9,713,251	2,254,617	331%
15- Real securities received	51,779,727	26,353,848	96%
Total contra accounts	**61,492,978**	**28,608,465**	**115%**
* After deduction of provisions for doubtful debts	24,321,002	8,939,491	172%

Banque Beyrouth pour le Commerce Sal

Balance Sheet and Contra accounts	LL Million		
December 31, 1995	1995	1994	95/94

Liabilities and shareholders' equity

	1995	1994	95/94
1- Central bank	19,000,000	-	
2- Banks and financial institutions	12,945,212	9,293,839	39%
- Current accounts	*5,171,030*	*8,851,033*	*-42%*
- Time deposits and borrowings	*7,774,182*	*442,806*	*1656%*
3- Head office and branches, parent company and foreign sister financial institutions and subsidiaries	-	-	
4- Deposits from customers	490,942,168	377,306,705	30%
- Sight deposits	*52,835,480*	*36,767,942*	*44%*
- Time deposits	*50,014,021*	*31,076,074*	*61%*
- Sight saving accounts	*59,691,951*	*50,964,716*	*17%*
- Time saving accounts	*328,400,716*	*257,461,863*	*28%*
- Creditor accounts against debtor accounts	-	*1,036,110*	*-100%*
5- Engagements by acceptances	10,466,412	14,927,008	-30%
6- Miscellaneous creditor accounts	3,468,061	7,734,104	-55%
7- Regularization accounts	14,983,281	15,165,846	-1%
8- Subordinated borrowings and debenture loans	-	-	
9- Provisions for risks and expenses	6,676,932	1,368,858	388%
10- Share capital	15,000,000	8,000,000	88%
11- Reserves and premiums	663,759	421,479	57%
12- Balance carried forward	10,000	9,863	1%
13- Net income (or loss) for the year	2,180,525	3,300,137	-34%
14- Revaluation variance	1,521,759	-	
Total liabilities and shareholders' equity	**557,860,109**	**437,527,839**	**28%**
Contra accounts			
15- Engagements by signature issued	39,800,578	28,015,743	42%
- Guarantees and endorsements	32,596,578	16,259,029	100%
- Confirmed documentary credits	7,204,000	11,756,714	-39%
16- Bank's assets given as guarantees	-		
Total contra accounts	39,800,578	28,015,743	42%
Total footings	**347,918,404**	**465,543,582**	**-25%**

Security Bank of Lebanon

Balance Sheet and Contra accounts
June 24, 1995

	LL Million		
	20-6-1995 Before Reval.	24-6-1995 After Reval.	31-12-1994
Assets			
1- Cash and central bank	501,773	706,168	2,052,089
2- Lebanese treasury bills	197,875	198,861	1,819,325
3- Banks and financial institutions	1,468,021	3,593,482	1,847,749
5- Commercial bills discounted	12,055	11,999	176,723
6- Loans to cutomers	22,820,029	14,816,166	24,760,614
7- Bank acceptances	-	-	
8- Marketable securities	-	-	
9- Miscellaneous debtor accounts	121,333	103,958	88,461
10- Regularization accounts	61,929	70,736	143,560
11- Financial fixed assets	-	-	
12- Non financial fixed assets	800,681	7,373,546	854,008
13- Revaluation variance	-	-	
Total assets*	**25,983,696**	**26,874,916**	**31,742,529**
Contra accounts			
14- Engagements by signature received	16,764,232	16,814,680	17,542,233
15- Real securities received	7,309,994	7,269,797	7,583,613
Total contra accounts			

* After deduction of provisions for doubtful debts LL 9,502,556

Security Bank of Lebanon

Balance Sheet and Contra accounts
June 24, 1995

	LL Million		
	20-6-1995 Before Reval.	**24-6-1995 After Reval.**	**31-12-1994**
Liabilities and shareholders' equity			
1- Central bank	4,849,483	6,114,177	39,641
2- Banks and financial institutions	-	-	
4- Deposits from customers	7,974,571	8,043,841	15,045,810
5- Engagements by acceptances	-	-	
6- Miscellaneous creditor accounts	13,918,590	13,512,838	13,727,185
7- Regularization accounts	199,765	125,778	189,252
8- Subordinated borrowings and debenture loans	-	-	
9- Provisions for risks and expenses	1,196,122	1,140,348	1,220,114
10- Share capital	3,900,000	3,900,000	3,900,000
11- Reserves and premiums	351	315	351
12- Balance carried forward	(2,379,824)	(2,379,824)	2,727
13- Net income (or loss) for the year	(3,675,362)	(3,584,593)	(2,382,551)
14- Revaluation variance	-	-	
Total liabilities and shareholders' equity	**25,983,696**	**26,872,880**	**31,742,529**
Contra accounts			
15- Engagements by signature issued	270,489	269,324	544,973

CHAPTER V
CONCLUSION

5.1- CONCLUSION

"Organizations face a dilemma with respect to strategic change. On one hand, they desire change in order to remain competitive, adopt more effective and efficient technology and methods, and remain in harmony with their environment. On the other hand, organizations often resist change because they desire stability and predictability".[79]

In order to cope with this dilemma, companies should conduct strategic planning and define clear obejctives. At the same time they should be aware and ready to face a tendency of resistance due to cultural changes occuring within the organization.

By definition, Merger is one of two particular forms of combination:[80]

a) In one form, the ownership of two companies, often about equal in size, is combined to form a new company, the shareholders of both the old companies being given shares in the new one.

b) In the other form, one company, usually the larger, obtains ownership of the other, which then becomes a subsidiary company and may or may not keep its name.

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[79] - B. Hodge and W. Anthony, Organization Theory, (NY: Allyn and Bacon Inc, 1991), p.571.
[80] - J. Adam, Longman Dictionary of Business English, (Great Britain: Collins, Glasgow, 1982), p.301.

Merger is a managerial decision to expand externally rather than growing internally. It is not an end by itself, but rather a mean to an end. Merger is a strategy that involves risk , change and requires huge investments.

Companies adopt merger for various reasons, among them: growth, economies of scale and scope, synergy... However, the underlying motive for merger is "Profit" because it is the ultimate reason for the existence of any profit organization.

In the light of deregulation and globalization of markets as well as the intense competition, the world is witnessing a trend of mergers and acquisitions especially in the United States and Europe.

As Kevin Lomax, chairmain of Misys ,states:"Companies are going to be able to undertake and finance the development of new products and withstand the associated risk"[81] . In fact , magazines and newspapers nowadays,are abundant with stories of big companies and huge banks contemplating mergers in the aim of becoming bigger because "big is good", or "bigness reflects power". For example, the acquisition of First Fidelity Bancorp by First Union Corp's through $ 5.4 billion bid in stock represents the largest acquisition in the U.S.domestic banking industry and will create the sixth biggest bank[82] . This merger trend is spreading throughout the nations ,but at various degrees and at a different pace.

As far as Lebanon is concerned, the banking sector is characterized as being "overbanked".This concept implies that the number of banks operating in Lebanon is relatively high with respect to the population and to the size of the lebanese market: The first twenty banks in Lebanon have approximatly 83% share of the market (with respect to customers' deposits),wheras the remaining 59 banks have only 17% share[83] .

On the other hand,the Central Bank is issuing rules and regulations in order to regulate the banking industry starting with the capital adequacy ratio of 8% and the 10% amount of loans allowed for each individual with respect to the bank's capital.

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[81] - S. Talmor, "Bigger bites for software", The Banker (March 1995), p.65.
[82] - Clarence, p.26.
[83] - F.Baz, *Bilanbanques* (Lebanon: Bankdata Financial Services wll, 1995), p.13.

All these factors will induce banks to adjust their position to meet competition from local and foreign banks as well as BDL requirements. Banks operating in Lebanon, especially small ones, need to combine and merge together to form stronger and healthier units otherwise they will face liquidation or they will be driven out of the market.

However,there are many obstacles that will hinder the proper application of the merger strategy ,among them, we list:

- The family-owned type of banks abundant in the market that focuses on the "one man show"rather than on the "organisation as a whole".
- The merger law that only takes into consideration the acquisition of big banks to those in trouble or under liquidation .
- The absence of clear plans,objectives and guidelines to this expansion strategy.

The application of the merger theory to a real life case,that of Banque Beirut pour le Commerce and Security Bank helped the researcher in identifying several points and issues that need to be resolved in order to improve the application of the merger strategy to achieve the desired objectives and derive the expected benefits.

The merger of BBC and SBL does not present an ideal case. It can be considered an acquisition rather than a merger in the sense that SBL was deleted from the list of banks whereas BBC continued operating under its own name. In addition, in a merger, the assets and liabilities of both banks will be valuated whereas in an acquisition, only those of the merged bank will be valuated as what happened in this merger case.

5.2- RECOMENDATIONS

The assessment of this case helped the reseacher in drawing some conclusions and recommendations for future mergers:

1- The benefits of the merger should be clearly stated and explained to both parties.

2- Both parties should conduct strategic planning and set the desired objectives within the overall bank's objectives and in line with their available ressources , both financial and non financial.

3- Enough time should be dedicated to negotiations between the two banks in order to reach a fair agreement and the consent of all the persons who are concerned mainly on :the terms of the agreement, the price to be paid, the valuation of the banks ,the staff compensation.....
Otherwise,there will be breach of the agreement and will lead to filing law-suits that may take several months or years to be resolved .The case of BBC and SBL serves as a good example.

4- There should be segregation between ownership and management in order to decrease the probability of managers' pursuing their own desires instead of their bank's objectives .Merger is not a part time job and should therefore be dedicated to professional people.

5- The central bank should encourage small banks to merge rather than enforcing them to do so. The small banks should not be considered as losing and the big bank as the winner as was the case of BBCand SBL. Each bank should benefit from the merger otherwise it will not be a good solution.

6- The merger law should be modified in order to take into consideration the real meaning of merger. In fact,merger means the combination of two banks to form a new one rather than the acquisition of a big bank to a small troubled bank that will be deleted as a result of merger. The pitfalls encountered in the first attempt to merger (i.e.BBC and SBL) should be adjusted in order to facilitate and organize future mergers.

5.3- FINAL COMMENT

Mergers can be messy. Combining two different cultures can be chaotic as both parties try to blend. Most often, the process is expensive in monetary terms and in employee loss. The differences in culture between two companies can have a tremendous effect on whether or not the companies can successfully merge[84].

Mergers and acquisitions often fall prey to bad planning, unchecked egos, faulty pricing, or just plain bad luck. Many recent mergers have produced nothing but headaches and disappointments for the owners of the acquiring companies[85]. This suggests that merger is not a magic cure to all problems. Like any stategy, it has both advantages and disadvantages .What may be good for one company or industry ,at a certain time , may not be necessarily good for another company.

Finally, one cannot draw general conclusions based on one case study. Further researches need to be conducted in the future in order to study the long term effect of merger on the lebanese banking sector.

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84 - D. Anfuso, "Novell Idea: A Map for Mergers", *Personnel Journal* (March 1994), p.52.
85 - Clarence, p.26.

Appendix I- GENERAL INTERVIEW

1. What are the challenges facing the banking sector nowadays?

2. How do you perceive the role of banking sector in the reconstruction phase of Lebanon?

3. Do you consider merging a good solution for Lebanese banks to face the challenges of the future?

4. Do you consider that decreasing the number of banks operating in Lebanon would lead to more efficiency?

5. Are you willing to negotiate a merging case with another bank? In case you do, with what size of bank and kind are you willing to do merging with (a bank of your size, bigger, smaller) and why?

6. What do you consider the main motives behind merging?

7. What are the advantages and disadvantages of merging?

8. How do you consider the role of the Central Bank and legislations in encouraging merging?

Appendix II- INTERVIEW WITH BBC & SBL MANAGEMENT

Kindly provide me with available information regarding the merger activity within your bank.

1. With which bank (s) your bank did merge.

2. The motives behind the merger.

3. The difficulties faced during the process:
   (combining management, Employees, EDP systems, Accounting systems, procedures...)
   The steps followed to resolve these difficulties.

4. Before engaging into merger, did the bank set specific objectives and plans (short-term and long term) to achieve the process.

5. Why did your bank choosed to merge rather than growing internally?

6. Do you consider that these merges were successful? How did they affect the performance of the bank?

7. Did the Central Bank encouraged these mergers?
   If yes, in what sense? (tax exemption, loan facilities, bad and doubtful debts...)

8. Overview of your bank: Capital, No. of branches, No. of employee. Major events affecting the bank before and after merger.

9. Your final comment.

Thank you for your cooperation.

Appendix III: Board approval of the merger

سيكيوريتي بنك اوف ليبانون ش.م.ل

SECURITY BANK OF LEBANON S.A.L.

P. O. BOX 11-1889 PICCADILLY BLDG. 2ND FLOOR HAMRA STREET BEIRUT LEBANON

PAID UP CAPITAL L. L. 3,900,000,000

مرجع رقم : ٩٥/٤٠
بيروت في ٥ نيسان ١٩٩٥

حضرة السيد رفعت صدقي النمر المحترم
رئيس مجلس ادارة بنك بيروت للتجارة ش.م.ل.
بيروت - لبنان .

تحية وبعد،

بالاشارة الى كتابكم رقم ٧٧٧٦ تاريخ ١٩٩٥/٣/٣٠ نتشرف باحاطتكم علما بأن مجلس ادارة سيكيوريتي بنك اوف ليبانون ش.م.ل. قد انعقد اليوم وقرر الموافقة على عملية اندماج سيكيوريتي بنك اوف ليبانون ش.م.ل. مع بنك بيروت للتجارة ش.م.ل. وفقاً للاصول القانونية .

نقترح عليكم تنظيم مشروع عقد الاندماج بين المصرفين المشار اليهما بالسرعة الممكنة . علما ان مجلس ادارة سيكيوريتي بنك اوف ليبانون ش.م.ل. قد اخذ علماً بأن عقد الاندماج سيبنى على اساس شروط الاتفاق السابق بين بعض مساهمي هذا الاخير وبينكم .

نشكر تعاونكم .

وتفضلوا بقبول فائق الاحترام

شكري نعيس
رئيس مجلس الادارة .

Appendix IV : Communication of agreement to BDL

سيكيوريتي بنك اوف ليبانون ش.م.ل

SECURITY BANK OF LEBANON S. A. L.

P. O. BOX 11-1889 PICCADILLY BLDG. 2ND FLOOR HAMRA STREET BEIRUT LEBANON

PAID UP CAPITAL L. L. 3,900,000,000

مرجع رقم : ٩٥/٤١
بيروت في ٦ نيسان ٩٥

سعادة حاكم مصرف لبنان المحترم
مصرف لبنان
بيروت •

تحية وبعد،

المستدعي : سيكيوريتي بنك اوف ليبانون ش•م•ل•

بالاشارة الى الاجتماع الحاصل بين سعادتكم وبين الموقع اناه بتاريخ ٥ نيسان ١٩٩٥، نتشرف بافادتكم بأن المساهمين الذين وافقوا على عملية الاندماج بين المستدعي وبنك بيروت للتجارة ش•م•ل• قد تجاوزت اسهمهم خمسة وسبعين بالمئة من مجموع اسهم المستدعي •

تجدر الاشارة الى ان المساهمين الذين سبق ان وقعوا على العقد مع بنك بيروت للتجارة ش•م•ل• يملكون ما نسبته ٦٨،٥٧ ٪ من مجموع اسهم المستدعي ، والمساهمين الذين وافقوا اليوم على قرار مجلس ادارة المستدعي بالاندماج يملكون ما نسبته ٧،٢٧ ٪ من مجموع اسهم المستدعي •

لذلك ،

نرجو اخذ العلم بما ورد بيانه اعلاه •

وتفضلوا بقبول فائق الاحترام

شكري نعيبس
رئيس مجلس الادارة

مرفق : لائحة بأسماء المساهمين الذين وقعوا اليوم •

Appendix V : Preliminary approval of BDL

سيكيوريتي بنك اوف ليبانون ش.م.ل

SECURITY BANK OF LEBANON S.A.L.

P. O. BOX 11-1889 PICCADILLY BLDG. 2ND FLOOR HAMRA STREET BEIRUT LEBANON

PAID UP CAPITAL L. L. 3,900,000,000

مرجع رقم : ٩٥/٤٣
بيـــروت في ٨ /١٩٩٥/٤.

سـعادة حاكـم مصـرف لبنـان المحـترم
مصـرف لبنـان
بيـــروت .

المســتدعي: سـيكيوريتي بنـك اوف ليبانـون ش.م.ل.
مسـجل علـى لائحـة المصـارف تحت رقم ٢٦

الموضـوع: طلـب موافقـة على عمليـة اندماج بين بنـك بيـروت للتجـارة ش.م.ل. والمسـتدعي .

اتفـق بنـك بيـروت للتجـارة ش.م.ل. والمسـتدعي على الاندمـاج وفقـا" لاحكـا القانون رقم ١٩٢ تاريـخ ٤ كانـون الثانـي ١٩٩٣ . وقـد وقـع لهـذه الغايـة عقـد يتضمـن الخطـوط العريضـة لعقـد الاندمـاج المبدئـي في ٦ نيسـان ١٩٩٥ وسـلمت نسـخة منه لجانبكـم .

وافـق مجلـس ادارة المسـتدعي في اجتماعـه المنعقـد في ٧ نيسـان ١٩٩٥ علـى عقـد الاندمـاج ، وقـد ابلـغ المسـتدعي مديريـة الشـؤون القانـونيـة فـي مصـرف لبنـان نسـخة موقعـة عن محضـر اجتمـاع مجلـس الادارة المذكـور

نتشـرف بأن نـرفـق ربـطا" المسـتندات التاليـة :

١ - العقـد المبدئـي للاندمـاج المطلـوب الموافقـة عليـه .
٢ - ميـزانيـة السـنة الماليـة ١٩٩٤ خاصـة المسـتدعي والتي لم ينتهـي تدقيقهـا بعـد من مفوضـي المراقبـة .

٣ - وضعيـة ماليـة المسـتدعي كما هي في ٣١ آذار ١٩٩٥ موقعـة من رئيـس مجلـس الادارة .

../.

Appendix V : (cont'd)

لقد طلبنا من مفوضي المراقبة تنظيم تقرير باسرع وقت ممكن حول اعادة تخمين عناصر ميزانية المستدعي ، ونأمل بالحصول على التقرير خلال مدة عشرة ايام • وفور تسلمنا التقرير المشار اليه سنقدم نسخة منه لجانبكم •

لذلك، وعملا باحكام المادة الثانية من القانون رقم ١٩٢ تاريخ ٤ كانون الثاني ١٩٩٣ ، نطلب التفضل بموافقة المجلس المركزي لمصرف لبنان على عملية الاندماج بين بنك بيروت للتجارة ش•م•ل• وبين المستدعي •

وتفضلوا بقبول فائق الاحترا

شكري دعيبس
رئيس مجلس الادارة

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